Valener Inc.

Q1 2019 Results

Event Date/Time : February 8, 2019 – 1 :00 p.m. E.T.

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CORPORATE PARTICIPANTS

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

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

Gabrielle Ricard
Senior Advisor, Valener Inc.

CONFERENCE CALL PARTICIPANTS

Jeremy Rosenfield
Industrial Alliance

Ben Pham
BMO Capital Markets

Robert Kwan
RBC Capital Markets

Amber Brown
National Bank Financial

PRESENTATION

Operator

Good afternoon and welcome to Valener and Énergir's First Quarter 2019 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, February 8, 2019, at 1:00 p.m. Eastern Daylight Time.

I will now turn the call over to Ms. Gabrielle Ricard, Senior Advisor. Please go ahead, Ms. Ricard.

Gabrielle Ricard, Senior Advisor, Valener Inc.

Thank you, Gabriel. Good afternoon and welcome to Valener's first quarter 2019 conference call. With me today from Énergir are Sophie Brochu, President and Chief Executive Officer, and Éric Lachance, Senior Vice President and Chief Financial Officer, both acting as managers of Valener.

This call is being webcast, so 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.

During the course of the presentation we may 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.

With that being said, I will turn the call over to Sophie.

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

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

Q1 2019 is a very strong quarter. Results were positively driven by many factors. In Québec, we continue gaining new customers. South of the border, we are reaping the benefits of our recent investments and rate cases, while benefitting from a stronger US dollar. Excluding the one-time non-cash accounting adjustment related to the Tax Cut and Jobs Act that continues to affect our results, Énergir generated adjusted net income of $102.4 million in the first quarter compared to $84.5 million in the first quarter of last year. For Valener, adjusted net income was $24.6 million for the first quarter, up $4.6 million from the same period last year. Per share that's EPS of $0.63, up $0.12 per share from last year.

I am now on page four and I will focus on some of the highlights of this quarter. At Énergir QDA we are seeing the positive impact of the strong sales we closed last year. Normalized natural gas deliveries increased in Q1, mainly due to the maturation of new sales, which were strong in both the residential and commercial markets. These results are also supported by the continued economic strength of most sectors in the province.

As a follow-up to the Québec government call for projects to supply Côte-Nord in Northern Québec with LNG, the process is still ongoing and the final decision by the government should be taken next spring. The final bidders are currently in the due diligence process with the government representatives. As a reminder, this call for projects is not about bringing a specific volume of LNG, but rather to provide a supply solution able to deliver up to five Bcf of natural gas per year.

In a decision rendered in December, the National Energy Board approved an even lower transportation tariff than the one initially reached by the distributor's agreement with TCPL. In compliance with the decision, TCPL filed its finalized numbers with the NEB in mid-January. However, a stakeholder has filed a complaint regarding those numbers. The NEB has put in place a process to gather comments from other stakeholders. A final decision on those tariffs is expected somewhere in March. Nonetheless, the new lower tariff, as per the compliance filing, will still be implemented on March 1st while the NEB is processing the complaint, which could result in another tariff reduction on April 1st. All this definitely strengthens even further our competitive position in Québec.

Still in December, Énergir QDA proposed to the Régie a new temporary regulated model to alleviate the regulatory process as we move toward the implementation of an incentive mechanism. The new model will cover the rate cases 2020 to 2022 and then out to set a pre-approved indexation formula to be applied on QDA's operating expenses. The proposal also slightly modifies the way over- and under-earnings are shared. Finally, we are recommending that the current return on deemed equity be maintained at 8.9% for those three years. We are expecting a decision on the operating expenses and the ROE within the next month or so while the over- and under-earnings sharing decision should be rendered before December.

