Just Energy 3rd Quarter Results Conference Call
2/10/2011 – 2:00PM ET

Operator: Good afternoon, ladies and gentlemen. Welcome to the Just Energy Group Conference Call to discuss the 3rd quarter results for the period ended December 31, 2010. I will now turn the call over to Ms. Rebecca MacDonald. Go ahead, Ms. MacDonald.

Ms. Rebecca MacDonald: Good afternoon. With me this afternoon is Ken Hartwick, our CEO, and Beth Summers, our CFO. Ken and I will make a short presentation, and then we will open the call to questions. Let me preface the call by telling you that our earnings release and potentially our answers to your questions will conTaln forward looking financial information. This information may eventually prove to be inaccurate, so please read the disclaimer regarding such information at the bottom of our press releases. I'm pleased to announce our first set of quarterly results since our January 1 conversion to corporate structure. Our 3rd quarter was another outstanding full quarter for customer aggregation. As was the case for the past two quarters, our new customer additions were at unprecedented levels. Gross additions were 252,000 customers, up 84% from the level seen a year ago. Net additions were 80,000 customers, five times those of the previous 3rd quarter. As has always been the case for our business, customer growth is a clear sign of the fundamental health of Just Energy. These results evidence the continued adaptability Just Energy has shown throughout its history. Two years ago, Just Energy was a very successful business focused almost exclusively on the long term fixed price gas and electricity contract for residential and small commercial customers. Those two years have seen the worst scenario for our products, a slow, steady decline in commodity prices with little or none of the volatility seen in the past years. This type of market is the worst for our insurance product, which protects against commodity price volatility. Add to this a very weak economy and one record warm winter, and you can see this has been a challenging period for our management team, and as always, we have dealt with the challenges. We have made two creative acquisitions, one of which eliminated our most active competitor in our core markets, and the other provided a proven platform for entry into larger commercial markets. This period also saw the growth and development of a very successful water heating and home services business, diversification we are very proud of. Finally, we initiated our green, our Just Green program offering our customers a green alternative for their commodities consumption. Just Energy has responded. Our consumer energy division has continued success, particularly in U.S., with offerings centered around our Just Green products. In the case of our commercial division, our new broker channel is functioning smoothly, and we are obviously very happy with our Hudson Energy acquisitions. Overall, our customer base was up 42% year over year finishing at over $3.2 million, even excluding customers acquired with Hudson. Our organic net additions year to date are 288,000, which is 13% growth in only 9 months. Growth under any conditions has been a hallmark of Just Energy, and that tradition continues. Let me turn things over to Ken to talk about operations, then I will finish with a brief discussion of our future.

Mr. Ken Hartwick: Thanks, Rebecca. We have solid operating results for the quarter. Sales were up 13% year over year. This was less than our customer growth, largely due to the sharp decline in the U.S. dollar over the period and lower prices on commercial business. Also remember that there is normally a lag of up to 6 months between the point of time that we confirm a customer and the first cash flow from that customer. Accordingly, the full sales and margin benefit from our past two quarters of marketing success will be seen in Q4 this year and the year following. Our gross margin was up 5%, or 5% per share, less than our sales increase, but in line with our 5-10% per share operating target. Margins were up less than sales, largely due to the continued shift of our business towards commercial customers, which

