Q4 2016 Earnings Call

Company Participants

- Bill Rogers, EVP & CFO
- David Mordy, Director of IR
- Joe McGoldrick, EVP & President of Gas Division
- Scott Prochazka, President & CEO
- Tracy Bridge, EVP & President of Electric Division

Other Participants

- Ali Agha, Analyst, SunTrust Robinson Humphrey
- Charles Fishman, Analyst, Morningstar
- Jonathan Arnold, Analyst, Deutsche Bank
- Kevin Vo, Analyst, Tudor, Pickering, Holt & Co. Securities
- Michael Lapides, Analyst, Goldman Sachs
- Nick Raza, Analyst, Citigroup
- Shar Pourreza, Analyst, Guggenheim Partners
- Steve Fleishman, Analyst, Wolfe Research

Presentation

Operator

Good morning. Welcome to CenterPoint Energy's Fourth Quarter and full-year 2016 earnings conference call.

(Operator Instructions)

I will now turn the call over to David Mordy, Director of Investor Relations. Mr. Mordy?

David Mordy {BIO 20391499 <GO>}

Thank you, Thea. Good morning, everyone. Welcome to our Fourth Quarter 2016 earnings conference call.

Scott Prochazka, President and CEO; Tracy Bridge, Executive Vice President and President of our Electric Division; Joe McGoldrick, Executive Vice President and President of our Gas Division; and Bill Rogers, Executive Vice President and CFO will discuss our Fourth Quarter and full-year 2016 results and provide highlights on other key areas.

In conjunction with the call today we will be using slides which can be found under the investor section on our website, CenterPointEnergy.com. For a reconciliation of the non-GAAP measures used in providing earnings guidance in today's call please refer to our earnings press release and our slides which along with our Form 10-K have been posted on our website.

Please note that we may announce material information using SEC filings, press releases, public conference calls, webcasts and posts to the investor section of our website. In the future we will continue to use these channels to communicate important information and encourage you to review the information on our website.

Today management is going to discuss certain topics that will contain projections and forward-looking information that are based on management's belief, assumptions and information currently available to management. These forward-looking statements are subject to risks or uncertainties. Actual results could differ materially based upon factors including weather variations, regulatory actions, economic conditions and growth, commodity prices, changes in our service territories and other risk factors noted in our SEC filings.

We will also discuss our guidance for 2017. The guidance range considers Utility Operations performance to date and certain significant variables that may impact earning such as weather, regulatory and judicial proceedings, throughput, commodity prices, effective tax rates and financing activities. In providing this guidance the Company uses a non-GAAP measure of adjusted diluted earnings per share that does not include other potential impacts such as changes in accounting standards or unusual items, earnings or losses from the change in the value of the zero premium exchangeable subordinated notes, or ZENS securities. And the related stocks or the timing effects of mark-to-market accounting in the Company's Energy Services business.

The guidance range also consider such factors as enables most recent public forecast and effective tax rates. The Company does not include other potential impacts such as changes in accounting standards or Enable Midstream's unusual items.

Before Scott begins I would like to mention that this call is being recorded. Information on how to access the replay can be found on our website. With that I will now turn the call over to Scott.

Scott Prochazka {BIO 17360314 <GO>}

Thank you, David. Good morning, ladies and gentlemen. Thank you for joining us today and thank you for your interest in CenterPoint Energy.

I will begin on slide 4. 2016 was a strong year for CenterPoint. On a guidance basis EPS grew more than 5% and we finished the year at $1.16 per share versus 2015 earnings of $1.10 per share.

The $1.16 represents the midpoint of our initial guidance range of $1.12 to $1.20 but the lower end of the updated guidance we provided on our Third Quarter call. Our full-year earnings were impacted by certain Fourth Quarter events which Bill will discuss in more detail during his remarks.

Our Utility Operations contributed over 11% earnings growth on a guidance basis, finishing at $0.88 for 2016 versus $0.79 in 2015. Midstream Investments exceeded expectations by earning $0.28 per share which was at the top end of our guidance range.

Today we are reaffirming our 2017 guidance range of $1.25 to $1.33. Our forecast is built around ongoing growth contributions from both Utility Operations and Midstream Investments.

For 2018 we are forecasting that our earnings momentum will continue as we expect growth in both Utility Operations and Midstream Investments. With the current and anticipated rate filings, a fully integrated Energy Services business and continued strong performance from Enable we are now targeting achieving or exceeding the upper end of our 4% to 6% EPS growth rate for 2018 compared to 2017.

Turning to slide 5, our 2016 performance drivers, which were concentrated in our electric and natural gas utilities, include customer growth and rate increases associated with growth in rate base. We added more than 90,000 combined utility customers, grew rate base at approximately 5.4% and increased rate relief by $95 million. We accomplished this while earning near our authorized ROEs and while holding O&M increases to less than 2%, excluding items with revenue offsets as well as our recent acquisitions.

In addition to these accomplishments, I'm very proud of all the hard work that went into our two Energy Services transactions. These acquisitions complement our core business and are accretive to earnings at an attractive return. The integrations have been and will continue to be well executed and are expected to deliver long-term value to our customers and our shareholders.

