

30-Oct-2015

Exelon Corp. (EXC)

Q3 2015 Earnings Call

CORPORATE PARTICIPANTS

Francis Idehen

Vice President-Investor Relations

Christopher M. Crane

President, Chief Executive Officer & Director

Joseph Nigro

Executive Vice President, Exelon; Chief Executive Officer, Constellation, Exelon Corp.

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

Thomas D. Terry

Vice President-Tax

Darryl M. Bradford

Executive Vice President & General Counsel

Joseph Dominguez

SVP-Public Policy, Government & Regulatory Affairs

OTHER PARTICIPANTS

Daniel Eggers

Credit Suisse Securities (USA) LLC (Broker)

Steven Isaac Fleishman

Wolfe Research LLC

Greg Gordon

Evercore ISI

Jonathan P. Arnold

Deutsche Bank Securities, Inc.

Hugh D. Wynne

Sanford C. Bernstein & Co. LLC

Julien Dumoulin-Smith

UBS Securities LLC

Ali Agha

SunTrust Robinson Humphrey, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Deshanta and I will be your conference operator today. At this time, I'd like to welcome everyone to the Q3 2015 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

I will now turn the conference over to Francis Idehen. Please go ahead.

Francis Idehen

Vice President-Investor Relations

Thank you, Deshanta. Good morning, everyone, and thank you for joining our third quarter 2015 earnings call. Leading the call today are Chris Crane, Exelon's President and Chief Executive Officer; Joe Nigro, CEO of Constellation; and Jack Thayer, Chief Financial Officer. They are joined by other members of Exelon's senior management team, who will be available to answer your questions following our prepared remarks.

We issued our earnings release this morning along with the presentation, each of which can be found in the Investor Relations section of Exelon's website. The earnings release and other matters which we discuss during today's call contain forward-looking statements and estimates that are subject to various risks and uncertainties.

Actual results could differ from our forward-looking statements based on factors and assumptions discussed in today's materials, comments made during this call, and in the risk factors section on the 10-K which we filed in February, as well as in the earnings release and the 10-Q, which we expect to file later today. Please refer to the 10-K, today's 8-K and 10-Q, and Exelon's other filings for a discussion of factors that may cause results to differ from management's projections, forecasts and expectations.

Today's presentation also includes references to adjusted operating earnings and other non-GAAP measures. Please refer to the information contained in the appendix of our presentation and our earnings release for a reconciliation between the non-GAAP measures to the nearest equivalent GAAP measures.

We've scheduled one hour for today's call. I'll now turn the call over to Chris Crane, Exelon's CEO.

Christopher M. Crane

President, Chief Executive Officer & Director

Good morning, everyone and thanks for joining us this morning. We're pleased to deliver another very strong quarter in what's been a very good year for us, thus far. First, I'll highlight our financial and operational performance and then I'll switch over to our key strategic objectives.

On the financial front, we're reporting operating earnings of \$0.83 per share, over 6% EPS growth versus the same period last year and above our guidance range. Despite the delays in closing PHI which I'll address further, we are still on track to deliver our best year of earnings since 2012. We are raising our guidance range to \$2.40 to \$2.60. And Jack will provide more details on the financial performance during his remarks.

It's been a phenomenal year across our companies. At the utilities, we're set to invest \$3.7 billion this year in needed infrastructure enhancements and grid reliability and resiliency modifications, part of more than the \$16

billion investment that's planned over the next five years. This includes our smart meter installation program, which we now have completed nearly 5.5 million gas and electric installations across our operating companies.

Our utilities will exceed \$1 billion in net income in 2015, driven by industry-leading operational performance with each utility achieving first quartile safety, first and second quartile CAIDI results and ranking in first quartile in customer satisfaction.

We reached a settlement at PECO in its recent rate case filing which follows the BGE recent unanimous rate case settlement in Maryland. This highlights how strong operational performance supports recovery in constructive regulatory environments.

On the Generation side of the business, we had another solid quarter of operations performance. Nuclear capacity factor was 95.5%. Power dispatch match was 99%. Renewable energy capture was 94.8%. We also had great execution at Constellation this quarter showing the value of our generation to load matching strategy and our ability to optimize our portfolio even during adverse market conditions in a way that contributes meaningfully to our earnings.

The breadth of the Constellation platform gives us multiple channels to market. We are the number one retail electric provider and well ahead of our nearest competitor. We serve nearly 200 terawatt hours of wholesale and retail load, and we are also a top 10 marketer of gas in the U.S. delivering 4 Bcf to 6 Bcf of gas daily. On both sides of the company, we continue to run the business at high levels of performance, and the results are evident in this year's earnings.

Now I want to discuss three key initiatives we have been working on this year; capacity performance, Low Carbon Portfolio Standard and the Pepco Holdings merger. Starting with capacity performance, PJM's capacity performance design was implemented when it – at implementation this year's auctions, with constructive results. We are pleased with the outcome of the capacity auctions. The new penalty structure will hold generators accountable for reliability to the benefit of customers.

