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# ONE Gas, Inc. (OGS)

## Q2 2020 Earnings Call

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# MANAGEMENT DISCUSSION SECTION

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

At this time, I would like to turn the conference – over to Mr. Brandon Lohse. Please go ahead, sir.

## Brandon Lohse

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

Good morning and thank you for joining us on our second quarter 2020 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 include among others, statements about the length and severity of a pandemic or other health crises such as the outbreak of COVID-19. 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 Pierce Norton, President and Chief Executive Officer; Caron Lawhorn, Senior Vice President and Chief Financial Officer; Curtis Dinan, Senior Vice President and Chief Commercial Officer; and Sid McAnnally, Senior Vice President and Chief Operating Officer.

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

## Caron A. Lawhorn

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

Thanks, Brandon. Good morning, everyone. Yesterday we announced that we have reaffirmed our 2020 earnings guidance which was originally issued on January 21, 2020 with net income expected to be $186 million to $198 million with a midpoint of $192 million and diluted earnings per share of $3.44 to $3.58 and a midpoint of $3.56. I will elaborate on that in a moment, but will first review highlights from the quarter.

Net income for the second quarter was $25.3 million or $0.48 per diluted share compared with $24.5 million or $0.46 per diluted share in the same period 2019. Our second quarter results reflect an increase in net margin of $2.8 million over the same period last year, which includes new rates in Kansas and Texas and a net increase in the number of residential customers. The increase in net margin includes a reduction of $1.9 million due to the lower late payment, reconnect and collection fees primarily related to the moratoriums on disconnects for non-payment due to the COVID-19 pandemic.

Operating costs for the second quarter were $2.7 million higher than the same period last year. Expenses related to COVID are the main driver of the increase, which includes a $3.2 million increase in bad debt expense and a $2.2 million increase due to costs related to our response to COVID-19. Offsetting a portion of those cost increases is a reduction in expenses of $1.7 million for travel due to restrictions put in place because of the pandemic and a $1.1 million decrease in employee-related costs.

As you may recall, our non-qualified employee benefit plans impacts both operating costs, which reflects the expense associated with planned liabilities as well as other income or expense which reflects the increase or decrease in the value of the associated investment. We've experienced quarter to quarter swings in the net income impact of these plans in 2020 that was primarily driven by volatility in the financial markets. However, on a year-to-date basis the impact is not material.

We now have COVID-related accounting orders for all jurisdictions, but as of June the 30th we have not recorded any regulatory assets for financial reporting purposes. Although there are nuances among the states, these orders generally allow us to defer for regulatory accounting purposes net incremental expenses and certain [ph] rough (00:03:43) revenues due to COVID-19. In order to record the regulatory asset for financial accounting purposes, we must identify and quantify amounts that qualify for regulatory treatment in accordance with the accounting order. In addition, we must conclude that such amounts are probable of recovery. This evaluation is ongoing.

Our capital expenditures and asset removal costs increased $16.4 million this quarter compared with the same quarter last year due to the system integrity activities, including government relocation projects and extension of service to new areas. Authorized rate base, reflecting our recent regulatory activity, is approximately $3.71 billion as of June the 30th. 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 2020 our estimated average rate days, which is defined as authorized rate days 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 $3.91 billion with 42% of that in Oklahoma, 29% in Kansas, and 29% in Texas.

In April, we issued $300 million of senior notes to 2030 at a coupon of 2%. The proceeds from the issuance were used primarily to reduce our outstanding commercial paper balance. We ended the quarter with adequate liquidity, which includes nearly $470 million of capacity in our commercial paper programs and all of the capacity under our $250 million, 364-day credit facility.

The ONE Gas Board of Directors declared a dividend on July 20th of $0.54 per share, which is unchanged from the previous quarter. This dividend is consistent with our guidance for 2020.

