

May 13, 2016 – 1:00 p.m. E.T.  
Valener Inc. Q2 2016 Results



**Valener Inc.**

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**Event Date/Time: May 13, 2016 - 1:00 p.m. E.T.**

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## **CORPORATE PARTICIPANTS**

**Sophie Brochu**

*Gaz Métro – President and Chief Executive Officer*

**Pierre Despars**

*Gaz Métro – Executive Vice President, Corporate Affairs and Chief Financial Officer*

**Mariem Elsayed**

*Gaz Métro – Senior Advisor, Investor Relations*

## **CONFERENCE CALL PARTICIPANTS**

**Ben Pham**

*BMO Capital Markets – Analyst*

**Robert Kwan**

*RBC Capital Markets – Analyst*

## **PRESENTATION**

**Operator**

Good afternoon and welcome to Valener's Second Quarter 2016 Earnings Conference Call. At this time all participants are in a listen-only mode. Following the presentation we will conduct a question and answer session. Instructions will be provided at that time for you to queue up for questions.

If anyone has any difficulties hearing the conference, please press star followed by zero for operator assistance at any time.

Please note that this call is being recorded today, Friday, May 13, 2016 at one o'clock Eastern Daylight Time.

I will now turn the call to Ms. Mariem Elsayed, Senior Advisor, Investor Relations. Please go ahead, Ms. Elsayed.

**Mariem Elsayed, Senior Advisor, Investor Relations**

Thank you, Sarah. Good afternoon and welcome to Valener's second quarter 2016 conference call. With me today from Gaz Métro are Sophie Brochu, President and Chief Executive Officer, and Pierre Despars, Executive Vice President, Corporate Affairs and Chief Financial Officer.

This call is being webcast and I encourage you to download the supporting slides, which are available in the investor section of Valener's website under events and presentations.

As always, certain subjects we will cover involve forward-looking information. Please refer to the cautionary note section, which can be found on the second page of our presentation, as well as in our quarterly MD&A, which was published earlier today and is available on our website and on SEDAR.

We may also refer to certain indicators that are non U.S. GAAP financial measures and should not be considered in isolation or as substitutes for other performance measures that are in accordance with GAAP.

I will now turn the call over to Sophie.

**Sophie Brochu, President & Chief Executive Officer, Gaz Métro**

Merci, Mariem. Bonjour à tous. Good afternoon, everyone.

In the second quarter of 2016 Valener generated adjusted net income of \$32.4 million, unchanged from the second quarter of 2015. While Gaz Métro benefitted from better results compared to last year, the Seigneurie de Beauré wind farms experienced less favourable wind conditions. Overall these two trends offset one another, explaining the relative stability year over year. For the first six months the net income attributable to common shareholders was \$48.9 million, up 2 percent compared to prior year period. Adjusted net income per share was \$0.84 for the second quarter of 2016 compared to \$0.85 the year before. This is due to the greater number of shares outstanding resulting from the success and the increased participation in the company's dividend reinvestment plan. After six months it's an improvement of \$0.01 per share as the improved results in Gaz Métro more than offset the lower wind impact and the dilutive effect of the DRIP.

On the cash flow front there is a little timing noise. Valener generated normalized operating cash flows of \$11.3 million in the quarter ended last March, down \$4.5 million from the year ago period. Normalized operating cash flows per common share were \$0.29 compared to \$0.41 per share in the prior year period. This is mainly due to the timing of a Seigneurie de Beaupré distribution. In the second quarter of last year a \$4.7 million distribution was made to Valener. This year's corresponding distribution is expected to occur in the second half of the year. This timing difference was partly offset by an increase in distribution received from Gaz Métro following Valener's subscription of almost 4.5 million Gaz Métro unit in the second half of 2015. And, as you know Gaz Métro also raised its quarterly distributions by \$0.01 per unit in late 2015.

