

## Participants

**Bob Frenzel**, CFO of Xcel Energy ([XEL](#))

**Nate Abercrombie**, [The Stock Podcast](#)

## Interview Transcript

Nate: Bob Frenzel, thank you so very much for coming onto the podcast. It's a pleasure to have you on the program.

Bob: Thanks, Nate. It's great to be with you, too.

Nate: Welcome to Denver, by the way.

Bob: It's great to get to Denver periodically. We have substantial operations here.

Nate: I start out all of these interviews just asking about background. If you wouldn't mind just sharing a little bit about yourself and how you got into the business.

Bob: Sure. Happy to. I can't actually believe that it's been three years since I joined Xcel. I came here from Texas where I was the CFO of a generation company, but my education and first job were really in engineering. I was an industrial engineer in college. I was a nuclear engineer in the Navy where I ran nuclear power plants on aircraft carriers. You know, between those two, I spend some time in graduate school getting an MBA and working on Wall Street with Goldman Sachs advising energy and power clients; and ultimately, one of my clients hired me; and even Xcel Energy had been a client before, so it's great to come back to companies that you know, and work with people that you've worked with in different parts of your career.

Nate: That was Luminant?

Bob: Yeah, that was Luminant Energy where I was the CFO; and I also spent some time at the parent company, Energy Future Holdings, where I ran corporate development and strategy for the company for about three years.

Nate: Can you just provide us a little history of Xcel? Anything you'd like to share, but just some background of what Xcel does, where they operate, and just how they came together? Because, as I understand it, there were some mergers and acquisitions in the past that created what is today Xcel Energy, one of the largest utilities in the United States.

Bob: Yeah. Xcel, as we know it today, is really a holding company that operates four regulating utilities, gas and electric, and the combination of Xcel Energy happened over the course of probably two significant mergers in the last 25 years: one that combined our Southwestern Texas and New Mexico businesses with our Colorado business to form a company called New Century Energies; that company merged with Northern States Power, which is our Upper Midwest business, to form Xcel as we know it today. Xcel, broadly speaking, is 100% rate regulated electric and gas utility. We operate across eight states and 15 retail jurisdictions to deliver gas and energy to our customers.

Nate: How much of your business is gas versus electric?

Bob: We have three and a half million electric customers and two million gas customers; but when I think about it from a revenue or an income or an invested capital perspective, we're about 85% electric and about 15% gas on those metrics.

Nate: Is one business more profitable than the other? Do you get better treatment, rate treatment, for electric versus natural gas? You know, I interviewed Spark Energy, which is a retail electricity company, they operate nationwide, and they described their electric businesses being just less profitable, and customers being less sticky than their natural gas business. Now, I know you're regulated, so it's a different dynamic, but is there a big difference in terms of either profitability or just your ability to grow between electric and natural gas?

Bob: I think about electric and natural gas as having similar earnings opportunities. I think the invested capital in our electric business is just so much larger than the capital in our gas business. When you think about how regulated utilities have that income, it's generally around a return on invested equity; and our invested equity in our electric business ... because of the scale of both the generation fleet, the transmission fleet, and the distribution fleet ... is such that we have more earnings and more invested capital. The actual return on equity for the gas and the electric business is reasonably equitable.

Nate: Could you just characterize the earnings from transmission, distribution, and generation?

Bob: You know, Nate, the way I think about is where have we invested capital, and where are we earning a return on that capital. When I think about our rate base or net plant, we have about \$35 billion in net plant; roughly half of that is transmission and distribution, a third of that is generation, and the rest is either our natural gas system or other invested capital.

Nate: Could you just talk about the different geographies? You mentioned the different states. So, you operate in Minnesota; you operate in Colorado. You have, I think, eight states that you operate in today?

Bob: We serve customers in eight states, in Wisconsin, Minnesota, North and South Dakota, Colorado, Texas, and New Mexico. When I think about the composition of our earnings power, about a third of it is in Minnesota Electric, about a third of it is in Colorado Electric, and a third is in all the other jurisdictions combined. Clearly, our biggest drivers are electric customers in both Minnesota and Colorado.

Nate: You're the first regulated utility to come under the program, so thanks for that; but could you describe how a really good regulated utility is run? I can tell you that from the outside looking in, you talk to people who are familiar with utilities and they just think, "Oh, well, it's a pseudo government body," in the sense that it's overseen by the commission, and the people that run the business are almost like bureaucrats, but I certainly don't think that's the case. I think that good utilities are run by really good management teams, but I would love to hear your thoughts on just how a really good regulated utility is run, and what are those characteristics of a really good regulated utility?

