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Exelon Corp. (EXC)

Q4 2015 Earnings Call

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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 Exelon Corporation Q4 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 Mr. Francis Idehen. Please go ahead, sir.

Francis Idehen
Vice President-Investor Relations

Thank you, Deshanta. Good morning, everyone, and thank you for joining our fourth quarter and 2015 earnings call. Leading the call today are Chris Crane, Exelon's President and Chief Executive Officer, and Jack Thayer, Exelon's 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 a 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 the earnings release, today's materials, comments made during this call, and in the risk factors section of the 2014 10-K and the third quarter 10-Q. Please refer to today's 8-K and the 10-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 45 minutes 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

Thanks, Francis and good morning to everybody. Thank you for joining us on our fourth quarter call. Before I go into the results I want to take a moment to thank our crews who worked hard to restore power for our customers in Baltimore and Philadelphia affected by the January storms. BGE and PECO were able to restore approximately 22,000 customers throughout the weather event, keeping the average restoration times to less than three hours, which is a remarkable accomplishment given the challenges associated with traveling in the working conditions as the storm intensified.

I'll start off by reiterating our strategy and our capital allocation philosophy. The balance sheet strength is a priority that guides every strategic decision. It allows us to deliver stable growth, sustainable earnings and an attractive dividend for our shareholders. Our strategy for delivering these objectives is to harvest free cash flow from the GenCo, to invest primarily in the utilities for the benefit of our customers, invest in long-term contracted assets which meet our return requirements, and return capital to the shareholders.

Consistent with this capital allocation policy, we're announcing today an evolution in our dividend policy. Our board has approved a policy to raise our dividend by 2.5% each year for the next three years, beginning with the June 2016 dividend. The dividend increase shows our commitment to provide an attractive total return proposition for our shareholders and reflects the shift in focus towards our regulated utility and long-term contract businesses.

Our balance sheet and our cash flow profile support the shift of the dividend policy and maintain a high credit quality and investment grade rating remains at top priority. We continue to de-risk the company by growing our regulated business. This has allowed us to generate earnings with a lower risk profile. We remain as focused as ever on careful disciplined use of capital.

Let's turn now to 2015 results in each of our businesses and our goals for 2016. Despite a difficult year in the markets, we delivered earnings of \$2.49 a share in 2015, demonstrating once again our ability to run businesses well and manage through even the most challenging environments.

At our utilities, 2015 was a record year for us in many respects and growing regulated business continues to thrive. We achieved a major earnings milestone, our utilities earned over \$1 billion in net income, delivering the highest utility earnings on record. We invested nearly \$3.7 billion in needed improvements for our customers across the utilities, including the AMI and the grid modernization investments, significant gas and electric infrastructure and innovative technology and customer-oriented systems.

Our track record for reliability and customer service has allowed us to earn solid returns. Our utility earnings on aggregate across Exelon is at 9.5% in 2015. Our returns reflect the constructive regulatory relationship in our territories. PECO received a unanimous approval for both its \$127 million rate case settlement and a \$275 million long-term infrastructure improvement plan.

BGE received approval for recovery of more than \$200 million of energy efficiency and gas infrastructure replacement investments. And at ComEd, we achieved our fourth consecutive year of constructive outcomes in our formula rate filing. This year, we filed a rate reduction at ComEd, showing our ability to contain costs and limit the impact of capital investments on our customers' bill even during the current smart grid investment cycle. The utilities continue to drive high operational performance and that performance is getting better each year. Of the 26 metrics we track, 21 of them were best or second best ever in 2015, including reliability and customer satisfaction.

As for our goals in the utility business in 2016, our first primary goal is closing the PHI transaction. At which point, we'll begin the important job of integrating PHI into the Exelon family of utilities. We'll bring our management model to PHI utilities in order to improve the experience of the customers in the region. We'll work diligently to develop and implement an effective regulatory strategy for PHI.

We'll invest approximately \$4 billion in our existing utilities to refurbish and modernize the grid to improve service for our customers. That is part of the \$18 billion we'll invest in our existing utilities over the next five years. We will work to maintain first quartile operational and customer satisfaction numbers while continuing to focus on productivity and cost management.

Finally, we expect a decision in our November 2015 BGE rate case in June and we'll file our annual formula rate update at ComEd in April. By executing on these goals, we'll deliver one of the most compelling utility earnings growth stories.

