

407 *International*

407 INTERNATIONAL INC.

Management's Discussion and Analysis

March 31, 2017

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Management's Discussion and Analysis

The following is a discussion of the consolidated financial condition and results of operations of 407 International Inc. (the "Company") for the three-month period ended March 31, 2017 (the "MD&A"). The MD&A should be read in conjunction with the Interim Condensed Consolidated Financial Statements of the Company and the notes thereto for the three-month period ended March 31, 2017 (the "Financial Statements") and the Consolidated Financial Statements of the Company and the notes thereto for the years ended December 31, 2016 and 2015 (the "2016 Annual Financial Statements") as well as management's discussion and analysis for the year ended December 31, 2016. The Financial Statements are prepared in accordance with International Accounting Standard 34, *Interim Financial Reporting* ("IAS 34") and the 2016 Annual Financial Statements were prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). All amounts in the Financial Statements, the 2016 Annual Financial Statements and the MD&A are shown in millions of Canadian dollars unless otherwise indicated. Additional information relating to the Company, including the Company's 2016 Annual Information Form dated February 9, 2017 (the "AIF"), can also be accessed on the System for Electronic Document Analysis and Retrieval ("SEDAR") (www.sedar.com).

Forward-Looking Statements

The MD&A includes statements about expected future events and financial and operating results that are forward-looking. Forward-looking statements may include words such as anticipate, believe, could, expect, goal, intend, may, outlook, plan, strive, target and will. These forward-looking statements, including those set out in the "Outlook" sections of the MD&A, reflect the internal projections, expectations, future growth, performance and business prospects and opportunities of the Company and are based on information currently available to the Company. Actual results and developments may differ materially from results and developments discussed in the forward-looking statements as they are subject to a number of risks and uncertainties as discussed under the section entitled "Risks and Uncertainties" and are made based on certain assumptions including those relating to traffic and the operation and maintenance of Highway 407 ETR (as defined below). These forward-looking statements are also subject to the risks described in the AIF under the heading "Risk Factors". Readers are cautioned not to place undue reliance on the Company's forward-looking statements and assumptions as management of the Company and its subsidiaries ("Management") cannot provide assurance that actual results or developments will be realized or, even if substantially realized, that they will have the expected consequences to, or effects on, the Company. These forward-looking statements are made as of April 20, 2017, the date of the MD&A, and are subject to change as a result of new information, future events or other circumstances, as discussed above, in which case they will be updated by the Company as required by law.

Non-IFRS Financial Measures

Earnings Before Interest and Other, Taxes, Depreciation and Amortization ("EBITDA") is not a recognized measure under IFRS and investors are cautioned that EBITDA should not be construed as an alternative to net income (loss) or cash flows from operating activities as an indicator of the Company's performance or cash flows. The Company's method of calculating EBITDA may differ from other companies methods and may not be comparable to measures used by other companies. Management

uses EBITDA to assist in identifying underlying operating trends and allows for a comparison of the Company's operating performance on a consistent basis. Investors may also use EBITDA, amongst other financial measures, to assist in the valuation of the Company.

The earnings coverage and the earnings coverage ratio are not recognized measures under IFRS and investors are cautioned that the earnings coverage and earnings coverage ratio should not be construed as an alternative to net income (loss) or cash from operating activities as an indicator of the Company's performance or cash flows. Earnings coverage, as defined by the Company, is income before income tax expenses and interest expense on long-term debt less interest expense on long-term debt. Earnings coverage ratio, as defined by the Company, is income before income tax expenses and interest expense on long-term debt, divided by interest expense on long-term debt. The earnings coverage and the earnings coverage ratio are provided pursuant to and in compliance with National Instrument 44-102 *Shelf Distributions* of the Canadian Securities Administrators.

Our Business

The Company, through its wholly-owned subsidiary, 407 ETR Concession Company Limited ("407 ETR") operates, maintains and owns the right to toll the world's first all-electronic, open-access toll highway ("Highway 407 ETR") which is situated just north of Toronto. The Company's mission is to serve the Greater Toronto Area (the "GTA") by providing customers a fast, safe, reliable travel alternative, maximizing both customer satisfaction and shareholder value. Highway 407 ETR consists of four, six, eight and ten-lane sections (expandable to eight and ten lanes) from Highway 403/QEW in Burlington in the west to Brock Road in Pickering in the east for a distance of 108 kilometres.

The Company is also responsible for the development and operation of its integrated automation systems and the implementation and management of road-side tolling technologies and back-office systems, through its wholly-owned subsidiary, Canadian Tolling Company International Inc. ("Cantoll").

The Company's ability to create economic value depends largely on its ability to sustain revenue growth as well as to generate earnings and cash flows from operations growth by controlling the level of its operating expenditures while maintaining a safe highway and a high standard of customer service. Revenue growth depends mostly on the future demand for this alternate transportation route in the GTA and the levels of toll rates. The Company has continued to expand Highway 407 ETR to meet increasing demand and maintain a congestion-free experience for customers. Factors that could affect future demand include residential and commercial construction along the Highway 407 ETR corridor, economic conditions and the relative congestion of traditional alternative routes, such as Highway 401 and the Queen Elizabeth Way (the "QEW"), the addition of lanes on Highway 407 ETR and additional traffic likely to result from the opening of Highway 407 (east of Brock Road).

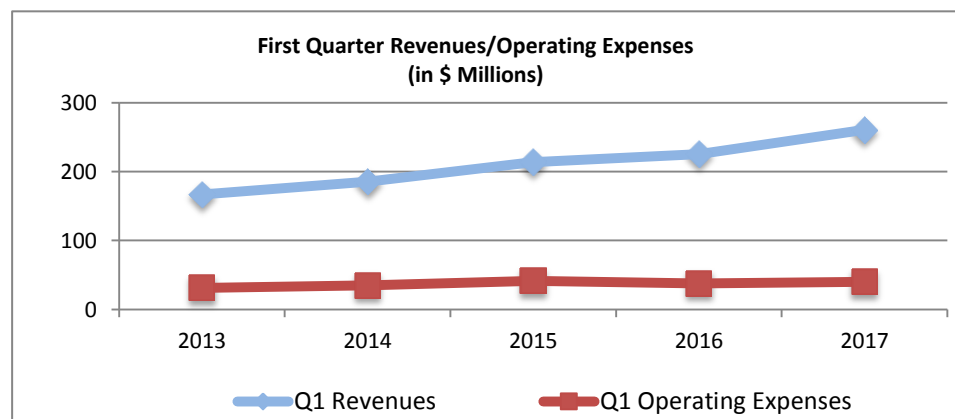
The Company's ability to remain profitable and improve cash flow from operating activities also depends largely upon other factors, such as its ability to widen Highway 407 ETR and the availability of funds on commercially reasonable terms to finance such an expansion as well as its ability to finance operating and capital expenditures and interest to bondholders. Management

is confident of the Company's current ability to access sufficient financial resources to finance such future amounts on commercially reasonable terms.

First Quarter Financial Highlights

(In \$ Millions, except per share amounts)		Selected Financial Information	
	<u>Q1 2017</u>	<u>Q1 2016</u>	
Revenues	260.7	225.3	
Operating Expenses	40.2	37.7	
EBITDA	220.5	187.6	
Depreciation and Amortization	24.4	25.8	
Interest and Other Expenses	77.2	73.8	
Income Tax Expense	31.5	23.4	
Net Income	87.4	64.6	
Dividends per share	0.268	0.242	
	<u>As at</u>	<u>As at</u>	
	<u>March 31, 2017</u>	<u>December 31, 2016</u>	
Total assets	5,370.7	5,329.2	
Total non-current liabilities	7,556.0	7,309.9	

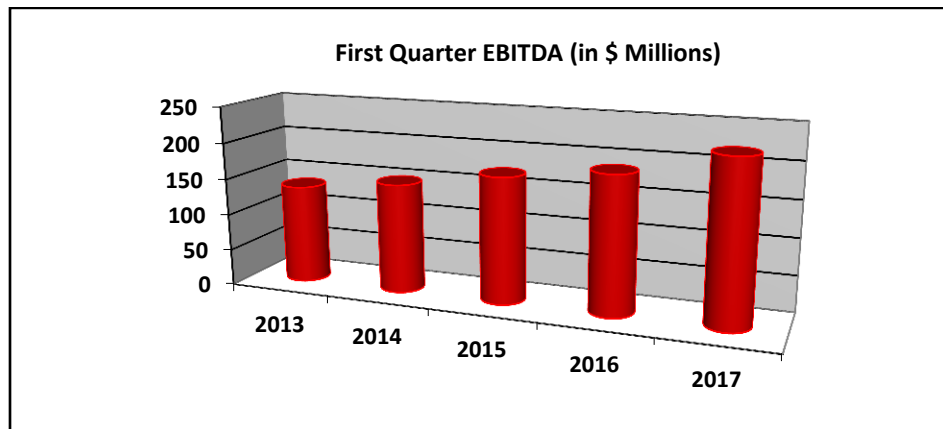
Revenues and Operating Expenses



Total revenues for the first quarter of 2017 amounted to \$260.7 million, an increase of \$35.4 million or 15.7%, compared to the same period in 2016, primarily due to higher tolling revenues attributed to a toll rate increase, coupled with higher trips and Vehicle Kilometres Travelled ("VKTs").

