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H.TO - Q4 2016 Hydro One Ltd Earnings Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Hydro One Limited fourth-quarter results investment community teleconference. As a reminder, this call is being recorded.

I would now like to turn the call over to Bruce Mann with the Hydro One management team. Please go ahead.

Bruce Mann *- Hydro One Limited - VP, IR*

Good morning, everyone, and thanks for joining us. I'm here in Toronto with Hydro One's President and CEO Mayo Schmidt and our Chief Financial Officer Michael Vels. We will provide some brief comments and background on the Q4 results and then we'll spend the majority of the time answering as many of your questions as possible.

There is a few slides which illustrate a couple of the points that we will go over in a moment. They should be up on the webcast now, or if you are dialed into the teleconference you can find them on Hydro One's website in the IR section under events and presentations.

The discussion this morning will undoubtedly touch on estimates and other forward-looking information. Please view the cautionary language in the earnings release and also in the full-year MD&A that we filed this morning. There are various factors, assumptions and risks that are listed there that could cause the actual results to differ, and all that applies equally to our dialogue on the call this morning.

And with that let me turn it over to Mayo Schmidt.

Mayo Schmidt *- Hydro One Limited - President & CEO*

Thank you, Bruce. Good morning everyone. We have now completed our first full year as an independent public Company following the IPO in late 2015, and I am pleased to report fourth-quarter results that continue to demonstrate the trend of positive results and operating cost controls as we continue to improve the capabilities and performance of our Company.

acquisition integration expertise with a significantly strengthened leadership team.

In 2017 across the organization the team has focused on stepping up our transformation, accelerating our growth and continuing to revitalize Ontario's electric grid. For the quarter, net earnings after adjusting for an IPO-related tax adjustment were up 3.2%. These results reflected a continued trend in cost efficiencies and revenue improvements.

We also put CAD699 million of capital into service during the quarter, bringing the full-year assets placed in service to CAD1.6 billion, in line with our targets as we continue to improve the execution across our engineering and construction functions. Total capital investments for 2016 were CAD1.7 billion and we completed all of the Company's work programs for the year as planned.

During the fourth quarter, we made significant improvements on our customer facing activities, introducing a number of new capabilities and programs that will improve customer experience while at the same time reduce our service costs. For example, we launched enhanced paperless billing and usage alert notification services for residential and small business customers. These will provide near real-time account information for customers who have been asking for providing them with an ability to adjust their electricity usage and will reduce the cost of mailing by millions for each bills for the year.

We made a decision to introduce the Winter Relief Program to help hundreds of customers in hardship get reconnected to the grid for the winter as they had their electricity service disconnected in past years due to unpaid bills. This program is about assisting families and staying warm during the winter, but it's also a program that will work with each customer proactively to better determine affordable payment arrangements. We engage customers, improving their knowledge of and ability to access the numerous governmental assistance programs that are available to them.

As a responsible utility, we need to recover the cost to build electricity to be fair to all of our customers, and all customers understand the necessity of paying for electricity. We can and will be better at assisting our customers in need who are having trouble affording their electricity bill.

Province-wide customer satisfaction polling results continue to reflect significant concerns about the total cost of power, particularly the delivery charge which we will continue at all levels to do our best to advocate for customers.

In addition to continuing our local outreach to customers and communities that we accelerated in 2016, we have also participated in the provincial government -- with the provincial government in advocating for our customers and recommending solutions to the province that could help to alleviate the impact of electricity price that many of our customers are experiencing. To provide great service you have to have great employees. Hydro One has a number of programs in place to attract and retain the best and brightest, and I am pleased to report the Company was selected as one of Canada's top employers for young people, recognizing our success in attracting and retaining top millennial talent and promoting diversity.

In addition, we were ranked as one of the top employers in the greater Toronto area, Canada's largest and most competitive employment market, and expect to continue to attract high-caliber talent to the organization.

Now on the operations front, we recorded a number of solid achievements as we concluded the year. An example is the rollout of fleet-wide telematic technology which will be enabled early in 2017 and will provide information on the efficiency and utilization of equipment across our best service territory, providing a good baseline against which we can improve fleet utilization and productivity.

In February we are rolling out our new Move to Mobile initiative to our first zone. This project uses technology to electronic tablets in the hands of thousands of employees in the field with connectivity back to our systems that will enable more effective scheduling, work matching and improvements in crew productivity and customer service. The program will continue with phased rollouts throughout 2017.

