Corrected Transcript

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ONE Gas, Inc. (OGS)

Q4 2015 Earnings Call

CORPORATE PARTICIPANTS

Andrew Ziola
Vice President-Investor Relations & Public Affairs

Curtis L. Dinan
Chief Financial Officer, Treasurer & Senior VP

Pierce H. Norton II
President, Chief Executive Officer & Director

OTHER PARTICIPANTS

Christopher Paul Sighinolfi
Jefferies LLC

Timothy Winter
G.research LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day everyone, and welcome to the ONE Gas Fourth Quarter 2015 Earnings Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Andrew Ziola. Please go ahead, sir.

Andrew Ziola

Vice President-Investor Relations & Public Affairs

Thank you, Dana, and welcome to the ONE Gas fourth quarter and full year 2015 earnings conference call. We appreciate your interest and investment in ONE Gas.

This call is being webcast live on the Internet, with a replay made available. After prepared remarks from our speakers', 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. 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?

Curtis L. Dinan

Chief Financial Officer, Treasurer & Senior VP

Thanks, Andrew. Good morning everyone, and thank you for joining us today. Our quarterly and year end results fell in line with our previously announced 2015 net income guidance range of $118 million to $120 million.

Net income for the fourth quarter 2015 was $39.2 million, or $0.74 per diluted share due primarily to new rates in Oklahoma and Texas, compared with $36.6 million or $0.69 per diluted share for the same period last year.

Despite weather that was 21% warmer than normal, and total gas sales volumes that were down 10% compared with the prior year, our high percentage of fixed charges and weather normalization mechanisms worked as expected, and the warmer weather did not significantly affect our fourth quarter results.

Operating costs for the fourth quarter were relatively flat compared with the same period last year. Employee-related expenses were higher, but were mostly offset by lower IT and outside service expenses. Full year 2015 net income was $119 million or $2.24 per diluted share compared with $109.8 million or $2.07 per diluted share in 2014.

In 2015, our results were impacted positively by new rates and residential customer growth in Oklahoma and Texas. We averaged 13,000 more customers in 2015, which is an increase of approximately 0.6% compared with 2014.

Operating costs overall were lower in 2015, driven by IT expenses incurred in 2014, associated with our separation from ONEOK and lower outside service cost due primarily to operational efficiencies. These lower costs were partially offset by higher head count and employee-related benefit expenses.

We ended the fourth quarter with a total debt-to-capitalization ratio of 40% and do not anticipate any equity needs in our five-year financial plan. Last month, the ONE Gas board of directors declared a dividend of $0.35 per share compared with the previous dividend of $0.30 per share.

With the separation complete, we now have more clarity around our expenses and performance as a standalone company, and recently increased our average annual dividend growth rate between 2015 and 2020 to 8% to 10% from 6% to 8%. This dividend level is consistent with the company's expected 55% to 65% dividend payout ratio.

We also announced our 2016 earnings per share guidance range of $2.40 to $2.60 per share with an expected earned ROE of 7.6% in 2016, compared with 7.4% in 2015. This improvement in ROE is primarily attributable to our recent rate case in Oklahoma. We expect capital expenditures to be $305 million in 2016, with more than 70% targeted for system integrity and replacement projects.

ONE Gas' rate base in expected to grow in average of approximately 5% per year between 2015 and 2020. This guidance includes the extension through 2019 of bonus depreciation, which improves our cash flows and debt metrics, but slightly lowers our rate base growth.

Following approval of our recent rate case in Oklahoma, our current authorized rate base defined as the rate base established in our latest regulatory proceedings including full rate cases and interim rate filings is approximately $2.7 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 2016 will average approximately $2.9 billion with 43% of that being our rate base in Oklahoma, 31% in Kansas, and 26% in Texas.

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

Pierce H. Norton II

President, Chief Executive Officer & Director

Thanks, Curtis, and good morning everyone. This time last year we were wrapping up our first year as a new standalone publicly-traded company. We spent a lot of time during the year, year one, laying out our plans and goals for the future success of our company. In year two, we were able to put our plans into action, working toward our goals and measuring our success, and I believe these results reflect those efforts.

We're committed to being a 100% regulated natural gas utility and are solely focused on leading the industry as a safe, dependable provider of natural gas for our customers. As Curtis mentioned, our capital expenditure plan includes investing more than 70% in system integrity and replacement projects. We replaced approximately 22 miles of cast-iron pipe in 2015 and will continue this pace over the next four years.

To give you some perspective, cast-iron is roughly 0.3% of our distribution pipe inventory. We expect to replace the remaining cast iron pipe in our system, about 70 miles in Kansas and Texas by 2019.

Let me update you on the regulatory activity. Last month in Oklahoma, the Corporation Commission approved a joint stipulation and settlement agreement for an increase in Oklahoma natural gas base rates. The performance based rate change tariff that was established in 2009 will continue with certain modifications. These new rates went into effect in early January and are reflected in our 2016 guidance.

