Second Quarter 2020 Earnings Call

Company Participants

- Beth W. Cooper, Executive Vice President, Chief Financial Officer & Assistant Secretary
- Jeffry M. Householder, President & Chief Executive Officer
- James F. Moriarty, Executive Vice President, General Counsel, Corporate Secretary and Chief Policy and Risk Officer

Other Participants

- Tate Sullivan
- Brian Russo

Operator: Welcome to Chesapeake Utilities Corp's Second Quarter 2020 Earnings Conference Call. During the presentation, all participants will be in a listen-only mode. Afterwards we will conduct a question-and-answer session. At that time, if you have a question, please press the 1 followed by the 4 on your telephone.

If at any time during the conference you need to reach an operator, please press star 0. As a reminder, this conference is being recorded Thursday, August 6, 2020. I would now like to turn the conference over to Beth Cooper, EVP and CFO. Please go ahead.

Beth Cooper: Thank you and good afternoon, everyone. It is great to be with all of you today. We appreciate you joining us today to review our second quarter and year-to-date results. We trust that you and your families are doing well and staying safe.

As shown on Slide 2, participating with me on the call today are Jeff Householder, President and CEO, and Jim Moriarty, Executive Vice President, General Counsel, Corporate Secretary, and Chief Risk and Compliance Officer. We also have other members of our management team joining us virtually.

Today's presentation can be accessed on our Web site, under the Investors section and Events & Webcasts sub-section, or via our IR app. After our prepared remarks, we will be happy to take your questions. Our focus for the call is to provide insight into our second quarter and year-to-date results, the expected impact of COVID-19 on our business to date, our progress on numerous key strategic initiatives, and our outlook for the future.

Moving to Slide 3, I would like to remind you that matters discussed in this conference call may include forward-looking statements that involve risks and uncertainties. Forward-looking statements and projections could differ materially from our actual results.

The Safe Harbor for forward-looking statements section of the company's 2019 annual report on Form 10-K and our 2020 quarterly reports on Form 10-Q provide further information on the factors, including the risks and uncertainties related to the COVID-19 pandemic that could cause such statements to differ from our actual results.

Now, I'll turn the call over to Jeff to provide opening remarks on our second quarter performance, more details on our COVID-19 response, and some insights again on our outlook going forward. Jeff?

Jeff Householder: Thank you, Beth. Good afternoon, and thank all of you for joining our call for the second quarter of 2020. We achieved solid second quarter results, with GAAP earnings per share of 66 cents, 16 cents above our 2019 second quarter results. As you'll hear later in the call, we didn't escape the impacts of weather or COVID-19 over the first half of the year, but we did find ways to overcome those impacts.

Our entire team of employees has worked hard to not only keep meeting customer expectations for reliable service but also to keep growing our energy delivery businesses. It's remarkable and a testament to the dedication and drive of our employees, contractors and suppliers, that in the face of the

COVID-19 pandemic, our results remained strong and we continue on target with growth projects that will contribute to future earnings.

Let me spend a couple of minutes updating you on our company's COVID-19 experience, as highlighted on Slide 4. You may recall from our Q1 call, we began pandemic preparations in late February, with full activation of our response actions in March. By the end of March, we had about 500 of 1000 employees working remotely, with adjusted technology, procedures and controls supporting our virtual office processes.

We were also working hard to secure PPE for our field personnel and refining the protocols for various field service functions, such as how we would enter an occupied building where the occupants might be sick. We did not see significant expense increases or margin reductions in March as the virus began to spread. Our first quarter results were impacted more by the lack of weather than COVID-19.

That has not been the case in the second quarter. Our coronavirus related expenses have increased, and as businesses closed during the lockdown period, our margins have been negatively impacted. That's been especially true in our Florida gas distribution businesses which served numerous hotel, restaurant and other hospitality industry customers that were for the most part closed during the second quarter.

We saw it coming and responded accordingly. Given the weather impacts in the first quarter, we were already looking at more aggressive management of our expenses. COVID-19, excuse me, elevated those cost reduction initiatives. And while we've achieved significant cost reductions, I assure you we have not cut $1 out of our safety and operational compliance programs.

All of our inspection, maintenance and replacement activities remain unchanged. In fact, we've been able to accelerate many of these activities, along with the construction of our new safety town gas operations training center in Dover. As I reflect on this quarter, I'm purely thankful for the contributions and the positive, can-do attitude of our team to keep Chesapeake Utilities moving forward in these unprecedented times.

I also want to acknowledge our employees' families who provided unconditional support for the Chesapeake team as we continued to deliver essential energy services. We all know that this pandemic has not been easy, especially for parents or grandparents, in addition to a daytime job and the usual stress of running a home, were also a teacher, a daycare worker, recreational coordinator, and all the other childcare functions required when normal activities were suspended.

As our economy begins to reopen and school districts contemplate what education looks like going forward, we're working to structure flexible work schedules for our employees with children to better accommodate their educational and childcare needs.

I'm often asked, when will this end and when will we get back to normal? We've been sending the message to our team that Chesapeake's normal has always been a little different (than) many of our peers -- a little more entrepreneurial, more interested in digging harder to find the opportunities that many overlook, or focused on starting with a customer's interest in mind, solving the customer's problem, and then finding a way to turn a profit on the deal.

I speak frequently to our employees about applying the same perspective to our pandemic response. So I don't know when this will end. We're planning on continuing our current work environment at least through the end of this year, and that will likely extend into 2021.

