Valener Inc.

Q4 and Full Year 2017 Results

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CORPORATE PARTICIPANTS

Sophie Brochu
Gaz Métro – President and Chief Executive Officer

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

Mariem Elsayed
Gaz Métro – Senior Advisor, Investor Relations

CONFERENCE CALL PARTICIPANTS

Ben Pham
BMO Capital Markets

Robert Kwan
RBC Capital Markets

Jeremy Rosenfield
Industrial Alliance Securities

PRESENTATION

Operator

Good afternoon and welcome to Valener's fourth 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, Friday, November 24, 2017 at one o'clock Eastern Standard 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, Gaz Métro

Thank you, Sylvie. Good morning and welcome to Valener's fourth quarter and full year 2017 conference call.

With me today from Gaz Métro are Sophie Brochu, President and Chief Executive Officer; Pierre Despars, Senior Vice President, Corporate Affairs and Chief Financial

Officer, both acting as managers of Valener; and Éric Lachance, Vice President, Finance.

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, Acting as Manager of Valener Inc.

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

Let's start the conversation in saying that 2017 marked Gaz Métro's 60th year in operation. Throughout each of those years we have tried to provide our customers with innovative products and services to better serve their evolving needs. The strength of our 2017 financial results speaks to the appeal of our commercial offer, which now spreads on both sides of the border. Gaz Métro's adjusted net income reached a new record of almost $230 million this year, up 6% from last year. Strong results at Gaz Métro translated into a record year for Valener as well, generation of $53 million of adjusted net income in 2017, up 6% from last year.

Now, 2017 also marks the year that my friend and colleague, Pierre Despars, has chosen to retire. Clearly, Pierre picked a good year to go out on top. We haven't seen the last of Pierre just yet. He will remain active within the Gaz Métro families as he stays on to serve on various boards of our affiliates. Today I have asked Éric Lachance, who has been shadowing Pierre for nearly a year now and who, as of January, will officially become the company's new CFO, to walk you through the financial portion of the call. He will do so in just a few minutes. But it is worthwhile, before that, to recap the commercial highlights of this year. I am now on slide four.

Following the completion of the Standard Solar acquisition in April, we have been focusing our efforts on reshaping the business model and signing new clients. Today, Standard Solar has already completed two projects totalling two megawatts that will be commissioned soon. Projects totalling installed capacity of 12 megawatts are either under construction or in their preliminary engineering stage and exclusive LOIs for an additional 27 megawatts has been signed over the last few months. These represent investments of approximately US$50 million. We continue to expect that as of fiscal 2018 Standard Solar will be able to add about 100 megawatts a year of capacity.

Last July, in response to a request for proposal issued by the State of 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 is to come from the 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. This development would almost double SDB's installed capacity, bringing it over 600 megawatts. Valener would have the right to elect whether or not to participate in the project alongside Gaz Métro. Selected projects are expected to be announced in early 2018.

This spring, in partnership with Investissement Québec, we completed the construction and installation and officially commissioned the second liquefaction train at our liquefaction storage and regasification plant in Montréal. This new train now triples the plant's production capacity, bringing it to over nine Bcf of LNG per year. In 2017, with the new system in place, we shipped 65 million cubic meters of LNG, an increase of 31 million cubic feet or 90% over what we shipped in 2016.

The $80 million project to strengthen and reinforce the network in the Saguenay region was completed on time and on budget. The new compression station in La Tuque has been installed and the existing compression station in Saint-Maurice upgraded. Commissioning of the new equipment took place in October and we now have the infrastructure in place to better respond to existing and future customer needs in the Lac Saint-Jean region.

In Bellechasse now, the $40 million project consisting of a 72-kilometre extension of the distribution network between the municipalities of Lévis and Sainte-Claire is now complete. The commissioning of this new segment and customer connections were completed in December 2016 and the remaining work related to the refurbishment of the land was completed this July. This project will help reduce GHG emissions by almost 9,000 tonnes while reducing the region's energy bill by approximately $2.5 million a year.

