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Gas and Electric Utilities

December 7, 2018

UGI Corporation (UGI) - BUY

UGI: Business Model Ready for the Next Stage of Growth; Maintaining BUY Rating, Raising F.V. to $66

Price:	$58.56
Fair Value Estimate:	$66.00
52-Week Range:	$42.51 - $58.60
Market Cap (MM):	10,178
Shr.O/S-Diluted (mm):	173.8
Average Daily Volume:	881,406
Dividend:	$1.04
Yield:	1.8%

FYE: Sept	2018A	2019E	2020E
EPS:	$2.74A	$2.94E	$3.15E
Prior EPS:		NC	NC
P/E Ratio:	21.4x	19.9x	18.6x

Quarterly EPS:			
Q1	$1.01A	$1.26E	$1.24E
Q2	$1.69A	$1.63E	$1.73E
Q3	$0.09A	$0.14E	$0.30E
Q4	$(0.04)A	$(0.08)E	$(0.11)E

EPS: Adjusted

1 Year Price History for UGI

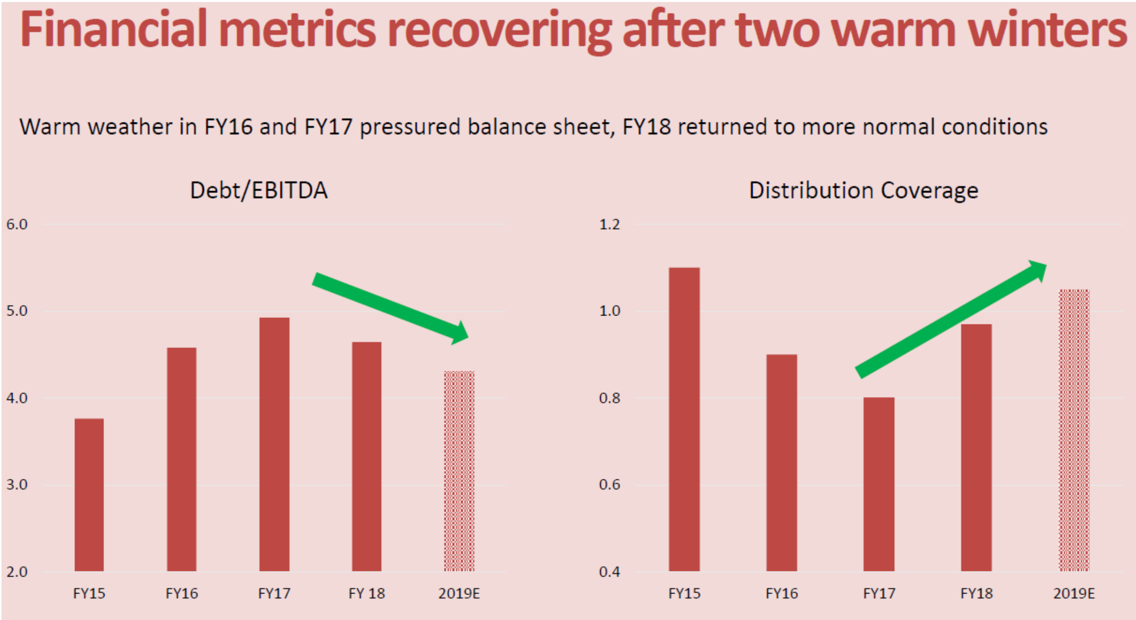
PORTFOLIO MANAGER BRIEF

UGI's investor day presentation framed the company's past performance as exemplary and its future outlook as exceptionally strong in terms of earnings growth and cash flow generation. Perhaps the most substantial key takeaway was the continuing focus on the AmeriGas operations, where unit prices have suffered due to below normal weather for the past few years. Normalizing weather, in-house reviews surrounding the IDR structure and a backstop (Standby Equity Commitment Agreement) should allow for improvement in unit performance on a go-forward basis. We've made no adjustments to our forward estimates, maintain our BUY rating but raise our Fair Value on UGI shares from $60 to $66.

