



CEO'S REPORT

(COST & RATES LANDSCAPE)

PRESENTED BY:

Paula Gold-Williams
President & Chief Executive Officer (CEO)

October 26, 2020

Informational Update

***Written version with notes,
posted for easy reference & dissemination***

The following document is CPS Energy President & CEO, Paula Gold-Williams' presentation to the Board of Trustees during their October meeting. It highlights key takeaways from each slide and offers quotes from Paula's presentation. The audio of the presentation is also available through CPS Energy's YouTube page.

On a high level, the theme of this presentation is that CPS Energy is using its **Guiding Pillars: Reliability, Customer Affordability, Security, Safety, Environmental Responsibility,** and **Resiliency**, all grounded in **Financial Responsibility** to drive customer-oriented decision making. We will not abandon one pillar for another. We are deliberate in everything we are doing, and we will make sure our approach is methodical, not rushed.

<https://www.youtube.com/watch?v=xrcZhvXTN3M&feature=youtu.be>

OBJECTIVES & TAKEAWAYS



- **EXPLAIN HOW OUR VALUE PILLARS GUIDE US**
- **SHOW HOW OUR RESIDENTIAL RATES COMPARE TO THE COMPETITIVE MARKETS IN TEXAS**
- **SUMMARIZE OUR MOUNTING PRESSURES**
- **DEMONSTRATE HOW VELOCITY MATTERS**

AGENDA



- **GUIDED BY OUR VALUE PILLARS**
- **OUR CUSTOMERS' BILLS**
- **DRIVING VALUE FOR OUR CUSTOMERS**
- **UTILITY ENERGY**
- **BUSINESS PRESSURES**
- **OUR CUSTOMERS**
- **VELOCITY IMPACTS AFFORDABILITY**

GUIDED BY OUR VALUE PILLARS & FOUNDATION



All business decisions are based on our commitment to being one of the best-managed & most financially responsible utilities in the nation!

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Key Takeaway:

CPS Energy has six *Guiding Pillars*: *Reliability*, *Customer Affordability*, *Security*, *Safety*, *Environmental Responsibility*, and *Resiliency*, all grounded in *Financial Responsibility*. Each of those guiding pillars are treated with equal importance when making decisions to run this community-owned business.

In Paula's Words:

"...when we have a major initiative or strategy, we look at every single one of these pillars and we try to make sure that we are optimizing that strategy thinking about the different implications, thinking about how to avoid risk and thinking about how to hit every single one of those pillars when we're making decisions, and then we have to make sure that we do it responsibly. We are a business owned by a community, owned by our customers."

GUIDED BY OUR VALUE PILLARS

WE LISTEN TO OUR CUSTOMERS TO AVOID RISKS



Per frequent surveys, customers tell us that their first priorities are:

Reliability



We work to prevent
ROLLING BLACKOUTS!

Customer Affordability



We work to prevent
BILL SHOCK!

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Key Takeaway:

Although we treat each *Guiding Pillar* with equal importance, our customers consistently tell us *Reliability* and *Customer Affordability* are their priorities. We take that feedback seriously and keep it in mind as we evaluate the best ways to meet the needs of our customers.

In Paula's Words:

"When we do talk to customers in these different opportunities, we tended to show them again the six pillars and we ask them to rank them and I will tell you every single time, it is about customer *Affordability* and it's about *Reliability*. Customers want to make sure that their power is always flowing..."

GUIDED BY OUR VALUE PILLARS

OUR APPROACH IS SUCCESSFUL



RELIABILITY:

- We developed our innovative *Flexible Path*SM strategy to ensure we incorporate clean energy proactively & carefully.

CUSTOMER AFFORDABILITY:

- We have had ONLY 1 Rate Increase in almost 10 years.
- That 1 Rate Increase was 6 Years ago.

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Key Takeaway:

CPS Energy's *Flexible Path*SM is a globally recognized, award-winning program. Even our ratings agencies recognize it as a progressive, but thoughtful approach to incorporating newer, cleaner technology to our system. Our deliberate approach combined with a focus on our *Guiding Pillars* is what has allowed us as a company to serve our community with only one rate increase in the last decade.

In Paula's Words:

"Our Flexible Path has been touted across the globe and the nation at the rating agencies as a very, very progressive approach that makes sure that we're always thinking about the things that we can do, and the thing about San Antonio is we take action, we get things done, we venture out, we take calculated risk and we make sure that we follow through, and our 3,100 employees make sure the things we say we're going to do we're going to do."

GUIDED BY OUR VALUE PILLARS

SEE OUR NEW SUSTAINABILITY REPORT



KEY SUCCESSFUL ENVIRONMENTAL COMMITMENTS TO DATE!

