The Williams Cos., Inc. (WMB)

EDITED TRANSCRIPT

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Theresa Chen

Analyst, Barclays

Good morning, everyone. It is my pleasure to welcome our next presenter, Williams Companies. From Williams, we have Alan Armstrong, CEO.

Alan Armstrong

President, Chief Executive Officer & Inside Director, The Williams Cos., Inc.

Thank you, Theresa, and good morning, everyone. It's a great time to be here in New York City, even with some of the heat we've been having in Oklahoma being shared with New York finally.

I've got a lot of comments to make this morning. I'm going to start off with what we've accomplished financially from a track record standpoint, then get into a little bit of the fundamentals that are driving our business and then look at the kind of growth opportunities that we have that are off the backs of those fundamentals.

First of all, our growth has been pretty extraordinary here. This is looking back at the last five years. You can see a lot of different metrics that we have on here, the 17.5% return on invested capital that we produced, and by the way, that's not just looking at project to project to project, that's looking at our entire portfolio. So that's projects that also offset declines in other businesses. So a very healthy ROIC.

And we test this. This is something that we pay a lot of attention to as a management team, partially because we're compensated on our ROCE for the business and our growth in ROCE. And so, it's something we pay a lot of attention to. That number is pretty impressive in a mature business, but I can tell you it's about to get even stronger than that as we've got a lot of projects that are coming on here over the next couple of years that are very low capital-intensive projects with very high returns. So, we're really excited about that particular number.

You also see here that we've now had 30 quarters in a row – over on the predictability side – thirty quarters in a row that we've met or beat our consensus estimates. And we haven't gotten there by lowering guidance. In fact, through that period we've been raising annual guidance through most of those years. And so, we've continued to have a very predictable business. The good news is, I would tell you, that we have a lot more of this growth to go on and a lot more of these returns.

So, if we study a little closer, the financial metrics that we've been able to produce, this is a look back five years and you can really see the signs of a very healthy company here with a lot of great growth. The 23% CAGR on our EPS has been pretty impressive. And as well though, really healthy across the board, including a very strong improvement in our credit

metrics for the business.

And probably one of the things that I think sometimes is most undervalued is the kind of coverage that we've continued to build on a growing dividend. So, we've grown our dividend at a 6% CAGR over this period but you can also see the coverage has continued to expand during this period as well, giving us a lot of opportunities to return value to our shareholders.

And what this has really accomplished with all that help has been the amount of free cash flow generation that we've done during the same five-year period, and you can see the kind of value that this business is producing. Now as we've gotten to a point where our credit metrics are in line, you're going to see even more free cash flow generation growth here in our business because our returns in our business are, believe it or not, even though they've been pretty good, as I mentioned earlier, they're actually getting higher.

And this is a look at why our business has been so predictable. So, this is our base business. So, this does not include Sequent. It does not include our E&P business. This is 92% of our business on a 2023 guidance basis. This is 92% of our business. This is one of my favorite slides to explain our business and our company because if you look at how we trade, a lot of times we trade with commodity prices, and you can see there's hardly any correlation there of EBITDA with price on either gas or oil. The tight correlation you can see there is the capacity on our big transmission systems as well as the gathering volumes. That's what you see in orange, the quarterly average volume, and the capacity that we have to sale – and the sold-out capacity on our transmission system.

So, if you want to be a long-term investor, this is what you ought to pay attention to for what drives this. It is natural gas demand and demand for capacity. I'm going to get to that point here in a minute, but it's not just an annual average volume of gas that we sell. We sell capacity. So, for instance, on our transmission systems, we really don't care what the renewable generation is in a market that we serve because the utilities have to buy the backup capacity to be able to back that up.

