Atmos Energy
First Quarter Conference Call
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<u>Presenters</u>
Kevin Akers, President & Chief Executive Officer
Chris Forsythe, Senior Vice President & Chief Financial Officer
Jennifer Hills, Vice President, Investor Relations

<u>Q&A Participants</u>
Richard Ciciarelli - Bank of America
Insoo Kim - Goldman Sachs
Charles Fishman - Morningstar Research
Ryan Levine - Citi
Marc Solecitto - Barclays

Operator
Greetings and welcome to the Atmos Energy First Quarter 2020 Earnings Conference 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, please press star zero on your telephone keypad. As a reminder, this conference is being recorded. It's now my pleasure to introduce your host, Jennifer Hills, Vice President, Investor Relations for Atmos Energy. Jennifer, please go ahead.

Jennifer Hills
Thank you, Kevin, and good morning, everyone, and thank you for joining us. This call is being webcast live on the internet. Our earnings release and conference call slide presentation, which we will reference in our prepared remarks, are available at atmosenergy.com under the Investor Relations tab. 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 22 and are more fully described in our SEC filings. Our first speaker is Chris Forsythe, Senior Vice President and CFO of Atmos Energy. Chris?

Chris Forsythe
Thank you, Jennifer, and good morning, everyone. We appreciate you joining us and your interest in Atmos Energy. Our 2020 fiscal year is off to a solid start. Yesterday, we reported first quarter net income of $179 million, or $1.47 per diluted share, in line with our expectations. We reported growth in both our distribution and pipeline and storage businesses, driven by continued customer growth and distribution and rate recovery in both segments. Consolidated

operating income rose 7% to $253 million in the first quarter. Slide four summarizes the key performance drivers for each of our operating segments.

Operating income for our distribution business rose 6.4% to $180 million. Rate increases, driven by increased safety and reliability capital spending, provided an incremental $27 million, primarily in our Texas, Louisiana, and Mississippi jurisdictions. Customer growth contributed incremental $4 million, as we have continued to benefit from the strong population growth in some of our service areas, most notably in the DFW Metroplex.

For the 12 months ended December 31st, we experienced 1.4% net customer growth in our North Texas distribution business and 1.2% net customer growth across our eight-state footprint. Consumption declined modestly due to colder weather last year before weather normalization mechanisms went into effect, and O&M expenses increased $8.6 million, associated with the distribution integrity management work and higher employee-related costs. Operating income for the pipeline and storage business grew 8% to $73 million, primarily driven by a $13.7 million increase due to the implementation of new rates from our 2019 GRIP filing, partially offset by a $5 million increase in O&M, related to the timing of well integrity work.

Consolidated capital spending grew 27% to $529 million, with 86% of our spending directed towards safety and reliability spending to modernize our system. We remain on track to invest between 1.85 billion and 1.95 billion this fiscal year. We have a well-established regulatory strategy, focused on reducing lag. In fiscal 2020, we expect to begin earning a return on 90% of our spending within six months of the test period end. Year-to-date, we have implemented $59 million in annualized regulatory outcomes, and currently, we have about $21 million in progress. Slides 13 to 18 provide details for all of these filings. Slide 19 outlines our planned activities for the remainder of the fiscal year. Our ability to attract the necessary long-term financing to fund our capital expenditure program, while maintaining the strength of our balance sheet, is critical to the successful execution of our strategic plan.

During the first quarter, we received $1.1 billion in net proceeds from long-term financing activities. In October, we issued $300 million of 10-year notes and $500 million of 30-year notes at an all-in effective rate of 3.15%. As a result, we were able to reduce our weighted average cost of debt to 4.32%. Our customers continue to benefit from these historically low rates. Additionally, we increased our weighted average maturities to 22 years and do not have a material maturity until 2027. From an equity perspective, we settled forward agreements on 2.7 million shares for approximately $259 million in net proceeds, and we executed new forward sales arrangements under our ATM for approximately 340,000 shares, with an anticipated net proceeds of approximately $37 million.