Our Generation business had a solid year. Operationally, in 2015 the Constellation – and Constellation performed well even in the face of weak markets. Nuclear capacity factor was 93.7%, refueling outage performance was very strong. Average refueling outage duration was 22 days; that's the lowest average since 2002.

Our gas and hydro plants outperformed the Dispatch Match targets. Our solar and wind assets did the same for the energy capture targets.

Our power business went 15 months without an employee OSHA recordable incident. It's the best safety performance ever. At Constellation, our generation to load matching strategy contributed meaningfully to the earnings. Our load serving business experienced growth in both power and gas. In 2015, we served 195 terawatt hours of wholesale and retail load, materially growing that platform from 155 terawatt hours the prior year.

We continue to have high customer wind and renewable rates. We are now a top 10 marketer of natural gas and significantly increased our delivery of retail gas to 720 Bcf last year. In 2016, at Exelon Generation, we'll continue to operate world-class fleet of assets at the highest level of performance while continuing to execute our strategy of growing the contracted generation business with 350 megawatts of wind projects in development.

At Constellation, we will achieve our targets of serving 210 terawatt hours of load across our wholesale and retail base, using our commercial platform as both a risk management vehicle and an earnings driver. Each of our businesses is well positioned to continue strong performance in 2016 operationally and financially.

We have some important priorities we are targeting in 2016. We'll continue our broad advocacy efforts to ensure that our unique class of nuclear assets are properly valued for their clean, safe and reliable attributes. Developments in New York for a clean energy standard are constructive. The leadership of the governor in New York has been very positive, but more work needs to be done and we will engage with key stakeholders in the state. We continue with our specific efforts with legislators and stakeholders in Illinois on the Low Carbon Portfolio Standard. We provided ample time to reach the resolution on the nuclear assets, suffering significant losses in the process.

If we don't see significant results, we will make the economically rational decision. We continue to engage with MISO on a constructive reform to address the issues in Zone 4. We'll work in the states in which we operate to develop compliance plans for the clean power pool.

This has been a challenging period for our sector. We are tackling those challenges aggressively. We're reducing our costs by \$350 million. We'll continue to shift our business mix to more regulated exposure, both organically with our \$18 billion capital into our existing utilities over the next five years and through our strategic acquisition of Pepco, which will raise that number of capital investment to \$25 billion over the next five years.

The company remains on a solid footing and our balance sheet remains strong and we continue to run the businesses at the highest operational levels.

With that, I'll turn the call over to Jack for the financial details.

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

Thank you, Chris, and good morning, everyone. As Chris stated, we had a strong year financially and operationally across the company. For the full year, we delivered earnings of \$2.49 per share and \$0.38 per share for the fourth quarter.

If bonus had not been extended, we would have delivered earnings of \$2.58 per share, meaningfully exceeding the midpoint of our guidance range. The appendix contains details on our fourth quarter financial results by operating company on slides 21 and 22.

My remarks today will focus on 2016 earnings and O&M guidance, our credit profile, the cost management initiative and an update of our gross margin disclosures.

Turning to slide six, we expect to deliver 2016 full year adjusted operating earnings of \$2.40 to \$2.70 and \$0.60 per share to \$0.70 per share for the first quarter. While we anticipate closing the Pepco Holdings deal in the first quarter, our guidance is a standalone figure that assumes the equity and debt issued for the PHI deal is unwound during the year. The impact of the extension of bonus depreciation is included in the guidance.

Our growing utilities earnings primarily reflect increased capital investment in distribution and transmission to improve reliability and customer service at ComEd as well as increased rates from PECO's recent distribution rate case, partially offset by higher O&M at PECO and BGE related to storm and bad debt cost.

Our strong operating performance at our utilities is fostering a positive regulatory environment in all our jurisdictions and is evident in the transformation in allowed and earned returns that we've achieved at BGE since the Constellation merger. BGE has improved reliability and customer satisfaction in every year as compared to

2012, the year of the merger, which in turn has led to improved regulatory outcomes and earned ROEs over that same period.

Last November, BGE filed an electric and gas distribution rate case with the Maryland Public Service Commission requesting revenue requirement increases of \$121 million and \$80 million to its electric and gas distribution rates respectively. The requested rates of return on equity in the application are 10.6% for electric distribution and 10.5% for gas distribution. We expect the Maryland PSC to rule on the rate case in the June timeframe with the new rates going into effect shortly after the final order.

The revenue requirement increases reflect the continued investment including smart grid being made at BGE to improve reliability and customer service.

