

Magellan – In The Know: Episode 38

Energising the Future: Sempra's Innovative Infrastructure Journey



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Host: [00:00:14] This is In The Know a monthly investment podcast brought to you by Magellan Asset Management.

Jeff Martin: [00:00:20] Our mission is to build the leading energy infrastructure company in North America. We're incredibly serious about it. We have a dedicated team that spends a lot of time talking about it, and we've organized the business around three growth platforms that are in the most important economic markets in North America. And I think this is a critical point. People rarely understand that utility EPS growth is loosely correlated to GDP growth, right? So, if you want to see utilities that grow faster than their peers, you need to be investing in the markets that are growing the fastest economically.

Host: [00:00:54] That's Jeff Martin, the chairman and CEO of Sempra. An energy infrastructure company delivering the energy needs of more Americans than any other firm in the United States. Welcome to Magellan in the know. In this episode, Magellan portfolio manager Joel Amores discusses Jeff Martin's personal journey from farm life through service as a US Army helicopter pilot to CEO and chairman of a Fortune 500 company. They discuss the importance of Sempra's strong corporate culture and the philosophy that has led to the company generating bond like stability in the face of an energy transition that promises extraordinary future growth. Sit back and enjoy this fascinating exploration of the methodology behind the management of this huge and successful company. But first, here's a warm welcome from Joel Amores.

Jowell Amores: [00:01:51] Welcome to our podcast Magellan in the Know. I'm Jowell Amores, a portfolio manager in the infrastructure team here at Magellan. And with me today is Jeff Martin, chairman and CEO of Sempra, one of the largest energy infrastructure players in North America. With 20,000 employees serving over 40 million customers across the gas and electric utility space, as well as one of the fastest growing LNG terminal networks in the world. So welcome, Jeff.

Jeff Martin: [00:02:19] Hey, first Joel, let me start by thanking you for hosting this podcast. We're always looking for ways to spend time with the investment community and reach new investors, so it's great to

spend time with you. I was going to mention to you that this is our 25th anniversary this year. The company was founded back in 1998 by way of merger with San Diego Gas and Electric and the Southern California Gas Company. Back then, Joel, you recall that we were called Sempra Energy. Today, a quarter of a century later, we're one of the largest infrastructure companies in North America with roughly 85 billion in assets. And in part, it's because we've been successful in not only growing the business but simplifying our business as well. We certainly look forward to spending time with you on today's podcast.

Jowell Amores: [00:02:59] So Sempra has been a portfolio holding for quite some time now. I actually can't recall off the top of my head exactly how long we've had this in the portfolio. But for those lucky enough to have been invested in Sempra since its beginning back in 1998, you'd have enjoyed returns of nearly 1,200% versus 435% for the S&P 500. So that's incredible considering the transformation over that time. Even in 2022, there was a 20% total return for shareholders. Most of our listeners will have heard this before, but Magellan's investment process spends a lot of time assessing agency risk or governance, if you will. So, this is really all about entrusting your hard-earned money with someone that will have your best interests at heart as a shareholder. This is important because for Sempra they're investing \$40 Billion US over the next five years, so about half their enterprise value. And it would be helpful to know how the person overseeing this tremendous amount of capital investment thinks, what makes him tick and how he ticks. Getting to know the steward of our capital and getting a better understanding of his decision-making process. In any case, enough. Enough from me. Let's hear from Jeff. So, Jeff, if you can share with our listeners and tell us tell our listeners a bit about yourself, your background and how you got to where you are today.

Jeff Martin: [00:04:32] I was fortunate to grow up on a farm in western North Carolina in the Appalachian Mountains. That's the largest mountain range in the eastern part of the United States. Thinking about it from an Australian perspective, I might compare it to some of the rural communities you might find in Victoria or New South Wales. I wouldn't trade my upbringing for anything. I've had great parents, three brothers, and I grew up in a household that kind of privileged faith, hard work and the importance of personal responsibility. I would also say that sports played a pretty big role in my life in my early years. In 1979, I recall, was in high school when a lot of Americans were taken hostage during the Iranian revolution. It dominated the news here in the States at that time, and I felt inspired to serve my country. So, I chose to attend the United States Military Academy at West Point. In Australia, Joel, I think the closest parallel might be your Duntroon Royal Military College. In addition to general studies and engineering, the key takeaway from my Academy experience was they really focus on teaching us to serve others first, before they entrusted us with leadership of others.

Jeff Martin: [00:05:40] That discipline of being focused on service to others, or what some people refer to as servant leadership, has been invaluable to my leadership development. And I like to think it's something that's very much present here in the ethos of Sempra. After West Point Joel, I went into the United States Army, I served as an infantry officer, also went to airborne school and went to flight school where for most of my career I flew attack and reconnaissance helicopters in the Army. After about six years of service, I left the military to attend law school at the University of Miami. And before coming to Sempra in 2004, I had worked as a lawyer in private practice as well as an in-house lawyer for a utility, and even worked in several start-up companies, both as a general counsel and a chief financial officer. Hopefully that background of where I came from, my commitment to service and then kind of having a cross discipline background in engineering, public administration and law, I think has probably served me well generally in the business world.

