TransAlta Corporation
Fourth Quarter 2015 & Year End Results
Conference Call & Webcast Transcript

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Speakers:

Dawn Farrell
President and Chief Executive Officer

Donald Tremblay
Chief Financial Officer

Jaeson Jaman
Manager, Investor Relations

OPERATOR:

Welcome to the TransAlta Corporation 2015 Fourth Quarter Results Conference Call and Webcast. As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation, there will be an opportunity to ask questions. To join the question queue, you may press star, then one on your telephone keypad. Should you need assistance during the conference call, you may signal an Operator by pressing star and zero.

I would now like to turn the conference over to the Mr. Jaeson Jaman, Manager, Investor Relations. Please go ahead.

JAESON JAMAN:

Thank you, Anastasia. Good morning everyone and welcome to the TransAlta Fourth Quarter 2015 Conference Call. My name is Jaeson Jaman, Manager, Investor Relations. With me today are Dawn Farrell, President and Chief Executive Officer; Donald Tremblay, Chief Financial Officer; John Kousinioris, Chief Legal and Compliance Officer; and Todd Stack, Managing Director and Treasurer.

The call today is webcast and I invite those listening on the phone lines to view the supporting slides which are available on our website. A replay of the call will be available later today and the transcript will be posted to our website shortly thereafter.

All information provided during this conference call is subject to the forward-looking statement qualification which is detailed in our MD&A and incorporated in full for the purposes of today's call.

The amounts referenced are in Canadian currency unless otherwise stated. The non-IFRS terminology used, including comparable gross margin, comparable EBITDA, comparable funds from operations, comparable free cash flow and comparable earnings are reconciled in the MD&A.

On today's call, Dawn and Donald will review our strategic and financial objectives in the context of our fourth quarter and 2015 year end results. They will also discuss TransAlta's priorities for 2016. After these prepared remarks, we will open the call up for questions.

I'll now transfer the call to Dawn.

DAWN FARRELL:

Thanks, Jason, and thanks to all of you who've joined us. I have a lot to cover today, so I'll jump in. I am going to review our year and recall the goals that we set for ourselves and give you my assessment of our performance against these goals, and then we're going to transition into what we're focusing on for 2016.

2015 was a year that highlights, I think, the strength of our assets and the ability of each of our businesses to generate solid cash flows. On a comparable basis, our businesses performed well this year, this year being 2015, when we consider all of the factors affecting the businesses, including prices, contracts, costs and the capital that we invest, and we achieved the targets that we set at the beginning of the year.

So, when I stand back and think about what 2015 looked like, I'm going to start first with our Canadian Coal business. It did deliver slightly higher EBITDA this year over 2014, it had a good fourth quarter on a comparable run-rate basis, and it did that despite lower availability in the first half of the year and some lower pricing in Alberta and the Pacific Northwest for some of the spot market sales. The business is achieving cost performance targets at the plant, and particularly at the mine, it's doing some great work there. It's also using lower capital over time, which is helping to improve the net cash the business delivers to TransAlta.

Donald will take you through, later on the call, the solid operational performance at Canadian Coal, but he'll also talk about that it was impacted in the fourth quarter by accounting provisions that he made at the end of this year for force majeure and other legal disputes that have occurred over the last couple of years.

Now, just while I'm on the Canadian Coal business, I do want to say a couple of words about the PPAs as we look ahead, because there's been a lot of speculation on these arrangements being returned to the balancing pool due to the new carbon price regime here in Alberta and the potential for an impact on the value of those PPAs as they come to the end of their lives. Now, we can't speculate on whether or not more PPAs will be returned to the balancing pool, but what we can do is determine the impact on us.

Our legal review shows that if the PPAs are returned, the balancing pool has two options. First, it can step in and act as the PPA buyer, in which case it will utilize the associated offer control and it will take on the financial obligations to pay the capacity payments. The second option it has is to return the plants to us and pay us our PPA book value, and under this option we gain the offer control ourselves again back and then we have the ability to dispatch the plant on a go-forward basis. So, TransAlta's plants are covered in either event. Only time will tell if there are any major changes to the PPA structure before the end of 2020, when most of them roll off in this market.

So, turning away from coal, the energy marketing business delivered a respectable level of EBITDA by the end of the year, despite their second quarter loss and lower volatility compared to 2014, when the team was able to capitalize on opportunities from the polar vortex that happened in the first quarter of that year. In addition, we reached an agreement with the Market Surveillance Administrator to settle all outstanding proceedings before the AUC at the end of September this year. We believe this provides closure and allows the market, our customers, our employees and our shareholders to move forward. Our strong practices will be confirmed with the release of the independent reviews that we had done of both our compliance programs and our outage practices. These reports will be made public in the next month or so and they confirm that our compliance practices are strong. Our guidance of $60 million to $80 million of gross margin in this business continues to be achievable going-forward.

So, let me turn to the gas and renewables business. This business is doing well and is very stable and highly contracted. We made further progress in contracting this year, including the extension of our Poplar Creek contract with Suncor, the acquisition of contracted renewable assets, and the recontracting of Windsor at our Parkinson generating station. We now have 55 plants in this segment and the Team has been able to add assets without substantially adding overhead to the business.

That being said, we're not able to efficiently hedge some of the generation from our wind and hydro assets in Alberta, and as a result, we did see some reduced revenues from these assets in 2015, compared to 2014. Particularly, you see that in the charts that Donald's going to show you on the hydro. Overall, the returns in this business have declined slightly over three years due to lower pricing in Alberta for wind and hydro, but we see this as a short-term phenomenon, and you can also see that the acquisitions that we've made have been able to take care of some of that shortfall.

