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ONE Gas, Inc. (OGS)

Q3 2020 Earnings Call

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OTHER PARTICIPANTS

Richard Ciciarelli
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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the ONE Gas Third Quarter Earnings Conference Call. Today's conference is being recorded, and at this time I'd 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 third 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.

I remind you that these statements made during this call that might include ONE Gas expectations or predictions should be considered forward-looking statements and are covered under the Safe Harbor provision of the Securities Acts of 1933 and1934. 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 updated our 2020 financial guidance, with net income and earnings per diluted share expected to be near the upper end of the ranges, which are $186 million to $198 million for net income and $3.44 to $3.68 for earnings per share. Our guidance for capital expenditures and asset removal costs remains $500 million to $525 million for the year.

Turning to our actual results, net income for the third quarter was $21.1 million or $0.39 per diluted share compared with $17.5 million or $0.33 per diluted share in the same period of 2019. Our third quarter results reflect an increase in net margin of $5.2 million over the same period last year, which is primarily due to $3.7 million from new rates and $2.7 million in residential sales from net residential customer growth. Operating costs for the third quarter were $0.8 million higher compared to the same period last year. This includes an increase of $1.8 million in the expenses related to our respond to the COVID-19 pandemic and a $1.5 million in employee related costs.

Offsetting a portion of those cost increases is a reduction in expenses of [$1.6 million] (audio gap) for travel and employee training costs that have been impacted by the pandemic. We have not recorded any regulatory assets for financial accounting purposes pursuant to the accounting rules received in all jurisdictions that allow us to defer for regulatory purposes certain net increases in expenses and lost revenues due to COVID-19. We continue to evaluate whether amounts expected to be recoverable under these accounting rules are both measurable and probable of recovery. And we'll record such amounts for financial accounting purposes when we meet that hurdle.

Our guidance for 2020 does not assume that we will record any regulatory assets by the end of the year. Our capital expenditures and asset removal cost decrease this quarter compared with the third quarter of last year simply due to timing. Yesterday, the ONE Gas Board of Directors declared a dividend at $0.54 per share [unchanged from the previous quarter. This dividend is consistent with our guidance for 2020.] (indiscernible).

Authorized rate base, reflecting our recent regulatory activity, is approximately $3.71 billion as of September 30. Authorized rate base is defined as the rate base reflected and completed regulatory proceedings including full rate cases and interim rate filings. We project that for 2020, our estimated average rate base which is defined as authorized rate base plus additional investments in our system and other changes in the components of our rate base that are not yet reflected in approved regulatory filings will be approximately $3.91 billion with 42% of that in Oklahoma, 29% in Kansas, and 29% in Texas.

We ended the quarter with adequate liquidity, which includes approximately $391 million of capacity in our commercial paper program and all of the capacity under our $250 million 364-day credit facility. Additionally, as of September 30, 2020, we have issued approximately $13 million of equity under the $250 million aftermarket equity program we put in place earlier this year. We have no plans [to issue equity] (indiscernible) for the remainder of 2020.

Now, I'll turn it over to Curtis for a regulatory and commercial update.

Curtis L. Dinan

Senior Vice President-Commercial, ONE Gas, Inc.

Thank you, Caron, and good morning everyone. First, I'll provide an overview of recent regulatory activity and then provide an update on our commercial activities. Kansas Gas Service filed a Gas System Reliability Surcharge or GSRS that seeks an increase in rate of approximately $7.5 million for capital expenditures incurred during the period covering July 2019 through June 2020. And order from the KCC is expected in December 2020 with new rates going into effect in January.

Texas Gas Service filed a rate case in December 2019 for all customers in the Central Texas and Gulf Coast service areas seeking a rate increase and requesting to consolidate the two service areas. In August, the Railroad Commission approved all terms of a $10.3 million settlement as well as consolidation of the Central Texas service area and the Gulf Coast service area into a new Central Gulf service area. This is a continuation of our strategy to consolidate jurisdictions which is a benefit to customers due primarily to a more [efficient regulatory process] (indiscernible). With this latest consolidation, we now have five jurisdictions in Texas, down from 10 at the time of spin off in 2014.

