Q2 2022 Earnings Call

Company Participants

- Bryan Hanson, Executive Vice President and Chief Generation Officer
- Daniel L. Eggers, Executive Vice President and Chief Financial Officer
- Emily Duncan, Vice President of Investor Relations
- James McHugh, Executive Vice President and Chief Commercial Officer
- Joseph Dominguez, President and Chief Executive Officer
- Kathleen L. Barron, Executive Vice President and Chief Strategy Officer

Other Participants

- David Arcaro, Morgan Stanley
- James Thalacker, BMO Capital Markets
- Jonathan Arnold, Vertical Research Partners
- Paul Zimbardo, Bank of America
- Shar Pourreza, Guggenheim Partners
- Steve Fleishman, Wolfe Research

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Constellation Energy Corporation Second Quarter 2022 Earnings Call. At this time, all participants are on -- in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time. (Operator Instructions) As a reminder, this call may be recorded.

I would now like to introduce your host for today's call, Emily Duncan, Vice President, Investor Relations. Vice President, Duncan, you may begin.

Emily Duncan {BIO 19245511 <GO>}

Thank you, Liz. Good morning, everyone, and thank you for joining Constellation Energy Corporation's second quarter earnings conference call.

Leading the call today are Joe Dominguez, Constellation's President and Chief Executive Officer; and Dan Eggers, Constellation's Chief Financial Officer. They are joined by other members of Constellation 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, all of which can be found in the Investor Relations section of Constellation's website. The earnings release and other matters, which we will discuss during today's call, contain forward-looking statements and estimates regarding Constellation and its subsidiaries 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 materials and comments made during this call. Please refer to today's 8-K and Constellation's other SEC filings for discussions of risk factors and other circumstances and considerations that may cause results to differ from management's projections, forecasts and expectations.

Today's presentation also includes references to adjusted EBITDA 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 it over to the CEO of Constellation, Joe Dominguez.

Joseph Dominguez {BIO 16668698 <GO>}

Thanks, Liz, for getting us started and for Vice President, Duncan for her preliminary remarks, otherwise known as Emily to all of us, and thank all of you for joining us this morning and for your continued interest in Constellation and our mission to provide reliable, clean energy to families and businesses across America 24/7, 365 a day.

Of course, as we talked this morning, all eyes are focused on Washington and the proposed Inflation Reduction Act, which would be clearly transformational for Constellation, both in terms of support for our clean energy nuclear assets as well as creating new opportunities for clean hydrogen production and fuels. I'll talk a little bit more about that in a minute.

But Dan and I will focus most of our time on the excellent quarter we just completed and the strong numbers and operational performance across Constellation. As always, I want to begin with a shout out to our talented women and men who work at our plants, sell power to our customers and work in our corporate centers. I know a few of you listen in to these calls, and we want to thank you for everything you do for Constellation.

As you've no doubt read in the release on -- turning to Slide 5, Constellation posted a second quarter EBITDA of $603 million, and we reaffirm our full year guidance. Our balance sheet continues to give us a competitive advantage in the market, and customers are increasingly utilizing our platform of sustainability solutions, setting the stage for the launch of our 24/7 product. Dan will walk you through the financial results in his remarks, and I've asked him to spend a few minutes this morning reminding you of how our hedge program works.

Turning to Slide 6. As you know, our people have led the way on the development of policies that support the continued operation of baseload clean energy nuclear assets. They produce the bulk of America's emissions-free energy 24/7, 365 days a year. So we're pleased to have that a small role in the crafting of the historic federal energy bill that now we believe is on the cusp of success. It recognizes the vital role of clean nuclear energy.

In that sense, the drafters of the IRA reached the same conclusion that many of our states have already reached, namely that without baseload nuclear assets, we don't stand a chance of achieving our climate objectives, our affordability goals, or the need to have reliable and resilient power on the grid that could withstand the extreme weather we increasingly face.

The provisions in the IRA, I'm going to stumble through that a couple of times, not only support the continued operation of our assets, but create policy support, which, if extended, supports the 80-year license life that our assets could operate to, giving Constellation and its owners long-term clarity.

Let me put this in context for you. By extending the licenses out to 80 years, our existing fleet of clean energy nuclear plants would have an operating life that is longer than any new renewable energy source that is going to be put on the grid this decade.

But it's not just the longevity and the electricity side of it that excites us, it's what we could do to provide sustainable jobs for the future of our industry and ensure that those jobs create opportunities where opportunities are needed.

Let me give you a little bit of a data point on this, just to tell you how extraordinary it is. From a job standpoint, extending the licenses at our plants to 80 years will create over 453 million people hours of work in high-paying jobs across the country, making the nuclear energy provisions of the IRA one of the largest creators of family-sustaining wages.

