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# CMS Energy Corp. (CMS)

Q2 2022 Earnings Call

## CORPORATE PARTICIPANTS

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*Treasurer & Vice President-Finance and Investor Relations, CMS Energy Corp.*

**Rejji P. Hayes**

*Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

**Garrick J. Rochow**

*President, Chief Executive Officer & Director, CMS Energy Corp.*

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## OTHER PARTICIPANTS

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**Andrew Weisel**

*Analyst, Scotia GBM*

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**Julien Dumoulin-Smith**

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good morning everyone and welcome to the CMS Energy 2022 Second Quarter Results. The Earnings News Release issued earlier today and the presentation used in this webcast are available on CMS Energy's website in the Investor Relations section. This call is being recorded. After the presentation, we will conduct a question-and-answer session. Instructions will be provided at the time. [Operator Instructions] Just as a reminder, there will be a rebroadcast of this conference call today beginning at 12 PM Eastern Time, running through August 4. 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 call over to Mr. Sri Maddipati, Treasurer and Vice President of Finance and Investor Relations.

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**Srikanth Maddipati**

*Treasurer & Vice President-Finance and Investor Relations, CMS Energy Corp.*

Thank you, Elliot. Good morning, everyone, and thank you for joining us today. With me are Garrick Rochow, President and Chief Executive Officer and 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.

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**Garrick J. Rochow**

*President, Chief Executive Officer & Director, CMS Energy Corp.*

Thanks, Sri and thank you everyone for joining us today. I'm excited to share another strong quarter at CMS Energy and a great first half of the year bolstered by favorable weather and higher weather normalized sales at the utility, great tailwinds. And over the course of the quarter, two outstanding regulatory outcomes which provide further evidence of the top tier regulatory jurisdiction in Michigan and give us continued confidence in our plan.

First, our integrated resource plan. If I could open this up for just a moment, 18 months of sophisticated supply modeling, thousands of pages of testimony, 10 months schedule, alignment across dozens of stakeholders, interveners, the Attorney General, business stakeholders and the Commission staff to reach a settlement with close to 20 parties. This plan, approved at the end of June, solidly positions us to lead the clean energy transformation, outstanding.

Next, our gas rate case. Important investments to ensure a safe, reliable, affordable and clean natural gas system, settled with many of the same parties and approved on July 7, a \$170 million increase, over 95% of our customer investment approved, excellent. Both outcomes demonstrate the quality of our regulatory environment in Michigan and increase our confidence in delivering the rest of the year and our long-term plan.

I want to emphasize why we continue to be confident in our plan. Delivering is not new for us. We have nearly two decades of commitments made and kept for all our stakeholders, including you, our investors. A key element in our performance is strong energy law in Michigan. We have a productive and solid energy law passed in 2008, which was enhanced and updated in 2016, both with bipartisan support.

This allows for timely recovery of investment, which we've outlined through long-term plan such as our IRP as well as our electric and natural gas distribution plants, which we filed in our rate cases. This, coupled with separate mechanisms, allow us timely recovery of fuel and power supply cost, as well as attractive economics on renewable energy investments and energy waste reduction programs and uniquely positioned Michigan as one of the safest places to invest capital, but let me be clear. We don't take this for granted.

We continue to improve our processes for stakeholder alignment, testimony development and business cases. So we are confident that our proposed customer investments deliver measurable benefit while keeping bills affordable. At CMS, we deliver. Our productive and supportive environment and our deliberate approach ensure that no matter the condition, we are positioned to deliver industry-leading results.

We remain committed to leading the clean energy transformation. On the solid foundation of strong energy law, we delivered and settled our IRP. This makes us one of the first utilities in the country to completely exit coal. As of the end of second quarter, we have nearly eliminated our long-term economic exposure to coal, which is now less than 2% of property, plant and equipment.

Not only have we reduced our long-term financial risk, but we've significantly mitigated our operational risk as well. The acquisition of simpler, more flexible natural gas units means fewer people to operate, a better heat rate and less maintenance. The ability to quickly ramp up and down the dispatch of these units will allow us to flex with changing market conditions and to better support the intermittent nature of renewables.

The acquisition of Covert combined with the RFP for 700 megawatts of capacity through PPAs, the buildout of 8 gigawatts of solar and our ongoing energy efficiency and demand response programs ensure that we have

sufficient capacity to meet the needs of our customers. This plan improves reliability and limits our customer's exposure to potentially volatile capacity and energy prices. The IRP strengthens and lengthens our financial plan, eliminates our exposure to coal, improves reliability, and is a solid win for everyone.

Strong execution and constructive regulatory outcomes lead to strong financial results, and I couldn't be more pleased with the first half of 2022. As I stated in my opening remarks, a strong quarter and a great first half of the year, where we delivered adjusted earnings per share of \$0.53 for the quarter. We remain confident in delivering full-year adjusted earnings per share of \$2.85 to \$2.89. And we continue to guide toward the high end of our long-term adjusted EPS growth range of 6% to 8%, which as I noted, is strengthened and lengthened by our IRP.

