The Wisman Fund
John L. Grove College of Business
Ethan Wolfe

HOLD	NEXTERA ENERGY INC (NEE)	4.15.2024

INVESTMENT THESIS

I recommend a hold on NextEra Energy. NextEra is an established player in the utilities sector, and still has room to grow. Its subsidiary, Florida Power & Light company, has a firm grasp on the electrical needs of Florida's rapidly growing economy. Meanwhile NextEra's other subsidiary, NextEra Energy Partners, is investing heavily in the transition to renewable energy sources across America. These two companies complement each other to make NEE an attractive stock. Despite NEE's poor performance in the Wisman Fund, the company's investments in strengthening its grid and expanding its renewables portfolio create lots of growth potential going forward.

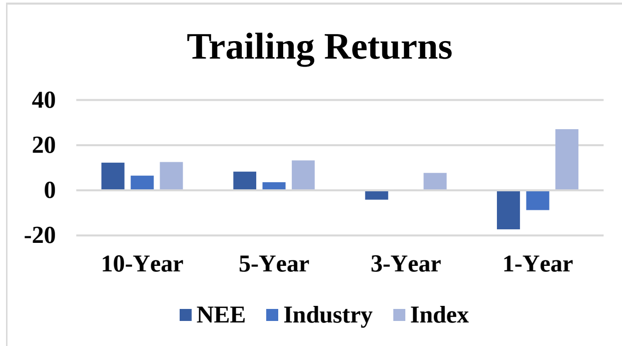
DRIVERS OF THESIS

- Well positioned for increasing clean energy demand due to increasingly strict clean energy targets and regulations.
- Supply chain issues are easing, leading to lower costs for many renewable projects.
- Decreasing financial leverage while increasing assets demonstrates growth while managing risk.
- Fairly valued according to DDM

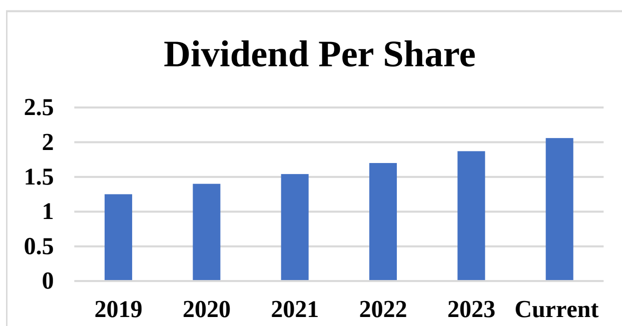
FIVE YEAR PERFORMANCE

Data Source: Yahoo Finance

NextEra Energy, Inc.	
NYSE	NEE
Price	$63.08
Fair Value	$71.00[2]
Sector	Utilities
Industry	Regulated Electric



Wisman Fund Characteristics	
Shares	35
Holding Period	11 Months
Holding Period Return	-17.80%
YTD Return	3.90%
Key Statistics	
Market Cap	$129.5967 B
Shares Outstanding	2.05 B
EBITDA	$16.70 B
Five Year Beta	0.51
Forward Dividend Yield	3.27%
Price/Earnings	17.52
Price/Sales	4.62
Price/Book	2.77
Price/Cash Flow	10.24



COMPANY SUMMARY

NextEra Energy, Inc. (NYSE: NEE) is a leading clean energy company headquartered in Juno Beach, Florida. NextEra Energy owns Florida Power & Light Company, which is America's largest electric utility that sells more power than any other utility, providing clean, affordable, reliable electricity to approximately 5.8 million customer accounts, or more than 12 million people across Florida. NextEra Energy also owns a competitive clean energy business, NextEra Energy Resources, LLC, which, together with its affiliated entities, is the world's largest generator of renewable energy from the wind and sun and a world leader in battery storage. Through its subsidiaries, NextEra Energy generates clean, emissions-free electricity from seven commercial nuclear power units in Florida, New Hampshire, and Wisconsin.

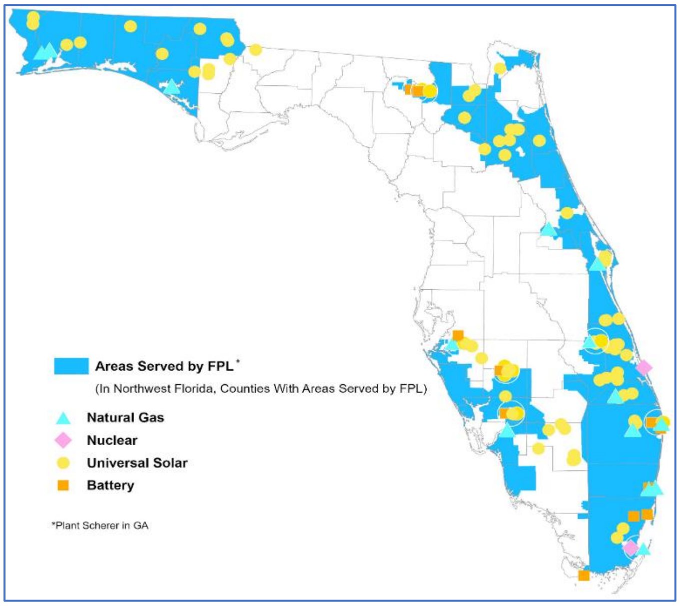
BUSINESS MODEL

In the United States, there are two main ways in which electricity generated and distributed to end-users. In a vertically integrated environment, the company which owns the means of electricity generation also owns and operates the means of distribution. On the other hand in a non-vertically integrated environment, end-users buy electricity from a distributor, and the distributor buys the electricity from the generation company. NextEra Energy (NEE) itself most resembles a holding company. However, through its subsidiaries, Florida Power and Light company (FPL) and NextEra Energy Resources (NEER), NEE most closely resembles a vertically integrated utility.

