



# ONEOK Inc. (OKE)

Updated August 7<sup>th</sup>, 2020 by Jonathan Weber

## Key Metrics

|                             |       |  |       |                                  |          |
|-----------------------------|-------|--|-------|----------------------------------|----------|
| <b>Current Price:</b>       | \$29  | <b>5 Year CAGR Estimate:</b>               | 19.0% | <b>Market Cap:</b>               | \$13B    |
| <b>Fair Value Price:</b>    | \$43  | <b>5 Year Growth Estimate:</b>             | 3.0%  | <b>Ex-Dividend Date:</b>         | 10/26/20 |
| <b>% Fair Value:</b>        | 67%   | <b>5 Year Valuation Multiple Estimate:</b> | 8.2%  | <b>Dividend Payment Date:</b>    | 11/15/20 |
| <b>Dividend Yield:</b>      | 12.9% | <b>5 Year Price Target</b>                 | \$50  | <b>Years Of Dividend Growth:</b> | 18       |
| <b>Dividend Risk Score:</b> | C     | <b>Retirement Suitability Score:</b>       | A     | <b>Last Dividend Increase:</b>   | 8.7%     |

## Overview & Current Events

ONEOK is an energy company that engages in the gathering and processing of natural gas, as well as a natural gas liquids business and natural gas pipelines (interstate and intrastate). ONEOK also owns storage facilities for natural gas. ONEOK is headquartered in Tulsa, Oklahoma, and was founded in 1906.

ONEOK reported its second quarter earnings results on July 28. The company reported that it generated revenues of \$1.66 billion during the quarter, which was 33% less than the revenues that ONEOK generated during the previous year's quarter. ONEOK missed the analyst consensus estimate by a lot, as the analyst community forecasted revenues to be \$660 million higher than the actual result during the quarter. Despite a steep revenue decline compared to the prior year's quarter, which can be explained by commodity price movements, ONEOK managed to remain quite profitable, which can be explained by the fact that its input costs declined as well, as those are also partially commodity-price based. During the most recent quarter, ONEOK generated adjusted EBITDA of \$530 million, which was down 16% versus the previous year's quarter, therefore declining significantly less than the company's revenues.

Distributable cash flows, which is operating cash flow minus maintenance capital expenditures, totaled \$300 million during the quarter, which was down 40% on a year-over-year basis. Distributable cash flows came in at \$0.67 on a per-share basis. ONEOK sees 2020's distributable cash flows declining slightly versus 2019, to \$1.94 billion, or roughly \$4.65 per share. ONEOK forecasts improving results during H2 compared to Q2, but DCF will nevertheless be down from 2019.

## Growth on a Per-Share Basis

| Year                      | 2010   | 2011   | 2012   | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   | 2020          | 2025          |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| <b>DCFPS<sup>1</sup></b>  | \$1.55 | \$1.67 | \$1.64 | \$1.78 | \$1.52 | \$1.19 | \$1.67 | \$3.56 | \$4.35 | \$4.84 | <b>\$4.30</b> | <b>\$4.98</b> |
| <b>DPS</b>                | \$0.91 | \$1.08 | \$1.27 | \$1.48 | \$2.13 | \$2.43 | \$2.46 | \$2.72 | \$3.25 | \$3.53 | <b>\$3.74</b> | <b>\$3.93</b> |
| <b>Shares<sup>2</sup></b> | 214    | 207    | 205    | 207    | 208    | 210    | 211    | 389    | 415    | 416    | <b>445</b>    | <b>460</b>    |

ONEOK's growth track record is not overly convincing, at least for the 2010-2016 time frame, during which there was no meaningful growth. 2018 was a strong year for ONEOK, as the company grew its profits and its distributable cash flows by a lot. The strong performance during 2018 can be attributed to the successful roll-up of ONEOK's MLP.

ONEOK grew its business at a strong pace in 2018 and 2019, and generally, further growth is expected during the coming years. This is due to many new growth projects coming online over the coming years, such as pipelines and fractionation services in the Permian basins. ONEOK continues to spend billions on these growth capital expenditures, although the company has reduced its growth spending in the near term, due to the impact of the global oil price crash that hurts some of its customers and results in lower production growth goals. Overall, growth spending should still allow for some cash flow growth over the coming years, even though 2020's distributable cash flows will likely be down versus 2019, according to management's guidance. From the new level that will be set during the current year, the company should be able to grow its cash flows meaningfully over the next couple of years, and we are forecasting a growth rate in the low to mid-single-digits, which is slightly less than what management aims for.

