Q1 2023 Earnings Call

Company Participants

- Daniel Eggers, Executive Vice President & Chief Financial Officer
- Emily Duncan, Vice President of Investor Relations
- Joseph Dominguez, President, Chief Executive Officer & Director

Other Participants

- David Keith Arcaro, Analyst, Morgan Stanley
- Durgesh Chopra, Analyst, Evercore ISI
- Paul Andrew Zimbardo, Analyst, Bank of America
- Ross Fowler, Analyst, UBS Investment Bank
- Shahriar Pourreza, Analyst, Guggenheim Securities
- Steven Isaac Fleishman, Analyst, Wolfe Research

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Constellation Energy Corporation first quarter 2023 Earnings Call. At this time, all participants are in a listen-only mode. Later, we will conduct a Q&A session and instructions will follow at that time. As a reminder, this call may be recorded.

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

Emily Duncan {BIO 19245511 <GO>}

Thank you, Leah. Good morning, everyone, and thank you for joining Constellation Energy Corporation's first 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'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 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 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, Leah, again who started this morning, and thank you, Emily, for that. Good morning, everyone, and thank you for joining our first quarter earnings call. I'm going to start on Slide 5 of the deck.

Once again, we're off to a strong year operationally and financially, thanks to the focus and dedication of the women and men that do their best every day to produce and deliver clean, reliable and affordable electricity to our customers. For the first quarter, we earned $658 million in adjusted EBITDA. But the top line story here is that based upon our performance to date, we can project that we will end the year comfortably in the top half of our guidance range. And if we continue to execute, we expect to be at or near the top of that range.

In addition, 2024 looks better to us than when we reported in February. Our Commercial team had a tremendous quarter, not only generating better-than-planned earnings in the quarter, but they were able to lock in value for the remainder of this year and for next. On the back of their strong execution, our gross margin is up $50 million in 2023 and $100 million in 2024. As Dan will cover, all in 2023 is up $100 million from where we were in February. For 2024, we expect to come in notably above current consensus, which you could see using our disclosures on Page 25 of the presentation.

And in our gross margin update, you'll also see how the PTC interacts with our portfolio to add value in the face of lower commodity prices. We think that the message here is pretty simple. Our company had a strong first year and is on track to have great years 2 and 3. Our business is unique, and we still have many opportunities in front of us to create value for our owners. We are the best operator of nuclear plants and the largest producer of carbon-free clean energy in the United States. We produced approximately 11% of our nation's clean energy last year.

Our Commercial business serves 25% of the entire competitive C&I market in the United States, 75% of the Fortune 100. Our businesses are essential to addressing climate change and will be needed for decades to come to provide clean and reliable energy, as America simultaneously reduces its reliance on fossil fuels, and the transportation, industrial, agriculture and residential sectors all increasingly turn to electrification to reduce harmful pollution.

Inflation Reduction Act, the IRA, provides unique opportunities for Constellation and its owners. Through the Nuclear Production Tax Credit, the U.S. government has made a long-term commitment to our nation's nuclear assets, recognizing that, without them, we simply cannot meet the climate goals. The PTC provides downside commodity risk protection, as you could see in our disclosures today, while ensuring that our plants remain economic and reliable.

The PTC protection level rises with inflation, providing a structural inflation risk protection. Other provisions of the IRA create unique growth opportunities, like increasing the output from our nuclear plants through upgrades and hydrogen. And finally, it gives us the opportunity to extend the time horizon of our fleet to 80 years. And we've made this point, I'll make it again, no other clean energy assets except hydro can run for this long without being replaced.

We have many ways to grow and bring more value to our shareholders. Against the baseline earnings level support provided by the PTC, over the life of the PTC, we will benefit from forward price inflation that grows with overall inflation in the country. And as you can see on Slide 18, depending on your assumptions about inflation, there are some meaningful top line growth opportunity ahead for us in the PTC.