Moving on to financial guidance, you'll recall that last quarter we indicated we could be below the midpoint of our earnings guidance range. At that time, we were still in the early stages of dealing with the pandemic. Three months later, we have an additional quarter of actual results behind us as well as more insight into how the pandemic is impacting ONE Gas both financially and operationally, as well as our customers. Although there are still uncertainties, we believe we are on track to achieve results in line with our original guidance for 2020. Our reaffirmed earnings guidance does not assume that we will record any regulatory assets for financial reporting purposes pursuant to the accounting orders we have received addressing the impact of COVID-19.

We are also updating our expectation for capital expenditures, including asset removal costs. We are increasing our estimated capital outlay for 2020 to a range of $500 million to $525 million, up from our original guidance of $475 million. This increase is primarily due to extensions of service to new customers in Texas and Oklahoma above the levels we had anticipated.

Now, I'll turn it over to Curtis for the commercial update.

## Curtis L. Dinan

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

Thank you, Caron and good morning everyone. First I'll provide an update or an overview of recent regulatory activity and then provide an update on the impact of COVID-19 on our commercial activities. Oklahoma Natural Gas filed a performance based rate change filing in February requesting an increase in base rates of $11.8 million. A unanimous settlement was reached and a joint stipulation was filed in June that included a base rate increase of $9.7 million. The Oklahoma Corporation Commission issued an order approving the joint stipulation and new rates became effective in June. Texas Gas Service made a GRIP filing in March for all customers in the West Texas service area for an increase in rates of $4.7 million, and new rates became effective in June. Texas Gas Service also filed a rate case in December for all customers in the Central Texas and Gulf Coast Service Areas seeking a rate increase of $15.6 million and requesting to consolidate the two Service Areas.

In July, the Administrative Law Judge issued a proposal for decision and recommended that the Railroad Commission approve all terms of a $10.3 million unanimous settlement based on an authorized return on equity of 9.5% and a capital structure with 59% equity. The ALJ also recommended approval of TGS's request to consolidate the two jurisdictions into a new Central Gulf Service Area, which the cities have opposed. If approved, new rates are expected to become effective in the third quarter of 2020, and our jurisdictions in Texas will be reduced to five from six. Kansas Gas Service will file a Gas System Reliability Surcharge or GSRS in August for the period covering July 2019 through June 2020. This filing will represent our first filing under the revised GSRS statute that will include 12 months of capital expenditures.

Moving on to our commercial activities, we have approximately 12,000 transport customers on our system that represented $114 million or 12% of our net margin in 2019. Our 40 largest transport customers accounted for $28 million or 25% of our 2019 transport revenues. I mentioned during our first quarter analyst call that two of these customers, one in the automotive industry and one in the residential shingle business had temporarily suspended operations. During the second quarter, both of those businesses resumed operations and in June had transportation volumes comparable to the same period last year. Outside of our 40 largest transport customers, we have approximately 30 other businesses that have reduced operations or temporarily or permanently suspended operations. Based on their current level of business activity, we are experiencing a negative impact to transport revenues of less than $50,000 per month which is an improvement from the $100,000 per month impact I described during our first quarter earnings call.

Year-to-date we have averaged approximately 21,000 more sales customers than the same period last year, which is partially the result of the moratoriums on disconnects. During the second quarter, the moratoriums expired in Oklahoma and Kansas and we resumed our normal collection activities including disconnecting delinquent accounts for nonpayment. The moratorium on disconnects in Texas has been extended until August 10. In all three states, we have continued our customer outreach programs to offer customers with delinquent bills alternative payment arrangements if they are not able to bring their accounts current. We have also been working with various social service agencies to help our eligible customers receive financial assistance.

Finally, construction activity with our builders and developers has remained robust through the first six months of 2020 including single- and multi-family construction as well as commercial development. The positive trend in growth capital spending to support our builder and develop our network resulted in an increase in capital expenditures for the first half of 2020 and is the primary driver behind our increase in full year capital spending that Caron described.

And now, I'll turn it over to Sid.