Constellation had a record year in 2015, driven by higher realized margins that benefited from a lower cost to serve our load and strong performance in our portfolio management group. In 2016, we expect a more normalized cost to serve load and portfolio management performance, which we expect will have a negative impact on earnings relative to an extraordinary 2015.

Overall, at Exelon Generation, the earnings impact from normalized margins and higher decommissioning costs, partially offset by fewer nuclear outages and cost management efforts, results in a forecast decrease in Ex Gen's earnings range versus last year.

Our cost management initiative savings in 2016 should largely offset the impact of inflation at Ex Gen, where labor and wage inflation are significant components of O&M. For reference, more detail on the year-over-year drivers by operating company can be found in the appendix on slides 23 through 26.

Moving to slide seven, as we've said in the past, bonus depreciation has a negative impact on earnings, but a positive impact on cash. In 2016, it creates a rounded \$0.09 earnings drag at the consolidated level with a \$0.06 impact at Exelon Generation and a \$0.03 impact at ComEd.

On the cash front, it increases cash flow by \$625 million in 2016. Despite the negative earnings impact of bonus depreciation in 2016 through 2018, we are affirming the CAGR of 3% to 5% for the enterprise, and 7% to 9% for the utilities through 2018 that we disclosed at EEI.

In addition, the extension of bonus depreciation will likely have a further effect on Exelon as a whole after the closing of the Pepco Holdings deal. Once the merger is completed and we begin the integration of PHI's operating, planning and regulatory functions, we will provide an update on PHI's forecast and the resulting accretion impact on Exelon's forecast.

On slide eight, our top financial priority remains maintaining our investment grade credit rating and ensuring the strength of our balance sheet. The five year extension of bonus depreciation improves the free cash flow position at Ex Gen, which has a positive impact on our FFO to debt metrics.

Ex Gen free cash flow over the 2016 to 2018 period is now projected to be \$5.35 billion or \$3.2 billion after taking into account committed growth capital. Since our EEI disclosure, Exelon Generation has commenced developing a further 350 megawatts of long-term contracted wind projects in Michigan and Oklahoma.

As you'll note on the slide, given our strong cash flow outlook, Ex Gen has a declining debt-to-EBITDA ratio starting at 3.2 times in 2016 and decreasing to 2.3 times debt-to-EBITDA by 2018. Bottom line, we are growing durable earnings and shrinking debt.

Turning to slide nine, I will provide an update on the cost management initiative that we announced towards the end of last year. We recently finalized the savings initiatives in January and have incorporated them in our current long range plan.

As we mentioned at EEI, the total identified savings are in the \$350 million range, with savings split equally between Exelon Generation and our corporate shared services organization. \$100 million of the savings at the shared services organization will be achieved within our information technology function, with the remainder coming from various corporate functions such as finance, legal, human resources and supply. The corporate savings will be allocated roughly equally between Exelon Generation and the utilities.

Overall, this means that roughly three-quarters of the total cost savings for the company will hit the bottom line in Exelon Generation, while the remaining quarter of the savings will be realized at the utilities and ultimately passed on to our customers. As a result, we expect a run rate earnings benefit from our cost management initiative of \$0.13 to \$0.18 per share beginning in 2018 with approximately 35% of the run rate savings achieved by the end of this year.

Our proven track record of cutting cost and running our business efficiently gives us confidence we'll be able to achieve or exceed these savings.

Slide 10 shows our 2016 O&M forecast relative to 2015. We project O&M for 2016 to be flat to 2015 and we expect a slightly negative O&M CAGR across the enterprise over the 2015 to 2018 period and a negative 1% CAGR at Exelon Generation. ExGen's year-over-year decrease is driven by a combination of factors. Fewer planned nuclear outages compared to 2015, lower pension cost and the impacts of the cost management initiative. The year-over-year increase at PECO and BGE is due to inflation and budgeting for normal storm and bad debt costs, which results in an incremental year-over-year O&M growth.

Slide 11 provides our fourth quarter gross margin update. This quarter's gross margin update now includes the impact of the Ginna RSSA 2016 and 2017 total gross margin. As we saw before, prices and heat rates for 2017 increased by the end of the quarter. We reduced our deviation to ratable.

For 2017 we ended the quarter with a power position of 5% to 8% behind ratable on a total portfolio basis when considering our cross commodity hedges. We're even further behind ratable in the Midwest, approximately 13% to 16%, when considering cross commodity hedges. We continue to align our hedging strategy with our views on the market.

