Manitoba Hydro Revenue Requirement Panel

May 29, 2023

Key Highlights

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OUTLINE

1. The Requested Rates and Other Items
2. Summary of Impacts of Payments to Govt
3. The Proposed 2% Rate Path
4. The Importance of Confirming the 3.6%
5. Reasons for the Rates In The Test Years
6. O&A and Capital Expenditures
7. Debt Management
8. Regulatory Deferrals and SAP S/4
9. Conclusions and Summary

1 The Requested Rates and Other Items

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What Manitoba Hydro is Requesting

Approvals requested are highlighted in Tab 1 (Letter of Application)

The requests to be reviewed as part of the Revenue Requirement panel are:

- Final approval of Orders 137/21 and 140/21, which approved, on an interim basis, a 3.6% rate increase effective January 1, 2022 (*Tab 1 – Item 1*);
- Approval of rate schedules incorporating an overall increase in General Consumers Revenue of 2.0% effective September 1, 2023, sufficient to generate additional revenues of $24 million in 2023/24 (*Tab 1 – Item 2*);
- Approval of a further overall increase in General Consumers Revenue of 2.0% effective April 1, 2024, sufficient to generate additional revenues of $38 million in 2024/25 (*Tab 1 – Item 3*);
- Endorsement of changes to existing deferral accounts and the establishment and amortization of new regulatory deferral accounts, as discussed in Tab 4, Appendix 4.3 (Amended) of this Application (*Tab 1 – Item 8*)

2 Summary of Impacts of Payments to Govt

Payments to Government

COST SAVINGS

50% reduction to the water rental fee
50% reduction to the debt guarantee fee

BENEFITS TO CUSTOMERS

$3.8 billion less revenue estimated to be collected from customers under the 2.0% rate path vs. 3.5% rate path

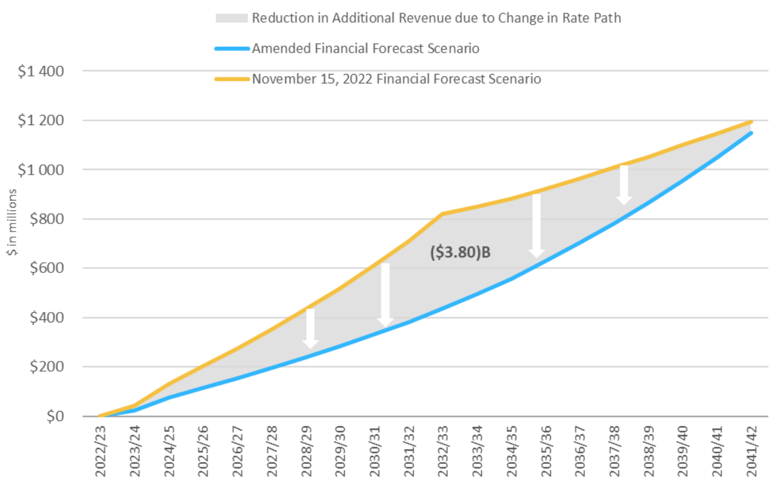
RESULTS IN A MATERIAL CHANGE TO MH'S FINANCES

Over the 20-year forecast, the direct savings from the reduction of the fees is estimated to total **$3.7 billion**.

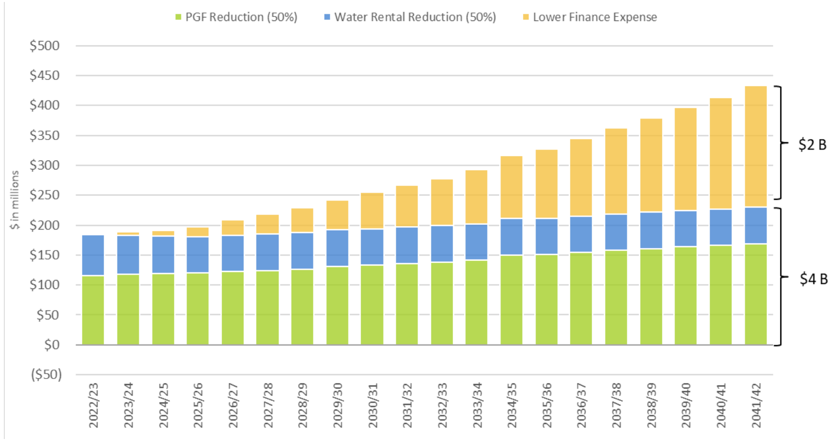
MH will also see savings associated with lower interest expense as a result of both debt retirement and debt avoidance.

The $3.7 billion reduction to government fees could result in an additional **$2 billion** of savings in the form of lower finance expense had the fees not been reduced.

Reduction in Additional Revenue due to Change in Rate Path



Savings due to Reduced Payments to Government



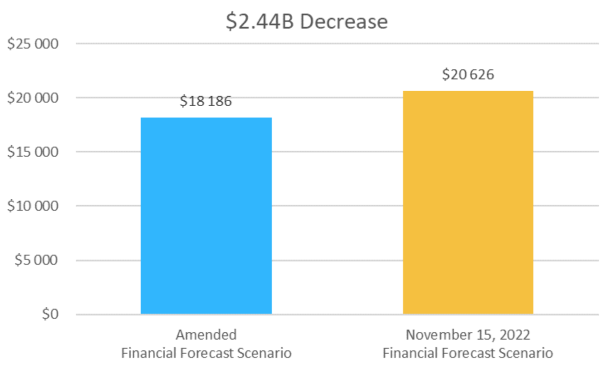
Impacts of Reduced Payments to Government

In the ***Amended Financial Forecast Scenario***, the $3.7 billion combined reduction to net finance expense and water rentals is matched by a $3.8 billion reduction to additional rate revenue by adjusting to the 2.0% rate path.

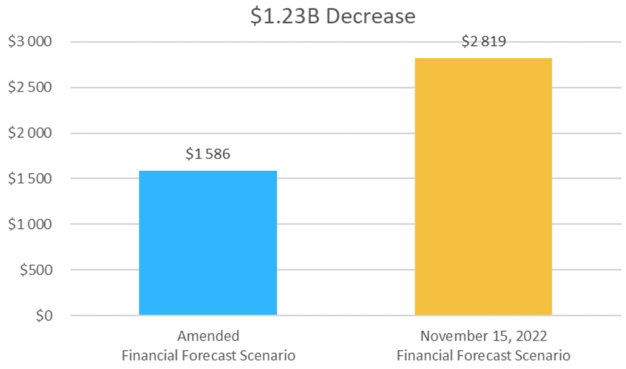
$3.7B

$3.8B

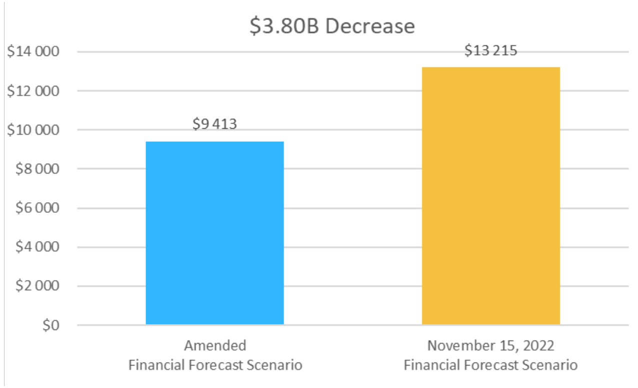
20 Year Cumulative Net Finance Expense



20 Year Cumulative Water Rentals & Assessments



20 Year Cumulative Additional Domestic Revenue



3 The Proposed 2% Rate Path

2% Rate Path Guided by Key Priorities

LEGISLATIVE COMPLIANCE
Compliance with legislated rate-setting regulatory framework that sets the maximum general rate increase at the level of inflation or 5%, whichever is lower, and to achieve debt-to-equity targets by 2035 and 2040

STABLE & PREDICTABLE RATES
Stable and predictable rates for customers, together with keeping rates low compared to other jurisdictions

FINANCIAL HEALTH
Gradually improving Manitoba Hydro's financial health over time

SYSTEM RELIABILITY
Ensuring system reliability and modernizing the grid through system investments funded from cash from operations where possible

THE PROPOSED 2% RATE PATH IS:

- A smoothed rate path to achieve the 70% debt ratio target and the rate cap
- Based on a balancing of the identified priorities
- Considers multiple financial metrics
- Based on average conditions

THE PROPOSED 2% RATE PATH IS <u>NOT</u>:

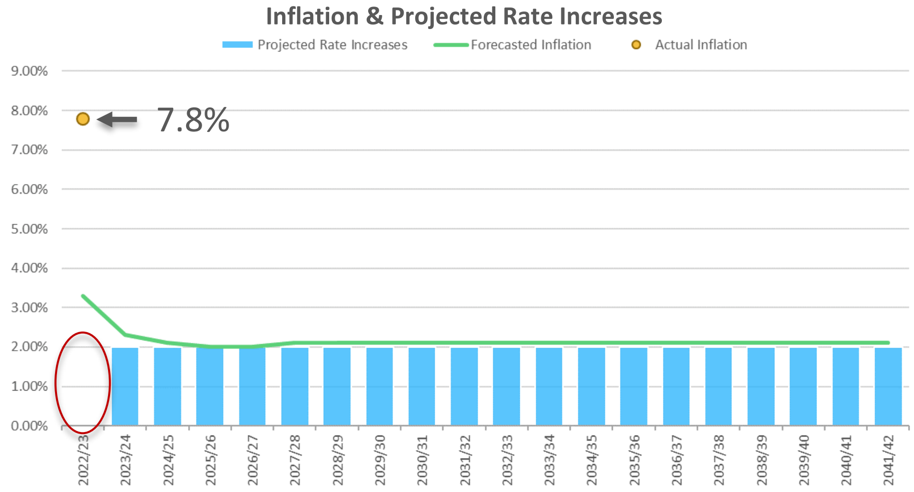
- Simply a mechanistic goal seek
- Overly focused on one priority for setting the rate path

