

## TransAlta Corporation

### Third Quarter 2020 Results Conference Call

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## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by and welcome to the TransAlta Corporation Third Quarter 2020 Results Conference Call.

At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. To ask a question during the session, you will need to press \*, 1 on your telephone.

Please be advised that today's conference is being recorded.

If you require any further assistance, please press \*, 0.

I would now like to hand the conference over to your speaker today, Chiara Valentini, Managing Director, Investor Relations. Thank you. Please go ahead.

### **Chiara Valentini** — Managing Director, Investor Relations, TransAlta Corporation

Thank you, Mariama, and good morning, everyone, and welcome to TransAlta's third quarter 2020 conference call.

With me today are Dawn Farrell, President and Chief Executive Officer; Todd Stack, Chief Financial Officer; John Kousinioris, Chief Operating Officer; Brett Gellner, Chief Development Officer; and Kerry O'Reilly Wilks, Chief Legal, Regulatory, and External Affairs Officer.

Today's call is webcast, and I invite those listening on the phones to view the supporting slides that are posted 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 the information provided during this conference call is subject to the forward-looking statement qualifications set out here on Slide 2, further detailed in our MD&A, and incorporated in full for the purposes of today's call.

All amounts referenced during the call are in Canadian currency unless otherwise stated.

The non-IFRS terminologies used, including comparable EBITDA, funds from operations, and free cash flow are also reconciled in the MD&A for your reference.

On today's call, Dawn and Todd will provide an overview of the quarter's results, along with expectations for balance of the year. And after these prepared remarks, we will open the call for questions.

With that, let me turn the call over to Dawn.

**Dawn Farrell** — President and Chief Executive Officer, TransAlta Corporation

Good morning, everyone, and thanks for joining us on our third quarter call here in 2020. We have some great third quarter and year-to-date results to report and, as well, we have a number of various key and important updates and accomplishments on our strategy of becoming Canada's leading clean electricity provider. I'm going to start with our strategic updates, and then I'm going to turn it over to Todd for the numbers.

During the quarter, the board and management of TransAlta made several key decisions that we announced this morning. They've included that we've determined we can now close the Alberta Highvale Mine, effective December 31, 2021. This decision advances our goal of being off thermal coal in Canada by four years—originally 2025, but now by the end of 2021. All Alberta power plants will now run only on natural gas, starting January 1, 2022.

Our only coal plant after the end of next year will be Centralia, which has a long-term contract supporting its cash flows, and we have a transition agreement on greenhouse gases in Washington State until the end of its life in 2025.

In Q3 we also made the final investment decision on Sundance Unit 5 repowering. This 730 megawatt project is estimated to cost between \$800 million and \$825 million and will come online in Alberta in the fourth quarter of 2023. The team has advanced the project substantially throughout the year, and we've received board approval to build the project, and I'm pleased to tell you today that we're on track.

Our gas conversions are also on track, with Sun 6 in its final stages of testing. Everything is proceeding extremely well. We'll be completely—we'll complete the full commissioning by mid-November, in just a couple weeks. The K2 and K3 conversions are on deck to be completed next year.

On our ESG front, our greenhouse gas emissions will be under 11.5 million tonnes by the end of 2022, down almost 70 percent from 2005. I want to be very clear; TransAlta has more than met its fair share of the Paris Agreement. To date, we alone have delivered 10 percent of Canada's goal of a 220 million-tonne reduction for Canadians by 2030.

We'll begin the conversation today about our plans for additional reductions as we work with customers to help them achieve their ambitions to reduce their own greenhouse gases. And due to the outstanding work by our finance team to raise project debt at South Hedland, we have created even more strength in our liquidity, which has never been stronger, all this at a time when there's great uncertainty due to COVID. This sets us apart as a company in which to invest.

We are positioned with the cash we need to continue to grow RNW and to fund our growth at TransAlta. We have positioned several assets as potential drop-downs to RNW and to hope to make an

announcement in the coming months. We'll also provide further updates to you on our project pipeline and what's next on the growth side.

On gas supply, two important milestones were met. We and Tidewater entered into agreement with ATCO to sell the Pioneer Pipeline for \$255 million. The transaction is expected to close in the second quarter of 2021. The TC team also received regulatory approval for the NGTL 2021 expansion project, which expands our supply options and helps us manage future pricing volatility.

TransAlta Corporation has been a leader in the deployment of innovative renewable technologies for decades. We were a pioneer in Canada in the deployment of wind power generation, and we're now growing our renewables fleet with a new addition of a commercial operation of our WindCharger Battery Storage system. This is Alberta's first utility-scale battery storage project, and it's a truly renewable system as it's powered by the Summerview wind farm.

The board also approved a Diversity and Inclusion Pledge, which was developed by our frontline diversity and inclusion council—great work by that team to get us clearly pointed at the future and set the foundation for our goal to have 40 percent of our workforce female by 2030.

Finally, but just as importantly, we delivered excellent financial results that demonstrate our continued drive to generate free cash flow for investors. I think this is the third quarter in a row which we've been over \$100 million of free cash flow, so congratulations to the hard-working TransAlta team that made that so.

By the end of the call, it will be very clear TransAlta's a leader in clean electricity and should be a sought-after investment by those who are interested in companies that deliver on economics and ESG. We call it E-ESG, or E-squared-SG. And we're very proud of the work we've all done to get us here today. Our work to convert our Alberta fleet to gas, our ownership in Hydro, our ownership in RNW, our

innovative work with customers, and the clear advantages we have with our marketing and trading team have created a strong and diversified portfolio of investments that have held up through a pretty interesting 2020.

So frankly, the team at TransAlta hasn't missed a beat.

Now I know the investment community is familiar with most of the projects that we're investing in, so I won't go through them line by line, but I want to provide you with a couple of updates. Our Skookumchuck wind project is close to completion, and we expect commercial operation to be imminent. Our 49 percent ownership option will be executed shortly thereafter.

