



# American States Water Co. (AWR)

Updated August 13<sup>th</sup>, 2021 by Samuel Smith

## Key Metrics

|                             |        |  |       |                                  |         |
|-----------------------------|--------|--|-------|----------------------------------|---------|
| <b>Current Price:</b>       | \$90.7 | <b>5 Year CAGR Estimate:</b>               | -4.2% | <b>Market Cap:</b>               | \$3.4B  |
| <b>Fair Value Price:</b>    | \$61.3 | <b>5 Year Growth Estimate:</b>             | 1.4%  | <b>Ex-Dividend Date:</b>         | 8/13/21 |
| <b>% Fair Value:</b>        | 148%   | <b>5 Year Valuation Multiple Estimate:</b> | -7.5% | <b>Dividend Payment Date:</b>    | 9/01/21 |
| <b>Dividend Yield:</b>      | 1.6%   | <b>5 Year Price Target</b>                 | \$66  | <b>Years Of Dividend Growth:</b> | 66      |
| <b>Dividend Risk Score:</b> | A      | <b>Retirement Suitability Score:</b>       | B     | <b>Last Dividend Increase:</b>   | 9%      |

## Overview & Current Events

American States Water is a utility company with two business units: Utilities (primarily water, some electricity) and Services (wastewater services on several US military bases). American States Water is based in California, where it operates its utilities business. The company's services unit spans several US states. American States Water is a Dividend King, which means it has 50+ years of rising dividends. The company has a small market capitalization of \$3.4 billion. American States Water reported its second quarter earnings results on August 2<sup>nd</sup>, 2021. Fully diluted earnings-per-share increased from \$0.69 in Q2 2020 to \$0.72 in Q2 2021, while revenue for the second quarter grew by 5.9% to \$128.41 million year-over-year. That said, consolidated adjusted diluted earnings per share increased by 7.8% per share, compared to last year's same period. The company also announced a 9% increase in quarterly dividend for September 1 dividend payment.

## Growth on a Per-Share Basis

| Year                      | 2011   | 2012   | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   | 2020   | 2021          | 2026          |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| <b>EPS</b>                | \$1.12 | \$1.41 | \$1.61 | \$1.57 | \$1.60 | \$1.62 | \$1.67 | \$1.72 | \$2.24 | \$2.33 | <b>\$2.45</b> | <b>\$2.62</b> |
| <b>DPS</b>                | \$0.55 | \$0.64 | \$0.76 | \$0.83 | \$0.87 | \$0.91 | \$0.99 | \$1.06 | \$1.22 | \$1.34 | <b>\$1.46</b> | <b>\$1.60</b> |
| <b>Shares<sup>1</sup></b> | 38     | 39     | 39     | 38     | 37     | 37     | 37     | 37     | 37     | 37     | <b>37</b>     | <b>36</b>     |

Between 2011 and 2020 American States Water was able to grow its earnings-per-share at a rate of 7.6% annually but moving forward we expect its growth rate to slow down considerably. On the other hand, the company managed to increase its profitability even during the last financial crisis, which shows that American States Water's profitability is not cyclical. We do not expect it to suffer from the current coronavirus outbreak or any related economic fallout as it provides essential services to consumers regardless of the state of the economy.

American States Water's utility business will most likely continue to grow at a slow pace, as regulators will allow the company to increase its rates over time in order to encourage spending on growth and maintenance projects. The company is building out its services business by getting contracts for wastewater services on additional US military bases. The contracts for wastewater services on US military bases span a 50-year period each, so getting one such contract provides for a decades-long and very safe revenue stream. Receiving one new contract every couple of years provides for solid revenue growth potential. On a quarterly basis, revenues can still see ups and downs depending on the amount of construction activity on military bases. American States Water should be able to increase its profits going forward. A low-single-digits earnings-per-share growth rate seems achievable, based on the further expansion of American States Water's services business and some profit increases for the utilities business.

American States Water has increased its dividend every year for 66 years in a row, which can only be described as a very long and successful dividend growth track record.

