Company Participants:
Patrick McCullough; CEO
Jim Brown; CFO

Analysts:
Carson Sippel; B. Riley FBR, Inc.
Endri Leno; National Bank Financial
Mark Jarvi; CIBC Capital Markets
Raveel Afzaal; Canaccord Genuity
Nelson Ng; RBC Capital Markets
Sameer Joshi; H.C. Wainwright & Co.
David Lieberman; Advisors Capital Management

Presentation

Operator: Good morning, and welcome to the Just Energy Group fiscal 2019 second quarter earnings conference call. All participants will be in listen-only mode. (Operator Instructions) After today's presentation, there will be an opportunity to ask questions. (Operator Instructions) Please note, this event is being recorded.

I would now like to turn the conference over to Pat McCullough, CEO. Please go ahead.

Patrick McCullough: Thank you, operator. Good morning, everyone, and thank you for joining our fiscal 2019 second quarter conference call. I'm Pat McCullough, Chief Executive Officer of Just Energy. With me today is our Chief Financial Officer, Jim Brown. Jim and I will discuss the results for the quarter, as well as our expectations for the future. We will then open this call to questions.

Let me preface the call by telling you that our earnings release, and potentially our answers to your questions, will contain forward-looking financial information. This information may eventually prove to be inaccurate, so please read the disclaimer regarding such information at the bottom of our press release.

Today, we'll offer some perspective on our results, followed by a deeper dive into a few of the key strategic initiatives we're pursuing that will continue to drive performance in the second half of the year and beyond.

In short summary, this was a quarter full of wins for the business that we're quite excited to talk to you about today. Base EBITDA achieved CAD37.3 million, surpassing year-ago results and our internal projections, as referenced in our recent press release. This EBITDA advancement was a result of margin enhancement efforts associated with our differentiated products and
service offerings. This overcame headwinds in G&A, bad debt, and higher ERCOT costs in the period, so we're very excited to put a number like this forward despite those headwinds, which will not continue in the second half of this year.

Margin expansion led to embedded gross margin of CAD2.3 billion. This is an all-time high for our company. As you know, embedded gross margin is our publicly recorded forward-earnings projection on gross margin. This is up 45% from CAD1.6 billion a year ago. So what we're essentially telling the market is our future earnings will be up on the gross margin line by 45% from where we had this book valued a year ago.

We also noted that within our margin enhancement efforts, that we were able to record CAD333 per RCE on incoming consumer contracts signed and renewed. This is higher than CAD197 a year ago, so significantly up. These are the margin enhancement efforts that we're very proud of and we expect to continue into the third quarter and, hopefully, beyond.

Additionally, we're pleased with our payout ratio, which has fallen off of levels near 100% over the last four or five quarters. We reported 82% on a trailing 12-month basis. We feel very good about what that means for the sustainability of our dividend. And additionally, we had some very large wins in terms of closing the $250 million USD refinancing, which solidifies our short-term financial needs as well as giving us capacity for inorganic growth. We bought a water filtration company, which puts us squarely into the health and well-being space and makes us feel like we're very relevant to our customers when you think about devices in homes with our name on it.

We closed a CAD225-million insurance wrap, which protects the downside on our earnings going forward. This is important, because if you think about the earnings challenges that the company has had in its recent past, this would cover some of the events that plagued us in fiscal 2018, things like the January winter freeze in Texas, things like the weather and hurricane challenges we had second quarter last year. So we're very pleased that this underpins our earnings going forward, and along with our margin enhancement, we think that's a very powerful recipe for forward earnings and, frankly, cash flows for the benefit of our shareholders.

Customer contracts grew. So we report RCEs, which are slightly down, but RCEs are a subset of what we're selling. That's only the commodity business, as depicted within RCEs. And while we're focused on that commodity book because we feel that has the greatest short-term upside for financial results in our company, the customer contracts include both commodity contracts and value-added products and service contracts. And both reporting with and without our water filter acquisition, those numbers are up year-on-year, which we're very pleased, and quarter-over-quarter.

In summary, the quarter was marked by many wins that are significant and items that our team is very proud of. The core business is strong and stable, and we're quite focused on this. We realized with the margin enhancement experience that we've had in the last quarter and a half, that the majority of the short-term earnings and cash upside for the business is on that commodity book, where the value-added products and services strategy is really meant to address the longer-term customer needs. So you'll see quite a bit of emphasis on margin
enhancement on the electricity and natural gas book that we manage, because we gained very strong confidence that there's a lot for us there.

