Badger Meter (BMI)

Updated July 19th 2018, by Nate Parsh

Key Metrics

Current Price:	$47	**5 Year CAGR Estimate:**	1.0%	**Volatility Percentile:**	57.9%
Fair Value Price:	$39	**5 Year Growth Estimate:**	3.4%	**Momentum Percentile:**	63.6%
% Fair Value:	121%	**5 Year Valuation Multiple Estimate:**	-3.5%	**Valuation Percentile:**	16.7%
Dividend Yield:	1.1%	**5 Year Price Target**	$47	**Total Return Percentile:**	3.9%

Overview & Current Events

Badger Meter was founded in 1905 in Milwaukee, WI. The company's first product was a "frost proof" water meter. Today, BMI manufactures and markets meters and valves that are used to measure and control the flow of liquids, such as water, oil and various chemicals. The company's products are also used to control the flow of air and other gases. BMI has a market cap of $1.25 billion and had more than $400 million in sales in 2017. The company is also a founding member of the American Water Works Association, a trade group that sets water measurement standards in the U.S.

BMI reported 2nd quarter earnings on July 18th. The company earned $0.42 per share during the quarter, beating estimates by $0.03 and improving almost 17% year over year. Revenue grew more than 9% to $113.65 million while also topping estimates by $2.54 million.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$0.85	$0.90	$0.96	$0.64	$0.98	$0.85	$1.03	$0.90	$1.11	$1.19	***$1.65***	***$1.95***
DPS	$0.20	$0.23	$0.26	$0.30	$0.33	$0.35	$0.37	$0.39	$0.43	$0.49	***$0.52***	***$0.88***

BMI has increased earnings per share by 3.4% per year over the past decade. BMI is expected to earn $1.65 per share in 2018, thanks in large part to a much lower tax rate. Investors should note that BMI does not offer quarterly guidance.

BMI had record sales and adjusted earnings in the 2nd quarter. Sales of municipal water products, which make up more than three-quarters of BMI's sales, grew 3.4%. Flow Instrumentations, which make up the remainder of sales, had growth of 6% due to improved oil and gas markets. International revenues were also strong, particularly in the Middle East where BMI's advanced meter system BEACON saw higher sales and service revenues. BMI's gross margins declined to 35% from 38%, largely due to a lower volume of products sold. Part of this lower volume was due to orders that were received during the quarter, but not shipped. The company expects this issue to be taken care of going forward and actually saw an increase order rate during the quarter. In January, BMI raised its prices on many of its products, which led to a portion of the sales increase, but no significant slowdown in orders.

BMI has increased its dividend for the past 25 years. The company has increased its dividend by an average of 11% per year over the past 10 years. BMI raised its dividend 13% on 8/11/2017. Dividend growth has varied over the past few years, with 15% raise in 2016 and ~5% raises in 2015 and 2014.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	24.9	19.8	21	28	18.9	28.8	25.6	33.2	30.6	34.8	***28.5***	***23.9***
Avg. Yld.	0.9%	1.3%	1.3%	1.7%	1.8%	1.4%	1.4%	1.3%	1.3%	1.1%	***1.1%***	***1.9%***

Shares of BMI have been at their most expensive over the past three years. As these years could be outliers, they were not included in the 2023 multiple estimate. Shares of BMI have had a price increase of $4 since our April 21st update, offering a forward multiple of 28.5. This is well above the 2008-2014 average P/E of 23.9. If the stock was to revert to this average, shares would have a multiple contraction of 3.4% per year through 2023.

BMI has rewarded shareholders with low double digit dividend growth over the past decade, but that still equates to a very low dividend yield (currently 1.1%). This is below the yield of the S&P 500 and significantly below the yield of the 10-year Treasury Bond.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	50.4%	50.8%	47.6%	41%	42.1%	37%	38.4%	38.2%	43.1%	39.8%	***40.4%***	***42.8%***
Debt/A	43.2%	24.4%	22%	18.1%	41%	37.8%	37.2%	34.7%	26.7%	29.2%	***29.6%***	***31.4%***
Int. Cov.	246.6	469.4	309.2	148.9	92.3	35.6	40.6	34.8	55.1	70.5	***65.9***	***47.3***
Payout	23.5%	25.6%	28.9%	46.9%	33.7%	41.2%	36%	43.3%	38.7%	41.2%	***31.2%***	***45.1%***
Std. Dev.	88.8%	59.8%	31.3%	42.2%	34.5%	31.1%	25.2%	24%	27%	26.4%	***28.9%***	***26.7%***

