

# FINAL TRANSCRIPT

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## **PNY - Q4 2008 Piedmont Natural Gas Earnings Conference Call**

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Jan. 05. 2009 / 2:30PM, PNY - Q4 2008 Piedmont Natural Gas Earnings Conference Call

## CORPORATE PARTICIPANTS

**John Sutphin**

*Piedmont Natural Gas - Manager, Finance, IR*

**Tom Skains**

*Piedmont Natural Gas - Chairman, President, CEO*

**Dave Dzuricky**

*Piedmont Natural Gas - SVP, CFO*

**Michael Yount**

*Piedmont Natural Gas - SVP, Utility Operations*

**Frank Yoho**

*Piedmont Natural Gas - SVP, Commercial Operations*

## CONFERENCE CALL PARTICIPANTS

**Dan Fidell**

*Brean Murray, Carret & Co. - Analyst*

**Greg McGowan**

*Sidoti & Co. - Analyst*

**Dave Parker**

*Robert W. Baird & Co. - Analyst*

## PRESENTATION

**Operator**

Ladies and gentlemen, thank you for standing by. Welcome to the Piedmont Natural Gas year-end 2008 earnings conference call. At this time, all participants are in a listen-only mode. Later we will conduct a question session. (Operator Instructions). As a reminder, today's conference is being recorded.

I would now like to turn the conference over to John Sutphin. Please go ahead.

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**John Sutphin** - *Piedmont Natural Gas - Manager, Finance, IR*

Thank you Gloria. Good afternoon everyone. Thank you for joining our 2008 year-end earnings conference call. This call is open to the general public, and is being webcast live over the internet. If you would like to access the webcast of this call, please visit our website at PiedmontNG.com, and choose the Investors link. On the right hand side of that page, you will find a link to the webcast.

On the call today presenting prepared remarks we have Tom Skains, President, Chairman, and Chief Executive Officer, and Dave Dzuricky, Senior Vice President and Chief Financial Officer. Other members of our executive management team are also in attendance. At the conclusion of the prepared remarks, we will open the discussion to questions.

Finally this call may include forward-looking statements within the meaning of the Securities Laws. Actual results may differ materially from those discussed in the forward-looking statements. For more information about the risks and uncertainties relating to these forward-looking statements, may be found in Piedmont's latest Form 10-K, which is available on the SEC's website at SEC.gov.

With that I will turn the call over to Tom.

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**Tom Skains** - *Piedmont Natural Gas - Chairman, President, CEO*

Thanks John. Good afternoon everybody, and thank you for joining us for our year-end 2008 conference call. We know many of you are just getting back from your holiday break, and we appreciate your time with us today. As you already know, we filed our 10-K, and issued our year-end earnings release last Monday.

I am going to walk through some of our highlights for 2008, talk about the year ahead in 2009, and then I will pass the call over to Dave for a more detailed discussion of our financial results. 2008 was another excellent year for Piedmont, with record net income of \$110 million, compared to \$104.3 million in 2007. That translates to EPS growth of more than 6%, as we grew diluted earnings per share from \$1.40 in 2007, to a record level of \$1.49 in 2008. In addition to EPS growth, we increased the quarterly dividend in 2008 for the 30th straight year, and provided shareholders with a 34% total return for the fiscal year, in a difficult and uncertain economic climate.

During our last conference call we guided you to the upper end of our original \$1.45 to \$1.55 earnings guidance range for 2008. We fell a little short of that projection, largely because of the decline in the wholesale natural gas prices, and the increase in our stock price after the date of our guidance. The subsequent decline in natural gas commodity prices, led to a greater gas storage valuation write-down than we expected at SouthStar, and the subsequent stock price appreciation led to greater stock-based incentive plan accrual than we expected. Dave will give more details on those two items in just a moment.

Overall, 2008 was still an outstanding year, characterized by solid margin growth and lower O&M expenses. Margin grew 5% in 2008. We added 20,500 new customers to our distribution systems in 2008, a gross customer addition growth rate of 2%, and we remain one of the fastest growing natural gas utilities in the nation.

For the year, we added 16,280 residential new construction customers, 2,360 new commercial customers, and 1,860 new residential conversion customers. Our conversion market was actually up 17% from 2007, due to the hard work and persistence of our sales and marketing team. O&M expenses were down 2% from 2007 as a result of our continued focus on cost control and business process improvements, primarily due to lower pension expenses from the Company's restructuring of its defined pension program.