The provisions of the IRA concerning clean hydrogen and, specifically, the ability of nuclear plants that earn both the nuclear PTC and the hydrogen PTC means that nuclear plants will become a key cog in clean hydrogen and sustainable fuels.

States that took early action to preserve their nuclear plants should be able to receive credit on their -- from the PTC payments so that state consumers get the benefit of the federal programs, and work is underway to achieve that result.

All told, here's how we see it. Passage of the IRA would be a win, win, win. It preserves and extends baseload clean energy resources that are vital to America's energy mix and our fight against the climate crisis. It preserves thousands and thousands of family-sustaining jobs and creates even more jobs.

And it saves consumers' money in states that have preserved these assets. For you, our owners, it means this. It resets Constellation's value as a critical infrastructure company with strong and more predictable financial results, unique growth opportunities and long-term durability on par with anyone.

Turning to Slide 7 and our generation highlights. Our fleet performed extremely well during the quarter. Let me start with the fossil and renewable fleet, really focusing on Texas. During the extreme heat in July, our plants ran as expected with minimal outages, all that were scheduled with ERCOT to occur at times that they would not impact the grid.

Our generation fleet's performance reflects the investments we've made in Texas along the way and shows how well we are positioned as a portfolio in Texas to serve customers well during extreme heat and price volatility.

Our clean energy nuclear plants at a 94.2 capacity factor and power and renewables achieved excellent results. And preliminarily, in July, our data indicates that our nuclear plants ran at over 98%. I remind you, this is different than any other resource out there in the market in terms of its ability to withstand temperature fluctuations and operate 24/7, 365. There is no other clean energy resource out there that does anything near that.

In fact, when our nation saw unprecedented heat, the performance of the U.S. nuclear fleet as a whole save lives, providing baseload clean energy during times of record demand. And as we see the continued evolution of the stack and the move away from fossil fuels to more intermittent forms of generation, we think the importance of these assets will only grow over time.

Turning to our commercial business and the summary on Slide 8. It again performed very well during the quarter, with strong volumes of electricity and gas delivered to our customers. And we closed a number of deals providing carbon-free solutions to help customers meet their sustainability objectives.

Customer renewals picked up significantly compared to the first quarter as we saw more customers come forward and be willing to interact. We doubled our renewal volume, making Q2 the best second quarter of renewals in three years. These renewals and our C&I business generally are an important part of our hedging strategy, which Dan will talk about in a second.

In addition, we're seeing margin expansion across the retail and wholesale channels, recognizing the higher risks in the market due to volatility. We also executed some of our largest core deals to date. Core deals, as a reminder, help our customers meet their carbon and energy goals, but they also support the development of new and additional renewable megawatts being added to the grid.

We've highlighted a number of the customers, Bank of America and P&C, in particular, who entered into very significant deals. In the future, our 24/7, 365 product will include nuclear energy as companies endeavor to reach even greater levels of sustainability by load matching their consumption with power produced at the same time. This will be a natural evolution of the core e product and other sustainability products that we have in the market.

In terms of our commitments, Slide 9 reminds you of what they are. We must, as a nation, do more to increase our clean generation and reduce emissions, and we have to help customers do the same thing. The transactions I just talked about with our business partners are part of leveraging our key advantages in helping them meet their sustainability goals.

But as we talked about on Analyst Day, to provide all of our C&I customers with the information they need, we need to give them reports explaining where they are on their path to sustainability. And I'm pleased to say that at the end of this month, we're going to have that in the hands of every one of our customers.

The other pillars of our carbon commitments are to grow our carbon-free generation to 95% of our output by 2030 and 100% by 2040, subject to policy and technology. That means we will be at zero emissions from generation by 2040, not, net zero, zero. And we're going to reduce our baseline operations-driven emissions to zero from a 2020 baseline.

When we announced these commitments on Analyst Day, which, unbelievable, was just six months ago, we told you that we did it with the intent to set the bar in the industry, to be a leader. It's terrific now to see that other companies are following in our footsteps. And I commend those companies and their leadership. We have to keep pushing each other.

Turning to Slide 10. This is a slide that should be familiar to you, and I just want to walk through it quickly before I flip things over to Dan. We intend to deliver value to our shareholders through our capital allocation strategy. We are on track to provide you that update later in the year.

We are committed to maintaining a strong investment-grade credit rating, which provides us a competitive advantage. And you've seen that advantage play its role in our success already in the six months of history of this company. We'll provide $180 million of annual dividend growing at 10%.

We believe that there are other opportunities to grow our business organically and inorganically, and we'll seek those opportunities, provided that they exceed a double-digit return threshold. And if we don't find those opportunities, we're going to provide capital back to our owners through special dividend or share buybacks.

