

EPCOR POWER L.P.
2006 Q2 Review Conference Call

July 25, 2006
09:00 MT

OPERATOR: Good morning, ladies and gentlemen. Welcome to the EPCOR Power L.P. 2nd Quarter Review conference call. I would like to introduce Randy Mah, Senior Manager, Investor Relations.

RANDY MAH: Good morning and thank you for joining us today. The news release on our 2nd Quarter financial and operating results was issued earlier this morning and is posted on our website at epcorpowlr.ca. This conference call is also being webcast from our website. You can access the webcast by clicking on the webcast link from the home page.

Let me now introduce the two executives on the conference call. We have Brian Vaasjo, President, and Stuart Lee, Chief Financial Officer. We will start with a brief summary on the highlights for the 2nd Quarter, followed by a question and answer session. During this conference call, forward-looking statements may be made. Statements made with respect to forward-looking information are subject to risks and uncertainties. Accordingly, actual results may differ materially from statements made today. For additional information on these risk factors, please review the reports filed by the Partnership with Canadian Securities regulators. EPCOR Power L.P. disclaims any intention or obligation to update any forward-looking statements unless required by law.

I will now turn the call over to Brian.

BRIAN VAASJO: Thanks, Randy. Before I turn it over to Stuart to review the financial highlights, I'd like to begin with a brief recap of events in the 2nd Quarter. Most notable in the quarter was the successful completion of the Partnership's first public offering in Canada of senior unsecured medium-term notes in the aggregate principal amount of \$210 million, which provides a fixed interest rate of 5.95% for a term of 30 years. This long-term debt replaces the Partnership's previous short-term borrowings and provides interest rate certainty for a 30-year period while eliminating near term refinancing risk.

In terms of the Frederickson acquisition, we have received the required regulatory approvals and I am pleased to report that the transaction is expected to close next week

on August 1st. With long-term PPAs with investment grade counterparties in place, this acquisition will contribute positively to funds generated from operations and to cash available for distributions on a sustainable per-unit basis.

I will now turn it over to Stuart.

STUART LEE: Thanks, Brian. The Partnership generated 2nd Quarter revenues of \$81 million, an increase of 12% compared to the same period a year ago. The increase is primarily due to unrealized changes in the fair value of foreign currency contracts, contract pricing increases and higher water flows at the Curtis Palmer facility. Net income of \$30.3 million in the 2nd Quarter increased 96% due to foreign exchange gains of \$9.5 million this quarter compared to the \$2.8 million loss in the 2nd Quarter of 2005. As well, net income benefited from the unrealized fair value change in forward foreign exchange contracts of \$5.2 million. Funds generated from operations was down 16% to \$31 million, primarily due to the step-down in pricing under the Curtis Palmer PPA and a \$3 million accrual for the expected additional payment to gas suppliers. Excluding the fuel cost accrual, funds generated from operations was down 8% from last year. In the 2nd Quarter, the weighted average plant availability was 87%, consistent with the same period in 2005.

In summary, the Partnership generated good results in the 2nd Quarter and it is the 11th consecutive quarter where funds generated from operations exceeded cash distributions.

I would now like to briefly comment on the de-designation of hedging relationships on foreign exchange contracts that impacted 2nd Quarter results. The Partnership voluntarily de-designated all of the foreign exchange cash flow hedges existing as of April 1, 2006. These foreign exchange contracts are part of the hedging program to manage future U.S. dollar denominated cash flows from U.S. power plants. As a result of the de-designation, a net derivative financial instrument of \$12 million was recognized and will be recorded in income in the same periods that the previously hedged U.S. revenue occurs.

Changes in the fair value of these foreign exchange contracts from April 1, 2006 onward are recorded as part of revenue of the U.S. plants. In the 2nd Quarter of 2006,

the unrealized fair value changes of these contracts and amortization of deferred gains totalling \$5.2 million was recognized in revenue and net income in the quarter.

I will now turn the call back to Randy to moderate the question and answer session.

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

QUESTIONS AND ANSWERS:

OPERATOR: Thank you. Ladies and gentlemen, to join the question queue, please press the numbers "01". If you wish to withdraw your question, press the "#" sign. If you have any questions, please press "01" now.

We have a question from Bob Hastings; go ahead, Bob.

BOB HASTINGS: Yes, just a couple of quick ones. The Castleton issues, you're saying there's some issues around the wood waste or the supply of it, but you don't think there will be any financial impact. Can you go into a little more detail on that?

STUART LEE: That's actually for the Calstock facility.

