# MANITOBA HYDRO
# DEBT MANAGEMENT STRATEGY

2009/10 - 2010/11

Finance & Administration
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## 1.0 Purpose of this Document

The financing of important core infrastructure projects through long term debt is a central and necessary function of crown-owned utilities in Canada, including Manitoba Hydro. As a Crown Corporation owned by the Province of Manitoba, Manitoba Hydro does not have access to share capital as a source of funds. Therefore, in order to finance its growth, Manitoba Hydro must rely on debt as its primary source of external capital.

As with most energy utilities, debt is an essential component of Manitoba Hydro's corporate capital structure. This *Debt Management Strategy* document provides information on the historical build-up of the Corporation's investment in fixed assets and the corresponding increase in Manitoba Hydro's long term debt. The document also summarizes the statutes that govern the Corporation's financing programs, and outlines the debt management objectives that will address the Corporation's borrowing requirements for the 2009/10 and 2010/11 fiscal years.

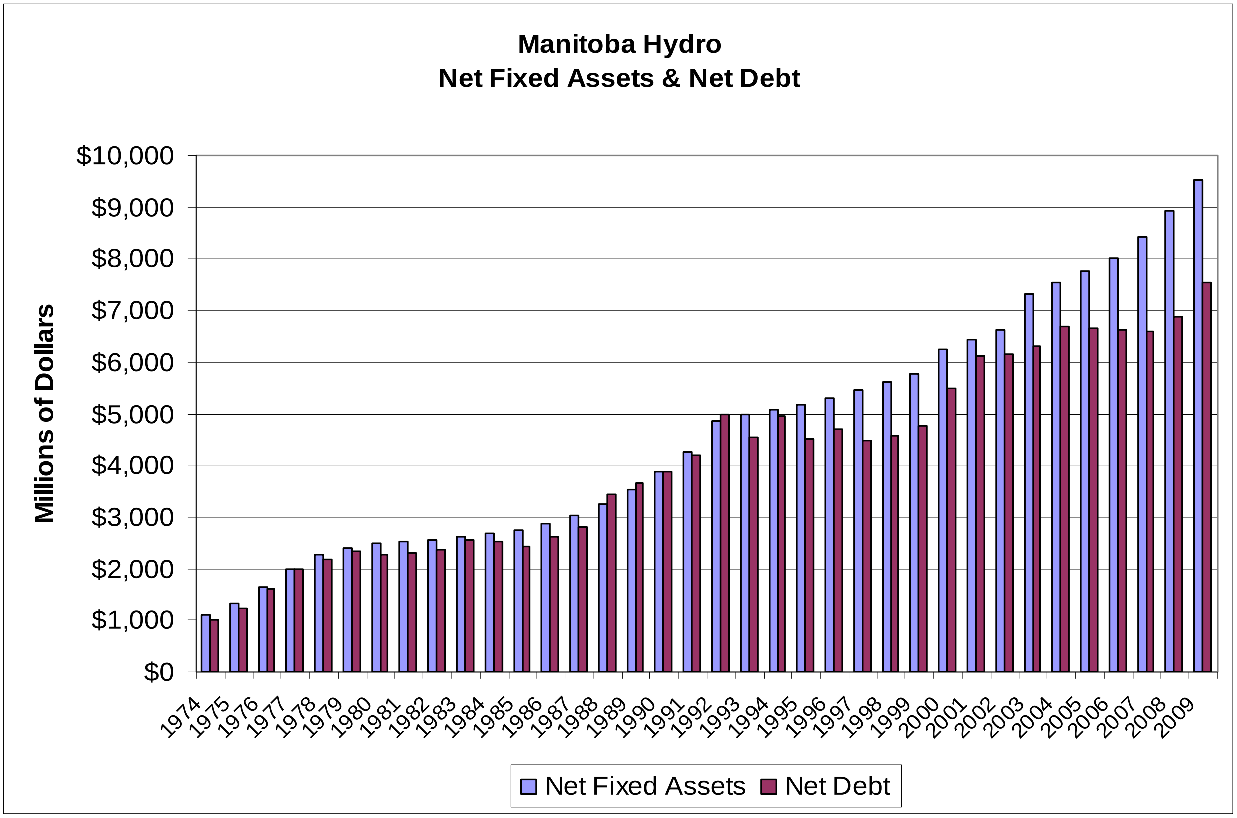
## 2.0 Overview of Manitoba Hydro's Capital Program

Debt financing has been beneficial for Manitoba Hydro and its ratepayers. It has fueled the growth of the Corporation from the early days of farm electrification and the development of the Winnipeg River generation system, through the years of development of the Nelson River generation and transmission system, right up to the current development and construction of the Wuskwatim Generating station in northern Manitoba. None of this would have been possible without debt financing.

