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CANADIAN UTILITIES LIMITED

An ATCO Company

Canadian Utilities Limited

First Quarter 2024 Results Conference Call Transcript

Date: **Thursday, May 2nd, 2024**

Time: **9:00 AM MT**

Speakers:

Colin Jackson, Senior Vice President, Finance, Treasury, Risk & Sustainability

Katie Patrick, Executive Vice President, Chief Financial Officer

Wayne Stensby, Chief Operating Officer, ATCO Energy Systems

Bob Myles, Chief Operating Officer, ATCO EnPower

Conference Call Participants:

Maurice Choy RBC Capital Markets – Research Analyst

Mark Jarvi CIBC Capital Markets – Research Analyst

Operator:

Thank you for standing by. This is the conference operator. Welcome to the First Quarter 2024 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 then zero.

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

Colin Jackson:

Thank you and good morning, everyone. We are pleased you could join us for Canadian Utilities First Quarter 2024 conference call.

With me today we have Katie Patrick, Executive Vice President & Chief Financial Officer of Canadian Utilities; Wayne Stensby, Chief Operating Officer of ATCO Energy Systems; Clint Warkentin, Executive Vice President & Chief Financial and Investment Officer of ATCO Energy Systems; Bob Myles, Chief Operating Officer of ATCO EnPower; and Greg Stevenson, Chief Financial Officer of ATCO EnPower.

Before we move into our formal agenda, I would like to take a moment to acknowledge the numerous traditional territories and homelands on which our global facilities are located. Today, we are speaking to you from our ATCO Park head office in Calgary, which is located in the Treaty 7 region. This is the ancestral territory of the Blackfoot Confederacy, comprised of the Siksika, the Kainai, the Piikani Nations, the Tsuut'ina Nation, the Stoney Nakoda Nations, that include the Chiniki, Bearspaw and Goodstoney First Nations. The City of Calgary is also home to the Metis Nation of Alberta, Districts 5 and 6. We honour and respect the diverse history, languages, ceremonies, and culture of the Indigenous people who call these areas home.

Katie will begin today with some opening comments on our financial results and recent company developments, followed by an update from Bob and Wayne on their respective business segments.

Following our prepared remarks, the Canadian Utilities team will take questions from the investment community. We ask that questions be limited to two per analyst, and if you have additional questions, please re-enter the queue. Please follow up with the Investor Relations team for any detailed modeling questions.

A replay of the conference call, a transcript, and a short supplementary presentation will be available following this call on our website at canadianutilities.com.

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 refer to our filings with the Canadian securities regulators. During today's presentation, we may refer to certain non-GAAP and other financial measures such as total of segment measures, adjusted earnings, adjusted earnings per share, and capital investment. These measures do not have any standardized meaning under IFRS, and as a result, they may not be comparable to similar measures presented by other entities.

Now, I'll turn the call over to Katie for her opening remarks.

Katie Patrick:

Thanks, Colin, and good morning, everyone. Thank you all for joining us today.

Canadian Utilities had a strong start to the year, delivering adjusted earnings of $225 million in the first quarter. This is up 4 per cent from the same period in 2023. This translates to adjusted earnings per share of $0.83.

ATCO Energy Systems delivered adjusted earnings of $221 million, an increase of 7 per cent from Q1 last year. Results were driven by rate base growth, and an increase to our allowed ROEs from 8.5 per cent to 9.28 per cent across our Alberta-based utilities.

ATCO EnPower delivered adjusted earnings of $8 million in the quarter, down $7 million from the same period last year. The energy storage business continues to show strong performance. However, renewable generation experienced lower earnings year over year. Drought in southern Alberta, wind conditions below historical averages, as well as lower merchant prices contributed to the lower earnings profile.

Beginning this quarter, ATCO Australia is reported as a distinct segment. Previously, Australia was reported in both the Energy Systems and EnPower segments. This change enhances our disclosure and aligns our reporting to how we think about the Australian business internally. This will allow us to provide more meaningful information on this segment as we move forward.

ATCO Australia delivered adjusted earnings of $11 million in Q1 2024, down from $16 million last year. Year-over-year results were impacted mostly by lower CPI expectations. As a rule of thumb, every ten basis points change in CPI results in approximately $1 million annual impact on the Australian business, and we are currently tracking approximately 1 per cent lower than 2023.

Operational execution remains a key priority for Australia and the business is performing very well. We developed over 3,500 new gas connections during the quarter, an increase of 18 per cent year over year, allowing us to grow haulage revenues during the quarter.

