

PETERBOROUGH DISTRIBUTION INC. SALE REVIEW: ANALYSIS OF HYDRO ONE OFFER

PREPARED FOR
THE CITY OF PETERBOROUGH

NOVEMBER 24 2016

REVISED

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AGENDA

- 1. Introduction**
- 2. Analysis and findings**
 - A. Shareholder perspective**
 - B. Municipal perspective**
 - C. Ratepayer perspective**
- 3. Summary**

HYDRO ONE OFFER OVERVIEW

The offer is for Peterborough's regulated electricity distribution business assets

- Purchase price: **\$105 million**
- Economic development
 - Plan to construct Regional Operating Centre within Peterborough
 - Estimate 30 additional Hydro One jobs at new Regional Operating Centre
- Jobs: all PDI employees will be offered a **12 month location and service guarantee**
- Customer distribution rates
 - Will be reduced by **1% and frozen** for years one through five
 - Potential for **distribution rate increases less than inflation** for years six through ten if approved by Ontario Energy Board
 - Proposed **Earnings Sharing Mechanism** would provide a guaranteed share of Hydro One's earnings in years six to ten to be used to offset distribution rates in year 11 and beyond
- Service Levels: Guarantees *backed by monetary compensation* if not fulfilled



HYDRO ONE OFFER OVERVIEW

Why is Hydro One making an offer?

- To create synergies and achieve cost savings by integrating PDI's assets and operations into Hydro One's distribution network

- The table to the right shows Hydro One's expected cost savings from its proposed purchase of Orillia Power Distribution Corporation (OPDC). Given PDI's costs, the percentage savings from PDI may be less, but would still be significant

Table 1: Projected Cost Savings - \$M

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
OM&A										
Status Quo Forecast	4.8	4.9	5.0	5.1	5.2	5.3	5.4	5.5	5.6	5.8
Hydro One Forecast	4.1	2.1	2.0	1.7	1.7	1.7	1.8	1.8	1.9	1.9
Projected Savings	0.7	2.8	2.9	3.4	3.5	3.6	3.6	3.7	3.8	3.9
Capital										
Status Quo Forecast	2.7	2.8	2.9	3.0	3.1	3.2	3.3	3.4	3.5	3.6
Hydro One Forecast	3.6	2.3	2.4	2.3	2.4	2.5	2.6	2.7	2.9	3.0
Projected Savings	(0.9)	0.5	0.5	0.7	0.7	0.7	0.7	0.7	0.6	0.6

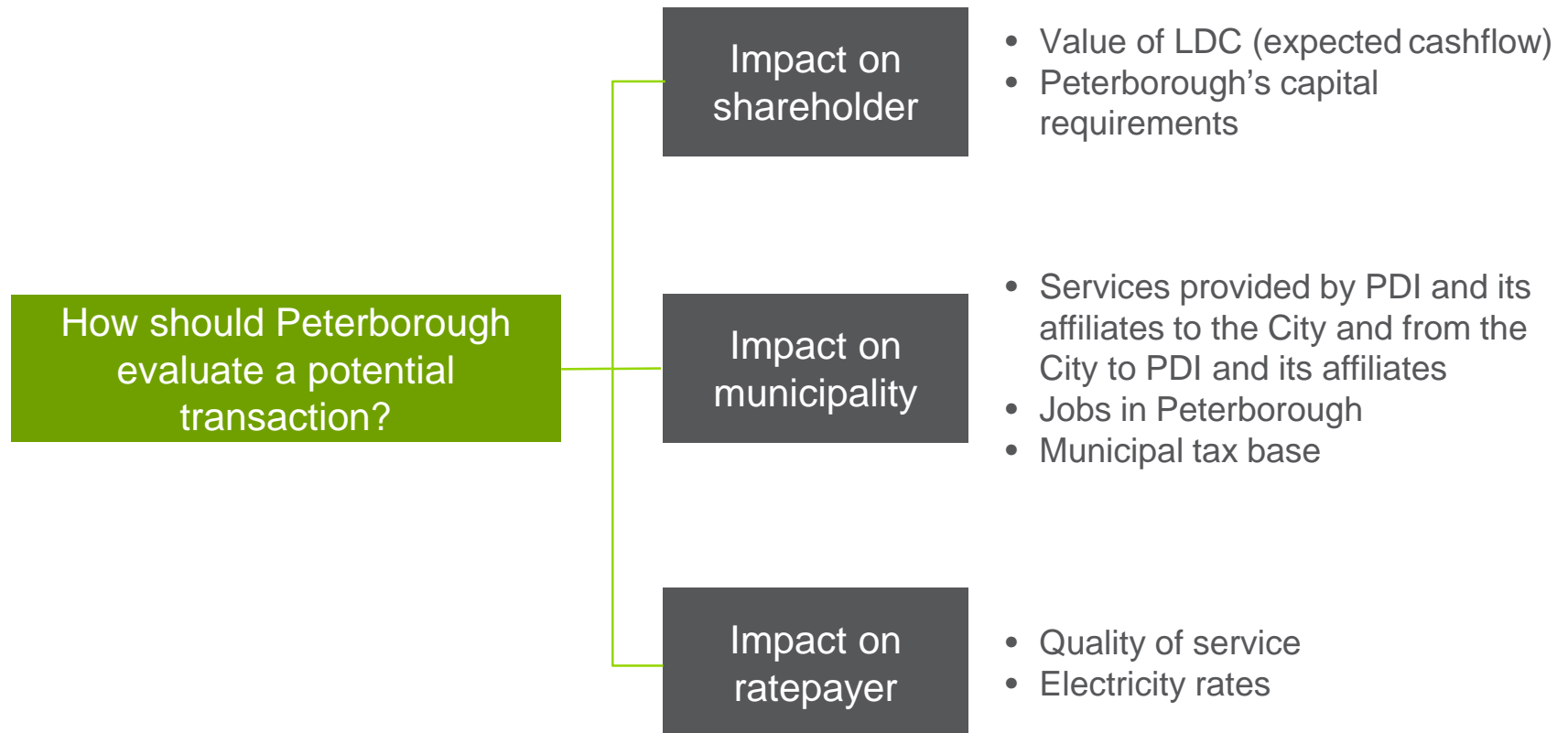
Source: OEB - Hydro One's MAAD submission for OPDC (EB-2016-0276)

