



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

September 30, 2019 and 2018

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 84%¹ and in 2018 we extended our PPA portfolio average life from 4 years to approximately 10 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	255MW
		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

Orazul Energy Perú S.A. ("OEP") is a subsidiary of Orazul Energia (UK) Holdings LTD. OEP was incorporated in Peru on October 10, 2016 and on December 20, 2016, acquired, from Duke Energy Corporation, 87.23% of Orazul Energy Group S.A.C. (formerly Duke Energy International Group), which owned a group of companies in Peru, Chile, Guatemala and El Salvador engaged primarily in power generation. On August 2, 2017, OEP acquired an additional 12.76% of Orazul Energy Group S.A.C. from Orazul Energía (España) Holding S.R.L. (which had previously acquired the participation from Duke Energy Corporation in 2016), increasing its share to the current 99.99%. On August 16, 2017, OEP merged by absorption with Orazul Energy Egenor S. en C. por A., one of its main subsidiaries in Peru. As part of the strategy to improve business efficiencies, a corporate restructuring was executed during 2017 and 2018, and the businesses located in Chile, Guatemala and El Salvador were carved-out.

¹ Estimated contracting level from 2019 to 2021.

OEP is indirectly owned by certain funds managed by I Squared Capital Advisors (US) LLC (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.

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

OEP received an indication of interest from transmission business companies to acquire OEP’s Peruvian 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 has started.

The sale process contemplates selling 100% of the shares of OEP’s subsidiaries, Etenorte SRL and Eteselva SRL, with more than 740 km of 220kV and 138kV transmission lines, which represent approximately US\$12.3 million in revenues and US\$10.2 million in EBITDA based on 2018 audited financial statements. Both subsidiaries have no direct full-time employees, operate under perpetual concessions regimes and are remunerated independently under the current regulation. 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.

In case the potential sale is closed, the Net Cash Proceeds may be used within 1 year 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) make an offer to purchase the Notes, at par. A year after the sale has closed, the Company should make an offer to purchase the Notes, at par, with any Excess Net Cash Proceeds after (i), (ii), (iii) or (iv) above.

The closing of a potential sale process is expected to take up to 6 months. There is no assurance that the sale of Etenorte SRL and Eteselva SRL will take place.

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 Interim Financial Statements as of September 30, 2019 and 2018.

For the nine-month period ended September 30, 2019 and 2018

	Nine months ended September 30		% Change
<i>In millions of U.S. dollars</i>	2019	2018	
Revenues of energy, capacity and transmission	101	101	0%
Revenues of hydrocarbons	12	20	-40%
Revenues	113	121	-7%
Cost of Sales of energy, capacity and transmission	(23)	(27)	-15%
Cost of Sales of hydrocarbons	(6)	(13)	-54%
Cost of sales (excluding depreciation)	(29)	(40)	-28%
Depreciation and amortization	(26)	(33)	-21%
Administrative expenses	(8)	(12)	-33%
Other income, net	1	2	-50%
Operating profit	51	38	34%
Finance income	1	1	-
Financial cost	(31)	(34)	-9%
Net foreign exchange difference	-	-	-
Finance cost, net	(30)	(33)	-9%
Profit before income tax	21	5	320%
Income tax expense	(9)	-	-
Profit (loss) from continuing operations	12	5	140%
Net profit (loss) for the period from discontinued operations	-	(1)	-100%
Profit (loss) for the period	12	4	200%

Results of Operations

The Company's net profit from continuing operations for the nine-month period ended September 30, 2019 amounted to US\$12 million compared to US\$5 million during the same period in 2018. The Company's results were mainly explained by the following:

Revenues

Sales of energy, capacity, transmission and hydrocarbons declined by US\$8 million, or 7%, to US\$113 million during the first nine months of 2019 from US\$121 million during the same period in 2018 due to lower hydrocarbon liquid sales driven by 28% lower production from 217,897 barrels ("bbl") during the nine-month period ended September 30, 2019 to 301,436 bbl during the same period in 2018, in connection with the unavailability of one of our wells. In addition, there were lower natural gasoline and Liquefied Petroleum Gas ("LPG") prices, from US\$66/bbl and US\$56/bbl during the nine-month period ended September 30, 2018, to US\$61/bbl. and US\$51/bbl in the same period in 2019, respectively, due to lower international prices.

