# REPORT ON FINANCE 2016

London Hydro

# Dear Stakeholders,

We are proud to present our 2016 Annual Report and our Report on Progress. In 2016, we continued with our innovative agenda that we began several years ago while the industry continues to undergo a paradigm shift yet again. Along with our innovative initiatives, we continue to work diligently to serve our customers efficiently while distributing electricity safely and reliably to all Londoners. In doing so, we also look for ways to keep our delivery charge as low as possible while providing new and improved services to help customers manage their electricity usage. In fact, we are pleased to note that in May of 2017, the distribution cost for a typical residential customer was reduced by 51 cents per month; although small, but relatively significant efforts given the fact that London Hydro's distribution charges only account for 21% of the total bill.

**FRONT** (LEFT TO RIGHT)
Andrea Graansma - Executive Assitant
Michael van Holst – Board Member
Peter Johnson – Board Member
Connie Graham – Board Member
Jack Smit – Board Member
Mohan Mathur – Chair
Gabe Valente – Board Member
Marilyn Sinclair – Board Member

**BACK** (LEFT TO RIGHT)
Syed Mir – CIO & VP Corporate Services
David Arnold – Chief Financial Oficer, VP Finance & Corporate Secretary
Elizabeth Carswell – Senior Director HR
Vinay Sharma – Chief Executive Officer
William Milroy – VP Engineering & Operations

Board Members



Vinay Sharma
Chief Executive Officer

Mohan Mathur
Board Chair

In 2015, we deployed many innovative solutions for our customers and in 2016, we made those solutions more robust giving our customers more capabilities and confidence in using energy management and other analytical tools. Our solutions and smart apps have been well recognized and awarded provincially, nationally and internationally. Today, London Hydro offers its customers several apps for customer convenience to help them manage power outages and restorations, delegate parents' or children's accounts, assist them in moving out of or into new premises as well as assist them with energy conservation. For our commercial and industrial customers our suite of smart apps offers to manage multiple properties and/or work sites, predict electricity costs as well as dynamically track energy efficiency programs. With these apps and our customer loyalty program (Aeroplan®), London Hydro is able to achieve a market acceptance of about 50% for digital on-line services and 30% for paperless billing.

Looking forward, we foresee a confluence of three paradigms which will define our industry. These three paradigms are: increasing decarbonisation of our economy; increasing democratization and decentralization of energy supply options; and, digital transformation of and artificial intelligence application in our system and business processes. We are proud to advise our stakeholders that London Hydro is already on the way to leverage these new paradigms to be future ready. We have undergone a digital transformation in the control and protection of our distribution system; as such, these digital devices are already equipped with intelligent logic to facilitate automatic control especially during an outage and makes decisions in minimizing the power disruption time. London Hydro is equally hard at work in energy efficiency and energy conservation initiatives for its own operation as well as assisting customers in making their operations efficient. We are proud to showcase the achievement in energy efficiency for our nearly 3,300 social housing units. This project was a $1.1 million investment resulting in annual savings of $450,000 and requiring almost little to nil investment from the London & Middlesex Housing Corporation. This project also saved about 2,500,000 kWh per year.

Also, in London, 334 customers have deployed their own local generation, many of them renewable, biomass and gas, for a total of 62 MW of generation – nearly 10% of London Hydro's peak demand. London Hydro is proud to partner with all of them; as such, London Hydro has invested in 11 such renewable generation projects.

London Hydro is a valuable corporation and a strong community organization with an excellent financial performance for 2016, earning a Net Income of $12.46 million resulting in a return on Shareholder Equity of about 8%. Our rate base grew by $7 million, from $293 million in 2015 to $300 million in 2016. The accompanying financial statements for the period ending December 31, 2016, are evidence of the exemplary performance and skills of our employees. On behalf of all of them, we submit this report fully recognizing their valuable contribution along with those of the Board of Directors, customers and stakeholders for making London Hydro a successful corporation.

We thank one and all.

# Management's Discussion and Analysis

The following discussion and analysis is of London Hydro Inc.'s ("the Company") financial position, results from operations, and cash flow and should be read in conjunction with the Financial Statements for the period ended December 31, 2016.

The results reported herein have been prepared in accordance with International Financial Reporting Standards ("IFRS") and are expressed in Canadian dollars. As a rate-regulated entity, the Company has elected to adopt IFRS14 which allows for certain regulatory transactions to qualify as assets and liabilities not usually allowed under IFRS. The Company's process for assessing the impact of such regulatory practices and direction on reported financial results are more fully described in notes 2, 3 and 11 to the Financial Statements for the year ended December 31, 2016.

This analysis contains forward-looking statements regarding management's future expectations of performance. Such statements are subject to general risks and uncertainties, such as economic conditions, regulatory and government decisions. Forward-looking statements are not guarantees of performance as future results may differ materially from those expressed by these statements.



# Overview

## The Company and its Strategy

The Company is a wholly owned subsidiary of The Corporation of the City of London ("City of London") and provides regulated electrical distribution services to the inhabitants of the City of London.

The Company is regulated by the Ontario Energy Board ("OEB"), and operates under the authority granted by the Ontario Energy Board Act (1998). London Hydro is one of the larger distribution companies in Ontario with a work-force of 322 personnel servicing 155,497 customers and a population base of approximately 383,000.

The City of London has directed the Company's Board of Directors to oversee the operation of the business, addressing several objectives of which include: to enhance the quality and reliability of electrical supply, to maintain the corporate value of the distribution assets and to ensure that distribution rates are fair and competitive with those charged in the industry.

## Corporate Vision and Strategy

The Company's vision is to pursue excellence as an industry leader. The Company's strategy is to be a leading energy services provider through the aggressive and innovative pursuit of customer focus, social and environmental responsibility, and financial health. Through the implementation of viable and economical technology, renewable generation projects and expanding application of green technologies in the community, the Company achieves its vision and strategy and adds value for its customers.

## Mission and Values

The Company's mission is to provide safe, reliable electricity and value-added services.

The Company achieves its mission by operating within the following set of core values:

**SAFETY** - Safety is our first priority.

**PEOPLE** - Our employees are our greatest strength. Our customers are our primary focus.

**INTEGRITY** - We are stewards of the public trust and we demonstrate the highest standards of professional ethics and accountability in all our activities. We treat others with respect and courtesy.

**AGILITY** - We are open and adaptable as we embrace the industry's future.

**CORPORATE AND SOCIAL RESPONSIBILITY** - We are committed to being a financially, socially and environmentally sustainable company.

### Strategic Priorities

In pursuit of its vision and strategy, the Company continues to focus on the areas of distribution systems and technology, human resources, customer services, financial/regulatory, communications and community leadership, and green energy.

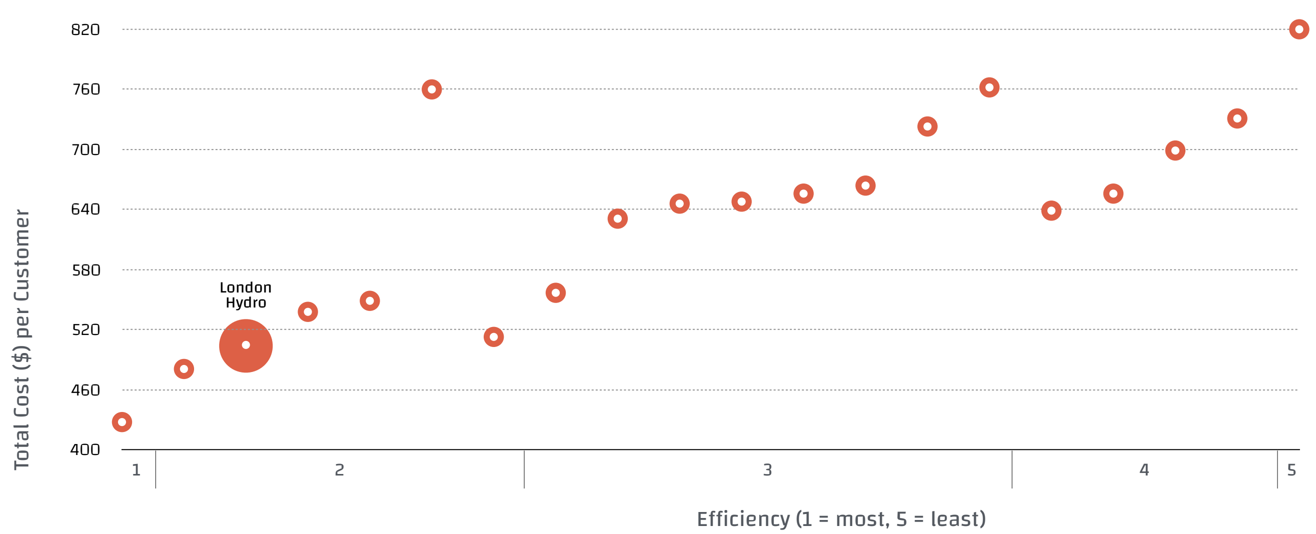
The strategic plan focuses on strategic investments in technology due to smart meters, Time-of-Use ("TOU") billing, renewable energy, and upcoming smart grid initiatives. The Company is an engineering and technology driven corporation and as such, continues to focus on deploying increased automation in the areas of the distribution system and energy management to improve reliability /contingency, customer care, retailer engagement and settlements.

To succeed in its plan, the Company will continue to invest in employee training and development, and maintain its focus on the development of a high performing corporate culture that promotes creativity and innovation in the workplace.

Improvements to customer service, customer communications and customer interactions with the Company, with due regard for controlling customer costs and other financial and regulatory constraints, are key priorities of the strategic plan. The Company continues to further increase communication with its customers as it has submitted the Distribution System Plan ("DSP") for the year as required by the OEB.

Further, the Company will continue to support the Ontario Green Energy Plan that has already resulted in the installation of new generation capacity in London over the last few years. Additional generation, mostly from renewable energy sources, is expected to be connected to London's distribution system over the coming years. The updated strategic plan is broken down into the following six pillars: Leadership, Customer Care, Reliability, Financial Stewardship, Supporting a High Performing Team, and Technology.

