

# Canadian Utilities Limited

## Year End 2018 Results Conference Call

### Transcript

**Date:** Thursday, February 28, 2019

**Time:** 8:00 AM MT

**Speakers:**

**Dennis DeChamplain** - Senior Vice President and Chief Financial Officer

**Myles Dougan** - Senior Manager, Investor Relations

**Conference Call Participants:**

**Patrick Kenny** National Bank Financial (Research) – Director, Equity Research

**Mark Jarvi** CIBC Capital Markets – Director, Institutional Equity Research

**Robert Kwan** RBC Capital Markets (Canada) – Managing Director

**Andrew Kuske** Credit Suisse Securities (Canada), Inc. – Research Analyst

**Jeremy Rosenfield** Industrial Alliance – Research Analyst

**Operator:**

Welcome to the Canadian Utilities Limited Year-End 2018 Results Conference Call and Webcast. As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation, there will be an opportunity to ask questions. To join the question queue, you may press star then one on your telephone keypad. Should you need assistance during the conference call you may signal an Operator by pressing star and zero.

I would now like to turn the conference over to Mr. Myles Dougan, Senior Manager, Investor Relations. Please go ahead, Mr. Dougan.

**Myles Dougan:**

Thank you, Ariel. Good morning, everyone. We're pleased you could join us for our Year-End 2018 Conference Call.

With me today are Senior Vice President and Chief Financial Officer, Dennis DeChamplain; Senior Financial Officer and Controller, Derek Cook; and Vice President, Finance and Risk, Katie Patrick.

Dennis will begin today with some opening comments on our financial results and recent Company developments. Following his prepared remarks, we will take questions from the investment community.

Please note that a replay of the conference call and a transcript will be available on our website at [canadianutilities.com](http://canadianutilities.com) and can be found in the Investors section under the heading Events and Presentations.

I'd like to remind you all that our remarks today will include forward-looking statements that are subject to important risks and uncertainties. For more information on these risks and uncertainties, please see the reports filed by Canadian Utilities with the Canadian Securities regulators. Finally, I'd also like to point out that during this presentation, we may refer to certain non-GAAP measures, such as adjusted earnings, adjusted earnings per share, funds generated by operations, and capital investment. These measures do not have any standardized meaning under IFRS, and as a result, they may not be comparable to similar measures presented in other entities.



Now, I'll turn the call over to Dennis for his opening remarks.

**Dennis DeChamplain:**

Thanks, Myles, and good morning, everyone. Thanks very much for joining us today on our Year-End 2018 Conference Call.

Canadian Utilities announced higher adjusted earnings in 2018 of \$607 million, or \$2.24 per share, compared to \$602 million, or \$2.23 per share in 2017. Canadian Utilities had fourth quarter 2018 adjusted earnings of \$187 million, or \$0.69 per share, compared to \$169 million, or \$0.63 per share, in the fourth quarter of 2017.

Higher fourth quarter 2018 earnings compared to the same period in 2017 were due to strong results in all of our business segments.

Strong earnings for 2018 were driven by our non-regulated businesses, mainly due to improved results in electricity generation, and in Alberta PowerLine.

The electricity generation business benefited from improved market conditions in 2018 as power prices in Alberta averaged \$55 per megawatt hour compared to \$22 per megawatt hour in 2017. The return of Battle River Unit 5 power purchase arrangement was also beneficial for cash flow, and it triggered the recognition of earnings mainly because we maintained high plant availability through our continued operational excellence.

In 2018, our electricity generation business also unlocked hidden value on our balance sheet and generated additional earnings through the sale of the Barking Power assets in the U.K. From a cash flow perspective, the total proceeds received on the sale of Barking Power were \$219 million. We also recognized earnings from this transaction related to the reversal of reclamation costs. With the sale of the Barking Power site to another party, the funds that were previously put aside to help pay for a reclamation for the site were no longer needed and we reversed them, resulting in an upside to earnings in 2018.