Again, we're going to see what happens here with the IRA. We'll gauge the reaction in the market. That will inform the decisions, but we are committed to providing you that information this year. I've heard some chatter and questions out there that maybe that slips, not going to slip. We will provide that information to the market.

Now let me flip it over to Dan.

Daniel L. Eggers {BIO 3764121 <GO>}

Thanks, Joe, and good morning, everyone. Starting on Slide 11. We had another strong quarter financially, earning $603 million in adjusted EBITDA. As expected, year-over-year EBITDA was slightly lower.

We benefited from higher realized energy prices and lower nuclear fuel costs, driven by the absence of accelerated amortization of fuel at Byron and Dresden. This was primarily offset by lower capacity revenues from both cleared megawatts in the Midwest and lower prices across PJM and New York. Higher nuclear outage costs were driven primarily by a long refueling outage at Salem and additional maintenance during our Byron following the reversal of the retirement decision last fall.

We are reaffirming our full year adjusted EBITDA guidance of $2.35 billion to $2.75 billion. As a reminder, we saw some favorability in the first half of the year by selling output from Byron and Dresden at higher prices after the retirement reversal due to the passage of the Clean Energy Jobs Act.

As of June 1, Byron, Dresden and Braidwood all shifted to the first 12-month cycle under the 5-year CMC program, with revenue starting at $30.30 per megawatt hour. This price is lower than the prices we realized for Byron and Dresden in the first five months of this year. We plan to provide an update for our 2022 EBITDA guidance range on next quarter's call.

Turning to Slide 12. Since we launched in February, we've gotten a lot of questions from both new and legacy investors about our approach to hedging, including how and why we hedge. So I'm going to spend a few minutes to revisit our hedging program. From a business perspective, there are several reasons why we hedge as we do.

First off, we serve 215 terawatt hours of retail and wholesale electric load annually in our commercial business, which accounts for the majority of our forward power sales. Our C&I customers generally sign contracts on a multiyear basis with an average term of at least two years that are often signed as long as six months before going into effect.

Each year, 60 to 70 terawatt hours of these contracts come up for renewal, where we have a renewal rate around 80%, depending on the year. And then we typically win one out of every three new contracts where we seek to add customers. This leads to a fairly consistent stacking of contracts that effectively takes the shape of a third over three years. Matching our generation output to these customer needs provides transaction efficiency and liquidity, particularly in the out-years.

Second, the CMC mechanism in Illinois represents about 27% of our generation, creating a hedge for the next five years. With the run-up in power prices over the last 12 months, the contract prices are now below market and benefiting the Northern Illinois customers. But as you know, the Illinois plants would have shut down without the CMC law, so we would have been receiving no revenues at these sites without the law.

Instead, we are now in a place to potentially extend the licensed lives of these strong dual unit sites, improving both the duration and economic value of these assets.

Third and foundationally, delivering on our financial covenants is of utmost importance, and our hedging program allows us to do that by providing certainty in the near-term earnings and cash flows.

Improved visibility helps us in several ways by supporting the balance sheet and our investment-grade credit ratings, a competitive advantage clearly seen in these recently volatile commodity markets, and providing confidence in our capital allocation decisions, including long-term investment needs and return of capital to shareholders.

We do have some flexibility within our hedging program to be opportunistic when we see attractive prices or pull back when we don't. So we'll manage the portfolio accordingly to capture the most possible value as we see market conditions. You've heard this from us since our Analyst Day, meeting our financial commitments is paramount to us, and our hedging program allows us to meet these commitments, delivering value for our shareholders.

Now turning to Slide 13. We provided an update to our gross margin disclosures, which is marked to June 30, 2022, for prices and positions. Looking at the table, you can see that the total gross margin for 2022 is unchanged from March 31 as we are nearly 100% hedged across the major regions.

Open gross margin is up significantly since the first quarter earnings call due to the increase in power prices across all major regions, offset by the mark-to-market of hedges since we are effectively fully hedged. The commercial team continues to perform well and executed $100 million of power new business during the quarter.

In 2023, total gross margin is up $200 million since last quarter to $8.15 billion. Open gross margin is up $500 million, partially offset by mark-to-market of hedges and execution of $50 million of power new business during the quarter. Across all regions, we capitalized on higher prices during the quarter. Executing sales at price levels well above those of previously executed hedges, we are now 88% to 91% hedged across our portfolio.

We've all watched the dramatic increases in forward gas and power curves over the past 12 to 18 months. But an interesting phenomenon also worth noting is the steep backwardation in the curves across our regions, with 2022 and '23 significantly higher than the out-years.

