



Essential Utilities (WTRG)

Updated May 10th, 2024 by Aristofanis Papadatos

Key Metrics

Current Price:	\$39	5 Year CAGR Estimate:	8.3%	Market Cap:	\$10.6 B
Fair Value Price:	\$36	5 Year Growth Estimate:	7.0%	Ex-Dividend Date:	5/9/2024
% Fair Value:	108%	5 Year Valuation Multiple Estimate:	-1.5%	Dividend Payment Date:	6/1/2024
Dividend Yield:	3.2%	5 Year Price Target	\$51	Years Of Dividend Growth:	32
Dividend Risk Score:	B	Retirement Suitability Score:	B	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 \$10.6 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 79 consecutive years.

In early May, Essential Utilities reported (5/2/24) financial results for the first quarter of fiscal 2024. Its revenue decreased -16% over the prior year's quarter, mostly due to lower natural gas prices, but the company benefited from rate hikes, customer growth and higher water and gas volumes. Given also gains from the sale of three non-regulated energy projects, earnings-per-share grew 35%, from \$0.72 to \$0.97, and exceeded the analysts' consensus by \$0.21.

Thanks to the asset sale, Essential Utilities now expects to exceed its previous forecast for earnings-per-share of \$1.96-\$2.00 this year. Accordingly, we have raised our forecast from \$1.99 to \$2.01. Moreover, management expects annual rate hikes of ~8% in the regulated water division and ~10% in the regulated gas division until 2028. The company is essentially immune to recessions and high inflation.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$1.20	\$1.14	\$1.32	\$1.35	\$1.41	\$1.47	\$1.58	\$1.67	\$1.77	\$1.86	\$2.01	\$2.82
DPS	\$0.63	\$0.69	\$0.74	\$0.79	\$0.85	\$0.91	\$0.97	\$1.04	\$1.11	\$1.19	\$1.23	\$1.65
Shares¹	178.6	176.5	177.4	177.7	178.4	232.6	254.8	262.2	263.3	273.5	280.0	330.0

Essential Utilities has compounded its earnings-per-share at a rate of 5.0% 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 24% of current annual revenue, we expect the company to grow its bottom line at an approximate 7% average annual rate for the next five years.

The growth strategy of Essential Utilities is to acquire smaller water utilities 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	20.8	23.5	23.9	24.7	25.0	27.6	28.0	28.3	26.6	21.6	19.4	18.0
Avg. Yld.	2.5%	2.6%	2.3%	2.4%	2.4%	2.2%	2.2%	2.2%	2.4%	3.0%	3.2%	3.2%

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 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. The stock is currently trading at a P/E ratio of 19.4, which is higher than our fair value estimate. If Essential Utilities trades at a P/E ratio of 18 in five years, it will incur a -1.5% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

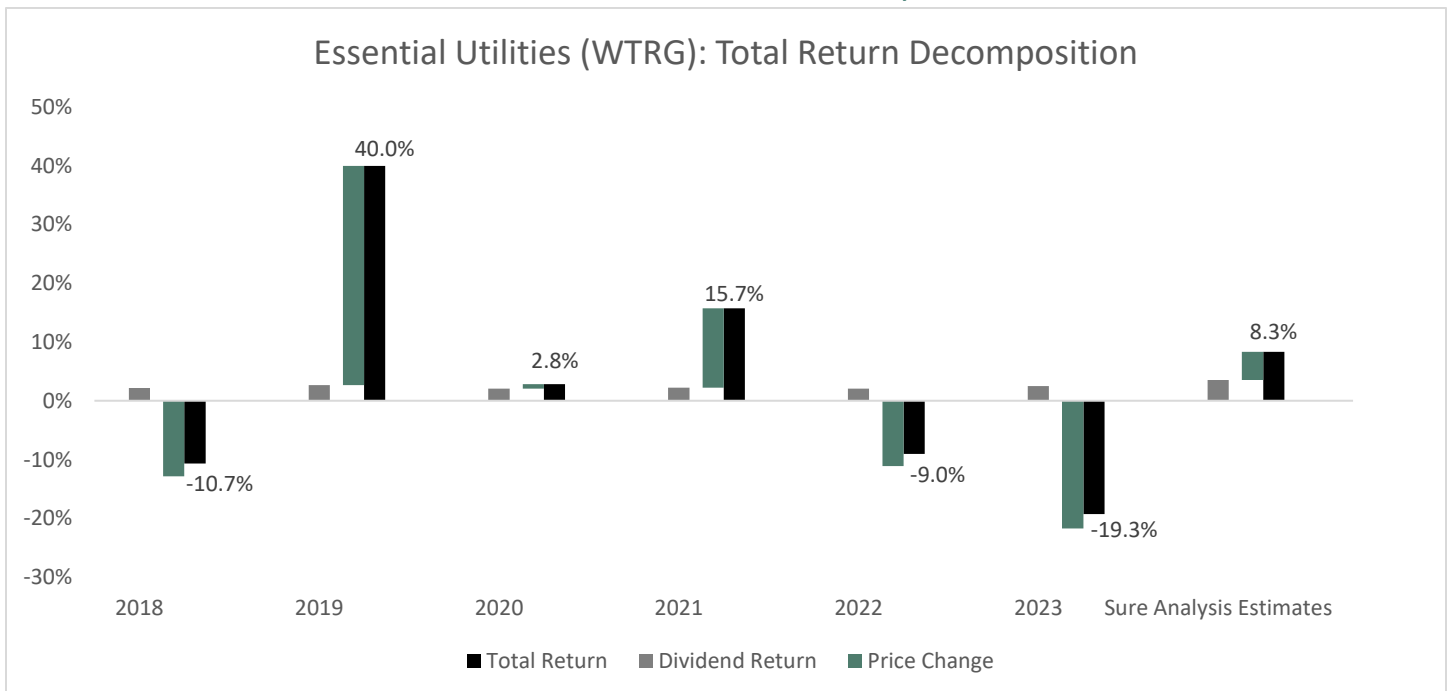
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	52.5%	60.5%	56.1%	58.5%	60.3%	61.9%	61.4%	62.3%	62.7%	64.0%	61.2%	58.4%

