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Exelon Corp. (EXC)

Q4 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Sarah, and I will be your conference operator today. At this time, I would like to welcome everyone to the 2017 Q4 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question-and-answer session. [Operator Instructions] Thank you. Mr. Dan Eggers, Senior Vice President of Investor Relations, you may begin your conference.

Daniel L. Eggers

Senior Vice President-Investor Relations, Exelon Corp.

Thank you, Sarah. Good morning, everyone, and thank you for joining our fourth quarter 2017 earnings conference call. Leading the call today are Chris Crane, Exelon's President and Chief Executive Officer; Jack Thayer, Exelon's Chief Financial Officer; and Joe Dominguez, Executive Vice President of Government and Regulatory Affairs and Public Policy. 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 discussions of risk factors and factors that may cause results to differ from management's projections, forecast, 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 over to Chris Crane, Exelon's CEO.

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

Thanks, Dan, and good morning to everybody and thank you for joining us today. Let me start by apologizing first for my voice is recovering from a cold as some of our other speakers are in the same place. So we'll try to make it through clearly without too much distraction.

2017 was a great year for Exelon, and I like to take a moment to talk about our business performance and some of our major accomplishments over the past 12 months. First and foremost, I'm pleased to report that Exelon delivered \$3.97 per share of GAAP earnings and \$2.60 per share of operating earnings for 2017. Jack will walk through the details, but I'd note that the earnings are solidly within the guidance range as we saw better utility, performance, and cost discipline absorbed \$0.09 of timing shift from 2017 to 2018 related to the Illinois ZEC contracts, and absorbed \$0.04 from FERC-related accounting changes.

Last week, the board approved our updated dividend policy, targets 5% annual growth for 2018 through 2020. It builds on our previous plan of 2.5% growth from 2016 through 2018 and keeps our recently shared goals of offering competitive dividend growth rates and providing a multi-year visibility. We're comfortable with the faster dividend growth rate, particularly in light of the significant positive business developments since 2016. We completed the PHI acquisition, increasing our earnings mix from utility operations. The New York and Illinois ZEC programs have preserved and extended the useful lives of our most valuable nuclear plants. And consistent with our inherent cost discipline, our forecasted O&M spend will be approximately \$725 million per year, lower in 2020 with the cost reduction initiatives identified since 2015. Jack will discuss our capital allocation plan shortly, but we're confident in our ability to grow our dividend competitively while meeting all our other capital commitments, and probably we're able to share more of our financial success with our shareholders throughout this updated dividend policy.

Tax reform passed at year-end is clearly a positive for us, allows for significant savings for our utility customers as the new tax rate flows through into lower bills. ExGen will benefit from lower tax rate and 100% expensing. In total, we see the run rate EPS benefit of \$0.10 in 2019. Operationally, we executed well in each area of our business line.

At our utilities, we invested a total of \$5.3 billion of capital in infrastructure and technology to provide a premier customer experience, fewer outages, and faster restoration times. That all contributed to higher customer satisfaction scores. In fact, our utilities achieved multiple best on record operational metrics and received national recognition for exceptional customer satisfaction.

Leading with our better service and performance, we are also busy on the regulatory front completing seven distribution and five transmission rate cases in 2017, and receiving a total of approximately \$400 million in revenue increases. Timely and fair regulatory outcomes help us to fund the future investment in the grid and improve the customer experience.

Our Generation fleet also performed well. The nuclear fleet produced 157 million megawatt hours, a record-setting year for Exelon, and we brought into service the two new CCGTs in Texas. I'm pleased to tell you that our fleet performed very well during December and January cold spell in the Northeast, once again demonstrating the value of nuclear generation as a highly reliable and carbon-free source of power.

On the regulatory and policy front, the ZEC programs in New York and Illinois were implemented, preserving several of our most at-risk nuclear stations and the reliability, economic, and environmental benefits they provide. We will continue to defend these programs as we work on similar programs in New Jersey and Pennsylvania that benefit our customers, our communities, and our employees. We also saw a recognition of the need to address the resiliency of the power system, an effort advanced with FERC's order in January. We believe a FERC order is an important step in addressing real resiliency and concerns. We urge FERC to adopt PJM's proposal around power price formation and adopt a comprehensive resiliency solution that we will realize that will take some more additional time to resolve. Joe Dominguez will discuss this in more detail later in the call.

We can talk about our successes this year without – or we can't talk about our successes this year without noting our strong commitment to corporate responsibility, improving and supporting the communities that we serve building on prior year's recognitions. In 2017, we were the first utility named to the Billion Dollar Roundtable, which recognizes companies that spend over \$1 billion with tier 1 diverse and minority home suppliers. Being an active part of our communities is a central tenet of Exelon, and this award reflects what we've been able to do for years. And in addition, DiversityInc named us one of the Top 50 Companies for Diversity, and the US Veterans Magazine named Exelon to its Best of the Best List of Veteran-Friendly Companies.

We also made a lot of progress in areas that will bring great value to our communities in 2017. We announced a new job training center in Washington DC modeled after the center we operate in Chicago. We were named to the Civic 50, a list of community-minded companies by Points of Light Foundation, and singled out as the utility sector leader. Exelon and its employees set new records in philanthropic activities, committing over \$52 million in giving and volunteering more than 210,000 hours in 2017.

Turning to slide 6, we'll show you the impact that Exelon's management model has had on our utility operations. Looking back to the Constellation merger for the legacy Exelon utilities, or since the merger with PHI, we've seen material improvement in operations across our utilities. The hard work of our employees and the benefit of our scale are clearly paying off. Our utilities primarily operate at first quartile levels across our key successes of reliability, safety, and customer service. However, this does not tell the full story of our performance with many performance at top decile levels across a number of these measures, and many being the best on record performance. In 2017 BGE, ComEd, and PHI had a best performance on (sic) SAIFI and CAIDI; and (sic) PECO and BGE and ComEd on customer satisfaction. Customer service remains central to the strong utility performance, and it did extremely well in this front in 2017.

