THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

NFG - Q4 2016 National Fuel Gas Co Earnings Call

EVENT DATE/TIME: NOVEMBER 04, 2016 / 3:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Brian Welsch *National Fuel Gas Company - Director, IR*

Ron Tanski *National Fuel Gas Company - President and CEO*

John McGinnis *National Fuel Gas Company - President of Seneca Resources*

Dave Bauer *National Fuel Gas Company - Treasurer and Principal Financial Officer*

CONFERENCE CALL PARTICIPANTS

Chris Sighinolfi *Jefferies LLC - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q4 2016 National Fuel Gas Company earnings conference call. (Operator Instructions) As a reminder, today's conference is being recorded.

I would now like to introduce your host for today's conference call, Mr. Brian Welsch, Director of Investor Relations. You may begin, sir.

Brian Welsch - *National Fuel Gas Company - Director, IR*

Thank you, Kevin, and good morning. We appreciate you joining us on today's conference call for a discussion of last evening's earnings release.

With us on the conference call from National Fuel Gas Company are Ron Tanski, President and Chief Executive Officer; Dave Bauer, Treasurer and Principal Financial Officer; and John McGinnis, President of Seneca Resources Corporation. At the end of the prepared remarks, we will open the discussion to questions.

The fourth-quarter fiscal 2016 earnings release and the November investor presentation have been posted on our investor relations website. We may refer to these materials during today's call.

We would like to remind you that today's teleconference will contain forward-looking statements. While National Fuel's expectations, beliefs, and projections are made in good faith and are believed to have a reasonable basis, actual results may differ materially. These statements speak only as of the date on which they are made, and you may refer to last evening's earnings release for a listing of certain specific risk factors.

I would also like to point out that the Company will be participating in the Jefferies Energy Conference in Houston at the end of this month. If you plan on attending, please contact the conference planners or me directly to schedule a meeting with management.

With that, I'll turn it over to Ron Tanski.

Ron Tanski - *National Fuel Gas Company - President and CEO*

Thanks, Brian, and good morning, everyone. We reported our 2016 fiscal-year results last evening, and overall, our strong hedge book helped us achieve solid results in the face of the low commodity prices that the whole industry has been facing during 2016.

Commodity pricing has now settled into a pattern where we think the impairment for our oil and gas properties that we recorded in the fourth quarter should be our last. If you recall, the Company took a number of actions this past year in response to those low prices.

Early in the year, we entered into a joint development agreement with a partner to participate in the drilling of 75 of our Marcellus wells. We also reduced our drilling activities by dropping to a one-rig drilling program, and we extended the target in-service date for our Northern Access Pipeline project to our 2018 fiscal year. All of those actions have put us in a strong financial position at the end of fiscal 2016.

Looking forward to fiscal 2017, our team at Seneca continues to focus on drilling and operational efficiencies, so we expect that our reserve additions from our ongoing drilling program will continue to be economic, even at the forward strip prices that we are seeing today. John McGinnis will have a lot more details regarding our exploration and production operations in just a few minutes.

In our utility operations, we are ready for the winter. Our natural gas storage capacity isn't quite full, but our operations team always plans to be ready to handle a winter that could be up to 10% colder than normal. We'll do that through the combination of natural gas that is in storage and our interstate pipeline supply contracts that will be transporting gas into our service territory from the supply basins where the gas is produced.

Also in the utility, we're in the midst of an 11-month litigation schedule for our rate case in our New York jurisdiction. We recently requested a one-month extension of the schedule to explore settlement options with the parties in the case, but we're not sure that those discussions will lead anywhere.

If we don't settle the case and continue through the full litigation, we would expect a resolution of the case in the spring, after the end of our heating season. As a result, there would be no major impact on our earnings for the 2017 fiscal year.

Switching to our interstate pipeline segment, we've recently received formal approval of our rate case settlement for our Empire Pipeline. We settled for a rate reduction, but with some other positive accounting adjustments, the impact to Empire's earnings for next year are expected to be minimal.