In 2016 total gross margin is flat to our last disclosure. As you know, we're highly hedged in 2016 which combined with the inclusion of the Ginna RSSA allowed us to offset the impacts of lower prices in 2016.

During the quarter, we also executed on \$50 million of both power new business and non-power new business. Total gross margin increased by \$50 million in both 2017 and 2018. The increase in 2017 is partially driven by the Ginna RSSA, which mitigates losses, while the increase in 2018 is driven by higher power prices across most of the regions, most notably in NiHub with around-the-clock prices increasing by \$0.64 per megawatt hour.

During the quarter, we also executed on \$50 million of non-power new business for both 2017 and 2018. As a reminder, the appendix includes several schedules that will help you in your modeling efforts.

That concludes our prepared remarks, and we'll now open up the line for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Greg Gordon with Evercore ISI.

Greg Gordon
Evercore ISI

Q

Thanks. Good morning, guys. Great presentation. Thank you.

Christopher M. Crane
President, Chief Executive Officer & Director

A

Hey, Greg.

Greg Gordon
Evercore ISI

Q

A couple questions. Can you talk in a little bit more detail about what your plan is and what the milestones are for making a decision in Illinois on the uneconomic units? And can you refresh our memory on where we stand on the – in terms of profit and loss on the three units that you had initially a year and a half or two years ago identified as impaired?

Christopher M. Crane
President, Chief Executive Officer & Director

A

Sure. As you know, we were successful and PJM was successful on the capacity market redesigns that gave some upside to the fleet in NiHub, greatly helped Byron and added help to Quad Cities. But since then, as you've seen the downturn in the forwards, Quad Cities continues to be challenged and more neutral on cash flows and earnings while maintaining the risk of operation.

We continue to work on Clinton; Clinton is negative. We have two initiatives underway, one working with MISO on Zone 4 reforms, and we'd like the design to be more like the new PJM capacity market design, but that in itself will not save Clinton.

As you know, there is a lot of work going on in Springfield with the administration and the legislature. And we have had very strong support from the leadership and the legislature and the administration on coming to a resolution on the energy outlook for Illinois. It's not only the clean energy standard, but there is an environmental jobs – green jobs bill and there's the utility of the future bill that have to be negotiated together.

There has been progress made in that dialogue, but it is critical that we have – that we're able to present to the legislature this spring a combined package that ensures the financial viability of our assets as they contribute highly to reliability and environmental, or we will have to make the rational economic decision. It's our job to get the stakeholders together. We're working hard on that and to bring the leadership what is a consensus package that's good for all of Illinois and its customers.

So we're in this spring time in Illinois and we're hopeful that we can have reasonable heads prevail and negotiate a balanced outcome and as I said present that to the leadership so they can provide the continued support.

Greg Gordon
Evercore ISI

Q

Okay. So Quad, because of the further decline in gas prices and power prices since the CP results, has gone back out of the money, so is that a fair summary?

Christopher M. Crane
President, Chief Executive Officer & Director

A

It is. With these forwards, it is.

Greg Gordon
Evercore ISI

Q

Okay. And the second question is, so you guys are going to – based on your cash flow slide on page 37, I think you're going to end the year with a pretty substantial cash balance. And if I look at the cash flow profile you project through 2018 that should continue to grow, all things equal. Your debt to EBITDA is going to be sub -3 times. By my measure you're trading at under 4.5 times EBITDA on the implied valuation of the nuclear business. That basically implies that the nuclear is a wasting asset. With \$8.5 billion of debt on the balance sheet, that you should be amortizing debt because these plants are going away in 10 years. I mean, what can you do to convince investors that this low gas price environment doesn't ultimately drive these assets out of business, because if they're 20-year or 30-year assets and not 10-year assets, the stock is undervalued.

Christopher M. Crane
President, Chief Executive Officer & Director

A

Yeah. First of all, there's more than 10 years on these assets. We got license renewal at Braidwood, it goes into the late 2040s. The money producing plants are the larger dual unit sites that will run into the 2040s, that's Byron, Braidwood, LaSalle, Limerick, Peach Bottom, and they are positioned well in the markets and Peach Bottom's in the 2030s I think, but the others are in the 2040s. So, we've got a long run left on these profitable plants.

If the smaller units or the single site units cannot be profitable and we can't get a market design, they will be retired and there is an upside based off of that retirement on free cash flow and earnings. We will remove the drag. As Jack described, we are very focused on the debt-to-EBITDA ratios at the GenCo, and over this period of time, we'll be reducing over \$3 billion of debt at the GenCo and continuing to manage that, matching our assets with our debt.