The Barking asset sale is consistent with our strategy of selling mature assets and recycling the proceeds into growing areas of our Company. We have more work to do on that aspect of our strategy in 2019. As you know, in September we announced that we are exploring strategic alternatives for our Canadian electricity generation business. We're also exploring strategic alternatives for a sell-down of our 80 per cent ownership interest in Alberta PowerLine.

We're working through these strategic reviews now and may have an update for the market later in the first quarter of 2019.

Canadian Utilities invested \$1.1 billion in Regulated Utilities in 2018. After depreciation and a few other adjustments, that capital investment generated about \$500 million in rate-based growth, or about 4 per cent growth over the last year. This \$500 million in rate based growth is consistent with the guidance that we've provided to the market. But even with this rate-based growth, earnings in some of our utilities were lower compared to 2017. These lower earnings were mainly due to the impact of the rate re-basing and the natural gas and electricity distribution utilities under Performance Based Regulation, or PBR.

With the rate rebasing, we gave up about \$115 million in adjusted earnings in 2018 compared to 2017. This was largely due to re-setting our revenues to match our lower operating cost structure. That lower revenue helps out our customers and was the starting point on January 1, 2018 for us. Our task was to find new operational efficiencies in 2018. We did exactly that, and generated about \$50 million of new earnings growth in those PBR utilities in 2018. Our earnings in the PBR utilities generated strong financial returns on equity of about 11 per cent in 2018. This is about 250 basis points above the approved ROE of 8.5 per cent.

This ROE achievement is consistent with what we told investors we were aiming for this year. These excellent results are due to the hard work of our employees as we've continued our transformation to become an even more efficient organization, and I applaud all of our employees for their great work in 2018.

Going forward, we expect these operational savings to grow and to generate continued strong ROEs, well above the improved rate of 8.5 per cent.



I do have some late breaking regulatory news to share with you. In June of 2018, the AUC initiated a process as the PBR re-opener thresholds were triggered by our electricity distribution and natural gas distribution companies. The AUC had set up a two-phase process. The first phase of the proceeding was to determine if a re-opener proceeding was warranted. Last night, the Alberta Utilities Commission released its decision on this first phase of the reopener provision for the 2013 to 2017 PBR term. The AUC determined that the 2013 to 2017 PBR plan will not be reopened. Based on this decision, our adjusted earnings as recorded in the years 2013 to 2017 are unchanged, and there will not be a second phase to this process.

On the unregulated side of the business, we invested \$800 million in long-term contracted assets, including the acquisition of a hydroelectric power station in Mexico. We invested \$664 million in the construction of the Alberta PowerLine project. This project is ahead of schedule, and the expected energization date has been advanced to March 2019 from the original target date of June 2019. This resulted in the recognition of an early energization incentive in the fourth quarter's earnings.

Going forward, in the period 2019 to 2021, we plan to invest \$3.6 billion in regulated utility and long-term contracted assets in Canada, Australia, and Latin America. These investments will continue to strengthen our high-quality earnings base.

On January 10, 2019, Canadian Utilities declared a first quarter dividend for 2019 of 42.27 cents per share. Canadian Utilities has increased its dividend per share for 47 consecutive years, the longest track record of annual dividend increases of any publicly-traded Canadian company.

All in all, 2018 was a very good year for Canadian Utilities. We overcame significant regulatory headwinds and grew earnings; we increased the dividend, and we've continued on our transformation path. All of these achievements will create long-term value for our share owners.

That concludes my prepared remarks. I'll now turn the call back over to Myles.

**Myles Dougan:**

Thank you, Dennis. I'll now turn the call over to our Conference Coordinator for your questions.

**Operator:**

Thank you. We will now begin the question-and-answer session. In the interest of time, we ask you to limit yourself to two questions. If you have additional questions, you are welcome to re-join the queue.