We generate strong free cash flow that can be used to fund robust organic growth at double-digit unlevered returns, disciplined M&A and fund a growing dividend and the buyback of our stock. Each of these will create additional value for our shareholders. And we're already doing this. We have announced $1.5 billion of growth in upgrades, hydrogen and wind repowering, double the per share dividend. And in March alone, we bought back approximately $250 million of our own stock as part of our authorized $1 billion buyback, which we will execute.

And there's more we can do. We have $2 billion of unallocated capital in '23 and '24 that can be used to further enhance our earnings growth. At our current stock price, I'd be happy to use this capital to continue buying back our stock all day long. We will continue to look for investment opportunities consistent with or adjacent to our core businesses, and we are committed to the energy transition. However, in the absence of any near-term M&A opportunities or a ramp up in growth CapEx, we will, in the short term, use the majority of the $2 billion to repurchase our own shares.

Constellation cannot be matched anywhere in this marketplace. Our clean, carbon-free nuclear fleet, paired with our customer-facing business, provides us with opportunities to grow and create value for you. It is the unicorn. I'll turn next to our quarterly operational updates beginning on Slide 6.

Nuclear performance was strong and slightly ahead of plan. We produced more than 40 terawatt hours of reliable, affordable and carbon-free generation from our nuclear plants, with an on-planned capacity factor of 92.8%. As some of you may be aware, during routine inspections during our Nine Mile Point one's refueling outage, we had an issue with nonsafety-related well. It's not uncommon in the industry, but it did extend Nine Mile's outage to 39 days. The cost of the repair is absorbed within our existing budget.

But the point I want to make here is that even with the extended outage at Nime Mile, we returned to service roughly in line with the industry average for a standard refueling outage of approximately 39 days. And the point here is that at Constellation, a long outage is just average for everyone else. And while Nime Mile lagged, our ability to lead the nation in returning units from outages was demonstrated at both Byron and Calvert Cliffs, which completed their refueling outages ahead of plan and at an average duration of 21 days in total.

Our renewables and natural gas fleet also performed well with 96.6% renewable energy capture and 98.4% power dispatch manage. The team is presently completing our summer readiness work to make sure that it's ready for the hot summer months to come.

Turning to Slide 7. I'll talk a little bit about the Commercial business, but I already mentioned before they've had an incredible start to the business. It's a business that benefits from the opportunities that volatility in the commodity market creates. We're able to leverage our expertise to give our customers certainty of their energy costs in this volatile market environment, while realizing higher unit margins across both wholesale and retail as risk is more appropriately reflected in pricing.

Our balance sheet strength is a key advantage to supporting our customers and being able to capture these healthy margins. Providers with more constrained balance sheets and less experience with volatile markets are not able to provide customers the certainty and the visibility that our customers desperately want and need. Our balance sheet strength allows us to provide this needed certainty to our customers.

We operate our generation and customer businesses symbiotically with each other, supporting and making the hall stronger. As such, we can optimize our positions across the combined generation and workload portfolios to create additional gross margin, particularly in times of volatility. And again, I'll just hit this, I think the results this quarter and what we've predicted for the remainder of the year and next demonstrate all of this. And we have continued success developing and providing sustainability products like core to our customers.

As I mentioned earlier, this strong performance creates additional value for both in 2023 and 2024. And before I turn it over to Dan for a full update on the financial outlook, I want to address our O&M disclosures from the last call. We're confident in the firmness of our forecast, and the entire management team is coming committed to ensuring that this forecast is met and it will be met. We will always look for additional opportunities to run our business as efficiently as possible.

Dan?

Daniel Eggers {BIO 3764121 <GO>}

Thank you, Joe, and good morning, everyone. Beginning on Slide 8, we earned $658 million in adjusted EBITDA, which is above our plan for the first quarter. The favorability to our expectations came with the strong results of Commercial, plus the updates the PJM winter bonus payment as we have gotten more clarity from PJM. Compared to the first quarter of 2022, our results were lower than the $866 million in adjusted EBITDA.

