

CITY OF VAUGHAN

EXTRACT FROM COUNCIL MEETING MINUTES OF MAY 17, 2016

Item 4, Report No. 6, of the Finance, Administration and Audit Committee, which was adopted without amendment by the Council of the City of Vaughan on May 17, 2016.

4

POWERSTREAM MERGER AND ACQUISITION

The Finance, Administration and Audit Committee recommends approval of the recommendation contained in the following report of the Chief Financial Officer & City Treasurer and Director of Financial Planning and Development Finance & Deputy City Treasurer, dated May 2, 2016:

Recommendation

The Chief Financial Officer & City Treasurer and Director of Financial Planning and Development Finance & Deputy City Treasurer recommend:

1. That the City of Vaughan endorse Vaughan Holdings Inc.'s decision to no longer pursue a sale of up to 10% of its shares in PowerStream.

Contribution to Sustainability

The PowerStream Merger and Acquisition will help to diversify and increase the yield of the City of Vaughan's investment portfolio. This relatively stable revenue stream will contribute to increased financial sustainability over a long term horizon. Ceasing the pursuit of the 10% sale of PowerStream shares has both financial and strategic benefits that will contribute to this sustainability.

Economic Impact

On October 7, 2015 City of Vaughan Council approved a three way merger of PowerStream with Enersource Inc. and Horizon Inc. and acquisition of Hydro One Brampton. The approximately \$61.6 million equity injection required was approved to be funded through a combination of Vaughan Holdings Inc. (VHI) cash holdings (\$16 million) and a request to City of Vaughan for an equity contribution (\$45.6 million). Furthermore, both VHI and the City of Vaughan approved VHI's pursuit of a 10% sale of its interest in PowerStream, to partially recover the City of Vaughan's initial equity contribution.

City staff have reassessed the available financing options and have concluded that there are no financial or strategic advantages to a sale of 10% of the equity in VHI. The VHI Board, at its March 22nd meeting, approved a recommendation to no longer pursue a sale from treasury of up to 10% of its shares in PowerStream to partially fund the equity injection.

Communications Plan

N/A

Purpose

The purpose of this report is to request that the City of Vaughan approve VHI's Board recommendation to not pursue a sale of up to 10% of its shares in PowerStream. This report is also to provide an update to Council and the public on the execution of the final legal agreements on the three way merger of PowerStream with Enersource Inc. and Horizon Inc. and acquisition of Hydro One Brampton.

CITY OF VAUGHAN

EXTRACT FROM COUNCIL MEETING MINUTES OF MAY 17, 2016

Item 4, Finance Report No. 6 – Page 2

Background - Analysis and Options

Funding options have been continuously evaluated throughout the Merger and Acquisition process

In October 2015, the City of Vaughan approved the VHI Board's recommendation to pursue a sale from treasury of up to 10% of its shares related to its PowerStream interests to substantially recover the City's portion of the required equity investment. As the merger and acquisition discussions progressed, funding strategies available were assessed to ensure the funding strategy put forward continued to align with the city's investment policy. As a result of this analysis, there is a revised funding strategy that is both financially and strategically more optimal to fund the equity contribution through VHI cash and City reserves. The City will also continuously monitor the investment for opportunities that optimize the return possibly through a future 10% sale of Treasury shares or a draw down on the outstanding Promissory Note that will now be held by MergeCo.

The table below outlines the financial comparison between pursuing a 10% sale, long term use of VHI cash/ City reserves and a combination of using VHI/City reserves followed by a draw down on the Promissory Note.

Table 1 – Funding options

\$Million	Option 1: 10% Sale	Option 2: 100% Cash/City Reserve	Option 3: "Hybrid": use City cash and then convert note in year 10
NPV*	490	491	491
Cash injection required	16	62	62

* NPV at discount of 5%; assumed 100% synergy target achieved; sale assumed at 1.5X multiple; no transaction cost is assumed for the sale

There is no significant financial advantage in pursuing a 10% sale as a recovery

The Net Present Value (NPV) of each funding option is very similar, which places VHI and the City in a place of indifference from a purely financial perspective. As noted in the footnote to the table above, the transaction costs of 10% have not been deducted from this analysis as they are uncertain at this time. This points to the fact that it is quite clear that with those added costs the 10% sale is even less advantageous.

While the long term use of VHI cash / City Reserves and the hypothetical "Hybrid" option appear identical, the "Hybrid" option would allow the City the flexibility to convert the Promissory Note (estimated at year 10) should funds be needed for future city capital programs or should market conditions be such that the City could invest those monies for a higher return than what the Note currently yields.

