

# 2016 AGA Financial Forum

## May 15 - 17, 2016





Presented by:  
John Hester  
President and CEO



# Safe Harbor Statement

This presentation includes “forward-looking statements” as defined by the Securities and Exchange Commission (SEC). We make these forward-looking statements in reliance on the safe harbor protections provided under the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, included in this presentation that address activities, events or developments that we expect, believe or anticipate will or may occur in the future are forward-looking statements. These include, without limitation, our 2016 outlook for our construction services and natural gas operations segments.

Forward-looking statements are based on assumptions which we believe are reasonable, based on current expectations and projections about future events and industry conditions and trends affecting our business. However, whether actual results and developments will conform to our expectations and predictions is subject to a number of risks and uncertainties that, among other things, could cause actual results to differ materially from those contained in the forward-looking statements, including without limitation, the risk factors described in Part I, Item 1A “Risk Factors,” and Part II, Item 7 and Item 7A “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and “Quantitative and Qualitative Disclosure about Market Risk” of our 2015 Annual Report on Form 10-K filed with the SEC, and other reports that we file with the SEC from time to time, and the following:

- The timing and amount of rate relief;
- Changes in rate design;
- Customer growth rates;
- Conditions in housing markets;
- The effects of regulation/deregulation;
- The impacts of construction activity at our construction services segment;
- The impacts of stock market volatility; and
- Other factors discussed from time to time in our filings with the SEC.

New factors that could cause actual results to differ materially from those described in forward-looking statements emerge from time to time, and it is not possible for us to predict all such factors, or the extent to which any such factor or combination of factors may cause actual results to differ from those contained in any forward-looking statement. The statements in this presentation are made as of the date hereof, even if subsequently made available on our Web site or otherwise. We do not assume any obligation to update the forward-looking statements provided to reflect events that occur or circumstances that exist after the date on which they were made.



# Presentation Agenda

- The Southwest Gas story
- Overview
- Summary financial results
- Our focus
- 2016 expectations



# The Southwest Gas Story

Centuri leadership change

Two Growing business segments

Strong balance sheet with  
access to capital markets

Decoupled rate design in  
all three states

Enhanced utility regulatory  
model

Infrastructure recovery  
mechanisms

Major Arizona general rate  
case filing

Large U.S. and Canadian  
presence

Progressing on holding  
company reorganization

Centuri business positioning –  
Focused on fast growing LDC pipe  
replacement segment



# Overview



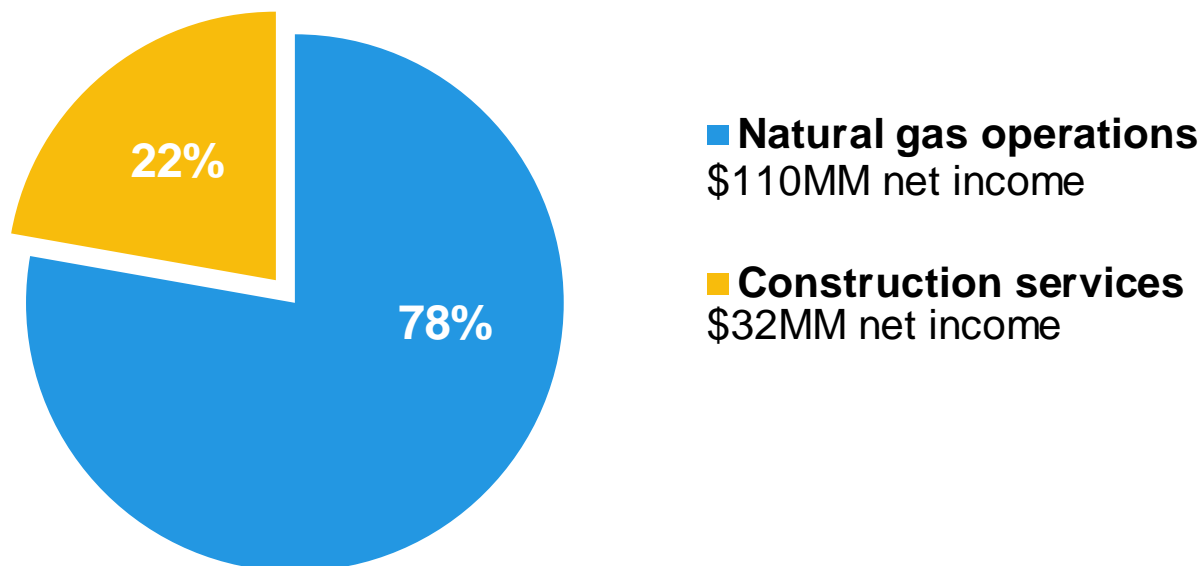


# Two Business Segments

Southwest Gas consists of two business segments

- Natural gas operations
- Construction services (Centuri)

**TMTD 3/31/16 Net Income  
\$142MM**





# Southwest Gas is a Regional Leader in Natural Gas Distribution

- Headquartered in Las Vegas
- Largest distributor of natural gas in Arizona and Nevada
- Distributes and transports natural gas in parts of California
- **1,964,000** customers in service territory at 3/31/2016
- Over **99%** of customers are residential and small commercial

