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# ONE Gas, Inc. (OGS)

Q1 2019 Earnings Call

## CORPORATE PARTICIPANTS

Brandon Lohse  
*Director-Investor Relations, ONE Gas, Inc.*

Caron A. Lawhorn  
*Senior Vice President & Chief Financial Officer, ONE Gas, Inc.*

Curtis L. Dinan  
*Senior Vice President-Commercial, ONE Gas, Inc.*

Pierce H. Norton II  
*President, Chief Executive Officer & Director, ONE Gas, Inc.*

## OTHER PARTICIPANTS

Aga Zmigrodzka  
*Analyst, UBS Securities LLC*

Christopher Paul Sighinolfi  
*Analyst, Jefferies 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 would 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 2019 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 our Safe Harbor provision of the Securities Acts of 1933 and 1934. 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 Caron Lawhorn, Senior Vice President and Chief Financial Officer; Curtis Dinan, Senior Vice President, Commercial; Sid McAnnally, Senior Vice President, Operations; and Pierce Norton, President and Chief Executive Officer.

And now, I'll turn the call over Caron.

Caron A. Lawhorn  
*Senior Vice President & Chief Financial Officer, ONE Gas, Inc.*

Thanks, Brandon. Good morning, everyone, and thank you for joining us today.

Net income for first-quarter 2019 was \$93.7 million or \$1.76 per diluted share, compared with \$90.8 million or \$1.72 per diluted share for the same period last year.

Our first-quarter results reflect new rates in Kansas, higher sales volumes, net of weather normalization in Texas and Kansas, and residential customer growth in Oklahoma and Texas. Operating costs for the first quarter were \$124.5 million, compared with \$118.8 million in the same period last year, primarily due to an increase in employee and legal related costs. We also experienced increased interest expense from replacing \$300 million of our maturing senior notes with \$400 million of new senior notes at a higher interest rate.

In Oklahoma and Kansas, we have begun returning excess accumulated deferred income taxes to customers, which is reflected as a reduction of revenues. Accordingly, we are also amortizing the associated regulatory liability through deferred income tax expense. As a result, our effective tax rate, including excess tax benefits on vested share-based compensation, for first-quarter 2019, is approximately five percentage points lower than the prior year, 16.6%, compared with 21.5% and it's consistent with our guidance for 2019. As previously indicated, the return of excess ADIT to customers is not expected to have a material impact on our net income.

Yesterday, the ONE Gas board of directors declared a dividend of \$0.50 per share, the same as the previous quarter. The dividend is consistent with the company's guidance for 2019. As we had indicated previously, we expect the average annual dividend increase to be 7% to 9% between 2018 and 2023, with a targeted dividend payout ratio of 55% to 65% of net income. We also reaffirmed our 2019 earnings per share guidance of \$3.27 to \$3.57 per share.

Authorized rate base, reflecting the recently completed regulatory activity in Oklahoma and Kansas, is approximately \$3.33 billion. Authorized rate base is defined as the rate base reflected and completed regulatory proceedings, including full-rate cases and interim rate filings. We project that for 2019, our estimated average rate base, which is defined as authorized rate base plus additional investments in our system and other changes in the components of our rate base that are not yet reflected in approved regulatory filings, will be approximately \$3.61 billion with 42% in Oklahoma, 29% in Kansas and 29% in Texas.

ONE Gas ended the quarter with approximately \$403 million of capacity under our commercial paper program and we do not anticipate any equity or capital market needs in 2019.

And now, I'll turn it over to Curtis Dinan for regulatory updates. Curtis?

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## Curtis L. Dinan

*Senior Vice President-Commercial, ONE Gas, Inc.*

Thanks, Caron, and good morning, everyone.

Let's begin with Oklahoma. In March, Oklahoma Natural Gas filed its third annual performance-based rate change filing or PBRC since the last general rate case that was approved in January 2016. This filing was based on a 2018 test year and includes two proposed customer credits. The first is a PBRC credit of \$15.4 million to be returned to customers over a 12-month period. This proposed credit represents all earnings, including amounts attributable to tax savings that are above the authorized ROE of 9.5% for 2018. The second proposed credit is \$12.7 million, associated with excess ADIT. We have one more PBRC filing in 2020 before a full rate case is required to be filed in 2021.

