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PIF.TO - Polaris Infrastructure Inc. - Special Call

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

David Quezada *Raymond James Ltd., Research Division - Equity Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Polaris Infrastructure announces extended power purchase agreement conference call. (Operator Instructions) Please be advised that this conference is being recorded.

At this time, I'd like to turn the call over to Marc Murnaghan, CEO. Please go ahead.

Marc Murnaghan - *Polaris Infrastructure Inc. - CEO & Director*

All right. Thank you. So thanks people for dialing in. We wanted to do this call just to give some more background in terms of the press release and not all the (inaudible) of the details that are important in a one-page press release that also just gives shareholders a chance to ask questions, and I'll put it up to that, and I'll talk for maybe 5 minutes here, and then we can just open up for questions.

So what I wanted to discuss first is that this process that we went through, which we had actually been trying to spearhead even 1.5 years ago, which was we really -- from a project perspective, the binary unit is just something that has always made imminent sense from our perspective. But that had to be a separate contract, technically.

So our view is always, we wanted to put it in one contract and harmonize that. And so that was something that we had wanted to do.

But that, at the same time, early this year, the government and the Ministry of Energy in Nicaragua did want to go through a process, not just with Polaris, and I would suggest that we are probably the largest private generator, around 10% to 12% of the energy delivered approximately, which is a lot. We're a big generator, but they wanted to talk to all generators about effectively extending terms of contracts in exchange for lower prices to benefit the whole system. And so as a country, they do have high input costs in the electricity side, so the tariffs to the consumers are very high.

And so this process was an attempt, not just for Polaris and the ministry, but for the ministry and all generators to effectively find a way to lower tariffs so that the health of the whole system is better, stronger and there's lower tariffs for the end users, which should end up increasing power demand in the country should increase actually investments in the country. And so that's how it was all started.

And then once that process started with us and the other generators, the principle was looking for, call it, an NPV equivalency. So that's -- the pre and post NPVs were, in ballpark, the same. So that was the spirit of the conversation.

And so for us to do that, the binary unit is actually key because one of the things I would mention is that we with the steam (inaudible) modeled in annual decline, we modeled it 3%, the America model that's actually on our -- on the website on SEDAR. So it has a much lower decline of about 1%. But -- whereas the binary unit, you should be at a 0% decline on that. So -- and given that the capital cost, which we think are about $20 million for call it a 7-megawatt unit, which is where we're kind of coming in. That's sort of $20 million for something that at this new price would produce about $6 million in free cash flow. So just over a 3- year payback, which for a full year like asset it is fantastic.

So with that, we're able to get to -- the way that we run our numbers in a small NPV bump of 2% to 3%. And then where we think the pickup comes is -- a pickup in NPV is now we're much better set up for refinancing. We have been talking about the opportunity to do a refinancing for some time now. But with the contract ending in $20 million, $20 million, it made both investing in the mining unit, but even a refinancing from our perspective, (inaudible). So now that we have, call it, an 18-year contract, we think that the refinancing is much more doable now, and it's a much better package to do that.

We're out of net debt the (inaudible) of one (inaudible). And when you adjust for the lower price, we would be at -- in a projected EBITDA next year of sort of just over 2x debt to EBITDA. And then -- but if you include the binary unit, we'd be at sub 2x below 2x debt to EBITDA. But now with an 18-year contract.

And so I think that is very low. So we will now look to really make that focus. The first thing in the new year is [to do selective] refinancing, which is where we think we can actually really increase sort of the NPV, and that's on an NPV basis. But in terms of, call it, cash flow per year basis, if you look at next year and you just do the top number, the lower price for next year versus the projected megawatt hours, you're looking at about anywhere from a $10 million to a, call it, $12 million negative. The binary unit would claw back $6 million of that so that we'd be -- again, that's what we think free cash flow of 7 megawatts (inaudible) would look like. But we're really making a difference here.

Again, so our debt service over the next 3 to 4 years. Our projections are -- it's about $28 million a year. So because we are paying down the loan pretty quickly in the next 3 to 4 years. So that $28 million, I think, is where we would sit in the [new service] today. But if we did -- if you just did a simple, call it, mortgage style or $120 million actually, which is the gross debt, put a 7% or 7.5% interest rate, which, I think, is doable, but had a 15-year amortization, instead of $28 million a year, annual debt service is $13 million to $14 million. So that is, call it, a $14 million, $15 million pickup on the free cash flow line.

So that was -- that in and of itself would be greater than the revenue loss for getting above the binary unit. So the potential positive is $6 million and $15 million versus $21 million on the positive side versus an $11 million on the negative. I think that's one of the reasons why we're very happy with this outcome.

And given the environment, we've had people talking to us about refinancing before this with a much shorter-term contract. And with the tailwinds in ESG, we really think that doing something on the refinancing side, is very doable.

In terms of the dividend, we get put in there, the plan is to keep that to $0.15 a quarter. What I would say is that still -- that's the plan.