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## Robert S. McAnnally

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

Thanks, Curtis. Operationally, we continue to adapt and adjust our work as needed to continue the reliable service our customers expect, while keeping our employees and customers safe during the pandemic. Thanks to the focus of our team in the field and the support provided by our employees across the company, we are currently on target or ahead of target in meeting our performance goals for maintenance and compliance work.

While we continue to monitor workforce availability, to-date we have not seen levels of absenteeism that impact our ability to execute work plans. We credit this performance in part to the success of the protocols we established in consultation with our third-party medical consultant that allow any employee who has concerns about a potential exposure or is experiencing COVID-like symptoms to quickly access guidance for medical screenings, keeping potentially impacted employees quarantined to protect them and their families, and to avoid spread in our work groups.

The success of this program to-date is in the numbers. Of our 3,640 employees, 42 have tested positive through June 30th. Of these positive tests, approximately 50% were employees working in the field. Our supply chain has also functioned smoothly, and we've not seen any disruptions in our ability to procure materials. Our supply of PPE remains at target levels, and we maintain open supply channels in the event of an unforeseen increase in demand.

As you saw in the earnings release, our capital spend is ahead of last year, both for system integrity and growth. Projects have been shovel-ready due to the work of our engineers and designers, and the work executed by third-party contractors has also gone uninterrupted. Our 24-month system integrity planning process allows our organization to accelerate or decelerate the capital workload from month to month by flexing scheduling as necessary. As a reminder, we continue to see a 20-plus-year runway for replacement of vintage material. Thanks to the work of our health and safety and IT teams, we are alert to COVID-19-related changes in our service territory and have created a structure that relies on the most recent medical information to determine the appropriate level of customer facing service work and elective construction activity in the field. This approach allows us to quickly react to changing circumstances, scaling work up or down as we assess the best path to execute our work in a way that provides a safe environment for our employees, our customers, and the public.

And now I'll turn it over to Pierce.

## Pierce H. Norton II

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

Thank you, Sid. In closing today, as we all continue to adapt to the changing environment brought on by COVID-19 pandemic, I want to highlight the resilience and incredible work ethic of our employees and what they've shown. We're taking advantage of our previously deployed technology and new technology at an exceptional rate. We continue to monitor trends and a variety of data points to make choices on how best to keep our employees and customers safe and we are looking ahead and planning what could happen and how we'll handle it.

In the midst of adversity, our employees continue to show their dedication to our core values and mission every day. As a natural gas utility, we have an important role in serving our communities. We're working to help ensure all of our customers have a choice to access affordable, reliable and environmentally friendly natural gas.

Finally, I'd like to thank our ONE Gas employees for staying vigilant in our safety protocols. Our shared commitment has allowed us to continue to operate with minimal disruptions from our customers. I'm extremely proud to work alongside our team and want to send a special thank you to every employee for the tremendous work being done to meet the demands of working differently during the pandemic. Thank you for joining us this morning.

Operator, we are now ready for questions.

# QUESTION AND ANSWER SECTION

**Operator**: Yes sir, thank you. [Operator Instructions] And we'll take our first question from Shar Pourreza with Guggenheim Partners.

**Shahriar Pourreza**
*Managing Director - Energy/Power, Guggenheim Partners*

Q

Hey, good morning, guys.

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

A

Good morning, Shar.

**Shahriar Pourreza**
*Managing Director - Energy/Power, Guggenheim Partners*

Q

Just a couple of quick, easy ones. First, the CapEx increase in 2020 for customer growth speak some pretty good volumes on your fundamentals. Should there be a direct read-through to 2021 and how does the increase in customer count help create some of that [ph] headwind for builds (00:17:11) on existing company – existing customers. Is that a potential to [ph] flex (00:17:16) in 2021 as well as 2020? So, how do we look at the fundamental today, the higher numbers, the higher CapEx and try to correlate it for next year?

**Curtis L. Dinan**
*Senior Vice President-Commercial, ONE Gas, Inc.*

A

Shar, this is Curtis. Great question. We have been, over the last really 18 months to two years have been seeing a little bit stronger customer growth across our system. The capital that we have been spending has been extending service lines into new areas, as our builders and developers have been very active. And so part of what we're seeing here in 2020 is the build-out of a lot of those subdivisions and we continue to see future build-out in those subdivisions as well. So, again, we have been seeing an upward trend in our numbers of new customers.

