

# CMS Energy Corporation NYSE:CMS

## FQ2 2023 Earnings Call Transcripts

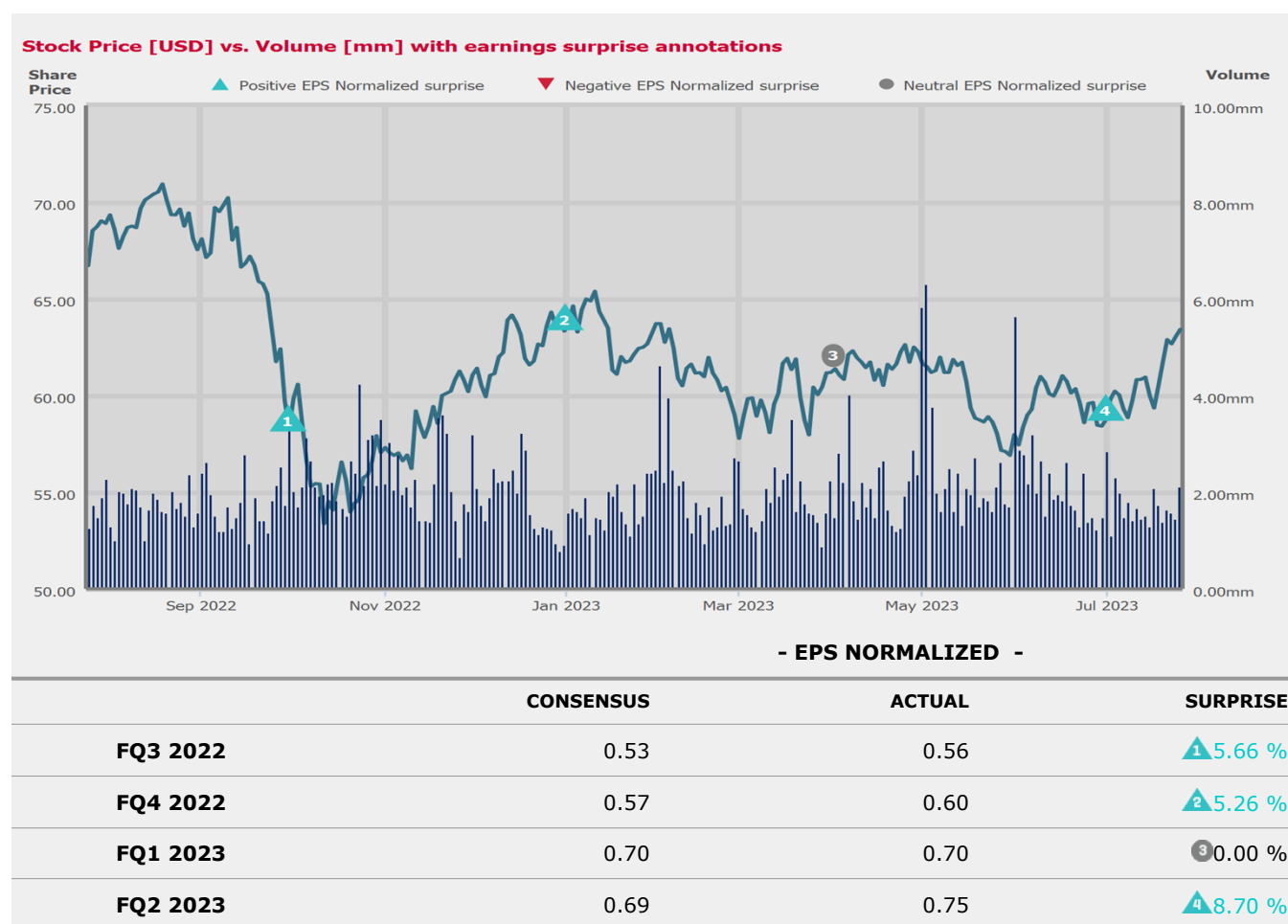
**Thursday, July 27, 2023 12:30 PM GMT**

S&P Global Market Intelligence Estimates

	-FQ2 2023-			-FQ3 2023-	-FY 2023-	-FY 2024-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
<b>EPS Normalized</b>	0.69	0.75	<span style="color: green;">▲ 8.70</span>	0.78	3.10	3.36
<b>Revenue (mm)</b>	1999.42	1555.00	<span style="color: red;">▼ (22.23 %)</span>	2158.23	8757.18	9086.86

