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H.TO - Q2 2020 Hydro One Ltd Earnings Call

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## PRESENTATION

### Operator

Good morning, ladies and gentlemen. Hello, and welcome to the Hydro One Limited Second Quarter 2020 Analyst Teleconference. (Operator Instructions) As a reminder, the call is being recorded.

I would now like to introduce your host for today's conference, Mr. Omar Javed, Vice President, Investor Relations at Hydro One. Please go ahead.

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### Omar Javed - Hydro One Limited - VP of IR

Good morning, everyone, and thank you for joining us in Hydro One's Second Virtual Earnings Call. Joining us today are our President and CEO, Mark Poweska; and our Chief Financial Officer, Christopher Lopez. In the call today, we will go over our second quarter results and then spend the majority of the call answering as many of your questions as time permits. There are also several slides that illustrate some of the points we will address in a moment. It should be up on the webcast now. Or if you're dialed into the call, you can also find them on Hydro One's website in the Investor Relations section under Events and Presentations. We also released our 2019 sustainability report this morning, which should be up on the website as well.

Today's discussions will likely touch on estimates and other forward-looking information. You should review the cautionary language in today's earnings release and our MD&A, which we have filed this morning regarding the various factors, assumptions and risks that could cause our actual results to differ as they all apply to this call.

With that, I turn the call over to our President and CEO, Mark Poweska.

As the world continues to grapple with the impacts of COVID-19 pandemic, we've also seen social movements around the world. We all share responsibility in confronting racism. Our organization is on a collective journey to better understand the experiences of black and indigenous employees with systemic racism and bias in order to create an inclusive environment. Recently, I joined other Canadian CEOs in signing a pledge to the BlackNorth Initiative. For us, this means committing to 7 goals to move Canada towards ending anti-black racism and creating opportunities for underrepresented groups. As Ontario's largest electricity transmission and distribution company, we recognize the impact we have in developing meaningful long-term change in our society.

The events of this year have also put a spotlight on the collective responsibility that governments, companies and individual share in building a more sustainable world. Corporations will be evaluated on how they adapt and actions they take today. As part of our corporate strategy, I prioritize the focus on environmental, social and governance issues. Why? Because our long-term performance depends on incorporating sustainability into all aspects of our business. Our stakeholders told us they expect an unwavering commitment to exceptional customer service, safety, efficiency and sustainability. They want us to look out for future generations. By becoming a more sustainable company, we can help create a better and brighter future for all. We are pleased that our efforts are being recognized as we recently secured a spot in Corporate Knights 2020 List of Canada's 50 best corporate citizens and ranked fourth amongst the global list of 143 utilities.

This morning, we released our 2019 sustainability report, solidifying our leadership in environmental, social and governance issues. Some highlights include: on the environmental front, our commitment to reduce our carbon footprint by converting 50% of our fleet of sedans and SUVs to electric vehicles or hybrids by 2025, in addition, our significant savings as a result of our recycling program. On social, 2019 saw our highest ever indigenous spend. Our recent achievements of Catalyst Accord commitments on gender diversity, including 50-50 gender diversity on our Board and our commitment to develop diversity in hiring goals.

On governance, our use of the sustainability, accounting standards support framework and the global reporting initiative, core sustainability reporting standards. We are also aiming to adhere to the task force on climate-related financial disclosures in the near future to secure transparent disclosures and drive the consistency of our sustainability performance data.

The social elements of sustainability are vital right now in determining how we all emerge from this uncertain period. To me, the social element means ensuring the health and safety of employees and the public. It means affordability for our customers, removing racism and building an inclusive culture, all while adapting our business model and helping to restart the economy. As an essential business, we have played a critical role in energizing life in the province during the COVID-19 pandemic. And we will continue to play a critical role in rebuilding the economy. We continue to do everything we can to protect our employees and stand up for customers and communities.

We weathered a number of storms, including 1 in June, where we safely restored power to 200,000 customers. Our hard-working crews demonstrated that we are still able to restore power just as quickly and just as safely as they were prior to the pandemic. Project work and capital deployment has ramped back up. And as of the beginning of June, our field work is back to normal levels. We now anticipate we will complete most of our work programs by the end of the year or in the beginning of 2021. We still have more than 3,000 office staff that are working from home. Our cautious, measured and safe approach to returning staff back into the office setting is working. And throughout the pandemic, we have not had any workplace transmissions of COVID-19.

Consistent with our staged approach, the first stage is a return of up to 10% of our office staff into an office, concentrating on employees requiring access to special equipment to perform their job effectively. In the long term, we are engaging with our employees on our work-from-home strategy. We continue to monitor our network and system very closely during this pandemic. This has been a very hot summer, and we've experienced higher usage peaks and much higher than last year. Our electricity system is prepared for this, and we continue to monitor our grid to provide safe and reliable power to our customers.

which provides supplies to food banks across the province.

By being more in tune with the needs of our customers, we've been successful in advocating for more measures to provide customer relief. The government introduced COVID-19 recovery rates which put a pause on peak pricing and introduced flexible electricity pricing until October 31, 2020, and introduced the COVID-19 Energy Assistance Program. As we continue to navigate the pandemic, our strong foundations have resulted in a proven ability to adapt.

Now we will look at how the electricity sector can support economic recovery in the province.

A safe, reliable transmission system is fundamental to supporting economic growth and jobs. This quarter, we moved forward on 2 large transmission projects. First, we continued our engagement process to build a transmission line from Chatham to Lakeshore to support the greenhouse industry, otherwise known as Leamington line. We were pleased with the record attendance of 4,000 people during our virtual community information session, which illustrates the impact -- impactful nature of the project. Second, we launched community engagement for the Waasigan transmission line, which is the first step in the environmental assessment process. This transmission line will increase the amount account of electricity that can flow through the system in Northwestern Ontario, providing local businesses and communities with the electricity they need to grow. These 2 projects are examples of how we continue to add value and support economic growth in Ontario.

