FINAL TRANSCRIPT

TransAlta Corporation

Second Quarter 2018 Results Conference Call

Event Date/Time: August 3, 2018 — 11:00 a.m. E.T.

Length: 57 minutes

CORPORATE PARTICIPANTS

Sally Taylor
TransAlta Corporation — Manager, Investor Relations

Dawn Farrell
TransAlta Corporation — President and Chief Executive Officer

Brett Gellner
TransAlta Corporation — Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Rob Hope
Scotiabank — Analyst

Patrick Kenny
National Bank Financial — Analyst

Mark Jarvi
CIBC Capital Markets — Analyst

Ben Pham
BMO — Analyst

Robert Kwan
RBC Capital Markets — Analyst

David Quezada
Raymond James — Analyst

Chris Varcoe
Calgary Herald — Analyst

Mitchell Moss
Lord Abbott — Analyst

PRESENTATION

Operator

Good morning. My name is Christine, and I'll be your conference Operator today. At this time, I would like to welcome everyone to the TransAlta Corporation Second Quarter 2018 Results Conference Call. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there'll be a question-and-answer session. If you would like to ask a question during this time, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, press the # key. Thank you.

Sally Taylor, Manager, Investor Relations, you may begin your conference.

Sally Taylor — Manager, Investor Relations, TransAlta Corporation

Thank you, Christine. Good morning, everyone, and welcome to TransAlta's second quarter 2018 conference call. With me today are Dawn Farrell, President and Chief Executive Officer; Brett Gellner, Chief Financial Officer; and Todd Stack, Corporate Controller.

Today's call 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 on our website shortly thereafter.

As usual, all information provided during this conference call is subject to the forward-looking statement qualification, which is set out on Slide 2, detailed in our MD&A, and incorporated for full for the purposes of today's call.

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

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

On today's call, Dawn and Brett will review the quarterly results and the outlook for the remainder of the year. After these prepared remarks, we will open the call up for questions.

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

Dawn Farrell — President and Chief Executive Officer, TransAlta Corporation

Thanks, Sally. Welcome, everybody, and hello to everyone who's joined our call today.

Let me start today by saying that I'm very pleased with our quarter and the performance of the business so far as we're moving through 2018.

This quarter, we delivered cash flows from the business well above last year. And the improving financial results over last year are primarily due to performance from our Hydro and Canadian Gas segments, and Brett's going to take you through some of that detail when it gets to his section.

Now as many of you know, this is the first quarter the Sundance units move from contracted baseload assets with long-term PPAs to flexible merchant assets. I'm glad to report today that the team is doing a great job of dispatching our assets into the market here in Alberta when they are both needed and when they are profitable.

I'm also happy to report today that we are well ahead of our plan on replacing recourse debt and reducing our data overall. During the first six months of the year, net debt was reduced again by $345 million. And subsequent to the quarter, our finance team completed our off-coal financing, which they did an excellent job of, and we used that money to repay our 2019 bond early.

Brett will get into the details, and he's pulled together some excellent charts that will show the results that we've achieved to date. What's important here is that our balance sheet is now very well positioned for anything that we want to do in the future.

We did make the decision in July to permanently retire the Sundance Unit 2. Our analysis was informed by the work we did on the capacity market, which also clarified that the rest of our units in the Sundance fleet and in Keephills are great candidates for the new capacity market that's emerging, and they'll be highly competitive.

Operationally so far this year we've had an excellent year, with over 90 percent availability across the fleet compared to 86.2 last year during the first half of 2017.

Now as I mentioned during our last quarter, our Greenlight initiatives are really impacting the efficiency of how we run and maintain our plants, resulting in fewer planned outages. And the team up at Alberta Coal is just having some tremendous runs and some tremendous weeks with those plants. So we're really proud of the work that they've done.

We remain focused on operational excellence because we know that at the end of the day it serves our customer needs for low-cost, reliable, and clean power.

Now, during the second quarter we did see an increase in power prices, which were expected as the market fundamentals here in Alberta return to more normal levels. The higher volatility in power prices did result in improved performance at Hydro, which is showing investors that our cash flows from the Alberta business as a whole are both consistent and reliable. Our fleet of plants continues to be key to providing reliability here in the market and low-cost power as well.

We also executed on our strategy of growing TransAlta Renewables. We dropped down long-term contracted assets from TransAlta during the quarter. Specifically, we entered into an agreement giving TransAlta Renewables the economic interest in our Lakeswind Wind Farm, our mass solar projects, as well as the ownership of the Kent Breeze Wind Farm.

In total, we transferred 91 megawatts of generation to TransAlta Renewables for $166 million in proceeds.

So to sum up, in the quarter we built on our strong start in quarter one. We are ahead of where we thought we'd be on our cash flow due to the great work across the organization and on a number of fronts. We do have positive momentum across the business, and we expect to deliver the year at the high end of our guidance range for free cash flow, which is our key performance indicator.

So with that, I'm going to turn it over to Brett, who will provide you more detail.

