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CW (Working Session) - September 22, 2015

Item 1

# **Vaughan Committee of the Whole (working session)**

**PowerStream Update  
September 22, 2015**

# Agenda

- ✓ Value Proposition
- ✓ Key Aspects of Transaction
  - Corporate Structure
- ✓ Business case
  - Synergies
  - Value to Shareholders & Customers
  - Relative Value
  - Acquisition Financing
- ✓ Key Legal Documents
- ✓ Conclusion

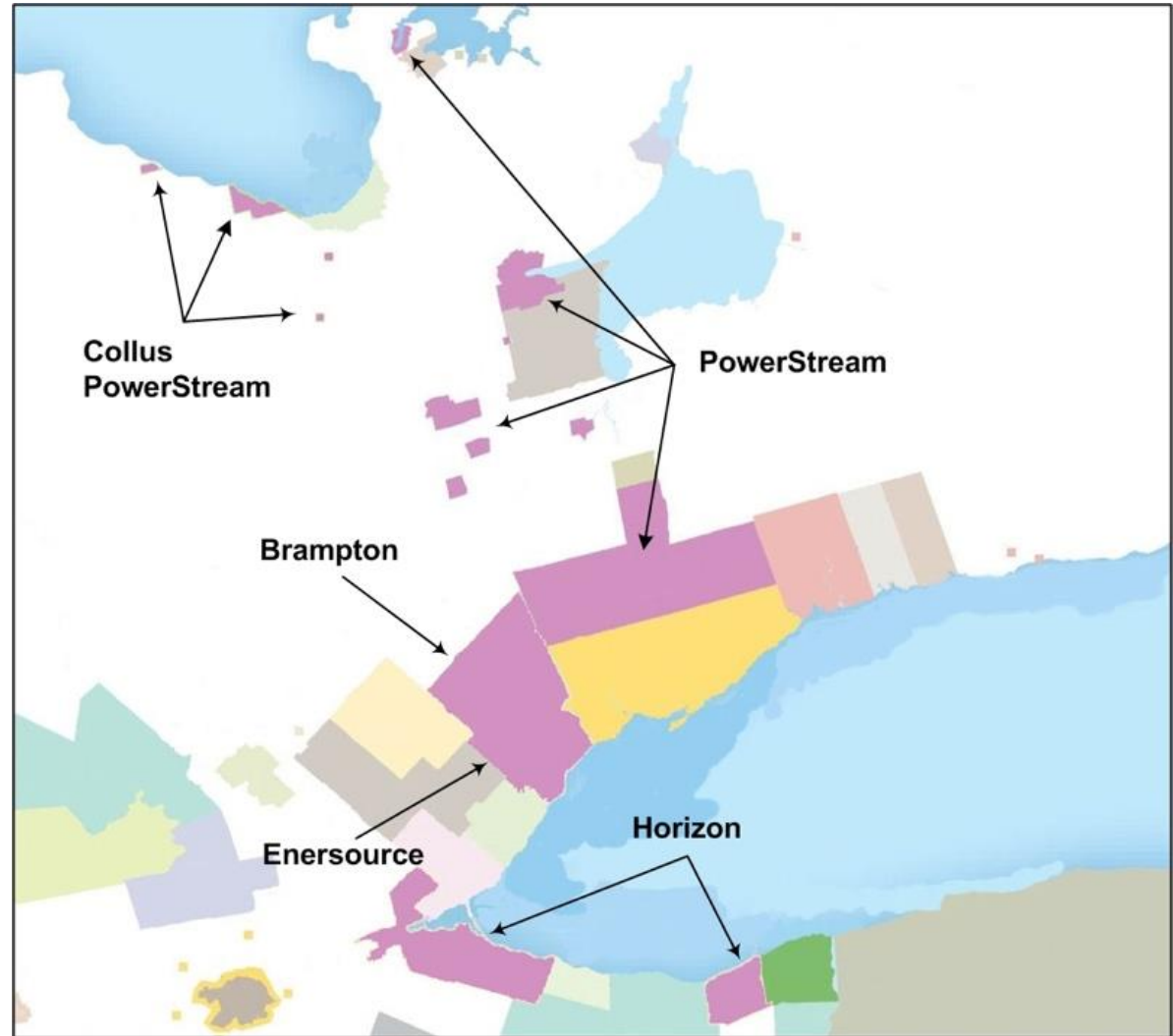
# Second Largest Electricity Distribution Company in Ontario



