Calgary Portfolio Management Trust

Capital Power

Utilities
TSX: CPX
Market Outperform | Buy

September 30, 2024

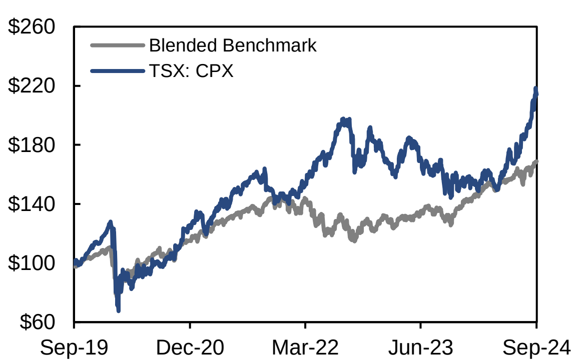
Caitlin Heggerud, Investment Analyst
Connor Bot, Investment Analyst

Return on Investment	
Current Share Price	$49.17
Target Price	$60.00
Dividend Yield	5.30%
Implied Return	27%
Conviction Rating	1

Market Profile	
52-Week Range	$35.20 - $50.86
Market Capitalization ($mm)	$6,595
Net Debt ($mm)	$5,395
Enterprise Value ($mm)	$11,990
Beta (5-Year Monthly)	0.64

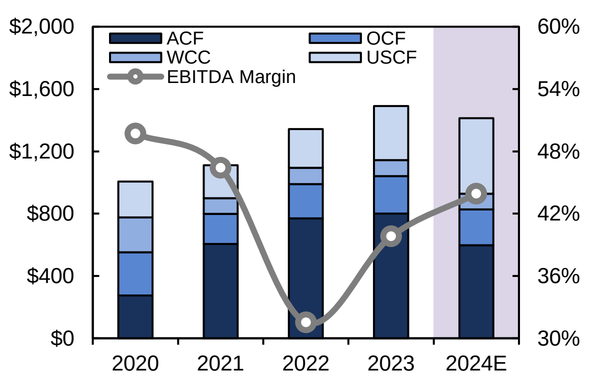
Metrics	2023A	2024E	2025E
Revenue ($mm)	$4,068	$3,168	$3,313
EBITDA ($mm)	$1,619	$1,266	$1,325
EPS	$6.04	$6.00	$5.24
EV/EBITDA	5.3x	8.6x	8.2x

Historical Trading Performance (Indexed to $100)



Source: S&P Capital IQ

Figure 1: LHS EBITDA Segmentation ($mm) vs RHS Margin



Sources: Company Filings, CPMT Estimates

Business Description

Capital Power (TSX: CPX) is an independent power producer (IPP) that develops, acquires, owns, and operates power generation facilities in the U.S. and Canada. The Company utilizes ~7,800 MW of net natural gas thermal power generation as its primary source, representing 84% of its owned capacity. CPX also boasts a net capacity of ~1,500 MW from wind and solar energy. The Company owns ~9,300 MW of total power generation capacity across 32 facilities, serving industrial and commercial clients, independent system operators, and government-owned or sponsored entities. CPX operates under four segments: (1) Alberta Commercial Facilities (ACF), (2) Western Canada Contracted (WCC), (3) Ontario Contracted Facilities (OCF), and (4) U.S. Contracted Facilities (USCF). The ACF segment is primarily uncontracted merchant power generation, while the remaining segments are contracted.

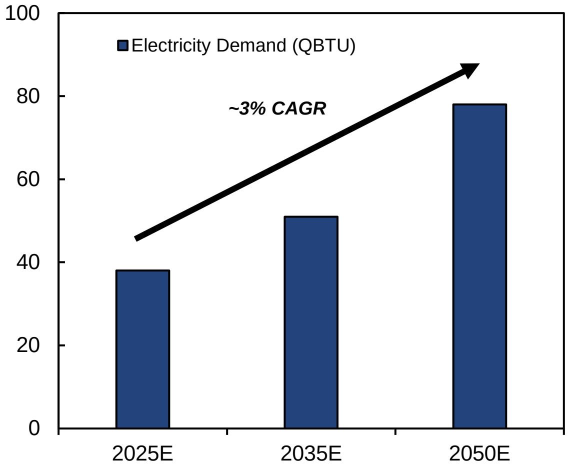
Industry Overview

CPX's core asset base is in Alberta, where the Company primarily competes with TransAlta (TSX: TA) in the Alberta regulated electricity market (REM). The Alberta REM operates as an energy-only market. This enables dispatchable generators to strategically engage in economic withholding, where IPPs intentionally limit their electricity supply by offering price-quantity pairs at elevated prices, increasing their realized power prices. The Alberta Energy System Operator stated that the current market design lacks sufficient incentives to attract investment in dispatchable generation, which is increasingly becoming needed in the market, indicating that regulations could change to encourage more predictable generation.

