Capital Power Corporation Conference Call
Fourth Quarter 2011 Results - March 14, 2012 11:00AM

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PRESENTATION

OPERATOR:
Welcome to the Capital Power Corporation's conference call to discuss the fourth quarter 2011 results. At this time all participants are in listen-only mode. Following the presentation we will conduct a question and answer session. Instructions will be provided at that time for you to queue up for questions. I would like to remind everyone that this conference call is being recorded on Wednesday, March 14, 2012 at 11:00AM Mountain Standard Time. I will now turn the call over to Randy Mah, Senior Manager Investor Relations. Please go ahead.

RANDY MAH:
Good morning and thank you for joining us today to review Capital Power's fourth quarter and year-end results. The financial results and the presentation slides for this conference call are posted on our website at www.capitalpower.com. Joining me on the call is Brian Vaasjo, President and CEO, and Stuart Lee, Senior Vice-President and CFO. After our opening remarks, we will open up the lines to take your questions.

Before we begin let me direct your attention to the cautionary statement regarding forward-looking information on slide 2. Certain information in this presentation and in responses to questions contains forward-looking information. Actual results could differ materially from conclusions, forecasts or projections in the forward-looking information, and certain material factors or assumptions were applied in drawing conclusions or making forecasts or projections as reflected in the forward-looking information.

Additional information about the material factors and risks that could cause actual results to differ materially from the conclusions, forecasts or projections in the forward-looking information and the material factors or assumptions that were applied in drawing a conclusion or making a forecast or projection as reflected in the forward-looking information are disclosed on page 27 of this presentation and in the Company's fourth quarter 2011 Management Discussion and Analysis dated March 13, 2012, that has been filed on SEDAR.

In our presentation we will be referring to various non-GAAP financial measures. These measures are not defined financial measures according to GAAP and do not have standardized meanings prescribed by GAAP and, therefore, may not be comparable to similar measures used by other enterprises. Please see slide 3 for information on these non-GAAP financial measures. Reconciliations to GAAP measures can also be found in the MD&A. I will now turn the call over to Brian for his remarks starting on slide 5.

BRIAN VAASJO:
Thanks Randy, and good afternoon. Capital Power's strong performance in the fourth quarter met our expectations for the quarter and allowed us to meet our full year expectations. Our average plant availability in the fourth quarter was 87%, which reflected the impact from the unplanned outage of Genesee 3. For the full year, we achieved average plant availability of 92%, slightly higher than the 90% obtained in 2010. Normalized earnings per share of $0.36 in the fourth quarter were 71% higher than a year ago. Full-year normalized EPS came in at $1.24 per share, which was in-line with our guidance.

Overall, Capital Power achieved strong year-over-year gains on many of our key financial measures including: funds from operations, cash flow per share, and EBITDA. Stuart will provide more details on the financial results in his comments.

Turning to slide 6, I'll quickly summarize two transactions that were completed as part of our strategy to rationalize our fleet and sharpen the focus of our fuel types. Last November, we completed the divestiture of our interest in Capital Power Income L.P. to Atlantic Power. Capital Power received $314 million dollars in combined consideration consisting of $145 million dollars in cash, $121 million of North Carolina Power Generation assets, and $48 million dollars in Atlantic Power shares. The Atlantic Power shares were subsequently sold in February for net proceeds of $52 million dollars.

As part of the fleet rationalization we announced last year our intent to divest our three small hydro facilities. In November we sold our 50% interest in the Taylor Coulee hydro plant to TransAlta for $8 million dollars. We expect to divest the remaining two hydro plants, Miller Creek and Brown Lake, by the middle of this year.

Moving to slide 7, I want to highlight how we effectively implemented our network hub strategy and portfolio management expertise to successfully mitigate the unplanned outage at Genesee 3. The G3 outage lasted approximately two months, from mid-November to mid-January, resulting in 222 gigawatt hours of production in the fourth quarter for the unit, down 54% compared to the average quarterly production in the last nine months of 2011.

We responded by dispatching our Clover Bar peaking facility, which had a 99% availability in the fourth quarter, to partially offset the lost production from G3. Combined with effective portfolio optimization activities, the financial impact of the G3 outage was minimized. The value of having Clover Bar as part of our fleet to help backstop lost production and for portfolio optimization could not have been more clearly demonstrated than it was in the fourth quarter.

