



# RGC Resources, Inc. (RGC)

Updated February 13<sup>th</sup>, 2023, by Yiannis Zourmpanos

## Key Metrics

|                             |      |                                            |       |                                  |            |
|-----------------------------|------|--------------------------------------------|-------|----------------------------------|------------|
| <b>Current Price:</b>       | \$24 | <b>5 Year CAGR Estimate:</b>               | 7.3%  | <b>Market Cap:</b>               | \$215.9 M  |
| <b>Fair Value Price:</b>    | \$18 | <b>5 Year Growth Estimate:</b>             | 10.0% | <b>Ex-Dividend Date:</b>         | 04/14/2023 |
| <b>% Fair Value:</b>        | 132% | <b>5 Year Valuation Multiple Estimate:</b> | -5.4% | <b>Dividend Payment Date:</b>    | 05/01/2023 |
| <b>Dividend Yield:</b>      | 3.3% | <b>5 Year Price Target</b>                 | \$29  | <b>Years Of Dividend Growth:</b> | 18         |
| <b>Dividend Risk Score:</b> | C    | <b>Retirement Suitability Score:</b>       | C     | <b>Rating:</b>                   | Hold       |

## Overview & Current Events

RGC Resources, Inc. operates as a distributor and seller of natural gas to industrial, commercial, and residential customers through its subsidiaries: Roanoke Gas, Midstream, and Diversified Energy. Residential customers are the largest customer segment of the company accounting for 58% of the total revenues in 2021, followed by commercial customers at 34%. The company operates in three segments: Gas Utility, the key revenue generator; Investment in Affiliates; and Parent & Other. The company was founded in 1883 and generates just under \$90 million in annual revenue.

On February 8<sup>th</sup>, 2023, RGC Resources, Inc. announced its Q1 2023 results, posting total revenues of \$33.3 million, up 43.1% year-over-year from \$23.2 million from the same period last year and beating the market estimate by \$7.3 million. The normalized EPS of \$0.33 missed the market estimate by \$0.06. In the first quarter, the company delivered a total of 620,000 decatherms, which is a 23% increase compared to the same period in the previous year. This rise in volume is attributed to the colder weather compared to the previous year, which led to a 31% increase in heating degrees. Furthermore, the company continued to benefit from an increase in transportation and interruptible volumes due to their single multi-fuel customer's increased usage of natural gas during the quarter.

## Growth on a Per-Share Basis

| Year          | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   | 2020   | 2021   | 2022    | 2023          | 2028          |
|---------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|---------------|---------------|
| <b>EPS</b>    | \$0.60 | \$0.67 | \$0.72 | \$0.81 | \$0.86 | \$0.95 | \$1.08 | \$1.30 | \$1.22 | -\$3.48 | <b>\$0.90</b> | <b>\$1.45</b> |
| <b>DPS</b>    | \$0.48 | \$0.49 | \$0.51 | \$0.54 | \$0.58 | \$0.62 | \$0.66 | \$0.70 | \$0.74 | \$0.78  | <b>\$0.79</b> | <b>\$1.06</b> |
| <b>Shares</b> | 7.0    | 7.1    | 7.1    | 7.2    | 7.2    | 8.0    | 8.1    | 8.2    | 8.4    | 9.1     | <b>9.4</b>    | <b>10.9</b>   |

RGC Resources, Inc. is highly dependent on Roanoke Gas' natural gas distribution business, which accounts for more than 98% of the firm's total revenues. The continued demand for natural gas ensures that the company operates as a stable company with consistent financial performance over time. Although the net loss posted in fiscal 2022 may reflect otherwise, it is essential to consider the earnings and dividend growth posted by the company over time and the fact that the current net loss is due to an impairment charge related to the Mountain Valley Pipeline.

The company is expected to continue its growth trajectory in the coming years owing to a strong natural gas demand as it remains the cheapest heat source compared with electricity and fuel. However, it is also important to realize that the company operates in a highly regulated industry, and its topline remains highly dependent on gas costs, consumption patterns, and weather/economic conditions. The increase or decrease in gas prices is passed on to customers through the PGA mechanism, which means that sometimes price increases are not allowed by regulators. We forecast a 10.0% growth in EPS through 2028. In addition, the company will likely be able to grow its dividends at a healthy pace in the future and has assumed a dividend growth rate of 6.0% for the next five years. For fiscal year 2023, we have revised down our EPS estimate to \$0.90 in-line with the company's forward guidance and street estimates.