Our updated five-year capital plan of approximately $7 billion translates to an annualized rate base growth in excess of 5% through 2021. This projected investment reflects continued growth throughout our six-state utility footprint. Tracy and Joe will provide capital highlights for their respective businesses.

Slide six shows some of Enable's highlights for 2016. Enable Midstream continues to be the dominant gathering and processing player in both the SCOOP and STACK plays. With 23 active rigs and some of the best returns of any of the shale plays, the SCOOP and STACK continue to fuel Enable's growth.

In 2016 Enable accomplished a number of goals including increasing their fee-based margin, extending their average contract length and reducing both O&M and G&A expenses. We continue to believe Enable is well-positioned for success in their industry. They have an attractive footprint, strong balance sheet and are focused on pursuing accretive growth and maintaining solid coverage.

Further, we believe that North American commodity resources are cost advantaged over foreign alternatives. Plus the evolving regulatory environment should encourage additional production which in turn benefits the midstream sector.

Turning to slide 7, a year ago we announced our intention to evaluate ownership alternatives for our Midstream Investments segment. This evaluation was driven by our desire to reduce earnings volatility associated with our ownership interest in Enable. As such, our criteria for completing a sale or spin of our Midstream Investments include achieving comparable earnings and dividends per share, improving the visibility of future earnings and lowering overall earnings volatility, all while seeking to maintain current credit ratings.

We continue to have dialogue with interested parties and will evaluate OGE's recent offer made pursuant to the ROFO terms of our partnership agreement. We also continue our work to understand tax characteristics and market implications of a spin. If we determined that neither a sale nor a spin would fulfill our criteria our third path will be to maintain our stake in Enable and continue to support efforts to reduce exposure to commodity price influences.

While the process has taken longer than originally anticipated, we expect to clarify which path we are on by the Second Quarter earnings call.

As we have disclosed Joe McGoldrick, who leads our Gas Division, will officially retire tomorrow after 38 years of service with CenterPoint and its predecessor companies. Joe has been an exceptional leader and highly valued member of the Company's executive committee. His deep industry knowledge and sharp business mind will be missed.

Joe's responsibilities will be separated into two roles. Scott Doyle, who has more than 20 years of electric and natural gas experience with the Company and most recently led our Regulatory and Public affairs departments, will head up the Natural Gas Distribution business. Joe Vortherms, who has been with the Company for 29 years, will continue to lead our growing Energy Services business. Joe has extensive experience across multiple areas of our gas business and also led the two recent gas marketing transactions.

I will close by expressing my appreciation to everyone in Houston who made Super Bowl LI a success. The world saw Houston at its best as it prepared for and hosted this special event. We were proud to do our part behind the scenes and we look forward to working with the city of Minneapolis as they prepare for Super Bowl LII in 2018.

Tracy will now update you on electric operations.

Tracy Bridge {BIO 17360316 <GO>}

Thank you, Scott. 2016 was another strong year for Houston Electric.

Turning to slide 9, Houston Electric's core operating income was $537 million in 2016 compared to $502 million in 2015, an increase of 7% year over year. The business benefited in 2016 from rate relief, customer growth and higher equity return, primarily due to true-up proceeds. These benefits were partially offset by higher depreciation and other taxes, higher O&M expenses and lower right-of-way revenues.

Houston Electric added over 54,000 metered customers last year, representing 2.3% growth since the Fourth Quarter of 2015. This year we are forecasting 2% customer growth, which equates to approximately $25 million to $30 million of incremental base revenue.

I'm pleased to report we managed O&M expense growth to under 1% versus 2015 excluding expenses that have revenue offsets. This year we are focused on keeping annual O&M growth under 2%.

In 2016 Houston Electric used both of our cost recovery mechanisms, transmission cost of service or TCOS and distribution cost recovery factor or DCRF, for timely rate relief. A complete overview of regulatory developments in 2016 can be found on slide 29. In December we filed TCOS for $7.8 million in annualized rate relief for transmission capital invested in 2016. We expect to file DCRF in April and TCOS in the Second Quarter of 2017.

Turning to slide 10, Houston Electric invested $858 million of capital in 2016 including $72 million related to the Brazos Valley Connection project, a nearly 60-mile transmission project. In response to ongoing customer and load growth, Houston Electric will continue to invest significant capital to ensure our system is safe, resilient and reliable. Our new five-year plan includes $4.1 billion of capital investment.

We anticipate capital investment in 2017 and 2018 will be higher than later years in the five-year plan due to our investment in the Brazos Valley Connection project. We began construction this month and the project is proceeding as scheduled. Total capital investment in the project is expected to be $310 million. We expect to complete construction and energize the Brazos Valley Connection by June 2018.

As shown on slide 11, our planned capital investments translate to projected rate base growth of approximately 5% on a compound annual growth basis through 2021. I am very pleased with Houston Electric's strong operational and financial results in 2016. And we expect continued growth in the coming years.

I will now turn the call over to Joe for an update on natural gas operations.

Joe McGoldrick {BIO 5483407 <GO>}

Thank you, Tracy. As we have previously mentioned we expected natural gas operations to be an earnings catalyst in 2016 and we delivered. Our natural gas operations, which includes both our Natural Gas Distribution business and our non-regulated Energy Services business had a strong year.

