# SHEDULE 2

## 2013 Budget Explanations

May 31, 2012

# 2013 Budget

## Overview

For comparative purposes, variance explanations compare 2011 actual results to the 2011 Budget, 2012 forecast results, based on a forecast that combined actual 2012 results to April 30, 2012, with a forecast for the remainder of the year, to the 2012 Budget and the 2013 Budget to the 2012 Budget. EGNB has only included explanations for variances greater than $10K.

## Revenue

For the 2013 budget year, EGNB has forecast total revenue from operations of $43.0 million. The table below summarizes EGNB's budgeted 2013 gas distribution revenue, miscellaneous operating revenue, allowance for funds used during construction ("AFUDC") and installation services margin with comparisons to 2011 and 2012.

Table 1
**Revenue**

| Line No. | (in thousands of dollars) | (1) 2011 Actual | (2) 2011 Budget | (3)=(1)-(2) 2011 Variance | (4) 2012 Forecast | (5) 2012 Budget | (6)=(4)-(5) 2012 Variance | (7) 2013 Budget | (8)=(7)-(5) Variance to 2012 Budget |
|---|---|---|---|---|---|---|---|---|---|
| 1 | Operating Revenue | | | | | | | | |
| 2 | Gas Distribution | $ 47,871 | $ 54,218 | $ (6,347) | $ 50,582 | $ 57,697 | $ (7,115) | $ 42,545 | $ (15,152) |
| 3 | Miscellaneous | 347 | 137 | 210 | 402 | 144 | 258 | 175 | 31 |
| 4 | Allowance for Funds Used During Construction | 65 | 13 | 52 | 164 | 53 | 111 | 42 | (11) |
| 5 | | 48,282 | 54,368 | (6,085) | 51,148 | 57,894 | (6,746) | 42,762 | (15,132) |
| 6 | Installation Services | | | | | | | | |
| 7 | Revenue | 2,726 | 4,478 | (1,752) | 1,750 | 1,947 | (197) | 590 | (1,357) |
| 8 | Cost of Goods Sold | (2,336) | (3,562) | 1,226 | (1,363) | (1,505) | 142 | (383) | 1,122 |
| 9 | | 390 | 916 | (526) | 387 | 442 | (55) | 207 | (235) |
| 10 | Total Revenue | 48,672 | 55,284 | (6,611) | 51,535 | 58,336 | (6,801) | 42,969 | (15,367) |

## 2011 Actual vs 2011 Budget

Operating Revenue

- Gas Distribution Revenue: actual gas distribution revenues were $6.3 million under budget, primarily due to lower than expected distribution rates ($2.9 million), lower customer attachments ($1.8 million), warmer than normal weather ($1.1 million), and a decrease in actual usage by customers as compared to the budget ($0.5 million).

- Miscellaneous Operating Revenue: miscellaneous operating revenue includes Agent Billing and Collection ("ABC") and Agent Billing ("AB") service revenue, late payment charges, transactional services, gain/loss on disposal of assets and accounts payable discounts taken. Actual miscellaneous revenues were $210K over budget, primarily due to late payment charges collected from customers being greater than forecast.

AFUDC was $52K over budget, with the primary driver for this variance being higher than budgeted monthly balances in the Construction Work in Progress ("CWIP") account, of which AFUDC is calculated on.

Installation Services Margin was $526K under budget. The margin was below budget due to significantly lower than anticipated number of jobs driven by the success of the Channel Partner Program, a lower number of attachments, and reduced margins on those jobs.

## 2012 Forecast vs 2012 Budget

Operating Revenue

- Gas Distribution Revenue: gas distribution revenues are forecast to end 2012 $7.1 million under budget, due to lower than forecasted distribution rates ($4.0 million), warmer than normal weather ($0.9 million), a reduction in customer attachments and in actual usage by customers as compared to the budget ($2.2 million).

- Miscellaneous Operating Revenue: miscellaneous revenues are expected to end 2012 $258K over budget, primarily due to revenue from the equipment rental program ($123K) and late payment charges collected from customers being greater than anticipated ($114K).

AFUDC is expected to be $111K over budget with the primary driver for this variance being higher than budgeted monthly balances in the Construction Work in Progress (“CWIP”) account, of which AFUDC is calculated on.

