ONE Gas, Inc. (OGS)

Jan 16, 2020

$94.17 (As of 01/15/20)

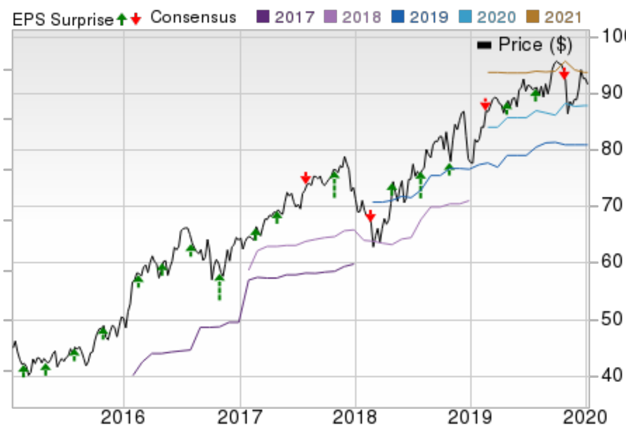
Price Target (6-12 Months): **$99.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 12/16/19) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:D
	Value: C | Growth: D | Momentum: B	

Summary

ONE Gas continues to benefit from new rates implemented in its service territories and residential customer growth, which are positively impacting demand. One Gas is poised to 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. It is investing in new technologies to improve efficiency and reliability of its services.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.

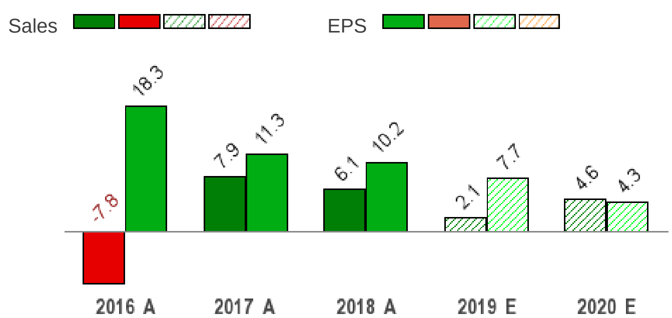
Price, Consensus & Surprise



Data Overview

52 Week High-Low	**$96.66 - $79.22**
20 Day Average Volume (sh)	**255,991**
Market Cap	**$5.0 B**
YTD Price Change	**0.6%**
Beta	**0.26**
Dividend / Div Yld	**$2.00 / 2.1%**
Industry	**Utility - Gas Distribution**
Zacks Industry Rank	**Bottom 36% (162 out of 254)**
Last EPS Surprise	**-2.9%**
Last Sales Surprise	**-2.2%**
EPS F1 Est- 4 week change	**0.1%**
Expected Report Date	**02/19/2020**
Earnings ESP	**2.1%**
P/E TTM	**27.8**
P/E F1	**25.8**
PEG F1	**4.4**
P/S TTM	**3.0**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2020	700 E	315 E	263 E	501 E	1,745 E
2019	661 A	291 A	249 A	468 E	1,669 E
2018	638 A	293 A	238 A	464 A	1,634 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	$1.77 E	$0.47 E	$0.37 E	$1.02 E	$3.65 E
2019	$1.76 A	$0.46 A	$0.33 A	$0.95 E	$3.50 E
2018	$1.72 A	$0.39 A	$0.31 A	$0.84 A	$3.25 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 01/15/2020. The reports text is as of 01/16/2020.

Overview

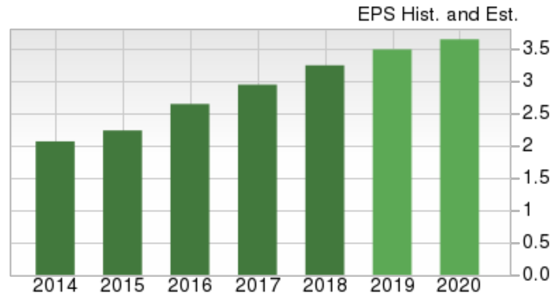
Headquartered in Tulsa, OK, ONE Gas, Inc. is a 100% regulated natural gas distribution utility. The company provides natural gas distribution services to more than 2.2 million customers in Oklahoma, Kansas and Texas. As of Dec 31, 2018, it owned 61,400 miles of natural gas distribution lines, natural gas transmission lines and service lines.

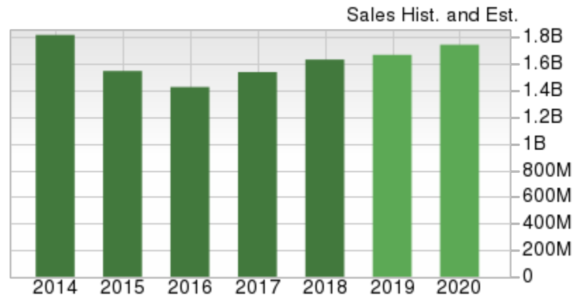
ONE Gas is the successor to the company founded in 1906 as Oklahoma Natural Gas Company, which became ONEOK, Inc. in 1980. On Jan 31, 2014, ONE Gas officially separated from ONEOK.