BOB HASTINGS: Oh, I'm sorry, Calstock.

STUART LEE: Yes. And so obviously, I think we've disclosed in the MD&A that there are two suppliers, that one which had a fire and the other one who was announced at -- beginning in October, they expect to close their mills for an indeterminate period, and so we're currently reviewing options with respect to those -- to that supply. We do have sufficient inventory in place, I think, for 2006, as well as being able to increase some supply from other suppliers. But on a go-forward basis, I think we're looking at when long-term arrangements can be made, and at this point in time don't have definitive outlook with respect to the impact potentially on costs, although we don't expect it to be significant.

BOB HASTINGS: I just wondered if you were having to go farther away, whether there's -- to get fuel, whether that was going to be -- add to your costs and whether people saw you're in a bit of a bind and therefore the price would go up as well.

STUART LEE: If we have to go further away, certainly transportation costs would go up, and there's also the, I guess, the -- you know, our arrangement with existing suppliers, we

have tipping fees paid that effectively offset a bunch of the transportation costs, and it's whether we can -- we can make similar sort of arrangements with new suppliers.

BOB HASTINGS: Okay. Thank you.

OPERATOR: We have a question now from Tony Courtright; go ahead, Tony.

TONY COURTRIGHT: Thanks very much. I notice that one of the items you reported in terms of enhanced revenue this quarter was gas sales diversions at Castleton. Could you elaborate because I had thought that your counterparty there was responsible for providing the gas and you were just responsible for the transportation of it?

STUART LEE: Sure. So on the Castleton, you are correct with respect to the arrangement with the PPA owner with respect to gas supply, but we also have a firm supply contract in place for transportation of gas and when the plant is not operating, we are seeking opportunities to sell that firm supplier's firm availability on the gas lines, and so there is some profit that we can make from selling that.

TONY COURTRIGHT: But is -- are you -- is the title of the gas in your name or is it in a supplier's name?

STUART LEE: I believe it's with -- I believe it's with TransCanada.

TONY COURTRIGHT: So is there a sharing arrangement here in terms of -- I mean, gas diversion sales, obviously they would have enjoyed being able to sell the gas, would have liked to have enjoyed selling the gas themselves as well, so I'm unclear how you guys are recognizing it, why they would have foregone that profit.

STUART LEE: It's not their gas, per se, that's being sold. It's the capacity on the line, so it's our -- it's our contract on that particular line on the gas transportation. And so the capacity charges that we pay on that line are below market, and therefore there's opportunities to sell capacity on that line.

TONY COURTRIGHT: So it's really a transportation --

STUART LEE: Exactly.

TONY COURTRIGHT: -- arbitrage.

STUART LEE: Yes.

TONY COURTRIGHT: All right. Wondering if you could elaborate whether there's any developments with respect to what you had previously reported in terms of a dispute with respect to the vendor of the Mamquam facility.

BRIAN VAASJO: At this point there's no additional information.

TONY COURTRIGHT: In terms of your cap-ex guidance, you're indicating slightly below the average of the prior two years. Does that guidance reflect any unusual expenditures at Mamquam?

BRIAN VAASJO: No, it does not.

TONY COURTRIGHT: And then finally, could I just ask what was the rationale for the change in the de-designation of the hedging?

STUART LEE: Effectively we have about a hundred contracts in place with respect to foreign exchange and there's a significant amount of work done on the accounting side to try and meet hedge accounting criteria, and quite frankly, we didn't see a lot of benefits with respect to the additional time and effort that was taking place to do that, especially given the fact that for this Partnership, the primary performance measurements are cash flow, and so that was the impetus to make that change.

TONY COURTRIGHT: All right. And I also noticed that you've indicated there is some hedging of the Frederickson, anticipated Frederickson cash flows for its currency exposure. Any idea of how much you've hedged of your anticipated repatriation there?

STUART LEE: So I think we've gone out -- we've gone out five to six years, based on expected cash flows out of that facility, and it would be, I think, in the range of about -- typically we'd go out probably in the range of about 70% of respective cash flows.

TONY COURTRIGHT: Great. Thank you.

OPERATOR: We have a question from Alice Dunning; go ahead.

ALICE DUNNING: With respect to the dispute with NAL and Devon, what kind of timeline are you expecting with respect to the concluding discussion with them?

BRIAN VAASJO: Well, at this point there's some discussion as we reported earlier. This is -- it's at a process of in discovery at this point in terms of the litigation. The time frame in which discussions/litigation will take is indeterminable at this point.

