

Condensed Consolidated Interim Financial Statements of

EPCOR UTILITIES INC.

Six months ended June 30, 2019 and 2018

EPCOR UTILITIES INC.

Condensed Consolidated Interim Financial Statements

Six months ended June 30, 2019 and 2018

Condensed Consolidated Interim Statements of Comprehensive Income 3

Condensed Consolidated Interim Statements of Financial Position 4

Condensed Consolidated Interim Statements of Changes in Equity 5

Condensed Consolidated Interim Statements of Cash Flows 6

Notes to the Condensed Consolidated Interim Financial Statements 7

EPCOR UTILITIES INC.

Condensed Consolidated Interim Statements of Comprehensive Income
(In millions of Canadian dollars)

Three and six months ended June 30, 2019 and 2018

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Revenues and other income:				
Revenues (note 5)	\$ 439	\$ 426	\$ 897	\$ 827
Other income	-	-	-	2
	439	426	897	829
Operating expenses:				
Energy purchases and system access fees	84	73	188	142
Other raw materials and operating charges	48	49	90	84
Staff costs and employee benefits expenses	85	84	173	166
Depreciation and amortization	79	70	157	141
Franchise fees and property taxes	29	30	60	59
Other administrative expenses	22	20	44	42
	347	326	712	634
Operating income	92	100	185	195
Finance expenses	(32)	(30)	(64)	(62)
Income before income taxes	60	70	121	133
Income tax expense (note 6)	(20)	(2)	(25)	-
Net income for the periods				
- all attributable to the Owner of the Company	40	68	96	133
Other comprehensive income (loss):				
Items that may subsequently be reclassified to net income:				
Unrealized loss on cash flow hedges (note 10)	(5)	-	(9)	-
Unrealized gain (loss) on foreign currency translation	(12)	11	(23)	24
Other comprehensive income (loss) for the periods	(17)	11	(32)	24
Comprehensive income for the periods				
- all attributable to the Owner of the Company	\$ 23	\$ 79	\$ 64	\$ 157

The accompanying notes are an integral part of these condensed consolidated interim financial statements

EPCOR UTILITIES INC.

Condensed Consolidated Interim Statements of Financial Position
(In millions of Canadian dollars)

June 30, 2019 and December 31, 2018

	2019	2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 31	\$ 32
Trade and other receivables	435	431
Inventories	22	19
	488	482
Non-current assets:		
Other financial assets (note 7)	130	94
Deferred tax assets	107	130
Property, plant and equipment (note 8)	9,811	9,582
Intangible assets and goodwill	387	368
	10,435	10,174
TOTAL ASSETS	\$ 10,923	\$ 10,656
LIABILITIES AND EQUITY		
Current liabilities:		
Trade and other payables	\$ 340	\$ 417
Loans and borrowings (note 10)	295	70
Deferred revenue	69	67
Provisions	20	30
Other liabilities (note 9)	54	46
	778	630
Non-current liabilities:		
Loans and borrowings (note 10)	2,599	2,630
Deferred revenue	3,541	3,465
Deferred tax liabilities	56	53
Provisions	85	89
Other liabilities (note 9)	195	98
	6,476	6,335
Total liabilities	7,254	6,965
Equity attributable to the Owner of the Company:		
Share capital	798	798
Accumulated other comprehensive income	66	98
Retained earnings	2,805	2,795
Total equity - all attributable to the Owner of the Company	3,669	3,691
TOTAL LIABILITIES AND EQUITY	\$ 10,923	\$ 10,656

The accompanying notes are an integral part of these condensed consolidated interim financial statements

EPCOR UTILITIES INC.

Condensed Consolidated Interim Statements of Changes in Equity
(In millions of Canadian dollars)

Six months ended June 30, 2019 and 2018

	Accumulated other comprehensive income (loss)				Retained earnings	Equity attributable to the Owner of the Company
	Share capital	Cash flow hedges	Cumulative translation account	Employee benefits account		
Equity at December 31, 2018	\$ 798	\$ -	\$ 107	\$ (9)	\$ 2,795	\$ 3,691
Net income for the period	-	-	-	-	96	96
Other comprehensive loss:						
Unrealized loss on cash flow hedges	-	(9)	-	-	-	(9)
Unrealized loss on foreign currency translation	-	-	(23)	-	-	(23)
Total comprehensive income (loss)	-	(9)	(23)	-	96	64
Dividends	-	-	-	-	(86)	(86)
Equity at June 30, 2019	\$ 798	\$ (9)	\$ 84	\$ (9)	\$ 2,805	\$ 3,669

	Accumulated other comprehensive income (loss)				Retained earnings	Equity attributable to the Owner of the Company
	Share capital	Cumulative translation account	Employee benefits account			
Equity at December 31, 2017	\$ 798	\$ 64	\$ (15)	\$ 2,665	\$ 3,512	
Impact of changes in accounting policies	-	-	-	1	1	
Adjusted equity at beginning of January 1, 2018	798	64	(15)	2,666	3,513	
Net income for the period	-	-	-	133	133	
Other comprehensive gain:						
Unrealized gain on foreign currency translation	-	24	-	-	24	
Total comprehensive income	-	24	-	133	157	
Dividends	-	-	-	(83)	(83)	
Equity at June 30, 2018	\$ 798	\$ 88	\$ (15)	\$ 2,716	\$ 3,587	

The accompanying notes are an integral part of these condensed consolidated interim financial statements

EPCOR UTILITIES INC.