- Hydro One's purchase price, employment and rate offers reflect "sharing" by Hydro One of the expected synergies and savings with the City and PDI ratepayers

FOCUS OF ANALYSIS IS THE HYDRO ONE OFFER

- Navigant has compared Hydro One's offer to continued ownership and operation of PDI by the City (Status Quo).
- Other options exist – such as sale to other parties or merger with other LDCs
- PDI and COPHI have explored these other options extensively over the past two years and determined that these other options would not provide the same benefits in the areas of:
 - Financial value to the City
 - Protect customers from increases in distribution rates
 - Ensure customer service excellence
 - Increase local jobs and economic activities
 - Ensure fair treatment of existing employees

PROPOSED DECISION FRAMEWORK



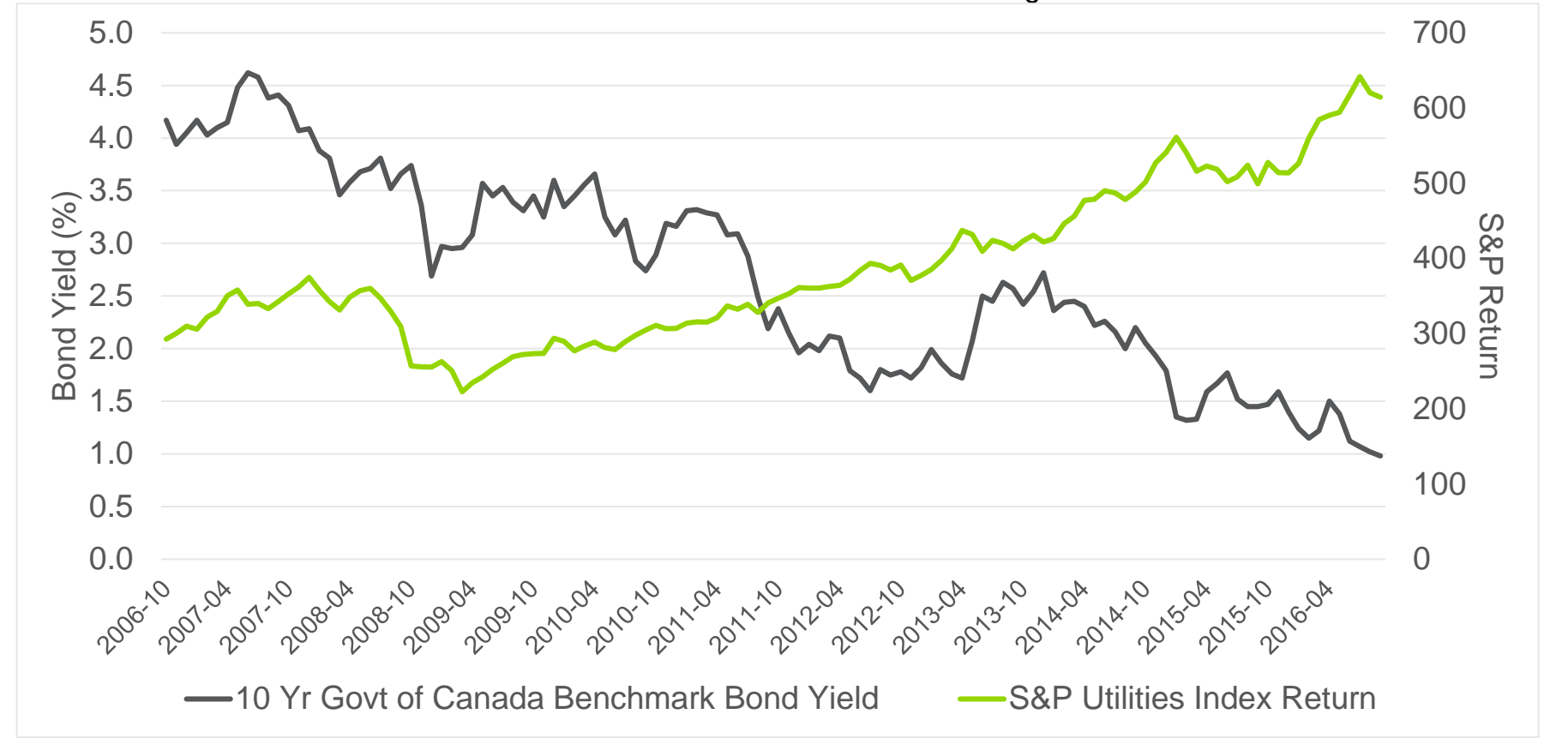


SHAREHOLDER PERSPECTIVE

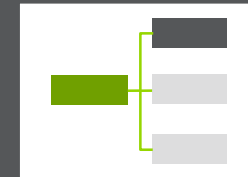
MARKET VALUE

Since 2008, the market valuation for utility companies has increased as long-term interest rates have fallen

