Corrected Transcript

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National Fuel Gas Co. (NFG)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Carol, and I will be your operator today. At this time, I would like to welcome everyone to the National Fuel Gas Company Second Quarter 2019 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, we will have a question-and-answer session. [Operator Instructions]

At this time, I would like to turn the call over to Ken Webster, Director of Investor Relations. Mr. Webster, please go ahead.

Kenneth E. Webster
Director-Investor Relations, National Fuel Gas Co.

Thank you, Carol, 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 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. At the end of the prepared remarks, we will open the discussion to questions.

The second quarter fiscal 2019 earnings release and May 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.

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National Fuel will be participating in the AGA Financial Forum later this month in Fort Lauderdale. If you plan on attending, please contact me to schedule a meeting with the management team.

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

Ronald J. Tanski

President, Chief Executive Officer & Director, National Fuel Gas Co.

Thanks, Ken, and good morning everyone. Thanks for joining us. As we highlighted in last evening's release, earnings for the second fiscal quarter of 2019 were fairly consistent with last year and in line with our expectations. Emerging from the winter heating season that was slightly colder than last year in our New York jurisdiction, we saw a slight uptick in earnings in the Utility business where throughput was 1.7 billion cubic feet higher than last year's second quarter. Because our weather normalization mechanism offsets most of the impact of colder weather, the increase in Utility earnings came largely from higher margin, lower interest expense and other minor rate adjustments.

The higher earnings in the Utility helped to offset an expected decrease in the pipeline and storage segment's earnings that was caused by the expiration of a shipper's transportation contract on our Empire Pipeline system. As we've talked about before, KeySpan had used that capacity to import Canadian gas and transport it to its downstate service territory. The proliferation of Pennsylvania's shale production closer to KeySpan's service territory ultimately made the Canadian gas uneconomic and KeySpan let the contract expire at the end of its term. Today, the capacity on the pipeline is fully contracted to move gas in the opposite direction and that capacity will be further expanded next year.

In our exploration and production business even though we achieved our highest ever average daily production rate this past quarter we were expecting more. It's a slight disappointment that we've modestly lowered the midpoint of our production guidance to the low end of the range that we established last August. Operationally, we've experienced longer drilling and completion times on our Utica wells which will shift production that we had planned for this year into fiscal 2020. The delay in well turn-on dates is not expected to materially change the economics of our Utica drilling program. Later in the call, John McGinnis will get into more details of Seneca's operations and plans.

In our pipeline business, all of our development projects continue to move along on schedule. In March, the Federal Energy Regulatory Commission or FERC issued a certificate for our Empire North Project. This is the project that will add the capacity that I talked about earlier and we plan to have it in service during the second half of fiscal 2020. With a certificate in hand we've placed orders for some of the items that have longer lead times and we've requested a limited Notice to Proceed from FERC to begin preliminary construction activities during the current fiscal year. Actually, last evening we filed for a full Notice to Proceed from FERC. Now this will lead to some spending on the project this year and we'll have a steady ramp-up in construction activities and spending through fiscal 2020. As a reminder this project will add $25 million per year in annual revenues to the system.

We also received another favorable ruling from FERC, on our Northern Access project. As you may recall, last August FERC issued an order finding that the New York Department of Environmental Conservation effectively waived its water quality certification authority under the federal Clean Water Act. The DEC and the Sierra Club subsequently requested rehearing from FERC and FERC denied those requests in April. In addition in February the U.S. Second Circuit Court of Appeals issued an order vacating and remanding the DEC's denial of the water quality certification. While we're certainly pleased with the progress that have been made on the legal and regulatory fronts and remain hard at work securing the remaining approvals necessary to seek a Notice to Proceed from FERC, we expect the construction is still a few years off.

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Construction is underway, however along our Line N pipeline in Pennsylvania where we're installing a lateral to connect our system to the new Shell petrochemical plant that is also under construction. We expect our pipeline lateral to be finished by the end of the summer and transportation services provided to Shell will add approximately $5 million in revenue on an annual basis. We've included more detail for those projects and our FM100 project in our quarterly slide deck that we have online.