Condensed Consolidated Interim Statements of Cash Flows
(In millions of Canadian dollars)

Six months ended June 30, 2019 and 2018

	2019	2018
Cash flows from (used in) operating activities:		
Net income for the period	\$ 96	\$ 133
Reconciliation of net income for the period to cash from operating activities:		
Interest paid	(62)	(72)
Finance expenses	64	62
Income taxes recovered	-	1
Income tax expense	25	-
Depreciation and amortization	157	141
Change in employee benefits provisions	(12)	(7)
Contributions received	30	24
Deferred revenue recognized	(34)	(32)
Fair value change on financial electricity purchase contracts	(2)	-
Other	2	-
Net cash flows from operating activities before non-cash operating working capital changes	264	250
Changes in non-cash operating working capital	(65)	(81)
Net cash flows from operating activities	199	169
Cash flows from (used in) investing activities:		
Acquisition or construction of property, plant and equipment and intangible assets ¹	(259)	(234)
Business acquisition	(31)	-
Proceeds on disposal of property, plant and equipment	1	1
Changes in non-cash investing working capital	(14)	(9)
Net payments received on other financial assets	1	166
Payment of Drainage transition cost compensation to the City of Edmonton	(17)	(21)
Net cash flows used in investing activities	(319)	(97)
Cash flows from (used in) financing activities:		
Net issuance of short-term loans and borrowings	225	112
Repayments of long-term loans and borrowings	(15)	(415)
Net refunds to customers and developers	(1)	(1)
Payments of lease liabilities, net of proceeds from finance lease receivable	(4)	-
Dividends paid	(86)	(83)
Net cash flows from (used in) financing activities	119	(387)
Decrease in cash and cash equivalents	(1)	(315)
Cash and cash equivalents, beginning of period	32	338
Cash and cash equivalents, end of period	\$ 31	\$ 23

1 Interest payments of \$4 million (2018 – \$2 million) has been capitalized and included in acquisition or construction of property, plant and equipment (PP&E) and intangible assets.

EPCOR UTILITIES INC.

Notes to the Condensed Consolidated Interim Financial Statements
(Tabular amounts in millions of Canadian dollars unless otherwise indicated)

June 30, 2019

1. Nature of operations

EPCOR Utilities Inc. (the Company or EPCOR) builds, owns and operates electrical, natural gas and water transmission and distribution networks, water and wastewater treatment facilities and sanitary and stormwater systems and infrastructure. The Company also provides electricity, natural gas and water products and services to residential and commercial customers.

The Company operates in Canada and the United States (U.S.) with its registered head office located at 2000, 10423 - 101 Street NW, Edmonton, Alberta, Canada, T5H 0E8.

The common shares of EPCOR are owned by The City of Edmonton (the City). The Company was established by Edmonton City Council under City Bylaw 11071.

Interim results will fluctuate due to the seasonal demands for electricity, water and natural gas, changes in electricity and natural gas prices, and the timing and recognition of regulatory decisions. Consequently, interim results are not necessarily indicative of annual results.

2. Basis of presentation

(a) Statement of compliance

These condensed consolidated interim financial statements have been prepared by management in accordance with International Accounting Standard 34 – *Interim Financial Reporting*. These condensed consolidated interim financial statements do not include all of the disclosures normally provided in the annual consolidated financial statements and should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2018, which have been prepared in accordance with International Financial Reporting Standards (IFRS).

These condensed consolidated interim financial statements were approved and authorized for issue by the Board of Directors on July 25, 2019.

(b) Basis of measurement

The Company's condensed consolidated interim financial statements are prepared on the historical cost basis, except for its derivative financial instruments including cash flow hedges, long-term investment and contingent consideration, which are measured at fair value.

These condensed consolidated interim financial statements are presented in Canadian dollars. The functional currency of EPCOR and its Canadian subsidiaries is the Canadian dollar; the functional currency of U.S. subsidiaries is the U.S. dollar. All the values in these condensed consolidated interim financial statements have been rounded to nearest million except where otherwise stated.

3. Significant accounting policies

These condensed consolidated interim financial statements have been prepared following the same accounting policies and methods as those used in preparing the Company's most recent annual consolidated financial statements except for the accounting policy for leases, which has been amended due to the adoption of a new accounting standard effective January 1, 2019.

The Company has adopted IFRS 16 - *Leases* (IFRS 16), which replaced International Accounting Standard (IAS) 17 – *Leases* (IAS 17) and related interpretations, using the modified retrospective approach with the cumulative effect of any adjustments recognized in the opening balance of retained earnings as of January 1, 2019, subject to elected practical expedients. The comparative information has not been restated and continues to be reported under the previous accounting standard. The Company's updated accounting policy resulting from implementation of the new standard, along with analysis of the changes from the previous accounting policy, are set out below.

EPCOR UTILITIES INC.

