Final Transcript

Customer: Just Energy
Call Title: Q4 2015 Conference Call and Webcast
Confirmation Number: 39455218
Host: Dorothy MacDonald
Date: May 14, 2015
Time/Time Zone: 1:00 pm Central Time

SPEAKERS

Deb Merril – President and Co-Chief Executive Officer
Pat McCullough – Chief Financial Officer
James Lewis – President and Co-Chief Executive Officer
Rebecca MacDonald – Executive Chairman of the Board

ANALYSTS

Damir Gunja – TD Securities
Nelson Ng – RBC Capital
Kevin Chiang – CIBC

PRESENTATION

Operator: Welcome to the Just Energy Group Inc. Conference call to discuss the Fourth Quarter 2015 Results for period ended March 31, 2015. At the end of today's presentation there will be a formal Q&A session.

I would now like to turn the meeting over to President and Co-CEO, Ms. Deb Merril.

Deb Merril: Thank you very much. Hi, my name is Deb Merril. I'm the Co-CEO of Just Energy and I would like to welcome you all to our Fiscal 2015 Fourth Quarter and Year-End Conference call. I have with me this afternoon Executive Chair, Rebecca MacDonald; my Co-CEO, James Lewis; as well as Pat McCullough, our CFO. Pat and I will discuss the results of the quarter and full year as well as our expectations for the future. We will then open the call to questions.

Before we begin, let me preface the call by telling you that our earnings release and potentially our answers to your questions will contain 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 release.

2015 was a remarkable year for Just Energy. Not only did we deliver outstanding financial results, we also made significant strides along many of the critical objectives we set out to accomplish. These are objectives that we feel provide the platform upon which to transform the company and execute the strategy effectively. A strategy that will position Just Energy to fully participate in what we view as a significant macro-trend in how individuals will consume energy and manage their energy needs in the future.

I want to first address the headline in this morning's AP Newswire, which was Just Energy reports fourth quarter loss compared to a profit a year earlier. For most of you on the call, it is obvious how misleading this is. In fact, our fourth quarter generated tremendous results, particularly compared to fourth quarter of last year. Let me once again explain, the loss from continuing operations in the quarter, $65 million, and the year, $576 million is entirely due to the change in non-cash mark-to-market valuation of our future supply position. As this future supply has been sold to customers at fixed prices, changes in the mark-to-market should have no impact on future margin and therefore company value.

Management remains adamant that quarterly mark-to-market will have no true impact on current and future results. As with other energy retailers, Just Energy uses base EBITDA as a preferred measure of operating performance. As you will see, our base EBITDA grew significantly both for the quarter and the year. Before diving any deeper into the results, let me take a moment to reflect it a bit more on why fiscal 2015 was so important to Just Energy's future. When Jay and I took reigns over one year ago, the polar

vortex had just slipped the retail energy market on their heads, leading to financial losses and even bankruptcy among many small players, in addition to causing a shift in consumer behavior. All of these things benefitted Just Energy on a relative and absolute basis due to our leading position in this space.

First, our world class risk management capability protects Just Energy against that kind of one-in-one hundred year type of event. We pride ourselves on the sophisticated risk management strategy that we've developed over the last several years, utilizing various instruments to minimize adverse impacts to business from weather. It is also worth mentioning that our hedging practices have actually improved as a result of the lessons we learned during the polar vortex.

Second, we saw consumers become more aware of their energy usage and bills and ultimately seek out better options than may have historically been presented. This [indiscernible] Just Energy and our record 1.4 million gross customer additions and our 276,000 net customer additions for the year is just one example of that. In fact, fiscal 2015 marked the 18th consecutive year of net customer additions for Just Energy.

We now serve over 2 million individual customers consuming the equivalent energy of 4.7 million residential customers. To put that into perspective, Just Energy now provide nearly 2% of North America's total energy consumption. What's important about our continued ability to grow this large established base business is that the growth is also very profitable growth. We realized higher margin for customer in both the residential and commercial business during fiscal 2015. This is directly related to the ongoing commitment to the margin improvement initiative that we have talked publicly about over the course of the past year.

To add some color on how far we've come along already this year, we're now signing consumer customers at $191 margin per RCE which compares to $166 one year ago. Additionally, commercial

margins are being added at $79 per RCE up from $67 one year ago. We were able to drive these improvements in margin because our innovative new products are gaining more appeal and presenting more value for customers. This is allowing us to price our energy management solutions at premium points without sacrificing customer satisfaction.

