

# **EPCOR Utilities Inc.**

## **Interim Management's Discussion and Analysis**

### **March 31, 2019**

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This management's discussion and analysis (MD&A) dated April 30, 2019, should be read in conjunction with the condensed consolidated interim financial statements of EPCOR Utilities Inc. for the three months ended March 31, 2019, and 2018, including significant accounting policies (note 3), business acquisition (note 4), revenues (note 5), other financial assets (note 6), property, plant and equipment (note 7), other liabilities (note 8), financial instruments (note 9), the consolidated financial statements and MD&A for the years ended December 31, 2018 and 2017, including significant accounting policies (note 3), business transfer and acquisitions (note 5), revenues (note 6), other financial assets (note 13), changes in liabilities arising from financing activities (note 24), related party balances and transactions (note 25), financial instruments (note 26), and the cautionary statement regarding forward-looking information at the end of this MD&A. In this MD&A, any reference to "the Company", "EPCOR", "Corporation", "it", "its", "we", "our" or "us", except where otherwise noted or the context otherwise indicates, means EPCOR Utilities Inc., together with its subsidiaries. Financial information in this MD&A is based on the condensed consolidated interim financial statements, which were prepared in accordance with International Financial Reporting Standards (IFRS), and is presented in Canadian dollars unless otherwise specified. In accordance with its terms of reference, the Audit Committee of the Company's Board of Directors reviews the contents of the MD&A and recommends its approval by the Board of Directors. This MD&A was approved and authorized for issue by the Board of Directors on April 30, 2019.

#### **OVERVIEW**

The Corporation, through wholly owned subsidiaries, builds, owns and operates electrical, natural gas, and water transmission and distribution networks, water and wastewater facilities and sanitary and stormwater systems and infrastructure in Canada and the United States (U.S.). The Company also provides electricity, natural gas and water products and services to residential and commercial customers. The Company provides Regulated Rate Option (RRO) and default supply electricity related services and sells electricity and natural gas to Alberta residential consumers under contracts through its Encor brand. In addition, EPCOR provides design, build, finance, operation and maintenance services for electrical, water and wastewater infrastructure for municipal and industrial customers in Canada and the U.S. EPCOR operates its business under the Water Services, Distribution and Transmission, Energy Services and U.S. Operations reporting segments. The Company operates in Canada and the Southwestern U.S.

Net income was \$56 million for the three months ended March 31, 2019, compared with net income of \$65 million for the comparative period in 2018. The decrease of \$9 million in the quarter was primarily due to lower Adjusted EBITDA, as described below, and higher income tax and depreciation expenses, partially offset by favorable fair value adjustments related to financial electricity purchase contracts and higher transmission system access service charge net collections.

Adjusted EBITDA was \$157 million for the three months ended March 31, 2019, compared with \$164 million for the comparative period in 2018. The decrease of \$7 million in the quarter was primarily due to lower water consumption per customer due to lower temperatures and higher precipitation, higher water treatment costs for operations in the city of Edmonton and lower Energy Price Setting Plan (EPSP) margins, partially offset by higher electricity distribution revenues due to higher customer rates and Encor customer growth. Adjusted EBITDA is a non-IFRS financial measure as described in Adjusted EBITDA and Net Income section on pages 3 and 4 of this MD&A.

## **SIGNIFICANT EVENT**

### **Acquisition of Rio Verde Utilities Inc.**

On February 28, 2019, EPCOR acquired 100% of the stock of Rio Verde Utilities Inc. (Rio Verde) in Arizona, U.S. for cash consideration of \$31 million (US\$24 million).

Rio Verde is located northeast of Scottsdale and the Greater Phoenix metropolitan area and 10 miles north of the Company's Chaparral service area in Fountain Hills. Rio Verde's regulated operations include 2,220 water and 1,876 wastewater service connections along with irrigation water service for five golf courses.

For further information on the acquisition, refer to the condensed consolidated interim financial statements of EPCOR Utilities Inc. for the three months ended March 31, 2019, and 2018.

## **SIGNIFICANT ACCOUNTING POLICY CHANGES**

Effective January 1, 2019, the Company implemented IFRS 16 - *Leases (IFRS 16)*, which replaces International Accounting Standard (IAS) 17 - *Leases (IAS 17)* and related interpretations. Adoption of the new accounting standard has resulted in amendments to the accounting policy related to leases. For a detailed discussion of the impacts of this new standard on EPCOR's accounting policies refer to note 3 of the condensed consolidated interim financial statements for the period ended March 31, 2019 and 2018.

Prior to January 1, 2019, when the Company was the lessee under a contract, a lease was classified either as a finance or operating lease depending on whether substantially all the risks or rewards of ownership of the asset were transferred. Leases or other arrangements that transferred substantially all of the benefits and risks of ownership of property were classified as finance leases. All other arrangements that were determined to contain a lease were classified as operating leases. Rental income under arrangements classified as operating leases was recognized as lease revenue within other commercial revenue, whereas rental payments under arrangements classified as operating leases were expensed on a straight-line basis over the term of the lease. Lease incentives received were recognized as an integral part of the total lease expense, over the term of the lease.