Brett Gellner — Chief Financial Officer, TransAlta Corporation

Okay. Thanks, Dawn, and good morning, everyone. So I'm going to start with our segmented cash flows, and we think these are important metrics because they show the cash flows from each of the businesses before pretax—before tax and interest, so a good barometer of how well we're doing in the business.

So as you'll see from this chart, our segmented cash flows totalled 203 million during the second quarter. This is an increase of 50 million year over year. All of our generation segments, except Canadian Coal, contributed cash flows equal to or better than last year.

This was driven primarily by two key factors. First, as Dawn mentioned, our hydro fleet benefitted from higher prices for ancillary services, which are required by the ISO to maintain grid stability and reliability.

Our merchant coal assets also benefitted from higher prices, although this was more than offset by the higher carbon costs, higher per unit coal costs, and the onetime cost associated with mothballing some of the units. We expect some of these costs to improve over the balance of the year as we align our cost structure to having fewer units operating.

The second biggest driver is lower sustaining capital, which again is expected given we have mothballed some of the units.

On a year-to-date basis, segmented cash flows were significantly higher than 2017. A key contributor to this increase was the 157 million onetime payment that we received for the termination of the Sundance B and C PPAs. This payment really is effectively a prepayment for the capacity payments that we would have received over the 2018/2020 period had the PPAs not been terminated.

So now total free cash flow, as you can see from this next chart, has been significantly higher compared to the last two years on both a quarterly and six-month basis. This has been driven by not only the strong performance in the segments, but also by the lower interest expense from having less debt.

So turning to Slide 7 and turning to our debt, we've made, as Dawn mentioned, significant progress in reducing our debt. Since 2015, we've reduced our debt by 1.2 billion, and our total net debt now stands at approximately 3 billion. Just under 900 million of that debt resides at TransAlta Renewables, which is secured by long-term contracted assets.

In July, we further strengthened our financial position by raising 345 million of debt associated with the off-coal payment and used those proceeds to redeem the $400 million bond that was due in November 2019, which had a significantly higher coupon. Our next debt maturity is not until the end of 2020, so we're in excellent shape from a debt maturity perspective.

With the recent financings completed in July, our senior debt level at the TransAlta Corp level is only 1.6 billion. This debt is supported by all the cash flows from our coal and hydro assets, our trading business, the gas assets not in TransAlta Renewables, and the dividend we receive from TransAlta Renewables as a 61 percent shareholder.

Given our progress on reducing debt, we now have one of the strongest balance sheets in the industry. So you can see from this chart, TransAlta's net debt to EBITDA, which does not include 50 percent of the preferred shares that are included by the rating agencies, is at 3 times, significantly below the industry peers. TransAlta Renewables also has a very strong balance sheet at 2 times net debt to EBITDA.

Now turning to the market fundamentals in Alberta. As Dawn mentioned, load growth continues to be strong. As a result, power prices have improved, and the outlook for the balance of the year and into next year remains very good. Our assets are well positioned to benefit from these strong fundamentals, given our diversified portfolio here in Alberta.

On the natural gas side, we continue to see low prices due to an abundant supply of gas. During the last several months, we have been using more gas at the coal facilities to take advantage of these lower prices, as well as to reduce our carbon obligations. Once the Tidewater pipeline is up and running, we can co-fire even more gas at these sites.

Our capital allocation plans for the next three years will continue to be strengthening our balance sheet, buying back shares, positioning the Company for growth, and funding the transition to 100 percent clean energy by 2025.

On the balance sheet front, we will generate strong excess free cash flow that will allow us to repay the $400 million bond maturing in late 2020, which will further strengthen the balance sheet. As well, our debt balances at the TransAlta and TransAlta Renewables level will be reduced by approximately 200 million from now until 2020, given the mandatory principal payments associated with the amortizing project debt.

In the first quarter, we initiated a normal course issuer bid with the intention of using incremental cash flow generated by the business to reduce the number of shares outstanding when we believe our shares are undervalued. So far, we have acquired and cancelled almost 588,000 shares at an average price of $6.77. We will continue to buy back shares at TransAlta under our normal course program, and with our strong results year to date, we expect to invest more heavily in the NCIB during the second half of the year than we have in the first.

From a growth perspective, we will continue to remain disciplined, but are seeing good opportunities to grow the business with projects that add long-term value. Earlier this year, we acquired two construction-ready wind projects in the Northeast US and are constructing the Kent Hills 3 wind expansion. We also have the option to invest in up to 50 percent of the gas pipeline being developed by Tidewater to supply our coal facilities with natural gas. And we are advancing the preliminary engineering work on the conversion of our coal facilities to gas.

So in summary, from a financial perspective we are very well positioned for the future. In light of our results during the first half of the year and the outlook for the remainder of the year, we are now targeting to be at the upper end of our free cash flow guidance range of 300 million to 350 million, which I'll remind you does not include the 157 million received for the termination of the PPAs.

Beyond 2018, we have a strong balance sheet and expect to generate solid cash flows that will allow us to continue to add projects to the fleet, which will create long-term value and continue to diversify our cash flows.

So with that, I'm going to hand it back to Dawn.

