# 2.8 EXHIBIT 5: COST OF CAPITAL AND CAPITAL STRUCTURE

## INDEX

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# 2.8 EXHIBIT 5: COST OF CAPITAL AND CAPITAL STRUCTURE

## 2.8.1 CAPITAL STRUCTURE

**Overview of Capital Structure**

The purpose of this evidence is to provide an overview of Guelph Hydro's capital structure and financing plans for the 2016 Test Year. Detailed schedules on capital structure and debt issuances can be found in this Exhibit, Appendix 5-A: Chapter 2 Appendix 2-OA and Appendix 5-B: Chapter 2 Appendix 2-OB. Guelph Hydro's capital structure for ratemaking purposes and the ensuing evidence has been prepared in accordance with the Report of the Board on Cost of Capital for Ontario's Regulated Utilities (the "Cost of Capital Report") (EB-2009-0084) issued on December 11, 2009.

**Capital Structure:**

In its 2012 Cost of Service Application (EB-2011-0123), Guelph Hydro's deemed capital structure of 60.00% total debt and 40.00% equity had an OEB-approved regulated rate of return of 6.80%.

**Table 5-1**

**2012 - Board Approved**

| Description | Deemed Portion | Effective Rate |
|---|---|---|
| Long-Term Debt | 56.00% | 5.26% |
| Short-term Debt | 4.00% | 2.08% |
| Return On Equity | 40.00% | 9.42% |
| **Weighted Debt Rate** | | 5.05% |
| **Regulated Rate of Return** | | 6.80% |

Guelph Hydro has prepared this Application with a deemed capital structure of 56.00% Long Term Debt, 4.00% Short Term Debt, and 40.00% Equity to comply with the Cost of Capital Report.

The Total Capitalization (debt and equity) equate the Total Rate Base of $162,960,102 (please see Appendix 5-A of this Exhibit and Exhibit 2, Tab 1, 2.5.1 Rate Base).

**Table 5-2**

| 2016 - Test Year | | |
|---|---|---|
| **Description** | **Deemed Portion** | **Effective Rate** |
| Long-Term Debt | 56.00% | 5.18% |
| Short-term Debt | 4.00% | 2.16% |
| Return On Equity | 40.00% | 9.30% |
| **Weighted Debt Rate** | | 4.98% |
| **Regulated Rate of Return** | | 6.71% |

**Cost of Debt: Long Term**

On December 6, 2010, Guelph Hydro finalized an arrangement with a group of investors with CIBC acting as advisor, to secure $65 million of financing (debentures) at an interest rate of 5.264%, which interest rate included a spread of 1.65% over the benchmark Government of Canada (please see Appendix 5-B of this Exhibit).

The proceeds from this debt issue were partly used to retire a promissory note for $30 million owed to the City of Guelph, and partly used to retire $12.558 million intercompany promissory note payable to Guelph Hydro Inc. (GHI). The remaining amount of $22.442 million was used to fund Guelph Hydro's Smart Meter Plan and the Arlen Transformer Station. A copy of Guelph Hydro's 2010 promissory note is provided in Appendix 5-C of this Exhibit.

Guelph Hydro intends to issue an additional $30 million in long-term debt to fund capital expenditures that were incurred in the 2012 to 2015 period (which had been funded out of cash from operations) and to fund on-going capital expenditures in 2016 and beyond. The $30 million incremental long-term debt will be issued in either mid-to-late 2015 or in 2016, depending on market conditions. Should Guelph Hydro issue long-term debt in 2015, it will file an update to this pre-filed evidence. One of the benefits of undertaking a debt issue in 2015 is that the actual debt costs will be known with certainty. The additional long-term debt issue will ensure consistency between the company's actual capital structure with its deemed capital structure of 60% debt-to-40% equity. Because Guelph Hydro's capital expenditures in the 2012 to 2015 period have been funded out of cash from operations, the company's actual debt-to-equity ratio has fallen below its deemed debt-to-equity ratio. As at December 31, 2014, Guelph Hydro's actual long-term debt-to-equity ratio was 1.08, which is indicative of an under-leveraged balance sheet relative to the OEB-allowed debt-to-equity ratio of 1.50. With the planned incremental $30 million in long-term debt, Guelph Hydro's actual (or "book") capital structure will largely reflect the deemed 60% debt-to-40%-equity capital structure.

**Explanation of the applicable debt rate for each existing debt instrument**

Guelph Hydro is requesting a return on deemed Long Term Debt for the 2016 Test Year of 5.18%, which rate has been determined as a weighted average interest rate:

($65,000,000 X 5.264% + $30,000,000 X 4.85% X 7/12) = $4,270,276 total interest for 2016 Test Year

Issuance/floatation costs of $250,000 are included in the 4.85% interest rate for the new $30 million long-term debt issue.

**Table 5-3**

**Addition to Debt Rate for Issuance (Floatation) Costs**

| | |
|---|---|
| Total Issuance Costs | $250,000 |
| Principal amt of debt | $30,000,000 |
| Less Issuance costs | $29,750,000 |
| Assumed Interest Rate | 4.81% |
| Interest Expense | $1,442,750 |
| Effective Debt Rate | **4.85%** |

$4,270,276/ ($65,000,000 + $30,000,000 X 7/12) X 100 = 5.18% weighted interest rate for 2016 Test Year.

In order to make the OEB's Appendix 2-OB work, Guelph Hydro has changed the formula in cell I112 from "=IF(H112=0,"",J112/H112)" to "=IF(H112=0,"",J112/(H99+H100*7/12))".

**Cost of Debt: Short Term**

Guelph Hydro is requesting a return on deemed Short Term Debt for the 2016 Test Year of 2.16%. The requested Short-Term Debt rate is in accordance with the Cost of Capital Report, and Guelph Hydro will adjust the rate as needed to determine its final revenue requirements in accordance with the Cost of Capital Parameter Updates for 2016 Cost of Service Applications anticipated to be issued by the OEB on or about November 2015. Guelph Hydro's use of a Return on Short Term Debt of 2.16% is without prejudice to any revised Cost of Capital Parameter updates that may be adopted by the OEB.

Appendix 5-B: Chapter 2 Appendix 2-OB of this Exhibit presents Guelph Hydro's debt instruments.

**Preferred Shares**

Guelph Hydro currently has no preferred shares in its equity structure, and has no plans to issue any preferred shares in 2016 and beyond.

**Common Equity**

Guelph Hydro issued 1,000 common shares on October 31, 2000 (please see Exhibit 1, Appendix 1-K: Guelph Hydro 2013 Audited Financial Statements – Note 19).

| | |
|---|---|
| Authorized: | |
| Unlimited number of common shares | |
| Issued: | |
| 1,000 common shares | $ 43,374 |

## 2.8.2 COST OF CAPITAL (RETURN ON EQUITY AND COST OF DEBT)

**Return on Equity:**

Guelph Hydro is requesting a return on equity ("ROE") for the 2016 Test Year of 9.30% in accordance with the formulaic methodologies documented in the Cost of Capital Report and the Cost of Capital Parameter Updates for 2015 Cost of Service Applications issued by the OEB on November 20, 2014. Guelph Hydro understands that the OEB will finalize the ROE for 2016 rates based on the formulaic methodology in the Cost of Capital Report on or about November 2015, and Guelph Hydro will rely on the OEB's 2016 ROE to determine its final revenue requirement. Guelph Hydro's use of an ROE of 9.30% is without prejudice to any revised ROE that may be adopted by the OEB.