Turning to slide 8, this slide shows the operating performance of our fleet with respect to plant availability for the fourth quarter and for the full year 2011. In the fourth quarter, average availability was 87%, compared to 91% in the fourth quarter of 2010. The reduction of plant availability was primarily attributable to the unplanned outage at Genesee 3 that resulted in 44% availability at G3. As mentioned, we were able to partially offset the lost production through the dispatch of Clover Bar, which had 99% availability in the fourth quarter. Overall, the fleet performed well with 100% availability from Genesee 1 and 2, Island Generation, and the North Carolina facilities. For 2011 we achieved average plant availability of 92%, compared to 90% in 2010.

I'll conclude with a recap of our 2011 performance on slide 10 against our targets. For our operational targets, our plant average availability of 92% did not meet our 94% target. Keephills 3, Joffre, and Genesee 1 and 2 performed better than expected, however the underperformance was due to the unplanned outages at Clover Bar 3 and Genesee 3.

Our target for plant maintenance capex and Genesee mine extension was approximately $56 million dollars. We came in slightly higher at $57 million, which excludes approximately $14 million dollars for maintenance capex at the New England facilities that were acquired during the year and not included in the target.

Turning to slide 11 for the construction of Keephills 3 facility, our 50% portion of the final costs was $949 million dollars, which was a little better than our target of $955. Keephills 3 began commercial operations in September 2011, which was one quarter delayed on the 4 1/2 year construction project. Our target for Quality Wind and Port Dover & Nanticoke Wind projects was to continue on time and on budget with commercial operations dates in 2012. Quality Wind continues to be on budget and on schedule to meet the target. For PDN, due to delays in the process to obtain regulatory approvals, we have revised the target commercial date to 2013.

Turning to slide 12, for 2011 we had a committed capital target of approximately $1.5 billion dollars for acquisitions or development projects that were in-line with our targeted rates of return. We were slightly under the target with committed capital of $1.4 billion dollars, which was for the acquisition of the three facilities in New England and two North Carolina facilities from the Atlantic Power transaction and for our wind development projects in Alberta and Ontario.

Finally, turning to slide 13, I'll quickly recap our 2011 financial performance versus our original financial targets provided in January 2011. Overall, I'm pleased with our 2011 financial performance, which exceeded the majority of our targets. Normalized EPS was $1.24 versus our original target of $1.16. Funds from operations, excluding CPILP, were $352 million dollars, significantly in excess of the target of $277 million. On a cash flow per share basis, we achieved $3.89 in 2011 compared to the target of $3.53. Finally, the dividend coverage ratio of 2.1 times was in line with our target. I'll now turn it over to Stuart.

STUART LEE:
Thanks Brian. I'll quickly recap our financial performance for the fourth quarter of 2011 on slide 15 and provide further discussion on certain measures in later slides. Revenues and other income of $398 million dollars were down 16% compared to the fourth quarter of 2010. EBITDA of $140 million dollars was

up 56%. Normalized earnings per share came in at $0.36 for the quarter, compared to $0.21 in the fourth quarter of 2010. Funds from operation (excluding the non-controlling interest in CPILP) were $88 million dollars, up $10 million dollars or 13% compared to 2010. On a cash flow per share basis we generated $0.90 in the fourth quarter, compared to $0.97 in the fourth quarter 2010.

Turning to slide 16, normalized EPS of $0.36 was in-line with expectations. The $1.11 per share difference compared to reported EPS of $1.47 was primarily due to the gain on sale of CPILP, which contributed approximately $1.08 per share. EBITDA of $140 million dollars was up 56% year-over-year. The increase was driven by strong year-over-year performance in three operating segments: Alberta commercial plants and portfolio optimization, Ontario and BC contracted plants, and Alberta contracted plants. The start-up of the new Keephills 3 facility and the New England facilities acquired in 2011 also contributed to higher EBITDA. FFO, excluding CPILP, was $88 million dollars, up 13% year-over-year. This was due to a full quarter of operations from the Keephills 3 facility and a higher realized price of $75 dollars per megawatt hour at the Alberta commercial portfolio versus $64 dollars per megawatt hour in the fourth quarter of 2010.

