Capital Power
Q4 2022 Results Conference Call
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Corporate Participants
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Conference Call Participants
Maurice Choy
RBC Capital Markets

Mark Jarvi
CIBC Capital Markets

John Mould
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Jessica Hoyle
Scotiabank

Naji Baydoun
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David Quezada
Raymond James

Operator
Welcome to Capital Power's Fourth Quarter 2022 Results Conference Call. As a reminder, all participants are in listen-only mode and the conference call is being recorded today, March 1, 2023. I will now turn the call over to Mr. Randy Mah, the Director of Investor Relations. Please go ahead.

Randy Mah
Thank you. Good morning and thank you for joining us today to review Capital Power's fourth quarter and year-end 2022 results.

Our 2022 Integrated Annual Report and the presentation for this conference call are posted on our website at capitalpower.com.

Joining me this morning are Brian Vaasjo, President and CEO, and Sandra Haskins, Senior Vice President, Finance, and CFO. We will start with opening comments and then open the lines to take your questions.

Before we start, I would like to remind everyone that certain statements about future events made on the call are forward-looking in nature and are based on certain assumptions and analyses made by the Company. Actual results could differ materially from the Company's expectations due to various risks and uncertainties associated with our business.

Please refer to the cautionary statement on forward-looking information on slide 2. In today's discussion, we will be referring to various non-GAAP financial measures and ratios, as noted on slide 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 the GAAP measures, which are provided in the analyses of the Company's results from Management's perspective. Reconciliations of these non-GAAP financial measures to their nearest GAAP measures can be found in our 2022 Integrated Annual Report.

Before I turn it over to Brian, I want to acknowledge that Capital Power's head office in Edmonton is located within the traditional and contemporary home of many Indigenous people of the Treaty 6 Region and the Métis Nation of Alberta Region 4. We acknowledge the diverse Indigenous communities that are located in these areas and whose presence continues to enrich the community and our lives as we learn more about the Indigenous history of the lands on which we live and work.
Okay, over to Brian for his remarks, starting on slide 4.

**Brian Vaasjo**

Thanks, Randy, and good morning. 2022 was an excellent year in delivering on our strategic objectives. We exceeded our $500 million committed capital for growth target in 2022 through the acquisition of the Midland Cogen facility with our joint venture partner, Manulife Investment Management.

We also added 116 megawatts in renewables with a COD of Clydesdale Solar and Strathmore Solar. We announced that we had successfully re-contracted two natural gas facilities with 4.5 year and 6 year extensions for Island Generation and Arlington Valley.

For our renewable facilities, we executed three excellent long-term renewable contracts. This included a 10-year contract for MEGlobal Canada for Whita Wind, a 15-year contract with Shaw Communications for Clydesdale Solar, and a 23-year contract with Public Service and Procurement Canada for the Halkirk 2 Wind project.

We are also advancing technologies to enable a clean power system through abated natural gas to achieve net zero by 2045. The Genesee 1 and 2 repowering project continues to progress and is on track to meet its revised cost of $1.1 billion and our off-coal commitment by the end of 2023.

We are leveraging our ability to find savings in the switchyard while attracting and retaining labour, which remain the most significant cost risks.

Lastly, we reached a major milestone for the Genesee CCS project, by announcing a limited notice to proceed. As we moved into the next stage of final due diligence and commercial and financial technical assessment, we expect to announce a final investment decision later this year.

Turning to slide 5, I’ll provide an update on the IESO procurement process in Ontario, where our three natural gas facilities are very well-positioned for success.

Under the expedited RFP, the IESO is aiming to procure 600 megawatts of gas and 900 megawatts of storage. We submitted three projects with a total capital cost of over $600 million on February 16. Our submission included a 100 megawatt natural gas turbine expansion for East Windsor, and battery projects of 114 and 47.5 megawatts for York Energy and Goreway, respectively. The IESO is targeting to announce awards in May of this year.

The IESO also had a procurement process for same technology upgrades. This involves uprates at existing facilities targeting 300 megawatts of incremental natural gas, with uprated projects eligible for contract extensions through 2035. We’ve submitted two proposals, for Goreway and York Energy. We did not submit a proposal for an uprate at East Windsor, because it did not meet the initial criteria for capacity characteristics.

On slide 6, I’ll provide an update on our three North Carolina solar projects. Our expectations had been that once the supply chain related issues caused by COVID had subsided, costs would return to more normal levels. Unfortunately, that has not materialized as these projects continue to be uneconomic with their existing 2020 PPAs and significantly higher construction estimates due to industry-wide cost pressures.

