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APU - Q2 2019 Amerigas Partners LP and UGI Corp Earnings Call

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PRESENTATION

Operator

Good morning. My name is Denise, and I'll be your conference operator today. At this time, I'd like to welcome everyone to the UGI Corporation-AmeriGas Second Quarter Fiscal Year 2019 Conference Call. (Operator Instructions)

Thank you. Brendan Heck, Director of Investor Relations, you may begin your conference.

Brendan Heck - *UGI Corporation - Manager of IR*

Thanks, Denise. Good morning, everyone, and thank you for joining us. With me today are Ted Jastrzebski, CFO of UGI Corporation; Hugh Gallagher, President and CEO of AmeriGas Propane; and John Walsh, President and CEO of UGI.

Before we begin, let me remind you that our comments today include certain forward-looking statements, which management believes to be reasonable as of today's date only. Actual results may differ significantly because of risks and uncertainties that are difficult to predict. Please read our earnings release and our annual report on Form 10-K for an extensive list of factors that could affect results. We assume no duty to update or revise forward-looking statements to reflect events or circumstances that are different from expectations.

We'll also describe our business using certain non-GAAP financial measures. Reconciliations of these measures to the comparable GAAP measures are available in the appendix of our presentation.

Now let me turn the call over to John.

John Lawrence Walsh - *UGI Corporation - President, CEO & Director*

Thanks, Brendan. Good morning, and welcome to our call. I hope that you've all had the opportunity to review our press release that's reporting second quarter results for UGI and AmeriGas.

Our results in Q2 reflect the second consecutive quarter of very warm weather in Europe as well as the impact of limited weather volatility in the Marcellus region on our capacity management business. Despite these challenges, we delivered a solid performance in the quarter, posting the second-best Q2 adjusted EPS in our history.

On today's call, I'll comment on key activities and market developments in the quarter, and then I'll turn it over to Ted who'll provide you with an overview of UGI's financial performance. Hugh will review Q2 for AmeriGas, and I'll wrap up with an update on our strategic initiatives.

Our Q2 GAAP EPS was $1.38, and our adjusted EPS was $1.43. Net adjusted Q2 EPS was 15% below our record fiscal '18 Q2 adjusted EPS of $1.69 but 9% above Q2 fiscal '17 adjusted EPS of $1.31. As I noted earlier, this is the second-highest Q2 adjusted EPS in UGI's history. Both quarters have been adjusted for the mark-to-market valuation of unsettled hedges and other items, which Ted will cover later. I should also note that our Q2 fiscal '18 results included a $0.09 positive impact from tax reform in our Utilities business, which was subsequently returned to ratepayers in Q3 fiscal '18. We're affirming our updated guidance of $2.40 to [$2.60,] which we reviewed on our April 2 call. Ted will provide more detail on our outlook in his comments.

In addition to the solid earnings performance in the second quarter, there was significant progress on our strategic projects and initiatives. On April 2, we announced an agreement to acquire all the common units of AmeriGas owned by the public. This agreement was the outcome of the strategic review process we announced at our Analyst Day in early December. We believe this agreement is in the best interest of our AmeriGas unitholders who will receive a fair value for their units and have the opportunity to become shareholders in UGI. This is also a favorable outcome for UGI shareholders as we expect the transaction to significantly enhance retained cash flow and to be earnings accretive in fiscal '20 and beyond. The transaction is subject to approval by AmeriGas unitholders, and we hope to receive that approval and close the transaction in our fiscal fourth quarter.

We're making good progress on our PennEast project. We've completed all required survey work in Pennsylvania, which is 2/3 of the route. And the Pennsylvania Department of Environmental Protection has determined that our applications are administratively complete. Pennsylvania DEP has formally initiated their technical review of our submission.

There is noteworthy progress in New Jersey as well. Having received favorable court rulings related to survey access, our PennEast team was given legal rights to complete the majority of the field surveys required for an updated submission of our New Jersey permit applications. We're awaiting a final court ruling regarding survey access for a small number of state-owned land parcels along the route. Project remains on track to commence construction-type activities as soon as possible, which in all likelihood will be in 2020 given anticipated permitting reviews.

