[SCG] - SCANA Corporation - 2nd Quarter 2017 Earnings Conference Call/Webcast
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Officers
Iris Griffin; VP, Finance
Kevin Marsh; Chairman, CEO, SCANA
Jimmy Addison; CFO, SCANA
Steve Byrne; COO, SCE&G

Analysts
Travis Miller; Morningstar
Stephen Byrd; Morgan Stanley
Michael Lapides; Goldman Sachs

Presentation

Operator: Good afternoon, ladies and gentlemen. Thank you for standing by. I will be your conference facilitator today. At this time I would like to welcome everyone to the SCANA Corporation conference call. (Operator Instructions)

As a reminder, this conference call is being recorded on Thursday, August 3rd, 2017. Anyone who does not consent to the taping may drop off the line.

At this time I would like to turn the call over to Iris Griffin, Vice President of Finance.

Iris Griffin: Thank you and welcome to our Analyst Call.

As you know, earlier today we announced financial results for the second quarter of 2017. Joining us on the call today are Kevin Marsh, SCANA's Chief Executive Officer, Jimmy Addison, SCANA's Chief Financial Officer, and Steve Byrne, Chief Operating Officer of SCE&G. During the call, Kevin will provide an overview of the abandonment plan for the new nuclear project, Jimmy will provide an overview of our financial results, and Steve will discuss the wind-down activities at the new nuclear site. After our comments, we'll respond to your questions. The slides and the earnings release referred to in this call are available at scana.com.

Finally, before I turn the call over to Kevin, I would like to remind you that certain statements that may be made during today's call are considered forward-looking statements and are subject to a number of risks and uncertainties as shown on Slide 2.

The company does not recognize an obligation to update any forward-looking statements. Additionally, we may disclose certain non-GAAP measures during this presentation, and the required Reg G information can be found in the Investors section of our website under Webcasts & Presentations.

I'll now turn the call over to Kevin.

Kevin Marsh: Thanks, Iris, and thank you all for joining us today.

I'll begin our discussion on Slide 3 with the summary of our decision on the new nuclear project. As you are likely aware, earlier this week we announced our intentions to cease construction and pursue an abandonment plan under the provisions of the Base Load Review Act.

This conclusion was reached after an extremely challenging and complex evaluation of the project from multiple perspectives. Our analysis led us to a view that while continuing construction on both units would be too expensive, completing one unit may have been a viable option should our project ownership structure stay the same.

While there where various risks to this scenario and no final determination had been made, Santee Cooper notified us of its intent to suspend construction on the project. Santee's decision made further analysis of this alternative unnecessary as SCE&G concluded that it would not be in the best interest of its customers and other stakeholders to continue the project on its own.

As a result, on Tuesday of this week, we held an allowable ex parte briefing and filed the abandonment petition with the Public Service Commission of South Carolina.

Slide 4 summarizes the various requests that SCE&G made in its filing. Essentially, we have asked the commission to affirm SCE&G's decision to abandon the new nuclear project. A link to the transcript of the ex parte briefing as well as the abandonment petition can be found in the Investor section of our website.

Slide 5 presents the timeline for the filing of the abandonment petition as well as a request for revised rates. As a reminder, the commission will vote on our petition within six months from the date it is filed.

We will continue to work with the office of Regulatory Staff and any other intervening parties to attempt to reach a fair and balanced resolution to this matter.

I will now turn the call over to Jimmy to review our financial results.

Jimmy Addison: Thanks, Kevin. I'll begin our earnings discussion on Slide 6. Earnings in the second quarter of 2017, were $0.85 per share compared to $0.74 per share in the same quarter of 2016. Higher electric margins were slightly offset by the impact of less extreme weather in the second quarter of 2017, when compared to the same quarter of last year.

In the footnote, you will notice that weather increased electric margins by $0.04 per share in the second quarter of 2017, compared to $0.05 per share in the second quarter of 2016, resulting in a negative $0.01 per share impact to earnings quarter-over-quarter.

Additionally, increases in gas margins due to customer growth and rate increases, as well as positive variances in O&M and other income, were partially offset by CapEx-related items, including interest expense, depreciation, and property taxes.

Now please turn to Slide 7. Earnings per share for the six months ended June 30, 2017, were $2.04 per share versus $1.97 for the same period in 2016. Higher electric margins were significantly offset by the impact of milder weather in 2017, compared to the prior year.

As noted at the bottom of the slide, weather decreased earnings by $0.20 per share for the first six months of 2017, while weather was earnings neutral for the comparable period of 2016.

Additionally, increases in gas margins as well as positive variances in O&M and other income, were partially offset by increases in interest expense, depreciation, and property taxes.