We have multiple accomplishments to be proud of, as members of our passionate San Antonio community, which include the following:

- In 2018, we closed two older coal units early as part of the thoughtful progressive transformation of our power generation fleet to cleaner technologies.
- In 2019, as part of our *Flexible Path*SM, we made a foundational commitment to reduce our net carbon emissions profile by 80% by 2040.
- We are now working toward full carbon neutrality by 2050 in support of the City of San Antonio's Climate Action & Adaptation Plan (CAAP); a plan our Board of Trustees endorsed with a resolution on August 26, 2019.

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Key Takeaway:

CPS Energy first brought renewable energy to San Antonio in 2000 and hasn't looked back since. We are focused on looking forward and have developed a *Flexible Path*SM to continue to drive for an 80% reduction in carbon emissions by 2040 and carbon neutrality by 2050. For example, two coal units were closed 15 years early in 2018. Although some are calling for a faster transition, CPS Energy is determined to take deliberate steps toward these goals in a way that makes sense specifically for our Greater San Antonio Area customers.

In Paula's Words:

"...while there are a lot of focus on what is there left to do and there's a lot to do globally to try to figure out how to transition the utility energy industry, and there's a lot of great effort going on.... I want to make sure that everyone does truly understand that CPS Energy has done a ton of things already."

DRIVING VALUE FOR CUSTOMERS

GET MORE FOR THEIR MONEY - MONTHLY



TODAY: We have the most attractive pricing, while spending the most in Texas on renewables & conservation.

Texas Cities Residential Monthly Bill Comparison



Note: Bills reflect 12-month average pricing through August 2020; shown at average monthly usage of 1,000kWh & 5MCF.

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Key Takeaway:

Even though there is not competition *in* San Antonio, CPS Energy is still a competitive market when compared against other markets in the state – regulated or not. When comparing average monthly residential bills, San Antonio has a lower expense than other major Texas cities. Furthermore, substantially more of that customer expense is invested in renewable generation and conservation program than in the compared markets.

In Paula's Words:

"78 years we've been owned by this community, so the way that we solve problems is just a bit different and it works for us and the focus is on residential customers because they're individuals and they need a lot of consideration in San Antonio, our customers. We know they need help and assistance and grace and consideration and empathy."

DRIVING VALUE FOR CUSTOMERS

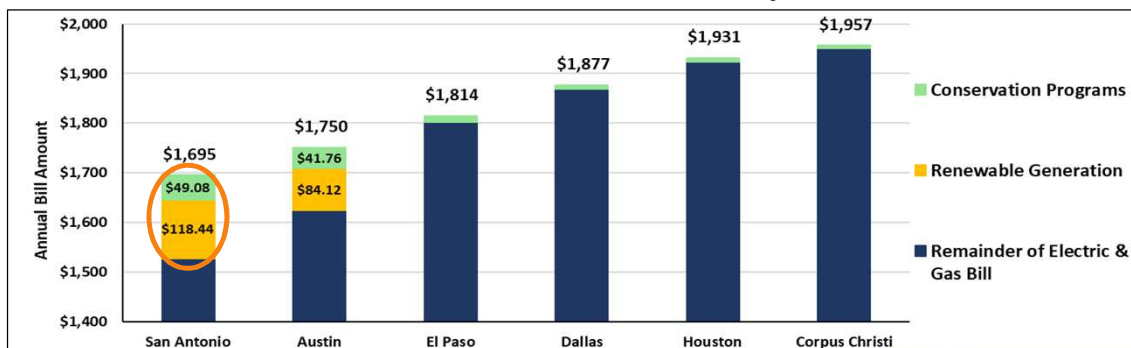
GET MORE FOR THEIR MONEY – ANNUALLY



1ST
CONGRATULATIONS
SAN ANTONIO FOR BEING
A SHINING CITY FOR
SOLAR ENERGY!
San Antonio Ranks 1st in Texas & 6th in the U.S. for Solar Energy Within City Limits

~10% of customers' bills goes to funding our commitment to sustainability (vs. <1% in some Texas cities).

Texas Cities Residential Annual Bill Comparison



Note: Bills reflect 12-month average pricing through August 2020; shown at average monthly usage of 1,000kWh & 5MCF.

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Key Takeaway:

It is important to understand that the heavy investment in conservation programs and renewable generation is more than just statistics demonstrating CPS Energy's leadership in the state and nation. This is another form of reinvestment in the community, empowering our customers to keep their electric bills down and continuing the drive to carbon neutrality.

In Paula's Words:

"Again, we are, by far, out-spending and out-investing in renewable generation, both solar and wind, and our conservation program is one of the biggest in the state and actually one of the biggest and best performing in the nation and that's why we got a national award last year from the Alliance to Save Energy."

