



Middlesex Water (MSEX)

Updated November 17th, 2022 by Samuel Smith

Key Metrics

Current Price:	\$88.8	5 Year CAGR Estimate:	-0.1%	Market Cap:	\$1.5 B
Fair Value Price:	\$76.1	5 Year Growth Estimate:	1.4%	Ex-Dividend Date:	11/15/22
% Fair Value:	117%	5 Year Valuation Multiple Estimate:	-3.1%	Dividend Payment Date:	12/01/22
Dividend Yield:	1.4%	5 Year Price Target	\$82	Years Of Dividend Growth:	50
Dividend Risk Score:	A	Retirement Suitability Score:	C	Rating:	Sell

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 \$1.5 billion and it produces about \$143 million in revenue annually. Middlesex has paid consecutive dividends since 1912 and has reached its 50th consecutive year of dividend increases.

On October 28, 2022. Middlesex reported third quarter diluted earnings per share of \$0.80, as compared to \$0.65 per share for the same period in 2021. Net income increased \$2.8 million to \$14.3 million.

Consolidated operating revenues for the three months ended September 30, 2022 increased \$7.9 million to \$47.7 million compared to the same period in 2021. The increase in revenues were primarily due to a \$7.6 million increase in the Middlesex System in New Jersey due to the New Jersey Board of Public Utilities (“NJBPU”) approved January 1, 2022 base rate increase and higher weather-driven customer demand, and a \$0.6 million increase related to customer growth in our Delaware systems and higher weather-driven demand, partially offset by a 6% rate reduction effective September 1, 2022.

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	\$2.43	\$2.61
DPS	\$0.74	\$0.75	\$0.76	\$0.78	\$0.81	\$0.86	\$0.96	\$0.98	\$1.05	\$1.11	\$1.25	\$1.40
Shares¹	15.8	16.0	16.1	16.2	16.3	16.4	16.4	17.4	17.5	17.5	17.6	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 to \$1.40 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	36.5	31.3
Avg. Yld.	4.0%	3.7%	3.6%	3.3%	2.3%	2.2%	1.8%	1.6%	1.4%	1.0%	1.4%	1.7%

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 20s, the current multiple is 36.5.

¹ In millions

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We are forecasting a decline back towards 31.3 in five years, indicating a headwind to total returns. Given the stock's growth profile, especially with inflation and interest rates on the rise, we believe upside in the multiple from here will be challenging.

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%	51%	54%

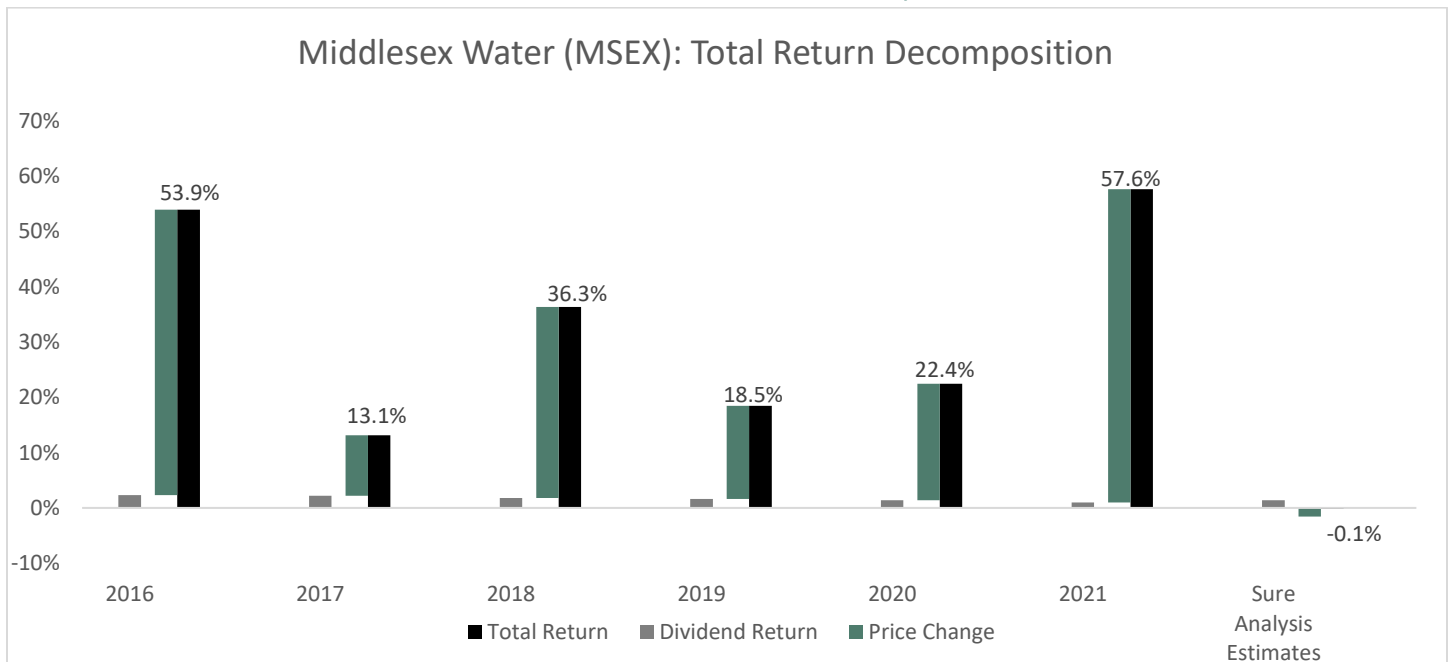
Like many other regulated utilities, Middlesex' quality metrics have remained steady in the past decade thanks to the monopoly-like nature of its assets. However, since pricing is regulated, they cannot drive excessive profitability, thereby explaining the resistance to significant margin expansion. 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 46% 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 overvalued here. We see annualized total returns of -0.1% 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 weak 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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