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ONE Gas, Inc. (OGS)

Q3 2023 Earnings Call

CORPORATE PARTICIPANTS

Erin Bender Dailey

Director-Investor Relations & Sustainability, ONE Gas, Inc.

Robert Sid McAnnally

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

Caron A. Lawhorn

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

Curtis L. Dinan

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

OTHER PARTICIPANTS

Gabriel Moreen

Analyst, Mizuho Securities USA LLC

Jamieson Ward

Analyst, Guggenheim Securities LLC

Tanner James

Analyst, BofA Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the ONE Gas 2023 Third Quarter Earnings Conference Call. Today's conference is being recorded.

At this time, I would now like to turn the conference over to Erin Dailey. Please go ahead, Ms. Dailey.

Erin Bender Dailey

Director-Investor Relations & Sustainability, ONE Gas, Inc.

Thank you, Elliot. Good morning, everyone, and thank you for joining us on our third quarter 2023 earnings conference call. This call is being webcast live and a replay will be available later today. After our prepared remarks, we are happy to take your questions. 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, 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. 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.

And now, I'll turn the call over to Sid.

Robert Sid McAnnally

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

Thanks, Erin, and good morning, everyone. Thank you for joining us as we discuss our third quarter performance. Prudent management and operational execution have kept us on track to achieve the midpoint of our 2023 financial guidance despite strengthening macroeconomic headwinds affecting our industry.

As our results show, we've met the dual challenges presented by inflation and higher interest rates this year, while also leveraging process improvements to better balance our capital deployment, putting us ahead of our capital plan for the year. We continue to effectively meet growing customer demand while also prioritizing safety and enhancing the reliability of our system.

The investments we're making position us well to support growing customer needs long into the future. I've spoken before about the economic growth we're experiencing in Texas, Oklahoma, and Kansas. An effective mix of business-friendly government policies, access to affordable energy, and attractive costs of living are converging to bring new manufacturing and technology-based jobs to our region. With these jobs, come families needing places to live and looking to become parts of our communities.

Economic development of this kind is the most durable variety of growth, as it rests on strong and long-dated fundamentals. This type of development also presents growing demand for natural gas, for homes, for businesses, and for industry. While the jump in interest rates has understandably pressured home building in the near-term, we remain bullish about the intermediate and long-term pillars of growth across our regions. As we deploy capital, we remain thoughtful about making the right investments, so our system is capable of reliably serving the growing customer base that we see today and the substantial increase in growth that is to come. As always, safety remains our top priority.

Now, I'll turn it over to Caron to discuss our financial performance for the quarter. Caron?

Caron A. Lawhorn

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

Thanks, Sid, and good morning, everyone. As Sid noted, we had solid financial performance this quarter despite the headwinds posed by rising interest rates and sticky, though moderating, inflation. Our teams have done a great job managing the risks we can control. As a result, we are narrowing our earnings guidance with earnings per diluted share now expected to be in the range of \$4.06 to \$4.22.

We've also seen good execution on our capital projects. We expect to invest approximately \$725 million of capital in 2023, up from the \$675 million reflected in our original guidance. As Curtis will discuss in a moment, the increase is primarily attributable to system maintenance and reinforcement projects. Net income for the third quarter was \$25.2 million or \$0.45 per diluted share, compared with \$23.7 million or \$0.44 per diluted share in the same period 2022.

As I have noted in previous quarters, rising interest rates and the inverted yield curve continue to present challenges. For perspective, excluding amounts related to the Kansas securitization, interest expense for the first three quarters of 2023 is up approximately 40% from the same period last year. The increase is primarily attributable to the rising rates on commercial paper and our issuance of \$300 million of 4.25% senior notes in August of 2022.

A reminder that in the first quarter of 2024, we have \$300 million of 3.6% notes and \$473 million of 1.1% notes coming due. We are considering multiple factors such as interest rates, yield spreads, and our debt to equity ratio as we look to refinance those notes. As expected, employee expenses were also elevated as compared to the

third quarter last year due to planned investments in our workforce with operations and maintenance expenses due to labor and benefit costs increasing \$7.5 million.

However, we saw a decrease of \$2.3 million due to lower outside services costs as we continue to in-source work previously supported by contractors. We anticipate O&M expense increases will continue to moderate as we realize the benefits of in-sourcing work and improved internal processes and as inflation continues to ease in line with our assumptions. We have continued to enter into equity forward sale agreements, greatly de-risking our anticipated market exposure. In September, we executed additional forward sale agreements for 1.38 million shares of our common stock with required settlement by December 31, 2024.