Moving to Green Mountain Power, the 2019 rate case was approved just before Christmas. Combining the ripple effect of the 2018 rate case and a few other positive items, GMP is now expecting an adjusted net income increase of US$5 million over last year. The key parameters of the 2019 rate case are an authorized rate of return of 9.3% over US$1.6 billion rate base with a 50% equity thickness. From the customer standpoint, given the effect of the US tax reform implemented last year, GMP is able to offset the authorized 5.4% rate increase into a 0.9% bill decrease through the remainder of this fiscal year. In parallel, the work on the new multi-year regulation plan is continuing and GMP still expects a decision this coming June. GMP also continues its strong operational performance for customers and is working toward construction of three solar/storage projects totalling 15 megawatts of solar by the end of this fiscal year. And finally, during the quarter, the team at Standard Solar has started the construction of seven new projects totalling 15 megawatts and bringing the total megawatts in construction to 50 megawatts. With the 20 megawatts in operation, we are expecting to reach our first 100 megawatts in operation and construction by the end of this fiscal year.

Let me now turn to renewable natural gas, which we call RNG. We are very pleased with the developments that occurred over the last three months. First, our agreement with a customer, with Université Laval; second, the study that was published last fall that evaluates and confirms the significant technical and economic potential for RNG production in Québec. We continue to see strong demand from our customers for RNG. With many other new things to be announced over the coming months, RNG is building up serious momentum. The energy potential is real. RNG will greatly contribute to achieving GHG reduction targets and we have to collectively see this innovation opportunity in Québec. We firmly believe that Québec should take the lead in this sector in North America and Énergir intends to make a significant contribution.

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

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

Thank you, Sophie.

On to slide five, Valener generated adjusted net income of $24.6 million in the first quarter, an increase of 23% from the first quarter of 2018. On a per share basis, adjusted net income increased by $0.12 at $0.63 compared to $0.51 in the last year first quarter. These results were driven by a solid first quarter for Énergir, partly offset by lower power production at the Seigneurie de Beaupré wind farms. This decrease in power production is mostly due to the exceptionally strong wind conditions of last year's first quarter. Normalized operating cash flows were $12.3 million in the first quarter of 2019, up 9% from last year's first quarter. This increase stems mainly from the $1 million favourable timing difference in income taxes paid.

On to slide six, Énergir generated adjusted net income of $102.4 million in Q1-2019, up 21% from last year's first quarter. The Vermont distribution and transport sectors were the biggest contributors to the strong growth, although QDA's net income also increased from last year's first quarter. On a per unit basis, Énergir generated adjusted net income of $0.60 per unit in the first quarter, an increase of $0.11 from Q1 2018.

On to slide seven, QDA generated adjusted net income of $65.9 million in the first quarter of 2019, up $1.8 million from the first quarter of 2018. The parameters of the 2019 rate case led us to forecast a $14.9 million decrease in net income year over year with $5.5 million of that decrease in the first quarter of 2019. This decrease is largely due to the 2018 over earning and fewer non-rate-based investments; however, the decrease was more than offset by the increase in normalized natural gas deliveries as well as a favourable regulatory timing difference that is expected to reverse by year end.

In November and December 2018, the Federal and Québec governments published economic statements presenting changes to the tax depreciation applicable to certain assets. This will translate in a tax decrease for Énergir, which will eventually be returned to customers. Following this change, Énergir's net income attributable to partners is expected to decrease by approximately $6 million on an annual basis. We expect this unfavourable impact to be partly offset by the delivery volume growth seen in the first quarter, but it's still too early to confirm this expectation at the end of Q1 2019.

On to Vermont on slide eight, Énergir operations generated adjusted net income of $38.2 million, up 10.4% from last year. This increase stems first from the US$7.4 million favourable impact of the start of the amortization of the regulatory liabilities created following the US tax reform. This favourable impact will reverse by the end of fiscal 2019 due to the timing difference between the amortization and the credit given to the customer; second, the parameters of the GMP 2018 and 2019 rate cases, as Sophie mentioned earlier; and last, the appreciation of the US dollar. The 2019 rate case also includes a 5.42% rate increase which will, however, be fully offset by the start of the reimbursement to customers of the regulatory liabilities resulting from the December 2017 US tax reform. This will translate to an overall decrease in bills of 0.9%.