Cost of sales (excluding depreciation)

Cost of sales decreased by US\$11 million, or 28%, to US\$29 million during the first nine months of 2019 from US\$40 million during the same period in 2018, primarily due to: (i) US\$5 million lower cost of royalties, storage and transport of natural gasoline and LPG related to lower sales in connection with a production decrease; (ii) US\$4 million decrease in personnel expenses due to the management integration process between Kallpa and OEP which started in January 2019; and, (iii) US\$1 million lower cost of natural gas royalties related to lower thermal generation, from 331 GWh during the nine-month period ended September 30, 2018 to 253 GWh during the same period in 2019, among others.

Depreciation and amortization

Depreciation and amortization decreased by US\$7 million, or 21% to US\$26 million during the first nine months of 2019 from US\$33 million during the same period in 2018, due to the write-off and end of the useful life of certain assets.

Administrative expenses

Administrative expenses decreased by US\$4 million, or 33% to US\$8 million during the first nine months of 2019 from US\$12 million during the same period in 2018, primarily due to a decrease in personnel expenses related to the management integration process between Kallpa and OEP which started in January 2019, added to additional synergies as lower legal services and headquarter fees.

Financial cost, net

Financial cost, net decreased by US\$3 million, or 9% to US\$30 million during the first nine months of 2019 from US\$33 million during the same period in 2018, primarily due to the reduction in the interest rate of our shareholder loan to zero since January 2019.

Income tax expense

Income tax expense amounted to US\$9 million during the first nine months of 2019 from no income tax expense during the first nine months of 2018. The estimated average effective tax rate for the first nine months of 2019 was 43% (3% for the same period in 2018). In 2018, the higher impact of exchange loss in local currency offset the US\$5 million profit before income tax. In 2019, the average effective tax rate responded to non-deductible expenses.

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 2019 and 2018, cash flow generated by operations was primarily used for investment activities and to service our outstanding interest and debt obligations.

As of September 30, 2019, our cash and cash equivalents amounted to US\$79 million.

Cash Flows

<i>In millions of U.S. dollars</i>	Nine-month ended		%
	2019	2018	
<i>Cash from operating activities</i>	79	77	3%
Income tax paid	(2)	(10)	-80%
Net cash from operating activities	77	67	15%
Net cash used in investing activities	(12)	(5)	140%
Net cash used in financing activities	(36)	(33)	9%
Net increase in cash	29	29	0%
Cash and cash equivalent as of January 1	50	23	117%
Effects of variations on exchange difference on held cash	-	-	-
Cash as of September 30	79	52	52%

Cash Flows from Operating Activities

Our main source of operating funds corresponds to cash flow generated from our operations. Net cash provided by operating activities increased by 15% to US\$77 million during the first nine months of 2019 from US\$67 million during the same period in 2018.

The increase was primarily driven by US\$8 million lower income tax paid during the first nine months of 2019 due to application of prior year tax credit, added to higher taxable income from 2017, paid in 2018; among others.

Cash Flows Used in Investing Activities

Net cash used in investing activities increased in US\$7 million to US\$12 million during the first nine months of 2019 from US\$5 million used during the same period in 2018.

During the first nine months of 2019, uses of cash from investing activities were mainly US\$8 million in payments related to the option agreements signed with distribution companies to extend the contract terms of certain PPAs, recorded as intangibles and US\$4 million in capital expenditures.

During the first nine months of 2018, uses of cash from investing activities were mainly US\$7 million in capital expenditures, partially offset by US\$1 million dividends received from a Chilean subsidiary; among others.

Cash Flows from Financing Activities

Net cash flows used in our financing activities increased by 9% to US\$36 million during the first nine months of 2019 from US\$33 million during the same period in 2018.

During the first nine months of 2019, we used cash to (i) amortize US\$20 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 nine months of 2018, we used cash for (i) a US\$17 million capital reduction; and, (ii) US\$16 million in interest related to the 2027 Senior Notes.