We also achieved a number of additional goals that we set for ourselves in 2015. On our operational excellence initiatives, we continue to drive cost-effective and reliable operations. I'm really proud of the work the team has done on the safety front. We did achieve, in 2015, our best ever safety results and far exceeded our targets. We delivered our adjusted fleet availability of 89%, which was firmly in line with our guidance, despite a force majeure outage at Canadian Coal, and thermal de-rates that were higher than expected by warmer than usual weather in the May and June period. The Coal team has made tremendous improvements at the mine since taking over the operation in 2013. We exceeded our target for the year by delivering coal costs at $23 per tonne, which equates to a 15% reduction since we took over the mine in 2013. This is an excellent result and we see these savings as being sustainable into the future. We also completed, as you know, a number of initiatives to reduce overhead costs in our business at our corporate offices. On a run rate basis, this provides almost $50 million in sustainable cost reductions annually.

We continue to work on strengthening our financial position. This was a goal related to reducing our debt, and as of January our debt does still sit at $4.1 billion, slightly higher than the beginning of 2015, due to the U.S. dollar appreciation and the acquisition of wind and solar projects in the year. Donald will run you through the details of this later in the call.

Regarding our investment grade rating, we did set a goal to remain investment grade with all our rating agencies. We were able to maintain investment grade ratings with S&P, DBRS and Fitch, even in a low-price environment and, you know, the work we did on the cost side was really helpful for that, but we did not achieve our goal when it came to Moody's, and they announced a change to our rating in December. The Moody's downgrade did not have a material impact to our business and the impacts were well within the range of the liquidity we have for the Company, so we will be moving forward with our investment grade ratings from the three credit rating agencies.

Our goal for growth has been to add $40 million to $60 million of new EBITDA per year. In 2015, we added two Canadian wind facilities as part of the recontracting efforts with Suncor. We also acquired wind and solar assets in the U.S. for approximately $200 million. The cash flows from these projects provide a solid return and are future candidates for dropdowns to TransAlta Renewables at the right time.

Australia was a busy market for us. We did complete the construction of our pipeline and we're delivering cash out of this investment, and we're delivering the expected cash. We continue to fund the construction of South Hedland, which is expected to be on line in mid-2017, and it will deliver annualized EBITDA in 2018 of approximately $80 million, and, of course, it will deliver some EBITDA in 2017 when it comes on.

There has been a lot of feedback since our most recent dropdown regarding the fuel mix at TransAlta Renewables and whether it's really appropriate to have such a large component of gas-fired generation in a renewable company, so I do want to talk about that for a minute. I want to clarify that TransAlta Renewables is a company built on strong and stable cash flows. Although the name suggests a pure-play renewable company, we were clear at the outset when we marketed the company, that TransAlta Renewables would also hold contracted gas and infrastructure assets. What sets TransAlta Renewables apart from TransAlta is the risk profile associated with the cash flows. With nearly all of its cash flow from contracted assets with solid counterparties, TransAlta Renewables represents a lower risk profile then TransAlta, which does have merchant exposure and takes on development projects. Investors have a choice for allocating their capital, depending on their risk appetite. Both companies provide solid returns, but investors need to make informed decisions based on the fundamentals of each company.

I want to take a few minutes to comment on the low-price environment here in Alberta. An oversupplied market in Alberta drove the average price in 2015 to a five-year low of $34 a megawatt hour. Our expectation, given the current market fundamentals, is that 2016 will continue to print low prices in the spot market and lower prices in the contracted market. In 2015, we completed work to achieve a sustainable cost structure that fits this low-price environment; we have solid hedging in place, again this year, and expect performance from our Alberta business to be at similar levels to 2015. We are planning our financial future based on a lower economic environment over a longer rather than shorter timeframe. Beyond this year, it's difficult to predict where things will be, especially, given the uncertainty in the policy environment for carbons. We're being very cautious with our approach to hedging in 2018, until we have better certainty on the final details of the carbon policy.

As we come out of 2015, the market environment has changed dramatically. Factors, including the change in the Canadian dollar, the lower growth outlook in Alberta and the impact on carbon prices, have caused us to really step back and think about our financial flexibility. Our decisions, just early in the year, to both reduce the dividend, and focus our efforts on replacing bonds with project-level debt will give us stronger flexibility for the future given the uncertainty that we currently see.

In closing, I am pleased with the work we did in 2015. As always, there's always more to do, but we delivered strong operational performance despite the market conditions. As we look at our financing needs over the next couple of years, our internal cash flows are sufficient to finish building South Hedland and fund our sustaining capital and obligations to the business. The construct of any sort of coal deal here in Alberta will build our confidence for reinvesting cash in the Alberta marketplace.

I'll turn the call over to Donald for his review of our financial performance and then I'll come back and talk bit about our priorities for 2016.

DONALD TREMBLAY:

Thank you, Dawn. I want to start with an overview of our 2015 performance against the outlook we provide for the year. Given the prices in Alberta and Pacific Northwest, our comparable EBITDA came in quite strong in 2015 at $945 million, including a non-cash adjustment of $59 million to provision for prior year disputes relating to force majeure claims. This is not an issue with our current performance as operators or any concerns about our technical decision-making practice. It is part of our regular process to review the amount of provisions we are anticipating, as the PPA framework requires us to enter into complex arbitration with binding decisions. As we think about the future and the final years of the PPAs in the market, we believe it was prudent to review all of our dispute provisions with an eye to being conservative in our estimated exposure.

Excluding the adjustment to provisions at year end, comparable EBITDA for the year was $1 billion, within our guidance range. Our coal assets were not materially impacted by lower prices as they are mostly contracted or hedged, but our wind and hydro assets in Alberta were affected. Availability at Canadian Coal was slightly below our expectations for the year but delivered strong availability in the last quarter at 91%. Major improvements in our mining and coal plant operations this year offset the shortfall in Canadian Coal availability and significantly improved our competitive position for the future.

Contributions from wind and solar assets acquired in the last part of the year more than offset the shortfall from low prices in Alberta on our wind facilities. Also contributing to our performance this year was the addition of the natural gas pipeline in Australia during the second quarter. The pipeline, as well as the wind and solar addition, will contribute fully in 2016, assisting in our transition from coal.

