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ONE Gas, Inc.
Form 10-Q
August 01, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

X Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2017.

OR

___ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____.

Commission file number 001-36108

ONE Gas, Inc.
(Exact name of registrant as specified in its charter)

Oklahoma 46-3561936
(State or other jurisdiction of (I.R.S. Employer Identification No.)
incorporation or organization)

15 East Fifth Street, Tulsa, OK 74103
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (918) 947-7000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No ___

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes X No ___

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer X Accelerated filer ___

Non-accelerated filer ___ (Do not check if a smaller reporting company)

Smaller reporting company___

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Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

On July 25, 2017, the Company had 52,269,117 shares of common stock outstanding.

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ONE Gas, Inc.

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As used in this Quarterly Report, references to “we,” “our,” “us” or the “company” refer to ONE Gas, Inc., an Oklahoma corporation, and its predecessors and subsidiary, unless the context indicates otherwise.

The statements in this Quarterly Report that are not historical information, including statements concerning plans and objectives of management for future operations, economic performance or related assumptions, are forward-looking statements. Forward-looking statements may include words such as “anticipate,” “estimate,” “expect,” “project,” “intend,” “plan,” “believe,” “should,” “goal,” “forecast,” “guidance,” “could,” “may,” “continue,” “might,” “potential,” “scheduled” and other words of similar meaning. Although we believe that our expectations regarding future events are based on reasonable assumptions, we can give no assurance that such expectations or assumptions will be achieved. Important factors that could cause actual results to differ materially from those in the forward-looking statements are described under Part I, Item 2, Management’s Discussion and Analysis of Financial Condition and Results of Operations, “Forward-Looking Statements,” in this Quarterly Report and under Part I, Item IA, “Risk Factors,” in our Annual Report.

INFORMATION AVAILABLE ON OUR WEBSITE

We make available, free of charge, on our website (www.onegas.com) copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, amendments to those reports filed or furnished to the SEC pursuant to Section 13(a) or 15(d) of the Exchange Act and reports of holdings of our securities filed by our officers and directors under Section 16 of the Exchange Act as soon as reasonably practicable after filing such material electronically or otherwise furnishing it to the SEC. Copies of our Code of Business Conduct and Ethics, Corporate Governance Guidelines and Director Independence Guidelines are also available on our website, and we will provide copies of these documents upon request. Our website and any contents thereof are not incorporated by reference into this report.

We also make available on our website the Interactive Data Files required to be submitted and posted pursuant to Rule 405 of Regulation S-T.

GLOSSARY

The abbreviations, acronyms and industry terminology used in this Quarterly Report are defined as follows:

Annual Report	Annual Report on Form 10-K for the year ended December 31, 2016
ASU	Accounting Standards Update
Bcf	Billion cubic feet
CERCLA	Federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended
Clean Air Act	Federal Clean Air Act, as amended
Clean Water Act	Federal Water Pollution Control Amendments of 1972, as amended
COSA	Cost-of-Service Adjustment
DOT	United States Department of Transportation
EPA	United States Environmental Protection Agency
EPS	Earnings per share
Exchange Act	Securities Exchange Act of 1934, as amended
FASB	Financial Accounting Standards Board
GAAP	Accounting principles generally accepted in the United States of America
GRIP	Texas Gas Reliability Infrastructure Program
GSRS	Kansas Gas System Reliability Surcharge
Heating Degree Day or HDD	A measure designed to reflect the demand for energy needed for heating based on the extent to which the daily average temperature falls below a reference temperature for which no heating is required, usually 65 degrees Fahrenheit
IRS	Internal Revenue Service
KCC	Kansas Corporation Commission
KDHE	Kansas Department of Health and Environment
LDC	Local distribution company
MMcf	Million cubic feet
Moody's	Moody's Investors Service, Inc.
NPRM	Notice of Proposed Rulemaking
NYMEX	New York Mercantile Exchange
OCC	Oklahoma Corporation Commission
ONE Gas	ONE Gas, Inc.
ONE Gas Credit Agreement	ONE Gas' \$700 million revolving credit agreement, which expires January, 2019
ONEOK	ONEOK, Inc. and its subsidiaries
PBRC	Performance-Based Rate Change
PHMSA	United States Department of Transportation Pipeline and Hazardous Materials Safety Administration
Pipeline Safety, Regulatory Certainty and Job Creation Act	Pipeline Safety, Regulatory Certainty and Job Creation Act of 2011, as amended
Quarterly Report(s)	Quarterly Report(s) on Form 10-Q
RRC	Railroad Commission of Texas
S&P	Standard & Poor's Ratings Services
SEC	Securities and Exchange Commission
Securities Act	Securities Act of 1933, as amended
Senior Notes	ONE Gas' registered notes consisting of \$300 million of 2.07 percent senior notes due 2019, \$300 million of 3.61 percent senior notes due 2024 and \$600 million of 4.658 percent notes due 2044.

Separation and Distribution Agreement	Separation and Distribution Agreement dated January 14, 2014, between ONEOK and ONE Gas
WNA	Weather-normalization adjustments
XBRL	eXtensible Business Reporting Language

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ONE Gas, Inc.

STATEMENTS OF INCOME

(Unaudited)	Three Months Ended		Six Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2017	2016	2017	2016
	(Thousands of dollars, except per share amounts)			
Revenues	\$279,689	\$245,923	\$830,097	\$754,288
Cost of natural gas	82,572	56,457	345,726	292,186
Net margin	197,117	189,466	484,371	462,102
Operating expenses				
Operations and maintenance	101,241	97,119	210,598	203,250
Depreciation and amortization	37,851	35,565	74,870	70,249
General taxes	13,973	13,161	29,719	28,908
Total operating expenses	153,065	145,845	315,187	302,407
Operating income	44,052	43,621	169,184	159,695
Other income	875	416	2,121	434
Other expense	(462))(314))(802))(769)
Interest expense, net	(11,305))(10,848))(22,786))(21,695)
Income before income taxes	33,160	32,875	147,717	137,665
Income taxes	(12,537))(12,575))(50,638))(52,621)
Net income	\$20,623	\$20,300	\$97,079	\$85,044
Earnings per share				
Basic	\$0.39	\$0.39	\$1.85	\$1.62
Diluted	\$0.39	\$0.38	\$1.83	\$1.61
Average shares (thousands)				
Basic	52,553	52,386	52,565	52,452
Diluted	52,969	52,836	53,012	52,972
Dividends declared per share of stock	\$0.42	\$0.35	\$0.84	\$0.70

See accompanying Notes to the Financial Statements.

ONE Gas, Inc.

STATEMENTS OF COMPREHENSIVE INCOME

	Three Months		Six Months	
	Ended		Ended	
(Unaudited)	June 30,		June 30,	
	2017	2016	2017	2016
	(Thousands of dollars)			
Net income	\$20,623	\$20,300	\$97,079	\$85,044
Other comprehensive income (loss), net of tax				
Change in pension and other postemployment benefit plan liability, net of tax of \$(81), \$(73), \$(161) and \$(145), respectively	129	115	258	231
Total other comprehensive income (loss), net of tax	129	115	258	231
Comprehensive income	\$20,752	\$20,415	\$97,337	\$85,275
See accompanying Notes to the Financial Statements.				

ONE Gas, Inc.
BALANCE SHEETS

	June 30,	December
(Unaudited)	2017	31,
Assets	(Thousands of dollars)	
Property, plant and equipment		
Property, plant and equipment	\$5,545,302	\$5,404,168
Accumulated depreciation and amortization	1,710,509	1,672,548
Net property, plant and equipment	3,834,793	3,731,620
Current assets		
Cash and cash equivalents	5,113	14,663
Accounts receivable, net	152,278	290,944
Materials and supplies	36,876	34,084
Natural gas in storage	114,996	125,432
Regulatory assets	82,302	83,146
Other current assets	20,014	20,654
Total current assets	411,579	568,923
Goodwill and other assets		
Regulatory assets	421,094	440,522
Goodwill	157,953	157,953
Other assets	47,711	43,773
Total goodwill and other assets	626,758	642,248
Total assets	\$4,873,130	\$4,942,791
See accompanying Notes to the Financial Statements.		

ONE Gas, Inc.
BALANCE SHEETS
(Continued)

	June 30, 2017	December 31, 2016
	(Thousands of dollars)	
(Unaudited)		
Equity and Liabilities		
Equity and long-term debt		
Common stock, \$0.01 par value:		
authorized 250,000,000 shares; issued 52,598,005 shares and outstanding 52,267,296 shares at	\$526	\$526
June 30, 2017; issued 52,598,005 and outstanding 52,283,260 shares at December 31, 2016		
Paid-in capital	1,734,083	1,749,574
Retained earnings	224,570	161,021
Accumulated other comprehensive income (loss)	(4,457)	(4,715)
Treasury stock, at cost: 330,709 shares at June 30, 2017 and 314,745 shares at December 31, 2016	(21,426)	(18,126)
Total equity	1,933,296	1,888,280
Long-term debt, excluding current maturities, and net of issuance costs of \$8,445 and \$8,851, respectively	1,192,848	1,192,446
Total equity and long-term debt	3,126,144	3,080,726
Current liabilities		
Notes payable	79,000	145,000
Accounts payable	60,458	131,988
Accrued interest	18,958	18,854
Accrued taxes other than income	33,562	42,571
Accrued liabilities	16,202	22,931
Customer deposits	60,523	61,209
Other current liabilities	23,982	21,380
Total current liabilities	292,685	443,933
Deferred credits and other liabilities		
Deferred income taxes	1,077,992	1,038,568
Employee benefit obligations	296,881	303,507
Other deferred credits	79,428	76,057
Total deferred credits and other liabilities	1,454,301	1,418,132
Commitments and contingencies		
Total liabilities and equity	\$4,873,130	\$4,942,791
See accompanying Notes to the Financial Statements.		