We continue to guide toward long-term dividend growth of 6% to 8%, with a targeted payout ratio of about 60% over time. And we'll update our current \$14.3 billion five-year customer investment plan on our year-end call to include the anticipated upside from the approval of our IRP. We are strongly positioned to deliver in the remainder of the year.

With that, I'll turn the call over to Reiji, to offer additional detail.

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## Reiji P. Hayes

*Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

Thank you, Garrick, and good morning, everyone. As Garrick noted, we had a strong first half of the year, are ahead of plan and are well-positioned to achieve our financial objectives over the next six months and longer term. To elaborate, the first half of 2022, we delivered adjusted net income of \$499 million or \$1.73 per share, up \$0.09 per share versus our 2021 first half results, largely driven by favorable weather and economic conditions in the state. The waterfall chart on slide 7 provides more detail on the key year-to-date drivers of our financial performance versus 2021.

As noted, favorable sales have been the primary driver of our positive year-over-year variance to the tune of \$0.16 per share driven by weather. From an economic standpoint, we've continued to see strong commercial industrial load in our electric business while weather normalized residential load continues to exceed our plan assumptions and pre-pandemic levels.

Rate relief, net of investment-related expenses contributed \$0.03 per share of upside as we continue to benefit from our prior gas and electric rate cases. These sources of upside were partially offset by increased operating and maintenance or O&M expenses, largely driven by customer initiatives embedded in rates to improve safety, reliability and our rate of decarbonization, which equated to \$0.07 per share of negative variance versus the first half of 2021.

We also note the \$0.03 per share of negative variance in the final year-to-date bucket, which is primarily driven by investment costs related to the 2019 Ray compressor station incident for which we are not seeking recovery at this time as per our recent gas rate case settlement agreement and the company's recent commitment to donate \$5 million in support of income-based bill assistance for our electric customers as per our IRP settlement agreement. These sources of negative variance are partially offset by the aforementioned strong non-weather sales performance in the first half of the year.

As we look to the second half of 2022, we feel quite good about the glide path to achieve our EPS guidance range. As Garrick mentioned, we had a constructive outcome in our gas rate case, the approved settlement agreement at \$170 million significantly de-risked our financial plan and when coupled with our December 2021 electric rate order, provides \$0.10 per share of positive variance versus the second half of 2021. The forecasted

rate relief net of investment-related costs in the second half of the year more than offsets our estimated impact of normal weather, which we assume will provide \$0.01 per share of negative variance versus the comparable period in 2021.

Moving on to cost savings, we continue to anticipate lower O&M expenses at the utility driven by the expectation of a more normalized level of storm activity this year versus the atypical levels experienced in 2021, which I'll remind you, equated to \$0.16 per share of downside in the third quarter of 2021 versus our financial plan. We also expect the usual solid cost performance driven by the CE Way, as well as other cost reduction initiatives in motion.

To close out our assumptions for the second half of the year, we assume normal operating conditions at Enterprises given the outage at DIG in the fourth quarter of 2021 and the usual conservative assumptions for weather normalized load at the utility. Lastly, it's worth noting that we have accrued a healthy level of contingency given our strong year-to-date performance as illustrated in the \$0.24 to \$0.28 of negative variance highlighted in the penultimate bar of the chart, which increases our confidence in delivering for you, our investors.

Moving on to the balance sheet, on slide 8, we highlight our recently reaffirmed credit ratings from all three rating agencies. 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.

Turning to our 2022 planned financings on slide 9, we continue to plan for \$800 million of debt issuances at the utility. And while our plan does not call for any financings of the parent this year, we are currently assessing funding options for the acquisition of the Covert natural gas facility in the first half of 2023 as per our approved IRP. As a reminder, the current financing plan for Covert assumes the issuance of hybrid securities. However, we're evaluating alternatives, including using our existing ATM equity issuance program, given the relative cost in the current environment. It's worth noting that this would be accretive to the previously provided \$0.03 to \$0.04 per share of EPS accretion attributable to the purchase of Covert and further strengthen our 6% to 8% long-term adjusted EPS growth outlook. Lastly, we have preserved a strong liquidity position which supplements our use of commercial paper over the coming months.

And with that, I'll turn the call back to Garrick for some concluding remarks before Q&A.

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## Garrick J. Rochow

*President, Chief Executive Officer & Director, CMS Energy Corp.*

Thanks, Rejji. I'll leave you with this. Nearly two decades of industry-leading financial performance for you, our investors, regardless of conditions, administrations, political parties, economic environments, even a pandemic, we deliver. Our strong legislative and regulatory construct, a robust capital runway, industry-leading cost management, conservative planning and our commitment to deliver across the triple bottom line, all of this makes for a strong investment thesis and makes us an investment you can count on.

