Capital Power
First Quarter 2017 Results
Conference Call
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OPERATOR: Welcome to the Capital Power's First Quarter 2017 Results Conference Call. At this time, all participants are in a listen-only mode. Following the presentation, the conference call will be opened for questions. The call is being recorded today, May 1, 2017.

I will now turn the call over to Mr. 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 2017 results which were released earlier this morning. The financial results and the presentation slides for this conference call are posted on our website at capitalpower.com.

Joining me on the call are Brian Vaasjo, President and CEO, and Bryan DeNeve, Senior Vice President and CFO.

We will start the call with opening comments and then open up the line 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 number 2.

In today's presentation, we will be referring to various non-GAAP financial measures, as noted on slide number 3. These measures are not defined financial measures according to GAAP and do not have standardized meanings prescribed by GAAP, and therefore, are unlikely to be comparable to similar measures used by other enterprises. These measures are provided to complement GAAP measures in the analysis of the Company's results from Management's perspective. Reconciliations of these non-GAAP financial measures can be found in the Company's first quarter 2017 MD&A.

I will now turn the call over to Brian Vaasjo for his remarks, starting on Slide 4.

BRIAN VASSJO: Thanks, Randy. The highlight of the first quarter is Capital Power's execution on its growth strategy with the recent acquisitions of contracted natural gas assets totaling 1,079 megawatts of capacity.

On April 13, we completed the acquisition from Veresen of the York Energy Center and East Windsor facilities, both located in Ontario. The transaction was originally announced in February of this year.

On April 12, we announced the acquisition of Decatur Energy Center from LS Power, which I'll provide more details on shortly.

These acquisitions are expected to increase the Company's AFFO by $67 million and Adjusted EBITDA by $115 million in the first full year of operations. Overall, our long-term contracted Adjusted EBITDA, as a percentage of total Adjusted EBITDA, is expected to increase from 66% in 2016 to 80% in 2017.

Turning to slide 5, I'll provide more details on the Decatur Energy transaction. We have an agreement with LS Power for the purchase of the Decatur Energy Center for US$441 million, subject to working capital and other closing adjustments. Decatur is a 795 megawatt natural gas combined cycle plant located in Alabama. The facility operates under a 10-year tolling agreement which expires in December 2022. This is the third PPA for Decatur and it's well-positioned for re-contracting based on its re-contracting history and the need for capacity in the region. There is also optionality for Decatur as the facility will sell power into the PGM market starting in 2023.

The acquisition is being financed with both equity and debt. This includes the completion of the subscription receipt offering for gross proceeds of $183 million. The debt portion will come from utilizing a temporary expansion of our credit facility, followed by long-term financing.

Decatur is expected to add $43 million in AFFO in the first full year of operation and expected to generate approximately $60 million of Adjusted EBITDA per year. We expect the acquisition to be completed in June of this year subject to regulatory approvals and satisfaction of other customary closing conditions.

With the next two slides, I want to highlight the benefits from adding the two Ontario facilities and the Decatur facility in the United States.

First, slide 6 illustrates our geographical breakdown based on capacity. At the end of 2016, 74% of Capital Power's megawatts were in Alberta. This was followed by 13% in B.C., 7% in Ontario, and 6% in the U.S. With the recent acquisitions, and including our Bloom Wind project in the U.S. that is expected to begin commercial operations soon, you can see how we've achieved geographical diversification away from Alberta. The capacity in Alberta will be reduced from 74% to 53% and will largely shift to the U.S. where capacity will increase from 6% to 26% of our total.

Turning to slide 7, we've updated this chart to include Decatur. This chart shows the growth in our contracted Adjusted EBITDA from 2010 to 2017. As you can see, our contracted Adjusted EBITDA has increased 211% during this period, which translates into an 18% compound annual growth rate. For 2017, you can see the significant increase in contracted Adjusted EBITDA from several sources, which includes Bloom Wind starting in the third quarter, the start of annual off-coal compensation payments from the Alberta Government, and contributions from the acquisition of the three natural gas plants that I discussed.

