02-Aug-2016

ONE Gas, Inc. (OGS)

Q2 2016 Earnings Call

CORPORATE PARTICIPANTS

Andrew Ziola
Vice President-Investor Relations & Public Affairs

Curtis L. Dinan
Chief Financial Officer, Treasurer & Senior Vice President

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

OTHER PARTICIPANTS

Christopher Paul Sighinolfi
Jefferies LLC

MANAGEMENT DISCUSSION SECTION

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

And 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, Levi, and good morning, and thank you for joining us for our second quarter 2016 earnings conference call. This call is being webcast live with a replay made available. After prepared remarks from our speakers, we'd be happy to take your questions.

A reminder, that statements made during this call that might include ONE Gas expectations or predictions should be considered forward-looking statements and are covered by the Safe Harbor provision of the Securities Act's 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 Vice President

Thanks, Andrew. Good morning, everyone, and thank you for joining us. Net income for the second quarter 2016 was $20.3 million, or $0.38 per diluted share, compared with $12.1 million or $0.23 per diluted share for the same period last year. New rates in Oklahoma and Texas positively impacted results. This includes the approved rate case in Oklahoma this past January and approvals from various GRIP and cost-of-service filings in Texas over the past year.

Operating costs for the second quarter were $110 million, compared with $112.5 million for the same period last year. Outside services, fleet-related cost and IT expenses decreased, but were partially offset by higher employee-related costs. Year-to-date, operating costs were $232.2 million compared with $234.9 million for the same period last year. I will provide additional detail on operating costs as it relates to our updated guidance in a moment.

Capital expenditures for the second quarter were approximately $70 million compared with $71 million for the same period last year. ONE Gas ended the quarter with $54 million of cash and cash equivalents, no borrowings under our $700 million credit facility, and a total debt-to-capitalization ratio of 39%.

Last week, the ONE Gas board of directors declared a dividend of $0.35 per share, unchanged from the previous quarter. This dividend is consistent with the company's guidance for 2016. As we have indicated previously, we expect the average annual dividend increase to be 8% to 10% between 2015 and 2020.

Now, onto our updated guidance. As announced in the press release, we updated our net income guidance range for 2016 to $135 million to $140 million compared with the previous range of $127 million to $137 million. Earnings per diluted share is expected to be $2.55 to $2.65 compared with the previously announced range of $2.40 to $2.60. This updated guidance reflects lower operating costs, approximately 2%, driven by lower outside service cost, lower fleet, and IT expenses.

Day-to-day processes are being improved by leveraging technology throughout the organization, including field operations, customer service and information technology, enabling our company to be more efficient and customer-focused. Net margin is expected to be slightly lower, less than 1%, due primarily to warmer-than-normal weather in our service territories experienced primarily in the first quarter of 2016. We still expect capital expenditures to be approximately $305 million in 2016, with more than 70% targeted towards system integrity and replacement projects. For line item breakdown, we provided an updated guidance table on the last page in the press release.

We expect our earned ROE for 2016 to be 7.6% compared with an ROE of 7.4% for 2015, reflecting the approved rate filings this year. At June 30, 2016, our current authorized rate base, defined as the rate base established in our latest regulatory proceedings, including full rate cases and interim rate filings was approximately $2.7 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 $3 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, for that update. And good morning, everyone. I'll start with a brief regulatory update and then I'll wrap up with a few comments on the updated guidance.

Beginning with Texas. In June, we filed a rate case requesting an increase in revenues of $11.6 million for our Central Texas and South Texas jurisdictions. Our request is based on a 10% return on equity and a common equity ratio of 60.5% based on ONE Gas' actual equity ratios as of December 31, 2015. This rate case reflects $43 million of investments in its systems and facilities for these service areas.

This filing also includes a proposal to consolidate the South Texas service area with the Central Texas service area. If approved, new rates are expected to be effective no later than January of 2017. In March of 2016, we filed a rate case requesting an increase in revenues of $12.8 million for the El Paso, Dell City and Permian service areas. The request is based on a 10% return on equity, and a 60.1% common equity ratio. This rate case reflects $34 million of system and facility investments. The filling also included a request to consolidate these three service areas into a new West Texas service area. We recently concluded the Hearing on Merits at the Texas Railroad Commission and we expect a final decision by October.

Now, onto Kansas, where we filed a rate case in May. The procedural schedule for Kansas Gas Service's filing was approved by the Kansas Corporation Commission on June the 8. The evidentiary hearing are scheduled for October 18 through the October 20 and a final order from the commission is due December 28.

Now, I'd like to share my thoughts related to our updated guidance. I'm very pleased with our company's focus on our processes and the outcomes we are producing. From day one of this company's spin, I have stated that we will be a focused organization dedicated to a standard, our standard, to operate and maintain this 100% regulated natural gas distribution business. Every day, we focus on the process of maintaining or lowering our operating expenses to sustainable levels. We will continue to invest in our systems and in our technology to further improve the efficiency of our operations, and we'll remain vigilant in driving cost to sustainable levels. These expected improvements will help us better serve our customers, as well as moderate future cost increases.