In terms of, call it, payout ratios, the way it is next year, look, we know it is super conservative in terms of the way we characterize it, which is when we have (inaudible) payout ratio is [running on] free cash flow, which is, after principal, nobody else does that. It's usually on an operating cash flow basis. On an operating cash flow basis, we'd be in the 30% to 35% pro forma. On a free cash flow without any, call it, 3 5 4, it would end if they (inaudible) the binary unit, we'd be sort of in the 70%, 75%. That number will drop 50% once the binary unit comes online. And to the extent we do, do a refinancing that will drop down to sort of 30% to 40% on a free cash flow basis, so back to realistically even lower than where we are today.

So that will be the plan to really focus on those 2 things to get that down. But in the meantime, we'll keep the dividend there. And part of that, too, is we are a very strong cash position.

The actual receivables in the Nicaragua have improved. Actually last quarter, as we reported, that improved. So we're sitting with cash of around [$60 million] on the balance sheet. So we can fund the binary unit. We can fund (inaudible), which we do expect to be extending that and working on that next year. So we can fund both of those and pay the dividends at the same time, while working on our refinancing, which would really, I think, free up more free cash flow.

So I think those are sort of the numbers. Strategically speaking, we now have an 18-year contract in Nicaragua. The 2 big plants in Peru were 19 years left on those to the 20 and 8 megawatts and the 5-megawatt plant has 15 years left. So we now have a weighted average of 18.1 years contracted, which is very high.

And so I think before the #1 cost for renewable power company is our cost of capital. And so our view is that this is what this is all about, this trying to lower our cost of capital. Our larger comparables, I would say, have performed very well much more because they've reduced their cost of capital, and they've increased their cash flow. And that's really what we're trying to set ourselves up for from both a cost of debt perspective, a cost of equity perspective. And I would say, even with this strategic partnership perspective, that we now sort of reset the table. And I think it's a good way to start 2021, and we can now go and try to continue with the growth plan at all at the same time.

So that's it to my comments. So if there's any questions, we can go let that happen.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from David Quezada with Raymond James.

David Quezada - *Raymond James Ltd., Research Division - Equity Analyst*

Congrats on the announcement. It looks like a really attractive contract extension there.

My first question, just on the binary unit. Will you be able to tack on some project-level debt with that? Or will that be just primarily out of cash on hand? And maybe any thoughts you have on just your thought process around going with the 7-megawatt binary unit. Is that, as opposed to, say, 10 like you maybe have talked about in the past? And is that primarily just because you're looking to match the net capacity with the PPA level?

Marc Murnaghan - *Polaris Infrastructure Inc. - CEO & Director*

Yes. So just to be clear, so on the binary unit and on the funding in question, we have about $28 million -- I think we have $30 million in sort of cash reserves against the debt in at the project level. So we can't use all of that. But if you call it 12, it would be sort of the traditional debt services over count.

So between the cash we have on hand plus the cash that we (inaudible), it's not like going to be on to put a $20 million check down tomorrow to get going on it. It's progress payments, right? So we'll be able to fund that with cash on hand and cash flow, no problem.

The issue around the 7 is that, without getting too technical, I'll try to do this. There's always this -- there is a risk when you do buying is that you -- because you reinject the water of the cooler. So there's a cooling risk. Now we've already done numbers that suggest that 10 to 12 megawatts, there actually isn't much because what happens is you take out an amount of temperature, and you decide that, and you decide that based on making sure you don't cool the resource down and you run numbers to do that. And so we think we could be 10 to 12.

However, when we look at a 7-megawatt unit, so we have one injection well, it's called [11-2]. It's in the north, it's the furthest sort of aways from the resource of all those injection wells. But more importantly, it's big, it can take -- it could take 7 to 8 megawatts of sort of cooling from the binary unit on its own. And based on tracer tests that we've done, we know there's no connection with the field.

So if you think of -- I would just say, if it's a 7-megawatt binary unit with effectively no cooling risk versus 10 to 11 with cooling risk, to me, that's a pretty simple decision.

So could you push it? Yes, you could. But I think right now it's 7 for sure. What we might do, and I don't know this, is that we'll try to nail it down in Q1 is, could we do a 10-megawatt capacity binary unit with 2 5-megawatt turbines, but only started with 7 and see how it goes.

So I don't have an answer to that now, but we may -- you might do a configuration like that. I guess I don't have that yet.

David Quezada - *Raymond James Ltd., Research Division - Equity Analyst*

No that makes a ton of sense. And then maybe just a follow-up question on that. Like -- and I apologize if you've mentioned this already, but just thinking about the time line to build out that project and procure the equipment and everything. Do you have kind of a ballpark of when you think you could be online?

Marc Murnaghan - *Polaris Infrastructure Inc. - CEO & Director*

Yes. So I think -- could we do it before 2023? Maybe. The issue is it's the turbines in a long lead time, there's probably 12 months on the turbines. So the plan would be to finalize designs Q1 and then get the turbines order and quickly choose the equipment supplier.

So from there, it's probably a 12-, 18-month process. Back half of 2022 is probably the best we could do. Yes.

Operator

(Operator Instructions) Since there are no further questions come up at this time. This concludes today's conference call. Thank you for your participation. You may now disconnect.