Moving on to our commercial activities. During our second quarter analyst call, I discussed the return to normal business levels for a couple of our large transport customers that had temporarily curtailed operations at the start of the pandemic and that we were not seeing any other significant disruptions with our transport customers. For the third quarter 2020, our transport revenues and volumes were above the same period in 2019. And on a year-to-date comparison between years, our transport revenues have erased the second quarter 2020 impact and are now flat year-over-year.

We continue to see strong interest in natural gas from builders and developers. Capital spending to extend our service to reach new customers is the primary driver behind our increased capital expenditures guidance for 2020 as we described last quarter. Despite the pandemic, we're seeing positive economic signs across our footprint particularly in Texas and Oklahoma. As an example in the Austin area, there have been over 100 new business relocations or expansions announced thus far in 2020, which are expected to provide over 14,000 additional new jobs. This increase in economic activity across our territories has resulted in continued growth in our customer base. Year-to-date, we have averaged approximately 24,000 more sales customers than the same period last year. This increase includes the connection of 18,600 new customers compared with 14,600 new customers in the same period last year or a 27% increase over last year's [pace]. As I described during our last two quarterly analyst calls, the impact of the moratoriums on disconnects for non-payment by our customers which expired in May in Oklahoma and Kansas and early October in some areas of Texas has also impacted our average customer counts.

And now, I'll turn it over to Sid for an update on operations.

Robert S. McAnnally

Senior Vice President-Operations, ONE Gas, Inc.

Thanks, Curtis. Our team in the field continues to adapt well to the current environment with maintenance and compliance work on or ahead of schedule. Our supply chain remains uninterrupted and we see no forward constraints to our planned work, thanks to steady performance by our resource management team related to materials and contractor resources.

As Caron mentioned, while our capital spend was lower this quarter than the third quarter of last year, the issue is timing rather than performance. We've been pleased with the cadence of capital execution year-to-date with more consistent capital spend quarter-to-quarter than last year due to favorable weather and improved planning by our asset management, engineering and field operations teams. We remain on track to meet our capital expenditure guidance as discussed earlier.

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

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

Thank you, Caron, Curtis and Sid. The pandemic has changed many things for many people. Our homes have become the place where we spend more and more time. Our customers take comfort in the warmth of our – that our product provides, especially as we head into colder weather. As we near the end of the year, it's natural to reflect on how far we've come. For me, three things stand out our resiliency, adaptability and commitment to safety. Our performance this year demonstrates the resiliency of our business model and the continued value of natural gas as a preferred energy source for homes and businesses. This year we were able to grow our customer base, improve system integrity and established a remote workforce amidst great adversity.

Despite the challenges brought on by the pandemic, our industry is accustomed to front line response. Across our organization, we quickly implemented additional safety protocols and new processes designed to keep our employees and our customers safe during the pandemic. Thanks to the adaptability and diligence of each employee, we have continued providing service to our customers with minimal disruptions.

Finally, in closing, I'd like to recognize the ONE Gas employees and give each of them a special thank you for their continued professionalism under stress, resolve when there is no clear end in sight and poise in the face of uncertainty. We'll get through this pandemic by relying on the values that we anchor our company to as we address the challenges and that face our business. Thank you all for joining us this morning. Operator, we're now ready for questions.

QUESTION AND ANSWER SECTION

Operator: All right. [Operator Instructions] All right. And the first question is from Richard Ciciarelli with Bank of America.

Richard Ciciarelli
Analyst, Bank of America
Q

Hey, good morning. Can you hear me okay?

Robert S. McAnnally
Senior Vice President-Operations, ONE Gas, Inc.
A

We can. Good morning, Richard.

