

An Assessment of the Financial Impact of the Partial Sale of Hydro One

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Financial Accountability Office of Ontario

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Table of Abbreviations

Abbreviation	Term
CT	Corporations tax
DRC	Debt Retirement Charge
EBITDA	Earnings before interest, taxes, depreciation and amortization
ESDI	Electricity sector dedicated income
FAO	Financial Accountability Office of Ontario
FMV	Fair market value
GBE	Government Business Enterprises
HOI	Hydro One Inc.
IPO	Initial public offering
NBV	Net book value
NPV	Net present value
OEB	Ontario Energy Board
OEFC	Ontario Electricity Financial Corporation
OPG	Ontario Power Generation
PB	Price to book value of equity multiple
PE	Price to earnings multiple
PIL	Payments-in-lieu of taxes
RSD	Residual stranded debt
UCC	Undepreciated capital cost
TEV	Total enterprise value

Essential Points

- + The Province of Ontario plans to sell part of its wholly owned electricity transmission and distribution company, Hydro One. It plans to sell 15 per cent of the company in 2015–16 and an additional 45 per cent in subsequent years.
- + The FAO estimates the market value of Hydro One to be \$11–\$14.3 billion.
- + The initial 15 per cent sale of Hydro One would significantly reduce the Province's deficit in 2015–16.
- + In subsequent years in which the Province sells shares in Hydro One, the impact on the budget balance (i.e. surplus/deficit) would depend on market conditions and policy decisions of the Province around the repayment of electricity sector debt, and would range from negative to positive.
- + In years following the sale of 60 per cent of Hydro One, the Province's budget balance would be worse than it would have been without the sale.
- + The Province's net debt would initially be reduced, but will eventually be higher than it would have been without the sale.
- + The total amount credited to the Trillium Trust to finance infrastructure as a result of the sale is estimated at \$3.3–\$5.8 billion.

Executive Summary

Background

Hydro One is an electricity transmission and distribution company¹ wholly owned by the Province of Ontario. In 2014, the company operated 97 per cent of Ontario's transmission capacity and the largest distribution system in Ontario, spanning 75 per cent of the province.²

Consistent with a recommendation from the Premier's Advisory Council on Government Assets³ (the council), in its 2015 Budget the Province announced its intention to sell up to 60 per cent of Hydro One. The Province would sell 15 per cent of Hydro One in 2015–16 and the balance in subsequent sales for which it has not announced a specific timeline. In April 2015, the council estimated the value of Hydro One at \$13.5–\$15 billion.⁴ In October 2015, Hydro One's prospectus implied an estimated proceeds value of the company of \$11.3–\$12.5 billion.⁵

The 2015 Budget also noted that

*uniquely attractive conditions enable the government to maximize value and obtain greater net proceeds. ... these would be available to be credited to the Trillium Trust and directed into building transit, transportation, and other priority infrastructure, through Moving Ontario Forward...*⁶

As such, the Province has made a commitment to use the net proceeds from the Hydro One transaction to finance its infrastructure plans, as part of a broader asset optimization initiative.

1 The company's subsidiaries are Hydro One Networks Inc., Hydro One Remote Communities Inc., and Hydro One Telecom Inc. as of October 18, 2015.

2 <http://www.hydroone.com/ourcompany/pages/quickfacts.aspx>

3 The 2014 Budget announced that the government is undertaking a review of government assets to unlock their value. As part of this review, the Province created the Premier's Advisory Council on Government Assets to recommend how to maximize the value and performance of government business enterprises, including Hydro One. (2014 Ontario Budget, p. 163)

4 Striking the Right Balance: Improving Performance and Unlocking Value in the Electricity Sector in Ontario, Premier's Advisory Council on Government Assets, p. 23. This estimate excludes the value of Hydro One Brampton Networks Inc. and represents the fully distributed equity value of Hydro One, which is the value assessed if shares are already publicly traded. The Council also recommended proceeding with a sale or merger of Hydro One Brampton, with an estimated value of about \$600 million.

5 Hydro One's amended and restated preliminary base PREP prospectus, p. 15, October 9, 2015. The FAO has estimated the \$11.3–\$12.5 billion value using the anticipated share price of \$19–\$21 multiplied by the number of shares of 595 million. This figure is based on a pricing range for marketing purposes that is not on the same basis as the fully distributed equity value. For example, this figure excludes the \$800 million special dividend issued to the Province that would be a part of the council's original estimate. Note that the Province has the option to sell up to 15 per cent of the company by exercising an over-allotment option defined in the prospectus.

6 2015 Ontario Budget, p. 79.

The partial sale of Hydro One could also have important direct implications for non-residential electricity customers.⁷ They pay a Debt Retirement Charge (DRC), which is levied on electricity consumption to help pay down the debt of the former Ontario Hydro, the predecessor to Hydro One. The DRC is not only an additional charge for electricity consumers, but also a significant source of revenue for the Province.

Purpose of the Report: Key Questions

In this context, this report answers the following key questions:

- + How much can the Province expect in proceeds from the partial sale of Hydro One?
- + What is the impact of the partial sale on the DRC?
- + What is the impact on the Province's budget balance (surplus/deficit)?
- + What is the impact on the Province's net debt?
- + What is the impact on the Trillium Trust?

Each of the sections that follow answers one of the key questions.

Financial Impact Scenarios

There are two key areas of uncertainty associated with the financial impact of the partial sale of Hydro One: the amount of proceeds and the impact of the sale on the DRC.

