SJW Group (SJW)

Updated February 28th, 2020 by Nathan Parsh

Key Metrics

Current Price:	$61	**5 Year CAGR Estimate:**	5.6%	**Market Cap:**	$1.74B
Fair Value Price:	$51	**5 Year Growth Estimate:**	7.6%	**Ex-Dividend Date:**	2/7/2020
% Fair Value:	121%	**5 Year Valuation Multiple Estimate:**	-3.7%	**Dividend Payment Date:**	3/2/2020
Dividend Yield:	2.1%	**5 Year Price Target**	$73	**Years Of Dividend Growth:**	54
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	6.7%

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. The company generates $420+ million in annual revenues.

On 10/9/2019, SJW Group and Connecticut Water Service announced that their merger was completed. The combined company is the second largest public pure play water and wastewater utility company in the U.S. SJW Group will serve almost 1.5 million customers in California, Connecticut, Maine and Texas.

SJW Group released earnings results for the fourth quarter on 2/27/2020. The company's adjusted earnings-per-share was $0.34 for the quarter, which was $0.04 below estimates and a decrease of 10.5% from the previous year. Revenue increased 27.4% to $125.8 million, which was $4.5 million higher than excepted. For the year, adjusted earnings declined 29% to $1.78, while revenue increased 5.7% to $420.5 million. Earnings-per-share for 2019 included a $0.72 impairment due to costs related to the merger with CTWS and a $0.24 impairment due to changes in revenue recognition. The majority of revenue growth in the fourth quarter was due to the completed merger with CTWS, but SJW Group benefited from higher customer usage and an increase in water rates as well. Operating expenses increased nearly 48% year-over-year due to new CTWS expenses, higher per-unit costs for purchased water, groundwater extraction and energy charges. Shares of SJW Group were down 7% following earnings. SJW Group expects earnings-per-share in a range of $2.25 to $2.35 for 2020.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$0.84	$1.11	$1.18	$1.12	$2.54	$1.85	$2.57	$2.45	$2.51	$1.78	***$2.30***	***$3.32***
DPS	$0.68	$0.69	$0.71	$0.73	$0.75	$0.78	$0.81	$1.04	$1.12	$1.20	***$1.28***	***$1.43***
Shares[1]	19	19	19	20	20	20	21	21	29	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 grew 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 12/5/2018 in order to fund 50% of the proposed transaction.

SJW Group and Connecticut Water Service have increased their dividends for the past 54 years and 50 years, respectively. SJW Group announced a 6.7% dividend increase for the 3/2/2020 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 43%, or $1.43/share by 2025.

[1] In millions of shares

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	29.1	21.2	20.4	24.3	11.2	16.6	15.7	18.8	24.7	39.9	***26.5***	***22.0***
Avg. Yld.	2.8%	2.9%	3.0%	2.7%	2.6%	2.5%	2.0%	1.9%	1.8%	1.7%	***2.1%***	***2.0%***

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 decreased $11, or 15.3%, since our 11/1/2019 update. Due to the completed merger with CTWS, we are maintaining our 2025 target P/E of 22. If shares were to revert to this new target P/E by 2025, then then valuation would be a 3.7% headwind to annual returns over this period of time.