Bob: When I think about great utilities, I think about excellent operations and an excellent safety culture, high reliability, low cost; and increasingly in this day and age, a cleaner more renewable energy supply. When I think about Xcel Energy, we try to hit on all five of those characteristics as we operate our company. We come to work every day with a competitive mindset. We think of our customers as having choice. We want to be their

provider of choice, and so we strive to deliver them products and services at an affordable price with an increasingly lower and lower emissions profile.

Nate: Yeah. It's interesting you mentioned choice. There's a lot of changes going on right now in the industry with respect to choice, especially on the West Coast. Even here in Colorado you see Boulder trying to carve themselves out so that they can be 100% renewables. I just read an article the other day about Tri-State ... which is on the other side of the Rockies, but still in Colorado ... where the municipalities and the co-ops would like to have cleaner energy, and so they're considering other options, and I'm just curious: from your perspective, where are you seeing it? I mean are those pressures, from your perspective, for Xcel, in terms of trying to find some ways to mitigate customers leaving Xcel from a generation perspective? Obviously, if they're still in your service area, they're still gonna pay for transmission and distribution; but from a generation perspective, and the choice dynamics that are going on, how is Xcel dealing with those issues today?

Bob: Xcel Energy has been a leader in environmental transition for the better part of 15 years. We've been the number one wind provider to our customers. We know that our customers are seeking cleaner and greener and affordable and reliable energy solutions, and today we know that they've got more choices; they've got option like rooftop solar and batteries that they can install in their homes. We increasingly want to offer products and services that they find attractive at an affordable price. I think that competitive pressures for customers to leave the systems has pushed the industry across the country to get more competitive and more in tune with our customer needs.

Bob: Customers who have the ability to make choices around their electricity provider will do so. We offer 100% renewable connect programs. We offer our large industrial customers opportunities to lower their emissions profiles to satisfy their own environmental and social and governance issues. So, as we continue to communicate with our customers, I think they continue to make us their provider of choice.

Nate: Yeah. I appreciate you talking about the renewable energy component, and I would really like to get your thoughts on just the steps you need to take to get to 100% carbon-free by 2050; but one thing that I will highlight that I did see in that article about Tri-State was that ... I guess it was a Montrose, this area out in Western Colorado ... they have conventional coal and natural gas fire, electricity, and the cost is 28% higher than Xcel's average rates here in Denver and in the rest of Colorado, which is just really pretty amazing when you think about how they're largely conventional fossil fuel fired energy, and Xcel has a huge proportion of renewable energy, and you're moving even further into carbon-free types of generation technologies. I just think that's pretty amazing.

Bob: we are below the national average in terms of delivery cost, and we try to stay competitive both regionally, because we know that businesses make regional decisions as well as national decisions, and we want to be competitive on a cost-per-unit basis; as well as delivering a greener, cleaner product.

Nate: So, the fact that your delivered cost is lower than the national average, and the fact that you do have a lot of renewables; and in the past renewables were more expensive, but maybe they're less expensive now than conventional: How do you do that? How do you execute on delivering such a low delivered cost? Your rates are just so much lower than, for example, this co-op in Western Colorado; but being below the national average, how do you do that with your resource mix, especially with the new technologies and the renewable energy that you're delivering to your customers? Is it because you have exposure to the resources, the high wind speeds out here in Eastern Colorado, or is it something else?

