Hydro One Check In

October 7, 2015

Confidential Advice to Cabinet
Commercially Sensitive

Purpose

- Provide an update on the Global Coordinators' and Pricing Committee's preliminary analysis of the current price range for Hydro One shares
- Outline how and why this price range differs from the February 2015 Hydro One valuation, including impacts on the Trillium Trust and fiscal plan
- Provide an overview of options and associated considerations for moving forward

Summary

- Ahead on cash receipts
- Ahead on impact on the financial position
- Still on track to get the $4 billion for infrastructure (and $9 billion overall)
- Not far below the original mid point of the Council evaluation, adjusting for the dividend and discount despite drop in market.
- No one knows the final price
- Volatility in the market underscores wisdom of approach

Valuation Update

($Billion)	Low	Mid	High
Initial Range	13.5	14.25	15.00
Less Dividend	1.0	1.0	1.0
	12.5	13.25	14.00
Applying IPO Discount	0.8	0.8	0.8
Revised Initial Range	11.7	12.45	13.2
Current Range	11.0	11.6 to 11.75	12.25 to 12.50

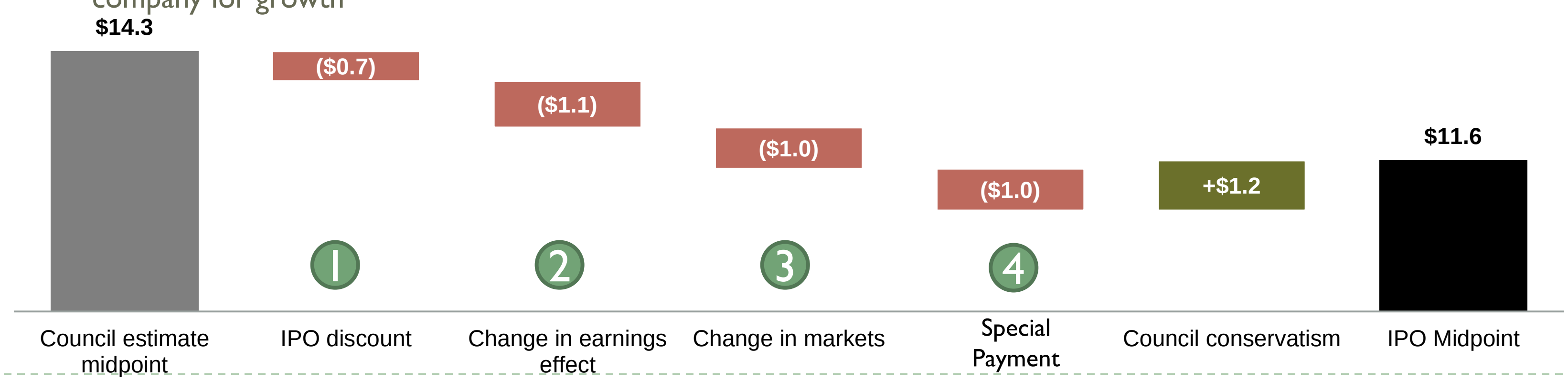
Context/Timeline

- The Hydro One preliminary prospectus filed on September 17th did not contain any IPO pricing information
- Currently, an amended and restated prospectus will be filed on October 9th. It would contain a price range for the Hydro One shares to be used by the Global Coordinators in their marketing and roadshows
- The Minister of Energy must approve this pricing range, and a Pricing Committee has been formed to provide the Minister with advice and a recommendation – the price used in marketing is not necessarily the final price
  - The Pricing Committee consists of Ed Clark, David Denison, David Leith and Tom Rahilly
- The Pricing Committee will meet on October 7th to develop pricing recommendations, which they will present to the Minister of Energy for decision on that day
  - The board of Hydro One will approve the range on October 8th and it will be filed with the OSC on October 9th
- Once this range is approved and the amended and restated prospectus is filed, the Global Coordinators would begin their marketing and roadshows
  - To date 75 meetings have been scheduled in Toronto, Calgary, Vancouver and Winnipeg beginning the week of October 13th, and Montreal, New York, Boston and Toronto during the last two weeks of October
- Based on results of the marketing and roadshows, the Global Coordinators would provide the Pricing Committee with advice on final IPO pricing. The Pricing Committee would in turn develop recommendations for the Minister of Energy
- When the final price is determined, it would be included in the supplemented prospectus, which is currently scheduled to be filed on October 29th with a planned closing date of November 5
  - An IPO would typically close 5 days after filing the Final prospectus