We also made solid progress improving the precision and effectiveness of our capital deployment capabilities. For example, we ended 2016 almost exactly on target for what was nearly a CAD1.7 billion capital program composed of large and complex projects and extensive asset replacement

One of the operating achievements that I'm particularly proud of is the improvement in the safety performance across the Company. The total number of safety-related incidents dropped significantly, 33% decrease over the past year to one of the lowest levels ever recorded by the Company. The improvement was largely driven by an internal initiative known as Journey to Zero and we look forward to continuing to progress in this important area of our business.

One of our goals in 2016 was to improve the Company's merger and acquisition integration expertise. Learning is aided by experience, and during 2016 we closed on and welcomed our new Great Lakes Transmission team to the organization and we successfully integrated two local distribution companies, Haldimand and Woodstock, and agreed to purchase Orillia Power. We took this opportunity to bring process, talent and discipline to these activities. Combined with new management who are skilled in these areas we made significant improvements in our capabilities.

Our enhanced integration capabilities for local distribution companies resulted in positive experiences for customers and will reduce costs for the entire system. There is a significant cost opportunity to the provincial electricity system if the many local distribution companies were consolidated creating significant cost savings. Over time we believe with provincial support this can be a positive outcome for the Ontario electricity sector.

We accomplished a great deal in 2016 and intend to build on that effort in 2017. We will continue to solidify our leadership position in the electricity sector. I expect the team to accelerate the transformation of how we conduct business in all parts of the Company to drive continued efficiencies and savings.

We will continue to foster deeper connections and engagement with customers. Our First Nations engagement and outreach is a key initiative and will continue to increase. We will build on the work, our efforts in 2016 to refine the effectiveness and efficiency of our deployment of capital investments as we accelerate the work required to upgrade the electricity grid in Ontario.

We will continue to work with our regulator, the Ontario Energy Board, to support the need to maintain reliability in the system through appropriate investments while at the same time delivering outcomes that customers value as efficiently as possible. We are transitioning both businesses, transmission and distribution, to an incentive-based regulatory construct and believe we will operate in a manner that benefits our customers across the province while continuing to deliver returns to our shareholders.

I will close by saying that thousands of men and women in Hydro One continue to prove day in and day out in some of the harshest and most dangerous conditions in North America a level of commitment to customers and safety that never ceases to impress me. Together with the extremely talented leadership team and the entire organization aligned around our priorities we are excited about 2017 as we make the significant transition from a government entity to a commercial organization focused on creating ever-increasing value for customers and shareholders.

And with that, let me turn it over to Michael to discuss the financials. And then we'd be pleased to take your questions. Michael?

Michael Vels - *Hydro One Limited - CFO*

Thank you, Mayo. Good morning, everybody.

I will turn your attention to slide 2 which outlines our fourth-quarter financial highlights. Our fourth-quarter revenue net of purchase power increased by 2.7% compared to last year while our operations, maintenance and administration costs reduced by 4.7%. After adjusting for an IPO-related tax adjustment in the fourth quarter of last year our net earnings for the quarter actually increased by 3.2% and would have increased by more than that if you were to further adjust for other IPO adjustments such as the IPO recapitalization.

For the full year, the earnings increase of 4.5% as posted would also be higher on an underlying basis if the effect of various IPO-related adjustments were excluded from the comparisons. Net earnings for the quarter were seasonally consistent with the fourth quarter of last year from a weather perspective. On the operating cost side, OM&A for the quarter was lower than last year, mainly due to lower project cost adjustments coupled with

Below the operating cost line depreciation increased mostly due to investment in the Company's rate base. And interest expense was impacted for the quarter by higher debt balances together with somewhat higher interest cost as we termed out a significant amount of commercial paper early in the quarter at higher long-term rates.

Net earnings in the fourth quarter of 2015, as I mentioned, included a positive and nonrecurring IPO-related tax adjustment of CAD19 million. For the full year the reported earnings increase of 4.5% reflects a slow start to the year for 2016 resulting from unseasonably warm weather, but then offset by the combination of strong peak loads in the second and third quarters, accelerated cost reductions and lower bad debt expenses.

As I mentioned earlier, the year-over-year comparability of 2016 versus 2015 is impacted by several IPO-related effects including the divestiture of the Brampton distribution business in late August 2015, the recapitalization of the Company at the time of the IPO and the positive fourth-quarter tax adjustments mentioned earlier. As we enter 2017, the year-over-year comparability of our results going forward I'm pleased to say we will no longer be affected by the IPO-related items as these are all now more than a year behind us.

Moving to slide 3, which is a summary of our capital expenditures and rate base growth, on this slide we point out the updated estimated five-year capital investment levels and the resulting levels of rate base growth for the five-year period 2017 through to 2021 updated to now use 2016 actuals as a growth rate base period. Based on our most recent estimates, we now expect the level of rate base growth to exceed 5% annually over the five-year period. These capital investment levels are based upon our best estimates of future investment required to maintain the reliability of the electrical system and do reflect the estimates included in our recent transmission segment rate filing and the investments we plan to include in our distribution rate filing at the end of March. I would remind everybody that all of these amounts are management estimates and are all subject to OEB approval.