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

## QUESTION AND ANSWER SECTION

**Operator:** Thank you very much, Garrick. [Operator Instructions] Our first question comes from Shar Pourreza from Guggenheim Partners. Your line is open. Please go ahead.

**Shahriar Pourreza**

*Analyst, Guggenheim Securities LLC*

Hey, guys. Good morning.

Q

**Garrick J. Rochow**

*President, Chief Executive Officer & Director, CMS Energy Corp.*

Good morning, Shar.

A

**Shahriar Pourreza**

*Analyst, Guggenheim Securities LLC*

Garrick, pretty clear cut print here. But just given, sort of, the regulatory outcomes that are now secured, you know, like the IRP, the gas settlement, looks like the electric rate case is on track. As we're kind of thinking about maybe the cadence of updates, is the plan to still update CapEx and financing in the fourth quarter? I guess, just given the visibility we have, why not provide a full guidance in capital update sometime in the third quarter or EEI timeframe? I guess, in other words, given the regulatory execution that you've clearly highlighted today, could you provide early indication on growth and 2023 numbers ahead of schedule?

Q

**Garrick J. Rochow**

*President, Chief Executive Officer & Director, CMS Energy Corp.*

Well, first of all, Shar, thanks for the compliments. We are executing well and I'm pleased with the first half of the year, but we're still on plan for our Q4 call for our capital update. Let me offer little color and context around that. You know, big reason for our execution, our ability to deliver year-after-year is one of the things we work through with that capital plan, and that's from the bottom up. We're looking at every one of those capital investments to make sure it's going to offer the affordability and benefits to our customers. And so, they'll stack on one another.

A

We want to make sure that we're also able to execute on those. So that's a matter of understanding our workforce, work lined up in a year and so that we're ensuring that we can deliver on that capital plan. And then you add that IRP. Yes, there's Covert, which is great visibility, but one of the other portions of that settlement was bringing in storage, battery storage, 75 megawatts in the period of 2024 to 2027. So we've got to make sure that's constructed and built into this five-year plan as well as we've spoken in the past about this voluntary green pricing programs, this additional renewables for some of our largest customers. And so that's materializing as well. And so that's another factor that's going in that plan. So we want to make sure that we can deliver on it. That leads to the success of our execution. And so that's why we're going to be putting that out in our Q4 call.

**Shahriar Pourreza**

*Analyst, Guggenheim Securities LLC*

Okay. Got it. And then just, obviously, looking at the results year-to-date and how 2022 is shaping up. July looks like a strong weather month. And obviously, you guys are – because you highlighted that you have normal weather planned for the remainder of the year. Does a strong third quarter weather push you ahead of guidance

Q

and maybe what are sort of some of the offsets and moving pieces there that we should be thinking about? Because just looking at the results to date, it seems like you're well ahead of your numbers. But...

**Garrick J. Rochow***President, Chief Executive Officer & Director, CMS Energy Corp.*

A

Again, Shar, we feel good about where we're at here in the first half of the year. But as you know, and as I said in my prepared remarks, we plan conservatively. Here's what I know. In 2021, during the third quarter, we lost \$0.16 due to storms. We still delivered on 2021. But again, there's a lot of year left and so we're prudent as we move forward. The other thing we look at is where are there opportunities to reinvest, to provide benefit for our customers and investors as we move towards the end of the year. That helps to derisk future years and again continues to strengthen and lengthen that long-term EPS growth rate of 6% to 8% toward the high end.

**Shahriar Pourreza***Analyst, Guggenheim Securities LLC*

Q

Okay. Terrific. Thanks, guys. Appreciate it. Thanks, Rejji, too. Bye.

**Operator:** Our next question comes from Jeremy Tonet from JPMorgan. Your line is open.

**Garrick J. Rochow***President, Chief Executive Officer & Director, CMS Energy Corp.*

A

Good morning, Jeremy.

**Jeremy Tonet***Analyst, JPMorgan Securities LLC*

Q

Hi. Good morning. Hi. Just want to pick up a little bit, I guess, with the strong results here, and it did seem like load performance was just better than expected and wondering if you could provide a bit more commentary on that. And I guess, do you see any of that abating or just, kind of, things in general from a load even absent weather and load growth perspective is going to continue at this pace or do you see something stopping?

**Rejji P. Hayes***Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

A

Hey. Good morning, Jeremy. It's Rejji. I appreciate the question. You know, obviously, we feel quite good about the load trends we're seeing in our service territory. And I'll just remind folks on some of the specifics. And so we had residential down a little over 0.5%. So that's year-to-date versus year-to-date, 2021, commercial and industrial. And as always, our industrial excludes one large low margin customer, up about 3% and then all in, up about a 1.5%. And so we feel quite good about that and, particularly, with respect to residential, we continue to see that good stickiness with the hybrid workforce, which likely will be a trend that continues on and obviously that's a high-margin segment.

