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# ONE Gas, Inc. (OGS)

Q4 2016 Earnings Call

## CORPORATE PARTICIPANTS

Andrew Ziola

*Vice President-Investor Relations & Public Affairs, ONE Gas, Inc.*

Pierce H. Norton II

*President, Chief Executive Officer & Director, ONE Gas, Inc.*

Curtis L. Dinan

*Chief Financial Officer, Treasurer & Senior VP, ONE Gas, Inc.*

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## OTHER PARTICIPANTS

Sarah Elizabeth Akers

*Analyst, Wells Fargo Securities LLC*

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good day, and welcome to the ONE Gas Fourth Quarter Year End Earnings Conference Call. Today's conference is being recorded.

At this time, I'd like to turn the call over to Andrew Ziola. Please go ahead.

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Andrew Ziola

*Vice President-Investor Relations & Public Affairs, ONE Gas, Inc.*

Good morning. This call is being webcast live and a replay will be made available. After prepared remarks from our speakers, we'd be happy to take your questions.

A reminder that statements made during this call that might include ONE Gas expectations or predictions should be considered forward-looking statements and are covered by the Safe Harbor provision of the securities acts of 1933 and 1934. Actual results could differ materially from those projected in any forward-looking statements. For a discussion of factors that could cause actual results to differ, please refer to our SEC filings.

Our first speaker this morning is Curtis Dinan, Senior Vice President, Chief Financial Officer and Treasurer of ONE Gas. Curtis?

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Curtis L. Dinan

*Chief Financial Officer, Treasurer & Senior VP, ONE Gas, Inc.*

Thanks, Andrew. Good morning, everyone, and thank you for joining us.

Net income for the fourth quarter 2016 was \$42.3 million or \$0.80 per diluted share, compared with \$39.2 million or \$0.74 per diluted share for the same period last year. Investments made in our systems led to new rates including the effect of the Oklahoma rate case and various other rate filings in Texas over the past year. Residential customer growth in Oklahoma and Texas also led to our positive results.

Operating costs for the fourth quarter were higher compared with the same period last year, reflecting an increase in environmental remediation expenses, outside services and IT expenses, partially offset by lower employee-related expenses.

Last month, the ONE Gas board of directors declared a dividend of \$0.42 per share, an increase of \$0.07 or 20%, compared with the previous dividend of \$0.35 per share. As a reminder, our targeted dividend payout ratio range is 55% to 65%.

Full year 2016 net income was \$140 million or \$2.65 per diluted share compared with \$119 million or \$2.24 per diluted share for 2015. In 2016, our results were impacted positively by new rates and residential customer growth in Oklahoma and Texas. We averaged 12,000 more customers in 2016 which is an increase of approximately 0.6% compared with 2015.

Operating costs overall were relatively flat in 2016 compared with 2015. In mid-January, we announced our 2017 earnings per share guidance of \$2.87 to \$3.07 per share with an expected earned ROE of 8.1%, compared with 7.7% earned in 2016. The improvement in ROE is primarily attributable to our recently completed rate cases.

With our updated capital plan, in which we spend more than two times depreciation, we expect our regulatory lag to average approximately 100 basis points. Also included in that announcement in January, we updated our five-year net income and EPS guidance to a range of 5% to 7% annually between 2016 and 2021. Our previous guidance focused on 2015 to 2020 which included a growth rate of 5% to 8%. With 2016 EPS increasing by 18%, our outlook for 2020 and 2021 is in line with our previous estimate.

At December 31, 2016, our current authorized rate base, defined as the rate base established in our latest regulatory proceedings including full rate cases and interim rate filings, was approximately \$2.9 billion. Considering additional investments in our system and other changes in the components of our rate base that have occurred since those regulatory filings, we project that our rate base in 2017 will average approximately \$3.1 billion with 41% of that being our rate base in Oklahoma, 32% in Kansas and 27% in Texas.

Our capital expenditure guidance for 2017 is \$350 million with more than 70% targeted for system integrity and replacement projects. Our five-year capital plan is expected to be in the range of \$350 million to \$380 million annually which is an increase from our previous range of \$305 million to \$325 million. The primary driver of this revised plan is a continued focus on acceleration of pipe replacement and system integrity projects.

And now I'll turn it over to Pierce Norton, ONE Gas President and Chief Executive Officer. Pierce?

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## Pierce H. Norton II

*President, Chief Executive Officer & Director, ONE Gas, Inc.*

Thanks, Curtis, and good morning, everyone. As we begin our fourth year of being a stand-alone publicly-traded company, approximately 95% of our rate base has completed a full rate case review. The results of which have positively impacted our 2016 results and have been incorporated into our 2017 and five-year guidance. 2016 began with new rates in Oklahoma, our first full rate case in Oklahoma since becoming a stand-alone company. In Kansas, we reached a settlement with the Kansas Corporation Commission last fall with new rates being implemented January 1, 2017.

