

Table 1
Inventory Levels 2004 – 2008 (\$ Million)

\$ M	2004	2005	2006	2007 Forecast	2008 Forecast
Year End Actual					
- Materials & Supplies	15.7	16.7	22.6	23.2	23.4
- Smart Meters		5.4	0.5		
Total Year End Actual	15.7	22.1	23.1	23.2	23.4
Annual Average Materials & Supplies	16.3	17.4	25.2	23.1	23.3

Over the 2004 – 2006 period, particularly in 2006, annual inventory levels excluding smart meters increased by 44%. Further slight increases are expected over 2007-2008 period and onward.

The slight increase in inventory is primarily driven by a growing work program and increased material prices. A large number of aging assets required refurbishment and replacement, contributing to the required inventory levels. The unit prices have increased with the suppliers for the new contracts due to the market increase in the price of steel and other commodities. This increase is reflected in the inventory value of transformers, wire and cable, insulators, arresters and some poles.

Most of Hydro One Distribution's materials and supplies are sourced from inventoried stock. The basis of forecasting inventory levels assumes that historical inventory patterns are maintained, and modified as appropriate to reflect planned work program changes.

Inventory is held for the maintenance of existing assets and new development activities. Inventory primarily includes component parts - lines, poles, wire and cable, switches,

1 transformers, protective devices, metering systems, minor parts such as circuit breaker
2 contacts, pallet switches, insulators – and consumable items such as lubricants, gaskets,
3 and protective clothing.

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5 Key drivers that influence the inventory level include the OEB customer service quality
6 indicator for connection of new services that require LDC's to connect new services in 5
7 or less working days for at least 90% of the requests for new connections, vendor lead-
8 time, and demand levels for the forecasted work program.

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10 **2.1 Monthly Inventory Levels 2004-2006**

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12 The actual monthly inventory numbers for 2004 - 2006 are shown in Table 2 below.

13
14 The inventories of consumable material are seasonal in nature, driven primarily by storm
15 season and new connections. Monthly inventories are ramped up to meet these increased
16 needs. The trend indicates lower inventories at the beginning and end of each year, with
17 an increase during the spring and early summer. This spring and summer timeframe
18 increase is due to the building of storm inventory for distribution transformers and related
19 hardware. The drop at the end of the year is due to the consumption of storm stock.
20 December 2005 also included \$5.4 million of smart meters inventory, which were
21 consumed during 2006, resulting in an ending balance of only \$0.5 million.

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Table 2
Historical Monthly Inventory Levels 2004 – 2006

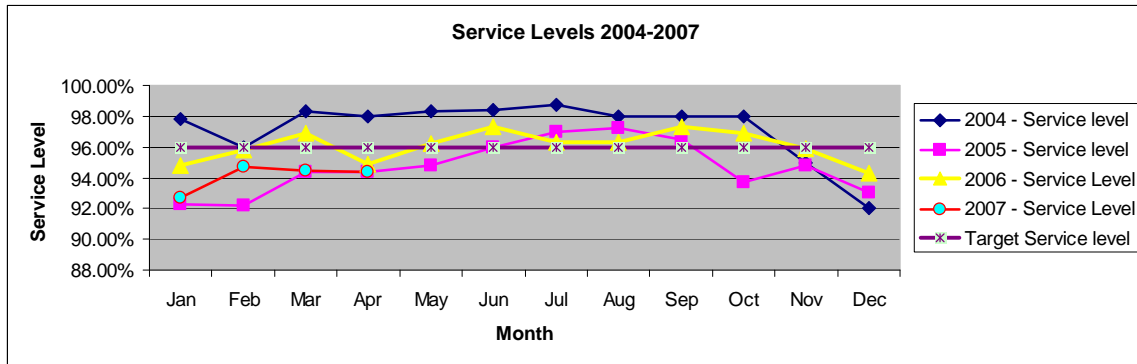
Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2004	15.3	16.6	17.2	16.7	15.9	16.3	16.6	17.3	16.3	16.3	15.2	15.7
2005	16.8	16.8	17.3	17.2	20.1	16.3	16.5	15.9	16.6	16.1	16.6	22.1
2006	23.9	25.3	27.4	27.6	26.8	26.0	26.3	24.9	23.3	23.7	23.6	23.1

3.0 PERFORMANCE METRICS

3.1 Service Levels

As a mean of driving improvement in the provision of materials from inventory, a service level metric has been adopted which represents the percentage of the time the warehouse was able to fill an order by the required date. Table 3 below provides the monthly trend of the service level metric over the 2004 to May 2007 period. The current target for the service level metric is at 96%.

Table 3
Inventory Service Level Monthly Trend



1 Inventory service levels are within the 96%-98% range for most of 2004. The decline in
2 service level at the end of 2004 and part way through 2005 was due to a transition period
3 of closing warehouses across the province and opening the Barrie central warehouse..
4

5 The 2006 inventory service levels fluctuated within approximately 1% of the current
6 target of 96%. This reflects efforts to optimize inventory to ensure the required material
7 is available when needed as well as collaborative forecasting with key suppliers to ensure
8 product is available.
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10 The inventory service level dips at the beginning and end of 2006 as well as at the
11 beginning of 2007 were due to a large number of storms and associated inventory “stock-
12 outs”. The 2007 service level is increasing and is expected to reach the current target of
13 96%.
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15 **3.2 Inventory Turns**

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17 Another performance metric associated with materials and supplies is inventory turns.
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19 Inventory turns are a measure of how quickly a company replenishes its entire stock of
20 materials and supplies annually. The more turnovers there are, the less time inventory sits
21 idle, which helps improve cash flow.
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23 Inventory turns are calculated by dividing the value of annual issues from the warehouse
24 by the yearly average value of inventory on hand. The 2006 inventory turns is 3.6. This
25 indicates Hydro One Distribution replaces its inventory, on average, approximately every
26 three months. For 2007, inventory turns are projected to improve to about four.
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