**Forecasts of new debt anticipated in the bridge and test years - Financing Plans**

Guelph Municipal Hydro Inc. (GMHI) is the sole shareholder of Guelph Hydro. Guelph Hydro attempts to maintain an actual capital structure that mirrors its deemed structure through managing its debt load and through rebalancing equity via dividends to its shareholder as necessary. Due to capital expenditures undertaken between 2012 and 2015 which were largely financed out of cash from operations, the Company's actual debt-to-equity ratio has fallen below its deemed debt-to-equity ratio. To bring the company's capital structure back into balance with its deemed capital structure, and to more appropriately match long-term assets with long-term liabilities, Guelph Hydro intends to issue an additional $30 million in long-term debt in 2016 to fund distribution capital. Tables 5-4 and 5-5 below show Guelph Hydro's deemed debt before and after the issuance of the additional long-term debt.

**Table 5-4: Prior to Long-Term Debt Issue**

| Current Deemed Debt Compared to Actual Long Term Debt | | |
|---|---|---|
| Deemed Long Term Debt Percentage | 56.00% | A |
| 2016 Rate Base | $162,960,102 | B |
| Deemed Long term debt | $91,257,657 | C = A x B |
| Actual Long Term debt | $65,000,000 | D |
| Deemed debt in Excess of Current Long Term Debt | $26,257,657 | E= C - D |

**Table 5-5: Post-Long-Term Debt Issue**

| Deemed Debt in Excess of Current Long Term Debt | | |
|---|---|---|
| Deeemed Long Term Debt Percentage | 56.00% | A |
| 2016 Rate Base | $162,960,102 | B |
| Deemed Long term debt | $91,257,657 | C = A x B |
| Actual Long Term debt | $95,000,000 | D |
| Deemed debt in Excess of Current Long Term Debt | -$3,742,343 | E= C - D |

**Financial Market Overview and Forecast**

The 2012 to 2015 period can be characterized as the post-2008/2009 financial crisis recovery period. Canadian government bond yields reached historic lows over this period driven by economic growth concerns, moderating inflation expectations and geopolitical events. With the worst of the economic crisis considered to be over, corporate debt spreads, which had remained low for much of 2014, began to move higher late in 2014 due to volatility in financial markets and due to the decline in oil prices, which was indicative of increased corporate risk. Nevertheless, despite periodic increases in short-term volatility, the demand for corporate credits is expected to remain stable into 2015 and beyond, and Guelph Hydro believes that it will be able to issue new long-term debt at relatively attractive long-term rates.

## Forecast Long-Term Debt Issues

**Table 5-6**

| Description | Expected Issue Date | Term | Principal | Underlying Govt Bond Rate | Corporate Spread Forecast | Forecast Coupon Rate before flotation cost |
|---|---|---|---|---|---|---|
| $30 M Issue | June 2016 | 10 Years | $30,000,000 | TBD | 2.0% | 4.81% |

Forecasted debt rates are based on the most recent projection of equivalent term Government of Canada Bonds, as provided by a consensus forecast from three Schedule 1 Chartered banks (please see Exhibit 5, Appendix 5-D), plus Guelph Hydro's estimate of corporate spreads at the time of issuance.

**Table 5-7**

**Consensus Forecast of 10-year Government of Canada Bonds + Guelph Hydro's Credit Spread**

| | Forecast before flotation costs | |
|---|---|---|
| **Schedule I Bank** | **2015** | **2016** |
| Canadian Imperial Bank of Commerce | 2.85% | 2.75% |
| Royal Bank of Canada | 3.15% | 4.04% |
| Bank of Montreal | 2.28% | 2.99% |
| **Average/Consensus Forecast** | **2.76%** | **3.26%** |
| Credit Spread from CIBC | 1.55% | 1.55% |
| Average 10-Year Bond Rate for Guelph Hydro | **4.31%** | **4.81%** |

## Short-Term Debt

For the 2016 Test Year, Guelph Hydro does not forecast the need to issue short-term debt. Together with the planned long-term debt issue, cash levels are expected to be sufficient to fund short-term financing needs throughout the test year. Guelph Hydro maintains a short-term credit facility that is available for the company to draw upon in the event that short-term funds are required.

As outlined in the Board's Cost of Capital Report, short-term debt is deemed throughout the forecast as 4% of the company's capital structure for ratemaking purposes.

For the purposes of the pre-filed evidence, the forecast short debt interest rate applied for the determination of 2016 revenue requirement is 2.16%, the Board's approved rate for the 2015 Cost of Service applicants. The final short-term debt rate will be updated according to the Cost of Capital guidelines prior to the January 1, 2016 distribution rates implementation date.

Guelph Hydro's use of a Return on Short Term Debt of 2.16% is without prejudice to any revised Cost of Capital Parameter updates that may be adopted by the OEB.

**Credit Rating**

Guelph Hydro's long-term debt has been issued directly by the company via a private placement to institutional lenders. This obligates Guelph Hydro to obtain and maintain a credit rating. Guelph Hydro's debt obligations are rated by S&P as follows:

**Table 5-8**

| Rating Agency | Short-Term Debt | Long-Term Debt |
|---|---|---|
| Standard & Poor's | Not rated | A/Stable |

The most recent ratings report from S&P is provided in this Exhibit, Appendix 5-E. Currently, Guelph Hydro has outstanding long-term debt in the amount of $65 million, detailed in Appendix 5-B of this Exhibit.

**Rate Base and Rate of Return**

Exhibit 5, Appendix 5-A: Chapter 2 Appendix 2-OA details Guelph Hydro's rate base, deemed debt/equity ratios, deemed rate of return, debt/equity ratios and rates of returns for 2012 Board Approved, and 2016 Test Year Forecast.

**Profit or loss on redemption of debt and/or preference shares**

This filing requirement is not applicable to Guelph Hydro as it does not have any preferred shares, nor did it redeem any debt.

**Current promissory notes or other debt arrangements with affiliates**

Guelph Hydro does not have any promissory notes or other debt arrangements with its affiliates.

## 2.8.3 NOT-FOR-PROFIT CORPORATIONS

A Reserve Requirement is not applicable because Guelph Hydro is a for-profit corporation.

