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One Gas, Inc. (OGS)

Q4 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Please stand by. We are about to begin. Good day, everyone, and welcome to the ONE Gas Fourth Quarter 2014 Earnings Conference Call. Today's conference is being recorded. At this time, I'd like to turn the call over to Mr. Andrew Ziola. Please go ahead, sir.

Andrew Ziola

Vice President-Investor Relations & Public Affairs

Thank you, and welcome, everyone. This call is being webcast live on the Internet, with a replay made available. After our prepared remarks this morning, we'd 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 provision of the Securities Acts of 1933 and 1934. Actual results could differ materially from those projected in any forward-looking statement. For a discussion of factors that could cause actual results to differ, please refer to our SEC filings.

Our first speaker this morning is Pierce Norton, President and Chief Executive Officer. Pierce?

Pierce H. Norton

President, Chief Executive Officer & Director

Thanks, Andrew. Hello, everyone, and thanks for joining us for the call. We appreciate your interest and investment in ONE Gas.

Joining me on the call today is Curtis Dinan, our Chief Financial Officer. On this morning's call, we will cover the following four topics. Review fourth quarter and full year 2014 results, discuss our successful transition into a standalone company, provide a brief regulatory update, and then we'll take your questions.

We're extremely pleased with how we transitioned into a standalone 100% regulated utility this past year. In 2014, our results were positively impacted by new rates in Oklahoma and Texas. Our level of capital spending reflects our continued commitment to invest in safety and reliability in our systems, and we expect to recover these costs through our regulatory mechanisms. We average 13,000 more customers in 2014, which is approximately 0.6% compared with 2013, which also contributed to our results. In addition, we earned incremental margin from volume increases from compressed natural gas, commercial and industrial customers.

Operating costs were higher compared with last year's reflecting expenses related to the separation from ONEOK. However, the costs related to the separation were lower than originally anticipated. Curtis will discuss the numbers in more detail in a moment.

Our transition into a standalone company was very well executed. I'm extremely proud of our employees and the effort they made to ensure the process went smoothly, completing the separation of projects on time and on budget, and in certain projects, earlier and under budget. All while maintaining the high quality service our customers and employees expect and deserve. We were essentially independent from our shared services arrangement with ONEOK at the end of 2014. And we began 2015 excited to execute on our strategy and to continue to bring value to our customers, employees, shareholders and communities. We can now take many of those resources used to stand up the company, and focus them on implementing efficiency upgrades in the field.

Curtis will now review the financial highlights for the quarter and full year 2014. Curtis?

Curtis L. Dinan

Chief Financial Officer, Treasurer & Senior VP

Thanks, Pierce, and good morning. Fourth quarter net income increased to \$36.6 million or \$0.69 per diluted share compared with \$30.3 million or \$0.58 per diluted share for the same period last year. 2014 net income increased to \$109.8 million or \$2.07 per diluted share compared with \$99.2 million or \$1.90 per diluted share in 2013.

Last month, the One Gas board of directors declared a dividend of \$0.30 per share, an increase of 7% compared with the previous dividend of \$0.28. This dividend level is consistent with the company's expected 55% to 65% dividend payout ratio and our expected average annual dividend increases of 6% to 8% over the next five years.

Pierce discussed the factors behind the increase and our results year-over-year. And I'd like to give more detail around the operating costs related to the separation as well as what to expect in 2015.

2014 operating cost increased due to outside service cost, including cost associated with the separation from ONEOK, an increase in insurance and IT expenses, which is part of the previously disclosed annual recurring increase of \$11 million and an increase in employee-related costs, related to higher labor and compensation cost, including at risk compensation.

Early last year, we estimated the cost associated with the separation would total approximately \$12 million, which we later revised to \$9.2 million. Actual costs totaled approximately \$7 million. This reduced amount came primarily from IT projects that were completed ahead of schedule and under budget.

