Canadian Utilities Limited
First Quarter 2019 Results Conference Call
Transcript

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Speakers:

Dennis DeChamplain - Senior Vice President and Chief Financial Officer
Myles Dougan - Senior Manager, Investor Relations

Conference Call Participants:

Linda Ezergailis TD Securities, Inc. – Managing Director
Mark Jarvi CIBC Capital Markets – Director, Institutional Equity Research
Patrick Kenny National Bank Financial (Research) – Director, Equity Research
Robert Kwan RBC Capital Markets (Canada) – Managing Director
Operator:
Welcome to the Canadian Utilities Limited First 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, Claudia. Good morning, everyone. We’re pleased you could join us for our First Quarter 2019 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 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 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 our Senior Vice President and Chief Financial Officer, Dennis DeChamplain for his opening remarks.
Thanks Myles, and good morning everybody. Thank you for joining us today on our First Quarter 2019 Conference Call. Canadian Utilities announced higher adjusted earnings in the first quarter of 2019 of $200 million or $0.73 per share compared to $181 million or $0.67 per share in the first quarter of 2018. This $19 million growth in the first quarter earnings over 2018 was due to continued investment in our utilities, strong financial results from our Alberta electricity generation business, and ongoing cost efficiencies achieved in the electricity distribution and natural gas distribution utilities.

Stronger power prices in Alberta drove higher earnings in our electricity generation business this quarter. The average Alberta power pool electricity price for the first quarter of 2019 was $69 per megawatt hour, or nearly $35 per megawatt hour higher compared to the first quarter of 2018. The increase was mainly due to two factors. The first factor was near record low temperatures in February which increased electricity demand. The second factor was lower available electricity generation capacity due to coal-fired generation outages and low wind generation.

In March, we completed the construction and energization of our Alberta Power Line project. This tremendous achievement involved many people, including communities and Indigenous peoples. The success of this 500-kilometre electricity transmission line construction project would not have been possible without their support. The earnings contribution from Alberta Power Line, or APL, was lower this quarter than Q1 2018 due to the lower capital investment needed to complete the final stages of this project, but bringing the project in service a full three months early allowed us to record earnings for the remainder of the early energization incentive.

Last quarter, we told you that we had commenced a strategic review of our 80% ownership in APL. As part of this process, Canadian Utilities is providing an opportunity for Indigenous communities along the route to obtain an equity interest in APL. We intend to remain as the operator of APL over the 35-year concession arrangement.

As you know, in September of last year, we announced that we are exploring strategic alternatives for our Canadian electricity generation business. We are working through both of these strategic reviews now. While I had hoped to have an update for you this quarter, we are not quite at the decision stage and therefore have no update to report at this time.
On the utility side of our Company, we generated higher earnings this quarter mainly due to ongoing rate base growth and cost efficiencies achieved, particularly in the natural gas distribution and electricity distribution utilities. Earnings from the utilities were up $7 million in the first quarter of 2019 compared to last year, but they could have been even higher than that. Our natural gas transmission and electricity transmission utilities are awaiting final rate decisions from the Alberta Utilities Commission, or AUC. If the AUC approves all aspects of our two rate applications, the potential increase to first quarter 2019 adjusted earnings could have been approximately $8 million. We expect those two rate decisions in mid-2019 hopefully in time to record next quarter. We will record the impact on our earnings when we receive the decisions.

We also had an inflation adjustment that brought down the Australia results this quarter. We think the way this inflation calculation works in the Australian regulatory model will not be a continuing issue as we move through 2019, but it did produce a reduction in earnings this quarter.

On our last quarterly conference call at the end of February, I told you that the AUC had just released a decision on the 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. This decision agreed with our submission that the achievements of the utilities were not due to a flaw in the PBR plan but rather were the result of management decisions responding to the incentives the PBR plan created. This process is now closed, and we’re very pleased with the decision.

