

Kodiak Gas Services, Inc.

Compression undersupply remains, '24 guide tracks pre-CSI expectations

Reiterate Rating: BUY | PO: 29.00 USD | Price: 25.13 USD

PM Summary: 4Q in-line; '24 guide hits pre-acq. midpoint

After the market close (3/6), KGS reported adjusted EBITDA of \$114mm, in-line with cons but below BofA expectations of \$118mm. The stock u/p midstream (AMNA) the following trading day by ~6% due to investor confusion around cons EBITDA of \$514mm that included some analysts', including BofA's, CSI contribution. KGS provided initial '24 guidance for EBITDA of \$460-\$490mm (midpoint: \$475mm) vs. pre-CSI acquisition announcement (12/19) cons/BofA estimates of \$473mm/\$472mm, so essentially in-line. The company guided '24 discretionary cash flow higher in the range of \$295-\$310mm, earmarked for continued investment in its fleet & return of capital to shareholders. In 4Q, KGS initiated its dividend at \$0.38/sh. (\$1.52 annualized). '24 capex guidance was \$205-\$235mm (\$220mm midpoint) vs. cons of \$232mm prior to the CSI announcement, including \$165-\$185mm for growth & \$40-\$50mm for maintenance. KGS expects to grow fleet HP in the LSD-MSD range in '24. We update our '24/'25/'26E EBITDA estimates to \$536mm/\$655mm/\$676mm to reflect guidance. We reiterate our Buy rating and \$29 PO.

Strong service pricing, but supply chain issues easing

The availability of engines needed to drive power generation has been a growing concern with expanding data center presence for cloud computing and generative AI. So, CAT announced that it would be making a multi-year capital investment in its large engine division which would increase capacity for new engines and aftermarket parts, helping to meet increasing power demand but also supporting oil and gas. However, more engines could mean lower service pricing for KGS. On the positive side, customers have indicated that they plan to invest in compression to grow their businesses. TRGP, a KGS customer, noted that it could spend up to \$700mm (41% of growth capex) annually on gathering, compression and treating to keep pace with Permian production growth.

Dividend on middle ground among peers at 6% yield

KGS paid its first dividend of \$0.38/sh. in 4Q (\$1.52 annualized), and now yields ~6% which is the median yield for our midstream coverage. Management plans to allocate 35-40% of its discretionary cash flow towards its dividend. The balance of its cash flow will be directed towards growth capex to scale its Permian operation as discretionary cash flow increases with CSI post-deal synergies. Remaining cash flow will be used to return capital to shareholders and de-lever, bringing KGS closer to achieving its leverage target range of 3.0x-3.5x by '25 (currently ~4.0x).

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	1.42	0.26	2.02	2.17	2.50
EPS Change (YoY)	-41.1%	-81.7%	676.9%	7.4%	15.2%
Consensus EPS (Bloomberg)			1.53	1.83	2.02
DPS	11.17	0.93	1.42	1.52	1.52
Valuation (Dec)					
P/E	17.7x	96.7x	12.4x	11.6x	10.1x
Dividend Yield	44.5%	3.7%	5.6%	6.0%	6.0%
EV / EBITDA*	11.1x	10.1x	8.3x	6.8x	6.6x
Free Cash Flow Yield*	-1.6%	2.4%	9.2%	9.9%	10.8%

* For full definitions of *IQmethod*SM measures, see page 5.

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08 March 2024

Equity

Key Changes

(US\$)	Previous	Current
2024E EPS	2.14	2.02
2025E EPS	2.24	2.17
2026E EPS	NA	2.50
2024E EBITDA (m)	547.5	535.9
2025E EBITDA (m)	661.3	654.8
2026E EBITDA (m)	NA	676.0

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Stock Data

Price	25.13 USD
Price Objective	29.00 USD
Date Established	24-Jul-2023
Investment Opinion	C-1-7
52-Week Range	15.05 USD - 29.00 USD
Mrkt Val / Units Out (mn)	1,945 USD / 77.4
Free Float	23.3%
Average Daily Value	7.85 USD
BofA Ticker / Exchange	KGS / NYS
Bloomberg / Reuters	KGS US / KGS.N
DPU Growth	17.9%
Net Dbt to Eqty (Dec-2023A)	159.9%

KGS/AMNA: Kodiak Gas Services Inc / Alerian Midstream Energy Index

CSI: CSI Compressco LP

HP/ u/p/ cons: Horsepower / underperformed / consensus

CAT/TRGP: Caterpillar Inc. /Targa Resources Corp

LSD/MSD: Low single digit / mid single digit

iQprofileSM Kodiak Gas Services, Inc.