## Custom Performance Report 2015




# Fiscal 2016 Operations Overview

The Company's 2016 results in comparison to historical and planned performance are summarized in the following table:

**RESULTS FOR THE YEAR ENDED**

| FINANCIAL HIGHLIGHTS | 2016 | 2015 | CHANGE | | % OF PLAN |
|---|---|---|---|---|---|
| Energy Quantity - Distributed - Gigawatt Hours | 3,280.1 | 3,254.1 | 26.0 | 3,284 | -0.1% |
| (in thousands of $'s) | | | | | |
| Sale of Energy | 430,713 | 387,820 | 42,893 | 412,076 | 4.5% |
| Distribution revenue | 65,158 | 64,042 | 1,116 | 66,561 | -2.1% |
| Other revenue | 10,690 | 9,920 | 770 | 10,423 | 2.6% |
| Cost of power | 423,092 | 379,937 | 43,155 | 412,076 | 2.7% |
| Operating expenses | 41,167 | 39,206 | 1,961 | 41,037 | 0.3% |
| Amortization expenses | 18,717 | 17,755 | 962 | 18,808 | -0.5% |
| Net finance costs | 1,228 | 5,797 | -4,569 | 2,953 | -58.4% |
| Income tax expense | 3,979 | 3,160 | 819 | 2,340 | 70.0% |
| Net earnings before regulatory adjustments | 18,378 | 15,927 | 2,451 | 11,846 | 55.1% |
| Net earnings after regulatory adjustments | 12,467 | 10,175 | 2,292 | 11,846 | 5.2% |
| Operating expenses as a % of distribution revenue | 63.2% | 61.2% | | 61.7% | |
| Return on Equity | 8.3% | 6.9% | | 7.9% | |

**YTD RESULTS FOR THE YEAR ENDED**

| | 2016 | 2015 | CHANGE |
|---|---|---|---|
| Energy Distributed | 3,280.1 | 3,254.1 | 0.8% |
| Number of Customers | 155,497 | 153,948 | 1.0% |
| Operating Cash flow | 25,264 | 38,312 | |
| Investing Cash flow | (33,676) | (30,787) | |
| Financing Cash flow | 2,696 | (7,304) | |
| Cash flow | (5,716) | 221 | |
| Cash and cash equivalents - end of year | 713 | 6,429 | |

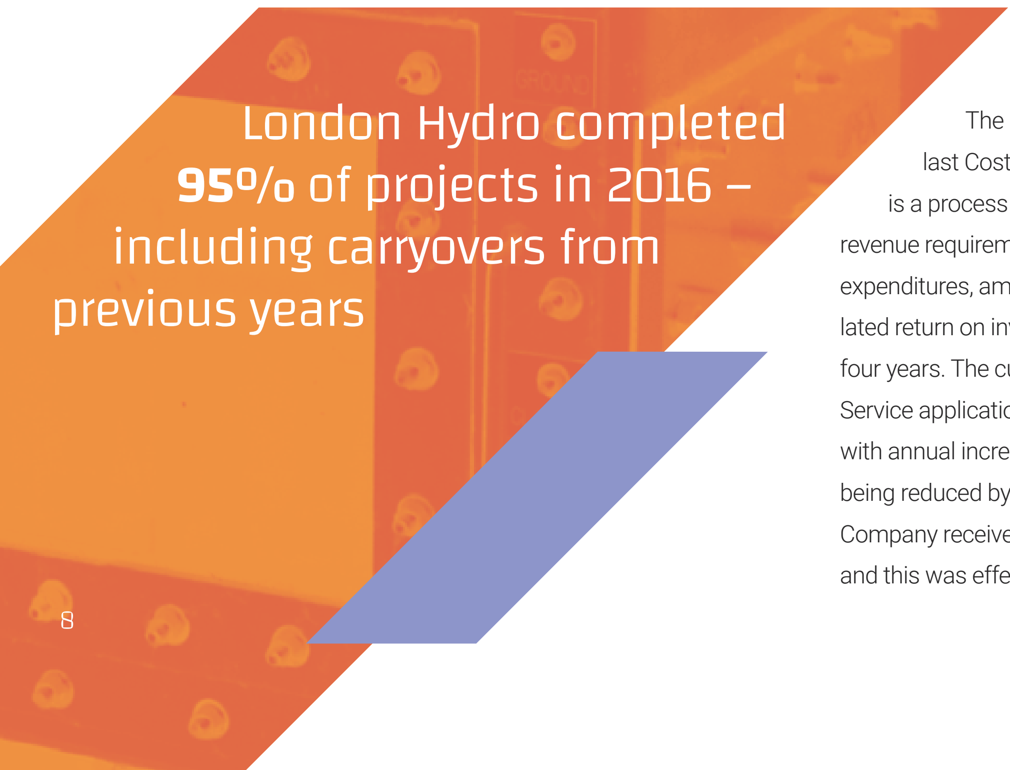
### Energy Quantities Distributed

Total energy distributed on the system increased by 0.8% to 3,280.1 gigawatt hours (2015 – 3,254.1 gigawatt hours). Although the population grew by 1.0% over the course of the year, all groups of customers are continuing to conserve electricity through active conservation efforts. The warmer summer temperatures compared to recent years reduced the impact of the conservation efforts.

### Energy Revenue and Cost of Power

The sale of energy increased during the period to $430.7 million (2015 - $387.8 million). The increase of $42.9 million or 11.1% is attributable primarily to the increase in energy prices combined with the increase in the number of customers. The cost of power purchased increased during the year to $423.1 million (2015 - $379.9 million). The increase of $43.2 million or 11.4% represents the electricity increases in commodity and non-commodity pricing, fluctuations in the spot market price and global adjustment rates determined by the Independent Electricity System Operator ("IESO").

All variances due to timing of customer billing or regulated pricing are recorded in retail settlement variance accounts ("RSVA"), which are recovered from or returned to customers in accordance with regulatory directives.




### Distribution Revenues

The Company is compensated by a regulated distribution rate based on the number of customers connected to the distribution system and their energy consumption and demand levels. Approximately 54% (2015 – 47%) of revenues are derived from a monthly fixed customer charge, while the remaining 46% (2015 – 53%) is dependent upon the customers' energy consumption and demand levels.

Beginning in 2016, fixed revenues will represent a greater percentage of the distribution rates for residential and small commercial customers as the OEB is moving towards 100% fixed rates for these customers. The change in rate structure will be completed over a four-year period. This is the most significant factor relating to the increased percent of fixed revenues in 2016 as compared to 2015. As part of the 2017 Cost of Service proceeding, London Hydro requested that the progression towards fixed rates for residential customers be delayed, but the OEB denied the request.

Total customers as at December 31, 2016 were 155,497 (2015 – 153,948). Distribution revenue composition remained relatively unchanged from the prior year with approximately 63% from residential customers (2015 – 63%), 33% from general service customers (2015 – 32%), and the remaining 4% from large users and other customers (2015 – 5%). Total distribution revenues for the period increased by $1.2 million (1.6%) to $65.2 million (2015 – $64.0 million).

The Company successfully completed its last Cost of Service in 2013. The Cost of Service is a process wherein the Company applies for the revenue requirement in order to cover the costs of operating expenditures, amortization of capital assets and a regulated return on investment. This process occurs once every four years. The current rates are a result of the last Cost of Service application and were effective as of May 1, 2013 with annual increases to account for inflationary costs while being reduced by a stretch factor approved by the OEB. The Company received approval for the 2016 factor at 1.95% and this was effective as of May 1, 2016.

Subsequent to yearend, the Company received successful approval of its 2017 Cost of Service Application. The approved rates included in the application represent a decrease of $1.40 per month for the average residential customer, effective May 1, 2017, as compared to the current rates.

The Company recorded a reduction of $0.8 million in 2016 associated with LRAM (Lost Revenue Adjustment Mechanism) through distribution revenue, partially due to a change in the recovery rules allowed by the OEB for this program.

### Operating Expense and Amortization

Total operating expenses increased during the year to $41.1 million (2015 - $39.2 million). The overall increase of $1.9 million or 5.0% is primarily attributable to increased labour and benefits costs of $0.9 million, $0.4 million for regulatory costs, $0.3 million for professional services, $0.2 million for maintenance, and $0.1 million for bad debts.

Subsequent to yearend, the provincial government announced that all local distribution companies are not to disconnect residential customers during the months of November through to April each year. At this time, it is unknown what impact, if any, the announcement will have on future bad debt expenses.

Amortization expense increased slightly to $18.7 million (2015 - $17.8 million) primarily as the Company continues to invest in infrastructure and information technology to maintain reliability for its users.

### Other Revenue

Other revenue increased slightly to $10.7 million (2015 - $9.9 million) due to increases in late payment charges ($0.1 million), income tax incentive credits ($0.1 million), the sale of scrap materials ($0.3 million) as well as non-cash revenue generated from the amortization of deferred revenue ($0.1 million) and gain on the sale of capital assets ($0.1 million).

### Net Finance Costs

Interest expense decreased significantly to $1.3 million (2015 - $5.9 million) as the mark-to-market adjustment changed from a loss to a gain. The adjustment was a gain of $1.5 million in 2016 compared to a loss of $3.2 million in 2015. Excluding the mark-to-market expense incurred for financial statement purposes relating to the two swap agreements, the interest expense would have remained consistent at $2.7 million (2015 - $2.7 million).

The first agreement is a 7-year interest rate swap agreement maturing on March 31, 2020, having an all-in rate of 3.33%. As of December 31, 2016, the total outstanding on this agreement is $6.1 million (December 31, 2015 - $8.4 million) with monthly installments of $192,000 plus interest.

The second agreement is a 7.5-year interest rate swap agreement maturing on June 30, 2022, having an all-in rate of 2.65%. As of December 31, 2016, the total outstanding on this agreement is $85 million (December 31, 2015 - $85 million) with interest only payments made on a quarterly basis.

A total unrealized loss on the interest rate swap of $4.4 million, recorded on the Statement of Financial Position, represents what the Company's cost would be to unwind these agreements as at December 31, 2016. Currently, the Company plans to maintain these agreements until the maturity dates.

### Income Tax Expense

The Company is required to make payments in lieu of tax ("PILs") to the Ontario Electricity Financial Corporation. The amount of PILs is approximately equivalent to the income taxes that would be paid if the Company was a taxable corporation under the Income Tax Act (Canada). Income tax expense for the year ended December 31, 2016 was $4.0 million (2015 - $3.2 million).

The Company has a deferred tax liability of $1.2 million (December 31, 2015 - $0.7 million deferred tax asset) as a result of temporary differences related to tax values of Property, Plant and Equipment in excess of their carrying amount for financial reporting purposes, losses incurred related to the interest rate swap, and expenses incurred for taxation purposes for employee future benefits but not yet deducted for accounting.

CICA 3465.103 recognizes that, as a rate regulated entity, Future Income Tax Liabilities, which will be paid on behalf of customers, will be recovered from customers as they are paid and, therefore, increases or decreases in Future Income Tax liabilities are offset by a regulatory asset.

### Regulatory Assets/Liabilities

As a regulated distributor of electricity, the Company is obligated to provide energy to all customers at the Regulated Price Plan ("RPP") or at the Hourly Ontario Energy Price ("HOEP") plus global adjustment charges, unless they elect to purchase their energy from an energy retailer which also entails adding a global adjustment charge. The regulatory framework requires that all energy commodity and non-commodity costs be billed at regulated rates to consumers who are on the RPP.

Variances between purchased costs and amounts billed are required to be captured in the RSVA for disposition through future rates.

At December 31, 2016, the Company had regulatory assets of $6.6 million (December 31, 2015 - $2.9 million), representing an increase of $3.7 million, the majority of which relates to increased amounts collected from customers as of May 2016 for cost of power variances after the OEB approved recovery.

The Company also had regulatory liabilities of $12.4 million at December 31, 2016, compared to $2.7 million as of December 31, 2015. This change is primarily the result of the increased liability from power cost variances.

**DID YOU KNOW?**

London Hydro serviced **$2.7M** in new and upgraded Commercial distribution services

## Capital Resources

### Capital Structure and Dividend Policy

The Company has three debt agreements which account for total debt of $111.1 million.

The Company's distribution rates are based on a regulatory deemed capital structure of 60% debt and 40% equity. To the extent that the Company's existing capital structure and debt rates do not reflect the deemed structure included in distribution rates, the economic performance of the Company will be suboptimal.

The Company's dividend policy provides for an annual dividend, subject to satisfactory cash flow. In accordance with that policy, during the year the Board of Directors declared a dividend in the amount of $5.0 million. A special dividend in the amount of $5.0 million was also declared, which was paid in quarterly installments during fiscal 2016.

