

ONE Gas, Inc. (OGS)

\$83.28 (As of 03/09/20)

Price Target (6-12 Months): **\$88.00**

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: C

Growth: C

Momentum: C

Summary

ONE Gas fourth-quarter earnings surpassed the Zacks Consensus Estimate and increased from the year-ago level. The company has been gaining from new rates and customer growth, which are positively impacting demand. One Gas will benefit from long-term investment plans that are aimed at strengthening its infrastructure. The company's 100% regulated operation and high percentage of residential customers increase earnings visibility. One Gas' shares have outperformed its industry in the past six 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.

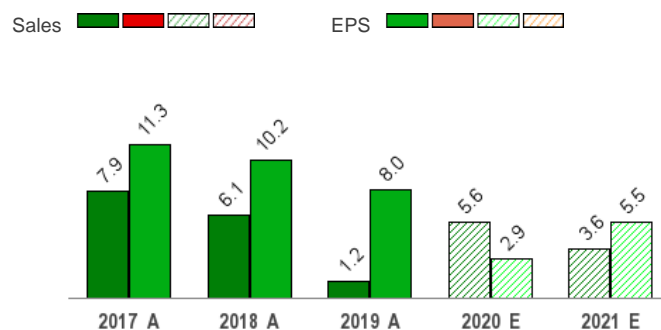
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$96.97 - \$80.54
20 Day Average Volume (sh)	314,413
Market Cap	\$4.4 B
YTD Price Change	-11.0%
Beta	0.49
Dividend / Div Yld	\$2.16 / 2.6%
Industry	Utility - Gas Distribution
Zacks Industry Rank	Top 18% (45 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.1%
Last Sales Surprise	-3.2%
EPS F1 Est- 4 week change	-0.3%
Expected Report Date	05/04/2020
Earnings ESP	0.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					1,809 E
2020	700 E	315 E	263 E	501 E	1,746 E
2019	661 A	291 A	249 A	453 A	1,653 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021					\$3.81 E
2020	\$1.76 E	\$0.46 E	\$0.38 E	\$1.03 E	\$3.61 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.

P/E TTM	23.7
P/E F1	23.1
PEG F1	3.9
P/S TTM	2.7

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 03/09/2020. The reports text is as of 03/10/2020.

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 Dec 31, 2019, it owned 43,300 miles of natural gas distribution lines, natural gas transmission lines and service lines.

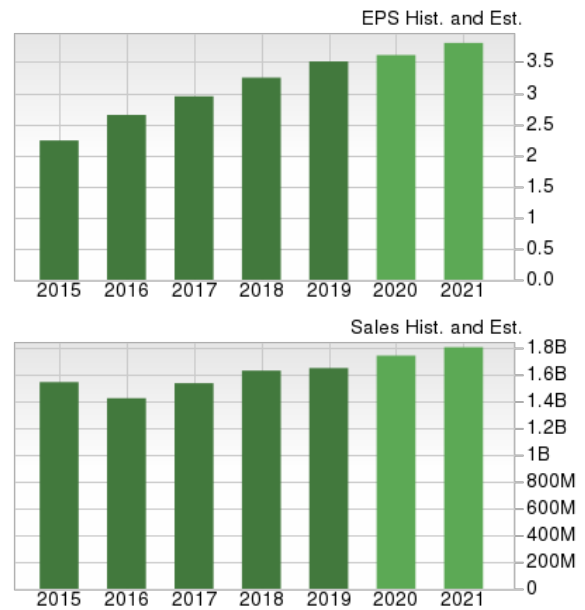
ONE Gas is the successor to the company founded in 1906 as Oklahoma Natural Gas Company, which became ONEOK, Inc. in 1980. On Jan 31, 2014, ONE Gas officially separated from ONEOK.

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 six months, shares of One Gas have lost 8.5%, narrower than its industry's 8.8% decline.

