Canadian Utilities Limited
Second Quarter 2021 Results
Conference Call Transcript

Date: **Thursday, July 29, 2021**

Time: **9:00 AM MT**

Speakers:

Colin Jackson - Senior Vice President, Finance, Treasury, Risk and Sustainability

Dennis DeChamplain - Executive Vice President and Chief Financial Officer

Brian Shkrobot - Senior Vice President, Finance and Regulatory, CU Inc.

Conference Call Participants:

Maurice Choy - RBC Capital Markets - Research Analyst

Andrew Kuske - Credit Suisse - Managing Director

Mark Jarvi - CIBC Capital Markets - Research Analyst

Matthew Weekes - iA Capital Markets - Research Analyst

Operator:
Welcome to the Second Quarter 2021 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.

I would now like to turn the conference over to Mr. Colin Jackson, Senior Vice President, Finance, Treasury, Risk and Sustainability. Please go ahead, Mr. Jackson.

Colin Jackson:
Thank you. Good morning everyone. We are pleased you could join us for our Second Quarter, 2021 Conference Call.

With me today is Executive Vice President and Chief Financial Officer, Dennis DeChamplain, and CU Inc.'s Senior Vice President, Finance and Regulatory, Brian Shkrobot. Dennis will begin today with some opening comments on recent Company developments and our financial results. 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 that all 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 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, Colin, and good morning, everyone. Thank you all very much for joining us today on our Second Quarter 2021 Conference Call.

Canadian Utilities achieved adjusted earnings of $115 million, or $0.43 per share, in the second quarter of 2021. This is $21 million, or $0.09 per share, higher than the second quarter of last year. The

$21 million of growth in our earnings was primarily driven by strong performance in our Puerto Rico LUMA business, our Australian natural gas utility and our Canadian distribution utilities.

Our Australian natural gas utility benefited from a rising CPI, which continued to trend upwards towards a more stable level during the second quarter. Economic activity in Western Australia has also improved in 2021, with mining activity, in particular, looking strong coming out of the pandemic. We're optimistic that these trends will continue through the remainder of 2021, and create momentum coming out of the pandemic.

In Puerto Rico, we marked a significant milestone on June 1st, with the successful completion of the one-year transition period, which, on top of being completed ahead of schedule, it involved countless regulatory, operational, safety, financial planning and readiness activities. Following the successful transition, LUMA assumed full operation of the electricity transmission and distribution system under a Supplemental Agreement. We will operate under the Supplemental Agreement until such time that PREPA has concluded its bankruptcy proceedings, at which point we'll move directly into the 15-year operating agreement.

Since commencing our work in Puerto Rico, there have been challenges, some of which have been covered in the local media. As with any undertaking of this scale, there will always be challenges and resistance to change, but we remain committed. We'll be putting our heads down and working to meet our commitments to all stakeholders, including the people of Puerto Rico.

On the regulatory front, we have continued to gain more progress on prospectivity, with several decisions received in the quarter.

In mid-June, the AUC issued its decision on the ATCO Gas Transmission application to acquire the Pioneer Pipeline. The Commission ruled favourably and approved the application as filed. The AUC also approved our application to transfer the 30-kilometre western segment of the Pioneer Pipeline to Nova Gas Transmission, as this segment is located within NGTL's service area. NGTL is awaiting approval from the Canadian energy regulator and the transfer is expected to close in the fourth quarter of this year.

Further direction on the 2023 cost of service application process for the Alberta distribution utilities was also received in June and came in largely in line with our expectations. Applications from both our electricity and natural gas distribution companies will be filed in the fourth quarter of this year.

Following the one-year 2023 cost of service period, the AUC has also approved a third PBR term to commence in 2024. A generic proceeding will be initiated in the third quarter of 2022 to outline the parameters of this third PBR cycle, including a review of the term, capital funding provisions, inflation and productivity factors, and consideration of an earnings sharing mechanism.

In terms of capital investment, we invested $430 million in our business in the second quarter of 2021. Of this $430 million, $412 million was invested in our core utility businesses to ensure the continued generation of stable earnings and reliable cash flows. This investment does include the Pioneer Pipeline acquisition that I noted earlier.

In our Energy Infrastructure businesses, we continued to invest in our clean energy strategy in the second quarter, exploring opportunities in both the renewable energy generation and clean fuel streams of the strategy, including our recently announced collaboration with Suncor to pursue a world-class hydrogen production facility in Alberta.