# APPENDIX 5-A: Chapter 2 Appendix 2-OA Capital Structure and Cost of Capital

# Appendix 2-OA
# Capital Structure and Cost of Capital

**This table must be completed for the last Board approved year and the test year.**

**Year:** 2012 Board Approved

| Line No. | Particulars | Capitalization Ratio | | | Cost Rate | Return |
|---|---|---|---|---|---|---|
| | | (%) | | ($) | (%) | ($) |
| | **Debt** | | | | | |
| 1 | Long-term Debt | 56.00% | | $78,218,963 | 5.26% | $4,117,446 |
| 2 | Short-term Debt | 4.00% | (1) | $5,587,069 | 2.08% | $116,211 |
| 3 | **Total Debt** | 60.0% | | $83,806,031 | 5.05% | $4,233,657 |
| | **Equity** | | | | | |
| 4 | Common Equity | 40.00% | | $55,870,688 | 9.42% | $5,263,019 |
| 5 | Preferred Shares | | | $ - | | $ - |
| 6 | **Total Equity** | 40.0% | | $55,870,688 | 9.42% | $5,263,019 |
| 7 | **Total** | 100.0% | | $139,676,719 | 6.80% | $9,496,676 |

**Notes**

**(1)** 4.0% unless an applicant has proposed or been approved for a different amount.

# Appendix 2-OA
# Capital Structure and Cost of Capital

**This table must be completed for the last Board approved year and the test year.**

**Year:** 2016 Test Year

| Line No. | Particulars | Capitalization Ratio | | | Cost Rate | Return |
|---|---|---|---|---|---|---|
| | | (%) | | ($) | (%) | ($) |
| | **Debt** | | | | | |
| 1 | Long-term Debt | 56.00% | | $91,257,657 | 5.18% | $4,723,581 |
| 2 | Short-term Debt | 4.00% | (1) | $6,518,404 | 2.16% | $140,798 |
| 3 | **Total Debt** | 60.0% | | $97,776,061 | 4.98% | $4,864,378 |
| | **Equity** | | | | | |
| 4 | Common Equity | 40.00% | | $65,184,041 | 9.30% | $6,062,116 |
| 5 | Preferred Shares | | | $ - | | $ - |
| 6 | **Total Equity** | 40.0% | | $65,184,041 | 9.30% | $6,062,116 |
| 7 | **Total** | 100.0% | | $162,960,102 | 6.71% | $10,926,494 |

**Notes**

**(1)** 4.0% unless an applicant has proposed or been approved for a different amount.

# APPENDIX 5-B: Chapter 2 Appendix 2-OB Debt Instruments

# Appendix 2-OB
# Debt Instruments

**This table must be completed for all required historical years, the bridge year and the test year.**

**Year** 2012

| Row | Description | Lender | Affiliated or Third-Party Debt? | Fixed or Variable-Rate? | Start Date | Term (years) | Principal ($) | Rate (%) (Note 2) | Interest ($) (Note 1) | Additional Comments, if any |
|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Senior Unsecured Debentures, Series A | | Third-Party | Fixed Rate | 6-Dec-10 | 20 | $ 65,000,000 | 5.264% | $3,421,600.00 | |
| | | | | | | | | | | |
| Total | | | | | | | $ 65,000,000 | 0.05264 | $3,421,600.00 | |

**Notes**

1 If financing is in place only part of the year, calculate the pro-rated interest and input in the cell.
2 Input actual or deemed long-term debt rate in accordance with the guidelines in *The Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* , issued December 11, 2009, or with any subsequent update issued by the Board.
3 Add more lines above row 12 if necessary.

**Year** 2013

| Row | Description | Lender | Affiliated or Third-Party Debt? | Fixed or Variable-Rate? | Start Date | Term (years) | Principal ($) | Rate (%) (Note 2) | Interest ($) (Note 1) | Additional Comments, if any |
|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Senior Unsecured Debentures, Series A | | Third-Party | Fixed Rate | 6-Dec-10 | 20 | $ 65,000,000 | 5.264% | $3,421,600.00 | |
| | | | | | | | | | | |
| Total | | | | | | | $ 65,000,000 | 0.05264 | $3,421,600.00 | |

**Year** 2014

| Row | Description | Lender | Affiliated or Third-Party Debt? | Fixed or Variable-Rate? | Start Date | Term (years) | Principal ($) | Rate (%) (Note 2) | Interest ($) (Note 1) | Additional Comments, if any |
|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Senior Unsecured Debentures, Series A | | Third-Party | Fixed Rate | 6-Dec-10 | 20 | $ 65,000,000 | 5.264% | $3,421,600.00 | |
| | | | | | | | | | | |
| Total | | | | | | | $ 65,000,000 | 0.05264 | $3,421,600.00 | |

**Year** 2015

| Row | Description | Lender | Affiliated or Third-Party Debt? | Fixed or Variable-Rate? | Start Date | Term (years) | Principal ($) | Rate (%) (Note 2) | Interest ($) (Note 1) | Additional Comments, if any |
|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Senior Unsecured Debentures, Series A | | Third-Party | Fixed Rate | 6-Dec-10 | 20 | $ 65,000,000 | 5.264% | $3,421,600.00 | |
| | | | | | | | | | | |
| Total | | | | | | | $ 65,000,000 | 0.05264 | $3,421,600.00 | |

**Year** 2016

| Row | Description | Lender | Affiliated or Third-Party Debt? | Fixed or Variable-Rate? | Start Date | Term (years) | Principal ($) | Rate (%) (Note 2) | Interest ($) (Note 1) | Additional Comments, if any |
|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Senior Unsecured Debentures, Series A | | Third-Party | Fixed Rate | 6-Dec-10 | 20 | $ 65,000,000 | 5.264% | $3,421,600.00 | |
| 2 | Senior Unsecured Debentures, Series A | | Third-Party | Fixed Rate | 1-Jun-16 | 10 | $ 30,000,000 | 4.85% | $ 848,676.47 | |
| | | | | | | | | | | |
| Total | | | | | | | $ 95,000,000 | 0.05176 | $4,270,276.47 | |

# APPENDIX 5-C: Debentures Pricing

CIBC

# GUELPH HYDRO ELECTRIC SYSTEMS INC.
## Pricing Sheet – Series A

| | |
|---|---|
| **Issuer:** | Guelph Hydro Electric Systems Inc. ("GHESI") |
| **Amount:** | $65 million |
| **Description:** | Senior Unsecured Debentures, Series A |
| **Term:** | 20 years |
| **Repayment:** | Interest payable semi-annually in arrears; principal repaid in full at maturity |
| **Pricing Date:** | December 1, 2010 |
| **Closing Date:** | December 6, 2010 |
| **Maturity Date:** | December 6, 2030 |
| **Benchmark:** | Government of Canada 5.00% due June 1, 2037 |
| **Current Benchmark Price:** | $123.49 per $100.00 par value |
| **Current Benchmark Yield:** | 3.614% |
| **Credit Spread:** | 1.65% |
| **Yield:** | 5.264% |
| **Price:** | $ 100.00 per $100.00 par value |
| **GHESI Coupon:** | 5.264% (same as Yield) |
| **Redemption Price:** | Canada + 41 bps |

