

ONE Gas, Inc. (OGS)

\$79.71 (As of 04/30/20)

Price Target (6-12 Months): **\$84.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 12/16/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:D

Value: D

Growth: D

Momentum: A

Summary

ONE Gas' first-quarter earnings missed estimates due to warmer winter in its service territories, which in turn had an adverse impact on demand. The company continues to gain from new rates and customer growth. One Gas will benefit from the \$2.5-billion investment plan that is aimed at strengthening its infrastructure, improve systems integrity and replace old pipelines. The company's 100% regulated operation and high percentage of residential customers increase earnings visibility. One Gas' shares have outperformed the industry in the past 12 months. However, seasonality of business, a highly-competitive natural gas distribution industry and other sources of energy needed for heating are the primary headwinds. Any failure to meet stringent laws and regulations can affect the company's operations or financial results.

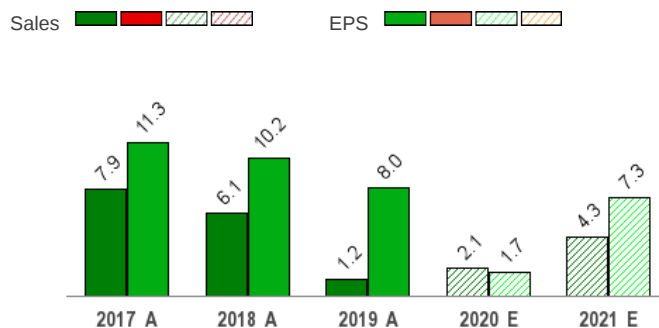
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$96.97 - \$63.67
20 Day Average Volume (sh)	292,169
Market Cap	\$4.2 B
YTD Price Change	-14.8%
Beta	0.28
Dividend / Div Yld	\$2.16 / 2.7%
Industry	Utility - Gas Distribution
Zacks Industry Rank	Top 4% (10 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-3.4%
Last Sales Surprise	-16.4%
EPS F1 Est- 4 week change	-1.6%
Expected Report Date	08/03/2020
Earnings ESP	-1.1%
P/E TTM	23.0
P/E F1	22.3
PEG F1	3.8
P/S TTM	2.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	688 E	320 E	277 E	504 E	1,761 E
2020	528 A	304 E	266 E	490 E	1,688 E
2019	661 A	291 A	249 A	453 A	1,653 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.88 E	\$0.55 E	\$0.37 E	\$1.03 E	\$3.83 E
2020	\$1.72 A	\$0.46 E	\$0.33 E	\$1.00 E	\$3.57 E
2019	\$1.76 A	\$0.46 A	\$0.33 A	\$0.96 A	\$3.51 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 04/30/2020. The reports text is as of 05/01/2020.

Overview

Headquartered in Tulsa, OK, ONE Gas, Inc. is a 100% regulated natural gas distribution utility. The company provides natural gas distribution services to more than 2.2 million customers in Oklahoma, Kansas and Texas. As of Mar 31, 2020, it operated 62,340 miles of natural gas distribution lines, transmission lines and service lines.

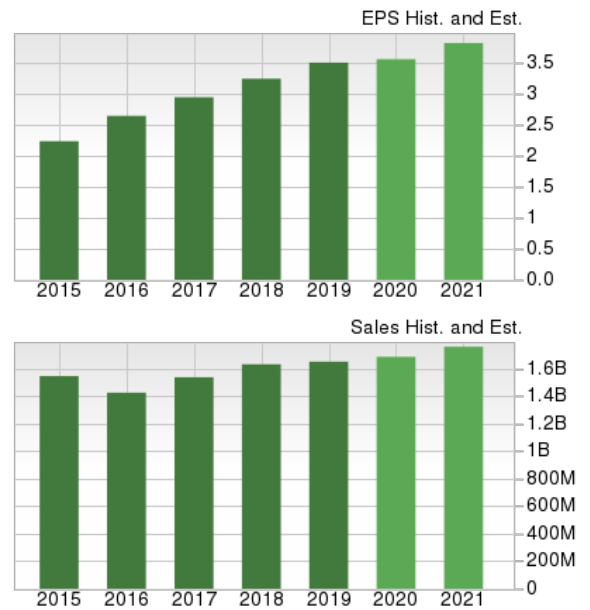
ONE Gas is the successor to the company founded in 1906 as Oklahoma Natural Gas Company, which became ONEOK, Inc. in 1980. On Jan 31, 2014, ONE Gas officially separated from ONEOK.

