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Exelon Corp. (EXC)

Q2 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello and welcome to Exelon's second quarter earnings call. My name is Nora, and I'll be your event specialist today. All lines have been placed on mute to prevent any background noise. Please note that today's webcast is being recorded. During the presentation, we'll have a question-and-answer session. [Operator Instructions]

It is now my pleasure to turn today's program over to Dan Eggers, Senior Vice President of Corporate Finance. Sir, the floor is yours.

Daniel L. Eggers

Senior Vice President-Corporate Finance, Exelon Corp.

Thank you, Nora. Good morning, everyone, and thank you for joining our second quarter 2020 earnings conference call. Leading the call today are Chris Crane, Exelon's President and Chief Executive Officer, and Joe Nigro, 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 the presentation, both 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 material and comments made during this call. Please refer to today's 8-K and Exelon's other SEC filings for discussions of risk factors and other factors, including uncertainty surrounding the impacts of the COVID-19 pandemic, 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 reconciliations between the non-GAAP measures and the nearest equivalent GAAP measures.

I'll now turn the call over to Chris Crane, Exelon's CEO.

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

Thanks, Dan, and I appreciate everybody joining the call this morning and spending time with us.

Starting off, as you've seen from our releases this morning, on a GAAP basis we earned \$0.53 per share. On a non-GAAP basis, we earned \$0.55 per share. We had a great quarter, outperforming our guidance range of \$0.35 to \$0.45 per share due to achieving cost savings earlier than planned. Joe we'll get into it, but our load assumptions came out how we expected, but we've had excellent operations but also have confronted some serious challenges throughout the quarter.

First, ComEd reached an agreement with the US Attorney's Office in Illinois that concludes – includes a three-year deferred prosecution agreement and a payment of \$200 million – which ends the investigations into ComEd and Exelon. We have taken robust actions to identify and address deficiencies, including enhancing our compliance governance to prevent this type of conduct.

We apologize for the past conduct that did not live up to our values. These new policies and oversight will ensure it won't happen again. We're extremely disappointed in the seriousness of the past misconduct, and we know many stakeholders understandably feel the same disappointment. We have – you have our commitment that we will take every possible step to earn back the confidence and trust we have lost with others. This will not happen overnight and it will be a formidable task, but we're resolved to get there.

Second, our country is addressing the important issues of racial inequity and social justice, and we are doing so as well. Our employees and communities, our customers are diverse, and we have a critical leadership role in pursuing equity and fairness for all those who are facing ingrained injustice and discrimination. That means living our values both within and outside the walls of our company. Sponsoring job programs in underserved communities is a big focus of ours, developing a larger base of diverse suppliers in our footprint, supporting through philanthropic and volunteerism a wide variety of organizations, pursuing equity and economic development, making it clear what our values are through action, and speaking up when we see injustice.

Our focus on our values and respect diversity and inclusion cannot waver, and we know black lives matter. All our diverse communities matter, and we're standing to protect them and help serve them. We've doubled down on our work to support our diverse and underserved customers and communities since we all are impacted by continued inequity, and we must do more.

Switching to the COVID issue, COVID-19 continues to impact our communities. We remain focused on the safety of our employees, running our operations at best-in-class levels, and supporting our customers and communities, incorporated pandemic-related policies into our management model that keep our employees and our contractors safe, implementing responsible reentry plans that are predicting on key milestones that will ensure employee safety and confidence that they can come back to the workplace.

We've created contingency plans to monitor system configuration and allow us for rapid emergency response in storm or normal operations, and providing a deferred payment arrangement for residential and low income

customers that are affected by the high rate of unemployment that we're dealing with in the communities that we serve.

On the operational highlights, operations are strong with pandemic conditions and extreme storms across the territory. In early June, PECO faced its eighth largest storm in history, which brought sustained winds of over 40 miles per hour and gusts of more than 60 miles per hour, 400 customers were out within an hour of the storm beginning, but we were able to restore 80% of those customers with widespread damage in 36 hours.

We had already prepared and drilled new procedures for storm response during the pandemic. Eighty percent of our back office storm rolls are performed now remotely. Within 48 hours, 3,750 contractors and mutual assistance personnel were safely onsite in the PECO region to restore customers and onboard – they were onboarded electronically, which we continue to develop the techniques for that. Despite the pandemic and the active storm season, all utilities are in top quartile for outage duration and outage frequency.

Nuclear had its best second quarter capacity factor in more than a decade at 95.4%. Safety, we safely completed in this quarter five refueling outages. There have been eight for the year, and most ahead of schedule while protecting our employees and the contractors. Power dispatch match was 97.4% and our renewable capture rate was 92.7%, so overall very, very strong operational performance.