- 1 million customers

- \$2.7 billion in assets

- \$2.5 billion rate base



# Value Proposition



## **Improved Financial Returns to Shareholders**

- Steady and growing dividend stream at a level higher than the Status Quo
- \$125M investment has nominal payback of 11 years
- \$125M investment will increase in value to \$230 - \$300 million, due to synergy savings and Brampton dividends

## **Cost Savings for Customers Compared to Status Quo**

- Rates will be lower than expected in the Status Quo
- Customers will save an average of approximately \$40-\$50/year over 25 years

## **Stronger Platform for Growth in the Future**

- Much larger utility with a bigger geographic footprint, more diversification, and greater capital resources and opportunities to finance expansion

## **Greater Influence on Government Policy**

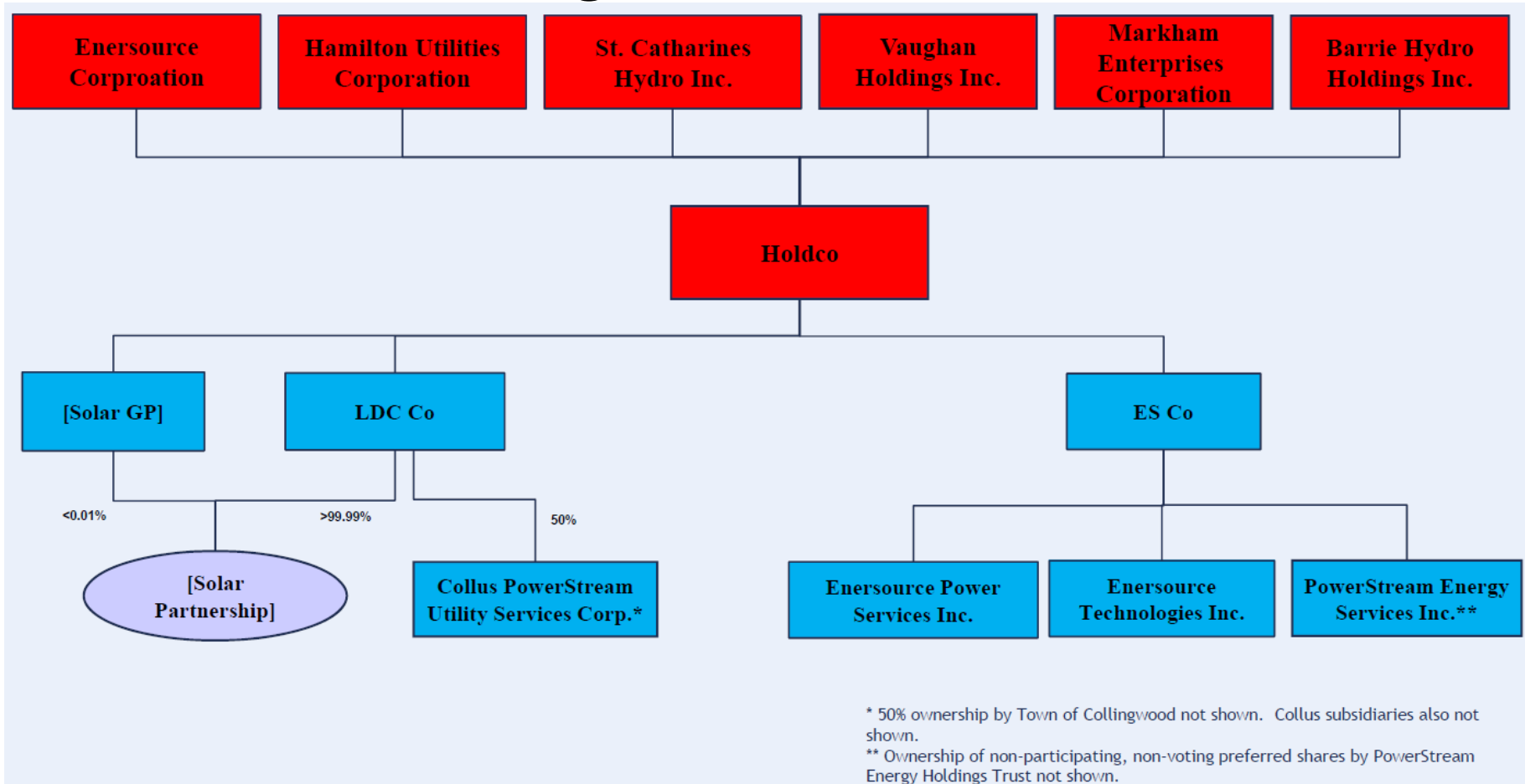
- MergeCo will be in a key position of leadership to influence government and regulatory energy policy for the benefit of customers and shareholders