In May, Green Mountain Power completed its acquisition of hydroelectric power plants 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. We're so proud, so proud of Green Mountain Power that in August was recertified B Corp, just three years after being recognized as the first utility in the world to become B Corp certified. B Corps are companies that believe business can be a forced for good and are certified by the non-profit B Lab to meet vigorous standards of social and environmental performance, accountability, and transparency. Today there are over 2,200 B Corps in 50 countries, representing 130 industries. This badge is further evidence of GMP's unwavering customer-centric approach that has helped improve lives and transform communities.

Also in Vermont, VGS completed its Addison County Natural Gas Project, the largest project in its history, which added 66 kilometres of pipeline to the network, extending from north of Burlington to the town of Middlebury. It has been a challenging project indeed, but it is now fully in service and has to date signed up 600 new customers, of which about 250 have been already turned on. And though the potential market in Addison County includes about 4,000 new potential customers, a significant portion of the anticipated load has been reached through signups to date. The completion of the Addison project will bring VGS's asset base to around US$250 million in 2018.

I am now on slide six. Today, the portfolio of products we offer our customer ranges from natural gas, in both gas and liquid forms, to renewable natural gas, as well as hydro, wind, and solar energy. Gaz Métro offers increasingly diverse and low carbon energies in a geographic area that now includes not only Québec but also 14 US states. All of this while also becoming a leader in energy efficiency. I like to remember that in 2001 we became the first energy distributor in Québec to implement a global energy efficiency plan and have since completed more than 120,000 energy efficiency projects that save our customers over $100 million annually and avoided the emission of nearly one million tonnes of greenhouse gases.

We also collaborated with Groupe Desgagnés and the Port of Montréal to provide an LNG supply solution for marine fuel. The LNG supply system is being operated by Gaz Métro and has been in operation since last May, allowing ship owners in Québec and fleets passing through the Port of Montréal to fuel up with LNG. We are completing the same work with the Port of Québec, which will be LNG ready very soon. These are important milestones for the entire maritime transportation sector.

Renewable energy is another part of the solution we will be offering. We've built the necessary infrastructure for the City of Saint-Hyacinthe to inject RNG produced at its biomethanation facility in our distribution network. Once the city begins feeding RNG into our network, which is very soon, we expect we will be very soon, we have committed to purchase approximately 13 million cubic meters a year for 20 years. And we have a similar agreement in place with the Régie intermunicipale de valorisation des matières organiques de Beauharnois-Salaberry et de Roussillon. Sorry for the translation. We will purchase the RNG produced by them and composting plant for minimum of 20 years, during which it has committed to inject into our network their RNG. The project remains subject to approval by the Régie de l'énergie.

Going forward, Gaz Métro remains on the lookout for opportunities to invest in projects to participate more actively in reducing the environmental footprint of the energy sector. This ability to act, seize, and create business opportunities defines us and prepares us for the future.

I will now turn the call over to Éric, who will walk you through the firm's financial performance.

Éric Lachance, Vice President, Finance, Gaz Métro

Thank you, Sophie.

On to slide seven, Valener generated adjusted net income of $53 million in fiscal 2017, an increase of 6% from fiscal 2016. On a per-share basis, adjusted net income was $1.37, up $0.07 from 2016. These results were driven by growth at Gaz Métro and strong and consistent power production at the Seigneurie de Beaupré Wind Farms, similar to last year and in line with expectations. For Q4, a typical softer quarter given weather patterns and warmer temperatures, Valener recorded an adjusted net loss of $0.07 per share compared to a net loss of $0.02 per share in the fourth quarter of 2016. Normalized operating cash flows were $56 million in fiscal 2017, up 7% from last year. Growth came from higher distribution received from Gaz Métro as a result of subscribing to additional Gaz Métro units in September 2015 and March 2017, as well as Gaz Métro increasing its quarterly distributions from $0.28 per unit to $0.29 per unit as of January 2016. Also, the Seigneurie de Beaupré Wind Farms paid out $1 million more in distributions this year as a result of higher normalized operating cash flows. For the fourth quarter, Valener generated normalized operating cash flows of $18.1 million, up 8% from the fourth quarter of 2016, essentially for the reasons I just mentioned.