while generating lower margins, also have lower aggregation costs and ongoing customer care costs, resulting in a very similar long-term customer value. Margins are also adversely impacted in the short term by the success of our blend and extend program. Under blend and extend, customers nearing the end of their contract, locked in at very high prices, can elect to see an immediate lower price by extending their contracts for up to five years. Because we have already purchased gas or electricity for this customer, this reduces our margin for the remainder of the contract but increases the margin for the term of the extension. We accepted reduced margin of $3.4 million in Q3 on blend and extend and other contract adjustments. For the 9 months, total margin reductions have been $6.9 million. However, these retention efforts have resulted in $20.5 million in increased future margins from the extension period. We think this is an excellent return on investment, despite the short term cost to earnings. Sales of our Just Green products remain strong. During the quarter, 37% of our new residential customers contracted to take on an average of 92% of their consumption from green sources. The current and past success of Just Green means that currently, 10% of our residential electricity portfolio and 5% of our gas portfolio are higher margin Just Green customers. On a cost side, our general administrative expenses went from $10.89 per customer a year ago to $8.21 per customer in Q3. This reflects the lower customer care costs inherent in the commercial business and continued cost management. This is a trend which should continue. We saw the impact of an improving economy in two areas: our attrition is below target levels in the U.S. after two years of above target losses. We saw fewer foreclosures and fewer moves in the quarter, and we are hopeful that this downward trend will continue. In Canada, attrition was slightly above, and renewals were lower than targets due to the long period of low price volatility and a very high fixed price premium to the prevailing utility spot prices. Our reduction of this premium should improve our future renewal rates. Our level of bad debt has improved. In the trough of the recession, our bad debt peaked at 3½% of sales in the markets where we bear bad debt risk. In Q3, our bad debt losses were 2.5%, back in the middle of our 2-3% target range. Remember that we only bear bad debt risk on 36% of our revenues. In all other markets, the utility bears the risk as part of its regulated rate base. Our water heater business remains strong. We passed 110,000 installed units, and we are installing more new high efficiency Energy Star rated units daily. The addition of high efficiency furnaces and air conditioning systems to our product line has also been well received. Our ethanol plant in Saskatchewan is operating at near capacity levels, and the result is a positive contribution from this facility. Overall, our adjusted EBITDA was up 25% per share, and net income, which as you're aware, is not a measure we use for analysis due to non-cash mark-to-market on our future supply was up 117% per share. Previously, we had guided a 5-10% per share growth in both margin and distributable cash at parent ratio of less than 100% after all marketing. Our margins are up 5% year over year after 9 months, and our current based of locked in contracts should result in gross margin growth up toward the top end of the 5-10% target range for the year. This would clearly indicate that we expect very strong margin growth in the 4th quarter. Our distributable cash is down 11% per share in the quarter due to high interest costs, higher taxes, and the weak U.S. dollar. After 9 months, it is down 12% per share, reflecting the effect of a record warm winter in the prior winter. Clearly we expect that it will end the year lower than our 5-10% per share per target due to that warm weather. Our pay ratio was 81% for the quarter and 103% for the 9 months. As I noted, our customer base slowing in Q4 should generate strong results, and we currently expect a payout ratio comfortably below 100% for the year in line with our guidance. Let me also respond to a question we have received from analysts and investors. As regard to our taxes as a corporation in fiscal 2012, while we have not utilized any tax laws or similar structures, we will fully avail ourselves of the optimal tax year end as other converted trusts have done in order to minimize the first year Canadian tax we pay as a corporation. Let me turn things back to Rebecca to talk about the future.

Ms. Rebecca MacDonald: Thanks, Ken. We have always been proud of the fact that Just Energy is a unique growth and income vehicle. The results of the past three quarters show that our growth is as strong as ever. We must work hard to mainTaln our position as a North American market leader in supply of deregulated commodities, and we have every intention of doing so. Let me finish by talking about an important milestone. At the end of January, we paid our first monthly dividend as a corporation.

As we promise, it was 10.3¢ per share, exactly the same as what our monthly distribution had been as a trust. What was different, was the tax treatments for our taxable holders. Ontario tax rates are approximately 47% on distributions and 27% of dividends. I am pleased that starting last month, our taxable equity holders will have 38% more after tax going forward. We are one of the few trusts that have been able to mainTaln their level of payout without the use of tax loss vehicles. It says a lot about the solidity of our business model and our ability to grow through the corporate tax we will have to pay. As Ken just pointed out, even with disappointing weather, we have seen in the past year our payout ratio should be comfortably under 100% as we projected in our guidance before the year began. Looking forward, you should expect to see continued creativity in our product offerings and further geographic expansion of our business. I would like to thank all our shareholders for their continued support. We were Canada's most successful trust, and we look forward to building a similar track record as a corporation. On that note, I would open up for questions.

Operator: Ladies and gentlemen, if you would like to ask a question, please press 01 on your telephone keypad. Once again, if you would like to ask a question, please press 01 on your telephone keypad. And our first question comes from Tony Courtright. Please go ahead.

