

# Final Transcript

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## **SPEAKERS**

**Deb Merrill – Co-Chief Executive Officer**  
**Pat McCullough – Chief Financial Officer**  
**James Lewis – Co-Chief Executive Officer**

## **ANALYSTS**

**Orhan Eldarov – RBC Capital Markets**  
**Carter Driscoll – FBR Capital Markets**

## **PRESENTATION**

**Operator:** Welcome to the Just Energy Second Quarter Fiscal 2017 Earnings Conference Call. My name is Ashley, and I will be your operator for today's call. At this time all participants are in a listen-only mode. Later, we will conduct a question-and-answer session.

I will now turn the call over to Deb Merrill, Co-CEO of Just Energy. Deb, you may begin.

**Deb Merrill:** Thank you very much. Good morning, everybody, and thank you for joining us this morning for our Fiscal 2017 Second Quarter Earnings Conference Call. My name is Deb Merrill, I'm the Co-CEO of Just Energy, and I have with me this morning our 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, 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.

The second quarter of this fiscal year was tremendous, building on a very strong first quarter, and placing the company on a clear path to achieving our financial expectations for the year. Our business performed very well. We continue to deliver results that demonstrate the significantly improved profitability profile of the company as well as highlight our ability to generate meaningful cash flow to meet our ongoing capital commitments, while also funding our strategic growth initiatives.

As we head into our strongest seasonal quarters, Q3 and Q4, the key performance metrics that we deem most critical to measuring our financial success and future trajectory are strong. In fact, as I prepared to speak with you today, it struck me how consistent and at times repetitive these calls have become over the recent past. And that's a positive thing, given that as a company we're consistently delivering results in any environment.

Our ongoing ability to drive gross margin and earnings growth in a competitive environment clearly underlines that our strategic vision is producing the intended results. We are very pleased with the UK business, which is performing exceptionally well. We've now grown the customer base by 16% over the past year. And while we experienced declines in the total company level during the quarter, we are steadfast in our belief that the refusal to engage in aggressive pricing tactics that had developed within our industry during the current commodity price environment, is the appropriate strategy for Just Energy.

We are committed to evolving the company to capture more accretive profits and cash flow by not chasing market share at the expense of margin. This effort has resulted in the addition and renewal of customers in all segments at margins above those customers lost. We are able to drive these improvements because our new innovative products are gaining more appeal and presenting more value for our customers.

We are pleased with the progress we've made on our product line. We're focused on delivering energy management solutions, including commodity, energy efficiency, and renewable products. These value-driven products and structures are a key component of our growth strategy, and are allowing us to price our energy management solutions competitively without sacrificing customer satisfaction. This is very evident when you look at our improving attrition rates. The success of this strategy is once again evident in our results this quarter, as we grew gross margin by double-digits and delivered base EBITDA growth of 24% or even more impressive 34%, when normalizing for the prepay commission expenses.

This strength and profitability resulted in significantly improved cash flow. Base funds from continuing operations increased 39% during the quarter to \$52.6 million. This translated to a payout ratio of 36% during the second quarter and 48% for the first six months of the fiscal year. These are levels that this company has not seen in years. In fact, this quarter represents the lowest single quarter payout ratio in company history.

Our debt profile also continued to improve. During the quarter, we took steps to repay and restructure our debt, ultimately resulting in a 6% decrease in total debt and debt-to-EBITDA ratio of 2.4 times, an improvement from 3 times one-year ago and 2.6 times at fiscal yearend.

To summarize, it was another strong quarter for Just Energy. As we look ahead, we are planning for and are well-positioned for growth. We have tremendous opportunities to achieve our near and long-term goals through the addition of new products, markets, partnerships, and the customer loyalty program.

The combined impact of these initiatives will drive value to our customers and sustainable growth for our business. I'll touch on a few of these exciting opportunities before we conclude today's call, but first, let me ask Pat to provide some additional color to the quarter's financial results. Pat?

