MGE Energy (MGEE)

Updated March 11th, 2024 by Samuel Smith

Key Metrics

Current Price:	$79.0	**5 Year CAGR Estimate:**	2.3%	**Market Cap:**	$2.9B
Fair Value Price:	$64.4	**5 Year Growth Estimate:**	4.1%	**Ex-Dividend Date:**	5/30/24[1]
Fair Value:	123%	**5 Year Valuation Multiple Estimate:**	-4.0%	**Dividend Payment Date:**	6/15/24[2]
Dividend Yield:	2.2%	**5 Year Price Target**	$79	**Years of Dividend Growth:**	46
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 $2.9 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 46 years. MGE principally operates gas and electric utilities, in addition to transmission and construction businesses.

On February 23, 2024, MGE Energy Inc. reported its financial results for the fourth quarter of 2023. In 2023, MGE Energy reported GAAP earnings of $117.7 million, or $3.25 per share, marking an increase from $111.0 million, or $3.07 per share, in the previous year. The company continued its investment in new, cost-effective renewable generation, contributing to its asset growth, with increased electric investments included in the rate base leading to higher electric earnings for the year. Notably, the Red Barn wind project was completed in April 2023, followed by the completion of the Badger Hollow II solar project in December 2023. However, gas retail therm deliveries saw a significant decrease of approximately 13% compared to the prior year, primarily due to warmer-than-normal weather in 2023. Gas consumption by commercial and industrial customers dropped by approximately 10%, while residential gas consumption decreased by about 15% throughout the year. In the fourth quarter of 2023, MGE Energy's earnings were $20.1 million, or 55 cents per share, slightly lower than $21.1 million, or 58 cents per share, in the same period the prior year. The decrease in gas net income by $1.9 million in the fourth quarter of 2023 compared to the previous year was attributed to lower gas sales, with gas retail therm deliveries decreasing approximately 15% due to warmer weather conditions.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$2.32	$2.06	$2.18	$2.20	$2.43	$2.50	$2.60	$2.92	$3.07	$3.25	***$3.68***	***$4.50***
DPS	$1.11	$1.16	$1.21	$1.26	$1.35	$1.39	$1.44	$1.52	$1.63	$1.67	***$1.71***	***$2.20***
Shares[3]	34.7	34.7	34.7	34.7	34.7	34.7	36.2	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 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 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 mid-single digits.

[1] Estimate

[2] Estimate

[3] In millions

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Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	17.2	20.3	24.9	22.9	26.7	31.6	27.4	24.9	22.5	20.9	***21.5***	***17.5***
Avg. Yld.	2.8%	2.8%	2.2%	2.5%	2.1%	1.8%	2.0%	2.1%	2.4%	2.5%	***2.2%***	***2.8%***

MGE's price-to-earnings multiple has moved significantly higher in the past half-decade to the mid-20s to low 30s and has since fallen back into the low 20s. It sits at 21.5 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 means that the current multiple seems unsustainable. Thus, we are forecasting a headwind to annual total returns in the coming years from multiple contraction. The dividend yield also tells us the stock is overvalued as it is still at 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 2.8% 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

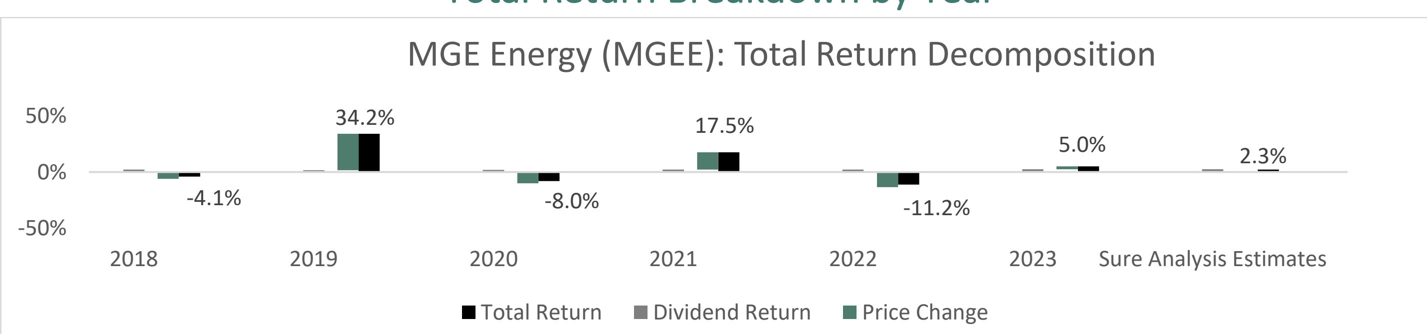
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	48%	56%	56%	57%	56%	56%	55%	52%	53%	51%	***46%***	***49%***

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. 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 around 50% 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 slightly overvalued right now. We are forecasting total annualized returns for the next five years to be 2.3% as multiple contraction will offset some of 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 a bit more growth than that. MGE therefore is rated a Sell right now.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	620	564	545	563	560	569	539	607	715	690
Gross Profit	198	188	189	197	190	202	204	214	244	269
Gross Margin	32.0%	33.4%	34.6%	35.0%	33.9%	35.6%	37.9%	35.2%	34.1%	39.0%
Operating Profit	41	44	45	53	56	72	74	77	86	100
Operating Margin	138	124	124	125	114	111	110	117	138	146
Net Profit	22.3%	22.0%	22.7%	22.1%	20.4%	19.5%	20.4%	19.3%	19.3%	21.2%
Net Margin	80	71	76	98	84	87	92	106	111	118
Free Cash Flow	13.0%	12.6%	13.9%	17.3%	15.0%	15.3%	17.2%	17.4%	15.5%	17.0%
Income Tax	36	69	64	23	(59)	(34)	(31)	(16)	(21)	15

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	1,694	1,726	1,801	1,855	1,989	2,082	2,254	2,372	2,518	2,675
Cash & Equivalents	66	81	96	108	83	23	45	17	12	11
Accounts Receivable	42	37	40	42	44	40	41	46	55	47
Inventories	46	48	41	44	42	45	47	52	74	73
Total Liabilities	1,035	1,036	1,077	1,077	1,172	1,226	1,278	1,344	1,436	1,535
Accounts Payable	42	41	48	48	46	55	55	64	59	65
Long-Term Debt	406	391	387	427	511	543	577	625	710	762
Shareholder's Equity	659	690	724	778	817	856	976	1,027	1,082	1,140
LTD/E Ratio	0.62	0.57	0.53	0.55	0.63	0.64	0.59	0.61	0.66	0.67

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	4.9%	4.2%	4.3%	5.3%	4.4%	4.3%	4.3%	4.6%	4.5%	4.5%
Return on Equity	12.6%	10.6%	10.7%	13.0%	10.6%	10.4%	10.1%	10.6%	10.5%	10.6%
ROIC	7.7%	6.6%	6.9%	8.4%	6.7%	6.4%	6.3%	6.6%	6.4%	6.4%
Shares Out.	34.7	34.7	34.7	34.7	34.7	34.7	36.2	36.2	36.2	36.2
Revenue/Share	17.88	16.27	15.71	16.24	16.15	16.41	15.13	16.77	19.75	19.08
FCF/Share	1.04	1.99	1.85	0.67	(1.71)	(0.97)	(0.86)	(0.43)	(0.59)	0.43

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