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**Semester Project Report**

# **Hydro One Limited**

*Stock Price, Cost of Capital, Capital Structure & Payout Policy*

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*Submitted by*

Annik Aucoin — 30249373

Brooke Negash — 30240646

Ivan Imshenetsky — 30143926

Leila Pollock — 30207918

Victoria Aborowa — 30173048

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FNCE 451 — Corporate Finance

*Haskayne School of Business, University of Calgary*

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Professor Tashfeen Hussain, Ph.D.

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## General Information

<b>Company</b>	Hydro One Limited
<b>Ticker</b>	TSX: H
<b>Industry</b>	Regulated electric transmission and distribution
<b>Head Office</b>	Toronto, Ontario
<b>Share Price (April 10, 2026)</b>	C\$58.94
<b>Market Capitalization</b>	C\$35.35 billion (599.8 million shares)
<b>2025 Net Income (Common Shareholders)</b>	C\$1.339 billion
<b>2025 Basic EPS</b>	C\$2.23
<b>Annualized Dividend Per Share</b>	C\$1.3324
<b>Estimated Cost of Equity (<math>K_e</math>)</b>	5.48%
<b>Estimated After-Tax Cost of Debt (<math>K_d</math>)</b>	3.61%
<b>Estimated WACC</b>	4.82%
<b>Regulatory Allowed ROE (OEB, through 2027)</b>	9.36%
<b>Regulatory Deemed Capital Structure</b>	40% equity / 60% debt
<b>Rate-Regulated Revenue Share</b>	~99%

Hydro One Limited is Ontario's largest electricity transmitter and distributor, and it is an appropriate subject for this analysis because its value is determined almost entirely by regulatory outcomes, rate base investment, and capital allocation rather than by commodity prices or cyclical demand. Approximately 99% of revenues are rate-regulated under the Ontario Energy Board (OEB), the company operates under a regulatory allowed ROE of 9.36%, and a deemed 40%/60% equity-to-debt capital structure governs its rate applications through 2027. These characteristics make Hydro One analytically well suited to rigorous cost-of-capital estimation and capital structure evaluation, while also raising a pointed valuation question: is the market pricing its unusually stable cash flows correctly?

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## Highlights of the Report

**Stock Price Assessment.** Hydro One (C\$58.94) trades at the highest forward P/E (24.8×) and EV/EBITDA (18.2×) among Canadian utility peers while offering the lowest dividend yield (2.3%). A Gordon Growth Model analysis implies an intrinsic value of approximately C\$51.64, indicating the stock trades at roughly a 14% premium to fundamental value. The stock is assessed as *fair to slightly expensive*; premium quality is fully priced.

**Cost of Capital.** Three independent methods (CAPM 4.99%, DDM 5.16%, BYPRP 6.29%) produce an equally weighted cost of equity of **5.48%**. The after-tax cost of debt is 3.61% (pre-tax coupon 4.20%, effective tax rate 14%), yielding a current-market **WACC of 4.82%**. A sensitivity analysis spanning plausible beta and debt-cost assumptions confirms the result is robust, with WACC ranging from 4.58% to 5.06%.

**Capital Structure.** Hydro One's market-value capital structure (64.9% equity, 35.1% debt) is materially more conservative than the OEB regulatory deemed structure (40%/60%). This conservatism underpins the company's premium credit rating and supports its premium equity valuation, though it implies a degree of under-leveraging relative to what the regulator considers optimal.

**Payout Policy.** The annualized dividend of C\$1.3324 implies a trailing payout ratio of 59.75% and reflects six consecutive years of dividend growth averaging approximately 5.7% per annum. The policy is prudent, sustainable, and consistent with a capital-intensive regulated utility balancing income delivery against the internal financing demands of a C\$2 to 3 billion annual capital program.

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# Hydro One Limited

*Stock Price, Cost of Capital, Capital Structure, and Payout Policy*

## 1. Introduction

Hydro One Limited (TSX: H) is Ontario's sole provincial electricity transmitter and its largest distribution utility, serving approximately 1.5 million customers. Roughly 99% of revenues are governed by Ontario Energy Board rate decisions, giving the firm an unusually transparent financial profile: earnings are driven by the allowed ROE of 9.36%, the regulated rate base of C\$29.0 billion at year-end 2024, and capital allocation efficiency. The central analytical question is not whether Hydro One is a high-quality company, but whether the market prices that quality correctly. This report concludes that the quality is real but fully priced and the stock is fair to slightly expensive. All market data are as of April 10 to 11, 2026; Bank of Canada yields are as of April 9, 2026.