Jowell Amores: [00:06:42] Yeah, West Point is a fascinating place because it's obviously very difficult, the acceptance. I looked it up the other. The acceptance rate's 9%. And you have to be again, you have

to be privileged enough to be nominated by a US congressman. And so, you're taking the elite of the elite. And so, one thing I've always been curious about is the type of experiences that you had there, which I imagine are unique to anywhere in the world and how that's influenced your day to day life.

Jeff Martin: [00:07:20] You know, a couple of things I'll probably mention. This is probably true of anyone that goes in the military service. When you start, you obviously start at the bottom of the totem pole. You get your hair cut short and you go from civilian life into a uniform. And part of it is less about self-discipline, it's more about enduring the discipline that's imposed on you. And the challenge at West Point is it's also a university and you take a very, very high course load, primarily in math and science courses. And everyone that goes there, Joel, has to play a sport. So, I played both football and rugby when I was at the academy, carried a very heavy course load. And then obviously we're managing kind of the difficulties of kind of the military experience. But what was amazing, and I think you touched on this, was I think we started with something close to 1,600 freshmen, when I was there and we graduated 940. So, you have a very high attrition rate, and you probably learn more by the common experience with other really talented men and women. Right? That you go through things together. And I think the key takeaway is always this idea that, by starting on the very bottom of an organization, it teaches you when you go into leadership positions in the future to have a lot of empathy for people at the bottom and make sure that your mentorship and workforce development and the culture you're building are right. So, I don't want to give West Point too much credit, but I certainly think it was a challenging part of my life, to be honest with you. But I think it's really touched me in a lot of ways, both personally and professionally.

Jowell Amores: [00:08:53] I actually think growing up with three brothers myself was probably the more challenging part growing up and probably prepared you well for West Point. But even growing up in western North Carolina seems very interesting to me. I've had the opportunity to be in that part of the country but certainly not growing up and I guess the question I had for that part of your upbringing was what was the one benefit or advantage you had growing up there that most aren't likely to experience elsewhere?

Jeff Martin: [00:09:29] You know, I grew up on a small farm, incredibly mountainous region of the country. And I think it was just this idea that we all had chores. Right. You know, when you grew up on a farm, we had cattle and horses and chickens and dogs and we had, you know, crops. And every one of the boys had a certain number of rows they were responsible for. And you had to go weed the garden and you had to go take care of the animals. Typically, you may know this in the rural communities, oftentimes you have to do that before you eat. So, you typically go take care of the animals at a very early time in the morning. So, I think was a very, very young person, a boy growing up with brothers. I think it was just kind of a very early work ethic and kind of a shared work ethic with your family about making the farm work.

Jowell Amores: [00:10:17] Yeah. And I could see, I could understand how that would transfer really well to, to an institution like, West Point.

Jeff Martin: [00:10:25] The other thing I might mention you might be interested in is at the military academy, they have something, Joel, called the whole candidate score. And typically, when you apply there, you get a certain number of points for having a varsity letter or being the captain of a sport or your GPA. But the number one point giver in the whole candidate score is being an Eagle Scout. So, you have to cross some threshold of like 4,000 points for your application to even be considered to be in that 9% that you referenced. But the number one point score is Eagle Scout, where you are in the Boy

Scouts for a long period of time. You get to the very top of that. And that was one of the things that was helpful that I was also in Boy Scouts and attained the rank of Eagle Scout. You know, you're very, very young at the time, but it was part of that whole ethos of developing a work ethic -- that sense of a civic duty and participating in an organization like the Scouts.

Jowell Amores: [00:11:19] So now that we've got a little bit more about your background, Jeff, I'm curious again about how those experiences influenced and shaped your everyday life. And so, I'm curious to know what your mornings look like. What does the CEO of Sempra do before he heads it into the office? Now my guess is that you get up at 3 a.m. at the latest every day, run a casual ten miles on the soft sands of San Diego and then finish that off with a two mile warm down swim. Is that about right?

Jeff Martin: [00:11:50] Well, I'm smiling because I wish I was that ambitious with my fitness. But I do target between 20 and 25 miles a week of walking or jogging. I think last year I was able to do about 900 miles during the year. So, I take that pretty seriously and I do it in the morning times. And if I'm on my A game, I also do it in the evening. I try to do it twice a day. In fact, I'm going to work out later this evening, but I typically get up around 5 a.m. I think it's that quiet period during the day when my wife and I have developed some routines together and our daughter is still asleep. But to kick off the workday, you usually focus, Joel, on catching up on both the news and the markets digitally, including out of Asia. And I usually read 4 or 5 newspapers a day. I like to read some foreign papers like the FT, obviously The Wall Street Journal, but I also read regional papers where we have utility operations. But it's common for me to either forward news articles to other members of the team, or ask for updates on key matters early in the morning. And I sometimes have early morning calls with stakeholders on the East Coast because they're already further ahead in their business day. And then it's usually a big glass of celery juice every day. And I head to the office about 8 a.m.