In Australia, our natural gas distribution business continued work on the next five-year regulatory access arrangement. The regulator is expected to deliver a final decision in late third quarter of this year. There are still many aspects of the next access arrangement to resolve, so the total impact to earnings isn’t known yet, but we will keep you apprised as the regulatory process develops.

We have a few more regulatory updates in our MD&A, but they are all for proceedings underway with no major decisions impacting this past quarter, but we do expect decisions on a couple of them in the second quarter. If you have questions about those proceedings, I’ll be happy to answer them in a moment.

All in all, Canadian Utilities had a very good first quarter of 2019. We achieved strong earnings growth this quarter and completed the very large Alberta Power Line project on budget and ahead of schedule.
That concludes my prepared remarks. I’ll now turn the call back to Myles.

Myles Dougan:
Thank you, Dennis. I’ll turn the call over now to the 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 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’re using a speakerphone, please pick up your handset before pressing any keys. To withdraw from questions, 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 and one at this time.

Our first question comes from Linda Ezergailis with TD Securities. Please go ahead.

Linda Ezergailis:
Thank you. I have some questions about your ATCO Gas Australia access arrangement. Can you maybe help us understand a little bit the dynamics related to the adjustment in the quarter and how the balance of the year will look vis-à-vis, I guess, the prior quarter and the prior year, or why this was just temporal and one-time in nature?

Dennis DeChamplain:
Sure Linda. Thanks, and good morning. Just wanted to point out at the outset, the adjustment for our first quarter earnings for Gas Australia doesn’t have anything to do with our next access arrangement, the AA5, so they are completely separate issues. In the first quarter of 2019, as you see, there’s a $6 million drop year-over-year from Gas Australia, and in Australia the regulatory compact there is we’re essentially governed on a real return basis. We need to translate that to nominal dollars for our adjusted earnings and U.S. GAAP purposes. Part of that translation involves adding an inflation amount to our rate of return calculations. In Q1 2019, the Australian CPI was 0%, whereas in Q1 2018 it was
about 45 basis points. The decrease of 45 basis points on a $1.2 billion rate base roughly accounts for that $6 million drop in the year-over-year earnings that you see.

Going forward, we do not expect Australian CPI to be flat for the remainder of the year. Our business plans and forecasts, we had baked in about a 1.8% increase in inflation, and that is the amounts that we were expecting. We do expect CPI to be north of zero in the future quarters, and that’s why we’re saying that we don’t expect that to continue.

Linda Ezergailis:
Okay, and then just maybe with respect to the draft AA5 decision, do you plan to submit a response, and what is your initial reaction and read on that decision?

Dennis DeChamplain:
Yes, we do plan on submitting a response. The process down under is different than what we experience here in Alberta for the rest of our utilities. In Alberta, as you know, the AUC and intervenors will ask their, I call it a thousand questions, and we respond; and then at the end of the discovery process, the AUC will come out with its final decision. In Australia, the regulatory authority there engages a consultant, they come in, they look at our application, and the regulator comes out with a draft decision, which we received in April. We have six weeks to respond. So, that’s part of the, I’ll call it the discovery process down under that we don’t have here in Alberta. We have six weeks to respond. In the draft decision, some of the comments by the regulator there invited us to comment further on the initial position that the draft has outlined. The draft decision, it does take a significant cut in our growth capital and associated revenues, which we don’t think is appropriate, and we are responding as such. There is some reductions in our operating costs, and again we’re using the six-week time period to augment our evidence that we’ll put back to the regulator.

After we respond in early June, other parties will have, I think it’s about four weeks to respond to our filings on the draft decision, and if we feel the need to reply to what’s been said by customers in their July period, then we’ll have the opportunity to kind of put in a reply or a rebuttal, or additional evidence. That’s the process that it goes through. A decision is scheduled for September, so absent any process delays, and we usually see process delays in our regulatory proceedings, we should be able to have a decision in the third quarter and we’ll
be able to update you at the end of the second quarter as we get through this next, we'll call it, 6 to 10 weeks in the process.

