



An **ATCO** Company

CU INC.

INTERIM CONSOLIDATED FINANCIAL
STATEMENTS

(UNAUDITED)

FOR THE THREE MONTHS ENDED MARCH 31, 2018

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CONSOLIDATED STATEMENT OF EARNINGS

| <i>(millions of Canadian Dollars)</i> | Note | Three Months Ended March 31 | |
|--|------|--------------------------------|-------|
| | | 2018 | 2017 |
| Revenues | | | |
| Rendering of services | 5 | 751 | 775 |
| Costs and expenses | | | |
| Salaries, wages and benefits | | (51) | (55) |
| Energy transmission and transportation | | (44) | (54) |
| Plant and equipment maintenance | | (34) | (39) |
| Fuel costs | | (5) | (4) |
| Purchased power | | (23) | (22) |
| Depreciation and amortization | | (122) | (119) |
| Franchise fees | | (79) | (83) |
| Property and other taxes | | (18) | (19) |
| Other | | (58) | (55) |
| | | (434) | (450) |
| Operating profit | | 317 | 325 |
| Interest income | | 4 | 5 |
| Interest expense | | (89) | (89) |
| Net finance costs | | (85) | (84) |
| Earnings before income taxes | | 232 | 241 |
| Income taxes | | (63) | (66) |
| Earnings for the period | | 169 | 175 |

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

| <i>(millions of Canadian Dollars)</i> | Three Months Ended March 31 | |
|--|--------------------------------|------|
| | 2018 | 2017 |
| Earnings for the period | 169 | 175 |
| Other comprehensive loss, net of income taxes | | |
| Items that will not be reclassified to earnings: | | |
| Re-measurement of retirement benefits ⁽¹⁾ | - | (3) |
| Comprehensive income for the period | 169 | 172 |

(1) Net of income taxes of nil for the three months ended March 31, 2018 (2017 - \$1 million).

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEET

| | | March 31 | December 31 |
|---|------|---------------|-------------|
| <i>(millions of Canadian Dollars)</i> | Note | 2018 | 2017 |
| ASSETS | | | |
| Current assets | | | |
| Cash | | 67 | 29 |
| Accounts receivable and contract assets | | 358 | 350 |
| Accounts receivable from parent and affiliate companies | | 26 | 44 |
| Inventories | | 32 | 25 |
| Prepaid expenses and other current assets | | 20 | 20 |
| | | 503 | 468 |
| Non-current assets | | | |
| Property, plant and equipment | 6 | 14,741 | 14,631 |
| Intangibles | | 524 | 521 |
| Long-term advances to affiliate company | | 130 | 130 |
| Other assets | | 13 | 15 |
| Total assets | | 15,911 | 15,765 |
| LIABILITIES | | | |
| Current liabilities | | | |
| Bank indebtedness | | – | 3 |
| Accounts payable and accrued liabilities | | 466 | 461 |
| Accounts payable to parent and affiliate companies | | 17 | 41 |
| Other current liabilities | | 18 | 19 |
| Long-term debt | | 180 | – |
| | | 681 | 524 |
| Non-current liabilities | | | |
| Deferred income tax liabilities | | 1,243 | 1,200 |
| Retirement benefit obligations | | 152 | 152 |
| Deferred revenues | | 1,689 | 1,675 |
| Other liabilities | | 5 | 5 |
| Long-term debt | | 7,388 | 7,567 |
| Total liabilities | | 11,158 | 11,123 |
| EQUITY | | | |
| Equity preferred shares | | 187 | 187 |
| Equity preferred shares to parent company | | 79 | 79 |
| Class A and Class B share owner's equity | | | |
| Class A and Class B shares | | 1,056 | 1,056 |
| Retained earnings | | 3,431 | 3,320 |
| | | 4,487 | 4,376 |
| Total equity | | 4,753 | 4,642 |
| Total liabilities and equity | | 15,911 | 15,765 |

