ONE Gas, Inc. (OGS)

Updated February 25th, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	$80	**5 Year CAGR Estimate:**	9.5%	**Market Cap:**	$4.43 B
Fair Value Price:	$79	**5 Year Growth Estimate:**	7.0%	**Ex-Dividend Date:**	02/23/2023
% Fair Value:	102%	**5 Year Valuation Multiple Estimate:**	-0.3%	**Dividend Payment Date:**	03/10/2023
Dividend Yield:	3.2%	**5 Year Price Target**	$110	**Years Of Dividend Growth:**	9
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Rating:**	Buy

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 $2.6 billion in annual revenues and is based in Tulsa, Oklahoma.

On January 24th, 2023, ONE Gas raised its dividend by 4.8% to a quarterly rate of $0.65.

On February 22nd, 2023, ONE Gas reported its Q4-2022 and full-year results for the period ending December 31st, 2022. Revenues came in at $818.2 million, 37.2% higher year-over-year. Once again, demand for natural gas remained elevated while the company achieved customer growth, which, along with higher rates, resulted in improved performance.

The company's operating income came in at $103.6 million versus $87.0 million in the comparable period last year due to a $13.6 million increase in rates, an increase of $1.6 million in residential sales due to net customer growth in Oklahoma and Texas, and a decrease of $2.1 million in employee-related costs. These increases were offset partially by an increase of $1.0 million in outside service costs, an increase of $1.1 million in bad debt expenses, and an increase of $3.6 million in depreciation expenses. Accordingly, earnings-per-share grew from $1.13 to $1.23 year-over-year. For the year, earnings-per-share grew by almost 6% to $4.08.

Management sees its ongoing positive momentum lasting through this year. For FY2023, they expect earnings-per-share to be between $4.02 and $4.26. We have utilized the midpoint of this range in our calculations.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$1.90	$2.10	$2.26	$2.67	$3.10	$3.27	$3.53	$3.70	$3.85	$4.08	***$4.14***	***$5.81***
DPS	---	$0.84	$1.20	$1.40	$1.68	$1.84	$2.00	$2.16	$2.32	$2.48	***$2.60***	***$3.56***
Shares[1]	52.3	52.4	52.6	52.5	52.5	52.7	52.9	53.1	53.6	54.2	***54.2***	***57.0***

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 to land between 8% and 9% through 2026. 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 2026.

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 2026. Consequently, we have applied a 7% CAGR in both our EPS and

[1] Share count is in millions.

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DPS growth estimates. This year's DPS hike of 4.8% fell below this range, but this was likely in order to balance the prior hike of 6.9% on a CAGR basis. Management targets a payout ratio of 55% to 65%; hence EPS growth makes for a good indicator of future dividend growth.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	---	16.7	19.9	21.0	21.9	22.6	24.6	20.3	18.7	19.4	***19.3***	***19.0***
Avg. Yld.	---	2.4%	2.7%	2.5%	2.5%	2.5%	2.3%	2.9%	3.2%	3.1%	***3.2%***	***3.2%***

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 18.7X ONE Gas' FY2023 projected EPS. Our fair P/E is maintained close to this multiple, at 19X. The company's resilient operational history, great moat, and robust dividend deserve a premium, but not as high as our previous one, given raised interest rates. We also expect the company's 3.2% yield to remain at similar levels going forward, as shares tend to appreciate relatively in line with dividend growth.

