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CANADIAN UTILITIES LIMITED
An ATCO Company

Canadian Utilities Limited
First Quarter 2022 Results
Conference Call Transcript

Date: **Thursday, April 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

Jason Sharpe - President, ATCO Gas and Pipelines

Conference Call Participants:

Mark Jarvi CIBC Capital Markets – Research Analyst

Maurice Choy RBC Capital Markets – Research Analyst

Matthew Weekes IA Capital Markets – Research Analyst

Operator:
Thank you for standing by. This is the conference Operator.

Welcome to the First 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' First Quarter 2022 Conference Call.

With me today is Executive Vice President and Chief Financial Officer Brian Shkrobot, and President of ATCO Gas and Pipelines, Jason Sharpe.

The call today will begin with some opening comments from Brian on recent Company developments and financial results, followed by an update from Jason on our gas and pipeline utility businesses. After these prepared marks, 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 like to point out that, during this presentation, we may refer to certain non-GAAP or segmented measures such as adjusted earnings, adjusted earnings per share, and capital investment. These measures do not have any standardized meaning under IFRS. 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:
Thanks, Colin, and good morning, everyone. Thank you all very much for joining us today for our first quarter 2022 conference call.

Canadian Utilities achieved adjusted earnings of $219 million or $0.81 per share in the first quarter of 2022. This is $28 million or $0.11 per share higher than the first quarter of last year. The $28 million year-over-year increase in the first quarter earnings was a result of cost efficiencies, rate-based growth, and the timing of expenditures in our Alberta utilities, along with stronger contributions from our LUMA Energy investment, and our first full quarter of earnings from the Alberta Hub natural gas storage facility, which was acquired in December of 2021.

While our business overall performed very well in the first quarter of this year, this growth in year-over-year earnings was primarily driven by the exceptional performance of our Alberta-based distribution utilities, the gas distribution utility in particular.

I'll turn the call over to Jason shortly to provide some additional colour on our Canadian gas business. But for those who may not be aware, 2022 is a noteworthy year for both our Alberta distribution utilities. It marks the final year of the second-generation performance-based regulation cycle, which we tend to refer to internally as PBR2. The attention of the PBR regulatory framework is to provide incentives to utilities operators to find system efficiencies and to make system improvements that will drive long-term customer benefits and improvements to the overall system. In line with the goals of this regulatory framework, our distribution utilities have done a great job of identifying and executing on efficiency improvements throughout PBR2. These efficiencies will create lasting benefits for customers. In the near term, this also drives great earning performance that you're seeing for Q1 2022.

While we continue to expect our distribution utilities to perform well through the rest of the year, I would highlight that the performance in our gas distribution business in Q1 2022 has also been impacted from the timing of certain expenditures. For this reason, the exceptional performance delivered by our gas business during Q1 is likely to temper somewhat throughout the remainder of the year.

With that, I'll turn the call over to Jason to speak to the great work the gas business has been doing and to touch on our long-term strategy for that business.

Jason Sharpe:
Thank you, Brian. Good morning, everyone.

As Brian alluded to, we've been working hard in the gas utility to find efficiencies and drive not only near-term earnings growth but long-term sustainability as we position our business for what the future energy transition will look like.

In light of the global challenges currently being faced related to energy security and customer affordability, it's important to touch on the important interplay between our gas system, decarbonization, and the overall energy transition.

First, it's important to recognize that the composition of energy sources will vary from geography to geography. In Canada, there are several drivers that support the long-term importance of our natural gas, and the utilization of our existing natural gas networks, and the ability of this to be supportive to the country's decarbonization goals.

Natural gas has a high energy density, and a lower carbon footprint than many of the competing energy sources, which is key in our cold Canadian climate. Utilizing our existing gas systems, we're able to provide safe, reliable, cost-effective energy to heat homes and power industry across our service territory, including remote areas and during peak seasonal demands where temperatures are regularly below minus 30.