North America's gross electricity demand is expected to grow through 2040 at a CAGR of ~3%, supported by onshoring, industrial electrification, population growth, and the expansion of data centres. As the energy mix shifts, installed capacity is predicted to be dominated by renewables such as wind and solar generation. The nature of renewable power generation necessitates the use of dispatchable generation sources, such as natural gas, to meet power demand during peak consumption and maintain grid stability. This is particularly crucial for critical infrastructure that requires a reliable and predictable power supply. Following recent acquisitions and facility upgrades, CPX is now North America's fifth-largest generator of electricity from natural gas. North American electrical transmission grids are aging, with ~30% of infrastructure nearing its end-of-life. As regulated utilities take time to modernize grids, IPPs are positioned to benefit from strained reserve margins and corresponding capacity pricing in key markets, such as the Midcontinent Independent System Operator (MISO) and U.S. Western Electricity Coordinating Council (WECC) regions, where the Company holds 12% and 26% of its generation capacity, respectively. The MISO and WECC regions include a mix of energy-only and capacity markets. In capacity markets, generators are compensated for the electricity they produce and for maintaining available capacity to meet future demand, particularly during periods of peak demand.

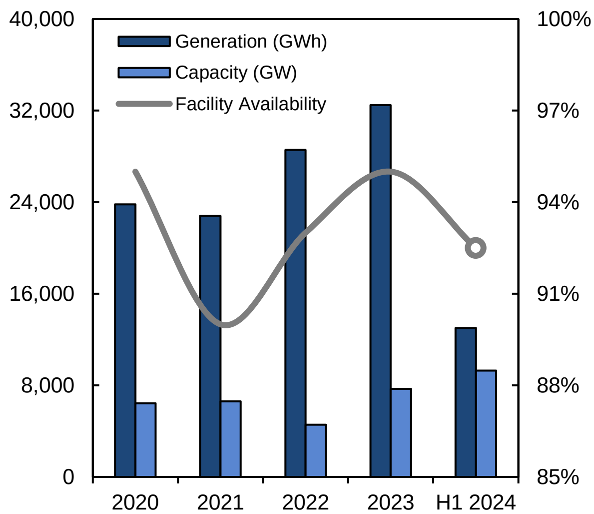
With interest rates expected to continue declining through 2025, IPPs are positioned for financial relief and better access to capital, attracting investors who seek predictable growth and (cont.)

Figure 2: North American Electricity Demand (QBTU)



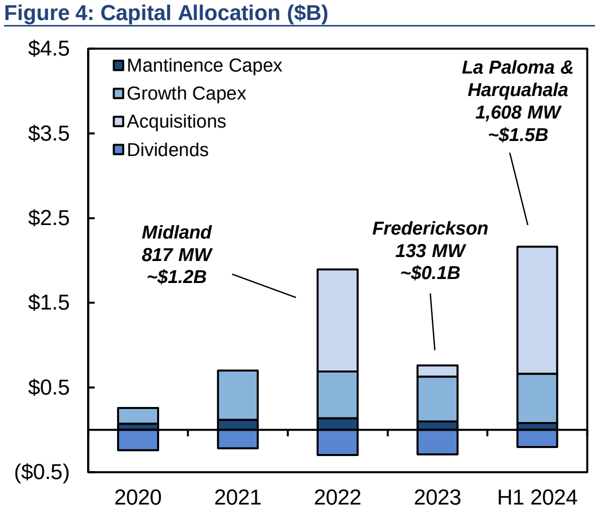
Source: Company Filings

Figure 3: LHS Generation & Capacity vs RHS Availability



Sources: Bloomberg, Company Filings

Figure 4: Capital Allocation ($B)



Source: Company Filings

reliable capital return in a low-rate environment. U.S. IPPs have returned 30% YTD, while Canadian utilities have risen 11%.

Mandate Fit

Quality Management: Avik Dey has been the President and CEO of CPX since 2023, following the planned retirement of Brian Vaasjo. Dey was previously the co-head of Carlyle International Energy Partners and the head of CPPIB's Energy & Natural Resources group, in which he oversaw the deployment of ~$10B of capital from the group's 2014 inception. Dey has overseen the deployment of over $12B of capital in the energy and power spaces throughout his career prior to joining CPX, and brings a wealth of experience in sourcing, acquiring, integrating, and operating assets in the North American power space. CEO and NEO compensation are 79% and 63% at-risk, respectively, ensuring alignment between management and shareholders. Additionally, 20% of incentives for executive and management are linked to the Company's ESG targets.