As of December 31st, we had about $240 million remaining under equity forward arrangements that must be utilized by the end of our fiscal year. We continue to believe that we can satisfy our fiscal 2020 needs through our ATM program. As a result of this financing activity, our equity capitalization was 58.6% as of December 31st, and we finished the quarter with approximately

$2 billion of liquidity under our credit facilities and equity forward agreements. The strength of our balance sheet and our five-year financial plan continues to be recognized by the credit rating agencies.

In December, Moody's upgraded our long-term debt rating to A1 with a stable outlook, and S&P reaffirmed our A credit rating. Details of our financing activities and our financial profile can be found on slide seven through ten. Our first quarter performance leaves us well positioned to meet our 6% to 8% earnings per share growth target. As a result, yesterday, we reaffirmed our fiscal 2020 earnings per share guidance in the range of $4.58 to $4.73 per diluted share. Thank you for your time this morning. I will now turn the call over to Kevin Akers for his closing remarks.

Kevin Akers
Thank you, Chris. As you can see from our fiscal first quarter results, we are off to a good start to the year, as we remain on track to meet our capital spending goals and earnings growth targets. From an operational perspective, we remain focused on executing our proven investment strategy of operating safely and reliably, while we modernize our natural gas distribution transmission storage systems, as well. We are continuing our investments in people, process, and technologies that will enable Atmos Energy to scale safely and efficiently, while investing $10 billion to $11 billion over the next five years.

I would like to highlight one of our larger investments, the Bethel Salt Dome project, which we began in fiscal 2019 and is estimated to be completed in 2025. As we've discussed previously, we plan to invest between $100 million to $120 million to develop a third salt-dome cavern at our Bethel storage facility. This project will enable us to safely perform regulatory compliance work on our two existing caverns and meet the growing demand in the North Texas market. The construction of the power and leaching facilities, have been completed, and we began the leaching process in mid-December. The leaching process is estimated to take between 25 and 30 months, and we anticipate finishing our required compliance work on all three caverns and have them in service by late 2025.

Natural gas is an important driver of economic growth in this country, and we have seen our industrial business grow in our Kentucky mid states and Mississippi divisions, particularly in the automotive manufacturing sector and in the spirits industry. Over the last few quarters, clean, efficient, and affordable natural gas lead transport has supported the expansion of existing facilities and fueled new industrial project development. Once these expansion projects fully come online over the next few years, we expect to deliver an additional two BCF annually to these customers.

Additionally, we continue to expand deliveries to CNG customers with the addition of a new customer in Colorado. As a result, our customer expects to replace nearly 90,000 gallons of diesel fuel annually. During the first quarter, we continued to enhance our sustainability reporting capabilities. In December, we launched a Corporate Responsibility section on our website to provide greater disclosure of our focus on safety and long-term sustainability and to highlight how we are working to meet the needs of our various stakeholders.

We also published our second corporate responsibility and sustainability report, as well as an updated methane emissions report, both of which can be found in the Corporate Responsibility section under Reports. The continued modernization of our natural gas distribution, transmission, and storage systems will help ensure all residential, commercial, public authority, and industrial customers continue to have access to reliable, affordable, abundant, and efficient natural gas.

To support this effort, last week we were pleased to announce that we joined the One Future coalition, a voluntary alliance of leading companies across the natural gas supply chain, focused on technology and policy to drive continued improvement in reduction of methane emissions. We look forward to working with One Future as we move toward achieving our target of a 50% reduction in methane emissions by 2035.

In closing, I want to thank our 4,800 employees who are dedicated every day to safely operating our system, providing exceptional customer service, and giving back to the communities where we live and work. We appreciate your time this morning, and now we will take any questions you may have.

Operator
Thank you. We'll now be conducting a question-and-answer session. If you'd like to be placed in the question queue, please press star one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star two if you'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing star one. One moment, please, while we pull for questions. Our first question is coming from Richard Ciciarelli from Bank of America. Your line is now live.

Richard Ciciarelli
Hey, morning. Um, can you guys hear me okay?

Kevin Akers
Yes, good morning, Richie. How are you doing?

Richard Ciciarelli
Doing well. Um, I just had a question on the, uh, O&M profile. Um, it seems like it was, uh, a sizable uptick this year. And I appreciate some of that was for like the increased, um, employees due to the faster growth but just curious like how you intend to shape the O&M curve through the outlook given like the 2% to 3%, uh, growth that you're managing towards?