We also continue to focus on our environmental stewardship. In July, we released our 2019 corporate sustainability report that shows the accomplishments that we made. Benchmarking air emissions report once again found Exelon has the lowest carbon emission rate of the top 20 investor-owned power producers, nearly five times less than the number two producer and the largest producer of carbon-free generation.

In 2019, utility energy efficiency programs helped customers save 22.3 million megawatt hours and avoid 8.7 million metric tons of carbon. Exelon utilities set a goal to electrify 30% of the vehicle fleet by 2025 and 50% by 2030, avoiding more than 65,000 metric tons of carbon from 2020 to 2030.

We're committed to deliver affordable zero-emissions power and helping our customers and our community reduce the harmful emissions that exist in their communities. These efforts are important to transition to a clean energy economy, but they are not enough to address the climate crisis. We continue to advocate for policies at the state and federal levels that will address the challenges.

Now I'm going to turn the call over to Joe for the financial update.

Joseph Nigro

Senior Executive Vice President & Chief Financial Officer, Exelon Corp.

Thank you, Chris, and good morning, everyone. Today, I will cover our second quarter results, our quarterly financial updates, including trailing 12-month ROEs at the utilities, and our hedge disclosures.

Turning to slide 9, we earned \$0.53 per share on a GAAP basis and \$0.55 per share on a non-GAAP basis, which exceeded our guidance range of \$0.35 to \$0.45 per share. Exelon Utilities delivered a combined \$0.29 per share net of holding company expenses. Utility earnings were modestly higher relative to expectations, driven largely by ComEd formula rate timing and O&M timing, which was partially offset by the record-setting storm in the Philadelphia area, which cost \$0.04 per share to PECO.

ExGen outperformed expectations for the second quarter, earning \$0.26 per share. The upside was largely driven by lower O&M, where we saw targeted savings for 2020 coming sooner than we originally budgeted. These

savings were realized by lower outage costs, lower labor costs, travel and entertainment and training costs being lower as well.

On the last call, we announced \$250 million of savings across the organization to help offset the impacts of COVID-19, which we expected would be more weighted to the back half of this year. The organization has been hard at work and is on track to achieve these savings in 2020, with some coming earlier than anticipated, as you can see in our second quarter results.

During the quarter, load at the utilities and Constellation was in line with our expectations. For the third quarter, we expect earnings of \$0.80 to \$0.90 per share, and we are affirming our full-year guidance of \$2.80 to \$3.10 per share.

On slide 10, we show our quarter-over-quarter earnings walk. The \$0.55 per share in the second quarter of this year was \$0.05 per share lower than the second quarter of 2019. Exelon utilities less HoldCo earnings were down \$0.10 per share compared with last year. The decrease was driven primarily by storm costs at PECO, ComEd formula rate timing, and higher bad debt expense, partially offset by favorable weather at PECO. ExGen's earnings were up \$0.05 per share compared with last year, benefiting from lower O&M and income taxes. This was partially offset by lower capacity revenue, primarily in PJM, and the impacts of COVID-19 on load and bad debt expense.

Turning to slide 11, looking at our utility returns on a consolidated basis, we remain in our consolidated 9% to 10% target range, with a 9.1% trailing 12-month ROE as of the second quarter. Earned ROEs for the utilities remained above 9% but dipped from last quarter by 60 basis points. The decline was primarily driven by lower earnings at PECO as a result of the June storm, higher bad debt at PECO and PHI, and declining Treasury yields, which impacted ComEd's ROE.

As a reminder, this calculation is backward-looking. So as we think about the next couple of quarters, you should expect to see some pressure on ROEs as we roll off the better pre-COVID-19 earnings quarters and carry the burdens of PECO's poor first quarter weather and second quarter storms as well as the impact of lower Treasuries on ComEd. These headwinds are captured in our full-year guidance, so you should have the financial impact already assumed. Looking further into the future, we remain focused on delivering stronger earned returns at the utilities and supporting our growth targets.

Turning to slide 12, since the last call, there were some important developments on the regulatory front. First, regulators in all our jurisdictions have approved COVID-19 recovery mechanisms. Second, BGE was the first utility in Maryland to file a multiyear plan after getting the green light on this approach from the Maryland PSC in February. The filing will support planned capital investments from 2020 to 2023 as well as investments made in late 2019 to maintain and increase reliability and benefit customer service for our electric and gas distribution system.

The critical infrastructure sector will be a key component to Maryland's economic recovery, and BGE has designed a multiyear energy infrastructure investment and customer relief plan to assist with the economic recovery. BGE will invest more than \$5 billion to fund enhancements to the safety, reliability, security, resiliency, and environmental attributes of the grid and improve customers' experience.

