



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

March 31, 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, transmission and natural gas production and processing assets. We are the only vertically integrated power company that owns and operates natural gas extraction and transmission assets in Peru.

We conduct our operations through two primary business units: Orazul, which is comprised of hydropower generation and transmission assets, and Aguaytía, which is an integrated gas-to-power complex comprised of natural gas production and processing, thermal power generation and transmission. We generate and sell electricity to regulated customers (distribution companies) and non-regulated customers under short-term and long-term power purchase agreements (“PPAs”) and to the spot market. Our contracting level under PPAs is approximately 92%¹ with an average life of approximately 9.2 years, reducing the risk related to the fluctuation of spot market prices of electricity.

Our businesses are summarized in the following table:

	Entity	Location	Type	Overview
Orazul	Orazul	Cañon del Pato	Hydro Generation/ Run-of-river	266MW
		Carhuaquero	Hydro Generation/ Run-of-river	110MW
	Etenorte	Huallanca - Chimbote - Carhuaquero - Chiclayo	Transmission	349km
	Entity	Location	Type	Overview
Aguaytía	Termoselva	Aguaytía	Thermal Generation (natural gas)	192MW
	Eteselva	Aguaytía - Tingo Maria - Vizcarra - Conococha – Paramonga	Transmission	391km
	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, INDECOP, 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.

¹ Estimated for the following 3 years (2020-2022). Calculated based on the optimal contracting level.

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.

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 the US\$450 million senior secured loan facility with Deutsche Bank AG, Banco de Crédito del Perú, Scotiabank and Banco Internacional del Perú S.A.A., as lenders, 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.

Potential sale of Transmission business companies

In the fourth quarter of 2019, OEP received an indication of interest from transmission business companies to acquire OEP’s transmission business. In that context, in line with our aspiration of generating value through the portfolio optimization, a sale process of OEP’s transmission companies started in November 2019.

On March 10, 2020, OEP and Orazul Energía (UK) Holdings LTD signed a purchase agreement with Interconexión Eléctrica - ISA Peru, part of the ISA group, to sell its 100% ownership of Orazul Energy Group S.A.C. (“OEG”). OEG is a subsidiary of OEP, domiciled in Peru and the owner of 99.99% of the shares of Etenorte S.R.L. and Eteselva S.R.L., with more than 740 km of 220kV and 138kV transmission lines.

Etenorte S.R.L. and Eteselva S.R.L., represent approximately US\$12.4 million in revenues and US\$10.9 million in EBITDA based on 2019 audited financial statements (US\$12.3 million in revenues and US\$10.2 million in EBITDA based on 2018 audited financial statements). 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.

The amount of the sale is expected to be north of US\$140 million and subject to the normal closing price adjustments. Once the transaction is closed, the 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.

After the purchase agreement was signed, in our financial statements OEG has been classified as held-for-sale 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 financial statements).

The closing of the sale agreement is subject to the approval from Peruvian authorities. The transaction is expected to close no later than year-end 2020.

COVID-19

We know 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 measures 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 developed contingency plans to face this emergency and will ensure its full implementation. Such plans include:

- Development of personnel rotation plans in line with applicable travel restrictions and labor law.
- Securing 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.
- OEP ensures full compliance with legal measures being adopted by the Peruvian Government.
- OEP is taking extraordinary measures to limit or mitigate the contracting of the virus, adapting best practices from large public service and medical organizations.

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 corresponds to long-term notes that only require interest payments in the course of the next years. Debt service amounts are secured by significant cash flow from our operations.

OEP is currently in compliance with all financial obligations. We expect to maintain such compliance throughout the current turmoil.

Liquidity:

We are extremely cautious with our liquidity. We have taken several measures to protect liquidity, which are mostly implemented.

All cash on hand, other than the necessary for local weekly working capital, is to be maintained in US bank accounts, maintaining bear minimum in local market. As scheduled payments become due, the Company will transfer funds to local bank accounts. Other than current local payments, all new receipts of funds, are to be converted to US dollars and transferred to US accounts.

We are working to ensure 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.

During this period, we are managing cash in a conservative manner in order to maintain continuity of business, and as well to be prepared for any unplanned disruptions. We are maintaining at least one year of debt service cash on hand. Over the next six months, we are going to closely monitor the evolution of our cash flow.

The following weeks will be challenging, but we will strive to continue to provide electrical service to all of our customers while maintaining safe our employees and contractors. We will periodically inform the evolution of the operations, debt management and liquidity as matters progress.

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 March 31, 2020 and 2019.