In J.D. Power's customer satisfaction study, BGE earned the top rank for business electric service among the large utilities in the East. It was the best of 11 utilities in the region and was ranked highest nationally among 87 utilities in employee professionalism. Kudos to the hard work of our utility professionals who strive every day to provide service levels for our customers.

Turning to slide 7, we also had another strong year at Generation and Constellation. Our nuclear assets continue to perform at top tier levels. Look, we had a combined capacity factor of 94.1%, marking over 94% utilization rate for the four of the past five years. In 2017 we had 13 refueling outages with an average duration of 23 days. With the addition of Fitzpatrick plant in high utilization, we generated a nuclear fleet record of 157 billion megawatt hours. On the Constellation side, our C&I operating metrics remain strong. 74% customer renewables, average

customer duration of more than five years, and power contract terms of more than 25 months on average. These statistics speak to our deep customer relationship that has been the bedrock of the Constellation business. We continue to see stable unit margins with our C&I customers, and our aggressive cost management is helping to further support operating margins.

And now I'd like to turn it over to Jack to walk through some of the numbers.

Jonathan W. Thayer

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

Thank you, Chris, and good morning, everyone. My remarks today will focus on 2017 results, 2018 earnings guidance, and annual updates to our financial disclosures.

Turning to slide 8. As Chris stated, we had a strong year financially and operationally across the company. For the full year of 2017, our adjusted non-GAAP operating earnings were \$2.60 per share, and comfortably within our guidance range. We're pleased with our full year results, particularly considering the unexpected \$0.09 timing drag from the Illinois ZEC contracts that were signed this January rather than in December, as well as a \$0.04 impact from a FAS 109 asset impairment related to income taxes for our FERC-regulated assets. For the fourth quarter, we earned \$0.55 per share. Utilities less holding company EPS was \$0.29 per share, benefiting from favorable storm expense and lower O&M expenses which were offset relative to our plan by the FAS 109 impairment. Generation performed mostly in line with our expectations as our cost optimization efforts offset some market softness experienced earlier in the quarter.

Turning to slide 9, we're providing full year 2018 adjusted operating earnings guidance of \$2.90 to \$3.20 per share. The growth in utility earnings reflects continued rate base growth as we deploy capital to the benefit of our customers as well as improved improvement in PHI's earned ROEs. At Exelon Generation, the year-over-year increase is primarily driven by the full year recognition of ZEC revenue from New York and Illinois, the \$0.11 recognition of the 2017 Illinois ZEC payments which is higher than the 2017 drag due to the now lower tax rate, the impact of tax reform, and cost optimization efforts partially offset by lower energy prices. We expect our first quarter earnings to be in the range of \$0.90 to \$1 per share. More detail on year-over-year drivers by operating company can be found in the appendix starting on slide 59.

On slide 10, we roll forward our outlook for utility CapEx and rate base which now covers 2018 through 2021. We plan to invest \$21 billion into our utilities over the next four years to ensure reliable, more resilient, and more efficient transmission and distribution of electricity and gas that improves the customer experience. Our four-year capital program is up from what we shared with you last year as we accelerate our gas main replacement programs at BGE and PECO, and take advantage of opportunities to further improve reliability and resiliency, all of which allows us to provide our customers with safe, reliable service. This results in a capital plan across our utilities with a \$5 million annual run rate. Turning to rate base, we now project annual growth of 7.4% compared to 6.5% at the last update, which reflects the expanded CapEx budget and the impacts of tax reform. Tax reform will increase rate base by approximately \$1.7 billion in 2020, relative to our previous expectations. For your convenience, in the appendix we provided a more detailed analysis of the capital and rate base outlooks by individual utility beginning on slide 27.

Turning to slide 11. Equally important to deploying capital to strengthen our systems is timely revenue recovery. Of \$11.5 billion of rate base growth projected through 2021, approximately 70% is covered either under formula rates or mechanisms supporting our ability to make additional investments and earn a fair return on our capital. Where we do not have mechanisms, we will continue to work with stakeholders to enact and implement these

types of tools. I would also note that over 70% of our rate base is in jurisdictions that are decoupled from volumes, improving our earnings visibility and aligning with the ambitious energy efficiency goals in our states.

Slide 12 shows a trailing 12-month blended transmission and distribution earned ROEs of the utilities. Our utilities continue to execute, delivering stronger earned returns for the year in addition to the robust operational performance Chris already discussed. Over the past year, PHI's earned ROEs improved at Delmarva and Pepco and remained flat in Atlantic City Electric. Although I should point out that the FAS 109 impairment costs about 60 basis points of ROE at each utility. We're encouraged by the improvements at PHI and we expect to see further gains as pending rate cases are resolved throughout 2018. The legacy Exelon utilities had a strong 2017, earning 10.3% as a group helped by favorable storm expense and O&M partially offset by the FAS 109 regulatory asset impairment in the fourth quarter of 2017. Improving the earned ROEs at PHI and sustaining the strong performance at the legacy Exelon utilities will be a core focus in our efforts to meet our overall utility earnings growth targets. We expect to earn 9% to 10% ROEs across our utilities in 2019.

Turning to slide 13, we remain busy on the regulatory front. Since our last earnings call, ComEd received an order authorizing a revenue increase of over \$95 million. Since implementing the formula rate structure, we've recovered 90% plus of our [indiscernible] (00:17:28), with this year being the 100% for the first time. Pepco filed electric rate cases in Maryland and in the District of Columbia, with orders expected in the third and fourth quarters of this year respectively. In addition to the recently filed Pepco Maryland and DC rate cases, we have pending rate cases at Delmarva, with orders expected in 2018. Combined, we're asking for \$133 million in revenues, which reflect recovery on multiple years of reliabilities, smart meter, and other capital investments that have been made to improve performance across these jurisdictions. Later this spring, we plan to file our rate case at PECO for the first time in three years, and we'll file our standard formula update at ComEd in April. More details on the rate cases and their schedules can be found on slide 65 to through 71 in the appendix.