**Shahriar Pourreza**
*Managing Director - Energy/Power, Guggenheim Partners*

Q

So we could see a similar CapEx flux next year just given sort of the demographics and the growth in your customer base?

**Curtis L. Dinan**
*Senior Vice President-Commercial, ONE Gas, Inc.*

A

Yeah. We haven't given – updated that guidance yet, but keep in mind, even the guidance that we've just updated, it's an increase of about $20 million to $25 million on a $475 million base. So, it is a little bit of an uptick but not a major trend mover, I guess I would put it in that perspective.

**Shahriar Pourreza**
*Managing Director - Energy/Power, Guggenheim Partners*

Q

All right. And then just lastly given the weak HDDs year-to-date, what level of cost deferral and cost savings are being contemplated for 2020 and how does that bridge to your reaffirmed guidance?

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

A

Shar, this is Caron. It seems you're talking about how we're looking at the COVID impact on 2020. We have – we went – we have not assumed that we will be able to establish for financial accounting purposes any regulatory asset. So we don't have any offset anticipated in 2020 and we laid out what we have experienced so far through 2020 in our highlights for the quarter. So, as we think that going forward we do have some uncertainty still, Curtis – Curtis described the impact on our transportation customers being a little bit less than we had anticipated at the end of the first quarter. We've talked about the growth capital. We've been managing our expenses. So all those things have been taken into consideration as we think about our 2020 expected results and our guidance.

**Shahriar Pourreza**
*Managing Director - Energy/Power, Guggenheim Partners*

Q

Got it. That's all the questions I had. Thank you very much.

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

A

Thank you, Shar.

**Operator**: And we'll now take our next question from Chris Sighinolfi with Jefferies.

**Christopher Paul Sighinolfi**
*Analyst, Jefferies LLC*

Q

Hey, everyone. Thanks for the...

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

A

Good morning, Chris.

**Christopher Paul Sighinolfi**
*Analyst, Jefferies LLC*

Q

Hey, thanks for the added color today and for taking my questions. I guess to follow maybe on that last point, clearly Caron, you had detailed the fact that the headwinds anticipated maybe three months ago on the financial performance are now not viewed to be as problematic and – you know, you mentioned having an additional quarter under your belt. Curtis mentioned some of the drivers of resumed activity in your service territory, but I'm just wondering if you could expand a little bit. Is it just a confluence of various small things that in aggregate make the situation less problematic, or was there any particular sort of single item that you'd been fearing that maybe is tracking much better? Just I guess a little bit of better appreciation from my perspective on what's causing the improved outlook?

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

A

Hey, Chris. So I think the main items we thought about were our regulatory filings. We were concerned at the end of the first quarter that those procedural schedules may not stay on track. They largely did stay on track, those are – a couple more have been concluded. The – we're still waiting on the approval of the Railroad Commission on the Central Texas and Gulf Coast rate cases, but that has largely gone on a path consistent with our expectations. We've already talked about the transportation revenues that impact. The work in the field has continued with minimal disruptions. Both for capital work and for O&M work we've had no significant supply chain or workforce disruptions. We already talked about our growth capital a bit. So we had some concerns at the end of the first quarter about whether we might see some slowdowns in permitting that might impact that work. That has not materialized.

Also, the economic impact of the pandemic has not adversely impacted customer interest in new connections. So, that's remained strong. And then we've also had – at the first quarter we had an adverse impact from our non-qualified plans due to market activity. That has reversed itself. So relative to last year, the impact is not material. Those are kind of the big drivers. And then as you mentioned, there are a number of smaller puts and takes that we've also considered as we thought about guidance for 2020.