In total, we now have forward sale agreements covering approximately 1.69 million shares of common stock, which must be settled by the end of this year, and approximately 2.9 million shares, which must be settled by the end of 2024. Had all forward shares been settled at September 30, we would have received net proceeds of approximately \$351 million, implying an average per share price of roughly \$76.45.

Amid continued geopolitical uncertainty, we have also taken steps to ensure we have adequate liquidity as we execute our capital plan. On October 20th, we expanded our credit facility to \$1.2 billion from \$1 billion. Yesterday, the ONE Gas board of directors declared a dividend of \$0.65 per share, unchanged from the previous quarter. As we close out the year, we will remain focused on prudent expense management as we serve our customers.

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 an update on our regulatory activities. Last December, we filed a request for a voluntary renewable natural gas tariff in Oklahoma, which will give customers the opportunity to purchase the environmental attributes of RNG. A unanimous settlement agreement recommending approval of the tariff was filed and a hearing before an administrative law judge was held on October 19. An order is expected before year end, which will allow us to implement the program.

In Texas, we filed a Gas Reliability Infrastructure Program for the consolidated West-North region in March. The Railroad Commission and all municipalities, except for three, approved a \$7.3 million increase or allowed it to take effect with no action. Texas Gas Service appealed the three municipalities' denial and implemented the new rates in June, subject to the outcome of the appeal. In August, the Railroad Commission granted the appeal and approved the increase.

Finally, in August, Kansas Gas Service submitted an application to the Kansas Corporation Commission requesting an increase of approximately \$8 million pursuant to the gas system reliability surcharge statute, which allows Kansas Gas Service to file for a rate adjustment to recover and earn a return on qualifying infrastructure investments incurred between rate filings. The KCC has until late December to issue an order.

Turning to commercial and operating activities, as Caron noted, we expect to surpass our planned capital deployment for the year, in part due to process changes that have improved project planning and execution. Those improvements, along with mild winter weather, allowed us to complete more of our planned work in the first quarter, and we have maintained this pace throughout the year. Of note, we are nearing completion of our Mopac Phase 2 project, the last of the major reinforcement projects to arise out of our evaluation of Winter Storm Uri. The diligence of our operations, engineering, and project management teams to execute our work plan puts us in an even stronger position as we head into the winter heating season.

Looking at growth, we continue to see a slight deceleration in the pace of new meter sets as elevated mortgage rates impact the immediate term decisions of homebuilders and potential buyers. Year-to-date through September, our meter sets have matched the pace set in 2021. As we discussed on our second quarter call, our region continues to enjoy strong economic growth, with new employers moving into our territories, bringing jobs, people, and an ongoing need for new housing.

In fact, we're on pace to post a record number of new meter sets for the month of October, despite 30-year mortgage rates cresting 8% earlier this month. I think this illustrates both the challenges in forecasting when baseline conditions remained volatile and the durability of the regional growth story Sid described earlier. We remain prepared to meet the growing demand for gas that accompanies that economic development.

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. A high-performing workforce is the foundation of the essential work that we do. Over the last three years, we've come through a global pandemic and multiple winter storms, events that ultimately strengthened our commitment to one another and to the customers we serve. The high levels of service maintained through those challenges strengthened our customers' confidence and the reliability of our service and across the ONE Gas footprint, our team shared the experience of providing an essential service to our customers in a way that reinforced the value of culture and connection.

At the end of September, we welcomed Angela Kouplen to ONE Gas as Senior Vice President and Chief Human Resources Officer to help us navigate the changing workplace and to continue our investment in our primary asset, the people that we work alongside. Angela brings deep executive experience and a passion for developing people, and we look forward to the contribution she will make to our company as we focus on ensuring that ONE Gas continues to be a place where we can all contribute, grow, and thrive.

In closing, I thank each of my coworkers for their commitment and dedication to delivering safe and reliable natural gas to 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: Thank you. [Operator Instructions] Our first question comes from Gabe Moreen with Mizuho. Your line is open.

Gabriel Moreen

Analyst, Mizuho Securities USA LLC

Q

Hey. Good morning, everyone. Appreciating that there's a lot of moving parts that probably will go into your refreshed five-year outlook. But can you just speak a little bit – and I don't mean to front-run it, to how you're feeling about your 4% to 6% EPS growth outlook over that the last time you issued it given the refinancing, the moderating O&M, the meter sets and customer growth. So, I'm just curious kind of how you're feeling about that given all the shifts that have occurred since you issued the last five-year plan?

