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H.TO - Q2 2016 Hydro One Ltd Earnings Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to Hydro One Limited's second-quarter 2016 results investment community teleconference. As a reminder this call may be recorded. I would now like to turn the call over to Mr. Bruce Mann with the Hydro One management team. Please go ahead.

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

Thanks very much, Christy, and good morning, everyone, appreciate you joining us. I am 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 to the Q2 results and then spend the majority of the call answering as many of your questions as time permits.

There is also a few slides which illustrate some of the points we will go over in the moment. They should be up on the webcast right now. Or if you are dialed in to call you can find them on Hydro One's website in the Investor Relations section under Events and Presentations.

But lastly, as the discussion this morning will undoubtedly touch on some estimates or other forward-looking information, you should please review the cautionary language which is in today's earnings report and also in our full-year MD&A, that discuss the various factors and assumptions and risks that might cause actuals to be different as they apply equally to the dialogue on the call this morning. And with that I will turn it over to Mayo Schmidt.

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

Thank you, Bruce, and good morning, everyone. This was Hydro One's second full quarter as a public Company and the results are demonstrating traction as we move through the early phases of the transformation of the Company following the IPO late last year.

The CAD152 million net income for the second quarter is an increase of CAD21 million or 16% from last year, principally driven by improvements in transmission revenues and cost reductions. I would characterize these results as strong, reflecting improving operating cost control together with the impact of rate changes implemented earlier in the year.

And sequentially from the first quarter we also saw more seasonally normal weather patterns during the second quarter than we saw during the first quarter of this year.

The traction on the OM&A cost front was a product of a number of items including that of our billing and back-office systems environment and the related support operations are stable and enabling us to drive better cost efficiencies in this area. Not only has the systems environment stabilized but our network reliability on both transmission and distribution sides of the business has also improved.

During the quarter we were deeply engaged on the regulatory front both on the transmission and distribution sides of the business. On the transmission side on May 31 Hydro One filed an application with the OEB for 2017 and 2018 rates in what I will refer to as a transitional application. It will be the Company's last two-year period application and also the last that will reflect the cost of service framework.

The Company's next transmission application is expected to be for five years from 2019 to 2023, and will fully reflect the OEB's renewed incentive-based regulatory framework.

While May 31's filing is primarily a cost of service-based application, it incorporates many of the principles that the OEB included in its renewed regulator framework for electric utilities around customer input and performance outcomes as these are directly aligned with Hydro One's objective in terms of transforming to be a best-in-class customer centric commercial utility.

The focus is on customer needs, preferences and input together with the metrics, peer benchmarking and trended performance. The accelerated level of capital investment proposed in the application is supported by assessments of reliability risk and asset condition.

It is also informed by extensive customer consultations and total cost benchmarking and reflects the increasing urgency in terms of the investment necessary to rejuvenate Ontario's aging electricity infrastructure and maintain reliability standards.

For the filing period we are holding OM&A costs flat to slightly declining despite upward pressure from inflation, depreciation, a growing rate base and increased regulatory compliance costs. This reflects our committed discipline to control operating costs and run the business more efficiently.

For the distribution segment we are working very hard at the next rate application expected to be filed in 2017, which will be under an incentive-based regulatory framework and will cover the five-year period from 2018 to 2022.

As we did to prepare and support the transition filing, on the distribution side we completed extensive customer consultations and gathered appropriate inputs that will support the rate application. As we speak, various productivity, benchmarking and other metrics-based studies are underway that will also provide input to and support the application.

We are making solid progress in the important initiative of further enhancing Hydro One's senior leadership team. Most recently we announced the appointment of Ferio Pugliese as EVP of Customer Care and Corporate Affairs, and Jamie Scarlett as EVP and Chief Legal Officer.

These two leaders bring strong skill sets and commercial customer centric backgrounds and will contribute significantly to the organization muscle we are building. In addition, we have well advanced searches underway for COO role as well as other senior corporate positions, and we expect to have announcements in a relatively new term -- short term, excuse me.

During the second quarter we made some positive movement forward on the acquisition of Great Lakes Power electricity transmission business in Northern Ontario that we announced last quarter. During July the Competition Bureau issued a no action letter, the positive step that leaves approval by the OEB as the only remaining step to closing.

The evidentiary phase of the merger application with the OEB is complete and we expect to receive a decision in the second half of the year, and possibly as soon as the next couple months.

