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EDITED TRANSCRIPT

H.TO - Q3 2015 Hydro One Ltd Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Hydro One Third Quarter Results Investment Community Teleconference. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions will follow at that time. (Operator Instructions). As a reminder, this call may be recorded.

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

Bruce Mann - *Hydro One Inc. - VP, IR*

Thank you very much, operator. Good morning, everyone. Thanks for joining us. I'm here with Hydro One's President and CEO, Mayo Schmidt, and our Chief Financial Officer, Michael Vels. We're going to provide some brief comments and background to the third quarter results, and we'll talk a little bit to the recapitalization and the public offering, both of which fall in the quarter, and then we'll spend the majority of the call answering as many of your questions as time permits. There is also several slides, which illustrate or support some of the points we'll go over in a moment. They should be up on the webcast now or if you're dialed into the teleconference, you can find them on the Investor Relations section of the Hydro One website.

I just wanted to point out that the results that we reported this morning of Hydro One Inc., which is a wholly owned subsidiary of Hydro One Limited, the results for the quarter ended September 30th, all of which occurred in advance of the initial public offering of Hydro One Limited shares, which we completed last week. And Hydro One Inc. is today the operating subsidiary, which olds all the regulated assets, which is approximately 99% of the consolidated business as well as of the outstanding borrowings of that entity.

So, from the fourth quarter, going forward, Hydro One Limited will be the reporting issuer to the common shareholders, although both companies will continue to issue public statements. As the discussion this morning will undoubtedly touch on estimates or other forward-looking information, you should review the cautionary language in today's earnings report, that in our 2014 Annual Report and in our IPO prospectus, which was filed two weeks ago regarding the various factors and assumptions and risks that could cause our actual results to differ. All of those cautions apply equally to our dialogue on the call.

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So, with that, let me turn it over Mayo and then Mike, and then we will be pleased to take your questions. Go ahead, sir.

Mayo Schmidt - *Hydro One Inc. - President, CEO*

Thank you, Bruce. Good morning, everyone. In addition to the third quarter financial results that represented strong increases from the prior year, the company has made progress on a number of fronts. We recently completed a successful initial public offering, and the company is now an independent public company with new senior management and a fully independent board of directors. We have a high quality institutional shareholder base, and there was substantial retail demand to which 40% of the IPO shares were allocated.

Many of our new shareholders are also our customers, as we had a very significant demand from the Ontario residents. As we have the opportunity to communicate during our many investor meetings associated with the IPO, the new board and management see tremendous opportunity at Hydro One to introduce transformational change, create a tier 1 cost structure to significantly increase customer focus and to deliver on prudent and profitable growth strategies.

We've had the opportunity to transform Hydro One into a respected Canadian champion that contributes to the communities in which we operate and continue to sharpen our commitment to service and reliability for our customers who are the basis of our business and the foundation of our future success. As you can see on slide three and four, the core of Hydro One is an unmatched base of essential energy infrastructure that powers Canada's biggest and most diverse provincial economy.

Our cost businesses produce excellent cash flows that are highly predictable and growing, and they have the potential to grow faster as we drive improved performance and cultural change. This is a tremendous base upon which to grow, and that's exactly what we intend to do for the benefit of our customers, employees, shareholders, and the Province of Ontario.

For those of you on the call that might not be deeply knowledgeable of our business, Hydro One is one of the largest electric utilities in North America. And our scale and leadership position in Ontario gives us multiple competitive advantages.

We operate in one of the most stable and transparent regulatory environments in Canada. Our rate base is growing as much of Ontario's electric transmission and distribution infrastructure requires significant upgrading and enhancement due to its age, and there are increasing requirements for new and extended transmission links to new generation sources of renewable energy being put into place.

Over and above the rate base growth, we will continually seek greater efficiency in cost savings from economies of scale, productivity improvements, the use of new technology and systems. These cost savings will benefit our customers through lower rates and can benefit shareholders in various forms of incentive regulation.

With assets of $23 billion, Hydro One is both the largest electrical transmission and distribution business in Ontario. Our core businesses are stable and 99% regulated. We operate more than 29,000 circuit-kilometers of transmission lines, servicing both the industrial and the retail sectors, and we span a geographic area larger than the State of Texas. And importantly, we have a strong investment grade balance sheet with an A category credit rating, which provide us with some of the most favorable debt capital cost in the industry.