# APPENDIX 5-D: Schedule 1 Chartered Banks

# Canadian Economic Outlook

BMO Capital Markets Economics

November 21, 2014

| | 2013 Q1 | 2013 Q2 | 2013 Q3 | 2013 Q4 | 2014 Q1 | 2014 Q2 | 2014 Q3 | 2014 Q4 | 2015 Q1 | 2015 Q2 | 2015 Q3 | 2015 Q4 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **PRODUCTION** | **(quarter/quarter % change : a.r.)** | | | | | | | | | | | | | | | |
| Real GDP (chain-weighted) | 3.2 | 2.0 | 2.7 | 2.9 | 1.0 | 3.6 | 2.2 | 2.1 | 2.3 | 2.5 | 2.7 | 2.6 | 2.0 | 2.3 | 2.4 | 2.2 |
| Final Sales | 2.0 | 3.0 | 1.5 | 1.7 | 1.7 | 5.5 | 2.3 | 1.9 | 2.2 | 2.5 | 2.8 | 2.7 | 1.8 | 2.5 | 2.5 | 2.3 |
| Final Domestic Demand | 0.8 | 2.1 | 1.9 | 0.9 | 0.0 | 3.2 | 1.7 | 1.3 | 1.7 | 2.0 | 2.0 | 1.9 | 1.5 | 1.4 | 1.8 | 1.9 |
| Consumer Spending | 1.8 | 3.6 | 3.1 | 2.7 | 1.3 | 3.7 | 2.3 | 1.6 | 1.9 | 2.1 | 2.2 | 2.0 | 2.5 | 2.5 | 2.1 | 2.0 |
| Durables | 5.6 | 11.9 | 2.1 | -0.4 | -0.9 | 14.7 | 10.0 | -3.0 | -1.0 | 1.0 | 2.0 | 1.5 | 3.8 | 4.3 | 1.8 | 1.5 |
| Non-Durables | 0.1 | 1.6 | 4.9 | 5.5 | 4.2 | -0.7 | 1.0 | 2.2 | 2.2 | 2.1 | 2.2 | 2.0 | 2.3 | 2.9 | 1.9 | 2.0 |
| Services | 1.9 | 3.2 | 1.8 | 1.7 | 1.5 | 2.7 | 1.3 | 2.2 | 2.3 | 2.4 | 2.3 | 2.2 | 2.3 | 1.9 | 2.2 | 2.1 |
| Government Spending | -0.1 | -0.2 | -0.1 | -1.1 | -0.1 | 2.0 | 0.9 | 1.3 | 1.3 | 1.1 | 1.1 | 1.1 | 0.1 | 0.3 | 1.2 | 1.2 |
| Business Investment | 3.2 | -0.3 | 0.5 | -1.4 | -2.5 | 1.8 | 1.3 | 1.7 | 2.3 | 4.3 | 3.7 | 4.2 | 2.6 | -0.3 | 2.7 | 4.5 |
| Non-Residential Construction | 4.9 | 0.7 | 3.8 | -2.1 | -0.5 | 0.6 | 1.0 | 1.5 | 2.0 | 4.5 | 4.0 | 4.5 | 5.0 | 0.3 | 2.6 | 4.6 |
| Machinery and Equipment | 0.1 | -2.2 | -5.5 | -0.1 | -6.3 | 4.2 | 2.0 | 2.0 | 3.0 | 4.0 | 3.5 | 4.0 | -1.7 | -1.3 | 3.1 | 4.4 |
| Residential Construction | -4.5 | 6.6 | 0.5 | -2.3 | -5.1 | 11.9 | 3.0 | 0.0 | 0.0 | 0.0 | 0.7 | 0.7 | -0.4 | 1.2 | 1.2 | -0.1 |
| Exports | 8.2 | 2.0 | 0.6 | 3.7 | 1.2 | 18.9 | 8.1 | 4.5 | 4.9 | 5.3 | 5.4 | 5.5 | 2.0 | 5.9 | 6.2 | 4.7 |
| Imports | 4.1 | -0.9 | 2.4 | 1.4 | -3.8 | 10.5 | 6.0 | 2.5 | 3.3 | 3.5 | 4.0 | 3.9 | 1.3 | 2.3 | 4.1 | 4.0 |
| | **(billions of chained 2007 dollars : a.r.)** | | | | | | | | | | | | | | | |
| Inventory Change | 11.8 | 8.1 | 12.2 | 17.3 | 14.8 | 6.3 | 6.1 | 6.7 | 7.1 | 7.0 | 6.7 | 6.3 | 12.4 | 8.5 | 6.8 | 5.9 |
| Contribution to GDP Growth | 1.4 | -0.9 | 1.1 | 1.3 | -0.6 | -2.0 | -0.1 | 0.1 | 0.1 | -0.0 | -0.1 | -0.1 | 0.2 | -0.2 | -0.1 | -0.1 |
| Net Exports | -41.8 | -38.1 | -40.5 | -37.8 | -30.7 | -21.4 | -18.9 | -16.4 | -14.3 | -11.9 | -10.1 | -8.0 | -39.6 | -21.8 | -11.1 | -7.0 |
| Contribution to GDP Growth | 1.1 | 0.9 | -0.6 | 0.7 | 1.6 | 2.6 | 0.6 | 0.6 | 0.5 | 0.5 | 0.8 | 0.9 | 0.2 | 1.1 | 0.6 | 0.2 |
| | **(billions of dollars : a.r.)** | | | | | | | | | | | | | | | |
| Nominal GDP | 1,874 | 1,879 | 1,903 | 1,919 | 1,952 | 1,968 | 1,987 | 1,990 | 2,013 | 2,038 | 2,061 | 2,084 | 1,894 | 1,974 | 2,049 | 2,138 |
| (% chng : a.r.) | 5.6 | 1.2 | 5.2 | 3.3 | 7.0 | 3.3 | 3.9 | 0.6 | 4.8 | 5.0 | 4.5 | 4.6 | 3.4 | 4.2 | 3.8 | 4.3 |
| **INFLATION** | **(quarter/quarter % change : a.r.)** | | | | | | | | | | | | | | | |
| GDP Price Index | 2.2 | -0.7 | 2.6 | 0.4 | 5.9 | -0.4 | 1.8 | -1.5 | 2.5 | 2.5 | 1.8 | 1.9 | 1.4 | 1.8 | 1.3 | 2.1 |
| CPI All Items | 1.6 | -0.1 | 1.9 | 0.5 | 2.8 | 3.7 | 1.3 | 1.2 | 2.0 | 2.7 | 2.1 | 2.1 | 0.9 | 2.0 | 2.0 | 2.2 |
| Excl. Food & Energy | 1.3 | 0.9 | 0.9 | 0.3 | 2.4 | 2.3 | 2.1 | 1.8 | 1.9 | 2.0 | 2.0 | 2.0 | 0.9 | 1.6 | 2.0 | 2.1 |
| Food Prices | 1.2 | 0.8 | 0.8 | 0.9 | 2.2 | 5.5 | 1.5 | 2.2 | 2.2 | 2.3 | 2.0 | 2.6 | 1.2 | 2.2 | 2.3 | 2.1 |
| Energy Prices | 3.3 | -3.6 | 9.9 | -2.2 | 10.9 | 13.6 | -6.7 | -10.1 | 2.6 | 9.9 | 3.5 | 2.4 | 1.5 | 4.1 | 0.9 | 2.5 |
| Services | 0.6 | 2.4 | 2.6 | 0.5 | 1.6 | 3.6 | 3.3 | 1.4 | 1.4 | 2.3 | 2.0 | 2.2 | 1.4 | 2.1 | 2.1 | 2.2 |
| | **(year/year % change)** | | | | | | | | | | | | | | | |
| CPI All Items | 0.9 | 0.8 | 1.1 | 0.9 | 1.4 | 2.2 | 2.1 | 2.2 | 2.0 | 1.8 | 2.0 | 2.2 | | | | |
| BoC Core | 1.3 | 1.2 | 1.3 | 1.2 | 1.3 | 1.7 | 2.0 | 2.3 | 2.1 | 1.8 | 1.8 | 1.9 | 1.2 | 1.8 | 1.9 | 2.1 |
