VALENER
energy company

Valener Inc.

Q1 2018 Results

Event Date/Time: February 9, 2018 - 1:30 p.m. E.T.

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[1] Formerly Gaz Métro Limited Partnership

CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Robert Kwan
RBC Capital Markets

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PRESENTATION

Operator

Good afternoon and welcome to Valener's First Quarter 2018 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, February 9, 2018 at 1:30 p.m. 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, Énergir, L.P.

Thank you, Sylvie. Good morning and welcome to Valener's first quarter 2018 conference call. With me today from Énergir are Sophie Brochu, President and Chief Executive Officer, and Éric Lachance, 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, Énergir, L.P., acting as manager of Valener

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

Q1 2018 is a very noisy one. Results were influenced by many factors. South of the border we saw the enactment of the US tax reform. In Québec, polar December temperatures, strong winds, and a fired up economy all drove our Québec distribution activities results to exceed expectations.

Excluding the one-time non-cash accounting adjustment related to the tax reform, Énergir generated adjusted net income of $84.5 million in the first quarter compared to $88.9 million last year. For Valener, adjusted net income was $20 million for the first quarter, down $300,000 from Q1 of last year. Per share that's EPS of $0.51 for the first quarter of 2018, down $0.01 from last year. Of note to remember, new shares are issued under our dividend reinvestment plan.

The US tax reform had multiple effects on short, medium, and long term. Some of the impacts are yet to be fully understood. In Énergir's case, many will depend on how regulators will choose to act on it. Net-net our preliminary analysis tend to confirm that in the short term it's a gain for our customers and a non-cash drag on earnings. I am happy to tell you that Éric will explain the details of this complex situation in a minute.

Well, one reform was not enough for the Trump administration. As you know, two weeks ago the White House announced its decision regarding tariffs on imported solar modules and cells. You have the details on page three. Imports will be subject to a 30% tariff that will gradually lower to 15% over four years. The first 2.5 gigawatts of imported sales each year will be excluded from the tariff. While the market has been bracing itself for some form of a price hike on imported parts, we view positively the announcement and the clarity it provides, as it lifts some of the uncertainty surrounding the US solar industry.

Now Standard Solar, the US solar company we acquired last April, continues to focus its efforts on bringing on deck new clients. Some delays were experienced as a result of the flux of the pending decision on tariffs. Now that the decision has been articulated, we expect Standard Solar to move forward with its development projects while maintaining its competitive position. As it stands, Standard Solar has 23 megawatts either in operation or under construction. This represents investment of approximately US$33 million.

Let’s move on to slide four. Let’s recap on highlights from the first quarter.

In November, the City of Saint-Hyacinthe began injecting our Québec distribution network with renewable natural gas, which we call RNG. The operations of the facilities are ramping up and we expect approximately 13 million cubic metres of RNG to be injected in fiscal 2018. On the longer term, this could increase to 16 million cubic metres. Furthermore, on the commercial side, L’Oréal Canada, one of Énergir clients, has committed itself to the path of carbon neutrality through the procurement of RNG. We believe as the appetite for RNG will keep increasing and this is why we remain focused on signing similar agreements with other producers.

As already mentioned, the enactment of the US federal tax change lowers the corporate tax rate for our utilities from 35% to 21%. Green Mountain Power and Vermont Gas Systems have pledged to return 100% of the tax benefits to their customers. That is US$6 million and US$2.4 million that GMP and VGS will respectively be giving back to their customers in the form of a credit over the next nine months.

Finally, with the new fiscal year came the start of a new beginning for the company. On November 29th, Gaz Métro became Énergir. A corporate name change to showcase how we’ve transformed over the last decade. As you know, today we distribute more than just conventional natural gas. As I have just covered, renewable natural gas, hydro, wind power, and solar energy are all part of our energy portfolio. We remain Québec’s leading natural gas distributor, of course, but we’re also aiming to introduce renewable natural gas into our network. We are deeply invested in developing innovative energy projects that show promise and we continue to diversify our energy sources to that effect. It’s about catering to our customers, helping them use energy more efficiently, and caring for the environment. For instance, to date we have realized over a 120,000 projects for our customers thanks to grants and programs promoting energy efficiency. These projects have resulted in a reduction of nearly one million tonnes of greenhouse gas emissions since 2001.

A quick word on the highly competitive bid to supply the State of Massachusetts with 1,000 megawatts of renewable energy: Following that process and despite a strong proposal, we were disappointed that none of the wind plus hydro solutions Énergir submitted with Boralex were retained. We continue to believe that the combined wind/hydro offer we can provide is a sought after product in the northeastern United States. While hydro power provides stability of supply, wind power, considered a Class I type of renewable energy, provides the environmental attributes necessary to achieve their energy goals. As you know, the project that was announced a few days ago is going through some special considerations south of the border. We will let this project go. We will let this process go. And we remain on the starting block. If ever we are called upon, we will be there. And we will continue to look for other opportunities to bring clean renewable wind power to the market and reduce the environmental footprint of the energy sector.

Despite the new name, some things have not changed and will not change. We will remain true to our values and meet our commitments. Commitments to our employees, commitments to our customers, and commitments to our shareholders. And we will continue to provide the same services without change or interruptions to ensure customer satisfaction. We are pleased with our first quarter results under the energy emblem and we are well positioned to reach our goals and ambition for the 2018 and the long term.

I will now turn the call over to Éric.

Éric Lachance, Senior Vice President, Corporate Affairs & Chief Financial Officer, Énergir, L.P., acting as manager of Valener

Thank you, Sophie. I'm going to start by covering in more detail the one-time impacts of the US tax reform that you will see in our financial statements, as they impacted several of our segments.

On to slide five, on a consolidated basis, these impacts had a combined negative $24.2 million impact on Énergir's net income. Note that all of these adjustments are non-cash and therefore you will not see them impact the statement of cash flows.

In the Energy Distribution segment, a $6.4 million negative adjustment was recorded mainly as a result of write-off related to the Addison County Natural Gas Project that was booked in recent years. So, just to be clear, this is not a new write-off; those are ones that were done in the past. Also, deferred tax liabilities were reduced by $238 million to reflect the reduction of the tax rate from 35% to 21%. Consequently, we recorded an increase in the regulatory liabilities line item on the balance sheet of $247 million. This represents the amount that GMP and VGS will be giving back to customers over time in the form of lower rates. As a reminder, deferred tax liabilities reduce the asset base upon which we earn a return and since GMP and VGS will be reimbursing customers, their respective asset base that is earning a return will increase as we return that money in the form of deferred taxes to the customers. Obviously, all this is subject to regulatory approval upon the timing at which it will happen. We expect to integrate this in the normal course of business and do not expect to alter Énergir's distribution policy as a result.

In the Corporate Affairs segment, a $20.3 million negative adjustment was recorded to reflect the reduction of deferred tax assets related to accumulated net operating losses on the NNEEC corperation, the holdco for our US subsidiaries. Excluding these one-time items, Énergir generated an $84.5 million of net income in the first quarter, $4.4 million lower than in the first quarter of 2017. On a per-unit basis that's $0.49 per unit in Q1 of 2018, down $0.04 per unit compared to Q1 2017. The year of change is mainly a result of increased expenses in our Corporate Affairs segment and the unfavourable effect of a stronger Canadian dollar. The stronger loonie had a $1.1 million negative impact on this quarter's adjusted net income compared to last year. On a per unit basis the impact was $0.01.

As for Valener, you will see on page six it generated adjusted net income of $20 million in the first quarter, down $300,000 from the first quarter of last year. Adjusted net income per share was $0.51 in the first quarter of 2018 compared to $0.52 per share in the first quarter of 2017, stemming from lower Énergir adjusted net income, partly offset by increased power production of almost 30% at the Seigneurie de Beaupré Wind Farms.

Normalized operating cash flows were $11.3 million in the first quarter of 2018, down $900,000 from the same quarter of last year. Higher distributions received from Énergir, both from an increase in units held by Valener in Énergir raising its quarterly distributions, were more than offset by an increase in taxes paid due to a temporary inefficiency in the consolidation of the wind losses as a result of better than expected 2017 results in the Québec distribution sector. This will be normalized over the next 12 months and is unrelated to the tax reform.

On to slide seven, QDA generated $64.1 million of net income, unchanged from last year but significantly higher than what we had expected under the 2018 rate case. That's mainly because of timing difference between the revenue and cost recognition, which we expect will reverse over the course of the year, and an increase in delivered normalized natural gas volumes as a result of economic growth. In light of this data we expect that QDA will end the fiscal 2018 year with a net income of at least $3 million more than the $132.7 million that we had initially projected. Also note that we have updated our quarterly net income projection for QDA given the new information. We have provided the new break down. Lastly on QDA, in response to the rate submitted to the Régie de l'énergie in October, we are pleased that the Régie has confirmed the requested 8.9% authorized ROE for 2019 as well as the earnings sharing mechanism. Both of these have been unchanged since 2015.

On to Vermont on slide eight, Énergir's Vermont operation generated adjusted net income of $27.1 million in the first quarter of 2018, down $200,000 or less than 1% from the first quarter of last year. Results were driven by the negative impact of the appreciation of the Canadian dollar offset by the increase in VGS average asset base reflecting the completion of the Addison County Natural Gas Project as well as the timing difference between the revenue and cost recognition. In natural gas transportation we generated adjusted net income of $4 million during the first quarter, down $1.5 million from the first quarter of last year. The decrease is in part due to lower volume transported by PNGTS.

In the Electricity Production on slide nine, we recorded net income of $700,000 in the first quarter, down $100,000 from a year ago as stronger winds at the Seigneurie de Beaupré were offset by ongoing efforts at Standard Solar to sign new customers.

In Energy Services, Storage and Other we generated adjusted net income of $1.8 million during the quarter, up from $1.4 million in the first quarter of 2017. As a reminder, CCUM is now being entirely consolidated following the acquisition of the share we did not own last year and the LNG sales are now being recorded at 58% reflecting Énergir's share in the partnership with Investissement Québec. Q1 2017 LNG results were recorded at 100%, as a reminder.

Corporate Affairs, the segments where, among other things, we recorded our subsidiaries financing costs, development expenses for various projects, as well as revenue and corporate expenses not allocated to other segments, recorded an adjusted net loss of $13.2 million in the first quarter of 2018 compared to $10.2 million in the first quarter of last year. The increase in expenses was driven by higher financing costs related to the issuance of long-term debt for unregulated activities in May 2017 as well as tax expenses in certain subs related to various reforms currently underway and certain changes to the holding structure made during the current quarter.

Note that in the first of quarter of fiscal 2017 the financial reporting structure for segmented information was changed to better reflect our management analysis information. As a result of these changes, the interest portion of long-term debt and the income taxes related to the financing of Énergir limited partnership interest are now being reported in the Corporate Affairs segment. They were previously being allocated to each business segment using a method based on the carrying value of the ownership interest. Prior year figures were reclassified to conform to the current quarter's presentation.

On to slide ten, Q1 CapEx totalled $126 million and included investment in SSI towards the development of solar parks as well as usual maintenance capital expenditures. We continue to expect fiscal 2018 CapEx to range between $535 million and $560 million, including investment in affiliates, as we continue investing and securing and reinforcing our network and supporting Standard Solar expansion initiatives.

That concludes the call, operator. We will now open the line 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 Robert Kwan of RBC Capital Markets. Please go ahead.

Robert Kwan, RBC Capital Markets

Good afternoon. If I can just start on asking around the tax reform but at the higher level, you moved very quickly in Vermont to make the decision to return the benefit directly to customers and rates. I'm just wondering were there other alternatives that were discussed internally, whether that was accelerating any capital or other recoveries to offset that.

Éric Lachance, Senior Vice President, Corporate Affairs & Chief Financial Officer, Énergir, L.P., acting as manager of Valener

Well, the impact basically that has been announced to be returned is the one that is affecting the current year revenue. So instead of just creating a deferred account that would have had to be returned in the following years, the companies both decided that it was best to actually pass immediately along those impacts of lower basically gross up from taxes directly to the customer as a form of credit. So they have no impact in terms of the returns being earned.

Robert Kwan, RBC Capital Markets

Understood. You've got a statement that the interest deductibility rules or caps, you're currently reviewing them. Is that because you're currently exceeding the cap?

Éric Lachance, Senior Vice President, Corporate Affairs & Chief Financial Officer, Énergir, L.P., acting as manager of Valener

Well, yes and no in the sense that the issue we have is that we have a holding that has both regulated and non-regulated. It's not clear as of yet how it's going to be treated for debt that we have within the holdco. So, in that sense, there could be a need to further refine how much debt that we keep at the holding level in the States.

Robert Kwan, RBC Capital Markets

Understood. And then have you—do you have cross-border tax structures in place?

Éric Lachance, Senior Vice President, Corporate Affairs & Chief Financial Officer, Énergir, L.P., acting as manager of Valener

Like all companies, obviously we try to balance how we do move our investment between Canada and the US so, as such, we already moved away, as the social context did evolve with respect to cross-border structure. But, that being said, you should have in mind that about $8 million of negative headwind in terms of accounting, tax impact that we have ahead of us on a yearly basis but, that being said, in terms of effective cash taxes, it doesn't change the fact that it won't be until 2023 that we expect to be in a position to pay actual cash taxes.

Robert Kwan, RBC Capital Markets

Okay. So $8 million potential accounting non-cash headwind to earnings but no impact on cash taxes?

Éric Lachance, Senior Vice President, Corporate Affairs & Chief Financial Officer, Énergir, L.P., acting as manager of Valener

Exactly. Until 2023. And then, again, while we would love to give you more clarity, the fact is depending on how fast we return the money to the customers in terms of deferred tax and how fast this would create rate base and everything is going to influence the overall net impact on both cash flow and net income.

Robert Kwan, RBC Capital Markets

Right. Okay. So if it's not impact, if you're not a cash tax payer on the assets there may not be, as you've mentioned in earnings impact, but as we look forward is there, there is a cash flow impact in terms of the benefit is actually being returned to the customers, so do you have incremental... Like the cash must be going, the cash flow must be going down. Does that not hurt your ability to fund the utility?

Éric Lachance, Senior Vice President, Corporate Affairs & Chief Financial Officer, Énergir, L.P., acting as manager of Valener

Well, the good news is we have the headroom to fund it, so it doesn't affect our ability to fund it. You're right that basically we have three items that is going to put pressure on cash flow. The first one is since we're—until we are in a fiscal position to pay taxes, the fact that there is a lower tax rate means that we collect less taxes from the customer on an accounting basis, so this reduces the cash flows for every current year.

The pace at which we will return the previous deferred tax is going to also put a negative impact on cash flows. As of yet we don't know if it's going to be done like it was done in the Regan years or if there's going to new guidelines being done, so this I cannot say, but it's going to put pressure on cash flows for sure because it's money we return to the customer.

The third one, as you're probably aware, is with respect to the new amortization schedule. Previously, utilities were allowed to use bonus depreciation, which created a more deferred taxes. We're returning to a MACRS schedule, which will create less deferred taxes as well. So, again, until we move where we have actually more fiscal taxes than book taxes, it's going to put negative pressure on cash flows. That being said, given the scale of the company and the cash flows we're producing, we don't expect any negative impact on our ability to fund those investments.

Robert Kwan, RBC Capital Markets

Understood. Okay. And if I can just finish with the Québec gas business, you've talked about, based on the quarter you've had, kind of at least $3 million better than the rate case, I guess historically you've tended to be quite conservative, so I'm just wondering what are the moving pieces or how much of the variance in fiscal Q1 is due purely to cost that you know you will incur in future quarters and how much of it might be you being conservative around things like future usage.

Éric Lachance, Senior Vice President, Corporate Affairs & Chief Financial Officer, Énergir, L.P., acting as manager of Valener

Again, what we feel comfortable at this stage is that we feel confident that we'll be $3 million ahead. Just as a remainder, on the previous call we had mentioned that giving the Régie's decision with respect to cap and trade we were facing a headwind in terms of less cap and trades being on our balance sheet of $5 million impact on net income. So also keep that in mind when you try to estimate where we're going to land at the end of year.

Robert Kwan, RBC Capital Markets

Okay. That's great. Thank you very much.

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 Nigel Dyer of BMO Capital Markets. Please go ahead.

Nigel Dyer, BMO Capital Markets

Hi. Good afternoon. Just following up on SBx, just wondering, you know, with regards to what's going on with the project that won the bid right now, has Massachusetts actually come back to you at all or are you just waiting at this point to hear back, if at all?

Sophie Brochu, President & Chief Executive Officer, Énergir, L.P., acting as manager of Valener

There is no discussions between us and the Massachusetts, because those who won are Hydro-Québec and the interactions are with the customer and Northern Pass. We are not having any discussions directly with them.

Nigel Dyer, BMO Capital Markets

Okay, thanks. And then just with regards to the corporate segment, it was mentioned that there's a chance to the holding structures during the quarter. Just wondering if maybe could expand on what exactly is being done there.

Éric Lachance, Senior Vice President, Corporate Affairs & Chief Financial Officer, Énergir, L.P., acting as manager of Valener

Well, basically, like I answered in a previous question, we had made some changes to the corporate structure in how we detain our investment in the United States, so you already see some of the impact of the $8 million that I was referring to in the first quarter of the year.

Nigel Dyer, BMO Capital Markets

Okay. Thanks.

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, Énergir, L.P., acting as manager of Valener

Well, thank you very much for your time and we look forward to speaking with you in a quarter. Ciao.

Operator

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