Capital Power
First Quarter 2015 Conference Call
April 27, 2015

Corporate Participants
Randy Mah
Senior Manager, Investor Relations

Brian Vaasjo
President & CEO

Stuart Lee
SVP, Finance and CFO

Conference Call Participants
Ben Pham
BMO Capital Markets

Linda Ezergailis
TD Newcrest

Paul Lechem
CIBC World Markets

Andrew Kuske
Credit Suisse

Robert Kwan
RBC Capital Markets

OPERATOR: Welcome to Capital Power's first quarter 2015 results conference call. 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 Monday, April 27, 2015 at 9:00 am Mountain Daylight 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 first quarter 2015 results, which were released on April 24, 2015. The financial results and the presentation slides for this conference call are posted on our website at www.capitalpower.com. We will start the call with opening comments from 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 start, I would like to remind listeners that certain statements about future events made on this conference call are forward-looking in nature and are based on certain assumptions and analysis made by the company. Actual results may differ materially from the company's expectations due to various material risks and uncertainties associated with our business. Please refer to the cautionary statement on forward-looking information on Slide 2.

In today's presentation we will be referring to various non-GAAP financial measures, as noted on Slide 3. These measures are not defined financial measures, according to GAAP, and do not have standardized meanings described by GAAP and, therefore, are unlikely to be comparable to similar measures used by other enterprises. Reconciliations of these non-GAAP financial measures can be found in the Management's Discussion and Analysis for Q1 2015. I'll now turn the call over to Brian for his remarks starting on Slide 4.

BRIAN VAASJO: Thanks Randy and good morning. Last month, the Shepard Energy Centre officially began commercial operations. The facility is now able to generate its full capacity of over 800 megawatts (MW) for delivery into the Alberta power market. I want to acknowledge the excellent work of our joint venture partner, ENMAX, who led the successful construction of the facility. Final construction costs are expected to not exceed $854 million, which includes an accrued performance bonus to the turbine manufacturer, based on final facility performance measurements related to electrical output and heat rate. The higher performance measurements are expected to improve the overall economics of the project and are more than offset the additional capital costs from the performance bonus.

Turning to slide 5, our Board of Directors have approved the construction of the Beaufort Solar project in North Carolina, which is Capital Power's first solar project. This 15 MW project was part of the portfolio of wind and solar development sites from our acquisition of Element Power last December. It's a fully contracted facility with a 15-year PPA with Duke Energy. We will begin construction shortly with commercial operations targeted for December of this year. This project has a sale leaseback arrangement where we would sell the asset to a tax equity investor when the solar project begins commercial operations, in exchange for lease payments.

Slide 6 summarizes the plant availability operating performance of our plants for the first quarter of 2015, compared to the same period a year ago. Overall, we had strong operating performance across the fleet, with an average plant availability of 98%, compared to 94% in the first quarter of 2014. The strong first quarter operating results benefitted from minimal unplanned outages and the deferral of a short-term planned outage to the second quarter. I'll now turn the call over to Stuart.

STUART LEE: Thanks, Brian. I'll start my comments on slide 7. With the recent $225 million secondary offering of Capital Power's shares by EPCOR, their ownership position in Capital Power LP (CPLP) was reduced to 9% from 18%. On the April 2nd closing date, EPCOR also exchanged its remaining CPLP units to common shares on a one-for-one basis and effectively transitioned into one of Capital Power's largest institutional shareholders. The decrease in ownership resulted in the termination of the Registration Rights Agreement, meaning that Capital Power is no longer obligated to assist EPCOR in making secondary offering under a prospectus. EPCOR has advised that it plans to eventually sell all, or a substantial portion of its remaining interest, subject to market conditions and requirements for capital. With EPCOR no longer holding CPLP units, we will be reviewing the CPLP structure with the goal of simplifying the organizational structure and reporting and reducing costs associated with the CPLP entity.

Turning to slide 8, Capital Power is generating strong contracted cash flows and, with minimal committed growth CAPEX, our capital allocation decisions are based on the following three options. The first priority is dividend growth. We have robust contracted cash flow and a base that is supportive of continuing to increase the dividend. Second is growth opportunities. In order to increase long-term contracted cash flow and cash flow in general, over time and to be able to support a growing dividend, we need to continue to expand our asset base. And then third, looking at alternatives like debt reduction and share buy-backs. We recently bought back $75 million in debt and will now look at share buy-backs. The TSX has approved our normal course issuer bid application to purchase up to 5 million common shares over a one-year period, ending April 6, 2016. We've also suspended the DRIP, effective the second quarter dividend payable this July.