This was also the first rate case in Kansas since the separation and the first full rate case to go into effect since January of 2013. In Texas, we consolidated several jurisdictions during the past year and have reduced the

number of our jurisdictions to 6 from 10. During 2016, we completed rate cases in our new Gulf Coast, Central Texas consolidated and West Texas jurisdictions.

We remain focused on being a premier natural gas distribution company with safety continuing to be our top priority. We are committed to reinvesting in our systems as evidenced by our updated five-year capital guidance of \$350 million to \$380 million per year, providing the safe and reliable natural gas service our customers' expect. We will continue evaluating our distribution system by utilizing a risk-based analysis to further strengthen our ability to make data-driven decisions about pipeline and facilities replacements, continuing to spend capital prudently to lower the risk in our systems.

As I previously mentioned, during our first three years, our regulatory activity included 95% of our rate base going to full rate case review. As we move forward, specifically for 2017, we will have an annual PBRC filing in Oklahoma, a GSRS filing in Kansas, and in Texas, a rate case in the Rio Grande Valley and COSAs or GRIP filings in the other jurisdictions. We'll also remain focused on leveraging technology and improving our processes to become more efficient as an organization in order to reduce cost to sustainable levels.

I'd like to now take this opportunity to thank our 3,400 employees for what they do every day. I continue to be proud of their dedication and commitment to meeting the needs of our customers, so they can enjoy the benefits of natural gas.

Operator, we're now ready for questions.

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. [Operator Instructions] We'll go to Sarah Akers with Wells Fargo.

Sarah Elizabeth Akers  
*Analyst, Wells Fargo Securities LLC*

Q

Hey, good morning.

Pierce H. Norton II  
*President, Chief Executive Officer & Director, ONE Gas, Inc.*

A

Good morning, Sarah.

Sarah Elizabeth Akers  
*Analyst, Wells Fargo Securities LLC*

Q

I think I heard that ongoing lag is estimated to be about 100 basis points and that compares to the prior expectation of about 100 bps to 150 bps. But can you just talk about the improvement that you've been seeing to tighten that expected lag?

Curtis L. Dinan  
*Chief Financial Officer, Treasurer & Senior VP, ONE Gas, Inc.*

A

Hi, Sarah, this is Curtis. So a couple of things occurring there. As you recall, when we separated, we had the stay-out provision in the State of Kansas where we could not have any new rates going to effect until January 1, 2017, outside of the normal or the annual GSRS filings. And so we completed that rate case, reached a

settlement with the commission last fall and those new rates did go into effect January 1 of this year. So, as Pierce was describing, we've now had all of our – about 95% of our rate base go through these different filings, so that's really caught us up so to speak to reduce from the 100 basis points to 150 basis points closer to around 100 basis points.

So we'll continue to file our interim filings whether those are PBRCs in Oklahoma. It's the GRIP filings and COSAs in Texas. It's the GSRs filings in Kansas or rate cases up there. So it's just more of the same continuing as we go.

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Sarah Elizabeth Akers  
*Analyst, Wells Fargo Securities LLC*

Q

Got it. And then the 2017 guidance in [ph] bed (10:42) are performance base rate adjustment in Oklahoma, or are you still earning within that ROE band where it doesn't trigger an increase?

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Curtis L. Dinan  
*Chief Financial Officer, Treasurer & Senior VP, ONE Gas, Inc.*

A

We are in the process of completing that filing and we'll make that here in the first quarter and we just have to wait until we get to that point.

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Sarah Elizabeth Akers  
*Analyst, Wells Fargo Securities LLC*

Q

Got it. Thanks a lot.

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Curtis L. Dinan  
*Chief Financial Officer, Treasurer & Senior VP, ONE Gas, Inc.*

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Thank you.

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Pierce H. Norton II  
*President, Chief Executive Officer & Director, ONE Gas, Inc.*

A

Thank you, Sara.

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**Operator:** [Operator Instructions] And we've no additional questions. I'll turn the call back to Mr. Ziola for any additional or closing comments.

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Andrew Ziola  
*Vice President-Investor Relations & Public Affairs, ONE Gas, Inc.*

All right. Well, thank you all for joining us this morning. Our quiet period for the first quarter starts when we close our books in early April and extends until we release earnings in early May. We'll provide details on the conference call at a later date. We look forward to seeing many of you at some upcoming investor conferences next week. Other than that, have a great rest of your day. Thank you.

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**Operator:** And that does conclude our call today. Thank you for your participation. You may disconnect at this time.

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