MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

December 31, 2018 and 2017

ORAZUL ENERGY PERU S.A. AND SUBSIDIARIES

US$550,000,000 – 5.625% Senior Notes due 2027

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 Aguaytia, 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 unregulated 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 we have extended our PPA portfolio life from 4 years to an average life of approximately 10 years, which reduces the risk related to spot market prices of electricity.

Our businesses are summarized in the following table:

	Entity	Location	Type	Overview
Orazul Energy Peru	Orazul	Cañon del Pato	Hydro Generation/ Run-of-river	255MW
		Carhuaquero	Hydro Generation/ Run-of-river	Carhuaquero I – V 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	52.5mmscfd 1,200-1,300 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 for the following 3 years (2019-2021)

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. After the Peruvian antitrust authority (INDECOPI), approved the December 2017 Inkia acquisition by the Sponsor, the related parties of OEP include Kallpa Generación S.A. ("Kallpa") and Samay I S.A. ("Samay"). 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 bonds issued pursuant to Egenor's second program of local corporate bonds. The Notes are rated BB by Fitch Ratings and Standard & Poor's.

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 Audited Consolidated Financial Statements as of December 31, 2018 and 2017.

For the year ended December 31, 2018 and 2017

In the following table, columns A and B show the Statement of Profit or Loss for the year ended December 31, 2018 and 2017 as presented in the set of financial statements. For comparison purposes, we have included column C that shows December 2017 reexpresed as if IFRS 15 had been applied since January 1, 2017 and column D that shows the percentage change comparing 2018 and 2017.

All the explanations below are based on columns A, C and D to compare financial results applying same accounting standards.

	Year Ended December 31		% Change	Applying IFRS 15 As of December 31	% Change
	A	B		C	D
In millions of U.S. dollars	**2018**	**2017**		**2017**	
Revenues of energy	132	184	-28%	149	-11%
Revenues of hydrocarbons	24	19	26%	19	26%
Revenues	**156**	**203**	**-23%**	**168**	**-7%**
Cost of Sales of energy	(36)	(76)	-53%	(41)	-12%
Cost of Sales of hydrocarbons	(13)	(9)	44%	(9)	44%
Cost of sales (excluding depreciation)	**(49)**	**(85)**	**-42%**	**(50)**	**-2%**
Depreciation	(46)	(39)	18%	(39)	18%
Administrative expenses	(23)	(27)	-15%	(27)	-15%
Other income (expenses), net	4	2	100%	2	100%
Operating profit	**42**	**54**	**-22%**	**54**	**-22%**
Finance income	2	5	-60%	5	-60%
Financial expenses net	(45)	(73)	-38%	(73)	-38%
Net foreign exchange difference	(1)	1	-200%	1	-200%
Finance cost, net	**(44)**	**(67)**	**-34%**	**(67)**	**-34%**
Loss before income tax	**(2)**	**(13)**	**-85%**	**(13)**	**-85%**
Income tax benefit (expense)	5	(11)	-145%	(11)	-145%
Profit (loss) for the year	**3**	**(24)**	**-113%**	**(24)**	**-113%**
Net (loss) profit for the year from discontinued operations	(11)	1	-1200%	1	-1200%
Total other comprehensive loss for the year	**(8)**	**(23)**	**-65%**	**(23)**	**-65%**

Results of Operations

The Company's net profit for 2018 amounted to US$3 million compared to a loss of US$24 million in 2017. The Company's results were mainly explained by the following:

Revenues

Sales of energy, transmission and hydrocarbons declined by US$12 million, or 7%, to US$156 million in 2018 from US$168 million in 2017, primarily due to: (i) US$10 million reduction in PPA energy sales with non-regulated customers due to the termination of certain contracts; (ii) US$8 million decrease in demand from distribution companies mainly due to the migration of small-to-mid-size distribution companies' clients to the bilateral PPA market; (iii) US$2 million lower PPA revenues associated with 88 GW of RER contracts; and (iv) US$1 million in lower third-party transmission revenues due to a compensation received in April 2017 by a recalculation of a prior year.