**Pat McCullough:** Thank you, Deb. We're pleased with the strong start to the year as we demonstrate the improving profitability profile of the company. The business is performing exceptionally well, and we are pleased with the consistency in our ability to deliver stable predictable bottom line growth in just about any market environment, which is allowing us to generate stronger cash flow and position the company for future success.

First, I'll cover some of the highlights of the second quarter, and then provide some added color in certain areas. Our second quarter base EBITDA increased 24% to \$56.9 million, as strong performance offset the \$4.3 million of additional prepaid commission expenses during the period compared with the second quarter of fiscal 2016.

If you exclude this additional expense item, base EBITDA for the quarter increased by 34% to \$61.2 million compared to the prior year. This translates to a \$15.5 million year-over-year improvement, of which \$15.8 million was driven by strong operational and product performance with negative \$300,000 impact from foreign exchange translation.

During the quarter, gross margin improved 10% to \$183.5 million as a result of higher realized margin per customer from differentiated products and pricing discipline. The consumer division gross margin

increased 8% as a result of higher margin contribution per customer, while the commercial division gross margin increased by 15%. We believe that clear opportunities exist for ongoing margin per customer improvement, and a number of recent trends helped give us this confidence.

Average realized gross margin over the trailing 12 months ending September 30 was \$261 per RCE in the consumer division, and \$80 per RCE in the commercial division. This equates to improvements in consumer and commercial of 19% and 29% respectively. If you take a look through our MD&A, you can also see these incremental improvements between customers added and lost continue to hold true in the recent standalone quarter.

Our strong customer value proposition is allowing us to price our energy management solutions at premiums without sacrificing customer satisfaction. And we were pleased to see customer attrition improve 2 percentage points year-over-year, and 1 percentage point better than Q1 fiscal 2017. It's particularly encouraging that attrition rates improved in both the consumer and commercial divisions in what we consider highly competitive market environments.

General and administrative expenses for the second quarter increased \$6.4 million or 16% year-over-year. This was primarily driven by higher costs required to support customer growth in the UK, as well as costs associated with international expansion and new strategic initiatives. Selling and marketing expenses, which consist of commissions paid to channel partners, decreased 9% year-over-year, primarily due to lower commission costs associated with lower gross customer additions and decreased residual commission expenses.

Now, I'll review some of our other key financial metrics and balance sheet items. Base funds from operations of \$52.6 million increased 39% from the prior year. The increase in base FFO was higher than the 24% increase in base EBITDA, due to the additional cash generated from gas deliveries compared

with the prior period, as we are paid on deliveries instead of consumption in some of the Canadian provinces and Michigan.

The payout ratio on base funds from operations was 36% for the quarter and 48% for the first six months of the fiscal year. On a trailing 12-month basis, the payout ratio is currently 50%. We're very pleased with the progress we've made as it demonstrates the viability of our future \$0.50 a share dividend.

Cash and cash equivalents of \$118.8 million were up 34% year-over-year and up sequentially, driven by strong operating cash flow of \$61.1 million during the current period, up from \$15.4 million one year ago. The bottom line performance drove this increase along with the negotiation of payment term extensions with some key suppliers. This resulted in a deferral of approximately \$34 million of commodity payments on a go-forward basis.

We continue to pursue aggressive debt reduction; total debt of \$644 million as of September 30, 2016 decreased by 3% from \$660.5 million as of March 31. While not reflected in the quarter-end results and balances, in early November we redeemed a principal amount of \$225 million of the 6% convertible debentures scheduled to mature on June 30, 2017. We also redeemed the remaining principal amount of \$55 million on the 9.75% senior unsecured notes due June 2018 on October 6. This completely retires the 9.75% notes. Management is confident in its ability to address the remaining \$95 million balance of the June 30 convertible debentures through fiscal 2017 free cash flow and working capital improvements. Internally, we've already turned our attention to calendar year 2018 and 2019 maturities.