Growth and infrastructure replacement remain the key themes at Utilities. We've added almost 8,500 new residential heating and commercial customers year-to-date, and demand for gas service continues to be robust. Our gas utility recorded a record send-out in mid-January, and underlying demand for gas service is strong. In addition to the expenditure for our growth programs, we're continuing to invest record levels of capital on infrastructure replacement and reinforcement.

Our infrastructure replacement program for cast iron and bare steel remains on pace with our PUC-approved long-term infrastructure replacement plan. The forecast capital spend of almost $400 million in fiscal '19 will be another record for us.

AmeriGas had a challenge this quarter with particularly warm weather in the Southeast. While overall volumes were slightly below last year, we delivered very strong performance in our ACE and National Accounts programs. ACE volumes were up 7% over prior year while National Accounts growth reached 6%. Hugh will comment in much more detail on AmeriGas' Q2 performance in a few minutes.

UGI International faced a significant weather challenge in the quarter with weather that was 7.5% warmer than normal and 10% warmer than prior year. However, the impact of lower volumes was largely offset by effective margin management and diligent expense control. We benefited from positive contributions from the DVEP and UniverGas acquisitions made in late fiscal '17 and early fiscal '18. The solid performance in this weather-challenged quarter once again demonstrates the resiliency and earnings power of UGI International.

I'll return later on the call to comment on our strategic initiatives, but I'd like to turn it over to Ted at this point for the financials. Ted?

Thaddeus J. Jastrzebski - *UGI Corporation - CFO*

Thanks, John. As John mentioned, the results this quarter were solid but fell short of our record earnings last year. Adjusted earnings per share were $1.43 versus $1.69 in Q2 2018.

This table lays out our GAAP and adjusted earnings per share for the second quarter of fiscal 2019 compared to the second quarter of fiscal '18. As you can see, our adjusted earnings exclude a number of items, such as the impact of mark-to-market changes in commodity hedging instruments, a loss of $0.07 this year versus a loss of $0.08 last year. This quarter, we had $0.02 of unrealized gains on our foreign currency derivative instruments, a loss of $0.01 in 2018. As mentioned last quarter, you can also see that we no longer have Finagaz integration expenses as this acquisition has been fully integrated.

Lastly, this quarter, we booked approximately $200,000 of expense related to the proposed merger with AmeriGas, but the impact to adjusted EPS is negligible. Adjusted earnings per share decreased $0.26 versus Q2 of 2018. For our LPG businesses, AmeriGas experienced [colder weather overall] , significantly warmer-than-normal weather in the Southeastern U.S. during January and February. They were down $0.01 versus last year.

Our international business continued to face warmer weather conditions, but net income is up as a result of focused margin and expense management. Additionally, we benefited from reduced statutory tax rates in France. I'll speak to international results in more detail in a moment.

For our natural gas businesses, adjusted EPS for both Midstream & Marketing and Utilities declined $0.22 and $0.04, respectively. Less volatile weather and increased pipeline restrictions in the Midstream & Marketing business limited capacity management margin.

As for utility, adjusted earnings were down versus last year primarily due to the $0.09 benefit in the prior period on revenues and associated margins as a result of the tax savings from the TCJA.

Turning now to the individual businesses. AmeriGas reported adjusted EBITDA of $290 million versus $309 million in the prior period -- prior year period. Although weather was cold nationally, this number was skewed by extreme cold in areas where we have a lighter operational footprint. The Southeastern U.S. experienced very warm weather during the critical heating months of January and February. The team maintained a disciplined approach to expense management and continues to search for opportunities to drive efficiencies. Hugh will discuss AmeriGas results in more detail in a few minutes.

UGI International reported adjusted income before taxes of $124 million. Weather for the quarter was 7.5% warmer than normal and 10% warmer than the second quarter last year. Furthermore, the international teams experienced warmer-than-normal weather in 11 of the past 12 months.

