SJW Group (SJW)

Updated October 30th, 2018 by Nate Parsh

Key Metrics

Current Price:	$62	**5 Year CAGR Estimate:**	3.2%	**Volatility Percentile:**	70.7%
Fair Value Price:	$45	**5 Year Growth Estimate:**	7.6%	**Momentum Percentile:**	51.6%
% Fair Value:	138%	**5 Year Valuation Multiple Estimate:**	-6.2%	**Growth Percentile:**	70.7%
Dividend Yield:	1.8%	**5 Year Price Target**	$65	**Valuation Percentile:**	7.3%
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Total Return Percentile:**	9.7%

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 Group has a small real estate division that owns and develops properties for residential and warehouse customers in California and Tennessee.

On August 6th, SJW Group announced that it will be purchasing Connecticut Water Service (CTWS) in a deal valued at $1.1 billion. This acquisition will add 135,000 customers in Connecticut and Maine to SJW Group's customer base. The addition of Connecticut Water Service will transform SJW Group into the third largest water utility company and help diversify SJW Group's customer base. This deal is expected to close in the 1st quarter of 2019

SJW Group released 3rd quarter earnings results on October 24th. The company earned $1.08 per share, $0.12 above estimates and a 15% increase from the previous year. Revenue grew 0.2% to $99.1 million, but missed estimates by $2.15 million. Included in the company's diluted EPS was a $0.32 charge related to SJW Group's proposed merger with Connecticut Water Service. Revenue was positively impacted by water rate increases ($3.1 million), federal tax rate due to tax law ($3.2 million) and new customers ($1 million). Water production expenses grew 3.4% to $55.1 million as purchased water and groundwater extraction costs increased, a trend that has been ongoing for several consecutive quarters. SJW Group's tax rate in the quarter was 21%, down from 41% a year ago.

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***
Shares	18.2	18.5	18.6	18.6	18.7	20.2	20.3	20.4	20.5	20.5	***21***	***23***

SJW Group'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 growth over the past 10 years is 8.5%. This is an impressive growth rate for a water utility. Connecticut Water Service has grown EPS at an average rate of 6.7% over the same time frame. We estimate that the SJW Group will grow earnings at the average growth rate of the combined companies (7.6%).

SJW Group and Connecticut Water Service have increased their dividends for the past 51 years and 48 years, respectively. SJW has a 10-year average growth rate of 4% while Connecticut Water Service's is 3% over the same time. We expect the combined company to maintain a payout ratio of around 42%, or $1.37/share by 2023.

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 Group's multiple was extremely high in the 2008-2010-time period. Share price is flat since our August 7th update. If shares were to revert to their long term average valuation of 20, the stock would experience multiple contraction of 6.2% per year through 2023.

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Safety, Quality, Competitive Advantage, & Recession Resiliency

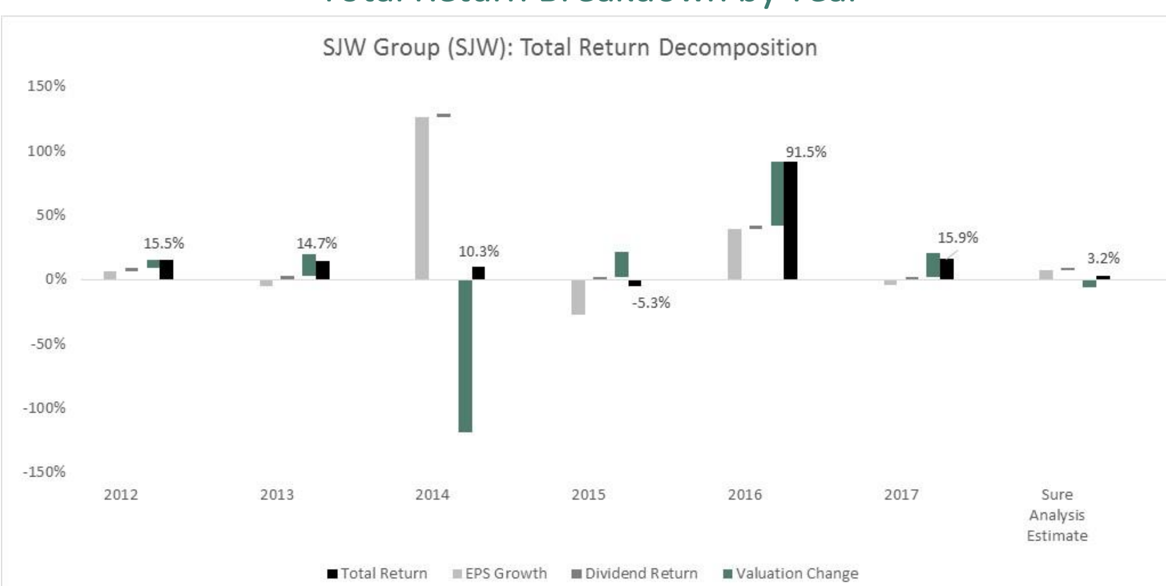
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	15.3%	15.1%	13.7%	14.1%	14.2%	14.1%	15.5%	14.5%	14.9%	15.9%	***16.4%***	***15%***
Debt/A	70.1%	71.2%	72.7%	74.6%	74.7%	71.1%	71.6%	71.3%	70.8%	68.2%	***71.6%***	***70.6%***
Int. Cov.	2.5	1.8	3.6	2.8	2.9	2.8	4.7	3.8	5	5.2	***4.9***	***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 Group experienced a decline in earnings that took several years to recover. Dividend growth slowed during this time, but the stock's yield reached as high as 3%. A major competitive advantage for SJW Group 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 Group 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. The company's dividend growth is rather conservative, but this allows SJW Group to have its dividend remain intact and growing if the company's earnings were to decline. Investors should be aware of is that SJW Group's earnings are highly concentrated in California (60% of expected sales post Connecticut Water Service merger) and Connecticut (30% of expected sales post-merger).

