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# Exelon Corp. (EXC)

Q2 2017 Earnings Call

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good morning. My name is Kayla and I will be your conference operator today. At this time, I would like to welcome everyone to the Exelon Corporation 2017 Q2 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there'll be a question-and-answer session. [Operator Instructions]

Thank you. Mr. Dan Eggers, Senior Vice President of Investor Relations, you may begin your conference, sir.

Daniel L. Eggers

*Senior Vice President-Investor Relations, Exelon Corp.*

Thank you, Kayla. Good morning, everyone, and thank you for joining our second quarter 2017 earnings conference call. Leading the call today are Chris Crane, Exelon's President and Chief Executive Officer; Joe Dominguez, Executive Vice President, Government and Regulatory Affairs and Public Policy; and Jack Thayer, Exelon's Chief Financial Officer. They're 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 discussion of risk factors and 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 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.

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## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

Thanks, Dan. And good morning and thank you, all, for joining us. We're pleased to deliver another good quarter. We achieved strong financial results, while continuing to enhance our operational performance and make significant gains on the policy front.

I'll begin by highlighting our financial performance and then briefly discuss some of the key policy and strategic objectives that are top of mind to many of you and us. Joe Dominguez will then cover in more detail the status of our recent wins in New York and Illinois, as well as our thoughts on potential PJM market reforms. Jack will walk you through the numbers.

As shown on slide 5, on a GAAP basis, in the second quarter, we earned \$0.09 per share versus \$0.29 last year. On an operating basis, we earned \$0.54 per share versus \$0.65 last year, which is near the top of our \$0.45 to \$0.55 guidance range. These are strong results relative to our expectations and led by ExGen.

Moving to slide 6. We continue to execute very well operationally with the second quarter extending some of the best-ers. On our color block chart shows key operating and customer satisfaction benchmarks for the utilities. Legacy Exelon Utilities again remained almost entirely in the first quartile, BGE and ComEd achieving first decile in CAIDI performance. BGE also delivered its best-ever SAIFI and CAIDI performance, and ComEd experienced its best-ever SAIFI performance.

And I'm proud to say that Pepco was identified in the J.D. Power study as one of the most improved utilities in customer satisfaction from 2016 to 2017. This is a great achievement and shows we are delivering on our commitments to our customers.

The scale of Exelon Utilities platform again significantly benefited our customers in the second quarter. We leveraged our management model and our geographic overlap to deliver better and faster service, particularly in the East. For example, in May, we dispatched Delmarva and PECO crews to assist BGE with the restoration of a multi-day natural gas outage that affected customers in West Baltimore.

The assistance provided by the other crews not only helped to reduce the outage time by a full day, but also allowed BGE to operate the balance of the system safely with a 100% gas odor response during the outage. We're glad to see our customers are benefiting from the Exelon Utility platform.

The nuclear team also had a great quarter. They achieved 90.9% capacity factor and completed six refueling outages. Nine Mile 1 registered its shortest outage duration on record.

In the power business, our assets performed well. Our two new Texas CCGTs, about 2,200 megawatts, are now online and fully operational. These plants are state-of-the-art and able to ramp up quickly to better serve the load that may come with the hot summer weather in Texas.

Moving to slide 7. We have seen several key developments in markets and regulatory matters. We had significant wins on the ZEC programs. As many of you already know, we prevailed on our motions to dismiss in both Illinois and New York, with both judges finding in favor on standing and legal merits.

These wins are strong affirmations of the ZEC program design. More importantly, these wins will support the continued operation of at-risk nuclear plants providing clean, affordable energy for our customers for many years to come. Needless to say, we are pleased with the results. Joe Dominguez will cover more of the details in a few minutes.

With respect to PHI, we wrapped up our first cycle of rate cases as part of Exelon with the DC order last week. Jack will discuss in more detail, but we're happy with the progress we're making at PHI operationally and on the regulatory front. We are pleased that in July the DC Court of Appeals affirmed the DC Commission approval of the PHI merger, resolving an open item.

PJM capacity results were announced on May 23 in all of our nuclear plants and PJM cleared the auction, except Quad Cities and Three Mile Island. The RPM results show considerable variability by year in the RTO zone. However, our disciplined bidding approach in recent years continues to provide greater stability in realized capacity revenues, which Jack will discuss shortly.

With Three Mile Island failing to clear PJM capacity auction for the third consecutive auction, we came to the difficult decision to close the plant in September of 2019 at the end of the next fuel cycle. A program that fairly compensates the plants for zero-emission energy, similar to what we have seen in New York and Illinois, is needed in order to continue operations.

It's important to note that the economic challenges facing TMI impact all nuclear plants in Pennsylvania. We remain hopeful that the state policymakers can find a solution that preserves these important assets. The total Pennsylvania nuclear fleet injects \$2 billion into the state's economy each year and supports 1,600 direct and indirect jobs.

With that, I'll turn the call over to Joe Dominguez, who will provide some details on ZEC challenges and other items.

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## Joseph Dominguez

*EVP-Public Policy, Government & Regulatory Affairs, Exelon Corp.*

Thanks, Chris. Good morning, everybody. As Chris said, I'm going to cover the ZEC rulings, the current status of ZEC legislative efforts in other states, the DOE study, and PJM operational and market reforms.

Let me start with the court cases. Obviously, we're pleased with the decisions in the district courts. The Illinois District Court decision has been appealed to the Seventh Circuit Court of Appeals. We expect the New York Court's decision to be appealed to the Second Circuit Court of Appeals.