BGE is expected to support more than 26,000 jobs and have at least \$15 billion of economic impact over the three-year period, which is critical as communities manage through the pandemic recovery. In conjunction with

the filing, BGE will provide customer relief and assistance in 2020 to 2023 for limited income customers and small businesses. We expect an order this December.

Third, in June, Pepco filed their multiyear plan enhanced proposal in DC with the PSC, addressing the impacts of the COVID-19 pandemic and current economic challenges. The enhanced plan would expand and establish a series of customer programs, targeting those that have been hardest hit, including small businesses, non-profits, and our residential customers. The flexibility of the multiyear plan structure provides Pepco the ability to offer these innovative adjustments in response to the pandemic. We expect an order by year-end.

Fourth, ComEd's annual formula rate update filing is expected to be decided in December of this year. This filing requests a reduction in delivery rates for the third year in a row and the fifth decrease in 10 years. Since the formula rate has been in place, ComEd's investments in modernizing the grid, reliability, resiliency, and clean energy growth have improved reliability by 70%, while keeping bills lower than they were nearly a decade ago.

And finally, last month, Delmarva Maryland received a final order for its distribution rate case. The Maryland commission approved the proposed order by the public utility law judge that recommended an \$11.7 million increase in annual electric distribution revenues. Importantly, the order increased Delmarva's allowed ROE by 10 basis points to 9.6%. We believe it is recognition of strong performance in reliability and customer satisfaction. More details on the rate cases can be found on slides 24 through 30 of the appendix.

Turning to slide 13, we are continuing our robust capital deployment program at the utilities, investing \$1.5 billion during the second quarter. Year to date, we have invested \$2.9 billion of capital into our utilities, improving our infrastructure and increasing reliability and resiliency for the benefit of all of our customers. Despite some early challenges from the pandemic, we are on track for the year.

Today I will discuss two projects that are part of these efforts and will bring improved performance to our customers in New Jersey and Pennsylvania. The first project is Atlantic City Electric Moss Mills-Moss Farm transmission line rebuild, which is a \$69 million project to rebuild 15 miles of 69 kV transmission lines and poles. This project upgrades a critical transmission line that runs through the entire northeastern portion of the Atlantic City territory in New Jersey spanning three different counties. Additionally, the Chestnut Neck substation will be retired and replaced with a modernized, mobile-ready substation, allowing for incremental flexibility.

The second project is PECO's Upland substation project in Philadelphia. The \$68 million project includes replacement of an existing 75-year-old substation with a new modernized substation and extension of 230 kV transmission lines and new 13 kV feeders into West Philadelphia. This project improves infrastructure that serves 10,000 customers in the Overbrook and Bala areas, including hospitals and universities. It will also enable customers to implement solar energy solutions. PECO engaged local diverse companies to participate in project implementation and construction, which provided approximately 250,000 construction hours.

On slide 14, we provide our gross margin update and current hedging strategy at the generation company. Turning to the table, there is no change in total gross margin in 2020 or 2021 since the last quarter. We executed new business consistent with our plan. In 2020, open gross margin was flat to the first quarter, and we executed \$100 million of power new business and \$50 million of non-power new business. In 2021, open gross margin increased by \$200 million due to increasing power prices across most regions. This was offset by our hedges and lower capacity revenues in New York and uncleared capacity from the PJM incremental auctions. In 2021, we executed \$50 million in power new business and \$50 million in non-power new business. We remain slightly behind our ratable hedging program in 2021 by 4% to 7% when considering cross-commodity hedges.

On slide 15, I'll give a brief update on Constellation's business and what we've seen to date on load performance. During the second quarter, commercial/industrial customer load was in line with our expectations. Load was within our down 9% to 15% projected range, although it varied from week to week. Our load forecast for the remainder of the year is unchanged. As we get more information, we are getting a better handle on the impacts from COVID-19, which is helping us to monitor how specific regions, customers, and industries are behaving with respect to COVID-19 impacts as they continue to evolve. Additionally, we are working with our large customers to better understand their load impacts and outlook.

Even as we evolve to an ever-changing landscape, our focus remains on being strategic partners with our customers and providing clean energy products. We work with our customers by providing proactive analytics and insights on their current loads, tools to manage and optimize in real time, and navigate emerging trends such as electrification impacts to their businesses while also reaching their environmental and sustainability goals. This partnership is key to our success and provides the most stability for our business via high retention rates and consistent margins.

Moving on to slide 16, we are committed to maintaining a strong balance sheet and investment-grade credit ratings. Our consolidated FFO to debt is projected to be 18% for 2020, consistent with last quarter. This reflects the pressures from COVID-19, as discussed in detail last quarter. Looking at ExGen, we are ahead of our debt-to-EBITDA target of 3.0 times. For 2020, we expect to be at 2.5 times and 2.0 times when excluding non-recourse debt.