As a refresh, the Great Lakes Power Transmission asset is directly contiguous on both ends with Hydro One's own transmission network. And upon completion of the transaction Hydro One will operate approximately 98% of Ontario's transmission grid.

This acquisition squarely aligns with our objective of growing within Ontario in our existing electricity transmission and distribution businesses and was a unique opportunity to add a high quality asset and operating team as we continue to expand in Canada's most populated province.

Lastly, I'd also like to point out that while making the transition to become a commercially focused enterprise is a key focus and value driver for Hydro One, so too is becoming an even better corporate citizen.

I was proud during the second quarter when Hydro One was ranked as the top utility in the 15th annual rankings of Corporate Knights Canada best 50 corporate citizens. The ranking is done across a set of 12 sustainability metrics including carbon productivity, gender leadership diversity, health and safety, performance and pension fund quality.

This was a testament to our core values and I believe demonstrates that we are well on our way to developing a great sustainability and corporate responsibility culture here at Hydro One.

And with that, I would like to turn this over to Michael to discuss the financials, and then we will be happy to take your questions. Thank you.

Michael Vels *- Hydro One Limited - CFO*

Thanks, Mayo; good morning, everyone. I refer you to slide 4. Before I get into the financial detail for the quarter, I'd just mention that early in the second quarter we assisted the Province of Ontario in the monetization of another approximately 15% of their equity ownership of Hydro One via a successful secondary offering.

This offering essentially doubled the float of the Company, which has already proven very positive in terms of increased liquidity and at the same time, of course, it was non-dilutive to public shareholders.

The Province's ownership interest is now 70%, halfway down to their goal of selling down to 40%. The larger float and the expiry of waiting periods post the IPO as a result of the meaningful S&P, Dow Jones, FTSE and MSCI Index conclusions for the Hydro One shares further contributing to liquidity and broad market visibility.

In terms of the financial results of the quarter, let me start by quickly highlighting a couple of the IPO and operating-related items that we also outline in the MD&A, which make the year-over-year financial changes less than fully comparable and that you may wish to adjust for as you compare the two periods.

On slide 5 we outline that for IPO-related effects, there are two items to bear in mind. First is the divestiture of Hydro One Brampton last year, which on a pro forma basis produces both revenue and earnings, as you can see on the slide. After the third quarter this item won't impact the comparatives any further and will only impact the third quarter by two months of comparability.

The second item is the impact of the recapitalization at the IPO, which brought our leverage up to match the regulatory deemed 60/40 debt to equity structure and results in an increase in interest expense.

The combined impact on net income of the Brampton divestiture and the IPO recapitalization compared to last year is a reduction of CAD14 million in the second quarter and CAD24 million for the year to date.

Moving to OM&A costs and, as Mayo mentioned, we started to deliver some measurable improvements in operating costs. Compared to the second quarter of last year, we are seeing expense improvements in the areas of [IG], bad debt, and other costs related to the now stabilized billing and back-office systems.

A new item for the quarter that has impacted both OM&A and revenues was the impact from our recent actuarial revaluation of the Company's pension plan with effect as of January 1, 2016. Based on this valuation and projected levels of pensionable earnings, our estimated annual pension contributions for 2016, 2017 and 2018 will decrease by approximately CAD70 million per annum.

This is a combined result of improvements in the funded status plan, future actuarial assumptions and the impact of changes implemented by management to improve the balance between employee and Company contributions to the pension plan.

These revised pension expenses are accounted for by an approximately CAD15 million decrease in OM&A costs for the quarter and for the year to date, which is in turn offset by a decrease in revenue of a corresponding amount recorded in a regulatory deferral account as these savings will ultimately be passed on to ratepayers in future periods.

For income taxes purposes, however, we don't record a current deduction from the savings associated with the capitalized portion of the pension costs, so you do see a modest increase in the effective tax rate for this quarter and thus a modestly negative impact on the bottom line.

The last item on the income statement I will point to is on adjusted earnings per share, which for the first time you will see we now have a diluted earnings per share number as well. Dilution calculation reflects the impact of long-term incentive plans and union stock ownership plans which were put into effect post the IPO and which are this quarter for the first time measurable enough to cause a CAD0.01 of dilution.

