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Q3 2024 HYDRO ONE LTD EARNINGS CALL

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- **Omar Javed** *Hydro One Ltd - Vice President;Investor Relations*
- **David Lebeter** *Hydro One Ltd - President and Chief Executive Officer, Director*
- **Harry Taylor** *Hydro One Ltd - Chief Financial and Regulatory Officer*

CONFERENCE CALL PARTICIPANTS

- **Operator**
- **Jessica Hoyle** *Scotiabank - Analyst*
- **Mark Jarvi** *CIBC Capital Markets - Analyst*
- **Maurice Choy** *RBC Capital Markets - Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Hydro One Limited's third-quarter 2024 Analyst Teleconference. (Operator Instructions) As a reminder, this 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.

Omar Javed *Hydro One Ltd - Vice President;Investor Relations*

Good morning, and thank you for joining us in Hydro One's quarterly earnings call. Joining us today are our President and CEO, David Lebeter; and our Chief Financial and Regulatory Officer, Harry Taylor. On the call today, we will provide an overview of our quarterly results, and then we will take some time answering questions as time permits.

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 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 as well.

With that, I turn the call over to our President and CEO, David Lebeter.

David Lebeter *Hydro One Ltd - President and Chief Executive Officer, Director*

Thank you, Omar. Good morning and thank you for joining us for our third-quarter 2024 earnings call. I would like to begin by acknowledging that tomorrow is National Indigenous Veterans Day in Canada, a day to acknowledge and commemorate the contributions and sacrifices made by the First Nations, Inuit and Métis soldiers who have served our country.

Additionally, remembrance day is only a few days away. This is a time for us all to collectively remember and honor those who sacrificed and those that continue to sacrifice in serving our country during times of war, conflict and peace. It's a moment for us to pause and be thankful for the freedoms we enjoy today, because of the sacrifices made by others.

I also want to take a moment to reflect on the various global conflicts. As events unfold across the world, they can have deep and profound impact on us all. The news of innocent lives lost can be overwhelming, and it is important that we support one another during these times. I want to extend my support and sympathy to those that have been affected by these global events.

Turning to the quarter. This morning, I will provide an update on our recent activities, and then Harry will take you through the third quarter financial results. In the spirit of looking after one another, I'm very proud of the Hydro One team who took time away from their families, including over Canadian Thanksgiving to participate in relief efforts following Hurricanes Helene and Milton.

Our thoughts and prayers are with our neighbors affected by those catastrophic events. In response, Hydro One sent 150 skilled employees to Georgia and Florida to restore power. We are proud to answer the call during their time of need. Time and time again, our teammates demonstrate how Hydro One is always caring for others. This commitment to caring was also evident during our annual Power to Give campaign.

In the month of September, Hydro One employees demonstrated their generosity and community spirit donating and contributing more than 4,500 volunteer hours during the month. This is a remarkable achievement that will make a meaningful impact for those in need across our communities. I'm incredibly proud of our employees' efforts and generosity, not only in September, but throughout the year. Their commitment to giving back and supporting our communities is a core value of Hydro One's culture and one they embody every day.

As I've mentioned on prior calls, the demand for electricity in Ontario continues to grow. This is being driven by population growth, energy transition and new manufacturing capacity such as the investments being made by Stellantis, Volkswagen and Honda. All of this is leading to greater economic growth in the Province.

Consequently, the Independent Electric System Operator, IESO, recently increased its energy demand forecast through to 2050. The IESO is now estimating a 75% increase in electricity demand over the next 25 years, which is higher than the 60% previously forecasted.

The IESO estimates new large potential projects such as data centers, commercial sector building electrification, EV production and its supply chain to contribute to the forecasted increase in demand. To meet the increased demand for electricity, work in the province is well underway, building more generation, building new transmission lines, integrating new technologies and expanding energy efficiency programs.

Hydro One is part of this growth and continues to play a critical role in meeting the increased demand and supporting the province's electrification goals. Whether it's through our investments in transmission and distribution systems, connecting new generation and energy storage solutions or using new technology in our control systems, we are building a grid to power Ontario's future. Together with industry and Indigenous communities, we will ensure a reliable, resilient and sustainable energy system for our children and grandchildren.