Jowell Amores: [00:13:04] Okay. So by the time you get into the office, you've done more than 99% of the population. But thanks for humbling all of us Jeff. So once you come in at 8 a.m., you step into the office. What does your typical day in the office look like? Can you give us some perhaps some insight on what occupied your time today? What were the sort of issues that the CEO of Sempra deals with on a day-to-day basis?

Jeff Martin: [00:13:32] Sure. I typically divide my business day into two parts. It's usually time, Joel, dedicated to working with internal stakeholders, either direct reports or skip reports, and also time set aside for external stakeholders like today's podcast. So as an example, turning to today, I held meetings with our corporate secretary. We discussed action items out of our September board meeting, which we recently held in Houston, and we put together an action plan for our November board meeting, which will be held both here in San Diego and also down in Ensenada, Mexico. The board, I will be taking them on a physical tour of our ECA Phase one LNG export construction site. And that's something they like to do because they really like to personally review safety, risk management and project level business controls. So I usually work that into the schedule with the board of directors. I also met this morning with the head of Human Resources who's right down the hall from me. And the topic of our discussion today was succession planning. So outside of our union workforce, we have succession plans for every employee in the organization with a particular focus on the director, VP and above level. And that's a very comprehensive process that we go through. So, this was her chance to update me on that. That will also be an update item for the board in November. I also have a pattern goal of either having a breakfast or lunch with an executive, either developmentally or to drive a certain business outcome.

Jeff Martin: [00:15:03] And today my lunch was with Trevor Mihalik, our CFO. So, we went through about 15 or 16 different key initiatives we have in the financial house, which was important. And we had some other strategy meetings this morning. But other days, and we'll talk about the A-system we use internally, but I also, even though I'm not on a board of directors of our subsidiaries, I do administer a utility committee meeting every two weeks and also separately on alternative weeks, an infrastructure committee meeting. And this allows me to have a recurring agenda with the leadership teams of the utilities and the infrastructure groups, so that I can have input to some of the business initiatives that they have. And then outside of internal stakeholders, the second part of my daily schedule is, and I try to be fairly programmatic about this in terms of scheduling well in advance who I'm meeting with, is to meet with investors and also officials at the state and federal level. You know, as a very large utility, those state and federal stakeholders are really important. You know, one example would be for your listening audience was last Friday we hosted Senator Joe Manchin here in our offices. And obviously he is the chair of a very important committee in Washington, DC.

Jeff Martin: [00:16:19] He chairs the Senate Energy and Natural Resources Committee. And even though we're not very politically oriented, we believe it's really important to have a cadence with external stakeholders and a lot of that, Joel, falls to the CEO, and it's something I actually enjoy. It gives me the opportunity to promote our mission and how we're helping to improve energy security and access to cleaner and more affordable fuels. In many ways I think of business as a game of addition. You're always looking to bring people around your business that can help the business be successful. You're looking for ways that your business can be more relevant to society. Investors don't want to invest in a business that's less relevant ten years from now. So that's really a focus of our external work. And I think it's also a hallmark of Sempra to have a very intense focus on our strategy and external relations. So as I divide my day, it's usually between internal stakeholders and external stakeholders. I usually finish up sometime around 6 p.m. or 7:00 p.m. in the evening.

Jowell Amores: [00:17:42] So a pretty full day. We mentioned earlier that before, with regards to some of the ethos that you picked up and you developed in West Point. And I'm curious, Jeff, you're a massive advocate for company culture. In fact, you came up with the company's people, priorities, and culture mantra. And I suspect there's a large element of military psyche in this and so with that, I was wondering if you can tell us what that actually means. How does that translate to your employees and how does that manifest into success for the business?

Jeff Martin: [00:18:27] Right. You've always heard that old adage, that culture eats strategy for breakfast and people joke around about that. But we spend a lot of time here at Sempra building a high-performance culture, we think over a long period of time that creates a differential benefit for our owners relative to companies that struggle around culture. And we think it really has created a true competitive advantage for us at Sempra. So when we think about the three elements of a high-performing culture, number one is safety and operational excellence. Number two is leadership and workforce development. And number three is our goal of creating a culture of belonging where every employee understands our mission, vision and values and feels attached to the business. You've got to remember, the majority of our employees today are millennials, and you've got the Gen Xers and the Gen Z's, and most of those people are not looking to join a company. They're looking to join a culture. So, making sure you've got a place where they can have a purpose driven life is important and we certainly spend time on that. The second thing we spend time on it, something that gets me energized is one of the other things you mentioned, which is priorities. And we have what we refer to internally,

Jeff Martin: [00:19:34] Joel, it's not very creative, but we call it our A-system. And annually we create a list of goals around our top five challenges and our top five opportunities. And the thesis is, if you can

solve those challenges, you reduce the likelihood of your business being less valuable. And if you can capture those new five opportunities, you can create real upside to how the business is valued and we refer to these as our five by five goals. And these become my CEO goals that I give to the board of directors. And then the board of directors holds me accountable for these by the end of the year, which impacts executive compensation. But I think what's most interesting inside the A-system is these five-by-five goals, it's created by our top 25 officers working together over a two month period of time. And once you finalize those for the board of directors, then the top eight members of my senior management team create their own five by five goals that intersect the CEO goals. Then it goes further in the organization with our top 25 officers, and then it goes down to our top 300 officers. So, let me explain why this is so important. The average company that's out there in the marketplace is comprised of a lot of well-meaning leaders and employees that try to set the right priorities and do good things.