For the 2018/2019 auction, we cleared a significant number of megawatts at higher price zones that – and these prices exceeded our own internal expectations. The transition auctions better reflect the value of the reliability of our nuclear units that they provide to the grid.

Our next major initiative was getting a low-power portfolio standard passed. We came into the year advocating for a better market design in Illinois, one that would level the playing field for nuclear energy as a key resource in the state.

We worked hard to introduce the carbon standard earlier this year, however the political situation in the state has made the budget the sole focus leaving little opportunity for progress on energy legislation. We are disappointed that we have not made the progress on this front, however the overall outlook for the nuclear fleet has improved as a result of policy and market factors. Namely, the constructive results of the capacity auction, the positive results from Illinois Power Agency's capacity procurement for 2016, the long-term impact of the Environmental Protection Agency's new carbon reduction rules. As a result we have decided as announced, to defer another year's decision about the future of Quad Cities, Byron and Clinton. Having said that, the Low Carbon Portfolio Standard remains a good policy for Illinois and a priority for Illinois.

On our last key initiative was the Pepco acquisition. Let me take time to share our perspective on where we're at with the deal. We are very excited we reached a settlement with the government of the District of Columbia, the Office of People's Counsel, the Office of the Attorney General and others in D.C. The settlement includes

commitments to provide substantially enhanced benefits to the consumer and businesses in the district. It includes bill credits, low income assistance and fewer and shorter outages, a cleaner, greener D.C. and investment in local jobs in the local economy.

The settlement package was specifically shaped to address the concerns articulated by the D.C. Public Service Commission in its August order. As you've seen, we have improved the reliability and the customer satisfaction at BGE and see the benefits of those performance improvements reflected in regulatory outcomes. We look forward to the opportunity to do the same with the Pepco family of utilities. The deal remains an important strategic element to the future of Exelon, allowing us to shift our business mix to a more regulated and durable earnings stream.

We realize the deal has taken longer than expected and we know that has required patience for many parties, especially our investors as we work to complete it. We received an order from the D.C. Public Service Commission two days ago that moves us in the right direction. The Commission granted our request to reopen the record and consider the settlement in the existing docket.

A schedule was set that is in line with our proposed time line. And the Commission has committed to consider the settlement in a fashion that is open, transparent and fair. We appreciate the Commission's commitment to ruling on the merger in a timely manner and we ask for your support as we get this across the finish line.

It has been a busy year. We've accomplished a lot, and there's a lot left to be done. In particular, we're embarking on a large-scale cost management initiative. We'll provide more details at the EEI Financial Conference. We are pleased with the performance we've delivered for the shareholders this year despite the significant market and regulatory headwinds as we always – we're working hard to serve our customers in the communities that we serve better.

I'll now turn the call over to Joe who will discuss the markets.

Joseph Nigro

Executive Vice President, Exelon; Chief Executive Officer, Constellation, Exelon Corp.

Thank you, Chris, and good morning, everyone. The Constellation business had another strong quarter outperforming our targets. Our portfolio management team performed very well, and as Chris mentioned, our retail and wholesale business is having a very strong year. In addition, our core strategy of matching our generation fleet with our load business continues to provide significant value for our shareholders.

It has been paying off across the volatility and price spectrum. We have captured higher prices for our generation during periods of extreme weather while managing our load obligations and we've captured higher margins during low volatility periods like this summer, as we've realized lower cost to serve our customers.

It also provides us with an important channel to market for our hedging activities which is important in times of low liquidity and in places where there is not an active market. Our past results and our current hedge disclosure show that our business can thrive in either market environment and provide a great deal of value to the enterprise.

My comments today will focus on power and gas markets during the quarter and our fundamental view, the recent PJM capacity performance auctions, and our hedge disclosures and hedging activity.

Turning to the power markets on slide four. NiHub remains undervalued, even independent of gas prices. PJM West price is more fairly valued when accounting for the new generation under development and expected in the East.

Our fundamental view of power prices remains unchanged. In addition, we especially see upside in the non-winter months and during off-peak hours. The difference between our fundamental view and the near term forward market prices at NiHub is primarily driven by changes in the dispatch stack. Additionally, fuel and coal markets are in contango while power is backwardated which is unusual. We think this is also contributing to lower prices than our views would support.

During the summer, the impacts of the change in the stack were masked across the power pool, because we did not see the peak loads that were expected, and delivered natural gas prices were extremely low. While we saw implied heat rates continue to deliver high, the absolute price was driven lower by the fuel prices.

If we extended this picture on the slide further out on the curve, you would see an ever greater disconnect between the forward curve and our fundamental view driven, mostly by a lack of liquidity. This lack of liquidity at NiHub [ph] is in most years (12:30), and we are seeing it in West Hub in 2019 and beyond in particular. Because of this lack of liquidity, our hedging activities mostly continue to be done through our load business and not in the over-the-counter markets.