Proceeds from the Partial Sale of Hydro One

Valuations of companies are subject to a high degree of uncertainty, and are impacted by market and economic conditions. Using publicly available information and generally accepted valuation approaches, the FAO estimates the proceeds of Hydro One to be \$11–\$14.3 billion,⁸ excluding the value of Hydro One Brampton.⁹ Based on this valuation, a 60 per cent sale of ownership would generate \$6.8–\$8.9 billion in cash proceeds for the Province.

While the FAO's valuation is largely consistent with the council's estimate of \$13.5–\$15 billion, the FAO's analysis generates a wider and somewhat lower range. The FAO cannot reproduce the council's estimate, because the Province has deemed this methodology to be a Cabinet record and has chosen not to release it.¹⁰

⁷ The 2015 Budget announced that the DRC would only be charged on non-residential consumption starting in 2016, and projected the DRC would be eliminated by the end of 2018 (2015 Ontario Budget, p.192).

⁸ The FAO's valuation uses data available to October 2015.

⁹ Hydro One Brampton was separated from Hydro One on August 31, 2015. Please refer to Hydro One's prospectus for additional details. As such, the FAO's valuation and estimate of the fiscal impact of the transaction excludes Hydro One Brampton.

¹⁰ Under the *Financial Accountability Officer Act, 2013* and *Freedom of Information and Protection of Privacy Act*, the Province is not permitted to disclose Cabinet records to the FAO unless the Cabinet gives permission or a record is more than 20 years old. The determination of what constitutes a Cabinet record is made by the Province.

Debt Retirement Charge

The Debt Retirement Charge (DRC) is a charge on non-residential electricity consumption, which the FAO estimates will generate \$0.6 billion per year in revenue for the Province from 2016–17 to 2018–19.¹¹ Under the *Electricity Act, 1998*, the gross proceeds from the partial sale of Hydro One, less certain deductions, must be used to pay down the debt of the former Ontario Hydro. If this debt is reduced sufficiently, the DRC could no longer be levied.

The FAO estimates that the revenue and other adjustments from the sale may be sufficient to eliminate the DRC. However, the FAO estimates are subject to uncertainty, because the Province has not announced the current level of residual stranded debt (RSD) or the assumptions and inputs into the estimation of the RSD, and because of uncertainty associated with the sale proceeds. As such, the FAO presents estimates of fiscal impact with and without the DRC.

Table ES-1 summarizes the four fiscal impact scenarios based on low and high estimates of sale proceeds and on whether the DRC is retained or eliminated, the two key areas of uncertainty.

TABLE ES-1: Financial Impact Scenarios

Financial Impact Scenarios	DRC Retained	DRC Eliminated
Low Proceeds	Low-DRC	Low-No DRC
High Proceeds	High-DRC	High-No DRC

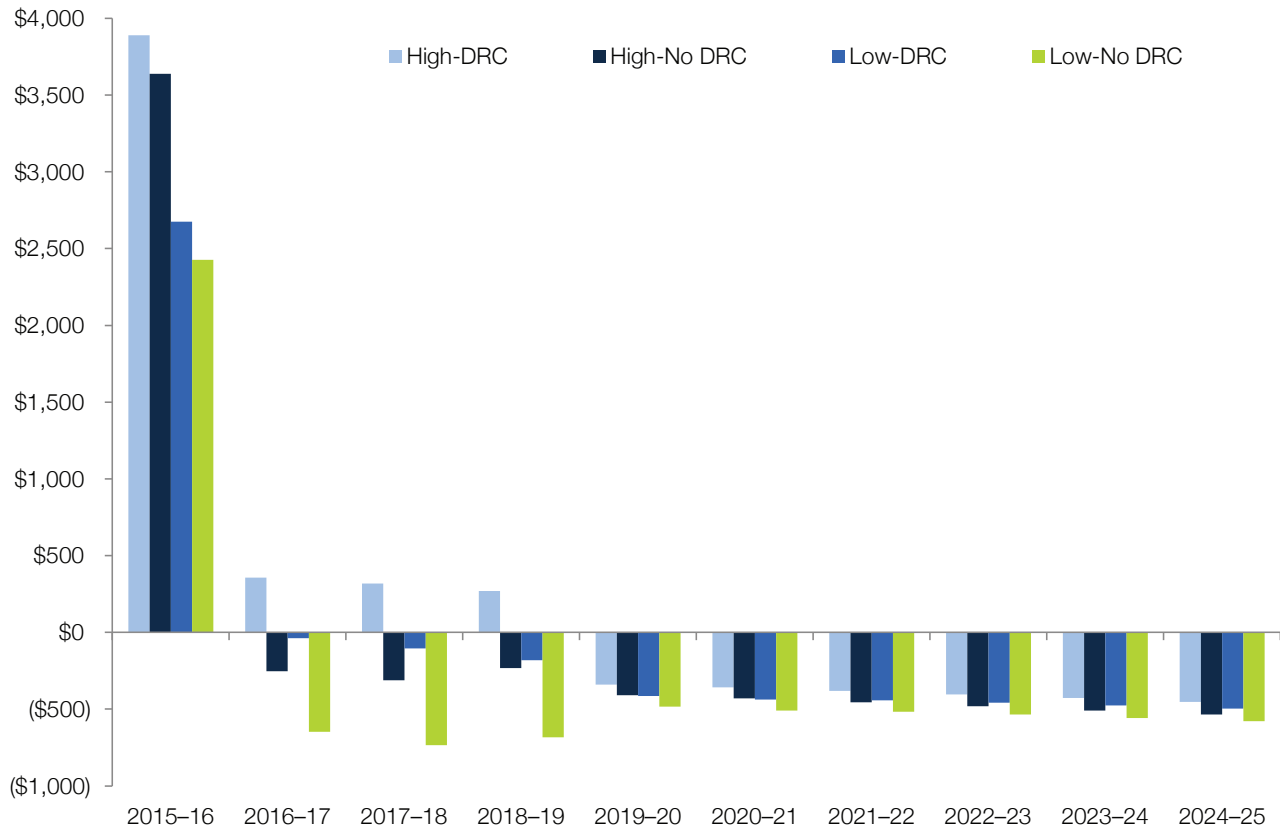
Financial Impact of the Partial Sale of Hydro One