On slide eight, Gaz Métro generated adjusted net income of $228.3 million in 2017, up 6% from an already strong 2016. In addition to the parameters in the Gaz Métro-QDA rate case as well as an increase of Green Mountain Power's asset base, unexpected growth and consumption from the small and medium load sectors in Québec drove an excess return of Gaz Métro-QDA. Québec's economy is firing on all cylinders and various sectors are benefitting. On a per-unit basis, Gaz Métro generated net income of $1.35 per unit in 2017 compared to $1.28 per unit last year and this despite the effect of issuing 4.5 million units at the end of March 2017.

For the fourth quarter, reflecting the typical warmer weather between July and September, Gaz Métro incurred a net loss of $14.2 million compared to a loss of $10.9 million in the fourth quarter of last year.

The energy distribution segment generated adjusted net income of $221.5 million in fiscal 2017, up $20 million or 10% from last year.

As you will see on slide nine, natural gas distribution in Québec reached a new high with $147.6 million of adjusted net income. That is $17.9 million higher than in fiscal 2016. Although under the parameters of the 2017 rate case, we had anticipated a $6.6 million increase over last year. We recorded an additional $11.3 million in net income as a result of the favourable impact of Gaz Métro's $8.4 million share in overearnings, which was driven by higher distribution revenues from new sales and the overall economic growth.

The Régie de l'énergie has confirmed that Gaz Métro's authorized ROE for fiscal 2018 will remain at 8.9% and based on the 2018 rate case, which calls for a $74 million increase in the average rate base, we expect Gaz Métro-QDA 2018 net income to be about $132.7 million. This is slightly lower from what had been expected in the 2017 rate case, mainly as a result of lower non-rate based investments.

The Régie also authorized a 4.5% increase in average distribution rates. Notwithstanding this, this increase in rates, clients are expected to see their overall energy bill decrease in 2018 as natural gas pricing remains competitive.

Finally, fiscal 2017 was the last year where we were eligible for the Global Energy Efficiency Plan performance incentive, which sought to encourage Gaz Métro-QDA to promote energy efficiency among its customers. Gaz Métro-QDA met its target and earned a performance incentive for the past ten consecutive years. Going forward, the impact of the plan will flow through the rate base without any material impact to net income.

On to Vermont on slide ten. Gaz Métro's Vermont operations generated adjusted net income of $73.9 million, up $2.1 million from last year. Results were positively affected by the increase in Green Mountain Power average asset base and GMP's share of synergy savings that was US$1.3 million more than last year and almost US$5 million higher than the anticipated that we had in the MOU entered during the CVPS acquisition.

This was partially offset by the unfavourable effect of no longer capitalizing AFUDC related to the Addison project, which had been capped at US$134 million by the VPUC.

In November, GMP and VDPS entered into an agreement on the 2018 rate case. The agreement provides for an overall rate increase of 5.02% and sets the authorized rate of return on common equity at 9.10% for 2018 and 9.30% for 2019. The agreement also provides for an average asset base of US$1.4 billion, below the initially anticipated asset base given the postponement of certain property, plant, and equipment investments.

In September, VGS and VDPS reached an agreement providing for a pricing increase of 4% and the use of amounts collected through the SERF, the System Expansion and Reliability Fund, for an amount of US$10.7 million. Considering scheduled withdrawals for fiscal 2018, we expect that the SERF balance will be approximately US$18 million on September 30, 2018. The agreement also provides for an average asset base of US$248 million, which now includes $134 million to reflect the full commissioning of the Addison project.

In natural gas transportation, we generated net income of $15.4 million, down $2.7 million from last year. The decrease stems from, mainly from lower short-term volumes transported by PNGTS due to warmer weather.