Installation Services Margin is expected to be $55K under budget, primarily due to EGNB’s discontinuing its installation services activities.

2013 Budget vs 2012 Budget

Operating Revenue

- Gas Distribution Revenue: gas distribution revenues are forecast to be $15.2 million less than the 2012 Budget. This revenue decrease is primarily the result of the 2012 legislative changes to the Gas Distribution Act which directed EGNB to establish new rate classes for all customers, with rates to be based on the lesser of the market based rate, or the cost of service rate with an allowed multiplier to allow for a level of cross-subsidization with a revenue to cost ratio not exceeding 1.2:1 for any class of customer. The regulation also stipulated the target savings level and alternative fuel sources to be used in determining market based rates.

- Miscellaneous Operating Revenue: miscellaneous revenues are expected to be $31K above the 2012 Budget, due to an increase in Agent Billing & Collections revenue.

AFUDC is forecast to be $11K below the 2012 Budget primarily due to a forecast reduction in CWIP balances resulting from reduced capital spending and a greater focus on attaching customers already on main, as well as a reduction in the rate of return on debt for regulatory purposes.

Installation Services Margin is forecast to be $235K below the 2012 Budget, primarily due to EGNB discontinuing its installation services activities, and only providing service on equipment.

## Expenses

For the 2013 Budget year, EGNB has forecast total expenses of $34.3 million. Below is a summary of EGNB's operating and maintenance expenses, bad debt expense, amortization of property, plant and equipment, municipal and other taxes, interest on amounts due to associates and affiliates and other interest and amortization of deferred development costs with comparisons to 2011 and 2012.

Table 2
**Operating Expenses**

| Line No. | (in thousands of dollars) | (1) 2011 Actual | (2) 2011 Budget | (3)=(1)-(2) 2011 Variance | (4) 2012 Forecast | (5) 2012 Budget | (6)=(4)-(5) 2012 Variance | (7) 2013 Budget | (8)=(7)-(5) Variance to 2012 Budget |
|---|---|---|---|---|---|---|---|---|---|
| 1 | Operating Expenses | | | | | | | | |
| 2 | Operating and Maintenance Expenses | 10,061 | 9,407 | 654 | 17,982 | 17,241 | 741 | 14,030 | (3,211) |
| 3 | Bad Debt Expense | 242 | 265 | (23) | 365 | 269 | 96 | 230 | (39) |
| 4 | Amortization of Property, Plant and Equipment | 6,250 | 6,533 | (283) | 6,910 | 7,486 | (576) | 7,466 | (20) |
| 5 | Municipal and Other Taxes | 1,129 | 1,186 | (57) | 1,188 | 1,317 | (129) | 1,195 | (122) |
| 6 | Interest on Amounts Due to Associates and Affiliates and Other Interest | 15,243 | 14,137 | 1,106 | 8,653 | 14,943 | (6,290) | 8,464 | (6,479) |
| 7 | Amortization of Deferred Development Costs | 2,974 | 2,911 | 63 | 2,957 | 2,990 | (33) | 2,908 | (82) |
| 8 | **Total Expenses** | 35,899 | 34,439 | 1,460 | 38,055 | 44,246 | (6,191) | 34,293 | (9,953) |

Operating and Maintenance ("O&M") Expenses

EGNB manages its O&M expenses, excluding incentives, at an aggregate level, where EGNB will try to offset increased costs in certain areas with cost reductions or savings in other areas of the organization.

EGNB has grouped its O&M expenses based on major cost categories rather than departments, as seen in the regulatory financial statement format filed with the Board. This presentation of O&M is better aligned with the NBSO Minimum Filing Requirements and EGNB may consider adjusting its future regulatory financial statements to this format if the Board believes it is a better representation of EGNB O&M expenses.

