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# ONE Gas, Inc. (OGS)

Q2 2022 Earnings Call

## CORPORATE PARTICIPANTS

**Brandon Lohse**

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**Robert Sid McAnnally**

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

**Caron A. Lawhorn**

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

**Curtis L. Dinan**

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## OTHER PARTICIPANTS

**Kody Clark**

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**Jamieson Alexander Ward**

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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 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 second quarter 2022 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 provisions of the Private Securities Litigation Act of 1995, the Securities Act of 1933, and the Securities and Exchange Act of 1934, each as amended.

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.

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

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

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**Robert Sid McAnnally**

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

Thanks, Brandon, and good morning, everyone. The last three years have tested all of us calling us to be flexible and resilient in the face of significant challenges. At ONE Gas, we committed to meet those challenges while maintaining our focus on three targets: a strong safety culture, excellent customer service, and building the capacity to respond to the organic growth in our service territory.

Today, we provide an update on our progress on those three targets. The American Gas Association recognized our employees for having the lowest serious injury rate among our peers for the fifth consecutive year. A national consumer research firm recognized our teams in Oklahoma and Texas for outstanding customer service. And earlier this year in our guidance, we significantly increased our capital program to expand investments that strengthen our system, while also responding to our growing customer base.

Last year, we added a fourth commitment, a stronger focus on ESG opportunities, and you'll hear more about that in a moment. Now, we're also called to respond to today's dynamic macroeconomic environment. With both inflation and an increase in the cost of gas impacting customer bills, we remain focused on customer affordability and on managing costs across the enterprise.

Our approach is simple. Be prudent in managing the present and remain consistent in the long-term execution of our core business and growth strategies. The courage and commitment that ONE Gas employees live every day provides a strong foundation for our confidence that we are navigating today's challenges in a way that also builds toward a bright future.

With that, I'll turn it over to Caron to discuss the financial details for the quarter. Caron?

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## Caron A. Lawhorn

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

Thanks, Sid, and good morning, everyone. Net income for the second quarter was \$32.1 million or \$0.59 per diluted share, compared with \$30.1 million or \$0.56 per diluted share in the same period 2021. Our second quarter results included an increase in operating income of \$7.5 million or 15% over the same period last year. This reflects an increase of \$14.4 million from new rates, primarily due to regulatory filings completed in the second half of last year. Continued residential customer growth, primarily in Oklahoma and Texas, contributed to an increase in operating income of \$1.5 million.

Our operating cost increased \$7.1 million over the second quarter of 2021, including an increase in outside services of \$5.8 million. In addition, employee-related costs were up \$0.7 million, which includes higher labor and employee benefit costs that were largely offset by a reduction in expense from the mark-to-market valuation of liabilities for our non-qualified employee benefit plans. Other expense net increased \$4.4 million for the quarter primarily due to an increase in expense from the decline in the value of assets associated with our non-qualified employee benefit plans. The increase was partially offset by a reduction in the non-service costs for our pension plans due to a re-measurement of our obligations, which I'll discuss in a moment.

Depreciation expense was \$4.2 million higher than the prior year, reflecting an increase in net property, plant and equipment as a result of our continued capital investments. Our capital expenditures and asset removal cost for the second quarter were \$149.1 million compared to \$129.4 million in 2021. Our capital investments for the full year are on track for \$650 million. Authorized rate base was approximately \$4.28 billion as of June 30, and we estimate our average rate base for 2022 will be approximately \$4.8 billion.

As Curtis will describe in more detail, securitization is progressing in all three states, and we expect each of our divisions will receive proceeds from the issuance of securitized bonds before the end of the year. As we receive

the proceeds, we will call a like amount of the notes related to Winter Storm Uri, \$1.4 billion of which is due in March 2023.

Looking at our liquidity, we are beginning to see the effect of higher natural gas prices on our investment in natural gas storage as well as working capital for receivables and payables. We ended the quarter with approximately \$509 million of capacity in our \$1 billion commercial paper program and no borrowings under our credit facility.

Our guidance for the year contemplated the issuance of \$35 million of equity under our at-the-market equity program, which we accomplished in the first quarter. Given our future liquidity needs and current market conditions, we continued to utilize our ATM program in the second quarter by executing forward sale agreements for approximately 592,000 shares of our common stock, which must be settled on or before January 2, 2024. Had we settled all these shares under these arrangements as of June 30, we would have generated net proceeds of \$48.3 million or \$81.54 per share.

We have [ph] \$139.3 million (00:06:24) of equity available for issuance under the ATM program. We believe these sources of liquidity position us well and give us flexibility as we seek to optimize our financing plans. Lastly, for the quarter, the ONE Gas Board of Directors declared a dividend of \$0.62 per share, unchanged from the previous quarter.

