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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Hydro One Limited's Third Quarter 2021 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.

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

Good morning, everyone, and thank you for joining us in Hydro One's earnings call. Joining us today are our President and CEO, Mark Poweska; and our Chief Financial Officer, Chris Lopez.

In the call today, we will go over our third 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'll address in a moment. It should be up on the webcast now, or if you're dialed into the call, you can find them on Hydro One's website in the Investor Relations section under events and presentations.

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.

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

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

Thank you, Omar. Good morning, and thank you for joining us for our third quarter earnings call.

Before we begin, I'd like to take a moment to remind everyone that Remembrance Day is the day after tomorrow. We remember those who have served and continue to serve our country during times of war, conflict and peace. I'm so very grateful for our freedom and acknowledge all who have given their lives and those who continue to serve so that we can have a better and brighter future for all, less we forget. Thank you.

Turning to our business, I'm proud of the Hydro One team and what we've accomplished, not only in this quarter, but throughout the challenges over the past couple of years. This quarter's earnings per share of $0.50 demonstrates our resilient business and robust fundamentals. It's the hard work of our teams that allowed us to restore power to our customers after storms hit, deploy over $500 million of capital investments, and further improve the experience for our customers. At Hydro One, we also feel a deep responsibility to the communities in which we operate, and we continue to support those who are working tirelessly to keep our communities safe and healthy. Hydro One donated $150,000 to support Feed Ontario, the province's largest collective of hunger relief organizations, providing food banks with fresh food and pantry staples. At the start of the pandemic, food banks saw a 26% increase in first-time visitors. Hydro One's donation will provide the equivalent of 450,000 meals to help Ontarians who are facing hunger.

In addition to our work with the food banks, we helped KidSport, a provincial charitable organization that helps children and youth aged 18 and under, whose families are experiencing financial hardship. Our support will give more than 150 children and youth the opportunity to participate in sport programs by providing financial assistance for registration fees and equipment in their communities. I'm also proud of our team for their personal giving and support for charitable organizations, and I'm pleased to announce that thanks to the generosity and dedication of Hydro One employees, we raised over $725,000 for local organizations during our recent power-to-give month, surpassing our fundraising goal of $250,000. These results demonstrate our win is one attitude as we came together to raise much-needed funds for the charities and communities where we live and work.

In support of indigenous-owned businesses, we announced a partnership with the Canadian Council for Aboriginal Business, CCAB, to provide 28 grants to businesses that are majority-owned and controlled by indigenous Canadians. We are proud to partner with the CCAB to invest in the success of indigenous-owned businesses, who play a critical role in our economy and have worked hard to persevere through the pandemic. We will continue to leverage our unique position in the province and the reach of our network to advance reconciliation and nurture respectful, positive and mutually beneficial relationships with indigenous communities. This partnership is part of Hydro One's commitment to ensure that 20% of our corporate donations and sponsorships are directed to indigenous communities.

Hydro One is also committed to increasing its indigenous procurement spend to 5% of the company's purchases of materials and services by 2026. These are all examples of how Hydro One continues to give back to the communities in which we operate. For us to succeed, we must continue to serve our customers with innovative solutions. We recognize that the electricity system is the backbone of a strong economy. It powers our customers, connects us to our neighbors and plays a vital role in energizing life for all. Our customers and our industry count on us to provide resilient and reliable power. Our customers also expect us to be ready for the future and whatever challenges it may bring. Therefore, we are investing in new technologies and supporting the shift to increased electrification of our economy. Hydro One is making strides in improving reliability and customer experience. Modernization of the grid is the gateway to achieve these positive outcomes.

In the distribution segment, smart switch installation is a key element to Hydro One's modernization initiative. In 2021, we continued to deploy smart technology on our distribution grid, and we are on our way to significantly exceeding deployment by the end of 2021. In addition to smart technology installations, we're also piloting several innovative solutions to improve reliability and the experience of those customers impacted by long interruptions. In one pilot, we've successfully deployed behind-the-meter battery energy storage systems, Tesla Powerwalls to customer homes. This solution is designed to maintain power supply to a household during power interruption, which improves reliability and the overall customer experience. On a different scale, and as part of our unregulated energy management services business, I'm also pleased to announce that we recently partnered with PowerFlex, a division of EDF Renewables North America to provide distributed energy resources for our commercial and industrial customers. The 2 projects in this partnership are battery energy storage systems with Georgia-Pacific in Englehart and Great Lakes Copper in London. These 2 battery systems will help our customers optimize their energy consumption and reduce their overall energy bills. They're expected to go into commercial operation by the first quarter in 2022. These are just some examples of our continued work, both on the regulated and unregulated side to innovate and strengthen the grid for the benefit of our customers.

