



Atmos Energy Corp. (ATO)

Updated May 8th, 2021 by Josh Arnold

Key Metrics

Current Price:	\$103	5 Year CAGR Estimate:	7.0%	Market Cap:	\$13.5 B
Fair Value Price:	\$96	5 Year Growth Estimate:	6.0%	Ex-Dividend Date:	05/21/21
% Fair Value:	107%	5 Year Valuation Multiple Estimate:	-1.4%	Dividend Payment Date:	06/07/21
Dividend Yield:	2.4%	5 Year Price Target	\$128	Years Of Dividend Growth:	37
Dividend Risk Score:	A	Retirement Suitability Score:	B	Last Dividend Increase:	8.7%

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 \$13.5 billion market capitalization. The company distributes and stores natural gas in eight states, serves over 3 million customers, and should generate about \$3.4 billion in revenue this year. Atmos has a 37-year history of raising dividends, putting it in rare company among dividend stocks.

Atmos reported second quarter earnings on May 5th, 2021, with results coming in ahead of expectations on the top and bottom lines. Revenue soared 35% year-over-year to \$1.35 billion, helping to drive strong earnings. Consolidated operating income was up \$50 million to \$382 million during the quarter, as rate case outcomes in both of the company's segments and customer growth in the distribution segment offset slightly lower pipeline and storage segment revenue.

Distribution operating income was up \$50 million to \$303 million, compared to \$254 million in the year-ago period. Rate cases saw operating income soar \$66 million, along with a \$5 million increase from customer growth. This was partially offset by higher depreciation and tax expenses. Pipeline and storage operating income was up fractionally to \$79 million, which was due to a \$14 million increase from higher rates, partially offset by higher depreciation and tax expenses.

Our estimate of earnings-per-share at \$5.05 following Q2 results as the company reiterated its guidance for the full year despite the strong rate case growth in Q2.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$2.26	\$2.10	\$2.50	\$2.96	\$3.09	\$3.38	\$3.60	\$4.00	\$4.35	\$4.69	\$5.05	\$6.76
DPS	\$1.36	\$1.38	\$1.40	\$1.48	\$1.56	\$1.68	\$1.80	\$1.94	\$2.34	\$2.34	\$2.50	\$3.67
Shares¹	90	90	90	91	100	101	104	106	117	123	127	140

Atmos' earnings-per-share has risen steadily in the past decade as the company continues to grow both organically and through acquisitions. We are forecasting a five-year annual growth rate of 6% moving forward.

The company can 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. Along with margin improvements, Atmos should be able to produce mid-to-upper single-digit earnings-per-share growth annually. It continues to file favorable rate cases with its various localities that provide for small revenue increases over time as well, as we saw again in 2020 full-year results, and indeed in first half 2021 results. The core distribution business performed very well in the first quarter, which we think is bullish for 2021 results.

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 earnings-per-share growth, or slightly higher, looks reasonable given recent history. Indeed, the most recent dividend increase for 2021 was 8.7%. We see the dividend rising to \$3.67 over the next five years.

¹ Share count in millions

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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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	14.4	15.9	15.9	16.1	17.5	20.8	22.0	21.8	23.5	22.4	20.4	19.0
Avg. Yld.	4.2%	4.1%	3.5%	3.1%	2.9%	2.4%	2.3%	2.2%	2.0%	2.2%	2.4%	2.9%

Atmos, like many other utilities and dividend stocks in general, has seen a sizable increase in its valuation in recent years. Shares have rallied since our last update to 20.4 times earnings. Thus, we are forecasting a modest headwind to total returns based upon a return to a more normalized valuation level of a price-to-earnings ratio of 19. Atmos is much more expensive than it was at the time of our last update. Given this, we see the yield rising from 2.4% to 2.9% over the next five years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	62%	65%	56%	50%	51%	50%	50%	49%	48%	50%	50%	54%

