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CANADIAN UTILITIES LIMITED

An **ATCO** Company

Canadian Utilities Limited

Second Quarter 2022 Results

Conference Call Transcript

Date: Thursday, July 28, 2022

Time: 9:00 AM MT

Speakers: **Colin Jackson** – Senior Vice President, Finance, Treasury, Risk and Sustainability
Brian Shkrobot – Executive Vice President and Chief Financial Officer

Conference Call Participants:

Mark Jarvi – CIBC Capital Markets – Research Analyst

Andrew Kuske – Credit Suisse – Research Analyst

Maurice Choy – RBC Capital Markets – Research Analyst

Operator:

Thank you for standing by. This is the conference operator.

Welcome to the Second Quarter 2022 Results Conference Call for Canadian Utilities Limited.

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. Colin Jackson, Senior Vice President of Finance, Treasury, Risk and Sustainability.

Please go ahead, Mr. Jackson.

Colin Jackson:

Thank you. Good morning everyone. We're pleased you could join us for Canadian Utilities' Second Quarter 2022 Conference Call.

With me today is Executive Vice President and Chief Financial Officer Brian Shkrobot. Brian will begin today with some opening comments on recent Company developments, our financial results, and key trends impacting our businesses. Following these 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 the Canadian securities regulators.

Finally, I'd also like to point out that, during this presentation, we may refer to certain non-GAAP or segment measures, such as adjusted earnings, adjusted earnings per share, 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 Brian for his opening remarks.

Brian Shkrobot:

Thank you Colin, and good morning everyone. Thank you all very much for joining us today on our second quarter 2022 conference call.

Canadian Utilities achieved adjusted earnings of \$136 million or \$0.51 per share in the second quarter of this year. This is \$21 million or \$0.08 per share higher than the second quarter of last year. The \$21 million year-over-year increase in the second quarter earnings was primarily driven by strong operating metrics, and CPI indexing in our international natural gas distribution business in Australia. Cost efficiencies, rate based growth and the timing of expenditures in Alberta utilities, along with a strong performance from our Alberta Hub asset also contributed to this great year-over-year earnings growth.

Going back to our Australia natural gas business, not only did we see growth in key operating metrics such as gross new connections, the business also benefited from upward pressure in Australian CPI and the regulatory CPI indexing mechanism.

Similar to the trends that we saw in the latter part of 2021, this upward trend in CPI serves to amplify the business' strong operating performance and drives additional earnings. Currently, in-country forecasts now suggest that CPI could grow as much as 6% or potentially even higher for the full year. This will be a key trend to monitor throughout the remainder of 2022.

While we're on the topic of CPI, it's worth touching in inflationary impacts across our businesses. As communicated on previous quarterly calls, our utilities have strong inflation protections embedded in their respective regulatory regimes. But it is also our long-held conservative financial tenets and operating expertise that ensures our businesses overall are not unduly exposed to these market risks. To date, the measured approach we take to financial leverage, the operating expertise across our businesses, and our experience managing through challenging financial times have kept us well insulated against these pressures. This being said, we will continue to closely monitor inflationary impacts to all of our businesses and we will leverage the expertise of our teams and long-held relationships to manage this exposure.

Moving on to our Canadian utilities, the strong performance that we saw from our businesses in the first quarter of this year continued into the second quarter. Our distribution utilities continued to deliver exceptional performance in their final year of the current performance-based regulation cycle, or PBR. The efficiencies unlocked in this PBR cycle will provide ratepayers longlasting benefits. I've touched on the mechanisms of PBR in prior calls, but as we move closer to the end of 2022 and the completion of our current PBR2 term, it's worth briefly touching on our expectations for the Alberta distribution utilities in 2023.

Consistent with the ultimate goal of PBR, efficiencies that our distribution utilities unlock in their second PBR term – and they were many – will be passed on to customers starting in 2023. To this effect, our Alberta distribution utilities will enter a rebasing year governed by a cost-of-service regulatory framework in 2023 before starting their third five-year PBR term in 2024.

