

ONE Gas, Inc. (OGS)

\$74.55 (As of 08/03/20)

Price Target (6-12 Months): **\$78.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 12/16/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM: C

Value: C

Growth: D

Momentum: C

Summary

ONE Gas' second-quarter earnings were better than expected due to new rates and residential customer growth, which in turn spurred the demand for natural gas. The company will benefit from the ongoing investment that is aimed at strengthening infrastructure and improving systems integrity. The company's 100% regulated operation and high percentage of residential customers increase earnings visibility. Usage of new technology in its service areas is lowering operating expenses. One Gas' shares have outperformed the industry in the past 12 months. However, seasonality of the business, a highly-competitive natural gas distribution industry and other sources of energy needed for heating are the primary headwinds. Any failure to meet the stringent laws and regulations can affect the company's operations or financial results.

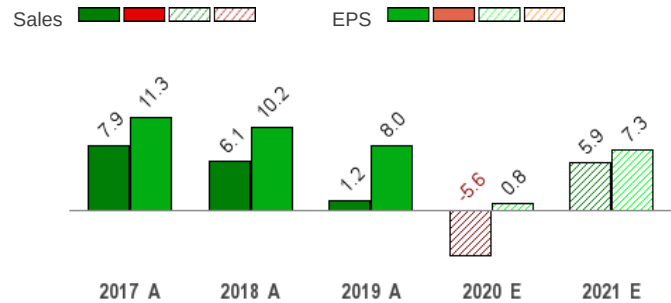
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$96.97 - \$63.67
20 Day Average Volume (sh)	236,776
Market Cap	\$3.9 B
YTD Price Change	-20.3%
Beta	0.24
Dividend / Div Yld	\$2.16 / 2.9%
Industry	Utility - Gas Distribution
Zacks Industry Rank	Bottom 10% (228 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	6.7%
Last Sales Surprise	-7.8%
EPS F1 Est- 4 week change	-0.2%
Expected Report Date	10/26/2020
Earnings ESP	-1.0%
P/E TTM	21.4
P/E F1	21.1
PEG F1	3.6
P/S TTM	2.6

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	617 E	313 E	277 E	504 E	1,652 E
2020	528 A	273 A	266 E	490 E	1,560 E
2019	661 A	291 A	249 A	453 A	1,653 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.78 E	\$0.51 E	\$0.41 E	\$1.05 E	\$3.80 E
2020	\$1.72 A	\$0.48 A	\$0.34 E	\$0.99 E	\$3.54 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 08/03/2020. The reports text is as of 08/04/2020.

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. The company has been registering an increase in average customer count in these three states since 2014. As of May 19, 2020, it operated 62,340 miles of natural gas distribution, transmission and service lines.

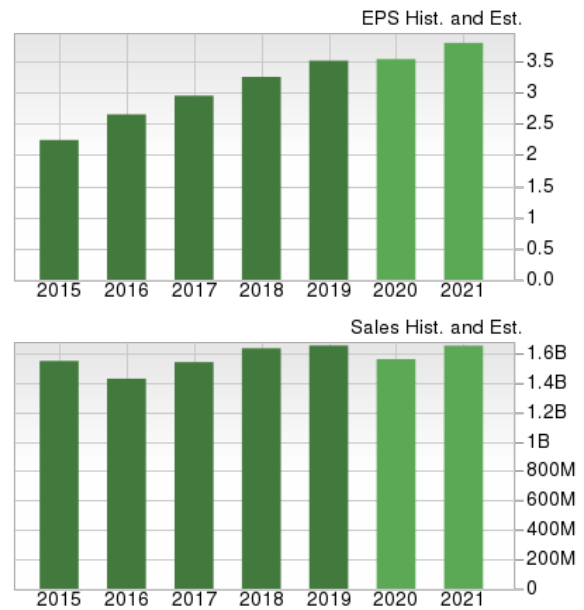
ONE Gas is the successor to the company founded in 1906 as Oklahoma Natural Gas Company, which became ONEOK, Inc. in 1980. On Jan 31, 2014, ONE Gas officially separated from ONEOK.

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. ONE Gas' existing assets have close a proximity to significant natural gas reserves and transportation infrastructure. This results in lower transportation, storage and commodity costs, thereby giving the company a competitive advantage over peers.

