ONE Gas, Inc. (OGS)

Updated June 22nd, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	$76	**5 Year CAGR Estimate:**	8.9%	**Market Cap:**	$4.0 B
Fair Value Price:	$76	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	08/13/2021[1]
% Fair Value:	100%	**5 Year Valuation Multiple Estimate:**	0.1%	**Dividend Payment Date:**	09/01/2021
Dividend Yield:	3.1%	**5 Year Price Target**	$102	**Years Of Dividend Growth:**	7
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	7.4%

Overview & Current Events

ONE Gas, Inc. is one of the largest publicly traded natural gas utilities in the United States. The company provides natural gas distribution services to approximately 2.2 million customers. ONE Gas is the largest natural gas distributor in Oklahoma (88% market share) and Kansas (72% market share), and the third-largest in Texas (13% market share). Its customers are residential, commercial, and transportation-related in all three states. ONE Gas is the successor to the company founded in 1906 as Oklahoma Natural Gas Company, which became ONEOK, Inc. (NYSE: OKE) in 1980. On January 31st, 2014, ONE Gas officially separated from ONEOK, Inc. The company generates around $1.6 billion in annual revenues and is based in Tulsa, Oklahoma.

On May 3rd, ONE Gas reported its Q1-2021 results for the quarter ended March 31st, 2021. Revenues came in at $625.29 million, 18.39% higher YoY, with demand for natural gas spiking due to the harsh winter conditions during the period. Specifically, in February, the U.S. encountered Winter Storm Uri, which caused the company to experience unforeseeable and unprecedented market pricing for gas costs in its Kansas, Oklahoma, and Texas jurisdictions, which resulted in aggregated natural gas purchases for the month of February of approximately $2.1 billion. The company tapped into the debt markets to cover for the increased costs, though at incredibly cheap rates (<1% cost of debt). Still, higher revenues were offset by the higher commodity costs, causing operating income to decline to $130.3 million, 2.1% lower YoY. Excluding this extraordinary event, ONE Gas' net margin (a non-GAAP measure which excludes natural gas costs) increased by $9.1 million YoY, powered by an increase in rates and in net residential customer growth in Texas and Oklahoma, which suggests a continuous improvement in the company's underlying business.

Management reaffirmed its guidance with FY2021 net income expected to be in the range of $198 million to $210 million, or $3.68 to $3.92 per diluted share. We forecast FY2021 EPS of $3.80.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	---	$1.84	$1.90	$2.10	$2.26	$2.67	$3.10	$3.27	$3.53	$3.70	***$3.80***	***$5.09***
DPS	---	---	---	$0.84	$1.20	$1.40	$1.68	$1.84	$2.00	$2.16	***$2.32***	***$3.18***
Shares[2]	---	52.3	52.3	52.4	52.6	52.5	52.5	52.7	52.9	53.1	***53.2***	***55.0***

Since its separation from ONEOK, ONE Gas has grown its profitability annually at a very consistent rate and without any notable disruptions. Due to the company's dominant market share in 2/3 states it operates in, ONE Gas should continue growing its net income gradually powered by gradual population/customer growth and base rate increases as approved by regulators. For context, the company expects base rate increases of around 8% for 2021. Growth CAPEX and acquisitions of smaller competitors should also contribute to EPS growth over time, which we expect to see a CAGR of 6% in the medium term. The company has hiked its dividend rapidly since initiating it in 2014. We expect a DPS CAGR of 6.5% in the medium term, powered by the company's underlying net income growth. Management targets a payout ratio of 55%-65%; hence EPS growth makes for a good indicator of future dividend growth.

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[1] Estimated dates based on past dividend dates

[2] Share count is in millions.

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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	---	---	---	16.7	19.9	21.0	21.9	22.6	24.6	20.3	***19.9***	***20.0***
Avg. Yld.	---	---	---	2.4%	2.7%	2.5%	2.5%	2.5%	2.3%	2.9%	***3.1%***	***3.1%***

Since ONE Gas's separation from ONEOK, its shares have traded with a P/E ranging from 15 to 25 over the years. The valuation is currently near its historical average, around 20 times its 2021 expected net income. We expect the multiple to remain near its current levels, powered by the company's resilient operational history, great moat, and robust dividend. We also expect the company's 3.1% yield to remain at similar levels going forward, as shares tend to appreciate relatively in line with dividend advancements.

