



Grant Thornton

An instinct for growth™

Project G T Strategic Advice

Presentation to the Town of Newmarket Council

May 19, 2015

Troy MacDonald

Partner

T +1 416 369 6401

E Troy.MacDonald@ca.gt.com

Brent Jackson

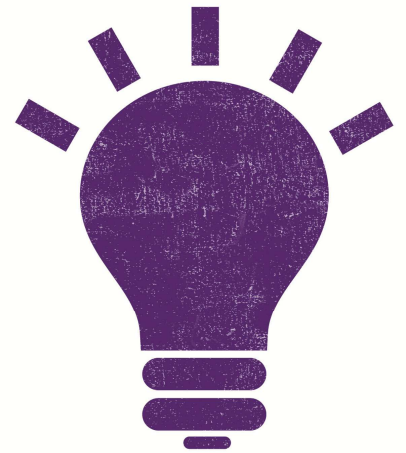
Director

T +1 416 360 3067

E Brent.Jackson@ca.gt.com

Table of contents

- Introduction
- Conclusion
- Our Scope of review
- Our Findings
- The Changing Ontario electricity distribution market



Introductions



Troy MacDonald, CPA, CA, CBV
National Practice Leader – Corporate Finance

Troy is an advisory services partner based in our Toronto office, specializing in Corporate Finance and Infrastructure. Troy is also a member of the global Energy, Environment and Sustainability sector group with a focus on the power sector.

Troy is our firm's national leader for corporate finance. He specializes in advising public and private sector clients on implementing transactions and debt and equity financing solutions in both domestic and international markets. Troy specializes in advising on power and infrastructure projects.

Previously, Troy was a member of the Grant Thornton capital markets team based in London, England with Grant Thornton UK LLP. This team focused on implementing public market transactions in global capital markets.

Troy is also a member of the Grant Thornton LLP Partnership Board.



Brent Jackson, CPA, CA, CBV
Director – Corporate Finance

Brent helps lead the business valuations practice for Grant Thornton LLP's Corporate Finance group. Over the twelve years Brent has worked in Grant Thornton's Corporate Finance group, he has performed over 100 valuations in relation to M&A transactions, estate planning, tax reorganizations, fairness opinions and financial reporting (purchase price allocations and goodwill review) and has worked on several different power company advisory engagements.

Brent has been a key team member on all of the LDC engagements referenced in the proposal; including a review related to a potential merger of three utilities, advising on the potential merger of a municipally owned utility, and the financing of capital expenditures for another utility. In all instances, Brent worked closely with the management team and board of directors to help exceed the clients' needs.

Brent holds both the Chartered Accountant (2003) Chartered Business Valuator (2005) designations.

Our Scope of review

- The Town of Newmarket have engaged Grant Thornton LLP to prepare a report that provides an analysis on matters pertaining to Newmarket Tay Power ("NT Power"), the shareholder and the Ontario LDC Market, including items such as:
 - Potential Transactions analysis: financial/operational issues surrounding the potential sale or merger of NT Power.
 - Hydro service rates: comparative information and influences on hydro service rates
 - Service level benchmarking: NT power service level feedback and evaluation criteria.
 - Industry Risks: Discussion on the industry risks surrounding a Municipally owned Utility
 - Governance: Review of the current governance structure between NT Power and Newmarket Hydro Holdings.
 - Service level agreements: Discussion on potential improvements to current service level agreements with the shareholder.

Conclusion

- When compared to its peers, N T Power appears to be operating at an above average level in almost all of the metrics we analyzed (hydro rates, financial statement metrics, service levels, etc.).
- The current governance structure is sound and well positioned for future growth.
- The LDC is both financially and geographically well positioned to potentially take advantage of the current consolidation in the market and other strategic alternatives. Whether a buyer/seller or potential merger partner, there are plenty of opportunities to build greater scale and be positioned for consolidation.
- N T Power should continue with its current strategy.

Our Findings

Potential Transaction Analysis

- Our financial model comparing the economic value to the shareholder, created through a sale or merger with another utility resulted in the following:

	IRR	Economic Value	
		Annual Cash	Value creation
Status Quo	6.81%	\$ 17,092	\$ 21,847
Merger	7.10%	\$ 18,736	\$ 21,676
- Although the increase in financial benefits is not significant, a merger with the right LDC or group of LDCs could result in some financial gain while also keeping options for continued equity growth in the future
- We then qualitatively discussed an outright sale of the LDC, which we believe does not make sense today for the following reasons:
 - current uncertain market conditions;
 - a financially strong utility with healthy shareholder returns;
 - opportunity to generate returns in excess of the Town's cost of capital; and
 - maintain control of power distribution in the community.
- However, while NTPower continues to focus on their core business, we also think they should continue to actively monitor and explore merger activity to seek opportunities to build greater scale and be positioned for consolidation.