So, we've actually seen demand continuing to grow. As we can see on this slide, this is a picture and in the blue bar there is the average annual demand for gas, for power generation alone here. And you can see the blue bar showing how that's continued to grow at a 6% clip -- sorry, 6% here in 2022 versus 2023. But also, the peak. So, peak day demand is growing. It was about 50 Bcf a day of peak last year and everybody was really impressed by that and we did have a very hot summer in the heavily populated areas last year. This year, even though you hear all the talk about the heat, the heat within the markets that really have a lot of population like here in New York City really has been pretty mild this summer and that's leaving out this week. But so far in terms of what's produced this number, we really haven't had it that hot, but yet we had 53 Bcf day this year, and we've actually seen five days so far over 50 Bcf a day. So, a pretty impressive setup.

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Another point to be made from this slide though is the fact that the forecasters have continued to miss this. The EIA that continues to show, and you can see that in the dots there, that that's their year ahead forecast, and they've consistently missed this. And frankly, it is almost all on the backs of expectation for more power generation from renewable capacity that hasn't shown up. That has been the primary reason that they've continued to miss this.

And it's not that it's not getting installed, it's just the utilization rate of the capacity that's being installed that's been missed as we've gone through and studied these numbers. And so good news, I would tell you, for our business and for natural gas demand. And this is really before the current wave of electrification takes hold.

And there is so much money being spent right now at ports and airports, all in grant money from DOE to electrify all kinds of equipment in and around. That's just going to continue to drive more and more both annual average demand for power as well as peak demand for capacity and natural gas is going to be -- and particularly pipelines and storage capacity are going to be the beneficiaries of that continued electrification.

The other area that will affect this on top of electrification is a shift from gas to coal. And this just looks at the power plants within the states that we operate in and the areas that we have an opportunity to serve. And you can see here 74 coal plants that have a net capacity of 79 gigawatts, and that is about 4.6 Bcf per day of natural gas capacity.

Just to put that in perspective, our Transco system today is right at 20 Bcf a day. So pretty nice growth, and we are seeing a lot of this conversion. The Duke ERP that just came out here a couple of weeks ago calls for a lot more gas capacity in their area as they convert from coal. And we certainly are seeing the response to that need for gas in the open seasons that we've been offering in the Mid-Atlantic region and down into the Carolinas and Georgia.

The other area of obvious growth, and this isn't so hard to predict because it is such a long lead item is the LNG side. And so, today that number is about 12 to 13 Bcf a day of active projects that are going, but there's 26 Bcf a day of both current active projects or facilities as well as those that are in execution now. We are extremely well positioned to serve a lot of this. We already serve four of the existing operating plants, and we are in negotiations on several others to continue to serve LNG, and particularly finding ways to get both Haynesville gas and Marcellus gas into these markets.

In addition to that, though, there's another 15 Bcf a day of new supply. So, the fundamentals right now are better than they have ever been for gas. I know that doesn't fit a lot of people's narrative around what's really going on, but the truth is we really kind of capitulated. Everybody’s been wanting something else to happen, some other solutions,

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some other technical solution as a backup for renewables but the point is we've kind of gotten to the point where there really aren’t too many alternatives, and we're going to have to start really building out the capacity and relying on natural gas to back up our power generation. And obviously, the LNG will put demands on our systems as well.

So, we have three major pipelines that we operate: Transco, Northwest Pipeline, and we own half of Gulfstream with Spectra. And you can see here that Transco is by far the most valuable pipeline in the U.S. Just some stats on that – 44% more throughput than the next largest natural gas pipeline – that's pretty impressive in terms of its size and scale, and it's continuing to rapidly grow.

You can see the five-year EBITDA CAGR at 13%. That's really impressive when you realize that we have a rate case that we've just started the test period for here recently. So, a lot of the capital investment that we've been making on emission reduction projects has not yet been captured in that earnings growth, and we're coming on the tail end of the rate case.

So, we've got another step-up in earnings coming from the rate case for that business as well. And then in addition to that, we've got 2 Bcf a day that will get us to 21 Bcf a day here by 2025. So that will be 20% of nation's natural gas capacity in one pipeline system. It also is fully contracted. A lot of people think sometimes that we would be impacted by whether it's hot or it's cold. The truth is these pipelines are completely sold out 100% and so very predictable cash flow.

