



# Essential Utilities (WTRG)

Updated November 9<sup>th</sup>, 2023 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b>	\$35	<b>5 Year CAGR Estimate:</b>	10.3%	<b>Market Cap:</b>	\$9.3 B
<b>Fair Value Price:</b>	\$34	<b>5 Year Growth Estimate:</b>	8.0%	<b>Ex-Dividend Date:</b>	11/9/2023
<b>% Fair Value:</b>	103%	<b>5 Year Valuation Multiple Estimate:</b>	-0.7%	<b>Dividend Payment Date:</b>	12/1/2023
<b>Dividend Yield:</b>	3.5%	<b>5 Year Price Target</b>	\$50	<b>Years Of Dividend Growth:</b>	32
<b>Dividend Risk Score:</b>	B	<b>Retirement Suitability Score:</b>	B	<b>Rating:</b>	Buy

## Overview & Current Events

Aqua America changed its name to Essential Utilities and its ticker from WTR to WTRG on February 3<sup>rd</sup>, 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 \$9.3 billion company has raised its dividend for 32 consecutive years, which qualifies it to be a member of the Dividend Champions, and has paid a quarterly dividend for 78 consecutive years.

In early November, Essential Utilities reported (11/6/23) financial results for the third quarter of fiscal 2023. Its revenue dipped -5% over the prior year's quarter due to lower natural gas prices but the company benefited from rate hikes and customer growth. As a result, its earnings-per-share grew 15%, from \$0.26 to \$0.30, and exceeded the analysts' consensus by \$0.01. The utility raised its dividend by 7% in the previous quarter.

Essential Utilities reiterated its positive guidance for 2023. It expects record earnings-per-share of \$1.85-\$1.90 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 2025. The company is essentially immune to a potential recession and high inflation.

## Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
<b>EPS</b>	\$1.16	\$1.20	\$1.14	\$1.32	\$1.35	\$1.41	\$1.47	\$1.58	\$1.67	\$1.77	<b>\$1.88</b>	<b>\$2.76</b>
<b>DPS</b>	\$0.58	\$0.63	\$0.69	\$0.74	\$0.79	\$0.85	\$0.91	\$0.97	\$1.04	\$1.11	<b>\$1.23</b>	<b>\$1.65</b>
<b>Shares<sup>1</sup></b>	177.9	178.6	176.5	177.4	177.7	178.4	232.6	254.8	262.2	263.3	<b>265.0</b>	<b>320.0</b>

Essential Utilities has compounded its earnings-per-share at a rate of 4.8% 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 22% 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
<b>Avg. P/E</b>	21.2	20.8	23.5	23.9	24.7	25.0	27.6	28.0	28.3	26.6	<b>18.6</b>	<b>18.0</b>
<b>Avg. Yld.</b>	2.4%	2.5%	2.6%	2.3%	2.4%	2.4%	2.2%	2.2%	2.2%	2.4%	<b>3.5%</b>	<b>3.3%</b>

<sup>1</sup> 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 25.0 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. Indeed, the surge of interest rates to a 16-year high have caused a 28% decline of Essential Utilities this year. The stock is currently trading at a 10-year low P/E ratio of 18.6, which is still higher than our fair value estimate. If Essential Utilities trades at a P/E ratio of 18 in five years, it will incur a -0.7% annualized drag in its returns.

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

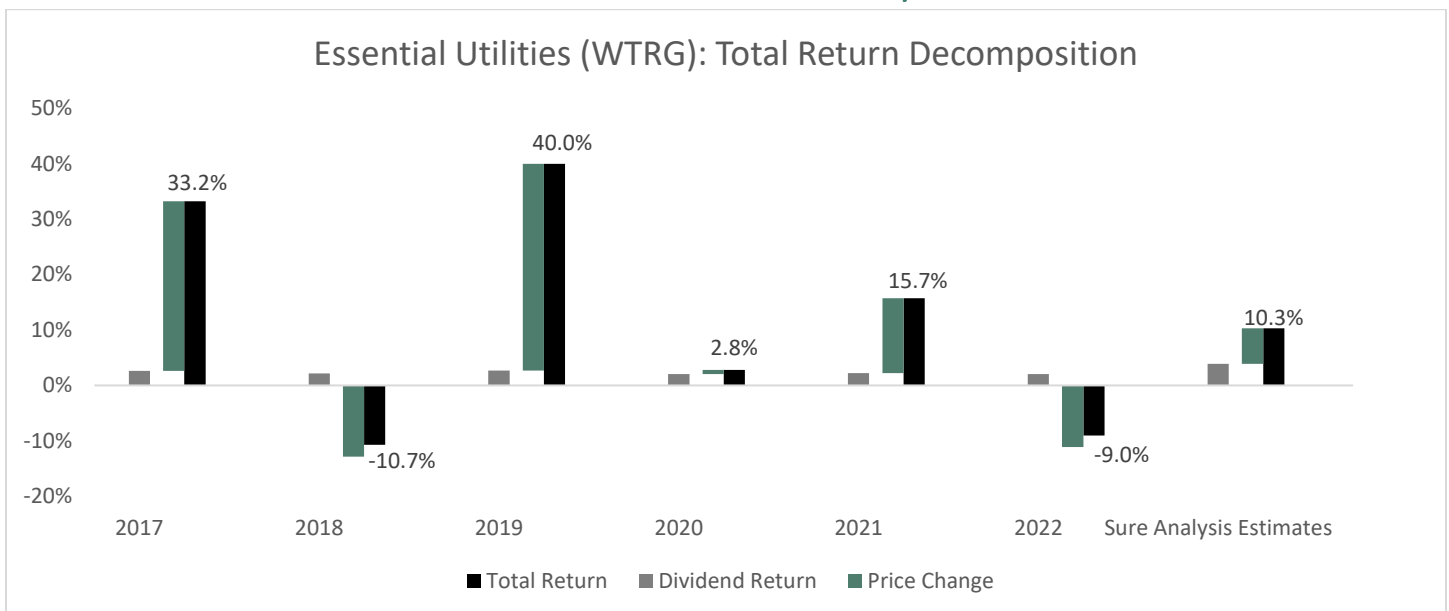
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	50.0%	52.5%	60.5%	56.1%	58.5%	60.3%	61.9%	61.4%	62.3%	62.7%	65.4%	59.6%