In natural gas transportation on slide nine, a C$16.2 million adjustment was recorded mainly as a result of regulatory development related to the US tax reform that occurred during the quarter. The new developments led us to change our estimate of regular liabilities. If we exclude this adjustment, this segment recorded a $7.7 million adjusted net income for the first quarter compared to $3.9 million in the first quarter of 2018. This increase is mainly due to higher volume being transported by PNGTS due to the colder temperatures and a new long-term contract.

In electricity production, we recorded a $0.2 million adjusted net loss for the first quarter compared to adjusted net income of $0.7 million in the first quarter of 2018. This decrease is mostly explained by normal wind regimes observed and power production at the Seigneurie de Beaupré wind farms in comparison to extremely strong wind conditions of the first quarter of 2018. The wind farms paid out a $1.5 million distribution that was only slightly lower than last year's first quarter distribution of $1.6 million.

In energy services storage and other on slide 10, we generated adjusted net income of $4.2 million, up $2.4 million from the first quarter of 2018. This increase is attributable mainly for the priority distribution paid by Gaz Métro LNG to Énergir in December 2018, which increased its share earnings as Énergir received more cash than its proportionate share.

Still on slide 10, CapEx totalled $123 million for the first quarter of 2019 compared to $218 million in the first quarter of 2018. This decrease is largely explained by GMP's investments in Transco, which were significantly higher in Q1 2018. The rest of the decrease stems from the energy distribution segment and from investments in Standard Solar's projects. For fiscal 2019, we continue to expect CapEx to range between $525 million and $575 million, including investments in affiliates, as we continue investing in securing and reinforcing on networks and supporting Standard Solar's expansion initiatives.

During Q1, the S&P rating agency revised its credit rating assigned to Énergir Inc.'s first mortgage bond from A-plus to A. This was in no way related to Énergir Inc.'s risk profile, but rather simply a change in interpretation of the criteria that has been applied for years. The corporate rating was reconfirmed at A-stable.

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

QUESTION AND ANSWER SESSION

Operator

Thank you. At this time I would like to remind everyone in order to ask a question, please 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 will come from the line of Jeremy Rosenfield from Industrial Alliance. Your line is open.

Jeremy Rosenfield, Industrial Alliance

Thanks. Just a couple of questions to clarify. First on QDA, the expected impact for the tax change, that's not reflected in the $130 million forecast for 2019. Is that correct?

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

The $130 million that we guided for the rate case, that was not included. That's right.

Jeremy Rosenfield, Industrial Alliance

Okay. I just wanted to make sure about that. And then just on transportation, the positive impact from colder weather, I'm just curious if you've seen that carry into Q2 in the January period with persistent cold weather. To what degree is that persisting?

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

We don't guide on the current quarter.

Jeremy Rosenfield, Industrial Alliance

Okay. Okay, I'll leave it there. Thanks.

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

No problem. Thanks.

Operator

Your next question comes from the line of Ben Pham from BMO. Your line is open.

Ben Pham, BMO Capital Markets

Thanks. Good afternoon. Some of your comments on the TransCanada tolls with the settlement, that's likely coming down and appealed, but the direction is down. I'm just curious about your comments. Sophie, you mentioned it being a potential positive impact on your business. Is that just really giving you some room on the Québec utility in terms of ability to grow? Do you see that? And I guess is there some sort of positive volume flow through on PNGTS and some of the other pipelines you own?

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

Well, simply said, the transportation cost is a component of the ultimate bill paid by our customers, so any time the transportation cost gets lower it increases the competitiveness of our delivered product.

What I was trying to say, and I stumbled on my poor English, was that we are already competitive across markets, so that furthers the competitive position enhances even more the attractiveness of the juice. So it's just ultimately another positive that could happen, but we don't need that to get into a competitive position, because we are, it's just a very nice wind at our back.

