

# Alectra Inc. and Guelph Hydro Merger

**General Committee  
February 5, 2018**

# AGENDA

1. Formation of Alectra
2. Current Opportunity
3. Analysis
  - Is Guelph Hydro a good asset to acquire?
  - Is the Guelph Hydro valuation reasonable and is Markham receiving a fair ownership percentage?
  - Is the merger a good investment for Markham?
  - Does the merger result in a benefit to Alectra customers?
  - How does the merger impact Markham's number of board seats?
  - Are there any significant changes to existing agreements that could cause concern?
4. Next Steps
5. Recommendations

## Formation of Alectra

- In November, 2015, the Markham Enterprises Corporation (“MEC”) Board and Markham Council approved the merger of PowerStream, Horizon and Enersource, as well as the purchase of Hydro One Brampton Networks Inc. (“HOBNI”).
- Alectra is owned by (though their respective utility corporations): Markham, Mississauga, Hamilton, St. Catharines, Vaughan, Barrie, and OMERS
- The merger and acquisition of HOBNI occurred in early 2017 and resulted in significant changes to the ownership structure of Markham’s hydro asset:

	Pre-Merger	Post-Merger
<b>Ownership %</b>	<b>34.185% of PowerStream</b>	<b>15.73% of Alectra</b>
<b>Board Seats</b>	<b>4 (all 4 could be non-independent) of 13</b>	<b>2 (only 1 could be non-independent) of 13</b>

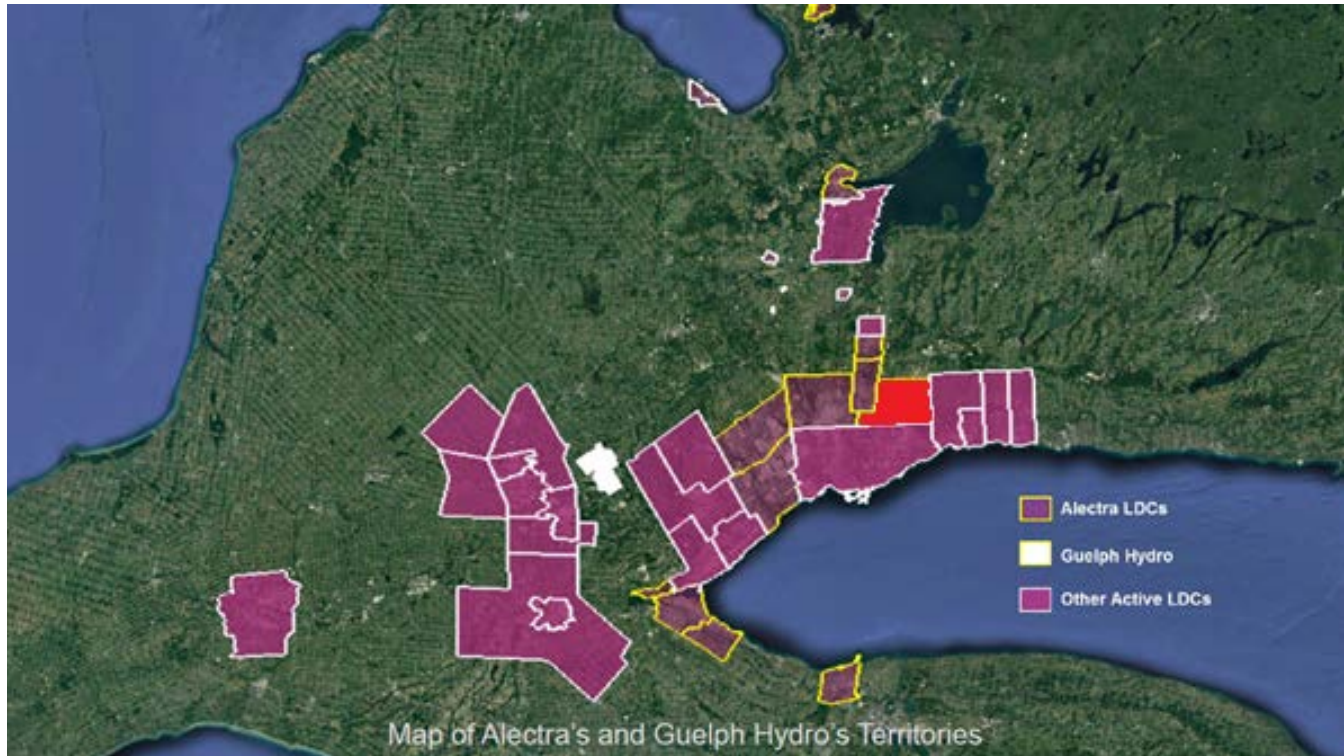
- With the reduction in Markham’s ownership percentage as a result of the Alectra merger, there is a shift away from being an “owner” to being an “investor”

