

# FINAL TRANSCRIPT

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## **DTE - Q3 2011 DTE Energy Co Earnings Conference Call**

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## CORPORATE PARTICIPANTS

**Dave Meador**

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**Peter Oleksiak**

*DTE Energy Company - VP, Controller*

**Nick Khouri**

*DTE Energy Company - VP and Treasurer*

## CONFERENCE CALL PARTICIPANTS

**Kevin Coles**

*Credit Suisse - Analyst*

**Noz Gomwalla**

*BofA Merrill Lynch - Analyst*

**Paul Ridzon**

*KeyBanc Capital Markets - Analyst*

## PRESENTATION

**Operator**

Good day and welcome everyone to the DTE Energy third-quarter 2011 earnings release conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Dave Meador. Please go ahead, sir.

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**Dave Meador** - *DTE Energy Company - EVP, CFO*

Thank you and good morning everybody. Welcome to our third-quarter earnings call. Before we get started, I encourage you to read the Safe Harbor statement on page 2 including the reference to forward-looking statements. With me this morning are Peter Oleksiak, our Vice President and Controller; Nick Khouri, our Vice President and Treasurer; and Mark Rolling, who is our Director of Investor Relations. I also have members of the management team with me that I can call on during the Q&A period.

This morning we'll cover the third-quarter results and the final order we recently received in the Detroit Edison rate case. We'll be at EEI next week and we'll take the opportunity there to update you on our long-term plans, including an early outlook of 2012 operating earnings. We'll provide updates on the growth story of the 2 utilities, as well as Power and Industrial's REF business line, and Gas Storage and Pipelines' Bluestone project. Additionally, we'll provide an update on how we will finance our growth plans over the next several years. Gerry and I will be at EEI Monday so the focus of this call will be on the quarter and 2011.

Let me start on slide 5. We have a disciplined growth plan that will provide 5% to 6% long-term earnings growth per share, which, when combined with our attractive dividend, provides a 9% to 10% total shareholder return. And all of this is always set around one of our north stars which is maintaining a strong balance sheet. Both utilities have robust growth plans. At Detroit Edison the growth is driven primarily by mandated environmental controls and renewable energy. While at MichCon, the growth is driven by infrastructure investments including a long-term cast iron main replacement plan and a program to move gas meters outside of customers' homes.

In Michigan, we are supported by both the 2008 comprehensive energy legislation and a very constructive regulatory structure. And we see it as our responsibility to earn this favorable construct every single day. Utilize continuous improvement capabilities to ensure our utilities are as efficient as possible, and that at the same time, we're minimizing rate increases to our customers.



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This intense focus on continuous improvement has resulted in O&M costs which in absolute terms are lower than 2005 levels. That means, over the last 6 years, we've offset over \$325 million of inflation. This has enabled both of our utilities to earn their authorized returns, and at the same time we've improved operational metrics throughout the Company by holding down rate increases to customers. We continue to see attractive growth opportunities in our non-utility businesses as well, particularly in the Power and Industrial Projects and the Gas Storage and Pipelines. And as I mentioned, we'll take you through their long-term growth plans at the EEI financial conference on Monday and Tuesday.

On the next couple pages, I'll provide an overview of the quarterly results, the rate order and also an update on our guidance. Turning to slide 6 are the highlights from our third quarter. We continue to have a good year and turned in another solid quarter. DTE Energy had operating earnings of \$1.07 per share, compared to \$0.96 in the third quarter of last year. The key quarter-over-quarter drivers include lower earnings at Detroit Edison due to higher planned O&M spend in the quarter. Power and Industrial had one-time non-repeating items last year in the third quarter so earnings this year are lower. Our midstream business continues to provide solid earnings. And Energy Trading earnings are up sharply, driven by ongoing improved economic performance.

With 3 quarters of the year behind us, and the final rate order at Edison now completed, we're confident in tightening our operating earnings guidance for the year to \$3.50 to \$3.70 per share, from \$3.40 to \$3.70 per share. Moving the midpoint up \$0.05. And I have a page on the guidance coming up that we can take you through. The balance sheet remains strong and we will hit all of our goals for the year. Also, we just recently renewed our \$1.8 billion credit line, taking them out 5 years with a nice reduction in fees.