Subsequent to yearend, a regular dividend was declared by the Board of Directors in the amount of $5.0 million. The dividend will be paid in quarterly installments during fiscal 2017.

### External Credit Facilities and Credit Rating

The Company has an uncommitted revolving bank credit facility of $40.0 million, a committed 364 day extendable revolving bank loan facility of $30.0 million maturing on March 31, 2019, and $6.6 million in Standby Letters of Credit issued to the IESO as security. In the event that the maturity date of the committed extendable operating loan facility is not extended, the due date for repayment of this loan facility is one year from the date of maturity.

As at December 31, 2016, the Company has drawn down $20.0 million (2015 - $5.0 million) on its committed loan facility and $nil (2015 - $nil) on the uncommitted facility.

The Company's 'A/stable' long-term corporate credit rating was reaffirmed by Standard & Poor's in May 2016. This rating reflects the Company's low-risk as a distribution company with regulated cash flows. The Company's current credit rating provides for a reduction in the IESO prudential requirement by approximately $59.0 million.

### Liquidity and Cash flow

Cash generated from operating activities decreased to $25.3 million (2015 - $38.3 million). Cash flows primarily relate to amounts of $12.5 million from net income after regulatory adjustments, $18.7 million from amortization expenses, $1.5 million from the non-cash gain on the interest rate swap, $5.9 million from regulatory balances, and decreases of $12.9 million as a result of a change in non-cash working capital.

Cash used in investing activities increased to $33.7 million (2015 - $30.8 million) which primarily represents the purchase of capital assets and intangible assets.

Cash generated from financing activities provided $2.7 million (2015 - $7.3 million used) due to the net debt proceeds of $12.7 million less the dividend payment of $10.0 million.

The year-to-date change in cash is a decrease of $5.7 million. The cash balance as of December 31, 2016 was $0.7 million.





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# Independent Auditors' Report

To the Shareholder of London Hydro Inc.

We have audited the accompanying financial statements of London Hydro Inc., which comprise the statement of financial position as at December 31, 2016, the statements comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

## Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

## Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. In our opinion, the financial statements present fairly, in all material respects, the financial position of London Hydro Inc. as at December 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

## Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of London Hydro Inc. as at December 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants
March 30, 2017
London, Canada

December 31, 2016 with comparative amounts at December 31, 2015
*(in thousands of dollars)*

| | Note | 2016 | 2015 |
|---|---|---|---|
| **ASSETS** | | | |
| **Current assets** | | | |
| Cash | 5 | $ 713 | $ 6,429 |
| Accounts receivable | 6 | 86,914 | 71,014 |
| Income tax receivable | | - | 416 |
| Materials and supplies | 7 | 845 | 749 |
| Prepaid expenses | | 1,896 | 1,826 |
| Total current assets | | 90,368 | 80,434 |
| **Non-current assets** | | | |
| Property, plant and equipment | 8 | 268,702 | 250,739 |
| Intangible assets | 9 | 17,617 | 16,648 |
| Deferred tax assets | 10 | - | 740 |
| Total non-current assets | | 286,319 | 268,127 |
| **Total assets** | | 376,687 | 348,561 |
| Regulatory balances | 11 | 6,550 | 2,896 |
| **Total assets and regulatory balances** | | $ 383,237 | $ 351,457 |
| **LIABILITIES** | | | |
| **Current liabilities** | | | |
| Accounts payable and accrued liabilities | 12 | $ 56,257 | $ 54,070 |
| Due to shareholder | 21 | 8,671 | 7,428 |
| Income tax payable | | 223 | - |
| Current portion of long-term debt | 14 | 2,304 | 7,304 |
| Customer and other deposits | | 436 | 594 |
| Deferred revenue | 13 | 1,399 | 1,192 |
| Total current liabilities | | 69,290 | 70,588 |
| **Non-current liabilities** | | | |
| Long-term debt | 14,23 | 108,826 | 91,130 |
| Post-employment benefits | 15 | 14,481 | 13,845 |
| Customer and other deposits | | 5,600 | 5,663 |
| Deferred revenue | 13 | 16,309 | 12,950 |
| Deferred tax liability | 10 | 1,163 | - |
| Unrealized loss on interest rate swap | 14,23 | 4,406 | 5,935 |
| Total non-current liabilities | | 150,785 | 129,523 |
| **Total liabilities** | | 220,075 | 200,111 |
| **Equity** | | | |
| Share capital | 16 | 96,116 | 96,116 |
| Retained earnings | | 55,251 | 52,784 |
| Accumulated other comprehensive loss | | (586) | (292) |
| **Total equity** | | 150,781 | 148,608 |
| **Total liabilities and equity** | | 370,856 | 348,719 |
| Regulatory balances | 11 | 12,381 | 2,738 |
| *Commitments and contingencies (Note 20), Subsequent event (Note 24)* | | | |
| **Total liabilities, equity and regulatory balances** | | $ 383,237 | $ 351,457 |

**On behalf of the Board:**

Director

Director

The accompanying notes are an integral part of these financial statements.





London Hydro Inc.
Statement of Comprehensive Income

For the year ended December 31, 2016
with comparative amounts for 2015
*(in thousands of dollars)*

| | Note | 2016 | 2015 |
|---|---|---|---|
| **Revenues** | | | |
| Sale of energy | | $ 430,713 | $ 387,820 |
| Distribution revenue | | 65,158 | 64,042 |
| Other | 17 | 10,690 | 9,920 |
| | | 506,561 | 461,782 |
| **Operating expenses** | | | |
| Cost of power purchased | | 423,092 | 379,937 |
| Operating expenses | 18 | 41,167 | 39,206 |
| Depreciation and amortization | | 18,717 | 17,755 |
| | | 482,976 | 436,898 |
| **Income from operating activities** | | 23,585 | 24,884 |
| **Finance (income) / expense** | | | |
| Finance income | 19 | (80) | (101) |
| Finance expenses | 19 | 1,308 | 5,898 |
| | | 1,228 | 5,797 |
| **Income before income taxes** | | 22,357 | 19,087 |
| Income tax expense | 10 | 3,979 | 3,160 |
| **Net income for the year** | | 18,378 | 15,927 |
| Net movement in regulatory balances, net of tax | 11 | (5,911) | (5,752) |
| **Net income for year and net movement in regulatory balances** | | 12,467 | 10,175 |
| **Other comprehensive income** | | | |
| Items that will not be reclassified to profit or loss: | | | |
| Remeasurements of post-employment benefits | | (294) | 179 |
| Tax on remeasurements | 10 | 78 | (47) |
| Net movement in regulatory balances, net of tax | 11 | (78) | 47 |
| **Other comprehensive income / (loss) for the year** | | (294) | 179 |
| **Total comprehensive income for the year** | | $ 12,173 | $ 10,354 |

The accompanying notes are an integral part of these financial statements.

London Hydro Inc.
Statement of Changes in Equity

For the year ended December 31, 2016
with comparative amounts for 2015
*(in thousands of dollars)*

| | Note | Share Capital | Retained Earnings | Accumulated Other Comprehensive Income / (loss) | Total |
|---|---|---|---|---|---|
| **Balance at January 1, 2015** | | $ 96,116 | $ 52,609 | $ (471) | $ 148,254 |
| Net income and net movement in regulatory balances | | - | 10,175 | - | 10,175 |
| Other comprehensive income | | - | - | 179 | 179 |
| Dividends | 16 | - | (10,000) | - | (10,000) |
| **Balance at December 31, 2015** | | $ 96,116 | $ 52,784 | $ (292) | $ 148,608 |
| **Balance at January 1, 2016** | | $ 96,116 | $ 52,784 | $ (292) | $ 148,608 |
| Net income and net movement in regulatory balances | | - | 12,467 | - | 12,467 |
| Other comprehensive income | | - | - | (294) | (294) |
| Dividends | 16 | - | (10,000) | - | (10,000) |
| **Balance at December 31, 2016** | | $ 96,116 | $ 55,251 | $ (586) | $ 150,781 |

The accompanying notes are an integral part of these financial statements.





London Hydro Inc.
Statement of Cash Flows

For the year ended December 31, 2016
with comparative amounts for 2015
*(in thousands of dollars)*

| | Note | 2016 | 2015 |
|---|---|---|---|
| **Operating activities** | | | |
| Net income and net movement in regulatory balances | | $ 12,467 | $ 10,175 |
| Adjustments for: | | | |
| Depreciation and amortization | 8,9 | 18,717 | 17,755 |
| Amortization of deferred revenue | 17 | (173) | (79) |
| Post-employment benefits | 15 | 342 | 275 |
| Gain on disposal of property, plant and equipment | 17 | (234) | (162) |
| Net finance expenses | 19 | 1,228 | 5,797 |
| Income tax expense | 10 | 3,979 | 3,160 |
| | | 36,326 | 36,921 |
| Change in non-cash working capital: | | | |
| Accounts receivable | | (15,900) | 1,952 |
| Materials and supplies | | (96) | (94) |
| Prepaid expenses | | (70) | (257) |
| Accounts payable and accrued liabilities | | 2,187 | 307 |
| Due to / from shareholder | | 1,243 | 485 |
| Customer deposits | | (221) | 348 |
| | | (12,857) | 2,741 |
| Other: | | | |
| Regulatory balances | 11 | 5,911 | 5,752 |
| Income tax paid | | (2,065) | (4,639) |
| Income tax received | | 706 | 177 |
| Interest paid | | (2,837) | (2,741) |
| Interest received | | 80 | 101 |
| | | 1,795 | (1,350) |
| **Net cash from operating activities** | | 25,264 | 38,312 |
| **Investing activities** | | | |
| Purchase of property, plant and equipment | 8 | (31,110) | (28,099) |
| Purchase of intangible assets | 9 | (6,546) | (6,655) |
| Proceeds on disposal of property, plant and equipment | | 241 | 162 |
| Contributions received from customers | | 3,739 | 3,805 |
| **Net cash from investing activities** | | (33,676) | (30,787) |
| **Financing activities** | | | |
| Dividends paid | 16 | (10,000) | (10,000) |
| Proceeds from long-term debt | 14 | 20,000 | 5,000 |
| Repayment of long-term debt | 14 | (7,304) | (2,304) |
| **Net cash from financing activities** | | 2,696 | (7,304) |
| Change in cash | | (5,716) | 221 |
| Cash, beginning of year | | 6,429 | 6,208 |
| **Cash, end of year** | | $ 713 | $ 6,429 |

The accompanying notes are an integral part of these financial statements.

**1. Reporting entity**

London Hydro Inc. (“the Company”) is a rate regulated, municipally-owned hydro distribution company located in the City of London. The Company is a wholly-owned subsidiary company of the Corporation of the City of London and was incorporated on April 26, 2000 under the laws of the Province of Ontario, Canada.

The Company delivers electricity and related energy services to inhabitants of the City of London. The address of the Company’s registered office is 111 Horton Street, London, Ontario, Canada.

**2. Basis of presentation**

a) Statement of compliance

The Company's financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

b) Approval of financial statements

These financial statements were approved by the Board of Directors on March 30, 2017.

c) Basis of measurement

These financial statements have been prepared on the historical cost basis, unless otherwise stated.

d) Functional and presentation currency

These financial statements are presented in Canadian dollars, which is the Company's functional currency.

e) Use of estimates and judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses and disclosure of contingent assets and liabilities. Actual results may differ from those estimates.