Entering into the summer construction season, we're pretty well lined up with all our pipeline modernization projects in both the interstate pipeline business and the Utility business. We're pleased that the New York Public Service Commission approved an extension of our system modernization tracker through March 2021. This extension allows us to continue to make significant investments in the safety and reliability of our distribution system and provides line of sight on continued albeit modest growth in the Utility for the next couple of years. As you may recall, this tracking mechanism was part of our last rate case and kicked in last December when we exceeded established mileage and plant-related targets. It allows us timely rate recovery of incremental investments in pipeline modernization across our New York service territory and was originally scheduled to sunset in March 2020.

On a personal note, you may have seen my retirement announcement for this July. You've all gotten to know Dave Bauer over the years and he will become President and CEO effective July 1st. The Board and I have full confidence in Dave and the entire management team and we expect it will be a seamless transition. Our succession plan for other management moves on July 1st will likewise consist of the internal shifting of our experienced homegrown talent.

We're pleased with where our business is headed. We've investment plans and operating procedures to keep both our regulated and gathering pipeline systems safe. We believe that our oil and gas development strategy continues to work and needs no major retooling and we remain confident that we will meet our targeted 15% to 20% average annual growth production – production growth over the next few years.

And now I will turn the call over to John McGinnis and Dave Bauer to cover some more of the operational and financial details for the quarter.

John P. McGinnis

President, Seneca Resources Company, LLC

Thanks, Ron. Good morning, everyone. Seneca experienced mixed results in the second quarter. On a positive note, we saw some really nice well results. We brought to production four Utica development wells at DCNR 007, the first new wells since 2016. These wells are looking great and this tract is now producing over 60 million a day. Three of the wells are producing at rates of around 15 million a day and our fourth well, which is still cleaning up, is currently at just over 10 million a day. Our two new Marcellus wells at DCNR 100 came on as expected as did our most recent Utica pad in the WDA.

However, the quarter was not without its challenges. Though we achieved record daily production levels this quarter, we fell short of our expectations. The shortfall relative to our expectations was mostly a result of some operational curtailments, the impact of our continued testing efforts to optimize our Utica drilling and completion design in the WDA and, to a lesser extent, drilling and completion delays at Tract 007 in the EDA. While these operational delays have the effect of pushing production out to future periods, they are not expected to have a material impact on our ultimate well recoveries or program economics.

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Looking to the full year, we are lowering our fiscal 2019 production forecast by around 5% or 10 Bcf at the midpoint to a range of 205 to 215 Bcf. In addition to the items I discussed pertaining to the second quarter, our revised guidance range reflects the expected impact of drilling and completion delays in the EDA on production for the remainder of the year and builds in additional production downtime to reflect the operational realities we experienced in the first half of the fiscal year. Our updated guidance range also reflects expected production impacts from our WDA Utica drilling and completion optimization efforts for the remainder of the year, as well as the Company's continued trend of drilling longer laterals in both the EDA and WDA. These longer laterals are expected to benefit our overall program economics. However, the longer drilling completion times will defer the online dates related to future development pads beyond the prior plan.

Even with this decrease, we still expect production growth to range between 15% and 20% year-over-year and to continue to grow at that rate for the next several years with our three-rig program. We continue to make excellent progress with our Utica program in the WDA. We brought online a total of 11 wells over the past two quarters, three at the end of November, another four the last week of December, and four new wells in March. As we continue to focus on optimizing our drill and completion design in this area, we are testing landing target and several completion design variations that so far have included stage spacing, proppant loading and produced fluid blend. Due to this ongoing testing, we expect to see some variability within our program as we fine tune our well design.

We experienced some of this variability last quarter where two of our Utica wells underperformed compared to the remaining wells brought to production. Our early assessment of these two wells indicates that the poor performance is attributable to a high produced fluid blend percent used during the completion operations. Of the 21 CRV Utica wells brought online to-date, our poorest performers were either brought online too aggressively or were completed with a 95% or greater produced fluid blend. Though a limited data set, our results so far suggest that percent produced fluid blend may be nearly as impactful to well performance as our restricted drawdown management practice. Therefore, based on our learnings, going forward we'll employ a lower produced fluid blend in our completion design on future WDA Utica wells. Our most recent Utica pad brought online in March utilized a fluid blend ranging between 75% to 85% on all four wells and [all four wells] are producing consistent with our type curve.