# Key Aspects of Transaction



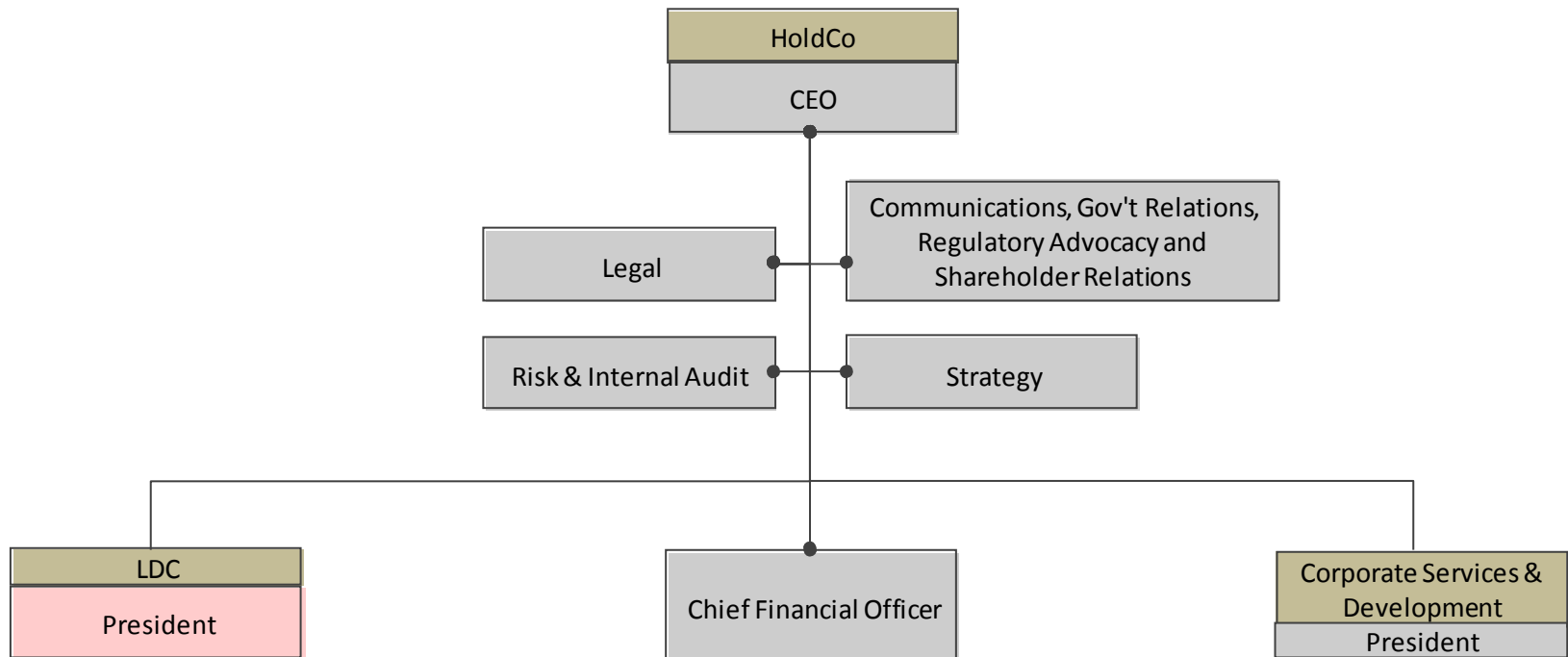
Issue	Result
Relative Value	PowerStream @ 46%
Local Presence & Facilities	Maintain existing facilities
Solar Carve Out	Maintain solar cash flows through special shares
Governance	6 of 13 Board Members to be appointed by PS shareholders
Executive	Significant presence in Executive for current PS Staff
Liquidity Rights	Improved rights to raise capital for growth, or to monetize existing investment