Florida Power & Light Company

FPL is a rate-regulated electric utility engaged primarily in the generation, transmission, distribution, and sale of electric energy in Florida. FPL is the largest electric utility in the state of Florida and one of the largest electric utilities in the U.S. On December 31, 2023, FPL had 33,276 MW of net generating capacity, approximately 90,000 circuit miles of transmission and distribution lines and 883 substations. FPL provides service to its electric customers through an integrated transmission and distribution system that links its generation facilities to its customers.

FPL serves more than 12 million people through approximately 5.9 million customer accounts. The following map shows FPL's service areas and plant locations as of February 16, 2024, which cover most of the east and lower west coasts of Florida and are in ten counties throughout northwest Florida.



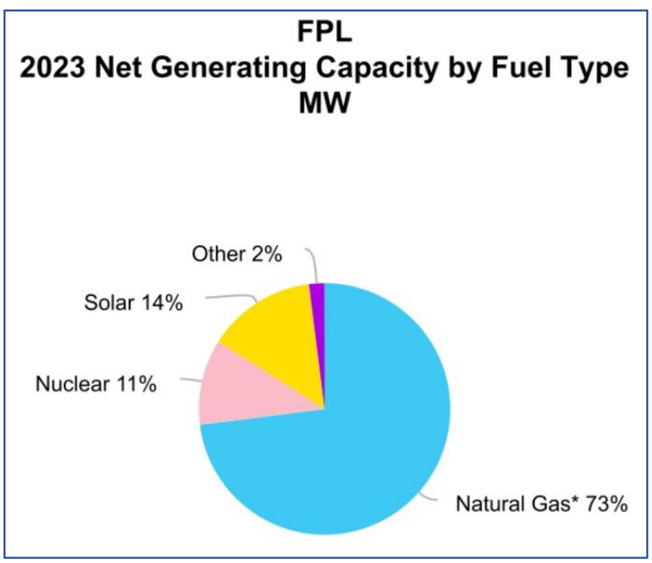
Floria Power & Light Company Service Area
NextEra Energy 2023 Annual Report/10-K

FPL uses franchise agreements with municipalities in the state of Florida to provide its electric service to retail customers. These agreements typically last decades and secure FPL the exclusive right to be that municipality's electric utility provider. As of

December 31, 2023, FPL held 226 such agreements throughout Florida.

Franchise agreements prevent any competitor firms from taking customers from FPL, but this does not mean that FPL has no competition. They claim that self-generation methods such as rooftop solar panels and batteries are their greatest source of competition. Tax incentives, economic conditions, and regulatory changes make these options more favorable than they otherwise would be, but FPL maintains a lower cost of service for most potential customers. Additionally, FPL strives for greater reliability than these systems.

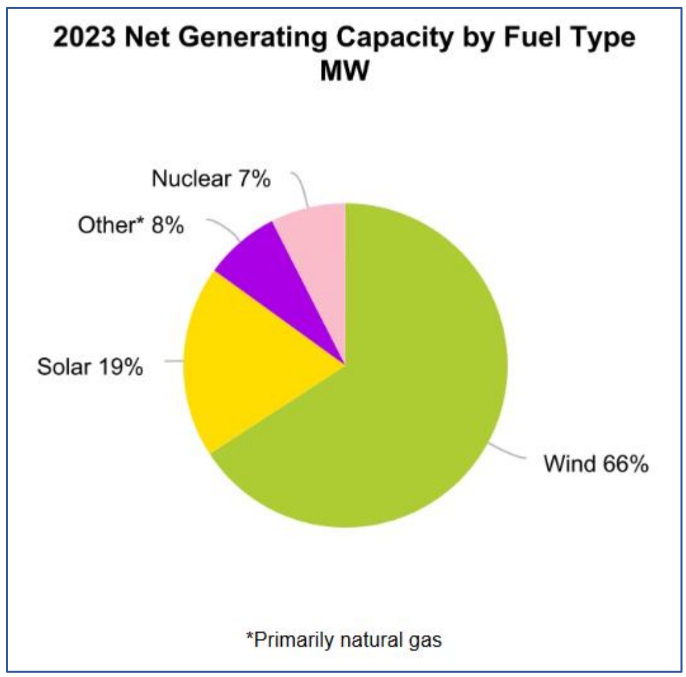
As of December 31, 2023, FPL had approximately 33,520 megawatts of net generating capacity. This power is generated through a mix of natural gas, solar, and nuclear facilities owned by FPL. Additionally a small amount of capacity is generated at non-FPL-owned coal facilities in Mississippi and Georgia and purchased contracted through purchased power agreements.



NextEra Energy 2023 Annual Report/10-K

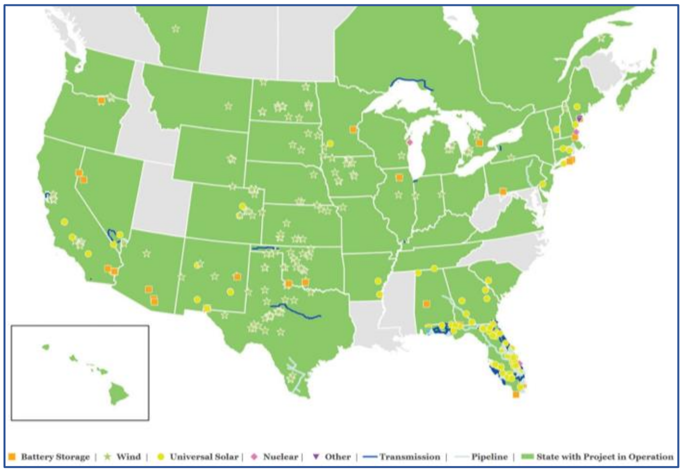
NextEra Energy Resources

NEER is a diversified clean energy that emphasizes the development, construction, and operation of long-term contracted assets with a focus on clean energy. The NEER segment owns, develops, constructs, manages, and operates electric generation facilities in wholesale energy markets in the U.S. and Canada and includes assets and investments in other businesses with a clean energy focus, such as battery storage and renewable fuels. NEER, with approximately 30,600 MW of total net generating capacity as of December 31, 2023, is one of the largest wholesale generators of electric power in the U.S.



