ONE Gas, Inc. (OGS)

Updated February 26th, 2022 by Nikolaos Sismanis

Key Metrics

Current Price:	$81	**5 Year CAGR Estimate:**	9.8%	**Market Cap:**	$4.3 B
Fair Value Price:	$82	**5 Year Growth Estimate:**	7.0%	**Ex-Dividend Date:**	02/24/2022
% Fair Value:	100%	**5 Year Valuation Multiple Estimate:**	0.1%	**Dividend Payment Date:**	03/11/2022
Dividend Yield:	3.1%	**5 Year Price Target**	$114	**Years Of Dividend Growth:**	8
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	6.9%

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 February 23rd, 2022, ONE Gas reported its Q4-2021 results for the period ending December 31st, 2021. Revenues came in at $593.74 million, 22.6% higher year-over-year. Demand for natural gas remained elevated while the company achieved customer growth, which, along with new rates, resulted in improved performance.

The company's operating income came in at $87.0 million versus $85.0 million in the comparable period last year, due to a $9.5 million increase from rates, primarily in Texas and Oklahoma, a $5.6 million decrease in bad debt expense, and a $1.8 million increase attributed primarily to net residential customer growth. Accordingly, EPS came in slightly stronger, growing from $1.09 to $1.12 year-over-year.

Management sees its ongoing positive momentum lasting through this year and expects FY2022 EPS to be between $3.96 and $4.20. We have utilized the midpoint of this range in our calculations.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$1.84	$1.90	$2.10	$2.26	$2.67	$3.10	$3.27	$3.53	$3.70	$3.85	***$4.08***	***$5.72***
DPS	---	---	$0.84	$1.20	$1.40	$1.68	$1.84	$2.00	$2.16	$2.32	***$2.48***	***$3.40***
Shares[1]	52.3	52.3	52.4	52.6	52.5	52.5	52.7	52.9	53.1	53.5	***53.7***	***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 to gradually grow its net income, powered by incremental population/customer growth and base rate increases as approved by regulators.

The company expects base rate increases of to land between 7% and 8% through 2025. Growth CAPEX and acquisitions of smaller competitors should also contribute to EPS growth over time. Specifically, management expects EPS growth between 6% and 8% through 2025.

Regarding its dividend, the company has rapidly grown it since initiating quarterly payments in 2014. Management also targets DPS growth between 6% and 8% through 2025. Consequently, we have applied a 7% CAGR in both our EPS and DPS growth estimates. This year's DPS hike of 6.9% appears to follow this pace.

[1] Share count is in millions.

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.

Management targets a payout ratio of 55%-65%; hence EPS growth makes for a good indicator of future dividend growth.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	---	---	16.7	19.9	21.0	21.9	22.6	24.6	20.3	18.7	***19.9***	***20.0***
Avg. Yld.	---	---	2.4%	2.7%	2.5%	2.5%	2.5%	2.3%	2.9%	3.2%	***3.1%***	***3.0%***

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 close to the midpoint of this range, standing at nearly 20x ONE Gas' FY2022 EPS, which is also our target multiple estimate. We expect the stock's valuation to be sustained at 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

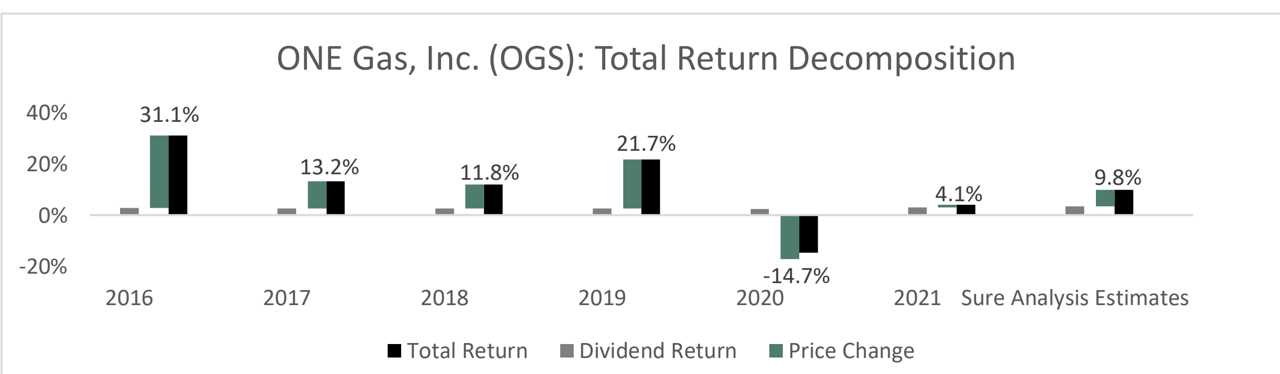
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	---	---	---	53%	52%	54%	56%	57%	58%	60%	61%	***59%***

ONE Gas' dividend should be considered quite safe. The company has maintained the payout ratio within 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 generated consistent shareholder value creation since its separation from ONEOK. While Storm Uri at the beginning of the year may have set the company slightly back in terms of its profitability growth for the whole year, FY2022 should once again see record EPS levels as per management's guidance. Based on our growth estimates and the current dividend yield, we forecast annualized returns of around 9.8% in the medium term. We rate the stock a hold at its current levels but would rate it a strong buy close to $75 ceteris paribus, amid exceptional earnings growth visibility.

Total Return Breakdown by Year



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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
LTD/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.