Management Discussion and Analysis for Year 2013

Service Quality

Customer accessibility is an important component of Horizon Utilities' customer service delivery model. In order to continuously monitor and integrate customer issues, concerns, and needs into its business plans, Horizon Utilities performs an annual Customer Satisfaction Survey (and has done so since 2001) in addition to information obtained from daily conversations between its Call Centre representatives and customers. Meeting these Service Quality measures is crucial to Horizon Utilities' success in being "easy to do business with"; a corporate objective which Horizon Utilities strives to achieve. Horizon Utilities' Service Quality measures are well above the Industry Standard in all three of the measures in this performance category.

Customer Satisfaction

Customer Satisfaction corresponds to meeting customers' expectations. First Contact Resolution ("FCR") represents fully addressing the customer's need the first time that they call, thereby eliminating the need for the customer to follow up with a second call. Horizon Utilities' FCR target is to address the needs of 90% of customers within one call to Horizon Utilities' Customer Care Centre. Horizon Utilities began measuring FCR in mid-2012 and further began reporting this measure to the Ontario Energy Board in 2013 on an annual basis. In 2013, Horizon Utilities has been successful in resolving customer inquiries at the first point of contact 90% of the time.

For 2013, Horizon Utilities defined billing accuracy as the number of customer invoices within Horizon Utilities control that were created without errors. Within that definition, billing was accurate 99.95% of the time in 2013. The OEB has revised the definition of this measure effective October 2014 to equal the number of accurate bills issued divided by the total bills issued. The billing accuracy target as of October 2014 is 98%. Future reporting will be reported consistent with the new OEB definition.

Horizon Utilities engages UtilityPULSE for its annual customer satisfaction survey. Overall, 95% of customers are satisfied with the services provided by Horizon Utilities.

Safety

The Safety metric is yet to be determined by the Ontario Energy Board.

System Reliability

Horizon Utilities' Average Number of Hours that Power to a Customer is Interrupted (i.e., duration) measure has been trending higher in recent years. The increasing trend in this measure is the result of Horizon Utilities' aging infrastructure, coupled with an increasing frequency of severe storms.

Horizon Utilities' Average Number of Times that Power to a Customer is Interrupted (i.e., frequency) has gradually increased in recent years. The failure of aging infrastructure is causing a high volume of service interruptions.

Horizon Utilities is taking action to address its declining trend in system reliability. It has conducted a detailed review of its assets and prepared a comprehensive plan, which provides for the renewal of its distribution system over the next twenty years. Horizon Utilities has adopted a proactive, balanced approach to investment to address immediate risks associated with end-of-life assets; manage distribution system risks; ensure the safe and reliable delivery of electricity; and balance ratepayer and utility affordability.

Asset Management

Horizon Utilities uses an asset management model to identify key asset replacement priorities. Horizon Utilities has refined its long-term distribution system capital plan through a logical and sequential process including: i) a detailed assessment of the health of its assets by an independent engineering consulting firm using industry best practices; ii) a comprehensive Asset Management Plan ("AMP"); and iii) a long-term Distribution System Plan ("DSP") providing for annual distribution system capital investments on a prioritized basis.

The DSP is the capital expenditure program for Horizon Utilities. The DSP Implementation Progress measure is a new measure introduced by the OEB in 2013. This measure represents 2013 actual capital expenditures as compared to the 2013 budget on a percentage basis. Horizon Utilities' 2013 capital expenditures were 5% higher than budget. Horizon Utilities has filed a DSP for the years 2015-2019 with the OEB.

Cost Control

The total costs for Ontario local electricity distribution companies ("LDCs") are evaluated by the Pacific Economics Group LLC ("PEG") on behalf of the OEB to produce a single efficiency ranking. LDCs are divided into five groups based on the magnitude of the difference between their respective individual actual and predicted costs. In 2012, Horizon Utilities was placed in Group 2, where a Group 2 LDC is defined as having actual costs 10 to 25 percent below predicted costs. The significance of this categorization is that Horizon Utilities is ranked as high as 7th and not below 21st of the 71 LDCs ranked, given that only six of 71 LDCs are in Group

1 and 15 are in Group 2.