NextEra Energy 2023 Annual Report/10-K

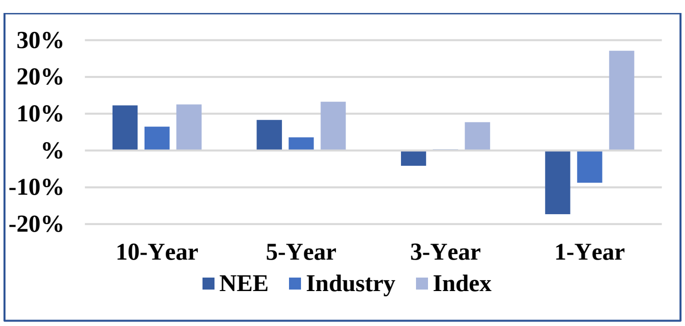
NEER primarily sells its capacity and/or energy output through long-term power sales agreements with utilities, retail electricity providers, power cooperatives, municipal electric providers, and commercial and industrial customers. In addition, NEER develops and constructs battery storage projects, which when combined with its renewable projects, serve to enhance its ability to meet customers' firm capacity needs, or as standalone facilities. NEER is the world's largest generator of renewable energy from the wind and sun based on 2023 MWh produced on a net generation basis, as well as a world leader in battery storage. The NEER segment also owns, develops, constructs, and operates rate-regulated transmission facilities in North America.



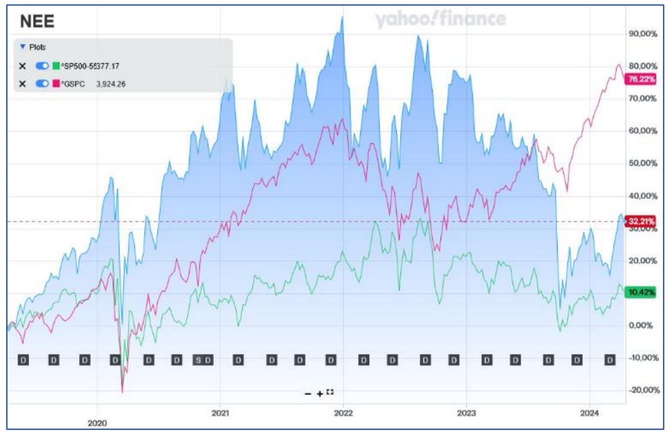
NextEra Energy Resources Projects
NextEra Energy 2023 Annual Report/10-K

STOCK PERFORMANCE

NextEra Energy Inc has outperformed its industry in both the five and ten-year time frames. It has performed nearly in-line with the index over the ten-year time frame. Despite this, its performance is less attractive on the three and one-year time frames, underperforming both the industry and the index by a considerable margin.



Data Source: Morningstar.com



Five Year Returns (Comparisons with S&P 500 and S&P 500 Utilities Sector)
Data Source: Yahoo Finance

INVESTMENT THESIS

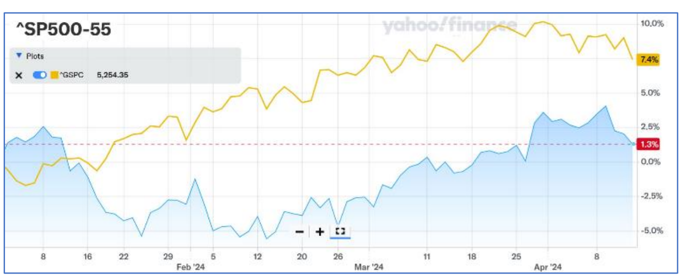
The investment thesis is based on an analysis of economic conditions, industry sector outlook, financial analysis, and the two-stage dividend discount model to calculate fair value of NextEra Energy Inc's stock.

ECONOMIC CONDITIONS

Business Cycle

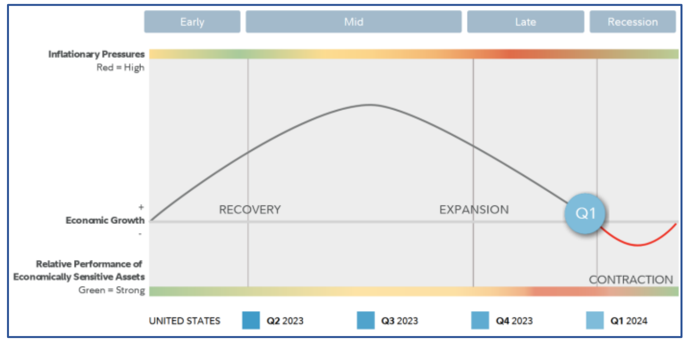
The utilities sector holds vital importance in the global economy, encompassing entities which provide essential services like electricity, water, and gas. The utilities sector's significance lies in its foundational role, supporting the basic needs of households, businesses, and industries.

Historically, the utilities sector consistently underperforms the market, when using the S&P 500 index as a benchmark for market returns. Over the past five years, the utilities sector has only managed to return 10.42 percent. This amounts to an annualized return of only 2.0%. For comparison, the S&P 500 index had an annualized return of 12.1 percent over the same period.



YTD Returns: Utilities Sector (blue area) vs S&P 500 (yellow line)
Data Source: Yahoo Finance

As of April 14th, 2024, Fidelity indicates that the United States economy is in the late expansion stage of the business cycle. It is important to note, however, that the visual representation of the current business cycle stage (see below) is somewhat misleading since it implies that the economy is right on the brink of a recession. This is not *necessarily* the case, and it should be recognized that Fidelity has indicated a late-stage expansionary period for well over a year at the time of writing.