As you know, we layer in foreign currency exchange contracts to reduce volatility in UGI International's net income resulting from the translation effects of changes in foreign currency exchange rates. If you remove the impact of currency, margin decreased last year due to the sustained warm weather impact on volumes, but that was primarily offset by unit margin management.

On a weather-adjusted basis, our team delivered a solid quarter. Operating expenses were well controlled given the warm weather. And while up slightly versus last year, this was largely due to higher compliance costs associated with energy conservation, which are passed on to customers.

Midstream & Marketing reported income before taxes of $52.3 million. Total margin decreased $54 million compared to Q2 of last year on weather that was slightly colder. The primary driver of approximately $47 million of the decrease came from capacity management where we did not experience the same type of extreme cold and volatility that we did in the early part of the quarter last year coupled with increased pipeline restrictions. The remaining decrease came from electric generation where volumes from our Hunlock facility were lower, reflecting a lack of economic [dispatch] opportunities.

Operating expenses increased versus last year, reflecting higher compensation and benefits expenses, slightly higher expenses associated with greater peaking, LNG and natural gas-gathering activities.

UGI Utilities reported income before taxes of $108.1 million. When looking at comparative results, it's important to remember that the 2019 second quarter reflects the impact of the May 17, 2018, Pennsylvania PUC order addressing, among other things, the credit to ratepayers of tax savings from the TCJA. As a result, revenues in the quarter were reduced by $23 million. Excluding the impact of the revenue reduction, total margin increased $8 million due to higher core market volumes, which increased due to customer growth and slightly colder weather.

Operating and administrative expenses decreased [slightly]. The primary driver is lower uncollectible accounts, which improved versus last year. Depreciation increased $1.2 million from increased distribution system and IT capital investments.

Before I turn it over to Hugh, I want to comment briefly on our guidance and the dividend announcement last week. Last month, we revised our guidance range to $2.40 to $2.60. Based on our first half results and our historical performance in the third and fourth quarters, I want to highlight some of our initiatives that'll help us achieve our revised guidance range.

First, we continue to focus on OpEx management. This has been a major focus for the UGI teams as we continue to look for efficiencies throughout our business.

Next, we expect increased margin from our additional midstream assets such as Ponderosa and Texas Creek that we'll not benefit from -- that we did not benefit from in prior years. As I mentioned earlier, we've increased margins at UGI International to offset the energy conservation compliance costs. Margin increases are not realized immediately as there's a timing lag, which simply means our customers buy product over time, not all at once. We expect to realize some of these margin benefits in the third and fourth quarters.

Lastly, on a year-over-year basis, 2019 will not have the $22.7 million revenue reduction associated with the May 2018 Pennsylvania PUC order that we had in the third quarter of 2018.

We believe that these factors will increase our performance versus historical results in the third and fourth quarters and help us to achieve our revised guidance. UGI remains well positioned to deliver on our commitment of 6% to 10% long-term EPS growth.

To our dividend. For the 32nd consecutive year, UGI is increasing annual dividend. The quarterly dividend is now $0.30 per share, representing a 15.4% increase. As a reminder, we have an additional increase planned after the closing of the AmeriGas transactions. In total, the dividend will increase 25% by transaction close.

That concludes my remarks, and I'll now turn the call over to Hugh for his report on AmeriGas. Hugh?

Hugh J. Gallagher - *UGI Corporation - President & CEO of AmeriGas Partners*

Thanks, Ted. Our adjusted EBITDA for the second quarter of fiscal 2019 was $290.3 million compared to $309.5 million for the second quarter of last year. Nationwide degree days in Q2 were 4% colder than the 15-year norm and 5% colder than last year. Our financial results, which usually track the weather quite well, did not this quarter largely due to regional weather patterns that I want to explain.

