

EPCOR Power L.P.
Third Quarter Results Conference Call

October 30, 2006
09:00 MT

OPERATOR: Good morning, ladies and gentlemen. Welcome to the EPCOR Power L.P. third quarter results analyst conference call. I would like to introduce Randy Mah, Senior Manager Investor Relations. Please go ahead.

RANDY MAH: Good morning, and thank you for joining us today. The news release on our third quarter financial and operating results was issued earlier this morning and is posted on our website at epcorpowlp.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'll start with a brief summary on the highlights for the third quarter, followed by a question and answer session.

During this conference call forward-looking statements may be made. Statements 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. Good morning. Before I turn it over to Stuart to review the financial highlights, I'd like to provide a brief recap of events since we reported our second quarter results. Last week, we announced a ten-year extension to the PPA term on the Manchief power plant with the Public Service Company of Colorado. The ten-year extension under substantially similar terms as the existing PPAs eliminates recontracting risks, stabilizes cash flows during the extension period and increases the Partnership's overall weighted average contract life. During the ten-year extension period, capacity payments will be approximately 15% lower than the existing PPAs. PSCo will have an option to purchase the Manchief plant during the latter part of the extension term period. If PSCo were to exercise this purchase option, the Partnership would receive a fixed purchase price which we believe will maintain the

economic value of the ten-year PPA extension and compensate the Partnership for the plant's expected residual value.

In August, we announced and are now close to completing the acquisition of Primary Energy Ventures. Based on current markets and operating conditions, this transaction is expected to be accretive to cash available for distributions by approximately \$0.06 per year. The Partnership plans to finance the acquisition with an equity issue representing approximately 70% of the purchase price.

I will now turn the call over to Stuart.

STUART LEE: Thanks, Brian. The Partnership's results were in line with management's expectations, giving consideration to lower natural gas prices in the quarter and its impact on enhancement and diversion opportunities at the Ontario plants. The results also reflect typical seasonal variation due to summer price rates under the Ontario PPAs, as well as historically lower water flows in the third quarter at our hydro facilities. Operating margin was down 10% to \$38 million for the quarter ended September 30th, 2006, compared to the prior year quarter primarily due to the drop in Ontario gas prices which averaged \$6.45 per gigajoule compared to \$10.88 per gigajoule in the third quarter of 2005. As a result, net enhancement and diversion margin was down close to \$5 million. This was partially offset by two months of positive contributions from the Frederickson facility, which generated \$2.4 million of operating margin.

Net income was also impacted by a small foreign exchange loss of half a million dollars in the quarter, which is primarily unrealized, versus a gain in the prior year's quarter of \$11.3 million. Funds generated from operations for the third quarter of 2006 was \$29 million and reflects lower operating margins, as previously discussed. The current year's step-down in pricing at Curtis Palmer was offset in the quarter by higher water flows in the same period in 2005. Overall, results this quarter can be attributed to three primary drivers: historical seasonal trends, lower natural gas prices and the addition of the Frederickson plant.

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

RANDY MAH: Thanks, Stuart. Operator, we're now 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.

Bob Hastings from Canaccord, please go ahead with your question.

BOB HASTINGS: Well, yes, just to get more of an update on the Primary Energy Ventures acquisition, you had some waivers that you had to get in place and I was wondering how we're doing on that, and the regulatory front.

BRIAN VAASJO: Good morning, Bob. Brian Vaasjo here. I can't really get into too much detail at this point, but what I can say is that the overall transaction is going very well and we expect to close very soon, and which implies, obviously, that discussions with the PERC independent directors and the regulatory approvals have gone well.

BOB HASTINGS: Okay. I assume that you can't make much in the way of comment -- in our previous meeting it was mentioned that you hadn't been able to talk to management. You expected to do that and you're looking at synergies of what the impacts might be. Is it still a little too early to make comments on that?

BRIAN VAASJO: It would still be too early to make comments on that, Bob.

BOB HASTINGS: Okay. But -- now, the last thing is regarding that acquisition, I notice that you haven't changed any of your targets of \$0.06 accretion. I think you mentioned that once this was all closed, you looked at maybe paying out a portion of that in increased distributions; would that still be the case?

BRIAN VAASJO: That'll be considered in due course after the close.

