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ONE Gas, Inc. (OGS)

Q1 2022 Earnings Call

CORPORATE PARTICIPANTS

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Caron A. Lawhorn

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Curtis L. Dinan

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

OTHER PARTICIPANTS

Kody Clark

Analyst, Bank of America

Gabriel Moreen

Analyst, Mizuho Securities USA LLC

MANAGEMENT DISCUSSION SECTION

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

Now, I'll turn the call over to Sid.

Robert Sid McAnnally

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

Thanks, Brandon, and good morning, everyone. There are many issues calling for attention in today's dynamic environment. At ONE Gas, we're focused on positioning the company to address the emerging business

environment, while continuing to execute our strategic plan. A review of the current landscape suggests that we're on the right path as our team maintains focus on safe and reliable delivery of natural gas to our customers, building additional capacity to respond to the significant organic growth in our service territory, and making progress toward our renewable natural gas goals.

I'll turn it over to Caron and then Curtis to discuss the details that lead us to these conclusions. Caron?

Caron A. Lawhorn

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

Thanks, Sid, and good morning, everyone. Net income for the first quarter was \$98.9 million or \$1.83 per diluted share, compared with \$95.6 million or \$1.79 per diluted share in the same period 2021.

Our first quarter 2022 results were impacted by \$3.6 million of expenses related to a decrease in the unrealized mark-to-market value of assets and liabilities associated with our non-qualified employee benefit plans. These non-cash items, which are not included in our guidance, impacted EPS by \$0.05 for the first quarter of 2022. By comparison, in the first quarter of 2021, we recognized income of \$100,000.

Turning our attention to the operational performance of the business, our first quarter results include an increase in operating income of \$10.5 million or 8% over the same period last year. Operating income reflects an increase of \$15.1 million from new rates, primarily due to regulatory filings completed in the second half of last year, including the Oklahoma Natural Rate Case and interim filings in Kansas and Texas.

In addition, natural gas sales from residential customers increased \$2.6 million due to the growth in our customer base that we continue to experience, primarily in Oklahoma and Texas. Our operations and maintenance expenses increased \$4.2 million over the first quarter of 2021 due to increases in outside services of \$3.7 million and employee-related costs of \$2.2 million. Partially offsetting those increases is a decrease in our bad debt expense of \$2.4 million.

The profile of our customer receivables has improved since year-end with fewer of our receivables in a past-due status. Further, we continue to see an increase in energy assistance payments from social service agencies on behalf of our customers. In the first quarter, we received \$3.5 million more in energy assistance payments than this time last year. We appreciate the efforts of our customer service team and their work on behalf of our customers. That said, we are very mindful of the impact of higher natural gas prices on our customers' bills. We will keep a close eye on our receivables and continue to work with our customers who need payment arrangements or other assistance.

Depreciation expense was \$4.8 million higher than the prior year, reflecting an increase in net property, plant and equipment as a result of our higher level of capital investment. Our capital expenditures and asset removal costs for the first quarter were \$123 million compared to \$109 million in 2021. The increase is consistent with our expectation that capital investment will be \$650 million for the full year, an increase of about 20% over the \$544 million we invested in 2021. Authorized rate base was approximately \$4.16 billion as of March 31, and we estimate our average rate base for 2022 will be approximately \$4.32 billion.

Securitization continues to progress in all three states, as Curtis will describe momentarily. We anticipate that we will receive the proceeds in Texas and Oklahoma before the end of the year. We expect to use the proceeds to call a portion of the notes related to Winter Storm Uri, \$1.4 billion of which is due in March 2023.

Looking at our liquidity, we ended the quarter with \$494 million of capacity in our commercial paper program and no borrowings under our credit facility. With the issuance of \$35 million of equity under our at-the-market equity program during the quarter, we have issued the amount of equity we had contemplated in our guidance for 2022. Yesterday, the ONE Gas board of directors declared a dividend of \$0.62 per share, unchanged from the previous quarter.

And lastly, we have affirmed our 2022 financial guidance, including a net income range of \$215 million to \$227 million, earnings per diluted share of \$3.96 to \$4.20, and capital investments of \$650 million. As Curtis will discuss, our outlook for growth of our customer base and rate base remains strong in 2022 and beyond.