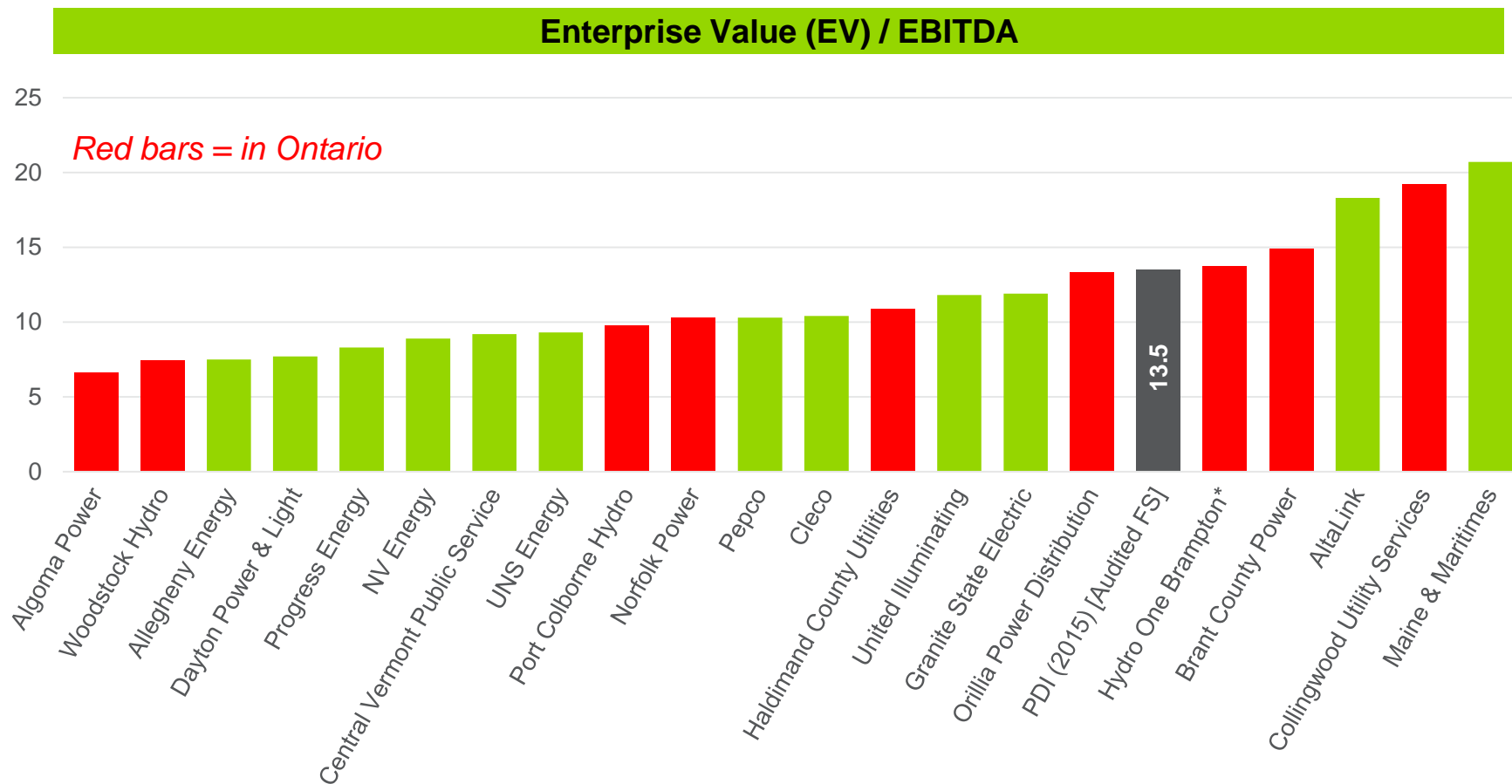
S&P Utilities Index Return and 10-Year Sovereign Yield