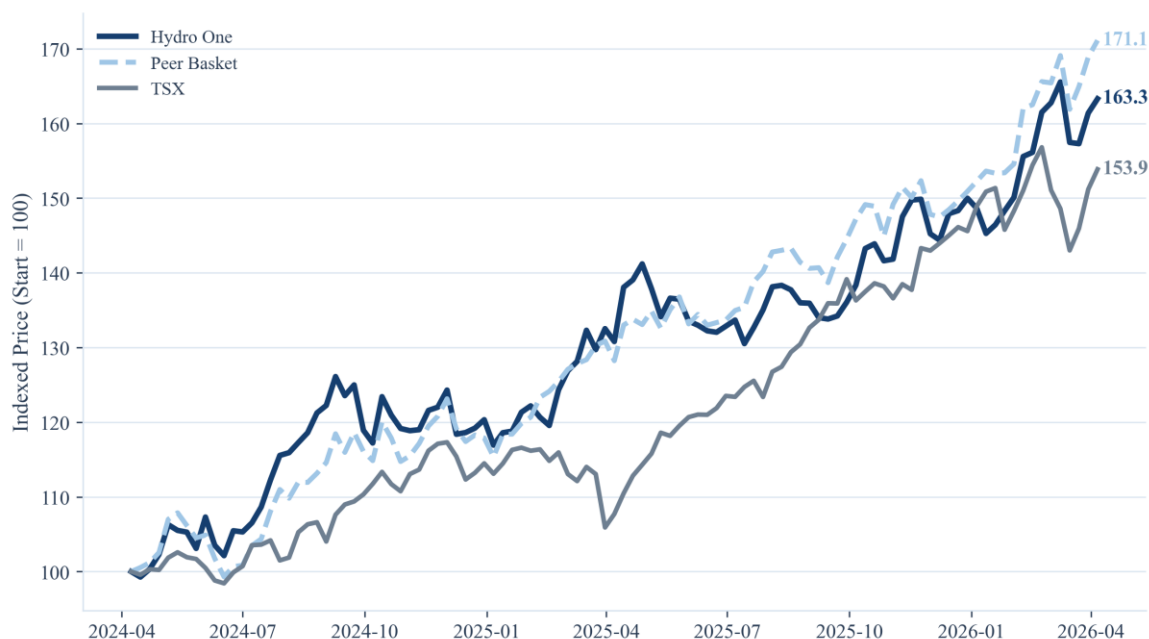
## 2. Critical Assessment of the Stock Price

### 2.1 Relative Performance

Over the two years ending April 2026, Hydro One appreciated from an indexed base of 100 to approximately 163.3, outpacing the TSX Composite (153.9) by roughly 9 percentage points, while the utility peer basket rose to 171.1. That Hydro One trailed the peer basket is analytically significant: the outperformance appears driven by a broad re-rating of defensive regulated utilities rather than isolated company-specific catalysts. Figure 1 illustrates this pattern.

## Hydro One Relative Share Performance

Hydro One has outperformed the broad TSX, though the peer basket has been even stronger



**Figure 1. Two-Year Relative Share Performance (April 2024 to April 2026)**

Source: Yahoo Finance, author calculations.

## 2.2 Peer Valuation Comparison

Hydro One commands both the highest forward P/E (24.8x) and the highest EV/EBITDA multiple (18.2x) in the peer group, while offering the lowest dividend yield (2.3%). The EV/EBITDA gap relative to Fortis (14.1x) is notable: two companies with comparable regulatory business models are priced roughly 29% apart, indicating that the market assigns an explicit quality premium to Hydro One's concentrated Ontario T&D franchise. Figure 2 maps the trade-off between systematic risk and yield across the peer set.

**Table 1. Canadian Utility Peer Comparison (April 11, 2026)**

Company	Fwd P/E	EV/EBITDA	5Y Beta	Div. Yield	Interpretation
Hydro One	24.8×	18.2×	0.41	2.3%	Premium on every metric; lowest yield in peer set
Fortis	20.7×	14.1×	0.44	3.2%	Closest quality peer; more attractive on yield

Company	Fwd P/E	EV/EBI TDA	5Y Beta	Div. Yield	Interpretation
Emera	20.5×	12.8×	0.46	3.9%	Higher yield; higher leverage risk
Canadian Utilities	18.8×	9.6×	0.60	3.6%	Lower multiple; higher beta; better income value
Algonquin	15.8×	8.3×	0.89	4.0%	Highest yield and risk; outlier in peer group

Source: Yahoo Finance, S&P Capital IQ consensus estimates, author calculations.