Curtis, I'll turn it over to you.

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 our commercial activities. Over the next several years, a portion of our growth capital is focused on expanding into new areas to support several new developments. As we capture significant projects, we're designing and building our system capacity not just for the current opportunity, but also for the next major expansion. Our new customer connections are strong today, and these expansion projects will continue to provide additional growth opportunities for many years to come.

I'd like to take a moment and highlight two large projects. In the Oklahoma City Metro, we completed the first phase of a two-year, \$26-million expansion project that will support the development of over 10,000 planned building lots over the next five to seven years. While meeting the immediate needs of residential and commercial customers, this project also positions us for the next wave of population growth in this area. And in Austin, which is one of the fastest-growing housing markets in the US, we have several significant expansion projects underway. Approximately five years ago, we completed a mainline extension to an area of Boston that felt a little remote at the time.

In the first quarter of this year, we began construction from that initial expansion of a 23-mile, multi-phased, mainline extension where we will invest an additional \$50 million to \$55 million to reach several other developments that are expected to have approximately 20,000 residential and commercial lots completed over the next five to seven years. Like the Oklahoma example, these projects position us for further opportunities over the coming decade.

These two projects are good examples of the type of repeat business we are earning with our builder and developer partners. It also demonstrates how we use market data and internal system information to align system enhancements and market opportunities. Our expansion strategy focuses on long-term projects that enhance our system resiliency and position our service areas to capture future growth opportunities.

Turning to renewable natural gas. RNG is a key part of our efforts to reduce our emissions profile. On the RNG front, we are uniquely situated in a service region that has over 175 bcf of annual RNG production potential and are encouraged with the increasing engagement of RNG developers in our markets.

We have completed 10 projects through the preliminary interconnect design and the developers are completing their evaluation of the projects. We expect to have gas supply options from several projects across our footprint that will support our Oklahoma RNG opt-in tariff that will be filed later this year.

Moving on to securitization. In Oklahoma, the Oklahoma Development Finance Authority received a hearing before the Oklahoma Supreme Court on April 13 seeking validation of the bond issuance as required by statute. If the court issues a ruling that validates the bond issuance, the ODFA would then be able to issue the securitized bonds associated with the Oklahoma natural gas financing order. Pending a ruling, the financing order requests the ODFA to issue bonds and provide the net proceeds to Oklahoma Natural Gas this year.

On March 31, Kansas Gas Service submitted its application for a financing order to the Kansas Corporation Commission, as contemplated by the unanimous settlement agreement requesting flexibility to recover Winter Storm Uri costs over 5 to 12 years. The KCC has until September 27 to review the application and issue a financing order. If the financing order is approved, ONE Gas will proceed with the bonds issuance.

And in Texas, the process to issue securitized bonds is being led by the Texas Public Finance Authority. The Railroad Commission issued a financing order on February 8 and under the statute, the Finance Authority must issue the securitized bonds by August 7.

Turning to other regulatory matters. On March 15, Oklahoma Natural Gas filed its required PBRC application for a \$19.7-million increase in base rates, as well as an offsetting EDIT credit of approximately \$9.1 million. As filed, the net impact would be a \$1-per-month increase in the average residential customer bill.

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 an increase of \$9.1 million and \$5 million with new rates expected to take effect in June and July. Last week, we filed a cost of service adjustment in the Rio Grande Valley, requesting an increase of \$2.9 million. If approved, new rates would become effective in August of this year.

And, finally, I'll wrap up with a quick comment on the state of our operations. Industry-wide inflation has affected material and supply cost, and lead times for certain items have increased. We have been able to mitigate the impacts through a diverse supplier network, our previous buildup of key materials and supplies, and our advanced purchasing strategy to commit to future production slots for key materials and supplies, sometimes up to two years in advance. These practices have allowed us to maintain our inventory of critical parts and avoid disruptions to our planned capital and maintenance work. We continue to monitor the ongoing situation, but we remain confident in our capital investment forecasts and our ability to execute.

And now I'll turn it over to Sid for closing remarks.

Robert Sid McAnnally

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

Thank you, both. After more than two years, our employees who have been working remotely are back in the office with a hybrid schedule. The importance of our culture, with its emphasis on safety and value creation, came into focus as we welcomed employees back and offered our gratitude to teams in the field who worked successfully through the pandemic.

