Canadian Utilities Limited
Third Quarter 2019 Results Conference Call Transcript

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Speakers:

Myles Dougan – Director, Investor Relations

Dennis DeChamplain – Executive Vice President and Chief Financial Officer

Conference Call Participants:

Maurice Choy RBC Capital Markets (Canada) – Research Analyst

Andrew Kuske Credit Suisse – Research Analyst

Mark Jarvi CIBC Capital Markets – Research Analyst

Patrick Kenny National Bank Financial – Research Analyst

Jeremy Rosenfield Industrial Alliance Securities – Research Analyst

Ben Pham BMO Capital Markets – Research Analyst

Operator:
Welcome to the Canadian Utilities Limited Third 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, one on your telephone keypad. Should you need assistance during the conference call, you may signal an Operator by pressing star, zero.

I would now like to turn the conference over to Mr. Myles Dougan, Director, Investor Relations. Please go ahead, Mr. Dougan.

Myles Dougan:
Thank you, Savis. Good morning, everyone. We're pleased you could join us for our third quarter 2019 conference call.

With me today is Executive Vice President and Chief Financial Officer, Dennis DeChamplain, Senior Vice President and Controller, Derek Cook and Vice President Finance Treasury and Risk, Colin Jackson.

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 Dennis for his opening remarks.

Dennis DeChamplain:

Thanks, Myles, and good morning, everyone. Thank you all very much for joining us today on our third quarter 2019 conference call.

Canadian Utilities announced adjusted earnings of $106 million in the third quarter of 2019, which is $26 million lower compared to the $132 million we recorded in the third quarter of 2018. You may recall we recorded $42 million in adjusted earnings in the third quarter of 2018, associated with the balancing pools termination of the Battle River Unit 5PPA, and a completion of performance obligation and availability incentives.

While that was a good financial result last year, it also set us for quite a challenge this year to close that earnings gap, and close that earnings gap is exactly what we've done. Our adjusted earnings in the first nine months of 2019 are $432 million or $12 million higher than the first nine months of 2018. Our pipelines and liquids and electricity businesses have both done well so far in 2019. Their positive earnings results have come from several areas.

First, thanks to all of our people involved in the regulatory filings, we've produced positive earnings impacts from the electricity transmission 2018 and 2019 general tariff application decision and the natural gas pipeline 2019 and 2020 general rate application decision.

Second, we continue to achieve rate-based growth across most of our utilities in no small part due to the focus of our capital teams. Through their great work we continue to deliver more energy safely and reliably for our customers.

Third, our operating teams across the Company have maintained a keen eye on cost containment and the implementation of cost efficiencies. Our customer's benefit when we provide the best services and the most cost-effective way, and our share owners benefit as we respond to the operating efficiency incentives inherent in our regulatory construct and generate premium returns on equity. Due to the great work of all of our people, we have been able to achieve some remarkable financial results.

Continuing with that theme, during the quarter we completed the sale of our entire 2,100-megawatt Canadian fossil fuel-based electricity generation portfolio in three separate transactions. Canadian Utilities received $821 million of aggregate proceeds. We also recognized a gain on sale of $139 million, which is after tax, and that has been excluded from adjusted earnings.

These sale transactions removed the coal fired electricity generation assets from Canadian Utilities' asset portfolio and have the added benefit of significantly reducing our overall greenhouse gas emissions as of October 1, 2019.

We also continue working on the sale of Alberta PowerLine. In September we confirmed that seven Indigenous communities entered into definitive agreements to purchase the combined 40% ownership in APL. The remaining 60% of APL will be owned by an investment consortium. Canadian Utilities will remain as the operator of APL over its 35-year contract with the Alberta Electric System Operator.

We are pleased to announce that late yesterday, October 30, we achieved another milestone towards the closing of Alberta PowerLine Limited Partnership sale. Bond holder consent was achieved with more than 95% of bondholders providing their approval during the initial written consent solicitation process. With the sale of APL, it's expected to close in the fourth quarter of 2019.

Going forward, we will focus on opportunities that globally diversify our portfolio of utility and energy infrastructure assets and leverage the breadth of our energy expertise. Our success as a financially secure and stable energy infrastructure company is a result of our disciplined and prudent capital investment in utility and utility-like assets, which regulated our long-term contracted earnings. We will continue to look for similar investment opportunities outside of Alberta, in North America, Latin America, and Australia.

