## HYDRO ONE LIMITED
### CONDENSED INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (unaudited)
### For the three months ended March 31, 2016 and 2015

| **Three months ended March 31** *(millions of Canadian dollars, except per share amounts)* | **2016** | **2015** |
|---|---|---|
| **Revenues** | | |
| Distribution (includes $40 related party revenues; 2015 – $40) *(Note 19)* | 1,286 | 1,389 |
| Transmission (includes $377 related party revenues; 2015 – $406) *(Note 19)* | 386 | 406 |
| Other | 14 | 13 |
| | 1,686 | 1,808 |
| **Costs** | | |
| Purchased power (includes $712 related party costs; 2015 – $799) *(Note 19)* | 896 | 970 |
| Operation, maintenance and administration *(Note 19)* | 256 | 278 |
| Depreciation and amortization | 190 | 187 |
| | 1,342 | 1,435 |
| **Income before financing charges and income taxes** | **344** | **373** |
| Financing charges | 96 | 94 |
| **Income before income taxes** | **248** | **279** |
| Income taxes *(Notes 5, 19)* | 33 | 45 |
| **Net income** | **215** | **234** |
| Other comprehensive income | – | – |
| **Comprehensive income** | **215** | **234** |
| **Net income and comprehensive income attributable to:** | | |
| Noncontrolling interest | 1 | 2 |
| Preferred shareholders | 6 | 4 |
| Common shareholders | 208 | 228 |
| | **215** | **234** |
| **Earnings per common share** *(Note 17)* | | |
| Basic | $0.35 | $0.47 |
| Diluted | $0.35 | $0.47 |
| **Dividends per common share declared** *(Note 16)* | $0.34 | $0.05 |

*See accompanying notes to Condensed Interim Consolidated Financial Statements (unaudited).*

**HYDRO ONE LIMITED**
**CONDENSED INTERIM CONSOLIDATED BALANCE SHEETS (unaudited)**
**At March 31, 2016 and December 31, 2015**

| *(millions of Canadian dollars)* | **March 31, 2016** | **December 31, 2015** |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | 253 | 94 |
| Accounts receivable *(Note 6)* | 851 | 776 |
| Due from related parties *(Note 19)* | 170 | 191 |
| Other current assets *(Note 7)* | 120 | 105 |
| | 1,394 | 1,166 |
| Property, plant and equipment *(Note 8)* | 18,166 | 17,968 |
| Other long-term assets: | | |
| Regulatory assets | 3,040 | 3,015 |
| Deferred income tax assets | 1,407 | 1,636 |
| Intangible assets (net of accumulated amortization – $288; 2015 – $274) | 335 | 336 |
| Goodwill | 165 | 163 |
| Other assets | 10 | 10 |
| | 4,957 | 5,160 |
| **Total assets** | **24,517** | **24,294** |
| **Liabilities** | | |
| Current liabilities: | | |
| Short-term notes payable *(Note 11)* | 955 | 1,491 |
| Accounts payable and other current liabilities *(Note 9)* | 930 | 868 |
| Due to related parties *(Note 19)* | 136 | 138 |
| Long-term debt payable within one year *(Note 11)* | 50 | 500 |
| | 2,071 | 2,997 |
| Long-term liabilities: | | |
| Long-term debt (includes $51 measured at fair value; 2015 – $51) *(Notes 11, 12)* | 9,551 | 8,207 |
| Regulatory liabilities | 200 | 236 |
| Deferred income tax liabilities | 40 | 207 |
| Other long-term liabilities *(Note 10)* | 2,722 | 2,723 |
| | 12,513 | 11,373 |
| **Total liabilities** | **14,584** | **14,370** |
| *Contingencies and Commitments (Notes 21, 22)* | | |
| *Subsequent Events (Note 24)* | | |
| Noncontrolling interest subject to redemption | 22 | 23 |
| **Equity** | | |
| Common shares *(Note 15)* | 5,623 | 5,623 |
| Preferred shares *(Note 15)* | 418 | 418 |
| Additional paid-in capital | 15 | 10 |
| Retained earnings | 3,812 | 3,806 |
| Accumulated other comprehensive loss | (8) | (8) |
| Hydro One shareholders' equity | 9,860 | 9,849 |
| Noncontrolling interest | 51 | 52 |
| **Total equity** | 9,911 | **9,901** |
| | **24,517** | **24,294** |

*See accompanying notes to Condensed Interim Consolidated Financial Statements (unaudited).*

**HYDRO ONE LIMITED**
**CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (unaudited)**
**For the three months ended March 31, 2016 and 2015**

| **Three months ended March 31, 2016** *(millions of Canadian dollars)* | **Common Shares** | **Preferred Shares** | **Additional Paid-in Capital** | **Retained Earnings** | **Accumulated Other Comprehensive Loss** | **Hydro One Shareholders' Equity** | **Non-controlling Interest** | **Total Equity** |
|---|---|---|---|---|---|---|---|---|
| January 1, 2016 | 5,623 | 418 | 10 | 3,806 | (8) | 9,849 | 52 | 9,901 |
| Net income | – | – | – | 214 | – | 214 | 1 | 215 |
| Other comprehensive income | – | – | – | – | – | – | – | – |
| Distributions to noncontrolling interest | – | – | – | | – | – | (2) | (2) |
| Dividends on preferred shares | – | – | – | (6) | – | (6) | – | (6) |
| Dividends on common shares | – | – | – | (202) | – | (202) | – | (202) |
| Stock-based compensation | – | – | 5 | – | – | 5 | – | 5 |
| **March 31, 2016** | **5,623** | **418** | **15** | **3,812** | **(8)** | **9,860** | **51** | **9,911** |