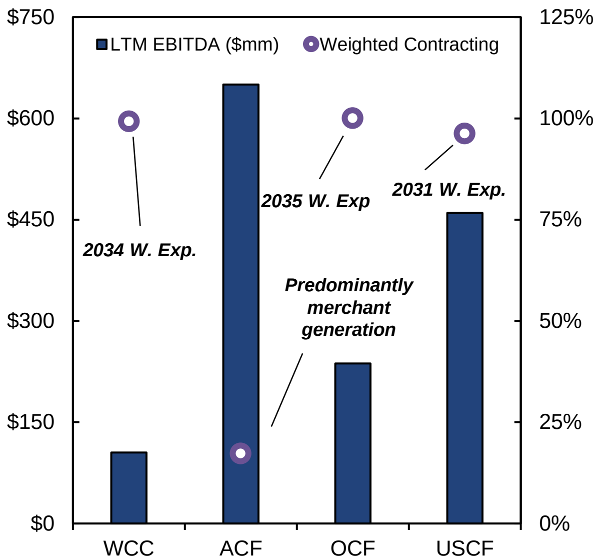
Competitive Advantage: CPX is one of the few predominantly pure-play natural gas IPPs in North America, with significant dispatchable capacity in key markets. The Company, as a significant owner of natural gas flexible generation capacity, is positioned to capitalize on these assets as the North American grid increasingly requires more stable power generation to supplement intermittent renewables. This increased need also raises the likelihood of favourable recontracting terms. CPX maintains operational excellence at its thermal generation plants, exemplified by its 91% plant availability in Q2 2024, a metric in which the Company outperforms its peer, TA. The Company's reliable, heavily contracted natural gas operations allow it to also be a significant renewable operator and developer, with an additional 3.4 GW of renewable solar and wind capacity under development. CPX has a history of accretive acquisitions for natural gas power generation infrastructure in key areas, which it further improves upon by integrating into the Company's network and streamlining plant operations. This was recently exemplified through CPX's acquisitions of the La Paloma and Harquahala plants as well as the Fredrickson plant, which transacted at 4.8x and 6.7x EV/EBITDA, respectively.

CPX acquires assets in electricity markets in which it foresees upcoming grid strain, dispatchable generation need, and growing grid load. The Company is positioned to capitalize on these factors, coupled with its operational expertise and the scarcity of flexible generation assets. As the North American power generation landscape shifts to favour generation with low carbon intensity, natural gas is predicted to be a key variable power source to supplement renewable base generation at times of peak electricity demand. CPX is well-positioned to continue expanding its fleet across North America, making a presence in key electricity markets in which dispatchable generation is a vital support to renewable baseload and critical to evolving electricity needs.

Strong Balance Sheet: CPX maintains a strong balance sheet and low leverage relative to peers, with a Net Debt/EBITDA ratio of 3.1x versus the peer average of 4.6x. The Company holds a BBB- credit rating from S&P, which it has consistently maintained since 2012. This stability is notable considering the significant price restructuring in the Alberta REM in 2021 and CPX's acquisitions and upgrades post-COVID, signaling the Company's financial resiliency.

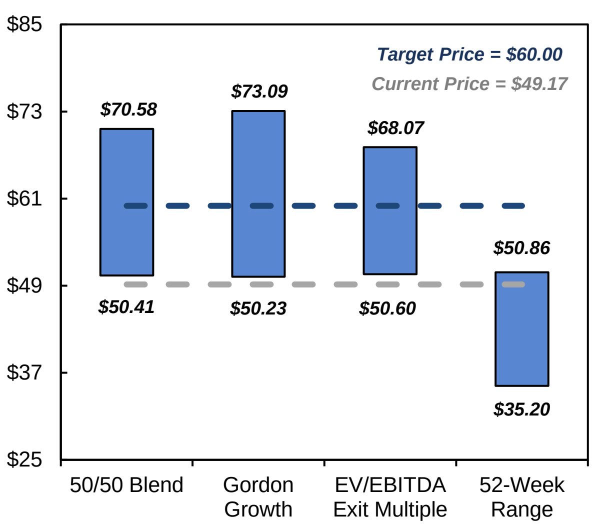
CPX has net debt of $4.8B, which has increased by $1.8B over the last two years on the back of acquisitions and plant upgrades. The Company's interest coverage ratio is 1.9x as of Q2 2024, which is significantly derisked due to the highly contracted nature of (cont.)

