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PRESENTATION

Operator

Welcome to Southwest Gas Holdings Second Quarter 2024 Earnings Conference Call. (Operator Instructions)

I will now turn the call over to Justin Forsberg, Vice President of Investor Relations and Treasurer of Southwest Gas Holdings.

Justin Forsberg - *Southwest Gas Holdings Inc - Vice President, Investor Relations*

Thanks, Joanna, and hello, everyone. Thanks for your interest in Southwest Gas. This morning, we issued and posted the Southwest Gas Holdings website our second quarter 2024 earnings release and the associated Form 10-Q. The slides accompanying today's call are also available on Southwest Gas Holdings' website. We'll refer to those slides by number throughout the call today.

Please note that on today's call, we will address certain factors that may impact this year's earnings and provide some longer-term guidance. Some of the information that will be discussed today contains forward-looking statements. These statements are based on management's assumptions on what the future holds but are subject to several risks and uncertainties, including uncertainties surrounding the impacts of future economic conditions and regulatory approvals.

This cautionary note, as well as a note regarding non-GAAP measures, is included on slides 2 and 3 of this presentation, today's press release, and our filings with the Securities and Exchange Commission, which we encourage you to review. These risks and uncertainties may cause actual results to differ materially from statements made today. We caution against placing undue reliance on any forward-looking statements, and we assume no obligation to update any such statement.

As shown on slide 4, on today's call, we have Karen Haller, President and CEO of Southwest Gas Holdings, and Rob Stefani, Chief Financial Officer of Southwest Gas Holdings, as well as Justin Brown, President of Southwest Gas Corporation; and other members of the management team available to answer your questions during the Q&A portion of the call today.

I'll now turn the call over to Karen.

Karen Haller - *Southwest Gas Holdings Inc - President, Chief Executive Officer, Director*

Thank you for joining us today to discuss the Southwest Gas Holdings second-quarter results. Starting with slide 5. The successful closing of the Centuri IPO in April marked a significant milestone in our transformational strategy of returning Southwest Gas to its core foundation as a premier fully regulated natural gas utility. We are pleased with the market's reception of the offering, and we look forward to completing the separation of Centuri in a timely manner.

During the quarter, we continued to make progress positioning the utility for long-term success and growth. Following the completion of our general rate case in Nevada, we are seeing the positive impact associated with the recovery of our investments to enhance safety and reliability and meet the needs of our growing customer base. We are looking forward to filing our general rate case in California later this month and continue to work collaboratively with our stakeholders in Arizona as we look forward to receiving their testimony next month on our pending rate case.

Additionally, we finished the second quarter with the extension of record operating margin performance on a trailing 12-month basis. Customer growth and demand remained strong, and the entire Southwest Gas team is intensely focused on safely addressing the needs of our customers, investing in the communities we serve, and delivering value for our shareholders. We are strategically deploying capital and investing in our operations so that we can meet the demand for safe, reliable, and affordable energy solutions while also working constructively with our regulators and legislators to complement our strong organic rate base growth.

We are encouraged by the strong momentum underway, and we are raising utility 2024 net income guidance by $5 million to now be in the range of $233 million to $243 million. We are also adjusting our long-term utility net income growth compound annual growth rate to reflect the now higher 2024 base year expectations, and we are reaffirming our other guidance estimates. As demonstrated with the constructive Nevada regulatory outcome, the nature of expected revenue increases from rate cases will provide net income growth, which as a result of rate case timing will continue to be nonlinear over the forecast period.

We expect to benefit from our refreshed rate structures to catch up with the historic inflationary environment we experienced and the significant system investments we have made for the benefit of our customers over the past few years. Our confidence in our future is further demonstrated by a reaffirmed expected rate base, compound annual growth rate over the same period in the range of 6.5% to 7.5%, and our commitment to maintaining a strong investment-grade balance sheet and competitive dividend.

As you can see on slide 6, we have already made excellent progress on our 2024 strategic priorities, and we are on track to achieve them all. Following the successful execution of Centuri's IPO, Southwest Gas Holdings continues to evaluate its strategic separation options during the current lockup period that was required in the IPO. We may ultimately separate the business through a series of sell-downs or share exchanges.