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ONE Gas, Inc.
STATEMENTS OF CASH FLOWS

(Unaudited)	Six Months Ended June 30,	
	2017	2016
	(Thousands of dollars)	
Operating activities		
Net income	\$97,079	\$85,044
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	74,870	70,249
Deferred income taxes	50,308	36,031
Share-based compensation expense	4,951	7,451
Provision for doubtful accounts	3,501	2,757
Changes in assets and liabilities:		
Accounts receivable	135,165	98,321
Materials and supplies	(2,792)	707
Natural gas in storage	10,436	38,412
Asset removal costs	(22,837)	(27,672)
Accounts payable	(68,992)	(42,897)
Accrued interest	104	53
Accrued taxes other than income	(9,009)	(5,573)
Accrued liabilities	(6,729)	(16,156)
Customer deposits	(686)	1,113
Regulatory assets and liabilities	19,782	(2,966)
Other assets and liabilities	(5,880)	31,341
Cash provided by operating activities	279,271	276,215
Investing activities		
Capital expenditures	(154,666)	(144,760)
Other	477	492
Cash used in investing activities	(154,189)	(144,268)
Financing activities		
Repayments of notes payable, net	(66,000)	(12,500)
Repurchase of common stock	(17,512)	(24,066)
Issuance of common stock	2,208	1,983
Dividends paid	(44,042)	(36,638)
Tax withholdings related to net share settlements of stock compensation	(9,286)	(8,902)
Cash used in financing activities	(134,632)	(80,123)
Change in cash and cash equivalents	(9,550)	51,824
Cash and cash equivalents at beginning of period	14,663	2,433
Cash and cash equivalents at end of period	\$5,113	\$54,257
See accompanying Notes to the Financial Statements.		

ONE Gas, Inc.
STATEMENT OF EQUITY

(Unaudited)	Common Stock Issued (Shares)	Retained- Earnings Stock (Thousands of dollars)	Additional- Paid-in Capital
January 1, 2017	52,598,005	\$ 526	\$ 1,749,574
Cumulative effect of accounting change	—	—	—
Net income	—	—	—
Other comprehensive income	—	—	—
Repurchase of common stock	—	—	—
Common stock issued and other	—	—	(15,961)
Common stock dividends - \$0.84 per share	—	—	470
June 30, 2017	52,598,005	\$ 526	\$ 1,734,083
See accompanying Notes to the Financial Statements.			

ONE Gas, Inc.
STATEMENT OF EQUITY
(Continued)

(Unaudited)	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Equity
	(Thousands of dollars)			
January 1, 2017	\$161,021	\$(18,126)	\$ (4,715)	\$1,888,280
Cumulative effect of accounting change	10,982	—	—	10,982
Net income	97,079	—	—	97,079
Other comprehensive income	—	—	258	258
Repurchase of common stock	—	(17,512)	—	(17,512)
Common stock issued and other	—	14,212	—	(1,749)
Common stock dividends - \$0.84 per share	(44,512)	—	—	(44,042)
June 30, 2017	\$224,570	\$(21,426)	\$ (4,457)	\$1,933,296

See accompanying Notes to the Financial Statements.

ONE Gas, Inc.

NOTES TO THE FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Our accompanying unaudited financial statements have been prepared pursuant to the rules and regulations of the SEC. These statements also have been prepared in accordance with GAAP and reflect all adjustments that, in our opinion, are necessary for a fair statement of the results for the interim periods presented. All such adjustments are of a normal recurring nature. The 2016 year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP. These unaudited financial statements should be read in conjunction with the audited financial statements and footnotes in our Annual Report. Due to the seasonal nature of our business, the results of operations for the three and six months ended June 30, 2017, are not necessarily indicative of the results that may be expected for a 12-month period.

We provide natural gas distribution services to more than 2 million customers through our divisions in Oklahoma, Kansas and Texas through Oklahoma Natural Gas, Kansas Gas Service and Texas Gas Service, respectively. We serve residential, commercial, industrial and transportation customers in all three states. In addition, we also provide natural gas distribution services to wholesale and public authority customers.

Use of Estimates - The preparation of our financial statements and related disclosures in accordance with GAAP requires us to make estimates and assumptions with respect to values or conditions that cannot be known with certainty that affect the reported amount of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements. These estimates and assumptions also affect the reported amounts of revenue and expenses during the reporting period. Items that may be estimated include, but are not limited to, the economic useful life of assets, fair value of assets and liabilities, provision for doubtful accounts, unbilled revenues for natural gas delivered but for which meters have not been read, natural gas purchased but for which no invoice has been received, provision for income taxes, including any deferred tax valuation allowances, the results of litigation and various other recorded or disclosed amounts.

We evaluate these estimates on an ongoing basis using historical experience and other methods we consider reasonable based on the particular circumstances. Nevertheless, actual results may differ significantly from the estimates. Any effects on our financial position or results of operations from revisions to these estimates are recorded in the period when the facts that give rise to the revision become known.

Segments - We operate in one reportable and operating business segment: regulated public utilities that deliver natural gas to residential, commercial, industrial, wholesale, public authority and transportation customers. The accounting policies for our segment are the same as described in Note 1 of our Notes to the Financial Statements in our Annual Report. We evaluate our financial performance principally on operating income. For the three and six months ended June 30, 2017, and 2016, we had no single external customer from which we received 10 percent or more of our gross revenues.

Recently Issued Accounting Standards Update - In March 2017, the FASB issued ASU 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost," which requires (1) separation of net periodic service costs for pension and other postemployment benefits into service cost and other components, (2) presentation of the service cost component in the same line as other compensation costs rendered by pertinent employees during the period, and (3) reporting the other components of net periodic benefit costs separately from the service cost component and outside a subtotal of income from operations. Additionally, only the service cost component is eligible for capitalization, when applicable. However, all of our cost components remain eligible for capitalization under the accounting requirements for rate regulated entities.

We are required to adopt this guidance for our interim and annual reports for periods beginning after December 15, 2017. When adopted, the presentation changes required for net periodic benefit costs will not impact previously reported net income; however, the reclassification of the other components of benefits costs will result in an increase in operating income and an increase in other expenses for 2016 and 2017. We continue to evaluate the impact of this guidance including the impact on our capitalization policies considering our regulated operations.

In January 2017, the FASB issued ASU 2017-04, “Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment,” which simplifies how an entity is required to test goodwill for impairment by eliminating Step 2 of the goodwill test, where the measurement of a goodwill impairment loss was determined by comparing the implied fair value of a reporting unit’s goodwill with the carrying amount of that goodwill. Upon adoption, a goodwill impairment will be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. This new guidance is required for our interim and annual reports for periods beginning after December 15, 2019, and early adoption is

permitted. We do not expect this guidance to have a material impact on our financial statements and will adjust our goodwill testing procedures accordingly upon adoption.

In March 2016, the FASB issued ASU 2016-09, “Improvements to Employee Share-Based Payment Accounting,” which includes various new aspects to simplify how share-based payments are accounted for and presented in the financial statements. The new standard modifies several aspects of the accounting and reporting for employee share-based payments and related tax accounting impacts, including the presentation in the statements of operations and cash flows. We adopted this new guidance in the first quarter 2017, and in accordance with the transition requirements, we recorded \$5.2 million of excess tax benefit in income tax expense and have transitioned all provisions of this new guidance prospectively, other than our presentation of our withholding shares for tax-withholding purposes, which we accounted for retrospectively in the financing activities section of the statement of cash flows. We recorded a noncash cumulative-effect increase of \$11.0 million to retained earnings, with an offset to a deferred tax asset, as of the beginning of the reporting period in 2017, for excess tax benefits earned prior to January 1, 2017, that had not been recognized. We continue our use of the estimation method to account for share unit awards forfeitures rather than actual forfeitures. The retrospective impact of our withholding shares for tax-withholding purposes to our Statement of Cash Flows for the six months ended June 30, 2016, was a \$8.9 million increase to net cash provided by operating activities and a \$8.9 million decrease to net cash used in financing activities.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842),” which prescribes recognizing lease assets and liabilities on the balance sheet and includes disclosure of key information about leasing arrangements. A modified retrospective transition approach is required for leases existing at the time of adoption. We are evaluating our population of leases, analyzing lease agreements, and holding meetings with cross-functional teams to determine the potential impact of this accounting standard on our financial position and results of operations and the transition approach we will utilize. This new guidance is required for our interim and annual reports for periods beginning after December 15, 2018, and early adoption is permitted.

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers,” which clarifies and converges the revenue recognition principles under GAAP and International Financial Reporting Standards. In July 2015, FASB delayed the effective date for one year. We have substantially completed evaluating all of our sources of revenue to determine the potential effect on our financial position, results of operations, cash flows and the related accounting policies and business processes. We are evaluating this information to determine what information will be disclosed in our financial statements and footnotes. In addition to updating our revenue recognition disclosures, additional disclosures may include disaggregation of revenues by types of service, source of revenue or customer class, performance obligations and other types of revenues.

We continue to monitor accounting task forces and the FASB for additional implementation guidance related to: (1) the accounting for funds received from third parties to partially or fully reimburse the cost of construction of an asset; (2) the evaluation of collectability from customers if a utility has regulatory mechanisms to help assure recovery of uncollected accounts from ratepayers; and (3) the accounting for alternative revenue programs, such as weather normalization, that may impact the final conclusions of our evaluation. Until these items are resolved, we cannot complete our evaluation of the potential effect the new guidance will have on our financial position, results of operations, cash flows or business processes.

We will adopt this new guidance for our interim and annual reports beginning with the first quarter 2018.

2. REGULATORY ASSETS AND LIABILITIES

The tables below present a summary of regulatory assets, net of amortization, and liabilities for the periods indicated:

	June 30, 2017		
	Current	Noncurrent	Total
	(Thousands of dollars)		
Under-recovered purchased-gas costs	\$26,500	\$ —	\$26,500
Pension and postemployment benefit costs	31,498	408,593	440,091
Weather normalization	20,311	—	20,311
Reacquired debt costs	812	7,703	8,515
Other	3,181	4,798	7,979
Total regulatory assets, net of amortization	82,302	421,094	503,396
Over-recovered purchased-gas costs	(14,049)	—	(14,049)
Ad valorem tax	(606)	—	(606)
Total regulatory liabilities (a)	(14,655)	—	(14,655)
Net regulatory assets (liabilities)	\$67,647	\$ 421,094	\$ 488,741

(a) Included in other current liabilities in our Balance Sheets.

	December 31, 2016		
	Current	Noncurrent	Total
	(Thousands of dollars)		
Under-recovered purchased-gas costs	\$29,901	\$ —	\$29,901
Pension and postemployment benefit costs	31,498	427,448	458,946
Weather normalization	17,661	—	17,661
Reacquired debt costs	812	8,108	8,920
Other	3,274	4,966	8,240
Total regulatory assets, net of amortization	83,146	440,522	523,668
Over-recovered purchased-gas costs	(10,154)	—	(10,154)
Ad valorem tax	(1,768)	—	(1,768)
Total regulatory liabilities (a)	(11,922)	—	(11,922)
Net regulatory assets (liabilities)	\$71,224	\$ 440,522	\$ 511,746

(a) Included in other current liabilities in our Balance Sheets.

