

[TSE:JE] - Just Energy Group, Inc., Q1 2018 Conference Call and Webcast
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Officers

Deb Merrill; Co-CEO
Pat McCullough; CFO
Rebecca MacDonald; Executive Chair
James Lewis; Co-CEO

Analysts

Damir Gunja; TD Securities
Carter Driscoll; FBR Capital Markets
Amit Dayal; Rodman & Renshaw
Sophie Karp; Guggenheim Securities

Presentation

Operator: Good day, and welcome to the Just Energy first quarter 2018 conference call and webcast. (Operator Instructions)

Please note, this event is being recorded.

I would now like to turn the conference over to Deb Merrill, Co-CEO. Please go ahead.

Deb Merrill: Good morning, and thank you for joining us for our fiscal 2018 first quarter earnings conference call. My name is Deb Merrill. I'm the Co-CEO of Just Energy. And I have with me today our Executive Chair, Rebecca MacDonald, my Co-CEO, James Lewis, as well as Pat McCullough, our CFO. Pat and I will discuss the results for the quarter, 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.

I will start today's discussion by first providing some perspective on the near-term results and operations. I will conclude the call with some of the exciting longer term activities that tie into our growth strategy, centered around Just Energy's position as a trusted adviser to our customers.

Our first quarter results are exactly what we expected, and puts us on track to deliver fiscal 2018 guidance. As planned, we made investments during the quarter to support our growth strategy. We expect these OpEx investments to continue throughout the fiscal

year, and we remain confident we are setting the stage for prolonged profitable growth on a global scale.

During the quarter, our combined attrition rate improved to 14%, and our renewal rates remained flat versus prior year. At the second level, we achieved positive net additions in our very profitable Consumer business for the second quarter in a row. Consumer net additions of 13,000 RCEs improved as compared with 7,000 net additions last quarter and net attrition of 28,000 RCEs one year ago. This result was driven primarily by our U.K. business, which posted its largest sales quarter of all time.

The U.K. business continues to perform at a very high level, and is positioned to be a key growth engine for us this year and beyond.

Offsetting some of this success, we have seen consumer renewal headwinds associated with the regulatory changes in Ontario. The new rules challenge our ability to communicate with customers, which prevent us from actively pursuing renewals. This was the main reason behind this weaker metric. Otherwise, we saw good results in all other jurisdictions.

Consumer attrition improved 21% in the quarter. This compared to 24% last quarter and 26% a year ago. This clearly demonstrates that our customer-centric approach and value-driven products are motivating our customers to stay longer with us. We are seeing steady improvements in internally tracked net promoter score, which is a leading customer loyalty metric. Overall, our more profitable Consumer business is turning the corner toward sustained growth.

On the Commercial side, we continue to see very competitive pricing driving negative net additions. This is driven by a large number of customers up for renewal in Q1, and heavy competition driving margins below acceptable levels. Our commercial renewal rate remained steady at 54%.

As a management team, we remain disciplined, ensuring each customer account is profitable. We have demonstrated that we will walk away from unprofitable business. The way to win the game in the commercial space is to sell not only on price, but offering [real] differentiated value.

In line with this focus, we are very excited to announce that we have purchased and launched a startup B2B energy efficiency and LED retrofit business branded Just Energy Advanced Solutions. With this platform, we offer commercial customers commodity as well as savings through energy efficiency devices through a no CapEx, high return business model.

In the short period of time we've had the business, we've already seen our sales exceed expectations in Ontario, and we're actively pursuing expansion into key states in the United States. This will be one of the primary drivers to delivering differentiated value to our commercial customers.

Pat will now take us through some of the financial highlights.

Pat McCullough: Thanks, Deb. Although the Q1 EBITDA was less than one year ago, we had planned for a lower profit quarter, primarily driven by a smaller customer book and investments in our channel and geographic growth.

Gross margin for the Consumer division decreased 7% from prior year due to a decrease in customers. Average realized gross margin for the consumer division for the trailing 12 months ending June 30th, 2017, was \$252 per RCE, slightly lower than last quarter. This was associated with the new channel U.K. switching site transfer of customers at lower margins and lower costs of acquisition, but delivering a strong payback period.