The thing you always have to count when you're accounting for how many days there are in that quarter because that's kind of the variability in that business. So, it's a pretty steady business for us. This is, though, a picture of the growth that we have ahead. So, we've talked about our track record. We've talked about the strong fundamentals that set us up for the future. These are the projects that we have coming online, and you can see here the ones in blue that are going to be completed here in either 2023 or early 2024, that will give us a lift in 2024. And then you can see in 2025 – and I would tell you a lot of these projects in 2025 are very large-scale projects. Some of them are not requiring a lot of capital because the producers are putting the capital in, in places like the Deepwater Gulf of Mexico.

But our Deepwater EBITDA from this will double through 2025. And in fact, with the projects that we have coming online, we're probably going to exceed that because we've had a few more projects come on recently. So, the Deepwater has got a lot of growth for us with pretty limited capital investment required on our part. And then you can see a number of transmission projects in the purple that will come on towards the end of next year and into 2025 that are Transco expansions.

And the good news is, I'll tell you, there are more projects to come. So, those are projects in

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execution. This is the pipeline ahead of us. If you followed us closely, you've seen this number of 30 projects be there for a long time, and you might say, well, are you guys ever going to move any of those into execution? The truth is that we've moved 9 of these projects into execution since 2020. If you went back and looked at the last couple of years and two years before that, we're moving about 4 to 5 projects a year out of our pipeline into execution.

And we've had a really good track record of moving these projects from potential projects into execution. I would also say though that the fundamentals that we're seeing are actually just now showing up, and given the number of things that we're pursuing with customers right now, I actually expect for the first time in quite some time for this pipeline of projects to actually expand a bit on us just given the number of requests for services that we're getting, particularly on the pipeline side of our business.

And so, we also have been able to grow the business with bolt-on expansions. And I would just tell you, you can't look at our acquisitions and find one that we haven't had some very strong competitive advantages. In other words, we're not out just looking for what the cost of capital in the market is. We're looking to make some outsized returns. And in each of these cases, we have some very strong competitive advantages that we knew about going into the transaction.

And I'm proud to say the team has done a fantastic job of executing on those opportunities. And in the case of MountainWest, which we just did earlier this year, that is showing up with a lot more growth already. We've already fully executed projects that were not even in our upside case for that project originally. So, a lot of demand going on out West, particularly in coal conversion. So, if you look in Wyoming, you've got a couple of very large PacifiCorp plants out there that are now converting from coal to gas, and we will be serving those projects as well.

So, a lot of great growth showing up. The storage assets that we bought in and around the Dallas area, part of that project was that we, through our Sequent operation, already held about 30% of that capacity, and we realized it could be priced up pretty substantially versus what we were paying for it, and we would still be willing to pay it. And so, we bought that, and we've been able to almost double the rates across the business there that was up for re-upping contracts. And in addition to that, we've now built a new transmission project, we're in the process of commissioning as we speak. And so that will come online here in the third quarter. That's a transmission line that will bypass some of the local pipeline systems and go directly into the power generators in that area, so a really high margin project for us on that as well. And then on the Trace Midstream deal, we've always had a big relationship with Chevron, and we knew they had a pretty large package of gas to the south of the Trace system that we thought we could win with the addition of this asset, and we've been able to do that.

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And so, we've now contracted that acreage and are expanding that by 400 million a day. And in addition to that, we got a large commitment to our Louisiana Energy Gateway from Rockcliff, the producer on that Trace system. So really, it's hard to look at any deals that we're doing that don't have something that we bring to the table that adds value over and above what that value would be to the broader market.

So, we always get questions about our capital allocation. And I would tell you, I think the questions will get louder on this, frankly, because this free cash flow is starting to pile up and we’ve continued over the last several years just to let our credit drift lower. We're at a point where we're trading like we're BBB+ on our debt.