Looking at our consolidated earnings for fiscal 2017, we laid out our earnings guidance and the assumptions behind our forecast in the release, and we expect earnings to be steady for next year. Now, this is exactly what you should expect, given the steady business in our rate-regulated segments, our strong hedge book for our production, the relatively flat pricing that we see in the futures market for our unhedged oil and natural gas production, and our one-rig drilling program for most of the year in our exploration and production segment. Remember also that a portion of the production from our newer joint development wells coming online will be split with our joint development partner.

As we've talked about for some time, we won't substantially increase our natural gas production until fiscal 2018. That's when we expect to have additional take-away capacity for our production areas via our Northern Access Pipeline and Transco's Atlantic Sunrise Project.

Transco recently announced a delay in the in-service date for their project to the middle of 2018. Now, that's a bit disappointing for us, but it will only have a minor effect on our development plans in our Eastern Development Area. On our own Northern Access Project, which is the pipeline for increased take-away capacity from our Western Development Area, we are expecting to receive our FERC certificate soon.

We also have an application on file with the US Army Corps of Engineers and the New York State Department of Environmental Conservation for federal water quality permits. We've had meetings with the New York DEC and we've provided a lot of additional information and studies to them in response to their questions. We're currently in the process of preparing additional information as a result of a meeting we had with them just two weeks ago.

Suffice it to say that the regulatory process these days for all major pipeline infrastructures has become more involved. We expect that the DEC will take the full year to review our application, which would keep us on track to receive a water quality certificate in March of 2017. We'll keep you posted if we find that there's any change in that schedule.

In our discussions with analysts, we get asked a lot of questions about our alternate plans if our Northern Access Pipeline gets delayed or a permit is denied. First, let me reiterate that as recently as our meeting with the New York DEC two weeks ago, we've gotten no indications from them that things are headed in the wrong direction or that things are off schedule.

But, we realize that no infrastructure project is a slam-dunk these days. If we were delayed or denied, in the very near term, we'd obviously adjust Seneca's drilling schedule to adjust production to the firm capacity that we do have. We'd also look to layer in firm sales with marketers and purchasers that do have additional capacity at our current interconnection to the Tennessee System.

We've also explored alternative routes to move Seneca's production, but those routes don't get us to a point that's as liquid as Dawn. Or they involve additional pipes where there would be successive rate or tariff charges that make those routes less economic.

For example, we've looked at a route that would move the gas west to an interconnection with Tennessee at Station 219. And we've also had preliminary discussions with Nexus to add a lateral that could connect their system to our production.

We think the Northern Access project is the best on the table so far compared to those alternatives. If, however, New York is intent on shutting down expansion and economic growth in the state, there are alternatives that we could pursue, but we don't think we're at that stage yet.

Now I'll turn the call over to John McGinnis, President of Seneca Resources.

John McGinnis - *National Fuel Gas Company - President of Seneca Resources*

Thanks, Ron, and good morning, everyone. Seneca produced 39.8 Bcfe during the fourth quarter compared to 37.6 Bcf in the last year's fourth quarter. Total annual net production was 161 Bcfe versus 158 last year, a 2% increase year over year.

In Pennsylvania, we produced 34.8 Bcf of gas during the fourth quarter, a decrease of 4 Bcf from our third quarter. This decrease in production was largely due to the lack of significant spot sales as a result of lower pricing. For the year, we sold a total of 7.5 Bcf into the spot market.

With respect to oil and gas reserves, we have completed our audit for this fiscal year. Our proved reserves decreased by 496 Bcfe to a total of around 1.85 Tcfe. This reduction was due to a number of factors, including negative revisions due to pricing, the sale of reserves as a result of entering into the joint development agreement, and removing a few PUDs due to pricing and revisions in our drilling schedule.

We continue to drive down our Marcellus well costs and operating expenses. Our well costs are now at $663 per foot, which we believe is the lowest of our peers in the Basin. As a result, our breakeven price is now less than $2 across a broad swath of our WDA acreage. In the EDA, our breakeven prices range between $1.50 and $1.60.

