

Energy & Utilities | Charlotte Cheng & Jared Kiepke

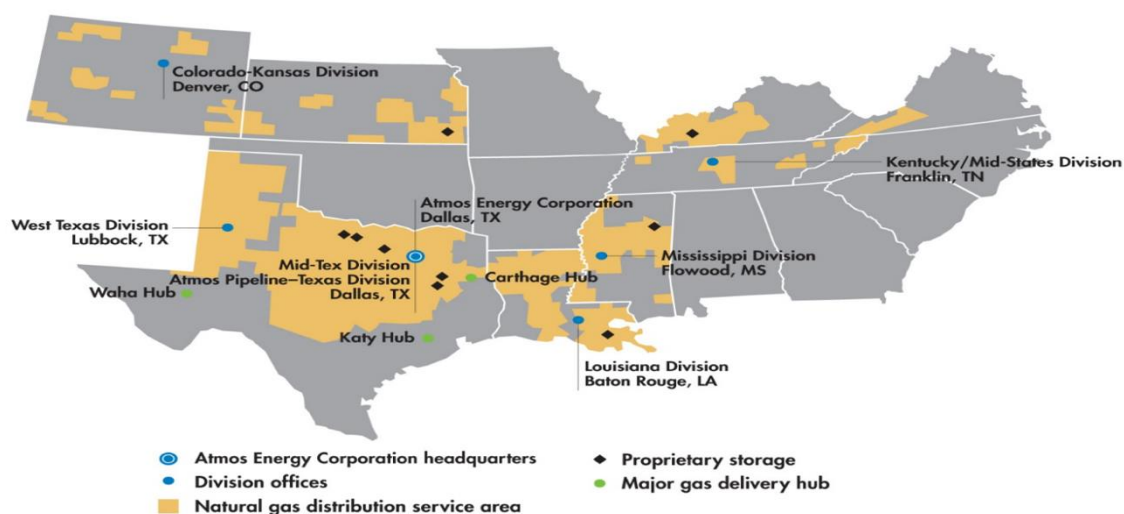
Senior Analysts: Kenzie Meyer, Jake Bresser, James Luessman



## Atmos Energy Corporation (ATO), \$106.31

### Introduction

ATMOS ENERGY CORPORATION – ATO – is the nation's largest fully regulated, natural gas-only distributor. Founded in 1983, they provide safe, clean, efficient and affordable energy. Atmos Energy Corporation has a vision to be the safest provider of natural gas services as they are modernizing their business and their infrastructure while continuing to invest in safety, innovation, environmental sustainability and the communities. The company is headquartered in Dallas and it serves more than 3 million distribution customers, in over 1,400 communities, across eight states. Atmos Energy Corporation also manages proprietary pipeline and storage assets, which also includes one of the largest intrastate natural gas pipeline systems in Texas.



### Recommendation

We recommend a **BUY** for Atmos Energy Corporation. It is a regulated utility distribution company with locational advantages and resistance. They have several assets located in eight states and they are currently serving more than 3 million customers. ATO has a strong financial performance and a successful investing strategy with 17 consecutive years of annual EPS growth and 36 consecutive years of annual dividend growth. The company has forecasted their earnings per share and dividend to be growing at 6% to 8% through fiscal 2023. They have projected annual capital expenditures of about \$10 to \$11 billion through fiscal 2024 with over 80% of the investments spent on safety and reliability. The current price is \$105.76, and our target range is \$112.53 to \$118.34.

## Investment Thesis

Atmos Energy has been consistently investing in modernizing their transmission and distribution system. Over the years, they invested heavily in the safety and technical training of their workforce to sustain their financial stability and successful growth of the company.

### Defensive Stock and Resistance

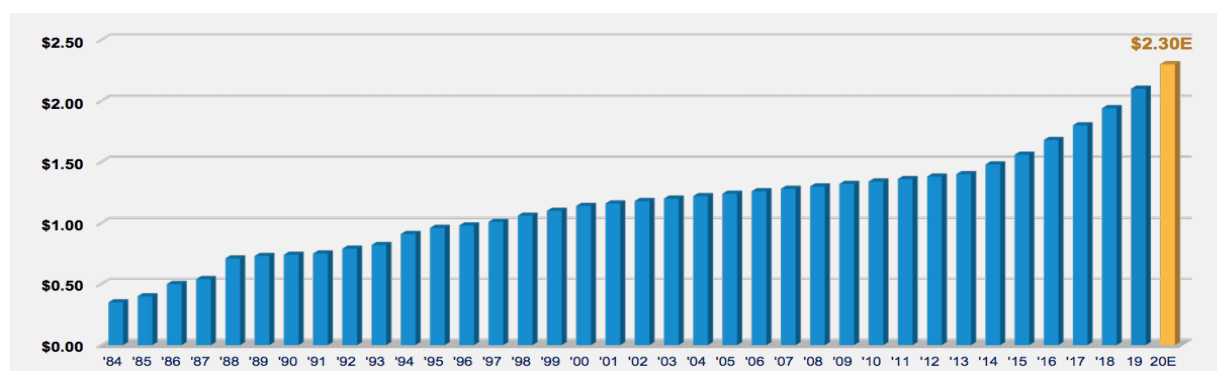
The economists and analysts forecasted that a recession is bound to happen anytime in the future given that the United States stock market has been in the longest bull market in history since the last recession in 2008. Therefore, we believe that by investing in ATO stock can help maintain expected returns and reduce the risk of portfolio through diversification. The beta of the company is at 0.16. The adjusted beta for the utilities industry in the United States is low at 0.5. Unlike cyclical stocks, ATO stock would not move more than the market as it is defensive. During the last recession, ATO stock was not affected by the market correction, instead the stock price rose steadily with continuous growth of solid earnings over the years.