In line with this clean energy strategy, I wanted to highlight that we released our 2020 Sustainability Report in May of this year, which included key information on how we're positioning our business for a lower emissions future. Notably, this report highlighted the 90 per cent reduction in Scope 1 emissions that we achieved against 2019 through the sale of our fossil fuel generating business, along with the 17 per cent reduction we've achieved since 2019 in our retained portfolio.

Hydrogen, a clean fuel that is part of our larger clean energy strategy, will play a critical role in affordably decarbonizing the production and delivery of heat to our customers. Amongst other benefits, it has the potential to utilize existing pipeline infrastructure, which will greatly reduce the transition time and costs necessary to move closer to a lower emissions world. We believe that hydrogen will become an important source of revenue and profitability for Canadian Utilities into the future, and that's why we've continued to take steps to maximize our presence in this market globally.

In early May, we announced our plans to develop Western Australia's first commercial scale green hydrogen production facility, called the Clean Energy Innovation Park, in association with our joint venture partner, the Australia Gas Infrastructure Group. This project leverages the learnings from our Clean Energy Innovation Hub in Australia, which was focused on investigating the potential role of hydrogen in Australia's future energy mix and has been successfully blending hydrogen into our gas system in Australia.

Not only is the Clean Energy Innovation Park a significant step forward for commercial hydrogen in Australia and for our own aspirations in the hydrogen market, we've also been successful in conditionally securing UD$29 million in funding from the Australian Renewable Energy Agency, referred to as ARENA, to kickstart this initiative. With the planned 10-megawatt electrolyzer, the Park will be capable of producing 4.6 tonnes of hydrogen per day and will utilize renewable power from an existing co-located 180-megawatt windfarm. The Park will also house related storage infrastructure and provide delivery to natural gas system injection points.

In May, we announced that we were working with Suncor to design a clean hydrogen production facility at ATCO's Heartland Energy Centre near Fort Saskatchewan, Alberta. This world-class project is expected to produce more than 300,000 tonnes per year of clean hydrogen and reduce Alberta's CO_2 emissions by more than 2 million tonnes per year.

This hydrogen project with Suncor will significantly advance Alberta's hydrogen strategy and Canada's net zero ambitions as a whole, generating substantial economic activity and creating jobs in the process. While it remains early days for this project, and there is significant technical development work to do, we're working with the provincial and federal governments to ensure that sufficient support structures are in place for a project of this scale to be successful.

I also want to take a minute to highlight our recently announced renewable natural gas, or RNG, development with Future Fuel Limited, that is located near Two Hills, Alberta, which is about an hour-and-a-half drive just east of Edmonton. The facility will utilize organic and agricultural waste from nearby communities to produce approximately 230,000 gigajoules per year of RNG. This is enough renewable natural gas to fuel 2,500 homes and will lead to the avoidance of up to 20,000 tonnes per year of CO_2 equivalent emissions.

While the scale is much smaller than the hydrogen opportunity we discussed a couple of minutes ago, this project, and others like it, that we intend to explore in the near term, are critical to our larger clean fuel strategy. This project serves as a blueprint for other rapidly executable projects and will provide near-term earnings and cash flows to support the ongoing development of our larger and longer lead hydrogen initiatives.

Lastly, I wanted to mention ATCOenergy's June launch of Rümi, an innovative start-up, aimed at providing homeowners with solutions for everyday household challenges by connecting them with trusted professionals. Rümi offers smart home technology products and repair and maintenance services to the Calgary and Edmonton markets, in addition to a wealth of general home management advice.

All in all, Canadian Utilities carried the momentum from the first quarter of 2021 into a strong second quarter, and we'll continue to push hard heading into the second half of this year.

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

Colin Jackson:
Thank you, Dennis. 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 co-ordinator now for questions.

Operator:
Our first call comes from Maurice Choy, RBC Capital Markets. Go ahead, please.

Maurice Choy:
Thank you, and good morning. My first question relates to all the key energy initiatives that you've announced. Obviously, you've got the hydro that you previously announced in Australia, the renewables in Chile, RNG in Alberta, as well as the hydrogen production facilities that may come online in Alberta and Australia. If you were to draw a spectrum of returns and compare these initiatives against perhaps the 8.5 per cent base ROE you get for Alberta regulated utilities, how would that spectrum look like and how would you rank these initiatives?

