MANITOBA HYDRO
2010/11 & 2011/12 GENERAL RATE APPLICATION

SUMMARY AND REASONS FOR APPLICATION

INDEX

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2.0 OVERVIEW

Section 2.1 provides a summary of Manitoba Hydro's current financial position and the projections for the future.

Section 2.2 provides a summary of the reasons for Manitoba Hydro's Application

2.1 SUMMARY OF FINANCIAL POSITION

Table 2.1.1 below compares the actual and forecast revenues, expenses and net income of the Corporation's Electrical Operations for the fiscal years ended March 31, 2008 to March 31, 2012. The proposed, and future rate increases are identified in the table as "proposed increases".

Table 2.1.1 - Actual and Forecast Net Income and Retained Earnings
Years Ending March 31

	Actual		Forecast		
(in millions of $)	2008	2009	2010	2011	2012
General Consumers Revenue					
- at approved rates	$ 1,075	$ 1,127	$ 1,160	$ 1,159	$ 1,177
- with proposed increases	n/a	n/a	n/a	33	69
Extraprovincial Revenue (net of fuel, power purchased and water rentals)	366	323	192	141	195
Other Revenue	8	16	7	7	8
	1,448	1,466	1,358	1,342	1,449
Expenses	1,112	1,178	1,237	1,263	1,363
Non-controlling Interest					1
Net Income (electric operations)	$ 337	$ 288	$ 121	$ 78	$ 87
Retained Earnings (consolidated)	1,822	2,120	2,227	2,315	2,396
Debt Ratio (consolidated)	76%	75%	74%	75%	76%

The Corporation's net income on electricity operations for 2008/09 reflected a continuation of favourable water flow conditions and strong extraprovincial sales as was the case in the previous year. These favourable conditions have allowed Manitoba Hydro to achieve its 75:25 debt/equity target for the first time in the Corporations history by the end of 2008/09, three years ahead of the 2011/12 target date.

Table 2.1.2 provides a summary of the revenue and expense projections contained in MH09-1 for the period of 2010 to 2012 and a comparison to the same projections from MH08-1.

Table 2.1.2 - MH09-1 to MH08-1 for Years Ending March 31, 2010, 2011, 2012
Increase/(Decrease)

	2010			2011			2012		
(in millions of $)	MH09-1	MH08-1	Variance	MH09-1	MH08-1	Variance	MH09-1	MH08-1	Variance
General Consumers at approved rates	1,160	1,159	1	1,159	1,190	(30)	1,177	1,214	(37)
Projected Rate Increases		45	(45)	33	82	(49)	69	120	(52)
Extraprovincial Revenue (net of fuel, power purchased and water rentals)	192	235	(43)	141	159	(17)	195	152	43
Other	7	7	(0)	7	7	(0)	8	8	0
Total Revenues	1,358	1,446	(87)	1,342	1,438	(96)	1,449	1,495	(46)
Operating and Administrative	372	358	13	380	365	14	403	379	25
Finance Expense	417	420	(3)	413	426	(13)	468	473	(5)
Depreciation and Amortization	368	371	(4)	386	388	(2)	407	431	(24)
Capital and Other Taxes	73	71	2	76	74	2	77	74	3
Corporate Allocation	8	8	0	9	8	0	9	8	1
Total Expenses	1,237	1,228	9	1,263	1,261	2	1,363	1,364	(1)
Non-controlling Interest							1	2	(1)
Net Income	121	218	(97)	78	177	(98)	87	133	(46)

As the table demonstrates, there has been a significant reduction in projected net income between MH08-1 to MH09-1. The decrease of $241 million over the three fiscal years ending March 31, 2012 is primarily due to decreases in revenues. Projected Manitoba load requirements are lower compared to MH08-1 as a result of the economic downturn. Although lower domestic demand combined with favourable water conditions has resulted in more surplus energy available for export, lower market export prices more than offset the favourable volume variances in net extraprovincial revenues. The total projected expenses for 2010 to 2012 are relatively stable between MH08-1 and MH09-1.

As a result of the decreased projections of net income, the debt/equity ratio is projected to rise to 76:24 by the end of 2012 versus the 75:25 that was projected in IFF08. Beyond 2012, the debt/equity ratio is projected to rise to 80:20 by 2019, largely due to the capital program, and then to improve significantly as the returns from capital investments are realized.

2.2 SUMMARY OF APPLICATION

Manitoba Hydro's last rate hearing which occurred in the spring of 2008 resulted in Board Order 90/08 which approved a 5% increase effective July 1, 2008 and a conditional 4% rate increase effective April 1, 2009. Board Order 32/09 varied the conditional 4% rate increase and approved a 2.9% increase for all classes except for roadway lighting.

Manitoba Hydro is applying to the Manitoba Public Utilities Board ("PUB") for approval of rate schedules incorporating a 2.9% increase for all rate classes effective April 1, 2010 and a further 2.9% effective April 1, 2011. This Application is made pursuant to *The Crown Corporations Public Review and Accountability Act*.

The requested rate increases of 2.9% in 2011 and 2012 maintain the appropriate balance between customer sensitivity and fiscal responsibility. In consideration of the economic downturn and the effects on ratepayers, 2.9% increases in each of the next two years are considered to be reasonable. Manitoba Hydro's proposed rate increases are considerably lower than rate increases in most other jurisdictions in Canada.

The ten-year period to 2020 is being referenced as "the decade of investment" in which major investments, totalling $16.5 billion, are being made to Hydro's generation, transmission and distribution systems. The decade following 2020 is being referenced as "the decade of returns" in which significant benefits are returned to the energy ratepayers of Manitoba.

During "the decade of investment", there will be a requirement to increase debt in order to finance Hydro's investments in new generation, transmission and distribution facilities. While the debt ratio is projected to increase from the current level of 74:26 to a high of 80:20 over the next decade, the ratio quickly recovers in "the decade of returns" and is projected to reach 51:49 by the end of that decade. This is accomplished with domestic rate increases which, over the longer term, are closely aligned with projected rates of inflation.

The Corporation faces a number of risks in the fulfilment of its mandate. Among those risks, drought continues to be a major risk facing Manitoba Hydro with its reliance on hydropower. However, because the Financial Forecast incorporates average revenues resulting from historical water flows over close to the past 100 years, drought is reflected in Manitoba Hydro's financial projections. Of course, the timing of drought is unknown and should the Corporation experience a repeat of the worst drought on record, the impact on retained earnings could exceed $2.4 billion. It is, therefore, important that Manitoba Hydro maintains an adequate level of retained earnings and that rates be raised gradually even during years of exceptional water flows. An adequate level of retained earnings also provides funding for capital investments which reduces the need for borrowing and reduces the financing costs that ultimately must be recovered from ratepayers. Furthermore, credit rating agencies closely monitor the adequacy of Manitoba Hydro's retained earnings and associated key financial ratios.

Tabs 4 through 6 of the application will update Manitoba Hydro's current financial position and incorporate the most current expense data and the Corporation's 2009 Integrated Financial Forecast (IFF09-1), along with updated forecasts of revenue, capital expenditures and other pertinent items. The remaining tabs in the application provide additional supporting material and an update on the status of PUB directives.