MGE Energy (MGEE)

Updated November 11th, 2020 by Samuel Smith

Key Metrics

Current Price:	$72.1	**5 Year CAGR Estimate:**	-2.8%	**Market Cap:**	$2.6B
Fair Value Price:	$47.3	**5 Year Growth Estimate:**	2.9%	**Ex-Dividend Date:**	11/30/20
Fair Value:	152%	**5 Year Valuation Multiple Estimate:**	-8.1%	**Dividend Payment Date:**	12/15/20
Dividend Yield:	2.0%	**5 Year Price Target**	$54.7	**Years of Dividend Growth:**	44
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	5%

Overview & Current Events

MGE Energy has grown from a small power station in Wisconsin built in 1902 to a $2.6 billion market capitalization integrated energy company. The company has paid consecutive dividends for more than 100 years and has raised its payout for the past 44 years. MGE principally operates gas and electric utilities, in addition to transmission and construction businesses, which collectively produce nearly $600 million in annual revenue.

MGE reported Q3 results on 11/5/20. The company reported $31.8M in Q3 earnings compared to $30.7M in the year-ago quarter with a GAAP earnings-per-share of $0.88 beating the year-ago quarter's result slightly. The company's revenue declined by -2.2% year-over-year to $135.21 million. The company also reported a $1M year-over-year increase in electric net income primarily due to AFUDC equity earned from the construction of their two projects as well as savings in operating maintenance costs. Meanwhile, MGEE's gas net income remained relatively flat.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$1.67	$1.76	$1.86	$2.16	$2.32	$2.06	$2.18	$2.20	$2.43	$2.50	***$2.63***	***$3.04***
DPS	$0.99	$1.01	$1.04	$1.07	$1.11	$1.16	$1.21	$1.26	$1.35	$1.39	***$1.43***	***$1.60***
Shares[1]	35	35	35	35	35	35	35	35	35	35	***35***	***35***

Earnings-per-share gradually increased from 2009 to 2014 but since that time, they have floundered a bit. Recent results have been strong, but we believe MGE will struggle to grow organically in the coming years. Its only sustainable growth catalysts are customer acquisition and renewable asset growth. We are therefore forecasting low single-digit earnings-per-share growth going forward. Investors would do well to consider that weather can contribute positively, but can easily swing the other direction.

We see continued low-single-digit growth for the dividend as well as MGE is comfortable with where the payout ratio is today. MGE is on par with other utilities in terms of dividend growth in the low-single-digits.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	15.0	15.8	17.2	17.0	17.2	20.3	24.9	22.9	26.7	31.6	***27.4***	***18.0***
Avg. Yld.	4.0%	3.6%	3.2%	2.9%	2.8%	2.8%	2.2%	2.0%	2.1%	1.8%	***2.0%***	***2.9%***

MGE's price-to-earnings multiple has moved significantly higher in the past few years after spending much of the last decade in the mid-teens. It sits at 27.4 times earnings today, and as a result, we believe MGE is quite overvalued. The

[1] In millions

lack of robust earnings growth it has exhibited and a lack of catalysts for it to pick up in the coming years mean that the current multiple seems unsustainable. Thus, we are forecasting a strong headwind to annual total returns in the coming years from multiple contraction.

The dividend yield is also telling us the stock is overvalued as it is still near its lowest point in the past decade. We think the combination of continued payout growth and a stock price that should come down over time will produce a much higher, more normalized 2.9% yield against the current 2.0%. The enormous increase in the valuation for MGE has not only made the stock very expensive, but it has made the dividend far less attractive as well.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	60%	57%	56%	50%	48%	56%	55%	57%	56%	56%	***54.4%***	***53%***