Chris Forsythe
Yeah. Some of that--a couple of things. We got the 2% to 3%--2.5% to 3.5% that's baked into our five-year plan through 2024. We had already--and that's a CAGR over that five-year period. So, we had already anticipated, as you noted, an uptick in O&M this year, as a result of the additional hiring that we had, obviously, in the first quarter. As you try to turn that out over four quarters, that can be a little bit difficult. We did have some timing, particularly in our pipeline and storage segment around some well integrity work, that was kind of accelerated more into the first quarter. So, when we look at the O&M guidance that we published for fiscal 2020, we feel like we are still on track to achieve that, at this point in time.

Richard Ciciarelli
All right. That makes a lot of sense. That's all I had. Thank you.

Operator
Thank you. Our next question is coming from Insoo Kim from Goldman Sachs. Your line is now live.

Insoo Kim
Thank you. Um, my first question is at the pipeline segment. When you look at the year-over-year decrease in transportation volumes, how does that magnitude compare versus your expectations? Um, I know you've expected some of that given the online of, you know, the Gulf Coast Express pipeline and whatnot, but, um, how does that magnitude like fare versus your expectation? And how does that place you, um, in terms of the expected growth of the segment for this year?

Chris Forsythe
Yeah, it's pretty much in line with our expectations. And honestly, we saw volumes pick up just a little bit versus what we expected, but pricing was a little bit down. So, net-net, we were in line with expectations. And, as we look forward, we'll continue to monitor the market conditions. You're very well aware of the supply and demand dynamics are ongoing, in the Permian Basin, and we'll just keep an eye on that. But at this point, we still think that our net income, as well as our guidance that—range that we have out there is still, is still good.

Insoo Kim
Understood. Um, and second, uh, Kevin, I know you touched upon this in your, uh, prepared remarks, but, you know, with ESG and electrification of the grid story having taken hold recently in our market, uh, so could you share your thoughts a little bit more on your view of the gas that plays a role in the future of the U.S. energy grid? And also, how do you see that potential shift creating, you know, maybe a secular decline in existing or new gas usage, um, on the customer base?

Kevin Akers
Yeah, I appreciate your question. First of all, let me say that, you know, I'm proud to be in the natural gas business, particularly this morning. As we sit here in Dallas, the wind-chill is in the low 20s, so, our customers are receiving safe reliable, heating for their home and have, hot showers, as well. So, you know, we're very, very proud of our product and what we're able to do from a reliability and efficiency standpoint.

But, you know, the way we see it, as you look at the population in U.S. today, about 335 million or so headed towards 360 million by 2030, that's like adding a Texas to the population in about a 10-year period with growth at about 2.5 million people or so a year there. That's going to require a diversified energy portfolio, and we see natural gas as a vital part of that energy solution as we move forward.

You know, as we said before, it's efficient, it's affordable, it's abundant, it's reliable, and it's flexible. There's not another fuel that's flexible like it to meet this growing demand of energy that's going to be required, you know, by 2030. You can compress, it you can decompress it, you can transport it, you can liquify it, you can store it below ground. There's nothing like it that's reliable and abundant today that's out there.

And, as a natural gas distribution utility having interstate transmission assets, we embraced our role operating responsibly and being good stewards of our environment. As you've heard us say before, we're working to tighten up our system with our modernization of our infrastructure, and we continue to deploy technology across our system, both in a monitoring capability, and equipment capability to make sure we are operating as responsibly and as efficiently as possible.

And we'll continue to work with our partners both, upstream as you saw with our joining of ONE Future to measure that we're getting the best available practices that are going on in the industry today to look at and maybe incorporate into our business, as well as partner with groups like AGA and GTI to not only tell our story, but to also look at what technology is available from a burner tip perspective or technology perspective, whether that's carbon capture or carbon storage. So, you know, as we see it, we see a continued growth of natural gas. It plays a viable role in the energy future now in the energy portfolio now and well into the future trying to meet that energy demand by, by 2030. Again there's nothing like it that's as flexible, reliable, and as efficient.