### Diversified Local Distribution Company Platform

Atmos Energy Corporation has a diversified asset base with constructive regulation. This multi-state regulated natural gas delivery company is the largest natural gas local distribution company with over 3 million customers in 8 states. The company has favorably positioned intrastate pipeline in spans Texas shale gas supply basins to serve the growing Texas Consumer and Supply Markets. By being committed to being the safest provider of the natural gas in the United States, Atmos Energy Corporation invests approximately \$2 billion every year to modernize their pipeline infrastructure.

### Strong Financial Performance and Dividend Growth

ATO company has a diluted EPS of \$4.35 and manage to grow their EPS for the 17<sup>th</sup> consecutive year and recorded a performance return of 15.31%, since the start of 2019. The adjusted net income increased 15% YoY from \$444M to \$511M. Atmos Energy Corporation's current annualized dividend of \$2.30 has increased 18.6% YoY and over the last 5 years they have an average annual increase of 7.35%. The 36<sup>th</sup> consecutive year of rising dividends are attractive to the investors who want to yield steady and solid dividend payments in their portfolio.



### Capital Investments and Acquisitions

In the past, Atmos Energy Corporation has made successful acquisitions with natural gas companies such as Mississippi Valley Gas deal, Western Kentucky Gas Utility, Greeley Gas, TXU Gas etc. For instance, ATO has acquired TXU Gas Company to become the largest pure-play natural gas utility company in the United States. The acquisition of TXU Gas cost \$1.925 billion. Such acquisition fits within their business strategy of growth in their core business. Atmos Energy Corporation is acquiring a large, regulated customer base to deliver stable, long-term growth to its customers. The company has increased their asset base through investing in capital expenditures. In 2019, there is a 15% increase in the capital spending of ATO to \$1.7B with 87% allocated to safety and reliability spending.

### Clean Energy Future

ATO works with the cleanest fossil fuel in existence as natural gas is best for our environment and energy that is clean, affordable and reliable. Given that Natural gas is a type of energy that is more efficient while it also partners with renewables to provide dependable and clean energy for the people. Atmos Energy Corporation has reduced emissions by 13.7% while modernizing their infrastructure by replacing 3,500 miles of pipelines. The company is committed to reduce their systems' methane emission by 50% by 2035.

### Valuation

For our valuation of Atmos Energy Corporation, we used the EVA expresses projection model tool combined with a dividend discount model. To come up with a range of values, we combined a best, worst, and average case scenario on EVA express at different weights. To find the worst case, we weighted the worst scenario at 70% and 15% for both average and best case, which resulted in a price of \$99.87. To find our best-case scenario, we used 70% best case and 15% for both average and worst case, this gave us a target price of \$111.48.

We also found a target price using a dividend discount model (DDM), we used a WACC of 5% and a very conservative long-term growth rate of 3%, resulting in a target price of \$125.19. After combining the DDM and worst-case scenario, weighted at 50% each, we found the low end of our target range to be \$112.53, or a 6.4% upside. To find the top end of our target range we again took the DDM at 50% but combined it this time with the best-case scenario also weighted at 50%, resulting in a target of \$118.34 or an 11.9% upside.

### Risks

#### Rate Change Delay by State Regulations

Atmos Energy Corporation is a regulated utility company and thus their returns are constantly monitored and questioned for its reasonableness by the appropriate regulatory agencies or by other third-party intervenors. Given that a normal regulatory review process can be long in the

context of traditional ratemaking, the company will have regulatory lag, in which ATO can suffer negative financial effects by placing their assets in service without the benefit of rate relief.

#### Exposed to Market Risks

Market risks are beyond the control of a company such as the volatility of commodity prices caused by the market supply and demand dynamics, counterparty creditworthiness and interest rate risk. If there is an increase in interest rates in the market, it could adversely impact the company's future financial results to the point that the company have difficulties in recovering their actual interest expense for the company's rates.

#### Increase in Regulation of Safety Operations

The safety of the public and customers are the company's top priority. However, in recent years, natural gas distribution and pipeline companies have encountered increasing federal and state oversight of the safety of their operations. Therefore, the costs that might be incurred in complying with new laws and regulations of safety operations may negatively impact the operating costs of Atmos Energy Corporation in the short-term.

#### Management

Atmos Energy Corporation is a diverse company that recognizes the value of diversity in their leadership and workforce. The Management Committee monitors the company's operation and financial performance while developing their strategy to drive long-term growth performance.