<sup>1</sup> The table above contains earnings-per-share for 2009 to 2016, and DCF-per-share from 2017 onwards

<sup>2</sup> In Millions

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## Valuation Analysis

| Year      | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Now   | 2025 |
|-----------|------|------|------|------|------|------|------|------|------|------|-------|------|
| P/DCF     | 15.1 | 20.8 | 26.6 | 28.2 | 40.5 | 32.7 | 24.5 | 15.4 | 13.1 | 15.7 | 6.7   | 10.0 |
| Avg. Yld. | 3.9% | 3.1% | 2.9% | 2.9% | 3.5% | 6.2% | 6.0% | 5.1% | 6.0% | 4.6% | 12.9% | 7.9% |

ONEOK has traded at relatively high price-to-earnings ratios in the past. Shares are trading for less than 7 times this year's forecasted distributable cash flows right now, which is a big discount compared to how shares were valued in 2017, 2018, and 2019. The growth outlook for the company and the American energy industry has deteriorated to some degree due to the low oil price environment, which hurts many producers, which is why we have reduced our fair value target from 13 times cash flows to 10 times cash flows, but this still leaves ample upside potential for ONEOK's shares.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year   | 2010  | 2011  | 2012  | 2013  | 2014 | 2015 | 2016 | 2017  | 2018  | 2019  | 2020  | 2025  |
|--------|-------|-------|-------|-------|------|------|------|-------|-------|-------|-------|-------|
| Payout | 58.7% | 64.7% | 77.4% | 83.1% | 140% | 204% | 147% | 76.4% | 74.7% | 72.9% | 87.0% | 78.9% |

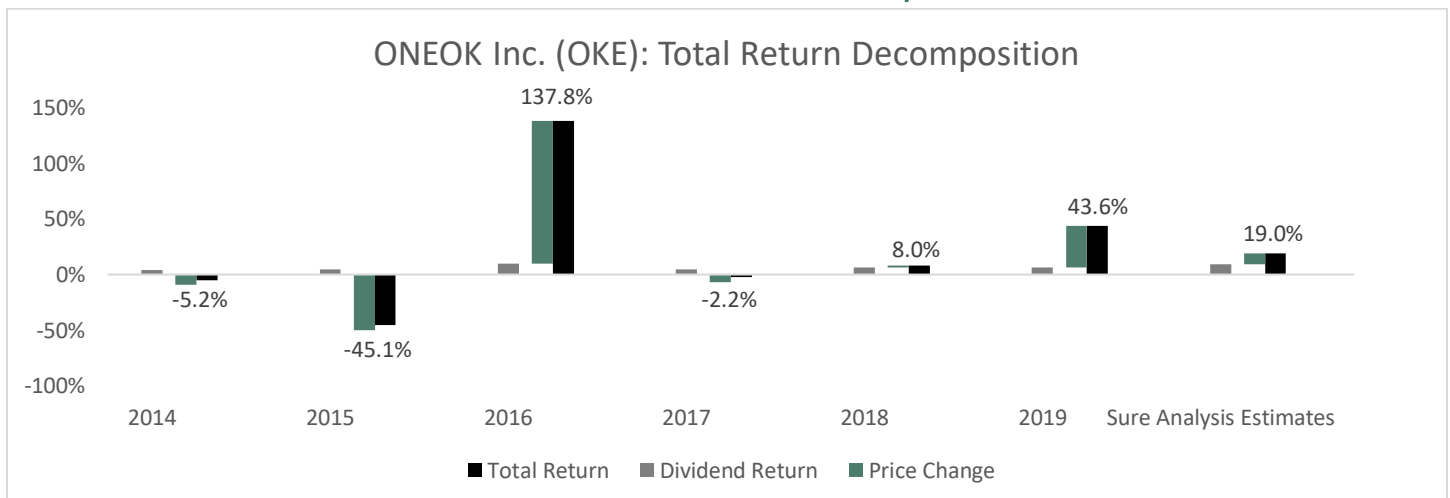
ONEOK paid out more than its net earnings during most of the last decade. Based on distributable cash flows, which we use from 2017 onwards, the dividend has been covered relatively well during the last couple of years, however, and coverage does not look too bad for the future, either. The risk of a dividend cut by ONEOK is not extremely high, but a cut should not be ruled out, as management may decide to focus on balance sheet liquidity in the near term.

A lot of ONEOK's revenues, especially after the roll-up of its MLP, are fee-based or hedged, which makes the company less sensitive to commodity price swings. This is why ONEOK can operate with considerable leverage without being in dangerous territory, as its cash flows are not overly volatile, although they are still impacted by the volumes that are transported by ONEOK. The fee-based nature of ONEOK's revenues and non-cyclical demand for natural gas, e.g. for heating, is what has made ONEOK more or less recession-resilient in the past.

## Final Thoughts & Recommendation

ONEOK is a natural gas focused infrastructure company, and even though it is not the largest among its peers, the company should nevertheless be able to benefit from the long-term trend of natural gas production in North America. We see ONEOK generating some cash flow growth going forward, but not at the level seen since 2017. The total return outlook is strong, which is why we rate the stock a buy, but we note that ONEOK's stock will likely remain volatile.