In 2009 we continue to look for ways to more efficiently operate our systems, and keep expenses down without sacrificing quality customer service, safety, or reliability. As to our joint venture performances, we benefited from the first full year of service at Hardy Storage, and from ongoing business operations at Cardinal Pipeline and Pine Needle LNG. SouthStar turned in lower performance in 2008 than 2007 for a variety of reasons that Dave will discuss in a moment, including the fourth quarter lower of cost or markets storage inventory write-down I mentioned just a few minutes earlier.

Let me now turn to some general comments about our fiscal year ahead in 2009. While we experienced 2% growth in gross customer additions in 2008, our fourth quarter 2008 growth figure came in slightly lower, at an annualized rate of about 1.9%. This tapered growth and the state of our national and regional economy, suggest the possibility that our customer growth in 2009, will be lower than previously forecasted. We will be closely monitoring our rate of customer growth over the 2008/2009 winter period, and will be prepared to give you a further update at our first quarter 2009 conference call in March.

Of course slower growth in new customer additions would reduce our capital requirements and our depreciation expense. In that regard one of our power generation customers has delayed the development of one of its new gas-fired power generation projects in North Carolina. Their revised development schedule will reduce our capital requirements in 2009 for related pipeline infrastructure by about \$20 million.

In addition as you know, wholesale commodity prices and short-term interest rates have both declined since we first provided our 2009 guidance in early November. All of that being said, we are still comfortable with and have reaffirmed our previously

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issued 2009 guidance range of \$1.55 to \$1.65 per share, even in light of these fluctuations, and economic and market conditions.

In short, our projection for 2009 earnings per share remains unchanged, even though the factors and related assumptions to achieving that level of performance are fluctuating, relative to our initial expectations. And finally, I would like to provide you with an update on the status of our Robeson LNG project, the project remains slightly ahead of schedule and on budget. After successfully rezoning the project site, we closed on the purchase of the land in November, and we continue to enjoy a positive relationship with the county and the local community.

We are in the project design and engineering phase, and continue to work with our consultants and the contractor on the project scope and costs. Although we are still working toward a 2012 in-service date, as we monitor our system design performance, and our customer growth rate this winter, we will again review our project timeline and development schedule, and we anticipate making an assessment towards the end of our first quarter of 2009.

With that, let me turn the call over to our Senior Vice President and Chief Financial Officer, Dave Dzuricky. Dave.

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**Dave Dzuricky** - Piedmont Natural Gas - SVP, CFO

Thank you Tom. Good afternoon, everyone. I hope all of you had a great holiday season. First, I would like to point out those items that led us to earn slightly lower than the upper end of the guidance range we pointed to you last quarter. Then as Tom mentioned, I will walk through the income statement, and finally, give an update on the general state of our liquidity.

First item Tom touched upon was the \$4.5 million lower of cost to market accounting adjustment recognized by SouthStar. Essentially when this adjustment was made, storage is revalued at the end of the fiscal period price, and if that repricing yields a lower inventory than is on the books, a write-down is required. In effect, we are recognizing a noncash charge to earnings in advance of our normal storage withdrawal schedule.

The total earnings per share reduction associated with the lower of cost or market accounting adjustment was \$0.04, but we have anticipated taking a \$0.02 write-down last quarter when we updated guidance. The additional \$0.02 came as a result of gas prices falling below our original forecasts.

The second unexpected item was higher accruals for our stock-based incentive plans during the year. From the time before we updated guidance to the end of the quarter, Piedmont stock rose almost \$5 per share, or an 18% increase. As a result, our incentive accruals needed to be about \$2.3 million higher than expected, which translates into another \$0.02 in earnings per share. Taking those two together the \$1.49 could have been \$1.53, which was at the higher end of our range.

Now let me turn to the income statement. Margin in 2008 grew \$28.8 million, or 5.5%, to \$553 million, this was due to 2% customer growth for the year, as well as some positive regulatory account adjustments related to gas costs. The same time, O&M expense decreased \$3.7 million, or 1.7% in 2008, due primarily to reductions in pension expense accruals from our restructuring of the pension program.