On the ratings front, in July Fitch affirmed our ratings and S&P took action to downgrade ComEd's issuer credit rating. However, S&P reaffirmed the senior secured and short-term ratings at ComEd, therefore not impacting our anticipated cost of borrowing. Furthermore, S&P changed the ratings outlook for Exelon Corporate, PECO, Pepco Holdings, ComEd, and ExGen to negative from stable. While we were disappointed in these actions, we remain committed to maintaining a strong balance sheet and investment-grade credit ratings.

We have successfully executed all of our planned long-term debt financings for the year. The 2020 financing plan was significantly accelerated to take advantage of attractive market conditions and provide ample short-term liquidity, leaving us well positioned for the balance of the year. The issuances in the second quarter were all meaningfully oversubscribed, and we secured record-setting low interest rates at the utilities.

Thank you. I'll now turn the call back to Chris for his closing remarks.

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

Thanks, Joe, and thanks for your comprehensive report.

Finally, turning to slide 17, I'll close on Exelon's value proposition, which is unchanged. We're focused on growing our utilities, targeting 7.3% rate base growth and 6% to 8% EPS growth through 2023. We will use the free cash flow as we have done from the GenCo to support utility growth, pay down GenCo debt, and support some of the external dividend.

We continue to optimize the value of the Gen business by seeking fair compensation for our zero-emitting generation fleet, closing on economic plants, and monetizing assets and maximizing their value through the Constellation avenue. We will sustain strong investment-grade credit metrics. We have remained committed to that and will not waver, and we'll grow our dividend, at this point right now annually at 5%, through 2020. The

strategic underpinning of this value proposition is sound, effective, and providing tangible benefits for our stakeholders.

Operator, we can now turn the call over for questions. Thank you.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Shar Pourreza of Guggenheim Partners. Your line is open.

Shahriar Pourreza

Analyst, Guggenheim Partners

Hey. Good morning, guys.

Q

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

Good morning.

A

Joseph Nigro

Senior Executive Vice President & Chief Financial Officer, Exelon Corp.

Good morning.

A

Shahriar Pourreza

Analyst, Guggenheim Partners

Just two questions here. First on financing, as we sort of think about some of the moving pieces like obviously the size of organic growth at the utilities, minimal headroom from a credit perspective, the CENG buyout, potentially maybe higher uncollectibles, Joe, do you show in your current vision any kind of potential scenarios maybe in the next 12 months that would require you to have to issue equity?

Q

Joseph Nigro

Senior Executive Vice President & Chief Financial Officer, Exelon Corp.

Shar, thank you for that question. And as you know, we've received this question many times over the last few months. As I said in my prepared remarks, we're committed to a strong investment-grade rating. That's a central tenet to our business and it has been like that for a very long time. We go through a very rigorous planning process, and we disclose the results of that process each year on our fourth quarter call. And under that most recent plan, there is no equity issuance in the plan.

A

Last month, we kicked off that process for our next plan that will take us through the end of this year. And as you can imagine, Shar, there are many variables that go into that process: market prices for power; obviously Treasury rates; our load forecast; our O&M projections; what our capital plans are; our funding strategy when you think about debt; and obviously we still have the FRR [Fixed Resource Requirement] out there, and that will be taken into account.

What I would say is we don't take any one of those variables in isolation. They obviously all work together to create the basis for our plan. We've been successful with our strong balance sheet in growing our utilities, and we've been harvesting the cash flow of ExGen now to do that.

We also look at the levers we have. We've been pretty successful with our cost-cutting over the last five years obviously. We've sold some assets. We look at alternate financing arrangements. And the last thing on that list is equity. But in our current plan, there is no need for equity. And as we move through the planning process that takes us through the end of the year, we'll relay or communicate the outcome of that on our fourth quarter call.

Shahriar Pourreza*Analyst, Guggenheim Partners***Q**

Great. Thanks, Joe. And then, Chris, just a question for you on strategy. In the past, it felt like you weren't confident that the ExGen business at least for now would have IG ratings or sufficient scale. With what we're seeing with IPPs eventually going IG, which would certainly alleviate the liquidity requirements, others looking at their own merchant fossil fleet as they derisk, can you give us any refreshed thoughts on the GenCo as a strategic fit within the portfolio over the long term? I guess do you now have some incremental confidence that the GenCo business could eventually stand on its own without the support from corporate? A transaction would obviously alleviate balance sheet concerns and the valuation disconnect. And we've obviously seen a few players looking to simplify kind of their own structures. So whether we're talking about the entire fleet or simply the fossil fuel assets, has your strategic thinking kind of changed over the past, let's say, 12 months?