And we have laid out on slide five, our transmission business is one of the largest in North America. And we operate 96% of Ontario's transmission network with electricity supplied by 116 generators, including from hydroelectric, nuclear, gas, wind and solar sources.

Hydro One's distribution business, which you can see on slide six, also serves the vast majority of the province's geography where we deliver power in more than 1.3 million residential, industrial, and business customers. We expect to continue to expand our distribution footprint opportunistically through accretive tuck-in acquisitions, which we have a multi-year track record of successfully executing.

We operate in a union environment. We have the benefit of recently settled collective bargaining agreements with both of our major unions. These agreements incorporate net zero cost elements, new employee share ownership initiatives, and very important, pension contribution and benefit changes. These agreements provide labor certainty, a positive shift toward 50/50 pension cost sharing, and most importantly, greater alignment

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of employee and shareholder interests. I believe this company is capable of a lot more, and I'm excited about the future working with the leadership team that embraces our objective of unlocking the full potential of this organization.

During the third quarter, we've successfully completed the integration of recently acquired Norfolk Power, adding 19,000 additional customers to our local distribution business. We're in the process of integrating the recently acquired Haldimand County Hydro as we speak, and we closed on the acquisition of Woodstock Hydro after the quarter at the end of October. Together, these acquisitions expand our LDC customer base by 5%.

Hydro One has been a successful acquirer of local distribution companies, as we are able to bring to the table unique synergies for shareholders and value to local community that other potential acquirers have difficulty replicating. We continue to place new assets into service through improved system and increased reliability.

For the year-to-date, we have made capital investments totaling $1.2 billion and expect full year spend will be approximately $1.5 billion. These investments, while contributing to the continued growth of our regulated rate base, are providing much needed upgrade and enhancement to Ontario's generally aged, transmission and distribution infrastructure.

With the combination of this asset base, financial strength, and scale, I firmly believe that there is a real opportunity to drive change in culture and performance while establishing a track record of driving consistent and growing value for customers, shareholders, and the Province of Ontario. And that's what we fully intend to do, as we go forward as an independent public company.

With that, I'll turn it over to Mike to discuss the financial statements and then we'd be happy to take your questions.

Michael Vels - *Hydro One Inc. - CFO*

Thank you, Mayo. Good morning, everybody. As we've laid out on slide nine and 10, the revenue for the quarter increased by 5.7%, largely driven by the distribution side of the business, but we had higher purchased power costs, which, as you can see, also directly increased our power cost expense line as well. Net of purchased power, which is essentially a pass-through cost, revenue increased by 1.7% principally due to higher consumption from warmer weather in the third quarter of this year compared to last year, and rate changes, which came into effect earlier in the year.

Operating costs for the quarter were favorable compared to recent historical trending, as costs associated with information systems, customer service, and bad debt expense associated with the 2013 billing system implementation, again, to reduce significantly and are expected to be mostly behind the company by next year. That year-over-year benefit is partially offset on the transmission side where in the third quarter of last year we had the benefit of some non-recurring insurance proceeds related to flood-related damages. This combination of high revenue and reduced costs resulted in pretax earnings growth of about $35 million for the quarter, an increase of 18% from last year.

Income tax expenses increased both for the quarter and the year-to-date due of course to the growth in pretax earnings but also as a result of an increase from last year in our effective tax rate to approximately 16%. This current effective rate is fairly representative of where I expect will be for the next couple of years. As a result of all of these factors, net earnings for the quarter increased by 11%.

Consistent with the earnings growth, we've reported growth in our cash from operating activities and funds from operations. The funds from operations also benefiting from better working capital management in the third quarter as we begin to manage our accounts receivable down to more normalized levels. Capital investments in both our transmission and distribution segments for the quarter and the year-to-date have increased year-over-year, as we continued to execute on enhancing the system and replacing the end-of-life and aged infrastructure.

I'll spend a couple of moments and talk through a couple of items related to the recapitalization and the initial public offering, which occurred after the close of the quarter as this will provide some important context to how we look at the company going forward. Following the IPO announcement in late April of this year, the three credit rating agencies that rate our debt each came out with their respective views related to Hydro One going public. Since that time, all three of these agencies have adjusted their credit ratings to reflect a reduced government ownership. After these rating changes, the company continues to be viewed as a high-quality, stable investment grade credit, with all ratings solidly in the A

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category, reflective of our strong balance sheet, regulated cash flows, and which continued to provide the company with the lowest borrowing costs in that sector.

