Artesian Resources Corp. (ARTNA)

Updated April 15th, 2020 by Samuel Smith

Key Metrics

Current Price:	$36	**5 Year CAGR Estimate:**	4.8%	**Market Cap:**	$347M
Fair Value Price:	$34	**5 Year Growth Estimate:**	3.6%	**Ex-Dividend Date:**	5/6/2020[1]
% Fair Value:	107%	**5 Year Valuation Multiple Estimate:**	-1.3%	**Dividend Payment Date:**	5/21/2020[2]
Dividend Yield:	2.8%	**5 Year Price Target**	$40	**Years Of Dividend Growth:**	25
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	1.5%

Overview & Current Events

Artesian Resources Corp. was founded in 1905 in New Castle County, Delaware. Through its subsidiaries, the company provides water, wastewater and other services primarily in the Delaware region. Artesian Resources sells and distributes water to residential, commercial, industrial, governmental, and utility customers throughout the state. In addition, Artesian Resources provides water for public and private fire protection in Delaware, Maryland, and Pennsylvania. The company produces 7.9 billion gallons of water annually through 1,311 miles of water main with a population of approximately 301,000 served. Artesian has 241 employees, a market capitalization of $347 million, and generated more than $80 million in revenue in 2018.

On March 11th, 2020, Artesian Resources reported full-year results for the period ended December 31, 2019. Net income grew by 4.5% year-over-year and diluted earnings-per-share increased by 3.9% year-over-year to $1.60. Growth was fueled primarily by growing the company's water and wastewater customer base and service area. The company also invested $40.7 million in its utility plant in order to provide the best possible service and quality water to customers. Water sales revenue increased by 3.9% to $73.6 million and other utility operating revenue increased by 10.3% to $4.9 million.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$1.00	$0.83	$1.13	$0.94	$1.07	$1.26	$1.41	$1.51	$1.54	$1.60	***$1.68***	***$2.00***
DPS	$0.75	$0.76	$0.79	$0.82	$0.85	$0.87	$0.90	$0.93	$0.96	$0.98	***$1.00***	***$1.16***
Shares[3]	7.7	8.6	8.7	8.8	8.9	9.1	9.1	9.2	9.3	9.3	***9.3***	***9.7***

Artesian Resources has enjoyed strong growth for a utility. EPS growth over the past decade has averaged 4.8% per year.

That being said, growth has been decelerating in the past four years, and we expect 3.6% growth over the next five years. Delaware's population growth averages approximately 1% per year, which along with 2% annual price increases, provides a baseline growth rate for the company of approximately 3%. The company can potentially increase this further by offering new services, improving economies of scale, and expanding its area, but growth beyond 4% per year may be difficult going forward.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	18.2	22.5	18.3	23.9	20.5	18.0	20.9	24.2	23.9	23.3	***21.4***	***20.0***
Avg. Yld.	4.1%	4.1%	3.8%	3.7%	3.9%	3.8%	3.1%	2.5%	2.6%	2.6%	***2.8%***	***2.9%***

[1] Estimate

[2] Estimate

[3] Share count is in millions.

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Due to its stability, Artesian Resources has historically commanded a rather high valuation. Its P/E ratio dropped to under 17 during the previous recession but has often floated over 20 during normal economic times. Currently the P/E ratio is higher than 21 and its dividend yield is 2.7%, both indicating overvaluation relative to historical norms.

Low government bond yields across the developed world have resulted in substantial equity premiums for recession-resistant stocks, meaning that even at rich valuations they potentially offer a sizable return premium over safe government bonds. Still, we believe that paying over 20x annual earnings is too rich given the lack of growth potential, and that a P/E of 20 or less for a company with this level of growth and high earnings resiliency is warranted.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	75%	92%	70%	87%	79%	69%	64%	62%	62%	62%	***60%***	***58%***

Artesian Resources has a debt/income ratio of approximately 8x, while debt/EBIT is less than 5x. Annual interest expense is approximately 25% of operating income, meaning that the company has an interest coverage ratio of around 4x. The company uses a substantial amount of leverage, but is in line with other utilities on this metric due to their stable, recession-resistant cash flows and large base of assets.