As we look to the balance of the year, we are reaffirming our guidance. I would first like to comment on events that were not contemplated in our guidance, both of which relate to market conditions. First, as I mentioned earlier, we have seen a net reduction in the market value of assets and liabilities associated with our non-qualified employee benefit plan. For the six months ended June 30, the impact of these non-cash adjustments was net expense of \$6.1 million.

Another non-cash component of our expenses is pension expense. We amended our pension plans effective April 30 to convert what had previously been variable cost of living adjustments for eligible participants to a fixed rate. This event triggered a re-measurement of our pension obligations. The impact of the re-measurement on pension expense for calendar 2022 is expected to be a reduction of approximately \$7.2 million, primarily due to an increase in the discount rate, which lowers the projected benefit obligations. The net of these two non-cash items does not materially impact our view of 2022.

We expect economic conditions to remain challenging for the balance of the year. Our team continues to focus on the things we can control – safety, managing our costs, and executing on our capital plan – and on managing and mitigating where possible the impact of the things we cannot control – interest rates, performance of the equity markets and inflation. Given the solid performance of our business through the first six months and what we can see for the balance of the year, we are confident in our guidance range.

And now, I'll turn it over to Curtis for an update on regulatory and commercial activities. Curtis?

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## Curtis L. Dinan

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

Thank you, Caron, and good morning, everyone. I'll start with a brief update on securitization and recent regulatory activity. In Oklahoma, the Oklahoma Development Finance Authority received validation of the bond issuance by the Oklahoma Supreme Court. On July 15, the ODFA began the marketing process for the bonds, which are expected to be issued and proceeds received in the third quarter of 2022. On July 14, Kansas Gas Service, the Kansas Corporation Commission staff and the Citizens' Utility Rate Board reached a settlement

agreement allowing the company to issue securitized utility tariff bonds. The bonds will be issued with a scheduled final maturity of between 7 and 10 years. The KCC has until September 27 to issue a financing order, and if approved, we can begin the process of issuing the bonds. And in Texas, the bond issuance process is being led by the Texas Public Finance Authority and is expected to be completed in the fourth quarter.

Turning to other regulatory matters, on March 15, Oklahoma Natural Gas filed its performance-based rate change application for a \$19.7 million increase in base rates. In May, both the Oklahoma Corporation Commission staff and the Attorney General's Office filed statements supporting an increase of \$19.6 million. Pursuant to our tariff, the new rates went into effect on July 13, reflecting the \$19.6 million revenue increase. Those new rates are interim and therefore subject to a refund pending final approval by the commission. A hearing is expected to be scheduled in September.

During the first quarter, Texas Gas Service made gas reliability infrastructure program filings for all customers in the Central Gulf and West Texas service areas, requesting increases of \$9.1 million and \$5 million, respectively. New rates in the Central Gulf service area took effect in June. In the West Texas service area, the City of El Paso denied the requested increase, while all other municipalities and the railroad commission approved the new rates or allowed them to take effect with no action. On July 22, Texas Gas Service appealed the city's action to the railroad commission. New rates were implemented in El Paso during July, pending the outcome of the appeal.

In April, Texas Gas Service filed a cost of service adjustment in the Rio Grande Valley service area and the cities approved an increase of \$2.5 million with rates taking effect in August. In June, Texas Gas Service filed a rate case seeking to consolidate the West Texas and two additional service areas into a single West-North service area and requesting a rate increase of \$13 million. If approved, new rates are expected to take effect in early 2023. Lastly, Kansas Gas Service expects to file a gas system reliability surcharge filing in August for the period covering July 2021 through June 2022.

Moving on to commercial activity. While interest rates have risen and the national housing market is beginning to slow down, activity in our service territories remains robust. We continue to see regional economic development announcements characterized by long-term multibillion dollar investments expected to generate thousands of jobs and corresponding population growth.

An imbalance between low available housing inventory and new demand remains. For the six-month period ending June 30, we added over 12,000 new customer connections, which is ahead of the approximate 11,000 we added during the same period last year. As we mentioned last quarter, we are constructing several significant mainline extensions to support anticipated residential and commercial growth. Those projects continue to progress on schedule.

Shifting to renewable natural gas, as Sid will touch on more in a moment and with the June release of our 2022 ESG report, I'd reiterate that RNG is an integral part of our emissions reduction strategy and energy transition plans. We have access to sufficient feedstock within our service territory to make a meaningful progress in using our system to make a positive, long-term environmental impact. We continue to make progress on the existing RNG projects we've discussed over the past few quarters and are on track to file the initial Oklahoma Natural Gas voluntary RNG tariff by year-end.