Figure ES-1 presents the FAO estimate of the impact of the sale of 60 per cent of Hydro One on the Province's budget balance (surplus/deficit). These estimates should be viewed as illustrative only, as they assume that the Province sells 15 per cent of Hydro One each year from 2015–16 to 2018–19. The estimates vary based on the low and high estimates of sale proceeds and whether the DRC is eliminated, as discussed above.

Under all scenarios, the Province would see an improvement in its budget balance in the first year in which the initial 15 per cent sale takes place. In subsequent years, as more shares are sold, the impact on the budgetary balance could be positive or negative depending on whether the DRC is eliminated and the prices obtained for Hydro One shares sold. By 2019–20 once the full 60 per cent has been sold, the Province would experience an ongoing negative impact on budget balance from foregone net income and payments-in-lieu of taxes from Hydro One.

¹¹ The 2015 Budget announced that the DRC would only be charged on non-residential consumption starting in 2016, and projected the DRC would be eliminated by the end of 2018 (2015 Ontario Budget, p.192).

FIGURE ES-1: Estimated Impact of the Partial Sale of Hydro One on the Province's Budget Balance (Surplus/Deficit), \$ Millions, 2015–16 to 2024–25



Source: FAO estimates

Note: Assumes the Province sells 15 per cent of Hydro One each year from 2015–16 to 2018–19.

The Province has determined that the specific estimates of the fiscal impact of the sale that are included in its budget projections are a Cabinet record and has chosen not to disclose them (as discussed above). Without knowing what is included in the budget projections (both amounts and timing), it is not possible for the FAO to offer a definitive opinion on whether the partial sale of Hydro One would help the Province to achieve a balanced budget or surplus in 2017–18.

Turning from annual deficits to net debt (the Province's stock of liabilities less its financial assets), assuming that the Province sells 15 per cent of Hydro One in 2015–16, Ontario's net debt would initially be reduced by \$2.4–\$3.9 billion. However, net debt would eventually increase as a result of the partial sale as the costs of forgone revenues from Hydro One begin to exceed the initial fiscal benefits.

The Trillium Trust is a dedicated revenue account of the Province, created to finance infrastructure. The Province has committed to credit the net proceeds of the partial sale of Hydro One to the Trillium Trust. The FAO estimates the net proceeds to be \$1.4–\$3.1 billion for the full 60 per cent sale of Hydro One. In addition, the Province has

committed to credit the gain from Hydro One's deferred tax assets to the Trillium Trust;¹² estimated by the FAO to be \$1.9–\$2.7 billion. As such the FAO estimates the total amount to be credited to the Trillium Trust as a result of the partial sale of Hydro One to be \$3.3–\$5.8 billion.

Questions for the Province

On the basis of the analysis presented here, legislators may wish to ask a number of questions about the proposed partial sale of Hydro One to better understand its economic and financial implications.

Issue and Importance	Question
There is much uncertainty around how the debt retirement charge (DRC) would be affected by the partial sale. The DRC is significant revenue for the Province and a cost for consumers of electricity.	Does the Province expect the partial sale of Hydro One to affect the date that the debt retirement charge would be eliminated?
The single most important unknown in the proposed transaction is the timing of sales after the initial 15 per cent sale in 2015–16. Timing would affect the Province's budget balance (surplus/deficit), including possibly whether a balanced budget is achieved in 2017–18.	When does the Province plan future sales of Hydro One shares beyond the initial 15 per cent committed in 2015–16?
The Province has not announced how it expects the partial sale of Hydro One to impact the provincial budget balance. Relative to not selling Hydro One, FAO analysis suggests that the transaction would improve the Province's budget balance with the initial 15 per cent sale, but it is unclear how the transaction would affect the budget balance in later years in which sales occur. Once 60 per cent of Hydro One has been sold, the FAO projects the Province would realize a permanent deterioration in budget balance as a result of the transaction.	What is the Province's estimate of the fiscal impact of sale of 60 per cent of Hydro One specifically over the next 10 years in terms of annual deficit/surpluses and net debt?

12 Ontario Newsroom: Asset Optimization – Broadening Ownership of Hydro One

1\ Introduction

1\1 Background

Hydro One is an electricity transmission and distribution company¹³ wholly owned by the Province of Ontario. In 2014, the company operated 97 per cent of Ontario's transmission capacity and the largest distribution system in Ontario, spanning 75 per cent of the province.¹⁴

Consistent with a recommendation from the Premier's Advisory Council on Government Assets¹⁵ (the council), in its 2015 Budget the Province announced its intention to sell up to 60 per cent of Hydro One, 15 per cent in 2015–16¹⁶ and the balance in subsequent sales for which no specific timeline has been announced. In April 2015, the council estimated the value of Hydro One at \$13.5–\$15 billion.¹⁷ In October 2015, Hydro One's prospectus implied an estimated proceeds value of the company at \$11.3–\$12.5 billion.¹⁸

Ontario's Electricity System

Ontario's electricity system consists of generation, transmission and distribution companies. Generation involves the production of electricity from sources such as nuclear, natural gas, solar and water (hydro). Transmission involves moving electricity through high voltage lines over long distances from generating stations to local distribution companies. Distribution companies take electricity from the transmission system and deliver it to consumers.