**Christopher Paul Sighinolfi**
*Analyst, Jefferies LLC*

Q

That is a great rundown. Thank you for that, Caron. And I guess on a related note, you'd mentioned no expectation to record any COVID-related regulatory assets. I guess can you remind me – obviously at the time of your first quarter call you didn't yet have procedures, plans in place or a rate filing – rate approvals in all the jurisdictions. But did you assume at that point you would make some? And if there's been a change there, I guess what's the [ph] driver (00:23:05)? Is the bad debt less than you expected? You mentioned some of the economic impact on your service territory maybe being less than maybe you had been concerned about, or are you better able to offset with costs? I'm just curious if it was a change, and if it was, what was maybe driving that?

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

A

So at the end of the first quarter – you're right – we only had one of the state's regulatory orders in hand. We now have all three of them. But there's still – they are not clear cut. So there is still some judgment that has to be applied in terms of when you identify and measure those incremental costs, making sure that that's consistent with the expectations of the order, and then again they've got to be probable of recovery.

So our thinking about that hasn't changed. It's not that we think that bad debt expense is going to be less than we thought. It's just that it's – the requirement to be able to record those regulatory assets, we haven't met that hurdle yet. So it's a timing issue.

**Christopher Paul Sighinolfi**
*Analyst, Jefferies LLC*

Q

Okay, understood.

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

A

Okay, Chris. This is Pierce. Chris, this is Pierce. The only thing I'd add to that is if you basically kind of look at the cost that COVID has – kind of gone into the operating expenses and you look at what you'd normally do in an operating environment where you have transportation across our territories that's pretty much been shut down due to COVID-19, those pretty much offset one another. And so then you're really focusing on your bad debt. And it's not that we don't think we will eventually have some accounting accrual. It's just that you need more clarity before you can take it.

**Christopher Paul Sighinolfi**
*Analyst, Jefferies LLC*

Q

Okay. Yeah. And clearly, Pierce, like we've talked about the fact that there has been a lot of stimulus put in people's hands thus far this year with regard to late filing of tax returns for those at [indiscernible] (00:25:01) or the stimulus checks or the unemployment benefits and this – and you know the federal growth setup on top of that. So I'm just kind of curious if you just haven't maybe seen impacts that you'll see later on as some of those support programs peter out and if that was part of your calculus or not. It sounds like it might be, but it's still a, to Caron's point, a timing issue, a latency. And then there is specifics to the regulatory orders that need to be ironed out I guess in your treatment. Is that a correct understanding from my perspective?

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

A

That's correct, Chris. It really – you said it well. It's a timing issue.

**Christopher Paul Sighinolfi**
*Analyst, Jefferies LLC*

Q

Yeah. Okay. Okay, that's all. And I guess a final question from me is just, you know with regard to the exemption KGS will have from Kansas State income taxes next year and I guess all utilities in Kansas, how that might affect the operating cash flow? I'm just remembering that with Tax Cuts and Jobs Act at the federal level we did see some modest headwind because you were collecting at a statutory rate, but on a cash line it wasn't the full statutory rate. So I'm just – at the state level, are there any such lag or delta we should be mindful of in our modeling?

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

A

This is Caron again. We don't expect a significant impact at all. We expect that the Commission will order a reduction in rates beginning in January for that, but then our tax expense will go down. We should not have an impact. We will be refunding the excess ADIT. We recorded $81.5 million of excess ADIT, but that won't start until our next Kansas rate case.

**Christopher Paul Sighinolfi**
*Analyst, Jefferies LLC*

Q

Okay. Wonderful. Thank you guys very much for all the [indiscernible] (00:26:42). I do appreciate it.

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

A

Thanks, Chris. Stay safe.

**Christopher Paul Sighinolfi**
*Analyst, Jefferies LLC*

Q

You too.

**Operator**: We'll now take our next question from Gabe Moreen with Mizuho.

**Gabriel Moreen**
*Managing Director, Mizuho Securities USA LLC*
Q

Hey, good morning everyone. If I could just maybe turn to kind of lost revenues – and I know you talked about the transportation revenues from several of your industrial customers – can you talk about which states are potentially granting you recovery for lost revenues, and going forward is there anything on the residential side that we ought to look for maybe in terms of, I don't know, excessive conservation going forward during the winter heating season that you'll sort of be looking out for and potentially recovering in the future?