Slide 14 provides an update on our outlook for utility EPS where we continue to forecast 6% to 8% EPS growth. Compared to last year, our EPS bands in 2019 and 2020 have both increased. The uplift from tax reform at the utilities through the increased rate base is mostly offset in the first couple of years but a drag from higher holding company expense since the lower tax rate provides less tax shield. As we look toward the back half of this period, we should start to see net benefit from the change in tax policy. Overall, the combination of strong rate base growth, timely regulatory recovery, and tax reform leave us on a path to sustain our leading utility EPS growth.

Slide 15 provides our gross margin update for ExGen, and on slide 38 we provide more detailed bridges compared to the previous quarter. I should point out that our decision to retire Oyster Creek a year earlier than previously planned is now factored into all of our disclosures for gross margins, O&M, and depreciation expense, with the collective EPS uplift being \$0.03 in 2018, \$0.07 in 2019, and \$0.01 in 2020 relative to our previous expectations.

Now turning to our gross margin update, our 2018 total gross margin is flat relative to our last disclosure as lower Oyster Creek contribution is offset by the inclusion of the Handley Generating Station, the 1,265 megawatt peaker in Texas that we bought out of the EGTP portfolio that serves as cost-effective resource for our Constellation retail operations. Total gross margin in 2019 is up \$50 million since the last quarter driven primarily by higher West Hub and NI Hub power prices, strengthening ERCOT spark spreads, and additional generation related to Handley partially offset by the early retirement of Oyster Creek.

Since we've not previously disclosed 2020 gross margins, let me help with the 2020 disclosures in context by bridging a few changes compared to the 2019 disclosures. Total gross margin is down \$300 million and it will be bucketed into, one, a \$150 million reduction to open gross margin primarily from the already announced

retirement of TMI. We have offsets in O&M and depreciation expenses, so this closure is net EPS-accretive to us. Secondly, a \$150 million decrease to the capacity in the ZEC line, which largely reflects the roll off of the robust and previously disclosed PJM capacity prices from the 2018-2019 auction. From a hedging perspective, we ended the quarter approximately 13% to 16% behind our ratable hedging program in 2018 and 8% to 11% behind ratable in 2019 when considering cross commodity hedges. We remain comfortable being more open when we look at market fundamentals, and particularly as we see opportunity for PJM price formation chances.

Turning to slide 16, our O&M expense outlook is consistent with the third quarter earnings call disclosures. That included our expanded \$250 million cost reduction program plus an additional \$50 million and \$120 million of O&M savings in 2018 and 2019 respectfully due to the earlier than planned closure of Oyster Creek. Turning to CapEx, our nuclear fuel and base line capital spend projections continue to decline. Our base CapEx benefits from the proactive investments we've made across the fleet in prior years, further focus on investment priorities, and the impact of closing uneconomic plants. Our nuclear fuel expenditures are also falling as we take advantage of well-supplied uranium markets and excess fuel processing capacity.

We continue to run an efficient organization and we'll always look for ways to reduce cost and run the fleet more cost effectively while maintaining the highest premium on safety and reliability. The combination of ZEC programs in New York and Illinois have extended the useful lives of our most profitable assets, and we continue to reduce ongoing capital needs for the plants, which we think makes it a more compelling case for the long-term value of these assets which the market still seems slow to reflect.

Turning to slide 17, we're rolling forward the free cash flow outlook for ExGen that cover 2018 through 2021. We expect the cumulative free cash flow to be \$7.6 billion, which is \$800 million higher than our previous four-year outlook. Our forecast takes into account power price forwards at year end, the current gross margin outlook for Constellation, the benefit of the cost cuts outlined in the third quarter call, the planned closure of TMI and earlier closure of Oyster Creek, our updated base CapEx and nuclear forecast, and the impact of tax reform. We're also updating how we plan to use ExGen's strong cash flow generation. We'll invest approximately \$700 million in growth capital which is primarily sited solar projects in support of our Constellation business, the Medway plant in New England, and some final payments around the Texas CCGTs. We plan to inject between \$3.3 billion and \$3.7 billion of capital in the utilities to fund the outsized growth without the need for external equity funding. With faster dividend growth, we will use approximately \$400 million to \$600 million of ExGen free cash flow to fund the dividend not covered by the utilities. We're comfortable with this dividend funding for ExGen, particularly considering that the four-year needs are less than 10% of our total free cash flow generation. Finally, we plan to retire between \$2.7 billion and \$3.3 billion of debt, which will be spread between ExGen and holding company debt. We'll continue to manage ExGen leverage to our 3 times debt to EBITDA commitment.

Turning to slide 18, we've already shared with you the impact of tax reform on Exelon in our 8-K from January 5, but we want to highlight that we're a clear beneficiary from tax reform and offer a few additional details. We expect to pass-through meaningful savings to our utility customers across the different jurisdictions, reflecting the lower tax expense recoveries and refund of deferred income tax regulatory liabilities partially offset by the impacts of higher rate base. We're thrilled that our customers will benefit so much from tax reform.

Our 2018 EPS guidance is inclusive of tax reform, and we expect a \$0.10 per share uplift to 2019 earnings. Generation earnings will benefit from a 22% effective tax rate. The utilities will benefit from an increased rate base of \$2 billion by 2021 while the lower tax rate will create less tax shield for our holding company interest expense. We expect to be a very modest cash taxpayer through 2021, and you can see the cash tax rates by year. We expect much stronger free cash flow from ExGen with a lower tax rate and 100% expensing of capital, which will more than cover the additional equity needs to utilities associated with the increased rate base. And we expect

the consolidated metrics will remain largely unchanged as a result of tax reform. And ExGen tax reform has a positive impact in 2018, with a more meaningful impact in the outer years that provides the company with additional financial flexibility.