Turning to slide 13, Natural Gas Distribution's operating income was $303 million in 2016 compared to $273 million in 2015, an increase of 11% year over year despite continued extremely mild temperatures across our service territories. The business benefited from rate relief, revenue from decoupling mechanisms, lower bad debt expense and customer growth. These benefits were partially offset by increased depreciation, higher labor and benefits expenses and increased contract services expense related to pipeline integrity and system safety.

Natural Gas Distribution added over 35,000 metered customers last year, representing 1% growth since the Fourth Quarter of 2015. Natural Gas Distribution is forecasting 1% annual customer growth again in 2017.

O&M expenses in 2016 were approximately 2% higher than 2015, excluding certain expenses that have revenue offsets. O&M expense discipline remains a priority to the business. And I'm very pleased with the improvements that we have made in our credit and collections processes as one example of that disciplined approach.

Natural Gas Distribution's multijurisdictional regulatory strategy resulted in strong rate relief in 2016. For a complete overview of regulatory developments in 2016 please see slides 30 and 31.

In November we filed a Texas Gulf rate case that seeks to combine our operationally and geographically aligned Houston and Texas coast jurisdictions. This case was required based on a prior settlement with the city of Houston. And we had exhausted the statutorily allowed GRIP filings there requiring us to establish new base rates. The filing seeks to recover $31 million in rate relief including recovery of deferred expenses and changes in depreciation rates and requested ROE of 10.25%. The final order is expected in the Second Quarter of 2017.

Though we are unable to file GRIP in the Texas Gulf area during the rate proceeding, we expect to file GRIP in South Texas and East Texas in the Second Quarter and a rate case and South Texas in the Fourth Quarter. In April, we will make our first formula rate plan filing, or FRP, in Arkansas. We also anticipate filing a rate case in Minnesota later this year.

During 2017 Natural Gas Distribution is unlikely to repeat 2016's performance in terms of new incremental rate relief as a result of the time required to prosecute the rate case in Texas and, of course, filing delay in GRIP filings.

Turning to slide 14, we invested $510 million in Natural Gas Distribution last year, back to a more normal level after completing our automated meter reading capital project in 2015. Our new five-year plan includes $2.7 billion of capital expenditures and reflects consistent annual investment. We are prioritizing capital investments with a focus on safety, reliability and growth.

As a result of our capital plan, as you can see in slide 15 rate base is projected to grow at a 6.6% compound annual growth rate through 2021.

Turning to slide 16, Energy Services delivered solid results in 2016. Operating income was $41 million in 2016 compared to $38 million in 2015, excluding a mark-to-market loss of $21 million and a gain of $4 million respectively and despite incurring $3 million of O&M expenses and $3 million of amortization expenses specifically related to acquisition and integration cost. The $3 million improvement is due in part to the acquisition of Continuum's retail energy services business.

In January, we closed on the acquisition of Atmos Energy Marketing or AEM. With similar business models and a commitment to customer service, AEM is a strategic fit for Energy Services that will allow us to access new markets and expand customer segments. Similar to the

Continuum transaction, the AEM acquisition is expected to be modestly accretive in the first year even after accounting for integration expenses.

Both of our recent transactions have positioned us to effectively serve our customers as well as improve margins and throughput. We expect to capture synergies and reduce G&A over time as we leverage economies of scale while maintaining our low value at-risk cost effective organizational structure. We anticipate Energy Services will contribute for $45 million to 55 million in operating income in 2017.

I am very pleased with Natural Gas operations performance in 2016. We expect strong growth going forward as we continue to focus on financial and operational performance.

Before I turn the call over to Bill I'd like to thank all the investors and analysts that I worked with over the years. Without you we cannot grow our business.

I have enjoyed a long and fulfilling career at a great Company and I always tried to make a difference and lead by example. I'm confident that Scott Doyle and Joe Vortherms will do the same.

I will now turn the call over to Bill who will cover financial activities.

Bill Rogers {BIO 15746544 <GO>}

Thank you, Joe. And congratulations on a distinguished career of service for our CenterPoint customers. Good morning, to everyone.

I will start with a reconciliation of our GAAP and guidance earnings for the Fourth Quarter and for the full year as provided on slide 18. This morning we reported $0.23 of earnings per diluted share on a GAAP basis and $0.26 in earnings per share on a guidance basis for the Fourth Quarter. This compares to a GAAP loss of $1.18 and a guidance basis income of $0.27 for the Fourth Quarter of 2015.

In Fourth Quarter 2016 we add back $0.01 of mark-to-market adjustments from our Energy Services business and $0.02 of ZENS-related adjustments in order to arrive at Fourth Quarter 2016 earnings on a guidance basis of $0.26. In Fourth Quarter 2015 we added back $1.44 associated with the impairment of our investment in Enable and a $0.01 per share loss related to ZENS or $0.27.

For the full-year 2016 we reported $1 in earnings per diluted share on a GAAP basis and $1.16 per share on a guidance basis. This compares to a GAAP loss of $1.61 and a guidance basis earnings per share of $1.10 for the full-year 2015.

