



National Fuel Gas Co. (NFG)

Updated April 16th, 2018 by Nick McCullum

Key Metrics

Current Price: \$52	5 Year CAGR Estimate: 7.8%	Quality Percentile: N/A
Fair Value Price: \$59	5 Year Growth Estimate: 2.0%	Momentum Percentile: N/A
% Fair Value: 88%	5 Year Valuation Multiple Estimate: 2.6%	Total Return Percentile: N/A
Dividend Yield: 3.2%	5 Year Price Target \$66	Valuation Percentile: N/A

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 \$4.5 billion. With 47 years of consecutive dividend increases, National Fuel Gas qualifies to be a Dividend Champion.

In early February, National Fuel Gas reported (2/1/18) financial results for the first quarter of fiscal 2018. In the quarter, revenues declined by 0.7% and earnings-per-share increased by 23.1%, driven by a substantial one-time tailwind from the recently-enacted federal tax reform. While 20%+ earnings growth is obviously unsustainable over the long-term, we believe that National Fuel Gas' performance will improve materially if oil prices continue to rise (as we expect).

National Fuel Gas also updated its 2018 financial guidance with the release of first quarter earnings. The company now expects to generate earnings-per-share between \$3.20 and \$3.40, which is roughly in-line with the prior year's bottom line. Note that this earnings-per-share guidance excludes the beneficial impact of the U.S. Tax Cuts and Jobs Act.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$3.18	\$2.60	\$2.65	\$3.09	\$2.63	\$3.14	\$3.52	-\$4.50	-\$3.43	\$3.30	\$3.30	\$3.65
DPS	\$1.27	\$1.32	\$1.36	\$1.40	\$1.44	\$1.48	\$1.52	\$1.56	\$1.60	\$1.64	\$1.68	\$2.00

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 \$3.65.

Growth will come from increasing capital expenditures. National Fuel Gas has provided guidance for between \$560 million and \$650 million of capital expenditures in fiscal 2018, which is up significantly from the \$455 million invested in capital assets in the prior fiscal year. Importantly, much of these investments are planned for the Exploration & Production segment, which is the company's largest.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	15.5	13.4	18.5	21.4	19.3	18.6	20.6	---	---	17.2	15.8	18.0
Avg. Yld.	2.6%	3.8%	2.8%	2.1%	2.8%	2.5%	2.1%	2.5%	3.1%	2.9%	3.2%	3.0%

National Fuel Gas is forecasting for earnings-per-share of \$3.30 using the midpoint of its recently-updated fiscal 2018 financial guidance. Using this guidance, the company is trading at a price-to-earnings ratio of 15.8. 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 of 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 2.6 percentage point boost.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	28.2%	22.1%	21.6%	22.0%	20.4%	14.9%	15.5%	14.3%	15.3%	14.1%	15.0%	15.0%
Debt/A	61.2%	66.7%	65.8%	63.8%	67.0%	64.7%	64.2%	69.1%	72.9%	72.1%	70.0%	65.0%
Int. Cov.	8.1	3.0	5.0	6.7	5.5	5.9	6.5	-6.3	-3.4	4.9	5.0	7.0
Payout	39.9%	50.8%	51.3%	45.3%	54.8%	47.1%	43.2%	N/A	N/A	49.7%	50.9%	54.8%
Std. Dev.	52.1%	32.8%	29.1%	36.9%	23.7%	18.8%	18.3%	23.9%	23.4%	18.1%	20.0%	20.0%

National Fuel Gas Co. has experienced a meaningful deterioration in several of its 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 increased its debt composition. Importantly, though, National Fuel Gas generated adequate interest coverage in the most recent fiscal year and 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 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 3.2% dividend yield, which is far higher than the average yield in the S&P 500 (~1.8%) and also noticeably above the company's long-term historical average. 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