Recently, we announced an important milestone for the Hydro One Telecom business. As the business has been evolving from a provider of connectivity to a full service, information and communications technology solutions provider, we felt that we needed a new brand identity to reflect this transformation. On October 28, we announced that Hydro One Telecom would be re-branded to Acronym Solutions. The name Acronym reflects its sharp, agile and simple approach to complex challenges and sends a strong message within the business community that it is the company committed to providing more choices to our customers. It signals an easier way to do business as compared to its competitors. Acronym will continue to innovate by offering a suite of value-added services that businesses can rely on. This important milestone reaffirms our commitment at Hydro One to transform the way we do business.

And finally, as an update on our Joint Rate Application that covers both transmission and distribution, we received from the regulator 2 procedural orders that lay out the path for the remainder of the proceeding. Interrogatories, which is the formal process of asking questions, have commenced and will run through the end of November. We've already received over 3,000 questions. And while the number of questions is as expected, the detail requested is much greater than what we've seen historically. This speaks to the thoroughness of the process and the intricacy of the responses required and the organization has mobilized to respond to these questions. This Q&A period will be followed by technical conference in mid-December. Following the conference, we expect there will be an oral hearing in early spring with a final decision expected in the back half of 2022. We are highly confident that we put forward a robust application that will help renew and modernize our grid and ultimately deliver continued prosperity to Ontario.

And with that, I'll turn it over to Chris to discuss our financial results this quarter. Over to you, Chris.

Christopher Felix Lopez - *Hydro One Limited - CFO*

Thank you, Mark. Good morning, everyone, and thank you for joining us today. I hope you and your families are safe and doing well.

In terms of our financial results for the quarter, we saw an increase in earnings per share to $0.50 compared to $0.47 last year. The main driver of higher earnings this quarter were approved rates for the transmission and distribution segments as well as the redemption of preferred shares in the prior year, partially offset by lower transmission peak demand and higher depreciation, amortization and asset removal costs. Our second quarter revenue, net of purchased power, was high year-over-year by 7.7%. This was comprised of approved rates for 2021 and the recovery of DTA amounts following the DTA Implementation Decisions by the OEB on April 8, 2021, that we discussed in the Q1 earnings call. As a reminder, the DTA recovery's net income neutral as there is a corresponding offset in taxes.

For the transmission segment, revenues were higher by 5%, reflecting approved rates from the transmission rate decision received in the second quarter of last year, as well as higher revenues resulting from the recovery of DTA amounts. However, the year-over-year revenue increase was partially offset by lower peak demand. Year-over-year peak demand for the quarter was lower by 7.4%, driven by weaker demand in July, August and September.

For the distribution segment, revenues net of purchased power were higher by 10.8%. In addition to approved rates and the recovery of DTA amounts, electricity distributed to Hydro One customers was also higher by 2.8%. That said, nearly 67% of the increase was attributed to the inclusion of demand from the acquired electric local distribution companies, or LDCS, Peterborough and Orillia. Demands in these 2 utilities was included partially last year as they had closed on August 1 and September 1, 2020. While the 2 LDCs contributed towards higher distribution revenues, the impact to net income was not material. On the cost front, operating, maintenance and administration expenses were flat year-over-year. Lower oped and vegetation management costs in the transmission business were offset by higher spends on emergency power restoration in the distribution business. The storm-related activity necessitated the partial deferral of our schedule work as we focused on power restoration this quarter.

For the remainder of the year, we expect robust activity as we complete our 2021 work plan. COVID-19 related costs were marginally lower this quarter at $3 million compared to $5 million in the same period last year. Depreciation expense was higher year-over-year due to the increase in capital assets, which is consistent with our capital investment program as well as higher asset removal costs and environmental spend. On financing, we saw an increase in interest expense in the quarter due to higher debt levels. In September, Hydro One increased $900 million of debt at competitive rates. The issuance consisted of a $450 million aggregate principal amount of 2.23%, medium-term notes due in 2031 and a $450 million aggregate principal amount of 3.1% medium-term notes due in 2051. The net proceeds of this offering are expected to repay and/or prepay maturing long-term and short-term debt and for general corporate purposes.