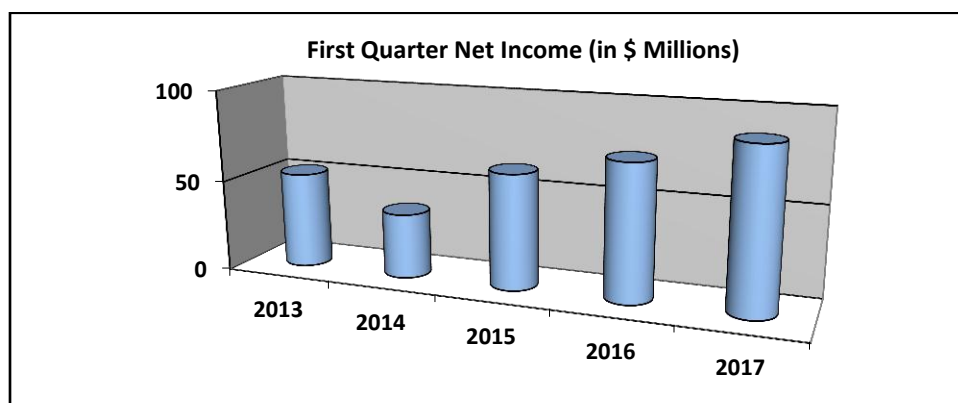
Total operating expenses for the first quarter of 2017 amounted to \$40.2 million, an increase of \$2.5 million or 6.6%, when compared to the same period in 2016. The increase was mainly due to higher provision for doubtful accounts resulting from a favourable adjustment in the prior year coupled with higher revenues.

EBITDA



EBITDA increased by 17.5% or \$32.9 million to \$220.5 million in the first quarter of 2017 as compared to \$187.6 million in the same period of 2016 a result of growth in revenues. EBITDA as a percentage of revenues was 84.6% in the first quarter of 2017 and was higher than 83.3% in the same period of 2016. Excluding contract revenues and expenses, EBITDA as a percentage of revenues was 84.8% in the first quarter of 2017 compared to 84.0% in first quarter of 2016. See “Non-IFRS Financial Measures”.

Net Income



Net income was \$87.4 million in the first quarter of 2017, an increase of \$22.8 million or 35.3% as compared to the same period in 2016 primarily due to higher EBITDA, offset by higher income tax expenses and higher interest and other expenses.

Dividends

Dividends to shareholders amounted to \$207.5 million in the first quarter of 2017, and were higher by \$20.0 million when compared to the same period in 2016.

Statement of Financial Position Items

Total assets were \$5,370.7 million at March 31, 2017 compared with \$5,329.2 million at December 31, 2016. The increase in the first quarter of 2017 is primarily due to higher cash and cash equivalents, increases in restricted cash and investments due to funding of debt service reserves for Senior Bonds, Series 17-A1, and timing of contributions and coupon payments, and higher contract receivables due to timing, offset by a decrease in trade receivables and others, decrease in property, plant and equipment and intangible assets reflecting depreciation and amortization of assets, offset by additions.

The non-current portion of long-term debt at March 31, 2017 amounted to \$7,053.6 million compared with \$6,814.0 million at December 31, 2016. The increase in non-current liabilities of \$239.6 million was mainly due to the issuance of Senior Bonds, Series 17-A1 during the quarter, increase in the non-cash inflation compensation component of the Real Return Bonds ("RRBs") due to an increase in the Consumer Price Index ("CPI"), offset by the recovery of the non-cash fair value adjustment of Senior Bonds, Series 04-A2 and the partial repayment of Senior Bonds, Series 99-A3.

The share capital and contributed surplus remained unchanged at March 31, 2017 at \$775.0 million (775,000,003 number of common shares issued and outstanding) and \$29.6 million, respectively, as compared to December 31, 2016.

Traffic Results

	Q1 2017	Q1 2016
Traffic/Trips (in millions) ⁽¹⁾	27,542	26,792
Average Workday Number of Trips (in thousands)	368,247	359,438
VKTs (in millions) ⁽²⁾	564,174	534,337
Average Trip Length (kilometres) ("ATL") ⁽³⁾	20.48	19.94
Unbillable Trips (percent) ⁽⁴⁾	2.34	2.22
Average Revenue per Trip (\$) ⁽⁵⁾	9.42	8.33
Transponder Penetration Rate (percent) ⁽⁶⁾	84.4	85.2
Transponders in Circulation as at March 31 ⁽⁷⁾	1,360,489	1,290,243

1. Trips are measured during the reporting period based on the number of vehicle transactions recorded on Highway 407 ETR.
2. VKTs refer to the sum of distances travelled on Highway 407 ETR during the reporting period.
3. Average Trip Length is calculated as the total VKTs divided by the total number of trips in the reporting period.
4. Unbillable Trips represents the number of trips that were not billed divided by the number of trips in the reporting period. Unbillable Trips includes unreadable transactions where a licence plate image was not captured, trips taken by vehicles from jurisdictions in which 407 ETR is unable to bill and trips taken by certain toll-exempt vehicles (such as emergency and 407 ETR service vehicles and vehicles with diplomatic plates).
5. Average Revenue per Trip is calculated as total tolls and fee revenue over total number of trips in the reporting period.
6. Transponder Penetration Rate is the ratio of transponder trips to total trips in the reporting period.
7. Transponders in Circulation are measured at the end of the reporting period based on the number of transponders registered to customers.

Total trips in the first quarter of 2017 were 2.8% higher than the same period in 2016. VKTs increased by 5.6% to 564.2 million in the first quarter of 2017 when compared with the same period in 2016 mainly due to economic growth and a positive

impact on traffic on the eastern section of Highway 407 ETR as a result of the opening of Phase I of Highway 407 (east of Brock Road). Average workday trips were higher by 2.5% when compared to the same period in 2016. ATL increased by 2.7% when compared to the same period in 2016 due to longer trips on 407 ETR resulting from travel on Highway 407 (east of Brock Road). Unbillable trips increased by 5.4% when comparing the first quarter of 2017 to the same period in 2016. The increase was mainly attributable to unfavourable weather conditions compared to the same period in 2016. The average revenue per trip was \$9.42 in the first quarter of 2017 compared to \$8.33 in the first quarter of 2016, representing an increase of 13.1%.

Overview of Current Operations

Construction

The Company continues to improve Highway 407 ETR through construction projects designed to increase capacity and improve traffic flow and customer convenience, including investments in widening bridge structures and adding new lanes to Highway 407 ETR. The Company also regularly undertakes various Highway 407 ETR rehabilitation initiatives designed to improve and replace existing elements of the infrastructure, such as resurfacing the asphalt pavement in certain sections of Highway 407 ETR, replacement of concrete pavement, replacement and relining of culverts under and along Highway 407 ETR and rehabilitating various bridge structures in order to continue to provide customers with fast, safe and reliable travel.

The widening of Highway 407 ETR between Highway 410 and Highway 427, including the widening of the northbound and southbound Highway 427 bridge structures over the Highway's infrastructure, has resumed after a temporary closure of work due to the winter season. The Company acts as agent and construction manager for the Highway 427 bridge structure work on behalf of the Province. Construction work is on schedule and is expected to be completed with the new lanes opened to traffic in the second half of 2017.

During the first quarter of 2017, the Company awarded the contract for the construction of the widening of Highway 407 ETR from Markham Road to just west of Brock Road, including the Sideline 26 interchange work. The construction work related to the section between York-Durham Line and Brock Road, including the Sideline 26 interchange work, is expected to be completed and opened to traffic in the latter half of 2018, and construction work between Markham Road and York-Durham Line is expected to be completed and opened to traffic in the latter half of 2019.

Information Technology

The Company continues to maintain and enhance the back-office systems. Formal processes are in place to identify, evaluate and implement potential system enhancements to ensure continued alignment with business strategies. The Company continues to focus on enhancing the core capabilities of capturing and processing vehicle information with continued investments in roadside equipment, automated licence plate recognition, complementary metal-oxide semi-conductor (CMOS) camera technology, and the operation of a front-capture camera enforcement system. The Company continues to enhance the security, functionality, scalability and usability of its self service (website and Interactive Voice Response) systems. The

Company continues to evaluate a new enterprise resource planning platform and is gathering information to determine options that will best address the future business needs of the Company.

Customer Service

The Company offers customers a broad range of services through its website, operations centre and automated telephone attendant and is committed to increasing customer awareness and customer service. The Company engages an external call centre specialist in benchmarking customer satisfaction to continually survey its customers. The results of recent surveys continue to show high levels of customer satisfaction and are consistent with other market research studies commissioned by the Company. In addition, the Company conducts email-based communications from the President and Chief Executive Officer thanking customers and seeking their feedback on the services provided by the Company.

Many 407 ETR customers continue to enjoy the 407 ETR Rewards Program. The program provides free kilometres on Highway 407 ETR and gas savings to qualified 407 ETR customers. Since inception, the program has offered more than \$143.4 million in benefits and savings to over 100,000 frequent light-vehicle transponder users.