Overall, the balance sheet improvement initiatives have resulted in significantly improved debt ratios and we are committed to further reducing our debt. As of September 30<sup>th</sup>, Just Energy's book value net debt was 2.4 times trailing 12-month base EDITDA, an improvement from the 2.6 times reported at March 31, 2016 and the 3 times reported for the prior comparable year-ago period. We believe the net result of the

near-term refinancing and pay-down maneuvers, I have just described, will put us at a net-debt-to-EBITDA ratio of close to 2 times by fiscal yearend.

During the quarter, we announced that JPMorgan Chase was added as a lender to our credit facility. As of September 30, 2016 we have not drawn on our \$292.5 million credit facility, although letters of credit totaling \$136.3 million dollars remain outstanding.

Turning now to our outlook, fiscal 2017 is off to a strong start and places us squarely on the path to achieving our previously provided full-year base EBITDA guidance of \$223 million to \$233 million. This range reflects double-digit year-over-year percentage growth.

In fiscal 2017, we had initially estimated that Solar/TerraPass would contribute \$10 million towards the double-digit percentage base EBITDA target. Given the secular challenges facing the solar industry today, we deem it prudent to remove these specific expectations for the current fiscal year. However, I want to be very clear that the performance of the core North American and UK businesses are tracking well ahead of full-year guidance more than offsetting any short term RCE or solar weaknesses to plan.

With that, I'll turn it over to Deb for some concluding remarks.

**Deb Merrill:** Thank you, Pat. So in summary, our first-half results have exceeded our expectations. And we're entering our seasonally strongest fiscal third and fourth quarter with confidence that we can build off that performance and deliver another year of double-digit earnings growth as well as meet our base EBITDA guidance.

We're experiencing great customer acceptance of our growing value-added product suite and long-term loyalty programs. Our differentiated offering has continued to drive growth in North America and the United Kingdom, and will be a catalyst to our geographic expansion plans in Europe and beyond.

Last quarter we spoke with you about our newly launched JE Perks program. This continues to show encouraging signs of acceptance and we've already seen dramatic attrition improvement in our pilot markets. Sales conversion rates were up 29% and all of this has been accomplished while raising the price. This clearly demonstrates that customers find value in this product and they're willing to pay for it. JE Perks is being scaled to all markets, so that the effects will be seen across our customer base in the coming quarters.

I've been in this industry for 22 years and I feel there's never been a more exciting time in this space. As we observe the consolidation in the marketplace amongst our competitors, it is becoming clearer that the retail industry provides opportunities for growth for them. As the largest independent retailer, we have a unique advantage to adapt quickly to ever-changing technology and product landscapes, bringing solutions to the market faster than our competitors.

Despite RCE attrition, management have conviction that customer growth is coming soon. With new superior products like JE Perks, new sales channel additions and new market launches like Germany and Ireland, we will see exceptional customer growth in the near-term. In closing, our business is healthy and growing stronger. We're committed to maintaining our dividend and pursuing prudent geographic expansion, and further strengthening the company's financial and strategic position, as we stay the course to become a premier world-class provider of energy management solutions.

And with that, I will open it up for questions.

**Operator:** Thank you. We will now begin the question-and-answer session. [Operator instructions]. Our first question is coming from Orhan Eldarov from RBC Capital Markets.

**Orhan Eldarov:** Hi, guys. How is it going?

**Deb Merrill:** Good. How are you?

**Orhan Eldarov:** Good, good, just filling in for the big man today. Yes, just have a couple of quick questions here. First about your expansion in Europe, I know you guys have talked about it over a couple of quarters in the past. You guys have said that it's a mature market, but the opportunity to enter would sort of allow you to start right away with your strategy of high value, high margin products, and sort of focusing on a profitable book. I was just wondering what is the competition like in, say, Germany and Ireland. Will you be able to offer those creative products, like smart thermostat and stuff like that, or how are you guys looking at growing there?

