Atmos Energy
Third Quarter 2019 Earnings Conference Call
August-07-2019

Operator: Greetings and welcome to the Atmos Energy Third Quarter Earnings call. At this time, all participants are in a listen-only mode. A question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, press *0 on your telephone keypad. As a reminder, this conference is being recorded. I would now like to turn the conference over to our host, Jennifer Hills, Vice-President of Investor Relations. Thank you, you may begin.

Jennifer Hills: Thank you Diego. Good morning everyone, this is Jennifer Hills, Vice-President Investor Relations, and thank you for joining us. This morning I'm joined by Mike Haefner, President and CEO, Kevin Akers, Executive Vice-President, Chris Forsythe, Senior Vice-President and CFO and Kim Cocklin, Executive Chairman. This call is being webcast live on the Internet and our earnings release and conference call slide presentation are available on our website, at: atmosenergy.com under Company and Investor Relations. As we review these financial results and discuss future expectations, please keep in mind that some of our discussion might contain forward-looking statements within the meaning of the Securities Act and the Securities Exchange Act.

Our forward-looking statements and projections could differ materially from actual results. The factors that could cause such material differences are outlined on slide 27 and are more fully described in our SEC filings. Our first speaker is Mike Haefner, President and CEO of Atmos Energy. Mike?

Mike Haefner: Thank you, Jennifer, and good morning everyone, and happy birthday, Jennifer. In investor relations, nothing says "Happy birthday," more than hosting an earnings call, so congratulations. Yesterday, we reported our fiscal 2019 third quarter results, and I'm pleased to report that we're on track to meet our fiscal 2019 earnings per share value of $4.25 to $4.35, an increased earnings per share for the 17th consecutive year. Capital spending increased 10% during the first nine months of the fiscal year, which demonstrates our commitment to modernizing our system. Approximatively 87% of this spending, was focused on safety and reliability investment, as we continue to execute a risk-based capital spending program to modernize our distribution and transmission systems.

Through June 30th, 2019, we've completed $2.1 billion dollars of financing, which has supported at fiscal 2019 capital spending, further strengthened our balance sheet, lowered the cost of financing for our customers and leaves us very well positioned to maintain our credit ratings for the long-term. We continue to invest in technology, our people and processes to achieve operating excellence, and scale our capabilities, to sustain our safety-driven strategies. With the team we have in place, we're extremely well positioned for continued success into the future.

Yesterday, we announced that I'll step down from my role as President and Chief Executive Officer, effective September 30^{th} to focus on my health. I'll remain with the company through the end of the calendar year to support the transition and I'll retire from the company and plan to step down from the board effective January 1^{st} of 2020. I also announced yesterday that Kevin Akers, currently Executive Vice-President has been appointed by the board to succeed me as President and CEO and become a member of the board effective October 1^{st} of this year.

Kim Cocklin will continue as Executive Chairman. This was a very difficult decision for me, but it's the right decision for the company, for me, and for my family. I've been facing a recent health issue that to this point has eluded a definitive diagnosis. I'm extremely optimistic this will resolve itself favorably in the long run, however, it's requiring an increasing amount of my time and it necessitates me pulling back on my commitment. This decision was made much, much easier for me by the fact that Kevin Akers is ready to assume the role of President and Chief Executive Officer. Kevin's a proven leader with broad company and industry experience, the majority of his nearly 29 years with the company has been in senior leadership positions.

He has deep operating experience, having previously served for overall for nine years as President of our Kentucky Mid-States Division, five years as President of our Mississippi Division and more recently, took on responsibility for the company's pipeline and storage operations. For the past several years, Kevin also oversaw our pipeline safety, supply chain, and customer service function. And he's been instrumental in driving the process improvement and technology initiative that has enabled the company to scale its operation to sustain our success. Many of you already know Kevin from our analyst days, the past two years as well as the AGA Financial Forum and other investor conferences this year.

