

# PowerStream Merger and Acquisition: Decision Support

Prepared for the City of Vaughan

September 22, 2015



# Proposed Transaction



- » The transaction has two major components
  - › Three-way merger between PowerStream, Enersource, and Horizon
  - › Joint acquisition of Hydro One Brampton
- » Would create the second largest regulated electricity distribution utility in Ontario by the number customers, nearly one million, and the third largest by regulated asset value

### **Navigant was retained to provide decision support to PowerStream's shareholders**

Navigant's analysis addresses five critical questions

1. Value and risks: What is the value of the transaction to PowerStream shareholders and what are the associated risks?
2. Cash flow: What are the expected cash flows to PowerStream shareholders under the status quo and the proposed transaction?
3. Liquidity: What flexibility is there for PowerStream shareholders (jointly and individually) to divest their holdings and what is the associated impact of such divestment under the status quo and the proposed transaction?
4. Acquisition price: Is the purchase price for Hydro One Brampton consistent with market value?
5. Merger relative value: Are PowerStream shareholders receiving an appropriate share of the equity in the new company ("MergeCo")?

## Navigant is a global provider of specialised professional services

Navigant Consulting Ltd. is the Canadian operating company and a wholly owned subsidiary of Navigant Consulting, Inc. (together “Navigant”). Navigant is a specialised global expert services firm that helps clients create and protect value in the face of critical business risks and opportunities. Our experts have deep industry knowledge in energy, healthcare, construction, and financial services. Navigant has over 5,000 professionals located in more than 50 cities around the world, serving clients in more than 70 countries. Navigant is traded on the New York Stock Exchange and had revenue of US \$860 million in 2014.

### Client Profile



Nearly 300 financial services companies including many of the largest banks in the U.S.



Over 80% of AMLAW 100 firms



50 of the largest electricity and natural gas utilities globally



Over 300 hospitals, health systems & academic medical centers, and global life sciences companies



Federal, state and local government departments and agencies

### Geographic Profile



### Talent Profile

- » 5,000+ employees as of Dec. 31, 2014
  - › 1,700 expert / consulting professionals
  - › 2,700 business process management services professionals
- » Credentials include CFAs, CPAs/CAs, economists, engineers, physicians, PhDs, and attorneys
- » Niche areas of expertise combined in unique ways
- » Broad networks of experts and affiliates
- » Collaborative and nimble resource management

## Navigant's Energy practice has the depth of knowledge and breadth of capabilities to solve the most complex energy sector challenges

Navigant Energy offers a full range of advisory services specifically targeted to the power and utilities and oil and gas industries. Navigant's Energy practice has over 400 consultants around the world and a breadth of capabilities to solve the most complex energy sector issues. Our consultants have substantial hands-on industry experience with unmatched expertise across the entire energy value chain. Our experts combine their business strategy knowledge with exceptional operational experience to deliver solutions that are technically and financially viable.

Market Intelligence	Strategy, Technology, and Organization	Markets, Customers	Operations & Asset Management	Financial, Risk and Regulatory
<ol style="list-style-type: none"> <li>1. Research</li> <li>2. Benchmarking</li> <li>3. Modelling</li> </ol>	<ol style="list-style-type: none"> <li>4. Business strategy, planning and implementation</li> <li>5. Technology, strategy assessment, and advisory</li> <li>6. Due diligence and M&amp;A support</li> <li>7. Innovation and R&amp;D management</li> <li>8. Technology and appliance standards, codes and testing</li> <li>9. Reverse engineering and test facilities</li> </ol>	<ol style="list-style-type: none"> <li>10. EE/DSM Market research and characterisation</li> <li>11. EE/DSM evaluation, measurement, and verification</li> <li>12. EE/DSM program design</li> </ol>	<ol style="list-style-type: none"> <li>13. Energy markets advisory</li> <li>14. Utility contracting support</li> <li>15. Energy project development support</li> <li>16. Integrated resources planning 2.0</li> <li>17. Electric transmission planning and operations</li> <li>18. Electric distribution planning and operations</li> <li>19. End user energy strategy</li> </ol>	<ol style="list-style-type: none"> <li>20. Retail regulatory support</li> <li>21. Energy SME litigation support</li> </ol>



# Sample Engagements



## **Merger of PowerStream and Barrie Hydro**

The City of Barrie retained Navigant to serve on the Joint Steering Committee to negotiate a merger agreement between Barrie Hydro and PowerStream. As part of this engagement, Navigant explored the potential savings, rate, and reliability impacts of the potential merger and made numerous presentations to Barrie City Council and senior staff regarding the implications of the potential merger. The merger was ultimately approved by the three municipal shareholders of the two utilities.