Notes to the Condensed Consolidated Interim Financial Statements
(Tabular amounts in millions of Canadian dollars unless otherwise indicated)

June 30, 2019

(a) Leases

At the inception of a contract, the Company determines whether a contract is, or contains a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

As a lessee

On initial identification of a lease contract, the Company recognizes a right-of-use (ROU) asset and a lease liability at the commencement of the lease contract. The lease liability is initially measured at the present value of the future unavoidable lease payments under the contract, discounted using the interest rate implicit in the lease contract. Where the implicit rate cannot be readily determined, the Company uses the incremental borrowing rate of the legal entity entering into the lease contract. Lease payments include fixed payments, including in-substance fixed payments less any lease incentives receivable, variable lease payments that depend on an index or a rate, the exercise price of a purchase option or optional renewal period that the Company is reasonably certain to exercise and penalties for early termination of a lease contract unless the Company is reasonably certain not to terminate early. Subsequently, the lease liability is measured at amortized cost, using the effective interest method. The lease liability is re-measured to reflect any reassessments or lease modifications. Lease payments are allocated between the principal repayment of the lease liability and finance expense. The finance expense on the lease liability is charged to net income over the term of the lease contract to produce a constant periodic rate of interest on the remaining balance of the lease liability for each period.

The ROU asset is initially measured at cost which includes the initial lease liability, any lease payments made at or before commencement date less any lease incentives received, any initial direct costs and restoration costs. The ROU assets are depreciated on a straight-line basis over the shorter of the respective asset's useful life and the remaining term of lease contract. The ROU assets are subsequently re-measured to reflect any reassessments or lease modifications.

The Company has elected not to recognize ROU assets and lease liabilities for lease contracts where the total term of the respective lease contract is less than or equal to 12 months or for low value lease contracts. The Company recognizes the payments relating to such leases (including principal and interest associated with these leases) as an expense on a straight-line basis over the lease term. These payments are presented within other administrative expense in net income.

As a lessor

On initial identification of a lease contract, the Company determines whether the contract is a finance lease or an operating lease. If a contract transfers substantially all of the risks and rewards incidental to ownership of the underlying asset to the customer, the contract is classified as a finance lease; otherwise, it is classified as an operating lease. Finance income related to contracts accounted for as finance leases is recognized in a manner that produces a constant rate of return on the net investment in the lease. The net investment in the lease is the aggregate of net minimum lease payments and unearned finance income discounted at the interest rate implicit in the lease. Unearned finance income is deferred and recognized in net income over the lease term. Lease payments received by the Company under operating leases are recognized as lease revenue within other commercial revenue on a straight-line basis over the lease term.

Where the Company is an intermediate lessor, it accounts for interests in the head lease and the sub-lease separately. If the sub-lease is classified as finance lease, the ROU asset relating to the head lease is derecognized and a finance lease receivable in the sub-lease is recognized in the statement of financial position.

The Company applies judgment in determination of the lease term for certain lease contracts with renewal options. The assessment of whether the Company is reasonably certain to exercise such options impacts the lease term, which could significantly affect the amount of lease liabilities and right of use assets recorded on the initial recognition of the lease contract.

IFRS 16 implementation impact

Prior to January 1, 2019, when the Company was the lessee under a contract, a lease was classified either as a

EPCOR UTILITIES INC.

Notes to the Condensed Consolidated Interim Financial Statements
(Tabular amounts in millions of Canadian dollars unless otherwise indicated)

June 30, 2019

finance or operating lease depending on whether substantially all the risks or rewards of ownership of the asset were transferred. Leases or other arrangements that transferred substantially all of the benefits and risks of ownership of property were classified as finance leases. All other arrangements that were determined to contain a lease were classified as operating leases. Rental income under arrangements classified as operating leases was recognized as lease revenue within other commercial revenue, whereas rental payments under arrangements classified as operating leases were expensed on a straight-line basis over the term of the lease. Lease incentives received were recognized as an integral part of the total lease expense, over the term of the lease.

On implementation of IFRS 16, the Company reassessed all outstanding contracts to determine whether they meet the criteria for recognition as lease contracts under IFRS 16.

As a lessor, all contracts which met the criteria for recognition as leases under IFRS 16, required no change in accounting and they continue to be recorded as finance or operating leases consistent with their respective classification under IAS 17.

As a lessee, all contracts which were classified as finance leases under IAS 17 and met the criteria for recognition as leases under IFRS 16, required no change in accounting. However, for all contracts which were classified as operating leases under IAS 17 and met the criteria for recognition as leases under IFRS 16, the Company has recognized ROU assets and lease liabilities on the statement of financial position, initially measured at the present value of unavoidable future lease payments. On initial recognition of ROU assets and lease liabilities for existing contracts at the beginning of January 1, 2019, the Company has elected to use the following practical expedients, where applicable:

- not apply the requirements of the standard to short-term leases;
- treat existing operating leases with a remaining term of 12 months or less at January 1, 2019 as short-term leases;
- not apply the requirements of the standard to low value leases;
- apply a single discount rate to a portfolio of leases with reasonably similar characteristics;
- adjust ROU assets at the date of initial application by the amount of any provision for onerous leases recognized in the statements of financial position immediately before the date of initial application; and
- exclude initial direct costs for the measurement of the ROU asset at the date of initial application.