Construction on Windrise, our contracted wind facility here in Alberta, is 45 percent complete, and we began receiving wind turbine generators on-site in mid-October.

We're advanced on the Kaybob cogen project. And as I said earlier, for Sun 5, we've received approval to proceed and are targeting commercial operation by fourth quarter 2023.

Now we're typically pretty conservative in terms of what we tell you about what's in the development pipeline, and we often only tell you about projects once they're signed, sealed, and delivered. But we thought today that because we have a lot of development potential at TransAlta behind the scenes that we'd highlight some of that.

We have over 2,500 megawatts of growth projects that are in various stages of development. This is a great amount of growth potential, and our business development efforts set us up well to generate growing returns for the considerable future. This is the first time we've provided details on many of these projects. We have a dedicated development staff that continues to advance all of our prospects, from PPAs, wind studies, permitting, to transmission access. And our goal continues to be to target 200 to



400 megawatts of development projects per year, and we have the cash and the financial capability to achieve this goal.

Now as I summarized earlier today, we announced that we will be entirely running on natural gas in Canada by the end of 2021. This is a tremendous milestone for us and a major step forward in delivering on our clean energy investment plans. This decision is the concluding chapter of our thermal coal legacy here in Alberta and further demonstrates our commitment to our Alberta customers that their electricity is moving towards carbon neutral.

Recent and upcoming milestones on this journey include: retiring Sundance Unit 3 on July 31, 2020; completing the boiler conversion of Sun 6 with full gas-firing and which is currently in testing it and commissioning mode; boiler conversions next year for Keephills Units 2 and 3; gas-firing Sundance Unit 4 and Keephills Unit 1 in 2022—although these units will be de-rigged to run fully on gas, we have sufficient ability in our portfolio to flex all of our capacity to ensure that we can fully optimize the fleet and serve the market here in Alberta; and finally, of course, the repairing of Sundance Unit 5.

Now as you can see from this slide, TransAlta has made tremendous progress as an organization in reducing our greenhouse gas emissions, especially in comparison to international agreements compared to our peers here in Canada and to the rest of Canada—and sorry, to our peers here in Alberta and to our peers in the rest of Canada. By the end of 2022, we'll have achieved a 32 million tonne reduction across our worldwide fleet. Of that, 21 million tonnes have been reduced in our Canadian operations.

As I said earlier, overall, we've contributed 10 percent to the Paris targets set by the Canadian government. We are among a very few companies in Canada to achieve such significant reductions, and in doing so, we are a clear leader in supporting Canada's commitment to the Paris Agreement. We are outpacing the rest of the province and the country by significant margins.

And we're not done yet. The pace of change in renewable energy technology is accelerating at an unprecedented level. We know that we can be long-term partners with our customers to provide green electricity and help integrate these new and leading technologies into their power supply.

This roadmap describes how we're conceptualizing the delivery of these technologies and implementing them with our customers. We are working with customers like BHP and Western Australia, where our recent contract replacement and extension at Southern Cross Energy recognizes the value and the need for integrating renewables to supplement baseload requirements that industrial customers need for their operations.

As we look at the mid-2020s, we're dusting off our prior work on carbon capture and storage that we'll be using to understand its potential value and supporting a future renewables build-out here in Alberta.

We're also relooking at the economics at Brazeau Pumped Storage. It's a potential 900 megawatt battery that has the potential to store wind and solar here in Alberta and provide firm green electricity. We are currently working with customers who may be interested in buying firm green electricity from Brazeau in the future.

And we have a team that works directly with flow battery companies, and we expect to make investments there in the coming years.

There are many technologies in various states of commercial readiness, and we stand ready to make necessary investments as they become more commercial for our customers. On hydrogen, many players are going to invest substantial dollars in creating hydrogen. We'd like to be one of the first power companies to blend hydrogen into our facilities, and we're working with potential partners today to see what opportunities may now be available.

Before I turn over the call to Todd, I want to take a moment to summarize the key takeaways from this call.

We are moving our corporate transition forward on an E-squared-SG principle, E for economics, E for environment, S for socially responsible, and G for governance.

TransAlta's track record on greenhouse gas reductions is indisputable. ESG investors should be looking carefully at TransAlta for their portfolios. We are moving into an ESG-focused investment space and are set to continue to deliver impressive emissions reductions in the country. We are one of Canada's largest suppliers of renewable electricity, and our new goal is to focus on firm green electricity supply, which will take us a decade to achieve; a great long-term goal for the team.

We have a proven track record of commercializing new and innovative technology and will continue to be a trusted partner for our customers.

And finally, we're committed to building a strong and modern organization, free from discrimination and systemic barriers.

So now let me turn it over to Todd, who will give you more colour on the numbers.

**Todd Stack** — Chief Financial Officer, TransAlta Corporation

Thanks, Dawn, and good morning, everyone. Before I jump into the details, I just wanted to echo your comment that our portfolio delivered great performance, both in Q3 and on a year-to-date basis. The Company is in a very strong financial position, and we're on track to deliver free cash flow near the high end of our guidance range.

Looking at Slide 13, the charts include several of our key metrics. For those listening, you may recall that last year in the third quarter, we received the residual PPA termination payment of \$56 million that was awarded to us for the Sundance Units 3 to 6 arbitration. In order to provide a more accurate

comparison of relative performance, the figures that I'm going to reference on our call will exclude the PPA termination payment.

During the quarter, we generated incredibly strong EBITDA and free cash flow due to contributions from all our business segments and were indicative of the resilience of our operations, our hedging and energy marketing capability, and our portfolio diversification. EBITDA of \$256 million in the quarter was up 3 percent versus 2019, and free cash flow was also very strong at \$106 million.

