



Middlesex Water (MSEX)

Updated March 10th, 2022 by Samuel Smith

Key Metrics

Current Price:	\$100	5 Year CAGR Estimate:	-0.2%	Market Cap:	\$1.8 B
Fair Value Price:	\$85	5 Year Growth Estimate:	2.1%	Ex-Dividend Date:	05/11/22 ¹
% Fair Value:	120%	5 Year Valuation Multiple Estimate:	-3.3%	Dividend Payment Date:	06/1/22 ²
Dividend Yield:	1.1%	5 Year Price Target	\$94	Years Of Dividend Growth:	47
Dividend Risk Score:	A	Retirement Suitability Score:	C	Last Dividend Increase:	6.4%

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 \$1.8 billion and it produces about \$160 million in revenue annually. Middlesex has paid consecutive dividends since 1912 and has reached its 47th consecutive year of dividend increases.

Middlesex reported fourth-quarter and full-year 2021 results on 02/25/22. Operating revenue in Q4 stood at \$34.0 million, down from \$34.6 year-over-year. Q4 operations and maintenance expenses increased to \$18.4 million from \$18.0 million in the year-ago period. Net income stood at \$7.2 million, down from \$8.3 million in the year-ago period.

Meanwhile, for the full year 2021, consolidated operating revenue increased 1.1% to \$143.1 million year-over-year primarily driven by customer growth and increased water consumption in Delaware water systems, and a full year revenue from their contract to operate and maintain the Highland Park, New Jersey water and wastewater systems. GAAP earnings per share for the year ended December 31, 2021, decreased to \$2.07 from \$2.18 per share in the year-ago period. Finally, depreciation expense for FY 2021 increased by \$2.6 million to \$21.1 million.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$0.90	\$1.03	\$1.13	\$1.22	\$1.38	\$1.38	\$1.96	\$2.02	\$2.18	\$2.07	\$2.70	\$3.00
DPS	\$0.74	\$0.75	\$0.76	\$0.78	\$0.81	\$0.86	\$0.96	\$0.98	\$1.05	\$1.11	\$1.16	\$1.24
Shares³	15.8	16.0	16.1	16.2	16.3	16.4	16.4	17.4	17.5	17.5	17.5	21.5

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 meaningful sources of growth will be the rate increase in New Jersey and inflationary pressures. 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 \$1.16 to \$1.24 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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	20.8	19.7	18.5	19.1	25.6	28.4	26.9	30.5	34.2	56.4	37.0	31.3
Avg. Yld.	4.0%	3.7%	3.6%	3.3%	2.3%	2.2%	1.8%	1.6%	1.4%	1.0%	1.2%	1.3%

¹ Estimate

² Estimate

³ In millions

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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 multiple is 37x. We are forecasting a decline back towards 31.3x in five years, indicating a headwind to total returns. Given the stock's growth profile, it simply cannot sustain a price-to-earnings multiple near its current level, especially with inflation on the rise and rising interest rates expected to follow.

As a result of the expected multiple contraction and weak dividend growth, we are forecasting the yield to increase to 1.3% from the current 1.2%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	82%	73%	67%	64%	59%	62%	49%	49%	48%	54%	43%	41%