## **Transaction advisor to Constellation Energy merger of Constellation Energy and Exelon**

Navigant was engaged by Constellation Energy to provide transaction due diligence and advisory assistance in support of the company's proposed merger with Exelon which would result in one of the nation's largest competitive energy products and services suppliers with 64 terawatt-hours of load per year delivered to over 100,000 businesses and approximately 1 million residential clients.

Navigant mobilized a cross functional team of transaction and energy professionals from its corporate finance and energy practices to perform a comprehensive due diligence process that focused on identifying any strategic, financial, or operating issues with the potential to affect the valuation/stock price of the combined entity post-close. Navigant's process and findings were delivered in a summary report identifying any potential red flag issues and recommendations on mitigation strategies for any key risks identified.



## **Transmission utility transaction diligence**

Navigant provided technical, financial and due diligence support to the a large utility investment holding company in its pursuit of the acquisition of AltaLink, an Alberta Transmission Facility Operator. Navigant's support included a review of the regulatory framework and ratemaking process for transmission facilities, a comparison of the Alberta regulatory framework with other jurisdictions globally and an assessment of the key risk factors related to the business.



## **Technical advisor to the Distribution Sector Review Panel**

Navigant provided technical consulting services to the Ontario Distribution Sector Review Panel. As part of this engagement, Navigant provided insight on previous local distribution company mergers and quantification of associated savings, trends in LDC spending and implications on the potential for further efficiencies, cost drivers for local distribution companies and potential efficiencies, and areas where local distribution companies are currently sharing common infrastructure, systems, and processes, and the potential for further efficiencies in these areas.

## Key aspects of the business case are reasonable

- » Navigant ***reviewed, analysed, and tested*** the business case assumptions, and revised as appropriate
- » Hydro One Brampton purchase price
  - › Price for Hydro One Brampton ***in within, but at the high end of, the valuation range***
- » Relative valuation of PowerStream, Enersource, and Horizon
  - › Relative valuation of PowerStream is ***reasonable***
  - › PowerStream Solar is ***likely undervalued***
    - As a result, management successfully negotiated that the PowerStream Solar assets be carved out and earmarked for only the existing PowerStream shareholders
    - Small negative impact to the expected PowerStream solar cash flows, up to \$1.7M for Vaughan
- » Synergies
  - › Synergies were ***reviewed and determined to be reasonable*** and achievable
    - Roughly half of the functional area synergies are likely conservative (i.e. synergies may be greater)
    - There are risks associated with the Synergies, but PowerStream has a track record of delivering

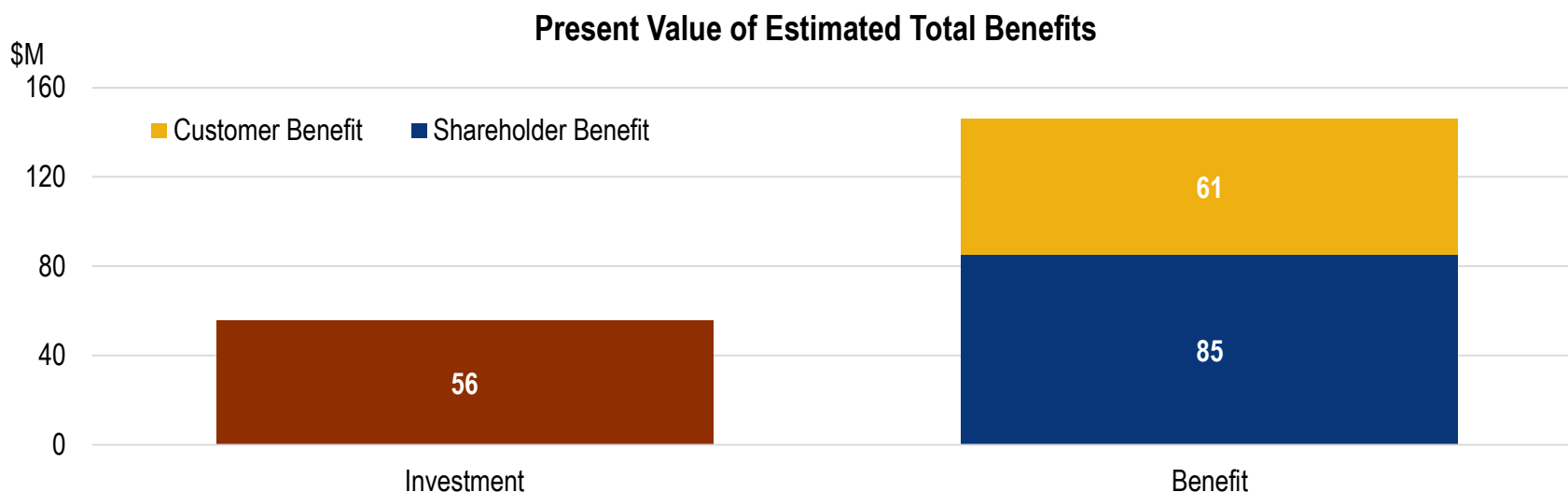
### Proposed transaction creates value for the City of Vaughan, but comes with risk