Current Business Cycle; Data Source: Fidelity

Additionally, Fidelity predicts that the utilities sector should outperform during both late-stage expansionary and contractionary (recessionary) periods.

Sector	Early	Mid	Late	Recession
Financials	+			–
Real Estate	+ +	–	+	– –
Cons. Disc.	+ +		– –	
Info Tech.	+	+	–	– –
Industrials	+ +			– –
Materials	+	– –		–
Cons. Stap.	– –	–	+	+ +
Health Care	– –			+ +
Energy	– –		+ +	– –
Comm. Serv.		+		–
Utilities	– –	–	+	+ +

Data Source: Fidelity.com

Interest Rates

Despite the predictions discussed above, the utilities sector has seen an underperformance recently. There are two likely reasons for this. The first stems from the idea that utilities are a proxy for government bonds, and the other is due to increased balance sheet pressure on utility companies.

The bond-proxy concept implies that, in general, investors who purchase shares of utility companies have similar investment goals as those who invest in U.S. Treasury securities: a regular stream of fixed or nearly fixed income. Treasury securities do this through coupon payments, while utility stocks accomplish something similar through higher-than-average dividend yields.

As of April 2024, the U.S. FOMC has targeted an all-time high Federal Funds Rate between 5.25 and 5.50 percent for five consecutive meetings (nine months)[5].

High interest rates mean two things for the utilities sector. The first is that the increased risk and lower dividend yield of utility stocks relative to treasury securities and their coupon rates mean that the former is significantly less attractive to income investors than the latter. The second is that higher interest rates increase the cost of capital. Utilities generally require significant upfront investment to establish and expand infrastructure, and today's high interest rate environment makes financing these activities significantly more expensive, putting increased pressure on the balance sheet of many of the sector's constituents.

As of April 14th, 2024, the FOMC still maintains that it plans on at least three rate cuts by the year's end[5]. However, due to recent inflation data coming in hotter than expected, investors are more uncertain about the quantity and timing of upcoming rate cuts.

SECTOR OUTLOOK

Regulated Electric Industry

NextEra Energy is the largest company in the utilities sector by market cap, and by extension is also the largest company in the regulated electric industry. According to Yahoo Finance, the regulated electric industry consists of "companies that generate, transmit, or distribute electric energy for sale."[1]

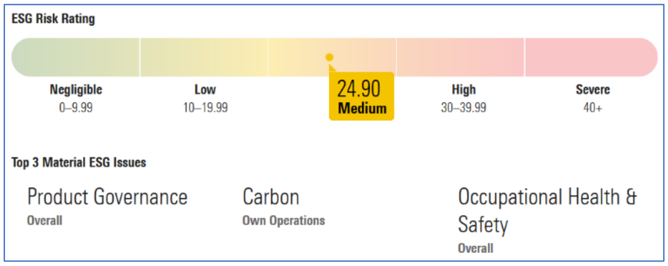
Demand Outlook

According to an article by the New York Times[6], demand for electricity in the United States is forecast to surge again soon. Utility companies have been adjusting their forecasts to reflect a renewed growth in demand for electricity in America. This comes after a long period of flat/no growth in electricity demand. This surge can be largely attributed to an "explosion in the number of new data centers, an abrupt resurgence in manufacturing driven by new federal laws, and millions of electric vehicles being plugged in.[6]" With artificial intelligence becoming more present, there is no reason to expect this trend reverse any time soon.

Company Specific Factors

Data from NextEra's financial statements support management's claims that they are well positioned for America's ongoing transition to clean, renewable sources of energy. An in-depth analysis of NextEra Energy's financials can be seen in later sections, but data supporting management's claim of being well positioned include increased investment into strengthening its grid and originating new renewable energy generation facilities.

ESG RATING



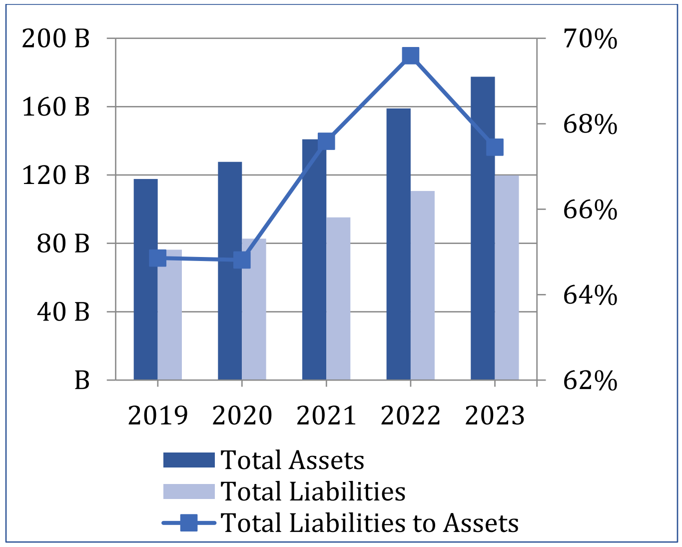
Source: Morningstar.com

ESG stands for environmental, social, and governance factors. This rating helps investors understand certain nonfinancial aspects of a company that may make it an attractive investment. As of April 14th, 2024, NextEra Energy has an ESG rating of 24.90, which is a medium risk level. The top 3 ESG issues are product governance, carbon, and occupational health & safety.

FINANCIAL ANALYSIS

Companies in the utilities sector are subject to unique challenges and circumstances which much be considered when conducting financial analysis. As discussed in "Economic Conditions," operating and maintaining a network for a utility requires significant upfront expenditures. As a result, it is not out of the ordinary for utility companies to have lower-than-average free cash flow, or a higher-than-average equity multiplier. These figures, along with several other key financial metrics for NextEra Energy will be explored and discussed in the following sections.