Table 3

**Operating and Maintenance Expenses**

| Line No. | | (1) 2011 Actual | (2) 2011 Budget | (3)=(1)-(2) 2011 Variance | (4) 2012 Forecast | (5) 2012 Budget | (6)=(4)-(5) 2012 Variance | (7) 2013 Budget | (8)=(7)-(5) Variance to 2012 Budget |
|---|---|---|---|---|---|---|---|---|---|
| 1 | Labour & Benefits | 8,888 | 9,172 | (284) | 9,808 | 9,477 | 331 | 9,189 | (288) |
| 2 | Admin/Office Expenses | 308 | 420 | (112) | 365 | 451 | (86) | 420 | (31) |
| 3 | Computer & Telecom Services | 333 | 376 | (43) | 326 | 352 | (26) | 352 | - |
| 4 | Professional Consulting | 2,529 | 2,308 | 221 | 2,947 | 2,439 | 508 | 2,051 | (388) |
| 5 | Travel and Training | 277 | 288 | (11) | 271 | 297 | (26) | 253 | (44) |
| 6 | Advertising & Promotions | 1,009 | 1,186 | (177) | 1,162 | 1,378 | (216) | 414 | (964) |
| 7 | Incentives | 3,841 | 5,166 | (1,325) | 4,818 | 5,897 | (1,079) | 225 | (5,672) |
| 8 | Tools & Safety | 202 | 123 | 79 | 206 | 205 | 1 | 167 | (38) |
| 9 | Fleet | 723 | 640 | 83 | 604 | 624 | (20) | 564 | (60) |
| 10 | Facilities | 663 | 700 | (37) | 736 | 740 | (4) | 666 | (74) |
| 11 | Insurance | 311 | 282 | 29 | 339 | 324 | 15 | 342 | 18 |
| 12 | NBEUB Assessments | 867 | 1,100 | (233) | 921 | 900 | 21 | 750 | (150) |
| 13 | Corporate Allocations | 1,470 | 1,539 | (69) | 1,518 | 1,510 | 8 | 1,913 | 403 |
| 14 | Gas transportation & related activities | 2,032 | 1,170 | 862 | 2,048 | 1,710 | 338 | 1,901 | 191 |
| 15 | **Total O&M prior to capitalization** | 23,453 | 24,470 | (1,017) | 26,069 | 26,304 | (235) | 19,207 | (7,097) |
| 16 | **Capitalized to:** | | | | | | | | |
| 17 | Property, plant & equipment | 4,353 | 3,895 | 458 | 8,087 | 9,063 | (976) | 5,177 | (3,886) |
| 18 | Development O&M capitalized costs | 9,039 | 11,168 | (2,129) | - | - | - | - | - |
| 19 | **Total capitalized** | 13,392 | 15,063 | (1,671) | 8,087 | 9,063 | (976) | 5,177 | (3,886) |
| 20 | **Total O&M expenses** | $ 10,061 | $ 9,407 | $ 654 | $ 17,982 | $ 17,241 | $ 741 | $ 14,030 | $ (3,211) |

<u>2011 Actual vs 2011 Budget</u>

EGNB's 2011 Actual O&M expenses were $1 million, or 4.2%, under budget, with the principal driver for this variance being lower incentive spending ($1.3 million) due to lower than forecast sales, lower labour & benefits costs ($284K) primarily due to lower than budgeted commissions, and lower NBEUB Assessments fees ($233K) due to a decrease in hearing activity and Public Intervenor costs, partially offset by higher gas transportation costs ($862K) due to lower than anticipated utilization of the Maritimes and Northeast Pipeline ("M&NP") Firm Service Agreement ("FSA"). Other variances within individual O&M expense categories are primarily due to:

- Admin/Office Expenses: administration and office expense costs were $112K under budget primarily due to lower material, supplies & stationery costs ($61K), outside services ($23K), copier ($17K), and postage and courier ($8K) costs.

- Computer and Telecom Services: computer and telephone related ("telecom") services were $43K below budget, primarily due to lower telecom costs ($14K) and lower software maintenance costs ($30K).

- Professional Consulting: professional consulting costs were $221K over budget, primarily due to higher than forecast legal and professional consulting costs arising from activity related to the legislative changes ($321K) offset by reduction in consulting fees for Construction and Maintenance due to a new contract for sewer lateral costs ($101K)

- Travel and Training: travel and training costs were $11K under budget, primarily due to lower airfare ($18K) and accommodations ($14K) related to reduced travel and conference attendance ($2K), partially offset by an increase to meal ($12K) and ground transportation costs ($9K).

- Advertising and Promotions: advertising and promotion expenditures were $177K under budget primarily due to a decrease in advertising & public relations costs ($115K) due to a reduction in programs, a reduction in sponsorship activity ($52K), and a reduction in trade & civic membership costs ($9K), due to an overall cost mitigation strategy.