Regulatory assets on our Balance Sheets, as authorized by various regulatory authorities, are probable of recovery. Base rates are designed to provide a recovery of costs during the period rates are in effect, but do not generally provide for a return on investment for amounts we have deferred as regulatory assets. All of our regulatory assets are subject to review by the respective regulatory authorities during future regulatory proceedings. We are not aware of any evidence that these costs will not be recoverable through either riders or base rates, and we believe that we will be able to recover such costs, consistent with our historical recoveries.

3. CREDIT FACILITY AND SHORT-TERM NOTES PAYABLE

The ONE Gas Credit Agreement contains certain financial, operational and legal covenants. Among other things, these covenants include maintaining ONE Gas' debt-to-capital ratio of no more than 70 percent at the end of any calendar quarter. At June 30, 2017, our debt-to-capital ratio was 40 percent and we were in compliance with all covenants under the ONE Gas Credit Agreement.

We have a commercial paper program under which we may issue unsecured commercial paper up to a maximum amount of \$700 million to fund short-term borrowing needs. The maturities of the commercial paper notes may vary but may not exceed 270 days from the date of issue. The commercial paper notes are generally sold at par less a discount representing an interest factor.

The ONE Gas Credit Agreement is available to repay the commercial paper notes, if necessary. Amounts outstanding under the commercial paper program reduce the borrowing capacity under the ONE Gas Credit Agreement. At June 30, 2017, we had

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\$79.0 million in short-term borrowings, \$1.8 million in letters of credit issued under the ONE Gas Credit Agreement and \$619.2 million of remaining credit available under the ONE Gas Credit Agreement.

4. LONG-TERM DEBT

We have senior notes consisting of \$300 million of 2.07 percent senior notes due in 2019, \$300 million of 3.61 percent senior notes due in 2024 and \$600 million of 4.658 percent senior notes due in 2044. The indenture governing our Senior Notes includes an event of default upon the acceleration of other indebtedness of \$100 million or more. Such events of default would entitle the trustee or the holders of 25 percent in aggregate principal amount of the outstanding Senior Notes to declare those Senior Notes immediately due and payable in full.

5. EQUITY

Treasury Shares - For the six months ended June 30, 2017, we repurchased approximately 256 thousand shares of our common stock for approximately \$17.5 million.

Dividends Declared - In July 2017, we declared a dividend of \$0.42 per share (\$1.68 per share on an annualized basis) for shareholders of record as of August 14, 2017, payable September 1, 2017.

6. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table sets forth the effect of reclassifications from accumulated other comprehensive income (loss) in our Statements of Income for the periods indicated:

Details about Accumulated Other Comprehensive Income (Loss) Components	Three Months Ended		Six Months Ended		Affected Line Item in the Statements of Income
	June 30, 2017	2016	June 30, 2017	2016	
	(Thousands of dollars)				
Pension and other postemployment benefit plan obligations (a)					
Amortization of net loss	\$10,648	\$10,036	\$21,296	\$20,073	
Amortization of unrecognized prior service cost	(1,149)	(908)	(2,298)	(1,816)	
	9,499	9,128	18,998	18,257	
Regulatory adjustments (b)	(9,289)	(8,940)	(18,579)	(17,881)	
	210	188	419	376	Income before income taxes
	(81)	(73)	(161)	(145)	Income tax expense
Total reclassifications for the period	\$129	\$115	\$258	\$231	Net income

(a) These components of accumulated other comprehensive income (loss) are included in the computation of net periodic benefit cost. See Note 8 for additional detail of our net periodic benefit cost.

(b) Regulatory adjustments represent pension and other postemployment benefit costs expected to be recovered through rates and are deferred as part of our regulatory assets. See Note 2 for additional disclosures of regulatory assets and liabilities.

7. EARNINGS PER SHARE

Basic EPS is based on net income and is calculated based upon the daily weighted-average number of common shares outstanding during the periods presented. Also, this calculation includes fully vested stock awards that have not yet been issued as common stock. Diluted EPS includes basic EPS, plus unvested stock awards granted under our

compensation plans, but only to the extent these instruments dilute earnings per share.

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The following tables set forth the computation of basic and diluted EPS from continuing operations for the periods indicated:

	Three Months Ended June 30, 2017		
	Income	Shares	Per Share Amount
	(Thousands, except per share amounts)		
Basic EPS Calculation			
Net income available for common stock	\$20,623	52,553	\$ 0.39
Diluted EPS Calculation			
Effect of dilutive securities	—	416	
Net income available for common stock and common stock equivalents	\$20,623	52,969	\$ 0.39

	Three Months Ended June 30, 2016		
	Income	Shares	Per Share Amount
	(Thousands, except per share amounts)		
Basic EPS Calculation			
Net income available for common stock	\$20,300	52,386	\$ 0.39
Diluted EPS Calculation			
Effect of dilutive securities	—	450	
Net income available for common stock and common stock equivalents	\$20,300	52,836	\$ 0.38

	Six Months Ended June 30, 2017		
	Income	Shares	Per Share Amount
	(Thousands, except per share amounts)		
Basic EPS Calculation			
Net income available for common stock	\$97,079	52,565	\$ 1.85
Diluted EPS Calculation			
Effect of dilutive securities	—	447	
Net income available for common stock and common stock equivalents	\$97,079	53,012	\$ 1.83

	Six Months Ended June 30, 2016		
	Income	Shares	Per Share Amount
	(Thousands, except per share amounts)		
Basic EPS Calculation			
Net income available for common stock	\$85,044	52,452	\$ 1.62

Diluted EPS Calculation

Effect of dilutive securities	—	520	
Net income available for common stock and common stock equivalents	\$85,044	52,972	\$ 1.61

8.EMPLOYEE BENEFIT PLANS

The following tables set forth the components of net periodic benefit cost for our pension and other postemployment benefit plans for the periods indicated:

	Pension Benefits			
	Three Months		Six Months Ended	
	Ended		Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
	(Thousands of dollars)			
Components of net periodic benefit cost				
Service cost	\$3,044	\$3,014	\$6,088	\$6,028
Interest cost	10,113	11,388	20,226	22,775
Expected return on assets	(14,624)	(15,296)	(29,248)	(30,592)
Amortization of net loss	9,027	8,885	18,054	17,771
Net periodic benefit cost	\$7,560	\$7,991	\$15,120	\$15,982

	Other Postemployment Benefits			
	Three Months		Six Months Ended	
	Ended		Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
	(Thousands of dollars)			
Components of net periodic benefit cost				
Service cost	\$627	\$638	\$1,254	\$1,276
Interest cost	2,472	2,627	4,944	5,254
Expected return on assets	(3,147)	(3,071)	(6,294)	(6,142)
Amortization of unrecognized prior service cost	(1,149)	(908)	(2,298)	(1,816)
Amortization of net loss	1,621	1,151	3,242	2,302
Net periodic benefit cost	\$424	\$437	\$848	\$874

We recover qualified pension benefit plan and other postemployment benefit plan costs through rates charged to our customers. Certain utility commissions require that the recovery of these costs be based on specific guidelines. The difference between these regulatory-based amounts and the periodic benefit cost calculated pursuant to GAAP is deferred as a regulatory asset or liability and amortized to expense over periods in which this difference will be recovered in rates, as authorized by the applicable utility commission. Regulatory deferrals related to net periodic benefit cost were not material for the three and six months ended June 30, 2017.

9.COMMITMENTS AND CONTINGENCIES

Environmental Matters - We are subject to multiple historical, wildlife preservation and environmental laws and/or regulations, which affect many aspects of our present and future operations. Regulated activities include, but are not limited to, those involving air emissions, storm water and wastewater discharges, handling and disposal of solid and hazardous wastes, wetland preservation, hazardous materials transportation, and pipeline and facility construction. These laws and regulations require us to obtain and/or comply with a wide variety of environmental clearances, registrations, licenses, permits and other approvals. Failure to comply with these laws, regulations, licenses and permits may expose us to fines, penalties and/or interruptions in our operations that could be material to our results of

operations. In addition, emission controls and/or other regulatory or permitting mandates under the Clean Air Act and other similar federal and state laws could require unexpected capital expenditures. We cannot assure that existing environmental statutes and regulations will not be revised or that new regulations will not be adopted or become applicable to us. Revised or additional statutes or regulations that result in increased compliance costs or additional operating restrictions could have a material adverse effect on our business, financial condition and results of operations. Our expenditures for environmental investigation, and remediation compliance to-date have not been significant in relation to our financial position, results of operations or cash flows, and our expenditures related to environmental matters had no material effects on earnings or cash flows during the three and six months ended June 30, 2017 and 2016.

We own or retain legal responsibility for the environmental conditions at 12 former manufactured gas sites in Kansas. These sites contain contaminants generally associated with manufactured gas sites and are subject to control or remediation under various environmental laws and regulations. A consent agreement with the KDHE governs all work at these sites. The terms of the consent agreement require us to investigate these sites and set remediation activities based upon the results of the investigations and risk analysis. Remediation typically involves the management of contaminated soils and may involve removal of structures and monitoring and/or remediation of groundwater.

We have completed or addressed removal of the source of soil contamination at 11 of the 12 sites, and continue to monitor groundwater at eight of the 12 sites according to plans approved by the KDHE. Regulatory closure has been achieved at three of the 12 sites, but these sites remain subject to potential future requirements that may result in additional costs. During 2016, we completed a site assessment at the twelfth site where no active soil remediation has occurred. We have submitted a work plan to the KDHE for approval to address a source of contamination and associated contaminated soil on a portion of this site. We are also conducting a study of the feasibility of various options to address the remainder of the site. Costs associated with the remediation at this site are not expected to be material to our results of operations or financial position.

With regard to one of our former manufactured gas sites, periodic monitoring and a 2016 interim site investigation indicated elevated levels of contaminants generally associated with manufactured gas sites. Additional testing and work plan development is underway in 2017 to determine a remediation work plan to present to the KDHE for approval, which could impact our estimates of the cost of remediation at this site. In the fourth quarter of 2016, we estimated the potential costs associated with additional investigation and remediation to be in the range of \$4.0 million to \$7.0 million. A single reliable estimate of the remediation costs is not feasible due to the amount of uncertainty in the ultimate remediation approach that will be utilized. Accordingly, we recorded a reserve of \$4.0 million for this site in the fourth quarter of 2016.

Our expenditures for environmental evaluation, mitigation, remediation and compliance to date have not been significant in relation to our financial position, results of operations or cash flows, and our expenditures related to environmental matters had no material effects on earnings or cash flows during the three and six months ended June 30, 2017 and 2016. A number of environmental issues may exist with respect to manufactured gas sites that are unknown to us. Accordingly, future costs are dependent on the final determination and regulatory approval of any remedial actions, the complexity of the site, level of remediation required, changing technology and governmental regulations, and to the extent not recovered by insurance or recoverable in rates from our customers, could be material to our financial condition, results of operations or cash flows.