**2. Basis of presentation (continued)**

e) Use of estimates and judgments (continued)

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in material adjustment is included in the following notes:

(i) 3(b) – measurement of unbilled revenue
(ii) 3(d), 3(e), 8, 9 – estimation of useful lives of its property, plant and equipment and intangible assets
(iii) 11 – recognition and measurement of regulatory balances
(iv) 15 – measurement of defined benefit obligations: key actuarial assumptions
(v) 20 – recognition and measurement of provisions and contingencies

f) Rate regulation

The Company is regulated by the Ontario Energy Board (“OEB”), under the authority granted by the *Ontario Energy Board Act, 1998*. Among other things, the OEB has the power and responsibility to approve or set rates for the transmission and distribution of electricity, providing continued rate protection for electricity consumers in Ontario, and ensuring that transmission and distribution companies fulfill obligations to connect and service customers. The OEB may also prescribe license requirements and conditions of service to local distribution companies (“LDCs”), such as the Company, which may include, among other things, record keeping, regulatory accounting principles, separation of accounts for distinct businesses, and filing and process requirements for rate setting purposes.

The Company is required to bill customers for the debt retirement charge set by the province. The Company may file to recover uncollected debt retirement charges from Ontario Electricity Financial Corporation (“OEFC”).

**Rate setting**

*Distribution revenue*

For the distribution revenue, the Company files a “Cost of Service” (“COS”) rate application with the OEB where rates are determined through a review of the forecasted annual amount of operating and capital expenditures, debt and shareholder’s equity required to support the Company’s business. The COS is filed every five years commencing with the 2017 rate application (previously every four years). The Company estimates electricity usage and the costs to service each customer class to determine the appropriate rates to be charged to each customer class. The COS application is reviewed by the OEB and interveners and rates are approved based upon this review, including any revisions resulting from that review.

London Hydro Inc.
Notes to the Financial Statements *(in thousands of dollars)*
For the year ended December 31, 2016

f) Rate regulation (continued)

**Rate setting** - *Distribution revenue (continued)*

In the intervening years an Incentive Regulation Mechanism ("IRM") rate application is filed. An IRM application results in a formulaic adjustment to distribution rates that were set under the last COS application. The previous year's rates are adjusted for the annual change in the Gross Domestic Product Implicit Price Inflator for Final Domestic Demand ("GDP IPI-FDD") net of a productivity factor and a "stretch factor" determined by the relative efficiency of an electricity distributor.

The Company previously filed a COS application in September 2012 for rates effective May 1, 2013 to April 30, 2017. The GDP IPI-FDD for 2015 was 1.6%, the OEB applied productivity factor is 0.0% and the OEB determined stretch factor is (0.15)%, resulting in a net adjustment of 1.45% to the previous year's rates effective May 1, 2015.

The GDP IPI-FDD for 2016 is 2.1%, the OEB applied productivity factor is 0.0% and the OEB determined stretch factor is (0.15)%, resulting in a net adjustment of 1.95% to the previous year's rates effective May 1, 2016.

In August 2016, the Company filed a COS application which has been approved by the OEB. The rates approved in the application result in a decrease for the typical residential customer of $1.40 per month compared to current rates. These new rates will become effective May 1, 2017.

As a licensed distributor, the Company is responsible for billing customers for electricity generated by third parties and the related costs of providing electricity service, such as transmission services and other services provided by third parties. The Company is required, pursuant to regulation, to remit such amounts to these third parties, irrespective of whether the Company ultimately collects these amounts from customers.

*Electricity rates*

The OEB sets electricity prices for residential and small commercial consumers twice each year based on an estimate of how much it will cost to supply the province with electricity for the next year. All remaining consumers, other than consumers with retail contracts who pay a contracted rate plus a global adjustment rate adder, pay the market price for electricity. The Company is billed for the cost of the electricity that its customers use and passes this cost on to the customer at cost without a mark-up.

**3. Significant accounting policies**

The accounting policies set out below have been applied consistently in all years presented in these financial statements.

a) Financial instruments

*Non-derivative*

All financial assets are classified as loans and receivables and all financial liabilities are classified as other liabilities. These financial instruments are recognized initially at fair value plus any directly attributable transaction costs. Subsequently, they are measured at amortized cost using the effective interest method less any impairment for the financial assets as described in note 3(f).

*Derivative*

The Company holds derivative financial instruments to manage its interest rate risk exposures. Derivatives are initially recognized at fair value; any directly attributable transaction costs are recognized in profit and loss as incurred as finance expenses. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are recognized in profit or loss.

Hedge accounting has not been used in the preparation of these financial statements.

b) Revenue recognition

*Sale and distribution of electricity*

Revenue from the sale and distribution of electricity is recognized as the electricity is delivered to customers on the basis of cyclical meter readings and estimated customer usage since the last meter reading date to the end of the period. Revenue includes the cost of electricity supplied, distribution, and any other regulatory charges. The related cost of power is recorded on the basis of power used.

For customer billings related to electricity generated by third parties and the related costs of providing electricity service, such as transmission services and other services provided by third parties, the Company has determined that it is acting as a principal for these electricity charges and, therefore, has presented electricity revenue on a gross basis.

Customer billings for debt retirement charges are recorded on a net basis as the Company is acting as an agent for this billing stream.

Notes to the Financial Statements *(in thousands of dollars)*

**3. Significant accounting policies (continued)**

b) Revenue recognition (continued)

*Other revenue*

Revenue earned from the provision of services is recognized as the service is rendered.

Certain customers and developers are required to contribute towards the capital cost of construction of distribution assets in order to provide ongoing service. Cash contributions are recorded as deferred revenue. Where an asset other than cash is received as a capital contribution, the asset is initially recognized at its fair value, with a corresponding amount recognized as deferred revenue. The deferred revenue, which represents the Company's obligation to continue to provide the customers access to the supply of electricity, is amortized to income on a straight-line basis over the useful life of the related asset.

Government grants and the related performance incentive payments under Conservation Demand Management ("CDM") programs are recognized as revenue in the year when there is reasonable assurance that the program conditions have been satisfied and the payment will be received.

c) Materials and supplies

Materials and supplies, the majority of which are consumed by the Company in the provision of its services, are valued at the lower of cost and net realizable value, with cost being determined on a weighted average basis, and includes expenditures incurred in acquiring the materials and supplies and other costs incurred in bringing them to their existing location and condition.

d) Property, plant and equipment

Items of property, plant and equipment ("PP&E") used in rate-regulated activities and acquired prior to January 1, 2014 are measured at deemed cost, less accumulated depreciation. All other items of PP&E are measured at cost, or, where the item is contributed by customers, its fair value, less accumulated depreciation.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes contracted services, materials and transportation costs, direct labour, overhead costs, borrowing costs and any other costs directly attributable to bringing the asset to a working condition for its intended use.

Borrowing costs on qualifying assets are capitalized as part of the cost of the asset based upon the lower of OEB prescribed rates and the weighted average cost of debt incurred on the Company's borrowings. Qualifying assets are considered to be those that take in excess of 12 months to construct.





**3. Significant accounting policies (continued)**

d) Property, plant and equipment (continued)

When parts of an item of PP&E have different useful lives, they are accounted for as separate items (major components) of PP&E.

When items of PP&E are retired or otherwise disposed of, a gain or loss on disposal is determined by comparing the proceeds from disposal, if any, with the carrying amount of the item and is included in profit or loss.

Major spare parts and standby equipment are recognized as items of PP&E.

The cost of replacing a part of an item of PP&E is recognized in the net book value of the item if it is probable that the future economic benefits embodied within the part will flow to the Company and its cost can be measured reliably. In this event, the replaced part of PP&E is written off, and the related gain or loss is included in profit or loss. The costs of the day-to-day servicing of PP&E are recognized in profit or loss as incurred.

The need to estimate the decommissioning costs at the end of the useful lives of certain assets is reviewed periodically. The Company has concluded it does not have any legal or constructive obligation to remove PP&E.

Depreciation is calculated to write off the cost of items of PP&E using the straight-line method over their estimated useful lives, and is generally recognized in profit or loss. Depreciation methods, useful lives, and residual values are reviewed at each reporting date and adjusted prospectively if appropriate. Land is not depreciated. Construction-in-progress assets are not depreciated until the project is complete and the asset is available for use.

The estimated useful lives are as follows:

| | Years |
|---|---|
| Distribution system and equipment | 25 - 60 |
| Building structures and components | 12 - 75 |
| Substation equipment | 15 - 45 |
| Metering devices | 15 - 30 |
| System supervisory equipment | 8 - 35 |
| Automotive equipment | 8 - 12 |
| Equipment, tools and furniture | 5 - 8 |
| Computer hardware | 3 |
| Renewable generation assets | 20 |

London Hydro Inc.
Notes to the Financial Statements *(in thousands of dollars)*
For the year ended December 31, 2016

**3. Significant accounting policies (continued)**

e) Intangible assets

Intangible assets used in rate-regulated activities and acquired prior to January 1, 2014 are measured at deemed cost, less accumulated amortization. All other intangible assets are measured at cost.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of intangible assets includes contracted services, materials and transportation costs, direct labour, overhead costs, borrowing costs and any other costs directly attributable to bringing the asset to a working condition for its intended use.

Borrowing costs on qualifying assets are capitalized as part of the cost of the asset based upon the lower of OEB prescribed rates and the weighted average cost of debt incurred on the Company's borrowings. Qualifying assets are considered to be those that take in excess of 12 months to complete.

Computer software that is acquired or developed by the Company after January 1, 2014, including software that is not integral to the functionality of equipment purchased which has finite useful lives, is measured at cost less accumulated amortization.

Payments to obtain rights to access land ("land rights") are classified as intangible assets. These include payments made for easements, right of access and right of use over land for which the Company does not hold title. Land rights are measured at cost less accumulated amortization.

With the market opening in 2002, wholesale market participants, including the Company, were charged with the responsibility of upgrading all their wholesale meter points to "IESO" compliant standards. Since the Company does not hold title to these assets, these expenditures have been classified as intangible assets. Wholesale metering upgrades are measured at cost less accumulated amortization.

Intangible assets in progress consist of application software under development and capital contributions paid towards refurbishment of a transformer station that is not owned by the Company, which is scheduled to be energized during the year ending December 31, 2018.

Amortization is recognized in profit or loss on a straight-line basis over the estimated useful lives of intangible assets, from the date that they are available for use. Amortization methods and useful lives of all intangible assets are reviewed at each reporting date and adjusted prospectively if appropriate. The estimated useful lives are:

| | Years |
|---|---|
| Computer software | 3 - 5 |
| Land rights | 25 |
| Wholesale metering | 30 |



London Hydro Inc.
Notes to the Financial Statements *(in thousands of dollars)*
For the year ended December 31, 2016

**3. Significant accounting policies (continued)**

f) Impairment

*Financial assets measured at amortized cost*

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows from that asset.

An impairment loss is calculated as the difference between an asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Interest on the impaired assets continues to be recognized through the unwinding of the discount. Losses are recognized in profit or loss. An impairment loss is reversed through profit or loss if the reversal can be related objectively to an event occurring after the impairment loss was recognized.

*Non-financial assets*

The carrying amounts of the Company's non-financial assets, other than materials and supplies and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit" or "CGU"). The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

g) Customer and other deposits

Customer and other deposits include cash deposits from electricity distribution customers and retailers to guarantee the payment of energy bills. Interest is paid on customer deposits at the rate of prime less 2% per annum.