The most intense cold was concentrated in the plains where, as you know, we have little in the way of operations presence. Conversely, in the Southeastern U.S. where we have a significant presence, we experienced temperatures that were significantly warmer than normal and last year, especially in January and February. So our overall adjusted EBITDA was down from last year primarily due to nearly 19% year-over-year shortfall in EBITDA contribution from our operations in the Southeast.

Similarly, retail volumes for the quarter were down 4% from last year, with the shortfall also primarily related to our operations in the Southeast.

Turning now to our growth thrust. Both our National Accounts and AmeriGas Cylinder Exchange programs continue to experience solid growth, with volume for both programs increasing in the range of 6% to 7%. We are making good progress in developing the home cylinder delivery concept. The integration of the business we acquired late last year has progressed very well, and we are in our initial -- we're planning our initial pilot for later this summer.

We continue to experience strong demand for AmeriGas Cylinder Exchange. We are finalizing expansion plans with a major retailer and a large convenience store chain that would result in the rollout of several hundred additional 24/7 automated cylinder vending locations by the end of this calendar year.

We were pleased to announce the transaction in which UGI would acquire 100% of AmeriGas, included in our 120-day review. As the various merger-related work streams continue to advance toward an anticipated Q4 closing date, we remain focused on key business initiatives for fiscal '20 as we strive to take the business forward and generate long-term, sustainable financial performance.

As I stated last quarter, we are focused on leveraging technology and our scale to advance our customer-facing capabilities and generate business efficiencies that will lower our costs. The Cylinder Exchange announcements we are making today are a tangible sign of this focus and that it is already starting to build momentum.

In closing, I want to thank our employees both on the front lines and in support roles for their continued commitment to our customers and our company. And with that, I'll turn it over to John for his closing remarks.

John Lawrence Walsh - *UGI Corporation - President, CEO & Director*

Thanks, Hugh. As I mentioned in my earlier remarks, we were pleased to report one of the best Q2 adjusted EPS results in UGI's history. In addition to that earnings performance, there were several other noteworthy achievements in the quarter that will position us well for future earnings growth.

Our Midstream & Marketing team remains focused on building out its asset network across the Marcellus region. We continue to grow our fee-based income stream as we added new gathering assets in the Marcellus and utilized our new Steelton LNG storage and vaporization facility. This shift to a higher percentage of fee-based income is central to our long-term midstream strategy.

Many East Coast LDCs, including UGI, experienced record natural gas send-out levels in mid-January, once again demonstrating the need for peaking solutions. In response to that rising demand, we've begun construction of our new LNG storage and vaporization facility near Bethlehem, Pennsylvania. This project representing approximately a [$60] million investment led 2 million gallons of LNG storage to our network. It will enhance our ability to meet the rapidly growing demand for LNG and strengthen our ability to use our LNG system assets dynamically based on market conditions.

Our investment outlook for utility remains very strong. We're deploying record levels of capital to address infrastructure needs while growing our customer base. Our teams are focused on providing safe, affordable and reliable access to low-cost natural gas to the 660,000 families and businesses we serve throughout Central and Eastern Pennsylvania. We're also committed to providing access in previously unserved or underserved areas of the Commonwealth. We're likely to invest approximately $2 billion in capital at the utilities over the next 5 years.

We filed our largest-ever rate case request of $71.1 million with the Pennsylvania PUC in late January. The scale of the request reflects the growth opportunities in our service territories and our commitment to infrastructure replacement. The filing is under review by the PUC, and we expect that the process will conclude later this year, with new rates going into effect for the fiscal '20 winter season.

Our most significant recent strategic event actually occurred just after the end of the quarter when we announced the proposed merger with AmeriGas on April 2. Yesterday, we filed our Form S-4 registration statement with the SEC. We're excited about the positive impact of this major transaction. When this transaction closes later this year, UGI will be exceptionally well positioned to fund future growth. This transaction will significantly enhance our cash available for growth investments and dividends. This will provide a broader funding foundation for the major capital investments in our natural gas businesses over the next decade and position the company for future M&A across the entire corporation.