Because the successful execution of a sell-down or share exchange is contingent on market and other conditions, we continue to preserve the potential for a tax-free spin, but we expect our significant net operating loss balance could serve as an offset to a taxable transaction. We remain committed to separating Centuri, and we are confident that we have taken the appropriate steps and actions to preserve flexibility, thereby allowing us to separate in an efficient manner for shareholders in any scenario.

As of the end of June, we have nearly $600 million of cash and our financing plan continues to show very limited financing needs over the next couple of years. I'll discuss our regulatory progress in more detail in a moment and would like to note, we are pleased with our progress so far this year and are on track to achieve all of our regulatory priorities. Additionally, we are executing on our planned utility optimization initiatives. Our rate case progress and our cost discipline efforts also reinforce our confidence in our increased net income guidance for 2024.

In terms of our utility and regulatory strategy for 2024, you will see on slide 7 that we have made notable strides. Earlier this year, we completed the general rate case in Nevada with a positive outcome, having received an authorized increase of nearly $300 million in rate base and a revenue increase of about $59 million compared with our original proposal of nearly $74 million. This revenue outcome represents 98% of our request after the depreciation adjustment and before adjustments to cost of capital. Our Arizona rate case of $126 million represents a requested return on nearly $650 million or 24% of additional rate base in that state, the collection of higher overall costs since our last case, along with the requested system improvement benefit capital tracker that would represent about 40% of the company's required safety-related infrastructure investments dedicated to Arizona.

Of note, the Arizona Corporation Commission recently highlighted a similar tracker as an important 2024 achievement in its own annual report. At Great Basin, we are expecting refreshed rates to go into effect in September 2024, and we are on track to file a general rate case in California during the third quarter of 2024 that is anticipated to propose an increase in rate base of 60% to 70%.

On slide 8, we highlight our strong second-quarter 2024 performance across our company. The utility has continued its good start to the year with an $8 million increase in net income over the second quarter of last year. We continue to experience strong customer growth, adding approximately 40,000 new meter sets over the past 12 months, while continuing to make additional investments to ensure our system remains safe and reliable for the benefit of our customers.

We expect to continue to benefit from strong demographic and economic growth as Phoenix and Las Vegas continue to be among the top destinations for relocation and economic development, including semiconductor, battery, and electric vehicle manufacturers. And as I noted, we also have advanced our regulatory strategy in each of our jurisdictions.

Our operations and maintenance expenses were less than 2% higher in the first six months of 2024 compared to the first six months of 2023 and our balance sheet is strong, having now collected substantially all of the deferred purchase gas cost balance from customers. This is reflected in the nearly $600 million cash balance across the enterprise as of the end of June 2024.

With that, I'll turn the call over to Rob, who will review our financial performance for the year.

Robert Stefani - *Southwest Gas Holdings Inc - Senior Vice President, Chief Financial Officer*

On slide 10, we outline our earnings per share performance. The company's consolidated GAAP and adjusted EPS are shown by each consolidated entity. As Karen mentioned earlier, the utility finished the first half of 2024 with a very strong balance sheet and record net income. Southwest Gas Holdings finished the second quarter of 2024 with nearly $600 million of cash on hand, following the full collection from utility customers of the previously deferred natural gas costs from the 2022-2023 heating seasons.

Consolidated adjusted EPS at Holdings was $0.31 per share during the second quarter, which reflects a decrease of $0.23 per share when compared to the second quarter of 2023, reduced by the impacts of lower volumes of master service agreement work and bid work at Centuri and the higher interest expense at the HoldCo, partially offset by the strong utility performance. In the appendix, we provide a reconciliation of adjustments by operating company. The vast majority of the second quarter 2024 adjustments relate to the amortization of intangible assets at Centuri, and separation-related transactions adjustments, while the second quarter 2023 adjustments also include the impacts from the consulting fees related to the utility optimization program.

Now I'll provide a walk-through on the performance of Southwest Gas Holdings and the utility. Turning to slide 11, we depict a consolidated earnings walk on an adjusted basis. During the second quarter, the utility benefited from continued customer growth and rate relief, partially offset by modest O&M increases as well as reductions in interest income, all of which are discussed in detail on the next slide. Centuri's consolidated results were lower for the quarter as the second quarter of 2023 benefited from higher volumes of work under MSAs as well as higher offshore wind work and above-average natural gas bid work that did not reoccur in this year's second quarter.