In addition to our projects, we believe there are a number of other similarly situated projects that are not proceeding in North Carolina. In discussions with Duke, it is highly probable that the existing PPAs will be terminated, and a provision has been recorded in the fourth quarter for the associated penalties.

Duke is expected to announce procurement RFPs in the second quarter of this year, which provides an opportunity for us to rebid the three solar projects. Given that our sites are fully permitted and ready for construction, we’ve signed interconnection agreements allowing Duke to expedite construction and work towards a 2025 COD, while new projects entering the queue
couldn't reach COD until 2026 or 2027, and the required interconnection network upgrades for our solar projects are cost-competitive, whereas new projects would have significantly higher costs, we believe our solar projects, totaling 116 megawatts, are very well-positioned for the upcoming RFPs. I’ll now turn it over to Sandra.

Sandra Haskins
Thanks, Brian. Starting on slide 7, I’ll touch on the financial highlights for 2022. It was a record year for adjusted EBITDA, of approximately $1.4 billion, a 20% year-over-year increase, while AFFO of $848 million was up 40%.

We increased the dividend for the ninth consecutive year and have provided dividend guidance for a 6% annual increase to 2025. We established a green financing framework and completed the first-ever green hybrid bond offering in Canada of $350 million to fund eligible projects.

Overall, we delivered a total shareholder return of 23% in 2022, ahead of our 10% to 12% TSR target. In the past five years, we have delivered an annual TSR of 26%. With our strong internally generated cash flow, we are well-positioned to fund our committed growth capex.

Turning to slide 8, I’ll comment on the fourth quarter 2022 results. The fourth quarter had strong operating performance across the fleet, which was offset by some strategic decisions that were made heading into the quarter. To illustrate this, we have included an AFFO chart outlining the step changes from Q4 2021 to Q4 2022.

Starting with Q4 2021 AFFO of $149 million, quarter-over-quarter increases included a $50 million lift for the Alberta power market, $10 million from increased generation on our Ontario facilities, $17 million from the acquisition of Midland Cogeneration facility, and a $24 million uplift from lower current income taxes. These results were partially offset by $12 million, primarily from higher LTSA costs resulting from increased generation.

The strategic decisions impacting these results included $60 million for the optimization of our Alberta carbon emission credit inventory, which is expected to add a net present value uplift of over $10 million over 2023 and 2024. It also includes $30 million for the Genesee 3 planned outage which was deferred from the spring of 2022, and costs associated with CCS FEED study and community investments announced in the quarter. Overall, strong Q4 results were balanced by key strategic decisions, which shifted the timing of significant shareholder value to other periods.

On slide 9, I’ll review our overall 2022 financial performance that significantly exceeded our expectations. Adjusted EBITDA of approximately $1.4 billion was up 20% and benefited from strong fleet-wide performance, higher realized Alberta power prices, and the acquisition of Midland Cogen facility.

We generated $848 million in AFFO, up 40% compared to 2021. AFFO reflects strong adjusted EBITDA results, lower net finance expenses, lower preferred share dividends, partially offset by higher sustaining capex. Overall, financial results surpassed the top end of our revised financial guidance ranges, from outstanding fleet-wide performance.

Moving to slide 10, the chart illustrates the outlook for Alberta power prices in 2023. The blue line shows the 2023 monthly forward prices from November 18, 2022, which was used for the 2023 guidance ranges, with an average power price of $136 per megawatt hour for the year. The yellow line shows January and February month-to-date actual power prices, which have settled well below the November 18 forward prices due to very warm weather and strong renewable generation. In fact, January was the second warmest January since 1950 in Alberta.

However, for the balance of the year, current forward prices, as noted by the yellow dotted line, have strengthened relative to the November 2022 forward prices. While year-to-date results have been below expectations, going forward we expect to see similar market volatility as we have seen in recent years, and given our competitive
fleet of Alberta assets, we are well-positioned to capitalize on these opportunities.

Turning to slide 11, I'll touch on our Alberta power and natural gas hedge positions as of the end of 2022. The power hedge position for 2023 is 10,000 gigawatt hours in the high-$70 per megawatt hour range, which is unchanged from our disclosure at Investor Day in December.

Hedging has increased for 2024 to 7,000 gigawatt hours in the low-$70 per megawatt hour range, and 2025 has increased to 6,000 gigawatt hours, hedged in the high-$60 per megawatt hour range.

In addition to the remaining open baseload position, gas peaking and renewable assets are available to capture the higher power prices. The hedge strategy provides stability, by reducing fluctuations in cash flows, and optimizing price and volume positions that mitigate against price changes and market illiquidity.

