BUILDING MARKHAM'S FUTURE TOGETHER
2015-2019 Strategic Plan

MARKHAM

Proposed Merger of PowerStream, Enersource, and Horizon, and Acquisition of Brampton Hydro

Staff Recommendations Report
Special Council
November 19, 2015
7:00 PM

Agenda

1. Decision Support
2. PowerStream vs. MergeCo
3. Relative Valuation
4. Brampton Hydro Acquisition
5. Synergies
6. Risks to the Investment
7. Amendments to the Transaction
8. Guiding Principles for Decision Making
9. Investment Summary
10. Customer Benefits
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1. Decision Support

Due Diligence

- PowerStream Shareholders: Markham Enterprises Corporation, (MEC), Barrie Hydro Holdings Inc., and Vaughan Holdings Inc, retained independent consultants to provide strategic financial and legal advice:
  - Navigant Consulting Ltd.
  - BDR North America Inc.
  - Gowlings LLP

2. PowerStream vs. MergeCo - Summary

	PowerStream	MergeCo
Size	2nd Largest Municipally Owned LDC in Ontario	Largest Municipally Owned LDC in Ontario
Customers	370,000	1,000,000
Rate Base	$1B	$2.5B
Ownership	Barrie (20.5%), Vaughan (45.3%), Markham (34.2%)	Enersource (31%), Hamilton (18.2%), St. Catharines (4.9%), Barrie (9.4%), Vaughan (20.8%), Markham (15.7%)
Board Composition	13 members, no restrictions on independent members (majority non-independents)	13 members, 7 required to be independent
Markham Seats	4 seats - 3 non-independent ,1 independent	2 seats - maximum 1 non-independent (7.69% ownership/per seat)
Governance	100% Shareholder approval for major projects	Fewer unanimous approval matters, 2/3 Shareholder approval for most decisions, increased Board only approvals

Conclusion – Markham will transition from owner to investor

2. PowerStream vs MergeCo - Vision

PowerStream

- Strategic vision to grow via mergers, acquisitions and new business
- Control and influence
  - Pace and speed of investment
  - Nature of business

MergeCo

- Strategic vision to grow via mergers, acquisitions and new business
- Less control and influence
  - Board approved < $75M*
  - 2/3 shareholder > $75M*

  * After 75% of synergies achieved

Vision may not align with the City, e.g. funding capability. Less control and influence over projects and acquisitions selected by MergeCo.

3. Relative Valuation

- Deloitte was engaged to perform a relative valuation of each Local Distribution Company (LDC) for purposes of allocating MergeCo shareholdings to the respective Shareholders:

LDC	Relative Holding
Enersource	31.0%
Hamilton	18.2%
St. Catharines	4.9%
Barrie	9.4%
Vaughan	20.8%
Markham	15.7%

46%

Navigant's review indicates that 46% for PowerStream, plus 100% of PowerStream Solar is reasonable and that the shareholders are receiving appropriate value; BDR concurs

4. Brampton Hydro Acquisition

Holding Company	Equity Contribution
Enersource	$65M
Hamilton	($6M)
St. Catharines	($2M)
Barrie	$26M
Vaughan	$57M
Markham	$43M

Navigant estimates that the $607M purchase price for Brampton Hydro is within, but at the high end of market value. BDR also concludes the valuation is within a reasonable range.

5. Synergies

Synergies are key to the achievement of the projected investment rate of return and customer benefits.

- Estimated synergies in first 10 years:
  - operating savings of $310M
  - capital savings of $110M - $170M

6. Risks to the Investment

Achievement of Synergies

- Navigant concludes:
  - Synergies were *reviewed and determined to be reasonable and achievable*
  - Roughly half of the functional area synergies are likely conservative (i.e. synergies achieved may be greater)
  - Three major risk factors (i.e. information technology integration, collective bargaining agreements, and process change / standardization) may reduce overall synergies
  - PowerStream has a track record of delivering on synergy targets
- BDR accepts the reasonableness of the Navigant conclusions

6. Risks to the Investment (cont'd)

Timing of Rate Rebasing

- Under the current regulatory regime, a Shareholder retains the benefit of operating synergies following a merger for up to 10 years
- Where a rate application is required before 10 years, the allocation of the benefit between shareholders and customers will be affected
- Navigant has roughly estimated that rebasing one year earlier would reduce the value of the Transaction to the PowerStream Shareholders collectively by approximately $2M and would reduce the internal rate of return by approximately 0.2%.
  - For Markham, this represents a risk of less than $700k per year, if rebasing occurs one year earlier.

Navigant's view is that the management of the new company has a number of levers at its disposal to mitigate the early rebasing risk.

6. Risks to the Investment (cont'd)

Culture Clash

Navigant indicates:

"Each of the four companies has a unique corporate culture.

