Options for Wasaga Distribution Inc.:

Considerations For Wasaga Beach Council

Presentation to Council
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Presentation Overview

- Situation Analysis
- Options
- Economic Valuation
- Risk Assessment
- Decision Matrix
- Conclusions
- Next Steps

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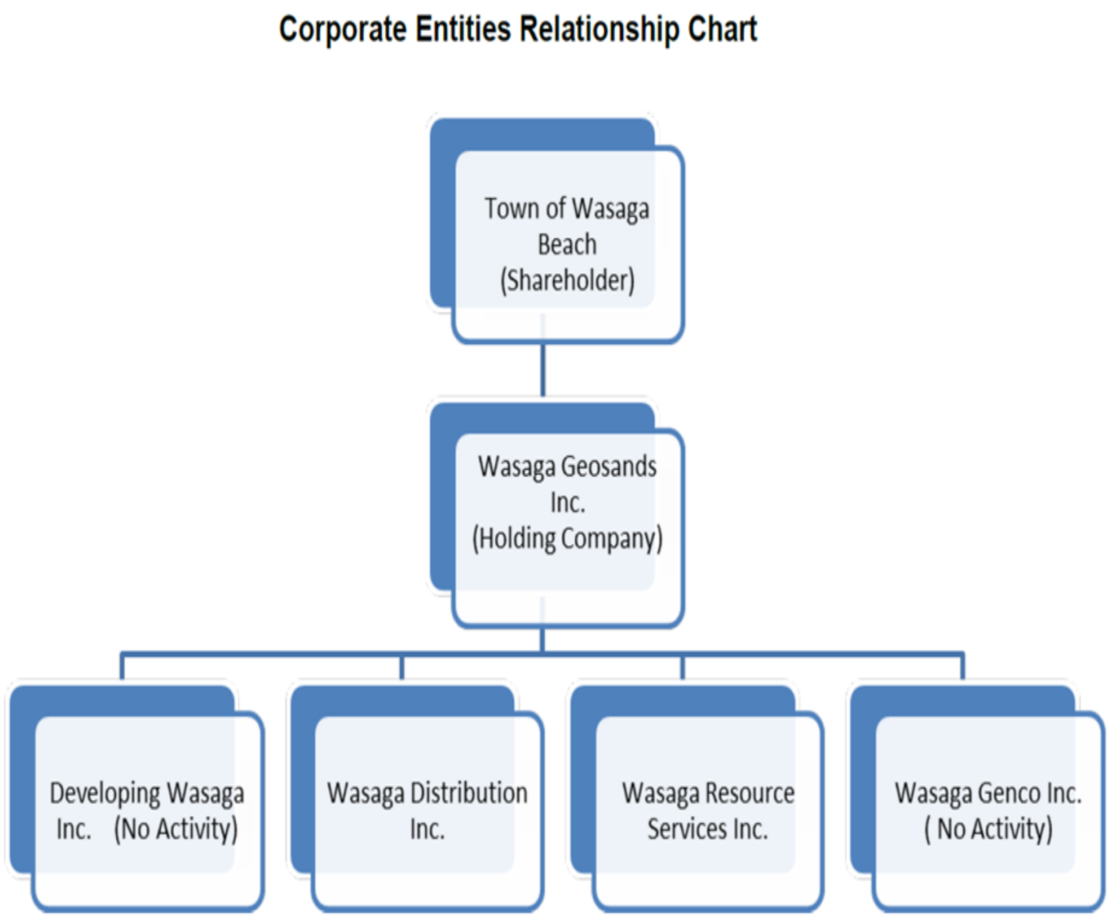
Corporate Structure



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Appearances before Town Council

January 19, 2016

- BLG presentation given to Council entitled "Electricity Distribution at the Crossroads".
- Requested (and received) direction to embark upon a process that would result in recommendations to Town Council concerning a range of outcomes that will help best leverage, or harvest, the benefits of your Municipal asset.
- The deliverables would include:
  - A business case recommending a particular path(s);
  - An economic valuation of the utility business; and
  - Legal, commercial and regulatory considerations.