And so for relative to 2019, residential is up about a little over 2% and so again, that stickiness just really carries on. We continue to see from an economic development perspective, just good activity in the service territory. And obviously, with some of the news in DC yesterday, I would think that the CHIPS Act and some of the other legislative items that may be coming down the pike could lead to more economic development opportunities or increase the probability of some of the stuff that is coming Michigan's way or is in the prospects for Michigan.



So very encouraged with the load trends and anecdotally, again, we're hearing from our customers that they continue to feel good about the economic environment. So I feel quite good about the road ahead and going forward, again, we continue to anticipate that you'll start to head back to those pre-pandemic levels. And so we would anticipate that from a residential perspective, but we continue to be surprised to the upside and commercial industrial continue to trend very well. So that's our take on load at the moment.

**Garrick J. Rochow***President, Chief Executive Officer & Director, CMS Energy Corp.*

A

And if I could just add just a macro factor here, and this is from the governor's office. This year-to-date, \$11.8 billion of investment opportunities announced in Michigan, those are projects that have agreed to locate, expand. There's actually 30 companies in all and 15,000 new jobs and so that's out at the governor's office here mid-July. And so what's very robust here in Michigan, we look at it from a macro perspective.

**Jeremy Tonet***Analyst, JPMorgan Securities LLC*

Q

Got it. That's very helpful there. And then just wanted to pivot a bit towards MISO, we've seen some capacity constraints there and that's led to some delays in coal plant retirements. Just wondering, should we be thinking about any implications to CMS here or anything else that you want to share on this front?

**Garrick J. Rochow***President, Chief Executive Officer & Director, CMS Energy Corp.*

A

I love our energy law. I really do. I'm not joking there. The 2016 energy law was here in Michigan, was solid on the supply-and-demand side. And so when we go through an integrated resource plan, we've got to do all the modeling, all the analysis to show that the supply and demand is going to meet and have some reserve margin on that. That's a requirement of a load serving entity which we are.

So I feel good about where Michigan is headed within MISO. Now, I can't speak for all of MISO, but I feel good about where Michigan's at. And I'll remind all the people on this call that part of this IRP is to bring Covert in. Covert right now is in the PJM market, and we're moving it over to the MISO market. That's 1.2 gigawatts of additional supply that's being brought into MISO and brought here to serve our customers. And so that's why we feel good about it. Our IRP, we're still on pace and plan for retirement of all coal to be out of coal by 2025.

**Jeremy Tonet***Analyst, JPMorgan Securities LLC*

Q

Got it. That's very helpful. Last one, if I could. Hot off the press climate, BBB, climate package being supported by Manchin here. Any preliminary thoughts at this point?

**Garrick J. Rochow***President, Chief Executive Officer & Director, CMS Energy Corp.*

A

Jeremy, you give me, like, what, 12 hours to digest it all. Here's what I would say on it, because we've done some preliminary review and we're still digesting a lot of facts on it. Solar PTC is a big win in there. And that's something we've been advocating for in Washington, we've been advocating in the industry. Hats off to Rejji. Rejji has been making the calls with CFOs a year and a half ago when it was first being talked about.

And so we're excited about that portion of it. What that means for our 8 gigawatts, that's going to be lower costs for our customers as we build out more solar and it will provide – put us on par with developers. So we like that.



We know there's a storage ITC as well that'll come into play in 2024 to 2027 as we build out 75 megawatts of storage. There's a lot of upside for the industry.

We're at the birthplace of the automobile, I talked about the \$11.8 billion. Most of that's in the automotive space. There's opportunities for load growth in the automotive business to grow as they make their transition. There's incentives in there for solar production in the US. In Michigan, one of our largest customers is the one of the world's largest producers of polysilicon crystals, which go into solar panels and in technology, electronics, and so that's another – we see that as an upside. There's a big tailwind on EVs. EVs are a nice part of load growth. It's not in our forecast, but there's the continuing credits for purchase of EVs. And so there's a lot of good stuff in here. We're still digesting all of the specifics, but feeling good, feeling good what's coming out of the Senate and, of course, there's negotiations for the house in front of us.

**Jeremy Tonet**

*Analyst, JPMorgan Securities LLC*

Q

Great. That's helpful. I'll leave it there. Thanks.

**Operator:** Our next question comes from Michael Sullivan from Wolfe Research. Your line is open. Please go ahead.

**Michael P. Sullivan**

*Analyst, Wolfe Research LLC*

Q

Hey, everyone. Good morning.

**Garrick J. Rochow**

*President, Chief Executive Officer & Director, CMS Energy Corp.*

A

Hey, Michael.

**Michael P. Sullivan**

*Analyst, Wolfe Research LLC*

Q

Hey, Garrick. Rejji, wanted to go over to you on just the latest commentary on the potential, looking at common equity for financing Covert. I think that was a \$815-million project. Any sense of how much the equity could be and how materially the \$0.03 to \$0.04 accretion could change?