Dawn Farrell

Thanks, Brett. So as we step back from the quarter and we look at the bigger picture, you can see from our results today that we've successfully stabilized and adapted our business to the new realities.

Currently, we are both transforming and growing the business off a very strong base, and value is being realized in the form of stable and growing cash flows.

The slide on Page 11 outlines the many initiatives we've undertaken which have resolved much of the uncertainty and led to further clarity on where we're going with this company. Investors today are beginning to recognize the value of the hydro assets here in Alberta and how the hydro and coal fleets work together today.

What I'm the most certain about today is that the cash flows from the hydro and coal and the coal to gas, which is yet to come which we're investing in, the cash flow from those businesses here in Alberta are here to stay and they're growing.

So when you add together the $150 million dividend that TransAlta shareholders received from TransAlta Renewables with the dollars that are coming from the rest of the Company, including the assets here in the Alberta market, the cash is growing significantly to 2021. And the balance sheet is the strongest it's ever been.

So with that period of stabilization well behind us, we are also in the homestretch of our transformation. Last month, we moved onto even stronger ground with respect to the capacity market. The latest rules released in July indicate that we will be well positioned to compete successfully for power contracts with our assets. This is an area where question marks have simply fallen away.

I'm also pleased with the progress the team is making on TransAlta Renewables. Their persistence in finding good investments with great returns will eventually grow the cash flows that we receive from that entity. Investors supported that growth through the equity issue that was also done in Q2; all positive for TransAlta shareholders, as well as TransAlta Renewables shareholders.

So thanks to everyone who worked hard over the quarter. We're keeping this call a little bit shorter, so I'm going to turn it back to Sally so we can get right into Q&A.

Thank you.

Sally Taylor

Thank you, Dawn. Christine, could you please open up the call for questions from the analysts and media?

Q&A

Operator

Thank you. At this time, I would like to remind everyone in order to ask a question, please press *, and the number 1 on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Your first question comes from the line of Rob Hope from Scotiabank. Your line is open.

Rob Hope — Scotiabank

Good morning, everyone. Just wanted to start off with the hydro assets. Can you walk us through the delta in the results from Q2 versus Q1 how much was ancillary? And then also, can you add some colour on I believe it's your June presentation you said that these assets could generate 75 million to $100 million of EBITDA in 2018, but you've already done 66 million? And then also, does this give you additional confidence that you can reach that 225 million to $275 million EBITDA run rate post-PPAs?

Brett Gellner

Okay. Rob, it's Brett here. Yeah. So on the quarter-over-quarter, just the way the PPA works is most of our margin is on the ancillary services side of the business. The ancillary side is, the prices for that are very much correlated with what you see for energy in the market, so when you see stronger energy prices, you usually see stronger ancillary service prices as well. So hydro is well positioned, and a big participant in the ancillary services market.

In terms of the balance of year, again, I think that'll depend to some extent on how prices hold in here to the back end, but yeah, we're tracking well so far. Remember, there is some seasonality in these assets because of water levels, and so that comes into play.

And then in terms of your long-term question, as you recall from our Investor Day, we laid out the road to the higher EBITDA from these assets. And really, it has to do with the way the financial contract is structured in that we have obligations to pay on both the energy and the ancillary, and in return we get a capacity payment for that. But come new markets, we'll still get a capacity payment because of the new capacity market, and then we will have the energy and ancillary to our count. So it's really governed by the nature of that financial contract.

So I don't know if that answered your question.

Rob Hope

Yeah. It did. That was helpful. Thank you. And then maybe moving something a little bit more broad, and Dawn touched on it in her opening remarks, if we look at RNW, it was developed as a way to highlight the value of the renewable assets. But the relationship between the two, one could argue that the value of the wholly owned assets at TA are not being recognized, specifically the hydro and some of the coal units there. So I just want to get a sense of what you could do to better highlight the value of those assets or realize the value of those wholly owned assets there?

Dawn Farrell

Yeah. I mean, I think this is a great year to start to really prove that up. So if you look at in this year we've had the Sundance units go from contracted to merchant; we have a more normal market happening here through seeing more normal cash flows.

On the hydro, I think frankly as we go through the year, people will start to realize that throughout this whole period from 2015 and '16 and '17 as we've been adapting the business to sort of the business realities, we've actually never really missed a beat when it comes to cash flow performance, and we've been growing the cash flow here.

So I think our first job is to show investors that when you look at the fleet here in Alberta, the combination of the hydro and the coal together today and the hydro and the coal to gas tomorrow, produces substantial cash flow. And so when you add that 150 that we get from renewables, which will eventually grow over time as we add assets there, to the actual cash flow that we're printing here in the Alberta market because we are needed for reliability in this market, we can extract value from the market as we dispatch our assets into the market. I think when you add those two together, you see that there's significantly more cash than I think people expected.

So I think this year makes a big difference in terms of proving that up one more time. We've proved it up for the last three years. We got to prove it up one more time. So I think that's the first step.

Beyond that, there's always lots of financial structuring-type ideas that come our way. To prove up value, I think fundamentally showing our investors that the cash flows are there, they're solid, and they're there for the long term—this business has a long-term nature to it—I think is probably the most important step we can take.