Currency: USD

Consensus as of Jul-24-2023 10:00 PM GMT



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# Call Participants

## EXECUTIVES

**Garrick J. Rochow**  
*President, CEO & Director*

**Rejji P. Hayes**  
*Executive VP & CFO*

**Srikanth Maddipati**  
*VP of IR & Finance and Treasurer*

## ANALYSTS

**Heidi Anne Hauch**  
*BofA Securities, Research Division*

**Jeremy Bryan Tonet**  
*JPMorgan Chase & Co, Research Division*

**Michael P. Sullivan**  
*Wolfe Research, LLC*

# Presentation

## Operator

Good morning, everyone. Thank you for standing by. Welcome to the CMS Energy 2023 Second Quarter Results Conference Call and News Earnings release. The earnings news release was issued earlier today and the presentation used in this webcast are available on CMS Energy's website in the Investor Relations section. Today's call is being recorded.

[Operator Instructions] As a reminder, there will be a rebroadcast of this conference call today, beginning at 12:00 p.m. Eastern Time, running through August 3. This presentation is also being webcast and is available on CMS Energy's website in the Investor Relations section.

At this time, I would like to turn the conference over to Sri Maddipati, Treasurer and Vice President of Finance and Investor Relations. Please go ahead, sir.

## Srikanth Maddipati

*VP of IR & Finance and Treasurer*

Thank you, Michelle. Good morning, everyone and thank you for joining us today. We apologize for the delay as we were experiencing technical difficulties. If you have any questions and were unable to participate on the call, please feel free to give me or [indiscernible] a call after this earnings call.

With me are Garrick Rochow, President and Chief Executive Officer; Rejji Hayes, Executive Vice President and Chief Financial Officer. This presentation contains forward-looking statements, which are subject to risks and uncertainties. Please refer to our SEC filings for more information regarding the risks and other factors that could cause our actual results to differ materially. This presentation also includes non-GAAP measures. Reconciliations of these measures to the most directly comparable GAAP measures are included in the appendix and posted on our website.

Now I'll turn the call over to Garrick.

## Garrick J. Rochow

*President, CEO & Director*

Thank you, Sri and thank you, everyone, for joining us today. CMS Energy, we deliver, we say it and we back it up. So what makes it work for all stakeholders is this investment thesis that we start with a nearly ever earnings call. I've reiterated the key points of this thesis on many occasions. Today, I want to draw attention to 3 key components. First, we continue to make industry-leading progress on the transformation to clean energy. This is required to position the business for the future and I will share more evidence of our good work this quarter with the exit of our coal units at our Karn facility and the acquisition of the Covert Generating Plant.

Next, Michigan continues to be a solid place for investment. Our energy legislation is one of the best in the country, where we operate in a top-tier regulatory environment, providing important certainty for critical customer investments and there continues to be evidence to support it. I'll share the details on our fourth consecutive settlement in our recent gas rate case. Finally, you'll hear from me on the strong progress we made in cost management, the CE Way and other countermeasures to offset the unplanned headwinds experienced early in the year. I'm pleased with the progress and remain confident in our plan to deliver 2023 and beyond.

Our investment thesis is simple. It's worked for more than 20 years, regardless of conditions to deliver the operational and financial results across the triple bottom line for all our stakeholders.

At CMS Energy, we like to say, leaders lead and we are leading the clean energy transformation. We've set industry-leading ambitious net zero targets for both our gas and electric systems and we continue to get it done. Our actions today serve as proof points that we can and we will achieve our targets. In June, we retired our Karn units 1 and 2, removing 515 megawatts of coal generation for Michigan, further

reducing our carbon profile. I'd like to take a moment to recognize the service of the individuals at Karn who dedicated their careers providing energy for our customers. I had the opportunity to be there in the final days of the facility's operations and I'm proud to share the pride our coworkers have for their work. I'm also proud of the work we have done to provide a just transition, either to retirement or a new place within our company, for those who served at this facility.