Now, looking back in our history, we have had a strong track record of delivering exceptional ROE outperformance across the decades and under numerous regulatory frameworks and structures. This achievement that we are very proud of and one that is rooted in our operating expertise, continued drive for finding efficiencies and the utilization of technology to modernize our systems.

On top of this expertise and as a result of our efficiency carryover mechanisms within our existing regulatory framework, we expect to carry forward as much as 50 basis points of outperformance into '23 and '24 as a reflection and a reward of the exceptional work that was done in the second PBR term.

So, while we do expect to see earnings from our Alberta distribution utilities to reset downward for 2023 as we pass on efficiencies achieved to ratepayers, we still have strong expectations for performance across our utilities. The factors that I highlighted combined with the drive of all our leaders to deliver top tier performance has me optimistic that we will continue to see outperformance in 2023.

Moving on to Luma Energy, we continue to see great earnings contributions from this investment, and numerous tangible signs that our work is improving the lives of people in Puerto Rico, bringing them closer to having a reliable and modern electricity system.

Over the last year of Luma's operations, Luma connected over 25,000 customers in net metering. That equates to 2,100 net metering installations per month, an equivalent tie-in of 130 megawatts of renewables to the Puerto Rico electricity system. The team has also executed numerous initiatives aimed at improving system reliability and reducing outage frequency, which has declined 30% since Luma assumed operations.

Along with the successes the team has seen on the safety and customer service fronts, this translates to a long list of tangible and meaningful achievements, and we certainly have no intention of slowing this momentum.

Moving on to capital, I just want to briefly touch on the capital investments we made in the second quarter of this year. The second quarter saw us invest \$297 million in our business with \$244 million of this being invested in our core utilities. This ongoing utility investment ensures the continued generation of stable earnings and reliable cash flows, while also driving rate-based growth.

In our energy infrastructure businesses, we invested an additional \$51 million in the quarter, an increase of \$36 million from 2021. These investments were tied to the ongoing energy transition initiatives we launched last year, which we continue to progress.

Our three previously mentioned solar developments – Deerfoot, Barlow and Empress – continue to progress forward alongside our RNG natural gas opportunity with Future Fuel. We expect to see commercial operation of our RNG facility and energization of our Deerfoot and Barlow projects by the end of this year, with Empress following later in the first half of 2023.

Similarly, our teams are hard at work on both our world-scale hydrogen production project with Suncor, and our Atlas Storage Hub carbon capture sequestration opportunity with Suncor and Shell. I'm pleased to say commercial discussions with both Suncor and Shell are progressing very well on both of these projects. Our teams are also rapidly advancing technical and engineering work related to key segments of the projects, including our testing of cap and storage for hydrogen. We expect to be in a position to provide more information on this in the near future.

We are also working and continue to work closely with government to help shape the commercial constructs that will govern both the hydrogen and carbon industries within the province and Canada more broadly. Establishing these constructs is key to ensuring an efficient, effective and economic decarbonization of our energy systems.

It has been a very busy quarter on the project front as we move numerous key energy transition opportunities forward and continue to progress our long-term strategy, and I look forward to providing further updates on these important initiatives in upcoming quarterly calls.

Overall, Canadian Utilities delivered another great quarter of earnings growth for our shareholders, with many of the key drivers of this earnings growth likely to persist through the remainder of this year.

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

Colin Jackson:

Thank you, Brian.

In the interest of time, we ask that you limit yourself to two questions. If you have additional questions, you are welcome to rejoin the queue.

I will turn the call back over to the conference coordinator for questions.

Operator:

Thank you. We will now begin the question-and-answer session. Once again, in the interest of time we ask you to limit yourself to two questions, and if you have any 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.

The first question comes from Mark Jarvi with CIBC Capital Markets. Please go ahead.

Mark Jarvi:

Thanks. Good morning everyone.