Turning to slide 17, Capital Power continues to generate strong cash flow. In 2011 approximately 63% of FFO, excluding CPILP, was used for dividends and sustaining capex, with the remaining 37% left for discretionary cash flow. This translates to approximately $131 million dollars in discretionary cash flow in 2011, which was up 19% compared to 2010. As you can see from the bar chart, discretionary cash flow continues to trend up with our expectation of $130 million to $170 million dollars in 2012.

Moving to slide 18, this slide summarizes Alberta commercial portfolio positions in the fourth quarter of 2011. Our realized price for Alberta commercial portfolio was $75 dollars per megawatt hour, which was in line with the $76 dollars per megawatt hour average spot price. For 2012, our lower hedged position is expected to result in higher realized prices for the portfolio relative to 2011. For 2012 approximately 48% of our Alberta baseload position is hedged in an average hedge price in the high-$60 dollars per megawatt hour. For 2013, 20% of the portfolio is hedged in the mid-$60 dollars per megawatt hour and for 2014, only 5% of the portfolio is hedged in the low-$60 dollars per megawatt hour range.

On slide 19 I'll review our outlook for 2012. Overall, normalized EPS and FFO are expected to exceed 2011 levels. This is based on our assumptions of Alberta power prices averaging $74 dollars per megawatt hour in 2012. We expect higher realized prices for the Alberta commercial portfolio due to lower hedge positions entering the year, as compared to 2011. We expect similar realized prices on our un-hedged positions, profitability from the Clover Bar peaking facilities, and incentive revenues from Genesee 1 and 2. In 2012 we have full year results from the three New England facilities acquired April 2011 and also from Keephills 3, which began commercial operations last September.

In 2012 we have planned maintenance outages for Genesee 2 and 3. The G2 planned outage is expected to last 25 days and the cost approximately $15 million dollars in maintenance expense and $12 million dollars in availability penalties. For G3, the planned outage is expected to last 28 days and Capital Power's portion of the maintenance cost is expected to be approximately $9 million dollars.

Turning to slide 20, I would like to conclude with a few comments regarding our financial disclosure. As you are aware we conducted a perception survey through a third party last year to gauge the street's view in a number of areas, including Capital Power's financial disclosure practices. Overall most respondents felt we provided comprehensive and transparent disclosure. However, we did receive feedback regarding areas for improvement. As you can see from the slide, we have implemented improvements in a number of areas to enhance our disclosure based on your suggestions. We thank you for your feedback and hope the improvements that we've made in our financial disclosure will enhance your understanding of Capital Power. I'll now turn the call back to Brian.

BRIAN VAASJO:
Thanks Stuart. On the next three slides, starting on slide 22, I'll quickly summarize our corporate priorities for 2012, which have not changed since they were announced at our Investor Day in December. Our operational targets include average plant availability of 91% or greater, reflecting the two scheduled maintenance outages at Genesee 2 and 3, which Stuart has mentioned. We have targeted plant maintenance capex of approximately $108 million dollars and maintenance and operating expenses of approximately $215 to $235 million dollars.

Turning to slide 23. The development and construction targets of our four wind projects, include completing Quality Wind and Halkirk Wind projects on-time and on-budget, with CODs in the fourth quarter this year.

For the other two wind projects, Port Dover & Nanticoke and K2 Wind, we're targeting to receive full notice to proceed in 2012.

Turning to slide 24, this slide presents our 2012 financial targets compared to the 2011 actual performance and illustrates the year-over-year improvements that we're projecting on each of our four major targets. We are targeting normalized EPS in the range of $1.50 to $1.70 per share, funds from operations of approximately $380 to $420 million dollars, cash flow of $3.90 to $4.30 per share, and a dividend coverage ratio of 2.2 to 2.6 times.

I'll wrap up on slide 25. As you can see from our 2011 results, we continue to execute on our strategy to deliver strong financial results that was highlighted by a 10% increase in cash flow per share. Our network hub strategy and effective portfolio management allowed us to successfully mitigate the impact of the unplanned outage at Genesee 3 through the dispatch of the Clover Bar peaking units.

Our young and modern fleet achieved 92% plant availability in 2011, up from our 90% in 2010. Overall, we exceeded the majority of our financial targets including normalized EPS and our cash flow measures. Our outlook for 2012 is positive, and with a continued execution of our strategy we expect to produce visible, sustainable, and growing cash flow. Normalized EPS, FFO, and cash flow per share are expected to exceed 2011 levels. I will now turn it back to Randy.