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	5.8%	4.6%	7.9%	7.8%	8.4%
Return on Equity	17.9%	2.9%	14.0%	13.1%	14.3%
Operating Margin	31.2%	28.6%	31.7%	27.6%	28.6%
Free Cash Flow	(32)	47	179	194	209

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	2.1x	13.3x	2.4x	2.6x	2.3x
Asset Replacement Ratio	1.4x	1.2x	1.5x	1.3x	1.3x
Tax Rate	23.7%	42.9%	21.0%	21.0%	21.0%
Net Debt-to-Equity Ratio	NM	159.9%	166.0%	154.0%	141.0%
Interest Cover	1.3x	1.2x	2.9x	2.7x	2.9x

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	708	850	1,099	1,432	1,498
% Change	16.7%	20.1%	29.2%	30.3%	4.6%
Gross Profit	441	500	602	745	788
% Change	11.2%	13.4%	20.6%	23.7%	5.8%
EBITDA	399	438	536	655	676
% Change	10.5%	9.8%	22.3%	22.2%	3.2%
Net Interest & Other Income	(83)	(209)	(119)	(149)	(145)
Net Income (Adjusted)	106	20	181	194	224
% Change	-41.3%	-81.1%	801.6%	7.5%	15.0%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	106	20	181	194	224
Depreciation & Amortization	174	183	177	243	248
Change in Working Capital	(18)	(22)	23	5	(2)
Deferred Taxation Charge	27	8	34	39	45
Other Adjustments, Net	(70)	78	22	23	6
Capital Expenditure	(251)	(220)	(258)	(311)	(311)
Free Cash Flow	-32	47	179	194	209
% Change	NM	NM	283.7%	8.4%	8.2%
Share / Issue Repurchase	NA	NA	NA	NA	NA
Cost of Dividends Paid	(838)	(72)	(127)	(136)	(136)
Change in Debt	861	(257)	567	(58)	(73)

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	20	6	5	5	5
Trade Receivables	98	113	183	196	205
Other Current Assets	86	112	177	192	199
Property, Plant & Equipment	NA	NA	NA	NA	NA
Other Non-Current Assets	3,002	3,013	3,948	4,015	4,078
Total Assets	3,206	3,244	4,313	4,408	4,487
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	189	211	368	401	414
Long-Term Debt	2,754	1,833	2,399	2,342	2,268
Other Non-Current Liabilities	33	58	103	148	199
Total Liabilities	2,976	2,101	2,871	2,890	2,882
Total Equity	229	1,143	1,442	1,517	1,605
Total Equity & Liabilities	3,206	3,244	4,313	4,408	4,487

* For full definitions of iQmethodSM measures, see page 5.

Company Sector

Natural Gas-Pipelines

Company Description

KGS was formed in June 2011 as a pure-play natural gas compression services company with a differentiated model characterized by high attention to customer service and technical expertise. KGS focuses on the large horsepower compression segment of the market, which is growing fast in low-pressure, unconventional reservoirs such as those found in the Permian.

Investment Rationale

Our Buy rating reflects KGS's growing, premium-priced model in the Permian backed by its stable take-or-pay compression business. We believe that KGS's high mechanical availability and operational reliability create customer stickiness.

Stock Data

Average Daily Volume

331,613

Quarterly Earnings Estimates

	2023	2024
Q1	-0.16A	0.41E
Q2	0.23A	0.45E
Q3	0.28A	0.61E
Q4	-0.09A	0.67E



Price objective basis & risk

Kodiak Gas Services, Inc. (KGS)

Our PO of \$29 is derived from a multiples-based approach to valuation which uses a 7.5x 2025E EV/EBITDA multiple based on peer group comparables.