### Hydro One Peer Defensiveness Map

Hydro One screens as a low-beta, regulated utility with a stable but lower cash yield

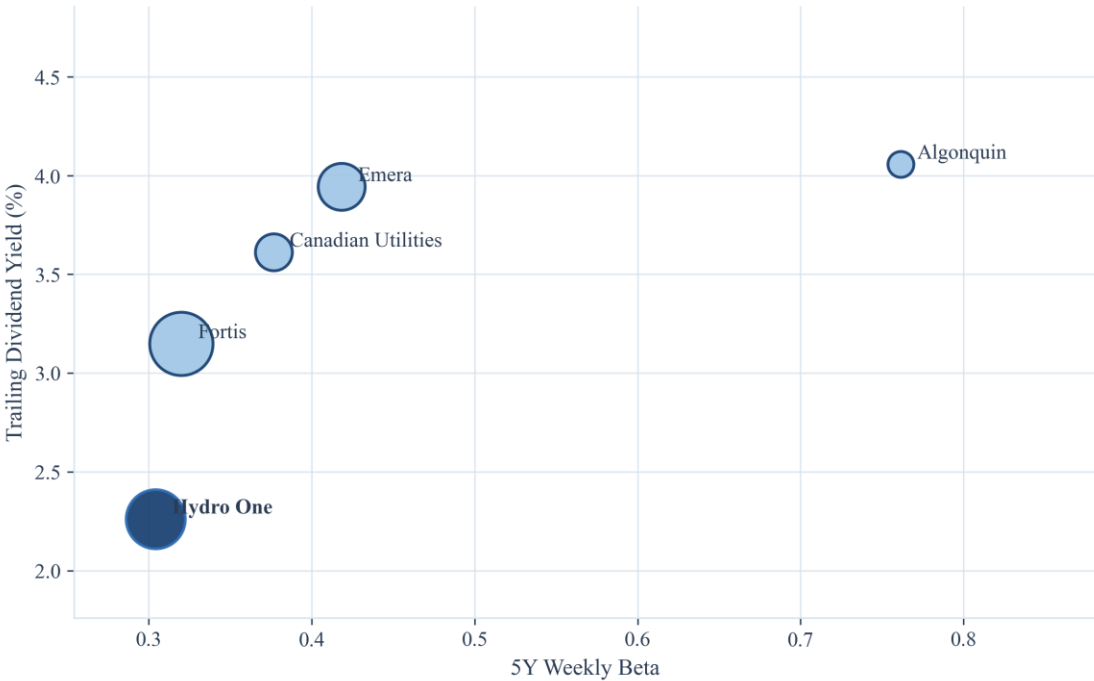


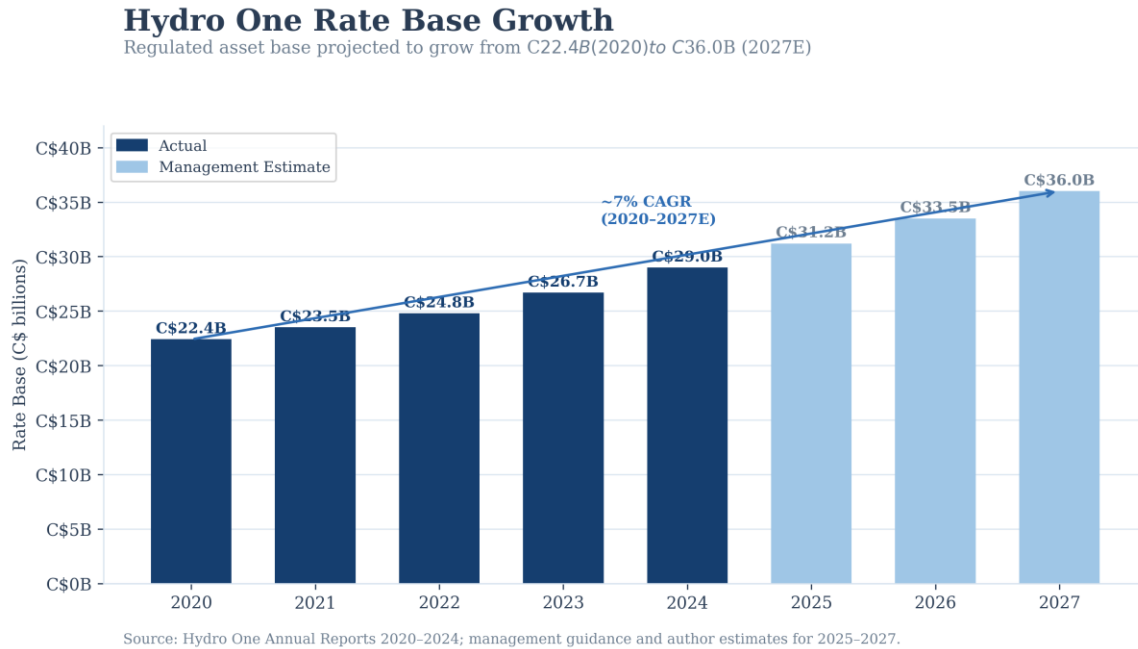
Figure 2. Peer Defensiveness Map: 5-Year Weekly Beta vs. Trailing Dividend Yield