I'd be remiss if I didn't specifically mentioned our great success in UK as well. We entered the UK commercial market just over two years ago. Over that period, our customer base has grown to 202,000 RCEs. Gross additions for the year were 148,000 up 90% from 78,000 a year ago. This market has grown to become 4% of our customer base. Not only has the UK has fully repaid our investment in the region, but it now makes a contribution to the profit of the company.

We launched our residential product offering in the UK as of last July. We believe this early success validates our model and our ability to compete outside of North America taking the lessons learned in evaluating new avenues for growth in new markets that will benefit from our innovative approach to energy management solutions. In addition to the strong financial results for the year, we also significantly improved our financial footing and flexibility by directly addressing the company's debt level. At year end 2015, our book value net debt was 598 million, down 322 million, a 35% reduction from one year ago. We sold two non-core non-strategic assets in November, our National Home Services water heater unit and our Hudson Commercial solar business, and the proceeds from these sales drove the debt reduction. Pat will discuss with you in more detail next.

Simultaneous to all we've discussed so far, we also reached a very unique strategic agreement with Clean Power Finance to enter the high growth residential solar market in a manner that leverages Just Energy's core competencies in sales and marketing, tapping into our 2 million captive customers and the millions of doors our team knocked on annually. This partnership enables Just Energy to provide solar

offerings to its customers in a way that positions us to benefit from the most profitable part of the solar value chain.

We lost our solar pilot program in California in March and New York in May. Whilst it is still very early in the pilot phase of the business, the initial results and feedback have been positive. Our plan now is to continue to carefully expand our solar footprint to other states where it makes economic sense and to continue to push the industry forward to develop more customer friendly products that provide value to the homeowner. In summary, it has been an excellent year for our company and one we feel strongly directs us on the path forward to becoming the premier world class provider of energy management solutions.

Now I'll turn the call overt to Pat McCullough to talk about the financial details for the quarter and fiscal year and then I will finish with a discussion of future trends and the outlook in the market.

Pat McCullough: Thank you, Deb. I want to echo what Deb said and that we are really pleased with the progress we made in 2015, how we finished off the year from a financial perspective and the strong start we're seeing here in fiscal 2016. Let me cover first some highlights of the fourth quarter and then I'll take you through the fiscal year results.

Fourth quarter sales were up 7% to $1.2 billion reflecting our year-over-year growth in customers. Gross margin of $194 million was up 41% from fiscal 2014 reflecting comparison to the polar vortex quarter last year as well as the higher US dollar. Base EBITDA was $68 million up 20% reflecting the strong margin growth offset by unforeseen legal costs which drove administrative expense higher. Lower debt after the closing of the NHS sale had a very positive effect on FFO for the quarter as it reached $32 million up 84% from fiscal 2014. Overall an extremely strong quarter.

Let me now cover the results for the fiscal year. Our sales for the year were up 10% to $3.9 billion reflecting our 6% increase in customers. The impact of the higher US dollar on conversion of US revenue as well as higher selling prices in fiscal 2015 compared to 2014. For the year, the overall net impact of the higher US dollar including impact on both revenues and expenses was approximately $8 million favorable. For the fiscal year, margins were up 19% to $600 million driven by our customer growth, the US dollar, higher volumes used for commercial customer, and higher realized margins per customer.

An important driver of profitability was higher new customer margins. We're able to do this because of our innovative new products that achieved both value for the customer and provided better margins for Just Energy. As Deb mentioned, new commercial customers were signed at $79 per RCE annual margin, up from $67 a year ago. A higher commercial margin is a conscious decision to reduce low margin commercial business and focus on more profitable customer segments. We've also benefitted from the market exit of a number of smaller low price competitors who failed because of less sophisticated risk management processes during the polar vortex. New residential customers were signed at $191 for RCE annual margin, up from $166 a year ago.

Improved margins per customer has been the focus here. Higher margin on residential customers is a positive trend, as these customers are largely locked into multi-year contract terms. Administrative costs were up $37 million or 32% year-over-year. We had anticipated double-digit growth to fund expansion of organic infrastructure but there were significant unforeseen impacts from the US dollar and non-recurring charges of $14 million and legal costs related to law suits brought during the year. We expect administrative costs to return to normal in fiscal 2016. Selling and marketing expense during the year increased by $35 million or 19% year-over-year compared to the 5% increase in customer additions. Selling costs included amortization of past advances to commercial agents and residual payments to our online channel.

These costs are not associated with customers added during the period. This trend of high growth in selling costs will continue until the shift to higher residual marketing channel stabilizes. Bad debt was at the low end of our target range at 2.4% of relevant revenue, up from 2.1%. This increase was attributable to higher defaults on very high polar vortex bills last year which became due in fiscal ’15. The proportion of revenue on which we bear credit risk will continue to increase as Texas, in particular, remains a fast growing market. Fiscal year 2015 EBITDA finished at $180 million, up $13 million or 8% from fiscal 2014.