On slide 6, you will note that total interest costs are modestly higher than last year on higher borrowings due to the IPO-related recapitalization I mentioned a moment ago. However, I would point out that these costs are being partially offset by the benefits of declining interest rates and a higher mix of short-term debt as we await an optimum time to refinance the Company's outstanding commercial paper.

Overall, you can see that we exited the quarter with a very strong balance sheet, conservative leverage and significant available liquidity. I will stop there and we would be pleased to take your questions.

QUESTION AND ANSWER

Operator

(Operator Instructions). Frederic Bastien, Raymond James.

Frederic Bastien - ***Raymond James - Analyst***

Just on the M&A side, I appreciate that you have a few steps to clear before we can think about M&A. But you are building a team M&A wise, so I was wondering how that was going.

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

Let me address that. It's Mayo. First of all, we are really in the period where we are developing and taking views on a scan of the market and opportunities for the future of the Company. It is going very well. We have done good research.

I think that our process here certainly hasn't changed in terms of our thinking that 2016 is really, as indicated, building the muscle in the organization and the competencies, as evidenced by some of these results, and control on cost and other steps.

2017 is really our transformational year where we have an opportunity for some of the breakout strategies related to opportunities. Great Lakes Power came very early; that wouldn't necessarily have been something we would have sought out at the time, although it is more of a tuck-in. But I think it is an illustration and an opportunity for the organization to build its competencies on integration and being effective.

So, we have got two LDC integrations underway right now. They are going well and the systems are developing very well around that and at Great Lakes yet to undertake following approvals.

Frederic Bastien - ***Raymond James - Analyst***

Okay, thanks for that. Also my other question, Mayo, you joined the firm about a year ago. Are there areas of the Company that you feel were in better shape than when you -- are in better shape than when you first joined? Or are there any surprises when you look at every important facet of the Company?

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

I think certainly there are. I think when we look at planning and construction, I think we have had our most immediate effect in those areas where, if you look over history, there would have been an approved spend that would not have been achieved. And in terms of planning and the analysis around building out the projects on our construction side of the business have improved significantly.

We have an expectation and we have built systems around hitting exactly as to the approved rate by the OEB. I would say the area that probably needs the most significant amount of work in the organization I think is self-evident is going to be the customer side of the business.

When we are faced with increasing energy prices, which are certainly not under our control, but yet we own the bill, it is really how we are, as an organization, going to get more local with our customers and get more visibility and communication going.

We have got a number of programs underway. One will be the move to mobile which I think will be very effective in moving from an extraordinarily difficult paper-based system to an, at the touch of a fingertip with an iPad source, the ability to gain access to customer information, deployment of crews, tracking of crews so we can better deploy.

So there are a number of initiatives. But clearly the customer area is the most opportunity and the area that needs the most work. And Ferio that's coming in as former president of WestJet Encore is a very strong individual on the customer side of the business. So we are quite pleased that he is going to be here.

And in a very short period of time, I hope to be announcing the appointment of a Chief Operating Officer for the Company, which I think, if all goes well here, I expect the market to be very pleased.

Frederic Bastien - ***Raymond James - Analyst***

Thanks very much. I appreciate the color.

Operator

Rob Hope, Scotiabank.

Rob Hope - ***Scotiabank - Analyst***

Just a follow-up from some of your prior comments there. Just regarding the scan of the market that you had mentioned on, just want to clarify that. Is that just the Ontario market or are you looking in more southern jurisdictions as well as what asset types you are looking at?

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

Rob, very much a North America scan. And I think for us right now it is as much about being informed and educated about opportunities. It is a consolidating environment out there. We particularly like our position as a regulated entity in transmission and distribution.

There is adjacent businesses but, at the same time, we are not of the mind that we are going to expose ourself to commodity risk. So I think very much looking at opportunities along the lines of transmission distribution regulated.

And of course that will be a process by which we will be more deeply and better informed over the course of the next year or so. And we will be at some point shortly here hopefully announcing the appointment of a business development strategy head that will have a North American experience.

Rob Hope - ***Scotiabank - Analyst***

All right, that is very helpful, thank you. And then just on the cost side. So, you do mention that you are making some progress on the cost front. Just want to get a sense of whether or not some of the Q2 benefit would be timing-related to I guess the underground locates and the bad debt costs. Or would some of this be more structural in nature I guess on the bad debt cost with your better systems in place?