ARIZONA



NEVADA



CALIFORNIA

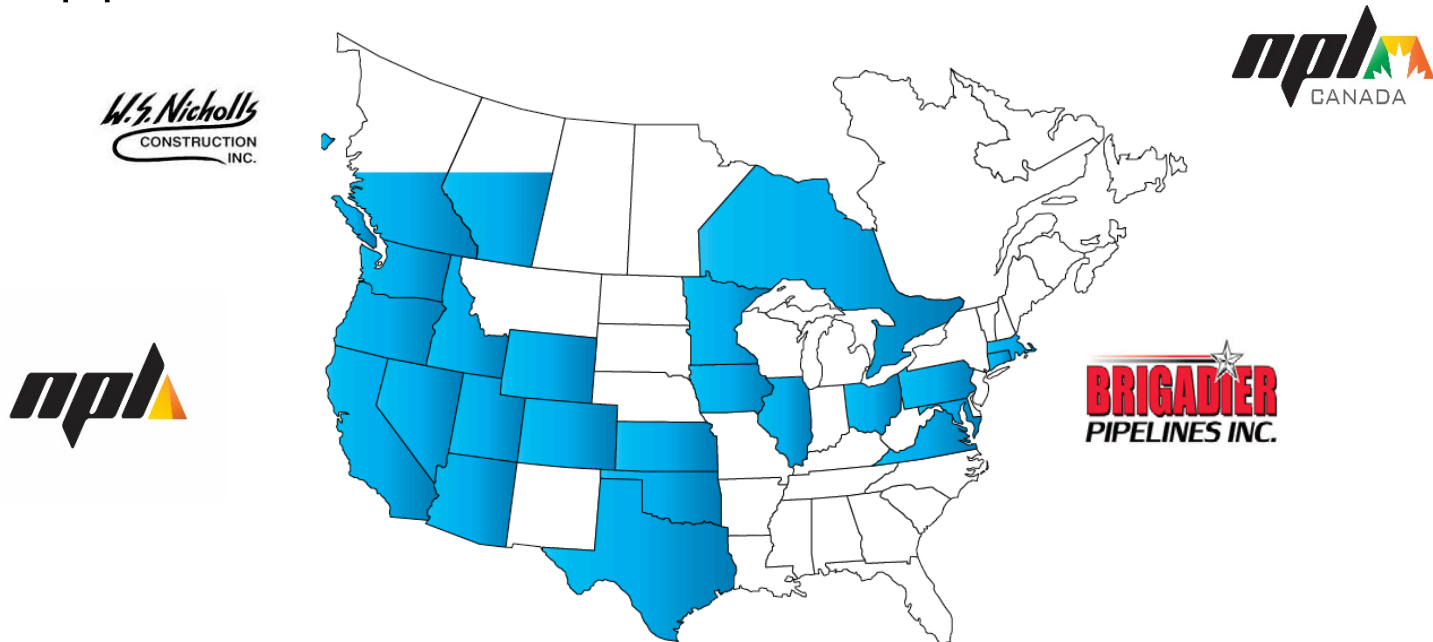




# Centuri Construction Group

## Construction Services – Markets

- Headquartered in Phoenix
- Operates in 22 markets across U.S. and Canada
- One of North America's largest full-service underground pipeline contractors





# Centuri Construction Group

## Construction Services - High Quality Customers

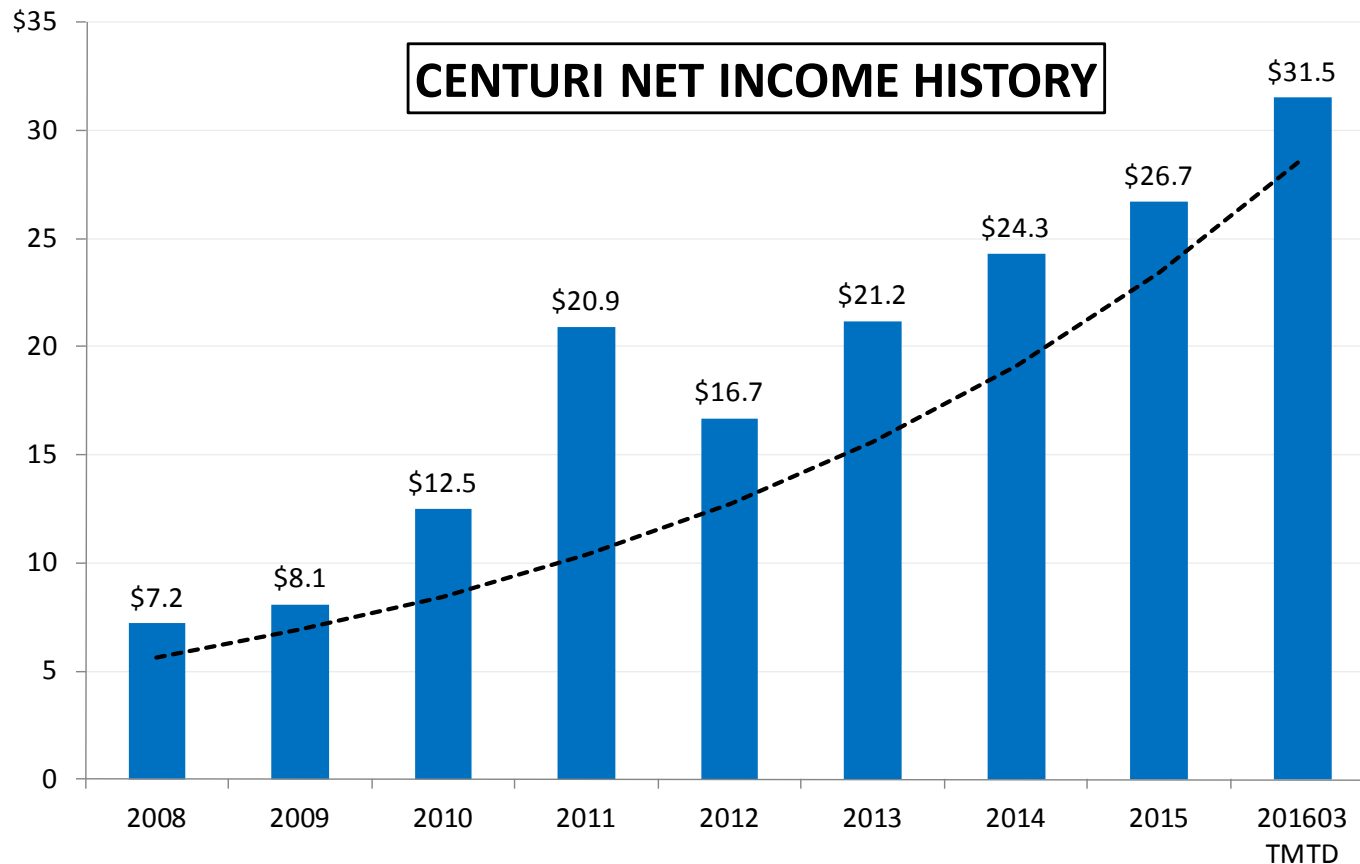




# Centuri Construction Group

## Historical Long-Term Profitability

(\$ in millions)