**Rejji P. Hayes**

*Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

A

Yeah, appreciate the question, Michael. I would say we're obviously still evaluating options. You have the purchase price of Covert spot on at \$815 million. And so, as you know, our rate construct, we would fund about half of that with debt at the utility, so call it roughly \$400 million and the balance would be parent financing and mathematically that gets you to about \$400 million, but we'll still consider what the alternatives might be. And obviously, we've got quite a bit of time to fund it. And so, we'll look at our dribbling, our ATM equity issuance program. Whether there will be the full \$400 million, remains to be seen. And so, we'll see how the price of other alternatives, like those hybrid securities, which – but for the past six to seven months or so – have really priced quite competitively and so if that changes over time, we may tranche it a little bit.

And so I'd say it's still early days, but we could go up to about \$400 million. We've got that much on the shelf, but we'll see how the pricing trends over the next handful of months. And then with respect to the accretion, at this

point, I'd say it's a little premature to offer precisely how accretive it would be to the \$0.03 to \$0.04 that we initially provided, because clearly that would depend on the price at which we issue equity if we do choose to dribble. And so I'd say more variables at this point to provide any prescriptive point of view, but it would be directionally accretive just based on the relative cost right now of our equity versus other securities.

**Michael P. Sullivan**

*Analyst, Wolfe Research LLC*

Q

Okay. Super helpful color. And then the last question, what do you guys think about making it three-for-three with settlements this year with the pending electric case?

**Rejji P. Hayes**

*Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

A

We'll see. I mean, I think, batting with 670 still gets you into Cooperstown. So we've been encouraged with the IRP and the gas rate settlement. Electric, obviously, many more stakeholders, many more variables but we've been successful there before. So we're cautiously optimistic. But early days and we'll look and see where the staff is in about a month and we'll go from there, but I would say early days to make any prediction at this point.

**Michael P. Sullivan**

*Analyst, Wolfe Research LLC*

Q

Great. Thanks a lot.

**Garrick J. Rochow**

*President, Chief Executive Officer & Director, CMS Energy Corp.*

A

Thank you.

**Operator:** Our next question comes from Julien Dumoulin-Smith from Bank of America. Your line is open.

**Julien Dumoulin-Smith**

*Analyst, BofA Securities, Inc.*

Q

Hey. Good morning. You guys really do execute. Hey.

**Garrick J. Rochow**

*President, Chief Executive Officer & Director, CMS Energy Corp.*

A

Yeah. Thanks, Julien.

**Julien Dumoulin-Smith**

*Analyst, BofA Securities, Inc.*

Q

Always. Always. Hey. So let me follow up on this last bit of angle. I just want nuance here. AMT, it's going to get a lot of attention this week, I imagine, for all the utilities here. What are you guys saying on that? I know, we asked you here for your hot takes a second ago, but just if you can rehash as best you understood, your, probably, assessment of this last year, if you will.

**Rejji P. Hayes**

*Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

A

So Julien, just to be clear, you're talking about the alternative minimum tax with respect to last night.

**Julien Dumoulin-Smith***Analyst, BofA Securities, Inc.*

Yes, exactly. The 15%.

Q

**Rejji P. Hayes***Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

Okay. Yeah. With respect to the climate bill. So again, as Garrick noted, we're still digesting, I think it's about 700 pages. And our folks in federal affairs and on the tax side are really, really good at what they do and they are fast readers. But 700 pages is a lot to digest in 12 hours. But I'd say based on what we've gleaned so far as I understand it, the structure that's contemplated is consistent with what we were talking about around EEI several months ago where there's a three-year average on pre-tax operating income around \$1 billion. And if you're below that threshold, you're not subject to the minimum tax. And so from our perspective, given our size, we would likely not chin that bar for some time.

A

Now, needless to say, we aspire to at some point because we're a growing company, but in the short term, I think we'd be perhaps not subject to it initially. And we're still looking at, again, if it's structured how it was when we were talking about this at EEI, you could apply tax credits to up to 75% of the tax liability. And again, we're still looking to see whether that's in the bill, but that's how it was structured initially. And so I'd say there's a bit more work to be done on our side before we can speak to it. But I'd say to cut through it in the short term, we don't think there's a significant impact on us again, given our size. And if they apply that three year average of \$1 billion of pre-tax operating income, we just wouldn't chin that bar for a little while.

**Julien Dumoulin-Smith***Analyst, BofA Securities, Inc.*

Yeah. No, that makes sense. Thank you for the hot takes there. Appreciate it. OPEB contribution to the quarter here, et cetera. Just curious if you can comment here. Obviously, that subjects gotten some attention of late broadly.

Q

**Rejji P. Hayes***Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

Yeah. From a pension perspective, again, our story has been quite good for some time now. As you may recall, we have been very active in making discretionary contributions to our pension plan over the year, particularly years in which we were pretty flush from an OCF perspective. And so, we're well over funded at this point where we have two pension plans and both are over 120% funded. Clearly asset experience is tough for most, but we have relatively low equity content in our pension plans. And I would say based on how our pension structured at this point, we're a bit more levered to interest rate movement and with discount rates effectively going up year-over-year, we actually see it in the short-term as a net benefit.