Deposits from electricity distribution customers are refundable to customers who demonstrate an acceptable level of credit risk as determined by the Company in accordance with policies set out by the OEB, or upon termination of their electricity distribution service.

**3. Significant accounting policies (continued)**

h) Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

i) Regulatory balances

Regulatory deferral account debit balances represent costs incurred in excess of amounts billed to the customer at OEB approved rates. Regulatory deferral account credit balances represent amounts billed to the customer at OEB approved rates in excess of costs incurred by the Company.

Regulatory deferral account debit balances are recognized if it is probable that future billings in an amount at least equal to the deferred cost will result from inclusion of that cost in allowable costs for rate-making purposes. The offsetting amount is recognized in net movement in regulatory balances in profit or loss or Other Comprehensive Income (“OCI”). When the customer is billed at rates approved by the OEB for the recovery of the deferred costs, the customer billings are recognized in revenue. The regulatory debit balance is reduced by the amount of these customer billings with the offset to net movement in regulatory balances in profit or loss or OCI.

The probability of recovery of the regulatory deferral account debit balances is assessed annually based upon the likelihood that the OEB will approve the change in rates to recover the balance. The assessment of likelihood of recovery is based upon previous decisions made by the OEB for similar circumstances, policies or guidelines issued by the OEB, etc. Any resulting impairment loss is recognized in profit or loss in the year incurred.

When the Company is required to refund amounts to ratepayers in the future, the Company recognizes a regulatory deferral account credit balance. The offsetting amount is recognized in net movement in regulatory balances in profit or loss or OCI. The amounts returned to the customers are recognized as a reduction of revenue. The credit balance is reduced by the amount of these customer repayments with the offset to net movement in regulatory balances in profit or loss or OCI.





**3. Significant accounting policies (continued)**

j) Post-employment benefits

*Pension plan*

The Company provides a pension plan for all its full-time employees through Ontario Municipal Employees Retirement System (“OMERS”). OMERS is a multi-employer pension plan which operates as the Ontario Municipal Employees Retirement Fund (“the Fund”), and provides pensions for employees of Ontario municipalities, local boards and public utilities. The Fund is a contributory defined benefit pension plan, which is financed by equal contributions from participating employers and employees, and by the investment earnings of the Fund. To the extent that the Fund finds itself in an under-funded position, additional contribution rates may be assessed to participating employers and members.

OMERS is a defined benefit plan. However, as OMERS does not segregate its pension asset and liability information by individual employers, there is insufficient information available to enable the Company to directly account for the plan. Consequently, the plan has been accounted for as a defined contribution plan. The Company is not responsible for any other contractual obligations other than the contributions. Obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense in profit or loss when they are due.

*Post-employment benefits, other than pension*

The Company provides some of its retired employees with life insurance and medical benefits beyond those provided by government sponsored plans.

The obligations for these post-employment benefit plans are actuarially determined by applying the projected unit credit method and reflect management’s best estimate of certain underlying assumptions. Remeasurements of the net defined benefit obligations, including actuarial gains and losses and the return on plan assets (excluding interest), are recognized immediately in OCI. When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognized immediately in profit or loss.

k) Finance income and finance expenses

Finance income is recognized as it accrues in profit or loss. Finance income comprises interest earned on cash and cash equivalents.

Finance expenses comprise interest expense on borrowings and customer deposits. Finance expenses are recognized in profit or loss unless they are capitalized as part of the cost of qualifying assets.

**3. Significant accounting policies (continued)**

l) Income taxes

The income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case, it is recognized in equity.

The Company is currently exempt from taxes under the Income Tax Act (Canada) and the Ontario Corporations Tax Act (collectively the "Tax Acts"). Under the Electricity Act, 1998, the Company makes payments in lieu of corporate taxes to the Ontario Electricity Financial Corporation ("OEFC"). These payments are calculated in accordance with the rules for computing taxable income and taxable capital and other relevant amounts contained in the Tax Acts as modified by the Electricity Act, 1998, and related regulations. Prior to October 1, 2001, the Company was not subject to income or capital taxes. Payments in lieu of taxes ("PILs") are referred to as income taxes.

Current tax comprises the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized in respect of temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. Deferred tax assets and liabilities are recognized for unused tax losses, unused tax credits and temporary differences to the extent that it is probable that future taxable profits will be available against which they can be used. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, using tax rates enacted or substantively enacted, at the reporting date.

m) Change in accounting policies

The Company has adopted the following amendments to standards, with a date of initial application of January 1, 2016.

*Annual Improvements to IFRS (2012-2014) cycle*

On September 25, 2014 the IASB issued narrow-scope amendments to a total of four standards as part of its annual improvements process. The amendments will apply for annual periods beginning on or after January 1, 2016. Earlier application is permitted, in which case, the related consequential amendments to other IFRSs would also apply. Each of the amendments has its own specific transition requirements. Amendments were made to clarify the following in their respective standards:







**3. Significant accounting policies (continued)**

m) Change in accounting policies (continued)

- Changes in method for disposal under IFRS 5 Non-current Assets Held for Sale and Discontinued Operations;
- Continuing involvement' for servicing contracts and offsetting disclosures in condensed interim financial statements under IFRS 7 Financial Instruments: Disclosures;
- Discount rate in a regional market sharing the same currency under IAS 19 Employee Benefits;
- Disclosure of information 'elsewhere in the interim financial report' under IAS 34 Interim Financial Reporting;

The amendments did not result in a material impact on the financial statements.

**4. Standards issued not yet adopted**

There are new standards, amendments to standards and interpretations which have not been applied in preparing these financial statements. These standards or amendments relate to the measurement and disclosure of financial assets and liabilities. The extent of the impact on adoption of these standards and amendments has not yet been determined.

i. Disclosure Initiative (Amendments to IAS 7)
ii. Recognition of Deferred Tax Assets for Unrealized Losses (Amendments to IAS 12)
iii. IFRS 15 Revenue from Contracts with Customers
iv. IFRS 9 Financial Instruments
v. IFRS 16 Leases
vi. Annual Improvements to IFRS (2014-2016) cycle

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Notes to the Financial Statements *(in thousands of dollars)*
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**4. Standards issued not yet adopted (continued)**

*i. Disclosure Initiative (Amendments to IAS 7)*

On January 7, 2016 the IASB issued Disclosure Initiative (Amendments to IAS 7). The amendments apply prospectively for annual periods beginning on or after January 1, 2017. Earlier application is permitted.

The amendments require disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flow and non-cash changes. One way to meet this new disclosure requirement is to provide a reconciliation between the opening and closing balances for liabilities from financing activities.

The Company will adopt the amendments to IAS 7 in its financial statements for the annual period beginning on January 1, 2017. The Company does not expect the amendments to have a material impact on the financial statements.

*ii. Recognition of Deferred Tax Assets for Unrealized Losses (Amendments to IAS 12)*

On January 19, 2016 the IASB issued Recognition of Deferred Tax Assets for Unrealized Losses (Amendments to IAS 12). The amendments apply retrospectively for annual periods beginning on or after January 1, 2017. Earlier application is permitted.

The amendments clarify that the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset. The amendments also clarify the methodology to determine the future taxable profits used for assessing the utilization of deductible temporary differences.

The Company will adopt the amendments to IAS 12 in its financial statements for the annual period beginning on January 1, 2017. The Company does not expect the amendments to have a material impact on the financial statements.



London Hydro Inc.
Notes to the Financial Statements *(in thousands of dollars)*
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**4. Standards issued not yet adopted (continued)**

*iii. IFRS 15 Revenue from Contracts with Customers*

On May 28, 2014 the IASB issued IFRS 15 Revenue from Contracts with Customers. The new standard is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted. IFRS 15 will replace IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfer of Assets from Customers, and SIC 31 Revenue – Barter Transactions Involving Advertising Services. On April 12, 2016, the IASB issued Clarifications to IFRS 15, Revenue from Contracts with Customers, which is effective at the same time as IFRS 15.

The standard contains a single model that applies to contracts with customers and two approaches to recognising revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. The new standard applies to contracts with customers. It does not apply to insurance contracts, financial instruments or lease contracts, which fall in the scope of other IFRSs. The clarifications to IFRS 15 provide additional guidance with respect to the five-step analysis, transition, and the application of the Standard to licenses of intellectual property.

The Company intends to adopt IFRS 15 and the clarifications in its financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

*iv. IFRS 9 Financial Instruments*

On July 24, 2014 the IASB issued the complete IFRS 9 (IFRS 9 (2014)). The mandatory effective date of IFRS 9 is for annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions. Early adoption is permitted. The restatement of prior periods is not required and is only permitted if information is available without the use of hindsight.

IFRS 9 (2014) introduces new requirements for the classification and measurement of financial assets. Under IFRS 9 (2014), financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. The standard introduces additional changes relating to financial liabilities. It also amends the impairment model by introducing a new ‘expected credit loss’ model for calculating impairment. IFRS 9 (2014) also includes a new general hedge accounting standard which aligns hedge accounting more closely with risk management. This new standard does not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness, however it will provide more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more judgment to assess the effectiveness of a hedging relationship. Special transitional requirements have been set for the application of the new general hedging model.

The Company intends to adopt IFRS 9 (2014) in its financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

London Hydro Inc.
Notes to the Financial Statements *(in thousands of dollars)*
For the year ended December 31, 2016

**4. Standards issued not yet adopted (continued)**

*v. IFRS16 Leases*

On January 13, 2016 the IASB issued IFRS 16 Leases. The new standard is effective for annual periods beginning on or after January 1, 2019. Earlier application is permitted for entities that apply IFRS 15 Revenue from Contracts with Customers at or before the date of initial adoption of IFRS 16. IFRS 16 will replace IAS 17 Leases.

This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by lessors.

The Company intends to adopt IFRS 16 in its financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of the standard has not yet been determined.

*vi. Annual Improvements to IFRS (2014-2016) cycle*

On December 8, 2016 the IASB issued narrow-scope amendments to three standards as part of its annual improvements process. Each of the amendments has its own specific transition requirements and effective date.

Amendments were made to the following standards:

- Clarification that IFRS 12 Disclosures of Interests in Other Entities also applies to interests that are classified as held for sale, held for distribution, or discontinued operations, effective retrospectively for annual periods beginning on or after January 1, 2017;
- Removal of out-dated exemptions for first time adopters under IFRS 1 First-time Adoption of International Financial Reporting Standards, effective for annual periods beginning on or after January 1, 2018; and
- Clarification that the election to measure an associate or joint venture at fair value under IAS 28 Investments in Associates and Joint Ventures for investments held directly, or indirectly, through a venture capital or other qualifying entity can be made on an investment-by-investment basis. The amendments are effective retrospectively for annual periods beginning on or after January 1, 2018.

The Company intends to adopt these amendments in its financial statements for the annual period beginning on January 1, 2017 or 2018 as applicable. The extent of the impact of adoption of the amendments has not yet been determined.