I'm happy to report our new transmission projects continue moving forward. During the quarter, Hydro One received approval from the Ministry of Environment, Conservation and Parks on the final Environmental Assessment Report for the Waasigan Transmission Line.

This approval paves the way for construction activities to commence, allowing for shovels in the ground before year-end. The total expected investment in the line will be \$1.2 billion and will bring an additional 350 megawatts of electricity to the region to meet current and future energy needs of Ontario's Northwest communities.

As a reminder, the line will be completed in two phases, with Phase 1 of the project targeted to be in service in 2025 and Phase 2 to be in service in 2027. Our Chatham to Lakeshore Transmission Line project, which began construction in the Spring of 2023 remains on track for completion by the end of 2024. Commissioning tests are progressing well, and we expect to have the line fully operational by year-end, completing the project one year ahead of schedule and under budget, as previously disclosed.

Once complete, the line will provide clean electricity to support the growth in the agri-food and manufacturing industries as well as a growing population in Southwestern Ontario, adding 400 megawatts of clean electricity to the region.

We are proud that both the Waasigan and Chatham to Lakeshore Transmission Lines will be co-owned with proximate First Nations through Hydro One's equity partnership model. We are also pleased to report significant progress in our regulatory efforts.

Settlements in principle have been reached for three, five-year revenue requirement applications for three of our transmission partnerships, including the Bruce-to-Milton Limited Partnership, the Niagara Reinforcement Limited Partnership and the Chatham x Lakeshore Limited Partnership.

On October 21, 2024, in collaboration with parties for the settlement conferences, Hydro One filed settlement agreements with the Ontario Energy Board or OEB for the Bruce-to-Milton Limited Partnership and the Niagara Reinforcement Limited Partnership. These agreements outlined total revenue requirements of \$193 million for Bruce-to-Milton and \$45 million for the Niagara Reinforcement over the five-year period. The settlement proposals accepted the rate-making framework proposed by the partnerships, including a modest 3% reduction in proposed OM&A expenses over the period and an additional 0.15% stretch factor.

With respect to the Chatham x Lakeshore Limited partnership, Hydro One has reached a settlement agreement in principle and expects to file this proposal with the OEB shortly. These settlement proposals support investment in our infrastructure to maintain a safe and reliable system that meets our customers' needs and highlights the constructive regulatory framework in Ontario. These achievements mark significant success for Hydro One and our First Nations partners.

Once approved, the proposed settlements will provide revenue and cost certainty for the projects from 2025 to 2029. Final approvals from the OEB are expected by year-end. Separately, in late October, the OEB released the cost of capital parameter for 2025. A deemed ROE was formulaically updated to 9.25% will be the applicable rate for these settlement agreements.

The rate will remain fixed for the duration of the rate period. In other news, I'm pleased that our good work and collective efforts continue to be recognized by others. We are recently named one of Canada's most responsible Companies for 2025 by Newsweek.

The list recognizes companies across 13 industries for their commitment to climate, social welfare and responsible governance. This award reflects the hard work and dedication of our entire team to positively impact our communities and the environment.

Hydro One is dedicated to responsible business practices that balance sustainability, social responsibility and governance. We take a holistic view of corporate responsibility that considers how these topics are incorporated deeply into our business. Through our actions, Hydro One strives to be a responsible corporate citizen contributing to a better future for all Canadians.

We were also honored to receive the Powerline Safety Award from the Electrical Safety Authority in recognition of our role in enabling the safe delivery of a very large piece of equipment to a brewery in Southwestern Ontario. In collaboration with our partners, Hydro One raised and lowered conductors along a 117-kilometer route, allowing for the safe movement of the equipment while minimizing the impact on customers. This award is a testament to the power of partnerships and our collective efforts to achieve an objective without compromising safety.

With that, I will turn the call over to Harry to discuss our financial results. Harry, over to you.

Harry Taylor Hydro One Ltd - Chief Financial and Regulatory Officer

Thank you, David. It certainly is an exciting time in the province, and Hydro One is well positioned to contribute to the energy transition and electrification initiatives underway to meet the needs of all Ontario residents and businesses.

Turning to our third-quarter financial results. We delivered basic earnings per share of \$0.62 compared to \$0.60 in the third quarter of 2023. The key drivers behind the year-over-year change included higher revenues net of purchased power, partially offset by higher income tax expense, primarily due to unfavorable timing differences compared to last year and higher pretax earnings, higher depreciation and amortization and asset removal costs as well as higher interest expense.

