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STOCK STORY: SEMPRA

Connecting growth to decarbonisation

Sempra Energy®

Global energy markets will need to evolve dramatically over the next three decades. Worldwide, the population is forecast to grow by nearly 2 billion[1] and global living standards are expected to rise as per capita consumption increases – and all this against the backdrop of a growing push towards decarbonisation. North America will be no different from this global trend, with its population predicted to grow by 0.4%[2] each year through 2050 and real GDP to expand at a 1.6%[3] CAGR over the same period, coupled with the challenge of the utilities sector needing to lift spending over 50% against its annual run rate to meet decarbonisation goals.

In this context, there are few businesses better placed to capitalise on these macro forces than Sempra.

Sempra is one of the largest energy infrastructure companies in North America, serving almost 40 million customers across its vast energy network. Its presence spans the US West Coast, Gulf region and Mexico via its three infrastructure platforms:

- California Utilities;
- Texas Utilities; and
- Sempra Infrastructure, which include its prolific liquified natural gas (LNG) assets.

To give a sense of its scale, across these platforms, Sempra's assets combine for approximately 300,000 miles of electricity transmission and distribution lines and gas pipelines in major North American markets, while accessing premium renewable resources and facilitating some of the region's largest energy exports. This includes more than 1 GW of renewable generation and over 30 Mtpa of LNG export capacity in operation or under construction.

All three infrastructure platforms will play a pivotal role in the long-term growth of the business, as each will position Sempra in some of the most attractive macro and structural tailwinds. Among the various macro drivers, the platforms should gain from operating in the top four largest economic (based on GDP) states/regions in North America, the top three electricity-consuming US states, and the region's three largest renewable generation markets.

In addition, the platforms benefit from some of the most progressive net-zero and grid modernisation policies in North America and the rest of the world. All in, this means significant capital investment for Sempra's subsidiaries over the coming decades. Indeed, management has earmarked US$40 billion of capital investments through 2027 – with more than 90% allocated for the regulated utilities – and bodes well for achieving its 6-8% annual earnings growth guidance for (at least) the next five years.

Much of this earnings growth will come from its planned investments in its California utilities segment – where San Diego Gas & Electric and SoCalGas combine to serve more than 25 million regulated customers. California remains the most favourable environment to invest in for Sempra, and for good reason. First, California is the largest economy in the United States and requires meaningful infrastructure investment to maintain this leadership position. Second, California has some of the most ambitious clean energy goals of any state, with 2030 objectives that include (among others):

1) Reducing carbon emissions by 40%;

2) Supporting 5 million electric vehicles; and

3) Providing core gas customers with 20% renewable gas.

Moreover, California maintains one of the more constructive regulatory environments in the US. Sempra's utilities enjoy a regulatory jurisdiction that allows an equity return of 9.8-9.95%, with no earnings exposure to volumes or commodity prices, and quick recovery of capital investments.

Sempra's Texas utilities platform includes Oncor, a regulated electricity transmission and distribution utility headquartered in Texas. The company operates more than 141,000 miles of transmission that connect to nearly 19 GW of renewable generation, and distribution lines that serve approximately 13 million customers, making it the largest pure-play T&D business in the country. Similar to the California platform, Oncor enjoys robust demographic growth (averaging more than 1,000 new residents per day) and record demand for interconnections as a product of the state's tremendous expansion in renewables generation. This has equated to an 8% CAGR in the asset base in just the last five years. Oncor will only continue to grow as evidenced by the strong policy support from both legislators and regulators (including authorised equity returns of 9.7%).

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[1] United Nations (https://www.un.org/en/global-issues/population#:~:text=The%20world's%20population%20is%20expected,billion%20in%20the%20mid%2D2080s)
[2] United Nations Department of Economic and Social Affairs (https://population.un.org/wpp/Download/Standard/MostUsed/)
[3] OECD (https://www.oecd-ilibrary.org/economics/real-gdp-long-term-forecast/indicator/english_d927bc18-en)

Despite its smaller earnings contribution, Sempra Infrastructure is an equally important part of the overall growth story. This platform includes a portfolio of LNG terminal assets throughout Texas and Mexico, as well as a network of energy transition assets. The LNG assets dominate this platform, due in large part to key markets access and sound economic earnings. These assets represent significant value for Sempra, as the terminals generate long-dated cash flows that are backed by take-or-pay earnings streams with typical 20-year maturities, and importantly, without exposure to commodity prices and volume risk. Demand for these assets has continued to rise, particularly for those countries seeking to decarbonise themselves or gain greater security for energy supplies.

To be sure, growth will come with its risks and challenges for Sempra. Constantly changing demographics and policy shifts may potentially be some of the major ones. But whatever the challenges may be, investors should take comfort in management's track record of delivering (5-yr adj. earnings CAGR of 16% and the deployment of over $30bn since 2017). Perhaps most importantly, they have done so in a long-term and risk-averse manner.

Jowell Amores, Portfolio Manager

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Sources: Company filings.