ANALYST NOTES

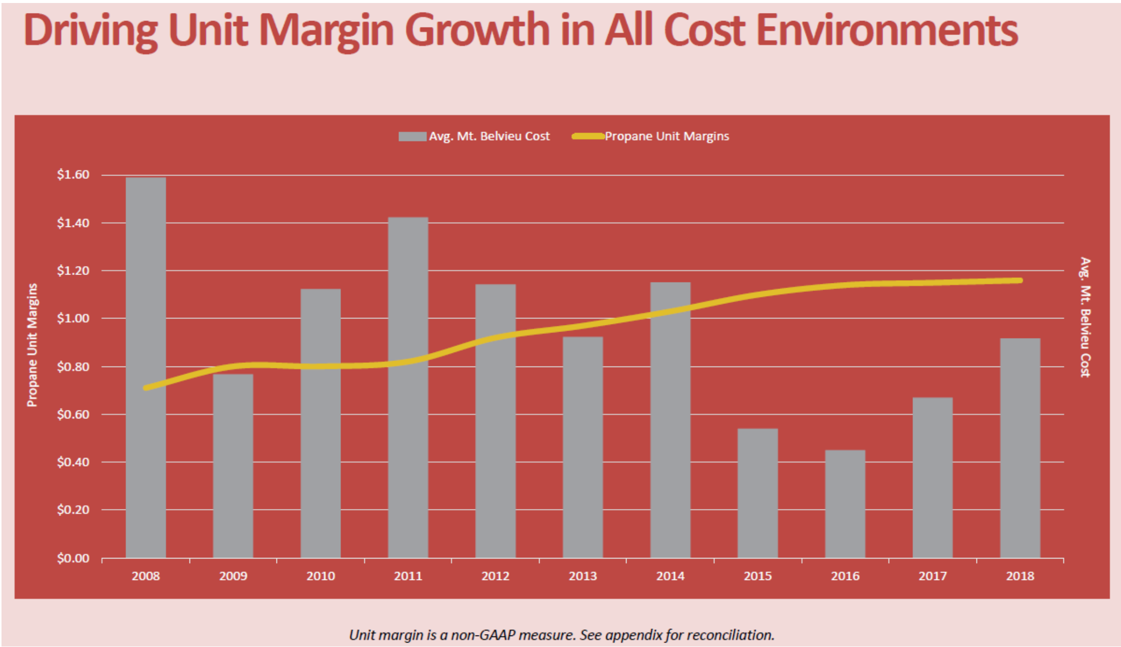
- AmeriGas - Substantial Focus on Improvement Across Key Metrics. It's certainly been a tough two years for AmeriGas from an adjusted EBITDA perspective, as unfavorable weather patterns below historic norms have led to downward guidance revisions, a weakened unit price and concerns surrounding distribution coverage. APU CEO Hugh Gallagher addressed these issues at length during the AmeriGas part of the presentation, highlighting that the internal review underway between UGI & APU is looking to strengthen the balance sheet further, and a variety of items are on the table, including a review of the IDR structure. To be clear, balance sheet strengthening actions have already been taken; over the last two years, $981MM of senior notes has been refinanced to lower interest rates (>100 bps) and lengthen maturities, while OPEX reduction initiatives continue to reduce costs and improve margins. Looking forward, the company has no debt maturities due until 2024, and during the review process, the SECA (Standby Equity Commitment Agreement) between UGI and APU will remain in place as a backstop in the event APU needs additional liquidity. We note that while its still early in the FY19 heating season, temperatures have been unseasonably low in several markets, which bodes well for achieving EBITDA guidance and coverage of the distribution if current trends carry into FY2Q19. Exhibit #1 highlights the impacts (and improvements) across APU's business model; Exhibit #2 shows the company's ability to maintain propane unit margins despite volatile pricing across the last several years.