I want to make a couple of points about why we are very confident in the ultimate outcome of those cases. First, the district court decided these cases at a very preliminary stage, where as a legal matter the courts had to

assume all of the facts that the plaintiffs pled were accurate. Those facts were not accurate. But even under the plaintiff's versions of the case, the courts found that they had no legal claim whatsoever.

Second, as you may know, often times where a party prevails in a case on a procedural or standing issue, the court will not proceed to decide the substantive legal issues. That wasn't the case here. In both decisions, the district courts rejected the entire waterfront of the plaintiff's claims through the substantive and procedural issues. I think that speaks to how high a hill they will need to climb on appeal to reverse those decisions.

At the heart of it, the decisions reject the plaintiff's arguments that state policies that favor cleaner sources of generation violate federal wholesale markets. The district court for the Southern District of New York summed it up this way. It said that competing generators have no complaint that they don't qualify for state programs because "they made business decisions about how they generate electricity."

Policymakers and customers increasingly want reliable, low-cost, zero-emission electricity. That's what we do at Exelon. The ZEC policies begin to recognize that nuclear energy plays an important role in meeting those customer needs and we're going to continue to advance that argument in Pennsylvania and other states. We're actively developing coalitions and we're working with policymakers to educate them on the issues. And as Chris said, the issues don't just face TMI but the entire nuclear industry as a whole and the entire industry, of course, in Pennsylvania.

Let me be clear, we're not just working on ZEC issues. We don't think that's the only approach. We have said for a long time that we think that the best market outcome is to price attributes directly into the market in the case of greenhouse gases and price on carbon. And it's more clear to us now than ever that federal wholesale markets need to evolve to fully incorporate attributes like resiliency, fuel diversity, and environmental qualities of the generation resources.

If the markets don't evolve, then the markets are going to have a diminished role in energy policy going forward. I know that in the past we fielded questions on these calls about whether as a company we remain committed to markets. We are committed but the markets have to be well-functioning. Our commitment to markets only extends so far as it provides the best outcomes for our customers.

We have said for years that the markets have problems. Those problems are undisputed. We have had many workshops at FERC and other places talking about price formation as an example. Yet those issues have remained unresolved, and the consequence has been that some of the most valuable resources for our customers are being forced out by a market that hasn't been working. That's why we feel confident that the DOE study and a reconstituted quorum at FERC is going to address some of these longstanding issues.

Now, let me talk about the study and some of the PJM market reforms that I'm hinting at here. As you know, the study has been worked on for a number of months. Everybody wants to see it. We hope to see it at some point in time this month. We think that it is going to focus on baseload resources, on the critical role of nuclear and the critical role of other fuel sources that have resilient on-site fuel. We think that the DOE study is important because it will frame the objectives for the administration for the next four years and we think it's going to be an important signpost to inform the agenda at FERC.

Here's what we hope to see in the report. First, we want to see a recognition of the value of nuclear and an appreciation of the state programs in Illinois, New York and the other places that are going to adopt these programs.

Let me be specific. We expect the FERC to respect those programs and not to tamper with the functioning. There are a couple of MOPR complaints that need to be addressed. The ISOs do not support those complaints, but that is on the docket and ready for action by a new FERC. And we have talked to the Department of Energy about those issues and we've had productive conversations.

The second issue is that we need to look at the market design changes that have been long pending. As many of you know, PJM has recently put out a white paper on this issue, talking about energy price formation primarily in the off-peak hours, and the need for all forms of generation to be able to set price.

From our perspective, this is a very important issue, and we appreciate PJM's timeline which calls for a FERC filing sometime in the first quarter of 2018 and full implementation of the market reforms by the summer of 2018. We're going to push very hard to make sure that happens.

Third, we hope the Department of Energy puts a spotlight on the issue of resiliency. Let me spend a moment talking about that. We have talked about reliability in the form of being able to run the system even in the event that we have major electrical components that fail. But as increasingly the system depends on both intermittent generation and natural gas-fired generation that don't have the ability to secure fuel for long-term operations, we need to make sure that our customers get electricity even in the event of a long-term disruption of the natural gas pipeline system. That's something that currently is not being modeled and needs to be modeled.

So, PJM has recently put out a white paper on this subject with a schedule of activities. The first activity is to address operational reserves beginning this winter. Importantly, that doesn't require any FERC activity or any stakeholder support. That within the tariff is within PJM's full province. And again, we are pushing to make sure these things are done. That's an important start and should begin to be reflected in pricing this winter for baseload resources that provide the kind of resiliency that I'm talking about.

But that's not the end of this subject. We have to, as an industry and as a country, come to grips with this potential risk to our system and examine the possibility of multiple pipeline failures. And the policies that come from that should favor fuel generation sources that have on-site fuel, like nuclear plants, that could run for a year or two in the event of these emergencies.

So we're going to continue to focus on that, and those are really the three areas that we're hoping that the DOE will provide some guidance on. So, obviously, we have a lot going on in the policy space, we're making very good progress, but a lot of work remains to be done.

I'll look forward to taking your questions after Jack concludes his part of the presentation.

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## Jonathan W. Thayer

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

Great. Thank you, Joe, and good morning, everyone. My remarks today will cover our second quarter results, an overview of our current rate cases, an update of our gross margin disclosures and a review of some of the key events that occurred this quarter.

On slide 9, as Chris mentioned earlier, we had a strong second quarter financially and operationally across the company. Our non-GAAP operating earnings were \$0.54 per share, near the top of our guidance range of \$0.45 to \$0.55 per share. Exelon's Utilities less HoldCo expenses delivered a combined \$0.33 per share. Relative to plan, utility results were slightly favorable, primarily driven by O&M timing across all of the utilities.

