

National Fuel Gas Company (Q1 2023 Earnings)
February 3, 2023

Corporate Speakers

- Brandon Haspett; National Fuel Gas Company; Director of Investor Relations
- David Bauer; National Fuel Gas Company; President, CEO & Director
- Justin Loweth; National Fuel Gas Midstream Company, LLC & Seneca Resources Company, LLC; President
- Karen Camiolo; National Fuel Gas Company; Treasurer & Principal Financial Officer

Participants

- John Abbott; BofA Securities; VP
- Trafford Lamar; Raymond James; Equity Research Associate
- Umang Choudhary; Goldman Sachs Group, Inc.; Associate

PRESENTATION

Operator^ Hello, everyone, and welcome to the National Fuel Gas Company Q1 FY 2023 Earnings Conference Call. My name is Dru, and I'll be your operator today.
(Operator Instructions)

I would now like to turn the call over to Brandon Haspett, the Director of Investor Relations. Please go ahead.

Brandon Haspett^ Thank you, Dru, and good morning. We appreciate you joining us on today's conference call for a discussion of last evening's earnings release. With us on the call from National Fuel Gas Company are Dave Bauer, President and Chief Executive Officer; Karen Camiolo, Treasurer and Principal Financial Officer; and Justin Loweth, President of Seneca Resources and National Fuel Midstream. At the end of the prepared remarks, we will open the discussion to questions. The first quarter fiscal 2023 earnings release and February investor presentation have been posted on our Investor Relations website. We may refer to these materials during today's call.

We'd like to remind you that today's teleconference will contain forward-looking statements. While National Fuel's expectations, beliefs and projections are made in good faith and are believed to have a reasonable basis, actual results may differ materially. These statements speak only as of the date on which they are made, and you may refer to last evening's earnings release for a listing of certain specific risk factors.

With that, I'll turn it over to Dave Bauer.

David Bauer^ Thanks, Brandon, and good morning, everyone. National Fuel's fiscal year started off with a great first quarter. Adjusted operating results were \$1.84 per share, an

increase of 24% versus last year, with each of our four business segments contributing to the increase. Starting with our Upstream business, production in Appalachia increased by 11%, which when combined with the \$0.50 per Mcf improvement in our natural gas price realizations, led to a 29% increase in EBITDA. This increase is particularly impressive, given that last year's EBITDA includes the benefit of our California assets, which we sold last summer.

Seneca's production growth also contributed to a 6% increase in gathering EBITDA. The combination of our valuable transportation and marketing portfolio along with great operational execution by our team drove the improved performance of our non-regulated businesses during the quarter. Justin will add more details on these results in a few minutes.

Our regulated segments also had a good quarter. Despite the inflationary headwinds I've discussed on past calls, earnings were up in both businesses.

We saw continued growth in Pipeline & Storage revenues, driven principally by the FM100 expansion and modernization project. As you recall, this project went in service in December 2021, so we saw the impact of a full quarter of both expansion revenues and the modernization rate increase associated with the project that went into effect last April.

In the Utility business, excluding some ratemaking adjustments that did not impact earnings, our underlying customer margin was up about \$6 million, driven by the ongoing benefits of our infrastructure modernization tracker in New York and increased usage, which was largely related to colder weather versus last year. The increase in margin more than offset the inflationary pressure on our operating expenses, leading to earnings growth for the quarter.

Turning to capital allocation, our fiscal '23 capital spending guidance is unchanged at \$830 million to \$940 million. At Seneca, we plan to continue our two-rig program. Despite the near-term drop in natural gas prices largely due to reduced demand in the early stages of winter, the long-term outlook is still constructive.

The pipeline of LNG projects expected to come online mid-decade as well as the continued transition from coal to gas generation support long-term baseload demand. Having said that, we remain flexible, and if market conditions warrant, we can adjust our spending to ensure we continue to generate free cash flow.

As you saw in last night's release, we've lowered our NYMEX natural gas price assumption to an average of \$3.25 per MMBtu for the remaining nine months of the year, which is in line with the forward markets. Obviously, this is a big decrease, but the impact is dampened by our hedging portfolio. We continue to believe in our disciplined hedging strategy as a way to protect earnings and cash flows from the inherent volatility of commodity prices.

