Xcel Energy Inc. (NASDAQ:XEL) Q1 2019 Results Conference Call April 25, 2019 10:00 AM ET

Company Participants

Paul Johnson - VP, IR

Ben Fowke - Chairman, President and CEO

Bob Frenzel - EVP and CFO

Conference Call Participants

Jonathan Arnold - Deutsche Bank

Ali Agha - SunTrust

Julien Dumoulin-Smith - Bank of America

Operator

Good day and welcome to the Xcel Energy First Quarter 2019 Earnings Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Paul Johnson, Vice President of Investor Relations. Please go ahead, sir.

Paul Johnson

Good morning. And welcome to Xcel Energy's 2019 first quarter earnings conference call. Joining me today are Ben Fowke, Chairman, President and Chief Executive Officer; and Bob Frenzel, Executive Vice President and Chief Financial Officer. In addition, we have other members of the management team available to answer your questions.

This morning, we’ll review our first quarter results and update you on recent business and regulatory developments. As you’re aware, there are slides that accompany today’s call available on our website.

As a reminder, some of the comments during today's conference call may contain for looking information. Significant factors that could cause results to differ from those anticipated are described in our earnings release and our filings with the SEC. On today's call, we will discuss certain metrics that are non-GAAP measures, including ongoing earnings, and electric and natural gas margins. Information on the comparable GAAP measures and reconciliations are included in our earnings release.

And I'll now turn the call over to Ben.

Ben Fowke

Thank you, Paul, and good morning.

Today, we reported first quarter earnings of $0.61 per share, compared to $0.57 per share last year. We're pleased with the strong start to the year and we are well positioned to deliver on our 2019 guidance and our long-term financial objectives.

So, let me start with some quick highlights from the quarter. In February, we increased our quarterly dividend by $0.025 per share, or 6.6%. This represents an annualized increase of $0.10 per share, which is a step-up over historic levels of $0.08 per share. We are growing the dividend at an increased rate due to our strong transparent earnings growth profile and the flexibility afforded by our low dividend payout ratio.

We also continue to make strong progress on our Steel for Fuel strategy, with almost 3,000 megawatts of new wins that has received regulatory approval and is moving forward in the construction process. In Colorado, the Commission approved our Certificate of Need for our Cheyenne Ridge wind farm based on constructive settlement which includes a construction cost cap and a customer protection mechanism. We will recover costs upon completion through riders until the next rate case, after the project goes into service.

Our Hale project in Texas is on track with construction expected to be completed in June, on time and within budget. And we are waiting for final generation interconnect studies and agreements for our Sagamore project in New Mexico and our Crowned Ridge III project in Minnesota. We expect construction to begin later this year. All of our other wind projects are in various stages of permitting and construction and will be completed as expected between 2019 and 2021. These projects highlight the excellent planning, construction and project management skills of our employees.

In December, we were the first utility in the United States to announce plans to achieve an

80% carbon reduction by 2030 and 100% carbon free electricity by 2050. We're excited to work with stakeholders as we continue to clean energy transition while providing reliable service and keeping the bills low. Legislative session is still ongoing in most of our states and we continue to work with stakeholders on various legislative initiatives that would impact the utility sector.

In Texas, there are bills under consideration that would provide the right of first refusal on new transmission projects and rider recovery for new generation and AMI investment. The outlook for these proposals is positive and points to a more constructive regulatory environment in Texas.

In New Mexico, the Energy Transition Act was signed into law by the Governor in March. This law targets a 50% renewable portfolio standard by 2030 and 100% carbon-free electricity by 2045. We believe we're well-positioned to meet to the 2030 milestone.

In Colorado, there's proposed legislation that quantified our plans to achieve a 100% carbon-free electricity by 2050 and 80% carbon reduction by 2030. In addition, the bill is expected to provide for voluntary securitization as an option, and it targets utility ownership of 50% of all generation and provides customer protections. We’re proud to be leading the clean energy transition and support these bills which are consistent with our carbon reduction objectives, and provide positive benefits for our customers and our shareholders. This is another example of our strong alignment with policymakers in our states.

I also want to recognize the efforts of our employees as they work through the polar vortex and the bomb cyclone that hit our various states. They did a great job working in extreme conditions to restore service in record time.

I’ll now turn the call over to Bob and he will provide more detail on the quarterly results and our regulatory plans.

Bob Frenzel

Thanks, Ben, and good morning to everyone.