ALICE DUNNING: And how much is the additional damage that they're seeking?

STUART LEE: What they're seeking is effectively going back and resetting the contract pricing at spot prices, back to the time that the DCR index was stopped being published, which goes back to the end of 2002, beginning of 2003.

ALICE DUNNING: And what is the dollar impact? Because I know you set aside some of the additional payments in your press release you've indicated that money has been set aside based on the new DCR. If you have to backdate it and if they win, how much potentially would you have to pay them?

STUART LEE: With respect to if they were successful in --

ALICE DUNNING: Yes.

STUART LEE: -- claiming frustration and then the --

ALICE DUNNING: That's right.

STUART LEE: -- spot prices?

ALICE DUNNING: That's right.

STUART LEE: I believe the potential amount might be in excess of \$40 million on a historic basis and obviously it would have an impact on a go-forward basis, as well.

ALICE DUNNING: So basically if they win, then EPCOR will be on the hook for another \$40 million plus on top of what you've already accrued?

STUART LEE: Correct.

ALICE DUNNING: Okay.

STUART LEE: And that's on a historic basis.

ALICE DUNNING: Okay. With respect to the expansion of the Frederickson facility, is there any talk of timing and what is the hurdle to do the expansion?

BRIAN VAASJO: So in the Pacific -- Brian Vaasjo here. In the Pacific Northwest marketplace, much of the plant activity in growth is associated with responding to RFP's and we would anticipate and would expect to have this plant participating in all upcoming RFP's that are relevant for it, so there's no specific plans per se in terms of announced RFP's as there are none at this point, but over the next couple of years we would expect that this plant would respond to some RFP's.

ALICE DUNNING: Okay. So it's basically whether or not they're going to win the RFP and if they win, then the trust will have the opportunity to participate in the development?

BRIAN VAASJO: Actually, no. The trust has the opportunity to participate in the opportunity before it's responding to any RFP's.

ALICE DUNNING: Oh, before it responds.

BRIAN VAASJO: Yes. It would not be a case of if the RFP is successful, then they can participate. The L.P. has to make a decision over the next six months as to whether it wishes to participate in the opportunity prior to responding to any RFP's.

ALICE DUNNING: And what is the size of an expansion, because the purchase price of the expansion of \$4 million, I'm assuming, is based on a particular size of facility?

BRIAN VAASJO: The plant is actually -- or what's envisioned, and it can change depending on what would be an appropriate response to an RFP, but it's actually a twin to the existing Frederickson facility, so it's, you know, in excess of 240 megawatts, so it's a fairly large facility.

ALICE DUNNING: Right. Right. And I guess my last question is there's an indication of higher maintenance expense at Mamquam and Queen Charlotte; was there some unexpected shutdown at the facility during the quarter?

STUART LEE: Yes, we expanded the scope of the planned shutdown with respect to that facility.

ALICE DUNNING: Okay. That's all the questions I have. Thank you.

OPERATOR: The next question is from Robert Kwan; go ahead, sir.

ROBERT KWAN: Good morning. I was wondering if you could comment on the outlook you have for the Castleton plant right now post the expiration of the contract in mid-'08.

BRIAN VAASJO: We're continuing to study that plant in terms of its overall viability past 2008. At this point we do expect that it is economically viable and we have started processes to see if there are potential off-takers in the region, so we would anticipate that there is an economic life beyond 2008. It may well, though, end up that it could be operated in merchant capacity.

ROBERT KWAN: Okay. And I guess associated with that plant, you've got the transportation agreement that I think extends out to 2012. Obviously it's making you some money right now on the resale of that capacity. Do you have any view as to, you know, if you don't think -- if it becomes evident to you that the plant's not viable past mid-'08 is that

transportation contract an asset to you or do you -- is it -- do you think it might end up being a liability, as well?

BRIAN VAASJO: A lot of that would depend upon particular market conditions at the time and with a contract that's got a remaining four-year life, it will be very much based on, you know, the forward markets at the time. But I would say that it's unclear at this point.

ROBERT KWAN: Okay. Maybe just switching to the DCR change and the impact on the fuel accruals, has the amount that you accrued, does that include interest expense on the amounts that you would have owed in the past?

STUART LEE: No.

ROBERT KWAN: Okay. And do you think that -- you know, is there a rationale as to why you haven't assumed that there may be some penalty interest on that?

STUART LEE: No specific rationale other than we've looked at obviously the terms that we would have settled with OEFC as well --

ROBERT KWAN: Okay.