The company operates through three divisions namely Oklahoma Natural Gas, Kansas Gas Service and Texas Gas Service, distributing natural gas to approximately 88%, 72% and 13% of the natural gas distribution customers in Oklahoma, Kansas and Texas, respectively. At the end of 2019, 93% of customers belonged to the residential category and 7% was included in the commercial category.

During 2019, Natural gas sales, Transportation revenues and Other revenues had accounted for 91.3%, 6.9% and 1.8% of total revenues, respectively.

ONE Gas' business strategy is focused on operating its systems in a safe, reliable and environmentally responsible manner, and strategically growing business, while delivering good quality customer service.

The company operates through one reportable and operating business segment, namely regulated public utilities that deliver natural gas to residential, commercial, industrial and transportation customers.



Reasons To Buy:

- ▲ One Gas has a strong long-term capital expenditure plan, with \$485-\$525 million anticipated to be spent per year over the 2021-2024 time period. After investing \$470 million in 2019, the company plans to invest \$475 million in 2020. Roughly, it is planning to invest \$2.5 billion over the next five years to strengthen and expand existing operations. Owing to consistent investment for strengthening operations, the company's rate base is expected to improve 7% per year, on average, between 2019 and 2024. In the past 12 months, shares of One Gas have lost 8.7%, narrower than the industry's 17.7% decline.

Regulated earnings, stable debt profile, steady demand from residential customers, new rates and systematic capital expenditure will drive the company's performance.

Nearly 70% of the planned long-term capital expenditure will be directed toward systems integrity and replacement projects. It continues to make progress in the Vintage Pipeline Replacement Program and has identified 5,240 miles of pipeline as vintage among its total pipeline of 62,340 miles. One Gas has been replacing vintage pipelines at the rate of 234 miles per year over the past five years. The company plans to replace 1,000 miles of vintage pipeline within the 2020-2024 time period, and 4,240 miles from 2025 and beyond. This replacement program will continue for the next couple of decades to complete the upgrade of all vintage lines.

- ▲ One Gas is managing its long-term debt quite efficiently and working toward consistently lowering the same. Its debt to capital has been declining over the past few years. At the end of first-quarter 2020, debt to capital of the company was 37%, down from the 2019-end level of 37.7%. This also compares favorably with the industry average of 48.8%. The metric was 39.3% at the end of 2015. The company has top-tier credit rating and its outlook is stable.

The company's times interest earned ratio at the end of first-quarter 2020 was 4.7, in line with the 2019-end level. The strong ratio indicates that the company will be able to meet debt obligations in the near future without any difficulties. At a time when every entity is looking forward to preserve liquidity amid uncertainty as a result of the outbreak of COVID-19, this stable ratio is reassuring for investors.

- ▲ Regular investment in a fully-regulated company and its ability to generate sufficient cash flows will support management's plans of rewarding shareholders through average annual dividend increase of 6-8% in the 2019-2024 time period. The targeted dividend payout ratio of the company is 55-65% of net income. Strong liquidity position allows the company to meet capital expenditure target and working capital requirements.

- ▲ This 100% regulated natural gas distribution utility has a high percentage of residential customers, providing stability and strong visibility of forward earnings. At the end of 2019, the company registered a steady increase of 2.5% in customer volume from 2015 end levels. Out of the total customer base, 93% comprises residential customers. Nearly 83% of net sales margin comes from residential customers. The company continues to supply natural gas to a large group of customers. None of its customers in the past three years accounted for 10% or more of gross revenues. This in a way provides stability to the company's earnings, as the loss of any customer will not substantially affect One Gas' top line.

The new rates effective 2019 in Oklahoma, Kansas Gas Service and Texas boosted annual revenues of the company. Systematic expenditure and rate approval from the commission will enable the company to continue with infrastructure strengthening initiatives.

- ▲ ONE Gas is utilizing new technologies in its services territories, resulting in efficiency improvement and expenditure control. The company expects annual O&M expenses to increase 2-3% between 2020 and 2024. Courtesy of cost-management initiatives and low and stable gas prices, the average gas bill for customers is expected to be near \$50 per month in 2020. Given the economic distress of customers due to the outbreak of COVID-19, the company has decided to suspend customer disconnections at least till May 15.

ONE Gas' supply assets are in close proximity to gas reserves. This results in lower transportation, storage and commodity costs, and provides it a competitive advantage.

Reasons To Sell:

- ▼ The company depends on natural gas distribution for its earnings. At present, the price of natural gas is low and the trend is expected to continue in 2019 and 2020 due to huge volume of shale production. However, restrictions or regulations on shale natural gas production and waste water disposal could result in an upward movement in the prices of natural gas, which might in turn lead to migration of customers to alternative cheaper sources of fuel, thereby impacting business and financial conditions.