On slide 4, which outlines liquidity and balance sheet metrics, in terms of financial strength you can see from that slide that we exited the quarter with a very strong balance sheet, conservative leverage and solid investment grade credit ratings. Shortly after we reported our third-quarter results in November we priced an offering of CAD950 million of medium-term notes at very favorable rates, the proceeds of which we used to term out a significant portion of short-term commercial paper borrowings that we had outstanding for much of 2016 to repay some maturing long-term debt and for other general purposes including the payment that we made upon closing the acquisition of Great Lakes Power.

As you can see, weighted average cost of debt has reduced to 4.3% and our redemption schedule is relatively unchanged with an average term of 15.9 years. We also have significant available liquidity.

On slide 5 we have a brief regulatory update. We continue to be engaged during the fourth quarter both on the transmission and distribution fronts from a regulatory perspective.

On the transmission side we are progressing on the two-year rate application that we filed with the OEB on May 31 for 2017 and 2018 rates. During December, we completed the oral hearing phase of the proceeding and intervener submissions were received in February.

The next step is for Hydro One to provide responses to these submissions which we will do next week. We currently estimate that the decision by the Board panel will be received in the middle of this year and we have applied for new rates to be effective on a retroactive basis to January 1, 2017. In the distribution segment we are progressing well in the development of our next rate application expected to be filed at the end of March time frame which will be under an incentive-based regulatory framework covering the five-year period from 2018 to 2022.

Lastly, on the regulatory front as we disclosed previously in November 2016, the OEB announced that the allowed return on equity for electric and gas utilities operating in Ontario for 2017 will be 8.78%. That's based on the Board's annual formulaic reset which takes into account changes from the prior year and forecasted government of Canada long bond rates together with A rated utility bond spreads.

extent that the interest rates continue to increase over the year from the September 2016 levels the ROE would increase over the current level.

Now looking for to 2017, as I mentioned, our expectation is that the lower return on equity will have an approximately CAD30 million effect on our results. There are also two other items that we draw your attention to as you assess the comparability of results going forward compared to 2016. Firstly, all of the work that we completed to bring our computer systems, collections and billings into control resulted in an approximately CAD16 million bad debt recovery, the positive effect which was mostly experienced in the first quarter of 2016 and it's unlikely to recur at the same level going forward.

Secondly, as I just mentioned, we termed out a very significant amount of debt later in the year. As a result for 2017 our effective interest rates will on average be higher by approximately CAD15 million as we are paying long-term rates for the full year. On the other side, as a management group we, of course, intend to continue to focus our efforts on finding efficiencies in the business to offset these effects and positively affect our 2017 earnings.

I will stop there. And we'd be pleased to take your questions.

Bruce Mann - *Hydro One Limited - VP, IR*

Thank you, Mayo and Mike. And, operator, if you could quickly explain to the participants how you'd like to organize the question-and-answer polling process we'd be ready to take questions from the participants.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Rob Hope, Scotiabank.

Rob Hope - *Scotiabank - Analyst*

Good morning. Thank you for taking my call.

Just looking south of the border, I want to get your thinking on whether or not the potential for large tax or policy changes has altered how you are looking at US opportunities? Will you instead look for clarity south of the border before potentially looking at opportunities down there?

Mayo Schmidt - *Hydro One Limited - President & CEO*

I think that's a good comment. In fact, we would look for clarity.

And I think considering the lifecycle of how we think about growing the business both internally and externally it does fit within our plans to get visibility over the course of this next year and with the team. We are certainly active in assessing opportunities for the business, but the nature of the utility business and the length of time it takes to prudently grow a business I think it falls right into the time spectrum of getting good visibility on how the US is going to approach.

That's helpful. And then as a follow-up, just in terms of your increased growth expectations and CapEx plans for 2017 to 2021, are you concerned that the government's focus on rising rates will potentially limit your ability to invest in your rate base there? Have you had any discussions with the government on that regard?

Michael Vels - *Hydro One Limited - CFO*

Well, as Mayo said, we've had many discussions with the province from a policy perspective as we continue to advocate for our customers and provide the province with recommendations as to policy decisions they may make to reduce the effect of electricity rates on our customers' bills. But I would distinguish that absolutely those discussions from the way the OEB has been operating.

The OEB is very independent of the province. Those policy discussions happen in clearly two different spaces and we haven't seen any change or difference in the way the OEB approaches our rate filings as we have just gone through the transmission one. And they have taken the same approach which is very tough and very focused on us supporting much needed investments in the system.