**Linda Ezergailis:**
That’s helpful context. Thank you. Maybe just moving back to Alberta, there’s been a recent change in the provincial government. Can you comment on how this might change anything for your company in terms of your approach to, I guess, your whole franchise there, but most specifically the outlook for the merchant power markets, and what you might be advocating on that front?

**Dennis DeChamplain:**
In terms of the outcome of the election, I guess we’ll say that we are pleased with the outcome. The incoming government seems to have a grasp of the economic issues facing our province, and we look forward to working with them on the files. In specific regards to the generation and capacity market, I think the UCP in their election platform said they will have a, I think it’s a 90-day consultation period with industry. We intend to participate in that consultation period and let our thoughts be known. We do think that an energy-only market has not served the test of time very well if you look at all the other jurisdictions that implemented them and moved away from them, so we will be expressing our views with government and other industry participants as the government works through their process.

**Linda Ezergailis:**
Thank you.

**Operator:**
Our next question is from Mark Jarvi with CIBC Capital Markets. Please go ahead.

**Mark Jarvi:**
Good morning. There is some commentary in the MD&A around filings for PBR2 on a nominal adjustment for going-in rates. Can you provide a bit more context on that and what it could mean?

**Dennis DeChamplain:**
Sure. Good morning, Mark. When the AUC came out with their decision on the going-in rates for PBR2, they laid out a set of five criterion which was essentially impossible to qualify as an anomaly. Some of the other companies are RnV’ed that decision, and the AUC accepted that RnV, and they’re going
through it. We launched—we, I guess, became part of that RnV as well because the AUC noted that our costs that we’re applying for recovery associated with our information technology would be a placeholder pending the outcome of our IT proceeding, and we don’t believe that is legitimate under the PBR framework with regards to, we’ll call it cherry picking, for lack of a better word, of adjusting some elements, but not all.

The approach on anomalies, they’re going through to see if those going-in rates for 2018, and if you look at the operating cost that was based on the lowest of the first four years, and from both of our distribution utilities it was 2016, so we’ll be looking at what could be considered a one-off or anomalous factors in the results in 2016, and they might look at 2017 as well. I think the AUC said maybe we should be looking at 2017 to see if there’s any anomalies there that could qualify.

They’re going through that process now, and RNVs are generally harder to forecast the timing outcome of. The AUC tries to stick to kind of rendering a decision 90 days after all the evidence is filed. That RNV process, all the timelines haven’t been laid out and finalized yet, and then they don’t—AUC doesn’t hold themselves bound by that 90-day decision internal rule, so we don’t know when we would get a decision on that.

Mark Jarvi:
Based on initial discussions and discovery, do you anticipate there being a retroactive adjustment, and directionally which way might it go?

Dennis DeChamplain:
Yes, they do come back. There would be an impact to 2018 rates, which would be the 100% retroactive impact, and also for the first couple of quarters or for who knows how far going into 2019.

Sorry, Mark, the....

Mark Jarvi:
Just where are you guys thinking, in terms of where the discovery and where initial discussions, which direction it might head, in your favour?
Dennis DeChamplain:
Yes, it could be different for each of the utilities. The AUC seems to be trying to put all of the distribution utilities on the same footing, so depending on how those new or revised, or even if there is any change to the criteria to quality as an anomaly, it could impact the various distribution utilities. We could go up, somebody else could go down, or vice versa, so we’ll really have to see how that plays out on an industry-wide basis.

Mark Jarvi:
Okay. Then going back to Linda’s question on the change in the ruling party and with the strategic review of the power assets, how has the election or the change in government impacted that process, or maybe it’s had no impact? Any comments on that?

Dennis DeChamplain:
I think we’ve had that question before. The outcome of the election does not have very much of a bearing at all on our strategic reviews. We’re continuing along our path with that.