These effects were partially offset by: (i) US$ 5 million in higher spot energy revenues due to higher spot prices (US$10.8/MWh during 2018 compared to US$9.5/MWh during 2017), coupled with higher net volumes (552 GWh during 2018 compared to 23 GWh during 2017); and, (ii) US$4 million in higher liquids sales mainly natural gasoline revenues due to higher prices (US$64/bbl in 2018 compared to US$ 45/bbl in 2017).

Cost of sales (excluding depreciation)

Cost of sales decreased by US$1 million, or 2%, to US$49 million in 2018 from US$50 million in 2017, primarily due to (i) US$ 7 million lower capacity purchases due to the higher capacity received by our thermal plant, and (ii) US$ 4 million in lower energy purchases in the spot market primarily due to the higher thermal generation.

These effects were partially offset by (i) US$ 5 million in higher gas royalties due to the increase in thermal generation and dispatch requested by COES in connection with the partial unavailability of the Camisea gas coupled with maintenance of other generators during 2018; (ii) US$ 4 million in higher cost of royalties, storage and transport of natural gasoline related to higher sales; and (iii) US$ 1 million increase in transmission charges due to a tariff adjustment.

Depreciation and amortization

Depreciation and amortization increased in US$ 7 million, or 18% to US$ 46 million in 2018 from US$ 39 million in 2017 due to property, plant and equipment additions during 2018 and the reduction in the useful life of certain assets.

Administrative expenses

Administrative expenses decreased by US$4 million during 2018, or 15%, to US$23 million from US$27 million in 2017, primarily due to (i) US$ 4 million lower bad debt allowance related to Maple Gas in 2018 compared to 2017, and (ii) US$ 3 million lower third-party services driven by the optimization plan executed during 2018. These effects were partially offset by an increase in US$ 3 million in personnel expenses which includes the net effect of the optimization plan executed during 2018 and the one-time severance payments as a result of the management integration process between Kallpa and Orazul.

Other income, net

Other income, net increased by US$2 million, or 100%, to US$4 million in 2018 from US$2 million in 2017 mainly due to lower other expenses in 2018 compared to 2017 due to lower labor contingencies provision and penalties, added to an advisory service rendered in 2018 to a related party in Chile.

Financial expenses, net

Financial expenses, net during 2018 decreased by US$ 23 million, or 34%, to US$44 million from US$67 million during 2017, primarily due to (i) US$ 30 million lower interest and refinancing costs related to the prepayment in April 2017 of the acquisition syndicated loan and the repurchase of local corporate bonds; and (ii) US$ 2 million lower interest to related parties mainly due to the capitalization of US$ 128 million shareholder loan in July 2017; partially offset by US$ 10 million higher interest expenses related to the 2027 Notes.

Income tax expense

Income tax expense decreased by US$16 million during 2018 to a US$5 million income in 2018 from a US$11 million expense in 2017. Income tax expense in 2017 resulted from exchange gains in local currency, coupled with non-deductible expenses related to the acquisition syndicated loan. Income tax in 2018 resulted in income mainly due to exchange losses in local currency and timing of deferred income tax.

Liquidity and Capital Resources

As of December 31, 2018, our cash and cash equivalents amounted to US$ 50.0 million. During 2018 and 2017, cash flow generated by operations was primarily used for working capital requirements, investment activities and to service our outstanding interest and debt obligations.

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;
- Financial income from the investment of cash and available funds; and
- Short-term under our US$25 million committed credit facilities and long-term borrowings,

Cash Flows

	Year ended December 31		% Change
In millions of U.S. dollars	**2018**	**2017**	
Cash from operating activities	**98**	**54**	**81%**
Income tax paid	-13	-14	-7%
Net cash from operating activities	**85**	**40**	**113%**
Net cash used in investing activities	**-10**	**-9**	**11%**
Net cash used in financing activities	**-48**	**-93**	**-48%**
Net increase (decrease) in cash	**27**	**-62**	**-144%**
Cash and cash equivalent as of January 1	23	85	-73%
Cash as of December 31	**50**	**23**	**117%**

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 113% to US$85 million in 2018 from US$40 million in 2017.

The increase was primarily driven by: (i) US$ 18 million in lower third party purchases added to improved terms in accounts payable to suppliers of goods and services, partially offset by lower energy sales; (ii) US$ 21 million in higher collections from natural gasoline sales due to the contracts signed with Petroperú and Perenco, including a pending balance from 2017; and (iii) US$ 4 million in lower income tax payments due to application of prior year tax credit added to other taxes and contributions, among others.