BOB HASTINGS: Okay. Thank you, very -- and do you have any anticipated closing? Is it the end of December or is it November?

BRIAN VAASJO: Very soon.

BOB HASTINGS: Okay. Good. Thank you very much.

OPERATOR: Tony Courtright from Scotia Capital, please go ahead.

TONY COURTRIGHT: Thank you. A couple of questions on the U.S. gas-fired plants, Manchief, the option for the power purchaser to acquire the plant is intended to immunize you against the benefit of the balance of the PPA and to compensate you for the expected residual value. What

is the expected residual value of such a plant? Is it in any relation to your un-depreciated book value of the plant or can you give us some idea of how you value these plants?

BRIAN VAASJO: Unfortunately, we're under some very tight confidentiality constraints with PSCo. They are negotiating similar type agreements with a number of other parties right now and as I say, unfortunately, we can't get into too much detail. But I can tell you we are quite happy with the values that have been arrived at and do truly in our minds reflect what would be the residual value of the plant.

TONY COURTRIGHT: Okay. Turning then to another U.S. gas-fired plant which is Castleton, its contract with, I think, TransCanada Energy Services expires mid-2008 and there you do have, I guess, an un-depreciated book value. Can you enlighten us as to whether there's been any change in terms of your outlook or prognosis for the continuing operation of that plant post-contract maturity?

BRIAN VAASJO: We continue to look at that issue and discuss its ability to attract another PPA in the marketplace. Our base case is that it continues to operate on a merchant basis and to the extent that we can get short or long-term contracts to support that would be quite beneficial.

TONY COURTRIGHT: All right. And then just finally in terms of turning to another issue, you've indicated you've extended credit facility, enlarged and extended a credit facility and also negotiated another credit facility. Can you outline for us what are the major financial covenants that govern the borrowings under these facilities and what your current levels are in relation to those covenants?

STUART LEE: So, Tony, it's Stuart. The covenants are basically identical to what was in place before. So you have a covenant on the debt to capitalization and I believe that's in the -- around 60% capital. We're probably running right now at around 36 to 37%, so lots of head room with respect to that. And the other one is basically EBITDA to overall debt requirement and again, we have considerable headroom with respect to that particular covenant, as well. But really, no change from our prior covenants.

TONY COURTRIGHT: All right. Thank you very much.

OPERATOR: Michael McGowan from BMO Capital Markets, please go ahead.

MICHAEL MCGOWAN: Hello. I just wanted to ask a question about the excess revenue at Castleton. Your revenue increased by \$5.1 million during the quarter, but your margins actually

decreased there by half a million. Could you let me know how much fuel costs increased associated with the sale of capacity and how much the plant outage contributed to the decrease in operating margin?

STUART LEE: So Michael effectively the margin earned on that opportunity on the transmission capacity is fairly small. It's about probably about \$100,000 in the quarter.

MICHAEL McGOWAN: Okay.

STUART LEE: So fairly insignificant. The decline in margins at Castleton for the quarter has two components to it. One is the issues on the operations in August where capacity payments were down about \$300,000. And secondly, we also have obviously de-hedged our foreign exchange contracts in Q2.

MICHAEL McGOWAN: Okay.

STUART LEE: There was an unrealized loss of about half a million dollars that was allocated out to the U.S. plants and Castleton would have picked up a portion of that.

MICHAEL McGOWAN: Okay. Now, if the increase in margin is very small associated with, I guess, relaxing the requirements or relaxing your sales into the forward contracts -- or sorry, the gas supply contracts there, why would you sell the gas and then purchase the requirements back in order to only pick up \$100,000?

STUART LEE: Effectively what we're doing is we're selling transmission capacity on the line.

MICHAEL McGOWAN: Okay.

STUART LEE: It's really -- Castleton itself is effectively a tolling arrangement on gas. So we're selling capacity and it's just -- it's an opportunity that, you know, even though the margins are small, it's an opportunity to make additional money.

MICHAEL McGOWAN: Okay. So if I'm taking a look at a revenue increase there of about \$5.1 million, I can assume that the fuel costs increased by about \$5 million?

STUART LEE: That's right.

MICHAEL McGOWAN: Okay. And are you able to describe the PPA and the fuel supply arrangements at Frederickson at all?

BRIAN VAASJO: Frederickson is a tolling arrangement.

MICHAEL McGOWAN: Okay.