Gross margin for the Commercial division increased by 11% from the prior year as a result of the implementation of operational improvements to increase the margin of new customers added.

Average realized gross margin for the trailing 12 months ending June 30th, 2017, was \$93 per RCE, an increase of 22% from one year ago. As Deb mentioned, our margin discipline is prevailing in a very competitive marketplace.

Base EBITDA for the quarter was \$32.5 million. While planned, it was less than a year ago due to GM reduction based on lower customer counts, SG&A investment and new channels and markets, and partially offset by foreign exchange.

Moving to the balance sheet, base funds from operation for the first quarter decreased 20% to \$21 million, which was a direct result of lower EBITDA from a year ago. Dividends and distributions for the quarter were \$22 million, an increase of 16%, reflecting dividend payments of \$3 million to preferred shareholders following the issuance of preferred shares in February 2017.

The payout ratio on base funds from operations was 65% for the trailing 12 months, in line with our external financial commitments. With an improved balance sheet and a strong cash position, we remain committed to this very sustainable dividend. We have confidence in these levels of dividend payment in the present and the foreseeable future. Our shareholders continue to benefit from a very high yield and safe financial fundamentals to support its ongoing payment.

We retained a robust cash and equivalents position this quarter at \$81 million, with the balance declining \$2.6 million, as strong operating cash flows offset the bulk of investing and financing activity during the quarter.

Long-term debt increased from \$498 million as of March 31st, to \$521 million as of June 30th, as a result of the withdrawal of \$25 million on our credit facility. We ended the quarter with book value net debt of 2.0 times base EBITDA, in line with our external commitments.

The company repurchased and retired \$11.4 million worth of common shares in the first quarter. The company remains committed to monitoring and opportunistically repurchasing shares in the future if we feel the shares are undervalued.

Given the high yield, the commitment to the common share dividend and the low share price, management believes that it is a prudent use of funds and beneficial to shareholders.

Before I wrap up my prepared remarks, I would like to reaffirm our fiscal year 2018 guidance of base EBITDA in the range of \$210 million to \$220 million. These expectations reflect continued growth investments in fiscal 2018.

With that, I will turn it back over to Deb.

Deb Merrill: Thanks, Pat. We spent the last year refining and innovating new differentiated value-driven products. Having successfully piloted and launched many new products, the challenge shifts to deploying them through multiple channels and in all of our markets.

We're excited to update you on our retail channel strategy. As of July, we've expanded our footprint into 85 new stores across 9 retail partners. We are pleased to announce a new partnership with Sam's Club. As of this week, we are operating in 42 Sam's Club locations in various states. We are proud to partner with Sam's Club, a premier retail leader, provides class-leading value and customer experience.

These 9 new retail partnerships provide the platform to scale 700 stores by July 1st, 2018. This retail channel is being augmented with additional alternative channel partners that will further expand our ability to reach more customers and achieve our growth target.

Our international geographic expansion remains on track. We will be fully launching Ireland in September, and we continue business development efforts in Germany and Japan.

Today we are capable of delivering more value to customers than ever in our history, and we are squarely on the path to future sustained growth. Our team is in the process of successfully executing a global enterprise strategy that is aggressively pursuing profitable growth.

In the year ahead, we will continue guiding the business forward by capitalizing on where we see the energy sector heading. Just Energy is well positioned as a market leader, to deliver energy solutions worldwide.

And now we'll open up to any questions you might have for us.

Questions and Answers.

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions) Damir Gunja with TD Securities.

Damir Gunja: Just on the retail channel, can you talk a little bit about your experience thus far maybe relative to your preliminary expectations? And are there any other retailers of note, in addition to Sam's Club, that you can talk about?

Deb Merril: Yes, sure. When we went into this, we felt like a good result for this would be one sale per store per day. So as we ramped up -- we started with a very small number of stores, and as we ramped up, what we found is that we're actually achieving better than targeted number of sales per day, which is a really good indication for us that the new processes and the iPad system that we rolled out to ensure that the customer has a great experience in the retail store is actually working.

So as we look at it, the results are actually better than what we expected. They're much, much higher. So we feel very confident of that.