Dennis DeChamplain:
Good morning, Maurice. I hope you're staying safe. Yes, the utility returns would be mostly at the far left of the spectrum, with the lowest risk and, therefore, the lowest return. The other projects that you've outlined—maybe I should check that—right now, we're seeing solar returns, returns for solar projects coming in lower than the utility returns, right in around that area in terms of an equity return on—equity returns. The other projects, we really do need to look at them on a project-by-project basis. Our method of operating, we prefer long-term contracted assets with credible counterparties. Also, we're partnering with likeminded firms that share our values, as we go to de-risk the investments.

I can't tell you for certain whether a Central West Pump Hydro would more or less risky than the hydrogen project. It depends on the long-term contracted outputs, the inputs, what kind of backstops you may have from counterparties, and what have you. Because of the additional risks, those returns are north of the utility returns, I'd say, kind of somewhat obvious, but I'm not prepared to get into specific returns for specific projects due to commercial reasons.

Maurice Choy:
That's fair enough. Maybe as a follow-up to that, would it be fair to say that you wouldn't enter into these initiatives after considering the government funding or subsidies that you may receive, that you wouldn't enter into these initiatives unless it's at least in line, if not better than the Alberta returns, again recognizing that you do outperform in Alberta, as well?

Dennis DeChamplain:
Well, we need to take a look at the projects. As we scan the environment, the Utilities, I'm going to say are at the far left of the spectrum. So, if we can't completely de-risk it down to the utility level, then, yes, we would be expecting higher returns.

Maurice Choy:
Understood, and then my second question.

Dennis DeChamplain:
But you do hit on a good point of kind of the approved return versus the achieved return coming out of our Utilities, which we do take into account, as well.

Maurice Choy:
When you look at far left of the spectrum, is that the 8.5 per cent, or is it 8.5 per cent plus outperformance?

Dennis DeChamplain:
There's a range there, depending. Given the regulatory resets and what we have achieved over the last decade, of north of 200 basis points outperformance, we get asked, "What are you going to do for me next year and how are you going to restock those fading shelves?" We do continue to outperform, it's a challenge to Management, and the teams do a great job of doing it. So, I'll say we do bank on somewhat outperformance, and the exact amount, I'll say we don't have an exact amount, it's a bit of a range, given the regulatory pressures and our views going forward.

Maurice Choy:
Understood, and then my second question, you know, maybe take a few years forward into the Suncor clean hydrogen project that you're considering, could you—if you were to FID this later this decade, can you help us understand roughly what the investment, your share would be, and would you consider bringing on a partner alongside yourselves and Suncor?

Dennis DeChamplain:
Never say never with another partner. We do think, between ourselves and Suncor, we have the capacity and the skills required in order to execute the project. Suncor brings hydrogen production experience, large project management experience. We're in the storage and piping business. So, we believe that we have the capability required and the capacity required to do the project on our own. In terms of capital costs and economic return details, those are still being worked out. Given that it's a world-class scale, there's great long-term potential for the project, and we're continuing to work through those details.

Maurice Choy:
I guess, would it be fair to look at the balance sheet capacity that you have—in particular, using the proceeds from the recent asset sales, would you say that what you have today is enough to fund these and all the other initiatives that you've announced so far?

Dennis DeChamplain:
Yes, we've looked at the stacking of opportunities and we wouldn't have pursued the hydrogen production facility with Suncor if we didn't have the ability to pursue the financial capacity and ability to proceed with it. We've been, I think, relatively clear on our strategy with regards to clean fuels and renewable energy. The pace and quantum can flux with opportunities, but we do have that capacity to execute on all the initiatives in our strategy.

Maurice Choy:
Great, thank you very much.

Dennis DeChamplain:
Thanks, Maurice.

Operator:
Our next call comes from Andrew Kuske, Credit Suisse. Go ahead, please.

Andrew Kuske:
Thank you. Good morning. Maybe I'll start with a narrow question first. Obviously, we've seen some pretty robust inflation in numbers around the world, in various regions, it's a bit different, but could you maybe just address any near-term positive impacts you have from the inflation data just by way of the regulatory mechanisms you have, and then the flip side of that is are you experiencing any cost pressures in any of your assets?

Dennis DeChamplain:
Sure. Maybe I'll start and then I'll ask Brian Shkrobot, who heads up the Finance and Regulatory, from CU Inc., to talk about the Alberta utilities.

We are seeing the positive impacts from the inflation in Australia. Last year, I think we had recorded in the first six months about 0.3 per cent in inflation, and this year it's been 1 per cent inflation. That additional 70 bps accounts for about $7 million in adjusted earnings coming out of Australia, so a great benefit in terms of the adjusted earnings coming from Australia. We do see cost pressures in Australia, along with a lengthening of some lead times, in order to get materials, pipe, in particular, into Perth to execute on our projects, but it's all very manageable right now.