For 2016 we add back $0.03 of mark-to-market adjustments from our Energy Service business and $0.13 of ZENS-related adjustments to arrive at our 2016 earnings on a guidance basis. For 2015 we added back the full-year impairment loss of $2.69 and a net loss of $0.03 associated with ZENS. We also subtracted $0.01 of mark-to-market gains to arrive at a guidance basis EPS of $1.10 for 2015.

Whether the comparison is on a GAAP or guidance basis we had solid earnings performance improvement in 2016 relative to 2015. That includes certain one-time events in the Fourth Quarter of 2016 that I will address shortly.

Next we move to slide 19. And I will summarize comments from Scott, Tracy and Joe to review Utility Operations performance and the contributions that take us from $0.79 of Utility Operations guidance EPS in 2015 to $0.88 in 2016. Core operating income improvements excluding amounts associated with equity return equates to a net $0.08 accretion. We had further $0.03 improvement from equity return primarily related to true-up proceeds. And we had a $0.03 improvement in the result of our $363 million investment in Enable 10% preferred securities which closed in the First Quarter of 2016.

Debt refinancing and balance sheet management reduced our year-on-year interest expense by $0.02. That interest expense savings is inclusive of an increase of debt of approximately $200 million. The year-on-year earnings improvements were partially offset by a Fourth Quarter $22 million pre-tax or $0.03 per share after-tax charge for a redemption premium to retire $300 million of debt that would otherwise mature in 2018. The other category total reduction of $0.04 a share and this category includes higher income taxes and lower other income.

Now turning our attention to slide 20, we show the combined $0.09 Utility benefit and the $0.03 year-on-year decline for our Midstream Investments bridging the $1.10 of 2015 EPS guidance to the $1.16 of 2016 EPS guidance. The components of our year-on-year decline of $0.03 related to Midstream began with a $0.06 year-on-year increase from basis difference accretion that was triggered by our 2015 impairment charge. On a going forward basis, accretion will be $0.07 a share assuming no further impairments our current effective tax rate and our current share count.

This increase was more than offset by a $0.02 per share tax adjustment including amounts associated with the Louisiana income at the Enable level. Further, in 2016 Enable had mark-to-market accounting losses relative to its gains in 2015. These 2016 losses on mark-to-market accounting relative to 2015 gains resulted in a year-on-year difference of $0.07.

On slide 21 we review our balance sheet strength and financing plans. We are very pleased that funds from operations to debt increased to 24% in 2016 versus 23% for 2015. Although we do not expect future years' FFO debt metric to be as strong we continue to target a minimum of 18% to 20% FFO to debt in order to maintain or improve existing credit ratings as well as maintain our debt capacity within our credit ratings.

We continue to look for opportunities to reduce interest expense. For example, in 2016 we had over $600 million of above 6% debt that was retired and our new issued 2016 financing, all at the CEHE level, had coupons of 1.85% and 2.4%. Our Fourth Quarter redemption of 6.5% debt otherwise maturing in 2018 is another example of thoughtful balance sheet management.

Now moving forward to 2017, we anticipate $200 million to $500 million of incremental borrowings to support our approximately $1.5 billion capital program and our recent acquisition of Atmos Energy Marketing. Although we anticipate higher debt by year-end 2017, we expect interest expense to decrease given recent refinancing activity and the coupons on 2017 maturities relative to the current interest rate forward curve. We do not anticipate issuing equity in 2017 or 2018 as we expect credit metrics to be at or above our targets.

With respect to our dividend, in January we declared a dividend with a 4% increase relative to the most recent paid quarterly dividend. We target competitive increases in our dividend and with our earnings growth we anticipate the payout ratio to decline as a result of our forecasted earnings momentum.

Moving it to slide 22, we are reiterating our 2017 full-year guidance range of $1.25 to $1.33. This is comprised of $0.93 to $0.97 for Utility Operations and $0.31 to $0.37 for Midstream Investments. The growth in Utility Operations guidance range to a 2017 midpoint of $0.95 has a number of drivers beyond utility rate relief and customer growth.

We anticipate Energy Services will deliver $45 million to $55 million of operating income for 2017 versus $41 million in 2016 after adjusting for the 2016 mark-to-market loss. This forecasted increase is both a result of recent acquisitions and expected higher operating income margin. We expect to receive a full year of preferred dividends from Enable in 2017.

The additional full quarterly payment is an increase of approximately $9 million in net income. As previously discussed, we anticipate capturing additional interest expense savings providing $10 million to $20 million of net income benefit. Midstream's investment range is a direct translation of Enable's $315 million to $385 million net income guidance attributable to unit holders.

We then apply CenterPoint's 54% share of the LP units, add basis difference accretion and tax effective result. Lastly, our 2017 effective tax rate should be 36%.

With that review of 2017 drivers, looking forward to 2018 as Scott stated earlier in the call we are targeting to achieve or exceed the upper end of our 4% to 6% EPS growth rate in 2018 over actual performance in 2017.

Finally, we appreciate that many of you are closely watching the potential for comprehensive tax reform. We have prepared a few slides to explain CenterPoint's current tax position from an income statement, cash payment and balance sheet perspective beginning on slide 24.

I have previously discussed our 2016 and projected 2017 effective tax rate. For 2016, CenterPoint's cash tax rate was approximately 4%. This is significantly lower than the statutory rate and is primarily a result of bonus depreciation and tax shield provided by Enable.