Moving to slide 8, this slide summarizes the availability operating performance of our facilities for the first quarter of 2017 compared to the same period a year ago. We had excellent operational performance in the first quarter with average availability of 97%, which was unchanged from a year ago. Our annual

2017 target is 95%, which reflects major scheduled maintenance outages for Genesee 1, Clover Bar, Southport, Roxboro, and Keephills 3.

I'll now turn the call over to Bryan DeNeve.

BRYAN DENEVE: Thanks, Brian. I'll start on Slide 9 with a review of our first quarter financial performance. Overall, first quarter 2017 financial results were in line with our expectations. This includes generating $91 million in adjusted funds from operations and normalized earnings per share of $0.34.

Alberta power prices in the first quarter averaged $22 per megawatt hour compared to $18 per megawatt hour in the first quarter of 2016. Our trading desk performed well and captured a 150% higher realized average price of $55 per megawatt hour on our Alberta Commercial assets versus the spot price.

Turning to slide 10, I'll review our first quarter financial results. Overall, the financial results this quarter were comparable on a year-over-year basis. Revenues were $338 million, up 1% from the first quarter of 2016. Adjusted EBITDA, before realized changes in fair values, was $134 million, up 5% from the first quarter of 2016. This is primarily due to lower corporate expenses reflecting the off-coal compensation and higher contributions from the Alberta, Ontario, and B.C. contracted facilities.

Normalized earnings of $0.34 per share were up 3% compared to $0.33 in the first quarter of 2016. As mentioned, we generated adjusted funds from operations of $91 million, which was down 2% on a year-over-year basis. Of note, 2017 marks the beginning of annual off-coal compensation payments that will be received in July of each year. Our financial results will include the accounting recognition of this income that'll be distributed equally throughout the year. From a cash flow perspective, AFFO will include the coal compensation annually in the third quarter when the cash is received.

On slide 11, I'll conclude my comments with an updated financial look for 2017. As mentioned, the annual off-coal compensation payments of $52.4 million start this year. The acquisitions of York Energy and East Windsor in April and Decatur Energy expected in June will provide partial year contributions to AFFO and Adjusted EBITDA. Brian will provide an update on our revised financial guidance for 2017 shortly.

Our commercial hedging profile for 2018 to 2020 as of March 31, 2017 is shown on the slide. For 2018, we are 61% hedged at an average contracted price in the high-$40 per megawatt hour range; for 2019 we're 40% hedged at an average contracted price in the low-$50 per megawatt hour range; and for 2020 we're 33% hedged at an average contracted price in the high-$40 per megawatt hour range.

In summary, our baseload merchant exposure is fully hedged in 2017 and we continue to increase our hedges in 2018, which has increased from 53% at the end of 2016 to 61% at the end of the first quarter 2017.

I'll now turn the call back to Brian Vaasjo.

BRIAN VAASJO: Thanks, Bryan. The charts on slide 12 show our first quarter operational and financial results versus the 2017 annual targets, and in some cases, our revised annual targets. The revised annual targets reflect the expected contributions from the acquisitions discussed earlier.

In the first quarter, average availability was 97%, which is ahead of our 95% plant availability target for 2017. Our sustaining capex in the first quarter was $4 million compared to the $80 million revised annual target. We reported $49 million in facility operating and maintenance expense in the first quarter versus the revised $215 million to $240 million target.

Finally, we generated $91 million in adjusted funds from operations in the first quarter. With the acquisitions, we have increased our 2017 AFFO target range to $340 million to $385 million, which is a 12% increase compared to the original target.

Slide 13 shows our growth targets for 2017. This includes the completion of our Bloom Wind project on time for commercial operations in the third quarter, and on budget. Our growth targets also include the execution of contracts for the output of two new developments. We continue to make progress on our development pipeline in the U.S., and in Alberta, under their Renewable Electricity Program, we are well-positioned to provide renewable generation from our Halkirk 2 and Whitla Wind sites.

I'll now turn the call back to Randy.

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

OPERATOR: Yes, sir. 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 will hear a tone acknowledging your request. If you are using a speakerphone, please pick up your handset before pressing any keys. To withdraw your question, please press star, then two. We will pause for a moment as callers join the queue.