From a cost perspective, Canada's proximity to significant natural gas resources also allows us to maintain favourable commodity economics, compared to geographies that must import all of their energy. This provides us not only with a reliable supply but also with a lower-cost pathway to decarbonization opportunities. Initiatives such as blending of hydrogen and renewable natural gas into our existing system are key to reducing emissions while maintaining that safe reliable cost-effective energy source that utilizes natural resources prevalent in our area.

Blending has the distinct benefit of not requiring any end-use supply modifications, utilizing the existing gas distribution networks, and reducing the system-wide carbon footprint. In addition, the blending work provides a stable market and infrastructure that can drive further investments and innovation in the renewable natural gas and hydrogen production and consumption markets.

Our work here to advance these blending initiatives is multifaceted.

We are actively leveraging the skills and learnings from our Australian gas utility, which today is blending hydrogen into segments of their network.

This year we'll be launching hydrogen blending activities in Alberta, in Fort Saskatchewan.

We are actively working with customers to connect new clean hydrogen markets with the supply that will be available here in the province. We're working closely with stakeholders to ensure that the benefits of renewable natural gas and hydrogen are well understood, and to ensure that buy-in exists across key stakeholder groups.

While both provincial and federal governments have released their visions for a hydrogen economy, we're continuing to work with all levels of governments on key initiatives, including the updating of regulations to allow for the blending of hydrogen and renewable natural gas into the greater system.

Alberta has the benefit of utilizing technologies that are already in place in geographies such as Australia and the UK.

While there are numerous other initiatives in our business that we can speak to here, I think this provides an overview of the opportunities we see within the gas utility, and why we believe we'll be a leader in the energy transition and Canada's energy future.

I'll now pass it back to Brian.

Brian Shkrobot:
Thanks, Jason. You raised a lot of really important points for investors, as they think about the future of natural gas in Canada. It will certainly play an important role, not only in facilitating energy transition, but in driving the hydrogen economy and continuing to provide reliable and affordable delivery of energy for customers in the future.

Taking us back to our discussion on earnings for the quarter, I want to quickly touch on our LUMA Energy investment, which contributed strong year-over-year earnings growth. As we talked about in our fourth quarter conference call, LUMA Energy assumed full operation of Puerto Rico's electricity transmission and distribution system on June 1, 2021. As a result, our Q1 earnings this year reflect a full quarter of operating earnings, while our Q1 2021 earnings reflect the fact that the business was still undergoing the necessary preparatory work required to assume operations in Puerto Rico.

Given the recent news in Puerto Rico around the restructuring plan for PREPA, it's worth quickly reminding everyone about the structure of our current supplemental agreement. This supplemental agreement has an initial term of 18 months and allows LUMA to begin executing on critical projects necessary to modernize and harden Puerto Rico's electricity transmission and distribution system.

While we await the conclusion of PREPA's bankruptcy proceedings, we're compensated for this work on a fixed fee basis.

Upon completion of these proceedings, we will move out of the supplemental agreement and into the 15-year ONM agreement. We are eager to see the bankruptcy proceedings completed, and we continue to expect this process to be completed in 2022.

Touching briefly on Australia, our natural gas utility saw first quarter earnings that were comparable to the same period in 2021. Looking to the remainder of 2022, we'll closely monitor the macroeconomic factors, with a view that both the increasing system demand and CPI that we saw drive earnings in 2021 could continue into a later part of 2022.

On the regulatory front, there have been two developments in the first quarter that are worth highlighting here.

On March 31, the AUC [Alberta Utilities Commission] issued its generic costs of capital decision for the 2023 year. Under this decision, the current generic costs of capital parameters of 8.5 per cent return on equity and 37 per cent equity thickness will be maintained for 2023. We view this as a positive development, as it provides regulatory prospectivity up to the end of 2023.

Now, I also want to provide an update on the AUC enforcement proceeding that we've spoken about previously. This inter-affiliate code of conduct issue was brought for attention in July last year, and it was at that time we initiated our own internal investigation. Since September, we have been working in cooperation with the AUC's enforcement branch to determine the most appropriate resolution to this matter. Based on this work, a joint settlement was filed with the AUC on April 14. This settlement remains subject to ultimate approval by the AUC and is currently under review.