**Deb Merrill:** Sure. I'll start and if anyone wants to jump in feel free. So Germany actually is a highly fragmented market with a lot of competitors. So you have about 800 different suppliers in Germany. And what you find is a lot of those are very focused on customers in their region or where the incumbent territory might have been in the past. You don't see a lot of change and a lot of product innovation.

So that's really why we keep saying that. Obviously we want to offer standard products but we truly believe that our ability to take the flat-bill, bundle that with loyalty reward programs, and things that we're doing in North America, we just don't see anybody doing it over there. So we feel very confident that we'll be able to make a pretty good impression, and be able to see that benefit in a very short order.

Ireland is an interesting market. It's much smaller obviously than Germany. Germany is the largest market in Continental Europe for us, which is why it's so attractive. But Ireland is small, but it's kind of an add on to our UK business, so it's relatively low cost to enter, but again starting to see some—we see the progress we're making there. We fundamentally believe that the value proposition will be much greater with the products that we bring.

**Orhan Eldarov:** And is Ireland also very fragmented, or just because it's smaller it's going to make you a bigger player?

**Deb Merrill:** Not nearly as many competitors, you have kind of being incumbents that are there. But not nearly as competitors as Germany, so it's much less fragmented, but again a smaller opportunity for us. So there are pros and cons to both.

**Orhan Eldarov:** Okay, great. And, yes, I think you mentioned earlier that you're starting to look at the way to take out your 2018s, so maybe that's a question to Pat. Are there any ways you're thinking of going about there? Is it going to be fairly sort of working cap solution or converts or what are you guys looking at?

**Pat McCullough:** Yes, what we're really trying to focus on there is taking our free cash flow that we're going to be generating this fiscal year and next fiscal year, as we're thinking about 2018 and beyond. This year, we expect another \$50 million, so \$50 million of free cash flow that will help us take out the rest of the 330s. But then in fiscal 2018, we're expecting something closer to \$75 million of free cash flow on a full-year basis.

So we can almost take out the entire \$100 million so it's free cash flow alone. You saw that we noted that we have some working capital improvements through direct supplier payment term extensions. We're

continuing to work that opportunity and we think that opportunity could be much higher than that \$35 million. So those two opportunities alone, free cash flow and off balance sheet trade financing, are our favorite types of capital to take out those shorter-term maturities.

But long story short, we could go look at private debt, other types of instruments, we're trying not to put any further dilution potential on the board. We want to limit that to the convertible we just did. But at this point, everything is in play with an emphasis on free cash flow and working capital financing.

**Orhan Eldarov:** Okay. Yes, that's fair. And would you be able to pin a number or range on how much more you can squeeze out of the working capital?

**Pat McCullough:** Yes. Working capital can be done in two ways. It can be done directly with suppliers or can be done by involving a third-party. Those third-party fees for that are quite compelling if it's commodity payable financing. They could be less than 5% annual money. We are limited within our excess borrowing base covenant, but we have almost \$300 million of capacity there. But we would never go that high if we had the opportunity to do more commodity payables, because the commodity prices themselves or the volume in the market could put borrowing base capacity at risk.

So we can probably limit this to another \$100-million-ish if it was there for us. We hope it could be, but it's going to take some time to determine if we can get another \$100 million done.

**Orhan Eldarov:** Okay, great. And, I guess, just one last question before I get back in queue, is for your solar, so you said you pulled your guidance for solar and that the base business is going to sort of more than offset or likely more than offset whatever weakness in solar you may see. Was there anything in last quarter, too, that led you to pulling your guidance or like is it because of the Republican sort of government? What drew you to that conclusion, was there anything specific?

**Pat McCullough:** There's pretty intense pressure on everyone's margins right now. If you look at what's happened to SunEdison, SolarCity, there's quite a bit of let's say lowered expectation for the tax equity and the sponsor equity returns on solar projects. Because of that there's a great deal of pressure on originators like us, but also fulfillment partners to push margins down.