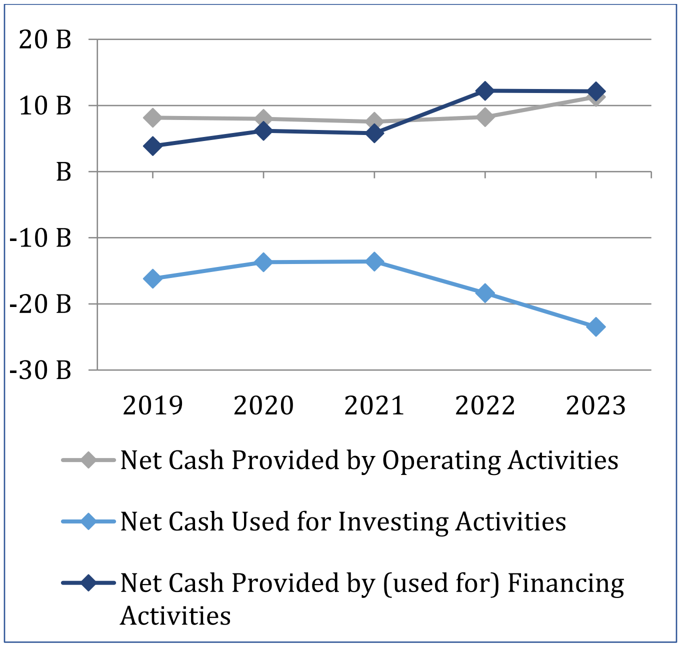
Balance Sheet



Data Source: Morningstar.com

Balance sheet analysis reveals a new downward trend in total liabilities to total assets in the year 2023. This comes after a period of an increase in the ratio from 2020 to 2023. Driving this reversal is a jump in total assets by 11.7 percent from 159 billion to 177 billion and a smaller 8.2 percent increase in liabilities from 111 billion to 120 billion. Decreasing leverage while managing to increase total assets suggests a positive development in NextEra's financial position. Lowering financial leverage decreases the company's risk of default and stabilizes their financial health in the long-term.

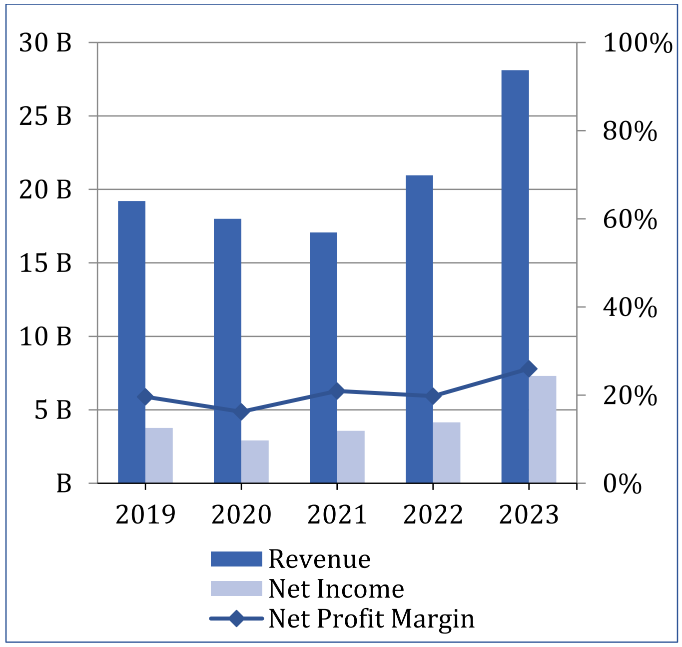
Statement of Cash Flows



Data Source: Morningstar.com

The cash flow data reveals a positive trend in the net cash provided by operating activities over the five periods, growing from $8 Billion to $11 Billion. This indicates generation of cash from business operations. The net cash used for investing activities is decreasing (cash outflows are increasing). The net cash provided by (used for) financing activities has also increased, after several periods of little or no growth. This increase coincides with NextEra's claimed investment into new renewable assets.

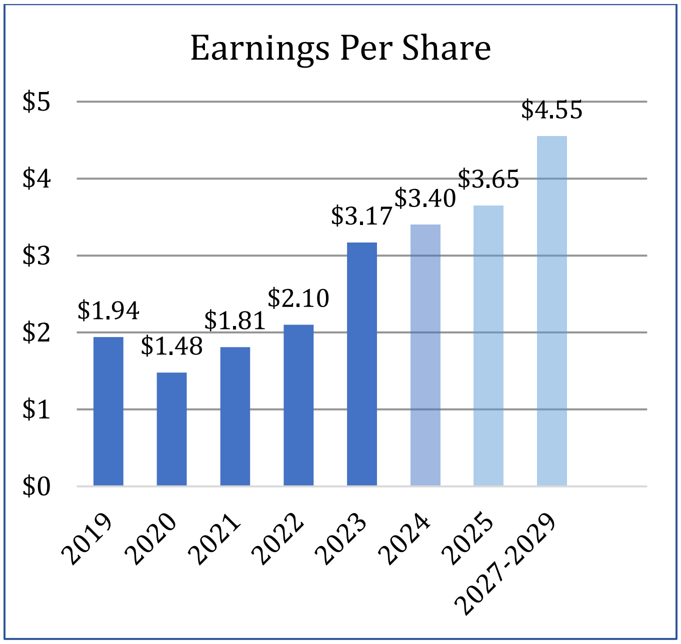
Income Statement



Data Source: Morningstar.com

NextEra's income statement reveals a slight downward trend in revenue from 2019 to 2021, followed by a stronger up trend in revenue from 2021 to 2023. Net income and net margin follow a similar pattern. Throughout the entire analysis period of 2019 to 2023, revenue has increased by 46 percent from $19 billion to $28 billion. Additionally net income has increased by 94 percent, from $4 billion to $7 billion. This growth may appear underwhelming in isolation, but these numbers paint a much brighter picture of NextEra's financial health when compared to its nearest competitors. More details can be found in the "Cross Sectional Analysis" section below.