I'll now review our first quarter results, starting on slide 9. In the first quarter, the company generated $108 million in Funds from Operations, which was in line with our expectations. Normalized EPS of $0.32 in the first quarter benefitted from higher captured prices from the portfolio trading activities, that were offset by lower settled prices for the Alberta commercial plants and the one-month delay from March to April on the effective date for Shepard's Energy Service Agreement. Despite a 52% decline in average Alberta power prices in the first quarter, year-over-year, our trading desk captured 103% higher realized average price of $59/MWh, versus the spot price of $29/MWh.

Turning to slide 10, I'll review our first quarter 2015 financial performance, compared to the first quarter of 2014. Revenues were $358 million, up 16% from Q1 2014, primarily due to the impact of our portfolio optimization operations. Revenue increased from $55 million to $160 million, reflecting the successful hedging program I referenced on the previous slide, with an average realized prices of $30 above spot. Adjusted EBITDA, before unrealized changes in fair values, was $116 million, up 9%. This increase was also attributable to portfolio optimization activities, which more than offset weakness in the plant dispatch level, in addition to a $5 million contribution from the US contracted segment and a small decrease in the corporate segment. Normalized earnings per share of $0.32 was flat year-over-year. As I highlighted earlier, Funds from Operations of $108 million were in line with our expectations for the quarter and up 17% year-over-year. Overall, we had positive year-over-year financial results, despite weak Alberta power prices.

I'll conclude my comments with our financial outlook on slide 11. Due to a significant decline in global oil prices that is expected to lower both economic and power demand growth in Alberta, along with lower forward natural gas prices for 2015, Alberta power price forwards for the next couple of years have declined. The forward prices for 2015 are currently in the low $30/MWh range, which is lower than our original forecasted assumption of $44/MWh. However at the beginning of this year, our Alberta base-load position for 2015 was significantly hedged in the mid-$50/MWh range. With the first quarter results in line with our expectations, there's no change to our revised Funds from Operations guidance. We continue to expect 2015 FFO to be in the lower end of the $365 million to $415 million guidance range.

Capital Power's financial strength is based on the foundation of strong contracted cash flow, which is not impacted by the fluctuation of Alberta's power price outlook. We remain confident in our credit rating and dividend growth outlook. I'll now turn the call back to Brian.

BRIAN VAASJO: Thanks, Stuart. The charts on slide 12 show our first quarter operational and financial results versus the 2015 annual targets. In the first quarter, average plant availability was 98%, which exceeded our 94% plant availability target for 2015. Our sustaining CAPEX was $6 million versus the $65 million annual target. We reported $41 million in plant operating and maintenance expense versus the $180 to $200 million target. Finally, we generated $108 million in Funds from Operations. Overall, we are on track to meet our 2015 annual operational and financial targets.

Turning to slide 13, we have two development and construction targets in 2015 relating to the K2 Wind project in Ontario and Genesee 4 & 5 here in Alberta. For the K2 Wind project, our goal is to be completed construction and start commercial operations in the middle of this year. For Genesee 4 & 5, the goal is to transition to the construction phase this year, with a revised commercial operations start date in 2019. In conjunction with ENMAX, we have concluded that this is the earliest date that the Alberta market would need this additional generation.

Lastly, I'd like to comment on an Executive rotation that we've recently announced, as noted on slide 14. Capital Power has an ongoing development program to build on the skills and knowledge of the Leadership team. Stuart, who is currently Senior Vice President Finance and CFO, will rotate with Bryan DeNeve, who is currently Senior Vice President Commercial Development and Commercial Services. The move will be effective on May 1st, 2015. I'll now turn the call back to Randy.

RANDY MAH: Thanks, Brian. Peter, we're ready to start the Question and Answer Session.

QUESTION AND ANSWER SESSION

OPERATOR: Ok, thank you. I'd just like to remind everyone, if you'd like to queue up to ask a question please press '01' now. Our first question comes from BMO Capital Markets, Ben Pham. Please go ahead.

BEN PHAM: Ok, thanks. Good morning everybody. I just want to go back to your commentary about Shepard and the change in economics and just wondering what is changing there? Is it the heat rate that's come in lower than what you initially forecasted? I just want to get more clarity on what's changing that?

STUART LEE: Sure, Ben. And, so still work to be done as far as confirming exactly what the positive benefits associated with both higher output and heat rate are. And so that work is ongoing. But preliminary indications, our output is approximately 5% better than contractually required, and heat rate about 1.5% better than contractually required. So, positive, but again, lots of work still to be done to confirm exactly those numbers.