In electricity production on slide 11, we recorded a $200,000 net loss during the year compared to a net income of $1.4 million in 2016, mainly from focused efforts on implementing Standard Solar's new business model. Notwithstanding the increased competition and economic uncertainty from the potential rise in custom duties on solar panels in the US that caused some delays in the completion of certain projects, Standard Solar has already completed the construction of two projects for a total of 2 megawatts and, as Sophie mentioned earlier, another 12 megawatts are currently under construction or in preliminary engineering and we have LOIs for another 27 megawatts. Winds observed and power production at the Seigneurie de Beaupré Wind Farms were essentially the same year over year; however, they generated higher operating cash flow in 2017 as a result, among other things, of higher revenue from an increase in average price. Accordingly, the wind farms paid out higher distributions this year, returning $33.7 million to the partners in 2017 compared to $28.3 million in 2016.

In energy services, storage, and other we generated adjusted net income of $4.6 million, up 7% from fiscal 2016 from higher deliveries of LNG and the favourable effect in relation to the acquisition of CDH of $700,000. We also recorded a one-time non-cash gain of $12.5 million in this segment for the valuation of CDH to fair market value, following the acquisition of the 50% interest we did not own. This amount is excluded from the adjusted net income.

On to slide 12, Gaz Métro invested approximately $510 million in CapEx in fiscal 2017, in line with guidance. Q4 CapEx totalled $126 million and included investments in the LSR facility to complete its capacity expansion, investment in Standard Solar towards the development of solar parks, as well as usual maintenance capital expenditure. For fiscal 2018 we expect CapEx to range between $535 million to $560 million, including investments in affiliates, and we continue investing in securing and reinforcing our networks and supporting Standard Solar's expansion initiatives.

We are very pleased with this year's results at both the Gaz Métro and Valener levels. In August we announced that Gaz Métro would be increasing its quarterly distribution to its partner from $0.29 per unit to $0.30 per unit in October and, accordingly, contributing almost $0.5 million per quarter to Valener's cash flow. In turn, Valener increased its quarterly dividend on common shares from $0.28 per share to $0.29 per share and extended a 4% CAGR target on common dividend by an additional four years, taking it to until 2022.

That concludes the call, operator. We will now open the lines for questions.

QUESTION AND ANSWER SESSION

Operator

At this time I would like to inform everyone in order to ask a question press star then 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 of BMO. Your line is open.

Ben Pham, BMO Capital Markets

Hi. Thanks. Good morning. I had a couple of questions on slide nine, Gaz Métro, on the earnings bridge to 2018, and first question is I'm wondering has the Régie allowed you to include non-rate base investments through a certain period or is it just through the existing three-year period?

Éric Lachance, Vice President, Finance, Gaz Métro

I'm not sure I followed your question.

Ben Pham, BMO Capital Markets

You know the $300 million in non-rate base investments you're earning an ROE on?

Éric Lachance, Vice President, Finance, Gaz Métro

Yes.

Ben Pham, BMO Capital Markets

So is that, so that's going to decline over time to the extent that you're buying more credits, but are you, have you been approved to book that in earnings for an extended period of time or do you have to go back each time to the rate case to get that approved?

Éric Lachance, Vice President, Finance, Gaz Métro

What we already bought has been approved and that is going to earn a return on equity even though it's not in the rate base. So, based on the rate case, the decision that we have this fall, it's only related that there's no decision with respect to including what we already had and what we will buy in the future within the rate base, as well as making future purchases that goes beyond the, ah, what do you call it, the period that has been approved by the government with respect to the cap and trade. So the last period of conformity ends in 2020 for now and the government should rule on the 2021 and above by year end, we expect.

Ben Pham, BMO Capital Markets

So you have good visibility to 2020. So, just to confirm, the minus 6.2, is that, that reflects the net impact—?

Éric Lachance, Vice President, Finance, Gaz Métro

Most of the impact is since we have no decision on purchases beyond 2020 we did assume that we would not purchase more cap and trade than what we currently have on balance sheet. So, as we use some of those during the year, that decreases the amount of cap and trade that is earning a return, hence that decline.

Ben Pham, BMO Capital Markets

Okay. So it's going to be a gradual decline through 2020 and then it's possible that you buy more credits at that point in time.

Éric Lachance, Vice President, Finance, Gaz Métro

Exactly. I mean we cannot, obviously, determine what the government is going to rule but, hypothetically, if we would not be entitled to earn, to purchase more cap and trade in the future, you'd be (inaudible) that this would be declining until 2020. If we would be allowed to purchase above 2020 then you would see an impact that would be anything between zero to the amount that you just described.

Ben Pham, BMO Capital Markets

Okay. All right, okay. Thanks for clarifying. And then just the other one on Gaz Métro, how should we think about the overearnings for 2018? I think it's a bit more limited than 2017 on the last conference call you mentioned that.

Sophie Brochu, President & Chief Executive Officer, Gaz Métro, Acting as Manager of Valener Inc.

Well, we'll see at the end.

Éric Lachance, Vice President, Finance, Gaz Métro

Yeah. We wish we could tell you that you're going to have overearnings guaranteed, but we're 97% regulated, so that's not such easy things to do.

Sophie Brochu, President & Chief Executive Officer, Gaz Métro, Acting as Manager of Valener Inc.

And we're one month into the year. We need to see how the year will evolve.

Ben Pham, BMO Capital Markets

Okay. So you'd say you're being quite conservative here with the 133 and then kind of see how things evolve over the next few months and six to twelve months.

Éric Lachance, Vice President, Finance, Gaz Métro

What we're saying is that that's the result of the rate case.

Ben Pham, BMO Capital Markets

Okay. All right. Okay, thank you very much.

Sophie Brochu, President & Chief Executive Officer, Gaz Métro, Acting as Manager of Valener Inc.

Merci.

Operator

Again, if you would like to ask a question, press star then the number one on your telephone keypad.

Your next question comes from the line of Robert Kwan of RBC Capital Markets. Please go ahead.

Robert Kwan, RBC Capital Markets

Good afternoon. Maybe if I can just start by following up on QDA. Is there anything structural with respect to what drove the overearnings in 2017 that is definitely not repeatable in 2018?

Sophie Brochu, President & Chief Executive Officer, Gaz Métro, Acting as Manager of Valener Inc.

Definitely. I mean weather patterns are unpredictable.

Robert Kwan, RBC Capital Markets

Sure. But there was nothing that, whether it was cost or otherwise, that you were able to do in 2017 that at least in theory is not repeatable in 2018?

Sophie Brochu, President & Chief Executive Officer, Gaz Métro, Acting as Manager of Valener Inc.

Structurally, I think it's fair to say what you just said.

Robert Kwan, RBC Capital Markets

Okay. Just turning to Vermont and the fiscal 2017 results, are you able to quantify what the full year's weather impact was on the results?

Sophie Brochu, President & Chief Executive Officer, Gaz Métro, Acting as Manager of Valener Inc.

We need to go back…

Éric Lachance, Vice President, Finance, Gaz Métro

Yeah, we will go back to you off line to give you more precise on that.

Robert Kwan, RBC Capital Markets

Okay. That's great. And then if I can just finish—oh, sorry?

Éric Lachance, Vice President, Finance, Gaz Métro

Just as a reminder, Vermont Gas is normalized, so it's really GMP that had an impact.

Robert Kwan, RBC Capital Markets

Okay. And then just finishing with Standard Solar, you talked about 100 megawatts per year. Is there a rule of thumb you can give just as to the profitability on the investment, assuming you could hit 100 megawatts of deployment per year?

Éric Lachance, Vice President, Finance, Gaz Métro

In terms of profit, no. As we said, the accounting of it is even more complex so, honestly, as we grow, it's a growing business and development, so as we achieve scale then we'll be more able to give you guidelines around cash flows that's going to be coming out of Standard Solar.

Robert Kwan, RBC Capital Markets

Is there something you can talk about of like when that business looks to deploy capital what type of hurdle rates, whether that's ROEs, whether that's FFO yields, or...?