We feel very comfortable where we're at, but it is a misnomer that is out there, that these are 10 year assets with a large debt profile on them. Jack, you want to...?

Jonathan W. Thayer
Chief Financial Officer & Senior Executive VP

A

No. I think you covered it, Chris. I mean, the goal is to create that fortress balance sheet to do the right things around our assets and sustain the profitability of the long-lived plants.

Greg Gordon
Evercore ISI

Q

All right. Thanks, guys.

Operator: Your next question comes from Dan Eggers with Credit Suisse.

Dan L. Eggers

Credit Suisse Securities (USA) LLC (Broker)

Hey, good morning, guys.

Q

Christopher M. Crane

President, Chief Executive Officer & Director

Hey, Dan.

A

Dan L. Eggers

Credit Suisse Securities (USA) LLC (Broker)

If we look at the dividend increase and kind of the 2.5% a year for the next three years. Can you maybe, Chris, share how the board thought about using capital to raise the dividend considering you already have a pretty healthy yield. And then what was the thought process behind 2.5% a year for those three years?

Q

Christopher M. Crane

President, Chief Executive Officer & Director

Sure, we had, as we talked back three years ago now, when we had to restructure the dividend, we had grown the dividend at Exelon based off of the earnings and cash flow on a very volatile business, the GenCo. We had to make the shift and take the pain at the time to refocus the payout and where that reliable cash flow would come from. We set out at that time after the merger with Constellation, improving the performance for the customers and the reliability of BGE and along with that improving the profitability. ComEd has done a phenomenal job improving reliability, making prudent investments and as our shareholders have seen, as you have seen, the strategic plan we laid out a few years ago is paying off, and it is – can be seen, it's transparent that the – by 2018, theoretically, the utilities would be covering the dividend.

A

In discussion with shareholders and feedback at the end of the year, the certainty that, and our confidence in the business needed to be fully displayed, in dialogue with the board, we thought that we can make these increases. We've talked about the free cash flow. We've talked about the balance sheet, and we're committed to that through 2018. It's – I think it's a positive sign in the right direction that we feel confident in our strategy going forward.

Dan L. Eggers

Credit Suisse Securities (USA) LLC (Broker)

Okay, got it. And then on the Pepco deal, I guess, we're kind of down to one month of room for the Commission to make a decision, I guess, A) have you heard anything or is there anything indicative of where the Commission could make a decision? And B), if the deal does not get approved, how do we think about the full return of the previously raised equity and the debt retirement?

Q

Christopher M. Crane

President, Chief Executive Officer & Director

So, the Commission did state that they would take this matter up before our March 4 date, and that's our only commitment is to try this till March 4. And if we can't get it by March 4 then we have to fold up and then start to execute on the debt reduction and the buyback of the equity issues, and that would start immediately. The plans – the contingency plans are in place by Jack and Stacy and the team, and that execution would then start at that point.

A

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

And Dan, just for modeling convention, what we've assumed is it takes us roughly five months to buyback the equity and that has a \$0.06 drag associated with it during 2016 on our standalone plan. And we'd assume we'd retire the majority of the debt associated with Pepco in March, which has a \$0.01 drag. So all-in on a standalone basis, there is about \$0.07 of drag in our EPS associated with PHI closing that out if we end up on a standalone basis.

Dan L. Eggers

Credit Suisse Securities (USA) LLC (Broker)

Q

And I think that the disclosure in the back of the \$1.6 billion or whatever buyback that you have in the appendix, that's based on just buying back the same number of shares you originally issued, although the notional amount is obviously less than you raised. And is there a possibility you guys could buyback the amount you raised rather than the number of shares?

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

To your point, we've – what we've modeled is buying back the 57.5 million shares that we issued for the transaction. I think, our balance sheet strength and where we see that orienting, from a debt-to-EBITDA basis provides a lot of flexibility. And we'll review what's the best means of creating value for shareholders.

Dan L. Eggers

Credit Suisse Securities (USA) LLC (Broker)

Q

Got it. Thank you, guys.

Christopher M. Crane

President, Chief Executive Officer & Director

A

Thanks.

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

Steve Fleishman

Wolfe Research LLC

Q

Yeah, hi good morning. Just on the dividend strategy change, I just wanted to confirm that's the plan kind of with or without Pepco?