May 17, 2016

- Status Update.
- Described methodology (Decision Making Criteria).
- Advised we will report back June/July, 2016.

July 26, 2016

- *In Camera* presentation of business case to Wasaga Beach Council.

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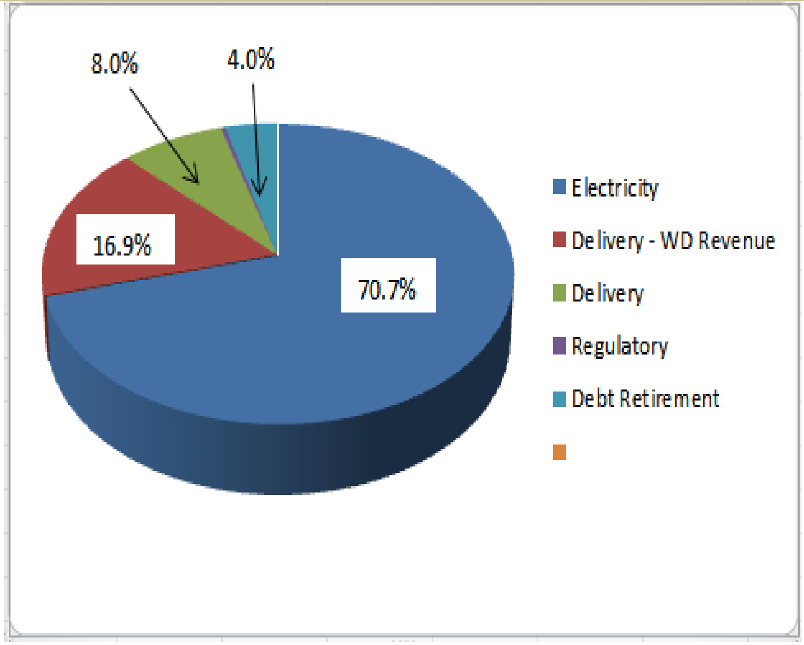
What part of the electricity bill does Wasaga Beach distribution represent?

Line Items	Cost	Percentage
Electricity	99.10	70.68%
Delivery - WD Revenue	23.73	16.92%
Delivery	11.25	8.02%
Regulatory	0.53	0.38%
Debt Retirement	5.60	4.00%
TOTAL	140.21	100.00%



For an average residential customer whose bill is $100 per month the Wasaga Beach **distribution** portion is about $17. Wasaga Beach distribution has no control over the balance of the bill.

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Situation Analysis

- Ontario government policy is to encourage Local Distribution Company (LDC) consolidation.
- Distribution Sector Review Panel, Drummond Report, Clark Report conclude that over $1B in reduced distribution costs should result from LDC consolidation.
- Former Minister of Energy's comments leave little room for interpretation.

Situation Analysis

- Currently in Ontario about 60 LDCs serve only 30% of all customers. WDI is one of these utilities.
- OEB regulatory changes designed to help facilitate consolidation by acknowledging that both shareholder & customers must benefit from consolidation.
- Temporary tax relief also provides incentive to consolidate.

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Options

1. Retain & Grow

2. Merger

3. Sale

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The Retain & Grow Option

On the plus side:

- Retention is the simplest option (although "growth" would be challenging).
- No complicated decision required.
- Continue operations in a familiar environment.
- The utility is operating efficiently (not necessarily indicative of financial performance).
- In the near term:
  - financial performance appears stable, and
  - dividends appear to be predictable.

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Wasaga Beach Distribution Financial Returns

	Five – year Average (2011 – 2015)		
	ROE (%)	Dividends [1] ($k)	Customers (k)
Collus Powerstream	7.5	1,028 [2]	16.5
Midland	7.0	433	7.0
Innpower	4.2	469 [3]	16.0
Orillia	9.9	386	13.5
Wasaga	5.4	320	13.0

1. Dividends paid by electricity distribution company.
2. Collus record distorted by capital restructuring in 2012.
3. Takes into consideration repayment of 2015 dividend.