Having provided that, it's important to note that CenterPoint is now and is expected to be a cash taxpayer. At the end of 2016 we had no remaining federal tax carryforwards. And we do not have tax credits.

With respect to our investment in the Enable partnership, the taxable income is based on their tax elections at the partnership level. These elections currently include bonus depreciation.

We have provided our deferred tax liability and deferred tax asset disclosure on slide 25. This is substantially the same disclosure in our Form 10-K filed this morning with the separation of the deferred tax assets and liabilities into utility-related and non-utility-related columns.

The majority of our deferred tax liabilities are not related to our utilities. A lower corporate tax rate for these non-utility-related items will likely be recognized as an income statement benefit or other comprehensive income, strengthening our balance sheet and reducing associated cash taxes over time.

A lower corporate tax rate for our regulated utility-related investments would likely result in a lower deferred tax liability with an associated and equal increase in regulatory liabilities. These regulatory liabilities would be amortized over time, providing lower rates for our customers.

Next I will move to slide 26. We have made three basic assumptions to provide a directional view of financial results from contemplated comprehensive tax reform relative to our current forecast. These assumptions are a lower corporate tax rate of 20%, the election to deduct 100% of capital expenditures and the disallowance of existing and future interest expense.

We would expect the loss of interest expense deduction to be a permanent item and, therefore, increase our effective tax rate relative to the new lower statutory rate. Under only those basic assumptions, the impact to CenterPoint should be a stronger balance sheet, greater earnings per share from a lower effective tax rate and lower cash taxes as a result of both lower statutory rates and the capital expenditure deduction. Under our current capital plan, the rate of growth in our rate base would modestly decline as a result of the increase in deferred tax liability and associated offset to rate base.

As I've stated, all of these directional assumptions are relative to our current forecasts and are based on our current business mix. And none of this is to suggest we have any insight into comprehensive tax reform or its timing if at all.

I will close by reminding you of the $0.2675 per share quarterly dividend declared by our Board of Directors on January 5. This represents a 4% increase over the previous quarterly dividend consistent with our 4% increases in 2015 and 2016 and marks the 12th consecutive year we have increased our dividend.

With that I will now turn the call back over to David.

David Mordy {BIO 20391499 <GO>}

Thank you, Bill. We will now open the call to questions.

In the interest of time I will ask you to limit yourself to one question and a follow-up. Thea?

Questions And Answers

Operator

(Operator Instructions) Jonathan Arnold, Deutsche Bank.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Good morning, guys. Just a quick one, Scott, I think you expected to give an update on your decision on direction with Enable on the Second Quarter call. Did you mean the call that will take place in the Second Quarter or the actual reporting of the Second Quarter earnings in Q3?

A - Scott Prochazka {BIO 17360314 <GO>}

It would be the reporting of the Second Quarter earnings in Q3. We anticipate the exercise would be virtually completed or essentially completed by the Second Quarter. But our first opportunity to discuss it would be in the Third Quarter call -- or the Second Quarter call, sorry.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Sorry about that. I just wanted to clarify.

Then could you also just talk about how you've thought about Enable in making the statement on 2018 growing at the high-end off of whatever you earn in 2017? Does that contemplate current status or do you think you could be there, in an exit scenario what should we take from that?

A - Scott Prochazka {BIO 17360314 <GO>}

Yes, Jonathan, we assumed that the performance of Enable continues to be strong. But we did do some testing of various performance levels of Enable and have concluded that under a number of growth scenarios for Enable, including very modest growth, we would still be able to achieve that.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Do you think you'd be able to achieve that if you no longer held the position for 2018? Should we assume that, too?

A - Scott Prochazka {BIO 17360314 <GO>}

Well I think under that scenario you've got a very different picture to look at. But as I told you to the extent that we move forward with an opportunity around the transaction our objectives were to maintain comparable earnings and dividend.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Yes, I saw that. So I guess we take this as a statement that should apply in all scenarios?

A - Scott Prochazka {BIO 17360314 <GO>}

Yes. That's a fair way to look at it.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Okay. Thank you.

Operator

Steve Fleishman, Wolfe Research.

Q - Steve Fleishman {BIO 1512318 <GO>}

Hey Scott, Bill, how are you? So first, just a technical question, what was the year-end tax basis for Enable?

A - Scott Prochazka {BIO 17360314 <GO>}

Steve, I'm looking at Bill. I think he is trying to find that number at the moment.

Q - Steve Fleishman {BIO 1512318 <GO>}

Okay. And maybe in the meantime, just in terms of just thinking about what you are going to know by the Second Quarter versus what you know now, I mean I don't know if tax reform is something that you need to know for things like the spin, or I guess I'm just a little confused like why hasn't something happened now and what are things that could happen in the next quarter or two that suddenly you know you will have an answer by then?

A - Scott Prochazka {BIO 17360314 <GO>}

It's not connected to clarity around tax policy. This is just the ongoing dialogue we've been having with parties and our estimate of when we believe that would come to an end. It has nothing to do with tax.

In fact, as we've mentioned this review is really around trying to address the volatility of earnings. And we are going to conclude this even without having clarity on what the future tax policy may look like.