| **Three months ended March 31, 2015** *(millions of Canadian dollars)* | **Common Shares** | **Retained Earnings** | **Accumulated Other Comprehensive Loss** | **Hydro One Shareholders' Equity** | **Non-controlling Interest** | **Total Equity** |
|---|---|---|---|---|---|---|
| January 1, 2015 | 3,314 | 4,249 | (9) | 7,554 | 49 | 7,603 |
| Net income | – | 232 | – | 232 | 1 | 233 |
| Other comprehensive income | – | – | – | – | – | – |
| Dividends on preferred shares | – | (4) | – | (4) | – | (4) |
| Dividends on common shares | – | (25) | – | (25) | – | (25) |
| **March 31, 2015** | **3,314** | **4,452** | **(9)** | **7,757** | **50** | **7,807** |

*See accompanying notes to Condensed Interim Consolidated Financial Statements (unaudited).*

**HYDRO ONE LIMITED**
**CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)**
**For the three months ended March 31, 2016 and 2015**

| **Three months ended March 31** *(millions of Canadian dollars)* | **2016** | **2015** |
|---|---|---|
| **Operating activities** | | |
| Net income | 215 | 234 |
| Environmental expenditures | (3) | (4) |
| Adjustments for non-cash items: | | |
| Depreciation and amortization (excluding removal costs) | 166 | 170 |
| Regulatory assets and liabilities | (10) | 88 |
| Deferred income taxes | 21 | 2 |
| Other | 2 | 2 |
| Changes in non-cash balances related to operations *(Note 20)* | (18) | (66) |
| **Net cash from operating activities** | 373 | 426 |
| | | |
| **Financing activities** | | |
| Long-term debt issued | 1,350 | – |
| Long-term debt retired | (450) | – |
| Short-term notes repaid | (536) | – |
| Dividends paid | (208) | (29) |
| Distributions paid to noncontrolling interest | (3) | – |
| Change in bank indebtedness | – | 33 |
| Other | (6) | – |
| **Net cash from financing activities** | 147 | 4 |
| | | |
| **Investing activities** | | |
| Capital expenditures *(Note 20)* | | |
| Property, plant and equipment | (358) | (339) |
| Intangible assets | (13) | (5) |
| Other | 10 | (5) |
| **Net cash used in investing activities** | (361) | (349) |
| | | |
| **Net change in cash and cash equivalents** | 159 | 81 |
| Cash and cash equivalents, beginning of period | 94 | 100 |
| **Cash and cash equivalents, end of period** | **253** | **181** |

*See accompanying notes to Condensed Interim Consolidated Financial Statements (unaudited).*

## 1. DESCRIPTION OF THE BUSINESS

Hydro One Limited (Hydro One or the Company) was incorporated on August 31, 2015, under the *Business Corporations Act* (Ontario). The Province of Ontario (Province) is the majority shareholder of Hydro One.

In October 2015, the Company acquired Hydro One Inc., a company previously wholly-owned by the Province. Hydro One is a continuation of business operations of Hydro One Inc. The principal businesses of Hydro One are the transmission and distribution of electricity to customers within Ontario.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### Basis of Consolidation and Preparation

These unaudited condensed interim Consolidated Financial Statements (Consolidated Financial Statements) include the accounts of the Company and its wholly owned subsidiaries. Intercompany transactions and balances have been eliminated.

The comparative information to these Consolidated Financial Statements has been presented in a manner similar to the pooling-of-interests method. The comparative information consists of the results of operations of Hydro One Inc. prior to October 31, 2015, and the consolidated results of operations of Hydro One from the date of incorporation on August 31, 2015 to December 31, 2015, which include the results of Hydro One Inc. subsequent to its acquisition on October 31, 2015. All comparative periods have been combined using historical amounts. In addition, Hydro One's issued and outstanding common shares prior to October 31, 2015 have been retroactively adjusted for the purposes of presentation to reflect the effects of the acquisition of Hydro One Inc. using the exchange ratio established for the acquisition. The Consolidated Financial Statements are referred to as "consolidated" for all periods presented.

Earnings for interim periods may not be indicative of results for the year due to the impact of seasonal weather conditions on customer demand and market pricing.

### Basis of Accounting

These Consolidated Financial Statements are prepared and presented in accordance with United States (US) Generally Accepted Accounting Principles (GAAP) and in Canadian dollars.

The accounting policies applied are consistent with those outlined in Hydro One's annual audited consolidated financial statements for the year ended December 31, 2015, except as described in Note 3, New Accounting Pronouncements - Recently Adopted Accounting Guidance. These Consolidated Financial Statements reflect adjustments, that are, in the opinion of management, necessary to reflect fairly the financial position and results of operations for the respective periods. These Consolidated Financial Statements do not include all disclosures required in the annual financial statements and should be read in conjunction with the 2015 annual audited consolidated financial statements. Certain comparative figures have been reclassified to conform with the current period's presentation.