Exhibit #1



Source: UGI

Exhibit #2



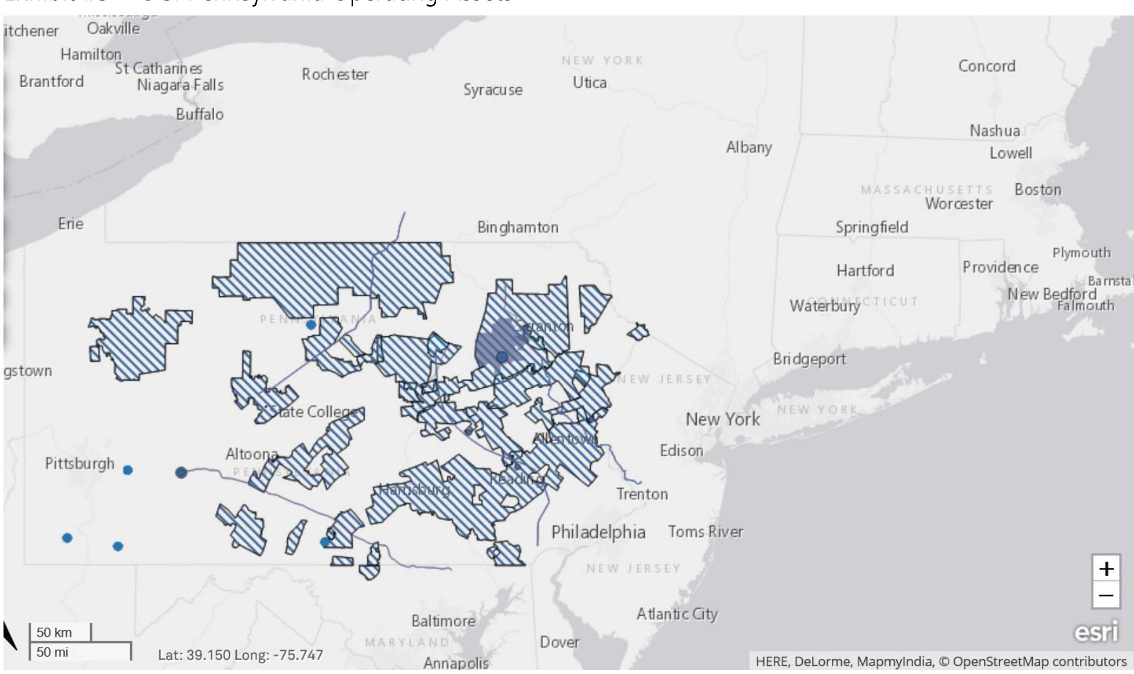
Source: UGI

Strategic Realignment Setting the Framework for Future Earnings Growth. UGI has added a new title (and responsibilities) to UGI Utilities CEO & President Robert Beard – Executive Vice President of Natural Gas. It also did the same to UGI International CEO Roger Perrault – he is now Executive Vice President of Global LPG. Given the growth opportunities across both platforms and UGI's current market capitalization, bringing the decision-making processes across both of those businesses to a single head should help streamline operational and investment decisions. In the NG operations, the synergies between the utilities and midstream make for a natural fit, and in the LPG operations, the ever-expanding nature of the services offered across multiple business units should benefit from a holistic approach to maximizing opportunities.

In natural gas, Mr. Beard is likely to have a full plate for many years to come. Beyond continuing to develop the PENNEAST pipeline project, UGI is looking at additional midstream opportunities to get NG to where it's needed. UGI's premier positioning sitting atop the Marcellus Shale and pre-existing success in midstream are significant advantages in these endeavors. And nowhere is NG needed more than in the Northeast; earlier this week, U.S. Department of Energy Secretary Rick Perry highlighted the absurdity of utilizing Russian LNG during the last winter heating season in the Northeast when domestic supplies were but a few hundred miles away. The challenge of course is getting any new infrastructure built north (or east) of Pennsylvania's borders; we don't see that situation changing near term given the political climates in many Northeast U.S. states. Providing lower-priced NG from PENNEAST to New Jersey-based gas utilities could free up supply and allow additional NG flows on pre-existing infrastructure to move into the Northeast, but that premise is dependent upon whether or not that supply would be utilized by others in the Mid-Atlantic region. It happens rather frequently; we note another energy company in the region, **Chesapeake Utilities (CPK, $87.77, BUY)**, ups the capacity on its Eastern Shore Natural Gas pipeline frequently given capacity gets soaked up every time it becomes available, and that's for the Mid-Atlantic region, which doesn't have nearly the demands of the Northeast.

One opportunity that may exist for UGI would be to build peak-shaving assets in the New England, or perhaps find alternate methods of getting LNG into the region. Other areas that look attractive include potential NG flows from west-to-east across Pennsylvania; that could unlock supplies not just in western PA, but also from Ohio. If we look at the UGI Pennsylvania map (Exhibit #3), we can see the company covers much of the state, with the exception of the Pittsburgh area. If we think about **Aqua America's (WTR, $35.02 BUY)** upcoming purchase of Peoples Gas (which does cover the Pittsburgh area and encompasses 250 miles of intrastate pipeline), it could provide an opportunity for the 2 companies to work together to increase midstream coverage across the state and beyond its borders. We note that UGI's Valley Forge, PA headquarters and Aqua America's Bryn Mawr, PA headquarters are 8.6 miles apart; we suspect they know one another fairly well.