Now on Slide 8, I'd like to briefly review the earnings results for our principal lines of business. SCE&G's second quarter 2017 earnings increased versus the same quarter 2016, due primarily to increasing electric margins partially offset by the impact of weather as well as increases in gas margins and lower O&M.

PSNC's earnings were up $0.01 per share for the second quarter of 2017 over the comparable period in 2016, due to higher margins as a result of the late 2016 rate increase and customer growth. SCANA Energy's earnings for the quarter increased due to higher gas margins.

I would now like to touch on economic trends in our service territory on Slide 9. Through the second quarter of 2017, companies announced plans to invest approximately $480 million with the expectation of creating over 7,500 jobs in our North and South Carolina territories.

At the bottom of the slide, you can see the South Carolina unemployment statistics as of June 2017, and 2016. South Carolina's unemployment rate is 4%, and is the lowest the state has been since December 2000.

South Carolina continues to see a decrease in unemployment despite continued growth in the labor force.

The other states in which we have service territories, North Carolina and Georgia, also continue to see declining unemployment rates of 4.2% and 4.8%, respectively. This positive business development continues to play a significant role in the strong customer growth numbers for our business.

On Slide 10, we present customer growth and electric sales statistics. The top half of the slide shows the customer growth rate for each of our regulated businesses. SCE&G's electric business added customers at a year-over-year rate of 1.6%. Our regulated gas businesses in South and North Carolina added customers at a rate of 2.9% and 2.6%, respectively. This strong customer growth continues to be a key fundamental for our businesses.

The bottom table outlines our actual and weather normalized kilowatt hour sales to retail customers for the 12 months ended June 30, 2017. On the 12-month-ended basis, whether normalized sales are higher by 0.8 of a percent versus the prior period.

Now please look to Slide 11, which recaps our regulatory rate base and returns. The pie chart on the left presents the components of our regulated rate base of approximately $11.5 billion.

In the box on the right, you will see SCE&G's base electric business in which we are allowed a 10 1/4% return on equity. The adjusted earned return for the 12 months ended June 30, 2017, and the base electric business continues to meet our stated goal of earning a return of 9%, or higher.

As you recall, we're allowed a return on equity of 10.25% in our gas LDC in South Carolina. These rates are set according to the Rate Stabilization Act. If the earned ROE of the gas business for the 12 months ended March 31st, falls outside a range of 50 basis points above or below the allowed ROE, then we file to adjust rates.

As of March 31, 2017, the 12-month earned return for SCE&G Gas was below the band, and we recently filed for an annual increase of approximately $9 million in mid-June. These rates will become effective beginning with the first billing cycle in November.

As of June 30, 2017, the 12-month earned return for PSNC Energy was 10.78%. This temporary situation is mainly due to timing and will move back towards the allowed ROE as CWIP is placed into service.

Slides 12 and 13 present our CapEx forecast and financing plan slides, respectively. These are both consistent with the slides from Monday's call covering the new nuclear project decision.

I would now like to discuss our 2017 earnings guidance on Slide 14. We are reiterating our 2017 GAAP-adjusted, weather-normalized earnings guidance range of $4.15 to $4.35 per share, and our internal target of $4.25 per share.

I also wanted to reset O&M expectations for the year, as we now project 2017 O&M expense to be relatively flat. This is primarily due to labor and related savings.

Our long-term, GAAP-adjusted, weather-normalized annual growth guidance target remains unchanged, as we plan to deliver 4% to 6% earnings growth over three to five years, using a base of 2016's GAAP-adjusted, weather-normalized EPS of $3.97 per share.

On Slide 15, we present some of the main drivers that are contemplated as part of the growth strategy. PSNC Energy has had a solid growth story for the last few years. We will continue to grow this business using the Integrity Management Rider and periodic rate cases to keep up with the growing demands of our North Carolina territory.

Additionally, Rate Stabilization Act increases may be needed to maintain a reasonable earned return at the SCE&G Gas business, as we continue to make investment in that system to meet demand due to customer growth in South Carolina.

As you're aware, these plans are not new to SCANA, but have been overshadowed by the focus on the new nuclear project. As we continue to refine our strategy, there could be additional growth at these gas businesses.

Additionally, we will focus on O&M control, particularly at SCE&G. We will also reap the benefits of lower projected interest expense as we issue less debt, and accretion from our share buyback program.

Slide 16 compares some of the aspects of our five-year plan before and after our decision to cease construction and pursue abandonment of the new nuclear project, and is consistent with what we presented on Monday's call.

As we previously discussed, we plan to focus our strategy on the core electric and gas businesses and on the redeployment of capital.

I'll now turn the call over to Steve to discuss wind down activities at the site.

