MGE Energy (MGEE)

Updated March 22nd, 2023 by Samuel Smith

Key Metrics

Current Price:	$73.5	**5 Year CAGR Estimate:**	1.8%	**Market Cap:**	$2.7B
Fair Value Price:	$60.5	**5 Year Growth Estimate:**	3.5%	**Ex-Dividend Date:**	5/29/23[1]
Fair Value:	122%	**5 Year Valuation Multiple Estimate:**	-3.8%	**Dividend Payment Date:**	6/15/23[2]
Dividend Yield:	2.2%	**5 Year Price Target**	$72	**Years of Dividend Growth:**	45
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Rating:**	Sell

Overview & Current Events

MGE Energy has grown from a small power station in Wisconsin built in 1902 to a $2.7 billion market capitalization integrated energy company. The company has paid consecutive dividends for more than 100 years and has raised its payout for the past 45 years. MGE principally operates gas and electric utilities, in addition to transmission and construction businesses.

MGE Energy reported Q4 results on 2/22/23. MGE Energy's earnings for 2022 were $111 million, compared to $105.8 million in 2021, due to investments in renewable energy and a new customer information system. The company is working towards an 80% carbon reduction by 2030 and net-zero carbon electricity by 2050. Gas retail deliveries increased by 15% due to colder weather, and gas use by commercial and industrial customers was up 16%, while residential consumption increased by 14%. Fourth-quarter earnings were $21.1 million in 2022, compared to $13.1 million in 2021, due to increased earnings from electric and gas asset growth and the timing of costs.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$2.16	$2.32	$2.06	$2.18	$2.20	$2.43	$2.50	$2.60	$2.92	$3.07	***$3.36***	***$4.00***
DPS	$1.07	$1.11	$1.16	$1.21	$1.26	$1.35	$1.39	$1.44	$1.52	$1.63	***$1.63***	***$1.75***
Shares[3]	34.7	34.7	34.7	34.7	34.7	34.7	34.7	36.2	36.2	36.2	***36.2***	***37***

Earnings-per-share have grown consistently over the past decade, though they did encounter a brief bump in the road in 2015. Recent results have been strong, and we believe that between its two sustainable growth catalysts of customer acquisition and renewable asset growth, the company should be able to achieve low-to-mid-single-digit earnings-per-share growth going forward. Investors would do well to consider that weather can contribute positively but can easily swing results in the other direction.

We see continued low-to-mid-single-digit growth for the dividend as well as MGE is comfortable with where the payout ratio is today. MGE is on par with other utilities in terms of dividend growth in the low-single-digits.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	17	17.2	20.3	24.9	22.9	26.7	31.6	27.4	24.9	22.5	***21.9***	***18.0***
Avg. Yld.	2.9%	2.8%	2.8%	2.2%	2.5%	2.1%	1.8%	2.0%	2.1%	2.4%	***2.2%***	***2.4%***

MGE's price-to-earnings multiple has moved significantly higher in the past half decade to the mid-20s to low 30s. It sits at 21.9 times earnings today, and as a result, we believe MGE is still overvalued. The lack of robust earnings growth it has exhibited and a lack of catalysts for it to pick up in the coming years mean that the current multiple seems

[1] Estimate
[2] Estimate
[3] In millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

unsustainable. Thus, we are forecasting a strong headwind to annual total returns in the coming years from multiple contraction.

The dividend yield is also telling us the stock is overvalued as it is still in the lower end of its range over the past decade. We think the combination of continued payout growth and a stock price that should come down over time will produce a higher, more normalized 2.4% yield against the current 2.2%. The current valuation multiple for MGE has not only made the stock expensive, but it has made the dividend less attractive as well.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	50%	48%	56%	56%	57%	56%	56%	55%	52%	53%	***49%***	***44%***