Moving on to Kansas, the Kansas Corporation Commission approved the settlement of Kansas Gas Services rate case and we implemented new rates in February. The net base rate increase is \$18.6 million and reflects an

amortization credit for the refund of excess ADIT. In a separate order, the KCC required Kansas Gas Service to refund its tax reform liability of \$16.6 million to its customers through a one-time bill credit. Customers will see this refund during the second quarter of 2019.

Looking ahead in Kansas, we plan to file our next Gas System Reliability Surcharge or GSRS, in August for the period covering September 2018 through June 2019. The new GSRS legislation that was passed last year, which expanded the definition of eligible capital expenditures, will apply to this filing. With this change in Kansas, approximately 90% of all capital spending for ONE Gas will be subject to an annual filing.

Finally, in Texas; in March, Texas Gas Service made Gas Reliability Infrastructure Program or GRIP filings for all customers in the West Texas and the Central Texas service areas for increases of \$4.1 million and \$5.5 million respectively. We anticipate new rates will be effective in July of this year. At this point, we've dealt with the majority of issues relating to tax reform as it relates to our customers, with the exception of excess ADIT in Texas. We will be working with our Texas regulators to determine how excess ADIT will be addressed.

And now, I'll turn it over to our CEO, Pierce Norton. Pierce?

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## Pierce H. Norton II

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

Thanks, Curtis, and Caron.

As we look ahead to the rest of 2019, our focus strategy is unchanged and centers on continuously improving the safety and reliability of our system. We expect to invest \$2.4 billion in our system over the next five years. To support this level of capital spending, we continue to build capacity in the resources that are required to plan and execute the work. This includes advances in supply chain and logistics, the utilization of emerging technologies and improved efficiency of internal and external labor.

Powering appliances with natural gas provides excellent value to our customers and we continue to work to find more efficient ways to provide better customer service. To maintain this competitive pricing advantage, we remain mindful of our financial metrics and the customer bill impacts. We would not be able to achieve our safety and reliability goals without the dedication of our more than 3,500 employees. I want to thank them for their contribution and for working hard every day, to serve our 2.2 million customers.

Thank you all for joining us this morning, and we look forward to seeing many of you at the American Gas Association Financial Forum in a few weeks.

Operator, we're now ready for questions.

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. [Operator Instructions] We will pause for just a moment to allow everyone an opportunity to signal for questions. And we'll take our first question from Aga Zmigrodzka of UBS. Please go ahead.

Aga Zmigrodzka  
*Analyst, UBS Securities LLC*

Q

Good morning.

Pierce H. Norton II  
*President, Chief Executive Officer & Director, ONE Gas, Inc.*

A

Good morning, Aga.

Aga Zmigrodzka  
*Analyst, UBS Securities LLC*

Q

In early April, [ph] some senators (00:09:24) announced new legislation they'll lay on the – around the Pipeline Safety Act, so [ph] as to raise the (00:09:29) risk related to the distribution pipelines' most recent incident. Could you please maybe comment how the proposed legislation could impact One Gas and the industry as a whole? Thank you.

Pierce H. Norton II  
*President, Chief Executive Officer & Director, ONE Gas, Inc.*

A

Aga, I want to get clarification; are you talking about the legislation that's proposed at the federal level?

Aga Zmigrodzka  
*Analyst, UBS Securities LLC*

Q

Yes.

Pierce H. Norton II  
*President, Chief Executive Officer & Director, ONE Gas, Inc.*

A

Okay. I'll let Curtis answer that question.

Curtis L. Dinan  
*Senior Vice President-Commercial, ONE Gas, Inc.*

A

Sure, Aga. This is Curtis. And we obviously have reviewed that legislation. What I would say is, it's pretty early in the process, so trying to handicap where that might go is really difficult to say at this point. We do have, same at the federal level as in the state levels, folks involved in monitoring the legislation and providing input where needed. So, it's really a little bit difficult to be too specific at this point, but again, we are aware of it and we're continuing to monitor what's there.