A

And so, we actually are seeing, actually a little bit of upside, particularly, since we recently remeasured our plan. So from our perspective, it's actually net positive at the moment and we feel quite good about the level of funding for the plan.

**Julien Dumoulin-Smith***Analyst, BofA Securities, Inc.*

Totally. All right. So no material OPEB impact here in the quarter?

Q

**Rejji P. Hayes***Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

No, no.

A

**Julien Dumoulin-Smith***Analyst, BofA Securities, Inc.*

Excellent. Thanks for clarifying. And the last one just super quick clarification from earlier on solar PTC, I mean, it clearly benefit the customers from an NPV perspective, but also, I think implicitly also helps utilities participate from a rate base perspective as well I take it?

Q

**Rejji P. Hayes***Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

Yeah. So, obviously our rate construct is a little nuanced, but it would help us as well because obviously it would allow us potentially, if you think about the 8 gigawatts of solar, we're going to be executing on over the next 15 to 20 years, we're currently structured to, at a minimum, own about half of that. And if we can be more competitive because of that benefit with, obviously, the elimination of normalization, then we could potentially pencil the owned projects in a manner that's comparable with the PPA or contracted portion and that would make a case for owning more than 50% over time. So obviously that could add to rate base opportunity. So we feel quite good about what we've read today but again, obviously more to digest.

A

**Julien Dumoulin-Smith***Analyst, BofA Securities, Inc.*

Yeah. Clearly, clearly. Okay, excellent. Well, thank you, guys. Speak to you soon.

Q

**Garrick J. Rochow***President, Chief Executive Officer & Director, CMS Energy Corp.*

Thanks Julien.

A

**Rejji P. Hayes***Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

Thanks Julien.

A

**Operator:** Our next question comes from Andrew Weisel from Scotiabank. Your line is open.

**Garrick J. Rochow***President, Chief Executive Officer & Director, CMS Energy Corp.*

Hey, Andrew.

A

**Andrew Weisel***Analyst, Scotia GBM*

Hi, good morning, guys. Two clarifying questions. First is for 2022, did you say that the entire \$0.24 to \$0.28 negative red bar is conservatism? I know you said you're trending well and you've affirmed guidance, but did I hear you right? Is that all conservatism? And second part of that question is you mentioned the potential to accelerate O&M expenses for 2023. Have you started that yet or are you waiting to get through the summer and the storm season? How flexible can you be to do that late in the year, in other words?

Q

**Rejji P. Hayes***Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

A

Yeah, Andrew, thanks for the question. I would say starting with that \$0.24 to \$0.28 of negative variance in the six months to go bucket of that waterfall chart on page 7. That is a combination of conservative planning. And so that's really a catch-all bucket. And so, we've got in there non-weather sales assumptions year-to-go. We've got a little Enterprises performance and so and some parent expenses. So there is conservatism as it pertains to those variables but the vast majority of that is just contingency that we've accrued just based on the performance in the first half of the year. And so obviously, weather has been a big help. It's offered upside to plan. We've seen a little cost performance as well and a little bit of non-weather upside.

So, sales have been strong as well as cost performance and that's what's driving a good portion of that bucket. So, it's really just where we parked the contingency, which gives us a lot of flexibility, which, kind of, segues into the second part of your question about what we're doing with respect to pull aheads. And so, I would say at this point, because we still have six months ago, we really try not to do a whole lot because we still have to get through storm season and see where Q3 is, which not just from a storm perspective, but also in terms of earnings contribution. That's usually where we have the vast majority of our EPS contribution. So we've been cautious.

We've done a little bit more with respect to forestry and we've done a little bit more reliability work. Obviously, we made some commitments as part of the IRP and gas settlements with respect to low income support. And so those are things we like to do, and we'll continue to evaluate opportunities for pull aheads to de-risk 2023, some more going into the second half of the year. It's also important to remember, we also put in place a really nice regulatory mechanism a few years ago, our voluntary refund mechanism, which effectively allows us to make decisions late in the year from an operational pull-ahead perspective, to get effectively the accounting benefit in the current year and then a commitment to do work in the subsequent year.

And so that gives us even more flexibility as we head into Q4 and deep into Q4. If we're seeing upside, that's in excess of plan. It just gives us a bit more flexibility to commit to more work and again, see the, sort of, accounting benefits of that in the current year. So a lot of flexibility going forward. We've made some moves today from an O&M pull-ahead perspective, but again, we're obviously cautious at this point because we've got a lot of Q3 left and we're waiting to see what happens with storms and weather.

**Andrew Weisel***Analyst, Scotia GBM*

Q

Great. Yeah. It's definitely a helpful mechanism you have. And then the other question I just wanted to clarify on equity, so I guess first question is when would you decide how to finance Covert and could that be something like an equity forward to de-risk? But then just to be very clear, beyond financing that acquisition, are you still affirming no plans for equity in the general business financing?