So two very different compositions. Obviously, you still have to look at it in total certainly as we've -- coming forward with our distribution filing we've taken an approach to that which does take into account the fact that electricity bills are high. And we are going to be responsible in the amount of investment that we put into that rate filing.

So you have to be aware of it. We have taken the path of being very active on the policy side in discussions with the government, but I don't see at this stage that there will be a change in approach from the OEB. They are going to be just as tough and clear as they always have been.

Rob Hope - *Scotiabank - Analyst*

Thank you for the clarity. I will jump back in the queue.

Operator

Andrew Kuske, Credit Suisse.

Andrew Kuske - *Credit Suisse - Analyst*

Thank you, good morning. I guess the first question is for Mayo.

And it just relates to your comments and what you are doing on the labor front in the Toronto market and trying to attract talent. And maybe you could just give us a bit of context because just the demographics of your workforce I believe you've got about a fifth of the workforce that is effectively you pension eligible. So how do you think about pivoting that workforce with retirements attrition and then effectively the new intake of people?

Mayo Schmidt - *Hydro One Limited - President & CEO*

It's an interesting observation. We do have a good number of individuals that are in the last part of their tenure with the organization.

I would say that organization's been highly effective in a couple of areas. One is attracting and retaining youth. We've got a highly accomplished professional engineering groups in the organization, and I know even myself watching and having visibility over the number of interested graduates that come to our particular business out of some, obviously, very good engineering schools.

So when we think about that pivot I think about we bring the young students in, they get some really good mentoring by our engineering groups as they move toward their retirement period. So we really think we've got from an age demographics a very good spread of talent across the organization. And while we are doing that we are also being very diligent about how we keep control of, I'd say, the labor force or the labor cost in the organization.

Andrew Kuske - *Credit Suisse - Analyst*

That's very helpful. And then one thing that jumped out of the results to me was on the cost reductions that you've got. And then it's more a question for Michael, and then how it was a bit offset by just vegetation management, and I think everyone on the call just realized the importance of vegetation management for transmission business.

But how do you think about just the payback on vegetation management? Because, obviously, it speaks to reliability, it speaks to a number of things for the system integrity. Just if you could quantify that a little bit on how much you spend and then how you think about the payback and the economic consequences that flow from it?

Michael Vels - *Hydro One Limited - CFO*

Thanks, that's a lot of questions in there. I will start off by saying that the way we look at vegetation management it is part of a plan that we put in place over a multiyear basis and it is part of our filings with the Ontario Energy Board.

The amount that we do and the amount that we plan for is driven by staying on a cycle that we believe is appropriate to balance the impact of customer rates against the reliability that's created by trees and other undergrowth falling on lines. In this case we are talking about our transmission corridors which we need to keep clear as well. So all that is to say from a quarter-to-quarter basis we do manage that program as and when we have ability to get into the areas we need to get into.

And it is to some extent driven by weather and labor availability. So what I would maybe in a shorter answer say is for this quarter the cost increase because of vegetation management, because of timing the weather was better, we were able to do more work. We took advantage of that to finish up our work program that we've committed to both ourselves and the OEB for the year.

In terms of the effect of that on the quarter, it's in the range of approximately CAD20 million increase in the activity. But as I mentioned before that's not a permanent cost increase, it's more of a timing difference.

Andrew Kuske - *Credit Suisse - Analyst*

That's very helpful. Thank you.

Operator

Robert Kwan, RBC Capital Markets.

Robert Kwan - *RBC Capital Markets - Analyst*

Good morning. Just around your updated capital plan, you've got the statement and it's consistent. What you talked about, though, in the past of just equity issuance not being anticipated for the plan that you are self-funded, I guess I'm just wondering as part of that when you are looking at

Michael Vels - *Hydro One Limited - CFO*

Thanks, Robert. As we project over the full-year period we clearly have internal assumptions and also stress testing around that regarding our dividend rate. We've not provided guidance on the dividend and don't intend to.

But we have said that we would expect our dividend to increase along with our earnings and have an intention of staying within our range of 70% to 80% of net income. So as we both look at likely outcomes over the five years, and the relative credit metrics, we are comfortable that we will be able to grow the dividend with earnings, stay within the range and retain our A credit rating.

Robert Kwan - *RBC Capital Markets - Analyst*

Okay, that's great. And maybe if I can finish with just your acquisition approach or mindset as you continue to add people to the team.

You've got a robust multiple and I think, Mike, on previous calls you've talked about one of the reasons you see yourself having that strong multiple has been the highly regulated nature of your business and almost laying the framework that that's what you intend as you go forward. As you think about acquisitions maybe even outside of regulated, though, is that something you are contemplating? And if it is how do you think about a business that you may see as having stable utility-like earnings and cash flows that might then deliver accretion but maybe the market values at lower multiples, and so how do you view that with respect to the potential for an acquisition that could be accretive but because of the way the market views it multiple dilutive?