We continue to align our hedging strategy with our views of the market, and in 2017, remain behind ratable with 6% to 9% of power exposure. We have even further behind – we are even further behind ratable in the Midwest with power exposure of 17% to 20%. This strategy exposes us to the significant upside we still see in that market, while partially protecting us from any further degradation of natural gas prices through our cross commodity hedging.


Before turning to the hedge disclosure itself, I'd like to touch on the recent PJM capacity auctions. Chris covered the results of the auctions a few minutes ago, so I'll focus on the key takeaways from the auction. The biggest impact was bidding behavior. In the 2018/2019 base residual auction and the transition auction, we saw market participants bidding in a more disciplined manner and recognizing the risks of penalties for non-performance. In addition, about half the new builds cleared versus what we saw in the 2017/2018 auction. And finally, the vast majority of demand response cleared as the base product, which may have read-through value as PJM transitions to a 100% capacity performance product in two years.

As I mentioned earlier, our load business remains solid. Our originations have been strong and our generation to load-matching strategy has worked well throughout the year. You can see the impact of this strategy throughout the gross margin disclosures.

In 2015, we have a net \$200 million increase in total gross margin since the end of the second quarter. We started the third quarter with \$100 million Power new business target remaining for the year. We had strong performance during the quarter, executing \$200 million in Power new business with the majority realized in the quarter.

As a result of this performance, we raised our Power new business target by \$150 million, resulting in only \$50 million of Power new business to go for the fourth quarter. Our performance was driven by our generation to load matching strategy including a lower cost to serve our load across the portfolio and our position management activity of a short bias with a backstop of our generation.

Exelon Corp. (EXC)
Q3 2015 Earnings Call

 **Corrected Transcript**
30-Oct-2015

As an example, Texas experienced quite a bit of heat in early August, and we saw the reserve margins in ERCOT come in as much as 10% lower than projected on those days. Spot prices increased, and we benefited and captured value from this move. As a result, we are also seeing upward movement in ERCOT pricing in the forward curve.

In 2016, the impact of capacity performance auctions increased total gross margin by \$150 million. This was partially offset by market price declines, net of hedges of \$50 million. During the quarter, we executed on \$150 million of new business and are raising our 2016 Power new business target by \$200 million to \$500 million total remaining.

This compares to a \$400 million new business target to go for 2015 at the same point last year. We are confident we can make this new target next year given our performance this year and the addition of the Integritys acquisition.

In 2017, our total gross margin increased by \$200 million to \$7.8 billion. Capacity performance results added \$300 million to total gross margin which was partially offset by \$100 million decrease due to the impact of lower prices on our open generation net of hedging.

During the quarter, we executed \$100 million of Power new business. We are confident that we have the right hedging strategy to capture the upside we see coming in the market and we have proven that our generation to load matching strategy brings value in both the low and high volatility environments.

I'll now turn it over to Jack to discuss the financial results for the quarter.

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

Thank you, Joe, and good morning, everyone. As Chris and Joe stated, we had another strong quarter financially and operationally. My remarks will focus on our financial results for the quarter, our full year guidance range, and provide an update on our cash outlook for 2015.

Starting with our third quarter results on slide six, Exelon delivered earnings of \$0.83 per share, exceeding our guidance range by \$0.08. This compares to \$0.78 per share for the third quarter of 2014. Exelon's utilities delivered combined earnings of \$0.33 per share outperforming the third quarter of last year by \$0.04.

During the quarter, we saw favorable weather at both PECO and ComEd. Cooling degree days were up 30% from the prior year and 28% above normal in southeastern Pennsylvania, and up 18% from the prior year and 3% above normal in Northern Illinois. Distribution revenues at both ComEd and BGE were higher quarter-over-quarter, reflecting the impacts of increased capital investment and higher rates respectively.

On September 10, PECO reached a settlement on its rate case filing. The agreed upon revenue requirement increase of \$127 million, represents 67% of the original proposal. The Pennsylvania PUC's decision is expected in December of this year with rates going into effect on January 1, 2016. The Pennsylvania PUC recently approved the new System 2020 plan, which will lead to an additional \$275 million being invested during the next five years to install advanced equipment and reinforce the local electric system, making it more weather-resistant and less vulnerable to storm damage.

An order on ComEd's annual formula rate filing is expected to be issued by the ICC in early to mid-December. As a reminder, ComEd requested a revenue decrease of \$55 million in its current filing. This reduction reflects the continued focus on cost management and operational efficiencies that are being realized from a stronger, more

reliable grid with fewer outages. More detail on each of these rate cases can be found in the appendix on slides 19 through 21.

Turning to Exelon Generation, it had another strong quarter, delivering earnings of \$0.55 per share, \$0.05 higher than the same period last year. As Joe mentioned, our generation-to-load matching strategy continues to provide value for our business and our shareholders. We benefited from a lower cost to serve both our retail and wholesale customers and had another strong quarter of performance from our portfolio management team.