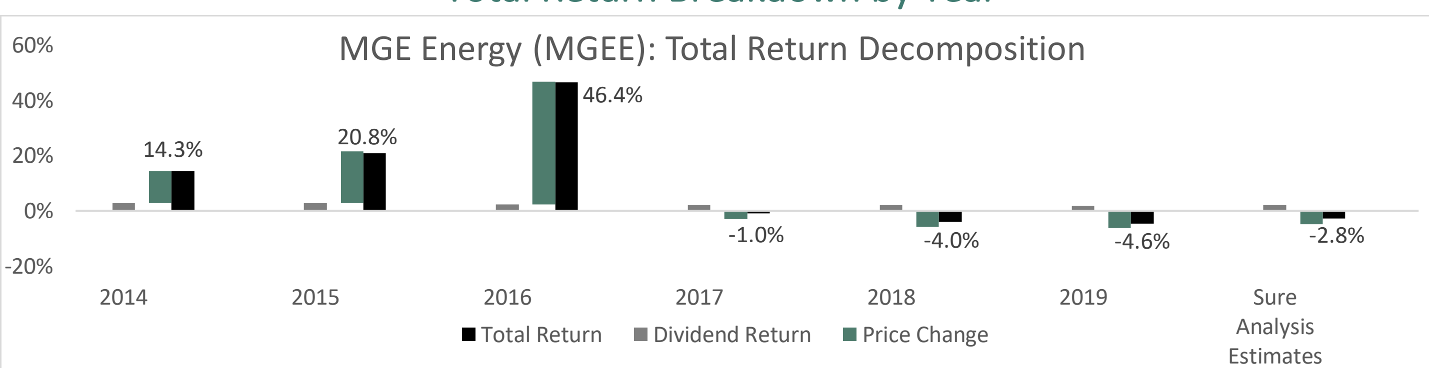
MGE's quality metrics have been roughly flat over the past decade, as it does not go after growth via acquisition, and its business has not really changed. Gross margins have drifted up over time but appear to have plateaued, while its debt-to-asset ratio remains flat as well around 60%. MGE's interest coverage is outstanding for a utility at 6.8, and we forecast this will improve slightly over time as earnings grow and MGE keeps its debt at manageable levels. The payout ratio should remain under 60% as dividend growth may slightly outpace earnings growth, but the two should be very close. Overall, MGE is conservatively financed and run basically the same way year after year, meaning changes in the quality metrics will likely be few and far between.

MGE's main competitive advantage is its virtual monopoly in its service area. Like many other utilities, MGE has a small but profitable service area where it is continuing to grow its customer base. That helped it hold up well in the Great Recession as earnings-per-share dipped slightly, but recovered quickly.

Final Thoughts & Recommendation

Overall, MGE appears very overvalued right now. We are forecasting total annualized returns for the next five years to be -2.8% as massive multiple contraction will offset the dividend and earnings-per-share growth. MGE has failed to grow its earnings faster than a low-single-digit rate, but the valuation is pricing in much more growth than that. MGE therefore looks unattractive for just about any type of investor as it is overvalued, its current yield is relatively low, and its dividend growth is unattractive as well, making it a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	533	546	541	591	620	564	545	563	560	569
Gross Profit	152	166	170	185	198	188	189	198	191	203
Gross Margin	28.5%	30.4%	31.4%	31.4%	32.0%	33.4%	34.6%	35.2%	34.1%	35.7%
Operating Profit	38	41	39	39	41	44	45	53	56	72
Operating Margin	97	108	113	128	138	124	124	126	115	112
Net Profit	18.1%	19.7%	20.8%	21.7%	22.3%	22.0%	22.7%	22.3%	20.6%	19.7%
Net Margin	58	61	64	75	80	71	76	50	56	58
Free Cash Flow	10.8%	11.2%	11.9%	12.7%	13.0%	12.6%	13.9%	8.8%	10.1%	10.3%
Income Tax	64	63	48	21	36	69	64	23	(59)	(34)

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	1,318	1,459	1,587	1,579	1,694	1,726	1,801	1,855	1,989	2,082
Cash & Equivalents	7	41	46	69	66	81	96	108	83	23
Accounts Receivable	44	37	41	45	42	37	40	42	44	40
Inventories	47	40	38	36	46	48	41	44	42	45
Total Liabilities	793	908	1,007	962	1,035	1,036	1,077	1,077	1,172	1,226
Accounts Payable	33	35	44	44	42	41	48	48	46	55
Long-Term Debt	359	364	362	404	406	391	387	427	511	543
Shareholder's Equity	525	551	579	618	659	690	724	778	817	856
D/E Ratio	0.68	0.66	0.62	0.65	0.62	0.57	0.53	0.55	0.63	0.64

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	4.4%	4.4%	4.2%	4.7%	4.9%	4.2%	4.3%	2.7%	2.9%	2.9%
Return on Equity	11.2%	11.3%	11.4%	12.5%	12.6%	10.6%	10.7%	6.6%	7.1%	7.0%
ROIC	6.5%	6.8%	6.9%	7.6%	7.7%	6.6%	6.9%	4.3%	4.5%	4.3%
Shares Out.	35	35	35	35	35	35	35	35	35	35
Revenue/Share	15.36	15.76	15.61	17.04	17.88	16.27	15.71	16.24	16.15	16.41
FCF/Share	1.84	1.83	1.37	0.61	1.04	1.99	1.85	0.67	(1.71)	(0.97)

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