Generation earned \$0.22 per share in the second quarter. This was favorable versus the plan, driven by the timing of O&M and realized gains from our nuclear decommissioning trusts. Our nuclear plants had another strong quarter with higher capacity factors than budgeted, and the Constellation team continued to deliver strong results with good customer wins.

Turning to slide 10. The \$0.54 per share in the second quarter of this year was \$0.11 per share lower than the second quarter of 2016. Overall, the utilities benefited from increased rates and higher rate base, partly offset by year-over-year weather impacts. ExGen was down year-over-year, primarily on the known impacts of lower power price realization and more planned refueling outages, partly offset by New York ZEC revenues.

On slide 11, our year-to-date earnings of \$1.19 per share are \$0.14 per share lower than the same period last year. The decrease is primarily driven by lower realized energy prices, partially offset by the New York ZEC revenues, with partial offsets from our utilities with higher rates supporting our ongoing reliability investments and a full-year contribution from PHI.

Turning to slide 12, we are reaffirming our full-year guidance range of \$2.50 to \$2.80 per share. We expect to deliver operating earnings of \$0.80 to \$0.90 per share in the third quarter, compared with \$0.91 per share last year. Our third quarter results will include a full quarter of contributions from the New York ZEC program that started on April 1.

In Illinois, the ZEC program went into effect on June 1, but the ICC has yet to conduct its ZEC procurement process. It's anticipated that the procurement events and the execution of contracts with winning ZEC suppliers will occur in the fourth quarter. Therefore, no revenues will be recognized until that process concludes. We would then include all of the Illinois ZEC revenues retroactive to June 1.

Moving to slide 13. Our utilities continued to execute, delivering strong earned returns in the quarter in addition to strong customer-focused operational performance. Looking at the trailing 12-month book ROEs, at PHI we saw some of the utilities register lower trailing ROEs relative to what we showed last quarter. The degradation was expected, primarily due to the timing of equity infusions that Exelon made into PHI in 2016 following the merger close.

For the legacy Exelon Utilities, our earned ROEs remain over 10%, lifting the consolidated Exelon Utilities platform to nearly 10%, including PHI. We still have work to do with the utilities to continue improving the product we're delivering to our customers, but we're happy with where the overall business is performing. As we've said before, we're confident in our ability to deliver on the plan that we put in place at PHI.

On slide 14, we updated the status of our rate cases. Since our first quarter call, the unanimous settlements in Delmarva, Delaware electric and gas cases were approved, with a combined revenue increase of \$36 million. We also received a commission decision in the Pepco DC rate case during the quarter with a revenue increase of \$37 million.

We've now completed our first cycle of planned rate cases in the PHI jurisdictions, with the second cycle already underway. We filed rate cases at ACE and Pepco Maryland last quarter, and just recently filed again at Delmarva Maryland during the second quarter. Combined, we are currently asking for \$168 million in revenues, which reflect recovery on multiple years of capital investments that have been made to improve the reliability of the grid across these jurisdictions.



We expect the final ruling on Pepco Maryland in the fourth quarter of this year, and decisions on ACE and Delmarva Maryland in the first quarter of 2018. We plan to file second rate cases in the remaining PHI jurisdictions later in 2017, and expect to have them resolved by the end of 2018, helping to put us in a position to earn our targeted ROEs in 2019.

We're proud of the hard work from our utilities and regulatory teams. These efforts are helping to bring PHI's revenues and earned ROEs back on course, while we simultaneously improve performance for our customers. More details on the rate cases and their schedules can be found on slides 35 through 42 in the appendix.

Turning to slide 15. The PJM base residual auction results were announced in May. We cleared 16.2 gigawatts of capacity in the auction, with the bulk of our capacity clearing in the ComEd and Eastern MAAC zones, which cleared above the rest of RTO pricing at \$188 per megawatt day.

We continue to follow a disciplined approach to bidding our plants based on their specific cost profiles. We believe this bidding discipline is the right strategy for our plants and has led to more stability in our capacity revenue streams than seen in other generators that have not been as disciplined.

Our Three Mile Island nuclear plant failed to clear in the PJM capacity auction for the third consecutive year with this auction. We've been losing both cash and earnings at the plant in recent years, and do not see a path to profitability as the market backdrop exists today. Accordingly, earlier in the quarter, we announced plans to retire the plant in the fall of 2019. We are engaged with stakeholders in Pennsylvania to find ways to preserve the plant, but we're still early in that process.

From a financial perspective, the closure will add \$0.04 to \$0.07 per share of EPS annually beyond 2019 depending on the refueling year. We expect to realize positive cumulative cash flows of approximately \$225 million through 2021 with the closure.

Slide 16 provides our gross margin update for ExGen. In 2017, total gross margin is flat to our last disclosure. During the quarter, we executed on \$200 million of power new business and \$50 million of non-power new business. We're highly hedged for the rest of this year and are well-balanced on our generation to load matching strategy.

Total gross margin decreased in the second quarter by \$150 million in 2018 due to the removal of EGTP from a portfolio as well as the impacts of lower capacity revenues in MISO and New York. Total gross margin in 2019 is down \$150 million from last quarter, driven by the removal of EGTP from the portfolio and the forecasted closure of TMI in September of 2019.

Let me be clear that, although gross margin is down due to the divestiture of EGTP and plant closure of TMI, the impacts of both are accretive to EPS and cash flow. The elimination of EGTP lowers gross margin by roughly \$100 million in 2018 and 2019, but is EPS-accretive by \$0.02 to \$0.03 per share in each of those years. So there are cost offsets you should consider.