Q - Steve Fleishman {BIO 1512318 <GO>}

Okay. Then I guess Bill, do you have the Enable answer?

A - Bill Rogers {BIO 15746544 <GO>}

I have that, Steve. That's within our footnote on income taxes and the best way to think about it is the deferred tax liability is $1.38 billion. And the other piece of data you need on that is where we record the investment in Enable, that's in our assets on our balance sheet and that's the equivalent of $10.71 a share at year-end.

Q - Steve Fleishman {BIO 1512318 <GO>}

Okay. Then just when you look at the plan for 2017 or 2018, can you give us a sense of where your earned returns are and just make sure comfort that those are going to be okay? I don't think you need to as part of your reviews like DCRF or TCOS or whatever, there is no real review of returns, right?

A - Scott Prochazka {BIO 17360314 <GO>}

Yes, Steve, the mechanism that has a return review would DCRF. So we cannot make a DCRF filing if we are earning over our authorized return per our EMR that we file.

That's the one that has the structured limitation to it. That said we do anticipate filing DCRF this year.

A - Bill Rogers {BIO 15746544 <GO>}

And Steve, our expected return on equity within the equity calculation for rate base would be within 25 basis points to 100 basis points less than our allowed return, depending upon the entity.

Q - Steve Fleishman {BIO 1512318 <GO>}

Great. Thank you. I appreciate it.

Operator

Shar Pourreza, Guggenheim Partners.

Q - Shar Pourreza

Good morning, guys. Just to confirm, your growth guidance, your trajectory for 2018 doesn't assume any sort of tax policy changes including some of the accretion that you may anticipate. Then when you think about longer-term growth how we should think about that when you've got a front-end loaded CapEx picture as far as on the electric side how we should think about the trajectory a little bit further out?

A - Scott Prochazka {BIO 17360314 <GO>}

I will answer the first part of that. I will ask Bill to comment on the second. The first part is no, we do not assume as we look to 2017 or 2018 forecasted or projected targeted growth performance that there's any form of change in tax policy.

Bill, do you want to comment on the second part of that?

A - Bill Rogers {BIO 15746544 <GO>}

With respect to longer-term growth I think your anchor point should be the rate of race-based grossed. And we would expect earnings contribution to grow approximately 1% less than that.

Q - Shar Pourreza

Okay, that's helpful. And sorry if I missed this. But what was the O&M guidance for the gas business for 2017. And then when you look at the utility in general how we should think about cost inflation through your five-year plan?

A - Joe McGoldrick {BIO 5483407 <GO>}

We remain committed to managing O&M in a very disciplined way. And so that will be approximately 2%, perhaps slightly above that in some years given the activity around pipeline integrity expenses. But we will do everything we can to continue with the strong O&M discipline that we've been executing on in the past.

Q - Shar Pourreza

Thanks guys. Congrats on the results.

Operator

Michael Lapides, Goldman Sachs.

Q - Michael Lapides {BIO 6317499 <GO>}

Hey guys, congrats on a good 2016. One question, I want to make sure I understand for Energy Services what is included and if anything what is not included in your 2017 guidance. Are you including all of the impact of both Continuum and AEM's acquisition in the 2017 guidance?

A - Scott Prochazka {BIO 17360314 <GO>}

Michael, this is Scott. Good morning.

Yes. We have factored in the net impact of all of that in our comments around 2017 performance, which includes essentially an integrated continuum and then the effects of the integration process associated with AEM. We think AEM will be I'll to describe it as modestly accretive this year. But all of that is included in the numbers that we provided.

Q - Michael Lapides {BIO 6317499 <GO>}

And do you think that business has a different growth rate than the gas distribution business does?

A - Scott Prochazka {BIO 17360314 <GO>}

I think that has the potential to grow at or slightly stronger than our utility business. It's really predicated on opportunities that come as a result of additional scale. But I would say it's very close in growth rate. It's not something that's dramatically different.

Q - Michael Lapides {BIO 6317499 <GO>}

Got it. And different topic. And this one may be for Bill, when I look at your debt schedule, both at CERC, even a little bit at CEHE and not much left at the parent. But you've still got a number of tranches in the almost 6% range up to the high 6%s, almost to the 6.9%.

And it doesn't look like the make-wholes are really that expensive, just treasury yield plus 20 to 35 basis points or so. How are you thinking about refinancing what effectively is high-cost debt in this environment and the timeline for taking some of that out?

A - Bill Rogers {BIO 15746544 <GO>}

Well first, you are right, we do have, I think, in today's environment what might be considered high coupon debt. The debt the just matured in February of this year had a coupon of 5.95%. The debt that matures in November has a coupon of 6 1/8%.

We think about that as an investment decision. And if it's net present value positive on a cash-on-cash basis to redeem debt early then we will do that. That's exactly how we thought about it in late 2016 when we executed the make-whole call and redeemed $300 million of debt. It was a $22 million charge to our earnings. But it was a net present value positive decision on our part.

Q - Michael Lapides {BIO 6317499 <GO>}

And was that $22 million charge, was that all cash?

A - Bill Rogers {BIO 15746544 <GO>}

Yes.