Overall, while Centuri's revenues and operating margins decreased, Centuri saw lower depreciation and amortization expenses due to lower capital expenditures as well as lower interest expenses over the period due to IPO-related debt reduction. Of note, Centuri's net income results at the consolidated Southwest Gas level differ from Centuri's reported stand-alone net income results on an interim basis due to differing income tax accounting methodologies as well as the impact of noncontrolling interest. The tax methodology differences should unwind in full-year results. The HoldCo was impacted by higher expenses compared to Q2 2023, primarily related to interest expense associated with higher variable interest rate impacts associated with the term loan and to a lesser extent, amounts outstanding on the revolving credit facility.

Moving on to slide 12, you will see the quarter-over-quarter performance drivers for our utility Southwest Gas Corporation. In the second quarter 2024, the utility operating margin increased by nearly $11 million compared to the same period last year. The improvement was driven primarily by an $18 million of increased recovery on prior investments in Nevada as well as a modest increase in recovery in California.

We also saw $2 million of improved margin as a result of continued customer growth throughout our service areas where we continue to see strong customer growth. Offsetting these increases in operating margin is a roughly $16 million reduction in regulatory account amortization, which was elevated during last year's second quarter and did not recur in this year's second quarter. Note that this regulatory amortization reduction is equally offset by a reduction in amortization expense, as I will discuss shortly. The remaining increase largely relates to the combined impacts of certain infrastructure and similar traction mechanism surcharge components, which combined with the variable interest expense adjustment mechanism in Nevada resulted in $2 million higher operating margin this quarter.

In addition, customer late fee assessments were $1.2 million higher, with the remaining balance driven by miscellaneous revenues and charges and impacts to margin from nondecoupled customers. O&M increased $4.9 million, primarily related to general labor cost increases across the business, leak survey and line locating activities, and insurance costs. These increases were partially offset by a reduction in external contractor and professional services costs.

We remain confident that we will be able to achieve our stated goal of continuing to keep O&M costs flat on a per-customer basis through 2026. And year-to-date O&M is up less than 2%, which is less than the inflation observed in broader macroeconomic measures.

The approximate $14 million decrease in depreciation, amortization, and general taxes was largely related to $16.1 million in lower regulatory account amortization associated with the elevated prior year recovery of regulatory program balances that is offset by a corresponding amount in the margin that I discussed a moment ago. Further, partially offset by higher depreciation expense associated with the 7% increase in average gas plant in service compared to the second quarter of 2023.

Other income decreased approximately $5 million, the net result of mostly expected drivers. We saw a $5 million decline in interest income related to the carrying charges associated with lower regulatory account balances, notably the deferred purchase gas cost balances, which flipped from a receivable balance from customers of over $780 million in June of 2023 to a net liability balance of $82 million at the end of this quarter.

COLI results were nearly $3 million lower than Q2 of 2023. Also included were the impacts of an increase in the nonservice-related components of employee pension and post-retirement benefit costs. These declines were partially offset by an increase in the equity portion of the allowance for funds used during construction, or AFUDC, and an approximately $3 million in software write-offs that occurred in the prior year quarter, which did not recur in 2024.

Interest expense at the utility increased by nearly $3 million from the prior year's second quarter, primarily due to regulatory treatment timing related to the utility industrial development revenue bonds, including the impacts of deferrals and return and recoveries included in revenue and operating margins that are amortized through interest expense, the impact of which was offset in the margin that I mentioned earlier. Overall, the second quarter and year-to-date performance at the utility has been strong, resulting in an increase to our 2024 net income guidance range, which Karen will discuss.

On slide 13, we have provided our 2024 financing plan for both Southwest Gas Holdings and Southwest Gas Corporation that has been updated to reflect the IPO outcome at Centuri, which still assumes the consolidation of Centuri. To the extent Centuri ceases to be consolidated in 2024, we will adjust our guidance accordingly. We continue to expect cash flow from operations to more than fund the entire capital expenditure program at the utility forecasted in 2024.

In addition, based on the strength of our balance sheet and successful recent refinancing efforts, we continue to anticipate very modest additional near-term equity needs of approximately $75 million during 2024. Again, that depends on the post-IPO separation execution form. And we have no significant capital markets needs over the next 12 months.