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

| <i>(millions of Canadian Dollars)</i> | Note | Class A and Class B Shares | Equity Preferred Shares | Retained Earnings | Accumulated Other Comprehensive Income | Total Equity |
|---|------|-------------------------------|-------------------------------|----------------------|---|-----------------|
| December 31, 2016 | | 1,056 | 266 | 3,163 | – | 4,485 |
| Earnings for the period | | – | – | 175 | – | 175 |
| Other comprehensive loss | | – | – | – | (3) | (3) |
| Losses on retirement benefits transferred to retained earnings | | – | – | (3) | 3 | – |
| Dividends | 7 | – | – | (3) | – | (3) |
| March 31, 2017 | | 1,056 | 266 | 3,332 | – | 4,654 |
| December 31, 2017 | | 1,056 | 266 | 3,320 | – | 4,642 |
| Earnings for the period | | – | – | 169 | – | 169 |
| Dividends | 7,8 | – | – | (58) | – | (58) |
| March 31, 2018 | | 1,056 | 266 | 3,431 | – | 4,753 |

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

CONSOLIDATED STATEMENT OF CASH FLOW

| <i>(millions of Canadian Dollars)</i> | Note | Three Months Ended March 31 | |
|---|-------------|--|-------------|
| | | 2018 | 2017 |
| Operating activities | | | |
| Earnings for the period | | 169 | 175 |
| Adjustments to reconcile earnings to cash flows from operating activities | 9 | 278 | 265 |
| Changes in non-cash working capital | | (9) | 86 |
| Cash flows from operating activities | | 438 | 526 |
| Investing activities | | | |
| Additions to property, plant and equipment | | (217) | (188) |
| Additions to intangibles | | (13) | (14) |
| Changes in non-cash working capital | | (30) | (22) |
| Other | | 1 | - |
| Cash flows used in investing activities | | (259) | (224) |
| Financing activities | | | |
| Dividends paid on equity preferred shares | 7 | (3) | (3) |
| Dividends paid to Class A and Class B share owner | 8 | (55) | - |
| Interest paid | | (82) | (83) |
| Interest received from affiliate company | | 2 | 2 |
| Cash flows used in financing activities | | (138) | (84) |
| Increase in cash position | | 41 | 218 |
| Beginning of period | | 26 | 24 |
| End of period | 9 | 67 | 242 |

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

MARCH 31, 2018

(Tabular amounts in millions of Canadian Dollars, except as otherwise noted)

1. THE COMPANY AND ITS OPERATIONS

CU Inc. was incorporated under the laws of Canada and its debt and equity preferred shares are listed on the Toronto Stock Exchange. Its head office and registered office is at 4th Floor, West Building, 5302 Forand Street SW, Calgary, Alberta T3E 8B4. The Company is controlled by Canadian Utilities Limited, which in turn is principally controlled by ATCO Ltd. and its controlling share owner, the Southern family.

CU Inc. is engaged in the following business activities:

- Electricity (electricity distribution, transmission and infrastructure development); and
- Pipelines & Liquids (natural gas transmission, distribution and infrastructure development).

The unaudited interim consolidated financial statements include the accounts of CU Inc. and its subsidiaries (the Company).

2. BASIS OF PRESENTATION

STATEMENT OF COMPLIANCE

The unaudited interim consolidated financial statements are prepared according to International Accounting Standard (IAS) 34 Interim Financial Reporting using accounting policies consistent with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board. They do not include all the disclosures required in annual consolidated financial statements and should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2017, prepared according to IFRS.

The unaudited interim consolidated financial statements are prepared following the same accounting policies used in the Company's most recent annual consolidated financial statements, except for the change in accounting policies described in Note 3 and income taxes. In interim periods, income taxes are accrued using an estimate of the annualized effective tax rate applied to year-to-date earnings.