Regulated earnings, 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 expenditures 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 56,250 miles. One Gas has been replacing vintage pipelines at the rate of 265 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. 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.

- ▲ Regular investment in a fully-regulated company and its ability to generate sufficient cash flows will support management's plans for rewarding its 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. The company, which scores strongly with the credit rating agencies, has a stable outlook.

- ▲ 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. At the end of 2019, 93% were 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 in the range of 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.

Close proximity to significant natural gas reserves in Oklahoma and Texas provides additional benefits to the company. Incidentally

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 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 Q4 Earnings Beat Estimates, Revenues Miss

ONE Gas reported fourth-quarter 2019 earnings of 96 cents per share, which surpassed the Zacks Consensus Estimate of 95 cents by 1.1%.

The figure also rose 14.3% from the year-ago level driven by new rates, and residential customer growth in Oklahoma and Texas.

Total Revenues

The company recorded total revenues of \$453 million in the fourth quarter, which missed the Zacks Consensus Estimate of \$468 million by 3.3%. Revenues also declined 2.6% from the year-ago level.

Quarterly Highlights

Total operating expenses in the reported quarter increased 9.2% from the year-ago figure to \$179.92 million.

Operating income in the reported quarter increased 1.2% year over year to \$81.9 million.

The company incurred interest expenses of \$15.7 million, up 7.5% from the prior-year figure. The increase in expenses was due to refinancing of its senior notes.

Financial Highlights

As of Dec 31, 2019, ONE Gas had cash and cash equivalents of \$17.9 million compared with \$21.3 million in the corresponding period of 2018.

Long-term debt (excluding current maturities) was \$1,286.1 million as of Dec 31, 2019, up from the comparable year-ago level of \$1,285.5 million.

The company's cash flow from operating activities in 2019 was \$310.4 million compared with \$467.7 million a year ago.

Guidance

ONE Gas has maintained its 2020 guidance, declared on Jan 21, 2020, for net income in the range of \$186-\$198 million. Its earnings per share guidance is 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 \$3.62 for the period.

The company's capital expenditures guidance, including asset removal costs, is estimated to be \$475 million for 2020. Out of this, 70% will be directed toward system integrity and replacement projects.

Quarter Ending **12/2019**

Report Date	Feb 19, 2020
Sales Surprise	-3.23%
EPS Surprise	1.05%
Quarterly EPS	0.96
Annual EPS (TTM)	3.51

Valuation

ONE Gas shares are down 11% in the year-to-date period, and down 5.8% over the trailing 12-month period. Stocks in the Zacks sub-industry was down 22.9% and the Zacks Utility sector was down 7.4% in the year-to-date period. Over the past year, the Zacks sub-industry was down 16% and the sector was down 11.6%.

The S&P 500 index is down 14.8% in the year-to-date period and down 2.3% in the past year.

The stock is currently trading at 22.82X of forward 12 months earnings, which compares to 18.24X for the Zacks sub-industry, 13.58X for the Zacks sector and 17.01X for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.8X and as low as 18.2X, with a 5-year median of 23.36X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$88 price target reflects 24.17X 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	22.82	18.24	13.58	17.01
	5-Year High	26.8	23.03	15.36	19.34
	5-Year Low	18.2	16.66	12.58	15.18
	5-Year Median	23.36	20.39	13.77	17.42
P/S F12M	Current	2.5	1.97	2.9	3.14
	5-Year High	2.96	2.3	3.31	3.44
	5-Year Low	1.11	1.01	1.76	2.54
	5-Year Median	2.36	1.66	2.03	3.01
P/B TTM	Current	2.06	2.1	3.64	3.99
	5-Year High	2.41	2.68	4.07	4.56
	5-Year Low	1.15	1.53	2.02	2.85
	5-Year Median	1.87	2.21	2.59	3.63

As of 3/9/2020

Industry Analysis Zacks Industry Rank: Top 18% (45 out of 253)