Mr. Tony Courtright: Thanks very much. Just as a leadoff question, to be cerTaln, despite the reorganization, have there been any changes, fundamental changes with your supplier, energy quality supplier arrangements?

Mr. Ken Hartwick: You're speaking about our suppliers like Shell and BP and others?

Mr. Tony Courtright: Correct.

Mr. Ken Hartwick: No, there have been none , the fundamentals of the supplier arrangement remain the same, and I think over the course of the past couple of quarters, we've actually added a couple of suppliers into the supply arrangement, so we've been able to broaden out that supplier pool in the process.

Mr. Tony Courtright: And typically, no cash collateral requirements?

Mr. Ken Hartwick: No, the structure is the same when we did the credit facility update and renewal, it's the same principle that the contract, customer contracts replace the collateral. We don't have posting requirements, so none of that has changed as part of the update.

Mr. Tony Courtright: Great. In terms of Canadian attrition or fail to renew, actually, it's not to do with that, it's more to do with just the performance in Canada, there seemed to be a disproportional reduction in the volume of electricity and gas delivered or consumed relative to the reduction in the number of customers. I can understand on gas, it might be warmer weather compared to last year, but on electricity, I've found that surprising. Can you explain that or comment on that?

Mr. Ken Hartwick: Yeah, I think across the Canadian book in general, we had, in that book, had a series of load following related cut, if you recall the difference between the load following customers vs. what our contracts were, or are typically, as far as balanced product, so some of those have begun to drop off through the Alberta book in particular, which we had acquired four years ago, so again, that part of the book is dwindling down, which is a positive for what we're doing.

Mr. Tony Courtright: Right. In Ontario, the government has announced that they'll provide 10% abatement of power costs for the next five years to defray the expense of all the renewable energy, I think. How does that work in connection with somebody that has a contract with Just Energy?

Mr. Ken Hartwick: It is, it applies exactly to whether the customer is a Just Energy customer or a Toronto Hydro customer, they get the 10% on their total bill, so they're exactly the same off with whoever they are, whoever they have as a supplier of their commodity.

Ms. Rebecca MacDonald: You know what, Tony? Come on! It's election year! Our government wants to give us back some of our money!

Mr. Tony Courtright: I just wonder whether you get 10% back, or do you get 10% of the regulated rate plan back, even though your contract costs might be higher than the regulated rate plan currently.

Mr. Ken Hartwick: Yeah, you get 10% back of your bill that you paid.

Mr. Tony Courtright: I see. Okay.

Ms. Rebecca MacDonald: Whatever your cost is.

Mr. Tony Courtright: Right. Okay, and then generally, how do you see the mix of your customer base evolving going forward? Do you, it's currently, I gather, around 60 reTall consumer and 40 commercial. What do you envisage it going forward?

Mr. Ken Hartwick: Right, so I think as we expand the geographic footprint of Hudson, or commercial side of our business, and they go through the licensing process to move into difficult states and some provinces that we're moving into, we would anticipate that moving closer to a 50/50 mix over the course of the next year, so it's, most of the business growing, but we think the commercial business can grow more quickly, which should shift it into that range.

Mr. Tony Courtright: Great. Okay, those are my questions. I appreciate it.

Mr. Ken Hartwick: Thanks, Tony.

Ms. Rebecca MacDonald: Thank you.

Operator: Okay, next up, we have Marco Pencak. Please go ahead.

Mr. Marco Pencak: Thank you. Good afternoon. First, a quick question for Beth. In your MD&A you talked about losses on sale of excess gas in the U.S. in the third quarter. Do you have a dollar value for that?

Ms. Beth Summers: Yeah, roughly between the reconciliation and the third party sales, about a $2 million impact in the 3rd quarter.

Mr. Marco Pencak: Okay. And then sort of going back to Tony's question, he talked about the mix of commercial vs. residential, I mean, when we look at your net customer adds during the 3rd quarter, if I've got the numbers right, you added 78,000 out of the 80,000 as commercial and only 2,000 as residential, so you do talk about the difference in pricing between spot and 5 year contracts, etc, but if we sort of assume that natural gas stays suppressed, and I guess by extension, in cerTaln jurisdictions, power prices will as well, other than blend and extend, strategically, what do you think you might have to do in order to stimulate growth on the residential side?