Michael Vels - ***Hydro One Limited - CFO***

So, it is a good question. Certainly the bad debts and the improved performance of all the related systems is something that we have been sequentially improving quarter over quarter. And we are, as I have mentioned in prior calls, probably by the end of 2016, I would say we would be operating close to what I would consider to be optimum performance in that systems bad debt area around billing.

And so, we will see sequential improvements but at a declining rate. And once we are there, that is a structural improvement that I wouldn't expect to reverse and therefore it is not timing.

Some of the other items are really -- some of the immediate cost savings and, as we call them, quick wins that we have put into the Company following our intense diagnostic scans that Mayo commissioned immediately after joining the Company and those are permanent savings.

And probably the rest of them would be just the ebb and flow of operational activity. The pension reduction I mentioned was permanent at least for the next three years, and you will expect to see that in reduced OM&A in the next -- in 2017 and 2018. But as I did mention, those are offset by revenue reductions and have a relatively limited impact on our bottom line.

Rob Hope *- Scotiabank - Analyst*

All right, thank you for the color.

Operator

Andrew Kuske, Credit Suisse.

Andrew Kuske *- Credit Suisse - Analyst*

I guess the first question is just on the OM&A. And in particular just in the other category, there was a pretty pronounced increase. And I know the color around it is consultancy costs and things to that effect. Could you just maybe flesh that out a little bit more?

Michael Vels *- Hydro One Limited - CFO*

Sure. That is the cost of -- from the benefits you are seeing on the operations side. So there are various things in there, but one of the most significant was some external help that we had to do the diagnostic and come up with some specific plans. In particular, many of those quick wins and cost reductions that I just referred to.

And that was completed by the end of the second quarter but of course did have a cost. And we will see the ongoing benefit of those for many years as we have been able to isolate areas of opportunity throughout the business that we are now spending time putting plans and numbers to and, as I said, beginning to execute on some of the lower hanging fruit immediately.

Andrew Kuske *- Credit Suisse - Analyst*

Okay, that is helpful. And then maybe just a broader question, probably directed towards Mayo. Just on what is happening in Ontario just from a policy standpoint. So, I guess a few months ago, maybe it was late May, we had the speculation around the green energy policy. And then in June we actually had the formal release of the climate change plan.

How do you think about just Hydro One's exposure to the changing policy environment in Ontario and then the opportunities that arise from that?

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

Sure, I think it is a great question. So, one is I would say because the idea -- and I sat at the Minister of Energy's energy table having discussions about the carbon sequestration; i.e. reduction of carbon in the system, which relates exactly to your question about the benefits for Hydro One, which would be the planning of increased charging stations for vehicles across the Province, of which I think the long-term plan would have several hundred, more of a movement in the future away from gas heating to electric.

I think in September my understanding is the government will be coming out further with their design of those plans. So I guess I am a little cautious to say there is going to be any material benefit to us certainly initially because these are longer-term plans.

I think it is yet to be determined if in fact those plans are going to be executed. But I think it is clear that if taking a longer-term view and if the plans are executed and the aspect of reduction of carbon by 80% to the 1990 standards would be very, very beneficial for this organization.

Andrew Kuske *- Credit Suisse - Analyst*

Okay, that is great. Thank you.

Operator

Ben Pham, BMO Capital Markets.

Ben Pham *- BMO Capital - Analyst*

Going back to -- just a follow-up on some of the questions on acquisitions. And I understand that your focus is more on the smaller scale type of local consolidation.

As you think about 2017 and I think you mentioned potential transformational type of events could occur, or not occur, even to 2018, 2019, 2020, just wonder how far would you be comfortable with pushing your balance sheet and your earnings mix outside of Ontario and even your regulated exposure that you have today?

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

Mike and I will both maybe take a piece of that. So let me be clear, the transformational is meant about the organization transforming from a crowd agency to a fully commercial organization that has capabilities to both -- one is manage the business which the way we have with cost control, look for growth opportunities.

It wouldn't be our view that we are in any way taking a view that in 2017 or thereafter we need to go out, must find a transformational opportunity. I think those will be at a time of our choosing with good analysis.

I would say right now the key thing that I have got my focus on, and I know Mike does, is Mike has been very focused on running a very strong integration program for the LDCs that we have acquired and Great Lakes will also have the benefit of that.

So, he has undertaken to really sharpen up the organization's abilities and capabilities in that area. And we are starting to see some pretty significant improvements which we are very, very pleased with which are signs that that muscle is being developed for the future.