I think from the other names, we'll be able to, over the months as we continue to roll those out, we'll be able to give you some more detail on those.

Damir Gunja: Okay. Maybe just switching to international expansion. Are you seeing some traction now in Germany? Or it sounds like you're perhaps still in the development stage there. I thought post the acquisition things might have ramped a little bit more quickly.

Deb Merril: Yes. We're actually looking to do a full hard launch in the next 60 to 90 days. So we've been doing a lot of work preparing sales channels and getting our product up. Germany's a very competitive market. And what we wanted to make sure is that we have differentiated products. So we don't want to go in there with what everybody else has. So we're going in there with our flat bill and some of our energy efficiency products as well, which will be what differentiates us and allows us to grow that market.

So we're being very, I guess prudent about the products we're launching, ensuring we're ready to do that in a very meaningful way.

Rebecca MacDonald: Damir, I would just like to add one thing on Germany. When we make an acquisition, I just want to remind you we bought really the company that's a startup that had the license. And as a management team, we have spent quite a bit of time in Germany. It's a very different market, and we don't want to rush with products that, in our opinion, are not going to differentiate us. And Deb pointed out that we are really well positioned to introduce a North American (inaudible) to European market, and we want to do that to launch it in a very responsible manner.

Damir Gunja: Okay, no. I appreciate that. And maybe just a final one. How should we think about the timing for Japan? I guess it's early days there. But is that more of a next year story?

James Lewis: Yes, Damir. I think what you'll see, we're well on target here. Probably a soft launch expect 90 days, and really see the benefit for fiscal 2019 here.

Damir Gunja: So flowing customers probably next year rather than this year?

James Lewis: We will start flowing customers the end of this year, the beginning of next year for the calendar year and really have a meaningful impact probably fiscal 2019.

Damir Gunja: Okay. I'll get back in the queue. Thank you.

Operator: Carter Driscoll with FBR Capital Markets.

Carter Driscoll: First question if I may is, can you talk about the acquisition you made for energy efficiency? I guess you'd call it maybe energy auditing effort to target retail [rate]. In the Commercial business, obviously you guys pay heavy emphasis on differentiation from a product perspective. Can you talk about how that applies, how you expect to roll it out and maybe the near-term impact? Thank you.

Deb Merrill: Sure. So it was a small business in Ontario, not meaningful necessarily to the bottom line, but really puts us on the path to deliver that differentiated value for Commercial. And we've been talking about Commercial for quarters and how it's all about everybody's getting beaten down on margins. And it's just because we're not really offering anything different other than just a commodity.

So this is really our first foray on the commercial side to show something different for customers. And what we've seen is that it's got a great value proposition for the customer, a very strong payback for and basically guaranteed savings from the installation of LED, the new LED system. But also gives us the ability to bundle commodity with that and really roll it out across new markets as well. That's probably the most exciting thing, where we can really connect with the business owner, bring something of value to them that they wouldn't be able to maybe finance themselves or to be thinking about themselves. So we are the experts coming in there and telling them how they can save some money and run their business in a more efficient way from a cost perspective.

So we've really seen some great traction on that from customers. We've seen great conversion, very high engagement as well. So those are all the things that will help us combat some of the, I would say complacency on renewal and really shrinking margins on the Commercial side.

Rebecca MacDonald: And I would just like to add after all these years starting different businesses in the energy space, I have never seen a business that just performs so well so

quickly. It really is like a hockey stick result with this acquisition, and we are very, very happy.

And another thing that as management, we are really pleased when you look at our margins that we have been able to achieve with the Commercial segment. Sometimes it's really, really tough to walk away from the business that you could possibly rationalize and could keep. But we made the commitment couple of years ago, and we are sticking to it. And when you look at a \$92 margin, that's really, really high margin for commercial sector.

So I can tell you, we are really pleased with this acquisition and it's going to differentiate us long run.

Carter Driscoll: So do you anticipate this actually contributing to increase margin expansion on the commercial side? Or could this be ported over to the residential side of the business as well?