The harder it is to make money in this space, the more creative we have to be with lower cost commercialization strategies. So door to door is a more expensive channel than digital, lead generation, telemarketing. So we're working on the nuances of how we go to market to ensure that we like the returns within solar. But fundamentally everyone's margin is under incredible pressure right now. That was the main reason that we thought we should remove that guidance.

**Orhan Eldarov:** Okay. All right, well, I'm going to get back in the queue, ask couple of questions after. Thank you.

**Pat McCullough:** Thank you.

**James Lewis:** Thank you.

**Operator:** [Operator instructions]. Next from FBR, we have Carter Driscoll.

**Carter Driscoll:** Good morning, Deb, James, Pat, Rebecca.

**Deb Merrill:** Good morning.

**James Lewis:** Good morning.

**Carter Driscoll:** Congratulations on another solid quarter of execution. First question, I guess is, as your bundling strategy, still in early days, but as it starts to pay off at least in terms of lower attrition rates, is there a metric you think we can be following whether it's an attach rate or a percentage up sell or is it still fairly early to try to get to some type of reportable metric? How do you think we can think about that, because it's a key portion to increasing your margin growth, certainly in light of still rolling off some of the older contracts, and what's to be likely kind of a flattening top line growth until you can kind of restart it? So any type of color you can provide there and then I have a follow-up or two. Thank you.

**James Lewis:** Carter, I think to start with, the first thing is the attrition at the high level. We're fairly level conservative with our approach. We want to pilot the opportunity first and then make sure that everything is working the way we think it is. We're pretty happy with the result so far, which is why we've seen attrition drop down there.

As we continue to roll out JE Perks to all our customers, we will look to some additional metrics. But right now the attrition is the best guideline that you see today. What we did talk about, in Deb's speech there and Pat's, was the ability of our sales people to have a higher, what we'll call, conversion rate when they're talking to folks at the door. It changes the conversation. So we've seen an increase there of 29% on that front. So that's an early indication of the positive results that you can look at.

**Carter Driscoll:** I'm sorry to interrupt. Just as a clarification, so when you talk about conversion rate, I mean have you provided past metrics in terms of what the conversion rate has been or are those internally held? I guess, I'm just trying to from an apples and apples perspective trying to get a sense of where 29% is relative to past quarters?

**Deb Merrill:** No. We haven't provided in the past that was more of an anecdote, just to give you some numbers to show what we're seeing internally. So we obviously measure all that stuff internally, but we don't actually disclose conversion rates. But we wanted to share with you that we're seeing a marked improvement in conversion when you have these products together.

And I think that, we've discussed amongst ourselves several times as we look forward and we're transforming the company, the industry is transforming, and we've debated around, how we best show this. Is it product for customer, the RCE metric? And I think, we've spoke with you about this, Carter, the RCE metric is tough as we—it's not really the most important metric for us now. It's margin, it's product for customer, it's number of customers and things like that.

So I think, we're going to have to address this in the coming quarters at some point, but we don't want to do it too early, and get kind of ahead of our skies, and then end up with something that doesn't make sense either. But to your point there, we have to at some point probably shift our metrics and how we measure this, the adoption rate and the implementation of the strategy. Because our metrics today don't do it justice.

**Carter Driscoll:** Yes. Understood. And maybe just shifting gears a little bit, you've had obviously very strong growth in the UK, you talked about Germany and Ireland. Maybe your expectations if you can lay it out for when you could see some type of material RCE contribution from either of those two new geographies. And then would like to follow up with kind of the base business and then the low commodity environment. Do you have to get more volatility or do you need to see the forward curves really spike up before you can expect more growth in your core RCEs, relative to what you're allowing to roll off and not pursue because they were maybe less profitable customers? Trying to get a sense of both internationally and then domestically. So kind of three questions in one, sorry for framing it that way.