- Tools and Safety: tools and safety costs were $79K over budget, primarily due to the Call Before You Dig campaign ($70), and Public Awareness and Promotional Items ($9K).

- Fleet: fleet costs were $83K over budget, primarily due to fuel costs higher than budget ($53K), and additional lease and maintenance costs ($30K).

- Facilities: facilities expenditures were $37K below budget primarily due to a reduction in lease costs due to the removal of some warehouse space ($16K) and a reduction in office repairs & maintenance costs ($23K)
- Insurance: insurance costs were $29K over budget, primarily due to higher than anticipated liability insurance ($27K) and broker insurance ($4K), partially offset by lower automobile insurance costs ($1K).
- Corporate Allocations: corporate allocations are $69K under budget due to a decrease in actual costs for IT-Enterprise Financial Systems ($28K), IT-Computer Support Services ($85K), and HR Benefits and Project costs ($92K), partially offset by an increase in Investor Relations costs ($18K), HRIS Services ($17K), internal legal costs as a result of the independent investor unit acquisition and government relations ($27K), an increase in Board of Director charges ($47) as a result of the government relations activity, an increase in Tax support ($10K), Dispatch Services ($8K) and Nomination costs ($5K).

Overall, amounts capitalized to Property, Plant and Equipment and Development O&M capitalized costs are $1.7 million below budget due to a lower amount capitalized to Development O&M and a slightly higher amount to Property, Plant and Equipment, when the capitalization percentages are applied.

<u>2012 Forecast vs 2012 Budget</u>

EGNB's 2012 Forecast O&M expenses are expected to end the year $235K, or 1%, under budget, with the principal drivers for this variance being lower incentive spending ($1.1 million) due to a wind down of the incentive program as a result of legislative changes and lower advertising and promotion costs ($216K) due to a change in brand awareness strategy and the resulting reduction in advertising and a reduction in sponsorships, partially offset by higher professional consulting and legal costs ($508K) due to activity arising from the legislative changes, and higher gas transportation costs ($338K) due to lower than anticipated utilization of the M&NP FSA. Other variances within individual O&M expense categories are primarily due to:

- Labour and Benefits: labour and benefit expenses are forecast to be $331K over budget, primarily due to additional pension plan costs ($400K) and other employee benefits costs ($193K), partially offset by reductions to base pay ($298K) primarily resulting from staff reductions as a result of a reduction in installations activities.
- Admin/Office Expenses: administration and office expense are forecast to be $86K under budget primarily due to lower than budgeted expenditures relating to the leak survey program ($21K), lower stakeholder relations related costs ($30K), lower

stationery costs ($17K), copier and other supplies ($11K) and utility costs ($7K), partially offset by higher other materials and postage ($7K).

- Computer and Telecom Services: computer and telecom services are forecast to be $26K under budget primarily due to lower software maintenance costs ($24K), lower cellular/pager costs ($17K), partially offset by higher computer equipment supplies costs ($10K).
- Travel and Training: travel and training costs are forecast to end $26K under budget, primarily due to lower airfare expenses ($5K) related to reduced travel and conference attendance ($1K) as part of cost mitigation activities and associated accommodation ($9K), meal ($5K) and ground transportation costs ($4K).
- Fleet: fleet costs are forecast to be $20K under budget, primarily due to a reduction of vehicles and associated expenses as part of decreased activities.
- Insurance: insurance costs are forecast to be $15K over budget, primarily due to higher than anticipated liability insurance ($14K) and broker insurance ($3K), partially offset by lower crime insurance ($1K).
- NBEUB Assessments: NBEUB Assessments are forecast to end $21K above budget primarily due to increased regulatory activity in 2012.

Amounts capitalized to Property, Plant and Equipment are forecast to end $976K under budget primarily due to the reduction in incentive spending which is capitalized to Property, Plant and Equipment at a rate of 94.59%. Beginning January 1, 2012, EGNB ceased capitalizing O&M expenses to Development O&M capitalized costs.