With the trend toward stricter standards, greater regulation and more extensive permit requirements for the types of assets operated by us that are subject to environmental regulation, our environmental expenditures could increase in the future, and such expenditures may not be fully recovered by insurance or recoverable in rates from our customers, and those costs may adversely affect our financial condition, results of operations and cash flows. We do not expect expenditures for these matters to have a material adverse effect on our financial condition, results of operations or cash flows.

Pipeline Safety - We are subject to PHMSA regulations, including integrity-management regulations. PHMSA regulations require pipeline companies operating high-pressure transmission pipelines to perform integrity assessments on pipeline segments that pass through densely populated areas or near specifically designated high-consequence areas. In January 2012, the Pipeline Safety, Regulatory Certainty and Job Creation Act was signed into law. The law increased maximum penalties for violating federal pipeline safety regulations and directs the DOT and the Secretary of Transportation to conduct further review or studies on issues that may or may not be material to us. These issues include, but are not limited to, the following:

- an evaluation of whether natural gas pipeline integrity-management requirements should be expanded beyond current high-consequence areas;

- a verification of records for pipelines in class 3 and 4 locations and high-consequence areas to confirm maximum allowable operating pressures; and
- a requirement to test previously untested pipelines operating above 30 percent yield strength in high-consequence areas.

In April 2016, PHMSA published a NPRM, the Safety of Gas Transmission & Gathering Lines Rule, in the Federal Register to revise pipeline safety regulations applicable to the safety of onshore natural gas transmission and gathering pipelines. Proposals include changes to pipeline integrity management requirements and other safety-related requirements. The NPRM comment period ended July 7, 2016, and comments are under review by PHMSA. As part of the comment review process, PHMSA is being advised by the Technical Pipeline Safety Standards Committee, informally known by PHMSA as the Gas Pipeline Advisory Committee (“GPAC”), a statutorily mandated advisory committee that advises PHMSA on proposed safety policies for natural gas pipelines. The GPAC reviews PHMSA's proposed regulatory initiatives to assure the technical feasibility, reasonableness, cost-effectiveness and practicality of each proposal. The potential capital and operating

expenditures associated with compliance with the proposed rule are currently being evaluated and could be significant depending on the final regulations.

Legal Proceedings - We are a party to various litigation matters and claims that have arisen in the normal course of our operations. While the results of litigation and claims cannot be predicted with certainty, we believe the reasonably possible losses from such matters, individually and in the aggregate, are not material. Additionally, we believe the probable final outcome of such matters will not have a material adverse effect on our results of operations, financial position or cash flows.

10. DERIVATIVE FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

Accounting Treatment - We record all derivative instruments at fair value, with the exception of normal purchases and normal sales that are expected to result in physical delivery. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, if so, the reason for holding it, or if regulatory rulings require a different accounting treatment.

If certain conditions are met, we may elect to designate a derivative instrument as a hedge to mitigate the risk of exposure to changes in fair values or cash flows.

The table below summarizes the various ways in which we account for our derivative instruments and the impact on our financial statements:

Accounting Treatment	Recognition and Measurement	
	Balance Sheet	Income Statement
Normal purchases and normal sales	-Recorded at historical cost	-Change in fair value not recognized in earnings
Mark-to-market	-Recorded at fair value	Change in fair value recognized in, and -recoverable through, the purchased-gas cost adjustment mechanisms

We have not elected to designate any of our derivative instruments as hedges. Premiums paid and any cash settlements received associated with the commodity derivative instruments entered into by us are included in, and recoverable through, the purchased-gas cost adjustment mechanisms.

Determining Fair Value - We define fair value as the price that would be received from the sale of an asset or the transfer of a liability in an orderly transaction between market participants at the measurement date. We use the market and income approaches to determine the fair value of our assets and liabilities and consider the markets in which the transactions are executed. We measure the fair value of a group of financial assets and liabilities consistent with how a market participant would price the net risk exposure at the measurement date.

Fair Value Hierarchy - At each balance sheet date, we utilize a fair value hierarchy to classify fair value amounts recognized or disclosed in our financial statements based on the observability of inputs used to estimate such fair value. The levels of the hierarchy are described below:

- Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 - Significant observable pricing inputs other than quoted prices included within Level 1 that are, either directly or indirectly, observable as of the reporting date. Essentially, this represents inputs that are derived principally from or corroborated by observable market data; and
- Level 3 - May include one or more unobservable inputs that are significant in establishing a fair value estimate. These unobservable inputs are developed based on the best information available and may include our own internal data.

We recognize transfers into and out of the levels as of the end of each reporting period.

Determining the appropriate classification of our fair value measurements within the fair value hierarchy requires management's judgment regarding the degree to which market data is observable or corroborated by observable market data. We categorize derivatives for which fair value is determined using multiple inputs within a single level, based on the lowest level input that is significant to the fair value measurement in its entirety.

Derivative Instruments - At June 30, 2017, we held purchased natural gas call options for the heating season ending March 31, 2018, with total notional amounts of 14.6 Bcf, for which we paid premiums of \$5.6 million, and had a fair value of \$4.0

million. At December 31, 2016, we held purchased natural gas call options for the heating season ended March 31, 2017, with total notional amounts of 14.3 Bcf, for which we paid premiums of \$5.4 million, and had a fair value of \$6.5 million. The premiums paid and any cash settlements received are recorded as part of our unrecovered purchased-gas costs in current regulatory assets as these contracts are included in, and recoverable through, the purchased-gas cost adjustment mechanisms. Additionally, changes in fair value associated with these contracts are deferred as part of our unrecovered purchased-gas costs in our Balance Sheets. Our natural gas call options are classified as Level 1 as fair value amounts are based on unadjusted quoted prices in active markets including NYMEX-settled prices. There were no transfers between levels for the three and six months ended June 30, 2017 and 2016.

Other Financial Instruments - The approximate fair value of cash and cash equivalents, accounts receivable and accounts payable is equal to book value, due to the short-term nature of these items. Our cash and cash equivalents are comprised of bank and money market accounts, and are classified as Level 1.

Short-term notes payable and commercial paper are due upon demand and, therefore, the carrying amounts approximate fair value and are classified as Level 1. The book value of our long-term debt, including current maturities, was \$1.2 billion at both June 30, 2017 and December 31, 2016. The estimated fair value of our long-term debt, including current maturities, was \$1.3 billion and \$1.2 billion at June 30, 2017 and December 31, 2016, respectively. The estimated fair value of our Senior Notes at June 30, 2017 and December 31, 2016, was determined using quoted market prices, and are classified as Level 2.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our unaudited financial statements and the Notes to the Financial Statements in this Quarterly Report, as well as our Annual Report. Due to the seasonal nature of our business, the results of operations for the three and six months ended June 30, 2017, are not necessarily indicative of the results that may be expected for a 12-month period.

RECENT DEVELOPMENTS

Dividend - In July 2017, we declared a dividend of \$0.42 per share (\$1.68 per share on an annualized basis) for shareholders of record as of August 14, 2017, payable September 1, 2017.

REGULATORY ACTIVITIES

Oklahoma - In March 2017, Oklahoma Natural Gas filed its first annual PBRC following the general rate case that was approved in January 2016. This filing was based on a calendar test year of 2016. The PBRC filing demonstrated that Oklahoma Natural Gas was earning within the allowed return on equity range of 9.0 to 10.0 percent. Therefore, Oklahoma Natural Gas did not seek a modification to base rates. The filing also requested an energy efficiency program true-up and utility incentive adjustment of approximately \$1.9 million. A joint stipulation and settlement agreement was filed on June 13, 2017, containing an agreement of these requests as filed. This joint stipulation and settlement agreement was heard by the administrative law judge on June 14, 2017, and is awaiting OCC approval. As required, PBRC filings are made annually on March 15, until the next general rate case, which is currently required to be filed on or before June 30, 2021, based on a calendar test year of 2020.

Kansas - In April 2017, Kansas Gas Service submitted an application to the KCC regarding the costs incurred at its 12 manufactured gas sites. Consistent with prior KCC precedent, Kansas Gas Service requested approval to: (1) defer expenditures incurred after December 31, 2016, as a regulatory asset and to amortize and recover such costs from customers in a future base rate proceeding over a ten-year period; (2) retain insurance recoveries up to \$9.5 million, the amount Kansas Gas Service has spent for the period November 1, 1997, through December 31, 2016, and to exclude such amounts from the determination of the revenue requirement in future base rate proceedings; and (3) share insurance recoveries (less legal and other costs prudently incurred in obtaining the insurance recoveries) in excess of \$9.5 million between customers and shareholders. The KCC is expected to issue an order no later than early January 2018.

In May 2016, Kansas Gas Service filed a request with the KCC for an increase in base rates, reflecting system investments and operating costs necessary to maintain the safety and reliability of its natural gas distribution system. Kansas Gas Service's request represented a net base rate increase of \$28.0 million. Kansas Gas Service was already recovering approximately \$7.4 million from customers through the GSRS mechanism, resulting in a total base rate increase of \$35.4 million. In October 2016, Kansas Gas Service reached a unanimous settlement agreement with all parties for a net increase in base rates of approximately \$8.1 million. Including the GSRS of approximately \$7.4 million, the total base rate increase is \$15.5 million. The agreement was a "black-box settlement," meaning the parties agreed to a specific revenue number but no specific return on equity or determination with respect to other contested issues. Additionally, the agreement modified the weather normalization clause to accrue the variation in net margin resulting from the difference in actual weather relative to normal weather over 12 months, rather than five months. The KCC issued an order approving the unanimous settlement agreement in November 2016, with new rates effective January 1, 2017.

Texas - West Texas Service Area - In March 2017, Texas Gas Service made GRIP filings for all customers in the West Texas Service Area requesting an increase of \$4.5 million. The RRC and the cities approved an increase of \$4.3 million for the customers in the service area, and new rates became effective in July 2017.

In March 2016, Texas Gas Service filed a rate case requesting an increase in revenues of \$12.8 million for its El Paso, Dell City and Permian service areas, as well as consolidation of these three areas. In September 2016, the RRC approved the consolidation and a base rate increase of \$8.8 million, which was based on a 9.5 percent return on equity and a 60.1 percent common equity ratio. In October 2016, new rates went into effect for all customers, except for those in the incorporated cities of the former Permian service area. Texas Gas Service filed for these new rates for customers in the incorporated cities of the former Permian service area in October 2016, and the rates became effective in December 2016.

Rio Grande Valley Service Area - In June 2017, Texas Gas Service filed a rate case requesting an increase in revenues of \$4.5 million for customers in its Rio Grande Valley Service Area. If approved, new rates are expected to be effective in the fourth quarter of 2017.