The unaudited interim consolidated financial statements were authorized for issue by the Audit Committee, on behalf of the Board of Directors, on April 25, 2018.

BASIS OF MEASUREMENT

The unaudited interim consolidated financial statements are prepared on a historic cost basis, except for retirement benefit obligations and cash-settled share-based compensation liabilities which are carried at remeasured amounts or fair value.

Revenues, earnings and adjusted earnings for any quarter are not necessarily indicative of operations on an annual basis. Quarterly financial results may be affected by the seasonal nature of the Company's operations and the timing of utility rate decisions.

3. CHANGE IN ACCOUNTING POLICIES

FINANCIAL INSTRUMENTS CREDIT LOSSES

The Company adopted the final component of IFRS 9 Financial Instruments, Impairments, on January 1, 2018. This component includes a new expected credit loss model. The new model takes into account an expectation of future events by estimating credit losses based on assessment of the counterparty credit risk. The change results in earlier recognition of bad debt expense. For accounts receivable and contract assets, the Company estimates credit loss allowances at initial recognition and throughout the life of the receivable.

Impact of adoption of IFRS 9 on consolidated financial statements

To determine the amount of expected credit losses, the Company used default and recoverability probabilities. At January 1, 2018 the total credit loss provision was less than a million, which was determined based on third party average default and recoverability probabilities. There was no credit loss provision recorded on adoption of IFRS 9.

The expected credit losses determined based on third party average default and recoverability probabilities, for respective credit ratings are as follows:

| January 1, 2018 (Millions of Canadian Dollars) | Credit Quality | | | Total |
|---|---------------------|----------------------|--------------------------------------|-------|
| | High (AA to AAA) | Medium (BBB to A) | Low ⁽²⁾ (BB and below) | |
| Expected loss rate | 0% - 0.03% | 0.05% - 0.26% | 0.36% - 1.05% | |
| Net Exposure ⁽¹⁾ | 19 | 88 | 65 | 172 |
| Loss allowance | - | - | - | - |

(1) Net exposure is gross receivables less collateral consideration received from the customer.

(2) For receivables from counterparties that do not have third party credit ratings, the Company used its best estimates to approximate their credit quality.

REVENUE RECOGNITION

The Company adopted IFRS 15 *Revenue from Contracts with Customers* on January 1, 2018, using the full retrospective transition method. Under the full retrospective transition method, the comparative figures for 2017 in the Company's unaudited interim consolidated financial statements are restated. Certain practical expedients have been applied.

The Company enters into contracts that include various goods and services promised to the customer. Determining whether the goods and services are considered distinct performance obligations may require significant judgment. Revenue is allocated to the respective performance obligations based on relative transaction prices, and is recognized as goods and services are delivered to the customer. Revenue is measured as the amount of consideration expected to be received in exchange for the goods transferred or services delivered. The amount of revenue recognized reflects the time value of money where a significant financing component has been identified.

Contract modifications are accounted for prospectively or as a cumulative catch-up adjustment depending on the nature of the change.

Where the amount of goods and services delivered to the customer corresponds directly to the amount invoiced, the Company recognizes revenue equal to what it has the right to invoice.

Where the Company arranges for another party to provide a specified good or service (that is, it does not control the specified good or service provided by another party before that good or service is transferred to the customer), only revenues net of payments to the other party for the goods or services provided are recognized.

Non-cash considerations received from the Company's customers are included in the amount of revenue recognized and measured at fair value.

Costs incurred directly to obtain or fulfill a contract are capitalized and amortized to expense over the life of the contract.

The Company makes judgments with respect to: determining whether the promised goods and services are considered distinct performance obligations by considering the relationship of such promised goods and services; allocating the transaction price for each distinct performance obligation identified through stand-alone selling price;

evaluating when a customer obtains controls of the goods or service promised; and evaluating whether the Company acts as principal or agent on certain flow-through charges to customers.