In the IPO prospectus and related marketing materials, both of which you can find on SEDAR and on the company's website, we outlined the creation of Hydro One Limited as the parent entity and the public company, above Hydro One Inc., as well as a number of recapitalization transactions that occurred immediately in advance of the IPO and the pro forma effect associated with these transactions.

As you can see on slide 11, Hydro One reported a full-year 2014 net income of $747 million. After getting the effect of the pre-IPO divestiture of Brampton, additional interest expense associated with the recapitalization of Hydro One Inc. and adjustments relating to exiting the problems of PILs regime post the IPO, net income on a go-forward basis would have been $708 million. After accounting for approximately $18 million in preferred share dividends and $2 million in minority interest, pro forma net income attributable to common shares would have been $692 million.

Looking forward to the fourth quarter and the full year, there are several items I'd draw your attention to and which we've outlined in the outlook section of Hydro One Limited's prospectus. These factors include the positive effect of weather and one-time credits in 2014, a higher effective rate expected in 2015 and a higher rate of operation spending for the remainder of 2015 compared to the same period last year. On balance, we expect these factors to result in fourth quarter net earnings that will be lower than 2014.

On slide 12, and as we've laid out in the various IPO materials, we anticipate that Hydro One's Board will establish an annualized common share dividend level going forward of approximately $500 million. With 595 million of shares now outstanding, this would equate to $0.21 per share per quarter or $0.84 on an annualized basis. We anticipate that the Board will declare the first common share dividend early in the new year for payment at the end of the first quarter of 2016, and we further anticipate that dividend would be in for a combination of the first quarter of 2016 in addition to the partial period of the fourth quarter of 2015 following the IPO.

The $500 million annualized dividend level reflects a target payout ratio of approximately 70% to 80% of net income. As the company paid this level of dividend in 2015, I would anticipate it would have fallen at the higher end of the target payout ratio range for the year, given the pro forma outlook and comparability items I discussed a moment ago. I also expect that for 2016, it will move towards the lower end of that range.

Echoing Mayo's comments, the management team and Board look forward to the opportunities that Hydro One can and will bring to its customers and its new shareholders, and we look forward to sharing the journey with you.

And with that, we'll now be pleased to take your questions.

Bruce Mann - *Hydro One Inc. - VP, IR*

Great. Well, thank you, Mayo and Mike. And, Christie, if you please go ahead and quickly explain to the participants how you would like to organize the Q&A polling process. The team here would be happy to answer everybody's questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). Our first question comes from the line of Robert Kwan with RBC Capital Markets. Your line is now open.

Robert Kwan - *RBC Capital Markets - Analyst*

Hi, good morning. Just on the quarter, do you have a sense of what the pro forma net income number would be inclusive of the recapitalization as well as the two months that Brampton was in the numbers?

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Michael Vels - *Hydro One Inc. - CFO*

I don't have that number on hand, Robert, but the way I would do it, I would just take the pro forma adjustments we used for 2014 and pro rate that evenly.

Robert Kwan - *RBC Capital Markets - Analyst*

OK. So there's nothing special in terms of weather, seasonality on those?

Michael Vels - *Hydro One Inc. - CFO*

No, I think -- Brampton, I think, was fairly consistent.

Robert Kwan - *RBC Capital Markets - Analyst*

OK. And just in terms of the recent storms that you've had, can you just talk a little bit about what the impact might or might not be? Was that storm major enough to classify under the major storm recovery?

Mayo Schmidt - *Hydro One Inc. - President, CEO*

The short answer to your question is, yes, it was. And so we anticipate that a large percentage of those storm costs would be capitalized and would not affect the earnings for the fourth quarter.

Robert Kwan - *RBC Capital Markets - Analyst*

OK. And then just last, as you think about Q3 as a whole, I know you've given the 2015 directional guidance. How would you assess the quarter versus just the overall expectations? And if you can maybe frame that, it sounds like weather had a good impact. Weather, I guess, was above normal in your view?