Central Texas Service Area - In March 2017, Texas Gas Service made GRIP filings for customers of the consolidated Central Texas Service Area requesting an increase of \$4.9 million. The request was approved by the cities and the RRC, and new rates became effective in June 2017.

In June 2016, Texas Gas Service filed a rate case requesting an increase in revenues of \$11.6 million for its Central Texas and South Texas service areas. The filing included a request to consolidate the South Texas service area with the Central Texas service area. Texas Gas Service filed this rate case directly with the incorporated cities of the Central Texas service area, which includes the city of Austin, and the RRC for the unincorporated areas. In October 2016, all parties to the filing reached a unanimous settlement agreement for an increase in revenues of \$6.8 million for the new consolidated service area. New rates were effective in November 2016, for customers in the incorporated cities of the former Central Texas service area. RRC approval was received in November 2016 and new rates became effective for customers in the unincorporated areas of the new consolidated Central Texas Service Area the same month. Texas Gas Service received approval for the same rates in the incorporated areas of the former South Texas service area with new rates effective in January 2017.

Gulf Coast Service Area - In December 2015, Texas Gas Service filed a rate case requesting an increase in revenues of \$3.1 million for its Galveston and South Jefferson County service areas and to consolidate these two service areas into a new Gulf Coast Service Area. Texas Gas Service filed this rate case directly with the incorporated cities and the RRC for the unincorporated areas. Texas Gas Service reached a unanimous settlement agreement with representatives of the incorporated cities and the staff of the RRC on behalf of the unincorporated areas for an increase in revenues of \$2.3 million. Following RRC approval, new rates became effective in May 2016.

Other Texas service areas - In the normal course of business, Texas Gas Service has sought GRIP and COSA increases in various other Texas jurisdictions to address investments in rate base and changes in expenses. Annual rate increases associated with approved filings totaled \$1.1 million for the six months ended June 30, 2017, and \$2.0 million for the year ended 2016.

FINANCIAL RESULTS AND OPERATING INFORMATION

We operate in one reportable and operating business segment: regulated public utilities that deliver natural gas to residential, commercial, industrial, wholesale, public authority and transportation customers. The accounting policies for our segment are the same as described in Note 1 of our Notes to the Financial Statements in our Annual Report. We evaluate our financial performance principally on operating income.

Selected Financial Results - For the three months ended June 30, 2017, net income was \$20.6 million, or \$0.39 per diluted share, compared with \$20.3 million, or \$0.38 per diluted share in the same period last year. For the six months ended June 30, 2017, net income was \$97.1 million, or \$1.83 per diluted share, compared with \$85.0 million, or \$1.61 per diluted share in the same period last year. Our prospective adoption of ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting," resulted in favorable impacts to income tax expense and our net income from recording \$5.2 million of excess tax benefits as a reduction to income tax expense in the first quarter 2017. The following table sets forth certain selected financial results for our operations for the periods indicated:

	Three Months Ended		Six Months Ended		Three Months	Six Months
	June 30,		June 30,		2017 vs. 2016	2017 vs. 2016
Financial Results	2017	2016	2017	2016		

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					Increase (Decrease)		Increase (Decrease)	
	(Millions of dollars, except percentages)							
Natural gas sales	\$250.9	\$217.2	\$763.2	\$688.6	\$33.7	16 %	\$74.6	11 %
Transportation revenues	21.4	21.2	51.6	51.0	0.2	1 %	0.6	1 %
Cost of natural gas	82.5	56.5	345.7	292.2	26.0	46 %	53.5	18 %
Net margin, excluding other revenues	189.8	181.9	469.1	447.4	7.9	4 %	21.7	5 %
Other revenues	7.4	7.6	15.3	14.7	(0.2)	(3)%	0.6	4 %
Net margin	197.2	189.5	484.4	462.1	7.7	4 %	22.3	5 %
Operating costs	115.2	110.4	240.3	232.2	4.8	4 %	8.1	3 %
Depreciation and amortization	37.9	35.5	74.9	70.2	2.4	7 %	4.7	7 %
Operating income	\$44.1	\$43.6	\$169.2	\$159.7	\$0.5	1 %	\$9.5	6 %
Capital expenditures	\$84.2	\$69.5	\$154.7	\$144.8	\$14.7	21 %	\$9.9	7 %

Net margin is comprised of total revenues less cost of natural gas. Cost of natural gas includes commodity purchases, fuel, storage, transportation, the cost of gas component of bad debts and other gas purchase costs recovered through our cost of natural gas regulatory mechanisms during the periods presented and does not include an allocation of general operating costs or depreciation and amortization. Our cost of natural gas regulatory mechanisms provide a method of recovering natural gas costs on an ongoing basis without a profit. Therefore, although our revenues will fluctuate with the cost of gas that we recover, net margin is not affected by fluctuations in the cost of natural gas.

The following table sets forth our net margin, excluding other revenues, by type of customer, for the periods indicated:

	Three Months Ended		Six Months Ended		Three Months Ended	Six Months Ended
	June 30,		June 30,		2017 vs. 2016	2017 vs. 2016
Net Margin, Excluding Other					Increase (Decrease)	Increase (Decrease)
Revenues	2017	2016	2017	2016		
(Millions of dollars, except percentages)						
Natural gas sales						
Residential	\$139.7	\$132.8	\$347.9	\$327.5	\$ 6.9	5 %
Commercial and industrial	27.5	26.7	66.4	65.5	0.8	3 %
Wholesale and public authority	1.2	1.2	3.2	3.4	—	—%
Net margin on natural gas sales	168.4	160.7	417.5	396.4	7.7	5 %
Transportation revenues	21.4	21.2	51.6	51.0	0.2	1 %
Net margin, excluding other revenues	\$189.8	\$181.9	\$469.1	\$447.4	\$ 7.9	4 %

Our net margin on natural gas sales is comprised of two components, fixed and variable margin. Fixed margin reflects the portion of our net margin attributable to the monthly fixed customer charge component of our rates, which does not fluctuate based on customer usage in each period. Variable margin reflects the portion of our net margin that fluctuates with the volumes delivered and billed. We believe that the combination of the significant residential component of our customer base, the fixed charge component of our sales margin and our regulatory rate mechanisms that we have in place result in a stable cash flow profile. The following table sets forth our net margin on natural gas sales by revenue type for the periods indicated:

	Three Months Ended		Six Months Ended		Three Months Ended	Six Months Ended
	June 30,		June 30,		2017 vs. 2016	2017 vs. 2016
Net Margin on Natural Gas Sales	2017	2016	2017	2016	Increase (Decrease)	Increase (Decrease)
(Millions of dollars, except percentages)						
Net margin on natural gas sales						
Fixed margin	\$141.5	\$139.9	\$280.7	\$281.8	\$ 1.6	1 %
Variable margin	26.9	20.8	136.8	114.6	6.1	29 %
Net margin on natural gas sales	\$168.4	\$160.7	\$417.5	\$396.4	\$ 7.7	5 %

Net margin increased \$7.7 million for the three months ended June 30, 2017, compared with the same period last year, due primarily to the following:

- an increase of \$4.7 million from new rates in Texas and Kansas;
- an increase of \$1.6 million from the impact of the modified weather-normalization mechanism in Kansas; and
- an increase of \$0.8 million in residential sales due primarily to net customer growth in Oklahoma and Texas.

Net margin increased \$22.3 million for the six months ended June 30, 2017, compared with the same period last year, due primarily to the following:

- an increase of \$14.3 million from new rates in Texas and Kansas;
- an increase of \$4.6 million from the impact of weather-normalization mechanisms, which offset warmer weather in 2017 compared with the same period in 2016;
- an increase of \$1.7 million in residential sales due primarily to net customer growth in Oklahoma and Texas; and
- an increase of \$1.0 million due primarily to higher transportation volumes from customers in Kansas and Oklahoma.

Operating costs increased \$4.8 million for the three months ended June 30, 2017, compared with the same period last year, due primarily to the following:

- an increase of \$2.4 million in employee-related costs;
- an increase of \$0.9 million in information technology costs; and
- an increase of \$0.9 million in costs associated with pipeline maintenance activities.

Operating costs increased \$8.1 million for the six months ended June 30, 2017, compared with the same period last year, due primarily to the following:

- an increase of \$2.4 million from the deferral in the first quarter of 2016 of certain information technology costs incurred as a result of our separation from ONEOK in 2014, which was approved in Oklahoma as a regulatory asset;
- an increase of \$2.4 million in costs associated with pipeline maintenance activities;
- an increase of \$1.9 million in information technology costs;
- an increase of \$0.9 million in employee-related costs; and
- an increase of \$0.7 million in bad debt expense; offset partially by
- a decrease of \$1.8 million in legal-related costs.

Depreciation and amortization expense increased \$2.4 million and \$4.7 million for the three and six months ended June 30, 2017, respectively, compared with the same periods last year, due primarily to an increase in depreciation from our capital expenditures being placed in service, offset by decreases of \$0.5 million and \$1.0 million, respectively, in amortization expense associated primarily with other postemployment benefit deferrals in Kansas.

Capital Expenditures - Our capital expenditures program includes expenditures for pipeline integrity, extending service to new areas, modifications to customer service lines, increasing system capabilities, pipeline replacements, fleet, facilities and information technology assets. It is our practice to maintain and upgrade our infrastructure, facilities and systems to ensure safe, reliable and efficient operations.

Capital expenditures increased \$14.7 million and \$9.9 million for the three and six months ended June 30, 2017, respectively, compared with the same periods last year, due primarily to increased system integrity activities and extending service to new areas.

Selected Operating Information - The following tables set forth certain selected operating information for the periods indicated:

(in thousands)	Three Months Ended June 30,								Variances 2017 vs. 2016			
	2017				2016				Increase (Decrease)			
Average Number of Customers	OK	KS	TX	Total	OK	KS	TX	Total	OK	KS	TX	Total
Residential	794	584	619	1,997	778	583	612	1,984	5	1	7	13
Commercial and industrial	73	50	35	158	73	50	35	158	—	—	—	—
Wholesale and public authority	—	—	3	3	—	—	3	3	—	—	—	—
Transportation	5	6	1	12	5	6	1	12	—	—	—	—
Total customers	872	640	658	2,170	867	639	651	2,157	5	1	7	13

(in thousands)	Six Months Ended June 30,								Variances 2017 vs. 2016			
	2017				2016				Increase (Decrease)			
Average Number of Customers	OK	KS	TX	Total	OK	KS	TX	Total	OK	KS	TX	Total
Residential	796	587	618	2,001	791	584	612	1,987	5	3	6	14
Commercial and industrial	74	50	35	159	74	50	35	159	—	—	—	—
Wholesale and public authority	—	—	3	3	—	—	3	3	—	—	—	—
Transportation	5	6	1	12	5	6	1	12	—	—	—	—
Total customers	875	643	657	2,175	870	640	651	2,161	5	3	6	14

	Three Months Ended June 30,		Six Months Ended June 30,	
Volumes (MMcf)	2017	2016	2017	2016
Natural gas sales				
Residential	11,995	10,576	62,129	62,262
Commercial and industrial	5,027	4,330	19,186	18,818
Wholesale and public authority	333	338	987	1,281
Total volumes sold	17,355	15,244	82,302	82,361
Transportation	49,087	49,601	110,178	108,821
Total volumes delivered	66,442	64,845	192,480	191,182

Total volumes sold increased slightly due to colder weather for the three months ended June 30, 2017, compared with the same period last year. The impact of weather on residential and commercial net margin is mitigated by weather-normalization mechanisms in all jurisdictions.