The implementation of IFRS 16 on January 1, 2019, did not result in any adjustment to the opening balance of retained earnings. However, it had an impact on the statement of financial position as a result of the recognition of ROU assets and lease liabilities primarily with respect to leases for land and buildings (including office spaces) as well as recording finance lease receivable related to sub-lease under the Company's lease contract. On the initial application of IFRS 16, the Company recognized the ROU assets of \$84 million within PP&E, finance lease receivable of \$41 million within other financial assets and lease liabilities of \$136 million within other liabilities. The \$11 million difference between the assets and liabilities recognized on initial application of IFRS 16 is due to adjusting ROU assets for leasehold inducement and other liabilities under lease contracts, which resulted in a reduction to the opening ROU assets recognized.

The Company measured the present value of the future lease payments under each contract using the incremental borrowing rate for the legal entity entering into the lease contract. The weighted average incremental borrowing rate for all lease contracts of the Company at the beginning of January 1, 2019, was 3.62%. The lease liability of \$136 million recognized on initial application of IFRS 16 represents the present value of lease commitments of \$164 million disclosed at December 31, 2018. There were no adjustments to the operating lease commitments disclosed at December 31, 2018 and leases recognized on adoption of IFRS 16 at January 1, 2019.

The ongoing impact of the application of IFRS 16 related to the Company's lease contracts, on the consolidated statements of comprehensive income is not anticipated to be material as the depreciation expense related to ROU assets and finance expenses on lease liabilities recognized under IFRS 16 will largely be offset by reduction in operating lease expense, which were recognized in net income before applying the new standard.

EPCOR UTILITIES INC.

Notes to the Condensed Consolidated Interim Financial Statements
(Tabular amounts in millions of Canadian dollars unless otherwise indicated)

June 30, 2019

(b) Standards and interpretations not yet applied

A number of new standards, amendments to standards and interpretations of standards have been issued by the International Accounting Standards Board and the International Financial Reporting Interpretations Committee, the application of which is effective for periods beginning on or after January 1, 2020. The Company does not expect to have any significant impact on its accounting policies on the implementation of these new accounting pronouncements.

4. Business acquisition

Acquisition of Rio Verde Utilities Inc.

On February 28, 2019, EPCOR acquired 100% of the stock of Rio Verde Utilities Inc. (Rio Verde) in Arizona, U.S. for cash consideration of \$31 million (US\$24 million).

Rio Verde is located northeast of Scottsdale and the Greater Phoenix metropolitan area and 10 miles north of the Company's Chaparral service area in Fountain Hills. Rio Verde's regulated operations include 2,220 water and 1,876 wastewater service connections along with irrigated water service for five golf courses.

The preliminary fair value of assets acquired of \$29 million and liabilities assumed of \$10 million, primarily consist of PP&E, intangible assets, customer/developer contributions and deferred tax liabilities. The excess of purchase consideration over the fair value of the net assets acquired of \$12 million has been recorded as goodwill.

5. Revenues

Revenues disaggregated by major goods or services, excluding intersegment revenues, are as follows:

Three months ended June 30, 2019	Water Services	Distribution & Transmission	Energy Services	U.S. Operations	Other	Consolidated
Energy and water sales	\$ 57	\$ -	\$ 92	\$ 44	\$ 9	\$ 202
Provision of services	105	99	7	17	3	231
Construction revenue	2	-	-	-	2	4
Other commercial revenue	2	-	-	-	-	2
	\$ 166	\$ 99	\$ 99	\$ 61	\$ 14	\$ 439

Three months ended June 30, 2018	Water Services	Distribution & Transmission	Energy Services	U.S. Operations	Other	Consolidated
Energy and water sales	\$ 59	\$ -	\$ 91	\$ 49	\$ 1	\$ 200
Provision of services	105	98	5	14	1	223
Construction revenue	2	-	-	-	-	2
Other commercial revenue	1	-	-	-	-	1
	\$ 167	\$ 98	\$ 96	\$ 63	\$ 2	\$ 426

Six months ended June 30, 2019	Water Services	Distribution & Transmission	Energy Services	U.S. Operations	Other	Consolidated
Energy and water sales	\$ 107	\$ -	\$ 210	\$ 81	\$ 22	\$ 420
Provision of services	203	209	12	33	8	465
Construction revenue	4	-	-	-	4	8
Other commercial revenue	3	-	-	-	1	4
	\$ 317	\$ 209	\$ 222	\$ 114	\$ 35	\$ 897

EPCOR UTILITIES INC.

Notes to the Condensed Consolidated Interim Financial Statements
(Tabular amounts in millions of Canadian dollars unless otherwise indicated)

June 30, 2019

Six months ended June 30, 2018	Water Services	Distribution & Transmission	Energy Services	U.S. Operations	Other	Consolidated
Energy and water sales	\$ 110	\$ -	\$ 173	\$ 88	\$ 3	\$ 374
Provision of services	200	204	10	29	4	447
Construction revenue	3	-	-	-	-	3
Other commercial revenue	3	-	-	-	-	3
	\$ 316	\$ 204	\$ 183	\$ 117	\$ 7	\$ 827

6. Income tax expense

In June 2019, the Government of Alberta enacted Bill 3, which introduced a phased reduction in provincial corporate tax rates from 12% to 8% by January 1, 2022. The revised rates are effective from July 1, 2019. The change has resulted in a deferred tax expense of \$17 million due to re-measurement of deferred tax assets and liabilities related to Company's Alberta operations.