We have now drilled 63 of the 75 Marcellus well commitment in our IOG joint development. 50 of these wells are online and producing. As I stated last quarter, the combination of the IOG Joint Development program, moderately reduced activity levels, and improved operational inefficiencies have led to a substantial decrease in our fiscal-year 2016 spending.

In addition, our completion operations commenced a little earlier than anticipated on one of our joint development pads, triggering a $20 million drilling CapEx contribution by our partner, IOG. As a result, Seneca's total capital expenditure for 2016 came in at $99 million, an 82% decrease from $557 million capital outlay in fiscal 2005 and $28 million below the midpoint of our guidance. But as I'll discuss a bit later, this means our 2017 capital expenditure forecast will be higher by about $20 million, as most of this capital just shifted between years.

Moving to our Utica/Point Pleasant appraisal program, our first Clermont Area Utica horizontal well has now been online for over 120 days. This well continues to outperform our initial estimates, and we are now increasing the EUR per thousand foot to 1.8 Bcf versus the 1.6 we announced last quarter.

Our second CRV Utica well will be brought online this quarter, and we have just completed drilling two additional Utica wells. Since the Utica/Point Pleasant zone is well over 300-foot thick in this area, we drilled one of these new wells in a deeper zone, the Upper Point Pleasant, to compare productivity to our initial well, which was drilled in the lower Utica. Our current appraisal plan is to have eight Utica wells drilled by the end of this fiscal year, with five online.

In California, we produced 712,000 barrels of oil during the fourth quarter, down slightly from the prior quarter. Annual net production in California was down about 120,000 BOE year over year to 3.4 million BOE.

This decrease in production was mainly due to the disruption of available steam volumes that began during the first quarter in our North Midway Sunset field. We have now alleviated this issue, and steam volumes have returned to pre-disruption levels.

On a side note, Seneca is always looking for ways to improve our operations. As an example, this past July, we brought online at our North Midway Sunset field the energy industry's largest solar photovoltaic facility in California.

This 3.1-megawatt system is estimated to generate around 5.4 million kilowatt-hours of electricity annually, all of which will be consumed onsite by Seneca's crude oil production equipment. This facility will supply around 20% of our electricity needs at North Midway Sunset on an annual basis.

For fiscal 2017, we are now forecasting capital expenditures to range between $180 million to $220 million. California remains the same, ranging between $35 million and $45 million, but we are raising our Pennsylvania spend by $20 million, as mentioned before. We forecast our Pennsylvania CapEx to now range between $145 million and $175 million, and this continues to assume only a one-rig drill program during most of the year, and daylight-only frac operations.

In addition, even though our forecasted total gross production volumes will continue to increase, we are lowering the midpoint of our expected net production for the year by 2.5 Bcfe, now ranging between 145 to 170 Bcfe. Our small decrease in forecasted net production is a result of operational schedule changes.

First, while we are still targeting the same number of IOG Joint Development Marcellus wells this year, some of these wells have been brought forward in the schedule, while 100% working interest Seneca wells will be brought online slightly later in the year.

And second, as I discussed a few minutes ago, as a result of our first Clermont WDA Utica well showing promising early results, we have prioritized additional Utica appraisal drilling in our operation schedule. Given that Utica wells take about twice as long to drill than our Marcellus wells, this will also slightly delay bringing on some new Marcellus pads.

And with that, I'll turn it over to Dave.

Dave Bauer - *National Fuel Gas Company - Treasurer and Principal Financial Officer*

Thanks, John, and good morning, everyone. As you read in last night's release, our GAAP earnings for the quarter were $0.44 a share. Excluding the ceiling test impairment charge, operating results were $0.66 per share or a 61% increase versus last year's fourth quarter. For the full fiscal year, earnings excluding ceiling test charges were $3.04, above the high end of the range of our guidance.

Several factors contributed to our performance for the quarter. First, at Seneca, DD&A and lease operating expenses were both towards the low end of the range of our guidance. In addition, Seneca was able to claim a $1.7 million or $0.02 a share income-tax benefit related to the solar facility John just mentioned. These facilities are a terrific investment. In addition to the tax credit, it will reduce our annual electric costs by about $800,000.

