



# American States Water Co. (AWR)

Updated March 10<sup>th</sup>, 2023 by Samuel Smith

## Key Metrics

<b>Current Price:</b>	\$84.7	<b>5 Year CAGR Estimate:</b>	5.1%	<b>Market Cap:</b>	\$3.2B
<b>Fair Value Price:</b>	\$69.3	<b>5 Year Growth Estimate:</b>	7.4%	<b>Ex-Dividend Date:</b>	5/17/23 <sup>1</sup>
<b>% Fair Value:</b>	122%	<b>5 Year Valuation Multiple Estimate:</b>	-3.9%	<b>Dividend Payment Date:</b>	6/01/23 <sup>2</sup>
<b>Dividend Yield:</b>	1.9%	<b>5 Year Price Target</b>	\$99	<b>Years Of Dividend Growth:</b>	68
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Rating:</b>	Hold

## 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 \$3.2 billion.

American States Water reported its fourth quarter and FY 2022 earnings results on March 1<sup>st</sup>. Compared to the fourth quarter of 2021, consolidated diluted EPS for the recorded fourth quarter decreased by \$0.05 per share. However, when adjusted, the EPS increased by \$0.05 per share. The recorded results for the fourth quarter reflect 2021 water rates, while the proposed 2022 water rates, if approved, would be retroactive to January 1, 2022 and would add \$0.09 per share to the quarter. Additionally, there was an unfavorable variance of \$0.01 per share due to lower gains on investments held to fund a retirement plan.

For the full year 2022, there was a recorded decrease of \$0.44 per share in consolidated diluted EPS compared to 2021. However, when adjusted, there was an increase of \$0.12 per share. The recorded results for 2022 also reflect 2021 water rates. If approved, the proposed 2022 water rates would have added \$0.38 per share to 2022 results. Additionally, there was an unfavorable variance of \$0.18 per share due to losses on investments held to fund a retirement plan, compared to gains in 2021.

## Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
<b>EPS</b>	\$1.61	\$1.57	\$1.60	\$1.62	\$1.74	\$1.72	\$2.24	\$2.33	\$2.47	\$2.59	<b>\$2.77</b>	<b>\$3.95</b>
<b>DPS</b>	\$0.76	\$0.83	\$0.87	\$0.91	\$0.99	\$1.06	\$1.22	\$1.34	\$1.40	\$1.53	<b>\$1.59</b>	<b>\$2.25</b>
<b>Shares<sup>3</sup></b>	38.7	38.2	36.5	36.6	36.7	36.8	36.9	36.9	36.9	37.0	<b>37.0</b>	<b>36.9</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 slightly to 7.1% per year. 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.

American States Water's utility business will most likely continue to grow at a decent 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

<sup>1</sup> Estimate

<sup>2</sup> Estimate

<sup>3</sup> In millions

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forward. A mid to high-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 68 years in a row, which can only be described as a very long and successful dividend growth track record.

## Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
<b>Avg. P/E</b>	17.2	20.1	24.6	25.6	27.5	38.2	42.0	34.9	37.2	40.4	<b>30.6</b>	<b>25.0</b>
<b>Avg. Yld.</b>	2.7%	2.6%	2.2%	2.2%	2.1%	1.6%	1.3%	1.6%	1.5%	1.5%	<b>1.9%</b>	<b>2.3%</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, leading to a very high price to earnings multiple. We believe that the current valuation is unjustifiably high, and we forecast meaningful headwinds to the stock's total returns from multiple compression, though the strong track record, low risk profile, and solid growth outlook have prompted us to keep the fair value estimate at 25 times earnings.

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

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
<b>Payout</b>	47%	53%	54%	56%	57%	62%	54%	58%	57%	59%	<b>57%</b>	<b>57%</b>