Mr. Ken Hartwick: Yeah, I think there's a couple parts. First of all, separating out a natural gas customer from an electricity customer. So if you go to some of our electricity markets, whether it's New

York or Texas or Massachusetts, there is much more volatility, just seasonal and otherwise, volatility in the electricity price. So the same dynamic that you have or difficulty in adding in a relatively flat gas environment, we think there's growth, definite ability to roll out residential market in those electricity markets because of the volatility. With respect to the gas, it's really been the push that we have had on the carbon green side to the gas and adding a feature to that product so the consumer is willing to pay a premium and willing to enterTaln the offer to begin with in order to sign up to that gas contract, so it really is a bit of a mix of the two, but somewhat of a different dynamic for each of the two different commodities.

Mr. Marco Pencak: Okay, so we haven't yet seen that really manifest itself, and are you sort of hoping that it's just a timing issue between when you finish, you have started those initiatives and when we might start to see the impacts of those customer adds then?

Mr. Ken Hartwick: Yeah, I think that's across, it's both the, again, you put what we're adding into the green book as well, so that each customer is more profitable that we are adding because of the green attribute that is going along with it, and also, again, if you look to our Ontario business as well, we have a bit of a choice when it comes to their sales organization that we've also been very aggressive in our sales organization and the results we've achieved in their water heater home services business, and that, I think, is also, maybe detracts somewhat from the number of salespeople we have on the commodities side of the business, and again, there's a limited number of people that want to do any job, but we think it's the right place to deploy the resources.

Mr. Marco Pencak: Okay. And then my last sort of set of questions has to do with the changes in the competitive landscape, both on the commercial and residential side. So first on the commercial side, now having had Hudson consolidate for a couple quarters, have you seen any change in how your competition on the commercial side is conducting themselves in the marketplace?

Mr. Ken Hartwick: I think it's, Hudson had been in operation for a number of years before we bought them, so I don't think there's been any change in that landscape over the course of the couple of quarters that we've owned Hudson. I think what we are getting more confident of is the team that came over with Hudson and the leadership we have on that commercial business is very strong, and as we've given them new markets to enter into, like Pennsylvania, which was one that we entered into this quarter, I think it expands our footprint and therefore makes us more attractive to brokers and customers because we might be in multiple jurisdictions where they operate, so I wouldn't say anything really on the competitive side responding to us yet as much as our ability to, like, say, offer more to a customer segment because of the expansion.

Ms. Rebecca MacDonald: No, the only thing I'd like to add anecdotally, you know, in some jurisdictions, we are seeing difficulties that competitors are having with getting the credit lines in order to procure the commodity, and that's not a problem that we have, so I think that we are definite, we do definitely have a competitive edge in cerTaln areas over other commercial competitors. I would say some of them are hurting just because of their inability to satisfy their potential suppliers with their balance sheet.

Mr. Marco Pencak: Okay, and how about on the residential side? I know you've talked previously about potential new and evolving marketing channels, etc, or the way that some of your competitors might be going to market to capture customers. Can you give us an update on what you're seeing?

Mr. Ken Hartwick: Yeah, I think the residential or consumer competitive landscape, again, tends to be very regional, so we, other than perhaps Direct Energy, which we see less of in most markets, we tend to have a group of competitors that are sort of New York specific, New York, New Jersey, in that area, and

then a group again down in Texas, but again, what we've sort of looked at from a regional standpoint is, again, our bread and butter is our door-to-door sales, it has been and continues to be what is going to drive the sale, but have also started to deploy some customer enrollment processes through internet and with a system of third parties, which we are starting to get the yield that we want from, so I think we'll continually explore those, but fundamentally, it is the door-to-door operation that is driving the residential side of the business.

Mr. Marco Pencak: And then how big an aggregation channel would Momentus be for you now? It's still very small?

Mr. Ken Hartwick: Very small. And again, it's like any business we started, or in starting it up, we're going very slowly with it. It's very deliberate. We're going to make sure we have the model working well. We like the number of reps that we're now bringing on board in the various jurisdictions that we operate, but, like I say, it's still a first year startup, and I think we're going to be another year before we start to count on that model as a major contributor to our quarterly or monthly results.