As we transition out of coal, it is imperative that we maintain reliability for our customers and our state. And so in June, we assumed ownership and operations of the Covert Generating Plant. This existing 1.2 gigawatt facility maintains important, low cost, reliable electric supply in Michigan and further bolsters the MISO footprint.

I'm proud to share our industry-leading commitments are being noticed, and we are now included in the MSCI ESG Leaders Index, the only vertically integrated utility to be included in this index. These are proof points, evidence in our leadership of this important transformation across the industry and will help us attract incremental capital to CMS Energy to bolster our customer investments. Adding to the good work of the quarter, we signed more contracts in our Voluntary Green Pricing program, which has now grown to 341 megawatts of own generation and I see further growth on the near horizon. We received approval for nearly \$11 million in grants for RNG facilities to support farms we partner with as we decarbonize our gas systems. And we expect our 201-megawatt Heartland Wind Farm, which qualifies for a 10.7% ROE, will be operational later this year.

While these are just a few highlights, they demonstrate what we do at CMS Energy. We set big goals, we get after it every day and we deliver, leading the clean energy transformation.

Turning to Slide 5. I want to take a moment to talk about the constructive regulatory environment in Michigan. Recently, the governor reappointed Chair Scripps to a full term ending in 2029 and appointed Alessandra Carreon to fill the remainder of Commissioner Tremaine Phillip's term, which ends in 2025. The appointment of Commissioner Carreon and continuity in leadership through the reappointment of Chair Scripps further reflect the constructive and stable nature of the Michigan regulatory environment, which remains one of the best jurisdictions in the country. We've connected with Commissioner Carreon and she has a strong background in decarbonization, in transportation electrification and is well suited for the role. We look forward to working with her and this commission.

As for the regulatory calendar, our gas rate case settlement is one more in the streak of settlements and our second gas settlement in just over a year. I'm pleased with the outcome and the team's work. This is a clear demonstration of the constructive regulatory environment in Michigan and speaks to our ability to work with multiple parties to provide the best outcome for our customers and our investors. We expect rates to go into effect October 1, with the start of the new test year.

In our electric rate case, we are awaiting staff's position by the end of August and a final order by March of next year. Within our filing, we are requesting approval for a small undergrounding pilot, roughly 10 miles and planned underground over 400 miles, annually. This is an area where we have a lot of opportunity to strengthen our system and improve reliability and resiliency while aligning with our Midwest peers.

Solid energy legislation, strong regulatory construct and the evidence to support it, a top-tier regulatory jurisdiction.

Moving on to the financials. For the second quarter, we reported adjusted earnings per share of \$0.75. We had a strong quarter, driven by operational and financial performance and we continue to build contingency through the CE Way as we deliver on our year-end financial objectives. Today, we are reaffirming all our financial objectives, including our full year guidance of \$3.06 to \$3.12 per share with continued confidence toward the high end. We're also reaffirming our long-term adjusted earnings per share growth of 6% to 8% per year with continued confidence toward the high end and remain committed to annual dividend per share growth of 6% to 8%.

As I stated in our Q1 call, this is not our first rodeo. The team has done a remarkable job of mitigating the gap left from a warm winter and a large ice storm. Through the CE Way, operational cost measures,

financings and other countermeasures, we have made great progress year-to-date. Year after year, we deliver and this year will be no different. This is not about winning one game or one season. It's about winning multiple seasons, a winning program, continuing the long track record of consistent growth and compounding off of actuals, bringing our investors a high-quality of earnings and doing it year after year.

Now I'll hand the call over to Rejji to provide some additional details and insights.

**Rejji P. Hayes**

*Executive VP & CFO*

Thank you, Garrick and good morning, everyone. We had a strong second quarter delivering adjusted earnings of \$0.75 per share driven by numerous cost reduction initiatives foreshadowed on our Q1 call, which I'll elaborate on shortly. Our financial performance over the past few months has materially offset the weather-driven challenges we faced in the first quarter. As such, as Garrick noted, we are reaffirming our guidance for the year. And on a year-to-date basis, we're on track with adjusted EPS of \$1.45 per share, given the back-end weighted nature of our plan this year.

