

Pinnacle West Capital(PNW)

\$75.75 (As of 08/18/20)

Price Target (6-12 Months): **\$80.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 05/09/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:C

Value: C

Growth: C

Momentum: B

Summary

Pinnacle West Capital's second-quarter earnings outpaced its estimates on the weather-driven hike in demand. The company has plans to invest \$4.7 billion in the 2020-2022 period. This will help the utility make its systems clean and resilient, strengthen its transmission and distribution infrastructure and aid in developing its innovative programs to support customers. Also, its efforts to reduce expenses will keep the utility service rates low for customers. The company carries investment grade ratings from the credit rating agencies. Also, in the past three months, shares of the utility have outperformed the industry. However, the company is subject to comprehensive guidelines by federal, state and local regulatory agencies, which could hamper growth. Also, its operations are affected by unstable commodity prices plus operational hazards.

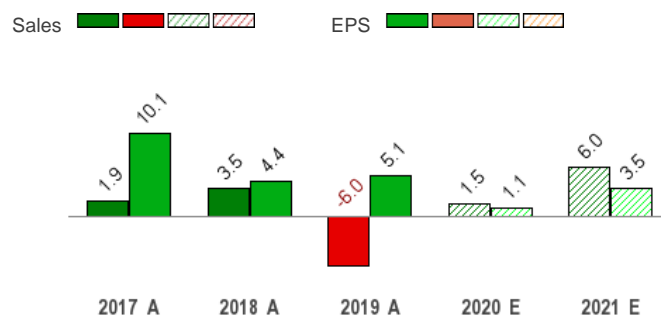
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$105.51 - \$60.05
20 Day Average Volume (sh)	1,049,025
Market Cap	\$8.5 B
YTD Price Change	-15.8%
Beta	0.38
Dividend / Div Yld	\$3.13 / 4.1%
Industry	Utility - Electric Power
Zacks Industry Rank	Bottom 23% (193 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	15.5%
Last Sales Surprise	3.1%
EPS F1 Est- 4 week change	-0.1%
Expected Report Date	11/05/2020
Earnings ESP	0.0%
P/E TTM	14.2
P/E F1	15.7
PEG F1	3.3
P/S TTM	2.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					3,734 E
2020	662 A	930 A	1,202 E	778 E	3,523 E
2019	741 A	870 A	1,191 A	670 A	3,471 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.32 E	\$1.55 E	\$2.85 E	\$0.10 E	\$4.99 E
2020	\$0.27 A	\$1.71 A	\$2.90 E	\$0.39 E	\$4.82 E
2019	\$0.16 A	\$1.28 A	\$2.77 A	\$0.57 A	\$4.77 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/18/2020. The reports text is as of 08/19/2020.

Overview

Phoenix, AZ-based Pinnacle West Capital Corporation was incorporated in 1985. The company provides electricity services (wholesale or retail) in the state of Arizona through its subsidiaries. The company is involved in the generation, transmission and distribution of electricity from coal, nuclear, gas, oil and solar.

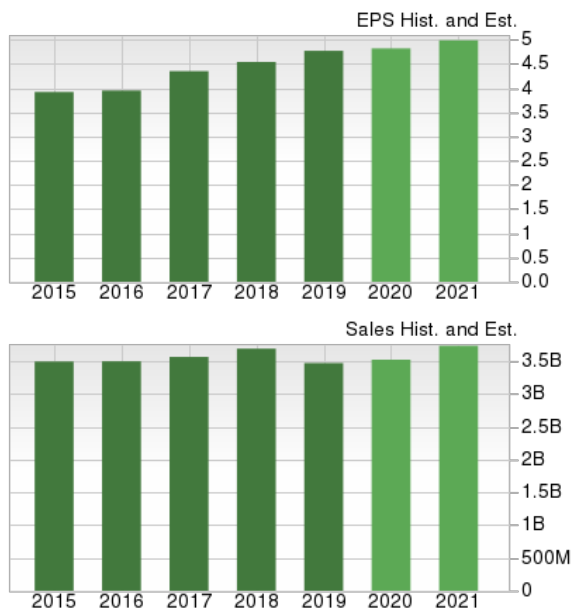
The company's only reportable segment is Regulated Electricity. The company derives 100% of its earnings from this segment. The Regulated Electricity segment consists of traditional regulated retail and wholesale electricity businesses and related activities. It includes electricity generation, transmission and distribution.