| **FINANCIAL** | **(average for the quarter : %)** | | | | | | | | | | | | | | | |
| Overnight Rate | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 | 1.00 | 1.00 | 1.05 | 1.90 |
| 3-Month T-Bill | 0.95 | 1.00 | 1.00 | 0.93 | 0.87 | 0.93 | 0.94 | 0.90 | 0.90 | 0.90 | 0.90 | 1.16 | 0.97 | 0.91 | 0.96 | 1.81 |
| 90-Day BAs | 1.20 | 1.18 | 1.18 | 1.23 | 1.26 | 1.27 | 1.28 | 1.27 | 1.27 | 1.27 | 1.27 | 1.52 | 1.20 | 1.27 | 1.33 | 2.15 |
| 10 Year Bond Yield | 1.92 | 1.96 | 2.58 | 2.58 | 2.47 | 2.35 | 2.14 | 2.04 | 2.07 | 2.16 | 2.32 | 2.56 | 2.26 | 2.25 | 2.28 | 2.99 |
| **Canada/US spread: (bps)** | | | | | | | | | | | | | | | | |
| 90 day | 86 | 95 | 96 | 87 | 82 | 90 | 91 | 88 | 88 | 81 | 57 | 60 | 91 | 88 | 72 | 61 |
| 10 year | -4 | -3 | -13 | -16 | -30 | -27 | -36 | -31 | -31 | -32 | -33 | -35 | -9 | -31 | -33 | -40 |
| **FOREIGN TRADE** | **(billions of dollars : a.r.)** | | | | | | | | | | | | | | | |
| Current Account Balance | -60.3 | -61.5 | -56.8 | -62.6 | -48.1 | -47.5 | -43.9 | -54.3 | -49.0 | -46.2 | -43.9 | -40.9 | -60.3 | -48.5 | -45.0 | -38.0 |
| (% of GDP) | -3.2 | -3.3 | -3.0 | -3.3 | -2.5 | -2.4 | -2.2 | -2.7 | -2.4 | -2.3 | -2.1 | -2.0 | -3.2 | -2.5 | -2.2 | -1.8 |
| Merchandise Balance | -6.7 | -7.8 | -5.7 | -9.0 | 7.1 | 6.6 | 10.3 | -1.5 | 2.8 | 4.8 | 6.7 | 9.2 | -7.3 | 5.6 | 5.9 | 11.0 |
| Non-Merchandise Balance | -53.6 | -53.7 | -51.1 | -53.6 | -55.2 | -54.1 | -54.2 | -52.8 | -51.8 | -51.0 | -50.5 | -50.1 | -53.0 | -54.1 | -50.9 | -49.0 |
| | **(average for the quarter)** | | | | | | | | | | | | | | | |
| Exchange Rate (US¢/C$) | 99.1 | 97.7 | 96.3 | 95.3 | 90.6 | 91.7 | 91.8 | 88.7 | 87.8 | 86.8 | 85.8 | 85.1 | 97.1 | 90.7 | 86.4 | 86.1 |
| Exchange Rate (C$/US$) | 1.009 | 1.023 | 1.038 | 1.049 | 1.103 | 1.090 | 1.089 | 1.127 | 1.139 | 1.152 | 1.166 | 1.175 | 1.030 | 1.102 | 1.158 | 1.161 |
| Exchange Rate (¥/C$) | 91.5 | 96.4 | 95.2 | 95.7 | 93.1 | 93.6 | 95.5 | 99.7 | 101.7 | 101.6 | 101.5 | 101.8 | 94.7 | 95.5 | 101.6 | 105.7 |
| Exchange Rate (C$/Euro) | 1.33 | 1.34 | 1.38 | 1.43 | 1.51 | 1.50 | 1.44 | 1.42 | 1.41 | 1.42 | 1.42 | 1.41 | 1.37 | 1.47 | 1.42 | 1.41 |
| **INCOMES** | **(year/year % change)** | | | | | | | | | | | | | | | |
| Corporate Profits Before Tax | -5.5 | -6.2 | 6.5 | 9.0 | 15.3 | 22.2 | 13.0 | 6.9 | 0.3 | 0.5 | 0.1 | 5.0 | 0.7 | 14.2 | 1.5 | 4.0 |
| Corporate Profits After Tax | 6.6 | 2.4 | 11.4 | 9.0 | 5.9 | 10.5 | 8.0 | 2.0 | 1.0 | 0.5 | -0.5 | 4.3 | 7.3 | 6.6 | 1.3 | 2.1 |
| Personal Income | 4.4 | 3.7 | 3.3 | 3.5 | 3.4 | 3.3 | 3.7 | 3.2 | 3.4 | 4.2 | 4.3 | 4.9 | 3.7 | 3.4 | 4.2 | 4.4 |
| Real Disposable Income | 3.3 | 2.6 | 1.8 | 2.1 | 1.8 | 1.3 | 1.6 | 0.8 | 0.9 | 1.7 | 1.8 | 2.1 | 2.5 | 1.4 | 1.6 | 2.0 |
| | **(average for the quarter : %)** | | | | | | | | | | | | | | | |
| Savings Rate | 5.9 | 5.1 | 4.7 | 4.9 | 5.2 | 3.8 | 3.8 | 3.6 | 3.8 | 3.6 | 3.6 | 3.7 | 5.2 | 4.1 | 3.7 | 3.7 |
| **OTHER INDICATORS** | **(quarter average)** | | | | | | | | | | | | | | | |
| Unemployment Rate (%) | 7.1 | 7.1 | 7.1 | 7.0 | 7.0 | 7.0 | 6.9 | 6.6 | 6.6 | 6.5 | 6.4 | 6.4 | 7.1 | 6.9 | 6.5 | 6.3 |
| Housing Starts (000s, a.r.) | 172 | 190 | 194 | 194 | 175 | 197 | 199 | 188 | 189 | 186 | 184 | 181 | 188 | 190 | 185 | 180 |
| Existing Home Sales (y/y % ch) | -10.1 | -3.2 | 9.6 | 8.3 | 1.3 | 6.0 | 4.8 | 7.5 | 9.7 | 0.1 | -3.7 | -5.0 | 0.8 | 5.0 | 0.0 | -1.0 |
| MLS Home Price Index (y/y % ch) | 2.4 | 2.1 | 2.8 | 4.0 | 5.0 | 5.1 | 5.3 | 5.4 | 3.6 | 1.9 | 1.9 | 0.5 | 2.8 | 5.2 | 2.0 | 1.0 |
| Motor Vehicle Sales (mlns, a.r.) | 1.73 | 1.78 | 1.79 | 1.79 | 1.74 | 1.85 | 1.99 | 1.99 | 1.90 | 1.89 | 1.88 | 1.87 | 1.77 | 1.89 | 1.89 | 1.85 |
| | **(quarter/quarter % change : a.r.)** | | | | | | | | | | | | | | | |
| Employment Growth | 0.9 | 1.2 | 0.8 | 0.9 | 0.4 | 0.3 | 1.4 | 2.0 | 0.9 | 0.9 | 0.9 | 1.0 | 1.3 | 0.8 | 1.1 | 1.0 |
| Industrial Production | 7.6 | -2.9 | 4.5 | 6.5 | 4.5 | 4.4 | -0.6 | 1.6 | 3.2 | 3.9 | 3.5 | 2.4 | 1.9 | 3.5 | 2.6 | 2.3 |
| Federal Budget Balance (% of FY GDP) | | | | | | | | | | | | | -0.3 | -0.1 | 0.3 | 0.4 |