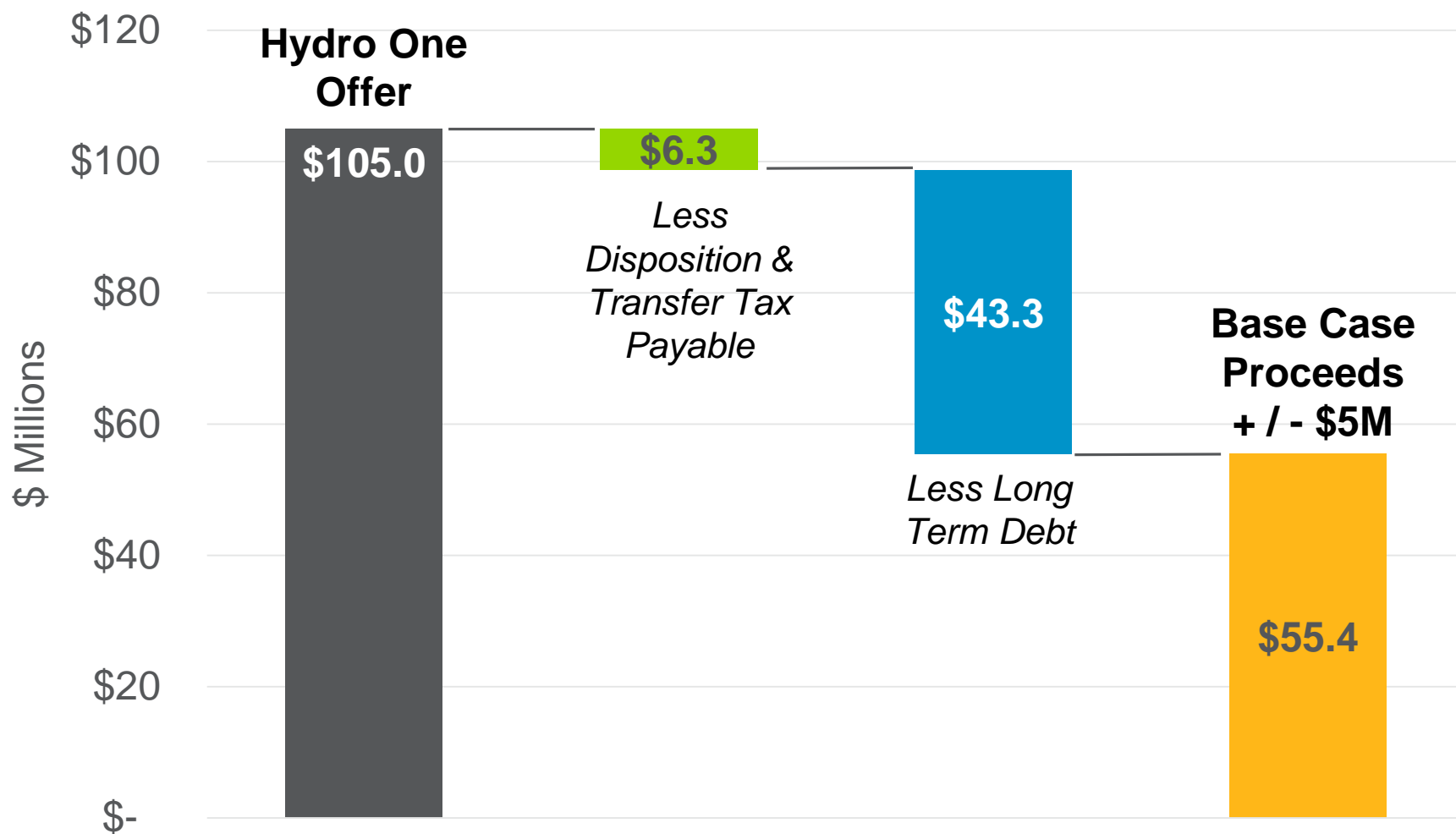
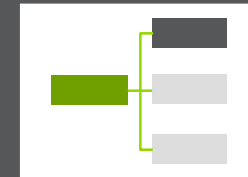
MARKET ANALYSIS

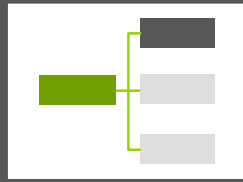


Hydro One's offer for PDI is competitive with other transactions and is "in the market"