On the utility side, we do see some modest erosion in FFO to debt, although all of our utilities remain at or above rating agency thresholds. We frequently made the case that our Generation business provides distinct competitive advantage to the overall company with the ability to recycle significant free cash flows. Our positive uplift to credit metrics and no need for external equity are additional examples relative to other utilities that are being pressured due to the tax reforms.

Turning to slide 19, we remain committed to maintaining a strong balance sheet and our investment grade credit rating. I hit on this in the previous slide, but we remain comfortably ahead of our corporate targets for FFO to debt and well above the downgrade thresholds. Looking at ExGen, we're well ahead of our debt to EBITDA targets in 2018. On a total basis, we expect to be at 2.5 times debt to EBITDA and only 2 times debt to EBITDA from a recourse debt perspective. We'll continue to manage our balance sheet at ExGen over time to the 3 times debt to EBITDA level, so look for us to focus on debt reduction at both holding company and GenCo.

Turning to slide 20, as Chris mentioned earlier the board has decided to increase the dividend growth rate policy from 2.5% to 5% annually through 2020. Chris spoke to the positive business developments that gave us the confidence to increase our dividend growth rate to be more competitive with utility peers, so I want to take a moment to talk about our financial thought process. Slide 20 shows the hypothetical portion of the dividend being funded by the utilities if we assume their piece of the dividend is based on a 70% payout ratio on utility less holding company expense. The residual dividend is then covered by ExGen. When we consider that the utilities are growing EPS at 6% to 8% per year and represent the growing majority of our earnings, we're comfortably growing the dividend at 5% based on a 70% utility earnings payout ratio, which keeps pace with this earnings growth.

On this approach, ExGen is funding around \$0.20 of dividend depending on the year, which is a payout ratio in the teens of our 2018 EPS guidance for the business and substantially less than that on a free cash flow basis. We're very comfortable committing the small portion of ExGen's financial output to supporting the dividend and are excited to be returning more capital to our shareholders through the dividend.

I will now turn the call over to Joe Dominguez to walk you through the latest on our regulatory and policy initiatives.

Joseph Dominguez

Executive Vice President-Governmental and Regulatory Affairs and Public Policy, Exelon Corp.

Thanks, Jack, and good morning, everyone. I'll cover slides 21 and 22 in the materials. Since our last earnings call, we continue to see positive momentum for policy changes at the state, FERC, and RTO levels that value the zero emission and resilient resources that benefit our customers and the environment most. As Chris said at the top of the call, we remain focused on three areas. First, ensuring that resilient resources are compensated fairly; second, addressing the price formation flaws that PJM has identified in its market; and third, preserving and expanding state policy initiatives like the ZEC programs and include nuclear energy within the umbrella of state-sponsored clean energy programs. I'll walk through each of these.

On resilience, FERC issued its order on January 8 in response to the DOE NOPR. Consistent with Exelon's recommendations, the order initiated a new resilience proceedings and directed the RTOs to immediately examine grid resiliency and provide a report to FERC within 60 days. FERC noted that the report should include

any recommended changes to market rules. In our filings at FERC, we urged the commission and the RTOs to view resilience as a broader scope of issues than the traditional reliability concerns that center around electric generation and transmission unit performance and weather events. In particular, as we've talked about in earlier calls, we urged FERC to consider the risk of a cascading loss of the electric system caused by natural gas infrastructure failure. We expect that the resilience proceedings and entrapping solutions will take some time as Chris indicated earlier.

But FERC's order clearly gives PJM the opportunity to address near-term solutions, including immediate price formation reforms. PJM has said it can implement those reforms within the course of this calendar year. Based upon PJM's comments, including Andy Ott's testimony before the Energy Committee of the U.S. Senate a week ago, we expect that PJM will continue to make a strong push for price formation reforms in its March filing.

In terms of next steps, we continue to see two alternative pathways that are going to be worked simultaneously. One, achieving a FERC-directed PJM filing as a byproduct of the resilience docket; and two, a stakeholder process at PJM followed by a 206 filing through its existing enhanced liaison committee process. PJM already has the price formation stakeholder process underway, and it is scheduled to conclude that process in the third quarter. In the meantime, PJM is pursuing more limited changes to price formation in the fast-start docket where filings are due next week. In summary, the commission is focused on resilience and the chairman's call for urgent action coupled with PJM's commitment to address market forums continues to give us confidence that reforms will be implemented in 2018. With that said, there's a lot of work ahead of us as PJM continues to engage with stakeholders and refine its proposal.

Turning to the next slide in our ongoing efforts concerning state policies that value zero-emission nuclear resources, Jack already noted that we've reached an important milestone last month in Illinois with the completion of the state procurement process and the awards of ZECs to the Quad Cities and Clinton. Now both the Illinois and New York programs are fully up and running. We remain confident that we'll successfully defend these legitimate state programs in federal fuels boards and state boards because they preserve for our customers the lowest cost and most reliable zero-emission resources in the market.

The New York and Illinois policy precedent that we established has been followed now in Connecticut and is under consideration in New Jersey, and I'll talk about New Jersey in closing. As many of you know, a bill had made it through two committees in the New Jersey legislature in late 2017. The votes were unanimous in support of the nuclear provisions. However, because the then Governor-Elect Murphy had indicated a desire for a more comprehensive package, a floor vote was not held. Since December, we've continued to work with our partners at [indiscernible] (00:32:56) and all stakeholders on new legislation. I could report that we are making good progress and I hope for legislative action in early 2018.