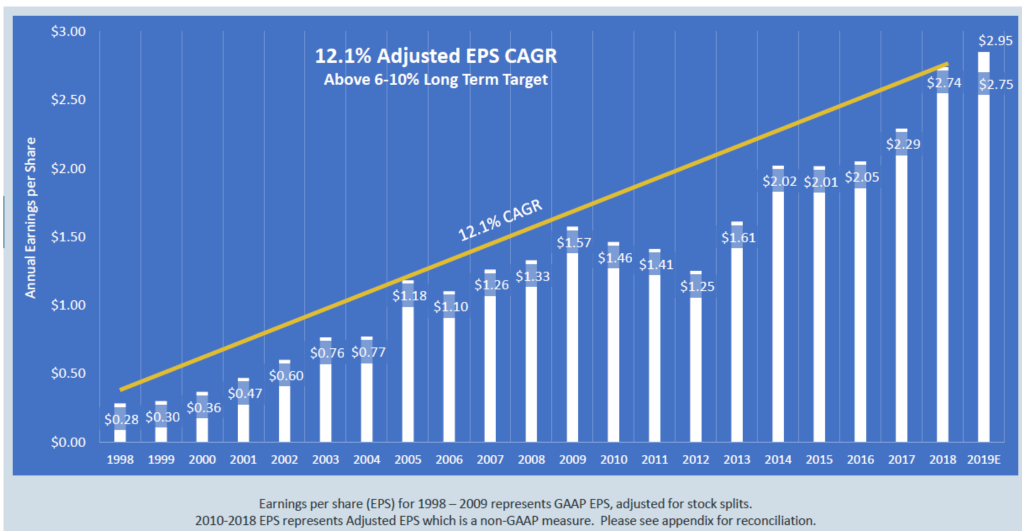
Exhibit #3 – UGI Pennsylvania Operating Assets



Source: SNL

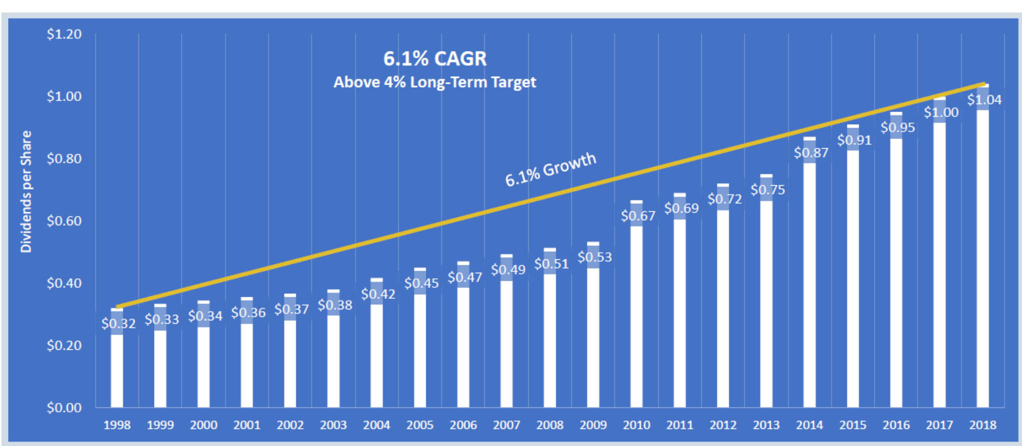
Summary/Valuation: As we look to boil down the tenor and tone of UGI's Investor Day and Presentation (the presentation deck was a massive 129 slides), our key takeaways are 1) AmeriGas is a top priority, and the issues surrounding two warm winters and distribution coverage will be addressed and remedied in short order; 2) the strategic direction going forward has been simplified into two basic core operations (NG and LPG) with two very experienced CEO's at the helm of both to unlock as much earnings potential as possible, and 3) UGI's historical performance is impressive and the trend is likely to continue. As we look first at AmeriGas, unit performance has been abysmal, and in our view not reflective of UGI's commitment to the business or the underlying improvements to its operations and outlook. We believe AmeriGas units represent a substantial investment opportunity, and with a current yield of approximately 11.25%, investors are being generously compensated for holding, especially with UGI backstopping the business through the aforementioned SECA. Turning next to the streamlined focus (NG and LPG), investors should substantially benefit from that holistic approach to the two key business lines. Then finally looking at UGI's historical performance, we note that its earnings CAGR of 12.1% and dividend growth of 6.1% have both exceeded long-term guidance ranges of 6-10% and 4%, respectively, which we display in Exhibits #4 and #5.

