



Middlesex Water (MSEX)

Updated September 16th, 2020 by Samuel Smith

Key Metrics

Current Price:	\$70	5 Year CAGR Estimate:	-4.7%	Market Cap:	\$1.2B
Fair Value Price:	\$47	5 Year Growth Estimate:	1.1%	Ex-Dividend Date:	11/13/20 ¹
% Fair Value:	149%	5 Year Valuation Multiple Estimate:	-7.7%	Dividend Payment Date:	12/1/20 ²
Dividend Yield:	1.5%	5 Year Price Target	\$49	Years Of Dividend Growth:	47
Dividend Risk Score:	A	Retirement Suitability Score:	C	Last Dividend Increase:	6.8%

Overview & Current Events

Middlesex Water Company was formed in 1897. The company is a water and wastewater utility in New Jersey and Delaware. Its market capitalization is \$1.2 billion and it produces about \$140 million in revenue annually. Middlesex has paid consecutive dividends since 1912 and has reached its 47th consecutive year of dividend increases.

Middlesex reported second quarter 2020 results on 7/31/20. During the quarter, the company completed the construction of its \$50 million transmission pipeline in its New Jersey system that it began back in 2018. The company also saw its revenues rise by \$1.9 million, net income rise by \$1.6 million, and diluted earnings per share increase to \$0.55 from \$0.49 in the year-ago period. The growth was largely driven by growth in demand from residential customers and other retail water consumption in the New Jersey system and customer growth in the Delaware system.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$0.96	\$0.84	\$0.90	\$1.03	\$1.13	\$1.22	\$1.38	\$1.38	\$1.96	\$2.00	\$2.13	\$2.25
DPS	\$0.72	\$0.73	\$0.74	\$0.75	\$0.76	\$0.78	\$0.81	\$0.86	\$0.96	\$0.98	\$1.03	\$1.20
Shares³	16	16	16	16	16	16	16	16	17	17	17	17

Earnings-per-share have been rising steadily over the past decade, although gains have been far from linear. The Great Recession saw earnings fall markedly in 2009 but recovery was fairly quick and since 2009, earnings have more than doubled. We see annualized earnings-per-share growth for the next five years in the low-single-digits as the only meaningful sources of growth will be the rate increase in New Jersey and lower taxes. Adding customers will also help some as it will also improve operational efficiencies through economies of scale. We are forecasting the dividend to continue its streak of small increases, rising from this year's expected payout of \$1.03 to \$1.20 in five years' time. Middlesex has an impressive streak of dividend increases that will continue to grow but on a percentage basis, the payout will rise rather slowly. The company's payout ratio was far too high during the Great Recession and management pulled way back on dividend increases to avoid a similar fate down the road.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	17.8	21.7	20.8	19.7	18.5	19.1	25.6	28.4	26.9	30.5	32.9	22.0
Avg. Yld.	4.2%	4.0%	4.0%	3.7%	3.7%	3.3%	2.3%	2.2%	1.8%	1.6%	1.5%	2.4%

The company's price-to-earnings multiple has risen sharply in recent years and as a result, the stock looks substantially overvalued today. After spending much of the past decade under 20, the current multiple is 32.9. We are forecasting a decline back towards 22 in five years, indicating a meaningful headwind to total returns. Given the stock's growth profile, it simply cannot sustain a price-to-earnings multiple near its current level.

¹ Estimate

² Estimate

³ In millions

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As a result of the expected multiple contraction and weak dividend growth, we are forecasting the yield to return to normalized levels in the mid-2% area from the current 1.5%. The yield is another way to demonstrate how overvalued Middlesex is today, but we see that situation being rectified by a lower stock price and higher payout going forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	75%	87%	83%	73%	67%	63%	58%	62%	53%	48%	48%	53%