And of course, as I mentioned, Great Lakes came at a time of its choosing, it just happened to be, in our view, strategic. So as I think as we think forward, it really is being alert to the opportunities and my expectation is they will be generally unexpected by everybody what comes to pass.

So we want to be prepared so that if in fact we believe that it is right for us financially and the metrics are right and it is an accretive transaction on all metrics, we would be interested in being engaged in that process. Mike, do you want to comment at all about the financial side of that, please?

Michael Vels *- Hydro One Limited - CFO*

I wouldn't add very much frankly to what Mayo has said. Ben, as we all know, these transactions are all unique. But there are certain things that -- where we understand and have emerging and strong opinions on.

Firstly, we do have a very strong balance sheet, based on strong liquidity and some level of debt capacity. That puts us in a very strong position and gives us a significant amount of flexibility.

Certainly it is an advantage that at the margin we would like to retain. And we are not in business to maintain a strong balance sheet, we are in business to create shareholder value. But that advantage that the rating and the balance sheet provides us is something we would like to retain for sure.

In terms of the type of business, too early really to speculate, but we fully understand that the value to our shareholders today and the valuation that they provide us is because we are a regulated business with a consistency of earnings and some level of visibility and transparency into the future. So it would be very unusual and unlikely for us to actively seek to move away from that profile.

Ben Pham - ***BMO Capital - Analyst***

That is very helpful. And just another question on the rate side of things, rate applications. On the distribution side, as you look to file an application next year, can you remind me with the last cycle why you had to go to cost of service where most others were still on incentive regulation? And how do you guys think about that to mitigate the potential of that happening again in this next cycle?

Michael Vels - ***Hydro One Limited - CFO***

Well, I'm not going to speculate too much on the prior filing except to say that the filing as it was filed and as the OEB reacted to it was really more -- looked more like a cost of service filing. And I think that was pointed out by the OEB in their remarks when they handed down their rate decision. And there was some level of compromise in that the filing ended up being for the full-year period.

As we move forward, the renewed regulatory framework has been issued by the OEB and some of the -- I think we have done internally, we feel very comfortable that we will be putting something forward to the OEB that will be truly an incentive-based framework.

We are going to put it in for five years. It will have the usual rate cap structure to it with the custom element related to our capital expenditures. And we actually feel very confident that the OEB will find it acceptable and we will be in an IRM structure.

Ben Pham - ***BMO Capital - Analyst***

Okay, thanks, Mike. Thanks, everybody.

Operator

Robert Kwan, RBC Capital Markets.

Robert Kwan - ***RBC Capital Markets - Analyst***

Mike, if I can just follow on just around the distribution rate filing that you expect to make in the first half next year. You talked about rate cap and customized recovery on the CapEx side. I'm just wondering, do you have any thoughts as well around things -- earnings sharing or dead bands if you think about a custom filing?

Michael Vels - ***Hydro One Limited - CFO***

Well, we certainly have thought about it, as you can imagine. We are not in a position to really talk about it publicly. It is not that -- that really wouldn't be appropriate as it's a remarkably complicated filing, will be, just by the scale and the nature of our Company. And to discuss and speculate on one aspect of it I think would be -- would just be wrong.

But, to be helpful, you can certainly look at some of the more recent filings that have been made and orders that have come down. And there are a variety of different types of bidding sharing mechanisms in those. So I think you could probably take some level of direction from where that is going. And clearly it is something that is going to be discussed by the OEB in the context of that filing.

Robert Kwan - ***RBC Capital Markets - Analyst***

Okay, fair enough. Just in terms of the Great Lakes Power Transmission acquisition, I'm just wondering, how does it work on synergies and cost savings on transmission? Does it follow the distribution side where you have 5 to 10 years of running room to keep the synergies?

Michael Vels - ***Hydro One Limited - CFO***

Yes, what we filed on that application is 10 years. After the first five years, then your synergies are ours and then we share in a dead band type of -- kind of structure of plus or minus 300 basis points.

Robert Kwan - ***RBC Capital Markets - Analyst***

Okay, so basically it is following the distribution --

Michael Vels - ***Hydro One Limited - CFO***

Pretty well.

Robert Kwan - ***RBC Capital Markets - Analyst***

-- framework. Okay. If I can ask one last question just on the pension side of things. If I am just understanding the accounting, as you mentioned, there is no margin impact because it is revenue and cost.