London Hydro Inc.
Notes to the Financial Statements *(in thousands of dollars)*
For the year ended December 31, 2016

**5. Cash**

| | 2016 | 2015 |
|---|---|---|
| Bank balances | $ 713 | $ 6,429 |

**6. Accounts receivable**

| | 2016 | 2015 |
|---|---|---|
| Trade receivables | $ 38,576 | $ 25,863 |
| Unbilled revenue | 45,507 | 42,085 |
| Other | 2,831 | 3,066 |
| | $ 86,914 | $ 71,014 |

Included in accounts receivable is approximately $8.6 million (2015 - $7.9 million) of customer receivables for water consumption that the Company bills and collects on behalf of the Corporation of the City of London. As the Company does not assume liability for collection of these amounts, any amount relating to water consumption that is determined to be uncollectible is charged to the Corporation of the City of London.

Also, included in the accounts receivable is $1.8 million (2015 - $1.8 million) of energy, water, and sundry receivables due from the Corporation of the City of London.

Trade receivables at December 31, 2015 have been increased in the amount of $0.5 million to reclass customer credit balances to accounts payable trade for comparative purposes.

**7. Materials and supplies**

Amounts written down due to obsolescence during the year ended December 31, 2016 was $0.1 million (2015 - $0.1 million).

London Hydro Inc.
Notes to the Financial Statements *(in thousands of dollars)*

For the year ended December 31, 2016

London Hydro Inc.
Notes to the Financial Statements *(in thousands of dollars)*

For the year ended December 31, 2016

**8. Property, plant and equipment**

a) Cost or deemed cost:

| | Land and buildings | Distribution substation equipment | Other distribution equipment | Other fixed assets | Construction in progress | Total |
|---|---|---|---|---|---|---|
| Balance at January 1, 2015 | $ 13,655 | $ 9,558 | $ 197,074 | $ 17,092 | $ 10,186 | 247,565 |
| Additions | 673 | 167 | 23,709 | 3,436 | 114 | 28,099 |
| Disposals / retirements | (17) | - | (793) | (801) | - | (1,611) |
| Balance at December 31, 2015 | $ 14,311 | $ 9,725 | $ 219,990 | $ 19,727 | $ 10,300 | $ 274,053 |
| Balance at January 1, 2016 | $ 14,311 | $ 9,725 | $ 219,990 | $ 19,727 | $ 10,300 | $ 274,053 |
| Additions | 1,450 | 191 | 25,840 | 3,297 | 332 | 31,110 |
| Disposals / retirements | (742) | - | (444) | (1,455) | - | (2,641) |
| Balance at December 31, 2016 | $ 15,019 | $ 9,916 | $ 245,386 | $ 21,569 | $ 10,632 | $ 302,522 |

b) Accumulated depreciation:

| | Land and buildings | Distribution substation equipment | Other distribution equipment | Other fixed assets | Construction in progress | Total |
|---|---|---|---|---|---|---|
| Balance at January 1, 2015 | $ 904 | $ 273 | $ 8,551 | $ 2,550 | $ - | $ 12,278 |
| Depreciation | 930 | 280 | 8,803 | 2,634 | - | 12,647 |
| Disposals / retirements | (17) | - | (793) | (801) | - | (1,611) |
| Balance at December 31, 2015 | $ 1,817 | $ 553 | $ 16,561 | $ 4,383 | $ - | $ 23,314 |
| Balance at January 1, 2016 | $ 1,817 | $ 553 | $ 16,561 | $ 4,383 | $ - | $ 23,314 |
| Depreciation | 960 | 283 | 9,216 | 2,681 | - | 13,140 |
| Disposals / retirements | (742) | - | (444) | (1,448) | - | (2,634) |
| Balance at December 31, 2016 | $ 2,035 | $ 836 | $ 25,333 | $ 5,616 | $ - | $ 33,820 |

c) Carrying amounts:

| Balance at | Land and buildings | Distribution substation equipment | Other distribution equipment | Other fixed assets | Construction in progress | Total |
|---|---|---|---|---|---|---|
| December 31, 2015 | $ 12,494 | $ 9,172 | $ 203,429 | $ 15,344 | $ 10,300 | $ 250,739 |
| December 31, 2016 | $ 12,984 | $ 9,080 | $ 220,053 | $ 15,953 | $ 10,632 | $ 268,702 |

**9. Intangible assets**

a) Cost or deemed cost:

| | Land rights | Wholesale metering | Computer software | Intangible work in progress | Total |
|---|---|---|---|---|---|
| Balance at January 1, 2015 | $ 202 | $ 1,085 | $ 18,645 | $ 458 | $ 20,390 |
| Additions | 31 | - | 5,071 | 1,553 | 6,655 |
| Disposals / retirements | - | - | (2,004) | - | (2,004) |
| Balance at December 31, 2015 | $ 233 | $ 1,085 | $ 21,712 | $ 2,011 | $ 25,041 |
| Balance at January 1, 2016 | $ 233 | $ 1,085 | $ 21,712 | $ 2,011 | $ 25,041 |
| Additions | 14 | - | 4,821 | 1,711 | 6,546 |
| Disposals / retirements | - | - | (4,032) | - | (4,032) |
| Balance at December 31, 2016 | $ 247 | $ 1,085 | $ 22,501 | $ 3,722 | $ 27,555 |

b) Accumulated amortization:

| | Land rights | Wholesale metering | Computer software | Intangible work in progress | Total |
|---|---|---|---|---|---|
| Balance at January 1, 2015 | $ 17 | $ 43 | $ 5,229 | $ - | $ 5,289 |
| Amortization | 18 | 43 | 5,047 | - | 5,108 |
| Disposals / retirements | - | - | (2,004) | - | (2,004) |
| Balance at December 31, 2015 | $ 35 | $ 86 | $ 8,272 | $ - | $ 8,393 |
| Balance at January 1, 2016 | $ 35 | $ 86 | $ 8,272 | $ - | $ 8,393 |
| Amortization | 19 | 43 | 5,515 | - | 5,577 |
| Disposals / retirements | - | - | (4,032) | - | (4,032) |
| Balance at December 31, 2016 | $ 54 | $ 129 | $ 9,755 | $ - | $ 9,938 |

c) Carrying amounts:

| Balance at | Land rights | Wholesale metering | Computer software | Intangible work in progress | Total |
|---|---|---|---|---|---|
| December 31, 2015 | $ 198 | $ 999 | $ 13,440 | $ 2,011 | $ 16,648 |
| December 31, 2016 | $ 193 | $ 956 | $ 12,746 | $ 3,722 | $ 17,617 |

During the year ended December 31, 2016, borrowing costs of $0.1 million (2015 - nil) were capitalized as part of the cost of intangible assets. A capitalization rate of 2.60% (2015 – 2.55%) was used to determine the amount of borrowing costs to be capitalized.

London Hydro Inc.
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**10. Income tax expense**

Income tax expense is comprised of:

| | 2016 | 2015 |
|---|---|---|
| Current income tax | | |
| Current year | $ 2,261 | $ 2,789 |
| Adjustment for prior years | (263) | (140) |
| | 1,998 | 2,649 |
| Deferred tax | | |
| Change in recognized deductible temporary differences: | | |
| Gain / (loss) on interest rate swap loss | 405 | (837) |
| Property, plant, equipment and intangible assets | 1,768 | 1,479 |
| Post-employment benefits | (91) | (73) |
| Deferred revenue | (101) | (58) |
| | 1,981 | 511 |
| Total current and deferred income tax in profit and loss, before movement of regulatory balance | 3,979 | 3,160 |
| Other comprehensive income | | |
| Post-employment benefits | (78) | 47 |
| Total current and deferred income tax, before movement of regulatory balances | 3,901 | 3,207 |
| Net movement in regulatory balances | (1,498) | (1,396) |
| Income tax expense recognized in Statement of Comprehensive Income | $ 2,403 | $ 1,811 |

Reconciliation of effective tax rate:

| | 2016 | 2015 |
|---|---|---|
| Income before taxes | $ 14,576 | 12,165 |
| Canada and Ontario statutory income tax rates | 26.5% | 26.5% |
| Expected tax provision on income at statutory rates | 3,863 | 3,224 |
| Increase (decrease) in income taxes resulting from: | | |
| Net movement in regulatory balances | (1,498) | (1,396) |
| Other items | 38 | (17) |
| | $ 2,403 | $ 1,811 |

Significant components of the Company's deferred tax balances:

| | 2016 | 2015 |
|---|---|---|
| Property, plant, equipment and intangible assets | $ (6,341) | $ (4,573) |
| Post-employment benefits | 3,837 | 3,668 |
| Deferred revenue | 173 | 72 |
| Future income taxes to be realized by customers | (2,331) | (833) |
| Loss on interest rate swap | 1,168 | 1,573 |
| | $ (1,163) | $ 740 |

**11. Regulatory balances**

Reconciliation of the carrying amount for each class of regulatory balances:

Regulatory assets:

| Regulatory deferral account debit balances | January 1, 2016 | Additions | Recovery/ reversal | December 31, 2016 | Remaining recovery years |
|---|---|---|---|---|---|
| IFRS-CGAAP transitional PP&E recoveries | $ 157 | $ - | $ (118) | $ 39 | 0.3 |
| Regulatory settlement account | - | 5,434 | (3,455) | 1,979 | 0.3 |
| Other regulatory accounts | 1,906 | 295 | - | 2,201 | |
| Income tax | 833 | 1,498 | - | 2,331 | |
| | $ 2,896 | $ 7,227 | $ (3,573) | $ 6,550 | |

| Regulatory deferral account debit balances | January 1, 2015 | Additions | Recovery/ reversal | December 31, 2015 | Remaining recovery years |
|---|---|---|---|---|---|
| Group 1 deferred accounts | $ 5,295 | $ (5,295) | $ - | $ - | |
| IFRS-CGAAP transitional PP&E recoveries | 275 | - | (118) | 157 | 1.3 |
| Regulatory settlement account | 47 | - | (47) | - | - |
| Other regulatory accounts | 966 | 940 | - | 1,906 | |
| Income tax | - | 833 | - | 833 | |
| | $ 6,583 | $ (3,522) | $ (165) | $ 2,896 | |

Regulatory liabilities:

| Regulatory deferral account credit balances | January 1, 2016 | Additions | Recovery/ reversal | December 31, 2016 | Remaining reversal years |
|---|---|---|---|---|---|
| Group 1 deferred accounts | $ (2,577) | $ (15,047) | $ 5,406 | $ (12,218) | |
| Other regulatory accounts | (161) | (2) | - | (163) | |
| | $ (2,738) | $ (15,049) | $ 5,406 | $ (12,381) | |

| Regulatory deferral account credit balances | January 1, 2015 | Additions | Recovery/ reversal | December 31, 2015 | Remaining reversal years |
|---|---|---|---|---|---|
| Group 1 deferred accounts | $ - | $ (2,577) | $ - | $ (2,577) | |
| Other regulatory accounts | (158) | (3) | - | (161) | |
| Income tax | (563) | 563 | - | - | |
| | $ (721) | $ (2,017) | $ - | $ (2,738) | |

The regulatory balances are recovered or settled through fixed and/or volumetric rate riders approved by the OEB. The volumetric rate riders are determined using estimates of future consumption of electricity by its customers. Future consumption is impacted by various factors including the economy and weather. The Company has received approval from the OEB to establish its regulatory balances. Regulatory balances attract interest at OEB prescribed rates, which are based on Bankers' Acceptances three-month rate plus a spread of 25 basis points. In all four quarters of 2016 the rate was set at 1.10%.