For the three-month period ended September 30, 2019 and 2018

	Three-month ended September 30		% Change
<i>In millions of U.S. dollars</i>	2019	2018	
Revenues of energy, capacity and transmission	31	32	-3%
Revenues of hydrocarbons	3	6	-50%
Revenues	34	38	-11%
Cost of Sales of energy, capacity and transmission	(9)	(10)	-10%
Cost of Sales of hydrocarbons	(2)	(6)	-67%
Cost of sales (excluding depreciation)	(11)	(16)	-31%
Depreciation and amortization	(9)	(11)	-18%
Administrative expenses	(2)	(3)	-33%
Other income, net	-	3	-100%
Operating profit	12	11	9%
Finance income	-	-	-
Financial cost	(11)	(11)	0%
Net foreign exchange difference	-	-	-
Finance cost, net	(11)	(11)	0%
Profit before income tax	1	-	-
Income tax expense	-	(2)	-100%
Profit (loss) from continuing operations	1	(2)	-150%
Net profit (loss) for the period from discontinued operations	-	(2)	-100%
Profit (loss) for the period	1	(4)	-125%

Results of Operations

The Company's profit (loss) from continuing operations for the three-month period ended September 30, 2019 amounted to US\$1 million profit compared to US\$2 million loss during the same period in 2018. The Company's results were mainly explained by the following:

Revenues

Sales of energy, capacity, transmission and hydrocarbons decreased by US\$4 million, or 11%, to US\$34 million during the third quarter of 2019 from US\$38 million during the same period in 2018, primarily due to (i) US\$3 million lower liquid sales, mainly due to lower production, from 69,686 bbl in the third quarter of 2019 compared to 84,652 bbl in the same period of 2018, related to the unavailability of one of our wells; and, (ii) US\$1 million lower spot energy revenues primarily due to a 23% decrease in spot prices, from US\$13.2/MWh during the third quarter of 2018 to US\$10.2/MWh during the same period in 2019.

Cost of Sales

Cost of sales decreased by US\$5 million, or 31%, to US\$11 million during the third quarter of 2019 from US\$16 million during the same period in 2018, primarily due to (i) US\$2 million lower cost of royalties, storage and transportation of natural gasoline and LPG related to lower sales in connection with lower production, (ii) US\$1 million lower cost of natural gas royalties in connection with lower thermal generation, from 219 GWh during the third quarter of 2018 compared to 147 GWh during the same period in 2019; and, (iii) US\$1 million decrease in personnel expenses due to the management integration process between Kallpa and OEP which started in January 2019.

Depreciation and amortization

Depreciation and amortization decreased by US\$2 million, or 18% to US\$9 million during the third quarter of 2019 from US\$11 million during the same period in 2018, due to write off and the ending of the useful life of certain assets.

Administrative Expenses

Administrative expenses decreased by US\$1 million, or 33% to US\$2 million during the third quarter of 2019 from US\$3 million during the same period in 2018, primarily due to a decrease in personnel expenses related to the management integration process between Kallpa and OEP which started in January 2019, added to additional synergies related to lower legal services and headquarter fees.

Financial cost, net

Financial cost, net amounted to US\$11 million during the first nine months of 2019, unchanged from the same period in 2018.

Income tax expense

There was no income tax expense during the first nine months of 2019 compared to US\$2 million income tax expense during the first nine months of 2018. During the first nine months of 2019, the current income tax was offset by a deferred income tax generated by a tax loss related to exchange loss in local currency.

Appendixes

EBITDA & Adjusted EBITDA reconciliation

	Nine months ended September 30,		Three months ended September 30,	
<i>In millions of U.S.</i>	2019	2018	2019	2018
Profit from continuing operations	12	5	1	(2)
(+) Income tax and profit sharing	9	-	-	2
(+) Financial expense, net	30	33	11	11
(+) Depreciation and amortization ²	28	34	10	12
Total EBITDA	79	72	22	23
(+/-) Non-recurring expenses, net	-	2 ³	-	(1)
Total Adjusted EBITDA	79	74	22	22

Material Indebtedness

<i>In millions of U.S. dollars</i>	Outstanding Principal Amount as of September 30, 2019	Interest Rate	Final Maturity	Amortization
Long-term debt:				
Unsecured:				
5.625% Notes due 2027	541	5.625%	April 2027	Principal due at maturity with semi-annual interest payments.
Total	US\$541			

Note: values net of transaction costs

² Includes depreciation classified as Administrative expenses in our consolidated financial statements.

³ Includes primarily one-time severance payments.