Yeah. Brett—

Brett Gellner

And, Rob, if you … to your question specifically around is the value being recognized on the TA Corp, I mean by looking, as you know, if you look at the value of RNW and you back that out of what's in the current share price for TransAlta, there's no question the market from our perspective is assigning a very low TV to EBITDA multiple to very good assets, to Dawn's point, ones that will have a long life to them.

And think about that. That includes our hydro, which we would argue is very valuable and perpetual; the coal assets, which will get converted to gas and have longer lives to them; plus the trading and the other assets that are not there.

So we're thinking through how we might be able to show that going forward in future investor presentations. And we showed that a little bit again at Investor Day, but we continue, need to just portray that going forward.

Rob Hope

All right. Thank you. I appreciate all the colour. I'll hop back in the queue.

Operator

Your next question comes from the line of Patrick Kenny from National Bank Financial. Your line is open.

Patrick Kenny — National Bank Financial

Oh, good morning. Just wondering if there was an update on finalizing the take-or-pay agreement with Tidewater? And maybe an update on your thoughts to go in for 50 percent of the capital cost of the pipeline, especially now that your balance sheet is in much better shape than you would have thought when you first entered into the deal?

Brett Gellner

Yeah. Good question, Patrick. Yeah. We're still working through the agreements, but from our perspective more or less full steam ahead here, and things are progressing as we have communicated.

From an investment perspective, again, as you recall, we've made investments in natural gas pipelines before. We own partial interest in the one in Australia. So to us, this is very much an extension of providing fuel to our assets. So we have not made that decision yet, but certainly it is one we're still evaluating, and to your point, we're well positioned to fund that.

Dawn Farrell

Yeah. And I think you want to also remember, Patrick, that we spend capital each year in the mine to get the coal out. So as that capital is coming down, if we invest in the Tidewater pipeline, net net, it's not that much different in terms of capital requirement. So it makes a strong case for us making that investment.

Patrick Kenny

Okay. Great. And I might have missed it, but was there any update on securing a second source of gas supply for the coal plants?

Brett Gellner

Yeah. No updates. As you can appreciate, evaluating all of our options there. I mean, our first objective here is to get the Tidewater one up and running. We do have a pipe in there today. It's smaller in size, and that's what's allowing us to co-fire, but it's got limitations in terms of how much gas we can get in there. And so we do need to get Tidewater in, but we will be looking at our broad gas supply trends.

We are evaluating our gas supply and transport strategies. And as we have something to announce, we'll let you know. But it's part of our overall conversion planning.

Patrick Kenny

Okay. Great. And then lastly, just wondering if you could provide a bit more colour on these data centre opportunities out there just across the portfolio? I mean, should we view the BitCity deal at Sarnia as somewhat of a template for future deals, kind of the five-year fixed pricing deal? And then also maybe you can touch on what the hurdles or challenges might be in attracting some of these data customers to your Alberta merchant fleet?

Dawn Farrell

Yeah. So I think, Patrick, it’s fairly early days for doing deals with these data centres. I talk to executives in our industries all across North America, and everybody is being approached by these data centres. And what they tend to be looking for is any place where they can find surplus power in that 30 to $50 range; that kind of is their sweet spot. Now we were –BitCity, I think—we haven’t really told you what the contract price is—but BitCity, I think, was attracted by the location, and there were other factors that allowed them to be in a higher-cost jurisdiction because Ontario is definitely that.

So I think the five-year outlook is appropriate because I really think that’s the length of their businesses, and they have to do a lot of capital reinvestment over time, so things change. So I think that makes sense for them.

I think in Alberta, to the extent—in order to attract them to that kind of market, we have to figure out a way to serve them directly behind the fence, so we’ve got people that are looking at that. Certainly, when we talk to the head of BitCity and other people like them, if you can provide them with that surplus power quickly and on a shorter-term contract, I mean they’ll locate in your service area.

So we’ve got a team working on it. I think it’s early days. I think there’s tonnes of opportunities because there’s lots of data; going to be necessary, especially as people get into these driverless cars, so. But all I’d say is it’s pretty early days there.

Patrick Kenny

All right. That's great. Thank you very much.

Operator

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

Mark Jarvi — CIBC Capital Markets

Hi. Good morning. I wanted to just start with the Canadian coal segment. Year over year, we saw a reduction in the O&M costs obviously with the shutdown of units. Wondering whether or not you think there's further room for improvement at the O&M level, but also maybe even just fuel costs in terms (audio gap)?

Dawn Farrell

Yeah. I think there's kind of two things there. One is as we—and as you can imagine, I mean, first of all on the fuel cost going from a 12 million tonne mine down to a much lower level of tonnage, so in all of these kinds of operations there's lots of fixed costs that have to be attacked. And Wayne and his team are doing that, so they are looking for ways to reduce the fixed costs overall to be able to get that per unit cost down on the fuel side. And we do anticipate that there's more room there as they move through the year.

