

August 9, 2017 – 1:00 p.m. E.T.
Valener Inc. Q3 2017 Results



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Event Date/Time: August 9, 2017 - 1:00 p.m. E.T.

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PRESENTATION

Operator

Good afternoon and welcome to Valener's Third Quarter 2017 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, Wednesday, August 9, 2017 at one o'clock Eastern Daylight Time.

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

Mariem Elsayed, Senior Advisor, Investor Relations

Thank you, Ruth. Good morning and welcome to Valener's third quarter 2017 conference call.

With me today from Gaz Métro are Sophie Brochu, President and Chief Executive Officer, and Pierre Despars, Senior Vice President, Corporate Affairs and Chief Financial Officer, both acting as managers of Valener.

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 that was published earlier today and is available on our website and on SEDAR.

We may also refer to certain indicators that are non US 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 and good day, everyone.

Today I am pleased to announce that Gaz Métro will be raising its quarterly distributions to its partners from \$0.29 per unit to \$0.30 per unit as of this coming October. The second distribution increase in two years is a direct result of the performance of our core regulated activities and the success of our growth initiatives. Accordingly, Valener will see the distribution it receives from Gaz Métro increase by approximately \$0.5 million per quarter. This is extra cash that it can then return to its own shareholders. As such, and in line with the extension of the 4% dividend CAGR announced on our last call, Valener will be increasing its quarterly dividend on common shares from \$0.28 per share to \$0.29 per share as of October. This will be Valener's fourth dividend increase in three years and the first increase since the announcement of the extension of the growth target through 2022. With high-quality underlying assets generating growing and predictable returns, counting on the pipeline of innovative projects and benefitting from a highly skilled and empowered team, Gaz Métro and Valener are both very well positioned to deliver value to their partners and shareholders.

Now, let's turn over to Valener's third quarter performance. I am now on slide four. Valener generated adjusted net income of \$2.5 million during the third quarter, up \$800,000 from the same period last year. Adjusted net income per share was \$0.06, up from \$0.04 in the third quarter of 2016 as both Gaz Métro and the Seigneurie de Beaupré wind farms recorded stronger year-over-year earnings. Normalized operating cash flow for the third quarter was \$14.4 million, a \$500,000 improvement from the third quarter of last year. That's \$0.37 per share, up \$0.01 per share compared to Q3 of last year.

On to slide five, Gaz Métro generated net income of \$11.1 million during the third quarter, up \$1.3 million or 13% from last year. The third quarter is a seasonally softer

quarter, mainly as a result of warmer weather. Nonetheless, the company continued to deliver solid results. Pierre will explain what drove these results when he walks you through Gaz Métro's segment results in a few minutes.

Let's now go through some of the more recent developments at Gaz Métro. Last April we completed the acquisition of Standard Solar, a leading US-based solar energy firm specializing in the development, installation, operation, and maintenance of commercial solar electric systems across the United States. Since then we have been focusing on drumming up business. We expect that Standard Solar will have its first 20 megawatts of capacity under construction by September 30th.

In May, after obtaining the remaining regulatory approvals, Green Mountain Power completed its acquisition of the hydroelectric power plant from Enel. The 12 power plants are located mainly in the New England area, have a total capacity of 14 megawatts, and were acquired for US\$16.3 million. And in Montréal we completed the construction and installation of the second liquefaction train designed to triple production capacity at our natural gas liquefaction, storage, and re-gasification plant. The new infrastructure is quite unique and is now in service and equipped to produce over 9 Bcf of LNG annually.

I'm now on slide six. Just two weeks ago in response to a request for proposal issued by the state of the Massachusetts for the supply of renewable energy, Gaz Métro and Boralex jointly submitted, together with Hydro-Québec, three separate proposals to supply the state with 1,000 megawatts of energy, of which 300 megawatts is to come from SBx Project firmed up by Hydro-Québec. Should our bid be successful, SBx would consist of the fourth phase of the Seigneurie de Beaupré wind farms and would be entirely developed, financed, built, and operated by Boralex and Gaz Métro, bringing SDB's total installed capacity to over 600 megawatts.