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. The stock has rallied 15% since our last research report, in February, but it could still offer an 8.3% average annual return over the next five years thanks to 7.0% earnings growth and its 3.6% dividend, partly offset by a -1.5% valuation headwind. We lower our rating from "buy" to "hold" but note that the stock will have ample upside whenever inflation and interest rates decrease. When that happens, utilities will become more appealing to income-oriented investors.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	780	814	820	810	838	890	1463	1,878	2,288	2,054
Gross Profit	491	505	523	527	530	557	768	987	1,072	1,126
Gross Margin	63.0%	62.0%	63.8%	65.1%	63.2%	62.6%	52.5%	52.6%	46.9%	54.8%
D&A Exp.	127	129	133	137	147	156	257	298	321	344
Operating Profit	314	321	333	334	323	340	435	603	661	709
Operating Margin	40.3%	39.4%	40.7%	41.2%	38.6%	38.2%	29.7%	32.1%	28.9%	34.5%
Net Profit	233	202	234	240	192	225	285	432	465	498
Net Margin	29.9%	24.8%	28.6%	29.6%	22.9%	25.2%	19.5%	23.0%	20.3%	24.2%
Free Cash Flow	35	6	13	(97)	(127)	(212)	(328)	(376)	(462)	(266)
Income Tax	25	15	21	17	(14)	(13)	(20)	(10)	(14)	-66

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	5,407	5,718	6,159	6,332	6,964	9,362	13,705	14,658	15,719	16,841
Cash & Equivalents	4	3	4	4	4	1,869	5	11	11	5
Accounts Receivable	56	57	64	66	68	69	189	198	266	200
Inventories	13	12	13	14	16	18	58	110	200	113
Goodwill & Int. Ass.	31	34	42	42	53	64	2,332	2,347	2,345	2,344
Total Liabilities	3,751	3,992	4,309	4,375	4,955	5,481	9,021	9,474	10,342	10,945
Accounts Payable	63	56	47	59	77	75	177	193	239	221
Long-Term Debt	1,638	1,773	1,895	2,125	2,558	3,074	5,670	5,977	6,828	7,054
Shareholder's Equity	1,655	1,726	1,850	1,958	2,009	3,881	4,684	5,184	5,377	5,896
LTD/E Ratio	0.99	1.03	1.02	1.09	1.27	0.79	1.21	1.15	1.27	1.20

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	4.5%	3.6%	3.9%	3.8%	2.9%	2.8%	2.5%	3.0%	3.1%	3.1%
Return on Equity	14.6%	11.9%	13.1%	12.6%	9.7%	7.6%	6.7%	8.7%	8.8%	8.8%
ROIC	7.3%	5.9%	6.5%	6.1%	4.4%	3.9%	3.3%	4.0%	4.0%	4.0%
Shares Out.	178.6	176.5	177.4	177.7	178.4	232.6	254.8	262.2	262.9	267.7
Revenue/Share	4.39	4.59	4.61	4.54	4.70	4.12	5.74	7.27	8.70	7.67
FCF/Share	0.20	0.03	0.07	(0.54)	(0.71)	(0.98)	(1.29)	(1.46)	(1.76)	(0.99)

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

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