Our quarterly shaping in 2023 will differ from last year, in part due to our hedge prices that are higher than last year, the comparability will be impacted by the start of the CMC program in June of 2022; timing of opportunities in the commercial business; the greater number of planned refueling outages in the first half of this year compared to last year; and the shaping of O&M.

In 2022, we saw ramping labor costs over the course of the year as we staff the organization. The difference in staffing levels and costs will be widest in the first quarter and then normalize as we move through this year. As Joe said, we remain committed to our 2023 O&M targets. For the full year, as Joe commented earlier, we expect to be comfortably in the top half of our guidance range of $2.9 billion to $3.3 billion.

Turning to Slide 9 and our gross margin outlook, we are now forecasting to be at $100 million in both 2023 and 2024. Overall, forward power prices in '23 and '24 have seen downward pressure since year-end following the record warm winter that has created an oversupply situation in natural gas markets. Our existing hedges and the nuclear PTC support in 2024 effectively mitigate much of this pressure.

When we look to 2025 and beyond, where we are comparably less hedged, we see prices at or above year-end levels, reflecting natural gas prices that are normalizing in the low $4 per Mcf range, and tightening supply-demand dynamics with announced plant retirements that are further supporting power prices. The upside to gross margins will then coming from the strength in our commercial business. where we are seeing better margins as risk is being more effectively priced given market volatility and higher liquidity requirements.

For 2023, our gross margin forecasts are up $100 million to $8.45 billion due to our existing hedges, strong performance by our Commercial team and the increased payment from PJM associated with Winter Storm Elliott. These drivers more than offset the weather-driven downturn in prices since year-end. As a reminder, the power new business to go line moves into the mark-to-market of hedges line when a transaction is executed, with this road naturally declining as we move through time and deliver on our plan.

So in the first quarter, we executed $250 million of new business and then increased our target by another $50 million, translating into the $200 million reduction in the new business to go line. In 2024, our total gross margin, including PTCs, is up $100 million from our last update to $9.05 billion when we take into account upward revisions to our Commercial business outlook of $100 million, our hedge positions and the PTC downside protection of $100 million.

With the drop in forward power prices the PTC is functioning as it should, stepping in to provide downside protection as some of our nonstate supported units fell below the PTC threshold. Taking into account the increase in gross margin and the cost lines we show on Slide 25 in the appendix, you can see that our outlook for 2024 is also higher than the consensus.

Turning to the financing clarity update on Slide 10, we are delivering on our promise to return value to our shareholders. Our first quarter dividend has doubled from the level we paid in 2022, and we started our $1 billion share repurchase program that was authorized by the Board in mid-February. We view our stock as very attractive at these share price levels, and we aggressively initiated our share buyback, completing nearly 25% of the authorized program by repurchasing 3.2 million shares for approximately $250 million in March. We will continue to be opportunistic for the remainder of the authorized program.

And we still have an additional $2 billion of unallocated capital in 2023 and 2024, that could be used to create additional shareholder value through growth investments, M&A or additional return of capital to our owners. In the first quarter, we also accomplished most of our financing plans for the year with good demand and at attractive rates. We remain on track to hit our credit metric targets and we continue to have constructive conversations with the ratings agencies. Both our S&P and Moody's ratings and metrics remain firmly in the mid- to high BBB equivalent range.

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

Joseph Dominguez {BIO 16668698 <GO>}

Thanks, Dan. And I'm going to go to Slide 11 and conclude our prepared remarks. And I'll just end where I started on the value that Constellation brings to you, our shareholders. We think it's a value that can't be found anywhere else. We own nearly 25% of the U.S. nuclear fleet, producing the most carbon-free energy in the country, nearly twice as much as our next competitor.