Pat McCullough: Yes. So the idea here where you're getting into an energy audit and really customizing solutions for individual premises, it works very well B2B because you have a larger premise, which is utilizing more electricity and gas. But we think it's also applicable to residential, especially if you're thinking high-value items. Think solar. Think storage. Think other energy efficiency. So it's definitely part of our strategy.

And as you think about the margin specifically to the commercial business as Rebecca was talking about, we just reported \$93 per RCE in commercial. That was \$76 one year ago. That's significantly higher, 20%. And as we're thinking about the drop-through on that, you're basically dropping through the old \$76 per RCE and trying to cover \$40 or \$50 of direct selling costs per year. Now when you're working with \$93, you've amplified the bottom line on the commercial business with more prudence around the commodity. Then if you can layer on top of that these energy efficiency solutions, you're going to expand products and margin even more significantly, because you're no longer talking about price with a customer. You're talking about savings over a period of time.

Rebecca MacDonald: And I'm sorry to jump in. I just wanted to add one more thing. Very often analysts, in particular, look at our business and they think, oh, my god, this is such a complex business. Complexities around the business can be sometimes discouraging when you try to analyze it.

I want to flip this. There are complexities in our business on the backend. But when you look at the front end and look what we are doing with energy solutions, with other bundled products, it really doesn't add another level of complexity. In our opinion, it actually simplifies our relationship with a customer and cements their commitment to us and our commitment to them. So these are all add-on products, which I don't want analysts or public to think it's adding another layer of complexity. It is not. It's a really simple add-on for us.

Carter Driscoll: All right. Maybe shifting gears a little bit. So you've seen good traction in your initial pilots and the rollout of your retail store channel. I think you said you're exceeding expectations. Can you maybe quantify how much you're exceeding expectations? And has it set a new bar for what you think you can achieve per store when you roll out to your fully realized platform in roughly 10 months or so?

Pat McCullough: Yes, we'll be helpful here, Carter. So as Deb mentioned, we're at 85 stores today. We're trying to get to 200 stores in September, 500 stores by the end of the fiscal year, and 700 stores by July 1st of next year.

We can make this business work with one sale per store per day. But we're seeing significantly more than that in the short term. Think 2x. But again, I caution that that's on 85 stores. That's not on 700 stores. And the footprint that we have in retail right now with our 9 retail brand partners is a footprint of 5,000 stores to choose the best 14%. That's what we're aiming to do.

So if we could hold, let's say two times that amount, two sales per store per day, that on an annual basis is 500,000 new contracts. That's bigger than our door-to-door segment by a long shot right now. So this is a very significant channel. This could be very meaningful for us.

We're looking at design margins that are similar to what we experience in the residential business on aggregate today. But we also recognize that this is a channel where we're going to have to put money towards the retail partner, towards rent and towards direct commission.

So you're going to see a three to four quarter payback on that gross margin as it tries to cover direct selling costs. But it's very similar economics to what we experience today. It's very similar to the door-to-door economics, without the nature of that selling process. And we're very excited about it, obviously.

Rebecca MacDonald: And we are not stepping away from door-to-door. But I would like to make it very clear, yes, this company started as a door-to-door organization, 100%. But what you can expect from us in the future is no more than 18% to 20% coming from door-to-door. 80% of our business now is coming from different channels. And that was by design. And we [have long grounds] that that's really the ratio that we would like to keep other channels versus door-to-door.

Carter Driscoll: Got it. Okay. All right. So maybe let me just follow-up there. If we have Sam's Club. Walmart? I mean just kind of throwing that out there. And/or you had talked about some, I mean national wireless retailer channels. Any color hint that you can offer us today?

Deb Merrill: I spoke earlier a little bit about we are pursuing additional channels. And we've been talking a lot about retail. But if you think about us, we're in big box like Sam's. We also are looking at we have grocery stores that we've launched in from a retail

perspective. But we're also looking at authorized agents kind of agreements that we're pursuing as well. Nothing of significance at this point. But that's also something that we're very much pursuing and looking at ways that we can partner with maybe cell phone stores or various different kind of partnerships. So we're absolutely looking at pursuing those as well.