Competition with other energy sources, low commodity prices and seasonality of business are headwinds for the company.

The company provides natural gas distribution services to customers in Oklahoma, Kansas and Texas. Any changes in regional economies and weather patterns of these states could adversely impact growth opportunities, usage patterns and financial condition of customers, in turn adversely impacting profitability. The company is yet to ascertain the full impact of COVID-19 on net income. It expects that demand destruction might result in lower-than-expected net income and earnings per share.

- ▼ The natural gas industry is highly competitive and the company has to compete against a large number of competitors to retain customers and prove reliability of its services. Natural gas competes with electricity for water, space heating and other energy-related needs. A fall in the price of electricity or other energy products will make natural gas less attractive to customers and hence reduce its demand, hurting prospects of the company.
 - ▼ Natural gas sales to residential and commercial customers are seasonal, as a substantial portion of their natural gas requirements are for heating. Accordingly, the demand of natural gas is higher normally during the months of November through March than in other months of the year. If winter weather is warmer it would have an adverse impact on demand and profitability of the company.
 - ▼ The company is subject to laws, regulations and other legal requirements enacted or adopted by federal, state and local governmental authorities relating to environmental, health, and safety matters. Any failure to comply with these regulations could result in significant fines or penalties and adversely affect its operations or financial results.
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Last Earnings Report

ONE Gas Q1 Earnings Miss Estimates, Warm Weather Hurts

ONE Gas Inc. reported first-quarter 2020 earnings of \$1.72 per share, lagging the Zacks Consensus Estimate of \$1.78 by 3.4%.

The figure also declined 2.3% from the year-ago earnings, primarily due to warmer weather in its service territories, which in turn adversely impacted demand for natural gas.

Total Revenues

The company recorded total revenues of \$528 million in the first quarter, which missed the Zacks Consensus Estimate of \$632 million by 16.5%. Revenues also declined 20.1% from the year-ago level.

Quarterly Highlights

Natural gas sales volume of 72.6 billion cubic feet (Bcf) in the reported quarter was down 16% year over year, primarily due to warmer weather. Total volumes delivered at the end of the quarter were 138 Bcf, down 9% from the year ago period.

Total operating expenses in the reported quarter were marginally up 0.3% from the year-ago figure to \$168.8 million.

Operating income in the reported quarter increased 4.4% year over year to \$133.2 million. The improvement was attributed to residential customer growth, and new rates in Kansas and Texas. At the end of the first quarter, the company's customer base rose 0.8% from the year-ago quarter.

The company incurred interest expenses of \$15.7 million, down 0.6% from the prior-year figure.

Financial Highlights

As of Mar 31, 2020, ONE Gas had cash and cash equivalents of \$11.1 million compared with \$17.9 million at the end of 2019.

Long-term debt (excluding current maturities) was \$1,286.1 million as of Mar 31, 2020, in line with the 2019-end figure.

The company's cash flow from operating activities in first-quarter 2020 was \$182.7 million compared with \$122.9 million in the year-ago period.

Guidance

ONE Gas reiterated its 2020 guidance for net income in the range of \$186-\$198 million. Its earnings per share guidance are projected in the range of \$3.44-\$3.68. The midpoint of management's 2020 EPS guidance is \$3.56, lower than the current Zacks Consensus Estimate of \$3.60 for the period.

The company expects a negative impact on earnings from lower revenues and net incremental expenses, including bad debt costs associated with the COVID-19 pandemic.

Quarter Ending 03/2020

Report Date	Apr 27, 2020
Sales Surprise	-16.43%
EPS Surprise	-3.37%
Quarterly EPS	1.72
Annual EPS (TTM)	3.47

Valuation

ONE Gas shares are down 14.9% in the year-to-date period, and 8.7% over the trailing 12-month period. Stocks in the Zacks sub-industry was down 23.9% and the Zacks Utility sector was down 15.4% in the year-to-date period. Over the past year, the Zacks sub-industry was down 17.7% and the sector was down 19.3%.

The S&P 500 index is down 8.9% in the year-to-date period but up 0.5% in the past year.

The stock is currently trading at 21.68X of forward 12 months earnings, which compares to 14.23X for the Zacks sub-industry, 12X for the Zacks sector and 20.8X for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.8X and as low as 18.23X, with a 5-year median of 23.4X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$84 price target reflects 22.88X of forward 12 months earnings.