**Curtis L. Dinan**
*Senior Vice President-Commercial, ONE Gas, Inc.*
A

So Gabe, this is Curtis. A few questions there. I'll try to hit each of them, but if I forget one, pull me back in. The first one on the lost revenues in the different states and which of these allow us to recognize that, we have some disclosures in the press release about the impact that it had on us in the first quarter. In the State of Kansas, lost revenue related to these different items is included and in some degree waived fees, either late payments or reconnect fees are covered in all of the states. So, again I think this falls into the category of what Caron was describing earlier as it relates to, we're tracking those items, but it – it's really a timing issue as to whether those items would get recognized or not.

As it relates to your last question around conservation and whether we might see that, we have a very high level of fixed fees, so outside of our transport customers we're not as volumetric sensitive as we have been in the last several years, around 72% fixed fee on our sales customers. So, there's not a large exposure to that. And then the environment that we're in, in a very low gas price environment, I don't know that we would necessarily forecast a high conservation impact that would impact – that would have an impact on those variable fees. Lastly – I know you had a – I think a third question in there. Help me with that one.

**Gabriel Moreen**
*Managing Director, Mizuho Securities USA LLC*
Q

No, I think you got them, Curtis. Thank you. Maybe if I could just follow up...

**Curtis L. Dinan**
*Senior Vice President-Commercial, ONE Gas, Inc.*
A

Okay.

**Gabriel Moreen**
*Managing Director, Mizuho Securities USA LLC*
Q

...in terms of the kind of process here for the if and when you decide to record some regulatory assets, what each state is telling you is a sort a separate track here in terms of being able to recover some of these expenses and – or is it going to be rolled into a rate case at some point. Just curious what the process and timing is on that.

**Curtis L. Dinan**
*Senior Vice President-Commercial, ONE Gas, Inc.*
A

Gabe, this is Curtis. We were – have a little bit of a hard time hearing your question. Could you ask that again?

**Gabriel Moreen**
*Managing Director, Mizuho Securities USA LLC*
Q

Sure. Can you hear me better now?

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

A

No problem.

**Curtis L. Dinan**
*Senior Vice President-Commercial, ONE Gas, Inc.*

A

Yes.

**Gabriel Moreen**
*Managing Director, Mizuho Securities USA LLC*

Q

Great. So, I was just asking just – for the – if and when you're going to re-establish regulatory assets, just the process and the timing from what you're hearing from various commissions about how that's going to take place. Is it a full blown rate case or there are separate tracks here where you might be able to just kind of take care of the COVID-related stuff on specific line – specifically.

**Curtis L. Dinan**
*Senior Vice President-Commercial, ONE Gas, Inc.*

A

So, Gabe, a couple of things. First off, we're filing in Oklahoma next year. We're required to, under our PBR mechanism, to file a full rate case. So that'll be the first one that – where we address it. It isn't 100% prescriptive. In the other two states there is some flexibility for consideration outside of a full rate case, but it remains until we start having further discussions with our regulators about that, and I think that will be dependent more upon how we see the pandemic unfolding and do we – like, kind of the environment that we're in today, we're not going to be in front of those commissions asking them to start that process right now nor would I expect that they would expect us to do that. So, it will still be a little while before those processes start, and that will give us better clarity. That will not only answer the questions you were asking, but also – earlier, in terms of the accounting treatment of how we'll recognize those. We'll get better clarity as this goes along.

**Gabriel Moreen**
*Managing Director, Mizuho Securities USA LLC*

Q

Thanks, Curtis.

**Operator**: We will now take our next question from Richard Ciciarelli with Bank of America.

Q

Hey, this is Terry [indiscernible] (00:31:31) on for Rich Ciciarelli. Two quick ones, the incremental CapEx for 2020, mostly [indiscernible] (00:31:40) in the first half of the year. What is kind of the timing for the recovery on this quantity on the bottom line and is there any change to the previous guidance on 70% of the CapEx [indiscernible] (00:31:51) to system integrity and replacements.