I am fairly certain that Chesapeake will emerge from this pandemic as a stronger company operationally than we were before we ever heard of COVID-19. In fact, before the pandemic began, we had a business transformation initiative underway to consider the organizational structure, the process standardization, and business simplification required for us to continue to grow on pace with our historic rates and consistent with our recently updated capital and earnings guidance.

In many ways, the COVID-19 pandemic has accelerated this process. We're moving forward on many fronts to improve our technology, our communications with employees, the collaboration across our business units, employee training and development, and working toward greater standardization of business and operational processes.

We've also continued our enhanced focus on safety, and are in the process of developing a formal safety management system across the company. And a couple of years ago we began a concerted effort to address gender diversity at Chesapeake.

Our Women in Energy chapter is very active and we have numerous female team members that have moved into leadership positions. We've expanded that effort to provide greater focus on addressing diversity of race and other issues that affect inclusion and equality in the workplace.

We've also continued to support the communities where we live and work. Chesapeake Utilities was among the first energy delivery companies to suspend customer service disconnects and late fees. We continue to work with customers to offer delayed payment options and budget payment plans as a result of their financial situation. And we'll continue to work with state regulatory commissions on the timing and process to reinstitute more traditional disconnect procedures.

We're also continuing to address the needs of our communities through philanthropy and volunteerism. We've made over $250,000 in contributions to local organizations to aid in the fight against the COVID-19 impact. And Chesapeake has also established a matching program for employee donations to local community organizations. And these contributions are above and beyond our normal giving levels.

As I noted earlier, in the midst of the pandemic, we've continued to execute our growth strategy, including pipeline and distribution system expansion projects, as well as our business development activities. Slide 5 highlights several of the accomplishments that are contributing to both solid quarterly earnings and future growth. We've recently completed the acquisition of Elkton Gas from South Jersey Industries, adding about 7000 new customers and expanding the Chesapeake footprint in Cecil County, Maryland.

Our eastern shore natural gas pipeline construction project in Maryland is underway, and we've recently placed our Florida Callaghan pipeline in service, a month ahead of schedule. Our gas distribution systems continue to add customers at a rate that's significantly above the average growth rate across the country. We announced two new renewable natural gas projects that will support local communities and resolving the long-term challenge and poultry waste disposal and the impact on local waterways in Delmarva.

Despite the unique operating circumstance created by COVID-19, all of our business units remain focused on growth. And at the same time, we're working to manage expenses as a partial offset to COVID-19 impacts. All of these initiatives enabled us to generate strong second quarter performance and to reaffirm our commitment to our 2022 capital and EPS guidance.

Later in our presentation, we'll discuss our major project, margin contributions table, which now estimates $38 million in 2020 and $52 million in 2021 given our announced projects to date.

Turning to Slide 6. Second quarter earnings per share, as I mentioned, 66 cents per share, a 16-cent increase compared to the same period last year. On a year-to-date basis, EPS increased 17 cents a share.

Despite COVID-19, we've grown the company, while managing costs associated with COVID-19, and seeking cost efficiencies on an ongoing basis.

Further, because of COVID-19 and the Federal CARES Act, Chesapeake was able to generate a favorable $1.7 million net income tax benefit due to the carry-back of tax NOLs to years pre-TCGAA. Before the CARES Act, all tax NOLs generated primarily from bonus depreciation and tax versus booked timing differences were required to be carried forward. As my colleague Cooper likes to say, we are pushing buttons and pulling levers, by which he means we are working to manage our costs, taking advantage of favorable tax and regulatory opportunities, restructuring debt to find lower interest rates, closing sales on (our immediate) properties, driving margins where possible, and taking many other actions to continue to deliver both short and long-term shareholder value.

Let me turn the call back to Beth now to discuss in more detail our second quarter results. Beth?

Beth Cooper: Thanks, Jeff. Turning to Slide 7. Net income for the quarter was $11 million, compared to $8.3 million for the same quarter of last year, representing 32% growth. The provisional tax rate was 16% this year as a result of the CARES Act for the quarter, compared to 27% last year. Year-to-date earnings were $39.9 million, compared to $37 million in 2019, representing growth of 7.9%.

The CARES Act, as Jeff mentioned, allowed us to carry back net operating losses in years with higher federal income tax rate, resulting in a benefit of $1.7 million. Before the CARES Act, again, all tax NOLs generated primarily from bonus depreciation and tax versus booked timing differences were required to be carried forward.

In terms of continuing operations, our EPS for the quarter grew by 10 cents per share, while our year-to-date EPS grew by 11 cents per share. These increases in EPS included the negative impact from COVID-19 that we will discuss later on in the presentation. A lot of the same factors driving our quarterly increase also drove our year-to-date performance. Weather was one deviating factor.

On a year-to-date basis, we've had overall warmer temperatures driven primarily by the first quarter. Colder temperatures in the second quarter helped to mitigate some of the (volume metric) reductions experienced in the first quarter, thereby reducing the negative impact on our year-to-date results. During the first quarter, we also recognized gains from several non-essential property sales that offset the weather impact.

Slide 8 summarizes the key drivers of our performance for the quarter as described in detail in our earnings release issued at the end of the day yesterday. Gross margin increased 5.1 million. Three pipeline expansions -- the West Palm Beach County, Florida expansion project, the Callaghan Intrastate Pipeline, and the Delmar Energy Pathways Project -- primarily contributed $1.8 million.

Demand from our oil and gas services increased gross margin by $1.1 million. Favorable retail propane margins, given local market conditions, and as we managed propane supply costs, increased gross margin by 900,000. Natural gas growth from initiating service to new customers added 800,000.