In addition, compared to the third quarter of 2014, we had a positive contribution from the Integrys acquisition. These positive factors were partially offset by realized nuclear decommissioning trust fund losses in 2015 as compared to gains in 2014, and the impacts of the divestitures of certain generating assets in 2014.

Last week we filed a settlement agreement with the New York PSC and FERC in regards to our Ginna facility. The new agreement shortens the RSSA period by 18 months, includes more market-based revenue, and requires that any extension must be justified by a study. The settlement is still subject to approval by both the FERC and the New York PSC.

While we're pleased that the negotiated RSSA will allow Ginna to continue powering the grid and the local economy until 2017, it's only a temporary solution to a long-term problem. Single unit nuclear facilities like Ginna face significant economic challenges brought on by poor market conditions and a lack of energy policies that properly value the clean and reliable energy that nuclear provides. More detail on the quarter-over-quarter drivers for each operating company can be found on slides 17 and 18 in the appendix.

As Chris mentioned, we are raising our full year guidance range for earnings to \$2.40 to \$2.60 per share. At the beginning of the year we provided a stand-alone guidance range of \$2.25 to \$2.55 per share. We narrowed the range in our second quarter earnings call to \$2.35 to \$2.55.

This guidance range included the impacts of the debt and share dilution from the PHI merger and assumed that the merger would close during the third quarter. Since the merger did not close, we have \$0.13 of earnings drag from the interest expense and share dilution. Without this drag we would have expected full year earnings to exceed the top end of our new guidance range of \$2.40 to \$2.60 per share due to strong performance of both the Utilities and Constellation this year.

Consistent with our past practice, our guidance range does not include the impact of an extension of bonus depreciation, which we would expect to be around an \$0.08 decrease per share. Nonetheless, we are comfortable that we will still be in the guidance range even if bonus depreciation were to be extended.

Turning back to Pepco for a minute. We will meet our original deal case accretion of \$0.15 to \$0.20. However, it will be pushed back until 2019. In addition, we expect the impacts of the merger to be neutral in 2017 and \$0.07 to \$0.12 accretive in 2018. These changes are primarily due to the delay in closing the merger, the consequent updates to PHI's business plan as a result of this delay, and due to the meaningful improvement in Exelon's business plan. The deal remains critically important to our long-term strategy.

Slide seven provides an update on our cash flow expectations for this year. We project cash from operations of \$6.8 billion across our businesses and free cash flow of \$925 million at Generation in 2015. As you can see, our projected ending cash balance is roughly \$9.6 billion for the year. Most of this is related to the fact that we raised the funds necessary to close the Pepco merger, which, as you know, has been delayed. \$2.75 billion of the debt was subject to redemption if the merger does not close by December 31. Yesterday, we announced a debt exchange

offering to amend the mandatory redemption date in those notes. This action will minimize our refinancing risk and allow our bondholders to stay invested in the bonds as year-end approaches.

In closing, I want to reiterate that our company can perform well in a rising interest rate environment, which is typically a headwind for our industry. This is because our earnings are positively correlated to interest rates due to both ComEd's ROE being directly tied to the 30-year Treasury rate as well as the discounting of our pension liabilities. As a general rule, every 25 basis point increase in interest rates equates to roughly \$0.02 of consolidated earnings uplift related to ComEd and the pension.

Thank you, and we'll now open the line for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Dan Eggers with Credit Suisse.

Daniel Eggers

Credit Suisse Securities (USA) LLC (Broker)

Q

Just, Jack, taking up with where you left off on the Pepco accretion numbers, you guys are going to have \$0.13 of drag because of the equity and the debt associated with the acquisition. If we look at 2016, how much of that \$0.13 gets offset, I guess, on a year-over-year base if we were to step forward one year?

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

Dan, we would anticipate that the transaction would close towards the end of the first quarter, and the transaction will be modestly dilutive to 2016 earnings.

Daniel Eggers

Credit Suisse Securities (USA) LLC (Broker)

Q

Including the \$0.13 or net of the \$0.13?

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

Including the impact of the shares and debt issue. So inclusive of that \$0.13 expense associated with interest and increased shares.

Daniel Eggers

Credit Suisse Securities (USA) LLC (Broker)

Q

Okay. If I go – yeah, I guess, next question. On the Constellation side with the retail margins coming through, can you guys maybe give some context as to how much contribution's coming from that business or where you guys sit in that historic margin range of \$2 to \$4 a megawatt hour, just so we can see a little better from the outside what's going on there?

Joseph Nigro

Executive Vice President, Exelon; Chief Executive Officer, Constellation, Exelon Corp.

A

Yeah. Hi, Dan. It's Joe. Good morning. Let's start with the second question first. We are still well within that \$2 to \$4 range. It's above the \$2 value, and it's below the \$4. Our commercial industrial originations remain solid, and we're happy with that.