On implementation of IFRS 16, the Company reassessed all outstanding contracts to determine whether they meet the criteria for recognition as lease contracts under IFRS 16.

As a lessor, all contracts which met the criteria for recognition as leases under IFRS 16, required no change in accounting and they continue to be recorded as finance or operating leases consistent with their respective classification under IAS 17.

As a lessee, all contracts which were classified as finance leases under IAS 17 and met the criteria for recognition as leases under IFRS 16, required no change in accounting. However, for all contracts which were classified as operating leases under IAS 17 and met the criteria for recognition as leases under IFRS 16, the Company has recognized right-of-use (ROU) assets and lease liabilities on the statement of financial position initially measured at the present value of unavoidable future lease payments.

The implementation of IFRS 16 on January 1, 2019, did not result in any adjustment to the opening balance of retained earnings. However, it had an impact on the statement of financial position primarily as a result of the recognition of ROU assets and lease liabilities with respect to leases for land and buildings (including office spaces), vehicles and equipment as well as recording finance lease receivable related to sub-lease under the Company's lease contract. On the initial application of IFRS 16, the Company recognized ROU assets of \$84 million within property, plant and equipment, finance lease receivable of \$41 million within other financial assets and lease liabilities of \$136 million within other liabilities. The \$11 million difference between the assets and liabilities recognized on initial application of IFRS 16 is due to adjusting ROU assets for leasehold inducement and other liabilities under lease contracts, which resulted in a reduction to the opening ROU assets recognized.

The ongoing impact of the application of IFRS 16, related to the Company's lease contracts on the consolidated statements of comprehensive income is not anticipated to be material as the depreciation charge of ROU assets and finance expenses on lease liabilities recognized under IFRS 16 will largely be offset by reduction in operating lease expense, which were recognized in net income before applying the new standard.

The Company used the modified retrospective approach to implement IFRS 16, and as a result, comparative information has not been restated and continues to be reported under the previous accounting standard.

## SIGNIFICANT SUBSEQUENT EVENT

### Changes to the Board of Directors

On April 30, 2019, Sheila Weatherill, retired as Vice Chair of the Board of Directors after serving as Director since 2002 and serving as non-executive Vice Chair since 2007, and Margaret Bateman was appointed as a Director.

## CONSOLIDATED RESULTS OF OPERATIONS

### Revenues

(Unaudited, \$ millions)		
Three months ended March 31,	2019	2018
Water Services segment	\$ 151	\$ 149
Distribution and Transmission segment	113	108
Energy Services segment	127	91
U.S. Operations segment	53	54
Other	21	5
Intersegment eliminations	(7)	(6)
<b>Revenues</b>	<b>\$ 458</b>	<b>\$ 401</b>

Consolidated revenues were higher by \$57 million for the three months ended March 31, 2019, compared with the corresponding period in 2018 primarily due to the net impact of the following:

- Water Services' segment revenues increased by \$2 million primarily due to higher commercial revenues, higher water and wastewater customer growth and higher customer rates, partially offset by lower water consumption per customer due to lower temperatures.
- Distribution and Transmission segment revenues increased by \$5 million primarily due to higher electricity distribution customer rates, partially offset by lower construction and maintenance revenues from the Transportation System Electricity Services agreement with the City.
- Energy Services' segment revenues increased by \$36 million primarily due to higher electricity prices, higher commercial services revenue and Encor customer growth.
- U.S. Operations' segment revenues decreased by \$1 million primarily due to lower water consumption per customer resulting from heavy precipitation and lower temperatures in Arizona and lower natural gas sales volumes due to warmer temperatures in Texas, partially offset by higher foreign exchange rates.
- Other revenues increased by \$16 million primarily due to revenues from EPCOR's Collingwood electricity distribution operations, which was acquired in October 2018 and higher construction revenue.

### Adjusted EBITDA and Net Income

We use earnings before finance expenses, income tax recovery (expense), depreciation and amortization, changes in the fair value of derivative financial instruments and transmission system access service charge net collections (collectively, Adjusted EBITDA) to discuss operating results for the Company's lines of business.

Change in fair value of derivative financial instruments represents the change in fair value of financial electricity purchase contracts between the electricity market forward prices and the contracted prices at the end of the reporting period, for contracted volume of electricity.

Transmission system access service charge net collections is the difference between the transmission system access services charges paid to the Alberta Electric System Operator (AESO) and the transmission system access service charges collected from electricity retailers. Transmission system access service charge net collections are timing differences, which will be collected from or returned to electricity retailers as the transmission system access service charges and customer billing determinants are finalized.

We believe that Adjusted EBITDA provides an indicator of the Company's ongoing ability to fund capital expenditures and to incur and service debt, which may be useful for external stakeholders in evaluating the operations and performance of the Company. Adjusted EBITDA is a non-IFRS financial measure, which does not have any standardized meaning prescribed by IFRS and is unlikely to be comparable to similar measures published by other entities.