With that, let me turn it back over to Chris.

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

Thanks, Joe. Turning to slide 23, we have updated some of the numbers behind our value proposition which highlight our strategy and commitment to our shareholders. We will continue to focus on growing our utilities, targeting 7.4% rate base growth and 6% to 8% EPS growth through 2021, rolling forward another year at above group trajectory. We continue to use our free cash flow from ExGen to fund these incremental equity needs at the utilities, pay down debt over the next four years at ExGen and in the holding company, and fund part of a faster dividend growth rate. We will continue to focus on optimizing value for our ExGen business by seeking fair

compensation for our carbon-free Generation fleet in New Jersey and in Pennsylvania as we have done with the ZECs in New York and Illinois.

We will continue to pursue adoption of price formation in PJM and resiliency initiatives at FERC; closing uneconomic plans, including TMI in 2019 and now an earlier retirement of Oyster Creek in 2018. Selling assets where it makes sense to accelerate our debt reduction plans and maximizing value through our gen to load match strategy at Constellation. We continue to sustain strong investment grade credit metrics and now growing our dividend consistently at 5% through 2020.

Finally turning to slide 24, I want to leave you with some key focus areas for 2018. We will continue to deliver operational excellence across all our businesses, focusing on modernizing the grid and improving our customer experience at the utilities, running our Generation fleet safely and reliably, and staying disciplined in our retail business to capture fair margins. At the utilities, we plan to invest \$5.4 billion of capital to benefit our customers, we will file a total of five distribution rate cases with the goal of achieving our targeted 9% to 10% ROE across the utility families in 2019. In Generation, we will work to establish the PJM price formation changes in 2018. We will start working on a broader resiliency initiative at FERC, which will take more time. We'll continue to defend the Illinois and New York ZECs in the courts, and we'll work with our stakeholders to establish fair payment for the environmental attributes of our nuclear plants in New Jersey and Pennsylvania.

Financially, we will begin to grow the dividend as discussed at 5% annually, continue to execute on our previously announced cost management initiatives. And finally, we will continue with our corporate responsibility initiatives, including the focus on gender parity issues through our participation as the only energy company in the UN's HeForShe campaign, building on last year's expansion of paid leave policies and our signing of the President's equal pay pledge.

The strategy underpinning the value proposition rolled out a couple of years ago is proving very robust. We are well-positioned to capture additional upside and feel confident about the prospects for Exelon in 2018 and beyond. With the many successes we've had in recent years and the relative stock outperformance, we still believe our stock is undervalued in absolute terms, and in particular compared with our peers. We remain committed to optimize the value of our business and earnings – your ongoing support for Exelon. Operator, we can now open it up to questions.

QUESTION AND ANSWER SECTION

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

Greg Gordon

Analyst, Evercore Group LLC

Q

Thanks. Good morning. On the stock valuation Chris, you and I definitely agree. Couple of questions. Just to be clear on the rollout of the 2020 disclosure, when we look at that, the lower gross margin associated with the TMI shutdown is actually earnings, just to be clear, you said is earnings-accretive. So we should think about the year-over-year sort of negative comp as flowing from the other two items. Is that correct?

Jonathan W. Thayer

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

A

The TMI, Greg, it is EPS-accretive.

Greg Gordon

Analyst, Evercore Group LLC

Q

Right.

Jonathan W. Thayer

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

A

So...

Greg Gordon

Analyst, Evercore Group LLC

Q

So they now would be offset by the \$200 million of energy pricing capacity revenues. But then you also have the cost-cutting on page 26 that we have to factor in to come up with a sort of net impact from the Q3 call, right? There was a...

Jonathan W. Thayer

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

A

That's correct. So there's a full break out of O&M expenses that we detailed in the appendix. You'll see the impact both in 2018 as well as 2019 and beyond from Oyster as well as TMI.

Greg Gordon

Analyst, Evercore Group LLC

Q

Great. And you also said you plan on retiring some parent maturities now, looking at the maturities schedule on page 40. I see that \$6.3 billion of Holdco debt, there's a \$900 million maturity in 2020, \$300 million in 2021. Should we think about that as the timing or is there other debt that's callable or revolver capacity that you can bring down in the interim?

Jonathan W. Thayer

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

A

So Greg, there's both – I apologize, I'm turning those slides. So in terms of the holding company maturities, you should expect us to tilt more heavily towards holding company in 2020 and 2021. You'll also see us pull – retire some 365-day paper we have in 2018 that retires in 2019, and then you'll see us work down the ExGen maturities as we get out the curve as well.

Greg Gordon

Analyst, Evercore Group LLC

Q

Okay. So I have one for Joe Dominguez and one for Joe Nigro. Joe Dominguez, is it your expectation – and clearly you can't speak for PJM – but is it your expectation to get this stakeholder process completed, that they may go through the enhanced liaison process or in fact they would probably have to go through the enhanced liaison process to get a stakeholder process done in 2018 or is it too soon for us to sort of call that? And then the alternative, is it a legally viable possibility that at the end of the resiliency proceedings that FERC actually has the record in place to haul PJM in to change its tariff?

Joseph Dominguez

Executive Vice President-Governmental and Regulatory Affairs and Public Policy, Exelon Corp.

A

Yeah, let me answer the second question first and just simply say yes, I think they may have to open a different proceeding but obviously they could issue a 206 order at any point in time and we believe that they have a sufficient record already to do so. Very clearly, PJM is going to supplement that record here in March, and I expect that other parties in their response 30 days later will do the same. Greg, it's my expectation that PJM is going to continue to urge to do exactly that, to give it some direction, to come in and resolve the price formation issues that it's identified. But at the same time, they have this alternative pathway that they're going to walk down in parallel where they can include the stakeholder process. And my expectation is that, as the owner of the tariff, that PJM continues to believe that they have significant price formation flaws, and they've said that repeatedly in many forums, and the next step for them is to bring it to FERC and to utilize the enhanced liaison committee process if the stakeholder process doesn't work.

