



COMPANY UPDATE / ESTIMATE CHANGE

Key Metrics

OGS - NYSE - as of	1/17/18	\$69.79
Price Target		--
52-Week Range	\$62.81 -	\$79.51
Shares Outstanding (mm)		52.3
Market Cap. (\$mm)		\$3,648.2
1-Mo. Average Daily Volume		218,928
Institutional Ownership		7396.0%
LT Debt/Total Capital	Q3'17	38.2%
ROE	TTM	8.3%
Book Value / Share	Q3'17	\$36.50
Price / Book Value		1.9x
Dividend Yield		2.6%
EBITDA Margin	FY'16	28.9%

EPS FY 12/31

		Prior	Current	Prior	Current
	2016A	2017E	2017E	2018E	2018E
1Q	\$1.22	--	\$1.44	A --	--
2Q	\$0.38	--	\$0.39	A --	--
3Q	\$0.24	--	\$0.36	A --	--
4Q	\$0.80	\$0.90	\$0.89	--	--
Year	\$2.64	\$3.09	\$3.07	\$3.29	\$3.16
P/E	26.4x		22.7x	--	22.1x

Gross Margin (\$MM)

		Prior	Current	Prior	Current
	2016A	2017E	2017E	2018E	2018E
1Q	\$273	--	\$287	A --	--
2Q	\$189	--	\$197	A --	--
3Q	\$180	--	\$188	A --	--
4Q	\$243	\$257	\$253	--	--
Year	\$885	\$929	\$926	\$965	\$904

Company Description: *ONE Gas, Inc. is a stand-alone, 100% regulated natural gas utility, trading on the NYSE under the symbol 'OGS,' and listed in the S&P MidCap 400 Index. OGS serves more than 2.1MM natural gas distribution customers across Oklahoma, Kansas and Texas.*

Natural Gas Utilities

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January 18, 2018

ONE Gas, Inc.

OGS — NYSE — Neutral-2

Adjusting for 2018 Guidance and Impact of Tax Cuts; Reiterating Neutral Rating.

Investment Highlights

- OGS initiated implied 2018 EPS guidance in the range of \$2.96 to \$3.20. The suggested mid-point of \$3.08 fell short of consensus at \$3.17, but is somewhat conservative, in our view.
- The company expects 2018 Cap Ex of \$375MM, which compels a slight upward revision to our model.
- OGS' 5-yr stretch targets (2018-2022) were extended a year, and are: 5%-7% average EPS growth per year, annual Cap Ex of \$375-\$415 (+\$30MM/yr), average annual rate base growth of 6%-6.5% (+100bps).
- At this time, we adjust our financial model for recent changes in the US tax code. Some line items see major revisions, but the net impact to income is negligible. Perhaps more importantly, we do not see recent tax changes as impacting OGS' long-term growth outlook.
- Investors may notice a sharp decline in our gross margin assumptions for 2018/2019. This is primarily offset by lower taxes, as OGS accrues a portion of its currently-allowed tariff structure as a refundable liability to customers. OGS guidance assumes no ultimate retention of any over-collected tax cash flow.
- ONE Gas hiked 2017 EPS guidance to the range of \$3.06-\$3.10; we calculate the \$0.09 raise to the mid-point was driven by \$0.03 of special items and \$0.06 of core ops. Adjusting for items, we view guidance as implying normalized EPS in 2017 of \$2.95 (mid-point). Reflecting tax changes and interim model tweaks, and in deference to guidance, our 2017/18/19 EPS estimates move -\$0.02/-0.13/\$-0.07.
- We are reiterating our Neutral rating on OGS. We are comfortable with valuation for ONE Gas from a long-term risk/reward standpoint, but take a tactical approach in assigning our rating at this time.