Richard Ciciarelli
Analyst, Bank of America
Q

Hey. Thanks for taking my question. I was just curious how you guys are thinking about COVID into peak winter heating season here. And I realize OGS has a higher proportion of residential versus C&I transport customers. But how are you thinking about factoring the lingering impact, especially with the resurgence of cases as you begin to look at your 2021 outlook and the moving pieces and maybe just also comment on the equity means into next year as well.

Robert S. McAnnally
Senior Vice President-Operations, ONE Gas, Inc.
A

Richard, it's – let me start and turn to Curtis for the commercial part of that question and then Caron can comment on and in terms of the financing question. We have been preparing for winter since March. We understood that there was a high probability that we would see a second wave and that we would see some comingling of COVID and the flu. So our medical protocols were built with that in mind. We have not seen constraints in our service territories and our employees have done a remarkable job of proactively participating in our medical program to make sure that we could provide them with the best medical advice to keep them and their families and our customers safe, but also to allow us to tamp down any widespread unavailability of employees in any of our service territories.

So we feel like we're well-prepared. We don't say that spiking the ball on the 50. We recognize that there is a challenging time ahead of us but we think we're as well prepared as we can be. So let me toss to Curtis to respond to the commercial question.

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

A

So, Richard, on the commercial side of things, as you know, we have a very high percent of our customer base being residential, and then about 12%, that's our transport customers.

So one of the things that I noted in my comments is that we're really not seeing an impact at this point from our transport customers that would seem to have returned to a normal level of operations and have actually closed the gap with the activity we saw in the third quarter, closing the gap from what we saw during the second quarter of this year.

And on the residential side of things, I think we're well prepared in our customer call centers to handle the call volume that we typically run into this time of the year. One of the good things about the moratoriums being lifted when they were at the end of May for Oklahoma and Kansas and a little bit later in Texas is that while those moratoriums were in place, the operations teams were able to divert those resources to handle a lot of our other normal annual activities and to get some of those things – get ahead of those activities such that when the moratoriums were lifted, we were able to focus more of our resources on the disconnect process, which helped with our collections through that period.

So several factors that we had to remain agile to handle during the year, but cooperation and the work between our commercial operations teams helped us work through that part of it to be ready when we could again resume disconnects, and that's helped our overall process.

The last piece I would say is, as Caron talked about, we do have the regulatory accounting orders in each of our jurisdictions. We'll continue to monitor the activities for increased expenses as well as areas where we've been able to decrease expenses so that – and can continue to accumulate those until we're able to go through the regulatory process to begin recovery of those.

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

A

So I'll pick up on the financing question. We have not updated our longer term guidance for financing, which currently is that we anticipate $850 million to $900 million of [net financing needs] (indiscernible) with about a quarter of that being equity. When we issue our guidance for 2021 which we expect to do probably sometime after the first of the year, we'll provide a closer look at what 2021 looks like.

Richard Ciciarelli
Analyst, Bank of America

Q

Okay. Got it. That's very helpful. I appreciate all the color there. And maybe just switching gears here obviously with elections on top of mind. Just curious how you're thinking about de-carbonization goals and just given really some of the potential for electrification and buildings and some of the supply and cost constraints on the R&D side, I mean, is that really the solution or is the green hydrogen potentially a more likely candidate? Just maybe curious if you can provide some thoughts overall on the timing and when we can see more formal adoption of these technologies?

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

A

Another good question, Richard. This is Curtis again. So on the commercial side, I've talked before about efforts we've had around renewable natural gas. There are several different projects and developers that we're talking to. Some already capture RNG and use it for alternative uses. What we may be able to bring to the table is the opportunity to improve the commercial economics of that captured gas; so by bringing it into our system and getting it tracked through to be used as a replacement for diesel or other products through compressed natural gas.

And so we're continuing to explore, and hopefully, we'll be in a position that we have some of those projects as we move into next year. We've proven the commercial ability of those projects and we've established the gas standards and everything that we would need to do to bring that product into our system. So we continue to make progress on that.