Through its wholly owned subsidiary, Arizona Public Service Company (APS), Pinnacle West transmits and distributes electricity to roughly 1.3 million residential, commercial and industrial customers. Excluding half of the Phoenix metropolitan area, the Tucson metropolitan area and Mohave County in northwestern Arizona, APS provides electric service to most of the counties in Arizona.

The company derives the majority of its revenues from APS. Pinnacle West's generation capacity owned or leased roughly 6,316 megawatts ("MW") of regulated generation and maintained a mix of both long-term and short-term power purchase agreements including purchase of renewable energy.

In 2019, the major energy sources supplied by the company were Nuclear (31.2%), followed by Gas, Oil and Other (25.5%) as well as Coal (22.7%). Meanwhile, Renewables and Purchased Power contributed 7.4% and 13.2% to the company's total power supplied, respectively.

Other subsidiaries of Pinnacle West are El Dorado Investment Company (El Dorado) and Bright Canyon Energy Corporation (BCE).



Reasons To Buy:

- ▲ Pinnacle West carries investment grade ratings of A3 and A- by Moody's and S&P, respectively. A higher rating denotes higher credit worthiness, thereby ensuring access to cheap financing options. The solid credit rating will allow the company to secure funds from the market at favorable conditions. The company does not have any long-term debt maturing until 2024. Pinnacle West currently has \$1.2 billion revolver capacity enough to meet its near-term obligations. In the past three months, shares of Pinnacle West have gained 4.1%, outperforming the industry's 1.6% rise.

At the end of the second quarter of 2020, long-term debt was \$5,922.2 million compared with \$4,832.6 million at the end of the fourth quarter of 2019. The company's times interest earned ratio came in at 3.53 at the end of the second quarter, up from the fourth-quarter 2019 level of 3.30. The strong ratio is indicative of the firm's ability to meet its debt obligations in the near future without any difficulty. Moreover, its current debt to capital is 54.45%, lower than the industry's average of 61.61%.

- ▲ Pinnacle West's subsidiary, Arizona Public Service, is the largest and longest-serving electric utility provider in Arizona. The Metro Phoenix region continues to witness solid growth in commercial activities with new developments being announced each month. The company expects more projects to expand their business in this area in near future. For example, Red Bull announced additional 700,000-square-foot distribution center, Ball Corporation announced plans to build a second location within the Phoenix metropolitan area next to the Red Bull. White Claw/Mark Anthony Brewing Inc. announced plans to build a 916,000-square-foot facility co-located next to Red Bull in Glendale and Nacero Inc. made public plans to build a \$3.3 billion natural gas to gasoline manufacturing facility in Casa Grande. While Stack Infrastructure plans to build a 1 million-square-foot data center on the 79 acres in the West Valley.

To efficiently provide serve to increasing customer base, the company has systematic investment plans to increase generation and strengthen its transmission and distribution lines. After investing \$1,231 million in 2019, Pinnacle West has plans to invest \$1,331 million, \$1,650 million and \$1,725 million in 2020, 2021 and 2022 respectively to strengthen and expand its existing infrastructure. Based on the strength of economic conditions in Arizona and the United States, the company projected its annual retail customer growth in the range of 1.5-2.5% from 2020 to 2022 and weather-adjusted retail electricity sales volume growth in the 0.5-1.5% band in the same time frame.

- ▲ The ongoing investment and planned future investment will assist the company to make its systems clean, make its services affordable, reliable and developing innovative program to assist its customers.

Apart from using new technology to provide high quality services to customers, the company is working toward achieving cost savings, which will help keep customer rates low. Through the implementation of Lean Six Sigma, the company is trying to lower its O&M expenses as well as enhance its customer and shareholder value. As a result of cost-management initiatives, the company was able to reduce O&M in the first six months of 2020. In the first six months of 2020, Pinnacle West reduced its O&M expenses by 6.9% year over year under its cost-control initiatives.

- ▲ Pinnacle West continues to focus on enhancing its renewable capacity. Under the Integrated Resource Plan, the company expects to add 2,894 MW of clean energy to its portfolio. Also, it plans to retire 1,400 MW of coal while 1,600 MW of gas purchase agreements are scheduled to expire over the next decade.

The company announced its goal to deliver 100% clean carbon-free electricity to customers by 2050, which includes a near-term target of 65% clean energy by 2030 with 45% renewable energy. The company also committed to exit coal by 2031.