**11. Regulatory balances (continued)**

a) Group 1 deferral accounts

The Group 1 deferral accounts consist of purchased power cost variances including the Smart Metering Entity Charge Variances. As a regulated distributor of electricity, the Company is obligated to provide energy supply to all consumers at regulated or spot rates unless they elect to purchase their energy from an energy retailer. The regulatory framework requires that all energy commodity and non-commodity costs be billed at regulated rates to consumers who are on the Regulated Price Plan.

Variances between purchase costs and amounts billed for electricity are required to be captured in the Retail Settlement Variance Accounts ("RSVA") for disposition through future rate riders. The variance accounts have been further defined by the regulator into commodity and non-commodity accounts. Those accounts defined as commodity accounts are eligible for regulatory review on a quarterly basis. All other accounts are defined as non-commodity and are currently eligible for review on an annual basis.

These variances were debit balances on January 1, 2015. Due to price fluctuations the accumulated variances became credit balances during 2015, and continued being credit balances in 2016. The 2016 IRM rate application was submitted to the OEB on October 19, 2015, which includes a claim to recover the debit balances at December 31, 2014 via rate riders. The OEB issued its decision with respect to this Application which authorizes the recovery of these balances over a one-year period commencing May 1, 2016.

On August 26, 2016, the Company filed its 2017 COS rate application, in which it proposed the disposition of the Group 1 account balances as at December 31, 2015 via rate riders. The OEB issued its decision with respect to this Application which authorizes the refund/recovery of these balances over a one-year period commencing May 1, 2017.

b) IFRS-CGAAP transitional PP&E recoveries

Compliant with OEB directives of the Accounting Procedures Handbook, the Company must use this account to record differences arising as a result of accounting policy changes caused by the transition from previous Canadian GAAP to Modified International Financial Reporting Standards ("MIFRS").

During 2012, the Company filed its 2013 Cost of Service Rate Application ("Application") which included a request for OEB approval for the recovery of certain authorized regulatory deferral accounts including these IFRS-CGAAP transitional PP&E differences. The OEB issued its decision with respect to this Application which authorizes amortization of the balance into rate base and revenue requirement amounts. Therefore, the approved distribution rates during the four year period commencing May 1, 2013, include the recovery of these IFRS-CGAAP transitional PP&E account differences.



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**11. Regulatory balances (continued)**

c) Regulatory settlement account

The regulatory settlement account with a debit balance on January 1, 2015 consists of the Lost Revenue Adjustment Mechanism Variance ("LRAMVA") approved for recovery by the OEB. During 2013, the Company filed its IRM rate application for the 2014 rate year. The OEB issued its decision with respect to this application which included a request for OEB approval for the recovery of LRAMVA for amounts as at December 31, 2012. The regulatory decision approved the recovery of these balances over a one-year period commencing May 1, 2014.

During 2015, the Company filed its 2016 IRM rate application which included a request for OEB approval for the disposition of the RSVA relating to Power and Global Adjustment subaccounts. These accounts include amounts accumulated between January 1, 2013 and December 31, 2014. The non-commodity RSVA accounts include amounts accumulated between January 1, 2012 and December 31, 2014. The OEB issued its decision with respect to this Application which authorizes the disposition of these balances over a one-year period commencing May 1, 2016.

d) Other regulatory accounts

Other regulatory debit balances include various deferred costs in connection with Climate Change programs, LRAMVA, IFRS transition expenditures, OEB Cost Assessment Variance, Retail Cost Variances and the residual balance of Stranded Meter costs previously approved for recovery by the OEB. Climate Change programs authorized by the OEB include renewable enabling improvements and investments towards smart grid. Costs incurred with respect to these various activities have been captured under deferral accounts for future rate recovery.

Other regulatory credit balances consist of amounts resulting from the implementation of the Harmonized Sales Tax.

On August 26, 2016, the Company filed its 2017 COS rate application, which includes a request for the disposition of the other regulatory account balances as at December 31, 2015 via rate riders. The OEB issued its decision with respect to this Application which authorizes the refund/recovery of these balances over a one-year period commencing May 1, 2017.

e) Income tax

As a result, the Company has recognized a regulatory deferral account for the amount of deferred taxes that will ultimately be recovered from/paid back to its customers. This balance will fluctuate as the Company's deferred tax balance fluctuates.

**12. Accounts payable and accrued liabilities**

| | | 2016 | | 2015 |
|---|---|---|---|---|
| Due to Independent Electricity System Operator | $ | 43,709 | $ | 39,888 |
| Debt retirement charge payable to OEFC | | 1,023 | | 1,603 |
| Harmonized sales tax | | 788 | | 372 |
| Payroll and benefits payable | | 2,669 | | 2,264 |
| Other | | 8,068 | | 9,943 |
| | $ | 56,257 | $ | 54,070 |

Accounts payable other at December 31, 2015 has been increased in the amount of $0.5 million to reclass customer credit balances from trade accounts receivable for comparative purposes.

**13. Deferred revenue**

| | | 2016 | | 2015 |
|---|---|---|---|---|
| Capital contributions for completed projects | $ | 8,700 | $ | 5,560 |
| Deposits held | | 9,008 | | 8,582 |
| | | 17,708 | | 14,142 |
| Less: Current portion | | 1,399 | | 1,192 |
| | $ | 16,309 | $ | 12,950 |

Included in deposits held is $3.8 million (2015 - $3.8 million) received from the Corporation of the City of London as contributions for the construction of capital assets.

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**14. Long-term debt**

| | | 2016 | | 2015 |
|---|---|---|---|---|
| Unsecured, committed extendible revolving loan bearing interest at prime, minus 0.5%, interest only payments due March 2019 | $ | 20,000 | $ | 5,000 |
| Unsecured, non-revolving term instalment loan bearing interest at the 7.6 year Bankers' Acceptance rate of 2.46% plus a stamping fee of 0.19%, interest only payments due June 2022 | | 85,000 | | 85,000 |
| Unsecured, non-revolving term instalment loan bearing interest at the 7.8 year Bankers' Acceptance rate of 2.43% plus a stamping fee of 0.9%, payable in monthly instalments of $192 principal plus interest due August 2019 | | 6,130 | | 8,434 |
| | | 111,130 | | 98,434 |
| Less: Current portion | | 2,304 | | 7,304 |
| | $ | 108,826 | $ | 91,130 |

The Company has an interest rate swap agreement with the Royal Bank of Canada for an unsecured loan in the amount of $85 million. Interest only payments are due quarterly and commenced December 2014. The principal is due at maturity. The agreement is a fixed rate swap and matures June 2022, which effectively converts variable interest rates on unsecured Bankers' Acceptances to an effective interest rate of 2.46%, plus a stamping fee of 0.19%, for an all-in rate of 2.65%.

The Company has an interest rate swap agreement with the Royal Bank of Canada for an unsecured loan in the original amount of $20.5 million to fund its Smart Meter capital expenditure program. Principal repayments on this loan commenced October 2010 and are being amortized over a 9 year period ending August 2019. The agreement is a fixed rate swap and matures August 2019 which effectively converts variable interest rates on unsecured Bankers' Acceptances to an effective interest rate of 2.43%, plus a stamping fee of 0.9%, for an all-in rate of 3.33%.

The swap agreements entered into with Royal Bank of Canada do not meet the standard to apply hedge accounting. Accordingly, the interest rate swap contracts are recorded at their fair value at the end of the period with the unrealized gain or loss recorded in the Statements of Comprehensive Income as finance expenses. The unrealized gain for the year ended December 31, 2016 was $1.5 million (2015 – unrealized loss $3.2 million).

At December 31, 2016, the Company would be required to pay $4.4 million (2015 - $5.9 million) if it wished to cancel the swap agreements.

Notes to the Financial Statements *(in thousands of dollars)*

**15. Post-employment benefits**

a) OMERS pension plan

The Company provides a pension plan for its employees through OMERS. The plan is a multi-employer, contributory defined pension plan with equal contributions by the employer and its employees. During the year ended December 31, 2016, the Company made employer contributions of $2.8 million to OMERS (2015 - $2.7 million), of which $0.8 million (2015 - $0.7 million) has been capitalized as part of PP&E and the remaining amount of $2.0 million (2015 - $2.0 million) has been recognized in profit or loss. The Corporation estimates that a contribution of $2.9 million to OMERS will be made during the next fiscal year.

As at December 31, 2016, OMERS had approximately 470,000 members, of whom 323 are employees of the Company. The most recently available OMERS annual report is for the year ended December 31, 2016, which reported that the plan was 93.4% funded, with an unfunded liability of $5.7 billion. This unfunded liability is likely to result in future payments by participating employers and members.

b) Post-employment benefits other than pension

The Company pays certain medical and life insurance benefits on behalf of some of its retired employees. The Company recognizes these post-employment benefits in the year in which employees' services were rendered. The Company is recovering its post-employment benefits in rates based on the expense and remeasurements recognized for post-employment benefit plans. Based on the most recent actuarial valuation as at December 31, 2016, the following information has been determined:

Reconciliation of the obligation:

| | 2016 | 2015 |
|---|---|---|
| Defined benefit obligation, beginning of year | $ 13,845 | $ 13,749 |
| Included in profit or loss: | | |
| Current service costs | 392 | 386 |
| Past service costs | 180 | - |
| Interest cost | 529 | 514 |
| Other benefits | 26 | 42 |
| | 1,127 | 942 |
| Actuarial (gains) / losses included in OCI: | | |
| Change in financial assumptions | 183 | (192) |
| Effect of experience adjustments | 111 | 13 |
| | 294 | (179) |
| Benefits paid | (785) | (667) |
| Defined benefit obligation, end of year | $ 14,481 | $ 13,845 |





**15. Post-employment benefits (continued)**

b) Post-employment benefits other than pension (continued)

Actuarial assumptions:

| | 2016 | 2015 |
|---|---|---|
| Discount (interest) rate | 3.9% | 4.0% |
| Salary levels | 4.0% | 4.0% |
| Immediate medical costs | 6.0% | 6.1% |
| Ultimate medical costs | 4.5% | 4.5% |
| Dental cost rate | 4.5% | 4.5% |
| Year ultimate rate reached | 2028 | 2028 |

A 1% increase in the assumed discount rate would result in the defined benefit obligation decreasing by $1.9 million. A 1% decrease in the assumed discount rate would result in the defined benefits obligation increasing by $1.8 million.

**16. Share capital**

| | 2016 | 2015 |
|---|---|---|
| Authorized: | | |
| An unlimited number of common shares | | |
| An unlimited number of non-voting, non-cumulative preference shares, redeemable at the paid-up amount | | |
| Issued: | | |
| 1,001 common shares | $ 96,116 | $ 96,116 |

*Dividends*

The holders of the common shares are entitled to receive dividends as declared from time to time.

On April 19, 2016 the Board of Directors declared a $5.0 million annual dividend and a $5.0 million special dividend both payable to the sole shareholder, the Corporation of the City of London, in quarterly installments in 2016.

On March 31, 2015 the Board of Directors declared a $5.0 million annual dividend and a $5.0 million special dividend both payable to the sole shareholder, the Corporation of the City of London, in quarterly installments in 2015.