*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      | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E  | 21.3 | 19.6 | 19.2 | 19.1 | 28.7 | 28.2 | 26.3 | 19.2 | 18.8 | N/A  | 26.4 | 20.0 |
| Avg. Yld. | 3.8% | 3.7% | 3.7% | 3.5% | 2.3% | 2.3% | 2.3% | 2.8% | 3.2% | 3.7% | 3.3% | 3.6% |

RGC Resources, Inc. is trading at a forward P/E of 26.4, which is a premium to its ten-year average of 19.4. We believe the higher multiple reflects the growth pathway for the company going forward. We have assumed a P/E of 20.0 to value the company in 2028 and believe that the stock might provide a better entry for investors in the future compared with the current price level. In addition, we have a 5-year price target of \$29 on the stock, suggesting a 21% upside potential from current levels.

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

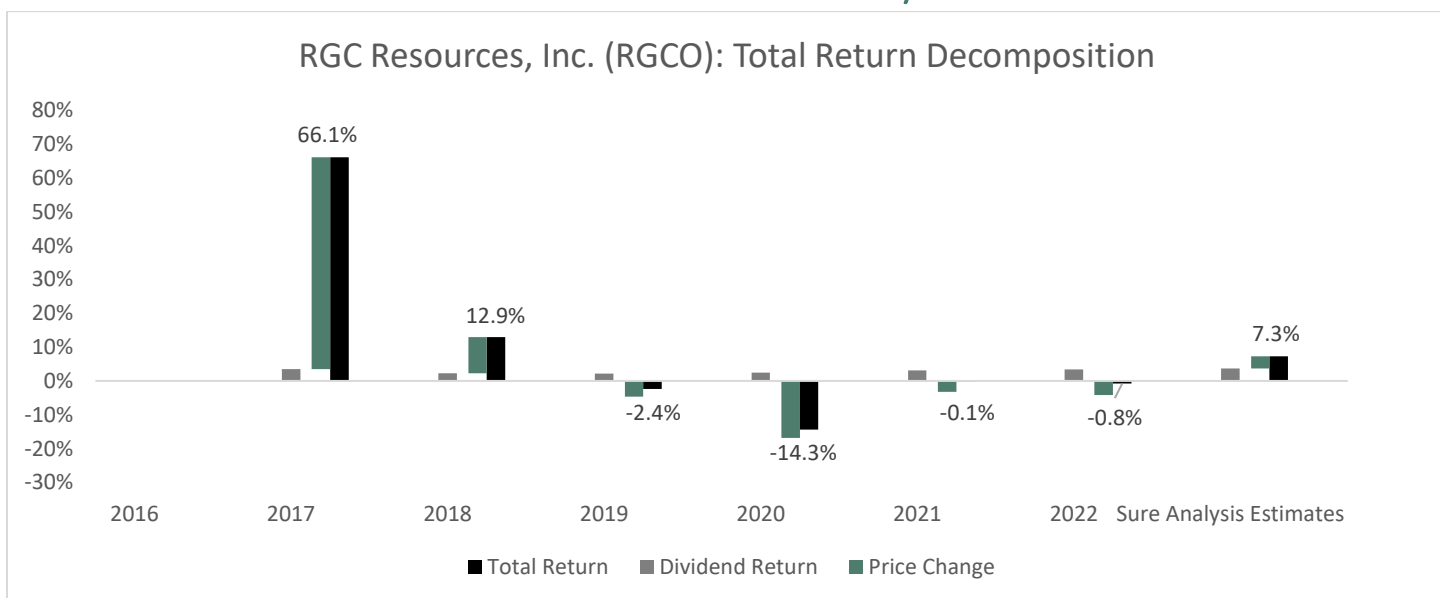
| Year   | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 80%  | 73%  | 71%  | 67%  | 67%  | 65%  | 61%  | 54%  | 61%  | -22% | 88%  | 73%  |

RGC Resources, Inc. has maintained a healthy payout ratio and has increased the dividends at a CAGR of 6.1% from 2018 to 2022. The company has continuously paid regularly scheduled cash dividends for the past 78 years and has been increasing its dividend payments over the past 17 years. The company's consistently high payout ratio reflects the ability of RGC Resources, Inc. to generate sufficient cash flow in all business cycles. In addition, RGC Resources, Inc. would not be overly affected by a possible recession since gas is a utility product that is generally considered a necessity, especially in winter, which keeps the demand alive for the company, despite the state of the economy.