On to Gaz Métro itself on slide 5, excluding non-recurring items Gaz Métro generated net income of \$140.5 million during the second quarter, an increase of 4 percent compared to last year. The higher net income was driven by the positive impact of the appreciation of the U.S. dollar on our U.S. operations, growth in the Gaz Métro-QDA non-rate base investments and a timing difference between the recognition of sales and expenses in Gaz Métro-QDA. This was partly offset by lower power sales at Green Mountain Power as a result of this winter's very warm weather. Yet, despite these adverse weather conditions, Gaz Métro results are stronger year over year.

Now on a per unit basis the net income was \$0.84 for the second quarter of 2016 and a \$1.28 for the first six months of 2016. This is down from \$0.90 in the second quarter of last year and a \$1.35 for the first six months of 2015. Higher net income was more than offset by a greater number of units outstanding following the issuance of 15.5 million units in the second half of last year. That said, we expect that by the end of fiscal 2016 Gaz Métro's net income per unit excluding non-recurring items will revert back to fiscal 2015 levels.

Let me now walk you through where we are with our latest projects, on to slide 6. As you will see, we are relentless in the pursuit and execution of our diversification strategy, both operational and geographical, and you know what? It's paying off. In Montréal we are making great progress on the expansion work to triple the gas liquefaction capacity of our LSR plant. This summer we will be going full speed ahead with over 200 workers on site with, as always, safety and security as our top priority. Upon completion our facility we'll have a liquefaction capacity of 9 Bcf per year. Although the plant is currently in operation and already shipping LNG to clients as far as the Northeastern United States and to remote communities in Québec, we expect the final commissioning to take place sometime in late 2016.

In Vermont, the first segment of the Addison project was completed and gassed up in February. The second segment of construction, consisting of putting an additional 49 kilometres of pipelines in the ground, is now under way. We expect work to be finished by the end of this calendar year.

In Bellechasse, Québec construction work to increase the distribution network by 72 kilometers is expected to begin in the spring. For Asbestos, we obtained project approval from the Régie in March and we expect fieldwork to start in the second half of 2016. We expect both of these development projects to be completed by the end of this year.

Now next month in the Saguenay region we will begin major work to improve and strengthen the transmission network to ensure reliable gas supply to our customers over the next ten years. We'll be building a new compression station in La Tuque and upgrading the existing station in Saint-Maurice. The project is valued at about \$80 million and work will take through 18 months to complete.

Our focus on promoting greener energies is unwavering and we've voiced this on numerous occasions. Last quarter we shared with you and highlighted some of the outcomes of last December's UN Conference on Climate Change in Paris, including how natural gas and Gaz Métro would be part of the solution in helping to achieve Québec's future energy transition. And just a few short months later, last April, the province of Québec released its Energy Policy 2030, confirming the role of natural gas and Gaz Métro. Gaz Métro indeed has shared the province's vision for a while now and even with renewable energy. Ten years ago it was clear to us that growing the company responsibly and sustainably meant that diversifying our portfolio by investing in renewable and cleaner energies was an avenue that we have to explore. A decade, tens of millions of dollars, and numerous partnerships later, we're extremely happy and proud to count wind energy and LNG as a part of our Québec energy bouquet.

We look at innovative options every day to better our energy mix. To this effect, for instance, our affiliate, Vermont Gas, recently announced that by the end of 2016 it would start distributing renewable natural gas generated from out-of-state sources. VGS is already planning to later supplement its network with additional RNG produced locally from agricultural residues from local farms. With these initiatives VGS will become one of the first utilities in the United States to offer renewable natural gas to its customers. Indeed, small is beautiful.

And just last week Green Mountain Power began customer installation of its Tesla Powerwall home battery, a battery that empowers customers to become more energy independent by storing power for use during outages. When paired with rooftop solar, customers can generate and store their own energy, increasing reliability and the production of clean power. The Powerwall should also allow GMP to reduce peak demand on the system, providing cost savings to all customers. We are proud to say that the GMP is the first utility in the United States to install the Powerwall for its customers.