And while we do not expect to close TMI until the fall of 2019, the retirement lowers our 2019 gross margin by roughly \$50 million, although the EPS impact is roughly \$0.05 positive. And as I said earlier, the retirement will be \$0.04 to \$0.07 EPS-accretive annually beyond 2019 depending on the refueling year.

From a hedging perspective, we ended the quarter approximately 11% to 14% behind our ratable hedging program in 2018, and 8% to 11% behind ratable in 2019 when considering cross-commodity hedges. The majority



of our length is concentrated in the Midwest to align with our fundamental view of spot market upside in NiHub. We remain comfortable being more open when we look at market fundamentals.

Turning to slide 17. On the topic of power market forwards, you have heard us and many others talk about the reduced liquidity in the forward power curves that arguably can create price distortions. We do not mean for this chart to be comprehensive, but it's illustrative of what has been happening in the forward power markets.

The top chart shows the volumes created on a cumulative two- and five-year forward period for PJM West on peak power using a six-month average to smooth some of the seasonal volatility. I would flag in this context that overall volumes have been on a pretty consistent decline, both in absolute terms and particularly when looking beyond two years, which can be seen in the narrowing of the two lines on the chart. Arguably more interesting when thinking about forward power price transparency is the amount of transactions in those years.

Looking at the lower right chart, prompt year volumes are over 71% of the five-year cumulative volumes, with 2019 representing another 23%. The volumes created in 2020 and beyond are only 6% of the total volumes, with 2021 nearly non-existent. Compared to last year, total volumes are lower and the amount of volumes in the out-years is even less.

We wanted to share some of this data with you, particularly as folks were thinking more about the roll forward of 2020 earnings estimates. We would note that our fundamentals group has a more constructive view on power markets than these illiquid forward curves suggest, but we appreciate that there is perceived safety in using the forwards. However, when running your numbers, we would just encourage you all to appreciate what is underpinning those forward prices.

Turning to slide 18, we remain committed to maintaining a strong balance sheet and our investment-grade rating. We have now removed EGTP from our credit metrics, which in turn has improved our consolidated net debt to EBITDA at year-end 2017 to 2.9 times, which is below our target of 3 times. If we focus only on recourse debt, our leverage is at 2.5 times EBITDA. We're pleased with the improvements in our balance sheet and we'll continue to focus on a combination of debt pay-down between ExGen and the holding company.

And with that, I'll turn the call back to Chris.

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## Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

Thanks, Jack. In closing, I'd like to remind you all that Exelon's success is a direct result of our people and the culture of performance and service that we've created as an organization. In June, we held our sixth Exelon Innovation Expo in Washington D.C. This annual event brings together employees, vendors, and other key stakeholders to share all the ways Exelon is working to embrace and advance the future of the energy industry. The expo is also an excellent opportunities for our employees across the company to share ideas, explore new technologies, drive collaboration, and push each other to do even better for our customers.

On slide 20, Exelon culture is also built on serving our communities, both externally and internally. We accomplished a lot on this front during the quarter and several awards really do stand out. First, Exelon is being added to the Billion Dollar Roundtable, which recognizes companies that spend over \$1 billion with Tier 1 diverse and minority-owned suppliers.

In 2016, we spent nearly \$2 million with these important partners. We are only one of 27 companies to be named to the roundtable, and the only utility or energy company. I especially want to thank Bill Von Hoene and Bridget Reidy for their leadership on expanding our supplier base to benefit our communities.

For the first time, Points of Light named us to the Civic 50, which recognizes the 50 most community-minded public and private companies in the United States. Our company strives everyday to better serve our communities, so this award is especially gratifying.

We're also named to DiversityInc's Top 50 Companies for Diversity, adding to our previous position as the best utility. We embrace diversity in all forms, so this represents an important distinction for our company.

On slide 21, the value proposition. We once again want to reiterate our value proposition, which remains the foundation of our commitment to the investors. We continue to grow the utility rate base at 6.5% annually through 2020 and regulated EPS by 6% to 8% annually through 2020, through capital investments that directly benefit our customers in each of our jurisdictions.

We continue to use the free cash flow generated at ExGen to fund incremental utility needs at the Utilities of \$2.5 billion and pay down approximately \$3 billion of debt over the next four years at ExGen and the holding companies.

We're focused on optimizing the value for our ExGen business by seeking fair compensation for our carbon-free generation fleet, closing uneconomic plants, selling assets where it makes sense to accelerate our debt reduction plans, and maximizing value through the gen-to-load matching strategy. We will continue to focus on sustaining strong investment-grade credit metrics and growing our dividend in a consistent, visible manner.

So I'd like to thank you, all, for joining again and for your interest. And now, we're ready to take questions.

## QUESTION AND ANSWER SECTION

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

Greg Gordon

*Analyst, Evercore ISI*

Q

Thanks. Good morning.

Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

A

Hey, Greg.

Greg Gordon

*Analyst, Evercore ISI*

Q

I think you covered this in the script, but I just wanted to make sure I heard it clearly. You went through the puts and takes associated with the changes in the gross margin outlook. And despite it being lower, a lot of that is coming from assets that are removed from the portfolio. And then there's obviously offsetting costs below the line that make that cash and earnings accretive.

So you don't have the slide in your deck, but you've periodically put it in the slide that shows the 2017 to 2020 ExGen free cash flow profile. Should I presume that you're still on track to generate enough cash to create the \$2.8 billion to \$3.2 billion in ExGen/HoldCo debt reduction that you've articulated?

Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

A

Yes.

Jonathan W. Thayer

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

A

Greg, we've been – yeah.

