Re: EXTERNAL - FW: Good question re: the capitalized interest -- you've got me thinking now....

From:	Ken Kandeepan <ken.kandeepan@ofina.on.ca>
To:	"Petsche, Nadine (TBS)" <nadine.petsche@ontario.ca>
Cc:	"Veinot, Cindy (TBS)" <cindy.veinot@ontario.ca>
Date:	Fri, 24 Feb 2017 07:44:53 -0500
Attachments:	image001.png (3.13 kB)

I believe a conversation with OPG is still useful Nadine, dividends from OPG won't constitute an offset to the Province.

OPG's net income has to increase to the point that there is an offset to the increase in the Province's IOD, additional dividends will simply be the icing on the cake since they will provide a cash offset.

Thanks

Ken k

On Feb 23, 2017, at 9:52 PM, Petsche, Nadine (TBS) <Nadine.Petsche@ontario.ca> wrote:

Hi Ken.

Not sure if you might have already had a call with John? The model as I understand it would have provincial investment in OPG being leant by OPG to the Trust in return for revenue (dividends) which would be consolidated by the Province as GBE income to help offset the Province's borrowing costs.

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From: Ken Kandeepan [mailto:Ken.Kandeepan@ofina.on.ca]
Sent: February-23-17 5:17 PM
To: Veinot, Cindy (TBS); Petsche, Nadine (TBS)
Subject: FW: EXTERNAL - FW: Good question re: the capitalized interest -- you've got me thinking now....

Hi Cindy and Nadine

I don't understand this, if either of you do appreciate an explanation, otherwise a discussion with OPG may be in order. How does the Trust generate revenues??

Thanks

Ken

From: LEE John -TREASURY [mailto:john.s.lee@opg.com]
Sent: Thursday, February 23, 2017 4:56 PM
To: Ken Kandeepan <Ken.Kandeepan@ofina.on.ca>
Cc: 'Veinot, Cindy (TBS)' <Cindy.Veinot@ontario.ca>; Christina Zhang <Christina.Zhang@ofina.on.ca>; MAUTI John -FIN & C CTRL <john.mauti@opg.com>; LIU Sheen -TREASURY <sheen.liu@opg.com>; RYFA Ken -TREASURY <ken.ryfa@opg.com>; CHENG Alec -FIN & C CTRL <alec.cheng@opg.com>
Subject: RE: EXTERNAL - FW: Good question re: the capitalized interest -- you've got me thinking now....

Ken:

Please find the response below:

To clarify the underlying structure: the interest on debts are to be paid and there will be periods of interest only payment to debt holders before cumulative deferred amount is to be collective from customers (the GA deferral amount on customer bills is to grow to offset the interest expense/payment). Illustration below

<image001.png>

Assume Deferred GA amount is $2B for Yr 1 and interest rate is 5%, on a consolidated basis incremental asset is $2B while incremental debt is*$2B* 56% (the sum of 51% senior debt and 5% OPG financing from capital markets). Revenue generated for Yr 1 is 2B*5% while interest expense is 2B*56%*5%, leaving net income positive. The same logic applies going forward

Hopefully this simplified example clarifies the approach .

John

From: Ken Kandeepan [mailto:Ken.Kandeepan@ofina.on.ca]
Sent: Thursday, February 23, 2017 3:21 PM
To: LEE John -TREASURY
Cc: 'Veinot, Cindy (TBS)'; Christina Zhang; MAUTI John -FIN & C CTRL; LIU Sheen -TREASURY; RYFA Ken -TREASURY
Subject: RE: EXTERNAL - FW: Good question re: the capitalized interest -- you've got me thinking now....

Thanks John

From: LEE John -TREASURY [mailto:john.s.lee@opg.com]
Sent: Thursday, February 23, 2017 3:09 PM
To: Ken Kandeepan <Ken.Kandeepan@ofina.on.ca>
Cc: 'Veinot, Cindy (TBS)' <Cindy.Veinot@ontario.ca>; Christina Zhang <Christina.Zhang@ofina.on.ca>; MAUTI John -FIN & C CTRL <john.mauti@opg.com>; LIU Sheen -TREASURY <sheen.liu@opg.com>; RYFA Ken -TREASURY <ken.ryfa@opg.com>
Subject: RE: EXTERNAL - FW: Good question re: the capitalized interest -- you've got me thinking now....

Ken:

We will review and provide a response to your questions.

John

From: Ken Kandeepan [mailto:Ken.Kandeepan@ofina.on.ca]
Sent: Thursday, February 23, 2017 2:37 PM
To: LEE John -TREASURY
Cc: 'Veinot, Cindy (TBS)'; Christina Zhang
Subject: EXTERNAL – FW: Good question re: the capitalized interest -- you've got me thinking now....

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Hi John

I reviewed OPG's submission and Gadi suggested that I forward my comments to you. Happy to discuss.

Thanks

Ken k

Slides 9 and 16 provide the most amount of details re the basis of the accounting. Slide 16 mentions that OPG's net income and EBITDA will improve providing the required offset to the increase in the Province's IOD from incurring additional debt to fund the 44% equity injection. No details are provided as to how OPG's net income will increase giving rise to the following comments.

The SPV/Trust is required to pay interest on both the senior debt and the sub debt to respectively the capital markets and OPG. Given that the SPV/Trust has no revenues from implementation to 2029, the only available option is to credit the outstanding liability each year by the annual interest costs instead of paying same. How willing is the market to provide debt funding, even if it is senior debt, when interest payments will only commence in 2030. And if market debt funding is indeed available what is the premium charged to compensate for accumulating the interest instead of making payments.

Alternatively, the SPV/Trust can use the cash inflow from OPG (the sub debt) to pay interest on the senior debt. That option is not possible mathematically unless the OPG funding exceeds 44% for total SPV/Trust funding of over 100%.

Assuming all of this works, OPG's net income will in my opinion, be impacted since upon consolidating the Trust, OPG's interest income from the SPV/Trust will be more than offset by the SPV/Trust interest expenses. The SPV/Trust incurs interest on both the senior and the sub debt, OPG's net income will actually reduce by the amount of the interest the Trust incurs on the senior debt unless there are offsetting increases in OPG's revenues. As such I am confused as to how the Province can offset the increase in its IOD from the debt incurred to fund the equity injection. On a cash basis the Province will also be out, unless OPG increases dividends.

There is also limited opportunity for OPG to generate additional revenues and net income based on the cash flow from the Province's equity injection. The funds will be promptly lent to the SPV/Trust to purchase the regulatory asset from the IESO and hence not be available for use by OPG to generate a return.

It would be useful if OPG furthers fleshes out the above, including income and cash flow projections for the SPV/Trust

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