



National Fuel Gas Co. (NFG)

Updated May 16th, 2021 by Aristofanis Papadatos

Key Metrics

| | | | | | |
|-----------------------------|------|--|------|----------------------------------|------------------------|
| Current Price: | \$52 | 5 Year CAGR Estimate: | 8.1% | Market Cap: | \$4.8 B |
| Fair Value Price: | \$61 | 5 Year Growth Estimate: | 2.0% | Ex-Dividend Date: | 6/28/2021 ¹ |
| % Fair Value: | 86% | 5 Year Valuation Multiple Estimate: | 3.2% | Dividend Payment Date: | 7/14/2021 ¹ |
| Dividend Yield: | 3.5% | 5 Year Price Target | \$67 | Years Of Dividend Growth: | 50 |
| Dividend Risk Score: | A | Retirement Suitability Score: | A | Last Dividend Increase: | 2.3% |

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 \$4.8 billion. With 50 years of consecutive dividend increases, National Fuel Gas qualifies to be a Dividend Champion.

In early May, National Fuel Gas reported (5/6/21) financial results for the second quarter of fiscal 2021. The company grew its production by an impressive 43% over last year's quarter, primarily thanks to the acquisition of Appalachian assets. In addition, the average price of natural gas rose 8%, from \$2.16 in last year's quarter to \$2.28. As a result, adjusted earnings-per-share grew 38%, from \$0.97 to \$1.34, and exceeded analysts' consensus by \$0.14.

The pandemic has affected the natural gas market much less than the oil market. In addition, the pipeline & storage and gathering segments provide a strong buffer to the earnings of National Fuel Gas. The two segments grew their EBITDA 19% and 40%, respectively, in the latest quarter thanks to strong volume growth. Management expects strong production growth in fiscal 2021 and raised its guidance for a third consecutive quarter thanks to favorable commodity prices. It now expects earnings-per-share of \$3.85-\$4.05 (vs. previous guidance of \$3.65-\$3.95), for 35% growth at the mid-point. We have raised our earnings-per-share forecast for the full fiscal year from \$3.80 to \$4.05.

Growth on a Per-Share Basis

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|---------------------------|--------|--------|--------|--------|---------|---------|--------|--------|--------|--------|---------------|---------------|
| EPS | \$3.09 | \$2.63 | \$3.14 | \$3.52 | -\$4.50 | -\$3.43 | \$3.30 | \$3.34 | \$3.45 | \$2.92 | \$4.05 | \$4.47 |
| DPS | \$1.40 | \$1.44 | \$1.48 | \$1.52 | \$1.56 | \$1.60 | \$1.64 | \$1.68 | \$1.72 | \$1.76 | \$1.80 | \$2.00 |
| Shares² | 82.9 | 83.3 | 83.7 | 84.2 | 84.6 | 85.1 | 85.5 | 86.0 | 86.8 | 91.0 | 91.5 | 94.0 |

National Fuel Gas pursues growth by growing its natural gas production and expanding its pipeline network. However, the company's earnings have barely grown over the last decade. Earnings-per-share have compounded at a rate of 2.9% per year since 2010. Moreover, the pandemic has somewhat hurt natural gas prices in recent quarters but the strong production growth of National Fuel Gas will more than offset this headwind this year. Due to the high comparison base formed by the all-time high earnings expected in this fiscal year, we are forecasting 2% long-term earnings-per-share growth for this Dividend Champion, which allows us to calculate a 2026 earnings-per-share estimate of \$4.47.

Investors should note that 90% of the production of National Fuel Gas is natural gas. Therefore, as the Exploration & Production segment generates about half of total profits, 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. This is the main reason behind our conservative growth forecast.

¹ Estimated date.