Greg Gordon

*Analyst, Evercore ISI*

Q

Okay. And then my second question is, given that how much you've improved your debt to EBITDA, both on a recourse and non-recourse basis, I know that you've talked about thinking about pivoting from ExGen debt reduction to parent debt reduction. But there's also a point in time here in the future where I think you guys were going to revisit the board with a conversation about the dividend growth rate.

So, given that you seem to be ahead of schedule on achieving your debt reduction goals, can you give us an update on how you're contemplating the conversation around the dividend to evolve?

Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

A

So, as we've discussed in previous calls, we gave you a three-year window, a three-year look on our dividend and the annual increase. We'll be in discussion with the board through the next couple of board meetings on what our continued dividend strategy would be for a period of time. We'd like to give you a three- to five-year look ahead and that would be timed somewhere around in the first quarter, as the board deliberates on that.

So we are balancing, looking at [indiscernible] (32:27) the strong balance sheet, any drag from interest expense at the HoldCo, the value that we can create through either dividend increase or debt reduction. It's top of mind and going through the analysis phase right now, and hope we'll be able to give you positive news very soon.

Greg Gordon

*Analyst, Evercore ISI*

Q

Great. One final question. From time-to-time, investors contemplate with a greater or lesser degree of certitude the thought process around whether you guys would ever consider splitting ExGen from the Utility business and under what circumstances that would be appropriate? And I guess, the water cooler talk around that, frankly, went up demonstrably after the successful floatation of Vistra on the New York Stock Exchange and the valuation at which they're trading.

Can you talk about how you think about and contemplate sort of significant long-term changes in strategy like that and whether that is, in fact, something that would be now an increased probability, given the facts as they lay today?

Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

A

Yeah. I wouldn't say there's an increased probability. As you would imagine, we need to look at our business strategy on some routine basis, as we do. We look at the combination of the ExGen and the Utility business right now, and our capabilities, while maintaining strong balance sheets, be able to do significant investment for our customers around reliability and innovation on the Utilities. So, having a free cash flow machine that's being given more certainty on its capabilities by programs like the ZEC and the fantastic work that Constellation achieves through the margins that they create, we like what we're doing right now.

What we have said in the past is we believe that we're undervalued and that we need to be seeing that value increase in the market as we make these accomplishments. We felt we're at a [ph] prove-me (34:51) state on PHI that not only do we have to integrate them successfully into our management model and drive the performance to our operational standards that we've set at the other Exelon utilities, but also achieve what is a fair and reasonable recovery on rate cases. And we're executing on that now. And I think we're proving ourselves. And we think that that should be translated into a more reasonable valuation not only at the Utility level, but at the ExGen level.

So we'll strive to continue to really achieve some lofty goals and secure what we think is solid revenues and be able to reinvest those revenues into creating greater returns for the investors.

Greg Gordon

*Analyst, Evercore ISI*

Q

Thanks, guys. Appreciate it.

**Operator:** Our next question comes from the line of Jonathan Arnold from Deutsche Bank.

Jonathan Philip Arnold  
*Analyst, Deutsche Bank Securities, Inc.*

Q

Good morning, guys.

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

A

Hey, Jon.

Jonathan Philip Arnold  
*Analyst, Deutsche Bank Securities, Inc.*

Q

So, Greg asked one of my questions, the strategy question. But if I could just – is there a timeframe, Chris, on when you would want to see that sort of realization and validation of your strategy and value? What sort of timeframe would you kind of want to succeed by before you'd consider an alternative?

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

A

Yeah. I think, Jonathan, we're seeing it this year. You can see that the stock is starting to perform better, which reflects a better valuation. We think there's more room to grow over the next year to two years, as our programs are solidified around the nuclear assets and new potential programs are put in place around price formation and other value-creating mechanisms.

The multiple that we see at the Genco should improve. We differentiate our sales from any other merchant generator with not only the class of assets we have, but the programs that recognize those class of assets. So we should see those come to strong fruition over the next year to two, and we'd like to see the compensation for it.

We also believe that we're doing a really great job on what we've committed to to the customers around reliability and service at all our utilities and gaining fair returns. Catching up a little bit on the PHI utilities in productive rate cases should also be a catalyst for achieving a better multiple on the EPS. So, next couple of years, we should be where we want to be at.

Jonathan Philip Arnold  
*Analyst, Deutsche Bank Securities, Inc.*

Q

So is it fair to say that P/E multiple is your main yardstick, then, you're looking at in terms of determining whether you've closed the gap to your satisfaction?

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

A

Well, as you do, we do a sum of the parts and look at the valuations and look at where we think we should be. That is one of the indicators. But the EBITDA multiple on the Genco is also a key indicator for us.

Jonathan Philip Arnold  
*Analyst, Deutsche Bank Securities, Inc.*

Q

Okay. Great. Thank you. And just on one smaller item. It looked like the financing needs at ExGen versus last quarter for this year came down about \$300 million. Is that to do with asset sale or something else, what's driving that change? The cash flows...

Jonathan W. Thayer

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

It's the proceeds from the joint venture.

A

Jonathan Philip Arnold

*Analyst, Deutsche Bank Securities, Inc.*

But the number is lower, though, Jack, is the...

Q

Jonathan W. Thayer

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

We had a tax gain on the sale.

A

Jonathan Philip Arnold

*Analyst, Deutsche Bank Securities, Inc.*

I got it. Okay. Thank you very much, guys.

Q

**Operator:** Our next question comes from the line of Steve Fleishman from Wolfe Research.

Steve Fleishman

*Analyst, Wolfe Research LLC*

Hi. Good morning. Couple quick questions. The comments on 2020 and the forwards, I guess we'll see in time, but just in the event that your fundamentals are wrong and the forwards are right, is there more that the company can do on costs and the like to deal with that?

