



# Middlesex Water (MSEX)

Updated March 12<sup>th</sup>, 2021 by Samuel Smith

## Key Metrics

<b>Current Price:</b>	\$74.8	<b>5 Year CAGR Estimate:</b>	-4.1%	<b>Market Cap:</b>	\$1.2B
<b>Fair Value Price:</b>	\$50.0	<b>5 Year Growth Estimate:</b>	1.9%	<b>Ex-Dividend Date:</b>	5/11/21 <sup>1</sup>
<b>% Fair Value:</b>	150%	<b>5 Year Valuation Multiple Estimate:</b>	-7.7%	<b>Dividend Payment Date:</b>	6/1/21 <sup>2</sup>
<b>Dividend Yield:</b>	1.5%	<b>5 Year Price Target</b>	\$55	<b>Years Of Dividend Growth:</b>	47
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	C	<b>Last Dividend Increase:</b>	6.3%

## 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 \$141.6 million in revenue annually. Middlesex has paid consecutive dividends since 1912 and has reached its 47<sup>th</sup> consecutive year of dividend increases.

Middlesex reported fourth-quarter 2020 results on 2/25/21. The company reported total revenue of \$34.63M, an increase of 5.8% compared to \$32.7M in the year-ago period. The rise in revenue was largely driven by higher water consumption by the company's retail and wholesale contract customers. The operations and maintenance expenses increased from \$17.4 million to \$18 million year-over-year. The company's net income for the quarter also grew to \$8.3M from \$8.1 million year-over-year while diluted earnings per share came in at \$0.47 compared to \$0.46 in the year-ago period. Middlesex also reported a \$0.27525 quarterly dividend.

## Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
<b>EPS</b>	\$0.84	\$0.90	\$1.03	\$1.13	\$1.22	\$1.38	\$1.38	\$1.96	\$2.00	\$2.18	<b>\$2.27</b>	<b>\$2.50</b>
<b>DPS</b>	\$0.73	\$0.74	\$0.75	\$0.76	\$0.78	\$0.81	\$0.86	\$0.96	\$0.98	\$1.05	<b>\$1.09</b>	<b>\$1.20</b>
<b>Shares<sup>3</sup></b>	16	16	16	16	16	16	16	17	17	18	<b>18</b>	<b>19</b>

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 roughly tripled. 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 \$1.09 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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
<b>Avg. P/E</b>	21.7	20.8	19.7	18.5	19.1	25.6	28.4	26.9	30.5	34.2	<b>32.9</b>	<b>22.0</b>
<b>Avg. Yld.</b>	4.0%	4.0%	3.7%	3.7%	3.3%	2.3%	2.2%	1.8%	1.6%	1.5%	<b>1.5%</b>	<b>2.2%</b>

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 trading at a multiple in the low to mid 20s, the current

<sup>1</sup> Estimate

<sup>2</sup> Estimate

<sup>3</sup> In millions

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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.

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%.

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

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	87%	83%	73%	67%	63%	58%	62%	53%	48%	48%	<b>48%</b>	<b>48%</b>