Pricing/Valuation

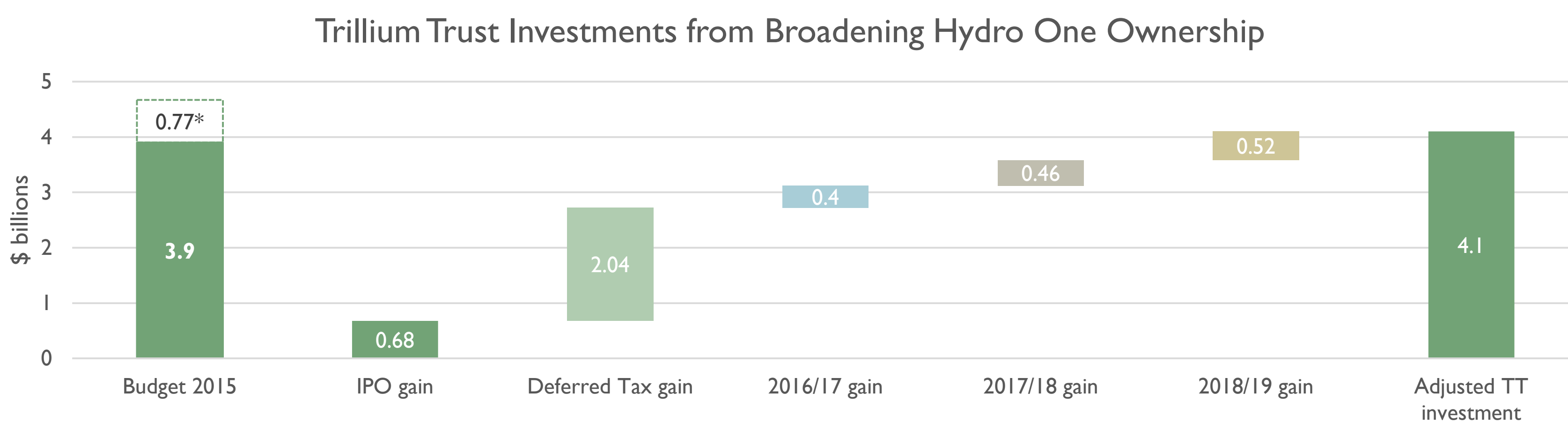
- The expected price range is $11 to $12.25 B. This price range reflects a special dividend and additional payments-in-lieu of ~$1B, an IPO discount of 5% to 8%, a reduction in value due to lower than expected earnings of ~$1B, and changes in market conditions offset by conservatism by the Council in its April estimates
- The Council has provided the chart below to provide greater detail (please note the range below is subject to pricing committee and government review)

1. IPO discount is based on the market's reaction to the IPO and determined after trading begins e.g., if the share price rises 5% after trading, then the IPO discount was 5%. Every IPO includes a discount from its fully distributed value
2. OEB 2015 rate filing decision reduced the allowable return on equity (ROE) for Hydro One's distribution business. The company also factors in a change in the allowable ROE for 2016, due to lower expected bond yields. This is updated annually, and applies to all rate-regulated entities
3. Markets are down for 2015, but the Council has indicated that the multiples used are only an estimate and subject to feedback from institutional investors and the investor road show
4. Hydro One plans to adjust its capital structure to position itself for growth which would result in $1B in payments ($800M dividend, in addition to $200M in higher PILs as a result of the IPO) to the Province. While this reduced the overall value of the company, it provided early cash to the province to reduce provincial debt. It also better positions the company for growth