Looking forward, long-term prices haven't moved quite as much as the front end of the curve. Our program economics are quite attractive at the current strip and should generate robust returns and significant free cash flow, which as I've said in the past, we expect to use to deleverage the balance sheet, pursue growth opportunities and return capital to shareholders.

As you likely saw in the media, over the Christmas weekend, we experienced exceptionally challenging weather conditions across our operating footprint, including a once-in-a-generation blizzard within our New York service territory. It's no exaggeration to say that Winter Storm Elliott wreaked havoc in our region, which is particularly noteworthy given that our region is no stranger to big snowstorms. I want to thank all of our employees who went above and beyond the call of duty to keep our system running safely.

Our region needed us to deliver, and the National Fuel team was up to the challenge. Whether it was dealing with freeze-offs at Seneca's wells, keeping our midstream compressor stations operational or assuring the gas supply was adequate, and emergency calls were responded to at the utility, I'm very proud of the effort of our entire National Fuel team.

This storm highlights the importance of resilient weather-hardened infrastructure. Less reliable but critical energy sources faltered, as tens of thousands of customers throughout our service territory were without power at some point during the holiday weekend. Across social media and anecdotally, people expressed their appreciation for natural gas service as they huddled around natural gas fireplaces to stay warm, continued to use natural gas stoves for food preparation, and in many cases, used natural gas generators to run furnaces, appliances or to power entire homes.

Against this backdrop, it's astonishing that New York State policymakers are unwavering in their push for a "rapid transformation" to a predominantly electric future, powered primarily by intermittent wind and solar.

In December of last year, the state's Climate Action Council finalized its Scoping Plan as required by the Climate Act that was enacted in 2019. If adopted as written, the Scoping Plan would remake the way energy is produced, distributed and consumed in most every element of the State economy. The breadth of what's contemplated is truly remarkable. On the demand side, the Scoping Plan would have in New Yorkers electrify almost everything at any cost. This will cause the demand for electricity to skyrocket – electrifying just the space heating demand in our service territory would require a near quadrupling of the electric grid.

On the supply side, the Scoping Plan foresees this increased demand for electricity being met almost entirely with new wind and solar generation.

The scale of what's required is truly unprecedented. Currently, there's approximately 2 gigawatts of wind and solar capacity in the State, which was installed over the course of

the last two decades. To meet its targets, the State will need to install on average, more than 4 gigawatts of wind and solar every year for each of the next 18 years.

Stop and think about that. It's taken us decades to get to our current 2 gigawatts of capacity, but we'll somehow be able to build double that amount each and every year for the next two decades. While many might consider that incredibly aggressive, the Scoping Plan sees it as a sure thing.

And even if the more than 80 gigawatts of wind and solar is built as planned, there will still be as much as a 45 gigawatt shortfall in winter electric generation that cannot be met with existing technologies. Then you have to consider the cost to build the electric transmission infrastructure needed to deliver these increasing power supplies, and utilities will need to make unprecedented investments in system modernization to upgrade electric service in our neighborhoods and address critical grid constraints that exist across our region today, all of which will almost certainly cause electric prices in New York to climb sharply.

On top of that, consumers will bear the cost of converting, which could be as much as \$50,000 per household. Within our service territory, those costs could be crippling with the median income in Erie County at just over \$62,000 and well below that level in the City of Buffalo.

Despite all of this, the Scoping Plan urges policies to encourage a “rapid transformation” by specific dates that aren't tied to any reliability milestones. This is an incredibly irresponsible approach. It makes no sense to mandate the electrification of space in Western New York. When it's uncertain, the necessary power and electric infrastructure will be there to meet the increased demand for electricity that will result.

Instead, the State should embrace a more reasoned approach to the energy transition, one that sets electrification targets that are linked to generation and reliability milestones while also continuously evaluating the cost effectiveness of these actions and their impact on customer affordability.

And I could see it happening in phases. In the near term, the focus should be on proving that wind and solar can be built at the pace contemplated by the Scoping Plan. During that period, consumers should be free to electrify based on their preferences, but there shouldn't be a mandate to do so. And in the meantime, policymakers should encourage “no-regrets” solutions like energy efficiency and improved building insulation, both of which will be required regardless of the energy used in the home and workplace. It should also scale existing technologies like renewable natural gas that can achieve significant emissions reductions now, and it should support research and development for new technologies like hydrogen, which will be critical for hard to decarbonize sectors of the economy.