## Total Return Breakdown by Year



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## Income Statement Metrics

| Year                    | 2010   | 2011   | 2012   | 2013   | 2014   | 2015  | 2016  | 2017   | 2018   | 2019    |
|-------------------------|--------|--------|--------|--------|--------|-------|-------|--------|--------|---------|
| <b>Revenue</b>          | 12,679 | 14,806 | 10,184 | 11,872 | 12,195 | 7,763 | 8,921 | 12,174 | 12,593 | 10,164  |
| <b>Gross Profit</b>     | 1,755  | 2,068  | 1,438  | 1,410  | 1,812  | 1,768 | 2,033 | 2,230  | 2,742  | 2,900   |
| <b>Gross Margin</b>     | 13.8%  | 14.0%  | 14.1%  | 11.9%  | 14.9%  | 22.8% | 22.8% | 18.3%  | 21.8%  | 28.5%   |
| <b>D&amp;A Exp.</b>     | 307    | 312    | 336    | 384    | 306    | 355   | 392   | 406    | 429    | 477     |
| <b>Operating Profit</b> | 924    | 1,160  | 947    | 869    | 1,137  | 1,074 | 1,286 | 1,407  | 1,835  | 1,917   |
| <b>Op. Margin</b>       | 7.3%   | 7.8%   | 9.3%   | 7.3%   | 9.3%   | 13.8% | 14.4% | 11.6%  | 14.6%  | 18.9%   |
| <b>Net Profit</b>       | 335    | 361    | 361    | 267    | 314    | 245   | 352   | 388    | 1,152  | 1,279   |
| <b>Net Margin</b>       | 2.6%   | 2.4%   | 3.5%   | 2.2%   | 2.6%   | 3.2%  | 3.9%  | 3.2%   | 9.1%   | 12.6%   |
| <b>Free Cash Flow</b>   | 251    | 20     | (882)  | (962)  | (494)  | (165) | 729   | 803    | 45     | (1,902) |
| <b>Income Tax</b>       | 214    | 226    | 181    | 166    | 151    | 137   | 212   | 447    | 363    | 372     |

## Balance Sheet Metrics

| Year                          | 2010   | 2011   | 2012   | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   |
|-------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| <b>Total Assets</b>           | 12,499 | 13,697 | 15,855 | 17,741 | 15,262 | 15,446 | 16,139 | 16,846 | 18,232 | 21,812 |
| <b>Cash &amp; Equivalents</b> | 30     | 66     | 584    | 146    | 173    | 98     | 249    | 37     | 12     | 21     |
| <b>Acc. Receivable</b>        | 1,284  | 1,340  | 1,349  | 1,110  | 745    | 594    | 872    | 1,203  | 819    | 835    |
| <b>Inventories</b>            | 707    | 550    | 517    | 188    | 190    | 205    | 201    | 433    | 438    | 507    |
| <b>Goodwill &amp; Int.</b>    | 1,023  | 1,014  | 996    | 1,025  | 1,015  | 1,017  | 1,005  | 993    | 967    | 958    |
| <b>Total Liabilities</b>      | 8,578  | 9,897  | 11,623 | 12,896 | 11,256 | 11,680 | 12,710 | 11,161 | 11,652 | 15,586 |
| <b>Accounts Payable</b>       | 1,212  | 1,342  | 1,333  | 1,273  | 891    | 616    | 875    | 1,141  | 1,116  | 1,210  |
| <b>Long-Term Debt</b>         | 4,887  | 5,736  | 7,343  | 8,329  | 8,216  | 8,981  | 9,441  | 9,139  | 9,381  | 12,707 |
| <b>Total Equity</b>           | 2,449  | 2,239  | 2,130  | 2,338  | 592    | 336    | 189    | 5,528  | 6,580  | 6,226  |
| <b>D/E Ratio</b>              | 2.00   | 2.56   | 3.45   | 3.56   | 13.88  | 26.74  | 50.02  | 1.65   | 1.43   | 2.04   |

## Profitability & Per Share Metrics

| Year                    | 2010  | 2011  | 2012   | 2013   | 2014   | 2015   | 2016 | 2017  | 2018  | 2019   |
|-------------------------|-------|-------|--------|--------|--------|--------|------|-------|-------|--------|
| <b>Return on Assets</b> | 2.6%  | 2.8%  | 2.4%   | 1.6%   | 1.9%   | 1.6%   | 2.2% | 2.4%  | 6.6%  | 6.4%   |
| <b>Return on Equity</b> | 14.4% | 15.4% | 16.5%  | 11.9%  | 21.4%  | 52.8%  | 134% | 13.6% | 19.0% | 20.0%  |
| <b>ROIC</b>             | 3.8%  | 3.9%  | 3.4%   | 2.2%   | 2.5%   | 2.0%   | 2.7% | 2.8%  | 7.5%  | 7.3%   |
| <b>Shares Out.</b>      | 214   | 207   | 205    | 207    | 208    | 210    | 211  | 389   | 415   | 416    |
| <b>Revenue/Share</b>    | 58.82 | 69.03 | 48.33  | 56.62  | 57.95  | 36.87  | 42.0 | 40.61 | 30.40 | 24.47  |
| <b>FCF/Share</b>        | 1.17  | 0.09  | (4.19) | (4.59) | (2.35) | (0.79) | 3.43 | 2.68  | 0.11  | (4.58) |

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

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