These plants can run for 80 years. That's a useful life that's longer than any other carbon-free generation that exists today. In the case of renewables, it will operate longer than any renewables that are built in this decade. We're the best operator of nuclear plants, period, and we provide power to nearly 1/4 of all competitive C&I customers in the U.S., including 3/4 of the Fortune 100. All of this puts us in the best position to meet the growing demand for clean energy and reliable, sustainable products.

Our balance sheet strength is an advantage over others in the market. We have unique opportunities to create additional value for our shareholders, the increasing value of the PTC over time. through the inflation adjustment that's embedded in the law and our strong free cash flow allows us to fund a growing dividend, robust organic growth. And where we could find compelling M&A, we'll do it. But if we can't find those opportunities, then we're happy to return capital to you through share buybacks.

I'll now open the call to questions.

Questions And Answers

Operator

(Operator Instructions) Our first question is from David Arcaro from Morgan Stanley.

Q - David Keith Arcaro {BIO 20757284 <GO>}

Maybe starting out with the Commercial results that were very strong. You had some good success in new business creation. I'm wondering if you could just elaborate on what you're seeing or where you're seeing the strength. And maybe more broadly, the competitive environment in retail, what are you seeing for churn and any changes in market share there.

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes. I think the financial retail and wholesale markets and, in turn, margin is really a reflection of the underlying physical power generation stack and the demand fundamentals. And when we see that physical stack get tight, when it's under weather-related stress, or demand is increasing, then we see higher volatility and markedly higher retail and wholesale prices. Of course, we all know this relationship between the physical stack and the financial markets, and the weather events in Elliott, Uri and many other unnamed storms, demonstrate that effect all through year.

But the physical stack is undergoing a rapid change from cold-touted resources that are less reliable because they don't have on-site fuel or introduce intermittency risk in the case of renewables. And so that physical stack is changing today. And today, I think when you participate in either the retail markets or the wholesale markets, you have to ask yourself really 3 basic questions. Do I have physical generation? Is it the kind of physical generation that's going to show up in extreme events? And do I have the financial balance sheet to deal with negative outcomes?

Many folks who haven't asked those questions historically have been hurt. Some driven out of business entirely. But this is where I think our fleet really shines. This is where our business model really shines. Because we have the physical assets that operate in extreme weather events, they're clean energy assets that are going to live for a long time and our Commercial business is both smart and benefited by the fact that we have a strong balance sheet.

So in effect, we have physical generation that runs. We have a Commercial business that has a competitive advantage of others. And so when others see risk of volatility, they add those costs into the price that they're willing to offer in wholesale and retail markets. Because we don't have those risks, that translates into incremental margins in our businesses. And so that's what we're seeing. I think that's really been the story of the first quarter. And really, it's been an evolving story. I think it's going to continue for some time.

At some point, people don't price in risk and they'll get hurt again. But right now, they're pricing in the risk. And for us, that's margin expansion because we have the right fleet and the right business model.

Q - David Keith Arcaro {BIO 20757284 <GO>}

Got it. That's helpful. I appreciate that perspective. And wondering if you could also give an update on the inflationary pressures that you're seeing just in terms of labor contracts and material costs. Was 1Q consistent with your expectations heading into the year? How do you see it trending for the year? I heard your confidence in being able to achieve it, wondering if you're seeing any difference in the pressures on the business this year so far.

A - Joseph Dominguez {BIO 16668698 <GO>}

No. I think we predicted it well in our plan, and we're right on plan.

Operator, we're ready for the next set of questions.

Operator

Our next question comes from Steve Fleishman of Wolfe.

Q - Steven Isaac Fleishman {BIO 1512318 <GO>}

Yes, just on the commercial upside you're seeing. I know I'm just -- the 24 gross margin is a lot better than we would have expected just on power prices. Does some of this benefit the way you contract go into '25 even, just given the way you contract? Or is it more kind of '23, '24?

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes. Steve, we're obviously not putting numbers out there for '25. But yes, this trend doesn't end in '24.