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:

- ▲ After investing \$470 million in 2019, OneGas plans to invest in the range of \$500-\$525 million in 2020, up from \$475 million planned earlier. The increase is primarily driven by the extension of services to new customers. The ongoing capital expenditures are directed toward pipeline integrity, extension of service to new areas, increase in system capacity, pipeline replacements, automated meter reading, government-mandated pipeline relocations, facilities, information technology assets and cybersecurity. In the past 12 months, shares of One Gas have lost 15.8%, narrower than the industry's 23.7% 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 capital expenditure will be directed toward systems integrity and replacement projects. It continues to make progress in the Vintage Pipeline Replacement Program. Of its total pipeline of 62,340 miles, the company has identified 5,240 miles of pipelines as vintage. One Gas has been replacing vintage pipelines at the rate of 234 miles per year over the past five years. 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 second-quarter 2020, the company's total debt to capital was 41.92%, which compares favorably with the industry average of 59.54%. It has top-tier credit rating and its outlook is stable.

The company's times interest earned ratio at the end of second-quarter 2020 was 4.6, down 10 basis points sequentially. A 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, subject to approval of the board of directors.

- ▲ 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 in Oklahoma, Kansas and Texas will continue to boost annual revenues of the company. Systematic expenditure and rate approval from the commission will enable it to continue with infrastructure strengthening initiatives. In addition, ONE Gas' supply assets are in close proximity to gas reserves. This results in lower transportation, storage and commodity costs, as well as provides it with 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.

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. Due to late payment, reconnect and collection fees —primarily related to the moratoriums on disconnects for nonpayment in response to the COVID-19 pandemic — resulted in a \$1.9-million decline in operating income for the second quarter.

- ▼ 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.

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

Last Earnings Report

ONE Gas Q2 Earnings Beat Estimates, Increase Y/Y

ONE Gas Inc. reported second-quarter 2020 earnings of 48 cents per share, beating the Zacks Consensus Estimate of 45 cents by 6.7%.

The bottom line also improved 4.3% from the year-ago earnings, primarily owing to new rates in Kansas and Texas and residential customer growth, which in turn, spurred demand for natural gas.

Quarter Ending **06/2020**

Report Date	Jul 27, 2020
Sales Surprise	-7.80%
EPS Surprise	6.67%
Quarterly EPS	0.48
Annual EPS (TTM)	3.49

Total Revenues

The company recorded total revenues of \$273.3 million in the second quarter, which missed the Zacks Consensus Estimate of \$296 million by 7.7%. Revenues also declined 5.9% from the year-ago level.

Quarterly Highlights

Natural gas sales volume delivered in the reported quarter was 20.7 billion cubic feet (Bcf), up 9.5% year over year, primarily on higher residential customer usage. Total volumes delivered in the same period were 71.6 Bcf, up 1.9% from the year-ago period.

Total operating expenses in the reported quarter inched up 3.2% from the year-ago figure to \$166.2 million.

Operating income in the reported quarter dipped 4.9% year over year to \$44.6 million.

In the second quarter of 2020, the company's customer base rose 1.1% from the year-ago time frame, which aided its top and the bottom line.

The company incurred net interest expenses of \$15.8 million, up 2.9% from the prior-year figure.

Financial Highlights

As of Jun 30, 2020, ONE Gas had cash and cash equivalents of \$10.5 million compared with \$17.9 million at the end of 2019.

Long-term debt (excluding current maturities) was \$1,581.9 million as of Jun 30, 2020, compared with \$1,286.1 million as of Dec 31, 2019.

Cash provided by operating activities in first-half 2020 was \$278.7 million compared with \$241.2 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 outlook are projected in the \$3.44-\$3.68 band. The midpoint of management's 2020 EPS guidance is \$3.56, marginally higher than the current Zacks Consensus Estimate of \$3.55 for the period.

Capital expenditure view including asset removal costs is increased to \$500-\$525 million from \$475 million, primarily due to the extension of services to new customers.

Valuation

ONE Gas shares are down 20.7% in the year-to-date period, and down 15.8% over the trailing 12-month period. Stocks in the Zacks sub-industry was down 28.9% and the Zacks Utility sector was down 20.7% in the year-to-date period. Over the past year, the Zacks sub-industry was down 23.7% and the sector was down 7.2%.

The S&P 500 index is up 2.3% in the year-to-date period but up 16.2% in the past year.