Carter Driscoll: Okay. And maybe just the last one for me, if I may. So you bought a decent amount of the shares back. So how do you balance your investments obviously to build out this new channel, which is obviously yielding very strong early results versus the repurchase versus the need to maintain a reasonable payout ratio on the dividend? Obviously it's a nice fat, juicy yield right now. And just want to give people confidence that you're not taking your eye off the ball on the dividend either.

Pat McCullough: No. The upfront OpEx cost associated with building out these new channels is already built into our guidance. There's no incremental cost that we're pursuing. In fact, we were a bit conservative with how much this would cost, and we're tracking really well. We've got some confidence in our guidance, given the fact that retail and the U.K. business, as mentioned in our disclosure, are both tracking super well.

So, in fact, the commentary that I provided in the earnings bit upfront was really to reinforce the \$0.50 a share on the common shares and the preferred dividend, in our minds, are rock solid today. Things can change. But we've got a lot of confidence that cash flow and that dividend's going to be there.

Carter Driscoll: Perfect. Okay. I'll go back in the queue. Thanks, guys.

Operator: Amit Dayal with Rodman and Renshaw.

Amit Dayal: Just a question around gross margin expectations for the next two quarters, I guess. On the Commercial division, it seems like we're losing higher GM customers and gaining sort of lower GM customers. How should we look at these trends sort of playing out over the next few quarters?

Pat McCullough: Yes. Thanks for the question. So as we're thinking about gross margin, we are not trying to hit a specific dollar per customer. The way we think about the business that we take on, we think about the average annual gross margin and we compare that to the direct selling cost.

So for example, if you had a commercial customer at \$90 and a cost of acquisition at \$45, that's a two quarter payback. If we had a \$20 gross margin customer that we were looking at with a \$5 cost of acquisition, we would like that business because it pays back in one quarter. So that's how we're thinking about the business that we take on.

So for example, when you look at the U.K. switching site, we took 70,000 residential customers this past quarter at lower margins, roughly half of what we've been reporting.

But the customer acquisition cost was near half of that. So it was paying back in just over two quarters. And we saw that as great business.

If we see a business with a payback as I'm describing with five, six, seven quarters, we really don't like it and we push it away. And we think we'd rather our competition have that bit of business than take it ourselves.

So as you are looking at the design margin that we report on incoming, and you're seeing it slightly lower, know that because we're managing the payback between average annual gross margin and direct selling costs, that the EBITDA drop-through is going to be at least as good as it's always been, despite the fact that you may see a smaller gross margin in the short term.

Amit Dayal: Understood. I was also curious you mentioned you have a pretty strong net promoter score. I was wondering if you could maybe give us a little color on how this may have improved for you and what that score actually is. I think this is interesting color that probably investors will appreciate.

Deb Merrill: Sure, yes. Actually, we're not publicly talking what the score is. But it's something we actually started about a year and a half ago as part of our pivot toward a customer-centric business. You have to understand whether your customers will promote your product to their friends and family. And what we're seeing is that as an entire industry, utilities tend to be negative, and we, unfortunately, get lumped with utilities. But that in an entire industry we see that as negative, we're seeing some really good trends and results. We have positive net promoter scores in a lot of our areas that we operate in.

But we're also finding that some of the programs like Just Energy Perks, which we've talked about in previous quarters, which is our loyalty program, we're seeing points that are between four and five times better on perks versus not having perks, which shows you that customers really are promoting our products with that.

And I think that all of those investments we've made in service as well as our new products like the unlimited plan, we're starting to see those things show up in our results, which then you see in our attrition numbers as well.

So all of those things that we've been talking about, making these investments in perks and really pivoting toward that consumer-friendly and really value-driven company is starting to show in the results as well.

Pat McCullough: If I can add on here. So if you focus on resi, which we care most about because that's the majority of our EBITDA in the short term, when you see gross additions being higher than your attrition than your renewals, so you're actually putting those net additions on the board two quarters in a row and we've got some confidence that that's going to continue to grow throughout this year and next, in addition, with that lower attrition at the same time experiencing the higher net promoter score and holding

higher margins than we traditionally have, that's, to me, evidence that we're value selling and creating a customer experience that has more value for our customers than we have been in the past and maybe that others are doing as well. Because normally to have those four metrics, customer growth, profit, attrition, and net promoter score all working towards the positive at once means that you got to be value selling and you got to be doing something that customers like, or you couldn't have those four moving together at once.