The same is true on the OM&A costs. Remember Sundance was a six-pack plant with lots of common costs across all of the units that created the economies to scale in the first place of having a six-pack plant. So as you move to two units and then potentially come back up to four as the market conditions improve, those fixed costs per unit move up and down. So again, the team is looking there.

So as we look ahead at projections, and as we gave you our guidance on our free cash flow, we do see more improvements, particularly on the OM&A per unit going forward. So I think you'll start to see that coming through our numbers as we go into Q3 and Q4 of this year.

Mark Jarvi

Okay. And then just following up on that comment about … in your comments about being the upper end of the range for cash flow guidance, obviously the hydro results (audio gap). What are the other sort of factors that gives you guys more confidence today about hitting the upper end of the range?

Dawn Farrell

Yeah. I mean, the number one thing is if the pricing in the market continues as it is and it continues to be volatile, that's where the opportunity comes to be at that higher end of the range. So we don't see any reason for the market to substantively change.

And then, of course, the other one is as we deliver on our performance on our cost reductions, both of those together are really the key factors for that.

Mark Jarvi

Okay. And then just want to go back to the capacity market design prepared remarks; also you made a comment about the Sundance unit, the permanent retirement of—shutdown of Unit 2.

So just maybe what you're thinking about current design, the balance of the units at Sundance, and whether or not it makes sense to convert and move forward with all four units or sort of some rationalization more of those units?

Dawn Farrell

Yeah. So we're done with the rationalization, so that—remember—you probably don't remember, but I unfortunately do—Sundance Units I and 2 were the first two units that were built in the early '70s in preparation for a very big boom in the power market at that time because of high oil prices. They're the smallest units. They were quickly put together. The designs improved massively from the first 2 units to 3, 4, 5, 6, and then of course K1 and 2.

So given that they were smaller units, had 350,000 operating hours on them, they would have taken the most capital to run into the future. And they would have had the shortest lives because of the federal carbon tax rules.

So when we were looking at how the capacity market was shaping up, we could have—there was a return available to us by converting those units, but we just found that it was minimal and it didn't meet our hurdles for those kind of units. So we decided to permanently shut them down, which allows us, frankly, to stop spending money on the mothballing because mothballing does cost money. It costs money to keep those units ready and able to start back up.

So when we looked at the capacity market evolution from January into June, we saw significant reshaping of that market as the ISO did what I think was an exceptional job of really listening to the input from stakeholders. And what you really see there is—to make it simple—as you know, capacity and energy together needs to be about a $60 price for there to be a return on the capacity. When you look at the way the market shaped up, it now has pushed enough revenue into the capacity side to make the coal-to-gas units quite competitive in the marketplace. So what that does is it enables us now to start deciding which units we would invest in first.

So the team is looking across all the Sundance units and the Keephills units. We'll make decisions probably here in October about what are the first units to go. I think it's also important for you to know that as Tidewater comes on, we actually—the co-firing opportunity—and I think Brett talked about co-firing in his comments—but those comments shouldn't be lost on you. There's huge opportunity in that as Tidewater comes in before we've even converted to use gas in the mix and get our costs down because effectively it reduces the carbon tax bill.

So net net, all of that is to say that the capacity market has shaped up to have the right price signals for investing in capacity, it's got the right price signals we think now for all of those units to clear, and we don't have any plans to consolidate any further.

Mark Jarvi

Great. Thanks for the colour. And maybe I'll just last question around the carbon tax. Obviously at the federal level we're hearing much higher (phon) about it and revisions and softening. There're obviously differences between provincial policies and the federal, but wondering what you guys are thinking if it impacts at all your plans for conversion timelines? Or how you guys think about positioning your fleet (audio gap)?

Dawn Farrell

Yeah. I mean, I think so first of all, the announcements earlier this week by the federal government were directed at the tradeable sectors, so it was any sector that has to compete in the international market for business because of costs. So they did do some adjustment to the levels. They did not do any adjustment to the non-tradeable sector, which power belongs to, it turns out. We only sell into the local market, so so far we don't expect any changes on that front.

As we do our scenarios, a lot of the algorithms have to consider how the plants will dispatch in the energy market and really the cost of energy and the margins for energy. And as you know, as plants are dispatching up and down there's different heat rates involved, and they have to also consider the price of gas. And what we see is just the price of gas has come down so significantly that when you add together the dispatching requirements with gas, these units are much more flexible on gas and their capital costs are way lower, and so it costs a lot less to maintain them on gas.

So those are the kinds of considerations. Right now, we wouldn't see any change in our plans on the conversion side. About the only thing that we may—we do have to think about is if there was a change in the carbon tax—suddenly it wasn't there—our plants would have to—within the short run we'd want to start some of our units back up because they'd be more competitive than the existing gas plants that are running today. So there might be a short-term opportunity there, but long term this fleet is headed for gas.

Brett Gellner

And, Mark, the only other add is, remember the carbon's important—don't get us wrong—but there's other regulations that drive our decisions, like being able to run longer if we convert under the federal rules. If we stay in coal, we'd probably have to invest into SOx and NOx, whereas if we convert we do not; just the maintenance capital required on gas versus coal is quite different. So when we look at these decisions, there's a whole bunch of things that we look at.