Christopher M. Crane

President, Chief Executive Officer & Director

A

It is.

Steve Fleishman

Wolfe Research LLC

Q

Okay. And secondly, what are your thoughts on the use of the bonus depreciation cash and it sounds like you haven't included that in the impact of bonus, so you're just taking the hit but not including reinvestment? What might you reinvest in?

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

A

We have significant investment in the utilities. We are putting debt on the holding company. We would anticipate less debt issuance to infuse the equity into the utilities as part of that. And there, we would look at other opportunities for further regulated or contracted investment if they met our hurdle rates, anything, Jack?

Jonathan W. Thayer*Chief Financial Officer & Senior Executive VP*

A

No that's right.

Steve Fleishman*Wolfe Research LLC*

Q

Okay. And then, the \$1.35 billion that you're putting into contracted generation at ExGen. That's all, is that all renewables projects?

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

A

Midway is in there, too.

Jonathan W. Thayer*Chief Financial Officer & Senior Executive VP*

A

There is a – there is contracted peaker up in in New England, that's a modest part of that, but the bulk of that is contracted wind or contracted distributed generation.

Steve Fleishman*Wolfe Research LLC*

Q

Okay. And are you assuming, you're not – are you including any debt financing on those assets, are you assuming for purposes here, you're just funding all of it, and could you add debt to those projects?

Jonathan W. Thayer*Chief Financial Officer & Senior Executive VP*

A

Steve, we're assuming that because of their contracted nature that we'll be able to secure project financing, which will get some measure of off-credit treatment to minimize the impact on the overall balance sheet.

Steve Fleishman*Wolfe Research LLC*

Q

Okay. And that – so the \$1.35 billion is just your equity investment in these?

Jonathan W. Thayer*Chief Financial Officer & Senior Executive VP*

A

\$1.35 billion is just cash.

Steve Fleishman*Wolfe Research LLC*

Q

Cash, okay.

Jonathan W. Thayer
Chief Financial Officer & Senior Executive VP

A

So, that can be either project financed or equity financed, some combination of both.

Steve Fleishman
Wolfe Research LLC

Q

Okay. Great. Thank you very much.

Christopher M. Crane
President, Chief Executive Officer & Director

A

Sure.

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

Jonathan Philip Arnold
Deutsche Bank Securities, Inc.

Q

Hi, good morning, guys.

Christopher M. Crane
President, Chief Executive Officer & Director

A

Good morning.

Jonathan W. Thayer
Chief Financial Officer & Senior Executive VP

A

Good morning.

Jonathan Philip Arnold
Deutsche Bank Securities, Inc.

Q

Just a quick one is on similar topic, does the projection you show for ExGen, net debt to EBITDA, stepping down to 2.3 times by 2018, how much of your free cash flow are you assuming you kind of reinvest or is all of it just rolling into the net debt calculation in that other slide?

Jonathan W. Thayer
Chief Financial Officer & Senior Executive VP

A

Jonathan, the major drivers of that are we have a \$700 million maturity in 2017 that we pay down, we pay down about \$1.2 billion of CP, and then a growing cash position, which ultimately takes you from that 3.2 times down to 2.3 times.

Jonathan Philip Arnold
Deutsche Bank Securities, Inc.

Q

So is it fair to say the 3.2 times of free cash flow is kind of all rolled into the debt projection or not entirely?

Jonathan W. Thayer
Chief Financial Officer & Senior Executive VP

A

It's rolled into the debt projection, it's financing or funding the dividend increase, it's basically insulating the balance sheet to a very strong position.

Jonathan Philip Arnold

Deutsche Bank Securities, Inc.

Q

Great. That was – my other things got asked. So, thank you very much.

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

Thank you.

Operator: Your next question comes from Praful Mehta with Citigroup.

Praful Mehta

Citigroup Global Markets, Inc. (Broker)

Q

Hi, guys.

Christopher M. Crane

President, Chief Executive Officer & Director

A

Good morning.

Praful Mehta

Citigroup Global Markets, Inc. (Broker)

Q

Actually going back to this debt question at ExGen, just want to understand, given the goal is to harvest gas from ExGen as you pointed out and to reinvest that cash. And we've talked about the lifetime of assets for the nuclear as well. Is there a level of just debt, as in currently the debt balance is let's say \$9 billion, is there a level of debt that you see is the right debt – gross debt number that you see at ExGen? Is it – between the 2018, 2019 timeframe, are you targeting a certain number?