Source: Yahoo Finance, author calculations, April 11, 2026.

### 2.3 Rate Base Growth and Fundamental Outlook

Hydro One's premium is supported by visible, funded growth. Figure 3 shows the regulated rate base growing from C\$22.4 billion in 2020 to approximately C\$36 billion by 2027, a compound rate of roughly 7% per year. Rate base growth drives earnings and dividends directly for a regulated utility, making this trajectory a legitimate anchor for the premium. The key caveat is that

the investment program is already well understood by the market and largely embedded in the current share price.



**Figure 3. Hydro One Rate Base Growth: Actual and Management Estimate (C\$ billions)**

Source: Hydro One Annual Reports 2020 to 2024; management guidance and author estimates for 2025 to 2027.

## **2.4 Gordon Growth Model Intrinsic Value**

Using the current annualized dividend of C\$1.3324, the cost of equity of 5.48% derived in Section 3, and a long-run growth rate of 2.90% capped at nominal GDP:

$$P_0 = D_1 / (K_e - g) = C\$1.3324 / (5.48\% - 2.90\%) = C\$51.64$$

At C\$58.94, the stock trades at approximately 13.8% above this estimate. Because near-term rate base growth of ~7% exceeds the terminal rate, the gap does not signal outright overvaluation; it does confirm that investors are already discounting an above-average growth outlook. The stock offers limited margin of safety, and valuation compression would be swift if allowed returns fall or rate base growth disappoints. The overall assessment is that Hydro One is fair to slightly expensive: premium quality is fully priced.

### 3. Estimate of the Cost of Capital

#### 3.1 Beta: A Blended Methodology

Estimating beta for a regulated utility requires methodological care because single-window regressions are noisy for low-volatility stocks. This analysis blends three inputs, as summarized in Table 2: a raw regression beta (30% weight), a Blume-adjusted beta (20% weight), and a peer-median beta (50% weight). The 50% peer weight anchors the estimate to the systematic risk profile of comparable regulated businesses, the most theoretically sound basis for a utility beta.

**Table 2. Beta Estimation Methodology**

Beta Component	Estimate	Weight	Rationale
Raw Beta (2Y/5Y weekly blend vs. TSX)	0.2561	30%	Reflects observed low-volatility trading
Blume-Adjusted Beta	0.6287	20%	Mean-reversion correction toward 1.0
Weighted Peer Beta (Fortis, Emera, CU, AQN)	0.4063	50%	Business-risk comparability anchor
<b>Selected Blended Beta</b>	<b>0.3613</b>	<b>100%</b>	<b>Final levered estimate used in all K<sub>e</sub> methods</b>

*Source: Yahoo Finance weekly return data; author calculations. Raw beta from 60%/40% blend of 2Y and 5Y regressions vs. TSX.*

#### 3.2 Equity Risk Premium

The selected CAPM ERP is 4.23%, anchored to Damodaran's forward-looking mature-market ERP for Canada, last updated January 5, 2026. Two cross-checks bound the selection: the Fernández 2025 practitioner survey reports Canada MRP of 5.60%, while the FP Canada 2025 Projection Assumption Guidelines imply a forward ERP of 3.14% (6.6% expected equity return less the 3.46% GoC yield). The selected value sits within this corridor:

*Cross-check range: 3.14% (FP Canada implied) ≤ 4.23% (selected) ≤ 5.60% (Fernández 2025)*