The other element, we'll maybe turn it over to Brian for some colour on the operator regulatory environment impacts on PBR, and your costs, Brian.

Brian Shkrobot:
Yes, thank you, Dennis. Thanks, Andrew, for your question. Yes, as Dennis mentioned, in Alberta, we do have—the PBR mechanisms for the distribution utilities adjust for inflation. So, to the extent that we have higher inflation, that gets adjusted into future rates. That said, similar to Australia, we are seeing some inflationary pressures on our materials, but not too significant, very manageable. We have really good long-term relationships with our suppliers, we're not seeing any issues in terms of getting that material at reasonable rates, continue to monitor through that, but nothing of significance to Alberta for the inflation at this time.

Andrew Kuske:
Thank you, that's helpful. For a second question, a little bit different, and it really relates PREPA. Dennis, you mentioned this in your prepared remarks, just a bit of resistance to change, that's been documented, and that you're committed to making the situation there better. I'm not going to belittle the dynamics of your business are difficult, but you're very capable. I'm not trying to be patronizing about this, because you've got a very extensive track record of doing these kinds of things, but is this just a function of time to win hearts and minds and just delivering what you promised to deliver in the front end, and in a very public process, through the whole dynamics around PREPA and how you wind up with the contract?

Dennis DeChamplain:
Yes, a great question, Andrew. If you look at the vested interests in PREPA for us going in, and I'll say versus what's in the hearts and minds of the people of Puerto Rico, I think there is general consensus, overwhelming consensus that a transformational change is required. There was a JP Power customer satisfaction survey and out of 50 companies, PREPA was No. 50, and they had a heck of a long way to get to No. 49 on the list. That wasn't any of the—I'll call it the stakeholders with the vested interests in PREPA, that was the customers, and that's been our focus going in, winning the hearts and minds of customers.

There was a large fire on June 11. It knocked out about a million customers. We had them all back online within 26 hours, I think, just over a day. I know you weren't belittling at all in your comments, but the way our teams worked through it, in a methodical, safe, efficient manner, it just exudes that operational excellence and the pride that we have in the people down in LUMA. Some of the management stocked from Quanta and from ATCO, and the boots on the ground coming from ex-PREPA employees, it was just wonderful to see. We're not out of the woods yet, there's a lot of work to do, but as we continue to perform and execute, we hope the public sentiment will help turn the vested interests and the noise will quiet down and let us get on with giving the Puerto Ricans the electrical system that they deserve in the years coming forward.

Andrew Kuske:
That's great, I greatly appreciate it, thank you.

Dennis DeChamplain:
Thanks, Andrew.

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

Mark Jarvi:
Thanks. Good morning, everyone. I wanted to start with RNG. You talked about sort of the announcement earlier, two months ago or last quarter. I don't believe that initiative will lead to sending the RNG, or renewable natural gas, into your own utility and ecosystem of your customers. I'm just curious when you think you'll start to introduce RNG into your own gas distribution utility in Alberta and what you need to see from regulators and policy before you can start to make those types of investments and integrate into your own utility?

Dennis DeChamplain:
Good morning, Mark. That's another great question. One of the elements that we're pursuing with the government in relation to hydrogen, but it's also applicable to RNG—right now, the Gas Utilities Act does not allow for or permit the injection of clean fuels in order to lower the CO_2 impact, compared to natural gas. We are working with the provincial government in order to try to get them to amend the GUA in order to allow for that. All of the discussions so far have been very receptive and have gone in a very positive nature.

I'll ask afterwards, Brian, if you've got anything to add here. You're closer to that than I am.

But, that's what we need in order to inject that blending up to potentially 20 per cent to help lower the emissions for our customers.

Brian?

Brian Shkrobot:
Yes, just to add on, yes, the provincial government, we are working with them directly and they're very open to it, it's in the works, per se, in terms of allowing the hydrogen or RNG into our systems. We've also introduced new producer rates, that would also facilitate the connection of the RNG into our systems. So, we've laid the foundations there and we expect in short order to have those approvals.

Mark Jarvi:
Then, would you envision yourself being a producer yourself, or some of Canadian Utilities or ATCO, which would supply RNG, or is it more likely to go to third parties?

Dennis DeChamplain:
No, we are investing in RNG production as part of our clean fuel's initiative. The first project out of the hopper is the Two Hills RNG project at 230,00 GJs, but that would be—because of the small capital costs and associated earnings impact, we're looking to build a portfolio of the RNG production facilities in Alberta, and also outside of Alberta, as our customers are looking to help decarbonize on their efforts, and that's not just in Alberta.

