

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

**Staff Update
Special General Committee
October 7, 2015
7:00 PM**

Agenda

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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. Vision

PowerStream and MergeCo

- Strategic vision to grow via mergers, acquisitions and new businesses

3. PowerStream vs. MergeCo

	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

4. 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

5. Brampton Hydro Acquisition

Holding Company	Equity Contribution
Enersource	\$65.0M
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.

6. Investment Summary

- Markham investment of \$38M-\$43M
- Rate of return estimated to be between 4.1% and 10.6%
- Shareholder value increase of \$2M - \$33M, assuming a 5% discount rate
- Transaction adds value

7. Funding Options

- Staff are examining options to address the \$38M-43M investment, including the potential to reduce investment requirements:
 1. Equity Injection (through City and MEC)
 2. Borrowing (through MEC)
 3. Conversion of City Promissory Note
 4. Sale of 10% of MEC's shares of PowerStream
- Different funding options change the relative cash flows, investment risk, and total contribution to the transaction.

8. Synergies

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

- PowerStream estimated synergies in first 10 years:
 - operating savings of \$311M
 - capital savings of \$114M
- Navigant concurs with the estimated synergies

9. 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

9. 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.

9. 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.”

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 \$2.8-\$3.6M in annual savings to generate similar savings to an average residential property taxpayer.

11. Guiding Principles for Decision Making

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

11. 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

11. 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

11. 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.

12. Timeline

- Proposed transaction announced – April 16, 2015
- Markham Staff report to General Committee “PowerStream Merger Update” – May 26, 2015
- Province’s original targeted transaction approval date – June 30, 2015
- City of Markham media release – August 25, 2015
- Merger Update Notice in local media – September 3, 2015
- PowerStream Board Approval for Merger and Acquisition – Sept 11, 2015
- Merger Update Notice in local media – October 1st and 8th, 2015

13. Status of Approvals

Approvals

- Board approval from Enersource, Horizon and PowerStream Boards – completed
- Shareholder (HoldCo's and Municipalities) approval:
 - Barrie, Vaughan and Mississauga – Approved
 - Markham, Hamilton and St. Catharines – Approval Pending
- Ontario Energy Board – Merger, Acquisition, Amalgamations and Divestitures (MAADS) application and approval

Targeted Closing Date – March 31, 2016

14. Next Steps

- Staff are pursuing amendments to the terms of the transaction and to the legal agreements to reduce risk to Markham
- Staff will report back to MEC, General Committee and Council with recommendations