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VISION
A customer focused company valued by the communities we serve.

MISSION
Serve communities through the efficient, safe and reliable delivery of high quality utility services.

CORE
Respect for the environment and for the safety of ourselves and others. Competency, integrity and efficiency in all our work. Respect for our community, customers and co-workers. A desire for continuous improvement.
CHAIR’S MESSAGE

In 2012, President & CEO Brian Curran announced his intention to retire, effective January 31, 2013. A recruitment committee was formed and efforts immediately advanced in order to find a successor. Dominic Parrella, Vice President Operations & Engineering, will succeed Brian upon his retirement in 2013.

Dominic joined the Sault Ste. Marie PUC in 1987 as the Distribution Engineer and progressed steadily through roles of increasing responsibility including his most recent role as Vice President, Operations & Engineering. Dominic was selected from 23 applicants identified through a Canada wide recruitment campaign undertaken during the month of September.

On behalf of the Board we would like to express our sincere thanks for the effective leadership and vision Brian has given to the PUC over his past 12 years of service. He leaves behind a strong corporate culture. In addition, during his time at the PUC, Brian has been a leading force in community service and has worked relentlessly to improve Sault Ste. Marie for all that live here. We are honoured to have had the benefit of his dedication and service to our community and our company.

I would also like to thank the Board members of PUC Services for their contributions during the past year and to thank all the employees in helping to make 2012 a safe and successful year. Once again, the past year was very challenging for both the Board and the company. And once again, all have risen to the challenge.

L.A. Guerriero
Chair, PUC Services Inc.
PRESIDENT’S MESSAGE

Thanks to the diligent efforts of every employee throughout 2012, we had no lost time injuries. The commitment to safety of all employees at PUC Services is clear. We continue to dedicate significant effort and attention to working safely and promoting a strong safety culture within the company. I would like to express my sincere congratulations to all staff for their continued dedication to putting safety first.

As in past years, 2012 was again a challenging year for PUC Services. On the water side of the business, the switch to free chlorine continued to impact all aspects of our operations. We initiated uni-directional flushing and responded to water quality issues through the year. We carried out extensive sampling at private residences and on the distribution system. We carried out an independent water quality survey to gauge customer satisfaction with the new disinfection method. We also carried out significant capital construction associated with City road reconstruction projects.

With the divestiture of PUC Telecom Inc. late in 2011, significant effort was expended to meet the commitments associated with that sale. Efforts continued with implementing time-of-use rates and converting all mandated customers to time-of-use. We completed substantial line construction work associated with the Sub 10 reconstruction project, and significant work to install and connect new customers and services. We undertook and achieved implementation of new technology to extend the life of underground cables without having to dig them up.

We prepared and filed a mandated Financial Plan for the water utility and we expended significant effort to prepare and submit our electrical Cost of Service rate application to the OEB. We continued to make good progress towards achieving the mandated conservation and demand management targets by 2014.

All of this while we continued to provide safe, reliable and economical electrical, water and wastewater services to our customers, both in Sault Ste. Marie and in the other communities and organizations we serve. Not to mention the planning and preparation that went into preparing for the move to the new building.

I would like to commend and sincerely thank every employee for their continued efforts in serving our customers and for their commitment to them. Thank you.

Dominic Parrella
President & CEO, PUC Services Inc.
OUR BUSINESS

Nature of Business

PUC Services Inc. is a utility services company with 181 full-time employees as of December 31, 2012. The company provides management, operating, maintenance and administrative services in the areas of municipal electrical distribution, drinking water production and distribution and municipal wastewater treatment.

The company has long term contracts with PUC Distribution Inc. for its electric distribution system and with the Public Utilities Commission of the City of Sault Ste. Marie for the water treatment and distribution systems in Sault Ste. Marie. The company also operates and maintains the City’s two sewage treatment plants.

PUC Services provides general management and customer care services to Espanola Regional Hydro Distribution Corporation in Espanola. In addition, the company provides services to several communities and organizations across the District of Algoma in Northern Ontario. Service contracts include Blind River, Echo Bay, Desbarats, Township of North Shore, Sault Ste. Marie Airport, the Algoma District School Board, the Huron Superior Catholic School Board and Richards Landing.

Significant Activities in 2012

On the electric side of the business, our staff worked hard, on behalf of PUC Distribution Inc., to improve outage performance and achieved an excellent outcome. The average duration of outages reached the lowest level since 2002 while the frequency of outages declined to the lowest level since 2008. This is exceptional performance and every employee should be proud of their achievement.