We continue to be pleased with the stability of our balance sheet and robust investment-grade credit ratings. As we look forward, we will continue to access the debt markets opportunistically. Income tax expense was $71 million for the quarter compared to $22 million in the same quarter last year. The increase in income tax expense was due to the recovery of DTA amount as a result of the DTA Implementation Decision, which, as discussed before, is net income neutral, lower net deductible timing differences and higher pretax earnings. The effective tax rate for this quarter was 19% versus the effective tax rate last year of 7%. This is consistent with the guidance we provided earlier this year of 14% to 22% over the next 5 years. As a reminder, the most significant impact will be over the 2021 to 2023 DTA recovery period. As previously communicated, the change in the effective tax rate as a result of the recovery of DTA amount is and will be net income neutral. Contributing to the year-over-year increase in net income attributable to common shareholders was the redemption of the Series 1 preferred shares announced in the third quarter of 2020. Upon announcement of the redemption, future dividends in the amount of $5 million were accrued up to the date of redemption, lowering net income to common shareholders in the third quarter of last year. As a reminder, the redemption of the preferred shares is expected to be approximately $0.02 accretive to shareholders.

Moving to investing activities. Capital investments for the third quarter were $513 million, which is a 2.6% increase from the third quarter in 2020. The increase was a result of higher investments in the distribution segment due to system capability reinforcement projects and storm-related asset replacements, partially offset by the timing spent on minor fixed assets. Year-over-year investment in the transmission segment declined as a result of lower station refurbishments and replacements, lower spend on spare transformers and timing of spend on minus fixed assets, partially offset by higher multiyear development projects and customer contributions.

We are pleased with our progress on capital investments this quarter. We placed $514 million of assets in service in the third quarter, a 38.5% increase compared to the prior year. This was largely a result of the lumpy nature of placing assets into service. The year-over-year increase related primarily to the completion of the New Ontario grid control center for the benefit of both the transmission and distribution segments. In addition, for both segments, there were timing-related differences for various projects and changes in the volume of work that contributed to the positive variance. On guidance, we continue to be committed to and affirm our target of 4% to 7% earnings per share growth through 2022. As a reminder, we expect to provide guidance post-2022 following the approval of the Joint Rate Application.

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

QUESTIONS AND ANSWERS

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

Thank you, Mark and Chris. We ask the operator 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.

Operator

(Operator Instructions) Our first question comes from Linda Ezergailis with TD Securities.

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

I'm wondering if you could help us understand, just looking out over the next year, obviously, you're very busy with the Joint Rate Application, but I'm wondering if you can give us an update on how your discussion with other municipal utilities is going, what might be the outlook for potential acquisitions over the next year, given all the benefits you bring to the table or might some of those conversations be deferred and decisions delayed until after the provincial election next year?

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

Thanks for the question, Linda. It's Mark here. So we have been active, speaking with the leaders of the LDCs as well as the local mayors and statistically, it's portfolio, so I'll ask Chris to give you some more details on where we're at.

Christopher Felix Lopez - *Hydro One Limited - CFO*

We are quite active at the moment. We're out speaking to interested municipalities in a potential transaction. So we are active. So we're not waiting at this point. You're correct that there is a provincial election. There's also municipal elections that come up in the same cycle, but the ones that we're speaking to are quite comfortable at this point. So we've given guidance before where we said we'd like to do $100 million to $200 million per year if we could. If those transactions come up, we would actually be in the market and we'd do them. So it's not being impacted by the election.

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

My follow-up question is with respect to any sort of inflationary pressure that you're seeing. You have a good relationship with your labor unions, have had some recent decisions on that front, but as it relates even to capital expenditures, I'm wondering if what the assumptions are embedded in your application and if actual inflation through 2027 might differ from what you have embedded in your applications? Would you consider potentially deferring some projects or might there be merit or some of the more integrity-related projects to stay on schedule and might that increase your capital budget?

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

Sorry, Chris, I was on mute there. I'll take a stab at it and then I'll pass it over to you. As you pointed it out, we do have labor stability so our labor costs are quite stable out until 2023, having agreements in place with our major unions, the society and the TWU and I'll also remind you that we do have inflation factors built into our custom incentive rate-making construct here. So we do have an annual inflation adjustment of our costs in our rates. So that's built-in, and that will carry us through 2022. We do expect a similar regulatory construct for our Joint Rate Application. Obviously, we are seeing supply chain costs and implications of that. We are managing those costs and to date, we've been able to deliver our overall programs without delay. So we are somewhat inflation protected in our construct. And Chris, do you want to add anything to that?

Christopher Felix Lopez - *Hydro One Limited - CFO*

Thanks, Mark. I think you covered it. Bottom line, our M&A is inflated by 2 factors. It's average hourly workers income and the other factor is GDP in Ontario. So we are covered on the M&A side. On the capital side, it's also inflated. If it is more than we anticipate or there are other impacts that are material, I think, Linda, you covered it, we have 2 choices. We could re-pace the investment or we could go back to the OEB and ask for another assessment. Right now, we're not seeing that pressure. So we believe that the Joint Rate Application covers those pressures.