407 ETR in the Community

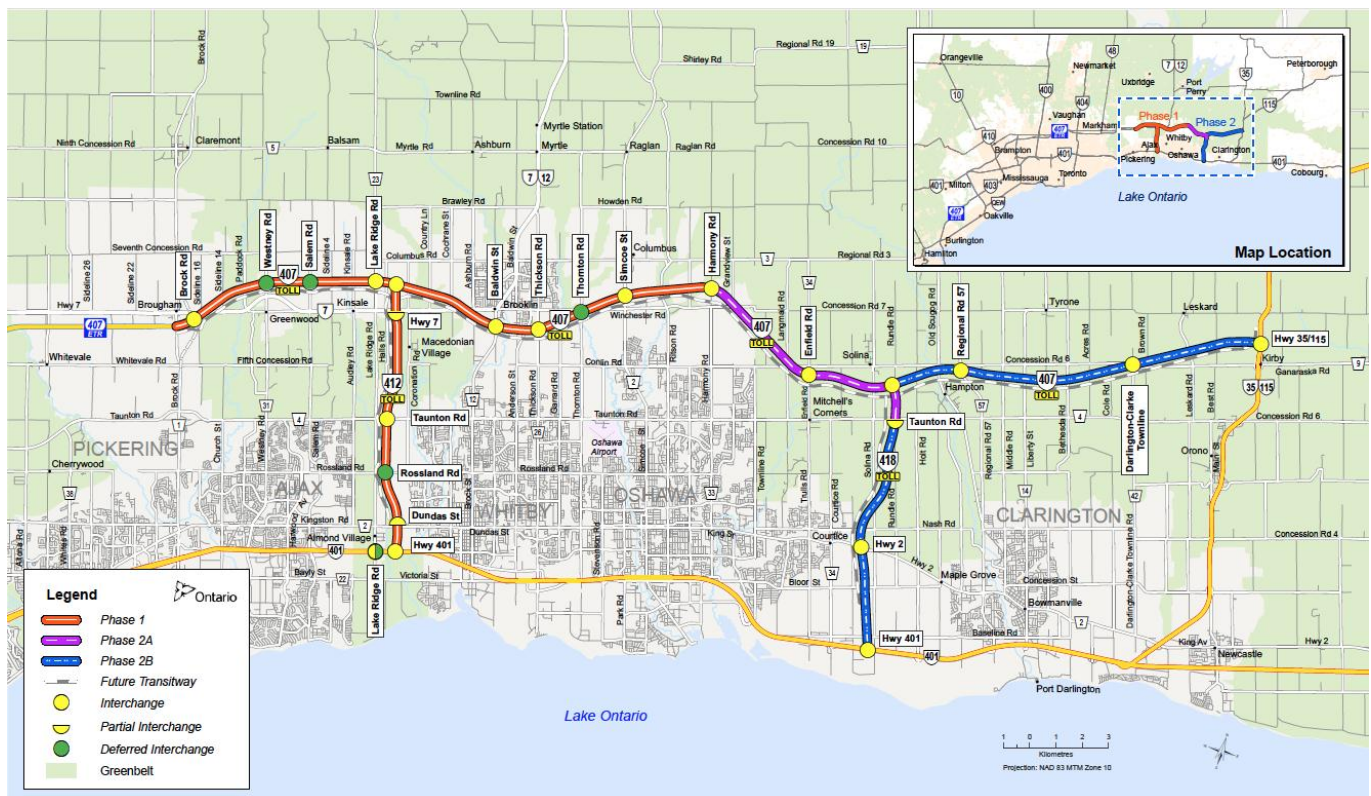
The Company and its employees continue to support the communities served by 407 ETR by providing support to hospitals along the corridor, sponsoring local youth and varsity sports activities and participating in various fundraising initiatives, including the most recent of which was the IceWave Volleyball Tournament, which raises funds for research into cures for childhood cancers conducted at the Hospital for Sick Children.

407 ETR further supports excellence in education through ongoing scholarships and support of York University.

Highway 407 (east of Brock Road)

Highway 407 begins at the eastern terminus of Highway 407 ETR at Brock Road, and extends towards Highways 35/115 [“Highway 407 (east of Brock Road)”]. The Province will maintain public ownership of Highway 407 (east of Brock Road), set tolls and receive toll revenues in respect of its use. Highway 407 (east of Brock Road) is being constructed in two phases (“Phase 1” and “Phase 2” respectively), as further described below:

- Phase 1 of construction is complete from Brock Road (at the eastern terminus of Highway 407 ETR) to Harmony Road in Oshawa and includes Highway 412, which runs north-south and connects Highway 407 (east of Brock Road) to Highway 401. Phase 1 has three lanes in each direction from Brock Road to Highway 412, two lanes in each direction from Highway 412 to Harmony Road and two lanes in each direction on Highway 412.
- Phase 2 of construction will complete the extension of Highway 407 (east of Brock Road) from Harmony Road to Highway 35/115 in Clarington. Phase 2 will include Highway 418, which will run north-south and connect Highway 407 (east of Brock Road) to Highway 401. An interchange at Taunton Road and Highway 418 is expected to be completed in 2017. Phase 2 is expected to be completed between Harmony Road and Highway 418 by December 2017, and between Highway 418 and Highway 35/115 by 2020.



In 2012, Ontario Infrastructure and Lands Corporation (“IO”) and Ontario Ministry of Transportation (“MTO”) contracted with 407 East Development Group (“EDG”), a consortium which includes Cintra and SNC-Lavalin Group Inc., to design, build, finance

and maintain Phase 1 of Highway 407 (east of Brock Road). Phase 1 was opened to traffic on a toll-free basis on June 20, 2016 until February 1, 2017, when tolling of Phase 1 of Highway 407 (east of Brock Road) commenced.

In January 2015, IO and MTO announced that they had selected the Blackbird Infrastructure Group, a consortium led by Cintra and Cement Roadstone Holdings plc, to design, build, finance and maintain Phase 2 of Highway 407 (east of Brock Road).

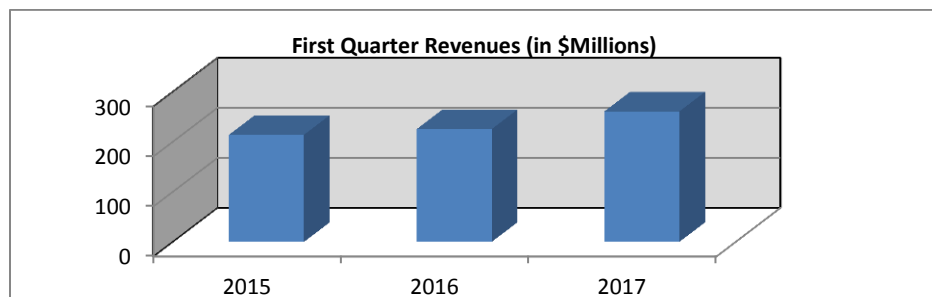
Pursuant to the agreement with the Province to implement and maintain the road-side tolling technology and back-office systems (the “Tolling Services Contract”) for Highway 407 (east of Brock Road), Cantoll completed all of the deliverables for Phase 1 and achieved substantial completion on November 30, 2016. In February 2017, Cantoll began providing tolling, billing and back-office services to the Province. This operational aspect of the Tolling Services Contract has an initial term of 10 years, and is renewable by 10-year increments, for up to 30 years in total.

The Company continues to perform the construction contract work associated with Phase 2 and maintains a \$9.0 million segregated funds account which will be released upon completion of Phase 2.

The Company believes that both phases of Highway 407 (east of Brock Road) will increase traffic levels on the eastern end of Highway 407 ETR.

First Quarter 2017 Results of Operations

Revenues



Revenues (In \$Millions)		
	Q1 2017	Q1 2016
Tolls	241.1	207.7
Fees	18.3	15.5
Contract	1.3	2.1
Total Revenue	260.7	225.3

The Company’s revenues are generated from toll charges for trips on Highway 407 ETR including camera charges for non-transponder trips (“Tolls”), monthly fees (“Fees”) and contract revenues. Fees include transponder lease fees, account fees relating to the maintenance and billing of non-transponder customer accounts, late payment charges, enforcement fees for past due amounts sent to the Ontario Registrar of Motor Vehicles (the “Registrar”) to refuse to renew or issue vehicle permits

until outstanding amounts are paid or settled (“Licence Plate Denial”) and service fees related to tolling, billing and back-office services pursuant to the Tolling Services Contract. Account fees are driven by the number of non-transponder customers that travel on Highway 407 ETR and are subject to seasonal fluctuation. Enforcement fees and late payment charges are applied to customers with overdue accounts. Contract revenues include the implementation of the road-side tolling technology and back-office systems work performed under the Tolling Services Contract.

Toll Revenues

Toll revenues amounted to \$241.1 million in the first quarter of 2017, an increase of \$33.4 million or 16.1%, compared to the same period in 2016. The increase in toll revenues is primarily attributable to a toll rate increase effective February 1, 2017, coupled with an increase in trips and VKTs.

Fee Revenues

Fee revenues amounted to \$18.3 million in the first quarter of 2017, an increase of \$2.8 million when compared to \$15.5 million for the same period in 2016. The increase was mainly due to higher transponder lease fees as a result of an increase in the number of transponders in circulation and higher tolling service fees, coupled with higher account fee revenue due to higher rates.

Contract Revenues

Contract revenues amounted to \$1.3 million in the first quarter of 2017 when compared to \$2.1 million for the same period in 2016 and mainly relate to the work performed for Phase 2. Contract revenues in the first quarter of 2016 mainly relate to work performed for Phase 1.

Outlook

Management anticipates higher revenues in 2017 compared to 2016 primarily due to the new toll rate structure that took effect on February 1, 2017 and higher traffic volumes, coupled with tolling service fees, offset by lower contract revenue.

Toll Rates

Effective February 1, 2017, the toll rate structure was revised and is illustrated in the following table:

TOLL RATE PER KM	2017 ⁽¹⁾ (in \$CAD)					
	Light Vehicle (LV)		Heavy Single Unit Vehicle (HSU)		Heavy Multiple Unit Vehicle (HMU)	
	EASTBOUND	WESTBOUND	EASTBOUND	WESTBOUND	EASTBOUND	WESTBOUND
Zone 1 ⁽²⁾ (AM Peak Periods) ⁽³⁾	0.3597	0.3465	0.7194	0.6930	1.0791	1.0395
Zone 2 ⁽²⁾ (AM Peak Periods) ⁽³⁾	0.3597	0.3597	0.7194	0.7194	1.0791	1.0791
Zone 3 ⁽²⁾ (AM Peak Periods) ⁽³⁾	0.3465	0.3597	0.6930	0.7194	1.0395	1.0791
Zone 1 ⁽²⁾ (PM Peak Periods) ⁽⁴⁾	0.3595	0.3732	0.7190	0.7464	1.0785	1.1196
Zone 2 ⁽²⁾ (PM Peak Periods) ⁽⁴⁾	0.3732	0.3732	0.7464	0.7464	1.1196	1.1196
Zone 3 ⁽²⁾ (PM Peak Periods) ⁽⁴⁾	0.3732	0.3595	0.7464	0.7190	1.1196	1.0785
Zone 1 ⁽²⁾ (AM Peak Hours) ⁽⁵⁾	0.4242	0.3942	0.8484	0.7884	1.2726	1.1826
Zone 2 ⁽²⁾ (AM Peak Hours) ⁽⁵⁾	0.4242	0.4092	0.8484	0.8184	1.2726	1.2276
Zone 3 ⁽²⁾ (AM Peak Hours) ⁽⁵⁾	0.3942	0.4242	0.7884	0.8484	1.1826	1.2726
Zone 1 ⁽²⁾ (PM Peak Hours) ⁽⁶⁾	0.4085	0.4474	0.8170	0.8948	1.2255	1.3422
Zone 2 ⁽²⁾ (PM Peak Hours) ⁽⁶⁾	0.4474	0.4240	0.8948	0.8480	1.3422	1.2720
Zone 3 ⁽²⁾ (PM Peak Hours) ⁽⁶⁾	0.4474	0.4085	0.8948	0.8170	1.3422	1.2255
Midday - Weekdays ⁽⁷⁾	0.3088		0.6176		0.9264	
Midday - Weekends & Holidays ⁽⁸⁾	0.2829		0.5658		0.8487	
Off Peak Period ⁽⁹⁾	0.2248		0.4496		0.6744	
Camera Charge per trip	4.10		50.00		50.00	
Trip Toll Charge per trip	1.00		2.00		3.00	

Note 1: Toll rates are effective from February 1, 2017.