Source: Ministry of Energy

13 The company's subsidiaries are Hydro One Networks Inc., Hydro One Remote Communities Inc., and Hydro One Telecom Inc. as of October 18, 2015.

14 <http://www.hydroone.com/ourcompany/pages/quickfacts.aspx>

15 The 2014 Budget also announced that the government is undertaking a review of government assets to unlock their value. As part of this review, the Province created the Premier's Advisory Council on Government Assets to recommend how to maximize the value and performance of government business enterprises, including Hydro One. (2014 Ontario Budget, p. 163)

16 The Council also recommended proceeding with a sale or merger of Hydro One Brampton, with an estimated value of about \$600 million.

17 Striking the Right Balance: Improving Performance and Unlocking Value in the Electricity Sector in Ontario, Premier's Advisory Council on Government Assets, p. 23. This estimate excludes the value of Hydro One Brampton Networks Inc. and represents the fully distributed equity value of Hydro One, which is the value assessed if shares are already publicly traded. This figure is based on a pricing range for marketing purposes that is not on the same basis as the fully distributed equity value. For example, this figure excludes the \$800 million special dividend issued to the Province that would be a part of the council's original estimate.

18 Hydro One's amended and restated preliminary base PREP prospectus, p. 15, October 9, 2015. The FAO has estimated the \$11.3–\$12.5 billion value using the anticipated share price of \$19–\$21 multiplied by the number of shares of 595 million. This figure is based on a pricing range for marketing purposes that is not on the same basis as the fully distributed equity value. For example, this figure excludes the \$800 million special dividend issued to the Province that would be a part of the council's original estimate. Note that the Province has the option to sell up to 15 per cent of the company by exercising an over-allotment option defined in the prospectus.

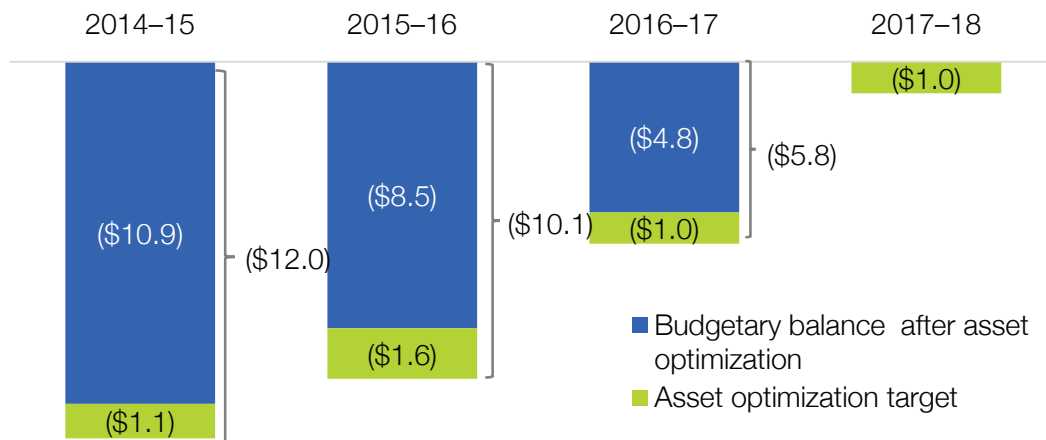
The Budget noted that

*uniquely attractive conditions enable the government to maximize value and obtain greater net proceeds. ... these would be available to be credited to the Trillium Trust and directed into building transit, transportation, and other priority infrastructure, through Moving Ontario Forward...*¹⁹

As such, the Province has made a commitment to use the net proceeds from the Hydro One transaction to finance its infrastructure plans.

The proposed partial sale of Hydro One is part of a broader asset optimization initiative that the Province is undertaking. The 2015 Budget set the asset optimization target at \$5.7 billion over 10 years in revenue on a budget basis, of which \$4.9 billion was to be realized from 2014–15 to 2017–18 (Figure 1-1). Revenue from asset optimization is therefore important to help achieve budget balance in 2017–18. However, the asset optimization target includes a number of initiatives, and the government has not announced how much of the target is expected to be achieved through the partial sale of Hydro One.

FIGURE 1-1: Ontario's Projected Budgetary Balance and Asset Optimization Target from 2014–15 to 2017–18, \$ Billions



Source: FAO calculations based on the Ontario 2015 Budget

Note: 2014–15 excludes \$249 million in net proceeds from the sale of General Motors shares in 2013–14.

Finally, the partial sale of Hydro One could have important implications for non-residential electricity customers who pay a debt retirement charge (DRC), which is levied on electricity consumption to help pay down the debt of the former Ontario Hydro, a predecessor of Hydro One. The DRC is not only an additional charge for electricity customers, but also a significant source of revenue for the Province.

¹⁹ 2015 Ontario Budget, p. 79

1\2 Key Questions

In this context, this report answers the following key questions:

- + How much can the Province expect in proceeds from the partial sale of Hydro One?
- + What is the impact of the partial sale on the Debt Retirement Charge?
- + What is the impact on the Province's budget balance (surplus/deficit)?
- + What is the impact on the Province's net debt?
- + What is the impact on the Trillium Trust?

