Q1 2022 Earnings Call

Company Participants

- Bryan Hanson, Constellation Energy Corporation
- Daniel Eggers, Constellation Energy Corporation
- Emily Duncan, Constellation Energy Corporation
- James McHugh, Constellation Energy Corporation
- Joseph Dominguez, Constellation Energy Corporation

Other Participants

- Michael Lapides, Goldman Sachs Group, Inc., Research Division, VP
- Paul Zimbardo, BofA Securities, Research Division, VP in Equity Research & Research Analyst
- Shahriar Pourreza, Guggenheim Securities, LLC, Research Division, MD and Head of North American Power
- Stephen Byrd, Morgan Stanley, Research Division, MD and Head of North American Research for the Power & Utilities and Clean Energy
- Steven Fleishman, Wolfe Research, LLC, MD & Senior Analyst

Presentation

Emily Duncan {BIO 19183068 <GO>}

Thank you, Shannon [ph]. Good morning, everyone. Thank you for joining us for our first Constellation Energy Corporation earnings conference call as a stand-alone company. 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'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 -- all of which can be found in the Investor Relations section of Constellation's website.

The earnings release and other matters which we discuss during today's call contain forward-looking statements and estimates regarding Constellation and its subsidiaries following the completion of the separation from Exelon 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 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 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 it over to the CEO of Constellation, Joe Dominguez.

Joseph Dominguez {BIO 16668698 <GO>}

Thanks, Emily. Good morning, everyone. Thanks for joining the call and for your interest in our company. As you can imagine, there's quite a bit of excitement here in Baltimore as we gather as senior executives to celebrate the occasion and milestone of our first earnings call.

We had a strong quarter with good performance and across the board here at Constellation, exactly the way you want to start off. Our nuclear team, our power and renewables business, and our commercial business all performed exceptionally well throughout the quarter. It's a strong start, and I just want to pause for a second and give a shoutout to the talented women and men for everything they do for our company. You're the reason for our success.

Since this is our First Quarter, I wanted to start on Page five of the deck and take a moment to remind you what we're all about here at Constellation. As you know, we produced the most carbon-free energy in America and have one of the lowest carbon intensities of any large power company in America by a very wide margin.

But we're not resting on our laurels. We announced on Analyst Day our goal for our generation to be 95% carbon-free by 2030 and 100% clean by 2040. That's not net clean. That's clean. Our power and renewables business has some of the best natural gas and renewable energy facilities in the nation, and they are producing some strong results.

And finally, our commercial and customer-facing business deliver sustainable energy solutions to millions of families and businesses across America, including many of the nation's leading companies.

We support our communities by providing good-paying jobs, generously contributing to charitable organizations, volunteering and delivering clean energy and solutions everywhere we sit. All of this work is supported by a strong investment-grade balance sheet that we carefully manage to provide liquidity throughout the commodity cycle.

In sum, we are committed to being a leader in solving the climate crisis. We have the financial tools in place to provide maximum flexibility, and we remain a stalwart presence in the communities that we're privileged to serve.

Let me flip to Slide 6. Delivering the results that we report today in a very complicated energy world is, of course challenging. But it's only part of the challenges we faced here at Constellation during the First Quarter. In addition to running the business and delivering strong results, our folks have handled the corporate separation with Exelon, standing up new teams and capabilities. We have many leaders in new roles, and I'm proud to say that the separation has gone smoothly and without disruptions.

Our IT platforms have had no issues. We're on track to separate the platforms and terminate the transition services agreement between Exelon and Constellation on time and on budget. Thanks again to the hard work and excellence of the teams at Constellation and Exelon who are working on those issues.

Our plants continue to operate at world-class levels, and our customers continue to receive top-notch service and be linked to clean energy products. In fact, some of the highest customer satisfaction scores we've ever received as a company we've received this quarter.

Since separation, we have delivered first quartile adjusted EBITDA of $866 million. We paid our first dividend. We reduced our debt by nearly $2.5 billion ahead of schedule, and strengthening that strong balance sheet that I mentioned at the outset is a core strength of ours and a competitive advantage.

Dan will get into the details of all these achievements and more. But I want to say that, consistent with our past practice, while we are reaffirming guidance today we will not revisit guidance until we get through the summer.

From a policy standpoint, states continue to lead on addressing climate change. Maryland enacted the Climate Solutions Act, which will help the state reach its greenhouse goals. Importantly, for the first time, it recognized nuclear energy as an essential resource in achieving these goals.

In Pennsylvania, the regulations for the state to join RGGI are finalized. As a result, Pennsylvania is poised to participate in the program and reduce emissions by 225 million tons by 2030, producing cleaner air for families across the Commonwealth.

Both of these important policy outcomes are the result of the excellent work by our internal teams led by Kathleen Barron and all of our community partners. We appreciate that partnership. At the federal level, we continue to work with industry, labor and environmental partners to ensure that nuclear energy is part of the next federal energy package, and earning the same tax credits that other technologies have enjoyed for a long time and ensuring that this vital technology is an American resource for decades to come.

Now we all know that we're not across the finish line in D.C. with the anticipated tax package, but we believe that progress is being made, and we remain cautiously optimistic that a favorable outcome will be achieved this year. And look, I know that all of you, like the folks here at Constellation, like to look out the windshield at what's in front of us and not so much look in the rearview mirror. But I do think it's important sometimes to pause and remember the journey we've traveled.

It wasn't so many years ago where policymakers and even climate scientists ignored the vital role of nuclear energy as part of an overall strategy to solve the climate crisis while providing affordable and reliable power to customers. Environmental groups, many who cut their teeth in the antinuclear movement, pressed hard to close plants. And unfortunately, some entire countries took that advice.

