



**SUBJECT: Financial results for Burlington Hydro for the period ended December 31, 2019**

**TO: Corporate Services, Strategy, Risk & Accountability Cttee.**

**FROM: Finance Department**

Report Number: F-24-20

Wards Affected: not applicable

File Numbers: 125-01

Date to Committee: June 11, 2020

Date to Council: June 22, 2020

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**Recommendation:**

Receive and file finance department report F-24-20 providing financial results for Burlington Enterprises Corporation.

**PURPOSE:**

To provide information on the financial results for Burlington Enterprises Corporation and its related companies.

**Background and Discussion:**

The City has been provided with audited 2019 consolidated financial statements for Burlington Enterprises Corporation (BEC) as well as individual statements for each company. City Council, as the shareholder, received an overview of and approved the financial reports at the Annual General Meeting held on April 28, 2020 which was held virtually due to the Covid-19 pandemic.

BEC is accounted for in the City's financial statements on a modified equity basis.

The 2019 statements have been prepared using International Financial Reporting Standards (IFRS). The external auditors, KPMG LLP have expressed their opinion that the statements present fairly, in all material respects, the financial performance of BEC in accordance with IFRS.

**a) BEC**

The consolidated balance sheet of BEC shows a decrease in cash position with cash and temporary investments totaling \$5.7 million (2018 - \$14.8 million). The decrease in cash is primarily a result of capital project spending of net \$3.9 million, net regulatory assets increasing by \$2.1 million and principle payments on long term debt of \$1.5 million.

As the balance sheet is the consolidation of all three companies, the components of the balance sheet will be discussed in more detail under the analysis of the financial statements for the subsidiaries. The year end cash balance will be used to form part of the semi-annual dividend payments to the City during fiscal 2020. In the 2020 Budget and Ten-Year Forecast dividends for 2020 are budgeted at \$2.6 million of which \$2.0 million are from BHI and \$0.6 million are to flow from BESI.

For the year ended December 31, 2019 the consolidated statement of BEC identifies net income of \$5.3 million (2018 - \$5.6 million). The consolidated financial statement includes the accounts of all three companies, BEC and its wholly owned subsidiaries, Burlington Hydro Inc. (BHI) and Burlington Electricity Services Inc. (BESI). The comprehensive income was realized as follows:

i) BEC 2019 Comprehensive Income*	\$ (26,479)
ii) BESI 2019 Comprehensive Income	560,086
iii) BHI 2019 Comprehensive Income	<u>5,114,811</u>
Total Comprehensive Income	\$ 5,648,418

\*Dividends paid by BHI of \$2,000,000 and by BESI of \$600,000 are eliminated on consolidation. Comprehensive income includes remeasurement of liability for future benefits for BHI \$365K (2018- \$250k) which is added to net income of \$5.3 million to arrive at \$5.6 million in comprehensive income.

**b) BHI**

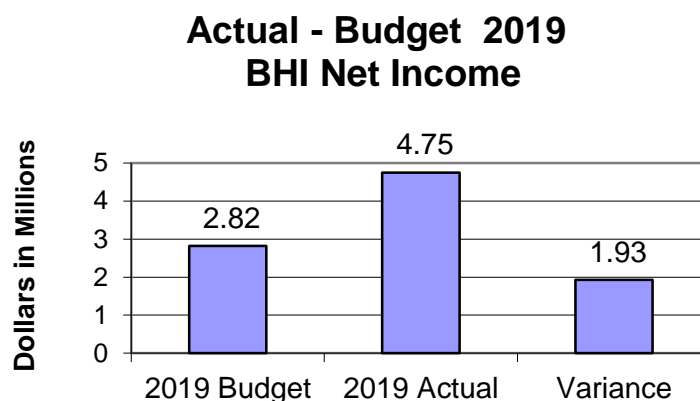
**i) Balance Sheet**

The balance sheet identifies assets totaling \$206.4 million (2018 - \$198.5 million) of which property, plant and equipment represent \$140.5 million or 68.1% of the total assets. Cash and temporary investments total \$4.9 million (2018 - \$14.0 million). The decrease can be attributed to the capital investments and regulatory assets detailed above.

The company's working capital position remains strong at \$23.6 million. This enables the company to tolerate seasonal swings in the IESO power bill.

## ii) Statement of Earnings and Retained Earnings

BHI results reflect net income exceeding budget as illustrated in the following chart:



Significant items affecting net income are as follows:

- Distribution revenue came in at 99% of target, (\$158k) unfavourable. Electricity sales tracked close to budget throughout the year. Other operating revenue came in above budget by \$1M. The major contributing factor to this increase was a \$620k recovery in administration costs related to the province's cancellation of the IESO conservation first framework.
- Another factor contributing to the results was depreciation lower than budget by \$305K due to the lower expenditure on Canada Revenue Agency true up payments for the Tremaine and Bronte transformer station resulting in lower depreciation.
- Net financing costs (interest expense net of interest income) were \$202k below budget as interest revenue was higher than expected as lower than budgeted IESO power bills in 2019 resulted in higher average bank balances.

