SJW Group (SJW)

Updated February 24th, 2019 by Nathan Parsh

Key Metrics

Current Price:	$62	**5 Year CAGR Estimate:**	3.1%	**Volatility Percentile:**	69.0%
Fair Value Price:	$45	**5 Year Growth Estimate:**	7.6%	**Momentum Percentile:**	62.7%
% Fair Value:	138%	**5 Year Valuation Multiple Estimate:**	-6.4%	**Growth Percentile:**	73.9%
Dividend Yield:	1.9%	**5 Year Price Target**	$64	**Valuation Percentile:**	9.9%
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Total Return Percentile:**	12.8%

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. The company has a market capitalization of almost $1.8 billion and generates nearly $400 million in annual revenues.

On December 3rd, 2018, the Connecticut Public Utilities Regulatory Authority, or PURA, denied approval to SJW Group's proposed merger with Connecticut Water Service (CTWS). The two companies have decided to file new applications that are intended to address the concerns of PURA. Both companies feel confident in the new application. The agreement to merge between SJW Group and CTWS remains in place. The proposed merger is worth more than $1 billon and had been expected to close within the first quarter of 2019.

SJW Group released financial results for the fourth quarter and full year 2018 on February 20th. The company earned $0.50 per share in the quarter, topping estimates by $0.10, but declining 40% from the previous year. Included in these results is a $0.50 per share charge related to the proposed merger with CTWS. Revenue grew 5.6% to $98.7 million, $3.7 million above estimates. Adjusting for costs related to the merger with CTWS, earnings-per-share SJW Group earned $2.51 per share during the year. This was a 2.5% improvement from the previous year. Revenue grew 2.2% to $397.7 million. Annual revenue was positively impacted by water rate increases ($28.9 million), a lower federal tax rate of 21% versus 35% due to tax law ($7 million), increases in customer usage ($5.1 million) and new customers ($2.6 million). Water production costs increased 6.7% to $168.7 million in 2018. Higher unit costs for purchased water, groundwater extraction and energy related charges were the main causes of production costs. We expect earnings-per-share to total $2.23 in 2019. This is a 12.6% decline from the previous year, but includes additional charges due to the proposed merger with CTWS and higher average share count.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$0.81	$0.84	$1.11	$1.18	$1.12	$2.54	$1.85	$2.57	$2.45	$2.51	***$2.23***	***$3.22***
DPS	$0.66	$0.68	$0.69	$0.71	$0.73	$0.75	$0.78	$0.81	$1.04	$1.12	***$1.20***	***$1.35***
Shares	19	19	19	19	20	20	20	21	21	29	***29***	***29***

SJW Group's earnings-per-share often vary wildly from year to year, but earnings-per-share growth over the past 10 years is 8.5%, an impressive growth rate for a water utility. Connecticut Water Service has grown earnings 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%) due to revenue growth and rate increases. In connection with the CTWS merger, SJW Group issued nearly 8 million new shares on December 5th in order to fund 50% of the proposed transaction.

SJW Group and Connecticut Water Service have increased their dividends for the past 51 years and 49 years, respectively. On January 30th, SJW Group announced a 7.1% dividend increase for the upcoming March 1st payment. 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 $1.35/share by 2024.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	28.7	29.1	21.2	20.4	24.3	11.2	16.6	15.7	18.8	24.7	***27.8***	***20.0***
Avg. Yld.	2.8%	2.8%	2.9%	3.0%	2.7%	2.6%	2.5%	2.0%	1.9%	1.8%	***1.9%***	***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. The share price is flat since our October 30th report. If shares were to revert to their long term average valuation of 20, the stock would experience multiple contraction of 6.4% per year through 2024.

Safety, Quality, Competitive Advantage, & Recession Resiliency

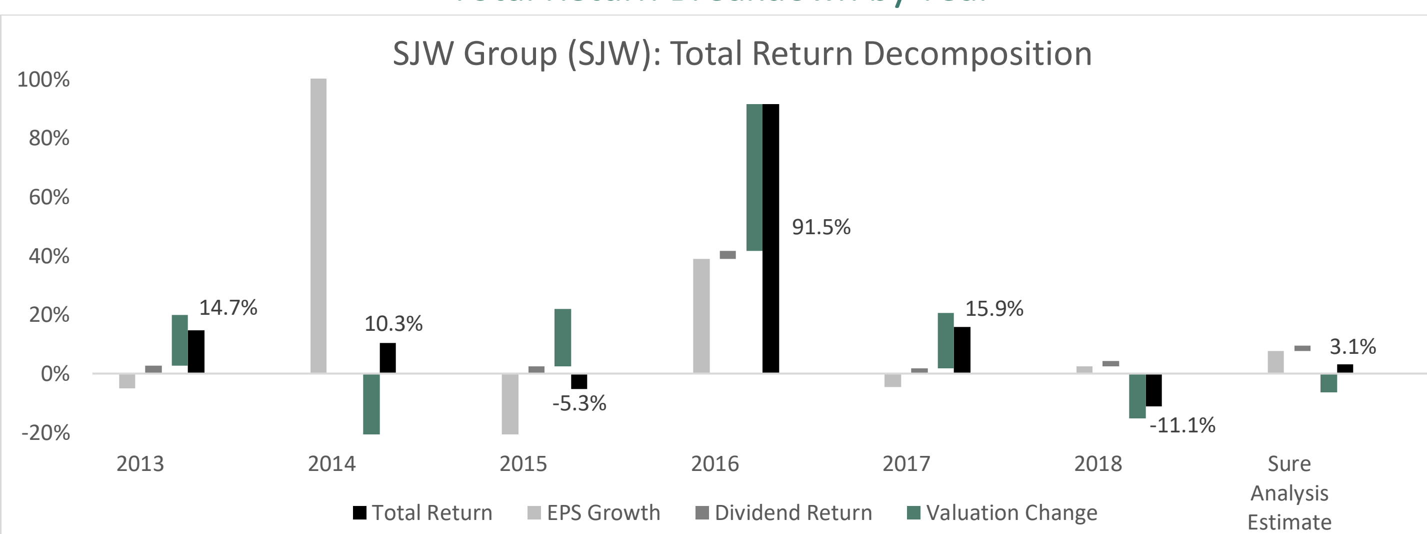
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	81.5%	81%	62.3%	60.2%	65.2%	29.5%	42.2%	31.5%	42.4%	44.6%	***53.8%***	***42%***

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. A key 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 was 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. 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

Following recent financial results, we now expect shares of SJW Group to return just 3.1% annually through 2024. While the denial of the company's merger with CTWS was a setback, both companies remain committed to completing the transaction. Completion of the merger will help diversify SJW Group's revenue base somewhat. Still, the stock trades well above our target valuation. We have reduced our 2024 price target by $1 to $64 due to our lower expected earnings-per-share guidance for 2019. We find SJW Group to be a sell given the large overvaluation in the share price.

Total Return Breakdown by Year



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

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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.