We had a strong first quarter with earnings of $0.61 per share compared with $0.57 per share in 2018. Most significant earnings drivers for the quarter include high electric and natural gas margins, which increased earnings by $0.15 per share, including the impact of favorable weather and various regulatory outcomes, and riders to recover our capital investments, partially offset by wind production tax credits that flow back to our customers. In addition, our lower effective tax rate increased earnings by $0.06 per share. However, the majority of the lower effective tax rate is due to an increase in production tax credits which flow back to our customers through electric margin and tax reform impacts, both of which are largely earnings neutral. Offsetting these positive drivers were increased depreciation interest and other taxes, reflecting our capital investment program, which reduced earnings by $0.11 per share, and higher O&M expenses, which decreased earnings by $0.06 per share.

Please note that we calculated the EPS deviations for both years presented, based on a blended statutory tax rate of 25%, following the implementation of tax reform.

Turning to sales. Our weather-adjusted electric sales increased 0.5% in the first quarter, reflecting continued strong customer growth, partially offset by lower use for customer. Weather-adjusted natural gas sales increased 2.5% for the quarter, as a result of strong customer growth and higher use per customer.

For 2019, we're still anticipating relative flat consolidated electric sales, which reflect some discrete known declines and large customer usage, and expectations of lower use per customer in the residential sector. For natural gas, we expect slightly positive sales in 2019, reflecting continued growth in C&I and residential loads.

Turning to expenses. Our O&M expenses increased by $40 million, reflecting costs from substantial winter storms, the in-servicing of the Rush Creek wind farm, higher business systems and benefit costs, and the timing of plant overhauls.

Over the last five years, we've increased our rate base by approximately 7% annually, while keeping O&M expenses relatively flat. Over the same time period, customer expectations and risk aversion have increased. As a result, we're increasing our O&M standing in strategic areas to enhance the customer experience, increase cybersecurity and reduce systematic risk in our operations. And we remain committed to our long-term objective of improving operating efficiencies and taking other costs out of the business for the benefit of our customers.

Therefore, we’ve raised our 2019 O&M guidance, which reflects a decline of approximately 2% from 2018 levels. We expect to offset the impact of the slightly higher O&M and are confident in our ability to deliver earnings in our guidance range consistent with our plan.

Next, let me provide a quick regulatory update. In March, SPS reached a settlement with the New Mexico Commission, resulting in a revised rate order, which eliminated the retroactive TCJA refund, increase the equity ratio to 53.97% from the previously authorized 51%, and increased the ROE up to 9.56% from the previously authorized 9.1%. Revised orders expected to increase annual revenue by $4.5 million, effective in March of 2019. We believe this is a constructive settlement and a sign of progress in New Mexico.

In addition, we're planning to file electric cases in Colorado later in the second quarter, Texas and New Mexico this summer to recover our investment in the Hale Wind Project as well as other SPS capital projects, and Minnesota in November.

With that, I'll wrap up. In summer, we had a strong first quarter. We increased our dividend for the 16th straight year. We reached constructive settlements in our rate case in New Mexico and in the CPCN proceeding for our Cheyenne Ridge wind farm. There is constructive legislation that's being considered in our various states. And we are well-positioned to deliver on our 2019 ongoing earnings guidance range of $2.55 to $2.65 per share, our 5% to 7% earnings growth objective and our 5% to 7% dividend growth objective.

This concludes our prepared remarks. Operator, we'll now take questions.

Question-and-Answer Session

Operator

Questions will only be taken from institutional investors. Reporters can contact media relations with inquiries, and individual investors and others can reach out to Investor Relations. [Operator Instructions] We'll take our first question from Jonathan Arnold Deutsche Bank. Please go ahead.

Jonathan Arnold

Thank you. I just wanted to ask about the update you gave on O&M, which obviously -- I think you've been saying you expected to go back to 2017 levels, now you're saying just down 2%. But, that would still put you at 2.3, roughly, in aggregate. So, which was the run rate you were talking about last quarter? So, just can clarify, are you talking about more of a structural uplift, some of these customer experience investments or are we really sort of increasing one area and saving elsewhere?

Ben Fowke

Well, I mean, I think, it's -- first of all, I guess, I would say, Jonathan, we are ahead of plan, and that's a good thing, despite the additional O&M that Bob described. We continue to take out costs out of our business smartly. But, we're reinvesting some of those cost savings into things that I think are really important for our customers, and improving the customer experience as part of that, reducing systematic risk in areas of cybersecurity, gas safety, proactively implementing best practices for wildfire risk. I think, these are things that are important. And we're putting a little more money in that than we originally planned. When we look ahead to 2019 -- or rather 2020, I think, you can expect us to keep O&M relatively flat with where we end up in 2019.