² 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 | 21.4 | 19.3 | 18.6 | 20.6 | --- | --- | 17.2 | 12.8 | 15.6 | 14.6 | 12.8 | 15.0 |
| Avg. Yld. | 2.8% | 2.1% | 2.8% | 2.5% | 2.1% | 2.5% | 3.1% | 2.9% | 3.2% | 4.1% | 3.5% | 3.0% |

National Fuel Gas is trading at a price-to-earnings ratio of 12.8, which is much lower than its historical 10-year average of 17.5. As we expect record earnings by 2026, we assume a fair price-to-earnings ratio of 15.0 for that year. If the stock reverts to this valuation level over the next 5 years, it will enjoy a 3.2% annualized gain in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|--------|-------|-------|-------|-------|------|------|-------|-------|-------|-------|--------------|--------------|
| Payout | 45.3% | 54.8% | 47.1% | 43.2% | --- | --- | 49.7% | 50.3% | 50.0% | 60.3% | 44.4% | 44.7% |

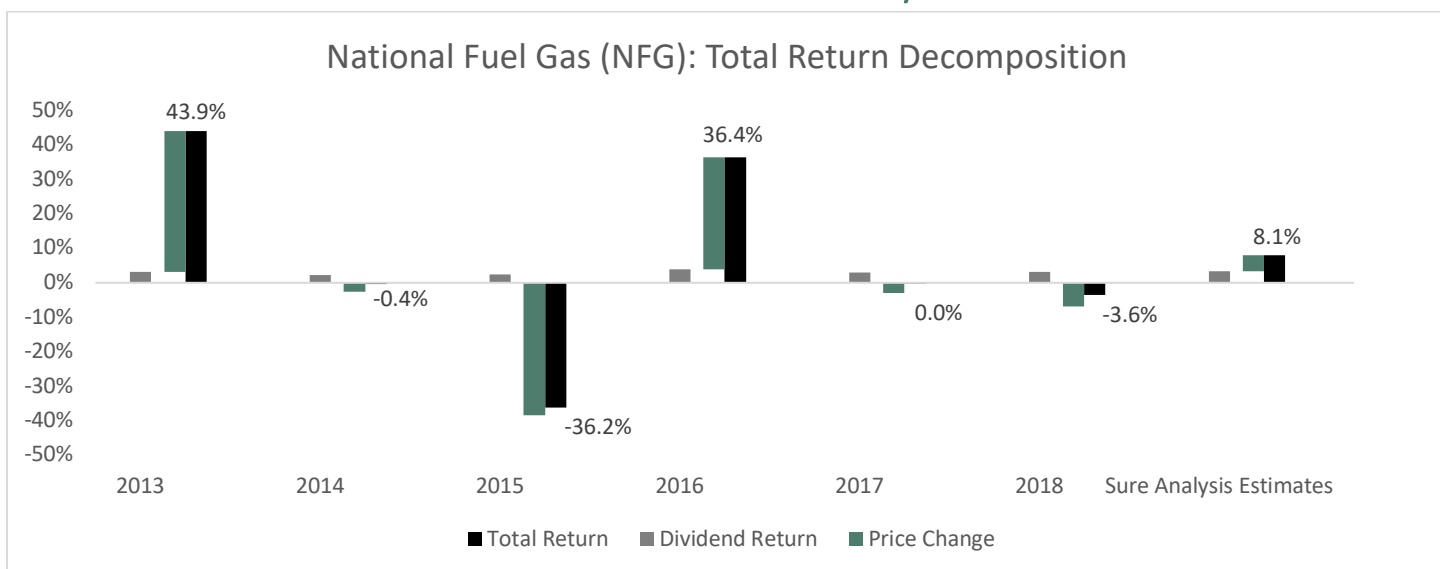
National Fuel Gas has a healthy balance sheet while its interest coverage level stands at a decent level, around 4.0. Moreover, its dividend payout ratio is sufficiently low to enable continued dividend growth even if earnings stall temporarily. Management has always targeted a dividend payout ratio around 50% in order to have a high margin of safety against the wide fluctuations of the price of natural gas. As the 3.5% dividend yield of National Fuel Gas is more than twice as much as the yield of the S&P (1.4%), the stock may entice income-oriented investors. However, these investors should be aware of the company's high dependence on the price of natural gas.

Qualitatively, National Fuel Gas' 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 difficult operating environments and downturns, such as the ongoing one, with less difficulty than its peers who may focus exclusively on the more cyclical areas of the energy sector.

Final Thoughts & Recommendation

National Fuel Gas has rallied 27% since our last report, in February, but it could still offer an 8.1% average annual return over the next five years thanks to its sustained production growth, its promising outlook and its reasonable valuation. Nevertheless, due to the cyclical nature of the stock and its steep rally, we lower our rating from "buy" to "hold".

