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ONE Gas, Inc. (OGS)

Q3 2022 Earnings Call

CORPORATE PARTICIPANTS

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Curtis L. Dinan

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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.

At this time, I would like to turn the conference over to 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 2022 earnings live webcast. A replay will be made available later today. We apologize for this morning's technical difficulties. If you have a question, feel free to ask that question at any point during the course of this call. And that number you will need to dial to ask that question is 539-444-8542 and the passcode is 342084332. Again, in order to ask a question during the call, feel free to dial this number at any point during the call and we will get the questions at the end of the conference call. Again, the number is 539-444-8542, passcode 342084332. I'll repeat that information at the end of our prepared remarks.

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 Reform Act of 1995, 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.

Before we begin, I wanted to mention that last night, we issued a corrected earnings news release after we realized that a line item was inadvertently omitted from the financing activities section in the statements of cash flows in the appendix. The corrected news release is available on our website.

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.

Robert Sid McAnnally

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

Thanks, Brandon, and good morning, everyone. Our earnings release reflects steady performance toward the guidance we provided in January, as evidenced by the completion of Winter Storm Uri securitization in Oklahoma,

which carried with it a credit rating upgrade from S&P, a record number of new meters set through the first nine months of the year, and capital execution that remains on track to hit approximately \$650 million this year.

In today's dynamic environment, many issues vie for our attention and demand our steadfast execution. Two years ago, we faced the uncertainties of the COVID-19 pandemic and the complexities inherent in managing a 3,700-person, three-state workforce, half of which remained in the field daily to serve our customers. Last year, we encountered Winter Storm Uri with sustained regional temperatures colder than at any point in our company's 116-year history. Our system and co-workers performed at a very high level, keeping our customers supplied with life-saving fuel during the crisis.

This year, we've confronted decades-high inflation and an aggressive monetary response by the Federal Reserve. With increasing demand and ongoing geopolitical conflicts impacting the cost of natural gas, coupled with persistently elevated inflation, we remain committed to customer affordability and managing costs. We're also focused on positioning the company to address emerging business challenges, while continuing to execute our strategic plan. A review of our achievements suggest that we're on the right path, building capacity to respond to the organic growth in our service territories and making progress toward our clean energy goals. As Caron and Curtis will describe in greater detail, our teams have also proactively worked to ensure the continued reliability of our service and prepare for future challenges.

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

Caron A. Lawhorn

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

Thanks, Sid, and good morning, everyone. When we initiated our 2022 guidance earlier this year, we contemplated an increase in operating expenses as we worked to build operational capacity to support our system expansions, as well as higher financing costs associated with our increased capital spend. However, the challenges Sid mentioned regarding elevated inflation and rising commodity and debt costs have pressured these expectations. Despite these headwinds, we remain on track to achieve our 2022 financial targets.

As was noted in our earnings release, we are narrowing our 2022 net income guidance to a new range of \$217 million to \$226 million, with earnings per diluted share of \$4.00 to \$4.16. As Sid mentioned, the full year capital expenditures including asset removal costs are still expected to approximate \$650 million.

Actual results for the third quarter reflect net income of \$23.7 million or \$0.44 per diluted share, compared with \$20.3 million or \$0.38 per diluted share in the same period last year. These results include an increase in operating income of \$5.3 million or 13% over the same period last year. This reflects an increase of \$15.6 million from new rates, primarily due to regulatory filings completed over the past 12 months and \$1.3 million from continued residential customer growth primarily in Oklahoma and Texas.

Operating costs increased \$9.4 million over the third quarter of 2021. We experienced an increase in outside services of \$4.8 million and employee-related costs were up \$2.4 million. Other income net increased \$2.6 million for the quarter, which reflects a reduction of \$2.5 million in non-service cost for our pension plans due to the remeasurement of our obligations which we discussed last quarter. We did not experience significant mark-to-market gains or losses on our non-qualified benefit plan assets during the third quarter.

Interest expense was \$4.2 million higher this quarter than in the same period of 2021. As I mentioned last quarter, higher natural gas prices and increased natural gas storage balances as compared to the prior year have

contributed to an increase in our working capital needs which we fund with commercial paper. Average CP rates were 3.5% this quarter, compared to 0.2% in the third quarter of last year.

In addition, we issued \$300 million of ten-year 4.25% senior notes in August, which brings our weighted average interest rate on long-term debt, excluding bonds related to Winter Storm Uri, to 4.14% as of September the 30th, compared to 4.08% last year. Depreciation expense for the third quarter was \$4.1 million higher than the prior year and our capital expenditures and asset removal costs were \$174.9 million, compared to \$144.5 million in 2021. These expenditures include system replacements as well as investments to extend service to new customers. Authorized rate base was approximately \$4.28 billion as of September 30th and we estimate our average rate base for 2022 will be approximately \$4.8 billion.