Safety, Quality, Competitive Advantage, & Recession Resiliency

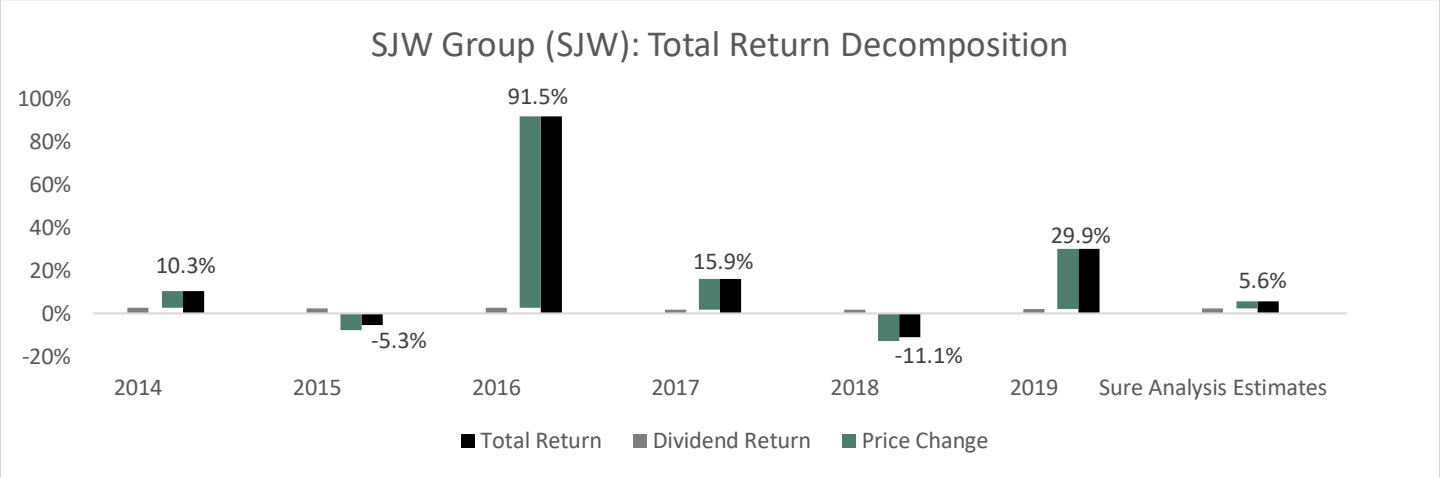
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	81%	62%	60%	65%	30%	42%	32%	42%	45%	67%	***56%***	***43%***

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 the concluded 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

Following fourth quarter and full-year results and the recent decline in share price, SJW Group is now expected to return 5.6% annually through 2025, which is an improvement from our previous estimate of a 1% annual loss over this period of time. The now completed merger of CTWS has positioned SJW Group as a leader in its sector of the economy. Due to expected earnings-per-share for the year, we have increased our 2025 price target $11 to $73 and now rate shares as a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	216	239	262	277	320	305	340	389	398	420
Gross Profit	116	134	141	142	182	179	196	213	211	224
Gross Margin	53.8%	55.9%	53.9%	51.5%	57.1%	58.8%	57.6%	54.7%	52.9%	53.3%
SG&A Exp.	38	39	43	44	41	47	42	49	49	66
D&A Exp.	30	33	35	37	39	42	46	51	57	
Operating Profit	42	54	55	53	93	80	97	102	92	73
Operating Margin	19.3%	22.8%	21.1%	19.3%	29.1%	26.2%	28.7%	26.2%	23.1%	17.4%
Net Profit	24	21	22	22	52	38	53	59	39	23
Net Margin	11.3%	8.7%	8.5%	8.1%	16.2%	12.4%	15.6%	15.2%	9.7%	5.6%
Free Cash Flow	(63)	(7)	(32)	(34)	(38)	(12)	(31)	(51)	(57)	
Income Tax	17	15	16	14	25	23	34	35	10	8

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	935	1,039	1,087	1,110	1,269	1,337	1,443	1,458	1,956	3,132
Cash & Equivalents	2	27	3	2	2	5	6	8	421	13
Accounts Receivable	21	13	12	14	15	16	16	17	19	88
Inventories	1	1	1	1						
Goodwill & Int. Ass.	14	10	11	18	14	16	24	14	16	662
Total Liabilities	680	775	813	789	909	954	1,022	995	1,067	2,242
Accounts Payable	5	7	8	13	7	16	19	23	25	35
Long-Term Debt	301	345	356	358	398	415	448	456	531	1,423
Shareholder's Equity	255	264	275	321	360	384	422	463	889	890
D/E Ratio	1.18	1.31	1.30	1.11	1.11	1.08	1.06	0.98	0.60	1.60

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.7%	2.1%	2.1%	2.0%	4.4%	2.9%	3.8%	4.1%	2.3%	0.9%
Return on Equity	9.6%	8.0%	8.3%	7.5%	15.2%	10.2%	13.1%	13.4%	5.7%	2.6%
ROIC	4.6%	3.6%	3.6%	3.4%	7.2%	4.9%	6.3%	6.6%	3.3%	1.3%
Shares Out.	19	19	19	20	20	20	21	21	29	29
Revenue/Share	11.51	12.71	13.88	13.86	15.66	14.87	16.50	18.82	18.64	14.72
FCF/Share	(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.