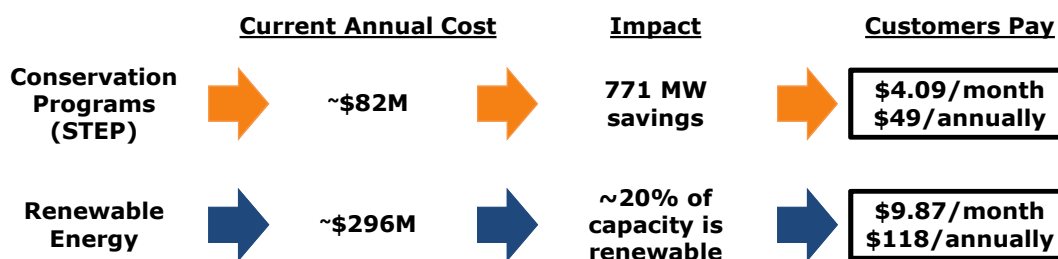
DRIVING VALUE FOR CUSTOMERS

HOW WE SPEND MATTERS



EVERYTHING COSTS MONEY:

- ~10% of customers' bills goes to funding our commitment to sustainability (vs. <1% in some Texas cities).
- We are engaging our community to design the future of these programs.



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Key Takeaway:

These conservation program and renewable generation investments are a reflection of CPS Energy's innovative approach to engaging the community in meaningful ways that has helped bring our utility to a generation mix that is made up of about 20% renewable sources and enough conservation efforts to avoid building an entire power plant. The world is taking note of San Antonio because of these efforts.

In Paula's Words:

"...we have made these investments and made these early again; we started twenty years ago {close to the year} 2000 timeframe because we knew that we needed to start investing, to start making sure that we had low to non-emitting sources coming into our portfolio and now we are incorporating them in a very affordable bill."

UTILITY ENERGY

THIS BUSINESS IS VERY COMPLEX



TYPE →

RETAIL

WHOLESALE

SYSTEMS →

ELECTRIC

GAS

**We work to
give the
benefits of
Competition!**

Competitive

- Our sources of revenues come from our customers.
- We do not get tax credits or Federal Funds like CARES¹.
- Statutorily, we must charge "rates sufficient."
- Our competitive businesses help offset costs / add value to retail electric customers!

1 - Coronavirus Aid, Relief & Economic Security (CARES) Act

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Key Takeaway:

As a whole, the energy business is complicated. And even though there is no competition for electric service and only a little bit of competition for natural gas service within the Greater San Antonio Area, CPS Energy still strives to bring our customers all the benefits of competition. That said, the Texas market is competitive, and when CPS Energy can participate – those financial gains are brought directly to the customer in the form of contributions to the City of San Antonio's general fund and the avoidance of rate increases.

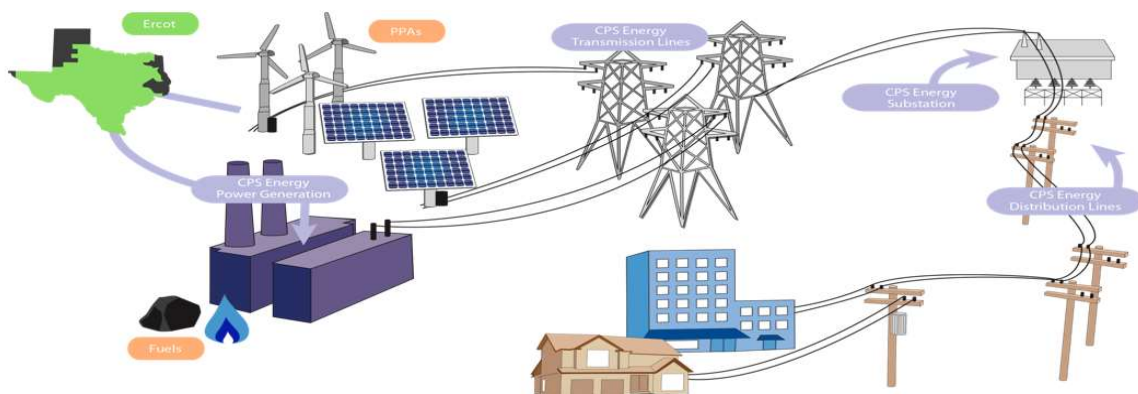
In Paula's Words:

"We are not in a competitive market, but we do operate in the state competitively So our wholesale sales business, the excess capacity [didn't perform] as well this year, but there were many years where the wholesale sales business has helped us and again has helped us over the last 10 years only have one rate increase."

UTILITY ENERGY MAKE IMPORTANT INVESTMENTS



**AGAIN, TO SUPPORT *RELIABILITY & AFFORDABILITY*,
we fulfill our obligation to serve by building & maintaining
infrastructure. This is a significant part of our overall cost structure.**



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Key Takeaway:

A business cannot survive if it does not cover its costs. The energy industry inherently has a lot of overhead expense that drives how rates are determined. There are obvious investments like power plants and lines, but there are other expenses like office buildings, customer centers, fleets and garages, real estate, etc. CPS Energy strives to manage these investments in a manner that meets the needs of our customers without creating unnecessary burdens on our customers.