Note 2: Effective February 1, 2017, Zone 1 means the area of the Highway between QEW to highway 401. Zone 2 means the area of the highway between highway 401 to highway 404. Zone 3 means the area of the Highway between highway 404 to Brock Road.

Note 3: AM Peak Period means weekdays between 6am-7am, 9am-10am.

Note 4: PM Peak Period means weekdays between 2:30pm-4pm, 6pm-7pm.

Note 5: AM Peak Hours means weekdays between 7am-9am.

Note 6: PM Peak Hours means weekdays between 4pm-6pm.

Note 7: Midday - Weekdays means between 10am-2:30pm.

Note 8: Midday - Weekends/Holidays means between 11am-7pm.

Note 9: Off-Peak Period means weekdays between 7pm-6am, weekends and holidays between 7pm-11am.

For further details on the Company's toll rates, please visit www.407etr.com:

Effective February 1, 2017, the Company implemented a new toll structure, including the introduction of differing toll rates for AM and PM Peak Hours and Peak Periods and direction of travel, to address customer travel patterns and to optimize revenues. The overall toll revenue is influenced by the mix of customers on Highway 407 ETR, which includes video and transponder customers, light and heavy vehicles, peak hours, peak period, midday period and off-peak period use, direction of travel, travel distance per trip, trip toll charge and regular zone and light zone toll rates.

On February 1, 2017, toll rates for light vehicles, heavy single unit vehicles (“HSU”) and heavy multiple unit vehicles (“HMu”) for eastbound travel increased by a weighted average of 12.2% and 13.7% during AM and PM peak hours, respectively; by 9.5% and 9.6% during AM and PM peak periods, respectively; for westbound travel increased by a weighted average of 11.0% and 11.5% during AM and PM peak hours, respectively; by 9.6% and 9.5% during AM and PM peak periods, respectively; by 9% during workday and weekend mid-day, respectively; and by 4% during off-peak hours. Camera Charge for light vehicles increased by 1.2%, with no change to trip toll charge when compared to the 2016 pricing structure.

Calculated Tolls

The Company continues to charge a Calculated Toll, in addition to the Trip Toll Charge, for trips taken on Highway 407 ETR where either the entry or exit point of a vehicle is not recorded by the Company’s tolling systems:

- For any vehicle (light or heavy), with a transponder for which there is a sufficient transponder trip history, a Transponder Vehicle Median Trip (referred to as a Calculated Trip) is charged using the median distance of the trips taken with the transponder in the preceding 72 days.
- For all light vehicles with a transponder for which there is insufficient transponder trip history, or if more than 25% of trips over the past 72 days did not accurately record either the entry or exit point, a Transponder Minimum Trip Toll is charged using the entry or exit nearest the recorded part of travel (in the same direction).
- For all light vehicles without a transponder, a Flat Toll Charge plus the Camera Charge is charged.
- For all heavy vehicles without a transponder, a Camera Charge of \$50.00 plus a Heavy Vehicle Minimum Trip Toll using the entry or exit nearest the recorded part of travel (in the same direction) is charged.
- For all heavy vehicles with a transponder for which there is insufficient transponder trip history, or more than 25% of trips over the past 72 days did not accurately record either the entry or exit point, a Heavy Single or Heavy Multiple Unit Vehicle Flat Toll is charged.

The following table illustrates the Flat Toll Charge for light and heavy vehicles:

	2017 and 2016 ⁽¹⁾		
	Light Vehicle ⁽²⁾	Heavy Single Unit Vehicle ("HSU")	Heavy Multiple Unit Vehicle ("HMu")
Flat Toll Charge (up to) (Peak Period/Hours) ⁽³⁾	4.50	19.85	36.95
Flat Toll Charge (up to) (All Other Periods) ⁽⁴⁾	3.20	12.80	23.85

(1) Flat Toll Charge effective since February 1, 2017 and February 1, 2016.

(2) Applicable to light vehicles without a transponder.

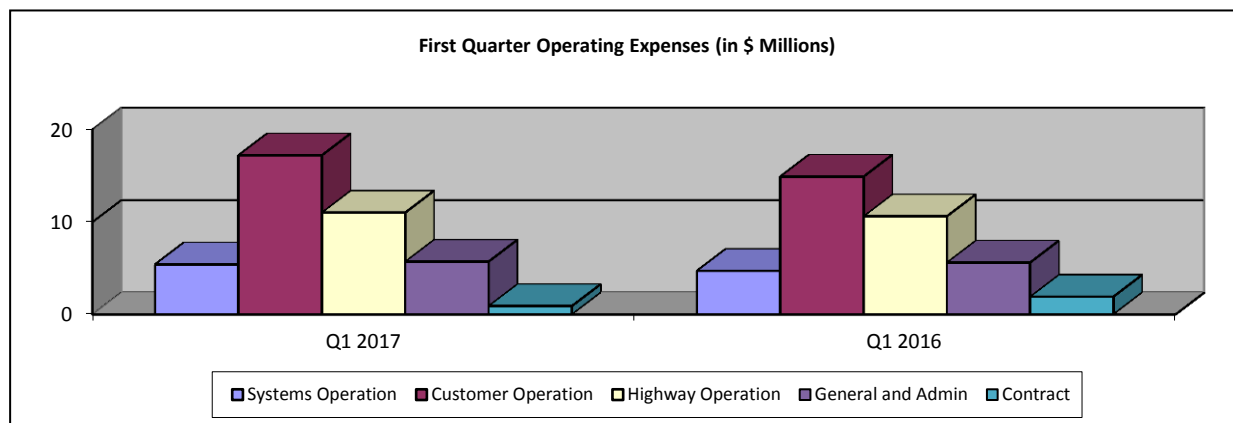
(3) Peak Period/Hours means weekdays between 6am-10am and 3pm-7pm in 2016.

In 2017 AM Peak Period means weekdays between 6am-7am, 9am-10am; PM Peak Period weekdays between 2:30pm-4pm, 6pm-7pm; AM Peak Hours means weekdays between 7am-9am; PM Peak Hours between 4pm-6pm

(4) All Other Periods means weekdays between 10am-3pm and 7pm-6am, weekends and holidays in 2016.

In 2017, All other Periods mean Midday - Weekdays between 10am-2:30pm; Midday - Weekends/Holidays between 11am-7pm and off-peak Period means weekdays between 7pm-6am, weekends and holidays between 7pm-11am.

Operating Expenses



Operating Expenses (in \$Millions)	% of revenues		% of revenues	
	Q1 2017	Q1 2017	Q1 2016	Q1 2016
Systems Operations Expenses	5.4	2.1%	4.7	2.1%
Customer Operations Expenses	17.2	6.6%	14.9	6.6%
Highway Operations Expenses	11.0	4.2%	10.6	4.7%
General and Administration Expenses	5.7	2.2%	5.6	2.5%
Contract Expenses	0.9	0.3%	1.9	0.8%
Total	40.2	15.4%	37.7	16.7%

Systems Operations Expenses

This category includes staff salaries and subcontractor costs for operating and maintaining the tolling system, salaries and the costs for operating and maintaining the Company's office computer network and salaries and other costs for developing, operating and maintaining the Company's integrated automation systems.

Systems operations expenses amounted to \$5.4 million in the first quarter of 2017, an increase of \$0.7 million when compared to \$4.7 million for the same period in 2016 mainly due to higher maintenance support and licence costs.

Outlook

Systems operations expenses for 2017 are expected to be higher than 2016 expenses mainly due to higher consulting and support costs, coupled with costs related to tolling services.

Customer Operations Expenses

This category includes costs incurred to operate the customer service centre and service existing customer relationships as well as general inquiries. These costs include the call centre, customer service centre, account management salaries, transponder distribution channels, billing, customer address system access fees, ombudsman services, collection of overdue accounts, customer litigation expense and the provision for doubtful accounts.

Customer operations expenses amounted to \$17.2 million in the first quarter of 2017, an increase of \$2.3 million when compared to \$14.9 million for the same period in 2016. The increase was mainly due to a higher provision for doubtful accounts.

The Company's customer service approach is focused on enhancing customer satisfaction as the needs and expectations of customers continue to develop. This customer-focused approach is reflected in the service results of the call centre. During the first quarter of 2017, the Company's call centre received 130 thousand telephone calls compared to 142 thousand calls received in the first quarter of 2016. The decrease in calls mainly relates to customers' ability to access the various self-service options through the Company's interactive voice recognition system and website, through which customers can perform a number of transactions without having to speak with a customer service representative. The average wait time required for a customer to speak with a customer service representative was 21 seconds in the first quarter of 2017, and was lower than the average wait time of 23 seconds in the same period of 2016. The target level of service for customers calling into the 407 ETR call centre is 80% of all calls being answered within 30 seconds and the level of service in the first quarter of 2017 exceeded the target by 3.4%.

The Company continues to use bill inserts, promotions and targeted advertising to communicate to customers about the benefits of using Highway 407 ETR, as well as educating drivers about environmentally and customer-friendly options, such as 407 ETR paperless billing, annual transponder leases and pre-authorized payment services. The Company continues to see growth in customers registering for 407 ETR paperless billing on the 407 ETR website, pre-authorization and other services which benefit customers and also result in lower costs for the Company.