To join the question queue, you may press star then one on your telephone keypad. You will hear a tone acknowledging your request. If you are using a speakerphone, please pick up your handset before pressing any keys. To withdraw your question, please press star then two. Webcast participants are welcome to click the Submit Question tab near the top of the webcast frame to type their questions. The Canadian Utilities Investor Relations Team will follow up with you by email after the call.

Once again, anyone on the conference call who wishes to ask a question may press star and one at this time.

Our first question comes from Patrick Kenny of National Bank Financial.

**Patrick Kenny:**

Good morning, Dennis, thanks for the update there. Just with respect to rate rebasing, I'm just curious how long you think it'll take to recover the full \$115 million impact. I think you said you've already recovered roughly \$50 million, just wondering how we should be thinking about the rest coming into play here through 2019 and beyond?

**Dennis DeChamplain:**

Good morning, Pat. Thanks for the question. Both of our utilities are kind of well on their way and we had a great start out of the gate. If you look back to where we were in 2017, that was the fifth and final year of that PBR 1 term. We don't expect to get to those levels until—to the back end of the PBR 2 term, which rolls out to 2022. We're on a great path; you know the re-openers for PBR 2 are the same as they were in PBR 1, that's if we exceed 300 basis points for any two consecutive years, or 500 basis points in any one year. Those are the—I'm not going to say the limiters on our returns, but those are items that we keep in mind as we drive our performance forward.

**Patrick Kenny:**

Good, it sounds like you're well on pace there. Then just on the decision to shut off the DRIP here, curious if that relates to any optimism around the sale process here for the power assets, or now with Alberta PowerLine. Can you speak to whether that's related to any confidence in those processes, or is that just purely related to your internal funding capabilities outside of any asset sales?

**Dennis DeChamplain:**

Yes, we launched the DRIP in 2012 when our cash flows were about a billion dollars a year, and we were embarking on the big build investment in the regulated utilities here in Alberta. Since that time, the cash flows have grown to about \$1.5 billion per year, and with our current plans, we don't need the DRIP. It has been suspended; it is not primarily linked to the Alberta PowerLine or the strategic reviews of Alberta PowerLine or the Canadian electricity business.

**Patrick Kenny:**

Okay, great, thanks for that. Maybe last question if I could, just with respect to the election in the spring here. Do you see a potential change in government having any impact or tilting your capital allocation strategy, either back towards Alberta or potentially towards more International? Just wanted to get your thoughts there.

**Dennis DeChamplain:**

I don't think the outcome of the election will influence that geographic diversification. We are heavily weighted in Alberta with over 90 per cent of our assets, and irrespective of the government of the day, our long-term plans will be to look to diversify that regulatory, economic, political risk out of Alberta, so we'll continue with our international diversification expansion.

**Patrick Kenny:**

Okay, that's great. Thank you very much.

**Dennis DeChamplain:**

Thanks, Pat.

**Operator:**

Our next question comes from Mark Jarvi of CIBC Capital Markets.

**Mark Jarvi:**

Good morning.

**Dennis DeChamplain:**

Morning, Mark.

**Mark Jarvi:**

Yes, I just want to touch on the earnings for the natural gas distribution utility. It was up year-over-year; obviously, you had a rebase. Maybe you can just kind of walk through what allows you guys to have that strong performance in that utility this quarter?

**Dennis DeChamplain:**

Well, we've been proceeding with our integration between our transmission and distribution utilities. Those integration savings, they build over time, so you're seeing some of the results in fourth quarter. We also have our efficiency measures that we've implemented, like our aerial meter reading program. Those continue to deliver savings in 2018, and those factors are building with the 2018 fourth quarter results, so you'll see that manifested there.

**Mark Jarvi:**

Okay. Then maybe just quickly on the Alberta PowerLine, you've talked about a sell-down interest. What's the range of the ownership position you want to hold onto, or would you be potentially open to the idea of completely selling your interest in the whole project, or 80 per cent interest?