Year to date, we've generated \$306 million of free cash flow, which is almost \$50 million better than 2019 on a comparable basis. Free cash flow per share is at \$1.11, which is a 22 percent increase over 2019's nine-month performance. All in all, a very strong performance from the business so far in 2020.

On Slide 14, we've laid out our Q3 and year-to-date performance by segment. As you can see, we had strong performance across the fleet, and total segment cash flows were in line with last year for the quarter and significantly ahead for year-to-date performance. This strong performance was primarily a result of the following.

The Centralia segment performed very well and more than made up for weakness here in Alberta, again showing that diversity of regions, contracts, and technologies can provide overall stable cash flows.

Our 2019 investments in Big Level and Antrim, as well as the recent acquisition of Ada, are delivering cash flows as expected in the Wind and Solar segment and in the North American Gas segment.

I would like to congratulate our Energy Marketing team on their outstanding performance in Q3. The investments we've made in this business over the past 20 years has positioned us to capture opportunities across all power markets in North America. Their results in Q3 were fantastic. Their ability to capitalize on their energy-marketing capabilities is a major asset to the Company.

This strong performance was partially offset by expected lower cash flow from the Alberta thermal fleet. Segment cash flow decreased by \$47 million and was partially due to higher sustaining capital spend during the gas conversion at Sundance Unit 6, which is expected to wrap up later this month.

The fleet delivered strong realized prices, consistent with last year. However, we are seeing gross margin pressures in the Alberta thermal business as we transition to shut down the mine. As we move towards the last phase of our mining operations, we will see continued pressure on our per tonne coal costs, as our mine delivers fewer and fewer tonnes of coal across the fixed-cost base of the mine. At the same time, we expect to see increasing cash from working capital as our remaining coal inventories get utilized.

Our Corporate segment was flat quarter over quarter, but up \$9 million on a year-to-date basis due to the realized net gains in 2019 from the total return swap. Adjusting for the total return swap impact, our corporate costs were down almost 10 percent on a year-to-date basis. I'm pleased with our ongoing cost-reduction efforts across the Company and our ability to take on new assets with no impacts to corporate overhead.

Slide 15 summarizes the current financial strength of the Company and highlights just how much free cash flow the business generates. At \$306 million of free cash flow to date, we are tracking to deliver towards the high end of our guidance range. Liquidity was strong at quarter-end at \$1.6 billion and we added significantly to this in Q4.

In October, we closed the second tranche of the Brookfield investment for \$400 million, and we also closed the AU\$800 million financing from the South Hedland Power Station. This sets us up extremely well to fund our gas transitions, deliver on our renewables growth plan, and return capital to shareholders through the share buyback program.

As you can see on the chart on the bottom right, over the past few years, we've been focused on reducing our corporate senior recourse debt levels in preparation for a fully merchant market. We're on track to meet this goal and have significant cash available to repay the bond maturity in November.

On Slide 16, you can see that spot market prices in the quarter averaged \$44 a megawatt versus \$47 in 2019. As I outlined last quarter, our baseload generation was fully hedged for the Q3 and the team was able to optimize dispatching around those hedges. We continue to see slightly lower load demand in Q4, due to the ongoing impact of COVID, and are highly hedged for the balance of the year.

Looking ahead to 2021, we continue to see constructive factors for Alberta power prices as compared to 2020.

First, with the end of the Alberta PPAs, roughly 2,400 megawatts of thermal capacity reverts to the asset owners on January 1st. As you know, in order to recover capacity costs, we anticipate plant owners will structure their energy offers accordingly, to reflect the recovery for the return—for the recovery—for the return of and the return on capital, as there is no other mechanism outside the price of energy to do so.

In addition to the end of the PPAs, we expect price support from three other factors. First, we expect some additional demand recovery in 2021. Second, we expect higher scarcity pricing due to a significant number of facility outages and coal-to-gas conversions. And finally, we expect the provincial carbon tax to increase to \$40 per tonne to remain in line with the federal program. This raises the cost of production and must be recovered through higher power prices.

Over the past quarter, we've seen the 2021 forward curve strengthen about 10 percent from \$51 a megawatt to \$56 a megawatt. In particular, we see stronger prices in Q1 at over \$62, with some peak hours priced above \$70.

Moving to Slide 17. We provided our update on hedge levels and based on prices strengthening for Q4 and Q1, we've added onto our hedge positions. For the balance of the year, our Alberta thermal baseload generation is now hedged for Q4 at approximately 90 percent at \$53 a megawatt hour. For the first quarter of 2021, our hedge levels are now over 40 percent at an average hedge price of \$60.

I know I've spoken at length on the Alberta market, but I want to reiterate that we see strength in the forward market prices and are well positioned to capture increasing margin in periods of tightening market supply and increased price volatility.

To close off our presentation, I want to highlight what I think makes TransAlta a highly attractive investment and a great value opportunity.

First, as Dawn pointed out, we are a leader in GHG emissions reductions, underpinned by a high-quality and highly-diversified portfolio. We have the largest hydro fleet in Alberta, and we've been operating for over a century. We are well positioned to capture market upside post-PPA.

The business is supported by a highly-contracted renewable portfolio that is complemented by our world-class energy marketing capabilities. The Company has a very strong financial foundation. Our balance sheet is in great shape. We have ample liquidity. We've continued to maintain capital discipline in our growth investments, and the Company has a track record of generating strong free cash flow. We believe the Company is at an exciting milestone, and we are well positioned for the future as a leader in clean electricity production.

With that, I'll turn the call back to Chiara.

**Chiara Valentini**

Thank you, Todd. Mariama, would you please open the call for questions from the analysts and media?

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## Q&A

### Operator

Certainly. As a reminder, to ask a question, you will need to press \*, 1 on your telephone. To withdraw your question, press the # or hash key. Please stand by while we compile the Q&A roster.

