National Fuel Gas – Downstream (Utility) Business: Comprehensive Analysis & Valuation

Team Members:
Ganesh Goyal
Ekath Patel
Prabhatkumar Mishra
Nitisha Mehta
Viraj Thakkar

1. Overview of the Utility Segment

National Fuel Gas Company's downstream operations are managed through its subsidiary, **National Fuel Gas Distribution Corporation**, which provides **regulated natural gas distribution services** to approximately **750,000 customers** across **Western New York and Northwestern Pennsylvania**. This segment services a mix of residential, commercial, and industrial customers, with a particularly strong presence in the Buffalo region.

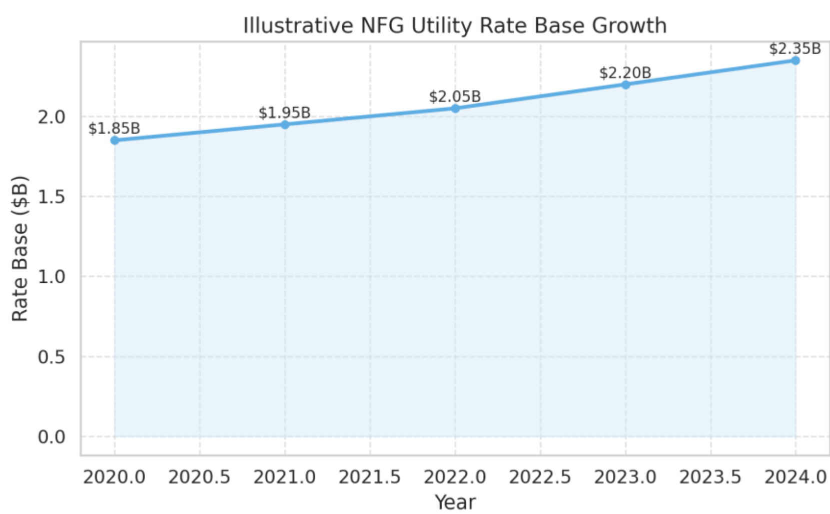
The business operates in a **highly regulated environment**, governed by state-level regulatory agencies—namely the **New York Public Service Commission (PSC)** and **Pennsylvania Public Utility Commission (PUC)**. These commissions establish rates using a **cost-of-service model**, which allows the utility to:

- Recover operational and capital costs,
- Earn a regulated return on equity (ROE),
- Provide transparency and predictability in cash flows.

This model shields the business from commodity price volatility, making it a **stable, cash-generative operation**—essential in offsetting the cyclicality of NFG's upstream (E&P) business.

Illustrative Rate Base Growth

This chart shows hypothetical rate base growth for NFG's utility business from 2020 to 2024, highlighting steady capital investment and regulatory support.

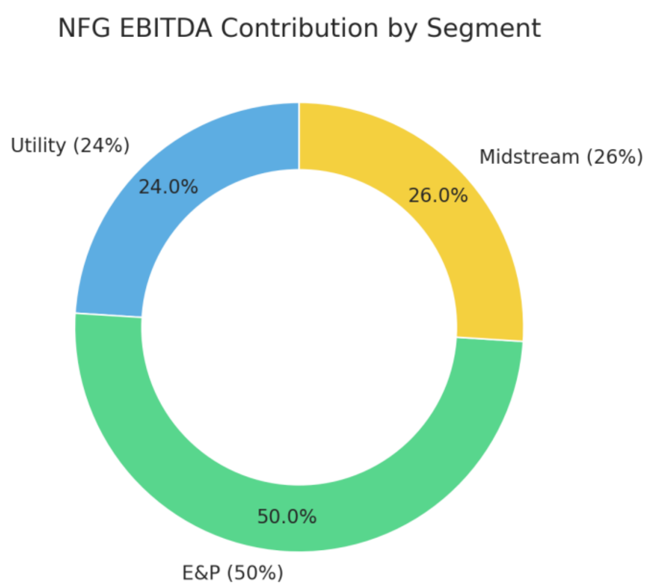


2. Strategic Role in NFG's Portfolio

Despite being smaller in revenue contribution compared to NFG's E&P and Midstream segments, the **utility business is a financial anchor**. It contributes **roughly 20–25% of NFG's total EBITDA** and plays a vital role in:

- **Maintaining a strong credit profile** due to its consistent cash flow,
- Supporting NFG's **dividend policy**,
- Providing a platform for **rate base expansion** through capital investments.

NFG regularly invests in upgrading infrastructure (e.g., leak-prone pipe replacement, modernization of metering systems), which directly increases its **regulated rate base**. This, in turn, grows allowed earnings under the cost-of-service model. The utility segment also benefits from **geographic proximity** to NFG's upstream assets, reducing transportation costs and improving system efficiency.



◆ 3. Regulatory Framework & Rate Base Growth

The utility's success is closely linked to its ability to expand its **rate base**, which represents the value of assets on which the company is permitted to earn a return. Through consistent capital expenditure programs focused on safety, modernization, and system reliability, NFG's utility segment positions itself for:

- **Stable earnings growth** over time,
- Enhanced **customer reliability metrics**,
- **Favorable rate adjustments** during rate cases.

Rate base growth is particularly important in the context of increasing regulatory pressure for system modernization and decarbonization. Utilities that consistently invest in infrastructure tend to receive **regulatory support** in the form of timely cost recovery and allowed ROEs ranging from **8.5% to 9.5%**.