So, as we talked about in my script with industrial demand out there, we're continuing to see good expansion of industrial load, good new growth on the industrial and commercial side, as well. And then, in addition, you heard Chris mention the 1.2 to 1.4 net growth on the residential side, as well in our market areas. So, both residential through the industrial markets, we continue to see good growth area.

Insoo Kim
Got it. Thank you very much.

Operator
Thank you. Our next question is coming from Charles Fishman from Morningstar Research. Your line is now live.

Charles Fishman
Good morning. I just want to make sure I understand this. On the pipeline and storage, you talked last quarter about the new pipeline coming on, competitor pipeline, uh, impacting, um, operating income. And obviously, we didn't see that in the last quarter. Uh, it was pretty darn good, um, but then you made the statement that it's on track. I mean, do you anticipate pipeline and storage being roughly flattish this year versus last year? Or—you know, when you say on track, if you could provide a little more color what that might be?

Chris Forsythe
Sure. Yeah. Good morning, Charles. This is Chris. You know, a couple of comments around that. You know, last quarter, you know, GCX came online in the middle of the quarter. So, we had some strong, pricing, opportunities, if you will, in the first half of the fourth quarter last year, which contributed to that quarter's results. As we move forward, you know, as we reiterated this morning, we're on track with our earnings per share targets. And I'll also say that our contribution of our business between distribution and pipeline storage is going to be roughly the same, as well. So, that's roughly 2/3 distribution and 1/3 on the pipeline storage side.

So, as we continue to grow in that 6% to 8% range certainly for 2020 and as we look out through 2024, we expect the business mix between our two segments to be in that roughly that 2/3, 1/3, you know, allocation, if you will. So, it can ebb-and-flow a little bit, but, we still see a lot of continued growth. And when you think about pipeline and storage, most of the earnings drivers in that segment is the continued safety and reliability work that we are doing on our APT system. You know, Kevin talked about the Bethel storage facility. So, it's driven by fundamental rate base growth as a result of the supply or the--what we're trying to accomplish from a safety perspective, as well as meeting the growing needs of the Dallas-Fort Worth Metroplex.

Charles Fishman
Okay. So, I mean, Chris, the takeaway from your answer is that, since the mix of business is staying the same, and we know distribution is growing pretty well that means pipeline and storage is really growing even though you're seeing this competitor pipeline?

Chris Forsythe
That's correct. And remember, too, on this competitive pipeline--and we've been talking about this for a couple of years the non-tariff businesses that run through the pipeline, that represents a relatively small piece of the overall puzzle for APT, primarily due to the existence

of a Rider REV mechanism. So, whatever we tend to pick up, in terms of a commercial business activity on that pipe, 75% of the benefit flows back to our regulated customers on the distribution side in our Mid-Tex Division in North Texas. So--and you heard us consistently say over the years, when they pick up a little bit here and there, but we don't view that as a material driver of our performance, it could have a little bit of an impact in a given year, given pricing dynamics, but we don't--certainly don't look to it as a source of fundamental growth for the long term.

Charles Fishman
Okay. And if I could ask–oh, go ahead.

Kevin Akers
Well, I was just going to add to that. Chris is exactly right. We don't see that as a competitor pipeline. Again, with its direction its heading, it's mainly focused on takeaway out of the Permian down to the Gulf Coast area there. So, we don't really see it as a competitor by nature, because our responsibility on the pipeline side itself is those core markets and serving those core markets.

Charles Fishman
Okay. Got it. Now if I can ask just one more question. Um, on the new, uh, dome storage that's being developed, how does that work from a regulatory standpoint? I mean, I would assume a lot of that is for the benefit of your distribution system, um, Mid-Tex et cetera?

Kevin Akers
Correct. It's for our--making sure we have the reliability to continue to meet the contractual demands of those customers behind APT. All those costs or investments into that are GRIP eligible, and so they recover through that mechanism.

Charles Fishman
Okay. So, it's under GRIP. Got it. Okay.

Kevin Akers
Correct.

Charles Fishman
That’s it. Thank you very much.

Kevin Akers
Thank you, Charles.

Operator
Thank you. Our next question is coming from Ryan Levine from Citi. Your line is now live.

Ryan Levine
Good morning.

Kevin Akers
Hey, Ryan.