Incorporation of *The Act* into the Rate Path

Although the ***Rate Cap*** and the ***Debt Ratio Targets*** do not strictly apply to this Application, Manitoba Hydro considered the implications of both for determining the proposed rate path

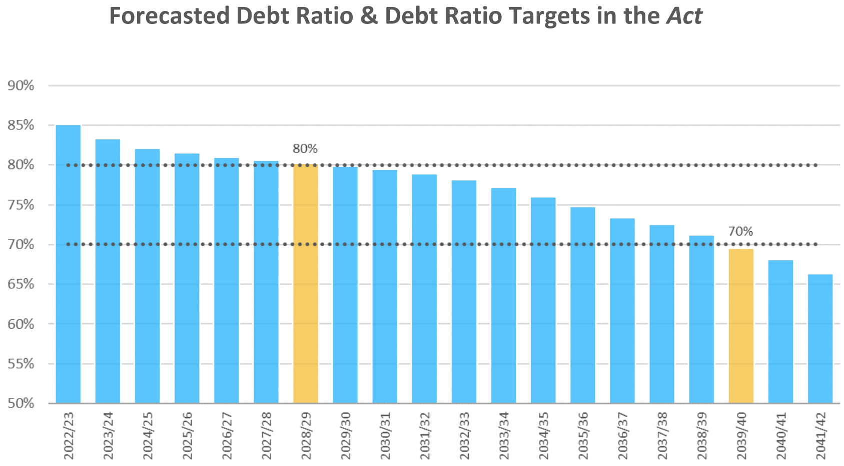
RATE INCREASES AT OR BELOW INFLATION

Rate increases are not forecasted to exceed the projected rate of inflation in any year of the forecast, including the Test Years



ACHIEVEMENT OF THE DEBT RATIO TARGETS

The current debt-to-capitalization ratio is 85:15 (Mar 31, 2023). The Debt ratio targets in the Bill are achieved on or before the target dates



Updated MB CPI Forecast

Manitoba Consumer Price Index Forecast

	Spring 2022	Spring 2023
2021/22	4.6 *	4.6 *
2022/23	3.3	7.8 *
2023/24	2.3	3.5
2024/25	2.1	2.2
2025/26	2.0	2.1
2026/27	2.0	2.0
2027/28	2.1	2.0
2028/29	2.1	1.9
& on	2.1	2.1

* Actual

Table represents current fiscal year over previous fiscal year, % change

Per Statistics Canada, ***Manitoba CPI for 2022/23 was 7.8%***

Updates to Manitoba Hydro's consensus forecast of key economic indicators is typically done annually each Spring

The consensus view is made up of up to 11 independent sources – Canada's primary financial institutions and several well-known and respected independent sources

Manitoba Hydro's Spring 2023 long-term forecast for Manitoba CPI remains at or around 2%

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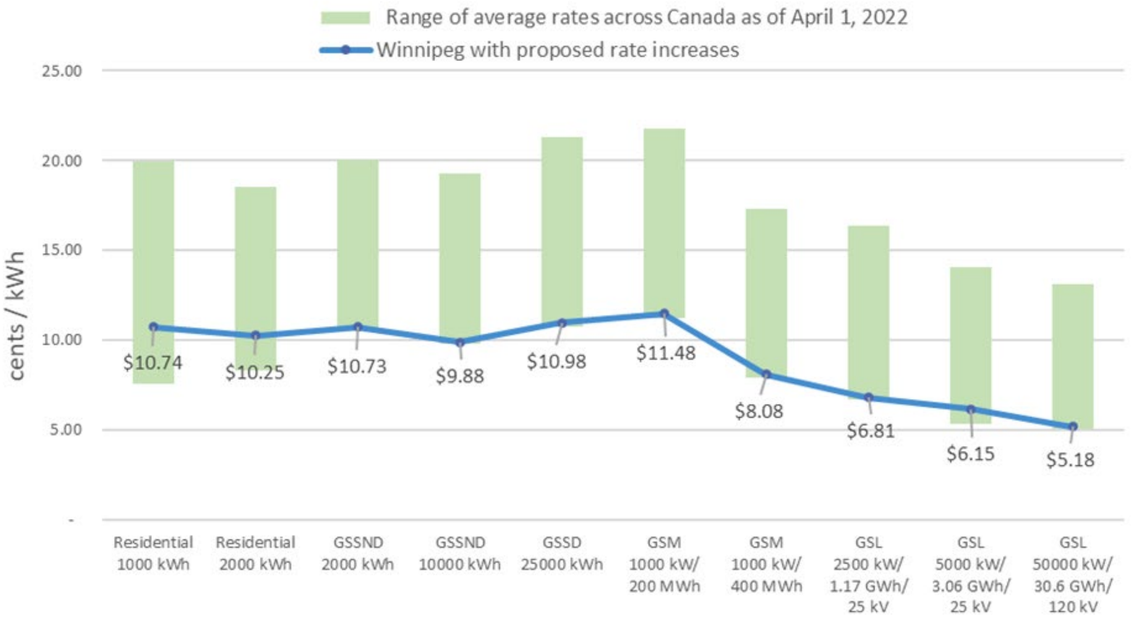
Stable & Predictable Rates, Lower vs. Other Jurisdictions

STABILITY & PREDICTABILITY

The pace at which Manitoba Hydro pursues its financial targets needs to be balanced against the impact to both today's customers and future customers

2% RATE PATH AND LOW RATES

Manitoba Hydro customers will continue to be the lowest or among the lowest in 2023/24 and 2024/25 even when comparing bills that reflect the 2.0% proposed rate increases while keeping the average rates of all other utilities at those in effect as of April 1, 2022



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Gradually Improving Financial Health Over Time

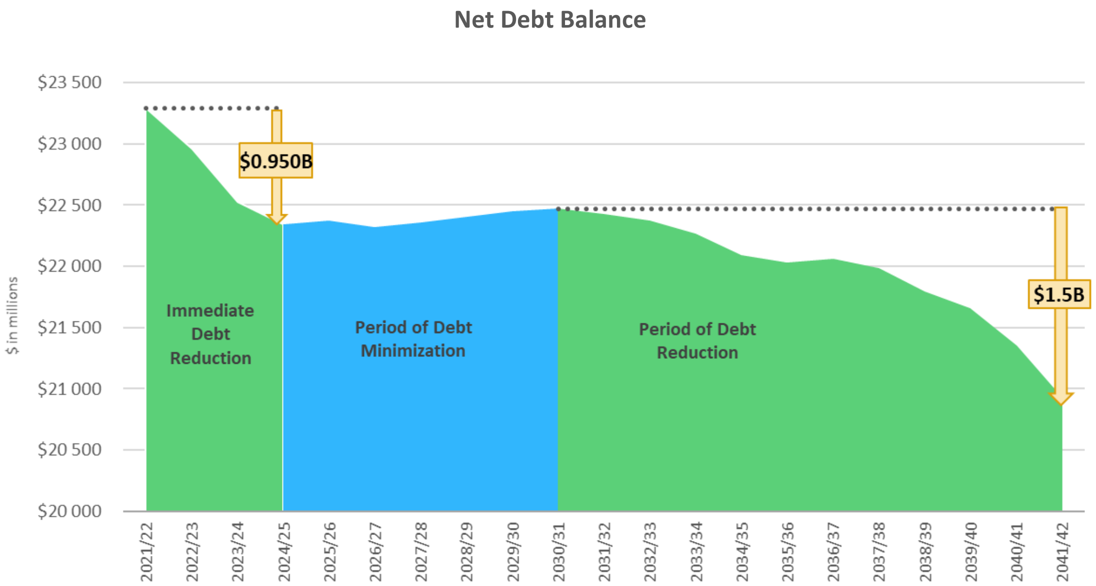
STEADY PROGRESS TOWARDS THE TARGETS

Progression towards the debt ratio targets outlined in *The Act* by gradually reducing debt in the capital structure and increasing retained earnings

REDUCED NET DEBT & INCREASED EQUITY

In order to hit the debt ratio targets, MH will need to increase its equity (Retained Earnings) and decrease its levels of absolute net debt over the forecast period

To achieve this necessary increase to retained earnings and reduction in net debt, the level of net income and cash generated from operations will need to increase