EXPECTED NET PROCEEDS FROM SALE OF PDI

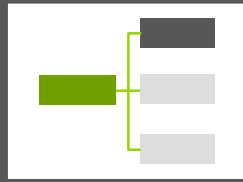




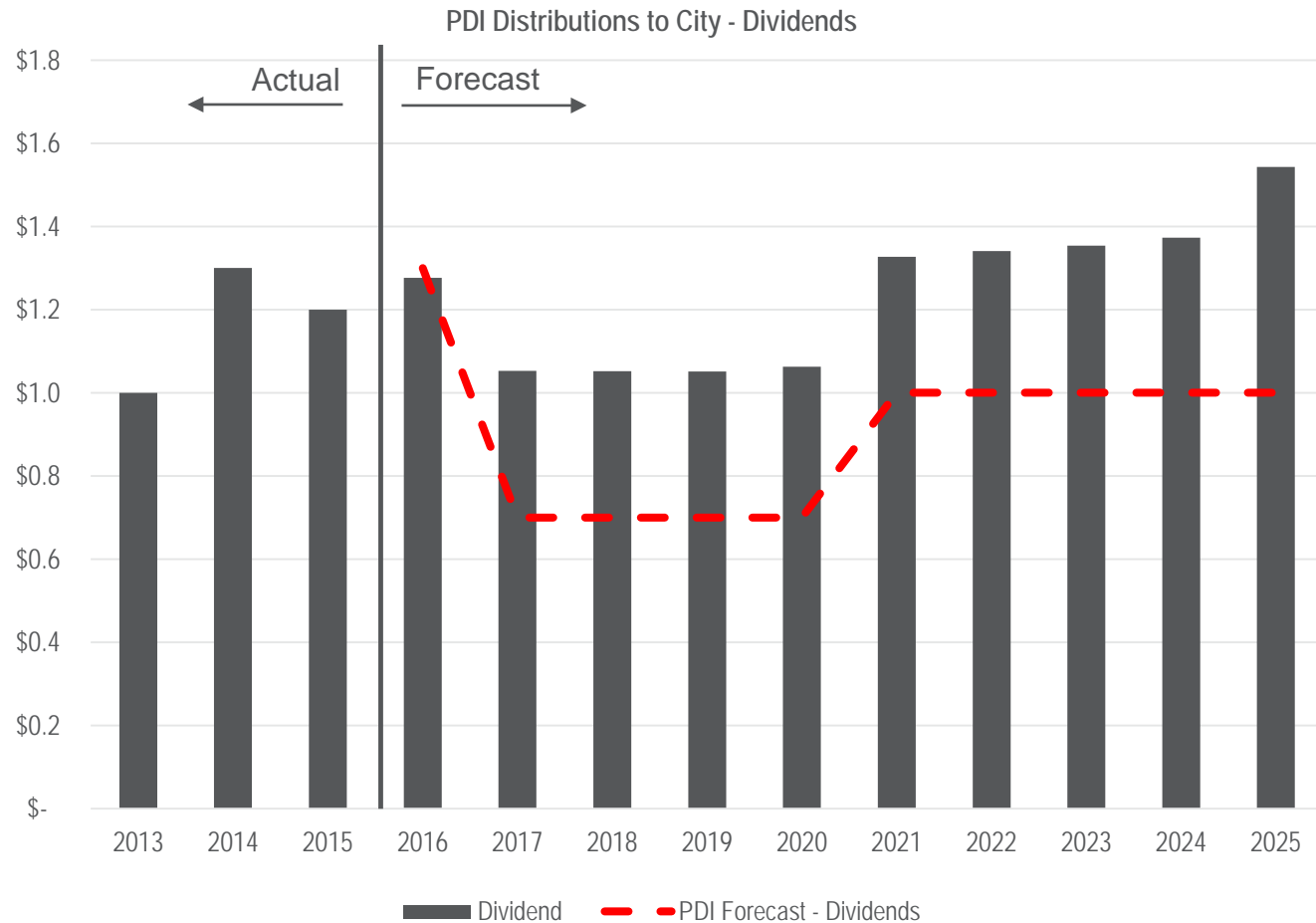
STATUS QUO PROJECTIONS

- Under Status Quo (continuing to own PDI), PDI revenues would be subject to the Ontario Energy Board's ratemaking formula
- PDI rates are reset (rebased) every five years to allow PDI to earn the regulated rate of return
 - In the intervening years, rates are allowed to increase at an amount less than inflation
- PDI's net income reflects its revenues less its costs (as in any business)
 - Some of PDI's net income is re-invested in the utility (capital expenditures) and the City will earn a return on this re-investment after rates are reset (rebased)
 - Remainder of net income is provided to the City as dividends
- Our focus is on cash flows to the City of Peterborough

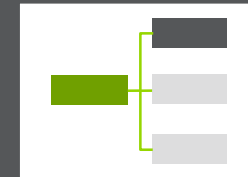
STATUS QUO PROJECTIONS



- Navigant's forecast of dividends payments to the City is \$1.3 million in 2016 increasing to \$1.5 million by 2025
- As compared to PDI's forecast, Navigant has a slightly more favorable view of the revenue that PDI will earn, plus expects that PDI could provide a slightly higher dividend payout ratio

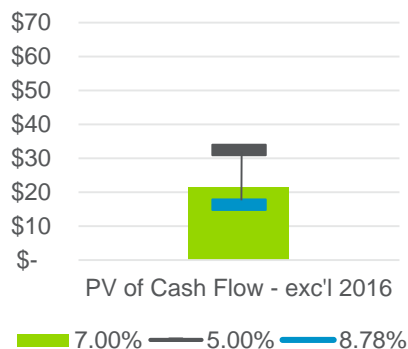
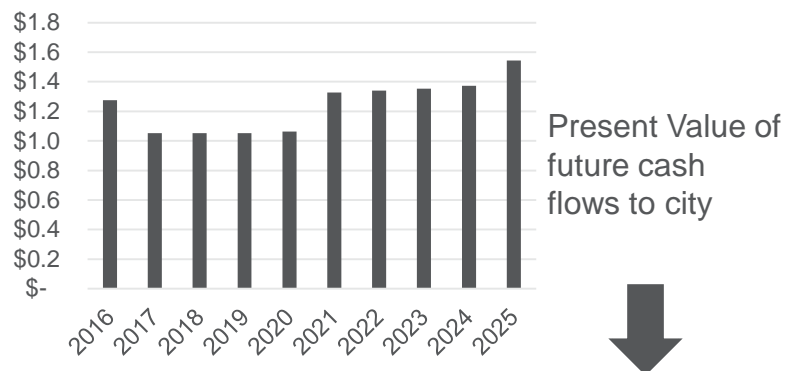


