ONE Gas, Inc. (OGS)

Updated November 13th, 2024 by Nikolaos Sismanis

Key Metrics

Current Price:	$75	**5 Year CAGR Estimate:**	3.5%	**Market Cap:**	4.26 B
Fair Value Price:	$59	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	11/19/2024
% Fair Value:	127%	**5 Year Valuation Multiple Estimate:**	-4.6%	**Dividend Payment Date:**	12/04/2024
Dividend Yield:	3.5%	**5 Year Price Target**	$76	**Years Of Dividend Growth:**	10
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Rating:**	Sell

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 2.3 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 November 4th, 2024, ONE Gas reported its Q3 results for the period ending September 30th, 2024. Revenues came in at $340.4 million, 1.36% higher year-over-year. Operating income came in at $59.4 million versus $57.2 million in the comparable period last year.

The increase in operating income was due primarily to an increase of $17.5 million from new rates. This was partially offset by i) an increase of $3.7 million in depreciation and amortization expense from additional capital investment, ii) an increase of $6.1 million in employee-related costs, due primarily to planned investments in the Company's workforce and ongoing in-sourcing efforts, and iii) an increase of $2.0 million in outside services.

Earnings-per-share landed at $0.34, 11 cents lower compared to last year, reflecting higher interest expenses despite the increase in operating income. For FY2024, management expects earnings-per-share to be between $3.85 and $3.95. We utilize the high end of this range in our calculations.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$2.10	$2.26	$2.67	$3.10	$3.27	$3.53	$3.70	$3.85	$4.08	$4.14	***$3.95***	***$5.04***
DPS	$0.84	$1.20	$1.40	$1.68	$1.84	$2.00	$2.16	$2.32	$2.48	$2.60	***$2.64***	***$2.84***
Shares[1]	52.4	52.6	52.5	52.5	52.7	52.9	53.1	53.6	54.2	55.6	***57.1***	***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 of the 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 2028. 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 2028. Regarding its dividend, its growth has slowed down notable lately, as management expects to need $2.3 billion to finance CAPEX needs through 2028, of which 45% to 50% is going to be funded by equity. Thus, management targets DPS growth between 1% and 2% through 2028. Consequently, we have applied a 1.5% CAGR in both our EPS and DPS growth estimates.

[1] Share count is in millions.

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Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	16.7	19.9	21.0	21.9	22.6	24.6	20.3	18.7	19.4	17.6	***19.0***	***15.0***
Avg. Yld.	2.4%	2.7%	2.5%	2.5%	2.5%	2.3%	2.9%	3.2%	3.1%	3.6%	***3.5%***	***3.8%***

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 the lower end of this range, standing at 19x ONE Gas' FY2024 projected EPS. We believe that a multiple compression is justified, given the higher opportunity cost related to higher interest rates. Our fair P/E remains at 15X, suggesting that further valuation headwinds are possible. The company's stable operational history, great moat, and solid dividend deserve a premium, but not as high as the stock's previous multiples, given the current interest rates environment. We also expect the company's 3.5% yield to remain at attractive levels going forward, as shares tend to appreciate relatively in line with dividend growth.