Northeastern states have adopted ambitious renewable energy targets and instituted regulatory requirements that favour wind power, which makes this market very appealing. Our bid will not only help Massachusetts achieve its goal in fighting climate change, it would also generate significant direct and indirect economic benefits in the region of Québec. Massachusetts is expected to announce selected projects at the beginning of 2018. Gaz Métro is thrilled at the possibility of expanding its partnership with Boralex yet again and in working with Massachusetts to foster a new relationship and to supply it with clean, stable, and sustainable energy well into the future.

We have said time and time again that renewable energy is something that we deeply believe in. We've been talking about our partnership with the City of Saint-Hyacinthe to inject our distribution network with renewable natural gas for a while now. The infrastructure required to connect the city's renewable energy output to our network is ready and we should begin injecting it with RNG very soon.

On another front, as of May, an LNG supply solution for marine fuel is now available at the Port of Montréal. Groupe Desgagnés, the Port of Montréal, and Gaz Métro joined efforts to develop an LNG supply system that is now being operated by Gaz Métro. The port is now LNG ready and the system is available to all ship owners in Québec, including the fleets passing through the Port of Montréal. This is an important milestone for the entire maritime transport sector as well as our own LNG development.

And finally in July, as part of its 2030 energy policy, the Québec government announced that it would provide financial assistance of up to \$27.4 million in order to carry out three distribution network extension projects. The government's contribution will allow us to connect the municipalities of Saint-Éphrem, Saint-Marc, located in the Portneuf regional county municipality, and different areas of the Appalaches regional county municipality. These extensions will add over 50 kilometres of pipeline to our distribution network in Québec.

I will now turn the call over to Pierre, who will walk you through segment performance.

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

Thank you, Sophie.

On to slide seven. Gaz Métro generated net income of \$11.1 million during the third quarter, up \$1.3 million or 13% from the third quarter of last year. As a result of stronger results, on a per-unit basis net income for the quarter was \$0.06, unchanged from the third quarter of last year, despite the 4.5 million units issued at the end of March. The energy distribution segment was the driving force behind the company's solid performance this quarter. The segment generated adjusted net income of \$11.9 million during the quarter compared to \$7.9 million in the same quarter of last year, up \$4 million or 51% increase.

As you'll see on slide eight, natural gas distribution in Québec recorded a net loss of \$500,000 during this typically warmer quarter. This is an improvement of \$3.1 million over last year as a result of growing returns on investments and the favourable impact of Gaz Métro's \$2.1 million share of overearnings recorded during the third quarter. Year to date we have recorded \$4.9 million of overearnings for Gaz Métro QDA and, as a result, we now expect to end the year about \$5 million above the \$136.3 million of net income prescribed for in the rate case.

Turning to slide nine, Gaz Métro's Vermont operations generated adjusted net income of \$12.4 million during the third quarter, up 8% from last year's \$11.5 million. The weaker Canadian dollar had a positive effect on earnings during the third quarter, as did the increase in Green Mountain Power's average rate base. The segment's results were partly offset by a timing difference between the recognition of sales and expenses. On an unadjusted basis, the Vermont operations recorded a net loss of \$5 million during the third quarter of last year as a result of the \$16.5 million impairment on non-current assets related to the VGS Addison project.

In natural gas transportation we generated \$1.9 million of net income during the quarter, down from \$3 million in the same quarter of last year. The decrease stemmed mainly from the lower short-term volumes transported by PNGTS, a 500 kilometre pipeline in which Gaz Métro has 38.3% interest that runs from the Québec border to the suburbs of Boston, and a make-whole payment related to the early extinguishment of TQM's \$100 million debt as part of a refinancing.