#### 3.3 Cost of Equity: Triangulation

**CAPM.** Using the 10-year GoC yield of 3.46%, selected beta 0.3613, and the forward-looking Damodaran ERP of 4.23%:

$$K_e(CAPM) = 3.46\% + 0.3613 \times 4.23\% = 4.99\%$$

**Dividend Discount Model.** Using the current dividend yield (1.3324/58.94 = 2.26%) and the long-run growth rate capped at 2.90%:

$$K_e(DDM) = 2.26\% + 2.90\% = 5.16\%$$

**Bond-Yield-Plus-Risk-Premium.** Using the Long Canada yield (3.89%) and a total-beta-derived sector premium capped at 2.40%:

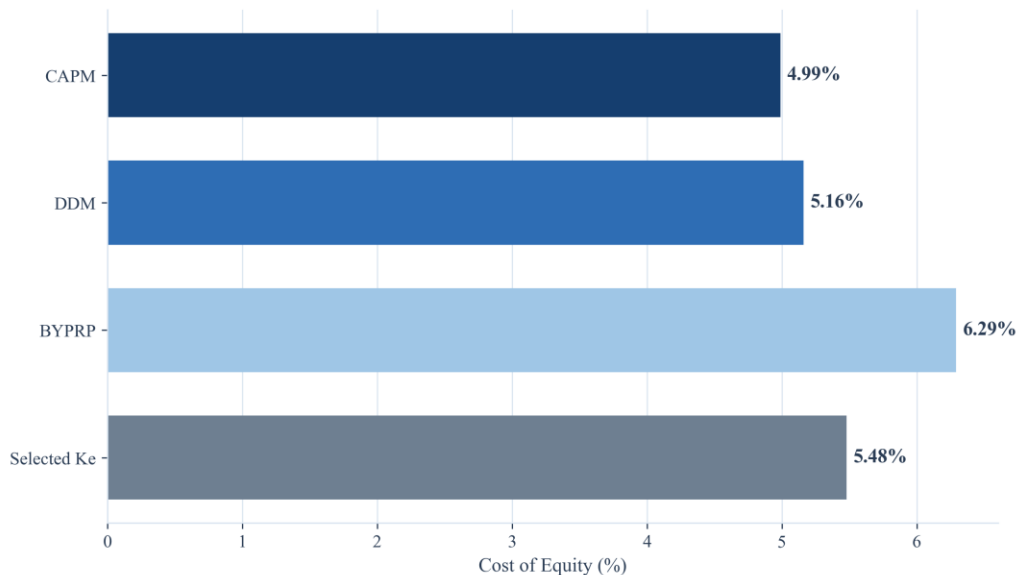
$$K_e(BYPRP) = 3.89\% + \min(2.40\%, \max(1.80\%, 1.2086 \times 4.23\%)) = 6.29\%$$

CAPM and DDM cluster tightly at 4.99% and 5.16%, validating each other. BYPRP at 6.29% serves as a conservative upper bound. The equally weighted average is the selected estimate:

$$K_e(\text{Selected}) = (4.99\% + 5.16\% + 6.29\%) / 3 = 5.48\%$$

### Hydro One Cost of Equity Triangulation

CAPM uses a forward-looking 4.23% Canada ERP anchor and triangulates to a 5.48% selected cost of equity



**Figure 4. Cost of Equity Triangulation: CAPM, DDM, and BYPRP**

Source: Bank of Canada, Yahoo Finance, Hydro One filings, FP Canada 2025 PAG, author calculations.

### 3.4 Cost of Debt

Hydro One's disclosed weighted-average coupon on long-term debt (4.20%) is selected as the pre-tax cost of debt. A cross-check against the BlackRock XCB Canadian corporate bond benchmark (YTM of 3.77%, distribution yield of 4.11%) confirms this is within the expected range for an investment-grade regulated utility. The effective tax rate of 14% reflects systematic timing differences between GAAP depreciation and CCA deductions on long-lived infrastructure assets, a recurring structural feature rather than a temporary anomaly.

$$Kd(\text{after-tax}) = 4.20\% \times (1 - 0.14) = 3.61\%$$

### 3.5 WACC

Market-value weights (64.9% equity, 35.1% debt) are derived from Hydro One's market capitalization (C\$35.35 billion) and total book debt (C\$19.12 billion). Table 3 summarizes the WACC computation.

