



Atmos Energy (ATO)

Updated April 20th, 2018 by Josh Arnold

Key Metrics

Current Price: \$84	5 Year CAGR Estimate: 3.5%	Quality Percentile: N/A
Fair Value Price: \$64	5 Year Growth Estimate: 6.5%	Momentum Percentile: N/A
% Fair Value: 131%	5 Year Valuation Multiple Estimate: -5.3%	Total Return Percentile: N/A
Dividend Yield: 2.3%	5 Year Price Target: \$87	Valuation Percentile: N/A

Overview & Current Events

Atmos Energy can trace its beginnings all the way back to 1906 when it was formed in Texas. Since that time, it has grown both organically and through mergers to a \$9.3B market cap. The company distributes and stores natural gas in eight states, serving over three million customers, and should do in excess of \$3B in revenue this year.

The company's recent Q1 report saw a sizable benefit from tax legislation but on an operating basis, higher gross margins helped push profits higher. Atmos' results were aided by warmer weather as well as rate adjustments in its Mississippi, Mid-Texas and West Texas divisions. Atmos' impressive EPS growth history is continuing on in 2018.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$2.00	\$1.97	\$2.16	\$2.26	\$2.10	\$2.50	\$2.96	\$3.09	\$3.38	\$3.60	\$3.95	\$5.40
DPS	\$1.30	\$1.32	\$1.34	\$1.36	\$1.38	\$1.40	\$1.48	\$1.56	\$1.68	\$1.80	\$1.94	\$2.64

Atmos' EPS has risen fairly steadily in the past decade as the company's history counts more than 250 separate entities coming together to form the company we have today. That history of mergers and acquisitions – along with prudent management – has afforded Atmos strong long term EPS growth rates. We are forecasting five-year annual growth of 6.5% moving forward, which is slightly below the company's historical rate of growth.

It will achieve this growth through continued improvements in gross margin, reductions in operating costs as a percentage of revenue, and top line growth via acquisitions as well as customer growth. Atmos has an impressive history of acquiring customers over the long term and recent results have continued that trend. Along with margin improvements, Atmos should be able to produce mid to upper single digit EPS growth annually.

We are forecasting similar growth for the dividend as years of weak dividend growth have given way to a management team that is more willing to boost the payout. The company's payout ratio is much lower than it has been in the past and thus, a dividend growth rate congruent with EPS growth looks reasonable given recent history.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	13.6	12.5	13.2	14.4	15.9	15.9	16.1	17.5	20.8	22.0	21.3	16.2
Avg. Yld.	4.8%	5.3%	4.7%	4.2%	4.1%	3.5%	3.1%	2.9%	2.4%	2.3%	2.3%	3.0%

Atmos, like many other utilities and dividend stocks in general, has seen a sizable increase in its valuation in recent years. Atmos has seen a P/E multiple as low as 12.5 in the past decade but today, it stands at nearly double that level. We are forecasting a sizable 5.3% headwind to total returns based upon a return to a more normalized valuation level of a P/E of ~16 from the current P/E of ~21.

That move, combined with forecasted dividend growth, will help push the yield up substantially from 2.3% today to 3.0% in five years. That would still be quite low by historical standards for Atmos but the current valuation has depressed the yield on the stock, a situation we believe will be partially rectified by a lower valuation and rising dividend in the coming years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	27.1%	27.1%	28.3%	30.4%	38.5%	36.4%	32.0%	38.1%	47.7%	46.6%	47.0%	48.0%
Debt/A	68%	66%	68%	69%	69%	67%	64%	65%	65%	64%	65%	65%
Int. Cov.	3.1	2.9	3.1	3.0	3.1	3.9	4.7	5.3	5.7	6.0	6.2	6.5
Payout	65%	68%	62%	62%	65%	56%	50%	51%	50%	50%	49%	49%
Std. Dev.	35.4%	22.8%	17.2%	25.7%	14.5%	15.8%	16.4%	19.2%	19.0%	12.1%	17.0%	20.0%

Atmos' quality metrics have largely been stable in the past decade as it is financed in much the same way as other utilities. It has roughly two-thirds of its assets funded by debt but its interest coverage is robust at 6.0. We expect continued gross margin improvement and revenue growth to improve its interest coverage in the coming years, although two risks exist to that assumption. First, gross margin volatility has been high in the past and that could happen again if there's a supply disruption and/or weather-related issues crop up. Second, Atmos could do a large acquisition funded by additional debt, which could reset its debt-to-asset ratio and interest coverage. Overall, however, Atmos' financial position looks very strong at the moment.

Its competitive advantage is in its wide distribution area and lack of direct competition in its service areas for residential and commercial customers. In addition, discretionary use of natural gas is low as people use what they need, regardless of economic conditions, meaning Atmos' recession performance is strong; EPS was stable during the Great Recession.

Final Thoughts & Recommendation

Atmos has strong fundamentals and a long track record of solid performance but the stock is trading well in excess of fair value today. We are therefore forecasting total annual returns of just 3.5%, consisting of the current 2.3% yield, 6.5% EPS growth and 5.3% headwind from the valuation reset. Atmos' current yield isn't high enough to be attractive and although its growth outlook is strong for a utility, the valuation is such that those seeking value should look elsewhere. Atmos is worth owning at lower levels, but today it looks unattractive for investors seeking value or yield.

Total Return Breakdown by Year