The first question comes from Rob Hope with Scotia Bank. Please go ahead.

ROBERT HOPE: Good morning. Congrats on a good quarter. Maybe just looking at your strategy moving forward, we've seen you being quite active on the M&A front. Looking forward, can you add some color on your U.S. strategy? Is this now more of a greenfield for renewables as well as potential M&A for thermal assets, and is there anything else in the hopper?

BRIAN VAASJO: Good morning. In actual fact, our general strategy has not changed over the last number of years. We've looked for contracted opportunities, both from a greenfield perspective and from an M&A perspective across North America. What's happened of late is that we've seen the progress on that in terms of the opportunities we've looked at. We've seen that from a natural gas perspective, we are becoming more and more competitive, and hence, our ability to prevail on two bidding processes, one here in Canada and, of course, one in the U.S.

So, we will continue to look at opportunities as they arise, and again, and continue to apply the same discipline we have historically that if acquisitions make sense for Capital Power, we'll go forward and execute on those opportunities. If they prove to be not meeting our financial characteristics or not meeting our strategy, then we won't pursue them. So, it's more a case that, again, we seem to have become more and more competitive on opportunities, and as we look forward, if those types of opportunities continue to arise, you could expect to see more and more M&A activity. Again, on the other hand, if they don't meet our criteria, you won't see any.

ROBERT HOPE: All right. Thank you for that color. That is appreciated. Moving on, and I realize that it's still early days, but how have the discussions and kind of framework for the Alberta capacity market, how are those shaping up versus your expectations?

BRIAN VAASJO: So, I think you're opening comment that its early days is reflective of where we're at. There's been some, I'll call it, modest consultation taking place. I wouldn't say anything that is overly indicative directionally. So, again, not really a lot to comment on at this point.

ROBERT HOPE: That's helpful. Thank you.

OPERATOR: The next question is from Andrew Kuske with Credit Suisse. Please go ahead.

ANDREW KUSKE: Thank you. Good morning. Maybe just following up on the diversification and just the rigor that you've put on your M&A activities and that have to be accretive to CPX, just wondering, just longer-term, how do you think about the strategy in the U.S.? If we go back a number of years ago, you had the networked hub strategy, I think you called it, around the IPO and trying to build up effectively your regions of influence in certain geographies. So, is that something that if all the conditions are fine from an economic standpoint, that's something that you would endeavor to do again?

BRIAN VAASJO: Good morning, Andrew. Certainly there is some value in having facilities close to each other. We're certainly finding that with our two assets in North Carolina and in Canada, too; obviously great efficiencies of having a significant amount of assets in Alberta or certainly in Ontario. That benefit continues to be there, and where we have opportunities that are in the same geographic regions, we see that as being quite positive, and generally in those circumstances, we can see some synergies associated with, again, operations are being close to each other.

ANDREW KUSKE: Okay. Helpful. Then maybe just closer to home, in your home market of Alberta, we've seen maybe some signs of life in the Alberta power market that look interesting that there's been fewer hours trading at extremely low levels. So, I guess, what's your read of this in the market? Is it some positive indications that the economy is back that are giving good support to demand? What extent is weather? Maybe just some color around what you're seeing in the market activity right now.

BRYAN DENEVE: Yes. It's Bryan DeNeve. We would agree, Andrew; we have seen some recovery in pricing in Alberta. There's a couple of things we would observe. The first one is when you look at demand growth for electricity in Alberta over the first three months, it certainly was very strong running around a 3.5% range on an annualized basis, so you have strong demand following, we actually saw a little bit of negative demand growth in 2016. So, that's one positive.

The other one is we're starting to see some clarity in terms of older existing coal-fired assets and the intent to shut down or moth ball those facilities. So, we had TransAlta comment around Sundance 1 and 2, and today we had Maxim comment around their Milner facility. So, I think that clarity is also, as we see that supply exit the market, that's helping bolster pricing.

ANDREW KUSKE: So then just finally on that, given the signs of life in the market and everything starts to look more positive, does that change the dialogue you have with the Government in relation to the market transition?

