



ORAZUL ENERGY PERU S.A. AND SUBSIDIARIES

US\$550,000,000 – 5.625% Senior Notes due 2027

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

June 30, 2020 and 2019

ORAZUL ENERGY PERU AND SUBSIDIARIES S.A.

About the Company

We are a Peruvian company and our business is composed of a diversified portfolio of hydropower and thermal power generation, natural gas production and processing assets¹. We conduct our operations through two primary business units: Orazul, which is comprised of hydropower generation and Aguaytia, which is an integrated gas-to-power complex comprised of natural gas production and processing and thermal power generation. We generate and sell electricity to regulated customers (distribution companies) and non-regulated customers under power purchase agreements (“PPAs”) and to the spot market. Our contracting level under PPAs is 92%² with an average life of approximately 9 years, reducing the risk related to the fluctuation of spot market prices.

Our businesses are summarized in the following table:

Entity		Location	Type	Overview
Orazul	Orazul	Cañón del Pato	Hydro generation/ Run-of-river	266MW
	Orazul	Carhuaquero	Hydro generation/ Run-of-river	110MW
Aguaytía	Termoselva	Aguaytía	Thermal generation (natural gas)	192MW
	Aguaytía Energy del Perú	Aguaytía	Hydrocarbons	45 mmscfd 1,050 bbls/day

OEP is indirectly owned by certain funds managed by I Squared Capital Advisors (US) LLC and co-investors (collectively, the “Sponsor”). On December 31, 2017, the Sponsor through Nautilus Inkia Holdings LLC (“Inkia”), acquired substantially all the Latin American and Caribbean business held by Inkia Energy Limited, an international company focused on the electric power sector, specifically on generation and distribution, with operations in Peru and other countries in Latin America. On April 30, 2018, the Instituto Nacional de Defensa de la Competencia y de la Protección de la Propiedad Intelectual, INDECOPI, the Peruvian antitrust authority, approved the acquisition by the Sponsor. Since then, the related parties of OEP include Kallpa Generación S.A. (“Kallpa”) and Samay I S.A. Since January 1, 2019, as part of a strategy to optimize operations and maximize benefits from having the same shareholders, Kallpa and OEP have integrated and streamlined their management teams, implementing a single management organization, with no legal mergers between the companies.

Management has extensive experience in the power generation business. Our executive officers have an average of approximately 15 years of experience in the power generation industry and have previously held senior positions in leading power generation companies, financial institutions and the Peruvian government. Our management team provides in-depth market knowledge and power industry experience, with significant experience in the Peruvian energy industry and government regulators. We believe that this overall level of experience allows our management team to lead the Company in the effective operation and maintenance of our facilities.

¹ On August 24, 2020, OEP sold to Interconexión Eléctrica - ISA Peru, part of the ISA group, its indirect ownership in the transmission business companies, Etenorte S.R.L. and Eteselva S.R.L., for US\$158.5 million. For further detail see “Sale of Transmission business companies”.

² Estimated for the following 3 years (2020-2022). Calculated based on the optimal contracting level.

Our Notes

On April 25, 2017, OEP issued senior notes for an aggregate principal amount of US\$550 million in the international capital markets under Rule 144A and Regulation S of the Securities Market Law of the United States of America (the “Notes”). These Notes accrue interest at a rate of 5.625% payable semi-annually and have final maturity in April 2027. The proceeds from this issuance were used to: (i) prepay the outstanding senior debt incurred in connection with our acquisition under a US\$450 million senior secured loan facility, and (ii) prepay US\$35 million and US\$40 million, in aggregate outstanding principal amount of local corporate bonds. The Notes are rated BB by Fitch Ratings and Standard & Poor’s.

Sale of Transmission business companies

On August 24, 2020, OEP sold to Interconexión Eléctrica - ISA Peru (“ISA Peru”), part of the ISA group, its indirect ownership in the transmission business companies, Etenorte S.R.L. and Eteselva S.R.L., for US\$158.5 million total consideration.