Impact on Trillium Trust

- Communications at the time of the 2015 Ontario Budget indicated that unlocking value from Hydro One would contribute about $4B to the Trillium Trust to help support investments in transit, transportation and other priority infrastructure projects
- While the valuation of Hydro One has changed since the Budget there has also been an increase in the estimated gain associated with the non-cash deferred tax asset/ regulatory asset associated with the IPO. This means that broadening Hydro One ownership would still be able to provide about $4B to the Trillium Trust with greater gains in the first year
- This will require a legislative amendment to the *Trillium Trust Act, 2014*
- See the graph below for details of how the Hydro One transaction would contribute to the Trillium Trust (illustrative, with estimates based on a revised mid-point marketing price / valuation range of $11.6 billion)



*Includes $770M in non-cash deferred tax asset/regulatory asset

Impact on Fiscal Plan

- The change in Hydro One valuation and the increase in the gain associated with the deferred tax asset / regulatory asset has changed the fiscal profile associated with broadening Hydro One's ownership since Budget 2015.The key estimated changes are outlined in the table below assuming the current mid-range valuation of Hydro One of $11.6B
  - The analysis below assumes 4.2% average annual growth in the fully distributed equity value.
  - The Secretariat's fiscal impact estimates used for the 2015 Budget assumed a 5% growth in fully distributed equity value of Hydro One (and without secondary offerings sales discounts)

Financial Impact Summary ($M)	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**Total**		**2019-20/ Ongoing**
Gain on Sale*	$680	$400	$460	$520	**$2,060**		**-**
Deferred Tax Asset / Regulatory Asset*	$2,040	-	-	-	**$2,040**		-
Loss of Net Income/PILs/Indemnity Payments*	($100)	($290)	($480)	($670)	**($1,540)**		**($770)**
Estimated Initial Contribution	**$2,610**	**$110**	**($20)**	**($150)**	**$2,560**		**($770)**
Potential Interest Savings**	$50	$150	$230	$320	**$750**		**$370**
Total	**$2,670**	**$260**	**$220**	**$170**	**$3,310**		**($400)**
2015 Budget Total	**$1,430**	**$770**	**$780**	**$820**	**$3,800**		**($350)**
Change from Budget	**$1,240**	**($510)**	**($560)**	**($650)**	**($490)**		**($50)**

**Based on KPMG analysis as at August 31, 2015, and compared to Hydro One March Business Plan, not the Fiscal Plan. Rounded to the nearest $10M, and may not add due to rounding*
***Potential IOD savings would decrease as infrastructure projects materialize*

Impact on Fiscal Plan with Higher Growth Scenario

- The impact on the fiscal plan is dependent on a variety of assumptions, one of which is the assumed growth rate of Hydro One's fully distributed equity value
- While 4.2% is the growth rate assumed by the Secretariat and incorporated for the purposes of fiscal planning updates, in the event that Hydro One's equity value realises higher than expected growth, the impact of the revised valuations compared to the Budget 2015 fiscal plan would be less
- The impact assuming a hypothetical 10% average annual growth in equity value is illustrated below (achieving such growth in the near term may be challenging)

Financial Impact Summary ($M)	2015-16	2016-17	2017-18	2018-19	Total		2019-20/ Ongoing
Gain on Sale*	$680	$530	$690	$870	**$2,770**		**-**
Deferred Tax Asset / Regulatory Asset*	$2,040	-	-	-	**$2,040**		
Loss of Net Income/PILs/Indemnity Payments*	($100)	($290)	($480)	($670)	**($1,540)**		($770)
Estimated Initial Contribution	**$2,610**	**$240**	**$210**	**$200**	**$3,260**		**($770)**
Potential Interest Savings**	$50	$150	$240	$340	**$790**		$400
New Total	**$2,670**	**$390**	**$450**	**$540**	**$4,050**		**($370)**
2015 Budget Total	**$1,430**	**$770**	**$780**	**$820**	**$3,800**		**($350)**
Change from Budget	**$1,240**	**($380)**	**($330)**	**($280)**	**$250**		**($20)**