In electricity production on slide 10, we recorded a \$700,000 net loss during the quarter compared to \$200,000 net loss in the third quarter of 2016. Stronger winds and greater

power production at the Seigneurie de Beaupré wind farms resulted in higher operating cash flows and higher distributions paid compared to the third quarter of last year. In total, the wind farms paid out \$10.3 million in distribution to the partners, compared to \$9 million in the third quarter of last year. Stronger results at SDB were offset by business development cuts at Standard Solar as we continued to focus our efforts on implementing a new business model. We expect that Standard Solar will have its first 20 megawatts of capacity under construction by the end of the fiscal year, of which half was already under construction as of the end of the third quarter.

In energy services, storage and other we generated net income of \$600,000 during the third quarter, down from \$1.4 million in the third quarter of last year. With the production capacity at our LSR plant in Montréal now tripled, we shipped 24.7 million cubic metres of LNG this quarter. That's more than double what we shipped last year. Note that as of April 24th, the official in-service date of the site's second liquefaction train, we are now reflecting 58% of the facility's LNG results in our financial statements as opposed to 100% as was previously the case. This reflects our interest in these activities as our partner, Investissement Québec, now owns the remaining 42%. The segment was negatively impacted by higher financing costs during the third quarter of this year as a result of our growth in activities.

Onto slide 11, Gaz Métro invested almost \$380 million in CapEx during the first nine months of the year, of which \$126 million was spent during the third quarter. The third quarter's capital expenditure included investments in the LSR facility to complete its capacity expansion, investments in Standard Solar toward the development of solar parcs, as well as the usual maintenance capital expenditures. We continue to expect that we will deploy approximately \$510 million by the end of the fiscal year. Gaz Métro, Green Mountain Power, and TQM each raised funds during the third quarter. In May, Gaz Métro completed a private placement of \$200 million first mortgage bonds. The bonds bear interest at the rate of 3.53% per year and will mature in 2047. The proceeds were used to repay existing indebtedness and for general corporate purposes. Green Mountain Power completed two private placements of mortgage bonds in April and June for US\$15 and US\$65 million. These bonds bear interest at 4.17% and 3.45% and will mature in 2047 and 2029, respectively. Finally, TQM proceeded to the early extinguishment of a \$100 million debt bearing interest at 4.25% and maturing this year and refinanced it with a new debt at 2.57% and maturing in 2021.

Clearly, this was another strong quarter. The gradual yet concrete realization of our growth initiatives is taking shape and it has already started delivering value. Gaz Métro's philosophy is and has always been to distribute a large portion of its adjusted net income to its partners, which includes Valener. To that effect, as Sophie mentioned at the start of the call, Gaz Métro is increasing its quarterly distribution to partners from \$0.29 per unit to \$0.30 per unit as of October, thereby continuing to ensure that Valener can rely on a predictable stream of distributions from its main investment. And while Valener's strategy is to maintain its financial flexibility, its objective is to pay out a majority of its cash flows to its shareholders. As such, and in line with the extension of the 4% dividend CAGR on common dividends announced last quarter, Valener is raising its dividend from \$0.28 per share to 0.29 per share.

Finally, before closing the call I'd like to remind you that Valener currently has four million Series A preferred shares outstanding which have a redemption option coming up on October 15th. Based on the conditions applicable we have determined that it is not in

our best interest to exercise the redemption option in October. Accordingly, shareholders of Series A preferred shares will have the option on October 15th to convert part or all of their shares into an equal number of Series B preferred shares. Series A shareholders who do not convert to Series B shares will be granted a new option to convert on October 15, 2022 and then again every five years after that. The Series A preferred shares have a fixed rate dividend for a period of five years and corresponding to the rate applicable to a five-year Government of Canada bond plus 2.81%. This rate will be set on September of 15, 2017 for five years starting October 15th. Series B preferred shares will have a floating rate dividend corresponding to the average annual return on 90-day Government of Canada bond plus 2.81%. This rate will also be calculated on September 15th for the period starting October 15 of the same year and the dividend payable January 15, 2018 and will be calculated quarterly thereafter.