Cash Flows Used in Investing Activities

Net cash used in investing activities increased in US$ 1 million during 2018 from US$ 9 million in 2017 to US$10 million in 2018.

During 2018, cash from investing activities was mainly used in capital expenditures for US$12 million mainly related to the completion of the flare and blowdown system in the gas plant, plugs installation in wells, tank for natural gasoline storage and implementation of automated control systems in our hydropower plants, among others. This was partially offset by dividends received from a Chilean subsidiary for US$ 1 million.

During 2017, cash from investing activities was mainly used in capital expenditures for US$ 13 million mainly related to the completion of a natural gasoline storage and loading plant, the initial capital expenditures of the flare and blowdown system in the gas plant, workover in wells, implementation of automated control systems in our hydropower plants and replacement of equipment, overhauls of machinery and IT software upgrades, partially offset by the sale of real estate for US$ 4 million.

Cash Flows from Financing Activities

Net cash flows used in our financing activities decreased to US$ 48 million in 2018 compared to US$ 93 million in 2017.

During 2018, we used cash to pay US$ 31 million in interests related to the 2027 Notes and for a capital reduction of US$17 million.

During 2017, we received aggregate proceeds of US$550 million from the Orazul Notes issued in April 2017 and we used cash to (i) prepay the acquisition loan for US$ 450 million, (ii) prepay local corporate bonds including a premium for US$ 83 million, (iii) pay an intercompany loan granted for the acquisition for US $83 million, (iv) pay US$ 15 million in interests related to the bonds, and (v) pay US$ 11 million in financing costs related to the bond issuance.

For the three-month period ended December 31, 2018 and 2017

In the following table, columns A and B show the Statement of Profit or Loss for the three-month period ended December 31, 2018 and 2017 as presented in the set of financial statements. For comparison purposes, we have included column C that shows the fourth quarter of 2017 reexpresed as if the IFRS 15 had been applied since January 1, 2017 and column D that shows the percentage change comparing the three-month period ended December 31, 2018 and 2017.

All the explanations below are based on columns A, C and D to compare financial results applying same accounting standards.

	Three months ended December 31		% Change	Applying IFRS 15 three months ended December 31	% Change
	A	B		C	D
In millions of U.S. dollars	**2018**	**2017**		**2017**	
Revenues of energy	32	46	-30%	37	-14%
Revenues of hydrocarbons	4	7	-43%	7	-43%
Revenues	**36**	**53**	**-32%**	**44**	**-18%**
Cost of Sales of energy	(9)	(17)	-47%	(8)	13%
Cost of Sales of hydrocarbons	(2)	(4)	-50%	(4)	-50%
Cost of sales (excluding depreciation)	**(11)**	**(21)**	**-48%**	**(12)**	**-8%**
Depreciation	(13)	(10)	30%	(10)	30%
Administrative expenses	(10)	(7)	43%	(7)	43%
Other income (expenses), net	2	1	100%	1	100%
Operating profit	**4**	**16**	**-75%**	**16**	**-75%**
Finance cost, net	**(11)**	**(10)**	**10%**	**(10)**	**10%**
Loss (profit) before income tax	**(7)**	**6**	**-217%**	**6**	**-217%**
Income tax benefit (expense)	5	(4)	-225%	(4)	-2.25
Loss (profit) for the period	**(2)**	**2**	**-200%**	**2**	**-200%**
Net (loss) profit for the period from discontinued operations	(11)	1	-1200%	1	-1200%
Total other comprehensive loss (income) for the period	**(13)**	**3**	**-533%**	**3**	**-533%**

Results of Operations

The Company's results for the three-month period ended December 31, 2018 amounted to a loss of US$ 2 million compared to a profit of US$ 2 million during the same period in 2017. These results were mainly explained by the following:

Revenues

Revenues decreased by US$ 8 million, or 18%, to US$ 36 million for the three-month period ended December 31, 2018 from US$ 44 million during the same period of 2017, primarily due to: (i) US$ 4 million lower demand from distribution companies mainly due to the migration of small-to-mid-size distribution companies' clients to the bilateral PPA market; (ii) US$ 3 million lower PPA energy sales due to the termination of certain contracts; (iii) US$ 3 million lower natural gasoline revenues due to higher stock in Q4-2017 (51,508 bbl in the fourth quarter of 2018 and 94,096 bbl during the same period of 2017); and (iv) US$ 1 million in lower LPG revenues due to production decrease (27,526 bbl in the fourth quarter of 2018 and 31,651 bbl in the same period of 2017). These effects were partially offset by: (i) US$ 1 million higher spot energy revenues due to higher volumes, and (ii) US$ 1 million higher capacity revenues at the Aguaytia thermal plant due to the resolution of congestion in the system's transmission lines.

