RGC Resources, Inc. (RGCO)

Updated March 22nd, 2024, by Yiannis Zourmpanos

Key Metrics

Current Price:	$20	**5 Year CAGR Estimate:**	12.4%	**Market Cap:**	$198 M
Fair Value Price:	$23	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	04/15/2024
% Fair Value:	86%	**5 Year Valuation Multiple Estimate:**	3.0%	**Dividend Payment Date:**	05/01/2024
Dividend Yield:	4.0%	**5 Year Price Target**	$31	**Years Of Dividend Growth:**	19
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Rating:**	Buy

Overview & Current Events

RGC Resources, Inc. (RGCO) 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 company's largest customer segment, accounting for ~58% of the total revenues, 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 6th, 2024, RGC Resources announced its Q1 2024 results. The company posted non-GAAP EPS of $0.50, beating the market's estimate by $0.11, and total revenues of $24.4 million, down 27% year over year.

This resulted in RGC Resources reporting a steeper rise in net income during the quarter ending December 31, 2023, to $5,019,992 or $0.50 per share, from $3,256,405 or $0.33 per share in the last year. The improvement stems from a $1.5 million contribution from its investment in Mountain Valley Pipeline, LLC (MVP), and better utility margins. In connection with the spiking operating costs and inflationary pressures, Roanoke Gas, holding as a subsidiary of RGC Resources, has invested in infrastructure to underpin reliability and expansion of the customer base, thus growing the finances for the company. CEO Paul Nester noted optimism in the MVPs' progress and comments on how the company is handling an increase in costs through a rate application with the State Corporation Commission. Finally, RGC Resources is actively addressing potential challenges, including inflation, increasing customer counts, and changing regulatory landscapes.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$0.67	$0.72	$0.81	$0.86	$0.95	$1.08	$1.30	$1.22	-$3.48	$1.14	***$1.16***	***$1.55***
DPS	$0.49	$0.51	$0.54	$0.58	$0.62	$0.66	$0.70	$0.74	$0.78	$0.79	***$0.80***	***$1.07***
Shares[1]	7.1	7.1	7.2	7.2	8.0	8.1	8.2	8.4	9.1	9.9	***10.3***	***12.4***

RGC Resources 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 is stable 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 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 demand for natural gas 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 regulators do not allow price increases.

Therefore, we have matched analysts' EPS estimate for 2024 at $1.16, but we revised the growth forecast to 6.0% to align with the company's long-term average, leading to our EPS estimate of $1.55 for 2029. In addition, the company will likely grow its dividends at a healthy pace and we have assumed a dividend growth rate of 6.0% for the next five years.

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[1] Shares in millions.

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Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	19.6	19.2	19.1	28.7	28.2	26.3	19.2	18.8	---	20.7	***17.2***	***20.0***
Avg. Yld.	3.7%	3.7%	3.5%	2.3%	2.3%	2.3%	2.8%	3.2%	3.7%	3.3%	***4.0%***	***3.4%***

RGC Resources is trading at a forward P/E of 17.2, slightly below 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 target P/E of 20.0 to value the company in 2029 and believe that the stock might provide a better entry for investors in the future compared with the current price level, leading to our five-year price target of $31.