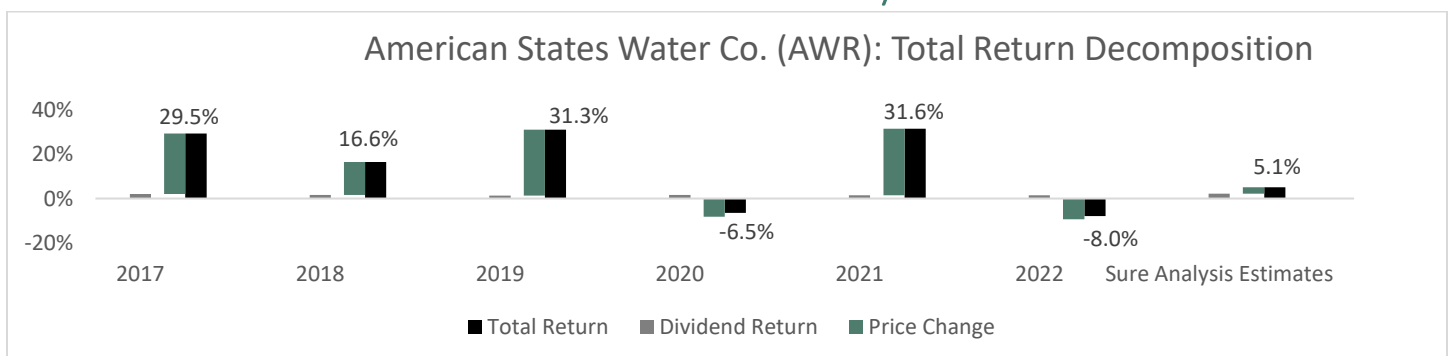
American States Water paid out roughly half of its net profits a year during the last decade. This is not a high payout ratio, especially for a stable company such as American States Water that generated strong earnings during the last financial crisis. We believe that the recession resilience, the moderate 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. 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 attractive growth rate will be somewhat offset by significant valuation compression, leading to expected annualized total returns of 5.1% over the next half decade. As a result, we rate the stock a Hold.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Revenue</b>	472	466	459	436	441	437	474	488	499	492
<b>Gross Profit</b>	357	349	338	333	337	328	354	369	378	368
<b>Gross Margin</b>	75.6%	74.9%	73.7%	76.4%	76.5%	75.1%	74.6%	75.5%	75.7%	74.9%
<b>SG&amp;A Exp.</b>	77	78	80	82	82	83	83	84	84	86
<b>D&amp;A Exp.</b>	41	42	43	39	39	41	36	37	40	42
<b>Operating Profit</b>	119	119	118	114	119	101	127	131	141	127
<b>Operating Margin</b>	25.2%	25.6%	25.8%	26.2%	27.0%	23.1%	26.8%	26.7%	28.2%	25.7%
<b>Net Profit</b>	63	61	60	60	69	64	84	86	94	78
<b>Net Margin</b>	13.3%	13.1%	13.2%	13.7%	15.7%	14.6%	17.8%	17.7%	18.9%	15.9%
<b>Free Cash Flow</b>	38	91	8	(33)	31	10	(35)	(8)	(29)	(48)
<b>Income Tax</b>	36	38	38	35	39	18	25	28	30	24

## Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Total Assets</b>	1,310	1,378	1,344	1,470	1,417	1,501	1,641	1,792	1,901	2,034
<b>Cash &amp; Equivalents</b>	38	76	4	0	0	7	1	37	5	6
<b>Accounts Receivable</b>	24	19	19	20	26	23	21	29	34	26
<b>Inventories</b>	5	4	5	4	5	6	6	9	12	15
<b>Goodwill &amp; Int. Ass.</b>	1	1	1	1	1	1	1	1	1	1
<b>Total Liabilities</b>	818	871	878	976	887	943	1,040	1,150	1,215	1,325
<b>Accounts Payable</b>	50	42	51	44	51	60	56	64	66	85
<b>Long-Term Debt</b>	332	326	349	411	380	417	486	575	618	724
<b>Shareholder's Equity</b>	492	507	466	494	530	558	602	642	686	710
<b>LTD/E Ratio</b>	0.68	0.64	0.75	0.83	0.72	0.75	0.81	0.90	0.90	1.02

## Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Return on Assets</b>	4.8%	4.5%	4.4%	4.2%	4.8%	4.4%	5.4%	5.0%	5.1%	4.0%
<b>Return on Equity</b>	13.2%	12.2%	12.4%	12.4%	13.5%	11.7%	14.5%	13.9%	14.2%	11.2%
<b>ROIC</b>	7.8%	7.4%	7.3%	6.9%	7.6%	6.8%	8.2%	7.5%	7.5%	5.7%
<b>Shares Out.</b>	38.7	38.2	36.5	36.6	36.7	36.8	36.9	36.9	36.9	37.0
<b>Revenue/Share</b>	12.15	11.98	12.19	11.87	11.96	11.83	12.82	13.20	13.48	13.27
<b>FCF/Share</b>	0.99	2.33	0.21	(0.90)	0.85	0.28	(0.95)	(0.22)	(0.78)	(1.31)

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

### Disclaimer

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