NOTE*: This was demonstrated in response to COALITION/MH I-11a-c.*

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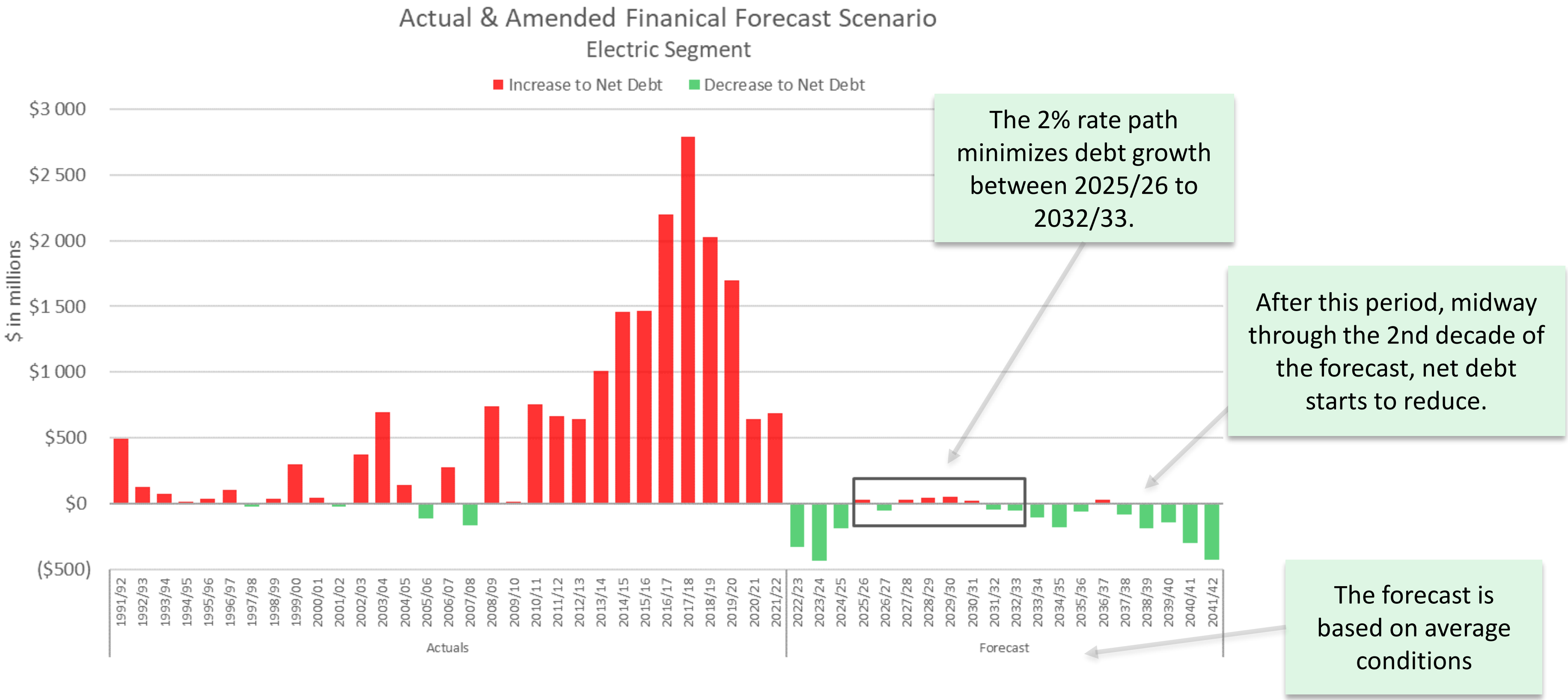
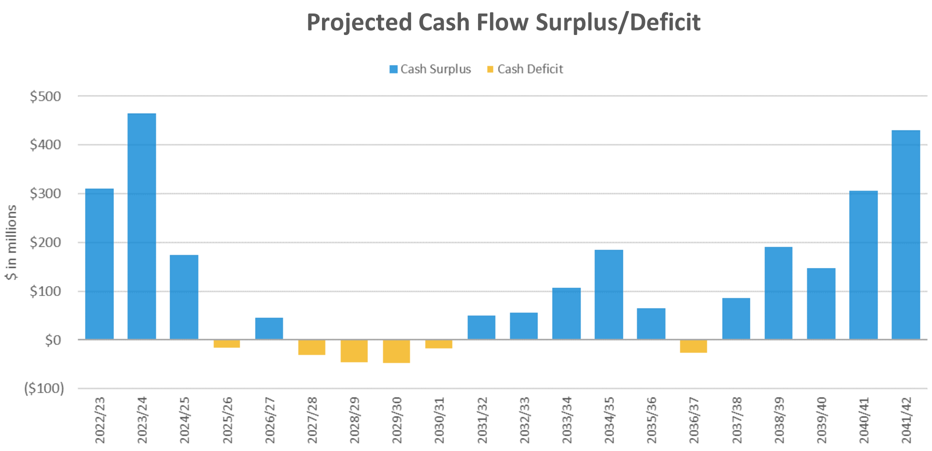
Change in Net Debt Under 2% Rate Path

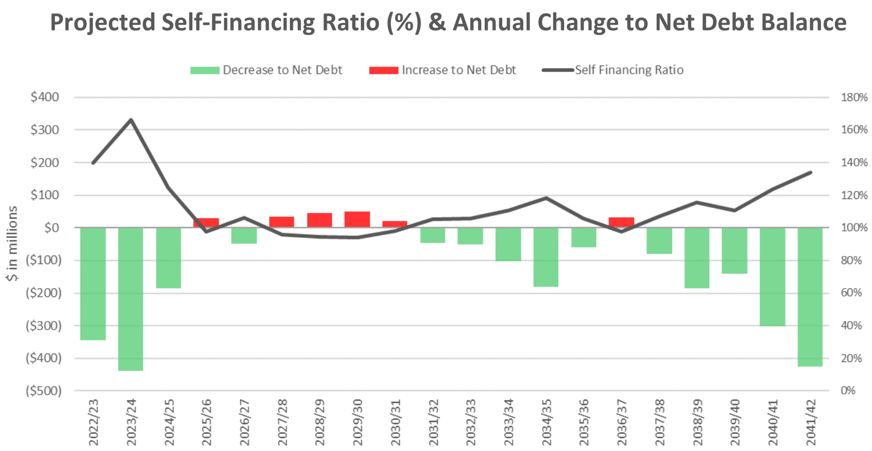


The Importance of Cash Flow & Link to CapEx

There Needs To Be A Surplus Of Cash After Investments In Order To Reduce Net Debt

- In years where there is a ***deficit*** instead of surplus, ***debt grows***
- What's important is the inflow vs. outflow of cash. That is what the Cash Flow Surplus/Deficit & the Self-Financing Ratio measure
- MH is monitoring the Self-Financing Ratio, which considers the ability to fund investments from cash from operations
- Long-standing financial objective to fund BOC with internally generated funds (i.e. cash from operations)





Comparison to Previous Rate Paths – MH Exhibit #93

AVERAGE NET INCOME
$645M vs $440M

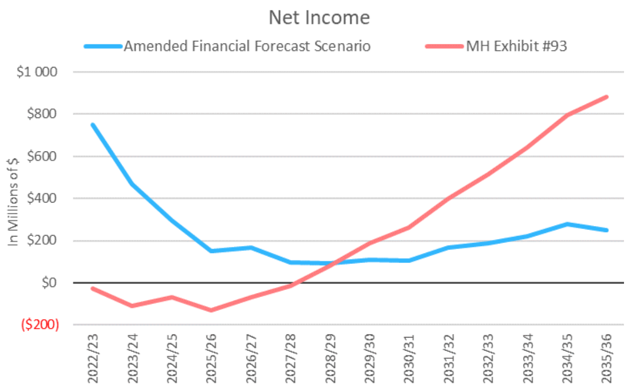
Average net income for the last five years under MH Exhibit #93 was approximately $645 million, compared to average net income of approximately $440 million in the last five years under the Amended Financial Forecast Scenario.

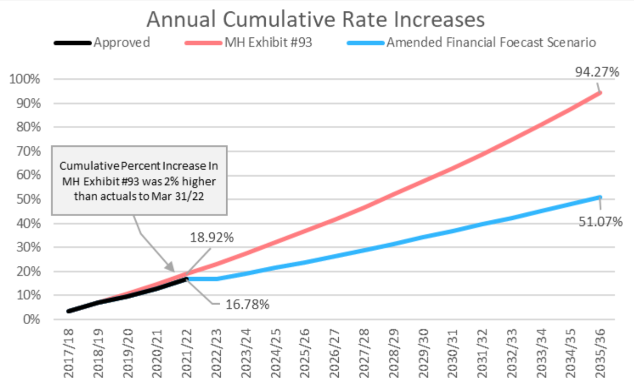
AVERAGE ANNUAL RATE INCREASE
3.57% vs 2%

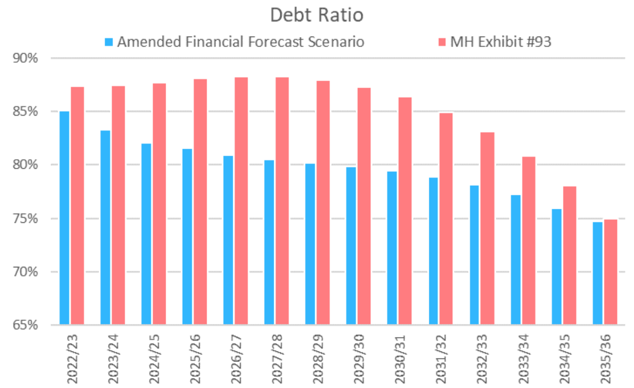
The average annual rate increase under MH Exhibit #93 was 3.57% compared to the 2% rate path under the current Amended Financial Forecast Scenario

DEBT RATIO
BOTH 75% by 2036

The debt ratio under the Amended Financial Forecast Scenario and MH Exhibit #93 both reach 75% by 2036







4 The Importance of Confirming the 3.6%

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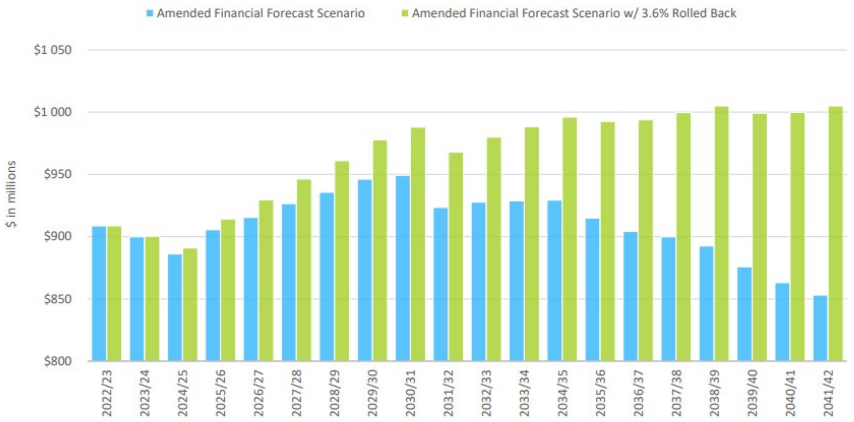
Confirmation of 3.6% interim rate increase

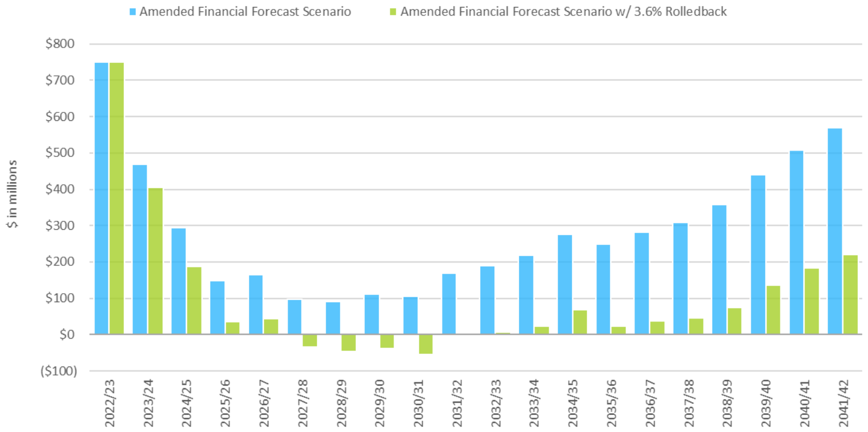
Confirmation of the 3.6% interim rate increase is part of the rate path & essential to improving Hydro's financial health and providing rate stability for customers

Compared to the Amended Financial Forecast Scenario, ***a scenario without confirming the 3.6% interim rate increase*** resulted in an additional $1.2 billion in finance expense and a $3.7 billion reduction in retained earnings over the 20-year forecast period.