Finally, impacting our results negatively in 2015 is the year-over-year performance of our energy marketing. 2014 was a great year our energy marketing business, as they captured significant value during the polar vortex in February 2014, while this year we generated negative margins during the second quarter. The team performed very well in the fourth quarter and delivered $26 million in EBITDA, in line with the same period last year.

We generated comparable FFO of $740 million for the year, within the guidance range provided for 2015. This speaks to the strength of the cash flows generated by the business and the success of our hedging strategy. Lower EBITDA was offset by lower interest expense, lower cash tax resulting from the Australian transaction, and add-back of non-cash provision adjustments. Comparable free cash flow for the year was $315 million or a $1.13 per share, above our guidance and ahead of last year. Comparable free cash flow excludes the settlement of the MSA case and the cost of implementing our reorganization.

Free cash flow in 2015 benefited from lower sustaining capital, following the deferral of an outage at Centralia, due to the higher level of economic dispatching, the new arrangement with our customer at Poplar Creek and reduction in capital expenditures in our gas-powered assets supported by condition-based assets. Also contributing to the sustaining capex in 2015 was the insurance recovery of some emerging capital at Canadian Coal and final settlement of our claim relating to the flood of 2013. Some of the work relating to the flood will be executed in 2016, and is included in our plan.

Just a few words on our performance for the quarter. As was the case last year, the fourth quarter was our strongest quarter this year. During the quarter, we generated comparable EBITDA of $327 million, better than last year, if we exclude the impact of the adjustments for provisions. Each of the business segments performed in line with or better than they did last year. I'm sure you have all had a chance to review the details of our fourth quarter performance that was released earlier today. As such, I'm not going to review each area in detail.

Slide 11 provides a breakdown of our free EBITDA for each segment to demonstrate the diversification of our business. Free EBITDA, which totaled $755 million in 2015, corresponds to the cash available from the business after they have paid for their sustaining CapEx. As you can see, the Canadian Coal fleet contributes just over 25% to free EBITDA, while gas and renewables account for more than 65% of our total free EBITDA.

The next topic I would like to discuss is our capital structure at the end of 2015, and our recently announced plan to reposition our balance sheet.

As Slide 12 indicates, after we closed our transaction with TransAlta Renewables in early January, we are carrying just less than $4.1 billion of debt on our balance sheet, net of our financial hedges. This is $159 million higher than last year. During the year, we funded the construction of the South Hedland project in Australia and acquired renewable projects in the US. This required $430 million of capital. A severe appreciation of the U.S. dollar added just over $200 million to our reported debt, net of the cross currency swaps. During the year and including the transaction we closed in January, we raised $600 million of equity using TransAlta Renewables.

We also started repositioning our capital structure and moving from corporate level debt to project level debt in 2015. At the end of the year, $848 million of our debt is non-recourse to TransAlta, compared to $454 million at the end of 2014, as we completed a very attractive financing, using two contracted wind projects in Ontario. We plan to raise an additional $400 million to $600 million of project level debt in 2016. Most of this debt will be in TransAlta Renewables and be non-recourse to TransAlta.

TransAlta's recourse debt balance of $3.2 billion in early January is down almost $300 million compared to last year. The repositioning of our balance sheet will result in a greater amount of debt held at TransAlta Renewables, as this is where the majority of our contracted assets reside. Finally, in January, we have access to $1.4 billion in liquidity.

In January, we announced a significant reduction in our dividend from $0.72 a year to $0.16 a year. This corresponds to $150 million of cash per year. As a result, we are not expecting to access the equity market to fund our capital requirements in 2016 and 2017. In 2017, our credit metrics will improve significantly as a result of the contribution from South Hedland. We also announced the suspension of our DRIP in January, as it was creating significant dilution for shareholders at the current stock price.

In closing, I want to briefly comment on the 2016 outlook and some of the assumptions we have made in our guidance for the year.

As Dawn mentioned at the outset of the call, power prices were at historical low in 2015, and we have assumed that these low prices will continue throughout 2016. We are highly hedged in 2016 at price levels comparable to the prices we realized in 2015. This level of hedging insulates our cash flow from a low price environment. We are expecting our Canadian Coal availability to be in the range of 87% to 89%. There is no indication that the wind and hydro resources will not be at long-term average.

As discussed in October, we expect our sustaining capex to be in the range of $330 million to $350 million, slightly higher than 2015, but in line with our actual over the last three years. Our major maintenance for 2016 includes major turnarounds at three units that we operate and two that are operated by our partner. Also included in major maintenance is significant work at our hydro facilities, including the Ghost River diversion and a stator generator replacement at our Bighorn generating station on the North Saskatchewan River.

I will now turn the call back to Dawn.

DAWN FARRELL:
Thanks, Donald. So, I'll close with my thoughts on what lies ahead in 2016, our plan of attack and how you can measure our success. 2016 will be another busy year and we continue our commitment to accountability and transparency. We'll discuss our wins and losses openly with you and you'll be able to understand how this impacts the long-term value at TransAlta.

Now, the first, of course, number one priority for TransAlta is to achieve some sort of coal transition agreement with the Alberta government. The policy decisions on carbon at the end of 2015 have us on hold as we think about future investments here in the province of Alberta. We know that coal is to be phased out by the end of 2030 and replaced with renewables and gas, and the government is committed to not unnecessarily stranding capital. We had been told there would be an announcement by the end of January regarding a negotiator to work with us on compensation, but now we do not have a timeframe for when this will be decided, so that's still an open question here in the market. We will be ready for when those discussions start. So, it is our top priority for 2016, and we really believe it's important to the future of the Company to come out of the year, if we can, with some sort of coal transition agreement.

Now, just to be clear, our efforts are going to be focused on achieving the best outcome for all of our stakeholders over the longer term. We recognize that you, as investors, dislike uncertainty and the sooner we have clarity the better. However, these are complex discussions and they'll take time and we want to make sure we do the best job for you. So, we're just asking for your patience.