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|-------------------------|-------|-------|-------|-------|--------|--------|-------|-------|-------|-------|
| Revenue | 1,779 | 1,627 | 1,830 | 2,113 | 1,761 | 1,452 | 1,580 | 1,593 | 1,693 | 1,546 |
| Gross Profit | 924 | 940 | 1,042 | 1,123 | 1,075 | 1,055 | 1,080 | 1,014 | 1,031 | 568 |
| Gross Margin | 51.9% | 57.8% | 57.0% | 53.2% | 61.0% | 72.6% | 68.4% | 63.7% | 60.9% | 36.7% |
| Operating Profit | 441 | 448 | 518 | 570 | 515 | 532 | 594 | 520 | 512 | 479 |
| Operating Margin | 24.8% | 27.5% | 28.3% | 27.0% | 29.3% | 36.6% | 37.6% | 32.6% | 30.2% | 31.0% |
| Net Profit | 258 | 220 | 260 | 299 | (379) | (291) | 283 | 392 | 304 | (124) |
| Net Margin | 14.5% | 13.5% | 14.2% | 14.2% | -21.5% | -20.0% | 17.9% | 24.6% | 18.0% | -8.0% |
| Free Cash Flow | (160) | (376) | 35 | (5) | (165) | 7 | 234 | 31 | (94) | (482) |
| Income Tax | 164 | 151 | 173 | 190 | (319) | (233) | 161 | (7) | 85 | 19 |

Balance Sheet Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total Assets | 5,221 | 5,935 | 6,218 | 6,728 | 6,565 | 5,636 | 6,103 | 6,036 | 6,462 | 6,965 |
| Cash & Equivalents | 80 | 74 | 65 | 37 | 114 | 130 | 556 | 230 | 20 | 21 |
| Accounts Receivable | 163 | 116 | 133 | 150 | 105 | 133 | 112 | 141 | 140 | 144 |
| Inventories | 82 | 78 | 94 | 67 | 65 | 71 | 74 | 78 | 80 | 85 |
| Goodwill & Int. Ass. | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 |
| Total Liabilities | 3,329 | 3,975 | 4,024 | 4,317 | 4,539 | 4,109 | 4,400 | 4,099 | 4,323 | 4,993 |
| Accounts Payable | 142 | 88 | 105 | 137 | 180 | 108 | 126 | 160 | 132 | 134 |
| Long-Term Debt | 1,089 | 1,570 | 1,649 | 1,723 | 2,084 | 2,086 | 2,384 | 2,131 | 2,189 | 2,660 |
| Shareholder's Equity | 1,892 | 1,960 | 2,195 | 2,411 | 2,025 | 1,527 | 1,704 | 1,937 | 2,139 | 1,972 |
| D/E Ratio | 0.58 | 0.80 | 0.75 | 0.71 | 1.03 | 1.37 | 1.40 | 1.10 | 1.02 | 1.35 |

Profitability & Per Share Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|-------------------------|--------|--------|-------|--------|--------|--------|-------|-------|--------|--------|
| Return on Assets | 5.0% | 3.9% | 4.3% | 4.6% | -5.7% | -4.8% | 4.8% | 6.5% | 4.9% | -1.8% |
| Return on Equity | 14.2% | 11.4% | 12.5% | 13.0% | -17.1% | -16.4% | 17.5% | 21.5% | 14.9% | -6.0% |
| ROIC | 8.6% | 6.8% | 7.1% | 7.5% | -9.2% | -7.5% | 7.4% | 9.6% | 7.2% | -2.8% |
| Shares Out. | 82.9 | 83.3 | 83.7 | 84.2 | 84.6 | 85.1 | 85.5 | 86.0 | 86.8 | 88.0 |
| Revenue/Share | 21.26 | 19.43 | 21.69 | 24.87 | 20.87 | 17.12 | 18.37 | 18.43 | 19.51 | 17.58 |
| FCF/Share | (1.92) | (4.49) | 0.42 | (0.06) | (1.95) | 0.09 | 2.72 | 0.36 | (1.09) | (5.47) |

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

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