Electricity and natural gas transmission

Revenue from electricity and natural gas transmission services is recognized when service is provided to customers and is measured in proportion to the amount it has the right to invoice under the contract.

Customer contributions for extensions to plant are included in deferred revenues and recognized as revenue over the life of the related asset.

Electricity and natural gas distribution

Revenue from distribution of electricity and natural gas is recognized when the services are provided to the customer based on metered consumption, which is adjusted periodically to reflect differences between estimated and actual consumption. Distribution of regulated and non-regulated electricity and natural gas is based on tariff-approved rates established by Alberta Electric Systems Operator and Natural Gas Exchange and rates stipulated in the contracts, respectively. The Company recognizes revenue in an amount that corresponds directly with the services delivered and the amount invoiced.

Franchise fees

Municipal governments charge franchise fees to the utilities in Canada for the exclusive right to provide service in their community. These costs are charged to customers through rates approved by the regulator. Franchise fees do not represent a separate performance obligation to a customer and are recovered through utilities transmission and distribution prices. The recovery is part of the provision of continuous electricity and natural gas transmission and distribution service performance obligation. Franchise fees invoiced to customers are recognized as revenues.

Practical expedients

Effective January 1, 2017, the IFRS 15 transition date, the Company elected to use the following practical expedients:

- (i). Information on the remaining performance obligations that have original expected duration of one year or less is not disclosed;
- (ii). For periods presented before January 1, 2018, the IFRS 15 adoption date, the information regarding the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the Company expects to recognize this amount as revenue, are not disclosed;
- (iii). Costs to obtain or fulfill a contract with an amortization period of less than a year have been expensed as incurred;
- (iv). Where the Company has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the Company's performance to date, revenue is recognized in the amount to which the Company has a right to invoice. Such performance obligations include:
 - Provision of continuous distribution of electricity service;
 - Provision of continuous distribution of natural gas service;
 - Provision of transmission of electricity service; and
 - Provision of transmission of natural gas service.

IMPACT OF CHANGES IN ACCOUNTING POLICIES

As the Company has utilized the practical expedients noted above there was no impact on the prior year consolidated statement of earnings, balance sheet, statement of changes in equity and statement of cash flow.

4. SEGMENTED INFORMATION

SEGMENTED RESULTS

Results by operating segment for the three months ended March 31 are shown below.

| 2018 | | | | | |
|-------------------------------------|---------------|------------------------|----------------------|------------------------------|---------------|
| 2017 | Electricity | Pipelines & Liquids | Corporate & Other | Intersegment Eliminations | Consolidated |
| Revenues | 335 | 416 | - | - | 751 |
| | 338 | 437 | - | - | 775 |
| Operating expenses ⁽¹⁾ | (119) | (193) | - | - | (312) |
| | (127) | (204) | - | - | (331) |
| Depreciation and amortization | (76) | (46) | - | - | (122) |
| | (75) | (44) | - | - | (119) |
| Net finance costs | (55) | (30) | - | - | (85) |
| | (56) | (28) | - | - | (84) |
| Earnings before income taxes | 85 | 147 | - | - | 232 |
| | 80 | 161 | - | - | 241 |
| Income taxes | (23) | (40) | - | - | (63) |
| | (22) | (44) | - | - | (66) |
| Earnings for the period | 62 | 107 | - | - | 169 |
| | 58 | 117 | - | - | 175 |
| Adjusted earnings | 73 | 85 | - | - | 158 |
| | 95 | 98 | - | - | 193 |
| Total assets ⁽²⁾ | 10,014 | 5,822 | 138 | (63) | 15,911 |
| | 9,952 | 5,685 | 138 | (10) | 15,765 |
| Capital expenditures ⁽³⁾ | 115 | 119 | - | - | 234 |
| | 96 | 110 | - | - | 206 |

(1) Includes total costs and expenses, excluding depreciation and amortization expense.

(2) 2017 comparatives are at December 31, 2017.