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

So it is something that we look at on a regular basis, and we do a deep dive strategic review of the benefits of keeping the two companies bolted – or two lines bolted together versus what are the alternatives. We have enjoyed a period of time of free cash flow from the GenCo that has allowed us to have a significant investment into the utilities for the benefit of the customers over a period of time since our last review. As you can imagine, it's something that we always look at, and I understand the basis of the question with the recent announcements from two other companies on where they have decided to go. But right now, there's work to be done to create the certainty and the value of the cash flows that would be maintained to allow a company to either stand on its own or continue to support the growth of the other side of the business.

And so, we're in the middle of trying to work through a legislative strategy in Illinois. We're on firm ground in New York. I know there's work going on in New Jersey. We have to look at the value of the assets and what's going on in Maryland and what can be done there legislatively to compensate the assets for their low carbon output. So it's something we look at, and it's something that we think we have been very clear on from the beginning.

And it's good to see other IPPs coming along and understanding the value of being investment-grade and not having stressed balance sheets with commodity cyclicalities like we see. But we think we can improve the value further and the strength further to be able to serve the states and the communities that we serve with good well-paying jobs, a strong balance sheet. And then we will continue to assess, do the assets stay bolted together through a corporate holding company structure, or is it better for all stakeholders involved to have some type of separation of the entities.

The one thing I can tell you is there's an annual review on all the non-nuclear assets to see if they propose more value to others than we have projected for ourselves, and that annual review will continue. And as we see assets that could perform better in somebody else's portfolio and we could monetize those assets, we'll do that. There's assets that we'll shut down that aren't carrying their own weight. There are assets in New England that have a

finite period of time under the ISO's regulation. And so, there is a constant flux in our non-nuclear business that we'll continue to evaluate, with our focus on strong balance sheet, debt reduction, and optimizing what we have on the balance sheet.

Shahriar Pourreza*Analyst, Guggenheim Partners*

Q

Terrific. Thanks, Joe and Chris, and congrats on good results in a tough year. I appreciate it.

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

A

Thanks.

Operator: Your next question comes from the line of Steve Fleishman of Wolfe Research. Your line is open.

Steven I. Fleishman*Analyst, Wolfe Research LLC*

Q

Hi, thanks.

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

A

Hi, Steve.

Steven I. Fleishman*Analyst, Wolfe Research LLC*

Q

So just – hey, Chris. The Illinois, I guess, ComEd deferred agreement and fine. Could you just maybe give views on implications that you're seeing for addressing the clean energy law, if any, and then also on future of the rate-making structure, anything you care to share would be helpful.

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

A

Sure. I'm going to let Joe Dominguez jump in on the second half of the question. He's here with us in the room. The first half of the question, does it affect the Exelon generation's drive for legislation on changing the capacity market? There's an obvious issue that trust has been eroded. Although it's isolated to ComEd, it has effect on all the entities. And so, there's been a lot of press reporting and there's been some disappointed stakeholders, and it's rightfully so.

And so, our job is to rebuild the trust of those that we serve and make sure that we can show that we have done a fantastic job – and Joe will cover some of this – in the investments that have been made at ComEd, and what the rate structure has done for us has been totally super-beneficial to the consumer. But there's a period of time where we're just going to have to continue outreach conversation and show our commitment to ethical behavior that doesn't compromise our integrity or the trustworthiness of us going forward.

So we're still working to engage with stakeholders on capacity market redesign. It's very critical for us to get it done. As you know, PJM is going to run an auction, and there's a strong sense from our analytic folks that some of the nuclear units are not going to be picked up in that auction; some are uneconomic at this point right now, and some more may become uneconomic.

And our commitment to you has always been, if we can't find a way or path to profitability, we'll have to shut them down, which is a sad turn of events that will affect the state's goals on carbon reduction. It will severely affect the communities around the plants and the very high-paying critical jobs that those communities benefit from.

So – but it's an unfortunate thing. We apologize for what went on. We had a code of conduct that clearly defined the behaviors, but it wasn't enough. And so, we've put controls in place to ensure it will never happen again. And we have to work with stakeholders, not only legislative and elected folks, but our customers and our other stakeholders and the communities that we serve to rebuild that trust.

The one thing I can tell you is this company is committed to doing the right thing for the communities that we serve, not only through philanthropic activities, but also volunteerism. I think you can look at us in all the communities that we serve and we're probably the strongest corporate partner out there, and we're going to continue that. And we know that we're only as good as a company as the communities that we serve, so that's what we've got to get back to. This is the most unfortunate thing to happen, not just because of time, it's because of trust, and it's because of a small amount of individuals making decisions that should not have been done and it shouldn't have gone undetected.