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The Retain & Grow Option

On the negative side:

- The industry is clearly consolidating

Period/Year	Number of LDCs
1990s	307
2000s	150
2014	73
2016 (estimate)	60 +/-

- WB board has concluded that LDC status quo without growth is likely not sustainable. But where would growth occur?

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The Retain & Grow Option

- Locally this process of consolidation is evident

  Aurora - Merged with PowerStream
  Barrie - Merged with PowerStream
  Collus – 50% Sale to PowerStream
  Georgian Bay - Purchased by Hydro One
  Gravenhurst - Purchased by Veridian
  Orillia - Sale to Hydro One (before OEB)
  Parry Sound - Merged with Lakeland
  Tay - Merged with Newmarket
  Midland – Pursuing sale option
  Collingwood – Pursuing sale option

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The Retain & Grow Option

- Regulatory pressures and burden are growing:
  - The OEB is continually looking to reduce LDC costs and improve efficiency.
  - The regulatory burden itself is costly particularly for small utilities.
- Consolidation incentives may not last long:
  - Tax incentives have an expiry date.
  - Will recent premium levels paid continue?
- The retain option may not provide the best value for the municipality's asset.

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The Retain & Grow Option

- This status quo option also provides a reference case for the assessment of other options.
- The criteria typically used to assess options against this reference case are:

1. Asset Value
2. Customer Rates
3. Service Quality
4. Local Employment
5. Local Control

- The Board has expanded on these criteria and used them in a decision process which will be discussed momentarily.

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The Merger Option

- Requires the development of a detailed business case.
- The benefits normally originate in 3 principal areas:

1. **Operating Expenses**
   - Economies of scale are expected at least up to the size of PowerStream
2. **Capital expenditures**
   - Hydro One has reduced capital costs by planning on a regional basis
3. **Regulatory costs**
   - There are significant economies of scale in these costs

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The Merger Option

- **This option comes with a number of difficulties:**
  - Cost savings usually mean job losses.
  - Allocation of capital spending across regions can be contentious.
  - Resulting harmonization of rates could mean winners and losers.
  - If merger partner is large the smaller entity may have little say in Board decisions (essentially a takeover situation).
  - If partners are similar size the merged entity will still be small and subject to further consolidation.
  - Requires a shareholders agreement with numerous complications including future exit provisions.
  - Normally means high transactions costs.

Valuation Methodology – Wasaga Beach Distribution (the LDC)

Since there is no market in LDC shares there are essentially two approaches to the valuation of LDCs:

1. **Discounted cash flow (DCF) Valuation**

- Requires detailed forecasts to get cash flow.
- These are discounted to get a value for the company.

2. **Relative Valuation**

- Premiums paid on recent transactions.

A confidential economic valuation was prepared by Henley International for BLG which used both methods.

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Valuation Methodology – Wasaga Resources Inc. (the affiliate)

- WRSI provides energy services to WDI under a contract.
- Its other activities including services to the town and water rental revenues are minor.
- In 2015, approximately 50% of WRSI revenues were from WDI.
- Henley prepared a confidential DCF valuation and a relative valuation.
- Consequently, the relative valuation uses an earnings multiple only.

Risk Assessment

Retain & Grow Option

- Falling energy demand and pressures to reduce costs could put dividends in jeopardy.
- Future capital expenditure requirements could require municipal equity investment.
- Long-term sustainability of small utility operation could become questionable.
- Province could ultimately force consolidation leaving less discretion to municipalities.
- Municipality may realize a lower value for asset than the alternatives.
- Franchise growth is limited, is growth by acquisition realistic?

