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# ONE Gas, Inc. (OGS)

Q3 2019 Earnings Call

## CORPORATE PARTICIPANTS

Brandon Lohse  
*Director-Investor Relations, ONE Gas, Inc.*

Caron A. Lawhorn  
*Senior Vice President & Chief Financial Officer, ONE Gas, Inc.*

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

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## OTHER PARTICIPANTS

Sarah Akers  
*Analyst, Wells Fargo Securities LLC*

Aga Zmigrodzka  
*Analyst, UBS Securities LLC*

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## MANAGEMENT DISCUSSION SECTION

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

At this time, I'd like to turn the call over to Mr. Brandon Lohse. Please go ahead, sir.

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Brandon Lohse  
*Director-Investor Relations, ONE Gas, Inc.*

Good morning, and thank you for joining us on our third quarter 2019 Earnings Conference Call. This call is being webcast live and a replay will be made available later today. After our prepared remarks, we will 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. And for a discussion of factors that could cause actual results to differ, please refer to our SEC filings.

Joining us on the call this morning are Caron Lawhorn, Senior Vice President and Chief Financial Officer; Curtis Dinan, Senior Vice President, Commercial; Sid McAnnally, Senior Vice President, Operations; and Pierce Norton, President and Chief Executive Officer.

And now, I'll turn the call over to Caron.

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Caron A. Lawhorn  
*Senior Vice President & Chief Financial Officer, ONE Gas, Inc.*

Thanks, Brandon. Good morning, everyone, and thank you for joining us today. Net income for third quarter 2019 was \$17.5 million or \$0.33 per diluted share, compared with \$16.3 million or \$0.31 per diluted share for the same period last year.

Our third quarter results reflect higher net margin from new rates and residential customer growth primarily in Oklahoma and Texas. Operating costs for the third quarter were \$114.6 million compared with \$110.5 million in the same period last year, primarily due to an increase in employee-related costs. Note that on a year-to-date basis, our operating costs have increased 2.4% which is in line with our guidance for the full year.

Interest expense has increased relative to the prior year due primarily to the refinancing of \$400 million of senior notes in the fourth quarter of last year at a higher interest rate. Income tax expense includes the amortization of the regulatory liability for excess accumulated deferred income taxes or ADIT, which was \$1.4 million for the third quarter and \$10.3 million for the year-to-date. You will recall that this amortization is offset in revenues.

Authorized rate base reflecting the recently completed regulatory activity in Central Texas is approximately \$3.5 billion as of September 30. Authorized rate base is defined as the rate base reflected in completed regulatory proceedings, including full rate cases and interim rate filings.

We project that for 2019, our estimated average rate base, which is defined as authorized rate base plus additional investments in our system and other changes in the components of our rate base that are not yet reflected in approved regulatory filings, will be approximately \$3.64 billion, with 42% in Oklahoma, 29% in Kansas and 29% in Texas. ONE Gas ended the quarter with approximately \$304 million of capacity under our commercial paper program.

As we have indicated previously, our lower cash flows in 2019 reflect the impact of tax reform. There are three contributors I would like to highlight. First, Oklahoma Natural Gas is still dealing with the final impact of tax reform on its base rates. Rates in Oklahoma were lowered in February of this year. And as Curtis will describe in a moment, our customers are receiving a credit for the outcome of the 2019 PBRC filing.

Secondly, we're returning approximately \$16 million to our customers in Kansas and Oklahoma for excess ADIT. And the third contributor I'll mention is that we're a cash tax payer in 2019 for the first time with expected payments of approximately \$30 million. We have previously shared that our financing plans contemplate \$500 million to \$550 million of net financing needs through 2023 with approximately one-third being equity.

Yesterday, the ONE Gas board of directors declared a dividend of \$0.50 per share unchanged from the previous quarter. This dividend is consistent with our guidance for 2019. As we've indicated previously, we expect the average annual dividend increase to be 7% to 9% between 2018 and 2023 with a targeted dividend payout ratio of 55% to 65% of net income.

Lastly, we are affirming our 2019 net income guidance of \$180 million to \$190 million or approximately \$3.39 to \$3.57 per diluted share. As you may recall, last quarter, we updated guidance based on our positive results for the first six months of the year.

And now, I'll turn it over to Curtis Dinan for a regulatory update. Curtis?

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Curtis L. Dinan

*Senior Vice President-Commercial, ONE Gas, Inc.*

Thanks, Caron, and good morning, everyone. Let's begin with Oklahoma. As anticipated and discussed last quarter, the Oklahoma Corporation Commission approved the settlement and stipulation in Oklahoma Natural Gas' performance-based rate change filing or PBRC. You'll recall that the stipulation requires Oklahoma Natural Gas to credit its customers \$15.6 million over a 12-month period which began in the third quarter and reflects the return of earnings from the 2018 test year that were above the 9.5% midpoint of its ROE band.

In addition, Oklahoma Natural Gas will credit its customers \$12.7 million in 2020 for the annual reversal of excess accumulated deferred income taxes. As a reminder, the provisions of the order will not have a significant impact on earnings in either 2019 or 2020 but, as Caron mentioned, does impact cash flows. We will have one more PBRC filing in 2020 before a full rate case is required to be filed in 2021. Having worked through the effects of tax reform, we expect this next filing based on a 2019 test year to result in a rate increase and be the first increase in Oklahoma since 2016.

And in Kansas, in August, we requested an increase of \$4.2 million or \$0.43 per residential customer per month related to the Gas System Reliability Surcharge or GSRS for the period covering September 2018 through June 2019. The filing covers less than one year due to the last rate case that included capital expenditures through August 2018. This is our first filing under the new legislation that expands the scope of expenditures that are eligible for recovery under GSRS and increases the cap on the monthly residential surcharge to \$0.80 per customer.