**Curtis L. Dinan**
*Senior Vice President-Commercial, ONE Gas, Inc.*

A

So a couple of points, and Caron can provide some more color on your 70% question, but – so it depends on the type of capital it is. When it's connecting new customers and those customers begin service, then our revenues are impacted at that point in time. All the other capital as well as that capital, to go into rate base, it has to be an interim rate filing like a GRIP or a GSRS or a PBR or has to go through a full rate case. So I think it's kind of a combination of those things. The growth capital is when that customer starts their service and then the others go through the full rate case. So then Caron can talk about how that impacts our total capital spend.

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

A

So, we've indicated that about 90% of our annual capital spend in a given year is covered in a regulatory filing. That is unchanged. With this increase in growth capital guidance for 2020, it's largely capital related to Texas and Oklahoma which will get covered in an annual filing. If there were Kansas, there would be a delay until it got covered in a rate case, but most of this growth capital increase is coming from the other two states.

Q

Got it. That's helpful. Then just one more. Can you talk about the – your long term growth [indiscernible] (00:33:22) outside of natural gas, just RNG and [indiscernible] (00:33:25). We've heard a couple of your peers began to make some progress on this and just wanted to get your thoughts and any updates there.

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

A

First talk about RNG.

**Curtis L. Dinan**
*Senior Vice President-Commercial, ONE Gas, Inc.*

A

So we do – on the RNG front – this is Curtis again. On the RNG front, we do – are continuing to pursue different projects around that. I wouldn't say that any of those projects are at a spot where we're prepared to give capital guidance or financial impact of any of those at this point. But there are a number of discussions going on with various parties in our service territories.

Q

Okay, got it. Thanks. And if I could just sneak one more in, if you could talk about your thoughts on M&A just in Australian companies is what some interesting [indiscernible] (00:34:20) that's regulated in the US [indiscernible] (00:34:23) your kind of latest thoughts on M&A.

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

A

This is Pierce. So, I'll take that one. The – our thoughts on M&A really haven't changed. We continue to execute on the five-year plan that we have and what's in front of us and we continue to think that that's probably the best thing for our shareholders. So, as far as those comments, really don't have anything else to say, but we're executing on our plan.

Q

Awesome. Thanks so much guys.

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

A

Thank you.

**Operator**: Our next question will come from Aga Zmigrodzka with UBS.

**Aga Zmigrodzka**
*Midstream and Gas Distribution Analyst, Director at UBS Equity Research, UBS Securities LLC*

Q

Good morning.

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

A

Good morning, Aga.

**Aga Zmigrodzka**
*Midstream and Gas Distribution Analyst, Director at UBS Equity Research, UBS Securities LLC*

Q

I have a follow-up question on bad debt. What was the historical bad debt as a percent of revenues and what was that in 2Q? And what you are seeing in July? Do you have any metrics that you are tracking and how they are shaking out?

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

A

Good Morning, Aga, this is Caron. I don't have a number on my fingertips, but all the information to calculate that is provided in our information and you can get our provision for doubtful accounts on the cash flow statements and we're up about – you'll see we're about $4 million relative to last year or – excuse me, 3Q – 3Q from last year. And then our revenues obviously around the financials as well. We – when we look at it, we're focused on the pass-through accounts and the performance of those accounts and that's working as we think about what our allowance should be.

**Aga Zmigrodzka**
*Midstream and Gas Distribution Analyst, Director at UBS Equity Research, UBS Securities LLC*

Q

Perfect. Have you seen any pressure on ROEs from low interest rates, and as you go for the process of your filing, the beta for the group has increased in the past few months. Could that help offset the negative impact from lower rates? What are your thoughts on that?