7. Other financial assets

	June 30, 2019	December 31, 2018
Long-term receivables from service concession arrangements	\$ 79	\$ 80
Finance lease receivables	40	1
Long-term investment	7	7
Loans and other long-term receivables	8	8
Other	1	1
	135	97
Less: current portion (included in trade and other receivables)	5	3
	\$ 130	\$ 94

Finance lease receivables

Approximate future payments to the Company under the finance lease receivables are as follows:

	June 30, 2019	December 31, 2018
Within one year	\$ 4	\$ -
After one year but not more than five years	16	1
More than five years	30	-
Unearned finance income	(10)	-
	\$ 40	\$ 1

The finance lease receivables primarily consists of the Company's sub-lease of a portion of the head office lease to a third party. Details of the sub-lease are provided in other liabilities (note 9). During the period ended June 30, 2019, the Company received lease rentals of \$2 million including financing income.

8. Property, plant and equipment

	June 30, 2019	December 31, 2018
Owned assets	\$ 9,732	\$ 9,582
Right-of-use assets ¹	79	-
	\$ 9,811	\$ 9,582

¹ The ROU assets primarily consist of land and buildings (including office spaces).

EPCOR UTILITIES INC.

Notes to the Condensed Consolidated Interim Financial Statements
(Tabular amounts in millions of Canadian dollars unless otherwise indicated)

June 30, 2019

The changes in ROU assets during the period were as follows:

	June 30, 2019
ROU assets recognized on implementation of IFRS 16	\$ 84
Depreciation for the period	(5)
Net book value, end of period	\$ 79

9. Other liabilities

	June 30, 2019	December 31, 2018
Customer deposits	\$ 31	\$ 30
Drainage transition cost compensation	28	45
Lease liabilities	130	-
Contingent consideration	48	49
Consideration payable - long-term investment in Vista Ridge	12	12
Leasehold inducements	-	8
	249	144
Less: current portion	54	46
	\$ 195	\$ 98

Lease liabilities

The changes in lease liabilities during the period were as follows:

	June 30, 2019
Lease liabilities recognized on implementation of IFRS 16	\$ 136
Payments during the period	(6)
Lease liabilities, end of the period	\$ 130

Approximate future payments to be paid by the Company with respect to its lease liabilities are as follows:

	June 30, 2019
Within one year	\$ 14
After one year but not more than five years	55
More than five years	91
Unrecognized finance expense	(30)
	\$ 130

The lease liabilities primarily consist of the Company's leases for land and buildings including office space in Edmonton, Canada. In 2007, the Company entered into a long-term agreement to lease commercial space in a new office tower in Edmonton, Canada, primarily for its head office. The agreement, which became effective in the fourth quarter of 2011, has an initial lease term of approximately 20 years, expiring on December 31, 2031, and provides for three successive five-year renewal options. The Company is not reasonably certain whether it will exercise the renewal option under the lease, accordingly the Company has not recognized any ROU asset or lease liability related to renewal option.

The Company has sub-leased a portion of the space under its office lease to a third party under the same terms and conditions as the Company's head lease with its landlord. The Company has classified the sub-lease as a finance lease. Accordingly, the Company derecognized the portion of ROU assets related to sub-lease and recognized the finance lease receivable, which is included in other financial assets (note 7) in the statement of financial position.

In addition to the above sub-lease, effective November 1, 2013, the Company sub-leased another portion of the space

EPCOR UTILITIES INC.

Notes to the Condensed Consolidated Interim Financial Statements
(Tabular amounts in millions of Canadian dollars unless otherwise indicated)

June 30, 2019

under its head office lease to a third party. The term of the sub-lease to the third party expires on October 31, 2023 with two renewal options of four years each. The Company has recognized the sub-lease as an operating lease. Approximate future payments to the Company under the operating lease are as follows:

	June 30, 2019
Within one year	\$ 1
After one year but not more than five years	5
	\$ 6

10. Financial instruments

Classification

The classifications of the Company's financial instruments at June 30, 2019 and December 31, 2018 are summarized as follows:

	Classification			Fair value hierarchy
	Fair value through profit or loss	Fair value through other comprehensive income	Amortized cost	
Measured at fair value				
Long-term investment	X			Level 3
Derivative liabilities				
Financial electricity purchase contracts - designated	X			Level 1
Cash flow hedges - bond forward contracts		X		Level 2
Other liabilities				
Contingent consideration – designated	X			Level 3
Measured at amortized cost				
Cash and cash equivalents			X	Level 1
Trade and other receivables			X	Level 3
Other financial assets excluding long-term investment			X	Level 2
Trade and other payables excluding derivative liabilities			X	Level 3
Loans and borrowings			X	Level 2
Other liabilities				
Customer deposits			X	Level 3
Drainage transition cost compensation			X	Level 2

Fair value

The carrying amounts of cash and cash equivalents, trade and other receivables, current portion of other financial assets, trade and other payables (excluding derivative liabilities) and certain other liabilities (including customer deposits) approximate their fair values due to the short-term nature of these financial instruments.

The carrying amounts and fair values of the Company's remaining financial assets and liabilities are as follows:

EPCOR UTILITIES INC.