The very thought that nuclear would receive state policy support was a joke to some. Well obviously all of that has changed in a few short years as people across the globe have come to understand the critical importance of clean nuclear energy.

Unfortunately, the change in mindset came too late to save some plants in Europe, where the painful consequences of very poor energy decisions are revealed today in more pollution and less energy and national security. No one is happy about that.

And although you know that we've been a strong voice and at the leading edge of this discussion about nuclear for years, I'm not reminding you of the history to tell you that we are right all along. That's not important right now.

What's important is this, as you evaluate our company, our ESG bona fides and our staying power for decades, we believe that it is more evident than ever that we operate the clean energy assets that America needs to battle through the climate crisis. So as we all step back and look at the windshield of the future of energy policy and ESG considerations, we believe that Constellation is perfectly positioned to benefit from the continuation and expansion of policy support and should be a central part of the ESG interest.

As I said at Analyst Day ESG is not a bolt-on here. It's a strategy that we intend to grow. That is why in our First Quarter, we established a sustainability council filled with leaders across the company to advise us on ESG issues.

We launched 9 employee research groups, sponsored by members of the Executive Committee, and these groups demonstrate our core value of respect, belonging and diversity by bringing people together, respecting what makes us different and special while promoting inclusion at the best energy workforce in America. They also support learning and development of our people.

Finally, we continue to strengthen our workforce. The photo that you see here on this slide is of the Simeon Career Academy electricity class at our Braidwood Clean Energy Center. Simeon is a public vocation high school on the South Side of Chicago, which provides college prep and career-focused education. Its student body is diverse filled with many African-Americans and other groups that historically have not proportionately benefited from the jobs and economic opportunity in the energy field. At Constellation, we're determined to make this change.

What I think is really cool here about this photo and what I've seen time and time again in my career is this concept that you can't be what you can't see. We have here African-American leaders, managers here at the company, teaching African-American students about careers in nuclear energy. You can't beat that.

As I turn to Slide 7, I want to talk a little bit about generation operating highlights. Overall, we produced 40.4 terawatt hours of carbon-free energy across our nuclear and renewable fleet, which avoided approximately 30.2 million metric tons of CO_2 during the quarter. Nuclear had a 93% capacity factor, and performed 3 outages averaging each 22 days, well below the industry average.

As you know, one of the ways that we manage cost after the Texas events last year was to push some work into this year. So our outages this spring were a bit more complicated than usual as we had to do some catch-up work.

We did a good job getting after that work, and we have to-date completed our most difficult planned outages for the year, and we are happy to have it successfully behind us as we headed into the summer. The fall outages we have planned for later in the year are the easier ones. Good work by nuclear there.

Our Texas fleet ran well during the winter, even during the extreme weather we saw in February. Overall, we had a 99.4% power dispatch match rate during the quarter. In my view, we validated last year's weatherization work on the Texas fleet, and we're done with those expenses. Finally, our wind and solar fleet had an energy capture of 96.1%, again exceeding our plan.

Turning to Slide 8. Our commercial business performed very well during the quarter and delivered energy solutions to customers both new and old. During the quarter, we delivered 53 terawatt hours of wholesale and retail energy to our customers across the United States.

On this slide, we show our trailing 12-month average win rates for power and gas and our renewal rates for power. As you can see, we've had a great deal of success in winning new customers and even more success retaining customers due to our product offerings and strong customer relationships.

I'm not surprised that we didn't miss a beat here in the business. But look, it's very good to know that we retained and expanded relationships as we separated from Exelon. Our customers continue to look to us to provide solutions to help them meet decarbonization goals.

We executed long-term deals with Comcast and Sheetz to provide them with renewable energy. These deals support 350 megawatts of new renewable generation being built, represent 12% of Comcast power needs for its operations, and will supply 70% of Sheetz's entire Pennsylvania needs, with nationally -- with national RECS that are energy matched. Great work there.

Turning to Slide 9. At Analyst Day we talked about how nuclear plants could do more than just supply carbon-free electricity to the grid. We can become clean energy centers that can solve the climate crisis by helping to produce the fuels that will help decarbonize other sectors of the economy.

I want to talk about hydrogen here. With the right policy support, we've done enough work now to believe that nuclear power plants will be the most competitive place in America to produce clean hydrogen. As we speak, we are completing the construction of our first electrolyzer project in New York under a DOE grant to test the technology. Like many others, we believe that clean hydrogen will play an incredibly important role in mitigating that -- the air pollution that is causing the climate crisis and the local health issues in the communities that we serve.

Hydrogen can be used to create clean aviation fuels, to reduce air pollution, reduce emissions in steel manufacturing and other industrial processes. It can be used to power fuel cells that power long-haul trucking and even to create fertilizers and other clean agricultural products. The opportunities for clean hydrogen are almost limitless. And again we think we can make it at our plants cheaper and more effectively than any other place in the U.S.

For the past six months, we've been working with a diverse set of public and private partners to develop a bid for a hydrogen hub, powered by nuclear energy and funded under the grants that were included as part of the bipartisan infrastructure bill. We'll have a lot more to say about this as we get closer to fruition, closer, frankly, to the submission of the bid, and you should look for us to provide a more detailed update next quarter.

Finally, I want to end with the technology piece here with a new DOE grant that we received. We were awarded a multimillion-dollar grant to explore using new direct air capture technology, so-called DAC technology, direct air capture, that would help scrape carbon out of the air using our cooling towers at the clean energy centers. It's pretty cool how it works.

Occidental has created a new membrane that we'll install in the cooling towers of our power plants. It's got a material that chemically interacts with high-moisture, higher temperature air. And as the water vapor from our cooling towers passes over the membranes, the membranes actually trap the CO2 in the air and could then be extracted.