Ben Pham, BMO Capital Markets

Okay. It's good to hear that. And maybe on some of the—I know you mentioned that the CapEx number's unchanged and earnings guidance unchanged, some timing to think about on some of the utilities. Maybe can you talk to me, high level, the financing side at Énergir, and then how should we think about that from the Valener perspective?

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

You mean in terms of future equity needs?

Ben Pham, BMO Capital Markets

Yeah, even just the debt. I'd say you're spending $500 million in CapEx. What's the debt and then excess cash and then how do we think about the Valener, the 29%?

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

Yeah, no, in terms of the 29%, based on the guidance on CapEx and the volume, we would not expect—Valener has ample liquidity to follow any equity injection that would be required in order to achieve the guidance that we just gave. So, they have the flexibility for it if there is a need for equity at the Énergir LP level.

Ben Pham, BMO Capital Markets

Okay. And you have a small DRIP outstanding. Is that correct?

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

Sorry, I didn't hear?

Ben Pham, BMO Capital Markets

Dividend reinvestment, like you have that.

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

Yes, there's a small DRIP. Sorry, I didn't hear the DRIP. Yes, we have a small one

Ben Pham, BMO Capital Markets

Okay. That's helping a little bit then, right? Is that why that exists then or is that just more for a shareholder total return profile?

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

It's a mix of both, honestly. I think the shareholders, they like it, and as well it sure helps as a source of funding over the long run.

Ben Pham, BMO Capital Markets

Okay. Those are my questions. That was very helpful. Thank you.

Operator

Again, if you'd like to ask a question, please press star then the number one on your telephone keypad. Your next question comes from Robert Kwan of RBC Capital Markets. Your line is open.

Robert Kwan, RBC Capital Markets

Good afternoon. Maybe I'll start with the Vermont side.

So, you've got the guidance of just over US$5 million positive benefit from the rate case year over year. I'm just wondering on top of that, is that really the major driver you see in the segment? I guess FX is also moving around. Is there anything as it relates to CVPS energy deal or anything at VGS on top of that?

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

No.

Robert Kwan, RBC Capital Markets

Okay. Coming back to the QDA tax side of things, the downward pressure you would see up at the Énergir level, is there any offset to that though at the Valener level when you look at the tax composition of the distributions flowing to Valener?

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

Yeah, that's a good question. Yes, absolutely, because the impact that we've seen, like we said, is because the taxes are not actually paid at the partnership level, so both associates, and that includes Valener, will see the benefit of those lower tax expenses. So, economically speaking, it's neutral for Valener and Énergir Inc. as well.

Robert Kwan, RBC Capital Markets

Okay. So, I guess there's kind of two statements here, because you're holding the guidance up at the Énergir level, you've got downward pressure on tax it looks like based on the quarter to a degree that you're outperforming the rate case by some amount but, as you said, it's too early to tell, but if you froze kind of the outlook here your plus or minus neutral at the Énergir level but you'd be positive as it flows down to the Valener level.

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

Yeah, you did the right math. Basically, if you follow the steps, what we're saying is that this negative impact related to taxes of around $6.6 million, I think, at the partnership level. Our view is that, mostly because of volume, this will be compensated at the partnership level. So, we'll still be in line with the $130 million that the rate case, but through a different route. At the Valener level that means we'll basically be on the upside.

Robert Kwan, RBC Capital Markets

Okay. Maybe I'll just finish on the LNG side. There was the priority distribution in the quarter. Just wondering how should we be thinking about the magnitude and timing of similar or are there similar distributions into the future?

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

It's not really much more material than what you've seen and it's not something that's going to last for many years. It's a private agreement but I would not be concerned that much around it for future years, honestly.

Robert Kwan, RBC Capital Markets

So, sorry, so it was kind of more isolated to the quarter?