First question is just on the distribution utilities in Alberta. It seemed like over the last couple of years you had pared back your capital investments a little bit, but obviously they are performing well and it seems like economic activity is decent in the province. Can you just update us in terms of where you are in your spending through the five-year period and where you'll end up relative to the original plan?

Brian Shkrobot:

Thank you, Mark, for your question.

In terms of the Alberta distribution utilities, our spending is consistent with our plan. I think we had some delay with some supply chain issues, but overall we continue to expect us to deliver on the same capital plan that we had outlined.

We have in front of the commission right now in our cost-of-service application a request to increase the modernization of our electricity system, and so depending on the approval of the regulator in terms of those plans it might adjust that projection slightly, but overall we are consistent with what we outlined in our capital plan.

Mark Jarvi:

Okay, thanks.

Then just turning to Australia, in the past you talked about different investment opportunities there. Can you just update us in terms of where you are, either in any sort of joint bids or outlook for transmission side of things, renewables, and I guess just appetite for M&A in that market or if you're really just focused on organic growth opportunities in Australia.

Brian Shkrobot:

Thanks, Mark.

Overall, we still view Australia as a great opportunity, a lot going on in that country. They're pretty proactive in terms of the government front supporting various initiatives, whether it's hydrogen, whether it's pumped hydro, and certainly we're active in both of those areas. Also, they have identified electric renewable zones where they'll need a transmission infrastructure and a lot of it. Each of those areas we are active in and we'll continue to be active in.

In terms of M&A, we monitor M&A opportunities. Of course, we will evaluate certain premiums that are being sought at these days and the competition for that type of M&A activities. So we'll be active on that front, or at least monitoring on that front, but we expect more to come from the greenfield opportunities.

Mark Jarvi:

Thanks a lot, Brian.

Operator:

The next question comes from Andrew Kuske with Credit Suisse. Please go ahead.

Andrew Kuske:

Thank you. Good morning.

I guess just in the core market, could you – really being Alberta – how do you think about just the current cycle we're in from an economic standpoint versus past cycles you've seen and how that translates into growth in the core utility base?

Brian Shkrobot:

Thank you, Andrew. It's a great question.

I guess I would address it in terms of economic cycle. We've seen quite a switch here and quite a volatility in the province. You see the oil prices a year ago and then you see where they are today, just kind of is an indication of overall activity in the province and how it could change. But overall, broadly with the goal of decarbonization in Alberta, not just—and throughout Canada, and being a utility that could well serve that need, we're optimistic that the economic cycle will continue on the energy decarbonization front.

In terms of the oil and gas activity, I think obviously there's a lot of factors influencing that area right now but I think we'll continue to see some high oil prices for some time. I think the province and the oil and gas industry is committed to continue on delivering value but also being mindful of the decarbonization front.

Overall, I think the economic cycles will continue to be strong here in Alberta, and I think we've got the business that could be resilient to accommodate any swing in that cycle.

Andrew Kuske:

That's helpful.

Maybe just an extension: do you get a little bit of the best of both worlds to a certain degree where you have larger energy companies looking to decarbonize, whether it's CCS or doing hydrogen initiatives, and you have some opportunities in that with irons in the fire, and then looking ahead you've got eventually combustion light vehicle sales will be banned in Canada and how does that play into really reinforcement of utility grids, EV chargers, and if we maybe focus just on both ends of the spectrum? The bigger decarb opportunities for oil and gas emitters, and then at a more microscopic level with the utility rate base.

Brian Shkrobot:

Great question, and certainly how you outlined it is consistent with our views.

We're very proud and happy to be able to support all our customers in their decarbonization goals. And again, from our base in Alberta here, both on the electric side and our natural gas clean fuels position, we can help them in multiple fronts.

We are certainly seeing oil and gas, a lot of new connections and electrifying a lot of their parts of business, so seeing growth on that front. In terms of the electric distribution system, you've touched on EVs. The whole, I guess, push to use more electricity obviously has an impact on our distribution systems and the need to modernize and invest in the infrastructure, not just in electric transmission but also in our electric distribution business, to support these decarbonization efforts.