We expect this process will allow us to capture up to 250,000 tons of carbon dioxide each year, which will do something really unique at our nuclear power plants. These clean energy centers won't be -- won't just be this place where we produce as much clean energy as anywhere in the planet in a concentrated basis, but they'll actually allow us to remove CO2. So we'll be able to go net negative at these clean energy centers, and we'll be able to use that technology to meet our 2030 and 2040 emissions goals.

Then lastly, on the commercial side, I want to say that we announced our 5-year collaboration with Microsoft for that 24/7, 365-day energy realtime matching solution. By combining renewable energy, clean energy, with exciting new battery storage, fuel cells, hydrogen technologies, we're going to be able to provide our customers with a realtime data-driven accounting solution that matches their consumption of clean energy with the production of clean energy on a geographic and time standpoint.

As we develop the product, we'll be working with Microsoft to give customers a transparent and independently verified view of their sustainability efforts. We've also been working with the RTOs.

In particular, we work with PJM and others to ensure that their systems give us the geographic and timestamp data so that we can match renewables and clean energy generation with the consumption by our governmental and commercial customers.

We expect PJM to provide load-matching data to members this year. That's important because we're not going to be able to decarbonize the power sector with clean energy until we have the capability to do with clean energy what we've been doing with energy since the dawn of electricity. That's matched consumption to production. I want to thank PJM for acting upon our request and leaning into this body of work.

And finally, before I turn it over to Dan, I'm going to touch on Slide 10 to reiterate our capital allocation strategy. We intend to deliver value to our shareholders through our capital allocation strategy and through a very disciplined strategy of capital management.

We are committed to maintaining strong investment-grade credit ratings, which provide us a competitive advantage. We will provide a $180 million annual dividend growing at 10% per year. As I said, we awarded the first dividend in the First Quarter.

We believe that there are opportunities to grow our business organically and inorganically, and we will seek opportunities that exceed a double-digit return threshold and will deliver value over the long term to you, our owners.

And where we don't find these opportunities or where they do not meet the thresholds, we will give money back to you, our owners, through special dividends or share buybacks. As I mentioned on Analyst Day we'll provide you with that clarity on exactly how we will return value in the back half of the year. With that, let me flip it to Dan for his update.

Daniel Eggers {BIO 3764121 <GO>}

Thank you, Joe. Good morning, everyone. Today I will cover our First Quarter results, power and gas markets, and provide an update on our gross margin disclosures and balance sheet.

Starting with Slide 11. We delivered strong financial results in our First Quarter as a stand-alone company. We earned $866 million in adjusted EBITDA, which is up nearly $1.3 billion year-over-year. These strong results reflect the absence of Winter Storm Uri from last year, which is a $1.2 billion EBITDA impact. This number is consistent with the First Quarter 2021 impact at Exelon Generation of $0.90 per share on the Exelon share count or approximately $880 million after tax.

We also benefited from higher hedge prices in the first part of this year with the reversal of retirements of Byron and Dresden in September, we're able to sell that output at higher prices, providing some timing favorability before the CMC contracts go into effect in June. We should see some of this benefit continue over the first two months of the Second Quarter as well.

Our commercial business captured value through optimizing the portfolio and strong new business execution during this period of higher prices. Nuclear fuel amortization expense was lower in the First Quarter of 2022 relative to 2021 primarily due to the absence of accelerated amortization following the reversals of the buyer and interest in retirements.

Lower capacity revenues reflect less volumes clearing, particularly in the Midwest, and we faced additional costs for nuclear outages as we catch up from our COVID- and Uri-related maintenance deferrals that Joe referenced.

We are reaffirming our full year adjusted EBITDA guidance range of $2.35 billion to $2.75 billion. As you think about full year expectations, in the First Quarter, we benefited from some unique opportunities, including the expected stronger power price realizations at Byron and Dresden and some timing opportunities in the commercial business.

Also, we ended the year fully hedged in the Midwest and Mid-Atlantic. And as I'll discuss in a few minutes, are now fully hedged across our portfolio, which limits the impact of rising prices in 2022 but is showing up in our 2023 disclosures.

Turning to Slide 12. As you know, we have seen a dramatic rise in natural gas and power prices over the last 12 months or so, both in the prompt year and also across the 23 to 25 forward price curves, which you can see on these charts. Starting with Henry Hub natural gas prices, forwards have increased on average $0.75 per million BTUs since the beginning of the year through March 31 and $1.50 since the beginning of 2021. As of Tuesday spot gas was $6.49 per million BTU, and forwards in '23 are at $5.25, levels we have not seen since 2008.

The increase in gas prices are driven by a combination of growing demand post-COVID, lower storage levels and a tight supply and demand balance in the domestic natural gas market. In addition, the tragedy in the Ukraine has exacerbated the rise in gas prices as the EU and the U.K. look to replenish, depleted storage and find other sources of supply outside Russia.

Unfortunately, for those involved, we do not see a change in these dynamics in the near term at the very least and expect higher natural gas prices to continue. As you know, higher fuel costs will have a significant impact on the price of power.

The continued rise of both natural gas and coal prices have certainly supported higher power prices out the curve. Power prices are further being supported by a number of other factors, including clean air regulations expected to increase allowance prices in some of our key markets and the continued retirement of coal units. As you can see in the charts, 2023 NiHub and West Hub forwards are 80% to 100% higher since January of 2021.

Turning to hedging. We've increased our hedge position since last quarter that can be put into 2 primary buckets. First, with these upward moves in prices, we have used the flexibility in our ratable hedging program to lock in more forward sales for 2023 and beyond. Locking in these prices reduces the volatility in our earnings outlook, provides more certainty to future earnings and cash flows, and provides us with greater visibility and confidence in future capital allocation decisions.