On the water side of the business, our staff worked hard, on behalf of the Public Utilities Commission, to resolve ongoing customer concerns over the change in water taste and odour following the switch to free chlorine disinfection residual late in 2011. We instituted “uni-directional flushing” to improve water quality in response to the taste and odour concerns. This type of flushing increases the speed of the water flowing in the main so as to produce a scouring action that removes loose sediment and deposits. The flushing starts at a water source (e.g. the water pumping stations) and moves through the distribution pipes in one flow direction only. This ensures that clear water is always used to flush the mains. Uni-directional flushing is a far more aggressive method of flushing the distribution system which effectively removes mobile scale and sediment that has accumulated in the pipes over many years of internal corrosion of the pipe wall.

Our Customer Service staff are especially to be commended for their efforts in responding to customer concerns and providing excellent service in the face of significant, ongoing customer dissatisfaction. 2012 was a very demanding year, especially for our Customer Service staff, but also our field operations staff who had to cope with sometimes difficult situations in the field.

Renewable Energy

Moving into 2012, we expected that the Province’s review of the Feed-in Tariff program would result in a favourable outcome such that we could add more solar generation to PUC’s holdings. Two key locations, the city’s new west end community centre and PUC Distribution’s new corporate building, were anticipated to be approved in 2012. Unfortunately, the Province has declared zero capacity for FIT projects in the Sault Ste. Marie area. In addition, transmission constraints on the transmission system preclude any further developments in the near term.

Energy Conservation

An energy audit on Sault Ste. Marie’s water treatment plant identified opportunities to reduce electricity consumption. The audit revealed significant opportunities in lighting retrofits, variable speed drives for large pumps and the use of heat pumps to capture heat from the influent water to both heat and cool the plant. Combined with the renewable generation from the solar panels and pressure reducing turbine that were installed in the plant several years ago, the plant energy efficiency projects could potentially reduce its non-renewable electricity requirements by more than 37%.

The cost of the proposed energy efficiency measures is estimated at approximately $800,000. PUC Services, acting on behalf the Public Utilities Commission, worked through 2012 to obtain funding from the Green Municipal Fund. An agreement was signed in late November 2012 to cover 80% of the costs. The funding is a combination of 20% grant and 80% low interest loan. Individual energy efficiency project cost-benefit evaluations will be used to confirm project implementation plans over the next couple years.

Environmental Stewardship

We strive to minimize environmental impacts from our business operations. Our 3-R’s Committee looks for opportunities to reduce, reuse and recycle surplus materials. In 2012 we diverted 68.3 tonnes of ferrous metal, 34.5 tonnes of non-ferrous metals and 8 tractor trailer loads of chipped wood from old power poles and cleared vegetation. In addition, 20.4 tonnes of paper and plastics were diverted from the waste stream for recycling. Waste materials considered hazardous were stored in accordance with applicable regulations and hauled away by contractors that are licensed to transport and dispose of such materials.
Corporate and Community Safety

We work particularly hard to ensure that our employees have as safe a work environment as possible. We have extensive training programs to cover all potentially hazardous conditions and situations. Our goal is to have no lost time due to injuries. For 2012, we had no lost time incidents.

PUC coordinates and schedules the Caution and Chance Electrical Safety Program each year for elementary students in Grades 3 to 5. In 2012, contracted staff delivered the program to 26 schools reaching a total of 1,722 students. The response from the schools and students once again has been fantastic!

PUC Services is a member of the Safe Communities Partnership of Sault Ste. Marie. The Partnership is committed to injury prevention throughout the community.

Community Involvement

PUC Services and its employees are active and generous participants in the community where our customers live and work. Our corporate contributions in support of charity and not-for-profit groups are an opportunity for PUC Services to help those who help others in the community.

PUC corporate donations in 2012 included $10,000 to the United Way and $10,000 to the Sault Area Hospital.