IMPACT ON SHAREHOLDER



All \$ values in millions

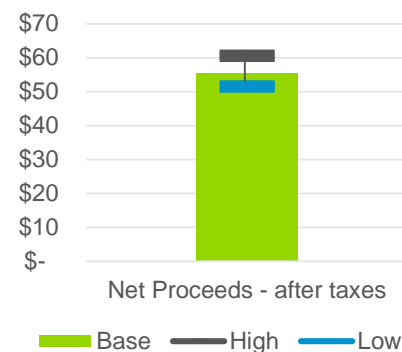
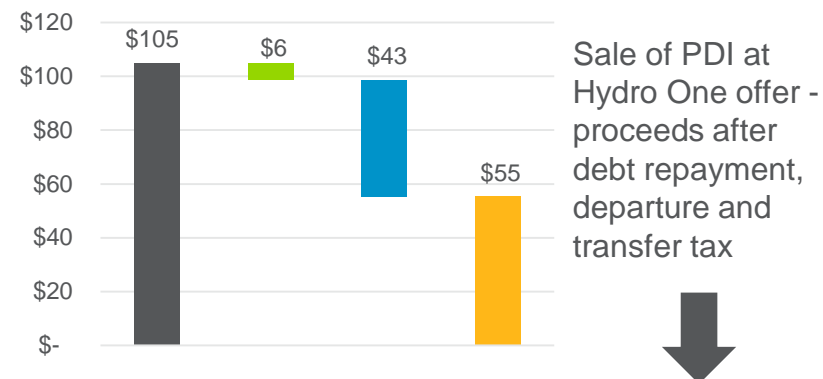
Hold



Discounted at city's cost of capital*

\$ Millions	Forecast	
	Navigant	PDI
Discount Rate		
5.00%	\$32.5	\$21.5
7.00%	\$21.5	\$14.3
8.78%	\$16.4	\$11.0

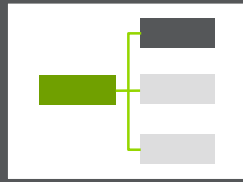
Sell



High and Low scenarios represent potentially lower or higher tax liabilities than Base

* Assumes that PDI is owned by the City in perpetuity – 2016 excluded since it will be realized by the City in both cases

PETERBOROUGH'S CAPITAL REQUIREMENTS

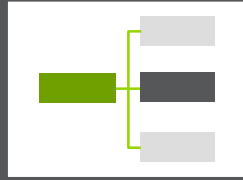


The City should assess its present and future capital requirements

- What are the City's future capital requirements?
- What are the possible sources for these capital requirements
 - Reserves
 - Ongoing distributions from PDI
 - Proceeds from sale of assets, including PDI
- What risks are associated with PDI's future cash flows?
- Can the proceeds of sale be put to better use elsewhere?
 - Example: the forecast \$55 million net proceeds from the sale invested in Canadian Corporate A Rated Bonds @ 3% would return \$1.65 M per year



MUNICIPAL PERSPECTIVE



Municipal perspective covers the potential impact on local jobs and service costs to the City resulting from the sale



Jobs in Peterborough – **Hydro One Offer Terms:**

- PDI's 60+ employees would be offered a 12 month location and service guarantee
- Estimate that 30 additional Hydro One jobs will join 70 existing employees at new Regional Operating Centre



Services – **Hydro One Offer Terms:**

- Transition Services Agreement (TSA) to be developed and agreed upon alongside the Asset Purchase Agreement
- TSA will describe the transfer of services currently provided to PDI by Peterborough Utilities Services Inc. (PUSI) to Hydro One
- Consider the impact on all services between PUSI, PDI and the City

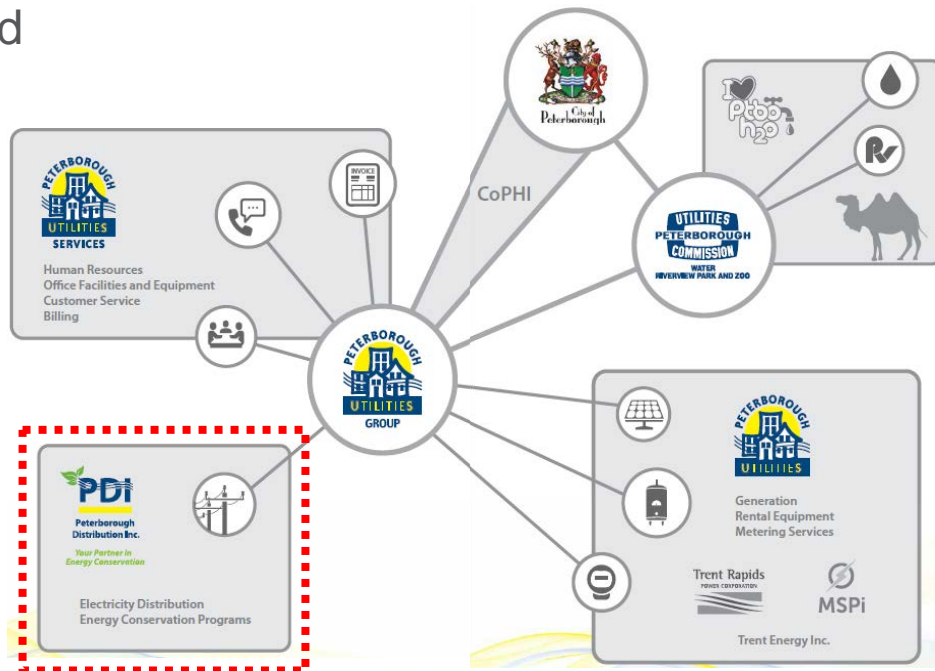


Municipal Tax base

- Annual payments of \$100,000 in Municipal Taxes, plus
- One-time payment of \$600,000 for the sale of land

