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CANADIAN UTILITIES LIMITED

An **ATCO** Company

Canadian Utilities Limited

Second Quarter 2024 Results Conference Call Transcript

Date: Friday, August 2nd, 2024

Time: 8:00 a.m. MT (10:00 a.m. ET)

Speakers: **Colin Jackson**, Senior Vice President, Financial Operations
Katie Patrick, Executive Vice President, Chief Financial Officer
Wayne Stensby, Chief Operating Officer, ATCO Energy Systems
Clint Warkentin, Vice President, Chief Financial & Investment Officer, ATCO Energy Systems
Bob Myles, Chief Operating Officer, ATCO EnPower
Greg Stevenson, Chief Financial Officer, ATCO EnPower

Conference Call Participants:

Mark Jarvi CIBC Capital Markets – Research Analyst
Maurice Choy RBC Capital Markets – Research Analyst
Benjamin Pham BMO – Senior Analyst
Robert Hope Scotiabank – Director, Equity Research

Operator:

Thank you for standing by. This is the conference operator. Welcome to the Second Quarter 2024 Results Conference Call and Webcast for Canadian Utilities Limited.

As a reminder, all participants are in a 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 a star button and the number zero.

I'll now like to turn the conference over to Mr. Colin Jackson, Senior Vice President of Financial Operations. Please go ahead, Mr. Jackson.

Colin Jackson:

Thank you, and good morning everyone. We are pleased you could join us for Canadian Utilities Second Quarter 2024 Conference Call.

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

Before we move on with today's remarks, 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, and the Stoney Nakoda Nations, which includes the Chiniki, Bearspaw and Goodstoney First Nations. I also want to recognize that the city of Calgary is home to the Metis Nation of Alberta, Districts 5 and 6.

During our second quarter, we proudly celebrated National Indigenous History Month, a time to honor the stories, achievements, and resilience of Indigenous Peoples. We carry this message beyond the month of June and respect the diverse history, languages, ceremonies, and cultures of the Indigenous Peoples who call these areas home.

We will first hear from Katie who will deliver opening comments on our financial results and recent company developments, followed by an update from Wayne and Bob on their respective business segments.

Following today's remarks, the Canadian Utilities team will then take questions from the investment community. We ask that you limit questions to two per analyst, and if you have additional questions, please reenter the queue. For any detailed modeling questions, please follow up with the Investor Relations team after today's call.

Please note that a replay of the conference call a short supplemental presentation and today's transcript will be available on our website at canadianutilities.com following the call. The materials can be found in the Investor section, under Events and Presentations.

Today's remarks 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 at 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 in capital investment. Beginning in this quarter, we have also provided adjusted earnings before interest, taxes, depreciation and amortization or Adjusted EBITDA for ATCO EnPower. These non-GAAP 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 very much for joining us today.

This quarter's results highlight our continued focus on operational execution and demonstrate the momentum we are building towards our strategic growth plans. Canadian Utilities delivered another strong quarter with adjusted earnings of \$117 million in the second quarter of 2024, up 17 per cent from the same period last year. This translates to adjusted earnings per share of \$0.43.

ATCO Energy Systems delivered adjusted earnings of \$112 million, an increase of 14 per cent from Q2 of last year. Results were mainly driven by our electric transmission business, which benefited from rate-base growth and higher allowed ROE in 2023. Wayne will dive into the energy systems results later on this call.

ATCO EnPower delivered adjusted earnings of \$18 million in the quarter, up \$10 million from the same period last year. Electricity generation recorded adjusted earnings of \$8 million in Q2 2024, up from \$5 million last year. These results benefit from a settlement with a major supplier related to wind turbine availability in 2023 and an increase of 24 per cent in generation. The details of which are provided in the MD&A.

Over to the energy storage side. Adjusted earnings doubled year-over-year to \$10 million. This business is performing very well and continues to drive growth amid strong spreads and high demand for natural gas and liquid storage. Bob will provide additional commentary on the EnPower results later on today's call.

ATCO Australia delivered adjusted earnings of \$17 million in the second quarter, consistent with the same period last year. Australia benefited from favourable changes to PPA power pricing and cost efficiencies. This was offset by lower CPI expectations, which fell from roughly 4.5 per cent in 2023 to approximately 3 per cent this year.