We really don't see a whole lot of value going a whole lot lower than that. And so that bucket has gotten pretty full. That balance sheet strength that we've been pursuing. And right now, for the first part of the year, we're at 3.5 and we've got guidance at 3.65 for the entire year. And that's, frankly, kind of right where we want to be. We don't think there's a whole lot of value in going much lower than that given the predictability of our cash flows and given where our debt trades today.

On the dividend side, we have maintained. We've said for a number of years now, probably five years now, we've said that we thought the $1.5 billion to $2 billion of capital would generate about 5% to 7% of growth for us. Obviously, that has the law of bigger numbers going on with it and 5% to 7% gets harder, but the good news is, we’ve gotten better and better returns on our projects. And so that 5% to 7% growth in EBITDA remains and we've been able to raise our dividend right in line with our core business and the value on top of that being our E&P business has driven that number on Adjusted EBITDA growth even higher than that.

On new investments, I'm happy to tell you that we have a number of good investment opportunities. We high-grade these all the time. At the very lowest part there on item Number 4 is our emissions reduction projects. So let me explain that very quickly. Within our Transco and our Northwest pipeline systems, we have plenty of room in the rates that we charge – in the regulated part of our business – that we charge our customers we have plenty of room to keep investing at about a 12.5% return on a cash-on-cash basis before tax.

And so that's very much just like a lot of utilities that you would otherwise invest in. That investment is allowed to us. That is at the bottom of the barrel for us in terms of return, but it's a very large opportunity for us. And so, when we get to the bottom of this stack and we have something left, we continue to use that because that's not an opportunity that will escape us. It's an opportunity that sits there. And so that's a place for us to invest excess capital, and we are investing pretty heavily right now in our emission reduction project investments, which will drive a very successful rate case outcome for us in 2025.

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By the way, the test period just started. We'll have a base case period and we'll be filing rates in March of 2025. Couldn't be a better time to go in for a rate case with debt costs coming up across the sector, equity prices up against the sector, inflation in cost, easy to argue that that will continue. And those are the kind of things that drive a successful rate case that we'll be up against. So, we're pretty pleased with the timing that we're going to be hitting on that front.

And then finally, on the financial flexibility, we've got a $1.5 billion stock buyback approved by our board and we've done about $130 million this year of buybacks. And the way we think about that – like we haven't overcomplicated this – we've been delivering the 6% CAGR on dividend growth and we think the bottom of the barrel of return for us is around 12% to 12.5% on that rate case, which is a very low-risk investment.

And so, when we hit a yield plus growth assuming a 6% growth, when we hit a 6% yield, that's the point that we've been opportunistically buying in the market. And while that number will change as we raise our dividend, it's pretty easy math and really the way we think about where and when we buy shares back.

And then finally, I would just tell you, we continue to have our eyes out for bolt-on transactions that we can do much like the ones that we've done, and we're very happy with today. Some of the things that are drivers for that today for us are that a lot of private equity shops have got a lot of floating rate exposure. And so, there's getting to be a pretty big spread in cost of capital between the private equity side that hold assets in and around – some of those in JVs with us frankly, so we know the assets very well.

So we're being very patient and letting those opportunities come to us at a price that we're pretty excited about when we do have some remaining opportunities that we think we can pick up at very attractive prices. And certainly, we would only do that if it winds up being better than that rate case investment opportunity at the 12.5% level.

So, with all that, I would tell you, it is a great time to be continuing our strategy that we've been on for quite some time. We believe natural gas has so much to bring to the table to solve some of our most critical problems, both here at home and around the world. And we are really happy as a company to be a part of the solution and be a part of driving down emissions in a dramatic fashion with the use of natural gas taking out heavier fuels. We've been on this strategy for quite some time, and it is really paying off very well for us, as you can see.

And the good news is that I really think we've got even better days ahead for us right now as really the market has run itself in a situation where it doesn't have very many alternatives if you want to lower emissions and you want to have reliable energy source. There are just not very many options left on the table for us here in the U.S. and around the world, and

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we're excited to be in the position we are to provide the infrastructure to help deliver that gas.