Moving on to Kansas; last November, the Kansas Corporation Commission approved our annual request for interim rate relief under the Gas System Reliability Surcharge or GSRS for an increase in rates of approximately $2.4 million, which became effective in December of 2015. The next Kansas general rate case filing is expected to be May of 2016 based on a 2015 test year with new rates expected to be effective in January of 2017.

Now on to Texas; in November 2015, Texas Gas Service notified the City of El Paso and the surrounding incorporated areas that it would be filing a full rate case instead of the El Paso Annual Rate Review or EPARR in 2016.

In December of 2015, we filed a rate case for the Galveston and South Jefferson County Service Areas, requesting an increase in revenues of $3.1 million. If approved by these cities and Railroad Commission, new rates should be effective in June of this year. And later this year, we plan to file a rate case in Central Texas jurisdiction, which includes the City of Austin.

In our other Texas jurisdictions, Texas Gas Service received approval in 2015 for interim rate relief under the Gas Reliability Infrastructure Program or GRIP, and cost of service adjustments totaling approximately $4.8 million driven by capital investments and changes in cost of service.

As a reminder, this regulatory timeline information is included on a state-by-state basis in our investor presentations, which are posted on our website.

Finally, I would like to close by thanking our employees [indiscernible] (9:55) our mission of delivering natural gas for a better tomorrow, and for their constant efforts to meet the needs of our customers. The foundation of our company's strategy is having a high performing workforce, and I appreciate their hard work every day.

Operator, we're now ready for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] We will take our first question from Chris Sighinolfi with Jefferies.

Christopher Paul Sighinolfi
Jefferies LLC

Q

Hey, good morning guys.

Curtis L. Dinan
Chief Financial Officer, Treasurer & Senior VP

A

Good morning, Chris.

Christopher Paul Sighinolfi
Jefferies LLC

Q

Thanks for the added color this morning and for the January update. I thought that was really helpful. Just I guess one quick question from me, Chris, when you talked about the cash flow side of it, the bonus depreciation extension that we got in December, I'm assuming that was all incorporated in the January forecast?

Curtis L. Dinan
Chief Financial Officer, Treasurer & Senior VP

A

That's right, Chris.

Christopher Paul Sighinolfi
Jefferies LLC

Q

Okay. And so, I guess the question I had is when we think of – you said no equity needs in the five-year plan, I am curious, when I think about the cash flow from operations that you guys had forecasted in January, I think it was [ph] $365 million (11:36) roughly. And I think about the CapEx you put forth for this year and then think about the dividend at the current share count. Basically, ballpark figure, you're cash flow neutral, but was curious, you guys did do a small share repurchase last year, and I was wondering if that has been contemplated at all, or if you could remind us what the conditions were around the purchase in the second quarter of last year?

Curtis L. Dinan
Chief Financial Officer, Treasurer & Senior VP

A

So about a year ago, the board gave us authorization to buy back up to $20 million a year in outstanding shares. That's exclusive of any funds that come in from employee stock purchase program or from dividend reinvestments those sorts of things. So that would push that number higher if that additional cash comes in. But essentially, what that program is designed for is to hold our outstanding shares at a constant level to not to have any dilution come in because of any issuances through that or through our different equity compensation program. So again that was a multiyear authorization that they provided to us and that's really the intent behind that program.

Christopher Paul Sighinolfi
Jefferies LLC

Q

Okay. So when we think about modeling forward, we should just think about a sort of a flat share count, not any decline? Or do you think if it's opportunistic, do you think you'll be in the market purchasing anything?

Curtis L. Dinan
Chief Financial Officer, Treasurer & Senior VP

A

No, again the intent behind that program is to hold those share counts relatively flat.

Christopher Paul Sighinolfi
Jefferies LLC

Q

Okay. Perfect. Terrific, guys. I think that's all I really had for you. Thanks a lot.

Curtis L. Dinan
Chief Financial Officer, Treasurer & Senior VP

A

Thanks, Chris.

Pierce H. Norton II
President, Chief Executive Officer & Director

A

Thanks, Chris.

Operator: We'll go next to Tim Winter with Gabelli & Co.

Timothy Winter
G.research LLC

Q

Good morning, guys, and congratulations on a strong year. So now you're about two years out from the spin out. Your stock has just doubled and there continues to be a lot of consolidation in the industry. I was wondering what your thoughts were given where your currency is about the whole consolidation arena where you guys fit in. Might you be interested in buying?

Pierce H. Norton II
President, Chief Executive Officer & Director

A

Okay. Well, so first of all, good morning, Tim. I guess the way I would answer that is consolidation has been going on in this industry for years, and in my opinion, each case has been unique and strategic to those individual cases. And the terms of those deals are driven by the buyers and the sellers in each individual deal. So I can't necessarily speak to the specifics of each deal, but we do understand the dynamics behind each one of those.