Retained earnings were \$40.6 million in 2019 (2018 - \$37.8 million) and reflect dividends paid to BEC of \$2.0 million.

## c) BESI

### i) Balance Sheet

The balance sheet identifies a decrease in cash and temporary investments to \$0.65 million (2018 - \$0.76 million). In 2019 \$0.60 million in dividends were paid to BEC and contributed to the budgeted dividend paid to the City of \$2.6 million. The cash balance and working capital remain adequate.

## **ii) Statement of Earnings and Retained Earnings**

In 2019 earnings were a net profit of \$560k (2018 – \$722k). The water billing services provided to the Region of Halton had revenues exceeding budget while cost of sales and operating expenses were at 97% and 96% of budget respectively. Favourable variances to budget were due to lower transfer pricing for BHI services and lower meter reading costs. This resulted in operating income of \$891k or 114% of budget.

The Co-Generation Division experienced an operating profit of \$18k. Included in this division are the Firehall #8 Solar Array, 1340 Brant Micro-Turbine and Haber Co-Gen Design/Build Project. The division realized an unfavourable variance to budget of (\$39k). This unfavourable variance primarily resulted from an engineering study on the Micro-Turbine which shortened the life from 11.5 years to 7 years resulting in increased depreciation costs.

The Vehicle Charging Station Division had an operating loss of (\$13k). Revenues did not reach budget as few multi-residential units were installed. Operating costs were related to marketing expenses.

The Street Light Division realized minor activity in 2019 which was the carry-over of completion of phase 4 of the City/Region streetlight contract for the supply and installation of LED luminaires to replace existing high-pressure sodium lights.

In December of 2017, Milton Hydro signed a contract to have BESI provide control room services. This business was on budget for the year. This activity is referenced as the Control Room Division.

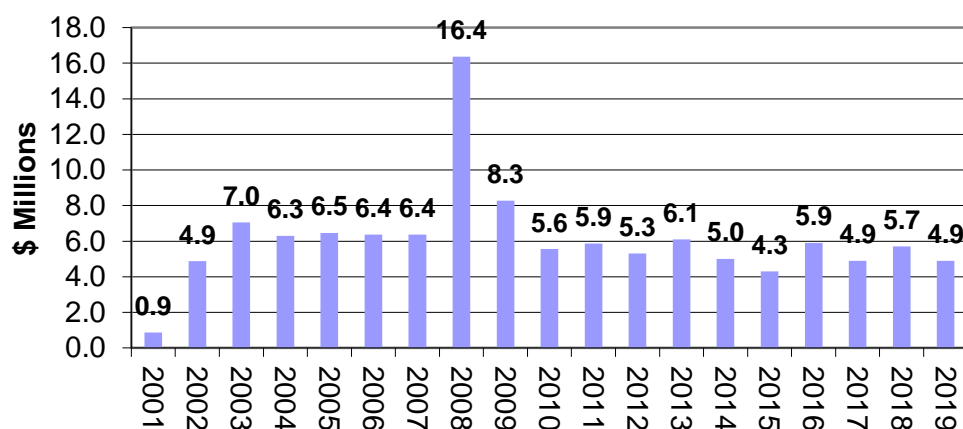
The Suite Meter Division relates to a single contract for a Condo project acquired in 2019. The net operating revenue for the division is on budget.

## **Financial Matters:**

The City, as shareholder of BEC was forecast to realize a dividend flow of \$2.6 million in 2019. In addition to dividends received, the City realized an increase in cash flow through interest on the note payable to the City from BHI. The City realized total interest payments of \$2.3 million in 2019.

Together with interest payments on the promissory note from BHI, the City as shareholder has enjoyed a sustained contribution to its capital plan. The following graph illustrates payments made to the City:

### Dividends and Interest from BEC (formerly BHEI)



Dividends and interest paid in 2008 include proceeds from the sale of the Fibrewired component of BESl. In 2009, the City also received a special one-time dividend amounting to \$2.0 million. In 2020 dividends are forecast to be \$2.6 million.

As noted in Finance report F-02-20 on the Hydro Business Plan as presented to CSSRA on February 13, 2020, the following are notable areas that will have an impact to the city's Hydro reserve fund.

First, is the decline in the dividend by \$200,000 annually beginning in 2021. The city currently receives an annual dividend of \$2.6 million and this will reduce to \$2.4 million next year. It is likely that this reduction will continue with no planned increases to the dividend in the future.