For the three-month period ended March 31, 2020 and 2019

	Three months ended		%
	March 31		Change
<i>In millions of U.S. dollars</i>	2020	2019 (*)	
Revenues of energy generation	34	33	3%
Revenues of hydrocarbons	2	4	-50%
Revenues	36	37	-3%
Cost of sales of energy generation	(7)	(7)	0%
Cost of sales of hydrocarbons	(1)	(2)	-50%
Cost of sales (excluding depreciation)	(8)	(9)	-11%
Depreciation	(7)	(7)	0%
Administrative expenses	(2)	(3)	-33%
Other income, net	-	1	-100%
Operating profit	19	19	0%
Finance income	-	-	-
Finance cost	(9)	(9)	0%
Net foreign exchange difference	-	-	-
Finance cost, net	(9)	(9)	0%
Profit before income tax	10	10	0%
Income tax income (expense)	2	(6)	133%
Profit from continuing operations	12	4	200%
Profit from discontinued operations, net of tax	-	-	-
Profit for the period	12	4	200%

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

Results of Operations

The Company's net income for the three-month period ended March 31, 2020 amounted to US\$12 million compared to US\$4 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\$1 million, or 3%, to US\$36 million during the first quarter of 2020 from US\$37 million during the same period in 2019, due to a US\$2 million decrease in hydrocarbon liquid sales driven by 36% lower production to 51,128 bbl. during the first quarter of 2020 from 79,649 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\$51/bbl. and US\$44/bbl. during the first quarter of 2020, from US\$58/bbl. and US\$55/bbl. during the same period in 2019, respectively, due to lower international prices. This effect was partially offset by an increase of US\$1 million related to higher energy sales under PPAs from an increase in energy demand. Energy sales increased to 562 GWh during the first quarter of 2020 from 458 GWh during the same period in 2019, mainly explained by the beginning of a 55MW PPA with Enel Distribucion in January 2020.

Cost of sales (excluding depreciation)

Cost of sales decreased by US\$1 million, or 11%, to US\$8 million during the first 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 15 GWh during the first quarter of 2020 from 45 GWh during the same period in 2019.

These effects were partially offset by:

- US\$1 million increase in expenses related to the Operating Service Agreement with Kallpa; partially compensated by a decrease in personnel expenses due to the management integration between Kallpa and OEP.

Depreciation

Depreciation amounted to US\$7 million during the first 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 first 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\$9 million during the first quarter of 2020, unchanged from the same period in 2019.

Other Income, net

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

Income tax income (expense)

Income tax decreased by US\$8 million, to US\$2 million income during the first quarter of 2020 from US\$6 million expense during the same period in 2019. The estimated average effective tax rate for 2020 was 20% (60% in 2019). The effective tax rate during the first quarter of 2020 corresponds primarily to exchange losses in local currency (3.7% 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 first quarter of 2019 (1.8% 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 under our US\$25 million committed credit facilities and long-term borrowings.

During the first quarter 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 March 31, 2020, our cash and cash equivalents amounted to US\$49 million (including US\$3 million cash under assets held-for-sale).

Cash Flows

	Three-month ended		%
<i>In millions of U.S. dollars</i>	2020	2019	
<i>Cash from operating activities</i>	14	22	-36%
Income tax paid	(2)	(1)	100%
Net cash from operating activities	12	21	-43%
Net cash used in investing activities	(4)	(5)	-20%
Net cash used in financing activities	-	-	-
Net increase in cash	8	16	-50%
Cash and cash equivalent as of January 1	41	50	-18%
Effects of variations on exchange difference on held cash	-	-	-
Cash as of March 31	49	66	-26%
Included in cash and cash equivalents per Statement			
of Financial Position March 31	46	52	-12%
Included as assets of held for sale	3	13	-77%

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 43%, to US\$12 million during the first quarter of 2020 from US\$21 million during the same period in 2019.

The decrease was primarily driven by (i) US\$10 million increase in payments to suppliers, mainly explained by US\$7 million payment related to intercompany services rendered by Kallpa during 2019; (ii) US\$1 million increase in income tax payment in advance; and (iii) US\$1 million decrease in collections of hydrocarbons given lower production during the first quarter of 2020. These effects were partially offset by (i) US\$2 million lower payments to employees related to the management integration between Kallpa and OEP; and (ii) US\$1 million decrease in payment of royalties given lower production during the first quarter of 2020.

Cash Flows Used in Investing Activities

Net cash used in investing activities decreased by US\$1 million, or 20%, to US\$4 million during the first quarter of 2020 from US\$5 million during the same period in 2019.

During the first quarter of 2020, cash from investing activities was mainly used for (i) US\$2 million in payments related to the acquisition of property, plant and equipment; and (ii) US\$2 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 quarter of 2019, cash from investing activities was mainly used for (i) 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; and (ii) US\$1 million in payments related to the acquisition of property, plant and equipment.

Appendixes

EBITDA & Adjusted EBITDA reconciliation

	Three months ended March 31,		Discontinued operations	As previously reported
<i>In millions of U.S.</i>	2020	2019	2019	2019
Profit from continuing operations	12	4	-	4
(+) Income tax and profit sharing	(2)	6	-	6
(+) Financial expense, net	9	9	-	9
(+) Depreciation and amortization	7	8	(1)	9
Total EBITDA	26	27	(1)	28
(-) Net profit for the year for discontinued operations	-	-	-	-
(+/-) Non-recurring expenses, net	-	(1)	(1)	-
Total Adjusted EBITDA	26	26	(2)	28

Material Indebtedness

<i>In millions of U.S. dollars</i>	Outstanding Principal Amount as of March 31, 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