PUC employees contribute generously to our community by participating in fundraising/charity events annually, such as:

- United Way PUC Employee Campaign: $30,270 raised in 2012
- CIBC Run for the Cure: $1,095 raised in 2012

Our Lotto

Many PUC staff voluntarily participate in this locally based lottery with proceeds benefiting the Group Health Centre Trust Fund (medical equipment), Sault Area Hospital Foundation (medical equipment) and United Steelworkers Fun Carnival.
FINANCIAL HIGHLIGHTS AND ANALYSIS

The financial highlights and analysis should be read in conjunction with the summary financial statements contained herein which are taken from the company’s audited financial statements. The purpose of its inclusion in the annual report is to provide supplemental analysis and background material to enhance understanding of the company’s business. Certain information included herein constitutes “forward-looking information”. Forward-looking information means disclosure regarding possible events, conditions or results that are based on assumptions about future economic conditions and courses of action.

Certain information included herein may contain forward-looking information attributable to third parties. Although the company believes that it has a reasonable basis for the forward-looking information, such information is subject to a number of risks and uncertainties that may cause actual events, conditions or results to differ materially from those contemplated by the forward-looking information. Some of the factors that could cause such differences include legislative or regulatory developments, financial market conditions, general economic conditions and weather. The company does not undertake any obligation to update publicly or to revise any of the forward-looking information included herein after the date hereof, whether as a result of new information, future events or otherwise.

Corporate Structure

PUC Services Inc. was formerly wholly owned by PUC Inc., however as of January 1, 2011 ownership was transferred to PUC Inc.’s sole shareholder, the Corporation of the City of Sault Ste. Marie. The Company provides operations and management services to its affiliated companies, PUC Distribution Inc., PUC Telecom Inc. and the Public Utilities Commission of the Corporation of the City of Sault Ste. Marie, in addition to non-affiliated entities.

Net Income

Net loss for the year ended December 31, 2012 was $184,272 compared to net income of $746,046 for the year ended December 31, 2011. Revenue decreased by $708,574 (5%) mostly related to management fee revenue. Expenses, before a one-time reduction for the impairment of property, plant and equipment, decreased by $68,256 in 2012. The one-time reduction amounted to $290,000.

Current Assets

The cash balance and the receivable/payable from affiliates netted out to $1,527,887 compared to the 2011 balance of $231,564. The company completed two solar projects in 2011, both of which were financed by cash on hand. Approval has been received from two lenders for financing the two projects in the amount of approximately $1.8 million. It is expected that the funds for these projects will be received in 2013. Improvements in the miscellaneous billing process have shortened the collection cycle and reduced accounts receivable at year end.

Net Fixed Assets

Capital expenditures in 2012 were for the normal replacement of streetlights, vehicles, electronic equipment and tools.

Long Term Liabilities

The employee future benefit obligation increased by approximately $144,000 in 2012 as calculated in accordance with Section 3461 Employee Benefits of the Canadian Institute of Chartered Accountants (CICA) Handbook. The loan payable to PUC Inc. remained at $8,310,000.

Contract Revenue

Contract revenue, which consists of revenue from non-affiliated entities, fell slightly in 2012.

Management Fee Revenue

Management fee revenue is derived from services provided to affiliated companies. The decrease in 2012 is the result of increased services rendered for the solar farm construction projects which were completed in 2011 and are one-time projects.

Generation Revenue

The generation revenue represents the energy production of the projects for the first full year they were in operation. Two solar generation projects were completed in 2011.

Operating Expenses

Operating expenses are within 1.8% of prior year.

General and Administrative Expenses

General and administrative expenses varied less than 1% in 2012 from 2011.
Interest Expense

Interest expense to an affiliated company (PUC Inc.) remained at $532,638 in 2012.

Liquidity and Capital Resources

The company’s source of liquidity and capital resources has traditionally been generated from operations. The principle use of these funds is working capital requirements, interest payments and capital asset purchases. Approval has been received for financing for the two solar projects completed in 2011. It is expected that the loans will be finalized in 2013 which will add approximately $1.8 million to the cash position.
# PUC Services Inc.
## Balance Sheet Summary
For the period ending December 31, 2012

### Assets

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash &amp; Investments</td>
<td>$ 10,973,098</td>
<td>$ 4,257,537</td>
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<tr>
<td>Accounts Receivable and Prepaids</td>
<td>2,741,364</td>
<td>3,339,792</td>
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<tr>
<td>Receivable from Affiliate</td>
<td>2,563,357</td>
<td>6,920,124</td>
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<tr>
<td>Inventory</td>
<td>270,819</td>
<td>279,530</td>
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<tr>
<td></td>
<td>16,548,638</td>
<td>14,796,983</td>
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<tr>
<td><strong>Net Fixed Assets</strong></td>
<td>9,943,904</td>
<td>10,633,123</td>
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<tr>
<td><strong>Future Taxes</strong></td>
<td>509,800</td>
<td>466,300</td>
</tr>
<tr>
<td></td>
<td>$ 27,002,342</td>
<td>$ 25,896,406</td>
</tr>
</tbody>
</table>