With 21 WDA Utica wells now online, we continue to be encouraged by overall results. Our type curve remains at 1.7 Bcf per 1,000 foot and we have another 6 Utica wells scheduled to come online late in fiscal 2019. And as stated last quarter, once all 27 wells have been producing for a few months, we'll provide an updated type curve and additional insight related to our drill and completion design optimization.

The WDA Utica has tremendous potential for our company and, combined with the co-development of our Marcellus and full ownership of the Midstream gathering, we envision strong integrated returns from our WDA assets for many years to come.

For the remainder of the year, we plan to bring to production 6 additional Utica wells and 6 Marcellus wells in the WDA and 10 Marcellus wells in the EDA. Five of the EDA wells, however, are scheduled to come online very late in the fourth quarter. Our fiscal 2019 CapEx guidance remains the same with capital expenditures ranging from $460 million to $495 million.

Moving forward we have locked in approximately 79 Bcf of firm sales in Pennsylvania at an average realized price of $2.42 per Mcf, and another 14 Bcf of production with basis protection through our firm sales portfolio. Therefore, we have locked in physical sales for almost 90% of our remaining fiscal 2019 production. We currently

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estimate around 11 Bcf available for sale into the spot market, but as we see opportunities we will continue to layer in additional sales.

Spot prices remained strong during the second quarter but have recently fallen into the plus or minus $2 range at each of our three receipt points. Fortunately, we have minimal spot exposure but please recall, our production forecast assumes no marketing curtailments for the remainder of the year.

So, moving to California, we produced 644,000 BOE of oil during the second quarter, a decrease of around 17% from last year's second quarter. This decrease was largely driven by the sale of our Sespe Oil Field last year. Having finally received the necessary permits last quarter, we have now begun drilling both production and steam injection wells in Pioneer adjacent to our South Midway field. We should begin to see production growth related to this property in fiscal 2020 as our steaming operations begin to heat the reservoir.

And though we continue to wait for an Aquifer Exemption permit at 17N, we have recently drilled 13 new wells and early results look quite promising. This property is now producing over 500 barrels a day compared to around 200 a day at the end of our last fiscal year.

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

David P. Bauer

Treasurer & Principal Financial Officer, National Fuel Gas Co.

Thank you, John. Good morning, everyone. National Fuel's second quarter GAAP earnings were $1.04 per share. Similar to last quarter, we had items impacting comparability relating to hedging ineffectiveness and the marking to market of investments in a non-qualified benefit plan. Excluding those items, our operating results were $1.07 per share which though a little below Street consensus were right in line with our own expectations. This was a quarter where the benefits of our integrated diversified business model were particularly evident. Our regulated businesses utility in particular had strong quarters relative to forecast which helped offset the near-term challenges in Appalachia that John described earlier.

Looking at the results of our operating segments, the utility had a really nice quarter driven in large part by improved operating margins which, excluding the refund provision for income tax reform, were up $0.02 per share. This was the result of two main factors. First, we're seeing a modest amount of customer and industrial usage growth which can be attributed to the continued strong economic backdrop in our service territories and the cost advantages of natural gas. Second, the system modernization tracking mechanism Ron described earlier contributed a little less than $1 million of additional margin.

We expect this tracker will provide about another $2 million for the remainder of the year as the weather breaks and our level of construction activity ramps up. Surcharges accrue volumetrically, so similar to most ratemaking items, there will be some seasonality to the cash flows and earnings related to this mechanism.

As expected, the earnings of our FERC-regulated pipeline businesses were down relative to last year largely due to the loss of the KeySpan contract on the Empire system which Ron described earlier. This reduced revenue by about $6 million in the quarter and will reduce full year fiscal 2019 revenue by about $14 million. The benefit from tax reform and the new rates from Empire's rate case settlement partially offset the loss of that contract.