The hedge position includes longer duration origination contracts as another mechanism to manage price risk. The graph on the left shows the relative magnitude of hedges that were long duration and extended out to years where we will see lower power prices. The weighted average hedge price is in the high-$60 per megawatt hour for contract terms greater than 12 months.

Natural gas prices will have an increasingly more material impact on our financial results as we transition off-coal. Natural gas volumes of 50,000 TJs in 2023, 60,000 in 2024, and 50,000 in 2025 have been hedged at favourable prices below $2.00 per TJ in 2023 and 2024 and below $3.00 per TJ in 2025, relative to the forwards shown in the table.

Turning to slide 12, I'll conclude our remarks by reviewing our 2023 targets and outlook. As highlighted earlier, 2022 was our strongest year for financial results, and 2023 results will build on this momentum. There are several large planned outages this year at Shepard, Decatur, and Genesee 1 and 2, and other outages at Halkirk and Quality Wind. Sustaining capex is expected to be between $135 million and $145 million. With the various planned outages, we have set a 94% availability target.

For 2023, we guided to $1.455 billion to $1.515 billion in adjusted EBITDA, and $805 million to $865 million in AFFO, based on an average forward price of $136 per megawatt hour. As mentioned, with Alberta power prices for January and February below these levels, we are currently trending towards the lower end of the guidance range. A further update will be provided with our first quarter 2023 results.

Our growth outlook for 2023 is positive. This includes our well-positioned natural gas facilities in Ontario to address the capacity gap in the province, as Brian highlighted earlier. As part of our $600 million of committed growth capital target, we expect to make an investment decision on two renewable projects this year.

Overall, we expect 2023 to be a good year, both financially and strategically. I'll now turn the call back over to Randy.

Randy Mah
Thanks Sandra. Operator, we're ready to take questions.

Operator
Thank you. The first question comes from David Quezada from Raymond James. Please go ahead. Sorry, he left the queue. The first question comes from Maurice Choy from RBC Capital Markets. Please go ahead.

Maurice Choy
Thank you, and good morning. I just want to come back to slide 10 and your directional guidance trending to the low end of your 2023 range. I'm trying to parcel out what you factor into this directional guidance. I assume that the January and February lower settled prices factored in. Your guidance based on a $136 spot price for the year, and as you mention in slide 10, the balance of the year has strengthened. Are those things factored into your directional guidance, or are you thinking that it may not settle as the forwards suggests, due to the volatility?
Sandra Haskins
Thanks, Maurice. You weren’t coming in very clearly, but I think that I caught the essence of your question. When you’re looking at slide 10, and what we are saying is that, in January and February, certainly power prices did settle well below where the forwards were. Based on that, our results coming into Q1 are expected to be below what we would have expected, going back to Investor Day when we were basing our guidance on $136 per megawatt hour.

When you look out, as you mentioned, the curve has lifted, and we expect the curve to remain very volatile as we go through the year, not unlike 2021 and 2022. In fact, when you think back to the beginning of 2022, we were in a similar position with respect to a very warm start to the year with January and February being mild months, and as a result, seeing similar low settled prices. But volatility continued throughout the year, and we expect that 2023 could continue to be similar to that, and as a result we are well-positioned to capitalize on that.

I would say that there is still some upside to the balance of the year. At this point, we haven’t updated our full forecast, which we typically do at Q1, and we’ll bake in any new trades that we have done over the last number of months, as well as other factors that have changed in the business. As you look out to the balance of the year, we are seeing periods of upside relative to our earlier guidance, but our comment around being lower in the range is based on what we’ve seen settle to-date.

Maurice Choy
Great, and if I can ask just one last one in here, Brian, your thoughts on your tenure as CEO and whether there is a process underway right now, assuming you’re not planning on staying past June?

Brian Vaasjo
I’m sorry, didn’t quite catch that question.

Maurice Choy
Just your thoughts on your tenure as CEO and whether or not there’s a process underway right now, assuming you’re not planning on staying past June?

Brian Vaasjo
Yes, there is an ongoing process in terms of finding a CEO to assume my role. That process continues and certainly do expect that it’ll come to fruition—it’ll definitely come to fruition through this year, I won’t be continuing as CEO.

Maurice Choy
Thank you for the colour.