Outlook

Customer operations costs for 2017 are expected to be higher than 2016 due to higher provision for doubtful accounts, higher billing costs, bank charges and tolling service costs.

Highway Operations Expenses

This category of expenses includes costs relating to operating activities such as maintenance of the major system elements of roadway surfaces, bridges and culverts, drainage and lighting systems, together with seasonal maintenance, highway patrol operations, road safety enforcement and police enforcement. Highway operations expenses are seasonal in nature mainly as winter maintenance expenses relating to snow plowing and salt application occur in the first and fourth quarters of the year, whereas most other repairs and maintenance take place in the second and third quarters of the year.

Highway operations expenses amounted to \$11.0 million in the first quarter of 2017 when compared to \$10.6 million for the same period in 2016 resulting from higher winter maintenance costs.

Highway maintenance cost per lane kilometre in in the first quarter 2017 increased to \$9,300 from \$8,900 during the same period of 2016 mainly due to higher salt usage due to unfavourable weather.

Outlook

Management anticipates highway operations expenses in 2017 to be in line with 2016 costs.

General and Administration Expenses

General and administration expenses include costs of public relations, finance, administration, facilities, human resources, business processes, legal, audit and executive.

General and administration expenses amounted to \$5.7 million in the first quarter of 2017 and were comparable to the \$5.6 million for the same period in 2016.

Outlook

General and administration expenses for 2017 are expected to be slightly higher than 2016 mainly due to tolling service costs.

Contract Expenses

The Company's contract expenses relate to costs incurred for work performed in completing its contract obligations under the Tolling Services Contract.

Contract expenses amounted to \$0.9 million in the first quarter of 2017 compared to \$1.9 million for the same period in 2016. The expenses in the first quarter of 2017 mainly include costs related to Phase 2 of the Tolling Services Contract, whereas the expenses in the first quarter of 2016 mainly include costs related to Phase 1.

Outlook

Contract expenses are expected to be lower in 2017 as the volume of work and costs related to Phase 2 are lower than those associated with Phase 1 of the Contract which was completed in 2016.

Depreciation and Amortization

Depreciation and amortization expenses amounted to \$24.4 million in the first quarter of 2017, a decrease of \$1.4 million when compared to \$25.8 million for the same period in 2016. The decrease was primarily a result of certain highway assets being fully depreciated at the end of the prior year.

Outlook

Management expects overall depreciation and amortization expenses in 2017 to be in line with 2016.

Interest and Other Expenses

Interest and Other Expenses (in \$ Millions)	Q1 2017	Q1 2016
Interest expense	\$ 86.9	\$ 84.8
Non-cash inflation component of:		
Interest expense (recovery), RRBs	3.0	(5.3)
Interest recovery, Senior Bond, Series 04-A2	(0.6)	(3.7)
Fair value adjustment, Senior Bond, Series 04-A2	(8.5)	0.1
Capitalized interest	(0.2)	(0.1)
Total interest expense on long-term debt	80.6	75.8
Interest income on financial assets designated as FVTPL	(3.3)	(2.0)
Other expense	0.1	0.2
Other income:		
Reclassification of gains and losses on cash flow hedges	(0.2)	(0.2)
	\$ 77.2	\$ 73.8

Interest and other expenses include interest expense on long-term debt and obligations under finance leases, reclassification of gains and losses on cash flow hedges from accumulated other comprehensive income, interest income on fair value through profit or loss ("FVTPL") of financial assets, and fair value adjustment of derivative financial instruments.

Interest and other expenses amounted to \$77.2 million for the first quarter of 2017 compared with \$73.8 million for the same period in 2016. Interest expense on long-term debt increased to \$80.6 million during the first quarter of 2017 from \$75.8 million during the first quarter of 2016 primarily due to the unfavourable variance on the non-cash inflation compensation component of the RRBs of \$8.3 million and the unfavourable non-cash accretion expense on Senior Bonds, Series 04-A2 of \$3.1 million due to an increase in the CPI during the first quarter of 2017 as compared to the decrease in CPI in the first quarter of 2016. Adding to the unfavourable variance was higher interest expense on senior bonds of \$2.1 million mainly resulting from the issuance of \$500.0 million Senior Bonds, Series 16-A1 on May 19, 2016, the issuance of \$250.0 million Senior Bonds, Series 17-A1 on March 24, 2017 and higher cash interest expenses on the RRBs and Senior Bonds, Series 04-A2 due to higher inflation offset by lower interest expenses on the Senior Bank Credit Facilities mainly due to prior year financing costs associated with these facilities. These unfavourable variances to interest on long-term debt were offset by the favourable non-cash fair value adjustment on Senior Bonds, Series 04-A2 of \$8.6 million. During the first quarter of 2017, the non-cash fair value adjustment recovery on Senior Bonds, Series 04-A2 was \$8.5 million and was primarily due to a decrease in the Break Even Inflation Rate

(the “BEIR”) offset by a decrease in the nominal discount rate as compared to the \$0.1 million non-cash fair value adjustment expense in the first quarter of 2016 primarily due to an decrease in the nominal discount rate offset by a decrease in the BEIR. Interest income was higher by \$1.3 million primarily due to higher investment yields being earned on investments and higher average cash balances.

Outlook

With the exception of the non-cash inflation component of interest expense relating to the RRBs and Senior Bonds, Series 04-A2 and the non-cash fair value adjustment on Senior Bonds, Series 04-A2, the Company expects interest and other expenses for 2017 to be higher than 2016, primarily due to the full-year impact of bonds issued in 2016 and additional bonds issued in 2017.

Income Taxes

Income Tax Expense (in \$ Millions)	<u>Q1 2017</u>	<u>Q1 2016</u>
Current income tax expense	28.6	10.4
Deferred income tax expense	2.9	13.0
Total income tax expense	31.5	23.4

The combined current and deferred annual effective tax rate of 26.5% was consistent to the prior year rate of 26.6%.

Current income tax expense amounted to \$28.6 million in the first quarter of 2017 compared to \$10.4 million in the same period in 2016 primarily due to higher earnings before taxes coupled with the full utilization of the Company’s non-capital losses. Correspondingly, deferred income tax expense was \$2.9 million in the first quarter of 2017 compared to \$13.0 million in the same period in 2016.

Outlook

With the exception of the non-cash inflation component of interest expense relating to the RRBs and Senior Bonds, Series 04-A2 and the non-cash fair value adjustment on Senior Bonds, Series 04-A2, the Company expects income tax expenses for 2017 to be higher than 2016 due to a higher income before tax expense.

Liquidity and Capital Resources

Cash Flow

Cash Flow for the first quarter ended March 31 (In \$ Millions)		
	Q1 2017	Q1 2016
Cash from operating activities	149.9	133.3
Cash used in investing activities	(60.5)	(45.3)
Cash used in financing activities	(76.5)	(71.9)
Increase in cash	12.9	16.1
Cash in the beginning of the period (1)	557.6	376.9
Cash end of period (1)	570.5	393.0
(1) includes cash equivalents		

Cash and cash equivalents at March 31, 2017 was \$570.5 million, an increase of \$12.9 million from December 31, 2016.

The cash increase of \$12.9 million during the first quarter of 2017 was mainly due to cash generated from operating activities of \$149.9 million and proceeds from the issuance of long-term debt and draws on the Senior Bank Credit Facilities (defined below) of \$370.8 million. These cash inflows were primarily offset by repayment of long-term debt and Senior Bank Credit Facilities of \$237.4 million, dividends paid to shareholders of \$207.5 million, net increase in restricted cash and investments of \$45.0 million, purchases of property, plant, equipment and intangible assets of \$15.6 million and payments of debt issue costs of \$1.5 million.

Cash generated from operating activities was \$149.9 million for the first quarter of 2017 compared with \$133.3 million for the first quarter of 2016. The increase in cash generated from operating activities of \$16.6 million was a result of higher cash receipts of \$33.9 million due to higher revenues, offset by higher cash payments for operating expenses of \$9.0 million primarily due to timing of payments and higher cash payments for income taxes of \$7.7 million.

Cash used in investing activities was \$60.5 million for the first quarter of 2017 compared with cash used in investing activities of \$45.3 million for the first quarter of 2016. Included in investing activities are changes in the restricted cash and investments required to be maintained by the Indenture (defined below). The increase in restricted cash and investments of \$45.0 million was due to the contributions to the debt service fund of \$87.1 million, the establishment of a debt service reserve fund for Senior Bonds, Series 17-A1 of \$13.4 million and interest received from restricted cash and investments of \$1.6 million. These increases to restricted cash were offset by the partial repayment of Senior Bonds, Series 99-A3 of \$2.4 million and coupon payments of \$54.7 million. The increase in restricted cash and investments of \$28.5 million in the first quarter of 2016 was due to the contributions to the debt service fund of \$84.0 million and interest received from restricted cash and investments of \$1.5 million. These net increases to restricted cash were offset by the partial repayment of Senior Bonds, Series 99-A3 of \$2.3 million and coupon payments of \$54.7 million. Non-trade receivables and other were \$1.1 million compared to \$2.1 million in the first quarter of 2016 primarily due to timing of payments from third party vendors. Included in investing activities are

investments in the widening of certain segments of the Highway, replacement of certain components of the Highway, enhancements and replacements of toll equipment, operations centre expansion, continuing development and enhancement of the information systems, and purchasing of new transponders. Purchases of property, plant and equipment and intangible assets were \$15.6 million compared to \$17.6 million in the first quarter of 2016.

Cash used in financing activities was \$76.5 million in the first quarter of 2017 compared with cash used in financing activities of \$71.9 million in the first quarter of 2016. Repayment of long-term debt amounted to \$237.4 million representing partial repayment of Senior Bank Credit Facilities of \$235.0 million and partial repayment of Senior Bonds, Series 99-A3 of \$2.4 million compared to partial repayment of Senior Bonds, Series 99-A3 of \$2.3 million in the first quarter of 2016. Dividend payments to shareholders were \$207.5 million in the first quarter of 2017 compared to payments of \$187.5 million in the first quarter of 2016. Payments towards debt issue costs amounted to \$1.5 million in the first quarter of 2017 relating to the issuance of Senior Bonds, Series 17-A1 compared to \$0.1 million in the first quarter of 2016. Proceeds from long-term debt in the first quarter of 2017 amounted to \$370.8 million, representing the issuance of \$249.8 million of Senior Bonds, Series 17-A1 on March 24, 2017 and draws under the Senior Bank Credit Facilities of \$121.0 million, compared to \$119.0 million draws under the Senior Bank Credit Facilities in the first quarter of 2016.