This was offset somewhat by higher incentive accruals I just mentioned, as well as an increase in our contract labor. As expected, depreciation expense increased \$4.5 million during the year, or year-over-year due to continued capital expenditures for our utility operations. Our joint venture income decreased \$9.4 million in 2008 to \$27.7 million. This was almost exclusively due to the lower income from SouthStar.

In addition to the \$4.5 million write-down from lower of cost or market accounting adjustments, SouthStar's income was down due to lower contributions from the management of storage and transportation assets, a slight loss on weather derivatives, and a Georgia Public Service Commission consent agreement. However, remember this compares to an extremely strong

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performance by SouthStar in 2007. The weaker performance during 2008 was partially offset by higher income from Hardy Storage, since it was in its first full year of operations.

Finally, utility interest expense increased \$2 million in 2008. So it was primarily due to higher regulatory interest expense, resulting from annual year-end true-ups we recognized in the fourth quarter. Otherwise interest expense was lower than in 2007. With regard to our liquidity, I am pleased to report that Piedmont remains in a stable position, despite volatile commodity prices, and tight credit markets.

Like the rest of the industry, we experienced a steep run-up in commodity prices in the summer, and then saw prices decline during our fourth quarter. This combination of events ultimately led to a need for additional short term debt capacity on a seasonal basis. Interestingly we had already started work on this well in advance of the credit crisis, thinking at the time that sustained high commodity prices may stretch our short term debt capacity.

Even at the height of the crisis, credit markets remained open to Piedmont, due to our ability to maintain investment grade ratings, and strong long-term relationships with our banking partners. Suffice it to say that we are very comfortable with our liquidity position at this point in time.

With that, I will turn it over to John Sutphin.

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**John Sutphin** - *Piedmont Natural Gas - Manager, Finance, IR*

Thank you Dave. This concludes our prepared remarks, and we now welcome your questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). You do have a question from Dan Fidell. Please go ahead.

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**Dan Fidell** - *Brean Murray, Carret & Co. - Analyst*

Good afternoon, guys. It is Dan Fidell from Brean Murray. Can you hear me?

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**Tom Skains** - *Piedmont Natural Gas - Chairman, President, CEO*

Yes. Good afternoon.

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**Dan Fidell** - *Brean Murray, Carret & Co. - Analyst*

Good afternoon. Thanks as always for the call, and congratulations on a nice year and nice finish.

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**Tom Skains** - *Piedmont Natural Gas - Chairman, President, CEO*

Thank you.

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**Dan Fidell** - *Brean Murray, Carret & Co. - Analyst*

Just had a couple of follow-up questions, I guess first, wondering if you can talk about some of the assumptions that are in your 2009 guidance for cost trend lines for O&M and for bad debt, I know bad debt has been trending around 0.3% of operating revenues, just wondering have you notched that number up at all, and also after all of the cost savings on the O&M side in recent periods, should we will looking for a small increase, or something along those ranges in 2009?

**Tom Skains** - *Piedmont Natural Gas - Chairman, President, CEO*

Yes. Thank you I am going to ask Dave to address our trend on bad debt, particularly bad debt as a percentage of our revenues, and then I will ask Michael to address some of the activities we are working on, in terms of further process improvements in our field operations area.

As you know, over the last several years we have worked hard to focus on our cost structures, and on our business processes, while at the same time we are actually improving the services that we provide our customers and the quality of our services, and as you know, we have since over the last three years worked on our management structure, we have deployed automated meter reading across the Company.

We have consolidated some of our call centers and our back office operations, and more recently we have restructured and reorganized the activities in our front office operations. The process now on the O&M side is to really look at how we can better provide services to our customers in the most efficient way possible, deploying new technology, and deploying the organization of our field staff in a way that transcends traditional district lines, and looks at our assets more holistically, but I will ask Michael to talk about what we are working on in 2009, and beyond I am going to ask Dave to address where we were with bad debt experiences in 2008 compared to previous years.

**Dave Dzuricky** - *Piedmont Natural Gas - SVP, CFO*

Thanks, Tom. Good afternoon, Dan. Always nice to hear from you. Let me give you a little bit of perspective on where we have been regarding our bad debt expense as a ratio to our revenues in 2007. As you properly note, we were at about 0.3 of 1% of revenue, and in 2008 we were down to about 0.25% as a percent of revenue. And even though our revenue was up, actually our bad debt expense in dollars was down compared to the prior year ever so slightly.