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

Mark Jarvi
Yes, good morning everyone. Maybe you can provide a little bit of extra detail around the uprate for the IESO and the extension of the contracts. Just kind of clarify whether or not the existing capacity would get the same extension, the same contract duration as the uprate, just in terms of how that all comes together?
Brian Vaasjo
In terms of the process, the uprates, just because of their nature, rely on the operation of the existing facility, because it's essentially increasing the capacity of the existing generation. The contract extension out to 2035 covers the existing facilities as well; so it's a combination of the uprate and existing facilities would have a blended contract out to 2035.

Mark Jarvi
Would there be sort of any, I guess change in the effective capacity payments for the current capacity, if that makes sense? Is there sort of...

Brian Vaasjo
Yes, that ends up being part of the negotiation with the IESO in terms of what the overall project looks like going forward to 2035.

Mark Jarvi
Do you have any sense of when you might get a decision on that?

Brian Vaasjo
It's a little bit fluid in terms of the timing and the various steps that the IESO has to go through, but we would expect, or we had hoped that there would be something that would be known through the month of March. Definitely, we'd see it no later than April.

Mark Jarvi
Okay. Then, there was a renewal of the NCIB. I don't know if it's Brian or Sandra who want to answer this, but just in terms of the desire to become more active on that, given where the share price is now and other, I guess, uses of potential free cash flow. Just sort of where the NCIB ranks in capital allocation priorities today?

Sandra Haskins
Yes, Mark, as you know, we decided a number of years ago to keep the NCIB available to us in the event that we do see lower share prices and no other options for capital allocation that we think would create more shareholder value. No set target with respect to buying back a number of shares. But it is something that we keep in our toolkit and would use if those two things came together, where we had the capital to deploy and felt that the share price was undervalued.

Mark Jarvi
But given, I guess, the potential growth in Ontario and the renewable projects, obviously Genesee repowering, CCS, the view would be that there's still lots of growth and that becomes a priority in terms of excess cash today?

Sandra Haskins
That's correct. Growth would be the priority.

Mark Jarvi
Okay. Last question for me is just, where do things stand now in terms of the MSSC and the battery at Genesee?

Brian Vaasjo
As we had indicated during Investor Day, we're looking at some technical alternatives to the utilization of batteries. That work and discussions with the AESO have been going well; haven't totally come to decision points, but again, continue to go very well.

And as well, the AESO is going through its own process of potentially increasing the 466 for a number of different reasons in the Alberta market, so that's another front on which we would see some potential relief for the utilization of batteries. Overall, it's looking very promising in terms of potentially not needing to go forward with that component of the Genesee 1 and 2 repowering.

Mark Jarvi
Given where you are in the timelines, when do you have to have clarity on that, Brian?

Brian Vaasjo
Actually, we've got until the summer in terms of—what it really requires is the lead time to order batteries.

Mark Jarvi
Understood. Okay. Thanks, Sandra. Thanks, Brian.

Operator
The next question comes from John Mould from TD Securities. Please go ahead.

**John Mould**
Hi, good morning everyone. Maybe just circling back on the CCUS project and timing on carbon pricing certainty. I'm just wondering if you could give a little more context on how that portion of the project is evolving, and when you're hoping to have that finalized?

**Brian Vaasjo**
Sorry, didn't hear what component of the project you were referring?

**Randy Mah**
Carbon tax certainty.

**Brian Vaasjo**
Oh, the carbon tax certainty. Sure.

**John Mould**
Or carbon pricing, maybe to put it that way. More of the contracting side of things.

**Brian Vaasjo**
The federal government is putting together the body and the resources to start addressing that issue, in terms of implementation as opposed to the actual sorting out what and how they're doing it, and I think you're seeing increasing comments in support for the need for a secure carbon price. I believe the Minister of Environment just yesterday was making a speech underlying the need for carbon certainty and carbon price certainty, and was implying that that would be around something like a contract for differences. I would say it's the element that's lagging the most, but we do believe we'll have some positive resolution, definitely in terms of coming to our approval in principle in July.

**IRA is fairly well-known at this point and there's expectations for similar ITC measures in Canada, but not quite finalized at this point?**

**Brian Vaasjo**
As we're moving forward and developing a number of projects across both Canada and the United States, we see prospects continuing to be very positive, and again, some elements or some areas, a little bit more clarity around what's intended. But we definitely continue to believe that we'll move forward on two projects this year, with significant comfort around the different federal programs, and in some cases state programs that are being finalized at this point.

**John Mould**
Okay, thanks for that. Then maybe just circling back on the Ontario uprates. What would be the scale of investment if you were successful with both of those? Can you give any context on that?