On March 10, 2020, OEP and Orazul Energía (UK) Holdings LTD signed a purchase agreement with ISA Peru, to sell its 100% ownership in Orazul Energy Group S.A.C. (“OEG”). OEG is a subsidiary of OEP and the owner of 99.99% of the shares of Etenorte S.R.L. and Eteselva S.R.L. The closing of the sale agreement was subject to the approval from Peruvian authorities.

On August 11, 2020, INDECOPI, the Peruvian antitrust authority, approved the acquisition by ISA Peru without any conditions.

The transaction price is subject to normal closing pricing adjustments within 30 days from the closing date. Net Cash Proceeds may be used within 1 year since the closing date to (i) purchase any Notes or repay other Senior Indebtedness, (ii) make capital expenditures in a Permitted Business (iii) reinvest in or purchase Additional Assets; or (iv) any combination of items (i); (ii) and (iii). On, or at any time prior to, the first anniversary of the closing date, OEP may make an Asset Sale Offer to purchase the Notes, at par, with any Excess Net Cash Proceeds.

Etenorte S.R.L. and Eteselva S.R.L., have more than 746 km of 220kV and 138kV transmission lines. In 2019 audited financial statements, represented approximately US\$12.4 million in revenues and US\$10.9 million in EBITDA. The sale of these companies has no impact in the normal operation of OEP’s hydro and thermal power generation and hydrocarbon businesses in Peru.

After the purchase agreement was signed, OEG was classified as held-for-sale in our financial statements since March 1st, 2020. The 2019 comparative condensed consolidated statement of profit or loss and other comprehensive income has been re-presented to show the discontinued operation separately from continuing operations (for additional information see note 3 of our consolidated interim financial statements).

Aguaytia’s License Agreement extension

On June 10, 2020, the Peruvian government, through the supreme decree DS014-2020-EM, approved the following:

- The extension of the concession of Block 31-C for an additional period of 10 years since March 2024;
- The commitment of the execution of an additional exploratory program, and;
- The appointment of OEP as corporate guarantor under the contract.

Aguaytía has the concession over a natural gas field located in the central rainforest of Peru (concession Block 31-C), from which obtains dry natural gas and natural gas liquids; those gas liquids are then processed at the fractioning plant which produces liquefied petroleum gas (LPG) and natural gasoline. Dry natural gas is used by its subsidiary, Termoselva S.R.L., for the generation of electrical energy.

COVID-19

We know the COVID-19 pandemic is causing anxiety and affecting our employees, businesses, customers and communities in a significant manner. At the same time, our operations are required to remain open for business at the highest level in order to provide the vital electrical service.

We want to inform you about the measure's management has adopted to ensure the safety and wellbeing of our employees, whilst guaranteeing the continuity of our operations, power service and financial liquidity:

Operational:

We have taken extraordinary measures to limit or mitigate the contracting of the virus, adapting best practices from large public service and medical organizations. We ensure full compliance with legal measures being adopted by the Peruvian Government.

- Implementation of personnel rotation plans in line with applicable travel restrictions and labor law.
- Secure supply of all necessary equipment and supplies to allow the work of operating teams in our plants.
- Ensure that mechanisms are implemented to communicate timely and effectively all instructions to be followed during this emergency.
- Implementation of home-office for employees and directives wherever activities allow it and curfews and mobility restrictions apply.
- Implementation of mechanisms to secure adequate and safe transport of personnel and supplies to and from operating facilities, minimizing use of public transport.
- Implementation of periodic health-monitoring systems wherever employees are operating.
- All of our contingency procedures are being shared with contractors performing essential tasks, ensuring their adequate compliance.