There are some strategic disadvantages to the 10% sale

In addition to the financial consideration, the 10% sale bears some strategic disadvantages. Firstly, early discussions with potential sales advisors indicate that VHI would likely be expected to provide the 10% buyer with one of its three MergeCo Board seats, thereby reducing the City's representation and control. Secondly, the corporate structure of VHI would be much more complex, requiring several layers of corporations to accommodate the integration of an external buyer in to the ownership structure of VHI.

CITY OF VAUGHAN

EXTRACT FROM COUNCIL MEETING MINUTES OF MAY 17, 2016

Item 4, Finance Report No. 6 – Page 3

Navigant Consulting concurs with Staff's current findings

Navigant Consulting, VHI's financial advisor, has reviewed the above NPV analysis and strategic considerations. They agree with staff findings that the 10% sale no longer provides any significant financial or strategic advantages.

Terms Finalized on Shareholder Legal Agreements - Merger Participation Agreement (MPA) and Share Purchase Agreement (SPA)

Over the last several months, City staff along with the City's external consultants Navigant (financial) and Gowlings (legal) have worked on the legal agreements with other merger partners. The negotiations have resulted in final agreements that are consistent with the principles and resolutions from the October 7, 2015 Council meeting. The final agreements included settlement on terms related to Board composition, independent and non-independent members, management structure, special approvals and dividend policy. In addition, the draft solar term sheet was negotiated with a final definitive solar management agreement to be approved by independent Board members.

Shareholders signed legal agreements to approve three way merger of PowerStream with Enersource Inc. and Horizon Inc. and acquisition of Hydro One Brampton

On March 24, 2016, the execution of the legal agreements took place with a signing ceremony held at Horizon Utilities in Hamilton. The event was attended by the Hon. Bob Chiarelli, Ontario's Energy Minister, mayors for the shareholder communities of City of Mississauga (Enersource), cities of Hamilton and St. Catharines (Horizon Utilities), cities of Barrie, Markham and Vaughan (PowerStream) and a representative for the Enersource shareholder Borealis (owned by the Ontario Municipal Employees Retirement System).

The signing of legal agreements Merger Participation Agreement and Share Purchase Agreement is the final step before seeking regulatory approval. Within the coming weeks, the shareholders will submit a Mergers, Acquisitions, Amalgamations and Divestitures (MAADs) application to the Ontario Energy Board (OEB) for approval; a process estimated to take a minimum of six months.

Transitional Committee established to formalize strategic plan of MergeCo

MergeCo has established a 13 member Transitional Committee, that over the next six months, will work to formalize a strategic plan for MergeCo and govern other transitional activities. VHI has appointed the Mayor and two independent board members - Teresa Moore and Pina D'Agostino - to this Transitional Committee.

The selection by VHI of these two independent board members was a result of a public and widespread recruitment process from a pool of qualified candidates. Ms. Teresa Moore is a partner in a professional chartered accounting firm with extensive experience in audit and accounting, tax, corporate finance and succession planning. Ms. Pina D'Agostino is an associate professor at the Osgoode Hall Law School, whose expertise in intellectual property law field makes her a highly sought after public speaker and consultant.

Regional Implications

Not applicable

CITY OF VAUGHAN

EXTRACT FROM COUNCIL MEETING MINUTES OF MAY 17, 2016

Item 4, Finance Report No. 6 – Page 4

Conclusion

On March 24, 2016, the City of Vaughan and other merger partners executed the legal agreements to finalize the merger and acquisition.

It is recommended that City of Vaughan continue its initial funding plan through a combination of VHI cash holdings (\$16M) and City equity contribution (\$45.6M), without a subsequent 10% sale of its interest in PowerStream. The 10% sale no longer offers significant financial or strategic benefits.

Attachments

None

Report prepared by:

Jackie Macchiusi, Senior Manager, Corporate Financial Planning and Analysis
Alex Ly, Senior Financial Analyst, Investments

POWERSTREAM MERGER AND ACQUISITION**Recommendation**

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Report prepared by:

Jackie Macchiusi, Senior Manager, Corporate Financial Planning and Analysis
Alex Ly, Senior Financial Analyst, Investments

Respectfully submitted,

Laura Mirabella-Siddall, CPA, CA
Chief Financial Officer and City Treasurer

Lloyd Noronha, CPA, CMA
Director of Financial Planning and Development /
Deputy City Treasurer