It is important to note that in addition to our limited equity needs of approximately $150 million in total in the next two years, inclusive of the $75 million this year which is expected through the ATM. In the third quarter, we extended our $550 million Southwest Holdings term loan to July 31, 2025, as well as the $400 million revolver at the utility, which now expires in August 2029. The Holdings term loan extension included a 17.5 basis point reduction in applicable spread from SOFR plus 130 down to SOFR plus 112.5 basis points. We continue to expect limited debt financing and refinancing needs at the utility through the end of 2026. At Holdings, we reiterate our plan to target solid investment-grade balance sheet metrics.

Moving on to slide 14. We take a look at our balance sheet strength and our commitment to maintaining the investment-grade profile. On the left-hand side, we walked through net debt by operating company. We finished the quarter with nearly $600 million of cash, largely due to the full collection of the previously deferred purchase guest costs. As a result, at the utility, the PGA balance has now flipped to the liability. This is down from an asset balance of approximately $200 million at the end of the first quarter of 2024.

On slide 22, additional details are provided on the PGA balance. As mentioned on the previous slide, we continue to expect the large utility cash balance to significantly obviate the need to pursue additional financing in the near term. On the right-hand side of slide 14, we note that we had no changes to our credit ratings or outlook from the agencies with the exception of Fitch, which has moved us from a watch negative to negative.

I'll now turn the call over to Karen Haller in slide 16 to discuss our guidance.

Karen Haller - *Southwest Gas Holdings Inc - President, Chief Executive Officer, Director*

Our second quarter results are evidence of the progress we continue to make executing our strategy, and we're enthusiastic about the rest of 2024. On slide 16, we are raising our 2024 utility net income guidance by $5 million, as mentioned earlier. This reflects performance thus far as well as expectations over the balance of the year. We believe that strong regional economic outlook in our service territories, the completion of our Nevada rate case outcome as well as expected results of our cost management efforts will drive 2024 results higher than our original net income guidance range, and our team remains focused on optimizing utility operations.

We reaffirm our 2024 utility CapEx at approximately $830 million, while nearly 50% of our forecasted capital spending related to maintaining a safe and reliable system for the benefit of all of our customers. The balance is to serve the needs of our growing customer base and our continuous improvement initiatives, which we expect to lead to future cost savings at the utility. Looking further out, we have adjusted our expected compounded annual growth rate for net income at the utility to fall within the range of 9.25% to 11.25% from 2024 to 2026, which maintains our outlook through 2026 and reflects the now higher expectations for the 2024 base year.

While the impact of the regulatory cycle is expected to result in somewhat lumpy net income growth over the forecasted period, our regulatory strategy and our plan to achieve a flat O&M per customer trend over that same period are expected to be important components of our growth story. Additionally, you can find the 2024 to 2026 drivers in the appendix of our presentation on slide 23. We also reaffirm our rate base CAGR to be in the range of 6.5% to 7.5% over the same 2024 to 2026 period, and we continue to expect to invest about $2.4 billion in total of CapEx over the next three years.

Before we open the call up to Q&A, I want to point to slide 17 and emphasize that our teams are focused on executing our strategic priorities, delivering strong financial results, and providing exceptional service to our customers. At Southwest Gas Holdings, we are confident in our path forward as a premier pure-play natural gas utility. We plan to continue delivering steady organic rate base growth through strong regional demand dynamics as well as earnings growth through financial discipline, operational excellence, and constructive regulatory relationships. We'll continue to execute toward the planned full separation of Centuri to create a more attractive value proposition for stockholders.

With that, I'd like to open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Richard Sunderland, JPMorgan.

Richard Sunderland - *J.P. Morgan Securities LLC - Analyst*

For the Centuri separation, can you run through your current thoughts on the relative attractiveness of a tax-free scenario versus generating proceeds to pay down debt? I guess I'm also curious here if you're focused on the absolute price of CTRI or that relative price between CTRI and SWX?

Robert Stefani - *Southwest Gas Holdings Inc - Senior Vice President, Chief Financial Officer*

Look, we continue to evaluate the separation options. Obviously, we're looking at the relative value between the two stocks. We're very focused at this point in time in the process to place a permanent CEO at Centuri. And so as we look out to separation alternatives, we're focused on the placement of that permanent CEO, and we'll continue to monitor market conditions. I think when you look at our net operating loss balance as Karen had highlighted, it obviously makes a sell-down or a taxable exchange, a potentially attractive option. We really reserve the spin scenario in the event of adverse kind of market conditions or other conditions, but are obviously looking hard at the sell-down in exchange.