Michael Vels - *Hydro One Limited - CFO*

I think it's fair to say that the market today values the fact that we have not only a regulated business but we operate in a jurisdiction that's stable and pretty transparent. Certainly as we look to other acquisitions what we have said is moving materially off that business mix into something that's either unregulated or brings commodity or other volatility into the mix is not something we would be drawn to as it's clearly, we think would have an effect on our multiple.

But utility-like earnings, low risk earnings, accretive acquisitions of a company that fits into the low volatility, low risk profile that we currently have would absolutely be something we'd look at. And we have to assess the potential impact on the Company's total mix and the Company's total trading multiple at that time.

Our job is not to buy companies and get bigger. Our job is to provide value to the shareholders. Going forward trading multiples and going forward accretion are, obviously, important and we take a look at them at the point in time that we were considering an acquisition.

Robert Kwan - *RBC Capital Markets - Analyst*

That's great. Thank you very much.

Operator

Linda Ezergailis, TD Securities.

Thank you. Maybe just to build on Robert Kwan's question about dividends, can you comment on how the Board might think of when to consider increases in terms of what time of year is it timed with some sort of annual strategic update or anything like that? And would it be an annual increase, or would there be discrete other considerations like after successful integration of an acquisition or something like that?

Mayo Schmidt - *Hydro One Limited - President & CEO*

Linda, it's Mayo. I would say that the Board reflects on this each quarter. The Board in this particular case reflected on a couple of things, one being that we are just coming into our first full cycle as a Company, a new leadership team, a new transmission filing going into a distribution filing.

So letting the business settle into itself with significant changes, I would say significant changes we've seen over the last year. But we have a Board that's clearly motivated to focus on as the management team is driving success in these areas. So I don't think it's going to be a particular event or series of events.

I think it's an organization in a disciplined, mature way that will continue to advance things such as cost control, growing our rate base, etc. And we've had really good success this year when we look at our growth from about 4.2% to 4.9%, and then with the new Dx will be above 5%.

So I think it's really just the maturing of an organization and just getting through the first full cycle. And I think as most Boards would is they will consider it each quarter and take a view based on the year ahead. And we've got a few things that are settling in in the organization now that give us visibility for a good period of time going forward.

Linda Ezergailis - *TD Securities - Analyst*

Okay, that's helpful context. Just looking out over the next year, assuming normal weather how might we think of the typical seasonality in your base plan for vegetation management and how, I guess, more broadly your other large cost items might vary in seasonality from last year beyond just the one-time IT and billing consideration from Q1 of last year?

Michael Vels - *Hydro One Limited - CFO*

I think I'd struggle to give you anything more than a very general answer to that. So maybe routing it and I comparing it to say last year, Linda, which I think is your question, we've certainly pointed to the fact that as we've brought the organization into focus it reduced our overdue receivables by very material amounts by sustained effort. That's an example of I'd call it a cost reduction or an improvement that is a little less, wouldn't recur to the same level.

Excluding that and talking about our work programs, I don't think we see anything that is very significant that would change the seasonality. We had a pretty nice run-up in the winter from the fourth quarter, and so we were able to finish up some work programs and as we pointed out get some veg management done that maybe we wouldn't have otherwise. And our storm restoration at the same time, of course, was less and we've benefited from that.

So what I can tell you is that our work programs year over year, in particular some of the larger ones like vegetation management, are very consistent. If you look at them on a total spending basis 2016 compared to 2017 they would be within a few million dollars of each other.

In terms of how they roll through the quarters, it's very difficult for me to say would there be a material change next year. I'd say the short answer would be we don't anticipate very material changes in the work program that we want to draw your attention to, but it is weather dependent and it is labor availability dependent.

So I'm afraid that is a general answer. If I could give you a more specific one I would.

I appreciate the context. And maybe just as a follow-on, with respect to consolidation with Ontario, can you give an update on the nature and volume of conversations you are having with the various municipalities and perhaps the snack bracket whether there's any larger entities you are talking to that?

Mayo Schmidt - *Hydro One Limited - President & CEO*

Thanks, Linda, for the question. I think the way that I reflect on M&A, of course, we wouldn't be specific about any activities that we might be having until such time as they become public. But having said that, to get to your question, I think the LDC market in Ontario is certainly one that's very active in considerations.