As for the margins, I think about it more on a total portfolio basis because there's retail margins are one component of it. The second thing is we serve a lot of wholesale [ph] polar (26:10) load as well, which have a different margin structure associated with them. But the money that we made in the third quarter was really driven by three key things.

The first thing is if you go back and look at our hedge disclosure at the end of the second quarter, we were effectively 100% hedged across our book for the year. And so we set up with a short bias recognizing we had the backstop of our own generation to serve load if the market got volatile.

The second thing is we costed our loads. When we sold them, the risk premiums were much higher than what was realized in the spot market, primarily driven by the low, low gas prices during the third quarter.

And then the last thing is we took an opportunity when the prices dropped at ERCOT through the summer to materially get our position longer as we walked into August, and then we saw some volatility, and we capitalized on that as well. So it was really those three components that drove the value.

Daniel Eggers

Credit Suisse Securities (USA) LLC (Broker)

Q

Okay. Got it. And I guess, last question, maybe Chris or Jack, is just on the decision to defer the nuclear plant closures. How much earnings drag should we assume is coming off those three plants in 2016? And given the delays in making a decision, what would actually get you guys to the point to decide to retire any of these assets that aren't making money?

Christopher M. Crane

President, Chief Executive Officer & Director

A

So, let's first talk about PJM and Quad and Byron. The CP auctions substantially changed the profile of cash flow and earnings. We have – still need the Low Power (sic) [Carbon] (28:00) Portfolio Standard to cement the long-term viability of these assets, but Quad is just marginal flat on free cash flow and just slightly dilutive on earnings. And if we can move the CP along, it will greatly improve that. Byron is in a little bit better shape based off of CP and we'll continue to watch that closely.

On Clinton, we were prepared with no action taken on the capacity market to go forward with the retirement. We have seen a commitment and action at MISO to evaluate Zone 4 as its only real competitive market to evaluate a redesign of a capacity construct that would adequately compensate the generators for the investments they're making.

We've also seen positive signals from the State of Illinois by evaluating – starting workshops to evaluate the problem statement and workshops to look at potential fixes on Zone 4 in Southern Illinois. So, now that we've seen some potential for improvement, we're willing to go another year.

That unit – Clinton is one of our newest units in the fleet. It's got over 30 years of potential run left. With support coming from MISO in understanding the problem statement at FERC and the state now considering what should be done in the southern part to ensure reliability, we saw that as enough promise to extend it one more year to see what we can do in 2016.

Daniel Eggers*Credit Suisse Securities (USA) LLC (Broker)*

Q

So, is your view that you'll have some sort of market reform in 2016, I guess in the first half of 2016 in MISO for those plants to look viable, or is it just the action that will get you comfortable even if it's not resolved?

Christopher M. Crane*President, Chief Executive Officer & Director*

A

We want it resolved in 2016. I don't know if it's going to be in the first half, but it has got to get resolved in 2016. Between the Low Power (sic) [Carbon] (30:19) Portfolio Standard and the capacity construct in MISO, it is going to be imperative for us to go forward. Quad in the subsequent auctions, cleared 2016/2017, 2017/2018. So we've got a blanket on that for a couple of years, but it did not clear 2018/2019.

Daniel Eggers*Credit Suisse Securities (USA) LLC (Broker)*

Q

Okay. Got it. Thank you, guys.

Operator: Your next question comes from Steve Fleishman with Wolfe Research.

Steven Isaac Fleishman*Wolfe Research LLC*

Q

Yeah. Hi. Good morning. A couple questions. Just on the POM accretion update that you gave, is the kind of pushout of the accretion all just due to delays in closing and just more time to get the cost cuts through and I guess maybe any rate relief through, like the rate freeze that you have? Is that the main difference?

Christopher M. Crane*President, Chief Executive Officer & Director*

A

That's part of it. The other part is our improved – from the time we announced the merger and from when we talked about the LRP last year...

Last quarter

Christopher M. Crane*President, Chief Executive Officer & Director*

A

Last quarter, excuse me, our position has improved. So, there's a little bit of we're better than we were, and the delay is the other part of it.

Steven Isaac Fleishman*Wolfe Research LLC*

Q

Okay. And then, I guess on the – just on the nuclear decision, and I would just wonder there's a little bit of a kind of risk of, hey, you were crying wolf on this because you talked about this for a while, then you're not shutting them this year. Just how is the risk of these shutting like real in 2016 or what is different in terms of making this decision now? I mean, gas prices are also a lot lower, too.

Christopher M. Crane*President, Chief Executive Officer & Director***A**

Yes. So, the – we opened the books to the key stakeholders in the state. They could see the red ink that was being produced by these assets. We were able to work with PJM and the other stakeholders on CP that gave us the improvement that we're not seeing the level of red ink or, in some cases, neutral on the assets. These are long-lived assets and there are big decisions to make. We're not crying wolf. We've actually gotten results. And if we could continue to get results, these units will become profitable and be able to stay within the fleet and the contributions they make to the communities that they serve.