🔷 4. ESG Considerations & Industry Outlook

Natural gas utilities, including NFG, are under **increasing ESG scrutiny**, particularly in states with aggressive climate agendas. In response, companies are:

- Exploring **Renewable Natural Gas (RNG)**,
- Testing **hydrogen blending** in pipelines,
- Upgrading leak detection and prevention systems,
- Participating in **low-income energy efficiency programs**.

NFG's operations are located in **cold-weather regions** where natural gas remains essential for heating. This provides a **longer transition runway** compared to utilities in warmer, more electrification-focused states. As decarbonization accelerates, NFG's downstream business will likely evolve toward hybrid solutions combining conventional gas with cleaner alternatives.

🔷 5. Comparable Companies for Valuation

To value NFG's downstream segment, we consider two public gas utilities with similar business models, customer base size, and regulatory environments:

Atmos Energy (NYSE: ATO)

- One of the largest gas-only utilities in the U.S.
- Serves over **3 million customers** across **8 states**.
- Known for its **premium valuation**, low-risk profile, and strong capital investment track record.
- 100% regulated business model, with consistent rate base growth.

Spire Inc. (NYSE: SR)

- A mid-sized utility serving **~1.7 million customers** across Missouri, Alabama, and Mississippi.
- Similar to NFG in its combination of regulated utility and midstream operations.
- Strong ROE and customer reliability ratings, though smaller scale than Atmos.

🔹 6. Valuation Methodologies

To determine a defensible valuation for NFG's utility segment, we triangulate using multiple standard valuation approaches:

◼ EV/EBITDA Valuation

Company	EV/EBITDA (fwd)
Atmos Energy	~13.5x
Spire Inc.	~11.0x
Average	**12.25x**

NFG Utility EBITDA Estimate: ~$240 million

→ Valuation = 12.25 × 240M = $2.94 billion

◼ P/E Ratio Valuation

Utility stocks typically trade at forward **P/E multiples of 16–20x**.
Assuming net income for NFG's utility segment is ~$150 million:

→ Valuation = 17 × $150M = $2.55 billion

◼ Price-to-Book (P/B) Ratio

The book value of the utility segment is estimated at ~$2.0 billion.
Using peer P/B ratios of **1.2–1.6x**:

→ Valuation Range = $2.4B – $3.2B

◼ Dividend Discount Model (DDM)

Using:

- Dividends/cash flow = $150M
- Cost of equity = 7%
- Growth rate = 4%
-

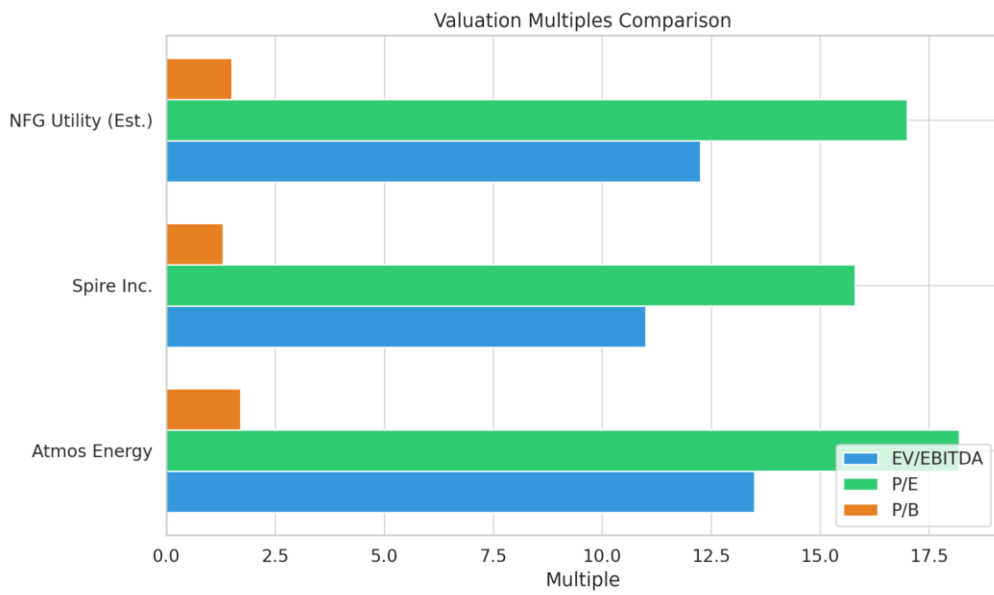
→ DDM Valuation = $150M / (0.07 - 0.04) = $5.0 billion

(Note: Includes long-term assumptions and may be optimistic.)

◆ 7. Peer Comparison Summary

Company	EV/EBITDA	P/E	P/B	Customers	ROE
Atmos Energy	13.5x	18.2x	1.7x	~3 million	9.4%
Spire Inc.	11.0x	15.8x	1.3x	~1.7 million	8.7%
NFG Utility*	12.25x	17.0x	1.5x	~750,000	9.0%

**Estimated figures for NFG's utility segment.*



◆ 8. Conclusion: Robust Valuation Across Scenarios

NFG’s downstream utility segment is a **strategically vital and financially stable** portion of its business model. It offers low-risk, recurring cash flows, strong regulatory support, and growth via long-term capital programs. The segment also plays a growing role in environmental strategy as ESG considerations reshape the industry.

Valuation triangulation across EV/EBITDA, P/E, P/B, and DDM suggests a range of $2.5B–$3.2B, with the primary estimate centered around **$2.94 billion**.