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# Atmos Energy Corporation (ATO) CEO Kevin Akers on Q4 2019 Results - Earnings Call Transcript

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FQ4: 11-06-19 Earnings Summary

*Press Release* *10-K* *Slides*

EPS of $0.49 beats by $0.01 | Revenue of $443.68M (-0.23% Y/Y) misses by $-139.3M

## Earning Call Audio

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00:00 -23:04

Atmos Energy Corporation (NYSE:ATO) Q4 2019 Earnings Conference Call November 7, 2019 10:00 AM ET

**Company Participants**

Jennifer Hills - Vice President of Investor Relations

Kevin Akers - President and Chief Executive Officer

Christopher Forsythe - Senior Vice President and Chief Financial Officer

**Conference Call Participants**

**Operator**

Greetings and welcome to the Atmos Energy Fourth Quarter Earnings Conference Call. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Jennifer Hills, Vice President of Investor Relations. Thank you. You may begin.

**Jennifer Hills**

Thank you, Jessie. 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 54 and are more fully described in our SEC filings.

Our first speaker is Christ Forsythe, Senior Vice President and CFO of Atmos Energy. Chris?

**Christopher Forsythe**

Thank you, Jennifer, and good morning everyone. We appreciate you joining us and your interest in Atmos Energy. Yesterday, we reported fiscal 2019 net income of $511 million, or $4.35 per diluted share. This represents the 17th consecutive year of rising earnings per share. Slide 6 and 7 provide details of the year-over-year changes to operating income for each of our segments. I will touch on a few of the fiscal year highlights. Consolidated contribution margin rose about 5% or about $95 million. Rate increases driven by increased safety and reliability capital spending provided an incremental $80 million. Virtually all of these increases were in our Texas, Louisiana, and Mississippi jurisdictions.

As we've discussed over the last couple of quarters, our pipeline and storage segment benefited from the supply and demand dynamics that have impacted pricing in the Permian Basin over the last 12 to 18 months. We were able to capture a portion of the widened Waha and Katy spread, resulting in a $12 million increase over fiscal 2018. However, as expected, a new merchant pipeline came online mid-summer and we saw narrower spread opportunities in the back half of the fourth quarter.

Finally, our distribution segment continuing to experience solid customer growth. Over the last 12 months, our distribution segment added a net 37,000 customers a 1.2% increase over the last year. Consolidated operating expenses rose approximately 6%, reflecting higher depreciation expense associated with increased capital spending and higher O&M spending, attributed to increased pipeline integrity and maintenance activities and higher employee costs.

As we discussed last quarter and fiscal 2019, we increased service related headcount in our Mid-Tex division to support the growth in our DFW market. Additionally, we continue to roll-out - our roll-out of advanced leak survey technology. All of this roll-out has modestly increased our O&M. It plays an important role in our ability to identify and mitigate risk.

Finally, we continue to increase the training provided to employees to further enable them to operate our system safely and reliably. Consolidated capital spending increased 15% to $1.7 billion with 87% of our spending directed toward investments to improve the safety and reliability of our system. Our ability to support this level of capital spending is due in part to the various regulatory mechanisms we have in place to minimize regulatory lag. During fiscal 2019 over 85% of our capital spending began to earn a return within six months of the test period ends.

We accomplished this by implementing a $117 million in annualized operating income increases in 23 regulatory proceedings. Since September 30th, we have implemented an additional $57 million through six regulatory proceedings that were filed in the back half of fiscal 2019. As of today, we have four filings pending, seeking about $6 million. Slide 39 to 53 summarizes regulatory activities for fiscal 2019.

Our ability to support this level of capital spending is also predicated on our ability to attract the necessary long-term financing to fund our ongoing capital expenditure program while maintaining the strength of our balance sheet.

During the fourth quarter, we continue to utilize equity forward agreements executed under our ATM to help meet our fiscal 2020 equity needs. We issued 1.4 million shares at an average price of $108.70. Additionally, we sell forward agreements for $1.1 million and 1.1 million shares for net proceeds of approximately $100 million. As of September 30, 2019, we had about $463 million remaining under equity forward arrangements.