## Current Opportunity

- In 2017, the City of Guelph undertook an investigation of ownership options for Guelph Hydro
- On October 5<sup>th</sup>, Alectra was selected as Guelph's preferred partner
- On November 30<sup>th</sup>, Alectra Inc.'s Board of Directors approved the transaction; the merger aligns with Alectra's strategic plan
- All mergers, including the current merger, require the unanimous consent of all shareholders and their Municipal Councils
- Guelph Council approved the merger on December 13, 2017
- The merger has received approval from all other shareholders and Councils
- Markham Enterprises Corporation (MEC) Board approved the merger on January 26, 2018 and recommends approval by the City

# Current Opportunity

*Geographic Context:*



# Current Opportunity

## Impact on Guelph and Guelph Hydro

- Guelph Hydro receives 1 board seat (increasing the Board from 13 to 14 members)
- Southwest Ontario Operations centre stays open for 10 years
  - Minimum of 70 full-time positions (current Guelph Hydro staff = 127)
  - Guelph Hydro branding stays in place for one year
- Establishment of a Green Energy & Technology Centre (GRE&T)
  - 8-10 new positions
  - \$5M capital commitment; \$3M annual operating expenses
  - Federal/Provincial programs are expected to offset a portion of the costs
  - Alectra has stated that the funding for the GRE&T Centre is not expected to adversely impact shareholder dividends

## Analysis

- MEC retained BDR North America Inc. (“BDR”) to assist with the analysis of the merger
- Staff identified 6 key evaluation criteria to help assess the deal:
  1. Is Guelph Hydro a good asset to acquire?
  2. Is the Guelph Hydro valuation reasonable and is Markham receiving a fair ownership percentage?
  3. Is the merger a good investment for Markham?
  4. Does the merger result in a benefit to Alectra customers?
  5. How does the merger impact Markham’s number of board seats?
  6. Are there any significant changes to existing agreements that could cause concern?

## Analysis

*Is Guelph Hydro a good asset to acquire?*

- Overview of Guelph Hydro and Guelph
  - 56,000 customers; \$159M rate base; 127 employees
  - Guelph is a growing community (over 130,000 residents and forecasted growth rates similar to Markham) with a well-educated workforce, supported by the presence of Guelph University
  - Ranked 7th in Canada as a location for technology companies
  - Guelph values energy efficiency and “green” initiatives and its identity as a “green” community



# Analysis

## *Is Guelph Hydro a good asset to acquire?*

- It is a growth area in terms of customer base, which is positive for long term value
- Close to other Alectra territories - allows resources to be shared and employees to be assigned to new work locations, but far enough away to provide some diversity in severe weather events
- Agreed to adoption of Alectra systems and processes and control centre consolidation, which will allow for the realization of cost synergies
- Guelph has agreed to the terms of the Current Alectra Shareholder Agreement, which addresses potential concerns about the existing rights of Alectra's shareholders

***Conclusion: Guelph Hydro is a good asset to acquire for its existing operations and potential for growth***

## Analysis

*Is the Guelph Hydro valuation reasonable and is Markham receiving a fair ownership?*

- Deloitte determined the relative fair market values of Alectra and Guelph Hydro
- For merger transactions, a “relative valuation” is an analysis performed to determine what ownership share each merger participant should receive, based on the value of the business each participant contributes
- Key drivers include: customer growth rates, terminal growth rates, weighted average cost of capital

## Analysis

*Is the Guelph Hydro valuation reasonable and is Markham receiving a fair ownership?*

- The merger parties have agreed on the relative valuation as follows:

	Guelph Hydro	Alectra
Negotiated Relative Proportions	4.63%	95.37%

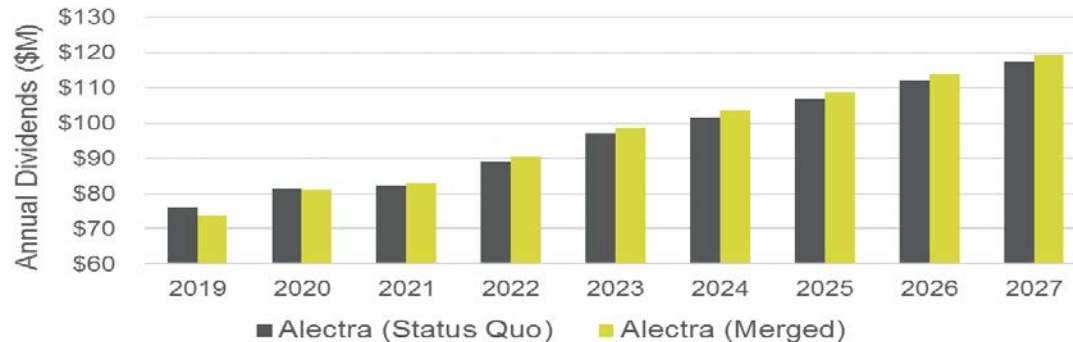
- BDR's assessment of the relative valuation is that the percentage ownership received by Guelph is reasonable
- Markham's ownership percentage of Alectra will decrease from 15.73% to 15.00%