Our Findings

Hydro Service rates

- For our analysis on hydro service rates, we calculated the average rates paid by N T Power's customers (residential, commercial, and industrial) in 2013 and compared these rates to five other comparable LDCs, as well as industry averages. We then calculated average monthly rates for residential customers (as illustrated in the graph below) assuming identical consumption levels and allocations for peak, mid-peak, and off-peak time of use to give us an accurate comparison of rate differences between N T Power and the five comparable companies.

Residential

	NT Power	Whitby Hydro	Innisfil Hydro	Orillia Power	Halton Hills Hydro	Oakville Hydro	Industry	Industry excluding HONI
Average distribution revenue per customer	\$ 303	\$ 409	\$ 419	\$ 353	\$ 287	\$ 337	\$ 428	\$ 321
Average billed kWh per customer	8,897	9,318	10,456	9,143	10,631	9,727	9,061	8,359
Average distribution rate per kWh	\$ 0.03410	\$ 0.04387	\$ 0.04009	\$ 0.03857	\$ 0.02701	\$ 0.03462	\$ 0.04720	\$ 0.03844

Commercial

Distribution Revenue per Customer	\$ 910	\$ 1,219	\$ 649	\$ 1,134	\$ 562	\$ 1,032	\$ 1,001	\$ 852
Average billed kWh per customer	29,533	40,758	32,439	34,025	32,183	34,371	30,425	31,919
Average distribution rate per kWh	\$ 0.03081	\$ 0.02992	\$ 0.02000	\$ 0.03332	\$ 0.01745	\$ 0.03001	\$ 0.03290	\$ 0.02669

Industrial

Average distribution revenue per customer	\$ 9,422	\$ 11,037	\$ 8,420	\$ 11,061	\$ 9,783	\$ 9,876	\$ 13,199	\$ 12,218
Average billed kWh per customer	747,485	1,084,988	770,268	861,144	1,030,504	841,917	1,110,117	1,155,786
Average distribution rate per kWh	\$ 0.01260	\$ 0.01017	\$ 0.01093	\$ 0.01285	\$ 0.00949	\$ 0.01173	\$ 0.01189	\$ 0.01057

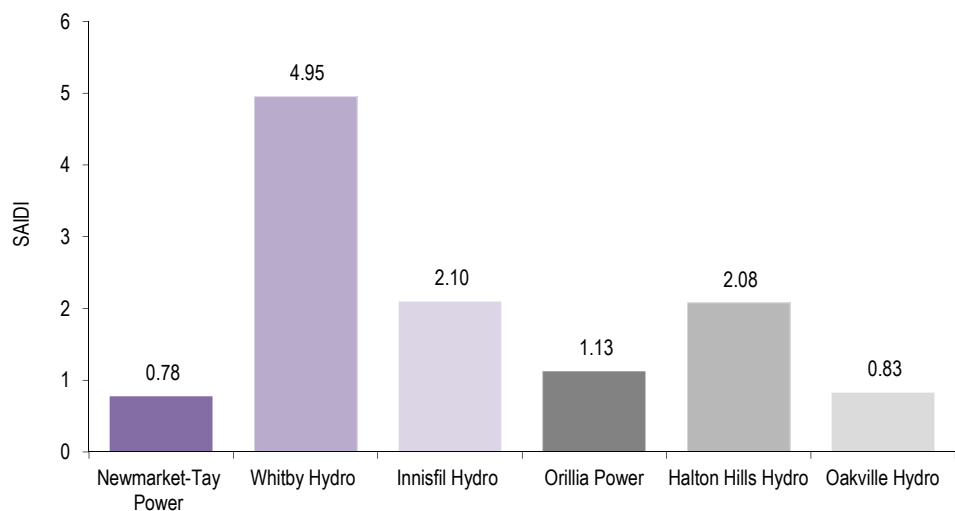
- N T Power's residential customers pay rates in line with, if not below, those of its most comparable counterparts in the LDC industry and significantly below industry average. Its commercial and industrial customers pay rates slightly above its most comparable LDCs and industry averages.