What's interesting is our organic customer growth rates remained significantly above the national average. Our incremental margin growth also for the second quarter closely approximated the incremental margin for the second quarter of 2019. Additional margin from the Boulden acquisition also finally added another half-million dollars.

Expense management resulted in costs increasing just 57% of margin gains while growing our businesses in this new normal. Increased customer consumption due primarily to colder weather during the quarter added $2 million. And finally, the estimated negative COVID impact for the quarter was $3.6 million on a pretax basis. However, the CARES Act tax adjustment allowed for a net operating loss carry-back to earlier periods with higher statutory rates and thereby provided a $1.7 million benefit to net income this quarter.

Moving to Slide 9, gross margin decreased 2.5 million during the second quarter due to COVID-19 reduced consumption, largely in the commercial and industrial sectors as businesses had to shut down or scale back operations in each of our service territories.

Operating expenses increased $1.8 million in the quarter due to costs for personal protective equipment and a pay premium of up to 25% of wages through the end of June for our field teams that were essential and front-facing with our customers.

To date, we have not recorded any regulatory assets for the net COVID-19 expense impact for our Delaware or Maryland regulated operations, nor have we approached the Florida Public Service

Commission regarding a similar request. We are evaluating the fluidity of the situation, the current estimates, and projected impact to determine the best path - the best path forward.

(Page 10) presents more detail on the financial impacts of COVID-19 for the quarter and year to date. The timing of the virus and subsequent slowdown in economic activity and business operations were largely felt in this quarter. As mentioned on the previous slide, our gross margin declined $2.5 million, with $2.2 million of the decline coming from our regulated energy segment. The impact on natural gas transmission and electric distribution operations was minimal.

In our natural gas distribution businesses, we saw volume declines of 6% to 8% for Delmarva Natural Gas Distribution commercial and industrial customers, and 10% to 12% for Florida Natural Gas Distribution commercial and industrial customers.

On a net basis, after the benefit of the CARES Act and lower rates on our short-term borrowings driven by the Federal Reserve's actions, we have estimated the COVID-19 impact for the quarter was 5 cents per share, and on a year-to-date basis, approximately 7 cents per share.

As we've continued to analyze the COVID-19 impact, weather impact and consumption changes for the first and second quarter, we did identify some declines in margin for the first quarter that we now associate with COVID-19. We are continuing to look at our projections as to what the COVID-19 impact could represent in the upcoming six months in regards to reduced consumption as well as reduced expenses.

We will provide refined estimates and future updates as we move through the year. We know that there will be no future impact on the tax side from the CARES Act and any financing implications will ultimately depend on the Fed's actions.

Like all Americans, we are hoping a vaccine can be developed to prevent the spread of COVID-19 and allow the people of this country to return to a more normal way of life. We thought the new normal would last through the end of the first quarter and warmer weather would diminish the virus. Now we are planning on continuing as we are just as Jeff mentioned, at least through the end of 2020.

Safety and security for our employees and customers is a driving factor in how we run the business and will result in higher operating expenses in delivering our essential services. For the better, we found out that most of our staff can telework efficiently and we can delay bringing folks back to the office, reducing travel costs and conference costs. This remote work phenomenon may continue for some teams into 2021, either part-time, some of the times, or full time.

On Slide 11 we highlight those expenses that we see increasing through the remainder of the year and those that we expect to decline year over year. To date, we have done a great job of managing our expenses, and that will continue. As Jeff mentioned, we were already underway in terms of looking at our business processes and how we collaborate across the organization to become more efficient and scalable overall. COVID-19 has allowed us to accelerate our efforts in this regard.

The forecast for 2020 capital expenditures remains on target for approximately $200 million. And that's really just the average of the range that's shown on Slide 12 of $185 million to $215 million. The majority of investment will be in regulated natural gas transmission and distribution projects.

On a year-to-date basis, we have invested $88.4 million. We will continue to monitor our investment progress and update our yearend projection after the third quarter. But we believe we are well on track and any variations would be largely attributable to construction, timing, and be carried over to next year.

As you can see on Slide 13, as of June 30, 2020, total capitalization was $1.3 billion, comprised of 45% stockholder's equity, 32% long-term debt at fixed rate, and 23% short-term debt, including bank lines of credit and the current portion of long-term debt.

Chesapeake has 465 million in bank lines of credit and will have funded $90 million of new long-term debt this summer at an average rate of 2.98%. The company has 300 million of availability under recently renewed private placement shelf facilities for the next three years.

We have utilized our traditional equity plans this year to issue stock and increase our equity beyond our retained earnings through our incentive plans, the 401-k supplement retirement plan contribution, and the dividend reinvestment and stock purchase plan. Over time we have indicated we will move back closer to our target capital structure. Our actions year to date are in line with this.

I would now like to turn the call back to Jeff to discuss our current and future growth opportunities.

Jeff Householder: Thank you, Beth. Turning to Slide 14. Our strategic planning process has long been integral to our growth. In many ways, our current plan for the 2020 through 2022 period mirror the plans we've executed over the past decades. Of course, the level of our growth expectations are somewhat greater these days than they were in 2010, but we have the same confidence that we can execute on investments that are consistent with our long-term strategy.

That strategy is fairly straightforward. Our regulated businesses provide stable, predictable earnings if we manage them correctly, and we've been able to do that over a long period of time. We look for non-regulated investments to augment our regulated earnings that meet three fundamental criteria. We're interested in investments that are related to our core energy businesses, that meet our return targets, and that exhibit risk profiles consistent with our existing non-regulated businesses.

