ONE Gas, Inc. (OGS)

Updated August 3rd, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	$74	**5 Year CAGR Estimate:**	9.3%	**Market Cap:**	$4.95 B
Fair Value Price:	$76	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	08/13/2021[1]
% Fair Value:	98%	**5 Year Valuation Multiple Estimate:**	0.5%	**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 August 2nd, ONE Gas reported its Q2-2021 results for the quarter ended June 31st, 2021. Revenues came in at $315.65 million, 15.5% higher YoY. Demand for natural gas remained very strong following Q1's Winter Storm Uri and the company's service areas experiencing a relatively colder Q2 YoY. The company's operating income came in at $51.1 million vs. $44.6 million in the comparable period last year, due to a $6.4 million increase from rates, primarily in Texas and Oklahoma, a $2.3 million increase attributed primarily to net residential customer growth in Oklahoma and Texas, and a $0.9 million increase in transportation volumes, primarily in Kansas and Oklahoma. Consequently, EPS grew 16.6% to $0.56.

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. Accordingly, 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. Capital expenditures, for instance, including asset removal costs, are expected to be approximately $540 million for 2021.

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	***19.6***	***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 19.6 times its 2021 expected net income. We expect the multiple to hover slightly higher from 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

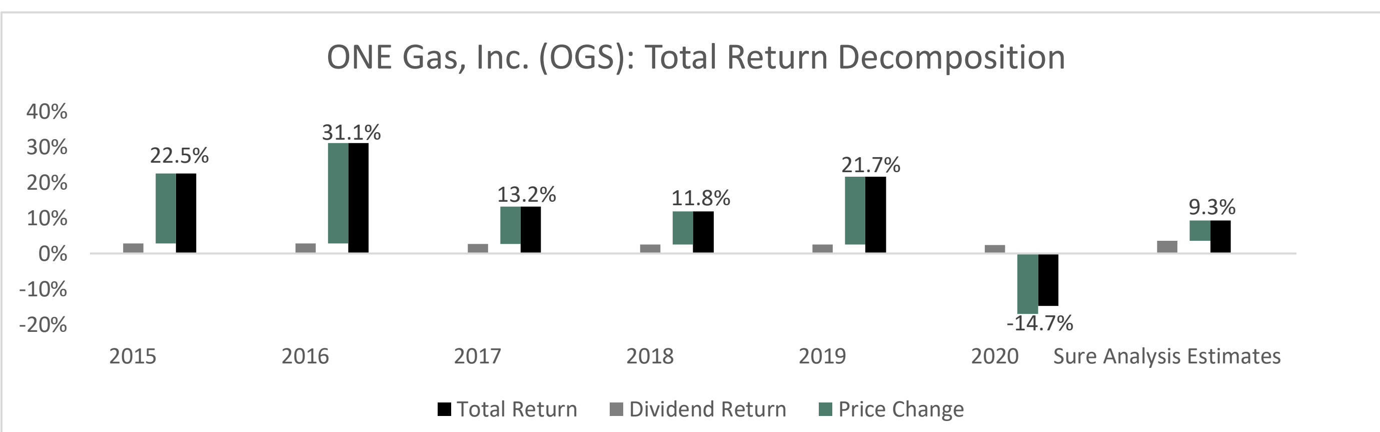
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	---	---	---	40%	53%	52%	54%	56%	57%	58%	***61%***	***63%***

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 in Q1 may have set the company slightly back in terms of its profitability growth for the whole year, FY2021 should once again see record EPS levels as per management's guidance. Based on our growth estimates and the chance for humble valuation tailwinds, we forecast annualized returns of around 9.3% in the medium term. Hence, shares earn a hold rating, but could be considered a buy if ONE Gas dip below $70.

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.