# MergeCo Structure will Enable Execution of Strategy



- Municipal Holding Companies are 100% owned by Municipalities, with the exception of Enersource Corporation (90% City of Mississauga, 10% Borealis)
- PowerStream Solar will reside in a segregated component of the LDC entity or a downstream partnership to preserve a full separation from the regulated LDC interests of MergeCo.

# MergeCo Organizational Structure



# ***Business Case***



# Estimated Synergy Savings

## 2016 – 2020

Estimated OM&A Synergy Savings

\$167 Million (approx)

Estimated Capital Savings

\$ 127 Million (approx)

Estimated Transition Costs

\$ 96 Million (approx)

(Includes Severance)

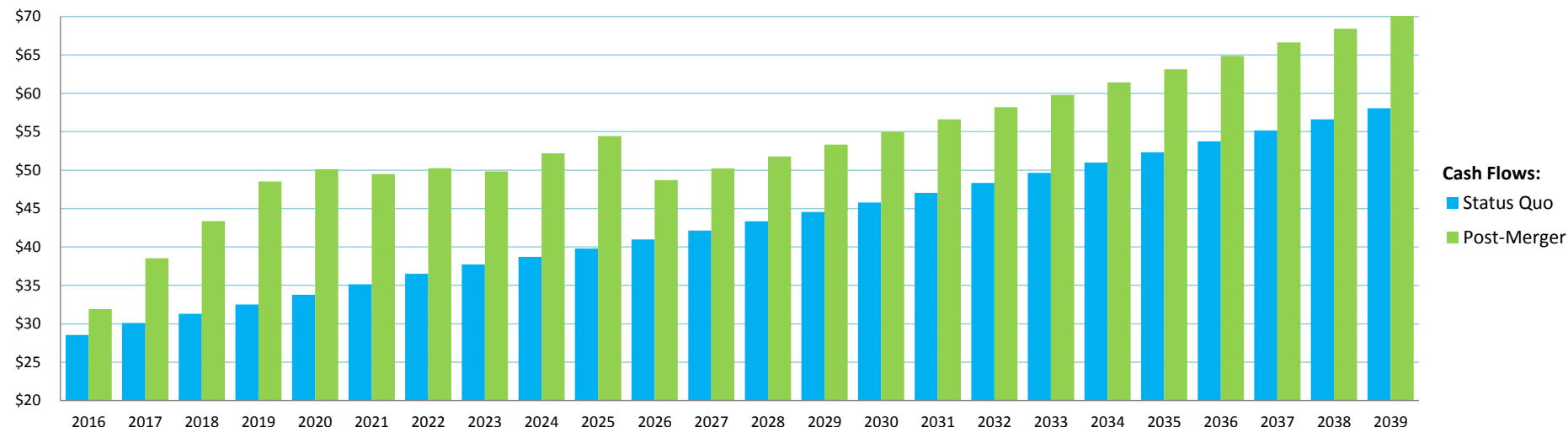
(Approx 45% OM&A; 55% Capital)

- Synergies of approximately \$47.5M/year after 2020
- **Pace/timing of achieving synergy savings is very important**
  - balancing financial need with HR/LR and broader cultural impact along with operational requirements.