**Curtis L. Dinan**
*Senior Vice President-Commercial, ONE Gas, Inc.*

A

So Aga, this is Curtis, and the one I would point to is our most recent general rate case in the Central Texas and Gulf Coast Service Areas where we had the unanimous consent with the 9.5% allowed ROE and the 59% cap structure in that filing. That's our most recent data point.

**Aga Zmigrodzka**
*Midstream and Gas Distribution Analyst, Director at UBS Equity Research, UBS Securities LLC*

Q

Perfect. And last one is really on timing of acquisitions. Is there any update there? Are you still planning to issue anything on ATM this year?

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

A

Aga, this is Caron. I don't have any updates on – to the guidance that we provided. You saw that we've issued a few shares in the second quarter, but I don't have any updates. We're not deviating from our – the parameters of our original guidance.

**Aga Zmigrodzka**
*Midstream and Gas Distribution Analyst, Director at UBS Equity Research, UBS Securities LLC*

Q

Thank you.

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

A

Thanks, Aga.

**Operator**: We will take our next question from Brian Russo with Sidoti.

**Brian J. Russo**
*Utilities Analyst, Sidoti & Co. LLC*

Q

Hi. Good morning.

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

A

Good morning, Brian.

**Brian J. Russo**
*Utilities Analyst, Sidoti & Co. LLC*

Q

Hey, just a follow-up on the equity. It's all under the ATM, and so you're still forecasting $43 million per year through that program?

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

A

So, Brian, this is Caron. The guidance that we provided was how much equity we expect to issue through 2024. We haven't provided guidance on any level for any particular year other than what we factored into our guidance for outstanding diluted shares in 2020.

**Brian J. Russo**
*Utilities Analyst, Sidoti & Co. LLC*

Q

Okay. Got it. Understood. And then just curious, how much additional investments are you able to capture in the Kansas GSRS filing, now that it's been extended to encompass 12 months of investment?

**Curtis L. Dinan**
*Senior Vice President-Commercial, ONE Gas, Inc.*

A

Brian, this is Curtis. We will be making that filing next month. So we are in the process of the final reviews in that and pulling all that data together. So, I'm not – don't have a filed number yet to give you, but there are additional items that qualify that did not previously. So, certain things like physical and cyber security cost and then expanded definition of safety-related expenditures all roll into that as well as an increase in the impact that it could have on the customers' monthly bill. So, all of those are – well, and you saw some of that impact last year when we had a partial year filing and the impact of that. So, I think we'll – again, we'll be prepared to share more of that once we make that filing in August.

**Brian J. Russo**
*Utilities Analyst, Sidoti & Co. LLC*

Q

Okay. So just to clarify, before the statute, how many months of investment did you capture in your annual GSRS filing, or – you know was there any timing lag? Just want to get a sense of how much this could help improve the inherent structural lag that you have in Kansas relative to Oklahoma and Texas.

**Curtis L. Dinan**
*Senior Vice President-Commercial, ONE Gas, Inc.*

A

So, it is a – it covers a period of 12 months, and so the filing we'll make in August will be capital spent through June 30th of 2020. This will be the first one that covers a full 12 months. Last year's partial year filing covered all capital that went through June 30 of 2019. I think if you're trying to look more broadly, as Caron made the point earlier that 90% of all of the capital we spend is now subject to an annual filing, and previous to the GSRS amendment that number was about 80%. So, we've seen about 10% more of our capital qualify for an annual program as a result of that legislation.

**Brian J. Russo**
*Utilities Analyst, Sidoti & Co. LLC*

Q

Very helpful. Thank you very much.

**Curtis L. Dinan**
*Senior Vice President-Commercial, ONE Gas, Inc.*

A

Thanks, Brian.

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

A

Thank you, Brian.

**Operator**: [Operator Instructions] And we'll pause for just a moment. And it appears there are no further questions at this time. I'd like to turn the conference back over to our presenters 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 third quarter starts when we close our books at the end of September and extends until we release earnings in early November. We'll provide details on the conference call at a later date. Have a great day.

**Operator**: And once again that does conclude today's conference. We thank you all for your participation. You may now disconnect.