So, this is not us backing down on a decision. This is us making progress on a path that we defined clearly at the beginning of this. If we did not see progress, we would shut the units down. We have seen progress and we continue to believe there's potential for more progress. If we do not see that progress, we will shut the plants down.

Steven Isaac Fleishman*Wolfe Research LLC***Q**

Great. Thank you very much.

Operator: Your next question comes from Greg Gordon with Evercore ISI.

Greg Gordon*Evercore ISI***Q**

Thanks. A few questions. First, back on Potomac. I have the fortune – good fortune of having followed them before you. You announced the acquisition and I've been keeping my model up-to-date and it actually looks to me like their financial situation has materially degraded over the year or so – year-and-a-half or so and through the time of the – that's been caused by this delay. They haven't gotten rate increases. They've got massive operating cost increases. They've added several hundred basis points of leverage to their balance sheet. I mean, they don't look like they are a viable entity in their current form if this deal doesn't close. So, is part of this problem with the delay in the accretion that you're coming from a deeper hole?

Christopher M. Crane*President, Chief Executive Officer & Director***A**

The delay – yeah. The delay in filing the rate cases has contributed to PHI's position that they're in now. They publicly spoke about what their future would be on a standalone. We believe that once we are able to fold them into the fleet and drive the synergies and help support them with the operational performance that will give the environment for fair regulatory recovery going forward as we've seen with BGE.

Greg Gordon*Evercore ISI***Q**

Yeah. I mean, certainly as I've observed, on a standalone basis, they've just seen a massive escalation in costs, which I'm sure you'd be able to control much more readily given Exelon's playbook, that should lead to the necessity for lower asks in terms of rate increases to get back to a decent return one would think, correct?

Christopher M. Crane*President, Chief Executive Officer & Director***A**

Yeah. I mean, that's part of the thesis in our filings and what we're able to do with the settlements. We can drive the synergies with our platform that will reduce the requests for needed scope of rate increases.

Greg Gordon

Evercore ISI

Q

Okay. Thanks. Going back to the \$0.08 impact to earnings from bonus depreciation, Jack, that's on this year's earnings? And is that sort of lower rate base net of capital allocation and can you just walk us through how you do that calculation?

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

Sure. So, that would be, Greg, on 2015. The \$0.08 would hit \$0.07 at ExGen, it would hit \$0.01 at ComEd. Importantly, it would also improve our cash flow by \$650 million. And at ComEd we would see the impact of bonus depreciation would cause a \$215 million reduction in ComEd's rate base.

Greg Gordon

Evercore ISI

Q

So, what do you assume you'd do with the \$650 million in cash? Just becomes a corporate – goes into the corporate general bucket or do you assume a specific offset in the denominator through less debt reduction, or is it just less debt? Is that the answer?

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

Effectively, we would reinvest that back into the utilities part of our business to fund our capital plan.

Greg Gordon

Evercore ISI

Q

Okay. And why is it such a big impact on ExGen?

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

It's the domestic production credits, there's a limiter that goes into place. And as those bonus depreciation hits, that limitation goes into effect and it meaningfully hits our ExGen part of our business. We're somewhat unique with our exposure to this within the industry.

Greg Gordon

Evercore ISI

Q

It hits your ability to consume production tax credits?

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A


It's more – Tom, do you want to – I'm going ask Tom Terry, our Head of Tax, to speak to this.

Thomas D. Terry

Vice President-Tax

A

Exelon Corp. (EXC)
Q3 2015 Earnings Call

 **Corrected Transcript**
30-Oct-2015

As a generator, we're entitled to claim so-called domestic production activity deduction which is computed as a percentage of generation income. So, as bonus depreciation reduces that income, it therefore reduces the related deduction.

Christopher M. Crane

President, Chief Executive Officer & Director

Okay. Got it. Thank you, guys.

A

Operator: Your next question comes from the line of Jonathan Arnold with Deutsche Bank.

Jonathan P. Arnold

Deutsche Bank Securities, Inc.

Good morning, guys.

Q

Christopher M. Crane

President, Chief Executive Officer & Director

Hey, Jon.

A

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

Good morning.

A

Jonathan P. Arnold

Deutsche Bank Securities, Inc.

Quick question. I noticed that in your recast of the 2015 guidance, there's now -- you obviously have the HoldCo drag which -- and I apologize if I missed this -- I'm guessing is part -- in part the financing on Pepco. But what would be -- A, is that right and B, what's a reasonable run rate for HoldCo expense as we look forward beyond this year?

