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Hawaiian Electric Industries, Inc. NYSE:HE

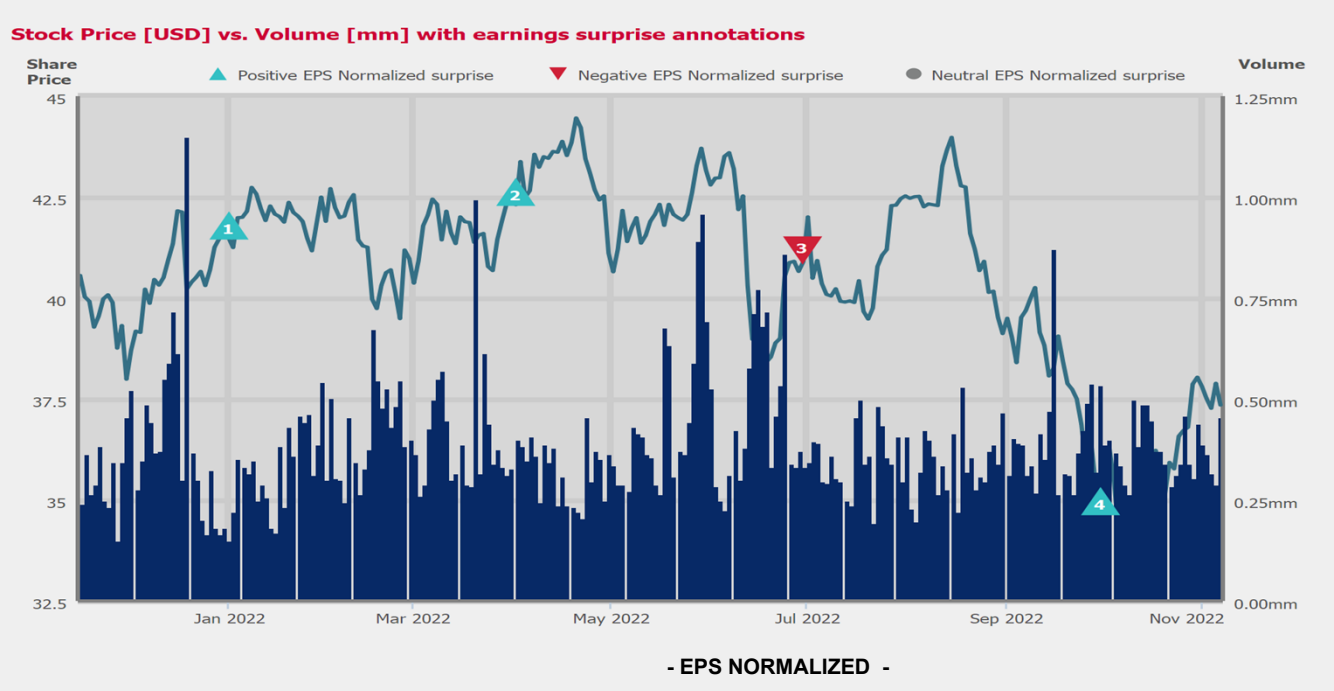
FQ3 2022 Earnings Call Transcripts

Monday, November 7, 2022 9:15 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2022-			-FQ4 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.54	0.57	5.56	0.52	2.13	NA
Revenue (mm)	745.51	1042.20	39.80	380.71	3004.09	NA

Currency: USD
Consensus as of Oct-27-2022 7:18 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2021	0.42	0.50	1 19.05 %
FQ1 2022	0.44	0.63	2 40.00 %
FQ2 2022	0.52	0.48	3 (7.69 %)
FQ3 2022	0.54	0.57	4 5.56 %

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Presentation

Operator

Good afternoon, and thank you for attending today's Q3 2022 Hawaiian Electric Industries, Inc. Earnings Conference Call. My name is Austin, and I shall be your moderator for today. [Operator Instructions]

I would now like to pass the conference over to our host, Julie Smolinski, Vice President of Investor Relations and Corporate Sustainability. Julie, please go ahead.