Your first question comes from Maurice Choy with RBC Capital Markets. Your line is open.

### Maurice Choy — RBC Capital Markets

Thanks and good morning. My first question is on, I guess, the guidance. You obviously just had a very strong Q3 result, yet you have also reaffirmed your guidance for this year. Can you discuss if Q3 was in line or better than your expectations? And depending on that response, are there any things that you're keeping a close eye on for Q4, that motivated you to reconfirm your guidance range?

### Todd Stack

Yeah. Maurice, I think, clearly, our guidance range for free cash flow was \$325 million to \$375 million, and sitting at \$306 million, we're very bullish on coming in at the high end of that program. We do still have a significant amount of sustaining capital, the Sun 6 turnaround, and conversion is still ongoing. There's still money to be spent in Q4 on that. So we do have a high capital spend. That's something that's definitely laying into our forecast for the balance of the year.

And on top of that, we did have some—you saw our sustaining capital guidance go down. A lot of that is just shifting. When we moved the K2 and the K3 conversions slightly next year, delayed them by a month or two each, it moved a bit of the capital into 2021. So that was part of the reason for not just reducing and rationalizing sustaining capital; it was a bit of a timing delay on those as well.



So I think capital, we're paying attention to. As I mentioned, we're highly hedged in the Alberta market but, really, looking for opportunities to generate some upside potential in the Alberta business.

**Maurice Choy**

Makes sense. And my final question's about, I guess, capital allocation and opportunities, particularly given that you have \$2.7 billion of liquidity. It sounds like you're also going to be able to introduce some drop-downs in the coming months. You've introduced an extra E to ESG, and Slide 10 has a number of attractive opportunities for you to improve your ESG profile. Wonder if you could discuss, broadly, the costs that would turn these potential partners for some of these opportunities? And if there is a preference for contracted versus merchant cash flow?

**Todd Stack**

I just want to touch on liquidity there. Maurice, you mentioned the \$2.7 billion, which we do—keep in mind, we do have the \$400 million bond maturity coming up here in November, so I don't want you to think we'll be at \$2.7 billion at the end of the year, and we are looking for the Skookumchuck project to complete, which will also be a capital expenditure in the balance of Q4 here.

**Dawn Farrell**

Yeah. So, Maurice, I'm going to start, and then I'm going to let John and Brett also chime in here because I think it's an important question.

So the reason I'm going to give that extra E—I'm going to give that credit to Mac Van Wielingen over at ARC Financial. He's written a number of papers on that, and I wrote him last night and said I'm stealing your idea, which I wanted to do because I do think it's important, as people reinvest cash into the future that's coming—which there's a lot of talk about this net zero by 2050—it is important that there is

economic cash flows to be reinvested into that future, and there's just not enough money available in the world to not do that in a very sustainable and economic way.

All else being equal, this team tends to go after contracted assets. We are very bullish on Sun 5, mostly because we also have a good hedge there with Shell, so we tend to always favour that overall.

And so what I'll do is I'll maybe turn to Brett on how he's thinking—how he's seeing returns on the growth side.

And then, John, any comments that you would have.

**Brett Gellner** — Chief Development Officer, TransAlta Corporation

Yeah. Thanks. Yeah. We're seeing a number of opportunities out there, especially as people focus on the ESG, as Dawn pointed, on the customer side, so not just here in Alberta and rest of Canada but the United States, in terms of looking for renewable projects. And so we do see good opportunities. Now, again, we're going to continue to be disciplined like we've been in the past. We're not going to chase low returns, and the contracted tenure tends to range between that 7 and 15 to 20-year period.

So again, is there a portion of merchant or a post-PPA risk that we have to factor in? We do, but we then factor that into the return expectations of the project. I think if you're looking at cogen projects, generally, those are well contracted. There might be a component of merchant associated but, as you know, they have steam and electricity components to them so, generally, that's how we approach those projects and, again, we like those kind of projects because of our position.

The bigger projects that are further out like Brazeau, clearly, we'll be looking to contract up to initiate those. Those are big, big projects, but we think very important projects. So it's a mix, but I echo what Dawn says. Generally, we're focused on contracted-type projects.

**John Kousinioris** — Chief Operating Officer, TransAlta Corporation

Yeah. I don't really have a lot more to add to that, Maurice. The one thing I would say is in talking about partners, we're not against bringing other partners into our projects. We tend to do it alone, but when I think of partners, I think of our customers as being partners, and the one area that we didn't talk much about is just the potential growth that we're seeing in Western Australia. Our relationship with BHP, we do see them as a partner, and our ability to do a bit of solar for them and potentially work to renew some gas and steamers for them is very, very important to us as we move forward. So when we think of growth, we do think of it in terms of partnerships with our customers.

**Maurice Choy**

Great. Thank you very much.

**Operator**

Your next question comes from Rob Hope with Scotiabank. Your line is open.

**Rob Hope — Scotiabank**

Morning, everyone. Just a clarification on Maurice's question. The MD&A says the midpoint of free cash flow guidance, and I think you highlighted the upper end—just want to confirm that.

**Todd Stack**

Yeah. Yeah. I do see ... between the midpoint and the upper end, I'm actually seeing closer towards the high end now.

**Dawn Farrell**

Yeah. And I just think, just to add one thing, we do have two big outages next year again with K2 and 3. And there's always an opportunity to potentially—especially with COVID, the team may want to do a little more pre-buying in Q4 and spend a little more capital just to make sure that everything that we

need is ready to go. So I think the team is looking at a little bit of flexibility on the capital side there are we go into Q4.

**Rob Hope**

Okay. And actually, that's a good segue to the capital side. So with the Hedland financing, which arguably, would be more than the market would've anticipated—maybe even yourselves—the Pioneer sale, and potential future drop-downs, you look a little over-capitalized here. So how do you think about investing in future projects versus some capital drag in the near term here versus share buybacks?