Net Finance Expense

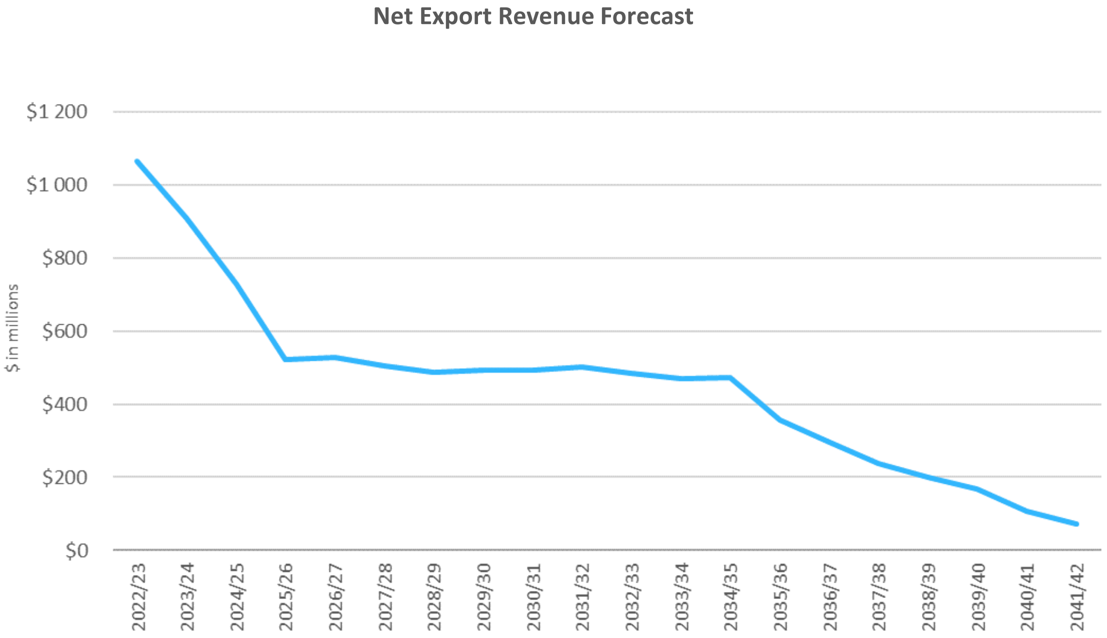


Net Income



5 Reasons for the Rates in the Test Years

Net Export Revenue is Decreasing Over the Forecast



EXPIRATION OF LONG-TERM CONTRACTS

The NSP system power sale ends at the beginning of 2025/26, after which net export revenue remains flat at roughly $495 million for the next ten years

NET EXPORT REVENUE DECREASE

There is a steady decline (dropping below $100 million by the end of the planning horizon) as a result of the addition of new wind PPAs that increase fuel and power purchased in the last seven years of the forecast

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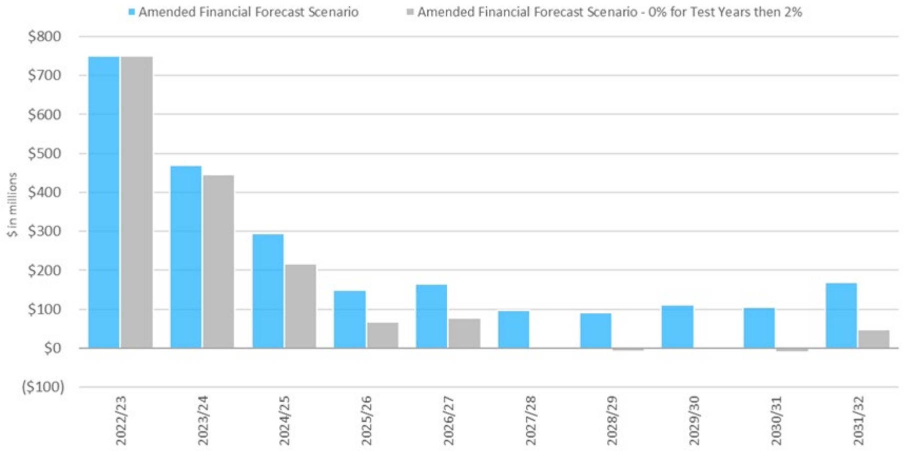
Importance of Rate Increases in 2023/24 & 2024/25

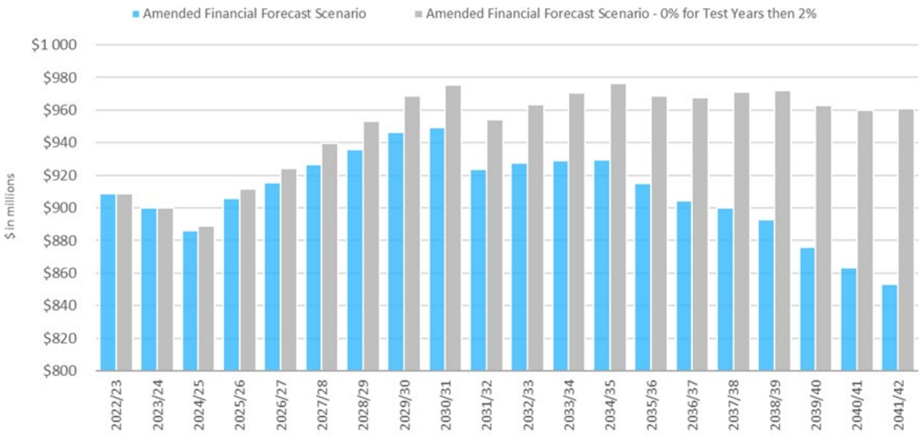
2% increases in 2023/24 & 2024/25 (with 3.6% interim) have a significant effect on results over the forecast

Without the 2% increases in 2023/24 & 2024/25 both net income and the debt ratio are impacted

- In certain years forecasted net income is near break-even or is a loss, and that's assuming average conditions
- The 70% debt ratio target by 2040 is not achieved

Finance expense remains elevated throughout the forecast period (impacting revenue requirement)





6 O&A and Capital Expenditures

Alignment to Prioritized Strategic Pillars

MANITOBA HYDRO 2026 ASPIRATION

Optimize / improve the efficiency of the current business and set the organizational foundations and capabilities to accelerate Manitoba Hydro's transformation and journey to realize Strategy 2040

Prioritized Strategic Pillars

1. Provide safe, reliable energy that responsibly meets the evolving needs of Manitobans
5. Keep energy prices as low as possible while providing the level of service Manitobans expect
2. Serve customers efficiently, responsively, and digitally

LINK TO O&A AND CAPITAL PLAN

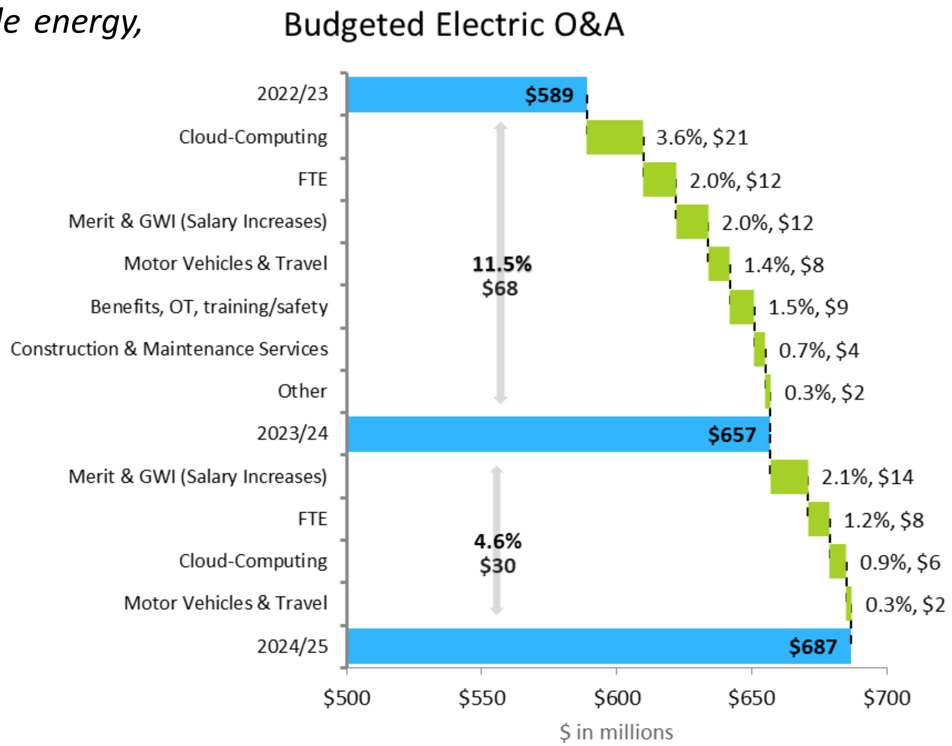
- Focus is on rebuilding trades and professional trainee programs to address attrition and **meet customer service level expectations**
- Shift to cloud computing enables technology debt to be addressed and is in line with industry best practice to **leverage new technologies**, **improve cyber security** and **facilitate continuous improvement**
- Business Operations Capital (BOC) is focused on capital investments which **optimize life cycle costs and improve reliability**
- **Federal funding** for three capital projects (Birtle, Pointe du Bois and Portage Area Capacity Enhancement) reducing BOC by almost $200M