We actually run theoretical cases at these acquisition multiples as an alternative to our plan, but every time that we run those numbers, we look at the runway that we have for continuing to invest in our assets and our efficiency opportunities, it tells us the same thing, which is continue to keep doing what we're doing, which is execute on our plan and continuing to invest in our existing systems and focus on our rate filings and safety and reliability of our system. So we're going to continue to do the same thing that we've been doing, and we're committed to that 100% regulated model.

Timothy Winter
G.research LLC

Q

Okay. And then just one other question. Thanks for that answer. How close do you think you can get to earning your allowed ROE over the next couple of years?

Pierce H. Norton II
President, Chief Executive Officer & Director

A

We've looked at that a lot, Tim, and based on the current capital spending levels, it looks like it's probably going to be 100 basis points to probably max 150 basis points swing there. So I'd say that's our targeted range. But our limitation there is the amount of capital that we're spending. And with the current mechanisms that we have, we have that 100 basis points to 150 basis point lag. But other than that, that's our goal. We're pushing toward getting that narrowed down into that level.

Timothy Winter
G.research LLC

Q

Okay. Thank you.

Operator: We'll go next to [ph] Stephen D'Amboise with Capstone Investment Management (16:15).

Q

Hi, guys. How are you?

Pierce H. Norton II
President, Chief Executive Officer & Director

A

Good. How are you?

Q

Good. I just had a quick question, what was the rational between pursuing a general rate case in El Paso versus filing an EPARR?

Pierce H. Norton II
President, Chief Executive Officer & Director

A

We took a step back and looked at EPARR, and there were some certain things that were not being necessarily picked up in EPARR in the way of expenses. And so we felt like it was better that those numbers were big enough. So we went ahead and notified the city of El Paso and the [ph] environs (16:51) area that we felt like it's best to do a rate case there. We engaged them. And so that's actually the way that process works under EPARR is that if you want to make any modifications to it, it says you opt out and then you go in and file a rate case. So it's simple as that.

Q

Are the GRCs to pick up other expenses or to modify EPARR so that in future times you'll pick up those expenses?

Pierce H. Norton II
President, Chief Executive Officer & Director

A

No, it's actually to pick up the additional expenses.

Q

Okay. That's it. That's all I had. Thanks guys.

Pierce H. Norton II
President, Chief Executive Officer & Director

A

All right, thank you.

Operator: Now we'll take a follow-up from Chris Sighinolfi with Jefferies.

Christopher Paul Sighinolfi
Jefferies LLC

Q

Hey, Pierce. Sorry, a quick follow-up to something Tim was enquiring about. We've seen in some of the other deals that I think he was referencing, we've seen companies pursue pipe assets. And so I was wondering in the context of being a 100% regulated, when you're defining it that way, should we interpret that to be a strictly distribution-regulated or would you entertain if a opportunity came up, let's say, within your service territory to own something that was transmission regulated, FERC regulated, something of that nature?

Pierce H. Norton II
President, Chief Executive Officer & Director

A

We certainly understand Chris that 100% regulated could include distribution and say intrastate type transmission deal. But in our areas it's not that we wouldn't necessarily entertain something like that. It's just we just don't see the need for it. We have so many pipes and so much access to supply in our areas, and our service providers do a good job and they do it at reasonable rates, which is good for our customers that we just don't see any need for it in our areas. So unless that changed I would say our focus isn't going to be on the 100% distribution side.

Christopher Paul Sighinolfi
Jefferies LLC

Q

Okay, that's what I suspected, but wanted to clarify. And then final, just sort of catch-up question for me with regard to 4Q and 2015 results. You guys talked about declines in fleet-related expenses. Is that just fuel?

Pierce H. Norton II
President, Chief Executive Officer & Director

A

Primarily fuel.

Christopher Paul Sighinolfi
Jefferies LLC

Q

Okay. I suspected that as well. Thanks a lot.

Pierce H. Norton II
President, Chief Executive Officer & Director

A

All right, thank you, Chris.

Operator: And with no further questions in the queue, I'd like to turn the conference back to Andrew Ziola for any additional or closing remarks.

Andrew Ziola
Vice President-Investor Relations & Public Affairs

Okay. Well, thank you for joining us this morning everybody. Our quiet period for the first quarter of 2016 starts when we close our books in early April and will extend until we release earnings in early May. We'll provide details on the conference call at a later date. If you've not done so, I encourage you to visit the Investor Relations page on our website, register for e-mail alerts, and view our fourth quarter and year-end earnings documents. Again, thank you, and have a good day.

Operator: Again that does conclude today's presentation. We thank you for your participation.