Jeff Martin: [00:20:53] In contrast, at Sempra, we are constantly creating and working to create what I call a hyper-aligned organization where across the top 300 officers and leaders there's strong alignment around our work priorities and a cadence of meetings to ensure we drive accountability and business outcomes down in the organization. So, a hyper-aligned organization with a high-performing culture over a longer period of time is going to deliver improved financial and operating results. And what we refer to as an intense focus on collective prioritization has allowed us, Joel, to lead our industry in operational performance, like reliability scores in our utilities. We lead in key safety statistics, particularly around weather, wildfire science and wildfire mitigation. And we've also led the entire utility industry recently with a five year EPS CAGR of roughly 11%. So the goal is always to bring people together around people, priorities and culture in a way that benefits society, rewards our stakeholders and delivers differential growth and income to our owners. I think a lot of that comes back to this ideal of a high-performing culture and the ideal of service to others.

Jowell Amores: [00:22:09] That's a lot of interesting information, Jeff, because these are things that we don't typically see in financial statements and reports. So now maybe just turning back towards the business. Jeff, on paper it looks like Sempra is a large regulated utility along with some LNG assets, but it's more than that, right? So can you share with us and our audience what they're actually invested in when they own Sempra stock? Why does this business model make sense and why does this business model work?

Jeff Martin: [00:22:46] I would start by saying that an investment in Sempra, you're investing behind a management team where we're the activist, right? Our job every day is to come to the office and find new and better ways to serve customers and drive value to our shareholders. And it comes back to something we talked about earlier, which is our mission is to build the leading energy infrastructure company in North America. We're incredibly serious about it. We have a dedicated team that spends a lot of time talking about it, and we've organized the business around three growth platforms that are in the most important economic markets in North America. And I think this is a critical point. People rarely understand that utility EPS growth is loosely correlated to GDP growth, right? So, if you want to see utilities that grow faster than their peers, you need to be investing in the markets that are growing the fastest economically. So when you think about it, Joel, someone builds a new residential subdivision. The utility, the incumbent utility, has to extend their transmission distribution franchise to that new residential community. So loosely speaking, over long periods of time, utilities in bigger economic markets with superior economic growth provide the best returns. So, speaking to Sempra, California's the fourth largest GDP market in the world, it's obviously the number one GDP market in the United States.

Jeff Martin: [00:24:09] We have the number one utility footprint between SoCalGas and SDGE in California. Texas, we're the largest pure play T and D business in Texas. In fact, that model, which does not include generation, is the largest pure play T and D model in the United States. And Texas is ranked as the ninth largest economy in the world. And in Mexico we are the largest foreign investor in that country with close to 13 billion invested. It's ranked number 15 in the world on a GDP basis. And most estimates with reshoring and decoupling from China show Mexico moving into the top ten in GDP by 2040. And we're a significant player, as you indicated earlier, in the US LNG export market. But when you put those three GDP markets together, Mexico, Texas and California, it's the third largest GDP market in the world and we have a very strong leadership position. We have a very strong leadership position in each of those markets and that really gives us part of our competitive advantage. These are contiguous markets with incredibly strong economic growth and we have a superior infrastructure position. The only other comment I'd mention to you is, and this just goes to the Sempra mindset, is we don't really think in terms of utilities and non-utilities.

Jeff Martin: [00:25:28] I think in the 20th century that was usually the dialogue that you had with investors, but as an example, we're investing in an electric transmission project in Mexico, we're also building electric transmission in Texas and we're building electric transmission in California. It really boils down to the same skill sets, the same expertise. And all of our businesses target a balanced capital structure and a similar cost of capital. So, whether the revenue model is based on regulated rates of return, the underlying business fundamentals are really the same across all three growth platforms. And then finally, we try to extract efficiencies across all three platforms around people, process, and technology. So the goal is to always ensure we're competing capital internally to deliver the highest returns to drive value to our owners. And I think you can see the benefits of this approach, Joel, we've had this conversation before. Over the last three years we've returned \$5 Billion to our owners in the form of dividends and share repurchases, while also growing our earnings per share on an adjusted basis at an annual clip of roughly 10%.

Jowell Amores: [00:26:36] I guess that answers my follow up question in the sense that this is very much geared towards being a long-term strategy and business model and where we see the benefits over the short term, because you've got to balance that. Now with regards to the business model, again, you've got those three platforms. And if I go back as far as when I started, when I started investing even before Magellan into Sempra, you had a much different business model, different company, not one that I would imagine you'd end up today. Now, I think it was close to two decades ago. You had an energy trading business and then within the last decade you also owned utility assets in South America. And so, I guess my question is, why did you, you've divested a lot of these businesses, businesses that while they made a lot of money, also brought on a certain amount of risk. My question to you is why did you stop with utility assets and LNG and infrastructure pipeline assets.