Once we're satisfied that the wind and solar contemplated is feasible, the state can then move on to another phase, where it encourages hybrid solutions for heating at a pace that's consistent with the build-out of generation.

Our own "Pathway" study has shown that by including a hybrid approach to heating and an "all of the" above energy strategy, emissions from our system can be reduced by more than the 85% called for in the New York climate legislation. And most importantly, by continuing to leverage the natural gas system, this approach is far less costly and goes a long way to ensuring energy reliability in the winter when it's needed most.

Only once the State has developed a cost-effective solution to the 45 gigawatt and winter generation capacity should it even consider moving to full electrification. Based on current technology, that's likely many decades away. Again, forcing electrification before reliability is assured is an incredibly risky proposition. Imagine it during a winter storm with no heat or no reliable means of transportation.

The administration in Albany acknowledges the Scoping Plan is not a legally binding document rather that's intended to serve as a blueprint for the future of energy in the state. The laws and regulations to achieve that blueprint will be written in the months and years to come.

We will be proactive in urging legislators and policymakers to forgo the Scoping Plan's risky "all-in" approach that tries to do everything all at once yet still falls dangerously short and instead embrace a more incremental, "all of the above" approach that sets realistic targets based on existing technologies and builds upon them as technologies improve.

So I've gone on quite a bit on regulatory policy. So now let's bring it back to the quarter.

I'll turn it over to Justin for an update on our nonregulated businesses.

Justin Loweth^ Thanks, Dave, and good morning, everyone. Seneca and NFG Midstream kicked off the year with a strong quarter. Seneca's 91 Bcfe of production was a 3% increase sequentially and an 11% increase when compared to last year's Appalachian production. We've continued our trend of solid operational execution with 17 wells turned in line during the quarter, which was in line with our plan.

Additionally, we saw better-than-expected well performance on these new pads, and we boosted PDP production with some additional compression on the Trout Run system, which was timed to capture peak winter pricing.

These results were particularly impressive given the extreme weather we faced in December related to Winter Storm Elliot. The Seneca and Midstream operations and marketing teams did a brilliant job managing through this multi-day event. In spite of sustained windshield temperatures below negative 30 degrees, we saw limited production impacts with any volumes offline being brought back very quickly. While the basin

experienced significant and sustained production impacts, we estimate less than 0.5 Bcf impact during the quarter.

This is a testament to the entire team who collectively deserve a huge thank you for keeping our production flowing in very challenging conditions, especially given that the storm occurred when most people should be at home and enjoying the holidays with their families.

Turning to our future development activity. Drilling and completion operations are proceeding according to plan.

As a result, our production rate should continue at about 1 Bcf per day net through the second quarter before production ramps up again into the second half of the fiscal year with several pads expected to turn in line in the spring and early summer. This is in line with our prior expectations, and as such, we are maintaining our full year production guidance of 370 to 390 Bcfe. As previously communicated, our first quarter of fiscal '23 had a significant amount of completions activity.

Not only did we have our dedicated frac crew operating in the WDA, but as planned, we also utilized a spot crew in Tioga County for the entire quarter. We have now wrapped up our spot frac activity, and going forward, we will only utilize our single dedicated completions crew across our operations.

As a result, our capital is expected to moderate and level out through the remainder of the fiscal year. Given this is consistent with our prior plans, capital guidance remains unchanged at \$525 million to \$575 million. As we look out to fiscal '24, natural gas prices will govern our level of spending. We will be focused on balancing capital efficiency, growth and free cash flow generation across our integrated development program and will modify our plans to best maximize these factors. Longer term, we remain bullish on natural gas pricing, particularly in fiscal '25 and beyond as new LNG export facilities come online.

Fortunately, a large percentage of our fiscal '23 and fiscal '24 production is protected by hedges and fixed-price firm sales. At the midpoint of our guidance, we have hedges in fixed price firm sales in place for nearly 70% of our expected remaining fiscal '23 natural gas production. We have another 20% with basis protection that is not hedged, which leaves only about 10% of expected production exposed to in-basin pricing. We've been opportunistic with our marketing portfolio over the past few months, locking in favorable basis differentials that result in strong realized prices.

