# EDITED TRANSCRIPT

Q3 2017 ATCO Ltd. (TSX: ACO.X, ACO.Y) and Canadian Utilities Limited (TSX: CU, CU.X) Earnings Calls

EVENT DATE / TIME: OCTOBER 26, 2017 / 10:00AM MDT



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Q3 2017 Earnings Call

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### **CORPORATE PARTICIPANTS**

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Anthony Maher ATCO Ltd. and Canadian Utilities Limited - Vice President, Controller

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### CONFERENCE PARTICIPANTS

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### **OPENING COMMENTS**

Dennis DeChamplain ATCO Ltd. and Canadian Utilities Limited – Senior Vice President and CFO

Good morning,

Before we start with your questions I just want to take a couple of minutes to make a few opening remarks, if that's alright with you.

As usual, Anthony Maher and Myles Dougan are with me today. Also on the call is our VP, Finance & Risk, Katie Patrick.

Our Electricity and Pipelines & Liquids global business units performed well this quarter due to continued capital investment, rate base growth and earnings from Alberta PowerLine.

Earnings growth in the third quarter of 2017 would have been even stronger if not for the prior period earnings impact of the Electric Transmission 2013 to 2014 Deferral Accounts Application decision. We also had some lower comparative earnings at ATCO Gas Australia due to warmer weather in 2017 compared to

2016 and some inflation rate adjustments. However, overall our utilities continue to perform well and we expect 2017 to be another good year for them.

In the unregulated businesses, with no new major projects announced, our Structures & Logistics business had another slower quarter. But it's still generating positive earnings and cash flow while we continue to broaden our product offering and further diversify into new market segments, such as education, health and correctional facilities.

We commenced construction on Alberta PowerLine's Transmission Project this quarter. We also closed the issuance of \$1.4 billion of bonds with maturities ranging from June 2032 to March 2054. This represents the largest public-private partnership financing ever completed in Canada.

Continuing with electricity, while our Independent Power Plants continue to operate with high availability rates and minimal unplanned outages, we were not able to realize the same kinds of returns in our forward sales program that we have achieved last year.

We are also busy looking for new business development opportunities in markets where we have a particular focus, such as Australia, Mexico, Chile, Canada and the US.

Overall, we continue with our plan to invest our capital in growing our Regulated Utility businesses, and in growing our unregulated businesses by investing in commercially secured, long-term contracted projects. We have invested more than \$1.2 billion in capital in the first nine months of 2017. 95% of this capital was in assets that earn a return under a regulatory business model or are secured under long-term contracts.

This capital investment is expected to contribute significant earnings and cash flow and create long-term value for share owners.

Now I'm sure you have some specific questions so I will turn the call back to you.

### **QUESTIONS & ANSWERS**

### Structures & Logistics

### What is the general outlook?

We think we will have a better Q4 than Q3 2017 in Structures & Logistics. But with no new major projects announced, our earnings in Structures & Logistics will be lower than in past years. For 2018, a similar year to 2017 seems likely unless we announce new contract wins.

### Is there a lot of opportunity, and what kind of activity level do you see in the sector?

With lower capital spending profiles for many of our natural resource customers and prospects for LNG developments in B.C. on hold, we see lower activity levels in Western Canada. That being said, we are looking at a number of opportunities in other markets, not to the size of a Site C or a Wheatstone, but with potential.

We have a decent lead list of projects we are looking at. Our lead list of potential projects is longer than it was at this time last year. But the sizes of the projects are smaller and the expected profit margins are tighter with stiffer competition. Of course, when we have some material new projects to announce, we will let you know.

### What is driving the tighter margins?

It really is a result of supply and demand, and currently, demand has fallen off for large modular projects. The margins are tighter for the new sectors we are securing projects in such as schools and hospitals when compared to doing work in remote areas.

### Are you looking at any potential M&A opportunities?

Yes, we continue to look for bolt-on acquisitions in markets where we have an existing interest and want to expand our presence or in new regions where we'd like to establish market share.

### **Electricity**

#### What is the latest news on the 400MW Clean Power Call in Alberta?

It is a multi-stage process:

- We participated in the REOI stage.
- We participated in the RFQ; the AESO selected 29 qualifying respondents eligible for the final Request for Proposal stage (RFP) on September 15, 2017 with 10 times the number of MWs called for.
- We did not advance to the RFP stage for the 400MW clean power call.

### Will you participate in the second round and when is that expected?

Yes, we plan to take our learnings from the first call and apply them to the next clean power call. We have not heard anything firm on the timeline for the second auction.

### What is the latest update on your solar projects?

Our proposed 25MW Kneehill solar power facility was submitted in the Negotiated Request for Proposals (NRFP) for 75MW of solar generation and we are awaiting a response from the Government of Alberta.