**Table 3. WACC Summary**

Component	Rate	Weight	WACC Contribution
Cost of Equity (K <sub>e</sub> )	5.48%	64.9%	3.56%
After-Tax Cost of Debt (K <sub>d</sub> )	3.61%	35.1%	1.27%
<b>WACC</b>	<b>4.82%</b>	<b>100.0%</b>	<b>4.82%</b>

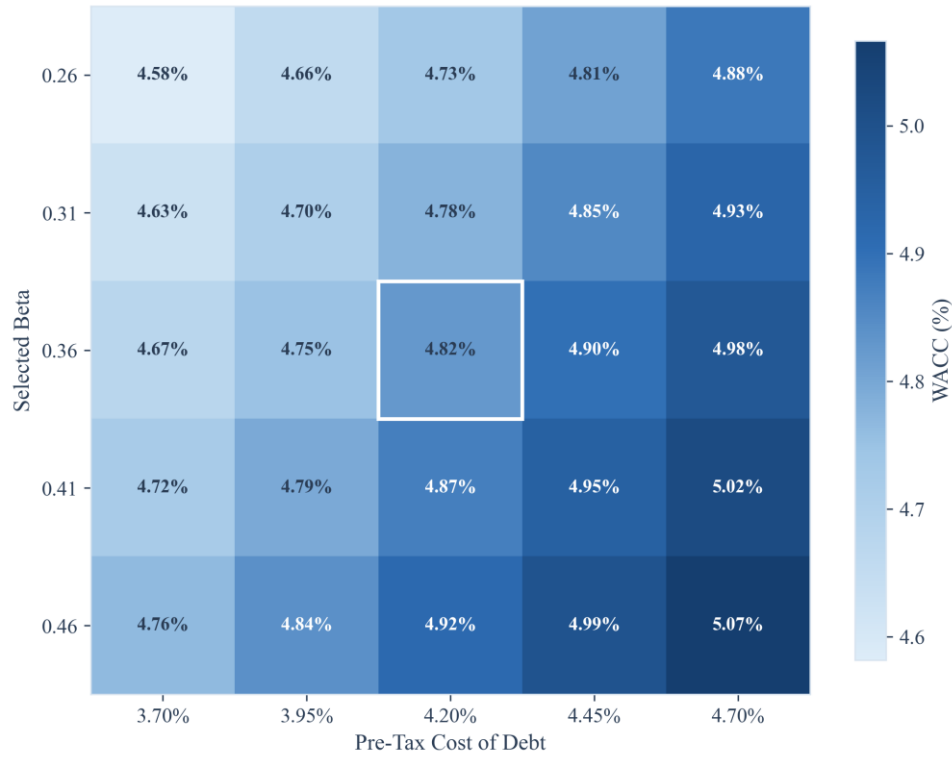
*Source: Yahoo Finance, Bank of Canada, Hydro One filings, author calculations.*

$$WACC = 0.649 \times 5.48\% + 0.351 \times 3.61\% = 3.56\% + 1.27\% = 4.82\%$$

Figure 5 confirms the robustness of this estimate. Varying beta from 0.26 to 0.46 and pre-tax debt cost from 3.70% to 4.70%, WACC ranges from 4.58% to 5.06%, a 48-basis-point spread that is narrow relative to estimation method differences. The base case (4.82%) sits centrally within the grid.