During the quarter, we submitted our revised six access arrangement or AA6 plan to the Australian regulator. A response included additional supporting material for demand and expenditure forecasts, our updated IT strategy as well as modeling for accelerated depreciation. We are actively engaged with the Australian regulator on the review of the additional information provided. We believe alignment is achievable and expect to finalize the AA6 plan in November of this year.

Finally, we continue to make progress on our growth priorities in Australia. We installed over 3,600 new customer connections during the quarter and over 7,100 new customers year-to-date. Beginning in July, we began work on a sell-down process for the Central West Pump Hydro Initiative, and we are busy evaluating next steps for this project. On the South Australian government Hydrogen Jobs plan, we continue to work alongside our partners to bring this initiative to market.

During the quarter, and as part of our ongoing drive for operational efficiencies, we took steps to streamline our cost structure. We took a hard look at our corporate overhead and business units to ensure our teams are fit for purpose and aligned to our renewed growth ambitions. Heading into the second half of the year, the Canadian Utilities team is refreshed, nimble, and laser-focused on executing our project pipeline.

Stepping back and looking at Canadian Utilities as a whole, cash flow from operations was \$471 million in the quarter, which supported our operations, capital program, and normal course financial commitments. Currently, our portfolio of operating assets generates enough cashflow to fund our development pipeline, and we do not anticipate the need for additional equity financing in the near term.

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:

Good morning, everyone, and thank you Katie.

Just before I get to the numbers, I want to address the current wildfire situation that we're seeing here in Alberta and, in particular, the recent devastating impact that the wildfires have had on the historic mountain community of Jasper.

As we speak this morning, there are over 100 active wildfires across Alberta and the ATCO Energy Systems teams are working with first responders on the response to these fires. In terms of Jasper, we, like so many others, are heartbroken for the devastation facing the mountain community. ATCO has provided natural gas and electricity to the community of Jasper for well over 80 years. We have employees who live in Jasper and our teams worked arm-in-arm on the response, and we will continue to partner with the community on the recovery, the re-entry, and the eventual rebuild.

ATCO Energy Systems delivered another strong quarter with adjusted earnings of \$112 million.

This is \$14 million up from the same period in 2023. Our second quarter results have benefited from the previously disclosed increase in allowable ROE from 8.5% in 2023 to 9.28% in 2024, as well as rate-base growth. As Katie mentioned, in this quarter we have carried out some restructuring as

we continue to focus on cost efficiencies and also get ourselves aligned and 100 per cent focused on our higher growth future.

Year-to-date, we have invested \$565 million to serve the evolving needs of our customers, and we are on pace to deliver our 2024 capital investment guidance of \$1.2 billion. The focus areas for our capital investment include customer growth and we continue to see large quantities of customer growth here in Alberta, system resilience, climate adaptation, decarbonization, and grid modernization.

In the second quarter, we announced the Yellowhead Mainline Project, an approximately 200 km pipeline that will deliver one billion cubic feet of natural gas per day to Alberta's industrial heartland. This investment will exceed \$2 billion and will enable tens of billions of dollars of new investment in major industrial projects such as Dow's Path to Zero project, as well as supporting the ongoing growth and demand that we're seeing. We are already consulting with stakeholders, and we expect to start the regulatory process this quarter with construction commencing in 2026.

On our electricity side, our Central East Transfer Out or CETO electric transmission project is also progressing well, and construction will begin later this quarter. As a reminder, this project is an 85 km, 240kV double circuit high voltage electric transmission line and the associated substation expansions.

In the quarter, along with the announcement of Yellowhead, we increased the top end of our guidance for three-year rate-base growth to \$4.7 billion, which represents a compound annual growth rate of 4.3 per cent. We also affirmed our long-term rate-base growth range of 4% to 5% for which we are feeling very good.

On the regulatory side, the Alberta Utilities Commission released a decision that concluded while there was no flaw in the electric and gas distribution performance-based regulation plan, there was a problem with the operation of the plans. We disagree with this decision, and we have sought permission to appeal it with the Alberta Court of Appeal. We expect a decision on our appeal in 2025, and we will continue to provide updates on this process.