Julie R. Smolinski
Vice President of Investor Relations & Corporate Sustainability

Thank you, Austin. Welcome, everyone, to HEI's Third Quarter 2022 Earnings Call. Joining me today are Scott Seu, HEI President and CEO; Paul Ito, interim HEI CFO; Shelee Kimura, Hawaiian Electric President and CEO; and Ann Teranishi, American Savings Bank President and CEO; and other members of senior management.

Our earnings release and our presentation for this call are available in the Investor Relations section of our website. As a reminder, forward-looking statements will be made on today's call. Factors that could cause actual results to differ materially from expectations can be found in our presentation, our SEC filings and in the Investor Relations section of our website.

Now Scott will begin with his remarks.

Scott W. H. Seu
President, CEO & Director

Aloha. Greetings, everyone. Thank you for joining us today. I'll give an overview of our results and outlook, update you on the Hawaii economy and our businesses and then turn the call over to Paul to further discuss our financials.

We're pleased with our consolidated third quarter earnings of $62.1 million and earnings per share of $0.57, which reflect good performance and the benefits of our combination of companies. The utility's performance was steady, and we were able to offset some of the pressures we've seen related to inflation, interest rates, O&M and fuel costs. Our utility outlook for the year has improved since our last webcast. We now expect the utility to end the year closer to the midpoint of its guidance range, better than the lower end that we had forecast last quarter.

The bank had another strong quarter, continuing to demonstrate its strength in a rising rate environment. Bank results have benefited from higher interest rates, strong loan growth and continued favorable credit trends. Given year-to-date performance and expected continued positive trends the rest of the year, we're raising our bank 2022 guidance range to $0.72 to $0.76. We're increasing the bottom end of our consolidated 2022 EPS guidance range by $0.08 with our updated range now $2.08 to $2.20 for the year.

Turning to the economy. Hawaii's economy has continued to show signs of strength, and we believe it remains well positioned to weather broader economic headwinds. Hawaii's unemployment rate was down to 3.5% in September, on par with the national average. Unemployment here has fared comparatively well during downturns, performing better than the national average during the financial crisis.

The housing market continues to perform well. While we've seen slower sales activity with higher interest rates, prices remain strong. The median Oahu single-family home price rose to $1.1 million in September up from the prior year. Tight supply and robust demand have long characterized our housing market, helping Hawaii housing fare well relative to the U.S. mainland in recessions and contributing to the strong credit quality of our predominantly real estate secured bank loan portfolio.

Tourism arrivals have recovered to 96% of prepandemic levels as of September primarily due to a strong recovery in domestic travel, and visitor spending in September was 18.5% above 2019 levels. With the lifting of Japan's COVID travel restrictions last month, we anticipate strengthening arrivals from that important market even with the lower yen. This will provide an offset to softening of domestic arrivals that could result from a potential U.S. mainland recession. Given projected improvement in Japan travel and continued strong federal government spending in Hawaii, the University of Hawaii Economic Research Organization forecast that if there were a recession on the mainland, impacts in Hawaii would be milder with expected positive Hawaii GDP growth in 2023.

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Turning to the utility. We are pleased with the utility's execution on a number of critical fronts to help customers manage their bills, provide reliable, resilient service, advance our climate change action plan and manage costs. In Hawaii, there continues to be strong alignment between public policy, our regulatory framework and our utility's climate change action plan.

Our clean energy transition is one of the most powerful ways to reduce exposure to fuel price spikes, stabilize customer bills and cut greenhouse gas emissions, all while maintaining a healthy utility. We continue pressing forward on all fronts.

We're bringing on new utility scale renewable generation at contracted prices below the current cost of oil. A few highlights. The state's largest solar-plus-storage project is now online, generating energy at less than half the cost of oil. 3 more solar-plus-storage projects are slated to come online in early 2023, with several others in 2024. A large battery storage project is also expected to go into service on Oahu by mid-2023.