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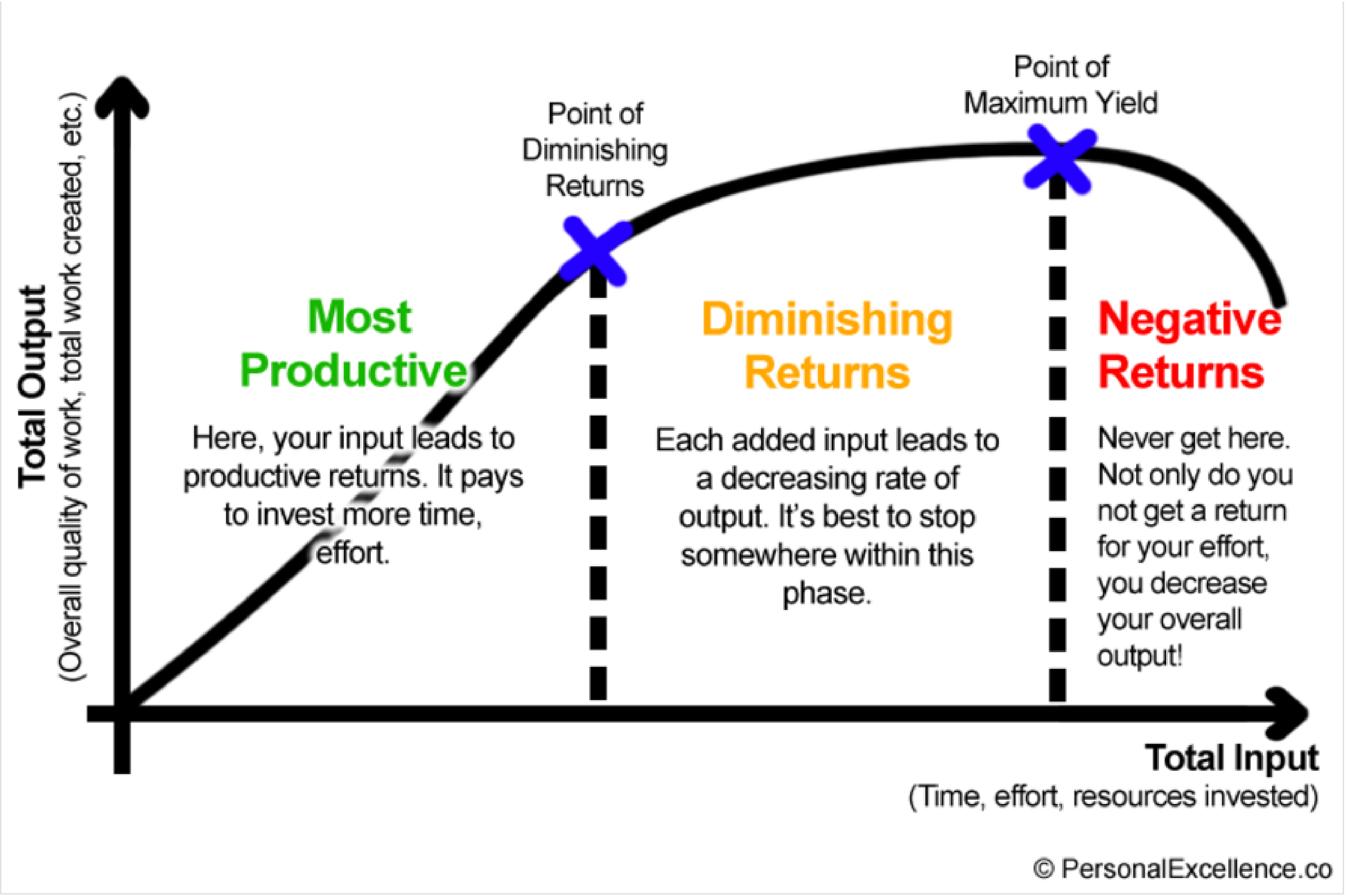
The Risk of the Retain & Grow Option

Diminishing Returns



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Risk Assessment

Merger Option

- Realizing cost savings means employment reductions.
- Loss of control if merger partners are larger.
- Possible need for future consolidation if partners are small.
- High transactions costs.
- Possible difficulties creating merged corporate culture.
- Need for complex shareholder agreement, business case and merger participation agreement.

