

# **Northwest Natural Holding Company (NWN) Q2 2024 Earnings Call Transcript**

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**Body**

Northwest Natural Holding Company (NWN)

Q2 2024 Earnings Call Transcript

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Company Participants

Nikki Sparley - Director of IR

David Anderson - CEO

Brody Wilson - CFO, VP, Treasurer and Chief Accounting Officer

Justin Palfreyman - President

Conference Call Participants

Chris Ellinghaus - Siebert Williams Shank

Tyler Rakers - Stifel

Presentation

Operator

Good morning. Thank you for attending today's Northwest Natural Holding Company Q2 2024 Earnings Call. My name is Jayla, and I'll be your moderator for today. All lines will be muted during the presentation portion of the call, with an opportunity for questions and answers at the end. I would now like to pass the conference over to our host, Nikki Sparley, Director of Investor Relations. Nikki, you may proceed.

Nikki Sparley

Good morning and welcome to our second quarter 2024 earnings call. As a reminder, some things that will be said this morning contain forward-looking statements. They are based on management's assumptions, which may or may not occur. For a complete list of our cautionary statements, refer to the language at the end of our press release. We expect to file our 10-Q later today. As mentioned, this teleconference is being recorded and will be available on our website following the call. Please note these calls are designed for the financial community. If you are an investor and have additional questions after the call, please contact me directly at 503-721-2530. News media may contact David Roy at 503-610-7157.

Speaking this morning are David Anderson, Chief Executive Officer, and Brody Wilson, CFO, Vice President, Treasurer and Chief Accounting Officer. David and Brody have prepared remarks and then will be available along with other members of our executive team to answer your questions.

With that, I'll turn it over to David.

David Anderson

Thanks, Nikki, and good morning and welcome. Our financial results are on track for the year and in line with our full year guidance issued in February. Brody will go through the detailed results here in a moment. This morning, I'll walk you through a few economic indicators and provide an update on our Oregon gas utility rate case. I'll wrap up with an update on our long-term decarbonization and growth initiatives.

Turning to a few comments on the economy. Related to our gas utility service territory, Oregon's unemployment rate remains low and on par with the national average at 4.1% in June. Employment growth increased in Oregon to 1.6%, compared to a drop in US employment growth to 1.5% annualized for June 2024. Single-family housing permits were up 8.6% year-over-year in Oregon and increased 19.1% in the Portland metro area, signaling favorable conditions for customer growth ahead. For June, unemployment rates in our water service territories were as low as 3%. In six of the nine counties, our water utilities served, single-family building permits posted double-digit growth for the 12 months ended June 2024, compared to the same period in 2023. Collectively, our gas and water utility customer base grew 1.8% over the last 12 months.

Moving to an update on our gas and water rate cases. Our utilities have continued to make necessary investments in safety, reliability and technology at record levels. For our water and wastewater utilities, we continue to find these systems need substantial investments to meet current and increasing quality standards and support customer growth. Like many other companies, we're also contending with inflationary pressures on operating expenses. These are all reasons why we decided to file rate cases for our gas utility in Oregon and a number of our water and wastewater utilities. We filed only after very careful consideration and with the utmost attention to the effect on customer bills. We know this is a difficult time. Our team has done all they can to reduce cost and operate as efficiently as possible while maintaining safe and reliable systems. I'm happy to report we've worked constructively with stakeholders in these cases and have made substantial progress. All party settlements have been filed in the majority of the dockets.

Concerning the gas utility Oregon general rate case, in July, Northwest Natural filed an all-party settlement resolving a majority of the case. That included a revenue requirement increase of $95 million that consisted of $85.4 million related to investments in the system and expenses and $9.6 million for increased depreciation. The settlement also included a 50-50 capital structure, an ROE of 9.4% and a cost of capital of approximately 7.1%. In addition, rate base would increase $357 million since the last rate case for a total rate base of $2.11 billion. We expect an order from the commission on the full rate case this fall, with rates effective November 1st.

This week, we filed a preliminary Oregon annual purchase gas adjustment, which updates rates for the projected gas cost. Gas prices have been dropping, resulting in an expected decrease of 3.4% in customer bills, which will help offset an increase in rates from the rate case. All in, we expect customers will pay about 2% more for their natural gas service this coming winter than they did in 2005. On an annual basis, that's about a 0.10% compounded growth rate. We've also settled several water and wastewater utility rate cases. That includes the case for our largest utilities in Arizona, with new rates expected to go into effect November 1st, 2024.