### Liabilities and Equity

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Liabilities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>2,533,055</td>
<td>2,449,679</td>
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<tr>
<td>Payable to Affiliates</td>
<td>12,008,568</td>
<td>10,946,097</td>
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<tr>
<td></td>
<td>14,541,623</td>
<td>13,395,776</td>
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<tr>
<td><strong>Long Term Liabilities</strong></td>
<td>9,955,644</td>
<td>9,811,284</td>
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<tr>
<td><strong>Equity:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common Shares</td>
<td>893,300</td>
<td>893,300</td>
</tr>
<tr>
<td>Special Shares</td>
<td>1,050,000</td>
<td>1,050,000</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>561,775</td>
<td>746,046</td>
</tr>
<tr>
<td></td>
<td>2,505,075</td>
<td>2,689,346</td>
</tr>
<tr>
<td><strong>Total Equity</strong></td>
<td>$ 27,002,342</td>
<td>$ 25,896,406</td>
</tr>
</tbody>
</table>
PUC Services Inc.
Results of Operations Summary
For the Period Ending December 31, 2012

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contract Revenue</td>
<td>$5,392,152</td>
<td>$5,543,833</td>
</tr>
<tr>
<td>Management Fee Revenue</td>
<td>7,180,218</td>
<td>8,105,775</td>
</tr>
<tr>
<td>Generation Revenue</td>
<td>224,839</td>
<td>63,664</td>
</tr>
<tr>
<td>Miscellaneous Revenue</td>
<td>436,967</td>
<td>229,478</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>13,234,176</td>
<td>13,942,750</td>
</tr>
</tbody>
</table>

| **Expenses**         |            |            |
| Operating Expenses   | 4,928,058  | 4,840,879  |
| General and Administrative Expenses | 5,942,423  | 5,911,788  |
| Depreciation         | 1,768,829  | 1,729,499  |
| Interest Expense     | 532,638    | 532,638    |
| Impairment of Property, Plant & Equipment | 290,000    | -          |
| Payment in Lieu of Taxes | (43,500)  | 181,900    |
| **Total**            | 13,418,448 | 13,196,704 |

| **Net Income/(Loss)**| $ (184,272) | $ 746,046 |

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Risk Factors

The company faces a number of risks in operating regulated and unregulated businesses.

Credit Risk

Credit risk is the risk that a party will fail to discharge its obligations and cause a financial loss to the company. The majority of company revenue is earned from a number of customers that are municipal governments, regulated electric distribution companies, and affiliated companies.

Environmental Risk

The company operates in industries that are subject to federal and provincial environmental regulations that are subject to change. Failure to comply with these regulations could result in orders to take specific actions or could subject the company to fines, penalties or third party claims. The company monitors developments in the environmental regulations and as required, utilizes consultants with the appropriate expertise.

Technology Risk

The use and complexity of the company’s electronic infrastructure continues to increase and its reliability and security are critical to all areas of operation. An information technology (IT) department oversees networks, voice over internet protocol communications, enterprise software, smart meter operation, systems security and other emerging IT issues. In addition, outside resources with expertise in specific areas are utilized as necessary.

Human Resource Risk

As part of the management service contracts, the company provides the workforce, unionized and non-unionized, necessary to operate various water, wastewater and electric distribution systems for the various municipalities and other entities. Labour disruptions can affect ongoing operations. Collective agreements with the union employees are in effect until April 30, 2014.

The company, like others in the utility services industry, faces a significant number of retirements within the next decade. The retirement of individuals in technical and trades positions will result in the loss of a large pool of expertise, therefore replacements are hired in advance of projected retirements to promote the transfer of knowledge.

Other Risks

The company maintains a level of insurance coverage deemed appropriate by management and for matters for which insurance coverage is available.

Accounting Policies

The audited financial statements of PUC Services Inc. have been prepared by management in accordance with Part V – Pre changeover accounting standards of the CICA Handbook. The company’s management makes estimates and assumptions concerning reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the audited financial statements and amounts of revenues and expenses of the company for the period covered by the audited financial statements. The significant accounting policies of the companies are summarized in the notes to the audited financial statements.