We are also doing our part to drive costs out of the system, benefit of our customers and shareholders. We've realized \$86 million in productivity savings this quarter as the pandemic provided an opportunity for us to accelerate work that use technology more effectively and was safer to execute in a socially distant manner. Chris will speak more to this later.

In April, we received the decision from the Ontario Energy Board on the company's 2020-2022 transmission rate application, demonstrating Ontario's constructive regulatory environment. In this decision, the OEB approved approximately \$3.4 billion of capital expenditures, which will allow us to meet the necessary investments required for a safe and reliable electricity system. In order to advocate for more flexibility and relief for our customers, we asked to the OEB to defer implementation of the approved rate, which they have supported. By doing this, we are able to eliminate any increases to the transmission portion of the bill in 2020 at a time when relief is needed more than ever. We are pleased with their decision to allow rate deferral so we can minimize any further adverse customer impacts. The OEB will determine the collection period for our foregone revenue in a future decision.

Last month, we received a decision on our appeal to the Ontario Divisional Court regarding the OEB's decision on the deferred tax asset. The Ontario Divisional Court set aside the decision of the OEB in order that the matter be returned to the OEB to correct the error that was identified, and make the appropriate tax savings allocations. We are awaiting next steps from the Ontario Energy Board, but are pleased that the OEB did not appeal the decision at the Ontario Divisional Court. Chris will go into further depth of both the impact of this ruling on our financials.

We are further pleased with the path the government is taking on the implementation of the OEB governance structure. The recent leadership announcements strengthen the OEB, and we welcome the new appointees and the returning members. We look forward to working on behalf of customers and all Ontarians in a period of constructive rate regulation under their leadership.

In other updates, on August 1, we successfully completed the acquisition of the distribution and business assets of Peterborough Distribution, and we look forward for to completing the acquisition of Orillia Power shortly. We are pleased to have the privilege of serving both cities and their unique needs as they continue to see significant growth.

a visible advocate for our employees and has been instrumental in leading our human resources transformation journey. I would like to welcome Stacey Mowbray to the Hydro One Board of Directors. We all will benefit from her strong track record in leading successful publicly traded consumer brands and I look forward to working with her. With her appointment, our nonexecutive board maintains the ratio of 50% women and 50% men, which is a testament to our values.

In closing, the last few quarters have been positive for Hydro One. We are successfully executing the strategy that was released last year in November, and these efforts are bearing fruit. Our relationships with our partners and stakeholders have strengthened. We've received multiple favorable rulings from the legal and regulatory bodies. We've reached tentative agreements with our unions, and our customer satisfaction is higher than before. Hydro One is on a stable and secure path towards long-term success.

Over to you, Chris.

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**Christopher Felix Lopez** - *Hydro One Limited - CFO*

Thank you, Mark. Good morning, everyone, and thank you for joining us today during what continues to be an extraordinary time. I hope you and your families are, and will continue to be, safe and well.

Ontario recently entered Stage 3 of the province's 3 stage reopening plan, in which most businesses and public spaces have reopened with requirements to follow public health advice and workplace safety guidelines. We continue to remain optimistic that together, we will find a solution that will allow everyone to move forward with a new normal way of life in the not-too-distant future.

In terms of our financial results for the quarter, we saw an increase in basic earnings per share to \$1.84 compared to \$0.26 last year. Adjusting for the Ontario Divisional court decision regarding the deferred tax asset, on which I will elaborate later in the call, the adjusted earnings per share was \$0.39 compared to \$0.26 last year.

In addition to hotter weather positively affecting peak demand, there were a number of favorable events this quarter that have contributed to the higher adjusted earnings. In April, we received the 2020-2022 transmission rate decision, which included onetime items such as the recognition of revenues related to prior year conservation and demand management as well as transmission revenues related to the first quarter. Despite the marginal higher reported OM&A number, we saw a positive contribution from OM&A to earnings this quarter. Excluding the other post-employment benefits, which are recovered in revenue and, therefore, net income neutral, OM&A costs were lower despite additional COVID-19-related expenses. I am pleased with these results, which is a testament to the resiliency of our employees, our, continued commitment to reducing costs for our customers and the fundamentals of the underlying business.

Our second quarter revenue, net of purchased power, was higher year-over-year by 13.4%. As mentioned, the primary driver of the increase was the hotter weather this quarter, resulting in higher average monthly Ontario 60-minute peak demand. While COVID-19 and milder weather had negatively impacted peak demand in April, we saw substantially hotter weather in May and June, with year-over-year peak demand up 23% in May and 5% in June. This favorable weather pattern resulted in a year-over-year quarterly increase in peak demand of approximately 5%. We continue to see the hotter weather translate into higher peak demand in July, as the year-over-year peak demand increase by approximately 12%.

In addition, the transmission decision included revenues related to changes in approved rates. The recognition of other post-employment benefits that were previously capitalized and onetime items such as catch-up revenue for the first quarter, which is recognized this quarter, and the disposition of balances from the regulatory deferral and variance accounts not previously recognized. Distribution revenues net of purchased power were also higher by 4.5%, driven by improved rates as well as higher energy consumption in the quarter.

In response to the pandemic, we prioritized essential and high-priority work and deferred other work in April and May. We expect to complete the deferred work program within the year as our teams returned to full complement at the beginning of June. On an ongoing basis, I am pleased with our continued efforts to reduce cost for our customers and highlight the lower corporate support costs this quarter. Consistent with the first quarter call, the impact of the measures taken by Hydro One to support our customers, including the Pandemic Relief Fund, financial assistance and increased payment flexibility, extending the Winter Relief Program and the temporary suspension of late fees are not expected to be material. We continue to incur higher operating expenses in the quarter of approximately \$23 million related to COVID 19. This includes the temporary standdown of casual workforce and the purchase of additional facility and cleaning-related supplies.

The cost of COVID-19 on a year-to-date basis, including any impact from load, now total approximately \$46 million, which includes a \$14 million allowance for bad debt, which has been deferred.