We're disciplined in our approach. We walk past more deals than we execute. One of the ways we've mitigated our non-regulated risk over the years is to link the non-regulated operations to a regulated business. Aspire Energy is a good example. Aspire is a non-regulated gathering system but its primary customers are natural gas distribution operations that we serve under long-term supply agreements that significantly lower Aspire's risk profile.

Over the past couple of years, we've also considered how future investments may contribute to our overall sustainability and ESG objectives. You've seen us acquired Marlin, a company that's working, among other things, to move renewable natural gas from biogas production sources to a pipeline or distribution system. And our recent RNG announcements on Delmarva signal our interest in investing in biogas production and processing, in addition to Marlin fuel transportation opportunities.

We've long sought to provide total shareholder value in the upper quartile of our peers in both short and long-term performance, the product of earnings, dividend growth driven by capital projects that can achieve an adequate return on investment at our prescribed targets.

As Beth noted, our 2020 capital forecast indicates we're still primarily investing in regulated businesses, most notably transmission pipelines and distribution mains to add services to new customers in existing or expanding geographic areas.

We're also comfortable with strategic investments in our unregulated businesses -- propane distribution, oil and gas services, CHP business, and Aspire -- that have many similar characteristics, as I said, to a regulated utility. But they can and have consistently generated increased returns above allowed regulated utility returns.

I know there's a considerable dialogue by several utility companies about divestiture of their non-regulated or midstream regulated assets, but for us, our non-regulated businesses are core to who we are and what we do. They're the means for achieving our higher-than-regulated ROEs and also our EPS growth track record, and frankly, our projected EPS growth profile.

Our largest investment dollars have been dedicated to new pipeline infrastructure on Florida and Delaware. On Slide 15, we highlight those recent pipeline expansions completed and those in flight. The projects recently completed include Eastern Shore's largest transmission project and the Northwest Florida expansion, which expanded Chesapeake's natural gas transmission business to the Florida Panhandle for the first time. Projects underway are progressing nicely.

As I mentioned earlier, we initiated service in June for the Callaghan project, a joint venture in Florida with (Primera Energy) to serve gas needs in Nassau and Duval counties. The Delmar Energy Pathway Project will expand services in Delaware and Maryland, most importantly, bringing natural gas to Somerset County for the first time.

Last year we announced the Guernsey Power Plant Pipeline expansion. Both the power plan and our pipeline, the first major expansion of pipeline services in Ohio, are proceeding on schedule.

Turning to Slide 16. Last December we announced that the company had entered into an agreement with South Jersey Industries to acquire the SJI subsidiary Elkton Gas, which operates in Cecil County, Maryland. We recently received regulatory approval for the acquisition, and as I mentioned earlier, that transaction was completed on July 31st. This acquisition complements our existing portfolio and enables us to expand and grow within our existing business on the Delmarva Peninsula.

I'd like to take this opportunity to publicly welcome the team at Elkton Gas to the Chesapeake Utilities family. Acquiring Elkton Gas is a natural fit for our company and we're excited about prospects for natural gas distribution expansion in this growing area along I-95.

Turning to Slide 17, let me highlight a couple of our recent regulatory initiatives. The Delaware Public Service Commission has approved the sale of our Sharp Propane Community Gas Systems to our (DNG) natural gas distribution unit at the asset's current replacement value, as opposed to book value. The replacement value will become the basis for (DNG's) rate-based additions.

And we continue to work with the Florida Public Service Commission on the Hurricane Michael limited proceeding. We requested a change in base rates to earn a return on the storm-related plan investments we made. We're also seeking a return on and/or recovery of other regulated costs incurred as a result of the hurricane.

We expect this proceeding to be finalized by the end of the year and potentially as early as the third quarter of this year given the current proceeding timeline. Interim rates were established in January, but we've fully reserved all revenue until final resolution of the proceeding.

Slide 18 includes a table of our current key projects and initiatives. For this quarter's presentation, the team has identified key projects for pipeline expansions, virtual pipeline growth via Marlin, acquisitions, and regulatory initiatives.

The estimated key projects are expected to generate $38.2 million and $52 million for the years 2020 and 2021, respectively. The estimated margin represents an increase of $1.6 million in 2020 and $7.9 million in 2021, compared to the estimate we provided at the end of the first quarter. In total, the incremental margin growth on these key projects and initiatives represents 15.5 million for 2020 and 13.7 million for 2021.

We note the additional margin estimates of 1 million in 2021 for renewable natural gas transportation and a margin of 1.2 million in 2020 and 4 million for 2021 now included for Elkton Gas. We've not yet provided margin estimates for the Hurricane Michael regulatory proceeding, which will increase these margin amounts once that proceeding has been finalized.

Now I'll just spend just a couple of minutes talking about our latest project announcements, both of which are in the renewable natural gas space. Slide 19 outlines the relationship between Chesapeake Utilities and Bioenergy DevCo, a leading global developer of anaerobic digestion facilities, that create renewable energy and healthy solar products from organic material.

The project involves removing excess organics from poultry wastes and converting it into renewable natural gas. The resources, excuse me, generated from organic wastes at Bio DevCo's anaerobic digestion facilities in Delaware will become utility-quality RNG once it's processed by our $6 million gas processing plant Chesapeake Utilities Corporation will build.

Eastern Shore Natural Gas Company and Marlin Gas Services will also make incremental investments associated with the transport and receipt of RNG for multiple suppliers, totaling approximately $7 million. These investments include an interconnect facility and additional transport equipment. The RNG will ultimately be delivered through Chesapeake Utilities' distribution systems to its natural gas customers.