Q

Jonathan W. Thayer

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

Steve, it's Jack. We have a long history of being proactive on costs. And our cost reduction programs are just generally part of our corporate DNA. So, over the past five years, we've saved \$500 million of synergies from the Constellation merger, another \$75 million from the integration of CENG. \$350 million of cost reductions from our November 2015 program, another \$125 million of savings from the November 2016 program, and we're on target for \$130 million of synergies from the PHI deal.

A

And just from a philosophical standpoint, we manage our business for the worst, Steve, while expecting a better outcome. And you can and should expect us to continue focusing on opportunities to run our business more efficiently and pull out additional costs.

We view cost management as incremental each year and building on what we've already done rather than a big one-time transformative event. Our regular increases in cost savings opportunities we think have added up to real economic value, and you should continue to see us focus on continuous improvement and driving further savings in the future.

Steve Fleishman

*Analyst, Wolfe Research LLC*

Okay. Good. And then, just on the PJM market structure changes, any sense on what they could possibly do to market pricing? Like, how much they could impact market?

Q

Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

Joe?

A

Joseph Dominguez

*EVP-Public Policy, Government & Regulatory Affairs, Exelon Corp.*

Yeah. Steve, we're not there yet. We're evaluating that, but we need some more details out of PJM around the program design. I think, as a general matter, you'll see some improvement in around-the-clock energy, specifically off-peak. And you'll see some benefits for the consumer on the capacity market side as those prices ought to go down.

But for machines that drive most of their revenue in the energy market like the nuclear machines, this will be a good outcome and we'll be supportive of keeping those lowest cost options available for our customers long-term.

Steve Fleishman

*Analyst, Wolfe Research LLC*

Okay. One final question, I guess, maybe for Chris. Just with the announcement earlier this week of the summer shutdown or abandonment, I'm just curious kind of from a nuclear support overall, does this better make your case of supporting existing nuclear or does it somehow make the other case that this is going to phase out over time anyway? Just thoughts there.

Q

Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

No, I think there are two different issues. One, it's not good for the industry to have the next wave of plants go through financial stress and the mismanagement by the suppliers to the industry. That is unfortunate. And we understand the decision that's been made to not go forward with the risks that they still have around it and the financial burdens that it would create for their customers. So, that's one thing.

If you look at what we're talking about with our nuclear assets, they are definitely providing a product and a service unlike any other generating assets, not only is it the reliability that we load a core for 18 to 24 months and they can run through any weather cycle and are not dependent on a fuel delivery that allows a baseload generation, a level of reliability to the system.

The compensation that should be sought and granted for their environmental benefits to the communities they serve. An example of Illinois' power stack, 60% of the power in Illinois is carbon-free. 90% of that comes from the nuclear facilities. It allows the state to make its goals that it wants to make on carbon reduction. And without these assets being fairly compensated, that would go in the opposite direction.

And finally, these assets that do provide the societal benefit around carbon and the societal benefit around reliability and sustainable national security, they also are great economic supporters of the communities they serve, the tax bases for the schools, the parks, the employment base. So, on many levels, they've been evaluated as critical and should be compensated for the lifespan that they have remaining to provide a bridge to what could be that source of energy that provides that same level of the great attributes going forward.

Steve Fleishman

*Analyst, Wolfe Research LLC*

Q



Okay. Thank you.

**Operator:** Our next question comes from the line of Praful Mehta from Citigroup.

**Praful Mehta**

*Analyst, Citigroup Global Markets, Inc.*

Thanks so much. Hi, guys.

Q

**Christopher M. Crane**

*President, Chief Executive Officer & Director, Exelon Corp.*

Morning.

A

**Praful Mehta**

*Analyst, Citigroup Global Markets, Inc.*

Morning. So, looking on the ZEC, has the win in New York and Illinois help set the framework or ease the discussion with other states, as in are you having more productive conversations given the legal win?

Q

And secondly, I guess linked with that, if it does roll out in other states over time, how do you think about capital allocation at that point, given you've already kind of hit your metrics from a credit perspective at ExGen with the current plan? Is it more just de-leveraging at the parent company or what else do you think in terms of capital allocation?

**Christopher M. Crane**

*President, Chief Executive Officer & Director, Exelon Corp.*

I'll let Joe cover the first part and Jack can go through our plans on the second part.

A

**Joseph Dominguez**

*EVP-Public Policy, Government & Regulatory Affairs, Exelon Corp.*

Yeah, I think the answer to the first part is yes. It does provide a bit of a catalyst for better discussions in other states. One of the themes that the opponents often roll at is that these policies have questionable legal merit. And so they talk to politicians and they say, why would you take a tough vote on this only to have it overturned in the court.

A

So these decisions resolve that issue and we expect, as these decisions get solidified in the appellate courts, that it'll provide additional catalysts for those discussions in other states.

**Jonathan W. Thayer**

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

And then, Praful, just in terms of capital allocation, as you mentioned, our balance sheet is in a stronger position this quarter than it was last quarter. We're effectively at the target that we set in the fall of last year. And what that allows us to do is much greater flexibility on where we focus our debt retirement plan.

A

So I think you'll see us, depending on maturities, look at both the holding company as well as ExGen for future retirements. And it obviously gives us a much greater degree of visibility and certainty around those cash flows, which I think plays into Chris's response on the valuation. We would expect that the valuation metrics for our generation company reflect the reduced volatility that's associated with these important assets.