We continue to track the impact of COVID-19 as directed by the OEB. The OEB has recently initiated a consultation process on the deferral accounts relating to the impacts arising from COVID-19. The consultation will assist the OEB in the development of appropriate accounting guidance as it assesses the policy direction with respect to the amounts

tracked and establishes the timing and process for disposition. The consultation process will likely conclude in late 2020 or early 2021. As such, we expect to receive definitive guidance on the COVID-19 tracking and deferral accounts in late 2020 or early 2021.

On financing, we saw a slight increase in interest expense due to a higher weighted average long-term debt balance as a result of the \$1.1 billion debt issuance in the first quarter of 2020. As a reminder, this issuance was completed at some of the most competitive rates achieved by our Canadian issuer. We remain very pleased with our strong balance sheet and robust investment-grade credit ratings.

The income tax recovery was \$849 million for the second quarter compared to \$6 million last year. The increase in income tax recovery was primarily attributable to the Ontario Divisional Court decision issued on July 16, which set aside the OEB ruling on the deferred tax asset. As a reminder, the deferred tax asset had resulted from Hydro One's initial public offering and its transition from the payment in lieu of tax regime under the Electricity Act; two, tax payments under the federal and provincial tax regime. While the Ontario Divisional Court decision concluded that it did not have the authority to substitute its own decision for that of the OEB, the court's order return the matter to OEB with clear directions. Though the decision was received in July, it was a subsequent event that required adjustments in the financial statements. As such, we have reversed the onetime charges taken at the end of 2018 and recognize an income tax recovery that has a onetime net income impact of \$867 million. Although a onetime item, it will result in an average annual increase in FFO in the range of \$50 million to \$60 million per year once the OEB has determined the path forward.

Due to the reasons discussed earlier, the effective tax rate this quarter was negative 326.5% versus negative 3.9% last year. Adjusting for the income tax recovery, our effective tax rate would have been 6.9%, which is consistent with our previous guidance of 6% to 13%. In the near term, our effective tax rate guidance is not expected to change. We will update you further once the OEB has determined the path forward.

Moving over to investing activities, the company placed \$165 million of assets in-service in the second quarter, a 40.2% decrease to the prior year. This was largely a result of higher in-servicing of station sustainment investments at several transmission stations last year and lower volume of overhead lines and component replacements in the second quarter of this year. We also in-serviced a substantial portion of the development project at Brant transmission Station in the second quarter of 2019.

Capital investment for the second quarter was \$429 million, which is a 15.9% increase from the second quarter in 2019. The increase was mainly due to higher investments in multiyear development projects for the transmission business, the construction of a new Ontario Grid Control Center

best efforts for a full recovery in the latter part of 2020.

As promised in our first quarter call, we have updated the future capital investment forecast to reflect the changes arising from the transmission decision as well as the Peterborough acquisition. The table will be updated next quarter with the expected closing of the Orillia acquisition. The changes do not materially impact our long-term capital investment growth rate or our long-term rate base growth.

Productivity savings of \$86 million in the second quarter represented a 61.7% increase year-over-year. Productivity improvements were a result of ongoing work in labor force efficiency and the previous rollout of technology solutions in the forestry, corporate and customer service areas. While we deferred some work programs with larger work crews to later in the year, the pandemics provided a unique opportunity to accelerate work that used technology more effectively and was safer to execute in a socially distant manner. This resulted in higher productivity being realized in the quarter. For the remainder of the year, we do not expect the same run rate as experienced this quarter as we revert back to the cadence of our regular work program.

Subsequent to the end of the quarter, on July 16, we received a final rate order from the OEB on our 2020-2022 transmission rate decision. The OEB accepted Hydro One's proposed reductions to in-service additions included in the draft rate order. As a reminder, since the capital reductions were predominantly in the sustaining category, we expect the deferred portion of capital to be deployed in our next rate application. As Mark mentioned, we were pleased that the OEB agreed to defer the implementation of approved rates in support of our customers. While there is no impact to net income, collection of our 2020 forgone revenue will be determined in a future decision from the OEB.

On the acquisition front, I am pleased that we successfully completed the purchase of the business and distribution assets of Peterborough Distribution from the city of Peterborough on August 1. We also continue to make good progress and expect to close the acquisition of Orillia Power Distribution Corporation from the City of Orillia in the third quarter of this year.

Finally, at this time, we do not see a change to the guidance we issued at our Investor Day and reaffirmed in last quarter's call. While due to COVID-19 we had prioritized near-term capital delivery to work that is essential, we are confident that we will complete the capital program as committed over the rate period. Further, considering the impacts of COVID-19 and the recent decision on the 2020-2022 transmission rate application, the approval of the Orillia Peterborough acquisitions, we continue to be committed to and affirm our guidance of 4% to 7% earnings per share growth through 2022.

I'll stop there, and we'll be pleased to take your questions.

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**Omar Javed** - *Hydro One Limited - VP of IR*

Thank you, Mark and Chris. We ask Shannon to explain how she'd like to organize the Q&A polling process. In case we aren't able to address your questions today, my team and I are always available to respond to follow-up questions. Please go ahead, Shannon.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question comes from Ben Pham with BMO.

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**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

Yes. Chris, do you want to take that question?

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**Christopher Felix Lopez** - *Hydro One Limited - CFO*

Sure. So I think the last comment I had in my opening remarks was that we've reaffirmed our 4% to 7% EPS growth over that time. So we're still very comfortable that the rate base CAGR is in the upper 4s. So yes, we did reduce it, but it was very marginal. The reduction that you just saw that was put through, it was a net impact of the transmission rate case, which is roughly a 10% reduction in capital expenditure, but still approval of 90% being more than \$3.4 billion of CapEx over the next 3 years. And then secondly, we updated for the acquisition of Peterborough. So in short, we're very confident in the upper 4s just on rate base growth. And then you add on any of the other growth that we get out of our potentially over-earning and our unregulated business, which is a smaller part.