## Hydro One WACC Sensitivity Heatmap

Base case WACC is 4.82% at a selected beta of 0.36 and a 4.23% CAPM ERP anchor



**Figure 5. WACC Sensitivity: Beta vs. Pre-Tax Cost of Debt**

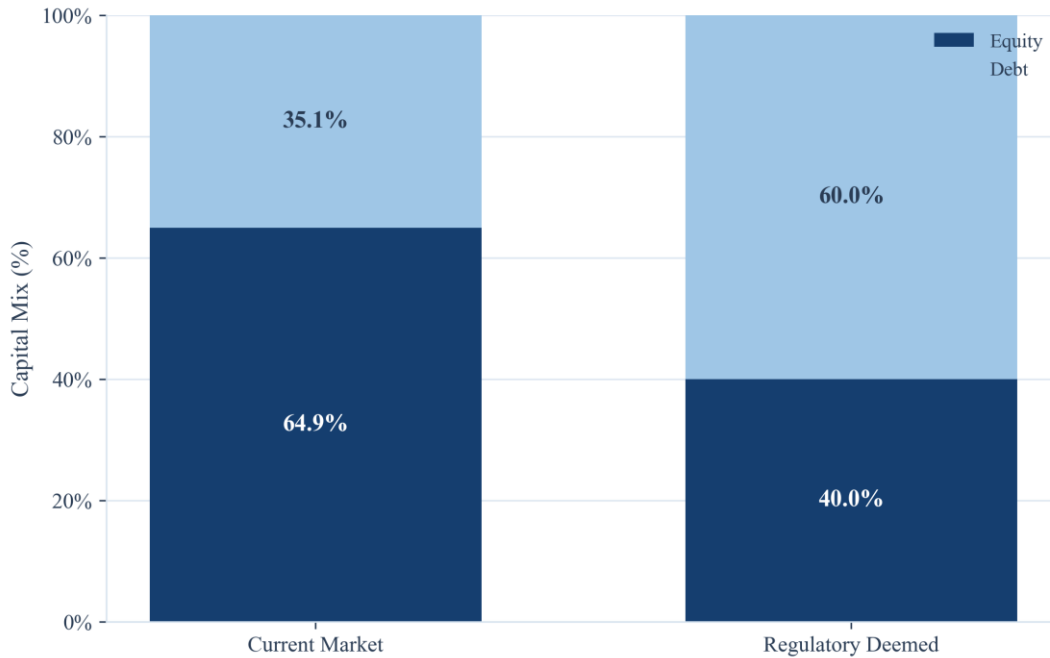
Source: Bank of Canada, Hydro One filings, author calculations.

### 4. Critical Assessment of the Firm's Capital Structure

Hydro One's market-value capital structure (64.9% equity, 35.1% debt) is materially more conservative than the OEB regulatory deemed structure (40%/60%), as shown in Figure 6. This gap reflects the premium at which the equity trades: elevated share prices mechanically raise the market-value equity weight even when debt is unchanged.

## Hydro One Capital Structure Comparison

Hydro One's market-value equity mix remains materially above the 40% deemed level



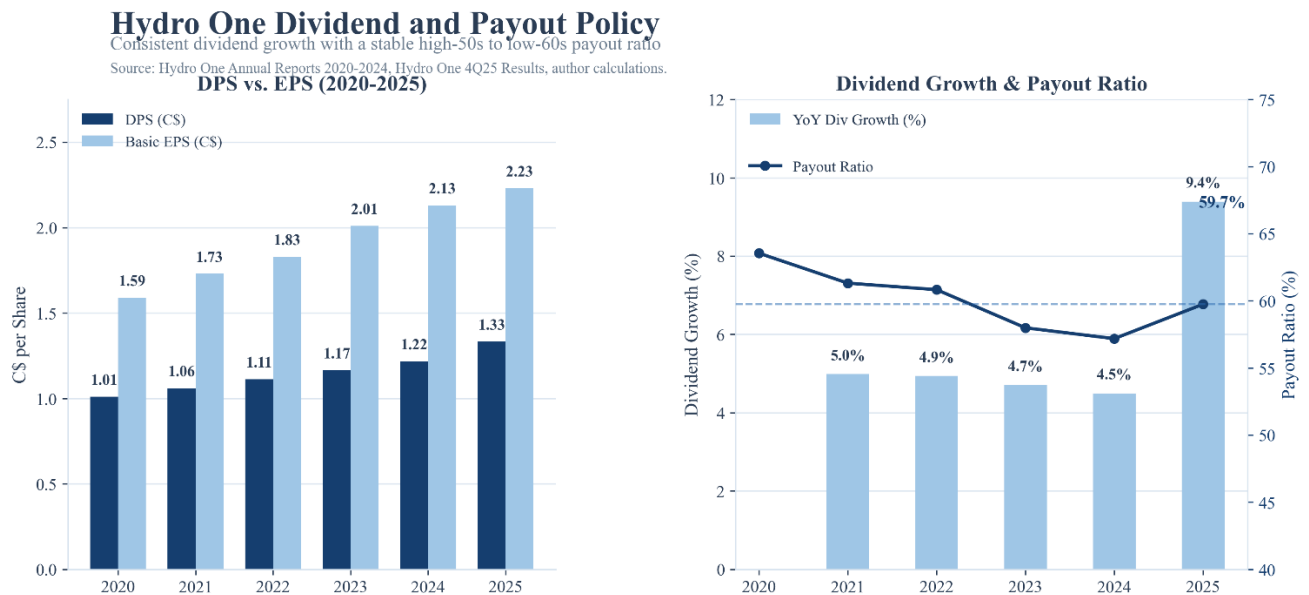
**Figure 6. Capital Structure: Market-Value vs. Regulatory Deemed**