(Unaudited, \$ millions)		
<b>Three months ended March 31,</b>	<b>2019</b>	<b>2018</b>
<b>Adjusted EBITDA by Segment</b>		
Water Services segment	\$ 71	\$ 73
Distribution and Transmission segment	50	46
Energy Services segment	11	13
U.S. Operations segment	24	27
Other	1	5
<b>Adjusted EBITDA</b>	<b>157</b>	<b>164</b>
Finance expenses	(32)	(32)
Income tax recovery (expense)	(5)	2
Depreciation and amortization	(78)	(71)
Change in fair value of financial electricity purchase contracts	11	-
Transmission system access service charge net collections	3	2
<b>Net income</b>	<b>\$ 56</b>	<b>\$ 65</b>

Changes in each business segment's Adjusted EBITDA, for the three months ended March 31, 2019, compared with the corresponding period in 2018, are described in Segment Results below. Explanations of the remaining variances in net income for the three months ended March 31, 2019, compared with the corresponding period in 2018 are as follows:

- Higher income tax expense of \$7 million primarily due to an increase in income subject to income tax in 2019.
- Higher depreciation and amortization of \$7 million primarily due to depreciation expense on 2018 asset additions as well as depreciation expense on ROU assets recognized on implementation of IFRS 16.
- Favorable changes in the fair value of financial electricity purchase contracts of \$11 million is primarily due to electricity market forward prices being higher than contracted prices in current period, with no corresponding amount in 2018.
- Higher transmission system access service charge net collections of \$1 million is primarily due to higher collections from customers, partially offset by higher payments to the AESO for system access.

## SEGMENT RESULTS

### Water Services

Water Services is primarily involved in the treatment, transmission, distribution and sale of water, the collection and conveyance of sanitary and stormwater and the treatment of wastewater within Edmonton and other communities in Western Canada. This segment's water and wastewater business also includes the provision of design, build, finance, operating and maintenance services for municipal and industrial customers in Western Canada.

(Unaudited, \$ millions, including intersegment transactions)		
Three months ended March 31,	2019	2018
Revenues	\$ 151	\$ 149
Expenses	116	109
<b>Operating income</b>	<b>35</b>	<b>40</b>
Exclude depreciation and amortization	36	33
<b>Adjusted EBITDA</b>	<b>\$ 71</b>	<b>\$ 73</b>

Water Services' Adjusted EBITDA decreased by \$2 million for the three months ended March 31, 2019, compared with the corresponding period in 2018, primarily due to lower water consumption per customer and higher water treatments costs due to an early spring run-off in 2019, partially offset by higher water and wastewater customer rates and customer growth.

### Distribution and Transmission

Distribution and Transmission is involved in the transmission and distribution of electricity within the city of Edmonton. The segment also provides commercial services including the design, construction and maintenance of street lighting, traffic signal and light rail transit electrical infrastructure for the City of Edmonton (the City) and other municipal and commercial customers in Alberta.

During the period, an agreement was executed with the City to provide electrical services related to installation, maintenance, and repair of street lighting, traffic signals and light rail transit, which is effective from April 1, 2019 and replaces the previous Transportation System Electricity Services agreement with the City. The new agreement is a master service agreement with an initial term of two years and is renewable at the City's option for an additional two years.

(Unaudited, \$ millions, including intersegment transactions)		
Three months ended March 31,	2019	2018
Revenues	\$ 113	\$ 108
Expenses	82	82
<b>Operating income</b>	<b>31</b>	<b>26</b>
Exclude depreciation and amortization	22	22
Exclude transmission system access service charge net collections	(3)	(2)
<b>Adjusted EBITDA</b>	<b>\$ 50</b>	<b>\$ 46</b>

Distribution and Transmission's Adjusted EBITDA increased by \$4 million for the three months ended March 31, 2019, compared with the corresponding periods in 2018, primarily due to higher electricity distribution customer rates, partially offset by lower Adjusted EBITDA from construction and maintenance work under the Transportation System Electricity Services agreement with the City.

## Energy Services

Energy Services is primarily involved in the provision of the RRO electricity service and default supply electricity services to customers in Alberta. The segment also provides competitive electricity and natural gas products under the Encor brand.

(Unaudited, \$ millions, including intersegment transactions)		
Three months ended March 31,	2019	2018
Revenues	\$ 127	\$ 91
Expenses	107	80
<b>Operating income</b>	<b>20</b>	<b>11</b>
Exclude depreciation and amortization	2	2
Exclude change in the fair value of financial electricity purchase contracts	(11)	-
<b>Adjusted EBITDA</b>	<b>\$ 11</b>	<b>\$ 13</b>

Energy Services' Adjusted EBITDA, decreased by \$2 million for the three months ended March 31, 2019, compared with the corresponding period in 2018, primarily due to lower EPSP margins, partially offset by growth in Encor customers.