Operator

Our next question comes from Rob Hope from Scotiabank.

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

I've a broader and longer-term question to start with. Mark, in your prepared remarks, you spent a lot of time highlighting the future technologies, whether it be switches or batteries. As you look into the JRAP and how you manage your business over the next 5 or 10 years, how do you adjust the rate construct or your business to potentially handle the headwinds and the tailwinds associated with batteries and potentially lower peak load or on the tailwind side, the electrification of vehicles and whatnot?

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

Yes, great question. So I think there's 2 parts to it. One is we are setting the grid up for the future of electrification so the investments that we're making now and throughout JRAP and things like updating our advanced metering infrastructure, putting more technology on the distribution side, really does enable adoption of new technologies and the growth of EVs and behind-the-meter storage and things like that. And so preparing for the future, we are making investments through the period to be ready for that. We are seeing an increase in demand through the period and as we advance towards electrification, we see that growing even further. So we are looking at where we need to support electrification and the economy in Ontario and where that may drive new transmission investments over the longer period.

So through JRAP, but even beyond JRAP as the country moves towards a net-zero economy. So I believe that in the lines of business, we are the integrators, and we are the enablers of de-carbonization and of adopting new technology. So whether that be new central sources of capacity in Ontario or distributed energy resources, they will be needing to connect to the grid in one way or another. So as the 98% transmission supplier, I think we're in a great position for that future. And if I look at Ontario broadly on the generation side, we aren't in the generation business directly, but they're -- right now, it's 96% decarbonated, but Pickering is shutting down in 2024, which will put some capacity strain on the system, and the ISO right now is going through their planning on how will they meet that future capacity in the province. And so we're working closely with them on identifying where there may be transmission opportunities to meet those future capacity. So we are looking -- setting the grid up for the future, but also looking at where are the rate opportunities for Hydro One in that?

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

Appreciate the fulsome response. And then maybe something a little bit shorter-term in nature. The 3,000 comments that have been received on JRAP so far, anything surprising in terms of push-back or is it just largely as expected, maybe a little bit of push-back on the capital plan as well as the OpEx plan?

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

Yes. I think you've got it. The largest area is around questions around our capital program, which is the basis of our Joint Rate Application. So that's not a big surprise. There are some clarifying questions that have been asked around how we are proposing to look at a capital factor and modifications to that. I'll remind you that in the last applications, we've built in productivity into our individual project portfolios. And this time, we're following the regulatory construct, which has a product kit, the stretch factor on top of it.

So we've changed that a bit around some questions on why we're doing that. And really, we're doing it to follow the regulatory construct. I think a couple of the positive things we're finding is that there's very few questions on our OM&A costs so far, which really, I think, demonstrates our strong control and productivity gains since the IPO. And intervenors have shown that our evidence is really strong in the areas of productivity framework, transmission project execution and customer engagement, in particular, which we've talked about in the past. So I don't think anything really surprising and the highest area of focus is absolutely around our capital investment program.

Operator

Our next question comes from Maurice Choy with RBC Capital Markets.

Maurice Choy - *RBC Capital Markets, Research Division - MD & Analyst*

The first question is just a follow-up on the last one on JRAP. So if everything appears to be in-line with your expectations, is there a possibility where, notwithstanding you've got 2 procedural orders already, but is there a possibility that you might even get an outcome or decision sooner than expected?

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

I would say that we will be going through the overall process, which will take us to the second half of next year before we get a decision. I don't see anything so far in the procedural orders that would vary our expectations on when we'll get a decision. We are in the interrogatory process.

We will be having a technical conference, December 13, 17, which is the opportunity for intervenors to dig more into our technical details. We'll have an oral hearing in the New Year. And the process should wrap up sometime next spring, and then the regulator will need some time to put together their decisions. So I don't see so far a change in what our expected timing is, which is really the back half of next year.

Operator

Our next question comes from Dariusz Lozny with Bank of America.

Dariusz Lozny - *BofA Securities, Research Division - Research Analyst*

We are just wondering maybe at the outset, could you give an update on load trends that you're seeing across the service territory and perhaps longer-term growth drivers? I know you've spoken at length about the opportunities in Leamington from greenhouses in the past. Just curious, maybe could you potentially talk about if you're seeing any other levers for growth in the years ahead, just across the province or otherwise?

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

Sure. Great question. Absolutely, the Leamington Area Southwest, we're continuing to see even more growth in that area. The Northwest, recently or earlier this week, actually, the province released its fall economic statement, which has a focus on mining and the Ring of Fire in the Northwest and partnering with nations in the far north to reduce some of the barriers to developing in the Northwest. So I think that's a positive sign on the government's desire to stimulate the economy and the resource sector in the Northwest, which comes along with required infrastructure to do that.