The second project we announced is a new relationship with CleanBay Renewables, an (enviro-tech) company focused on the production of sustainable renewable natural gas which will generate greenhouse gas credits, aimed at the vehicle fuel market, and provide Chesapeake Utilities the opportunity to bring additional renewable natural gas to its Delmarva operations. Under the arrangement, Chesapeake Utilities Corporation will transport the renewable natural gas produced at CleanBay's planned Westover, Maryland biorefinery to Chesapeake Utilities' natural gas infrastructure in Delmarva.

You know, I'm always encouraged when we identify projects that include opportunities for multiple Chesapeake business units, in this case, Marlin Gas Services, Eastern Shore Natural Gas Transmission, and our Delmarva LDC, as we show on Slide 20. It's great to see these units collaborate to serve customers' needs.

And further, we're excited to support the critical agro-business industry, poultry production, poultry processing, and grain farmers on Delmarva, while enhancing the environmental sustainability of the Chesapeake Bay, our namesake and origin of (source).

We believe these type projects have further growth opportunities on Delmarva, as well as potentially being replicated in other service territories, as we move to become one of the industry early leaders in transporting renewable natural gas. These projects are also supportive of our commitment to environmental sustainability. And let me turn the call over to Jim Moriarty for a few minutes to touch on many of our ESG efforts. Jim?

Jim Moriarty: Thank you, Jeff, and good afternoon everyone. It is a pleasure to be with you again today. As shown on Slide 21, Chesapeake Utilities is strongly committed to sound governance principles and the highest standards of ethical conduct by all our team members. This is how we work every day.

Our responsibility to operate in a safe and environmentally friendly manner that furthers our stewardship and facilitates sustainable practices is at the center of who we are -- active and informed engagement, which is embedded in our people, beginning with our board of directors and extending throughout the company, could not be more important as we together chart the road ahead.

Our diverse, cross-functional teams closely collaborate on advancing our increasingly vibrant ESG platform, as highlighted on Slide 22. In continuing our bedrock commitment to equity, diversity and inclusion, we have formed the Equity, Diversity and Inclusion, or EDI, Council.

Our vision for the EDI Council is for all our employees to embrace and share their diverse experiences and backgrounds with the mission to help improve the communities we serve and to make us a better company. The EDI Council is central to who we are and who we want to be, and will further enhance the collaboration around our workplace culture that is the engine driving our business.

In keeping with our commitments during the second quarter, Chesapeake Utilities presented a virtual Webinar entitled Women In Utilities, The Extraordinary Everyday By Demonstrating Diversity, which was hosted by CS Week, the largest utility customer service conference in the United States. We support and take pride in recognizing the significant and important contributions of each of our team members.

As another example, on July 10th we had the special opportunity to virtually join together to celebrate National Line Worker Appreciation Day and to say thank you to those who respond around the clock and in some of the most challenging conditions to provide essential energy services to our communities.

We work hard every day to ensure that the communities we serve continue receiving the value and benefits of clean, plentiful, and affordable energy delivery services so that no one is left behind. As Jeff mentioned earlier, our teams are building several environmentally responsible projects, including extending our system to deliver energy for the first time to Somerset County, Maryland. The FERC approved infrastructure project will displace wood chips and fuel oil now being used, and extend the environmental benefits and proven economic potential to a new county in Maryland.

We are also pursuing our partnerships with CleanBay Renewables and Bioenergy DevCo on various RNG projects. We were gratified by a recent study issued by the University of Delaware that explored additional policy considerations for the promotion of RNG development. We are pursuing several other RNG opportunities and look forward to unveiling several new projects as the terms and conditions are finalized.

We are excited about the projects underway by our diverse and engaged teams to reduce the carbon footprint of the communities we serve. Our commitment remains steadfast to take the steps necessary to deliver energy where and when it is needed while continuing to advance our environmental stewardship. I appreciate being with you all today and turn the call back to Jeff for some closing comments. Jeff?

Jeff Householder: Thanks, Jim. Just a couple of final comments. You know, our team is continuing to focus on safety, employee engagement, and growth as we deliver essential services to customers and communities where we work and live. We reaffirm our five-year capital expenditure guidance of $750 million to $1 billion for the years 2018 through 2022 as our strategic planning initiatives come into view for us and as we've outlined on Slide 23.

We also reaffirm our 2022 earnings guidance of $4.70 to $4.90 as we show on Slide 24. The compound average growth rate of 8.1% to 9.6% from earnings from continuing operations for the three years. We believe those growth rates can be achieved in the near term annual results based on our key projects coming online, continued customer growth, and operational efficiencies.

As you can see, we remain well-positioned to achieve our 2022 financial targets. This growth is underpinned by our five-year capital investment plan, with approximately 80% of our investments in utility infrastructure, and cleaner energy solutions like RNG.

This growth is also supported by the continuation of our strategic and sustainable growth in our non-utility businesses. We will continue our track record of delivering for our investors while maintaining a strong balance sheet, ensuring access to capital for growth, and our financial discipline. While the future through 2022 looks bright, we're staying focused on achieving strong results for this year, despite the unique circumstances we find ourselves in.

For closing, let me just thank all of you for participating in our call. And I want to thank all of our Chesapeake Utilities employees for their ongoing commitment to serving our customers, growing our company. We'll be happy now to address any questions you might have.