So that concludes the call, operator. We will now open the line for questions.

QUESTION AND ANSWER SESSION

Operator

At this time, if you would like to ask a question, press star followed by the number one on your telephone keypad. We'll pause for a moment to compile the Q&A roster. Your first question comes from Avery Haw with TD Securities. Please go ahead.

Avery Haw, TD Securities

Hi. Thank you. Just on Standard Solar and the solar capacity under construction, can you give a bit more colour on these projects just in terms of geography, PPA duration, and what the expected returns are like?

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

The targeted market is commercial and institutional. We seek returns in the teens for those projects at a project level. And the actual focus of the geography of Standard Solar in the east coast and south of the states. So this is, in summary, the strategy of Standard Solar.

Avery Haw, TD Securities

All right. Thanks for the colour. And when can we start seeing contribution from these projects?

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

As soon as they are in operation. There are projects under construction at this moment. We expect to have like 20 megawatts in operation by the end of this fiscal year. So we're

growing the business. And this is a contract, this is projects that are built and owned by Standard Solar with long-term PPAs, so 20-year PPAs, so the impact will be seen over the years, so it's going to be gradual but we will see the impact on the results of Gaz Métro, but at the beginning it's going to be marginal.

Avery Haw, TD Securities

Okay, thank you. And just with respect to your SBx wind bid, what are your expected project returns for that project and are they expected to be similar to your previous phases or better?

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

We're in a competitive bid at this moment, so we'll keep that information for ourselves at this point.

Avery Haw, TD Securities

Okay. Understood. And can you just confirm the structure of the project? Will Valener have an ability to directly invest alongside Gaz Métro and Boralex?

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

Yeah. For any project on Seigneurie de Beaupré's land Valener has an option to participate in the same proportion that they had in SDB two, three and four.

Avery Haw, TD Securities

Okay, great. Thank you.

Operator

Your next question is from Ben Pham with BMO. Please go ahead.

Ben Pham, BMO Capital Markets

Thanks. Good afternoon. Just on the last question on SBx, is there anything to think about in terms of, ah, if you were to win that project, your percent of non-reg is going to move around, and you talked about some thresholds at the investor day, so does that hit any sort of thresholds as you kind of think of building up solar too? Does that impact plans from that perspective too?

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

Let me do the calculation rapidly. The fact that there's going to be a higher leverage on those projects, so the impact should not be material. So we can do the math but leveraging those projects at 80% of debt, so 300 megawatts, so the impact will not be significant on that trigger, on that covenant.

Ben Pham, BMO Capital Markets

Okay. So, to refresh our memory, so it's based on net income then?

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

No, the trigger is the percentage of investment we own in non-regulated activity. So it's the equity invested in those projects. So when you compare the total, and you have to compare that to the total equity of Gaz Métro.

Ben Pham, BMO Capital Markets

Oh, the total equity. And as you're just looking at the Gaz Métro share, right? So it's a quarter of the total project.

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

Yes.

Ben Pham, BMO Capital Markets

Okay. All right. And then so financing similar to the past then and how peers finance wind projects in general?

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

Yes. But, look, we'll see at that point what will be the market conditions and what will be the best interest for all the partners.

Ben Pham, BMO Capital Markets

Okay. And then so like on equity side it's more looking at your preferred share room. Can you talk about—do you have room for that in your capital structure?

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

So you're talking at the Valener level?

Ben Pham, BMO Capital Markets

Yes, at Valener level now. Sorry.

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

Okay. Yes, we have margin there. Yes, we have.

Ben Pham, BMO Capital Markets

You do. Okay. So, 100 million? Or more?

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

I don't remember it. It's lower than that.