Kevin is surrounded by a very seasoned senior leadership team, Chris and the rest of our management committee will continue in their current roles. They've worked closely together for many, many years, and, even prior to being on the management committee. Not only are they respected colleagues, but they're also friends. And Kevin has the full support of our 4,700 employees. One of our board's most important responsibilities is succession planning and he's done that masterfully over our 36 years as an independent public company. This succession plan has been in place for several years, and just as with prior transitions from our founder Charlie Vaughan, to Bob Best, to Kim Cocklin to me, the transition to Kevin will be completely seamless.

As I mentioned earlier, Kim will continue in the role of Executive Chairman. I'll be forever grateful to him as a great leader, as a mentor, and a friend. His continued involvement in the company as Chairman as well as Advisor to the Cabinet and the rest of the management committee will provide further assurance of the company's continued success. And lastly, before I turn the call over to Chris, for the financial update, I'd like to thank the investors and analysts that I've have had the distinct pleasure to get to know over the past four years.

Your support and investment of time and capital has been so critical to the success of our safety investment strategy. Your insights and challenging questions have made us a better company and has made me a better leader. I'd also like to thank our 4,700 employees for their continued outstanding efforts, to improve every day to deliver safe, reliable, affordable, and exceptional natural gas service to the 3.3 million customers we serve in over 1,400 communities in our eight-state footprint.

They come to work every single day focused on safety or providing excellent customer service and executing our capital spending program, focused on modernizing our system. It's been my greatest honor to serve alongside them, for the past 11 years. They are the reason that Atmos Energy will continue to be successful for the long-term. Chris, over to you.

Chris Forsythe: Thank you, Mike and good morning, everyone. Yesterday, we reported 2019 Third Quarter net income of 80 million dollars of $0.68 per diluted share and there was $71 million dollars or $0.64 per diluted share in the prior year third quarter. Year-to-date net income was $453 million dollars or $3.88 per diluted share, and current, $564 million dollars or $5.09 per diluted share in the prior year period. Fiscal 2018 year-to-date results included $166 million dollar, a $1.49 per diluted share non-recurring income tax benefit from tax reform. Excluding the tax benefit, adjusted net income was $398 million dollars or $3.60 per diluted share. Our third quarter results were in line with our expectations, it made the drivers underlying our performance during the first half of the year, continuing to the third quarter. Slide 5 and 6 provide details for our quarter and year-to-date results.

I will touch on a few of the highlights. In our distribution segment, operating income increased $14.4 million dollars to $48.7 million dollars in the third quarter, as a modest increase in contribution margin was offset by our higher operating expenses. Contribution margin increased up $1 million-dollar quarter after quarter. We experience a $7 million dollar increase in new rates and a nearly $3 million dollar increase from customer growth. And 12 months into June 30th, 2019, we entered a net 35,000 customers which represents 1.1% net customer growth.

We are on track to exceed 1% net customer growth for the third consecutive year. These increases were offset by a $4 million dollar decrease in customer consumption, primarily due to warmer weather in the third quarter compared to the prior year. As a reminder, most of our weather normalization mechanisms end in April, so our contribution margin does not cover for most of the quarter. Operating expenses rose approximately 6% quarter over quarter, affecting high depreciation expense, associated with increased capital spending and planned 10% increase in O&M expense.

As we discussed last quarter, we increased service-related headcount in our Mid-Tex Division to support the growth of a DFW market. Additionally, we experienced a 7% quarter over quarter increase in line locates, as many of our communities in which we operate continue to experience strong growth. We continue to roll new leak survey technology into our operations. This technology is 1,000 times more sensitive than traditional leak survey technology. Therefore, we are finding more potential leak indications, which drives the need to hire or contract for people to evaluate and assess these, indications.

While the deployment of this technology will increase O&M expense in the near-term, it plays an important role in our ability to identify and mitigate risk. For example, during the quarter we were able to we used this technology in several of our jurisdictions that were hit by heavy storms, to assess or assist them for damage. The performance of pipeline and storage segments substantially offset the operating income decrease in our distribution segment. Operating income increased $12 million dollars, driven by strong growth and contribution margin, partially offset by higher operating expenses.