O&A Increases are Required

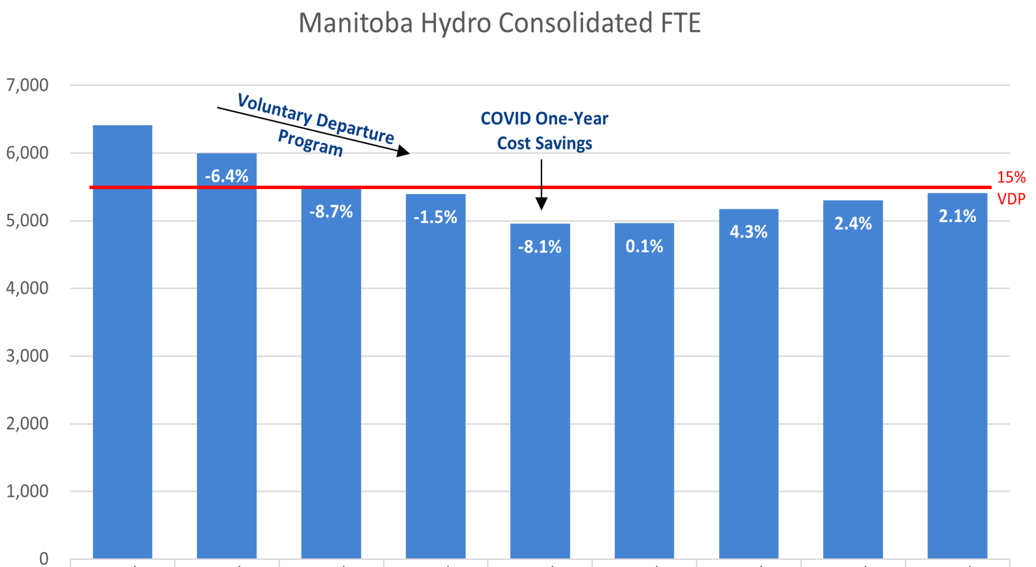
Operating & Administration (O&A) costs are increasing to ensure Manitoba Hydro continues to provide safe, clean, reliable energy, operating as efficiently and effectively as possible

O&A INCREASES ARE LARGLY DRIVEN BY:

- FTE & Salary Increases
- Cloud Computing
- Motor Vehicle Expenditures, including Fuel
- Inflationary Increases



Full Time Equivalents (FTEs)



	2016/17 Actual	2017/18 Actual	2018/19 Actual	2019/20 Actual	2020/21 Actual	2021/22 Actual	2022/23 Forecast	2023/24 Preliminary Budget	2024/25 Preliminary Budget
FTE	6,411	5,998	5,475	5,393	4,954	4,962	5,175	5,298	5,408

Note: FTEs include full time, part time, terms, seasonal, students and subsidiary (Centra, Manitoba Hydro International (MHI) and Manitoba Hydro Utility Services (MHUS)) employees.

SIGNIFICANT REDUCTION IN FTE

Manitoba Hydro has experienced almost a **25% reduction in FTEs from 2016/17 through 2021/22** – which includes:

- 15% reduction through the Voluntary Departure Program (VDP) started in 2017
- 2020/21 hiring freeze to support government cost savings initiative related to COVID-19, along with 3 unpaid days to most employees
- High levels of attrition

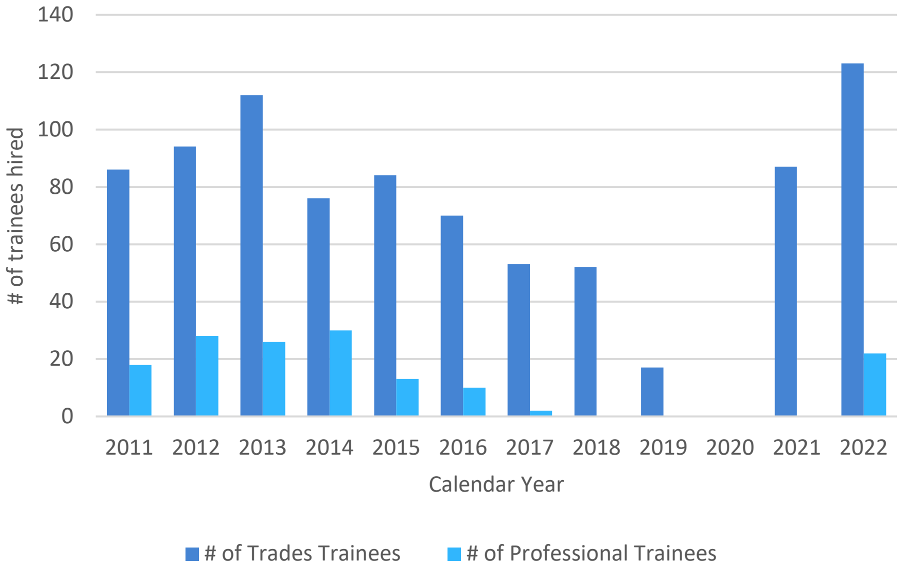
IMPACT ON RELIABILITY AND CUSTOMER SERVICE LEVELS

- We are falling behind on the maintenance of our aging assets, which impacts reliability
- Our ability to meet customer in-service dates (developers, large industrials, telecoms, etc.) has deteriorated

PLAN TO REBUILD TO PRE-PANDEMIC LEVELS

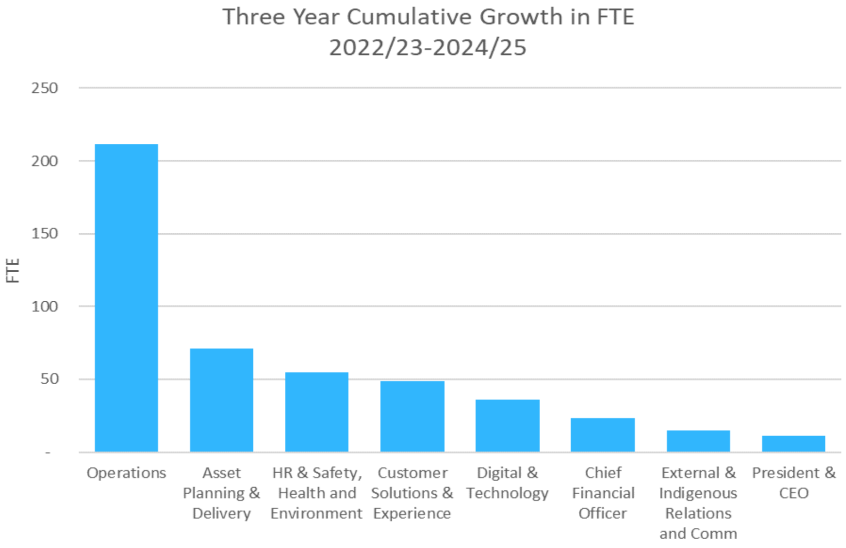
- Focus is on trades/technical trainees and professional trainees
- **2024/25 Preliminary Budget maintains the 15% VDP reduction**

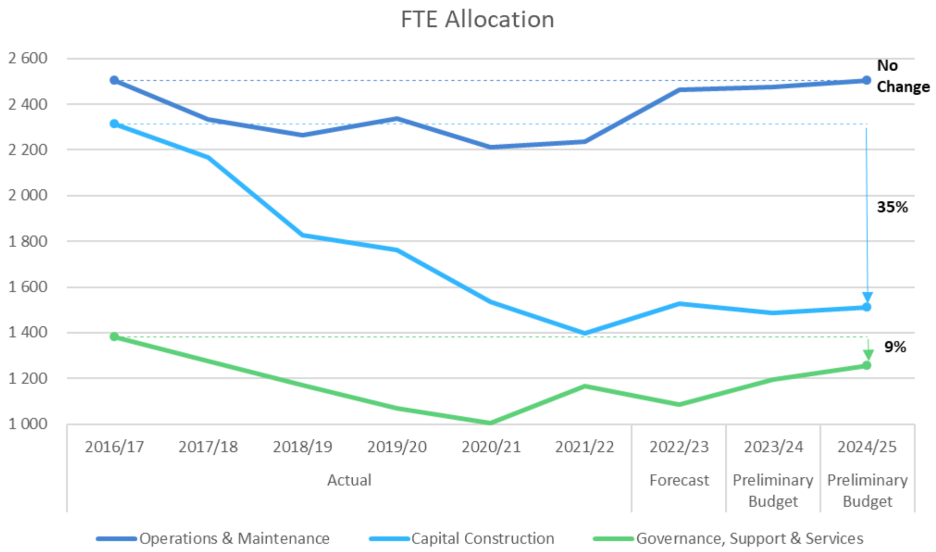
Focus is on Rebuilding the Core Workforce



- Manitoba Hydro is a training utility; **specialized learning and on-the-job training required for most trades' employees**, which takes 2-4 years for trainees to be deemed qualified
- **Recruitment** into trades/technical and professional trainee programs **slowed down and/or was halted** following VDP and due to years of cost reductions
- FTE increase in Test Years is required to **rebound to sustainable levels** to fill the "gap" that was created from previous years, worsened with attrition
- This increase is **necessary to ensure reliability, improve customer response times and catch up on maintenance** of Manitoba Hydro's assets