We're also in an H2 at scale project with the University of Texas and some other parties including the DOE to run some different scale projects of converting or producing hydrogen both from renewable power as well as from landfill gas and then using that hydrogen that's produced to run a computer center at the University of Texas as well as provide fuel for hydrogen fuel cell vehicles. So we're continuing to – that project just started earlier in the mid-part actually of 2020. So it's about a three-year project, but promising results come out of that.

But I'm going to Sid as he can talk a little bit more about what we're doing and what we're seeing on the operations side analyzing [the impact of hydrogen]. (indiscernible)

Robert S. McAnnally
Senior Vice President-Operations, ONE Gas, Inc.

A

Yeah. Richard, thank you for the question. As you know, there is a commercial component to this, an R&D component, as you point out, but there are also some practical implications that companies need to consider as emergent opportunities like hydrogen start to be developed. We have two working groups in place currently. One is looking at technical issues including the engineering implications. There will be policies and procedures around hydrogen use. And there are also some system integrity implications to make sure that you can introduce hydrogen at the proper blending rate and handle that safely in terms of continuing to focus on safety of our system. The second is a really interesting working group that's looking at the gas supply implications. Hydrogen is a different material to compress and transport. And so the location and manufacturing facilities comes into play. We're scoping all of that right now and excited about continuing the conversation.

Richard Ciciarelli
Analyst, Bank of America

Q

All right. Thanks very much for all the color there. That's all I have.

Operator: All right. [Operator Instructions] The next question is from – and I apologize if I say this incorrectly, Aga Zmigrodzka with UBS.

Aga Zmigrodzka
Analyst, UBS Securities LLC

Q

Good morning.

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

A

Good morning, Aga.

Aga Zmigrodzka
Analyst, UBS Securities LLC

Q

Could you give us an update on bad debt and how is it trending this year as we head into winter?

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

A

Sure. Good morning, Aga. This is Caron. So we're still – as Curtis described some of our collections activity that's still at play. So we're not out of the COVID impact certainly by a long stretch. We currently are $8.8 million of bad debt expense through the nine months. That compares to $4.6 million last year. So we're up about $4 million year-over-year. And again, we're just working to monitor the situation. We think that there are still moratoriums in place in some of the service areas. And so until we get completely back to normal collections activities for an extended period of time, it's going to be difficult to really determine what the impact has been.

Aga Zmigrodzka
Analyst, UBS Securities LLC

Q

And how does it change in the concepts related to eliminating state income taxes from rates could impact ONE Gas's cash flow going forward?

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

A

We don't expect it to have a material impact in the scheme of things. It's not a lot of large in our overall tax picture. The elimination of the state income tax is not a large event.

Aga Zmigrodzka
Analyst, UBS Securities LLC

Q

Okay. And last question from me, to follow-up on Richard's question on de-carbonization. Is there a regulatory framework in place to invest in [RNG] across your jurisdictions; do you have tariffs established to potentially cover some additional costs related to investment in RNG and the quality outcome?

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

A

So Aga, this is Curtis. RNG is actually contemplated in the tariffs in Texas. It is a recoverable gas cost there. So that has previously been contemplated as part of the gas supply picture. In Oklahoma, there was legislation introduced in the last session to compel the commission to study RNG and to look at ways to bring RNG into the Oklahoma gas supply. With the pandemic starting that was not a bill that was considered all the way through session. But outside of that the Oklahoma Corporation Commission has opened up a notice of inquiry looking at several different energy questions, one of which is renewable natural gas and this – and the way that the state and the commission should deal with that product.

So there are efforts underway at the at the state levels also. I'm not as much at this point in Kansas, but the other two states are a little bit further along in that regard.

Aga Zmigrodzka
Analyst, UBS Securities LLC

Q

Thank you for the color and stay safe.

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

A

Thank you, Aga.

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

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

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

Operator: This concludes today's call. Thank you for your participation. You may now disconnect.