**Dawn Farrell**

Yeah. It's a good question. I mean, for sure, TransAlta is really going to—it's really got some great opportunities ahead of it here, and our investment path at TransAlta is really well known. I mean, you know what we're doing on K2 and K3. I think you know what we're doing on Sundance Unit 5. So really, the asset team looks at—there's a couple considerations on that.

If you look at the way the Company is set up, I mean, we are fundamentally going to be a gas and renewables company by the end of next year. And if you look at the kinds of projects that we look at, some of them fit. We see very clearly projects that we look at that fit very well into RNW and some other projects potentially fit into TransAlta because we have tax benefits and other things in TransAlta as well that we want to use up.

So we'll be looking at that, but broadly with the amount of capital that we've brought in, it means that we'll have to consider more carefully our capital allocation relative to dividend growth at TransAlta and share buybacks. So I think you're on the right track in terms of thinking about that, Rob.

**Rob Hope**

All right. And then just one final one. Just layering on some hedges; good to see the additional disclosure on the hedges in the early part of 2021, but hedging does kind of fall off in the balance of the year. Is that just a view that you want to see the forward curve kind of move up in the balance of the year to reflect what your view of the fundamental power price should be?

**Dawn Farrell**

Yeah. It's kind of two things that go on. I'll set it up, and people can add here. So first of all, it is Alberta and, frankly, hedges—the liquidity of hedging in Alberta only really opens up a quarter, maybe a quarter and a half ahead of a quarter. So when you see them dropping off, it's because really the liquidity and the three quarters after the first quarter is pretty low, and there's not a lot of transactions that take place there. That's number one.

And then number two, absolutely for sure, we think as price formation goes through the year there's more opportunity. So our team is very good at figuring out when to take some hedges off the table. I don't if anybody wants—

**John Kousinioris**

No. I mean, I think that's right. We've seen liquidity sort of recover and be—

**Dawn Farrell**

Yeah.

**John Kousinioris**

—reconstructed for Q1, which is why we're layering hedges that are now, I think, Todd, were around 45 percent hedged for Q1 of next year. And we are noticing that liquidity for the second quarter is beginning to ramp up as well. And we're just being pretty disciplined from a price perspective. Quite a big change is happening in the market next year, and there's no point from our perspective, given where

we think fundamentals are—Todd touched on all the things that he thinks will impact the market next year—to rush ahead and hedge a position at prices that we don't think would be appropriate.

**Rob Hope**

All right. Appreciate the colour. Thank you.

**Operator**

Your next question comes from Mark Jarvi with CIBC Capital Markets. Your line is open.

**Mark Jarvi — CIBC Capital Markets**

Yeah. Good morning, everyone. Just with the Keephills 1 and the Sundance 4 to move to gas only and the de-rate, how much do those units have to run to actually break even at current fuel costs and power prices? Like is this essentially a quasi-mothball? Or do you actually think that those units will be quite active?

**Dawn Farrell**

Yeah. I mean, frankly, we don't really break it down unit by unit. We run it as a portfolio, so it's really the optionality of those units in the portfolio. So as the asset optimizers look at how to set up for the various weeks, days, hours, they all have different strategies in terms of whether or not they'll have those units on or off, on standby. But currently, they've determined that having them in that state on gas is beneficial to the portfolio.

**Mark Jarvi**

Okay. And then you were just talking about power price, hedges, and whatnot. What's the current perspective? And you talked about your gas transportation, but where is that on any fuel cost hedges for next year?

**Todd Stack**

So in terms of next year, I think we are pretty much entirely hedged for the first quarter. It then drops off a bit, I think, for quarters two through four. We're at about a 60 percent hedge level there, Mark. And then in terms of prices, I would say that our prices sort of for the first quarter would be roughly in that \$2.90 range. And then for the balance of the year, they're kind of bouncing around that kind of \$2.50, \$2.60 range.

**Mark Jarvi**

Okay. That's very helpful. And then maybe sort of a broader question. With the repowers that you were doing, a couple power tunnel repowerings, maybe a cut gas plant coming in, they're all quite efficient, low-emissions intensity; chance that there actually won't be a lot of carbon tax revenue generated from the fossil fuel fleet in Alberta. Do you think that they'll have to revisit the tier scheme and the best gas standard? Or do you think the standard was set up to incent you guys make these decisions? And maybe just your views on any of the changes and what people are doing impacts how the tier is set up?

**Dawn Farrell**

I don't know. That's a big question. I mean, that's a big policy question between the Alberta government and the federal government. And I think as we go forward over the next decade and environmental policy changes around the tier, the carbon pricing, the Clean Fuel Standard, I think there's a lot of moving parts in there.

And effectively, we continue to like to have a portfolio rather than a single plant investment, or a single strategy because we do think that, on average, our portfolio will perform. And I think, Brett, there's some nuances, too, in terms of the peakers, the coal-to-gas peakers have the ability to run more than just regular peakers in that.

**Brett Gellner**

Yeah. I mean, there's a few things. Clearly, if it does change, which again would be speculation on our part—

**Dawn Farrell**

Right. Right.

**Brett Gellner**

—if it does, that everybody's impacted by that and anybody still on slower co-firing gas and coal would be impacted more than what our units would be impacted by, but it would impact all gas units in the province.

In terms of Dawn's point, any new peaker is limited because they can't meet the 0.37 to only running, I believe, at 30 percent in a year. So new peakers are challenging to build going forward. So our boiler-converted units are really like peakers and they'll operate accordingly. Some of them will run more baseload and mid-merit than others, but certainly echo again back to the points we made that it's a fleet. It's a diversified fleet and—

**Dawn Farrell**

Right.

**Brett Gellner**

—we kind of are managing it in that way, Mark.