In Paula's Words:

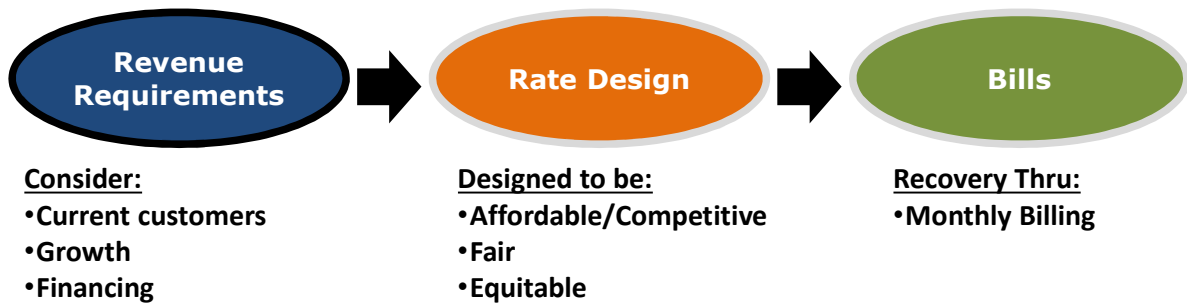
"We invest in generation assets, transmission, distribution centers, fleet locations, call centers, payment centers. All of these things are required to serve a full community. And again, we make sure that the infrastructure and the maintenance costs are covered and that's what we have to always make sure that we are paying attention to covering those costs."

UTILITY ENERGY

OUR APPROACH TO GENERAL RATE DESIGN



Bills must be designed to recover our total system costs.



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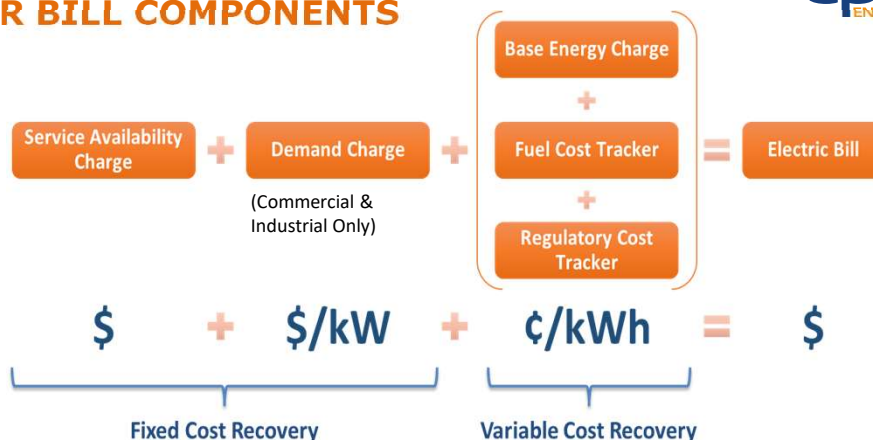
Key Takeaway:

We are constantly having to balance recovering the cost of previous investments while still looking to future needs of the community, especially related to the rapid growth we see in the San Antonio area. Both elements have to be considered when designing rates in the status quo while still working to keep every customer's bill reasonable, equitable, fair, *Customer Affordable*, and competitive.

In Paula's Words:

"It just takes a lot to think about all of the things that are required in terms of running the business and then we design the bills and we're trying to make sure again that we keep them affordable, that they're competitive, that they're fair and equitable and that means that, in general ... the billing that customers pay is dependent upon the efficiency of what it takes to serve them and that's what it is when it's equitable. That's what we do across the different groups of customers. And then again, we translate that into monthly billing that customers get and, and know what they're paying for."

UTILITY ENERGY CUSTOMER BILL COMPONENTS



Customers' bills have a fixed component & a variable component. However, those charges do not align with our cost structure.

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Key Takeaway:

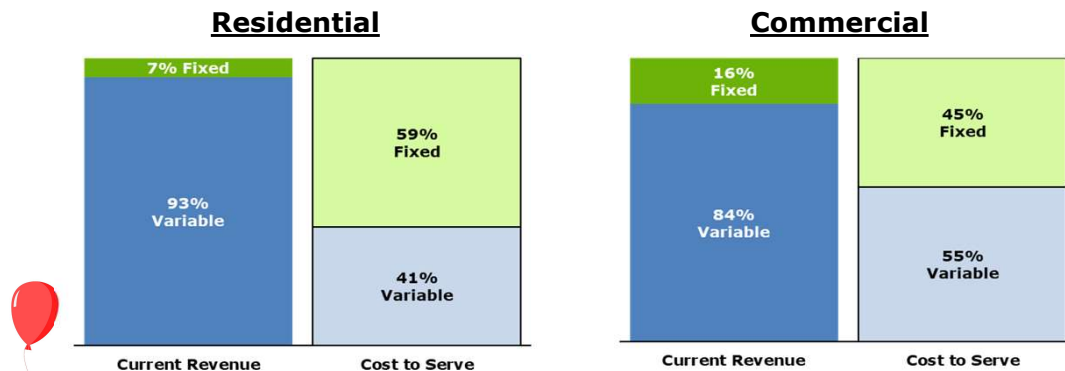
We have some remarkable professionals who find the right ways to balance the complexities of recovering cost through our rate structure, but one thing we are figuring out is that the structure is not optimized to operate the company in a manner that serves the customers. Rates are currently set up in a manner that leans heavily on each customer's individual consumption of energy – meaning it can vary widely from bill-to-bill. In reality a much larger part of CPS Energy's expenses do not change that much month-to-month. Our team is evaluating ways we can restructure bills in a way that better reflects the expense structure of our operations, effectively recovers the cost to serve our customers, and still has minimal bill impact.

In Paula's Words:

"... this has always been set up for decades and decades in the industry is this volumetric approach. And so you'll see it, we estimate all of the kilowatt hours that are going to be needed and then we apply that and figure out the per-unit amount that we're going to charge every month, and it's a pretty sophisticated approach, but it definitely can be updated and [we're up for that] and we think the RAC and other entities across San Antonio can help us look at a better way to do great design."

UTILITY ENERGY

SA NEEDS BETTER COST-TO-BILL ALIGNMENT



It will be good to restructure our rates!
However, rates are like a balloon; costs moved from one part of the business must be absorbed by other parts of the business.

Note: Values based on FY2017 Cost of Service study; Commercial includes small business rate class (PL).

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Key Takeaway:

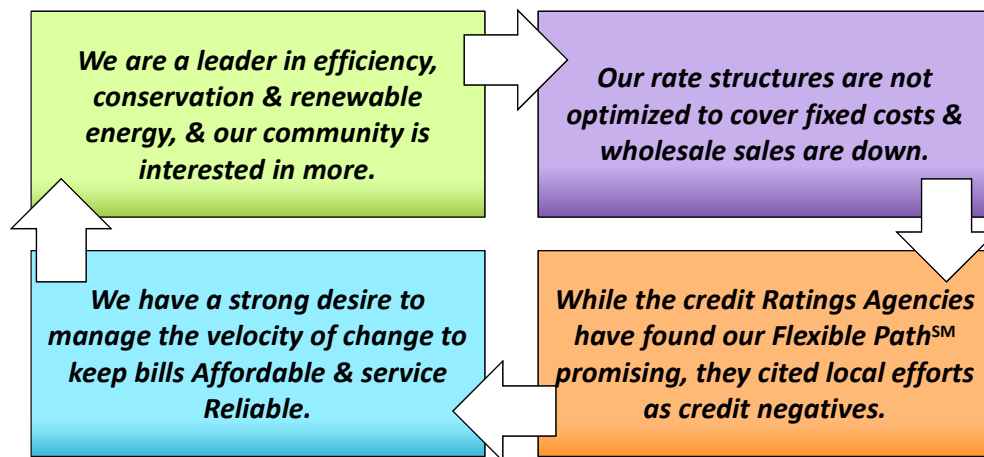
This is a graphic depiction of how fixed and variable revenues compare to fixed and variable costs to serve for both residential and commercial customers. As you can see – neither revenue stream is reflective of its respective cost. Adjustments can be made, but it is like squeezing a balloon – no additional air (funding) is being added, it is just being shifted around within the confines of the balloon.

In Paula's Words:

"I have an analogy here that that our costs though are like a balloon. Again, you don't get any additional funding. You can make your balloon a little smaller every day by looking for how you can, you know, chip away at costs. But as far as funding is concerned, it's like a balloon; you squeeze one end and you try to help your residential customers, then [those costs get born] by your commercial and business customers ... You cannot load up your commercial customers. It's not a simple perspective of saying we'll just give them more cost. We don't want to become the most expensive [business city] in Texas and maybe the nation by loading up those costs."

BUSINESS PRESSURES

WE ARE FACING INCREASING CHALLENGES



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Key Takeaway:

CPS Energy is doing a lot of great work for the customers, community, and environment, but this work is not without its challenges. This slide highlights four of the key pressures the company is facing right now: increasing interest in more environmental efforts despite the strides we are already making, financial challenges tied to the slower wholesale market and lack of optimized rate structure, balancing the desire to move fast while managing the velocity to a point that it doesn't cause bill shock or impact **Reliability**, and a negative outlook from our credit ratings agencies resulting from, in part, local efforts. These are all pressures we can handle, but are pressures we also need to manage carefully – but we are committed to keeping our customers at the forefront of our efforts.