Mayo Schmidt - *Hydro One Inc. - President, CEO*

I wouldn't know the safety impact of weather on the third quarter, Robert. We had a fairly good weather from the perspective of driving some distribution consumption. Beyond that, I -- the revenue is up by about 1.7%. I'd say -- I would guess the majority of that would have been our new rate increases with the remaining amount related to distribution consumption. So weather is not a massive impact in the third quarter.

In terms of the rest of the quarter, we're satisfied with the outcome. We are pleased to see the customer costs and bad debts coming under control. There's a bit more work to be done there, which will certainly continue to impact [a loan] and significantly reducing basis through the fourth quarter and into next year. But that was a good trend. We're happy to see it. And the rest of the quarter was pretty standard.

Robert Kwan - *RBC Capital Markets - Analyst*

All right. That's great. Thanks very much.

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Mayo Schmidt - *Hydro One Inc. - President, CEO*

You're welcome.

Operator

Thank you. Our next question is from Andrew Kuske of Credit Suisse. Your line is open.

Andrew Kuske - *Credit Suisse - Analyst*

Thank you. Good morning. The first question is just to Mike on the OM&A costs in the distribution side of the business. Clearly there's decline there. Could you just walk through a little bit of the proportionality of the bad debt expense and the company's CIS versus some of the other elements?

Michael Vels - *Hydro One Inc. - CFO*

Sure. Directionally, the effect from the last quarter of the reduced -- and when we talk about impact of systems, it's the cost of customer support where we have incremental people still managing or who were still managing customer questions -- the bad debts and then other system remediation costs. So the system remediation costs are primarily behind us. When we talk about elevated levels of spending, it's still the bad debts and the customers.

In terms of impacts on the quarter for distribution, I'd say the reduction or the improvement in OMA was primarily improvements in the customer and bad debt, but also some cost control on the rest of the business as well.

Andrew Kuske - *Credit Suisse - Analyst*

OK. That's helpful. And a bigger, broader question to Mayo. It's probably been a little bit less than the 100 days that you've been in the seat at this stage. And maybe you can just give us some primary views on how you think you can change the organization on a go-forward basis and maybe draw some comparables to what you saw when you first started (inaudible) to what you're seeing now?

Mayo Schmidt - *Hydro One Inc. - President, CEO*

Sure. I'd be happy to do that. So the way to think about I think timing-wise, we've put our prospectus together. We've done about 2.5 weeks down on the road and we're back about 10 days ago. And I think the thing that strikes me the most in what is the dissimilarities, one is we've got a very strong operating platform, whereas that needed to be bolstered substantially at my prior engagement, as well, the financial stability of this organization is considerable compared to that start as well.

So having said that, I think the basis, the way I'd start with, is very, very strong, and it's certainly a large base in the organization. I think the things that are striking are when you look at the differential between the current corporation and what we would all think about more clearly is a commercial operation, the areas are significant. We really live in the two regulatory rules -- one is that supports our rate base and the one that we're growing and as rapidly as we're allowed to, to replace really aged infrastructure; the other is obviously the government oversights and not just dozens but north of 100 of different steps that we take as a government crown that we've now transitioned out of.

So there's really the things that we stopped doing that have the opportunity to do the other things that need to be done. So I think the opportunity really is putting in a more structured schedule of work processes in the distribution businesses we have, refining our ability to construct the transmission businesses, which I think there is really probably bigger opportunities on the distribution but certainly opportunities in both.

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I think also our project management, we've got really talented people in the organization. It's really a matter I think of how we organize and moving away from what would typically in a crown circumstance be more, in our business, anyway, more siloed to a business that operates across boundaries and creates that flexibility in dynamic activity of communication and actually efficiencies.

So we're doing a couple of things here. One is preparing for the future world, particularly in the distribution as a PBR and performance-based business, we expect to be prepared when it's time to go to the OEB to present our case in that regard. And the transmission, of course, will continue for the couple of years here and without, at this point in time, expect anything different other than to continue on in the rate base, but certainly anticipate there is always the potential for change, which we'll be ready for.

Andrew Kuske - *Credit Suisse - Analyst*

OK. That's very helpful. Thank you.

Mayo Schmidt - *Hydro One Inc. - President, CEO*

Yes. Absolutely. Thank you, Andrew.

Operator

Thank you. Our next question is from Linda Ezergailis of TD Securities. Your line is open.