Safety, Quality, Competitive Advantage, & Recession Resiliency

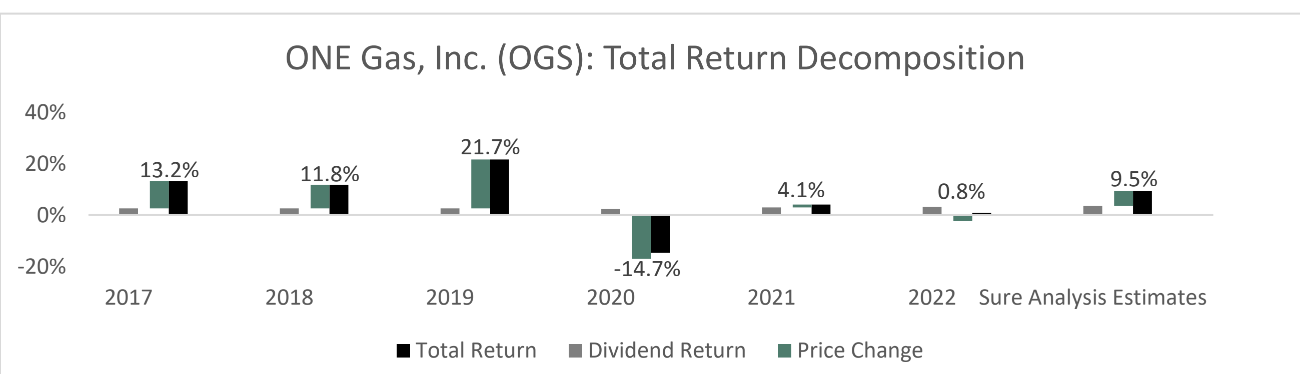
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	---	40%	53%	52%	54%	56%	57%	58%	60%	61%	***63%***	***61%***

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 produced reliable returns for shareholders since its separation from ONEOK. This year, the company should once again achieve record EPS levels as per management's guidance. Based on our growth estimates and the current dividend yield, we forecast annualized returns of around 9.5% through 2028. While the stock would earn a hold rating based on its total return potential, we rate it a buy amid exceptional earnings and dividend growth visibility.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	1,377	1,690	1,819	1,548	1,427	1,540	1,634	1,653	1,530	1,809
Gross Profit	393	420	406	427	488	526	507	536	562	584
Gross Margin	28.6%	24.8%	22.3%	27.6%	34.2%	34.2%	31.1%	32.4%	36.7%	32.3%
D&A Exp.	130	145	126	133	144	152	160	180	195	207
Operating Profit	216	220	225	239	289	317	288	295	304	310
Operating Margin	15.7%	13.0%	12.4%	15.5%	20.2%	20.6%	17.7%	17.9%	19.8%	17.1%
Net Profit	97	99	110	119	140	163	172	187	196	206
Net Margin	7.0%	5.9%	6.0%	7.7%	9.8%	10.6%	10.5%	11.3%	12.8%	11.4%
Free Cash Flow	(75)	(138)	(50)	114	(18)	(103)	73	(107)	(107)	(2031)
Income Tax	60	62	68	73	85	93	54	43	42	40

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	3,491	3,846	4,649	4,635	4,943	5,207	5,469	5,708	6,029	8,402
Cash & Equivalents	4	3	12	2	15	14	21	18	8	9
Accounts Receivable	260	357	327	216	291	299	295	250	293	342
Inventories	103	166	213	175	160	170	152	160	147	235
Goodwill & Int. Ass.	158	158	158	158	158	158	158	158	158	158
Total Liabilities	2,337	2,607	2,855	2,793	3,055	3,247	3,426	3,579	3,795	6,053
Accounts Payable	137	170	159	107	132	144	175	120	152	259
Long-Term Debt	1,323	1,474	1,243	1,204	1,337	1,550	1,585	1,803	2,001	4,177
Shareholder's Equity	1,155	1,239	1,794	1,842	1,888	1,960	2,043	2,129	2,233	2,350
LTD/E Ratio	1.15	1.19	0.69	0.65	0.71	0.79	0.78	0.85	0.90	1.78

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	2.8%	2.7%	2.6%	2.6%	2.9%	3.2%	3.2%	3.3%	3.3%	2.9%
Return on Equity	8.3%	8.3%	7.2%	6.5%	7.5%	8.5%	8.6%	9.0%	9.0%	9.0%
ROIC	4.0%	3.8%	3.8%	3.9%	4.5%	4.8%	4.8%	4.9%	4.8%	3.8%
Shares Out.	52.3	52.3	52.4	52.6	52.5	52.5	52.7	52.9	53.1	53.7
Revenue/Share	26.30	32.75	34.35	29.06	26.95	29.06	30.81	31.04	28.67	33.70
FCF/Share	(1.44)	(2.67)	(0.95)	2.13	(0.35)	(1.94)	1.38	(2.01)	(2.00)	(37.84)

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