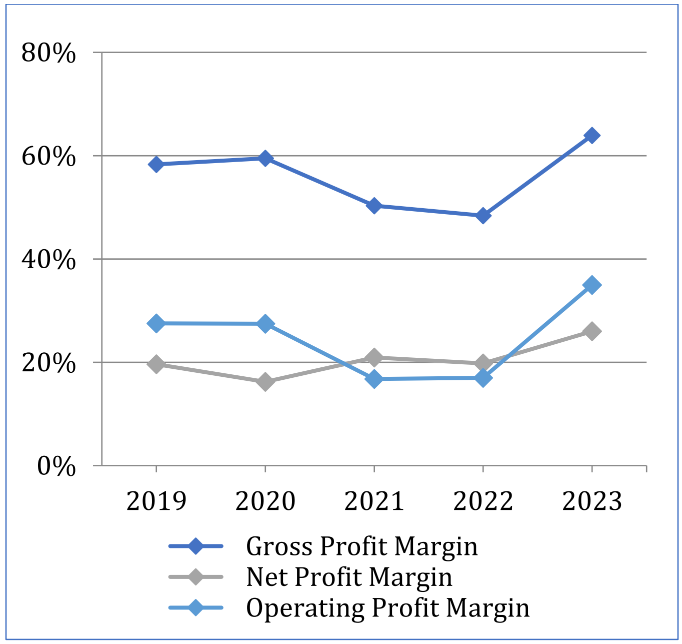
Earnings Per Share



NEE Earnings Per Share (Lighter bars are estimated values)
Data Source: Value Line Investment Survey

Earnings per share (EPS) is a financial measure indicating the portion of a company's profit allocated to each outstanding share of common stock. It's calculated by dividing net income by the total number of shares. EPS is a crucial metric for investors to assess a company's profitability and potential returns. In the graph above, EPS data collected from the Value Line Investment Survey is plotted. EPS growth has been observed in each period since 2020, with growth expected to continue into the foreseeable future. These EPS estimates imply an EPS growth rate range of 6.2 percent to 9.5 percent during the period from 2024 to 2029. These figures are greater than or equal to industry estimates over the same period. Comparisons to competitors and industry will be discussed in the following sections.

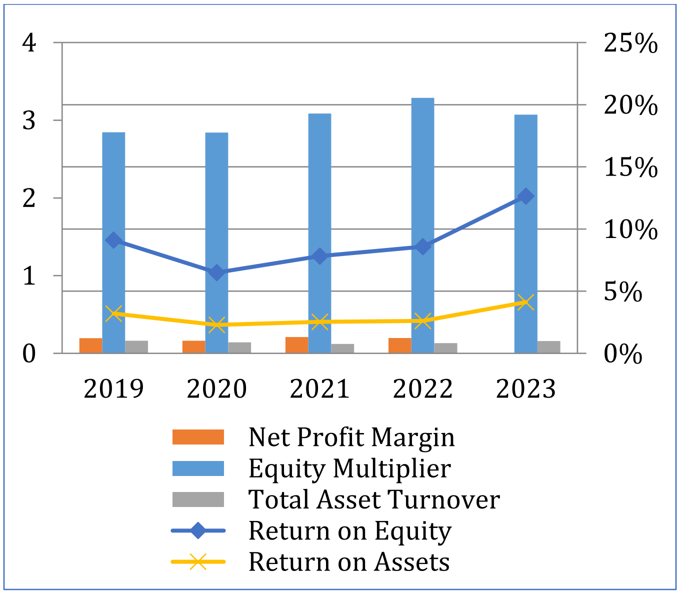
Profit Margin



Data Source: Morningstar.com

Gross profit margin measures the percentage of revenue that exceeds the cost of goods sold, indicating a company's efficiency in production and pricing. NextEra's financials indicate flat or decreasing gross profit margin between 2019 and 2022, with a sharp increase in 2023. Operating profit margin reflects the percentage of revenue remaining after deducting operating expenses, offering a measure of operational efficiency and profitability. This follows a very similar pattern to the gross profit margin according to NextEra's financials. Net profit margin indicates the percentage of revenue that translates into profit after accounting for all expenses, providing insight into overall profitability. This metric has been showing a weak upward trend, with some volatility in individual periods. Overall, NextEra's profit margins indicate improving financial health in 2023.