The settlement is comprehensive in nature. It includes both a financial administrative penalty and a number of process improvements that we've committed to undertaking to ensure a situation like this does not occur in the future. Many of these process improvements we've already completed.

Now, we acknowledge that we made administrative and regulatory errors, and that these are serious missteps that have impacted customer trust. We remain committed to rebuilding this trust, upholding the integrity of the affiliate code of conduct, and ensuring something like this does not ever happen again.

For absolute clarity, neither the original costs in question, nor any penalties related to these items, have or ever will in the future impact customer rates.

Now moving on to capital, I want to briefly touch on the capital investments we made in the first quarter of 2022. In the first quarter, we invested $265 million in our business, with $218 million of this being invested in our core utilities. This ongoing utility investment ensures the continued generation of stable earnings and reliable cash flows and drives rate-based growth.

In our energy infrastructure business, the first quarter saw us invest an additional $44 million, an increase of $36 million from last year. These investments were tied to the ongoing energy transition initiatives that we launched back in 2021.

I'm also happy to report that, just last week, we announced an agreement with Microsoft for the purchase of all renewable energy from our Deerfoot solar facility. The 37-megawatt facility, which will be energized in the fourth quarter of 2022, is a key step forward in our renewable generation strategy, and highlights the work we are doing to support the decarbonization efforts for our customers.

Shifting to our larger clean hydrogen strategy and the awarding of port space for our Atlas storage hub, carbon capture and storage opportunity, we are continuing to see tangible evidence from both the federal and provincial governments of their support for large-scale hydrogen development. The recent federal budget included investment tax credits for carbon capture and storage as well as clean energy, which paints a clear picture of the importance of these projects.

As we've communicated from day one, the success of our hydrogen project will rely on the cooperation and collaboration of industry and government to ensure policies are in place to make a project of this scale successful.

As most here will already be aware, Indigenous relations and reconciliation are core to our values at Canadian Utilities. In line with these values, I'm happy to say that the first quarter of 2022 also saw us complete a meaningful transaction with Denendeh Investments Inc., or DII, a longtime Indigenous partner in the North. On March 31, 2022, we announced the closing of a transaction which makes DII and ATCO Electric fifty-fifty partners in our Northland Utilities Enterprises business in the Northwest Territories. This transaction demonstrates our continued commitment to economic benefit and capacity-building with Indigenous communities and will create long-term benefits for DII.

Lastly, I would like to highlight later today we'll be releasing our 2021 sustainability report. This report demonstrates our continued focus on energy transition, climate change and environmental stewardship, operational reliability and resilience, people and community, and Indigenous relations. I would also encourage everyone to take a look at the report on our website.

Overall, Canadian Utilities had a strong first quarter of 2022 that saw us advance key growth initiatives while delivering strong year-over-year earnings growth for our shareholders.

That concludes my prepared remarks. I will now turn the call back to Colin.

Colin Jackson:
Thank you, Brian and Jason.

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 it over to the conference coordinator now for questions.

Operator:
Thank you.

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 speaker phone, please pick up your handset before pressing any keys. To withdraw from the question queue, 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 e-mail after the call.

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

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

Mark Jarvi:
Thanks, and good morning, everyone.

Maybe the first question is just with the hydrogen project. Maybe you can just think about or tell us in terms of after the federal budget announcement what are you looking for next, whether it's in the provincial level, or just even continuing the partnership, and now with Shell being involved in the Hub, can you maybe just talk a little bit about how that sort of project's coming together in terms of partnerships?

Brian Shkrobot:
Thanks, Mark, and good morning.

Yes. I would say that we're viewing the income tax credit announcement in the federal budget quite positive. I think we had some expectation that we'd be getting, say, 50 per cent of that carbon capture, so it was kind of in line with our expectations, and then the 35 per cent income tax credit related to transportation and storage and usage is also good news and in line or better, quite frankly, than what we were expected to land on this.