Second, our New York hedge position is considerably higher than last quarter, which reflects the interplay of the New York ZEC program and forward prices. We have a refresher on the New York ZEC program on Slide 18, but in simple terms, the New York ZECs were designed with the consumer protection mechanism that adjusts the ZEC prices as we cross revenue thresholds, which we are now projecting for tranche 4 that begins in April 2023 for the next 2-year term.

At current prices, we are effectively fully hedged for our New York output over the Tranche 4 ZEC term. With that context, looking at 2023, we are now 86% to 89% hedged on a fleet-wide basis, which is between 11% to 14% higher than where we were hedged at Analyst Day.

And while we do not show it here, you're safe to assume that we have increased our 2024 hedge position by a similar amount, which reflects both our normal hedging activity and the New York ZEC effect. As a reminder, the carbon mitigation credits in Illinois represent approximately 27% of our hedge position in each year of the contract.

Moving to our gross margin update on Slide 13, and I should note, these numbers are calibrated at March 31 to the prices and positions, as you may recall, the gross margin table that we shared at our Analyst Day in January were based on November 30 forward prices, but we included a $50 million downward adjustment in our EBITDA guidance to reflect the drop in prices during December.

Accounting for these prices, total gross margin would have been $7.3 billion for 2022. Looking at the chart, you can see the total gross margin for 2022 is unchanged accounting for this adjustment. Open gross margin is up significantly since Analyst Day due to the higher prices across all regions, which is then offset by the mark-to-market of our hedges.

We had strong performance across power and nonpower new business, executing $250 million of power new business and $150 million in nonpower during the quarter. As I referenced on the last slide, we're now effectively 100% hedged for 2022, so power price moves are having very limited impact on our results at this point.

In 2023, total gross margin is up $300 million since Analyst Day to $7.95 billion, driven by higher prices in all regions. We executed $150 million in power and nonpower new business.

Contracted revenues decreased by $50 million, driven by the interplay of current higher prices and the dynamics of setting the ZEC level for the next tranche of the New York ZEC program, which I said begins in April 2023. These higher prices resulted in a decline in the ZEC level itself but is offset by higher power prices that are showing up in our open gross margin calculation.

Turning to the financing and liquidity update on Slide 15. As Joe said, our investment-grade credit rating is the cornerstone of our financial policy. Investment-grade ratings and a strong balance sheet provide us with many competitive advantages, including ample access to liquidity, the ability to participate in customer channels like wholesale load auctions and provides flexibility in how we provide credit support, such as using final guarantees in lieu of letters of credit.

Our credit metrics remain very strong and are well above agency thresholds. Following separation, S&P raised their outlook from stable to positive and Moody's from negative to stable, both while reaffirming ratings at BBB- and Baa2, respectively. Since separation, we have retired or paid down nearly $2.5 billion of long-term debt and term loans, which completed our debt paid out for the next two years.

We saw opportunities to accelerate our debt reduction this quarter and pulled forward a $523 million senior note due to be retired in June, and then in April, we paid off the $880 million term loan originally due in August for the CENG acquisition. Given the sharp rise in commodity prices and higher volatility, we've received a lot of questions about our collateral position. So I'm going to spend a moment on it.

First and foremost, our investment-grade credit ratings provide significant advantages to our liquidity and our ability to run the business. In the bottom left chart, you can see we have access to $5.7 billion in liquidity facilities and use less than half of our availability, leaving ample capacity for times of stress.

You will also see in our 10-Q that we have a cash position as of March 31 of $1.6 billion, much like you saw on our September 30 financials last fall, we have benefited from significant cash collateral postings to us, driven by the dramatic rise in gas and power prices during the quarter.

As a reminder, we saw a significant amount of generation directly to customers through our retail and wholesale channels, limiting the amount of transactions across the exchanges, which thereby reduces our collateral needs when prices move in either direction. This arrangement positions us differently from some market participants.

So let me now answer the question as to why so much cash collateral came into us again this quarter. Two primary reasons. One, we sell a significant amount of gas to our customers.

Unlike power, we have generation length, we are naturally short natural gas because we don't produce the physical molecules. We procure the gas and they execute the sale to a customer, and given our contracting cycle, we procured gas at much lower levels than the market today. These rising prices have, in turn, required counterparties to post cash collateral to us.

And two, we participate in some power markets where we have more loads than generation length with New England being a good example. Because we have procured power for these customer obligations, as prices rise, the counterparties, again need to post to us. The combination of these 2 positions leads to the much higher cash balances that you see in our 10-Q.

For those calibrating your models excluding these cash collateral movements, we'd still point you to a year-end net debt balance in the low $5 billion range, which would be consistent with the credit metrics on this page, assuming our free cash available for allocation is used for purposes other than incremental debt pay-down. I'd like to now turn the call back to Joe for his closing remarks.

Joseph Dominguez {BIO 16668698 <GO>}

Yes. Thanks, Dan, for that good comprehensive summary. Look, as I think about the last quarter, I'm going to flip to Slide 15. You're familiar with our value proposition. But the things that were important for us were to get the separation done, demonstrate that we continue the performance in the commercial business and the other operating businesses to the same levels or better than what we had done when we were all part of Exelon.

We've certainly benefited from some of the changing fundamentals around natural gas and coal. Well I'm sure we'll get questions about our long-term views. I think it's safe to say that the short-term market, the 12- to 18-month market is something that is heavily influenced by a lot of behaviors. But we've seen fundamental changes. We're not going to go back to the gas price and coal price environment that we saw just really, frankly, 12 to 18 months ago. That provides strong support for nuclear.