To the extent the new company is not effectively able to integrate the four cultures, and retain PowerStream's strong innovative culture, the ability of the company to grow could be hindered."

7. Amendments to the Transaction

Completed

- Unanimous shareholder consent for LDC mergers and acquisitions until 75% of synergies achieved
- Founding shareholders maintain original board seats for six years
- Limited Partnership Comfort Letter Received from the Province
- Promissory note extension available until 2056 at OEB deemed rate

Pending

- Staff are seeking a municipal backstop to fund MEC's portion of the transaction – further follow up underway
- Tax mitigation language has been improved with respect to mitigation of departure tax liability for first and subsequent share sales

8. Guiding Principles for Decision Making

1. Ensure benefit to Markham taxpayers
2. Alignment with Markham's Investment Policy
3. Ensure benefit to PowerStream customers

8. Guiding Principles for Decision Making (cont'd)

1. Ensure benefit to Markham taxpayers:

- Maintain or improve cash flow to City's Life Cycle Reserve to ensure proper repair and replacement of City's facilities and infrastructure over the next 25+ years
- Reduce upward pressure on future tax rate increases

8. Guiding Principles for Decision Making (cont'd)

2. Alignment with Markham's Investment Policy

- Preservation of principal
- Return on Investment - preference for increased cash flows over long term compared to increase in enterprise value
- Liquidity - retain ability to sell investment

Overall goal is to minimize the risk profile of the investment

8. Guiding Principles for Decision Making (cont'd)

3. Ensure benefit to PowerStream's customers:

- Mitigate distribution rate increases
- Improved service and reliability
- Leadership in Conservation Demand Management

Overall goal is ensure financial and non-financial benefit for customers.

9. Investment Summary

Net Present Value	Option	Funding Source	Cash flows Years 1-10	Cash flows Years 11-24	Cash flows Years 25+	Total
1. Deloitte and PowerStream – Core Dividends Only	1 – Status Quo	N/A	$60M	$81M	$131M	$272M
	2 - Transaction	Equity	$54M ($6M)	$105M $24M	$169M $38M	$328M $56M
2. Navigant Adjustments – Core and Solar Dividend, Promissory Note Interest and Funding Source	1 – Status Quo	N/A	$78M	$128M	$164M	$370M
	2 - Transaction	10% Sale plus MEC equity	$92M $14M	$122M ($6M)	$164M $0	$378M $8M

9. Investment Summary - Cash Flows

Scenarios	Years 1-10	Change from SQ	Years 11-24	**Years 1-24**	Change from SQ	Years 25+	**Total**	Change from SQ
Status Quo (SQ)	$78M		$128M	$206M		$164M	$370M	
Transaction - Equity Funded	$66M	($12M)	$134M	$200M	($6M)	$179M	$379M	$9M
Transaction - Debt @ 4%	$87M	$9M	$117M	$204M	($2M)	$179M	$383M	$13M
Transaction - Promissory Note Funded	$94M	$16M	$122M	$215M	$9M	$166M	$381M	$11M
Transaction- 10% Sale of MergeCo to 3rd Party - with Markham funding the remainder; approx $8M	$92M	$14M	$122M	$214M	$8M	$164M	$378M	$8M