(3) Includes additions to property, plant and equipment and intangibles and \$4 million of interest capitalized during construction for the three months ended March 31, 2018 (2017 - \$4 million).

ADJUSTED EARNINGS

Adjusted earnings are earnings for the period after adjusting for:

- the timing of revenues and expenses for rate-regulated activities,
- dividends on equity preferred shares of the Company,
- one-time gains and losses,
- significant impairments, and
- items that are not in the normal course of business or a result of day-to-day operations.

Adjusted earnings are a key measure of segment earnings used by the Chief Operating Decision Maker (CODM) to assess segment performance and allocate resources. Other accounts in the consolidated financial statements have not been adjusted as they are not used by the CODM for those purposes.

The reconciliation of adjusted earnings and earnings for the three months ended March 31 is shown below.

| 2018 | | | | | |
|--|-------------|------------------------|----------------------|------------------------------|--------------|
| 2017 | Electricity | Pipelines & Liquids | Corporate & Other | Intersegment Eliminations | Consolidated |
| Adjusted earnings | 73 | 85 | – | – | 158 |
| | 95 | 98 | – | – | 193 |
| Rate-regulated activities | (13) | 21 | – | – | 8 |
| | (39) | 18 | – | – | (21) |
| Dividends on equity preferred shares of the Company | 2 | 1 | – | – | 3 |
| | 2 | 1 | – | – | 3 |
| Earnings for the period | 62 | 107 | – | – | 169 |
| | 58 | 117 | – | – | 175 |

Rate-regulated activities

ATCO Electric and its subsidiaries, ATCO Electric Yukon, Northland Utilities (NWT) and Northland Utilities (Yellowknife), as well as ATCO Gas and ATCO Pipelines are collectively referred to in the consolidated financial statements as utilities.

There is currently no specific guidance under IFRS for rate-regulated entities that the Company is eligible to adopt. In the absence of this guidance, the utilities do not recognize assets and liabilities from rate-regulated activities as may be directed by regulatory decisions. Instead, the utilities recognize revenues in earnings when amounts are billed to customers, consistent with the regulator-approved rate design. Operating costs and expenses are recorded when incurred. Costs incurred in constructing an asset that meet the asset recognition criteria are included in the related property, plant and equipment or intangible asset.

The Company uses standards issued by the Financial Accounting Standards Board (FASB) in the United States as another source of generally accepted accounting principles to account for rate-regulated activities in its internal reporting provided to the CODM. The CODM believes that earnings presented in accordance with the FASB standards are a better representation of the operating results of the Company's rate-regulated activities. Therefore, the Company presents adjusted earnings as part of its segmented disclosures on this basis. Rate-regulated accounting (RRA) standards impact the timing of how certain revenues and expenses are recognized when compared to non-rate regulated activities, to appropriately reflect the economic impact of a regulators' decisions on revenues.

Rate-regulated accounting differs from IFRS in the following ways:

| Timing Adjustment | Items | RRA Treatment | IFRS Treatment |
|---|---|--|--|
| 1. Additional revenues billed in current period | Future removal and site restoration costs, impact of colder temperatures. | The Company defers the recognition of cash received in advance of future expenditures. | The Company recognizes revenues when amounts are billed to customers and costs when they are incurred. |
| 2. Revenues to be billed in future periods | Deferred income taxes. | The Company recognizes revenues associated with recoverable costs in advance of future billings to customers. | The Company recognizes costs when they are incurred, but does not recognize their recovery until customer rates are changed and amounts are collected through future billings. |
| 3. Regulatory decisions received | Regulatory decisions received which relate to current and prior periods. | The Company recognizes the earnings from a regulatory decision pertaining to current and prior periods when the decision is received. | The Company does not recognize earnings from a regulatory decision when it is received as regulatory assets and liabilities are not recorded under IFRS. |
| 4. Settlement of regulatory decisions and other items | Settlement of amounts receivable or payable to customers and other items. | The Company recognizes the amount receivable or payable to customers as a reduction in its regulatory assets and liabilities when collected or refunded through future billings. | The Company recognizes earnings when customer rates are changed and amounts are recovered or refunded to customers through future billings. |