- Bob: In recent years, as the technology has improved, as the OEM vendors have reduced capital costs for wind farms; and as the capacity factors of those farms have gone up, we see wind and solar come down in both capital costs and in dollars per megawatt hour. Some of that is helped by tax incentives. but generally today, if you assume the tax credits, wind is cheaper on the margin than some of the fossil generation assets; and we've been replacing that fossil generation energy with wind energy and saving our customers money, but that's more of a recent phenomenon than a legacy phenomenon. When I think about cost competitiveness, it's really about coming to work every day with your customer in mind, and spending money in as an efficient and effective way as possible. And we believe that our corporate structure and our operations are excellent; and as such, drive lower costs for our customers.
- Nate: Since you are the first regulated utility on the program, I'd really like to hear about the regulatory process. If Xcel wants to build a transmission line or a distribution line, or if you want to build a wind farm, what is the process in getting those types of capital projects approved at the commission?
- Bob: Our systems generally need capital on an annual basis to maintain their health, to expand their size to accommodate new customers, and to accommodate new sources of supply, like renewable energy; and when you take the new capital projects onto the network, if they're sufficiently large then we go seek pre-approval from our commissions to add them; and if the commissions agree with us that the investment is needed ... whether it's a new wind farm, a new natural gas power plant, or a new pipeline ... if they agree that it's needed or will provide customer benefit, then they approve that project, we spend the capital, and then our rate base increases; therefore, our revenue and our net income increases.
- Bob: We've got \$36 billion of invested net plant; and under the regulatory constructs in our state, we're allowed to earn a fair return on that invested capital. In addition to a return on and a return of that capital over some period of time, we're also allowed to recover our normally incurred operating expenses, When you take all of those components, starting with invested capital, and you add those up, and you divide by the sales in a particular territory, that comes up with a per unit rate that we then get authorized by the commissions to charge our customers for electricity or natural gas.
- Nate: Would you say that replacement cost is anywhere close to rate base? If I were to ask you if you had to rebuild the entire Xcel system, is it anywhere close to rate base?
- Bob: In our most recent investment materials on our website, we've actually tried to calculate what replacement of our entire system would look like if we started today. If I put it into perspective, we think that between our transmission, our distribution, and our gas networks businesses alone, ignoring electric generation, that's \$100 billion worth of invested capital. Today, it sits on our books at about \$15 billion to \$20 billion of rate base.
- Nate: Wow.
- Bob: So, rate base to replacement cost is probably one-fifth, and it tells you the value of the assets that the regulated utilities operate today, and how hard and how expensive it would be to replace.
- Nate: Yeah. That's amazing.

Bob: I know it sounds surprising, but when you think about it we're investing into transmission and distribution assets that sit in the ground for 50-plus years. So, to have assets that are in their depreciable lives, that are towards the latter third of that, shouldn't surprise you when you think about it.

Nate: Since we're on rate base, and because I'd think that a lot of the listeners, because this is a value-based podcast, a lot of listeners look at free cashflow and ... We've had a conversation before about portfolio managers, at least my experience in dealing with portfolio managers, wanting to know what the free cashflow profile is for a utility, and how it's important to emphasize that free cashflow profiles for utilities is pretty irrelevant because you want a utility to spend capital to grow EPS and to grow the dividend: first of all, do you get that question very often from investors, generalist investors, about free cashflow? And how do you respond to those investors?

Bob: I understand conceptually portfolio managers and analysts wanting to understand the free cashflow of any asset or any business; for regulated utilities, we are a little different. I think of total shareholder return as the combination of earnings growth and dividend growth; and in the absence of investing in growing our rate base, we're not gonna have earnings growth, or sufficient earnings growth, and therefore our dividend growth will suffer. Today, as a company, our earnings growth profile is 5-7% EPS annual growth; we have rate-based growth that's in that same area. So, we're growing rate base effectively at the same rate, or slightly below, the rate of earnings growth, and we expect our dividend to grow at or above our earnings profile. So, as a utility investor, I'm looking at the certainty of the dividend, and the dividend growth rate is I think about dividend cashflow models and value in stocks. The shorthand to valuing utilities is often a P/E ratio; because utilities generally have similar capital structures, P/E is a very effective way to measure relative valuation of utilities.

Bob: The other one I look at is total enterprise value to rate base. Rate base is the earnings power of the utility, and growing rate base grows earnings. So, in between periodic rate cases, you may have somewhat lower EPS; but the earnings power, , is how much invested capital does the utility have in the ground, and how much return do they need on that invested capital. So, rate-base is a mechanism by which we look at the earnings power over a long term of a regulated utility.

Nate: What are the range or allowed returns right now that you're seeing today, how is that compared to 10 years ago or 15 years ago, and how are you thinking about returns going forward?

Bob: Recent regulatory rate cases around the country probably center on returns on equity in the mid-9s to high 9 ROEs, so 9.5% to 10% ROE; that number has come down over the last five to 10 years. As interest rates have come down, allowed returns on equity generally follow a 30-year US treasury, and some spread to that number. So, as the treasury rates or corporate bond rates have come down, regulated utility ROEs have also come down.

Nate: And as interest rate go back up, allowed returns will also go back up.

Bob: as interest rates have been lower over the last 10 years, I'd say that the regulated ROEs were slower to come down and match that; and our expectation, as rates potentially rise in the future, that the allowed ROEs for regulated utilities would probably lag a bit there as well. We have slightly lower ROEs than some other utilities in the country, and our ROEs may have come down faster over the last five years than some of our peers; and we think that it's likely that our ROEs should rise a little bit faster as rates come up as well.