Mark Jarvi:
Okay. Thanks.

Operator:
Once again, if you have a question, please press star then one. We kindly remind you to limit yourself to two questions, please.

Our next question is from Robert Kwan with RBC Capital Markets. Please go ahead.

Robert Kwan:
Good morning. Just with respect to the strategic reviews for those two assets, I’m just wondering, are you approaching it as an either-or for those two reviews, or could it be both? Then, I guess, in addressing the last question around the Alberta government, just to be clear, the capacity market framework review has no bearing on your decision on the Canadian power side, and then as it relates to Power Line, is the Indigenous investment really the scope of what you’re looking at from a strategic review, or is there a potential second or follow-on step?
Dennis DeChamplain:
Okay, Robert, that’s part A, B and C to your questions. I think Part A was are the Alberta Power Line and generation business, are they independent of combined, could we do one or both? I guess the answer is we are doing both strategic reviews. The outcomes of those strategic reviews could be zero transactions, one transaction, or two transactions as we work through them. We don’t view it as kind of an either-or. We’re looking at each of those strategic reviews on its own merits.

I don’t have Part B of your question, so I’m going to flip to Part C with regards to the Indigenous communities along the line. I think we’ve said before we’re going through that process, and we are approaching it that we could sell up to our entire 80% interest in Alberta Power Line, so to the extent that it’s available to the Indigenous communities or independent third parties, we are looking at all of those options with a view to potentially completing exiting our ownership percentage of APL, bearing in mind that our electricity transmission division will continue to have the contract to operate that line over the 35-year concession arrangement.

Robert Kwan:
Got it. The middle question was…

Dennis DeChamplain:
Was it a capacity market question?

Robert Kwan:
Yes, just to confirm, when you were saying that the government change doesn’t have a real bearing on the Canadian power sale, just as that extension, the timing isn’t tied to seeing how this capacity market plays out?

Dennis DeChamplain:
No, it’s not.

Robert Kwan:
Okay. If I can just finish with coming to regulatory, you’ve got the direct assign transmission filing and the Hanna recovery. I just want to be clear with the accounting treatment given you’re under IFRS without the regulatory asset. Are you booking—you’re booking the returns into earnings under your
adjusted earnings calculation, is that correct, and really what you’re looking at here is recovering the cash?

**Dennis DeChamplain:**
Yes. Those Hanna assets have been kind of essentially in service since 2012, so we have been including in our rate base and in our earnings depreciation, call it like a return on and return of capital since 2012. To the extent that there would be, we’ll call it a capital disallowance, what we do for accounting purposes is we reduce—we don’t write off the value of those assets from our properly, plant and equipment on our balance sheet. We reduce the rate base going forward that we charge to customers, thereby instead of earning a 8.5% return, it would be an 8.49% effective return on our entire assets.

The impact of the Hanna decision, though, in Q2, if there would be a capital disallowance, which we don’t think there’s grounds for, we would need to set up a refund to customers for the amount of earnings and depreciation that we’ve recorded over those six, seven years since those assets have been service, so there could be a one-time hit to our results in Q2 only because it goes back so far, we’ll call it a retrospective claw back from our rate base.

**Robert Kwan:**
Okay. Just so I’m clear, though, when you’re talking about the one-time hit, are you talking about the IFRS reporting, or are you talking about your adjusted earnings which are effectively U.S. GAAP equivalent?

**Dennis DeChamplain:**
The adjusted earnings component.

**Robert Kwan:**
Okay, and so ultimately, if everything goes as planned, there really is no change to how you book adjusted earnings, but is this proceeding really then about recovering the cash?