Note: Outlined areas represent forecast periods

## MARKET CALL

- North American markets are spending too much time pondering Europe, Japan and China, and giving too little weight to better growth and job news closer to home. We're sticking with our view that labour market progress will see the Fed hike as early as March, stinging the bond market in the process. That said, our overall call for the extent of rate hikes in Canada and the US is on the dovish side, allowing the bond market to recoup some of its losses later next year.
- Dollar-Canada has made quicker work than we expected towards our unchanged target of 1.18, but the recent leg was rooted in oil's decline, which is vulnerable to some reversal if OPEC trims output, production falls short due to geopolitics, or global growth rebuilds demand. Still, the Bank of Canada is likely to engineer a different source of loonie weakness as it lags behind the Fed in hiking in 2015.
- In light of downside news on Japan, we've weakened our call for the yen in anticipation of more aggressive monetary stimulus. Beyond our 2016 forecast horizon, the yen could see a more dramatic weakening if, as is increasingly likely, Japan finds that monetizing its debt and letting inflation lower its debt/GDP ratio is its only way out. We slightly lowered our euro targets as well, given that our Fed surprise still lies ahead.

## INTEREST & FOREIGN EXCHANGE RATES

| | | 2014 | 2015 | | | | 2016 | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **END OF PERIOD:** | | **18-Nov** | **Mar** | **Jun** | **Sep** | **Dec** | **Mar** | **Jun** | **Sep** | **Dec** |
| **CDA** | Overnight target rate | 1.00 | 1.00 | 1.00 | 1.25 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 |
| | 98-Day Treasury Bills | 0.89 | 1.00 | 1.05 | 1.20 | 1.45 | 1.45 | 1.45 | 1.40 | 1.45 |
| | 2-Year Gov't Bond | 1.00 | 1.65 | 1.90 | 2.20 | 2.20 | 1.95 | 1.85 | 1.95 | 2.00 |
| | 10-Year Gov't Bond | 2.00 | 2.55 | 3.00 | 3.05 | 2.80 | 2.75 | 2.70 | 2.75 | 2.80 |
| | 30-Year Gov't Bond | 2.56 | 3.30 | 3.45 | 3.50 | 3.35 | 3.25 | 3.20 | 3.25 | 3.35 |
| **U.S.** | Federal Funds Rate | 0.10 | 0.25 | 0.75 | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 | 1.50 |
| | 91-Day Treasury Bills | 0.01 | 0.40 | 0.60 | 0.85 | 1.10 | 1.35 | 1.25 | 1.20 | 1.40 |
| | 2-Year Gov't Note | 0.51 | 1.05 | 1.60 | 1.80 | 1.70 | 1.65 | 1.65 | 1.70 | 1.90 |
| | 10-Year Gov't Note | 2.32 | 2.95 | 3.60 | 3.45 | 3.25 | 3.25 | 3.30 | 3.35 | 3.45 |
| | 30-Year Gov't Bond | 3.05 | 3.50 | 4.00 | 3.90 | 3.70 | 3.65 | 3.70 | 3.75 | 3.80 |
| Canada - US T-Bill Spread | | 0.87 | 0.60 | 0.45 | 0.35 | 0.35 | 0.10 | 0.20 | 0.20 | 0.05 |
| Canada - US 10-Year Bond Spread | | -0.33 | -0.40 | -0.60 | -0.40 | -0.45 | -0.50 | -0.60 | -0.60 | -0.65 |
| Canada Yield Curve (30-Year — 2-Year) | | 1.56 | 1.65 | 1.55 | 1.30 | 1.15 | 1.30 | 1.35 | 1.30 | 1.35 |
| US Yield Curve (30-Year — 2-Year) | | 2.54 | 2.45 | 2.40 | 2.10 | 2.00 | 2.00 | 2.05 | 2.05 | 1.90 |
| **EXCHANGE RATES** | CADUSD | 0.88 | 0.88 | 0.85 | 0.85 | 0.86 | 0.87 | 0.87 | 0.87 | 0.86 |
| | USDCAD | 1.13 | 1.14 | 1.17 | 1.18 | 1.16 | 1.15 | 1.15 | 1.15 | 1.16 |
| | USDJPY | 115 | 115 | 116 | 118 | 116 | 115 | 115 | 114 | 114 |
| | EURUSD | 1.24 | 1.22 | 1.21 | 1.22 | 1.25 | 1.26 | 1.27 | 1.29 | 1.30 |
| | GBPUSD | 1.58 | 1.58 | 1.57 | 1.59 | 1.62 | 1.62 | 1.62 | 1.63 | 1.63 |
| | AUDUSD | 0.86 | 0.84 | 0.83 | 0.82 | 0.84 | 0.86 | 0.87 | 0.88 | 0.90 |
| | USDCHF | 0.97 | 0.99 | 1.01 | 1.00 | 0.98 | 0.98 | 0.98 | 0.97 | 0.96 |
| | USDBRL | 2.57 | 2.75 | 2.70 | 2.82 | 2.83 | 2.87 | 2.92 | 2.97 | 3.02 |
| | USDMXN | 13.54 | 13.18 | 13.18 | 13.26 | 13.18 | 13.20 | 13.35 | 13.35 | 13.29 |