Note Important Disclosures on Pages 5-6
Note Analyst Certification on Page 5

ADDITIONAL DISCUSSION—MULTIPLE ITEMS

Our OGS model and outlook reflect the material changes from recent tax legislation in the US that we can surmise at this time, which is substantially directed by commentary from ONE Gas. Likely our most useful takeaway with some clarity on the tax front is that the earnings growth profile of OGS is unchanged. A step function reduction in gross margin is substantially offset by a lower tax burden; tariff rates have yet to be adjusted, but timing here should not impact net income unless (simplistically) allowed rates of return are adjusted (a scenario we view as unlikely). This flows in line with our standing assumptions, and we remain comfortable with the qualitative outlook for OGS.

Aside from tax puts and takes, our model sees net downward pressure to our earnings estimates over the next few years, mostly as we refine our margin outlook for 2018 that was likely a bit aggressive from a core operations perspective. Nonetheless, escalation in Cap Ex projections supports future growth assumptions.

SUITABILITY

We assign OGS a suitability rating of ‘2.’ A complete description of our suitability scale is on page 5. ONE Gas represents one of the only 100% regulated publicly traded natural gas distribution companies, operating what we view as strong franchises in three states. A relatively narrow geographic footprint and short history as a standalone company, along with smaller scope versus the largest Utility sector companies, push OGS just below our most conservative ‘1’ suitability rating. Resilient cash flow, below-sector leverage, and a strictly regulated business mix keep OGS well above our more aggressive ‘3’ rating.

CONSIDERATIONS AND RISKS

ONE Gas has been a standalone company since 2014, and thus holds a short track record of independently managing certain corporate level functions. OGS’ strategic focus and growth strategy consists only of regulated operations, which is unique in the gas utility industry. A deviation from the articulated strategy would likely come as a surprise to investors, and longer-term could alter the risk profile of the company.

Nat gas competes with other fuels, primarily on the grounds of cost and reliability. Lower electricity prices and/or a substantial change in hydraulic fracturing laws that reduces the supply of US-produced natural gas could negatively impact growth in the future. Management has little control over these potential trends.

Regulatory approval is necessary for OGS’ subsidiaries to grow earnings/cash flow and generate an attractive return on investor/invested capital. A deterioration of relationships at the germane OK, KS or TX regulatory commissions could have a pronounced negative effect on the company.

Gas distribution is a capital intensive business, and we believe continued access to debt and equity financing may be important for the company to be able to pursue all prudent Cap Ex investments. Broader capital market disruptions could affect the company’s ability to grow and execute its growth strategy.

Natural gas is a combustible fuel and volatile compound; several highly publicized disasters have impacted the industry in recent years. Should OGS experience a disaster, we believe the company could be responsible for direct costs and/or compensation; issues could also damage regulatory relationships.

As a mid-cap company, ONE Gas may present an element of liquidity risk for larger investors.

Our Suitability rating is 2 on a 1-to-4 scale (1 = most conservative, 4 = most aggressive).

Additional information is available upon request.