BRIAN VAASJO: It's -- the fuel is provided effectively by the public PUDs in the region, the off-takers.

MICHAEL MCGOWAN: Okay. So the fuel is provided by the PUDs and then you get a fixed tolling revenue?

BRIAN VAASJO: Correct.

MICHAEL MCGOWAN: Now, what are your availability requirements in order to earn that revenue?

BRIAN VAASJO: Don't have that number in front of us right now, but it's in the low 90s.

MICHAEL MCGOWAN: Okay. Do you actually have to run the plant in order to earn it?

BRIAN VAASJO: No. It just needs to be available.

MICHAEL MCGOWAN: Okay. Okay. I'll jump back in the queue, thanks.

OPERATOR: Robert Kwan from RBC Capital Markets, please go ahead.

ROBERT KWAN: Good morning. I was just wondering is there any update on the status of the Devon and NAL litigation since the last quarter?

BRIAN VAASJO: It is in litigation and as such we're unable to comment on it.

ROBERT KWAN: Okay. Is there any kind of estimate as to when you think the timing on that might be resolved?

BRIAN VAASJO: No.

ROBERT KWAN: Okay. Is it -- can you tell us, you know, are you also kind of in side negotiations on a settlement or is this really we're going to see how the litigation itself plays out?

BRIAN VAASJO: Really can't comment on that.

ROBERT KWAN: Okay. And then just on Primary, now that you've spent some time kind of talking with management and getting a better understanding of the assets there, you mentioned that in the previous call that the PERC assets would be interesting to you, that, you know, you'd obviously -- you are well-positioned to acquire those if you wanted to move ahead. Do you still feel that that's the case?

BRIAN VAASJO: Our position on that hasn't changed and since we last spoke, we've done no additional work on that potential opportunity.

ROBERT KWAN: Okay. Thank you very much.

OPERATOR: Claire Mitenko from National Bank Financial, please go ahead.

CLAIRE MITENKO: Good morning. Where do you expect maintenance capital spending to be at for year-end and which facilities do you expect work will occur on during the fourth quarter?

STUART LEE: On maintenance capital?

CLAIRE MITENKO: Yes.

STUART LEE: So maintenance capital, I think, in line with what we've -- in line with the guidance we provided, I think we expect the total to be in the \$10-\$12 million range for the full year.

CLAIRE MITENKO: Okay. And now which facilities do you plan to have work on, 'cause there's kind of a big chunk left for the last quarter.

STUART LEE: So we have a spare turbine that's ordered for the North Bay and Kapuskasing facilities that was delivered in October, we have a little bit of work, I think, at the Calstock facility with respect to fuel cells, and other than that it's kind of spread out between the remaining facilities.

CLAIRE MITENKO: Okay. Is there going to be any major outages for the turbine change-out?

STUART LEE: It's not a turbine change-out. We've basically ordered a spare turbine.

CLAIRE MITENKO: Okay. All right. Thank you very much. That's it.

OPERATOR: Daniel Shteyn from Desjardins Securities, please go ahead.

DANIEL SHTEYN: Good morning, Gentlemen. A couple of questions here, starting off with just follow up on one of the questions which you have answered which was I believe you, Brian, stated that there has been no additional work done on the acquisition of PRI assets. Just wondering what was the reason that no additional work was done? Is it something that you no longer believe is attractive or you simply haven't had the time to get to it, given everything else you had on your plate?

BRIAN VAASJO: We actually took the position that before we looked at that any further we wanted this transaction to close.

DANIEL SHTEYN: I see. So that's something potentially that you may be pursuing after the close. Okay. Very good.

The other thing is here I wanted to talk a little bit more about Primary Energy Ventures acquisition. I know that you've provided guidance for \$0.06 of distributable cash per unit accretion from this acquisition. I was wondering if at the current time you were ready to provide a little bit more financial disclosure on it with regards perhaps to the gross margin

contribution that you would be expecting from this acquisition, as well as the breakdown in the gross margin between capacity and energy revenues.

BRIAN VAASJO: Just in terms of disclosure, upon close there will be some disclosure. Other than that, most of the disclosure associated with the new facilities would likely come in a supplementary prospectus around the financing, the equity financing that we would anticipate happening relatively soon after the close of the transaction given market conditions, and we would expect some of the information that you're looking for would certainly be in there.

