



Essential Utilities (WTRG)

Updated November 9th, 2022 by Aristofanis Papadatos

Key Metrics

Current Price:	\$44	5 Year CAGR Estimate:	4.3%	Market Cap:	\$11.7 B
Fair Value Price:	\$32	5 Year Growth Estimate:	8.0%	Ex-Dividend Date:	11/9/2022
% Fair Value:	137%	5 Year Valuation Multiple Estimate:	-6.0%	Dividend Payment Date:	12/1/2022
Dividend Yield:	2.6%	5 Year Price Target	\$47	Years Of Dividend Growth:	31
Dividend Risk Score:	B	Retirement Suitability Score:	C	Rating:	Hold

Overview & Current Events

Aqua America changed its name to Essential Utilities and its ticker from WTR to WTRG on February 3rd, 2020 in order to reflect its acquisition of Peoples, a natural gas distribution company. Essential Utilities is the second largest publicly traded water utility in the U.S., serving approximately 5.5 million customers across ten states. The \$11.7 billion company has raised its dividend for 31 consecutive years, which qualifies it to be a member of the Dividend Champions, and has paid a quarterly dividend for 77 consecutive years.

In early November, Essential Utilities reported (11/7/22) financial results for the third quarter of fiscal 2022. Its revenue grew 20% over last year's quarter, mostly thanks to rate hikes, surcharges and higher volumes in the regulated water business. Earnings-per-share grew 37%, from \$0.19 to \$0.26, exceeding the analysts' estimates by \$0.04.

Essential Utilities reiterated its positive guidance for 2022. It expects record earnings-per-share of \$1.75-\$1.80 thanks to 6%-7% rate base growth and 2%-3% total customer growth. Moreover, management expects 5%-7% average annual earnings-per-share growth until 2024. The company is essentially immune to a potential recession and high inflation. It also raised its dividend by 7% in the third quarter and thus extended its dividend growth streak to 31 consecutive years.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$0.87	\$1.16	\$1.20	\$1.14	\$1.32	\$1.35	\$1.41	\$1.47	\$1.58	\$1.67	\$1.79	\$2.63
DPS	\$0.54	\$0.58	\$0.63	\$0.69	\$0.74	\$0.79	\$0.85	\$0.91	\$0.97	\$1.04	\$1.15	\$1.54
Shares¹	175.4	177.9	178.6	176.5	177.4	177.7	178.4	232.6	254.8	262.2	263.0	300.0

Essential Utilities has compounded its earnings-per-share at a rate of 7.5% per year over the last decade. It grew its customer base 2% last year organically and via acquisitions and has repeatedly confirmed its guidance for 2%-3% annual customer growth. Even better, we note that the company has many acquisitions in its pipeline, which can add up to \$500 million in annual revenue in the next few years. As this amount is 25% of current annual revenue, we expect the company to grow its bottom line at an approximate 8% average annual rate for the next five years.

The historical growth strategy of Essential Utilities has been to acquire smaller water utility businesses and integrate them into its vast operations. It has implemented nearly 200 acquisitions and growth ventures in the last ten years. The takeover of Peoples was a major acquisition, given that the \$4.3 billion value of the deal was 37% of the market cap of Essential Utilities at the time of the transaction. The new company has ample room for future growth via infrastructure investment.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	21.9	21.2	20.8	23.5	23.9	24.7	25.0	27.6	28.0	28.3	24.6	18.0
Avg. Yld.	2.8%	2.4%	2.5%	2.6%	2.3%	2.4%	2.4%	2.2%	2.2%	2.2%	2.6%	3.3%

¹ In millions.

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While we are usually hesitant to publish estimates that deviate significantly from historical base rates, we believe that the 10-year average price-to-earnings ratio of 24.5 of Essential Utilities is significantly higher than its fair valuation level. Instead, we believe that a fair P/E ratio for a stock like Essential Utilities is around 18. The stock is currently trading at a P/E ratio of 24.6, which is much higher than our fair estimate. If Essential Utilities reaches a P/E ratio of 18 over the next five years, it will incur a -6.0% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