With that, I'll turn the call over to Bob, who will speak to EnPower's results this quarter.

Bob Myles:

Thanks, Wayne, and good morning, everyone.

As Katie indicated earlier, EnPower's adjusted earnings were up from the same period in 2023. Within our electric generation business, we recognize an expected settlement related to the historical availability of our wind turbines. Following our contractual discussions with our wind turbine supplier, we have agreed on the amount of generation that was lost in 2023 due to these technical issues, and we are finalizing the recovery with this supplier.

In addition, the vendor has also recently completed the necessary warranted repairs to the wind turbines, which should continue to improve generation into the second half of 2024. We expect the settlement to be completed in the second half of this year.

Looking at our generation this quarter, our Oldman River Hydro asset was returned to service following significant spring rainfall and the alleviation of drought conditions in Southern Alberta in Q1 2024. Wind generation increased 9 per cent as our Forty Mile and Adelaide assets benefited from favourable weather conditions and stronger operating performance. We also saw contributions from our Barlow, Deerfoot, and Empress Solar assets, which achieved commercial operations in the second half of 2023.

Moving to our Storage and Industrial Water business, we recorded another strong quarter, with adjusted earnings growing \$5 million from Q2 2023 to \$10 million in Q2 2024. Higher earnings this quarter were primarily driven by increased volumes, with the team securing several fixed and long-term contracts. These contracts provide line of sight to higher margins and earnings as we move forward through 2024. EnPower's Adjusted EBITDA for the quarter was \$45 million, up 45 per cent from \$31 million last year. These results reflect the operational performance discussed earlier.

During the quarter, the federal government passed Bill C-59, which approved investment tax credits related to, among other things, carbon capture utilization and storage. This enabled us to take a positive Final Investment Decision on our Atlas carbon storage hub alongside our partner Shell.

This multi-phase open-access carbon storage hub is a major milestone in our commitment to advancing products and services which may contribute positively to society's goal of reducing emissions. This is the first step in ATCO EnPower's work to create a full value chain for hydrogen development from production and carbon abatement to transport and export. The Atlas Carbon Storage Hub is integral to ATCO's long-term strategy and sustainability aspirations.

Finally, in speaking more about the Heartland Hydrogen Hub, we have made significant progress advancing this important opportunity. We have entered into a Letter of Intent with an operator and equity partner for both domestic and export opportunities. We are also progressing discussions with interested First Nations to participate in our large hydrogen initiative. We continue to work towards making a project FID in 2025, and we will continue to provide updates as we progress this important project.

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

Katie Patrick:

Thanks, Bob and Wayne.

Canadian Utilities delivered another great quarter, and we are in a strong footing for 2024. As we talked about on our Q1 call and during our AGM, the entire Canadian Utilities team is focused on delivering this new phase of growth we have set out for ourselves. We're building momentum across our businesses, growing earnings, all while delivering sustainable share-owner value.

With that, we will now open the line for questions.

Operator:

We will now begin the question-and-answer session. To join the question queue, you may press star then one on your telephone keypad. You'll hear a tone acknowledging your request. If you're using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two. Once again, anyone on the conference call who wishes to ask a question may press star then one at this time.

The first question comes from Mark Jarvi with CIBC Capital Markets. You may now go ahead.

Mark Jarvi:

Thanks. Good morning, everyone.

Just on the hydrogen project, you got a Letter of Intent. When would you be in a position to share who the partners are, outline sort of how you see this coming to the formation of the project, and are you leaning towards more of an export for the offtake, or is it a domestic use case at this point?

Bob Myles:

Hi, Mark. Bob here. I want to be able to tell you who the party is, but right now it's still confidential. But I did want to share with everyone that we did, as we said in Q2— you know at the end of Q2, we wanted to be able to announce that we have found a partner. We really were focusing on bringing a partner in who brings operational capabilities on the hydrogen side.

But with regards to domestic and export, we are pursuing both, and we're currently looking at the export side because there are a lot of auctions that are proceeding in the Southeast Asia market, and we really want to be participating in that. As you know, a lot of the export is really tied to us being able to address the rail concerns and being able to get the product to market, so we do want to progress both domestic and export.