BRIAN VAASJO: No. It would have really no impact from the perspective of, this is the energy-only market that we're referring to and certainly there's an element of energy in the capacity market that'll evolve, but certainly it wouldn't have a significant impact on the dialogue. It actually has more of a significant impact with investors.

ANDREW KUSKE: Okay. Very helpful; thank you.

OPERATOR: The next question is from David Quezada with Raymond James. Please go ahead.

DAVID QUEZADA: Thanks. Good morning, guys. First question on the Decatur asset; any additional operational detail or color you can provide there? Are there any synergies involved at all with that acquisition?

BRIAN VAASJO: So, as you know and we've indicated, we're under some degree of confidentiality around that acquisition. Once we close, which we continue to believe to be in the June timeframe, we'll be in a position where we can disclose much more to the market.

DAVID QUEZADA: Okay. That's fair enough. Then just my other question; on the renewable side, your U.S. pipeline, any commentary on how things are trending there? Are you still comfortable with availability of financing and power hedge opportunities? Are there any trends noteworthy there?

BRYAN DENEVE: No. Certainly we still continue to actively bid in two to three of those opportunities at any given point in time. There's still an appetite in the market in terms of financial capability. As noted in the materials, we still anticipate two development projects coming across the line in the balance of this year, and certainly we would expect at least one of those to be in the U.S. So, as we look forward, those are part of our capital allocation that we're looking to finance as we move forward in time.

DAVID QUEZADA: Okay. Great. Thank you. That's all I had.

OPERATOR: The next question comes from Robert Kwan with RBC Capital Markets. Please go ahead.

ROBERT KWAN: Good morning. Just with respect to the new AFFO guidance range, just given you initially reaffirmed that range with the Decatur acquisition, I'm just wondering what are some of the major drivers; is it just at the time you just didn't want to have any range or was it the Q1 results or is there something else as you think about 2017 that's driving the number?

BRYAN DENEVE: Yes. No, Robert; in hindsight we should've included that updated range when we announced Decatur. So, we thought this just provided an opportunity to clarify that we're on track in accordance with our original guidance and then the acquisitions are just adding to that as we move forward.

ROBERT KWAN: Okay. Then maybe just to finish here, are there any kind of updates in terms of your potential involvement around the renewable electricity call, and just your expectations for that given the number of renewable facilities that have already been permitted and ready for transmission connections?

BRIAN VAASJO: So Robert, in respect of the upcoming call, as you say, it will be very competitive. Our Whitla site specifically is an extremely competitive site with an excellent wind regime, and certainly, we think that there are some advantages being in Alberta that we can bring to bear. So, we expect to be very competitive in that first round.

ROBERT KWAN: Do you think that the call itself is shaped, I don't know, it's probably the wrong word, but kind of to your advantage or to your liking as it relates to location and any advantages of being in the right places?

BRIAN VAASJO: So, as we understand it, and the messaging has been very consistent, that there's essentially going to be two criteria. One is that from a transmission perspective, that it's at a site that you basically plug it in, and both of our sites, Whitla in particular, meets that status.

The second one is, as we understand it—again, and it could change over time, but it's strictly economic. So, what is the price that you want to be paid per megawatt hour over your production over the next 20 years? Again, we think we'd be very competitive from that perspective.

Our understanding is that is the only two criteria.

ROBERT KWAN: Okay. Brian, if I can just clarify then on at least your understanding on number one, is it just that you need to be able to be physically connected to the transmission system even if the transmission system itself is bottlenecked or has problems getting into the main grid?

BRIAN VAASJO: That is our understanding.

ROBERT KWAN: Okay. That's great. Thank you.

OPERATOR: For any further questions, please press star, and one on your telephone.

The next question comes from Patrick Kenny with National Bank Financial. Please go ahead.

PATRICK KENNY: Morning guys. Just back on the M&A front here; so you've been able to achieve, call it, mid-single digit accretion on the last two transactions, in large part, because of the dry powder you had on the balance sheet, as well as, in the case of Decatur at least, utilizing some old tax shields. But looking forward, if you assume a more normalized 50-50 debt equity split, let's call it, on the financing structure and also a more normalized cash tax burden, just wanted to get your thoughts on whether or not you'd still be comfortable transacting on deals going forward just given the strategy to diversify geographically or to continue ramping up your contracted cash flow profile, even if the transaction didn't result in near-term accretion.