The supplemental indenture for RRBs Series 99-A5, 99-A6 and 99-A7 requires the Company to fund a series excess inflation reserve should the principal outstanding multiplied by the difference between the applicable CPI at the time of measurement divided by the applicable CPI at the time of issue exceed a pre-established threshold level. As at December 31, 2016 and March 31, 2017, CPI had not reached the levels to require funding of the excess inflation reserve and Management does not anticipate CPI to reach these levels. Sufficient cash from operations will be generated in the event that funding of the reserve becomes necessary.

Certain Events of Default under the Indenture would allow bondholders to declare the bonds to be immediately payable. These Events of Default are described in the Company's AIF available at www.sedar.com. As at December 31, 2016 and March 31, 2017, the Company is in compliance with the terms of the Indenture.

Outlook

The Company is committed to maintaining its current credit ratings on all debt obligations. The Company expects to maintain sufficient liquidity and to generate cash from operations to meet all of its ongoing obligations and to pay dividends to its shareholders. The Company expects to gradually increase its financial leverage to fund operating and capital expenditures, to pay interest to debtholders, and to pay income tax while maintaining healthy debt service coverage and earnings coverage ratios.

Quarterly Financial Information

Net Income and Net Income per Share (in \$Millions, except per share amounts)								
	<u>Q1 2017</u>	<u>Q4 2016</u>	<u>Q3 2016</u>	<u>Q2 2016</u>	<u>Q1 2016</u>	<u>Q4 2015</u>	<u>Q3 2015</u>	<u>Q2 2015</u>
Revenues	260.7	297.3	321.3	290.8	225.3	253.4	277.6	257.2
Operating expenses	40.2	42.2	36.4	33.4	37.7	48.6	40.8	31.3
Depreciation and amortization	24.4	25.2	26.9	27.0	25.8	21.7	22.2	21.7
Interest and other expenses	77.2	97.0	100.4	101.6	73.8	81.3	80.3	98.5
Income tax expenses	31.5	34.9	41.7	34.4	23.4	27.8	36.4	29.1
Net income	87.4	98.0	115.9	94.4	64.6	74.0	97.9	76.6
Net income per share (basic and diluted)	0.113	0.126	0.150	0.122	0.083	0.095	0.126	0.099

Toll and fee revenues are subject to seasonal fluctuations that may materially impact quarter-to-quarter financial results; therefore one quarter's revenues are not necessarily indicative of another quarter's revenues. Seasonal and other trends affecting the Company's revenues include factors such as economic activity, recreational travel, weather conditions, pricing structure, fuel prices and traffic volumes on neighbouring infrastructure. In particular, this seasonality generally results in relatively lower revenues during the first quarter, relatively higher levels of toll and fee revenues in the second and fourth quarters and the highest revenue in the third quarter. Contract revenues may fluctuate depending on the amount of contract work awarded, completed and accepted by the customer. Interest expense on RRBs and Senior Bonds, Series 04-A2 is calculated based on changes in CPI; as such, interest expense in respect of RRBs and Senior Bonds, Series 04-A2 will fluctuate due to the volatility of CPI.

Net income of \$97.9 million in the third quarter of 2015 was \$21.3 million higher than the second quarter of 2015, mainly due to higher revenues and lower interest and other expenses resulting from a favourable non-cash fair value adjustment on Senior Bonds Series 04-A2, offset by an unfavourable non-cash inflation compensation of RRBs, coupled with higher deferred income tax expense, higher operating expenses, and higher depreciation and amortization expenses. Net income of \$74.0 million in the fourth quarter of 2015 was \$23.9 million lower than the third quarter of 2015, mainly due to seasonally-lower revenues coupled with higher operating expenses and higher interest and other expenses due to a favourable non-cash fair value adjustment on Senior Bonds Series 04-A2, offset by an unfavourable non-cash inflation compensation of RRBs, partially offset by lower deferred income tax expense and lower depreciation and amortization expenses. Net income of \$64.6 million in the first quarter of 2016 was \$9.4 million lower than the fourth quarter of 2015, mainly due to seasonally-lower revenues and higher depreciation and amortization expenses primarily due to the change in the method of amortizing concession rights, offset by lower operating expenses, lower interest and other expenses due to a favourable non-cash inflation compensation of RRBs and Senior Bonds Series 04-A2, coupled with non-cash fair value adjustment on Senior Bonds Series 04-A2 and lower income tax expense due to lower earnings before tax. Net income of \$94.4 million in the second quarter of 2016 was \$29.8 million higher than the first quarter of 2016, mainly due to seasonally-higher revenues and lower operating expenses, offset by higher income tax expense due to higher earnings before tax, coupled with higher depreciation and amortization expenses primarily due to the

change in the method of amortizing concession rights and higher interest and other expenses due to an unfavourable non-cash inflation compensation of RRBs and Senior Bonds Series 04-A2 and additional debt issued during the quarter. Net income of \$115.9 million in the third quarter of 2016 was \$21.5 million higher than the second quarter of 2016, mainly due to seasonally-higher revenues, offset by higher income tax expense due to higher earnings before tax and higher operating expenses. Net income of \$98.0 million in the fourth quarter of 2016, \$17.9 million lower than the third quarter of 2016, mainly due to seasonally lower revenues coupled with higher operating expenses, partially offset by lower income tax expenses due to lower earnings before tax and lower interest and other expenses due to a favourable non-cash inflation compensation of RRBs and Senior Bonds Series 04-A2.

The Company recorded net income of \$87.4 million in the first quarter of 2017, \$10.6 million lower than the fourth quarter of 2016, mainly due to seasonally lower revenues, offset by lower interest and other expenses due to lower fair value adjustments on Senior Bonds, Series 04-A2, lower income tax expense due to lower earnings before tax and lower operating expenses.

Earnings Coverage

Earnings Coverage (in \$Millions)	Twelve month period ended March 31	
	2017	2016
Income before income tax expenses and interest expense on long-term debt	927.1	772.6
Interest expense on long-term debt	388.9	342.8
Earnings coverage	538.2	429.8

The Company experienced earnings coverage ratios of 2.38 times and 2.25 times for the twelve month periods ended March 31, 2017 and 2016, respectively. The Company expects income before income tax expenses and interest expense on long-term debt to continue to be sufficient to cover interest expense on long-term debt. The earnings coverage ratio is different from the Company's debt service coverage ratio as such is defined in the Indenture. See "Non-IFRS Financial Measures".

Financial Instruments and Other Instruments

Financial instruments used by the Company consist of cash and cash equivalents, restricted cash and investments, trade receivables and other, contract receivables, amounts due to/from customers for contract, trade and other payables, long-term debt and derivative financial instruments.

Cash and cash equivalents

Cash and cash equivalents of \$570.5 million as of March 31, 2017 consist of cash, government treasury bills and provincial promissory notes with maturities of three months or less. Cash and cash equivalents are used for working capital and other general corporate purposes. The cash and cash equivalents amount includes a \$10.0 million reserve required by the Master

Trust Indenture dated as of July 20, 1999 and effective as of May 5, 1999 between the Company, 407 ETR and The Trust Company of Bank of Montreal (now BNY Trust Company of Canada) (the “Indenture”).

Restricted cash and investments

Restricted cash and investments are required to be maintained in reserve accounts under the Indenture and various supplemental indentures for the benefit of the bondholders and a segregated funds account under an agreement between Cantoll and the Province to implement and maintain the road-side tolling technology and back-office systems relating to the Tolling Services Contract. Restricted cash and investments consist of cash, bankers’ acceptances, floating rate notes, government treasury bills, provincial promissory notes and federal notes with, from time to time, both short-term and long-term maturities.

Long-term debt

Long-term debt was used to finance the acquisition of 407 ETR from the Province and to finance the construction of the extensions of Highway 407 ETR, highway widening projects, deferred interchanges, operating and capital expenditures, interest to bondholders and other general corporate purposes.

Senior Bank Credit Facilities

The Company has three revolving credit facilities with a current aggregate principal amount of up to \$1.0 billion (the “Senior Bank Credit Facilities”) and will be used to refinance existing debt, fund future operating and capital expenditures, interest payments and for general corporate purposes. The obligations under the credit facilities rank pari passu with the senior debt of the Company. The Company issued to the Canadian chartered banks senior pledged bonds with an aggregate principal amount of \$1.2 billion, resulting in the indebtedness arising from the credit facilities being secured under the Indenture. The credit facilities bear interest at floating rates based, at the option of the Company, on the prime rate for Canadian dollar loans, and the interbank bid rate for Canadian dollar bankers’ acceptances, plus an applicable fixed margin. The Company is obligated to pay a commitment fee to the banks, calculated on the undrawn portion of the credit facilities.

The Company may draw on these credit facilities until the maturity date. The maturity date is December 1, 2020. The Company may also repay a portion or all of the obligations owing under the credit facilities at any time during the term. As at March 31, 2017, the Company has drawn \$488.0 million (2016 - \$602.0 million) under the credit facilities and has classified the drawn amount under current liabilities. The Company repaid a net amount of \$114.0 million during the first quarter of 2017.

Derivative financial instrument

The Senior Bonds, Series 04-A2 is a derivative financial instrument and is reported at fair value. The Company is obligated to make semi-annual cash payments to the holders of Senior Bonds, Series 04-A2, (consisting of principal and interest) determined by the product of \$13.0 million and the applicable CPI at the time of payment divided by the applicable CPI at time of issue.