The expected impact of these margin enhancements, G&A cuts, that we'll be talking about more on this call, risk management activities and improvements, like the insurance wrap, will help drive performance this year and EBITDA growth for the rest of this fiscal year and fiscal 2020. We're remaining very focused on capital stewardship and cash generation for the support of our dividend and our growth. We're committed to balance sheet discipline and generating superior return on invested capital. We're committed to value-added products and service expansion and really setting the stage for predictable, prolonged and stable growth.

With that, I'd like to turn the call over to Jim Brown, our Chief Financial Officer. Jim?

Jim Brown: Thank you, Pat. As Pat noted, our business is strong, with record-breaking embedded gross margin of CAD2.3 billion. Our balance sheet is healthy, and we remain committed to a strategy of comparable growth and dividend distributions. First, I'd like to cover some highlights of the second quarter, then provide some additional color in certain areas.

We are pleased to announce we've seen significant improvement in our second quarter base EBITDA, which improved 81% to CAD37.3 million due to positive contributions from our gross margin initiatives, which include contract margin enhancement and new risk management practices to neutralize our commodity costs throughout the year. This was partially offset by higher bad debt and administrative expenses.

As a reminder, and as was stated in previous quarters, losses due to changes in fair value derivative instruments, including net profits, is not reflective of the economic results or cash flows of the company.

Similar to other energy retailers, Just Energy uses base EBITDA as a preferred measure of operating performance. As you can see, our base EBITDA grew significantly for the quarter. During the quarter, realized gross margin increased 22% to CAD173.3 million, due in large part to expanded [unit] margins in North America and greater sales in the United Kingdom.

The consumer division gross margin increased 17% to CAD125.2 million as a result of focusing on higher-margin customers, while the commercial division, where gross additions remain strong, had an increase in gross margin of 36%, to CAD48.1 million.

We remain committed to enhancing our risk management activities, including our insurance wrap program, which was finalized in early October and adds an additional layer of protection to the company's earnings stability.

Annual gross margin per RCE for customers added and renewed in the quarter ended September 30, 2018, was CAD333 per RCE for the consumer division, a significant increase from CAD197 per RCE in the prior-year period. In the commercial division, signed margins increased to CAD96 per RCE, an increase from CAD88 per RCE in the prior year.
As we noted in our Investor Day, we are keenly focused on securing and retaining higher-margin customers who will ultimately drive long-term growth, rather than customers who are price-sensitive.

Despite our increased unit prices for the first time in five years, our combined attrition remained flat at 13% for the trailing 12 months, as compared to the same time last year. Consumer attrition of 20% decreased 3 percentage points year-over-year, while commercial attrition remained the same as a year ago at 5%.

Moving back to the income statement, general administrative expenses for the second quarter rose to CAD11.7 million. This increase was largely due to the expansion of our UK business and the cost of attractive top talent to our organization, coupled with an investment in operational efficiencies and automation.

As an example, we launched a new cloud-based (inaudible) forecasting tool in the quarter to increase the accuracy and timeliness of position management, while at the same time, reducing IT infrastructure costs associated with this program. Efforts such as this are examples that will ultimately drive greater cost savings as soon as the second half of fiscal year. Selling administrative expenses decreased 30% year-over-year, to CAD56.7 million, primarily due to capitalization of upfront commissions along with consolidation of regional sales offices.

Now I’ll review some other key financial metrics and balance sheet items. Base funds from operations was CAD26.2 million, an increase of 241% from a year ago. The increase was largely driven by significant improvements in our base EBITDA, which came from our gross margin expansion. The payout ratio on base funds from operation was 85%, compared to 279% this time last year. On a trailing 12-month basis, the current payout ratio is 82%. As we noted during our Investor Day in September, we are committed to returning our payout ratio to 75% and believe we are taking the appropriate actions for that to occur.

Managing our balance sheet continues to be a top priority for the company. As announced on September 12, 2018, the company entered into a $250 million USD non-revolving multi-draw senior unsecured term loan facility to secure refinancing of our $150 million USD euro bond, which matures in July of 2019. In addition, the facility provides flexible capital for future acquisitions and general corporate purchases.

Net debt to base EBITDA increased to 3.5% on a trailing 12-month basis, which is higher than 3.2x we reported in the last quarter, primarily due to higher utilization of our credit facility in the second quarter partially offset by higher base EBITDA.

Turning to our outlook, we've taken several initiatives to attract higher-margin customers in conjunction with implementing a pricing optimization strategy across the organization. To further drive profitability, we have put in place several top 10 initiatives, in particular the reduction of administrative expenses through greater automation and consolidation.

We believe we have the right strategy and people in place to drive profitability, gross margin and customer growth through our existing channels by aggressively promoting high growth products
and services while also developing additional strategic alternative channels. These actions will contribute in the third and fourth fiscal quarters. As a result, we are reaffirming our fiscal 2019 base EBITDA guidance in the range of CAD200 million to CAD220 million.