<sup>1</sup> In millions

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## Valuation Analysis

| Year      | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Now         | 2026        |
|-----------|------|------|------|------|------|------|------|------|------|------|-------------|-------------|
| Avg. P/E  | 15.4 | 14.3 | 17.2 | 20.1 | 24.6 | 25.6 | 27.5 | 38.2 | 42.0 | 34.9 | <b>37.0</b> | <b>25.0</b> |
| Avg. Yld. | 3.2% | 3.2% | 2.7% | 2.6% | 2.2% | 2.2% | 2.2% | 1.6% | 1.3% | 1.6% | <b>1.6%</b> | <b>2.4%</b> |

American States Water performed relatively well during the last financial crisis, which explains why the company's stock continued to trade at a valuation that is elevated. Its valuation has expanded further since the stock's recent run-up has led to a very high price to earnings multiple. We believe that the current valuation is unjustifiable, and we forecast meaningful headwinds to the stock's total returns from multiple compression, though low interest rates have prompted us to increase the fair value estimate to 25 times earnings.

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

| Year   | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  | 2021         | 2026         |
|--------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------------|--------------|
| Payout | 49.1% | 45.4% | 47.2% | 52.9% | 54.4% | 56.2% | 59.3% | 61.6% | 54.5% | 57.5% | <b>59.6%</b> | <b>61.1%</b> |

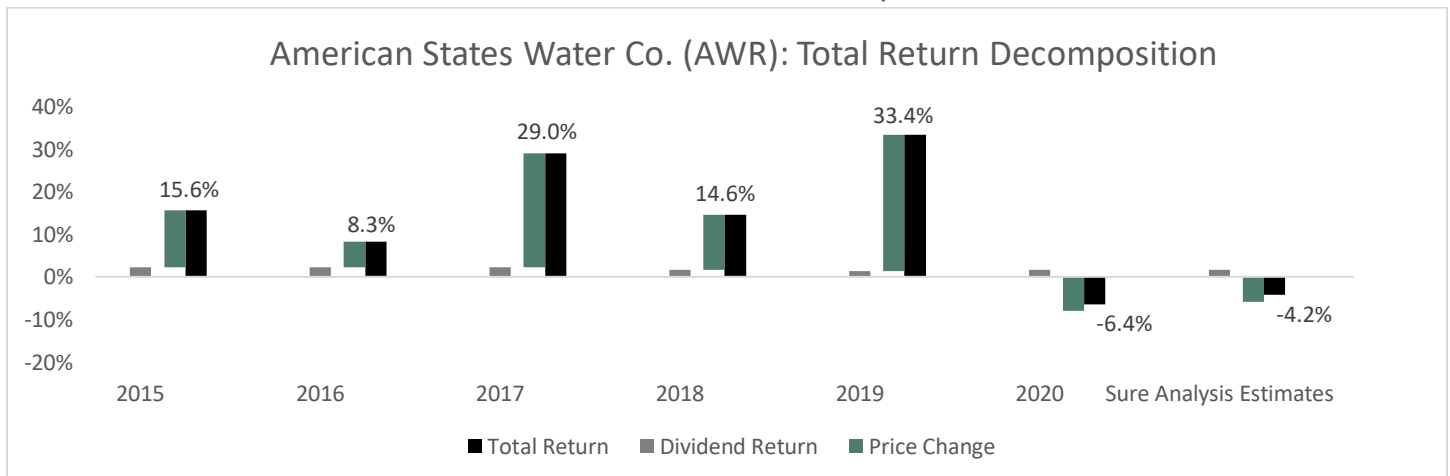
American States Water paid out roughly half of its net profits a year during the last decade. This is not a high payout ratio, especially for a stable company such as American States Water that generated strong earnings during the last financial crisis. We believe that the recession resilience, the moderate payout ratio, and the strong dividend growth track record mean that American States Water's dividend is very safe.

Utilities are not cyclical, and due to the decades-long contract durations with the US military, the services business is not cyclical either. American States Water is therefore quite recession-proof. There is a low risk of an earnings decline, shown by the fact that even during the last financial crisis, profits kept increasing. Competition is not a major issue for American States Water's business, as the company operates with very long-term contracts.

## Final Thoughts & Recommendation

American States Water was a stable performer during the last financial crisis, and the company's dividend looks very safe for the foreseeable future. The company should be able to grow its profits during the coming years as well. American States Water nevertheless does not look like an attractive investment today, though, as its valuation is very high, which will pressure total returns significantly, and the meager dividend yield and low-single-digits growth rate will be offset by significant valuation compression, leading to expected annualized total returns of -4.2% over the next half decade. As a result, we rate the stock a sell.