Final Thoughts & Recommendation

After third quarter earnings, we maintain our expected annual return through 2023 of 3.2% for SJW Group. This return is calculated from earnings growth (7.6%), dividends (1.8%) and multiple reversion (-6.2%). Though the merger with Connecticut Water Service have been a headwind in recent quarters, we continue to believe that the combination of the two water utility companies will be a positive. That being said, the stock simply doesn't offer sufficient total returns to warrant purchasing as the current level. We maintain our 2023 price target of $65. The stock is a borderline sell at current prices due to its valuation.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	220	216	216	239	262	277	320	305	340	389
Gross Profit	130	133	128	147	154	156	197	194	215	232
Gross Margin	59.1%	61.3%	59.5%	61.5%	59.0%	56.4%	61.6%	63.7%	63.4%	59.7%
SG&A Exp.	24	28	38	39	43	44	41	47	48	55
D&A Exp.	24	26	30	33	35	37	39	42	46	51
Operating Profit	46	29	42	54	55	53	93	80	93	98
Operating Margin	20.9%	13.6%	19.3%	22.8%	21.1%	19.3%	29.1%	26.2%	27.4%	25.2%
Net Profit	21	15	24	21	22	22	52	38	53	59
Net Margin	9.7%	7.0%	11.3%	8.7%	8.5%	8.1%	16.2%	12.4%	15.6%	15.2%
Free Cash Flow	-20	-10	-63	-7	-32	-31	-36	-9	-28	-48
Income Tax	N/A	N/A	17	15	16	14	25	23	34	35

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	851	878	935	1039	1087	1110	1269	1337	1443	1458
Cash & Equivalents	3	1	2	27	3	2	2	5	6	8
Accounts Receivable	13	12	21	13	12	14	15	16	16	17
Inventories	1	1	1	1	1	1				
Goodwill & Int. Ass.	8	11	14	15	11	18	19	16	24	14
Total Liabilities	597	626	680	775	813	789	909	954	1022	995
Accounts Payable	6	7	5	7	8	13	7	16	19	23
Long-Term Debt	236	254	301	345	356	358	398	415	448	456
Shareholder's Equity	254	253	255	264	275	321	360	384	422	463
D/E Ratio	0.93	1.00	1.18	1.31	1.30	1.11	1.11	1.08	1.06	0.98

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	2.7%	1.8%	2.7%	2.1%	2.1%	2.0%	4.4%	2.9%	3.8%	4.1%
Return on Equity	8.7%	6.0%	9.6%	8.0%	8.3%	7.5%	15.2%	10.2%	13.1%	13.4%
ROIC	4.5%	3.0%	4.6%	3.6%	3.6%	3.4%	7.2%	4.9%	6.3%	6.6%
Shares Out.	18.2	18.5	18.6	18.6	18.7	20.2	20.3	20.4	20.5	20.5
Revenue/Share	11.84	11.57	11.51	12.71	13.88	13.86	15.66	14.87	16.50	18.82
FCF/Share	-1.06	-0.51	-3.39	-0.39	-1.72	-1.55	-1.76	-0.42	-1.34	-2.32

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.