I'm also pleased to report that we received updates from our rating agencies on our financial strength in the third quarter. In July and August, Dominion Bond Rating Service released a series of reports affirming our A range corporate credit rating and stable outlook for ATCO, Canadian Utilities, and CU, Inc. Earlier this month SMP Global Ratings affirmed their A- credit rating and stable outlook for our Companies as well.

We do intend to maintain these strong investment grade credit ratings to provide efficient and cost-effective access to funds required for our operations and growth.

That concludes my opening prepared remarks. I'll pass the call back over to Myles.

Myles Dougan:

Thank you, Dennis. I'll turn the call over now to our conference co-ordinator for your questions.

Operator:

We will now begin a 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, one on your telephone keypad. You will hear a tone acknowledging your request. If you're using a speaker phone, please pick up your handset before pressing any keys. To withdraw your question, please press star, two. Webcast participants are welcome to click on the submit question tab near the top of the webcast frame and type their questions. The Canadian Utilities Investor Relation 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, one at this time. We will pause for a moment as callers join the queue.

Our first question comes from Maurice Choy with RBC Capital Markets. Please go ahead.

Maurice Choy:

Good morning. My first question, I guess just a follow-up on the capital deployment. It sounds like the commentary has been unchanged. I wonder whether if— it is a case where we're still casting a wider net or there have been targets, be it market type assets that you've further refined since Investor Day?

Dennis DeChamplain:

Hi, Maurice. Good morning. There has been no significant change in our capital investment prospects. We're still forecasting our $3.5 billion of investment over the next three years, and we're continuing our pursuits for re-deploring the proceeds that we've garnered on the sale of our generation business.

Maurice Choy:

I guess since you brought up the $3.5 billion, in relation to the transmission GTA—obviously you've asked for 2020 to 2022, but also establishing an escalator for 2023 and 2024. Notwithstanding the AUC still has to review this extension bit of it, can you speak a little bit about how this escalator may relate to your capital project opportunity or the rate-based growth of this business?

Dennis DeChamplain:

Our transmission business is different. Regulatory requirements for transmission is a little bit different than natural gas. Our rates on the electricity transmission side are date certain. That means at the end of our test period, we must file for new rates whereas in our gas businesses we can stay out on existing rates. What we've done is put in an option at our request to escalate the approved 2022 rates into 2023 and '24 at our option.

When we approach that time period we'll be assessing whether the escalated rates for the—we'll call it the fourth and fifth years, will adequately recover our costs including an opportunity to earn a fair return, and we'll take a look at what those growth prospects are in the transmission business at that point in time before we—if approved by the AUC, pull the trigger on that escalator or not.

Maurice Choy:

Thanks, and just finally on Australia. I guess other than getting better clarity on the ROE and I believe your commentary on cost rebasing is largely unchanged. Has there been anything that may have changed your view of your ROE from say Q2 or at the September Investor Day?

Dennis DeChamplain:

No, not really, Maurice. The return on equity as we've disclosed has dropped from the 7.21% to 5.02%. That results in about a $15 million per annum drop in regulated earnings coming out of ATCO Gas, Australia. There has been a little bit of work in the third quarter by the regulator taking a look at the load forecast. There's been some puts and takes or to-ing and fro-ing, I'll call it, with the regulator and submissions on that. We're right now in a holding pattern until we receive the decision in November as currently anticipated.

Maurice Choy:

Thank you very much.

Dennis DeChamplain:

Thanks, Maurice.

Operator:

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

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

Andrew Kuske:

Good morning. Maybe the first question is just on the outlook for rate-based growth in Alberta, and maybe we could just discuss a little bit of the mix of replenishment capital that is effectively driven by assets that are sort of towards the end of their life versus new growth capital.

Dennis DeChamplain:

Good morning, Andrew. Over our plan period we're still looking at $400 million to $500 million worth of rate-based growth per annum. That results in about 4% growth per year. With the growth prospects, and what we've seen over the past couple of years in Alberta, we've really gone to more maintenance capital as opposed to growth capital. Maintenance capital is absolutely required for safe reliable service. Examples of that are our urban pipeline replacement program that we have in our gas transmission and a lot of the CapEx and our electricity transmission. On a kind of a rough order of magnitude, I'll call it about two thirds system maintenance and reinforcement capital and about one third on growth capital.