I look forward to updating all of you on our progress next quarter. With that, I'll turn it back to Pat for final remarks.

Patrick McCullough: Thanks, Jim. We recognize it's early and there is still a lot to be done, but I expect the Q2 results to be representative of our new resolve as an organization to execute faster and promote positive change. Operating with urgency and accountability through sustainable, predictable and profitable growth is our priority and our commitment.

With that, I would like to open the call up for questions. Operator?

Questions & Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions) Carter Driscoll, B. Riley FBR.

Carson Sippel: This is Carson Sippel on for Carter Driscoll. I just had a couple quick questions. First, for the customers that you're currently signing up, are they signed up with the better pricing and the ones that provide better margins to you?

Patrick McCullough: Can you explain your question, Carson? This is Pat. I didn't fully grasp what you're asking.

Carson Sippel: So the customers that you're signing up presently and in the past quarter, are these the customers that have, yes, the better pricing? Like you said you raised your prices, so these customers that are currently witnessing the higher pricing that provides better margins to Just Energy?

Patrick McCullough: Yes, that's right. So when we report the CAD333 per RCE, what we're reporting there is our consumer segment, which includes both residential customers and small C&I customers in all markets, so Canada, the US and the UK, and we're showing you what we have signed all new contracts and renewed all new contracts at. So that is the entire population, without the commercial business in it, a new margin level.

So if you think about our book, we have about a 2.5-year realized life on a residential account, so we sign one-, two-, three-, four- and five-year contracts. We have annual attrition on those contracts. We end up realizing 2.5 years, but then we renew 75%-plus of those contracts. But to rebase your pricing on the entirety of the book, you would need to have that incoming price step-up for 10 consecutive quarters, and then you would capture 100% of your book.

When we report CAD333 up from CAD197 last year, we're essentially telling you that a big part of our book has been repriced at the higher level. We also had that phenomenon in previous quarters, the net result being an embedded gross margin calculation getting up to 45%. That
should continue at -- if we can hold these levels of pricing in Q3 and Q4 -- and we're confident we can -- then you'll see this pancake or compound on itself, and you'll see the trailing 12-month gross margin per RCE results really move forward quickly.

Carson Sippel: And then one more quick question about pricing. Can you comment on if there are any price differences between the regions?

Patrick McCullough: There certainly are. So every market is unique in terms of the value propositions that we offer, but also the competitive landscape is different. In a market like Texas, where there's not an incumbent utility, we can speak directly to our customers. We hold the entirety of the customer relationship or the customer journey on a one-to-one basis, so we can promote our value better. So we generally would see a higher price, higher margin in a market like Texas. Take New York, where we're selling through Con Ed as a line item on the bill, we have to work harder to engage with that customer and promote our differentiated value to them.

So when you're seeing this CAD333, it is a blend of Canada, our Midwest markets, our Northeast markets, Texas and the UK, so the mix of what we sell in which market really does matter to those results.

Carson Sippel: And then one last one from me. So in regards to the filter group acquisition, have you started realizing any of the cross-selling opportunities that you mentioned at the Analyst Day?

Patrick McCullough: We haven't in the second quarter, obviously. We closed the deal on October 1st. We are in the planning and integration phase for a couple months, and then we will be working to cross-sell to existing customers and markets, like Texas, but that will be something we'll be talking about in future quarters. Remember, while that's an important acquisition to us strategically and for our customers, we talked about CAD5.5 million of first year EBITDA, so it's not going to be material to the bottom line, which is why we're really focused on the commodity booking, what can be done with that in the short term.


Endri Leno: I'll just start off with a couple. If you can talk a little bit about the retail channel, the kiosk and the Ecobee updates in the quarter, please.

Patrick McCullough: Sure. Absolutely. So retail continues to develop to be a really important channel for us. It was actually overtaken in sales this quarter by our digital channel, so our digital channel and our retail channel are neck-and-neck as our most important residential or consumer channels. We did well in excess of 30,000 sales, converted sales, through retail. We're in close to four-digit stores at this point, and we've expanded to well over 20 brands.

So that retail channel is a very important one to us, and if you followed our material at Investor Day, we had an authorized agent channel, which is a long-lead development we've been working on, which should really impact fiscal 2020, which we're excited about, and you'll hear us talking about how we sell through other large enterprises with superior brand recognition and brand
awareness than Just Energy's.

Endri Leno: The other question, in terms of acquisitions and then as you're looking at this add-on and diversification to your earnings and EBITDA, have you looked at anything? If you can provide any guidance in terms of what kinds of acquisitions are you looking at particularly with the increased capacity that you have now.