The government has not yet provided a concrete timeline at this point regarding the results of the NRFP.

### Can you provide an update on the Alberta Power market?

On August 30<sup>th</sup>, the AESO published an update on the capacity market consultations. The Straw Alberta Market or "SAM" 2.0 does not contain significant conclusions because the first three months of the working group focused on process, and developing an understanding of the topics to be discussed.

SAM 3.0 is due to be released in December.

## What do you expect Alberta power prices to look like in the next few years, given the Sundance termination?

Looking at forward prices before and after the Sundance PPA turn back announcement, it appears to have been a short-lived bounce - they settled right back down and are still in the \$44 - \$45 range. The Balancing Pool forecast of about a \$2 increase didn't appear to materialize; we suspect prices will continue to languish in 2018.

### Any update on the Battle River 5 PPA?

Not much has changed here. We do not have any intel on the government's legal dispute with Enmax.

### Any updates on potentially converting coal to gas?

No updates right now; the conversion costs are relatively inexpensive, but we need to see the rules of the capacity market prior to making any final investment decisions.

### Why were Independent Power Plant earnings negative this quarter?

Our Independent Power Plants did generate earnings this quarter. Earnings were lower compared to Q3 2016 due to forward sales and increased business development expenses.

#### Why were forward sales lower this quarter?

The biggest reason is the spark spread. In Q3 2016, the spread was about \$1, whereas in Q3 2017, it was \$14. Therefore, we were not able to realize as much of a profit from this program, comparatively speaking.

### So for 2018, you'd still expect a bit of a drag on earnings from your forward program?

It is possible, but it depends on how much we are hedged and how far out we are hedged.

### How much capacity do you hedge, and has this program increased?

Due to the competitive nature of that information, we prefer not to disclosure our hedging capacity and strategies. However, we have grown this program and are hedging more than we historically have.

## What would IPP earnings have looked like without the business development expenses, and do you expect them to remain at this level going forward?

I don't have a specific number, but yes, we've definitely ramped up our business development efforts. IPP earnings in third quarter would have probably been in the mid-single \$million digits without these business development costs.

### Accounting wise, will you be able to retroactively capitalize these business development costs?

Under IFRS rules, there is a point where you can begin capitalizing if the project seems reasonable. We need to meet specific accounting criteria before development costs can be capitalized.

### Is there still potential for you to build Inter Pipeline Ltd.'s cogeneration gas plant?

We've recovered all our costs from that project, and it is no longer an active file for us.

### Is the \$1.4 billion of Alberta PowerLine's debt the gross amount, or your share?

The gross amount of Alberta PowerLine's debt is \$1.4 billion. We own 80% of Alberta PowerLine.

### Is the debt to capitalization split for APL about 85%-90% then?

Yes that is a good estimate.

#### Is Alberta PowerLine still tracking to cost and in-service date?

Yes, we are still tracking to cost and in-service date. The route that was approved was longer than the route that was submitted in our initial bid. This increased the total cost of the project.

Alberta PowerLine has a lump-sum turn-key contract with Valard, our EPC contractor, and therefore any additional costs will be their responsibility, so Alberta PowerLine will be kept whole.

## What is the accounting treatment for Alberta PowerLine, given it is a service concession arrangement?

We earn a margin on our construction and O&M activity, therefore, even though it is not yet in service, we earn a return based on the overall margin for the entire project. We build up a receivable until the project goes into service, and then we draw down the receivable over the next 35 years as we bill and collect from the AESO.

### Is interest capitalized or expensed?

Interest is part of our regular debt expenses, and is a flow-through cost that is added to our margin.

### Pipelines & Liquids

## What was the earnings impact of the warmer weather in Australia, and do you expect it to continue into Q4?

About \$3 million; in Q3 2016, the average temperature was 18 degrees, whereas this quarter it was above 19 degrees.

With respect to Q4, natural gas companies tend to experience more volatility in the shoulder season, so I'm not sure what the weather impact will be but we don't expect it to have as much of an impact as Q3's weather did.

## Can you provide some more detail on the inflation adjustment in your international natural gas distribution business this quarter?

We forecast inflation quarterly, and then true-up our forecast once the actual inflation is announced. In Q2 2017 we estimated slightly higher, and therefore took a \$3 million earnings hit with the true-up this quarter. Our estimate for Q3 2017 inflation was slightly lower than the actual.

### What are the cost savings you realized in 2016 in your storage & industrial water business?

In Q3 2016, we sold our Kisbey gas plant, and were able to book a considerable upside into earnings last year when the potential liabilities associated with those assets came off our balance sheet. This year we don't have that same upside.