Andrew Kuske:

Okay, that's great. Then maybe just a follow-up. When we see the policy coming up from the Alberta government today on just the rail over the production quotas—how do you think about just longer-term expectations for hydrocarbon production out of the province, and how does that impact the longer-term growth rates for CU?

Dennis DeChamplain:

The hydrocarbon producers have been a great driver for the Alberta and Federal economies as our customers required additional transmission facilities—powering the north in getting the backbone of our grid up to the oil producing areas. That really led to the, we'll call it, the big build in the northern part of our province. In the southern part of our province we had, along with Altalink as well, we had significant investments to rebuild our backbone to enable the interconnection of renewable generation. That backbone is largely built now for the major oil sands up north and the renewables down south. We don't expect to see huge rate-based growth in our Electric Transmission company as a result of hydrocarbon growth. As more wells are drilled and explored, as we interconnect the fields up in the Montney Duvernay area our electricity distribution business will benefit. Again, it's a long-term play. We'll see how that drives our customers' investment decisions for a future major plant.

Andrew Kaske:
Very helpful. Thank you.

Dennis DeChamplain:
Thanks, Andrew.

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

Mark Jarvi:
Good morning. I wanted to come back to your comments on the credit rating agencies. Were there any more discussions with them around shifting you down to a lower volatility—the business risk given the sale of the power assets?

Dennis DeChamplain:
Good morning, Mark. No, we haven't had any further discussions with the credit rating agencies regarding the improved quality of our earnings. We are looking to meet up with them soon, and when our paths connect, we will be continuing to advocate that, but we haven't made any further grounds since we've last chatted.

Mark Jarvi:
Okay. Then obviously there's a little bit of uncertainty, and it's a bit hard to predict, but with the general cost of capital review coming up next year in Alberta—does that impact at all on how you guys think about redeploying the capital so much as maybe holding back a little bit depending if they do lower

ROEs to help you guys preserve balance sheet strength. Is there any thought around holding back a little bit to see how that plays out?

Dennis DeChamplain:

Not so much. A lot of our utility capital is required for that safe reliable service. As I mentioned earlier, about two thirds maintenance and one third growth capital. Projects like our urban pipeline renewals will be continuing, we have re-enforcement programs that are risk based, and while those risks and timing of our actions change, our commitment to safe and reliable service does not. So, we'll continue to deploy our capital as required in our regulated utilities in order to meet our obligations to serve requirements. If the generic cost of capital outcome results in lower ROEs, then that would be consistent with a kind of overall environment for all companies in the lower for longer scenario. We'll take a look at as we re-deploy our capital. If returns and utilities come down, returns in other targets may come down as well, so we'll take a look at that as we progress.

Mark Jarvi:

Maybe as you stand today given the proceeds that have come in, where the balance sheet is, and your discussion with the rate agencies, how confident would you guys be with re-deployment—like the bulk of the proceeds now—any concerns or any reservations about spending that money right now, or sort of—yes, any commentary around that?

Dennis DeChamplain:

We're not spending the money right now. We are sitting on the cash, and that helps our net debt for our FFO to debt calculations. As we've discussed at our Investor Day and continually, we will continue our prudent disciplined approach to re-deploying that capital. We're looking at our target markets outside of Alberta, rest of Canada, the United States, LatAm and Australia as well.

Mark Jarvi:

Good. Thanks, Dennis.

Dennis DeChamplain:

Thank you.

Operator:

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

Our next question comes from Patrick Kenny with National Bank Financial. Please go ahead.

Patrick Kenny:

Good morning, guys. Dennis, there's been several new wind and solar projects announced in Alberta over the past few months. Wondering if this trend continues, if tying all these projects into the grid might represent a bit of an upside to your electric rate-based growth outlook?

Dennis DeChamplain:

As I mentioned a little bit earlier, the big build for transmission, we upgraded our network, the backbone, ourselves and Altalink to 240kv, our Hanna project and the Altalink projects, I think. We initially energized one circuit. We built those towers for the ability to carry two circuits, and I'll say the major capital has already been invested. It's the lowest overall cost to be able to build a tower where you can hang two circuits on it. Right now, some of those lines, we've only hung one circuit. As the growth materializes, we have the ability to go in and double the capacity of those lines. If there's future major wind projects that need to be interconnected, that backbone has been built in order to accommodate it.