Figure 5: LTM EBITDA ($mm) & Contract Weighting[1]



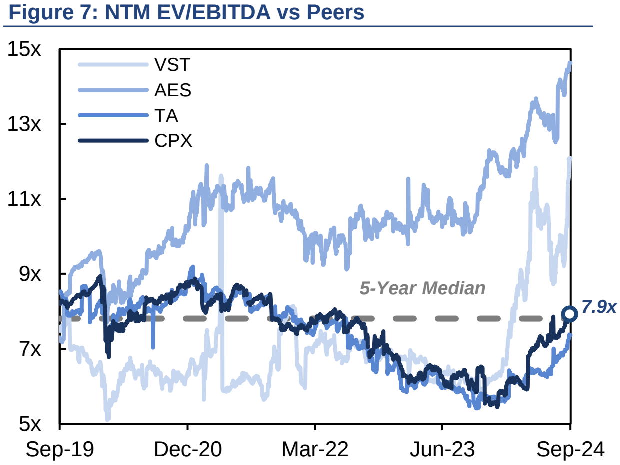
Source: Company Filings

Figure 6: Football Field Valuation



Source: CPMT Estimates

Figure 7: NTM EV/EBITDA vs Peers



Source: S&P Capital IQ

CPX's cash flows and the Company's hedges against natural gas price volatility. The Company has no significant maturity hurdles until 2026, which it has ample liquidity to redeem, with most of its obligations spread throughout the late 2020s and early 2030s.

Growing Free Cash Flow: CPX has shown strong financial performance through both inorganic and organic growth. EBITDA has grown to $,619mm from 2018 to 2023, representing a five-year CAGR of 21.2%. The Company's EBITDA margin for 2023 was 39.8%. Between 2018 and 2023, FCF saw a modest contraction from $90mm to $58mm, hampered by significant capital investment; FCF in 2022 was $232mm. CPX's cash flow profile is highly contracted with investment-grade counterparties. ~75% of EBITDA is secured through predictable take-or-pay agreements, providing a stable revenue foundation. CPX has close to 100% of its EBITDA contracted in all geographies, with the exception of its ACF segment, where it engages in merchant generation and intentionally avoids contracting. The Company is highly-hedged against its natural gas costs, further mitigating risks associated with its cash flows from commodity exposure. CPX reduces exposure to natural gas prices through hedging and power purchase agreements, allowing it to take advantage of the natural gas-electricity differential. The Company has grown its dividend at a five-year CAGR of 6% and expects to continue growing its dividend per share by 6% through 2026.

Risks

Regulatory Changes: Regulatory changes in electricity markets have the potential to reduce CPX's realized electricity price. Although this cannot be avoided, effects can be mitigated through geographic diversification between electricity markets. Changes in pricing regimes have the potential to harm revenues and profitability in the long-term given the sticky nature of power generation assets.

M&A: Although CPX has utilized M&A as a key driver of growth, poorly executed transactions, particularly overpaying for assets, can erode value by eroding returns and contributing to underperformance. Additionally, integration challenges may arise post-acquisition, including recontracting issues, operational inefficiencies, and portfolio misalignments. Although the Company's acquisitions have proven to be key drivers for its expansion and profitability, assets must be continually evaluated for suitability.

Investment Thesis and Valuation

CPX was valued at $60 using a five-year DCF with a WACC of 5.7%. The terminal value was derived from a 50/50 blend of (1) the Gordon Growth method, using a 2.0% terminal growth rate, and (2) an EV/EBITDA exit multiple of 9.0x. The Company currently trades at 7.9x EV/EBITDA, compared to a peer average of 11.0x EV/EBITDA. The CPMT believes that the Company should trade at a premium multiple to its current valuation due to positive tailwinds for CPX's dispatchable generation assets as well as its operational excellence. The Fund believes that the Company will become increasingly attractive as it expands its presence in key markets and its acquisitions and capital investments drive returns.

With the ongoing shift towards renewable energy, which is often limited by intermittent electricity generation, the demand for complementary flexible power generation will grow. CPX is well positioned to meet this need with its extensive fleet. The CPMT also believes that the Company will continue to drive incremental operating improvements and increasingly favourable recontracting terms at its facilities, further improving the Company's potential as a vehicle for growing and consistent returns.

(1) Callouts signify weighted average PPA expiry in years