SJW Group (SJW)

Updated August 7th, 2018 by Nate Parsh

Key Metrics

Current Price:	$62	**5 Year CAGR Estimate:**	3.2%	**Volatility Percentile:**	72.1%
Fair Value Price:	$45	**5 Year Growth Estimate:**	7.6%	**Momentum Percentile:**	56.1%
% Fair Value:	138%	**5 Year Valuation Multiple Estimate:**	-6.2%	**Valuation Percentile:**	8.9%
Dividend Yield:	1.8%	**5 Year Price Target**	$65	**Total Return Percentile:**	15.1%

Overview & Current Events

SJW Group is a water utility company that produces, purchases, stores, purifies and distributes water to consumers and businesses in the Silicon Valley area of California and the area north of San Antonio, Texas. SJW also has a small real estate division that owns and develops properties for residential and warehouse customers in California and Tennessee.

SJW announced 2nd quarter earnings results on July 25th. The company earned $0.72 per share, in-line with estimates, but a 20% drop from the previous year. Revenue declined 2.9% to $99.1 million. This was $5 million below estimates.

On August 6th, SJW announced that it will be purchasing Connecticut Water Service (CTWS) for $70 in cash instead of doing a stock for stock merger. This acquisition will add 135,000 customers in Connecticut and Maine to SJW's customer base. The addition of CTWS will transform SJW into the third largest water utility company and help diversify SJW's customer base away from just California and Texas.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.08	$0.81	$0.84	$1.11	$1.18	$1.12	$2.54	$1.85	$2.57	$2.45	***$2.25***	***$3.25***
DPS	$0.65	$0.66	$0.68	$0.69	$0.71	$0.73	$0.75	$0.78	$0.81	$1.04	***$1.12***	***$1.37***

SJW's earnings-per-share often vary wildly from year to year. The company saw earnings decline at the height of the last recession. Earnings-per-share (EPS) growth over the past 10 years is 8.5%. This is an impressive growth rate for a water utility company. CTWS has grown EPS at an average rate of 6.7% over the same time frame. We estimate that the SJW will grow earnings at the average growth rate of the combined companies (7.6%) going forward.

As with the previous quarter, SJW's EPS results included a negative impact due to its acquisition of CTWS. For the 2nd quarter, earnings were negatively impacted by $0.10 per share due to acquisition activities. Revenue declines were largely attributed to charges related to tax reform legislation passed at the end of 2017. One item investors should be aware of is that water production costs are starting to increase over the last couple of quarters. For the 2nd quarter, water production expenses grew almost 3% to $39.9 million, as costs for purchasing and extracting water continue to climb higher. On the positive side, SJW saw an increase of $3.3 million increase in customer use of water.

SJW and CTWS have increased their dividends for the past 51 years and 48 years, respectively. SJW has a 10-year average growth rate of 4% while CTWS's is 3% over the same time. We expect the combined company to maintain a payout ratio of around 42%, or $1.37/share, in line with SJW's recent history.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	26.2	28.7	29.1	21.2	20.4	24.3	11.2	16.6	15.7	18.8	***27.6***	***20.0***
Avg. Yld.	2.3%	2.8%	2.8%	2.9%	3.0%	2.7%	2.6%	2.5%	2.0%	1.9%	***1.8%***	***2.1%***

Price-to-earnings multiples for water utilities tend to be high, but SJW's multiple was extremely high in the 2008-2010-time period. Share price has decreased $5, or 7.5%, since our July 13th update and the stock now trades with a forward P/E of 27.6, down from 29.8 previously. If shares were to revert to their long term average valuation, the stock would experience multiple contraction of 6.2% per year through 2023, down from 7.7% earlier. Even after a small share price decline, SJW's stock is overvalued relative to its own history.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	15.3%	15.1%	13.7%	14.1%	14.2%	14.1%	15.5%	14.5%	14.9%	15.9%	***16.4%***	***15%***
Debt/A	70.1%	71.2%	72.7%	74.6%	74.7%	71.1%	71.6%	71.3%	70.8%	68.2%	***71.6%***	***70.6%***
Int. Cov.	2.5	1.8	3.6	2.8	2.9	2.8	4.7	3.8	5	5.2	***4.9***	***3.5***
Payout	60.2%	81.5%	81%	62.3%	60.2%	65.2%	29.5%	42.2%	31.5%	42.4%	***49.8%***	***42.2%***
Std. Dev.	62.1%	43.1%	33.1%	32.7%	21.6%	23.6%	23.5%	26.6%	31.5%	26.3%	***27.5%***	***32.4%***