Patrick McCullough: Yes, we're always keeping our eye on the market. I think we've said publicly a few times that buying commodity books would be interesting to us if volatility returns in a significant way and hit multiples on -- let's say commodity books drop below 3x. That's happened in the past with events like polar vortex, and that's where we would be keen on acquiring books, provided they were healthy books.

Outside of that, we probably -- you probably won't see us buying any commodity books at today's 5x-plus EV-to-EBITDA. And if you observed what we've been doing in the last two years buying small bolt-on capabilities in the value-added products and services arena with well-structured deals that really limit the amount of cash that we put upfront, that will remain our strategy.

The truth is right now, with the acquisition of the water filter business, which is a different sale -- it's a want sale versus a need sale if you think about the customer's perspective -- we need to digest that acquisition. We need to scale it along with our Ecobee product, so we're really going to be focused on what we have right now. Don't expect a big announcement in the short term that we're going to have a big inorganic add-on. And we see so much opportunity on the core commodity book right now, that we're really focused on leveraging that.

With regards to Ecobee, we're selling more Ecobees. We've sold over 5000 Ecobees in one month this quarter. So we do believe that Ecobee is a compelling product that we can cross-sell to our customer base. It obviously provides nice direct return for the business, but it also supports our equity investment in Ecobee, which is 8%-ish. So we're pretty excited about that product, that company and what could be done with it. But, yes, we see a lot of opportunity to sell more Ecobees and water filters to the existing commodity book and new customers.

Endri Leno: And one more question before I jump in the queue is that -- if you can talk a little bit about the working capital outflow in the quarter and the first half of the year, and how do you see that evolving for the remainder of 2019? Thanks.

Patrick McCullough: Thanks for the question, Endri. There are basically three elements to that. One is greater sales with more upfront commissions. We see gross ads expanding on a trailing 12-month basis, and those all now -- not just our commercial business, like it used to be, but to residential business as well -- go to our balance sheet first.

Secondly, general seasonality -- we always have more capital to use in the second quarter due to ERCOT's summer and injections of natural gas for winter. And the third part is what I alluded to in my discussion on gross margin, is we are becoming more sophisticated in how we hedge volatility, and by hedging volatility, the primary instrument we use is options, and options in
many cases require upfront premiums, sometimes for the entire year.

So we see that trend reversing for a couple reasons. One is a lot of those costs have been incurred and have reversed as we give customers cash receipts as the year goes on, and, second, profitability in the second half of the quarter is obviously expected to be higher than the first half.

Operator: Mark Jarvi, CIBC Capital Markets.

Mark Jarvi: I'm wondering if you could comment in terms of what you're seeing in terms of current pricing, whether the step-up that you saw in terms of the new additions and the renewals and gross margin per RCE -- whether or not that can hold flat or still go higher from what you're seeing in terms of the marketplace right now.

Patrick McCullough: Sure. We believe it's sustainable, and we'll give you a couple facts and then a little bit of more recent evidence. So number one, we truly have differentiated value propositions in the market. We add things like loyalty rewards, which are very material to our customers and to all of our commodity products. We have almost 1 million customers on our loyalty rewards program right now. And we add things like the customer brand promise, which is best-in-class, where we give our customers more flexibility to manage their account or switch products without cancellation fees.

We are attaching Ecobee's and soon water filters, so we're creating a stickier relationship. So we do expect to be able to price at a premium to our competition going forward, because we feel like we have the better product and service lead. You guys probably have heard that we have won awards for the most trusted brand in Texas recently. We won an award for most innovative product in Ireland recently. We're really having a lot of external acknowledgment of that differentiated value prop that we're bringing.

Secondly, we were below market. We were not raising our prices over the last five years, as Jim mentioned, despite the fact that our competition was, so there's a bit of a catch-up game here where we're getting something that we probably always do, but we're not going after.

Another market dynamic that I know you guys think about, ERCOT has higher pricing on a forward basis next August than this past August, which was well up from a year ago August, so that is going to keep our competition in the marketplace thinking about pushing prices up, in our minds, because their costs are going up. And as you're noticing in our results, we do not see an attrition spike, despite the fact that we started raising prices in a material way towards the beginning of our first quarter.

Now, I can tell you I'm looking at October and November, the first few days of November, and I'm seeing the residential gross margins expand from what we just reported. So we just reported CAD333. If we continue to hold the pricing for the rest of this quarter -- and there's a caveat on that -- we'll push that past CAD350 next quarter when we report. So we actually do feel that we're going to go on a run here of several quarters of expansion on margin due to the differentiation that we're bringing to the market, and it's going to continue to drive net gross
margin up and short-term gross margin. But really, as we replace, quarter in and quarter out, big chunks of the book, you're going to have a nice year-over-year profit improvement layering effect, which we hope to enjoy for a few years.