I talked a little bit about policy where we have gotten some successes at the state level, and we're obviously still waiting on the federal government. Here's what we believe. Given the importance of nuclear energy, we don't think there will be an energy package that happens this year or anywhere down the road that isn't going to include nuclear energy. That's a sea-change difference. When you're an owner of this company, that's an option you have.

Talked a little bit about the technical optionality we see with the nuclear plants becoming clean energy centers, where we can power the grid, but we could do much, much more than that. We can capture carbon at the sites, and we can make other hydrogen-related products at the sites that I think are going to be competitive advantages for years to come.

You've seen a lot of supply chain issues, inflationary pressures occurring to other businesses. Not saying we're immune from those things. But certainly, given the composition of our fleet and the fact that our costs aren't rising with the oil and gas and coal costs, certainly to the same degree as others, gives us, again a competitive advantage.

Then finally, look, we're going to manage this business in a very disciplined way both with regard to growth but also the balance sheet itself. Dan talked about that balance sheet giving us a competitive advantage, and it has. We're seeing margin expansion as others who frankly don't have the same balance sheet capability really having to increase margins, and we're getting the upside of that.

So I like where we're at here at the end of the First Quarter. We have hedged into higher-priced markets. And frankly, our objective is to ensure that we hit the targets we've given to the Street or do better.

And so we've hedged, and we've continued to hedge, as Dan said, into '24 and beyond, into the higher prices that we like to see. I'm sure you'll have some questions about that. But I like where we are positioned. So with that, let me flip it back to you for your specific questions. As I said, the senior team here is ready to answer them.

Questions And Answers

Operator

(Operator Instructions) One moment for our questions. Our first question comes from Stephen Byrd with Morgan Stanley.

Q - Stephen Byrd {BIO 15172739 <GO>}

Congrats on the great results. So I wanted to maybe focus first on just the outlook for federal legislation, and you provided some great commentary. How are you thinking just given the evolution of everything we've seen politically, could you just maybe speak a little bit more to your sense for the chances of success?

I do agree with your point that, if anything passes, it does appear highly likely that nuclear support will be in that. So I think that's well-appreciated. But I'm just curious more about your sense of the prospects for something getting across the finish line?

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes, sure, Stephen. Look, as you all would well imagine, as a new CEO of a new company, spent a good bit of time over the last few months in Washington literally having dozens of meetings with White House policymakers and others. I still believe that there's a strong appetite to get something done on clean energy.

I think they don't like to call them the Build Back Better tax pieces, but there's a lot in there that all sectors of the energy business like in terms of the tax policies. I think there's strong support certainly continuing within the Democratic Party, Senator Manchin and others to get something done.

What we're seeing is whether or not there's an appetite to do it from a bipartisan standpoint. Stephen, as much as I think -- as I said, that there's something in it for Republicans and Democrats, we're all observing the challenges of getting anything done from a bipartisan standpoint, and certainly, this close to an election, that might be a lift.

What I do believe is that the Democrats will try to get this done, in particular Senator Manchin will try to see if there's an appetite, but they're not going to be strung out forever trying to get bipartisan support if it becomes evident that the votes just aren't there to get to 60.

So I think people are assessing that in D.C. One of the things that, honestly, I thought was a bit of a disaster with Build Back Better was the amount of which the kind of political interplay was being spelled out every day in the newspapers. It was counterproductive. Often is counterproductive in negotiations to have that kind of play-by-play going on and certainly was there. I think they've learned their lesson, and they're very clearly trying not to do that. But there's a difference between not being vocal about it and not doing something about it.

We see activity on the ground. I think very clearly here, the next couple of months are going to be telling, right, whether or not there is something from a bipartisan standpoint or the Democrats can decide at the end of the day that they have to move their own bill. We're going to know that here in the next 4 to 8 weeks.

But my point is, as I said, more fundamental, we're building this company for the long haul. I think all of you need to kind of spend some time and take a timeout and remember how far we've come. I think all of the momentum is at our backs. As at least I appreciate these bipartisan discussions, there's nothing but support for the nuclear components of the bill. I'm happy to see that. We've worked on it for a long time.

And honestly, as I said in my scripted comments here, the work or the problems that we've seen in Germany and Europe I think have simply reinforced the U.S. policymakers the importance of keeping this fleet alive from a national security standpoint, an energy security standpoint. And although we are hyper focused on those things right now, the climate change problems are not going away. That's what we built this company to address. That's what we will address, and I'm confident that policy will back it up.

Q - Stephen Byrd {BIO 15172739 <GO>}

That's super helpful color. Maybe just my last question, just building on your point on national security is uranium. I think you all have taken a very thoughtful approach to ensuring you have uranium supply. But we do get in the United States a decent amount of uranium from Russia.

And I was just curious, what do you see as possible moves in terms of supply chain adjustments at the industry level? Then feel free to comment on your position, but I think you guys are in good shape. But more broadly, I'm interested in your take on what adjustments might occur at the national level in terms of how we procure uranium?

A - Joseph Dominguez {BIO 16668698 <GO>}

I think -- it's not just uranium. I think it's all fuels and a lot of technologies, we're going to see an onshoring movement. We certainly support that. I'm going to ask Bryan Hanson to provide some color. You pointed out that we're in a pretty good spot. We are about what we're seeing in the marketplace. But as a general rule, Stephen, I think uranium and uranium-related services like other things in energy, we're going to learn from this situation, and we're going to decide to move those onshore.

Again what I'm liking in terms of what I'm seeing out of Congress is a focus on these areas. We're talking about it. And again to the extent that there are limits on imports from Russia over some period of time, we support weaning ourselves off of Russian fuels, but it needs to be done in a pragmatic way. I think policymakers understand that. Bryan?