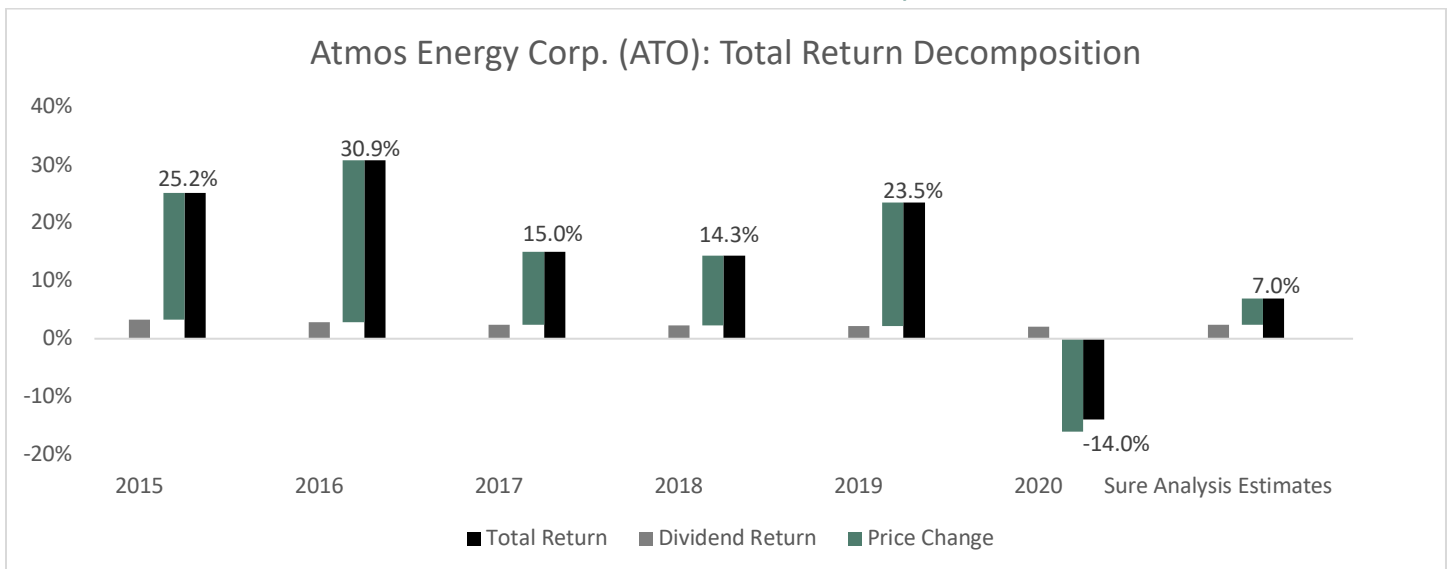
Atmos' payout ratio has drifted lower in recent years as dividend increases have been a lower priority than other spending. We expect the payout ratio to remain around 50%, where it is today, as dividend increases roughly match the growth rate of earnings in the coming years. Atmos' dividend is safe and with the 2.4% yield, we see the payout as attractive compared to the broader market.

The company's 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 likely to be resilient, as seen in 2020.

Final Thoughts & Recommendation

Atmos has strong fundamentals and a long track record of solid performance, but the stock is now somewhat expensive in our view. We are forecasting total annual returns of 7%, consisting of the current 2.4% yield, 6% earnings-per-share growth and a small potential headwind from the valuation. Because of this, we are moving Atmos from a buy to a hold rating following the big rally into Q2 results.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	4286	3436	3875	4941	2927	2455	2760	3116	2902	2,821
Gross Profit	1301	1324	1412	1582	1631	1708	1834	1948	2043	2,162
Gross Margin	30.3%	38.5%	36.4%	32.0%	55.7%	69.6%	66.5%	62.5%	70.4%	76.6%
D&A Exp.	233	247	238	254	275	293	320	361	391	430
Operating Profit	456	452	502	611	612	657	736	728	746	824
Operating Margin	10.6%	13.1%	13.0%	12.4%	20.9%	26.8%	26.7%	23.4%	25.7%	29.2%
Net Profit	208	217	243	290	315	350	396	603	511	601
Net Margin	4.8%	6.3%	6.3%	5.9%	10.8%	14.3%	14.4%	19.4%	17.6%	21.3%
Free Cash Flow	-40	-146	-232	-92	-152	-292	-270	-343	-725	(898)
Income Tax	107	98	143	187	190	197	221	8	139	145

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	7283	7496	7934	8595	9075	10011	10750	11874	13368	15,359
Cash & Equivalents	131	64	66	42	29	48	26	14	25	21
Accounts Receivable	216	178	231	263	205	120	135	139	127	140
Inventories	294	262	250	285	249	185	189	174	136	119
Goodwill & Int. Ass.	740	741	741	742	743	727	730	730	731	731
Total Liabilities	5027	5136	5354	5508	5880	6548	6851	7104	7617	8,568
Accounts Payable	291	83	70	78	79	114	143	135	177	141
Long-Term Debt	2415	2527	2824	2653	2895	3269	3515	3644	3994	4,523
Shareholder's Equity	2255	2359	2580	3086	3195	3463	3899	4770	5750	6,791
D/E Ratio	1.07	1.07	1.09	0.86	0.91	0.94	0.90	0.76	0.69	0.67

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	3.0%	2.9%	3.2%	3.5%	3.6%	3.7%	3.8%	5.3%	4.1%	4.2%
Return on Equity	9.4%	9.4%	9.8%	10.2%	10.0%	10.5%	10.8%	13.9%	9.7%	9.6%
ROIC	4.5%	4.5%	4.7%	5.2%	5.3%	5.5%	5.6%	7.6%	5.6%	5.7%
Shares Out.	90	90	90	91	100	101	104	106	117	123
Revenue/Share	47.28	37.69	42.26	50.62	28.73	23.71	26.01	28.06	24.70	22.96
FCF/Share	-0.44	-1.60	-2.53	-0.94	-1.49	-2.82	-2.54	-3.09	-6.17	-7.31

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

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