1\3 Scope

This report does not seek to:

- + Assess the merits of the decision to sell Hydro One
- + Forecast the impact of the partial sale of Hydro One on electricity rates in Ontario
- + Assess the prospects for performance improvements at Hydro One that might result from the partial sale or any future changes at Hydro One
- + Assess the financial impact of any government spending financed by the sale of Hydro One, i.e. transportation projects financed by the Trillium Trust.

1\4 Methodology

In line with the key questions that this project seeks to answer, the FAO's methodology first estimates the likely proceeds from the proposed partial sale of Hydro One, then uses this estimate to assess the impact on the Province's budget balance and net debt over the next 10 years, from 2015–16 to 2024–25. This assessment includes an analysis of the likely impact on the DRC.

Two methodological points are worth highlighting:

- + **Timing of the sale:** While the Province has committed to selling 15 per cent of Hydro One in 2015–16, it has not provided a timeline for the subsequent sale(s) of shares. To provide legislators with an understanding of the full financial impact on the Province, the FAO assumes that the Province would sell 15 per cent of Hydro One in each year from 2015–16 to 2018–19. The results of this analysis are sensitive to the timing of subsequent sales.
- + **Forecast of results:** The FAO bases its analysis on Hydro One results from the 12 months ending in the second quarter of 2015.²⁰ Figures after 2015–16 are forecast using historical growth rates of results as reported in the company's annual report. These forecasts are subject to changes in the financial performance of Hydro One and changing economic conditions, such as interest rates.

²⁰ The FAO's financial analysis of Hydro One is based on the company's financial statements that have been prepared in accordance with United States (US) Generally Accepted Accounting Principles (GAAP). The FAO has not accounted for any potential changes in the preparation of the company's financial statements, such as adoption of International Financial Reporting Standards (IFRS).

During the preparation of this report, meetings were held with the ministries of Finance and Energy and Treasury Board Secretariat to obtain additional information on fair market value estimation methods for rate-regulated companies, accounting line items that would be impacted and related accounting treatments.

Under the *Financial Accountability Officer Act, 2013* and *Freedom of Information and Protection of Privacy Act*, the Province is not permitted to disclose Cabinet records to the FAO unless the Cabinet gives permission or a record is more than 20 years old. The determination of what constitutes a Cabinet record is made by the Province. In some cases, in the course of this project, the FAO requested information that the Province had deemed to be a Cabinet record, and chose not to provide. Where relevant, these gaps in information have been identified in this report.

Other methodological points are discussed where relevant in the chapters that follow.

2\ Financial Impact Scenarios

There are two key areas of uncertainty in estimating the financial impact of the partial sale of Hydro One:

- + The amount of sale proceeds
- + Whether the Debt Retirement Charge (DRC) would be eliminated.

To provide a full picture of the range of potential financial impacts that the partial sale of Hydro One might have for the Province, the FAO has developed four scenarios based on these two areas of uncertainty. Table 2-1 summarizes these scenarios.

TABLE 2-1: Financial Impact Scenarios

Financial Impact Scenarios	DRC Retained	DRC Eliminated
Low Proceeds	Low-DRC	Low-No DRC
High Proceeds	High-DRC	High-No DRC

The remainder of this chapter reviews the two key areas of uncertainty in greater detail.

2\1 Proceeds from the Partial Sale of Hydro One

The fair market value (FMV) of Hydro One is critical in determining the cash (gross) proceeds that the Province would receive from the partial sale of the company. FMV may be considered the price that a buyer or group of buyers would be willing to pay for ownership in the company. Given that the Province has decided to sell Hydro One on the stock market, comparing the share prices of comparable firms is a reasonable way to measure FMV.

To estimate the FMV of Hydro One, the FAO compared the share prices of publicly traded companies that have operations similar to Hydro One. The FAO then divided the share prices of each company by a measure of the company's financial performance to generate a comparable metric that could be applied to the financial performance of Hydro One. As a result, the share price, or FMV, of Hydro One is estimated.²¹ Overall, the FAO estimates the FMV of Hydro One at \$11–\$14.3 billion, excluding the value of Hydro One Brampton (a former subsidiary of Hydro One).

²¹ Section 4.2 in the appendix provides more information and detailed calculations.

The estimate of gross proceeds presented above is subject to uncertainty, including

- + investors' perception of the risk that Province would intervene in the operations, governance, regulation or market of Hydro One
- + the economic conditions at the time of the sale
- + the transaction terms.

2\2 Debt Retirement Charge

The DRC is revenue for the Province. It is raised by levying a charge on the bills of electricity consumers (as of 2016, only non-residential electricity consumers)²². DRC revenue is used to pay down the unfunded liability of the Ontario Electricity Financial Corporation (OEFC),²³ a wholly owned agency of the Province. The Province may levy the DRC until the Minister of Finance declares residual stranded debt (RSD) is retired.²⁴ The FAO estimates revenue from the DRC to be roughly \$0.6 billion per year.²⁵

The *Electricity Act, 1998*²⁶ requires that an amount equivalent to the proceeds from the sale of Hydro One be paid to the OEFC less certain deductions, which the FAO has identified to be:

1. the acquisition cost of the Province's investment in Hydro One
2. the cumulative net income from the company (less interest costs of investment)
3. transaction costs.

Amounts payable to OEFC would effectively reduce the OEFC's RSD. The Province's 2014 Fall Economic Statement estimated the RSD to be \$2.6 billion as of March 31, 2014²⁷, and estimated that the RSD would be paid off by the end of 2018,²⁸ implying an average reduction of \$0.5 billion per year.