A - Bryan Hanson {BIO 18995088 <GO>}

Yes. I'd say we're working well with policymakers, both the industry and policymakers working together to expand the capacity and capability in the United States to provide enrichment conversion services. So I see that accelerating more so as we talk about it amongst the utilities. I think for our company, as we look forward, we've said we're good out through several years around our enrichment conversion capabilities.

And if you think about the cost impact to us overall, three things I'd remind you: one is nuclear fuels, 20% of our production costs are nuclear plants; two, our fuel team does an outstanding job in their hedging policies and strategies to make sure we use multiple contracts, long-term contracts, different hedges collars around the high side, low side of the prices we would pay to ensure that we have a robust supply; and then finally, once that fuel is actually loaded in the reactor, it's amortized over 5 to six years, depending on the length of fuel cycle for that particular plant. The costs are really muted for us, maybe $1 a megawatt hour out through past 2025 for us right now. So we're sitting in a good spot.

Operator

Our next question comes from Steve Fleishman with Wolfe Research.

Q - Steven Fleishman {BIO 1512318 <GO>}

Yes. First, just on hedging strategy. Just given the change global environment and the fact that you have a lot more core hedged through the Illinois agreement, plus also, I guess the potential PTC, are you thinking about maybe hedging less going forward than you have?

A - Joseph Dominguez {BIO 16668698 <GO>}

Steven, I'm going to ask Jim to jump in here. We're not vigorously tied to the 1/3, 1/3, 1/3 that you saw from this company in prior years. We have, as you pointed out, through the state support mechanisms, a lot of our volume already hedged -- but look, we saw a good run of prices during the course of the quarter.

And Jim's message to the team was opportunistically seasonally where it makes sense let's grab some of that value. In point of fact, as we're sitting here today some of the high points that we saw during the quarter have now worked their way back a little bit. We're pretty glad that we had those hedges. So look, I don't think we're going to be slaves to 1/3, 1/3, 1/3, but we're going to see value.

And you ought to know that, as we're going to run this company, we're going to be disciplined around the balance sheet, but we're going to be disciplined about making sure that every time we give a projection to you, we hit it or do better. So we're going to continue to use the hedging strategy to give us that sort of assurance. Jim, jump in here with more color.

A - James McHugh {BIO 20604624 <GO>}

Yes. Thanks, Joe. I guess what I would add to your question about, well, given that we have the policy deals, the way we think about this hedging window is typically in this kind of 3-year window, there's some customer contracts that go a little longer. So the way we think about that is we want to be able to Joe's point, capture the moments when we have the opportunity when you see prices run like this, and I think overall, we're still going to be able to have some flexibility, and Dan mentioned the flexibility.

So we tie that in constantly to what are we trying to achieve in hitting the targets that we've provided, as Joe mentioned, and achieve with the balance sheet goal of keeping a strong balance sheet. So I think we'll continue the same general strategy with flexing up or down here and there as we see the market move in periods like this. I don't think there's a vast change to the overall philosophy of what we're trying to achieve.

Q - Steven Fleishman {BIO 1512318 <GO>}

Okay. One other question. You guys probably saw the Energy Harbor announcement this past week with a contract on site -- 10-year contract on site, I think with a data center host customer.

I'm just curious how much are you looking at opportunities like that? And is that another way to potentially get kind of above-market hedges or essentially contracts? Can you talk about that?

A - Joseph Dominguez {BIO 16668698 <GO>}

Sure, Steve. We have looked at it. And as you know, we announced at our Analyst Day we did a deal at our combined cycle machines down in Texas, where we get incredibly strong interest from data center companies that come behind the fence line, and not only at the fossil plants in Texas, but, of course taking advantage of the clean energy production at our nuclear plants and the high reliability that they get sitting behind the fence line there.

We've held back a little bit on that. First, not interested in getting into more commodity risk around bitcoin and cryptocurrency. And honestly, I think all of the events that have transpired since Analyst Day kind of reinforce that sense of running the business and not having commodity exposure in terms of the production.

So far, that's the way we've run things. We will look at contracts. But right now, I'm holding tight to see what happens in Washington because I want to see how that policy would work and interplay with any contract we might have with a data center behind the fence line. But is it an opportunity? Sure, it is.

The Tier 0 data center market is going to do nothing but grow even if the cryptocurrency piece of it starts to stagnate a little bit, and those will be opportunities for us. But they're not things that we need to jump at with our nuclear plants. I think hydrogen and certainly how the production tax credit work are things that we need to see pretty clearly before we enter into long-term deals.

Operator

Our next question comes from Paul Zimbardo with Bank of America.

Q - Paul Zimbardo {BIO 18277958 <GO>}

I wanted to continue on Steve's line of questioning. Just more specifically around retail. How have those conversations gone? Not talking about the crypto data mine but just large commercial, industrial, the Microsofts of the world chief in recognizing that 0 carbon value. Is it about higher margins, more duration? Just if you could give a little more flavor on those conversations?

A - James McHugh {BIO 20604624 <GO>}

Yes, sure. It's Jim. I can start. I think the conversations with our large commercial and industrial customers is going very well. They're very interested in sustainability products in general. We're talking to them about a number of things, the least of which I think is 24/7 and 365 that we've talked about. Our partnership with Microsoft on that product is going really well.

We plan to pilot that product in this quarter coming out with some customers with the plan to be -- have commercial offering towards the second half of this year for those products. And a lot of our customers are asking for different flavors from a type of carbon-free matching and generation supply as well as what percentage of an hourly match you're looking for.