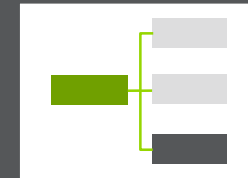
SERVICES TO AND FROM THE CITY

- Peterborough Utilities Group provides various services to the City and its affiliates including IT, customer service, billing, HR and finance
- Sale of PDI would not directly affect the provision of these services, but there would be some changes / re-alignment required
 - SCADA services currently provided from PDI to PUI would need to be provided by Hydro One
 - Water meter reading currently leverages PDI's electric meter infrastructure. Would require leasing arrangement with Hydro One for continued access to infrastructure
 - Billing system currently used by PUC, PDI and PUI is at the end of its useful life. A simpler replacement system for PDI and PUI would be required.
- Overall impact on City and Peterborough Utilities Group costs and services levels from these changes are not expected to be significant





RATEPAYER PERSPECTIVE



The City should consider the impact of the sale on the ratepayers



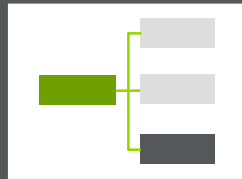
Service levels – **Hydro One Offer Terms:**

- Service levels will be guaranteed with monetary compensation for missed targets
- Reliability is also a critical aspect of “service”



Distribution rates – **Hydro One Offer Terms:**

- Will be reduced by 1% and frozen for years one through five
- Potential for distribution rate increases less than inflation for years six through ten if approved by Ontario Energy Board
- Proposed Earnings Sharing Mechanism would provide a guaranteed share of Hydro One’s earnings in years six to ten to be used to offset distribution rates in year 11 and beyond



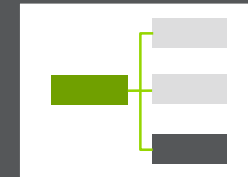
SYSTEM RELIABILITY

- Comparing the system reliability for PDI and Hydro One (around the Peterborough area) indicates that reliability levels are similar
- Hydro One's overall provincial average numbers are higher than for the area around Peterborough (OEB reports a provincial average SAIDI of 12.22 and a SAIFI of 3.07 for Hydro One in 2015)

Measures	LDC	2012	2013	2014	2015	4-year Average
Average # of Hours that Power to a Customer is Interrupted (SAIDI)	PDI	2.43	2.73	0.90	3.59	2.41
	Hydro One	2.33	2.09	2.14	4.56	2.78
Average # of Times that Power to a Customer is Interrupted (SAIFI)	PDI	2.12	1.41	0.83	2.81	1.79
	Hydro One	0.62	0.90	0.67	1.49	0.92

Source: OEB and Hydro One

CUSTOMER SERVICES

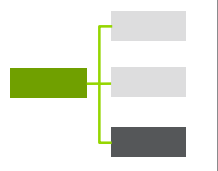


Both PDI and Hydro One have generally met or exceeded the Industry's Customer Service performance targets