Rebecca MacDonald: Considering (inaudible) here forever, I can tell you this management team that has been put in place a little bit over three years ago, inherited a terrible balance sheet, inherited a very negative net promoter scores with the customer. And when the team came up with a 2020 plan, they were very, very clear of getting ready to change all of that, as they have demonstrated. And just now with the results of our turning positive in the net promoter score, I'm really proud of the job that they have done, even though that they did some unpopular things. But we are here, all the long run, we have played the long game and we have a creative vision where we want to be in 2020. And so far, everything that has been put in place is actually getting us there. And I cannot be more pleased with the team than I am today.

Amit Dayal: Appreciate all this color. Thank you so much. That's all I have, guys.

Operator: (Operator Instructions) Sophie Karp with Guggenheim Securities.

Sophie Karp: Could you maybe comment a little more about the regulatory environment across the territories where you operate? I know you mentioned Ontario and some changes there. Maybe you could give us a little more color on what's happening.

And also, are you seeing any similarly potentially impactful regulatory changes pending elsewhere? Thank you.

Pat McCullough: So, Sophie, let me clarify the question. I heard that you're looking for color across the geographies in terms of the environment that we're competing in, and, then, specifically regulatory issues in those environments. Do I have that right?

Sophie Karp: Yes, the regulatory issues specifically. Thank you.

Pat McCullough: Okay.

James Lewis: We think regulators, if anything, actually -- actually it's a good question. How do we (inaudible) engage? And then [greatly] for us, we're active in those discussions. We received a positive trend in the Mid-Atlantic region and Midwest. Surprising, and we are seeing some additional discussion in the West, Nevada being one place.

So we were happy with the discussions. We're seeing regulators and legislators ask the question, how do we get the customers more engaged? What things the customers are

interested in? How do we get some of the HSAs that relate to energy into consumer homes? And we talked a lot at our [first] program with our (inaudible) energy adviser, we think we're well ahead of that curve and proud to be a part of those discussions.

On the flip side, Pat again talked about Ontario. One of the things that popped up this year, [go] contact a customer once a month. And while we understand some of that, our belief is that with our product and our solutions, we think customers are (inaudible). Rebecca talked about the improvement in net promoter score there.

So we'll continue to be a part of those discussions. But Ontario and New York, they've been having some discussions there on how do they deliver to the consumers new innovations. We're part of those discussions. But those are the areas where we see some headwinds that could be negative.

Rebecca MacDonald: And I just want to add a little to Ontario. Ontario is the first market to deregulate in the world, so it's a very, very mature market. The unfortunate thing about Ontario is energy portfolio is highly politicized. And it's well know that (inaudible) government that we have in this province, that has really tried to stifle the competition.

Long run, I think even the government that tried to stifle the competition will have to realize that the best solution for the customer is giving customer a choice. And that's what we are trying to promote. We just want every customer to have an option looking at different providers. Obviously, we would want to gain as much market share as we possibly can. But we welcome the competition across the board. We think it's healthy and it's very, very good for the customer. And I'm hoping that energy portfolio will one day get depoliticized in this problem.

Sophie Karp: Thank you. That's all for me.

Operator: And there are no further questions. So this concludes our question-and-answer session. I'd like to turn the conference back over to Deb Merrill for any closing remarks.

Deb Merrill: Thank you. Appreciate that. And appreciate everybody joining us and all the great questions. As we said earlier, we are really happy with the progress we're making on all the fronts for our future sustained growth, and we look forward to delivering those results throughout the year.

Also wanted to take a quick moment on behalf of Jay, Rebecca, Pat and myself, to thank all of our employees. And we talked about various businesses. We talked about the LED business. We talked about the U.K. We have so many things going right for us right now and so many employees who are really working hard to deliver this vision. And we couldn't be prouder of the team and the employees that we work with. So want to take a moment to thank them. And we will talk to you all next quarter.

Pat McCullough: Thank you.

Rebecca MacDonald: Thank you.

Operator: The conference has now concluded. Thank you for attending today's presentation, and you may now disconnect.