Full year 2014 depreciation and amortization was \$125.7 million compared with \$144.8 million in 2013. This decrease was driven by a one-time \$10 million regulatory asset charge in December 2013 related to the settlement agreement approved by the Kansas Corporation Commission authorizing the separation of Kansas Gas Service assets to One Gas from ONEOK. Additionally, the expiration of the take or pay rider at Oklahoma Natural Gas and lower amortization of the ad valorem surcharge rider at Kansas Gas Service contributed to lower depreciation and amortization, but did not impact net income as the amounts are equally offset by lower revenues.

Full-year 2014 interest expense was \$45.8 million compared with \$61.4 million in 2013. This decrease was due to the company's separation from ONEOK and the initial debt offering as a standalone company. We ended the fourth quarter with total debt to capitalization ratio of 41% and do not anticipate any equity needs in our five-year financial plan. At December 31, 2014, we recalculated our pension liability and adopted the new mortality tables

that were published last October. Additionally, the discount rate used in our actuarial calculation declined by 100 basis points to 4.25%. Both of these items are consistent with our 2015 earnings guidance. The impact of these two factors resulted in our pension plan being approximately 82% funded at year-end.

Now on to 2015 guidance, we affirmed our net income range of \$108 million to \$113 million (sic) [\$118 million] (7:56), and we expect our earned ROE for 2015 to be 7.4%, compared with an ROE of 7.6% for 2014, reflecting capital lag and rate case outcomes affecting 2016 and 2017. The legislation that was passed at the end of 2014, extending retroactively 50% bonus depreciation for all of 2014 had a positive impact on our cash flows of approximately \$55 million that will be reflected in 2015. However, it does not impact our 2015 net income guidance.

We expect capital expenditures to be \$300 million in 2015, with more than 70% targeted towards system integrity and replacement projects. These capital expenditure levels are the same as indicated in our 2015 guidance issued in December. At December 31, 2014, our current authorized rate base defined as the rate base established in our latest regulatory proceedings including full rate cases and interim rate filings is approximately \$2.3 billion. Considering additional investments in our system and other changes in the components of our rate base that have occurred since those regulatory filings, we project that our rate base in 2015 will average approximately \$2.7 billion with 41% of that being a rate base in Oklahoma, 34% in Kansas and 25% in Texas.

Pierce, that concludes my remarks.

Pierce H. Norton

President, Chief Executive Officer & Director

Thanks, Curtis. Now for a brief regulatory update. This past November, the Kansas Corporation Commission approved our annual request for interim rate relief under the gas system reliability surcharge, our GSRS, for an increase in base rates of approximately \$3.5 million, which became effective in December 2014.

The next Kansas general rate case filing is expected to be in May 2016, using 2015 as a test year, with new rates effective in January 2017. Oklahoma Natural Gas will file the general rate case in August based on a test year consisting of 12 months ending March 31, 2015. We expect the outcome of this rate case to be reflected in our financials early 2016.

On February 11, Texas Gas Service made an annual filing for Interim rate relief, under the Gas Reliability Infrastructure Program, or GRIP statute, for its Central Texas service area in the amount of \$3.7 million. If approved, the new rates will become effective in mid-April.

CNG continues to be an increasing source of revenue in our territory. At December 31, 2013, we supplied 100 stations. At December 31, 2014, that number had increased to 114.

When you look at the amount of dekatherms that has been dispersed through all those stations, we've increased volumes by 47%, since last year. Although we started with relatively low volumes, this data tells us that our strategy is working to let the free market spend capital on CNG station infrastructure and we'll collect incremental transport revenues.

In closing, I'd like to thank our 3,300 employees for their hard work and dedication, as we successfully transitioned into a standalone company. While continuing to serve our customers and operate our assets safely and reliably every day.

I appreciate your efforts and commitment to excellence. Operator, we're now ready for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you, sir. [Operator Instructions] And at this time, I'm showing no questions in queue. I'd like to turn the call back to you, Mr. Ziola, for any additional or closing remarks.

Andrew Ziola

Vice President-Investor Relations & Public Affairs

Thank you very much, everybody, for joining us this morning. Our quiet period for the first quarter starts when we close our books in early April and extends until we release earnings on April 29 after the markets close. We'll provide details on that conference call at a later date. Thank you for joining us and have a wonderful day.

Operator: And that does conclude today's conference. We do thank you for your participation. Please have a great day.

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