Jeff Martin: [00:27:51] Well, I would probably say that one of the things, as you described our historical investment strategy, is that we saw the opportunity to move away from some of the volatility that gets injected into your cash flows from commodities. And also we saw that a lot in general in power generation, particularly the concern that you would have stranded investments or be disintermediated by renewables. So I think across that evolution of being Sempra Energy 25 years ago to be in Sempra, we've really completed this transition from an integrated energy company to an energy infrastructure company. And actually, Joel, we go to great lengths today to avoid commodity exposure. So, as you mentioned, we've got a \$40 Billion five year capital plan in our utility investments. We target returns on equity that average approximately 10%. And we're growing rate base at roughly 9% annually. And we expect that growth to continue. And I would tell you, as you follow our earnings calls, we certainly expect that that rate base growth is more likely to go higher than 9% in the coming months and years.

Our rate base today is roughly \$45 Billion, just five years ago it was \$14 Billion. So, it's about a three times increase in rate base over five years. And we have the opportunity, in my estimation, to more than double that by 2030. So that's really industry leading growth on our utility platform. And in contrast, Sempra Infrastructure targets mid double digit equity returns, and of our \$40 Billion capital plan, because we're so efficient with third-party investors and project-level investments, it's earmarked for about 10% of our capital campaign.

Jeff Martin: [00:29:31] But I think as I highlighted, what's really unique for your listening audience, is by avoiding commodity exposure, including minimal exposure to power generation, our transmission and distribution business produces high quality recurring cash flows, practically bond like with lower risk. And in combination, our growth platforms also benefit from strong tailwinds that I think are around energy security and obviously the energy transition. And I think we've talked about this before, but the IEA is forecasting about \$10 trillion of new investments in North America to make the energy transition take place by 2050. And over 50% of those dollars are expected to only be invested in expanding and modernizing the grid. So, I will tell you today, I think our business is undervalued relative to the value of our assets. And over time, I think there's upside in our valuation. There's been plenty of private equity examples where utilities have sold a piece of a transmission business, Joel, at 35 or 40 times. At Sempra, we own 300,000 miles of T&D, it would extend across the United States 100 times, right? So being a big infrastructure owner of transmission and distribution assets reduces risk to our shareholders, increases the recurring nature of our cash flows, gives us exposure to tremendous tailwinds. And I think it has the opportunity to be revalued because of scarcity. There won't be that many new transmission lines built, and the incumbent owners will be the beneficiaries of majority of that future growth.

Jowell Amores: [00:31:12] Yeah, it's something we certainly recognize with your business and hence our large commitment to Sempra shares. And it's always a good reminder of that and especially it's good to convey that to our audience.

Jowell Amores: [00:31:32] Now, as far as looking forward, again, I'm sure like every other CEO in throughout the world, you're expected to have a crystal ball and know what the future looks like. But my question is what do shareholders have to look forward to over the next 10 to 20 years with regards to the Sempra stock?

Jeff Martin: [00:31:56] Well, I've talked about this a little bit, and I think, when you look back, the good news is you'll hear a lot of companies like ours who are issuers of equity that will talk about what they're going to do in the future. And what I'm always pleased to tell people, Joel, is, I'm more than happy to tell people we're going to do what we've done in the past. Right. So, you've talked about having a 1,200% total shareholder return over 25 years. But even in the last three and five years, we've produced really solid financial results. So, I think the thing to look forward to is an investment in Sempra is an investment in a management team that has tremendous rigor around operational excellence and safety, and that should be a foundational consideration for any investor. And at the same time, because we're in these great economic markets, we have the chance to intensely compete capital internally for the highest hurdle rates. And over time, as long as you're maximizing your operating cash flow, right, and you're sourcing equity as cheaply as possible to finance the business, you're going to have the opportunity to outcompete and produce superior returns. So, the game is always, to maximize your results relative to your peer group. And I think we have an interesting capital structure and an interesting business model that should allow us to produce very solid results in the future.

Jeff Martin: [00:33:12] And I think I've made reference to it several times in today's podcast, but there's a unique set of tailwinds in the United States related to this trend toward embracing the importance of

energy security and reliability, the need to make sure that there's an energy transition, which I personally think will take place in a different way regionally all around the country. It will be different in Australia than it is in the United States. But the requirement for more capital and the value of scale and businesses that have the largest platforms, it will provide an incumbent advantage. So I'm very bullish that we have the opportunity to more than double the rate base of our utilities by the end of the decade. I think we can experience similar growth inside of our Sempra infrastructure business. And I don't control central bank policy, but I think when you see this sector return to more of the last three-year mean or five-year mean average for PEs, and you think about the scarcity value of companies like ourselves that sit on top of really, really important geographic areas and have scale and transmission and distribution, I think there's a chance to create a tremendous amount of value through 2030.