Secondly, is the interest that the city receives on its promissory note. Since 2014 the city has received an annual rate of 4.88% equating to an annual cash flow of \$2.3 million. As detailed under shareholder risks Hydro anticipates a reduction in the rate. At the time of the preparation of the budget to approximately 4.13%. This equates to an annual reduction of \$360,000. Upon the completion of the cost of service review should the rate be lower this can have an even greater impact on the cash flows to the Hydro reserve fund. Based on recent rate approvals, subsequent to the preparation of the business plan, at a rate of 3.21% this would impact the city by \$800,000 annually from our 2020 amount.

Overall, the city with certainty will experience an overall reduction in cash flow to the Hydro reserve fund of \$560,000 annually. With the potential for a greater impact in 2021. Given current conditions, the rate will most certainly fall lower.

The city's Hydro reserve fund is an integral part of the city's capital infrastructure program. It provides \$2.1 million annually to support the annual capital renewal program. Furthermore, it is anticipated over the next five years that it is providing for the

annual average repayment of \$2.5 million in debt charges on special circumstances debt towards major capital projects of varying types throughout the city. As well the reserve fund is relied on for city's storm allocation program until 2024 and direct cash contributions towards capital projects as well.

The Hydro reserve fund is being closely monitored and adjustments will be made as required in order to ensure a sustainable reserve fund balance.

Lastly, effective in 2019 the OEB changed the streetlight attachment rate from \$22.35 to \$43.63. With the OEB's 2020 inflation rate applied, the 2020 rate will be set at \$44.50. The City has 4,796 poles with streetlight attachments. To assist the City, BHI absorbed the price impact of \$102,000 for 2019. By not passing the increase on to the City in 2019, Burlington Hydro has "in effect" paid a special dividend of \$102,000. The 2020 impact of the rate increase is \$106,000 will impact the city's operating budget.

## **Shareholder Risks**

### **Regulatory/Political Risk**

Although the OEB is the regulatory body that governs provincial utilities, the provincial government focus on energy matters can impact the operations of Burlington Hydro. The provincial government has focused its attention on reducing red tape and championing affordability issues in the energy sector, among other policy concerns. A decision to remove the delivery of conservation programs from local utilities has impacted Burlington Hydro in that an expected incentive payment for achieving conservation targets will not be received. This bonus would have provided additional dividends to the shareholder.

Moving forward, the shareholder will need to work closely with Hydro staff to monitor any effects on the cash flow by government legislation and to look at strategic investments that will return value to the shareholder.

As an unregulated company BESI provides the best opportunity to design strategic initiatives that provide value to the shareholder.

### **Cost of Service Review**

Burlington Hydro is preparing for a cost of service rate review to be effective with rates on May 1, 2021. The OEB has established a five-year cycle in which the local distribution companies must undergo a full "cost of service" review. BHI will prepare a cost of service application in 2020 for May 1, 2021 rates. As a result of the 2014 cost of service review, the City was impacted by having the interest rate on the promissory note dropped from 5.87% to 4.88%. The current Hydro business plan projects the rate at 4.13% resulting in a decrease of (\$359K) interest income to the city mid 2021. The current rates, subsequent to preparation of the business plan, as of November 1, 2019

are 3.21%. The original interest rate on the note was 7.25%. City staff have taken a conservative approach in the cash flow forecast for the capital program.

### **Covid 19 Pandemic**

Also, of impact is the Covid 19 pandemic currently being experienced globally. The cash flow impacts of the situation as outlined at the AGM held April 28, 2020 include longer collection times resulting in current collections dropping from 90% to 80%. More payment arrangements are being requested and there is a potential for more write offs. Ontario has noted a decline in electricity demand by nearly 10%.

The Corporation has taken steps to mitigate the impact by:

- purchasing accounts receivable credit insurance to insure against nonpayment of Hydro bills
- Increasing the operating line of credit from \$10M to \$20M
- curtailing all discretionary spending
- reducing inventory levels
- cutting back on capital expenditures.

To date the impact has been nominal on the 2020 budget however, management continues to model different scenarios and refine the forecast as impacts change.

### **Climate Implications**

BHI is a stakeholder committee member in the City's Climate action plan and provides expertise to help contribute to the development of the plan.

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### **Engagement Matters:**

Burlington Hydro conducted a customer survey that resulted in a 96% overall customer satisfaction score.

In response to the Covid 19 pandemic Burlington Hydro covered the costs associated with bringing new electrical service and equipment needed to power the temporary Pandemic Response Unit built at Joseph Brant Hospital.

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### **Conclusion:**

As shareholder the City wishes to thank the Board and Management of Hydro for the continued strong results achieved by BEC and its companies.

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Respectfully submitted,

Sandy O'Reilly

Controller and Manager of Financial Services

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**Report Approval:**

All reports are reviewed and/or approved by Department Director, the Chief Financial Officer and the Executive Director of Legal Services & Corporation Council. Final approval is by the City Manager.