We have over 400 megawatts of renewable capacity and over 2 gigawatt hours of battery storage approved and active under Stage 1 and 2 RFPs, and we're continuing to see more. We're filing our final draft Stage 3 RFP for Hawaii Island today and is accepted by the PUC, target launching it before year-end. Our Oahu and Maui Stage 3 RFP drafts are under PUC review. Together, our Stage 3 RFPs seek an additional 1,600 gigawatt hours annually of variable renewable dispatchable energy and between 540 and 740 megawatts of renewable firm capacity.

We also continue to expand customer resources and programs. Rooftop solar continues to grow and there is strong interest in our battery bonus program, which received 1,400 applications totaling 10.9 megawatts in September alone. We're advancing EV charging as well, recently launching our Charge up Commercial, make-ready commercial charging infrastructure pilot, and our public charging expansion proposal is under PUC review. And last month, the PUC issued an order that would establish more aggressive time-based rate structures with the goals of making greater use of available renewable energy, reducing peak system demand and benefiting customers.

While the unique economic environment has brought cost headwinds this year, we've been able to significantly mitigate those pressures and control O&M expense increases to about half the rate of inflation. We're also focused on managing cost increases within the annual revenue adjustment, or ARA, long term. Under PBR, the inflation factor is set based on the October GDPPI forecast, which is 3.9% for 2023. Therefore, the net increase in our ARA allowance next year will be 3.68% or 3.9% minus the 22 basis point customer dividend.

Our work helping customers through flexible payment plans and connecting those in need with additional resources has led to positive trends in customer payments, and we're continuing those efforts. Overall, the utility is executing well. We continue to see the PBR framework as positive and are optimistic about the opportunities that provides the utility.

Turning to the bank. ASB has continued its strong performance, benefiting from the rising interest rate environment and strong loan growth and maintaining its high-quality position, including its low-risk profile, solid credit quality and low-cost funding base. Our bank digital transformation continues to progress. Our combination of ASB and Hawaiian Electric continues to demonstrate stability across economic cycles, and we're seeing that again today. While high interest rates tend to pressure utility's cost of debt, they benefit bank earnings, contributing to overall earnings stability. The bank continues to deliver solid dividends to the holding company, supporting our external dividend and limiting equity needs over time.

Before I hand the call over to Paul, just a quick update on our CFO search. We've been steadily working through our recruitment process and have been able to interview a number of strong candidates. I anticipate finalizing our selection within the next several weeks.

Now Paul will further discuss the financials.

Paul K. Ito
VP of Tax, Controller, Treasurer & Interim CFO

Thank you, Scott. Turning to Slide 6. In the third quarter, we generated consolidated net income of $62.1 million and diluted earnings per share of $0.57 compared to net income of $63.4 million and diluted EPS of $0.58 in the same quarter last year. Bank net income was up to $20.8 million compared to $19.3 million last year, while utility net income was almost flat at $49.8 million compared to $50.3 million last year.

Consolidated last 12 months return on equity remained healthy at 10.5%. Utility ROE was in line with expectations despite impacts from higher fuel prices, O&M and other pressures. Notably, approximately 50 basis points of ROE drag was due to the impacts of elevated fuel prices. Bank ROE remained strong at 14.2% on a last 12 months basis.

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On Slide 7, we show the major variances across our enterprise compared to the third quarter of last year. Higher bank net income was primarily driven by higher net interest income partially offset by a smaller negative provision and lower noninterest income. Net interest income of $65.7 million was up 9% due primarily to higher average earning asset balances and higher yields, partially offset by lower Paycheck Protection Program, or PPP, fee income as PPP loans continue to pay down.

Noninterest income was down $1.8 million to $13 million, primarily due to lower bank-owned life insurance income and lower mortgage banking income as the higher interest rate environment has impacted production. The bank's noninterest expense was flat with lower deferred compensation expense from market fluctuations offsetting higher compensation and benefit costs. Overall, the bank continues to manage expenses well as it invests in its digital transformation.

On the utility side, we saw $6 million more in ARA revenues and $1 million from lower penalties for fuel efficiency on Hawaii Island, offset by lower net income due to tax adjustments recorded last year, higher O&M, lower revenues due to a timing change for revenue recognition at our Maui utility, higher depreciation and higher interest expense. The higher O&M was driven by increased generating station maintenance, increased preventative maintenance and higher bad debt expense, partially offset by higher expenses from generating station overhauls performed in the third quarter of last year.