Employee Future Benefit Costs

The company provides employee future benefits to current and retired employees including certain health and life insurance benefits. Future benefits for employees are recorded on an accrual basis. The accrual is based on costs determined by an independent actuary using the projected benefit method prorated on service and based on assumptions that reflect management’s best estimates. The assumptions were determined by management with reference to recommendations of the actuary. The last actuarial valuation was completed for the year ended December 31, 2010.

The company makes contributions on behalf of employees to the Ontario Municipal Employees Retirement System (OMERS), a multi-employer defined benefit pension plan. Pension fund premiums paid on behalf of employees are expensed when paid to OMERS. Employee future benefits are included in labour costs and charged to operations or capitalized as part of the cost of fixed assets.

Future Tax Assets

As of October 1, 2001, the company became liable for payments in lieu of income and capital taxes in the same manner as if they were taxable under federal and provincial tax laws. As of the effective date of the regulations the assets of the company were deemed to be disposed of and reacquired at fair market value. The resulting tax bases of these assets were greater than their book value resulting in a future tax benefit associated with the additional deductions available for tax purposes. The future tax benefit is recognized on the balance sheet.
Future Accounting Standards

The company, as a publicly accountable enterprise, was required to adopt International Financial Reporting Standards (IFRS) for annual reporting purposes for its fiscal year beginning January 1, 2011. However, the audited financial statements have been prepared in accordance with Part V – Pre changeover accounting standards of the CICA Handbook. An evaluation process is currently underway to determine the date of transition to IFRS. The impacts on the financial statements are not reasonably determinable or estimable at this time.

Legal Issues

The company is subject to various litigation and claims with customers, suppliers, former employees and other parties as a normal course of operating a business. Currently, there are no significant legal matters pending.

Outlook

During 2012, the company extended its management service agreements with its affiliated companies to November 30, 2017 which will allow it to continue to provide its customers the benefits efficiencies of scope, using the shared services approach. The company anticipates significant focus on the planning and completing of infrastructure replacement programs for its major customers, PUC Distribution Inc. and the Public Utilities Commission of the Corporation of the City of Sault Ste. Marie.

Major projects to be undertaken by the company on behalf of its customers include meeting customer needs in the area of renewable energy generation facilities as a result of the Green Energy Act; meeting provincially mandated targets for energy conservation and demand management; the completion of the 2013 cost of service electric rate application which was filed in 2012; and, addressing the ongoing customer concerns related to taste and odour of the drinking water following conversion to free chlorine distribution residual in Sault Ste. Marie.

The planned completion of two additional solar generation projects has not moved forward due to transmission constraints in the region. The company will continue to monitor the solar generation sector and other “green energy” opportunities in order to obtain a reasonable return on investment and foster the “green energy” message of its sole shareholder, the Corporation of the City of Sault Ste. Marie.
CORPORATE GOVERNANCE

The role of the PUC Services Inc. Board is to maximize shareholder value taking into account the legitimate interests of various stakeholders. Functions of the Board include the appointment of the President and Chief Executive Officer, the provision of leadership in the development of a corporate strategic plan, approval of the corporate capital and operating budgets, review of annual financial statements, establishment of corporate policies, ensuring that policies are being followed and monitoring the performance of senior management.

The Finance and Audit Committee of the Board has the responsibility to ensure that the corporation has:

- implemented appropriate systems to identify, monitor and mitigate significant business risks;
- implemented appropriate systems of internal control to ensure compliance with legal, ethical and regulatory requirements, and that these systems are operating effectively;
- reviewed and approved annual operating budgets;
- effectively carried out the internal audit function;
- fairly presented annual audited financial statements in all material respects in accordance with generally accepted accounting principles.

Officers of the Corporation (as of December 31, 2012)

H.J. Brian Curran, P. Eng., MBA
President and CEO

Terry Greco, CPA, CA
Treasurer

Claudio Stefano, P. Eng., MBA
Secretary

Executive Team: (as of December 31, 2012)

Brian Curran  Claudio Stefano  Dominic Parrella  Terry Greco

Board Members: (as of December 31, 2012)

Pat Mick  Mark Howson  Larry Guerriero  Rick Wing  Doug Lawson

Bruno Barban  Frank Fata  Marchy Bruni  Victoria R. Chiappetta  Cecilia Bruno