## 3. NEW ACCOUNTING PRONOUNCEMENTS

The following tables present Accounting Standards Updates (ASUs) issued by the Financial Accounting Standards Board (FASB) that are applicable to Hydro One:

### Recently Adopted Accounting Guidance

| ASU | Date issued | Description | Effective date | Impact on Hydro One |
|---|---|---|---|---|
| 2015-04 | April 2015 | Debt issuance costs are required to be presented on the balance sheet as a direct deduction from the carrying amount of the related debt liability consistent with debt discounts or premiums. | January 1, 2016 | Reclassification of deferred debt issuance costs and net unamortized debt premiums as an offset to long-term debt. Applied retrospectively. (See note 11) |

### Recently Issued Accounting Guidance Not Yet Adopted

| ASU | Date issued | Description | Effective date | Anticipated impact on Hydro One |
|---|---|---|---|---|
| 2016-02 | February 2016 | Lessees are required to recognize the rights and obligations resulting from operating leases as assets (right to use the underlying asset for the term of the lease) and liabilities (obligation to make future lease payments) on the balance sheet. An exemption election is available for short-term leases. | January 1, 2019 | Under assessment |
| 2016-09 | March 2016 | This guidance simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. | January 1, 2017 | Under assessment |
| 2016-10 | April 2016 | This guidance clarifies the identification of performance obligations and the implementation of the licensing guidance with respect to revenue from contracts with customers. | January 1, 2017 | Under assessment |

## 4. BUSINESS COMBINATIONS

### Great Lakes Power Transmission Purchase Agreement

On January 28, 2016, Hydro One Inc. reached an agreement to acquire various entities that own and control Great Lakes Power Transmission LP, an Ontario regulated electricity transmission business operating along the eastern shore of Lake Superior, north and east of Sault Ste. Marie, Ontario from Brookfield Infrastructure, for $222 million in cash, subject to customary adjustments, plus the assumption of approximately $151 million in outstanding indebtedness. The acquisition is pending approval from the Competition Bureau as well as regulatory approval by the Ontario Energy Board (OEB).

## 5. INCOME TAXES

Income taxes / provision for payments in lieu of corporate income taxes (PILs) differs from the amount that would have been recorded using the combined Canadian federal and Ontario statutory income tax rate. The reconciliation between the statutory and the effective tax rates is provided as follows:

| **Three months ended March 31** *(millions of Canadian dollars)* | **2016** | **2015** |
|---|---|---|
| Income taxes / provision for PILs at statutory rate | 66 | 74 |
| Increase (decrease) resulting from: | | |
| Net temporary differences included in amounts charged to customers: | | |
| Capital cost allowance in excess of depreciation and amortization | (14) | (13) |
| Pension contributions in excess of pension expense | (7) | (8) |
| Overheads capitalized for accounting but deducted for tax purposes | (4) | (5) |
| Interest capitalized for accounting but deducted for tax purposes | (5) | (4) |
| Environmental expenditures | (2) | (2) |
| Non-refundable investment tax credits | (1) | (1) |
| Prior year's adjustments | (2) | – |
| Other | 2 | 3 |
| Net temporary differences | (33) | (30) |
| Net permanent differences | – | 1 |
| Total income taxes / provision for PILs | 33 | 45 |
| Effective income tax rate | 13.31% | 16.13% |

## 6. ACCOUNTS RECEIVABLE

The following table shows the details of accounts receivable at March 31, 2016 and December 31, 2015:

| *(millions of Canadian dollars)* | **March 31, 2016** | **December 31, 2015** |
|---|---|---|
| Accounts receivable – billed | 463 | 379 |
| Accounts receivable – unbilled | 431 | 458 |
| Accounts receivable, gross | 894 | 837 |
| Allowance for doubtful accounts | (43) | (61) |
| Accounts receivable, net | 851 | 776 |

The following table shows the movements in the allowance for doubtful accounts for the three months ended March 31, 2016 and year ended December 31, 2015:

| *(millions of Canadian dollars)* | **Three months ended March 31, 2016** | **Year ended December 31, 2015** |
|---|---|---|
| Allowance for doubtful accounts – beginning | (61) | (66) |
| Write-offs | 11 | 37 |
| Change in allowance for doubtful accounts | 7 | (32) |
| Allowance for doubtful accounts – ending | (43) | (61) |

## 7. OTHER CURRENT ASSETS

| *(millions of Canadian dollars)* | **March 31, 2016** | **December 31, 2015** |
|---|---|---|
| Regulatory assets | 46 | 36 |
| Materials and supplies | 20 | 21 |
| Deferred income tax assets | 19 | 19 |
| Prepaid expenses and other assets | 35 | 29 |
| | 120 | 105 |

## 8. PROPERTY, PLANT AND EQUIPMENT

| *(millions of Canadian dollars)* | **March 31, 2016** | **December 31, 2015** |
|---|---|---|
| Property, plant and equipment in service | 26,216 | 26,070 |
| Less: accumulated depreciation | (9,566) | (9,414) |
| | 16,650 | 16,656 |
| Construction in progress | 1,361 | 1,155 |
| Future use land, components and spares | 155 | 157 |
| | 18,166 | 17,968 |

## 9. ACCOUNTS PAYABLE AND OTHER CURRENT LIABILITIES

| *(millions of Canadian dollars)* | **March 31, 2016** | **December 31, 2015** |
|---|---|---|
| Accounts payable | 162 | 155 |
| Accrued liabilities | 595 | 598 |
| Accrued interest | 120 | 96 |
| Regulatory liabilities | 53 | 19 |
| | 930 | 868 |