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**Benjamin Pham** - *BMO Capital Markets Equity Research - Analyst*

All right. That's great. And I'm not sure how much more detail you can provide on some of the trends you're seeing in volumes, the data you see July up also quite a bit. But it is quite interesting to see volumes move up quite a bit during COVID-19. So is there any way to normalize some of the demand for weather conditions you're seeing? And is there anything -- maybe just highlight what you're seeing in terms of your customer mix and what's been occurring within each of the customer classes on demand?

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**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

Ben, it's Mark here. I'll maybe start with that. And Chris, if you want to add in, you can go ahead. There was a recent call with the IESO, a stakeholder engagement meeting, when they really talked about what they're seeing across the province for loads between the different customer classes. So on the residential side, we're actually seeing about a 10% to 15% increase in daily peak volumes during these heat waves relative to pre-COVID demand. So on the residential, it's -- the heat has really had an impact on the loads for small commercial daily peak and energy reductions of about 4% compared to pre-COVID period. And then for the large commercial and industrial, we're seeing recent increases in consumption since Stage 2 reopening. However, the demand for this segment is still slightly below the pre-COVID levels.

So to summarize, really, our residential loads are increasing, obviously, a lot driven by the fact that people are working from home, a lot of people. And the heat, small commercial, slight decrease in consumption there, which, as the economy reopens, we expect that to start to recover. And the same thing with the large commercial and industrial, but have seen that demand increase in that quicker as stage 2 is reopening.

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**Christopher Felix Lopez** - *Hydro One Limited - CFO*

Yes, Mark, I'll just add a couple of comments. I think you're correct. We did see in July another increase, this is all publicly available information, from the IESO. So peak load was up 12% to 13% for the month of July, and we've seen a very strong start to August. So it is a trend that's continued. No doubt the warmer weather has added to that. But I think the underlying shift from where we consume our power hasn't been as -- I think some of the assumptions early on that we saw from other countries was that load will drop 10%. We simply haven't seen that.



starting to normalize, we should see that continue, and, in fact, we have in July and August.

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**Operator**

Our next question comes from Julien Dumoulin-Smith with Bank of America.

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**Julien Patrick Dumoulin-Smith** - *BofA Merrill Lynch, Research Division - Director and Head of the US Power, Utilities & Alternative Energy Equity Research*

Wanted to follow-up a little bit on cash flow. I mean, obviously, there's some gyrations, as you already alluded to here. But can you speak to how the GTA might start to flow in and how you think about the future use of these cash benefits, just broadly?

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**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

Yes. Chris, do you want to talk to that?

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**Christopher Felix Lopez** - *Hydro One Limited - CFO*

Absolutely. So thanks, Julien, and thanks for the question, and good to see you -- here from you again. Overall, what we've done so far is we've received a decision that says it's a divisional court that says, look, the money will be returned to shareholders based on that decision. So that's \$867 million. The next phase of this is the court will issue an order. So the time has expired for an appeal and the court would now issue an order that is very specific to the OEB. The OEB will go through a process to confirm that they've corrected and then there'll be a process by which we work out when it gets put in rates.

There are a number of options there. They could ask for an update to a rate order that's in place today or possibly the more likely scenario would be to ask us to consider the return of the DTA at the next rate order. And that could be as late as 2022. So that's the next -- the end of 2022 going into '23. So that could be the next period for this. So it's uncertain, Julien, as to exactly when we would start to see the cash flow benefit of that. I would say it would be no later than '23 on, which is the next rate case. It could be sooner, but that would depend on the OEB process.

As for what we would do with that, the benefits would be \$50 million to \$60 million near term. So let me say near term, that's the average run rate of the DTA going forward. But recall that we've already been sharing the benefits with existing rate payers today. So by the end of 2022, that could be as high as \$300 million. As it stands today, it's approximately \$150 million. So if you add that on, that could increase the DTA cash flow benefit for a period of time, up towards the \$100 million mark. But the long-term projection is around \$50 million to \$60 million per year.

As for what we would do with that -- Julien, as for what we do with that, it's probably too soon to call. It would depend on when we get it and when it starts coming through. But then clearly, we'd look at our position on FFO, and that would put us in a much stronger position and give us more ability with our balance sheet. So we'll have a look at that and determine that at that point.

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**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

Yes. It's Mark here, Julien, welcome. And so I'll start the response to that question. Really I think communities right now are focused on COVID and how they're going to reopen and restart their economies as well. We are working with those communities. Many of them are our customers. So we're we're working to support them through COVID and do what we can do to help support that. What they might do with their local utilities in the future as a result of the impacts of COVID is still yet to be known. We -- obviously, if one is willing to to divest their municipal assets, we would be interested in looking at those. But at this point, we're really just looking at supporting those communities throughout COVID, and we'll work with them in the future.

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**Operator**

Our next question comes from Linda Ezergailis with TD Securities.

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**Linda Ezergailis** - *TD Securities Equity Research - Research Analyst*

Just a follow-up question with respect to shifting load. As you see residential load having increased and not affected as much as initially contemplated potentially, how might this shape your capital expenditures? Are there any projects maybe that might be accelerated? Are there some that might be deferred or are less of a priority? Or do you think it's still too early to tell kind of how structurally loads might be shifting over the longer term?

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**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

I take that in the short term, there isn't a lot of change. We have our approved rate filings from now to 2022, and those are based on our capital investments, and that hasn't changed. And we don't expect that to change. So in the short term, I don't see an impact. I think the longer-term impacts of COVID on demand and load and requirements for new infrastructure is still yet to be seen. I think there is an opportunity for investment in the electrical system as part of economic recovery for the province. And we will be working with the others in the sector, the IESO and government, on putting our ideas forward on where some prudent investments in the system could help with recovery from COVID. But in short, we have approved rates for both Dx and Tx based on our capital investments from now until 2022, and I don't see that changing.

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**Linda Ezergailis** - *TD Securities Equity Research - Research Analyst*

And maybe you can just help give us an understanding of the recent Power Workers' Union's settlement that was announced. How might this change your cost and cost trends? And does the tentative settlement provide for any additional flexibility as it relates to use of technology or potentially outsourcing. Can you comment on attributes beyond just the cost?