On Slide 8, utility CapEx through the third quarter was approximately $217 million. This year's CapEx continues to be lower than originally anticipated due to supply chain disruptions, customer work delays resulting -- resource availability and permitting delays. We've reprioritized projects that are ready to commence in order to accelerate the pace of our CapEx program. Work has been ramping up and for the full year, we expect CapEx in the range of $350 million to $375 million.

Turning to Slide 9 on the drivers for the rest of the year for the utility. As Scott referenced, there have been many headwinds that have impacted utility results in the quarter and year-to-date. However, I would note that utility performance year-to-date and as forecasted for 2022, which I'll cover more in a moment, has been very good under the first full year of PBR in spite of these headwinds.

With our updated guidance for the utility, net income is forecasted to increase approximately 6% over 2021, a very strong result. While the PBR framework did not contemplate an economic environment with high inflation, high fuel prices, high interest rates and supply chain challenges occurring all at the same time, the utility has been able to mitigate these challenges and still deliver strong results.

The utility is aggressively managing O&M costs to respond to the inflationary and high interest rate environment. Looking forward, we anticipate continued higher O&M this year from generating station overhaul and maintenance expenses as we cycle our generators more often to ensure reliability through the stage of our clean energy transition. We also continue to see bad debt expense pressures with elevated oil prices, although fuel costs were slightly lower in September, translating to lower customer bills. We still expect O&M this year will be modestly above ARA recovery levels.

The utility remains focused on operating efficiently to help offset cost pressures. Reducing space needs in our hybrid work environment, managing labor costs efficiently and utilizing lower-cost internal resources to complete our work has benefited utility results to date, and the utility will continue to focus on these going forward.

We are seeing higher interest expense as short-term rates increase. Higher fuel prices have increased the carrying costs as we fund fuel payments ahead of customer collections, resulting in higher short-term borrowings at higher interest rates. This, along with bad debt expense, should moderate when fuel costs come down.

On the long-term debt side, we accelerated the financing from November to June to enhance liquidity and prefund December maturity. While that increased interest expense year-over-year, it allowed us to lock in a more attractive fixed rate that is below the rates available today, resulting in meaningful savings over the life of the debt.

As discussed last quarter, net PIMs are forecasted to be a slight drag this year. We expect to incur the maximum penalty under the fuel cost risk-sharing mechanism due to significantly higher prices in the market. While we expect no RPS-A PIM reward due to supply chain and other macro factors resulting in delays in third-party renewable projects, several projects are on track for our 2023 completion to contribute toward 2023 PIMs. In addition, we now expect higher PIM rewards this year from the interconnection experience and low to moderate income energy efficiency PIMs and lower O&M than previously forecast, contributing to our improved outlook for 2022.

On Slide 10, turning to the bank. ASB's strong net interest income growth reflected higher yields and balances across nearly the entire loan portfolio and higher yields in the investment securities portfolio, partially offset by lower PPP fees, now almost fully recognized, and higher funding costs. Our funding cost increased 8 basis points to 13 basis points during the quarter as the strong loan growth required additional funding from wholesale borrowings and public term certificates. Our cost of funds remains very attractive at a low

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level and competitive versus peers. Net interest margin expanded to 2.96% in the third quarter versus 2.85% in the second quarter as the benefits of a higher rate environment and higher yields were only partially offset by the lower PPP fees and higher funding costs.

On Slide 11, turning to drivers of bank performance for the rest of the year. We expect further NIM expansion in the higher rate environment with additional Fed rate increases in the fourth quarter. We have increased our NIM range to 2.9% to 2.95% for the year. We continue to have strong loan pipeline and expect continued growth in the fourth quarter although potentially at a more moderate pace given the robust loan growth so far this year. We expect continued lower mortgage banking income this year given the impact of higher interest rates on mortgage production.

