ONE Gas, Inc. (OGS)

Updated October 31st, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	$60	**5 Year CAGR Estimate:**	9.4%	**Market Cap:**	$3.34 B
Fair Value Price:	$62	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	11/14/2023
% Fair Value:	97%	**5 Year Valuation Multiple Estimate:**	0.6%	**Dividend Payment Date:**	12/01/2023
Dividend Yield:	4.3%	**5 Year Price Target**	$79	**Years Of Dividend Growth:**	9
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Rating:**	Hold

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 October 30th, 2023, ONE Gas reported its Q3 results for the period ending September 30th, 2023. Revenues came in at $335.8 million, 6.6% lower year-over-year. The decline in revenues was mainly due to weather across ONE Gas' territories for the second quarter being warmer than the prior year period. However, the impact on operating income was mitigated by weather normalization mechanisms.

Specifically, operating income came in at $57.2 million versus $47.1 million in the comparable period last year. This was due to a $14.6 million increase in rates and an increase of $2.3 million due to lower outside service costs. These increases were offset partially by an increase of $7.5 million in labor and benefit costs.

Earnings-per-share landed at $0.45, one cent higher compared to last year, as higher interest expenses somewhat offset the increase in operating income. For FY2023, management narrowed their guidance, expecting earnings-per-share to be between $4.06 and $4.22 (from $4.02 to $4.26). We continue to utilize 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***	***$5.28***
DPS	---	$0.84	$1.20	$1.40	$1.68	$1.84	$2.00	$2.16	$2.32	$2.48	***$2.60***	***$3.32***
Shares[1]	52.3	52.4	52.6	52.5	52.5	52.7	52.9	53.1	53.6	54.2	***55.9***	***60.0***

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 7% and 9% through 2027. Growth CAPEX and acquisitions of smaller competitors should also contribute to EPS growth over time. Specifically, management expects EPS growth between 4% and 6% through 2027.

Regarding its dividend, the company has rapidly grown it since initiating quarterly payments in 2014. Management also targets DPS growth between 4% and 6% through 2027.

Consequently, we have applied a 5% CAGR in both our EPS and DPS growth estimates. This year's DPS hike of 4.8% was in-line with this outlook. Management targets a payout ratio of 55% to 65%; hence EPS growth makes for a good indicator of future dividend growth.

[1] Share count is in millions.

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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	***14.6***	***15.0***
Avg. Yld.	---	2.4%	2.7%	2.5%	2.5%	2.5%	2.3%	2.9%	3.2%	3.1%	***4.3%***	***4.2%***

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 below this range, standing at 14.6X ONE Gas' FY2023 projected EPS. We view the compression as justified, given the higher opportunity cost related to higher interest rates. Our fair P/E has now thus declined to 15X. The company's resilient operational history, great moat, and robust dividend deserve a premium, but not as high as the stock's previous multiples, given the current macroeconomic environment. We also expect the company's 4.3% 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

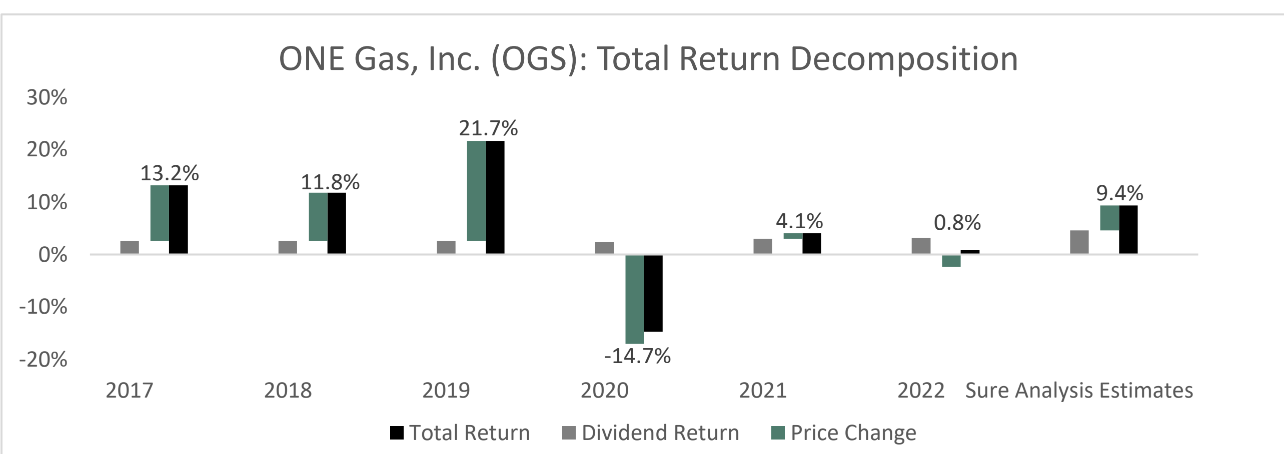
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	---	40%	53%	52%	54%	56%	57%	58%	60%	61%	***63%***	***63%***