The company has provided guidance of $163 million to $173 million of base EBITDA for fiscal 2015 and updated that guidance to the upper end of that range following the third quarter results. Actual results succeeded the upper end of the range by $7 million based on strong fourth quarter performance despite higher than anticipated operating costs associated with the legal and regulatory expenses.

For the year, funds from operations were $93 million, up from $89 million in fiscal 2014 consistent with our change in EBITDA. Our dividend payout ratio was 94% for the full year, down from 139% in fiscal 2014. Based on our current $0.50 per share dividend, that ratio would have been 81% for the last 12 months. We have a target of 65% payout ratio and we expect to make a significant step toward that number with our guidance for fiscal 2016.

At fiscal year-end 2015, our book value net debt was $598 million or 3.3 times our trailing 12 months base EBITDA. This is down from $919 million, a reduction of 35% from one-year ago. During the year, Just Energy used the proceeds from the sale of NHS to repay the debt of approximately $260 million associated with that business as well as repay our credit facility. Debt reduction remains a clear priority for us at Just Energy. While much has been accomplished to improve the overall balance sheet and debt position, management feels there is more that can be done. As such, we have defined a logical, financially prudent approach to further reducing debt that also recognizes certain restrictions on our ability to prepay some maturities.

This will involve our growth in cash flow to repurchase our debt in the market further reducing our debt to EBITDA going forward. Just Energy is in a strong position to execute the deleveraging plan and we believe the results will place the company in a stronger more financially flexible position. It's important that we remain aligned with the corporate strategy of financial optimization through adherence to a capital light high return on investment capital business model. Overall the years surpassed our expectations and exceeded our guidance.

Let me turn it back to Deb to talk about trends for the future.

Deb Merril: Thank you, Pat. As I alluded to earlier, the energy management solutions industry is bringing value added products to market that address the transformation in how energy will be consumed in the future. The retail energy industry has historically been viewed as offering only opaque financial instruments that yielded little value and which consumers didn't fully understand. Today, technology and innovative products make it a relevant industry, adding real value to consumers and providing significant growth opportunities for companies with sales and marketing expertise that can provide exceptional customer service.

Products like our Just Energy conservation program offer dual fuel flat bill contact bundled with smart thermostat reflecting that innovation and technology. Just Energy has the longevity, size, independent and forward thinking solutions to capitalize on this emerging opportunity and to disrupt the traditional utility model. We believe the opportunities that come from this disruption are robust and global and we continually evaluate new market opportunities that offer strong demographics, clear participation in industry trends, and a favorable regulatory landscape. This reflects the future of continued growth.

While our vision is long-term, we expect to see the benefits of our strategy and leading market position in fiscal 2016. While it's still early the solar strategy has launched and leverages our core competency to offer nearly immediate accretion and significant profitability enhancement streams as soon as the second half of fiscal 2016. In summary, the organization is committed to measureable financial improvement that will serve as a springboard to capturing significant global opportunities. Through prudent fiscal management as well as a clear strategy for the future, we are in a very solid position heading into 2016. Our core business is healthy and growing. We're generating record numbers of new customers while customer margins are improving. We have a leading market position in all our geographic territories and our sales and marketing expertise will allow us to step with the evolving needs of our target customers.

As such, we are committed to delivering fiscal 2016 double-digit base EBITDA growth over a strong 2015 we just completed. I will be remiss if I didn't take a moment to thank our employees. We have 1,300 employees in three different countries that worked tirelessly this past year to ensure these results for our shareholders. On behalf of Rebecca, Jay, Pat and I, we want to express our sincere appreciation for their efforts this past year and for their support in the future.

We will now open for questions.

Operator: Our first question comes from Damir Gunja from TD Securities.

Damir Gunja: Just with respect to your guidance, can you share what currency assumption for the Canada US dollar you are using there?

Pat McCullough: We're using 1.20.

Damir Gunja: And I guess you've got a few or at least one legal item outstanding. Can you share sort of what you think legal expenses might look like for the coming year?

James Lewis: Damir, I think what we've sort of set aside as you can imagine is unknown but we think we have the right amount of reserves as you saw there. We put $14.5 million for the year between legal reserves and the AG settlement. We think that's appropriate now. I mean as we go forward if we need to adjust, we well.

Damir Gunja: Any other sort of one-time items we should think about as we head into the next fiscal year?

Pat McCullough: Damir the one thing that we tried to point out in the outlook was that we will become a federal cash tax payer in Canada in fiscal '16. We expect to not become a federal cash tax payer in the US until fiscal '18, but we wanted to point that out so that will be a trend that impacts cash flow.