Notes to the Condensed Consolidated Interim Financial Statements
(Tabular amounts in millions of Canadian dollars unless otherwise indicated)

June 30, 2019

	June 30, 2019		December 31, 2018	
	Carrying amount	Fair value	Carrying amount	Fair Value
Non-current portion of other financial assets ¹	\$ 86	\$ 97	\$ 86	\$ 98
Long-term investment in Vista Ridge	7	7	7	7
Derivative liabilities				
Financial electricity purchase contracts - designated	-	-	2	2
Cash flow hedges - bond forward contracts	10	10	-	-
Loans and borrowings	2,894	3,420	2,700	2,939
Other liabilities				
Contingent consideration	48	48	49	49
Drainage transition cost compensation	28	28	45	45

1 Excluding long-term investment in Vista Ridge and finance lease receivables of \$44 million (December 31, 2018 – \$8 million).

Fair value hierarchy

The financial instruments of the Company that are recorded at fair value have been classified into levels using a fair value hierarchy. A Level 1 valuation is determined by unadjusted quoted prices in active markets for identical assets or liabilities. A Level 2 valuation is based upon inputs other than quoted prices included in Level 1 that are observable for the instruments either directly or indirectly. A Level 3 valuation for the assets and liabilities are not based on observable market data.

Other financial assets

The fair values of the Company's long-term loans and receivables are based on the estimated interest rates implicit in comparable loan arrangements plus an estimated credit spread based on the counterparty risks at June 30, 2019 and December 31, 2018.

Derivative liabilities

The derivative liabilities consist of financial electricity purchase contracts and bond forward contracts.

The fair value of the Company's financial electricity purchase contracts is determined based on exchange index prices in active markets and are based on the external readily observable market data such as forward electricity prices. It is possible that the fair value amounts will differ from future outcomes and the impact of such variations could be material.

The Company entered into bond forward contracts (the hedging instruments) to manage its interest rate risk associated with movements in long-term Government of Canada bond rates related to a planned future long-term debt issuance (the hedged item). The Company performed an effectiveness test at inception and continues to perform effectiveness tests at each reporting date to ensure that the changes in fair values of the hedging instruments and the hedged items are moving in opposite directions and offsetting each other. These financial instruments have been classified as cash flow hedges. In the cash flow hedging relationship, the effective portion of the change in the fair value of the hedging instrument is recognized in other comprehensive income (OCI), while the ineffective portion is recognized in net income within finance expenses. The amounts recognized in OCI as cash flow hedging gains / losses are reclassified to net income as the interest payments on the hedged item are recognized in net income and will effectively adjust the interest expense recognized on the hedged item. If it becomes probable that the hedged items will not occur all the amounts recognized in OCI as cash flow hedging gains / losses will immediately be reclassified to net income. The Company has entered into the following bond forward contracts:

EPCOR UTILITIES INC.

Notes to the Condensed Consolidated Interim Financial Statements
(Tabular amounts in millions of Canadian dollars unless otherwise indicated)

June 30, 2019

Type	Contract maturity	Notional value	Forward yield
Bond Forward Transaction	December 27, 2019	\$ 50	2.147%
Bond Forward Transaction	November 28, 2019	\$ 50	2.047%

The counterparties to the bond forward contracts are major Canadian financial institutions. The contracts can be unwound at any time before maturity.

The fair value of the Company's bond forward contracts is based on a discounted cash flow model, using readily available information from the market. The inputs used include notional amounts, the quoted forward market price, the contractual fixed settlement rate and an applicable discount factor. The Company does not anticipate any material adverse effect on its financial covenants resulting from its involvement in this type of bond forward contracts, nor does it anticipate non-performance by the counterparties.

The Company closed both bond forward contracts on July 8, 2019, on issuance of long-term debt and paid the outstanding balance of \$10 million to the counterparties. Out of the total \$10 million loss, the effective portion of the cash flow hedges of \$9 million has been recorded in other comprehensive income and will be recognized in net income over a period of 30 years along with the interest expense for the related long-term debt. The \$1 million ineffective portion of the loss has been recognized in net income within finance expenses.

Derivative liabilities are presented within trade and other payables in the consolidated statements of financial position.

Loans and borrowings

The fair value of the Company's long-term public debt is based on the pricing sourced from market data as of June 30, 2019 and December 31, 2018. The fair value of the Company's remaining long-term loans and borrowings is based on determining a current yield for the Company's debt at June 30, 2019 and December 31, 2018. This yield is based on an estimated credit spread for the Company over the yields of long-term Government of Canada bonds for Canadian dollar loans and U.S. Treasury bonds for U.S. dollar loans that have similar maturities to the Company's debt. The estimated credit spread is based on the Company's indicative spread as published by independent financial institutions.

On June 25, 2019, the Company entered into agreements for \$450 million dual-tranche long-term notes, consisting of a \$100 million 3 year note at an interest rate of 1.949% and a \$350 million 30 year note at an interest rate of 3.106%, both issued on July 8, 2019. Subsequent to the period ended June 30, 2019, the Company closed the transaction and received the funds on July 8, 2019.

Short-term loans and borrowings are measured at amortized cost and their carrying value approximate their fair value due to the short-term nature of these financial instruments.

Contingent consideration

The contingent consideration is payable in U.S. dollars and payment is mainly dependent on securing newly executed long-term contracts for the supply of water by EPCOR 130 Project Inc. and additional customer connections for natural gas by Hughes Natural Gas Inc., the timing of which is uncertain. The fair value of the Company's contingent consideration is determined based on the expected timing of securing new contracts and customer connections and the resulting cash flows are then discounted at risk adjusted discount rates. Any change in the timing of execution of new contracts, discount rate or foreign exchange rate can have a material impact on the fair value of contingent consideration.