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**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

We do have a tentative agreement with the PWU for both the customer service operations and the main PWU agreement, which represents a large portion of our employees. It is premature for me to speak about the details of that, because those agreements haven't been ratified. We're expecting the customer service to be ratified in early September and the main agreement to be ratified in October, at which time we'll be more free to speak about the elements of those agreements.

**David Quezada** - *Raymond James Ltd., Research Division - Equity Analyst*

My first question here, just on the topic of productivity savings. Obviously, you had another really strong quarter there, and there were some technology additions that drove that. Could you just maybe talk about how you're tracking versus your targets and what you see as the runway for additional savings going forward?

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**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

Yes. As we've talked about in the past, really, what we're trying to do with our productivity savings is essentially offset inflation. So that means about \$50 million a year in productivity savings increases. And we saw a fairly good increase in our productivity savings in Q2. A lot of that driven by our ability to deploy technology, which I think COVID helped to accelerate and our move to mobile with a lot of our forestry teams to iPads in their hands, dispatching crew resources using electronic means has really helped us. The other area that we saw improvements in Q2 is incremental customer service savings, which came as a result of our call center in-sourcing, and settlement of settlements, which is another element of our call center, which we've brought back into the company, and we're seeing savings as a result of that.

As well on the capital front, we saw incremental fleet rationalization. We accelerated our overtime reduction in transmission stations, and we saw increased wrench time in the move to mobile. So right across, we saw quite a bit of productivity improvement in Q2. The other area was we increased our procurement during Q2 as we stockpiled some resources and materials, like poles and transformers, which, as a result of COVID, has -- we wanted to make sure we had enough stockpile. So we got the incremental productivity savings as a result of improved volume-wise.

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**David Quezada** - *Raymond James Ltd., Research Division - Equity Analyst*

That's great color. And then just maybe 1 other one. I appreciate it's not a huge part of your business, but the unregulated side. I'm just wondering if you can update us where you are with the charging network and maybe any news on the fiber optics side of the business?

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**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

Yes. Chris leads our growth portfolio. So I'll ask Chris to speak to those.

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**Christopher Felix Lopez** - *Hydro One Limited - CFO*

Yes. I'll take telecom first, which is the fiber optic question. So overall, we've seen our telecom revenue is quite strong. Part of our plan is to grow that business. So growing that business with new products has been a little more challenging in this period. So when you think about the longer term, it has been impacted slightly here in Q2 and Q3, but we think we can recover that. But the positive side is we've seen a higher demand for our services in regards to short-term telecommunications needs by corporates. So that has actually underpinned our profitability in that business quite well for this year. So we've seen that. We're back on track there.

In regards to the Ivy Charging Network, we continue to expand our partnership there with Ontario Power Generation, OPG, and it's going very well. We had started with fast charging units. And now we're looking at some of the slower charging units that would be used in residential and sort of noncommercial uses. So that business continues to grow at a very good rate for us. The only thing I remind you overall is that it's not a big component of our business. Remember, 99% of our earnings comes from regulated sources, and that will continue to be the case for some time to come. But on the unregulated side, some of those things are presenting themselves quite well.

**Robert Hope** - *Scotiabank Global Banking and Markets, Research Division - Analyst*

First question, just on Mark's comments about the potential of infrastructure spending as a measure of stimulus during COVID-19. How would that occur under your incentive framework? Or would there have to be an overlay there?

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**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

Yes, Rob, good question. This is Mark here. So I think it's early on to figure out how that would work with the OEB. If the IESO directed us to build additional infrastructure as a result of economic stimulus, we would have to work with the IESO and the OAB on whether it would be incremental above our approved capital program or offset somewhat within. So I think it's pretty early on to determine what that might look like. We're really just putting forward opportunities for where we see there is load growth and the need for additional infrastructure. Particularly in the Southwest, we're building 1 new line in infrastructure to feed the greenhouse industry down in the southwest of Ontario. But we haven't even built that and it's fully subscribed by customers already. There's opportunity for more growth there as well as in the mining sector that we see that there's opportunity in the northwest for mining and additional infrastructure to support that. So early days, we're putting things forward that we think might be helpful. How that might be rolled into rates and into our capital program, we'd have to follow all of that.

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**Robert Hope** - *Scotiabank Global Banking and Markets, Research Division - Analyst*

And then secondly, how are you thinking about your COVID costs that you're tracking, including bad debt? Have those actually started to pick up? And then as you go into the consultations with the OEB, how do you kind of discuss the fact that you're actually seeing OM&A large savings versus the increasing COVID costs as well as the strong results so far?

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**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

I think part of what's happening right now with the cost recovery or the cost collection accounts is we're working with the others in the sector, and we will work with the OEB on how do you separate the impact of COVID from the day-to-day impacts of weather and things like that. And that's not clear to us yet, even on the revenue side, as to -- how do you separate those things. So part of the consultation process will be to get some clarity on how each of the utilities in the province will capture and dissect those costs. And then at that point, the consultation will turn to what might be appropriate for recovery in the future from the utilities. So again, pretty early on, we are in consultation. We aren't expecting really the clarity on what it might look like until late 2020, early 2021. So we'll continue to work with the others in the sector and the OEB through that and update you guys as we go along.

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**Christopher Felix Lopez** - *Hydro One Limited - CFO*

Rob, it's Chris. Just a clarifying follow-up there. I think you started the question with costs starting to accelerate. Just in regards to bad debt, we have not seen that. Bad debts have remained very flat. In fact, they're slightly down on last year. So we made a provision in Q1 for \$14 million, and we kept that. We did not change it. There's still a ways to go here in terms of COVID-19. So we've kept that for now, but we've not seen an increase in bad debt from that period.

In regards to cost, we did see an increase in this quarter of \$23 million. That was primarily at the front end of Q2. So at the back end, it's really slowed down here. So we do not expect that run rate to continue. Now again, if you end up with a second or third wave, that could change. But for now,

Our next question comes from Mark Jarvi with CIBC Capital.