We will continue to focus on cost management to address inflationary and tight labor market conditions as well as invest in our digital transformation. We expect that favorable credit trends will partially offset additional provisioning for continued loan growth. We now expect a lower provision expense for the year of between negative $3 million and $3 million positive compared to our prior expectation of $0 to $10 million.

On Slide 12, we turn to our guidance updates. On the utility side, as mentioned, we expect $350 million to $375 million in CapEx for the year. Although we expect O&M to be modestly above ARA levels and PIMs to be modest negative -- net negative this year, our EPS expectation is better than last quarter given improved outlooks for the interconnection experience and LMI energy efficiency PIMs and a slightly better O&M forecast. We now expect to be closer to the midpoint of our utility guidance range rather than toward the lower end of what we've communicated last quarter. We are currently going through our annual process of refreshing our longer-term utility earnings forecast, and we will provide that update when we announce our 2023 guidance in February.

Turning to the bank. As mentioned, we expect a higher NIM and a lower provision for the year. This also translates to a higher expectation for return on assets of 85 basis points compared to last quarter's expectation of 70 basis points. We now expect earning assets growth in the mid-single digits versus last year's expectation of low single digits. And we are pleased to be raising bank EPS guidance of $0.72 to $0.76 compared to previous guidance of $0.59 to $0.68. We still expect a holding company loss of $0.28 to $0.30 for the year, excluding the $0.06 gain on sale at Pacific Current in the first quarter, although we expect that higher interest expense will put us towards the upper end of that range.

As Scott mentioned, given the favorable change to the 2022 outlook for both bank and utility earnings, we are increasing the low end of the range and updating our consolidated guidance range to $2.08 to $2.20.

Now I'll turn the call back to Scott.

Scott W. H. Seu
President, CEO & Director

Thank you, Paul. So overall, we're pleased with the quarter's results and forecast a good outcome for the year. Our economy is healthy and is well positioned to weather a potential slowdown. Our utility is managing costs against near-term headwinds, and we remain confident in our ability to perform well under PBR. As we push forward on our clean energy transition, both our customers and our company are poised to benefit.
The bank's high quality continues to be demonstrated through its strong performance, and the benefits of the combined HEI enterprise through different economic environments is again being proven. Overall, we're confident in the future of our enterprise. Mahalo, and we look forward to your questions.

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Question and Answer

Operator

[Operator Instructions] Our first question is from Julien Dumoulin-Smith from Bank of America.

Julien Patrick Dumoulin-Smith
BofA Securities, Research Division

Listen, I suppose, well -- listen, well done on managing the cost environment here. I mean, clearly, nicely done around the utility and the prospects and turning that around here as well as the bank. To that end, I wanted to inquire how are you thinking about these O&M efforts sort of pairing with improvements here for PIMs year-over-year into '23? To what extent -- have you -- to the extent to which you've been able to move it from the low end to the midpoint of the range on the utility, does that bode favorably going into '23 as you get to run rate on some of these O&M cost-saving efforts? Or are there continued O&M pressures that you're seeing going into '23, that these are really offsetting?

Is this sort of a net positive year-over-year as you think about it? Or is this just fighting the inflationary impacts going into '23 as you think about these more aggressive efforts you put in place this quarter?

Scott W. H. Seu
President, CEO & Director

Julien, this is Scott. There are going to continue to be some cost pressures on the utility going forward even into 2023 with this high inflation, that is impacting overall costs. But as we mentioned, what the utility has been able to do so far is they have ramped up their -- some of their O&M work to be able to provide the reliable service as we transition to more renewables. We're expecting to see continued pressures on the generation O&M side. But what the utility has been able to do so far is really help offset some of those pressures by some of the measures we described, how we use outside services, how we manage labor, even things like how we are looking at leased office spaces. So it's an ongoing effort by the utility. So far, they've been able to perform pretty well, and they're going to continue those efforts going forward into 2023.

Julien Patrick Dumoulin-Smith
BofA Securities, Research Division

Got it. Excellent. What about PIMs here, it's a positive as well as -- how do you think about the sort of the trend, if you will, the exit run rate coming out '22 on the bank, obviously, noticing the uptick in bank segment guidance here as well. How do you think about those contributing into next year as well? Again, understand that the backdrop on inflation, obviously something you're managing on the utility side.