## Final Thoughts & Recommendation

As a utility company operating in a highly regulated sector, RGC Resources, Inc. has limited upside potential. However, owing to robust natural gas demand and the company's extensive record of solid execution, we believe that RGC Resources, Inc. will continue to deliver value to shareholders in terms of continued dividends and consistent profitability. Accordingly, our hold rating is premised upon the 7.3% annualized total returns for the medium-term, with the forecasted earnings-per-share growth of 10.0% and 3.3% dividend yield offset by a valuation headwind.

## Total Return Breakdown by Year



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## Income Statement Metrics

| Year             | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  | 2021  | 2022   |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------|
| Revenue          | 63    | 75    | 68    | 59    | 62    | 66    | 68    | 63    | 75    | 84     |
| Gross Profit     | 15    | 16    | 17    | 18    | 20    | 20    | 21    | 23    | 25    |        |
| Gross Margin     | 23.3% | 21.3% | 24.5% | 31.3% | 32.5% | 31.0% | 31.0% | 35.8% | 33.9% | 0.0%   |
| D&A Exp.         | 5     | 5     | 5     | 6     | 6     | 7     | 8     | 8     | 9     |        |
| Operating Profit | 9     | 10    | 10    | 11    | 12    | 11    | 12    | 13    | 15    | 15     |
| Op. Margin       | 13.9% | 12.9% | 14.7% | 19.0% | 19.6% | 17.5% | 17.0% | 19.8% | 19.7% | 17.7%  |
| Net Profit       | 4     | 5     | 5     | 6     | 6     | 7     | 9     | 11    | 10    | (32)   |
| Net Margin       | 6.7%  | 6.3%  | 7.5%  | 9.8%  | 10.0% | 11.1% | 12.8% | 16.7% | 13.4% | -37.7% |
| Free Cash Flow   | 0     | (8)   | 3     | (3)   | (8)   | (10)  | (7)   | (10)  | (8)   |        |
| Income Tax       | 3     | 3     | 3     | 4     | 4     | 3     | 3     | 3     | 3     | (11)   |

## Balance Sheet Metrics

| Year               | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|--------------------|------|------|------|------|------|------|------|------|------|------|
| Total Assets       | 125  | 139  | 146  | 166  | 183  | 220  | 258  | 282  | 310  | 290  |
| Cash & Equivalents | 3    | 1    | 1    | 1    | 0    | 0    | 2    | 0    | 2    |      |
| Acc. Receivable    | 4    | 4    | 3    | 3    | 3    | 4    | 4    | 3    | 5    |      |
| Inventories        | 11   | 12   | 9    | 8    | 9    | 9    | 7    | 7    | 9    |      |
| Total Liabilities  | 75   | 87   | 93   | 110  | 123  | 140  | 175  | 193  | 210  | 197  |
| Accounts Payable   | 6    | 5    | 5    | 5    | 5    | 5    | 4    | 4    | 8    |      |
| Long-Term Debt     | 28   | 39   | 40   | 48   | 61   | 70   | 103  | 124  | 140  | 136  |
| Total Equity       | 50   | 52   | 53   | 56   | 60   | 80   | 83   | 89   | 100  | 93   |
| LTD/E Ratio        | 0.57 | 0.76 | 0.75 | 0.87 | 1.02 | 0.88 | 1.24 | 1.39 | 1.41 | 1.46 |

## Profitability & Per Share Metrics

| Year             | 2013 | 2014   | 2015 | 2016   | 2017   | 2018   | 2019   | 2020   | 2021   | 2022   |
|------------------|------|--------|------|--------|--------|--------|--------|--------|--------|--------|
| Return on Assets | 3.4% | 3.6%   | 3.6% | 3.7%   | 3.6%   | 3.6%   | 3.6%   | 3.9%   | 3.4%   | -10.6% |
| Return on Equity | 8.5% | 9.3%   | 9.7% | 10.7%  | 10.8%  | 10.5%  | 10.7%  | 12.3%  | 10.7%  | -32.9% |
| ROIC             | 5.5% | 5.6%   | 5.5% | 5.9%   | 5.5%   | 5.4%   | 5.2%   | 5.3%   | 4.5%   | -13.5% |
| Shares Out.      | 7.0  | 7.1    | 7.1  | 7.2    | 7.2    | 8.0    | 8.1    | 8.2    | 8.4    | 9.1    |
| Revenue/Share    | 8.97 | 10.60  | 9.61 | 8.25   | 8.59   | 8.52   | 8.42   | 7.74   | 9.10   | 9.23   |
| FCF/Share        | 0.01 | (1.11) | 0.42 | (0.42) | (1.07) | (1.27) | (0.89) | (1.24) | (1.02) |        |

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

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