And we received the final order at Detroit Edison, which I will now cover on the next page, which is slide 7. But first, let me set the context for the Detroit Edison rate order. The comprehensive energy legislation which was passed in 2008, had features that were negotiated among all key stakeholders. This included the renewable energy and energy efficiency plans, the de-skewing of business rates for business customers, and a 12-month rate case cycle with 6 months self implementation of rates.

Over the last few years there were several tracking mechanisms added to our regulatory framework, including a bad debt tracker, the storm and restoration tracker, and an electric choice tracker. What probably wasn't contemplated was the complexity of how to deal with multiple tracking mechanisms being modified or eliminated during a period of self implementation. This was further complicated this year by a separate depreciation case at Detroit Edison which was finalized in June.

The good news from a complexity standpoint is that almost all the trackers have been removed. The bad debt, the storm restoration, and choice trackers were eliminated. But we still retain a modified revenue decoupling mechanism at Detroit Edison. So Detroit Edison will be a simpler story going forward, although we do have a couple reconciliation cases to work our way through. And then as a reminder, at MichCon we still have a bad debt tracker and a decoupling mechanism there also.

In the Detroit Edison case, the intersection of the trackers, self implementation and the depreciation case added complexity. And we had one item that we asked the MPSC to relook at this week. And we really appreciate the Commission resolving this in a timely manner. It was related to the accounting treatment of the impact of change in depreciation rates during the self implementation period. There are some other technical issues in the case that we will pursue in a rehearing process, and we'll file for that rehearing in the next several weeks. Beyond that it was constructive order and we look forward to working with the existing commissioners and the new Chairman.

On page 8 is an update on our 2011 operating earnings guidance. Overall we're tightening our earnings per share range by bringing up the lower end of the range by \$0.10 and increasing the midpoint \$0.05 to \$3.60. The lower range for Detroit Edison incorporates the partial year 50 basis points reduction in the authorized return on equity for that utility. We now expect unconventional gas to have a tiny loss for the year as we continue to prove up the oil reserves in the Marble Falls and prepare those assets for monetization. Energy Trading, as I previously noted, is having a very solid economic performance year-to-date, giving us the confidence to move their range closer to historical earning levels. The revised guidance is \$593 million to \$628 million, with a midpoint of \$3.60 per share.

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Now let me pass it over to Peter Oleksiak who will take you through some additional details on the quarter.

**Peter Oleksiak** - DTE Energy Company - VP, Controller

Thanks, Dave, and good morning, everyone. I'd like to start with slide 10 and third-quarter earnings results. For the quarter, DTE's operating earnings per share was \$1.07. I'd like to remind everyone that a reconciliation to GAAP reported earnings is contained in the appendix. Detroit Edison contributed \$0.92. And MichCon, which typically incurs an operating loss in the third quarter, came in at a \$0.06 loss. The non-utility segments combined to earn \$0.27. The drivers for the non-utility second-quarter results were Energy Trading at \$0.13, Gas Storage and Pipelines at \$0.08, Power and Industrial Projects at \$0.07, and Unconventional Gas Production at a \$0.01 loss. Finally, Corporate and Other had a loss of \$0.06 in the quarter.

Let's move on to slide 11 and a summary of the quarter-over-quarter performance by segment. Operating earnings for consolidated DTE Energy are up \$20 million for the quarter. Detroit Edison's operating earnings was \$157 million, down \$8 million from the prior year. I'll cover more details on Detroit Edison in a moment. As noted earlier, the third quarter is typically a loss for the seasonal gas utility business. MichCon had an operating loss of \$11 million, down \$5 million from the prior year. The decrease in earnings was driven by a true-up of the final rate order in 2010, and lower storage revenues in 2011.

Our non-utility segments are up \$23 million, in total, primarily driven by our Energy Trading segment, partially offset by lower earnings at our Power and Industrial Projects. Energy Trading is up \$34 million in 2011, coming off a loss of \$12 million in the third quarter of 2010. The improvement is driven by favorable economic performance and the benefit of accounting timing. As Dave mentioned in his update on earnings guidance, the Trading company is essentially back at historical levels of income with a strong third-quarter performance. For your reference, we've provided our standard year-to-date economic to accounting earnings walk for the segment in the appendix which shows the improved economic earnings in 2011 versus 2010.

Another driver in the quarter-over-quarter performance at the Power and Industrial Projects segment, which was down \$14 million in the quarter. This is primarily resulting from non-repeating earnings last year from the fuel industry fuels tax credit. Lastly, Corporate and Other was up \$10 million from last year, primarily due to lower interest in 2011. We expect this favorability to reverse in the fourth quarter with the timing of tax-related expense.

