



# National Fuel Gas Co. (NFG)

Updated August 17<sup>th</sup>, 2018 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b> \$57	<b>5 Year CAGR Estimate:</b> 6.3%	<b>Volatility Percentile:</b> 41.4%
<b>Fair Value Price:</b> \$61	<b>5 Year Growth Estimate:</b> 2.0%	<b>Momentum Percentile:</b> 23.5%
<b>% Fair Value:</b> 94%	<b>5 Year Valuation Multiple Estimate:</b> 1.3%	<b>Valuation Percentile:</b> 74.7%
<b>Dividend Yield:</b> 3.0%	<b>5 Year Price Target</b> \$67	<b>Total Return Percentile:</b> 38.0%

## Overview & Current Events

National Fuel Gas Co. is a diversified energy company that operates in five business segments: Exploration & Production, Pipeline & Storage, Gathering, Utility, and Energy Marketing. The company's largest segment is Exploration & Production. National Fuel Gas was founded in 1902 and has grown to a market capitalization of \$4.9 billion. With 48 years of consecutive dividend increases, National Fuel Gas qualifies to be a Dividend Champion.

In early August, National Fuel Gas reported (8/2/18) financial results for the third quarter of fiscal 2018. The company exceeded the analysts' estimates by a wide margin, as its earnings per share of \$0.73 were 12% above the consensus (\$0.65) and 6% higher than those in Q3-2017. While the average realized natural gas price fell significantly, from \$2.94 in Q3-2017 to \$2.43 in Q3-2018, the reduced tax rate from the recent tax reform fully offset this negative effect. In addition, the company increased its natural gas output by 4% over last year.

Thanks to an expected further increase in its natural gas output, the company raised its guidance for this year from about \$3.30 to \$3.30-\$3.40 and we have raised our estimate to \$3.38. Moreover, management initiated guidance for earnings per share growth around 2%, to \$3.45, for next year thanks to further production growth of natural gas.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$3.18	\$2.60	\$2.65	\$3.09	\$2.63	\$3.14	\$3.52	-\$4.50	-\$3.43	\$3.30	<b>\$3.38</b>	<b>\$3.73</b>
<b>DPS</b>	\$1.27	\$1.32	\$1.36	\$1.40	\$1.44	\$1.48	\$1.52	\$1.56	\$1.60	\$1.64	<b>\$1.68</b>	<b>\$1.92</b>

Remarkably, National Fuel Gas' earnings have barely grown over the last ten years. More specifically, earnings per share have compounded at a rate of 0.4% per year over the last 10 years. With that said, this includes a difficult ten-year stretch that includes both the 2007-2009 financial crisis as well as the precipitous drop in natural gas prices that began in 2014. We are forecasting 2% long-term earnings-per-share growth for this high-quality Dividend Champion, which allows us to calculate a 2023 earnings-per-share estimate of \$3.73.

Investors should note that 90% of the production of National Fuel Gas is natural gas. Therefore, as the Exploration & Production segment generates almost half of its total earnings, it is evident that the earnings of the company greatly depend on the price of natural gas. This means that there is always a great degree of uncertainty surrounding long-term forecasts of the earnings of this company.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	15.5	13.4	18.5	21.4	19.3	18.6	20.6	---	---	17.2	<b>16.9</b>	<b>18.0</b>
<b>Avg. Yld.</b>	2.6%	3.8%	2.8%	2.1%	2.8%	2.5%	2.1%	2.5%	3.1%	2.9%	<b>3.0%</b>	<b>2.9%</b>

National Fuel Gas is trading at a price-to-earnings ratio of 16.9. For context, National Fuel Gas has traded at a price-to-earnings ratio of 18.1 over the last decade. We believe an earnings multiple around 18 represents an approximation of fair value for this blue-chip Dividend Champion. If the company returns to fair value over the next 5 years, annualized returns will get a 1.3 percentage point boost.

*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.*

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

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>GP/A</b>	28.2%	22.1%	21.6%	22.0%	20.4%	14.9%	15.5%	14.3%	15.3%	14.1%	<b>15.0%</b>	<b>15.0%</b>
<b>Debt/A</b>	61.2%	66.7%	65.8%	63.8%	67.0%	64.7%	64.2%	69.1%	72.9%	72.1%	<b>68.0%</b>	<b>65.0%</b>
<b>Int. Cov.</b>	8.1	3.0	5.0	6.7	5.5	5.9	6.5	-6.3	-3.4	4.9	<b>5.0</b>	<b>7.0</b>
<b>Payout</b>	39.9%	50.8%	51.3%	45.3%	54.8%	47.1%	43.2%	N/A	N/A	49.7%	<b>49.7%</b>	<b>51.5%</b>
<b>Std. Dev.</b>	52.1%	32.8%	29.1%	36.9%	23.7%	18.8%	18.3%	23.9%	23.4%	18.1%	<b>20.0%</b>	<b>20.0%</b>

National Fuel Gas Co. has experienced a deterioration in some quality metrics over the last decade. More specifically, gross profits as a proportion of total assets has declined while the company's balance sheet has become more leveraged. Importantly, though, the net debt of National Fuel Gas is \$1.7 billion, which is just 6 times its annual earnings. Thus the company has adequate interest coverage. Moreover, its dividend payout ratio is sufficiently low to enable continued dividend growth even if earnings stall temporarily.

Qualitatively, National Fuel Gas' most unique competitive advantage is its combination of regulated and stable businesses (like pipelines and utilities) with cyclical and (potentially) higher-growth sectors (like exploration & production). This allows the company to endure through difficult operating environments with less difficulty than its peers who may focus exclusively on the more cyclical areas of the energy sector.

### Final Thoughts & Recommendation

The largest contributor to National Fuel Gas Co.'s expected total returns is its 3.0% dividend yield, which is far higher than the average yield in the S&P 500 (~1.8%). Still, the company's total return potential is lackluster, particularly given its poor financial performance in recent years. National Fuel Gas fails to earn a buy recommendation, although existing investors may want to continue holding its stock (especially if their cost basis is significantly below today's market value, and shares are held in a taxable investment account).

### Total Return Breakdown by Year

