



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, 2021 and 2020

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 Aguaytía, 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 85%² with an average life of approximately 8.4 years, reducing the risk related to the fluctuation of spot market prices.

Our businesses are summarized in the following table:

Entity		Location	Type	Capacity
Orazul	Orazul	Cañón del Pato	Hydro generation/ Run-of-river	266MW
		Carhuaquero	Hydro generation/ Run-of-river	110MW
Aguaytía	Termoselva	Aguaytía	Thermal generation (natural gas)	192MW
	Aguaytía Energy del Perú	Aguaytía	Hydrocarbons	55 mmscfd 4,179 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 18 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\$158.3 million. For further detail see “Sale of Transmission business companies”.

² Estimated for the following 3 years (2021-2023). Calculated based on the optimal contracting level.

Our Notes

On April 25, 2017, OEP issued senior unsecured 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 March 10, 2020, OEP and Orazul Energía (UK) Holdings LTD signed a purchase agreement with Interconexión Eléctrica – ISA Peru (“ISA Peru”), part of the ISA group, to sell its 100% ownership in Orazul Energy Group S.A.C. (“OEG”). OEG was 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.

On August 24, 2020, OEP sold to ISA Peru, its indirect ownership in the transmission business companies, Etenorte S.R.L. and Eteselva S.R.L., for US\$158.3 million total consideration after working capital adjustments.

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.

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 (for additional information see note 3 of our consolidated financial statements).

Aguaytia’s License Agreement extension

Aguaytia has a concession over a natural gas field located in the central rainforest of Peru (concession Block 31-C), from which it 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.

On June 10, 2020, the Peruvian government, through 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.

Gas Price Declaration – Regulatory Update

During the past few years, based on the Electricity Law, the Peruvian electricity system used the marginal cost of electricity to determine the dispatch ranking of the power generators. Thus, spot prices only included the variable portion of the gas supply cost. However, because of a legal action initiated by Luz del Sur S.A.A., a distribution company, a Supreme Court resolution was published in September 2020 that:

- Declared that Supreme Decree 043-2017-EM, which regulates the gas price declaration mechanism, is illegal and void, alleging it contravenes main principles of the Constitution and the Electricity Law, and that it does not solve systemic issues set forth Supreme Decree 039-2017-EM;
- Instructs the Ministry of Energy and Mines (MINEM) to issue new regulation; and,
- Questions the nature of fixed costs of take or pay and ship or pay conditions in current gas supply, transportation and distribution contracts.

The Company considers that Supreme Court ruling is illegal because:

- i. It violates the foundations of the marginal cost system recognized in the Electricity Law;
- ii. It led MINEM to issue new regulation forcing gas plants to declare prices including fixed costs related to the provision of fuel, which is contrary to the Electricity Law; and,
- iii. The Supreme Court cannot instruct the Executive branch on how to issue new regulations.

The Company filed constitutional actions, which were admitted for analysis and further resolution.

On December 19, 2020, MINEM issued the Supreme Decree 031-2020-EM that instructed COES to propose to OSINERGMIN, the system regulator, a procedure to determine the variable cost of thermal plants using natural gas. On February 2021, COES submitted its proposal to OSINERGMIN.

On March 22, 2021 OSINERGMIN published its proposal to modify Technical Procedure N°31 for comments. Such proposal considered that variable cost of natural gas power plants should be determined using the total unitary natural gas price (supply, transportation, and distribution).

On April 5, 2021, the Company sent comments to the proposal, arguing that it is illegal and contrary to the Electric Concession Law and marginal cost principles. Comments were supported by several legal and regulatory reports issued by external advisors.

On May 3, 2021, OSINERGMIN ratified its position through Resolution 092-2021-OS/OD. Therefore, the new procedure will be in force effectively since July 1, 2021 and COES will consider the total unitary gas prices of each plant to determine the merit order for dispatch.

It is expected that the average system marginal cost will increase approximately from US\$10/MWh to US\$25-30/MWh. We expect our gross margin will not be affected materially in the second half of 2021.

COVID-19

In March 2020, the World Health Organization declared the spread of the coronavirus or COVID-19 as a global pandemic. In response, the Peruvian government ordered certain measures to contain the pandemic leading to partial lockdowns of economic activities with restriction on the mobility of people and the suspension of work activities, among others. The Company's operations required to remain open for business at the highest level to provide the vital electrical service for the country. Therefore, in general, the pandemic did not have significant effects on the Company's financial position, financial performance, and cash flows as of and for the year 2020 and the first three months of 2021.

As of March 31, 2021, the Company's Management has maintained measures adopted during 2020 related to security, continuity of operations and financial risk management, such as:

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 adopted by the Peruvian Government.

We have developed and implemented contingency plans to face this emergency and ensure their full compliance, including:

- 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.
- Home-office for employees and directives wherever activities allow it and curfews and mobility restrictions apply.
- Mechanisms to secure adequate and safe transportation of personnel and supplies to and from operating facilities, minimizing use of public transport.
- 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 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 our Notes that only require interest payments during the next years. Debt service amounts are covered 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 period.

Liquidity:

During this period, we manage our cash in a conservative manner and have taken several measures to protect liquidity and maintain continuity of business. Still, over the next months, we will continue to closely monitor the evolution of cash flow and to 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 consolidated financial statements as of March 31, 2021 and 2020.