There was around $30 a megawatt hour of backwardation in the forward groups at NI Hub and West Hub between 2022 and '24. This steepness in the curve is unique. Looking back at history, the past three years backwardation would have been about $3 to $5 per megawatt hour. And the curves are pretty flat when we look back to the three years before that.

I talked about the importance of our retail customers a few moments ago. Many of our retail power customers sign multiyear contracts at a fixed price, providing them with the visibility and certainty they need to manage their businesses and budgets.

However, when combining a fixed-price contract with a steep backwardation in the commodity curve, we've been running into some margin pressure in the near term as we deliver at a lower-than-market price now and then make up for make up for the pressure in the out-years when the cost to serve is then lower than the fixed price contract.

We are managing through this headwind, but wanted to flag since these are different -- use a different market conditions than we've encountered before. I should stress, as Joe pointed out, we have seen some margin improvement this year. There's a little bit of a timing phenomenon, but operationally, this is a good outcome for us.

Turning to the financing and liquidity update on Slide 15. Our credit metrics remain very strong. We have a BBB- rating at S&P with positive outlook and a Baa2 at Moody's with a stable outlook, and our metrics are 10% to 20% higher than our downgrade thresholds.

As a reminder, we have already retired or paid down nearly $2.5 billion of long-term debt and term loans this year, completing our debt paid out for the next two years.

And as Joe mentioned, the value of having an investment-grade balance sheet continues to grow and provide competitive advantages in today's market. We continue to be in a strong liquidity position, with more than $2 billion in unused capacity and a cash balance of $800 million as of June 30.

We have received many questions about our pension since the separation. As of June 30, our pension-funded status is just over 93%, which has improved since year-end due to a combination of the $192 million pension contribution we made in February and the positive impact from higher discount rates on the liability that have collectively more than offset the impact of asset returns.

As a result of the higher-funded status, we've been de-risking the asset mix of the portfolio, which has helped to mitigate the impact of negative equity returns in the first half of this year. We will run a full re-measurement of our pension, OPEB and related trust assets at year-end in normal course. Any change that differ to the assumptions previously embedded in our projections are recognized over time rather than immediately in our financials. Therefore, such changes will have no impact to our current year earnings.

Our financial strength sets us apart from others in the market. This strength provides us with more opportunities to transact in volatile markets, where margins expand as risk is more appropriately reflected in pricing, and we are better positioned to service our customers, all while meeting any additional collateral postings without the need for additional liquidity and those associated costs.

I'd like to now turn the call back to Joe for his closing remarks.

Joseph Dominguez {BIO 16668698 <GO>}

Thanks, Dan. I want to just close by talking a little bit and summarizing Constellation's value proposition. It was a decade ago that we were really starting this discussion about the importance of preserving the nuclear plants.

And I think just so much has changed during that period of time. And really, a lot has changed here in the last year or 2, where you've seen some of the horrible policy decisions that in closing these plants have an impact on electricity prices, reliability and, of course, the fight on the climate crisis.

So it's just so great to see this package coming together in Washington. And we're confident it will pass, and it's going to really change America. So it's a great thing. We just think we're a unique company that cannot be replicated. We own 25% of the U.S. nuclear fleet. And we produce 10% of the carbon-free antigen, nearly twice as much as the next largest carbon-free generator.

And these plants could run for 80 years, well beyond 2050, in most cases. We provide power to nearly 23% of all competitive C&I customers in the U.S., 3/4 of the Fortune 100. This puts us in a position to meet the growing demand for customer-driven carbon-free energy and sustainability solutions.

We think we're the best operator of nuclear plants in the country, and the metrics back that up. We thrive in times of volatility, as both Dan and I discussed earlier.

We generate strong free cash flow through our best-in-class operations, retail and wholesale platforms, and we support clean energy across the country with a good focus on cost and reliability. We have a strong balance sheet and our investment-grade credit rating is extremely valuable, and we deliver value to our shareholders through disciplined capital allocation.

I'll now turn it over to the operator for questions.

Questions And Answers

Operator

(Question And Answer)

Thank you, Joe, Dan and Emily. Great presentation, sounds like everything is going great. (Operator Instructions) And with that, one moment for our questions, and looks like the queue is set. And the first participant to come to the microphone will be Steve Fleishman, and Steve is with Wolfe Research. Steve, give me one second to moving you up and then you can -- are free to talk.

Q - Steve Fleishman {BIO 1512318 <GO>}

Well, Joe, you even got the operator excited. So I think that's the first.

A - Joseph Dominguez {BIO 16668698 <GO>}

Well, we thank Liz for that. Enjoy the show. She's a shareholder.

Q - Steve Fleishman {BIO 1512318 <GO>}

Yes. So this bill's not passed yet, and so I just want to just get a little more color on your confidence, such confidence that it's going to get done, and also make sure that the corporate min tax provisions would not impact Constellation.