## 10. OTHER LONG-TERM LIABILITIES

| *(millions of Canadian dollars)* | **March 31, 2016** | **December 31, 2015** |
|---|---|---|
| Post-retirement and post-employment benefit liability *(Note 13)* | 1,580 | 1,560 |
| Pension benefit liability *(Note 13)* | 935 | 952 |
| Environmental liabilities *(Note 14)* | 181 | 185 |
| Asset retirement obligations | 9 | 9 |
| Long-term accounts payable and other liabilities | 17 | 17 |
| | 2,722 | 2,723 |

## 11. DEBT AND CREDIT AGREEMENTS

### Short-Term Notes and Credit Facilities

Hydro One meets its short-term liquidity requirements in part through the issuance of commercial paper under Hydro One Inc.'s Commercial Paper Program which has a maximum authorized amount of $1.5 billion. These short-term notes are denominated in Canadian dollars with varying maturities up to 365 days. The Commercial Paper Program is supported by Hydro One Inc.'s committed revolving credit facilities totalling $2.3 billion. At March 31, 2016, Hydro One Inc. had $955 million in commercial paper borrowings outstanding (December 31, 2015 – $1,491 million).

At March 31, 2016, Hydro One's consolidated committed, unsecured and unused credit facilities totaled $2,550 million, which include Hydro One's credit facilities of $250 million and Hydro One Inc.'s credit facilities of $2.3 billion.

### Long-Term Debt

At March 31, 2016 and December 31, 2015, all of the Company's long-term debt was issued by Hydro One Inc. under Hydro One Inc.'s Medium-Term Note (MTN) Program. The maximum authorized principal amount of notes issuable under this program is $3.5 billion. At March 31, 2016, $2,150 million remained available for issuance until January 2018.

The following table presents Hydro One Inc.'s outstanding long-term debt at March 31, 2016 and December 31, 2015:

| *(millions of Canadian dollars)* | **March 31, 2016** | **December 31, 2015** |
|---|---|---|
| Notes and debentures | 9,623 | 8,723 |
| Add: Net unamortized debt premiums | 16 | 17 |
| Add: Unrealized mark-to-market loss[1] | 1 | 1 |
| Less: Deferred debt issuance costs | (39) | (34) |
| Less: Long-term debt payable within one year | (50) | (500) |
| Long-term debt | 9,551 | 8,207 |

[1] The unrealized mark-to-market loss relates to $50 million of Series 33 notes due 2020. The unrealized mark-to-market loss is offset by a $1 million (2015 – $1 million) unrealized mark-to-market gain on the related fixed-to-floating interest-rate swap agreements, which are accounted for as fair value hedges.

On February 24, 2016, Hydro One Inc. issued the following notes under its MTN Program:

- $500 million notes (MTN Series 34 notes) with a maturity date of February 24, 2021 and a coupon rate of 1.84%;
- $500 million notes (MTN Series 35 notes) with a maturity date of February 24, 2026 and a coupon rate of 2.77%; and
- $350 million notes (MTN Series 36 notes) with a maturity date of February 23, 2046 and a coupon rate of 3.91%.

On March 3, 2016, Hydro One Inc. repaid $450 million of maturing long-term debt notes (MTN Series 10 notes) under its MTN Program.

Principal repayments and related weighted average interest rates are summarized by the number of years to maturity in the following table:

| Years to Maturity | Long-term Debt Principal Repayments *(millions of Canadian dollars)* | Weighted Average Interest Rate *(%)* |
|---|---|---|
| 1 year | 50 | 1.2 |
| 2 years | 600 | 5.2 |
| 3 years | 978 | 2.4 |
| 4 years | – | – |
| 5 years | 1,150 | 2.4 |
| | 2,778 | 3.0 |
| 6 – 10 years | 1,100 | 3.0 |
| Over 10 years | 5,745 | 5.4 |
| | 9,623 | 4.4 |

Interest payment obligations related to long-term debt are summarized by year in the following table:

| Year | Interest Payments *(millions of Canadian dollars)* |
|---|---|
| 2016 | 336 |
| 2017 | 423 |
| 2018 | 392 |
| 2019 | 369 |
| 2020 | 359 |
| | 1,879 |
| 2021-2025 | 1,638 |
| 2026 + | 4,367 |
| | 7,884 |

## 12. FAIR VALUE OF FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

### Non-Derivative Financial Assets and Liabilities

At March 31, 2016 and December 31, 2015, the Company's carrying amounts of cash and cash equivalents, accounts receivable, due from related parties, short-term notes payable, accounts payable, and due to related parties are representative of fair value because of the short-term nature of these instruments.

### Fair Value Measurements of Long-Term Debt

The fair values and carrying values of the Company's long-term debt at March 31, 2016 and December 31, 2015 are as follows:

| | March 31, 2016 | | December 31, 2015 | |
|---|---|---|---|---|
| *(millions of Canadian dollars)* | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Long-term debt | | | | |
| $50 million of MTN Series 33 notes[1] | 51 | 51 | 51 | 51 |
| Other notes and debentures[2] | 9,550 | 11,091 | 8,656 | 9,942 |
| | 9,601 | 11,142 | 8,707 | 9,993 |

[1] The fair value of the $50 million MTN Series 33 notes subject to hedging is primarily based on changes in the present value of future cash flows due to a change in the yield in the swap market for the related swap (hedged risk).