Pinnacle West's investments in clean power generation, transmission & distribution lines will help it to serve customers efficiently. New commercial development is also driving demand.

Reasons To Sell:

- ▼ The company's operations are exposed to fluctuations in commodity price and transportation cost of electricity and natural gas. Potential volatility in market prices of fuel, electricity and other renewable energy commodities could create operational risks for the company. In addition, deregulation or restructuring of the electric industry may result in increased competition for the company.
- ▼ Since the company's operations are fully regulated, it has to count upon regulatory authorities for the timely recovery of investments through rate relief. Moreover, the company has nuclear generation facilities which need to undergo scrupulous safety, security and other licensing requirements. The company will be affected by unplanned outage in nuclear plants stemming from safety reasons and unexpected production stoppage.
- ▼ The company, along with its subsidiaries, is subject to numerous environmental laws and regulations, and changes in, or liabilities under, existing or new laws or regulations. Cost of complying with new regulations could increase cost of operations while failure to meet the same might impact its business.

Pinnacle West's growth could be deterred by fluctuations in commodity prices, stringent environmental regulations and unplanned outages in nuclear generation facilities.

Last Earnings Report

Pinnacle West Q2 Earnings and Revenues Beat Estimates

Pinnacle West delivered adjusted earnings per share of \$1.71 in the second quarter of 2020, which beat the Zacks Consensus Estimate of \$1.48 by 15.6%.

The bottom line also improved from the year-ago quarter's adjusted earnings of \$1.28. The result reflects the impact of hotter-than-normal weather, which boosted demand.

Total Revenues

In the quarter under review, total revenues of \$929.6 million improved 6.9% on a year-over-year basis. The top line also surpassed the Zacks Consensus Estimate of \$902 million by 3.1%.

Operational Highlights

In the second quarter, total operating expenses were \$661.7 million, down 1.7% from the year-ago quarter.

Operating income improved 33.2% year over year to \$261.9 million.

Interest expenses were \$62.7 million, up 9% year over year.

Financial Highlights

Cash and cash equivalents worth \$6.7 million as of Jun 30, 2020 were down from \$10.3 million on Dec 31, 2019.

Total long-term debt was \$5,922.2 million as of Jun 30, 2020, higher than \$4,832.6 million at 2019 end.

Cash flow from operating activities for first-half 2020 was \$369 million compared with \$345.9 million in the comparable year-ago period. For the first six months of 2020, capital expenditure of the company was \$676.9 million compared with \$541.4 million in the corresponding quarter of last year.

Guidance

Management reaffirmed 2020 EPS in the range of \$4.75-\$4.95, the midpoint of which is \$4.85, higher than the current Zacks Consensus Estimate of \$4.83.

The company is going to invest \$4.7 billion in Arizona Public Service Company (APS) over the 2020-2022 time period. Pinnacle West Capital expects retail customer growth of 1.5-2% annually over the same time frame.

Quarter Ending 06/2020

Report Date	Aug 06, 2020
Sales Surprise	3.06%
EPS Surprise	15.54%
Quarterly EPS	1.71
Annual EPS (TTM)	5.32

Valuation

Pinnacle West Capital shares are down 15.8% in the year to date period, and down 20.1% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Utility sector was down 13.6% and 13.4% in the year to date period, respectively. Over the past year, the Zacks sub-industry is down 8.1% and Zacks Utility sector is down 8.6%.

The S&P 500 index is up 5.2% in the year to date period and 17.1% in the past year.

The stock is currently trading at 15.38X of forward 12 months earnings, which compares to 13.68X for the Zacks sub-industry, 12.73X for the Zacks sector and 22.91X for the S&P 500 index.

Over the past five years, the stock has traded as high as 21.18X and as low as 12.79X, with a 5-year median of 18.19X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$80 price target reflects 16.24X of forward 12 months earnings.