Q - Steven Isaac Fleishman {BIO 1512318 <GO>}

Okay. Great. And then big picture question. Just any concerns you have about IRA related to just this debt ceiling issue, with the Republicans having IRA removing a bill? And just any thoughts on likelihood that, that is a real risk?

A - Joseph Dominguez {BIO 16668698 <GO>}

Steve, at this point, we just see that as kind of -- it's hard to use the word normal. But the political back and forth, that's occurring. But I don't think there's any prospect that President Biden is going to cut or gut the IRA to deal with this issue. And at the end of the day, we're confident it will get solved.

Q - Steven Isaac Fleishman {BIO 1512318 <GO>}

Okay. And then lastly, just on upgrades. The -- I know you kind of came out with some growth investment for uprates that were, I think, more ones that were a little more normal course, but I think they're still working on kind of the potential for others over time. Just any update on how you're thinking about uprate opportunities?

A - Joseph Dominguez {BIO 16668698 <GO>}

Nothing that we're ready to announce today, Steve. But to your point, we are working through some other opportunities, and we think there will be.

Operator

And our next question comes from Shar Pourreza of Guggenheim Partners.

Q - Shahriar Pourreza {BIO 15145095 <GO>}

Quick ones here. I know, Joe, you guys mentioned on the fourth quarter call that you were working with kind of state policymakers to potentially reduce their support in light of sort of the federal PTC. Any updates on those efforts, especially as you look at states like New York?

A - Joseph Dominguez {BIO 16668698 <GO>}

No, Shar, the only thing I'd say on that, we've -- those conversations have continued to evolve, nothing unexpected. There's nothing that is different about the way they're looking at it than the way we're looking at it based on the conversations we've had. We just haven't -- those agreements haven't been memorialized, and in some cases, might not get memorialized until after the guidance is actually issued because it's -- obviously, we still have a whole year really to go before we get to it. But I think those conversations are progressing very well.

Q - Shahriar Pourreza {BIO 15145095 <GO>}

Okay. Perfect. And then on the gross margin side, obviously, you talked about it a little bit. You're now looking at about $100 million in PTC credits for the nonstate-supported plants. Could we get a little bit more detail on where that is coming from? And it looks like from the sensitivities, it might be weighted towards LaSalle. But any additional color you can provide here as we see this creep up in gross margin for the first time?

A - Daniel Eggers {BIO 3764121 <GO>}

Yes, Shar, this is Dan. I think if you look into the sensitivity table on Page 23, you can see the moves up or down with (inaudible), NiHub and the PJM West fleets, which would suggest that we're having plans in both markets, where at the bus, they're going to be all below the PTC threshold [ph] there. Remember that our PTC sensitivity is only for the plant who do not have state support. So to narrow that down, right, it's going to be LaSalle in the Midwest and then Limericach, Peach and Calvert in the East. So it is affecting on both sides. And you can see the sensitivity to price there, which also is a useful tool for you guys to desensitize your models.

Q - Shahriar Pourreza {BIO 15145095 <GO>}

Okay. Perfect. And then just last thing, sort of to ask -- and I'm getting questions on it this morning. But I guess would you have guided to the top half without the additional PJM invoice uplift?

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes.

Operator

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

Q - Paul Andrew Zimbardo {BIO 18277958 <GO>}

Nice update across the board. Well done.

A - Joseph Dominguez {BIO 16668698 <GO>}

Thank you.

Q - Paul Andrew Zimbardo {BIO 18277958 <GO>}

Following up on the capital allocation discussion, you referenced growth and potential consolidation as influencing the timing. Just are there things discrete that you're watching for? And just in general, when should we expect you to start to move some of that unallocated to the allocated bucket?

A - Joseph Dominguez {BIO 16668698 <GO>}

Let me flip that to Dan.