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

Praful, we're retiring about \$3.6 billion over the next five years at ExGen, and I think that provides us, rather than targeting a specific number, I think more importantly it provides us with a considerable amount of flexibility and insulation and allows us to position from a point of strength, our merchant fleet, to compete on a long-term basis. It's clearly differentiated it from the balance sheets of some of our competition, and we think that that will be a competitive advantage as we proceed through the coming years.

Praful Mehta

Citigroup Global Markets, Inc. (Broker)

Q

Got you. Thank you. And then secondly, in terms of the dividend, if the Pepco transaction weren't to close, as you grow your dividend by the 2.5% as you've talked about, how are you looking at the payout ratio relative to just the utility earnings by 2018 and is there a target level that you're comfortable with in terms of payout relative to just utility earnings?

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

So, from a dividend standpoint, in effect what we do is we set a minimum from a payout ratio at the utilities but we've got a lot of flexibility in how we can fund that growth. So, rather than targeting a specific payout ratio in aggregate, what we're really looking at is a minimum payout ratio at the utilities of 65% to 70% and then we look at where best to fund the dividend as well as fund the investment in the utilities to grow the regulated earnings stream of the company at 7% to 9%.

Praful Mehta

Citigroup Global Markets, Inc. (Broker)

Q

I got you. So there is a scenario where the payout from just the utility business or I guess the total payout relative to the utility earnings could go higher than the 70% if in case the Pepco transaction doesn't close?

Christopher M. Crane

President, Chief Executive Officer & Director

A

That's a possibility, but if you look at – go back to what Jack said, a payout ratio of 65% to 70% by 2018 theoretically with our earnings profile, the utilities would cover that dividend and that's a theoretic position we wanted to be in because we need to make decisions on further capital infusions for necessary projects to drive customer satisfaction and reliability.

Praful Mehta

Citigroup Global Markets, Inc. (Broker)

Q

Got you. Thank you.

Operator: Your next question comes from Barbara Chapman with BNP.

Barbara Chapman

BNP Paribas

Q

Hi.

Christopher M. Crane

President, Chief Executive Officer & Director

A

Hey, Barbara.

Barbara Chapman

BNP Paribas

Q

How are you guys doing?

Christopher M. Crane

President, Chief Executive Officer & Director

A

Good, yourself?

Barbara Chapman

BNP Paribas

Q

Good, good. If somebody could speak to your sources and uses slide on 27, please, and help answer a couple of questions? One, the issuance needed at Baltimore Gas and Electric just seems larger than what we've dealt with. So I'm kind of curious what's going on there as far as an investment standpoint? But also, on the corporate issuance, it doesn't appear there is a placeholder for the reissuance of the debt that was not exchanged and therefore called last year. So, if you can explain if the Potomac merger goes through are we done now with the permanent debt financing for that?

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

So, Barbara, let me start with your second question first. This is on a standalone basis. So you'll note under the debt retirements that we have a further \$1.875 billion of retirements here. If PHI goes through, then clearly we would look to fill the gap of what we called during the fourth quarter of 2015 through a further financing at the holding company. And on a pro forma basis, this sources and uses table would show the impact of that.

With respect to BGE on a – we're retiring \$300 million there, we're issuing \$750 million, so the net \$450 million. You'll recall we have a significant gas program there, where we're hardening and replacing infrastructure within our gas utility as well as we have a significant investment in reliability on the distribution and transmission side.

Barbara Chapman

BNP Paribas

Q

Okay. So we're back – we're still on the original thought that closing Potomac you will be out with – to refinance what had to be called then?

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

Absolutely.

Barbara Chapman

BNP Paribas

Q

Okay. Because it's confusing the way this is written on that issue, okay. And then...

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

And then Barbara just, I mean, the difference this time obviously is we would issue on the other side of the transaction completing. So we have sources of funding that we can use to bridge and then we would do a large HoldCo issuance to replace that short-term financing.

Barbara Chapman

BNP Paribas

Q

Okay. And then on the Potomac merger, you're not on the agenda for today's meeting, correct?

Christopher M. Crane

President, Chief Executive Officer & Director

A

No.

Barbara Chapman
BNP Paribas

Q

And they cancelled one of the February meetings. So are there only two meetings left for them to opine?

Christopher M. Crane
President, Chief Executive Officer & Director

A

Let me let Darryl Bradford address that.