Mark Jarvi: And can you maybe just elaborate in terms of pricing between new customers and renewals, just sort of maybe give us a bit of color on how that compares relative to the CAD333?

Patrick McCullough: Yes, it's not something we disclose, but I think it's obvious to say that attracting a new customer and earning that trust is harder than renewing a customer that you've already served well. So generally, the big margin expansion can happen on your renewing book, but, fundamentally, we will call customers and move them off prior to renewal, which is a lot of what we've done.

Now, the interesting thing that I want to point out to you is we're giving you a blended new adds and renewals, and we're also giving you the counts on gross adds. Our gross adds are up significant year-on-year in all channels and segments, which means despite the margin enhancement that we're talking about and the price increase with it, we're selling at rates well above a year ago, which means the customers are validating our value in the market.

Mark Jarvi: And then just talking about RCE additions, it was effectively flat in the quarter. At the Investor Day, you talked about a target of 10% annually. Maybe you can just reconcile what you're seeing in terms of the ability to add customers, grow the book versus the tradeoff of profitability, and how you guys see that evolving over the next year relative to the target of 10%.

Patrick McCullough: Yes, it's a great question. I think I acknowledged it on Investor Day. We really thought, coming into this year, that we had the ability to put 200,000 net RCEs on the board, if you think about just the commodity book and don't think about the customer contract count. That's obviously going to be pressured by our margin enhancement efforts, both on a fail to renew and attrition basis.

So I'm probably going to tell you that I don't know that we want to put a 200,000 net add goal ahead of the ultimate embedded gross margin or forward-earnings expansion opportunity that we see. So as we're managing our business every day, every week and every month, we're thinking about, okay, we have a save type of activity on a customer or a planned renewal type of activity on a customer or a new sale, and we're thinking about the pricing from a total customer lifecycle and a total enterprise value creation potential.

So it might be in our best interest to go flat this year on the commodity book and take price increases, like CAD197 up to CAD333, and then stabilize that and then promote growth and not push the envelope once we find that elasticity point where our customers say, "Okay, we love your value more than your competition, but we only love it to this amount." That's where you'll see price increases stop and stabilize, maybe shrink a bit if we've gone too far with the attrition result, which we haven't seen to this point, and that's when you'll see the growth kind of snap through.

So know that from an investor perspective, we're truly focused on enterprise value creation and
shareholder returns. We're not focused on market share, which I know a lot of companies do get quite distracted with. So I wouldn't say that 200,000 number that we thought we could do at the beginning of the year is the most important target to us right now. If we can get it, we'll get it. We love the customer count additions and increases that we're seeing across all products. So we do feel like there's growth there, but we're really going to be focused on a stable, cash flowing commodity book maximized and then return to a big growth emphasis.

But having said that, there's quite a bit of channel and product expansion, so we still believe strongly there's a big growth story here. You just may see us [cull] that for a couple of quarters as we take major steps forward on profit.

Mark Jarvi: I'll finish with one more question, just on the cost to acquire trend. Aggregation costs were up pretty substantially quarter-over-quarter. Obviously, you're getting the benefit of higher margins. I'm just wondering what it is that's driving the aggregation costs. Is it the challenge when you're bringing them in? Or maybe you can just elaborate on how those have moved up in parallel sort of with the higher margins.

Patrick McCullough: Yes, it's really the concentration of the retail channel now that it's at scale. It is definitely as extensive a channel as door-to-door was, so even though we're losing door-to-door emphasis, we're gaining retail. I think we mentioned in Q1 retail overcame digital and became our largest channel in that period. That's reversed, but both are still large in Q2. And it's really the mix of channel sales that drives that as much as anything. Now, as you scale, you do get a little bit of fixed absorption, but it's primarily a variable cost, so it's really a result of the retail channel.

Operator: Raveel Afzaal, Canaccord Genuity.

Raveel Afzaal: Can you speak about what your book looks like in Texas? How many variable rate customers do you have, what are the fixed rate customers, just heading into this quarter that you guys just reported?

Patrick McCullough: Yes, so we don't have very many variable, month-to-month customers in Texas. One of the reasons is we did raise price there. But we are very proactive with our customers, so as we raised price in Texas on variable month-to-month, we were engaging with our customers to say, hey, why don't you get back into a fixed-price contract? So as we saw the variable book attrit recently, we did drive two-thirds of those attriting customers back into higher-margin, fixed contracts for long terms.