Exhibit #4



Source: UGI

Exhibit #5



Source: UGI

Beyond the outperformance in earnings and dividends, UGI (unlike other energy companies with large regulated utility profiles) is largely self-funding; its Free Cash Flow generating ability ($2.7B over the last 5 years) aided by its non-regulated operations allows it to essentially self-fund its growth initiatives. As we look across the major business lines, they're all growing, and the outlook points to those trends continuing for many years. Additionally, the earnings profile is less weather sensitive, and currency and commodity exposure have been dampened. It's a unique business model, worthy of a higher utility multiple for the reasons outlined previously, and we've increased our P/E multiple assumption (on 2020 EPS of $3.15) on UGI shares from 19x to 21x, and raised our Fair Value from $60 to $66.

As for AmeriGas, we consider them an extraordinary value at current price levels given the 11.25% yield. The units trade as if a distribution cut is imminent; based on the metrics outlined in Exhibits #1 & #2, the ongoing review in terms of IDR's, the SECA agreement, the cost reductions from operational improvements, recent refinancings to lower interest expense and maturities, no debt refinancings needed until 2024 and continued ability to make tuck-in acquisitions to add volume to its stable propane unit margin profile, the distribution appears sustainable. So while we're not changing estimates, ratings or our Fair Value target, we are reiterating our BUY rating on APU units, particularly given the 11.25% yield.

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AmeriGas Partners, L.P. currently is, or during the past 12 months was, a Janney Montgomery Scott LLC client. Janney Montgomery Scott LLC, provided investment banking related services.

Janney Montgomery Scott LLC currently acts as a market-maker in the securities of Aqua America, Inc..

Janney Montgomery Scott LLC intends to seek or expects to receive compensation for investment banking services from UGI Corporation, AmeriGas Partners, L.P., Chesapeake Utilities Corporation and Aqua America, Inc. in the next three months.

The research analyst is compensated based on, in part, Janney Montgomery Scott's profitability, which includes its investment banking revenues.