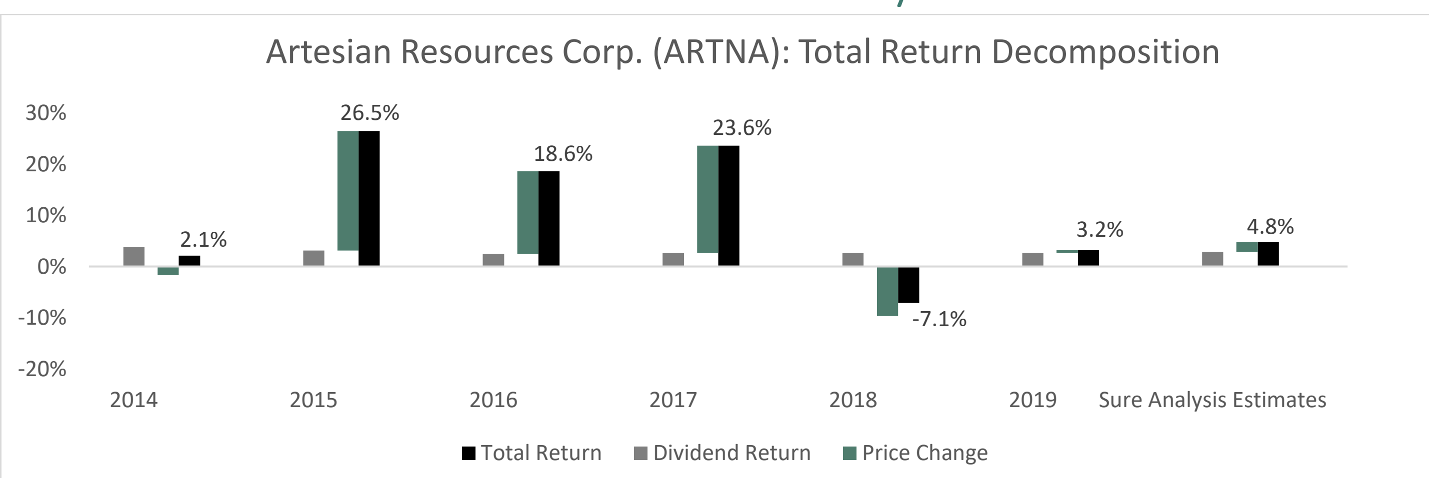
Like most utilities, the company's earnings have historically been very recession resistant. During the previous recession, the company's earnings-per-share declined by 5% in 2007 and declined by a further 7% in 2008. By 2009, the company had recovered to match its 2006 peak earnings and surpassed that peak in 2010. The company operates in a regulated environment with long-term contracts, and its cash flows should be very safe going forward. The company has increased its dividend for 25 consecutive years, although at times the payout ratio was high. Since 1992, the company has had the same CEO, Dian Taylor, who has proven to be an intelligent allocator of shareholder capital.

Final Thoughts & Recommendation

Artesian Resources has been a very successful utility company with a long stretch of consecutive annual dividend increases, and a solid growth rate in an otherwise slow-growing industry.

However, valuations have become very high in the utility sector, and Artesian Resources has not been spared from this. Forward returns are likely to be lower than past returns, as the company's P/E multiple is above its long-term average and its dividend yield is below its long-term average. We expect total returns over the next five years to average approximately 4.8% per year, and therefore consider Artesian Resources to be a hold at the current time.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	65	65	71	69	72	77	79	82	80	84
Gross Profit	30	30	34	32	35	39	41	41	39	41
Gross Margin	46.5%	45.5%	48.7%	47.0%	48.8%	50.1%	51.6%	50.1%	48.8%	49.2%
D&A Exp.	7	7	8	8	9	9	9	10	10	11
Operating Profit	20	19	23	20	23	26	27	27	25	25
Operating Margin	30.1%	28.5%	32.3%	29.5%	31.4%	33.3%	34.6%	33.1%	30.6%	30.0%
Net Profit	8	7	10	8	10	11	13	14	14	15
Net Margin	11.7%	10.4%	14.0%	12.0%	13.1%	14.7%	16.4%	17.0%	17.8%	17.9%
Free Cash Flow	-2	3	3	0	-5	8	2	-5	-20	(22)
Income Tax	5	5	7	6	6	8	8	7	5	5

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	372	379	392	404	422	432	451	495	530	560
Cash & Equivalents	0	0	1	0	0	0	0	1	0	1
Accounts Receivable	5	3	4	4	4	5	5	5	6	6
Inventories	1	1	1	1	2	2	2	2	1	1
Total Liabilities	276	266	274	282	297	299	312	348	377	400
Accounts Payable	3	3	3	4	4	5	6	9	8	8
Long-Term Debt	136	120	118	117	125	115	111	117	134	153
Shareholder's Equity	95	113	118	122	126	132	139	147	153	160
D/E Ratio	1.43	1.06	1.00	0.96	0.99	0.87	0.80	0.79	0.87	0.96

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.1%	1.8%	2.6%	2.1%	2.3%	2.6%	2.9%	3.0%	2.8%	2.7%
Return on Equity	8.2%	6.5%	8.5%	6.9%	7.7%	8.8%	9.5%	9.8%	9.5%	9.5%
ROIC	3.4%	2.9%	4.2%	3.5%	3.9%	4.5%	5.2%	5.5%	5.2%	5.0%
Shares Out.	7.62	8.16	8.72	8.84	8.93	9.01	9.16	9.24	9.29	9.3
Revenue/Share	8.52	7.97	8.09	7.82	8.12	8.55	8.63	8.90	8.65	8.96
FCF/Share	-0.20	0.42	0.32	-0.02	-0.59	0.86	0.17	-0.58	-2.14	(2.34)

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