# Centuri Construction Group

## CEO



## **Paul M. Daily hired as CEO April 18, 2016**

### **Background:**

- 35 years construction industry experience
- 8 years at InfraSource Underground Services
- 9 years U.S. Army as commissioned officer
- Graduate of U.S. Military Academy at West Point



# Summary Financial Results





# 2016 Highlights

## Consolidated

- Dividend increase for tenth straight year (11%)
- Holding company applications approved by three state commissions

## Natural Gas Operations

- Added 26,000 net new customers over the past twelve months
- Paiute Pipeline Elko County Expansion Project (Adobe Lateral) placed in service
- Continued progress of infrastructure replacement mechanisms (NV and AZ)
- Filed general rate case application in Arizona

## Construction Services

- Revenues increased \$25 million, or 14%, compared to prior year quarter
- Link Line renamed NPL Canada
- Hired new CEO – Paul Daily



# Twelve Months Ended March 31,

(In thousands except per share amounts)

	<u>2016</u>	<u>2015</u>	<u>Over/(Under) Prior Year</u>
<u>Contribution to net income</u>			
<b>Natural gas operations</b>	\$ 110,287	\$ 123,194	\$ (12,907)
<b>Construction services</b>	31,493	19,132	12,361
<b>Consolidated</b>	<u>\$ 141,780</u>	<u>\$ 142,326</u>	<u>\$ (546)</u>
 Average number of common shares outstanding	 <u>47,196</u>	 <u>46,537</u>	 <u>659</u>
 Basic earnings per share	 <u>\$ 3.00</u>	 <u>\$ 3.06</u>	 <u>\$ (0.06)</u>



# Twelve Months Ended March 31, 2016

## Consolidated

- Gas segment results reflect strong growth in operating margin offset by higher expense levels. Increased expenses influenced by pension costs, depreciation, general taxes, and integrity management programs
- Changes in returns on COLI policies accounted for \$6.6 million of \$12.9 million of reduced gas segment contribution
- Centuri 12-month run rate is representative of the financial state of integrated construction services operations at this time



# Our Focus





# Core Fundamentals

- Growth
- Regulation
- Cost containment
- Safety
- Capital expenditures and credit ratings
- Shareholder returns



# Growth





# Customer Growth Breakdown

## Natural Gas Operations

(In thousands)

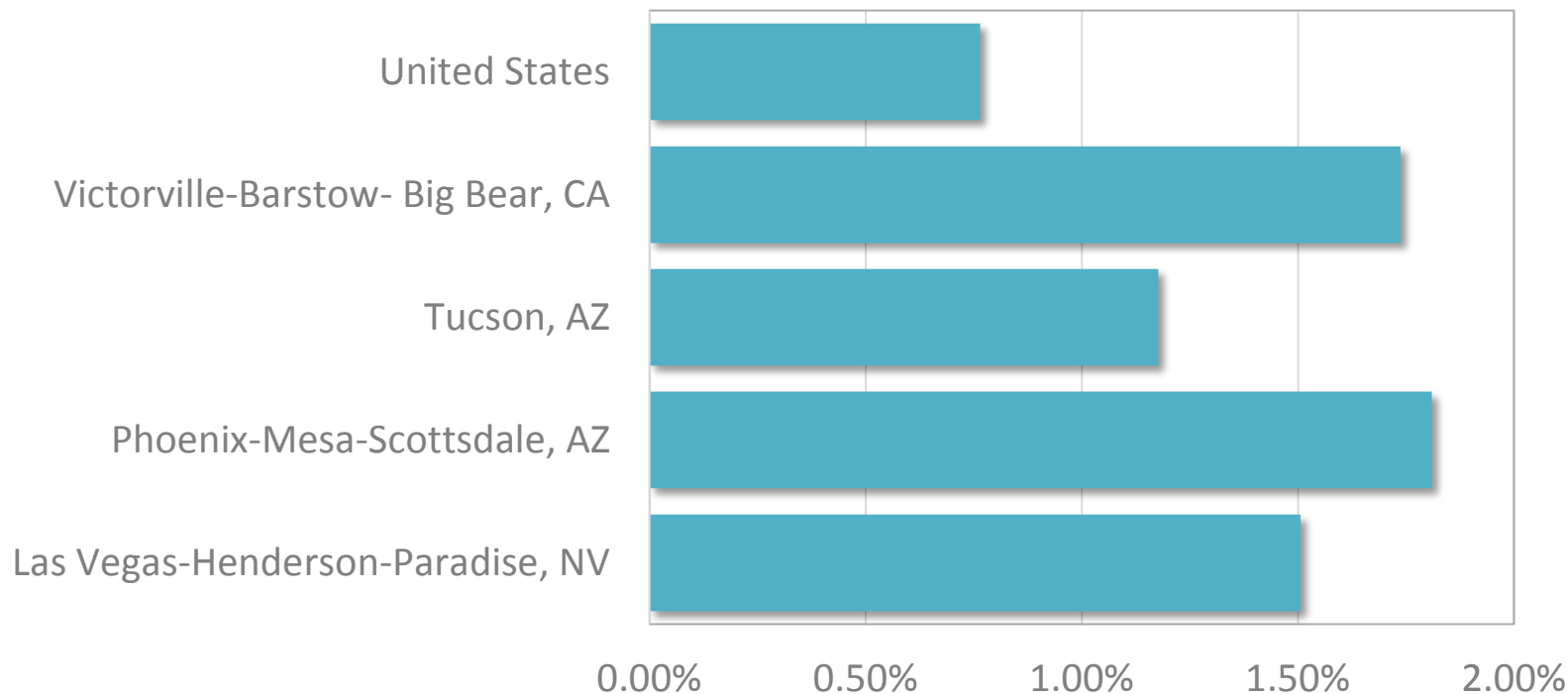
	Twelve Months Ended March 31,		
	2014	2015	2016
Beginning period	1,886	1,912	1,938
New meter sets	21	21	24
Meter turn-on/turn-offs	5	5	2
Ending period	<u>1,912</u>	<u>1,938</u>	<u>1,964</u>