22 2015 Ontario Budget, p.192

23 The difference between the assets and liabilities of the OEFC is called the unfunded liability. The unfunded liability of OEFC is estimated to be \$9.8 billion at March 31, 2014 (2014 Ontario Economic Outlook and Fiscal Review, Government of Ontario, 2014). The Province dedicates revenues to pay down this debt, consisting of payments-in-lieu of taxes of OPG, Hydro One and municipal electricity utilities, and the cumulative net income from OPG and Hydro One in excess of the interest cost of the Province's original investment in these companies (OEFC's 2014 annual report, p. 5, as per the *Electricity Act, 1998*).

24 OEFC's 2014 annual report, p. 5, as per the *Electricity Act, 1998*. Residual stranded debt is defined as the OEFC's unfunded liability less the estimated amount of future net income and PILs from Ontario Power Generation and Hydro One. At March 31, 2014, the net present value of these dedicated income streams was estimated by the Province to be \$7.2 billion. The residual stranded debt is calculated as the unfunded liability less the net present value (NPV) of these dedicated income streams.

25 DRC revenues totaled \$956 million in 2014-15. However, the residential portion is to be eliminated by the end of calendar 2015, which is approximately one-third of the total DRC, as indicated by Ministry of Finance officials.

26 Section 50.3 of the *Electricity Act, 1998*.

27 2014 Ontario Economic Outlook and Fiscal Review, Government of Ontario, 2014.

28 *ibid*

The FAO estimates that the RSD would likely not be eliminated ahead of 2018–19 under either valuation scenario (Table 4-8, p. 44). However, the margin of error is small and there is significant uncertainty associated with these estimates, which includes forecasting the future net income from Hydro One. As such, the FAO has estimated the financial impact of the partial sale of Hydro One under both scenarios.

2\2\1 Areas of Uncertainty

The Province has not yet announced its estimate of the RSD for March 31, 2015 or how the changes in future net income of Hydro One would impact this estimate. The FAO has requested more information on the calculation of future net income, but the Province has determined this information to be a Cabinet record, and has chosen not to release it (see Section 1.4 for explanation).

2\2\2 Question for the Province

On the basis of the analysis presented here, legislators may wish to ask the following question about the proposed partial sale of Hydro One to better understand the economic and financial implications of the transaction.

Issue and Importance	Question
There is much uncertainty around how the debt retirement charge (DRC) would be affected by the partial sale. The DRC is significant revenue for the Province and a cost for consumers of electricity.	Does the Province expect the partial sale of Hydro One to affect the date that the debt retirement charge would be eliminated?

3\ Financial Impact of the Partial Sale of Hydro One

This chapter estimates the impact of the partial sale of Hydro One on the Province's budget balance (surplus/deficit) and net debt for each of the four previously identified scenarios.

3\1 Impacts on the Province's Budget Balance

Figure 3-1 presents the FAO estimates of the impact of the sale of 60 per cent of Hydro One under the four scenarios, assuming that the Province sells 15 per cent of Hydro One each year from 2015–16 to 2018–19. The sections that follow explain in more detail how the FAO estimated each component of the fiscal impact.

3\1\1 One-Time Gain on Deferred Tax Assets

Immediately after the Province sells the initial 15 per cent of Hydro One, the Province would realize a gain (a type of revenue) of \$1.9–\$2.7 billion dollars.²⁹

This gain results from provisions of the *Electricity Act, 1998* and the federal *Income Tax Act*³⁰ that would result in Hydro One increasing the recorded value of its assets and allowable depreciation expenses for tax purposes. This allows the company to report lower income for tax purposes, thereby generating tax savings. The FAO has estimated the total of future annual tax savings at \$2.2–\$3.2 billion,³¹ which would be recorded as an income by Hydro One. Since this transaction would occur after the sale, 85 per cent of this one-time increase in net income would be recognized by the Province.

3\1\2 Gains from Sale of Investment (Net Proceeds)

Provincial revenues would increase by the net proceeds from the sales, which the FAO assumes would be recorded as “Gains from Sale of Investment” in Ontario's Public Accounts. The FAO estimates that the net proceeds of the full 60 per cent sale would be \$1.4–\$3.1 billion.

The FAO estimates the book value³² of Hydro One on the Province's balance sheet to be \$7 billion (Section 3.2.1). As the Province's stake in Hydro One is sold, the recorded value of this asset would be reduced proportionally. The net proceeds (or net gain) from the sale are the gross proceeds of \$6.8–\$8.9 billion, less the proportionate reduction in the asset.³³