Linda Ezergailis - *TD Securities - Analyst*

Great. Thank you. A few questions on the quarter. Very helpful for you to stratify the transmission and distribution capital expenditures in Q3 and year-to-date. I'm wondering if we can have a corresponding number for sustaining capital.

Michael Vels - *Hydro One Inc. - CFO*

That's something we'll look at disclosing. I don't have that immediately at hand. But the percentage of sustaining capital for the quarter would have been consistent with our history. So I think it would take the same percentage for the first and second quarters. You'd come up with a pretty well bang on with numbers. But that's a number we can certainly provide.

Linda Ezergailis - *TD Securities - Analyst*

OK. That would be appreciated. And also, just noticing in some of your regulatory proceedings, your Essex County Transmission Reinforcement project, I'm wondering if you're planning to start constructing before the cost allocation is reviewed from a policy perspective by the OEB. And I'm just wondering if you could describe maybe what are some of the complexities and implications of the issues relating to that cost allocation.

Mayo Schmidt - *Hydro One Inc. - President, CEO*

That's -- there's probably not a -- we probably do not have enough time on this call to talk about all the complexities of the cost allocation, but in -- just on answering your question very shortly, first of all, we are planning to begin development in advance. So we're not slowing down on that. And the issues on cost allocation is really about who bears the costs. So it's not an issue of the company not recovering the costs. The real question is whether or not transmission customers or distribution customers are charged those costs.

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So, from our perspective, we don't see it as a financial exposure for the company. It is more a case of getting, understanding and clarity of the problem, the regulator, as to who should bear the costs. So we are continuing with the development on the basis that we believe those costs would be fully recoverable. As I said, and sorry to repeat myself one more time, we're just not sure at this stage (inaudible).

Linda Ezergailis - *TD Securities - Analyst*

Great. Thank you. And just a very quick detailed question on the quarter. Your NCI, is it reasonable for the net income in the Q3 to be annualized as a go-forward run rate as well as the FFO deduction for NCI?

Mayo Schmidt - *Hydro One Inc. - President, CEO*

Yes, I think that would be a safe assumption. The reason that it has been in that situation is because of fast amortization of startup costs so we've had, starting at our partnership. So those are -- most are behind us. I think that's a fair annualized number to use.

Linda Ezergailis - *TD Securities - Analyst*

Great. Thank you. I'll jump back in the queue.

Mayo Schmidt - *Hydro One Inc. - President, CEO*

Great. Thank you.

Operator

Thank you. Our next question is from Ben Pham of BMO Capital. Your line is open.

Ben Pham - *BMO Capital - Analyst*

OK. Thanks. And I had a question about the Ontario LDC consolidation potential. And as we head into next year with the time limited tax relief, I was just wondering how you guys think about the market shaping out from a consolidation perspective. A couple of years ago, there was a town that talked about getting back to 10 regional LDCs. I mean do you guys agree with that?

Michael Vels - *Hydro One Inc. - CFO*

Well, I wouldn't want to comment -- I wouldn't want to comment, Ben, on what number another party predicted we might get to, Ben. And the reason why is that particularly in these LDCs, it really is sort of the leadership of a mayor or the council, and at times, related to the age of their infrastructure and what capital they want to deploy or how they want to, in some cases, relieve that and just simply monetize it and spend their capital in other ways.

So we've got multiple discussions that are generally underway, which is recently consistent. When they actually materialize, and that may take a period of some part of the year or even a year or more, but we have multiple discussions that are underway without necessarily being able to say, at this date, we've got three that are going to transpire. It's really a case of when they mature, and that's based on the city council and mayor.

So we do think that there has been significant motivation, for efficiency purposes, to attempt to consolidate that sector. We feel like we're in a very good spot. We also want to be disciplined that we don't overpay, and of course, that's subject to negotiation. There are certainly other parties that will compete with on the LDCs, but we believe that with the extent of our presence across the transmission that work and the existing LDCs that

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were really, really well positioned to be the natural acquirer that have probably the best value and synergies unless some other outside party or third party simply feels they just need to find a point of entry and overpay.

So I think you will see generally consistent processes. We've got about -- there's been 88 that have been acquired over the course of history here. There's probably around 70-ish that are still actively operating in the market. Some number of those will come to market over the next year or two.