As you can see in the waterfall chart on Slide 7, weather has been a significant headwind to our financial performance in the first half of this year, driving \$0.37 per share of negative variance versus the comparable period in 2022. Rate relief net of investment-related expenses has resulted in \$0.06 per share of positive variance versus the first half of 2022, driven by last year's constructive electric and gas rate case settlements. From a cost perspective, our financial performance in the first half of the year has been significantly impacted by higher operating maintenance, or O&M expenses, to the tune of \$0.15 per share versus the comparable period in 2022, attributable to storm restoration costs in the first quarter.

However, it is worth noting that our operational O&M expenses, which represent the majority of our O&M expense and primarily excluding costs associated with our energy waste reduction programs and employee benefits have trended favorably during the second quarter and we are down roughly 10% versus the second quarter of 2022.

So we're seeing the fruits of the numerous operational cost reduction initiatives we put in place earlier in the year, such as reducing our use of consultants and contractors, limiting hiring, accelerating longer-term IT cost reduction initiatives and eliminating other discretionary spending. And of course, leveraging the CE Way, our lean operating system. We anticipate that our strong cost performance will continue as we move through the second half of the year.

Rounding out the first 6 months of the year, you'll note the \$0.18 per share positive variance versus the first half of 2022 highlighted in the catch-all bucket in the middle of the chart. The primary source of upside here was related to financing efficiencies and shortly capitalize on attractive conditions in the convertible bond market by pricing an \$800 million issuance and using the majority of the proceeds to pre-fund future parent company financing needs. Usually, prefundings like this are subject to negative carry. However, given the current inverted yield curve, we've managed to reinvest the proceeds at deposit rates favorable to the underlying funding costs.

Lastly, we used the balance of the proceeds from the Convert offering to tender a portion of select bonds well below par, which has delevered our balance sheet. All in, this opportunistic financing transaction was earnings accretive and has further strengthened our liquidity position.

Looking ahead, as always, we plan for normal weather, which equates to \$0.06 per share of negative variance versus the comparable period in 2022. Due to the absence of strong sales of the electric utility driven by last year's warm summer, we anticipate that the estimated negative variance attributable to weather will be more than offset by rate relief, net of investment-related costs, which we have quantified at \$0.08 per share versus the first half of 2022. Our estimates reflect the terms of our recently filed gas rate case settlement agreement, which is subject to commission approval and the residual benefits of our 2022 electric rate case settlement.

Closing out the glide path for the remainder of the year, as noted during our Q1 call, we anticipate lower overall O&M expense of the utility driven by the ongoing benefits of the aforementioned cost reduction initiatives. Some expected favorable year-over-year variance related to service restoration costs and the

usual cost performance fueled by the CE Way, which collectively equates to \$0.26 per share of positive variance versus the comparable period in 2022.

Lastly, as we discussed during our first quarter call, we're assuming modest growth at NorthStar and the benefits associated with the roughly \$0.12 per share of pull-ahead exercised in the fourth quarter of 2022. As per our original guidance, all in, we estimate these items will drive \$0.17 to \$0.23 per share of positive variance versus the comparable period in 2022.

In summary, we made great progress to offset the challenging weather experienced in the first quarter but needless to say, we'll continue to plan conservatively and execute as we always do.

Moving on to the balance sheet. On Slide 8, we highlight our recently reaffirmed credit ratings from Moody's. As you know, we continue to target mid-teens FFO-to-debt over our planning period. As always, we remain focused on maintaining a strong financial position which, coupled with a supportive regulatory construct and predictable operating cash flow growth, supports our solid investment-grade ratings to the benefit of customers and investors.

Moving on to the financing plan. Slide 9 offers more specificity on the balance of our planned funding needs in 2023, which are limited to debt issuances at the utility. This includes both first mortgage bond financings and a securitization financing to address the recovery of the undepreciated rate base at the recently retired Karn coal facilities.

As for the parent company, given the timing of the convertible bond issuance, we've been able to delay the settlement of the equity forwards that priced last year. So the roughly \$440 million of forward equity contracts will be settled commensurate with the needs of the business over time.

As I've said before, our approach to our financing plan is similar to how we run the business. We plan conservatively and capitalize on opportunities as they arise. This approach has been tried and true year in and year out and has enabled us to deliver on our operational and financial objectives, irrespective of the circumstances to the benefit of our customers and investors. And this year is no different.

And with that, I'll hand it back to Garrick for his final remarks before the Q&A session.