Robert Sid McAnnally

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

A

Well, Gabe, it's good to hear from you. And of course, we appreciate the question. As you point out, this call is really pointed at third quarter and prior-year performance. And so, we'll not provide guidance today. But I think you look at the performance of the company and the way that we've been able to navigate a challenging environment this year. Curtis spoke to the in-sourcing and Caron talked about the financial impact of the in-sourcing that we've done that's looked at how we manage an increasing cost of outside services.

And we've talked before about the fact that when we have the opportunity to bring work inside the company and can compete both from a performance and a cost standpoint, we'll do that. And I think that's borne fruit for us, that's a strategy that is likely to continue. Caron also spoke to the way that we are looking at managing our financial structure. And I think the way that the company has utilized the ATM and block sales demonstrates that we'll be opportunistic as we think about the rest of this year demonstrated by the way that we've performed earlier in the year.

Caron, anything you'd add?

Caron A. Lawhorn

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

A

I think that's a great summary, and we look forward to talking more after we release guidance about our view of what the next few years look like, given this continued higher for longer interest rates and the continued inversion – the yield curve, which everyone is grappling with.

Robert Sid McAnnally

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

A

Gabe, the only other thing that I would mention before passing to Curtis is, I spoke in the prepared remarks about the durability of our growth. And one thing that we have confidence in, as demonstrated by our recent performance with mortgage rates, where they are, is the longer-term story. We have a significant amount of clarity into growth in our service territory going forward, and we think durability is an important factor of that growth when we look at the underlying mechanics of economic development in our service territory and the knock-on growth that comes with that.

We've got a pretty clear picture about what we need to do as we think about preparing for that. And I think we've demonstrated that with the attention that we've paid to our capital process and why you see the over performance in our capital performance today. Curtis, anything you'd add?

Curtis L. Dinan

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

A

So, just around the growth activity that we see. We have seen again this year a little bit of a deceleration in meter sets. But October was a bit of a positive turn for us. We do continue to see developers and builders active in our territories. So, while there may be a pause, I think we really view that as more temporary than long-lasting. So, maybe October is starting to show the signs of that.

Robert Sid McAnnally

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

A

Thank you for the question, Gabe.

Operator: Our next question comes from Jamieson Ward with Guggenheim Partners. Your line is open.

Jamieson Ward

Analyst, Guggenheim Securities LLC

Q

Good morning, guys. How are you?

Robert Sid McAnnally

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

A

We're well, Jamieson. How are you this morning?

Jamieson Ward

Analyst, Guggenheim Securities LLC

Q

Doing well. Thank you. Just jumping a bit head first. I want to ask you what's in it, but in terms of timing, should we expect the 2024 annual guidance slides at the end of November again like they came last year or would you be reverting back to releasing in January, so we get a sense of when to expect?

Robert Sid McAnnally

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

A

Jamieson, and this ties back to our answer to Gabe's question. We believe the more clarity we can provide about the future opportunities that the company has, the better off we are in being clear about the future and the better off you are in being able to ask us questions. We try to be as transparent as possible. I think our past behavior demonstrates that. We think transparency is always a good policy, but it's particularly helpful when you have the kind of forward story that we have.

So, we thought the cadence worked very well last year, particularly because it gave us the opportunity in the December investor meetings to speak to the forward year. So, right now, our plans are to continue the cadence that we started last year because we think it was helpful to everyone.

Jamieson Ward

Analyst, Guggenheim Securities LLC

Q

Perfect. That's great. I mean, we'd always rather have information sooner rather than later. I don't think anyone will disagree. And thank you for answering that. I just have one more on the – well, specific to the \$50 million of incremental CapEx, when should we be assuming that that spending in particular begins earning a return?

Curtis L. Dinan

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

A

Jamieson, this is Curtis. And if you look back in 2023, the cadence of our filings, whether it was GRIP filings in Texas, our PBR filing in Oklahoma or GSRS in Kansas, we'll be following that same cadence in the coming years as we have for each of the past few years.

Jamieson Ward

Analyst, Guggenheim Securities LLC

Q

So, the spending was kind of sprinkled across all categories, but it wasn't specific to any particular bucket that might have a nearer term recovery period or for anything else we could model or factor in? Just to clarify there.

Curtis L. Dinan

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

A

No, no, all of our capital goes into the GRIP filings. All of our capital goes into the PBR filings. And the majority of our capital spend in Kansas goes into the GSRS filing. And most of the...