Pipeline and Storage revenues for the quarter were in line with our forecast and we don't expect any major changes in the second half of the fiscal year. Therefore, we're keeping fiscal 2019 revenue guidance for the Pipeline segment at approximately $285 million. As I mentioned on prior calls, fiscal 2019 is a cyclically higher

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year for compressor maintenance and pipeline integrity work, which will likely drive a 5% to 10% increase in O&M expense. Most of that increased spending was weighted to the first half of the fiscal year. As you can see from last night's release, Pipeline and Storage O&M was up $7.1 million or 19% for the six months. Looking to the second half of the year, I expect the Pipeline O&M will be pretty much flat to fiscal 2018 levels.

Turning to our non-regulated businesses as John discussed earlier, Seneca's production in the quarter was below our expectations which weighed on the earnings with both our E&P and Gathering segments. Pricing was generally in line with our expectations gas was a couple cents lower and oil a couple dollars higher but the net impact was very small.

With respect to Seneca's operating expenses there are a few items worth noting. Seneca's LOE for the quarter was $0.94 per Mcfe, above the range of our guidance. This was not unexpected. As I said on last quarter's call, elevated natural gas prices in Southern California caused a spike in steaming costs. Prices have since moderated and at the same time we've made changes to our supply portfolio and now source most all of our steam fuel in indices that are more closely tied to Rockies pricing.

Looking to the back half of the fiscal year, more moderate steam fuel costs combined with the expected increase in Seneca's Appalachian production should cause third and fourth quarter LOE to trend towards the middle of our full year $0.85 to $0.90 per Mcfe guidance range. Quarter-over-quarter DD&A expense increased from $0.70 to $0.74 per Mcfe due to the timing of capital spending and reserve additions. We still expect the year to be in a range of $0.70 to $0.75 per Mcfe, which approximates our long term expected F&D cost.

One further note on Gathering, the shift in timing of Seneca's production has a corresponding impact on fiscal 2019 Gathering revenues which we now expect will be in the range of $125 million to $130 million. Bringing it all together, we're keeping our fiscal 2019 earnings guidance range at a $3.45 to $3.65 per share. Though our E&P and Gathering earnings projections were impacted by the drop in Seneca's forecasted production, several items offset that impact, including our updated commodity price assumptions, additional firm sales contracts and a rate reduction on a portion of Seneca's upstream transportation capacity.

Our Appalachian spot price for the remainder of the year is $2.10 per MMBtu and with only about 10 Bcf spot exposure for the remainder of the year, changes in spot prices should not have a material impact on earnings. But that being said, should we see a severe drop in local pricing, we may look to curtail production until the higher-price winter months.

Our capital spending guidance is unchanged at a range of $725 million to $810 million. Since we aren't changing earnings or capital guidance, it follows that our financing needs are also unchanged. We still expect our funds from operations should cover substantially all of our capital expenditures this year, with our financing needs tied primarily to our dividend and any changes in working capital.

In conclusion, all things considered, the second quarter was a good one for National Fuel with positive developments across the system, including improved margins at the Utility, continued progress on our pipeline projects and good well results at Seneca. Production guidance is modestly lower, but at the end of the day, our program is still well-positioned to deliver solid returns and consistent production growth.

Looking forward, I'm excited for the future of National Fuel. We have great assets that span the natural gas value chain. The economics for our drilling program remain strong. We have a great backlog of pipeline projects and the current state regulatory backdrop supports the accelerated modernization of our utility system. Our balance sheet

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is solid and we fully expect to continue our longstanding practice of returning capital to shareholders through our dividend. All of this should translate to growth in shareholder value in the years to come.

With that, I'll turn it over to the operator and open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question today comes from Holly Stewart from Scotia Howard Weil. Please go ahead.

Holly Stewart
Analyst, Scotia Howard Weil

Q

Hi. Good morning, gentlemen.

Ronald J. Tanski
President, Chief Executive Officer & Director, National Fuel Gas Co.

A

Hi, Holly.