We also received the draft AA6 response following our submission in late 2023. We are happy to see the draft includes provisions for 82,000 new customer connections through 2029. The proposed ROE was also increased to 8.47 per cent, reflecting a higher for longer interest rate environment. There was work to be done on aligning our views around operating efficiencies, capital levels, and accelerated depreciation. We look forward to collaborating with the regulator on how we can confidently invest in Australia, reduce uncertainty for consumers, and support Australia's rapidly evolving energy future. We will respond to this draft by June and expect the final AA6 framework to be finalized by November.

We continue to evaluate numerous growth opportunities in Australia. Our engineering teams are developing energy storage projects that will complement our existing Osborne JV and other renewable power generation assets in the region. We look forward to providing additional updates later in the year as we make headway on these projects.

Stepping back and looking at Canadian Utilities as a whole, cash flow from operation was $502 million in the quarter, which supported our operations, capital program, and normal course financial commitments. We also repaid a $120 million CU Inc. debenture upon maturity with cash on hand.

With that, let's dive into each segment in more detail.

I will now turn the call over to Wayne to discuss the ATCO Energy Systems results.

Wayne Stensby:

Thank you, Katie.

ATCO Energy Systems continues to perform well, and we are seeing positive momentum in this quarter's results. Adjusted earnings were $221 million in the first quarter of 2024, which is a $14 million increase over the same period from last year.

As Katie mentioned, and as we had previously discussed in the Q4 2023 call, Alberta regulators have approved an increase in the allowable ROE from 8.5 per cent in 2023 to 9.28 per cent in 2024. This has benefited adjusted earnings in both our electricity and natural gas businesses in Alberta. This decision provides us with certainty on our returns from our utility investments and sets out, importantly, a path forward.

ATCO Energy Systems invested over a billion dollars in our four Alberta based utilities through 2023, and we've invested an additional $282 million in the first quarter of 2024. Our investments are focused really in five areas; which would be customer growth or customer connections, system reliability and safety, climate adaptation and resiliency, decarbonization, and new technology. Our growth outlook remains strong, supported by customer growth in projects like the Central East Transfer Out Transmission Project, which is scheduled to begin construction later this year.

We are on track to deliver the investment levels in line with our three-year plan, and we will provide additional detail on our capital priorities and our programs at our annual general meeting next week.

On the regulatory side, we received a decision in late March from the AUC that had approved the previously announced ATCO pipeline's negotiated settlement for the 2024 and 2025 GRA. As previously mentioned, we are happy to have certainty and a stable outcome regarding these matters. We will continue to work closely with our regulator as we advance growth across our Alberta utilities.

Finally, I want to thank our Energy Systems team for their tremendous work across the past quarter. I'm proud to say that despite the many challenges the team faced during the unprecedented cold spell in January, we were able to keep Albertans warm with reliable gas and electricity. Our system was tested during this period, and we're evaluating future upgrades and investments in order to provide the reliability that our customers expect during these ever-challenging times.

We are also anticipating, and in fact have begun, an active wildfire season, and our teams have been busy preparing through the winter months. They have identified the high-risk areas of our system, and we have invested in hardware upgrades and improvements across our service territory. As well, we've increased our inventory to mitigate supply chain timelines, and we've been working with our contractor teams to ensure there are sufficient resources available across the season. As in previous years, we are also working closely and fully engaged with Alberta Forestry and Parks and our municipal partners in order to provide a coordinated response.

As I look ahead, I see a lot to be excited about in 2024 and beyond. Alberta has experienced the highest population growth in Canada in 2023, and industrial activity continues to show very strong momentum and growth. Alberta's energy needs are expanding, and Energy Systems is well positioned to move that energy, deliver that energy to where our customers need it. We look forward to growing with Albertans and playing our part in the energy transition.

With that, I'll pass the call over to Bob to speak about EnPower.

Bob Myles:

Thanks, Wayne.

Within our storage and industrial water business, we saw stronger spreads on our natural gas storage during the quarter. This led to a 25 per cent increase in adjusted earnings for the quarter in that business. The EnPower team has secured several fixed long-term contracts for storage, and this has provided better visibility on earnings and higher overall margins.

As Katie indicated, on the generation side of EnPower, our Oldman River hydro asset was curtailed in the quarter due to exceptionally dry conditions in Southern Alberta. Following significant recent precipitation, this facility is now once again operating.

Wind generation was down compared to Q1 2023, as we saw wind generation across the province below five-year average levels. We lost generation when temperatures were below the safe operating temperatures for our turbines. These negative impacts were partially offset by contributions from our Barlow, Deerfoot, and Empress solar assets, which achieved commercial operations in the second half of 2023.

We are prepared to take advantage of more favourable summer water flow, solar hours, and wind conditions as we move forward through the remainder of this year.