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 per management's guidance, despite the disappointing stock price performance. Mainly driven by our growth estimates and the current dividend yield, we forecast annualized returns of 9.4% through 2028. We rate the stock a hold, but praise its exceptional earnings and dividend growth visibility.

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	1,690	1,819	1,548	1,427	1,540	1,634	1,653	1,530	1,809	2,578
Gross Profit	420	406	427	488	526	507	536	562	584	647
Gross Margin	24.8%	22.3%	27.6%	34.2%	34.2%	31.1%	32.4%	36.7%	32.3%	25.1%
D&A Exp.	145	126	133	144	152	160	180	195	207	228
Operating Profit	220	225	239	289	317	288	295	304	310	350
Operating Margin	13.0%	12.4%	15.5%	20.2%	20.6%	17.7%	17.9%	19.8%	17.1%	13.6%
Net Profit	99	110	119	140	163	172	187	196	206	222
Net Margin	5.9%	6.0%	7.7%	9.8%	10.6%	10.5%	11.3%	12.8%	11.4%	8.6%
Free Cash Flow	(138)	(50)	114	(18)	(103)	73	(107)	(107)	(2031)	961
Income Tax	62	68	73	85	93	54	43	42	40	47

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	3,846	4,649	4,635	4,943	5,207	5,469	5,708	6,029	8,402	7,776
Cash & Equivalents	3	12	2	15	14	21	18	8	9	9.7
Accounts Receivable	357	327	216	291	299	295	250	293	342	554
Inventories	166	213	175	160	170	152	160	147	235	340
Goodwill & Int. Ass.	158	158	158	158	158	158	158	158	158	482
Total Liabilities	2,607	2,855	2,793	3,055	3,247	3,426	3,579	3,795	6,053	5,192
Accounts Payable	170	159	107	132	144	175	120	152	259	360
Long-Term Debt	1,474	1,243	1,204	1,337	1,550	1,585	1,803	2,001	4,177	2,925
Shareholder's Equity	1,239	1,794	1,842	1,888	1,960	2,043	2,129	2,233	2,350	2,584
LTD/E Ratio	1.19	0.69	0.65	0.71	0.79	0.78	0.85	0.90	1.78	1.13

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	2.7%	2.6%	2.6%	2.9%	3.2%	3.2%	3.3%	3.3%	2.9%	2.7%
Return on Equity	8.3%	7.2%	6.5%	7.5%	8.5%	8.6%	9.0%	9.0%	9.0%	9.0%
ROIC	3.8%	3.8%	3.9%	4.5%	4.8%	4.8%	4.9%	4.8%	3.8%	3.7%
Shares Out.	52.3	52.4	52.6	52.5	52.5	52.7	52.9	53.1	53.7	54.3
Revenue/Share	32.75	34.35	29.06	26.95	29.06	30.81	31.04	28.67	33.70	47.44
FCF/Share	(2.67)	(0.95)	2.13	(0.35)	(1.94)	1.38	(2.01)	(2.00)	(37.84)	17.69

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