Hydro One Inc.
Submission to the Board of Directors

Date: March 25, 2015

Subject: **Hydro One Inc. 2015 Budget & 2016-2019 Business Plan Update**

Submitted by:	**Approved for Submission to the Board by:**
Information Copy Original Signed by	Information Copy Original Signed by
Ali R. Suleman **Chief Financial Officer (Acting)**	**Carmine Marcello** **President and Chief Executive Officer**

RECOMMENDATION

That the Board of Directors of Hydro One Inc. (Hydro One or Company) approve the updated 2015 Budget and 2016-2019 Business Plan resulting from the Ontario Energy Board's (OEB) decision regarding the Distribution Business.

KEY HIGHLIGHTS

- On March 12, 2015 the Ontario Energy Board released its decision regarding Hydro One Networks Distribution Rates Application for 2015-2019 (EB-2013-0416). The decision impacts the revenue requested by Hydro One Networks for recovery in the 2015-2017 period. The adjustment in revenue will impact Net Income and requires the 2015 Budget and 2016-2019 Business Plan to be updated.
- Net Income has been adjusted to reflect the annual year end OEB Cost of Capital adjustments ($37M) and the OEB Distribution decision to reduce funding for OM&A spending ($18M). Appendix A, "2015 Net Income Adjustments", outlines the impacts of the various changes to the budgeted Net Income for 2015. The revised budgeted Net Income for 2015 is $695M, down from $750 million.
- Capital expenditures have not changed for both the Transmission and Distribution Businesses.
- The Corporate Scorecard has been updated for Net Income and Distribution Unit Costs as a result of an update to the 2015 budget.
- As a result of the Cost of Capital and OEB Distribution Decision the adjusted financial results for 2015-2019 are shown in Appendix C "HOI- Financial Results". For a continuity of change to the Cost of Capital parameters for Transmission and Distribution, please refer to Appendix D "OEB Approved Cost of Capital Continuity".

The Appendices to this Submission include 2015 Distribution OM&A Bridge, Net Income Adjustments, HOI Financial Results and OEB Approved Cost of Capital Continuity.

This Board Memorandum was reviewed and approved for submission to the Board of Directors of Hydro One Inc. by the Audit, Finance and Pension Investment Committee at its meeting on March 25, 2015.

Appendix A

Net Income Adjustments

Results Shown in $M

	Gross	2015 Net After-Tax	
Board Approved 2015-19 Business Plan			**RROE 9.7%**
Net Income		**750**	
OEB Cost of Capital Update (effective Jan 1, 2015) - Note 1			**RROE 9.3%**
Tx Cost of Capital update	(31)	(22)	
Dx Cost of Capital update	(20)	(15)	
Net Income		**713**	
OEB Decision Updates (March 2015) - Note 2			
Compensation Adjustment	(8)	(6)	
Work Program Changes	(14)	(10)	
Requested Distribution Studies / Reports	(3)	(2)	
Net Income		**695**	
Board Approved OM&A (Post 2015-19 Business Plan Approval) NOT Included in Net Income Reduction			
Outsourcing (Non CSO)	(3)	(2)	
Outsourcing (CSO)	(5)	(4)	
CIS Efficiency	(7)	(5)	
	(16)	**(12)**	

Note 1:

As part of the process to update the 2015-2019 Business Plan the annual change in the OEB Cost of Capital will also be reflected. The Cost of Capital update contains three components; the allowed return on equity (change 9.7% to 9.3%), the allowed return on long term debt (unchanged 5.0%) and the allowed return on short term debt (change 3.2% to 2.2%).

The reduction to net income resulting from the change in the Cost of Capital parameters is $15M for the Distribution Business and $22M for the Transmission Business. The approved 2015-19 Business Plan does not reflect updated Cost of Capital parameters as that information was not available at that time.

Note 2:

The financial impact of the Distribution Decision was primarily in OM&A. The OEB directed the Distribution Business for 2015 to;

- reduce the Vegetation Management Program by $13M from $142 to $129
- apply a reduction of $7.7M to compensation
- reduce the Conservation Demand Management Program (CDM) by $1M and
- increase the contribution to the Low-Income Energy Assistance Program (LEAP) by $0.5M.

Taking the above adjustments reductions into account the OEB is permitting the Distribution Business to spend $542.6M OM&A in 2015, down from the filed $564.3M. A comparision of these reductions to the 2015-19 Business Plan approved last November is shown in Appendix B: the “2015 Distribution OM&A Bridge”.

As shown in Appendix B the Vegetation Management work program was reduced from the 2014-2019 Business Plan (used for the OEB submission) to accommodate other work programs. In addition, as a result of the numerous requests by the OEB for studies and reports $2.5M has been added to the 2015 OM&A plan.

