Canadian Utilities Limited
Second Quarter 2019 Results
Conference Call Transcript

Date: Thursday, July 25, 2019
Time: 8:00 AM MT
Speakers:
Dennis DeChamplain
Executive Vice President and Chief Financial Officer
Myles Dougan
Senior Manager, Investor Relations
Operator:
Welcome to the Canadian Utilities Limited Second Quarter 2019 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 Second Quarter 2019 Conference Call. With me today is Executive Vice President and Chief Financial Officer Dennis DeChamplain, and Assistant Controller John Jeffery. 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 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 Canadian securities regulators.

Finally, I’d 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, everybody. Thank you all very much for joining us today on our Second Quarter 2019 Conference Call.

Canadian Utilities announced adjusted earnings in the second quarter of 2019 of $126 million, or $19 million higher than the $107 million in the second quarter of 2018. Second quarter earnings growth was due to the favourable impact of electricity and natural gas transmission regulatory decisions, as well as ongoing growth in the regulated rate base, earnings growth in the hydrocarbon storage business, further cost efficiencies, as well as income taxes.

During the quarter, we also entered into definitive agreements to sell non-regulated electricity assets. In May 2019, Canadian Utilities entered into definitive agreements to sell its entire Canadian fossil fuel-based electricity generation portfolio for aggregate proceeds of approximately $835 million, subject to customary closing adjustments. The sale will occur as three separate transactions. The transaction for Canadian Utilities’ 50% ownership interest in the 260 megawatt Cory Cogeneration Station closed in July 2019. The remaining two transactions, one for 10 partly or fully-owned natural gas-fired and coal-fired electricity generation assets located in Alberta and British Columbia, and the other for Canadian Utilities’ 50% ownership in the 580 megawatt Brighton Beach Power joint venture in Ontario, are both expected to close in the second half of 2019.

In June 2019, Canadian Utilities, along with its partner Quanta Services Inc., entered into definitive agreements to sell Alberta PowerLine Limited Partnership through a competitive process for total proceeds of approximately $300 million, and the assumption of approximately $1.4 billion of APL debt. As part of these agreements, Canadian Utilities is offering an opportunity for Indigenous communities along the transmission line to obtain up to a 40% equity interest in Alberta PowerLine. The final ownership mix will be determined upon close of the purchase opportunity for Indigenous communities. Canadian Utilities will remain the operator of APL over its 35-year contract with the Alberta Electric System Operator. The sale is expected to close in the fourth quarter of 2019, subject to receipt of regulatory approvals and satisfaction of other customary closing conditions.
On the utilities side of our Company, we received several regulatory decisions this quarter. As a result, we generated higher earnings in the quarter due to the favourable impact of the electricity transmission 2018 to 2019 general tariff application and natural gas transmission 2019 to 2020 general rate application decisions.

Going forward, we continue to execute on our $3.6 billion capital investment plan over the next three years. We remain focused on building a globally diversified portfolio of utility and energy-related infrastructure assets, leveraging the breadth and depth of our energy expertise in the Alberta market.

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

Myles Dougan:
Thank you, Dennis, and I'll turn the call over to our conference coordinator now for questions.

Operator:
Thank you. We will now begin the question-and-answer session. In the interest of time, we ask that you to limit yourself to two questions. If you have additional questions, you are welcome to rejoin 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 on the Submit Question tab near the top of the webcast frame and type their question. 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 then one at this time.

Our first question comes from Linda Ezergailis of TD Securities.

Linda Ezergailis:
Thank you. I’m wondering if you could help us navigate this Australia access arrangement for ATCO gas down there. You provided some helpful context in your MD&A, but I’m just wondering how we
might think of the magnitude of the reset starting next year and some other moving parts with respect to other rebasing related to demand and throughput.

**Dennis DeChamplain:**
Good morning, Linda. Thanks for your question. We can’t say right now what the impact will be on 2020 because we won’t be getting the final decision until September/October timeframe. What I can say is that Australia will be subject to the binding rate of return guidelines that are out right now. If you were to take a look at the risk-free rate, and I’ll say right now, the relative return on equity will drop from 7.15% that we have right now to about 5.15%, or a 200-basis-point drop in the ROE. For Australia, a 100-basis-point reduction results in about a $7 million per year earnings impact. That’s part of the reset. But that risk-free rate is not finalized yet. That will be finalized between now and the decision, so it can move.