And finally, last quarter, I spoke about our efforts to mitigate the impacts of inflation and supply chain disruptions to our operations. We've had success in further diversifying our supply chain by identifying and developing new suppliers. This has been an initiative by our resource management group over the past few years and has paid off

during these challenging times. While not a return to normal, we have seen some improvements in our supply chain and remain confident in our capital investment forecast and ability to execute.

Now, I'll turn it over to Sid for closing remarks.

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## Robert Sid McAnnally

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

Thank you, both. On June 28, we published our 2022 ESG Report, which includes additional disclosures compared to previous publications. The report lays out the tenets of our ESG philosophy and strategy, and provides relevant disclosures and metrics in alignment with TCFD and SASB reporting standards. I'm grateful for the efforts of all those who worked so diligently to help produce this report; and while I'm encouraged by our continued progress, I look forward to even more progress in next year's report as we further expand our work in this important area.

You've heard us talk before about the application of new technologies to solve problems in a cost-efficient way. When you identify a problem for which no technology exists, you have the opportunity to be innovative. Recently, a group of employees at ONE Gas received the United States patent for inventing a new technology that allows us to respond to a natural disaster event in real time by overlaying our pipeline assets with the areas impacted by the event.

For example, if there is an earthquake, the location and impact of the earthquake is automatically captured by this new technology and overlaid against our pipeline system, allowing us to identify and prioritize assets that need to be inspected. This innovation is one of many examples of the ingenuity of our employees and their ability to bring to their work improved efficiency and productivity, while also improving the safety and well-being of our customers and our communities.

In closing, our role is clear, to safely provide natural gas to our customers in an environmentally responsible way, and that work is made possible by the commitment of each one of our 3,650 employees. I'm grateful for their dedication to safety, reliability and growth and privileged to work alongside each of them every day.

Thank you all for joining us this morning. Operator, we're now available for questions.

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. [Operator Instructions] Our first question is from Julien Smith with Bank of America.

**Kody Clark**

*Analyst, BofA Securities*

Q

Hey. Good morning, everyone. It's Kody Clark on for Julien. Thanks for taking my questions.

**Robert Sid McAnnally**

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

A

Good morning, Kody.

**Kody Clark**

*Analyst, BofA Securities*

Q

Good morning. So first thinking about the 2022 EPS guidance, can you give maybe a little bit more color on how you're thinking about results within the range given some of the moving pieces you discussed, so the non-qualified benefit plan as well as the pension? Can you talk a little bit more about how that plays into your view on guidance? I know you reiterated, but if you can just give a little bit more color there. Thanks.

**Caron A. Lawhorn**

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

A

Good morning, Kody. This is Caron. Related to the mark-to-market on the assets and liabilities of the nonqualified plans, we don't include those in guidance. And what I mean by that is, of course, we've experienced a decline in market value through the six months. But for the balance of the six months, we don't assume positive or negative mark-to-market as we think about the guidance range. With respect to the re-measurement of the pension plan, that's fixed. We've re-measured the pension plan. We've determined the impact on our expense for the balance of the year. As I said, it's about \$7 million for 2022 and that will remain. We'll re-measure the pension plan again at the end of that – at 12/31 for next year.

**Kody Clark**

*Analyst, BofA Securities*

Q

Okay. Understood. And just following up on that, curious if there's any offsets that you're targeting this year as second half 2022 implies 11% growth over the second half of 2021 to kind of meet the midpoint of that guidance. Just wondering if there's any levers that we should be thinking about that would move you higher within the range for the second half?

**Caron A. Lawhorn**

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

A

So regulatory activity will have some impact on the second quarter. By far, the biggest impact that we've pointed to is this pension number, which is going to be \$7 million for the balance of the year. Other than that, it's the basic blocking and tackling.

**Kody Clark**

*Analyst, BofA Securities*

Q

Okay. Got it. Thanks for the time, Sid and team.

**Robert Sid McAnnally**

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

Thank you.

A

**Operator:** Our next question is from Robert Mosca with Mizuho Securities.

**Robert Mosca**

*Analyst, Mizuho Securities USA LLC*

Hi. Good morning, everyone.

Q

**Robert Sid McAnnally**

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

Good morning.

A

**Robert Mosca**

*Analyst, Mizuho Securities USA LLC*

Just wondering if you guys can maybe talk about the genesis of El Paso's denial for that group rate increase. I think you've had – there's been issues there before. Just wondering what that dynamic is. And is that an area of concern longer term or is that kind of just run-of-the-mill happenings?