- For 2016, Company is projecting net customer growth of about 1.5%
  - Slowly improving economic conditions provide organic growth opportunities



# Long-Term Customer Growth Potential

## Projected Population Annual Growth Rates 2016 - 2026



Source: IHS Global Insight



# Growth In Service Territories



**Las Vegas - Opened April 6, 2016**  
**100 to 150 events annually**



**Apple To Build A \$2 Billion Data**  
**Command Center In Mesa, Arizona**



**Resorts World Las Vegas**  
**\$4 billion project**



**Caterpillar to bring regional HQ to**  
**downtown Tucson, Arizona**



# Regulation





# Regulation Key Highlights

## Natural Gas Operations

- **General rate cases**
  - Arizona general rate case
  - California 2016 post-test year attrition filing
- **Infrastructure recovery mechanisms**
  - Arizona COYL program
  - Nevada GIR mechanism
- **Expansion projects**
  - Paiute Pipeline Company - Elko County expansion project (Adobe Lateral)
  - Nevada SB 151 - Expansion/Economic Development Legislation
- **Other regulatory proceedings**
  - Holding Company Reorganization



# Regulation – General Rate Cases

Arizona General Rate Case

Natural Gas Operations

End of rate case moratorium: Filed May 2016

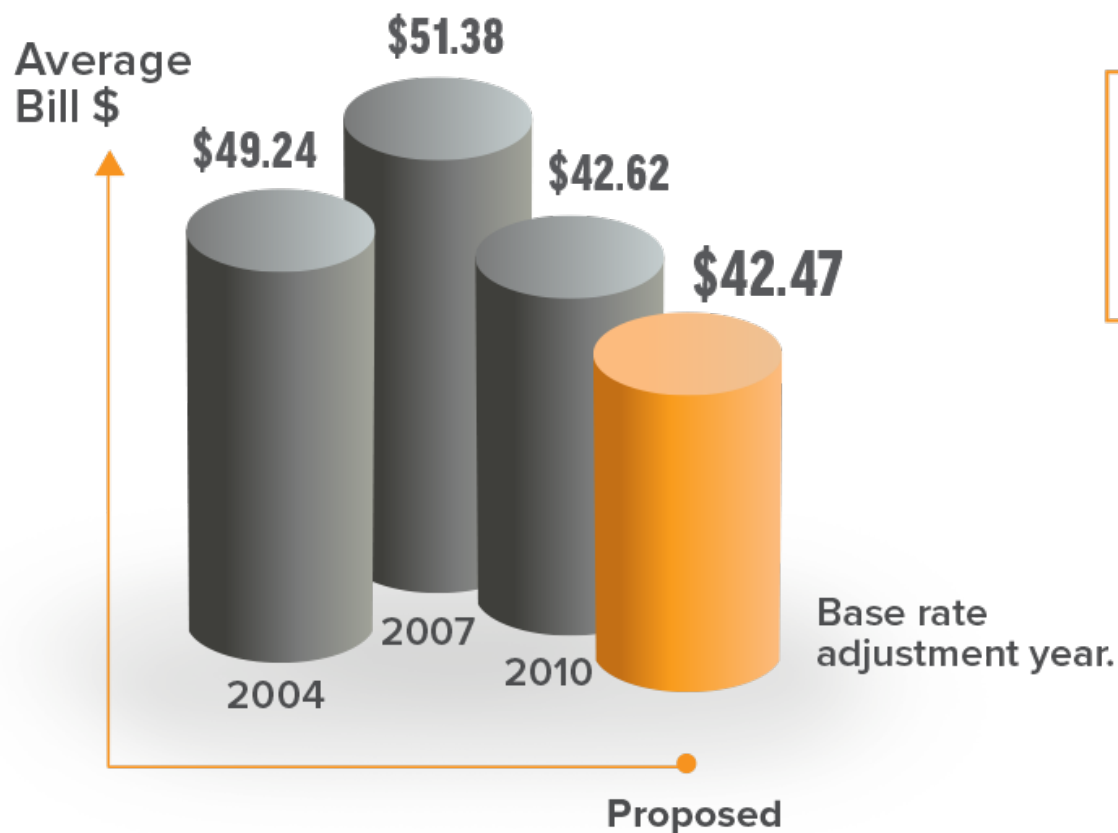
	Southwest Gas Requested
Rate Relief	\$32 Million
Depreciation study	(\$42 Million)
Rate Base	\$1.3 Billion
ROE	10.25%
Capital Structure - Equity	52%
Rate Design	Continuation of Decoupling Mechanism Gas Infrastructure Modernization Mechanism Property Tax Tracker
Estimated Effective Date	May 2017



# Regulation – General Rate Cases

Arizona General Rate Case

Natural Gas Operations



Proposed bill **lower** than average bill in the past 3 rate cases.



