



National Fuel Gas Co. (NFG)

Updated November 6th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	\$54	5 Year CAGR Estimate:	7.9%	Volatility Percentile:	26.3%
Fair Value Price:	\$62	5 Year Growth Estimate:	2.0%	Momentum Percentile:	37.4%
% Fair Value:	87%	5 Year Valuation Multiple Estimate:	2.8%	Growth Percentile:	4.6%
Dividend Yield:	3.1%	5 Year Price Target	\$69	Valuation Percentile:	76.0%
Dividend Risk Score:	A	Retirement Suitability Score:	A	Total Return Percentile:	44.3%

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 \$4.6 billion. With 48 years of consecutive dividend increases, National Fuel Gas qualifies to be a Dividend Champion.

In early November, National Fuel Gas reported (11/1/18) its financial results for the fourth quarter of fiscal 2018. The company grew its production by 17% in Q4 over last year and by 3% in the full year, thus achieving the highest output in its history. In addition, it increased its proved reserves of natural gas by 17% in fiscal 2018. However, in Q4, the average natural gas price decreased 17% over last year and thus the earnings-per-share decreased 8%, from \$0.53 in Q4-2017 to \$0.49 in Q4-2018, falling below the analysts' consensus of \$0.54.

On the bright side, management raised its earnings-per-share guidance for fiscal 2019 from \$3.30-\$3.60 to \$3.35-\$3.65 thanks to higher expected price realizations and lower projected operating expenses. Moreover, it continues to expect 24% production growth, from 178.1 Bcfe in fiscal 2018 to about 220 Bcfe in fiscal 2019.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$2.60	\$2.65	\$3.09	\$2.63	\$3.14	\$3.52	-\$4.50	-\$3.43	\$3.30	\$3.34	\$3.45	\$3.81
DPS	\$1.32	\$1.36	\$1.40	\$1.44	\$1.48	\$1.52	\$1.56	\$1.60	\$1.64	\$1.68	\$1.72	\$1.92
Shares	80.5	82.1	82.9	83.3	83.7	84.2	84.6	85.1	85.5	86.0	\$86.5	89.0

Remarkably, National Fuel Gas' earnings have barely grown over the last ten years. Earnings-per-share have compounded at a rate of 0.5% 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 2024 earnings-per-share estimate of \$3.81.

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, the earnings of the company greatly depend on the price of natural gas. As a result, there is always great uncertainty in the long-term forecasts of the earnings of this company.

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	15.7	18.0
Avg. Yld.	2.6%	3.8%	2.8%	2.1%	2.8%	2.5%	2.1%	2.5%	3.1%	2.9%	3.1%	2.8%

National Fuel Gas is trading at a price-to-earnings ratio of 15.7. 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 2.8 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.



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Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
GP/A	22.1%	21.6%	22.0%	20.4%	14.9%	15.5%	14.3%	15.3%	14.1%	15.4%	15.5	15.0%
Debt/A	66.7%	65.8%	63.8%	67.0%	64.7%	64.2%	69.1%	72.9%	72.1%	67.9%	68.0	65.0%
Int. Cov.	3.0	5.0	6.7	5.5	5.9	6.5	-6.3	-3.4	4.9	4.7	5.0	7.0
Payout	50.8%	51.3%	45.3%	54.8%	47.1%	43.2%	N/A	N/A	49.7%	50.3%	49.9%	50.4%
Std. Dev.	32.8%	29.1%	36.9%	23.7%	18.8%	18.3%	23.9%	23.4%	18.1%	20.0%	20.0%	20.0%