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**Mark Thomas Jarvi** - *CIBC Capital Markets, Research Division - Director of Institutional Equity Research*

Chris, I thought I heard you say that inside the distribution utility that some of the lower OM&A came from standing down in crews and a little bit of reduced activity. Maybe can you help parse apart how much that contributed in the quarter? And maybe what would be a more normalized OM&A for the distribution segment this quarter?

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**Christopher Felix Lopez** - *Hydro One Limited - CFO*

Thanks, Mark. I wouldn't -- so I think if you think about the questions on productivity, we were able to accelerate some productivity from later in the year. So I don't expect that same level of productivity we achieved this quarter to continue at that rate for the balance of the year. In the first half of the year, if you add up the status of Q1 and Q2, we had quite an impact on productivity. So that's been a large source of the OM&A savings here in Q2. So I would still expect us to -- what you should see is COVID-19 costs sort of drop away now and then some of our work programs pick up. But I would expect our run rate to stay roughly similar. So that's probably the best way to look at it, Mark, is that -- and I was hinting to that a second ago when we talked about COVID-19 costs being heavily weighted to April and May.

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**Mark Thomas Jarvi** - *CIBC Capital Markets, Research Division - Director of Institutional Equity Research*

Okay. And then are you able to provide any sort of color around when you think about when trends are favorable, whether it's lower storms or weather and you can try to get ahead on OM&A, whether or not that transmission and distribution? But how much flex do you guys have in a given year in terms of how much you can manage OM&A costs?

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**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

Yes. It's Mark here. As we've talked about in the past, really, we tried to manage and achieved \$50 million in productivity savings. We do have expectations by the OEB that we complete our work programs during the rate period, which, in this case, for both Tx and Dx goes until 2022. So we do have flexibility within that rate period to advance and/or move work in and out of a particular year, provided we achieve our overall objectives by the end of the rate period. So we do look at the flexibility based on what's happening within year to move work from period-to-period with the objective of completing all our required work and achieving the outcomes that we've committed to, to the OEB by the end of the rate period.

Chris, do you have anything you want to add to that?

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**Christopher Felix Lopez** - *Hydro One Limited - CFO*

Yes. I think the other 1 -- the only thing I would add there is that we have some demand programs like customer connections, stores and so on. So we will be conscious of that also. So we will flex our work program to absorb those additional costs. And when those costs are not there, we can accelerate some of the work program that we had for future years. So we do have that flexibility. We assess that quarterly, depending on what happened in the quarter and what we see happening for the balance of the year. So we have quite a bit of flexibility there to do that work.

**Christopher Felix Lopez** - *Hydro One Limited - CFO*

We saw -- what you saw was transmission was more just the case of -- when we looked at the work that we could do safely and in an isolated manner, we focused on those kinds of activities that could be done safely for all our staff. So we accelerated some work from later in the year that allowed us to do that safely. So that's what you saw in the quarter, not necessarily a focused effort on bringing costs forward from a future year.

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**Operator**

Our next question comes from Robert Kwan with RBC Capital Markets.

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**Robert Michael Kwan** - *RBC Capital Markets, Research Division - MD & Energy Infrastructure Analyst*

Just wondering if you could talk about your interactions with the government, both the operational as well as from a rate perspective, generally, but a couple of things I'd be interested in your thoughts specifically. First, whether it's operational just spending, your thoughts on Bill 171 and whether -- or if you can quantify what you think the cost or the rate base impact to that would be?

And then as it relates to rates, have your discussions ever moved or incorporated your thoughts on the generation mix and the cost of generation, notwithstanding you don't have any, but that maybe positions you as a little bit more of an independent expert as it relates to just optimizing kind of the mix of -- within the customer rate basket?

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**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

Yes, Robert, it's Mark Poweska here. Maybe I'll talk in general about interactions with government, focuses that I'm seeing from government right now. And probably no surprise to you that the government is really focused on the impacts of the pandemic and how they can support the electricity customers across the province. And so they've been taken several actions as a result of that, including holiday from the time of use rate fixing that, eliminating or freezing the industrial conservation initiative, which is really targeted at not penalizing large industrials for using energy at peaks because the fact that we are in energy long and capacity long right now. And they don't want them to ramp back and slow down the economy by doing that. So they're trying to incent the use of energy to get the economy going.

So there's a lot of things that government is looking at right now, and we've seen the actions they've taken, which is really around supporting customers and restarting the economy. There hasn't been a lot of chatter lately around what they're doing with rates long-term and what they want to do with the global input or global adjustment. But I suspect at some point, they will turn to that. The bill provides a mechanism by which utility companies may be required to move utility infrastructure, if necessary, for the transit. So we are working with the transit authorities to make sure that we're doing our part in order to not hold up the investments in the transit infrastructure, particularly in downtown Toronto.

So the risk to utilities is that if the utilities delay projects, some of the costs can be passed on to the utilities. So we're working very closely with Metrolinx and the ones that we're associated with, to make sure that we're in lockstep with them so that we don't have a risk of some of those costs being passed on this.

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**Robert Michael Kwan** - *RBC Capital Markets, Research Division - MD & Energy Infrastructure Analyst*

Got it. And do you expect to see any major move into facilities that would be larger kind of tickets as part of 171?

**Robert Michael Kwan** - *RBC Capital Markets, Research Division - MD & Energy Infrastructure Analyst*

And if I can just finish with some of the COVID costs. You've highlighted your cost to date and largely being able to offset that by what seems like more timing on the OM&A. So as you kind of push that back into the second half, can you talk about -- I think the number was \$46 million incurred to date? How much of that do you think you will not be able to offset? And as you get into the consultation process, being the largest LDC, what's your position on just looking to recover the straight out COVID costs versus whether it's any cost to offset or bringing things that have benefited, like weather and residential use, into this, just to kind of minimize it on a net basis?