The significant timing adjustments as a result of the differences between rate-regulated accounting and IFRS are as follows:

| | 2018 | 2017 |
|--|------|------|
| <i>Additional revenues billed in current period</i> | | |
| Future removal and site restoration costs ⁽¹⁾ | 19 | 19 |
| Impact of colder temperatures ⁽²⁾ | 12 | - |
| <i>Revenues to be billed in future periods</i> | | |
| Deferred income taxes ⁽³⁾ | (33) | (29) |
| <i>Settlement of regulatory decisions and other items ⁽⁴⁾</i> | 10 | (11) |
| | 8 | (21) |

(1) Removal and site restoration costs are billed to customers over the estimated useful life of the related assets based on forecast costs to be incurred in future periods.

(2) ATCO Gas' customer rates are based on a forecast of normal temperatures. Fluctuations in temperatures may result in more or less revenue being recovered from customers than forecast. Revenues above or below the normal in the current period are refunded to or recovered from customers in future periods.

(3) Income taxes are billed to customers when paid by the Company.

(4) Includes Performance Based Regulation (PBR) interim rate accrual of \$9 million. Starting January 2018, natural gas distribution and electric distribution commenced a new PBR period. New rates came into effect April 1st, 2018, which will reverse the PBR interim rate accrual during 2018.

5. REVENUES

The Company disaggregates revenues from contracts with customers based on the revenue streams of the operating segments. Disaggregation of revenues by operating segment and revenue streams for the three months ended March 31 are shown below:

| 2018 | | | | |
|------------------------------|-------------|---------------------|-------------------|------------|
| 2017 | Electricity | Pipelines & Liquids | Corporate & Other | Total |
| Revenue Streams | | | | |
| Rendering of Services | | | | |
| Distribution services | 140 | 275 | – | 415 |
| | 136 | 289 | – | 425 |
| Transmission services | 169 | 64 | – | 233 |
| | 160 | 64 | – | 224 |
| Customer contributions | 9 | 4 | – | 13 |
| | 10 | 5 | – | 15 |
| Franchise fees | 8 | 72 | – | 80 |
| | 7 | 77 | – | 84 |
| Total rendering of services | 326 | 415 | – | 741 |
| | 313 | 435 | – | 748 |
| Other | 9 | 1 | – | 10 |
| | 25 | 2 | – | 27 |
| Total | 335 | 416 | – | 751 |
| | 338 | 437 | – | 775 |

6. PROPERTY, PLANT AND EQUIPMENT

A reconciliation of the changes in the carrying amount of property, plant and equipment is as follows:

| | Utility Transmission & Distribution | Land and Buildings | Construction Work-in- Progress | Other | Total |
|---------------------------------|---|-----------------------|--------------------------------------|-------|--------|
| Cost | | | | | |
| December 31, 2017 | 17,144 | 610 | 439 | 648 | 18,841 |
| Additions | – | – | 224 | – | 224 |
| Transfers | 97 | 2 | (104) | 5 | – |
| Retirements and disposals | (10) | – | – | – | (10) |
| March 31, 2018 | 17,231 | 612 | 559 | 653 | 19,055 |
| Accumulated depreciation | | | | | |
| December 31, 2017 | 3,826 | 139 | – | 245 | 4,210 |
| Depreciation | 99 | 4 | – | 11 | 114 |
| Retirements and disposals | (10) | – | – | – | (10) |
| March 31, 2018 | 3,915 | 143 | – | 256 | 4,314 |
| Net book value | | | | | |
| December 31, 2017 | 13,318 | 471 | 439 | 403 | 14,631 |
| March 31, 2018 | 13,316 | 469 | 559 | 397 | 14,741 |

The additions to property, plant and equipment included \$4 million of interest capitalized during construction for the three months ended March 31, 2018 (2017 - \$4 million).