We continue to focus on optimizing the financing of our business. During the third quarter of 2022, we executed forward sales agreements for approximately 570,000 shares of our common stock at an average sales price of \$80.46 per share, bringing us to approximately 1.2 million shares available for issuance as of September 30 at an average sales price of \$80.84 per share. Had we settled these shares at quarter end, we would have generated net proceeds of about \$94 million. These shares are in addition to the \$35 million we issued and sold earlier in the year. We have \$85 million of equity available for issuance under the ATM program. We ended the quarter with \$575.4 million of capacity in our \$1 billion commercial paper program and no borrowings under our credit facility. We have no maturities of long-term debt in 2023.

Turning to securitization. On August 25th, we received approximately \$1.3 billion of proceeds from the issuance of securitized bonds by the Oklahoma Development Finance Authority related to Winter Storm Uri. In September, we used those proceeds to repay \$1.3 billion of related senior notes due in 2023 and 2024. As the proceeds reflect recovery of costs deferred by Oklahoma Natural Gas, there was no material impact to earnings.

On August 18th, the Kansas Corporation Commission issued an order approving the terms of the July 14th settlement agreement and also issued a financing order. The bonds will be issued by Kansas Gas Service Securitization I, L.L.C., a special purpose, wholly-owned subsidiary of ONE Gas. Our registration statement has been filed with the SEC. Once approved, we will proceed with the bond offering. We expect the bond issuance to be completed in the fourth quarter of this year. At September 30th, Kansas Gas Service has deferred approximately \$339.6 million in extraordinary costs.

In Texas, we expect the bond issuance process, which the Texas Public Finance Authority is leading, to be completed in the fourth quarter. Lastly, for the quarter, the ONE Gas board of directors declared a dividend of \$0.62 per share, unchanged from the previous quarter.

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

Curtis L. Dinan

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

Thank you, Caron, and good morning, everyone. Recall that in March, Oklahoma Natural Gas filed its performance-based rate change application for an increase of \$19.7 million. In May, the Oklahoma Corporation Commission staff and the Attorney General's Office filed statements supporting an increase of \$19.6 million. In July, pursuant to our tariff, new rates went into effect, reflecting the \$19.6 million revenue increase. Those new rates are interim, and therefore, subject to a refund pending final approval by the Commission. On September 29th, the Administrative Law Judge recommended approval of the joint stipulation and a final order is expected sometime in the fourth quarter.

And in Texas, Texas Gas Service made gas reliability infrastructure program filings for all customers in the Central Gulf and West Texas service areas in the first quarter. In the West Texas service area, the city of El Paso denied the requested increase, and Texas Gas Service subsequently appealed the city's action. In August, the Railroad Commission approved the appealed rate increase, and new rates that were implemented in El Paso during July were allowed to remain in effect.

The West-North Consolidated Texas rate case that was filed in June requesting an increase of \$13 million continues to follow the procedural schedule and the hearing is scheduled for later this week. If approved, new rates are expected to take effect in early 2023. Lastly, Kansas Gas Service filed a \$7.8 million gas system reliability surcharge in August with rates expected to take effect in December or early January.

Moving on to commercial activity. For the nine-month period ending September 30th, we added nearly 20,000 new customer connections, which is up nearly 16% compared to the same timeframe in 2021. The month of September had the second highest number of meters set since our spin from ONEOK and Oklahoma City had the third highest monthly meter set for any of our metro service areas since spin.

Building permits have declined from historic highs but remain resilient. During August, we saw increased building permit activity in six of our eight major metropolitan areas. Oklahoma City and Austin saw the most significant rise with a 24% and 8% increase respectively. More broadly, the I-35 corridor from Kansas City to San Antonio has been recognized as the fastest population and job growth region in the US. Rising interest rates are leading to some slowing in the national housing market and to some degree in our service territories. However, we remain optimistic given the continued population growth and economic development we are experiencing across our service territory.

Regarding renewable natural gas, we continue to be encouraged by the growth and investment we are seeing in this space. Recent acquisitions of RNG-related companies demonstrate the market value of RNG and further validates our strategy to utilize our assets to connect RNG supply with demand for the product, no different than how we transport wellhead gas for customers today. Before year end, we expect to file a voluntary RNG tariff in Oklahoma and are exploring similar options in other jurisdictions.

As colder weather moves across our territories, our co-workers in the field continue to perform at a very high level, completing several system enhancement projects and assisting our customers with light up season. In addition to the enhancements on our system, we have added to our transport and storage positions to support our growing customer base. Over the past 18 months, we have increased our leased storage capacity to 58 Bcf from 48 Bcf.

Additionally, we have added firm transport capacity at various delivery points and further diversified our gas supply by adding firm transport from the Gulf region. We continue to invest in mobile CNG trailers that provide flexibility to backstop possible points of system constraint. Those are just a few of the tangible actions we've taken to increase reliability and system performance to support our customers.

And finally, I've spoken previously about our efforts to mitigate the impacts of inflation and supply chain disruptions to our operations. Availability of construction materials continues to improve. While lead times are longer than normal, we've been able to adjust our timelines and have committed to future production slots of critical items. We continue to navigate through these challenges but do not foresee any issues completing our 2022 capital program and remain confident in our ability to execute in 2023.