Ryan Levine
Hey. Um, what's your appetite to invest in the build-out of RNG infrastructure given your footprint and stated objectives of both, uh, AGA and Atmos?

Kevin Akers
Again, we're--we want to operate responsibly. We want to take a look at opportunities that are out there, but we're going to take a look at it in the way that we've done everything else about our business. And what I mean by that is, if you take a look at how we set up our rate structures over time, our annual mechanisms, our pipe, pipe mechanisms, those sort of things, we have to look at it from a regulatory perspective on investment and recovery of that investment and what those opportunities look like, as well as what are the laws or regulations around that that exist today or may exist in the future.

So, all that to say, we're keeping an eye on it. We're looking at it. But we are working, with other industry partners and seeing what other states are doing to see how the regulatory environment plays out on those and how the legislative environment plays out on those. And when we see something that is of interest to it or ready to move forward, we'll, like we said, with the rest of our rate structure make sure that it is tied up with our investment and the recovery, and it benefits our customers across the enterprise.

Ryan Levine
Okay. Um, and then another one in terms of the O&M cost increase. I was wondering what impact the new PHMSA regulation have in your, uh, your increased guidance for 2020 versus 2019.

Chris Forsythe
What--you see the O&M guidance that we've put out there. We have already kind of anticipated those PHMSA, rules coming into effect beginning in July of this calendar year. So, it's going to be--have a muted impact in 2020 and will continue to roll in on a full fiscal year basis and beginning in 2021. But we've already contemplated that in our O&M, forecast through 2024.

Ryan Levine
Is there a way to quantify the magnitude of that impact versus the other items that were highlighted, uh, from an earlier question?

Chris Forsythe
We don't have that information readily available.

Ryan Levine
Okay. Um, and then the last question for me, curious what your gas price assumption is in your 2020 guide. And, um, you know, with the weakness in spot, uh, basis in some of your jurisdictions, curious how much, um, regulatory headroom you have, um, versus your guidance, in terms of customer builds?

Chris Forsythe
Well, we've got—you know, you'll see it in our Analyst Day this deck that we put out last fall, I think, we're at an all-in price anywhere from $3.20--$5.25 to $5.50 inclusive of storage and transportation costs. Storage and current transportation is usually between $1 and $1.50. So, we assumed a high 2, low 3 range on the commodity pricing. So, to the extent that we have, lower pricing that we're able to capture from our various sources of gas, it's obviously a benefit that flows back to our customers. And we've got a very good gas supply team, in our shared services function that is working, to minimize the cost of gas across the enterprise.

Ryan Levine
Okay. Great. Thank you.

Operator
Thank you. As a reminder, it's star one to be placed in the question queue. Our next question today is coming from Marc Solecitto from Barclays. Your line is now live.

Marc Solecitto
Hi. Good morning.

Chris Forsythe
Good morning.

Marc Solecitto
Um, kind of following up on some of the earlier questions, can you quantify the year-over-year impact from Waha basis differentials in fiscal 1Q?

Chris Forsythe
If you look through our MDA, it's roughly down about a 750,000 to 1 million. It's in our line item that flows--it's not on our Mid-Tex line, but it's our pipeline--it's in our three-system line item. So, it's out there in the 10-Q.

Marc Solecitto
Got it. Okay. And then in terms of your FY '20, um, EPS guidance, I think, Waha spreads were $12 million year-over-year tailwind in fiscal '19. Just curious what the embedded assumption

was in your fiscal ‘20 guidance. Or maybe said differently, if you captured any benefit in fiscal ’20, would that represent upside to your budget?

Chris Forsythe
We made a call based upon market conditions at the time that we put the plan together last summer, but, we haven't released those specific details.

Marc Solecitto
Got it. Okay. Thank you.

Operator
Thank you. We've reached the end of our question-and-answer session. I'd like to turn the floor back over to management for any further or closing comments.

Jennifer Hills
Thank you, Kevin. We appreciate your interest in Atmos Energy and thank you for joining us. A recording of this call is available for replay on our website through May 7, 2020. Goodbye.

Operator
Thank you. That does conclude today's teleconference. You may disconnect your line at this time and have a wonderful day. We thank you for your participation.