## U.S. Operations

U.S. Operations is primarily involved in the treatment, transmission, distribution and sale of water, and the collection and treatment of wastewater within the Southwestern U.S. This segment also provides natural gas distribution and transmission services in Texas. All of the Company's operations conducted in the U.S. are included in this segment.

During the quarter the Arizona Corporation Commission (ACC) considered U.S. Operation's rate application for consolidation of all Arizona water districts, which resulted in a tie vote with no decision being rendered. The Company filed for interim rates for all 11 water utility districts of Arizona, which was approved by the ACC in March 2019. The ACC subsequently ordered the Company to file new rate application for all 11 water utility districts that may include regional consolidation options. The application is due to be filed by May 1, 2020. In late March, the ACC approved the Company's request to refund US\$4 million related to tax reform savings previously collected from the Company's residential and commercial water customers. The refund to customers will occur during the second quarter of 2019.

(Unaudited, \$ millions, including intersegment transactions)		
Three months ended March 31,	2019	2018
Revenues	\$ 53	\$ 54
Expenses	41	38
<b>Operating income</b>	<b>12</b>	<b>16</b>
Exclude depreciation and amortization	12	11
<b>Adjusted EBITDA</b>	<b>\$ 24</b>	<b>\$ 27</b>

U.S. Operations' Adjusted EBITDA decreased by \$3 million for the three months ended March 31, 2019, compared with the corresponding period in 2018, primarily due to lower water consumption per customer as a result of heavy precipitation and lower temperatures.

## Capital Spending and investment

(Unaudited, \$ millions)		
Three months ended March 31,	2019	2018
Water Services segment	\$ 48	\$ 49
Distribution and Transmission segment	40	37
U.S. Operations segment	15	13
Other	6	2
Total capital spending	109	101
Rio Verde acquisition	31	-
<b>Total capital spending and investment</b>	<b>\$ 140</b>	<b>\$ 101</b>

Total capital spending and investment increased by \$39 million for the three months ended March 31, 2019, compared with the corresponding period in 2018, primarily due to the acquisition of Rio Verde in Arizona with no corresponding acquisition in 2018. The Distribution and Transmission segment had higher spending on a new substation in the Riverview neighborhood in Edmonton and various lifecycle projects, partially offset by lower spending on new underground and aerial distribution lines. The U.S. Operations segment had higher spending on various growth projects and higher foreign exchange on capital spending, which was partially offset by lower spending on various lifecycle projects. In Other, there was higher spending on the Customer Information System Replacement project which is a new customer billing system for customers served by Energy Services.

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION – ASSETS

(Unaudited, \$ millions)	March 31, 2019	December 31, 2018	Increase (decrease)	Explanation of material changes
Cash and cash equivalents	\$ 24	\$ 32	\$ (8)	Refer to Consolidated Statements of Cash Flows section.
Trade and other receivables	428	431	(3)	
Inventories	20	19	1	
Other financial assets	132	94	38	Increase primarily due to the recognition of finance lease receivables on the implementation of IFRS 16 (\$41 million), partially offset by payments received on long-term receivable and finance lease receivable.
Deferred tax assets	124	130	(6)	Decrease primarily due to deferred tax expense on income subject to tax.
Property, plant and equipment	9,738	9,582	156	Increase primarily due to capital expenditures, the recognition of ROU assets on the implementation of IFRS 16 (\$84 million) and acquisition of Rio Verde, partially offset by depreciation expense and unfavorable foreign currency valuation adjustments.
Intangible assets and goodwill	387	368	19	Increase primarily due to capital expenditures and acquisition of Rio Verde, partially offset by amortization and unfavorable foreign currency valuation adjustments.

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION – LIABILITIES AND EQUITY

(Unaudited, \$ millions)	March 31, 2019	December 31, 2018	Increase (decrease)	Explanation of material changes
Trade and other payables	\$ 377	\$ 417	\$ (40)	Decrease primarily due to lower accrued electricity costs due to timing of payments as well as lower capital accruals, holdbacks payables and other trade payables, partially offset by higher accrued interest on long-term debt.
Loans and borrowings (including current portion)	2,772	2,700	72	Increase primarily due to issuance of short-term debt (\$84 million), partially offset by principle repayments of long-term debt and favorable foreign currency valuation adjustments on U.S. dollar denominated debt.
Deferred revenue (including current portion)	3,583	3,532	51	Increase primarily due to customer and developer contributions received, and acquisition of Rio Verde, partially offset by deferred revenue recognized and favorable foreign currency valuation adjustments.
Provisions (including current portion)	124	119	5	Increase primarily due to higher employee benefit accruals and acquisition of Rio Verde
Other liabilities (including current portion)	252	144	108	Increase primarily due to recognition of lease liabilities on the implementation of IFRS 16 (\$136 million), partially offset by Drainage transition cost compensation payment, payments against lease liabilities and favorable foreign currency valuation adjustments.
Deferred tax liabilities	56	53	3	
Equity attributable to the Owner of the Company	3,689	3,691	(2)	



## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, \$ millions)				
<b>Cash inflows (outflows)</b>				
<b>Three months ended</b>			<b>Increase</b>	
<b>March 31,</b>	<b>2019</b>	<b>2018</b>	<b>(decrease)</b>	<b>Explanation</b>
Operating	\$ 133	\$ 109	\$ 24	Increase primarily due to higher net cash flows from operations, partially offset by lower funds from the change in non-cash operating working capital.
Investing	(174)	28	(202)	Decrease primarily due to payments received on long-term loans receivable from Capital Power in 2018 (\$163 million), acquisition of Rio Verde in 2019 (\$31 million), higher capital expenditures and lower funds from the change in non-cash investing working capital, partially offset by lower payment of Drainage transition cost compensation.
Financing	33	(447)	480	Increase primarily due to lower repayment of long-term debt and higher proceeds from issuance of short-term debt, partially offset by higher payments for lease liabilities and higher dividend payments to the City.
Opening cash and cash equivalents	32	338	(306)	
Closing cash and cash equivalents	\$ 24	\$ 28	\$ (4)	

### Operating Activities and Liquidity

The Company maintains its financial position through rate-regulated utility and contracted operations, which generate stable cash flows.

The Company expects to have sufficient liquidity to finance its plans and fund its obligations, including current liabilities in excess of current assets, for the remainder of 2019 with a combination of cash on hand, cash flow from operating activities, the issuance of commercial paper, public or private debt offerings and availability of committed credit facility described below under Financing.

Cash flows from operating activities would be impaired by events that cause severe damage to our facilities and would require unplanned cash outlays for system restoration repairs. Under those circumstances, more reliance would be placed on our credit facilities for working capital requirements until a regulatory approved recovery mechanism or insurance proceeds are put in place.

### Capital Requirements and Contractual Obligations

During the first quarter of 2019, there were no material changes to the Company's capital requirements or purchase obligations, including payments for the next five years and thereafter, from those previously disclosed in the 2018 annual MD&A.

### Financing

Generally, our external financing is raised at the corporate level and invested in the operating business units. Our external financing has consisted of commercial paper issuance, bank loans under credit facilities, debentures payable to the City related to utility assets transferred from the City, debentures payable to the other municipalities,

publicly issued medium-term notes and U.S. private debt notes.

The Company has bank credit facilities which are used principally for the purpose of backing the Company's commercial paper program, issuance of bank loans for operational requirements and providing letters of credit, as outlined below:

(Unaudited, \$ millions)				Banking	
	Expiry	Total facilities	Letters of credit issued	Commercial paper issued	Net amounts available
<b>March 31, 2019</b>					
<b>Committed</b>					
Syndicated bank credit facility <sup>1</sup>	November 2023	\$ 600	\$ -	\$ 122	\$ 478
<b>Uncommitted</b>					
Bank credit facilities <sup>2</sup>	No expiry	200	121	-	79
Bank credit facility	No expiry	25	-	-	25
Bank credit facility	April 2019	13	-	-	13
Total uncommitted		238	121	-	117
<b>Total credit facilities</b>		<b>\$ 838</b>	<b>\$ 121</b>	<b>\$ 122</b>	<b>\$ 595</b>

(Unaudited, \$ millions)				Banking	
	Expiry	Total facilities	Letters of credit issued	Commercial paper issued	Net amounts available
<b>December 31, 2018</b>					
<b>Committed</b>					
Syndicated bank credit facility <sup>1</sup>	November 2023	\$ 600	\$ -	\$ 38	\$ 562
<b>Uncommitted</b>					
Bank credit facilities <sup>2</sup>	No expiry	200	80	-	120
Bank credit facility	No expiry	25	-	-	25
Bank credit facility	April 2019	14	-	-	14
Total uncommitted		239	80	-	159
<b>Total credit facilities</b>		<b>\$ 839</b>	<b>\$ 80</b>	<b>\$ 38</b>	<b>\$ 721</b>

<sup>1</sup> The Company's \$600 million committed syndicated bank credit facility is available and primarily used for backstopping EPCOR's commercial paper program. The committed syndicated bank credit facility cannot be withdrawn by the lenders until expiry, provided that the Company operates within the related terms and covenants. The extension feature of EPCOR's committed syndicated bank credit facility gives the Company the option each year to re-price and extend the terms of the facility by one or more years subject to agreement with the lending syndicate. The Company regularly monitors market conditions and may elect to enter into negotiations to extend the maturity dates. At March 31, 2019, commercial paper totaling \$122 million was issued and outstanding (December 31, 2018 - \$38 million).

<sup>2</sup> The Company's uncommitted bank credit facility consists of five bilateral credit facilities (totaling \$200 million) which are restricted to letters of credit. At March 31, 2019, letters of credit totaling \$121 million have been issued and outstanding (December 31, 2018 - \$80 million) to meet the credit requirements of electricity market participants and to meet conditions of certain service agreements.