The changes in the liability for contingent consideration are as follows:

	June 30, 2019	December 31, 2018
Balance, beginning of the period / year	\$ 49	\$ 43
Payment during the period / year	-	(1)
Unwinding of interest included in finance expenses	1	3
Foreign currency valuation adjustments	(2)	4
Balance, end of the period / year	\$ 48	\$ 49

EPCOR UTILITIES INC.

Notes to the Condensed Consolidated Interim Financial Statements
(Tabular amounts in millions of Canadian dollars unless otherwise indicated)

June 30, 2019

Drainage transition cost compensation

The transition cost compensation is payable in installments to the City to compensate for stranded costs related to the transfer of the Drainage business. The carrying value of the Drainage transition cost compensation represents the present value of the liability, discounted using interest rates prevailing at the time of initial recognition of liability. The fair value of the Drainage transition cost compensation is determined based on the future cash outflows discounted at risk adjusted interest rates prevailing at June 30, 2019 and December 31, 2018, respectively.

11. Segment disclosures

The Company operates in the following reportable business segments, which follow the organization, management and reporting structure within the Company.

Water Services

Water Services is primarily involved in the treatment, transmission, distribution and sale of water, the collection and conveyance of sanitary and stormwater and the treatment of wastewater within Edmonton and other communities in Western Canada. This segment's water and wastewater business includes the provision of design, build, finance, operating and maintenance services for municipal and industrial customers in Western Canada.

Distribution and Transmission

Distribution and Transmission is involved in the transmission and distribution of electricity within Edmonton. This segment also provides commercial services including the design, construction and maintenance of street lighting, traffic signal and light rail transit electrical infrastructure for the City and for other municipal and commercial customers in Alberta.

Energy Services

Energy Services is primarily involved in the provision of regulated rate option electricity service and default supply electricity services to customers in Alberta. This segment also provides competitive electricity and natural gas products under the Encor brand.

U.S. Operations

U.S. operations is primarily involved in the treatment, transmission, distribution and sale of water, and the collection and treatment of wastewater within the Southwestern U.S. This segment also provides natural gas distribution and transmission services in Texas. All of the Company's operations conducted in the U.S. are included in this segment.

Other

Other includes all of the remaining business segments of the Company, which do not meet the criteria of a reportable business segment. Other primarily includes Ontario natural gas and electricity distribution businesses and the cost of the Company's net unallocated corporate office expenses.

EPCOR UTILITIES INC.

Notes to the Condensed Consolidated Interim Financial Statements
(Tabular amounts in millions of Canadian dollars unless otherwise indicated)

June 30, 2019

Three months ended June 30, 2019

	Water Services	Distribution & Transmission	Energy Services	U.S. Operations	Other	Intersegment Elimination	Consolidated
External revenues	\$ 166	\$ 99	\$ 99	\$ 61	\$ 14	\$ -	\$ 439
Inter-segment revenue	-	3	4	-	-	(7)	-
Total revenues	166	102	103	61	14	(7)	439
Energy purchases and system access fees	-	-	74	1	9	-	84
Other raw materials and operating charges	27	8	-	11	4	(2)	48
Staff costs and employee benefits expenses	37	20	7	9	13	(1)	85
Depreciation and amortization	35	23	2	14	5	-	79
Franchise fees and property taxes	8	19	-	2	-	-	29
Other administrative expenses	8	4	9	3	2	(4)	22
Operating expenses	115	74	92	40	33	(7)	347
Operating income (loss) before corporate income (charges)	51	28	11	21	(19)	-	92
Corporate income (charges)	(8)	(5)	(2)	(2)	17	-	-
Operating income (loss)	43	23	9	19	(2)	-	92
Finance recoveries (expenses)	(19)	(15)	(1)	(11)	14	-	(32)
Income tax expense	-	-	-	(2)	(18)	-	(20)
Net income (loss)	\$ 24	\$ 8	\$ 8	\$ 6	\$ (6)	\$ -	\$ 40
Capital additions	\$ 66	\$ 54	\$ 1	\$ 20	\$ 9	\$ -	\$ 150

EPCOR UTILITIES INC.

Notes to the Condensed Consolidated Interim Financial Statements
(Tabular amounts in millions of Canadian dollars unless otherwise indicated)

June 30, 2019

Three months ended June 30, 2018

	Water Services	Distribution & Transmission	Energy Services	U.S. Operations	Other	Intersegment Elimination	Consolidated
External revenues	\$ 167	\$ 98	\$ 96	\$ 63	\$ 2	\$ -	\$ 426
Inter-segment revenue	-	2	4	-	-	(6)	-
Total revenues	167	100	100	63	2	(6)	426
Energy purchases and system access fees	-	-	72	1	-	-	73
Other raw materials and operating charges	24	12	-	14	1	(2)	49
Staff costs and employee benefits expenses	35	23	8	7	13	(2)	84
Depreciation and amortization	34	20	1	11	4	-	70
Franchise fees and property taxes	9	19	-	2	-	-	30
Other administrative expenses	7	4	7	3	1	(2)	20
Operating expenses	109	78	88	38	19	(6)	326
Operating income (loss) before corporate charges	58	22	12	25	(17)	-	100
Corporate income (charges)	(8)	(5)	(2)	(1)	16	-	-
Operating income (loss)	50	17	10	24	(1)	-	100
Finance recoveries (expenses)	(20)	(15)	(1)	(11)	17	-	(30)
Income tax recovery (expense)	1	-	-	(4)	1	-	(2)
Net income	\$ 31	\$ 2	\$ 9	\$ 9	\$ 17	\$ -	\$ 68
Capital additions	\$ 64	\$ 42	\$ -	\$ 24	\$ 3	\$ -	\$ 133

EPCOR UTILITIES INC.