The Company is also coordinating to ensure adequate cash management during the current situation. Two factors to financially maintain financially the continuity of our business is debt management and liquidity. The following is a brief description of the status:

Debt Management:

Our total debt of US\$550 million (without transactions costs) corresponds to long-term notes that only require interest payments during the next years. Debt service amounts are secured by significant cash flow from our operations.

OEP is current on its debt and meets all its financial obligations. We expect to maintain such compliance throughout the current turmoil.

Liquidity:

During this period, we are managing our cash in a conservative manner and have taken several measures to protect liquidity and to maintain continuity of business, as well as to be prepared for any unplanned disruptions. Currently, we maintain one year or greater of debt service cash in hand. Over the next six months, we are going to continue monitoring closely the evolution of cash flow and be extremely cautious with our liquidity.

OEP ensures timely payment of local obligations: suppliers, contractors, providers of services, etc. It is critical to maintain working capital flow of our suppliers and level of service.

We will continue to be proactive and attentive to the evolution of the market by keeping a close and systematic communication with all financial stakeholders. We will periodically inform the evolution of the operations, debt management and liquidity as matters progress.

Finally, OEP will continue to provide electrical service to all its customers while maintaining safe its employees and service personnel.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with our unaudited condensed Consolidated Financial Statements as of June 30, 2020 and 2019.

For the six-month period ended June 30, 2020 and 2019

	Six months ended June 30		% Change
<i>In millions of U.S. dollars</i>	2020	2019*	
Revenues of energy, capacity and transmission	62	66	-6%
Revenues of hydrocarbons	4	9	-56%
Revenues	66	75	-12%
Cost of Sales of energy, capacity and transmission	(13)	(14)	-7%
Cost of Sales of hydrocarbons	(2)	(4)	-50%
Cost of sales (excluding depreciation)	(15)	(18)	-17%
Depreciation	(13)	(13)	0%
Administrative expenses	(4)	(6)	-33%
Other income, net	-	1	-100%
Operating profit	34	39	-13%
Finance income	-	-	-
Financial cost	(19)	(20)	-5%
Net foreign exchange difference	(1)	-	-
Finance cost, net	(20)	(20)	0%
Profit before income tax	14	19	-26%
Income tax benefit (expense)	5	(9)	156%
Profit from continuing operations	19	10	90%
Net profit for the period from discontinued operations	1	1	0%
Profit for the period	20	11	82%

(*) 2019 comparative information has been restated due to a discontinued operation, as detailed in section "Sale of Transmission business companies".

Results of Operations

The Company's net income for the six-month period ended June 30, 2020 amounted to US\$20 million compared to US\$11 million during the same period in 2019. The Company's results are mainly explained by the following:

Revenues

Sales of energy, capacity and hydrocarbons declined by US\$9 million, or 12%, to US\$66 million during the first six months of 2020 from US\$75 million during the same period in 2019, due to:

- US\$5 million decrease in hydrocarbon liquid sales driven by 31% lower production to 101,527 bbl. during the first six months of 2020 from 148,211 bbl. during the same period in 2019, in connection with the unavailability of one of our wells, added to lower natural gasoline and liquified petroleum gas ("LPG") prices, to US\$39/bbl. and US\$42/bbl. during the first six months of 2020, from US\$60/bbl. and US\$52/bbl. during the same period in 2019, respectively, due to lower international prices.

- US\$3 million lower capacity income from our thermal power plant mainly explained by the reduction in the electricity demand during the 1H 2020, as a result of the measures taken by the Peruvian government to control the COVID-19 pandemic. The reduction in the maximum monthly demand resulted in Aguaytia thermal plant not being considered under the system's reserve margin, and therefore did not receive capacity payments from the system from April to June.
- US\$2 million decrease in energy sales to the spot market, mainly explained by lower average spot price of US\$6.2/MWh during the first six months of 2020 compared to US\$7.3/MWh during the same period in 2019. Spot prices were affected by the -12% y/y decrease in demand during the first six months of 2020, from +5% y/y during the same period in 2019, due to the quarantine decreed by the Peruvian government from March 15 to June 30, 2020. In addition, due to the higher energy sales under PPAs, there was a 45% decrease in net sale volumes to the spot market to 259 GWh during the first six months of 2020 from 474 GWh during the same period in 2019.

