Hydro One

Company Overview and Key Initiatives

Key Initiatives:

- Rate Applications: Hydro One is currently before the Ontario Energy Board seeking approval for 2017-18 transmission rates and 2018-2022 distribution rates. These are cost-of-service applications, which comprehensively detail Hydro One's capital and operational spending. The OEB and public intervenors have opportunity to question Hydro One's proposed investments and activities. As these applications seek to raise rates and are the first of their kind since the broadening of ownership, they have attracted considerable public interest.
- Local Acquisitions: Hydro One has in recent years acquired Local Distribution Companies such as Haldimand Hydro, Norfolk Power, and Woodstock Hydro. It is current before the Ontario Energy Board seeking approval to purchase Orillia Power. The matter is on hold pending review of Hydro One's 2018-2022 distribution rate application for any potential negative impacts on Orillia customers.
- Customer Service: In response to previous customer service issues such as problems with billing accuracy, Hydro One is taking action to improve customer satisfaction**.** Activities include:
    - Re-designing the electricity bill, based on behavioural science insights, to provide consumers with a cleaner and easier to use invoice. The bill is expected to go live on November 27th, 2017.
    - Re-designing the Hydro One website and providing customers with proactive e-mail alerts about billing and usage.
    - Increased available resources at call centre, complete with new training, to address call volume.
    - Incorporate office of Hydro One Ombudsman, now required in legislation.
- Disconnections and Arrears: In recent years, Hydro One has seen an increase in customers struggling to pay electricity bills. Over 11,000 customers (1.24% of customer base) experienced disconnection in 2016. Hydro One has launched new measures to assist customers in managing their electricity costs:
    - Interest-free installment plans for customers.
    - 2nd installment plans for customers who have previously defaulted.
    - Increased available Low-Income Energy Assistance Program (LEAP) funding by $2M.
    - Proposing in the 2018-2022 distribution rate application to have pre-paid meters available as an option for customers who are looking to more directly control costs. These meters would only flow the amount of electricity that the customer has pre-paid for. Hydro One has denied that these meters would be used in a punitive fashion against customers in arrears.
    - Facilitating credit counseling services between customers and Credit Canada Debt Solutions
    - Proactively discontinuing the practice of disconnecting during the winter months (this preceded the introduction of the *Protecting Vulnerable Energy Consumers Act, 2017* and subsequent OEB order that prohibited winter disconnection across Ontario).
    - Assisted the Ministry in designing the Distribution Rate Protection program and the First Nations Delivery Credit, key components of Ontario's Fair Hydro Plan.
- Reliability: In recent years Hydro One's transmission reliability has remained flat. In addition, Hydro One's 2017/18 Rate Application indicates that the transmission system is facing increasing risk due to the condition of its assets.

    - To mitigate these future challenges, Hydro One has modified its asset management approach to include reliability risk as a leading indicator of future system performance shifted the balance of capital investment towards sustainment capital, with a focus on lines investments (beginning in 2018).
    - For example, condition assessments have identified 2,300 km of conductor (line) for priority replacement due to being at or near end of useful life.
    - With the planned investments, Hydro One believes overall reliability risk would improve (i.e. decline) by 2% by 2019.
    - Ontario recognized the importance of enhancing reliability in the 2017 Long Term Energy Plan and the OEB has been asked to review the standards that apply to transmission and distribution utilities and to consider options for improving the standards.
- <u>Avista Acquisition</u>: On July 19, 2017, Hydro One announced the proposed acquisition of Avista, primarily and electric and natural gas utility in the U.S. Pacific Northwest, for $6.7B. Hydro One concurrently announced a $1.54B bought deal offering of debentures (including the over-allotment option), convertible to common shares at $21.40 per share upon the transaction being finalized (expected in second half of 2018).
    - The transaction is expected to be accretive to earnings per share in the mid-single digits in the first full year of operation.
    - Hydro One signaled Avista represents a significant and stable increase to earnings and cash flow and represents a platform for future growth opportunities.
    - Avista shareholders voted to move forward with the transaction on November 21st

Background:

Company Overview

- Owns and operates the majority of Ontario’s transmission grid (~98%) with a local distribution network serving ~25% of end customers in the province.
- Net income of ~$721M in 2016 with Revenues of $6.5B
- Expenses for 2016 include $410 million for Transmission business, $613 million for Distribution business, and $20 million for other areas
- Consists of 3 main subsidiaries:
    - Hydro One Networks Inc. – operates transmission and distribution assets across the province.
    - Hydro One Telecom – provides broadband telecommunications services.
    - Hydro One Remote Communities Inc. – operates generation and distribution assets in 21 remote northern communities.
- Primary source of revenues are regulated rates set by the OEB.
- On May 4, 2017, Hydro One declared a quarterly cash dividend to common shareholders of $0.22 per share payable on September 29, 2017.
- 5,494 regular employees (as at December 31, 2016). ~90% covered under labour agreements, including:
    - The Power Workers' Union (3,470)
        - 3 year term, covering Apr 1/15 to Mar 31/18
    - The Society of Energy Professionals (1,365)
        - 3 year term, covering Apr 1/16 to Mar 31/19

- The company is listed on TSX under "H" with 595,385,325 shares outstanding
- Financial statements of Hydro One are prepared in accordance with United States Generally Accepted Accounting Principles (GAAP).
- All data are consolidated on Province books using modified equity basis.

Regulatory

Distribution

- On March 31, 2017 Hydro One filed a five year Custom IR distribution rate application with the Ontario Energy Board (OEB). This application is to set rates for the years 2018-2022 inclusive.
- If the OEB approves the application as filed, a typical residential customer of Hydro One Networks R1 (medium-density) rate class using 750 kWh per month, would see increases in its distribution rates averaging $2.35 per month from 2018-2022.
    - Note: this rate increase would be mitigated by the new Distribution Rate Protection program, which limits what Hydro One R1 customers pay in distribution to $36.43/month. This program also applies to Hydro One R2 (low-density) customers as well as customers of 7 other LDCs.

Transmission

- On May 31, 2016, Hydro One filed an application with the Ontario Energy Board requesting its transmission revenue requirement for the two-year period 2017-18. Hydro One was requesting that transmission rates increase 4.6% in 2017 and 5.2% in 2018.
- The OEB has issued a decision which disallows a number of costs Hydro One was seeking to recover (primarily related to capital spending, executive salaries, and tax benefits). While final rates are not yet approved, Hydro One estimates that now the typical Hydro One R1 (medium density) residential customer using 750 kWh per month seeing a total bill decrease of $0.07/month in 2017.

Broadening the ownership of Hydro One

- Following recommendations from the Premier's Advisory Council on Government Assets, Ontario broadened the ownership of Hydro One to create lasting public benefits and ongoing public protections. In May 2017, the Province completed its anticipated final share offering of Hydro One.
- The Province is prohibited by law from selling its voting securities in Hydro One if this would reduce the Province's ownership below 40 per cent. By law no other shareholder or group of shareholders is permitted to own more than 10 per cent of Hydro One.
- The Province has exceeded its objective to raise $9 billion in gross proceeds and other revenue benefits from broadening the ownership of Hydro One. The government has dedicated about $3.7 billion in net revenue gains from the sale of Hydro One shares in 2015 and 2016 to the Trillium Trust to support investments in public transit, transportation and other priority infrastructure under Moving Ontario Forward. Net revenue gains from the May 2017 offering will also be dedicated to the Trillium Trust.
- Over the last two years, the new leadership at Hydro One has demonstrated its commitment to improved performance and customer service excellence. Hydro One's rates continue to be set by the independent regulator, the Ontario Energy Board.

Governance

- Incorporated in 1998 under Ontario's Business Corporations Act, 1990.
- A robust governance agreement exists between Ontario and Hydro One, specifying governance standards, composition and nomination process for the Board, certain Provincial rights (voting, acquire additional shares up to 45% and no lower than 40% under legislation, etc.), amongst other terms.
- Required to file regular financial updates with the Ontario Securities Commission (OSC).

- Additional company information is available on the company's governance website.

Financials

($million)	2014	2015	2016	2017 Q3
Financial Figures				
Revenues	6,548	6,538	6,552	1,522
OM&A	1,192	1,135	1,069	277
Net Income	731	690	721	219
Total Assets	22,550	24,294	25,351	26,245
LT Debt	8,373	8,224	10,671	11,563
Total Equity	7,603	9,901	10,067	10,152
Financial Ratios				
Net Income Growth	-8.9%	-5.6%	4.5%	
Return on Equity	9.6%	7.0%	7.2%	
Allowed ROE (Transmission)	9.36%	9.30%	9.19%	8.78%
Allowed ROE (Distribution)	9.66%	9.30%	9.19%	8.78%