Notes to the Condensed Consolidated Interim Financial Statements
(Tabular amounts in millions of Canadian dollars unless otherwise indicated)

June 30, 2019

Six months ended June 30, 2019

	Water Services	Distribution & Transmission	Energy Services	U.S. Operations	Other	Intersegment Elimination	Consolidated
External revenues	\$ 317	\$ 209	\$ 222	\$ 114	\$ 35	\$ -	\$ 897
Inter-segment revenue	-	6	8	-	-	(14)	-
Total revenues	317	215	230	114	35	(14)	897
Energy purchases and system access fees	-	-	164	3	21	-	188
Other raw materials and operating charges	47	17	-	23	7	(4)	90
Staff costs and employee benefits expenses	74	40	14	18	30	(3)	173
Depreciation and amortization	71	45	4	26	11	-	157
Franchise fees and property taxes	16	40	-	4	-	-	60
Other administrative expenses	15	8	15	6	7	(7)	44
Operating expenses	223	150	197	80	76	(14)	712
Operating income (loss) before corporate income (charges)	94	65	33	34	(41)	-	185
Corporate income (charges)	(16)	(11)	(4)	(3)	34	-	-
Operating income (loss)	78	54	29	31	(7)	-	185
Finance recoveries (expenses)	(37)	(30)	(2)	(23)	28	-	(64)
Income tax expense	-	-	-	(2)	(23)	-	(25)
Net income (loss)	\$ 41	\$ 24	\$ 27	\$ 6	\$ (2)	\$ -	\$ 96
Capital additions	\$ 114	\$ 94	\$ 1	\$ 35	\$ 15	\$ -	\$ 259

EPCOR UTILITIES INC.

Notes to the Condensed Consolidated Interim Financial Statements
(Tabular amounts in millions of Canadian dollars unless otherwise indicated)

June 30, 2019

Six months ended June 30, 2018

	Water Services	Distribution & Transmission	Energy Services	U.S. Operations	Other	Intersegment Elimination	Consolidated
External revenues	\$ 316	\$ 204	\$ 183	\$ 117	\$ 7	\$ -	\$ 827
Other income	-	-	-	-	2	-	2
Inter-segment revenue	-	4	8	-	-	(12)	-
Total revenues and other income	316	208	191	117	9	(12)	829
Energy purchases and system access fees	-	-	136	4	2	-	142
Other raw materials and operating charges	43	21	-	23	2	(5)	84
Staff costs and employee benefits expenses	70	44	15	15	24	(2)	166
Depreciation and amortization	67	42	3	22	7	-	141
Franchise fees and property taxes	16	39	-	4	-	-	59
Other administrative expenses	14	8	12	6	7	(5)	42
Operating expenses	210	154	166	74	42	(12)	634
Operating income (loss) before corporate charges	106	54	25	43	(33)	-	195
Corporate income (charges)	(16)	(11)	(4)	(3)	34	-	-
Operating income	90	43	21	40	1	-	195
Finance recoveries (expenses)	(40)	(30)	(2)	(21)	31	-	(62)
Income tax recovery (expense)	1	-	-	(3)	2	-	-
Net income	\$ 51	\$ 13	\$ 19	\$ 16	\$ 34	\$ -	\$ 133
Capital additions	\$ 113	\$ 79	\$ -	\$ 37	\$ 5	\$ -	\$ 234

The Company's assets and liabilities by business segments at June 30, 2019 and December 31, 2018 are summarized as follows:

June 30, 2019

	Water Services	Distribution & Transmission	Energy Services	U.S. Operations	Other	Intersegment Elimination	Consolidated
Total assets	\$ 6,483	\$ 2,419	\$ 196	\$ 1,460	\$ 4,134	\$ (3,769)	\$ 10,923
Total liabilities	4,955	1,623	151	1,192	3,102	(3,769)	7,254

December 31, 2018

	Water Services	Distribution & Transmission	Energy Services	U.S. Operations	Other	Intersegment Elimination	Consolidated
Total assets	\$ 6,331	\$ 2,362	\$ 221	\$ 1,468	\$ 3,938	\$ (3,664)	\$ 10,656
Total liabilities	4,844	1,590	202	1,194	2,799	(3,664)	6,965

EPCOR UTILITIES INC.

Notes to the Condensed Consolidated Interim Financial Statements
(Tabular amounts in millions of Canadian dollars unless otherwise indicated)

June 30, 2019

Non-current assets by geography

	June 30, 2019	December 31, 2018
Canada	\$ 9,020	\$ 8,743
U.S.	1,415	1,431
	<u>\$ 10,435</u>	<u>\$ 10,174</u>