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. While the stock has remained overvalued for several years, it has corrected -28% this year due to the surge of the 10-year treasury yield to a 16-year high, which has rendered the yields of utilities less attractive. As a result, the stock can now offer a 10.3% average annual return over the next five years thanks to 8.0% earnings growth and its 3.5% dividend, partly offset by a -0.7% valuation headwind. Given also the resilience and safety of this utility, we rate it as a buy. It is the first time in a decade that Essential Utilities offers such an attractive return to investors who can wait patiently for interest rates to moderate.

## 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>	762	780	814	820	810	838	890	1463	1,878	2,288
<b>Gross Profit</b>	478	491	505	523	527	530	557	768	987	1,072
<b>Gross Margin</b>	62.8%	63.0%	62.0%	63.8%	65.1%	63.2%	62.6%	52.5%	52.6%	46.9%
<b>D&amp;A Exp.</b>	124	127	129	133	137	147	156	257	298	321
<b>Operating Profit</b>	302	314	321	333	334	323	340	435	603	661
<b>Operating Margin</b>	39.6%	40.3%	39.4%	40.7%	41.2%	38.6%	38.2%	29.7%	32.1%	28.9%
<b>Net Profit</b>	221	233	202	234	240	192	225	285	432	465
<b>Net Margin</b>	29.0%	29.9%	24.8%	28.6%	29.6%	22.9%	25.2%	19.5%	23.0%	20.3%
<b>Free Cash Flow</b>	60	35	6	13	(97)	(127)	(212)	(328)	(376)	(462)
<b>Income Tax</b>	21	25	15	21	17	(14)	(13)	(20)	(10)	(14)

## Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Total Assets</b>	5,052	5,407	5,718	6,159	6,332	6,964	9,362	13,705	14,658	15,719
<b>Cash &amp; Equivalents</b>	5	4	3	4	4	4	1,869	5	11	11
<b>Accounts Receivable</b>	56	56	57	64	66	68	69	189	198	266
<b>Inventories</b>	11	13	12	13	14	16	18	58	110	200
<b>Goodwill &amp; Int. Ass.</b>	28	31	34	42	42	53	64	2,332	2,347	2,345
<b>Total Liabilities</b>	3,517	3,751	3,992	4,309	4,375	4,955	5,481	9,021	9,474	10,342
<b>Accounts Payable</b>	66	63	56	47	59	77	75	177	193	239
<b>Long-Term Debt</b>	1,592	1,638	1,773	1,895	2,125	2,558	3,074	5,670	5,977	6,828
<b>Shareholder's Equity</b>	1,535	1,655	1,726	1,850	1,958	2,009	3,881	4,684	5,184	5,377
<b>LTD/E Ratio</b>	1.04	0.99	1.03	1.02	1.09	1.27	0.79	1.21	1.15	1.27

## Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Return on Assets</b>	4.5%	4.5%	3.6%	3.9%	3.8%	2.9%	2.8%	2.5%	3.0%	3.1%
<b>Return on Equity</b>	15.2%	14.6%	11.9%	13.1%	12.6%	9.7%	7.6%	6.7%	8.7%	8.8%
<b>ROIC</b>	7.2%	7.3%	5.9%	6.5%	6.1%	4.4%	3.9%	3.3%	4.0%	4.0%
<b>Shares Out.</b>	177.9	178.6	176.5	177.4	177.7	178.4	232.6	254.8	262.2	262.9
<b>Revenue/Share</b>	4.31	4.39	4.59	4.61	4.54	4.70	4.12	5.74	7.27	8.70
<b>FCF/Share</b>	0.34	0.20	0.03	0.07	(0.54)	(0.71)	(0.98)	(1.29)	(1.46)	(1.76)

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

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