BEN PHAM: Ok, and do you guys share that change with EPCOR? Is that mostly just looking at the merchant margins, going forward?

STUART LEE: So that's with ENMAX and…

BEN PHAM: ENMAX, sorry.

STUART LEE: …the overall economics for both parties would change, reflecting that.

BEN PHAM: Ok. I just wanted to clarify on page 21. You highlighted $75 million for share buy-back. Are you looking at debt repayment and share buy-back, kind of, in the same category when you talk about that $75 million?

STUART LEE: So we have bought back already about $75 million worth the shares through the course of Q4 last year, sorry, debt through Q4 last year and Q1 this year and, I think, consistent with the philosophy of looking at both sides of the balance sheet, we'll be looking at equity repurchases in a similar amount through the course of the balance of the year.

BEN PHAM: Ok, so it's additive. Ok, thanks, thanks a lot. That's it for me.

OPERATOR: Thank you. Our next question comes from Linda Ezergailis from TD Newcrest. Please go ahead.

LINDA EZERGAILIS: Thank you. I'm wondering if you can give us an update on seasonality or the timing of your turnarounds this year, specifically G1 and K3? And I don't know if there's anything smaller planned for Q2, specifically?

STUART LEE: So no change in timing. G1 is Q2 of this year and K3, we'd be looking into Q4.

LINDA EZERGAILIS: Ok, and nothing else planned? Even on a minor level?

STUART LEE: Nothing else major; there are some smaller turnarounds at some of the gas assets but nothing that we'd quantify as major.

LINDA EZERGAILIS: Ok, that is very helpful. And just a follow-up question on the quarter – can you speak to the cost difference between how you addressed your CO_2 credits? I think in Q1 you dipped into your inventory. Can you comment on how much cost you saved on that?

STUART LEE: So, if you look at prior year in 2014, we would have used the SGER rate at $15.00/tonne and the cost associated with that for the full year was about $3 million. And so a reduction this year, associated on year-over-year basis by using our inventory associated with that.

LINDA EZERGAILIS: Ok, so that's the inventory gets booked into the income statement at zero cost.

STUART LEE: No, typically we end up buying those credits, or some of it is self-generated. On average, historically the cost of those credits has been in the $10 to $11 range; right now it's a little bit higher than that. But, historically, there has been a positive delta between what we had to buy those at and what the SGER costs are.

LINDA EZERGAILIS: Ok, great. Thank you.

OPERATOR: Thank you. Our next question comes from Paul Lechem from CIBC World Markets. Please go ahead.

PAUL LECHEM: Thank you, good morning. Wondering if you can give us some colour around the hedging in 2016 and 2017? The contracted price has gone up from last report from Q4: 2016 has gone from low-$50's now to, I believe, the mid-$50's. 2017 has gone from mid-$50's to high-$60's, so can you talk how you are able to do that in such a depressed power price environment and what else you're seeing in the hedging outlook?

STUART LEE: So for 2017, Paul, we would have, again, from our perspective, when we look at the forwards relative to our internal forecast we look at, particularly 2017, as forwards being significantly below where we think the market is likely to move. So we stepped in and bought some 2017 power which has overall moved up our balance of hedged prices to buy back at a relatively low prices. And, for 2016, it's a movement between periods of non-peak and off-peak, so not a significant movement but enough to take it up a couple of dollars.

PAUL LECHEM: Ok. Could you talk a little bit about…you made some comments about potentially collapsing the CPLP structure – can you talk about what that would involve? The time frame to get there? What kind of savings you might be able to achieve if you do that?

STUART LEE: So we're looking at a couple different options associated with trying to reduce the amount of external reporting and some of the compliance costs associated with having, effectively, two public entities – both at the CPC level on the equity side, and CPLP on the debt side. And one option would be collapsing the structures altogether. Another option might be trying to move the debt from CPLP level up to CPC and leaving the structure in place but reducing the reporting requirements. So we are looking at a number of different options. Not likely to see anything before the end of the year associated with the different options. Potential cost savings would be, kind of, in the $1 million per year range associated with that.

PAUL LECHEM: Ok. And just lastly…now that EPCOR is down below 10%, and they converted into common shares, is there any change to their call option on their debt that they have? That option that they can call the debt, does that still remain?

STUART LEE: Yes, there's no change to the call option.

PAUL LECHEM: Ok, and how much debt do you have outstanding with EPCOR right now?

STUART LEE: I believe it is about $335 million. And, again, from our perspective, if that was called early, that would be positive for us because we could refinance it at lower rates.