Cost of sales (excluding depreciation)

Cost of sales decreased by US$1 million, or 8%, to US$11 million for the three-month period ended December 31,2018 from US$12 million in the same period of 2017, primarily due to US$ 2 million lower cost of liquids, mainly royalties, storage and transport of natural gasoline related to lower sales; partially offset by US$ 1 million in one-time severance payments as a result of the management integration process between Kallpa and Orazul.

Depreciation and amortization

Depreciation and amortization increased in US$ 3 million, or 30% to US$ 13 million for the three-month period ended December 31, 2018 from US$ 10 million in the same period of 2017 due to property, plant and equipment additions during 2018 and the reduction in the useful life of certain assets.

Administrative expenses

Administrative expenses increased by US$ 3 million, or 43%, to US$ 10 million for the three-month period ended December 31, 2018 from US$ 7 million in the same period of 2017, primarily due to (i) US$ 4 million increase in personnel expenses which includes one-time severance payments mainly as a result of the management integration process between Kallpa and Orazul, and (ii) US$ 2 million increase in bad debt allowance related to Maple Gas; partially offset by US$ 3 million lower third parties services.

Other income

Other income increased by US$ 1 million, or 100%, to US$ 2 million for the three-month period ended December 31, 2018 from US$1 million in the same period of 2017 mainly due to an advisory service rendered to a related party in Chile.

Income tax expense

Income tax expense decreased by US$ 7 million, to a US$ 5 million income for the three-month period ended December 31, 2018 from US$ 2 million expense during the same period in 2017, primarily due to higher deferred income tax related to tax loss carryforward.

Appendixes

EBITDA & Adjusted EBITDA reconciliation

	Year ended December 31,		Three months ended December 31,	
In millions of U.S.	**2018**	**2017**	**2018**	**2017**
Loss (profit) for the period	3	(24)	(2)	2
(+) Income tax and profit sharing	(5)	11	(5)	4
(+) Financial expense, net	44	67	11	10
(+) Depreciation and amortization[2]	48	41	14	11
Total EBITDA	**90**	**95**	**18**	**27**
(+) Maple Gas bad debt allowance	2	6	2	0
(+/-) Non-recurring expenses, net[3]	6	2	4	1
Total Adjusted EBITDA	**98**	**103**	**24**	**28**

Material Indebtedness

In millions of U.S. dollars	**Outstanding Principal Amount as of Dec. 31, 2018**	**Interest Rate**	**Final Maturity**	**Amortization**
Long-term debt:				
Unsecured: 5.625% Notes due 2027	540	5.625%	April 2027	Principal due at maturity with semi-annual interest payments.
Total	**US$540**			

Note: *values net of transaction costs*

[2] Depreciation and amortization include US$ 2 million for the year ended 2018 and 2017, classified in Administrative expenses in our audited financial statements.

[3] Includes primarily one-time severance payments related to the management integration process between Kallpa and OEP in 2018, and an optimization plan executed by OEP in 2017.

Subsequent event

On December 20, 2016, Orazul Energía Partners LLC, granted a subordinated loan in favor of OEP for US$ 256 million, related to the acquisition of Orazul Energy Group shares.

On July 4, 2017, Orazul Energía Partners LLC assigned US$128 million of the subordinated loan to Orazul Energia (UK) Holdings Ltd. On the same date, Orazul Energia (UK) Holdings Ltd. approved the capitalization of such debt and increased the capital stock issued by OEP. After the capitalization, the outstanding amount of the subordinated loan was US$ 128 million.

In January 2019, Orazul Energy Partners LLC reduced the subordinated loan interest from 6% to 0%, without modifying the terms of maturity and payment. These changes were effective from January 1, 2019.