We also recently received the results of our annual employee engagement survey from Gallup and were pleased to learn that our employee engagement scores improved. This improvement at ONE Gas compares to the average national engagement score which declined for the first time in more than a decade. An increased level of employee engagement is a testament to the work of our leaders and employees in maintaining our company culture and demonstrating our core values through challenging times.

We also received notice from the American Gas Association that for the fifth consecutive year, ONE Gas had the lowest rate of significant injuries among our peers. Our company would not be able to achieve our safety, reliability, and growth goals without the dedication of our more than 3,600 employees. I want to thank each of them for their contributions and for working hard every day to serve our 2.3 million customers.

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

QUESTION AND ANSWER SECTION

Operator: Yes. Thank you. [Operator Instructions] And we'll take our first question from Julien Dumoulin-Smith with Bank of America.

Kody Clark

Analyst, Bank of America

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.

Good morning.

Kody Clark

Analyst, Bank of America

So, first, wondering if you can clarify the commentary around pension not being included in guidance, and specifically, do you mark-to-market on a quarterly basis? What's the split of debt and equity? And what impact are you assuming for the year? I mean, should we be assuming that you're coming in \$0.05 below the midpoint given the drag in the first quarter? Or are there some offsets that would put you back at the midpoint?

[audio gap] (00:15:09-00:15:48) I think the line might be cutting out.

Operator: Yes, one moment.

Caron A. Lawhorn

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

Sorry. My apologies. I didn't have a microphone on. Let me try that again. The \$0.05 impact I spoke of is associated with the mark-to-market of the assets and liabilities associated with our non-qualified plans. It does not include pension and OPEB expense. Our pension and OPEB expense is flat compared to last year, but it's actually declining over time because the pension plan has been closed to new entrants for some time. Retiree medical has also been closed to new entrants, and our plans are well funded and, of course, interest rates are rising, which improves the discounted impact of that. Did that answer all the questions you had on that?

Kody Clark

Analyst, Bank of America

Yeah. So, the...

Caron A. Lawhorn

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

...how it relates to the guidance?

A

Kody Clark

Analyst, Bank of America

Yeah, the guidance question and just where you stand within that given the – given the guidance...

Q

Caron A. Lawhorn

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

Yeah, so, on the mark-to-market – the mark-to-market fluctuates from quarter to quarter. And, over time, it's not a material number and is easily absorbed in our range of guidance. So, we don't try to estimate a specific income or expense number associated with that when we think about our guidance for the year. As I mentioned...

A

Kody Clark

Analyst, Bank of America

Okay. That's understood.

Q

Caron A. Lawhorn

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

...we had \$3.6 million of expense this quarter and last year, it was only \$100,000, and it was actually income. So, we get these big swings from quarter to quarter, but over time, not a big impact.

A

Kody Clark

Analyst, Bank of America

Okay. Understood. And then just second, we've seen some very constructive price markers for LDCs of late. And given some of the recent strong performance of shares in gas utilities in general, I'm wondering if you all have any updated thoughts on M&A. There seems to still be a disconnect between valuations in the public and private markets despite gas utilities re-rating relative to electrics.

Q

Robert Sid McAnnally

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

Yeah. Kody, we've noted that dislocation in pricing, but our position remains the same. As Curtis lined out, we are very pleased with the inventory of organic opportunities that we have. We think the strategic plan is on target. So, we are heads-down and all about execution, and believe that we've got the right strategy in place for the current environment.

A

Kody Clark

Analyst, Bank of America

Okay. Thanks, Sid and team. I'll pass it off here and jump back in the queue.

Q

Robert Sid McAnnally

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

Thanks, Kody.

A

Operator: [Operator Instructions] And we'll now take a question from Gabe Moreen with Mizuho.

Gabriel Moreen

Analyst, Mizuho Securities USA LLC

Hey. Morning, everyone. A couple of housekeeping ones. One is on the equity issuance. I think Caron mentioned that you're done for the year. Can you just speak to whether you issued anything after the first quarter was finished to date?

Caron A. Lawhorn

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

Morning, Gabe. We did not.