**Rejji P. Hayes***Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

A

Yeah. To answer the last question first. If you put aside the potential funding of Covert, as we mentioned on the call today with potentially considering equity, there is no plan to issue equity beyond that until 2025, as per our initial guidance when we rolled out our \$14.3 billion five-year plan in Q1 of this year. So we're still committed to not issuing equity through 2024 or more specifically until 2025, but for the funding of Covert.

And in terms of how we'll time that and how we'll think through that, obviously, we'll look at the valuation of the stock versus the relative cost of other hybrid securities. And we'll look to be opportunistic from time-to-time and

we've seen just great pricing in the past with those dribble programs, and so we'll look to utilize some of that. But again, I think we've got a lot of flexibility because we're not scheduled to acquire Covert until May of next year. So quite a bit of time to evaluate and we'll be opportunistic and dribble out some, likely over the coming months.

**Andrew Weisel**

*Analyst, Scotia GBM*

Thank you very much. That's helpful.

**Rejji P. Hayes**

*Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

Thank you.

**Operator:** Our next question comes from David Arcaro from Morgan Stanley. Your line is open. Please go ahead.

**Garrick J. Rochow**

*President, Chief Executive Officer & Director, CMS Energy Corp.*

Good morning, David.

**David Arcaro**

*Analyst, Morgan Stanley & Co. LLC*

Hey good morning. Thanks so much for taking my question. Good morning. I was wondering if you could just comment on how you see the equity ratio at the utilities trending over time after we saw it tick down a little bit from the gas rate case?

**Rejji P. Hayes**

*Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

Yeah. David, thanks for the question. Obviously, we would love to see equity ratios, if not stabilize, go the other way and go up, because we do believe that we have yet to see a remediation from tax reform when it was enacted in 2017, which led to a 200-basis-point degradation in our FFO to debt overnight, as well as cash flow degradation. And so we're going to continue to make the case in our cases that we file that equity thickness should go up. And again, we'll make the case going forward.

And what I would mention is, obviously, in the case of the gas rate case settlement, there were a number of stakeholders involved in that process. We thought given the circumstances and all the other constructive aspects of the settlement, we were comfortable with the equity thickness where it was. But again, we still think it should be higher than that. I think it's also important to note that we still have deferred tax flow back from tax reform. Again, we're giving back deferred taxes to customers and that has the effect of skinning or reducing the zero cost of capital component in our rate making capital structure, which offsets some of that reduction in the authorized equity thickness.

And so to be very specific here, our equity thickness in this gas settlement went down from a little over 52% to about 50.75%. So roughly 130 basis points of reduction. However, about 50 basis points of that was offset in our rate making equity thickness because of the reduction of that zero cost of capital there. And so again, we'll continue to make the case. We still think equity thickness should continue to go up or should start to go up. And again, the onus is on us to make the case.

**David Arcaro***Analyst, Morgan Stanley & Co. LLC*

Q

Got it. Thanks. That's helpful color. And the other topic I was curious about was on the VGP. And could you talk about your progress there? And if you see a case for seeing momentum, kind of, accelerate in customer interest?

**Garrick J. Rochow***President, Chief Executive Officer & Director, CMS Energy Corp.*

A

Yeah, we certainly see a lot of customer interest. We've signed some additional contracts over the quarter. Due to non-disclosure agreements, I can't talk about all of them. One of I can share is the state of Michigan signed a contract over the quarter and so recall that's a 1000 megawatts of renewable build, incremental to our plan and so we're starting to layer in those contracts as we move forward and have those customers secured. In addition, we look at – went out to RFP, look at what it would cost to construct that 1000 megawatts. Again, I won't put as a 1000, that's going to become very module. It's going to come in little tranches as we build out for our customers, but still good interest, really good interest and we continue to line up contracts to support that build. Is that helpful?

**David Arcaro***Analyst, Morgan Stanley & Co. LLC*

Q

Okay. Got it. Yeah. No, that's helpful. Thanks. Maybe one more just quick one. You know, to the extent that, Rejji, you were to do common equity or something, with kind of 100% equity content here for Covert. Does that offset potential equity needs later in the plan, just given the initial thinking was something with a lower equity content, 50% or so?

**Rejji P. Hayes***Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

A

So I'm just going to go back to what we committed to when we rolled out our five-year plan again before the IRP and before Covert. So just everyone's grounded. So we said \$14.3 billion of capital and we would not need to issue equity until 2025 and 2026, so the outer years of the plan. And at that point, we would do about \$250 million per year in 2025 and 2026. So now with Covert, we said we may dribble a portion of that. And I would say the funding of Covert, that's not going to eliminate those outer year needs, if that's specifically the question.