We may or may not be able to speak publicly on the progress we're making in these discussions, we don't know if they'll be confidential yet, but we do believe that there will have to be some level of confidentiality because we'll need to share our assessments of future cash flows and financing structures around the coal plants. So, we may not be able to tell you everything we want to tell you, but we will give you as much information as we can. In the meantime, we'll be busy working to ensure that we've got all of our ducks in a row and that we can be thoughtful as we go into discussions with government, and we will be working with our other colleagues here in the Alberta market.

Our second priority is doing the right work to ensure our strategy of raising non-recourse project level debt is executed well and ensures we can accelerate what needs to be done to replace the bonds coming due in 2017, and beyond. It's no small task. If you really stand back from it, what we're doing is we're setting up the capital structure for TransAlta Renewables based on their long-term contracted assets, and we're setting up the long-term structure for TransAlta based on TransAlta having more merchant assets in it. That's what is really behind our efforts here and we really are working at a very accelerated pace so that we can give you more certainty over the long term for both of those companies.

Our third goal is to ensure that the savings that we hammered into the Company in 2015 are sustained and are resistant to change as we go forward, no matter what the market looks like. We believe these savings are sustainable, but you'll need to see this as you see our run rates and our performance in 2016.

So, just a few additional priorities before I hand it back to Jaeson for questions.

Another priority, of course, is finishing South Hedland. We're just around a year away from today when we'll be starting that project and bringing it on commercially. So, I think the team's got a lot of momentum in that project and certainly met all of their deadlines in 2015, but 2016 and 2017 will be critical, and all of you that have been involved in construction projects know that there's always lots of work that has to be done when you get to the end of the project.

We will also be focusing on building strong and long-term relationships with our customers and partners, as we near the end of our PPAs. Today's buyers are tomorrow's customers and we need to keep that in mind as we transition through to the end of the PPAs.

Now, coming back to TransAlta Renewables, we will continue our efforts to grow this company. We'll continue to take the same diligent approach that we have in the past when reviewing new deals that could be considered for TransAlta Renewables. We will no longer use TransAlta Renewables for the purposes of debt repayment at TransAlta, and our focus is on growing the distribution per share for those shareholders, and, of course, we're one of the biggest shareholders, so that increases our distributions.

So, in summary, 2015 was a good year despite an environment that gave us two significant negative events, an absolute slowdown in the Alberta market with extremely low spot prices here, and a significant change in the policy environment for coal. We generated strong free cash flow and we met our targets. We made some tough choices to support a stronger future and ensure we don't have to go to the market for cash during a time of what we think is unusual uncertainty. We continue to see investments for TransAlta Renewables that will grow the Company and replace our coal cash flows. How quickly we can grow will depend entirely on discussions with government on coal compensation and the pace at which we can convert our bonds to project debt over time and how quickly we can get the capital structures for TransAlta Renewables and for TransAlta set up properly.

Our priorities now are to conserve cash, maximize our financial flexibility and be ready to compete once the environment here becomes clearer. We'll report our accomplishments on this front, so you'll have confidence that TransAlta will remain strong over the medium and longer term.

So, with that, I'll turn it back to Jaeson.

JAESON JAMAN:

Thank you, Dawn. The Q&A format will be the same as always. We'll answer questions from the investment community first and then open the call to media. Lastly, I would also remind everyone on the call that my Team and I will be available after the call for any follow-up questions you may have.

Operator, we will now open the line for questions.

OPERATOR:

Thank you. Ladies and gentlemen, we will now begin the analyst question and answer session. Any analyst who wishes to ask a question may press star and one on their touchtone phone. You will hear a tone acknowledging your request. Please ensure you lift the handset if you are using a speakerphone before pressing any keys. If you wish to remove yourself from the question queue, you may press star and two. Any analyst who has a question may press star and one at this time. There will be a brief pause while we compile the Q&A roster.

The first question is Ben Pham of BMO Capital Markets. Please go ahead.

BEN PHAM:

Okay, thanks, and good morning. I wanted to go back to your earlier comments about the balancing pool and the pushback of the PPA, you highlighted two options. With the option of the book value pickup and the plant potentially moving towards dispatch, from your perspective, does that preclude you from negotiations with the government then, with respect to the climate change, and what do your lawyers think on that?

DAWN FARRELL:

Ben, thank you for the question—we don't know anything at all about the framework of the negotiations with the government on coal. We do have some indication that they're running some models at the ISO to try to figure out sort of what a more measured approach might be, because, as you know, a lot of the coal plants shut down between 2025 and 2030, and so we know there's some discussion about ensuring that there's a really good path on reliability. We don't have really any way to relate what's going on in the short-term PPA discussion with what's going on with that coal conversation. So for now, really, all we can do is assess it within the current framework, this is what could happen and these would be the choices that we would have.

BEN PHAM:

Have discussions started yet?

DAWN FARRELL:

No, no, there've been no discussions at all.

BEN PHAM:

Okay.

DAWN FARRELL:

Maybe I didn't make that clear in my comments. We thought we'd have a negotiator appointed by the end of January. It's now the end of February and we don't have a timeframe for that, and we have no indication that there's a decision on who that will be or what that process will be. We do have some reason to believe that it should be before the end of March, but without the negotiator, without an initial set of discussions around what the framework is, we would just be speculating, so all we're trying to do is get ready for a number of different potential options that'll happen during that timeframe.

BEN PHAM:

Okay, and the other thing I wanted to check with is—I just haven't got to details in the back yet—on the Warren Buffet option, can you expand on that a bit? Did the option expire, which gave you an opportunity to buy back? Just maybe some more details on that.

DAWN FARRELL:

Sorry, say that again, Ben. What are you thinking?

BEN PHAM:

I thought I saw something in the back, correct me if I'm wrong, just with the natural gas, Sundance 7?

DAWN FARRELL:

Oh, what we're thinking about for Sundance 7, is that what you're asking?

BEN PHAM:

I thought I saw something in terms of you buying back your option on Sundance 7, or maybe I was reading it incorrectly.

DONALD TREMBLAY

So, as a result of us pushing back the Sundance 7 project, we agreed with our partner TAMA to continue that project on our own, and they have an option to get back in if we go ahead with that project, and that's also applicable for other projects we'll have. So, it was low probability of starting that project in the short term. We made that decision with our partner.