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, Caron and Curtis. As we approach year end, we acknowledge the challenges in front of us heading into 2023. However, our long track record of delivering results gives us confidence that the experience of our team, the strength of our service territory, and the value of our long-term strategy will successfully guide us into the future.

In closing, I extend my gratitude to each one of our co-workers for their dedication to safety and service to our customers. I especially want to recognize our IT group, who in response to an external challenge this morning, have overperformed in allowing us to have the call and field your questions today. So we appreciate your patience. And a reminder to all of our co-workers how privileged we all are to work alongside you every day.

Thank you all for joining us this morning. Brandon?

Brandon Lohse

Director-Investor Relations, ONE Gas, Inc.

Thanks, Sid. Again, I want to remind everybody that the phone number for the questions to be called into is 539-444-8642. That's 539-444-8642, passcode 342084332. We will pause momentarily as we aggregate the questions.

QUESTION AND ANSWER SECTION

Curtis L. Dinan

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

This is Curtis. And a question has come in about our capital expenditures of \$650 million for 2022. \$650 million was our guidance for this year, and we remain on track to complete that. It is a little bit fourth quarter-loaded in the sense that we have several large projects that are in flight. I've spoken about several of those during the second – or during the first quarter and second quarter calls. So just some added context around those. We're expecting that to continue through the end of the year. And we remain on track to hit our \$650 million target.

Caron A. Lawhorn

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

This is Caron. Another question has come in. I'm not exactly sure what is being asked. It has to do with our equity capital. As I commented on the call, we have raised or we have sold forward some equity that we will exercise at some point. And we have not provided any update on our longer-term guidance. Our normal cadence is to do that once a year as we release 2023 guidance.

Robert Sid McAnnally

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

We've got a question from David Arcaro. David, thanks for the question. It concerns whether or not the company has an interest in unregulated RNG. As we've shared in the past, we really like our forward organic growth opportunities and system maintenance opportunities. We do think there's an opportunity for us as we participate in RNG projects as an entity that is connecting for-profit generators with customers who are interested in exposure to a lower carbon fuel.

And we've chosen that role because we believe it allows us to participate in the energy future that we all see without having to divert capital away from those opportunities that we see in front of us. We are fortunate because of the growth in our service territory not to be constrained with projects or have to really cast a ballot for ways to spend capital. We have robust capital, a robust capital portfolio in front of us, but we do think it's important to participate in alternative fuels as those opportunities present themselves.

So you can expect us to hold the line on partnering with people who are generating RNG and looking for a partner to bring that online. We think, because we're a distribution system and our pressures are lower than typical mids, we have the opportunity to offer a really – a partnership that is better in many cases that helps those generators not have to look at compression at higher cost. So we kind of like the way it stacks up for us, David. Thanks very much for the question.

We have another question that's come in that asks about pressure on customer bills. And as you all know, since spin, we've really focused on how we can work with customers to help them moderate their usage. We're fortunate that we maintain a pretty healthy advantage over our electric competition in our service territory, but that doesn't mean that every day, we're not focused on how we can continue to look at managing our costs and being prudent in the way that we invest our dollars. We, of course, balance that with the need to think about how we maintain a reliable and safe system, and we'll always look at focusing on those two things with an eye toward the longer-term and our strategic plan.

Curtis L. Dinan

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

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A question has come in about the pace of housing development and do we see any signs of that slowing or do we still have a high confidence level of growth in Texas and Oklahoma? And we do still have a high confidence level. As I mentioned, we set some records in the third quarter and in the month of September, specifically with the number of connections that were made and we continue to see that. One of the things that we've noticed is there's been a lot of – there have been numbers that things have slowed. I'll just give you an example where you have to understand the context.

So something is down 10% and it's down 10% from having been up 100%. So some of that slowing is good because these markets were frankly too hot. And so a little bit of a slowdown, I believe, is a positive. It brings rationality back into the housing market. And we continue to see influx of population, continuing economic growth with new companies, announcing expansions, and with that, more workers needed in those areas. So we do remain very optimistic around those key markets for us.

Robert Sid McAnnally

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

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Yeah. And to that question, we also see continued economic development in our service territory. When you look at what's happening in the three states that we serve, particularly the Tulsa and Oklahoma City areas and the entire Austin region, we continue to see significant investment by companies who are playing a much longer ball. And so we like the opportunities that sit in front of us in those territories.

Brandon Lohse

Director-Investor Relations, ONE Gas, Inc.

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Just one more time. If you have a question, please dial the following number 539-444-8642, passcode 342084332. We'll pause momentarily for any last remaining questions.

Brandon Lohse

Director-Investor Relations, ONE Gas, Inc.

All right. 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 late February. We'll provide details on the conference call at a later date. Have a great day.

Operator: This concludes the ONE Gas Third Quarter Earnings Conference Call and Webcast. You may now disconnect.

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