**Dennis DeChamplain:**

Yes, we're running through the process right now. We're pursuing the shared equity ownership with indigenous communities, so providing them an opportunity. We're also considering the sell-down of the remaining equity, so we'll see what those offers, or what the price is. We can see ourselves going all the way down to zero if that's available.



Either way, ATCO Electric, the electricity transmission company, will continue to operate that line over its 35-year concession agreement.

**Mark Jarvi:**

Okay, thanks.

**Operator:**

Our next question comes from Andrew Kuske of Credit Suisse.

**Andrew Kuske:**

Thank you, good morning. Maybe just the first question is, how could you—maybe give some context on your business development activities at CU and how they've changed over the last five years? Because obviously you've gone from really robust growth in Alberta—and there's still growth in Alberta, but pivoting to explore some opportunities elsewhere around the world, and you've invested capital in other jurisdictions.

**Dennis DeChamplain:**

Good morning, Andrew, thanks. Our BD efforts, as you say, there is still growth in Alberta, and we haven't turned our back on our home province or home country. We have, in our target markets, Australia, Mexico, South America, we do have boots on the ground. We have Managing Directors, essentially, in Mexico and Chile, heading up smaller business development teams, and are active in those markets. So, we're moving out from Calgary and putting the focus in those target markets where we're looking at.

I think that's the big difference over the last five years, where we are out in the marketplace in those areas where we're looking to invest.

**Andrew Kuske:**

Okay, that's helpful. Then, I might have missed it in the MD&A, but the quantum of the PowerLine energization and the shipping incentive; how much was that in the quarter?

**Dennis DeChamplain:**

In the quarter, that was about \$12 million of adjusted earnings.

**Andrew Kuske:**

Okay, that's helpful. Thank you.

**Dennis DeChamplain:**

Thanks, Andrew.

**Operator:**

Our next question comes from Robert Kwan of RBC Capital Markets.

**Robert Kwan:**

Good morning. If I can just come back to funding, just wondering, how much CapEx do you think you can spend per year, excluding the impact of any asset sales, without needing to turn on the DRIP? Then if you can also talk about what an underlying, perhaps slash hybrid, issuance assumption would be in that?

**Dennis DeChamplain:**

Good morning, Robert. Our plants that we have right now, we've got about \$3.6 billion over the three years, if you think our—the equity support for that at 37 per cent is around the \$1.2 billion, \$1.3 billion of equity, our cash flows cover that. We do have additional capacity on our balance sheet for further growth. Our preferred shares take up about 9 per cent of our capital structure. To fund additional expansion beyond that, you alluded to hybrids; we've got about a billion dollars of additional capacity through prefs or hybrids, and should the opportunities arise, then we would look to probably pull the trigger on that type of financing—keeping the DRIP in mind, whether we would turn that back on. But right now, we would probably lean towards a hybrid or a pref offering before turning the DRIP back on.

**Robert Kwan:**

Got it. You've got kind of the balance sheet capacity and the pref/hybrid, as you talked about. I'm just wondering—so you've got the ability to fund, the \$3.6 billion, and you talked about some excess room. I



guess, just recognizing that cash flow is not equity, how much excess per year do you think you could actually fund of growth, and kind of hold the credit metrics you want?

**Dennis DeChamplain:**

We're tight on the credit metrics. S&P's looking for a 15 per cent to 20 per cent FFO to debt; we're below that right now. They know that, and they've seen our plans and are confident in our ability to get back up to the range, so we are tight with respect to additional internal capacity, given those credit metric impacts.

**Robert Kwan:**

Got it. If I can just finish, ATCOenergy, you just really kind of built that back up. I'm just wondering, is it profitable yet, or are there still a lot of upfront costs? But taking a step back, the potential sale of your Canadian power business; is the retail business strategic, then, going forward?

**Dennis DeChamplain:**

We believe the retail business is strategic, I mean, with the connection to the customers here in Alberta. It's a great avenue for us and our brands who are continuing to explore that. Any decision on our strategic review of the power business is likely not to impact the retail business. We are growing that business. I'm going to say we're in third place with market share; we've grown to over 10 per cent of the market, so we are continuing to sign up customers and we're looking to expand the business in 2019 and beyond.