But with that said, we still remain confident that the consumers have been protected, served. And as you heard me say, we have lower rates and higher reliability than we did 10 years ago. And so that's because we have strong regulations, a regulatory body that's focused on the same thing that we're focused on, is reliable, affordable, clean energy.

With that, I'll let Joe talk about what his thoughts are on rate-making and regulatory process.

Joseph Dominguez

Chief Executive Officer, ComEd, Exelon Corp.

A

Thanks, Chris. Steve, good morning, by the way. I think Chris covered a lot of it. Just to level-set for the folks on the call, the formula rate continues through the end of 2022. So we have some additional time to see what the future looks like, whether it's a continuation of the formula with additional transparency or a return to traditional rate-making.

As both Chris and Joe have talked about, we think the formula has provided enormous benefits to our customers. If you take a look at page 7 on the deck, you see the key metrics and you see all green for ComEd. But in a certain sense, that almost understates the performance at ComEd. We are not only top quartile in all those dimensions, we're actually top decile in all of those dimensions. And last year at ComEd, we had the best-performing year ever in the history of the company, over 110 years the best-performing year. And as I look at the metrics at the close of July, we are tracking 20% better than last year in SAIFI and 11% better in CAIDI. So we've still got a number of months to go, but very, very proud of the team at ComEd and the operational performance. Customer satisfaction is the highest it's ever been. We were J.D. Power's number one Midwest utility at the end of 2019. We had never achieved that objective.

So I focus on that for two reasons: one, the transformation that's occurred at ComEd, and it's been recognized here; and second, we always tell you that from an Exelon perspective, and Chris says this virtually every call, that we think of good regulatory and political outcomes as being driven by good operational performance. And I think at ComEd, we can lay claim to perhaps having the best operational performance in the country.

So we'll see with that looks like going forward. From comments from the governor's office that we've recently seen, it's clear that, at least from his perspective, the formula was tied to the transformation that's occurred, the investments in smart meters and other devices. And to the extent that there's a renewal or a new methodology that's installed, it's going to have to be related to a new policy objective, and that's tied up in a lot of the clean energy goals.

But I guess from my perspective, Steve, whether we continue with the formula or whether we return to traditional rate-making, I think the entire team at ComEd believes it's going to be constructive. And one reason we're confident in that is that there's been an evolution in Illinois. As we've been in the formula, Illinois policy for rate-making has evolved. The state now uses forward-looking test years. And the gas utilities have used that, that's been constructive. We're decoupled as a state. We have bad debt and other rider mechanisms that are strong and transparent and better than we were in in 2011 when we first went to the formula.

But I guess the biggest difference that I would point to is the operational performance between 2011 and now is so much better. If you take the thesis that operational performance drives regulatory results, then in a certain sense the outcomes we were seeing in 2011 were driven by poor operational performance at ComEd, and today that's a different story.

And so the final point I would make is we've had an eight-year history of making the investments in underground cables and poles and including smart devices across our system. Not only – the commission has seen that now for eight years. What we'd be continuing, whether it's in a formula rate or traditional rate-making, is those programs that have been wildly successful in terms of improving reliability, integrating clean energy, making the system more resilient in the face of climate change, and doing all of that stuff and keeping customer bills low. As Chris said, our average bill today – or I think Joe said this – is lower than it was 10 years ago. And in part that's a story about wholesale power prices. But in a big measure, it's about energy efficiency at ComEd and the overall efficiency of the organization.

So the punch line for me is this, Steve. Regardless of whether we're in formula or not, I think we've got good alignment in terms of the investments we're making in the system. We're going to continue to make those prudent investments going forward, and I think the results are going to be constructive.

Steven I. Fleishman

Analyst, Wolfe Research LLC

Great, thank you very much.

Q

Operator: Your next question comes from Julien Dumoulin-Smith of Bank of America. Your line is open.

Julien Dumoulin-Smith

Analyst, BofA Securities, Inc.

Hey. Good morning, team. Thanks for the time.

Q

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

Hey, good morning. Thanks for joining.


A

Julien Dumoulin-Smith

Analyst, BofA Securities, Inc.

Q

Exelon Corp. (EXC)
Q2 2020 Earnings Call

 **Corrected Transcript**
04-Aug-2020

Thank you. Listen, perhaps just to pick up where we left off on the last question if I can, can you speak specifically to the utility and mending the relationship in terms of the franchise arrangement? Maybe that's a Joe question again, but can you provide some context in that process, the back-and-forth obviously in the public?

And then, at the same time, just to clarify the last question or the last response if you can, in the event in which the formula rates are not extended, it would be conceivable if you go back to traditional rate-making context in which you would benefit or at least you would have available to you those mechanisms you just alluded to, Joe. I just want to make sure we're explicit about that as well.