We looked at the provinces, on two occasions the province has done an estimate of the savings associated with consolidation of the industry and it runs just generally around the CAD1.7 billion. And that would be I would I think of as full consolidation of the entire system. Now one would expect that would take years because if it were to occur because the municipalities, of course, make their own decisions at their own time which is generally driven by an asset base that is on the decline.

So typically they do two things: say, one, we cannot invest any more capital in maintaining our system and secondly, we have other cost considerations within the municipality and then they will come to an organization like ours. But it would be at any one time a multiple of particular LDCs that would be considering alternatives to the course that they are on today.

They typically end up taking about 12 months in terms of a municipality coming to an end conclusion. I think about Haldimand, Norfolk, Woodstock, Orillia, all of those the maturity lifecycle of those was about nine to 12 months in the making and then, of course, getting to close with the OEB's system.

So I do think, though, as I look at over the next few years we could see a bit of an acceleration of that consolidation because the LDCs are beginning to realize for them the opportunity to consolidate and motivated by the tax structure the government puts in place. A lot of these opportunities are very, very compelling from an accretion point of view. And when you get to the larger LDCs that's a bigger, more difficult question because those are certainly rare in Ontario, and I really wouldn't have any insight or comment on what those LDCs would be thinking.

However, as we look at the math on a consolidation of an LDC and the larger the opportunity, the more compelling but the metrics of the financial outcomes are beyond compelling for larger transactions. It's just a case of the will to take that step.

Linda Ezergailis - *TD Securities - Analyst*

Okay, thank you.

Operator

Mona Nazir, Laurentian Bank.

Mona Nazir - *Laurentian Bank Securities - Analyst*

Good morning. So, firstly, I just wanted to touch on slide 3 your projected rate base growth chart versus the same exhibit post-Q3. There's a CAD2 billion increase in 2019 and 2020 alone.

Michael Vels - *Hydro One Limited - CFO*

Thank you. The increase for those two years is almost entirely driven by the transmission projections.

In fact, compared to the estimates that we had previously in our IPO document the early years for distribution have decreased slightly. And that's responsive to as we mentioned earlier in the call an appreciation of the increasing bills that our customers are facing, and we took a pretty keen look at what we can do to either maintain or improve reliability in the distribution system whilst keeping the investment levels at or a slightly lower rate. So yes, it's pretty well all the transmission system.

Mona Nazir - *Laurentian Bank Securities - Analyst*

Okay. And one of the trends that we are seeing across the power industry has been significant investments in the energy grid and we saw that in the Edison Electric report released this week. There has been a doubling of spend last year versus 10 years ago, and aside from M&A, which you did touch on, are there any thoughts in your mind to accelerate your CapEx program or do you see any need to?

Mayo Schmidt - *Hydro One Limited - President & CEO*

Let me put it this way. We think with a reasonable increase year over year, and that gets into modest increases, we can actually improve the system. The system today in Ontario is, I would say, on the decline if we didn't spend any increased capital, but we think with the area of a 0.5 percentile type increases it actually stems that decline.

So it really becomes a case of a couple of things. One is our customer consultations and our conversations with the OEB in terms of what we want to accomplish over the next five years. So I would think what you will see, at least initially, is modest increases which we've illustrated here.

But I don't think you will see the anomaly that you're seeing in the USA up here in Ontario in the years directly ahead of us. And I think Hydro One has proven to do a terrific job in terms of our alignment and our local crews in terms of maintaining the plant and equipment going forward. So I don't think you will see a dramatic change in the trend here on behalf of Hydro One.

Mona Nazir - *Laurentian Bank Securities - Analyst*

Okay. And just lastly for me, and this is a different type of question. You've reported your first full year of public financial results.

When you started the IPO process to looking at where you are today, are you where you expected to be or ahead of the plan? And what is the biggest takeaway for both of you if any that you keep in the back of your mind as you go forward?

Mayo Schmidt - *Hydro One Limited - President & CEO*

I think it's a number of things. One is the leadership team that has been attracted here and has put their shoulder to the wheel is, in my view, has been one of the most significant things that's happened in the organization to be able to attract and retain the competencies and skills that we've attracted across Canada and North America.

Secondly, the really good work that's been done on the regulatory front in a very complicated environment. Third is the organization working to as an advocate for the customer has come into really an entirely new zone. We are seeing transformation occur across the organization and the response we are getting from customers has been significant.

and additional work that's done in that area.

But I think on the customer front, the regulatory front, the skill set and then, quite frankly, the entire employee base has really been engaged in what we call is our transformation of good to great. And it was really identified, as a crown agency this was a good Company but in order to become a great Company that we had to change materially some of the things that we were doing both operationally on the customer front.