Tomorrow's greener energies are what we are already implementing today. I will now turn the call over to Pierre, who will walk you through segment performance as well as the recently announced refinancing of our wind farms. Pierre?

**Pierre Despars, Executive Vice President, Corporate Affairs & Chief Financial Officer, Gaz Métro**

Thank you. Sophie.

On to slide 8, Gaz Métro generated net income of \$140.5 million during the second quarter of 2016, a \$4.9 million increase or 4 percent over the second quarter of last year, and for the six months ended March 31st Gaz Métro generated net income excluding non-recurring items of \$215.8 million, a 6 percent increase from the prior year period.

And now on to slide 9 where we'll review segment performance. The energy distribution segment generated net income excluding non-recurring items of \$133.4 million during the second quarter of fiscal 2016, up \$5.4 million or 4 percent from the second quarter of last year. Natural gas distribution in Québec generated net income of \$112.9 million, up \$7.2 million from the second quarter of fiscal 2015 mainly as a result of an increase in capitalized interest in non-rate base investments and a timing difference between revenue and cost recognition, part of which is expected to reverse by the end of fiscal 2016, as provided for in the 2016 rate case. Note that in Gaz Métro-QDA we have more than made up for the lag from the first quarter and we continue to expect that we will finish the year with approximately \$124 million of net income.

Turning to slide 10, Green Mountain Power and Vermont Gas generated a combined net income of \$20.5 million during the second quarter, down \$1.8 million from last year. While the stronger U.S. dollar and the increase in GMP's average rate base both had a favourable effect on earnings, these were more than offset by the lower power sales at Green Mountain Power, mainly in the residential market, as a result of warmer weather,

and the unfavourable effect of no longer capitalizing allowance for funds used during construction or the AFUDC related to the Addison project as it is likely that we will use a portion of the contingency built into the project. The allowed rate of return on future construction cost will therefore not be part of the authorized rate base upon completion of the project. The natural gas transportation segment generated net income of \$7.4 million during the second quarter, up \$800,000 or 12 percent compared to the same period last year, driven primarily by a provision recorded by PNGTS in the second quarter of last year following a rate decision by the FERC and the favourable effect of the stronger U.S. dollar. This was partly offset by the lower sales as a result of warmer weather this winter.

On to slide 11, in power production we generated net income of \$1.5 million during the second quarter, down \$600,000 for the year ago period mainly due to less favourable wind conditions, as Sophie mentioned earlier. The energy services storage and other segment generated net income of \$900,000 in Q2, up \$500,000 from the prior year period largely as a result of a marked increase in LNG sales. We shipped close to 4 million cubic metres more than that in the second quarter of last year, nearly doubling our shipments, mostly from short term contracts.

Through the first six months of fiscal 2016 Gaz Métro invested \$207 million in power, plant, and equipment with further investments to come in all our business segments, notably for the Addison expansion project in Vermont, capacity expansion at our LSR plant in Montréal, and improvement to our Québec network mainly in the Saguenay region. We remain on track to deploy approximately \$485 million in CapEx by the end of fiscal 2016, as previously guided. On March 31st Valener amended the terms of its credit facility, pushing its maturity out to March 2021. This is a six-month extension from the previous term. All other terms remain the same.

Just last week Valener and Gaz Métro, together with our partner Boralex, announced the \$617 million non-recourse refinancing of the Seigneurie de Beaupré Wind Farm 2 and 3. The refinancing provided the partnership with an additional \$132 million in funds as well as lowering its overall interest rate. These funds were used to repay a portion of the covered tranche of the loan, cover up-front fees and transaction costs, and finally pay out an \$80 million special distribution to the partners proportionately to their respective share in the venture. Gaz Métro received \$20.4 million that it has used to pay down debt and Valener received \$19.6 million that it will use to pay down a part of its credit facility. This distribution provides Valener with added flexibility to pursue its strategy of supporting Gaz Métro's growth.