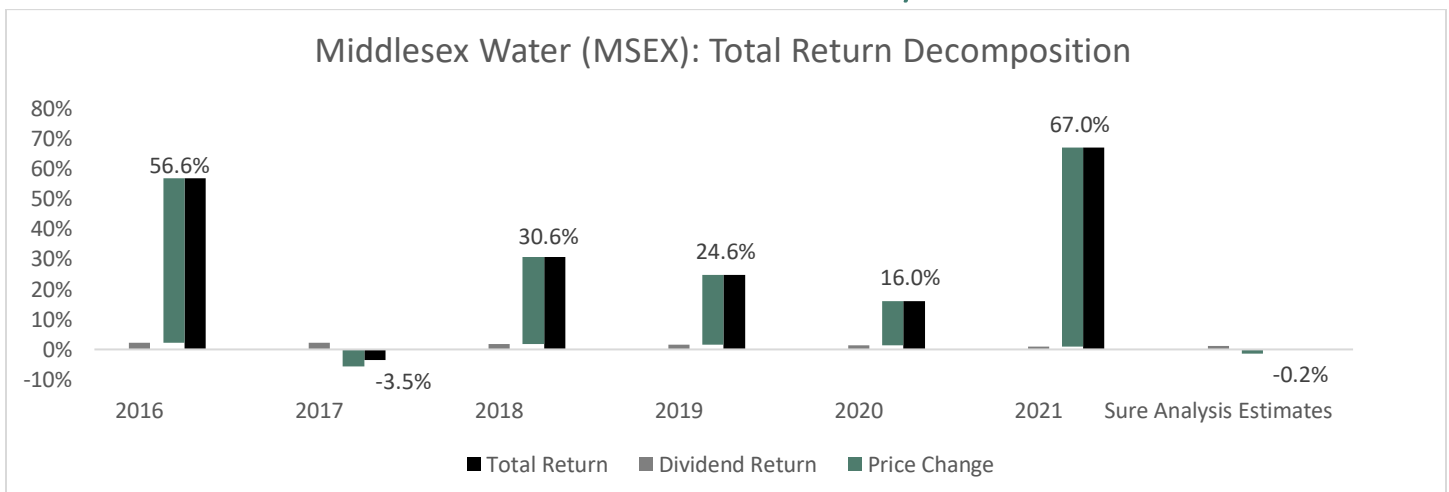
Like many other regulated utilities, Middlesex' quality metrics have remained steady in the past decade thanks to the monopoly-like nature of its assets. However, since pricing is regulated, they cannot drive excessive profitability, thereby explaining the resistance to significant margin expansion. 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 43% today, making the dividend 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 looks to be very overvalued here. We see annualized total returns of -0.2% going forward as the current yield and low single digit expected annual earnings-per-share growth will be more than offset by multiple contraction. The company's impressive dividend growth 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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	110	115	117	126	133	131	138	135	142	143
D&A Exp.	11	12	12	13	14	15	16	17	21	27
Operating Profit	28	31	34	36	40	38	37	36	37	33
Operating Margin	25.0%	27.0%	29.4%	28.4%	30.3%	28.9%	26.9%	26.4%	26.4%	23.2%
Net Profit	14	17	18	20	23	23	32	34	38	37
Net Margin	13.0%	14.5%	15.7%	15.9%	17.1%	17.4%	23.5%	25.2%	27.1%	25.5%
Free Cash Flow	8	14	10	25	(0)	(7)	(26)	(53)	(52)	(46)
Income Tax	7	9	10	11	12	11	1	(3)	(4)	(5)

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	562	530	576	581	620	661	768	910	976	1,020
Cash & Equivalents	3	5	3	3	4	5	4	2	4	4
Accounts Receivable	12	12	10	10	10	11	12	12	15	15
Inventories	1	2	2	3	4	4	5	5	5	5
Total Liabilities	377	339	376	372	399	430	517	584	628	650
Accounts Payable	4	6	6	7	12	14	19	23	30	21
Long-Term Debt	171	164	161	142	153	174	209	258	282	326
Shareholder's Equity	182	189	197	207	218	229	249	324	346	368
LTD/E Ratio	0.92	0.85	0.81	0.68	0.69	0.75	0.83	0.79	0.81	0.88

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	2.6%	3.0%	3.3%	3.5%	3.8%	3.6%	4.5%	4.0%	4.1%	3.7%
Return on Equity	8.0%	9.0%	9.6%	9.9%	10.7%	10.2%	13.6%	11.8%	11.5%	10.2%
ROIC	4.1%	4.7%	5.2%	5.6%	6.3%	5.9%	7.5%	6.5%	6.3%	5.5%
Shares Out.	15.8	16.0	16.1	16.2	16.3	16.4	16.4	17.4	17.5	17.5
Revenue/Share	6.90	7.13	7.22	7.72	8.09	7.93	8.35	8.00	8.06	8.13
FCF/Share	0.50	0.85	0.61	1.56	(0.02)	(0.45)	(1.59)	(3.15)	(2.97)	(2.63)

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

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