# Regulation – General Rate Cases

## California Annual Attrition and Implementation Plan

### Natural Gas Operations

- 2016 attrition increase of \$2.5 million
- Natural Gas Transmission Pipeline Comprehensive Pressure Testing Implementation Plan (Implementation Plan)
  - Involved replacement of 7.1 miles of transmission pipeline and installation of remote control shut-off valve
  - CPUC approved adjustment to recover costs which is expected to result in a margin increase of \$1.7 million in 2016



# Regulation – Infrastructure Recovery Mechanisms

## Natural Gas Operations

### Nevada gas infrastructure replacement (GIR) mechanism

- 2014 PUCN authorized \$14.4 million replacement work for 2015
- 2015 PUCN authorized \$43.5 million replacement work for 2016
- December 2015 PUCN approved surcharge revenue of approximately \$4 million effective January 2016 based upon deferrals of \$38 million

### Arizona customer-owned yard line (COYL) program

- May 2015 ACC approved surcharge revenue of \$2.5 million effective June 2015 based upon cumulative capital expenditures of \$16 million
- May 2016 ACC approved surcharge revenue of \$3.7 million effective June 2016 based upon cumulative capital expenditures of \$23.1 million



# Regulation – Expansion Projects

## Natural Gas Operations

- **Proposed LNG facility**
  - Received pre-approval from ACC in December 2014
  - Purchased site for facility in October 2015
  - Contract to construct is expected to be in place in second half of 2016, with construction expected to take two to three years
- **Paiute Pipeline Company (FERC)**
  - \$35 million, 35 mile lateral to interconnect Paiute with Ruby Pipeline and increase gas supply deliverability to Elko
  - FERC approval received in May 2015, construction began in the second quarter of 2015, project completed and placed in service in January 2016
  - Rates to recover project were implemented in January 2016 and will result in incremental revenue of approximately \$6 million
- **Nevada SB 151 – Expansion/Economic Development Legislation**
  - Facilitates expansion of natural gas service to unserved or underserved areas in Nevada
  - Final regulations approved by PUCN in January 2016



# Regulation – Other Regulatory Proceedings

## Natural Gas Operations

### Holding Company Reorganization

- In October 2015, filed regulatory applications with the three state commissions (ACC, CPUC and PUCN) for approval to reorganize as a holding company
- The reorganization is designed to provide further legal separation between the regulated and unregulated businesses and provide additional financing flexibility
- The reorganization is subject to approval of the state regulatory commissions, consents from various third parties, and final Board approval
- Received approval from the CPUC in January 2016, PUCN in March 2016 and the ACC in May 2016
- The reorganization could become effective in the second half of 2016



# Cost Containment





# Cost Containment

## Natural Gas Operations

- Company expects to experience operating cost increase pressures
  - Heightened pipeline safety and system reliability mandates
    - Will not trade-off higher risk for lower costs
- We will look to mitigate these cost increases through continued focus on technological advances
- Goal to keep total operating expense increases within combined rate of inflation and customer growth



# Safety





# Safety Measures

## Natural Gas Operations

### Key metrics

#### ➤ **Damage Prevention**

- Damages per 1,000 Line Locate Tickets
  - An 8.2% improvement year over year
  - 1<sup>st</sup> Quartile – AGA Best Practices Program

#### ➤ **Emergency Response**

- Percent of Incidents Responded Within 30 Minutes
  - A 6.1% improvement year over year



# Capital Expenditures and Credit Ratings

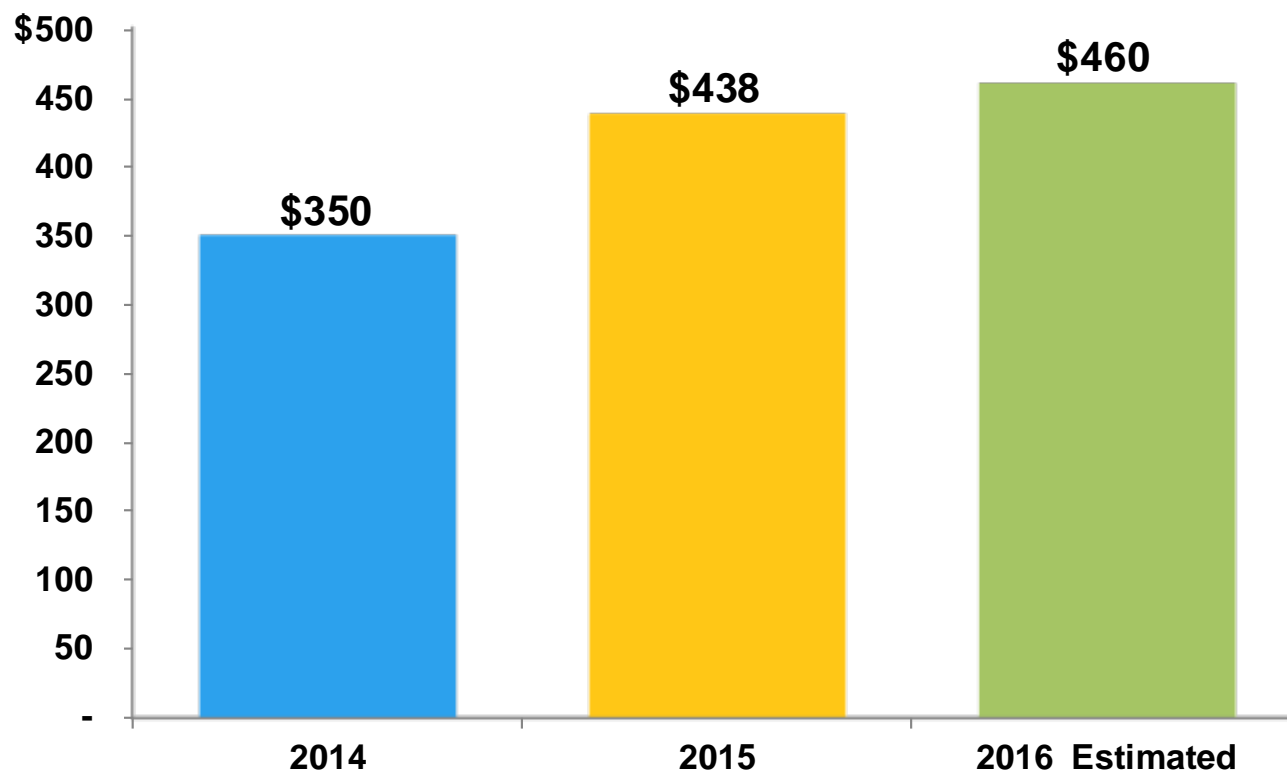




# Capital Expenditures

## Natural Gas Operations

(In millions)