The Company has a Canadian base shelf prospectus under which it may raise up to \$2 billion of debt with maturities of not less than one year. At March 31, 2019, the available amount remaining under this base shelf prospectus was \$1.80 billion (December 31, 2018 - \$1.80 billion). The Canadian base shelf prospectus expires in December 2019.

During the period, the Company entered into bond forward contracts, the hedging instruments, to manage its

interest rate risk associated with movements in long-term Government of Canada bond rates related to a planned future long-term debt issuance, which is the hedged item. The Company has entered into following bond forward contracts:

Type	Contract maturity	Notional value	Forward yield
Bond Forward Transaction	December 27, 2019	\$ 50	2.147%
Bond Forward Transaction	November 28, 2019	\$ 50	2.047%

These financial instruments have been classified as cash flow hedges. In the cash flow hedging relationship, the effective portion of the change in the fair value of the hedging instrument is recognized in other comprehensive income (OCI), while the ineffective portion is recognized in net income within finance expenses. At March 31, 2019, unrealized loss on cash flow hedges of \$4 million has been recognized in OCI.

For further information on the cash flow hedges, refer to the condensed consolidated interim financial statements of EPCOR Utilities Inc. for the three months ended March 31, 2019, and 2018.

If the economy were to deteriorate in the longer term, particularly in Canada and the U.S., the Company's ability to extend the maturity or revise the terms of bank credit facilities, arrange long-term financing for its capital expenditure programs and acquisitions, or refinance outstanding indebtedness when it matures could be adversely impacted. We believe that these circumstances have a low probability of occurring. We continually monitor our capital programs and operating costs to minimize the risk that the Company becomes short of cash or unable to honor its debt servicing obligations. If required, the Company would look to reduce capital expenditures and operating costs.

### **Credit Rating**

In September 2018, Standard & Poor's Ratings Services confirmed its A- / stable long-term corporate credit and senior unsecured debt ratings and DBRS confirmed its A (low) / stable senior unsecured debt and R-1 (low) / stable short-term debt ratings for EPCOR.

### **Financial Covenants**

EPCOR is currently in compliance with all of its financial covenants in relation to its syndicated bank credit facility, Canadian public medium-term notes and U.S. private debt notes. Based on current financial covenant calculations, the Company has sufficient borrowing capacity to fund current and long-term requirements. Although the risk is low, breaching these covenants could potentially result in a revocation of EPCOR's credit facilities causing a significant loss of access to liquidity or resulting in the Company's publicly issued medium-term notes and private debt notes becoming immediately due and payable causing the Company to find a means of funding which could include the sale of assets.

For further information on the Company's contractual obligations, refer to the 2018 annual MD&A.

### **RISK FACTORS AND RISK MANAGEMENT**

This section should be read in conjunction with the Risk Management section of the 2018 annual MD&A. EPCOR believes that risk management is a key component of the Company's culture and that we have cost-effective risk management practices in place. At the same time, EPCOR views risk management as an ongoing process and we continually review our risks and look for ways to enhance our risk management processes.

As part of ongoing risk management practices, the Company reviews current and proposed transactions to consider their impact on the risk profile of the Company. There have been no material changes to the risk profile or risk management practices of EPCOR as described in the 2018 annual MD&A that have affected the condensed consolidated interim financial statements for the three months ended March 31, 2019.

Currently, EPCOR's risks include new business integration risk, health and safety risk, political and legislative risk, regulatory risk, strategy execution risk, information technology related security risks, reputational damage and stakeholder activism, actual performance compared to approved revenue requirement, business interruption risks, weather and climate-change risk, failure to attract, retain or develop top talent, electricity price and volume risk, project risk, environment risk, credit risk, financial liquidity risk, billing error risk, foreign exchange risk, conflicts of interest, and general economic conditions, business environment and other risks.

## **Litigation Update**

The Company is not involved in any material litigation at this time.

## **FUTURE ACCOUNTING STANDARD CHANGES**

A number of new standards, amendments to standards and interpretations of standards have been issued by the International Accounting Standards Board and the International Financial Reporting Interpretations Committee, the application of which is effective for periods beginning on or after January 1, 2020. The Company does not expect to have any significant impact on its accounting policies on the implementation of these new accounting pronouncements.

## **CRITICAL ACCOUNTING ESTIMATES**

In preparing the condensed consolidated interim financial statements, management necessarily made estimates in determining transaction amounts and financial statement balances. The following are the items for which significant estimates were made in the condensed consolidated interim financial statements: electricity revenues, costs and unbilled consumption, fair values and income taxes. Although the current condition of the economy has not impacted our methods of estimating accounting values, it has impacted the inputs in those determinations and the resulting values. Interim results will fluctuate due to the seasonal demands for energy, water, related impacts on sanitary and stormwater systems, changes in energy prices, and the timing and recognition of regulatory decisions. Consequently, interim results are not necessarily indicative of annual results.