## Total Return Breakdown by Year



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## Income Statement Metrics

| Year                    | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>Revenue</b>          | 420   | 467   | 472   | 466   | 459   | 436   | 441   | 437   | 474   | 488   |
| <b>Gross Profit</b>     | 301   | 350   | 357   | 349   | 338   | 333   | 337   | 328   | 354   | 369   |
| <b>Gross Margin</b>     | 71.6% | 75.0% | 75.6% | 74.9% | 73.7% | 76.4% | 76.5% | 75.1% | 74.6% | 75.5% |
| <b>SG&amp;A Exp.</b>    | 74    | 71    | 77    | 78    | 80    | 82    | 82    | 83    | 83    | 84    |
| <b>D&amp;A Exp.</b>     | 41    | 43    | 41    | 42    | 43    | 39    | 39    | 41    | 36    | 37    |
| <b>Operating Profit</b> | 95    | 111   | 119   | 119   | 118   | 114   | 119   | 101   | 127   | 131   |
| <b>Operating Margin</b> | 22.6% | 23.8% | 25.2% | 25.6% | 25.8% | 26.2% | 27.0% | 23.1% | 26.8% | 26.7% |
| <b>Net Profit</b>       | 46    | 54    | 63    | 61    | 60    | 60    | 69    | 64    | 84    | 86    |
| <b>Net Margin</b>       | 10.9% | 11.6% | 13.3% | 13.1% | 13.2% | 13.7% | 15.7% | 14.6% | 17.8% | 17.7% |
| <b>Free Cash Flow</b>   | (0)   | 33    | 38    | 91    | 8     | (33)  | 31    | 10    | (35)  | (8)   |
| <b>Income Tax</b>       | 30    | 36    | 36    | 38    | 38    | 35    | 39    | 18    | 25    | 28    |

## Balance Sheet Metrics

| Year                            | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  |
|---------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>Total Assets</b>             | 1,238 | 1,281 | 1,310 | 1,378 | 1,344 | 1,470 | 1,417 | 1,501 | 1,641 | 1,792 |
| <b>Cash &amp; Equivalents</b>   | 1     | 23    | 38    | 76    | 4     | 0     | 0     | 7     | 1     | 37    |
| <b>Accounts Receivable</b>      | 19    | 19    | 24    | 19    | 19    | 20    | 26    | 23    | 21    | 29    |
| <b>Inventories</b>              | 3     | 5     | 5     | 4     | 5     | 4     | 5     | 6     | 6     | 9     |
| <b>Goodwill &amp; Int. Ass.</b> | 1     | 1     | 1     | 1     | 1     | 1     | 1     | 1     | 1     | 1     |
| <b>Total Liabilities</b>        | 830   | 826   | 818   | 871   | 878   | 976   | 887   | 943   | 1,040 | 1,150 |
| <b>Accounts Payable</b>         | 38    | 41    | 50    | 42    | 51    | 44    | 51    | 60    | 56    | 64    |
| <b>Long-Term Debt</b>           | 343   | 336   | 332   | 326   | 349   | 411   | 380   | 417   | 486   | 575   |
| <b>Shareholder's Equity</b>     | 409   | 455   | 492   | 507   | 466   | 494   | 530   | 558   | 602   | 642   |
| <b>D/E Ratio</b>                | 0.84  | 0.74  | 0.68  | 0.64  | 0.75  | 0.83  | 0.72  | 0.75  | 0.81  | 0.90  |

## Profitability & Per Share Metrics

| Year                    | 2011  | 2012  | 2013  | 2014  | 2015  | 2016   | 2017  | 2018  | 2019   | 2020   |
|-------------------------|-------|-------|-------|-------|-------|--------|-------|-------|--------|--------|
| <b>Return on Assets</b> | 3.8%  | 4.3%  | 4.8%  | 4.5%  | 4.4%  | 4.2%   | 4.8%  | 4.4%  | 5.4%   | 5.0%   |
| <b>Return on Equity</b> | 11.7% | 12.5% | 13.2% | 12.2% | 12.4% | 12.4%  | 13.5% | 11.7% | 14.5%  | 13.9%  |
| <b>ROIC</b>             | 6.2%  | 7.0%  | 7.8%  | 7.4%  | 7.3%  | 6.9%   | 7.6%  | 6.8%  | 8.2%   | 7.5%   |
| <b>Shares Out.</b>      | 38    | 39    | 39    | 38    | 37    | 37     | 37    | 37    | 37     | 37     |
| <b>Revenue/Share</b>    | 11.15 | 12.20 | 12.15 | 11.98 | 12.19 | 11.87  | 11.96 | 11.83 | 12.82  | 13.20  |
| <b>FCF/Share</b>        | 0.00  | 0.87  | 0.99  | 2.33  | 0.21  | (0.90) | 0.85  | 0.28  | (0.95) | (0.22) |

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

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