This issuance completed a very busy financing year, when we are able to successfully raise over $2 billion of debt and equity financing. In the process, we reduce a weighted average cost of debt from 5.21% to 4.58% and increased our weighted average maturities from 16 years to 22 years, helping to ensure our customers benefit in the current low interest rate environment for years to come. And our equity capitalization increased 230 basis points to 59% as of September 30.

We finished the fiscal year with approximately $1.6 billion of liquidity under our credit facilities and equity forward agreements. Details of our financing activities including our equity forward arrangements, as well as our financial profile can be found on Slide 9 to 11.

Looking forward, fiscal 2020 represent the 9th year of executing our operating plan to modernize our distribution, transmission and storage systems. Our plan to summarize on Slide 13. We expect fiscal 2020 earnings per share to be in the range of $4.58 to $4.73 per diluted share, with about 68% of our earnings coming from our distribution segment. By fiscal 2024, we anticipate earnings per share to be in the range of $5.90 to $6.30 per diluted share.

Slides 14 and 15 present some of the details supporting our fiscal 2020 guidance. O&M is expected to be in line with fiscal 2019. Our O&M will continue to be focused on risk-based activities that address system safety and compliance. These activities include enhanced leak survey, pipeline integrity work and continued records establishment and retention. It also includes spending to work to help us, to set a baseline of understanding of our system for PHMSA's new integrity management rules go into effect on July 1, 2020. As we've discussed in the past, we have been anticipating these new rules for few years and reflected that activity in our future O&M projections.

As a result, similar to last year's five-year plan, we continue to assume O&M inflation of 2.5% to 3.5% annually. Depreciation will rise due to high-level capital spending; interest expense was lower as we reduced our weighted average cost of debt and expect to capitalize more interest through AFUDC.

And finally, we expect our effective tax rate to be between 20% and 22% in fiscal 2020, inclusive of the impact of amortizing our excess deferred tax liabilities. Excluding this amortization, we anticipate the effective tax rate to range between 23% to 25%.

Fiscal 2020 capital spending is expected to rise about 12% and range between $1.85 billion to $1.95 billion with approximately 86% of this spending dedicated to safety and reliability spending. Approximately 73% of the spending will be allocated to our distribution segment. Almost 90% of our consolidated capital spending is expected to earning a return within six months of the test period end.

Continued spending for system replacement modernization will be the primary driver for the anticipated increase in capital spending, net income and earnings per share in fiscal 2024. As you can see on Slide 17, we anticipate capital spending to increase 7% to 8% per year off of fiscal 2019 spend levels, for total of $10 billion to $11 billion over the next five years. This level of spending is expected to approximately 4 times depreciation annually. This result in rate base growth about 12% to 14% per year. This translates into an estimated rate base at $17 billion to $18 billion in fiscal 2024, up about $9 billion at the end of fiscal 2019 as you can see on Slide 18.

Annual filing mechanisms will be the primary means that which will be cover our capital spending. These mechanisms enable us to more efficiently deploy capital and generate the returns necessary to attract new capital needed to finance our investments. And these mechanisms produce a smaller impact to our customer bill will provide in the regular rate adjustments that support our system modernization efforts. We've assumed no material changes to these mechanisms through fiscal 2024. In fiscal 2020, we anticipate completing filings for $160 million to $180 million of annualized regulatory outcomes that will impact fiscal years 2020 and 2021.

Moving to Slide 20. In line with our financial performance for fiscal 2019, Atmos Energy's Board of Directors approved their 144th consecutive quarterly cash dividend yesterday. The indicated annual dividend for fiscal 2020 is $2.30, a 9.5% increase over fiscal 2019. We continue to expect dividends per share to grow in line with earnings per share over the next five years. And we will continue to target a payout ratio of approximately 50% as it strikes the right balance between using funds to invest in the modernization of our system and providing return to our shareholders who support our operating plans with their investments.

This five-year plan continues the financing strategy that we've been executing over the last few years. It balances the interest of our customers and our investors, while preserving our strong credit metrics that minimize the cost of financing for our customers.