Page 12 shows an earning loss for Detroit Edison. Again, the Company produced operating earnings of \$157 million for the quarter, a decrease of \$8 million from the prior year. We experienced a \$1 million improvement in margin, driven by self implementation rates recorded in the third quarter, offset by the revenue true-up recorded as a result of the October final order. Even though our electric utilities decoupled, we closely monitor sales levels and the underlying economy for our region.

Overall temperature normalized service area load was up just over 0.5% in the quarter, and close to 1% up year-to-date. Industrial load is up another 2% year-to-date, temperature normalized, driven primarily by the automotive sector. As a note, we had a very hot summer with a lot of storm activity, as did much of the country. But Edison's revenue decoupling mechanism and restoration tracker neutralized those impacts from hitting the bottom line. The primary change in earnings for the quarter is an increase in the timing of planned maintenance O&M expense within our generation fleet. We are still on track to achieve our O&M plans for the year.

That concludes an update on the earnings for the quarter. And I'll turn the discussion over to Nick Khouri who will cover cash flow and capital expenditures.

**Nick Khouri** - DTE Energy Company - VP and Treasurer

Thanks, Peter. As always, improved cash flow and balance sheet strength remains a key priority for Management and Board of Directors. Through the first 9 months of this year, DTE Energy's cash and balance sheet metrics are on track to hit our full-year goals and, in fact, are nearly equal to the historically strong year we saw in 2010.

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Page 14 summarizes our balance sheet metrics. We expect to end this year well within our targeted leverage and cash flow ranges. In addition, we have completed our 2011 funding requirements, including a \$200 million contribution into our pension plan earlier this year. As we've said all along, we do not foresee the need for new equity in 2011. Liquidity remains strong, especially, as Dave mentioned, with the recent 5-year extension of our \$1.8 billion of credit facility.

Page 15 provides an overview of DTE's cash flow in the first 3 quarters of this year, versus the same period last year. Cash from operations at \$1.5 billion was on par with the strong internal cash seen last year. As expected, capital is up compared to last year, which I will detail in a minute. All told, net cash after dividends was a positive \$100 million through the first 3 quarters of 2011.

Page 16 details capital spending. Year-to-date, total capital at DTE is up about 20% or \$180 million from the prior year. Capital at Edison is higher, reflecting an increase in both environmental spending and the acceleration of wind projects in Michigan. As we discussed on our call last quarter, we have accelerated the timing of our wind investments in Michigan. Renewable capital in 2011 is now projected at \$350 million for the full year, up from the original guidance of \$50 million.

Since renewable investments at Detroit Edison are funded with a pre-existing surcharge, the new capital can be supported without an increase in customer rates while still maintaining our balance sheet target. At MichCon, both operational expansion capital is up this year, while non-utility capital is down due to the 2010 equity contribution from Millennium as that pipeline went into service. In summary, DTE's cash and balance sheet targets are on track with year-to-date actuals nearing the historically strong year we saw in 2010, allowing us to accelerate our investment in the renewable portfolio for Detroit Edison.

Now let me turn it back over to Dave to wrap up.

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**Dave Meador** - DTE Energy Company - EVP, CFO

Thanks, Nick. Let me wrap up on slide 18. 2011 is shaping up to be another good year for DTE Energy which is allowing us again to deliver on the commitments that we've made to you. With solid year-to-date results and increased certainty around Detroit Edison, we're narrowing our guidance range for the year and moving the midpoint to \$3.60 per share. We continue to make investments, as Nick outlined in his capital schedules, necessary to drive our long-term growth. And we look forward to sharing our future plans with you in more detail next week at EEI. Gerry and I are scheduled to deliver our presentation at 9.45 on Tuesday morning, and we look forward to seeing many of you there next week.

With that, we would be happy to take your questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Kevin Coles, Credit Suisse.

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**Kevin Coles** - Credit Suisse - Analyst

With the ROE reset, will this impact your ability to grow from '11 into '12 by your stated 6% EPS growth? Or are there some easy tweaks you can do to your current strategy to support the growth?

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**Dave Meador** - DTE Energy Company - EVP, CFO

We'll lay out our 2012 and future growth plans next week. But we're still confident that we can grow 5% to 6% off the base of the original midpoint of this year. If you took \$3.55 forward, we're comfortable with everything that we see right now in the portfolio of businesses. In addition to what we can do at Detroit Edison to hit that objective.