For example, we recently locked in a long-term basis of NYMEX plus \$0.50 for some of our Leidy South capacity.

We remain committed to building a marketing and hedging portfolio that delivers strong returns and supports meaningful free cash flow generation. This positions us well for stability through commodity price cycles, which can be hard to predict.

At Midstream, we are focused on system expansion to meet both Seneca and our third-party shippers' needs with particular emphasis on meeting our customers turned in line target dates. Additionally, for Seneca, we are building out centralized facilities in our Tioga system and ensuring gathering lines are in place to provide fuel gas to Seneca's e-frac fleet, which will allow us to displace substantially all-diesel fuel for completion operations with dual benefits of both lower emissions and lower fuel costs. We also continue to focus on growing our third-party shipper throughput. With over 400 miles of gathering lines able to connect into multiple interstate pipelines, there are various opportunities to serve third-party producers proximate to our existing systems.

During the quarter, we signed an updated agreement with a third-party shipper and expect additional volumes to flow in our system later this year. While this project is not a game changer, it demonstrates the value of our system and our willingness to develop commercial arrangements to tie in incremental volumes. In fiscal '23, I expect third-party volumes will represent about 10% of system throughput, up from zero just three years ago, and we will continue to chase similar third-party opportunities to drive value from our midstream systems in the years to come.

Turning to our Sustainability practices. I want to highlight some of our recent work and achievements. In our Gathering business, we commenced the Equitable Origin certification process and hope to complete the process by the end of the year.

And at Seneca, we completed our annual Equitable Origin Re-Verification Assessment in December '22, demonstrating continuous improvement under all 5 principles of the EO100 Standard for Responsible Energy Development. We continue to focus on emissions monitoring and have made strides there as well.

We are using LIDAR and OGI equipment mounted to aircraft to identify and measure methane emissions across our operations, and we are evaluating the potential to use satellites in the future.

In conclusion, it was a great quarter across the board.

As we look forward, lower natural gas prices will impact our near-term cash flow, but the combination of growing production, holding the line on capital and a robust marketing and hedging portfolio mitigates a good portion of that decrease.

Beyond '23, Seneca's deep inventory of high-quality acreage combined with our low-cost integrated approach to development, positions us very well for strong returns and continued growth.

With that, I'll turn the call over to Karen.

Karen Camiolo^ Thanks, Justin, and good morning, everyone. Last evening, National Fuel reported first quarter fiscal 2023 Adjusted Operating Results of \$1.84 per share, up 24% compared to last year.

Dave and Justin already hit on the high points for the quarter, so I'll briefly touch on one other item. At the Utility, I want to remind everyone of the impact of an order issued in our New York jurisdiction relating to our pension and post-retirement benefit plans.

Based on the fully funded status of these plans, we made a filing last summer, seeking to temporarily suspend recovering revenue from our customers in connection with these obligations.

While this order has no earnings or cash flow impact to National Fuel, it does lead to a drop of approximately \$18 million in EBITDA, which is fully offset by a benefit to non-service costs that fall below operating income. During the quarter, the impact to revenue, and therefore EBITDA, was a reduction of about \$4 million. This was correspondingly offset with lower non-service costs. Looking forward, we'd expect this EBITDA impact to be largest in our fiscal second quarter as the revenue impact mirrors customer volumes, which are highest during these peak winter months.

Turning to guidance. We've lowered our full year earnings guidance to a range of \$5.35 to \$5.75 per share. This decrease was almost entirely attributable to the drop in natural gas prices, partially offset by some smaller tailwinds across all of our businesses.

We're now forecasting NYMEX pricing to average \$3.25 per MMBtu for the last three quarters of the year. Somewhat offsetting this is the modest improvement in Appalachian basis differentials, which we now expect to average \$1 per MMBtu for the remainder of the year. As Justin mentioned, we have firm sales in place for 90% of our remaining expected production and fixed price firm sales or hedges in place for nearly 70% of our remaining expected production. We also entered into some favorable collars during the quarter, adding 11 Bcf of new positions with a \$4.75 floor for April through October.

These are well timed and helped to mitigate some of the impact we've seen with this recent pricing pullback. While our hedge portfolio adds a nice level of protection, we still do retain exposure to movements in pricing.