**Deb Merrill:** Sure. Well hopefully, I can follow all that, and I can say back for you. But so Germany and Ireland, I am pretty comfortable saying that fiscal 2018 Germany will have a pretty good contribution to our customer growth. The strategy that we're implementing now will hopefully put us in the market by the end of this, potentially, calendar year if not definitely the first quarter of fiscal—the last quarter of our fiscal year. So as we ramp that up toward the last quarter of this year, we expect to kind of have that on the ground running in Q1 2018. So we feel pretty good about that.

Ireland is a little bit slower, because it's a little bit longer lead time that we're seeing. So I would expect sometime in the middle or second-half of the year for Ireland to pick up a little bit. So from that perspective—I don't know if you want to talk about the North American—

**James Lewis:** I think in the North America corridor, what we are seeing—actually I'll bring up the UK. This past September you have results on volatility in the UK market, which you hadn't seen in probably the past five or six years there with a line going down between France and the UK, some [indiscernible] and some wind not producing. And in that volatility, what you see in price in spike, you are seeing some repetitive struggle over there, which then fits right into our bailiwick of attracting customers with our flat-bill opportunities there and fixed rates. So when we do see volatility, you are absolutely right, we do see some increased awareness out there, some increased additions.

In North America here we hadn't seen a lot of volatility. We had some early weather up in the Toronto area, Canada and some in the Northeast there, but we continue to see low volatile environment. When we do see a pick up, we do expect the customer growth on the residential and commercial side to pick up. But one of the things we also expect to see is, as volatility happens, we see other players didn't have in the market. And we're starting to see that, again, you've heard some of the major utility affiliate looking to get out of the market in the Midwest there. That provides opportunities at some of the low cost providers out there or low cost customer pricing companies leave the marketplace.

**Deb Merrill:** And I think, Carter, just low volatility North America, as we've been talking about expanding our sales channels that we have to be able to operate in low volatility and high volatility markets. I mean, and that's kind of what we're building here is even in low volatility we can't just sit there and say, oh well, sorry, customers aren't shopping because we have low volatility.

We have to find other ways to reach customers, which is why we're building new sales channels, which is why we're spending a lot of time and energy starting to figure out how we can connect with customers in a low volatility environment, so that we can encourage them to think about our product and demonstrate the value.

**Carter Driscoll:** Okay. And maybe just quickly Texas any—I mean, it's a very large market, obviously, extremely competitive anything changed Q-over-Q? Still operating again that low volatility market, I'm imagining, but the fixed rate product maybe have some early success there.

**James Lewis:** No, Texas, you're right, it's a low volatile environment. This past summer, you had peak loads and you see the volatility return there. And for us we're consistent, as Pat talked about, our goal is consistency there; as we put our hedges on we'll continue to do so. I think some other players maybe doing a little bit different. But no we're still seeing—it's very competitive as you mentioned. But we think on a risk adjusted basis, that's the way we're pricing and it's showing up in our profitability.

**Carter Driscoll:** Okay. And then just maybe shifting gears, Pat, just can we quickly go back over, so the goal for this year is to obviously get rid of the remaining 6% converts due at the end of next June. And I think, you highlighted about \$50 million—your expectation of \$50 million free cash flow fiscal 2017, if I heard correctly. And then working cap, I'm assuming is how you expect to finance the balance and then refinance the balance. Is that correct?

**Pat McCullough:** That's correct. We have \$50 million that will be coming to the company on a free cash flow basis after dividends here in the remaining 4 months of the period or 4.5 months. And then, between our credit facility expansion and those trade payables financing, we think will knockout the 95 in the next couple months with those items alone.

But we're also looking forward to the convertibles and the euro bond, we'd like to be productively taking those out as we can. But again, a lot of free cash flow support coming in 2018, more trade payables financing opportunities. And then obviously by taking out CPP in that high yield note, all of the restrictions on our balance sheet at that senior unsecured level, and even a senior secured, but subordinated, that real estate that is now open to us, where there were heavy restrictions within that CPP facility. So there's quite a bit of optionality that the business has now to deliver things that are not shareholder dilutive to refinance the 2018 and 2019 maturities.