29 Section 4.3.2 of the Appendix provides more details and calculations.

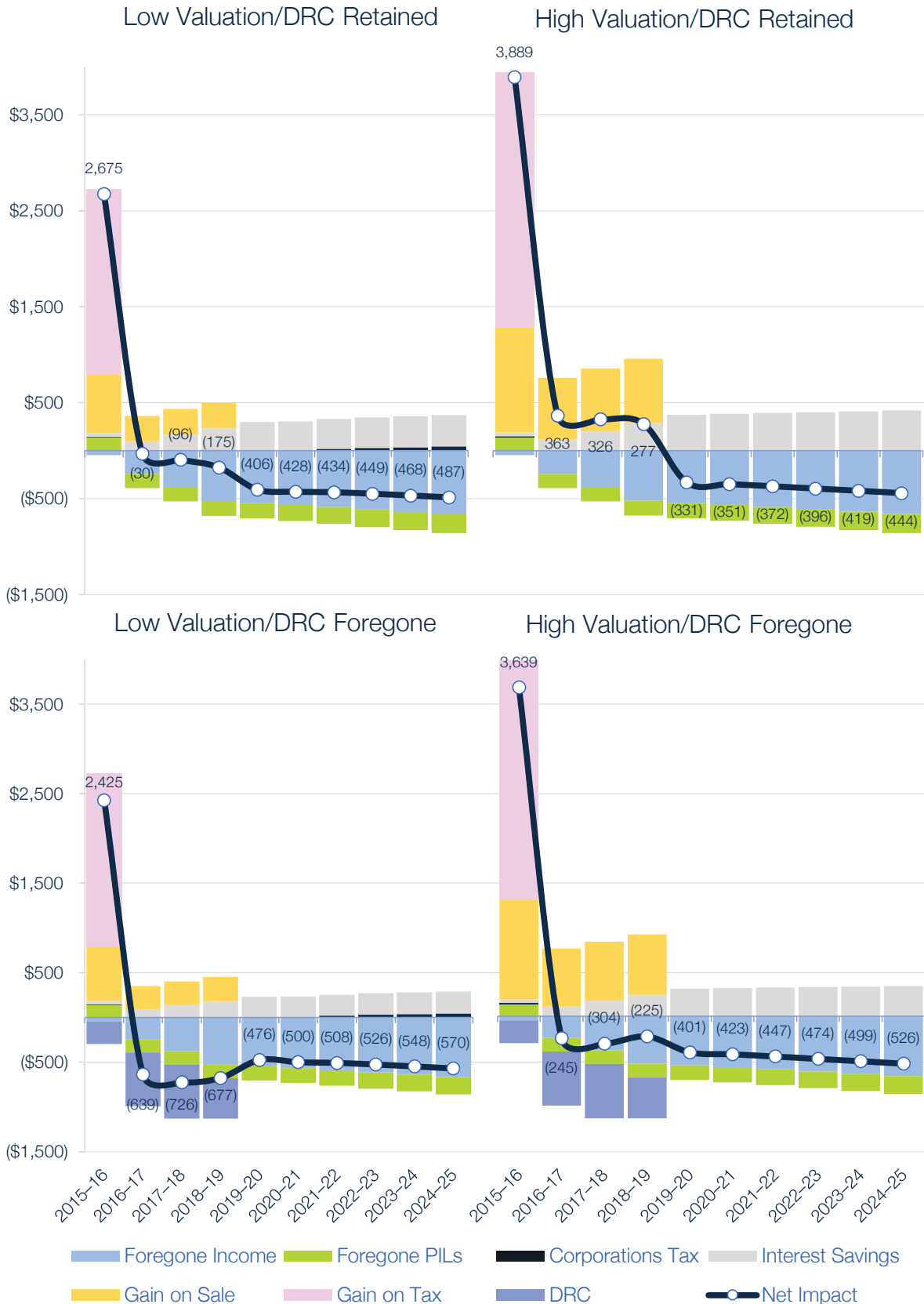
30 Section 149(10) of the *Income Tax Act*, and section 16.1 of Ontario Regulation 207/99.

31 This “tax shield”, as it was termed by the council, is a benefit to Hydro One in that it would pay less income tax than it otherwise would.

32 This value is determined by accounting standards and is estimated on a different basis than market value.

33 Since the FAO assumes that the Province sells 15 per cent of Hydro One each year from 2015-16 to 2018-19, the estimate of net proceeds takes into account growth in the book and market value of Hydro One (see Appendix 4.5.2 to calculate net proceeds).

FIGURE 3-1: Estimated Financial Impact on the Budget Balance, \$ Millions



Source: FAO estimates

Note: Data labels indicate net impact on budget balance. For more details see Table 4-9 and Table 4-10.

3\1\3 Electricity Payments-In-Lieu of Taxes and Corporations Taxes

Electricity payments-in-lieu of taxes (PILs) are revenue for the Province. As a Crown corporation, Hydro One is exempt from federal and provincial corporations tax (CT)³⁴ and, instead, makes PILs to the Province.³⁵ These PILs are equivalent to the amount of both federal and provincial CT payments that Hydro One would make if it were subject to CT. Upon the sale of the initial 15 per cent of Hydro One, the company would become subject to federal and provincial CT,³⁶ and would no longer pay PILs to the Province. Hydro One recognized an expense of approximately \$100 million in PILs in the year ending in the second quarter of 2015.

The company would not pay the equivalent PILs amount in CT to the Province for two reasons:

- + The value of Hydro One's assets³⁷ would allow the company to claim depreciation that would shield some or all of its income from CT for some time (Section 4.3.2).
- + While the company would eventually begin paying CT, the Province would not regain all the revenues it once collected in PILs, since the Province would only receive the provincial portion of the CT, while the PILs were equivalent to both the federal and provincial CTs. The provincial portion of PILs from Hydro One is estimated to be approximately \$40 million over the last year. The federal portion of PILs (\$60 million per year) is the ongoing revenue loss to the Province from the switch from PILs to CT.

In 2015–16, in conjunction with the initial 15 per cent sale, the Province would recognize a one-time revenue from the payment by Hydro One of a departure tax.³⁸ However, the payment would reduce Hydro One's net income by the same amount. As such, the departure tax has no impact on the overall budget balance and net debt position of the Province. Hydro One's prospectus announced that the departure tax would be \$2.6 billion^{39,40} (Section 4.3.1).

34 The Province presents a Corporations Tax line, which includes the corporate income tax (CIT), corporate minimum tax and insurance premium revenues. The FAO estimates the impact to the federal and provincial CIT but refers to CT for consistency with the provincial presentation.