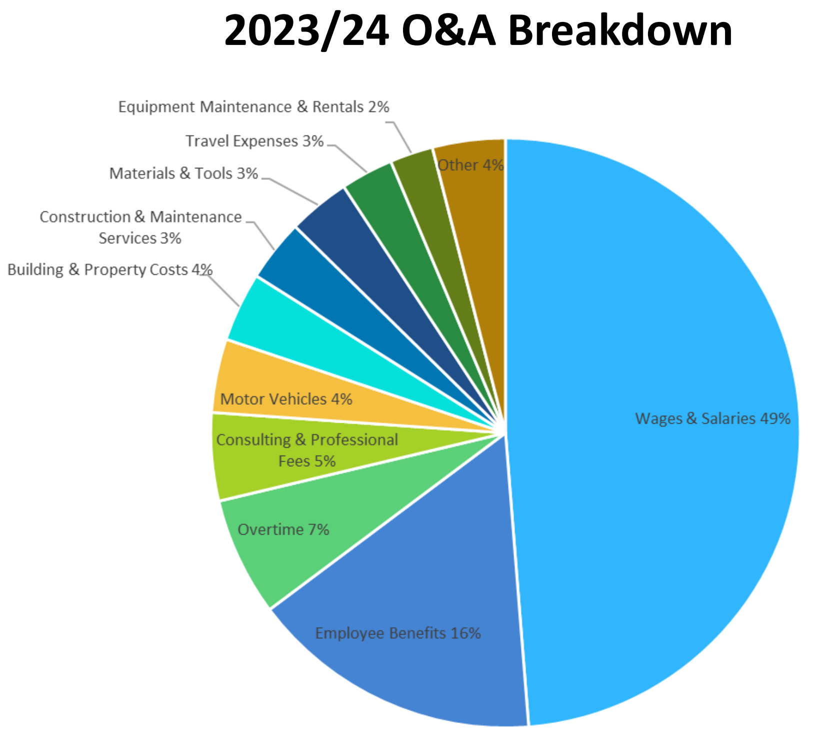
FTE Growth is Primarily in Operations





While FTEs are growing, 15% FTE reduction is maintained through the Test Years

Majority of O&A Costs Related to Staffing



Over 70% of O&A expenses are staffing related:

- 49% Wages & Salaries
- 16% Employee Benefits
- 7% Overtime

Over 80% of O&A expenses are Operational Employee Related expenditures

- Includes safety equipment and training, travel (meals/ accommodations/per diems) and motor vehicle expenses directly tied to staffing

What is driving the increase in Consulting and Professional Fees?

Primarily Cloud, including SAP S/4

Several items including:
- Keeyask environmental monitoring and partnership requirements
- Other environmental monitoring
- IRP
- Asset Management
- Project Management
- Staff Augmentation

Budgeting Processes

Manitoba Hydro leverages top-down and bottom-up budgeting, for both O&A and capital, to validate that plans are in place to meet the needs of the business while keeping the financial health and impact on customers in focus at an enterprise level.

O&A

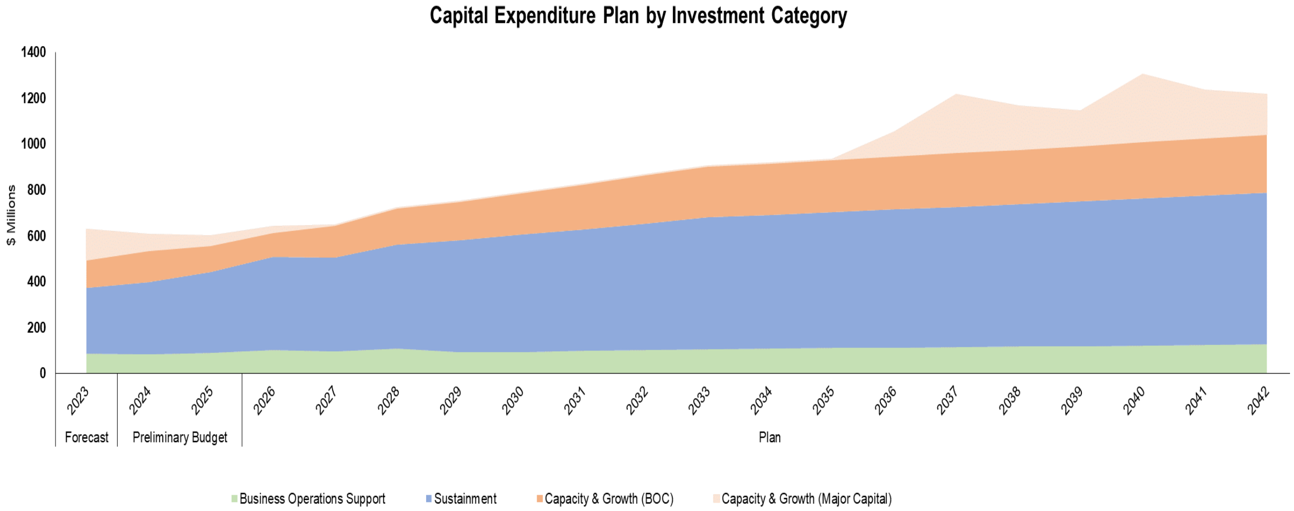
- Combined top-down and bottom-up approach taken
- Top-down guidelines based on enterprise approach to pace O&A and FTE growth
- Detailed budgeting developed by each business unit bottom-up
- Forecasts examined thoroughly from bottom-up exercise to understand required changes
- Senior Management review and approval of bottom-up budgets

CAPITAL

- Targets are recommended by Asset Management, Fleet, Digital & Technology and Corporate Facilities
- Targets are evaluated along with the financial forecast keeping the financial health and impact on customers in focus at an enterprise level
- Senior Management review and approval of targets
- Detailed project budgets developed; balanced to targets through portfolio adjustments

Capital Expenditure Plan

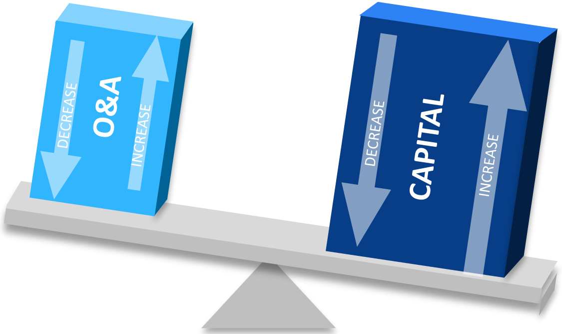
- Manitoba Hydro's **assets are aging and need investment**
- **Sustainment of our existing assets is the primary focus** of Manitoba Hydro's Capital Expenditure Plan
- Increased investment is required to **maintain required levels of performance** and **mitigate risks** related to safety, reliability, compliance, and the environment
- Majority (>90%) of forecasted capital expenditures are related to Business Operations Capital (BOC)

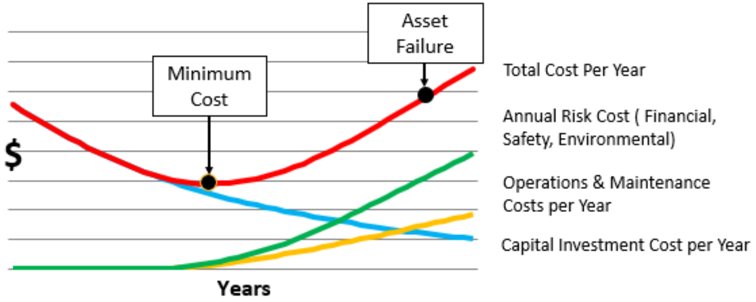


- Future resource requirements (identified as Major Capital) are also forecasted in the later part of the forecast
- Capital Expenditure Plan is **rigorously planned, reviewed, and tested**

O&A and Capital Expenditures are Directly Linked

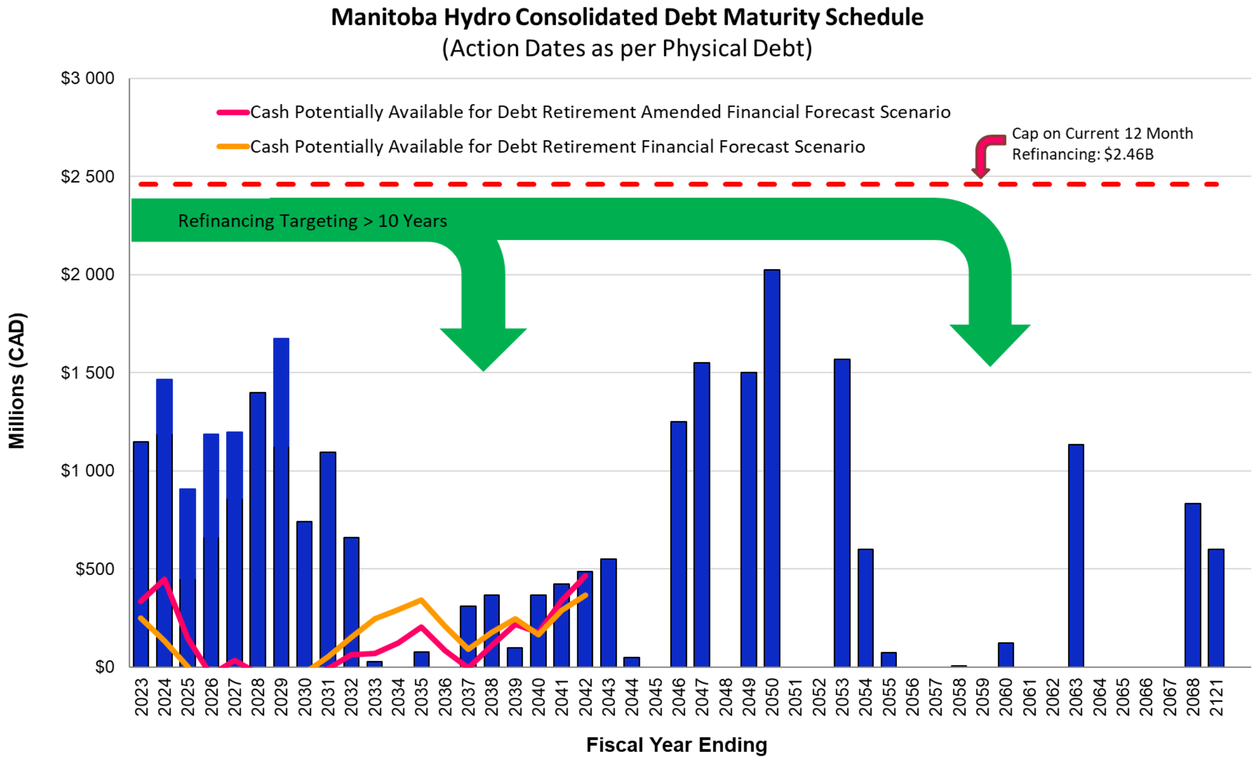
- O&A increases are required to **ensure reliability, improve customer response times and catch up on maintenance** of Manitoba Hydro's assets
- Capital plan is focused on investments which **optimize life cycle costs and improve reliability**
- **Reducing capital expenditures arbitrarily will increase O&A** as reliability needs to be maintained
- Running assets to failure is not cost effective - **O&A costs will increase with the age of an asset** resulting in higher overall total costs