Mark Jarvi:
Got it, and I want to go into the segments a little bit. One is in the corporate. You brought up Rümi and the new initiative they've launched. Are there any upfront costs we have to be mindful off, that might be a bit of a drag in the next few quarters, as you start to build that; and then the second—it looks like the ATCOenergy business seems to be churning forward here and doing well and contributing. Is there anything special about the contribution in this quarter, Q2, or seasonality, or do you think that that contribution, which seemed to have a positive impact this quarter, should persist?

Dennis DeChamplain:
For the first part, is there going to be any drag from Rümi, no, we don't see much of a drag. We're continuing to expand our products and services into, first, the Edmonton and Calgary markets. Should it be successful, when it's successful, we could be looking to expand that outside of Alberta borders, so there's a potential there. There may be some costs, but there's nothing in the near term that should impact the corporate results. The results in Q2 and year to date for ATCOenergy varied in the corporate segment. There's nothing unusual or one-time nature in those results that would cause that to be a blip. We're looking for continued performance out of ATCOenergy as they continue to build their market share here in Alberta.

Mark Jarvi:
Okay. Last one, just on the Alberta distribution utilities, the gas and electric seem to have fairly strong results, year-over-year improvement. There was a mention for the gas about some timing of costs. Is that sort of a retrospective, or is that you deferred some costs, it'll show up next quarter? Then, on the electric side, is that just stronger industrial load as activity picks up in oil and gas base, or is there sort of a weather factor there around residential loads in the quarter?

Dennis DeChamplain:
In terms of gas, and then I'll—I don't know the answer to the second question, so I'm going to punt that one over to Brian, too!

In terms of gas, that’s in-year timing. There’s some expenses in the first half of the year that we expect to incur in the second half of the year. That’s the timing that we’re referring to.

Brian, on the load, for the first bit, weather impacts.

Brian Shkrobot:
Yes, on electric and growth in earnings, again, it’s mainly driven by the continued operating efficiencies that we have implemented over the years and we continue to see the compounding effects of those benefits.

As for the load, yes, we do see strong growth in our customers. We are not impacted by weather, per se, too much, but it’s really driven by strong customer growth, and, again, mainly due to the cost efficiencies and programs that our people have implemented for the benefit of customers and shareholders over the years.

Mark Jarvi:
Perfect. Thanks for taking my questions.

Dennis DeChamplain:
Thanks, Mark.

Operator:
Our next question comes from Matthew Weekes, iA Capital Markets. Please go ahead.

Matthew Weekes:
Hi, and thanks for taking my question. I was looking for a little bit of clarification. You talked about the economic growth …

Dennis DeChamplain:
Sorry, Matthew, we’re having extreme difficulty hearing you.

Matthew Weekes:
Sorry. Can you hear me better now?

Dennis DeChamplain:
Much better. Thank you, Matthew. Sorry about that.

Matthew Weekes:
Sorry about that. Thanks. So, yes, I was just wondering if you'd be able to comment on kind of separating what the impact in the quarter was from the settlements that occurred in the Australian gas business, which was mentioned in the MD&A, as providing a tailwind, versus recovering economic growth and inflation?

Dennis DeChamplain:
Yes, thanks, Matthew. We talked about it a little bit earlier, with regards to inflation, when I was answering Andrew's question. The impact from inflation in the first half of the year is about a $7 million uplift on the results due to CPI. The settlement that we had related to back when we bought ATCO Gas Australia, which it just happens to be the tenth anniversary today that we acquired Western Australia Gas Network, or WAGN. That settlement added about $2 million to the Q2 results for Australia, and that's included in the results and that gives you most of the uplift in Australia's earnings.

Matthew Weekes:
Okay. So, it doesn't like it was really too material overall.

Dennis DeChamplain:
No.

Matthew Weekes:
Okay, thank you very much.

Dennis DeChamplain:
They're continuing to perform and execute, and as I referred to in my opening comments, the economic activity is really picking up there, and we've got—for now, being able to manage the impacts of inflation on their performance. So, they're continuing to perform extremely well.

Matthew Weeks:
Okay, thanks for the clarification on that. That's it for me, I'll turn it back.

Dennis DeChamplain:
Thanks for your question, Matthew.

Operator:
This 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, Operator, and thank you all for participating today. We appreciate your interest in Canadian Utilities and we look forward to speaking with you again soon. Thank you, and good-bye.

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