### Regulatory

### What impact did ATCO Pipelines GRA decision have?

The biggest element was the change in depreciation rates from what we filed versus what was approved. Depreciation rates reverted back to where we were before interim rates. There was no material earnings impact for the year 2017.

### Can you provide an update on Electric Transmission's 2018 to 2019 General Tariff Application?

We were hoping to have a hearing in Q4 of this year, but due to the volume and complexity of intervener requests that we received, the hearing will probably take place in Q1 2018. So we'd expect to receive the decision about six months later; sometime in the second half of 2018.

### What about PBR 2.0?

Last year the AUC set out the rules of engagement for PBR 2.0. We filed our application in Q2 2017, and in Q3 2017, our distribution utilities participated in an oral hearing. Since then we've received arguments, and we are currently preparing to submit replies. We expect a decision in early 2018, which will set rates effective January 1, 2018.

### Do you expect to achieve higher than the 8.50% ROE from your PBR utilities?

With PBR 2.0, we have a lot of levers such as the efficiency carryover mechanism from the first PBR that gives us a 50 bps adder to the 2018 and 2019 ROE. The productivity factor is also lower in PBR 2.0. The AUC includes these levers to incent us to look for further operating improvements.

We will remain focused on reducing costs, and to continue to perform better than the regulated rate, but in the early years of PBR 2.0, probably not to the extent we have seen in the past.

### Can you provide an update on the GCOC decision?

We expect a decision sometimes in the second half of 2018.

The jury is out on how it will impact our distribution utilities under the new PBR 2.0 framework until the final rules for PBR 2.0 are received in early 2018.

The other potential impact is whether the income tax methodology changes from current tax to future tax. While a change to future tax could result in higher cash flows to our utilities, it would result in higher rates to customers in the short to medium term. We are therefore unlikely to advocate for any change to the current methodology.

#### What about the Utility Asset Disposition?

Our suggested changes are to provide for the recovery of prudently incurred costs. Currently, if it's an extraordinary retirement, that cost goes to shareowners, not customers. In the meantime, we do not think there is a large regulatory risk. These types of exogenous events such as wind, fire, etc. are included in our forecasts and put into deprecation rates when we do in-depth studies.

### Corporate & Other

### Has ATCOenergy progressed in terms of metrics, hurdles and benchmarks?

We do not separately disclose our retail earnings yet. As with any start up, it will take a couple years to get a critical mass in order to turn a profit.

### What is ATCOenergy's service area, and does it supply both gas and electricity?

Our service area is all of Alberta, and yes, we supply both.

### Is ATCOenergy going to be used to help/backstop your power generation business? Or solely retail?

It will be helpful for sure, for our power generation business. However, we sold our customer list over a decade ago, and we are getting back into that business for the customer connection and customer service aspects as part of our larger company strategy to become more customer focused.

### Where are you in your cost savings initiative?

We are still progressing forward. The major rationalization was completed in late 2015, and our next step will come as an upgrade to our back-office IT systems. We will continue to evaluate processes across the organization with the goal of streamlining and finding synergies. We were hoping for Q4 of 2017, but this IT upgrade has been delayed to the first half of 2018.

### **Finance**

### Are you updating your capital allocation funding and dividend policy given the S&P downgrade?

There is no change with respect to our capital allocation or dividend policy. We took note of S&P's FFO-to-debt requirement, and are carefully considering that as we sanction new projects.

### Your dividend payout ratio is at the top end of the range, do you plan to continue that?

We are proud of our long track record of annual dividend increases. We continue to emphasize that track record. We will be reviewing our plans in Q4 in preparation for making a recommendation to the Board of Directors on the dividends.

### **Global Expansion**

### What business development opportunities are you currently exploring, and in what markets?

We are continuing to look for bolt-on acquisitions for Structures & Logistics. We are exploring new opportunities in our desired markets of Canada, Australia, Mexico, Chile and the US that align with our strategy.

#### Can you provide an update on the Tula cogeneration plant in Mexico?

No update on the Tula cogeneration plant, we are still activity working with Pemex on the file.

#### Can you provide an update on the Tula pipeline in Mexico?

No update on this project. We are still working on resolving the land access issues.

### What is your focus for growth in Chile aside from expanding the existing Structures business?

Ideally, we would like a small distribution utility company. The connection to the customers is great for us; there is growth opportunity on the distribution side. We would use this distribution business to gain critical mass, and execute a similar strategy as we did in Australia when we acquired ATCO Gas Australia.

### What is your outlook on Australia?

We are quite keen on Australia; we have critical mass, rule of law, and regulatory environment on our side. There continues to be opportunities which our business development guys are chasing. We are hopeful that they land something in the near future.

### Does the FX rate increase your appetite for acquisitions outside of Canada?

The FX rate has incrementally helped some of the projects we are looking at, however nothing has materially moved into the money as a result of the FX rate.