DANIEL SHTEYN: Okay. How much of that information do you intend to disclose? Do you think, you know, gross margin breakdown between capacity versus energy or like -- what kind of disclosure are you considering right now?

BRIAN VAASJO: I would suspect at this point not quite to that level of detail.

DANIEL SHTEYN: Mm-hmm. Okay. Lastly -- sorry, actually two more questions, if I may. Regarding the -- your potential increase in distributions, I understand you will probably want to wait till the close and the financing. Do you think that the -- what is the timeline on the board deliberating as to any potential increase in distributions, is that something that you may think may happen by December or is that -- could that go into next year?

BRIAN VAASJO: No. We would anticipate pretty soon, you know, after the close and potentially around information being released around financing.

DANIEL SHTEYN: Okay. And last question, one of the things -- one of the items that drives a certain amount of volatility in your P&L and cash flows is your enhancement and diversion revenues. I was wondering if at the current time you were able to provide a little bit more guidance as to what you expect in terms of a contribution from such activities on a quarterly basis. Otherwise, I find it very hard to get a lock on the volumes and the pricing, especially since I don't really know how much the cost of fuel is, since it's buried under the fuel cost -- well, I do see the revenue as a stand alone line. Do you have any additional colour that you can provide on that?

STUART LEE: So Daniel, it's Stuart. It's pretty difficult to provide guidance unless -- you know, unless you start quantifying what the expected gas prices are.

DANIEL SHTEYN: Okay.

STUART LEE: So, I mean, you really have to start -- start determining what your forecast on gas prices are for the upcoming quarters and I think everybody's going to have a different view on what gas prices may be going forward. And that's really the primary driver. It also obviously varies between summer and winter rates when the best opportunities are based on the PPA terms and things like duct-firing come into it, as well, so there's a number of different variables that could contribute to it.

DANIEL SHTEYN: I understand. But I think at least the pricing aspect of it could be addressed perhaps through a sensitivity, you know, in addition to the range, so I'm still thinking potentially -- and even if the range has a certain -- you know, it's -- it doesn't have to be very tight but at least as long as there is a range it's already quite helpful because at that point in time I can kind of decide where in the range I wanted to look at, depending on the seasonality.

STUART LEE: Yes. That's a fair comment. We'll take a look at it. One of the best things I could suggest, and we'll look at it, as well, but one of the best things to look at is the historical performance, take a look at gas prices and historical performance and it should give you a fairly good indication of how enhancement and diversion revenues have lined up, based on gas prices.

DANIEL SHTEYN: I have. I wasn't really able to draw any satisfactory conclusions because I do think that volumes have fluctuated, as well. So I'm saying -- I'm not necessarily looking to you to -- as a -- you know, as the only source of information, but I think it would be helpful if a range was provided with a sensitivity around it.

STUART LEE: Okay. Noted.

DANIEL SHTEYN: All right. Thank you very much. That's all for my questions.

OPERATOR: Michael McGowan from BMO Capital Markets, please go ahead.

MICHAEL MCGOWAN: Hi. I have a question about the accrual regarding the higher fuel costs at Tunis. The \$5.7 million, does that relate solely to Tunis or all of the Ontario plants?

STUART LEE: It would relate to Tunis and it would relate to Nipigon.

MICHAEL MCGOWAN: Tunis and Nipigon?

STUART LEE: Yes.

MICHAEL MCGOWAN: Okay. So all the plants that were subject to the DCR re-indexing at the start of the year?

STUART LEE: Correct.

MICHAEL McGOWAN: Okay. And is there any amount accrued in there that is -- in relation to the -
- I guess, the negotiations that are going on at Tunis, are you accruing in excess of the increase
in the DCR rates?

STUART LEE: So we've accrued in excess of that. In relation to the -- what we refer to as the TMC,
which is going back to the old provisions and escalation, which is based on a one-year as
opposed to a three-year averaging.

MICHAEL McGOWAN: Okay. So how much would the excess accrual be?

STUART LEE: Approximately, I think in the \$3 million range.

MICHAEL McGOWAN: Okay. And can you discuss at all what options are available to you to offset
the higher fuel costs or offset the reduction in fuel supply at Calstock?