**Mark Jarvi**

Okay. Fair enough. I know it's a tricky question, but appreciate the answer. The last one, any update to discussions with your partners on Sheerness and what the plans are for those units?

**Brett Gellner**



No updates.

**Mark Jarvi**

No?

**Brett Gellner**

Business as usual right now and just—

**John Kousinioris**

Yep.

**Brett Gellner**

—and no change there.

**John Kousinioris**

That's right.

**Brett Gellner**

Yeah.

**Mark Jarvi**

Okay. Thank you.

**Operator**

Your next question comes from Ben Pham with BMO. Your line is open.

**Ben Pham — BMO**

All right. Thanks. Good morning. I wanted to follow up on some of the repowering questions. And you effectively pinned down your entire Alberta portfolio and where that's going and the transition. Can you comment on your decision to not move with two repowerings. I can think of why, but I just wanted

to walk through the process with you. And then on the derating, I would assume there's still optionality to move up capacity, assuming you can procure gas from pipe? Is that correct?

**Dawn Farrell**

Okay. So just I want you to start over again. We're not quite sure what the question is.

**John Kousinioris**

Yeah. Ben—

**Dawn Farrell**

Yeah. You're breaking up. Sorry.

**John Kousinioris**

You broke up a bit on your first question, so maybe try that again for us.

**Ben Pham**

Yeah. Sure. Yeah. So there was a thought of repowering two coal units at one point in time—

**Dawn Farrell**

Right. Correct.

**Ben Pham**

—and you moved with one, and you were trying to figure out when you'd do the second. There was a bunch of EBITDA scenarios that you provided. So I was curious more what led you to one?

And then the second question—I wasn't sure that you heard that—was just you've opted to derate, and I'm wondering—I think there's probably still options for you to move that capacity higher, assuming you can get more gas to the facilities.

**Dawn Farrell**

Right. Right. Okay. I want to be crystal clear on the second question and the first question. So first of all, on the second question, we're derating those units not because of gas supply but because of the ability of those units to just run on gas—

**John Kousinioris**

Physically, yes.

**Dawn Farrell**

—physically, because they haven't been converted to gas. Next year, we'll do additional studies for Sundance Unit 4 and for K1 to determine if they are candidates for gas conversion, simple boiler conversions. We don't see them needed in that capacity fully in 2022, but they may be needed in '23, '24. So we'll do those studies next year; there's some optionality there.

In terms of the second, they'll also be looked at, and the whole fleet will be looked at in terms of the second repowering. There is definitely a potential for a second repowering in our fleet. These are very, very attractive repowerings, as you're seeing from us. What we want to do, though, is also very much assess climate change policy around that second repowering because if we get much more aggressive climate targets, there's a very good chance that a second repowering would also have to have some sort of carbon capture and storage associated with it.

And it goes back to our comments around green firm power. We just think it's going to get—as you go through the decade, there'll be a requirement, we think, for more and more cleaner power, which can be achieved by blending some hydrogen in at the plants by CCS. So when we look at our second repowering, we're very much thinking about, how do you make those megawatt hours less greenhouse gas-intensive?

So it's definitely not off the table. It is off the table for 2025. We originally, I think, had thought maybe by 2025, we'd have a second repowering. So for sure, we've slipped out of that 2025 period, probably in '26, '27, in there. We'll do that analysis all of next year, but we'll be doing that analysis also thinking very carefully about how to ensure that we can meet environmental standards going forward over the next 20 years. Does that make sense?

**Ben Pham**

Yeah. No. Yeah. Absolutely. And maybe just on that topic of crystal clear, maybe a question on the free cash flow guidance, Todd. I just want to make sure I got the messaging right. So your formal guidance is still at the midpoint in your MD&A package, and so you're sticking with that, but you're just saying that it looks like there's a possibility to exceed or be at the higher end. And if you do hit the midpoint, don't penalize us for it. Or are you actually saying ignore the MD&A, and our new guidance is at the upper end? I just wanted to make sure I understood, really, your positioning on that.

**Todd Stack**

Yeah. I definitely see it moving above the midpoint, and we are planning on driving the business to deliver towards the high end of that goal.

**Ben Pham**

Okay. All right. Thank you.

**Operator**

Your next question comes from Andrew Kuske with Credit Suisse. Your line is open.

**Andrew Kuske — Credit Suisse**

Thank you. Good morning. I guess, 20 years ago, we started the PPAs, and there was some uncertainty going into it. And now we're finishing them, and there's uncertainty as they finish. So I guess,

just in that context, you talked a little bit about the lack of liquidity in the hedging market but, ideally, as things stabilize and we've got a better view on bidding behaviour, what level of hedging do you think you want to have in the Alberta market specifically for your portfolio? And then how does that triangulate with these credit rating metrics?

**Dawn Farrell**

Yeah. So, Andrew, I think that's an important question. And I do think I've been predicting—and it will take some time to see if I actually can be right about this—but as the PPAs roll off and as people in Alberta are completely unhedged in a spot market, I do think there is going to be a whole bunch more contracts than vehicles for hedging that are going to emerge.

And we've got a team of people working very closely with customers to see what can be done there as well because I think the PPAs have provided a sort of muting to the market. And once it is a full spot market, for sure, financial contracts should emerge, and there should, over time, be a much more transparent signal in terms of what some of the pricing might look like.

So for example, even today, we're talking to some customers about even three and seven-year hedges, that kind of thing. Now, early, early days—people really need to see what the market looks like. They need to assess the risk of it but, as you know, in all markets, that should emerge.

In terms of our hedge values, it completely depends. So if we're sitting in a market where it pays nothing for us to hedge because prices are low or prices are weak, we're not going to hedge up then, and if prices get really spicy for whatever reason, we'll probably hedge up more at that point. So our hedge volumes will move sort of from year to year. We will disclose where we're at and what our thoughts are as we're going into the market.