Based on our spending assumptions, we anticipate the need to raise between $5.5 billion and $6.5 billion in incremental long-term financing over the next five years. The strength of our balance sheet enables us to use a prudent mix of long-term debt and equity financing in order to maintain a balanced capital structure with a targeted equity to capitalization ratio ranging from 50% to 60%, inclusive of short-term debt. This strategy is summarized in Slide 21. And consistent prior plans, our financing plan have been fully reflected in our earnings per share guidance through fiscal 2024.

In October, we got off to a great start toward executing this plan with the issuance of $800 million in long-term debt. We issued a mix of 10-year and 30-year notes to achieve a weighted average cost of debt of 3.18% in this offering. As a result, our overall weighted average cost of debt decreased another 26 basis points to 4.32%. From an equity perspective, we announced during fiscal 2019 that we did not receive the need for discrete equity issuance in fiscal 2020. The equity forwards we executed during fiscal 2019 are expected to satisfy substantial portion of our equity needs for the fiscal year. We expect to remain - raise the remaining equity needs for 2020 through our ATM program.

In closing, the execution of our operating plans to modernize our system through disciplined capital spending, timely recovery of those investments through our various regulatory mechanisms and balanced long-term financing support our ability to grow earnings per share and dividends per share 6% to 8% annually through fiscal 2024. And as you can see on Slides 22 and 23, the execution of this plan will also keep customer bills affordable, which helped us to sustain this plan for the long term.

Thank you for your time this morning. I will now turn the call over to Kevin for his prepared remarks.

**Kevin Akers**

Thank you, Chris. Fiscal 2019 was the eighth consecutive year of successfully executing our proven investment strategy, focused on operating safely and reliably while we modernize our natural gas distribution, transmission and storage system. Our 70,000 miles of distribution pipeline and 5,700 miles of intrastate pipeline provide safe and reliable service to our customers every day.

In addition to achieving our financial targets for fiscal 2019, we continue to modernize our system. In fiscal year 2019 as you saw on Slide 27, our team replaced about 770 miles of distribution pipe, 120 mile of transmission pipe and 53,000 service lines across the eight states in which we operate.

We continue to utilize technology to modernize our business. In fiscal 2019, we deployed new technology called Locus Map that allows us to digitally capture asset data as we complete our project. This technology is helping us to scale our operations and improve the quality and timeliness of our asset data collection requirement. At the end of fiscal 2019, this roll-out was about 50% complete and on track to be fully implement by the end of fiscal 2020.

We also continued our systematic roll-out of advanced leak detection technology to enhance our ability to monitor our system, keep the public site and to help us prioritize the pipe replacement work. At our customer support centers, we completed the implementation of new technology that we refer to as skill-based routing. Skill-based routing matches a caller due to the customer support associate that suited to handle their need by using predicted analytics within our SAP system. Our electronic billing continues to be one of the highest in the industry at 43%. Based on a 2019 American Gas

Association, Edison Electric Institute benchmarking survey our penetration for electronic billing was rated Number 1 for gas only utility and Number 4 for all gas electric in combination utility.

We increased our electronic billing penetration about 2.4% in fiscal year 2019. Also in fiscal year 2019, our Spanish Account Center was released, along with an upgrade to our integrated voice response system. These are just a few examples of the many initiatives we have in progress or completed as we modernize our system and our business.

As you know, our vision is to be the safest provider of natural gas services and training is key to part of that vision. In 2019, we provided nearly 288,000 hours at our Charles K. Vaughan center and surpassed the 1.3 million mark in total training hours, since the facility opened in 2010. This training is critical to our success because it helps us work smarter and safer.

We also completed our pipeline safety management system assessment and are working on our high level road map for addressing gas. While we have had components of a safety management system including procedures, policies and practices for years, the safety management system formalizes what we are doing and as another layer of rigor and discipline for the identification and assessment of risk. It is an integral part supporting our vision of being the safest provider of natural gas services.

Our employees continue to provide exceptional customer service at every opportunity. Our customers give us a 98% satisfaction rating for both our contact center agents and our service technicians. These men and women are the heart, the soul and face of Atmos Energy. I'm extremely proud of them and how well they represent as each and every opportunity.