Darryl M. Bradford
Executive Vice President & General Counsel

A

Hi, Barbara. Barbara, the Commission has historically called a special meeting. They do that on 48 hours notice, so they could do it at one of their scheduled meetings. I think they moved back their meeting in February because of a conflict with NRC but we wouldn't be surprised at all if the decision whether to approve the merger is not heard at one of their scheduled meetings, but rather would be set on 48 hours notice at a special meeting.

Barbara Chapman
BNP Paribas

Q

Okay. And so there would be a posted notice that there is a special meeting then?

Darryl M. Bradford
Executive Vice President & General Counsel

A

Yeah. 48 hours ahead of time is what the regulations require.

Barbara Chapman
BNP Paribas

Q

Okay. Thanks for clearing that up. Thank you.

Operator: And your final question comes from the line of Shar Pourreza with Guggenheim Partners.

Shahriar Pourreza
Guggenheim Partners

Q

Good morning, everyone.

Christopher M. Crane
President, Chief Executive Officer & Director

A

Hi, Shar.

Jonathan W. Thayer
Chief Financial Officer & Senior Executive VP

A

Good morning.

Shahriar Pourreza
Guggenheim Partners

Q

So just looking at slide eight, is there a scenario that could potentially see some of your ratios, including your debt to EBITDA, essentially south of 2.3 times, especially if we continue in a sort of a prolonged low gas price environment?

Jonathan W. Thayer

Chief Financial Officer & Senior Executive VP

A

I think, Shar, obviously, there is a measure of commodity sensitivity within our ExGen business. We think we're at a – I would characterize it as a trough in the cycle and we're showing debt pay down and the reduction to 2.3 times. To the extent that our fundamental view comes into play and we're able to benefit from our behind ratable strategy, that will give us even more balance sheet flexibility.

Shahriar Pourreza

Guggenheim Partners

Q

Okay. That's helpful. And then just on the on the dividend policy, when you think about sort of your second leg of growth. Should we assume sort of like step functions to get you closer to what your consolidated growth is or should we assume maybe another large increase post 2018?

Christopher M. Crane

President, Chief Executive Officer & Director

A

So, we would analyze, the best shareholder capital return policy. We'd be looking at other further investments that can be made, to create stronger and continuing growth in our investment in the regulated utilities. But it will be analyzed. And as I said, we theoretically hit a target of a payout in 2018, we'll take into consideration the best uses of capital allocation at that point, and we would anticipate some growth continuing after 2018, there is a lot of infrastructure and technology advancements that are coming along that will benefit the customers and benefit reliability and drive much more productivity within our workforce.

So it's something that we'll look at and we are heading in the right direction.

Shahriar Pourreza

Guggenheim Partners

Q

Excellent. Excellent. Just one last question. Just around, maybe you could touch on the New York Clean Energy Fund that's being proposed, sort of the outlook for Ginna post the RSSA and then is there any impact to the put option with EDF?

Christopher M. Crane

President, Chief Executive Officer & Director

A

I'll let Joe Dominguez cover this.

Joseph Dominguez

SVP-Public Policy, Government & Regulatory Affairs

A

Sure. Good morning. As Chris said, at the top of the call, it's not the Clean Energy Fund, but it's the zero emission credit program that benefits nuclear. As Chris said at the top of the call, it's been a constructive development for us in New York. We still have quite a ways to go, but as a threshold, political matter, having a governor of the prominence of governor Cuomo step forward and propose to compensate nuclear fairly to keep it in business is important and if we get the details right I would go so far as to say it's kind of a watershed event for the industry.

But we don't have the compensation details sorted out yet. The RSSA at Clinton will expire in March of 2017. So practically speaking, we need to see the details for the New York program this year. Once we see those details, obviously it could provide incremental revenue that would factor into the put if that's what in fact occurs, but we don't have important details right now on the level of compensation or how the procurement mechanism would work. So it's all speculative until we do the work over the three months or four months and nail this down.

Christopher M. Crane

President, Chief Executive Officer & Director

A

In my conversations with the leadership at EDF, they are very comfortable with our operations on the nuclear side and in this market environment they are not looking at exercising the put at this time. So, we'll continue to work on the regulatory side and drive strong operational performance and we have a little time on Ginna, to the end of the RSSA in 2017 and like Joe said, we got a very supportive administration that recognizes the clean benefits of nuclear and that's really appreciated.

Shahriar Pourreza

Guggenheim Partners

Q

Congrats on the results.

Christopher M. Crane

President, Chief Executive Officer & Director

A

Thanks.

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

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