And I think as evidenced on the transmission side of the business where the group came in and delivered on an exact plan when you are putting CAD1.6 billion of assets into service in a particular year, it's a terrific outcome to be able to hit that number as applied for with the Ontario Energy Board. So I am really proud of our team for being able to manage to that level of exactness, especially when you've got weather-related events and the ebbs and flows of some of the needs of the system that change based on performance.

Mona Nazir - *Laurentian Bank Securities - Analyst*

That's great, thank you.

Operator

Ben Pham, BMO.

Ben Pham - *BMO Capital Markets - Analyst*

Okay, thanks, good morning. I wanted to add a couple of questions on slide 3 and following up on the capital spending questions.

On the distribution CapEx you've laid out, can you comment on what's driving a lot of that growth over time in distribution? Is it also the end of useful life that's driving that so much to transmission?

Michael Vels - *Hydro One Limited - CFO*

Yes, that's correct. The distribution system assets are, similar to transmission, are very old, deteriorated and goes on that demographic profile of the assets becomes increasingly worse and creates reliability issues. So the primary issues in distribution are our distribution stations are becoming very aged and deteriorated and we have a certain number that we have to replace every year just to stay at the status quo.

And then the other significant work program that's included in there is pole replacement where we have a very material number of deteriorated poles across the system and they get worse every year, as well. So we are -- our plans really for the next five years are not to let those demographics and those conditions degrade because they will if we do so begin to have a material effect on our reliability numbers.

We, on the other hand, do not have at this stage plans for the distribution system to materially increase the reliability levels mostly to keep pace and to improve at the margin the demographics of those assets.

Ben Pham - *BMO Capital Markets - Analyst*

Okay. And then on the slide or on exhibit next to it rate base growth, you've highlighted, I think you've commented plus 5%. And just looking at some of the numbers it looks like you are looking to be a bit more, it looks like it's a little bit higher than the 5%, I think a little bit closer to 6% when I run the math. So is that more, I mean transmission is filed, is that more you guys are waiting for distribution, some visibility on that before perhaps updating the rate base growth guidance?

I think that's exactly right but it's not just distribution. The answers I gave you I think you were asking about distribution on the last question. Transmission is filed but we haven't received our order yet, which we expect to get halfway through the year.

So I think we've been fairly realistic or conservative, whichever way you would like to phrase it, in terms of we've included there what we have filed with the OEB. But it's, obviously, subject to approval and subject to adjustment. So that's why we are being not as prescriptive, I guess, in terms of the anticipated future growth.

Ben Pham - *BMO Capital Markets - Analyst*

Okay. And Michael, you mentioned some headwinds for this year which you think you could offset that by some efficiencies in the business. Do you think and are you confident that most of those efficiencies could fully offset some of the headwinds that you are facing?

Michael Vels - *Hydro One Limited - CFO*

I think all we can say on that is we are going to try our best. It's, obviously, three significant numbers we pointed out. We have done a lot of work and taken a ton of cost out of the system this year.

We have to keep repeating that. It does become harder every year. But as Mayo said the new people that we have on board, the new management team and some of the systems and processes and technology that's going into place over the next couple of years, we are -- our job is to find ways to offset it and we are going to do our best to do that.

Ben Pham - *BMO Capital Markets - Analyst*

Okay, thanks Michael. Thanks everybody.

Operator

Robert Catellier, CIBC World Markets.

Robert Catellier - *CIBC World Markets - Analyst*

Hi, thank you. Just a quick follow-up on Ben's last question.

You gave a qualitative answer as to what you are hoping to achieve on efficiency gains. I wondered if you were willing to put to quantify some brackets around that lower upper end of what's possible this year?

Michael Vels - *Hydro One Limited - CFO*

That's not something that we're able or prepared to do at this point. We have been fairly consistently pointing at more information that will be available as and when we file our distribution filing.

So we'd be happy to discuss some more of the details at that point. But at this stage we do not have a projection for cost reduction that we can put out there publicly at this stage.

Sure, I understand. I did want to explore the dividend growth conversation a little bit more.

It seems you are managing rate base growth to minimize build pressure on the distribution side. But ultimately the rate base growth if anything has strengthened.

And so even with the transmission order pending it seems like there's enough in your five-year plan to take that bold step and initiate a dividend increase or dividend growth outlook for the street. So maybe you can speak to that a little bit more.

Michael Vels - *Hydro One Limited - CFO*

Sure. I probably wouldn't say much more than what Mayo outlined as the Board does look at it every quarter. There is no doubt that even with our focus on cost reduction and being responsible about capital levels, just the nature of the replacement needs for the system as you've correctly pointed out results in an increase in the rate base which is fairly material. And as we've said very consistently we anticipate that as that translates into net earnings we are going to increase the dividend along with the net earnings growth.