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Risk Assessment

Sale Option

- Privatization of Hydro One may cause it to lose interest in small LDCs. Hydro One may choose to pursue larger transactions.
- Tax and regulatory incentives to consolidate have time limitations.
- Recent premiums may not continue into the future.
- Sale means loss of local control but LDC remains regulated.
- Sale price must at least exceed monetized value of future dividends plus a premium.
- WDI represents only 17% of the total bill for the average residential customer.
- Premiums paid are NOT recoverable in LDC rates.

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WB Directors’ Decision Matrix

- The Wasaga Beach Board used an objective decision process to ensure transparency, consistency and fairness.
- There are 6 steps involved:

1. Identify the decision criteria to be used.
2. Assign weights to the decision criteria that reflect their relative importance.
3. Assign a score for each of the options against each criterion.
4. Multiply the weight times the score to get a weighted score.
5. Add the weighted scores across all criteria for each option.
6. Rank the options based on total score – the highest score is ranked first.

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WB Directors' Decision Matrix

	Option			
Criteria	**Retention**	**Sale**	**Merger**	**Partial Sale**
Value	5.1	9.7	4.9	5.3
Customer Rates	5.0	5.4	3.7	3.6
Service Quality	8.6	5.3	5.1	5.3
Local Employment	7.4	4.7	5.1	5.6
Local Control	5.4	3.4	4.1	4.6
Net Transaction Cost	8.6	4.9	2.0	1.9
Sustainabilty	5.6	9.6	5.0	5.4
Public Impact	6.7	6.3	4.7	4.9
Risk	1.6	9.6	4.9	4.4

WB Directors’ Decision Criteria

		Option			
Criteria	**Weight**	**Retention**	**Sale**	**Merger**	**Partial Sale**
Value	10	51	97	49	53
Customer Rates	4	20	22	15	14
Service Quality	8	69	42	41	42
Local Employment	5	37	24	26	28
Local Control	4	22	14	17	18
Net transaction Cost	3	26	15	6	6
Sustainability	9	50	86	45	49
Public Impact	6	40	38	28	29
Risk	10	16	96	49	44
	Total Score	330	433	275	283

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Conclusions

- The LDC industry in Ontario continues to consolidate.

- Three options face the Council all of which have risks:

  - Retain and Grow
  - Merge
  - Sell

- The WDI & WRSI Boards of Directors have examined these options using a rigorous decision process and concluded that Council should consider the 100% sale of the Utility, through a competitive RFP process in order to maximize value to the shareholder at this point in time.

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Next Steps: Council considers whether & how to proceed?

- Does Council wish to go through their own decision analysis process?
- Council may establish a **Transaction Steering Committee** to oversee process (comprised of Councillors, Senior Staff, WB directors?)
- Will Council engage the public on these issues?
- If so, what forms will the public engagement take? Some options include:

➢ background materials and fact sheets;

➢ public information meeting;

➢ through the press via letters to the editor, press conference, other media releases;

➢ web page;

➢ speaking engagements with local stakeholder organizations.

Next Steps: should Council decide to pursue a competitive solicitation process

- Establish an electronic data room.
- Communicate the RFP process to potential proponents.
- Sign Confidentiality & Non-Disclosure Agreements.
- Prepare RFP and Confidential Information Memorandum.
- Prepare an acceptable form of Share Purchase Agreement.
- Proponents undertake an extensive due diligence review.
- Council evaluates proposals received.
- A final proposal is negotiated and presented to Council.
- If accepted, application is made to the OEB for approval.
- The transaction closes only after OEB approval is received.

Discussion

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