So think about a couple tens of thousands of customers is all we actually have on variable month-to-month in Texas right now, so it's not driving the big results you're seeing here. It's really fixed-price, new contracts and renewing contracts that's the main driver behind it. So I know that's quite a bit different than a few of our competitors, Raveel, but there's no (inaudible) dependence on a high churn variable book. And we don't acquire -- by the way, we don't acquire residential customers on variable contracts.

Raveel Afzaal: And can you speak about the weather volatility that we saw in Texas, what sort
of an impact it had on the competitive landscape in that market?

Patrick McCullough: Yes, so we definitely saw some choppiness in July. It impacted us, as we showed you on Investor Day, by a few million dollars, so it wasn't a material result to us, but it was because we had a very sophisticated series of hedges in place. And obviously, we did not have the insurance wrap done in July, so we didn't have to rely on that. So we think that was a great result that shows the power of our supply and hedging team and their work. But we do know that many of the folks in our market that didn't have weather hedges on a book our size could have had tens of millions of dollars of issues if they weren't properly hedged for weather.

Raveel Afzaal: Did you see a lot of your competitors going out of business, or at least -- I mean, like you guys are very sophisticated, but the smaller guys in the market, did you guys see those guys going out of business, like who didn't have the right hedges in place?

Patrick McCullough: Raveel, I mean, we see people going out and being consolidated, basically. One of our larger competitors who was -- or not larger competitors, but one of the larger small competitors recently got acquired by a company, and I think it was due to margin compression and maybe taking maybe aggressive stances against the Texas summer.

But the interesting thing about Texas summer is, while volatility went up and forward prices went up, real-time prices still remained very low, and if you gambled, you could have won. That's a bad gamble, because -- and as a public company, we would never do that because we can't risk that, nor would we want to.

But I think that the real issue will be if real-time prices show up for the non-hedgers. Yes, that would be a much greater opportunity. We do see pressure, though, for people who are getting out of the market who can't afford the collateral costs.

Raveel Afzaal: And how is the weather outlook looking for Q4? I think it's too early to say, but I think October was a bit colder than expected. Can you just speak about how you see the outlook for weather variations or any other volatility that you guys expect seeing in this quarter?

Patrick McCullough: Sure. Yes, we're not worried about it at all. I think we've all talked in the past about Just Energy, how we hedged gas for this winter. We have mild and extreme weather hedges in place in every market we serve of any scale, and we do it at the metropolis areas. So for example, we'll have a specific collared swap differential on those in New York City than Chicago than Dallas, so we're really well buttoned-up on natural gas in the winter. And of course, we have an insurance wrap behind it if we have any funny intra-month volatility.

So we're truly not worried about what weather does this winter because of the robust hedges and insurance wrap behind that, but, no, we don't know any more than you do in terms of what to expect at this point.

Raveel Afzaal: And just, finally, I'm guessing the bulk of this growth, the pricing improvement, came from Texas, but can you speak a little bit of about the UK, because it looks like pricing over there has also been going higher, and just what impact that has had on your margin
improvement?

Patrick McCullough: Yes, you're right to think Texas first and, frankly, the North American market. The UK market is a unique one with the Big Six and a highly competitive market. We don't have quite the pricing power there, and a great deal of value prop enhancements that we've made, we have the UK business lined up to receive those this year.

So you're going to see us be able to differentiate in a meaningful way in the UK in the next quarter or two and then probably see more price enhancement there, or at least we'll attempt to premium price for that value there. But, no, it's not a large contributor to the CAD333 you see this quarter. It's really coming from Canada, the Northeast, Midwest and Texas.

Operator: Nelson Ng, RBC Capital Markets.

Nelson Ng: Just a quick clarification on the customer count. You guys mentioned that you lost Sears as a customer, but then you also gained a large UK commercial customer. Were those two items a wash, or was it a net negative?

Patrick McCullough: So for customer counts, I think you're referring to --

Nelson Ng: RCEs, yes.

Patrick McCullough: Yes, and one of our large North American customers, that we're refraining from naming, was getting themselves into an insolvency issue. So we were able to monitor that credit risk and get out at the perfect time, so we did fire a customer because of a very public insolvency issue.

And then at the same time, as you see in the commercial book, what we're most excited about in the commercial book is -- I mean, really the way we measure success in the commercial space is not around RCEs or customers, but around contracts, sales, term margin, okay, so, again, really well-aligned to embedded gross margin and, ultimately, our enterprise value. So as we're managing the levers of that business, you're seeing a great deal of progress in the sales term margin in that business, and we're very excited about where it's running.

The commercial business's contribution to this quarter was well ahead of expectations, so we're talking about consumer pricing and how meaningful that was, but we're really excited about both new sales coming in recently in the commercial book in October, which you haven't seen yet, but also sales term margin enhancement that's very interesting versus prior years.