[2] The fair value of other notes and debentures represents the market value of the notes and debentures and is based on unadjusted period-end market prices for the same or similar debt of the same remaining maturities.

### Fair Value Measurements of Derivative Instruments

At March 31, 2016, Hydro One Inc. had an interest-rate swap in the notional amount of $50 million (December 31, 2015 – $50 million) that was used to convert fixed-rate debt to floating-rate debt. This swap is classified as a fair value hedge. Hydro One Inc.'s fair value hedge exposure was equal to about 1% (December 31, 2015 – 1%) of the principal amount of its total long-term debt of $9,623 million (December 31, 2015 – $8,723 million).

### Fair Value Hierarchy

The fair value hierarchy of financial assets and liabilities at March 31, 2016 and December 31, 2015 is as follows:

| **March 31, 2016** *(millions of Canadian dollars)* | **Carrying Value** | **Fair Value** | **Level 1** | **Level 2** | **Level 3** |
|---|---|---|---|---|---|
| **Assets:** | | | | | |
| Cash and cash equivalents | 253 | 253 | 253 | – | – |
| Derivative instruments | | | | | |
| Fair value hedge – interest-rate swap | 1 | 1 | 1 | – | – |
| | 254 | 254 | 254 | – | – |
| **Liabilities:** | | | | | |
| Short-term notes payable | 955 | 955 | 955 | – | – |
| Long-term debt | 9,601 | 11,142 | – | 11,142 | – |
| | 10,556 | 12,097 | 955 | 11,142 | – |

| **December 31, 2015** *(millions of Canadian dollars)* | **Carrying Value** | **Fair Value** | **Level 1** | **Level 2** | **Level 3** |
|---|---|---|---|---|---|
| **Assets:** | | | | | |
| Cash and cash equivalents | 94 | 94 | 94 | – | – |
| Derivative instruments | | | | | |
| Fair value hedge – interest-rate swap | 1 | 1 | 1 | – | – |
| | 95 | 95 | 95 | – | – |
| **Liabilities:** | | | | | |
| Short-term notes payable | 1,491 | 1,491 | 1,491 | – | – |
| Long-term debt | 8,707 | 9,993 | – | 9,993 | – |
| | 10,198 | 11,484 | 1,491 | 9,993 | – |

The fair value of the hedged portion of the long-term debt is primarily based on the present value of future cash flows using a swap yield curve to determine the assumption for interest rates. The fair value of the unhedged portion of the long-term debt is based on unadjusted period-end market prices for the same or similar debt of the same remaining maturities.

There were no significant transfers between any of the fair value levels during the three months ended March 31, 2016 or year ended December 31, 2015.

### Risk Management

Exposure to market risk, credit risk and liquidity risk arises in the normal course of the Company's business.

#### *Market Risk*

Market risk refers primarily to the risk of loss that results from changes in costs, foreign exchange rates and interest rates. The Company is exposed to fluctuations in interest rates as its regulated return on equity is derived using a formulaic approach that takes into account anticipated interest rates, but is not currently exposed to material commodity price risk or material foreign exchange risk.

The Company uses a combination of fixed and variable-rate debt to manage the mix of its debt portfolio. The Company also uses derivative financial instruments to manage interest-rate risk. The Company utilizes interest-rate swaps, which are typically designated as fair value hedges, as a means to manage its interest rate exposure to achieve a lower cost of debt. In addition, the Company may utilize interest-rate derivative instruments to lock in interest-rate levels in anticipation of future financing.

*Fair Value Hedges*
For derivative instruments that are designated and qualify as fair value hedges, the gain or loss on the derivative as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in the Consolidated Statements of Operations and Comprehensive Income. The net unrealized loss (gain) on the hedged debt and the related interest-rate swaps for the three months ended March 31, 2016 and 2015 was not significant.

#### *Credit Risk*

Financial assets create a risk that a counterparty will fail to discharge an obligation, causing a financial loss. At March 31, 2016 and December 31, 2015, there were no significant concentrations of credit risk with respect to any class of financial assets. The Company's revenue is earned from a broad base of customers. As a result, Hydro One did not earn a significant amount of revenue from any single customer. At March 31, 2016 and December 31, 2015, there was no significant accounts receivable balance due from any single customer.

At March 31, 2016, the Company's provision for bad debts was $43 million (December 31, 2015 – $61 million). Adjustments and write-offs were determined on the basis of a review of overdue accounts, taking into consideration historical experience. At March 31, 2016, approximately 6% (December 31, 2015 – 6%) of the Company's net accounts receivable were aged more than 60 days.

Hydro One manages its counterparty credit risk through various techniques including: entering into transactions with highly-rated counterparties; limiting total exposure levels with individual counterparties; entering into master agreements which enable net settlement and the contractual right of offset; and monitoring the financial condition of counterparties. The Company monitors current and forward credit exposure to counterparties both on an individual and an aggregate basis. The Company's credit risk for accounts receivable is limited to the carrying amounts on the Consolidated Balance Sheets.

Derivative financial instruments result in exposure to credit risk since there is a risk of counterparty default. The credit exposure of derivative contracts, before collateral, is represented by the fair value of contracts at the reporting date. At March 31, 2016 and December 31, 2015, the counterparty credit risk exposure on the fair value of these interest-rate swap contracts was not significant. At March 31, 2016, Hydro One's credit exposure for all derivative instruments, and applicable payables and receivables, had a credit rating of investment grade, with one financial institution as the counterparty.