At the Pipeline and Storage segment, revenues of $76 million for the quarter and $306 million for the fiscal year were toward the high end of our guidance on the continued strength of producer volumes.

Fiscal 2016 was another terrific year for our Midstream businesses. On a combined basis, EBITDA from our pipeline and storage and gathering businesses was up 8% over last year. Lastly, O&M expenses at the Pipeline and Storage segment were lower than we had expected, really due to a number of smaller items that all happened to go in the right direction.

Our team has done a terrific job controlling operating expenses across the system. And the pipeline and storage segment is a great example. Over the past five years, we've increased revenues in this segment by more than 40%, with no meaningful change in O&M expense.

Looking to next year, we're keeping earnings guidance at $2.85 to $3.15 per share. This guidance reflects the new production range John described earlier as well as a slight revision to our pricing assumptions. All of our remaining major assumptions for next year, both with respect to Seneca and the rest of the businesses, are unchanged. You can refer to page 7 of last night's release for a summary of our guidance.

Seneca has a great hedge book for 2017, particularly on the gas side, where we are more than 80% hedged. Our recent focus has been adding natural gas positions for 2018 and beyond.

When prices spiked in October, we executed 16.5 Bcf of gas trades for fiscal 2018 at about $3.20 per Mcf, which brings our total for 2018 to 77 Bcf. We also added a total of 1.1 million barrels of new oil hedge positions for 2017 to 2019 at prices in the low $50 area. Considering these new trades, our fiscal 2017 oil production is nearly 45% hedged at an average price of $64 a barrel.

Turning to capital spending, we made some small tweaks to the budgets of the individual segments. But our overall consolidated capital budget is still $725 million to $835 million.

The $20 million increase in Seneca's budget is purely timing. As John mentioned earlier, Seneca collected $20 million of joint interest billings about a month sooner than originally forecasted, which has the effect of shifting $20 million of capital from fiscal 2016 to fiscal 2017.

The budgets at the midstream companies were refined to reflect our updated construction plans. However, our budget for the Northern Access Project is unchanged at $455 million.

Based on our updated forecast, we still project an outspend in fiscal 2017 in the area of $300 million, all of which is driven by Northern Access. The remaining segments, including E&P, are expected to generate free cash flow in 2017. We had $130 million in cash on hand at year-end, which will cover a large portion of the outspend.

Initially, the difference will be financed using short-term debt. This past September, we renewed our $500 million, 364-day committed credit facility. And in total, we have access to $1.25 billion of short-term credit, all of which is currently undrawn.

With respect to long-term debt, as we've previously discussed, as a result of our recent ceiling test charges, a covenant in an old bond indenture has prohibited us from issuing incremental long-term debt. As you can see in last night's release, our ceiling test charge for the quarter was pretty modest compared with prior quarters: about $19 million after tax.

While ceiling test charges are always possible, we don't expect any in fiscal 2017, assuming prices stay at their current levels. Consequently, we don't expect this covenant will be an issue after the March quarter.

As we go through the fiscal year, we will evaluate our longer-term financing options for Northern Access, with the goal of obtaining the lowest-cost capital while at the same time maintaining our credit rating.

With that, I'll close and ask the operator to open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Chris Sighinolfi, Jefferies.

Chris Sighinolfi - *Jefferies LLC - Analyst*

Ron, thanks for the additional color this morning, particularly in regard to contingency plans for Seneca and the pipeline if the regulatory process proves more longer-dated than what you think. I mean, obviously realize that's not the formal plans, but it's super-helpful. So appreciate the color on the alternatives.

I guess I have two questions. First for John, can you just remind me, or remind us, the WDA development plans as they stand today? I know the rig that you have running now presumably remains in the CVR to complete the IOG JV work and perform the Utica tests that you talked about.

But just curious: as you get ahead of the firm transport capacity coming, I guess two questions. When should we see rig additions and sort of where would they naturally go first?

John McGinnis - *National Fuel Gas Company - President of Seneca Resources*

Yes, good question. Actually, yes, we will remain at a one-rig case in the WDA at least into summer, this summer, of 2017. We're looking at June-July of potentially adding a second rig.