We'll probably get a lot better at that as we go through 2020 and see how the market shapes up and see how some of these customer discussions emerge. But I think it'll start to look very much like some of the things you see in other commodity markets, where there'll be times when it does not pay off to continue to hedge. We can't blindly set a level on hedge, is another way to say it. We'll have to really be on top of it with our asset optimizers. Does that make sense? Am I being clear?

**Andrew Kuske**

Yeah. No. That's very helpful. And maybe a follow-up to it is, do you anticipate an evolution to your financial reporting? And just a change to that, given the fact that you've got a marketing group now, but you're really operating the PPAs, Marketing group does some other things on optimization basis, but as you go into a full energy-only market, the functions kind of change? And should the reporting change around that, too?

**Dawn Farrell**

Yeah. I mean, for the last 10 years, we've reported on fuel type because fuel type tended to have different levels of capital. Coal was a big capital user, and it made some sense for the market to see—especially as we were growing the portfolio with more gas and renewables, you could start to see that just the shape of the way the Company reinvested capital was changing.

There is an argument, and we'll be doing the work on it, for having sort of more of an Alberta portfolio because we do operate it as a portfolio, and we have to think in terms of what the asset optimizers do and how we manage those units here. And frankly, we make electricity, and electricity is electricity, no matter how it's made. So we are thinking about that. We haven't made any decisions on that at all but, certainly, you may expect to see something as we go through next year.

**Andrew Kuske**

Okay. That's very helpful. Thank you.

**Dawn Farrell**

Thanks.

**Operator**

Your next question comes from John Mould with TD Securities. Your line is open.

**John Mould — TD Securities**

Thanks. Good morning. I'd just like to start with great result for Energy Marketing in the context of California volatility, but I'd like to focus on the opportunities to potentially provide firm supply in the Pacific Northwest. You'll have one operating unit at Centralia through 2025, and just in the context of some of the other coal retirements coming in that region, what opportunities could you have to provide from supplying that market, whether it's a potential gas conversion at Centralia or other investments there?

**Dawn Farrell**

That's a good question. So what we know about that region is that there'll be a number of RFPs in the region for the next five years from a number of the players looking for a way to replace all of the coal that's being shut down. And we know that those RFPs will start with looking for more green and accepting more intermittent power. And of course, there's opportunities there with our land, with solar and, potentially, some interesting opportunities on wind, but we know that the region is very, very nervous about—as they go forward and all the coal shuts down, what are they going to do about firm supply?

We also know, because we've worked very closely with the environmentalists in that region, that they do see some sort of gas transition at least until 2040 because, frankly, nobody can conceptualize—

even though we're all trying to do it desperately, nobody can conceptualize yet how to get the kind of supply that you need to create green baseload. It's just not feasible yet.

So we've been encouraged by the local customers and local utilities there to think about how to submit into those RFPs. And it could even be something, frankly, where we provide operating reserve or something like that. So at this point, it looks like the RFPs in that area will be green to start with in the 2020, '21, '22 time frame. And then they'll be focusing on how to get some baseload.

So we continue to look at it, and it could be even—you think, could it be a coal-to-gas conversion, which is actually pretty big in that region. It takes a lot of gas, and that region doesn't have as much gas as you think. But it might be putting a peaking unit back in. Remember, we've got that BHP plant there that we've pretty well stole everything out of, but putting a small LM6000 in there might win a competition if we can get it amortized to 2040.

So those are the kinds of things that are going on. Very, very early days on that but something the team will be looking at as we go forward.

### **John Mould**

Okay. Thanks for that. And then maybe just circling back on Sheerness and the dual fuel plans there and maybe to ask Mark's question a different way, are you able to provide any colour on just the future coal versus gas fueling there? And how carbon emissions and broader ESG considerations feed into the thinking of the owners regarding the future of coal at those units? Or how you think about TA cogen stake in Sheerness?

### **John Kousinioris**

Yeah. John, it's John. With respect to sort of TA—I'll try to answer your question in reverse. With respect to TA Cogen's interest in the Sheerness facilities, we haven't had any discussions in terms of



changing the ownership that we have there with our partners CKI. So right now, the status quo is effectively what we're seeing there.

In terms of dual fuel, I think all I can say is that I think the folks at Heartland are pretty much focused on trying to increase and really transition towards a gas-fired facility there; that'll be their focus. Will we see some dual fuel burning over the course of 2021? I do expect that but, as time goes by, our expectation would be is that it would be predominantly run on natural gas.

**John Mould**

Okay. Great. And then maybe just lastly on Brazeau. You've talked before about the ability—pumped storage, just to be clear—you've talked before about the ability to maybe build that in stages. I'm just wondering how much of that project's output would need to be contracted before you really felt like you could start to move forward with that? And maybe how its ancillary value to the broader market kind of plays into that need to contract up the facility before deciding to move ahead?

**Dawn Farrell**

Yeah. I mean, I think you've got to get it contracted into that 70 percent, 80 percent range to take a risk on that size of investment for us. Now potentially if we had a partner that maybe could take more merchant risk than we could, you can change some of that. But for sure, as we look at sort of the ESG world of investing and you look at some of the demands to reduce carbon, there's a lot of companies now that have to really focus on their Scope 2 emissions, which is the emissions that come from their power supply.

And you can see some opportunities. It's actually a very interesting project because it's less about the power hedging. It's more about the environmental permits that come out of it and the RECs

and really figuring out how to attract capital into that side of it. So it's—but as we do more work on that, and we'll talk about that, but it's actually hedging the greenhouse gas side of it more than the power side.

**John Mould**

Okay. Very much appreciate those contexts. Those are my questions. Thanks.

**Dawn Farrell**

Thank you.

