



# SJW Group (SJW)

Updated November 6<sup>th</sup>, 2020 by Nathan Parsh

## Key Metrics

<b>Current Price:</b>	\$61	<b>5 Year CAGR Estimate:</b>	2.9%	<b>Market Cap:</b>	\$1.76 billion
<b>Fair Value Price:</b>	\$44	<b>5 Year Growth Estimate:</b>	7.6%	<b>Ex-Dividend Date:</b>	11/6/2020
<b>% Fair Value:</b>	139%	<b>5 Year Valuation Multiple Estimate:</b>	-6.3%	<b>Dividend Payment Date:</b>	12/1/2020
<b>Dividend Yield:</b>	2.1%	<b>5 Year Price Target</b>	\$63	<b>Years Of Dividend Growth:</b>	54
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Last Dividend Increase:</b>	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 about \$530 million in annual revenues.

SJW Group released earnings results for the third quarter on 11/4/2020. Adjusted earnings-per-share increased 176% to \$0.91, which was \$0.01 better than expected. Revenue improved 45.5% to \$165.9 million, \$8.7 above estimates. Adjusting for the merger with CTWS, revenue increased 13% year-over-year. Higher customer usage added \$2.4 million to results and cumulative water increases contributed \$2.3 million. Operating expenses were up 56% to \$124 million, most of which was due to higher water production expenses.

SJW Group reaffirmed its guidance for earnings-per-share of \$1.95 to \$2.05 for 2020, and we reiterate our guidance for \$2.00 in earnings-per-share for this year.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	\$0.84	\$1.11	\$1.18	\$1.12	\$2.54	\$1.85	\$2.57	\$2.45	\$2.51	\$1.78	<b>\$2.00</b>	<b>\$2.88</b>
<b>DPS</b>	\$0.68	\$0.69	\$0.71	\$0.73	\$0.75	\$0.78	\$0.81	\$1.04	\$1.12	\$1.20	<b>\$1.28</b>	<b>\$1.43</b>
<b>Shares<sup>1</sup></b>	19	19	19	20	20	20	21	21	29	29	<b>29</b>	<b>29</b>

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, but we don't expect any significant additional dilution on the horizon.

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 was 3% over the same time. We expect the combined company to payout \$1.43/share in dividends by 2025.

## Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
<b>Avg. P/E</b>	29.1	21.2	20.4	24.3	11.2	16.6	15.7	18.8	24.7	39.9	<b>30.5</b>	<b>22.0</b>
<b>Avg. Yld.</b>	2.8%	2.9%	3.0%	2.7%	2.6%	2.5%	2.0%	1.9%	1.8%	1.7%	<b>2.1%</b>	<b>2.2%</b>

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 \$9, or 12.9%, since our 8/8/2020 update. Due to the completed merger

<sup>1</sup> In millions of shares

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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 valuation would be an 6.3% headwind to annual returns over this period of time.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

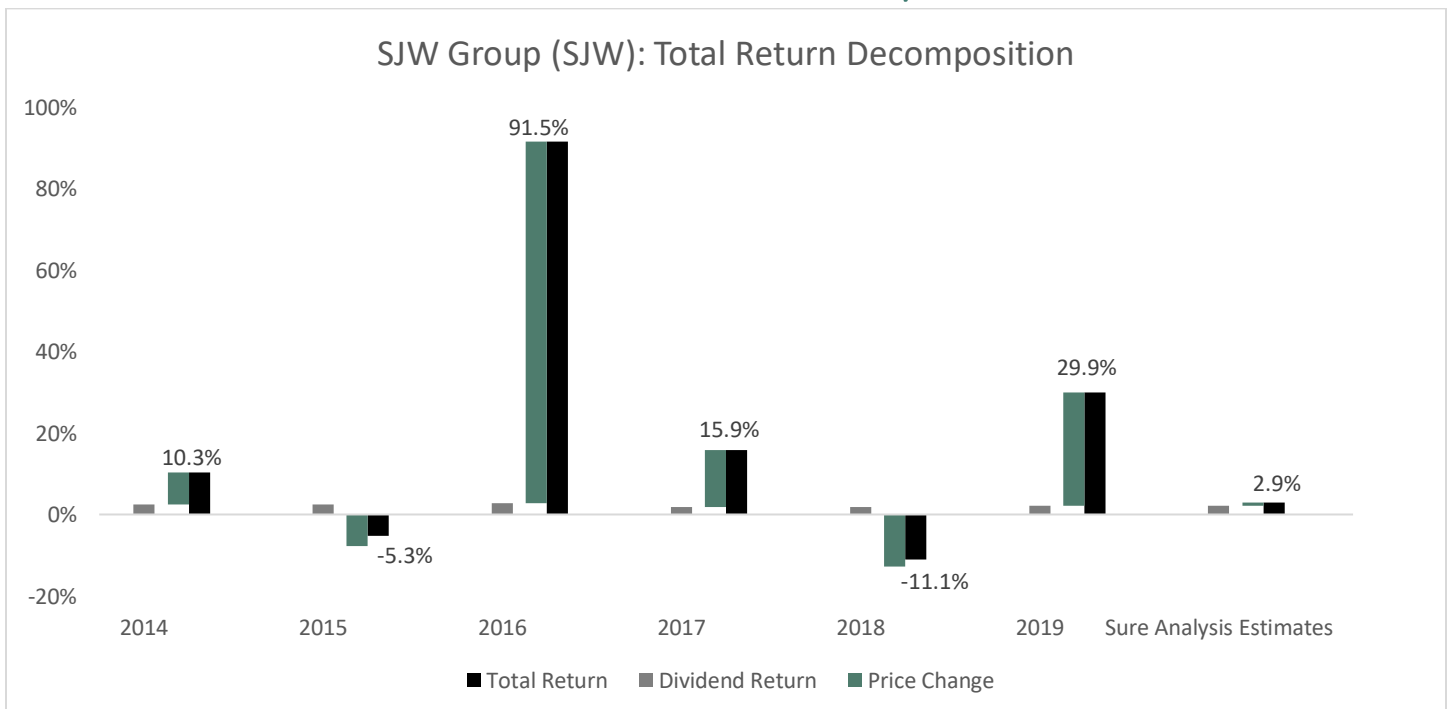
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	81%	62%	60%	65%	30%	42%	32%	42%	45%	67%	64%	50%

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 third quarter results, SJW Group is now projected to return 2.9% annually through 2025, which is up from our previous estimate of 0.1%. Projected returns stem from 7.6% earnings growth, a decent dividend yield offset by a mid-digit valuation reversion. The addition of CTWS contributed \$37.1 million in new revenues, up \$4 million sequentially. Even without CTWS, SJW Group continues to perform well as the legacy business grew 13%. Water production costs were once again higher, but not unexpected as the company continues to invest capital into its infrastructure. Shares have declined since our last update, but SJW Group still trades with a premium multiple. We maintain our 2025 price target of \$63 as well as our sell rating on SJW Group.

## 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.

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