For further information on the Company's other critical accounting estimates, refer to the consolidated financial statements and MD&A for the years ended December 31, 2018 and 2017.

## **OUTLOOK**

For the remainder of 2019, EPCOR will focus on the completion of integration of Drainage, Collingwood electricity distribution operations and Rio Verde. In addition, we will continue to target growth in rate-regulated and contracted water, wastewater, electricity and natural gas infrastructure. We expect much of this investment to come from new infrastructure to accommodate customer growth and lifecycle replacement of existing infrastructure primarily related to the Edmonton and U.S. based operations. We intend to expand our water and electricity commercial services activities and to invest in renewable energy generation, including solar and biogas facilities, which will be ancillary to our existing operations and will enhance our environmental performance.

EPCOR was previously awarded franchises by two municipalities and one township in the South Bruce region of Ontario near Kincardine to build, own and operate a natural gas distribution system. On April 12, 2018, EPCOR received an Ontario Energy Board (OEB) decision awarding conditional certificates of public convenience and necessity related to these franchise areas. EPCOR has filed a leave-to-construct application with the OEB and for approval of the franchise agreements. In a separate application, EPCOR has also filed with OEB for approval of the rates to be applicable in the distribution system area. Following passage of the regulations by the Ontario provincial government to provide funding to expansion projects, the OEB initiated adjudication of the leave-to-construct application with a decision expected by end of the second quarter of 2019. Subject to obtaining OEB approvals, and timely interconnection to Enbridge's natural gas transmission system, the initial phase of EPCOR's South Bruce

natural gas distribution system is expected to be operational by second half of 2020, with the system substantially complete in 2021.

EPCOR is proposing to build a new solar farm just south of its existing E.L. Smith Water Treatment Plant (E.L. Smith WTP). The proposed solar farm will generate “green” energy to help power the existing E.L. Smith WTP and its water treatment and distribution processes, while reducing its greenhouse gas emissions. The solar farm is expected to have a peak generation capacity of approximately 10 megawatts. All significant government approvals are currently expected to be received in the second quarter of 2019, which will allow the solar farm to be operational before the end of 2020.

## **QUARTERLY RESULTS**

(Unaudited, \$ millions)		
<b>Quarters ended</b>	<b>Revenues</b>	<b>Net income</b>
March 31, 2019	\$ 458	\$ 56
December 31, 2018	466	107
September 30, 2018	465	55
June 30, 2018	426	68
March 31, 2018	401	65
December 31, 2017	572	87
September 30, 2017	534	75
June 30, 2017	474	56

Events for the past eight quarters compared to the same quarters of the prior years that have significantly impacted net income included:

- March 31, 2019, first quarter results included lower EPSP margins, lower water consumption per customer due to low temperatures and high precipitation, higher water treatment costs due to an early spring run-off in 2019, higher depreciation expense due to 2018 additions, and higher income tax expense. Partially offsetting these decreases were higher electricity distribution customer revenues due to higher rates, favorable fair value adjustments related to financial electricity purchase contracts, higher Encor customer growth and higher transmission system access service charge net collections.
- December 31, 2018, fourth quarter results included higher income tax recovery due to recognition of non-capital loss carry-forward balances, higher distribution revenues due to higher customer rates, higher EPSP margins, higher transmission system access service charge net collections, lower finance expense due to lower average debt outstanding and lower interest rates, and no losses on sale of surplus land. Partially offsetting these increases were lower water and wastewater revenues, unfavorable fair value adjustments related to financial electricity purchase contracts and higher depreciation expense due to asset additions for 2018.
- September 30, 2018, third quarter results included lower EPSP margins, higher unfavorable fair value adjustments related to financial electricity purchase contracts, lower transmission system access service charge net collections, higher finance expense due to the additional debt assumed upon the transfer of Drainage, as well as, higher depreciation expense due to the transfer of Drainage and asset additions for 2017 and 2018. Partially offsetting these decreases were three months of income from Drainage in 2018 compared to one month in 2017, higher water and wastewater revenues, higher electricity distribution customer rates and no losses on sale of surplus land in 2018.
- June 30, 2018, second quarter results included income from Drainage and Hughes, higher water and wastewater revenues, lower water treatment costs for operations in the city of Edmonton, higher electricity distribution customer rates, higher favorable fair value adjustments related to financial electricity purchase contracts. Partially offsetting these increases were lower EPSP margins, lower transmission system access

service charge net collections, higher interest expense due to the additional debt assumed upon the transfer of Drainage, as well as, higher depreciation expense due to the transfer of Drainage and asset additions for 2017 and 2018.