In addition to providing safe and reliable service and exceptional customer service, our employees support the communities where we live and work. In fiscal 2019, I'm proud to say that we donated nearly $5 million to various charitable causes as well as helped our most vulnerable customers gain access to nearly $6 million of funding to help pay their heating bills. By all measures, fiscal 2019 was another successful year for Atmos Energy.

I'm very excited about the future of Atmos Energy and I look forward to executing the ninth year of our successful strategy as we maintain our focus on our vision of being the safest provider of natural gas services.

This straightforward focused improvement strategy benefits all stakeholders as we strive to safely provide excellent customer service in an environmentally responsible manner. The $10 billion to $11 billion capital spending plan over the next five years will continue to be in the areas of system modernization, system fortification, customer growth and technology that improve safety drive efficiency and build scale. Over 85% of these investments will be focused on safety and reliability, identified by our risk-based capital allocation strategy. Continued emphasis will be placed on the removing industry identified materials such as Bare Steel, Vintage Plastics and Cast Iron.

Atmos Pipeline Texas investments in addition to safety, we will focus on reliability, fortifying our ability to meet the growing demand particularly here in our North Texas service territory. At the end of the five-year investment period, our safe system will be significantly more modern. As you can see on Slide 27, we anticipate this level of filming will support the replacement of 5,000 miles to 6,000 miles of distribution and transmission pipe or about 6% to 8% of our total system. Included in this amount is the replacement of our last 400 miles of cast iron in our system by the end of 2021. And the replacement of all bare steel main outside of our Mid-Tex Division. We also plan to replace between 200,000 and 300,000 steel service plans, which is expected to reduce our inventory about 29%. And 75% of our system will be equipped with wireless meter reading by the end of this period.

Finally, this level replacement is expected to reduce methane emissions from our system by 10% to 15% over the next five years. We continue to fine-tune our planning and forecasting capabilities, incorporating lessons learned and new requirements to ensure the work is done right, and to further improve our ability to execute on our strategy.

We have a proven track record of managing and growing these investments in a safe and responsible manner because of our employees and our leaders. They have despite the skills, experience, and training and have the technology to execute this strategy exceptionally well. Our management committee leads the execution of this strategy. This committee have supported by seven divisional leadership team, each comprised of a President and Vice President, representing operational and financial areas of responsibility and a strong centralized shared service team.

This somewhat unique structure helps us to ensure strong governance and executional oversight at the local level and it also serves to internally develop a wide number of people for potentially more senior roles in the company. Our management team is supported by the engaged Board of Directors. The Board of Directors possesses a strong balance of experience to provide deep insight, strong governance and management oversight with a fresh perspective.

During fiscal 2019, we further strengthened our Board oversight with the establishment of the corporate responsibility and sustainability committee. This committee now monitors the current and emerging ESG landscape or issues that could materially affect our business and overseas all of our ESG efforts. Together, this positions Atmos Energy for sustained success in the future as we continue to provide safe, reliable, efficient and affordable natural gas service to our 3 million customers in over 1,400 communities. All as we continue working in sync with our regulators to advance safety and reliability.

Our cultured Atmos spirit is the secret sauce that supports us and provides the necessary foundation for our continued success in our ability to execute consistently. Now 20 years old, Atmos spirit established the long-standing guiding principles of our culture today. These principles are inspiring trust, create your best, bring out the best in others, make a difference and focus on the future. Reflect the values, beliefs and behaviors we embrace as a company.

In closing, I would like to thank our 4,700 our employees for their dedication to safely operating our system, providing exceptional customer service and for giving back to the communities where they live and work each and every day. They are the heart and soul of our company and the biggest reason Atmos Energy will be successful for the long term.

We appreciate your time this morning, and now we will take any questions you may have.

**Question-and-Answer Session**

**Operator**

[Operator Instructions]

**Operator**

It appears we have no questions at this time. So I would like to pass the floor back over to Ms. Hills for any additional concluding comments.

**Jennifer Hills**

Thank you for joining us today. A recording of this call is available for replay on our website through February 5, 2020. We appreciate your interest in Atmos Energy. Good bye.