**Garrick J. Rochow**  
*President, CEO & Director*

Thank you, Rejji. Our track record spans 2 decades and consistently delivers industry-leading results in any conditions. This is what we do. We deliver for all stakeholders, year in and year out. And this year will be no different.

With that, Michelle, please open the lines for Q&A.

# Question and Answer

## Operator

[Operator Instructions] Your first question will come from Jeremy Tonet of JPMorgan.

### Jeremy Bryan Tonet

*JPMorgan Chase & Co, Research Division*

Maybe just want to start off with the undergrounding pilot, if you could and just wondering if you could expand a bit more, I guess, on what would define success there? Or I guess, future outlook for how quickly that could fold into the plan in larger size over time?

### Garrick J. Rochow

*President, CEO & Director*

So I've got a interesting story this year. I mean, I was out with our crews here, this is about 2 weeks ago and we had been undergrounding in a -- replacing undergrounding in a subdivision area. So remember, in Michigan, subdivisions are underground, a lot of people request their service underground. And so we know how to do this work. And in fact, we have a large gas business that does a lot of undergrounding and so we're sharing practices back and forth. And so again, -- right now, we're starting out with a pilot. And that's just a nice way to step into this with the Public Service Commission to show them our capabilities and being able to deliver that at a low cost for our customers.

Again, as I've shared in past calls, the cost for undergrounding in Michigan, given the soil, given where we intend to put the undergrounding, it's really conducive. It's really almost at parity with aboveground construction. So it makes it really affordable for our customers. And so we intend to use that practice. It's recognized through EPRI as a best practice, not everywhere but strategically or selectively across our system. And so starts with 10 miles. We got 6 counties identified. We got a project starting up in one of the north of Grand Rapids area here in about 2 weeks. The Public Service Commission will be on that site as well to watch that, observe that. And what we intend to grow that is to about 400 miles annually. As I've shared in the past, about 15% -- 10% to 15% of our system is undergrounded, other Midwest peers around 35% to 40%. And so again, it's a best practice and we see this as a way to improve reliability and resiliency for the future.

### Jeremy Bryan Tonet

*JPMorgan Chase & Co, Research Division*

Got it. That's helpful. And storms has been topical in Michigan, obviously, in recent time here. I'm just wondering if you could provide a bit more color, I guess, on your efforts -- hardening efforts in where you stay and where you want to be to improve resiliency there and just kind of how you feel local stakeholders are aligned against those -- against this outlook in the state?

### Garrick J. Rochow

*President, CEO & Director*

As I shared in the Q1 call, our focus on, clearly on reliability and resiliency coming off the large ice storm. We're making a lot of investments, considerable investments across the electric system. And we've seen good performance here over the course of the summer. Even just the last night, we had 65-mile winds come through and the system performed well. We've got 20,000 customers out this morning and we're quickly restoring them. And so the investments we are making -- it's a large system but the investments we are making are certainly showing benefit.

So we've got a great plan. We're filing that plan here in September with a 5-year -- with our 5-year infrastructure plan. This audit that's underway that we'll start here in September will be another point of alignment for the right investments across the electric system to improve reliability and resiliency. So those things are going well and our system is performing well. And so I feel good about our performance this summer, we'll continue to be focused on it.



**Operator**

Your next question comes from Julien Dumoulin-Smith at Bank of America.

**Heidi Anne Hauch**

*BofA Securities, Research Division*

This is Heidi Hauch, on for Julien. Just first question, noting your plans to file another IRP in the next year or 2, do you see any read-throughs for your next IRP related, the latest peer IRP settlement approved by the Michigan PSC, either from the coal retirement front, renewables' investments or otherwise?

**Garrick J. Rochow**

*President, CEO & Director*

Well, first, I want to congratulate that [ Pierre ] utility that had an IRP settled this week. So congratulations to the DTE team. A lot goes into those IRPs. And if you take one thing away from that IRP, it just speaks to the constructive environment here in Michigan, 4 settlements for us, a settlement in IRP for DTE, that's really good. So we'll obviously look at their IRP and look at what we want to take into our next IRP. The other things that we'll consider, the Inflation Reduction Act has certainly changed, PTCs and ITCs and is shaping the industry investment. Infrastructure and Jobs Act has also shaped some things in our industry. And so all that will go into our next IRP and into some of our thinking.