**Robert Kwan:**

Okay, that's great. Thank you very much.

**Operator:**

Once again, if you have a question, please press star, then one. Our next question comes from Jeremy Rosenfield of Industrial Alliance Securities.

**Jeremy Rosenfield:**

Yes, thanks, just a clean-up question on the energization incentive at APL that was recognized in the quarter. I'm just curious if the March 2019 energization is not achieved for some reason, is some of that incentive subject to reversal or repayment in 2019?

**Dennis DeChamplain:**

Good morning, Jeremy. Yes, there would be a reversal of it. There hasn't been any cash yet. At the end of December of 2018, we were 90 per cent complete on the project, and we had always said, the last kind of key risk trigger that we needed to get through was the onset of winter so we'd be able to do our construction. We were able to pass that trigger.

Right now we're about 98 per cent complete that project; we've got maybe 10 per cent of the line left to string. Everything that we know now is still pointing towards our ability to achieve the early energization. Never say never, but we're 98 per cent plus the way there right now.

**Jeremy Rosenfield:**

Okay, I guess that's good news, excellent. If we could just turn to the Pembina-Keephills pipeline; correct me if I'm wrong, but I believe the capital cost estimate has increased from previous disclosure. Could you just clarify that for me and let me know what maybe is causing that cost estimate to move?

**Dennis DeChamplain:**

Yes, we originally estimated it at \$150 million. We're disclosing right now \$200 million. There's been no change, essentially, in the scope of the project. We received bids back from contractors on the work, and those bid prices were considerably higher than what we had baked into the original estimate. We've gone back to the customers; customers are still all right with the costs of the project at the higher estimate. We're working our way through the facility application with the Alberta Utilities Commission, so once that permit is obtained, we'll proceed with the construction, and those costs will go into natural gas transmission's rate base.

**Jeremy Rosenfield:**

Great. Just to be clear, the revised cost of \$200 million is included in the capital plan?



**Dennis DeChamplain:**

That's correct.

**Jeremy Rosenfield:**

Okay. Maybe just one last question, in terms of—there are a few contract extensions on the power side. I think I'm maybe just going to touch only on the Primrose and Rainbow Lake contract in Alberta. If you could just talk about, strategically, in terms of the Alberta power outlook, assuming that you do hold onto your Alberta assets there, what are you thinking for contracted exposure versus market exposure, outlook for the Alberta power market over the near-term, any thoughts you have on that?

**Dennis DeChamplain:**

Yes, that power business was built off the back of our IPP with long-term contracted assets. I think at the end of 2018, including that, we're about 50 per cent contracted. When Sheerness comes off of its PPA at the end of 2020, that 50 per cent contracted, 50 per cent merchant will go to about one-third contracted and two-thirds merchant. For Canadian Utilities, those extensions were good in order to hang on to that contracted component. That's where we're at, and that's why we signed up the extensions.

In terms of the Alberta power market outlook, forwards are still in that mid-50s range for forward power. Capacity market coming online; the terms of that capacity market are just a one-year term, so it's favourable for incumbent generators. We're proceeding with our coal-to-gas conversion plans. We will aim to be the first thermal generator to be completely off—or Alberta generator to be completely off coal, so we're marching down that path in order to extract value from our assets.

**Jeremy Rosenfield:**

Okay, good, great. That's it for me, thank you.

**Dennis DeChamplain:**

Thanks, Jeremy.

**Operator:**

This concludes the question-and-answer session. I'd like to turn the conference back over to Mr. Myles Dougan for any closing remarks.

**Myles Dougan:**

Thanks, Operator, and thank you all for participating today. We really appreciate your interest in Canadian Utilities, and we look forward to speaking with you again soon. Bye for now.

**Operator:**

This concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.