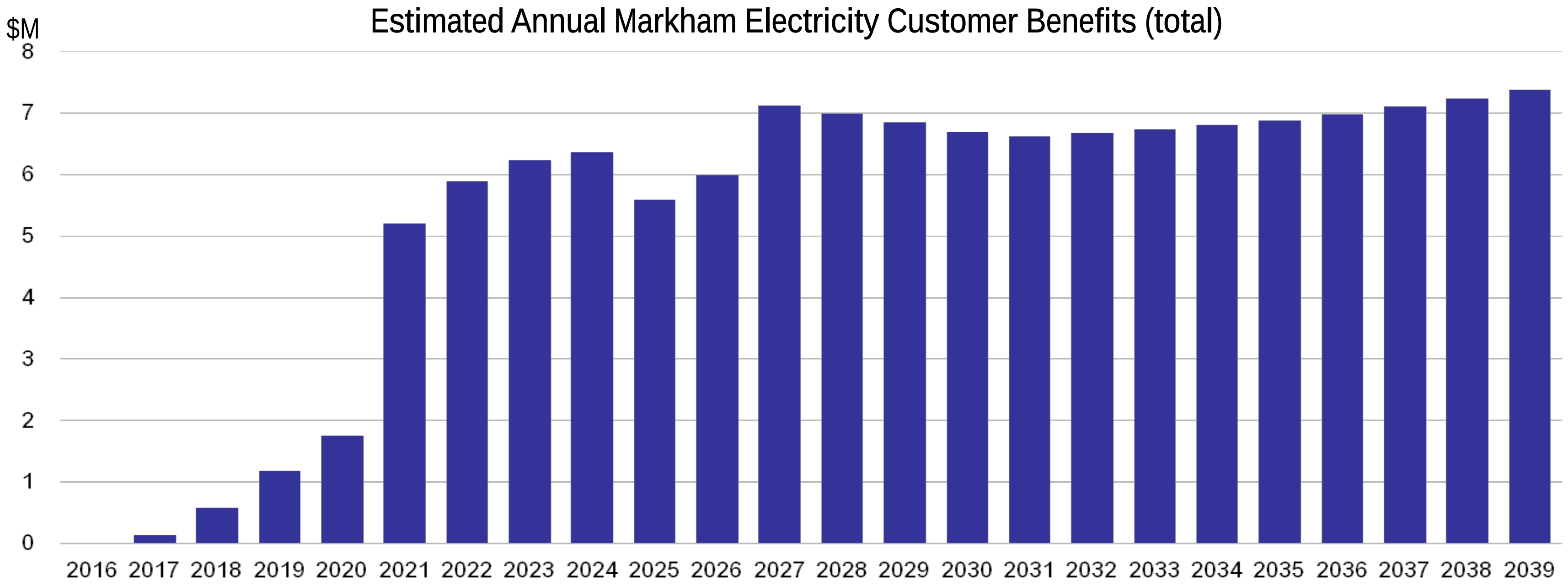
9. Investment Summary - Analysis

- Cash flows to Markham estimated to increase by $8-13M Net Present Value (NPV) depending on funding source
- Transaction as an investment does add value vs status quo
- Return on incremental investment is greater than 5% under all funding source options in the long term
- Transaction has risk (predominant risk is the successful achievement of synergies – timing and magnitude)
- Staff have negotiated amendments to reduce the Transaction risk
- Transaction incremental value is not compelling and is not recommended independent of customer benefits

10. Customer Benefits

- Achieving synergies drives customer benefits
- Full synergy benefits will flow to the customer after ten years or earlier if there is rebasing through the Ontario Energy Board
- The customer savings on the distribution portion (20%) of their electricity bill are meaningful:
  - Total NPV of Markham customer savings over first 25 years is $64M:
    - Average of $40/year for all customers
    - $24-$30/year for average residential customers
- Impact to Markham owned buildings - approximately $60,000 per year
- Markham would need to find approximately $5.4M in annual savings to generate similar savings to the Markham taxpayers.

10. Customer Benefits – Markham Average Total of $5.4M per year



Source: Navigant Project Aura Valuation and Business Case Model (September 10, 2015)

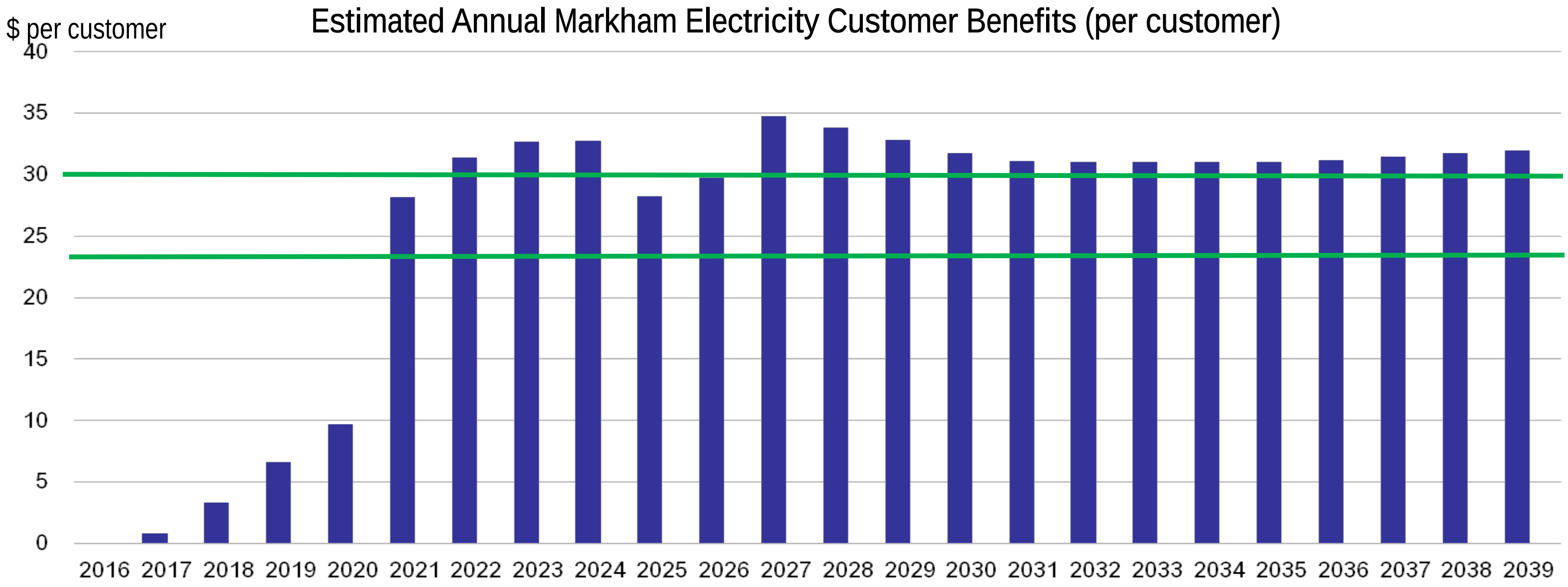
Notes:

1) All values nominal

1) Customer benefits over the first 5 years are driven by avoided capital expenditures

2) Customer benefits after the first 5 years are driven by lower operating costs and avoided capital expenditures

10. Customer Benefits – Residential Average $24-30 per customer per yr



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Notes:

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1) Customer benefits over the first 5 years are driven by avoided capital expenditures

2) Customer benefits after the first 5 years are driven by lower operating costs and avoided capital expenditures

10. Customer Benefits – All PowerStream

2014 Statistics	Customers	**Annual Savings per Customer**	Annual Bill (Assumes Distribution is 20%)	Savings as % of Distribution Bill	Savings as % of Total Bill
Residential	316,765	**$ 24.56**	$ 1,359.94	9.0%	1.8%
General Service < 50 kW	31,865	**$ 69.73**	$ 3,861.47	9.0%	1.8%
General Service > 50kW to 4999 kW	4,789	**$ 873.54**	$ 48,373.86	9.0%	1.8%
Large User	2	**$ 13,751.59**	$ 761,520.00	9.0%	1.8%
Unmetered Scattered Load	2,890	**$ 14.02**	$ 776.64	9.0%	1.8%

11. Recommendations

WHEREAS:

- PowerStream's Board of Directors has approved and recommended to its shareholders the merger with Horizon and Enersource and purchase of Brampton Hydro the "Transaction"
- Unanimous shareholder approval is required for the Transaction
- The Transaction will form a company currently called "MergeCo"
- MEC, VHI and BHHI jointly hired independent consulting and legal services from:
  - Navigant Consulting Ltd.
  - BDR NorthAmerica Inc.
  - Gowlings LLP

11. Recommendations

- On October 7, 2015 the City at General Committee received presentations from Navigant, PowerStream and City Staff
- The Transaction requires an equity contribution from Markham of $43-47.3M depending on closing costs and adjustments
- The City's promissory note of $67.9M with PowerStream will have an interest rate reduction from 5.58% to 4.54% as deemed by the Ontario Energy Board ("OEB")
- The dividends from MergeCo are expected to increase, but there is incremental uncertainty compared to PowerStream
- PowerStream's solar assets, dividend income and equity return have been segregated for its shareholders' benefit, but will result in a $1M NPV reduction

11. Recommendation

- Greater than 5% incremental investment return is expected
- Staff negotiated significant amendments to the Transaction to reduce risk, but it is still not financially compelling given the remaining risk
- The Transaction cannot be recommended by City staff solely on an investment basis
- The Transaction will deliver meaningful customer benefits
  - After year six an average savings of $40/yr for all customers and $24-30/yr for residential utility bills (5-9% of the distribution portion of the bill)
  - Offsetting future increases

11. Recommendations

NOW THEREFORE, be it resolved:

1. The City of Markham approves the Transaction as described in the Merger Participation Agreement, Unanimous Shareholder Agreement and Share Purchase Agreement.
2. Completion of the Transaction be conditional on:
   a. The terms being substantially as set out in the above mentioned agreements and the draft PowerStream Solar Business Services and Indemnity Agreement.

11. Recommendations

b. Amendments to the agreements satisfactory to the CAO as follows:
   i. Unanimous shareholder approval required for mergers and acquisitions until 75% of the targeted synergies achieved;
   ii. Extension of the promissory note to 2056 at OEB deemed interest rates;
   iii. Clarity on departure and transfer tax mitigation strategies for first and subsequent sales of shares in MergeCo;

c. Municipal financial backstop to be negotiated;

d. Maximum equity contribution of $47.3M;

e. Confirmation from the Province of Ontario, satisfactory to the Chief Administrative Officer and the City Solicitor, with respect to the terms and rates of the shareholder loans to LDC's;

f. Approval of MergeCo's strategic plan by MEC Directors.

11. Recommendations

3. Staff work to reduce the City's equity contribution, including but not limited to a 10% formal sale with the other shareholders of PowerStream with consideration for MergeCo's value.
4. If the 10% sale is unsuccessful staff will report back with alternate funding options, including no additional funding from Markham.
5. Mayor and Clerk be authorized to execute the necessary agreements once modified or amended to the CAO's satisfaction. .