Now part of that is due to the fact that, as Tom mentioned before, we have been fine-tuning processes all around the organization, and one of those areas is the way we manage our uncollectible expense or our bad debt expense, and how we proactively work with our customers, in order to avoid having to write-off some of our Accounts Receivable.

And June Moore and her folks, and Michael Yount and his folks, have been doing yeoman's work in this regard. As a result, you will know that in our November 3rd release of guidance, we didn't mention uncollectible expense as any significant factor in the overall determination of our guidance, and that is why. We did not consider it to be a major element affecting one way or the other our guidance for 2009, Dan. Unless you have any other questions, let me kick it over to Michael, as Tom suggested.

**Michael Yount** - *Piedmont Natural Gas - SVP, Utility Operations*

Hey, Dan. Michael here. Tom touched on two of the aspects that we are working on, particularly in the operations area. One is deploying our work force, I think the term to use is more holistically, outside of our traditional and historic district lines, we find that we are able to move folks around, and essentially meet our customer service needs more quickly, than perhaps we have been able to in the past, by sticking strictly within those district lines. More broadly, in a variety of areas we have got an internal program called Optic, and what that is allowing us to do is to take a look at a variety of the work processes that we use in the

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operations area, and really see if we can't bring technology, as well as improved processes to bear, to be more efficient in the way we go about doing the work that we do.

In the technology arena, that may mean a work management system. It can mean an upgrade to our GIS system, which impacts a lot of different things that we do. It is broad, it cuts all the way across the operations area, and it is continuous. We will be at it in '09 and '10 and '11. We want to always look at how can we deliver good solid customer service that exceeds our customers expectations, and consistently try to do it for less. As usual any benefits that we gain from that are built into the guidance.

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**Dan Fidell** - *Brean Murray, Carret & Co. - Analyst*

Very good. Thank you. Very detailed comments, and much appreciated. Maybe I could ask one more question, and then let someone else ask a question.

In terms of Robeson, can you tell us the next steps into '09 specifically we should be looking for, I understand the D&E is going on now, and you haven't made any specific comments on it. The mid-2012 in-service date at this point, but what would be the next hurdle that we should be looking for in the next 12 months?

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**Tom Skains** - *Piedmont Natural Gas - Chairman, President, CEO*

Thank you. This is Tom, and I will respond to that. I addressed this in my prepared remarks, but I will just reiterate what I said earlier. Again, we are on budget and ahead of schedule to date, things are going very well in terms of the rezoning process, which has been complete, the purchase of the land site, and working with the local community.

We are in the process now of finalizing project scope, and costs with our consultants and our contractor, and really the thing to do at this point for us is to finalize that body of work, and as I mentioned earlier, review again our customer growth rate this winter, along with our system design and our operations performance this winter, to make another assessment of the project timeline and development schedule, and this will address the 2012 in-service date question. So that assessment we think will be made in the next couple of months, by the end of our first quarter of 2009. Once that assessment is made, then we will then be in a position to discuss that more.

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**Dan Fidell** - *Brean Murray, Carret & Co. - Analyst*

Thank you very much for your comments today.

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**John Sutphin** - *Piedmont Natural Gas - Manager, Finance, IR*

Thanks, Dan.

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**Operator**

Next we will go to the line of Greg [McGowan] with Sidoti & Company, please go ahead.

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**Greg McGowan** - *Sidoti & Co. - Analyst*

This is Greg. How is everyone?

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**Tom Skains** - *Piedmont Natural Gas - Chairman, President, CEO*

Good afternoon.

**Dave Dzuricky** - *Piedmont Natural Gas - SVP, CFO*

Hi, Greg.

**Greg McGowan** - *Sidoti & Co. - Analyst*

Refresh my memory here, I think you budgeted CapEx for about \$245 million for fiscal 2009. I guess we should just reduce that by \$20 million to get the new estimate there?

**Dave Dzuricky** - *Piedmont Natural Gas - SVP, CFO*

That is correct.

**Greg McGowan** - *Sidoti & Co. - Analyst*

Okay. And in the past, I think you stated your objective is to keep set capital at about 45 to 50%. Is 50% a hard ceiling, or is that more of a goal?