### *Liquidity Risk*

Liquidity risk refers to the Company's ability to meet its financial obligations as they come due. Hydro One meets its short-term liquidity requirements using cash and cash equivalents on hand, funds from operations, the issuance of commercial paper, and the revolving standby facilities. The short-term liquidity under the Commercial Paper Program, and anticipated levels of funds from operations should be sufficient to fund normal operating requirements.

## 13. PENSION AND POST-RETIREMENT AND POST-EMPLOYMENT BENEFITS

Estimated 2016 annual pension plan contributions are approximately $180 million, based on an actuarial valuation as at December 31, 2013 and projected levels of 2016 pensionable earnings. Employer contributions made during the three months ended March 31, 2016 were $46 million (2015 – $46 million).

The following table provides the components of the net periodic benefit costs for the three months ended March 31, 2016 and 2015:

| | Pension Benefits | | Post-Retirement and Post-Employment Benefits | |
|---|---|---|---|---|
| **Three months ended March 31** *(millions of Canadian dollars)* | **2016** | **2015** | **2016** | **2015** |
| Current service cost | 36 | 37 | 11 | 11 |
| Interest cost | 77 | 76 | 17 | 16 |
| Expected return on plan assets, net of expenses[1] | (109) | (102) | – | – |
| Actuarial loss amortization | 24 | 30 | 2 | 3 |
| Net periodic benefit costs | 28 | 41 | 30 | 30 |
| Charged to results of operations[2] | 22 | 19 | 13 | 12 |

[1] The expected long-term rate of return on pension plan assets for the year ending December 31, 2016 is 6.5% (2015 – 6.5%).

[2] The Company follows the cash basis of accounting consistent with the inclusion of pension costs in OEB-approved rates. During the three months ended March 31, 2016, pension costs of $50 million (2015 – $42 million) were attributed to labour, of which $22 million (2015 – $19 million) was charged to operations, and $28 million (2015 – $23 million) was capitalized as part of the cost of property, plant and equipment and intangible assets.

## 14. ENVIRONMENTAL LIABILITIES

Hydro One records a liability for the estimated future expenditures for land assessment and remediation and for the phase-out and destruction of PCB-contaminated mineral oil removed from electrical equipment when it is determined that future environmental remediation expenditures are probable under existing statute or regulation and the amount of the future expenditures can be reasonably estimated. Future expenditures have been discounted using factors ranging from approximately 2.0% to 6.3%, depending on the period over which expenditures are expected to be incurred.

During the three months ended March 31, 2016, total environmental expenditures were $3 million (2015 – $4 million) and interest accretion was $2 million (2015 – $2 million). At March 31, 2016, total environmental liabilities, including the current portion, were $206 million (December 31, 2015 – $207 million).

## 15. SHARE CAPITAL

### Common Shares

The Company is authorized to issue an unlimited number of common shares. At March 31, 2016, the Company had 595,000,000 common shares issued and outstanding.

### Preferred Shares

The Company is authorized to issue an unlimited number of preferred shares, issuable in series. At March 31, 2016 and December 31, 2015, the Company had 16,720,000 Series 1 preferred shares outstanding.

## 16. DIVIDENDS

During the three months ended March 31, 2016, preferred share dividends in the amount of $6 million (2015 – $4 million) and common share dividends in the amount of $202 million (2015 – $25 million) were declared.

## 17. EARNINGS PER SHARE

Basic earnings per common share (EPS) is calculated by dividing net income attributable to common shareholders of Hydro One by the weighted average number of common shares outstanding.

Diluted EPS is calculated by dividing net income attributable to common shareholders of Hydro One by the weighted average number of common shares outstanding adjusted for the effects of potentially dilutive share grant plans, which is calculated using the treasury stock method.

| Three months ended March 31 | 2016 | 2015 |
|---|---|---|
| Net income attributable to common shareholders *(millions of Canadian dollars)* | 208 | 228 |
| Weighted average number of shares | | |
| Basic | 595,000,000 | 477,837,100 |
| Effect of dilutive share grant plans | 1,131,071 | – |
| Diluted | 596,131,071 | 477,837,100 |
| EPS | | |
| Basic | $0.35 | $0.47 |
| Diluted | $0.35 | $0.47 |

### Pro forma Adjusted non-GAAP Basic and Diluted EPS

The following pro forma adjusted non-GAAP basic and diluted EPS has been prepared by management on a supplementary basis which assumes that the total number of common shares outstanding was 595,000,000 during the three months ended March 31, 2016 and 2015. The supplementary pro forma disclosure is used internally by management subsequent to the IPO of Hydro One to assess the Company's performance and is considered useful because it eliminates the impact of the issuance of common shares to the Province prior to the IPO. Prior to the IPO, the Province was the sole shareholder of Hydro One and disclosure of EPS did not provide meaningful information. EPS is considered an important measure and management believes that presenting it for all periods based on the number of outstanding shares on, and subsequent to, the IPO provides users with a basis to evaluate the operations of the Company with comparable companies.

| Three months ended March 31 | 2016 | 2015 |
|---|---|---|
| Net income attributable to common shareholders *(millions of Canadian dollars)* | 208 | 228 |
| Pro forma weighted average number of common shares | | |
| Basic | 595,000,000 | 595,000,000 |
| Effect of dilutive share grant plans | 1,131,071 | – |
| Diluted | 596,131,071 | 595,000,000 |
| Pro forma adjusted non-GAAP EPS | | |
| Basic | $0.35 | $0.38 |
| Diluted | $0.35 | $0.38 |

The above pro forma adjusted non-GAAP basic and diluted EPS does not have any standardized meaning in US GAAP.