The IRP process takes about 12 to 18 months to build really a thoughtful and thorough plan that we'd submit to the commission. I anticipate we'll start that process in 2024, building out that. So we play it out. That means we file maybe late 2025, 2026 time frame. And so there's still some work to define that and tie that down. But that's our early indications of how we think about our next IRP.

**Heidi Anne Hauch**

*BofA Securities, Research Division*

Great. And then second question from me, can you comment on the latest MPSC investigation into the natural gas meters and new service delays? How are you planning to address or improve these issues? And are there any potential capital opportunities that may result from this investigation?

**Garrick J. Rochow**

*President, CEO & Director*

Thank you for your question. It probably goes without saying this but I'll say it anyways, we take every MPSC inquiry seriously. And from a customer perspective and bills, we've got to get that right. But maybe a little background here, Heidi, our meters communicate wirelessly. That's our smart grid, it's all wireless. And obviously, there's a wireless carrier that communicates that signal back to our home offices here. And as you might imagine, those wireless carriers are moving from 3G to 5G. So they're shutting down some of the 3G systems, moving to 5G. And they made us aware of that and we were working with our meter vendor to upgrade those meters so they have the right communication components to operate at 4G and 5G technology. That process too is underway. However, the meter vendor ran into supply chain problems in part due to the pandemic, where they couldn't get the components for the meter.

That delayed our deployment of these meters. And so when we walked in, in January of 2023, we had about 190,000 meters that we're no longer communicating. Today, that's around 33,000 and we continue to work with our meter vendor to close that and we expect that to be closed by August. As you imagine, when those meters are not communicating, it creates the potential for estimated reads. Our meter vendor was supposed to go out and read meters for us to close that gap. They did not meet our expectations around that and we had to step in and close that gap, which we've done. And our reads are being completed and any consecutive estimates are now within historical parameters.

And so from a meter perspective, from a consecutive estimate perspective, those are resolved or will be resolved in August. We will report to the commission on August 4 and so we'll do that. From a materiality perspective, it's -- we've factored that in both the reading of the meters and any penalties we may see from the Public Service Commission. And they're incorporated within our guidance that we've offered. I do not see a capital opportunity here. But rest assured that from a customer perspective and MPSC

perspective, we are running this to ground. We're doing a root cause on it and make sure that it will not happen again for our customers.

Thanks for your question, Heidi.

**Operator**

Your next question comes from Michael Sullivan at Wolfe Research.

**Michael P. Sullivan**

*Wolfe Research, LLC*

Maybe this one is for Rejji. Just wanted to ask on the delay in the draw on the forward equity and just how we should think about timing there? Whether that ends up getting needed at all? I think my recollection is outside of that, you had no other needs until 2025. But yes, maybe just a little more color on what the equity picture looks like going forward now that you've done the Convert?

**Rejji P. Hayes**

*Executive VP & CFO*

Yes, Mike, thanks for the question. Yes, we will still plan to settle the equity. It will likely be, I'll say the back half of this year and deep into the second half, so call it, late Q3 or in Q4. But we do still plan to settle the equity over the course of this year.

**Michael P. Sullivan**

*Wolfe Research, LLC*

Okay. Great. And just in terms of the impact on metrics and FFO, the debt from the Convert issuance and the tender and delay in equity, does that kind of move you at all up or down within your mid-teens target?

**Rejji P. Hayes**

*Executive VP & CFO*

No. The convert transaction was for all intents and purposes, when you take into account all of the puts and takes, it's effectively credit neutral, maybe modestly accretive. And then the delay of the equity settle, again, it's still going to take place over the course of this year. So again, all credit neutral. And so we'll still be right in that mid-teens area and well in alignment with the expectations of the credit rating agencies so we can maintain our investment-grade ratings.

**Operator**

There are no further questions from the phone line. So I will turn the conference back to Garrick Rochow for any closing remarks.

**Garrick J. Rochow**

*President, CEO & Director*

Thanks, Michelle. I'd like to thank you for joining us today. We'll see you on the road, too. Take care and stay safe.

**Operator**

Ladies and gentlemen, this does conclude your conference call for this morning. We would like to thank you all for participating and ask you to please disconnect your lines.

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