***Conclusion: Alectra shareholders are receiving appropriate value in terms of relative ownership percentage***

# Analysis

## *Is the merger a good investment for Markham?*

- Forecasted synergies up to rebasing year (\$32.3M to \$40.9M) are expected to be greater than forecasted transition costs (\$14.3M)
- BDR believes the quantum and timing of the synergies forecasted by Alectra are reasonable
- Will not impact the realization of synergies from previous merger
- The associated net increase to shareholder dividends forecasted between \$6.9M to 11.3M – Markham's share would be between \$1.0M and \$1.7M, notwithstanding a small decrease in dividends in the early years



Note: Graph depicts dividends to all Alectra shareholders

- There should also be an increase to the Markham's share of enterprise value of Alectra, although the quantum is unknown at this time

# Analysis

*Is the merger a good investment for Markham?*

## Summary

- No cash outlay from shareholders
- Does not increase investment risk exposure
- Forecasted synergies are realistic and does not impact existing Alectra merger synergies
- Forecasted additional dividends to Markham between \$1.0 and \$1.7M

***Conclusion: The investment potential of the merger between Alectra and Guelph Hydro is positive as it a) requires no equity injections, b) does not increase investment risk exposure, and c) results in additional dividends of approximately \$1.0M to \$1.7M over the next 8-10 years.***

***The Alectra Board will be requested to make all reasonable efforts to mitigate the forecasted dividend reductions in the early years.***

# Analysis

*Does the merger result in a benefit to Alectra customers?*

- Merger synergies accrue to shareholders for the first 10 years, it is not expected that there will be any financial customer benefits until approximately 2028
- After the initial 10 years, a 0.9% saving on existing Alectra customer rates is expected, or an average of \$7/year for an average customer (\$4-5/year for an average residential customer)
  - this would be in addition to the \$40/year savings for an average customer (\$24-30/year for an average residential customer) that were forecasted from the original Alectra merger
- In addition, the merger provides an additional service centre in an area that experiences different weather patterns than most of the Alectra territory and this provides improved extreme weather resilience to the rest of Alectra's customers

***Conclusion: The Alectra and Guelph Hydro merger will result in nominal savings to the customer starting in approximately 10 years and will provide improved community resilience***

# Analysis

*How does the merger impact Markham's number of board seats?*

- Pre-Merger

Shareholder	Ownership %	Board Seats
Mississauga/OMERS	31.00%	4
Vaughan	21.49%	3
Hamilton	18.15%	2
Markham	15.73%	2
Barrie	8.78%	1
St. Catharines	4.85%	1
<b>TOTAL</b>	<b>100.0%</b>	<b>13</b>

- Post-Merger

Shareholder	Ownership %	Board Seats
Mississauga/OMERS	29.57%	4
Vaughan	20.49%	3
Hamilton	17.31%	2
Markham	15.00%	2
Barrie	8.37%	1
St. Catharines	4.63%	1
Guelph	4.63%	1
<b>TOTAL</b>	<b>100.0%</b>	<b>14</b>

- For a minimum of six years after the original Alectra merger (January 2017), Markham's number of representatives on the Board of Directors will not change, notwithstanding any changes in Markham's relative share

# Analysis

*How does the merger impact Markham's number of board seats?*

- After the later of that initial six years, and the introduction of any new shareholders, Board representation will be based on the ratio of one representative for each 7.1428% ownership interest (was 7.6923% prior to this merger)
- Since Markham will have 15% ownership, we are entitled to 2 Board seats
- Future mergers may result in Markham dropping below the 14.2856% ownership level which could result in losing a Board seat
- Guelph has one permanent board seat, notwithstanding 4.63% ownership
- The cumulative effect of additional mergers may at some point reduce Markham's board representation down to one member

***Conclusion: There is no immediate impact on Markham's representation on the Alectra Board. However, Alectra should review the Board of Directors model and composition in consultation with all Shareholders prior to reporting back to the Alectra Board, and report back to the Shareholders within approximately six months and in any event, prior to any additional mergers.***



## Analysis

*Are there any significant changes to existing agreements that could cause concern?*

- Only substantive changes to the Unanimous Shareholders' Agreement are the increase in the Board of Directors from 13 to 14 members and the change to the ratio for representation on the Board
- All other substantive provisions of the agreement remain the same
- Guelph has agreed to adopt all of Alectra's systems and the provisions of the existing Shareholders' Agreement except those set out in the report
- Due diligence will continue until closing of the transaction