We pride ourselves on our ability to deploy capital effectively across our businesses. Our disciplined approach to capital allocation positions us well to deliver on our long-term commitment of 6% to 10% EPS growth. We're excited about this major enhancement to UGI's cash engine for growth.

As we look forward to fiscal '20 and beyond, we're energized by the pending transaction and by the range of investment opportunities across our businesses. We have great confidence in the ability of our teams to execute operationally and identify attractive growth investments that align with our business unit strategies.

With that, I'll turn the call back over to Denise who will open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Dennis Coleman with Bank of America.

Dennis Paul Coleman - *BofA Merrill Lynch, Research Division - Global Head of High Grade Debt Research and MD*

A couple of questions for me if you would, please. Just on the rate case, can you just remind me what the time line is? I know you just talked about concluding later this year. But are there any milestones we can watch for along the way or filings or actions by the PUC that we should watch for?

John Lawrence Walsh - *UGI Corporation - President, CEO & Director*

Yes. The -- we filed in late January. The PUC review process is underway. Testimonies are being -- have been filed, and hearings have been scheduled. The typical time frame for a resolution is early fall in these cases. Previously, for us and most other companies in Pennsylvania, that involves a settlement, but that process will obviously play out over the next 4 to 5 months -- 4 months or so.

Dennis Paul Coleman - *BofA Merrill Lynch, Research Division - Global Head of High Grade Debt Research and MD*

Okay. Have you had settlement discussions already? Or is that something that's scheduled as well?

John Lawrence Walsh - *UGI Corporation - President, CEO & Director*

The -- we're still in the process of the various parties filing testimony. That would follow the conclusion of that process.

Dennis Paul Coleman - *BofA Merrill Lynch, Research Division - Global Head of High Grade Debt Research and MD*

So too soon for that. Okay.

John Lawrence Walsh - *UGI Corporation - President, CEO & Director*

Yes.

Dennis Paul Coleman - *BofA Merrill Lynch, Research Division - Global Head of High Grade Debt Research and MD*

I guess one other one. You mentioned the M&A and the APU transaction allowing you to do that. Talk a little bit of -- I guess it's a broad question, but areas that you're looking at. And I know you've talked about this in the past, but any updates there would be useful.

John Lawrence Walsh - *UGI Corporation - President, CEO & Director*

Sure. We look broadly across -- in terms of M&A, we look across the entire corporation. So we would continue to do that across our propane businesses. Further opportunities to invest in Europe would certainly fit that description. We're focused in the short term in AmeriGas on the upcoming transaction, but longer term, there will be opportunities there. And on the natural gas side of our business, most recently, we've made several acquisitions involving natural gas-gathering systems and continue to look for opportunities there as that segment or area evolves.

So we'd look broadly across the greater Marcellus region for midstream investment opportunities M&A and have a continuing interest in utilities M&A. And anything we look at is always subject to our normal return requirements in terms of deploying capital. So we'd look at it through that filter. But it's a broad-based set of activities we have that spans the entire corporation to look at M&A opportunities. And then capital -- major capital project opportunities are not exclusive to the natural gas side of the [house] but tend to be clustered on that side.

Operator

Your next question comes from Chris Sighinolfi with Jefferies.

Christopher Paul Sighinolfi - *Jefferies LLC, Research Division - Senior Equity Research Analyst, Master Limited Partnerships*

Just wanted to touch on a couple of things. I guess first off, with regard to -- I guess it's a 2-part question. But with regard to the performance this past quarter, and we talked about this, I think, on your last quarter call, but something that's detailed in the S-4 is just the experience that AmeriGas has faced but you see on the UGI front as well with regional variations in weather and the difficulty that, that is, I guess, presenting in terms of forecasting and maybe even operating the company. I'm just wondering if there's things that came out of the review that you might look to do differently in regards to, I guess, both forecasting but also operating the company. Anything that comes to mind that could help us think about minimization of variability on a go-forward basis post the acquisition?