In Paula's Words:

"We've been in this business a long time. We have people with tremendous skills, talents and abilities and what we do passionately is think a [again] about how though do we all figure it out? It's our responsibility to make it so that most people don't think about it at all. All they got to do is hit their power switch but for us, we've got to look at the complexity of it."

BUSINESS PRESSURE SA's IMPORTANT CREDIT RATINGS



Ratings Agencies are watching our financial performance & local issues that could impact our governance.

MOODY'S

S&P Global
Ratings

FitchRatings

CPS Energy Rating:

Aa1

Outlook: Stable

AA

Outlook: Stable

AA+

Outlook: Negative



"The Negative Outlook reflects Fitch's concern that rate increases required to maintain a financial profile consistent with the current rating may not materialize..."

A recent petition was proposed... that would revise the governance & management structure of the utility, as well as institute certain carbon reduction & rate policies. Fitch views the proposed governance change as a potential asymmetric additive risk consideration."

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Key Takeaway:

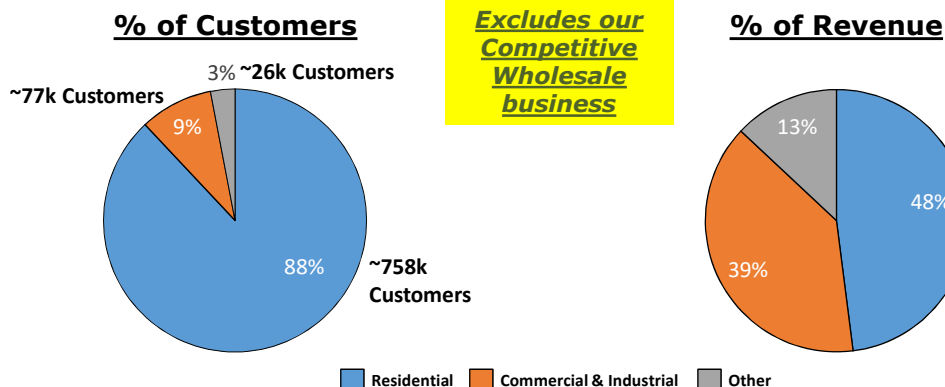
Two key elements in the single negative outlook from the Fitch ratings agency were the fact that CPS Energy has not sought a rate increase in a long time, and the proposed petition to revise the governance structure of the utility. Although it has been about a decade, CPS Energy has dealt with, and recovered from a negative outlook. We will recover from this one too. But it is important to understand that stable ratings and outlooks are important factors investors consider when issuing debt to CPS Energy. The stronger the rating, the more cost effective the debt – which is a financial benefit to our entire community.

In Paula's Words:

"For the first time in a long time, we've had a negative outlook."

OUR CUSTOMERS

RETAIL REVENUE CHARACTERISTICS



Residential customers make up nearly ~90% of our customers, but contribute less than 50% of all revenue.

Other – Includes Streetlights & Public Authorities, such as the Military

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Key Takeaway:

Although they only represent about 10% of our accounts, Commercial customers make up about 40% to 50% of our revenue. The other 50% of the revenue comes from the other 90% of our customers – residential. Some have called for shifting more of the burden to commercial customers, but they do already account for a large portion of total billing revenue.

In Paula's Words:

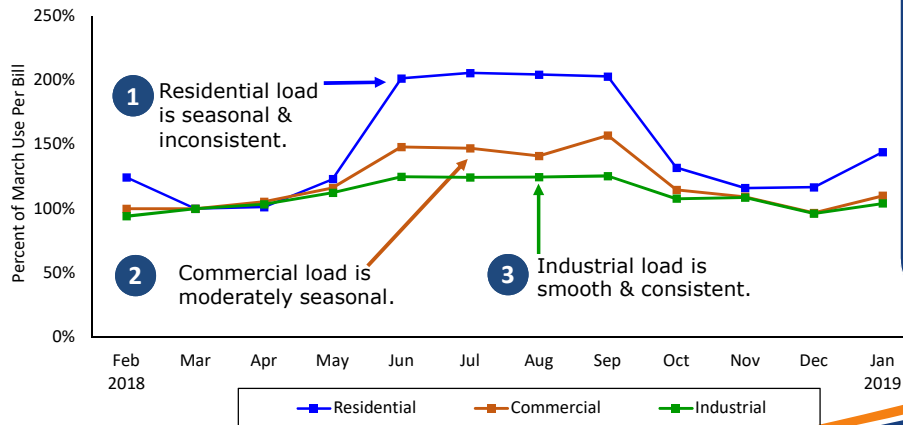
"I've had people say, 'well, so what [your a business], you know should pay more.' The point is [businesses] already are paying more and I believe, again residents have to be respected and businesses and large industrial accounts have to also be respected, because they are contributing a lot to the overall support of a cost structure"

OUR CUSTOMERS

**OPERATIONAL EFFICIENCY IS THE KEY TO
COST EFFECTIVENESS**



How You Use Energy Matters



Customers with consistent load use infrastructure efficiently & that cost is spread over higher sales volumes (i.e., more kWh's).