*Source: Yahoo Finance, Hydro One filings, author calculations.*

A Modigliani-Miller perspective would suggest Hydro One is leaving value on the table by operating below the regulatory-deemed leverage ratio, since the tax-shield value of additional debt is real. This argument is incomplete for three reasons specific to regulated utilities. First, the OEB sets allowed returns on the deemed structure, not the market-value structure; a shift toward more debt does not automatically increase the equity eligible for the 9.36% allowed ROE, so the tax shield gain may not translate into earnings improvement. Second, Hydro One's premium valuation is partly a reward for credit strength and financial conservatism; increasing leverage to extract a tax shield risks eroding that quality premium, offsetting the mechanical WACC benefit. Third, a C\$2 to 3 billion annual capital program requires financial flexibility through market cycles. Hydro One's capital structure is deliberately conservative, and that conservatism is a feature of the investment case, not a flaw.

## 5. Critical Assessment of the Firm's Payout Policy

Hydro One's payout policy is disciplined and well calibrated for a capital-intensive regulated utility. As shown in Figure 7, the company has grown its dividend every year from C\$1.0104 in 2020 to C\$1.3324 in 2025, a six-year CAGR of approximately 5.7%, while basic EPS grew at 5.8% over the same period. The payout ratio has remained in a stable 58 to 60% band, confirming that dividend growth was funded by earnings growth rather than ratio expansion.



**Figure 7. Dividend Per Share, EPS, and Payout Ratio (2020 to 2025)**  
 Source: Hydro One Annual Reports 2020 to 2024, 4Q25 Results, author calculations.

A trailing payout ratio of 59.75% is moderate for a mature regulated utility. Retaining approximately 40% of earnings internally partially funds the C\$2 to 3 billion annual capital program, reducing equity market dependence and dilution risk. Management guidance of approximately 6% average annual dividend growth is consistent with the rate base CAGR and the stable payout ratio, making it a credible and sustainable commitment.

Mechanically, Hydro One could support a higher payout ratio; with near-100% regulated revenues and investment-grade credit, a 65 to 70% payout would be sustainable. Management has instead positioned the company as a compounding total-return utility rather than a high-yield income vehicle, accepting a 2.3% yield (versus 3.2 to 4.0% for peers) in exchange for more consistent long-run growth. That trade-off carries a real cost: Hydro One's yield is materially below every peer, weakening its appeal for income-oriented investors who are the natural constituency for regulated utility stocks. The payout policy is well designed for Hydro One's strategic positioning but is not optimized for current income.

## **6. Limitations of the Analysis**

Three key limitations apply. First, book debt (C\$19.12 billion) is used as a proxy for market-value debt; to the extent legacy bonds trade below par, the debt weight is slightly overstated and WACC modestly understated. Second, the Gordon Growth Model intrinsic value of C\$51.64 is a conservative cross-check, not a complete DCF; a multi-stage model reflecting near-term ~7% rate base growth would produce a higher value. Third, both CAPM and DDM are sensitive to regulatory outcomes: a future OEB decision to lower the allowed ROE would reduce the DDM growth rate and could compress the equity beta, lowering the cost of equity. Hydro One's 24.8x forward P/E also leaves limited cushion against rising benchmark yields, with each 50-basis-point yield increase reducing the GGM value by roughly C\$6 to 7 per share.

## **7. Conclusion**

Hydro One is a premium-quality regulated utility with real and well-established strengths: regulatory stability, ~7% rate base CAGR, conservative financial management, and ~5.7% dividend CAGR. The analytical challenge is that these qualities are also well known to the market.

At C\$58.94, the stock trades at a 14% premium to a Gordon Growth Model estimate of C\$51.64, commands the highest forward P/E (24.8x) and EV/EBITDA (18.2x) in the peer group, and offers the lowest dividend yield (2.3%). The WACC of 4.82% is derived from a cost of equity of 5.48% anchored to Damodaran's January 5, 2026 forward-looking ERP of 4.23%, and an after-tax debt cost of 3.61%. The market-value capital structure is deliberately conservative relative to the OEB deemed benchmark, and the payout policy is sustainable and internally consistent. All four sections of this report converge on the same conclusion: Hydro One is an excellent company that the market has correctly identified as such, warranting a Hold for existing shareholders and a patient wait for a more attractive entry point.

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