BEN PHAM:

Okay, thanks for clarifying that.

DAWN FARRELL:

I think, Ben, there's kind of two things to think about there. One is there's no way you can make an investment, in our view. I mean, others, maybe they're bigger risk takers than we are, but in our view, with the current uncertainty in the Alberta market around carbon policy, there's no way to advance a decision on Sun 7. It's a great project, it's the lowest cost project in the province, it's an excellent replacement for coal, but you could not finance that project in this market with the uncertainty that's in the future. I don't think you could bring $10.95 to it. So, as a result of that, the deal we made with TAMA was the project continues to be on our shelf, our inventory of things we can do, we'll continue to advance it, and may have an option to come back in if we get it. If we do finally get to the place where we can invest in that project, and in particular if we can get long-term contracts for it, they'll come back into the project. So, effectively, it's our project for now and they have an option to come back.

BEN PHAM:

Okay. Okay, thanks for clarifying that. Thanks everybody.

OPERATOR:

The next question is from Linda Ezergailis of TD Securities. Please go ahead.

LINDA EZERGAILIS:

Thank you. Just to follow up to Ben's question on the Berkshire Hathaway relationship, would they be coming in at cost, or at a premium, and what about outside Alberta, are you working with them, or is there a potential outside of Alberta to be working with them?

DONALD TREMBLAY:

So, they will come back at cost. The deal is, if we decide not to go ahead with the project, some of the costs we co-invest will be reimbursed to them—that was part of the initial deal with them, anyways.

LINDA EZERGAILIS:

Okay.

DAWN FARRELL:

I mean, we've known them for a long time, we know the kind of profile they have. If we had a great project outside of Alberta with long-term contracts, they'd be one of the first people we'd talk to about partnering.

LINDA EZERGAILIS:

Okay, that's helpful. I'm still going through all the results, but maybe you can help me understand some of the changes in non-cash operating working capital for the year, might some of that reverse in 2016, or what are some of the moving parts there?

DONALD TREMBLAY:

Some will clearly reverse in 2016. We have higher receivables at the end of year, higher inventory, so that should come back in 2016 for sure, and some of the reduction in 2016 is due to payments that we made on some accruals at the end of 2014.

LINDA EZERGAILIS:

Okay. Thank you.

OPERATOR:

The next question is from Paul Lechem of CIBC. Please go ahead.

PAUL LECHEM:

Thank you. Good morning. Just a few questions around the coal PPAs and the possibility that they get with the balancing pool—if they get returned to the balancing pool and the balancing pool then chooses to terminate them, could you give us a sense of what is the amount that they would have to pay if they return the PPAs to you or cancel the PPAs? You said it's based on the book value. What is that?

DAWN FARRELL:

Yes. So there's a calculation of the PPA book value, but just to be clear, I think there would be, you know, there would be a negotiation in terms of what exactly that value is and how you account for that, so I don't think there's a crystal clear formula, but, basically, if you're thinking about it Paul, you think about it this way. Just think about what the book value would be based on the PPAs at a certain time and then what the net present value of the capacity payments. From an economic perspective, effectively, if the net present value of the capacity payments is higher than the PPA book value, they pay the PPA book value to us.

Now, the benefit of them pushing it back to us is, once they do, then the PPA goes away and we can change our capital on the plant and we have more flexibility with how we dispatch them, and we've got offer control. When we look at the math today, it shows that they would continue to pay the capacity payments, but that could change as we get closer and closer to the end. Frankly, we think that it's beneficial both ways.

PAUL LECHEM:

Can I ask a follow-up question about the implications if and when these plans become merchant? So that shift in your contracted mix to more merchant, what does that do in terms of credit ratings of the business? How do the rating agencies look at that?

DAWN FARRELL:

Well, that's why we've been working so hard to set up the Company to be able to withstand lower prices. So, when we worked with the credit rating agencies, Paul, effectively, last year, as we were working through our work with the credit rating agencies, we always thought that we had to be in a certain position with our capital structure by the end of 2020, because PPAs would roll off then. It became very clear in our discussions with the credit rating agencies that we had to really advance our credit metrics earlier to be able to maintain investment grade once the PPAs rolled off. So, all of the work that we've done on the cost structure, all of the work that we do on hedging, and all the work we're doing to try to improve our balance sheet, has been keeping in mind that, effectively, we have to be there by 2017, not by 2020. So, you know, we're well advanced on that front, and we had pretty clear discussions with them about what that could look like. Remember, if we did get PPA book value payments early, we would have money to structure our balance sheet. Those are the kinds of thought that we have today.

PAUL LECHEM:

Fair enough, and then just lastly, are the coal mines—as and when they become merchant, are they capable of more dispatching then they are currently, I mean, will more money need to be spent to make these plants more dispatchable, and how would you operate them differently?

DAWN FARRELL:

Well, that goes back to the discussion with government, right. So, until we have clarity around how they want these coal plants in Alberta, it's very hard to determine how much money you would put into them and what sort of dispatch you'd want to be able to do, and what sort of reliability the system wants. So, you know, my sense of it is we're not going to see any fast moves here by anybody in the short term, because even though the market's in over-supply today, it doesn't take very much for the market not to be in over-supply. So, I think quite a bit of discussion this year, as we go through the coal transition discussions, will be about those kinds of factors.

DONALD TREMBLAY:

The one thing I would add, our experience that we're having currently in Centralia is something that could probably be reflected at some point in Alberta, as well, on a full PPA basis.

DAWN FARRELL:

Yes. So, remember we do a lot of this kind of work at Centralia. You know, we just (inaudible 39:50) that plant down, we moved the capital to reflect what how much we see the plants are going to run, what kind of availabilities they're going to need. So, we do have a lot more flexibility. We don't actually have very much flexibility under the PPAs. PPAs are very restrictive. They require very high levels of availability and investment. So, there is less flexibility, which was intended, because they wanted good reliability coming out of the coal plants over the last 15 years. Those are the kinds of discussions that have to be on the table as we talk through the discussions with the government.