- Nate: That's just a function of how the ROEs are determined in the different regulatory footprints? Is that a good way to think about things?
- Bob: Every state has a regulatory commission that helps set rates; and as part of that rate-setting process, they determine what your allowed return on equity should be; depending on that regulatory body, you could end up with a 25 or 30 or 40 basis point differential in allowed ROEs, based on how the commission looks at the theoretical way to set a forward-looking ROE. Our commissions, for whatever reason, over time have trended to the lower end of that spectrum; and therefore, the companies have a lower ROE than some of our peers; that may have caused some earnings pressures in the past, but we also expect to have those rise back to median or above faster than some of the other utilities as well. So, when I think about upside for investors in a regulated utility, when I think about Xcel Energy,
- Nate: Yeah. I read something just the other day about performance-based rates, and that's something that you guys have exposure to in Minnesota, could have exposure to, because apparently they're still trying to figure out how it works, so the process. Are performance-based rates something that Xcel wants to have? I don't think performance-based rate-making is necessarily new; in fact, we have performance-based programs inside our rate structures today. As I think about our Energy Efficiency and Conservation programs where we spend money to incent our customers to use less of our product; and if we are successful at that, we earn an incentive on the amount of energy efficiency that we can promote amongst our customers: that's a performance-based rate-making mechanism that exists today.
- Bob: I think commissions are thinking through "How do I incent excellent behavior and how do I reward that?" So, if performance-based rate-making is done well, then I think there's a great opportunity to benefit our customers, as well as our shareholders, and all of our stakeholders in our companies.
- Nate: You mentioned growth drivers. Could you just talk about where Xcel is focusing its investments today? I think this would also be a really good segue into your goal of cutting carbon emissions to zero by 2050, but would love to hear where you're investing today and where you see the needs to invest.
- Bob: Over the next five years, Xcel Energy across all of our companies expects to spend almost \$20 billion into our systems. Our focus over the past two or three years, and our focus for the next five to 10 years, is really transitioning our generation portfolio. So, an out-sized proportion of our capital has been going into new wind farms; and we expect, in the latter half of next decade, to do solar farms and to battery storage opportunities in other assets that will help drive our clean energy transition strategy. Our goal was to be 80% carbon-free by 2030. We're the first utility to announce that we're gonna be carbon-free by 2050. In addition to investments to enable a clean energy transition, we're also investing what I call "closer to the customer," so investments in our distribution grid that help enable our customers to have more access to electric vehicles, more access to distributed energy generation, higher reliability on the distribution grid so that they have a reliable product at a low cost that's increasingly green; but we still operate 15,000 megawatts of other generation; we operate hundreds of thousands of miles of distribution systems and transmission systems, and all of that needs continued investment to make sure that it's safe and reliable and can deliver to our customers.
- Nate: As an Xcel customer here in Denver, when I receive an email or a letter in the mail that says, "Xcel will give you a refund," or you can buy a Nest thermostat or some sort of smart meter at a discount through Xcel, is that essentially the investment that you're ... ? I mean you're getting paid for it, and I'm obviously going to consume



less energy as a result, but is that part of the investment process? I mean as a customer I see that investment in those offers and opportunities that I get in the mail.

Bob: Typically, if you receive a mailer, circular, or something like that, it's not a capital investment we're offering. We're offering you a rebate for having lower energy utilization in your home. We call those programs "energy efficiency" or "conservation" or "demand-side management," generally, those expenses are real-time expenses that we get real-time recovery of from our regulators. In addition, we also get incentives if we use more of those because we're actually getting our customers to buy less and less of our product. Nate: I see. Okay.

Bob: Across all of Xcel, we spend almost a quarter of a billion dollars in energy efficiency and demand-side management programs.

Nate: I see. So, the steps that you need to take in order to get to zero carbon emission by 2050 ... I mean I'm not asking for insight into which plants are gonna close over the next several years, but I am curious at a high level how you all are thinking about that. By the way, I think your goal also helped contribute to the fact that you guys were rated the number one utility in 2018 by Utility Guide, which is something that I read a lot of, but congratulations for that. But what steps do you need to take, and what do you need to do, to hit those goals?

Bob: Thank you. With known technology, we believe that we can be 80% carbon-free by 2030, and that's gonna be more wind, more solar, more storage on our systems, but generally it's sitting in front of us right now. To go from 80% carbon reduction to being carbon-free 20 years later, we absolutely need technological advances. We need, , some form of dispatchable generation. Wind and solar and batteries tend to not be ready all the time with a pushbutton start; today, that need is being solved by nuclear plants, coal plants, and natural gas fire plants. In the future, if you want to be carbon-free, we're gonna need some form of generation that either captures the carbon that it emits, so we call that CCS, or Carbon Capture and Storage. We could go to a next generation of nuclear, and not necessarily large-scale nuclear, but the Department of Energy has been funding small modular reactor research for a long period of time. We look at advanced geothermal, or using the Earth's heat, to create combustion energy, which is renewable. Any and all of those technological advances, and stuff that maybe isn't even on the horizon: that's what we need to go from 80% reduction by 2030 to carbon-free by 2050.