**Based on KPMG analysis as at August 31, 2015, and compared to Hydro One March Business Plan, not the Fiscal Plan. Rounded to the nearest $10M, and may not add due to rounding*

***Potential IOD savings would decrease as infrastructure projects materialize*

Current Status

Overview & Messaging

- The Province will proceed with an initial public offering of 15% of Hydro One, and file the amended and restated prospectus on October 9, 2015
  - The amended and restated prospectus will include a share price range, as approved by the Minister of Energy
- The Global Coordinators would proceed with marketing beginning the week of October 13th, after the amended and restated prospectus is filed with the OSC – 75 meetings already scheduled
- Proceeding with the road show continues the pricing discovery process and would help inform and develop pricing for the order book
  - Pricing for the order book could be higher than or lower than the range described in the amended and restated prospectus
- After the roadshow is complete, the Pricing Committee would recommend a final price to the Minister of Energy to include in the supplemented prospectus on October 29th with a closing date of November 5th

Key Messaging

- We are committed to broadening ownership to allow us to invest in vital infrastructure
- We would continue to be on track to deliver approximately $4 billion to the Trillium Trust
- Putting a value on the company means comparing it to similar organizations. This valuation is mostly a reflection of where the market is right now and changes to earnings to due lower allowed ROE
- Selling 15% ensures that the Province will capture more of the future growth over time.
- We said that we would meet targets as described in the 2015 Budget and return the proceeds to either invest in infrastructure or pay down debt, and we are doing that

Current Status
Considerations

Policy/Legal

- This would support collective agreements in place with the unions and discussions already underway with COO
- Proceeding with the sale would support Government credibility in its commitment to support infrastructure
- Avoids the need to "unwind" pre-IPO preparations such as new Hydro One management and Board, removing oversight of Officers of the Legislature, imposing restrictions on Hydro One (e.g., sale of all or substantially all of its OEB-regulated transmission and distribution assets)
- A large majority of Ontarians polled are against the sale of Hydro One. If there is a perception of a lower return on the sale this could reinforce their opposition