- March 31, 2018, first quarter results included income from Drainage and Hughes, higher water and wastewater revenues, lower water treatment costs for operations in the city of Edmonton, Encor customer growth, unfavorable fair value adjustments related to financial electricity purchase contracts in 2017 and higher transmission system access service charge net collections. Partially offsetting these increases were lower EPSP margins, higher interest expense due to the additional debt assumed upon the transfer of Drainage, as well as, higher depreciation expense due to the transfer of Drainage and 2017 asset additions.
- December 31, 2017, fourth quarter results included lower transmission system access service charge net collections, lower EPSP margins, higher depreciation expense due to asset additions, no fair value gain on sale of investment in Capital Power, no favorable fair value adjustments related to interest rate swaps in 2017 and higher financing expenses. Partially offsetting these decreases were higher water, wastewater and electricity distribution customer rates, income from the Drainage operations, higher income related to industrial services contracts, higher water volumes in U.S. due to above average temperatures, lower income taxes and higher favorable changes in the fair value of financial electricity purchase contracts.
- September 30, 2017, third quarter results included lower EPSP margins, higher depreciation expense due to asset additions, lower income from industrial services contracts primarily due to the termination of the Suncor financing and operating agreements in 2016, no fair value gain on sale of investment in Capital Power, no dividend income due to the sale of Capital Power shares and lower favorable fair value adjustments related to financial electricity purchase contracts. Partially offsetting these decreases were higher water, wastewater and electricity distribution customer rates, higher transmission system access service charge net collections and no unfavorable fair value adjustments related to interest rate swaps.
- June 30, 2017, second quarter results included lower income related to industrial services contracts, lower EPSP margins, loss on sale of surplus land, lower water and wastewater volumes due to higher precipitation in the city of Edmonton, higher water treatment costs due to poor river quality conditions in the North Saskatchewan River and no dividend income due to the sale of Capital Power shares. Partially offsetting these decreases were favorable fair value adjustments related to financial electricity purchase contracts in 2017 and unfavorable fair value adjustments related to interest rate swaps in 2016 with no corresponding transaction in the second quarter of 2017, higher water, wastewater and electricity transmission customer rates and higher transmission system access service charge net collections.

## **FORWARD - LOOKING INFORMATION**

Certain information in this MD&A is forward-looking within the meaning of Canadian securities laws as it relates to anticipated financial performance, events or strategies. When used in this context, words such as “will”, “anticipate”, “believe”, “plan”, “intend”, “target”, and “expect” or similar words suggest future outcomes.

The purpose of forward-looking information is to provide investors with management’s assessment of future plans and possible outcomes and may not be appropriate for other purposes. Material forward-looking information within this MD&A, including related material factors or assumptions and risk factors, are noted in the table below:

<b>Forward-looking Information</b>	<b>Material Factors or Assumptions</b>	<b>Risk Factors</b>
The Company expects to have sufficient liquidity to finance its plans and fund its obligations, including current liabilities in excess of current assets, for the remainder of 2019.	EPCOR is able to generate the expected cash flow from operations and various means of funding remain available to the Company.	EPCOR's operations do not generate the expected level of cash flow and / or circumstances arise limiting or restricting the Company's ability to access funds through the various means otherwise available.

There have been no changes in the material forward-looking information previously disclosed in the 2018 annual MD&A, including related material factors or assumptions and risk factors.

For further information on the Company's forward looking information, refer to the 2018 annual MD&A.

Whether actual results, performance or achievements will conform to the Company's expectations and predictions is subject to a number of known and unknown risks and uncertainties which could cause actual results to differ from expectations and are discussed in the Risk Factors and Risk Management section above.

Readers are cautioned not to place undue reliance on forward-looking statements as actual results could differ materially from the plans, expectations, estimates or intentions expressed in the forward-looking statements. Except as required by law, EPCOR disclaims any intention and assumes no obligation to update any forward-looking statement even if new information becomes available, as a result of future events or for any other reason.

#### **GLOSSARY**

<b>ACC</b> means Arizona Corporation Commission	<b>IAS</b> means International Accounting Standard(s)
<b>Adjusted EBITDA</b> earnings before finance expenses, income tax recovery (expense), depreciation and amortization, changes in the fair value of derivative financial instruments and transmission system access service charge net collections	<b>OCI</b> means other comprehensive income
<b>AESO</b> means Alberta Electric System Operator	<b>OEB</b> means Ontario Energy Board
<b>Capital Power</b> means Capital Power Corporation and its directly and indirectly owned subsidiaries including Capital Power L.P., except otherwise noted or the context otherwise indicates	<b>ROU</b> means right-out-use
<b>Drainage</b> means drainage utility services within the city of Edmonton	<b>Rio Verde</b> means Rio Verde Utilities Inc.
<b>E.L. Smith WTP</b> means E.L. Smith Water Treatment Plant	<b>RRO</b> means Regulated Rate Option
<b>EPSP</b> means Energy Price Setting Plan	<b>the City</b> means The City of Edmonton
<b>IFRS</b> means International Financial Reporting Standard(s)	

**ADDITIONAL INFORMATION**

Additional information relating to EPCOR including the Company's 2018 Annual Information Form is available on SEDAR at [www.sedar.com](http://www.sedar.com).