2016 - 2018 Estimate: \$1.4 billion - \$1.6 billion

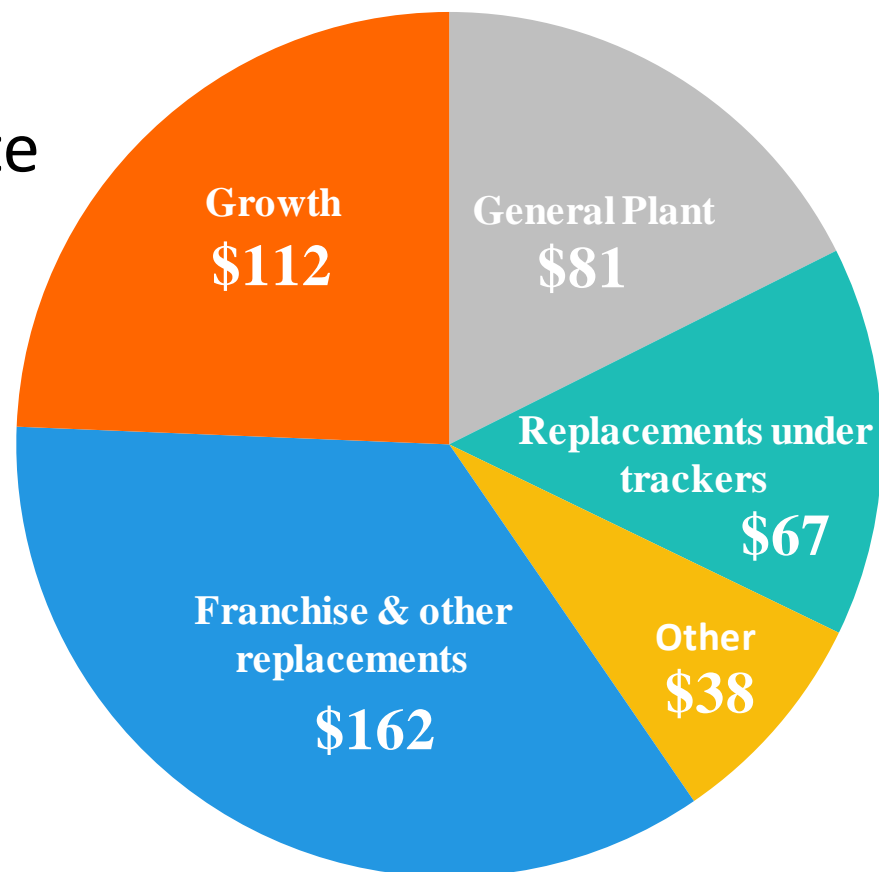


# 2016 Capital Expenditures

## Natural Gas Operations

(In millions)

- 2016 total estimate
  - \$460 million



2016-2018 estimate: \$1.4 billion to \$1.6 billion



# Investment Grade

## Strong liquidity will support capital expenditure and working capital needs

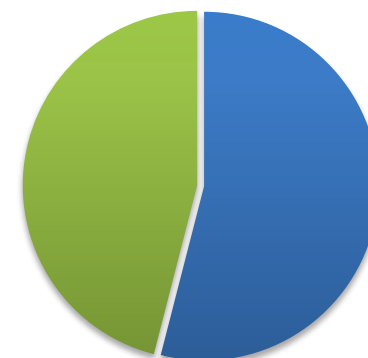
- Stable operating cash flows
- \$300 million revolving credit facility
- Uncommitted commercial paper program

## Strong investment-grade credit ratings

Rating Agency	Rating	Outlook	Reaffirmed
Moody's	A3	Stable	January 2016
S&P	BBB+	Stable	January 2016
Fitch	A	Stable	April 2016