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Key Takeaway:

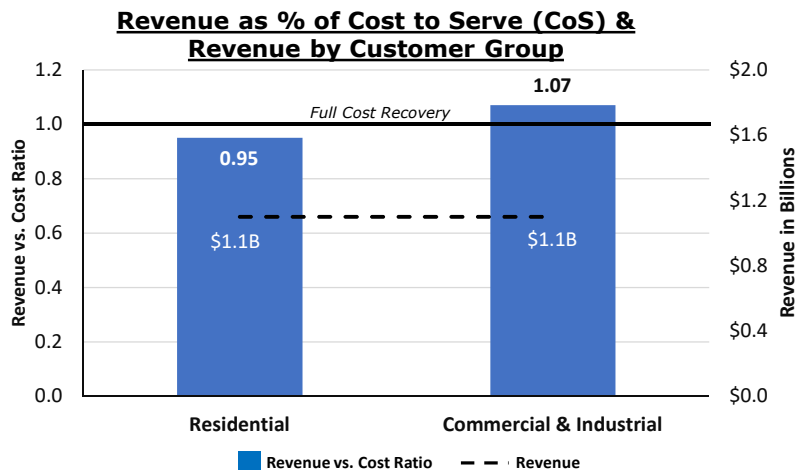
The important thing to understand here is that regardless of how much commercial customers are charged, our system has to be built to generate enough power to accommodate all demand, which spikes because of residential use. As demonstrated in slides 8 & 9, we have put a lot of resources into helping all customers, including residential, manage their energy use. Extra effort has been put into specifically managing energy use during peak hours, which is what drives the need for expensive infrastructure like power generation.

In Paula's Words:

"... the large customers have a fairly even load for the year and when they're putting more and more kilowatt hours on the system consistently, they're actually helping us bring the overall cost down per unit. That's why it's important. If all the businesses left San Antonio, then all of the costs that are still needed will still have to be borne by everyone else."

OUR CUSTOMERS

BUSINESSES ALREADY HELP RESIDENTS



Note: Based on FY2017 Cost of Service Model; Residential includes RE, RA, & RCE; Commercial & Industrial (C&I) includes PL, LLP, ELP, LPT & SLP (including Public Authorities); Excludes all lighting groups

- Even though C&I customers pay a lower effective price per kWh, they are actually contributing more than their CoS.
- As a regulatory standard, no Customer Group should pay more than 110% of their CoS.

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Key Takeaway:

As a not-for-profit entity, CPS Energy is designed to recover cost rather than turn a profit. Ideal models keep rates within 10% of cost recovery – you can deviate from the actual cost to serve, but if you go more than 10% rates become less equitable, making San Antonio a less competitive market both for commercial and residential growth.

In Paula's Words:

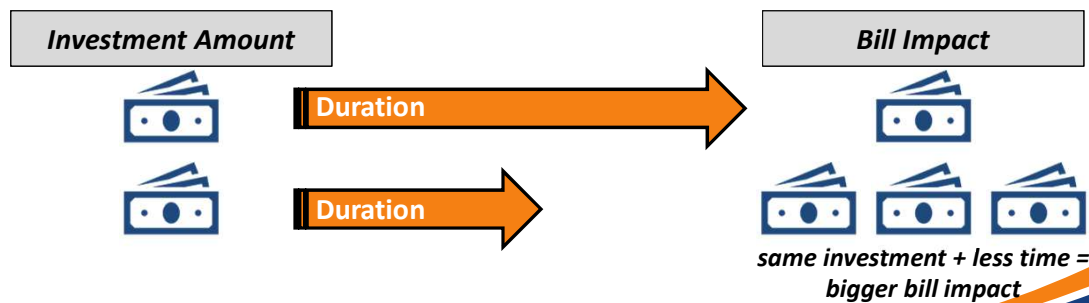
“You figure out what is the cost to serve a group of similar customers all year long and you figure out whatever that is. That’s the hundred percent of the cost and, theoretically, the hundred percent of the cost of it takes to serve that customer is what you need to recover.” [Businesses though, on average, pay a 7% premium (they have a 1.07 cost allocation factor), which allows Residential customers to get an overall 5% discount (they have only a .95 cost allocation factor). It is therefore not right to assume businesses need to also take on more cost for customers who are not paying their bills.]