Mr. Marco Pencak: All right. Okay, thank you.

Ms. Rebecca MacDonald: Thanks.

Mr. Ken Hartwick: Thanks, Marco.

Operator: Okay, once again, ladies and gentlemen, if you would like to ask a question, please press 01 on your telephone keypad. And we have a question from Tal Woolley. Please go ahead.

Mr. Tal Woolley: Hey, good afternoon. Just wanted to be clear on guidance again. You were saying the Q4, you're expecting that you'll exceed your 5-10% margin guidance, but for the year, you'll still be shy of that prior guidance?

Mr. Ken Hartwick: Right. From a margin standpoint, we expect to exceed it for the quarter.

Mr. Tal Woolley: Okay. All right. And I just noticed, how much do the, I think you go out, it's still about 40,000 customers outside the pool count that are still contributing. Do you have an assessment of how much they contributed to the quarter?

Ms. Rebecca MacDonald: You know what? Can you please repeat the question?

Mr. Tal Woolley: Yeah, you've got about 40,000 customers that you're not including in the official count. You sort of designated them as short term, and I was just wondering how much they contributed to the quarter.

Ms. Beth Summers: I mean, I think roughly I would say a million, perhaps, from a gross margin perspective.

Mr. Tal Woolley: All right. And just, you were talking about these new channels that you're opening up. Does that change, like, your incentive structure that you have to use with your existing salespeople, because you're sort of effectively introducing some competition, potentially, for the same customers. Do you have to go back and review your commissions?

Mr. Ken Hartwick: No. In fact, the, again, when you look at some of the markets where we're operating the other channels in, like I say, New York, we're just scratching the surface on the number of

customers, and so when you get into the bigger markets that we're in, you just don't get any bump between the two sales channels, so if anything, we've seen a little bit of lack of pressure on our commission side of what we do, in part because of what Rebecca said, we see a number of competitors, either having difficulty getting the necessary credit, and therefore less sales activity, so it probably is a little less inflation on our commissions and what we've seen a number of years back.

Mr. Tal Woolley: Okay. I guess just my last question, on the approach to sort of, you know, using blend and extend, and maybe reducing prices, can you talk to me about how, you know, is this sort of, do you think this is a short term situation where it's just sort of a function of where your book is right now and what prices is[sic] or do you think it's sort of like a longer term tool that you see yourself kind of using?

Mr. Ken Hartwick: It's a relative, if you looked across our book, we've had low gas prices now for closing in on three years, so in a simplistic way, you'd look and say, we have two years worth of our customers with higher gas prices, once we go through the blend and extend program for that book of customers, then the current customers that are sitting on the book that we've signed the last three years will have very competitive prices, and then we think we have a couple things happen. First of all, you don't need to do blend and extend to those customers, because of the price points they're at, and secondly, I think that some of the attrition that you see across that lower price book will inherently decline because of the prices that they're now priced at, and I think this is something that, this, maybe it was called something different, but was done a number of years ago back in the company's history, when with a similar rapid decline in prices, but I think if you call temporary, I think it's temporary for about another year.

Mr. Tal Woolley: Okay.

Ms. Rebecca MacDonald: You know what? You have to appreciate that, and Ken's just touched upon it. He was not around in the late 90s when we did this as well, but we always respond very quickly to make sure that we are proactively working with the customers on keeping them and not letting them go to a very big sticker shock when he looks at the utility prices that have been exceptionally low, and it has always, always worked well for us, so we just react in the same way we did in the 90s.

Mr. Tal Woolley: Okay, that's great. Thank you very much.

Mr. Ken Hartwick: Thanks a lot.

Operator: Okay, and that was our last question.

Ms. Rebecca MacDonald: Well, if there are no other questions, thank you very much for attending our conference call. Look forward to having you at our results report in the 4th quarter. In the meantime, if you want to ask us any additional questions offline, you have all our numbers, so feel free to call us directly. Thank you very much.

Operator: Thank you very much, ladies and gentlemen. This conference is now concluded.