The table below shows summary valuation data for PNW

Valuation Multiples -PNW					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	15.38	13.68	12.73	22.91
	5-Year High	21.18	15.36	15.28	22.91
	5-Year Low	12.79	11.07	11.3	15.25
	5-Year Median	18.19	13.2	13.72	17.58
P/S F12M	Current	2.33	2.3	2.7	3.72
	5-Year High	3.15	2.46	3.29	3.72
	5-Year Low	1.76	1.55	1.75	2.53
	5-Year Median	2.47	1.91	2.07	3.05
P/B TTM	Current	1.52	2.21	3.85	4.55
	5-Year High	2.1	2.27	4.17	4.56
	5-Year Low	1.27	1.29	2.01	2.83
	5-Year Median	1.76	1.6	2.64	3.75

As of 8/18/2020

Industry Analysis Zacks Industry Rank: Bottom 23% (193 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Companhia Paranaense de Energia COPEL (ELP)	Neutral	3
Entergy Corporation (ETR)	Neutral	2
Hawaiian Electric Industries, Inc. (HE)	Neutral	2
Alliant Energy Corporation (LNT)	Neutral	3
Pampa Energia S.A. (PAM)	Neutral	3
Portland General Electric Company (POR)	Neutral	2
The AES Corporation (AES)	Underperform	3
Pacific GasElectric Co. (PCG)	Underperform	5

Industry Comparison Industry: Utility - Electric Power				Industry Peers		
	PNW	X Industry	S&P 500	LNT	PCG	POR
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Underperform	Neutral
Zacks Rank (Short Term)	3	-	-	3	5	2
VGM Score	C	-	-	C	B	C
Market Cap	8.53 B	8.40 B	23.71 B	13.39 B	18.17 B	3.76 B
# of Analysts	3	3	14	2	2	2
Dividend Yield	4.13%	3.48%	1.63%	2.83%	0.00%	3.67%
Value Score	C	-	-	D	B	B
Cash/Price	0.00	0.07	0.07	0.02	0.84	0.08
EV/EBITDA	9.96	9.76	13.45	13.52	-5.72	8.05
PEG Ratio	3.34	3.44	3.01	3.99	2.63	3.39
Price/Book (P/B)	1.52	1.58	3.18	2.41	4.78	1.42
Price/Cash Flow (P/CF)	6.80	7.69	12.70	11.41	0.93	6.02
P/E (F1)	15.72	17.42	21.98	22.08	6.59	17.42
Price/Sales (P/S)	2.47	1.85	2.46	3.77	1.01	1.76
Earnings Yield	6.36%	5.74%	4.33%	4.53%	15.17%	5.74%
Debt/Equity	1.13	1.05	0.76	1.18	9.60	1.06
Cash Flow (\$/share)	11.14	4.27	6.94	4.70	10.06	6.97
Growth Score	C	-	-	C	C	C
Hist. EPS Growth (3-5 yrs)	6.28%	5.32%	10.44%	7.93%	5.70%	4.49%
Proj. EPS Growth (F1/F0)	1.05%	0.93%	-5.97%	5.19%	-63.87%	0.84%
Curr. Cash Flow Growth	-2.09%	6.78%	5.22%	10.43%	3.97%	4.88%
Hist. Cash Flow Growth (3-5 yrs)	6.02%	6.02%	8.52%	6.17%	5.38%	5.53%
Current Ratio	0.77	0.86	1.33	0.86	0.55	0.96
Debt/Capital	53.02%	50.98%	44.50%	53.34%	90.57%	51.49%
Net Margin	17.37%	9.66%	10.13%	18.37%	-37.92%	11.07%
Return on Equity	10.69%	9.28%	14.59%	12.30%	34.60%	9.04%
Sales/Assets	0.18	0.22	0.51	0.21	0.20	0.25
Proj. Sales Growth (F1/F0)	1.48%	0.00%	-1.54%	0.00%	5.38%	0.25%
Momentum Score	B	-	-	C	A	F
Daily Price Chg	-0.85%	-0.21%	-0.41%	-0.46%	2.07%	-0.45%
1 Week Price Chg	-5.06%	-0.86%	1.09%	-1.74%	3.41%	-1.74%
4 Week Price Chg	-6.39%	0.00%	3.41%	5.76%	-1.37%	-3.49%
12 Week Price Chg	1.90%	5.20%	9.80%	14.37%	-15.52%	-4.94%
52 Week Price Chg	-20.07%	-10.89%	3.43%	3.43%	-19.73%	-25.09%
20 Day Average Volume	1,049,025	340,511	1,894,669	1,141,702	19,426,350	607,435
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	-7.79%	0.00%
(F1) EPS Est 4 week change	-0.10%	0.15%	1.86%	0.83%	23.68%	1.26%
(F1) EPS Est 12 week change	0.63%	0.00%	2.86%	0.83%	-61.86%	1.47%
(Q1) EPS Est Mthly Chg	7.22%	-0.60%	0.80%	NA	325.81%	-10.53%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	C
Momentum Score	B
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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