STUART LEE: -- which didn't include any interest component to it.

ROBERT KWAN: Okay. And maybe just one last question on Frederickson. You've got, you know, the options I think for six months upon closing to take up on the Greenfield site. Just kind of directionally, when you think about how the L.P. might be involved in development activities, you know, would that be something that you'd be interested in doing, kind of putting the money out on the Greenfield site that doesn't have any visibility into an RFP and then, I guess, the L.P. assuming future development risk on that site?

BRIAN VAASJO: So just on a site unrelated to one of the -- that the L.P. has, the basic development protocol and the basic opportunity protocol between EPCOR and EPCOR Power L.P. is that as you -- I think you're aware that if there's any acquisition opportunity for an operating power plant, the right of first look goes to the Power L.P.

ROBERT KWAN: Mm-hmm.

BRIAN VAASJO: On the development side, the developments are first looked at EPCOR.

ROBERT KWAN: So for something like Frederickson, so we may see, say, the L.P. take up the option, but the development activity would occur at EPCOR; is that --

BRIAN VAASJO: No. In regards to the Power L.P. that is an L.P. asset that it would have purchased the option and therefore, it would -- it would be sharing the development risk with EPCOR.

ROBERT KWAN: Okay. And just kind of directionally, is that -- you know, is development risk something that you feel is appropriate for the L.P.?

BRIAN VAASJO: In terms of growing the Partnership, we believe there are likely projects that have a risk profile that is not too dissimilar from the relatively low-risk profile of the L.P. For example, construction of wind farms.

ROBERT KWAN: Mm-hmm.

BRIAN VAASJO: You know, with permits in place and so on and so forth, it's a relatively low-risk development, in contrast to developing a coal plant.

ROBERT KWAN: Okay. So I guess if I'm kind of understanding from a pure Greenfield perspective, you know, if wind is something that might be acceptable then, you know, something on an existing kind of Frederickson site, that's something that you would be comfortable having kind of Greenfield development?

BRIAN VAASJO: Yes.

ROBERT KWAN: Okay. Thanks very much.

OPERATOR: The next question is from Daniel Shteyn; please go ahead with your question.

DANIEL SHTEYN: Yes. Good morning, Gentlemen. I have a couple of questions here. First, just starting off with the accrual for fuel expenses for the Tunis plant, I believe in your press release you mentioned that it was actually broken up into two chunks, that \$3 million was provided for during the 2nd Quarter of the year and there was mention of another \$1.9 million. Now, I wasn't too clear if the \$1.9 million was actually taken -- the accrual was actually taken last quarter or did it come through this quarter, as well?

STUART LEE: Most of that accrual came through in the 1st Quarter, Daniel.

DANIEL SHTEYN: Okay. And it was just buried in the OM&A someplace?

STUART LEE: It would have been in fuel costs.

DANIEL SHTEYN: Fuel costs. I see. Okay. No, the reason I was asking is I didn't pick up on that last quarter. Okay. The next question that I have is actually -- it's got to do with the \$4 million for the Frederickson development, so as I understand the \$4 million is just a

fee for the fund to participate on a 50% basis in the development of the Greenfield opportunity, right? It doesn't actually pre-pay any of the actual development expenses. This is just a fee payable to EPCOR Utilities?

BRIAN VAASJO: That is correct, although just to be clear, what that includes is there is the opportunity that I previously described, a plant very similar to Frederickson is actually permitted, so -- and there's also rights on lands and so on and so forth, and the extent of engineering work, so it's sort of a whole package around the opportunity as opposed to, you know, just a concept. It's a fully developed project.

DANIEL SHTEYN: Okay. So it's actually, you know, a portion of that \$4 million is reimbursing the sponsor, EPCOR Utilities, for some of the costs and assets that have already been purchased?

BRIAN VAASJO: That is correct.

DANIEL SHTEYN: Okay. I guess next question that's got to do with cap-ex, your press release states that the outlook hasn't materially changed from the beginning of the year. Now, on a year-to-date basis you've expensed about \$2 million and I believe your guidance was something like the average of the preceding two years on a full-year basis; is that correct?

STUART LEE: Yes. I think our guidance is it'll be slightly lower than what we've seen over the last two years, which has been in the \$14 million a year range.

DANIEL SHTEYN: Okay. So now that \$2 million has been spent, so presumably there is something like \$10-12 million still to come during the next two quarters, and just wondering which assets the bulk of this cap-ex would be spent on and in which quarter?