So we're seeing that. As I said before, we're also seeing that with Pickering coming off, there is a bit of a capacity crunch, where we will need new resources within the province or rely on imports from our neighbors. And the ISO is going through that process right now to decide on what that might look like. Depending on where that lands, there's opportunities for us in each of those scenarios for future infrastructure. So we're definitely seeing load growth. The other thing we're seeing is that companies are starting to transition and decarbonize themselves. We've had announcements in the province with several steel mills announcing that they will be going to electric arc furnaces. So we are seeing the industrial sector starting to decarbonize. And we're seeing growth in the EV and battery manufacturing in Ontario. So a lot of good growth signs, a lot of it underpinned by the fact that we are over 96%, 94% to 96% depending on the year, decarbonized on the electricity supply side. So we're in a position to decarbonize the industry and downstream.

Dariusz Lozny - *BofA Securities, Research Division - Research Analyst*

Okay. Great. And maybe just one more quick one on the re-branding of the telecom business. Is there anything to read into that, perhaps are you maybe taking a more active role as far as growing that business? Should we be on the lookout for potentially additional data points in the near future as far as that segment is concerned?

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

Yes. It's definitely one of the areas that we've said all along that we are looking at growing in the unregulated sector, along with our energy management services company, which, as I said in my opening remarks, we've announced a couple of joint ventures on that side. Really, the re-branding of our telecom business is to reflect that when they started out as Hydro One Telecom, they were really selling dark fiber services and connectivity. Now they are a full-service provider of digital services for companies. And so the name, you can imagine, knocking on the door of customers saying, hey, I'm from Hydro, and I'm going to sell you digital services really didn't match the business and where that business has evolved to. So we felt it was important that we gave them a brand and an entity, which reflected what they do and really sets them up to grow that unregulated business.

Operator

(Operator Instructions) Our next question comes from Mark Jarvi with CIBC Capital Markets.

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

Maybe the question is for Chris. Your balance sheet is in great shape. You have the benefit of the deferred tax asset. Just, we are still a lot of questions around where rates are going and bond yields next year. So just any updated views on debt financing plans over the balance of the next year maybe?

Christopher Felix Lopez - *Hydro One Limited - CFO*

It's pretty much business as usual for us. We borrow about $1 billion to $1.5 billion per year. So that will be on the cards for next year. We've completed our debt borrowing for this year. We said we would still look at opportunistically entering the market if the rates were there, but our next year, $1 billion to $1.5 billion. And the balance sheet is in great shape. It's in great shape to provide for the growth that we see coming through the JRAP period. So there is further investment coming in and just as a reminder, that balance sheet allows us to grow that investment over the JRAP period without the need for any new equity. So that's the reason why it's there and it's doing extremely well.

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

So maybe, Chris, you could just maybe help define what you would say is opportunistic would be that if rates rolled over here a little bit that you'd do more in the first half of next year? Or maybe you can give us a bit more detail on what you would see as the right opportunity to do something a bit different or off plan?

Christopher Felix Lopez - *Hydro One Limited - CFO*

It would be exactly like you said, if there was a dip in interest rates, we would look at it as an opportunity to enter and do some early borrowing for next year. So we wouldn't borrow the whole $1 billion to $1.5 billion at the back end of this year, but we may enter it and borrow a small amount. So that's the opportunistic part, but each year, it's roughly the same, about $1 billion to $1.5 billion of borrowings.

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

Got it. And then it's obviously not a big part of your business, but you guys have the IV partnership with OPG. They also came out with their own, I guess, it's more of a fleet charging thing with power on. Are you guys involved in that, if not, why not, and then just what are you seeing in sort of the first early days of the IV partnership?

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

It's Mark here, Mark. So we are not involved in that one. There were some carve-outs in our joint agreement with OPG on IV. So we are doing some things together. We're doing some things separate. They've gone their own direction on some pieces, and we're actually growing outside of IV as well in the EV charging, particularly the large truck charging facilities. So we had envisioned right off the beginning with IV. We carved a few areas out that we agreed that we would individually go after as a company. So that is in alignment with our strategy. Chris runs that business as well. Do you have anything you want to add to that, Chris?

Christopher Felix Lopez - *Hydro One Limited - CFO*

No, I think you covered it Mark.

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

I think there are probably no further questions until the operator confirms that. So in light of that, this does conclude our Q&A session for today. And we would like to thank everyone for their time with us this morning. We appreciate your interest and your ownership. 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.