Comparing Q1 2023 to Q1 2024, our average sale price for power generation declined from $106 to $84 per megawatt hour as a result of a rapidly declining merchant pricing environment in Alberta.

Over the past 12 months, we increased the proportion of our generation assets contracted under power purchase arrangements from 18 per cent in Q1 2023 to 79 per cent in Q1 2024. This aligns with our strategy to have approximately 75 per cent of our generation portfolio under long term contracts, which for us reduces risk, lowers volatility, and increases access to the capital necessary to develop our pipeline of renewable energy projects.

Looking over the long term, Canadians are demanding more and cleaner forms of energy. In April, the federal government confirmed their intent to have Bill C-59 approved by June 1, 2024. This is the legislation containing provisions for carbon capture, utilization and storage, as well as Clean Technology Investment Tax Credits. These investment tax credits (ITC) will allow us and our partners to invest with more certainty. Our development portfolio will allow us to capitalize on opportunities in the energy transition, and the team is working hard to ensure our path forward is commercially viable and will generate sustainable long-term shareholder value.

As it relates to our project pipeline, we continue to advance several initiatives. Our Forty Mile Solar project is shovel ready, and our focus remains on contracting a significant portion of the generation prior to commencing construction. We also continue to make progress on the Atlas Carbon Sequestration project with our partner Shell Canada. Together we are advancing towards FID in Q2 of this year once the carbon capture and storage ITC has been passed into legislation. Our Forty Mile operating project has completed construction, and we are now in the commissioning phase of this project. This will add 23 megawatts of additional capacity, and we are on track to begin commercial operations in the back half of 2024.

On our large hydrogen project, we are in the final stages of a process to select a partner, we are progressing commercial discussions with potential off-takers, and we have been moving forward with technology selection and other technical work associated with this project.

We remain excited for the potential growth of EnPower and the business, and we will continue to provide updates on these projects throughout 2024.

With that, I'll now pass the call back to Katie.

Katie Patrick:

Thanks, Bob.

Canadian Utilities is off to a good start in 2024. We are executing well on our operating plans and continue to make progress on our growth opportunities.

As most on this call are aware, we released updated rate-based growth and capital guidance for our utilities at year-end and are advancing on this work. In addition, we have provided substantially more detail on our EnPower projects and milestones in our investor presentations.

Finally, Colin and I would like to thank the many investors we recently met with as we were proactively increasing our engagement and transparency with the investment community. I would also like to thank the internal team for their hard work over the past quarter and demonstrating our core values of safety, integrity, agility, caring, and collaboration every day.

With that, we will now open the line 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're using a speakerphone, please pick up your handset before pressing any keys. To withdraw your question, please press star then two.

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

Maurice Choy:

Thank you, and good morning, everyone. I just want to pick up on the discussion on the large-scale hydrogen project. I appreciate that you're in final stages of selecting a partner and discussions for commercial offtakers are ongoing. Can you just provide a little more colour and be more specific as to what tends to be the negating factors that prevent some of these selections? And more specifically, if you look out through the next seven months or so, how should we think about the progression of these updates? Is it we'll hear everything all at once or progressively every quarter there'll be more and more to share?

Bob Myles:

Thanks, Maurice. Bob here. To me there's going to be a number of different announcements as we go forward. But the first thing we really are focused on is ensuring that we have the appropriate partner for us. That partner is really—we're looking in the area of a strategic partner and someone that can help us develop the project. But at the same time, we're also looking at partners in the area of offtake. I don't mind sharing with you that we're looking both domestically and export, and there's a lot of momentum in both of those areas. There's significant interest in Southeast Asia right now for hydrogen—or hydrogen derivative projects from Western Canada. So, we're having very lengthy discussions in both of those areas as we speak.

Hopefully, as I said, we'll be able to make an announcement on a partner later this quarter, and then we still want to get to our FEED in 2024 with a financial investment decision in 2025. That's still our plan.

Maurice Choy:

Thanks. Just to be clear, is the partner and the off taker likely to be the same as it was with your prior ex-partner or two separate entities?

Bob Myles:

Maurice, it could be, or it could be separate. We're looking at a scenario where they're separate and a partner that will come in as a strategic. But for example, when you talk about Southeast Asia, more than likely that will just be an offtaker from Southeast Asia.

Maurice Choy:

Understood. Thank you for that.

Bob Myles:

Does that help?