1. Transaction **requires ~\$56M investment** from the City of Vaughan, plus or minus closing adjustments (10%)
2. The transaction is **expected to create between \$71 and \$102M of shareholder value**, approximately 30% to 80% more than the \$56M initial investment, representing a 6 to 9% return on investment
3. Vaughan's initial investment is expected to be **recovered through increased dividends over 10 years**, if ratepayer benefits are also considered, the simple payback period is reduced to seven years
4. Over 25 years, the present value of the **projected benefit to Vaughan electricity customers is \$61M**, equivalent to an **average of \$40 per year for all customers and \$25 per year for residential customers**
5. The transaction can be **funded with limited or no cash** if the City of Vaughan (i) sells 10% of PowerStream and reinvests the proceeds, or (ii) swaps its shareholder loans for equity; the former also **mitigates risk associated** with the *transaction*
6. The investment has **more risk and is expected to provide a lower return** than investments made to-date in PowerStream, although under certain reasonable conditions the return could be higher
7. The transaction is expected to **have a limited impact on the liquidity** of Vaughan's existing investment, and could result in a small improvement



## Combined shareholder and customer benefit is substantial

- » \$146M of total benefit (present value) for \$56M investment
  - › \$85M of benefit is realised through increased dividends and equity value to Vaughan
  - › \$61M of benefit is realised through lower electricity rates than would otherwise