As a reminder, both the transmission and distribution segments had net income-neutral items in revenue that include normal course regulatory adjustments, such as OEB approved recovery of historical cost deferrals. There are corresponding offsets for these items in the tax expense and in OM&A, thus making them net income neutral.

Our third quarter revenue, net of purchased power increased year-over-year by 6%. Transmission revenues increased by 5.7%, primarily due to changes in OEB-approved rates for 2024 and higher average monthly peak demand. These were partially offset by the revenue impact of the net income neutral items mentioned earlier. Distribution revenues, net of purchased power increased by 6.1% year-over-year due to changes in OEB approved rates for 2024, higher energy consumption and a higher number of customers.

On the cost front, operating maintenance and administration expenses in the quarter were essentially unchanged year-over-year, increasing slightly by 0.3%. In the Transmission segment, costs were higher by 1.8%, mainly due to higher work program expenditures attributable to stations, lines maintenance and vegetation management.

In addition, we also had some net income neutral items that were offset in revenue. In the Distribution segment, costs were lower by 4.3%, mainly due to lower corporate support costs and regulatory adjustments, partially offset by higher work program expenditures,

mainly attributable to customer programs and emergency power restoration. Depreciation expense for the third quarter was higher year-over-year by 6%. This was due to the growth in capital assets and higher asset removal costs, partially offset by lower amortization of regulatory assets.

Regarding financing, we saw a 10.5% increase in interest expense year-over-year, mainly due to a higher weighted average interest rate on our long-term debt and more long-term debt resulting from issuances in the second half of 2023 and year-to-date this year. These charges were partially offset by a lower average volume of short-term notes outstanding and higher capitalized interest due to a higher average balance of assets under construction.

During the quarter, Hydro One issued \$1.2 billion of medium-term notes. This consisted of \$700 million of 4.25% notes due in 2035 and an additional \$500 million of 4.85% notes due in 2054. The issuance was completed under our sustainable financing framework.

One of our differentiating factors is the strength and stability of our balance sheet, along with our creditworthiness, both of which we are happy to report, remain robust. Our current FFO to debt metric, which is a good proxy for creditworthiness, remains well above the threshold limits, the credit rating agencies use to qualify our credit rating.

Turning to taxes. Our income tax expense in the quarter was \$56 million compared to \$36 million in the same quarter last year. Contributing to the increase were unfavorable timing differences compared to last year. As a reminder, we put several information technology initiatives in service in the third quarter last year that qualified for 100% capital cost allowance.

This year, we also had higher adjusted pretax earnings, and these were partially offset by the impact of the net income neutral items discussed earlier. The effective tax rate this quarter was 13% versus an effective tax rate last year of 9.1%. The effective tax rate for nine months was 14.5% compared to a rate of 15.3% last year, which included the deferred tax asset recovery through June 30, 2023. The current rate is consistent with our effective tax rate expectations of 13% to 16% for the remainder of the JRAP period.

Moving to our investing activities. In the third quarter, we placed \$597 million of assets in service for our customers, which was a decrease of 14.6% compared to the prior year. In the Transmission segment, we saw a decrease of 2.4% year-over-year, primarily due to a lower volume of line refurbishments and the timing of assets placed in service for information technology initiatives. These were partially offset by an increase in assets placed in service for grid operating and control facilities as well as the timing of investments placed in service for customer-driven work.

In the Distribution segment, in-service additions decreased by 22.9% from the prior year due to the timing of investments placed in service for information technology initiatives and the timing of assets placed in service for system capability reinforcement projects. These were partially offset by a higher spend on customer connections and a higher volume of wood pole replacements.

In terms of our capital expenditures, for the third quarter, we invested \$773 million, which was an increase of 21.2% over 2023. The increase occurred in both the Transmission and Distribution segments, resulting from higher investments in new transmission and distribution infrastructure, increased customer connections and a higher volume of line refurbishments and wood pole replacements. They were partially offset by a lower spend on information technology initiatives.