Questions & Answers

Operator: Thank you. If you would like to register a question, please press the 1 followed by the 4 on your telephone. You'll hear a three-tone prompt to acknowledge your request. If your question has been answered and you would like to withdraw your registration, please press the 1 followed by the 3. One moment please for the first question. Our first question comes from the line of Tate Sullivan with Maxim. Please proceed with your question.

Tate Sullivan: Great. Thank you all and thank you for all the details. And I thought I'd start with the gross margin contribution that you discussed in Slide 18. And besides the RNG opportunity, and you introduced the gross - incremental gross margin for 21 million, what changed with Marlin since we last heard from you? It looks like the gross margin if I looked at it correctly, might have doubled from the year ago. So, is it more states or am I looking at that correctly?

Beth Cooper: So, in terms of, Tate, in terms of how you're looking at that, the second quarter, when you look at Marlin's results year over year, the second quarter of this year tended to be a higher quarter than the second quarter of last year. And that's driven really from several things.

One is Marlin, since we've acquired that business, we've been moving down a path to convert more of their services to where they're - it's aligned with a contract, we're still providing emergency services, but a greater part of that business has shifted to where, you know, we're contracted to provide service and there's a retainer type level of fee that's being charged.

And so that's one of the things that happened for Marlin, as well as just an uptick in the emergency type services. If you look at it kind of on a year-to-date basis, what you can see from Marlin's business is that last year the first quarter was strong coming in, and that's because we had a lot of emergency services in the first quarter of last year.

Marlin is continuing to look for new opportunities in the existing CNG space that it operates in. It's also, as Jeff and Jim both talked about, we've announced these new contracts where Marlin's margin is going to be expanding in the RNG space, and those are two of the projects. We also have some other projects that we're working on in both CNG and also in RNG. And we've also mentioned in the past that we'll be looking for Marlin to expand into the LNG arena hopefully at some point here.

And so we're really kicking on all cylinders. We're kicking within our own footprint as well as a little bit beyond. And you'll see that Marlin has the capacity to continue to expand into all of those areas. Jeff, I don't know if there's anything you'd like to add.

Jeff Householder: No, I think that covered it pretty well. I would say that we certainly, as you indicated, have an interest in focusing on long-term commitments with pipelines and utilities principally engaged in pipeline integrity work, on the maintenance work.

And so that provides an opportunity for us to then have a more stable revenue stream in this business. And we're seeing some pretty significant opportunities come our way. And I think some of the margin increase that you're seeing here is reflective of the marketing work that we've been doing, especially in the Southeast and the Mid-Atlantic with utilities that we know quite well.

Tate Sullivan: Okay, great. I mean that was one very notable theme, and many others, the Marlin strength, given everything else going on too. But within 2Q and the operating income margin and unregulated besides Marlin, were there other - was propane a positive contributor, were there other - because I think it was your highest 2Q operating income margin in unregulated in quite a while as I understand it.

Beth Cooper: Yes, you're absolutely looking at it correctly. I mean, it was a strong quarter. I mean, first off, if you just look at even the COVID impact on that particular segment relative to the overall COVID gross margin impact, out of the $2.5 million of COVID impact, the unregulated segment was negatively impacted by about 300,000.

And really there, Tate, if you dig down and, you know, were to look at under the, you know, under the covers, so to speak, what you would see is that it was a pretty small amount in each of the unregulated, key unregulated, businesses, that being Sharp, our Florida propane operation and Aspire.

So they were pretty much able to overcome the COVID-19 impact. In the case of Sharp and in our Florida propane operation, retail margins have stayed strong. That's been driven partly coming out of the first quarter, and you know, the weather impact, and you know, being able to keep those up, coupled with supply and what we've been able to do there.

The other thing that happened for us is, you'll recall, we, you know, we consummated the Boulden acquisition at the end of the year. And so, Boulden continued to add very strongly, you know, during the quarter.

And so, you know, those were big drivers, some of the bigger drivers. There were some others that were, you know, smaller. But overall, unregulated performed very well. Certainly, the weather in April contributed, you know, with a lot of people being at home, continuing to use gas. And so, overall, unregulated fared very well again during the quarter.

Tate Sullivan: Yes. And just before I jump back in queue, just looking at right on the regulated side and the customer growth figures, I mean, I don't - there's going to be any concern, I know that, but it seems very high for the Delmarva Natural Gas Distribution, that 5% year-over-year. Is that including some of the converted propane customers or a meaningful portion, or is that on organic number?

Beth Cooper: There is some customer conversion activity in there, but it is not a significant, you know, it's not a significant part of it. I mean, we continue to see a lot of expansion, you know, as new developments are being, you know, are basically in the pathway of our distribution system as it's expanding in the beach areas, areas that are north of Dover, Delaware, which I know, but you know, their bedroom communities of Wilmington, Delaware, like the Middletown area, continues to grow and expand.

And so, you know, it's continued to be very strong growth in our Delaware area, in principally those two markets. And so it's driven more by the growth that's happening there than as much as customer conversions. There are some of those, but that's not the driver.

Tate Sullivan: Okay. Thank you, Beth.

Jeff Householder: We're also continuing to see significant growth on the systems in Florida. There's a lot of activity in the Palm Beach area. We've extended, as you may recall, four small pipeline segments, so, peninsula pipeline, out to reach the emerging growth that's west of the existing city limits of west of I-95. So, things are popping in Florida as well.

I might also just take a second and point out, we mentioned the regulatory action on the propane side. We are converting the community gas systems, the underground propane systems, over to natural gas. That's not going to all happen at once. We have a number of those systems scattered across Delmarva serving almost 10,000 accounts at this point.