Greg Gordon

Analyst, Evercore Group LLC

Q

Thanks. And for Joe Nigro, the initial auction parameters for the next capacity auction came out several days ago. There was a significant change in import capacity into ComEd and some concern from investors that perhaps that would disadvantage the incumbent generation vis-à-vis capacity price outcomes. Can you give us some color on your thinking there?

Joseph Nigro

Chief Executive Officer-Constellation & Executive Vice President-Exelon, Exelon Corp.

A


Yeah. Good morning, Greg. We expected to see an increase in both into Eastern PJM and into ComEd an increase into the import capability, and they've been slightly higher than what we expected. There were obviously other variable changes as well when you think about the NETCO increase AND the impact, all other things equal, that could have on the demand curve and shifting the demand curve out. We're still, like everyone else, analyzing this. I think at the end of the day though, as we've said for years, the big thing is it's going to come down to bidding behavior, and it always does. So there's a lot of variables in play here, including those changes to the imports, but the bidding behavior won't matter.

Joseph Dominguez

Executive Vice President-Governmental and Regulatory Affairs and Public Policy, Exelon Corp.

A

Exelon Corp. (EXC)
Q4 2017 Earnings Call

 **Corrected Transcript**
07-Feb-2018

Hey, Greg, it's Joe Dominguez. If I can just chime in, that CTEL has moved around over the last few auctions. So we're going 1.7 gigawatts, the other way now. A year ago we've – but two auctions ago, 1 gigawatt of that was already in the transmission limit. So we've seen the zones separate before with these higher CTEL numbers.

Greg Gordon

Analyst, Evercore Group LLC

Okay. Thanks, guys.

Q

Operator: And your next question comes from the line of Julien of Bank of America Merrill Lynch.

Julien Dumoulin-Smith

Analyst, Bank of America Merrill Lynch

Hey. Good morning. Can you hear me?

Q

Jonathan W. Thayer

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

Yeah.

A

Joseph Dominguez

Executive Vice President-Governmental and Regulatory Affairs and Public Policy, Exelon Corp.

Good morning.

A

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

Very. Good morning.

A

Julien Dumoulin-Smith

Analyst, Bank of America Merrill Lynch

Hey, excellent. Congratulations again on a healthy set of updates here. I wanted to follow-up a little bit more strategically on the ExGen side. Obviously, well done on handling. Curious as to the thoughts about the desire to hold on to the Texas combined cycles. Can we read into some of the commentary around the desire to back start Constellation here or is there still kind of a broader thought process around merchant generation here. Just kind of wanted to elaborate on that.

Q

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

Those assets, as we've discussed in the past, are highly efficient and they're a very good match for our load book in Texas. The capabilities that we have, the heat rates on them, the ramping, they're very valuable and their capacity factors have been some of the highest for the CCGTs in Texas. So we'll continue to operate in this part of the fleet and be able to reap the benefits of their efficiency as we manage that book in Texas. As always, we look at all of our assets on an annual basis, but the previous review of those asset said they're more valuable in the fleet to note.

A

Julien Dumoulin-Smith

Analyst, Bank of America Merrill Lynch

Q

Great. And then secondly, I know you commented on New Jersey with respect to legislation, but can you comment a little bit on how the Oyster Creek development reflects on the profitability of the nuclear units in that region? Just curious if you can give us a little bit of a sense of the latest on those assets and the profitability maybe from an ROE perspective. Obviously, your peer in the region comments on that in kind.

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

Yeah. The Oyster Creek decision was simply a site specific. The market has tightened over the years in that location. But running it another year with the losses and the investments that we would had to have made was not financially prudent. Knowing that the reliability of the system can be sustained in that area without that asset, we're comfortable and most importantly we have an employee transition program that we're implementing that allows us, for those that are not at retirement and wish to retire, ability to go into the rest of our vast fleet and continue to pursue their careers. So employee-wise, right thing to do moving forward, allowing people to make the transition; and economic-wise no sense in continuing for losses for another year. So it was an easy decision. The other assets have been openly discussed as the challenges happen in that part of the market, and that's why we're pursuing in supporting our co-owner on that legislative agenda.

Julien Dumoulin-Smith

Analyst, Bank of America Merrill Lynch

Q

Great. Thank you all.

Operator: And your next question comes from the line of Stephen with Morgan Stanley.

Stephen Calder Byrd

Analyst, Morgan Stanley & Co. LLC

Q

Hi. Good morning.

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

Good morning.

Jonathan W. Thayer

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

A

Good morning.

Stephen Calder Byrd

Analyst, Morgan Stanley & Co. LLC

Q

I just wanted to hit on the retail business and just overall get your sense for the competitive environment in the retail business. Any trends you're seeing on that side of the business?

Joseph Nigro

Chief Executive Officer-Constellation & Executive Vice President-Exelon, Exelon Corp.

A

Yeah. Good morning, Stephen. It's Joe. I'll talk briefly about that. You see the metrics on our business on slide 7, and Jack talked to those in his prepared comments. We still have the best and the largest customer-facing business in the industry. And as recently as late December and early January, our generation to load strategy continues to serve us well. The market remains competitive. It's a little early to see what if any impact the current

cold snap or the previous cold snap had on competitive behavior. As we said all along, we're going to remain disciplined to what we think is fair pricing and not just chase volume.

What we have seen though from competitors, which is kind of interesting, is two things. One is we've seen one of our large competitors back away in certain regions from selling a full fixed price full requirements product to their customers, and we will continue to do that as we have historically and we'll honor obviously all the commitments we have. In addition to that, we've seen some of our competitors try to pass-through costs that we've honored through our contractual arrangements with our customers as costs that we will bear. So I won't say we've seen the competitive aspect of the market change, and as I said we'll remain disciplined. But we have seen some things from competitors that we haven't seen in the recent past which may or may not lead to different outcomes in the future.