Turning to Broadband. We were very pleased with the Ministry of Infrastructure's announcement last week to provide subsidies to Internet service providers for work associated with designated broadband projects. The \$400 million program is intended to provide financial support to ISPs to carry out their work and deliver high-speed Internet access to rural communities.

While it is too early to comment on the impact of this program on our magnitude of work, we are hopeful this move will advance the pace of orders. Our expectation of the magnitude of work remains between \$300 million and \$700 million of incremental rate base in the Distribution segment.

As a reminder, this is not included in our capital investment projections nor in our earnings guidance at this point. With respect to LDC consolidation, we continue to be active in engaging with local distribution companies and their respective municipalities to facilitate further consolidation within the sector. We are committed to being disciplined in our process. And as such, we will not pursue opportunities that do not meet our stringent investment criteria.

Looking ahead, we maintain our guidance of 5% to 7% compound annual growth for earnings per share for the 2023 to 2027 period, using the normalized 2022 earnings per share of \$1.61 as a base. Finally, I am pleased to report that our Board of Directors declared a dividend of \$0.3142 per share payable to common shareholders of record on December 11, 2024.

With that, we'll open the phone lines and be pleased to take questions.

QUESTIONS AND ANSWERS

Omar Javed *Hydro One Ltd - Vice President; Investor Relations*

Thank you, David and Harry. We ask that the operator explain how they would like to organize the Q&A polling process. In case we can't get to your questions today, my team and I are always available to respond to follow-up questions. We ask that you limit your question to one question and one follow-up. If you have additional questions, we request you to rejoin the queue. Please go ahead.

Operator

(Operator Instructions)

Jessica Hoyle, Scotiabank.

Jessica Hoyle *Scotiabank - Analyst*

Good morning. Thanks so much for taking my questions. So just to start, just given the higher demand forecast out of the IESO, can you talk a little bit more about what you see in terms of incremental transmission opportunities moving forward?

David Lebeter *Hydro One Ltd - President and Chief Executive Officer, Director*

Good morning, Jessica, David Lebeter here. We've been working with the IESO on their forecast, and we have identified areas where there are capacity constraints in the province that we anticipate will be addressed moving forward. The next phase, not the IESO has updated their forecasted growth is to go back to their planning and update their planning. We expect to see something from that early next year.

Jessica Hoyle *Scotiabank - Analyst*

Great. Thanks so much. And then, just how are you thinking about the supply chain and inflation risks given this increasing demand for electricity, not only in Ontario, but also just across the continent?

Harry Taylor *Hydro One Ltd - Chief Financial and Regulatory Officer*

Hi, Jessica, it's Harry Taylor. We have a procurement team that has been well out in front coming out of the pandemic in writing contracts with our vendors, our vendor partners and anticipating supply chain issues, securing supply with pricing based on indices, et cetera.

So I would say there really isn't any new news. Supply chain issues have been with us for a while. And for all our significant vendors and requirements in terms of materials, we have long-term contracts with multiple vendors to ensure we've got adequate supply and at the same time, ensure our pricing is certainly market-based, if not better.

Jessica Hoyle *Scotiabank - Analyst*

Appreciate the color.

Operator

Mark Jarvi, CIBC.

Mark Jarvi CIBC Capital Markets - Analyst

Yeah. Good morning, everyone. Maybe just on the government support for broadband. At what point will you have clarity? And then do you think the dollar value that's been put forward is enough to maybe bring you up to the top end of the \$300 million to \$700 million rate base growth for your side of that equation?

Harry Taylor Hydro One Ltd - Chief Financial and Regulatory Officer

Hey, Mark, it's Harry Taylor. It's too early to determine whether we're at the bottom end or the top end of the range. I know it's a wide range. We are certainly very welcoming of the incentive. Do expect that it will break the log jam in terms of orders and applications that we see. Candidly, if this doesn't, I don't know what would. But at this point, we just haven't -- it was just announced last week. We haven't seen the uptick yet.

So it's tough to try to put a pin in a wide range at this point. We will update as and when we see the trend develop and try to narrow the range as best we can. Obviously, we'd like it to be at the top end to serve Ontarians and put it into our rate base, but it is subject to the applications from the ISPs.

Mark Jarvi CIBC Capital Markets - Analyst

Understood. And then, David, just follow up on your comments about interactions with the IESO around ultimately transmission planning demand. The government is also pretty vocal about being sort of an energy exporter. What conversations are you having around that in terms of transmission interconnects, a role for Hydro One to play if we are sending more power south?