Contribution margin increased $22 million dollars as a result of APT's GRIP bonds in 2018 and 2019, combined with a $4.5 million-dollar quarter over quarter rise in APT's through system revenue as a result of the ongoing supply and demand dynamics back in the Permian Basin. The activity we experienced in the quarter was higher than anticipated, due to two unexpected force majeure events and other pipelines, which drove higher than expected volumes into our system. However, as a new merchant pipeline comes online starting late this summer, we expect the Waha to Katy spread to case to narrow.

Offsetting the growth and contribution margin was a $10 million dollar increase in operating expenses, as a result of high depreciation related to increased capital expenditures in a planned decrease in pipeline integrity work. Year-to-date consolidated capital spending was 10% or increased 10% to $1.2 billion dollars which is in line with our plan. We continue to focus our spending and improving the safety and reliability of our spending--of our system--or reliability of our systems manually with 87% focused on safety and reliability. Based on work completed year-to-date and planned spending for the remainder of the fiscal year, we continue to expect our fiscal 2019 capital spending to between $1.65 billion dollars and $1.75 billion dollars. From a regulatory perspective, to date, we have completed 21 filings which should add approximatively $110 million dollars in annualized operating income over fiscal 2019 and fiscal 2020.

And we have six filings pending seeking about $87 million dollars in annualized operating income. We are on track to complete some of these filings during the fourth quarter, with rates taking effect in the first quarter of fiscal 2020. Assuming these proceedings are resolved in line with our expectations, we remain on track to meet our target of completing $160 million to $180 million dollars of annualized operating outcomes.

Our balance sheet continues to remain strong and supports our capital spending program. As of June 30th, our equity total capitalization was 60% and we had approximately $2 billion dollars of putting under credit facilities and through our equity forward agreements. Slide 9 summarizes our fiscal 2019 financing activities. Year-to-date, we have completed $2.1 billion dollars of financing including the issuance of $1.1 billion dollars in long-term debt and $1 billion dollars of equity. During the quarter, we continue to utilize forward agreements under our ATM to help meet our fiscal 2020 needs.

We issued 1.1 million shares at an average price of $101.41. Additionally, we settled the forward agreements for 1.1 million shares, the net proceeds are approximatively $100 million dollars. As of June 30th, we had about $410 million dollars remaining in our--under our forward agreements. Detail of our equity-forward activities can also be found on slide 9. As Mike mentioned in his opening remarks, we are well-positioned to be meet our fiscal 2019 earnings guidance range of $4.25 to $4.35 per diluted share, partly given a higher than expected Permian Basin activity we saw during the third quarter, we now expect to be at the higher end of this range.

Slides 12 and 13 provides selected information underlying our fiscal 2019 guidance. And we are well-positioned to meet our five-year annual EPS growth target of 6% to 8% through fiscal 2023. We'll be rolling forward our five-year plan through fiscal 2024, on our fiscal year-end earnings call in November. Thank you for your time this morning. I will now turn the call over--call over to Kevin for some closing remarks. Kevin?

Kevin Akers: Thank you, Chris and good morning, everyone. Mike, thank you for those kind remarks. We are deeply indebted to you for leadership, your vision, and unwavering dedication and support for Atmos Energy and every one of our 4,700 employees. I'm very excited about the future of Atmos Energy, and I look forward to continuing the execution of the successful strategy that Kim and Mike have put in place, as we maintain our focus on our vision of being the nation's safest provider of natural gas services. A key to achieving that vision is to continue the evolution and refinement of our strategy by making investors in safety and reliability, by modernizing our business to sustain our company for the long-term.

This straight-forward focus and proven strategy benefits all stakeholders as we strive to safely provide excellent customer service in an environmentally responsible manner. As we've discussed before, increasing our spending 9 to 10% per year, through fiscal 2023, requires that we also invest in our people and technology. I'm proud to report that during the third quarter, we crossed over to 1-million-hour mark for total cumulative hours of training provided at our state-of-the-art Charles K. Vaughan center, which opened in 2010. This training is essential for our employees to become highly qualified gas professionals. We continue to roll out our latest map digital asset date collection solution, through the first nine months of this fiscal year, we've had approximatively 35% of our company and contract construction crews trained on using this important technology.