Management Effectiveness

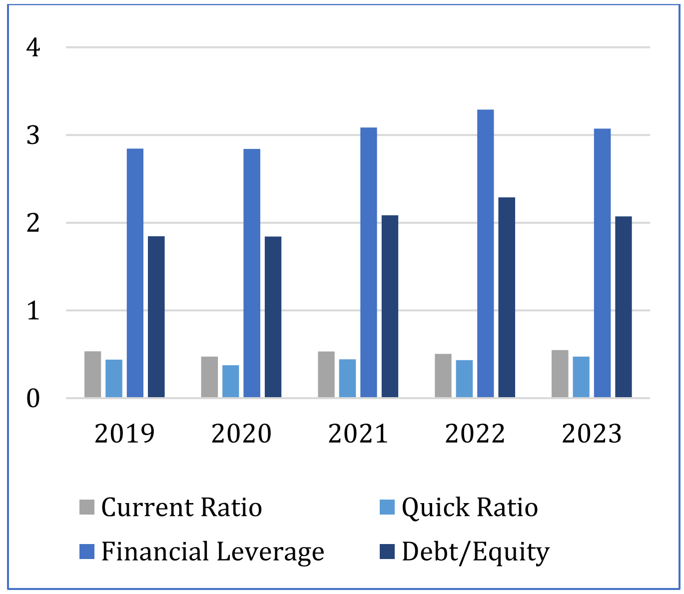


Data Source: Morningstar.com

Return on assets and return on equity are both common ratios used to evaluate a company's management effectiveness. ROA assesses how effectively a company uses its assets to generate profit, while ROE measures the return generated on shareholders' equity. Both ratios can be computed using total asset turnover, equity multiplier, and net profit margin. Total Asset Turnover indicates how efficiently a company converts its assets into revenue, and Equity Multiplier highlights the extent of debt financing relative to shareholders' equity. Investors typically favor higher ROA, ROE, Total Asset Turnover, and Net Profit Margin, as they signify better profitability and operational efficiency. Conversely, a lower Equity Multiplier is preferred, as it indicates less reliance on debt for asset funding and potentially lower financial risk.

As seen in the graph above, NextEra Energy has seen increasing ROA and ROE growth since 2020, with equity multiplier finally falling by a bit in 2023. These all reflect well on NextEra Energy's management effectiveness in FY2023.

Financial Health



Data Source: Morningstar.com

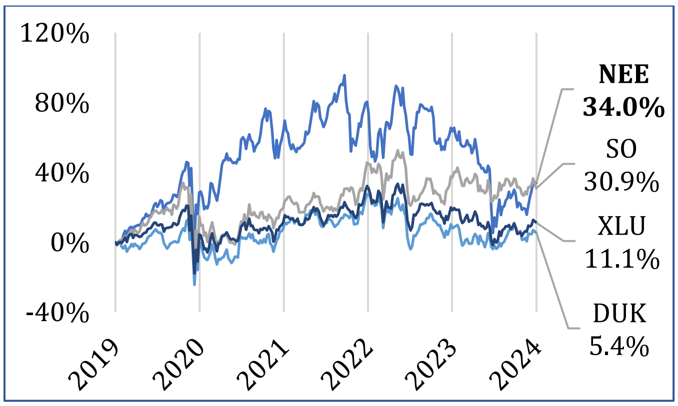
Financial health ratios are a set of metrics used to evaluate the financial well-being and stability of a company. The current ratio evaluates a company's short-term liquidity. The quick ratio offers a stricter measure by excluding inventory. Both ratios ideally remain above one to ensure the company is liquid enough to cover all its current liabilities. Financial leverage indicates debt usage relative to equity, with lower leverage preferred by investors for reduced risk. Likewise, the debt-to-equity ratio assesses the balance between debt and equity financing, with lower ratios signaling stronger financial health and less risk.

The graph above summarized NextEra Energy's financial health ratios. In the 2023 period, its current ratio and quick ratios were both below one, which could raise red flags about its liquidity. However, it is important to note that these values are not out of the ordinary for electric utility companies, as they tend to have significant investments in long term assets.

CROSS-SECTIONAL ANALYSIS

This analysis will compare NextEra Energy's key ratios and data to its closest competitors, the regulated electric industry, and the utilities sector. Cross sectional analysis allows investors to gain insight into how a company is performing relative to its peers. Since average financial ratios, growth rates, etc. vary greatly from sector to sector and even between industries, comparing to close competitors is the closest thing to a benchmark for these metrics.

Returns

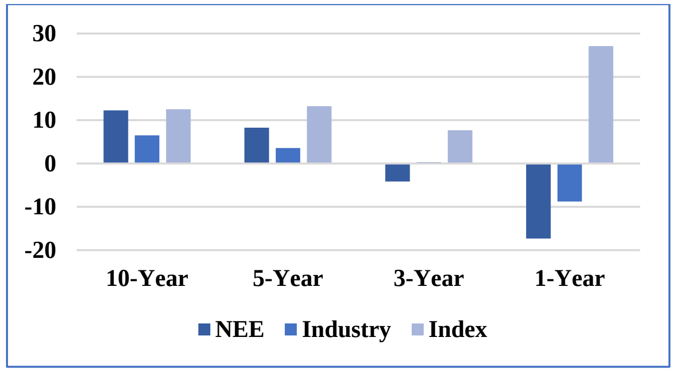


Data Source: Microsoft Excel Financial Data

The chart above compares five year returns of NextEra Energy (NEE), the utilities sector, represented by the Utilities Select Sector SPDR Fund (XLU), Duke Energy (DUK), and the Southern Company (SO). The chart shows that NextEra has continuously outperformed its nearest peers and the industry in which it operates.

Trailing Returns

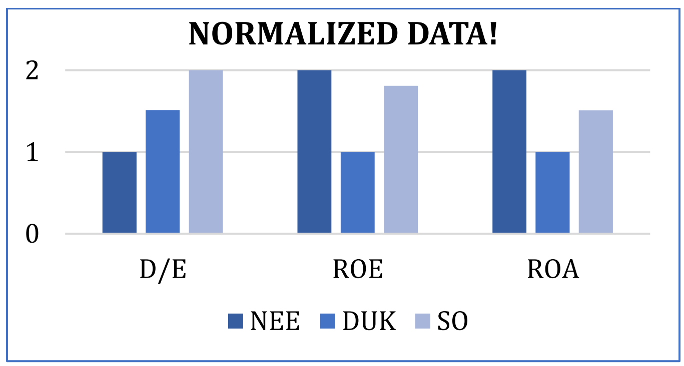
Examining trailing returns enables investors to assess how well an investment has performed over time, providing valuable insights into its historical performance relative to benchmarks and similar investments.