Appendix B

2015 Distribution OM&A Bridge

Results Shown in $M

	2014-19 Business Plan OEB Filed	OEB Approved	2015-19 Business Plan Nov Board Approved	Delta OEB Approved - 2015-19 Business Plan	Requested Approval for Increased OM&A
Vegetation Management	142.0	129.0	129.4	(0.4)	0.4
Conservation Demand Mgt R&D	3.0	2.0	2.0	0.0	0.0
LEAP* Funding	1.2	1.7	1.2	0.5	(0.5)
Compensation Adjustment	0.0	(7.7)	0.0	(7.7)	7.7
Remaining Work Program	418.1	417.6	431.7	(14.1)	14.1
Total OM&A	**564.3**	**542.6**	**564.3**	**(21.7)**	**21.7**
				OEB Requested Studies/Reports	3.0
				Total OM&A	**24.7**

* Low-Income Energy Assitance Program (LEAP)

Appendix C

HOI Financial Results

$M except where noted	Actual	Actual	Actual	Budget	Business Plan			
	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	5,729	6,074	6,548	6,530	6,774	6,993	7,200	7,322
Income before PILs	867	912	837	825	914	982	1,100	1,152
Net Income	**746**	**803**	**748**	**695**	**759**	**809**	**896**	**945**
EBITDA	**1,884**	**1,948**	**1,937**	**1,992**	**2,141**	**2,301**	**2,500**	**2,603**
Cash Flow	**(476)**	**(564)**	**(465)**	**(158)**	**(749)**	**(427)**	**(316)**	**(272)**
Debt Ratio	55%	54%	53%	52%	53%	53%	53%	52%
FFO Coverage	4.1x	4.7x	4.2x	4.3x	4.4x	4.2x	4.3x	4.2x
ROE (GAAP)	11.5%	11.5%	10.0%	8.7%	9.1%	9.4%	9.9%	10.0%
Capital Expenditures	**1,455**	**1,394**	**1,528**	**1,602**	**1,613**	**1,567**	**1,591**	**1,537**
OM&A	**1,047**	**1,080**	**1,166**	**1,115**	**1,153**	**1,170**	**1,169**	**1,177**
Depreciation	**659**	**676**	**721**	**786**	**836**	**871**	**915**	**940**
Dividends	370	218	287	118	588	448	478	513
PILs	121	109	89	131	155	173	204	207
Total Long-term Debt	8,480	9,056	8,925	8,988	9,701	10,131	10,438	10,754
Total Equity	6,833	7,415	7,947	8,415	8,586	8,948	9,366	9,798

HOI Financial Results – Change from Nov Board

$M except where noted	Actual	Actual	Actual	Budget	Business Plan			
	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	0	0	192	(75)	(78)	(60)	0	(2)
Income before PILs	0	0	78	(77)	(61)	(54)	(2)	2
Net Income	**0**	**0**	**80**	**(55)**	**(44)**	**(38)**	**1**	**3**
EBITDA	**0**	**0**	**74**	**(78)**	**(81)**	**(60)**	**(1)**	**(3)**
Cash Flow	**0**	**0**	**(128)**	**24**	**2**	**(28)**	**(17)**	**(69)**
Debt Ratio	0%	0%	0%	0%	0%	0%	0%	0%
FFO Coverage	0.0x	0.0x	0.0x	0.0x	0.2x	0.1x	-0.1x	-0.2x
ROE (GAAP)	0.0%	0.0%	1.1%	-0.7%	-0.5%	-0.4%	0.1%	0.1%
Capital Expenditures	**0**	**0**	**21**	**0**	**0**	**0**	**0**	**0**
OM&A	**0**	**0**	**(63)**	**3**	**3**	**1**	**0**	**0**
Depreciation	**0**	**0**	**(14)**	**0**	**0**	**0**	**0**	**0**
Dividends	0	0	(0)	0	0	(15)	(30)	(30)
PILs	0	0	(1)	(21)	(17)	(16)	(2)	(2)
Total Long-term Debt	0	0	(3)	(25)	(37)	(42)	(0)	119
Total Equity	0	0	151	(14)	(58)	(82)	(51)	(18)

Appendix D

OEB Approved Cost of Capital Continuity

	Transmission		Distribution	
	2014-19 Business Plan OEB Filed	OEB Approved	2014-19 Business Plan OEB Filed	OEB Approved
Allowed Return on LT Debt				
2015	5.0%	5.0%	4.9%	4.9%
2016	5.1%	5.0%	5.0%	4.9%
2017	[redacted]		5.0%	4.9%
Allowed Return on ST Debt				
2015	3.2%	2.2%	3.2%	2.2%
2016	4.4%	4.0%	4.4%	2.0%
2017	[redacted]		5.4%	4.0%
Allowed Return on Equity				
2015	9.7%	9.3%	9.7%	9.3%
2016	10.0%	9.7%	10.0%	9.7%
2017	[redacted]		10.2%	9.9%