And we continue to systematically roll out our advanced mobile leak detection technology that will enhance our ability to safely operate our systems, as Chris mentioned earlier. Implementing a safety management system is another strategic focus. While we've had components of a safety management system including procedures, policies and practices for many years, a safety management system formalizes what we are doing and is an integral part supporting our vision of being the safest provider of natural gas services.

We've completed our pipeline safety management system assessment and plan to have our high-level roadmap developed for addressing gas later this fall. These are just a few of the examples of how our investments in training and technology position us for sustained success in the future. In closing, I would like to thank our 4,700 employees, their dedication to safely operating our system while providing excellent customer service and giving back to the communities where they work and live. That is the biggest reason Atmos Energy will be successful for the long-term. We appreciate your time this morning, and now we'll take any question you may have.

Jennifer Hills: Operator?

Operator: Thank you, at this time we will be conducting a question and answer session. If you would like to ask a question please press *1 on your telephone keypad. That's the * key followed by the 1 key on your telephone keypad. A confirmation tone will indicate that your line is in the question queue. You may press *2 if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. Our first question comes from Christopher Turnure, with JP Morgan. Please state your question.

Christopher Turnure: Good morning everyone. Very sorry to hear the news Mike, best wishes to you and your family.

Mike Haefner: Thank you, Chris.

Christopher Turnure: As we look forward to fourth quarter earnings and potentially an Analyst Day again this year, how can we think about the outlook for beyond the current plan kind of 2024 and beyond anything potentially changing there, especially given the acceleration of capex that we saw out of you guys, last year?

Chris Forsythe: Chris, this is Chris Forsythe, and good morning. Our intent this fall was to not have an Analyst Day, but we'll have an extended fiscal year and earnings call, where we'll cover off the remainder of fiscal '19 and be really focused on where we're going to be going in fiscal 2020. And really that the story and the strategy remains the same, you know, as we've talked about with you and others, on the call, we have a long backlog of work to do, if you will, just a lot of work to, you know, get down in terms of pipe replacement.

So you know we will be you know, just rolling it forward another year, you'll expect to see you know just an increase in line with the increases in capital spending that you've seen from us over the last several years, financing strategies can be pretty consistent with what you've seen as well. We'll update and refresh those numbers on that call. But I think the key takeaway today is that the strategy is the same and it would just be a roll forward of what we've demonstrated up to 2023 at this point.

Christopher Turnure: Okay and Chris, that kind of all sounds great, obviously and you feel like there's no customer bill pressures or even kind of balance sheet constraints despite the strength of your balance sheet right now that would come into play in that timeframe that would perhaps slow the rate base growth trend?

Chris Forsythe: Well we're not seeing anything from a custom bill perspective, you know, you can go back to our charts that we've shown that our bill is by far the lowest bill in the household from a utility perspective, and you know the strength of our balance sheet and we're committed to maintain the strength of that balance sheet going forward.

Christopher Turnure: Okay great. And then my second question is around near-term financing, as you mentioned in the remarks and I think the queue as well, you priced around a million shares this quarter and then you also pulled down around a million shares as well from, I guess one of the earlier ATMs. So given your prior commentary on not I think it was not needing anymore equity this year from the ATM programs, was there something that changed there or caused you to, tap that equity during the quarter?

Chris Forsythe: No, no I think what we were indicating is that we didn't have any discreet equity needs. In our last quarter call we said we had no discreet equity issuances planned through the end of fiscal 2020. We do have, we did have the proceeds available to us under the forward arrangement which as you known expire, some of the most of the proceeds right now expire at the end of March, with about a little over $100 million dollars expiring at the end of September.

So we're needing to utilize those proceeds, so we'd intended all along to drawdown on those proceeds as capital needs arise or cash needs arise, in that period. So, all of that again, is baked into our fiscal '19 year guidance, it's based into our five-year plan of $5.40 and $5.80 and as we look forward, you know we stated that in the current five-year plan we have published you know, that $5 to 6 billion dollar incremental financing needs that we intend to finance that in a balance fashion using both long-term debt and equity. So again we'll--you know, that strategy is going to look very similar when we roll that forward in November, but again, the financing that we did in the third quarter is not to satisfy FY19 equity needs, it will satisfy our FY2020 needs and beyond.