Wholesale sales represent contracted natural gas volumes that exceed the needs of our residential, commercial and industrial customer base and are available for sale to other parties. The impact to net margin from changes in volumes associated with these customers is minimal.

		Three Months Ended June 30,							
		2017		2016		2017 vs. 2016		2017 2016	
Heating Degree Days	ActualNormal	ActualNormal	ActualNormal	ActualNormal	Variance	Actual as a percent of Normal			
Oklahoma	182 191	162 191	12 %	95 %	85 %				
Kansas	345 419	320 411	8 %	82 %	78 %				
Texas	29 53	45 51	(36)%	55 %	88 %				

		Six Months Ended June 30,							
		2017		2016		2017 vs. 2016		2017 2016	
Heating Degree Days	ActualNormal	ActualNormal	ActualNormal	ActualNormal	Variance	Actual as a percent of Normal			
Oklahoma	1,574 1,966	1,727 1,966	(9)%	80 %	88 %				
Kansas	2,331 2,922	2,440 2,913	(4)%	80 %	84 %				
Texas	658 1,062	899 1,034	(27)%	62 %	87 %				

Normal HDDs are established through rate proceedings in each of our rate jurisdictions for use primarily in weather-normalization billing calculations. See further discussion on weather normalization in our Regulatory Overview section in Part 1, Item 1, "Business," of our Annual Report. Normal HDDs disclosed above are based on:

- 10-year weighted average HDDs as of December 31, 2014, for years 2005-2014, as calculated using 11 weather stations across Oklahoma and weighted on average customer count for Oklahoma;
- 30-year average for years 1981-2010 published by the National Oceanic and Atmospheric Administration, as calculated using 4 weather stations across Kansas and weighted on HDDs by weather station and customers for Kansas; and

an average of HDDs authorized in our most recent rate proceeding in each jurisdiction, and weighted using a rolling 10-year average of actual natural gas distribution sales volumes by jurisdiction for Texas.

Actual HDDs are based on the quarter-to-date and year-to-date, weighted average of:

- ❖ 1 weather stations and customers by month for Oklahoma;
- ❖ 4 weather stations and customers by month for Kansas; and
- ❖ 9 weather stations and natural gas distribution sales volumes by service area for Texas.

Through March 31, 2017, Kansas Gas Services' WNA clause required it to accrue the variation in net margin resulting from actual weather differing from normal weather occurring from November through March. Beginning in April 2017, Kansas Gas Services' WNA clause requires an accrual each month of the year.

CONTINGENCIES

We are a party to various litigation matters and claims that have arisen in the normal course of our operations. While the results of litigation and claims cannot be predicted with certainty, we believe the reasonably possible losses from such matters, individually and in the aggregate, are not material. Additionally, we believe the probable final outcome of such matters will not have a material adverse effect on our results of operations, financial position or cash flows.

LIQUIDITY AND CAPITAL RESOURCES

General - We have relied primarily on operating cash flow and commercial paper for our liquidity and capital resource requirements. We fund operating expenses, working capital requirements, including purchases of natural gas, and capital expenditures primarily with cash from operations and commercial paper.

We believe that the combination of the significant residential component of our customer base, the fixed-charge component of our natural gas sales net margin and our regulatory rate mechanisms that we have in place result in a stable cash flow profile. Because the energy consumption of residential customers is less volatile compared with commercial and industrial customers, our business historically has generated stable and predictable net margin and cash flows. Additionally, we have several regulatory rate mechanisms in place to reduce the lag in earning a return on our capital expenditures. We anticipate that our cash flow generated from operations and our expected short- and long-term financing arrangements will enable us to maintain our current and planned level of operations and provide us flexibility to finance our infrastructure investments.

Our ability to access capital markets for debt and equity financing under reasonable terms depends on market conditions and our financial condition and credit ratings. We believe that stronger credit ratings will provide a significant advantage to our business. By maintaining a conservative financial profile and stable revenue base, we believe that we will be able to maintain an investment-grade credit rating, which we believe will provide us access to diverse sources of capital at favorable rates in order to finance our infrastructure investments.

Short-term Financing - The ONE Gas Credit Agreement, which is scheduled to expire in January 2019, contains certain financial, operational and legal covenants. Among other things, these covenants include maintaining ONE Gas' total debt-to-capital ratio of no more than 70 percent at the end of any calendar quarter. At June 30, 2017, our total debt-to-capital ratio was 40 percent, and we were in compliance with all covenants under the ONE Gas Credit Agreement.

We have a commercial paper program under which we may issue unsecured commercial paper up to a maximum amount of \$700 million to fund short-term borrowing needs. The maturities of the commercial paper notes may vary but may not exceed 270 days from the date of issue. The commercial paper notes are generally sold at par less a discount representing an interest factor.

The ONE Gas Credit Agreement is available to repay the commercial paper notes, if necessary. Amounts outstanding under the commercial paper program reduce the borrowing capacity under the ONE Gas Credit Agreement. At June 30, 2017, we had \$79.0 million in short-term borrowings and \$1.8 million in letters of credit issued under the ONE Gas Credit Agreement. At June 30, 2017, we had approximately \$5.1 million of cash and cash equivalents and \$619.2 million of remaining credit available under the ONE Gas Credit Agreement. The total amount of short-term borrowings authorized by ONE Gas' Board of Directors is \$1.2 billion.

Long-Term Debt - The indenture governing our Senior Notes includes an event of default upon the acceleration of other indebtedness of \$100 million or more. Such events of default would entitle the trustee or the holders of 25 percent in aggregate principal amount of the outstanding Senior Notes to declare those Senior Notes immediately due and payable in full.

Credit Ratings - Our credit ratings as of June 30, 2017, were:

Rating Agency Rating Outlook

Moody's	A2	Stable
S&P	A-	Positive

Our commercial paper is currently rated Prime-1 by Moody's and A-2 by S&P. We intend to maintain strong credit metrics while we pursue a balanced approach to capital investment and a return of capital to shareholders via a dividend that we believe will be competitive with our peer group.

Pension and Other Postemployment Benefit Plans - Information about our pension and other postemployment benefits plans, including anticipated contributions, is included under Note 11 of the ONE Gas Notes to the Financial Statements in our Annual Report. See Note 8 of the Notes to the Financial Statements in this Quarterly Report for additional information.

CASH FLOW ANALYSIS

We use the indirect method to prepare our Statements of Cash Flows. Under this method, we reconcile net income to cash flows provided by operating activities by adjusting net income for those items that impact net income but may not result in actual cash receipts or payments and changes in our assets and liabilities not classified as investing or financing activities during the period. Items that impact net income but may not result in actual cash receipts or payments include, but are not limited to, depreciation and amortization, deferred income taxes, share-based compensation expense and provision for doubtful accounts.

The following table sets forth the changes in cash flows by operating, investing and financing activities for the periods indicated:

	Six Months Ended June 30,			Variance 2017 vs. 2016
	2017	2016		
	(Millions of dollars)			
Total cash provided by (used in):				
Operating activities	\$279.3	\$276.2	\$3.1	
Investing activities	(154.3)	(144.2)	(10.1)	
Financing activities	(134.6)	(80.1)	(54.5)	
Change in cash and cash equivalents	(9.6)	51.9	(61.5)	
Cash and cash equivalents at beginning of period	14.7	2.4	12.3	
Cash and cash equivalents at end of period	\$5.1	\$54.3	\$(49.2)	

Operating Cash Flows - Changes in cash flows from operating activities are due primarily to changes in net margin and operating expenses discussed in Financial Results and Operating Information. Changes in natural gas prices and demand for our services or natural gas, whether because of general economic conditions, changes in supply or increased competition from other service providers, could affect our earnings and operating cash flows. Typically, our cash flows from operations are greater in the first half of the year compared with the second half of the year.

Before considering the impacts of operating asset and liability changes, cash flows were higher for the six months ended June 30, 2017, compared with the same period in 2016, due primarily to an increase in net income, higher noncash expenses for depreciation and amortization and deferred income taxes. The decrease in operating asset and liability changes partially offset these increases. Working capital changes related to accounts receivable and natural gas in storage were impacted by higher costs of natural gas in the first six months of 2017, compared with the same

period in 2016. Additionally, we collected a tax receivable in 2016 related to the extension of the IRS rules for bonus depreciation in late 2015.

Investing Cash Flows - Cash used in investing activities increased for the six months ended June 30, 2017, compared with the prior period, due primarily to an increase in capital expenditures related to increased system integrity activities and extending service to new areas during the six months ended June 30, 2017.

Financing Cash Flows - Cash used in financing activities increased for the six months ended June 30, 2017, compared with the prior period, due primarily to larger repayments of notes payable and an increase in the dividend rate of seven cents compared with the same period in 2016, offset by the purchase of fewer shares of treasury stock.

ENVIRONMENTAL, SAFETY AND REGULATORY MATTERS

Environmental Matters - We are subject to multiple historical, wildlife preservation and environmental laws and/or regulations that affect many aspects of our present and future operations. Regulated activities include, but are not limited to, those involving air emissions, storm water and wastewater discharges, handling and disposal of solid and hazardous wastes, wetland preservation, hazardous materials transportation, and pipeline and facility construction. These laws and regulations require us to obtain and/or comply with a wide variety of environmental clearances, registrations, licenses, permits and other approvals. Failure to comply with these laws, regulations, licenses and permits may expose us to fines, penalties and/or interruptions in our operations that could be material to our results of operations. In addition, emission controls and/or other regulatory or permitting mandates under the Clean Air Act and other similar federal and state laws could require unexpected capital expenditures. We cannot assure that existing environmental statutes and regulations will not be revised or that new regulations will not be adopted or become applicable to us. Revised or additional statutes or regulations that result in increased compliance costs or additional operating restrictions could have a material adverse effect on our business, financial condition and results of operations. Our expenditures for environmental investigation, and remediation compliance to-date have not been significant in relation to our financial position, results of operations or cash flows, and our expenditures related to environmental matters had no material effects on earnings or cash flows during the three and six months ended June 30, 2017 and 2016.