Maurice Choy:

Yes, it does. Second question, I want to come back to a comment about Australia that Katie had mentioned. You mentioned that the resegmentation of information allows you to provide more meaningful information moving forward. In the past, you've always broken down the earnings from Australian Gas. Just not the power business. However, the power business isn't that big from a contribution perspective. So, what meaningful information are you hoping to provide that we don't already have? Or is it that you expect this to be bigger moving forward, thereby justifying its own line item?

Katie Patrick:

Yes. Thanks for that, Maurice. I think the big thing is right now—you're right, we've always provided both the power and Australian gas separately. They just were under different segments. As I mentioned, it's partly about the fact that internally we are viewing Australia now more holistically, especially with the appointment of John Ivulich as the country's CEO down there. But it is about the moving forward where we will continue to have growth on both—well, predominantly on the energy transition side of the business down there. So, we're hoping that with the segmented disclosure that that will allow us to provide more meaningful disclosure in that regard.

Maurice Choy:

Got it. Just so I'm a little more pointed in my follow up question here, as you think about funding your energy transition, I recognize that separating EnPower is one of the potential options here. But how should we view Australia as a business? Is it still core to you? And holistically, where does it fit into your overall funding plan?

Katie Patrick:

Yes, Australia is definitely still a core business for us. We're really excited about the prospects that we see down there. I think in some ways the government in Australia, as evidenced by the South Australian Hydrogen project that we've mentioned on previous calls, is moving quicker than even in Canada. So, from a market perspective, we're still really excited about the opportunities to participate in the energy transition down there, and Australia definitely remains a core holding for us.

I think as a follow-up, you asked about the funding down there. The gas utility remains a self-funding entity in Australia, and as we look to growth projects, there's a couple of things. I mean, obviously we do have access to parent equity if needed. But as well, the Australian business has the ability—they are relatively under leveraged at the Australian level and have the ability probably to access some funds for growth in that regard.

Maurice Choy:

Perfect. That makes sense. Thank you very much.

Operator:

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

Mark Jarvi:

Yes. Good morning, everyone. Maybe on the access arrangement or at least the draft that's come out, when you think about the ROE, equity thickness is maintained. How do you think that translates to expected earnings relative to what the ROE was now? How much capital, for lack of a better word, was disallowed relative to what you would have expected and that you're sort of arguing for as we get to the final decision?

Katie Patrick:

Yes, I would just say I think it's a little early for us to jump towards the earnings impact of that. The ROE is obviously a positive upside for us, but that yet also has to be determined on a final basis as we approach nearer to the November timeframe. But in terms of some of the things we mentioned, we want to work with them on the operating capital, on the total amount of operating expenses, the capital. But it is a little early before we can sort of put those things together because as with our previous access arrangements, there was pretty substantial movement between the draft that we received and the final decision. I think it's too early to sort of make any calls on the impact to earnings.

Mark Jarvi:

Okay, and then coming back to the GRA and the gas pipeline, because it asks for some working capital recovery or construction work in progress on this Yellowhead mainline pipeline, which is quite substantial. They didn't grant that, but yet in the filings that shows that that project could be coming sooner than later. Can you just outline the project status of it? How you think about it? How do you think we'll get regulatory approval when capital starts to need to be deployed on that project?

Wayne Stensby:

Absolutely. Thanks, Mark. The connection into the GRA was really around whether we were going to, call it, a two year period or a three year period. Given the state of some of those pipeline expansion projects, we're quite satisfied with the two-year period. The working capital, of course, as you'd be aware, we do get AFUDC nonetheless on all of the capital projects that are underway.

Back to system expansion, I think not only the project you mentioned, but there are a significant amount of growth demands that we see coming out of the pipelines business, and we look forward to making subsequent announcements in that regard over the next quarter, I would say, and firming some of that up. But we are seeing very, very strong underpinned by customer contracts, which I think is a fundamental part of how we see the next three and even five years of growth in our business.

Mark Jarvi:

In those filings, it said that CapEx for that one pipeline could be north of 1.5 billion, up to 2.5 billion. Would that be sort of shared with someone else? Are you seeing that this goes down a rate regulated path? Is there other options you're thinking about? When you say some clarity in the next quarters, is that specific around this project or smaller pipelines you're looking at?

Wayne Stensby:

No, I would say specific around this precise opportunity, and that range of CapEx is still correct, as far as we see it. It would be within the ATCO Pipelines regulated rate base.

Mark Jarvi:

The update would just be a new filing, essentially, and kick off of a new case?

Wayne Stensby:

Any sort of subsequent development projects within ATCO Pipelines, as the projects progressed, the next big regulatory piece would be a needs application with the AUC.

Mark Jarvi:

Understood. Okay. Thanks to everyone and see you next week.

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. Please go ahead.

Colin Jackson:

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

Operator:

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