## ECONOMIC UPDATE

| CANADA | 14Q2A | 14Q3F | 14Q4F | 15Q1F | 15Q2F | 15Q3F | 2013A | 2014F | 2015F | 2016F |
|---|---|---|---|---|---|---|---|---|---|---|
| Real GDP Growth (AR) | 3.6 | 1.9 | 2.5 | 3.0 | 3.1 | 2.8 | 2.0 | 2.3 | 2.7 | 2.3 |
| Real Final Domestic Demand (AR) | 3.2 | 1.3 | 1.6 | 1.6 | 2.2 | 2.0 | 1.5 | 1.4 | 1.9 | 1.8 |
| All Items CPI Inflation (Y/Y) | 2.2 | 2.1 | 2.1 | 2.0 | 1.7 | 2.0 | 0.9 | 1.9 | 2.1 | 2.3 |
| Core CPI Ex Indirect Taxes (Y/Y) | 1.7 | 2.0 | 2.3 | 2.2 | 2.2 | 2.2 | 1.2 | 1.8 | 2.2 | 2.0 |
| Unemployment Rate (%) | 7.0 | 6.9 | 6.5 | 6.5 | 6.4 | 6.4 | 7.1 | 6.9 | 6.4 | 6.3 |

| U.S. | 14Q2A | 14Q3A | 14Q4F | 15Q1F | 15Q2F | 15Q3F | 2013A | 2014F | 2015F | 2016F |
|---|---|---|---|---|---|---|---|---|---|---|
| Real GDP Growth (AR) | 4.6 | 3.5 | 2.6 | 2.8 | 2.8 | 2.6 | 2.2 | 2.2 | 2.9 | 2.4 |
| Real Final Sales (AR) | 3.2 | 4.2 | 2.4 | 2.8 | 2.9 | 2.9 | 2.2 | 2.2 | 2.9 | 2.5 |
| All Items CPI Inflation (Y/Y) | 2.1 | 1.8 | 1.7 | 1.6 | 1.3 | 1.8 | 1.5 | 1.7 | 1.8 | 2.3 |
| Core CPI Inflation (Y/Y) | 1.9 | 1.8 | 1.8 | 2.0 | 1.9 | 2.1 | 1.8 | 1.8 | 2.1 | 2.1 |
| Unemployment Rate (%) | 6.2 | 6.1 | 5.9 | 5.8 | 5.7 | 5.7 | 7.4 | 6.2 | 5.7 | 5.6 |

## CANADA

A surprise drop in monthly GDP for August was a second marker pointing to a sub-2% growth pace for the third quarter. But even if a strong September won't do much to boost Q3's results, its hand-off to Q4 will mean that growth prospects for the tail end of the year will look more respectable than previously envisioned. In the labour market, the arrival of the much awaited catch-up in jobs has us now on track to reach full employment sooner. Reduced slack in the nearer-term means that the outlook for core inflation will look stouter than the headline, staying incrementally above the BoC's 2% target.

## UNITED STATES

The continued slide in oil prices, combined with expectations for a more gradual rebound, has seen us chop our 2015 CPI forecast to 1.8%, from 2.0%. However, we still expect that core inflation could firm a little as slack in the domestic economy diminishes. GDP growth should average around 3% a quarter through to mid-2015, although the decline in unemployment may be more gradual from here as previously discouraged workers begin to be drawn back into the labour market.

Royal Bank of Canada (RBC)

Kindly find attached the latest financial markets monthly report detailing RBC Research's official published rates forecast (page 5).

| | Q1-15 | Q2-15 | Q3-15 | Q4-15 | *Q1-16* | *Q2-16* | *Q3-16* | *Q4-16* |
|---|---|---|---|---|---|---|---|---|
| 5yr GoC | 2.35 | 2.50 | 2.75 | 3.00 | *3.25* | *3.45* | *3.65* | *3.75* |
| 10yr GoC | 2.80 | 3.00 | 3.25 | 3.55 | *3.75* | *3.95* | *4.15* | *4.30* |
| 30yr GoC | 3.25 | 3.40 | 3.60 | 3.85 | *4.00* | *4.25* | *4.50* | *4.70* |

# APPENDIX 5-E: Credit Rating – Standard and Poor's Report

STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

# Research

## Summary:

# Guelph Hydro Electric Systems Inc.

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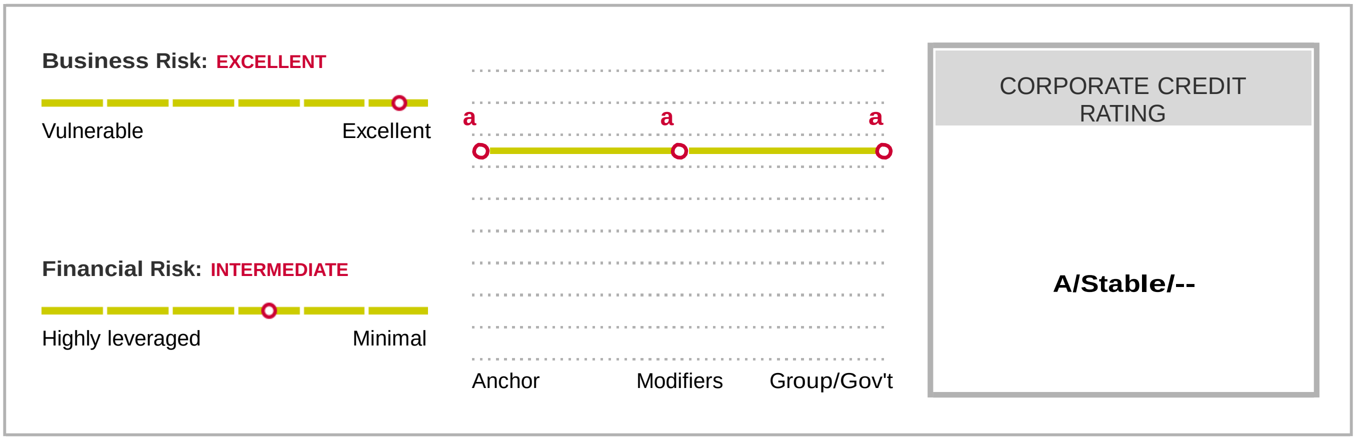
Summary:

# Guelph Hydro Electric Systems Inc.




## Rationale

| Business Risk: Excellent | Financial Risk: Intermediate |
|---|---|
| • A relatively transparent and predictable regulatory regime<br>• Commodity costs are pass-through<br>• The ability to recover all fixed and variable operating costs | • Stable, regulated cash flow<br>• "Low" likelihood of extraordinary government support |

**Outlook: Stable**

The stable outlook reflects Standard & Poor's Ratings Services' assessment of Guelph Hydro Electric Systems
Inc.'s (GHESI) predictable and stable cash flows from its low-risk, regulated distribution business. The outlook also reflects our expectation that management will continue to focus on its core regulated business during our two-year outlook horizon.

### Downside scenario

Although we don't expect it, a material, adverse regulatory ruling or a significant increase in leverage leading to sustained deterioration in forecast adjusted funds from operations (AFFO)-to-debt close to 13% could lead to a downgrade. Debt-financed unregulated activity exceeding 10% of total AFFO could also lead to a lower rating.