7 Debt Management

Debt Management Summary



MARCH 31, 2023

Variable Rate Debt as a % of Portfolio
1%

Debt Maturing within 12 months as a % of Portfolio
6%

Weighted Average Term to Maturity of Debt Portfolio
19.1 Years

Weighted Average Interest Rate of Debt Portfolio
3.4%

OBJECTIVE

To provide **low cost, stable funding** to meet the financial obligations and liquidity needs of the Corporation, while *maintaining risk at prudent levels* and *reserving sufficient flexibility* to adapt to changing circumstances.

Debt Management in an Exciting Time

- The energy sector has seen unprecedented changes in recent years. The trends of **decarbonization, digitalization and decentralization** will continue to shape and disrupt Manitoba Hydro's business environment in the coming years.
- The **pace and breadth of these changes are unpredictable**, but the **$10 billion of long-term debt** which Manitoba Hydro has **maturing this decade is not.**
- With no external borrowing for new major capital on the horizon this decade, **now is the time for** recovery **of Manitoba Hydro's** financial health **and** financial metrics to proactively position ourselves as financially resilient to respond to the emerging needs and expectations of our customers.

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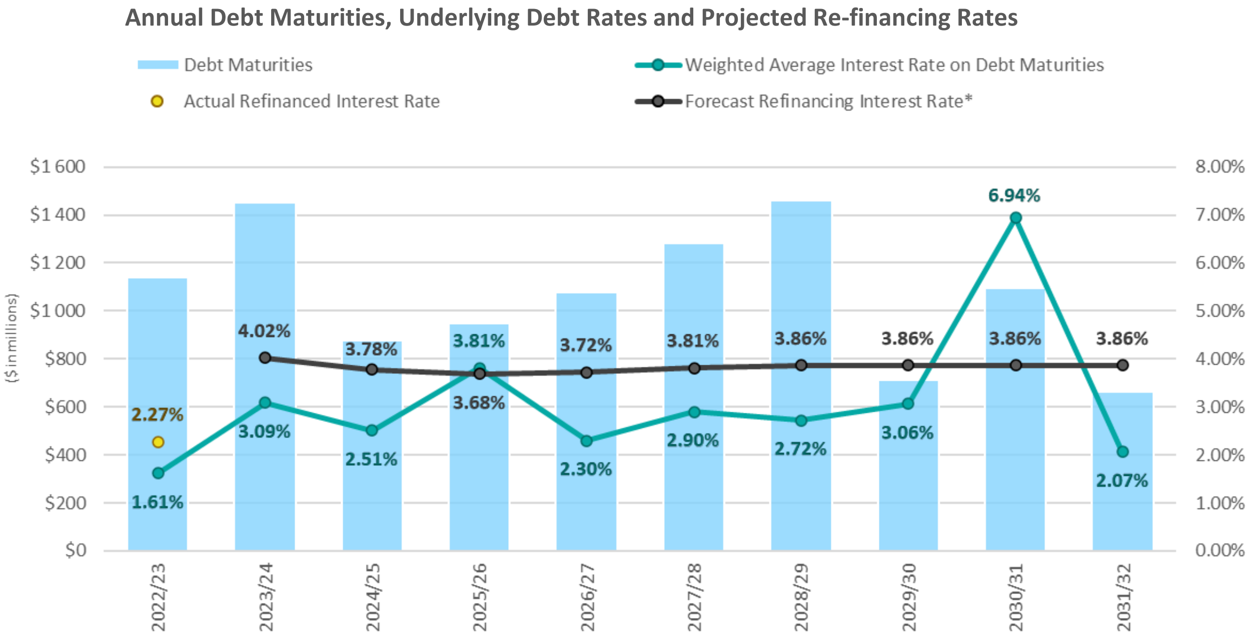
Interest Rate Risk



*Forecast rates are a blended rate of 85% fixed rate debt and 15% floating rate debt to match model assumptions on forecasting borrowings
NOTE: Interest rates presented above exclude the Provincial Guarantee Fee

RISK MITIGATION

- ✓ Target an Interest Rate Risk Profile (IRRP) **< 10%**
- ✓ Minimize addition to the refinancing schedule in the next decade
- ✓ Target to maintain longer term weighted average term to maturity (WATM) of debt portfolio.
- ✓ Manage refinancing risk by continuing to smooth the debt maturity schedule

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Financial Health and Debt Management

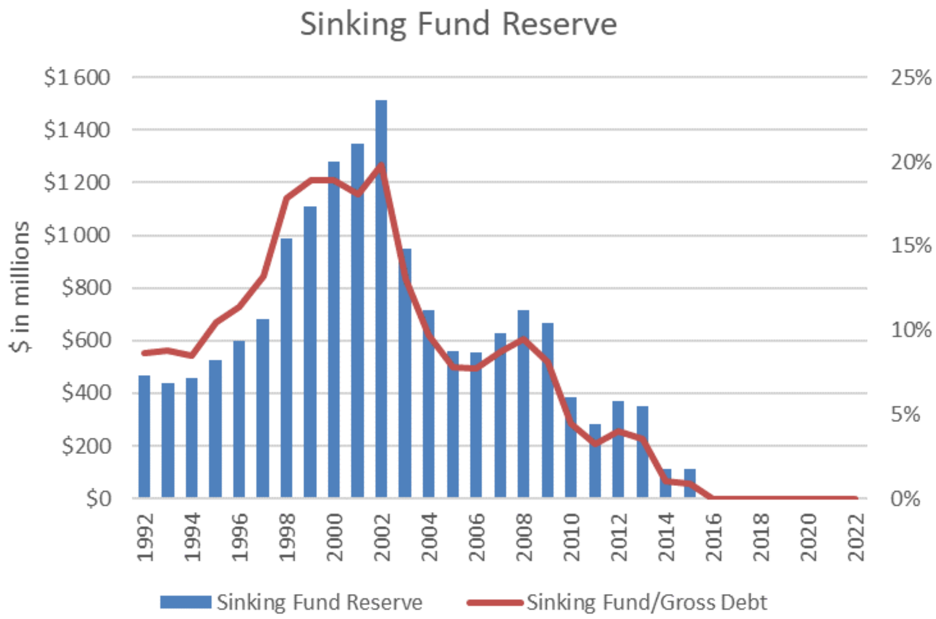
Challenge	Impact	Target Metric
Liquidity	Solvency and stability	Cash on hand: 6 months cash requirements Sinking fund reserve: minimum legislated contribution
Debt Level	Interest Expense Level Financial Flexibility Contingent Liability to Province	Debt in Capital Structure Ratio: legislated targets 80% by 2035, 70% by 2040 Improve other metrics including Cash Flow/Debt
Interest Rate Environment	Interest Expense Volatility	Interest Rate Risk Profile: within policy and guideline limits target IRRP < 10% of debt portfolio
Borrowing Authority Limit	Access to low-cost debt financing	Temporary borrowing authority = $500 million New borrowing authority = new approved capital Remaining refunding authority = debt refinanced
Independent Assessment	Self-supporting Status	Credit Opinions from Moody’s, DBRS and S&P affirming status

Sinking Fund Reserve

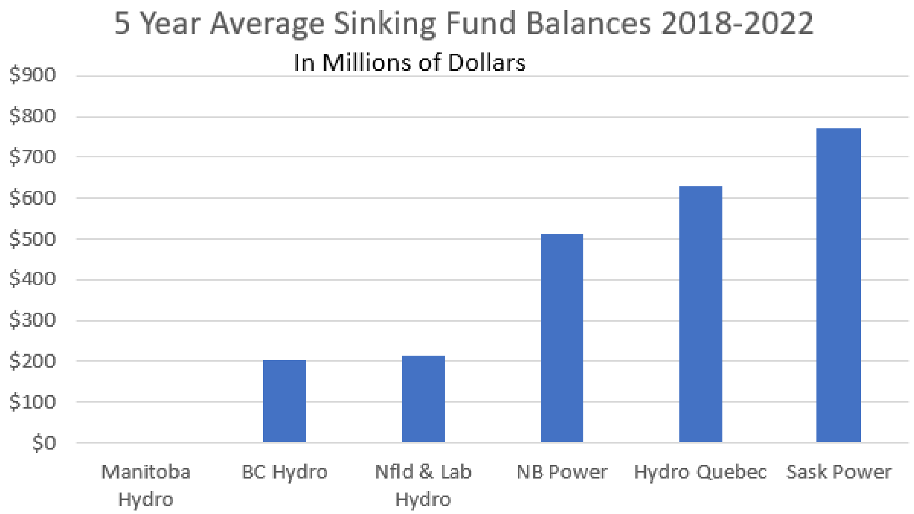
The Manitoba Hydro Act **requires MH to set aside a reserve out of internally generated funds for the repayment of debt**