Market

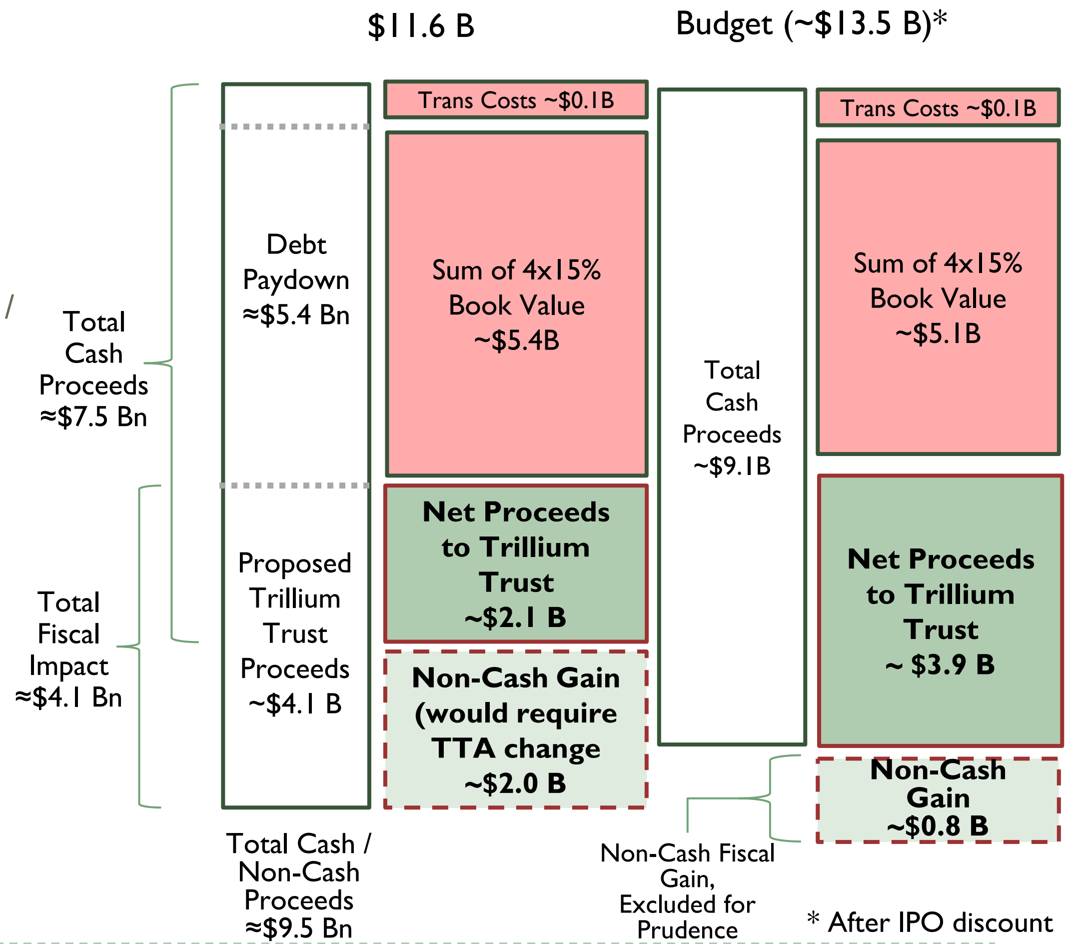
- Proceeding with institutional investor meetings would help inform and develop pricing for the order book
- Pricing for the order book could be higher than or lower than the range described in the amended and restated prospectus
- Hydro One's peer group is primarily Fortis and Emera, which have established and known management teams. Hydro One's management team is new and would market based on previous accomplishments and expectations of growth
- The Global Coordinators have indicated there are significant expectations for the Hydro One IPO which will have broad institutional investor appeal – the financial sector is approaching year-end, so brokers will be pushing for commissions to support targets
- Some investors are reportedly "making room" for the pending IPO

Trillium Trust

$11.6 B and Budget Scenarios

- The diagrams to the right illustrate the total amounts that could be dedicated to the Trillium Trust over 2015-16 to 2018-19 for the $11.6 B and Budget IPO valuation scenarios provided previously.
  - Based on the midpoint of the latest valuation range, post-IPO discount, about $2.1 B in net proceeds would be available to be dedicated to the Trust (vs. about $3.9 at the time of the Budget).
  - The non-cash gain of $2.0 B due to the consolidation of Hydro One's deferred tax asset / regulatory asset gain could potentially be dedicated to the Trust, but this would require an amendment to the *Trillium Trust Act*. The Act currently would only allow net cash gains to be dedicated to the Trust.
  - The $800M pre-IPO Dividend to the Province is not shown.
    - It would be used to help pay down the ~$5 billion Hydro One debt.

Illustrative Transaction Summary
15 Per Cent Share Sales over four years



* After IPO discount

Proposed Direction

- The Province will move forward with further amendments to the *Trillium Trust Act, 2014,* that if passed, would name Hydro One as a qualifying asset as well as to ensure that all fiscal benefits of the estimated gain, including those associated with the non-cash deferred tax asset as part of the IPO would also be directed to the Trillium Trust (currently, only cash net proceeds are directed to the Trillium Trust)
- These amendments to the *Trillium Trust Act, 2014*, if passed, would allow the fiscal benefits of the estimated gain (cash and non-cash) to be used for investments in transit, transportation and other priority infrastructure projects