John Lawrence Walsh - *UGI Corporation - President, CEO & Director*

Yes. In terms of challenges presented just by variable weather conditions, it's not a new challenge for us, but we have to be prepared and [duly] respond. And I think -- and Ted noted it in his comments. I think in Europe, we did a nice job of responding to where we had the most challenging weather this year.

One of the areas that we're focusing on is where we can better leverage our scale to take fixed costs out of our activities, deploy technology, drive our costs down. So certainly, the more we can do in terms of -- in some cases, we're broadly deploying technology that we've already begun to utilize and drive it across our propane businesses consistently. That will help us in terms of addressing challenges inevitably that come up each year with where the cold and where the warm weather occurs.

So that's, I think, a consistent theme that you'll be hearing from us as we move forward, is can we accelerate some of these efforts and enable us to be a little bit more nimble in terms of how we respond to differing operating conditions, both warm and cold.

Christopher Paul Sighinolfi - *Jefferies LLC, Research Division - Senior Equity Research Analyst, Master Limited Partnerships*

Okay. And just a clarification point for me. It's not regarding the quarter. It's more on the S-4, which you filed last night and talked about in your release. I just want to be clear, the forecast that I see in there, those are all -- I know it's a series of footnotes, but those are all independent. They're not pro forma books. Is that correct? In terms of like per...

John Lawrence Walsh - *UGI Corporation - President, CEO & Director*

What is in the S-4...

Christopher Paul Sighinolfi - *Jefferies LLC, Research Division - Senior Equity Research Analyst, Master Limited Partnerships*

Go ahead.

John Lawrence Walsh - *UGI Corporation - President, CEO & Director*

There's -- it's -- as you've seen by looking -- reviewing it, Chris, it's a very extensive document. So you have various advisers that did some forecasting based on information that was provided to them by the company. The basis for our planning for the company is a budgeted plan process that we go through each summer as we come out of the winter. So that's sort of the foundation for the work that was done and then shared with financial advisers that work with the various independent parties within that process with some minor updates. And obviously, we -- as we've come out of the winter now, we initiate another pretty extensive process looking at each of our businesses and the markets in which we operate. And that'll be reflected when we come to market with an updated view for fiscal '20. So that's kind of the way that process works.

Christopher Paul Sighinolfi - *Jefferies LLC, Research Division - Senior Equity Research Analyst, Master Limited Partnerships*

Okay. But I guess when I look -- and clearly, the attributes of the deal are significant on the cash front. And you and Ted have talked about that. You talked about that on the merger call and again today. And we had a chance to separately go over some of that.

But I guess when I think about EPS accretion, which I think you guys noted beginning in fiscal '20, I guess the spirit of my question, John, is when I look at Page 70 of that, I see independent -- it looks to be independent forecast based on the implied share count. Is it safe or fair to assume that the accretion you talk about would be sort of levels in excess of what I see reflected on that page? Or are those numbers third party provided and not something we should anchor to?

John Lawrence Walsh - *UGI Corporation - President, CEO & Director*

Those numbers are -- as I said, some of the numbers -- and I have to look at the document to review the specific forecast that you're referencing. Basically, they started with information that management provided, and then those advisers ran different scenarios for the special committee of the AmeriGas Board that was established.

And then fundamentally -- yes, just fundamentally, what I'd say on EPS accretion, Chris, is come back to the statements we made when we announced the transaction. This will be EPS accretive. It's much more of a cash flow impact, but it's EPS positive. That EPS benefit tends -- will grow over time because we have a sizable increase in cash available for reinvestment. So it's a positive EPS story at the outset that is enhanced over time by our ability to take that cash and redeploy it.

Operator

There are no further questions queued up at this time. I turn the call back over to John Walsh.

John Lawrence Walsh - *UGI Corporation - President, CEO & Director*

Okay. Well, thank you for your time and attention this morning. We look forward to speaking with you in the near future when we review our future results. Thank you.

Operator

This concludes today's conference call. You may now disconnect.