Jonathan Arnold

And your comments on, despite the higher expense, still being in the guidance range, are you -- is embedded within that comment that you're skewing a little lower in the range than you might have otherwise been or am I reading too much into that?

Ben Fowke

No, absolutely not, Jonathan. We're ahead of our internal plans as of right now.

Jonathan Arnold

Okay, perfect. Thank you.

Operator

We’ll now take our second question from Ali Agha with SunTrust. Please go ahead.

Ali Agha

First question, there's been some opposition to the Mankato acquisition, as you filed for approval for that. Can you just give us an update and your current confidence level of getting that approved?

Ben Fowke

Yes. Ali, it's not really unusual in these sorts of situations for the department to have negative comments, not only with us but other utilities in the state. But, I think what you'll find and if history is any guide, is as we give the department more information, so they can better model the customer benefits, you start to see the comments be more supportive. We believe that this is of great economic benefit to our customers. I think, it's an important asset for us to own for the long-term and we ultimately think this gets approved.

Ali Agha

And the timing I believe is June or so, is that right?

Ben Fowke

Yes. I believe that's right.

Ali Agha

Okay. And then, also, can you remind us, currently, what's the regulatory lag in the system? And have you reached a point where the rest of it is just structural, or is there any further improvement potential...

Ben Fowke

We’ve achieved the 50 basis points objective, Ali. And, there's some opportunity for improvement. But to your comment, you’re starting to get to the point where we've got -- most of it is structural lag at this point.

Ali Agha

I see. And then, last question, apart from calling out O&M being maybe slightly higher for this year than budgeted, are there other movements in your basic assumptions for the year, either positive or negative to be aware of? And just specifically on O&M again, I don’t know if I picked it up, but what kind of incremental spending are we thinking about this year versus what you had previously assumed?

Bob Frenzel

Hey, Ali, it’s Bob. We've had favorable weather through the first quarter and favorable sales for the first quarter. So, we think there's some benefit there to offset some of the higher expenses that Ben mentioned. We also have an expectation for slightly lower interest expense through the that year than we’ve given original guidance for. And as he mentioned in the previous question that we are above our internal forecasts for the year. So, we feel confident in our ability to deliver earnings within our range.

Ali Agha

Okay. And Bob, just to clarify, you’re talking about O&M being down 2% versus ‘18 as your base assumption for the year? What was it before that, just to give a sense of how much it's changed?

Bob Frenzel

Yes. We've been guiding to flat to 2017. And so, the guidance -- we're probably 2% above ‘17 levels or 2% below ‘18 levels of guidance for ‘19.

Ali Agha

I got you. Thank you.

Operator

It appears there are no further questions at this time. Mr. Frenzel, I'd like to turn the conference back to you for any additional remarks.

Bob Frenzel

It appears that there might be -- let's take one more call.

Operator

Yes. We do seem to have another question that just joined from Julien Dumoulin-Smith with Bank of America. Please go ahead.

Ben Fowke

Julien, we could never not let you get a question in.

Unidentified Analyst

Hey, sorry. This is actually Richie here on Julien.

Ben Fowke

We’ll see you later, Richie.

Unidentified Analyst

Just had a quick question on the Texas rider legislation. How meaningful is the improvement in regulatory lag there as that legislation passes, given the Sagamore plant is coming online in 2020?

Ben Fowke

Well, remember, we already have a settlement deal for our wind assets. But, I mean, look, it's helpful. I mean, it's helpful as that system continues to grow on with really good sales. I would expect that we're going to need more generation, potentially both fossil and renewable. And that's a great thing to have along with the rider for the investment and the smart meters that we're looking to do. So. It's going to help. And, again, I think the environment in SPS is getting better.

Bob Frenzel

Hey, Richie. It's Bob. Just to add on to what Ben said. We're expecting to file rate cases in Texas and New Mexico to support the investment. We expect our Hale wind farm to go in service next month -- or sorry, early June. And we'll put those into rates almost immediately, based on the settlement mechanisms that Ben mentioned. In addition to the wind, we’ll also get the rest of the capital in Texas in time -- in service in more real time. And that's all part of the wind settlement agreement. I think the AMI and the generation, potential riders that are working through legislation would further increase as we seek to do AMI and additional generation in the next decade.

Operator

It appears there are no further questions at this time. Mr. Frenzel, I'd like to turn the conference back to you for any additional remarks.

Bob Frenzel

Thanks for participating in our call this morning. And please feel free to contact our Investor Relations team with any follow-up questions.

Ben Fowke

Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.