Accounting and Control Matters

Accounting Policies

The Financial Statements are prepared in accordance with IAS 34. The Company has identified the accounting policies and estimates that are critical to the understanding of the Company's operations and financial results which have been disclosed in the Annual Financial Statements, except for the following new accounting pronouncements which were adopted on January 1, 2017:

IAS 7 *Statement of Cash Flows* ("IAS 7"): This amendment requires that an entity provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes from cash flows and non-cash changes. The Financial Statements include additional disclosure of supplementary cash flow information and net changes in financial liabilities as a result of adopting this amendment.

IAS 12 *Recognition of Deferred Tax Assets for Unrealized Losses* ("IAS 12"): This amendment sets out restrictions on how an entity assesses whether taxable profits will be available against which it can utilize deductible temporary differences. There was no impact to the Financial Statements as a result of this amendment.

Critical Accounting Estimates

The preparation of the Financial Statements in conformity with IAS 34 requires Management to make certain judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities as at the date of the Financial Statements, the reported amounts of revenues and expenses of the reporting period, as well as disclosures made in the accompanying notes to the Financial Statements. Judgement is commonly used in determining whether a balance or transaction should be recognized in the Financial Statements, and estimates and assumptions are more commonly used in determining the measurement of recognized transactions and balances. However, judgements and estimates are often interrelated. The Financial Statements have been prepared using similar estimation methods for the critical accounting estimates as were used for the Annual Financial Statements and they conform to the requirements of IAS 34. These estimates and associated assumptions are based on past experience and other factors that are considered relevant. Actual results could differ materially from these estimates.

Future changes in accounting policies

IFRS 9 *Financial Instruments* ("IFRS 9"): This standard replaces the current IAS 39 Financial Instruments Recognition and Measurement. This standard introduces new requirements for classifying and measuring financial assets and liabilities. The latest date of mandatory implementation of IFRS 9 is January 1, 2018. The Company is currently evaluating the impact on the financial statements.

IFRS 10 *Sale or Contribution of Assets between an Investor and its Associates or Joint ventures ("IFRS 10")*: This standard sets out guidance for the accounting for the loss of control of a subsidiary and the subsequent recognition of any investment retained in the former subsidiary. The latest date of mandatory implementation of IFRS 10 is yet to be determined by the IASB.

IFRS 15 *Revenue from Contracts with Customers ("IFRS 15")*: This standard replaces IAS 11 Construction Contracts, IAS 18 Revenue and IFRIC 13 Customer Loyalty Programmes. This standard outlines a single comprehensive model for entities to account for revenue arising from contracts with customers. The latest date of mandatory implementation of IFRS 15 is January 1, 2018. The Company is currently evaluating the impact on the financial statements.

IFRS 16 *Leases ("IFRS 16")*: This standard replaces IAS 17 Leases. This standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective is that lessees and lessors provide relevant information in a manner that faithfully represents lease transactions and gives a basis for users of financial statements to assess its effect on the financial position, financial performance and cash flows of an entity. The latest date of mandatory implementation of IFRS 16 is January 1, 2019. The Company is currently evaluating the impact on the financial statements.

IAS 28 *Investments in Associates and Joint Ventures ("IAS 28")*: This standard sets out guidance on the election of exemption from applying the equity method for investments in each associate and joint venture separately at its initial recognition. The latest date of mandatory implementation of IAS 28 is yet to be determined by the IASB.

IFRIC 22 *Foreign currency transactions and advance consideration ("IFRIC 22")*: This interpretation addresses that the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of an asset, expense or income (or part of it) is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. The latest date of mandatory implementation of IFRIC 22 is January 1, 2018. The Company is currently evaluating the impact on the financial statements.

Risks and Uncertainties

Litigation

Proposed Class Action Regarding Bankruptcy and Consumer Proposals

In April 2012, 407 ETR was served with a statement of claim for a proposed class action commenced in the Ontario Superior Court of Justice. The proposed class of plaintiffs includes all 407 ETR customers that have been placed or kept in Licence Plate Denial, pursuant to the Highway 407 Act (Ontario), for Highway 407 ETR tolls and related fees incurred prior to their bankruptcies or consumer proposals.

The class action plaintiffs are seeking damages of \$20.0 million for general and special damages, \$5.0 million for aggravated, exemplary and punitive damages, the granting of a \$20.0 million constructive trust in favour of class members, and disgorgement of pre-bankruptcy tolls and fees paid by the plaintiffs.

In October 2011, in the separate legal proceeding of *Matthew Moore v. 407 ETR*, Justice Newbould of the Ontario Superior Court of Justice ruled that Licence Plate Denial survives bankruptcy, which is a central issue in the proposed class action. This decision of Justice Newbould was appealed by the Superintendent of Bankruptcy to the Ontario Court of Appeal. In December 2013, the Ontario Court of Appeal set aside the lower court's decision. The Court of Appeal decision was appealed by 407 ETR and upheld by the Supreme Court of Canada which released its decision on November 13, 2015. The result was that pre-bankruptcy amounts can no longer be collected by 407 ETR through Licence Plate Denial. The decision by the Supreme Court of Canada in the *Matthew Moore* case has had no material effect on the Company's financial position.

A settlement was reached with class counsel at a mediation concluded in August 2016, and approved at a settlement hearing before the Ontario Superior Court on November 15, 2016. The settlement provides for a voluntary settlement payment by 407 ETR of \$8.0 million on an all-inclusive basis and was subject to an opt-out process which concluded in March 2017. The settlement amounts will be distributed to eligible class members, net of proposed class counsel fees of \$2.9 million (inclusive of disbursements and taxes) and class administration fees of \$0.6 million. The settlement also includes refinements to 407 ETR's business practices for bankruptcies and consumer proposals. The amount available per eligible class member will be determined by eligibility and compensation criteria to be applied by class counsel, with accountability to the Court. The distribution of settlement funds will be undertaken by class counsel and is expected to be concluded by July 2017.

[407 ETR v. Ira Day : Clarification of Limitation Period Applicable to 407 ETR](#)

In November 2014 (with supplementary reasons in July 2015), the Ontario Superior Court of Justice decided a question of law in the case of *407 ETR v. Ira Day*, regarding the applicable limitation period for 407 ETR to commence civil proceedings for recovery of 407 ETR debts owed by customers to 407 ETR. The Court determined that under the Ontario Limitations Act, 407 ETR has two years from the earliest possible date of Licence Plate Denial notification prescribed by the Highway 407 Act to commence such legal proceedings. 407 ETR appealed this decision to the Ontario Court of Appeal.

On September 28, 2016, the Ontario Court of Appeal released its unanimous decision reversing the lower court decision of Justice Edwards. The decision confirms that the applicable limitation period under the Ontario Limitations Act for 407 ETR to commence civil proceedings is two years from the expiry of a person's licence plate permit after Licence Plate Denial notification. The Court also found that 407 ETR has the right under the Ontario Limitations Act to contractually extend the limitation period through its transponder lease agreement with either business or individual customers. In November 2016, Mr. Day filed an application for leave to appeal this decision to the Supreme Court of Canada. A decision granting or denying leave to appeal is expected in 2017.

Management does not believe that the ultimate decision in the *407 ETR v. Ira Day* case will materially affect the Company's financial position.

[Toll Revenues](#)

The Company's ability to derive revenue depends on a wide variety of factors, many of which are not within the control of the Company. These factors include the growth in the population and volatility of the economy of the GTA and southern Ontario,

fuel prices, weather conditions and the construction of competing infrastructure. In addition, toll rate increases are subject to economic, price elasticity and political risks. To mitigate these risks, Management prepares a detailed operating budget consistent with the Company's strategic objectives, which includes revenue projections based on traffic growth and price elasticity assumptions supported, from time to time, by studies performed by third party expert traffic consultants. The operating budget and actual price setting is approved by the Company's board of directors (the "Board"). Actual results are monitored against the revenue projections on a monthly basis, giving Management adequate time to analyze and respond to variances.

Capital Structure

The Company has a complex capital structure that may give rise to unforeseen challenges by tax authorities of the Company's interpretation of certain tax legislation. To mitigate such risks, Management seeks the advice of external tax experts.

Operations and Maintenance

The Company's operating and maintenance expenses for the future operation of Highway 407 ETR are impacted by uncertainties related to costs of services, materials and equipment, changes in regulatory requirements, useful lives of productive assets, critical accounting estimates, weather conditions and other matters that are not certain. To address these risks, Management prepares a detailed operating budget in the third quarter of each year. This budget is approved by the Board. Management monitors the level of operating expenditures each month in comparison to the budget. Department heads are accountable for cost over-runs, and Management compensation is based, in part, on adherence to the approved spending limits. In addition, the Company follows a periodic maintenance and rehabilitation program for Highway 407 ETR and tolling system to avoid unexpected significant repairs.

Information Technology

The Company's operations for Highway 407 ETR and Highway 407 (east of Brock Road) are substantially dependent on the information technology employed in its tolling and billing systems, including the roadside tolling equipment and the back-office systems used for account processing and collections. The Company continues to monitor and enhance the core system capabilities to mitigate risk. The integrity, reliability, availability and confidentiality of information and supporting systems is critical to the Company's daily and strategic operations. As such, cyber security continues to be a focus with ongoing threat monitoring and improvements in areas of data and network security given that cyber attacks and breaches could result in corruption of the Company's data, breach of customer privacy, damage to information technology infrastructure, loss of sensitive corporate information and reputational damage. To address these risks, the Company's corporate security group is accountable for the planning, execution and governance of the framework-based security program. The Company uses an iterative risk-based approach to manage information technology and cyber security threats, addressing identified gaps in a prioritized and systematic manner within the security framework. The Company ensures it has adequate controls and procedures to detect, identify and address cyber security events, including security incident response, business continuity and data recovery plans. Execution of the security program relies on internal expertise, strong partnerships, industry leading security technologies, and consultation with third-party experts on cyber security strategies and remediation plans. The Company maintains cyber-liability insurance coverage to further protect against cyber-risk exposures.