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes. Let's do it backwards. Dan, why don't you talk about the AMT first?

A - Daniel L. Eggers {BIO 3764121 <GO>}

Yes, Steve, thanks for the question. So when we talk about our cash tax exposure, I guess, number one, certainly, we're going to be over the $1 billion pretax earnings threshold as we look forward. So we'll qualify it in that sense. We've told you that we expect that our cash tax rate to be moving up from a modest payer this year to be a more meaningful payer next year and the years beyond.

When we look at '23, our cash tax rate would be above the AMT under all circumstances. We would expect to be a cash taxpayer, absent the PCC, once that goes in effect in '24, we'll manage the credits to cover our tax liabilities and use the transfer market to monetize those that wouldn't fit and rate the AMT construct.

A - Joseph Dominguez {BIO 16668698 <GO>}

Thanks, Dan. And Steve, as to your question on the IRA, it's -- look, there's just a lot of work that's been done, and we're pretty close. At this point, what we're seeing is probably what everybody is seeing who's following the bill.

Strong progress, getting managed on board was key. Senator Sinema is out there, reports yesterday on some, what I would describe, maybe not others, but what I would describe as fairly modest changes to the bill. And so if that all holds true and the parliamentarian gets the work done, we see a pathway to passage here in August. And then, of course, they'll go to the house when they come back from recess. But there's no reason, at this point, that we could see not to be confident. Kathleen, do you have anything to add?

A - Kathleen L. Barron {BIO 19492153 <GO>}

No, I think that's right. I mean, I think, Steve, you've followed us for long enough. You've seen hurdles get cleared over the last couple of months. There are a couple of remaining, as Joe said, the problem with is getting to work on the tax title and the energy title. And we just -- we have a couple of more days here to let the Senate continue doing their work, but we're getting close.

Operator

Great. So the next question is that's wrapped up is going to be from Paul Zimbardo at Bank of America. Paul, give me one second to move you to the queue and then you're ready to rock and roll.

Q - Paul Zimbardo {BIO 18277958 <GO>}

I'll will be the next context today. Appreciate it. Wanted to touch a little bit on the cost side of the business. Just given the inflationary pressures, are the guidance -- the multiyear guidance that you put out for O&M, maintenance capital, still good ones to focus on, or are you starting to see some pressure on those numbers?

A - Joseph Dominguez {BIO 16668698 <GO>}

Hey, Paul. I think we're -- like everybody else, we're starting to see some labor pressure. But we benefit from a few things here. We have -- for the O&M at our plants, we have long-term agreements to support the operation of the plants. And they have built in escalators at 2% to 3%. And that's something, obviously, we had already factored into our plan. So we -- that being probably one of the largest drivers of our cost is locked in.

Most of our big labor agreements are also locked in, in some cases, through 2027 at 2.5%. So we're not immune in this environment to inflationary pressures, but we find ourselves in a pretty strong position. I'll also add, we carry -- and this is one of our strengths, we carry a lot of the nuclear parts inventory in-house so that we could quickly recover from maintenance events. And that's a benefit because it's already bought. It's already on the sidelines here. Dan, anything more to add on that?

A - Daniel L. Eggers {BIO 3764121 <GO>}

I think that's right. We'll keep an eye on all the pieces, but certainly, between the labor deals that we have and the supply contracts, the delays that significantly played out at this point.

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes. I think we feel comfortable, Paul, is the bottom line.

Q - Paul Zimbardo {BIO 18277958 <GO>}

Okay. Great. And if I could quickly ask just about the nice uptick in new customer win rates, renewal rates, just how those conversations have evolved now that commodity prices have proven pretty sticky, to be higher than before?

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes. Well, I'm going to ask Jim McHugh to weigh in, but I think you just -- you've actually nailed it.

I think in the early days, and we certainly saw this in the first quarter, renewal rates were down because our customers quite naturally were wondering if this is a short-term blip and things were going to kind of cascade backwards to where prices were before. And now we see a lot more renewables. Now some of that's just time-driven. Some of these contracts are coming up. Customers have to make the decision. But I think the conversations we're having, Jim, right, are that customers now understand we've had a transformation in energy pricing, and they're locking in deals.

A - James McHugh {BIO 20604624 <GO>}

Yes, I think that's right, Paul. From a pure locking-in commodity perspective, they have to get their budget certainty, too, right. So they're coming up on their renewals, and they're coming up on when they need to kind of get their deals, unable to drag their feet for a little bit.

But it's pretty apparent, I think, to them and to us that we're kind of in a different energy complex right now, and they're more willing to lock in. We saw that during the second quarter with the increased renew rates. We also saw increased -- during the second quarter, the terms stretched out a little bit longer from where they were in the first quarter.