With that, let me turn it over to Brody.

Brody Wilson

Thank you, David, and good morning everyone. I'll begin by discussing overall earnings drivers for 2024, highlights for the second quarter and year-to-date results and conclude with guidance for the year. As a reminder, Northwest Natural's earnings are seasonal with a majority of revenues and earnings generated in the first and fourth quarters during the winter heating months. Also, our segment reporting includes our Natural Gas Distribution or NGD segment and Other, which includes our interstate storage services and asset management services, Northwest Natural Water, Northwest Natural Renewables and holding company expenses.

Before I walk through detailed second quarter results, I wanted to emphasize a couple financial themes for 2024. As you may remember, 2024 is an investment year for us that is setting the stage for future growth. While we continue to maintain strong credit ratings, a solid balance sheet and an unchanged long-term earnings growth outlook, our earnings guidance for 2024 reflects a combination of lag related to our capital investments and inflationary pressures that we are experiencing simultaneously. To resolve the regulatory lag, we filed a gas utility Oregon rate case late last year. As David mentioned, we recently filed an all-party settlement and expect new rates will go into effect November 1st.

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Now, moving to the second quarter results. We reported a net loss of $2.8 million, or $0.07 per share, for the second quarter of 2024, compared to net income of $1.2 million, or $0.03 per share for the same period in 2023. Lower earnings at our gas utility drove consolidated results as a result of regulatory lag on investments and inflationary pressures we discussed earlier.

Utility margin increased $0.4 million, primarily due to customer growth and the amortization of deferrals. Gas utility O&M decreased $3.5 million, reflecting cost-saving measures. Utility depreciation and general taxes increased $2.5 million. Other income declined $4.2 million, mainly driven by higher pension costs. Interest expense increased $0.4 million from incremental long-term debt financing. Our other businesses provided net income of $200,000, which was a decrease of $1.3 million compared to the same period last year, primarily due to a gain on settlement in 2023.

For the first six months of 2024, we reported net income of $61 million, or $1.60 per share, compared to net income of $72.9 million, or $2.03 for the same period in 2023. Lower earnings at our gas utility drove the consolidated results with similar themes as we noted for the quarter, namely regulatory lag on investments and inflation pressures.

A few more details on the gas utility results. Utility margin increased $0.9 million as a result of customer growth and the amortization of deferrals, partially offset by the effect of warmer weather on customers that opt out of weather normalization and lower gains on gas costs. Gas utility O&M decreased $3.8 million, reflecting lower employee benefit and contractor costs related to cost-saving measures. Partially offsetting this was higher payroll and information technology costs. Utility depreciation and general taxes increased $4.5 million due to higher property, plant and equipment investments. Other income decreased $8 million, mainly from higher pension costs, but also lower interest income and equity AFUDC. Interest expense increased $1.9 million from incremental long-term debt financing. Our other businesses reported a decrease of $2.9 million, primarily due to a gain on settlement in 2023.

With the overall cost of capital increasing, we have remained disciplined in our approach to deploying capital. For 2024, cash provided by operating activities was $246 million. We invested $200 million into the business, with the majority of the investments for safety and reliability projects in our regulated gas and water businesses. These were planned and included in our rate case requests. Our objective remains to keep our balance sheet strong with ample liquidity.

The company reaffirmed 2024 annual earnings guidance today for net income in the range $2.20 to $2.40 per share. Guidance assumes continued customer growth, average weather conditions, and no significant changes in prevailing regulatory policies, mechanisms or outcomes or significant changes in laws, legislation or regulations. In our earnings release, we have also provided our expectations regarding the quarterly distribution of consolidated earnings. We continue to target a long-term earnings per share growth rate of 4% to 6% compounded annually from 2022 through 2027.

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

David Anderson

Thanks, Brody. Turning to our gas utility, we continue to work on decarbonization initiatives. Related to renewable natural gas, our utility RFP closed in May with very good responses. We're currently evaluating the offtake proposals and expect to begin contracting soon. Work continues on our hydrogen pilots.