So I'd qualitatively say to you yes, at that level of improvement in the rate base you'd anticipate similar increases in net earnings. And we will be confident going forward in our ability to have the dividend rate track that. But in terms of getting down to more specifics about what quarter and at what rate I think that's something that we will announce as and when the Board decides to change the dividend.

Robert Catellier - *CIBC World Markets - Analyst*

Okay, then one more question on that subject. How does the, I guess, the media attention to build pressure influence the Board's willingness to look at the dividend or other aspects of your regulatory filings? Does it come into play for the dividend growth at all or does it have any influence do you think on the government's intention to ultimately reduce its ownership over the long term?

Mayo Schmidt - *Hydro One Limited - President & CEO*

This is Mayo. Maybe a couple of thoughts around your point of view.

So we really think about as a management team recommending to the Board of Directors what ultimately will be the regulatory filing. We think about we have very, very good analytics in this organization and great visibility of, of course, the entire grid transmission and distribution. So we have great insights into where things are on the decline in terms of repeated service calls to a particular unit.

So we've really committed that we will apply to the OEB with exactly what the system needs. We don't intend to overbuild the system or in any way gold plate it, but at the same time we have no intention to let it decline. So our applications really are for continual improvement in the system in which we operate and that's very much supported by the Board of Directors.

Secondly, when Mike and I went in front of the OEB to start the transmission filing then ultimately the distribution filing, that's exactly the message that we gave. I suspect what you'll see is, of course, government will consider these cost pressures, but it's up to us to make sure that we have a solid system because if there are failures it falls back to the operator and the owner of the system which is ourselves.

So we would not intend in any way to let this system deteriorate and we will apply and continue to apply for things that are necessary going forward. When you talk about price pressures, there's no doubt that when we have -- we have the largest distribution business in the province, we have hundreds of thousands of contacts with customers every year so the visibility we get on the system, which we communicate directly to

They are well aware of it. They are communicating almost daily on this with the Ontario population. And we are certainly very confident that the province is clear on what needs to be done and will take the actions that they think are in the best interest of the citizens.

And we do expect to see a continued focus on these cost pressures for customers. It doesn't change what we need to do as caretakers of the system and we will apply every effort we have to see this system not deteriorate.

Robert Catellier - *CIBC World Markets - Analyst*

Okay, thank you for the insight.

Operator

Patrick Kenny, National Bank.

Patrick Kenny - *National Bank Financial - Analyst*

Good morning, guys. Just a quick follow-up on LDC consolidation.

In light of the province looking at ways to reduce distribution charges for customers, have you had any discussions with the government on any potential modifications or at least an extension to the tax incentives currently being offered to help accelerate M&A and overall efficiencies across the province?

Mayo Schmidt - *Hydro One Limited - President & CEO*

Thanks for the question, Patrick. I would say without being specific about any one particular point and to your good point is there are tax incentives.

We have communicated broadly, and this would include the province and also the local distributions, the compelling nature of consolidation and the benefits that accrue for the population here in Ontario. And we are certainly encouraged that whether it be our provincial government who has done their own analysis and has concluded that there is significant value creation from consolidation that really goes to how local municipalities view about owning their own LDC.

The things that we offer are the employees get to continue, there is also a ceiling or a freeze put on the cost of escalating cost of power for the municipalities. So the value creation for municipality and the fact that we border on both ends almost every LDC in the province, all of these are significantly accretive.

So it really just comes down to a recognition of that. But we think both the province and the understanding of the LDCs of the value creation here is pretty clear.

Patrick Kenny - *National Bank Financial - Analyst*

All right, great. Sounds like stay tuned on that front.

And then I guess just lastly for Michael along with your updated rate base CAGR forecast, would you also have an updated outlook on your cash tax horizon? Thanks.

We don't have any change or update to that. We still believe that the cash tax savings that related from the IPO revaluation will result in the alternative minimum tax be paid by the Company for at least the next five years.

And we have not updated that projection at this point. Not for any particular reason, we just don't believe that there is any material change.

Patrick Kenny - *National Bank Financial - Analyst*

Okay, thank you very much.

Operator

That does conclude our Q&A session for today. I'd now like to introduce -- return the call back over to Bruce Mann for any further remarks.

Bruce Mann - *Hydro One Limited - VP, IR*

Well, thanks, operator, very much for conducting the call this morning. The team here at Hydro One wants to thank everyone for participating and investing some of your time this morning. We appreciate your interest.

We know it's a busy time for everyone. And to the extent that anyone was in the queue that has questions that we weren't able to answer or didn't have time to, please feel free to reach out to my colleague Omar or myself.

We are here all day and we will get them answered. Everyone have a nice weekend and thank you again for joining us.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program and you may all disconnect. Everyone have a great day.
