MGE Energy (MGEE)

Updated April 24th, 2018 by Josh Arnold

Key Metrics

Current Price:	$58	**5 Year CAGR Estimate:**	-1.3%	**Quality Percentile:**	N/A
Fair Value Price:	$42	**5 Year Growth Estimate:**	2.7%	**Momentum Percentile:**	N/A
% Fair Value:	138%	**5 Year Valuation Multiple Estimate:**	-6.2%	**Total Return Percentile:**	N/A
Dividend Yield:	2.2%	**5 Year Price Target**	$48	**Valuation Percentile:**	N/A

Overview & Current Events

MGE Energy has grown out of a small power station in Wisconsin built in 1902 to a $2B market cap, integrated energy company today. The company has paid consecutive dividends for more than 100 years and has raised its payout for the past 40 years. MGE principally operates gas and electric utilities as well as transmission and construction businesses.

MGE's recent Q4 report showed very modest adjusted EPS growth after a sizable, one-time tax benefit is excluded. The company's growth has been in question for some time and in Q4, it saw roughly flat margins while its utilities saw a small amount of customer growth. MGE's earnings growth in Q4 was driven by colder weather that increased usage.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.59	$1.47	$1.67	$1.76	$1.86	$2.16	$2.32	$2.06	$2.18	$2.20	***$2.32***	***$2.65***
DPS	$0.96	$0.97	$0.99	$1.01	$1.04	$1.07	$1.11	$1.16	$1.21	$1.26	***$1.29***	***$1.55***

EPS gradually increased from 2009 to 2014 but since that time, it has failed to move higher. Indeed, this year's estimates are in line with 2014, indicating a total lack of growth over time. Q4 was a relative bright spot but we believe MGE will struggle to grow in the coming years. Its only real growth catalyst is customer acquisition and that is being done at a low single digit rate. We are therefore forecasting 2.7% EPS growth going forward, which is slightly below its historical rate of growth. With flat margins and a lack of catalysts for meaningful top line improvement, MGE looks poised to continue to struggle to move the needle when it comes to EPS.

We see continued low single digit growth for the dividend as well as MGE is comfortable with where the payout ratio is today. Dividend growth will likely slightly outpace EPS growth in the coming years but expect the payout ratio to remain roughly where it is today. MGE is on par with other utilities in terms of dividend growth in the low single digits.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	14.2	15.1	15.0	15.8	17.2	17.0	17.2	20.3	24.9	22.9	***24.8***	***18.0***
Avg. Yld.	4.2%	4.4%	4.0%	3.6%	3.2%	2.9%	2.8%	2.8%	2.2%	2.0%	***2.2%***	***3.2%***

MGE's PE multiple has moved significantly higher in the past few years after spending much of the last decade in the mid-teens. It sits at nearly 25 today, and as a result, we believe MGE is rather overvalued. The lack of EPS growth it has exhibited and a lack of catalysts for it to pick up in the coming years mean that the current PE multiple seems completely unsustainable. To that end, we are forecasting a strong 6.2% headwind to total returns in the coming years as the valuation drifts back down to historical levels around 18 from the current 24.8.

The dividend yield is also telling us the stock is overvalued as it is still near its lowest point in the past decade. MGE's yield used to routinely be in the 4%+ range but of late, it has been half that value. We think the combination of continued payout growth and a stock price that should come down over time will produce a much higher, more normalized 3.2% yield against the current 2.2%. The enormous increase in the valuation for MGE has not only made the stock very expensive, but it has made the dividend far less attractive as well. This situation should be rectified in the coming years but prospective shareholders will need to be patient and wait for a better entry price.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	49.5%	54.1%	59.3%	60.8%	63.3%	60.4%	58.1%	62.6%	66.3%	66.5%	***66.5%***	***66.5%***
Debt/A	62%	61%	60%	62%	63%	61%	61%	60%	60%	58%	***58%***	***58%***
Int. Cov.	6.8	6.8	6.7	5.4	5.8	6.8	7.0	6.2	6.5	6.7	***6.8***	***7.0***
Payout	60%	66%	60%	57%	56%	50%	48%	56%	55%	57%	***56%***	***58%***
Std. Dev.	36.0%	22.1%	17.9%	23.8%	15.9%	17.8%	18.0%	22.0%	21.2%	20.5%	***21.0%***	***21.5%***

MGE's quality metrics have been roughly flat over the past decade as it doesn't go after growth via acquisition and its business hasn't really changed. Gross margins have drifted up over time but appear to have plateaued while its debt-to-asset ratio remains flat as well around 60%. MGE's interest coverage is outstanding for a utility at 6.8 and we forecast this will improve slightly over time as earnings grow and MGE keeps its debt at manageable levels. The payout ratio should remain under 60% as dividend growth may slightly outpace EPS growth, but the two should be very close. Overall, MGE is conservatively financed and run basically the same way year after year, meaning changes in the quality metrics will likely be few and far between. That's great from a predictability standpoint but it isn't helping growth.

MGE's main competitive advantage is in its virtual monopoly in its service area. Like many other utilities, MGE has a small but profitable service area where it is continuing to grow its customer base. That helped it hold up well in the Great Recession as EPS dipped slightly but recovered quickly.

Final Thoughts & Recommendation

Overall, MGE looks very overvalued here. We are forecasting total annual returns for the next five years to be -1.3%. This disappointing performance will consist of the current 2.2% yield, 2.7% EPS growth and a sizable 6.2% headwind from the valuation reset. MGE hasn't shown the ability to grow its earnings over a low single digit rate, but the valuation is pricing in much more growth than that. MGE therefore looks unattractive for just about any type of investor as it is overvalued, its current yield is relatively low and its dividend growth is low as well. We recommend investors sell MGE and invest the proceeds into a stock with more attractive total return characteristics.

Total Return Breakdown by Year