# Value to Shareholders



**Core Business Cash Flows (\$m)**



**Cash Flows:**  
■ Status Quo  
■ Post-Merger

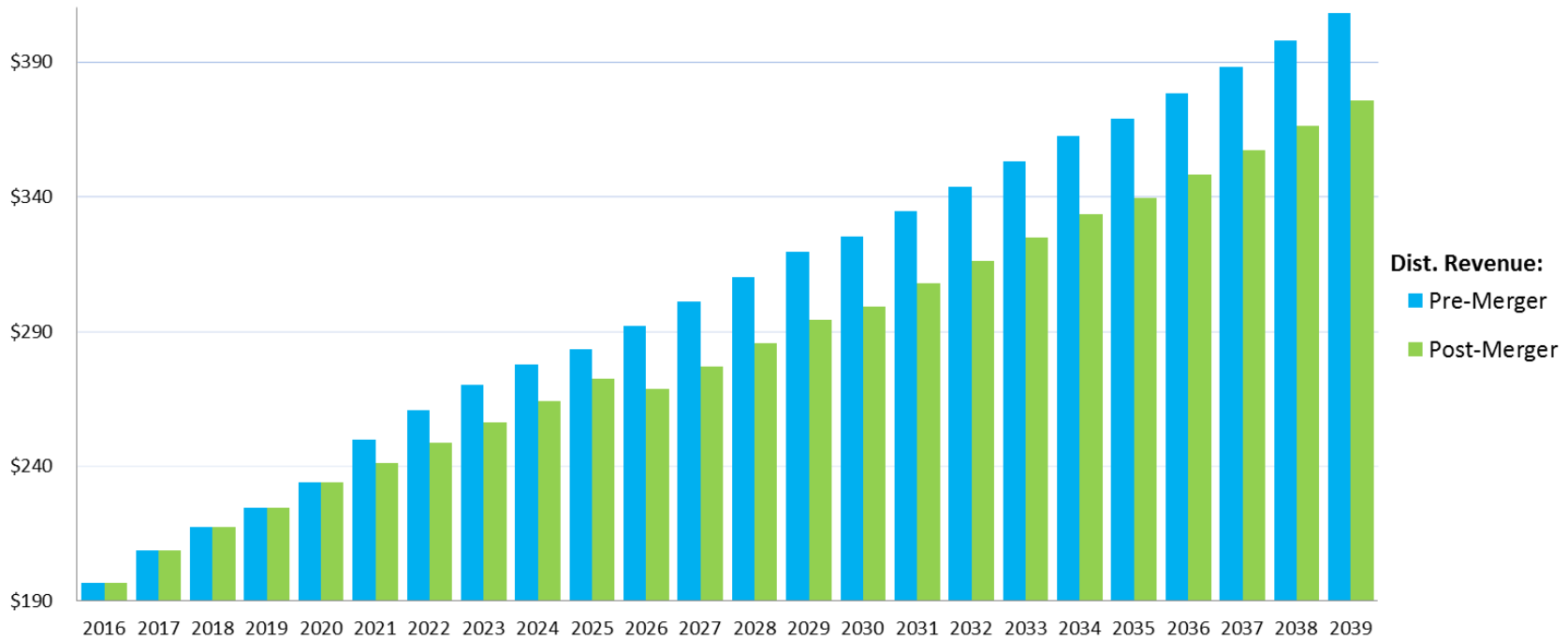
\*Updated to assume Promissory Notes and Deferred Interest are at 4.77% (long-term OEB rate); stand alone cash flows are amended to reflect impact of 2021-2025 rebasing that would occur if merger does not happen