Stephen Calder Byrd

Analyst, Morgan Stanley & Co. LLC

Q

That's very helpful color. And just shifting over to the ZEC litigation in Illinois, we continue to sort of like your overall legal position. It seems like there's some chance that the court might actually kick the decision over to FERC effectively. Is that a fair reading in terms of a possibility and what's your sense in terms of your outlook should sort of the decision go back to FERC?

Joseph Dominguez

Executive Vice President-Governmental and Regulatory Affairs and Public Policy, Exelon Corp.

A

It's Joe Dominguez. Let me address the last one. I think all of the five FERC commissioners were asked during – the four new commissioners were asked during the confirmation hearings what their view is concerning these state programs, and all indicated that they did not see the situation as something where FERC needed to really put a halt to these programs or claim preemption but rather that they could use tools like mitigation to address any impacts in the market. So we would expect that if the matter does go over to FERC, consistent with their testimony before the U.S. Senate, the commissioners would indicate that they could mitigate the market through their existing tools and that they would not be in favor of preemption. And quite obviously, the plaintiffs in Illinois feel the same way and they've urged the court not to send it to FERC for that reason.

In terms of your reading of the argument, I think you're exactly right. [indiscernible] (00:49:49) brought in this question of primary jurisdiction which is a discretionary tool that allows the court at its discretion to send the matter to FERC. At this point, both parties approve that.

Stephen Calder Byrd

Analyst, Morgan Stanley & Co. LLC

Q

Great. That's all I had. Thank you very much.

Operator: And your next question comes from the line of Steve with Wolfe Research.

Steve Fleishman

Analyst, Wolfe Research LLC

Q

Hi, good morning. So just first on the – maybe high level at ExGen. So obviously you have the gross margin numbers, and in 2020 they fall a certain amount. Is it fair to say kind of at the high level all the below the line stuff, O&M, interest as you're paying down debt, depreciation as you're closing plants, are all those kind of offsets so you'll end up mitigating some chunk of that gross margin hit?

Jonathan W. Thayer

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

A

Steve, so if you look at slide 54 we provide the additional ExGen modeling data. But as we look at ExGen's EPS profile out the curve, to your point, the lower depreciation, the lower operating O&M all leads to these retirements being accretive. So we should see strong and better than last quarter performance anticipated from ExGen as we look out of the LRP.

Steve Fleishman

Analyst, Wolfe Research LLC

Q

Okay, and then one other question. Just in the event that the energy price formation changes are at PJM through the enhanced liaison process, could you just clarify the timeframe on that and process?

Joseph Dominguez

Executive Vice President-Governmental and Regulatory Affairs and Public Policy, Exelon Corp.

A

So again, this is, as Greg said earlier, ultimately PJM's discretion when to pull the trigger on that. But right now it's set to conclude its stakeholder process in Q3. At that point, PJM will have all the input from stakeholders and, as usual, will have refined its proposal along the way. And at that point, in our view, we'll be in a position to make a filing at FERC.

Steve Fleishman

Analyst, Wolfe Research LLC

Q

And then how long FERC takes to rule – I guess it depends on – that's FERC's call.

Joseph Dominguez

Executive Vice President-Governmental and Regulatory Affairs and Public Policy, Exelon Corp.

A

That's FERC's call. This is a 206 proceeding, so there's no mandatory clock like we see in the 205 proceedings.

Steve Fleishman

Analyst, Wolfe Research LLC

Q

Yeah. Okay. Thank you.

Operator: And your next question comes from the line of Michael with Credit Suisse.

Michael Weinstein

Analyst, Credit Suisse Securities (USA) LLC

Q

Hi, good morning.

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

Good morning.

Michael Weinstein

Analyst, Credit Suisse Securities (USA) LLC

Q

Hey. The target for ExGen is still 3.0 times debt to EBITDA. Is that, I mean, considering that you're already below that, is that something that needs to come down at some point or is there a reason why it would increase over time?

Jonathan W. Thayer

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

A

So Michael, as you've seen the gross margin expectations and EBITDA expectations for the ExGen business go down, that 2 times non-recourse or 2 times recourse debt to EBITDA and 2.5 times gross debt to EBITDA number will move up. We will be paying down debt as maturities come, but we'll also be shifting our focus to the holding company debt and using the flexibility we have around the strong balance sheet at ExGen to target retirement of a good portion of or a good amount of holding company bonds as they mature.

Michael Weinstein

Analyst, Credit Suisse Securities (USA) LLC

Q

I see. I mean, what's the purpose of having a 3.0 times target? Is there something you're trying to achieve with ExGen at that point?

Jonathan W. Thayer

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

A

I think differentiation from our IPP peers. We have I believe the strongest balance sheet in the integrated space. That takes the risk of that overhang that we've seen come pop-up from time-to-time among semesters off the table, positions us to maintain a strong investment grade rating from all the agencies. It's an important competitive advantage in the Constellation business. And as we clarified the longevity of these nuclear assets, we believe over time that while we trade currently at 5 times EBITDA from a valuation standpoint, we are making the case that we should trade in line with our IPP peers, which would be 7 to 8 times. And I think the market is not recognizing that now, but certainly it's all part of our strategy to accomplish them.

Michael Weinstein

Analyst, Credit Suisse Securities (USA) LLC

Q

Right. You guys mentioned the enhanced liaison process. Just wondering is that something that you simply expect PJM to use or is that something that PJM is telling you they will be using for sure?

Joseph Dominguez

Executive Vice President-Governmental and Regulatory Affairs and Public Policy, Exelon Corp.