The staff of the Kansas Corporation Commission has filed a recommendation with the commissioners that the GSRS filing be approved as filed. An order from the Kansas Corporation Commission is expected sometime later in the fourth quarter. In Texas, we anticipate filing a rate case in Central Texas before the end of the year, which will include addressing the refund of excess ADIT to those customers.

And now, I'll turn it over to our CEO, Pierce Norton. Pierce?

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## Pierce H. Norton II

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

Thanks, Curtis. Of late, my remarks on these quarterly calls have focused on what we're doing to ensure the safety and reliability of our system. In keeping with that theme, I'm pleased to report that as of this month, we have removed all sections of cast iron from our system. This is a major milestone for our company, our customers and our communities. This accomplishment is the culmination of years of executing our plan to eliminate cast iron in our natural gas distribution systems. We will redirect the time, energy and resources expended on cast iron to other types of vintage pipe through our risk-based replacement program, which has been a key part of managing the integrity of our system and optimizing our capital spend.

At our current pace in spending level, we still anticipate 20-plus years to replace our existing inventory of vintage assets. Our long-term strategy remains to be a 100% regulated natural gas distribution company focused on operating safely, managing expenses and building a sustainable future for our customers and employees. As always, I want to take the opportunity to again recognize our employees who live out our core values everyday as they go about their work. I'm thankful for their efforts and their commitment to serving our customers and our communities.

I'd like to thank you all for joining us this morning. And operator, we're now ready to answer any questions.

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. [Operator Instructions] Our first question will come from Sarah Akers with Wells Fargo.

Sarah 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 Akers

*Analyst, Wells Fargo Securities LLC*

Q

So looks like in the quarter, bad debt expense was up. Is that a material increase on a percentage basis, and do you think that's indicative of any weakness in the local economy or what's driving that?

Caron A. Lawhorn

*Senior Vice President & Chief Financial Officer, ONE Gas, Inc.*

A

Good morning, Sarah. This is Caron. No, I think it's just a normal routine evaluation of where we are on our bad debt. So, there's a little bit of fluctuation as you would expect as we have collection activity that fluctuates a bit with the weather. So before we get into the cold part of the year, we have done some disconnects and people are reconnecting so [ph] as to suit (00:10:36) our routine evaluation of where we are on that reserve.

Sarah Akers

*Analyst, Wells Fargo Securities LLC*

Q

Got it. And then, in terms of customer growth, what level of growth did you see in the quarter? And are you starting to hear any pushback on new gas hookups like we're starting to hear on the coast?

Curtis L. Dinan

*Senior Vice President-Commercial, ONE Gas, Inc.*

A

Sarah, this is Curtis, and the short answer is, no. We're not seeing the pushback on new homes being connected to natural gas. Our activity around capturing new developments in our marketplace have remained very strong. It's a little hard to compare quarter-to-quarter at a growth rate of customers, it's really better to look at it on an annualized basis just because of the time – especially when you're in a shoulder month like the third quarter because the timing of hookups can be a little bit different for customers that are new to the system or coming back on the system. But overall, I would say the trends have remained very strong for us and we're not seeing any weakness in that area.

Sarah Akers

*Analyst, Wells Fargo Securities LLC*

Q

Great. Thank you.

Curtis L. Dinan

*Senior Vice President-Commercial, ONE Gas, Inc.*

Thank you.

A

Pierce H. Norton II

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

Thanks, Sarah.

A

**Operator:** [Operator Instructions] And next, we'll hear from Aga Zmigrodzka with UBS.

Aga Zmigrodzka

*Analyst, UBS Securities LLC*

Good morning

Q

Pierce H. Norton II

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

Good morning, Aga.

A

Aga Zmigrodzka

*Analyst, UBS Securities LLC*

In Kansas, OGS filed its first GSRs under newer legislation. Could you please discuss how much [ph] CapEx (00:12:05) do you plan to recover with this filings versus your last GSRs and how will that reduce your regulatory lag?

Q

Curtis L. Dinan

*Senior Vice President-Commercial, ONE Gas, Inc.*

So Aga, this is Curtis. In that filing, I don't have right here the exact amount of capital that we had included in that as part of the increase, but the yield of it is about \$4.2 million of new revenues. Overall, I think our latest guidance has been that of all of our capital, about 90% of it is subject to annual filings whether it's through the GSRs or other mechanisms we have in the other territories. What drove that increase from the old 80% is the GSRs legislation and we're just now starting to partially see the effects of that.

A

Aga Zmigrodzka

*Analyst, UBS Securities LLC*

Perfect. Thank you. And Caron mentioned one-third of funding will be financed with equity. Should we assume that most of that will be through ATM in 2020 and beyond?

Q

Caron A. Lawhorn

*Senior Vice President & Chief Financial Officer, ONE Gas, Inc.*

Good morning, Aga. We have not determined exactly how we will finance our needs. It would make sense for us to consider an aftermarket program and we certainly are but we haven't made any final decisions on that.

A

Aga Zmigrodzka

*Analyst, UBS Securities LLC*

Okay. Great. Thank you for taking my questions.

Q

Pierce H. Norton II

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

A

Thank you.

**Operator:** And with no further questions, I'd like to turn the call back over to management for any additional or closing remarks.

Brandon Lohse

*Director-Investor Relations, ONE Gas, Inc.*

Thank you all again for your interest in ONE Gas. Our quiet period for the fourth quarter starts when we close our books in early January and extends until we release earnings in February. We'll provide details on the conference call at a later date. Have a great day.

**Operator:** Once again, that does conclude our call for today. Thank you for your participation. You may now disconnect.

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