These effects were partially offset by:

- US\$1 million increase in energy sales under PPAs to 1,029 GWh during the first six months of 2020 from 905 GWh during the same period in 2019, mainly explained by the beginning of a new PPA with Enel Distribución for up to 100MW and the ramp up of the Toromocho mine (Minera Chinalco), that offset the lower consumption from our customers affected by the quarantine decreed by the Peruvian government.

Cost of sales (excluding depreciation)

Cost of sales decreased by US\$3 million, or 17%, to US\$15 million during the first six months of 2020 from US\$18 million during the same period in 2019, primarily due to:

- US\$2 million lower cost of royalties, storage and transport of natural gasoline and LPG related to lower sales in connection with lower production.
- US\$1 million lower cost of natural gas royalties related to lower thermal generation, to 15 GWh during the first six months of 2020 from 106 GWh during the same period in 2019.

Depreciation

Depreciation amounted to US\$13 million during the first six months of 2020, unchanged from the same period in 2019.

Administrative expenses

Administrative expenses decreased by US\$2 million, or 33%, to US\$4 million during the first six months of 2020 from US\$6 million during the same period in 2019, primarily due to a decrease in personnel expenses and lower third-party services.

Other Income, net

Other income, net decreased by US\$1 million to zero during the first six months of 2020 from US\$1 million during the same period in 2019, mainly due to lower services rendered by Cañón del Pato's maintenance workshop, added to income from an insurance recovery in 2019.

Finance cost, net

Finance cost, net amounted to US\$20 million during the first six months of 2020, unchanged from the same period in 2019.

Income tax benefit (expense)

Income tax decreased by US\$14 million, to US\$5 million benefit during the first six months of 2020 from US\$9 million expense during the same period in 2019. The estimated average effective tax rate for 2020 was -36% (47% in 2019). The effective tax rate during the first six months of 2020 corresponds primarily to exchange losses in local currency (6.2% devaluation of the Peruvian sol against the U.S. dollar) which generated tax losses and made the deferred income tax positive, compared to exchange gains in local currency during the six months of 2019 (2.6% revaluation of the Peruvian sol against the U.S. dollar).

Liquidity and Capital Resources

Our main cash requirements are primarily for the following purposes:

- Working capital requirements;
- Capital expenditures related to maintenance projects; and,
- Debt and interest service.

Our main sources of liquidity have traditionally consisted of the following:

- Cash flow from operating activities; and,
- Short-term borrowings under our US\$25 million committed credit facilities and long-term borrowings.

During the first six-months of 2020 and 2019, cash flow generated by operations was primarily used for investment activities and to service our outstanding interest and debt obligations.

As of June 30, 2020, our cash and cash equivalents amounted to US\$30 million (including US\$6 million cash under assets held-for-sale).

Cash Flows

<i>In millions of U.S. dollars</i>	Six-month ended		%
	2020	2019	
<i>Cash from operating activities</i>	35	43	-19%
Income tax paid	(3)	(2)	50%
Net cash from operating activities	32	41	-22%
Net cash used in investing activities	(8)	(9)	-11%
Net cash used in financing activities	(35)	(16)	119%
Net decrease (increase) in cash	(11)	16	-169%
Cash and cash equivalent as of January 1	41	50	-18%
Effects of variations on exchange difference on held cash	-	-	-
Cash as of June 30	30	66	-55%
Included in cash and cash equivalents per Statement			
of Financial Position June 30	24	51	-52%
Included as assets of held for sale	6	15	-62%

Cash Flows from Operating Activities

Our primary source of operating funds is cash flow generated from our operations. The net cash from operating activities decreased by US\$9 million, or 22%, to US\$32 million during the first six months of 2020 from US\$41 million during the same period in 2019.