Nelson Ng: And then my next question relates to just cost savings and efficiencies. I think Jim mentioned that there are a few initiatives that would be kind of realized in fiscal Q3 and Q4. I think in the Investor Day, you guys talked about realizing at least CAD20 million of efficiencies -- or gains in cost savings. Could you just give us like a profile in terms of what you think you can achieve I guess this fiscal year?

Patrick McCullough: Sure. So, yes, we were talking about a run rate savings concept from
where we were running, and if you think about our second half, we expect to be CAD10 million to CAD20 million below our first half G&A spend. And if you include a bit of the sales overhead that aren't reported in G&A, you get to that CAD20 million run rate that we're talking about. We think we can do another CAD20 million on top of that next year.

So if you got yourself to -- I think we said CAD114 million-ish, if I have the numbers right, in half one. We expect to be close to underneath CAD100 million in half two. And then we expect to be able to carve another CAD20 million off that whole year in fiscal 2020 if we deliver all of our cost-savings plans that we intend to.

Nelson Ng: And this is on top of -- I guess net of I guess additional spending for growth, so you're still -- I guess there's additional spending to kind of grow the business, but the cost savings would kind of more than offset that incremental investment?

Patrick McCullough: Yes. There are a couple -- let me give you a couple things to think about. You're right, there's going to be growth investments, but there always has been if you think about what we've been doing in our past. The second thing is we haven't paid a bonus to our employees in the last two years, so we are accruing for a bonus, which could be as large as CAD10 million to CAD15 million on a full-year basis. So you're going to have to overcome those year-over-year headwinds.

Now, how are we doing it? We're doing it through structural cost savings. We're doing it by consolidating the back-office and back end of our operation, both offices, people, the systems and process. So you saw a chunk of spend this quarter that was associated with severance and investment into our IT architecture, which we are cleaning up and streamlining so we can take the unproductive elements of our processes out and save some real money.

Nelson Ng: And then just one last question, just on the Texas market. So in terms of the outlook for next summer, I believe the pricing is still high, and I guess the -- and it sounds like the competitiveness in the market has somewhat faded in Texas. Do you have a sense of whether competition will kind of ramp up over the coming year?

Patrick McCullough: We wouldn't expect competition to increase given we see forward peak pricing in August next year being roughly 10% higher than we all just realized this year, which was several times higher than the previous year. So because we're seeing those values of CAD300 per megawatt hour at times for forward summer next year, that's not an environment that people want to run into because there are big collateral requirements and there is liquidity risk for, let's say, the little start-up that might be a price bottom-feeder, for lack of a better word.

So we don't expect to have any big competition in the market. The truth is, I'm not sure if it will impact what we're doing, because we are operating off of differentiated value that's understood by our customers, and those guys that come in, they come in with pure and visible price-based products, and it's a little bit of a different animal these days than what we're doing.

So, obviously, we're taking a major step forward, and we're learning every day about customer reaction to what we're doing and customer satisfaction and loyalty, so we'll be constantly
Updating you on the evolving scenarios that we see, but we're not expecting any big price pressure to come into the ERCOT market in the next four quarters.

Nelson Ng: And then you did mention collateral, so I think the collateral cost increased materially this quarter. Is it very seasonal? So are you expecting collateral costs to come back down and then go back up next summer?

Patrick McCullough: Yes, Nelson, that's exactly correct. There may be some mild increase in the winter too, because we're very protecting of our balance sheet and when -- we enter into bilateral agreements to protect ourselves against having to post collateral as well. There are two elements to the Texas collateral. One is the forward requirement, which recently changed, and the second is having to [post a day ahead], and both of those are 100% correlated to price, so we figured it's better to have security in place to make sure we aren't exposed to those cash flows and have some incremental financing costs.

Operator: Sameer Joshi, H.C. Wainwright.

Sameer Joshi: My question focuses on the forecast of CAD200 million to CAD220 million in base EBITDA. What are the contributions to that? Is cost saving a major contributor, or is there any contribution from any of the acquired companies that gives you that confidence?

Patrick McCullough: Thanks for the question, Sameer. The largest contributor to the second half uptick in profit is, number one, it is the profitable part of our book. We make more money on gas contracts than we do electricity contracts. And so you'll see our history for Q4 is normally our highest profit quarter and free cash flow quarter, so very important to us.

However, if you think about the contributors overall from the first half to the second half or year-ago second half to a higher outlook this second half, it really is margin expansion first. It's the margin enhancement actions that we've taken. Cost productions are definitely in the fold, though, to the tune of CAD10 million to CAD20 million from a half-over-half basis. So you'll see [bad debt] improve. You'll see G&A improve dramatically. You'll see a little bit of sales overheads within the selling line improve.