Ben Pham - *BMO Capital - Analyst*

And just on that point, would you say that the last couple of years, I think in 2009, there was pretty much exemptions in tax and other things. I mean why hasn't there been an accelerated pace of consolidation? Is it -- just more of your comments about more from a seller perspective reluctance to sell.

Mayo Schmidt - *Hydro One Inc. - President, CEO*

You know, I think (multiple speakers) -- I'm sorry, go ahead, Mike.

Michael Vels - *Hydro One Inc. - CFO*

I'm not sure I fully understand your question.

Ben Pham - *BMO Capital - Analyst*

Well, I mean from -- I was just wondering, before the three utilities that you guys acquired, I mean, there hasn't been a lot of consolidation since 2009 where as a governmental entity, there's no entitlement to the tax situation. So I'm just wondering why hasn't there been more acquisitions from the Hydro One side of things historically since the last couple of years. I mean has there been more just the seller is reluctant to sell? Is it more because of upside rather than accretion potential from a Hydro One perspective?

Mayo Schmidt - *Hydro One Inc. - President, CEO*

I think it really is quite simple. It's the willing seller or willing buyer, and I think it's really is, as I sort of mentioned, that there is volumes of conversations that take place and approaches. And of course, you're dealing in between elections, the city council, the members are coming off, who is the leader, who is the strong party, and ultimately, getting to a number.

And frankly, we've had even recently, in this particular year, we've had situations where we've walked away from all LDCs because the multiple is not something we were prepared to pay in our discipline. And our teams are very adept because we're 88 into this that we really do know how to price and we know how to connect to them. And at times, we can offer them opportunities to consolidate into their community from our other LDCs on infrastructure that actually needs to get consolidated.

So it's a nice pace. And so we offer those opportunities. But it's -- the issue is it's not as commercial on the other side in terms of the willing seller as it might be on our side with the practice of -- they're selling one where we have a history of having bought just a number less than 100. So our practices are well developed and these people are going through it for the first time.

Ben Pham - *BMO Capital - Analyst*

OK. Got it. And lastly, on your table for the transmission projects, on the last one, the Northwest line, just wondering if you can give us an update on that. And is the CapEx numbers you've provided in the five-year plan, does that include that project?

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Michael Vels - *Hydro One Inc. - CFO*

The capital numbers that we've provided in our forward-looking estimates included only the development element for the Northwest Bulk Transmission Line. In terms of the outlook for that, there is no way we can call the timing on that at this point. It does require the ISO to control the need. And then there would be a process for Leave to Construct. To the extent that that was achieved, we are the designated transmitter and we would build that one. So there's no way to estimate the timing of that, and as a result of that, we did not include the construction of that transmission line in our forward-looking estimates, only the development.

Ben Pham - *BMO Capital - Analyst*

OK. Thanks, everybody.

Michael Vels - *Hydro One Inc. - CFO*

Before we reply to the next question, we had a question about sustaining capital. I'll provide those numbers on this call. So, for the third quarter, our transmission sustaining capital was $176 million. Again, for the third quarter, our distribution sustaining capital was $96 million. So, that will answer the question that we had earlier in the call.

Operator

Thank you. Our next question is from Jeremy Rosenfield with Industrial Alliance. Your line is open.

Jeremy Rosenfield - *Industrial Alliance - Analyst*

Thanks. Good morning. Just one quick question and just related to the Hydro One Brampton going forward. I'm wondering if you have an idea as to the recurring sort of revenue or earnings impact from providing the services to Hydro One Brampton. And just in terms of how that's being treated, is that included actually in the rate base or is that sort of contracted outside of the regulatory framework?

Mayo Schmidt - *Hydro One Inc. - President, CEO*

That's contracted. Effectively, this very simplified answer is it's provided outside of the regulatory framework as you call it. It's just a cost recovery from our perspective. So it has no material effect either on our intra-quarter operations or going forward on our rate base. So it's not a factor of that. Apart from the reduction in ongoing earnings, which we outlined in the IPO prospectus, there's no other impact on either our rate base or on our quarterly earnings.

Jeremy Rosenfield - *Industrial Alliance - Analyst*

OK. Great. The only other thing that I wanted to ask you about was, just on the Conservation and Demand Management relative to target, it's sort of been improving but hasn't quite hit the target. And I'm just sort of wondering what's the strategy going forward from a higher level. Is there going to be more emphasis put into trying to bring that up closer to where the benchmark is?