Nate: Personally, because I used to work in the renewable energy industry, I have lots of questions that I could ask you about renewables; but rather than ask you just specific like, "How much does wind cost today in Colorado?" or the questions that have specific answers, I'd be curious whether or not you could share anything about what you're seeing today in the renewable energy industry that you think would be interesting for listeners to hear both from just a broader industry perspective, but then also just more specific to Xcel.

Bob: The most impressive trend that I've seen in the last five years in renewable energy is the continued advancement of the technology. The challenge that we still have as an industry is that the wind doesn't always blow and the sun doesn't always shine, and the amount of storage that we think we need to bridge those gaps is a substantial amount of cost, real estate, metallurgical science, etc., that is going to be challenging to bridge the goal of what I call 100% renewable to carbon-free. we do believe there needs to be some form of generation that can bridge that period; it's not a huge period of time, 10% or 15% of the time when the wind and the sun aren't necessarily there; and the battery storage, or some form of storage, aren't sufficient to make up the difference.

- Bob: The cost curves, and the capital cost curves, continue to impress me and others who watch, that the equipment manufacturers can continue to advance the technology in wind farms and solar panels, such that the end cost to the customer is increasingly affordable and competitive. Today, we have significant tax credits that support the implementation or the installation of renewable generation assets; in the future, those tax credits are expected to expire; and when we talk to equipment manufacturers, they increasingly believe they'll be able to keep up with the declining cost curve such that the tax credit sunset is less impactful to the customers, and we think we'll be able to continue to deliver renewable energies to our customers at a cost-effective rate.
- Nate: It's interesting you mentioned 100% renewables versus zero carbon emissions. So, there's clearly a distinction there, and I honestly think that this is maybe a misconception within the industry and for everybody. When they think 100% renewables: yeah, maybe they're getting 100% wind or solar because of the RECS; but when you say, "100% carbon-free," you're talking about not needing the fossil fuel backup ready-to-start-at-a-moment's-notice type of assets that are required to fill the gap whenever the wind's not blowing and the sun's not shining. Is that correct?
- Bob: I think any individual customer can probably be off the grid or 100% renewable. What's hard is the whole grid at some point needs its ability to recharge itself, and our insights into that science would suggest that the amounts of storage capacity that you would need to keep the grids reliable and sustainable is so significant that you wouldn't make that kind of investment. In the short-term, the difference between 100% renewable and carbon-free is being filled by assets like hydro-electric power or nuclear power, which are none-emitting resources, but are also not considered renewable resources either. In the future, we need to replace some of the stuff that's provided by nuclear with dispatchable non-emitting resources; and whether that's small modular reactors, whether that's geothermal, whether it's natural gas fire plants that carbon capture on the back end: any and all those are potential solutions to the gap that we see that batteries can't make up.
- Nate: I see. But at the same time I've also seen that storage is something that Xcel is very interested in invested in; and from what I understand, it's going to be the regulated utilities, the big utilities like yourselves, that are the ones that essentially push the cost curve down lower because you're gonna be buying the battery installations that will then enable manufacturers to increase production capacity, etc. But could you just talk about storage, how you're thinking about storage today, and the role that it will play at least in Colorado? Because I think the article that I had seen was specific to Colorado energy storage, the commission wanting to see a lot more investment in the storage.
- Bob: We think storage is gonna be an increasingly important part of our energy mix; it plays a significant role in elongating daily solar patterns; it will help with voltage and frequency modulation on our grids. The limitation that we see in storage today is the ability to put enough energy in storage for not one hour or two hours or three hours when you're trying to elongate the solar curve, but it's trying to extend solar across one, two, or three days where the sun isn't really shining sufficiently, and the wind isn't blowing sufficiently, and we still need to power the Colorado economy, or the Minnesota economy. As we think about our ability to keep the grid energized, we feel like there are time periods in the year. We could see this in history: there are times when the wind doesn't blow and the sun doesn't shine; and the amount of storage capacity that we would need to satisfy that need for not an hour or two ... we're talking about days where we have low solar and low wind output concurrently ... where the amount of storage would be substantial.
- Nate: Do you have a ballpark estimate on how much storage you would need today, based on the amount of wind and solar that you have in the fleet?