RANDY MAH:
Thanks Brian. Matthew, we're ready to start the question and answer session.

QUESTION AND ANSWER SESSION

OPERATOR:
Ok, perfect. So, ladies and gentlemen, if you've got a question please go ahead and hit '01'. We'll give everybody a few seconds here to queue up. So, '01' if you've got any questions. And, actually, we do have a first question from Linda Ezergailis of TD Securities. Please go ahead, Linda.

LINDA EZERGAILIS:
Thank you. Just a question with respect to the outage at G3. Is Keephills 3 at all at risk of some sort of a similar electric design issue that caused the recent outage at G3 or is it a different configuration and the issue is specific to G3?

BRIAN VAASJO:
Brian here. That was one of our first concerns and we looked at it within the first week of Genesee 3 being out and concluded that the same set of circumstances that gave rise to the outage at G3 was not replicable at Keephills 3. Nonetheless, some of the modifications in procedure and so on that we've adopted at Genesee 3 were actually carried over to Keephills 3 as well.

LINDA EZERGAILIS:
Ok. So that risk has been designed out of both plants now entirely?

BRIAN VAASJO:
Yes.

LINDA EZERGAILIS:
Ok. Thank you. And, just a follow-up question on your targets for 2012. It doesn't appear that you've disclosed any specific capital deployment targets. Is that a function of just being more flexible as to the opportunities that might present or do you think that the competition is increasing for those types of opportunities out there? If you could maybe just comment on the acquisition end and new project environment right now?

BRIAN VAASJO:
So, Linda, as you may recall on our Investor Day what we had said is that, certainly, the numbers that we had been identifying in previous years probably gained more attention than was warranted from the standpoint of, generally, people believing they were hard targets as opposed to our estimates as to what might be done by Capital Power, given the circumstances of each particular year.

So, when you look at 2012 what we had indicated is we would expect that, given the market circumstances and the changes that have taken place, we would see a number more in the order of about $750 million dollars as the kind of number that may potentially come to pass in 2012. And that's down 50% from what was our target in 2011 and much of that is market driven. As we see it, the competition for contracted plants, although a little bit cyclical, tends to have significantly increased and it makes those opportunities a little bit more difficult for us to capitalize on. And when you look at the merchant acquisition side, likewise, although values seem to have held when we look at the opportunities that may be available to us, they don't have the shorter-term financial attributes that are in our criteria. So, we don't see, on the acquisition side, a lot of activity in 2012. On the other hand we continue to pursue a handful of development opportunities that, likewise, could certainly count in our capital deployment numbers, and we would see most of that kind of activity giving rise to our committed capital as opposed to acquisitions.

LINDA EZERGAILIS:
Thank you. And one final detailed question. What is the timing of the planned outages in your two Genesee plants this year? The turnaround?

STUART LEE:
So, with respect to the G3 outage it will be fall of this year and with respect to G1 it'll be later this spring.

LINDA EZERGAILIS:
Ok. So, would G3 be straddling Q3 and 4?

RESPONSE:
It'll be Q4.

LINDA EZERGAILIS:
Great, thank you.

OPERATOR:
Ok, our next question is from Juan Plessis of Canaccord Genuity. Please go ahead, Juan.

JUAN PLESSIS:
Thank you very much. Your average hedge price for 2012 is now in the high-$60 per megawatt hour, which is up from the mid-$60's you indicated at your Investor's Day, yet the proportion of generation hedged doesn't appear to have changed and is still at 50%. Can you tell me what's going on there?

STUART LEE:
So Juan, it's probably in the neighborhood of $1.00 to $2.00 movement; it's pretty small. And, again, results from the desk and the way it will come in and out of a specific position pretty modest change, overall.

JUAN PLESSIS:
Ok. So we shouldn't expect the continued increase in that hedge price?

STUART LEE:
It depends on where forwards trade at and what position the desk takes. But, I would expect, as we get further in the year, that you'll see the hedge position increase in overall percentage and it will really be a function of the market on what that price is.