2013 Budget vs 2012 Budget

EGNB's 2013 Budget O&M expenses reflect a $7.1 million decrease in comparison to its 2012 O&M Budget, with the principal drivers for this variance being lower incentive spending expectations ($5.7 million), due to the elimination of incentives for new customers attaching to the system in response to legislative changes occurring in 2012, and lower Advertising & Promotions costs ($1.0 million). Other variances within individual O&M expense categories accounting for the remaining $0.4 million decrease compared to the 2012 Budget are primarily due to:

- Labour and Benefits: labour and benefit expenses are forecast to be $287K below the 2012 Budget, primarily due to an overall reduction in labour costs ($910K) due to staff reductions as a result of the amendments to the Gas Distribution Act in 2012, and a corresponding reduction in other employee benefits costs ($160K), partially offset by additional pension plan costs ($783K).

- Admin/Office Expenses: administration and office expenses are forecast to be $31K less than the 2012 Budget, primarily due to cost mitigation strategies in the 2013 Budget as a result of the amendments to the Gas Distribution Act in 2012.

- Professional Consulting: professional consulting costs are forecast to be $388K less than the 2012 Budget, primarily driven by the elimination of contracting out emergency response to a third party and performing this service in-house ($225K), and an overall reduction in the use of outside professional services, as a result of the amendments to the Gas Distribution Act in 2012.

- Travel and Training: travel and training costs are forecast to be $44K less than the 2012 Budget, primarily due to reductions in travel as a result of cost mitigation strategies in the 2013 Budget as a result of the amendments to the Gas Distribution Act in 2012.

- Tools and Safety: tools and safety expenses are forecast to be $38K less than the 2012 Budget, primarily due to reductions in staff, and required tools, as a result of the amendments to the Gas Distribution Act in 2012.

- Fleet: fleet expenses are forecast to be $60K less than the 2012 Budget, primarily due to reductions in vehicles required and the associated repairs, maintenance and fuel costs as a result of cost mitigation strategies in the 2013 Budget as a result of the amendments to the Gas Distribution Act in 2012.

- Facilities: facilities costs are forecast to be $74K less than the 2012 Budget, primarily due to reductions in space required, and the associated repairs and maintenance costs, as a result of the amendments to the Gas Distribution Act in 2012.

- Insurance: insurance expenses are forecast to be $18K more than the 2012 Budget, primarily due to increased liability insurance costs ($14K) and broker insurance costs ($4K).

- NBEUB Assessments: NBEUB Assessments are forecast to be $150K less than the 2012 Budget, primarily due to the expected move to a single proceeding to review both the budget and set annual distribution rates.

- Corporate Allocations: corporate allocations are $403K higher than the 2012 Budget due to proposed change in the corporate allocation methodology.

- Gas Transportation and Related Activities: gas transportation and related activities are $191K higher than the 2012 Budget due to the anticipated trend of lower than anticipated utilization of the Maritimes and Northeast Pipeline ("M&NP") Firm Service Agreement ("FSA") continuing in 2013.

Amounts capitalized to Property, Plant and Equipment and Development O&M capitalized costs are forecast to be $3.9 million less than the 2012 Budget due to a reduction in O&M expenditures ($5.3 million), partially offset by an increase in O&M capitalization rates ($1.4 million)

Other Operating Expenses

2011 Actual vs 2011 Budget

Bad Debt Expense was $23K under budget primarily due to a reduction in revenues and enhanced collection efforts.

Amortization of Property, Plant and Equipment was $283K under budget due to the timing and nature of capital expenditures.

Municipal and Other Taxes were $57K under budget due primarily to changes in property assessment values as compared to budget.

Interest on Amounts Due to Associates and Affiliates and Other Interest was $1.1M above budget due to higher than budgeted Long Term Debt ("LTD") requirements during 2011 due to lower than budgeted cash flow from operations.

Amortization of Deferred Development Costs was $63K above budget primarily due to a reclassification of actual intangible software costs and their associated amortization from Property, Plant and Equipment resulting from accounting changes ($144K), partially offset by lower than budgeted amortization on Development O&M ($81K) resulting from lower than budget additions.

2012 Forecast vs 2012 Budget

Bad Debt Expense is expected to be $96K above budget as a result of current accounts receivable balances considered at risk at the time the 2012 forecast was prepared.

Amortization of Property, Plant and Equipment is expected to be $576 under budget due to the timing and nature of capital expenditures, and an overall reduction in capital expenditures planned as a result of recent amendments to the Gas Distribution Act.

Municipal and Other Taxes are expected to be $129K below budget primarily due to a decrease in capital expenditures as compared to budget.