Michael Vels - *Hydro One Inc. - CFO*

Well, it's a bit of a joint effort obviously for all of the distribution. (Inaudible) work to achieve the problems of CDM targets. So it is an industry-wide issue.

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From our perspective, certainly, it's an important, very important target for us. It's something that we have a significant amount of people and resources allocated to. It's -- as we've talked to (inaudible) continue our focus on customer service and serving our customers better. And we'll also be looking to innovation to find new ways to enable our customers to conserve, particularly those in the north that they have higher bills as they use electricity to heat their houses to a greater extent than our southern customers.

So I guess the short answer is we did perform fairly well as a company, as Hydro One, in 2014. We did meet the minimum requirement for the year. And we'll continue to redouble our efforts. So I don't anticipate going forward that it's going to have a material effect on our financial statements, but it is clearly a very significant focus for the company.

Jeremy Rosenfield - *Industrial Alliance - Analyst*

OK. Thank you.

Operator

Thank you. Our next question is from Paul Lechem of CIBC. Your line is open.

Paul Lechem - *CIBC - Analyst*

Thank you. Good morning. I just wanted to continue actually on the CDM vein for now. There was a comment in the prospectus saying there was a clawback related to 2014 CDM of around $28 million to be recorded in Q3. I was just wondering if that actually was recorded in the quarter.

Michael Vels - *Hydro One Inc. - CFO*

Yes, it was. Yes, it was. And it would have offset improvements in revenue as a result of increased rates in the transmission business. That is the last time we expect that adjustment as it only impacted 2013 and 2014. And those catch-up for the clawbacks were recorded for those respective years in 2014 and 2015, both in the third quarters. And so, we had an equivalent adjustment of [$33 million] in the third quarter of 2014. As outlined and as you're correct in saying, we have $28 million in this quarter. However, we do not anticipate a clawback next year as that is not a part of our current transmission rate decision.

Paul Lechem - *CIBC - Analyst*

So, how -- it says in your Q3 write-up that you received $26 million from the OPA this quarter versus $7 million last year for CDM. Can you explain the increase year-over-year then and how does that relate to the $28 million call-back?

Michael Vels - *Hydro One Inc. - CFO*

They are completely unrelated.

Paul Lechem - *CIBC - Analyst*

All right. So why the increase from $7 million last year to $26 million?

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Michael Vels - *Hydro One Inc. - CFO*

Yes. Sorry, I was just checking some facts here. That's an answer I'll give to you [back on]. If you're OK -- we don't have those numbers at hand exactly.

Paul Lechem - *CIBC - Analyst*

OK. Just looking into Q4, given your initial comments around payout ratio and the dividend for this year and what that implies for net income for the year and therefore for Q4, just trying to understand that sort of the delta going into Q4. So the thing that it could impact Q4, I think there is a mention in the prospectus there is an $8 million expense related to granting of share to your unions, is that still expected, to unionize employees? Is that still expected to occur in Q4?

Michael Vels - *Hydro One Inc. - CFO*

The most significant impact, as far as you can tell at this point, and clearly, it's an estimate, so there's not a high level of certainty at this stage, is there was some positive weather effects in the quarter in 2014, and now those might reoccur. Thus far, we haven't seen it. In fact, it'd be safe to say that so far the first month of the quarter being as mild as it is would have had an outcome of worst results for the first quarter of 2015 than last year. Secondly, we have a pretty material increase in our tax rate. And we've outlined what we anticipate our tax would be for the year. And thirdly, the other significant item is that in the fourth quarter last year, we had a lower level of OMA spend. The run rate on our OMA spend for 2015 is higher, as we catch up on some of our brush control, forestry and some of the other maintenance programs that we have in distribution. And as a result, the run rate of our OMA expense is, for the fourth quarter, anticipated to be higher than last year. Those would be the most significant impacts.

Your comment on the share grants. When we do book any of our share grants in the fourth quarter, that would be a non-cash charge. And we, at this stage, have not finalized the accounting for those share grants, and that's something we'll disclose in our fourth quarter.