Gabriel Moreen

Analyst, Mizuho Securities USA LLC

Okay. So, first quarter, that \$35 million-ish was it, Caron, if I'm reading that right? Okay.

Caron A. Lawhorn

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

That's correct.

Gabriel Moreen

Analyst, Mizuho Securities USA LLC

Great. And then, can I ask about this review in front of the Oklahoma Supreme Court on the securitizations? I'm not as familiar. Can you talk about – is that – what the challenge is about, what the issues are being debated? Obviously, I think it might be a novel thing in Oklahoma. Can you just maybe speak to that a little bit and timing as to when you expect an outcome there?

Curtis L. Dinan

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

Hey, Gabe. This is Curtis. And the hearing before the Supreme Court was required under the statute. So, the process is going just through the normal course, as we expected and if you have seen our other industry peers in the state on both the gas and electric side, we're all going through the same process, where the commissions have issued the financing order, that then moves the process to the Supreme Court to review those, at which point when they issue an order then it would go back to the Oklahoma Development Finance Authority to go through the bond issuance process.

We don't have a time line for when the Supreme Court would issue a ruling. There's nothing contemplated or required in the statute, so that's completely up to the timing of the Supreme Court's action.

Gabriel Moreen

Analyst, Mizuho Securities USA LLC

Thanks, Curtis. And then maybe just bigger picture sort of on the – well, I guess it'll remain to be seen whether it's a step change in gas costs or not in the medium to long-term, but for now, that step change in gas costs, whether it changes anything about how you're thinking about kind of the business, capital allocation, and then also within guidance, is there anything for increased working capital costs or bad debt?

Curtis L. Dinan

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

A

So, Gabe, I'll take the first part of that and we're obviously very mindful of the impact that it has on our customers. But in terms of our capital spending program, there's really a couple of things to think about. One, on the growth side, we're responding to what the market demand is. Housing inventories are low, and that market continues to move very quickly, so there's a high demand for our product. The builders and developers that are putting in these new neighborhoods want to be able to offer natural gas service in those neighborhoods. So, that's driving a big portion of our capital.

And then, as we've talked about several times before, the spending that we do on system integrity, we're agnostic to those other factors. We have to spend the capital on the system that's needed to maintain system integrity and reliability. And just as we have since day-one, we continue to stay focused on the spending for those items as well.

Caron A. Lawhorn

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

A

And, Gabe, as it relates to guidance, of course, we issued our guidance in January prior to this recent kind of ramp-up in inflation and increase in interest costs. So, no, there's nothing specific in the plan related to that other than the general inflation that we would normally expect in a year. That said, we have certainly evaluated and continue to evaluate the impact on our plan. And for now, we've affirmed guidance and believe that those impacts are manageable for 2022.

Gabriel Moreen

Analyst, Mizuho Securities USA LLC

Q

Got it. Thanks, Caron. Thanks, Curtis.

Robert Sid McAnnally

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

A

Thanks for the question, Gabe.

Operator: [Operator Instructions] We'll now take a follow-up from the line of Julien Dumoulin-Smith with Bank of America.

Kody Clark

Analyst, Bank of America

Q

Hey, everyone. Kody again. Just one quick follow-up housekeeping item. Just looking at residential volumes down 4% year-over-year while residential customer growth continued and heating degree days were higher. It looks like a mix in Texas might be a factor here, but wondering if you can give a little bit more color on what's driving this dynamic?

Curtis L. Dinan

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

A

Yeah, Kody. This is Curtis again. That's purely related to Winter Storm Uri and the impacts that we saw in the first quarter last year versus what the weather patterns were like this year, just a concentration of the cold weather in February, but then also it's not – it's difficult to compare as well because some of our customers around the

territories were also dealing with electric outages. And so, while their volumes may have been even higher last year, not having electricity, that had an impact as well. So, it's really an apples-and-oranges comparison.

Kody Clark

Analyst, Bank of America

Yeah. Understood. Got it. Thanks so much for the time again.

Robert Sid McAnnally

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

Yeah. Sure, Kody. Thank you for the question.

Operator: [Operator Instructions] And we'll pause for just a moment. And it appears there are no further telephone questions. 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 second quarter starts when we close our books in early July and extends until we release earnings in August. 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.

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