The table below shows summary valuation data for OGS

Valuation Multiples - OGS					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	21.68	14.23	12	20.8
	5-Year High	26.8	23.03	15.32	20.8
	5-Year Low	18.23	12.58	11.35	15.19
	5-Year Median	23.4	20.4	13.79	17.44
P/S F12M	Current	2.46	1.67	2.54	3.3
	5-Year High	2.96	2.3	3.29	3.44
	5-Year Low	1.16	1.02	1.75	2.54
	5-Year Median	2.39	1.66	2.04	3.01
P/B TTM	Current	1.98	1.89	3.1	3.89
	5-Year High	2.41	2.68	4.05	4.55
	5-Year Low	1.18	1.41	2.01	2.84
	5-Year Median	1.89	2.21	2.6	3.64

As of 4/30/2020

Industry Analysis Zacks Industry Rank: Top 4% (10 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Atmos Energy Corporation (ATO)	Outperform	1
Chesapeake Utilities Corporation (CPK)	Outperform	1
Black Hills Corporation (BKH)	Neutral	3
MDU Resources Group, Inc. (MDU)	Neutral	3
New Jersey Resources Corporation (NJR)	Neutral	3
South Jersey Industries, Inc. (SJI)	Neutral	3
Spire Inc. (SR)	Neutral	3
Southwest Gas Corporation (SWX)	Neutral	2

Industry Comparison Industry: Utility - Gas Distribution				Industry Peers		
	OGS	X Industry	S&P 500	NJR	SJI	SR
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	D	-	-	F	D	C
Market Cap	4.21 B	3.95 B	20.61 B	3.23 B	2.64 B	3.73 B
# of Analysts	4	2.5	14	2	3	5
Dividend Yield	2.71%	3.38%	2.11%	3.70%	4.13%	3.41%
Value Score	D	-	-	D	C	C
Cash/Price	0.00	0.01	0.06	0.00	0.00	0.01
EV/EBITDA	11.60	11.60	11.87	18.49	13.89	12.73
PEG Ratio	3.77	2.74	2.47	2.67	1.86	4.00
Price/Book (P/B)	1.97	1.79	2.67	1.67	1.86	1.59
Price/Cash Flow (P/CF)	11.45	9.12	10.66	11.40	11.17	9.83
P/E (F1)	22.08	18.14	19.01	16.01	19.02	19.01
Price/Sales (P/S)	2.77	1.60	2.10	1.35	1.62	1.94
Earnings Yield	4.48%	5.53%	5.05%	6.25%	5.25%	5.26%
Debt/Equity	0.60	0.95	0.72	0.84	1.45	1.06
Cash Flow (\$/share)	6.96	3.61	7.01	2.96	2.56	7.43
Growth Score	D	-	-	F	F	C
Hist. EPS Growth (3-5 yrs)	12.30%	6.69%	10.88%	5.31%	NA	2.92%
Proj. EPS Growth (F1/F0)	1.57%	3.71%	-7.32%	8.21%	34.22%	2.90%
Curr. Cash Flow Growth	10.48%	10.67%	5.92%	-18.24%	-5.11%	7.02%
Hist. Cash Flow Growth (3-5 yrs)	9.29%	7.61%	8.55%	3.04%	5.32%	15.49%
Current Ratio	0.58	0.78	1.23	0.86	0.38	0.62
Debt/Capital	37.65%	48.80%	43.84%	45.69%	59.25%	49.04%
Net Margin	12.16%	7.65%	11.08%	7.21%	4.72%	9.53%
Return on Equity	8.74%	9.04%	16.44%	9.89%	6.80%	7.85%
Sales/Assets	0.27	0.32	0.54	0.54	0.27	0.25
Proj. Sales Growth (F1/F0)	2.14%	0.16%	-1.42%	-3.01%	3.57%	-1.53%
Momentum Score	A	-	-	A	A	A
Daily Price Chg	-3.53%	-3.20%	-2.39%	-5.83%	-3.51%	-2.95%
1 Week Price Chg	-1.92%	0.00%	-1.74%	-2.06%	7.41%	-5.87%
4 Week Price Chg	0.96%	13.57%	17.07%	9.36%	22.92%	4.04%
12 Week Price Chg	-16.36%	-13.99%	-18.53%	-20.18%	-10.88%	-15.35%
52 Week Price Chg	-8.76%	-15.68%	-9.82%	-31.74%	-9.90%	-13.71%
20 Day Average Volume	292,169	507,658	2,641,413	582,584	931,132	267,530
(F1) EPS Est 1 week change	-1.04%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-1.59%	-0.08%	-6.62%	0.96%	-2.06%	0.10%
(F1) EPS Est 12 week change	-1.59%	-1.72%	-13.28%	-1.86%	-0.33%	1.43%
(Q1) EPS Est Mthly Chg	1.10%	-2.91%	-11.97%	0.00%	-112.50%	-8.70%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	D
Momentum Score	A
VGM Score	D

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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