Jamieson Ward

Analyst, Guggenheim Securities LLC

Q

Got it.

Curtis L. Dinan

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

A

...increase as it relates to this year was more system maintenance type of spending. So, that's what would qualify in Kansas as well.

Jamieson Ward

Analyst, Guggenheim Securities LLC

Q

Thank you very much. That's all I have.

Robert Sid McAnnally

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

A

Thank you for your question.

Operator: [Operator Instructions] We now turn to Tanner James with Bank of America. Your line is open.

Tanner James

Analyst, BofA Securities, Inc.

Q

Hi. Good morning.

Robert Sid McAnnally

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

A

Good morning, Tanner.

Tanner James

Analyst, BofA Securities, Inc.

Hi. Do you guys have any visibility for plans for terming out some of the upcoming maturities versus your short-term debt? And then, you'd kind of mentioned a little bit in the – or in the answer to Jamieson. But how should we think about the cadence of your formal rate case filings and timing on your ability to recover the portion that is recoverable through rate? Thank you.

Robert Sid McAnnally

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

Yeah. Let's go to Curtis to speak to rate cadence and then Caron can speak to your initial question, Tanner. Curtis?

Curtis L. Dinan

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

So, let me just go state by state. So the capital spending, everything we spend in Texas qualifies for a GRIP filing. And if you saw the cadence that we had here in 2023 in February, we filed Central Texas. In March, we filed West Texas. And then we had the rate case in RGV. And so the rate case next year, we would have a COSA filing. And you can look at cadence in prior years to have a sense of that.

In Oklahoma, all of our capital is recovered through the PBR filing, which we typically do at the end of February. And in Kansas, the capital that we've spent in 2023 through the end of June was a part of the filing that we did just a couple of months ago in August. Our next filing for GSRS in Kansas would be next August. You can do one every 365 days, no sooner than that. And that will pick up all capital spending through June 30 of next year. All capital spending that qualifies for that mechanism, which is the majority of our spending in Kansas.

Caron A. Lawhorn

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

And to address your question on the refinancing, I really don't have much more to add than what I said in the comments. We're looking at all factors with the rates and spreads where they are, different tenures, how that impacts our maturity profile, how it impacts our capital structure, which supports our regulatory construct. All of those things are things that we are looking at and balancing as we refinance that debt.

Robert Sid McAnnally

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

Yeah. Tanner, the only thing I would add is, to speak to how prepared and are preparing for the challenges that we think we'll face going forward. We have increased the capacity of our regulatory group recognizing that the cadence of rate activity will increase and that started last year, really early last year. We've also done the same when you look at the financial side of the house. So, we think we've built capacity to take on the challenges in the short-term that continue to support the opportunities that we have in the long-term.

Tanner James

Analyst, BofA Securities, Inc.

Understood. Thank you. And then, with commodities declining here, how do you estimate the customer build trajectory for the upcoming winter 2023 to 2024?

Robert Sid McAnnally

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

A

Jamieson – or Tanner, excuse me, we've seen just on average across our territory last year, we saw an average bill of somewhere in the \$81 range per month. And this year, we see somewhere around maybe 8% to 10% decrease from that.

Tanner James

Analyst, BofA Securities, Inc.

Q

Great. Thanks. And then lastly, in the press release, you called out the year-to-date weather impact net of normalization. How do you quantify that on an EPS basis? And then what are the – are there any offsets built into your guidance for that?

Caron A. Lawhorn

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

A

So, as we plan guidance for the year, we anticipate normal weather. And we are largely protected from those big swings because of our weather normalization mechanism. And so, because of that protection. We don't see a lot of volatility associated with it. Ultimately, it don't have the EPS impact of that.

Tanner James

Analyst, BofA Securities, Inc.

Q

Great. Thank you very much.

Robert Sid McAnnally

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

A

Thank you for the questions.

Operator: We have a follow up question from Gabe Moreen with Mizuho. Your line is open.

Gabriel Moreen

Analyst, Mizuho Securities USA LLC

Q

Thanks, everyone. My question actually got answered. Thank you.

Robert Sid McAnnally

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

A

Thank you, Gabe.

Operator: This concludes our Q&A. I'll now hand back to the management team for closing remarks.

Erin Bender Dailey

Director-Investor Relations & Sustainability, ONE Gas, Inc.

Thank you 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 released 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 2023 third quarter earnings conference call and webcast. You may now disconnect.

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