PAUL LECHEM:

Okay. Thanks, Dawn.

OPERATOR:

The next question is from Jeremy Rosenfield of Industrial Alliance Securities. Please go ahead.

JEREMY ROSENFIELD:

Thanks, good morning. I just had a clean-up question to start with. There was a provision that you took in the fourth quarter in the Canadian Coal segment and I'm wondering what's changed related to your outlook for the force majeure. Historically, what is it that has changed that has brought that about?

DONALD TREMBLAY:

I don't think anything changed, in our view. We believe that, basically, when we declare force majeure, it's because we believe there's a force majeure. However, arbitration processes are complex, very technical, and difficult to predict, so we prefer to be prudent at this stage, and when we look at all the force majeure issues that we have, our decision was to be prudent and to increase the provisions, but nothing has changed in our view of the likelihood of us being successful, because when we made the decisions, we made good decisions based on solid advice from our technical team, and we are on solid ground.

DAWN FARRELL:

I think what's changed is it's a very uncertain environment and we want to be more conservative and we're going to be more conservative as we go forward, just as a matter of policy.

JEREMY ROSENFIELD:

Let me see if I understand correctly. This relates to future operations and not to specific previous force majeures that have been claimed in the past?

DONALD TREMBLAY:

No, this is relating to previous force majeure that we had over the last three years, and it's also other issues, it's not only force majeure, but we have other litigations, so we decided to increase our provisions to be prudent and to reflect the process in front of arbitrations.

DAWN FARRELL:

Just to be crystal clear, in a very low priced environment, with negative economics going on in Alberta, with people facing lots of issues in their credit and their own financial situations, you know, the disputes get tougher and are elevated, and people are much more incented to win and throw lots of resources at it. So, in this environment, it just means that you need to be more conservative, especially in Alberta here.

JEREMY ROSENFIELD:

I suppose it would be too much to ask for any specific, you know, cases this might be related to?

DONALD TREMBLAY:

I don't want to be specific.

DAWN FARRELL:

Yes, and it's not related to any one case. We do this process every year, and so this year we assessed that it would be better to be conservative.

JEREMY ROSENFIELD:

Right, okay. Just in terms of the outages that you have planned for the coming year, can you provide any details on which are the plants that are going to be having the major outages and whether they're going to be different than in previous years, in terms of size?

DAWN FARRELL:

I think we have three outages this year. So our capital plans are set-up two-years in advance. We have to give notification to the ISO two years in advance and you can look on the ISO website to see where the planned outages are set up. I think we've got one starting just imminently here in March. At this point, it's just along the same plan that we've had in the past.

JEREMY ROSENFIELD:

Okay, perfect. Then, just going back to one of the questions on Sun 7 that was asked previously, if you look at where the forward curve is right now, out around the 2020 timeframe, and I think it's sort of in the $60 or so range, can you sort of elaborate—and I think you might have on previous calls, but can you just sort of elaborate on what degree of contracting you think you might need in that $60 range in order to move forward with Sun 7?

DAWN FARRELL:

Yes, well, first of all, the plant is not economic at sixty bucks. Gas plants, to get a full return of their capital, need to be more in that $70 range. So, it's getting better, but then there's also the carbon policy, which remember we only have a recommendation from a panel, that has not been adopted or turned into legislation by government, so we don't really know what's really going to happen there, and we need better modeling to understand that, because you don't want to be locking in $60. Remember, the way the carbon policy has been talked about today in *The Leach Report*, you effectively get credits for a natural gas plant, but that's only if the plant runs 95%, full-out, at its most efficient and its best T-rate. That's not going to happen here in Alberta. Those plants are never going to run like that. They're going to run at somewhere between 60% and 80%, which means they're going to be running at poor heat rates, which means they're going to be paying carbon tax above the level, if the Leach Panel is, in fact, accepted. So, really, getting certainty around the cost has become more difficult, and then trying to get long-term contracts around the profits is still difficult.

Currently, if you had to build that plant on the spot market, my view would be that you'd be lucky to get 20% debt—I'm looking at Todd and he's shaking his head, doesn't even think it could get that. So, you can't really get the financing unless you got a lot of equity. So, in that plant, you'd need $1.6 billion of equity to invest, you'd want a 15% to 20% return on that equity, and you'd need more certainty on the environment around carbon and pricing. My view is you'd have to be pretty entrepreneurial, big risk taker to take that on, and that's not our profile.

JEREMY ROSENFIELD:

Okay, thanks for the colour there. That's it.

OPERATOR:

The next question is from Andrew Kuske of Credit Suisse. Please go ahead.

ANDREW KUSKE:

Thank you, good morning. Could you maybe give us a little better perspective on a recent 13F filing by Brookfield, as it relates to TransAlta ownership? I ask the question in particular, because there's some filings a few days ago that were previously blocked out because they were subject to confidential treatment by the SEC, and that expired on Feb. 11. I don't know what you can say about this, but if you could just give us some perspective, it would be appreciated.

DAWN FARRELL:

Well, I think Andrew, you have to call Brookfield. I mean, I don't know. I was in Board meetings, doing all my work here, and someone told me about it. I mean, Brookfield is a smart investor, so I was kind of smiling, I think it's good news, but you have to call them. I don't know what all of that means.

ANDREW KUSKE:

Okay, fair enough, and if I may just ask another question. I guess, given your outlook in the presentation and what you've done from an assumption basis on Pac-Northwest pricing and Mid-C pricing, if you could just give us maybe a bit of colour on your hydro outlook. Are you seeing any kind of dichotomy of Pac-Northwest U.S. on hydro levels versus BC, and then what that means really for Centralia and how that cascades into Alberta?