Safety, Quality, Competitive Advantage, & Recession Resiliency

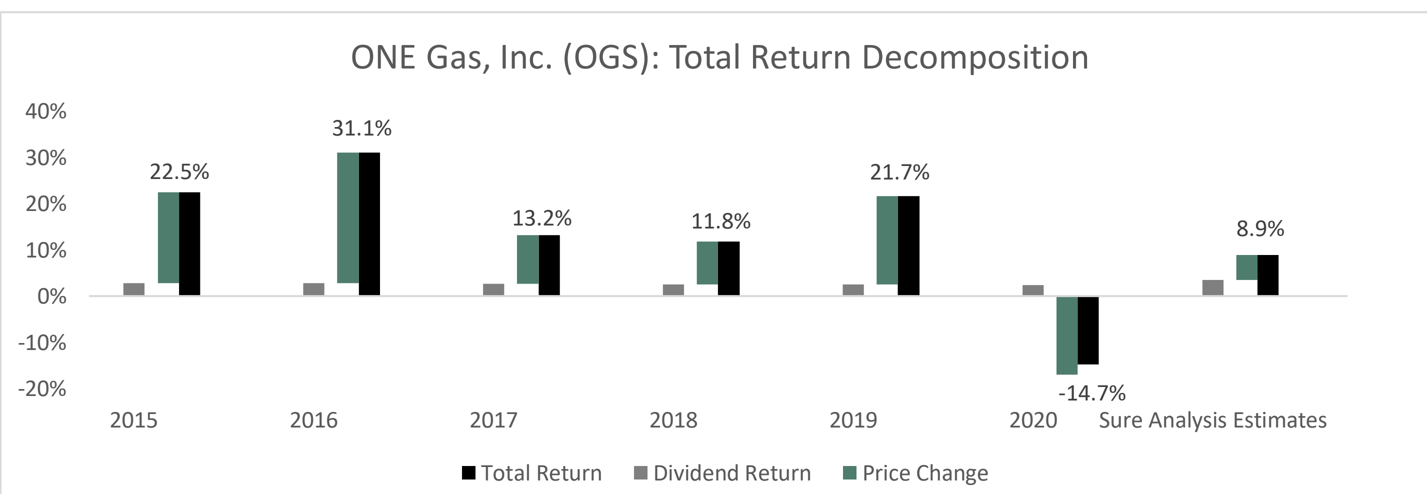
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	---	---	---	40%	53%	52%	54%	56%	57%	58%	***61%***	***63%***

ONE Gas' dividend should be considered quite safe. The company has maintained the payout ratio in line with its 55%-65% target range, while its operating cash flows are resilient due to natural gas enjoying relatively predictable consumption, especially during the winter months. Being the dominant natural gas provider in Oklahoma and Kansas, the company possesses a significant competitive advantage. Due to the CAPEX-demanding nature of its operations, smaller competitors should pose no threat in these two states. In Texas, competition is harsher, though the company could have greater growth prospects due to the state's much more dynamic population growth. Overall, ONE Gas is a quality operator, proven by its consistently improving profitability and smooth detachment from ONEOK. We expect a relatively robust performance even under a potential recession due to natural being a necessity fuel both for residential consumption and in certain fields of transpiration.

Final Thoughts & Recommendation

ONE Gas has delivered consistent shareholder value creation since its separation from ONEOK. While Storm Uri may have set the company slightly back in terms of its profitability growth, FY2021 should once again see record EPS levels as per management's guidance. Based on our growth estimates, we wouldn't be surprised if they end up stronger, and we forecast annualized returns of around 8.9% in the medium term. Hence, shares earn a Hold rating.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	1,621	1,377	1,690	1,819	1,548	1,427	1,540	1,634	1,653	1,530
Gross Profit	378	393	420	406	427	488	526	507	536	562
Gross Margin	23.3%	28.6%	24.8%	22.3%	27.6%	34.2%	34.2%	31.1%	32.4%	36.7%
D&A Exp.	132	130	145	126	133	144	152	160	180	195
Operating Profit	200	216	220	225	239	289	317	288	295	304
Operating Margin	12.3%	15.7%	13.0%	12.4%	15.5%	20.2%	20.6%	17.7%	17.9%	19.8%
Net Profit	87	97	99	110	119	140	163	172	187	196
Net Margin	5.4%	7.0%	5.9%	6.0%	7.7%	9.8%	10.6%	10.5%	11.3%	12.8%
Free Cash Flow	(48)	(75)	(138)	(50)	114	(18)	(103)	73	(107)	(107)
Income Tax	56	60	62	68	73	85	93	54	43	42

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	3,285	3,491	3,846	4,649	4,635	4,943	5,207	5,469	5,708	6,029
Cash & Equivalents	4	4	3	12	2	15	14	21	18	8
Accounts Receivable	273	260	357	327	216	291	299	295	250	293
Inventories	133	103	166	213	175	160	170	152	160	147
Goodwill & Int. Ass.	158	158	158	158	158	158	158	158	158	158
Total Liabilities	2,127	2,337	2,607	2,855	2,793	3,055	3,247	3,426	3,579	3,795
Accounts Payable	133	137	170	159	107	132	144	175	120	152
Long-Term Debt	1,150	1,323	1,474	1,243	1,204	1,337	1,550	1,585	1,803	2,001
Shareholder's Equity	1,158	1,155	1,239	1,794	1,842	1,888	1,960	2,043	2,129	2,233
D/E Ratio	0.99	1.15	1.19	0.69	0.65	0.71	0.79	0.78	0.85	0.90

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets		2.8%	2.7%	2.6%	2.6%	2.9%	3.2%	3.2%	3.3%	3.3%
Return on Equity		8.3%	8.3%	7.2%	6.5%	7.5%	8.5%	8.6%	9.0%	9.0%
ROIC		4.0%	3.8%	3.8%	3.9%	4.5%	4.8%	4.8%	4.9%	4.8%
Shares Out.	---	52.3	52.3	52.4	52.6	52.5	52.5	52.7	52.9	53.1
Revenue/Share	30.97	26.30	32.75	34.35	29.06	26.95	29.06	30.81	31.04	28.67
FCF/Share	(0.92)	(1.44)	(2.67)	(0.95)	2.13	(0.35)	(1.94)	1.38	(2.01)	(2.00)

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