## 18. STOCK-BASED COMPENSATION

### Long-term Incentive Plan

On March 31, 2016, the Company granted awards under the Long-term Incentive Plan (LTIP). These awards consist of approximately 124,120 Performance Stock Units (PSUs) and 149,120 Restricted Stock Units (RSUs), all of which are equity settled. The grant date fair value of the awards was $7 million. Due to the timing of the grant of the award, no compensation expense was recognized during the three months ended March 31, 2016. No long-term incentives were awarded during the three months ended March 31, 2015.

## 19. RELATED PARTY TRANSACTIONS

The Province is the majority shareholder of Hydro One. The Independent Electricity System Operator (IESO), Ontario Power Generation Inc. (OPG), Ontario Electricity Financial Corporation (OEFC), the OEB, and Hydro One Brampton Networks Inc. (Hydro One Brampton) are related parties to Hydro One because they are controlled or significantly influenced by the Province.

| | | Three months ended March 31 | |
|---|---|---|---|
| | | **2016** | **2015** |
| **Related Party** | **Transaction** | *(millions of Canadian dollars)* | |
| **Province** | Dividends paid | 176 | 29 |
| **IESO** | Power purchased | 710 | 791 |
| | Revenues for transmission services (based on OEB-approved uniform transmission rates) | 376 | 405 |
| | Distribution revenues related to rural rate protection | 31 | 32 |
| | Distribution revenues related to the supply of electricity to remote northern communities | 8 | 8 |
| | Funding received related to Conservation and Demand Management programs | 7 | 12 |
| **OPG** | Power purchased | 2 | 6 |
| | Revenues related to provision of construction and equipment maintenance services | 1 | 2 |
| | Costs expensed related to the purchase of services | 1 | 1 |
| **OEFC** | Payments in lieu of corporate income taxes | – | 18 |
| | Power purchased from power contracts administered by the OEFC | – | 2 |
| | Indemnification fee paid (terminated effective October 31, 2015) | – | 5 |
| **OEB** | OEB fees | 4 | 3 |
| **Hydro One Brampton** | Revenues from management, administrative and smart meter network services | 1 | – |

Sales to and purchases from related parties are based on the requirements of the OEB's Affiliate Relationships Code. Outstanding balances at period end are interest free and settled in cash.

The amounts due to and from related parties as a result of the transactions referred to above are as follows:

| *(millions of Canadian dollars)* | **March 31, 2016** | **December 31, 2015** |
|---|---|---|
| Due from related parties | 170 | 191 |
| Due to related parties[1] | (136) | (138) |

[1]Included in due to related parties at March 31, 2016 are amounts owing to the IESO in respect of power purchases of $130 million (December 31, 2015 – $134 million).

## 20. CONSOLIDATED STATEMENTS OF CASH FLOWS

The changes in non-cash balances related to operations consist of the following:

| **Three months ended March 31** *(millions of Canadian dollars)* | **2016** | **2015** |
|---|---|---|
| Accounts receivable | (75) | (85) |
| Due from related parties | 21 | 26 |
| Materials and supplies | 1 | (1) |
| Prepaid expenses and other assets | (6) | 1 |
| Accounts payable | 6 | (12) |
| Accrued liabilities | (7) | 22 |
| Due to related parties | (2) | (45) |
| Accrued interest | 24 | 16 |
| Long-term accounts payable and other liabilities | – | (4) |
| Post-retirement and post-employment benefit liability | 20 | 16 |
| | (18) | (66) |

### Capital Expenditures

The following table illustrates the reconciliation between investments in property, plant and equipment and the amount presented in the Consolidated Statements of Cash Flows after accounting for capitalized depreciation and the net change in related accruals:

| **Three months ended March 31** *(millions of Canadian dollars)* | **2016** | **2015** |
|---|---|---|
| Capital investments in property, plant and equipment | (367) | (340) |
| Capitalized depreciation and net change in accruals included in capital investments in property, plant and equipment | 9 | 1 |
| Capital expenditures – property, plant and equipment | (358) | (339) |

The following table illustrates the reconciliation between investments in intangible assets and the amount presented in the Consolidated Statements of Cash Flows after accounting for the net change in related accruals:

| **Three months ended March 31** *(millions of Canadian dollars)* | **2016** | **2015** |
|---|---|---|
| Capital investments in intangible assets | (12) | (5) |
| Net change in accruals included in capital investments in intangible assets | (1) | – |
| Capital expenditures – intangible assets | (13) | (5) |

### Supplementary Information

| **Three months ended March 31** *(millions of Canadian dollars)* | **2016** | **2015** |
|---|---|---|
| Net interest paid | 80 | 85 |
| Income taxes / PILs paid | 9 | 18 |

## 21. CONTINGENCIES

### Legal Proceedings

Hydro One is involved in various lawsuits, claims and regulatory proceedings in the normal course of business. In the opinion of management, the outcome of such matters will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