- Bob: Well, take Colorado: Colorado is a 600 megawatt, 6500 peak system; this is just our system in Colorado, not all of Colorado. If the sun doesn't shine and the wind doesn't blow, you need 6000 megawatts, it's probably an average load of 3000 for two or three days, and it would be a stunning amount of battery. We could do the math. We could say it would take the entire eastern slope or 10 county area of battery dedicated. I mean it's an enormous number: enormous.
- Nate: I appreciate that.
- Bob: It's why we say we need technology to get us to zero, is there's a small piece, and it's not a lot: 10-15% dispatchable gen can charge the batteries and help with that equation when the wind is blowing less and the sun's shining less. Not a lot, it's a little, which is why you can go off the grid, and I can go off the grid, and Paul can go off the grid, but Susie over there can't go off the grid. We need someone who's generating with controls to charge our batteries when our solar panels don't work. So, Ben likes to say the small grid can be carbon-free, but the big grid can't, if that makes sense.
- Nate: Yeah. That makes a ton of sense. Could you just talk about the demand trends that you're seeing in Colorado; and how has the marijuana industry, how has electric vehicles, and how has ... ? I've been talking to one of your employees who is also on the board of RTD, the Regional Transportation District; it's basically public transportation here in Denver, and he finds this subject to be very interesting as well, the public transportation demand component. Could you talk about not just Colorado, but in all of your footprints characterize demand trends?
- Bob: We operate utilities in states that have good growth, which generally means that our population in those states is also gonna grow maybe above the national average. So, when I think about demand and energy utilization, we take the product of the number of customers that are coming into our system, , which gets offset by increasingly our customers are more and more energy efficient. All of those appliances are coming at higher SEER ratings, higher efficiency ratings for our new appliances. New housing stock is all being built to better energy efficiency standards. So, as we see customer growth, we're seeing equal and offsetting declines in use per customer; which means that our energy, both on a gas and on an electric side, have been generally flat, and we expect them to be flat to maybe slightly increasing over the next five years. Trends that change that over time: certainly electric vehicles is the single largest driver of potential future demand. Today, I saw a stat that we probably have 20,000 electric vehicles in our service territory today; we expect 2,000,000 by 2035. So, that'll grow electric demand by about 30 to 40 basis points per year, so not a ton, but over time a very significant portion of electric demand to grow. Interestingly, when you think about electric vehicles, you can fill up your electric vehicle for about a dollar a gallon equivalent on our electricity price versus gasoline prices, about a dollar a gallon, and that comes at a one-third lower emissions profile today; and by 2035 we're talking about an eighth of the emissions profile of gasoline.
- Nate: Wow. That's impressive.
- Bob: So, it's a big emissions profile driver if we can increase electric vehicle penetration.
- Nate: I am curious, though, just because my last interview was a California-based marijuana company: How has marijuana driven demand in Colorado? Has it been a big driver?

- Bob: Colorado was one of the first states to legalize recreational use of marijuana; and what we saw, is an increase in electric utilization by the grow houses that were gonna grow marijuana and distribute marijuana in the state. I'd say over the course of the last five years, we've seen electric demand in Colorado grow about 1% in total over a five-year period from the marijuana industry;
- Nate: What about public transportation? I read an article a while back about Kansas City to Colorado is one of the places that they're considering putting in a hyperloop, and obviously a hyperloop would require enormous amounts of electricity. I'm not assuming that you've read this article, but is public transportation a big driver for utilities in terms of a light rail here? I don't know about Minneapolis, but public transportation here at least consumes electricity. Is that a driver?
- Bob: We see a significant amount of interest in our municipalities, and the bus systems, that support those municipalities in terms of electric demand. We're talking to most of our largest cities in our service territories about their goals and their emissions reductions goals; and while a lot of them may have converted from gasoline buses to natural gas fleets 20-plus years ago, they're now looking at the next generation of buses being electric. We certainly support them, and we want to help them with their charging station infrastructure, and that's an additional source of energy demand and growth that's obviously a source of emissions reduction for cities and states, and they're very focused on what they can control, and it's one of the largest arrows in their quiver around what they can control. They want to buy power from us that is low emissions; and they want their electric service, in terms of the buses, to be low emissions. So, if we can supply a bus with 80% carbon-free energy, you're talking about a tremendous emissions reduction that cities could effect on their own.
- Nate: Yeah. So, three to five years from now, do you think demand is gonna be flat? Do you think it's gonna be up, down, who knows? Is it based on the economy?
- Bob: The correlation of electric demand or natural gas demand to gross domestic product is highly correlated. How the economy goes, so goes energy utilization. I would say there are some transitioning in these periods that we're in, when we're talking about electric vehicles or buses, will be a transition that will disconnect maybe that correlation that's historically persisted from today; but the things that work on the other side of that equation is more distributed generation, and people putting rooftop solar goes the other direction. So, net-net I think we'll see very slight positive electric consumption over the next three to five years.
- Nate: Let me go into financials. You mentioned the amount of money. I think you mentioned \$20 billion over the next several years that you're gonna spend in investing in the system. Could you just talk about the utility funding process, what that's like for Xcel, and just how you fund your growth projects for your business?
- Bob: funding for our capital investments comes from generally three sources: cash from operations, which is substantial, plus incremental debt that we put at our operating company levels that are approved by our commissions, and equity. Annually, we have a dividend reinvestment program that generates \$75 million to \$80 million of new equity issuances a year. Then, in 2018, we issued just over \$800 million in common equity to fund our capital plan for the next five years.
- Nate: For the next five years. So, you won't need any more equity for the next five years?