A - Daniel Eggers {BIO 3764121 <GO>}

Paul, I think that Joe talked about the upgrade. I was asked earlier, we're looking at a number of growth opportunities that take a little time to manifest, so we're going to continue to work through those. We continue to look at the market for potential M&A opportunities. I think nuclear (inaudible) comes to the top of that list, and we're going to be pretty focused there. We have the $750 million of buyback to work our way through. I think we have a little time to get through there. And we'll continue to analyze both the scope of opportunity and then -- when we can put that out. So I'm not going to give you an exact time line, but we're certainly keeping a close eye on how quickly we can deploy opportunities that come to there.

Q - Paul Andrew Zimbardo {BIO 18277958 <GO>}

Okay. Great. And then I heard the opening commentary on your view on '23 and '24. Is it still a fair expectation 2024 formal EBITDA guidance would come on the fourth quarter call? Or could that come sooner?

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes. No, it will -- the formal guidance come on the fourth quarter call. But Paul, what we've been trying to do with these new disclosures is to kind of give you all of the moving pieces, which will update quarter-to-quarter. So you'll see the formal guidance, but you can start to piece together the story, obviously.

Operator

Our next question is from Durgesh Chopra of Evercore ISI.

Q - Durgesh Chopra {BIO 20053859 <GO>}

Just, Joe, a finer point on capital allocation. You talked about the attractiveness of the share price. I just want to be clear in terms of the unallocated $2 billion [ph] for '23 and '24, could that potentially go towards an upside share buyback?

A - Joseph Dominguez {BIO 16668698 <GO>}

Good. Sure. But it would mean that the other opportunity sets that we've talked about, whether that be organic or inorganic growth opportunities, did materialize in the time frame. We have -- and we understand it's kind of a short time period to execute in '23 and '24 on those opportunities. And if they don't occur, as I said in the prepared remarks, all day long, we buy the stock price at this level.

Q - Durgesh Chopra {BIO 20053859 <GO>}

And then just maybe, Dan, going back to the PTC, the $100 million accretion gross margin. Can you -- is there a way for us to get to what a dollar PTC value you're using to get to that, like an average across the different assets that you have?

A - Daniel Eggers {BIO 3764121 <GO>}

No, I'm not going to -- I can't give you at least to give you a specific unit or price comparison because of the bus parts differences of the plants. What I would say if you can look back at the sensitivities on '23 at a plus or minus $5 movement, you can see how much the PTC would change from where we are. So you could price out on those protectively 4 plants, somewhat you could price out how much move you would have to get the PTC back to 0. That's probably the best way of thinking about it right now.

Operator

And our next question comes from Ross Fowler of UBS.

Q - Ross Fowler {BIO 16864050 <GO>}

Congrats on the good quarter. Just -- I heard your earlier comments, and I just wanted to follow up on Paul's question a little bit. So if I kind of -- look, there's a lot of puts and takes left before we get to the fourth quarter call and sort of guidance for '24. But if I kind of go back to Slide 25, where you're pointing us to, and I kind of take gross margin, less the adjusted O&M and the TOTI, I'm sort of that $3.7 billion, $3.8 billion. Of course, there's a lot of puts and takes and there will be a range around that. But that's the context of your comments that you're materially higher than consensus expectations, because consensus is kind of $3.4 billion...

A - Joseph Dominguez {BIO 16668698 <GO>}

That's right.

Q - Ross Fowler {BIO 16864050 <GO>}

Okay. Just wanted to make sure I'm thinking about that correctly.

A - Joseph Dominguez {BIO 16668698 <GO>}

Yes, you got it. And like I said, I think all the pieces are right there in front of you.

Operator

I would now like to turn it back to Joe Dominguez for fiquestnal remarks.

A - Joseph Dominguez {BIO 16668698 <GO>}

Well, thanks again for joining. It really has been kind of a remarkable quarter and the progress we've seen in the business, that points to really a nice outcome for us this year, and next is very exciting to all of us. So we look forward to our next quarterly call, and we'll conclude the call. Thank you.

Operator

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