**Carter Driscoll:** Yes. I'm sure CPP would have loved to hold on to that level yield and you're happy it's gone. I'll get back in the queue, I appreciate it. Thanks for answering all my questions.

**Pat McCullough:** Thanks, Carter.

**Operator:** And next we have another question from Orhan Eldarov from RBC Capital Markets.

**Orhan Eldarov:** Hi, Pat, just to clarify when you said that debt-to-EBITDA of 2 times by year end, did you mean fiscal 2017?

**Pat McCullough:** Yes, we did. If we're able to get that working capital trade financing done, that's obviously off balance sheet debt. It's net asset hit, right, because your liabilities or payables go up. But

we'll be closing in on 2.0 times quickly, if we get to 2.1, 2.2 with just earnings alone that's where I have your expectations. But if we get more of our refinancing done with off balance sheet debt, we could probably close pretty quick to 2.0.

**Orhan Eldarov:** And you're considering working capital financing as off balance sheet debt or what are you referring to?

**Pat McCullough:** Yes, because what we're doing is we're extending payment terms. So it's a perpetual payment term extension. So it's not debt, it's technically our trade payables, our current liabilities go up so there will be a net asset reduction, but it won't be an increase in debt.

**Orhan Eldarov:** Okay, technically speaking it won't be debt, but it'd still be pretty senior, right, on the—

**Pat McCullough:** It would, yes. That's why there's a borrowing base covenant that I was referring to from the credit facility, because that commodity payables is securitized at the top.

One other thing to point out here, the reason we don't see the next \$100 million of potential here as, let's say, synthetic debt is because half of our markets we're being paid on about a six-week time period, so those purchase of receivable markets, think of the US markets outside of Texas. We get payment on six-weeks timing. We end up paying our suppliers based on our legacy supply agreements in two to three weeks. So there's an incredible mismatch in working capital.

So on one hand, we're paying our suppliers before we're getting paid on half of the business, but on the other hand there's actually a liquidity risk there if commodity prices shot up and volume shot up, we're going to have to pay more to our suppliers before we get paid those higher amounts. So we're pretty determined to get this commodity payable extension done on a big piece of our commodity payables.

That will inherently match our incoming cash flow with our out coming cash flow. And that's the reason I'm taking the position that this really is not synthetic debt, it's getting a balanced working capital design for our business which had not been here in place or not been here historically.

**Orhan Eldarov:** Would there be any room to shorten the receivable cycle instead in?

**Pat McCullough:** There would, but that's the most valuable part of our collateral pool with our suppliers and our banks. So we have looked at receivable factoring; that's a very difficult conversation with our counterparties, hence why we're working on trade financing on the payable side.

**Orhan Eldarov:** Okay, okay, makes sense. And just a quick one on solar, have you guys already expanded into New Jersey? With your sort of walking away from our solar guidance, are you going to pull back from any extension plans in your current states where you operate like California, New York, stuff like that?

**Deb Merril:** No absolutely not. We're continuing to believe this is a good product for us to have for our customers. It's going to be a short-term challenge and compressed a little bit from a margin standpoint, but from an offering standpoint, we believe that the markets we're in New York, New Jersey, we're moving into Massachusetts shortly as well as actually looking at Texas. So we still believe that there's a lot of opportunity here for us to grow the business, it just won't be at the levels and the thought that we had before, but going to continue to expand that.

And we're also trying to find the right formula for sales. I think that training our sales force, and how we go about getting customers is something that we—it's taking a little bit longer, but I think that we're starting to see some nice benefit from it. But we're going to do it in a much slower and smaller way.

**Orhan Eldarov:** Okay. That makes sense. And lastly, I know that the election results just came in recently, but general Republican agenda is nothing new. Do you guys think there will be any pressure in reducing or eliminating subsidies or any sort of preferential tax treatment for rooftop solar?