Q

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

So, Jonathan, we commented in our earnings script that the equity and debt financing associated with PHI because we didn't close as anticipated in Q3 would be a \$0.13 drag on the year. So, our guidance contemplates that drag and incorporates that. Obviously, prospectively, we would anticipate closing the transaction towards the end of the first quarter of 2016. We would get the benefit of Pepco's earnings, and the pro forma would be modestly dilutive for 2016 until we, as Chris mentioned, execute the rate cases and grow the revenues and earnings at PHI over the course of the next several years.

A

Jonathan P. Arnold

Deutsche Bank Securities, Inc.

I heard the comment about the \$0.13 dilutive. That was a 2015 comment or wasn't that a 2016 comment?

Q

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

No, that's a \$0.15 comment, Jonathan.

A

Jonathan P. Arnold

Deutsche Bank Securities, Inc.

Okay.

Q

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

2015. Sorry. That is a 2015 drag. In 2016, we have the benefit of PHI for three quarters.

A

Jonathan P. Arnold

Deutsche Bank Securities, Inc.

Okay. Got it. So, should we – and once you close, will you start to net everything -- the HoldCo financing for that deal kind of into the segment or do you think you'll still have a discrete parent drag that might be larger going forward?

Q

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

We will incorporate the shares issued or we have the shares issued, the 893 million shares in the share count. That will be the divisor for all of our business units. And then we'll – we have the corporate holding company that it'll get allocated.

A

Jonathan P. Arnold

Deutsche Bank Securities, Inc.

Okay. So, I shouldn't – once we get into 2017, let's say, there's no – the parent segment, best guess, is kind of flat.

Q

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

Starting in 2017, we'll start to see accretion going into 2018 and very strong at the end of the LRP period.

A

Jonathan P. Arnold

Deutsche Bank Securities, Inc.

Okay. Thank you, guys. And then can I ask one other thing? We saw this Maryland AG filing in the Circuit Court. Any thoughts around timing? How concerned are you that it might be Maryland that ends up throwing a wrench in the works?

Q

Christopher M. Crane

President, Chief Executive Officer & Director

Darryl, you want to cover that?

A

Darryl M. Bradford

Executive Vice President & General Counsel

Yeah. Jonathan, it's Darryl Bradford. We have a – the Attorney General has asked for leave to file an amicus brief. We're going to be filing our opposition to that today along with the Maryland Public Service Commission. Whether the Attorney General is allowed to file its brief or not, we feel that the Maryland decision is a very strong one. The parties that are appealing have a very heavy burden. They'll return it. There will be a hearing in the Circuit Court on December 8 on this. And we believe that decision was very solid and we believe it will be upheld.

A

Jonathan P. Arnold

Deutsche Bank Securities, Inc.

Okay. Great. Thank you very much.

Q

Operator: Your next question comes from the line of Hugh Wynne with Bernstein.

Hugh D. Wynne

Sanford C. Bernstein & Co. LLC

Thank you. I was wondering if you could provide any high-level perspectives on the cost-cutting initiatives that you had mentioned in the scripted remarks.

Q

Christopher M. Crane

President, Chief Executive Officer & Director

Yeah. We're going to be putting out the details at EEI. But we've looked at our corporate center BSC, business service cost. We're looking at our IT costs and some of the work that we can do there, and also at the generating company. So we should be able to provide more detail on that, or we will be providing more detail at EEI.

A

Hugh D. Wynne

Sanford C. Bernstein & Co. LLC

All right. Thanks very much.

Q

Operator: Your next question comes from Julien Dumoulin-Smith with UBS.

Julien Dumoulin-Smith

UBS Securities LLC

Good morning.

Q

Christopher M. Crane

President, Chief Executive Officer & Director

Morning.

A

Julien Dumoulin-Smith

UBS Securities LLC

So, first question, going back to Pepco, if you will, the 2019 figure -- what's embedded in there? Is that simply just closing on the transaction, executing status quo, or are there rate case assumptions, et cetera? I'm just trying to get a little bit more sense that far out in terms of what's baked in.

Q

Christopher M. Crane

President, Chief Executive Officer & Director

So, there are rate case assumptions that we're taking straight out of PHI's LRP. Once we close, we'll be able to get deeper into those numbers and the drivers, but it is based off of their assumptions on what they'll recover in rate cases and their assumption on costs and cost controls going forward. So we'll be able to do more on that and provide updates when we get into the details after close.

A

Julien Dumoulin-Smith

UBS Securities LLC

Q

Got it. Two clarifications, it might be a little tricky. First, earned ROEs approximately, I mean, is it fair to say – well, I'll let you comment on that on the Pepco side.

And then separately, as you think about this transaction, you've got, I suppose, the cost update coming at EEI. Is there some fungibility between those two as well?

Christopher M. Crane

President, Chief Executive Officer & Director

A

Yeah. I'm sure there is because you're going to have – the Massachusetts model will dictate the overheads down to the specific companies. So there should be with this improvement, minor adjustments, but too early to speculate now on where that goes.

On the ROEs, the calculation would be straight out of the LRP that PHI is operating under now, their LRP. That will have to be updated post-close with our assumptions of not only the cost reductions, but the operational improvements.