A significant portion of the annual capital construction program is provided from cash generated from operations. Utilizing funds from operations reduces the amount that would otherwise need to be borrowed each year by the Corporation. To ensure that borrowing is kept to the minimum required levels, Manitoba Hydro has set a capital coverage ratio of greater than 1.20 (except for major new generation and transmission). The capital coverage ratio indicates the extent to which cash generated internally is sufficient to fund base capital construction expenditures without additional external financing.

The Corporation's net income of $298 million in 2008/09 improved Manitoba Hydro's financial strength and enabled Manitoba Hydro to achieve its 75:25 debt to equity target ratio at March 31, 2009. The favourable hydraulic generation conditions experienced in 2008/09 have continued into 2009/10. However, the economic downturn has exerted downward pressure on export prices and net income, and this will continue until the economy begins to recover.

The following chart illustrates the growth in net fixed assets and net long term debt that has occurred over the past 35 years. While debt has grown to approximately $7.5 billion as at March 31, 2009, the corresponding investment in generation, transmission, distribution and other assets has grown at a much greater pace to a net book value of approximately $9.5 billion at March 31, 2009. The current market or replacement value of Manitoba Hydro's assets is many multiples of the net book value.




In managing Manitoba Hydro's debt portfolio, the Corporation works closely with the Province of Manitoba to structure the optimum balance of short and long term debt, denominated in both Canadian and US currencies. The Province of Manitoba administers the borrowing programs and investment activities on behalf of Manitoba Hydro by transacting within the financial markets and advancing the funds to Manitoba Hydro. Administering the borrowing program through the Provincial Government provides lower cost financing to Manitoba Hydro due to the province's strong credit rating and its ability to borrow at lower interest rates.

## 3.0 Borrowing Authority of Manitoba Hydro

Manitoba Hydro's authority to issue debt for new capital borrowing purposes is provided for through The Manitoba Hydro Act, The Loan Act, and The Financial Administration Act. The following sections provide a synopsis of the authority received by Manitoba Hydro through this legislation.

### 3.1 The Manitoba Hydro Act

The Manitoba Hydro Act grants the following powers to the Corporation for issuing debt in the name of the Manitoba Hydro Electric Board:

1. **Temporary Borrowing Authority**
The principal amount of short term promissory notes outstanding at any one time shall not exceed in the aggregate the sum of $500 million in Canadian and/or United States, and/or equivalent Canadian funds in other foreign currencies at the time of issue.

2. **Government Guarantee**
The debt of the Corporation may, subject to the Corporation's request and approval, be unconditionally guaranteed as to principal and interest, if any, by the Government of Manitoba.

3. **Power of the Corporation to Borrow and Issue Securities**
The Corporation may raise money by way of loan, notes, bonds and debentures in the name of The Manitoba Hydro-Electric Board subject to the approval of the Lieutenant Governor in Council for purposes provided in the Manitoba Hydro Act or to refund any loan or advance previously made by the Corporation.

   Borrowing authority, under Section 35 of the Manitoba Hydro Act or any other act, will treat Canadian and US borrowings on a one for one par value basis.

   Borrowing authority, under Section 35 of the Manitoba Hydro Act, will be abated for the Canadian dollar equivalent using the nominal rate of exchange when the loan is denominated in a currency other than Canadian or US dollars.

## 3.2 The Loan Act

The Loan Act is approved each year and grants Manitoba Hydro borrowing authority to meet the Corporation's projected financing requirements. Authority granted under the Loan Act is for new investment requirements. Refunding authority to refinance maturing long term debt is provided through the Financial Administration Act.