Mark Jarvi

No, understood. Yeah. Appreciate those comments. Thank you.

Operator

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

Ben Pham — BMO

Thanks. I had a question on the commentary around share buybacks for that second half, and it sounds like you're being a bit more direct with how you see the pace of share buybacks versus last quarter, where I think you might have mentioned we want to get debt to a certain position and then consider share buybacks. Maybe that's more of a subtle change. But also since that time you've lost a CFO. So I guess my question really is is this pace of share buybacks, was this always in the game plan for Donald and the entire team? Or is this kind of a slight shift in how you guys think about things where debt is versus maybe where Donald was thinking about things?

Dawn Farrell

Yeah. So let me start by saying there's absolutely nothing different here today than there was under Donald. So the plan that Brett and I are presenting here today and where we're going is exactly what we all as a team agreed to and agreed with our board and have agreed with the credit rating agencies and all of the people that matter here. So there's no change from that.

I think what we said in the first quarter—and maybe we weren't as clear—is that we were going to be very prudent in the first quarter because any kind of share buyback that we do has to account for that we're going to reduce that final debt in 2020, and we have to have the cash to be able to do that. So it was really contingent on whether or not we were more optimistic about our cash flow forecast than less optimistic.

I think what you can take from what Brett and I have talked about today is that we're pretty optimistic about the cash flows. And we've been very clear about the cash flows being at the top end of the range, which does afford us a little bit more flexibility on buying back shares in the back half of this year.

So I think that's all you can take from it is we're optimistic about where the cash is at.

Ben Pham

Okay. That's great. And then Rob brought up a pretty interesting question on the hydro. And 47 million in the quarter, if you annualize that—maybe that's due to seasonality—I mean if the hydro can generate that much under the PPA then that generally bodes well for post-2021. What I'm curious about, though, is in past years, even during peak pricing, you've never really seen 47 million; maybe one or two quarters. So can you comment on maybe the ancillary market? Is it different now than it was before? Is it more a function of the megawatts being bigger or regional differences? And maybe just a bit more colour on any differences on ancillary for hydro?

Dawn Farrell

I don't actually think there's any—I mean, I'd have to go back and do some real research with our team to see if there's any real differences in the ancillary market, but in terms of my reviews I haven't seen a major shift there. I just think—and we said this all along and I think we've got to just get our messaging through—when you put a carbon tax into the market here, it reduces the amount of megawatt hours demanded by the coal fleet because it's got a higher cost structure, and it needs a higher price in order to clear in the market.

But what that also means is the hydro gets that margin into it. So I think it's just a reflection of just how the carbon price is starting to move through the market, and it does create more volatility, which hydro loves.

I think in terms of taking 47 and multiplying it by 4, remember, we get most of our water in the spring, and then we have a bit of storage that we can carry into the summer and the fall. And it's critical from a reliability perspective that we hold back water and have it there when the system needs it. So the hydro has always been a very valuable resource, but I don't think it's any change in the ancillary services market at all. I think it's probably more how pricing is being affected by compliance costs.

Ben Pham

Okay. All right. Thanks a lot, Dawn.

Operator

Again, if you would like to ask a question, please press *, and the number 1 on your telephone keypad.

Your next question comes from the line of Robert Kwan from RBC Capital Markets. Your line is open.

Robert Kwan — RBC Capital Markets

Maybe if I can just continue here on something hydro-related and any commentary you've got on the capacity market framework with respect to mitigation. And it looks like—I'm not sure if you agree—but it looks like actually a significant proportion of the market may be mitigated on capacity, but the energy seems to be a lot more promising. And if hydro is really kind of an energy and ancillary, is that actually kind of an upside for your hydro assets, just based on how that framework seems to be following?

Dawn Farrell

Yeah. And again, I think the important thing to look at for TransAlta is the fleet, right? So we've got the Sundance units; the Keephills units; we've got part of Sheerness, part of Genesee, and we've got the hydro. And when you put that in the big pot and you mix it all together and bake the cake, the combination of where we can get capacity, we see some assets get a lot of capacity revenue; we see other assets get a lot of energy revenue. The hydro actually gets both. It's a very, very strong asset because, A, it's got a low-cost base, as you know, depreciated assets over a long period of time; not a lot of sustaining capital is required for those assets.

So it's a great—it can basically be a capacity price taker and make good money in the capacity market. It gets a good UCAP in this market, so that's positive as well. And then of course, if it turns out that there's more revenue in the energy market, then hydro will pick that up and there might be a little less capacity revenue in some of the other assets.

But net net when we look at—when we model the full portfolio, I think the most important thing is you got a really good set of stable and reliable cash flows coming from the Alberta business.

Robert Kwan

Got it. And if I can also come back to the Sun 2 retirement decision. You fought pretty hard to get the ability to swap the years with Unit I, and you talked about kind of the age of the units, but I thought a lot of work and capital went into the plants when the boiler tubes failed. So I'm just kind of of wondering with all of that, how that factored into the decision? Or do you actually also see the capacity market when you model it out, it’s actually balancing that closely on an edge that taking that one unit out’s really going to help you right across the fleet?