Jowell Amores: [00:34:24] We do too. And this is a business that we think generates a significant amount of cash flow, cash flow growth at a very attractive risk adjusted price. Now, you mentioned the utility portion of the business, but you also have a very fast growing Sempra Infrastructure segment, much of which is represented by your LNG assets. Now one thing we always talk about, we talk about the risk averse that we look for in cash flows and LNG being i it's energy tilt is always a concern for most investors and we've seen the global energy dynamics come into effect. So when we talk about that, we're talking about Ukraine, the Ukraine and Russia conflict. And then to a lot of our listeners who have seen it more recently has been the disruptions you've seen in Australian LNG. Now, I guess one question I had was how does this affect your LNG business and how does it affect your ability to generate predictable and reliable cash flows?

Jeff Martin: [00:35:46] Right. I think it's a really wonderful question and it goes back to first principles about our business model. Remember, we talked about our business 20 years ago and the size of our commodity desk. We had one of the largest commodity desks in the world. And I think managing those big, complex businesses in the past, Joel, has made us better risk managers today for our investors. And the way we approach the LNG marketplace is no different than the way we approach an electric transmission line or a pipeline in the United States. And that is to make sure that we look at that value chain from where the natural gas is lifted in the basins, the transportation that's required to get it to a coastal area and then we build the infrastructure. And our preferred model has traditionally been, we use Cameron LNG as an example. We use a tolling model where you'll partner with an oil major who will source the natural gas upstream in the basin. They'll arrange for their transportation, and they'll bring it to my facility. And our facility on one side, on the domestic side, Joel, is a short natural gas position and on the international side, the waterway is a long LNG position. And what we really want to do is put ourselves in a situation where we're going to go into that value chain and we're going to find a piece of infrastructure where we can go get 50 to 60% loan-to-value in project financing. We'll source equity from other partners who have like-minded view of the investment opportunity and we're going to try to generate that mid double-digit equity return off that asset.

Jeff Martin: [00:37:18] We're not taking the commodity exposure. We're not taking the delivery exposure. We're not in the shipping business. Now, the folks that will bring the gas on one side and take the ships and the liquefied natural gas on the other side, they're the ones that have market access in Asia. You have market access in Europe. But the great thing for you and others investors, we're putting dollars in the United States, we're putting dollars in North America and markets that we know and understand. We're not involved in the complexities of Australia at the moment or in China or in Europe. We think there's an opportunity right here in the United States where we have really low-cost natural gas supplies for a very, very long period of time that we can build the infrastructure that unlocks new markets, that allow some of our allies to have improved economic security. They have more fuel choices to displace coal, if they so want to. And here at home, it's improving our trade deficit and it's creating

jobs. Right. So, it's something I think that people that understand the role of natural gas is a natural partner with renewables. The United States has a really important leadership role to play in the world, just as I would submit that Australia does, to make sure that we're providing more fuel diversity to the world so each of these regional markets can move down the energy transition pathway in a more efficient way.

Jowell Amores: [00:38:39] That's great to hear, Jeff. Now we haven't talked about some of the risks you face as a business and clearly there's tremendous growth opportunity as you've just mentioned. Now, I'm curious as to how do you manage those risks as the CEO. I can imagine it's not too different of an approach to managing risk in the military. So again, things that I might throw out is the attention to detail process driven. You know, going through a long checklist. I'm curious to understand how you think about risk and managing such a large enterprise with a lot of growth opportunities.

Jeff Martin: [00:39:19] Right. Well, I would just start to extend your military metaphor. In the military, particularly when you were a commissioned officer, your primary job was to make sure that your unit was prepared to fight and win on the battlefield. Right. And that led to a lot of rigorous training here domestically and some training overseas. And the whole goal was to make sure that you were emphasizing safety process tactics in a way to deliver the outcomes that you were supposed to. So, coming back into a business environment, I always tell folks, Joel, it starts with our governance framework. Our board of directors, as you know, provides oversight of risk management across the enterprise, and we have a shared governance model that ensures that similar oversight of our operating businesses is conducted through our internal boards of directors and their safety committees. So, the tone starts at the top with our board of directors, and we've got a set of board skills at the top that understands all aspects of our business model. And then as management, we incorporate risk mitigation in every facet of our business, whether it's large transactions, developing projects or to the safety of our employees and public, like I talked about in my military training. Throughout all of our businesses, we have incorporated sustainable business practices that are central to the mission that I talked about of being North America's leading energy infrastructure company. In fact, it's our commitment to service and betterment of the communities that we serve that we also think serves the long-term interests of shareholders, not just the short-term interests. And let me provide you with an example. One of the ways that we've incorporated risk mitigation into our business is our approach to climate adaptation. We first look at how climate is changing in the markets that we serve.