ONE Gas, Inc.			mar	jun	sept	dec			mar	jun	sept	dec			
Income Statements (000's), FYE Dec	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17	Q4'17E	FY'17E	FY'18E	FY'19E	
Operating Revenues	\$1,818,906	\$1,547,692	\$508,364	\$245,923	\$232,191	\$440,753	\$1,427,232	\$550,408	\$279,689	\$247,142					
Cost of gas	991,949	705,959	235,729	56,457	52,253	197,358	541,797	263,154	82,572	58,769					
Gross Margin (GM)	826,957	841,733	272,635	189,466	179,938	243,395	885,435	287,254	197,117	188,373	252,860	925,600	904,150	928,250	
Operating Expenses															
O & M	420,686	414,476	106,131	97,119	99,402	114,490	417,142	109,357	101,241	95,371	114,490	420,460	411,080	413,130	
D & A	125,722	133,023	34,684	35,565	36,241	37,339	143,829	37,019	37,851	38,423	39,690	152,980	163,680	172,360	
General Tax	55,255	55,105	15,747	13,161	13,403	13,033	55,344	15,746	13,973	13,799	13,910	57,430	61,420	63,060	
Total Operating Expenses	601,663	602,604	156,562	145,845	149,046	164,862	616,315	162,122	153,065	147,593	168,090	630,870	636,180	648,550	
Operating Income	225,294	239,129	116,073	43,621	30,892	78,533	269,120	125,132	44,052	40,780	84,770	294,730	267,970	279,700	
Other Income	1,625	263	18	416	911	102	1,447	1,246	875	1,042	2,600	5,760	2,640	2,650	
Other Expense	(2,949)	(2,813)	(455)	(314)	(357)	(364)	(1,490)	(340)	(462)	(444)	(360)	(1,610)	(14,600)	(14,600)	
Interest Expense	(45,842)	(44,570)	(10,847)	(10,848)	(10,809)	(11,235)	(43,739)	(11,481)	(11,305)	(11,495)	(11,720)	(46,000)	(48,170)	(50,310)	
Income Before Tax	178,128	192,009	104,789	32,875	20,637	67,036	225,338	114,557	33,160	29,883	75,290	252,880	207,840	217,440	
Income Tax	(68,338)	(72,979)	(40,046)	(12,575)	(7,900)	(24,722)	(85,243)	(38,101)	(12,537)	(11,086)	(28,230)	(89,950)	(40,540)	(40,770)	
Net Income	\$109,790	\$119,030	\$64,743	\$20,300	\$12,737	\$42,314	\$140,095	\$76,456	\$20,623	\$18,797	\$47,060	\$162,930	\$167,300	\$176,670	
Average shares outstanding (FD)	52,946	53,254	53,107	52,836	52,942	52,967	53,254	53,056	52,969	52,926	52932.82501	52,971	52,951	52,967	
EPS (GAAP)	\$2.08	\$2.23	\$1.22	\$0.38	\$0.24	\$0.80	\$2.64	\$1.44	\$0.39	\$0.36	\$0.89	\$3.07	\$3.16	\$3.34	
Non-recurring items															
EPS (adjusted if necessary)	\$2.08	\$2.23	\$1.22	\$0.38	\$0.24	\$0.80	\$2.64	\$1.44	\$0.39	\$0.36	\$0.89	\$3.07	\$3.16	\$3.34	
Dividends	\$0.840	\$1.200	\$0.350	\$0.350	\$0.350	\$0.350	\$1.400	\$0.420	\$0.420	\$0.420	\$0.420	\$1.680	\$1.840	\$2.000	
Rate of Change Analysis:															
Gross Margin	1.7%	1.8%	3.7%	7.1%	5.5%	5.2%	5.2%	5.4%	4.0%	4.7%	3.9%	4.5%	-2.3%	2.7%	
Op Income	2.2%	6.1%	6.5%	39.5%	23.8%	6.3%	12.5%	7.8%	1.0%	32.0%	7.9%	9.5%	-9.1%	4.4%	
EPS--Adj if Necessary	9.8%	7.3%	7.9%	70.0%	73.2%	8.2%	18.3%	18.2%	1.3%	47.6%	11.3%	16.3%	2.8%	5.6%	
EBITDA	-3.9%	6.0%	7.2%	23.2%	14.0%	7.0%	11.0%	7.6%	3.4%	18.0%	7.4%	8.4%	-3.6%	4.7%	
O&M Expense	7.0%	-1.5%	-0.4%	-2.3%	0.7%	4.3%	0.6%	3.0%	4.2%	-4.1%	0.0%	0.8%	-2.2%	0.5%	
Margin Analysis:															
O&M / GM	50.9%	49.2%	38.9%	51.3%	55.2%	47.0%	47.1%	38.1%	51.4%	50.6%	45.3%	45.4%	45.5%	44.5%	
General Tax / GM	6.7%	6.5%	5.8%	6.9%	7.4%	5.4%	6.3%	5.5%	7.1%	7.3%	5.5%	6.2%	6.8%	6.8%	
Op Income / GM	27.2%	28.4%	42.6%	23.0%	17.2%	32.3%	30.4%	43.6%	22.3%	21.6%	33.5%	31.8%	29.6%	30.1%	
Net Income / GM	13.3%	14.1%	23.7%	10.7%	7.1%	17.4%	15.8%	26.6%	10.5%	10.0%	18.6%	17.6%	18.5%	19.0%	
Tax Rate	38.4%	38.0%	38.2%	38.3%	38.3%	36.9%	37.8%	33.3%	37.8%	37.1%	37.5%	35.6%	19.5%	18.8%	
			*New base rates OK	*Raised guide from net income: \$127MM-\$137MM				*New base rates KS	*Narrowed EPS guide from \$2.87-\$3.07	*Reiterated guide	*Hiked EPS guide from \$2.94-\$3.04				
												*Guidance EPS \$3.06-\$3.10	*Guidance \$156MM-\$168MM net income; \$2.96-\$3.20		