Our Findings

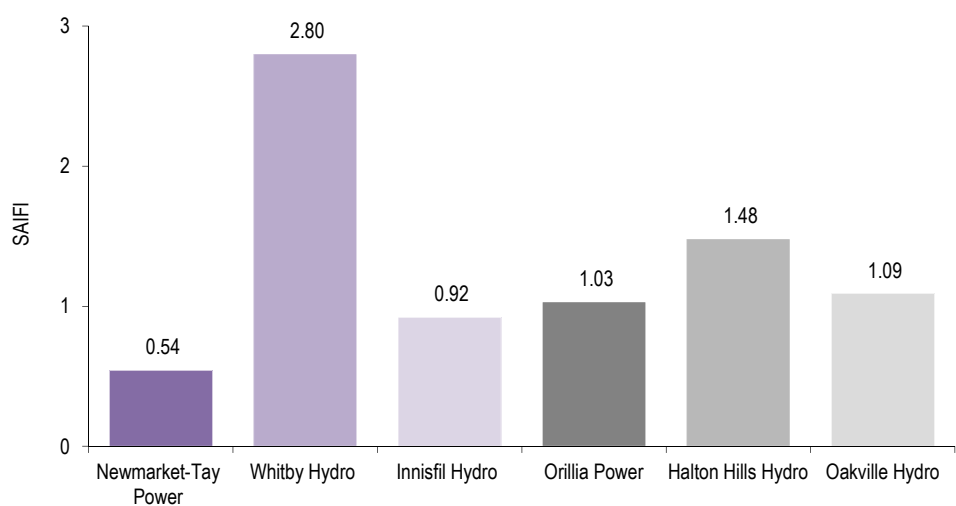
Service Level Benchmarking

- For our analysis on service level reliability, we compared the three most relevant service level reliability metrics of N T Power to those of five other comparable L D C s.
- We found that the average duration (SAIDI) of service interruptions was shorter and the average frequency (SAIFI) of service interruptions experienced by N T Power's customers was far fewer than those of its most comparable L D C counterparts, illustrating the Company's excellent service levels in its most recent year (2013).

SAIDI



SAIFI



Our Findings

Industry Risks

- As part of our analysis, we were asked to consider all of the potential risks associated with owning a utility. The following risks were discussed in our report:
 - Regulatory: The OEB regulates the industry, restricting utilities on rates, leverage ratios, transactions (who you transact with and for how much), with penalties in all instances. A good grasp of the regulatory environment and any upcoming changes is essential.
 - Operational: The two main operational risks include maintaining service levels and working with a unionized labour force.
 - Market Value: Although values have remained stable and high, the OEB could change this and it is still unclear what effect, if any, the Provincial Government's recent consolidation incentives will have on the industry.
 - Political: The low electricity rates and high service levels of an efficient LDC help alleviate political risks associated with a municipally owned utility.
 - Financial: High reporting costs (due to the regulatory nature of the business) as well as a desire to look outside of the utility to generate higher returns can lead to additional risks.
- Although there are several risks associated with owning regulated utility, the risks can be mitigated effectively within the risk tolerance of a municipality.

Our Findings

Governance

- We reviewed N T Power and the N H H L's organizational governance structure, processes and practices against the Institute of Internal Auditor model's essential elements to determine which have been adopted by N T Power and determined the level at which they are operating. In providing our commentary, we also considered other municipally owned utilities and their current governance practices.
- We looked at the board meetings, the board members, the committees and corporate mission and objectives of N T Power
- Based on our experience, it would appear N T Power is following best practices for the majority of their governance structure, policies and activities
- For the time being, the current governance structure for N H H L appears adequate.

Our Findings

Service Level Agreements

- We understand that N T Power and its shareholder have two SLA s for street lighting and water. We also understand N T power and its shareholder both have separate contracts with the same third party provider for billing services and customer information systems.
- We understand there are many other services that could potentially be shared, including:
 - call centre
 - purchasing
 - fleet
 - street lamp
 - asset management
 - Corporate (treasury, IT, accounting)
 - leasing of office and operational facilities
 - communications
 - facilities operations
 - customer service support
 - back office admin support
 - human resources
- N T Power should potentially explore additional SLA s with the municipality ensuring the SLA s are structured not to limit their further options while also giving the shareholder protection.

The changing Ontario Electricity Distribution market

- To date, 2015 has been a period of significant change in the Ontario LDC industry. The Provincial Government of Ontario (the "Provincial government") has put forward a series of initiatives to drive industry consolidation, including the following:
 - the planned Western GTA merger of Powerstream, Hydro One Brampton, Enersource and Horizon;
 - the planned initial public offering and partial monetization of Hydro One;
 - the changes to the MAAD rules to allow for greater synergy retention by LDCs; and
 - the changes to the departure and transfer taxes for LDCs (including the removal of the tax for LDCs serving less than 30,000 customers).
- The next few years are extremely important to Ontario's electricity distribution sector. Stakeholders will be evaluating new ownership structures, transaction opportunities and business models to create efficiencies and achieve shareholder objectives.