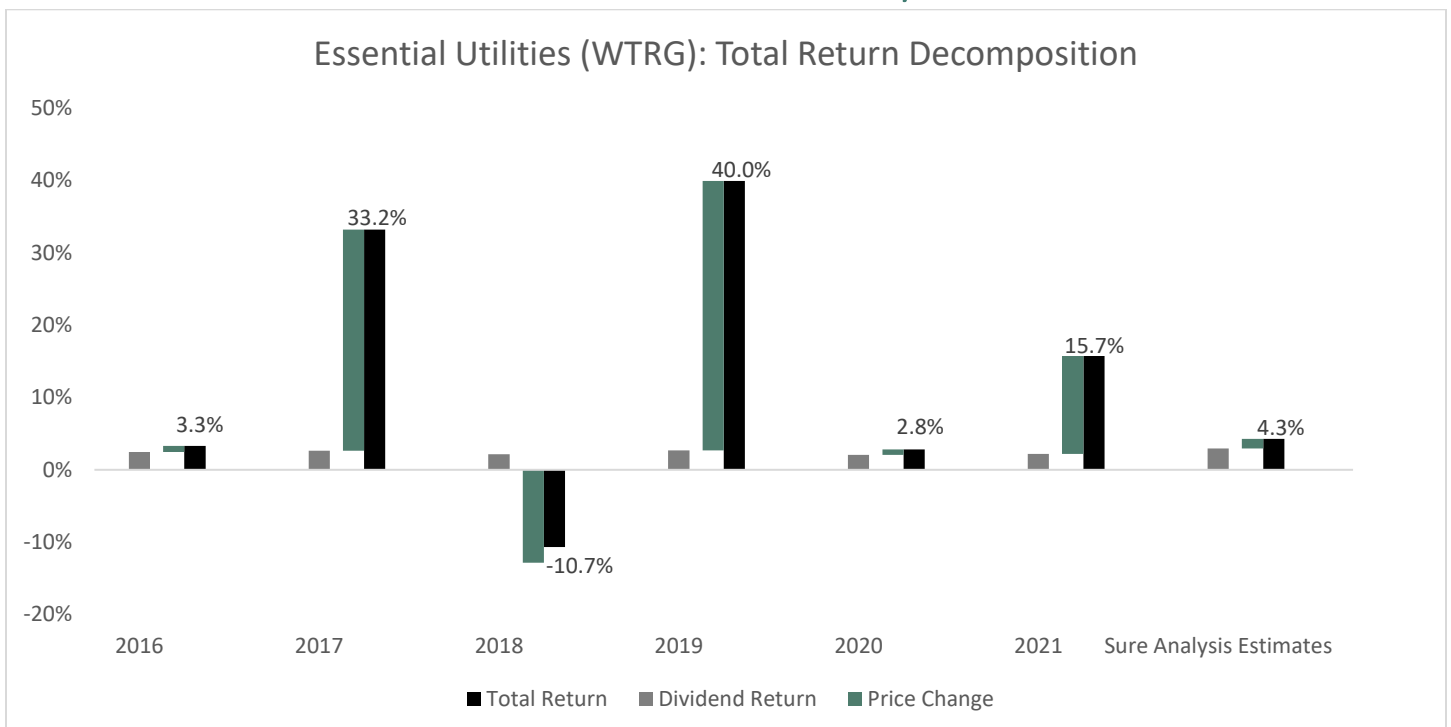
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	62.1%	50.0%	52.5%	60.5%	56.1%	58.5%	60.3%	61.9%	61.4%	62.3%	64.2%	58.5%

The competitive advantage of Essential Utilities comes from its entrenched position in a highly capital-intensive and regulated industry. The company has invested billions of dollars into its network of infrastructure assets and its fee hikes must be approved by regulatory authorities. For competitors, these barriers are highly discouraging, which limits competition and leads us to believe that the company will remain highly profitable for decades to come. The company's interest coverage has been quite stable, typically ranging between 3 and 4. Thanks to the reliable cash flows that result from the regulated nature of their business, utilities can safely operate with a lower interest coverage ratio than their peers in other sectors.

Final Thoughts & Recommendation

The presence of Essential Utilities in the water utility industry gives it a higher level of stability than almost any other company in our investment universe. This advantage is of paramount importance. With that said, in our view the stock has remained overvalued in recent years. We expect the stock to offer a 4.3% average annual return over the next five years, as its 8.0% earnings growth and its 2.6% dividend may be partly offset by a -6.0% valuation headwind. The stock receives a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	751	762	780	814	820	810	838	890	1463	1,878
Gross Profit	481	478	491	505	523	527	530	557	768	987
Gross Margin	64.0%	62.8%	63.0%	62.0%	63.8%	65.1%	63.2%	62.6%	52.5%	52.6%
D&A Exp.	116	124	127	129	133	137	147	156	257	298
Operating Profit	318	302	314	321	333	334	323	340	435	603
Operating Margin	42.3%	39.6%	40.3%	39.4%	40.7%	41.2%	38.6%	38.2%	29.7%	32.1%
Net Profit	197	221	233	202	234	240	192	225	285	432
Net Margin	26.2%	29.0%	29.9%	24.8%	28.6%	29.6%	22.9%	25.2%	19.5%	23.0%
Free Cash Flow	21	60	35	6	13	(97)	(127)	(212)	(328)	(376)
Income Tax	65	21	25	15	21	17	(14)	(13)	(20)	(10)

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	4,859	5,052	5,407	5,718	6,159	6,332	6,964	9,362	13,705	14,658
Cash & Equivalents	6	5	4	3	4	4	4	1,869	5	11
Accounts Receivable	53	56	56	57	64	66	68	69	189	198
Inventories	12	11	13	12	13	14	16	18	58	110
Goodwill & Int. Ass.	28	28	31	34	42	42	53	64	2,332	2,347
Total Liabilities	3,473	3,517	3,751	3,992	4,309	4,375	4,955	5,481	9,021	9,474
Accounts Payable	56	66	63	56	47	59	77	75	177	193
Long-Term Debt	1,669	1,592	1,638	1,773	1,895	2,125	2,558	3,074	5,670	5,977
Shareholder's Equity	1,386	1,535	1,655	1,726	1,850	1,958	2,009	3,881	4,684	5,184
LTD/E Ratio	1.20	1.04	0.99	1.03	1.02	1.09	1.27	0.79	1.21	1.15

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	4.3%	4.5%	4.5%	3.6%	3.9%	3.8%	2.9%	2.8%	2.5%	3.0%
Return on Equity	14.9%	15.2%	14.6%	11.9%	13.1%	12.6%	9.7%	7.6%	6.7%	8.7%
ROIC	6.7%	7.2%	7.3%	5.9%	6.5%	6.1%	4.4%	3.9%	3.3%	4.0%
Shares Out.	175.4	177.9	178.6	176.5	177.4	177.7	178.4	232.6	254.8	262.2
Revenue/Share	4.29	4.31	4.39	4.59	4.61	4.54	4.70	4.12	5.74	7.27
FCF/Share	0.12	0.34	0.20	0.03	0.07	(0.54)	(0.71)	(0.98)	(1.29)	(1.46)

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

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