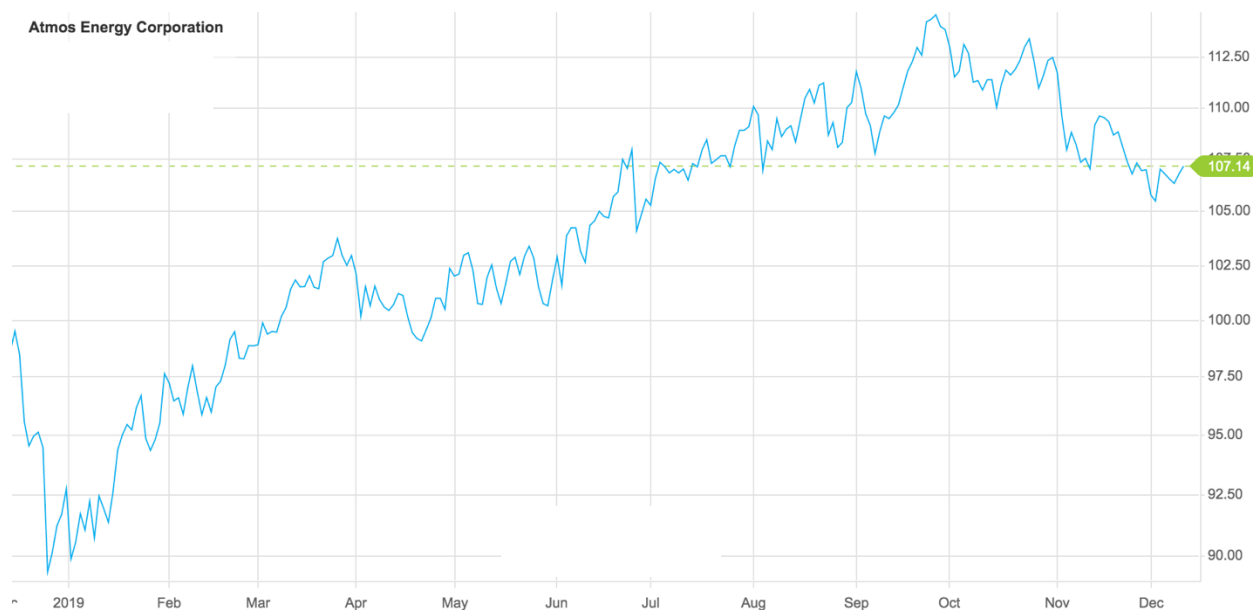
1. CEO - Kevin Akers

Kevin Akers has been the CEO and president of Atmos Energy Corporation since October 2019. Prior to his role, he served as the Executive Vice President from November 2018 to October 2019 and he also served as Senior Vice President from January 2017 through October 2018. He has been working in ATO company since 1997 and held various roles throughout the years before he was the CEO of the company. Kevin's 29 years at Atmos Energy has proven him to have successful leadership ability and deep industry experience to continue ATO safety-driven investment strategy.

2. VP & CFO - Christopher T. Forsythe

Chris Forsythe was named Senior Vice President and Chief Financial Officer in February 2017. He has extensive regulatory experience in the utility sector as he joined the company in June 2003 and is a graduate of Baylor University.

## Stock Chart



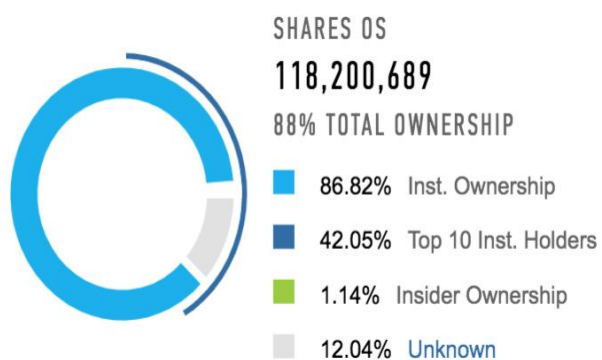
ATO company's stock price is at \$107.14. Atmos Energy Corporation stock is expected to continue growing based on some of the key factors stated in this report.

## Peer Analysis

Company Name	Price	Mkt Cap (M)	PE (NTM)	PEG (NTM)	Adj EPS YoY (%)	Sales (M)
Atmos Energy Corporation	\$106.96	\$12,765	22.7	3.2	8.7	\$2,902
CenterPoint Energy, Inc.	\$24.56	\$12,335	14.7	3.9	4.1	\$10,486
ONEOK, Inc.	\$71.05	\$29,350	18.8	1.7	15.9	\$12,623
Xcel Energy	\$61.49	\$32,245	22.2	4.1	1.4	\$11,523
Entergy Corporation	\$116.39	\$23,174	20.8	9.6	-6.0	\$11,069

## Ownership Summary

*Excellence. Our Measure. Our Motto. Our Goal.*



Holder	%OS	Mkt Val (M)
The Vanguard Group, Inc.	12.16	\$1,538
SSgA Funds Management, Inc.	7.09	\$897
BlackRock Fund Advisors	6.24	\$789
T. Rowe Price Associates, Inc. (Investment Management)	5.11	\$647
Magellan Asset Management Ltd.	3.01	\$381