Data Source: Morningstar.com

Over the ten and five-year trailing return periods, NextEra Energy outperforms its industry. On the three and one-year periods, however, NextEra has performed considerably worse than the industry. Notably, neither the industry nor NextEra have outperformed Morningstar's index in any of the periods.

Financial Ratios



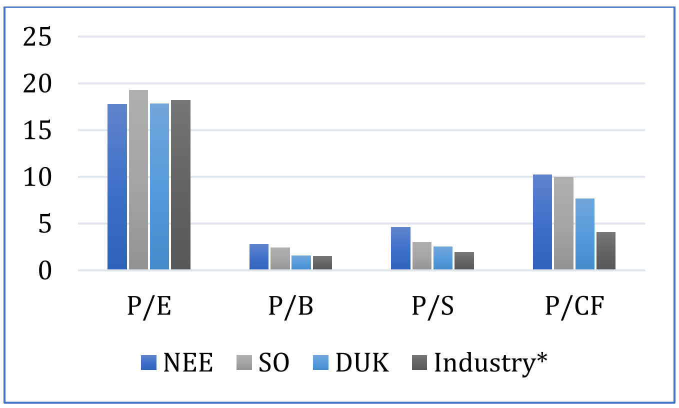
Cross sectional comparison of D/E, ROE, & ROA (Values are normalized to compare multiple ratios on the same graph. A value of 1 represents the lowest value in that series, while a value of 2 represents the highest value in that series.

Data Source: Morningstar.com

The graph above shows normalized data for select financial ratios. These ratios show that NextEra has a lower debt / equity ratio than DUK and SO while having a higher ROE and ROA. This is a positive indicator for NextEra's financial health in comparison to these select competitors.

Relative Stock Valuation

A relative valuation model refers to other companies and benchmarks. Relative valuation looks at valuation ratios like price-to-earnings (P/E), price-to-sales (P/S), price-to-cash flow (P/CF), and price-to-book (P/B). Higher relative valuation ratios than peers may suggest that a company is overvalued. The chart below compares the relative valuation ratios of NextEra Energy (NEE), the Southern Company (SO), Duke Energy (DUK), and the regulated electric industry. NextEra Energy appears to be overvalued compared to its peers and its industry compared using P/B, P/S, and P/CF. However, NextEra appears undervalued compared to all references when using the P/E ratio. Overall, these ratios hint toward NextEra being overvalued, but do not provide any definitive answers.



Data Source: Morningstar.com

FAIR VALUE

Absolute Stock Valuation

The goal of absolute stock valuation is to estimate a fair value or fair value range for a stock's price. Several methods can be used to generate a fair value estimate, but using a discounted cash flow model is one of the most common. For stocks which pay regular and consistent dividends like NextEra Energy, using a dividend discount model is the most appropriate.

According to Morningstar.com, NextEra's most recent dividend payment was $1.87 per share. To use the dividend discount model, it is necessary to estimate the dividend growth rate of the company and the cost of capital (investor's required return). The capital asset pricing model (CAPM) is used to estimate required return, while several methods can be used to estimate dividend growth rate.

For this analysis, a two-stage dividend discount model was used. This implies that there will be an initial period of high dividend growth before the growth rate falls to a more stable level into perpetuity.

Using a risk-free rate of 4.56 percent, a market risk premium of 6.6 percent, and a beta of 0.51, the CAPM indicates that the required return on NextEra's stock is 7.93 percent. To estimate the initial growth rate, the historical compound annual EPS growth rate was calculated and averaged with external and internal EPS growth estimates. To minimize the risk of mis-estimating growth rate, a range between 6 and 10 percent was used to assess different scenarios.

Using the median initial growth rate of 8 percent, assuming a five-year initial growth period and then a 5 percent stable growth rate thereafter, a fair value of $76.70 is computed. After applying a 20 percent margin of safety it is concluded that NextEra's stock is within the fair value range with a market price of $63.08 at the time of writing (trading at a 17.8 percent discount compared to fair value).

RISKS

High Interest Rates

As with all utility companies, NextEra maintains a high level of debt compared to the broader market. This is necessary to invest in the infrastructure required to transmit their products from generation facilities to end consumers. Operating with a high level of debt leaves the sector as whole, NextEra included, vulnerable to high interest rates. In 2023, NextEra's adjusted EPS was offset negatively by 10 cents due to higher-than-expected interest rates.

Natural Disasters

Approximately two-thirds of NextEra Energy's net income in 2023 came from the Florida Power & Light company. It is well-known that Florida seasonally experiences natural disasters, such as hurricanes. These pose a threat to the infrastructure established by FPL. According to their latest conference call, FPL has invested in strengthening its grid with stronger utility poles and underground installations, but the risk of natural disasters causing damage to infrastructure is present, nonetheless.

Regulatory Changes

While most of NextEra's business takes place in the state of Florida, which has relatively corporation-friendly regulations and lax environmental laws, the fact that the company operates in a highly regulated industry cannot be ignored. Changes in policy could lead to high costs in ensuring compliance with any new regulation.

RECOMMENDATION

I recommend a hold on NextEra Energy (NEE). Overall, I agree with management's optimistic outlook for the company's future in 2024 and beyond. Discounted cash flow models indicate that it is fairly valued with hints of undervaluation. Additionally, NextEra's industry position, and current and planned investments into new renewable projects suggest there is room for growth. However, relative stock valuation gives mixed signals which lean toward overvaluation. Additionally, as long as high interest rates remain elevated, financing new investment will be expensive and income investors will flock to risk-free securities over utility stocks; it will be more difficult for NextEra to see significant growth in these conditions.

REFERENCES

1. Yahoo Finance
2. Morningstar
3. NextEra Energy 2023 Annual Report
4. Value Line Investment Survey
5. Federal Open Market Committee
6. The New York Times

DISCLOSURE