Holly Stewart
Analyst, Scotia Howard Weil

Q

Congratulations, Ron, may we all be so lucky.

Ronald J. Tanski
President, Chief Executive Officer & Director, National Fuel Gas Co.

A

It gets here faster than you think, Holly.

Holly Stewart
Analyst, Scotia Howard Weil

Q

Maybe I'll start off one for John, just you mentioned the minimal curtailments in the guidance. Just maybe high level how are you all viewing the market right now in EDA? Is this temporary maybe due to just shoulder season patterns in demand or are we seeing pipes backfill post Atlantic Sunrise and the widening maybe to continue here?

John P. McGinnis
President, Seneca Resources Company, LLC

A

Holly, obviously during the shoulder months we always see this kind of decrease in spot prices across the basin to tell you the truth. Honestly, I hope it's temporary but we're expecting maybe a little bit lower prices through summer. As always it depends a little bit on how hot the summer is.

Holly Stewart
Analyst, Scotia Howard Weil

Q

Sure.

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John P. McGinnis
President, Seneca Resources Company, LLC

A

But as you know, we've locked in quite a bit. So, we do have some exposure. But if it stays in just above at $2 and above I think we're actually fine with that.

Holly Stewart
Analyst, Scotia Howard Weil

Q

Okay. That's good color. Maybe I guess on that note recognizing you are pretty locked in on the firm sales for 2019 but given pricing overall for NYMEX is kind of trending toward multi-year lows here. How are you thinking about that three-rig program as we move in the back half of 2019 and beyond?

John P. McGinnis
President, Seneca Resources Company, LLC

A

Yeah. Well we've committed to firm capacity on pipe and so we have – we'll stay at three rigs. We've committed to Leidy South, it's 330 million a day. And so, our goal in the short-term, at least over the next couple of years, is make sure that when that pipe comes online that we can fill it.

Holly Stewart
Analyst, Scotia Howard Weil

Q

Okay, great. And then maybe just one other one, we've heard a lot I think this quarter about just water in general whether it's impacting the LOE or whether it's actually water infrastructure assets for sale, so it's been pretty topical. Can you maybe help us think through to your water handling both in the EDA and the WDA, and if there's an opportunity for your Midstream business, I guess it would be particularly in the EDA on third party water volumes?

John P. McGinnis
President, Seneca Resources Company, LLC

A

Yeah. It's actually a tough question. We have a very large central water facility in the WDA. In the EDA it's a much smaller because the volumes that we see being produced in the east are just not what we see in the west. So, we have a very large water facility. We typically do bring in third-party produced water when it's necessary, when we need the water but we also will supply water to other operators when they need it. I'm not sure it's a business I want to get into. We view it as a means in which to drive down our water costs.

Holly Stewart
Analyst, Scotia Howard Weil

Q

Okay. That's helpful. Thank you, guys.

Operator: Our next question comes from Ryan Levine from Citi. Please go ahead.

Ryan Levine
Analyst, Citi Investment Research

Q

Good morning. What percentage of your California production is urban, and how do you view the exposure to some of the political commentary coming out of the state?

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John P. McGinnis
President, Seneca Resources Company, LLC A

Yeah, California is a fun place to do business. Honestly, we don't see this bill – I think it's Bill 345 which you are referring to. We don't believe the bill will survive. There's a lot of opposition already and not just from our own industry. But having said that, we have stepped back and taken a look at potential impact in our operations. And honestly, we think it would be minimal because almost all of our operations are very rural in the San Joaquin Basin.

Ryan Levine
Analyst, Citi Investment Research Q

And is any of the rural near any hospitals or any key infrastructure that's being proposed to be of concern?

John P. McGinnis
President, Seneca Resources Company, LLC A

No.

Ryan Levine
Analyst, Citi Investment Research Q

Okay. That's all from me. Thank you.

Operator: Our next question comes from Gordon Loy from Raymond James. Please go ahead.

Gordon Loy
Analyst, Raymond James Q

Good morning, all, and thank you for your time. So, I just had a kind of two quick questions. The first one in the opening remarks you guys mentioned that there's a continued trend towards drilling longer laterals. And I just wanted to get a sense of I guess what's the average lateral length that the company is drilling now and where do you guys foresee that going to?