We own or retain legal responsibility for the environmental conditions at 12 former manufactured gas sites in Kansas. These sites contain contaminants generally associated with manufactured gas sites and are subject to control or remediation under various environmental laws and regulations. A consent agreement with the KDHE governs all work at these sites. The terms of the consent agreement require us to investigate these sites and set remediation activities based upon the results of the investigations and risk analysis. Remediation typically involves the management of contaminated soils and may involve removal of structures and monitoring and/or remediation of groundwater.

We have completed or addressed removal of the source of soil contamination at 11 of the 12 sites, and continue to monitor groundwater at eight of the 12 sites according to plans approved by the KDHE. Regulatory closure has been achieved at three of the 12 sites, but these sites remain subject to potential future requirements that may result in additional costs. During 2016, we completed a site assessment at the twelfth site where no active soil remediation has occurred. We have submitted a work plan to the KDHE for approval to address a source of contamination and associated contaminated soil on a portion of this site. We are also conducting a study of the feasibility of various options to address the remainder of the site. Costs associated with the remediation at this site are not expected to be material to our results of operations or financial position.

With regard to one of our former manufactured gas sites, periodic monitoring and a 2016 interim site investigation indicated elevated levels of contaminants generally associated with manufactured gas sites. Additional testing and work plan development is underway in 2017 to determine a remediation work plan to present to the KDHE for approval, which could impact our estimates of the cost of remediation at this site. In the fourth quarter of 2016, we estimated the potential costs associated with additional investigation and remediation to be in the range of \$4.0 million to \$7.0 million. A single reliable estimate of the remediation costs is not feasible due to the amount of uncertainty in the ultimate remediation approach that will be utilized. Accordingly, we recorded a reserve of \$4.0 million for this site in the fourth quarter of 2016.

Our expenditures for environmental evaluation, mitigation, remediation and compliance to date have not been significant in relation to our financial position, results of operations or cash flows, and our expenditures related to

environmental matters had no material effects on earnings or cash flows during the three and six months ended June 30, 2017 and 2016. A number of environmental issues may exist with respect to manufactured gas sites that are unknown to us. Accordingly, future costs are dependent on the final determination and regulatory approval of any remedial actions, the complexity of the site, level of remediation required, changing technology and governmental regulations, and to the extent not recovered by insurance or recoverable in rates from our customers, could be material to our financial condition, results of operations or cash flows.

With the trend toward stricter standards, greater regulation and more extensive permit requirements for the types of assets operated by us that are subject to environmental regulation, our environmental expenditures could increase in the future, and such expenditures may not be fully recovered by insurance or recoverable in rates from our customers, and those costs may adversely affect our financial condition, results of operations and cash flows. We do not expect expenditures for these matters to have a material adverse effect on our financial condition, results of operations or cash flows.

Pipeline Safety - We are subject to PHMSA regulations, including integrity-management regulations. PHMSA regulations require pipeline companies operating high-pressure transmission pipelines to perform integrity assessments on pipeline segments that pass through densely populated areas or near specifically designated high-consequence areas. In January 2012, the Pipeline Safety, Regulatory Certainty and Job Creation Act was signed into law. The law increased maximum penalties for violating federal pipeline safety regulations and directs the DOT and the Secretary of Transportation to conduct further review or studies on issues that may or may not be material to us. These issues include, but are not limited to, the following:

- an evaluation of whether natural gas pipeline integrity-management requirements should be expanded beyond current high-consequence areas;
- a verification of records for pipelines in class 3 and 4 locations and high-consequence areas to confirm maximum allowable operating pressures; and
- a requirement to test previously untested pipelines operating above 30 percent yield strength in high-consequence areas.

In April 2016, PHMSA published a NPRM, the Safety of Gas Transmission & Gathering Lines Rule, in the Federal Register to revise pipeline safety regulations applicable to the safety of onshore natural gas transmission and gathering pipelines. Proposals include changes to pipeline integrity management requirements and other safety-related requirements. The NPRM comment period ended July 7, 2016, and comments are under review by PHMSA. As part of the comment review process, PHMSA is being advised by the Technical Pipeline Safety Standards Committee, informally known by PHMSA as the GPAC, a statutorily mandated advisory committee that advises PHMSA on proposed safety policies for natural gas pipelines. The GPAC reviews PHMSA's proposed regulatory initiatives to assure the technical feasibility, reasonableness, cost-effectiveness and practicality of each proposal. The potential capital and operating expenditures associated with compliance with the proposed rule are currently being evaluated and could be significant depending on the final regulations.

Air and Water Emissions - The Clean Air Act, the Clean Water Act, analogous state laws and/or regulations promulgated thereunder, impose restrictions and controls regarding the discharge of pollutants into the air and water in the United States. Under the Clean Air Act, a federally enforceable operating permit is required for sources of significant air emissions. We may be required to incur certain capital expenditures for air-pollution-control equipment in connection with obtaining or maintaining permits and approvals for sources of air emissions. We do not expect that these expenditures will have a material impact on our results of operations, financial position or cash flows. The Clean Water Act imposes substantial potential liability for the removal of pollutants discharged to waters of the United States and remediation of waters affected by such discharge.

International, federal, regional and/or state legislative and/or regulatory initiatives may attempt to regulate greenhouse gas emissions. We monitor relevant legislation and regulatory initiatives to assess the potential impact on our operations. The EPA's Mandatory Greenhouse Gas Reporting Rule requires annual greenhouse gas emissions reporting as carbon dioxide equivalents from affected facilities and for the natural gas delivered by us to our natural gas distribution customers who are not otherwise required to report their own emissions. The additional cost to gather and report this emission data did not have, and we do not expect it to have, a material impact on our results of operations, financial position or cash flows. In addition, Congress has considered, and may consider in the future, legislation to reduce greenhouse gas emissions, including carbon dioxide and methane. Likewise, the EPA may institute additional regulatory rulemaking associated with greenhouse gas emissions. At this time, no rule or legislation has been enacted for natural gas distribution that assesses any costs, fees or expenses on any of these emissions.

CERCLA - CERCLA, also commonly known as Superfund, imposes strict, joint and several liability, without regard to fault or the legality of the original act, on certain classes of "persons" (defined under CERCLA) that caused and/or contributed to the release of a hazardous substance into the environment. These persons include, but are not limited to, the owner or operator of a facility where the release occurred and/or companies that disposed or arranged for the

disposal of the hazardous substances found at the facility. Under CERCLA, these persons may be liable for the costs of cleaning up the hazardous substances released into the environment, damages to natural resources and the costs of certain health studies. We do not expect that our responsibilities under CERCLA will have a material impact on our results of operations, financial position or cash flows.

Pipeline Security - The U.S. Department of Homeland Security's Transportation Security Administration issued updated pipeline security guidelines in April 2012. Our pipeline facilities have been reviewed according to the current guidelines and no material changes have been required to date.

Environmental Footprint - Our environmental and climate change strategy focuses on taking steps to minimize the impact of our operations on the environment. These strategies include: (1) developing and maintaining an accurate greenhouse gas emissions inventory according to current rules issued by the EPA; (2) improving the integrity of our various pipelines; (3)

following developing technologies for emission control; and (4) utilizing practices to reduce the loss of methane from our facilities.

We participate in the EPA's Natural Gas STAR Program to voluntarily reduce methane emissions. We continue to focus on maintaining low rates of lost-and-unaccounted-for natural gas through expanded implementation of best practices to limit the release of natural gas during pipeline and facility maintenance and operations. Additionally, in March 2016, we were one of 40 founding partners to launch the EPA's Natural Gas STAR Methane Challenge Program, whereby oil and natural gas companies agree to promote and track commitments to reduce methane emissions beyond what is federally required. Our Methane Challenge Program commitment to annually replace or rehabilitate at least two percent of our combined inventory of cast iron and noncathodically-protected steel pipe aligns with our planned system integrity expenditures for infrastructure replacements. We anticipate reporting in 2018 our calendar year 2017 performance relative to our commitment.

Additional information about our environmental matters is included in the section entitled "Environmental Matters" in Note 9 of the Notes to the Financial Statements in this Quarterly Report.

Regulatory - Several regulatory initiatives impacted the earnings and future earnings potential of our business. See additional information regarding our regulatory initiatives in Management's Discussion and Analysis of Financial Condition and Results of Operations.

IMPACT OF NEW ACCOUNTING STANDARDS

Information about the impact of new accounting standards, if any, is included in Note 1 of the Notes to the Financial Statements in this Quarterly Report.

ESTIMATES AND CRITICAL ACCOUNTING POLICIES

The preparation of our financial statements and related disclosures in accordance with GAAP requires us to make estimates and assumptions with respect to values or conditions that cannot be known with certainty that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. These estimates and assumptions also affect the reported amounts of revenue and expenses during the reporting period. Although we believe these estimates and assumptions are reasonable, actual results could differ from our estimates.

Information about our estimates and critical accounting policies is included under Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, "Estimates and Critical Accounting Policies," in our Annual Report.

FORWARD-LOOKING STATEMENTS

Some of the statements contained and incorporated in this Quarterly Report are forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. The forward-looking statements relate to our anticipated financial performance, liquidity, management's plans and objectives for our future operations, our business prospects, the outcome of regulatory and legal proceedings, market conditions and other matters. We make these forward-looking statements in reliance on the safe harbor protections provided under the Private Securities Litigation Reform Act of 1995. The following discussion is intended to identify important factors that could cause future outcomes to differ materially from those set forth in the forward-looking statements.

Forward-looking statements include the items identified in the preceding paragraph, the information concerning possible or assumed future results of our operations and other statements contained or incorporated in this Quarterly

Report identified by words such as “anticipate,” “estimate,” “expect,” “project,” “intend,” “plan,” “believe,” “should,” “goal,” “guidance,” “could,” “may,” “continue,” “might,” “potential,” “scheduled,” and other words and terms of similar meaning.