To that end, a \$0.25 decrease from our updated NYMEX guidance price will impact earnings by \$0.21 per share for the year. Keep in mind that we do have 65 Bcf of costless collars, so this impact is not necessarily linear. As noted in the release in our investor presentation, the remainder of our earnings guidance assumptions are largely unchanged. We are holding our capital spending forecast the same with a range of \$830 million to \$940 million for the full year.

Moving on to cash flows. We are now expecting funds from operations to exceed capital spending by \$200 million for the fiscal year. This is a reduction of about \$125 million

from our prior estimate. The impact of lower pricing is being partially offset by a lower expected cash tax rate this year.

Previously, we were expecting our cash tax rate to be in the high single digits, but with our lower forecasted taxable income, that is now forecasted to be around 5% to 6% for the year.

While our FFO is lower, we are projecting a larger source of working capital for the year, principally due to an expected decrease in receivables at Seneca and lower storage injection costs at the Utility based upon our lower natural gas price assumptions. These improvements are expected to keep our total cash flow after capital spending generally consistent with last quarter.

In addition to operating cash flows, we also have reduced hedging collateral deposits to zero as of today, down from \$90 million to start the year. As a result, we are well positioned to deliver on our near-term goal of deleveraging. We originally had \$549 million of long-term debt maturing next month. Last fall, we borrowed \$250 million on our 364-day term loan, which matures at the end of June.

A portion was used for working capital needs and the remainder was used for an early redemption of \$150 million of our March maturity. Next month, we expect to redeem the remaining \$399 million, largely with cash on hand. We expect to meet any shortfall using short-term liquidity.

This leaves us right on track with our plans in the near term. Longer term, the forward NYMEX curve is still averaging near \$4 per MMBtu in 2024 and beyond. At that level, we'd expect to see steady growth in our free cash flow based upon our current plans.

Furthermore, our integrated model and consistent and methodical approach to hedging provide a level of stability and predictability that underpin our cash flow outlook. Combining this with credit metrics that continue to improve and are headed towards the mid-BBB area, we expect to have great flexibility as it relates to capital allocation decisions going forward.

With that, I'll ask the operator to open the line for questions.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question today comes from John Abbott from BofA.

John Abbott^ My first question is to you, Dave. It's -- my first question is -- yes, my first question was potential deal opportunities.

In the past, Dave, you'd express some interest and potentially adding to your regulated businesses. Now assuming that something did become available, what sort of size would

you be sort of thinking about that if you were to go down that path? And how do you sort of think about a potential funding of that opportunity if that were to become available?

David Bauer^ Yes. Well, ideally, it would be of a size that we could do within our balance sheet or with a, call it, a modest amount of equity.

That puts it in a kind of more modest-sized transaction to the extent that we were to look to go bigger than that, we have to be more creative in how we finance it either with a partner or some other means.

John Abbott^ And then my second question is for you, Karen. I mean, you, appreciated the color on cash taxes for this year. I think you said, around 5% or 6%. How -- if you sort of look into the future, Karen, you look into 2024, how do you see cash taxes progressing at this point in time based off strip pricing?

Karen Camiolo^ So there will be an increase, but we're largely looking at moving into the, call it, lower teens at current strip prices going out into '24, '25.

Operator^ Our next question today comes from Trafford Lamar from Raymond James.

Trafford Lamar^ First one centers around CapEx. Obviously, unchanged for the full year. And I guess, for Justin, how are you kind of viewing the OFS environment right now with regards to inflation? Obviously, you are a quarter ahead of most of the Appalachian E&Ps. And so just kind of seeing maybe peaked from '22 levels? Or you're still seeing kind of a higher rate of inflation similar to last year?

Justin Loweth^ Sure. Yes. So right now with where we sit, I would say, generally, the service costs have kind of peaked. It's always hard to say exactly the peak goes flat from here or maybe we come down depending upon obviously commodity prices.

But if you're thinking more holistically across the industry, what that really means, though, is anyone entering a new contract, it's going to be at a higher level. But from the current levels that people are entering, it's largely -- it seems to largely be kind of reaching the max of where they're going on major services.

More specific, as it relates to Seneca, we pretty much have most of our services certainly for the balance of this fiscal year locked in. We have a new contract we executed with NexTier on our e-frac fleet as well as working on some of our longer-term rig contracts.