Richard Sunderland - *J.P. Morgan Securities LLC - Analyst*

And then just on timing here, is there a scenario where you could do something before the lockup expiry? Just overall, how do you think about balancing speed to separation against all the factors you just ran through?

Robert Stefani - *Southwest Gas Holdings Inc - Senior Vice President, Chief Financial Officer*

I think the -- like I said, we're focused on the process to put a permanent CEO in place. Paul Caudill is serving as the interim CEO and has a long track record, both in the EPC services as well as his time as CEO of NV Energy and his time within Berkshire. So we have a lot of confidence in him as an interim CEO, but we are looking through the process of placing a permanent CEO. From a timing perspective, the lockup period expires here in September, would be an early look. I think just given where markets are, we're focused on that CEO placement in the near term.

Operator

Ryan Levine, Citi.

Ryan Levine - *Citi Investment Research (US) - Analyst*

I saw the ATM news this morning. Any color you could share around the reason for that filing and the size of the $340 million amount in that filing? Any color you can give?

Robert Stefani - *Southwest Gas Holdings Inc - Senior Vice President, Chief Financial Officer*

Yes. Good question, Ryan. First, I'd highlight the $340 million is the exact amount that was outstanding under the prior shelf. We haven't changed the size from several years ago when that was issued. We didn't utilize the ATM in prior periods. And so it's really just an extension so that we have the ability to execute the ATM if we need it.

As we said on the call, we have less than $75 million of equity needs this year and there's a chance that we may not choose to go to market. Obviously, if we were to embark on a strategy to sell-down Centuri shares, then that could obviate the need to raise $75 million. We also continue to look at our cash flow generation from the utility and continue to look at, do we need to do all $75 million this year or not? But the ATM was effectively just refreshed in order that we could do the $75 million this year if we needed it.

Similarly, next year, our equity needs, as we've stated before, we said $150 million in total over the next couple of years. So we have about $75 million of equity needs in each year, '24 and '25, so very limited equity needs, really no debt refinancing needs. We redid that term loan at Holdings like we talked about. So all in all, a very strong balance sheet with $600 million of cash, and access to our credit facilities, and we'll continue to evaluate even the need for the $75 million.

Ryan Levine - *Citi Investment Research (US) - Analyst*

And then in terms of the $0.09 HoldCo drag or parent drag, can you lineate what that is in terms of how much is interest expense versus maybe one-time in nature costs versus amortization or other items that may be embedded in that $0.09 change?

Robert Stefani - *Southwest Gas Holdings Inc - Senior Vice President, Chief Financial Officer*

Yes. So as you think about it, we put the term loan, the $550 million term loan in place early in the second quarter of 2023 or kind of in the April time frame. And so we've -- as far as the first half of the year, the year-to-date over year-to-date that in 2024, the term loan was obviously on a year-to-date basis, outstanding for a longer period of time than it was year-to-date in 2023. When we refinanced that term loan, we did compress the spread from 130 basis points down to 112.5. We just closed on the extension of the term loan earlier this week. And so from an adjustment basis, obviously, at the Holdings level, there is some noise in there just around our costs associated with the Centuri separation and IPO, which we've adjusted out. So the vast majority of the cost at the Holding is the interest expense. There's very limited amount of that.

Ryan Levine - *Citi Investment Research (US) - Analyst*

So most of the $0.09 you're saying is the financing year-over-year comparison?

Robert Stefani - *Southwest Gas Holdings Inc - Senior Vice President, Chief Financial Officer*

Yes, that's right.

Operator

(Operator Instructions) This concludes the Q&A portion of today's conference. I would now like to turn the call back over to Justin Forsberg for closing remarks.

Justin Forsberg - *Southwest Gas Holdings Inc - Vice President, Investor Relations*

Thanks, and thank you all for joining us today and for your questions. This concludes our conference call. slide 18 of today's presentation includes my content information. And as always, feel free to reach out at any time. We appreciate you joining us today. Talk soon.

Operator

This concludes today's Southwest Gas Holdings Second Quarter 2024 Earnings Call and Webcast. You may disconnect your line at this time. Have a wonderful day.