Interest on Amounts Due to Associates and Affiliates and Other Interest are expected to be $6.3 million under budget due to the planned retirement of LTD associated with funding the regulatory deferral as a result of the amendments to the Gas Distribution Act in 2012.

Amortization of Deferred Development Costs are expected to be $33K under budget due to a lower than budgeted amortization on Development O&M resulting from lower than budget additions.

<u>2013 Budget vs 2012 Budget</u>

Bad Debt Expense is forecast to decrease by $39K compared to the 2012 budget, primarily due to an overall decrease in combined expected gas distributions and installation services revenues year over year, resulting from forecasted reduction in new customers and lower distribution rates, as a result of the amendments to the Gas Distribution Act in 2012, and an exit from the installation activities.

Amortization of Property, Plant and Equipment is forecast to result in a $20K decrease compared to the 2012 budget due to reduced forecast capital additions in 2013 as a result of the amendments to the Gas Distribution Act in 2012.

Municipal and Other Taxes are forecast to decrease by $122K compared to the 2012 budget primarily due to reduced forecast in additions to capital as a result of the amendments to the Gas Distribution Act in 2012.

Interest on Amounts Due to Associates and Affiliates and Other Interest are forecast to decrease by $6.5 million compared to the 2012 budget due to the planned retirement of LTD associated with funding the regulatory deferral as a result of the amendments to the Gas Distribution Act in 2012.

Amortization of Deferred Development Costs is forecast to decrease by $82K compared to the 2012 budget primarily due to the reductions in additions to Development O&M in 2012 as compared to those originally budgeted resulting in a reduced amortization.

## Rate Base

Information with respect to EGNB's year end Rate Base and the levels of Property, Plant and Equipment, Development O&M capitalized costs, Working Capital allowance and other elements within rate base are provided below.

Table 4
**Rate Base**

| Line No. | (in thousands of dollars) | (1) 2011 Actual | (2) 2011 Budget | (3)=(1)-(2) 2011 Variance | (4) 2012 Forecast | (5) 2012 Budget | (6)=(4)-(5) 2012 Variance | (7) 2013 Budget | (8)=(7)-(5) Variance to 2012 Budget |
|---|---|---|---|---|---|---|---|---|---|
| 1 | Property, plant and equipment | 162,532 | 166,571 | (4,039) | 172,072 | 186,574 | (14,502) | 174,158 | (12,416) |
| 2 | Development O&M capitalized costs | 102,786 | 106,942 | (4,156) | 99,937 | 101,368 | (1,431) | 97,134 | (4,234) |
| 3 | Franchise fee | 575 | 562 | 13 | 500 | 475 | 25 | 425 | (50) |
| 4 | Deferred costs | 108 | 109 | (1) | 31 | 109 | (78) | - | (109) |
| 5 | Term deposit | 2,974 | 2,955 | 19 | 2,978 | 2,963 | 15 | 2,978 | 15 |
| 6 | Working capital allowance | 1,960 | 1,327 | 633 | 2,104 | 1,532 | 572 | 1,486 | (46) |
| 7 | Regulatory Deferral | 178,747 | 176,984 | 1,763 | - | 187,399 | (187,399) | - | (187,399) |
| 8 | Rate Base | 449,682 | 455,450 | (5,768) | 277,622 | 480,420 | (202,798) | 276,181 | (204,239) |

2011 Actual vs 2011 Budget

Property, Plant and Equipment was $4.0 million below budget primarily due to a cancellation of a strategic project ($2.7 million), a delay in transportation equipment costs ($0.5 million) due to the timing of vehicle purchases, and the impact of the lower than forecast ending year balance ($1.4 million) from 2010.

Development O&M Capitalized Costs were $4.2 million below budget primarily due to a reduction in additions from O&M spending below budget ($2.1 million), a reduction in amortization ($0.2 million) and the impact of the lower than forecast ending year balance ($2.3 million) from 2010.

Franchise Fee was $13K above budget due to a miscalculation, which caused an overstatement of accumulated amortization in the 2011 Budget.

Term deposit costs were $19K above budget due to the timing of the payout of the accrued interest on the term deposit.

Working Capital Allowance is $633K over budget, primarily due to a higher prepaid expense balance ($697K), partially offset by a lower inventory balance ($64K).