And this platform that we're building with them is going to help us be able to supply that. We do tend to see in these types of customized solutions higher margins than the pure commodity sales when we're just selling energy supply contracts. So I think that's a great opportunity for us in general as these kind of customized sustainability products that they're looking for.

There's been, with the high-energy markets, customers have certainly wanted to understand what the sustainability of these prices are, and they've cut down their terms on some deals, but the margin expansion has occurred for us, as Joe mentioned. So we've seen good results in terms of margin expansion, even just on the supply deal, and then the sustainability products have margin on top of that.

Lots of interest. We hear feedback all the time and get feedback from our customers about how we can help them go ahead and meet their sustainability aspirations and what are part of their ESG goals.

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes, Paul, I think if I could complement Jim's points here, just, there's one piece of it that the customers are asking us for the sustainability products. The other piece is we see, obviously starting with the U.S. government, a focus on load matching from a geography and a time standpoint.

This is following a trend we've seen in Europe where regulators, customers, governmental entities and producers are all trying to, as I said, bring together the production of clean energy with the consumption of clean energy. If we're really going to move to a clean energy economy, we've got to make sure that those things match up, we send the right price signals for things like storage and other technologies that'll help us match these things up.

So beginning with the executive order that President Biden signed earlier in this year, there's been a growing focus on load match. The other piece of that is what's going to happen out of the SEC process? What are people going to have to demonstrate to support their assertions around sustainability? Those are all big focus areas. But we've got to be ready with the technology to fill the niche to be able to deliver that value to our customers.

And I mentioned this earlier in my comments, the RTOs, too, have to provide the industry with the data that tells us when renewable energy is being produced, when storage is being operated, and where it's happening relative to consumptive load. And many folks are surprised to learn that, right now, the RTOs don't offer that capability. So we've worked with PJM and others, and I complemented PJM's leadership for getting after this.

But there are a lot of pieces that still need to come together for the 24/7 business to really develop it's kind of full muscularity. There are a lot of these regulatory questions that need to be answered, technical capabilities. But what we're trying to do is move this business, and we obviously have the support of supply but move this business into a position where it anticipates the continuing trend in the direction of matching load and generation, which we have to do if we're going to make a dent in the climate crisis.

Q - Paul Zimbardo {BIO 18277958 <GO>}

Okay very comprehensive. Then one other, if I can, just in light of the $300 million higher total gross margin for 2023, is there a refresh view or a way to think about the Analyst Day disclosure about the $2.8 billion to $3.2 billion free cash flow for 2022 and 2023?

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes, Paul, it's a good question. We're not going to remark that annual guidance or the multiyear guidance on a quarterly basis. But certainly, I think we talked about the idea, we're confident in our capital budgets and our cost budgets. So there's more at the top line. You can probably translate it down to what it means for us.

Operator

Our next question comes from Michael Lapides with Goldman Sachs.

Q - Michael Lapides {BIO 6317499 <GO>}

I actually have two questions, one for Dan, one for Joe. Dan, kind of a little bit of a modeling or just kind of trying to think about the gross margin line. When we see forward curves move up a lot in a year like 2023, safe to assume that you don't get to capture -- for the unhedged portion or uncontracted portion of the portfolio, you don't get to capture all of that benefit simply because some of your retail contracts they have prices set, or if they're floating, they have caps.

And therefore, when we think about kind of moves in the curves for the unhedged portion of the portfolio that there's some portion of that move that just won't kind of trickle down to your bottom line?

A - Daniel Eggers {BIO 3764121 <GO>}

Michael, the forward sales for our customer business are going to be reflected in our hedge values, right? So those prices are locked in, and you'll see that in the hedge percentage and in the (inaudible) value. So when prices move, that does translate through. We provide sensitivities in the appendix pages that can be sent (inaudible) the prices.

Those work awfully well, to be totally honest. So when you think about the movements in the market, I think that's a good way to help calibrate where we're heading. But otherwise, we should capture. I mean sometimes when you get into the final year and the small percentages, there might be some seasonality where our hedges are. But generally speaking, when you think about a 23 with our position, you should expect that to carry through.

Q - Michael Lapides {BIO 6317499 <GO>}

Got it. Then, Joe, you made a comment in your opening remarks, you talked a lot about how some parts of the world, and especially Europe, may not have focused on the criticality of nuclear generation. I want to talk about that a little bit, and I'm curious for your feedback.

One of Europe's largest nuclear generators has made no moves to retire plants. In fact, they're building plants. But they have faced given legacy issues with the plants or simply just aged, massive operational issues that have brought plants off-line and have reduced the amount of nuclear power in France, and that impacts the broader European market.

I'm just curious how you think and your team thinks about your nuclear fleet and the U.S. nuclear fleet and the potential whereas these plants age, that operational performance, which has improved dramatically in the U.S. Over the last 10, 15 years for the nuclear fleet, actually turns the other direction or faces headwinds or risks?

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes, that's a good one, Michael. I think what's aged at our clean energy centers is the name of late. I think when you look at just about every other piece of equipment inside we've updated them aggressively.

You know from watching this company for a long time, and I know you have, that we've invested capital in these machines even during times where commodities were, frankly, at a real trough level. So it's -- I think some folks who are neophytes in our business look at the age when the plant was commissioned and think the plant is that old.

When in reality, the pumps, the main pieces of equipment, oftentimes steam generators and other things that need to be replaced have been replaced -- turbines, we've effectively rebuilt computer systems and electronic controls and cabling systems. So we've done a lot of that work. The situation in France is one that we've talked about we don't have.

The weld issues were a characteristic of the design they use that we don't. The other thing that tends to happen in France is, when they have an issue, they shut down the entirety of the fleet. The U.S. regulators have taken a more structured approach to dealing with issues as they come up and allowing operators to address them during outages.