Debt Rating

The Company seeks to maintain an appropriate debt rating to ensure access to capital, on commercially reasonable terms, to finance its operating and capital expenditures and interest to bondholders, provide an appropriate investment return to its shareholders and refinance its existing indebtedness without, in each case, exceeding its debt capacity or resulting in a downgrade to the credit ratings assigned to its existing indebtedness. The Company's ability to do so will depend upon a number of factors, including, among other things, market conditions, rating agencies' criteria and the Company's debt structure. To control this risk, Management is focused on maintaining an optimal level of liquidity through maximizing cash flows by actively pursuing the collection of its trade receivables and by controlling the level of operating and capital expenditures.

Risks Arising from Financial Instruments

Credit risk

Financial assets that are exposed to credit risk consist primarily of cash and cash equivalents, trade receivables and other, contract receivables, amounts due from customer for contract and restricted cash and investments.

The Company is exposed to credit loss in the event of non-performance by counterparties to derivative instruments that have a positive fair value, cash and cash equivalents, short-term investments and restricted cash and investments. The Company manages this risk by dealing with reputable organizations having high-quality credit ratings from independent credit rating agencies. The Board sets exposure limits and these are monitored on an on-going basis.

Concentration of credit risk with respect to trade receivables is minimized due to the millions of accounts comprising the Company's customer base. The amounts disclosed in the statements of financial position are net of the allowance for doubtful accounts and certain amounts that are billed to customers but excluded from revenues in accordance with the Company's revenue recognition policy for toll and fee revenues. The amounts are estimated based on prior experience, anticipated collection strategies and ultimate recovery of balances for which collection is uncertain.

Trade receivables and other are aged as follows:

(\$ Millions)	As at	As at
	March 31, 2017	December 31, 2016
Unbilled	\$ 74.6	\$ 64.0
0-60 days	50.8	64.7
61-90 days	3.8	7.0
91-120 days	1.9	4.9
121-150 days	1.6	4.3
151+ days	31.6	25.9
Sub total ¹	164.3	170.8
Other ²	15.3	16.0
	<u>\$ 179.6</u>	<u>\$ 186.8</u>

1. Amounts are net of allowance for doubtful accounts and certain amounts that were billed to customers but excluded from revenues in accordance with the revenue recognition policy for toll and fee revenues.

2. Other consists of salt inventory, prepaids, contract retention receivable, other non-trade related receivables and an advance payment to supplier.

In accordance with the revenue recognition policy, toll revenues are recognized on the date trips are taken on Highway 407 ETR. Tolls and other charges are recorded in trade receivables as “Unbilled” until invoiced. The provision for doubtful accounts is based principally on historical collection rates and Management’s expectation of success rates for collection of overdue accounts by the Registrar through Licence Plate Denial as well as Management’s expectation of success rates for collection through legal proceedings. When a licence plate associated with a customer’s unpaid 407 ETR account becomes unattached from the vehicle or expired, the Registrar is required to refuse to renew another single vehicle permit issued to the same customer or issue a new vehicle permit to that customer. The legislation affording 407 ETR the right to Licence Plate Denial requires a series of notices to be sent to customers with delinquent accounts. This process takes a minimum of 150 days from the date an invoice is sent until a customer is subject to Licence Plate Denial, followed by up to two years before a customer’s licence plate is subject to renewal. The Licence Plate Denial process, together with other collection strategies, is expected to result in the successful collection of net trade receivables that are more than 151 days past due. The Company’s provision for doubtful accounts could materially change and may result in significant changes to trade receivables balances as Management continues to monitor the collection of outstanding 407 ETR charges through the Licence Plate Denial process with the MTO, as well as collections through legal proceedings.

In addition to the collection of 407 ETR customers’ overdue accounts through the Licence Plate Denial process, Management continues to assign certain delinquent accounts to third party collection agencies utilizing various programs, and to employ internal collections staff as well as taking legal action. In conducting collections litigation, from time to time, 407 ETR may receive judicial decisions that impact the Company’s ability to recover delinquent amounts through civil proceedings and could result in a material change to the provision of overdue accounts.

Management continuously monitors the collection of overdue accounts including the allowance for doubtful accounts. In determining the allowance for doubtful accounts, the Company considers a number of factors affecting the likelihood of collection. In determining the collectability of customer accounts, the Company does not obtain information about the credit quality of customers whose accounts are not overdue or not impaired.

An increase of 1% in the weighted-average provision rate would have increased the provision for doubtful accounts by approximately \$2.6 million (2016 - \$2.3 million) and decreased equity by approximately \$1.9 million (2016 - \$1.7 million) for the three-month period March 31, 2017.

The Company is exposed to credit risk with respect to contract receivables in the event of non-payment by customers. The Company manages this risk by dealing with reputable customers with good credit ratings.

[Interest rate risk](#)

As at March 31, 2017, all long-term debt is fixed rate debt (except for the drawn portion of the Senior Bank Credit Facilities and the inflation-linked bonds as described below); therefore, changes in interest rates do not impact interest payments on its current bonds but may impact the fair value of such long-term debt.

The Company also manages this risk by investing its cash and cash equivalents and restricted cash and investments in debt instruments with credit ratings equal to or higher than those required by the Indenture. A decrease of 25 basis points in interest rates would have decreased interest income by approximately \$0.7 million (2016 - \$0.6 million) and equity by approximately \$0.5 million (2016 - \$0.4 million) for the three-month period ended March 31, 2017.

Inflation risk

The Company is exposed to inflation risk as interest expense and debt service payments relating to Senior Bonds, Series 99-A5, Series 99-A6, Series 99-A7, Series 00-A2 and Series 04-A2 (collectively, the "RRBs") are linked to the CPI. An increase of 50 basis points in the CPI would have increased interest expense by approximately \$8.6 million (2016 - \$9.9 million), decreased equity by approximately \$6.3 million (2016 - \$7.3 million) and decreased debt service payments by approximately \$0.2 million (2016 - \$0.1 million) for the three-month period ended March 31, 2017. The BEIR is highly volatile and may lead to significant changes in the fair value of Senior Bonds, Series 04-A2 that may not be representative of actual inflation paid or to be paid to the Senior Bonds, Series 04-A2 noteholders. An increase of 10 basis points in the BEIR would have increased interest expense by approximately \$6.2 million (2016 - \$6.4 million) and decreased equity by approximately \$4.6 million (2016 - \$4.7 million) for the three-month period ended March 31, 2017. A decrease of 10 basis points in the BEIR would have reduced interest expense by approximately \$6.1 million (2016 - \$6.3 million) and increased equity by approximately \$4.5 million (2016 - \$4.6 million) for the three-month period ended March 31, 2017. This inflation risk is partially mitigated by the Company's right to increase toll rates.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. Quarterly cash flow projections are prepared by Management and reviewed by the Board to ensure sufficient continuity of funding. The Company manages its liquidity risk by dispersing the contractual maturity dates of its financial liabilities, thereby ensuring the Company is not exposed to excessive refinancing risk during any given year. Further, the Company maintains an optimal level of liquidity through maximizing cash flows by actively pursuing the collection of its trade receivables and contract receivables, and by controlling the level of operating and capital expenditures. Cash and cash equivalents and restricted cash and investments are invested in highly-liquid interest-bearing investments.

The following are the commitments, contractual maturities and related interest obligations as at March 31, 2017:

(in \$Millions)	Less than <u>1 year</u>	1 to 2 <u>years</u>	2 to 3 <u>years</u>	3 to 4 <u>years</u>	4 to 5 <u>years</u>	Beyond <u>5 years</u>
Trade and other payables	\$ 64.4	\$ -	\$ -	\$ -	\$ -	\$ -
Income tax payable	21.1	-	-	-	-	-
Obligation under finance leases	4.1	2.5	2.1	1.7	1.5	0.6
Interest payments on finance leases	0.6	0.4	0.4	0.1	0.1	-
Long-term debt	801.8	14.6	15.4	316.4	707.9	5,870.8
Derivative financial liability	6.1	6.1	6.1	6.1	6.1	106.2
Interest payments on long-term debt	344.5	327.1	326.2	317.3	299.2	4,310.3
	<u>\$ 1,242.6</u>	<u>\$ 350.7</u>	<u>\$ 350.2</u>	<u>\$ 641.6</u>	<u>\$ 1,014.8</u>	<u>\$ 10,287.9</u>

Interest payments on long-term debt and obligations under finance leases are funded by proceeds from long-term debt and the Company's cash generated from operations.

Additional Information

Related Party Transactions

The Company entered into the following transactions with related parties:

Related Party	Relationship	Classification in the Financial Statements	Nature of transaction with the related party	Three-month period ended March 31	
				(\$ millions) 2017	(\$ millions) 2016
Cintra	Parent of shareholder	Operating expenses	Payment for administration costs	\$ 0.2	\$ 0.3
407 East Development Group	Subsidiary of shareholder	Operating expenses	Reimbursement of administration costs	\$ -	\$ (0.1)
Blackbird Infrastructure Group	Subsidiary of shareholder	Operating expenses	Reimbursement of administration costs	\$ (0.1)	\$ (0.1)

Transactions with related parties are measured at their exchange amounts, which is the consideration agreed to by the parties.

Amounts owed to (by) related parties were as follows:

Related Party	Relationship	Classification in the Financial Statements	As at	
			March 31, 2017	December 31, 2016
SNC-Lavalin Inc.	Parent of shareholder	Trade and other payables	\$ -	\$ 0.8
Cintra	Parent of shareholder	Trade and other payables	\$ 0.2	\$ 0.2
Cintra	Parent of shareholder	Trade and other receivables	\$ (0.1)	\$ -
Blackbird Infrastructure Group	Subsidiary of shareholder	Trade and other receivables	\$ (0.1)	\$ (0.1)

Overall Outlook

The outlook for 2017 is positive with revenue growth primarily due to higher toll rates, higher traffic volumes and additional revenues from the operations of Highway 407 (east of Brock Road) and the Tolling Services Contract. Management's goals and objectives are focused on driving business growth while containing expenses, maintaining a high level of customer satisfaction, and achieving efficiencies throughout the organization, as well as strengthening Highway 407 ETR's presence in the GTA. As a result, 2017 income before income tax expenses and interest expense is expected to be higher than in 2016.