Dawn Farrell

No. No. I mean, first, as you know, we fought not to have to put those water wells in, and we would have been just as happy to shut those units down in 2013. And if it were not for the way the PPA worked and the arbitration worked, and if we had been smart enough to come to a deal on that, those units wouldn’t have run past that time frame. So I think we didn’t have to fight that hard to move the years over to the unit. The government just gave us that ability to do it. It kept us with an option in the market as we were modelling. We thought that there would be one more unit that would clear into the capacity market, and in fact it does clear in the capacity market. It just didn’t meet our investment hurdles.

And so when it comes to we’ve told the market we’re really disciplined about allocating capital, I think we keep demonstrating that. And I just wasn’t prepared to put money into a marginal asset. So really, it was a decision we made on that asset on a stand-alone basis.

Robert Kwan

Got it. So this was more of a hurdle rate decision?

Dawn Farrell

Absolutely.

Robert Kwan

Okay. Got it. If I can just finish on Centralia, it looked like in the quarter there's some reference to major maintenance being done last year, and that's why the maintenance capital was down this year. So was there a turnaround take-in? Or has it been deferred? I guess specifically just as we're seeing Mid-C pricing quite strong, are the units running at pretty high rates in the third quarter?

Dawn Farrell

Well, we don't talk about the third quarter until we get through the third quarter, but yeah, the units—I mean, first of all, we spend less and more per year based on what the actual work is in the plants. And some of the maintenance, as you know, is time-based and some of it is condition-based, so when you look at any given year, what's behind it is a very strong technical plan that determines when you have to spend the money.

We also, of course, have to consider for Unit 1 that there's only a couple more years left on it, so we estimate the operating hours going forward and think about how to spend based on that. We always spend our money during the time when the units are dispatched off because of the hydro conditions, and this year was no different. And the units are operating well as we go through the quarter here.

Robert Kwan

Okay. That's great. Thank you.

Operator

Your next question comes from the line of David Quezada from Raymond James. Your line is open.

David Quezada — Raymond James

Thanks. Morning, everyone. I just had a quick question on the TransAlta Renewables side. I'm wondering if you have any new kind of high-level thoughts on the opportunity set for RNW? I know you've been active in the US and Canada via dropdown so far this year. And does the new—the now stronger balance sheet at the TA level maybe open up RNW more to do, I guess, direct transactions outside of the yieldco relationship?

Dawn Farrell

Yeah. So I would say, first of all, there's a massively strong balance sheet at TransAlta Renewables level, and of course that is a great currency. And we can also, if we really saw some huge growth opportunities, it's got a good currency if we wanted to expand it using equity. But for now what we see is, first of all, as I said earlier to somebody else, the acquisition market is super frothy and the valuations are super high, and they're not stuff that we like all that much, so we continue to look at a bunch of acquisitions, but for the most part they never meet our investment hurdles.

Where we see real value is in the market for more behind the fence cogeneration and sort of corporate clients that are looking for green in their portfolio. There's a huge demand coming from there. They tend to be—they're not big plays. They tend to be single, more like 80 million to $100 million. We've got the companies set up to be able to do quite a few of those a year, and frankly, they got better returns and they're the kind of returns that we want for that entity.

So as we look at renewables today, we see some really good stuff on the greenfield side. Now it takes a little bit longer to get those cash flows coming in, but that also allows us some good flexibility in terms of financing.

So TransAlta Renewables in itself is a strong entity for growing itself, and then of course—and I think that makes a big difference to where we go from here—

David Quezada

No, it's great colour. Thank you very much.

Operator

Your next question comes through the line of Chris Varcoe from the Calgary Herald. Your line is open.

Chris Varcoe — Calgary Herald

Hi. This is a question for Dawn. Just to follow up on your comments earlier, wondered if you could just give us a little more colour about what would happen if the carbon tax was removed either in Alberta or across Canada, would you slow down or alter your plans at all on the conversions of the coal plants? I'm just wondering whether you would change your strategy at all?

Dawn Farrell

Yeah. I can't really speculate on all the things that could change, but here's my perspective on how I look at it. So we've done enormous research on what customers want from us as a power company, and remember, TransAlta doesn't really sell into … we don't sell to the homes. We're not a retailer. We sell either to the wholesale market or to large industrial and commercial customers with big, big loads. And our research shows that despite what's going on in any sort of political environment—you've got one side that wants the carbon tax and the other side that doesn't and you've got all sorts of stuff in between—what the corporate customers, our corporate clients want from us is low-cost, green, and reliable and firm power. And what they're telling us today is they would like to have their portfolios weighted more heavily to renewables, and over time they'd like to get 100 percent to renewables. And they'd really like to get us to be investing in storage, particularly batteries. So if they had their preference, they would be picking renewables with batteries.

So when we stand back from it and we look at the demand for power and we look at the people who buy power and the purchasing departments, they want low cost and green. And it turns out that the price of green has come down significantly, so we can actually provide them with that, and that's where we're focusing.