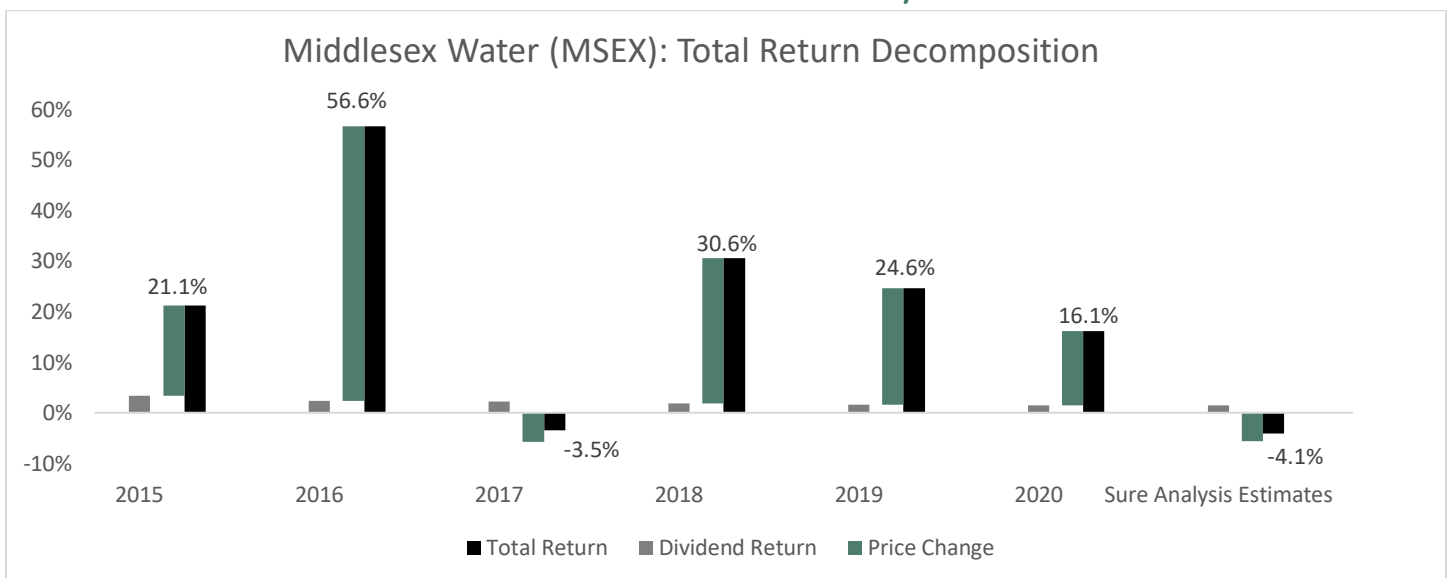
Like many other regulated utilities, Middlesex' quality metrics have remained steady in the past decade thanks to the monopoly-like nature of its assets. However, since pricing is regulated, they cannot drive excessive profitability, thereby explaining the resistance to significant margin expansion. Its assets are mostly debt-financed, allowing for an excellent interest coverage ratio for a utility. Middlesex has the balance sheet to weather virtually 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 -4.1% going forward as the current yield and 1.9% 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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	102	110	115	117	126	133	131	138	135	142
D&A Exp.	10	11	12	12	13	14	15	16	17	21
Operating Profit	24	28	31	34	36	40	38	37	36	37
Operating Margin	23.7%	25.0%	27.0%	29.4%	28.4%	30.3%	28.9%	26.9%	26.4%	26.4%
Net Profit	13	14	17	18	20	23	23	32	34	38
Net Margin	13.2%	13.0%	14.5%	15.7%	15.9%	17.1%	17.4%	23.5%	25.2%	27.1%
Free Cash Flow	(1)	8	14	10	25	(0)	(7)	(26)	(53)	(52)
Income Tax	7	7	9	10	11	12	11	1	(3)	(4)

## Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	538	562	530	576	581	620	661	768	910	976
Cash & Equivalents	3	3	5	3	3	4	5	4	2	4
Accounts Receivable	11	12	12	10	10	10	11	12	12	15
Inventories	2	1	2	2	3	4	4	5	5	5
Total Liabilities	357	377	339	376	372	399	430	517	584	628
Accounts Payable	6	4	6	6	7	12	14	19	23	30
Long-Term Debt	161	171	164	161	142	153	174	209	258	282
Shareholder's Equity	177	182	189	197	207	218	229	249	324	346
D/E Ratio	0.89	0.92	0.85	0.81	0.68	0.69	0.75	0.83	0.79	0.81

## Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	2.6%	2.6%	3.0%	3.3%	3.5%	3.8%	3.6%	4.5%	4.0%	4.1%
Return on Equity	7.7%	8.0%	9.0%	9.6%	9.9%	10.7%	10.2%	13.6%	11.8%	11.5%
ROIC	4.0%	4.1%	4.7%	5.2%	5.6%	6.3%	5.9%	7.5%	6.5%	6.3%
Shares Out.	16	16	16	16	16	16	16	17	17	18
Revenue/Share	6.43	6.90	7.13	7.22	7.72	8.09	7.93	8.35	8.00	8.06
FCF/Share	(0.05)	0.50	0.85	0.61	1.56	(0.02)	(0.45)	(1.59)	(3.15)	(2.97)

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

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