So both of those, I think, are indicators of what Joe just mentioned. And of course, these same customers are also talking to us about the future products, too, because they have an eye on their sustainability needs and their energy footprint. So those conversations are generally going pretty well right now.

Great. Thank you, both.

A - Joseph Dominguez {BIO 16668698 <GO>}

Thanks, Paul.

Operator

Great. Thanks, Paul. Good questions. And next up to ask a question is Shar Pourreza with Guggenheim, and Shar, give me one second, while I activate you for questions.

Q - Shar Pourreza

Hey, guys. How's it going? It's actually James for Shar. Can you hear me?

A - Joseph Dominguez {BIO 16668698 <GO>}

Good morning.

A - Daniel L. Eggers {BIO 3764121 <GO>}

Yes, good morning. How are you doing?

Q - Shar Pourreza

Good morning. So I guess, I wanted to start with your comments on growth in capital allocation and how that kind of ties into the IRA potentially passing this summer. Would that change your views at all around inorganic nuclear growth. And are you seeing any opportunities out there right now?

A - Joseph Dominguez {BIO 16668698 <GO>}

You know, I think I've talked a little bit about this before on last quarter's call. I always thought that with the IRA out there, and we were certainly seeing this, it was just going to be hard to pin down valuation. Sellers were always going to want to value the IRA. And we wanted to see the certainty, even though we were cautiously optimistic, and we saw the progress.

So I think what the IRA does is narrows the bid-ask spread by effectively providing a strong price floor under the nuclear units at over $40 a megawatt hour. So that allows us to have conversations that we haven't had before.

In terms of getting into specifics here, you all know that we're focused on acquiring assets, and that's part of the inorganic growth strategy, if the price makes sense to us. And if you see any nuclear plant transacting, I think it's fair to guess that Constellation is going to be involved in that discussion. But I wouldn't describe the pace as increasing or not. I think right now, people are just waiting for this to get done.

And then I think maybe revisiting that question in the third quarter, it'd be interesting to see if there's an uptick in activity. But I think folks have to digest this. They have to understand what it means for their business. And then I think there'll be an opportunity to have a landscape where assets will become available.

Q - Shar Pourreza

Excellent. And I guess, just sort of on the hydrogen side of the legislation, the opportunity here as we look at the capital allocation, could you actually start spending growth capital in '23, or is it really just something that has some technical looking at to the pilots?

A - Joseph Dominguez {BIO 16668698 <GO>}

My thought on that would be that anything we spend in '23 would be relatively modest compared to the amount of cash that we'll be generating as a business. And I think capital in that area would probably scale up more meaningfully in '24. Thank you.

Q - Shar Pourreza

Excellent. Thanks, Joe.

Operator

All right. The next wonderful and exciting question comes from James Thalacker at BMO Capital Markets. James, give me one second to move you up to the speaker queue, and you're all set.

Q - James Thalacker {BIO 1794957 <GO>}

Hi. Thanks, guys. Hopefully I can live up to that intro on the exciting side. Just a real quick question, just sticking on the supply side. A lot of people are focused on the pricing side. But just wondering, I noticed that just yourself and Duke had signed LOIs with Global Laser Enrichment over the last couple of months.

And just wondering if the -- there's been increased focus on energy security and domestic supply production, how do you guys see bringing uranium back in terms of both production as well as enrichment here in the U.S., and how this technology might sort of play into that. I know it's going to be longer dated.

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes. I think in terms of a U.S. strategy, I think policymakers are right to be focused on incentivizing more production capability in the U.S. I think that's a pretty exciting technology. Bryan Hanson, who runs our fleet, is here. And maybe, Bryan, you could add a little bit of color.

A - Bryan Hanson {BIO 18995088 <GO>}

Yes. I just said it's important for the U.S. to reestablish itself as an international leader in enrichment services. As you know, we currently have very modest amounts in the U.S. today.

So I think based on this desire, we're seeing a lot of new innovations come about, both in GLE, as you referenced, and a couple of other companies that are also looking at the United States to expand enrichment services. And we want to be an active part of that.

Q - James Thalacker {BIO 1794957 <GO>}

And just as a follow-up, I know that these things are going to probably take longer than probably most investors' attention span. But as you think about bringing back sort of domestic, not only supply, but also enrichment to the U.S., how long of a time frame do you think before we're kind of we've wrestled back a large chunk of what sort of currently offshore?

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes, I think most of the manufacturers think somewhere after 2026, out in the 2028 to 2030 period. And again, through our contracting and contracts that we have, we're -- again, we're hedged for multiple years out in the future and feel comfortable where we are in our fuel position today.