Q - Michael Lapides {BIO 6317499 <GO>}

And the only reason why I ask is that the debt, a lot of the refinancing opportunities that may exist right now are actually either at CERC or at CEHE, meaning not necessarily as much at the parent because you've done a good job of dealing with parent debt. It strikes me that would refinancing a lot of that debt down at the opcos would give you the opportunity over time, especially as you go in for rate relief to potentially impact customer bills, maybe alleviate any upward pressure on customer bills due to the investment you are making. Maybe even give you more headroom to increase the amount of capital you deploy.

A - Bill Rogers {BIO 15746544 <GO>}

You are correct. And we take a look at those opportunities regularly and should they be NPV positive for the customer, in the case of CEHE and our CERC-related gas utilities then we will redeem that debt and refinance it. And in that case there will be no charge to earnings.

Q - Michael Lapides {BIO 6317499 <GO>}

Got it, thanks Bill. Much appreciated.

Operator

(Operator Instructions) Ali Agha, SunTrust.

Q - Ali Agha {BIO 1509168 <GO>}

Thank you. Good morning. Scott, coming back to your thinking through on the Enable ownership, obviously you guys have been working at it for a while now and one of the impediments. And you alluded to that again has been the tax leakage associated with that, particularly if there is a sale for cash. Is it fair to assume that that scenario is probably not high on the table given the tax leakage implications and perhaps sale for stock or spinoff if you are going to do anything are the two most likely outcomes?

A - Scott Prochazka {BIO 17360314 <GO>}

We haven't handicapped each of these individually but we've certainly been clear about the challenges we have with a cash sale from a tax leakage standpoint. So I would say your characterization is perhaps accurate. We do continue to have the challenges associated with tax leakage if we were to pursue a sale as you pointed out.

Q - Ali Agha {BIO 1509168 <GO>}

Yes. And on the OGE ROFO, they have had a ROFO before and you guys decided not to take it and they went the other way and now they have come back with the ROFO a second time around. Again, is that procedural or is that something as a real option given that we've already been through this exercise before with them?

A - Bill Rogers {BIO 15746544 <GO>}

It's Bill. That is largely procedural. If we intend to have discussions with third parties, then under our partnership agreements our partner has a right of first offer. And so long as we are having those discussions and don't complete a transaction within a time limit we will need to give them another right of first offer.

Q - Ali Agha {BIO 1509168 <GO>}

Right. So Bill, fair to say, I mean this is just the same ROFO that's come back again?

A - Bill Rogers {BIO 15746544 <GO>}

That's correct.

Q - Ali Agha {BIO 1509168 <GO>}

I see. Then and then Scott also to be clear on your comments, as you mentioned if none of these options comes to conclusion doing nothing and working with the system is an option.

Am I to read into that that's probably become a bigger option today than maybe it was when you started the process? Are you committed to doing something or doing nothing may end up being the best option after all?

A - Scott Prochazka {BIO 17360314 <GO>}

I think we've been pretty consistent about expressing that any of these are viable options. But the real gating item here is whether something other than retaining our ownership would allow us to achieve the objectives we've laid out.

If we can't achieve the objectives we've set forth then our option of maintaining our ownership and continuing to work with Enable to be less volatile is certainly a very viable path. We have been doing that all along, quite frankly. And they've had some great successes in the efforts that they have made in 2016 to just do that. And that effort would continue going forward.

Q - Ali Agha {BIO 1509168 <GO>}

And last question again just to round this out, fair to say that the fact that it has taken longer than expected has been to try to figure out the most tax efficient way of making an exit if possible? Has that really been the issue that held you guys back?

A - Scott Prochazka {BIO 17360314 <GO>}

You know we, for practical purposes we didn't really, weren't able to start this process until the latter part of the summer last year. Shortly after we made the announcement the market fell off precipitously. And we needed to have a viable forecast from Enable that we could use in these discussions.

So we weren't really able to start anything until the August time frame of last year. So we are not as far into this as it appears we might be. But we are committed to working this through and exploring the various options that we have. And we will make our decisions accordingly based on our ability to achieve those objectives.

Q - Ali Agha {BIO 1509168 <GO>}

Understood. Thank you.

Operator

Kevin Vo, Tudor, Pickering.

Q - Kevin Vo {BIO 19930628 <GO>}

Hi. Good morning. Just following up on Ali's questions on Enable, I know you mentioned how the decision will likely come before any potential tax reform. But could you walk us through how the tax reform could lower the tax leakage at all from Enable? From a sale or spin of Enable how should we think about the impact there?

A - Bill Rogers {BIO 15746544 <GO>}

Kevin, it's Bill. So on a cash sale of Enable assuming we had a lower statutory rate and that statutory rate was also the capital gains rate for corporations, then that would lower our tax bill.

Q - Kevin Vo {BIO 19930628 <GO>}

Okay. That's the question I had. Thank you.

Operator

Charles Fishman, Morningstar.

Q - Charles Fishman {BIO 4772353 <GO>}

Hi. Good morning. You know, since my questions on Enable have been answered let me just give one to Joe before he gets out of Dodge.

Joe, a couple years ago you instituted or were able to get together with the Minnesota commission and get a decoupling mechanism for weather. And if memory serves me this might be your first winter where that's really going to come in handy. Is that working or do you anticipate it working to your expectations this winter?