John P. McGinnis
President, Seneca Resources Company, LLC A

Sure. Let's start in the WDA. Six months, nine months ago we're drilling 6,000 foot roughly plus or minus 1,000 foot appraisal wells in the Utica. Today, we're drilling 8,000, 9,000 even over 10,000 foot Utica wells. Our Marcellus wells, we just recently drilled a Marcellus pad, we typically averaged 6,000 to 7,000 foot. Most of those wells were 8,000, 9,000, 10,000 foot wells. So, we're seeing an increase of anywhere from 2,000 to 3,000 feet per lateral at least in the WDA.

A perfect example in the east is we're now at a pad in the Gamble Lycoming area where we had assumed or expected that we'd be drilling a 4,500 foot lateral. We just finished that well and it ended up being, I think, north of 5,500, if I remember correctly.

And so, just to give you a sense of perspective for – let's go to the west, for every 2,500 foot of lateral probably adds – let's say we have four wells on a pad, it may add four or five days of drill time and it may add – obviously it is going to add additional completion time because we're going to be having more stages. So, every four, five, six well pad if we're drilling that greater of a lateral probably add anywhere from three to four weeks just to get that pad online.

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Gordon Loy
Analyst, Raymond James

Q

Got it. That makes sense. And then my follow-up is I'm looking on slide 19 and you have kind of the well cost estimate for the Utica CRV, and it's currently at about $895 per lateral foot, is that kind of the expected well cost when you guys shift into more development mode or is that just what it's kind of averaging right now?

John P. McGinnis
President, Seneca Resources Company, LLC

A

That's essentially kind of what it's averaging right now. Early on we try to make forecasts on that and then as we get more and more wells then we tend to look at what the average is, our contracts obviously that are associated with it, so...

Gordon Loy
Analyst, Raymond James

Q

Okay. That's helpful then. And that's all from me then. Thanks for the time.

Operator: Our next question comes from Chris Sighinolfi from Jefferies. Please go ahead.

Christopher Paul Sighinolfi
Analyst, Jefferies LLC

Q

Hey, everyone. Good morning.

Ronald J. Tanski
President, Chief Executive Officer & Director, National Fuel Gas Co.

A

Hey, Chris.

Christopher Paul Sighinolfi
Analyst, Jefferies LLC

Q

Hi, Ron. Hey. Ron, just wanted to echo Holly offering my congratulations on your long career with NFG and the pending retirement. I personally learned a lot from our interactions and conversations and also enjoyed the time spent travelling together, so thanks for all of that and wish you the best in retirement.

Ronald J. Tanski
President, Chief Executive Officer & Director, National Fuel Gas Co.

A

Thanks. I'll buy you a beer when I see you at AGA.

Christopher Paul Sighinolfi
Analyst, Jefferies LLC

Q

There you go. I think they're free but I'll let you pay for it. I think also Dave, congrats on your new role. I think therein lies a question, Ron, you had mentioned in your prepared remarks the anticipated shift among the internal team given Dave's pending move to the CEO role. But just any further clarification on what we might expect as the CFO search process either internally or externally takes shape and we move towards July?

Ronald J. Tanski
President, Chief Executive Officer & Director, National Fuel Gas Co.

A

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Yeah, it's our typical practice to announce those as they're made with all of the attendant pictures and releases and we'll just keep to that and announce it then.

Christopher Paul Sighinolfi
Analyst, Jefferies LLC

Q

Okay. But it's not something where we would see an interim notification. Your intention is before July to have fully staffed the CFO position?

Ronald J. Tanski
President, Chief Executive Officer & Director, National Fuel Gas Co.

A

Yes.

Christopher Paul Sighinolfi
Analyst, Jefferies LLC

Q

Okay.

Ronald J. Tanski
President, Chief Executive Officer & Director, National Fuel Gas Co.

A

Yes.