I'd like to close by thanking our 3,400 employees for what they do every day for our customers. I appreciate their hard work, dedication, and commitment to delivering our product, natural gas, to more than 2.1 million customers safely and reliably.

Operator, we're now ready for the questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And we'll take our first question from Chris Sighinolfi with Jefferies.

Christopher Paul Sighinolfi
Jefferies LLC

Q

Hey, Pierce. How are you?

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

A

Hey. Good morning, Chris. How are you?

Christopher Paul Sighinolfi
Jefferies LLC

Q

I'm well. Thanks. Just a couple of follow-up items from last night's release and your prepared remarks. I was curious, you had mentioned the case that was filed in Texas where you just had the Hearing on Merits. I think it was with regard to El Paso, Dell City and the Permian areas. Can you just talk about, perhaps, I don't know, to the extent you can discuss, say, given the Railroad Commission is making a decision, but principally what were the issues there? Was it an issue regarding how much you had spent? Was it an issue regarding the ROE, or [indiscernible] (10:19), or was it an issue regarding the equity slice, or was it something entirely different than these?

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

A

Well, at anytime, Chris, that you're in a full blown rate case, it's basically everything that you mentioned.

Christopher Paul Sighinolfi
Jefferies LLC

Q

Okay.

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

A

You look at ROE, you look at the equity percentages, the spend, the expenses. So it's all wrapped up into one for our total kind of case. So, there wasn't anything particularly focused out on that. It's just a combination of multiple things.

Christopher Paul Sighinolfi
Jefferies LLC

Q

Okay. And then, I guess, switching gears – and so we'll get a decision on that here shortly. And then, I guess, switching gears, then on the cost improvements, and clearly you reiterate today, Pierce, but that was kind of at the time of the separation something that you were driving home to us was you guys could be an independent sense sort of laser-focused on efficiency gains and the execution of the business.

Curious, and amongst that, you've seen some benefits we talked about last quarter from lower fuel cost and things of that nature which may be transient nature, we'll have to see. But Curtis was talking about some of the improvements you're making in technology and automation. Could you just explore a little bit more of that? And then how does it relates where that might go over the next couple of years?

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

A

So the technology improvements that we're making, Chris, without getting into tremendous amount of details, it allows us to be more efficient in our processes. So it allows us to be more efficient in the way we dispatch people not only on the customer side, but on the asset side. That was the piece that was actually missing prior to the spin as we focused on how we dispatch the work on the asset side of the business.

So it really boils down to the two pieces which is internal labor and outside labor, or external labor. So what we focus on is, we ask that question, is it better on any particular type of task, both from a maintenance project and capital project standpoint to perform that work either internally or externally. So what we're finding out is by putting that focus on there, we're able to optimize the differences there between doing things internally and externally, and that's where we're seeing a lot of the gains. It's actually helped by the technology that we're deploying.

Christopher Paul Sighinolfi
Jefferies LLC

Q

Okay. And in terms of the successful continuation of that, let's just pretend for a moment that the fuel side remains subdued. The regulatory picture progresses the way that you sort of anticipate new [indiscernible] (13:12). Does this efficiency element in and of itself Pierce have you – is it large enough to drive us towards the upper end of your growth range, or is it something where you think more along the lines of some puts and takes and we wind up sort of without any changes to the out-year projections?

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

A

Well, I would say Chris that number one, there's a long way to go between now and a five-year projection, so it's the first thing that I'd say. Number two, there's a lot to regulatory outcomes, which I think that probably has more to do with it than anything. We've always stated that you can either get a higher regulatory outcome or lower regulatory outcome, and that's what kind of drives us between that low number and that high number.

Certainly, the efficiencies, as we indicated in our script, was – it's about moderating those cost increases, because you're going to have increased cost to the customer because of the investments in the assets, which is the right thing to do for reliability and safety reasons. So we want to try to offset some of those increases due to – and moderate those increases by maintaining a certain level of cost structure.

Christopher Paul Sighinolfi
Jefferies LLC

Q

Okay. Got it. All right. Well, thanks a lot for taking my questions. I appreciate the time.

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

A

Okay. Thank you, Chris.

Operator: [Operator Instructions] And it appears there are no further questions at this time. Mr. Ziola, I'd like to turn the conference back to you for any additional or closing remarks.

Andrew Ziola
Vice President-Investor Relations & Public Affairs

Well, thank you. It looks like Chris won the Starbucks Card this quarter. So again, thank you for joining us. 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 will provide details on that conference call at a later date. If you have not done so, I encourage you to visit the Investor Relations page on our website and register for e-mail alerts and view our second quarter 2016 documents. Have a great rest of your day.

Operator: This conclude today's conference. We appreciate your participation. You may now disconnect.