And gross margin for us -- forecasting the short-term is quite easy, since we signed multi-year contracts. We just take the billed rate minus our costs, which is already locked in with our suppliers, multiplied by expected volume and then hedged for variation around that. So it's really primarily driven by gross margin, which you're already seeing coming through this quarter. It will continue to improve next quarter and then in the fourth quarter.

Sameer Joshi: And is there any contribution from the acquired companies that is also boosting this?

Patrick McCullough: From which companies, Sameer?

Sameer Joshi: The filter group and EdgePower acquisitions?
Patrick McCullough: Yes, it's not material. So we'll see a couple million dollars from each of those in the second half, but, no, that's not going to be a material contributor to the difference. It's really the core commodity book and the margin enhancement efforts we've made.

Sameer Joshi: And then from the UK, I think last quarter I heard that it was around 9% of your total business. Going forward, how big do you expect it to be? And then corollary to that is what contribution to the base EBITDA do you expect from the UK business?

Patrick McCullough: Yes, so we don't report the UK segmented out. It's not how we run the business, frankly. We run the business by product lines. But, no, the UK business has ranged from 7%, 8% to 15% quarter in, quarter out. You'll see when we get to the fourth quarter it's a very large contributor to the fourth quarter, because that is their big gas market quarter, and also there's been significant growth compounding in the last three years in the UK business, so a really important business to us.

We are definitely investing many of our SG&A dollars both in growing products horizontally if you think about differentiation and more value-added products and services, and we are definitely investing in absolute organic customer growth through selling. It's a very important market. We do expect big things.

Generally, if the UK ranges at 10% to 15% of our gross margin, it's relatively a similar drop-through to the bottom line, although we have been investing heavy G&A in that business, so this year it'll pull the ultimate EBITDA back a little bit relative to the North American business. And, again, it gets back to our bigger North American markets will have the biggest contribution to the second half, not the UK.

Operator: David Lieberman, Advisors Capital Management.

David Lieberman: My question is actually more around some of the fixed assets that you have, and the bonds -- or the preferreds. Some of them -- the A, for example, has sold off, and yield to worst on it is probably about 20%. Have you considered, from a use of capital standpoint, buying it back to lock -- or buying those assets in some capacity to lock in a 20% return?

Patrick McCullough: We are recognizing the differences between our cost of equity in all forms today and our cost of debt, and I think if you find us in a surplus cash position, which is not that present given the big seasonal cycle we're going through on the back end of summer, you may see us do interesting things in the market. We're not committed to doing that right now. We're really committed to dropping through free cash flow and delevering. But we understand your point when you think about the cost of equity on that product and the cheap takeout that we could get good (inaudible) around.

David Lieberman: And just one other question, going back to churn a little bit. Do you find that the churn levels are different from marketing type to marketing type -- digital, door-to-door, retail, and so on? Have you found that the churn levels can be improved, for example, on the retail store, where perhaps there's a bit more of an initial relationship than there might be in some of the other ways?
Patrick McCullough: Absolutely, and it's interesting, because I think some customers, no matter what channel they come through us -- or come to us through, they want to engage with us, and those end up being the stickiest customers. The ones who want to know their options, want to get advice from us, those are the guys that stay, and they can come from any channel. But you're right, if you have a face-to-face, upfront sale, you have accelerated that process. You've made it more comfortable for the customer, and they are more likely to engage with you with more frequency through the whole customer journey.

So 100%, there are a ton of differences there. That's why we took on retail, even though there is a cost to it. We wanted to be there in front of people, associated with great brands, like Sam's Club as an example, and get the halo effect of that. But we're also selling digitally through some channel partners that have better brand recognition than we do in the marketplace, which is super helpful. And you can also get sticky customers through those types of acquisitions as well.

David Lieberman: That's great. Well, we're really excited with what you're doing. Now it's a big execution story, so we're excited to see how it turns out. I appreciate the time, guys.

Operator: This now concludes our question-and-answer session. I would now like to turn the conference back over to Pat McCullough for any closing remarks.

Patrick McCullough: Thank you, operator. Before we conclude today's call, I wanted to pass out my deepest gratitude to our employees. Our employees have done a superb job really rallying around what we're trying to do as a business for the benefit of our shareholders. So thanks go out to our employees in all regions and all parts of the business. Your dedication to building this business through innovation and commitment to customer service is the backbone of our success. It is acknowledged and appreciated.

Thank you, everyone, for participating in the call and for your support of the business. We'll talk to you next quarter. Thank you.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.