One should not place undue reliance on forward-looking statements, which are applicable only as of the date of this Quarterly Report. Known and unknown risks, uncertainties and other factors may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by forward-looking statements. Those factors may affect our operations, markets, products, services and prices. In addition to any assumptions and other factors referred to specifically in connection with the forward-looking statements, factors that could cause our actual results to differ materially from those contemplated in any forward-looking statement include, among others, the following:

- our ability to recover operating costs and amounts equivalent to income taxes, costs of property, plant and equipment and regulatory assets in our regulated rates;
- our ability to manage our operations and maintenance costs;

• changes in regulation of natural gas distribution services, particularly those in Oklahoma, Kansas and Texas;
 • the economic climate and, particularly, its effect on the natural gas requirements of our residential and commercial industrial customers;
 • competition from alternative forms of energy, including, but not limited to, electricity, solar power, wind power, geothermal energy and biofuels;
 • conservation efforts of our customers;
 • variations in weather, including seasonal effects on demand, the occurrence of storms and disasters, and climate change;
 • indebtedness could make us more vulnerable to general adverse economic and industry conditions, limit our ability to borrow additional funds and/or place us at competitive disadvantage compared with competitors;
 • our ability to secure reliable, competitively priced and flexible natural gas transportation and supply, including decisions by natural gas producers to reduce production or shut-in producing natural gas wells and expiration of existing supply, and transportation and storage arrangements that are not replaced with contracts with similar terms and pricing;
 • the mechanical integrity of facilities operated;
 • operational hazards and unforeseen operational interruptions;
 • adverse labor relations;
 • the effectiveness of our strategies to reduce earnings lag, margin protection strategies and risk mitigation strategies;
 • our ability to generate sufficient cash flows to meet all our cash needs;
 • changes in the financial markets during the periods covered by the forward-looking statements, particularly those affecting the availability of capital and our ability to refinance existing debt and fund investments and acquisitions;
 • actions of rating agencies, including the ratings of debt, general corporate ratings and changes in the rating agencies' ratings criteria;
 • changes in inflation and interest rates;
 • our ability to recover the costs of natural gas purchased for our customers;
 • impact of potential impairment charges;
 • volatility and changes in markets for natural gas;
 • possible loss of LDC franchises or other adverse effects caused by the actions of municipalities;
 • payment and performance by counterparties and customers as contracted and when due;
 • changes in existing or the addition of new environmental, safety, tax and other laws, rules and regulations to which we and our subsidiaries are subject;
 • the uncertainty of estimates, including accruals and costs of environmental remediation;
 • advances in technology;
 • population growth rates and changes in the demographic patterns of the markets we serve;
 • acts of nature and the potential effects of threatened or actual terrorism, including war;
 • cyber attacks or breaches of technology systems or information, affecting us, our customers or vendors;
 • the sufficiency of insurance coverage to cover losses;
 • the effects of our strategies to reduce tax payments;
 • the outcomes, timing and effects of litigation and regulatory investigations, proceedings, including our rate cases, or inquiries;
 • changes in accounting standards;
 • changes in corporate governance standards;
 • discovery of material weaknesses in our internal controls;
 • our ability to comply with all covenants in our indentures and the ONE Gas Credit Agreement, a violation of which, if not cured in a timely manner, could trigger a default of our obligations;
 • our ability to attract and retain talented employees, management and directors;
 • declines in the discount rates on, declines in the market value of the debt and equity securities of, and increases in funding requirements for, our defined benefit plans;
 • the ability to successfully complete merger, acquisition or divestiture plans, regulatory or other limitations imposed as a result of a merger, acquisition or divestiture, and the success of the business following a merger, acquisition or

divestiture;

the final resolutions or outcomes with respect to our contingent and other corporate liabilities related to the natural gas distribution business and any related actions for indemnification made pursuant to the Separation and Distribution Agreement with ONEOK; and

• the costs associated with increased regulation and enhanced disclosure and corporate governance requirements pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

These factors are not necessarily all of the important factors that could cause actual results to differ materially from those expressed in any of our forward-looking statements. Other factors could also have material adverse effects on our future

results. These and other risks are described in greater detail in Item 1A, Risk Factors, in our Annual Report. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these factors. Other than as required under securities laws, we undertake no obligation to update publicly any forward-looking statement whether as a result of new information, subsequent events or change in circumstances, expectations or otherwise.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our quantitative and qualitative disclosures about market risk are consistent with those discussed in Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in our Annual Report.

Commodity Price Risk

Our commodity price risk, driven primarily by fluctuations in the price of natural gas, is mitigated by our purchased-gas cost adjustment mechanisms. Additionally, we inject natural gas into storage during the summer months and withdraw the natural gas during the winter heating season. Pursuant to programs that are approved by our regulatory authorities, we use derivative instruments to mitigate the volatility of natural gas prices for anticipated natural gas purchases during the winter heating months. Premiums paid and any cash settlements received associated with these derivative instruments are included in, and recoverable through our purchased-gas cost adjustment mechanisms.

Interest-Rate Risk

We would be exposed to interest-rate risk with any new debt financing. We are able to manage interest-rate risk through the use of fixed-rate debt, floating-rate debt and, at times, interest-rate swaps. Fixed-rate swaps may be used to reduce our risk of increased interest costs during periods of rising interest rates. Floating-rate swaps may be used to convert the fixed rates of long-term borrowings into short-term variable rates.

Counterparty Credit Risk

We assess the creditworthiness of our customers. Those customers who do not meet minimum standards are required to provide security, including deposits and other forms of collateral, when appropriate. With more than 2 million customers across three states, we are not exposed materially to a concentration of credit risk. We maintain a provision for doubtful accounts based upon factors surrounding the credit risk of customers, historical trends, consideration of the current credit environment and other information. In Oklahoma, Kansas and most jurisdictions we serve in Texas, we are able to recover the natural gas cost component of our uncollectible accounts through our purchased-gas cost adjustment mechanisms.

ITEM 4. CONTROLS AND PROCEDURES

Quarterly Evaluation of Disclosure Controls and Procedures - Our Chief Executive Officer (Principal Executive Officer) and Chief Financial Officer (Principal Financial Officer) have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report based on the evaluation of the controls and procedures required by Rules 13(a)-15(b) of the Exchange Act.

Changes in Internal Control Over Financial Reporting - In the three months ended June 30, 2017, we implemented a new accounts payable system that electronically captures invoice data and provides electronic routing for invoice approvals.

The implementation of this new system is part of ONE Gas' continuing efforts to take advantage of new technology that creates operating efficiencies and was not implemented as a result of any identified deficiencies in internal

controls over financial reporting. While there are inherent risks involved with the implementation of new systems and changes have taken place in internal controls associated with the transition to the new system, management believes it is adequately monitoring and managing the transition.

Other than described above, there have been no changes in our internal control over financial reporting during the three months ended June 30, 2017, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are a party to various litigation matters and claims that have arisen in the normal course of our operations. While the results of litigation and claims cannot be predicted with certainty, we believe the reasonably possible losses from such matters, individually and in the aggregate, are not material. Additionally, we believe the probable final outcome of such matters will not have a material adverse effect on our results of operations, financial position or cash flows.

ITEM 1A. RISK FACTORS

Our investors should consider the risks set forth in Part I, Item 1A, Risk Factors, of our Annual Report that could affect us and our business. Although we have tried to discuss key factors, our investors need to be aware that other risks may prove to be important in the future. New risks may emerge at any time, and we cannot predict such risks or estimate the extent to which they may affect our financial performance. Investors should carefully consider the discussion of risks and the other information included or incorporated by reference in this Quarterly Report, including “Forward-Looking Statements,” which are included in Part I, Item 2, Management’s Discussion and Analysis of Financial Condition and Results of Operations.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table sets forth information relating to our purchases of our common stock for the periods indicated:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
April 1 - 30, 2017	—	—	—	
May 1 - 31, 2017	203,929	\$68.53	203,929	
June 1 - 30, 2017	15,244	70.00	15,244	
Total	219,173	\$68.63	219,173	\$7,255,651 (a)

(a) - In February 2015, our Board of Directors established an annual limit of \$20 million of treasury stock purchases, plus funds received through the dividend reinvestment, direct stock purchase and employee stock purchase plans. Stock purchases may be made in the open market or in private transactions at times and in amounts that we deem appropriate. There is no guarantee as to the exact number of shares that we may purchase, and we can terminate or limit the program at any time.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

Readers of this report should not rely on or assume the accuracy of any representation or warranty or the validity of any opinion contained in any agreement filed as an exhibit to this Quarterly Report, because such representation, warranty or

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opinion may be subject to exceptions and qualifications contained in separate disclosure schedules, may represent an allocation of risk between parties in the particular transaction, may be qualified by materiality standards that differ from what may be viewed as material for securities law purposes, or may no longer continue to be true as of any given date. All exhibits attached to this Quarterly Report are included for the purpose of complying with requirements of the SEC. Other than the certifications made by our officers pursuant to the Sarbanes-Oxley Act of 2002 included as exhibits to this Quarterly Report, all exhibits are included only to provide information to investors regarding their respective terms and should not be relied upon as constituting or providing any factual disclosures about us, any other persons, any state of affairs or other matters.

The following exhibits are filed as part of this Quarterly Report:

Exhibit No.	Exhibit Description
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10.1	ONE Gas, Inc. Annual Officer Incentive Plan (incorporated by reference to Appendix A to ONE Gas, Inc.'s Definitive Proxy Statement on Schedule 14A filed on April 5, 2017 (File No. 1-36108)).
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31.1	Certification of Pierce H. Norton II pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
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31.2	Certification of Curtis L. Dinan pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
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32.1	Certification of Pierce H. Norton II pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished only pursuant to Rule 13a-14(b)).
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32.2	Certification of Curtis L. Dinan pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished only pursuant to Rule 13a-14(b)).
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101.INS	XBRL Instance Document.
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101.SCH	XBRL Schema Document.
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101.CAL	XBRL Calculation Linkbase Document.
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101.LAB	XBRL Label Linkbase Document.
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101. PRE	XBRL Presentation Linkbase Document.
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101.DEF	XBRL Extension Definition Linkbase Document.
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Attached as Exhibit 101 to this Quarterly Report are the following XBRL-related documents: (i) Document and Entity Information; (ii) Statements of Income for the three and six months ended June 30, 2017 and 2016; (iii) Statements of Comprehensive Income for the three and six months ended June 30, 2017 and 2016; (iv) Balance Sheets at June 30, 2017 and December 31, 2016; (v) Statements of Cash Flows for the six months ended June 30, 2017 and 2016; (vi) Statement of Equity for the six months ended June 30, 2017; and (vii) Notes to the Financial Statements.

We also make available on our website the Interactive Data Files submitted as Exhibit 101 to this Quarterly Report.

SIGNATURE

Pursuant to the requirements of the Exchange Act, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: August 1, 2017 ONE Gas, Inc.
Registrant

By: /s/ Curtis L. Dinan
Curtis L. Dinan
Senior Vice President,
Chief Financial Officer and Treasurer
(Principal Financial Officer)