A - Joe McGoldrick {BIO 5483407 <GO>}

Yes, Charles, your memory is good. This is, in fact, we've had it in place for almost a year now and it benefited us last year as well. And obviously, with these mild temperatures this year it will also continue to be a benefit.

So as I said in my remarks we had a great 2016 despite these mild temps. And that was in large part due to the Minnesota decoupling.

And we recently got it was a $25 million true-up that was approved last fall that we have begun to bill under that mechanism. It's a three-year pilot. So we are hopeful that we can translate that into a permanent tariff after that three-year period expires.

Q - Charles Fishman {BIO 4772353 <GO>}

Okay. Then just as a follow-up, with the transmission loop around Minneapolis that you are working on, where does that stand?

A - Joe McGoldrick {BIO 5483407 <GO>}

Yes. The beltline project continues to go well. We are actually a little bit ahead of schedule. I can't remember the exact date as to when that will conclude.

But we are spending significant capital on that, replacing that 60-plus or so mile loop around the city of Minneapolis. And everything is on track if not ahead of schedule.

Q - Charles Fishman {BIO 4772353 <GO>}

You are on the home stretch of that, aren't you? Just another year or two?

A - Joe McGoldrick {BIO 5483407 <GO>}

No. There is more than that. There is about four or five more years, Charles.

Q - Charles Fishman {BIO 4772353 <GO>}

Okay. Thank you. That's all I had. And good luck Joe.

A - Joe McGoldrick {BIO 5483407 <GO>}

Thank you.

Operator

Nick Raza, Citigroup.

Q - Nick Raza {BIO 20528692 <GO>}

Thank you, guys. Just a couple of quick follow-ups. On Enable, assuming that a transaction does occur is there a thought around what you would do with the preferreds you currently own with the Company?

A - Bill Rogers {BIO 15746544 <GO>}

Nick, it's Bill. Should there be a transaction we could go one of two directions. We could continue to own a preferred and make sure that we are protected in a right way by its current non-cumulative feature and so we've built that into the original structure that we negotiated with Enable or we could include that preferred in the sale or a transaction with another party.

Q - Nick Raza {BIO 20528692 <GO>}

Okay. And that would effectively reduce the tax basis, correct?

A - Bill Rogers {BIO 15746544 <GO>}

The preferred is its own tax basis.

Q - Nick Raza {BIO 20528692 <GO>}

Okay, fair enough. Then I guess if I look at slide 15 and 14, your rate base is growing on average about 200 to 250. And I guess you are spending about $534 million a year pretty flat for the Natural Gas Distribution.

But if I take out the system maintenance and improvements that's only about $100 million. Am I missing something?

A - Bill Rogers {BIO 15746544 <GO>}

You are looking at slide 14?

Q - Nick Raza {BIO 20528692 <GO>}

14 and 15.

A - Bill Rogers {BIO 15746544 <GO>}

Yes. So you are correct. The majority of the spend is in that blue category, if that is what you were trying to confirm.

Q - Nick Raza {BIO 20528692 <GO>}

Well I guess what I'm getting at is that if I take the system maintenance and improvements out you only have about $100 million left. So how does the rate base going from $2.8 billion to $3.7 billion, which is an average of about $200 million a year growth. I'm sure it's probably something else that I am missing.

A - Joe McGoldrick {BIO 5483407 <GO>}

Nick, this is Joe. I think if you are just trying to back into the rate base number it would be for the most part it's CapEx minus D&A and deferred taxes.

A - Bill Rogers {BIO 15746544 <GO>}

It's Bill, just to jump in here and follow on Joe McGoldrick's comments. You know, rate base is the CapEx less depreciation, less deferred taxes.

Q - Nick Raza {BIO 20528692 <GO>}

And that's actually a good segue. In terms of your current deferred tax liabilities on slide 25 I understand the $2.3 billion is in the Utility Business. Where is most of that located? Is it Transmission & Distribution or Natural Gas Distribution?

A - Bill Rogers {BIO 15746544 <GO>}

Well it's across all asset classes but you can see really the majority of that is in PP&E, as disclosed both in this table on 25 as well as our tax footnote.

Q - Nick Raza {BIO 20528692 <GO>}

Okay. And you mentioned there'd be a liability should there be a tax relief presented there would be a reduction in rate. Do you know what that would be if all of this deferred tax liability were to go away in terms of percentage of rate reduction?

A - Bill Rogers {BIO 15746544 <GO>}

That would depend on when new rates are set. So it would be either a matter of going through our mechanisms where they have them at the gas utilities or through general rate cases.

And I said regulatory liabilities because there would likely be different regulatory liabilities depending upon the nature of the original deferred tax liability. And the amortization of that life of the regulatory liability would be part of the rate case and/or the mechanism.

Q - Nick Raza {BIO 20528692 <GO>}

Okay, fair enough. So fair enough. All right. Thanks guys.

A - David Mordy {BIO 20391499 <GO>}

Thank you, everyone for your interest in CenterPoint Energy. We will now conclude our Fourth Quarter 2016 earnings call. Have a nice day.

Operator

This concludes CenterPoint Energy's Fourth Quarter and full-year 2016 earnings conference call. Thank you for your participation. You may now disconnect.