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**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

Yes. I'll start it, and then I'll ask Chris to talk about the OM&A costs. So as I said earlier, we will work with the OEB and the others in the sector on the 3 cost recovery counts that they've set up. And just for a reminder, that's -- one is looking at the cost for us to make the billing changes. The other is looking at revenue. And the third is looking at miscellaneous costs such as bad debt. So we will continue to work with the OEB on that. And as we get more clarity on how that will be calculated and what parts of that might be recoverable in the future, we will share that with you.

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**Christopher Felix Lopez** - *Hydro One Limited - CFO*

Robert, I'll just clarify something there. So the \$46 million that you're quoting, that's the total -- the subtotal of what we've tracked to date and reported to the OEB. And every utility is doing that, by the way. So in that number, there's \$14 million of bad debt. So we've dispersed that essentially, but that's related to nonrecovery of revenues. And then the remaining part is mostly OM&A. So we had \$5 million from Q1, which we reported in Q1 and \$22 million in Q2. There was a small amount from lost revenue. That was \$4 million, but, a minor amount. So \$28 million is the largest piece, which is OM&A. And like I said, we do not expect that to continue to increase at the rate you saw in Q2. There might be some small flow through costs in Q3. Our first job is to minimize that as much as possible, and that's what we're doing to the extent we can offset. And then we need to look at the way that you calculate the net impact of COVID-19. So part of it is the actual impact, but then are some savings from potentially doing things differently. So how much of that gets ascribed to COVID-19.

The ideal situation is if the industry could offset overall. But again, that will come through the consultation process. And not every utility has the same ability to do that. Where we can do that, we'll lead by example. But we're not expecting every utility to be in the same position that Hydro One is.

The second part is we need to look at the impact on load, given that we've had a very positive weather impact. So how does that sort of get squared away with COVID-19? We've not been reporting impacts on loads for COVID-19, even through the tracking accounts. We want to discuss that through the consultation process and ensure that we're all aligned. But that going to affect transmitters as well as generators, as well as distribution units. So we're going to take part in the consultation process that comes out. But right now, our focus is on minimizing those costs as far as we can.

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**Operator**

Our next question comes from Andrew Kuske with Crédit Suisse.

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**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

Yes, great question, Andrew. And you're right, we do want to be higher. We are at some of the highest we've seen in customer sat and a lot of that's driven by the support we've been giving our customers and the improvements we've made in our in our customer service, both in the call center as well as in our connections processes. So we are seeing a good improvement and an increase. We're actually looking at how we can benchmark to other utilities across the sector. Both in Canada and the U.S., there isn't actually a good consistent way in which utilities measure customer satisfaction, which we've found so far. So we're working on what that might look like. And we're also working through the Canadian Electrical Association to see if we can standardize that, at least, across the Canadian utility so that we can know how we compare to others.

The reasons why customers are satisfied with us so far is really kind of improvements in our time to restore power outages or improvements in reliability. The work we've been doing for advocating for customers such as our relief measures for COVID as well as trusted partners we've been lobbying for or advocating for customers with things like off-peak time of use pricing and now we're working with governments to provide some relief for customers.

Areas that we can improve so that we can drive up our customer even higher is improving our tree, talarian and maintenance efforts. So we've been doing that through our oC Pre Met program, but we will continue to do that. And obviously, electricity prices, even though, we're a small percentage of that, it continues to be on the customers' minds. So I don't have a target yet, but we are looking at what is a good comparator way of consistently measuring customer satisfaction that we can compare to other utilities, and we hope to have something on that -- this year on that.

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**Andrew M. Kuske** - *Crédit Suisse AG, Research Division - MD, Head of Canadian Equity Research and Global Co-ordinator for Infrastructure Research*

That's great color. And when you think about that collection of activities and efforts you've had through the system and your customer base, is that part of your calling card when you have M&A discussions with other munis around the province?

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**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

Yes. We think that our results are demonstrating the value that we can bring to the table, and we can bring to the table for other LDCs. And it's not just us saying it, it's our customers telling us that now with some of the highest customer sats scores as well as our proof points such as our productivity improvements and things like that. So absolutely, Andrew, I think that demonstrating that we're the best of what we do is a good way to incent others to look at us as a either a partner or possibly a good acquirer of their assets.

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**Operator**

Our next question comes from Patrick Kenny with National Bank.

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**Patrick Kenny** - *National Bank Financial, Inc., Research Division - MD*

Just on the back of the strong quarter here, thanks to weather, plus the positive impact to FFO still to come here from the DTA decision. Can we just get a refresh on how much dry powder you see there being on the balance sheet to pursue LDC consolidation opportunities over, say, the next 12 to 18 months?



**Christopher Felix Lopez** - *Hydro One Limited - CFO*

Sure. So I think definitely a strong quarter, but a strong quarter really just underpins the current position that we've always set around our FFO. So to maintain the current ratings, we need to stay above 11% FFO to debt. We are comfortably above that at this moment in time. The benefit from the DTA decision won't be factored into our FFO to debt calculation until there is certainty around when the DTA will be recovered through rates. So as I said in 1 of the earlier questions -- in response to 1 of the other questions is that could be as late as 2023. So it's too soon, Pat, as to call what that dry powder is. We have enough flexibility in our balance sheet today to continue to acquire the smaller LDCs in Ontario, and I think that's where we can deliver the most value in 2, 3, 4, 5 [in] years if we wanted to. So there is no restriction there. That's not a limiting factor for us. And any particular uptick from the DTA is still some time off. So it's too soon to give you a figure on just how much flexibility that will provide.

**Patrick Kenny** - *National Bank Financial, Inc., Research Division - MD*

That's helpful. And then over on the ESG front, as you look to establish more concrete targets this year, such as GHG reductions, I know most of your emissions come from your vehicle fleet. But curious as you continue to switch certain customers over from propane to electricity, if that will count as a net reduction to your emissions? And I guess, just maybe how material this switching opportunity might be for the company from a load standpoint, say, over the next 5 years?