A recent update of the PEG analysis released August 22, 2014 indicates a change in Horizon Utilities' relative efficiency. Horizon Utilities was placed in Group 3, where a Group 3 utility is defined as having actual costs within 10% of predicted costs. Horizon Utilities has identified certain inconsistencies between its internal data and that used by PEG in its analysis. Horizon Utilities is working with the Ontario Energy Board and PEG to resolve these inconsistencies and a final determination of its relative peer group ranking.

Total costs per customer and per kilometer are computed by PEG based on an econometric model to adjust distributors' costs reported on the financial statements to benchmark distributors' cost performance. They are based on, but do not represent Horizon Utilities' costs as identified on its financial statements. Total costs refer to operating and capital costs and include Horizon Utilities' costs to operate, maintain, administer and renew its distribution system, buildings, and related underlying systems and processes.

Horizon Utilities' operating and capital costs are increasing year-over-year. The increase in capital costs corresponds to Horizon Utilities' ongoing need to invest in the necessary renewal of its distribution system, buildings, and related underlying systems and processes. A significant portion of Horizon Utilities' asset infrastructure is now at end-of life and largely due for renewal. Horizon Utilities is replacing assets proactively along a carefully managed timeframe in a manner that balances system risks and customer rate impacts. Increases in operating costs are mainly attributable to increases in distribution system and facilities maintenance, information technology costs supporting new regulated and internal business processes, salary/wage inflation, inflation in non-labour expenses, partially offset by significant productivity achievements. Horizon Utilities experienced a low level of growth in its service territory both in terms of number of customers and total kilometers of lines. As a result, cost per customer and per kilometer of line have increased year over year with the increase in capital and operating costs. Utilities with low growth rates with upward cost pressures experience higher increases in cost per customer and kilometer of line as compared to utilities with higher growth rates that are able to fund capital renewal and operating costs through customer growth.

New suburban LDCs are not confronted by infrastructure maintenance and capital renewal challenges of LDCs in older municipalities Suburban LDCs, where the focus is on new capital rather than maintenance, can capitalize more labour costs, resulting in lower pressure on the key sector comparator of OM&A costs

Conservation & Demand Management

Horizon Utilities' 2011–2013 Conservation and Demand Management ("CDM") results are based on the Ontario Power Authority ("OPA") report. Horizon Utilities' CDM targets for 2011–2014 are 60.36MW of demand savings and 281.42 GWh of energy savings. As of 2013, Horizon Utilities achieved 56.2% of its demand target and 85.6% of its energy targets. Horizon Utilities' CDM Annual Reports for 2011 and 2012 can be found on Horizon Utilities' website at http://www.horizonutilities.com/ourCompany/Pages/regulatory-affairs.aspx.

Connection of Renewable Generation

The Connection of Renewable Generation is comprised of the Feed-In Tariff ("FIT") program (projects of >10kW of connected load) and the microFIT program (projects of <10kWof connected load). Horizon Utilities is required to conduct Connection Impact Assessments ("CIA") prior to connecting Renewable Generation projects. Horizon Utilities is required to connect microFIT projects within five business days after receiving authorization from the Electrical Safety Authority. In 2013, all CIAs were completed on time and all microFIT projects were connected within the required timeframe.

Financial Ratios

The Current Ratio is defined as current assets (e.g. cash, accounts receivable) divided by current liabilities. The Current Ratio was low in 2009 and 2011 which necessitated new debt issuances in 2010 and 2012. All other years are in a healthy range of 1.10-1.12.

Leverage (Total Debt divided by Equity), a measure of the extent of debt financing, increased both in 2010 and in 2012 due to the issuance of additional long-term debt as previously discussed.

Horizon Utilities' current distribution rates were approved by the OEB and include the opportunity to achieve a deemed return on equity of 9.58%. Horizon Utilities' dollar weighted average return over the three-year period is 10.18%. Horizon Utilities achieved returns higher than the deemed rate in 2012 and 2013 mainly due to higher revenue than forecast, as a result of increased energy consumption; and lower operating costs. Horizon Utilities has mitigated the overall real growth in its operating cost base with productivity savings arising from related process improvement initiatives such as: the implementation of a paperless work order system for meter related field work; the implementation of a planning and scheduling system which has increased the productive time for field crews; and refined budgeting and financial processes.