Praful Mehta

*Analyst, Citigroup Global Markets, Inc.*

Q

Got you. But then, after the debt reduction targets are hit at the HoldCo, from either buyback or even dividend perspective, is that on the table as well?

Jonathan W. Thayer

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

A

I'd say we have plenty of holding company debt to retire and that provides us with considerable flexibility, and it's one of the items we'll be looking at, as Chris mentioned, in our review with the board of the outlook for the company and its strategic plan around dividend and other capital allocation decisions.

Praful Mehta

*Analyst, Citigroup Global Markets, Inc.*

Q

Got you. And secondly, just the interesting slide you provided on the market liquidity and what that means in terms of forward curve, does that also mean that acquiring more retail footprint or a larger retail footprint is a good way to mitigate some of those liquidity risks, given forward curves are just not there and you need to hedge? Or do you think this will just play out with spot prices being higher than forward curves over time?

Joseph Nigro

*CEO-Constellation & Executive Vice President, Exelon Corp.*

A

Praful, good morning. It's Joe Nigro. It does imply that the best way for us to get to market with our generation is through our load serving business. As you know, we have a very substantial commercial, industrial and residential business, and that we also participate in all the wholesale load serving auctions, and we'll continue to do that.

And our portfolio of output on the generation side is well-balanced with our power load portfolio. And we use the standard product market to what I would call filling gaps geographically or for timing or other things. But the balance with our gen-to-load matching strategy is very strong and we'll continue to do that.

Praful Mehta

*Analyst, Citigroup Global Markets, Inc.*

Q

Okay. So you don't need incremental retail at this point. What you have already is fully matched is what you think.

Joseph Nigro

*CEO-Constellation & Executive Vice President, Exelon Corp.*

A

If we see an opportunity and it makes economic sense, I think you've seen in the past with the acquisitions of both Integrys as well as ConEd, they've been value enhancing to the bottom line and we've been disciplined in how we'll do it and we'll continue to take that approach. And if there's an opportunity in the future to bolt-on more retail, it'd be a good fit for our portfolio, we would definitely do that.

Praful Mehta

*Analyst, Citigroup Global Markets, Inc.*

Q

Got you. Thanks so much, guys.

**Operator:** Our next question comes from the line of Michael Weinstein from Credit Suisse.

**Michael Weinstein***Analyst, Credit Suisse Securities (USA) LLC*

Q

Hi, guys. Hey. Just to follow up a couple of earlier questions. Could ExGen be spun just publicly, even a small amount of it, just to establish that independent validation evaluation, and while still enabling you to benefit from its cash flows and other innovation benefits at the Utilities?

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

A

We'd have to think through that one. Right now, we have a very solid strategy on growth and value creation with the ExGen cash flows. So it differentiates us and we're not issuing equity at the holding company to support this growth. There's no dilution coming in with this growth. It is very strong organic growth. We're adding another PHI over the next couple of years without paying a premium.

So, in Q2, want to validate its value by spinning it off would not be probably the approach that we would go for. If we ever found that the value is constrained or our strategic growth was hampered based off of the companies being together, you could have that conversation to create value. But there's no reason that having them together and using the synergies that we have between having the two companies, that we shouldn't be valued fairly for that as we execute on our strategic plan.

So, could you physically possibly spin a Genco? You could, and then you'd have to consider when you did that what's its investment grade, what's the impediment on its trading business, what's the issue with going to the capital markets to maintain your nuclear plant, all kinds of hair around that.

But we like what we're doing right now. We like the way that we're creating the value. And we think we are differentiating ourselves, as I've said, from any other merchant generator in the business. Strong balance sheets, different class of assets, fairly – very well run, and fairly matched to our load book.

So we like where we're at and wouldn't speculate on anything else, and really can see the value creation and want the market to recognize it as we do execute on what we say. We tell you we're going to do something, we do it, and it comes in in value creation to you.

**Michael Weinstein***Analyst, Credit Suisse Securities (USA) LLC*

Q

And also, just to clarify on Jack's earlier remarks, with ExGen's projected gross margins a bit lower in the forward curve and also from the removal of other assets, the offset that allows you to achieve \$3 billion of debt pay-down, that that target has not been changed, it's mostly efficiencies, cost savings, and that kind of thing?

**Jonathan W. Thayer***Chief Financial Officer & Senior Executive Vice President, Exelon Corp.*

A


It hasn't been changed.

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

A

It's cash flow-positive, the retirement of TMI.

**Exelon Corp. (EXC)**  
Q2 2017 Earnings Call

 **Corrected Transcript**  
02-Aug-2017

Jonathan W. Thayer

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

Yeah.

A

Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

It's...

A

Jonathan W. Thayer

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

\$225 million through 2021. With EGTP, we have the debt – what's that?

A

Joseph Nigro

*CEO-Constellation & Executive Vice President, Exelon Corp.*

JV.

A

Jonathan W. Thayer

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

All right. And we have the proceeds from the renewables JV. Where EGTP is \$0.02 to \$0.03 accretive, TMI is \$0.04 to \$0.07 accretive. So I think we're very comfortable with our outlook for free cash flow. And we'd expect to update the number that we provide in the Q4 call in next year.

A

Michael Weinstein

*Analyst, Credit Suisse Securities (USA) LLC*

Okay. Very helpful. Thank you.

Q

**Operator:** Our next question comes from the line of Shar Pourreza from Guggenheim Partners.

Shahriar Pourreza

*Analyst, Guggenheim Securities LLC*

Morning, guys.

Q

Jonathan W. Thayer

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

Hey, Shar.