With regards to the other aspects of your question, with regards to throughput and demand, that will come out in that final decision right now. Bear in mind that over the recent past Australia has been performing about 300 basis points over and above the approved return, and as we saw with the Alberta PBR utilities, when they came out of their first generation five-year PBR term, the outperformance was a little bit lower than what they had recently experienced, just given the nature of the reset on the operating costs and capital. So, we would expect some of that 300-basis-point historic outperformance to be eroded slightly going forward, but, again, we can’t say for certain until we get that final decision later on this year.

**Linda Ezergailis:**
Helpful context, thank you. Moving on to something maybe a little bit more aspirational, prospectively, in Western Canada, I see you’re going to be adding another 19 EV charging stations in 2019 and 2020. Can you comment on the rationale? Is it more of a strategic toehold that you want to establish to understand the possibilities there, are they already economic on a standalone basis, and what might be the ultimate potential of that foray into the EV world?
Dennis DeChamplain:
This is what we call a very small project and, as you say, dipping our toe into it. We really believe in the future electrification of transportation industry and getting our experience with the EV stations here in our home province will be a good foundation for future growth and opportunity in that market as we move forward, but it's not going to be a big money-maker for us, that's for sure, our first 20 stations.

Linda Ezergailis:
Okay, thank you.

Operator:
Our next question comes from Ben Pham of BMO Capital Markets.

Ben Pham:
Okay, thanks. Good morning. Some of the tax benefits that you booked during the quarter in both regulated and non-regulated, I'm just curious on the regulated side. Can you remind me, is that going to be a flow-through benefit to your customers eventually, or are you going to keep some of that upside in the PBR regime?

Dennis DeChamplain:
Good morning, Ben. The upside in the regulated companies comes from accelerated capital cost allowance measures that were introduced by the Government of Canada and enacted in April of 2019, so it is kind of a go-forward benefit to us, and that upside is not passed on to customers through PBR 2.

Ben Pham:
Okay. So, your realized ROE that you had expected the beginning of the year, it looks like there’s certainly some nice upside potential from that.

Dennis DeChamplain:
Yes, that helps both our electricity distribution and natural gas distribution companies, and that goes to, as we’ve been saying, restock the savings shelves and the earnings opportunities. So, that would help us get back to—well, actually, we kind of already are at the first trigger of 300 basis points two years in
a row. Bear in mind that neither of those companies exceeded 300 basis points last year, so 500 basis points is not in the cards for either of those two companies this year, so 2019 will not, in our estimates right now, result in a reopener for either of those companies.

**Ben Pham:**
Got it, that's great, and my second question, maybe with your assets sales on the power side and maybe a refresh on your BD thoughts, just specific on the power, and some news on Heartland being pushed up to regulatory. You still own Oldman, but are you still looking to build out power in Alberta and in Canada, generally?

**Dennis DeChamplain:**
Probably not in Alberta, Ben. Take a look at the market, it's oversupplied right now. The Government announced yesterday that they'll be sticking with the energy-only market and kind of shelving the plans or holding the plans to conversion to capacity market in advance. Either way, we don't view the ability for Canadian Utilities to secure long-term contracts, profitable long-term contracts in the Alberta market as something that's available in the market right now, given the oversupply position. We are looking for a utility, long-term contracted assets. So, to the extent that we could find those generation opportunities in the rest of Canada, we would look at that. We are attempting, or more than attempting, we are diversifying geographically outside of Alberta, and Canada, as well. It's really our target markets. We're looking at the rest of the Canada, the United States, Latin America, and Australia, as well.

**Ben Pham:**
Okay. All right, thanks, Dennis. Thanks, everybody.

**Dennis DeChamplain:**
Thanks, Ben.

**Operator:**
Our next question comes from Andrew Kuske of Credit Suisse.
Andrew Kuske:
Thank you. Good morning. Last year, you had a lot of heavy lifting with restructuring costs, and I guess the question really is—you’ve had some pretty big reductions in operating expenses in a number of the segments, and are you really seeing the full benefit of just all the heavy lifting you did in the past years this time around, or are these kinds of the run rates we should think about into the future?

Dennis DeChamplain:
Good morning, Andrew. Thanks. Yes, we are seeing the benefits of the restructuring that we did. We took a restructuring charge in Q2 of 2018. That helped with the lower operating costs. We’re seeing the benefit of those lower run rates now. We are continuing to look for advancements and opportunities in efficiencies with regards to the remaining base of the operating costs through information technology improvements and improvements to our kind of workforce management and asset management in our utility systems. So, we’re continuing to advance opportunities to help lower that run rate going forward, and, again, those go to help bolster our returns on equity above that, you know, the approved returns that we’ve been seeing in the last number of years.