- Bob: Outside of our dividend reinvestment program that delivers \$75 million to \$80 million of equity a year, we don't expect to have any common equity issuances.
- Nate: Okay. Thanks for that. I would love to hear your description of the shareholder return story of investors.
- Bob: The total return story to an equity investor is a combination of capital appreciation and dividend yield. We expect to grow our earnings per share by 5-7% over the next five years, and our dividend yield is in the low 3s, 3-3.5%, depending. The combination of those two at the midpoint of the earnings growth rate is a 9-10% total return story, with a very low beta and a low risk profile. Over the last one-, three-, five- and 10-year periods, the total shareholder return of Xcel Energy has exceeded that of the S&P in all of those periods, non-risk adjusted. If you risk adjust it, it's been a substantial out-performer.
- Nate: The way that you just characterized the investment story from a risk adjusted bases, and I'm not asking you to read into what Warren Buffet does, but he's obviously a huge holder of utilities across the United States. First of all, have you heard why he's so interested in investing in utilities?
- Bob: There's a reason why they call Warren Buffet the "Oracle of Omaha" and I'm Bob Frenzel: If I had insight into what Warren Buffet was thinking all the time, I might not be sitting here in front of you, Nate. I think people attribute the quote to him that says, "You don't own utilities to get rich; you own utilities to stay rich." They're a very stable, very steady source of capital appreciation and current income in terms of the dividend. You put those two together and it's pretty straightforward as to why he probably owns utilities. The other thing that I think is a hallmark of Warren Buffet's investment style is that he invests in assets that he understands. At a macro level we sell electricity and natural gas: if those are products that you think are gonna continue to persist, then it's probably pretty straightforward as to how we operate in a macro sense. So, the preservation of value in regulated utility land, plus the growth, plus the dividend, is a great investment thesis, we think.
- Nate: Could you just touch on what your payout ratio is? Are you where you wanna be longer term? Then, secondly, I'm just curious about the relationship between your dividend growth rate and your EPS growth rate: Should it always be linear? Or in what scenarios would it just differ, if your dividend-per-share growth rate is 5% in one year while EPS growth rate was 8%?
- Bob: When I look at the regulated utility universe, I think payout ratios range probably somewhere between 50-80%, depending on which company, and I would say they're generally targeted in the mid-60s. Xcel Energy is about 61% payout ratio today, so probably a little bit below the median of our peer universe. We have a goal of growing our dividend at 5-7%, and slightly ahead of our earnings. So, I think over time you'll see our payout ratio will creep upward very slightly closer to the median, but I wouldn't expect that to happen in one fell swoop.
- Nate: Then, on the balance sheet, could you just talk about the balance sheet metrics that you're most focused on? I think it would also be helpful just to understand, for listeners to understand, the cost of debt for a utility, how low it is relative to other companies out there, and why that is.
- Bob: We've got a very interactive relationship with our credit rating agencies: Moody's, S&P, and Fitch. We issue new public debt securities to the market to the tune of \$1.5 billion to \$2 billion of debt annually. Credit quality and interest expense are very important for us as we think about delivering low cost energy to our customers. Keeping our interest rates low and affordable is important. Our operating company credit metrics are all A-

rated, and we issue debt somewhere in the neighborhood of 75-125 basis points over the 10 or 30 year treasury respectively; it ends up in net coupons somewhere in the 3.5-4.5% interest expense. So, a very low cost of debt relative to a lot of other sectors; but it's important, because we're a capital-intensive business, that we have a low cost of debt to finance our operations. Our most important credit metrics are generally funds from operation divided by debt. We look at the ratio of holding company debt to total company debt, and we look at debt to EBITDA and interest coverage metrics.