And it's presumptuous for me to question the way the regulatory environment works in France. But honestly, it's a big part of the story there. But I feel very comfortable about the investments we've made in the plants. I don't think it's like a coal plant, as an example, where everything is of the vintage that it was when the plant was originally built, and you see kind of this sliding performance and increasing cost profile. We haven't seen that.

I think one good illustration of that, frankly, is when we did Peach Bottom, and we went from 60 to 80 years and through the NRC licensing process. What we found was that the investments we have been making to get the plants from 40 to 60 years had a lot more life than that incremental 20-year increase in their license life and carried us through all the way to 80.

And I think that's illustrative that a lot of the changes that Bryan and his team are making, the technology improvements we've made now for decades are things that will carry us for many decades without expecting any diminishment in the performance of the unit, in fact just the opposite, or any increase in the cost of operating and maintaining the units, in fact just the opposite. So that's the way I would summarize it. Bryan, anything more to add?

A - Bryan Hanson {BIO 18995088 <GO>}

I'd just add just much to Dan's chagrin, we invest in the plants like they're going to run forever Joe. So we just stay attuned to that, right? There's nothing significant in the future that isn't already on our forecast around making these plants (inaudible) years.

A - Joseph Dominguez {BIO 16668698 <GO>}

There you go, Michael. You got a little bit of flavor of the discussion in our management team.

Operator

Our next question comes from Shar Pourreza with Guggenheim Partners.

Q - Shahriar Pourreza {BIO 15145095 <GO>}

Joe, can you just maybe elaborate on your capital allocation opportunities? It's kind of in light of the potential improvement in cash flows, especially as we're kind of thinking about growth. Are you seeing more organic or inorganic opportunities as we think about kind of asset-level opportunities?

Then conversely, does this kind of environment kind of make your fossil fuel assets more attractive as we think about sale opportunities. So maybe some thoughts on accelerating decarbonization here, for instance, with ERCOT or the Eastern gas assets?

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes. I would say our Texas assets are worth more now in terms of our own valuation than three months ago when we kicked the company off. But they're also producing more value. They remain some of the lowest-emitting resources in the entirety of the Texas market.

Look, I think we own the 2 best combined cycle machines in Texas, not only in terms of their operational performance and their emissions levels but something we haven't talked about in Texas, but probably should is the ability to withstand drought conditions because we don't need cooling water. They're air-cold machines. So not only are they very good, but they're air-cold machines. So if you have drought, they're going to be able to run through that. We like where we're positioned there.

And while the work certainly isn't done, and the Texas Commission has acknowledged as much in terms of market design there, they've taken a lot of risk off the table, and the weatherization efforts there have worked. Point is, yes, I see the rising value of those things, but they're also delivering a lot of value to our customers in Texas right now.

No hurry to give them up. I think the trend in terms of upward value is going to grow even stronger there. Not -- but that's probably where things are going to stop. We're not going to be a company that is going to be buying a lot of additional fossil fuel units. We've made that clear from an ESG commitment standpoint, and that's where things stand right now on that. Does that address your question on fossil?

Q - Shahriar Pourreza {BIO 15145095 <GO>}

No, it does. That's super helpful. Then just really last thing, sort of maybe be beating a dead horse here on the hedge profile, but maybe just give a little bit more color as we're thinking about the efforts in '24 and '25? I mean some of your peers were able to at least speak maybe directionally with a stated EBITDA range, and the scale of the opportunity seems really large?

A - Joseph Dominguez {BIO 16668698 <GO>}

Look, I think we have a much bigger open position out there. And as Dan said, we try to give some good sensitivities. I think those are projectable, and the prices are pretty healthy out there. But I'm going to kind of stick to where Dan and I have been throughout the call.

We'll have a period of time later on in the year when we can provide the update we'll provide updates in terms of our performance this year. I want to get through the summer. I want to be able to see how the fleet performs this summer. I want to then be able to factor in things like capital return.

We owe you a big update at the end of the year on those sorts of things, and then we'll start wrapping in '24 to '25. I'm cognizant of what some of the other players in this space have said. Obviously the improved pricing has lifted our boats there. But I want to shy away from being specific until we get some more ground under our feet. Dan, anything more to add there?

A - Daniel Eggers {BIO 3764121 <GO>}

Yes -- no, I agree. I mean charter, just you're looking at hedge percentages and that sort of thing in 24. It is a starting point, A, we gave you '24 at the Analyst Day. We talked about the increase since then. I've highlighted the fact that the Illinois CMC is about 27% of our output. So that's going to be hedged as it is.

The New York assets given where prices are with the ZEC mechanism is going to look like that going forward. You can get a handle on kind of the building blocks of some of those pieces. But as Joe said, you do the math, there's still a lot of open exposure there on our generation link. We think that's going to be an opportunity, particularly with the prices you're seeing in the Mid-Atlantic.

A - Joseph Dominguez {BIO 16668698 <GO>}

And hopefully, Congress will act, and we'll have some sense of what that looks like for us at the same (technical difficulty) So still a lot of moving pieces but a great start.

Operator

This concludes the question and answer session. I would now like to turn the call back over to Joe Dominguez, President and CEO, for closing remarks.

A - Joseph Dominguez {BIO 16668698 <GO>}

Well just -- I just want to end up where I started off. Thank you, all for your interest in the company. I'm thankful for the men and women who run this company. They've been doing a great job. Look forward to continuing this discussion in our next quarter, and frankly, continuing the good performance. Have a wonderful day.

Operator

Ladies and gentlemen. thank you for participating in today's conference. This concludes today's program. You may all disconnect. Everyone have a great day.