Paul Lechem - *CIBC - Analyst*

OK. We're also looking at Q4. The walkthrough you get from actual 2014 to the pro forma and the $18 million impact of the recap from (multiple speakers) higher interest, is that all going to be -- is that all going to show up in Q4 given the timing of the recap? (Multiple speakers) --

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Michael Vels - *Hydro One Inc. - CFO*

Yes, a quarter of it will. Yes, that's correct because that primarily will be [needed] to the incremental $800 million of debt that we took on to move our leverage up to 60% of the company's rate base. And our rates have not changed materially. There might be a small spread between the long and short-term rates because the $18 million merit was calculated on the basis of us coming out. So it is more of a long-term effect. The effect the fourth quarter might be a little less than that because we're still funding most of that incremental leverage through our CP program which attracts lower rates.

Paul Lechem - *CIBC - Analyst*

OK. And finally, what are the increased costs in Q4 around both the IPO itself but also being a public company in the quarter? How should we think about the costs of that?

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Michael Vels - *Hydro One Inc. - CFO*

It's a good question. Clearly, IPO costs are significant, but those are almost entirely to the account of our shareholder and the Province of Ontario. So I don't anticipate IPO costs being an impact in the fourth quarter. In terms of the new board and public company costs, there will be some. I'm not sure at this point if they are material.

Paul Lechem - *CIBC - Analyst*

OK. That's it for me. Thank you.

Operator

Thank you. Our last question is from Robert Catellier of GMP Securities. Your line is open.

Robert Catellier - *GMP Securities - Analyst*

Hi, good morning. I just want to talk a little bit about the, in terms of equipment replacement at Bruce and whether or not there's a read-through from the potential [Bruce] (inaudible) program. And --

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Michael Vels - *Hydro One Inc. - CFO*

It's Mike Vels here. I think either the conference is breaking or your phone is not picking you up. You're breaking up badly. If you could maybe just restate the question again.

Robert Catellier - *GMP Securities - Analyst*

Yes. I'd like to talk about your views of Bruce refurbishment and whether or not you think that will proceed, and any capital deployment opportunities for the company.

Michael Vels - *Hydro One Inc. - CFO*

We don't have any particular comment on that. I can't really comment on their plans at this point. And I don't anticipate there's any material impact on the company.

Robert Catellier - *GMP Securities - Analyst*

OK. And then just you've mentioned about the cost of NERC Cyber Security Standards in terms of expenditures made for that. I'm wondering if you could talk about the materiality and how long you expect those investments will -- how that'll impact the company going forward or whether they are one-time.

Michael Vels - *Hydro One Inc. - CFO*

So I'm not sure I can fully answer your question from a material -- from a materiality perspective. It depends on how you really frame it. Right? So, for a company that has $23 billion in assets and a very significant amount of spending, it's -- in isolation, I guess I would say it's not material to the company's annual earnings. Having said that, it's not [changed] either. So in a year, we could easily spend probably on an incremental basis $15 million to $20 million just on complying with NERC compliance. So it's not, in isolation, not a material number to the company but it's significant.

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In terms of one-time versus ongoing, that's an ongoing requirement. So the impacts of initiatives in North America in general to harden in these systems and to increase defenses against cyber security and in general, secure the entire network, which stretches over vast geographical territories, it's something that where personally I believe the requirements will continue to increase. And secondly, the compliance for those requirements doesn't happen instantaneously. The spending occurs over several years as businesses put plans in place to reach those requirements over a period of time. So it is going to be an ongoing cost to our company. The capital is associated with that. I do go into our rate base and the recovery for rate base and the OMA, of course, at the same time. So it's something that we take very seriously. As I've said, it's a significant cost and one that will be ongoing.

Robert Catellier - *GMP Securities - Analyst*

Great. So it sounds like a normal course expenditure to be the prudent operator that ultimately gets recovered in the rate base.

Michael Vels - *Hydro One Inc. - CFO*

That's exactly right.

Robert Catellier - *GMP Securities - Analyst*

OK. That's it for me. Thanks.

Operator

Thank you. That concludes our Q&A session for today. I would now like to turn the call back to Bruce Mann for any further remarks.

PRESENTATION

Bruce Mann - *Hydro One Inc. - VP, IR*

Well, thanks, operator, very much. The management team here at Hydro One thanks everybody for investing some of your time with us this morning. We know it's a busy period for everybody. We appreciate your interest and support. And to the extent you have questions that weren't answered on the call, please feel free to reach out to us. Our contact information is at the end of this morning's release. This concludes our call today. Have a lovely weekend.

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.

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