**Brian Vaasjo**
Yes, I'm trying to recall offhand. It's sort of in the order of magnitude of $100 million.

**John Mould**
Okay. Great, okay, I'll leave it there. Thank you very much.

**Operator**
The next question comes from Jessica Hoyle from Scotiabank. Please go ahead.

**Jessica Hoyle**
Thanks very much. I just wanted to touch on Genesee repowering. You mentioned that you experienced labour issues early on, but strategies to retain that talent were progressing well. Can you just provide a little bit more colour here on what you're currently seeing in terms of risks on that project at this point in time?

**Brian Vaasjo**
Okay, great. Thank you for that. Then on the two renewable projects you're hoping to finalize this year, are you seeing better relative opportunities for renewable power in terms of that FID timeline in Canada or the U.S. right now, and how's the policy environment playing into that given that the
We’re fully resourced at this point in time, and we’re talking about hundreds and hundreds of jobs. Things are going very well from that perspective.

Jessica Hoyle
Great, thanks for that. Then just another one here; just in terms of what you’re seeing in the market on midlife natural gas opportunities at this point?

Brian Vaasjo
There continues to be opportunities in the market. As we continue to monitor what’s going on, we do expect that there’ll be a number of opportunities coming to the market through the balance of the year.

Jessica Hoyle
Thanks for the colour.

Operator
The next question comes from Naji Baydoun from iA Capital Markets. Please go ahead.

Naji Baydoun
Hi, good morning. Just wanted to pick up on that last comment, and maybe put it in a broader picture of cost of capital. What’s your view on that today, given the last note issuance? I guess it would’ve been close to what the preferreds would have reset at.

What’s kind of your view on cost of capital today, and how does that maybe play into your thinking about new acquisitions?

Sandra Haskins
Sure. When we look at the cost of capital for us and where interest rates are going, we do factor that into our hurdle rates, and we do take a longer-term view as opposed to just where rates are today. But we do see that there is upward pressure on the debt side with respect to our cost of capital, and that, as I said, is part of our analysis when we’re looking at what hurdle rates we should be using on any of these growth projects.

Brian Vaasjo
When you think about it from a competitive perspective, particularly interest rates, generally will be reflected in everybody’s cost of capital; it’s sort of like all boats rise.

Naji Baydoun
I guess generally it doesn’t also change your philosophy on leverage profile or kind of the balance sheet, or how much debt you’d be comfortable adding, given just the increased costs?

Sandra Haskins
Yes, when we look at our leverage, we are looking at our credit metrics and our overall balance sheet, feel that we’re well-positioned with our cash flow that we have available to supply funding for our growth. We continue to stay well within our credit metrics for both rating agencies.

Naji Baydoun
Okay, that’s very clear. Just one other question, maybe just your approach or the philosophy behind, I guess, new gas versus storage. I think for East Windsor, there was also potentially considerations for a battery investment there; just maybe the puts and takes of the different options that you’re considering in the Ontario market?

Brian Vaasjo
As we look at the different locations, and some of it is out of our hands, or on the technical end. For example, building additional natural gas at York, there wouldn’t be stakeholder support associated with that. That automatically moves you towards batteries.

Goreway, in the shorter-term, battery solutions seem to be a better approach; in the longer-term, that may well be a site, because we do expect additional procurement rounds, do expect that that may be a site for additional natural gas growth. A lot of it is what is appropriate in this round, and again, what will gain stakeholder support.

For all three projects, we’ve got a written approach or written support from the various city and town councils supporting those projects. That’s of course a very significant part of the
scoring and the approval process. But the three projects we put forth we think are the best fit at this point in time for moving forward with construction and providing additional capacity in the market from our facilities.

**Naji Baydoun**
Okay, that makes sense. Thank you for the colour.

**Operator**
The next question comes from David Quezada from Raymond James. Please go ahead.

**David Quezada**
Thank you. Good morning everyone. Just one for me; I'm curious, Brian, among your pipeline of projects in the MISO region in the U.S., are you able to comment at all how those projects stack up in terms of the position in the grid interconnection queue?

**Brian Vaasjo**
They stack up well in terms of their general competitiveness. They are in various queues for interconnection, which is typically these days for projects to be within the striking range of RFPs, they do need to be pretty much in the queue and in process to get interconnection, and also you get a greater idea of cost when you're in the queue and working with the various agencies who are providing the transmission connections.

**David Quezada**
That's great colour. Thanks, Brian.

**Operator**
This concludes the question-and-answer session. I would like to turn the conference back over to Mr. Randy Mah for any closing remarks.

**Randy Mah**
Okay, if there are no more questions, we will conclude our call. Thank you for joining us today and for your interest in Capital Power. Have a good day everyone.

**Operator**

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