I am just wondering was that mostly booked against the distribution OM&A versus transmission. And then with that is that then also a pretty big driver of the year-over-year change in OM&A? It's just not mentioned in the OM&A kind of line item writeups?

Michael Vels - ***Hydro One Limited - CFO***

It is about CAD14 million -- sorry, it is CAD14 million for the quarter, Robert. So I did mention that in the remarks, I think I must have just said it too quickly.

Robert Kwan - ***RBC Capital Markets - Analyst***

Okay, but was that one of the bigger drivers then as to why say distribution OM&A declined year over year?

Michael Vels - ***Hydro One Limited - CFO***

Oh, thank you, sorry. I misunderstood the question. There were really two principal drivers in there. The one is that pension number and the other almost as large is what I refer to as primarily the lower systems and bad debt expenses as we sequentially improve those systems. Those would have been the two significant drivers in the distribution business.

Robert Kwan - ***RBC Capital Markets - Analyst***

Okay, that is great. Thank you. [Pardon me]?

Michael Vels - ***Hydro One Limited - CFO***

No, (inaudible), so you are correct, that was the biggest driver in distribution followed by the bad debt.

Robert Kwan - ***RBC Capital Markets - Analyst***

Great, thanks very much.

Operator

Linda Ezergailis, TD Securities.

Linda Ezergailis *- TD Securities - Analyst*

Maybe I just can get another clarifying question on the OM&A. The transformer equipment refurbishment, some stations maintenance, that was in the OM&A as well. Would that be more on the transmission side of your operating expenses?

Michael Vels *- Hydro One Limited - CFO*

Yes, that is correct.

Linda Ezergailis *- TD Securities - Analyst*

And is that a timing thing or is that again a systemic reduction permit?

Michael Vels *- Hydro One Limited - CFO*

That would be more in the timing box. So it is really a level of activity. The station refurbishment tends to be a little more choppy from quarter to quarter in the transmission business mostly related to when we can get outages when we schedule the work.

So, our work programs in those areas tend to be pretty consistent and even to some extent increasing over time. So there would have been a timing difference.

Linda Ezergailis *- TD Securities - Analyst*

Okay, thank you. And I realize it is hard to predict the weather, but we are approaching mid-August and it is very hot here in Toronto. And so, I am just wondering if you could help us -- and I know you don't normalize for weather in your historical numbers.

But can you help us maybe get a sense of sensitivity of the variant that we can think of in terms of book ends of very hot summers versus very cold summers and what that has done for your revenue and earnings potentially?

Michael Vels *- Hydro One Limited - CFO*

Well, I am really hoping it rains tomorrow, I can tell you that. But -- certainly not from a business perspective. I guess the short answer would be no, we can't. But trying to be a little more helpful than that. Certainly the seasons that are critically important from a weather perspective if you wanted to look at weather, it's obviously this period right now and the winter.

So, in the first quarter, as you saw when we had unusually mild weather for the -- coming out of the winter, both for distribution consumption and the transmission peak load was lower than the prior year and that impacted us quite materially on a revenue line. That is a primary contributor to the revenue shortfall for the year to date.

For this quarter ended June, the weather was fairly normal and nothing out of the ordinary. So, part of the revenue improvement was related to the transmission peak load. But that is also impacted by industrial demand as well. So, it is hard to separate the two. But I would say the second quarter was a more normalized weather pattern.

So now we are in a very, very, very hot summer. And so you will -- it is a fair assumption to say that as it is above last year and above historical norms, the expectation would be to see some level of increased distribution electricity consumption as people run their air conditioners in office buildings and that sort of thing. And the peak load on the transmission system is likely to be higher. But it is very hard to, in fact virtually impossible, to run a correlation and actually forecast what a particular weather pattern in a week will do to your month.

The other thing I would also point out is [conservation] and demand management does have an effect year over year and can actually materially affect the distribution consumption numbers.

Linda Ezergailis - ***TD Securities - Analyst***

Okay, that is -- okay. Now with respect to July, you wouldn't have any actual data on your transmission 60-minute peak load number or anything like that that you could share with us? Can we get it on the OEB side or something or a system site?

Michael Vels - ***Hydro One Limited - CFO***

Yes, you should be able to access it on the iso-site, I-S-O site, where they do show daily electricity prices and the peak load achieved across the entire system.