OUR CUSTOMERS

THE VELOCITY OF CHANGE MATTERS



TODAY & TOMORROW:
As we design the future of our conservation & renewable energy programs, balancing the sequence & timing of investment is important to ensure bills remain *Affordable*.



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Key Takeaway:

Some people say that CPS Energy moves too slow – but that sentiment does not account for the way in which speed can impact bills. We can move faster on renewable energy, conservation programs, plant retirements, but all those actions have bill implications for our customers. If we are not deliberate about the moves we make and how fast we make them, we are ultimately hurting our customers. We cannot do that.

In Paula's Words:

"The faster you do things the more you will cause spikes in a bill."

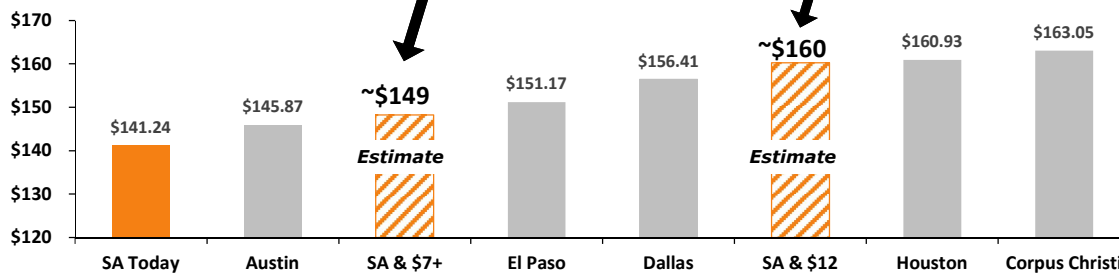
VELOCITY IMPACTS AFFORDABILITY PRELIMINARY ESTIMATE VIEW



Bill Impact of...

**...triple spending
on conservation.**

**...plus accelerating coal
unit retirements.**



Note: Data represents trailing 12 month averages ending August 2020; deregulated markets electric data from powertochoose.org (Terms 12; 4&5 star rated REPs); bills calculated at average monthly usage of 1,000kWh & 5MCF.

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Key Takeaway:

Some high-level estimates of increased velocity in conservation spending and coal plant retirement can have real implications for customers. This slide shows rough estimates indicating tripling conservation spending could add another ~\$7/month and an early coal plant retirement could add another ~\$12/month. With a \$141.24 average monthly bill, that would present customers a 13% increase on expenses, which could have serious implications in one of the poorest large cities in the country.

In Paula's Words:

"Our hesitation hasn't been because we don't want to move forward. Our hesitation is, again, we don't want to adversely, improperly [affect customers] and then accelerate [the] affect on [**Customer**] **Affordability**. In the middle of COVID, I think we have a major responsibility not to do that haphazardly at all. Just because we see one of our pillars that we can improve, we can't sacrifice the other five."

VELOCITY IMPACTS AFFORDABILITY

AGAIN, EVERYTHING COSTS MONEY



THERE WILL BE MORE DISCUSSIONS ABOUT THE IMPACTS OF:

- Energy Efficiency,
- Renewables,
- Storage Technologies,
- Fossil Fuels,
- Customer Assistance Programs, etc.

MORE TO COME...

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Key Takeaway:

The conversation does not end here. We are committed to reducing our own emissions, but we have to be deliberate and thoughtful in our approach. We are committed to energy efficiency. We are committed to renewable energy. We are committed to exploring storage technologies. We are committed to minimizing fossil fuels. But most importantly, we are committed to our customers and our community.

In Paula's Words:

"I've been a customer longer than I've been an employee, let alone the CEO. And I've had very tough times in my family when we have not been able to pay our bills either, and it's been extremely difficult on my family. So I understand, and [at CPS Energy] we are passionate about helping people."



Thank You



Appendix

GLOSSARY / DEFINITIONS (1 OF 2)



Acronym or Word	Definition	Acronym or Word	Definition
Residential	Revenues billed on RE, RA, & RCE Rates	SB	Small Business
RE	Residential Service Electric Rate	PL	Power & Light Electric Rate
RA	Residential All Electric Service Electric Rate	LCI	Large Commercial & Industrial
RCE	Large Use Residential Capacity Energy Electric Rate	LLP	Large Lighting & Power Service Electric Rate

GLOSSARY / DEFINITIONS (2 OF 2)



Acronym or Word	Definition	Acronym or Word	Definition
ELP	Extra Large Power Service Electric Rate	TS & STLT	Revenues billed on Traffic Signal, Streetlight, & ANSL Rates
LPT	Large Power Time of Use Electric Rate	TS	Traffic Signal Service Electric Rate
SLP	Super Large Power Service Electric Rate	STLT	Streetlight & ANSL Rates
Resi + SB	Combined Residential & Small Business	ANSL	All Night Security Light Electric Rate