Nate: So, from a valuation perspective, what do you think are the most important metrics for a utility?

Bob: It starts with earnings. Earnings throughout dividend yield drives relative P/Es.

Nate: If you weren't a shareholder, but knowing what you know about the company, what would you pay the closest attention to if you were trying to get comfortable with an investment in Xcel's stock?

Bob: There's a couple of characteristics of highly investible regulated utilities, and I think about one is the management team, and are they capable of delivering out-sized returns year in and year out, and executing on their communication and their plans? Xcel Energy, we have met or beat our earnings guidance for the last 14 years in a row; and I think that if you look at correlations, you'll see that the ability to meet or exceed your earnings targets drives higher P/Es than your peers. The second thing I'd look at is the quality of the capital plan. Equity investors are rewarded when the regulated utilities can invest capital and grow their rate base at an affordable rate. If you can have certainty that the management team can execute on the capital plan, then you reward them for that capability. Then, finally, I look at the regulatory jurisdictions in which they operate in, and I look at the constructive or nonconstructive outcomes they have ... not just the company, but other companies in their state have ... in their regulatory proceedings. You take the combination of a management team, a high-quality capital plan, and a regulatory framework in the states in which they operate, and those tend to be the areas that drive the best share price performance for regulated utilities.

Nate: Thank you. I appreciate that. Then, my final question: a funny story to share with the listeners about an investor interaction, or just a self side conference, that you'd be willing to share?

Bob: A funny story about one of our peer companies, and I have to tell you the name of the company because it's relevant to the story; but when I was a young investment banker and Duke Energy was one of my most important clients, and I would go down and see Duke Energy three or four times a year and talk about anything and everything under the sun. One trip, we were going down to see Duke Energy and they wanted to talk about equity capital issuance. So, we decided we'd bring the Head of Equity Capital Markets from the bank down to meet with Duke. We told them we had this meeting with Duke, "Pick a date," and that we'd meet him at the company because he was coming from a different location.

Bob: So, we all fly in, we get to the company, and Terry's not there. Where's the Head of Equity Capital Markets? We're gonna have an equity conversation with one of the biggest utilities in the sector and our Head of equity Capital Markets isn't there. We start calling him and he says, "Well, I'm here. Where are you?" Well, he had landed at Raleigh-Durham and went to Duke University because that's where his assistant booked his plane ticket. He told his assistant, "I need to go to Duke," and she booked him a ticket to Duke University. So, he's standing in the middle of the campus at Duke University, and we're standing in the middle of Duke Energy's campus, which is in Charlotte 175 miles away, so we do the whole meeting via telephone. We told the client

Company: Xcel Energy  
Ticker: XEL  
GICS Sector: Utilities  
Date: 3/12/2019

Market Cap: \$29B  
Cash & Equivalents: \$0.2B  
Total Debt: \$17B  
Enterprise Value: \$46B

Price: \$56.46  
2020 P/E: 20.0x  
2020 EV/EBITDA: 10.9x  
2020 Div Yield: 3.0%

the  
stock  
podcast  
www.TheStockPodcast.com

that his plan had gotten delayed and he couldn't make it, even though he was just across the state in Raleigh-Durham.

Nate: I like that. Well, thank you so very much for coming onto the program. It's a pleasure talking to you and super interesting. It was great to learn more about Xcel, so thank you.

Bob: It's great to talk to an Xcel Energy customer and someone who's an advocate for the company, and we appreciate the time to be out here in Denver talk to you; and hopefully, as your listeners may not be focused utility investors, but if they want to get smarter about the opportunity to make and preserve wealth by investing in regulated utilities, we're happy to have more dialogue with any and every investor that feels like we could be an investible security for them.

Nate: Thank you. I'm sure our listeners appreciate that. Thanks for your time, Bob.

Bob: I appreciate it.

*This transcript may not be 100% accurate and may contain misspellings and possibly other inaccuracies. This transcript is provided "as is", without any warranties of any kind. Investing with the Buyside, LLC retains all rights to this transcript and provides it solely for your personal, non-commercial use. Investing with the Buyside, LLC shall have no liability for errors in this transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. All financial metrics in the header were taken the day the podcast went public and earnings estimates are the average of Wall Street analysts.*

*© COPYRIGHT 2019, Investing with the Buyside, LLC All rights reserved. Any reproduction, redistribution or retransmission is prohibited.*