**Dave Dzuricky** - *Piedmont Natural Gas - SVP, CFO*

Well, Greg, this is Dave. If you will refer to our 10-K, we target our long-term debt to total capital at 45 to 50%. Anything relating to capital structure is a longer term goal rather than an instantaneous goal.

If we got to debt of 50.1%, would we issue equity, no, we wouldn't. But it is a policy guide for us and the capital structure and the way we finance is kind of an ongoing process, but as you will notice as we look back across our history, we have been very good at keeping ourselves within that 45 to 50% of total cap ratio, relative to our long term debt.

**Greg McGowan** - *Sidoti & Co. - Analyst*

That is helpful. Finally, you are finished with the North Carolina rate case, maybe just talk about what is next on the regulatory front?

**Frank Yoho** - *Piedmont Natural Gas - SVP, Commercial Operations*

Greg, this is Frank Yoho, on the regulatory front as you mentioned, we finished our North Carolina rate case, and an order is out on that. In South Carolina we have a RSA, and that updates our rates on an annual basis. So that continues.

And thirdly, we have not been in a rate case in Tennessee for a number of years, and in that respect, we continue to evaluate the need as to when we do go in for a rate case in Tennessee. So from our three regulatory perspectives that is where we stand today.

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**Greg McGowan** - *Sidoti & Co. - Analyst*

Are you achieving your allowed rate of return in Tennessee right now?

**Frank Yoho** - *Piedmont Natural Gas - SVP, Commercial Operations*

From a historical perspective we have been doing pretty good in Tennessee, but once again we update that and continue to evaluate that on an ongoing basis, but from historical looking backwards, we have been fairly close to our allowed rate of return.

**Greg McGowan** - *Sidoti & Co. - Analyst*

Okay. Thank you very much.

**Operator**

Next we will go to the line of Dave Parker with Robert Baird. Please go ahead.

**Dave Parker** - *Robert W. Baird & Co. - Analyst*

Good afternoon. Congratulations on a great year. Just maybe one question left in the Q, pension expense, and any change in the financial markets, maybe if you would walk through what our expectations for 2009, and maybe what was baked into what your initial guidance was, and if things have changed there?

**Dave Dzuricky** - *Piedmont Natural Gas - SVP, CFO*

Thank you, Dave. This is Dave, and good afternoon to you. There has been a lot of turmoil in the markets, haven't there?

**Dave Parker** - *Robert W. Baird & Co. - Analyst*

Yes. (laughter)

**Dave Dzuricky** - *Piedmont Natural Gas - SVP, CFO*

How is that for a non-answer.

**Dave Parker** - *Robert W. Baird & Co. - Analyst*

I like that.

**Dave Dzuricky** - *Piedmont Natural Gas - SVP, CFO*

Let me try to collect my thoughts here for a minute, and say to you that of course, pension expense is actually an equation, where we are taking a look at both assets and liabilities. And certainly, with the changes in how we calculate our liabilities, where we are no longer using government securities, but now we are using high quality A and AA-rated corporate, and with spreads where they are over Treasuries, that had had a significant downward impact on the liabilities that we have calculated under FAS 87.

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So even though our assets have dwindled fairly appreciably, our liabilities also have as well. And where we try to focus on is where we are, in terms of having assets surplused to the liabilities as a fund, and we are very comfortable there, and all of that was built into the guidance, David.

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**Dave Parker** - *Robert W. Baird & Co. - Analyst*

Okay. Do you know, as far as resetting those estimates, is that an annual or a quarterly look, or refresh my memory on how that works?

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**Dave Dzuricky** - *Piedmont Natural Gas - SVP, CFO*

It is an annual look, David. Then we true it up at the end of the year.

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**Dave Parker** - *Robert W. Baird & Co. - Analyst*

Okay. Perfect, thank you very much.

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**Dave Dzuricky** - *Piedmont Natural Gas - SVP, CFO*

Yes, sir.

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**Operator**

(Operator Instructions). Sir, there are no questions in queue at this time. Please continue.

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**John Sutphin** - *Piedmont Natural Gas - Manager, Finance, IR*

Great. Thank you, Gloria. As always we thank you for your interest in Piedmont Natural Gas, and for taking the time to be with us today. If you have any further questions pertaining to our 2008 results, please contact our Investor Relations department. This concludes our 2008 year-end earnings call.

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**Operator**

Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation, and for using AT&T Executive Teleconference Service. You may now disconnect.

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