JUAN PLESSIS:
Ok, thanks for that. And, the next question, the Bridgeport facility, I think that one experienced an outage in the fourth quarter. What's going on there and has that plant been returned to service?

STUART LEE:
The facility is back in service and it was a combination of a planned outage that was extended as opposed to just an unplanned outage so it was a planned outage that we had anticipated through to the modeling in the acquisition process so nothing untoward there. But it was extended for an additional week to complete maintenance.

JUAN PLESSIS:
Ok, thanks. And just lastly, with respect to income taxes. Wondering if you could tell us what a good run rate is for your effective tax rate, going forward and, also, given the plant startup of Halkirk and Quality Wind at the end of this year and then the other two facilities later on, what would that do to your cash tax profile over the next several years?

STUART LEE:
Sure. So, on the first part of your question, Juan, the effective rate is between 20 and 25%. And on the second part of your question on cash taxes, particularly with the wind projects coming in line we don't expect to be near term cash taxable other than some Part 6.1 taxes on our preferred dividends as well as some minor cash taxes that get captured between some of the US and Canadian structures, so, fairly minimal cash taxes over the next couple of years.

JUAN PLESSIS:
Ok. Thank you very much.

OPERATOR:
Ok. Our last question is from Robert Kwan of RBC Capital Markets. Please go ahead, Robert.

ROBERT KWAN:
Good morning. I apologize if I missed the number earlier. The trading impact in Alberta for the quarter?

STUART LEE:
So if you look overall, Robert, at the performance for Alberta Commercial area, results came in about $70 million dollars of EBITDA, which was effectively in line with where we expected it to fall prior to the G3 outage. And the way I'd comment on the overall performance is strong performance from our portfolio management group in positioning the portfolio to effectively absorb the loss of that EBITDA from G3; both from the position as well as from the way they operated the Clover Bar facility.

ROBERT KWAN:
Is there a way to quantify, then, what portfolio management activities as a whole? Or what the G3 outage was, maybe, to put it differently?

STUART LEE:
So, I guess if you kind of look at what G3 typically contributes in a quarter, it'd be somewhere between $15 and $20 million dollars of EBITDA, depending on where pool prices are. So, if you work back and look at a facility that was out for half the quarter, you'd have a good idea what the impact from that lost margin would be on that facility.

ROBERT KWAN:
Ok, that's great. And, just on New England, when you look at, kind of, how the plants performed in 2011 and then your guidance for $51 million of EBITDA for 2012, I'm just wondering what you are expecting for pricing? It certainly looks like pricing has continued to decline in the beginning of this year - just wondering if there is something else at work as well?

STUART LEE:
So, if you look at Q4, one of the things that'll impact the overall margins will be the impact of the Bridgeport outage so, not necessarily reflective of a good run rate going forward. But, to your comment, we have seen some softening in spark spreads, a function, obviously, of fairly warm winter - also a function of declining gas prices. We haven't, at this point in time, re-forecast, from the time we would have presented our original forecast for 2012, from the time of Investor Day. We'll be going through that process at the end of the quarter as we get into April. So, I have no specific changes to guidance but would acknowledge the fact that we are seeing forwards on spark spreads in New England that have softened.

ROBERT KWAN:
Ok. And, just the last thing, just to clarify, just on the mechanics of the hedges in Juan's question of, you know, price going up, percentage going down a very minor amount. Just given where the forward curve is, is it fair to say, if we're just thinking of how this works through the quarters, that, really, the mechanics would have been that, maybe, you bought back some hedges in Q2?

STUART LEE:
Wouldn't be specific about what quarter we bought back or where we positioned it but fair to say there would have been some in's and out's in the overall portfolio positioning.

ROBERT KWAN:
Or maybe put differently...are there other things that you are doing within the portfolio other than buying back hedges and, therefore, we'd have to look to quarters where the price would be below your hedge book?

STUART LEE:
Again, Robert, without getting specific it's a pretty modest change. You're talking about a 2% change in the overall portfolio hedge position and very modest change in price so I wouldn't read too much into it.

ROBERT KWAN:
Ok, fair enough. Thank you.

OPERATOR:
Ok, so we've got another question from Linda Ezergailis of TD Securities. Please go ahead, Linda.

LINDA EZERGAILIS:
Thank you. Just another detailed financial question. What sort of a DRIP participation rate are you hoping for, thinking might be possible based on the experiences of the similar companies?