So you're looking at multiple years before we will get gas, natural gas service in front of all of those developments and start converting them. So you'll see some propane margin erosion as we convert those and natural gas increases. And we are working very hard to obviously replace that propane loss with additional community gas systems on Delmarva as well as propane growth in other places. And part of that was the Boulden acquisition that Beth mentioned (unintelligible).

Tate Sullivan: Okay. Thank you. I'll jump back in queue.

Beth Cooper: Thank you, Tate.

Operator: Our next question comes from the line of Brian Russo with Sidoti. Please proceed with your question.

Brian Russo: Hi, good afternoon.

Beth Cooper: Good afternoon, Brian.

Brian Russo: Hey. Just on the RNG million-dollar gross margin contribution. What specific investment or project is that tied to with Bioenergy or CleanBay?

Beth Cooper: That right now is associated with - is partially associated with the first project that we announced. But all contracts for both projects are not completely done. And so that is a preliminary estimate of the margin impact that will likely, you know, we will come out with a more refined higher estimate for all of those contracts once everything is finalized.

Brian Russo: Okay, got it. And then...

Jeff Householder: It's a - I'll just one thing. It's a combination of things, as Beth said, and we're, as she said, working to refine these contract agreements. We've made, as we mentioned earlier, we're making an investment in the gas processing equipment at that Bioenergy DevCo facility, and so there are margins associated with that. And we're also transporting the gas through Marlin Gas Services. There'll be some investment for new equipment there, and again, associated margins to support those transportation activities.

Brian Russo: Okay. So, just back of the envelope, should we just assume kind of an 11-1/2%, 12% ROE (to back into) what type of - what dollar investment amount yield...

Jeff Householder: I would answer that question but Beth always gets mad at me when I do. So, Beth, why don't you (unintelligible).

Beth Cooper: What I would say at this point, Brian, is, you know, you, as always, should know that, yes, I mean we're going to be targeting a return that's above a regulated LDC return for that business. But what we've not done yet, because, as I mentioned, and Jeff also mentioned this, some of the contracts are still underway.

So we've included some estimates out on some of the investment dollars. And so what I would do is look at what information is out there, make a return assumption like you are at above utility return. And then as we continue to disclose additional investment dollars that are associated with these projects, you can adjust from there.

Brian Russo: Okay, great, understood. And in terms of Marlin Gas, has that - have those services been dispatched in response to the tropical storm?

Jeff Householder: I don't believe that we have dispatched anything directly as a result of that, that I know of. We have, you know, zero -- I shouldn't say zero -- but virtually no impact on any gas system in Florida. And then obviously, as that storm went further north, to Delmarva, we've had no issues that we know of on the Delmarva Peninsula, certainly not in our distribution or transmission systems.

And to my knowledge, we've not dispatched Marlin for any repair or (whole) purposes to any utility that needed it.

Brian Russo: Okay. I was just curious, you know, in the mid-Atlantic or, you know, in the southeast. Yes.

Jeff Householder: Yes. We really haven't seen any substantive damage to any of the gas systems that would require, you know, Marlin to actually dispatch.

Beth Cooper: Right.

Brian Russo: Okay. Understood. And I'm curious, why haven't you filed for deferral of the COVID expenses? Is it because you've done such a good job of offsetting that with, you know, the CARES tax benefits and elsewhere? Is it kind of a - you'd file a net expense impact so you're offsetting that? Just curious.

Beth Cooper: Jeff, do you want me to take that or would you like...

Jeff Householder: Yes, sure. Go ahead. Go ahead.

Beth Cooper: From our standpoint right now, Brian, you know, the situation, as we talked about, has, you know, continued to evolve. You know, I think everybody initially thought, okay, this pandemic, you know, it's going to be this amount of time and then everybody will be back to normal.

And so what we don't, you know, what we want to do is really be able to evaluate the magnitude, we're continuing to work on our projections. We are looking at the organization overall. We're considering the other regulatory filings that are already underway, as well as, you know, other potential changes that might come about as a result of future stimulus packages.

And so, you know, we don't want to be quick to the gate. We want to make sure that we're deliberate, we evaluate what, you know, we think the impact is going to be, and then we'll make the necessary filing. And so, you know, again, it's evaluation, analysis, and looking at the situation overall and as it continues to evolve.

Brian Russo: Okay, understood...

Jeff Householder: And it's certainly, as you indicated, it's a reasonable expectation to believe that regulatory agencies will be looking for a net number. And so, you know, we need to figure out, as do many of our colleagues and utilities across the country, you know, what that net is, you know, what's different that's just due to COVID, versus impacts from weather or other effects.

Brian Russo: On the Hurricane Michael proceedings in Florida, is it on schedule? And what gives you confidence that a conclusion can occur by the third quarter?

Jeff Householder: Well, we have a - it is on schedule. We have a September hearing date that the commission has established. And so there's a conversation going on now between our staff, the Public Service Commission staff, (unintelligible) (public) council, to see if we can reach any sort of settlement agreement that would eliminate the need for that hearing. I don't know that we will get there, but we're getting close to the point where we will begin to prepare for the hearing and just move down the usual track to deal with this issue.

Brian Russo: Okay, great. And then just, you know, taking a quick look at the balance sheet or the cash flow statement, are you retiring long-term debt with lower interest rate short-term debt? Is that part of the balance sheet management plan that you mentioned briefly earlier?