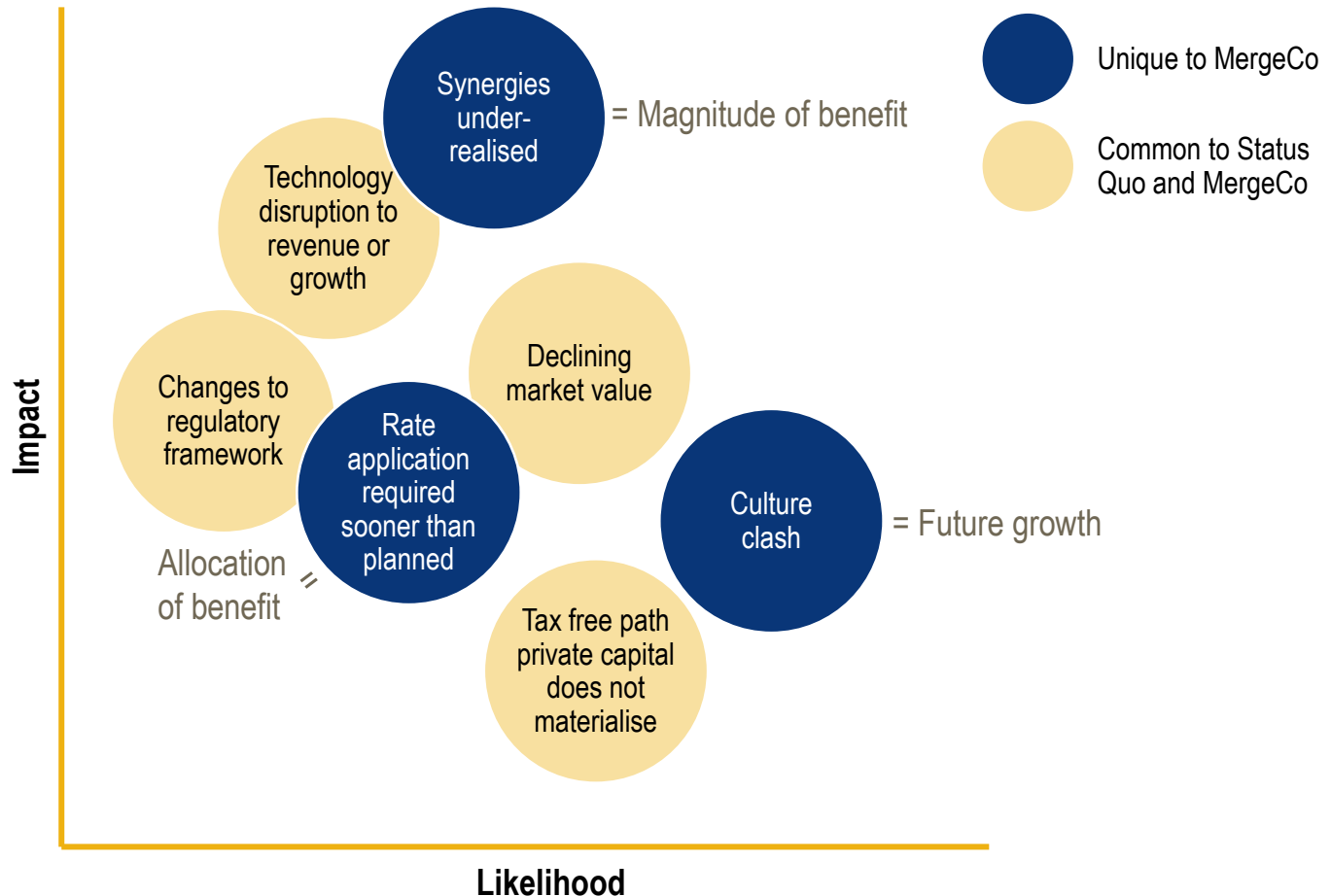


Source: Navigant. "Decision support for the proposed three-way merger between PowerStream Holdings Inc., Enersource Corporation, and Horizon Holdings Inc., and the joint acquisition of Hydro One Brampton Networks Inc.". September 18, 2015.

Notes:

1) All values discounted at 5%

Navigant assessed the risks associated with the transaction based on (i) likelihood of occurrence and (ii) impact on value



**Four considerations on funding options; 10% sale provides second highest cash flow, but mitigates risk**

Consideration	Status Quo	100% Cash	Convertible Note	10% Sale
1. Cash flow magnitude				
Investment required	\$7M	\$56M	\$0	\$11M
Net present value (10-years)	\$101M	\$87M	\$126M	\$122M
2. Cash flow risk	--	Neutral	Increase	Neutral
3. Investment exposure	--	Increase	Neutral	Neutral
4. Liquidity	--	Decrease	Decrease	Neutral

## **No Warranties or Representations, Limitation of Liability**

THIS REPORT (THE “REPORT”) WAS PREPARED FOR VAUGHAN HOLDINGS INC. ON TERMS SPECIFICALLY LIMITING THE LIABILITY OF NAVIGANT. NAVIGANT’S CONCLUSIONS ARE THE RESULTS OF THE EXERCISE OF ITS REASONABLE PROFESSIONAL JUDGMENT. USE OF THIS REPORT BY THE READER FOR WHATEVER PURPOSE SHOULD NOT, AND DOES NOT, ABSOLVE THE READER FROM USING DUE DILIGENCE IN VERIFYING THE REPORT’S CONTENTS.

NAVIGANT DOES NOT MAKE ANY REPRESENTATIONS OR WARRANTIES OF ANY KIND WITH RESPECT TO (I) THE ACCURACY OR COMPLETENESS OF THE INFORMATION CONTAINED IN THE REPORT OR IN ANY OF THE OTHER DOCUMENTS, (II) THE PRESENCE OR ABSENCE OF ANY ERRORS OR OMISSIONS CONTAINED IN THE REPORT, (III) ANY WORK PERFORMED BY NAVIGANT IN CONNECTION WITH OR USING THE REPORT, OR (IV) ANY CONCLUSIONS REACHED BY NAVIGANT AS A RESULT OF THE REPORT, AND (E) ANY USE WHICH YOU MAKE OF THIS REPORT, OR ANY RELIANCE ON IT, OR DECISIONS TO BE MADE BASED ON IT, ARE THE RESPONSIBILITY OF YOU. NAVIGANT ACCEPTS NO DUTY OF CARE OR LIABILITY OF ANY KIND WHATSOEVER TO YOU, AND ALL PARTIES WAIVE AND RELEASE NAVIGANT FOR ALL CLAIMS, LIABILITIES AND DAMAGES, IF ANY, SUFFERED AS A RESULT OF DECISIONS MADE, OR NOT MADE, OR ACTIONS TAKEN, OR NOT TAKEN, BASED ON THIS REPORT.