Joseph Dominguez

Chief Executive Officer, ComEd, Exelon Corp.

That's right. Chris, is it okay if I go?

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

Yes, go please.

Joseph Dominguez

Chief Executive Officer, ComEd, Exelon Corp.

Sure. So, Julien, let me answer the short question that you asked last first. Yes, if we return to traditional rate-making, we would intend to file a rate case using a forward-looking test year, and that rate case would likely be filed in the first quarter of 2023. So that's number one.

In terms of the franchise agreement, we've been through a process with the city where we've been meeting periodically, just about every week, although that got interrupted a bit with COVID. We're making good progress, I thought, on the franchise agreement. Then we had the DPA. And we had a hearing last week with city council and also some input from the mayor's office. The mayor's office indicated that from her perspective, two things need to happen before we could continue the conversation around the franchise agreement. One is we have to deal with the ethics reforms and the compliance mechanisms. And from my perspective, that is assuring the city that the measures we've taken are the appropriate ones, and then having reporting requirements and other things with the city so that they understand that we're implementing those and that we're moving forward appropriately.

The mayor has a big ethics agenda, so we're going to embrace that ethics agenda here. The hiring of Dave Glockner, which we've talked about before, is quite an important piece. Dave comes to us with an impeccable reputation. As many of you know, he came out of the US Attorney's Office serving as Chief of the Criminal Division of that office for 11 years. But most importantly and for folks outside of Northern Illinois, you don't see this. But Dave has an unbelievable reputation within the community. And for folks like the Mayor who have served in the US Attorney's Office as a colleague of Dave's, that's quite an important point.

But we need to work through ensuring that we have a transparent mechanism of providing regular updates to the city in terms of the adherence to the new protocols that we've adopted. That's one piece of it. The mayor has also indicated that we need to be committed to the goals of sustainability, to the goals of equitable and affordable energy for all customers in the city, and that's kind of the sweet spot of our strategy around electrification, around clean energy, energy efficiency, the many jobs programs we sponsor. So we look forward to a good conversation on that.

There's a tangential issue relating to the franchise agreement, that being the issue of the city's takeover or municipalization of the grid here in Chicago. We've spoken about that previously on this call. Commissioner Reynolds, who's leading for the city the negotiations with ComEd, testified at the hearing last week and indicated that the city will have a feasibility study out shortly on the possibility of municipalization. At least, he indicated in his testimony that the view would be that that would not be feasible. And there are a few big reasons for that. One is it's a \$5 billion to \$6 billion system, and then the separation cost would be another \$5 billion.

So I think we'll tie together a few of these issues here. We need to assure the city of the reforms. I've talked about we'll have a conversation about the programs around clean energy, electrification, jobs programs, benefits to customers affordability, and then I imagine we'll continue to have this backdrop of municipalization. But if the feasibility study comes out as Commissioner Reynolds indicated, I don't think that's going to necessarily be a pathway, but we have our work to do with the city.

I'm confident we will get there. It may take a year or more to hash out. That's something Commissioner Reynolds indicated as well. But the way our franchise agreement works, and I've talked about this previously on this call, is that if it is not continued, it simply rolls over year to year on its own terms. It's just like a lease in that sense, where it just automatically renews year to year. So that's probably more than you wanted to hear, Julien, but that's the whole story on the franchise agreement.

Julien Dumoulin-Smith

Analyst, BofA Securities, Inc.

Q

Excellent, guys. Thank you. I'll leave it there.

Operator: Your next question comes from Stephen Byrd of Morgan Stanley. Your line is open.

Stephen Calder Byrd

Analyst, Morgan Stanley & Co. LLC

Q

Hi, good morning

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

Hi, Stephen. How are you doing?

Stephen Calder Byrd

Analyst, Morgan Stanley & Co. LLC

Q

Good. Good. Congrats on a good quarter. I just want to follow up on Shar's question just as you think about your credit outlook. Joe, you gave a very thorough response. I was just thinking through, I guess, your prior plan, which did not include equity, had you hitting the credit stats. And you mentioned in response to the last question just a variety of things that could impact those credit stats. And I was just wondering at a high level, as you think about kind of the major puts and takes as you see it that can impact your credit stats, I was thinking about, for example, Constellation on one end in terms of the temporarily weak demand. But what are kind of the bigger puts and takes that you're just thinking through as you think about your credit stats since the last time you had the full planning process?

Joseph Nigro

Senior Executive Vice President & Chief Financial Officer, Exelon Corp.