I think a lot of the economic projects for the wind and solar, the closer you are to a hook up, the better it is for those projects. Those customers really pay for the interconnection costs. So, if it costs, we'll call it $50 million to interconnect your solar project to the distribution system, customers typically would fund that while we would get the capital that would be offset with the customer contribution and as a result there wouldn't be material rate-base growth as a result.

Patrick Kenny:

Thanks for that. Curious to your thoughts on Mexico as a target market these days, given we saw some resolve over the summer on some of the gas pipeline contracts in the country. Maybe perhaps we could just get a refresh on your geographical pecking order for re-deploying the sale proceeds between, Canada, U.S., South America, Australia, and Mexico?

Dennis DeChamplain:

As we look to re-deploy the capital, we'll call it—our target is for regulated or long-term contracted earnings in utility or utility-like. If you consider a regulated utility as being up there in the pecking order, those aren't really available in Mexico. So, to re-deploy those proceeds, we would be looking at other jurisdictions—to re-deploy in a regulated utility we would be looking at other jurisdictions besides Mexico. We're still looking in Mexico for the long-term contracted earnings. We do have a few projects down there now where we do have heavily contracted earnings such as our Veracruz hydro plant, and we continue to work with potential customers down there. Options for utility scale solar that can be built if we have the off-take, and we're considering those types of projects down in Mexico as well.

I can't tell you the rest of Canada, number one. United States, number two. Mexico, three. Australia, four. South America, five…that type of a pecking order. We evaluate each of those projects as it comes. Definitely geographic diversity is a major consideration for when we review our potential projects and re-deployment of our cash.

Patrick Kenny:

Fair enough. I got it. Then lastly, looks like there's going to another round of petrochemical diversification subsidies here in the province. Can you just maybe remind us how your Heartland water assets and footprint might be positioned here to capitalize on the next wave of petrochemical growth in that area.

Dennis DeChamplain:

Thanks for that water question. We have our small water company right now. We do have a contract to supply water to IPLs new facility that will be coming online, I think, 2020 or 2021— the 2021 time range. We do have that water license, we're able to interconnect IPL through our, call it, our little water backbone that we have there. We are continuing to work with customers in the Heartland to help them with their needs.

Patrick Kenny:

That's great. That's it for me, guys. Thanks.

Dennis DeChamplain:

Thanks, Pat.

Operator:
Our next question comes from Jeremy Rosenfield with Industrial Alliance Securities. Please go ahead.

Jeremy Rosenfield:
Good morning. Just a quick question on the Pembina Keephills Pipeline, it looks like the capital cost estimate has creeped up a little bit here quarter-over-quarter. Can you just sort of walk us through what changes have been made, if any to the project, or what's really causing the capital costs to move around here?

Dennis DeChamplain:
Thanks, Jeremy. When we initially disclosed that, it was at $230 million, and then there was a time where we moved it down to $200 million. Since then we've been consistent with our regulatory applications that's in there at $230 million—the project is in flight right now. We do expect those costs to come through between the $200 million and $230 million mark. There are some contingencies associated with that project. I think most notably some of the river crossings with directional drills that we need to traverse. A couple of water bodies here, and that will be one of the key elements of whether all the contingency is required or not. We won't be passing through those events until later this fourth quarter, early first quarter, and we'll be able to give an updated number at that point in time.
We're right in there at that $200 million to $230 million range.

Jeremy Rosenfield:
Then in terms of the regulatory approval process for the pipeline projects specifically, can you just remind us as to where you are with that?

Dennis DeChamplain:
We received approval for that Pembina Keephills in August 2019, and it was approved as filed, which was about a full year after we filed that application with the AUC. So it put us behind the eight ball a little bit, and thanks for following up because it's been lost a little bit. One of the great successes in the third quarter was that we were able to get that approval from the AUC and will still be able to meet our customers required in-service date of second quarter of next year.

Jeremy Rosenfield:

That's great. Then as just as a little clean up question. There was a note in the MD&A around changes in the recording of depreciation expense, I believe, in the third quarter and the electric distribution segment, if I'm not mistaken. Can you just sort of explain what's going on terms of depreciation rate changes and depreciation expenses, and if this is going to be something material that we should just be aware of within that segment specifically going forward?

Dennis DeChamplain:

On the electricity distribution side?

Jeremy Rosenfield:

Yes, I believe there is just a note in the MD&A on that.

Dennis DeChamplain:

I think my colleagues are signaling to me about $20 million per year.