Safety, Quality, Competitive Advantage, & Recession Resiliency

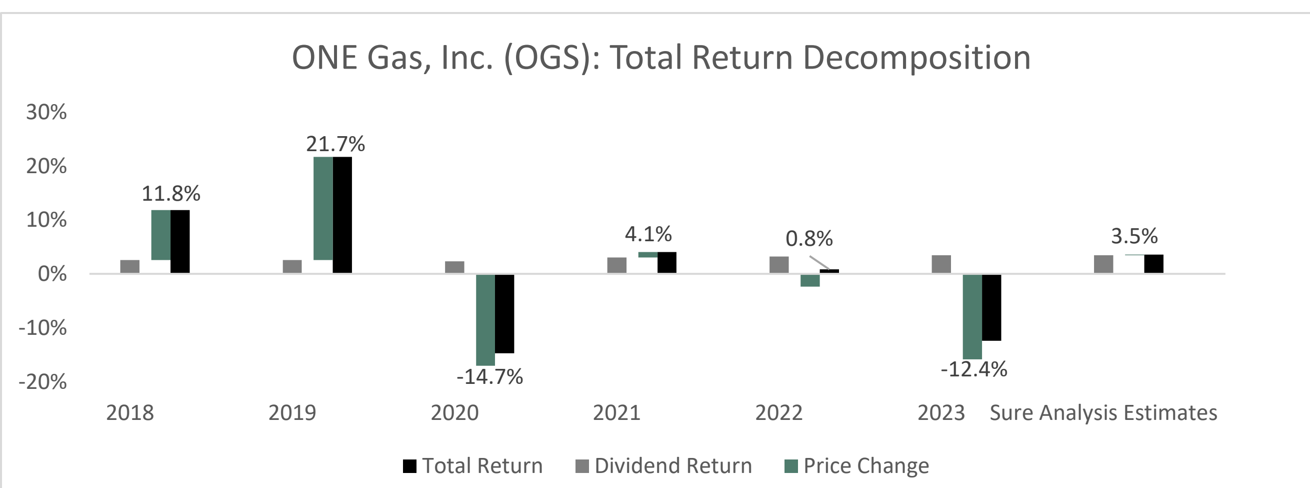
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	---	53%	52%	54%	56%	57%	58%	60%	61%	63%	***67%***	***56%***

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. Earnings are expected to be down this year as per management's guidance, but should continue to sufficiently cover the underlying dividend**.** Our growth estimates and the current dividend yield, along with the possibility of a valuation headwind imply annualized returns of just 3.5% through 2029. We rate the stock a sell, but praise its clear earnings and dividend growth visibility.

Total Return Breakdown by Year



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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	1,819	1,548	1,427	1,540	1,634	1,653	1,530	1,809	2,578	2,372
Gross Profit	406	427	488	526	507	536	562	584	647	729
Gross Margin	22.3%	27.6%	34.2%	34.2%	31.1%	32.4%	36.7%	32.3%	25.1%	30.7%
D&A Exp.	126	133	144	152	160	180	195	207	228	280
Operating Profit	225	239	289	317	288	295	304	310	350	378
Operating Margin	12.4%	15.5%	20.2%	20.6%	17.7%	17.9%	19.8%	17.1%	13.6%	15.9%
Net Profit	110	119	140	163	172	187	196	206	222	231
Net Margin	6.0%	7.7%	9.8%	10.6%	10.5%	11.3%	12.8%	11.4%	8.6%	9.7%
Free Cash Flow	(50)	114	(18)	(103)	73	(107)	(107)	(2031)	961	273
Income Tax	68	73	85	93	54	43	42	40	47	41

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	4,649	4,635	4,943	5,207	5,469	5,708	6,029	8,402	7,776	7,771
Cash & Equivalents	12	2	15	14	21	18	8	9	9.7	19
Accounts Receivable	327	216	291	299	295	250	293	342	554	348
Inventories	213	175	160	170	152	160	147	235	340	265
Goodwill & Int. Ass.	158	158	158	158	158	158	158	158	482	452
Total Liabilities	2,855	2,793	3,055	3,247	3,426	3,579	3,795	6,053	5,192	5,005
Accounts Payable	159	107	132	144	175	120	152	259	360	278
Long-Term Debt	1,243	1,204	1,337	1,550	1,585	1,803	2,001	4,177	2,925	3,049
Shareholder's Equity	1,794	1,842	1,888	1,960	2,043	2,129	2,233	2,350	2,584	2,766
LTD/E Ratio	0.69	0.65	0.71	0.79	0.78	0.85	0.90	1.78	1.13	1.10

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	2.6%	2.6%	2.9%	3.2%	3.2%	3.3%	3.3%	2.9%	2.7%	3.0%
Return on Equity	7.2%	6.5%	7.5%	8.5%	8.6%	9.0%	9.0%	9.0%	9.0%	8.6%
ROIC	3.8%	3.9%	4.5%	4.8%	4.8%	4.9%	4.8%	3.8%	3.7%	4.0%
Shares Out.	52.4	52.6	52.5	52.5	52.7	52.9	53.1	53.7	54.3	55.9
Revenue/Share	34.35	29.06	26.95	29.06	30.81	31.04	28.67	33.70	47.44	42.46
FCF/Share	(0.95)	2.13	(0.35)	(1.94)	1.38	(2.01)	(2.00)	(37.84)	17.69	4.89

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