MANITOBA HYDRO

2012/13 & 2013/14 GENERAL RATE APPLICATION

VOLUME I

SUMMARY & REASONS FOR APPLICATION

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2.0 OVERVIEW OF TAB 2

The purpose of Tab 2 is to provide an overview of Manitoba Hydro's current financial position, as well as the reasons for the proposed rate increases. Section 2.1 provides a summary of Manitoba Hydro's current financial position and the projections for the 2012/13 and 2013/14 test years, and Section 2.2 provides a summary of the reasons for Manitoba Hydro's Application.

2.1 SUMMARY OF FINANCIAL POSITION

Manitoba Hydro is projecting that net income from electricity operations will be approximately $60 million for the year ended March 31, 2012, a decrease of $79 million or 57% lower than the net income of $139 million in the previous fiscal year. The reduction in net income is largely attributable to lower prices in export markets and higher power purchases. Low export prices reflect reduced power demand due to current economic conditions and low prices for competing energy sources.

The net income of $60 million projected for 2011/12 will increase Manitoba Hydro's retained earnings to $2.4 billion at March 31, 2012. Although this is the highest level of retained earnings in the Corporation's history, it is very important for Manitoba Hydro to maintain a strong financial structure to adequately address the risks of the Corporation and to avoid large rate increases to electricity consumers in the future.

Without the requested rate increases of 2.5% effective September 1, 2012 and 3.5% effective April 1, 2013 together with the reinstatement of the 1% rate rollback, Manitoba Hydro is projecting a net loss of $35 million in 2012/13 and a further net loss of $23 million in 2013/14 (Table 1).

Table 1 below compares the actual and forecast revenues, expenses and net income of the Corporation's Electric operations for the fiscal years ended March 31, 2010 to March 31,

2014. Table 1 also illustrates the impact on retained earnings and financial ratios with and without the proposed rate increases.

Table 1 - Net Income - Electricity Operations

	Actual		Projected	Forecast	
(in millions of $)	2010	2011	2012	2013	2014
Revenue					
General Consumers Revenue					
- at approved rates	$ 1,145	$ 1,200	$ 1,209	$ 1,281	$ 1,308
- 1% rate deferral			(23)		
Extraprovincial Revenue	427	398	363	341	363
Other Revenue	6	6	7	16	16
Total Revenue	1,578	1,605	1,556	1,638	1,687
Expenses					
Operating, Maintenance and Administrative	378	397	401	447	532
Finance Expense	373	388	385	440	452
Depreciation and Amortization	358	365	353	401	354
Water Rentals and Assessments	121	120	119	106	112
Fuel and Power Purchased	104	106	146	182	158
Capital and Other Taxes	76	81	82	87	92
Corporate Allocation	8	9	9	9	8
Total Expenses	1,418	1,466	1,496	1,672	1,709
Non-controlling Interest	-	-	-	(1)	(1)
Net Income (loss) before proposed rate increases	$ 160	$ 139	$ 60	$ (35)	$ (23)
Proposed rate increases	n/a	n/a	-	20	80
Rate rollback reinstatement				35	12
Net Income after proposed rate increases & rate rollback reinstatement	$ 160	$ 139	$ 60	$ 20	$ 68

Retained Earnings and Financial Ratios (before proposed rate increases)

	2010	2011	2012	2013	2014
Retained Earnings	2,189	2,327	2,387	2,352	2,053
Debt to Equity Ratio	73:27	73:27	74:26	77:23	83:17
Interest Coverage Ratio			1.10	0.96	0.98
Capital Coverage Ratio			1.13	1.06	0.95

Retained Earnings and Financial Ratios (after proposed rate increases & rate rollback reinstatement)

	2010	2011	2012	2013	2014
Retained Earnings	2,189	2,327	2,387	2,411	2,203
Debt to Equity Ratio	73:27	73:27	74:26	76:24	82:18
Interest Coverage Ratio			1.10	1.05	1.12
Capital Coverage Ratio			1.13	1.19	1.18

2.2 REASONS FOR APPLICATION

The Corporation faces a number of risks in the fulfillment of its mandate. These risks include drought/low water levels, loss of property and equipment due to weather or other events, increases in costs due to aging infrastructure, as well as decreases in revenues due to economic circumstances for competing energy sources. The immediate risks pertaining to this Application are the current low export prices that continue to reduce extraprovincial revenues compared to historical levels. The reduction in extraprovincial revenues has a significant negative impact on Manitoba Hydro's current and projected net income and places upward pressure on domestic rates.