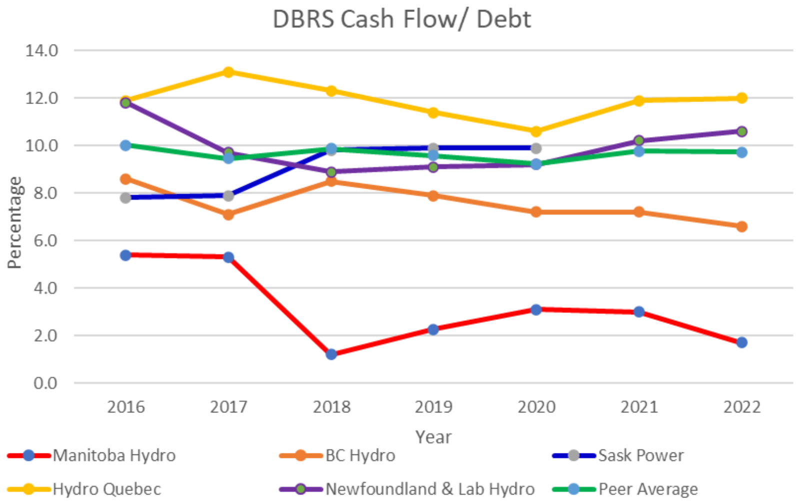
- Reserve **contribution formula retires debt** over a period of approximately **42 years**
- MH has held sinking fund reserves throughout history
- In the last decade, MH was reinvesting all earnings in assets to expand its core business
- To minimize accumulation of gross debt and impacts to finance expense, MH began reducing the accumulated sinking fund balances
- As investing activities exceeded cash flow from operations, MH was unable to contribute to the sinking fund reserve

MH requires Cash flow from Operations to exceed Cash used for Investing activities in order to contribute earnings of the corporation to the sinking fund reserve for debt retirement



Sinking Fund Reserve Mitigates Risks



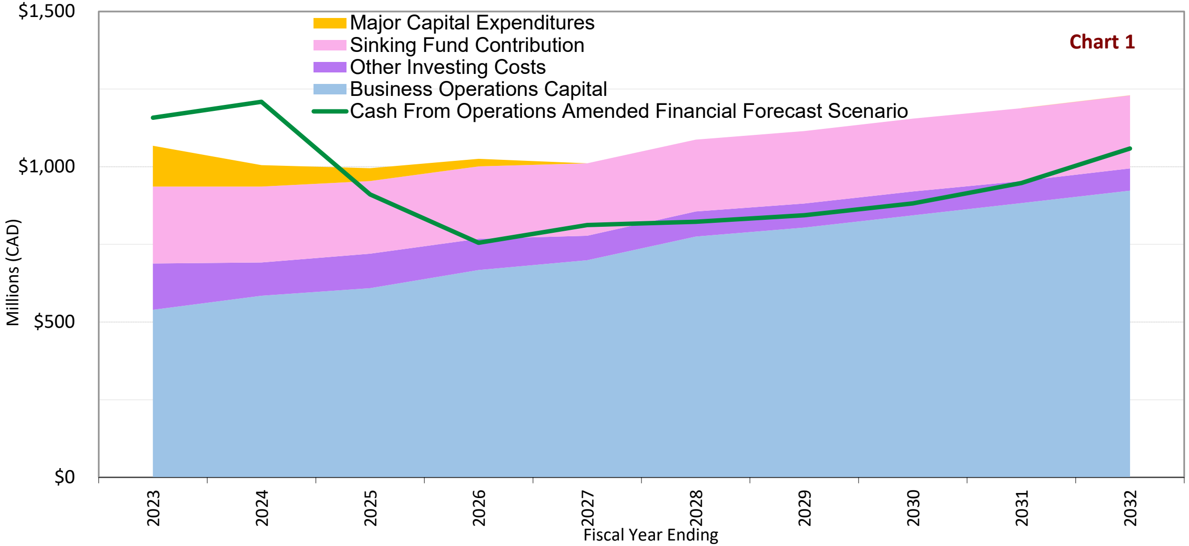


The sinking fund reserve protects against liquidity risk and interest rate risk providing the utility with cash to repay debt maturity obligations each year.

Financial Resilience

The attributes of a self-supporting Crown corporation (CC) pertaining to cash flow:

- CC is **generally profitable** and does **not rely** on material subsidies or **supports from the provincial government**
- CC is generally able to meet its **ongoing costs and maintenance capital expenditures** through **internally generated cash**
- **Debt servicing costs** will be met through the regular course of business or through a well-defined recovery mechanism (e.g., **rates**)



Source: DBRS 2022 Canadian Provincial and Territorial Government Outlook, p 58

- **Debt servicing costs** are **interest** and **principal payments** on debt over a particular period of time.

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8 Regulatory Deferrals & SAP S/4

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Regulatory Deferral Requests

1. **Keeyask in-service deferral account**: Endorsement of the deferral account and approval of an amortization period of 106 years
2. **SAP S/4 deferral**: Seeking PUB approval for the establishment of a regulatory deferral account to record the annual O&A expenses of costs related to the potential implementation of SAP S/4 CCA and to amortize the deferred balance for rate setting purposes over a period of 10 years subsequent to the actual in-service date
3. **Depreciation Methodology**: ***To be discussed in detail as part of the Depreciation Panel***
4. **Major Capital Projects Deferral Account**: Determination of an amortization period. Manitoba Hydro has proposed amortization on a straight-line basis over a period of 2 years effective April 1, 2025.
5. **DSM Deferral**: Write-off of the DSM Deferral debit and credit accounts. Consistent with PUB Order 161/19 Directive 7 for Centra Gas. There is no impact to forecasted net income

The Effect of a Regulatory Deferral

For the year ended March 31	2022/23	2023/24	2024/25
REVENUES			
Domestic Revenue			
at approved rates	1 875	1 847	1 853
additional	-	24	74
Extraprovincial	1 283	1 153	964
Other	29	29	29
	3 186	3 052	2 920
EXPENSES			
Operating and Administrative	589	657	687
Net Finance Expense	909	900	886
Depreciation and Amortization	618	632	643
Water Rentals and Assessments	81	83	79
Fuel and Power Purchased	139	163	156
Capital and Other Taxes	160	162	163
Other Expenses	118	80	74
Corporate Allocation	7	7	7
	2 621	2 684	2 695
Net Income before Net Movement in Reg. Deferral	565	368	224
Net Movement in Regulatory Deferral	190	106	77
Net Income	755	474	301
Net Income Attributable to:			
Manitoba Hydro	**751**	**469**	**295**
Wuskwatim Investment Entity	4	5	6
Keeyask Investment Entity	0	0	0
Total Non-Controlling Interests	4	5	6
	755	474	301

HOW REGULATORY DEFERRALS IMPACT THE INCOME STATEMENT

Using the proposed SAP S4 regulatory deferral as an example, the following outlines how costs are initially recorded and then are updated through net movement as a result of a regulatory deferral being established

+ **SAP COSTS INITIALLY INCLUDED IN O&A**

	2022/23	2023/24	2024/25
Operating & Administrative	589	657	687
Adjustments in Net Movement in Reg Deferral:			
Provision for Ineligible OH	(20)	(20)	(20)
Provision for SAP S/4HANA	-	(13)	(23)
Operating & Administrative Including Net Movement	*569*	*625*	*644*

- **SAP COSTS "REMOVED" VIA NET MOVEMENT**

SAP S/4 Regulatory Deferral

- Manitoba Hydro's current SAP ECC was implemented in 1997
- The business case for SAP S/4 is still in development
- The Financial Forecast Scenario includes anticipated expenditures for SAP S/4 on the basis it is considered likely that SAP S/4 is implemented.
- If implemented, it's anticipated that SAP S/4 would be cloud-based, and its costs would be captured as O&A expenditures
- Establishment of a regulatory deferral for SAP S/4 will defer costs of an implementation until it is in-service, similar to how it would be treated if it were a capital project (like the previous SAP implementation)

Impact to Net Income **Establishment and Amortization of SAP S/4HANA CCA** ***(in Millions)***	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28**	**2028/29**	**2029/30**	**2030/31**	**2031/32**
Net Income before SAP S/4HANA CCA deferral	$ 751	$ 456	$ 272	$ 125	$ 142	$ 72	$ 67	$ 88	$ 121	$ 185
Deferral of SAP S/4HANA CCA	-	13	23	24	24	25	25	23	-	-
Amortization of SAP S/4HANA CCA									(16)	(16)
Net Income including deferral and amortization of SAP S/4HANA CCA	**$ 751**	**$ 469**	**$ 295**	**$ 149**	**$ 166**	**$ 97**	**$ 92**	**$ 111**	**$ 105**	**$ 169**

9 Conclusions and Summary

Conclusion and Summary

As part of this smoothed rate path,
confirmation of the 3.6% increase and the 2% rate increases
in 2023/24 & 2024/25 play a critical role, as follows:

DEBT

Minimize increases to finance expense as a result of being able to retire debt an minimize the amount of new debt.

INTEREST PAYMENTS

Reducing finance expense allows Manitoba Hydro to use more of the revenues generated from customers to fund operations versus making interest payments.

EXPORT REVENUES

Address the anticipated reduction in export revenue as dependable export contracts expire starting in 2025/26.

CAPITAL EXPENDITURES

Provide sufficient cash from operations to fund required capital expenditures and minimize the use of new debt; and Improve Manitoba Hydro's ability to mitigate the financial impact of imposed risks.