Julien Dumoulin-Smith

UBS Securities LLC

Q

Great. Last little question here. Oyster Creek, you guys filed an interesting 8-K recently regarding must-offer requirements into 2019. Is there an ability to clip – participate for a partial year into the subsequent capacity auction at all?

Christopher M. Crane

President, Chief Executive Officer & Director

A

Joe Dominguez will take that.

Joseph Dominguez

SVP-Public Policy, Government & Regulatory Affairs

A

Hey, Julien. It's Joe Dominguez. Julien, we've looked at that – that would be very difficult, especially with the new CP environment. So, you've seen our must-offer exemption, we don't intend to participate with that unit.

Julien Dumoulin-Smith

UBS Securities LLC

Q

Got it. Just wanted clarify. Thank you.

Operator: Your final question comes from Ali Agha with SunTrust.

Ali Agha

SunTrust Robinson Humphrey, Inc.

Q

Thank you. Good morning.

Christopher M. Crane

President, Chief Executive Officer & Director

A

Morning.

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

Morning.

Ali Agha

SunTrust Robinson Humphrey, Inc.

Q

First question, just wanted to clarify the \$0.08 beat that you had in the third quarter above the high end of your guidance. Was that all coming from the stronger performance at Constellation, or what was the main driver there?

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

It was both across the utility business as well as at the Constellation and next-gen part of our businesses. So, we had strong weather and operating results at both PECO and ComEd. And then we had good operating results at BGE. And then as Joe articulated in his discussion, we had strong performance from the generating part of our company.

Ali Agha

SunTrust Robinson Humphrey, Inc.

Q

Okay. Second question, this disconnect in pricing between your fundamental view of NiHub and the forwards. So, we've been hearing that for the last several quarters now. I'm just curious, what – you've had retirements happen during that time. What in your opinion is going to trigger that to coincide? Is it just a surge in demand, extreme weather? I mean, like I said, we've been seeing this for a while. What do you think will change that?

Joseph Nigro

Executive Vice President, Exelon; Chief Executive Officer, Constellation, Exelon Corp.

A

Good morning. It's Joe. I think there's a couple of things, but I think the biggest thing is there's just a complete lack of liquidity at – in NiHub, especially when you get beyond like the 2016-2017 period. We think that when you – with normal weather in 2016, we think NiHub is somewhat fairly valued. But as you move out on the curve, it gets materially undervalued and that's driven mostly by the lack of liquidity.

If you look at it, you have gas prices that are in a contango market, and M3 is relevant because it's – across the power pool a lot of hours are setting price using M3 gas. So if you look at like 2016 to 2018, you got \$0.25 of value on the curve just associated – or I'm sorry, \$0.40 of value associated with Henry Hub prices and another \$0.20 to \$0.25 with M3. There's \$0.65 of value in the gas curve. And yet the power prices at NiHub today are \$0.25 backwardated.

In addition, coal is in contango as well. So we – that's part of it, the coal retirements are part of it. We have seen heat rate expansion even at these low gas prices. We think some of that is being masked, quite frankly, by the fuel being so low. But when you put all that together and then the complete lack of liquidity, that's where we're coming up with the driver of higher prices in the future.


Ali Agha

SunTrust Robinson Humphrey, Inc.

Q

Understood. And then last question, assuming these forward curves stay as they are, and I know that at EEI you'll update your curves to add 2018 to the mix as well, but when you look at – I mean, you're showing us fairly flat

Exelon Corp. (EXC)
Q3 2015 Earnings Call

 **Corrected Transcript**
30-Oct-2015

margins, 2016, 2017. The cost savings that you're planning are they going to be strong enough, so that just directionally GenCo can show a positive net income stream because depreciation and other expenses are going up as well. Or are we still looking at flat to perhaps declining GenCo profile given what the forward curves are telling us right now?

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

Ali, it's Jack. I know that there's a lot of interest in us in engaging on the cost reduction topic before EEI. But I think it's probably better to align our disclosure around that cost reduction effort with our outlook for 2016, 2017 and 2018 hedge disclosures. You'll obviously see the significant benefit of CP in that period aligned with the benefits of cost reduction. So, while the story is positive. We'd ask for your patience in terms of transparency around that until EEI.

Christopher M. Crane

President, Chief Executive Officer & Director

A

The bottom line is we're seeing improvement over the LRP period.

Ali Agha

SunTrust Robinson Humphrey, Inc.

Q

Okay. So, from an Exelon perspective, just directionally you would – as we stand here today, 2018-2019 earnings, with Pepco in there, should be higher than where we are in 2015. Is that a fair statement?

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

Yes.

Ali Agha

SunTrust Robinson Humphrey, Inc.

Q

Thank you.

Operator: Thank you, ladies and gentlemen. This concludes today's conference call. You may now disconnect.

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2015 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.