**Deb Merrill:** We've always said, we're not betting too much on subsidies that we're looking at things that benefit our customers without subsidies. But I think, the ITC is safe until 20...

**Pat McCullough:** So four more years.

**Deb Merrill:** So four more years, but for us there's so much opportunity out there for other things coming into play as well, I mean battery, solar, smart home technology. So it's kind of one small piece and even if the government or subsidies change over time, we're still diversified in our product, in our scope, in our footprint that it won't have a material impact.

**Pat McCullough:** And just a little bit of history, the ITC was actually put into place by the Republicans. Now, the Democrats have taken it as kind of a badge of honor. But it's had both party support in the past and the design of that ITC is to create a runway to get the industry scaled, and allow frankly penetration, which will raise the cost of the underlying grid and make solar more competitive.

So there will be a point in time in the future where solar can stand on its own in many markets, but that as you heard from Deb isn't a core part of our strategy, but an important product offering that we want to be able to address.

**Orhan Eldarov:** Okay, that's fair. All right, guys. Thanks so much. That's enough for me.

**Deb Merrill:** Thank you.

**Operator:** Thank you. And once again we have Carter Driscoll from FBR.

**Carter Driscoll:** Yes. I'm sorry, just a follow-up on the solar question. When you're doing origination, I'm assuming there is some mix between what you're originating for a lease versus a loan. Can you talk about that spread and maybe the selling cycle in terms of trying to get a customer to sign?

**Pat McCullough:** Yes. It's a great question, because it's one of the hardest things we're learning is to find, first of all, product capacity in every market, meaning who has a competitive loan product, because the loan product delivers more value to the ultimate customer as they're holding some of or all of the ITC benefit depending on how you price it, and local abstracts [ph].

The loan products are relatively new. Our channel partner has only gotten into the loan product as they merged with Kilowatt Financial. So we are looking at opportunities to partner with others to ensure that we have the broader product suite in every market. But then also you have to have that fulfillment and EPC capacity available to you in every market and that has been challenged in the Northeast, specifically markets like New York.

As we're selling that though, let's think about it from an equity perspective. So the ultimate financier in the solar products is looking at a different unlevered after tax IRR for a loan product versus a lease product. And the tighter the margins are and they're tighter on the loan product because you're delivering more of that, let's say, value to the customer versus being held by the ultimate financier, then it is imperative for us as the market moves away from PPAs to loans to have a much lower cost of acquisition model to ensure that these, let's say, the profit potential for us is there.

Now, I think we're a little bit surprised by how fast the market has just flipped to pushing more value to the customer, but also the absolute returns on every product, or every product is under attack. So that kind of compounds the challenge for everybody to make origination returns work.

**Carter Driscoll:** Right, so I mean it's a double-whammy, because it's accelerating, moving away from what SolarCity offers or had offered in the past and some of the other top installers to—it's really becoming an asset or consumers viewing it as an asset, and maybe starting to embrace things like storage and other types of opportunities. And I'm assuming that it elongates the selling cycle, you have more underwriting risk and things of that nature, which is clearly why you guys have removed that expectation for this year, I would expect.

**Pat McCullough:** Yes, yes, we think you're right.

**Carter Driscoll:** Okay. All right, I appreciate it. Thanks for that.

**Operator:** We have no further questions at the time.

**Deb Merrill:** Perfect. Well, just wanted to say thank you again for everybody for joining us. We still, like we said earlier, feel very comfortable and strong about the performance of the business this quarter. And on behalf of Jay and I, we also want to make sure we take a quick minute to thank our employees. We have a lot of employees that make this happen, and our partners and everyone who support us in this vision and what we're trying to achieve as a company. We very much appreciate your support.

So until next time, we will see you again in three months. Thank you.

**Pat McCullough:** Thanks.

**Operator:** Thank you, ladies and gentlemen, this concludes today's conference. Thank you for participating. You may now disconnect.