Source: Company reports and Hilliard Lyons estimates

ONE Gas, Inc.

ONE Gas, Inc.														
Balance Sheet Analysis (000's)	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17	Q4'17E	FY'17E	FY'18E	FY'19E
Cash	\$11,943	\$2,433	\$52,657	\$54,257	\$4,513	\$14,663	\$14,663	\$13,206	\$5,113	\$6,872	\$23,180	\$23,180	\$18,050	\$3,320
Trade A/R	326,749	216,343	195,158	115,265	105,060	290,944	290,944	249,155	152,278	127,689	305,490	305,490	320,760	336,800
Gas in storage	185,300	142,153	80,553	103,741	144,230	125,432	125,432	91,231	114,996	157,641	127,940	127,940	130,500	133,110
Other CAS	143,509	121,916	89,243	108,193	123,370	137,884	137,884	127,540	139,192	153,351	140,640	140,640	143,450	146,320
Total Current Assets	667,501	482,845	417,611	381,456	377,173	568,923	568,923	481,132	411,579	445,553	597,250	597,250	612,760	619,550
Net PP&E	3,293,720	3,511,911	3,557,734	3,611,481	3,680,325	3,731,620	3,731,620	3,773,888	3,834,793	3,912,279	3,977,590	3,977,590	4,188,910	4,416,550
Goodwill	157,953	157,953	157,953	157,953	157,953	157,953	157,953	157,953	157,953	157,953	157,953	157,953	157,950	157,950
Reg Assets	478,723	435,863	421,559	410,648	431,086	440,522	440,522	430,338	421,094	411,653	411,650	411,650	411,650	411,650
Other	51,313	55,838	43,247	49,294	47,142	43,773	43,773	46,563	64,455	43,625	44,930	44,930	50,570	56,920
Total Assets	\$4,649,210	\$4,644,410	\$4,598,104	\$4,610,832	\$4,693,679	\$4,942,791	\$4,942,791	\$4,889,874	\$4,889,874	\$4,971,063	\$5,189,370	\$5,189,370	\$5,421,840	\$5,662,620
CP of LTD	6	7	7	7	7	7	7	0	0	0	0	0	0	0
Other ST/Comm Paper--Approx	42,000	12,500	-	-	41,000	145,000	145,000	85,400	79,000	174,000	264,000	264,000	321,500	478,500
A/P	159,064	107,482	59,887	59,983	70,562	131,988	131,988	76,142	60,458	68,184	134,630	134,630	137,320	142,810
Other CLs	191,363	184,232	168,699	157,994	147,263	166,938	166,938	146,401	153,227	150,044	175,280	175,280	184,040	193,240
Total Current Liabilities	392,433	304,221	228,593	217,984	258,832	443,933	443,933	307,943	292,685	392,228	573,910	573,910	942,860	814,550
LTD	1,201,311	1,201,305	1,191,854	1,192,050	1,192,248	1,192,446	1,192,446	1,192,647	1,192,848	1,193,052	1,193,050	1,193,050	993,040	1,293,030
LT LoC w/ONEOK	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Def Income Tax	894,585	951,785	967,943	987,906	1,011,691	1,038,568	1,038,568	1,065,096	1,077,992	1,089,061	999,060	999,060	1,009,060	1,019,060
Other	366,844	345,544	342,527	337,304	368,564	379,564	379,564	379,610	393,053	364,730	483,360	483,360	488,190	493,070
Total Equity	1,794,037	1,841,555	1,867,187	1,875,588	1,862,344	1,888,280	1,888,280	1,944,578	1,933,296	1,931,992	1,939,990	1,939,990	1,988,690	2,042,910
Total Liab & SE	\$4,649,210	\$4,644,410	\$4,598,104	\$4,610,832	\$4,693,679	\$4,942,791	\$4,942,791	\$4,889,874	\$4,889,874	\$4,971,063	\$5,189,370	\$5,189,370	\$5,421,840	\$5,662,620