PAUL LECHEM: Gotcha.

STUART LEE: But not something we're necessarily expecting, given the fact that it's back-to-back debt.

PAUL LECHEM: Gotcha. Ok, great. Thank you.

OPERATOR: Ok, thank you. Our next question comes from Andrew Kuske from Credit Suisse. Please go ahead.

ANDREW KUSKE: Thank you. Good morning. I guess, maybe, if you give us some perspective on potential changes in customer behaviour in Alberta, just given what we've seen happen with the forward curve in the power markets? And, obviously, there's a lot happening in the next few years. You've got some of the plants coming off of PPA, you're trying to build some gas plants out into the future, gas prices are at really record lows, at least in the last few years. So, maybe, just give us a sense of the conversations with the clients and how they've changed over the last twelve months, or so?

BRIAN VAASJO: So, when we look at the market, and certainly with the discussions that we have with others, generally reflect a higher degree of uncertainly, particularly given where oil prices have gone. The issue is how long will the oil prices be at the existing levels and what will be the runway for them to move back to higher levels? General expectations are that they are not going to be getting back to the over $100/barrel mark, but more in the $80, $80 plus dollar range. And the time frames for that vary, depending on whom you're speaking to. Generally speaking, the view is that it should certainly be there in two plus years, although more and more there's discussions around how that kind of a recovery might happen sooner rather than later, depending on global demand and what's happening around crude oil development and drilling on a world-wide basis. So, a lot of the discussion has very much circled around what'll happen with oil prices and, in particular, its impact on Alberta.

The other thing that we're seeing and is getting a bit of a higher profile is the fact that there's a fair amount of momentum in the Alberta economy. Demand continues to go up for power. For example we've seen normalized growth in power demand in Alberta in the first quarter it's been about 2%, adjusted for weather. So we're still seeing some robust growth in power demand. So it'll be when the impact of lower oil prices meet with the momentum in the economy and the power prices have, or…pardon me, if oil prices have started to rebound and give confidence for some of the major projects that are being contemplated in the province. It may be a relatively shallow impact on power prices. So that's generally where the broader conversations are.

ANDREW KUSKE: Ok, that's very helpful. And, I guess, related to that – do you think we're in a situation, just overshoot to the downside now on power pricing and then, potentially, it's setting up for, as we've seen this in the past cycles, in short moves to the upside in power when things get tight and get squeezed very hard?

BRIAN VAASJO: So, our advice to the market has always been, "If you see significant downside, it's probably been overstated." And the same on the upside. When you see forwards in power prices —that shoot up relatively quickly and that tends to be an overshooting as well. Our view would continue to be the same that the market has overshot the downside.

ANDREW KUSKE: Ok, that's very helpful. Thank you.

OPERATOR: Ok, thank you very much. Our next question comes from Robert Kwan of RBC Capital Markets. Please go ahead.

ROBERT KWAN: Good morning. If I can just come back and clarify – in the 2017 hedges, so the hedges you bought back – effectively have you deferred the gain then into 2017 that gets the hedge price up?

STUART LEE: Yes, so we wouldn't have recognized anything, Robert, in 20—

ROBERT KWAN: Nothing in the quarter?

STUART LEE: No, nothing in the quarter and nothing in 2015 at this point.

ROBERT KWAN: Ok, perfect. And then, I guess, when we look at environmental – is there any update on CASA? And the other thing we're starting to see here is the potential for, kind of, a sub-federal framework here on carbons. I don't know if you have any thoughts on how that may or may not unfold?

BRIAN VAASJO: So, there's certainly here in Alberta there is a significant amount of momentum in terms of doing something more on the carbon side and, certainly, tied into that is the CASA framework. There's ongoing discussion, on an industry-wide basis, and it's too early for us to comment or even to have a strong sense as to the direction the Alberta government may be going. As you can appreciate, they are holding everything relatively close to their vest, from the standpoint of, depending on, again, the actions they take can have very positive or negative impacts on not just the power industry but across industries.

ROBERT KWAN: Ok. Can I take, though, that based on your actions to use your carbon credits that you're thinking that either something will be done more aggressively on carbon via CASA or, or an even earlier decommissioning than the fifty years, rather than some sort of larger carbon tax where your credits would become more valuable?

BRIAN VAASJO: The utilization of credits…so, firstly that tends to be an accrual as opposed to the way you ultimately price your carbon, so…or utilize your carbon credit. So for example, last year, there was an adjustment in 2014 results based on 2013, and a change in decision to utilize our credits as opposed to the $15/tonne. So, that tends to remain somewhat of an open question. Our view today is that it is more prudent to be going the direction we are but we are able to change that as we go through the year.