Average Annual Increase in Cash Flows	1 - 5 Years	6 - 10 Years	11 - 15 Years	16 - 20 Years	21 - 24 Years	Total Increase of Cash Flows
	\$11.2	\$13.7	\$8.4	\$10.2	\$11.6	\$264.1

# Value to Customers



PowerStream Service Territory - Distribution Revenue (\$m)



- Customers will share in merger efficiencies and will save approximately \$450M over 25 years, or approximately \$40-\$50/customer annually
- Better ability to serve customers through enhanced and shared systems and range of products/services available ,with increased resources to respond to reliability issues
- Investment in new business opportunities improves economic development in our communities

# Value to Customers (cont.)



## Typical Monthly Bill

	PowerStream	Enersource	Horizon	Hydro One Brampton
Residential	\$ 131.47	\$ 133.97	\$ 138.15	\$ 133.05
GS<50	\$ 318.47	\$ 335.93	\$ 329.27	\$ 325.12
GS>50	\$ 12,971.56	\$ 13,480.01	\$ 13,227.02	\$ 12,996.53

- PowerStream is currently undergoing a custom IR rate submission and new rates will be set for 2016:

Proposed 2016 Rates	
PowerStream	
Residential	\$ 143.82
GS<50	\$ 363.46
GS>50	\$ 13,141.40

## Distribution Revenue with Merger Transaction

- From 2026 onward, annual Distribution Revenue is approximately 8% lower as compared to PowerStream status quo

# Community Impact



York Region Municipalities of Vaughan and Markham, as well as the City of Barrie are expected to see significant benefits on electricity bills for municipal buildings

## Annual Total Bill Savings (\$ thousands)

Municipality	Stand Alone Utility	Merged Utility	Cost Difference
Barrie Municipal Buildings	\$ 17,829	\$ 17,521	-\$ 308
Markham Municipal Buildings	\$ 11,497	\$ 11,296	-\$ 202
Vaughan Municipal Buildings	\$ 12,498	\$ 12,275	-\$ 223

Large accounts in York Region and Simcoe County, as well as in Markham, would see savings on their total bills. For example, annual total bill savings after 10 years would be over:

- \$10,000 for Markham Campus of Seneca College
- \$11,000 for Markham-Stouffville Hospital
- \$43,000 for Royal Victoria Hospital
- \$9,000 for Vaughan City Hall
- The same savings can be seen at a number of other large facilities in PowerStream's current service territory.

# Valuation & Business Case Summary



Valuation model and Business Case model was reviewed, stress tested, and negotiated over 6 months by consultants representing each Shareholder's interests:

## VALUATION

(including unregulated and PowerStream Solar)

Valuation	Enterprise Value
PowerStream	49.1%
Enersource	29.2%
Horizon Utilities	21.7%

## BUSINESS CASE

(excluding PowerStream Solar)

Business Case	Enterprise Value
PowerStream	46.0%
Enersource	31.0%
Horizon Utilities	23.0%

## Closing Adjustments:

- Closing adjustments for each LDC determined prior to merge and leveraged accordingly by MergeCo
- Purchase price is subject to certain limited price adjustments i.e. for working capital and fixed assets

## ***PowerStream Shareholders continue to benefit from the economics of the underlying solar assets***

- PowerStream Solar will remain in LDC company
- Ring-fenced, similar to current structure, to comply with OEB requirements
- PowerStream Shareholders receive 100% of the dividends of the Solar business
- Revised dividend policy for PowerStream Solar is being developed and will provide a dividend stream similar to the one currently forecasted
- PowerStream Shareholders will indemnify the other Shareholders for risks associated with Solar business