Beth Cooper: Well, I mean, to the extent that, I mean, as long-term debt is getting retired, it's either getting funded through, you know, so to speak, when our balance sheet comes, either through, you know, as you said, current short-term borrowings that are growing, but also at the same time, you know, we're using stocks through our normal channels to also fund things.

So, ultimately, at the end of the day, what I would say, Brian, is there are several different levers that are happening. We have long-term debt that's being retired, we have short-term debt that we're using. We're also issuing $90 million of long-term debt this year. And then we've been issuing some equity that's also moved our equity to total capitalization up since the beginning of the year. So it's all of that.

Brian Russo: Great. And then one last question. You know, when you look at the updated gross margin charts, the projects under development and near completion, and of course the pipeline of potential RNG projects, it seems as if you're already pushing towards the high end of that EPS CAGR through 2022. So, just curious on your thoughts there, and then when we might get, you know, when might you roll over to 2023.

Beth Cooper: Well, I'll start and then I know Jeff and Jim can certainly add some further color around this. But you know, what I would say is we typically will review, you know, we're going through our strategic planning process coming up here as we come into the fall. And so part of that review will include looking at what our capital investment plan looks like over the next five years, looking at what our earnings growth trajectory looks like over the next five years.

And so, you know, what we would likely do is at some point look to, you know, put out new guidance. But I would not expect Chesapeake to go to kind of annual guidance. I think we want to look at it more from kind of a longer-term perspective. But we've not yet decided, you know, what that, you know, when that will be, but we are certainly going to be looking at that as we're coming in this next strategic planning cycle coming up here in the fall.

Brian Russo: Okay, great. Thank you very much.

Beth Cooper: Thank you.

Jeff Householder: Thank you.

Operator: Our next question is a follow-up from the line of Tate Sullivan with Maxim. Please proceed with your question.

Tate Sullivan: Hi, thank you for taking my follow-up. On renewable natural gas. So with the two that you've announced, Bioenergy and CleanBay, and does it - do both those deals in the 1 million in gross margin represent multiple biodigestion facilities or is it one biodigestion? Can you just explain what those two current agreements are?

Jeff Householder: Sure. And we are, as Beth said, we're working to actually finalize the contract agreements with Bioenergy DevCo for the facility at Seaford. We have executed a letter of intent that lays out most of the terms of that deal, but we're still working through some of the details.

The million dollars is a, and again, Beth will get mad at me for saying this, it's almost a placeholder for what we believe will be margins coming from a variety of different sources. We are building a gas processing equipment, as I said, at the Bioenergy DevCo facility, $6 million in investment.

We are ultimately, we'll build the interconnect on the Eastern Shore that we mentioned, $7 million of investment, that will bring gas into Eastern Shore that those margins are not included in that million dollars that'd be in Eastern Shore. We have Marlin investing in a variety of equipment to support the transportation of the biomethane that's come through the processing equipment to that interconnect position and ultimately into our distribution systems on Delmarva.

With Clean Energy, that deal at this point is a fairly significant -- or CleanBay, excuse me -- is a fairly significant Marlin transport operation, but we will be making investments in equipment that will transport that gas. Those margins are really not in that million dollars either.

And so again, we're working to finalize a number of agreements. We wanted to put something out there to indicate, you know, kind of an order of magnitude of where we're going with this. But that represents essentially the Bioenergy DevCo facility, there's the CleanBay facility in Westover, Maryland, and there are potentially a number of other facilities that CleanBay and Bioenergy DevCo are trying to finalize across the Delmarva Peninsula.

So we see a pretty interesting opportunity in front of us investing in potentially gas processing equipment, investing in transportation, either by fuel truck with Marlin, or by pipelines that probably Eastern Shore Natural Gas would install at a number of facilities over a number of years.

And we're just not quite at the point to give you more definitive margin numbers at this point, but I think that will coalesce here fairly quickly, and certainly over the next couple of months I would expect we'll be able to give you a little more definitive information.

Tate Sullivan: No, all the detail is great. And just one follow-up on the community gas systems, Jeff. What was the - was it something that happened the last month that you received regulatory approval to put that...

Jeff Householder: Yes. We - yes. The Delaware Public Service Commission, one of the issues when you have an underground - well, when you have any asset that's being acquired by utility is, you know, how do you actually bring that asset value into rate base into the utility.

And one of the things that's always been a point of contention everywhere I've ever worked, frankly, and every state I've ever worked in, is the purchase of an underground propane asset by a regulated natural gas utility and the conversion of those customers.

And it's been sort of a longstanding tradition that those assets would come in at the depreciated book value of the propane system. And you would basically enter those into the natural gas rate base and you'd begin earning on that level of rate base.

And of course, what actually happens is if you're buying those assets, acquiring them from a propane company, you're going to pay something, you know, closer to a market value for the assets. So you want to be able to bring those assets forward into rate based at that market value if you possibly can.

And what we were able to negotiate and get approved in Delaware is that we'd bring that asset in at the replacement value, if we were building a new natural gas distribution system. So it significantly increases the value of the assets that we're able to put into rate-based and ultimately earn on. It's a pretty significant accomplishment, frankly.

Tate Sullivan: Great, okay. Thank you. Have a good rest of the night.

Beth Cooper: Thank you.

Operator: As a reminder, to register for a question, press the 1 followed by the 4. Mr. Householder, there are no further questions at this time. I will now turn the call back to you. Please continue with your closing remarks.

Jeff Householder: Thank you. And just thank you again for joining us this afternoon and hanging in there all this time. We appreciate your interest in Chesapeake Utilities as always, and we look forward to speaking with you again soon. Goodbye.

Operator: That does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your line.