Linda Ezergailis - ***TD Securities - Analyst***

So we just take the simple average for the monthly 60-minute peak demand from the iso-site to get a sense of year-over-year variance?

Michael Vels - ***Hydro One Limited - CFO***

You can certainly get a sense of the year-over-year peak load variance. I can tell you having been in it myself, there is no algorithm that I have found yet that will translate into a great forecast for the month.

Linda Ezergailis - ***TD Securities - Analyst***

All right, well, I can try.

Michael Vels - ***Hydro One Limited - CFO***

No, no, if you want to chat about it off-line, because if you get one, I would love to have it. There are just so many other factors. I mean this is not a totally weather-driven business. So, it is where the delivery points occurred. It is what the industrial activity was, what the CDM programs were, where the load-shedding occurred. So it really isn't a high correlation impact.

When you have extremes and especially when you have mild weather in the winter, which for us would have been an extreme, it does have an effect. And at those periods of time, it can be a material effect. At other points in time frankly, even with the very, very hot weather that we are seeing right now, that is sort of expected and it is in your peak load forecast.

Linda Ezergailis - ***TD Securities - Analyst***

Okay, thank you.

Operator

(Operator Instructions). Paul Lechem, CIBC World Markets.

Paul Lechem - ***CIBC World Markets - Analyst***

Thank you, good morning. Mike, on page 6, you have got your debt maturity schedule. It looks like we are coming into a period of relatively high maturities over the next five, six years. And you made a comment about you are looking at an optimal time to refinance.

Is there any opportunity to refinance any of the upcoming maturities a bit early? What are your thoughts around the refinancing activity and what (multiple speakers)?

Michael Vels - ***Hydro One Limited - CFO***

I'm sorry, what was the last part of your question?

Paul Lechem - ***CIBC World Markets - Analyst***

Just what could that do to your debt cost?

Michael Vels - ***Hydro One Limited - CFO***

Okay. We do have a fairly high balance on our commercial paper podium right now. So the expectation is that we would see a higher volume and a significant amount of debt refinancing in the second half of this year.

So that has been clearly something that the market would be expecting and follows on a pretty successful series of issuance in the first half. So, clearly we have been benefiting to a large extent from those low commercial paper rates in the first half. And as we refinance, those benefits would reduce.

Paul Lechem - ***CIBC World Markets - Analyst***

Okay, so the amounts maturing in 2017 and 2018, has any of that then been refinanced through the first half of this year?

Michael Vels - ***Hydro One Limited - CFO***

Yes, yes. About CAD400-million-odd of our issuance was refinanced. Rolling into 2017, as you try to model the numbers, I would expect you should expect to see approximately CAD400 million to CAD500 million probably of our total debt with remaining commercial paper. And I expect the rest to be financed through our MTM program and trimmed out in that average of 15 to 17 years.

Paul Lechem - ***CIBC World Markets - Analyst***

Okay, I will --.

Michael Vels - ***Hydro One Limited - CFO***

By an issuance of 5, 10 and 20-year maturities.

Paul Lechem - ***CIBC World Markets - Analyst***

Okay, thanks. Mayo, I ask you this every quarter; I'm always surprised by the answer. The LDC activity, the consolidation activity in Ontario, at least your discussions around it, you said you have two integrations underway.

What are your discussions for further municipal LDC integration? Have they progressed any? Are any municipalities now actually more interested in pursuing sales? What can you tell us?

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

Well, one, I would say we continue to progress in that area. We have got a spectrum of different LDCs that we hear from time to time. Most recently, there has been a couple that have been more prominent in terms of being reported by the media. And of course the reason they are is they are not material to us necessarily from a financial point of view versus our balance sheet.

But the counselors, the city mayors do need to have community consultations to be able to get to the finish line. So there is two in particular that are interesting to us that we are in discussions with.

Then beyond that, there is a spectrum of a number, and that wouldn't be 10 or 20, but it would be a number that would be interesting over a period of time.

They typically can take generally over six months and I expect them to be over six months on any of these discussions, up to a year, year and a half simply because there is the community consultations and city counselors that have to be convinced of the merits for their local communities.

For us, the benefit really is an opportunity for consolidation of our systems. So we are serving and we book end a lot -- nearly all of these communities because we are 98% of course. So for us, we already have crews in the area.