Christopher Paul Sighinolfi
Analyst, Jefferies LLC

Q

Okay, great. And then if I could just pivot and follow up on some of the earlier questions, John, for you. You mentioned in the release last night and obviously on the call this morning multiple factors, the longer laterals, the testing on well and completion design and the delays that you cited in the DCNR tracks in the east. Some of that seems to be more impactful on fiscal 2Q and some of it seems be more impactful sort of on the program on the go-forward.

I was just wondering in terms of fiscal 2Q how if we thought of maybe as a percentage of the impact, how much of that was just the DCNR issues and are those resolved at this point?

John P. McGinnis
President, Seneca Resources Company, LLC

A

Yeah. I would say at least for specific to Q2, it was probably a small amount maybe a-half-a-B was related to some delays there. The larger impact will occur, going into the next couple of quarters. We had one well that we had to side track and re-drill that put us back about 30 days and then at 007 we actually had one well that had some collapsed tubing, which was a bit strange that took us a couple weeks, two to three weeks, to sort of get that fixed and so that sort of postponed the online date for three wells.

Christopher Paul Sighinolfi
Analyst, Jefferies LLC

Q

Okay. And then I guess the way that it reads those issues you see as – very much added sort of specific issues to those wells and not something that speaks to larger problems in that program. Is that right?

John P. McGinnis
President, Seneca Resources Company, LLC

A

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That's exactly correct, Chris.

Christopher Paul Sighinolfi
Analyst, Jefferies LLC

Q

Okay.

John P. McGinnis
President, Seneca Resources Company, LLC

A

But we view these as one-off issues and we don't foresee this being a consistent trend.

Christopher Paul Sighinolfi
Analyst, Jefferies LLC

Q

Okay. And then you also had noted I guess in the prepared remarks, John that the produced fluid percentage being problematic above 95%, better in the 75% to 85% range. But just wondering any variability in ranges other than 75% to 85%. Or are you indicating that that's the sweet spot your team believes is optimal for your program?

John P. McGinnis
President, Seneca Resources Company, LLC

A

Yeah. Actually, that's a great question, Chris. We have had a lot of debate on this. Our ranges will typically go, at least in the west, to as below 50% and to as high as 100%. And so we're not sure after only 21 wells, we're not sure what that sweet spot is yet but we do know that once we get to that 90%-plus, really 95%-plus that we are seeing an impact on these wells. It wouldn't surprise me that the fresher the blend the better the well. But how we manage that going forward is going to depend a little bit on the impact on the economics and the well results.

Christopher Paul Sighinolfi
Analyst, Jefferies LLC

Q

Okay. I guess then as it relates, Boone Mountain has been a standout for you guys, the appraisal there. Can you just remind me, is that simply the resource opportunity in that area or did you do something different with that well on completion design versus the areas that...

John P. McGinnis
President, Seneca Resources Company, LLC

A

No. No, that is just the resource potential within that area. We actually think, and our appraisal drilling over the next few years will try to lock it down, but we think there is a corridor between our Rich Valley 214 well and our Boone Mountain well that we'll be fairly productive. But again that's just something we're going to have to lock down over the next couple of years.

Christopher Paul Sighinolfi
Analyst, Jefferies LLC

Q

Okay. And I guess – this is all very helpful. The final question from me would be then you mentioned I think in the WDA 6 Utica, 6 Marcellus and then the EDA 10 Marcellus for the remainder of the year. I'm just curious given the program, so the time profile with longer laterals, et cetera, what sort of DUC inventory do you envision at the end of your fiscal year setting up for next year?

John P. McGinnis
President, Seneca Resources Company, LLC

A

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Yeah. Any DUCs that we have – the only DUC inventory we really have that significant will be on the WDA where we have two rigs running. In the EDA, as soon as we're done drilling on a pad we have a spot crew moving in to get that pad completed.

Christopher Paul Sighinolfi
Analyst, Jefferies LLC

Q

Okay. So, the delay in the timing didn't meaningfully change I guess that year-on-year cadence in terms of where your inventory to complete in the west might be, is that how I'm reading it?

John P. McGinnis
President, Seneca Resources Company, LLC

A

Yeah. No. It just pushes back a month, month-and-a-half is really what the delays do.