DAWN FARRELL:

Yes, no, I've been astonished actually by how low the Pac-Northwest can trade, despite what's going on with the water. So, we continue to think that the prices are going to be fairly low in the Pacific Northwest. The way we dispatched that plant, it really doesn't matter to us anymore what the prices are, because, effectively, we use the dispatching capability that we have there to capture prices when they're high, or buy from the market when they're low. But, currently, what we see is the weakness it seems to be in pricing across North America is all related to gas. Gas prices are significantly lower than people could ever imagine, and so any sort of gains you might make because of—you know, I had some analysis run where we looked at the current market conditions compared to, let's say, 10 years ago, and different hydro levels, and we're just at a different level in pricing and it's all natural gas related. When you're thinking about that Pacific Northwest market, because gas sits at the margin three of the quarters, the real thing to do is just really take a look at what your analysts are telling you about what they think gas prices are going to do, because it probably gives you a better hint than thinking about the water, at least at this point.

ANDREW KUSKE:

Okay, that's helpful. Thank you.

OPERATOR:

As a reminder, any analyst who has a question may press star, then one to join the question queue. The next question is from Robert Kwan of RBC Capital Markets. Please go ahead.

ROBERT KWAN:

Good morning. I'm just wondering if you have any updated thoughts on the Climate Leadership Plan, and specifically around things like contracting and general market design for the Alberta market, as you have your discussions on your position.

DAWN FARRELL:

Good question, Robert. Well, I would say that most participants in the market are trying to figure out how you can possibly transition from where we are today to the policy recommendations in The Leach Report, and maintain an energy-only market that's financeable as we go forward. I think, as we look at it, we see that the PPAs for the last 15 years have provided a lot of the attributes that you need to run an efficient market. I think people think about Alberta as being an energy-only spot market, but they forget that there's been a significant amount of PPA cover that has provided a lot of services to the marketplace, and as you know, there's not really a forward market here, it's very thin, you know, trades five megawatts at a time, and I think all of that is related to sort of the PPAs. So, I think, as many market participants look ahead, some have different views, but many of them, the majority of them look ahead, they can't figure out how to finance new additions in this market without some sort of capacity payment or some sort of contracting market. We would be in that category, but, you know, again, we need to get into these discussions, really put our thinking caps on, because people are always reluctant to change the market structure, and everything that we've seen when we looked around the globe is that any changes in market structure do tend to take three to five years. They're not easy to do. They do have to be led by the ISO. It takes very knowledgeable people that understand all of complexity to get to the other side, so that you have reliability and good pricing. It's easy to say. It's very, very, very difficult to do. But, I think, as we start to go down the road of thinking about coal transition, it potentially does lead to some broader discussions around contracting strategy, and I think most participants in the Alberta market would say the same thing.

ROBERT KWAN:

That's helpful. I guess, when I look at your guidance, and even just thinking more broadly about Alberta spot expectations, year to date, we're sitting around ten bucks below the mid-point of your assumption. Now, you've got a pretty high degree of contracting, but can you just talk about if prices stick down here in the low 20s whether that causes big issues for your guidance? Then, more broadly, what do you see as the path out of this low-price environment? Do you think it really needs to be demand driven or do you see the prospects for material decommissioning or mothballing the supply?

DAWN FARRELL:

Well, so 2016, our guidance is designed so that the low end of the guidance will capture the prices that you're seeing in the spot market today, and the high end of the guidance is, you know, some better pricing. So, we're not concerned at all about our 2016, and—I don't know if we've given 2017—we haven't given you 2017, but we've given you a wide enough range of guidance to withstand the current pricing environment. We anticipated this. We didn't anticipate $20 every day, but we certainly anticipated it and that's why we worked so hard on costs last year. Really, it doesn't affect our coal as much as it affects our hydro, and I think if you look at what the hydro was able to print in our 2015 year, it's probably equivalent for 2016, even in this pricing environment, so you've got a pretty good run rate on that.

I think in terms of what takes you out of this pricing, if you're talking about the contracted market in Alberta, it is higher when you get to 2017 and 2018, and we could be closing some hedges in 2018 at much higher prices then what you see in the spot market today. I think it's just the challenge of what the actual payments will be on the carbon tax to give us a little bit of uncertainty there, and that's part of the discussion this year. But, you know, the way out of here is Alberta starts to grow because oil and gas prices go back up and you see stronger growth. In which case, you start to eat away at the over-supply, and then we know that coal plants all start coming off in 2019, because of federal legislation, and that will definitely— we subscribe to EDC service, it's a good service for you guys to be looking at—see a big uplift coming out of 2019 and 2020. But, currently, the contracted market in 2017, 2018, and 2019 is much higher than what you see in the spot market.

DONALD TREMBLAY:

Just to add to this, Robert, clearly, the short term, January pricing has been pretty low, but most of the capacity is available currently. You will see in March, some of the capacities are for the major turnarounds, and that will probably reduce some supply, so we should see some better price at some point during Q2 and Q3.

DAWN FARRELL:

Yes, the market averaged $32 last year, right?

DONALD TREMBLAY:

Thirty-four.

DAWN FARRELL:

Yes, $34, we had lots of weeks and months like what we're seeing since we started in January. But, you know, we've prepared ourselves at the low end of our guidance, as if you saw those prices every day.

DONALD TREMBLAY:

Just again, to add on the point on hydro, like hydro can capture volatility. There was very limited volatility in 2015, and that is reflected in our results, but we do have a contract on our hydro, so the exposure to low price in hydro—it's not an exposure to low price that we had, it's an exposure to volatility, and we don't see a difference between 2016 to 2015, so the hydro should deliver a similar bottom line that we had before.

DAWN FARRELL:

Yes, but even if Alberta doesn't grow that much, Robert, the coal closures themselves will take prices up. They have to. It's the way the market works.

ROBERT KWAN:

Okay, and I guess, just with that Alberta power price outlook, and the low end, is that something that has been run by the rating agencies and you feel they're comfortable with the investment grade rating, even if prices stay low, and specifically, even as you get into the 2018/2019 timeframe where the top line power price is higher, net of significant carbon tax, that the margins may not be lifting a whole lot, are they okay with that?