The decrease was primarily driven by (i) US\$12 million increase in payments to suppliers and others, mainly explained by US\$7 million payment related to intercompany services rendered by Kallpa during 2019 and (ii) US\$5 million decrease in collections of hydrocarbons given lower sales during the first six months of 2020. These effects were partially offset by (i) US\$6 million lower payments to employees related to the management integration between Kallpa and OEP; and, (ii) US\$3 million decrease in payment of royalties given lower production during the first six months of 2020.

Cash Flows Used in Investing Activities

Net cash used in investing activities decreased by US\$1 million, or 11%, to US\$8 million during the first six months of 2020 from US\$9 million during the same period in 2019.

During the first six months of 2020, cash from investing activities was mainly used for (i) US\$4 million in payments related to the acquisition of property, plant and equipment; and, (ii) US\$4 million in payments related to the option agreements signed with distribution companies to extend the contract terms of certain PPAs, recorded as intangibles.

During the first six months of 2019, cash from investing activities was mainly used for (i) US\$6 million in payments related to the option agreements signed with distribution companies to extend the contract terms of certain PPAs, recorded as intangibles; and, (ii) US\$3 million in payments related to the acquisition of property, plant and equipment.

Cash Flows from Financing Activities

Net cash flows used in our financing activities increased by US\$19 million, or 119%, to US\$35 million during the first six months of 2020 from US\$16 million during the same period in 2019.

During the first six months of 2020, we used cash to (i) amortize US\$19 million of the shareholder loan granted by Orazul Energia Partners LLC; and, (ii) pay US\$16 million in interest related to the 2027 Senior Notes.

During the first six months of 2019, we used cash to pay US\$16 million in interest related to the 2027 Senior Notes, among others.

For the three-month period ended June 30, 2020 and 2019

	Three-month ended		%
	June 30		Change
<i>In millions of U.S. dollars</i>	2020	2019*	
Revenues of energy, capacity and transmission	28	33	-15%
Revenues of hydrocarbons	2	5	-60%
Revenues	30	38	-21%
Cost of Sales of energy, capacity and transmission	(6)	(7)	-14%
Cost of Sales of hydrocarbons	(1)	(2)	-50%
Cost of sales (excluding depreciation)	(7)	(9)	-22%
Depreciation	(6)	(6)	0%
Administrative expenses	(2)	(3)	-33%
Other income, net	-	-	-
Operating profit	15	20	-25%
Finance income	-	-	-
Financial cost	(10)	(11)	-9%
Net foreign exchange difference	(1)	-	-
Finance cost, net	(11)	(11)	0%
Profit before income tax	4	9	-56%
Income tax benefit (expense)	3	(3)	200%
Profit from continuing operations	7	6	17%
Net profit for the period from discontinued operations	1	1	0%
Profit for the period	8	7	14%

(*) 2019 comparative information has been re-presented due to a discontinued operation, as detailed in section "Sale of Transmission business companies".

Results of Operations

The Company's net income for the three-month period ended June 30, 2020 amounted to US\$8 million compared to US\$7 million during the same period in 2019. The Company's results are mainly explained by the following:

Revenues

Sales of energy, capacity and hydrocarbons declined by US\$8 million, or 21%, to US\$30 million during the second quarter of 2020 from US\$38 million during the same period in 2019, due to:

- US\$3 million decrease in hydrocarbon liquid sales driven by 26% lower production to 50,399 bbl. during the second quarter of 2020 from 68,562 bbl. during the same period in 2019, in connection with the unavailability of one of our wells, added to lower natural gasoline and LPG prices, to US\$30/bbl. and US\$41/bbl. during the second quarter of 2020, from US\$66/bbl. and US\$50/bbl. during the same period in 2019, respectively, due to lower international prices.
- US\$2 million decrease in energy sales in the spot market mainly explained by lower average spot price of US\$5.7/MWh during the second quarter of 2020 compared to US\$8.2/MWh during the same period in 2019. Spot prices were affected by a decrease in demand to -23% y/y during the second quarter of 2020, from 4% y/y during the same period in 2019 due to the quarantine decreed by the Peruvian government. In addition, due to the higher energy sales under PPAs, there was a 51% decrease in net volumes to 101 GWh during the second quarter of 2020 from 208 GWh during the same period in 2019.