A

I think there are a number of elements associated with that, right. Obviously, Treasuries have an impact at ComEd. They have an impact on our pension and other things, right. You think about market prices and you mentioned load; that clearly plays into it. We expect mostly to see recovery by the time we get into 2021. There are some minor impacts that we talked about the last quarter. We control things like cost, right. We'll continue to challenge ourselves in that regard.

There are other variables, too. We just talked about the Illinois legislation, what is the outcome of that. That will obviously be a binary impact. How much capital are we putting into our utilities and what that looks like? And all of those things go into the decision-making. Chris talked about uneconomic assets and actions around those. We've clearly sold assets where we thought the market had higher values on them. We've looked at alternative financings and have used project financing. We did the securitization of the receivables at Constellation.

So there's a lot of elements to it, Stephen. Some are kind of decisions we control, others where we're part of and we're working on, and they build upon themselves. And ultimately, our dividend, we have to make a recommendation to the board at the end of this year, and we'll do that, and determine how much capital we're putting in across our footprint. And then from there, we'll see what the funding plan looks like.

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

The one thing that I would add is the uneconomic. We will not run plants and lose free cash flow or earnings on assets that are not supporting themselves. It is very unfortunate for the communities that we serve, the employees, but we will not let the balance sheet get further deteriorated by non-profitable assets. And we will take swift action to resolve that dive in cash flow and earnings.

So, we're doing everything possible to prevent that, but it's a reality. We've shut two units down in the recent years. We could not see a path to sustainability of those assets in the portfolio. Not the greatest decisions we ever had to make, and we understand the impact that it has on the communities that we serve, the environmental goals of the states, and the economic impact of the states. But maintaining an investment-grade that can support the remaining facilities is our main focus.

Stephen Calder Byrd

Analyst, Morgan Stanley & Co. LLC

Q

That's very clear. Separately, just thinking about your cost control, you all have had good success in cost savings. Just thinking about potential benefits beyond the near term of those cost savings, is there any potential, for example, for that to create better customer rate headroom that could result in more CapEx at the utilities? How do you think about sort of sustainability of cost savings, and if you're able to sustain some of those savings, sort of what other knock-on benefits you could see?

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

Well, as you know, on the third quarter call each year we announce the next round of cost savings. I can tell you there's a significant effort in contingency planning going on within the generating company and the BSC, the business services company, now on if we maintain the fleet as we have it, how are we going to do it more economically, how are we using technology, but a significant amount of work in the financial organization, HR, legal, other organizations, to look at the world differently.

And we'll announce our next round probably in the third quarter? Fourth quarter. I'm looking at Dan to make I'm answering right because he's responsible for this. He's waving his hand at me, so the fourth quarter call. But we'll have a better picture of the future life of the nuclear fleet by that point. And if we are in the mode of, unfortunately, retiring plants, you can imagine that we'll have a significant reduction in the BSC overheads that could go back to the benefit of the customers from the modified Massachusetts formula; wouldn't necessarily say gives them more headroom to spend capital – we spend capital that is needed capital for reliability and customer service – but it should benefit the customers and take some of the overhead burden off of the utilities as we continue to refine how we can do work cheaper, better, faster, or be very efficient while serving the communities and the customers.

There's one thing we've learned during this pandemic. Our real estate footprint may not have to be as big as it is right now. We are very efficiently working with about 17,000 people working remotely. And there's a group right now that's assessing not only a safe reentry around the first of the year for some portion of the workforce that's not on the line and maintaining the system or the plants or backing those individuals up. But we will take a very strong look at all expenses around – and footprint around facilities.

We've closed the books with the controller's organization only having a few people come in for a couple days. And audit has maintained its schedule and its in-depth audit programs. So we're doing a lot and we're learning a lot. And I think that's going to translate into more savings as we go forward. But looking at Dan again, I guess I'm not going to be committal on the timing, but they're all squirming around me right now. Look, we'll be back to you at the end of the year with the outlook.

Stephen Calder Byrd*Analyst, Morgan Stanley & Co. LLC*

That's great. Thank you so much. I appreciate it.

Operator: Thank you. I would now like to turn the call back over to Chris Crane. Please go ahead, sir.

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

Thank you all again for joining the call. I want to thank you for the time. I really want to thank our employees for their commitment and dedication. As you can imagine, onboarding 1,200 contractors onto a nuclear site with all the site employees on deck going through testing and screening and answering the questions and still getting stuff done at world-class performance and efficiency, our utilities maintaining the highest levels of reliability. And right now we've got 200 folks – 100 ComEd employees and 100 contractors – driving across the country to support our eastern utilities for outages, so I think they arrived today. And so the willingness and the dedication is fantastic.

I hope that you and your families are safe and healthy. And with that, I'll close out the call.

Operator: Thanks to all our participants for joining us today. This concludes our presentation. You may now disconnect and have a good day.

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