Q - James Thalacker {BIO 1794957 <GO>}

Okay. Great. Well, thank you guys. Appreciate it.

A - Joseph Dominguez {BIO 16668698 <GO>}

Thank you.

Operator

All right. The next question comes from David Arcaro at Morgan Stanley. David, moving you to the speaker's area, and you're all set.

Q - David Arcaro {BIO 20757284 <GO>}

Great. Thanks so much for taking my question. Good morning. I was wondering, just if the -- if you get the nuclear PTC, is there a like baseline EBITDA and cash flow level that you would have in mind as to -- if all of your plants would have received the PTC into that low 40s per megawatt hour level, what that would mean for the kind of stable, low-risk and derisked piece of the EBITDA profile?

A - Joseph Dominguez {BIO 16668698 <GO>}

Hey, David, first of all, good morning. Appreciate your question. We're working through that. The legislation still hasn't gone. We want to see the final language. Even after the legislation is done, there's going to be some elements of it that will be subject to treasury interpretations, where we're going to need some guidance to settle it out.

It has -- the first year it's really effective for us is '24, which is outside of our guidance at this point. But we'll be working through that, quite obviously, and have devoted a good deal and thought to it. But at this point, I don't think we have all the data points yet to say. And secondarily, I just -- I don't want to be in the middle of this legislative discussion talking about profits until we see bills and see how this really translates to our business.

Q - David Arcaro {BIO 20757284 <GO>}

Understood. That's fair. I thought I'd give it a shot. And then you've mentioned some retail margin pressure that you're seeing this year. I was just wondering if you might be able to quantify that further as to how much that's impacting the EBITDA and how it might kind of come back in a positive way on the back end out in 2024?

A - Daniel L. Eggers {BIO 3764121 <GO>}

Yes, David, I think our target point was just kind of highlight that this is a trend that we haven't seen historically, right. We reiterated our guidance comfortably for the year. So we still feel good that this is going to be a little bit in the friction of the year. So I wouldn't over rotate in it by any means, the origination, as Joe pointed out.

We're having good margins on the business as customers are coming back, and they're looking at getting risk priced into those contracts. So we feel good about it. I guess a little bit of something we're keeping eye on for this year, maybe dragging in next year a little bit, but nothing has changed in our disclosures at this point.

Q - David Arcaro {BIO 20757284 <GO>}

Okay. Got you. That's helpful. And then just lastly, I was wondering if you could talk to how the 2024 hedge level might be shaping up just in terms of how much you might have layered on over the course of the quarter. Would it be similar to what we've added for the 2023 year, or any color there would be helpful.

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes, David, I'm going to ask Jim to jump in and answer that. But just not to be nitpicky, but in your prior question, you talked a little bit about how we levelize prices and that we might get the value back in outer-years. There's no might about it.

What we're doing is just smoothing the price trajectory for customers and levelizing that really over a period of years. We will get it back in the outer-years but by no means are we signaling that this has lost money and that there's any chance to it. Jim, why don't you cover the last question?

A - James McHugh {BIO 20604624 <GO>}

Thanks, Joe. As it pertains to the 2024 hedging question, I'll kind of highlight where we are and what's been going on in the portfolio. I want to basically -- I want to start with just a reminder that, like Dan said in his opening remarks about having the CMC structure, that starts us out at about a 27% hedge level.

And the way the -- in addition to that, the way the New York ZEC rate setting mechanism is happening right now with where prices are. That's also hedging a piece of our portfolio because as prices go up, we're able to -- we're offsetting the increase in generation value with the ZEC mechanism moved into.

So those are two things that start our portfolio already hedging a bit ahead of reasonable amount. But to give you some context of where we are, we had talked at the Analyst Day, we gave a number that we were 52% hedged in calendar year '24. In the last quarter, during Q1, we talked about we added a similar amount of hedges to calendar year '24 that we added to calendar year '23. So that would get you to the mid-60, like the 65% hedge level.

Well, this quarter, we added right -- again, right about a ratable amount or slightly less overall. And we're sitting around the 70% hedge number right now. So there's 30% of our portfolio that's still open, participating in the market conditions.

What we've been doing recently is just adding some of those incremental hedges as we've seen this gross margin moving higher with the forward markets and taking some opportunities to lock some of that in to achieve what Dan talked about during the opening remarks of the call, where we're looking at creating reliability and durability and stability in the gross margin EBITDA projections out there.

So we have a 70% hedge number right now. The activity in hedging is coming from our customer business, primarily it's coming from -- or with the forward markets and taking some opportunities to lock some of that in to achieve what Dan talked about during the opening remarks of the call, where we're looking at creating reliability and durability and stability in the gross margin EBITDA projections out there.