STUART LEE: Really I think you've got two different options: one obviously is looking at other
sources of supply, and one of the constraints in looking at that is looking at the potential
transportation costs of bringing that fuel in, so really looking at fuel suppliers within about a
300-kilometre radius of the particular facility to make it economic. The other is obviously to
curtail generation in off-peak periods, so it doesn't impact the capacity payment. And so those
are really the two options that are being reviewed, as well as working with existing suppliers to
see if there's opportunities to increase availability of supply.

MICHAEL McGOWAN: Have you quantified how much the reduction in power production would be
besides not producing in off-peak periods?

STUART LEE: It has been quantified. I don't have that number in front of me.

MICHAEL McGOWAN: Okay. Sorry? It has been quantified?

STUART LEE: It has been. We will have quantified it -- in trying to determine what the potential
impact would be for 2007, obviously we've quantified the dollars, so we've also quantified the
generation changes. I just don't have that number in front of me.

MICHAEL McGOWAN: Okay. So the one and a half million dollars, does that include increased fuel
costs and reduced generation, as well?

STUART LEE: It's basically taking a scenario that looks at decreased generation.

MICHAEL McGOWAN: Decreased generation?

STUART LEE: Right.

MICHAEL McGOWAN: Okay. Thanks.

OPERATOR: Tony Courtright from Scotia Capital, please go ahead.

TONY COURTRIGHT: I may have -- it's just a clarification on the foreign exchange risk management. You've increased your hedge -- or hedge, your -- that might not be the appropriate term, but you've increased your management of U.S. dollars to Canadian equivalent to 198 from 181 over the quarter, and so has the expected U.S. dollar receipts changed at all or is that relatively constant over the period 2006 to '12, other than for the lapse of Q3?

STUART LEE: It's -- you know, our view on it is relatively constant. Obviously we've added the Fredericksen facility in the quarter. But generally it's a fairly consistent cash flow coming out of those facilities.

TONY COURTRIGHT: All right. And in terms of PEV, that would still be undertaken; is that correct?

STUART LEE: That's correct.

TONY COURTRIGHT: Fine. Thank you.

OPERATOR: Daniel Shteyn from Desjardins Securities, please go ahead.

DANIEL SHTEYN: Thank you. One more question, and this one is with regards to maintenance capital. Would you be able to quantify your expectations for maintenance capital expenditures for 2007 at the current time?

STUART LEE: So Daniel, we haven't finished our budgeting process for 2007 at this point, so not in a position to comment yet. Certainly I think by the time we get to fourth quarter and look at it then, and then we'll probably have some sort of discussion in our annual MD&A.

DANIEL SHTEYN: Okay. I see. And the last question, even prior -- without necessarily looking at maintenance capital, if we just look at growth capital expenditures in terms of any improvements or re-powerments or brownfield projects that you may wish to undertake at your existing facilities, is there any of that that's in view for 2007?

BRIAN VAASJO: Again, it's a little too early to discuss particular types of budget items.

DANIEL SHTEYN: Okay. And last question and then I promise I'll stop bothering you. Going forward, in terms of your strategic direction, what is your expectation for growing the asset base of the fund and distributable cash per unit? Do you -- is the management team currently

in the position to say that your aim would be to execute on at least, you know, on at least one acquisition on an annual basis so as to try to dilute the PPA expiries post-2012 in Ontario?

BRIAN VAASJO: Well, I think our long-term objective, I think is -- we've been pretty consistent is to continue a pattern of stable cash flows and in time increasing distributions. And a necessary element of that is to carry out enhancements, developments and acquisitions. We are, I think as we consistently disclosed, we're actively looking at generally a couple of transactions at any particular point in time. So we would expect to continue to acquire assets and develop assets and enhancements in the foreseeable future. I hesitate to say that we would, say, have an acquisition every year. The problem with that is the worst thing that an entity can do is feel that they have to do an acquisition and make a bad transaction. So from that standpoint, you know, we expect to be very active, given market conditions, you know, favourable market conditions. We do expect to be maintaining and increasing distributable cash and distributions in the longer term.

DANIEL SHTEYN: Thank you, Brian.

OPERATOR: There is currently no question in the queue.

RANDY MAH: Okay. If there's no more questions then, that will conclude our conference call. Thank you again for joining us and we'll look forward to working with you over the coming quarters.

[CONFERENCE CALL CONCLUDED]