We are pleased that we are able to take advantage of improved market conditions to capitalize on better rates and ultimately pay a special distribution to the partners. Furthermore, we continue to expect that over the life of the project Valener will receive an average of \$8 million in annual distributions from the combined Seigneurie de Beaupré wind farms.

That concludes the call. Operator, we will now open the line to questions.

## **QUESTION AND ANSWER SESSION**

### **Operator**

At this time I would like to invite everyone in order to ask a question press star followed by the number one 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 Ben Pham from BMO. Your line is open.

### **Ben Pham, BMO Capital Markets**

Thanks. Good afternoon. I wanted to clarify the \$8 million distributions from Seigneurie, you know, sometimes you lever up the asset and the cash flows possibly could drop on the front end. Is that the case with this or is your distributions the same as it was before but you're effectively taking out some cash from the asset and using that for other alternatives?

### **Pierre Despars, Executive Vice President, Corporate Affairs & Chief Financial Officer, Gaz Métro**

The simple answer is that we will maintain the number that we've provided to you in terms of forecasts, so that's \$8 million, and it's based on the review of the wind regime that we have based on the actual wind measured that we've made since we are in operation. So based on the fact that we have been able to refinance a better rate with the revised wind regime we're comfortable that we will be able to maintain that level of distribution.

### **Ben Pham, BMO Capital Markets**

Okay. So no change there, okay, I just wanted to check that. And then the other question I had is on the distribution that you're getting, the \$40 million amongst, I guess, the two. So is that more you getting your debt down to a level that you need to get down to, or are

you basically paying down your credit facility in a near term, maybe you could use that cash for additional investments instead but haven't made a decision on that yet.

**Pierre Despars, Executive Vice President, Corporate Affairs & Chief Financial Officer, Gaz Métro**

At Valener we want to be in a position where they can invest in Gaz Métro's growth and in those future investments, so that will reduce the debt level and that will provide a lot of flexibility to Valener to support the future growth or the future investment that may come in the coming months or years. And so contribute to capital contribution to Gaz Métro.

**Ben Pham, BMO Capital Markets**

Okay. And just a last quick one for me to check, in Gaz Métro, the ROE, 8.9, percent, is that locked in through 2017 then? I'm just looking at one of your slides. And do you perhaps see some pressure on that later on with the bond yields being pretty well in Canada and some of the provincial regulators have really trimmed down their ROEs over the years.

**Pierre Despars, Executive Vice President, Corporate Affairs & Chief Financial Officer, Gaz Métro**

So in Gaz Métro-QDA, so natural gas distribution in Québec, we're operating under, I will say, a simplified approach for the establishment of the rate case, and we already had a decision for 2017 where the rate of return on a common share will be 8.9 percent. So this has already been established for 2017.

**Ben Pham, BMO Capital Markets**

And you're sensing that, you know, (inaudible) interest rates rise but the next you think 18 or 19, or do feel that the regulator, the 8.9 is a good level for now to maintain your credit metrics and your access to capital? Is that more the former or the latter?

**Pierre Despars, Executive Vice President, Corporate Affairs & Chief Financial Officer, Gaz Métro**

It's difficult for me to second guess what could be the decision of the Board but we're in a context where the interest rate did not fluctuate a lot since they issued their last decision on the rate of return. So if you look at what was the risk free rate, what has been their

decision, we're in a similar situation at this point. So I cannot speculate on what will be the rate of return but we're in the same kind of interest rate environment.

**Ben Pham, BMO Capital Markets**

Okay, that's it for me. Thanks. Thanks, everybody.

**Operator**

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

**Robert Kwan, RBC Capital Markets**

Great. Thank you very much. Just specific to the quarter, when you look at all of your businesses, obviously we had a very warm winter, do you've an estimate as to what the weather impact was across the board?