Mark Jarvi:

What holds you back from communicating who the operating partner is—just you haven't finalized all the documentation and the structure of the arrangement, or is there something else?

Bob Myles:

Mark, our partner, has asked us—we want to just get aligned on how we make this announcement. This is quite recent, like this is in the last couple weeks, so we hope to be able to inform everybody here in the very near future.

Mark Jarvi:

Okay. Turning into the access arrangement in Australia, given your interactions as you go through this process now, the last couple months, where are you seeing alignment—on which item and what aspects of the initial provisional decision are you still struggling to get alignment for what your views would be and pushback from the regulators?

Katie Patrick:

Thanks, Mark. Sorry, it's Katie. I mentioned a few areas that we continue to have discussion on. I think we've had very open dialogue with the regulator down there and have exchanged a lot of information. In particular, the operating costs, the accelerated depreciation, and the demand forecast are the three areas that we continue to work with them on. I do believe that there is an alignment or a solution that will come, somewhere between where our original submission was and where their original draft response was. But I think we should—obviously, we'll have that in roughly November timeframe and we look forward to a positive decision there.

Mark Jarvi:

Okay. Last question for me is, can you elaborate on the restructurings, any financial impact, whether it's near-term costs and/or medium or longer-term earnings benefits from those efforts?

Katie Patrick:

Sure. Yes, as I mentioned, we're focused on trying to drive cost efficiencies as we always are. In particular, we took a hard look at our corporate overhead structure in this quarter across our business units and at the corporate level. We do have note disclosure on the total amount of the severance and restructuring for the quarter with a small amount anticipated still to come, a very small amount.

In terms of ongoing cost savings, we were not going to disclose exact figures, but we obviously look to continue to benefit from those cost restructuring initiatives in the future years, but as well set ourselves up with the right team and the right people to drive growth across the business as we move forward into our new strategic initiatives.

Mark Jarvi:

Would we see any cost savings through the balance of this year?

Katie Patrick:

We do have some modest cost savings this year, yes.

Mark Jarvi:

Okay, I'll leave it there. Thanks for the time today, everyone.

Operator:

Our next question will come from Maurice Choy with RBC Capital Markets. You may now go ahead.

Maurice Choy:

Thanks, and good morning, everyone. Maybe just starting off with the Hydrogen bid, can you discuss what remains as the bottleneck in signing the off-taker, both on a domestic and export side? I know you mentioned specifically for the export there is the rail bit, so what is the status of

getting regulations amended to accommodate this? But just bottlenecks for both domestic and export, please.

Bob Myles:

Hi Maurice, Bob here again. If I could start with the domestic. On the domestic side, I would say the bottleneck is really still the need for certainty on the policies and the programs here in Canada. And in particular, I think the ITC has been really helpful from the Federal Government, but there's still uncertainty as to what's going to happen in the future with the clean fuel standard and will that continue or will it not. Those are the things that are really holding back some of the domestic market, in my mind.

With regards to export and having been very recently in the Japanese market, it's really coming down to the Asian market getting comfort with Canada. That Canada will be able to provide the product if they enter into contracts with us and it's all around rail, so if they can't get the confidence—they being the Asian market—that we can resolve our rail and issues here, then they're not going to enter into any contracts with Canada. That's what we're working on as we speak.

Maurice Choy:

Just to follow up on that rail bit, is it just purely regulation, or is it just availability of trains and ships? Can you just elaborate that. And specifically, when do you think this will get resolved on the rail side?

Bob Myles:

Yes, so the first thing on the rail side is there are a bunch of capital improvements that I think everybody feels is needed to be able to transport ammonia safely. Even though ammonia is being transported today, the projects we're looking at is an increase in the amount of ammonia that will be transported, so it's a safety issue that Transport Canada really needs to get comfort around, as well as our rail provider. Then secondly is the issue around indemnity and liability, and making sure everyone gets comfortable with that. Those are the two main areas of concern that we have to address.

With regards to timing, Maurice, we're pushing to still be involved in auctions this year, so we're pushing the government and we're pushing the rail provider to be able to address that with the industry in 2024, and that's our timeline.