Top Peers

Atmos Energy Corporation (ATO)	Neutral
Black Hills Corporation (BKH)	Neutral
Chesapeake Utilities Corporation (CPK)	Neutral
MDU Resources Group, Inc. (MDU)	Neutral
NewJersey Resources Corporation (NJR)	Neutral
South Jersey Industries, Inc. (SJI)	Neutral
Spire Inc. (SR)	Neutral
Southwest Gas Corporation (SWX)	Underperform

Industry Comparison Industry: Utility - Gas Distribution				Industry Peers		
	OGS Neutral	X Industry	S&P 500	NJR Neutral	SJI Neutral	SR Neutral
VGM Score	D	-	-	F	D	D
Market Cap	4.40 B	4.05 B	19.13 B	3.34 B	2.38 B	3.93 B
# of Analysts	4	2	13	1	2	5
Dividend Yield	2.59%	3.07%	2.26%	3.57%	4.58%	3.23%
Value Score	C	-	-	D	C	C
Cash/Price	0.00	0.01	0.05	0.00	0.00	0.01
EV/EBITDA	12.00	12.05	11.99	18.94	13.12	13.14
PEG Ratio	3.93	2.98	1.68	NA	NA	3.84
Price/Book (P/B)	2.06	1.80	2.64	1.73	1.67	1.67
Price/Cash Flow (P/CF)	11.96	9.61	10.70	11.81	10.07	10.37
P/E (F1)	23.01	16.76	15.44	16.74	16.78	19.84
Price/Sales (P/S)	2.66	1.58	2.05	1.40	1.46	2.05
Earnings Yield	4.33%	5.88%	6.47%	5.97%	5.94%	5.04%
Debt/Equity	0.60	0.95	0.70	0.84	1.45	1.06
Cash Flow (\$/share)	6.96	3.61	7.01	2.96	2.56	7.43
Growth Score	C	-	-	F	F	D
Hist. EPS Growth (3-5 yrs)	12.30%	6.00%	10.85%	5.31%	-2.54%	2.92%
Proj. EPS Growth (F1/F0)	2.92%	7.39%	6.25%	7.18%	37.05%	4.02%
Curr. Cash Flow Growth	10.48%	7.77%	6.09%	-18.24%	-5.11%	7.02%
Hist. Cash Flow Growth (3-5 yrs)	9.29%	7.61%	8.52%	3.04%	5.32%	15.49%
Current Ratio	0.58	0.78	1.24	0.86	0.38	0.62
Debt/Capital	37.65%	48.80%	42.57%	45.69%	59.25%	49.04%
Net Margin	11.30%	8.18%	11.69%	7.21%	4.72%	9.53%
Return on Equity	8.85%	9.05%	16.74%	9.89%	6.80%	7.85%
Sales/Assets	0.30	0.32	0.54	0.54	0.27	0.25
Proj. Sales Growth (F1/F0)	5.66%	5.01%	3.76%	-3.01%	7.02%	-0.54%
Momentum Score	C	-	-	C	B	D
Daily Price Chg	-5.50%	-6.19%	-7.65%	-8.02%	-8.33%	-5.37%
1 Week Price Chg	7.29%	3.88%	-0.67%	7.73%	3.88%	8.39%
4 Week Price Chg	-11.64%	-12.67%	-19.26%	-17.96%	-18.07%	-10.84%
12 Week Price Chg	-9.96%	-9.96%	-17.26%	-21.09%	-19.05%	-4.68%
52 Week Price Chg	-5.83%	-15.95%	-6.83%	-30.22%	-15.95%	-3.51%
20 Day Average Volume	314,413	423,884	2,684,709	593,755	889,099	282,191
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.28%	0.00%	-0.06%	-2.79%	1.66%	1.62%
(F1) EPS Est 12 week change	-1.03%	-1.03%	-0.46%	-2.79%	-1.60%	3.40%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	-0.40%	10.48%	0.47%	0.79%

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	C
Momentum Score	C
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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