For the more general clean technology income tax credits, I think it's a little bit early to tell how we could apply it to our ongoing clean hydrogen project with Suncor. But overall, we're quite happy, I think we've seen a lot of great developments both provincially and federally; there's the hydrogen conference just the other day, where we saw a lot of provincial support. So over all quite happy on how things are going.

As for the—you mentioned the Atlas project, that's a key piece of the puzzle, for natural gas-derived hydrogen production. Our proposal with Suncor and Shell, this has a direct tie to our clean hydrogen project with Suncor that we're pursuing. The Atlas project will serve as a hub for industry participants seeking economic carbon capture and storage capacity.

From a partnership perspective, the participation of the ATCO-Suncor joint venture provides a project with strong anchor tendency to support the long-term economics of that project, while Shell brings its deep expertise in carbon capture and storage to the partnership. So yes, I think we're quite happy of how things are developing, and following the announcement on March 31, which we've been identified as preferred proponents, the consortium with Shell and Suncor, and we've been asked to submit a full project proposal by no later than, I think, May 2, I believe it is.

Hopefully that answers your question, Mark.

Mark Jarvi:
That's helpful for sure. Thank you.

Then maybe just coming to topic of inflation and indexation in terms of the distribution utilities under PBR. Can you just remind us again of what inflation parameters would have been baked—or have come into the 2022 rates? I believe it was done in mid-2021, so maybe you're not getting the full benefit of what we've seen in the last six months, and then, thinking about inflation metrics and how that all gets folded into the rebate you've seen in 2023, maybe you can just go out an update in terms of how that can play into this year's rates, and what's going to happen next year.

Brian Shkrobot:
Yes Mark, great, yes. I can't remember the exact number that's been built into our 2022 rates, I believe it was 1 per cent to 2 per cent. But as you mention, it doesn't fully, I guess, factor in the latest increase seen here in the last quarter. That said, I would say our distribution businesses are still quite well protected in ways in terms of inflation increases. I'll turn the call over to Jason here shortly, but we continue to monitor the impacts of inflation, as well as supply chain disruptions. And maybe, Jason, you could just kind of comment on what you're seeing in your business and trends of inflation.

Jason Sharpe:
Thanks, Brian.

Think what I'd probably highlight is, at least in the gas distribution business, we carry a lot of stock, so the short-term impact of that inflation isn't hitting us, and then we have some stability also in our association agreements or labour agreements, so we haven't seen those impacts of inflation as of yet on our distribution business, and then, as Brian indicated, the future inflation, that will be built into some of the rate cases that are going on right now.

Brian Shkrobot:
Maybe just to add a little bit more on our electric side of our business, we are seeing some inflationary impacts, especially some of our long-lead material, that we are obviously monitoring and ensuring that we're putting our orders in early, to ensure that we can meet our customer timelines. Then even on the customers' perspective, we're seeing how that's impacting their business and potentially some kind of movement in the timelines that are being requested to hook them up. It's something, from a regulatory perspective; obviously inflation is one of the areas that we'll ensure that is well addressed in our 2023 costs of service application, as well as inflation will be an indexing factor when we go to PBR3, just like the first two PBR terms; so, relatively our utilities are fortunately somewhat protected from those inflationary impacts.

Mark Jarvi:
Just quick follow-up on that last comment, in terms of the rebasing, is it fair to assume that you take the trailing three-year operating costs and then just adjust those based on current inflation with all its, I guess, internal markup? Or like how do we think about the ability to at least manage through the inflation that's happened the last couple quarters, going forward into 2023?

Brian Shkrobot:
Yes, it is based on a three-year average as a guide, and of course it is going to be indexed. But I would say that is a one-year impact, and for utilities we've got to look at the long-term impact of the facts of inflation, such as the capital, it will be rolled in, to the extent that our capital comes in a little bit higher as a result of inflation, it will translate into the opening rate base for periods going forward, so there might be some short-term impacts, but from a long-term perspective inflation should be addressed through our rate cases.