A

Shahriar Pourreza

*Analyst, Guggenheim Securities LLC*

So, most of my questions were answered. But let me ask, what's sort of the viability within your long-term plans around Colorado Bend and Wolf Hollow, especially given the fact that you're doing much more contracted cash flows at ExGen? Is there an opportunity to either look to hedge these out with the munis or sell it to other IPPs?


Q

Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

A

**Exelon Corp. (EXC)**  
Q2 2017 Earnings Call

 **Corrected Transcript**  
02-Aug-2017

These are assets that are unlike the rest of the stack in Texas with their efficiency, their flexibility on ramping. They do provide a good support to our load book. We built them from way below what market costs are for greenfield sites or even brownfield sites, with our work through our venture with GE and our contractors. So they were built at a good price. They operate very well. We do have a load book in Texas that they serve well. And there's no need, as you can see from our debt metrics, for a fire sale.

So our origination folks are constantly looking at longer-term contract sales, and they'll be doing that as they continue in Texas and match some of the book that we have to those potentials.

So, Joe can add any more onto that.

---

**Joseph Nigro**

*CEO-Constellation & Executive Vice President, Exelon Corp.*

A

No, I think you covered it, Chris. I think the big thing is, when you think about what we're doing with the disposition of the assets we currently own in EGTP, the fill-in of these two assets to our load book is very helpful when you think about the volatility in Texas and you think about ancillary services and how these units are able to ramp in such quick rates. I think it's a very nice fit.

And from an origination perspective, as Chris said, we look at all corners of the market and we serve all types of customers and we're open to all opportunities. and we'll continue to explore those, especially with these two new state-of-the-art assets.

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**Shahriar Pourreza**

*Analyst, Guggenheim Securities LLC*

Q

Got it. And then, Joe, might as well just ask you is, with the pending potential policy initiatives in Pennsylvania, and obviously made some great headwinds in Illinois and New York, how are you sort of thinking about you layering on hedges in Pennsylvania pending potential legislation that may come about?

---

**Joseph Nigro**

*CEO-Constellation & Executive Vice President, Exelon Corp.*

A

Yeah. We think about that a lot, and we've talked quite a bit about how we run our hedging program. It's not an independent decision. We work very closely with all the finance organizations, the risk management organization. And we have a program where we're looking at the needs of the cash flows and the earnings of the company, and we match our hedging profile to that, and make sure that we can maintain the credit ratings that we have and we focus on our liquidity. And all of those things put together drive some of the decisions with our program.

As you can tell, looking at our numbers, we're well behind our ratable hedging plan in both 2018 and 2019, and you could see that's the case in the Midwest and that's the case in Texas as well. And it aligns to our market views. But those aren't independent decisions. They're tied in directly with what we're doing with debt reduction and managing our balance sheet, and we will continue to do that.

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**Shahriar Pourreza**

*Analyst, Guggenheim Securities LLC*

Q

Terrific. Thanks, guys.

---

**Operator:** And our final question comes from the line of Angie Storozynski from Macquarie.

**Angie Storozynski***Analyst, Macquarie Capital (USA), Inc.*

Q

Thank you. So, one more question about the retail book. So I understand that this is a preferred way of hedging your generation portfolio, but most of your retail book is C&I and those are sophisticated customers who basically look at the forward curve and then add probably a margin to what they see in the curve. So, that wouldn't necessarily help you with the forward curve not fully reflecting supply and demand fundamentals. So, how about shifting maybe towards mass retail customers or increasing your presence in that business?

**Joseph Nigro***CEO-Constellation & Executive Vice President, Exelon Corp.*

A

We are the fifth largest residential marketer in the country now on the power side, and we will continue to focus on growing that business, similar to the way we're continuing to focus to grow our commercial industrial business.

Like C&I marketing, it is a competitive market and you have headroom that you have to take into account and customer behavior. But we continue to focus on all of that and our mass market business continues to grow each year and we've been very successful on that regard and we'll continue to push it.

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

A

With reasonable margins.

**Joseph Nigro***CEO-Constellation & Executive Vice President, Exelon Corp.*

A

Absolutely.

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

A

The discipline that's required to continue to grow in residential versus some competitors that may not have the same pricing margin, we don't need to chase volume, we chase margin.

**Angie Storozynski***Analyst, Macquarie Capital (USA), Inc.*

Q

Okay. And the second question is about your disclosures for ExGen. So, obviously, as you're pointing out with retirements or deconsolidations of your gas plants in Texas, there's an offsetting change in O&M. Why not show EBITDA projections instead of gross margin? Just to capture that O&M production which would then fully show the financial backdrop that the business has?

**Jonathan W. Thayer***Chief Financial Officer & Senior Executive Vice President, Exelon Corp.*

A

So, Angie, we think we give you transparency into the operating costs of the company. We update that on an annual basis at the beginning of any given year. And you can back into effectively the operating costs of EGTP and TMI with the EPS disclosure that we give you. And then, I guess, finally, we give you some incremental data on slide 33 that also should help you.

So I think we're very comfortable with the gross margin disclosures that we have. It allows us to update it on a quarterly basis without having to update the entirety of the income statement, and that's the plan going forward.

Angie Storzynski

*Analyst, Macquarie Capital (USA), Inc.*



Okay. Thanks.

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Christopher M. Crane

*President, Chief Executive Officer & Director, Exelon Corp.*

Well, I'd like to thank you, all, for your interest in joining us today on the earnings call. We look forward to seeing many of you at the fall conferences and hear your questions on the earnings call in November. So, thank you very much and that will end the call.

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**Operator:** This is the end of today's call. You may now disconnect, and have a great day.

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