Operator: And our next question comes from Nelson Ng from RBC Capital.

Nelson Ng: I have a few questions on the solar business, Deb you mentioned that the pilot projects have started in California and New York. How long does the pilot projects need to go on for before you decide in terms of whether you rollout more widely within the state or into other states?

Deb Merril: From our perspective, the pilots are really to learn and kind of refine not only our sales process but our ability into manage those customers and work with those customers over time. It's not really a should we move forward or not, it really is the ability for us to learn and to figure out the best way for us to utilize our skills, so that we can get the best result. So, we fully intend to continue to rollout through New York and California and other markets as well in fiscal '16. And we're trying to really take

our very smart deliberate approach to making sure we learn in a very controlled environment before we really get big.

Nelson Ng: So you're currently just targeting very specific markets in California and New York, right?

Deb Merril: Yes, kind of our key learning how to operate. And one of the things we're really trying to do Nelson is the solar industry, if you look at conversion rates which from the time you get a customer, time the customer actually gets installed and a lot of customers that qualify are not following through and we think there are some things that we can do on the product side as well as how we interact with customers to make it easier for customers to be our solar customers. So we're really looking at utilizing our knowledge of customer behavior and pushing that industry forward from that perspective as well.

Nelson Ng: And then in relation to your fiscal '16 guidance, what assumptions have you made in terms of the contributions from the solar business?

Deb Merril: So we've put a little bit in there on solar, but like I said until we really know what we think we have here in the productivity, we wanted to make sure that we're a little bit— learn a little bit before we actually put the full effect in there.

Nelson Ng: And then just kind of moving onto the next question, customer additions in fiscal fourth quarter was down quarter-over-quarter, I was just wondering were there any factors that caused the slowdown. I know in the past I think fiscal Q4, the winters didn't really slow you down in the past so I was wondering if there are other factors from this past quarter?

James Lewis: We have a commitment to margin, so from our perspective we think we're going about it the right way. So we want to make sure that we're going after the most profitable possible customers.

Operator: Our next question comes from Carlo [indiscernible] from H. C. Wainwright.

M: Just again I realize it's early in the solar pilot, but in terms of maybe more specifics, the early indications of what you think you can earn in terms of EBITDA contribution or are those kind of meeting your early expectations and how quickly do you expect to ramp over the next say two to three quarters and then maybe two years out? And then maybe talk about some other market besides New York, California that you're targeting? And I have a couple of follow-ups.

Deb Merril: So far, I think from our perspective what we're trying to learn now is how much we can close per agent in the field, we're really making sure that we can get a lot of productivity out of our sales folks, which goes around training, sales pitch, product all of those things. So that's really, as we start to move through this, that's what we're focusing on right now.

M: And then maybe outside New York, California, could you highlight a couple of other regions you think might be targets as fiscal '16 unfolds?

Deb Merril: We're looking at Massachusetts, we're looking at Ontario and Texas. I know they are not traditionally looked out right now for the hot solar markets, but we believe there is some opportunities there as well. So kind of we could say most of the space that you see people operating in where we have a customer base, that's where we're going to focus first.

M: And then maybe switching gears little bit, obviously you have lot of very strong success in the very short timeframe in the UK, can you talk if you've been able to realize it's fairly early in targeting on the residential side, but the things that you can learn from the commercial side and port it over to the

residential side are very different markets within the UK. And then where do you see potential opportunity in either continental EU or other international markets do you think might be near-term targets?

Deb Merril: One of the things we're really seeing and we're excited about in the UK is that the products that we have in North America with the bundle that we are doing and some of the flat bill products and bundling with smart thermostats, you're not seeing a lot of that happening in the UK. So we actually think that this year we're going to try to bring some more innovative product over there that we're doing on the residential side in the US. So it's really not a commercial learning to residential, it's really residential North America learning to taking it over to residential UK. And we really believe that giving customers over there products that really has true value to them that they can really budget around that we'll have a big impact.

As far as the rest of Europe, I think our success here has given us a little bit of confidence in our ability to do these things and that has a lot to do with people in the UK, we have a great team over there. But we're always looking at additional opportunities in other markets where it makes sense. So I think that there are some opportunities in the Netherlands and some other countries, even outside of Europe.

M: And I don't know you haven't probably broken this out in the past and maybe really can't share, but you talk about your margin per customer in the UK, these are either North America or US?

Deb Merril: What we have said in the past, that we don't break it out, but we have said in the past is that our margins are slightly better over there than they are in North America what we've seen so far.