**Pierre Despars, Executive Vice President, Corporate Affairs & Chief Financial Officer, Gaz Métro**

It's difficult to say because we are weather normalized in Québec, so a good chunk of it has been weather normalized, and it's the same case for Gaz Métro in Québec and Vermont Gas. It's mainly at VGS level and there's a lot of element in there where we've seen more throughput on the residential and commercial market but not due to the weather. It's difficult for me to answer you specifically on the weather impact at Green Mountain Power level.

**Sophie Brochu, President & Chief Executive Officer, Gaz Métro**

Robert, just maybe to provide you a little colour, it gets to a point where when we put all together variation of, variation of demand because of efficiency, when we put together weather patterns, there is a little noise there that becomes to be a little difficult to decipher. Obviously the weather was extremely warm in the winter. April has been and March has been, ah, April and May are proving to be cold. So there is a little bit of movement there that is difficult to decipher. So it's not to avoid your question but there is an extent to which you can precisely modelize every degree days.

**Robert Kwan, RBC Capital Markets**

Fair enough. As I look at QDA, I guess what you put up for the quarter though was better than what you had presented earlier. Now you mentioned that you expect some of this to reverse. I guess was there any amount of margin though that you earned but maybe didn't book during the quarter? I know you guided to the 124 for the year but I'm just wondering are you, are there certain aspects where you're running better than expected?

**Pierre Despars, Executive Vice President, Corporate Affairs & Chief Financial Officer, Gaz Métro**

The \$124 million is in the QDA's activities and we were trailing behind the first quarter. We put in place a plan where we'll address, we will reduce expenses. It pays off in the second quarter. And we're also working on improving sales mainly on the large industrial side of the operation.

So we're comfortable saying that we will achieve that \$124 million. Will we be able to maintain all of that advance that we after the second quarter? I can't tell at this point but we're very comfortable with the \$124 million that we forecast.

**Robert Kwan, RBC Capital Markets**

Okay, that's great. And maybe just last on the greenfield side, you obviously have great sights in Québec, can you talk about some of, on the wind side outside of that? Are there other sites that you've got, whether that's in Québec or outside of Québec, and what your expected future development might be as it relates to the schedule of RFPs?

**Sophie Brochu, President & Chief Executive Officer, Gaz Métro**

Well, what I can say, Robert, is that we stay ahead of possibilities. We look at many possibilities. As you know, the Seigneurie de Beaupré wind farms are very large grounds. There is still room over there. We remain open at exploring various possibilities. None of them we can comment further on at this point of time but we look at every stone and we turn them on and we take hard looks.

**Robert Kwan, RBC Capital Markets**

And I guess outside of that, the Seigneurie sites, are there sites that you hold, whether that's in Québec or outside of Québec?

**Sophie Brochu, President & Chief Executive Officer, Gaz Métro**

No. No, we don't. No, we don't hold sites. We have quite a bit of land but those are not lands that we would put turbines on. No, no, not at this point in time. .

**Robert Kwan, RBC Capital Markets**

And then just on the Seigneurie sites with some of RFPs that have cleared, obviously it comes down to price but there's other factors there. What's your sense as to... Was it just the wind regime at the sites versus where others were or do you think there's any technical factors with respect to the remaining land that you've got that's causing a problem in terms of winning some of the RFPs that have cleared?

**Sophie Brochu, President & Chief Executive Officer, Gaz Métro**

No. I would say it's a matter of philosophy and we are in the business of making money and we try to choose the best project overall that can get the return that we are hoping for. We still believe that we have an exceptional site but they are returns at which some people are willing to go that we are not willing to go and we would rather be patient than investing money that does not clear the rate of return that we are shooting for.

**Robert Kwan, RBC Capital Markets**

That's not a bad thing. Okay. Thank you very much.

**Operator**

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

**Pierre Despars, Executive Vice President, Corporate Affairs & Chief Financial Officer, Gaz Métro**

Thank you very much for being with us this afternoon. See you next quarter.

**Sophie Brochu, President & Chief Executive Officer, Gaz Métro**

Have a great weekend. Ciao.

**Operator**

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