So even though there is some period of time where we have to provide the LDC a little bit of stability in terms of employment and cost structure, we do naturally want to integrate those businesses and we assist those businesses in managing their cost as well.

And in terms of our business, as I mentioned about Mike's initiatives here, we've really sharpened up our integration practices here. So I am very favorable toward more opportunities. These are in our backyard; they make a lot of sense for us. They don't move the needle necessarily in a material way.

But any time we can consolidate and get sharp on our cost structure, I think it is very beneficial for us. So we will continue that. I wouldn't say that there is a busy pipeline, we are sort of at the end of what would be discussions until something new happens.

Paul Lechem *- CIBC World Markets - Analyst*

Okay, last question from me, just around the move to incentive-based rates. I am just wondering what are the main levers you have to pull once you get onto these mechanisms to actually reduce costs. And I am just thinking in particular around your workforce.

Is it going to be driven primarily in terms of trying to become more efficient with your workforce? And if so, before going public, you signed three-year agreements with your unions which would be coming up for renewal around the time you move onto these incentive rate-making mechanisms.

Should we expect any changes there? How should we think about the levers you have to pull to actually reduce your cost structure around as you move into an incentive rate mechanism? Thanks.

Michael Vels *- Hydro One Limited - CFO*

I think it would be fair to say that there is no part of the business that would be exempt from that scrutiny. So everything from our head office costs, our organizational effectiveness and SG&A.

Mayo mentioned productivity initiatives related to helping our people in the field get to their work earlier, quicker and more effectively. And then also when they are there have access to high-quality information so that they can complete the job 100% and not be hampered by lack of information.

We have already referred to our systems costs. We have very, very significant computer systems and we'd be looking at how to run those more efficiently. We have procurement, massive procurement programs. And I'd say that the RFP and generally the strategic purchasing that was followed here was probably more like a government organization than a highly commercial organization and we are changing that.

And I will say it is a very, very, very long list. I think what you are getting at is the extent and degree of difficulty. And all of the lists we have and the lists we are compiling and continue to add to comes with different levels of difficulty.

As I said, there are some quick wins where we've actually already accomplished some achievements and there are others, as you pointed out, that require cooperation and participation by our unionized work staff. And those are potentially longer-term opportunities. But we have every intention of getting to them.

Paul Lechem - ***CIBC World Markets - Analyst***

Okay, thanks very much.

Operator

Jeremy Rosenfield, Industrial Alliance Securities.

Jeremy Rosenfield - ***Industrial Alliance Securities - Analyst***

Thank you. Just one follow-up question. Last week, there was -- the OEB came out with its 2015 benchmarking update. And I am just curious to see if you had any comments on the benchmarking that had been done and specifically on the stretch factor that is currently being applied to Hydro One's business and whether you see opportunities for improvement on that side of things.

Michael Vels - ***Hydro One Limited - CFO***

I don't have any particular or specific comment on the data that was issued. We are not currently subject to a stretch factor or a productivity benchmark. We will be next year and that may change up or down depending of course on the relative changes in that benchmarking information.

At this point, we don't anticipate a material change in that number, but obviously when we get closer to deploying, that could occur. But at this stage, I would say no change anticipated.

Jeremy Rosenfield - ***Industrial Alliance Securities - Analyst***

So, if I am understanding just correctly, you are not targeting any specific initiatives that would sort of try to move the stretch factor component between now and let's say when you file your application to move towards the TDR IR system?

Michael Vels - ***Hydro One Limited - CFO***

Well, just to understand your question, we are setting ourselves up and making sure we have the processes and systems and the people to be successful and from the get go, we're both meeting and improving on that stretch factor through our internal activities. The 0.6 stretch that is currently in place would be a consistent application. And it is up to us to ensure that we can do better than that.

Jeremy Rosenfield - ***Industrial Alliance Securities - Analyst***

Right. Okay, fair enough. Thank you. That is it.

Operator

Thank you. And that does conclude our Q&A session for today. I would like to hand the call back over to the Hydro One management team for any further remarks.

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

All right, thank you very much, Christy. The management team here at Hydro One thanks everyone for investing a bit of your time with us this morning and hope that you enjoy the rest of your summer. If you have any questions that weren't asked on the call or in the earnings release or MD&A, please feel free to reach out to one of us. Our contact info is at the bottom of this morning's earnings release. And that concludes today's call. Thank you very much.

Operator

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