Maurice Choy:

Got it. Thanks. The second question relates to—hopefully a small one—but obviously, the decision to suspend the DRIP in July. Not that you are saving much cash, given the participation rate here, but just philosophically speaking, what has changed between when you reinitiated the DRIP to right now?

Katie Patrick:

Sorry, Maurice, you cut out there for one second. Could you just—could you repeat the question?

Maurice Choy:

Yes, sorry about that. The question was about the DRIP and your position to suspend the program back in July. You weren't saving a whole lot of cash with this plan, because of the participation. But just wondering, philosophically speaking, what has changed from the time that you reinitiated the program to right now?

Katie Patrick:

Yes, I think there was two big factors there. We looked at the participation, which, as you noted, I think investors right now are very mindful of their cash dividend in this environment, and we looked at the participation, which was very low. As you noted, it was not saving a significant amount of cash. Combined with the dilutive impact based on the share price of where we're at with the DRIP, we did make the determination to suspend that at the moment.

Maurice Choy:

While it has impacted the EPS, clearly, you do have quite a bit of cash needs in the future. I suppose this DRIP—I should depart this DRIP position from how you view how much cash equity you need in the future, which still remains relatively higher than the cost, right?

Katie Patrick:

Yes, obviously, as we drive rate-base growth, we're going to continue to have needs to finance that growth. As I mentioned in my comments, in the near term, we don't anticipate needing equity. But as we move forward and start to accelerate that rate-base growth, we'll obviously consider all our options available to us to make sure we maximize shareholder value in our financing decisions.

Maurice Choy:

Understood. Thank you very much.

Operator:

Again, if you have a question, please press star then one. Our next question will come from Ben Pham with BMO. You may now go ahead.

Benjamin Pham:

All right, thanks. Good morning. There was reference to feeling good about the 4% to 5% rate-base growth. Can you clarify is that more? I think the thinking was that was going to be more of a long-term outcome versus something a bit more near-term next few years. Has that changed at all, or is it maybe there's a bit more of an accelerated CapEx that you can see?

Wayne Stensby:

Thank you. It's Wayne Stensby speaking. Yes, I think I was providing my sentiment that we continue to see very, very strong growth here in Alberta, and as we work with our customers, even

just through the last few months, we continue to see signs of increased demand for both electricity and gas capacity. We are maintaining the guidance that we shared at our May AGM. However, I would just indicate that we continue to feel very good about that guidance, and our focus is not only on Yellowhead, although Yellowhead is a very near-term permitting discussion for us, but it's a number of other opportunities as well.

Benjamin Pham:

On equity need question, if the rate base goes to 5 per cent, does that change the calculus on needing equity and that you can't self-fund your program anymore?

Katie Patrick:

Thanks, Ben. Yes, no, as I mentioned in the near term, we do not anticipate having any equity issuance needed to fund our near-term growth. Over the longer term, if we are successful, and we certainly will be in driving our rate-base growth to those levels of 5 per cent plus, then we'll have to look at all available options to us, including equity, capital recycling, or other measures to fund that growth.

Benjamin Pham:

Okay. Got it. Lastly, maybe just more of a reminder, the ten year is hitting 3 per cent here in Canada today. Can you remind us at what level does that ROE—it went up last year, but does 3 per cent actually push it down into next year? Can you also clarify that that only impacts your non-PBR utility assets, right?

Clint Warkentin:

Yes. Hi Ben. It's Clint Warkentin here. That's right. Long-term bond rates have come down since November, when the 2024 return on equity was set. The commission will establish 2025's return on equity in November of this year. The bond rates would be lower, so the ROE would come down if bond rates stay as they are at the moment.

In terms of the generic cost-to-capital decision, that return on equity applies across all of our regulated utilities, so our electric and gas distribution and transmission utilities. It's on a formula, so that will happen every year—November each year that it'll get redetermined.

Benjamin Pham:

I just want to check that the PBR ones, is that rebased too with that or are you protected there?

Clint Warkentin:

Sorry, on the PBR ones, so the return on equity piece does get determined every year.

Benjamin Pham:

Okay. All right. Got it. Okay. Thank you.

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, Anthony.

Thank you all for participating today. We appreciate your interest in Canada Utilities, and we look forward to speaking with you again soon. That concludes today's call.

Operator:

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