And with that, I will open it up for any questions you might have.

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Theresa Chen

Analyst, Barclays

So, we have time for a few questions. The mics coming around. Sir, please.

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Question #1

Alan, could you comment on yesterday's acquisition announcement, Enbridge buying Dominion’s distribution companies. Are those assets that you looked at? Could we see gas distribution companies in your portfolio at some point?

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Alan Armstrong

President, Chief Executive Officer & Inside Director, The Williams Cos., Inc.

I would just say that from our perspective, we always have to look at a deal like that and weigh how our currency is valued up against our discounted cash flow of our own operation. And I would just say that when we would look at an asset like that, the use of equity in a transaction like that just really wouldn't make much sense for us just because we've got some good growth that is undervalued as a currency there today.

And we have this rate base that's investable at a higher return than those LDCs offer in terms of incremental returns. So that kind of lower return doesn't make a whole lot of sense for us. And I'm not knocking at all. It probably makes a lot of sense for Enbridge.

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Question #2

Just two quick ones, Alan. Can you comment on the impact that MVP could have on Williams? And the second question is, given the outlook for LNG exports, and everybody is talking about the Permian and Haynesville supporting most of that, what do you think needs to happen or do you think will happen to unlock the potential of Northeast gas to fill more of the LNG exports than perhaps people are forecasting now?

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Alan Armstrong

President, Chief Executive Officer & Inside Director, The Williams Cos., Inc.

Yes, it's a great question. So first of all, as to MVP, if you think about MVP, we own a lot of the gathering. We're the largest gatherer by far in the Marcellus and Utica. So, we own a lot of the gathering business. And so, as that market opens up and that takeaway capacity opens up, that will mean incremental volumes flowing out on the upstream side for us,

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where it's very high margin.

But in addition to that, we just had an open season here about a month and a half ago that really kind of surprised us. We don't get surprised on open seasons very often because we usually kind of know who the targeted customers are, and we kind of have a prearranged understanding of who's going to step into the open season. In this case, the open season was oversubscribed by multiples, not by percentages, but by multiples of the capacity we had to offer. And it is because people knowing that there's going to be low-cost supplies available at 165.

And so that open season really showed the power of bringing those new supplies into Transco and our ability to now serve a lot of that Mid-Atlantic and Carolinas market with that low-priced Marcellus gas. So, people will get very fixated on physical molecules and how they flow and where they flow. The truth is, Transco is a very large header. So that's going to be another supply point just like Station 85 is a supply point today.

We have 2.5 Bcf a day today – even without all these expansions that you saw from that area – we have 2.5 Bcf a day of capacity North, we have 2.5 Bcf of capacity South, and we have 700 million a day of physical capacity on the Virginia lateral that goes East towards the coast in Virginia. And so, we have plenty of physical capacity, but we don't have the ability to deliver for all of the growing market there, particularly in the Duke and the Carolinas market area.

So, we've been fighting hard to get MVP approved even though we don't own it. It's such an important project for unlocking gathering volume potential for us in the West Virginia and Ohio area and as well new capacity that we are going to be able to make very high return projects off of because we were going to have to build all the way from Northeast PA and serve those markets. Now the pricing level that the customer pays is the same.

So, in other words, everybody always thinks about its regulated pipeline, how good could be? Just get a regulated rate of return. That's not the way it works. Nobody can force us to do an expansion. So, we're pricing up against the avoided costs. So, the harder it is to build projects and build new expansion projects, the more valuable our capacity is on that expansion.

So, our ability to expand along our existing lines is going to allow us extremely high returns. And previously, it was going to be big projects, but lower returns. We're going to have a lot of projects that are going to have extraordinarily high returns. So, MVP is a very positive thing for us, and we're really excited to see it finally get approved.

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Theresa Chen

Analyst, Barclays

Thank you very much.

Alan Armstrong

President, Chief Executive Officer & Inside Director, The Williams Cos., Inc.

Thank you, Theresa.