**Dennis DeChamplain:**
Well, we have been recovering the cash associated with those assets, because they have been included in our rates on an interim basis, pending the results of this decision. Even after we get this
decision, it may still be on an interim basis pending AUC’s review of the transmission inquiry for the utilization of transmission assets, which they announced probably almost two years ago now but has gone radio silent with regards to when and how they intended to proceed with that review. I think we saw that in (inaudible 28:18) where even on their, we’ll call it a final direct assign decision, the results were still interim pending results of that transmission utilization proceeding, so I don’t know if that would happen to us as well on Hanna. I suspect we’ll be afforded the same treatment.

Robert Kwan:
Got it. Okay, thank you, Dennis.

Dennis DeChamplain:
Thanks, Robert.

Operator:
Our next question is from Patrick Kenny with National Bank Financial. Please go ahead.

Patrick Kenny:
Yes, good morning, guys. Just first on the quarter, was any of the financial performance driven by colder temperatures, and if so, how much of the earnings uplift could we back out if we assumed more normalized weather?

Dennis DeChamplain:
Yes, the colder weather, we didn’t see it impacting our gas distribution utility too, too much. There are factors in there that kind of normalize for colder weather. I think the in gas distribution, we may see an earnings uptick if it’s cold and windy. I know you’re in Calgary, Pat, so that is essentially baked into that normalization for our gas distribution. I mean, the cold weather, though, did impact the power prices, most notably in February when it averaged about 20 below here in Alberta, so there is that uptick in the prices that we realized on our generation business, and to the extent that I can bifurcate it between colder temperature and lower generation capacity, I don’t have that information. I don’t know if the guys have somewhere deep in the bowels as to what per cent would be temperature versus supply, we’ll call it.
Patrick Kenny:
That’s all good. Thanks for that colour, we’ll take the extended ski season anyway. Back on the
discussion around the UCP and thinking about their cutting the red tape mandate, does this change the
narrative at all for CU from a capital allocation standpoint? Does this bring Alberta more in line with your
other international jurisdictions, just from a competitive standpoint, and maybe you can comment on
whether or not there’s anything in the UCP’s platform that you can point to that might represent some
upside potential to your CapEx budget or rate base outlook?

Dennis DeChamplain:
Yes, the first item with regards to red tape, and I could just feel my temperature rise a little bit as we
even start to talk about it, especially in light of the previous conversation we had about Hanna and
having a regulatory decision in Q2 of 2019 which can reach back to earnings that we booked in 2012,
so you think about red tape, look at our last deferral application that we filed that included, I think the
opening salvo was some 28,000 pages. AltaLink’s proceeding, I think it topped out at over 200,000
pages, and multi-years worth of retrospective impact. We also talked earlier on the call about our 2018
going-in rates for our PBR utilities still aren’t final because we have this pending RnV, so to have that
overhang and uncertainty facing us is... inordinate, in my view.

You put that beside the Australia access arrangement process where–it’s a different process, but we
will get final rates in advance of the test year. We worked with the consultant, but there were 57
questions that we got asked on our application, and it’s just as thorough a review, so when you think
about red tape and if you want some low-hanging fruit, let’s go after these regulatory and permitting
procedures. We still don’t have a permit to commence construction on our Pembina to Keephills
pipeline, which is 100% backed by customers.

It’s ludicrous the amount of hoops that we have to jump through in order to conduct business in the
province here, so we may have some things to say on the red tape file.

Do we think that the UCP platform will help our growth prospects and rate base going forward? Yes, we
do. Is that going to materially impact this year’s or next year’s results? That would be tough. Just some
of the permitting aside, we still need to go through adequate consultation and make sure the I’s are
dotted and the T’s are crossed. But it would be difficult to get, I think, new investment applied for,
sanctioned, and shovels ready where we would expect a material change in our immediate near-term outlook for our CapEx here in Alberta.

Patrick Kenny:
Okay. That’s great, Dennis. Appreciate those comments.

Dennis DeChamplain:
I’ll get off my soapbox now.

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

Myles Dougan:
Thank you, Claudia, 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-bye.

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