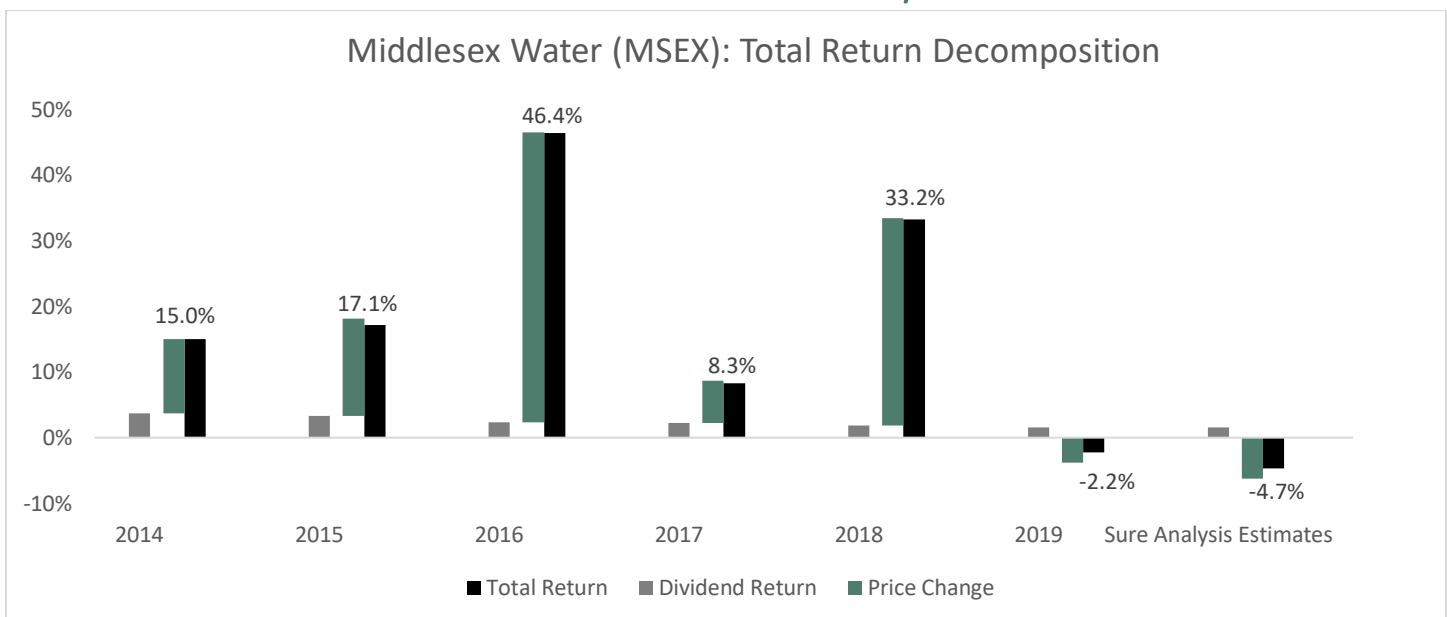
Like many other regulated utilities, Middlesex' quality metrics have remained steady in the past decade thanks to the monopoly-like nature of its assets. Its margins are right where they were 10 years ago and have remained very stable in the past few years in particular. However, since pricing is regulated, they cannot drive excessive profitability, thereby explaining the resistance to significant margin expansion. Its assets are 65% debt-financed, allowing for an excellent interest coverage ratio for a utility. Middlesex has the balance sheet to weather any economic storm so there is no question of safety, but obviously growth remains an issue. The payout ratio neared 100% in 2009 but slow growth in dividends and better rates of earnings-per-share growth have led it back down to 48% today. We see that rising slightly over time but overall, the dividend is very safe.

Middlesex' recession performance is decent given that it sells the most basic staple of all and indeed, its revenue was basically flat in 2009 at the height of the recession. Its earnings did not fare quite as well, but it certainly stood up to the downturn. Its obvious competitive advantage is in the monopoly it enjoys in its service area.

Final Thoughts & Recommendation

Middlesex still looks to be overvalued here. We see annualized total returns of -4.7% going forward as the current yield and 1.1% expected annual earnings-per-share growth will be more than offset by multiple contraction. The company's impressive dividend history is certainly worth noting but the current yield is likely too low to attract income investors. Middlesex would also be unattractive for those seeking growth or value, given the low potential for the former and high current valuation. We recommend selling Middlesex at current prices and investing the proceeds elsewhere due to its negative expected total returns over the next 5 years.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	103	102	110	115	117	126	133	131	138	135
D&A Exp.	10	10	11	12	12	13	14	15	16	17
Operating Profit	27	24	28	31	34	36	40	38	37	36
Operating Margin	25.9%	23.7%	25.0%	27.0%	29.4%	28.4%	30.3%	28.9%	26.9%	26.4%
Net Profit	14	13	14	17	18	20	23	23	32	34
Net Margin	13.9%	13.2%	13.0%	14.5%	15.7%	15.9%	17.1%	17.4%	23.5%	25.2%
Free Cash Flow	-4	-1	8	14	10	25	0	-7	-26	(53)
Income Tax	7	7	7	9	10	11	12	11	1	(3)

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	489	538	562	530	576	581	620	661	768	910
Cash & Equivalents	2	3	3	5	3	3	4	5	4	2
Accounts Receivable	12	11	12	12	10	10	10	11	12	12
Inventories	2	2	1	2	2	3	4	4	5	5
Total Liabilities	313	357	377	342	376	375	399	430	517	584
Accounts Payable	6	6	4	6	6	7	12	14	19	23
Long-Term Debt	155	161	171	164	161	142	153	174	209	258
Shareholder's Equity	173	177	182	186	197	204	218	229	249	324
D/E Ratio	0.88	0.89	0.92	0.87	0.81	0.69	0.69	0.75	0.83	0.79

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	3.0%	2.6%	2.6%	3.0%	3.3%	3.5%	3.8%	3.6%	4.5%	4.0%
Return on Equity	9.2%	7.7%	8.0%	9.1%	9.6%	10.0%	10.8%	10.2%	13.6%	11.8%
ROIC	4.4%	4.0%	4.1%	4.7%	5.2%	5.6%	6.3%	5.9%	7.5%	6.5%
Shares Out.	16	16	16	16	16	16	16	16	17	17
Revenue/Share	6.89	6.43	6.90	7.13	7.22	7.72	8.09	7.93	8.35	8.00
FCF/Share	-0.27	-0.05	0.50	0.85	0.61	1.56	-0.02	-0.45	-1.59	(3.15)

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

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