- US\$2 million lower capacity income from our thermal power plant mainly explained by the reduction in the electricity demand during the 1H 2020, as result of the measures taken by the Peruvian government to control the COVID-19 pandemic. The reduction in the maximum monthly demand resulted in Aguaytia thermal plant not being considered under the system's reserve margin, and therefore did not receive capacity payments by the system during the second quarter of 2020.
- US\$1 million lower energy sales under PPAs. Despite the overall reduction in electricity demand that affected consumption from our customers, there was an increase in our energy sales under PPAs to 454 GWh during the second quarter of 2020 from 441 GWh during the same period in 2019, mainly due to the beginning a new PPA with Enel Distribución for up to 100MW and the ramp up of the Toromocho mine (Minera Chinalco). However, it was offset by a 10% decrease in average PPA prices to US\$42/MWh during the second quarter of 2020 from US\$46/MWh during the same period in 2019, as the new contracts have lower energy prices compared to the average price of the portfolio.

Cost of sales (excluding depreciation)

Cost of sales decreased by US\$2 million, or 22%, to US\$7 million during the second quarter of 2020 from US\$9 million during the same period in 2019, primarily due to:

- US\$1 million lower cost of royalties, storage and transport of natural gasoline and LPG related to lower sales in connection with lower production.
- US\$1 million lower cost of natural gas royalties related to lower thermal generation, to zero during the second quarter of 2020 from 61 GWh during the same period in 2019.

Depreciation

Depreciation amounted to US\$6 million during the second quarter of 2020, unchanged from the same period in 2019.

Administrative expenses

Administrative expenses decreased by US\$1 million, or 33%, to US\$2 million during the second quarter of 2020 from US\$3 million during the same period in 2019, primarily due to a decrease in personnel expenses and lower third-party services.

Finance cost, net

Finance cost, net amounted to US\$11 million during the second quarter of 2020, unchanged from the same period in 2019.

Income tax benefit (expense)

Income tax decreased by US\$6 million, to US\$3 million benefit during the second quarter of 2020 from US\$3 million expense during the same period in 2019. The estimated average effective tax rate for the second quarter of 2020 was -75% (33% in 2019). The effective tax rate during the second quarter of 2020 is affected primarily by exchange losses in local currency which generated tax losses and made the deferred income tax positive, compared to exchange gains in local currency during the second quarter of 2019.

Appendixes

EBITDA & Adjusted EBITDA reconciliation

	Six months ended June 30,		Discontinued operations	As previously reported	Three months ended June 30,	
<i>In millions of U.S.</i>	2020	2019	2019	2019	2020	2019
Profit from continuing operations	19	10	1	11	7	6
(+) Income tax and profit sharing	(5)	9	0	9	(3)	3
(+) Financial expense, net	20	20	(1)	19	11	11
(+) Depreciation and amortization	14	14	4	18	7	7
Total EBITDA	48	53	4	57	22	27
(-) Net profit for the period for discontinued operations	-	-	-	-	-	-
Total Adjusted EBITDA	48	53	4	57	22	27

Material Indebtedness

<i>In millions of U.S. dollars</i>	Outstanding Principal Amount as of June 30, 2020	Interest Rate	Final Maturity	Amortization
Long-term debt:				
Unsecured: 5.625% Notes due 2027	542	5.625%	April 2027	Principal due at maturity with semi-annual interest payments.
Total	US\$542			

Note: values net of transaction costs