Q

**Curtis L. Dinan**

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

Robert, this is Curtis. And as you point out, it happened last year and then it had happened once a few years earlier. The net effect is that the rates went into effect as we had filed for them as the commission approved and all the others approved. We did go through the appeal process and we're in that now, just like we did last year. And again, those rates were allowed to take effect because the commission had already deemed the filing to be proper. And that's the only thing to qualify as you go through that filing. So it has happened a few times and it's just the situation we deal with in that community.

A

**Robert Mosca**

*Analyst, Mizuho Securities USA LLC*

Got it. Understood. And maybe just on the O&M side, just wondering if you see any changes in your inflation expectations or if things are tracking kind of how you laid out last quarter.

Q

**Robert Sid McAnnally**

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

It's an interesting question. I can't say that we had any more visibility around inflation than anyone else in the marketplace. We built a plan assuming some. As you heard in the remarks, we've adjusted our plans accordingly as we go forward. But we are confident, as Caron said, that the guidance captures our forward year look and we'll join you in watching how inflation progresses for the remainder of the year.

A

In terms of O&M, we remain focused on opportunities to not only recognize savings, but do so in a way that that doesn't impede our commitment to customer service. The example that we gave around the patent that we receive, we highlighted that really because we wanted to demonstrate the fact that we've got employees all

across the company who are focused on trying to find innovative ways to address problems, but in a way that also introduces efficiency into the organization. That's one of many examples of projects that are underway as we're focused on affordability, being very conscious of customer bills, and being dedicated to continued activity around efficiency programs and communicating with our customers in a meaningful way around how we might work together to get through this environment.

**Robert Mosca**

*Analyst, Mizuho Securities USA LLC*

Q

Great. That's helpful. And thanks, everyone. Appreciate the time.

**Robert Sid McAnnally**

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

A

Thank you for the question.

**Operator:** [Operator Instructions] Our next question will come from Jamieson Ward with Guggenheim Partners.

**Jamieson Alexander Ward**

*Analyst, Guggenheim Securities LLC*

Q

Hi, guys. How's it going?

**Robert Sid McAnnally**

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

A

Fine. Thanks.

**Jamieson Alexander Ward**

*Analyst, Guggenheim Securities LLC*

Q

Excellent. So I just wanted to clarify, you had the \$0.05 charge in the first quarter and then you had the moving pieces this quarter which seemed for the market impact and then on investments and then the net periodic benefit cost decreased. With two of those netting out, it seemed like it was around \$0.07. Is the right way to think about it that, at the end of the year, if everything else stayed the same from here on out, that you would have kind of \$0.12 excluded as one-time items from guidance? So even though that might be a drag from where you are now, you would present it as obviously the market's not going to repeat itself next year. Maybe it'll be down again, maybe it'll be up. But either way, that's a one-time item. Are you going to back it out that way or are you going to show results a different way? How should we think about the end of the year and kind of how you're going to present the performance in these plans and your results, and think about it going forward?

**Caron A. Lawhorn**

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

A

Jamieson, where we sit today, the impact of the mark-to-market on the non-qual plans for 2022 and the impact of the re-measurement for 2022 pretty much negate each other. So, as we think about the year...

**Jamieson Alexander Ward**

*Analyst, Guggenheim Securities LLC*

Q

Okay.

**Caron A. Lawhorn**

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

Okay, sorry.

A

**Jamieson Alexander Ward**

*Analyst, Guggenheim Securities LLC*

So if everything else stayed the same from here on out, you're saying there's no negative impact, so you'd just be flat. If we were – if you were to see improvement then, would that also be treated as one-time or would that be something you would book? Just trying to make sure rubbing my head properly around how you would treat any further change based on market performance of the investments in the plan in the third and fourth quarters. That's all.

Q

**Caron A. Lawhorn**

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

So the mark-to-market is – it's a non-cash, non-operating item. We historically have not provided a non-GAAP earnings number. We typically just stuck with our GAAP number and quantified for you any of the impact related to this mark-to-market because typically it's not been hugely material when you look at the full year. So at this point, I don't anticipate doing that – tailing that any differently.

A

**Jamieson Alexander Ward**

*Analyst, Guggenheim Securities LLC*

Understood. Thank you very much. Very clear.

Q

**Robert Sid McAnnally**

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

Thank you for your question.

A

**Operator:** It appears we have no further questions today. I'll now turn the call back over to our speakers for 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 in early October and extends until we release earnings in late October. We'll provide details on the conference call at a later date. Have a great day.

**Operator:** This concludes today's conference. You may please disconnect your lines.

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