Cash Flow Analysis (000's)	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17	Q4'17E	FY'17E	FY'18E	FY'18E
Net Income	\$109,790	\$119,030	\$64,743	\$20,300	\$12,737	\$42,314	\$140,095	\$76,456	\$20,623	\$18,797	\$47,060	\$162,930	\$167,300	\$176,670
D&A	125,722	133,023	34,684	35,565	36,241	37,339	143,829	37,019	37,851	38,423	39,690	152,980	163,680	172,360
Deferred Tax	49,935	63,789	16,113	19,918	23,740	27,017	86,788	37,461	12,847	11,021	10,000	71,330	10,000	10,000
(Inc) / Dec in Wrk Cap	(30,229)	116,433	52,330	27,146	(45,613)	(100,499)	(66,636)	9,951	52,602	(27,672)	(43,710)	(8,830)	(9,190)	(6,830)
Operating CF	255,218	432,275	167,870	102,929	27,105	6,171	304,076	160,887	123,923	40,569	53,040	378,410	331,790	352,200
Cap Ex	(297,103)	(294,320)	(75,261)	(69,499)	(86,576)	(77,735)	(309,071)	(70,471)	(84,195)	(94,391)	(105,000)	(354,060)	(375,000)	(400,000)
Dividends	(43,696)	(62,826)	(18,380)	(18,258)	(18,285)	(18,286)	(73,209)	(22,034)	(22,008)	(21,954)	(22,230)	(88,230)	(97,430)	(105,930)
Free Cash Flow	(85,581)	75,129	74,229	15,172	(77,756)	(89,850)	(78,204)	68,382	17,720	(75,776)	(74,190)	(63,880)	(140,640)	(153,730)
LTD Proceeds	1,199,994	-	-	-	-	-	-	-	-	-	-	-	100,000	300,000
LTD (Repayments)	-	-	-	-	-	-	-	-	-	-	-	-	-	(300,000)
Net Borrow/(Repay) Notes Payable	42,000	(29,500)	(12,500)	-	41,000	104,000	132,500	(59,600)	(6,400)	95,000	90,000	119,000	57,500	157,000
Cash Pmt/Distrib to ONEOK	(1,130,000)	-	-	-	-	-	-	-	-	-	-	-	-	-
DRIP/ESOP or Eq Raise	2,001	7,051	-	1,983	-	2,034	4,017	-	2,208	-	500	2,708	2,000	2,000
Stock Repurchased	-	(24,122)	(24,066)	-	-	-	(24,066)	(2,469)	(15,043)	-	-	(17,512)	(24,000)	(20,000)
Net Cash Flow	28,414	28,558	37,663	17,155	(36,756)	16,184	34,247	6,313	(1,515)	19,224	16,310	40,316	(5,140)	(14,730)
EBITDA	\$351,016	\$372,152	\$150,757	\$79,186	\$67,133	\$115,872	\$412,949	\$162,151	\$81,903	\$79,203	\$124,460	\$447,710	\$431,650	\$452,060
EV / TTM EBITDA	9.6x	10.4x	11.5x	11.7x	11.0x	11.1x	11.1x	11.2x	11.4x	11.6x	11.3x	11.3x	11.5x	11.0x
Selected Financial Statistics	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17	Q4'17E	FY'17E	FY'18E	FY'19E
Book Value	\$33.70	\$34.70	\$35.16	\$35.50	\$35.18	\$35.65	\$35.65	\$36.65	\$36.50	\$36.50	\$36.65	\$36.65	\$37.55	\$38.57
Tangible BV	\$30.73	\$31.72	\$32.18	\$32.51	\$32.19	\$32.67	\$32.67	\$33.67	\$33.52	\$33.52	\$33.67	\$33.67	\$34.57	\$35.59
Price / Book	1.2x	1.4x	1.7x	1.9x	1.8x	1.8x	1.8x	1.8x	1.9x	2.0x	2.0x	2.0x	1.9x	1.8x
LT Debt / Total Capital	40.1%	39.5%	39.0%	38.9%	39.0%	38.7%	38.7%	38.0%	38.2%	38.2%	38.1%	38.1%	33.3%	38.8%
Total Debt / Capital	40.9%	39.7%	39.0%	38.9%	39.8%	41.5%	41.5%	39.7%	39.7%	41.4%	42.9%	42.9%	44.8%	46.4%
ROE (TTM)	6.6%	6.5%	6.7%	7.1%	7.4%	7.5%	7.5%	8.0%	8.0%	8.3%	8.5%	8.5%	8.2%	8.5%