DONALD TREMBLAY:

We will have discussions with the rating agencies over the next few months on forecasts and more long term view, but nothing we saw currently is different from what we saw in fact over last year, year-and-a-half. So, basically, our forecast is in line with the current situation, there's no huge change.

DAWN FARRELL:

I think, Robert, it's a combination. The work that we're doing with the credit rating agencies is a combination of the work we're doing to set up the balance sheet of TransAlta Renewables and TransAlta, so, you know, they're with us kind of lock-step as we do that.

DONALD TREMBLAY:

We haven't showed them forecasts with $65 pricing for 2018.

DAWN FARRELL:

No.

ROBERT KWAN:

That's good.

DAWN FARRELL:

They see that we show them very conservative forecasts.

ROBERT KWAN:

Okay, got it. If I can just ask one last question, it's just around Centralia? Can you just comment on where you are on the coal supply and rail contracts and how much flexibility you have? I saw there was something in the MD&A around liquidated damages on volumes, just how do we think about that in this low price environment, where kind of in that economic dispatch, it looks like it's making sense most of the time.

DAWN FARRELL:

Yes, this is the last year of the current rail agreement. Our team's working on extending that agreement either to 2020 or 2025, so we have to make a decision on that. I think, certainly, they would've expected to see more economic benefit coming out of Centralia by this time. People would have expected to see higher prices, they're not there. We'll be endeavouring to get more flexibility in that agreement as we go forward, because, effectively, we need a minimum level of coal, but at the same time we don't want to be paying liquidated damages if we don't deliver all of it, and they need some certainty in terms of how much money they collect on the rail. So, we know the dynamic well. They're facing a lot of pressure throughout the U.S. because of low gas prices with all their coal plants. We've got a good relationship with them. They want us to keep delivering as much coal into that plant as we can until the end of the life of the plant. Those discussions, they'll happen this year and when we get them done we'll give you some colour on what they look like.

ROBERT KWAN:

Okay, and if you do end up getting short on coal at any point, under the PSC contract, are you just obligated to go into the spot market, or is there some other penalty provision?

DAWN FARRELL:

Yes, so no. We've got a good ability to manage a pile of inventory at Centralia. The key thing is nominating how much coal you need at the beginning of the year so they can get you the train sets and trying to figure out how to nominate enough coal, but not too much, and how to have a pile that's not too big and not too small, so we have an optimization that we do between that with the rail each year. Then, in terms of the actual purchases of the coal itself, we have a portfolio of contracts that are anywhere from spot market purchases to two to three-years, currently it's not going to be a problem to get coal in the U.S. market, so you have to kind of separate the coal purchases from the rail.

ROBERT KWAN:

Okay, that's great. Thank you very much.

OPERATOR:

This concludes the analyst portion of the Q&A. We will now begin the media question and answer session. Any member of the media who wishes to ask a question may press star and one on their touch-tone phone. You will hear a tone, acknowledging your request. Please ensure you lift the handset if you are using a speakerphone before pressing any keys. If you wish to remove yourself from the queue, you may press star and two. There will be a brief pause as we compile the Q&A roster.

The first question is from Geoffrey Morgan from the Financial Post. Please go ahead.

GEOFFREY MORGAN:

Good morning, thank you for taking my question. First of all, I wanted to ask—you mentioned that the government has yet to appoint an arbitrator or a negotiator on the coal phase-out. Was the last time you heard from the government on this during the climate change announcement, was that the last thing …

DAWN FARRELL:

Oh, no, no, we've been in discussions with them. I think it's a challenging appointment, right. They need somebody who's—I mean, it's challenging because you're working with a number of companies. You're working with them, you're working with the ISO on reliability and pricing, so you need to know something about the marketplace, you need to be able to manage a team of specialists that can think about capital markets and all of the things that go along with the infrastructure. So, I don't think the lack of appointment has anything to do with a delay. It's more just the challenge of finding the right kind of individual that can lead that effort. So, our discussions with them are that they're working hard to get the right person and again, I talked about this earlier on the call, everybody wants certainty, everybody wants to go fast, it's a complex discussion, and having the right person, waiting a bit of time to get the right person is better than appointing someone to get started.

GEOFFREY MORGAN:

Right, okay.

DAWN FARRELL:

Okay.

GEOFFREY MORGAN:

Just to clarify, you mentioned earlier that you're now expecting something maybe in March, is that …

DAWN FARRELL:

Yes, they want to get an appointment and get started as soon as they can, and they'd like to be in a position by the end of March, but it depends on getting the right person and then getting that person contracted and ready to go.

GEOFFREY MORGAN:

Okay.

DAWN FARRELL:

It seems like the right timeframe, but I think until there's some comfort that they've got the kind of person that can really work the file well, I think that's the bigger determiner.

GEOFFREY MORGAN:

Okay, I appreciate that. I've just got one more question, more of a clarification. I think earlier in the call there was some talk about putting some investments on hold until there's more certainty. Are we speaking just about coal—well, probably, natural gas investments, or is it the entirety of the renewables, other things that TransAlta can invest in? Are you looking to slow down all of your investment in Alberta until you have some certainty?

DAWN FARRELL:

We're certainly working very hard to ensure that we have a lot of options available to us.

GEOFFREY MORGAN:

Okay.

DAWN FARRELL:

We have options in our hydro fleet, we've got options in our wind fleet, we've got options with land that we own for solar, we've got options with Sun 7 with our gas plants, we've got options with customers who'd like to build co-gens, so we will spend small amounts of money getting our options lined up, but we cannot make any major investment decisions in this market until we have more clarity around the policy environment and the policy recommendations turned into actual laws, and we really understand what this market is going to be like. It kind of goes back to, I think it was Robert's questions around will the market continue as it is, will it change, because, fundamentally, to make investments in infrastructure in the power market in Alberta you have to be able to finance those investments, and to finance those investments you've got to access debt markets, and to access debt markets you've got to have more certainty than certainly what we see today.

GEOFFREY MORGAN:

Okay, I appreciate that. Thank you.

OPERATOR:

Once again, any member of the media may press star and one if they have a question.

There are no more questions at this time and this concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.