As you may remember, we partnered with Modern Hydrogen to become the first North American gas utility to deliver turquoise hydrogen, which permanently sequesters carbon in solid form, resulting in clean hydrogen blended directly on our system. In May, more than 100 key policymakers and other stakeholders attended our unveiling ceremony to see this technology firsthand, and in fact, just last week we also hosted a congressional delegation at the site so that they could see it, too.

At the same time, we're also piloting carbon capture technology that would reduce emissions from boilers for our largest customers. We're also examining ground source heat pump systems coupled with natural gas backup heating. We believe hybrid solutions are important to the future of energy and are excited to be at the cutting edge.

Turning to Northwest Natural Water, we continue to execute on our growth strategy. In June, we agreed to acquire Puttman Infrastructure and ICH, which will add 4,200 customers in Idaho, Oregon and California, which will ultimately grow to 19,000 as it is built out. Importantly, this acquisition provides an entry into the recycled water business.

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I'm very happy Tom will be joining our executive team to lead the water business. Tom's a recognized leader in the sustainable infrastructure market with over 25 years of experience investing, developing and operating innovative water, wastewater and recycled water systems. Most importantly, Tom shares Northwest Natural Water's core values and our commitment to customers. We expect this acquisition to close soon.

Moving now to an update on Northwest Natural Renewables. As you know, through that business, we're focused on providing cost-effective solutions to help a variety of sectors decarbonize using existing waste streams and renewable energy sources. Our first project is an investment in two facilities with EDL that is designed to convert landfill waste gases to renewable natural gas. Construction was completed on both facilities in 2023, and the raw gas production continues to be at the forecasted levels from the landfills. Our partners have finished installing needed additional equipment, and the plants are ramping up production to be able to process all of the landfill gas. I'm very pleased with its progress. EDL now expects both facilities to be online and ready to begin commercial operations later this fall. Our investment of approximately $25 million per facility will only be made at substantial completion or at our election upon reaching specified production levels. Importantly, the revenues and cash flows are expected to begin promptly thereafter from long-term, primarily fixed-price offtake agreements that we have contracted with investment-grade counterparties.

Thanks for joining us this morning. With that, we'll open it up to questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from Chris Ellinghaus with the company Siebert Williams Shank. Chris, your line is now open.

Chris Ellinghaus

Hey, David, how are you? The recycled water aspect of the recent announcement, can you just talk about where you see that market?

David Anderson

Yeah, let me look to Justin kind of take that one, if you don't mind.

Justin Palfreyman

Yeah. Good morning, Chris. The recycled water technology, it's really -- think about it as wastewater treatment plants that are installed and able to reuse the treated effluent, typically for irrigation purposes. And what that does is it really reduces the overall water required to serve a community. That's obviously important in water-scarce areas such as California, Arizona, areas of Idaho, Central Oregon. Actually, a lot of the areas that our water company currently has customers and provide service. So we see it as a really interesting technology and application that will help support growth and create new opportunities for us going forward.

Chris Ellinghaus

Do you have any other industries, like, say, geothermal, that could utilize your recycled water?

Justin Palfreyman

There are some commercial and industrial customers that Puttman Infrastructure serves in a similar format. Geothermal, I don't know that we have any specific applications there, but that's something that we could look into in the future.

Chris Ellinghaus

Okay. While I have you, what are your thoughts on the current environment for water M&A? And do you see any opportunities to accelerate sort of the tenor of your growth there?

Justin Palfreyman

Yeah. So the current m and a market, I would say it slowed down a little bit and that's probably a function of the cost of capital and just the bid-ask spread, if you will, out in the market today. So we're seeing a little bit of a slowdown, but we still have a robust pipeline of acquisition opportunities. Many of them are tuck-in acquisitions around our existing service territories. But we're always looking at opportunities to do something more substantial, and we'll take that on an opportunistic basis.

Chris Ellinghaus

Okay. And maybe this is for Brody, but vis-a-vis the water business and you guys have talked about how you see reporting that segment in the future, but is there an opportunity for you guys in terms of expediting your water reporting insofar as valuation for water utilities is materially higher, so there could be a material benefit to the stock of when that reporting takes place? So have you guys thought about that aspect?