Regulatory Deferral is $1.8 million over budget, primarily due to a shortfall in Gas Distribution revenue ($6.3 million) and Installation Services Margin ($526K), an increase in O&M expenses ($654K), an increase in interest expense ($1.1 million) and an increase in the opening balance ($0.2 million) resulting from higher than forecast additions in the last quarter of 2010. These additions were partially offset by reductions from Other Revenue higher than budget ($0.2 million), amortization lower than budget ($0.2 million) and a reduction in return on equity ($6.5 million) as a result of a regulatory decision reducing the regulated allowed rate of return to 10.9% from the budgeted rate of 12.75%, coupled with a reduction in the equity percentage of overall capital to 45% from the previous 50%.

2012 Forecast vs 2012 Budget

Property, Plant and Equipment is expected to be $14.5 million under budget primarily due to the cancellation of a strategic project and the delay of two other strategic projects to future years ($10.7 million), a reduction in distribution plant spending due to a reduction in attachments ($1.6 million), and the postponement of an IT project ($0.7 million), partially offset by an increase in transportation equipment costs ($0.3 million) due to the timing of vehicle purchases. This is all in addition to a lower opening balance resulting from lower than forecasted capital spending for the final quarter of 2011 ($2.3 million), partially offset by a reduction in depreciation ($0.6 million).

Development O&M Capitalized Costs are expected to be $1.4 million below budget primarily due to a reduction in amortization ($0.1 million) and the impact of the lower than forecast ending year balance ($1.5 million) from 2011.

Franchise Fee Costs are expected to be $25K above budget to bring it in line with the previous year's ending balances and current year's anticipated level of amortization.

Deferred Costs are expected to be $78K below budget due to due to a miscalculation, which caused an overstatement of equity call costs in the 2012 Budget.

Term deposit costs ares expected to be $15K above budget, primarily due to the timing of the payment of the interest earned.

Working Capital Allowance is expected to be $0.6 million above budget, primarily due to higher prepaid expense balances ($577K).

Regulatory Deferral is expected to be $187.4 million below budget due to the removal of the regulatory deferral account from rate base for purposes of calculating return in accordance with the 2012 legislative changes to the Gas Distribution Act.

<u>2013 Budget vs 2012 Budget</u>

Property, Plant and Equipment are forecast to decrease by $12.4 million as compared to the 2012 budget due to a dramatic reduction in budgeted new growth as a result of the 2012 legislative changes to the Gas Distribution Act.

Development O&M Capitalized Costs are forecast to decrease by $4.2 million as compared to the 2012 budget as a result of recognizing an additional year of amortization. Consistent with 2012, there are no new additions to Development O&M.

Franchise fee cost is forecast to decrease by $50K as compared to the 2012 budget due to the recognition of an additional year of amortization.

Deferred Costs are forecast to decrease by $109K as compared to the 2012 budget due to the recognition of an additional year of amortization.

Term deposit costs are forecast to increase by $15K as compared to the 2012 budget to reflect actual experience around the timing of the interest payments and interest rates.

Working Capital Allowance is forecast to decrease by $46K as compared to the 2012 budget, primarily due to lower budgeted inventory ($46K).

Regulatory Deferral is forecast to decrease by $187.4 million as compared to the 2012 budget due to the removal of the regulatory deferral account from rate base for purposes of calculating return in accordance with the 2012 legislative changes to the Gas Distribution Act.

## Non-Rate Base

Information with respect to EGNB's Non-Rate Base items is provided below.

Table 5

**Non-Rate Base**

| Line No. | (in thousands of dollars) | (1) 2011 Actual | (2) 2011 Budget | (3)=(1)-(2) 2011 Variance | (4) 2012 Forecast | (5) 2012 Budget | (6)=(4)-(5) 2012 Variance | (7) 2013 Budget | (8)=(7)-(5) Variance to 2012 Budget |
|---|---|---|---|---|---|---|---|---|---|
| 1 | **Non-Ratebase Assets** | | | | | | | | |
| 2 | Cash and Short Term Investments | 1,088 | - | 1,088 | 3,632 | 7,201 | (3,569) | 11,427 | 4,226 |
| 3 | Accounts Receivable | 14,149 | 14,083 | 66 | 14,299 | 14,807 | (508) | 13,607 | (1,200) |
| 4 | Inventory | 1,263 | 4,087 | (2,824) | 4,455 | 4,289 | 166 | 4,455 | 166 |
| 5 | **Total Non-Rate Base Assets** | 16,500 | 18,170 | (1,670) | 22,386 | 26,297 | (3,911) | 29,489 | 3,192 |
| 6 | **Non-Ratebase Liabilities** | | | | | | | | |
| 7 | Short Term Indebtedness | - | 667 | (667) | - | - | - | - | - |
| 8 | Accounts Payable | 10,979 | 15,941 | (4,962) | 16,004 | 23,522 | (7,518) | 14,746 | (8,776) |
| 9 | Long Term Deferred Post Employment Liabilities | - | 2,359 | (2,359) | 2,464 | 2,328 | 136 | 2,464 | 136 |
| 10 | **Total Non-Rate Base Liabilities** | 10,979 | 18,967 | (7,988) | 18,468 | 25,850 | (7,382) | 17,210 | (8,640) |

