



SJW Group (SJW)

Updated April 27th, 2019 by Nathan Parsh

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|---------------------------------|-------|
| Current Price: | \$60 | 5 Year CAGR Estimate: | 4.6% | Volatility Percentile: | 71.2% |
| Fair Value Price: | \$46 | 5 Year Growth Estimate: | 7.6% | Momentum Percentile: | 33.0% |
| % Fair Value: | 130% | 5 Year Valuation Multiple Estimate: | -5.0% | Growth Percentile: | 74.3% |
| Dividend Yield: | 2.0% | 5 Year Price Target | \$67 | Valuation Percentile: | 15.8% |
| Dividend Risk Score: | A | Retirement Suitability Score: | B | Total Return Percentile: | 20.3% |

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 \$1.7 billion and generates \$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 revised applications that are intended to address the concerns of PURA, including no base rate hikes until at least January 2021, a 2% rate credit for customers for one year and the guarantee of jobs for all of CTWS' employees. The proposed merger is worth more than \$1 billion and had been expected to close within the first quarter of 2019.

SJW Group released financial results for the first quarter on 4/24/2019. The company earned \$0.21 per share, \$0.07 higher than expected and an improvement of 250% from the previous year. Excluding costs related to the merger of CTWS Revenue in the first quarter of 2018, earnings-per-share still improved more than 10% year-over-year. Revenue grew 3.5% to \$77.7 million, which was slightly above expectations. The increase in revenue was primarily due to a \$3.1 million increase in water rate changes and \$800K in new customers. Gains in these areas were partially offset by higher customer usage. Water production expenses decreased nearly 12%. While costs for purchased water, groundwater extraction and energy related charges were higher in the quarter, the use of available surface water supplies more than offset these expenses. SJW Group had \$1.2 million in merger related expenses during the first quarter. The company's tax rate of 26%, versus its pre-tax reform rate of 35%, also contributed to results. Due to first quarter results, we are increasing our expected earnings-per-share total for 2019 to \$2.32 from \$2.23. This would represent a loss of 7.6% from 2018 if achieved. The decline in earnings is mostly related to the costs of the merger with CTWS. Once approved, and we feel that the revised application could lead to approval, SJW Group's earnings-per-share should return to growth.

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 | \$2.32 | \$3.35 |
| 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 52 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.

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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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 | 25.9 | 20.0 |
| Avg. Yld. | 2.8% | 2.8% | 2.9% | 3.0% | 2.7% | 2.6% | 2.5% | 2.0% | 1.9% | 1.8% | 2.0% | 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 has declined \$2, or 3.2%, since our February 24th report. If shares were to revert to their long-term average P/E ratio of 20, then valuation would be a 5% headwind to annual returns through 2024.

Safety, Quality, Competitive Advantage, & Recession Resiliency

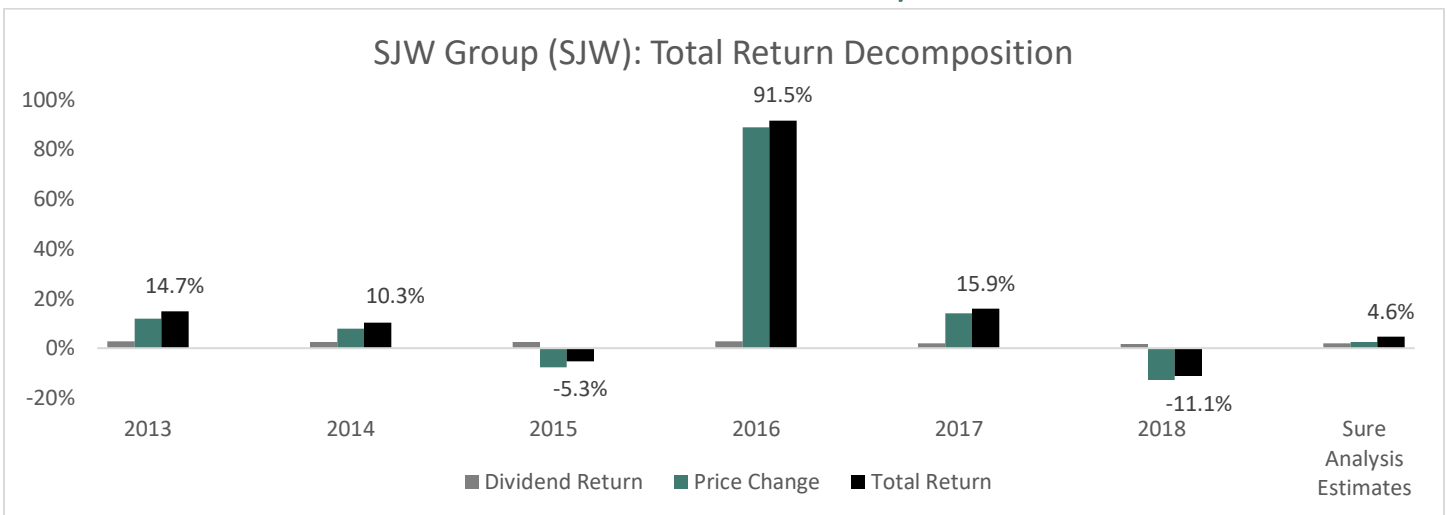
| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 82% | 81% | 62% | 60% | 65% | 30% | 42% | 32% | 42% | 45% | 52% | 40% |