## Capital Structure

As of March 31, 2016



■ Equity 54%

■ Long-term debt 46%

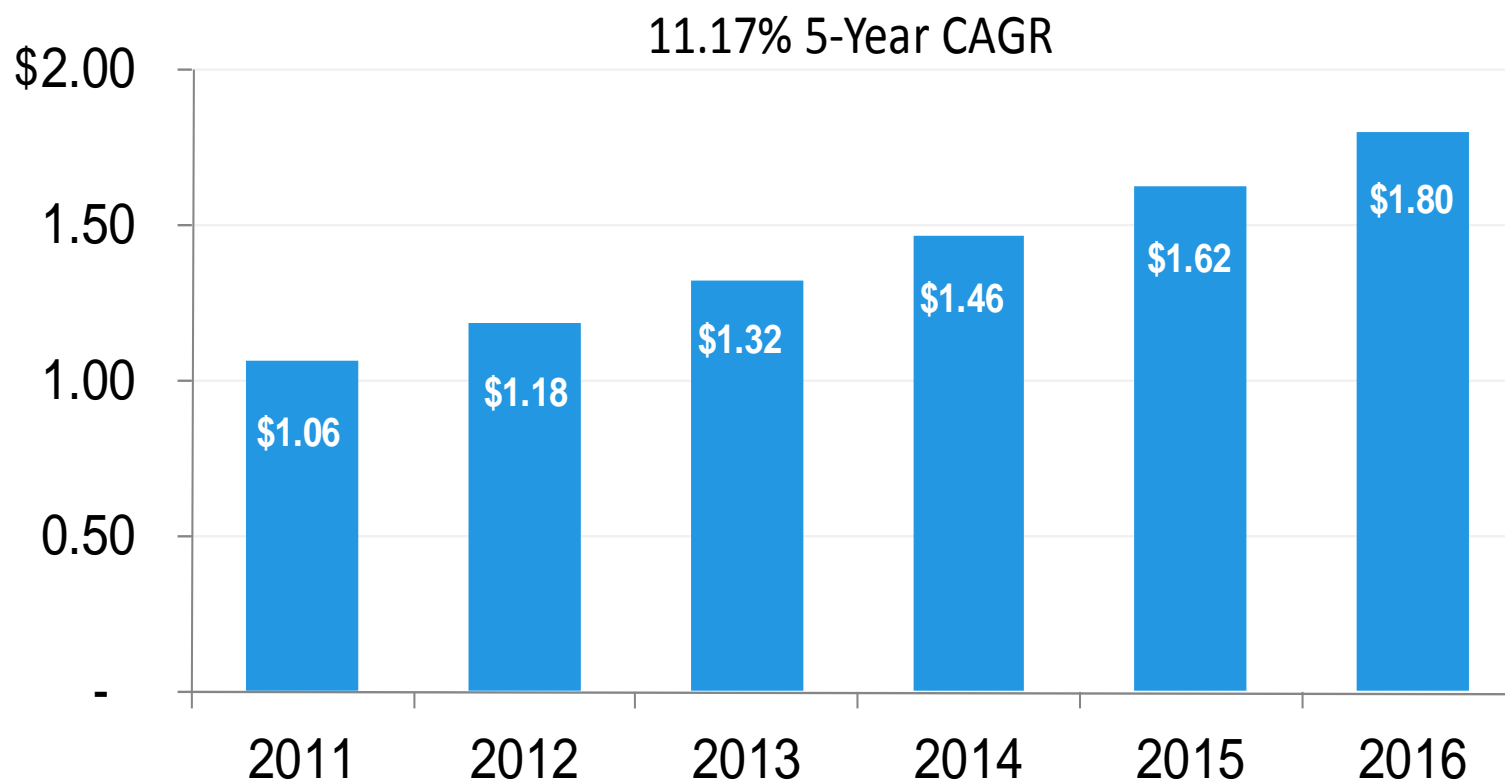


# Shareholder Returns





# Annualized Dividend Growth



CAGR = compound annual growth rate

February 2016, Board increased annual dividend \$0.18



# Stock Performance

**NYSE: SWX**  
**Common Stock Closing Price**  
**March 31, 2006 – May 11, 2016**





# 2016 Expectations





# 2016 Expectations

## Natural Gas Operations

- Operating margin increase of nearly 3% via combination of customer growth (similar to 2015), infrastructure recovery mechanisms, expansion projects, and California attrition
  - Additionally, new rates related to recovery of NV conservation programs to increase margin by nearly \$11 million, offset by similar amortization expense increase
- O&M expense increase expected to increase modestly
  - Higher general & incremental costs largely offset by pension cost decrease
- Depreciation & general taxes increase consistent with gas plant growth plus impact of NV conservation programs noted above
- Operating income to increase by 4% to 5%
- Average normal annual COLI returns of \$3 million – \$5 million
  - Continue to be subject to volatility, evidenced by swing over last two years
- Net interest deductions for 2016 increase of \$5 million - \$7 million due to capital expenditure financing requirements



# 2016 Expectations

## Construction Services

- Revenues 3% to 7% greater than 2015 levels
  - Primarily driven by strong base of large utility clients, many with multi-year pipe replacement programs, positioned to sustain and grow business
- Operating income approximating 5.5% to 6% of revenues
- Net interest deductions between \$6.5 million - \$7.5 million
  - Based on current interest rate environment
- Collective expectations exclude consideration of earnings attributable to noncontrolling interests
- Changes in foreign exchange rates could influence outcomes



# 2016 Areas of Focus

- Completion of Holding Company implementation process
- Successful prosecution of Arizona general rate case
- Expansion of infrastructure tracker mechanisms
- Capture customer growth opportunities
- Pursue Centuri expansion opportunities under the leadership of Paul Daily



# Questions?





# APPENDIX





**SOUTHWEST GAS**

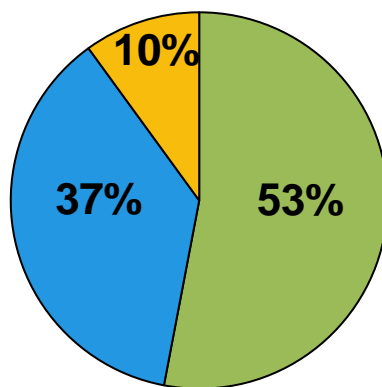
# Stable Customer Base

## Natural Gas Operations

### TMTD March 31, 2016 Customer & Operating Margin Distribution

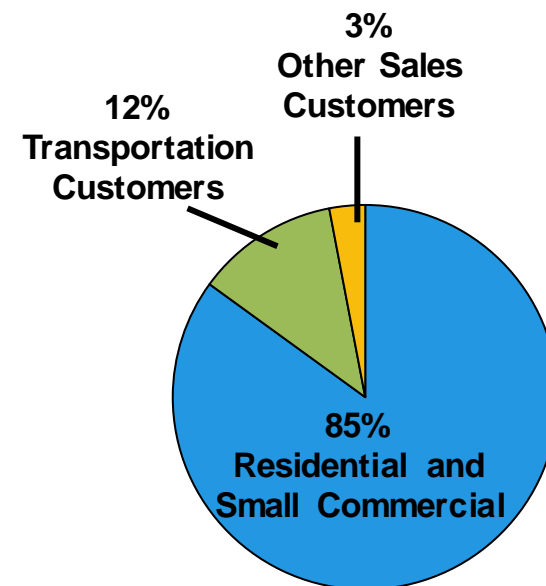
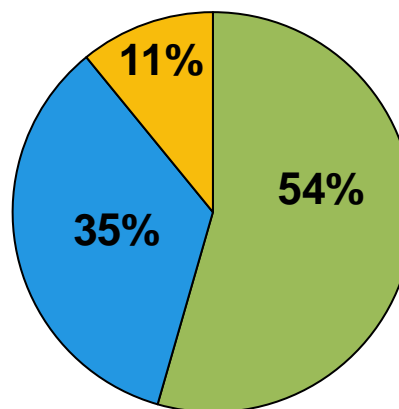
#### By State