***Conclusion: There are no substantive changes other than the increase to the size of the Board and the change of the ratio for representation on the Board. Staff will continue to work with Alectra's legal counsel to ensure the completion of the due diligence to the satisfaction of the City's Chief Administrative Officer.***

## Analysis - Summary

- Guelph Hydro is a good asset to acquire for its existing operations as well as its potential for growth
- Alectra shareholders are receiving appropriate value in terms of relative ownership percentage
- The investment potential of the merger between Alectra and Guelph is positive as it a) requires no equity injections, b) does not increase investment risk exposure, and c) results in additional dividends of approximately \$1.0M to \$1.7M over the next 8-10 years
- The merger will result in nominal savings to the customer starting in approximately 10 years and deliver improved community resilience
- There is no immediate impact on Markham's representation on the Alectra Board of Directors
- There are no substantive changes other than the increase to the size of the Board and the change of the ratio for representation on the Board

***Conclusion: Staff recommend that the proposed merger between Alectra and Guelph Hydro be approved***

## Next Steps

The following next steps are required in order for the transaction to close:

- Due Diligence results to the satisfaction of the CAO
- Unanimous approval of all Shareholders and their municipal owners
  - Approval is outstanding from the City of Markham
- Approval from the Ontario Energy Board of the MAADs Application (Mergers, Acquisitions, Amalgamations and Divestitures)
- Approval under the Competition Act

## Recommendations

- WHEREAS Markham Enterprises Corporation (“MEC”), a subsidiary of The Corporation of the City of Markham (the “City”) and the City, are parties to the Unanimous Shareholders Agreement for Alectra Inc. (“Alectra”) dated January 31, 2017 (the “Current Alectra Shareholder Agreement”);
- AND WHEREAS the Board of Directors of MEC has approved the purchase by Alectra of all of the issued and outstanding shares of Guelph Hydro Electric Systems Inc. (“GHESI”) from Guelph Municipal Holdings Inc. (“GMHI”) in consideration of the issuance to GMHI of Class G Common Shares in the capital of Alectra, and the amalgamation of Alectra Utilities Corporation (“AUC”) with GHESI, both of which at such time will be wholly-owned subsidiaries of Alectra, under Section 174 of the Business Corporations Act (Ontario), to continue as one local distribution company to be called Alectra Utilities Corporation, conditional upon the completion of a merger participation agreement to be entered into between Alectra, AUC, GHESI and GMHI, in accordance with the conditions set out therein;

## Recommendations

- AND WHEREAS it is desirable to amend the Current Alectra Shareholder Agreement to add GMHI and the Corporation of the City of Guelph as parties thereto (the “New Alectra Shareholder Agreement”);
- AND WHEREAS the form of the New Alectra Shareholder Agreement has been provided to the City;
- AND WHEREAS management of Alectra and staff of AUC, and their advisors, have provided a review of the key aspects of the New Alectra Shareholder Agreement to the Board of Directors and staff of MEC;

## Recommendations

NOW THEREFORE IT IS RESOLVED THAT:

1. The City authorizes and approves the New Alectra Shareholder Agreement, substantially in accordance with the form presented to the City, subject to any non-material modifications or amendments as approved by the President & CEO and the General Counsel & Secretary of Alectra, and by the Chief Administrative Officer of the City, and authorizes the City to enter into and deliver the New Alectra Shareholder Agreement in a form satisfactory to the President & CEO and the General Counsel & Secretary of Alectra, and by the Chief Administrative Officer of the City, and to perform, observe and comply with its obligations under such Agreement;

## Recommendations

2. The Mayor and City Clerk are hereby authorized and directed to execute and deliver the New Alectra Shareholder Agreement in accordance with the foregoing resolutions;
3. The Mayor and City Clerk are hereby authorized and directed to sign and/or dispatch and deliver all other documents, notices, articles, certificates to be signed and/or dispatched or delivered under or in connection with the New Alectra Shareholder Agreement or to take any action deemed necessary in respect of any of the foregoing;
4. The approvals above are subject to the Chief Administrative Officer being satisfied with the results of the continuing due diligence being conducted by Alectra;

## Recommendations

And Further:

5. That Alectra review the Board of Directors model and composition in consultation with all with all Shareholders prior to reporting back to the Alectra Board, and report back to the Shareholders within approximately six months and in any event, prior to any additional mergers;
6. That the Alectra Board be requested to make all reasonable efforts to mitigate the forecasted dividend reductions in the early years;
7. That the Alectra Board be requested to undertake a study to consider imposing a cap on total compensation for senior management; and
8. That Staff be authorized and directed to do all things necessary to give effect to these recommendations.