Non-rate base items are a function of the annual operations of EGNB and fluctuate with changes in operating revenues and expenses.

**Cost of Capital Summary**

Information with respect to EGNB's Cost of Capital is provided below.

Table 6
**Cost of Capital**

| | (1) 2011 Actual | (2) 2011 Budget | (3)=(1)-(2) 2011 Variance | (4) 2012 Forecast | (5) 2012 Budget | (6)=(4)-(5) 2012 Variance | (7) 2013 Budget | (8)=(7)-(5) Variance to 2012 Budget |
|---|---|---|---|---|---|---|---|---|
| Principal | | | | | | | | |
| Debt | 245,500 | 227,701 | 17,799 | 160,339 | 262,150 | (101,811) | 160,339 | (101,811) |
| Equity | 211,867 | 225,618 | (13,751) | 121,106 | 218,846 | (97,740) | 128,643 | (90,203) |
| Return ($) | | | | | | | | |
| Debt | 14,745 | 14,133 | 612 | 8,587 | 14,922 | (6,335) | 8,448 | (6,474) |
| Equity | 20,738 | 27,281 | (6,543) | 13,382 | 22,607 | (9,225) | 8,650 | (13,957) |
| Approved rates | | | | | | | | |
| Debt | 6.10% | 6.24% | -0.14% | 5.75% | 6.04% | -0.29% | 5.52% | -0.52% |
| Equity | 10.90% | 12.75% | -1.85% | 10.90% | 10.90% | 0.00% | 10.90% | 0.00% |

EGNB finances its operations through a combination of equity and debt financing.

2011 Actual vs 2011 Budget

Equity was $13.8 million below budget due to a regulatory decision received that directed EGNB to reduce the level of Equity to 45% from the previous regulated 50%. As a result, EGNB's cash requirements were funded through debt financing which was $17.8 million above budget.

Actual debt rates were 0.14% below budget rates due to lower than budgeted interest rates on the additional debt requirements. Equity rate was 1.85% below budget as a result of a regulatory decision reducing allowed return on equity to 10.9% from the budget level of 12.75%.

2012 Forecast vs 2012 Budget

Equity is forecast to be $97.8 million below budget primarily due to the removal of equity associated with the regulatory deferral account, coupled with a rebalancing of equity levels which had exceeded the allowed 45% as a result of the suspension of distributions in 2010. This was in response to 2012 legislative changes to the Gas Distribution Act, 1999 which prohibited the regulatory deferral. The balance of the funding associated with the regulatory deferral account was removed from Debt ($78.7 million) contributing to the debt being forecasted to be $101.8 million below budget. The remainder of the debt variance ($23.1 million) is a result of EGNB's cash requirements being below budget.

Debt rates are forecast to be 0.29% below budget due to the retirement of debt notes carrying a higher interest rate.

2013 Budget vs 2012 Budget

Equity is forecast to be $90.2 million below budget primarily due to the removal of equity associated with the regulatory deferral account, offset by a growth in equity of $9.9 million represents earnings retained as there are no forecasted distributions to be paid out. The balance of the funding associated with the regulatory deferral account was removed from Debt ($78.7 million) contributing to the debt being forecasted to be $101.8 million below budget. The remainder of the debt variance ($23.1 million) is a result of EGNB's cash requirements being below budget.

Debt rates are forecast to decrease by 0.52% as compared to the 2012 budget resulting from the expiration of debt notes with higher rates than the replacement debt.