The financial outlook for Manitoba Hydro's Electric operations for the years 2011/12 to 2013/14, as depicted through its projected net income, retained earnings and financial ratios in MH11-2, has deteriorated significantly since the 2010/11 & 2011/12 GRA proceeding concluded. Projected net income and retained earnings levels will be reduced due to the impact of continued low prices in export markets, and retained earnings will be significantly reduced in 2013/14 as a result of one-time adjustments pertaining to the transition to IFRS. These circumstances clearly demonstrate the need for additional electric rate increases in the 2012/13 and 2013/14 fiscal years and for the reinstatement of the 1% rate rollback directed in Order 5/12.

The rate proposals that are contained in this Application will result in overall average electricity rate increases of 3.57% for 2012/13 and 3.5% for 2013/14.

The approval of rate increases at the rate of inflation only, as was the case in Order 5/12, would be insufficient to maintain a reasonable level of net income and financial ratios. In particular, Manitoba Hydro is concerned about the projected decrease in its interest coverage ratio given the importance of this financial metric to bondholders and credit rating agencies. Even with the proposed rate relief in this Application this ratio is projected to deteriorate to the 1.05 level in 2012/13 and be at 1.12 in 2013/14 (well below the target level). Without the rate relief proposed in this Application for 2012/13 and 2013/14, the interest coverage ratio is projected to further deteriorate below the 1.0 level (which could have serious negative consequences on the credit rating of the Province and Manitoba Hydro).

The proposed rates are in keeping with Manitoba Hydro's approach to implement regular and modest rate increases to ensure the maintenance of an adequate financial structure. A sufficient level of equity allows the Corporation to withstand the risks and uncertainties inherent in its operations and to address adverse financial consequences outside of its control, and in doing so, promote rate stability and avoid the need for large or sudden rate increases in the future.

In addition to the application for grid rate increases, rate increases for customers in the Diesel Zone, are also included in this Application. Similar to those increases for grid customers, Manitoba Hydro is proposing to increase rates to the General Service (over 2000 kWh per month) and Government customers by 6.5%. This increase is based on the last two grid increases of 2.0% (for April 1, 2011 and April 1, 2012) and the proposed increase of 2.5% effective September 1, 2012. As with the last diesel application these rate increases are not based on the cost to serve these communities, which, if based on a cost based approach would require increases of approximately 19% to those customers who pay the full cost rate.

The 2.5% proposed interim rate increase to be effective September 1, 2012 is projected to generate additional revenue of approximately $20 million in the remainder of the 2012/13 fiscal year and together with the 2.0% interim rate increase that was approved by the PUB effective April 1, 2012 in Order 32/12, is projected to generate a similar level of additional revenue had a 3.5% rate increase been approved on April 1, 2012. This interim rate increase is required on a timely basis in order to generate net income of $20 million for 2012/13. This interim rate increase and the reinstatement of the 1.0% rate rollback that was directed in Order 5/12 and the 3.5% proposed rate increase to be effective April 1, 2013 will allow Manitoba Hydro to maintain its financial ratios at acceptable levels under current circumstances.

If the 2.5% proposed interim rate increase effective September 1, 2012 and proposed 3.5% rate increase effective April 1, 2013 are not approved and the 1.0% rate rollback is maintained, losses of $35 million and $23 million are forecast in 2012/13 and 2013/14, respectively and retained earnings would be forecast to be $55 million and $146 million lower by 2012/13 and 2013/14, respectively. Manitoba Hydro does not believe that it is acceptable to allow net income slip into a loss position and risk credit rating implications together with the need for larger rate increases at a later date.

Manitoba Hydro submits that under the circumstances and considering the current financial outlook, it is appropriate to grant the interim rate relief requested in this Application effective September 1, 2012 while at the same time proceeding with a GRA process to confirm the interim rates and review a further rate increase of 3.5% on April 1, 2013. This approach will maintain the financial position of the Corporation in the short term, while allowing for a full review of the rate requests during the 2012/13 & 2013/14 GRA process.

While Manitoba Hydro is submitting this Application with what it believes are the minimum rate increases necessary to preserve financial integrity and rate stability, measures continue to be pursued to further reduce costs to the absolute minimum necessary to maintain the ongoing safety and reliability of the electricity supply and delivery system.

Tab 4 of this Application provides more information regarding MH11-2 and the Corporation's financial targets, and Tab 5 provides more detailed information with respect to Manitoba Hydro's revenues, expenses and net income for the 2009/10 to 2013/14 period. The remaining tabs in Volume I of the Application provide additional supporting material, including discussions of the Corporate Strategic Plan, organizational structure and management control processes of Manitoba Hydro (Tab 3), capital expenditures (Tab 6), and demand side management (Tab 7). Volume II of this Application will include materials on Manitoba Hydro's electric load forecast, energy supply, proposed rates and customer impacts, and responses to a number of PUB directives.