Jeff Martin: [00:41:01] Then we identify what might be causing that change, and then we focus on innovation and new technology to address or mitigate that climate change and particularly any adverse impacts to our T&D system. So, take San Diego Gas and Electric, for example. They had a wildfire here in Southern California back in the 2007 time frame, and they made a decision that they were going to be a leader in wildfire mitigation. They've launched programs to enhance vegetation management, built one of the largest weather networks in the world for a utility, they incorporate fire behavior modeling in all their situational awareness, and they invest in technologies that help keep our customers safe. And today, it's recognized as the leading utility not only in the United States, but in the world for the advanced work they've done with meteorology, meteorological technology and making sure they can mitigate fires. In fact, I think there's a number of Australian utilities that have actually worked with SDGE to have kind of some economies of learning because of the wildfires that are also experienced in Australia. So, I think that's part of it is you can't just focus on growth, you've got to focus on growth and producing highly recurring cash flows that are risk adjusted and our sector trades at a 0.6 or 0.7 beta, you know, a 30 or 40% discount to market volatility. And it's incumbent upon us to make sure that we're taking risk out of the system every day and go back to my five by five. We talk about the five challenges

we're facing. Those are usually key risk factors, and it's part of our CEO goals. Every year at the start of the year.

Jowell Amores: [00:42:37] We spend most of our time whenever we're talking to you and the senior management team, we spend a lot of our time talking more about risks than opportunities in that regard. So, something we certainly hold close to our heart. Now, as far as maybe just diving a little bit more into that, when we think about growth and risk, how do you think about balancing the two, growth can open up the business to risks? And we've seen too many examples of companies taking on too much. And then subsequently, you know, what you'll have is stresses on the organization and personnel. And then what we're concerned with is, is the balance sheet. So how do you think about balancing those two aspects?

Jeff Martin: [00:43:24] It's a great question, and I think each of us could go back and think of stories we've seen in the past where companies made commitments they couldn't deliver. And then in an attempt to deliver those commitments, took on too much risk, and that never serves the interests of the investment community. And I think I talked about my rural upbringing before, but one of the things, Joel, you may find interesting that my mother used to always say was she always emphasized to the four boys, you know, to plant a garden, don't plant a field. And I think the moral of that story is that greatness requires focus. So, managing growth is certainly a priority for us. I think you've seen us over the last five years simplify our business model. And I tell people all the time, if you can make the business more simple, it's more valuable, right? It's easier to execute and has less risk associated with it. So, we divested our US Renewables platform, sold our Chilean and Peruvian businesses. We didn't think that was the right risk quotient for primarily utility investors and we recycled that capital back into our US utilities.

Jowell Amores: [00:44:27] So from a capital budgeting dilemma, you know, when you think about funding these growth opportunities, how do you go about, I guess in lack of a better term, picking your favorite child. So how did Sempra allocate the capital towards each of these opportunities? How does Jeff say no to Allen, who heads up the Texas utility business or Justin who manages the LNG business? How do you pick between the two? You make them run a race.

Jeff Martin: [00:44:58] The good news is in our distributed leadership model, if things are going properly, it's Allen is the one that's saying no, or Justin is the one that's saying no inside his organization -- they're managing their own capital opportunities. But you recall, Joel, I formerly served as the CFO of Sempra, and there's always been a constant focus, even before I became CFO, on allocating opportunities that are going to deliver the highest shareholder value. So, we have some of the highest ROEs at our utility businesses ranging from 9.7% at Oncor, 9.8% at Southern California Gas Company, and almost 10% actually it's 9.95% at SDGE. And I would mention that over long periods of time, both of our California utilities have earned, on average, well above their authorized ROEs. So, when it comes to competing inside of Sempra, Sempra infrastructure has to compete with those returns and they typically target equity returns in the mid double digits on a risk adjusted basis. And if they can't meet that, we certainly have plenty of opportunities in our utilities. So, our utilities today comprise over 90% of our \$40 billion capital plan, one that I expect to go up in the coming months. But I think this approach of having a lot of capital discipline and the pressures down in the business units not to bring things forward that don't meet really appropriate hurdle rates. So rarely it's me saying no in a high functioning organization, those CEOs below me should be saying no. But this approach helps us to continue to deliver shareholder value. And I would remind you, we've got a long-term EPS growth rate that we put out on the street of 6 to 8%. And, you know, historically we've been able to beat those numbers. So,

we'd like to believe, you know, across the balance of the decade, we're in great shape with the three platforms we have.

Jowell Amores: [00:46:46] Okay, fantastic. I'd actually like to see you organize a race between Allen and Justin. Justin looks like he's got some weak knees there, so it'd be interesting to see, if not anything, pure entertainment value. Now, would you say this is your biggest challenge in your role, and if not, what is?

Jeff Martin: [00:47:07] You know, I would probably mention a couple of things, one of which is making sure with all this growth, we really have a high-class problem, making sure that we're really, really thoughtful about efficiently financing that growth. And in terms of challenges, I've mentioned a few for you. I think it's common for businesses in our space to focus on growth without the discipline to get their cost structure right. So, for us, we've limited our field of investments to the T&D space. So, we know within the value chain there's a specific part of the value chain that we think is the sweet spot for our investors. So, we focus on that. We limited investments into a very narrow geographic area. We do not invest outside that area and all of our platforms are contiguous. You don't often times see that for companies of our scale. And we're constantly challenging our leadership to use innovation and new technologies to improve cost structure and productivity. So you don't just say you're going to grow O&M at inflation, it's O&M growth minus some productivity factor. And that's a constant dialogue where we use technology and innovation to help deliver that. And then I mentioned this at the outset, but capital efficiency is very important. That's why we work hard to optimize our operating cash flow. Joel, we compete capital internally and we source, and work real hard to source, the most efficient pockets of capital to fund our growth. You've seen that and I've talked about that earlier today with our capital recycling program, our project-level financing and even some of the platform-level financing that you saw us accomplish with KKR and ADIA. And I think over time, financing your business efficiently pays huge dividends. So all that growth is in front of us, I think it's just a good problem to have to be honest.