So we have a 70% hedge number right now. The activity in hedging is coming from our customer business, primarily it's coming from customer sales where we make those margins on the energy that we're selling. So it's been a good story for calendar year '24.

Q - David Arcaro {BIO 20757284 <GO>}

Okay, perfect. That's clear. Thanks so much.

A - Joseph Dominguez {BIO 16668698 <GO>}

Thanks, David.

Operator

Great question, David. All right. So we have time for one more question and that's going to go to Jonathan Arnold. Jonathan is with Vertical Research Partners. Jonathan, one second and then you'll move to the speaker stage.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Hi, guys. Can you hear me?

A - Joseph Dominguez {BIO 16668698 <GO>}

We can, Jonathan. Good morning.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Good morning. Just a quick question to sort of ease off of the starting to talk about 2024 and hedging. As you read the IRA legislation as it's currently drafted, what is going to drive the PTC most likely. Is it going to be a market clearing the busbar type price of the unit, or is it going to be some number that reflects hedges you have on, and then how do you think that would be determined, or just any insight you can give on how you think that's going to work?

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes, Jonathan, we think it could be either. And that's the way that treasury will ultimately interpret it, either as a hedge or you could do it -- you can take it the spot.

But that's -- when I talked earlier about one of the treasury interpretations that we're going to need in the long-term to really add certainty, that's one of the things that we're going to look at. The reason -- look, the reason we think that the hedge should be one of the means of setting the value of the PTC is this, the way we've always done business.

And in point of fact, if the IRS was telling us that the only way to guarantee the PTC at its full value is not the hedge and take everything to spot, then we would have to effectively stop participating to a great degree in some of these utility procurements that go out multiple years.

And with 33-plus percent of the energy that's being sold in PJM as an example, coming from nuclear, without the participation of nuclear baseload in these auctions, our customers, at the end of the day, families and businesses won't be able to get the certainty through their hedges.

So there's a number of examples where Treasury has used hedge values for for tax purposes. We think those will apply here. There's a lot of good reasons why it should apply to, again, facilitate these load options that all of the utilities seem to have and warrant. And those points will be made to treasury. And I think treasury will certainly accept it at the end of the day, but it's not a done deal just yet. It's one of these open issues.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Okay. So to the bills sort of not definitive and something to work out off to the -- off to passage effectively.

A - Joseph Dominguez {BIO 16668698 <GO>}

I think that's fair. I think the way we read the languages, it's open to either.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Okay. And then maybe I just want to make sure I had what you said on capital allocation, it's like the lie -- I get a buzz on the line, but do you say later in the year was

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes.

Q - Jonathan Arnold {BIO 1505843 <GO>}

or anything more specific on that?

A - Joseph Dominguez {BIO 16668698 <GO>}

What I said, Jonathan, I apologize if it was on our end. But what I was saying is this, with the IRA, if that were to pass and be enacted in September, we'd want to see a period of time to see how the market reacts.

Is the market, in our view, treating us fairly, and does it reflect the enormous transformational value that the bill would have on our business, and so that will drive how we utilize our cash, and that may change the option. So I think we'll see this thing in September.

We'll see fairly quickly how the market reacts. And what I was saying is that we are committed to providing that information before the end of the year. Is that going to happen on the third quarter call or sometime between the third and fourth quarter call?

I don't know yet. We haven't made that judgment, but we're going to provide that information. And the year is going to be 2022 in which we're going to provide it.

Q - Jonathan Arnold {BIO 1505843 <GO>}

And then maybe if I could just sort of follow up on that, the question David asked about the baseline under the nuclear PTC. Do you think you'll kind of give the market an indication of that as part of this price discovery process? Or sort of let us figure that out and then decide what to do on capital allocation, depending on book value, which is what I'm hearing?

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes. I think in terms of the long-term value of our assets and our business, the market is going to be able to figure that out fairly readily.

I know that the treasury interpretation on the reference point for setting the PTC is an issue, and certainly, in the earlier year of the program, perhaps it's an issue. But in the long-term, you're going to be able to look at the number of megawatts we produce and evaluate it against low 40s megawatt hour price, and you're going to have a pretty good sense of what the value of these companies can be.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Perfect. Thank you very much.

Operator

Great questions, everybody. That does conclude our Q&A session of the event the program. You may all move over to Joe or Dan. I think Dan maybe.

A - Daniel L. Eggers {BIO 3764121 <GO>}

Well, Liz, I just want to thank you again for starting to call and your colorful remarks throughout, and for all the folks who have listened in and the great questions we've received. So thank you very much, everybody. Have a great day.

Operator

All right, ladies and gentlemen. Thank you for participating in today's conference. This does conclude the program. You may all now disconnect, and have a wonderful day.