Mark Jarvi:
Sounds good. Thanks for the time and the answers.

Operator:
The next question comes from Maurice Choy with RBC Capital Markets. Please go ahead.

Maurice Choy:
Thank you, and good morning. Two questions from me, first on LUMA and second on the hydrogen projects as a follow-up.

First on LUMA. You mention in your prepared remarks that you expect the bankruptcy proceeding to complete later this year. Given that the government has decided to cancel the, I guess, PREPA's debt restructuring agreement, can you discuss what happens if this proceeding with regard to bankruptcy continues past the 18 months, and overall your view about your continued appetite in the region, particularly given the press related to the blackouts earlier this month.

Brian Shkrobot:
Sure. Thanks, Maurice, thanks for your question.

Yes. In terms of the PREPA bankruptcy proceedings, we had initially hoped to be mid this year, but we do think it's going to take a little bit longer, maybe closer to the end of the year. That said, in technical standards, the supplemental agreement would automatically terminate, unless an extension is negotiated and mutually agreed upon by the parties, which, quite frankly, we think is the most logical thing that would happen, to extent that it does not complete within 18 months.

We believe that the outcome of like a termination is highly improbable, and that the negotiated extension is, again, continue to be pushed forward, because they need a strong operator that can repair and modernize Puerto Rico's electricity system, and they look for a third party or external party coming in, and that's part of the agreement with FEMA. So, in all likelihood, and we're pretty confident that this will be either completed or their extension that would be granted.

Maurice Choy:
Thanks for that. My second question is about, more specifically, your hydrogen project with Suncor. You would have seen some news this morning relating to Suncor and an activist investor. So I just want to better understand your relationship and your desire for the project. Suppose there is a change in intent from your partner on this project. Could you discuss, A, what other partners you may be thinking about, and B, if you would go at it alone?

Brian Shkrobot:
I'm not specifically—I didn't hear the news this morning or what the comment you just mentioned, but I would say that we have seen no signs from Suncor from any backing out of the partnership. They continue to work very well with us. Again, it's a mutual partnership where we see combined value for what they bring to the table and what ATCO brings to the table.

I know there's a lot of industries like Suncor that are pursuing hydrogen as an alternative in a decarbonization strategy, so I think there will be lots of opportunities for all players, but again, I truly believe that the ATCO-Suncor partnership just makes a lot of sense, and from our perspective, we would want a strong anchor tenant for some of the capacity of any project that we build, so I wouldn't think that we would do it alone, we would need that strong partnership.

Maurice Choy:
Great. Thank you very much.

Operator:
Once again, if you have a question, please press star then one.

The next question comes from Matthew Weekes with IA Capital Markets. Please go ahead.

Matthew Weekes:
Good morning, thanks for taking my question.

I think just on the renewable power side and the goal to own, manage or operate 1,000 megawatts by 2030, just looking at that and sort of some of the things you're seeing in the federal budget about government support continuing and maybe strengthening for renewable electricity. Are you sort of seeing any support in terms of what you might be building out in that area of the business?

Brian Shkrobot:
Thank you, Matthew, thank you for your question.

Yes. We still see renewable generation as a great growth area for us. You might be aware of the kind of three solar projects that we are currently underway completing, the Barlow Deerfoot solar project, as well as the Emperor solar project, so we're right in the middle of that, and we recently announced the purchase power agreement with Microsoft. So, you could see a lot of demand for purchase power agreements and renewable clean energy.

Yes, I think there's going to be continued federal and provincial support for renewable generation, and we definitely see that as a growth area for us, and we'll continue to pursue it.

Matthew Weekes:
Okay, thanks. That's everything for me, thanks. I'll turn the call back.

Operator:
That concludes the question-and-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, Cherice, and thank you all for participating today. We appreciate your interest in Canadian Utilities, and we look forward to speaking to you again soon. Thanks, and goodbye.

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