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 2018, 93% of its customers belonged to the residential category and 7% was included in the commercial category.

During 2018, Natural gas sales, Transportation revenues and Other revenues had accounted for 89.7%, 6.7% and 3.6% 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:

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

▲ One Gas has a strong long-term capital expenditure plan, with $450-$500 million anticipated to be spent per year over the 2020-2023 time period. After investing $442 million in 2018, the company plans to invest $450 million in 2019. Roughly, it is planning to invest $2.4 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 6-7% per year, on average, between 2018 and 2023. In the past six months, shares of One Gas have gained 23.5% compared with its industry's 5% rally.

It continues to make progress in the Vintage Pipeline Replacement Program and has identified 5,400 miles of pipeline as vintage among its total pipeline of 61,400 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 1,150 miles of vintage pipeline within the 2019-2023 time period, and 4,250 miles from 2024 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 7-9% in the 2018-2023 time period. The targeted dividend payout ratio of the company is 55-65% of net income. Its current dividend yield is 2.12%, better than the Zacks S&P 500 composite's average of 1.75%.

The strong liquidity position allows the company to meet its 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 2018, the company registered a steady increase in customer volume, which was up 2.4% from 2014 end levels. At the end of 2018, 93% of its customers 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 February 2019 in Oklahoma and Kansas Gas Service will lead to an increase in annual revenues of the company. Additionally, new rates became effective in West Texas and Central Texas this July and June, respectively, which will result in a total increase of $9.6 million in revenues. The pending cases, on approval, will further increase its top line.

▲ 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 2019 and 2023. This will allow it to keep natural gas rates low, even amid increasing expenses.

In addition, the close proximity to significant natural gas reserves in Oklahoma and Texas provides additional benefits to the company. Incidentally, 58% of the total rigs in the United States are presently operating in Oklahoma and Texas.

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. In the past six months, shares of One Gas have gained 2.5% compared with its industry's 2.8% rally.

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

- 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.

Last Earnings Report

ONE Gas Q3 Earnings Miss Estimates, Revenues Rise Y/Y

Quarter Ending	09/2019
Report Date	Oct 28, 2019
Sales Surprise	-2.20%
EPS Surprise	-2.94%
Quarterly EPS	0.33
Annual EPS (TTM)	3.39

ONE Gas reported third-quarter 2019 earnings of 33 cents per share, which lagged the Zacks Consensus Estimate of 34 cents by 2.94%.

Nevertheless, the figure rose 6.45% from the year-ago quarter's level driven by new rates and residential customer growth.

Total Revenues

The company recorded total revenues of $249 million in the third quarter, which missed the Zacks Consensus Estimate of $254 million by nearly 1.97%.

However, revenues improved 4.62% from the year-ago quarter's level. The upside can be attributed to higher natural gas sales volumes and natural gas transportation volumes.

Quarterly Highlights

Total operating expenses in the reported quarter increased 6.2% from the year-ago quarter's figure to $160.2 million.

Operating income in the reported quarter increased 7.2% year over year to $38.8 million.

The company incurred interest expenses of $15.8 million, up 27.6% from the prior-year quarter's figure. Increase in expenses was caused by refinancing of the company's senior notes.

Financial Highlights

At the end of third quarter, ONE Gas had cash and cash equivalents of $12.6 million compared with $21.3 million at 2018-end.

Long-term debt (excluding current maturities) was $1,285.9 million as of Sep 30 2019, up from Dec 31, 2018 level of $1,285.5 million.

The company's cash flow from operating activities in the first nine months of 2019 was $288.5 million compared with $436.8 million in the year-ago period.

Guidance

ONE Gas has maintained its guidance declared on Jul 29, 2019 with net income projected in the range of $180-$190 million. The earnings per share (EPS) guidance is in the range of $3.39-$3.57. The midpoint of management's 2019 EPS guidance is $3.48, lower than the current Zacks Consensus Estimate of $3.5 for the period.

The company has set its capital expenditures guidance, including asset removal costs, at nearly $450 million in 2019. Out of this, 70% of these expenditures will be directed toward system integrity and replacement projects.

Valuation

ONE Gas shares are up 23.5% in the last six months period, and up 42.9% over the trailing 12-month period. Stocks in the Zacks sub-industry was up 5% but the Zacks Utility sector was down 3.5% in the last six months period. Over the past year, the Zacks sub-industry was up 2.1% but the sector was down 6.2%.