The stock is currently trading at 20.21X of forward 12 months earnings, which compares to 14.18X for the Zacks sub-industry, 12.94X for the Zacks sector and 22.59X 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 \$78 price target reflects 21.19X 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	20.21	14.18	12.94	22.59
	5-Year High	26.8	23.03	15.31	22.59
	5-Year Low	18.23	12.59	11.38	15.25
	5-Year Median	23.4	20.4	13.78	17.55
P/S F12M	Current	2.44	1.74	2.71	3.6
	5-Year High	2.96	2.3	3.29	3.6
	5-Year Low	1.16	1.02	1.75	2.53
	5-Year Median	2.43	1.69	2.06	3.04
P/B TTM	Current	1.8	1.92	3.69	4.5
	5-Year High	2.41	2.68	4.16	4.56
	5-Year Low	1.2	1.41	2.01	2.83
	5-Year Median	1.9	2.21	2.62	3.72

As of 8/3/2020

Industry Analysis Zacks Industry Rank: Bottom 10% (228 out of 254)



Top Peers

Company (Ticker)	Rec	Rank
Sempra Energy (SRE)	Outperform	3
Atmos Energy Corporation (ATO)	Neutral	4
Chesapeake Utilities Corporation (CPK)	Neutral	3
National Fuel Gas Company (NFG)	Neutral	4
NewJersey Resources Corporation (NJR)	Neutral	3
South Jersey Industries, Inc. (SJI)	Neutral	4
Spire Inc. (SR)	Neutral	3
ONEOK, Inc. (OKE)	Underperform	5

Industry Comparison Industry: Utility - Gas Distribution				Industry Peers		
	OGS	X Industry	S&P 500	NFG	SJI	SR
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	4	-	-	4	4	3
VGM Score	C	-	-	B	A	B
Market Cap	3.95 B	3.75 B	22.67 B	3.55 B	2.14 B	3.18 B
# of Analysts	4	3	13.5	3	3	5
Dividend Yield	2.90%	3.43%	1.77%	4.34%	5.09%	4.01%
Value Score	C	-	-	B	B	B
Cash/Price	0.00	0.04	0.07	0.03	0.00	0.03
EV/EBITDA	11.67	10.22	13.08	7.21	12.39	11.47
PEG Ratio	3.62	3.11	2.94	NA	1.49	3.54
Price/Book (P/B)	1.80	1.71	3.10	1.71	1.43	1.31
Price/Cash Flow (P/CF)	10.71	8.70	12.34	6.16	9.05	8.36
P/E (F1)	21.18	16.44	21.71	14.75	15.34	16.82
Price/Sales (P/S)	2.63	1.49	2.46	2.24	1.40	1.74
Earnings Yield	4.75%	6.01%	4.38%	6.77%	6.52%	5.95%
Debt/Equity	0.72	0.96	0.75	1.03	1.38	1.03
Cash Flow (\$/share)	6.96	4.07	6.94	6.66	2.56	7.43
Growth Score	D	-	-	B	B	B
Hist. EPS Growth (3-5 yrs)	10.58%	6.12%	10.46%	3.47%	NA	3.11%
Proj. EPS Growth (F1/F0)	0.71%	-0.27%	-7.08%	-19.32%	34.82%	-1.13%
Curr. Cash Flow Growth	10.48%	10.67%	5.47%	8.53%	-5.11%	7.02%
Hist. Cash Flow Growth (3-5 yrs)	9.29%	8.55%	8.55%	-3.17%	5.32%	15.49%
Current Ratio	0.71	0.81	1.32	0.85	0.30	0.62
Debt/Capital	41.92%	48.28%	44.21%	50.65%	57.99%	48.28%
Net Margin	12.35%	8.74%	10.25%	5.77%	6.05%	8.83%
Return on Equity	8.62%	8.87%	14.72%	13.13%	7.31%	8.35%
Sales/Assets	0.27	0.28	0.52	0.24	0.25	0.24
Proj. Sales Growth (F1/F0)	-5.61%	0.00%	-1.79%	-2.25%	-9.23%	-6.57%
Momentum Score	C	-	-	D	B	D
Daily Price Chg	-1.52%	0.00%	0.27%	1.18%	-0.69%	0.62%
1 Week Price Chg	-2.01%	-1.43%	0.14%	-2.10%	-1.64%	-2.70%
4 Week Price Chg	-2.41%	-0.94%	2.96%	-1.89%	-3.42%	-7.50%
12 Week Price Chg	-6.59%	-1.98%	10.90%	-1.98%	-15.41%	-13.04%
52 Week Price Chg	-15.46%	-20.87%	2.35%	-13.98%	-27.68%	-22.41%
20 Day Average Volume	236,776	351,791	2,043,624	582,499	909,985	351,791
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.21%	-0.06%	0.82%	-2.68%	-0.22%	-0.16%
(F1) EPS Est 12 week change	-0.84%	-0.66%	0.59%	-4.02%	0.33%	-3.91%
(Q1) EPS Est Mthly Chg	0.98%	0.00%	0.25%	-13.33%	5.08%	1.99%

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	C
Growth Score	D
Momentum Score	C
VGM Score	C

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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