### Upside scenario

We could raise the rating if we believe that GHESI will demonstrate sustainable long-term growth or deleveraging that result in AFFO-to-debt of greater than 23%.

Based on our current forecast and the company's current financial policy, which we do not expect will change, we believe the prospect of an upgrade is limited during our outlook horizon.

## Standard & Poor's Base-Case Scenario

Guelph Hydro is a local electricity distribution Company (LDC) operating in City of Guelph, Ont. The rating's key driver continues to be the Ontario Energy Board's (OEB) regulatory framework and the utility's performance within it.

## Assumptions

- The regulatory regime will be relatively stable, and GHESI will not experience any material, adverse regulatory decisions
- The company will continue to earn close to its allowed return on equity on its deemed capital structure
- It will not make any material, debt-financed unregulated investments
- Rates in 2014 and 2015 will be established under the OEB's relatively new incentive-rate mechanism (IRM)

## Key Metrics

| | 2013A | 2014E | 2015E |
|---|---|---|---|
| AFFO/debt | 8% | 14%-17% | 14%-17% |
| Debt-to-debt and equity | 51.6% | 50%-54% | 50%-54% |

Note: The AFFO/debt figure for 2013 was as a result of IFRS accounting regulation. In 2013, cost of power exceeded the regulatory charges and billings by approximately C$6.1 million, resulting in a regulatory asset of a similar amount. Under IFRS, this regulatory asset is treated as an expense therefore reducing net income and resulting in the drop of AFFO/debt metric to 8%. Based on the OEB regulatory practice, we expect that GHESI will be able to recover the C$6.1 million. The 2014E and 2015E figures above do not include the recovery of the regulatory asset.
AFFO--Adjusted funds from operations. A--Actual. E--Estimated.

## Business Risk: Excellent

We view GHESI's business risk profile as "excellent", reflecting our assessment of the OEB's regulatory framework. We view the regulatory process as transparent, consistent and predictable. The board publishes details of all hearings, and the rationale supporting its decisions. Consistency and predictability are supported by the use of standard methodology applied to all utilities in its jurisdiction, including a transparent formula for allowed returns, and a consistent deemed capital structure that has not changed for many years. In addition, during times of change, the regulator follows a public process of study and consultation that allows management to adjust to new regulatory or market developments.

The regulator's mandate is to balance the needs of the customer and utility investors. To date, it has imposed no penalties in the industry, although it does monitor performance standards.

Rates are typically determined in a timely fashion and allow for the recovery of prudently incurred costs and the opportunity to earn a modest return. Furthermore, several mechanisms, including rate riders, specific adjustments under incentive based ratemaking, and (in some circumstances) an ability to request a rate-reset hearing, support timely recovery of material and unexpected capital costs.

The LDC has no obligation to ensure an adequate supply of electricity and is not burdened with the procurement process or power purchase agreements which reduce operating risk. Furthermore, commodity costs flow through rates thereby limiting the LDC's exposure to commodity risk and associated cash-flow volatility.

We expect the company's customer profile to remain stable because Guelph has what we view as a strong, stable public sector with a large university, schools, hospitals, and municipal, county, and provincial government offices. We believe that the public sector is less sensitive to macroeconomic stresses and business cycles. GHESI's more volatile industrial customer base accounts for less than 10% of revenues. Operating efficiency, as measured by standard industry reliability measures, is above average, although there are no penalties or incentives for performance. In our opinion, the company's unregulated cash flow from its sister company, Envida Community Energy Inc., is not material to the ratings.

## Financial Risk: Inter mediate

We assess GHESI's stand-alone financial risk profile as "intermediate". For GHESI, we use the low-volatility table, reflecting the "very low" industry risk associated with regulated utilities and the supportive regulatory framework.

We do not expect the company to undergo another cost-of-service hearing and rate reset until 2016. During this IRM period, we expect rates to be adjusted annually by inflation minus a productivity factor. In our base-case scenario, we expect AFFO-to-debt to range from 14%-17%.

Although we have assumed that GHESI will continue to invest in rate-base growth that exceeds depreciation, we expect it will largely fund the growth with a mix of internally generated cash flow, cash on hand, and drawings on its revolver. We do not expect the company to increase leverage to match levels that the regulator prescribes during the current IRM period. We expect the utility's dividend policy to be stable, at the greater of C$3 million or 50% of net income (adjusted for movements in regulated assets and liabilities).

## Liquidity: Adequate

GHESI's liquidity is "adequate," in our view. We expect that liquidity sources will be sufficient to cover uses more than 1.1x over the next 12 months. We expect that in the event of a 10% decline in earnings, the company's sources of funds would still exceed its uses. In our view, GHESI has sound relationships with its banks and generally prudent financial risk management.

| Principal Liquidity Sources | Principal Liquidity Uses |
|---|---|
| • Projected FFO of C$11 million in 2014<br>• Committed credit facility, with C$10 million available that matures in August 2014. The company is renewing its credit facility by another year, such that it matures in August 2015. We expect that the company will be able to renew its credit facility before the maturity date | • Nondeferrable annual capex of C$5 million-C$7 million<br>• Dividends of about C$3 million |

## Government Influence

In accordance with our criteria for government-related entities, our view of a "low" likelihood of extraordinary government support is based on our assessment of:

- "Limited importance" role as the monopoly owner and operator of the regulated electricity distribution company in Guelph, given the province has oversight of electricity regulation and that the utility role could be provided by a private enterprise
- "Limited" link with Guelph, given our view that, in a stress scenario, although the city might provide some temporary liquidity support, it would be more likely to sell the utility than to support it in the long term with taxpayer dollars

The low likelihood of extraordinary government support has no rating enhancement on the 'a' stand-alone credit profile.

## Ratings Score

## Snapshot **Cor porate**

**Credit Rating** A/Stable/--

**Business risk: Excellent**

**Country** risk: Very low

Industry risk: Very low

Competitive position: Strong

**Financial risk: Inter mediate**

Cash flow/Leverage: Intermediate

**Anchor: a**

**Modifiers**

Diversification/Portfolio effect: Neutral (no impact)

Capital structure: Neutral (no impact)

Liquidity: Adequate (no impact)

Financial policy: Neutral (no impact)

Management and governance: Satisfactory (no impact)

Comparable rating analysis: Neutral (no impact)

**Stand-alone credit profile: a**

Likelihood of government support: Low (no impact)

## Related Criteria And Research

### Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

### Business And Financial Risk Matrix

| | Minimal | Modest | **Intermediate** | Significant | Aggressive | Highly leveraged |
|---|---|---|---|---|---|---|
| **Excellent** | | | **a+/a** | | | |
| Strong | aa/aa- | a+/a | a-/bbb+ | bbb | bb+ | bb |
| Satisfactory | a/a- | bbb+ | bbb/bbb- | bbb-/bb+ | bb | b+ |
| Fair | bbb/bbb- | bbb- | bb+ | bb | bb- | b |
| Weak | bb+ | bb+ | bb | bb- | b+ | b/b- |
| Vulnerable | bb- | bb- | bb-/b+ | b+ | b | b- |