ROBERT KWAN: Ok. And I guess, just the last question – M&A environment, your thoughts on acquisitions, valuations, if you're seeing things get worse? Get better? If they are getting better, are there any particular geographies or fuel types that are looking more promising at this point?

BRIAN VAASJO: So, on the M&A front, certainly a lower level of activity but we're also, as a general comment, seeing others be more aggressive from a pricing perspective. So, from our perspective there's even less of a chance of anything coming across to us in terms of an operating contracted facility that would be of interest to us or that we would be even closely competitive on.

ROBERT KWAN: And I guess with, Brian, that moving, kind of, further away from you does that change how you're thinking about the potential for some divestitures?

BRIAN VAASJO: No, not at this point. There's always one of the questions around a divestiture is utilization of capital and if we're not seeing lots of opportunities out there, don't believe investors want to see us sitting on cash. But as always, if there were significant opportunities that arise, the sale of assets is absolutely something that we consider when looking at financing.

ROBERT KWAN: Ok, so the thought of selling an asset north of 10 times and buying back stock under 10 times isn't…the spread isn't wide enough for you?

BRIAN VAASJO: I think when you look at levels of buyback and the fact that we've got significant cash flow today without going into the sale of assets; we'd certainly wait until we've seen what we're able to do from a cash flow perspective before we'd start selling assets.

ROBERT KWAN: Ok, that's great. Thanks very much.

OPERATOR: Thank you. Next question comes from Linda Ezergailis from TD Newcrest. Please go ahead.

LINDA EZERGAILIS: Thank you. I just have a follow-up question on your hedging activity. I think, implicitly, we all assumed that you are still substantially hedged for the balance of the year but can you just confirm that? I don't remember hearing or seeing anything post-Q1 what your hedging position is for this year?

STUART LEE: Yes, so we remain materially hedged and I think on an ongoing basis, coming into the year we'll provide guidance around what our position for the prompt year, as we did through Investor Day and year-end disclosure for 2015. But I think one of the things that we've modified in disclosure is the fact that we've dropped ongoing quarterly updates on the 2015 position. And that's reflective of the fact that I don't think it's helped a lot from a modeling perspective, for the market and, at the same time, providing us at a competitive disadvantage in providing that information to our peer group. But to the extent that there were material changes or would be material changes to the previous disclosure, we would be required to update that and I can confirm that there hasn't been material changes.

LINDA EZERGAILIS: Great, thank you.

OPERATOR: Our next question comes from Paul Lechem from CIBC World Markets. Please go ahead.

PAUL LECHEM: Thanks. On this Beaufort Solar project that you announced you're moving forward. Can you give us some sense of what the CAPEX will be on that? And why is it not in your CAPEX schedule in the MD&A, the amount that this project is going to cost?

STUART LEE: So total CAPEX on that, Paul, is about $35 million and the reason why it's not included is because, effectively, it's a sale lease-back and we'll sell it back to the tax equity partner, Wells Fargo. And, so, at the end of the day there's not really a net outflow on the capital spending side by the time we get to year-end.

PAUL LECHEM: Ok. And how should we think about the returns on this versus the other projects you have, like Shepard and K2?

STUART LEE: It's a bit of a different structure with a tax equity partner than you'd normally see. So, when we look at it, at the end of the day, there's really not much of an equity or overall capital investment. What it does provide is just under $1 million worth of annual EBITDA going forward with, effectively, nominal amount of upfront capital and then once it flips after ten years, a little bit more than that. So, from our perspective, a great project. Very low risk, a reasonable return on a low-risk project that allows us to develop solar expertise.

PAUL LECHEM: All right. And you're assuming construction risk though, is that correct?

STUART LEE: Correct.

PAUL LECHEM: And has there been any EPC contracts signed at this point, or no?

STUART LEE: Not signed yet, but we're well down that path with pricing in hand.

PAUL LECHEM: Ok, gotcha. All right. Thank you.

STUART LEE: Thanks.

OPERATOR: Yes, thank you. We have no questions in the queue for now.

RANDY MAH: Ok, if there are no further questions we will conclude our call. Thanks again for joining us today and for your interest in Capital Power. Have a good day, everyone.

OPERATOR: Ladies and gentlemen, this concludes Capital Power's first quarter 2015 conference call. Thank you for your participation and have a nice day.

[TRANSMISSION CONCLUDED]