7. EQUITY PREFERRED SHARES AND EQUITY PREFERRED SHARES TO PARENT COMPANY

Cash dividends declared and paid per share are as follows:

| <i>(dollars per share)</i> | Three Months Ended March 31 | |
|--|--------------------------------|--------|
| | 2018 | 2017 |
| Equity preferred shares | | |
| Cumulative Redeemable Preferred Shares | | |
| 4.60% Series 1 | 0.2875 | 0.2875 |
| 2.243% Series 4 | 0.1402 | 0.1402 |
| Equity preferred shares to parent company | | |
| Perpetual Cumulative Second Preferred Shares | | |
| 4.60% Series V ⁽¹⁾ | 0.2875 | 0.2500 |

(1) Effective October 3, 2017, the annual dividend rate for the Series V Preferred Shares was reset to 4.60 per cent for the next five years. Prior to October 3, 2017, the annual dividend rate was 4.00 per cent.

The payment of dividends is at the discretion of the Board and depends on the financial condition of the Company and other factors.

8. CLASS A AND CLASS B SHARES

DIVIDENDS

The Company declared and paid cash dividends of \$9.55 per Class A non-voting share and Class B common share during the three months ended March 31, 2018 (2017 - nil). The payment of dividends is at the discretion of the Board and depends on the financial condition of the Company and other factors.

9. CASH FLOW INFORMATION

ADJUSTMENTS TO RECONCILE EARNINGS TO CASH FLOWS FROM OPERATING ACTIVITIES

Adjustments to reconcile earnings to cash flows from operating activities for the three months ended March 31 are summarized below.

| | 2018 | 2017 |
|--|------|------|
| Depreciation and amortization | 122 | 119 |
| Income taxes | 63 | 66 |
| Contributions by utility customers for extensions to plant | 25 | 15 |
| Amortization of customer contributions | (13) | (12) |
| Net finance costs | 85 | 84 |
| Income taxes paid | (6) | (10) |
| Other | 2 | 3 |
| | 278 | 265 |

CASH POSITION

Cash position in the consolidated statement of cash flow at March 31 is comprised of:

| | 2018 | 2017 |
|-------------------|------|------|
| Cash | 67 | 249 |
| Bank indebtedness | - | (7) |
| | 67 | 242 |

10. FINANCIAL INSTRUMENTS

FAIR VALUE MEASUREMENT

Financial instruments are measured at amortized cost or fair value. Fair value represents the estimated amounts at which financial instruments could be exchanged between knowledgeable and willing parties in an arm's length transaction. Determining fair value requires management judgment. The valuation methods used to determine the fair value of each financial instrument and its associated level in the fair value hierarchy is described below.

| Financial Instruments | Fair Value Method |
|---|--|
| Measured at Amortized Cost | |
| Cash, accounts receivable and contract assets, accounts receivable from parent and affiliate companies, bank indebtedness, accounts payable and accrued liabilities and accounts payable to parent and affiliate companies. | Assumed to approximate carrying value due to their short-term nature. |
| Long-term advances to affiliate company and long-term debt | Determined using quoted market prices for the same or similar issues. Where the market prices are not available, fair values are estimated using discounted cash flow analysis based on the Company's current borrowing rate for similar borrowing arrangements (Level 2). |

The fair values of the Company's financial instruments measured at amortized cost are as follows:

| Recurring Measurements | March 31, 2018 | | December 31, 2017 | |
|---|----------------|------------|-------------------|------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Financial Assets | | | | |
| Long-term advances to affiliate company | 130 | 153 | 130 | 156 |
| Financial Liabilities | | | | |
| Long-term debt | 7,568 | 8,637 | 7,567 | 8,737 |