So our future focus is all about firming up green, and we'll do that with gas. Over time, we'll be investing in more batteries and storage to firm it up. And it's really to meet that demand because that's where we see the demand coming from, which basically says whatever the policy environment is, we think that the way to go is gas and renewables.

Chris Varcoe

So would you change at all the timing of the conversion? I guess I'm just really wondering more on the conversion issues whether that would change or skew the way you look at the timing of those plants being converted to gas?

Dawn Farrell

I mean, today when we look at gas prices and the reduced maintenance cost and the dispatchability of these items and the flexibility they bring to the market, it shows that we wouldn't change the timing. We're not spending a lot of time running any scenarios because at the end of the day what we've proven is whenever the policy changes, we can adapt very quickly to that, and our fleet is valuable across all scenarios. So today we wouldn't. And we'll wait and see.

And if things change, we might make some changes in the future. But generally, when you look at our fleet overall, long term we want to be clean by 2025.

Chris Varcoe

Okay. And lastly just a little off topic here, but could you give us your outlook on how you see the Alberta electricity market and the prices in the second half of this year and into 2019?

Dawn Farrell

I mean, I think the market is stronger than people thought it would be. We certainly—if you looked at the chart that Brett put up there, it's a great chart because it shows you that demand has grew even through a recession and has continued to grow, which helps with the stronger pricing. So, I mean, my call would be the pricing.

I think if you look in the forward market—Brett's got those numbers—it's as solid as it was in the second quarter here. But maybe, Brett, you can give him a sense of the pricing?

Brett Gellner

Yeah. I mean, the forward outlook right now is for Q3 and Q4, Chris, is kind of in that 63 to 57 in Q4, so not too far … a bit above Q2. Q2 was around 56, just to give you a sense. But I think it's important too, if you look at that chart that we did put up there and you go back a few years, I mean, we saw prices in that range and even higher at some points. So—

Dawn Farrell

Yeah.

Brett Gellner

—the prices now have a carbon price as well in it, but they're not—they're good prices, but still competitive and provide low-cost power.

Chris Varcoe

Thank you.

Operator

There are no further questions at this time. Ms. Sally Taylor, I turn the call back over to you.

Dawn Farrell

There actually is a question that we can take.

Operator

Okay. My apologies. The next question comes from the line of Mitchell Moss from Lord Abbott. Your line is open.

Mitchell Moss — Lord Abbott

Thanks for the call. I just wanted to first ask, in Q1 you guys had a capital structure FFO to net tab—or slide. Are you—the slide's not in there, but do you guys still believe that—are you still targeting the 20 to 25 percent FFO to debt for 2018 to 2020 in the 25 to 30 percent post-2020 FFO to debt?

Brett Gellner

Yeah. And our targets haven't changed. And if you go to our segmented—or our MD&A, you'll see those detailed calculations, if you want. Yeah. We didn't present that—

Dawn Farrell

Yeah.

Brett Gellner

—here today, but certainly nothing's changed from that.

Dawn Farrell

Yeah. Our numbers are up to 21 percent about, and we are still targeting at exactly the same range.

Mitchell Moss

Okay. Great. And you mentioned, I think, October is when you start to make decisions about the coal-to-gas switch. When do you see CapEx spending for those decisions to start to ramp up?

Brett Gellner

Yeah. So as we've communicated—sorry?

Dawn Farrell

Yeah. Go ahead.

Brett Gellner

Yeah. So as we've talked about in the past, we're still kind of in that 2021 start period for some of the conversions. So we expect to spend a little bit of money prior to that, but most of it will be starting in that 2021 period. Some of it could slip into the 2020 period, but it's not significant dollars, given the low cost per unit.

Mitchell Moss

Okay. So—

Dawn Farrell

Remember, it's about … it's between 40 million and $50 million a boiler, so we would start having to procure our equipment in that 2019 period, depending on how many we do at once.

Mitchell Moss

Okay. And I guess within the expectations of retiring—of meeting FFO to debt and also retiring your 2020 maturity you also factored in some level of spend for the boilers basically, I guess, starting in—

Dawn Farrell

Yeah.

Mitchell Moss

—2019?

Brett Gellner

Yeah. Yeah. Yeah. Yeah. Obviously, you run different scenarios depending on market prices and a whole bunch of factors, but given we've already repaid the '19's in advance, we're very confident our target—and those are late 2020's—so lots of free cash flow is going to be generated from here to there.

Dawn Farrell

Yeah. Remember that. So before today, we had 800 million due November 2019 and November 2020. We now have extinguished the November 2019. We've got all the way 'til 2020. And Brett showed you where our balance sheet is compared to our peers, so we've got a lot of flexibility here.

And so depending on where the cash flows are, we've accounted for that kind of spending as we go forward. So we're in a really good position.

Mitchell Moss

Okay. Great. Thank you very much.

Operator

There are no further questions at this time. Ms. Sally Taylor, I turn the call back over to you.

Sally Taylor

Thank you, Christine, and thanks, everyone, for joining us this morning. Please don't hesitate to give me a call if you have further questions.

Operator

This concludes today's conference call. You may now disconnect.

*****