## 3.3 The Financial Administration Act

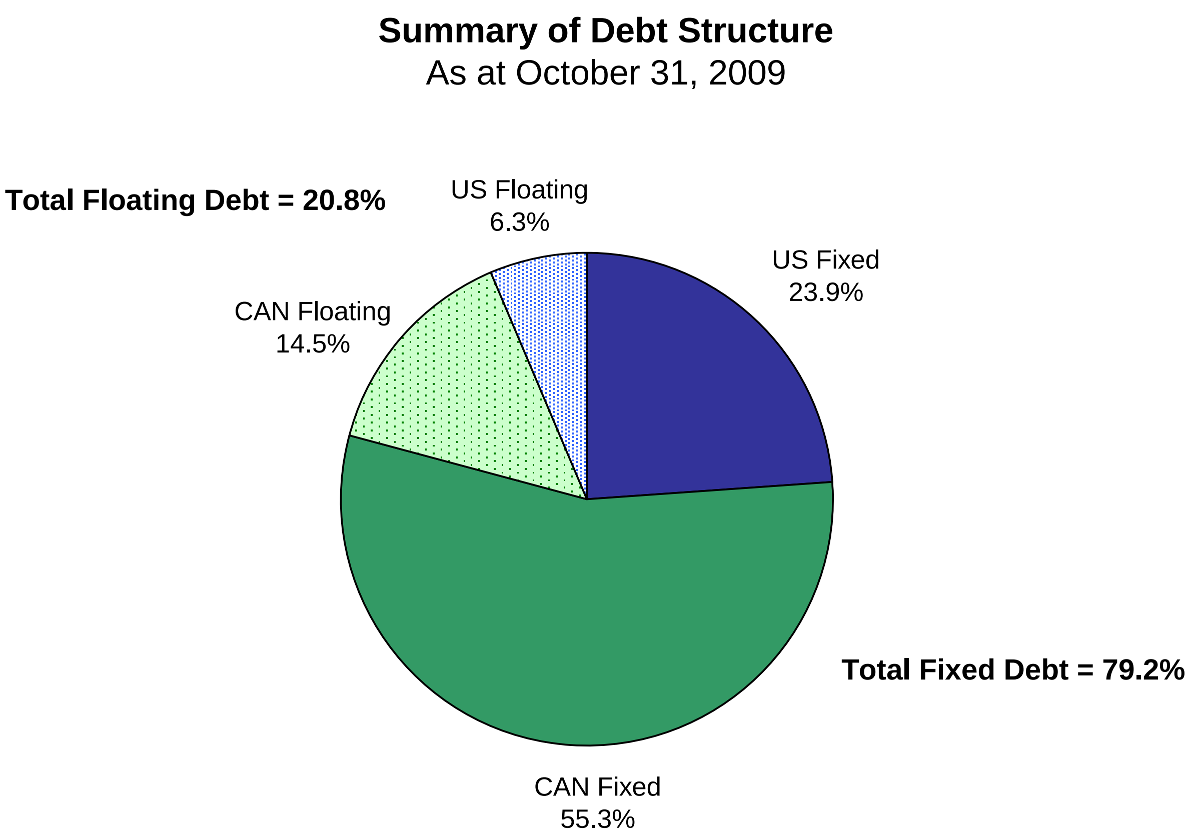
The Financial Administration Act authorizes the Minister of Finance to borrow money for any purpose authorized by any Act of the Legislature or for the payment, refunding, refinancing or renewal, from time to time, of the whole or any part of any loan made or provincial securities issued under any Act.

# 4.0 Debt Management Objectives

Manitoba Hydro manages its level of outstanding debt to achieve a capital structure with the appropriate balance between debt and equity. The Manitoba Hydro-Electric Board has approved a minimum debt to equity ratio of 75:25 as the optimal balance for the Corporation. This capital structure has also been reviewed and accepted as reasonable by the Public Utilities Board.

Manitoba Hydro's fundamental debt management objective is to provide stable, low-cost funding to meet the financial obligations and liquidity needs of the Corporation. Manitoba Hydro continually monitors the interest rate environment and acts to secure stable, low-cost financing with terms to maturity that meet investor appetite and fit the Corporation's debt maturity schedule.

Manitoba Hydro recently commissioned a study regarding the Corporation's optimal mix of fixed versus floating interest rate debt. According to relevant business and market factors, and based on an asset/ liability management framework, Manitoba Hydro's optimal range of floating rate debt is 14 - 27% of the debt portfolio. A summary of Manitoba Hydro's debt portfolio as at October 31, 2009 is as follows:




Manitoba Hydro operates as a going concern through the construction of facilities to produce and distribute energy and energy-related services to Manitoba consumers, and to support profitable extra-provincial electricity sales. The debt financing used to fund these revenue producing assets is viewed to be self-supported as evidenced by the investment grade credit ratings that the Corporation and Province receive on their short and long term debt from the various rating agencies such as Dominion Bond Rating Service, Moody's Investors Service, and Standard & Poors.

In order to maintain the self-supported nature of the Corporation's debt obligations and the attractive financing rates associated with the Corporation's debt, Manitoba Hydro places significant emphasis on maintaining the following financial targets:

**Interest Coverage** – Maintain an annual gross interest coverage ratio greater than 1.20. The interest coverage ratio indicates the extent to which net income is sufficient to pay gross interest on debt, and represents net income plus interest on debt divided by interest on debt.

**Capital Coverage** – Maintain a capital coverage ratio of greater than 1.20. The capital coverage ratio indicates the extent to which cash generated internally is sufficient to fund capital construction expenditures without additional external financing, and represents internally generated funds divided by capital construction expenditures (excluding major new generation and transmission projects).

**Debt/Equity** – Maintain a minimum debt/equity ratio of 75:25. The debt to equity ratio indicates the relative percentage of assets financed through debt versus equity.

**Note**: Financial targets may not be maintained during years of major investments in the generation and transmission system.

## 5.0 2010 Loan Act Authority

Incremental Loan Act Authority of $555 million is required for 2010/11 and 2011/12 as follows:

| | | (millions) |
|---|---|---|
| Projected Loan Act Authority Available March 31, 2010 (net) | | $629 |
| Add: | Projected Internally Generated Funds 2010/11 | 446 |
| | | $1,075 |
| Deduct: | Projected Capital Expenditures 2010/11 | $1,085 |
| | Sinking Fund Requirement | 99 |
| | Capital Bridging Requirements 2011/12 | 446 |
| | | $1,630 |
| **Incremental Loan Act Authority Required** | | **$555** |