Steve Byrne: Thanks, Jimmy. Please turn to Slide 17. There are a variety of activities that will be taking place over the next several months to wind down the nuclear construction site as part of our abandonment plan. These activities will be accomplished using a small crew of craft workers and SCE&G oversight.

First, we will ensure that the site is safe, which, among other things, entails laying down cranes, removing scaffolding, de-energizing temporary power supplies and filling in open excavations.

Next, we will stabilize the site by allowing contractors to retrieve their equipment, adding security fencing and gates, removing chemical hazards like welding gases and propane, and closing in areas where equipment preservation may enhance investment recovery.

Facilities that are still needed or were intended to be shared with our operating Unit 1, will be completed. The water treatment plant, service building, and security firing range are examples of these.

We will need to evaluate relinquishing the NRC-combined construction and operating license as well as other permits.

We plan to transfer off-site warehouse leases to SCE&G from Westinghouse. Additionally, we intend to complete the transmission associated with the nuclear project, as those assets are still needed to meet customer demand.

This concludes our prepared remarks. We'll now be glad to respond to any questions you might have.

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions)

Travis Miller of Morningstar.

Travis Miller: I can appreciate this has been a tiresome and busy couple days for you. So I'll keep it short here.

After the briefing that you had, just wondering what you think of the request would be the biggest challenge to achieve over the coming couple months.

Kevin Marsh: Well, I'll start off by saying we understand and we're not surprised that the commission was shocked at our decision. They expressed that in their opening comments to us. And that's really a result of the process whereby which we're unable to inform the commission in rules that were enacted. I think about 10 years ago, under the new regulations by the state, we're not allow it to communicate with the commission unless it's in a required hearing or in an ex parte briefing. That is the reason we did the ex parte briefing as quickly as we could after we filed our announcement about the abandonment.

So that was the first time they had heard about it because nobody's allowed to talk to them under that new process. That's unfortunate. It was not our goal to surprise the commission.

These are projects they've taken a lot of pride in. They understood the value these units would have provided to South Carolina over the long term. So I'm sure it was a shocking and a very disappointing decision for them.

We did our best to communicate the logic behind the decision. I think we did that very clearly. And they had a number of questions for us. But I'm certain the primary focus will be on the recovery of the abandonment cost.

We've taken a number of key steps to have them understand, as we'll continue to do throughout the regulatory process to minimize the impact of that on customers as best we can. The first process is to reduce the impact by the proceeds we get from the Toshiba parental guaranty as they come in to help mitigate rates for customers. The benefits of the tax deductions will work in their favor.

And as I've tried to explain it to people that have asked me that are non-accountants or non-financial people, non-regulatory people as I've been asked around the company, I've tried to explain it this way in round numbers. It's $4.9 billion dollars we have spent to date. The decision to go ahead would have put $5 billion on top of that. So essentially you'd be at $10 billion, which we would have had to ask the customers to pay for. I'm not sure we could have gotten that from the commission based on the fixed price commitments we had earlier.

The other option was to take off the Toshiba parental guarantee, take off the value of the tax deductions and whittle that number down to about $2 billion. So from our perspective, it was a $2 billion number we're going to ask the customers to continue paying for, or raise it to $10 billion and ask them to pay for that. That was a difficult analysis to go through.

And as we said earlier, without a partner, when Santee decided it was not economical for them to continue with the project, it made our decision pretty much absolute because we certainly couldn't go forward. Our goal was to share those thoughts with the commission. We'll do that in more detail. I'm confident as we file our testimony and then get into settlement discussions with the various interveners that will likely join the case, so I believe it will continue to center around the recovery of the abandonment cost.

Travis Miller: Okay. And you still remain confident that the BLRA will be upheld after at least this first discussion?

Kevin Marsh: It's clear that the law provides for it. We're following procedures outlined in the law, which will require us to make sure we didn't do anything imprudent to put ourselves in this situation. And we validated everything we had done on the project. But the fixed price option that was approved in the 2016, and we validated everything we had done on the project is prudent to that point. It was shortly thereafter, that we learned of the news of the Toshiba financial distress, followed by the Westinghouse bankruptcy in March of 2017.

So clearly, from our perspective, we had an active project that was moving forward. We were making progress and looking forward to hitting the targets. But when Westinghouse withdrew from the project by declaring bankruptcy, that put us in the situation where we had to do the analysis.

So we believe we were prudent to the point we learned of the financial distress and bankruptcy of Westinghouse. We acted prudently after that, and did a thorough evaluation of all options, which included building two plants, building one plant, abandoning one plant or full abandonment.

I am confident we made the right decision on behalf of customers and all the other stakeholders, and that we'll present that in a very clear and understandable form to the commission.

Travis Miller: Okay, great. I appreciate the thoughts.