And currently, it's scheduled to go to our Gamble and drill a couple pads there, but just to satisfy some lease extensions. But if we can get those extended, then we will bring the rig into the WDA to prepare for Northern Access. So we're looking at sometime June/July/August to bring in that second rig.

Chris Sighinolfi - *Jefferies LLC - Analyst*

Okay, perfect. And in terms of the East, I mean, I know you've done some Geneseo well tests and obviously we're waiting on the Atlantic Sunrise capacity there in mid-2018. But at what point I guess with the remaining locations you have on the Marcellus front, at what point do you -- should we expect maybe some more delineation of the Geneseo potential on the east side?

John McGinnis - *National Fuel Gas Company - President of Seneca Resources*

We will probably, over the next two to three years drill two to three more Geneseo wells, but moving into a full Geneseo development program probably won't happen until 2022-2023. And that's if we're not successful in continuing to add additional Marcellus acreage. The economics are good, but not as good as the Marcellus.

Chris Sighinolfi - *Jefferies LLC - Analyst*

Right, understood, okay. And then Dave, just had one question. I saw there was a dip in fourth-quarter interest on a relatively flat debt balance. Just curious, was there an elevated amount of capitalized interest in the quarter? If so, what sort of things are driving that? Or if it's something else, is it something else?

Dave Bauer - *National Fuel Gas Company - Treasurer and Principal Financial Officer*

Yes, I think it's a lot of little things, Chris. Capitalized interest certainly can make a difference, and I think we had a small adjustment to some interest accruals on some regulatory assets in the pipeline business that had the effect of lowering interest expense by the quarter -- or for the quarter.

Chris Sighinolfi - *Jefferies LLC - Analyst*

Okay. I think that's it for me. Ron, just I guess one real quick question. You mentioned this meeting with the New York DEC two weeks ago. I assume that was in response to the letter from the 19th?

Ron Tanski - *National Fuel Gas Company - President and CEO*

Actually, that had nothing to do with that letter. It was more set up to kind of review the status and to spot any issues that the DEC might be having. So we were there with our environmental consultant and our folks. And as I mentioned in my prepared remarks, that resulted in some more questions that they want us to answer and we are preparing responses to those.

You know, the letter on the 19th, you know, that's really the regulatory folks, or let's say the lawyers, just making sure that all -- basically all arguments are preserved for everyone's litigation position if we ever reach that down the road. And there was -- as a matter of fact, we fully expected that letter, and that had no impact on the discussions with the environmental folks.

Chris Sighinolfi - *Jefferies LLC - Analyst*

Okay, understood. I think we're all aware of you guys progressing in the wake of Constitution. So it's pretty -- I think it's evident to some of us that certain things that are transpiring in your process are likely in direct response to some of the things that have befell the Constitution project. It is that wrong in thinking that way?

Ron Tanski - *National Fuel Gas Company - President and CEO*

No, that's absolutely correct.

Chris Sighinolfi - *Jefferies LLC - Analyst*

Okay.

Ron Tanski - *National Fuel Gas Company - President and CEO*

Yes. And oh boy -- I think I mentioned a couple of calls ago that we actually delayed the filing of our application with the DEC and Army Corps to make sure we covered some of the things that we were aware that popped up in the Constitution application situation.

Chris Sighinolfi - *Jefferies LLC - Analyst*

Okay. Well, thanks again for all the added color. I'll get back in the queue.

Operator

(Operator Instructions) And I'm not showing any further questions at this time.

Brian Welsch - *National Fuel Gas Company - Director, IR*

Okay. Thank you, Kevin. We'd like to thank everyone for taking the time to be with us today. A replay of this call will be available at approximately 3 p.m. Eastern Time on both our website and by telephone and will run through the close of business on Friday, November 11, 2016.

To access the replay online, please visit our investor relations website at investor.nationalfuelgas.com. And to access by telephone, call 1-855-859-2056 and enter conference ID number 97603563. This concludes our conference call for today. Thank you, and goodbye.

Operator

Ladies and gentlemen, you may all disconnect and have a wonderful day.