Source: Company reports and Hilliard Lyons estimates

Analyst Certifications

I, Spencer E. Joyce, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Suitability Ratings

- 1** - A large cap, core holding with a solid history
- 2** - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
- 3** - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
- 4** - Speculative, due to small size, inconsistent profitability, erratic revenues, volatility, low trading volume or a narrow customer or product base

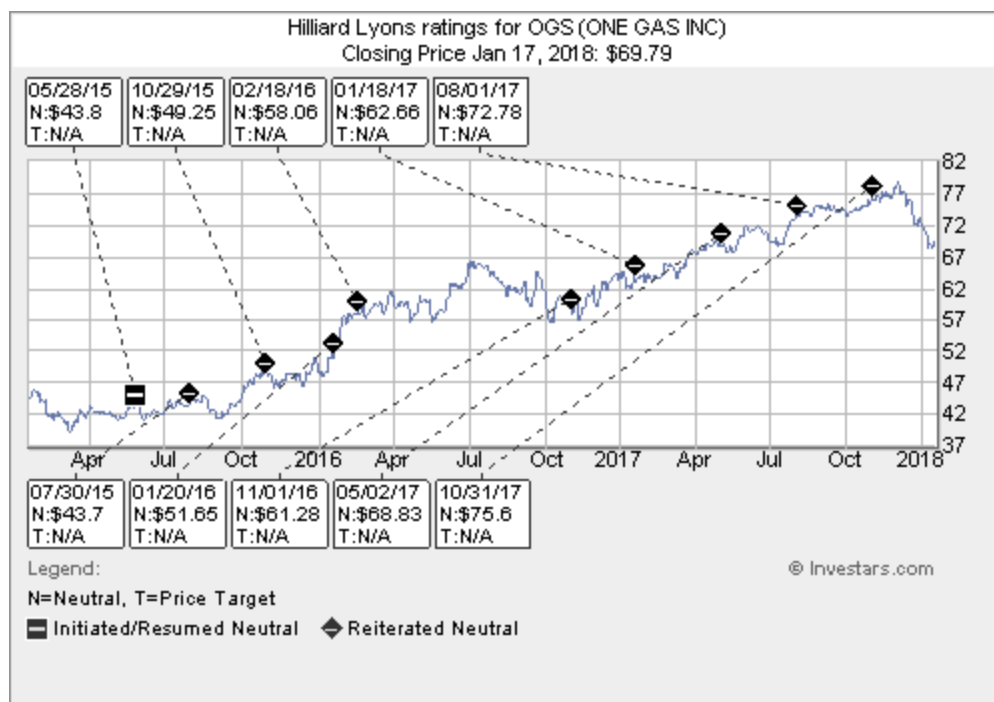
Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.

Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

Underperform - We believe the stock is vulnerable to a price setback in the next 12 months.



Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	31	28%	10%	90%
Hold/Neutral	75	67%	9%	91%
Sell	6	5%	0%	100%

As of 8 January 2018

Other Disclosures

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