Ben Pham, BMO Capital Markets

Okay. All right. And then can you, just the only last question I want to check is just the overearnings on Gaz Métro QDA. Is that, can you talk about what's driving that specifically? And then do you think that could be sustainable over the long run? Or is that more of a short-term situation?

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

You always have to remember that overearnings in a year when we're in a cost of service is a one-year thing, because you reset everything the next fiscal year. So this year the economic activity in Québec is higher, we see higher than what we had forecast in terms of throughput for commercial and smaller industrial customers, and that is the main driver behind the good performance of the QDA.

Ben Pham, BMO Capital Markets

Okay. So it gets harder each year then?

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

Yeah.

Ben Pham, BMO Capital Markets

Okay. All right. Okay, thanks, everybody.
Operator

And again, to ask a question, that is star one on your telephone keypad. Your next question comes from Robert Kwan with RBC Capital Markets. Please go ahead.

Robert Kwan, RBC Capital Markets

Great. Thank you. Just coming back to Standard Solar, the low teens returns that you put out, was that levered equity or is that an unlevered return?

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

Sorry, can you repeat the question? I missed the beginning.

Robert Kwan, RBC Capital Markets

Sure. Just the low teens return comment that you made on the investments in Standard Solar, was a levered equity or an unlevered return?

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

It's a levered.

Robert Kwan, RBC Capital Markets

Okay. And then just on the contracts, you mentioned the 20-year PPAs, are those at fixed prices?

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

It depends. It can vary from one customer to another one. So there's lot of variance in those PPAs.

Sophie Brochu, President & Chief Executive Officer, Gaz Métro

And those would be mostly with investment grade counterparts.

Robert Kwan, RBC Capital Markets

Got it. So where you don't have fixed pricing what's the pricing mechanism? Is it a voided cost of the grid or...?

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

I said not fixed pricing, because in some cases they are indexes and in some other cases they are not. So it's fixed price that can be indexed or not.

Robert Kwan, RBC Capital Markets

Okay. Understood. Okay. Just to finish a couple...

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

There's no market risk or market price risk associated with those PPAs.

Robert Kwan, RBC Capital Markets

Understood. Okay. Just to finish with a couple of clean-up questions on the quarter, on the Vermont utility side you had mentioned some timing around revenue recognition and cost. I'm just wondering what the nature of that is and did you have like, ah, quantify the dollar impact during the quarter?

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

The nature of those expenses usually is related to maintenance depending when you do the maintenance activity that is not capitalized. Some maintenance is capitalized, some others are not, so it's just a matter of that kind of displacement of those activities during the year. It's mainly that. It's not that significant but it has, it has an impact on the quarter because, as you know, this quarter has really low level of benefit.

Robert Kwan, RBC Capital Markets

That's great. And then just last, I assume it's not huge but how much was the make-whole payment at TQM?

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

It was close to a \$1 million.

Robert Kwan, RBC Capital Markets

It was \$1 million net to you?

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

No, net to TQM. So 50% to Gaz Métro.

Robert Kwan, RBC Capital Markets

Okay, great. Thank you very much.

Operator

Your next question comes from Jeremy Rosenfield with Industrial Alliance Securities. Please go ahead.

Jeremy Rosenfield, Industrial Alliance Securities

Thanks. Good afternoon. Just one clean-up question: On the project that the Québec government recently announced funding for for the Québec distribution network expansion, do you have an estimate for what Gaz Métro would be investing alongside the province or is the capital being deployed all the province's capital?

Sophie Brochu, President & Chief Executive Officer, Gaz Métro

No, there is a small portion of the capital that is deployed by Gaz Métro. It's roughly about \$5 million. So mostly, ah, the very large part of those projects need to be financed by the Québec government, because they cannot support themselves.

Jeremy Rosenfield, Industrial Alliance Securities

Right. Okay. Got it. That's it for me. Thanks.

Operator

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

Sophie Brochu, President & Chief Executive Officer, Gaz Métro

We thank you very much and we wish you a great end of summer.

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

Thank you.

Operator

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