



SJW Group (SJW)

Updated July 26th, 2019 by Nathan Parsh

Key Metrics

Current Price:	\$64	5 Year CAGR Estimate:	0.1%	Volatility Percentile:	65.6%
Fair Value Price:	\$39	5 Year Growth Estimate:	7.6%	Momentum Percentile:	45.8%
% Fair Value:	164%	5 Year Valuation Multiple Estimate:	-9.4%	Growth Percentile:	74.5%
Dividend Yield:	1.9%	5 Year Price Target	\$57	Valuation Percentile:	4.5%
Dividend Risk Score:	A	Retirement Suitability Score:	C	Total Return Percentile:	6.3%

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 \$1.8 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 ~\$1 billion and had been expected to close within the first quarter, but will now likely close in the third quarter.

SJW Group released financial results for the second quarter on 7/26/2019. The company earned \$0.47 per share, which was \$0.07 above estimates, but declined 24% from the previous year. Results included a \$0.05 impairment due to costs related to the merger with CTWS. Results also included a \$0.06 per share charge due to the company's settlement with the California Public Utilities Commission over customer billing practices. Revenue grew 3.9% to \$103 million, though this was \$6 million below estimates.

Revenues grew due to a \$3.6 million increase in water rate changes and \$800K increase due to new customers. These gains were partially offset by a 6% increase in water production costs, as lower customer usage saved the company \$600K. Operating expenses outside of water production costs were higher by \$1.5 million, mostly due to increased compensation and pension costs. Merger expenses with CTWS declined by \$900K. SJW Group's effective tax rate was 23%, down from 24% in the first quarter of 2018. Due to ongoing costs associated with the merger with CTWS, we have lowered our earnings-per-share forecast for the year to \$1.96 from \$2.32 previously. If achieved, this would be a decline of 22% from 2018. Once the merger is 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	\$1.96	\$2.83
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 1/30/2019, SJW Group announced a 7.1% dividend increase for the 3/1/2019 payment. SJW has a 10-

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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 48%, or \$1.35/share by 2024.

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	32.7	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%	2.4%

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 increased \$4, or 6.7%, since our 4/27/2019 update. If shares were to revert to their long-term average P/E ratio of 20, then valuation would be a 9.4% headwind to annual returns through 2024.

Safety, Quality, Competitive Advantage, & Recession Resiliency

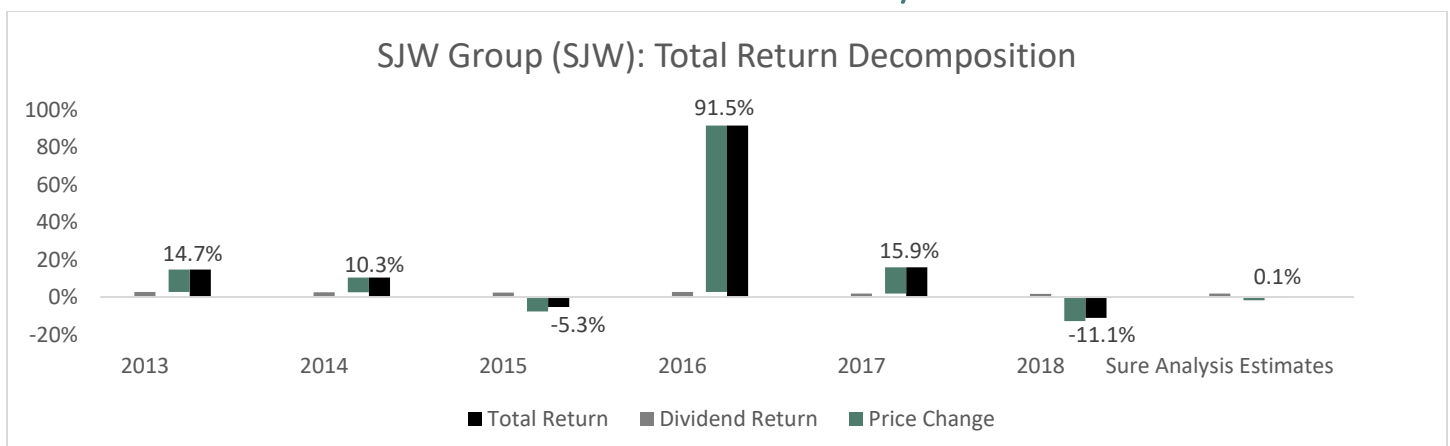
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	82%	81%	62%	60%	65%	30%	42%	32%	42%	45%	61%	48%

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

After adjusting our expected earnings-per-share for 2019, SJW Group is expected to return just 0.1% annually through 2024, down from 4.6% previously. The cost related to the company's merger with CTWS continue to add up and are weighing on the company's profitability. SJW Group trades with a valuation usually reserved for high growth stocks, not water utility companies. While we find the merger to be a positive for both water utilities, investors still holding shares of SJW Group are encouraged to consider locking in profits at the current price. Shares currently trade well above our fair value. Due to updated earnings expectations, we have lowered our 2024 price target for SJW Group \$10 to \$57.

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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