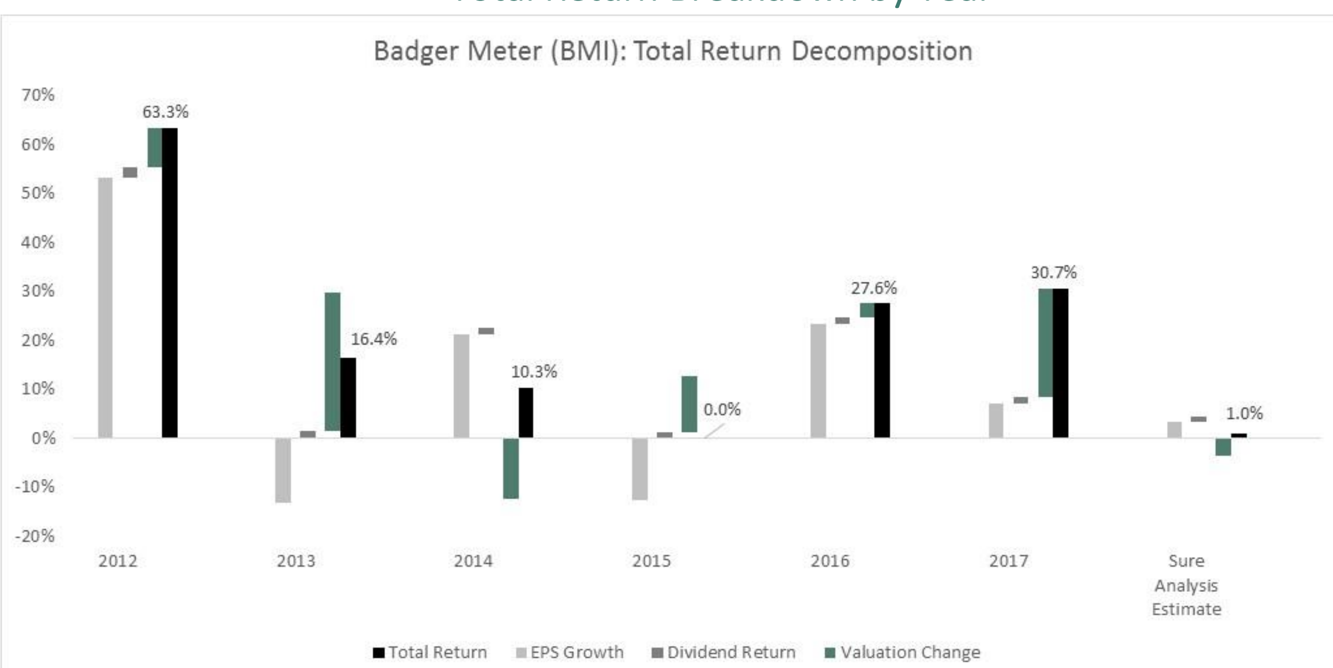
Unlike many companies at the height of the last recession, earnings for BMI actually improved. The vast majority of the company's sales are made to municipal water utilities. Consumers still need access to water, even in a recession. It is estimated that there are more than 30 million water meters in the U.S. that are not monitored with the advanced equipment that BMI offers. And with some states, like California, looking to improve its water monitoring systems in times of droughts, BMI is in a prime position to benefit.

BMI has seen its profitability decline from the 50% range, but this metric has stabilized in the past few years. Tax reform will be a major benefit to the company in future years, which should allow profitability to increase. BMI has also seen debt as a percentage of assets decline to nearly a 10 year low. BMI maintains a very low payout ratio, even in years in which earnings declined (2011, 2013 and 2015). This should give investors confidence that the company can continue to increase its dividend. It should be noted that if BMI produces EPS and DPS targets for 2023, the company would have its highest payout ratio since 2011. Even so, this still gives the company ample room to continue growing its dividend.

Final Thoughts & Recommendation

We forecast that Badger Meter can offer annual returns of just 1% through 2023, down from our previous estimates of 2.9%. This meager return is based off of earnings growth (3.4%), dividends (1.1%) and multiple contraction (3.5%). The low yield won't offer much protection if shares revert to their historical valuation. While 25 years of dividend growth is impressive for this small company, we feel that there are much better places for investors to invest their capital.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this article, and no plans to initiate one in the next 72 hours.