For the three-month period ended March 31, 2021 and 2020

	Three months ended March 31		% Change
<i>In millions of U.S. dollars</i>	2021	2020	
Revenue of energy	34	34	0%
Revenue of hydrocarbons	2	2	0%
Revenue	36	36	0%
Cost of sales of energy generation and hydrocarbons	(10)	(8)	25%
Depreciation	(6)	(7)	-14%
Administrative expenses	(1)	(2)	-50%
Other income, net	-	-	-
Operating profit	19	19	0%
Finance income	-	-	-
Finance costs	(9)	(9)	0%
Net foreign exchange difference	(2)	-	-
Finance cost, net	(11)	(9)	22%
Profit before income tax	8	10	-20%
Income tax expense (benefit)	(4)	2	-300%
Profit from continuing operations	4	12	-67%
Profit from discontinued operation, net of tax	-	-	-
Profit for the period	4	12	-67%

Results of Operations

The Company's profit for the three-month period ended March 2021 amounted to US\$4 million compared to US\$12 million in the same period in 2020. The Company's results are mainly explained by the following:

Revenue

Revenue of energy, capacity and hydrocarbons amounted to US\$36 million during the first quarter of 2021, unchanged from the same period in 2020.

Cost of sales (excluding depreciation)

Cost of sales (excluding depreciation) increased by US\$2 million, or 25%, to US\$10 million during the first quarter of 2021 from US\$8 million during the same period in 2020, mainly explained by higher property and business interruption insurance costs, among others.

Depreciation

Depreciation decreased by US\$1 million, or 14%, to US\$6 million during the first quarter of 2021 from US\$7 million during the same period in 2020, mainly due to the end of the useful life of certain assets.

Administrative expenses

Administrative expenses decreased by US\$1 million, or 50%, to US\$1 million during the first quarter of 2021 from US\$2 million during the same period in 2020, mainly due to lower third-party services.

Finance cost, net

Finance cost, net increased by US\$2 million, or 22%, to US\$11 million during the first quarter of 2021 from US\$9 million during the same period in 2020, mainly due to US\$2 million increase in foreign exchange loss due to the 3.7% devaluation of the Peruvian sol against the U.S. dollar during the first quarter of 2021.

Income tax expense (benefit)

Income tax increased by US\$6 million, to US\$4 million expense during the first quarter of 2021 from US\$2 million benefit during the same period in 2020. The estimated average effective tax rate during the first quarter of 2021 was 50% (-20% during the same period in 2020) mainly explained by the re-expression of the tax losses carry forward due to a 3.7% devaluation of the Peruvian sol against the U.S. dollar.

Liquidity and Capital Resources

Our principal cash requirements consist of the following:

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

Our principal 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 2021 and 2020, cash flow generated by operations was primarily used for investment activities and to service our outstanding interest and debt obligations.

As of March 31, 2021, our cash and cash equivalents amounted to US\$171 million.

Cash Flows

	Three months ended		%
	March 31,		Change
<i>In millions of U.S. dollars</i>	2021	2020	
Cash from operating activities	28	14	100%
Income tax paid	(3)	(2)	50%
Net cash from operating activities	25	12	108%
Net cash used in investing activities	(5)	(4)	25%
Net cash used in financing activities	(1)	-	-
Net increase in cash	19	8	138%
Cash and cash equivalent as of January 1	153	41	273%
Effects of variations on exchange difference on held cash	(1)	-	-
Cash as of March 31	171	49	249%

Cash Flows from Operating Activities

Our primary source of operating funds is cash flow generated from our operations. The net cash from operating activities increased by US\$13 million, or 108%, to US\$25 million during the first quarter of 2021 from US\$12 million during the same period in 2020.

The increase was driven by (i) US\$8 million lower payment to suppliers mainly explained by US\$6 million related to intercompany services rendered by Kallpa during 2019 paid in January 2020; and, (ii) US\$5 million increase in collections of energy and capacity related to outstanding balances from 2020. These effects were partially offset by US\$1 million higher income tax paid in advance during the first quarter of 2021.

Cash Flows used in Investing Activities

Net cash flows used in our investing activities increased by US\$1 million, to US\$5 million during the first quarter of 2021 from US\$4 million during the same period in 2020.

During the first quarter of 2021, cash used in investing activities was mainly for (i) US\$3 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 2020, cash used in investing activities was mainly 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.

Cash Flows used in Financing Activities

Net cash flows used in our financing activities increased by US\$1 million, to US\$1 million during the first quarter of 2021 from nil during the same period in 2020.

During the first quarter of 2021, we used cash to pay US\$1 million in interest accrued up to 2018 related to the shareholder loan granted by Orazul Energia Partners LLC. Starting 2019, this loan carries no interest.

Appendixes

EBITDA & Adjusted EBITDA reconciliation

<i>In millions of U.S.</i>	Three months ended March 31,	
	2021	2020
Profit from the period	4	12
(+) Income tax and profit sharing	4	(2)
(+) Financial expense, net	11	9
(+) Depreciation and amortization	6	7
Total EBITDA	25	26
(-) Net profit for the year for discontinued operations	-	-
(+/-) Non-recurring expenses, net	-	-
Total Adjusted EBITDA	25	26

Material Indebtedness

<i>In millions of U.S. dollars</i>	Outstanding Principal Amount as of Mar. 31, 2021	Interest Rate	Final Maturity	Amortization
Long-term debt:				
5.625% Notes due 2027	543	5.625%	April 2027	Principal due at maturity with semi-annual interest payments.
Total	US\$543			

Note: values net of transaction costs