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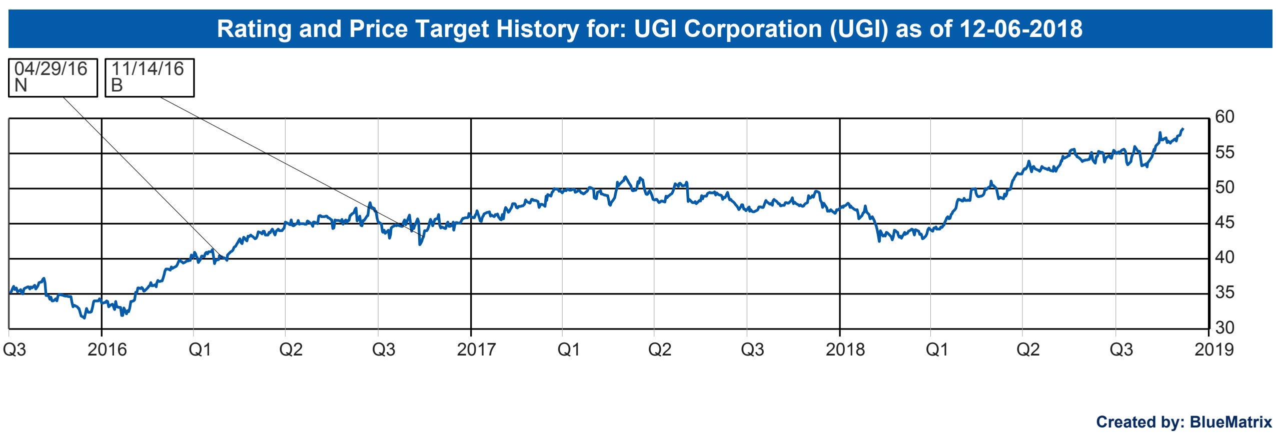
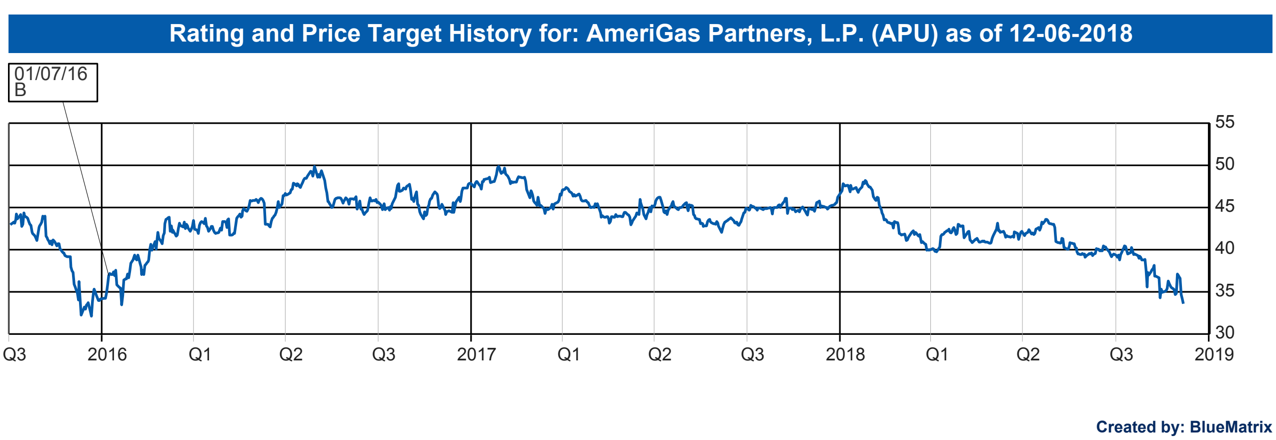
BUY: Janney expects that the subject company will appreciate in value. Additionally, we expect that the subject company will outperform comparable companies within its sector.

NEUTRAL: Janney believes that the subject company is fairly valued and will perform in line with comparable companies within its sector. Investors may add to current positions on short-term weakness and sell on strength as the valuations or fundamentals become more or less attractive.

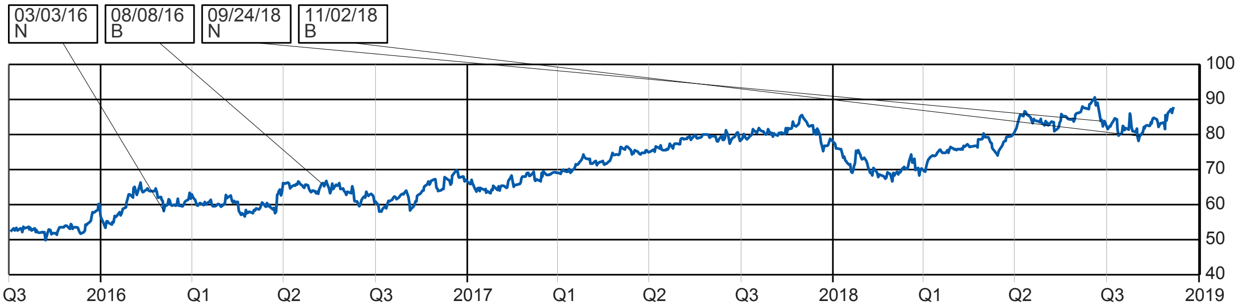
SELL: Janney expects that the subject company will likely decline in value and will underperform comparable companies within its sector.

Price Charts





Rating and Price Target History for: Chesapeake Utilities Corporation (CPK) as of 12-06-2018



Created by: BlueMatrix

Rating and Price Target History for: Aqua America, Inc. (WTR) as of 12-06-2018

Created by: BlueMatrix

Janney Montgomery Scott Ratings Distribution as of 09/30/2018

Rating	Count	Percent	IB Serv./Past 12 Mos.* Count	Percent
BUY [B]	124	49.60	26	20.97
NEUTRAL [N]	124	49.60	23	18.55
SELL [S]	2	0.80	0	0.00

*Percentages of each rating category where Janney has performed Investment Banking services over the past 12 months.

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