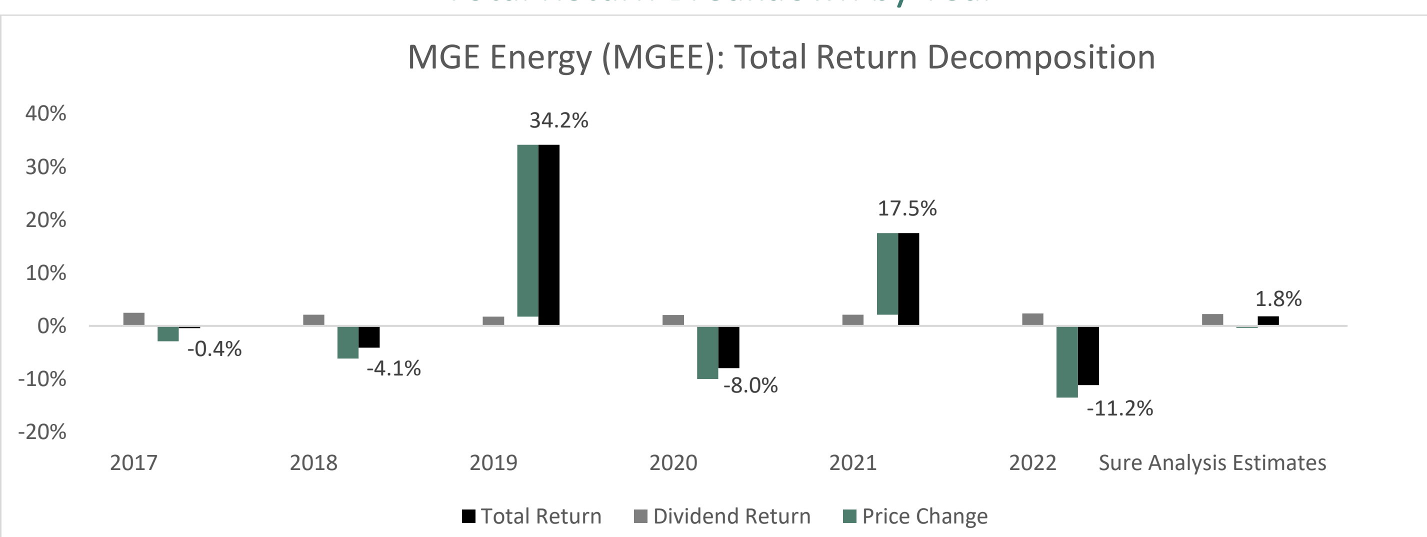
MGE's quality metrics have been roughly flat over the past decade, as it does not go after growth via acquisition, and its business has not really changed. Gross margins have drifted up over time but appear to have plateaued, while its debt-to-equity ratio continues to hover around a median of 60% as well. MGE's interest coverage is outstanding for a utility, and we forecast this will improve slightly over time as earnings grow and MGE keeps its debt at manageable levels. The payout ratio should remain under 60% as dividend growth will likely lag earnings growth, but the two should be very close. Overall, MGE is conservatively financed and run basically the same way year after year, meaning changes in the quality metrics will likely be few and far between.

MGE's main competitive advantage is its virtual monopoly in its service area. Like many other utilities, MGE has a small but profitable service area where it is continuing to grow its customer base. That helped it hold up well in the Great Recession as earnings-per-share dipped slightly but then recovered quickly.

Final Thoughts & Recommendation

Overall, MGE appears overvalued right now. We are forecasting total annualized returns for the next five years to be 1.8% as significant multiple contraction will largely offset the dividend and earnings-per-share growth. MGE has failed to grow its earnings faster than a mid-single-digit rate, but the valuation is pricing in much more growth than that. MGE therefore looks unattractive for just about any type of investor as it is overvalued, its current yield is relatively low, and its dividend growth is unattractive as well, making it a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	591	620	564	545	563	560	569	539	607	715
Gross Profit	185	198	188	189	198	190	202	204	214	244
Gross Margin	31.4%	32.0%	33.4%	34.6%	35.2%	33.9%	35.6%	37.9%	35.2%	34.1%
Operating Profit	39	41	44	45	53	56	72	74	77	86
Operating Margin	128	138	124	124	126	114	111	110	117	138
Net Profit	21.7%	22.3%	22.0%	22.7%	22.3%	20.4%	19.5%	20.4%	19.3%	19.3%
Net Margin	75	80	71	76	50	84	87	92	106	111
Free Cash Flow	12.7%	13.0%	12.6%	13.9%	8.8%	15.0%	15.3%	17.2%	17.4%	15.5%
Income Tax	21	36	69	64	23	(59)	(34)	(31)	(16)	(21)

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	1,579	1,694	1,726	1,801	1,855	1,989	2,082	2,254	2,372	2,518
Cash & Equivalents	69	66	81	96	108	83	23	45	17	12
Accounts Receivable	45	42	37	40	42	44	40	41	46	55
Inventories	36	46	48	41	44	42	45	47	52	74
Total Liabilities	962	1,035	1,036	1,077	1,077	1,172	1,226	1,278	1,344	1,436
Accounts Payable	44	42	41	48	48	46	55	55	64	59
Long-Term Debt	404	406	391	387	427	511	543	577	625	710
Shareholder's Equity	618	659	690	724	778	817	856	976	1,027	1,082
LTD/E Ratio	0.65	0.62	0.57	0.53	0.55	0.63	0.64	0.59	0.61	0.66

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	4.7%	4.9%	4.2%	4.3%	2.7%	4.4%	4.3%	4.3%	4.6%	4.5%
Return on Equity	12.5%	12.6%	10.6%	10.7%	6.6%	10.6%	10.4%	10.1%	10.6%	10.5%
ROIC	7.6%	7.7%	6.6%	6.9%	4.3%	6.7%	6.4%	6.3%	6.6%	6.4%
Shares Out.	34.7	34.7	34.7	34.7	34.7	34.7	34.7	36.2	36.2	36.2
Revenue/Share	17.04	17.88	16.27	15.71	16.24	16.15	16.41	15.13	16.77	19.75
FCF/Share	0.61	1.04	1.99	1.85	0.67	(1.71)	(0.97)	(0.86)	(0.43)	(0.59)

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