M: Pat maybe a couple of questions for you in terms of talking about re-utilizing a credit facility. I am assuming that you're not necessarily going to bring down your indebtedness as quickly as you did last

year for obvious reasons, but are you looking potentially to bring down the high yield debt and swap it for a cheaper credit facility, is that one of the early goals?

Pat McCullough: Yes, I think what the company needs on a go forward basis is a strong credit facility, so we are working towards a renegotiation of the existing credit facility as it expires at the end of this calendar year. At that point we'll be looking to restructure things like for the 330 and the 105. The coupon on the 105 is challenging for us but the size and the eminence of the 330s are also important to us. So that's the priority list for us with the balance sheet.

M: And then you talked about returning more to a normal administrative expense run rate in fiscal '15. Could you maybe qualify a little bit, maybe however you we want to do so versus revenue or maybe even as it relates to base EBITDA?

Pat McCullough: Our goal as management is to always drop through more gross margin than sales and more EBITDA than gross margin. So, as we look at this year, we were really challenged with the legal reserves that we took. So as we go forward and as we clarify things like our employment practices and defend ourselves vigorously, we don't expect to have that level of one timers impacting us on a go forward basis, so it'll be much more of G&A investment associated with the infrastructure needed for our growth.

M: Last question is typically, and maybe I'd missed it and didn't get time to go through the full press release so you talked about percentage of Just Green and maybe the consumption of the energy of the supply from Just Green?

James Lewis: It is 31% there of our customers taking Green and of that Green, they take the majority of their usage in Green [indiscernible] — 84%, yes.

M: 84% okay. Yes, I was wondering if it sounds flattish but sounds it kicked up plenty a bit. I'll take my questions offline.

Operator: Our next question comes from Kevin Chiang from CIBC.

Kevin Chiang: Just a couple of modeling questions from me. We've seen your renewal rates over the next five years become much more front end loaded as you increased the number of commercial customers you have. I am just wondering as you rollout solar and as you kind of look at your international expansion, is there a thought process of maybe managing this renewal cycle to spread it out more to reduce kind of the upfront risk or is it going to continuously be kind of 50% of your renewals are due in the next two years and kind of look out over the next little while here?

James Lewis: I think when you look at renewals there on the commercial side, what you've sort of seen is commercial customers want to lock in longer terms with the pricing low and some of those coming up from a year or two ago, where pricing where it is we could continue to see costs we're going to lock-in a little longer-term. So they'll probably even itself out here over the next couple of quarters.

Kevin Chiang: And just the month-to-month customers I know aren't included in that renewal table. But just generally how have they been trending, are they typically rolling over at the same pace you saw in previous years or months or have you seen any change in their customer behavior?

James Lewis: No material change. It's probably 1% change that falls into attrition there, so when you look at the attrition number the month-to-month attrition, there is 1% up which caused attrition rate for the commercial customers to be higher.

Kevin Chiang: And then just lastly from me, I know you're moving forward or from independent contractors to employees which I think will be a positive cultural shift but just trying to get a sense of how that impacts your P&L and your cash flow statement? I presume all of their wages now get booked into SG&A and I know currently you have a component that goes through cash flow statement in terms of contract initiation costs. I am wondering that disappears if you move to 100% employee base and away from independent contractors and then net-net, does that impact how you look at the dividend payout ratio longer term if I am right in those changes?

James Lewis: These are a couple of things there. So on an employee model there, it's around the residential and it does go into SG&A as you mentioned there. While we're seeing a slight pick-up there on some of the costs we haven't seen a material change there. What we have seen is early indications that we are getting some better conversions on the employees that are sticking around. So we feel good about early indications there.

Kevin Chiang: When you look at the sales force overall, are you losing some of your top performers or in general are people, are the better sales agents sticking around as you would have hoped?

James Lewis: No, I think when you look this, the sales agents themselves, especially those top performers, have stuck around. That's something that hasn't changed so we're excited about that. It was more around more regulatory or legal requirements on the employee side but we do think we'll get some benefit that we can leverage there as we look to bundle products. So we are bundling products out there that allows us to be more efficient and more effective and the sales force has been very responsive to that.

Operator: At this time, I am showing no further questions. I will now turn the call over Ms. Deb Merril for closing remarks.

Deb Merril: Again, thanks everyone for joining us on the call. Like we said earlier, we couldn't be happier with how the year shaped up and we're very much looking forward to fiscal 2016 and coming back next year and with another good year for all of our investors and shareholders. Everybody enjoy your day. Thank you.

Operator: Thank you, and thank you ladies and gentlemen. This concludes today's teleconference. Thank you for participating. You may now disconnect.