Operator: Stephen Byrd with Morgan Stanley.

Stephen Byrd: Just wanted to check, there was one change to the financial plan from a couple of days ago with the equity buyback amount is, I think now $1.2 billion. It was $1.0 billion before. What was the driver for the change there?

Jimmy Addison: Yes, Stephen. This is Jimmy. It's just kind of the time frame. Earlier we were really just taking a little shorter view of it, of the period over the next, I guess three to four years. And here we got a little further down in our financial plan, and I guess getting a little more prescriptive about it.

Stephen Byrd: Got you. Understood.

Jimmy Addison: I'm quite confident we'll make adjustments on that as we move through time due to a variety of changes in cash flows and share prices and things like that. But that's just our latest estimate.

Stephen Byrd: Point taken. And just to build on Travis' question a little bit. Have you all had an opportunity to have a dialogue with some of the legislators who have formed this energy caucus group, just to talk through the situation with those legislators?

Kevin Marsh: I've not had any personal discussions with any of them since they formed the group. We believe in open communication. So I'm confident we'll be talking to members of that group as we go forward.

We have a very active regulatory team who will certainly be reaching out to members of that group so we can help them understand the challenge that we had in making this decision and why we decided to seek the abandonment.

Our process at the commission is very open. And as we've said, the commission will take a lot of information in as they make their decision. I'm confident we'll be in settlement discussions. We've always been willing to do that. And I'm sure a lot of that will be impacted by the various opinions that are out there, not just their team, but our industrial customers and those that represent the various residential groups.

So if they're out there, we understand their concerns. We've not had a chance to make the detailed filing with the commission, which is where all the facts will be. And that is the published regulatory hearing that will take place to review those facts.

There could be others. We feel confident we can do a good job telling our story. And I understand they're disappointed. I mean, I'm sorry we can't deliver the plans that we had in place to put these two reactors in place. And I can understand their disappointment. I can understand their anger, because the state wanted these two reactors. At the same time, we just didn't feel like it was prudent to proceed with something that was too expensive for them in the long run and not cost-effective based on what we know today. And that will be the presentation to the commission and other groups that I'm sure we'll be available to and in front of throughout the rest of the year.

Stephen Byrd: Understood. Thank you very much.

Operator: (Operator Instructions) Michael Lapides with Goldman Sachs.

Michael Lapides: Jimmy, I'm confused. I mean, I think what you've laid out is pretty clear. And obviously, as you get into the regulatory negotiations, things are going to move around. That's the nature of any complex regulatory process.

I do have one accounting question, and it's really a tax question. When I go back and look at the slide deck from a couple of days ago, on Slide 7, you talked about $1.5 billion tax deduction due to the abandonment of the project.

And the thing I don't understand is that if you're still going to earn a return on equity, like you're going to have net income that is going to be generated by the project even though it's being abandoned, why is it being written off? Why the tax deduction?

Jimmy Addison: Very fair question. So the asset itself is not going to be used in the business, Michael. So the asset can't be used for its intended purpose initially. So it's much like inventory of parts or something like that. If it can't be used for its intended purpose, then you can deduct it for tax purposes. But we're confident in that tax position.

Now, again, we're going to -- and think of the other side of that. That revenue that's coming in from that abandonment is going to be taxable income. So certainly the cost associated with it should be a taxable deduction.

Michael Lapides: Right. And I may be totally missing, and happy to follow it off line.

You're still going to get a pretax earning stream out of the project. And granted, you'll get less than you otherwise would have because of the deduction, which helps customers. It helps the bill. But it just -- I don't know. I'll follow up off line. But that was the one question.

The other is --

Jimmy Addison: Let me, before you move on, let me frame it this way for you. If we didn't deduct it then, how would you ever deduct it? It would have been deducted through depreciation had it been put into service. You clearly get a deduction for any incurred cost. So it would never get deducted if you didn't deduct it now.

Michael Lapides: Yes, that makes sense. That makes total sense. And I'll follow up off line, because I may have some specific tax-related questions. Thanks, guys.

Jimmy Addison: Sorry to interrupt you. What was your other one?

Michael Lapides: No, I'm good. I was going to -- I'm fine. I'll follow up. Thank you, Jimmy.

Jimmy Addison: Okay, very good. Thank you, Michael.

Operator: (Operator Instructions).

Kevin Marsh: All right. Hearing no more questions, I would like to just wrap up for a minute.

The last few weeks have been some of the most challenging in our company's history. Our focus for the next few months will remain our employee transition, core business performance, and the execution of the regulatory abandonment proceeding with a particular emphasis on near-term rate mitigation for our customers.

Thank you for joining us today and for your interest in SCANA. Have a good afternoon.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines.