Valener Inc.

Q3 2018 Results

Event Date/Time: August 9, 2018 - 1:00 p.m. E.T.

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[1] Formerly Gaz Métro Limited Partnership

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good afternoon and welcome to Valener/Énergir's Third 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, August 9, 2018 at, 1:00 p.m. Eastern Daylight Time.

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

Mariem Elsayed, Senior Advisor, Investor Relations, Valener Inc.

Thank you, Jessa. Good morning and welcome to Valener's third quarter 2018 conference call. With me today from Énergir are Sophie Brochu, President and Chief Executive Officer, and Éric Lachance, Senior Vice President, Regulatory Affairs, IT, Logistics 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.

First a reminder: Third quarter results reflect the seasonality typically observed in the energy distribution sector.

Last quarter, Valener generated adjusted net income of $500,000 and adjusted EPS of $0.01. This comparing to $0.06 in Q3 of 2017. For Énergir, excluding savings of $1.8 million relating to the US tax reform, adjusted net income was $3.5 million for the third quarter, down from $11.1 million in the third quarter of last year. This is mostly a result of regulatory timing and the effect of the parameters in the 2018 rate cases of our regulated entities. That said, we now expect that QDA will finish the year with net income of approximately $9 million more than the $132.7 million originally forecasted in the 2018 rate case. This is mainly the result of stronger-than-expected normalized delivered volumes stemming from a booming Québec economy. Case in point: QDA's delivered volumes for the first nine months of the year are the highest we've seen since 2000. A word of caution for next year, however, because the economy in the province has been fuelling higher-than-expected volumes for the last two years now, this has been baked into the 2019 rate case filed with the Régie.

Let's move on to page four. Our desire to offer diversified energy solutions to our customers is one of our highest priorities, and to that effect, we are diligently deploying our strategic plan. Let me provide you a few examples. Following in the footsteps of L'Oreal Canada, two more of Énergir's industrial customers, eager to contribute to the energy transition, have signed renewable natural gas supply agreements. These agreements are similar in size to the one signed with L'Oreal Canada and will also be sourced by the City of Saint-Hyacinthe. And as we continue signing on new customers, we are also working on securing new sources of RNG.

Turning over to solar, the development of SSI continues to move forward, although at a slower-than-expected pace. As of June 30th, Standard Solar had 20 megawatts of solar projects in service and another 13 under construction. We expect to deploy US$20 million of CapEx in the fourth quarter, bringing total CapEx for the year to about US$50 million for Standard Solar. That's less than we had anticipated due to a certain number of factors, among which the uncertainty regarding the tariff on solar panels at the beginning of the year and some delays obtaining permitting and connection approvals that has pushed several construction projects, for which we already have otherwise, into 2019.

Let's turn to Green Mountain Power. During the heat wave that hit us all last month, the network of Tesla *Powerwall* batteries installed by GMP in customers' homes directly contributed to lowering energy cost as GMP was able to avoid purchasing higher-cost power during the peak. These Tesla home batteries, combined with energy stored on larger batteries at GMP Solar facilities, resulted in savings of close to $0.5 million. The 500 *Powerwall* batteries currently installed can store solar power or get power right off the grid and can provide clean backup power when needed. Energy storage is fuelled by customers and GMP can share access to the stored energy to pull down power demand at key times, driving down the cost for all its customers, which is exactly what it did during the peak of the heat wave. This innovative solution is an environmentally-conscious way to manage energy while keeping customers comfortable, safe, and lowering their energy bill.

Finally, as you know, PNGTS will be increasing its network capacity by adding a compressor to the Elliot station and leveraging upcoming work at TQM's East Hereford station scheduled to begin this month. Approval for compression on the TQM network has already been obtained and the regulatory application to add compression on the PNGTS network was submitted to FERC in April. Work is expected to be completed toward the end of 2019 and the additional capacity should be available by the fall of 2020.

With that, I will turn the call over to Éric.

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

Thanks, Sophie.

Now on to Valener on slide five. Valener generated adjusted net income of $500,000 in the third quarter of 2018 compared to $2.5 million in the third quarter of last year. Adjusted net income per share was $0.01 compared to $0.06 in the year-ago quarter from lower Énergir net income, which was partly offset by higher net income from the Seigneurie de Beaupré wind farms. Normalized operating cash flows were $12.8 million, down $1.6 million from last year, mainly a result of timing. As you'll recall from last quarter, there was an early wind farm distribution this year as Wind Farm 2 and 3 moved their distribution up to Q2 from Q3. All of this was partly offset by increased distributions from Énergir, which were about $900,000 higher than last year because of an increased number of units held by Valener and a $0.01 per unit increase in Énergir's quarterly distributions.

On to slide six, QDA generated a net loss of $6.8 million in the third quarter compared to a net loss of $500,000 in the third quarter of last year. The year-over-year decrease stems mainly from the partial reversal, as expected, of the favorable impact of regulatory timing recorded during the first half of the year as well as the parameters in the 2018 rate case, which set the $900,000 year-over-year decrease in net income, all this being partially offset by an increase in delivered normalized natural gas volumes in the higher-margin residential and commercial markets.

As for the 2019 rate case, we're still waiting on a decision by the Régie on the 4.1% rate reduction and the average base rate of $2.15 billion we requested earlier this year. We expect a decision by the fall.

On to Vermont on slide seven, Énergir's Vermont operations generated adjusted net income of $15.5 million in the third quarter of 2018, down $4.3 million from the third quarter of last year. The stronger Canadian dollar had a $700,000 unfavourable impact on earnings. Excluding foreign exchange, lower net income was mainly the result of parameters in GMP's 2018 rate case fixing lower net income year-over-year as well as the partial reversal, as previously anticipated, of the favourable impact of regulatory timing recorded in the first half of the year.

For 2019 we are still awaiting a decision by the VPUC on both GMP and VGS rate case files. A decision for GMP is expected in December and one for VGS is expected before November. Also, in June, GMP filed a proposal for the adoption of a new multi-year regulatory plan with the VPUC, which will replace the former plan that is currently in effect. The new plan has an expected term of three years and would come into effect on October 1, 2019. It includes various components, the combination of which addresses all elements related to GMP's cost of service. Working sessions are planned for this fall and a decision by the VPUC is expected in mid-2019. If approved, GMP will be required to file a traditional rate case after the three-year regulation plan expires.

On to slide eight, the Natural gas transportation segment generated net income of $4.5 million, up $2 million from last year. The increase is partly a result of higher volume transported by PNGTS as new long-term contracts came into effect and partly due to the favourable year-over-year comparison given that a make-whole payment was paid in Q3 of last year relating to the early extinguishment of TQM's debt as part of a refinancing.

In Electricity production, Énergir recorded net income of $2.4 million in the third quarter of 2018, a $3.1 million improvement compared to the year-ago quarter. Strong winds at the Seigneurie de Beaupré wind farms were the main drivers there as well as the positive impact of the HLBV accounting method on Standard Solar's net income.

On slide nine, as I mentioned in the last call, using the tax equity partner also means that we're using the HLBV accounting method to account for our interest in the Solar I Partnership. I will just take a few minutes to run you through what the method tries to accomplish and how it impacts our results. A tax equity partnership, in our case Solar One, is set up for a portfolio of projects over a specific period of time. For the most part, Standard Solar handles the engineering, procurement and construction of these projects, which are then sold to Solar I. Solar I owns the project and is responsible for the PPAs, but the operation and maintenance remains with Standard Solar and Standard Solar effectively controls Solar I. All of Solar I's assets and liabilities are consolidated onto Standard Solar's balance sheet and, therefore, onto the Énergir balance sheet.

The main thing to keep in mind with the HLBV method is that the way net income gets allocated between Standard Solar and the tax equity partner within Solar I is not proportional to their capital contribution. Instead, the net income allocation will vary year over year as allocation of tax attributes and other items also continue to vary. With that said, you can expect that for Solar I, at the beginning of the partnership, the tax liquidity partner will start out with a relatively large net loss and Standard Solar with a relatively large net income, and that is this disproportion will shrink over the life of the partnership. HLBV calculates the amount that each partner would receive if the partnership were liquidated at book value at the end of each measurement period. The change in the allocated amounts to each partner during this period is booked as income or loss allocated to that partner.

Finally, given certain clauses in the agreement with Standard Solar's current tax equity partner, the Solar I Partnership is considered as a variable interest entity. Accordingly, Standard Solar, which finances approximately 60% of the projects in the partnership, was allocated $4.8 million of net income in Q3 2018 and $8.1 million for the first nine months of the year. The tax equity partnership, otherwise known as the non-controlling partner, sorry, the tax equity partner is the non-controlling partner, was allocated a net loss of $4.3 million in the third quarter of 2018 and a net loss of $7.7 million for the first nine months of the year. Losses are allocated to the tax equity partner mainly because a tax equity partner receives several tax benefits outside of the Solar I partnership when the solar parks are commissioned, notably in the form of tax credits.

On to slide 10, both the Energy services, storage, and other segment and the Corporate affairs segment performed as expected. Adjusted net income in the corporate affairs segment was $14 million compared to an adjusted net loss of $11.3 million in the third quarter of last year. The difference mainly reflects higher financing costs related to the issuance of long-term debt from unregulated activities in May of 2017 as well as for Standard Solar investments, and higher tax expenses in certain subsidiaries following changes made to the holding structure in Q1.

Earlier this year we expected to end fiscal 2018 with a tax accounting headwind at Énergir of about $8 million as a result of these holding structure changes combined with the effect of the tax reform. Based on the most recent year-end data, we now expect the headwind to be about $4.5 million at the Énergir level, which, combined with the taxes that needs to be paid at the Valener level, to $2.6 million for Valener. In terms of the effective cash taxes paid by Valener, this doesn't change our assumption that we do not expect to pay any cash taxes until approximately 2023 as Valener is still reaping the benefits of higher depreciation on the Québec wind farms.

Q3 CapEx totalled $81 million, including mainly maintenance and capital expenditures. CapEx spending for the first nine months of the year was about $375 million and we now expect fiscal 2018 CapEx to be approximately $485 million, including investments in affiliates. The main reason for the decrease from $535 million to the $560 million range previously guided results from the lower expected Q4 CapEx investment by Standard Solar for the reasons Sophie mentioned.

Finally, a quick note on the impact of the US tax reform. From the information that is available to us today, we have nothing new to add from last quarter. As such, for 2019 we continue to expect a drag on cash flows but a slight positive impact on net income. And for approximately four years after that we expect a cash impact of approximately US$4 million per year. As you know, as these sums are returned to customers, the portion of the rate base that earns a return will increase by the same amount, which will have a positive impact on net income.

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

QUESTION AND ANSWER SESSION

Operator

Thank you. At this time, if you would like to ask a question, please press star followed by the number one on your telephone keypad. If you are using a speaker-phone, please lift your receiver before pressing any keys. Your first question comes from the line of Ben Pham from BMO. Please go ahead.

Ben Pham, BMO Capital Markets

Thanks. Good afternoon. Thanks for the slide on the Standard Solar tax equity, how the net income moves over time and also the ranges of cash distributions. Are you able to share how the shape looks on the cash flow side for you over that timeframe generally speaking? Because I would think that's the main driver of the dividend growth expectation.

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

Yeah, basically, the cash flow's going to also move through the time. As you can see on the lower left part of the slide, as long as the tax equity partner remains, the cash flows, SSI will receive between 40% and up to 70% of the cash flows that are generated by the partnership, and this is basically a waterfall that is agreed between the partners in order for the tax equity partner to achieve its required rate of return.

Ben Pham, BMO Capital Markets

But does Standard get 70% near the back end of the period or you can actually still get 70% in year one and two?

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

It could be many situations, honestly. It really depends on how the results are ended, inflows and outflows and the timing of certain tax allocations as well. It's really a model that is being built such that the partner achieves a certain level of IRR.

Ben Pham, BMO Capital Markets

Okay. And is the—your dividends maintained this quarter and I think maybe in past years you've looked at increasing it. Are you able to comment on that at all? And is that anything to do with the solar tariffs or anything else tax reform related that's maybe causing the pause a little bit on timing of dividend increases?

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

No. As we wrote in the press release, we're still committed, the board is still committed to achieve the 4% growth that was announced. Obviously, every dividend remains subject to board approval in the future, but we're still committed to that growth.

Ben Pham, BMO Capital Markets

Okay. Thanks for taking my questions.

Operator

If there are any additional questions at this time, please press star followed by the number one on your telephone keypad.

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

Robert Kwan, RBC Capital Markets

Good afternoon. Maybe just some questions here to start with QDA. So your guidance for the year is up a few million dollars, I'm just wondering, versus last quarter, what's changed. Was it just getting Q3 done and there was some outperformance or was it just conservative last quarter?

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

As you know, this is basically the volumes that have materialized that right now at this stage the best forecast we have is to achieve that $9 million. So, as Sophie mentioned in her introduction, the economy remains very strong, so that's the key reason for the $9 million.

Robert Kwan, RBC Capital Markets

Got it. Is it fair that given we're going into a fairly low-volume quarter there shouldn't be a ton of variance though around where the guidance is?

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

That's fair that the last quarters are low quarters, so you should not expect a material difference from that guidance, yes.

Robert Kwan, RBC Capital Markets

Got it. As we think about 2019, appreciate the comment just around what's been baked back into that rate case, but I'm also wondering at least how you filed. So rate base is up a little under 2% but can you also talk about any non-rate-based investments for 2019 versus this year?

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

No, it's too early to comment on this. We'll do it next quarter as per our usual practice.

Robert Kwan, RBC Capital Markets

Okay. If you just look at where the non-rate-base investments are right here right now versus where they were at the beginning of the year, just directionally, are they higher or are they lower?

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

If you look at the financial statements you'll see that our, ah, I forgot the exact term in English but basically the intangible investments have gone down throughout the year, yes. You'll find it in the statement.

Robert Kwan, RBC Capital Markets

Okay. And we'll get an update next quarter on what your expectation for that line item is going to be into fiscal 2019?

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

Yes.

Robert Kwan, RBC Capital Markets

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

Operator

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

Mariem Elsayed, Senior Advisor, Investor Relations, Valener Inc.

Great. Thank you, everybody. Have a great day.

Operator

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