So, yes, I think we're well suited and we like the view that we can help our customers on multiple fronts, and with that, the pace of that, will be quite honestly determined by the government direction and incentives that would, I guess, encourage that development.

Andrew Kuske:

Okay. Appreciate the colour. Thank you.

Operator:

Once again, if you have a question, please press star then one at this time. The next question comes from Maurice Choy with RBC Capital Markets. Please go ahead.

Maurice Choy:

Thank you and good morning.

My first question is about Australia. Obviously a very strong performance from the gas utility there. I'm trying to understand the staying power of the results that you have over there. Maybe just to kick off, can you remind us what the sensitivity is of inflation to earnings, how many basis points equates to how much in earnings?

Brian Shkrobot:

Thanks Maurice.

In terms of Australia, as you mentioned very, very strong year. As we mentioned on the opening call is that we've seen a lot of growth. We're getting a lot of new connections, but probably the largest driver is the CPI indexing that favourably benefits our business there. Certainly, we're seeing inflation continue to be high. We saw that at the end of 2021, but although some view that it might return back to more normal levels it certainly is remaining at the higher end.

As kind of a rule of thumb or guide, every 10 basis points increase in CPI inflation translates into approximately a million dollars of impact to earnings, so that's kind of some general guidance for you.

Maurice Choy:

Thanks.

Maybe as a follow-up to that, I suppose the only way for the number to come down, in terms of total earnings to come down, you'd pretty much need a deflation situation, but were we to have 6% this year but, you know, 3% or 2% next year, you're probably expecting earnings to stay about these levels moving forward?

Brian Shkrobot:

I would say, Maurice, that this is certainly heightened this year in 2021 with inflation 6% or higher. I would suggest that—and I think the market is expecting that a CPI would return to more normal levels in the near future. I think that same expectation was there at the end of last year but we're seeing a little bit longer delay of CPI to return.

Obviously, CPI in Australia and the world has been impacted by a lot of geopolitical factors right now, and to the extent that those stabilize we would, again, expect in the long term the CPI to return more to a more normal levels, and then obviously our Australia levels to adjust accordingly.

Maurice Choy:

Just to clarify, when you say adjust accordingly do you mean going down, or just year-over-year growth being more normal?

Brian Shkrobot:

We would expect Australia natural gas earnings to be lower than this year, to the extent that inflation returns to more normal levels.

Maurice Choy:

Understood.

Then my second and last question, I want to bring you back to Luma. Obviously, you would have seen some news about local residents taking to the streets and asking the government to cancel the PREPA contract with Luma given all the outages and rate hikes. Is that a case of just getting through some of the growing pains for the next one or two years and the local sentiment will get better from here? Or even if Luma is successful, is this the kind of discord that shareholders should expect for the remainder of the 15 years?

Brian Shkrobot:

Thanks for the question. This is not new. We've had ever since we started operations there has been I would say organized activity against Luma, and that our view it's truly driven by those that would benefit from us not being there. So, ultimately yes, the protestors—that protest that you referred to came and went.

Our view is that we will continue to operate the system in the way that we are accustomed to, safe and reliability. In terms of driving down outages by 30%, which I mentioned, those are the things that will continue to gain support for Luma. And we do see a lot of support on the street and the people that we talk to. Yes, there are some organized protests, and again, I would just call that noise in the overall grand scheme of things. We continue to operate our system well and continue to climb on the customer satisfaction.

We just will continue to do what we do best, which is to operate a safe and reliable system, and over time we expect that those protests will continue to decrease, and especially after the last part of the generation process is over and the unions that are supporting these protests no longer have a leg to stand on.

Maurice Choy:

Thank you very much.

Operator:

As there are no more questions from the phone lines, this concludes the question-answer session. I would like to turn the conference back over to Mr. Colin Jackson for any closing remarks.

Colin Jackson:

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

Operator:

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