Christopher Turnure: Okay, that's clear. Thank you, Chris.

Chris Forsythe: Thank you.

Operator: Our next question comes from Dennis Coleman, with Bank of America, please state your question.

Dennis Coleman: Yes, good morning. And, let me add my thoughts, Mike, never news that anyone likes to get, so certainly best wishes as you pursue your health and thoughts with your family as well.

Mike Haefner: Thank you so much Dennis, I certainly will miss all the opportunities that we you know, had the talk in the past and I'll miss seeing all you guys in the future. But again you know, as I mentioned in my comments, I'm very optimist that if I gear down a gear or two I'll have the opportunity to find a good solution for this.

Dennis Coleman: Right, I hope that's the case. Congratulations also to you, Kevin, best of luck with the new role and responsibilities. Big shoes to fill, but great company to work with.

Kevin Akers: Absolutely thank you.

Dennis Coleman: A couple questions for me, I guess first on the expense side, expenses did run up certainly a little more than we thought. Can you just talk about sort of, I guess the roll forward on the expense side? Some of it seems a bit transient but any help you can give there, Chris would currently be appreciated.

Chris Forsythe: Yeah, sure guys, I mean, like I mentioned in the prepared remarks, it's really continuation of what we've been experiencing and what we've been trying to accomplish from a risk-based perspective, and--and what we talked about the second quarter rolling into the third quarter. So that was, you know, continuing to roll out the AMLB “PH” technology that Kevin commented on, you know, we are--and because it's new to us, you know, the indications that came in just require a little bit more assessment. A lot of that work is O&M but over time, we expect as we gain proficiency that that should come back into line with the 2.5 to 3.5% guidelines that we established for the five-year plan last fall.

Additionally, you know, we talked about low pressure assessments, and when you get an opportunity with you know, increases in margins, you know, we're always looking to take risk off the table from an O&M expectance. So we've been increasing our--you know--I guess our risk-based O&M works, that's you know, inline inspections, that's right of way maintenance, that's low-pressure system assessments, anything we can do to reduce risk, in the current period that will benefit for future periods. So that's the type of work that you're seeing in the O&M line item, and we'll just continue to manage that going forward, you know, as needs arise and as opportunities arise as well.

Dennis Coleman: Okay, thanks for that. And then I guess, on the leak detection technology, obviously a fair amount said there. I guess--I thought I heard you say you've rolled it out to additional markets? I think last quarter it was just mostly Texas based, but can you talk about has it, have you rolled it out in all markets now?

Kevin Akers: This is Kevin, not in all of our markets. We currently had 11 units here, we've rolled an additional one out here, we've planned the next fiscal year to roll some additional units out to our West Texas area. We have an existing unit in Louisiana, and one in Mississippi as well. So that--those are the markets that we're talking about there.

Dennis Coleman: Okay, alright. That's it for me. Thank you.

Chris Forsythe: Thank you, Dennis.

Operator: Our next question comes from Ryan Levine with Citi. Please state your question.

Ryan Levine: Good morning. I wanted to also echo some of the previous comments about Mike, sorry to hear about this development, but best of luck to you and your family.

Mike Haefner: Thank you Ryan.

Ryan Levine: And then I guess in that lies the question, can you just speak to the transition process, and if this was sudden what are the steps over the next two quarters as Kevin takes the CEO seat?

Mike Haefner: Sure, this is Mike, Ryan. And as I mentioned in comments, this succession plan's been in place for quite a while, and even prior to that, the way we operate, you know, I've worked very closely with Kevin and the entire leadership team works very closely together. Over the last two-and-a-half years our management committee is--you know, meets for a half a day and then informally several days a week. So we're completely in lockstep. Kevin and I have worked side by side and all of the initiatives that he's been driving for scale and scope. So in a nutshell, the transition is going to be extremely smooth and uneventful internally, since we've been working so closely together all along, as well, I've mentioned and he and I are, you know, working even more closely now. But as I mentioned earlier, he'll assume the President CEO position on October 1.