The S&P 500 index is up 10.9% in the last six months period and up 23.8% in the past year.

The stock is currently trading at 25.74X of forward 12 months earnings, which compares to 20.19X for the Zacks sub-industry, 13.52X for the Zacks sector and 18.96X for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.8X and as low as 17.88X, with a 5-year median of 23.23X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $99 price target reflects 27.12X 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	25.74	20.19	13.52	18.96
	5-Year High	26.8	23.03	15.33	19.34
	5-Year Low	17.88	16.66	12.61	15.17
	5-Year Median	23.23	20.39	13.68	17.44
P/S F12M	Current	2.84	2.28	2.91	3.52
	5-Year High	2.96	2.28	3.26	3.52
	5-Year Low	1.1	0.98	1.7	2.54
	5-Year Median	2.31	1.6	1.95	3
P/B TTM	Current	2.36	2.66	4.06	4.49
	5-Year High	2.41	2.68	4.06	4.49
	5-Year Low	1.14	1.53	2.01	2.85
	5-Year Median	1.84	2.15	2.55	3.61

As of 1/15/2020

Industry Analysis **Zacks Industry Rank:** Bottom 36% (162 out of 254)

Top Peers

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

Industry Comparison Industry: Utility - Gas Distribution

Industry Peers

	OGS Neutral	X Industry	S&P 500	NJR Neutral	SJI Underperform	SR Neutral
VGM Score	D	-	-	C	F	D
Market Cap	4.97 B	4.61 B	24.22 B	3.97 B	2.92 B	4.25 B
# of Analysts	3	2	13	1	3	5
Dividend Yield	2.12%	2.73%	1.75%	2.84%	3.74%	2.99%
Value Score	C	-	-	C	D	D
Cash/Price	0.00	0.01	0.04	0.00	0.00	0.00
EV/EBITDA	14.27	13.48	14.11	21.43	20.90	13.00
PEG Ratio	4.44	2.88	2.06	2.56	2.45	4.29
Price/Book (P/B)	2.36	2.09	3.34	2.55	2.06	1.84
Price/Cash Flow (P/CF)	14.89	12.10	13.57	14.86	10.83	11.23
P/E (F1)	25.95	20.26	18.90	20.48	20.85	22.07
Price/Sales (P/S)	2.98	2.00	2.65	1.53	1.73	2.18
Earnings Yield	3.88%	4.83%	5.29%	4.88%	4.78%	4.53%
Debt/Equity	0.61	0.99	0.72	0.99	1.43	0.91
Cash Flow ($/share)	6.33	3.40	6.94	2.96	2.91	7.43
Growth Score	D	-	-	B	F	D
Hist. EPS Growth (3-5 yrs)	12.67%	5.57%	10.56%	4.31%	-2.54%	3.98%
Proj. EPS Growth (F1/F0)	4.48%	9.92%	7.59%	10.26%	37.99%	1.29%
Curr. Cash Flow Growth	7.90%	7.46%	14.73%	-18.24%	12.46%	7.02%
Hist. Cash Flow Growth (3-5 yrs)	6.38%	6.65%	9.00%	3.04%	8.99%	15.49%
Current Ratio	0.57	0.77	1.24	1.15	0.25	0.42
Debt/Capital	37.96%	49.94%	42.99%	49.76%	58.81%	45.06%
Net Margin	10.83%	8.72%	11.14%	6.54%	8.81%	9.37%
Return on Equity	8.63%	8.85%	17.16%	11.31%	6.56%	7.64%
Sales/Assets	0.30	0.35	0.55	0.61	0.28	0.27
Proj. Sales Growth (F1/F0)	4.57%	4.13%	4.23%	11.84%	1.52%	-1.05%
Momentum Score	B	-	-	C	F	A
Daily Price Chg	1.39%	0.98%	0.27%	1.69%	0.86%	1.36%
1 Week Price Chg	-1.10%	-1.23%	0.39%	-3.06%	-4.13%	-2.05%
4 Week Price Chg	-0.84%	0.34%	2.17%	-2.89%	-3.52%	-0.61%
12 Week Price Chg	-0.88%	0.95%	6.65%	-0.50%	-1.38%	-1.58%
52 Week Price Chg	16.89%	10.20%	22.43%	-3.12%	6.91%	10.20%
20 Day Average Volume	255,991	302,067	1,545,017	556,789	707,435	227,778
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.85%
(F1) EPS Est 4 week change	0.09%	0.00%	0.00%	0.00%	-2.99%	1.35%
(F1) EPS Est 12 week change	-0.25%	-0.01%	-0.41%	-0.69%	0.22%	-2.00%
(Q1) EPS Est Mthly Chg	2.31%	0.00%	0.00%	0.00%	-0.47%	2.44%

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	B
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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