But generally for the most part this year, most of that's locked in. So we're pretty relatively insulated from any further inflation beyond what I've already talked about. So we feel confident in our budget and our guidance that we put forth.

Trafford Lamar^ Perfect. Appreciate the color on that. And then our second question now similar to John's question earlier.

What about at this price environment, potential bolt-on opportunities for Seneca? How do you look at that? And then kind of, I guess, what's kind of the bid-ask spread been going around given the recent fall in natural gas you are seeing where opportunities come available.

Justin Loweth^ Yes. So we haven't seen a lot of new stuff come available. It's always tricky in a rapidly increasing or declining market on trying to find meet in the middle on what value makes sense. We remain very interested in opportunities that kind of fit us nicely. And so when I talk about that proximate or contiguous with our existing acreage, ideally have some element of takeaway capacity.

We love it if it has a gathering midstream angle. So we're continuing to look at opportunities that offer us those kind of -- some or all of those attributes. And really, we'll kind of watch to see as the prices evolve. I'm hopeful that there'll be more -- that will come available, but there's definitely bid asks are wide just given how much volatility we've seen on the way up, and it will probably be hard for people to accept a lower price given what they could have done if they just executed, say, three months ago.

Trafford Lamar^ Yes, that makes perfect sense. Okay. Congrats on a great quarter.

Operator^ Our next question today comes from Umang Choudhary from Goldman Sachs.

Umang Choudhary^ My first question was, I really appreciate your comments around the scoping plans, and to the extent you can share any insights and color regarding -- on the discussions which you're having with the regulators or the policymakers about managing the need to decarbonize as well also maintaining reliability of service be appreciated.

And then just to bolt-on to that question, how are you thinking about your business mix longer term as to grow EPS and dividend while managing this potentially -- which could potentially be a regulator risk down the road?

David Bauer^ Yes. Yes. So on the -- our engagement with regulators, the New York Public Service Commission, has got a series of proceedings on the future of not just the gas business, but also the -- all of the utility business in the State, and we've been active participants with that and have made a number of filings that we've gone back and forth on with the State. I mean it's still really early innings on this, but the discussion so far has been constructive.

In terms of the long-term business mix, I'd like to see a balance between regulated and nonregulated. And at times, we may be higher on the nonregulated side than regulated. But I think over time, we'll be able to achieve that balance and the Utility will be an important part of that.

Umang Choudhary^ Got you. That's really helpful. And then I guess just to follow up on that previous discussion. It sounds like a lot of your rig and your completion crews are under contract here, and to your point, you are hedged out in the near term.

So I was wondering if there's any price levels at which you will look back at your activity levels for this year. Like maybe it's beneficial to push the completions out by a quarter or two quarters because the pricing is a little bit more favorable down the road. Because we agree with you, the long-term outlook is much more favorable with LNG coming online in 2025 and beyond.

Justin Loweth^ Yes, absolutely. So we are not -- while we've spoken to and I've mentioned this on a number of calls that our longer-term plans envision continued growth in kind of the mid to single digits at least for the -- call the near to intermediate term, that's not something that we can't evolve.

And so we're going to be very mindful of the price environment. We're going to try to really balance capital efficiency, growth and free cash flow generation. We want to achieve the best mix of those three things. And if that means we're going to make some delays or slow things down, then that will make the most sense. So really what I guess I would just want to make sure it's really clear is, we're going to strive to find the optimal balance of those three things, and if we have a view or we're locking in longer-term pricing that we think makes sense to defer some things, then we'll be very open to evaluating that and incorporate into our longer-term operations plan.

Operator^ (Operator Instructions)

So we have no further questions at this time, so I will hand you back over to Brandon Haspett for closing remarks.

Brandon Haspett^ Thank you, Dru. We'd like to thank everyone for taking the time to be with us today. A replay of this call will be available this afternoon on both our website and by telephone and will run through the close of business on Friday, February 10. To access the replay online, please visit our Investor Relations website at investor.nationalfuelgas.com; and to access by telephone, call 1-866-813-9403 and enter conference ID number 856816. This concludes our conference call for today. Thank you, and goodbye.

Operator^ That concludes today's National Fuel Gas Company Q1 FY 2023 Earnings Conference Call. You may now disconnect your lines.