Scott W. H. Seu
President, CEO & Director

Yes. Let me answer first off on your PIMs question. So the biggest factors affecting our 2022 outlook for PIMs have been the fuel cost risk-sharing penalty due to the higher fuel costs that are really being seen globally. And then also, as we said, we're not forecasting any meaningful RPS-A PIM reward this year due to delays in some of those new renewable projects. As we look into next year, as you can see on one of our slides there, we do forecast now getting into the positive in terms of the RPS-A as we see these renewable projects coming online.

And just to reiterate, right, we are expecting a number of these new solar-plus-storage projects coming online in early next year with more to come in '24. So specifically, we'll provide more details towards our outlook when we address our '23 guidance in February.

As far as the bank is concerned, as long as the inflation environment is high and the interest rates are high, then the bank will continue to see benefit. So that's to my earlier point. Having the bank and the utility as part of the HEI enterprise does help to really mitigate the pressures that any one company is seeing in these varying economic situations. So that's what we expect to see continue going forward.

Julien Patrick Dumoulin-Smith
BofA Securities, Research Division

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Got it. Right. But there could be a nice swing from '22, given the, as you say, the moderate downside from a PIM penalty in the '22 year into both an RPS and a fuel benefit in '23, right? And I know you have this comment from '22 to '24 on earnings guidance, but really the PIMs' inflection really could be most acute from '22 to '23.

Scott W. H. Seu
President, CEO & Director

Yes, considering we're [indiscernible] for this year.

Operator

Our next question is with Paul Patterson from Glenrock Associates.

Paul Patterson
Glenrock Associates LLC

Can you guys hear me?

Scott W. H. Seu
President, CEO & Director

Yes.

Paul K. Ito
VP of Tax, Controller, Treasurer & Interim CFO

Yes.

Paul Patterson
Glenrock Associates LLC

Okay. So just to sort of follow up on the bank. The decline in provisions, could you give us a little bit more flavor as to what you're seeing there?

Scott W. H. Seu
President, CEO & Director

Yes. So very high level, there's actually 2 factors happening in tandem. With the bank's loan growth, of course, they do have to provide for additional provisioning as that loan portfolio grows. But that has been offset by release of provisioning because of some of the improving credit quality trends here in Hawaii. So I think that's actually been helpful. That's why we've gone from the $0 to $10 million projection that we had earlier to now negative $3 million to positive $3 million.

Paul Patterson
Glenrock Associates LLC

Okay. And then just on the deposit rate, I think you guys said it was in line with your competitors. And I'm just sort of wondering, it would seem to me, I guess, sort of building on Julien's question, that there might be some momentum with respect to the NIM in 2023. Or how should we think about that deposit? I mean the rate seems very low. I'm just sort of wondering how sustainable all that is or how we should think about those trends?

Paul K. Ito
VP of Tax, Controller, Treasurer & Interim CFO

Yes, Paul, this is Paul. So we -- obviously, the higher interest rate environment does increase our cost of funds, but our deposit betas have been very low in past cycles, and we expect it to remain relatively low in this cycle. So we will see net interest margin expansion as rates are increased. We are seeing some more rate-sensitive customers, commercial customers, and we've adjusted rates to accommodate some of those. But in general, our core deposit, which is 85%, is pretty resilient and -- in terms of -- not as rate sensitive, again, we do expect that we'll have an expansion of NIM as rates increase. So we have a -- we feel good about that.

Operator

At this time, there are no further questions. [Operator Instructions] There are no further questions. So I'll pass the conference back to the management team for any closing remarks.

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Julie R. Smolinski
Vice President of Investor Relations & Corporate Sustainability

Thank you all for your time, and we look forward to seeing many of you at EEI next week. Have a great rest of the week.

Scott W. H. Seu
President, CEO & Director

Thank you all.

Operator
That concludes today's call. Thank you for your participation. You may now disconnect your lines.

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