Customers



■ Arizona  
■ Nevada  
■ California

Margin

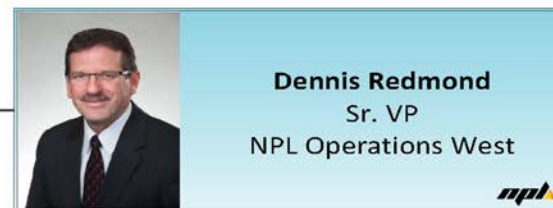
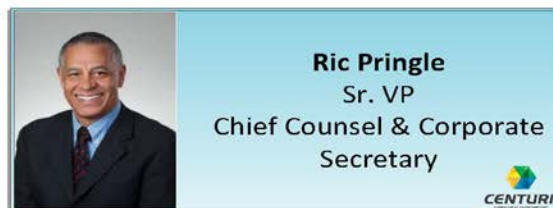
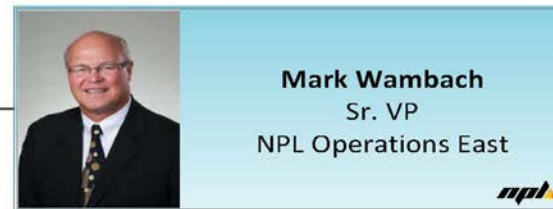
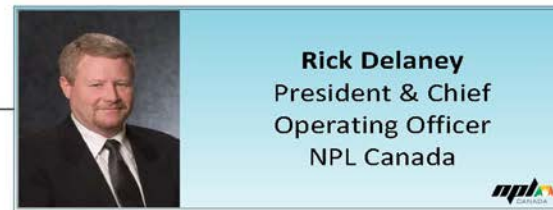
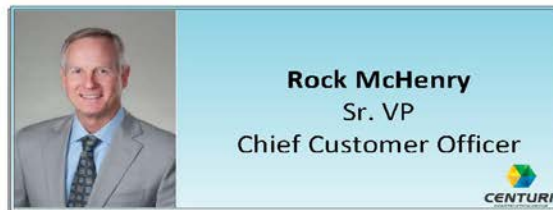


➤ Consistent trends year over year



# Centuri Construction Group

## Construction Services – Management Team





# Summary Operating Results

## Natural Gas Operations

(In thousands)

### Results of Natural Gas Operations

Gas operating revenues  
 Net cost of gas sold  
 Operating margin  
 Operations and maintenance expense  
 Depreciation and amortization  
 Taxes other than income taxes  
 Operating income  
 Other income (deductions)  
 Net interest deductions  
 Income before income taxes  
 Income tax expense  
 Contribution to net income - gas operations

TWELVE MONTHS ENDED MARCH 31,			
2016		2015	
\$	1,426,624	\$	1,448,709
	523,647		567,741
	902,977		880,968
	398,486		376,834
	220,525		206,336
	50,409		48,793
	233,557		249,005
	1,445		8,155
	64,229		67,168
	170,773		189,992
	60,486		66,798
\$	110,287	\$	123,194



# Twelve Months Ended March 31, 2016

## Natural Gas Operations

- Operating income decreased \$15.4 million between periods due to an increase in operating expense
  - Operating margin increased \$22 million including combined rate relief of \$6 million in the California jurisdiction and Paiute Pipeline Company
  - Operations and maintenance expense increased \$21.7 million primarily due to general cost increases, higher employee-related expenses, and greater legal expenses. System maintenance and integrity costs increased \$4.7 million
  - Depreciation and amortization expense increased \$14.2 million primarily due to an increase in average gas plant in service of \$281 million and an additional \$6 million of amortization costs related to the recovery of regulatory assets
- Net interest costs decreased \$2.9 million primarily due to redemptions of Industrial Development Revenue Bonds



# Summary Operating Results

## Construction Services

(In thousands)

	TWELVE MONTHS ENDED MARCH 31,	
	2016	2015
Construction revenues	\$ 1,034,029	\$ 798,822
Construction expenses	917,235	709,586
Depreciation and amortization	<u>57,479</u>	<u>51,267</u>
Operating income	59,315	37,969
Other income (deductions)	883	(388)
Net interest deductions	7,394	5,359
Income taxes	20,185	13,086
Noncontrolling interests	1,126	4
Net income	<u>\$ 31,493</u>	<u>\$ 19,132</u>



# Twelve Months Ended March 31, 2016

## Construction Services

- Revenues increased \$235.2 million
  - Additional pipe replacement work
  - \$72.5 million due to acquired companies
  - Favorable weather conditions during the first quarter of 2016 and the fourth quarter of 2015
  - Construction expenses increased \$207.6 million primarily due to additional pipe replacement and construction costs associated with the acquired companies
  - General & Administrative expense increased \$11.7 million
  - Prior period included \$5.6 million loss reserve on industrial project in Canada
- Depreciation expense increased \$6.2 million
  - Amortization of finite-lived intangible assets recognized from acquisition
  - Incremental depreciation from the acquired companies, and increased depreciation for additional equipment purchased



# Economic Overview – Service Area

## Natural Gas Operations

	<u>Unemployment Rate</u>		<u>Employment Growth</u>	
	<u>March 2015</u>	<u>March 2016</u>	<u>March 2015</u>	<u>March 2016</u>
<b>Southern California</b>	6.5%	5.8%	4.2%	3.4%
<b>Southern Nevada</b>	7.2%	6.0%	2.9%	2.7%
<b>Northern Nevada</b>	7.3%	6.3%	-0.1%	2.3%
<b>Southern Arizona</b>	5.4%	4.7%	1.6%	3.1%
<b>Central Arizona</b>	5.3%	4.5%	3.0%	3.7%



# Comparative Total Returns

## Total Returns for Periods Ended March 31, 2016

	1-Year	3-Year	5-Year	10-Year
<b>Southwest Gas</b>	<b>16.43%</b>	<b>14.56%</b>	<b>14.09%</b>	<b>12.16%</b>
<b>S&amp;P 600 Small Gas Index</b>	<b>29.35%</b>	<b>17.43%</b>	<b>13.20%</b>	<b>12.55%</b>
<b>Dow Jones Utilities</b>	<b>18.07%</b>	<b>13.66%</b>	<b>14.45%</b>	<b>9.73%</b>
<b>S&amp;P 500 Index</b>	<b>1.77%</b>	<b>11.77%</b>	<b>11.54%</b>	<b>7.00%</b>

**Total Return = Price appreciation plus gross dividends reinvested**