So the \$250 million we said we'd issue in 2025 and 2026. Because we're issuing equity to fund Covert, where we sit today, we don't think that obviates the need to do that equity in those outer years. But we'll see. I mean, obviously, we'll see what happens with respect to economic performance load, EPS, how much earnings we retain and so on. But again, from where we sit today, this does not eliminate the need for equity in those outer years.

**David Arcaro***Analyst, Morgan Stanley & Co. LLC*

Q

Okay. Great. Thanks. Yeah, that's I was getting at. Much appreciated.

**Rejji P. Hayes***Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

A

Thank you.



**Garrick J. Rochow***President, Chief Executive Officer & Director, CMS Energy Corp.*

A

Thanks.

**Operator:** Our next question comes from Ryan Levine from Citi. Your line is open.**Ryan Levine***Analyst, Citigroup Global Markets, Inc.*

Q

Good morning.

**Garrick J. Rochow***President, Chief Executive Officer & Director, CMS Energy Corp.*

A

Good morning, Ryan.

**Ryan Levine***Analyst, Citigroup Global Markets, Inc.*

Q

Good morning. I'm hoping to follow up on residential load patterns. It looks like year-over-year residential load on a weather normalized basis was a little bit softer than some of your peers in the neighboring jurisdictions. Curious if there's any color you could share on the drivers that you're seeing in your service territory?

**Rejji P. Hayes***Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

A

Yes. So our residential load, to be clear, Ryan, are you speaking about, you said year-to-date.

**Ryan Levine***Analyst, Citigroup Global Markets, Inc.*

Q

Well, actually.

**Rejji P. Hayes***Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

A

2022.

**Ryan Levine***Analyst, Citigroup Global Markets, Inc.*

Q

So yeah.

**Rejji P. Hayes***Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

A

Yeah.

**Ryan Levine***Analyst, Citigroup Global Markets, Inc.*

Q

Year-to-date and for the – seems like second quarter was a little bit better than first quarter, but just curious what you're seeing.

**Rejji P. Hayes***Executive Vice President & Chief Financial Officer, CMS Energy Corp.*

A

Yeah. So year-to-date, yeah, like I said, about a little over 0.5% down versus year-to-date 2021. And then on a quarterly basis, Q2 is a little up about a quarter or 25 basis points versus Q2 of 2021. And so as we said in the past, we've actually been quite pleased with what we've seen. We've been quite pleased with what we've seen so far in terms of residential load. It exceeds our expectations. We assumed a much more aggressive sort of return to work or return to facilities, type of work environment in 2022. And we're still seeing pretty good stickiness in that hybrid work environment and still seeing pretty good load in the residential segment, which obviously is higher margin.

So it's exceeded our expectations of performance. I can't speak to the performance of others, but we've been quite pleased with what we've seen being down only about a 0.5% year-to-date. And again, I'll remind you, we're up over 2% versus where we were pre-pandemic. So the stickiness and resilience is still there and that's upside obviously offering favorable mix. I think it's also worth noting that we plan and will continue to plan incredibly conservatively, Ryan. And so, when we see performance like that, even though it's slightly down, it's still offering upside relative to plan.

**Garrick J. Rochow***President, Chief Executive Officer & Director, CMS Energy Corp.*

A

I just want to add on to this, too. In both 2020 and 2021, we saw record interconnections, service line connections with residential homes. And so record from a company perspective, annual perspective, and so again, I can't compare that to what other utilities are seeing, but for us, it's really nice residential load performance across our service territory.

**Ryan Levine***Analyst, Citigroup Global Markets, Inc.*

Q

Appreciate that. And then to follow up on some of the potential pull forward of 2023 costs into 2022, you highlighted forestry and a few other items. Curious if you're seeing anything on the labor front to combat some of the inflationary pressures and competition for labor that may lead to some elevated costs in the back half of the year?

**Garrick J. Rochow***President, Chief Executive Officer & Director, CMS Energy Corp.*

A

Well, remember, one of the – just 40%, roughly 40% of our workforce is unionized, and we have a union contract for those, and those were signed in 2020. And that contract is a five-year contract that goes to 2025. And so there's some normal escalation. But if you go back to 2020 when that contract was signed, again, we didn't see quite this inflationary pressure. And so, again, it's measured, it's budgeted, it's planned for and so not seeing much change there.

Across our non-unionized workforce, we've had roughly our retention rate. We haven't seen that great resignation at all and we've seen solid retention across the pandemic period. And so, again, we haven't had to go out and do a lot of hiring over the time period and so that's been helpful too, from a cost perspective, labor perspective.

**Ryan Levine***Analyst, Citigroup Global Markets, Inc.*

Q

Appreciate the color. Thank you.

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**Operator:** We have no further questions. I'll now hand back to Mr. Garrick Rochow for closing remarks.

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**Garrick J. Rochow**

*President, Chief Executive Officer & Director, CMS Energy Corp.*

Thanks, Elliot, and thank you, everyone, for joining us today. Take care and stay safe.

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**Operator:** This concludes today's conference. We thank everyone for your participation.

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