A

As I said earlier, PJM has made no announcement in that regard. The point I'm trying to make here is that PJM and a lot of different audiences has now come forward and say we have a major flaw in price formation. And that PJM were historically, where it has significant issues in its market design, capacity performance being the most recent example, has used the enhanced liaison committee process mechanism to get matters to FERC or stakeholders who can't agree on supporting a particular proposal. Given the gravity of this issue and the significance of it and its connection to the resilience issues that FERC is already looking at, it would be our expectation that PJM would follow its strong words to the U.S. Senate to FERC and others and proceed to making a filing at the conclusion of the stakeholder process. That's the point I'm making.

Michael Weinstein

Analyst, Credit Suisse Securities (USA) LLC

Q

Got you. All right, thank you.

Operator: And our final question comes from Jonathan with 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

Good morning.

Jonathan Philip Arnold
Analyst, Deutsche Bank Securities, Inc.

Q

Strategy-wise, I mean, Chris, Jack you've both alluded to the value disconnect, and it's hard to imagine that you could be doing that much more to execute the current plan which seems to be going along. What's your level of patience to see the market reflect this under the current kind of dual strategy and just can you give us a refresh on how you're thinking.


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

A

Well as I've talked about this for a couple of years where patience is probably not the high point, but we understand it's our responsibility to deliver on these results and improve the thesis. So we took on five and a half years ago the road to greater regulated revenues coming in, greater certainty around balance sheet, total optimization of the gen to load match at Constellation while running world-class operations and efficient from a cost standpoint operations, and today's call reflects that. But let me go a little bit further and take a minute to give you more details on why we see our stock undervalued.

Simplistically with a \$3.05 midpoint for 2018 EPS, the stock trades at around 12% P/E versus our cheapest comp at PEG, which is 15%, and the regulated utility complex around 16%. Even on a consensus for 2019 and 2020, we trade around 12% to 13% versus PEG roughly around 15% and the utilities roughly around 15% to 16%. With our dividend growth at a competitive 5% rate, a 3.7% dividend yield is similar to much of the others in the group, and our utility operations accounting for 70% of the 2020 EPS. If you're using midpoint of our utility guidance range and consolidated Exelon estimates from the Street, we look more similar to the business model to our peers than the 2% to 4% P/E multiple discount that we see are suggested.

If you think about our valuation, looking at the businesses more specifically, our regulated utilities less holding company expense implies a fair market value of \$31 to \$32 per share using a consensus P/E in 2019 and 2020. When I think about our utilities growth base at 7%, our EPS growth at 6% to 8%, which we expect to continue and we have through this conversation next year; from lower-risk T&D utilities having the mechanisms covering 70% of our rate base additions and 70% of our low decouples so we have less volumetric risk; that our collective earnings of 9.5% ROE with strong credit metrics exceeding agency requirements, and doing all of this without needing outside equity to fund any of this growth, I think they should be treated as a premium utilities for the valuation, but the \$31 to \$32 is based off of a peer valuation which leaves us with an implied value of ExGen of approximately \$4 per share which we believe is entirely too low.

Exelon Corp. (EXC)
Q4 2017 Earnings Call **Corrected Transcript**
07-Feb-2018

The implied multiples for the business around 6 times P/E and 5 times EV to EBITDA respectively, using our disclosure and the Street's estimates, looking at the IPPs trading at 7 to 8 times EBITDA today, we struggle to bridge the valuation disconnects especially when you consider our leverage is well below our 3 times debt to EBITDA target, at 2.5 times, and is really running at about 2 times on recourse debt. Our FFO to debt ratio is going to stay north of 40% through the planning horizon as ZEC programs in New York and Illinois have preserved most of our at-risk nuclear plants, and our Constellation business provides a gen to load match advantage, and our discipline around bidding margins is proving wise again as we're starting to hear others taking on pain in recent months.

Our free cash flow generation from this business is \$7.6 billion over the next four years, which represents more than half of the implied enterprise value at ExGen with the assets with operational visibility well into the 2030s. We believe – we have done a lot of this in the past years to create value for the shareholders while the stock is outperformed. We do not see the share price reflecting anywhere near the value we see. We're focused on executing against the long-term commitments in our value proposition and near-term our 2018 business priorities, which we believe will deliver substantial value to our investors. So yes, I feel strongly about the stock being cheap. Short answer.

Jonathan Philip Arnold

Analyst, Deutsche Bank Securities, Inc.

Q

You sound impatient with the market to me.

Jonathan W. Thayer

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

A

And Jonathan, that doesn't even build in the fact that whether it's price formation or New Jersey ZECs, I mean, there a lot of incremental catalysts even beyond the robust story that Chris just described in the valuation where we currently see. So this is the strongest, long range plan that we've had since coming together as Constellation and Exelon, and we're excited about the outlook. The market's just not paying for it right now.

Jonathan Philip Arnold

Analyst, Deutsche Bank Securities, Inc.

Q

We kind of agree with you, but I guess how long do you give us?

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

Well we're not going anywhere.

Jonathan Philip Arnold

Analyst, Deutsche Bank Securities, Inc.

Q

All right. I'm inclined to ask that again.

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

A

Thanks, Jonathan.

Jonathan Philip Arnold

Analyst, Deutsche Bank Securities, Inc.

Q

Thank you.

Operator: And at this time, I would like to turn it back over to Chris Crane for any closing remarks.

Christopher M. Crane

President, Chief Executive Officer & Director, Exelon Corp.

Again, I want to thank you all for participating today. I want to thank the team here and the employees of Exelon for really delivering on a strategy that has taken a few years to get here. But we're operating on all cylinders and appreciate the dedication. So with that, I'll close it out and thank you.

Operator: And this concludes today's conference call. We thank you for your participation, and ask that you please disconnect your lines.

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