**Operator**

Your next question comes from Julien Dumoulin-Smith with Bank of America. Your line is open.

**Dariusz Lozny — Bank of America**

Hey. Good morning. It's Dariusz Lozny on for Julien. Just wanted to ask one quick question on the RNW side and it has to do with your recontracting efforts. It sounds like there was some progress made in Southern Cross in the last quarter. And I was wondering as we kind of look ahead to Sarnia and that contract, what the next milestones that we should watch for would be as far as that recontracting?

**John Kousinioris**

Darius, thanks for the question. You're right, we're pretty excited about the extension of the contract at Southern Cross and that extends the life by 15 years there.

With respect to Sarnia, I think the next milestone for us would be—and I think we've been pretty transparent about it—is just all the recontracting efforts that we have with the customers there that are behind the fence. Our sense is that they're advancing well. Our facility does a good job in serving their needs, and we're presently expecting and hopeful that those arrangements would be finalized pretty much across the board in the first half of next year.

**Dariusz Lozny**

Great. Thank you very much.

**Operator**

Your next question comes from Dan Healing with the Canadian Press. Your line is open.

**Dan Healing** — Journalist, Canadian Press

Hello. Thanks for taking my question. Dawn, I was wondering if you'd take a step back and just kind of go through the strategic rationale for moving up the coal retirements. Is it related to the Brookfield investment of a year or so ago?

**Dawn Farrell**

No, not at all. I mean, I think it's really related to kind of overall the economics of producing power in Alberta on coal with the carbon tax. If you look at Alberta, we've currently got a \$30 carbon tax; it'll be \$40 by next year, \$50 the year after. Coal plants get less economic and they're less flexible in a merchant market. So when you—we're doing a conversion right now to gas; that plant when it comes back will be highly flexible and will be much easier to run in a market that has more volatility.

John, did you want to add something?

**John Kousinioris**

Yeah. I mean, the only thing is the other thing you have to remember is when the Climate Leadership Plan came in from the previous government and even with the federal government, 2029 was the date that they—

**Dawn Farrell**

Right.

**John Kousinioris**

—set for the coal-fired generation to end. So really, it resulted in the Company just refocusing the way it would run its portfolio.

**Dawn Farrell**

Right.

**Dan Healing**

Okay. And I also had a question about what the impact on employees will be as you close down that coal mine and elsewhere in the operation?

**Dawn Farrell**

Listen, that is the bittersweet, sad part of this story.

**John Kousinioris**

That's the number-one thing.

**Dawn Farrell**

At the height of TransAlta, we had 1,500 people working out there. By the end of next year, we'll have 40 or 50 working on reclamation. Now they'll have good reclamation jobs for about 20 years, which is great, but those people have given their heart and soul to this company. They are some of the best families in the province, and our number-one thing is to make sure that they continue to work with us until the end of next year.

Having family members who worked in that business, I do know that having this certainty is actually helpful to them because they can make plans, but we'll be working really hard to make sure they all continue to work all through next year. And we'll be throwing them a party for all the work they did for the last 50 years for this province.

**Dan Healing**

Okay. Sounds good. Thanks very much.

**Operator**

Your next question comes from Naji Baydoun with Industrial Alliance. Your line is open.

**Naji Baydoun — Industrial Alliance**

Hi. Good morning. Just a couple of questions. Just going back to the Centralia asset. Now that you won't have any coal-fired facilities in Canada as of 2022, just wondering if you can give us your latest thoughts on Centralia? And I guess the question is, what would it take to completely remove all coal from your portfolio?

**Dawn Farrell**

Well, I mean, we'd have to probably sell Centralia to a private buyer. But the interesting thing about Centralia is, we have a 360 megawatt hedge on that plant that's very strong, and it helps create the cash flows until the end of 2025. And as well, when we negotiated that contract—so you have to go back to 2011. We worked with the governor in 2011, and we basically made an agreement that if they would get us some hedges that we would guarantee that we would shut the plant down at the end of its life. So we guaranteed that we'd shut Unit 1 down at the end of this year, which we are doing, and that we'd shut Unit 2 down at the end of 2025. And in return, we don't have an environmental liability for that because of the work we did with the state there.

So I mean, it's really a net present value discussion, but in the meantime the cash flows are strong in that plant and we can use them to reinvest in our green strategy. And having cash to reinvest is an important part of our E-ESG how we're visualizing that.

**Naji Baydoun**

Yeah. That makes sense. Thank you, Dawn, for that. And I guess, more of a broader question related to RNW. As more of your assets are converted to gas, does that change at all your drop-down strategy for TransAlta Renewables? Would you be looking to have or move more of your contracted assets into RNW and sort of keeping the majority of merchant exposure within TransAlta Corp? Like is there a minimum contracted profile that you would like to maintain at the TA level?

**Dawn Farrell**

That's a tough question to answer because there's a number of benefits that work in both portfolios. So we'll look at a project and it might have certain tax attributes that work better in TransAlta and another project that has the same sort of green attributes might work better in RNW. So as we now have brought the strategies pretty close together and we're really aiming at that ESG world, we will have to do a little bit more work, I think, to show investors what our investment policy is for both companies. We need a bit more time to do that.

But clearly, as we look at a number of portfolios that are coming up for sale in the market or looking at developing different projects, there are projects that work for both portfolios, and we'll want to make sure we allocate the capital to the right project in the right portfolio to get all the economic benefits that we can. Again, E-ESG, economic ESG, and so we're really looking at how to wrap that around both companies together.

**Naji Baydoun**

Okay. Thank you for that detail.

**Operator**

There are no further questions at this time. I will now turn the call back over to the presenters.

**Chiara Valentini**

Great. Thank you, everyone. That concludes our call for today. If you have any further questions, please don't hesitate to reach out to the Investor Relations team here at TransAlta.

**Operator**

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.