Safety, Quality, Competitive Advantage, & Recession Resiliency

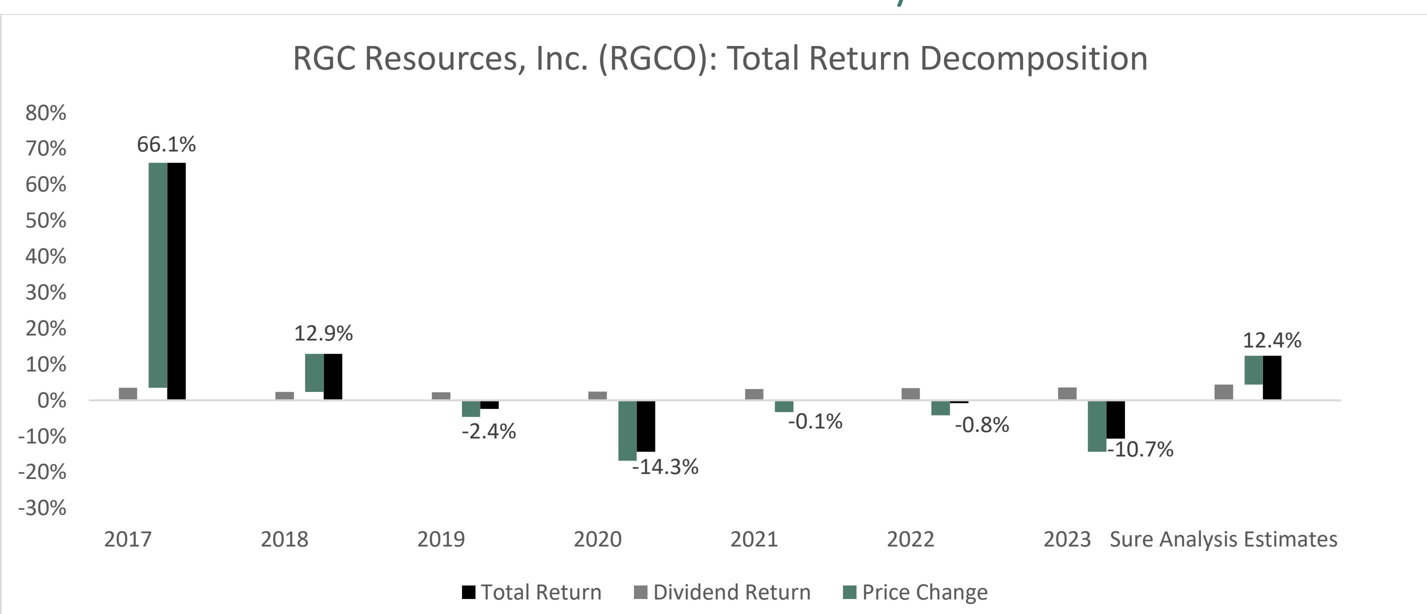
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	73%	71%	67%	67%	65%	61%	54%	61%	---	69%	***69%***	***69%***

RGC Resources 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 increased dividend payments over the past 19 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 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 will continue delivering value to shareholders through continued dividends and consistent profitability. Therefore, we maintain our buy rating premised upon the 12.4% annualized total returns for the medium-term, with the forecasted earnings-per-share growth of 6.0%, the 4.0% dividend yield, and a valuation tailwind.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	75	68	59	62	66	68	63	75	84	97
Gross Profit	16	17	18	20	20	21	23	25	-	30
Gross Margin	21.3%	24.5%	31.3%	32.5%	31.0%	31.0%	35.8%	33.9%	0.0%	30.9%
D&A Exp.	5	5	6	6	7	8	8	9	-	10
Operating Profit	10	10	11	12	11	12	13	15	15	18
Op. Margin	12.9%	14.7%	19.0%	19.6%	17.5%	17.0%	19.8%	19.7%	17.7%	18.6%
Net Profit	5	5	6	6	7	9	11	10	(32)	11
Net Margin	6.3%	7.5%	9.8%	10.0%	11.1%	12.8%	16.7%	13.4%	-37.7%	11.3%
Free Cash Flow	(8)	3	(3)	(8)	(10)	(7)	(10)	(8)		(1.5)
Income Tax	3	3	4	4	3	3	3	3	(11)	3.5

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	139	146	166	183	220	258	282	310	290	304
Cash & Equivalents	1	1	1	0	0	2	0	2	-	1.5
Acc. Receivable	4	3	3	3	4	4	3	5	-	4
Inventories	12	9	8	9	9	7	7	9	-	13
Total Liabilities	87	93	110	123	140	175	193	210	197	203
Accounts Payable	5	5	5	5	5	4	4	8	-	6
Long-Term Debt	39	40	48	61	70	103	124	140	136	141
Total Equity	52	53	56	60	80	83	89	100	93	101
LTD/E Ratio	0.76	0.75	0.87	1.02	0.88	1.24	1.39	1.41	1.46	1.40

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	3.6%	3.6%	3.7%	3.6%	3.6%	3.6%	3.9%	3.4%	-10.6%	3.8%
Return on Equity	9.3%	9.7%	10.7%	10.8%	10.5%	10.7%	12.3%	10.7%	-32.9%	11.7%
ROIC	5.6%	5.5%	5.9%	5.5%	5.4%	5.2%	5.3%	4.5%	-13.5%	4.8%
Shares Out.	7.1	7.1	7.2	7.2	8.0	8.1	8.2	8.4	9.1	9.9
Revenue/Share	10.60	9.61	8.25	8.59	8.52	8.42	7.74	9.10	9.23	9.82
FCF/Share	(1.11)	0.42	(0.42)	(1.07)	(1.27)	(0.89)	(1.24)	(1.02)	-	(0.15)

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