STUART LEE:
Over the long term what I think we would hope that we would see a participation rate that might get up into the 20 to 25% range. In the short term it'll take some time to get there so wouldn't expect that level of participation in 2012 but would expect it to grow over the next couple of years to that level of rate.

LINDA EZERGAILIS:
Ok, thank you.

OPERATOR:
Ok, so there are no other questions queued up at this time.

RANDY MAH:
So Matthew, maybe if you can remind everybody the instructions for asking a question?

OPERATOR:
Ok, perfect. Yeah, ladies and gentlemen, '01' if you've got a question. So that's '01' on your keypad. And, we do have another person that's queued up. It's Jeremy Rosenfield of Desjardins. Please go ahead, Jeremy.

JEREMY ROSENFIELD:
Great, thanks. Just in terms of the deployment that was outlined earlier, the deployment of capital up to $750 million. When you look at the various markets where you could put that into play, where do you see, maybe, the most attractive opportunities or if there are any attractive opportunities at this particular point?

BRIAN VAASJO:
So, at this point in time our portfolio of development activities is pretty much exclusively contracted and so from that standpoint we have opportunities that we're looking at in the desert Southwest. We have

opportunities in the broad Northeast market. We also have some opportunities that continue to exist and also new ones that come up in the Ontario and British Columbia markets. So, I would say basically, overall we're seeing contracted opportunities arising in, basically, all of our markets.

JEREMY ROSENFIELD:
Ok, and just to follow up on that, at Investor Day you had commented, I think, that there were a couple of RFPs that you were involved in. Has there been any progress on any of those RFPs? Can you provide any updates there?

BRIAN VAASJO:
I'm unable to be specific but I can say that there were two RFPs that we were very active on. One we were not successful and the other one we have moved on to the next round.

JEREMY ROSENFIELD:
Ok, is that, sort of, what you might have hoped for or would you've hoped for, let's say, to be next round for both of those?

BRIAN VAASJO:
Generally speaking, whether it's an acquisition opportunity or development opportunity you would hope to be successful to be on one out of four or one out of three in terms of a hit rate. If you happen to be successful on every one then that likely means that you are underpricing or overbidding.

JEREMY ROSENFIELD:
Ok, well, I guess, you're batting 500 so far. Great, those are my questions.

BRIAN VAASJO:
Thank you.

OPERATOR:
Ok, our next question is from Patrick Kenny from National Bank Financial. Please go ahead, Patrick.

PATRICK KENNY:
Hey guys, wondering if you could just update us on your discussions with S&P, just related to, I think, at Investor Day you talked about the adjusted FFO to adjusted debt targets and FFO to interest targets. Just wondering, given the volatility in the Alberta power market, if S&P has talked at all about tweaking those targets? Secondly, based on your guidance, when do you guys expect to meet those targets?

STUART LEE:
So, on the...we have had ongoing discussions with S&P and overall we still believe we're still in line with meeting their overall requirements by 2013. Getting closer, obviously, good progression in 2011. Expect further progression in 2012 and absolutely onside no later than 2013. I don't expect that they're likely to move from their targets and what they've set for us on the FFO to debt and the interest coverage ratios, it's pretty consistent on what their expectations are for a BBB mid-entity so I don't expect that they would necessary waiver from those.

PATRICK KENNY:
Ok, great. And, maybe as a follow-up, when they adjust their debt, do they bake in any debt for the Sundance PPAs?

STUART LEE:
They do. So, there is some imputed debt. We have been in discussion with them around the level of that adjustment and those discussions aren't, at this point, final.

PATRICK KENNY:
Ok, but pro-rated for your 52% ownership in Sundance C?

STUART LEE:
Correct.

PATRICK KENNY:
Ok, great. Thanks guys.

STUART LEE:
Thanks.

OPERATOR:
Yes, there are no other questions queued up at this time.

RANDY MAH:
Ok, if there are no further questions we'll conclude our conference call. Thank you for joining us today and for your interest in Capital Power and have a good day everyone.

OPERATOR:
Ladies and gentlemen, this concludes Capital Power Corporation's conference call to discuss the fourth quarter 2011 results. Thank you for your participation and have a great day.

[TRANSMISSION CONCLUDED]