Christopher Paul Sighinolfi
Analyst, Jefferies LLC

Q

Okay, all right. Thanks a lot. Appreciate all the time this morning.

Operator: [Operator Instructions] Our next question comes from Becca Followill from U.S. Capital Advisors. Please go ahead.

Becca Followill
Analyst, U.S. Capital Advisors LLC

Q

Good morning, guys. Following up on Chris' questions, the third part of the rationale for the lower guidance, the trending toward drilling longer laterals, what has changed from the prior guidance, are you – was there prior guidance X lateral and now it's X or what's different?

John P. McGinnis
President, Seneca Resources Company, LLC

A

Yeah, we've set our guidance, our range, very early, obviously before back in August I think is when we've set it. And as we move forward and begin to better understand some of these areas, we'll permit them long. And if we have the opportunity to continue to drill them longer, we'll do so. Historically, when we've drilled Marcellus wells, we've permitted them long and have always ended up being maybe 1,000, 2000 feet shorter than what we have permitted because of structural complications and we're just not finding that in the Utica. So, in terms of our forecast and we've tended to under-forecast what our final laterals will be based on what we've done to-date.

Becca Followill
Analyst, U.S. Capital Advisors LLC

Q

Okay, thank you.

John P. McGinnis
President, Seneca Resources Company, LLC

A

Does that make sense?

Becca Followill
Analyst, U.S. Capital Advisors LLC

Q

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That makes sense.

John P. McGinnis
President, Seneca Resources Company, LLC

A

Okay.

Becca Followill
Analyst, U.S. Capital Advisors LLC

Q

And then you also mentioned the reason for the two wells that underperformed, it was a combination of the produced fluid blend and choke management. Are you doing something different...

John P. McGinnis
President, Seneca Resources Company, LLC

A

Yeah, we choke manage all of our wells in the Utica, in the WDA Utica, and that's a positive. They don't come on as strongly but they're much better wells. The reason the two wells underperformed was because of produced fluid blend that was just too high.

Becca Followill
Analyst, U.S. Capital Advisors LLC

Q

So it was not choke management.

John P. McGinnis
President, Seneca Resources Company, LLC

A

Exactly.

Becca Followill
Analyst, U.S. Capital Advisors LLC

Q

And then because it's still – I mean, you're still really early in the development of this play with the number of wells you've drilled compared to how many you plan to. So, when you do your forecast for 15% to 20% growth how much do you factor into there the fact that the mix is going to change and some wells are not going to work, and you're still kind of mid-science so how do you risk-adjust that 15% to 20%?

John P. McGinnis
President, Seneca Resources Company, LLC

A

That's a great question. We've drilled 350 Marcellus wells and we've really gotten that – we have fine-tuned our forecasting related to that program. At Utica, we drilled a whopping 26 wells and so we're still learning as you just mentioned, and we try to be a bit conservative on our forecasts. But having said that, maybe at least during this early period as we're trying to understand and optimize our drilling and completion, it's going a little – typically a little slower than we envisioned. But I think as we continue to drill these wells we'll begin to lockdown at least a more accurate forecast going forward.

So, there is a lot of noise early. We try to be conservative. But I think because we've been drilling Marcellus wells for such a long time, pushing 10 years we underappreciated the learning curve related to some of these new areas.

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Becca Followill
Analyst, U.S. Capital Advisors LLC

Q

Got you. Thank you. That's all I had.

Operator: And we have no one left in queue. At this time I'll turn the call back to Mr. Webster for closing remarks.

Kenneth E. Webster
Director-Investor Relations, National Fuel Gas Co.

Thank you, Carol. 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 3:00 PM Eastern Time on both our website and by telephone. And will run through the close of business on Friday, May 10. To access the replay online, please visit our Investor Relations website at investor.nationalfuelgas.com. And to access by telephone, call 1-800-585-8367 and enter conference ID number 6683755. This concludes our conference call for today. Thank you and goodbye.

Operator: Thank you. This does indeed conclude today's conference and you may now disconnect.

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