Jowell Amores: [00:48:48] Yeah. No, we agree with you. Certainly agree with you. So you mentioned about balancing growth and risk. Now, how do you balance long term goals with the pressures of short term expectations? It wasn't too long ago when we had investor activists knocking, pounding the Sempra door. How do you manage those expectations across various stakeholders?

Jeff Martin: [00:49:14] Well, I start, and I say this from my board of directors, as CEO, I'm the lead activist in the organization. So I mean, I really think in a real dispassionate way, the only reason we're here is to be great stewards for your capital. And you don't fall in love with any asset. If someone values an asset higher than you and they're willing to pay for it, we're willing to invest something, right? So I think you come into it with a level of objectivity. And I think historically, this 25-year history that we've been discussing on today's podcast, one of the key lessons we've learned is always, always stay long-term focused. We'll look to under promise and overperform in the short-term and you have to execute quarter-by-quarter. But the quality of our strategy and long-term orientation has been a big part of Sempra's brand over a long period of time in the investment community. And I would mention that our track record over the last 25 years has resulted in delivering total shareholder returns of close to 1,200%, which you noted earlier. And that's significant, more than double the performance of the S&P 500 and the S&P 500 utility index. I would mention in the last five years, we've grown our utility rate base from 14 billion to 45 billion.

Jeff Martin: [00:50:27] There's not another American utility that's experienced that level of rate base growth in the last five years. We've been able to double our adjusted earnings over that period. It's highly uncommon in the utility space and we've grown our adjusted EPS at an 11% CAGR. In part, I think,

Joel, this confirms that we're focused on the right things with our high-performing culture, safety and risk management and the importance of operational excellence, disciplined capital allocation, making capital compete internally. And our main focus is to invest capital in a manner that consistently creates shareholder value. And I think our \$40 Billion five year capital plan should help us do that. We've got projected rate base growth embedded in that plan of 9%. I think that should go up in the future and our expected long-term EPS growth rate has been published at 6 to 8%. So I think you're on to something about balancing it. The goal is not to be a superhero, but over long periods of time to steadily outperform your peers, grow your dividend, take risk out of the business and where possible, continue to simplify the business model.

Jowell Amores: [00:51:35] That's fantastic, Jeff, and it's been a fantastic discussion today. But before we ask you for any final remarks, I have one last question for you. What would you define to be success for this company in in ten, 20 years time?

Jeff Martin: [00:51:51] Yeah. I would start by talking about something that I've been communicating to other investors recently, which is I think our industry is currently in a super cycle of growth that we expect to extend across multiple decades. And I mentioned this earlier, but the IEA expects that over 10 trillion will be invested in North America's energy transition and over 50% of every dollar will be spent on modernizing and expanding the transmission and distribution grid. So I think Sempra's business model is kind of over top of the target currently. And I think when you think about our sector in this higher growth environment, it's a sector that has traditionally grown over the last 20 years at 3%, sometimes 4% EPS growth. I think in the future you're going to see it grow at 5 or 6%. While companies like Sempra, Joel, they're really positioned in the top economic markets and have this high-performing culture that we've talked about, this hyper-alignment around collective prioritization. I think we should have the opportunity to grow earnings per share in the high single digits or better. And when you put that together with today's 3.3% dividend yield, it presents a very attractive total return opportunity. And this is a key point. I don't think it's just for utility investors. I mean, Warren Buffett is fond of saying that he likes to invest in businesses that earn very good financial returns and have the opportunity to deploy a lot of capital. That's the Sempra business model. So, looking across the balance of the decade, we've got a business model that's designed from the bottom up to produce growth well above our sector average, with average or below average sector risk. And we think it's the right formula for success, through 2030. I think there's a high degree of confidence in the Sempra management team that we're going to create a lot of value for our owners.

Jowell Amores: [00:53:35] Thanks so much for that, Jeff. That's been brilliant and we appreciate your time, your valuable time. It's been fantastic.

Jeff Martin: [00:53:42] Well, we certainly appreciate your support and our confidence in our business Jowell. We'll continue to work really hard to deliver on your expectations. Thank you again.

Host: [00:53:52] That was the chairman and CEO of Sempra, a leading North American energy infrastructure company, in discussion with Magellan portfolio Manager Jowell Amores. We trust you've enjoyed this episode of Magellan in the Know. Join us in a month's time for the next episode. For more information on upcoming episodes, visit [Magellan Group.com](https://www.magellangroup.com). slash podcast, where you can also sign up to receive our regular investment Insights program. Thanks for listening.

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