Éric Lachance, Vice President, Finance, Gaz Métro

The hurdle rate is going to be internal rate of return that's going to be the driver of the decision making. And the way we look at is on an on-risk basis, so to approve a project it has to meet a particular threshold of IRR that is based on the contracted revenues, and if we can hedge some RECs around it then we'll take that into account. But, if not, then it's going to be solely on what is being contracted.

Sophie Brochu, President & Chief Executive Officer, Gaz Métro, Acting as Manager of Valener Inc.

And eventually it will be, if RECs can come in then the return might be higher, yeah. There are upsides, but we're looking at it on a fairly conservative basis, trying to pin down in assess liability contracted as we initiate the project.

Robert Kwan, RBC Capital Markets

Got it. So it's a conservative look at the contracted cash flow stream. Are you able to provide a range of numbers as to what that IRR might be?

Sophie Brochu, President & Chief Executive Officer, Gaz Métro, Acting as Manager of Valener Inc.

Yeah, well, Standard is bidding right now in the market and if we were to provide a strong, very clear indication, it would go against the competitive lay of the land. But you know what has been our business model, financial hurdles, and I think you can expect that we are in line with our business model.

Robert Kwan, RBC Capital Markets

Maybe if I can ask it one last way, is it fair that, going into Standard Solar that you expected the returns to be accretive to your return on capital as you think about it from your utility businesses?

Sophie Brochu, President & Chief Executive Officer, Gaz Métro, Acting as Manager of Valener Inc.

Yes, absolutely. That's a good Thanksgiving approach.

Robert Kwan, RBC Capital Markets

Sounds good. Thank you very much.

Operator

Your next question comes from the line of Jeremy Rosenfield of Industrial Alliance Securities. Please go ahead.

Jeremy Rosenfield, Industrial Alliance Securities

Thank you. Good afternoon. Just a couple of questions. Just one on the rate application for QDA for 2019 and I'm wondering if you're going to be applying for, um, to revisit the incentive mechanism at some point in 2019 in that rate case.

Éric Lachance, Vice President, Finance, Gaz Métro

Yeah, that will be the objective, but it's going to be, it's not going to be integrated within the rate case per se. It's going to be part of another proceeding towards the Régie.

Jeremy Rosenfield, Industrial Alliance Securities

Okay. And that one hasn't been filed yet and can you conceptually talk about what it might look like? Or maybe it's still too early.

Éric Lachance, Vice President, Finance, Gaz Métro

It's still too early.

Jeremy Rosenfield, Industrial Alliance Securities

Okay. Perhaps at the next investor day.

Jeremy Rosenfield, Industrial Alliance Securities

Can you talk about, ah, it's probably, perhaps, immaterial, but at the Vermont Gas you mentioned in the remarks and there was the commentary in the quarterly update on the system expansion and reliability fund, the SERF fund. Can you just explain how that works in terms of withdrawals from the fund in fiscal 2018 and how you get back to the higher balance by the end of the year?

Éric Lachance, Vice President, Finance, Gaz Métro

Well, there's an inflow and outflow in the SERF fund. So basically, without going to the specific details, the idea around SERF was to develop future expansion of the network, so I would say that not the entire decrease in the gas price was returned to customers. Some of those funds were put aside and it's still ongoing. So you have inflows and outflows.

Jeremy Rosenfield, Industrial Alliance Securities

Okay. And so, you know, withdrawals that you take from the SERF fund would go into rate base over time? Is that how I should understand it?

Éric Lachance, Vice President, Finance, Gaz Métro

Actually, they go to decreasing the rates that you charge to the customer.

Jeremy Rosenfield, Industrial Alliance Securities

So it's basically just a regulatory asset liability deferral account. Okay. Okay, that's it from me, thank you.

Operator

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

Sophie Brochu, President & Chief Executive Officer, Gaz Métro, Acting as Manager of Valener Inc.

Have a good weekend. Thank you for your time.

Operator

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