David Lebeter Hydro One Ltd - President and Chief Executive Officer, Director

Good morning, Mark and thanks for the question. That's a really interesting question. There's a lot going on. So the first task, the government has said we're going to become energy self-sufficient, and we're going to be able to address the growth that we see in the province. That will be the 75% increase.

Second goal they said is to keep it affordable, and that's where the export comes in. If you're going to build out an energy system, you're going to want to make sure that you err on the side of having a bit more than you need, because being short is a real problem. And so you want to have access to export markets.

So we've worked with both the IESO and the government to identify one, constraints, as I pointed out earlier, where additional flow or ties would be required going south or going east or west as well, because we can move power in three different directions. It doesn't all have to go south as well as where they are thinking about citing the additional generation, that opens up opportunities.

So what I would expect to see next year as the government announces more details on what kind of an energy superpower means, where the generation is going to come from, additional build-out in the transmission going beyond 2030. So this will probably be late mid-2030s to late 2030s, particularly if it's nuclear. Does that answer your question, Mark?

Mark Jarvi CIBC Capital Markets - Analyst

Yeah. And then, your view would be that you still would be the transmitter of choice and the scale of these projects would be something that you think you would have sort of first right to look at?

David Lebeter Hydro One Ltd - President and Chief Executive Officer, Director

Yeah, absolutely. I mean, that's going to be our opening position. We believe we're the best suited to manage these projects and build them. We've demonstrated that with our Chatham to Lakeshore coming in early and under budget. We've demonstrated that with the Waasigan Transmission Line by how quickly we've moved into construction.

We have shovels in the ground this year. We have a strong relationship with the indigenous communities, our partners as well as with government. Government ultimately gets to make the decision as you saw with the Wawa to Porcupine, they did put a competitive process, but I think they're going to find -- and at the end of the day, they did award that to us. So obviously, they're seeing the value we bring to these lines. So that's our hope that we get designated. But if that isn't the case, we're certainly confident in our ability to compete.

Mark Jarvi CIBC Capital Markets - Analyst

Okay. Thanks for the time this morning. I appreciate it.

Operator

(Operator Instructions)

Maurice Choy, RBC Capital Markets.

Maurice Choy RBC Capital Markets - Analyst

Thanks and good morning. Maybe just a quick follow-up on the Wawa to Porcupine. You said they did award that to you. I think they designated you -- they proposed to designate you as a transmitter choice. But has that been awarded? Or -- and if not, any reason why the delay?

David Lebeter Hydro One Ltd - President and Chief Executive Officer, Director

Good morning, Maurice. It was designated to us. Then they had a consultative process for 45 days where the award was open for discussion and comment. That ended a couple of months ago. I'm still confident that we will get the final letter designating that project to us, so we can get moving forward on it.

They're just taking this time to make sure they reviewed all the comments and provided back comments to everybody involved. But it's, in my opinion, unlikely they're going to change their designation. So we're very confident that we will hear some positive news on that later on this year.

Maurice Choy RBC Capital Markets - Analyst

Thanks. And just to finish up on your comments about the Ontario government and their vision for the province's energy future. So they are obviously looking to launch their first integrated energy resource plan next year, as you mentioned. Thoughts on what would actually be different, meaningfully different from what is being done today and what that means for you?

David Lebeter Hydro One Ltd - President and Chief Executive Officer, Director

Building on the comments of an integrated plan means they're going to look at, taking to bring gas and electricity together so you can build out the system in the most rational way. It provides certainty to the gas companies as well as the electricity companies.

I would expect, given that they want to become an energy super power to be a long-term vision. So rather than the IESO's current process, which is looking out at a couple of years, I would expect this to be a 5- to 15-year outlook, so you can actually track a trajectory and start making investments.

Maurice Choy RBC Capital Markets - Analyst

Thank you very much.

Operator

Thank you. 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.

Omar Javed *Hydro One Ltd - Vice President;Investor Relations*

Thank you, Shannon. The management team at Hydro One thanks everyone for their time with us this morning during what is a busy period. We appreciate your interest and your continued support. If you have any 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.

Operator

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

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