I will be still around, and available to him and meet with him on a regular basis through the end of the calendar year, and also as I mentioned, Kim will continue as executive Chairman and he's always been tremendously helpful to all of us as an advisor. So I know it's not similar to many other companies, but you know, at Atmos, everybody's in the same--you know, we're in the same bullpen and dugout every single day of the week.

So it's--and this strategy as Chris said, is not going to change, it's a matter or scaling, sustaining our success, and just executing well, taking care of our employees in the process, making sure they're got development opportunities, the training they need, we remain in compliance and you know, all the things that we've talked about regularly Kevin's had the responsibility for, for the last couple of years. Obviously, executed by our division leadership and shared services leadership, but he's got a firm hand on the pillar right now. So it'll be a non-event.

Ryan Levine: Okay, thanks for the color. And then a couple more specific questions; in terms of the O&M cost inflation, over what period of time do you think they'll be some type of elevated level as the more sensitive centers detect additional opportunity, or for safety improvement?

Mike Haefner: I think, you know, we're already seeing some you know, improvements in, you know, in the productivity of the crews and I would just say that we're going to be back in line with the two-and-a-half, to three-and-a-half percent O&M--targeted O&M increase over the five-year plan though 2023 and the we'll roll that forward in November through 2024.

Ryan Levine: Okay. And what was the impact of the Waha basis differentials to your business this past quarter? I think you disclosed some numbers in previous quarters, so I'm curious what the update is?

Mike Haefner: It was the impact, quarter over quarter is about $4.5 million dollars.

Ryan Levine: In income?

Mike Haefner: In the third quarter, quarter over quarter in revenue. And it's a contribution margin which is effectively revenue for us. So.

Ryan Levine: Okay, that's helpful appreciate it, thank you.

Operator: Just a reminder, to ask a question at this time, press the * key followed by the 1 key on your telephone keypad. *1 to ask a question. Press *2 to remove yourself from the queue. Our next question comes from Stephen Byrd, with Morgan Stanley. Please state your question.

Stephen Byrd: Good morning.

Mike Haefner: Good morning.

Chris Forsythe: Good morning.

Stephen Byrd: Mike, I just want to say you'll be dearly missed. You're a great executive and a great person, just great to interact with. So we're all rooting for you to address this health issue successfully and we really wish you and your family all the best. I can't thank you enough for all your help over the years, and you will be missed.

Mike Haefner: Well, thank you so much for everything you've done as well, Stephen, I appreciate it.

Stephen Byrd: Alright, and Kevin, I look forward to working with you in your new role. Most of my questions have been addressed. I thought I'd just check really, on the financing plan. I think your financing plan is very clearly. But just given the very low interest rate environment that we're in, I just thought I'd double check in terms of just additional opportunistic ways to kind of lock in, you know, lower cost of debt over a long period of time. I think your average duration is already pretty long, at 22 years, but I just thought I'd check is there--just anything else that might be possible.

Kevin Akers: Yeah, that's a good question Stephen. That's something that we're, you know, we're evaluating right now, we're mindful of where the markets have gone certainly here in the last week or so, you know, you pointed out our matured--average duration is about 22 years. For all in average, our weighted average cost of debt right now is 4.55% after we effectuated the two debt offerings that we've done this fiscal year. So as we look forward, we're certainly evaluating opportunities to further drive that overall cost of that down, but nothing specific that I can comment on at this point.

Stephen Byrd: Understood, that's all I have. Thank you.

Kevin Akers: Great, thank you.

Operator: Thank you there are no further questions at this time. I'll turn it back to Jennifer Hills for closing remarks, thanks.

Jennifer Hills: Okay, thank you for joining us today, as a reminder a recording of this call is available for replay on our website through November 6th, 2019. We appreciate your interest in Atmos Energy and thank you for joining us. Goodbye.

Operator: Thank you, this includes today's conference. All parties may disconnect. Have a great day.