**Kevin Coles** - Credit Suisse - Analyst

Given your rate cases are largely capital-focused, are you going to see about working the Commission or feeling out their interest in trying to build in some longer stay-out periods? That way you can avoid the year-on-year volatility of rate cases.

**Dave Meador** - DTE Energy Company - EVP, CFO

Our sense, first of all, as I mentioned, that our rate proceedings will become much simpler with the removal of many of these trackers. And our general approach and philosophy is to stay out of rate cases as long as possible. We're very sensitive to the impact of rate increases on our customers. So we do everything we can do, including ongoing continuous improvement, to stay out of rate cases.

That said, we are going to be looking, for example, at the gas business. What you see across the country is the majority of what's happening on rates there is related to infrastructure investments. It's pretty common to have infrastructure-related trackers for gas LDCs. That's something we're very interested in at MichCon which would allow us even to stay out of rate cases even further.

But for the most part, at Detroit Edison, I think what you're going to get to over time is it's going to be assets placed in service is going to be the primary issue that we'll be covering off in these rate cases, and that's pretty routine for us. We don't have disallowances. And, as you know, most of the capital here is mandated capital.

**Kevin Coles** - Credit Suisse - Analyst

My last question is on the state 10% by 2020 renewable standard. Will your prefunded renewable energy surcharge fully fund the rest of the renewable program to meet the standard?

**Dave Meador** - DTE Energy Company - EVP, CFO

Yes.

**Operator**

[Noz Gomwalla] Bank of America.

**Noz Gomwalla** - BofA Merrill Lynch - Analyst

Do you mind just giving us an update on the economy and what you're seeing in terms of residential and commercial sales?

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**Peter Oleksiak** - DTE Energy Company - VP, Controller

There's a nice schedule in the supplemental; actually it's on the last page. It gives you your temperature normalized, service area. That's what we look at to get a pulse on the economy. Residential right now is actually flat year-over-year. We're probably anticipating that going forward. That's where a lot of our focus on our energy efficiency is at.

Industrial, we are seeing pick-up this year, around 2% year-to-date. We're anticipating that to continue on. And commercial we're seeing a pick-up, as well. So we're feeling pretty good in terms of a recovery here. And actually when we look at next year, we're looking at roughly about a 1.5% before efficiency growth.

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**Noz Gomwalla** - BofA Merrill Lynch - Analyst

So in the sense that your uncollectible tracker, it was moved into base rates and it was set on a 2011 test year or whatever you filed for the tracker, given that sales have come down, is that concerning at all?

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**Dave Meador** - DTE Energy Company - EVP, CFO

No, we're comfortable with where that is set. And then, just as a reminder, as we go into the heating season we do have a bad debt tracker at MichCon for the gas LDC.

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**Operator**

(Operator Instructions). Paul Ridzon, KeyBanc.

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**Paul Ridzon** - KeyBanc Capital Markets - Analyst

I was going to ask for an update on REF but I guess I'm going to get shot down and told to wait until next week.

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**Dave Meador** - DTE Energy Company - EVP, CFO

Yes. We have some new PowerPoint slides that we'll be talking off of that will make it a lot easier to do than I could do here. We're going to outline where we are on the existing machines and the whole siting construction process. And how we see that ramping up in 2012 and 2013. We'll lay that out in a fair amount of detail next week. The PowerPoints will be out first thing Monday morning.

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**Paul Ridzon** - KeyBanc Capital Markets - Analyst

It sounds like you've made some good progress. Look forward to it.

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**Operator**

(Operator Instructions).

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**Dave Meador** - DTE Energy Company - EVP, CFO

It sounds like we don't have any other questions on the quarter. As you know, we're pleased with where we are in the quarter and for the year. And we're happy that we could tighten the guidance and raise that midpoint \$0.05. And we do look forward to seeing everyone next week. We're booked pretty solid both days.

If you're not scheduled for a one-on-one and you have time to come to our presentation on Tuesday morning, that would be great. As we just mentioned with Paul, we're going to be laying out in more detail how we see the businesses growing over the next several years, including some new detail on the REF business line and an update on the Bluestone project. Thanks for joining us and we'll see you next week.

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**Operator**

That does conclude today's conference, ladies and gentlemen. We appreciate everyone's participation today.

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