Andrew Kuske:
Okay, thank you. I appreciate the colour. Then, just on capital management, you’ve obviously had a few large-scale monetizations, which are on their path to closing at this stage, so how do you think about further capital management just of your existing asset base, and then deployments? I know you touched upon this earlier on the call, but deployments by looking at other things you can do in the core Alberta base, or just elsewhere, and how do you weigh the opportunity set?

Dennis DeChamplain:
In terms of our existing portfolio, we continue to review it as part of our ongoing process where we review our existing assets and the strategic fit and performance, what have you, that has led to monetization of the generation assets and Albert PowerLine. So, we continue to look at that as part of our normal course of business in terms of redeployment of that capital, I think we’re patient with the capital. We’re looking for the right opportunity, utility and utility-like investments in the target markets.
We’ve got our Corporate Development Teams, along with the businesses, working on opportunities as we speak. We’ll continue on that path until we can effectively redeploy our capital.

Andrew Kuske:
Okay, that’s great. Thank you.

Operator:
Once again, if you have a question, please press star then one. Our next question comes from Maurice Choy of RBC Capital Markets.

Maurice Choy:
Thank you and good morning. My first question is about capital deployment again. I wonder if you could provide us sort of an update on your discussions with the credit rating agencies, how discussions there may or may not affect how you look at what you buy, where you buy, and the types of assets that you’re looking at.

Dennis DeChamplain:
Thanks, Maurice. We discussed the monetization of our generation and Alberta PowerLine with our credit raters, I’ll say, commencing last year. With those sales, I’ll say that improves the quality of the earnings, predictable reliability, reliable earnings. Our percent share right now from our regulated assets is, I’ll say, very high, north of 90%. We believe that really should put us being judged on the S&P’s low volatility table, which would bring our FFO to debt levels down to about 10% or 11%, in order to maintain our credit rating. In order to maintain that credit rating, if we were to go on the low volatility table, we would be looking at targets in the M&A world that would help us stay on that low volatility table. So, you’re looking at the utility and utility-like investments that can continue to provide that high quality, stable cash flows and earnings. I’ll say those are the credit rating implications of our—or not implications. I should say information that forms our view as to future deployment on the capital.

Maurice Choy:
Just to clarify, have they already commented on putting you on a low volatility table? Is there a timing that you can provide us on that decision?
Dennis DeChamplain:
No, they have not. We received confirmation of CU Inc.’s credit rating from DBRS this past week and we expect to hear from Standard & Poor’s on our current credit review in the imminent future. Either July or August, we expect to hear from S&P.

Maurice Choy:
Okay, and then my second question and this is—you’ve already touched upon it, on the Government’s decision to keep an energy-only market. Should we expect any impact at all on your sale process, whether it is the timing, the pricing, or overall process?

Dennis DeChamplain:
No, there’s no impact on our sale process as a result of the change in the market design in Alberta for either of the remaining two transactions that are expected to close in the second half of 2019.

Maurice Choy:
Okay, thank you very much.

Dennis DeChamplain:
Thanks, Maurice.

Operator:
Our next question comes from Jeremy Rosenfield of Industrial Alliance Securities.

Jeremy Rosenfield:
Yes, good morning. Just one more follow-up on the outlook for capital deployment. I’m just curious, Dennis, when you’re looking at growth opportunities, you highlighted on geographies, etc., and risk criteria, but in terms of sort of accretion and timing, are you thinking in terms of operating assets or an operating platform, or are you thinking of investment opportunities that are, let’s call them late-stage
developments, assets that could be built out, so there could be lag between deploying the capital and then when you start to realize earnings and cash flows from that investment?

**Dennis DeChamplain:**
Thanks, Jeremy. I don’t think I can rule—I wouldn’t want to rule out either of those. I mean, for operating assets on the M&A side, we’re looking at that, platforms for future growth. We’re prepared to invest now for existing kind of expansion from those assets, so a platform for future growth in the target markets we’re looking for, we’re open to. In terms of late-stage developed assets, we would look at that. We’re also looking at greenfield opportunities as well, which would—the late-stage, once a project has been de-risked, you pay for that, so don’t know how much that earnings opportunity there would be if it comes down to a strict cost of capital and there’s not much we can add in terms of our operating regulatory expertise. I don’t think we would win on a street fight with our cost of capital, but we would look at late-stage development opportunities.

**Jeremy Rosenfield:**
Okay. So, it sounds like nothing’s off the table. Okay, good. 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, Ariel, and thank you all for participating this morning. We very much 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.