# PowerStream Solar - forecasted dividends



## Factors not related to the merger transaction

- The refinancing of IO Ontario debt; IO financing can only be used if PowerStream is 100% municipally owned ; given that it is expected that PowerStream would obtain Private Equity financing even on a stand alone basis, it is not possible to use IO financing anymore. For 2016-2025 the total impact of increased interest cost and refinancing cost is approx. \$1.7M
- Updating the SLA to include markup; for 2016-2025 the total impact is about \$0.1M
- **Overall impact on dividends: reduction of \$1.8M (2.3%)**

## Factors related to the merger transaction

- The increased spread on long-term debt ; at 50 bps for 2016-2025 the total impact of increased interest cost and refinancing cost is approx. \$2.9M
- Updating the SLA to 10% markup; for 2016-2025 the total impact is less than \$0.1M
- Changing the dividend policy to 80% of net Free Cash Flow - for 2016-2025 the total impact is about \$1.2M . This effect is due to the timing only; at the end of 20 year period it will be reversed.
- **Overall impact on dividends: reduction of \$4.2M (5.5%)**



# HOBNI Acquisition Financing



## Purchase price - \$607M

- Option to finance the purchase HOBNI with 70% - 75% debt
- Shareholder equity requirements to purchase HOBNI will be subject to closing adjustments
- Debt/equity adjustments, working capital adjustments and other assets adjustments to be based on pre-merger financial statements
- Bridge financing of up to \$625M to purchase HOBNI, and \$500M revolving credit will be available for MergeCo

<i>(\$ millions)</i>	<b>City of Vaughan</b>	<b>City of Markham</b>	<b>City of Barrie</b>	<b>PowerStream Total</b>
	<i>45.315%</i>	<i>34.185%</i>	<i>20.50%</i>	
Ownership in MergeCo (Excl. Solar)	20.8%	15.7%	9.4%	46.0%
Equity Required (Excl. Solar)	\$56.5	\$42.6	\$25.6	\$124.7

## Sources of equity contribution:

- Debt conversion pre-merger
- Municipal support
- Private Equity funding

## ***Key Legal Documents***

# Key Legal Documents



The terms and conditions for the proposed transaction are accomplished primarily through three key agreements:

- *Share Purchase Agreement (SPA)* for the purchase of Brampton;
- *Merger Participation Agreement (MPA)* to give effect to the 3-way merger;
- *Shareholders Agreement (SA)* to govern the rights of the shareholders in the future

All key aspects of the legal documents have been negotiated and the agreements are now substantially final and complete;

Details are summarized as follows:

# Share Purchase Agreement (“SPA”)



## Share Purchase Agreement

- Purchase price – the purchase price is \$607M.
- Adjustments – the Purchase price is subject to certain limited price adjustments i.e. for working capital and fixed assets.
- Closing conditions – the Agreement will provide for limited closing conditions, including closing of the Merger, Competition Act approval, and OEB approval. The purchase is not subject to a financing condition. All requisite Shareholder and Municipal approvals will have been obtained prior to signing the Agreement(s).

# Share Purchase Agreement Cont'd



- Closing date – the target closing date is March 31, 2016.
- Anti-Flip – the Province has insisted on the inclusion of anti-flip provisions that would (a) prohibit the purchasers from selling all, or substantially all the shares or assets of Brampton without the consent of the Province for a period of 5 years, and (b) prohibit the sale of more than 49% of the equity of the entire merged entity (MergeCo) for a period of 3 years (except as between the current owners).
- Indemnification – the Agreement will provide for indemnification by the Province, on certain matters, i.e. environmental, and include thresholds and cap on claims.

# ***Merger Participation Agreement ("MPA")***



## **Merger Participation Agreement**

- Parties – the Parties to the Merger Participation Agreement (MPA) and the Shareholder Agreement (SHA) will be all of the municipal holding companies, their respective municipalities, the three merging utilities (PowerStream, Enersource and Horizon) as well as BPC Energy Corporation (Borealis/OMERS).
- Shareholders – the shares of MergeCo would be held directly by each of the municipal holding companies. There will be one or two indirect shareholdings; in the case of Enersource 10% of their interest owned by Borealis or in the case of the PowerStream's or Horizon's shareholders a sale of 10% would result in 10% indirect ownership by a major pension fund such as Borealis or Teachers'.