Aga Zmigrodzka  
*Analyst, UBS Securities LLC*

Q

Thank you and second question's more a housekeeping question, so in 1Q the weather was significantly below normal and you reported margin increase by \$3.3 million related to higher sales. Could you please discuss how ONE Gas can benefit from colder weather despite having weather normalization mechanism?

Pierce H. Norton II

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

A

Aga, I'm going to let Caron answer that question.

Caron A. Lawhorn

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

A

Good morning, Aga. This is Caron. So our weather normalization mechanisms are not perfect. So they're designed to offset – or to put us back to normal weather obviously, but it's – they are complicated algorithms, and they don't – they just don't work perfectly, especially in Texas. We have several jurisdictions in Texas, each with their own set of weather [ph] norm (00:11:12) parameters, and again, they just don't work exactly.

So we get pickups some time, especially in the shoulder months, I know March is not really a shoulder month, but that can happen as well.

Aga Zmigrodzka

*Analyst, UBS Securities LLC*

Q

Thank you a lot for your call.

Pierce H. Norton II

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

A

Thank you, Aga.

**Operator:** Thank you. And we'll take our next question, this coming from Chris Sighinolfi of Jefferies. Please go ahead.

Christopher Paul Sighinolfi

*Analyst, Jefferies LLC*

Q

Hi, good morning, guys.

Pierce H. Norton II

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

A

Hi, good morning, Chris.

Christopher Paul Sighinolfi

*Analyst, Jefferies LLC*

Q

Hi, Chris.

Christopher Paul Sighinolfi

*Analyst, Jefferies LLC*

Q

Hi, Pierce. A quick question, and I don't know if this is [ph] pertains (00:11:48) to Caron, the Kansas refund that's coming here in the second quarter, is that something a cash flow item, given it pertains to prior periods, or would that be recognized in earnings?

Pierce H. Norton II

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

A

Yeah, Chris that's more of an accounting question, so I'm going to let Caron answer that one.

Caron A. Lawhorn

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

A

Good morning, it's Caron. Yes, we do have that liability accrued. You'll notice, we disclosed that we accrued an additional \$2.4 million in 2019, and the remainder of that was already accrued in 2018.

Christopher Paul Sighinolfi

*Analyst, Jefferies LLC*

Q

Okay. So, it's not sort of an acute item that we'd see reflected next quarter. It's been accounted for and will lead up to a [indiscernible] (00:12:30)...?

Caron A. Lawhorn

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

A

It's been accounted for and it's cash flow, correct.

Christopher Paul Sighinolfi

*Analyst, Jefferies LLC*

Q

Yeah, okay. That's what I suspected; just want to check. And then you guys had mentioned, Caron, in the release last night, just on the other income line, some, I'm imagining it's equity market performance that was strong in the first quarter with regard to some of your non-qualified employee pension or benefit programs. Just curious, is there a baseline assumption that you make in the guidance for the performance of those plans and I guess, with the strength in the first quarter, have you sort of exceeded what might have been in the guidance or any color on that front would be helpful.

Caron A. Lawhorn

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

A

Yeah, we don't bake in any kind of anticipated earnings on those plans. We expect them to be essentially neutral. So, we experienced that pick-up in the first quarter, but there's a possibility that we could give it back later on the year depending on how the markets perform.

Christopher Paul Sighinolfi

*Analyst, Jefferies LLC*

Q

Okay. That is – those are my two clean-ups. Thanks a lot for the time.

Pierce H. Norton II

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

A

Thank you, Chris.

**Operator:** Thank you. [Operator Instructions] As we have no further questions, I'll hand the call back to you for any additional or closing remarks.

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## Brandon Lohse

*Director-Investor Relations, ONE Gas, Inc.*

Great. 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 extend until we release earnings in late July. We'll provide details on the conference call at a later date and have a great rest of your day.

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**Operator:** This concludes today's call. Thank you all for your participation. You may now disconnect.

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