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

It could be repeated, but this is the impact of a full year, just to give you an idea, that was basically we don't necessarily pay distribution every quarter at the LNG level, so that reflects the impact of basically a year. And this is not something that's going to last forever, so it's not something that you should see for many, many years or so on. So, honestly, it's not that meaningful in terms of valuation.

Robert Kwan, RBC Capital Markets

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

Operator

Your next question comes from the line of Amber Brown from National Bank. Your line is open.

Amber Brown, National Bank Financial

Good afternoon. I just have two questions. The first one is regarding your GMP rate case and specifically the acquisition, the CVPS acquisition, and there's a provision that says that you guys will return US$13.9 million. However, shortly down the page it also states that you will be returning US$18.5 million in synergy-related savings, so I just wanted to confirm which number that would be.

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

We have a commitment to return a minimum and a cumulative amount over the 10-year horizon. So, the way it accumulates is if we are over that floor it's 50-50 with the customer. And we file with the expectation of returning that US$18.5 million. I take your number, I don't have it exactly in front of me, but the US$18.5 m you're referring is because we expect to return more currently. But basically, if we were to be lower than the US$13.9 million, as per the agreement that would be our responsibility, but since we're above, it's 50-50. And we're committed to, in the aggregate, to also return up to $140 million of synergies.

Amber Brown, National Bank Financial

Okay, great. Thank you for that colour. And then my second question is regarding your distribution from SDB wind farm and you've guided towards roughly about $8 million in earnings per year until 2033, 2034 when those contracts roll off; however, in 2018, and it was closer to about $5.5 million to $6 million. So I just wanted to confirm that you're still thinking about $8 million in earnings.

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

Yeah, the $8 million is at P50 and also from fiscal year to fiscal year you have to be careful, because the timing of an actual distribution may mean that sometimes we have one more in a year and the other year we have one less. But the $8 million is still the running pace.

Amber Brown, National Bank Financial

Okay, great. Thank you so much.

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

You're welcome.

Operator

And your next question comes from line of Jeremy Rosenfield from Industrial Alliance. Your line is open.

Jeremy Rosenfield, Industrial Alliance

I just wanted to come back on the multi-year filing that you made in QDA. If you could just sort of talk about the strategy for formulaic indexation of the operating expenses and to what degree you think that could help the business over a several year timeframe.

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

Sure. First of all, I think the idea of the filing that we do is really one to simplify the regulatory back and forth and as well it's a will that there is both in terms of the company and the regulator and the interveners, so that goes into that spirit of trying to find a balance mechanism before going into a full incentive regime. So what we basically did is we looked at basically what has been the norm around QDA in terms of rate cases that have been filed around those type of regimes. So, basically, the clear benefit in addition to it is really for us to be able to, I would say, manage the business, try to find benefits for our customers and be able to, if you have a little more cost during one year, that will lead benefits to the other years, which would be both to the benefits of the customers and the company, that we can incur those because we have a predictable path around our OpEx going to increase in the next three years if the Régie agrees with what we proposed.

So that was really striking a balance based on what we've observed as a reasonable rate path based on Hydro-Québec, and so on, and gaining sufficient management flexibility so that both the company and its customers can benefit from basically more flexibility around how we manage the business.

Jeremy Rosenfield, Industrial Alliance

Okay. And then I'm just curious, you know, on the deemed equity and ROE. You've also applied to maintain those for a period of time, but does that not expose you to certain degree of risk if there are changes in capital market conditions or something else that may lead you to want to adjust that parameter over time?

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

Certainly, it's always a possibility, but honestly, when you look at the horizon of three years, when you look at the risk/reward, we're quite comfortable for that period of time. That's not something we would do over ten years, but for a three-year horizon that makes sense for us.

Jeremy Rosenfield, Industrial Alliance

Okay. Good. Thanks for that. That's it.

Operator

We have no further questions at this time. I'll now turn the call back over to the presenters.

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

We thank you very much for your time and speak to you soon. Thank you. Bye-bye.

Operator

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