STUART LEE: Probably the primary capital expenditures will be at the Ontario facilities in Q3 and Q4, and I think you'll be looking at timing probably roughly split between the two.

DANIEL SHTEYN: Okay. Evenly split. Now, and again, this \$10-12 million does not include any additional cap-ex that would be spent on Mamquam and Queen Charlotte, if there is any additional cap-ex?

STUART LEE: Obviously, there is cap-ex expected for Mamquam and Queen Charlotte, but nothing -- nothing out of the ordinary for this year.

DANIEL SHTEYN: And that would not be included in the 10-12 that I've just mentioned?

STUART LEE: It is included.

DANIEL SHTEYN: Oh, it is included.

STUART LEE: Yes.

DANIEL SHTEYN: Okay. Is it -- again, is it -- just to get an idea of the relative weight that would be spent on the hydros versus the Ontario, is it, you know, half? Is it a third? A quarter?

STUART LEE: When you're talking about hydros, you're talking about B.C. --

DANIEL SHTEYN: Sorry. Yeah. The Mamquam and Queen Charlotte.

STUART LEE: It would be less than a quarter.

DANIEL SHTEYN: Okay. Mm-hmm. Very good. Okay. So the last question got to do with the transportation agreement for Castleton. Now, unlike the gas -- so just so you understand, unlike the gas supply contract, the title to the transportation capacity is actually held by the income fund?

STUART LEE: Correct.

DANIEL SHTEYN: Okay. And have you disclosed what the pricing of the transportation agreement is at?

STUART LEE: We haven't.

DANIEL SHTEYN: Okay. I'd -- can you or not?

STUART LEE: At this point in time, Daniel, I don't think we're -- we'd be disclosing that.

DANIEL SHTEYN: Okay. And how -- can you maybe state how far below market, current market prices it's at as a rough range?

STUART LEE: I'd have to check on that detail, Daniel. I can comment that the actual margin that we're earning on that is fairly small.

DANIEL SHTEYN: Okay.

STUART LEE: So the actual --

DANIEL SHTEYN: I guess that's where I was driving at. Okay. That's fine. All right. That concludes my list of questions. Thank you.

OPERATOR: The next question is from Claire Mitenko; go ahead with your question.

CLAIRE MITENKO: Good morning. Can you just confirm that no additional costs from the gas dispute can be recovered from the OEFC?

STUART LEE: Effectively, on a go-back basis, I'd say no.

CLAIRE MITENKO: Okay.

STUART LEE: We've effectively settled with the OEFC on what the escalators were for prior years.

CLAIRE MITENKO: Okay. So that -- so the pricing part has been settled and it's just resettling on the costs. And if you end up paying gas spot prices going forward on those contracts, will you look to renegotiate the PPA or what's your strategy?

STUART LEE: I think our original thinking and our ongoing thinking is it would be very unlikely that we would be unsuccessful, I think is our view. We don't believe that frustration of contract is a reasonable claim, given the fact that we've gone back and offered effectively with the old DSCR index was.

CLAIRE MITENKO: Okay. And then just lastly, just a quick housekeeping item. In the Statement of Cash Flows there's an item "other" of \$2.9 million that's deducted. Can you just tell me what's -- what's that made up of?

STUART LEE: Sure. The primary piece of that is the deferred revenue coming out of Curtis Palmer, so on a revenue basis, because we set up a deferred liability account for that deferred revenue.

CLAIRE MITENKO: Okay.

STUART LEE: In previous years that's been drawn down. In fact, in the 2nd Quarter that balance was eliminated, and so now what you will see flowing through on the revenue line is effectively the actual cash that is generated out of that facility.

CLAIRE MITENKO: Okay.

STUART LEE: I don't know if that's clear or not.

CLAIRE MITENKO: No, I remember the explanation from previous --

STUART LEE: Yes.

CLAIRE MITENKO: -- from previous quarters. Okay. That's everything. Thanks.

OPERATOR: Currently there are no other questions in the queue.

RANDY MAH: Okay. We'll just wait a short moment here.

OPERATOR: If anyone does have a question, please press "01" now. And still there are no questions in the queue.

RANDY MAH: Okay. That concludes our conference call then. Thanks again for joining us and we look forward to working with you over the coming quarters.

OPERATOR: Ladies and gentlemen, this concludes the EPCOR Power L.P. conference call. On behalf of myself and the rest of the teleconference team, thank you for choosing TELUS. We ask that you disconnect your lines at this time.

(CONFERENCE CALL CONCLUDED)