**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

Yes. Good question. I'm not sure I have the details for the answer to that. Right now, our GHG emissions, the main sources, as you point out, one is our fleet. The other is we do have diesel generation for some of our non-integrated or off-grid facilities as well as SF6 gas, which is an insulating gas we use in our equipment. So those are the 3 big areas that we're going to look to offset and set targets on how we can reduce those.

The switching from propane to electricity because it's not included in our base GHG emissions right now, we'll have to determine on how we take credit for or if we take credit for that, the reduction in GHG as a result of that switch. Right now, we're seeing a small uptick in our fuel switching program. So getting off of either fuel gases or oil-based heating or propane to electricity, I don't see it as a big part of future growth or a big part of our GHG focus, but it's something for us to think about, Patrick.

**Operator**

Our next question comes from Mona Nazir with Laurentian Bank.

**Mona Nazir** - *Laurentian Bank Securities, Inc., Research Division - Director of Research and Transportation & Infrastructure Analyst*

I'm not sure if you have this, but just looking at the runway of potential LDC consolidation and targets, what kind of cumulative growth do you think that could bring in? Perhaps another way to think about it is even on an annual basis, is there a number of targets that you have in mind, whether that's 1 or 2?

**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

Yes. Chris leads our growth portfolio. So I'm going to ask Chris to speak to that.

does come down to that.

I think Mark answered the question previously around COVID-19 and the pressures they may be facing. Right now, really, we know municipalities are focused more on helping their residents in ensuring there's safe and reliable power, just like we do today. So we're really helping support them as we go forward today as a customer of ours that's normally within our service territory. And then we can help them in any other way as we move forward. We stand really and able to partner with any of them. And we'll continue to be there.

In terms of the opportunity that's left, there is around \$9 billion of rate base left in the province that is not in the hands of, say, Hydro One or an Electro, where there's a consolidation of smaller LDCs. The largest of which is Toronto Hydro, so if we exclude that, there's around \$5 billion just under of smaller LDCs around the province, ranging anywhere from tens of millions up to over the \$1 billion mark -- or close to \$1 billion mark out of Ottawa. So they're all -- we'd be willing to speak to all of them. It's just a case of when does it make sense, and how do we bring the most value to the municipality and the rate base. We did talk a little bit about our balance sheet. Our balance sheet can support a lot of these smaller roll-ups if and when they occur. Right now, for this year, we're focused on closing Peterborough and Orillia. We just closed Peterborough here in August. Orillia will be in September or in Q3. We want those to be very successful acquisitions, again, to further demonstrate how we partner and benefit the communities in which we we work and we supply power.

So that's our focus going forward. There is no specific number, Mona, but there's around \$4 billion of rate base there, 4 to 5 that we think is available when the time is right for both parties.

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**Mona Nazir** - *Laurentian Bank Securities, Inc., Research Division - Director of Research and Transportation & Infrastructure Analyst*

Perfect. That's very helpful. And just lastly, I'm wondering if you could share perhaps 1 of the biggest surprises or takeaways when you've been dealing with COVID impact on the overall business?

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**Mark Poweska** - *Hydro One Limited - President, CEO & Director*

Yes. It's Mark here. Maybe I'll just inform on that one. And really, I was impressed with the organization's ability to quickly transition to working from home and our deployment of technology to enable that working-from-home as well as our crew's ability to safely get back to work fairly quickly after the pandemic broke out, and we put our safety measures in place. So I've been proud of and impressed with the organization's ability to adapt overall. I also think it's really accelerated our use of digital tools and technologies that we've been using or looking at for a while. And this has really provided an opportunity or otherwise forced us to really use those. And I think some of those will stick long-term and provide long-term benefit.

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**Operator**

Our last question is from me as Elias Foscolos with Industrial Alliance.

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**Elias A. Foscolos** - *Industrial Alliance Securities Inc., Research Division - Equity Research Analyst*

With respect to the revenue beat -- or sorry, the strong year-over-year revenue, I guess, in Q2, you attributed the majority, I believe, to the warmer weather. But wouldn't it be more accurate to, call it, the warmer weather plus the combination of load shift to residential?

The overall consumption is how much energy our customers use and the customers of the other LDCs use is dependent on the sector, as I talked about before, whether that be residential, commercial or industrial. It's a different story for each of them. So I think dissecting, as I said before, what are the impacts of COVID versus what are the impacts of the hotter weather and how do you separate those out, is something that we'll work through with the other utilities as well as the OEB going forward.

Chris, do you want to add to that at all?

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**Christopher Felix Lopez** - *Hydro One Limited - CFO*

Sure. Elias, so I would say, if I look at revenue overall, an amount of that did come from, we say, volume, which is the higher peak demand. So what drove that. It appears to be primarily -- where they're not increased consumption, it could be a shift in load about when we're using those peaks now with more people being at home. So we could be changing the shape of the peak. But not particularly higher load consumed at home. I'll just remind you that a chunk of our distribution business is fixed. So for example, if you consume more power, there's a flow-through cost of power. So that doesn't come to Hydro One. So we buy the power, but we just flow that through. So there is no increase in net revenue to Hydro One as a result of that.

But there's a second part of that, which is when we received our decision on transmission -- we received it in Q2, and we received a number of onetime benefits from that. So we talked about conservation and demand management revenue. So once that decision was received, we're able to book that. But that relates to prior years. And then we're also able to book catch-up revenue from Q1 because the decision didn't come to Q2. So I would say roughly half of it comes from these onetime benefits that was just the timing of the decision and the other half comes from peak demand, which is not increased consumption but it's a change on where the load peak has occurred. So I would say it's about 50-50 is the way to answer that question.

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**Operator**

And that does conclude our Q&A session for today. I'd like to turn the call back over to Omar Javed for any further remarks.

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**Omar Javed** - *Hydro One Limited - VP of IR*

Thank you, Shannon. The management team here at Hydro One thanks everyone for their time with us this morning during what is definitely a busy period. We appreciate your interest and your ownership. If you have any further questions that weren't addressed on the call, please feel free to reach out, and we'll get them answered for you.

Thank you again, and enjoy the rest of your day, and be safe.

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**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.

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