Derek Cook:

Correct.

Dennis DeChamplain:

Twenty million dollars per year lower depreciation expense as a result of our depreciation study extends the lives. Our revenue comes down by the $20 million, our depreciation expense will come down by the $20 million leaving no impact to earnings. A very small impact to cash flows.

Jeremy Rosenfield:

Do you know if there's a seasonality associated with that or if it's flat across the year? Just out of curiosity.

Dennis DeChamplain:

The depreciation expense is flat across the year.

Jeremy Rosenfield:

Much appreciated. That's it for me. Thank you.

Dennis DeChamplain:

Unlike those distribution revenues.

Jeremy Rosenfield:

Great. I understand. Thank you.

Dennis DeChamplain:

Thanks, Jeremy.

Operator:

Our next question comes from Ben Pham with BMO. Please go ahead. Mr. Pham your line is live.

Myles Dougan:

Perhaps you're on mute Ben? Are you there?

Ben Pham:

Yes, I'm here. Sorry about that. Can you hear me okay now?

Dennis DeChamplain:

We can. Go ahead. Morning, Ben.

Ben Pham:

Perfect. Good morning. Calling from my cell phone. First question on Australia. Are we—going on the 5%, I know you've been over on that historically, but is there options for you guys in the industry to look at maybe changing how that would be calculated going forward rather than having it re-based by monetary policy every five years?

Dennis DeChamplain:

We're looking at that with the legislatures down there. We don't believe that the 5% is representative of the returns that we should be receiving on the systems. It gets set based on a 20-day observation period. Under the same rules, if you had your 20-day observation period back in January, your return on equity would be—call it materially higher than it is for 20 days in September. Unfortunately, it's a national regulation, the binding rate of returns, but we're continuing to advocate over our access arrangement number five in the next five years from 2020 to 2024, and we'll see how we progress over the term in order to get that turned around.

Ben Pham:

Okay. I know it's just—kind of usually have one month versus, say use an average for the last three years or five years or so.

Then second one, the Alberta Z factor, a decision that you quoted, I'm just curious, I know you've got a pretty large portion approved, but what are you thinking about the remaining 10% and how the regulators think about stranded asset risk and maybe just an update on—where is the regulator and maybe the government with the utility asset disposition conversation that's been going on for some time?

Dennis DeChamplain:

That's a good question. Where are they? In the Z factor decision there wasn't, call it, a dissenting comment, but there were comments from the commission pointing out the oddities that the same fire can have an extraordinary retirement in one utility and an ordinary retirement in two others. We were able to recover the book value of our assets in our gas distribution business and in our electric transmission business. The fact that our distribution company didn't reflect the fires in our most recent depreciation study which was just going into PBR, and that was the 2011, 2012 general tariff application for distribution. Our depreciation study at the time used our experience up until 2008, so we were not able to reflect the Slave Lake fire even though we accounted for it in our usual way, recovered our costs. We filed evidence to say that even if the book value of those costs were included in our depreciation study, it wouldn't make one iota difference on our depreciation expense.

The commission pointed that out with a view to spark conversation and move away from the, I don't know if rhetoric is the right word, but help the AUC get over their interpretation of stores block, and their singular interpretation that stores block means extraordinary losses go to the account of our share owners. So, we're continuing to advocate on the regulated front and on the legislative front. We've been pretty clear that our view is that once assets go in the ground based on an approved need, and our costs are determined to be prudent, that our utility is entitled to recover those costs irrespective of any future retirement event, whether ordinary or extraordinary. That's what we are advocating with the legislative side as well.

Ben Pham:

Sounds like the AUC has opined to some extent and announced—really do you think it's more Alberta governments—I think the last one had proposed a bill something along the lines of that. Do you think that will provide more clarity?

Dennis DeChamplain:

That last one, we'll call it failed Bill 13 that they implemented, the amendments gave the AUC unfettered discretion in order to determine how those assets or a loss on the destruction of assets should be attributed to shareholders or customers. Given that discretion to the AUC, we'd be advocating no discretion to the AUC as opposed to 100% discretion to the AUC.

Ben Pham:

Okay. I got it. Thanks a lot, Dennis.

Dennis DeChamplain:

Thanks, Ben.

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:

Thanks, Savis, and thank you all for participating this morning. We really appreciate your interest in Canadian Utilities. We look forward to speaking with you again soon. That's it for now. Thanks.

Operator:

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