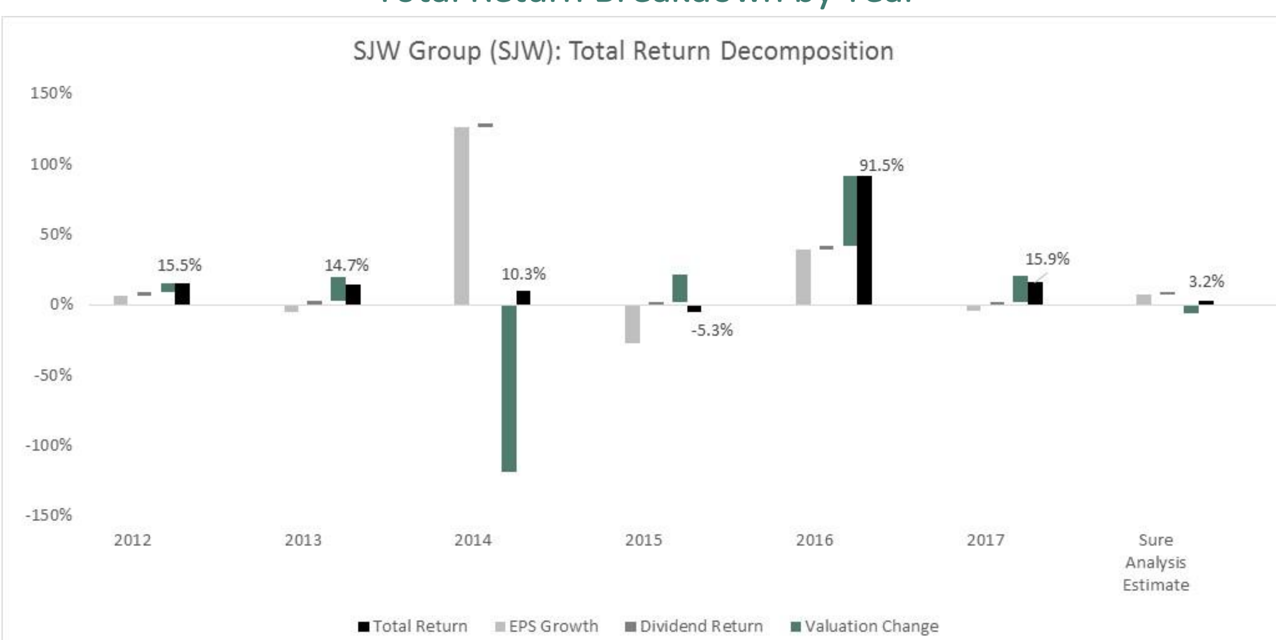
Many investors own utility companies for their reliable earnings and dividends, especially for uncertain economic times. During the last recession, SJW experienced a decline in earnings that took several years to recover. Dividend growth declined during this time, but the stock's yield reached as high as 3%.

A major competitive advantage for SJW is that it operates in two areas, Silicon Valley and Central Texas, that have seen high levels of population growth in recent years. These areas need improved water infrastructure to serve a growing client base, so local governments often allow the company to raise rates at a relatively high level in order to fund these projects. For example, SJW is approved for a 4.2% increase in 2018 for its customers in the Silicon Valley area. The company applied for rate increases of 9.8%, 3.7% and 5.2% over the next three years for this area. Dividend growth over the past decade is less than half of SJW's earnings growth. Because of this, SJW has a low payout ratio for a utility. The company's dividend growth is rather conservative, but this allows SJW to have its dividend remain intact and growing if the company's earnings were to decline. An additional issue that investors should be aware of is that SJW's earnings are highly concentrated in California (60% of expected sales post CTWS merger) and Connecticut (30% of expected sales post CTWS merger).

Final Thoughts & Recommendation

After second quarter earnings, we expect SJW to offer total returns of just 3.2% through 2023, up from 1.6% previously. This return is calculated from earnings growth (7.6%), dividends (1.8%) and multiple reversion (6.2%). SJW has seen a slight share price decline since our last update. While we continue to view the acquisition of CTWS as a positive, the stock simply does not offer adequate expected returns at this point. We suggest investors wait until SJW trades closer to its fair value (~$45) before purchasing shares of the water utility company. We maintain our 2023 price target of $65.

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.