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, aside from its pending merger, 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

We now expect shares of SJW Group to offer a total annual return of 4.6% through 2024, up from 3.1% previously. This increase is due to slightly higher expectations for earnings-per-share for 2019 and decrease in share price since our last update. We have raised our 2024 price target \$3 to \$67 to reflect our higher earnings expectation. While the merger with CTWS is still on hold, the two companies have filed a revised application with guarantees in hopes of moving the deal closer to completion. Still, shares of SJW Group continue to earn a sell rating from Sure Dividend due to low expected total returns.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 216 | 216 | 239 | 262 | 277 | 320 | 305 | 340 | 389 | 398 |
| Gross Profit | 133 | 116 | 134 | 141 | 142 | 182 | 179 | 196 | 213 | 211 |
| Gross Margin | 61.3% | 53.8% | 55.9% | 53.9% | 51.5% | 57.1% | 58.8% | 57.6% | 54.7% | 52.9% |
| SG&A Exp. | 28 | 38 | 39 | 43 | 44 | 41 | 47 | 42 | 49 | 49 |
| D&A Exp. | 26 | 30 | 33 | 35 | 37 | 39 | 42 | 46 | 51 | 57 |
| Operating Profit | 29 | 42 | 54 | 55 | 53 | 93 | 80 | 97 | 102 | 92 |
| Operating Margin | 13.6% | 19.3% | 22.8% | 21.1% | 19.3% | 29.1% | 26.2% | 28.7% | 26.2% | 23.1% |
| Net Profit | 15 | 24 | 21 | 22 | 22 | 52 | 38 | 53 | 59 | 39 |
| Net Margin | 7.0% | 11.3% | 8.7% | 8.5% | 8.1% | 16.2% | 12.4% | 15.6% | 15.2% | 9.7% |
| Free Cash Flow | -10 | -63 | -7 | -32 | -34 | -38 | -12 | -31 | -51 | -57 |
| Income Tax | N/A | 17 | 15 | 16 | 14 | 25 | 23 | 34 | 35 | 10 |

Balance Sheet Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---------------------------------|------|------|------|------|------|------|------|------|------|------|
| Total Assets | 878 | 935 | 1039 | 1087 | 1110 | 1269 | 1337 | 1443 | 1458 | 1956 |
| Cash & Equivalents | 1 | 2 | 27 | 3 | 2 | 2 | 5 | 6 | 8 | 421 |
| Accounts Receivable | 12 | 21 | 13 | 12 | 14 | 15 | 16 | 16 | 17 | 19 |
| Inventories | 1 | 1 | 1 | 1 | 1 | N/A | N/A | N/A | N/A | N/A |
| Goodwill & Int. Ass. | 11 | 14 | 10 | 11 | 18 | 14 | 16 | 24 | 14 | 16 |
| Total Liabilities | 626 | 680 | 775 | 813 | 789 | 909 | 954 | 1022 | 995 | 1067 |
| Accounts Payable | 7 | 5 | 7 | 8 | 13 | 7 | 16 | 19 | 23 | 25 |
| Long-Term Debt | 254 | 301 | 345 | 356 | 358 | 398 | 415 | 448 | 456 | 531 |
| Shareholder's Equity | 253 | 255 | 264 | 275 | 321 | 360 | 384 | 422 | 463 | 889 |
| D/E Ratio | 1.00 | 1.18 | 1.31 | 1.30 | 1.11 | 1.11 | 1.08 | 1.06 | 0.98 | 0.60 |

Profitability & Per Share Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Return on Assets | 1.8% | 2.7% | 2.1% | 2.1% | 2.0% | 4.4% | 2.9% | 3.8% | 4.1% | 2.3% |
| Return on Equity | 6.0% | 9.6% | 8.0% | 8.3% | 7.5% | 15.2% | 10.2% | 13.1% | 13.4% | 5.7% |
| ROIC | 3.0% | 4.6% | 3.6% | 3.6% | 3.4% | 7.2% | 4.9% | 6.3% | 6.6% | 3.3% |
| Shares Out. | 19 | 19 | 19 | 19 | 20 | 20 | 20 | 21 | 21 | 29 |
| Revenue/Share | 11.57 | 11.51 | 12.71 | 13.88 | 13.86 | 15.66 | 14.87 | 16.50 | 18.82 | 18.64 |
| FCF/Share | -0.51 | -3.39 | -0.39 | -1.72 | -1.68 | -1.84 | -0.60 | -1.51 | -2.48 | -2.67 |

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

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