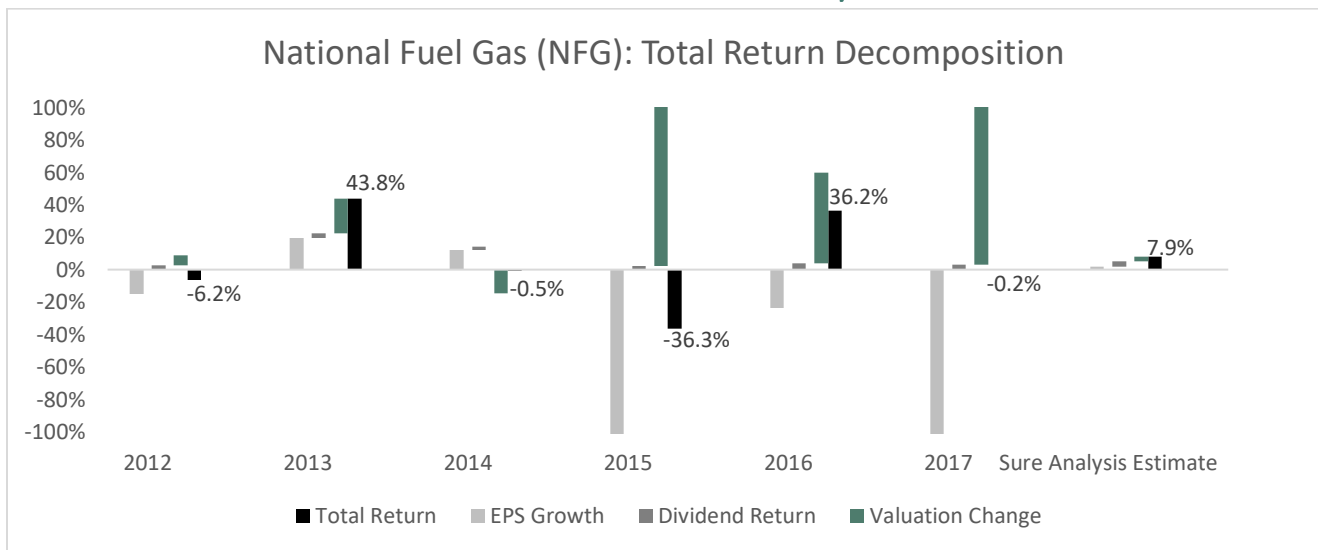
National Fuel Gas Co. has seen its gross profits as a proportion of total assets decline over the last decade. On the other hand, its balance sheet is healthy while its interest coverage stands at a decent level. Moreover, its dividend payout ratio is sufficiently low to enable continued dividend growth even if earnings stall temporarily. As its 3.1% dividend yield is much higher than the yield of S&P (1.8%), the stock may entice income-oriented investors. However, the latter should be aware of the high dependence of the earnings of the company on the price of natural gas.

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

Thanks to a rising natural gas price, production growth and lower operating costs, National Fuel Gas is likely to offer a 7.9% average annual return over the next five years. However, this return is lackluster, particularly given the poor financial performance of the company in recent years and its heavy dependence on the natural gas price. 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



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	2052	1761	1779	1627	1830	2113	1761	1452	1580	1593
Gross Profit	1054	1102	924	940	1042	935	891	895	935	873
Gross Margin	51.4%	62.6%	51.9%	57.8%	57.0%	44.2%	50.6%	61.6%	59.2%	54.8%
Operating Profit	410	440	441	448	518	570	515	532	553	487
Operating Margin	20.0%	25.0%	24.8%	27.5%	28.3%	27.0%	29.3%	36.6%	35.0%	30.6%
Net Profit	101	226	258	220	260	299	-379	-291	283	392
Net Margin	4.9%	12.8%	14.5%	13.5%	14.2%	14.2%	-21.5%	-20.0%	17.9%	24.6%
Free Cash Flow	298	4	-160	-376	35	-5	-165	7	234	30
Income Tax	53	137	164	151	173	190	-319	-233	161	-7

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	4769	5106	5221	5935	6218	6728	6565	5636	6103	6036
Cash & Equivalents	408	397	80	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Accounts Receivable	144	163	163	116	133	150	105	133	112	141
Inventories	80	74	82	78	94	67	65	71	74	78
Goodwill & Int. Ass.	27	5	5	5	5	5	5	5	5	5
Total Liabilities	3180	3360	3329	3975	4024	4317	4539	4109	4400	4099
Accounts Payable	197	128	142	88	105	137	180	108	126	160
Long-Term Debt	1249	1249	1089	1570	1649	1723	2084	2086	2384	2131
Shareholder's Equity	1589	1746	1892	1960	2195	2411	2025	1527	1704	1937
D/E Ratio	0.79	0.72	0.58	0.80	0.75	0.71	1.03	1.37	1.40	1.10

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	2.3%	4.6%	5.0%	3.9%	4.3%	4.6%	-5.7%	-4.8%	4.8%	6.5%
Return on Equity	6.3%	13.5%	14.2%	11.4%	12.5%	13.0%	-17.1%	-16.4%	17.5%	21.5%
ROIC	3.6%	7.7%	8.6%	6.8%	7.1%	7.5%	-9.2%	-7.5%	7.4%	9.6%
Shares Out.	80.5	82.1	82.9	83.3	83.7	84.2	84.6	85.1	85.5	86.0
Revenue/Share	25.44	21.30	21.26	19.43	21.69	24.87	20.87	17.12	18.37	18.43
FCF/Share	3.70	0.05	-1.92	-4.49	0.42	-0.06	-1.95	0.09	2.72	0.34

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

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