### Transfer of Assets

The transfer orders by which the Company acquired certain of Ontario Hydro's businesses as of April 1, 1999 did not transfer title to some assets located on Reserves (as defined in the *Indian Act* (Canada)). Currently, the OEFC holds these assets. Under the terms of the transfer orders, the Company is required to manage these assets until it has obtained all consents necessary to complete the transfer of title of these assets to itself. The Company cannot predict the aggregate amount that it may have to pay, either on an annual or one-time basis, to obtain the required consents. If the Company cannot obtain the required consents, the OEFC will continue to hold these assets for an indefinite period of time. If the Company cannot reach a satisfactory settlement, it may have to relocate these assets to other locations at a cost that could be substantial or, in a limited number of cases, to abandon a line and replace it with diesel-generation facilities. The costs relating to these assets could have a material adverse effect on the Company's results of operations if the Company is not able to recover them in future rate orders.

## 22. COMMITMENTS

The following table presents a summary of Hydro One's commitments under leases, outsourcing and other agreements due in the next 5 years and thereafter.

| **March 31, 2016** *(millions of Canadian dollars)* | **Year 1** | **Year 2** | **Year 3** | **Year 4** | **Year 5** | **Thereafter** |
|---|---|---|---|---|---|---|
| Outsourcing agreements | 159 | 135 | 100 | 75 | 2 | 11 |
| Trilliant agreement | 17 | 17 | 17 | 16 | 13 | 6 |
| Operating lease commitments | 11 | 10 | 8 | 5 | 7 | 3 |

Hydro One Inc. currently has outstanding bank letters of credit of $139 million relating to retirement compensation arrangements. Hydro One Inc. also provides prudential support to the IESO in the form of letters of credit. At March 31, 2016, Hydro One Inc. provided a letter of credit to the IESO in the amount of $12 million to meet its current prudential requirements. In addition, Hydro One Inc. provided prudential support to the IESO on behalf of its subsidiaries as required by the IESO's Market Rules, using parental guarantees of $330 million.

## 23. SEGMENTED REPORTING

Hydro One has three reportable segments:

- The Transmission Business, which comprises the transmission of high voltage electricity across the province, interconnecting more than 70 local distribution companies and certain large directly connected industrial customers throughout the Ontario electricity grid;
- The Distribution Business, which comprises the delivery of electricity to end customers and certain other municipal electricity distributors; and
- Other Business, which includes certain corporate activities and the operations of the Company's telecommunications business.

The designation of segments has been based on a combination of regulatory status and the nature of the services provided. Operating segments of the Company are determined based on information used by the chief operating decision maker in deciding how to allocate resources and evaluate the performance of each of the segments. The Company evaluates segment performance based on income before financing charges and income taxes from continuing operations (excluding certain allocated corporate governance costs).

Segment information is as follows:

| **Three months ended March 31, 2016** *(millions of Canadian dollars)* | **Transmission** | **Distribution** | **Other** | **Consolidated** |
|---|---|---|---|---|
| Revenues | 386 | 1,286 | 14 | 1,686 |
| Purchased power | – | 896 | – | 896 |
| Operation, maintenance and administration | 96 | 141 | 19 | 256 |
| Depreciation and amortization | 95 | 93 | 2 | 190 |
| **Income (loss) before financing charges and income taxes** | 195 | 156 | (7) | 344 |
| **Capital investments** | 235 | 143 | 1 | 379 |

| **Three months ended March 31, 2015** *(millions of Canadian dollars)* | **Transmission** | **Distribution** | **Other** | **Consolidated** |
|---|---|---|---|---|
| Revenues | 406 | 1,389 | 13 | 1,808 |
| Purchased power | – | 970 | – | 970 |
| Operation, maintenance and administration | 99 | 166 | 13 | 278 |
| Depreciation and amortization | 94 | 92 | 1 | 187 |
| **Income (loss) before financing charges and income taxes** | 213 | 161 | (1) | 373 |
| **Capital investments** | 211 | 132 | 2 | 345 |

**Total Assets by Segment:**

| *(millions of Canadian dollars)* | **March 31, 2016** | **December 31, 2015** |
|---|---|---|
| Transmission | 12,158 | 12,045 |
| Distribution | 9,195 | 9,200 |
| Other | 3,164 | 3,049 |
| **Total assets** | 24,517 | 24,294 |

All revenues, costs and assets, as the case may be, are earned, incurred or held in Canada.

## 24. SUBSEQUENT EVENTS

### Secondary Common Share Offering

On April 14, 2016, Hydro One announced the closing of a secondary offering (Offering) by the Province, on a bought deal basis, of 72,434,800 common shares of Hydro One on the Toronto Stock Exchange. In addition, the Province granted the underwriters an over-allotment option to purchase up to an additional 10,865,200 common shares of Hydro One which was fully exercised and closed on April 29, 2016. Following completion of the Offering and the over-allotment, the Province directly holds approximately 70.1% of Hydro One's total issued and outstanding common shares. This non-dilutive secondary offering increased the public float of Hydro One to approximately 29.9% or 178.2 million common shares. Hydro One did not receive any of the proceeds from the sale of its common shares by the Province.

### Dividends

On May 5, 2016, preferred share dividends in the amount of $4 million and common share dividends in the amount of $125 million ($0.21 per common share) were declared.