BRIAN VAASJO: Morning, Patrick. So, when you look at the issue of dry powder, certainly one of elements around that, as you mentioned, was our tax situation in the U.S. We continue to have some capability to utilize tax shields in the U.S. So, I guess to put it in your terms, there continues to be some dry powder there.

In terms of utilization of our balance sheet, we continue to have significant cash flow coming into Capital Power, which certainly we're utilizing for both greenfield and acquisition purposes as they would arise. But also what we've seen, and I think as you've obviously seen, there's been some significant appreciation in share price. So, the accretion criteria that we have, obviously as share price increases, becomes easier and easier to meet from a financing and from a shareholder result perspective.

Over this last year, since December, the aggregate of analyst expectations have increased over 10%, which, again, gives us a currency that's much more conducive to generating accretive acquisitions.

PATRICK KENNY: On the contracted cash flow profile, I think you guys mention over 80% contracted pro forma Decatur. But I guess with Genesee 1 and 2 PPAs coming off at the end of 2020, is that 80% mark, is that the target that you're looking at heading into next decade as you bring on other contracted assets?

BRYAN DENEVE: Yes. So, certainly we'll have a drop in contracted cash flow as the PPA expires post-2020. But, when we look forward and as we see more opportunities and continue to develop our pipeline of construction opportunities, we would see coming into 2021 in the 70% range, and that increasing over time in the next decade back towards 80%.

PATRICK KENNY: Okay. Great. Thanks, Bryan. Just lastly, any update on the seven U.S. wind farms that you have the PTC safe harbored, just with respect to timing of maybe locking down some PPAs there?

BRYAN DENEVE: Yes. We're still optimistic that we're going to see one to two of those come across wire here in 2017 with off-takes in place.

PATRICK KENNY: Just to confirm, I think back to Brian's comment about you still have a little bit of tax shields in the U.S., so safe to assume for now you'd be bringing in the tax equity partner; your tax appetite isn't quite there yet?

BRYAN DENEVE: That's correct.

PATRICK KENNY: Okay. That's all I had, guys. Thanks.

OPERATOR: The next question comes from Jeremy Rosenfield with Industrial Alliance Securities. Please go ahead.

JEREMY ROSENFIELD: Yes. Thanks. Just one strategic question related to the dividend payout, really, as you move forward with the higher sort of contracted cash flow profile. Has there been any thoughts at the Board level in terms of altering or modifying the dividend payout strategy to give some of that cash back to shareholders in the form of a higher payout ratio over time; obviously recognizing the balancing act between maintaining that cash flow for growth purposes versus paying that back out? Just your thoughts on that.

BRIAN VAASJO: It is an ongoing discussion with our Board and within Management as to what is a reasonable payout ratio for our business going forward. As you know, we've indicated what our intentions are for 2017 and 2018 and those continue to be the same. We may have additional guidance at Investor Day of this year in December or we may well continue with our guidance of 2017 and 2018.

JEREMY ROSENFIELD: All right. So, it's on the table then, but nothing definitive.

BRIAN VAASJO: That is correct.

JEREMY ROSENFIELD: Then just on Bloom, so maybe a little bit more precision in terms of the Q3 timing. I'm just wondering if the current assumption is that it's going to be early Q3, mid-Q3, late-Q3. Relatively speaking, we're talking about a matter of months, but just if you can have any additional detail there.

BRYAN DENEVE: Yes. So, certainly we were, the original COD target was very early Q3, in fact, probably early July. The construction is going very well, so we would expect there's a possibility that could move up into the June timeframe.

JEREMY ROSENFIELD: All right. Great. Thank you. That's it.

OPERATOR: There are no other questions at this time. I will turn the call back over to Randy Mah.

RANDY MAH: Okay. If there are no more questions, we'll conclude our conference call. Thank you 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 conference call. You may disconnect your lines. Thank you for your participation and have a nice day.