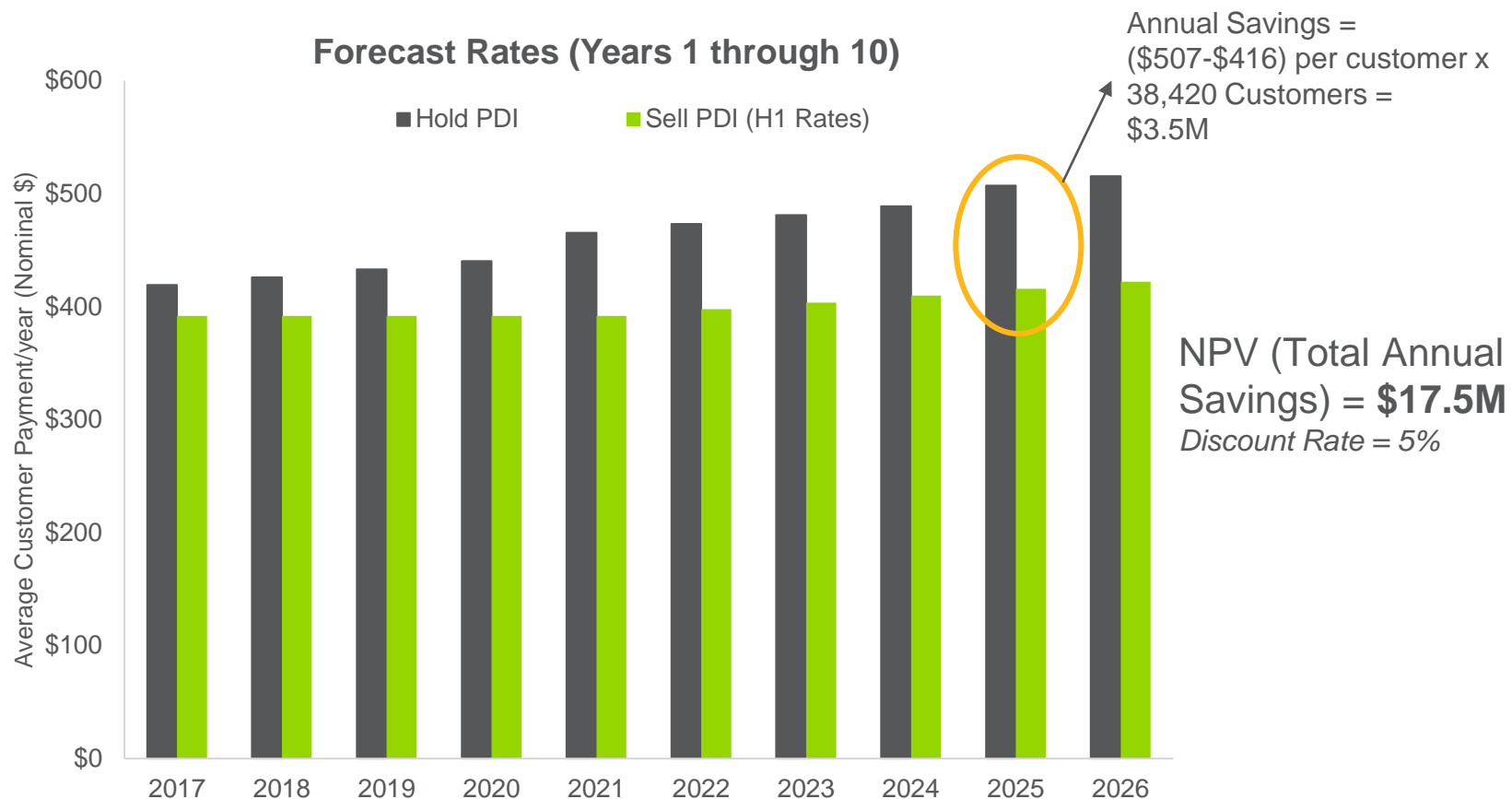
Performance Category	Measures	PDI		Hydro One		Industry Target
		2014	2015	2014	2015	
Service Quality	New Residential/Small Business Services Connected on Time	99.1%	98.8%	97.4%	97.5%	90%
	Scheduled Appointments Met on Time	99.6%	99.5%	99.3%	98.5%	90%
	Telephone Calls Answered on time	76.5%	81.8%	69.6%	76.4%	65%
Customer Satisfaction	First Contact Resolution	1	0	79.0%	82.0%	-
	Billing Accuracy	99.7%	99.2%	94.6%	98.6%	98%
	Customer Satisfaction Survey Results	84%	84%	85%	85%	-

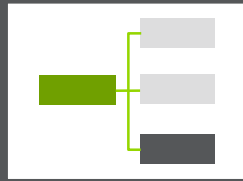
Source: OEB LDC Scorecards

FORECAST DISTRIBUTION RATES – YEARS 1 THROUGH



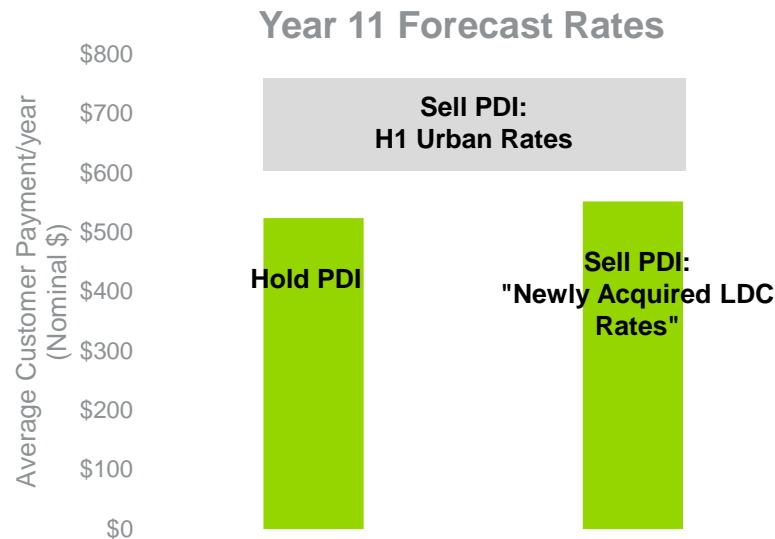
Average customer payment across all customer types (residential and business) is based on distribution revenues / total number of customers





FORECAST DISTRIBUTION RATES – YEARS 11+

- Hydro One is proposing to establish a “Newly Acquired LDC” rate class. The “Newly Acquired LDCs” would include Woodstock, Haldimand, Norfolk and, potentially, Orillia and Peterborough
- Establishment of this rate class will require approval of the Ontario Energy Board
- Given the relative density of customers, the rates for customers in this new rate class will likely be lower than Hydro One’s Urban rate class (which are lower than its Rural rate classes). Note also that there is considerable uncertainty in forecasting rates 11 years from now
- Additionally, Hydro One is offering funding through an Earning Sharing Mechanism to partially mitigate the impact of moving to new rates in Year 11





SUMMARY

SUMMARY OF FINDINGS

Shareholder value

- Additional value from sale = \$34 million (base case)
- Low = \$18 million, High = \$44 million

Municipality

- All 60+ PDI employees offered employment
- New Regional Operating Centre; +30 jobs

Ratepayers

Rates

- \$17.5 million ratepayer savings through year 10
- Expect similar rates in Year 11+, but some risk

Reliability

Similar

Customer Service

Similar