Upside risks to our price objective are 1) higher commodity prices, 2) increased rich gas production in the Permian, 3) growth in LNG export markets along the Gulf Coast.

Downside risks to our price objective are 1) US economic weakness and/or commodity prices, 2) slower Permian production growth, 3) customer concentration/shift to in-sourcing compression.

Analyst Certification

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US - Pipelines and MLPs Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Energy Transfer LP	ET	ET US	Neel Mitra, CFA
	Enterprise Products Partners, L.P.	EPD	EPD US	Neel Mitra, CFA
	Kinetik Holdings Inc.	KNTK	KNTK US	Neel Mitra, CFA
	Kodiak Gas Services, Inc.	KGS	KGS US	Neel Mitra, CFA
	ONEOK Inc	OKE	OKE US	Neel Mitra, CFA
	Targa Resources Corp.	TRGP	TRGP US	Neel Mitra, CFA
	The Williams Companies, Inc.	WMB	WMB US	Neel Mitra, CFA
NEUTRAL				
	Kinder Morgan Inc	KMI	KMI US	Neel Mitra, CFA
	Plains All American Pipeline, L.P.	PAA	PAA US	Neel Mitra, CFA
	Plains GP Holdings, L.P.	PAGP	PAGP US	Neel Mitra, CFA
UNDERPERFORM				
	Equitrans Midstream Corporation	ETRN	ETRN US	Neel Mitra, CFA
	MPLX LP	MPLX	MPLX US	Neel Mitra, CFA
	Western Midstream Partners, LP	WES	WES US	Neel Mitra, CFA
RVW				
	Golar LNG Limited	GLNG	GLNG US	Neel Mitra, CFA

iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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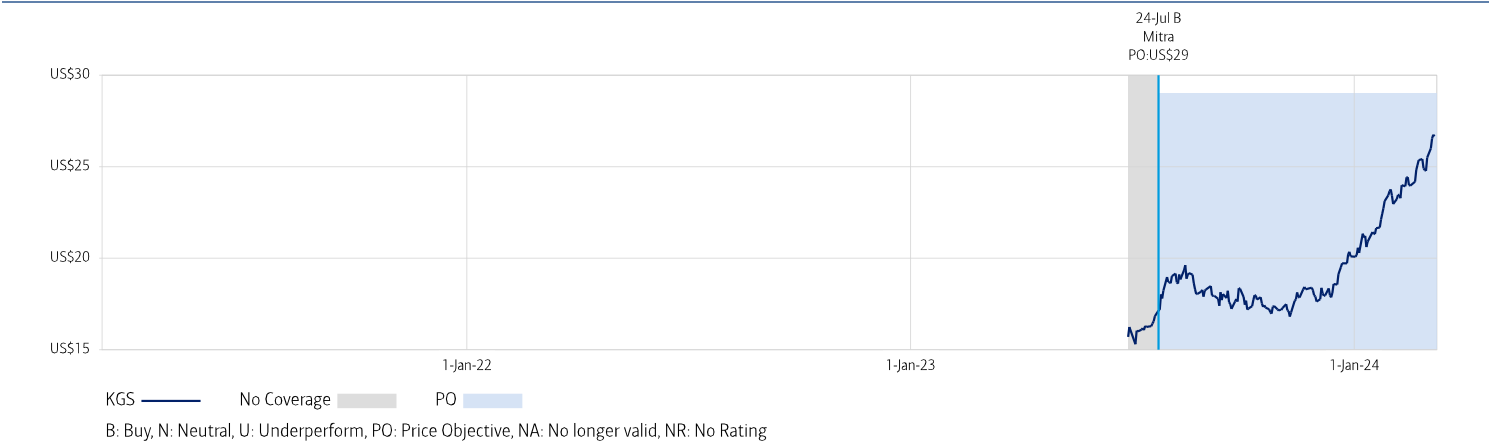
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Kodiak Gas Services (KGS) Price Chart



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Equity Investment Rating Distribution: Energy Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	83	61.48%	Buy	64	77.11%
Hold	28	20.74%	Hold	21	75.00%
Sell	24	17.78%	Sell	18	75.00%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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