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Brody Wilson

Yeah, thanks for the question, Chris. I think we're always considering all of our disclosures and what's valuable for our investors. And so we'll look at that both from a compliance requirement with the SEC, but then also on what we feel like is best for our investors to receive. So I would say, yes, we're always looking at that. And as this business grows, and as you know, for us on the water side, this is also an investment year. We've got a number of rate cases ongoing, and we've actually reached settlements on a number of those rate cases, setting us up for future growth in the water business. So, very pleased there. And we are always looking at that disclosures and what we plan to do in the future.

David Anderson

Yeah, we hear you, Chris, and that will drive us to make a decision. We absolutely understand evaluation impacts.

Chris Ellinghaus

Okay. One last question. Given that this is a lag year, it's a difficult year. When you get a final order in Oregon, have you thought about maybe giving some guidance at that point, maybe what your interpretation of the earnings power of that case is, or just some 2025 guidance on the earlier side?

David Anderson

We will think about that. We -- first thing to do is get through the case, right? I mean, the good news is we've got a settlement, but it still needs to be approved. So I don't want to get too far ahead of us, but we will consider that, Chris.

Chris Ellinghaus

Okay. Thanks for the details, guys. Appreciate it.

Operator

Our next question comes from Selman Akyol with the company Stifel. Selman, your line is now open.

Tyler Rakers

Hi, guys. This is Tyler Rakers on for Selman. On the Puttman water acquisition, you alluded to these growth opportunities, and I'm just sort of wondering what sort of CapEx looks like it's going into that and then whether it's more looking at growing the geographic footprint, whether it be California, or if it's more just entering more into the wastewater stuff. I'd love to get your thoughts.

David Anderson

Yeah, good questions, Tyler. So there are a few different aspects of that. In terms of the CapEx, there's certainly a long-term capital investment opportunity to support growth, but we are acquiring existing assets that serve an existing customer base. So there's a number of different communities, individual utilities that Puttman Infrastructure owns. And some of those -- many of those communities are only partly built out. So picture the treatment plant and the underground pipe infrastructure that's in the ground ready to serve future homes that are in rapidly growing areas, outside of Boise, Idaho, for example, and down in the San Diego market. And so there's long-term growth potential there and capital that already has been invested, but there's also future opportunities. And we see future opportunities in the existing service territories that they serve, but also opportunities to expand beyond that.

Tyler Rakers

Great. Thank you for that. And then on the hydrogen, I know you mentioned in the opening remarks about Modern. Just with the turquoise hydrogen, are you seeing that as sort of the path forward with that side of the business, or are you still looking at other forms of -- yeah, just hydrogen, whether it be blue or green or whatever it may be?

David Anderson

Yeah, this is David. We would look at all of them. What we were just trying to point out -- what's really unique about this opportunity is that these units can go directly on the distribution system in various places. And so you don't have to have a large hydrogen hub to make the hydrogen. So we are for all of the above on hydrogen. And I think this just shows you one more example of how R&D dollars and technology is coming to the gas business to help it decarbonize.

Tyler Rakers

Got it. And then on the -- regarding the warmer weather, you guys have mentioned, full year guidance expects more normal weather. I'm just wondering in terms of sort of sensitivity to warmer weather, how that affects future earnings.

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Brody Wilson

Yeah, thanks for the question. When we referenced the warmer weather, we did experience warmer than normal weather in the first quarter. Generally, for us, the heating quarters, first and fourth quarters are the largest impacted quarters by weather. So I think for the remainder of the year, we are forecasting and assuming normal weather. That's what we would always do. And we've worked really hard on earnings year-to-date, given the regulatory lag and inflation pressures, to help offset those with some O&M savings. And then, for the rest of the year, again, we're just -- we're assuming a normal weather for the remainder of the year.

David Anderson

And, Tyler, just a reminder on weather normalization. Most of our load is weather-normalized in Oregon, and some customers have an option to opt out, and then our Washington load doesn't have it. But well over 80% of our load is covered by weather normalization. So weather can have some impact. It's more of a minor side of the impact overall.

Tyler Rakers

Got it. Thank you, guys.

David Anderson

Thank you.

Operator

At this time, there are no other questions registered in the queue, so I'd like to pass the conference back over to David Anderson for closing remarks.

David Anderson

Well, thank you, everybody, for joining us. If you have any questions, please get a hold of Nikki, and we'll be happy to follow up in any way we can to help you out. Everybody, have a great weekend. Thank you.

Operator

That concludes today's conference call. Thank you for your participation and enjoy the rest of your day.

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