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**17. Other revenue**

| | | 2016 | | 2015 |
|---|---|---|---|---|
| City of London services | $ | 4,009 | $ | 3,996 |
| Late payment charges | | 1,915 | | 1,816 |
| Collection charges | | 687 | | 694 |
| Occupancy charges | | 634 | | 619 |
| Other services, recoveries and sundry revenues | | 632 | | 627 |
| Sale of scrap | | 588 | | 298 |
| Customer billing service fees | | 587 | | 586 |
| Income tax incentive credits | | 462 | | 319 |
| Pole and other rental income | | 414 | | 410 |
| Renewable generation revenue | | 355 | | 314 |
| Gain on disposal of property, plant and equipment | | 234 | | 162 |
| Amortization of deferred revenue | | 173 | | 79 |
| | $ | 10,690 | $ | 9,920 |

**18. Operating expenses**

| | | 2016 | | 2015 |
|---|---|---|---|---|
| Labour and benefits | $ | 25,088 | $ | 24,213 |
| Professional services | | 5,884 | | 5,559 |
| Office equipment services and maintenance | | 2,281 | | 2,011 |
| Rental, regulatory and other expenses | | 1,967 | | 1,568 |
| Facilities maintenance and repair | | 1,673 | | 1,521 |
| Postage | | 1,269 | | 1,250 |
| Property tax and insurance | | 1,173 | | 1,095 |
| Corporate training and employee expenses | | 1,140 | | 1,124 |
| Materials and supplies | | 1,049 | | 983 |
| Fleet operations and maintenance | | 904 | | 952 |
| Bad debts | | 700 | | 650 |
| Allocations to capital and billable activities | | (1,961) | | (1,720) |
| | $ | 41,167 | $ | 39,206 |

**19. Finance (income) and expenses**

| | | 2016 | | 2015 |
|---|---|---|---|---|
| Finance income | | | | |
| Interest income on bank deposits | $ | (80) | $ | (101) |
| Finance expenses | | | | |
| Unrealized (gain) / loss on interest rate swap | | (1,529) | | 3,158 |
| Interest on long-term debt | | 2,813 | | 2,643 |
| Interest on short-term debt | | 28 | | 27 |
| Interest on funds used for construction project | | (77) | | (17) |
| Other | | 73 | | 87 |
| | | 1,308 | | 5,898 |
| **Net finance expense** | $ | 1,228 | $ | 5,797 |

**20. Commitments and contingencies**

*General*

From time to time, the Company is involved in various litigation matters arising in the ordinary course of its business. The Company has no reason to believe that the outcome of any of these matters could reasonably be expected to have a materially adverse impact on the Company's financial position, results of operations or its ability to carry on any of its business activities.

*General Liability Insurance*

The Company is a member of the Municipal Electric Association Reciprocal Insurance Exchange ("MEARIE"). MEARIE is a pooling of public liability insurance risks of many of the LDCs in Ontario. All members of the pool are subjected to assessment for losses experienced by the pool for the years in which they were members, on a pro-rata basis based on the total of their respective service revenues. As at December 31, 2016, no assessments have been made.

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**20. Commitments and contingencies (continued)**

*Letters of credit*

At December 31, 2016, the Company had provided $6.6 million (2015 – $6.6 million) in bank standby letters of credit to the IESO.

*Vendor commitments*

The Company has commitments in connection with Information Systems projects of approximately $2.3 million (2015 - $0.8 million), Infrastructure projects of $2.0 million (2015 – $5.3 million) and new vehicle acquisitions of $0.3 million (2015 - $0.5 million).

*Operating leases*

The Company is committed to lease agreements for various vehicles, equipment and property rights. The future minimum non-cancellable annual lease payments are as follows:

| | | 2016 | | 2015 |
|---|---|---|---|---|
| Less than one year | $ | 299 | $ | 303 |
| Between one and five years | | 824 | | 1,027 |
| More than five years | | 191 | | 193 |
| | $ | 1,314 | $ | 1,523 |

Operating lease expense incurred during the year ended December 31, 2016 was of $0.3 million (2015 - $0.3 million).

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**21. Due to shareholder**

Trade balances due to shareholder

| | | 2016 | | 2015 |
|---|---|---|---|---|
| Water consumption | $ | 8,405 | $ | 6,746 |
| Non-interest bearing trade balance due to shareholder, without stated repayment terms | | 266 | | 682 |
| | $ | 8,671 | $ | 7,428 |

The Company delivers electricity to the City of London throughout the year for the electricity needs of the City of London and its related organizations. Electricity delivery charges are at prices and under terms approved by the OEB. The Company also provides additional services to the City of London, including water and waste water billing, customer care services and water meter replacement administrative services.

During the year ended December 31, 2016, the Company billed customers for water related service on behalf of the shareholder and remitted funds to the shareholder in the amount of $158.7 million (2015 – $151.1 million). The shareholder paid $3.9 million (2015 - $3.9 million) for this service.

During the year ended December 31, 2016, the Company performed water meter replacement administrative services on behalf of the shareholder. The shareholder paid $0.1 million (2015 – nil) for this service.

**22. Joint venture agreement**

On January 1, 2013, The Company entered into an agreement with London District Renewable Energy Co-Operative Inc. ("LDREC") to create a joint venture with the legal name "London Renewable Energy Initiative" for the intention of identifying, applying for and constructing solar projects that have been approved under the Feed-in Tariff ("FIT") government program. The Company has a 49% equity interest in LDREC while appointing 60% of the members of the Executive Committee resulting in controlling interest. To date no significant work has been completed and no amounts have been recorded in these financial statements in connection with this venture.

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**23. Financial instruments and risk management**

**Fair value disclosure**

The carrying values of cash, accounts receivable, unbilled revenue, due from/to shareholder and accounts payable and accrued liabilities approximate fair value because of the short maturity of these instruments. The carrying value of the customer deposits approximates fair value because the amounts are payable on demand.

The fair value of the long-term debt at December 31, 2016 is $92 million (2015 - $95 million). The fair value is calculated based on the present value of future principal and interest cash flows, discounted at the current rate of interest at the reporting date. The interest rate used to calculate fair value at December 31, 2016 was 2.16% (2015 – 2.16%). The fair value of interest rate swaps is recorded based on valuation amounts as provided by RBC Capital Markets on a quarterly basis.

**Financial risks**

The Company understands the risks inherent in its business and defines them broadly as anything that could impact its ability to achieve its strategic objectives. The Company's exposure to a variety of risks such as credit risk, interest rate risk, and liquidity risk, as well as related mitigation strategies are discussed below.

a) Credit risk

Financial assets carry credit risk that a counter-party will fail to discharge an obligation which would result in a financial loss. Financial assets held by the Company, such as accounts receivable, expose it to credit risk. The Company primarily assesses credit risk exposure by customer segment. Concentrations of consumption by segment or individual customer, may impact risk due to varying energy consumption patterns and allowable security deposit requirements associated with each segment. The Company is not exposed to a significant concentration of credit risk within any customer segment or individual customer. No single customer accounts for revenue in excess of 10% of total revenue.

The carrying amount of accounts receivable is reduced through the use of an allowance for impairment and the amount of the related impairment loss is recognized in profit and loss as bad debt expense. Subsequent recoveries of receivables previously provisioned are credited to profit and loss. The balance of the allowance for impairment loss at December 31, 2016 is $2.6 million (2015 - $2.5 million). During the year ended December 31, 2016, bad debt expense was $0.7 million (2015 - $0.7 million).



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**23. Financial instruments and risk management (continued)**

a) Credit risk (continued)

At December 31, 2016, approximately $0.8 million (2015 - $0.7 million) is included in the allowance for doubtful accounts for uncollectible amounts relating to water consumption. No bad debt expense has been realized in the Statement of Comprehensive Income in connection with water consumption as these amounts are fully recovered from the City of London.

The Company's credit risk associated with accounts receivable is primarily related to payments from distribution customers. At December 31, 2016, approximately $2.2 million (2015 - $2.0 million) is considered 60 days past due. The Company has 155 thousand customers, the majority of whom are residential.

By regulation, the Company is responsible for collecting both the distribution and energy portions of the electricity bill. On average, the Company earns 18% of amounts billed to customers with the remaining 82% being collected for other parties. The Company is therefore exposed to a credit risk substantially greater than the income that it regularly earns.

Credit risk is managed through collection of security deposits from customers in accordance with directions provided by the OEB. At December 31, 2016, the Company held deposits in the amount of $6.0 million (2015 - $6.3 million). Additionally, if presented with substantial credit losses, the Company would make an application to the regulator for recovery of those losses through distribution rate adjustments in future years.

b) Market risk

Market risks primarily refer to the risk of loss that result from changes in commodity prices, foreign exchange rates, and interest rates. The Company currently does not have significant commodity or foreign exchange risk. The Company is exposed to fluctuations in interest rates as the regulated rate of return for the Company's distribution business is derived using a complex formulaic approach which is in part based on the forecast for long-term Government of Canada bond yields. This rate of return is approved by the OEB as part of the approval of distribution rates.

A 1% increase in the interest rate at December 31, 2016 would have increased interest expense on the long-term debt by $0.2 million (2015 - $0.1 million), assuming all other variables remain constant. A 1% decrease in the interest rate would have an equal but opposite effect.

**23. Financial instruments and risk management (continued)**

c) Liquidity risk

The Company monitors its liquidity risk to ensure access to sufficient funds to meet operational and investing requirements. The Company's objective is to ensure that sufficient liquidity is on hand to meet obligations as they fall due while minimizing interest exposure. The Company monitors cash balances to ensure that sufficient levels of liquidity are on hand to meet financial commitments as they come due. The majority of accounts payable, as reported on the Statement of Financial Position, are due within 30 days.

The Company has an uncommitted operating revolving line of credit facility of $40 million with the Toronto Dominion Bank. At December 31, 2016, the amount drawn by the Company under this line of credit was nil (2015 - nil). The line of credit is unsecured and interest is at bank prime rate on prime based borrowings minus 0.5%, or at Bankers' Acceptances ("B/A") rates plus a 0.75% stamping fee on B/A based borrowings.

At December 31, 2016, the Company had a committed 364 day extendable operating revolving loan facility of $30 million with the Toronto Dominion Bank and the amount drawn by the Company under this loan facility was $20 million (2015 - $5.0 million). Under the terms of this agreement, the loan has a maturity date of March 31, 2019. The Company has a one year period from the loan maturity date to repay any outstanding balances in the event the lender elects not to extend the loan for an additional 364 day period. Interest is at bank prime rate on prime based borrowings minus 0.5%, or at B/A rates plus a 0.75% stamping fee on B/A based borrowings.

The Company also has a bilateral facility for $6.6 million for the purpose of issuing letters of credit mainly to support the prudential requirements of the IESO, of which nil has been drawn and posted with the IESO (2015 - nil).

London Hydro Inc.
Notes to the Financial Statements *(in thousands of dollars)*
For the year ended December 31, 2016

**23. Financial instruments and risk management (continued)**

d) Capital disclosures

The main objectives of the Company, when managing capital, are to ensure ongoing access to funding to maintain and improve the electricity distribution system, compliance with covenants related to its credit facilities, prudent management of its capital structure with regard for recoveries of financing charges permitted by the OEB on its regulated electricity distribution business, and to deliver the appropriate financial returns.

The Corporation's definition of capital includes shareholder's equity and long-term debt.

| | 2016 | 2015 |
|---|---|---|
| Long-term debt | $ 111,130 | $ 98,434 |
| Shareholder's equity | 150,781 | 148,608 |
| | $ 261,911 | $ 247,042 |

**24. Subsequent event**

On March 30, 2017, the Board of Directors declared a $5.0 million dividend payable to the sole shareholder, the Corporation of the City of London, in quarterly installments in 2017.

London Hydro

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