# Merger Participation Agreement

## Cont'd



- Amalgamation – PowerStream, Enersource, and Horizon would amalgamate with each other and continue as a new corporation (“MergeCo”).
- Closing Date – the Merger would close up to 30 days prior to the closing of the purchase of the shares of Brampton.
- Representations & Warranties – the Agreement provides for customary Representations and Warranties between the Parties, with respect to; financial matters, material contracts, corporate status, condition of assets, full disclosure, environmental, and tax matters.
- Indemnification – each of the Parties agree to indemnify one another for claims, with thresholds and caps.
- The SPA and SHA will provide for the payment of the Share purchase of Brampton. Debt financing for this purchase has been arranged.

# Shareholders Agreement



## Overview

- The SHA between the Parties will come into effect upon Closing of the Merger.
- The draft SHA is similar to PowerStream's existing SHA in terms of structure, and incorporates the matters agreed to in the 3-way/purchase LOI.
- The Agreement will define the “Business”, governance, composition of the Board of Directors.
- Composition of the Board of Directors: Total of 13 directors; 6 of 13 PowerStream appointments; Vaughan 3, Markham 2, and Barrie 1. As part of their respective allotment of board seats, each municipality may appoint 1 non-independent board member.
- The Agreement will set out the Guiding Principles, which will also help inform the initial Strategic Plan.



# Shareholders Agreement Cont'd



## Overview

- The Agreement sets out the unanimous approval matters and matters that require 66 2/3rds (Supermajority) approval. There is a much shorter list of the Unanimous and Supermajority matters than in PowerStream's current SHA, resulting in a greater delegation to the Board.
- The Agreement deals with the transfer of Shares and Liquidity Rights. The Agreement will provide, with 66 2/3rds approval, the ability to bring in third party capital in order to fund growth, and also with 66 2/3rds approval, the ability to monetize in whole or in part, with a mechanism to deal with the allocation of taxes.

# Risk Management



Risk	Response
Synergies may not be achieved	PowerStream has a track record of meeting or exceeding its targets
Integration challenges	This is our fourth transaction in 10 years: experience counts
Unidentified expenses/liabilities	Extensive due diligence already, and specific contractual protection
Transaction financing in a rising interest rate environment	Bridge financing for two years is secured; flexibility to arrange capital details after closing
Regulatory uncertainty affects business plan going forward	A larger, more prominent utility will carry more weight in the industry and have a greater role in policy

# Next Steps



## PowerStream

**PowerStream Board** – September 11<sup>th</sup>

**BHHI** – September 14<sup>th</sup>, **City of Barrie** September 21<sup>st</sup> or 28<sup>th</sup>, Oct 5<sup>th</sup> TBC

**VHI** – September 16<sup>th</sup>, **City of Vaughan** September 22<sup>nd</sup>, Final Approval TBD

**MEC** – September 16<sup>th</sup>, **City of Markham** September TBD

## **Horizon**

**City of St. Catharines** – TBD

**City of Hamilton** – September 2<sup>nd</sup> and 23<sup>rd</sup>

## **Enersource**

**Board** – September 3<sup>rd</sup>

**City of Mississauga** – September 16<sup>th</sup>

**Borealis** – by September 16<sup>th</sup>

# Conclusion



***By pursuing the merger transaction, we will be stakeholders of the most dynamic utility in Canada***

- ✓ *The 2<sup>nd</sup> largest LDC in Canada, serving 1 million customers*
- ✓ *Reduced upward pressure on distribution rates for our customers*
- ✓ *Scale and opportunity to innovate and grow*
- ✓ *Strategically positioned to take advantage of opportunities in a changing industry landscape*
- ✓ *Increased Shareholder value and cash flows*