35 Section 149 (10) of the *Income Tax Act*. Sections 89 and 90 of the *Electricity Act, 1998*. These payments ensure that Hydro One is subjected to similar tax treatments as the private sector to ensure fairness among all players in the electricity sector (Direction for Change, Charting a Course for Competitive Electricity and jobs in Ontario, Government of Ontario, 1997).

36 Section 149 of the *Income Tax Act* states that a corporation is exempt when the Crown owns 90 per cent or more of its shares.

37 Upon the sale, the company must revalue its assets to their fair market value, which is estimated to be higher than the current amount reported for tax purposes. The greater the FMV of its assets, the larger the depreciation deduction.

38 Departure tax is a term used to describe the deemed disposition rules from the payments-in-lieu of tax system as prescribed by the *Income Tax Act* and the *Electricity Act, 1998*.

39 Hydro One's prospectus, p. 108

40 The Hydro One prospectus announced that the Province will be purchasing additional common shares from Hydro One worth \$2.6 billion to help the company fund the departure tax (p. 102). Transaction would affect the cash balance but not the provincial income statement.

3\1\4 Income from Investment in Government Business Enterprises

As sole owner, the Province currently has claim to all of the net income of Hydro One,⁴¹ approximately \$750 million over the last year. Following the sale of 15 per cent of the company, the Province would have claim to only 85 per cent of the company's net income.⁴² The FAO estimates that the sale of 15 per cent of Hydro One would result in a reduction of approximately \$50 million in income from investment in GBEs in 2015–16⁴³ and on an ongoing annual basis thereafter. The FAO has termed this item “foregone income”, which will grow over time.⁴⁴ Each additional sale of ownership would increase the amount of foregone income. A 60 per cent sale of Hydro One would result in roughly \$500 million in foregone income on an annual basis, which would grow over time.

However, the FAO recognizes there may be potential for improvements to Hydro One's net income as result of changes currently being made or proposed at Hydro One, including the sale of shares on market and the resulting influence of new owners. Should the net income of Hydro One increase as a result of these changes, the foregone income from the sale would be reduced. Given the uncertainty associated with forecasting future changes at Hydro One, the FAO has not assumed any increases in profitability as a result of new ownership.

3\1\5 Interest on Debt

Interest on debt is an expense for the Province, and the only provincial expense that would be affected directly by the sale of Hydro One. The FAO has assumed that the cash received from the sale of Hydro One shares and other inflows (Appendix 4.5.2) would effectively reduce the Province's need to borrow, and therefore result in lower interest payments.⁴⁵ In addition, Hydro One has decided to increase the dividend payout ratio paid by Hydro One,⁴⁶ which increases the amount of cash received by the Province and reduces interest expenses. The FAO estimates the Province would realize annual interest savings of \$0.2–\$0.4 billion after 60 per cent of ownership is sold.⁴⁷

3\1\6 Areas of Uncertainty

There are two key areas of uncertainty associated with the financial impact of the partial sale of Hydro One: what the budget assumed as the financial impact of Hydro One and the timing of the sales subsequent to the initial 15 per cent in 2015–16.

41 Since Hydro One is consolidated in the Province's public accounts, the net income of Hydro One is reported on the Province's Consolidated Statement of Operations as Income from Government Business Enterprises (GBEs) rather than dividends.

42 PS 3070.08A, CPA Canada Public Sector Accounting Handbook, Public Sector Accounting Standards, 2015 Edition

43 The FAO estimates an initial annual reduction of approximately \$100 million in income, but has adjusted for the impact of the mid-year sale.

44 The FAO has assumed a 4 per cent annual growth rate in Hydro One's net income, which is largely based on the historical financial performance of Hydro One.

45 The FAO assumes that cash credited to the Trillium Trust offsets previously planned borrowing to finance existing infrastructure plans. In practice, the Province may not reduce borrowing, but rather invest the cash proceeds on a short-term basis, with roughly similar impact on the Province's budget balance.

46 Hydro One's amended and restated preliminary base PREP prospectus, p. 15.

47 Section 4.5 of the Appendix provides more details and calculations. The FAO has assumed an effective interest rate on debt of 3.5 per cent.

Budget assumptions on financial impact

As noted in Section 1.1, the Province has not publicly stated how it expects the partial sale of Hydro One to impact its fiscal (surplus/deficit) position. The Province did provide in the 2015 Budget an overall estimate of the fiscal impact of all asset optimization activities, including Hydro One. However, the government has determined that the specific estimates of the fiscal impact of the sale that are included in its budget projections are a Cabinet record and has chosen not to release this information. Due to this limitation, the FAO can only provide an estimate of the impact of the partial sale compared to the status quo (i.e. no sale) rather than compared to the fiscal plan presented in the 2015 Budget.

Timing

The FAO estimate of financial impact presented in this chapter assumes, for illustrative purposes only, that the government sells 15 per cent of Hydro One each year from 2015–16 to 2018–19. The estimate would change to the extent the timing of subsequent sales differs from the FAO assumption. The government has not announced the timing of the subsequent sales incorporated in the fiscal plan presented in the 2015 Budget. Without knowing the government’s assumed schedule for sales beyond the initial 15 per cent committed for 2015–16, the FAO is unable to provide more definitive estimates for the impact of the sale on specific years, and the impact to the government’s commitment to balance the budget in 2017–18. As noted above, the Province has determined that the specific estimates of the fiscal impact of the sale that are included in its budget projections are a Cabinet record and has chosen not to release this information.

3\1\7 Questions for the Province

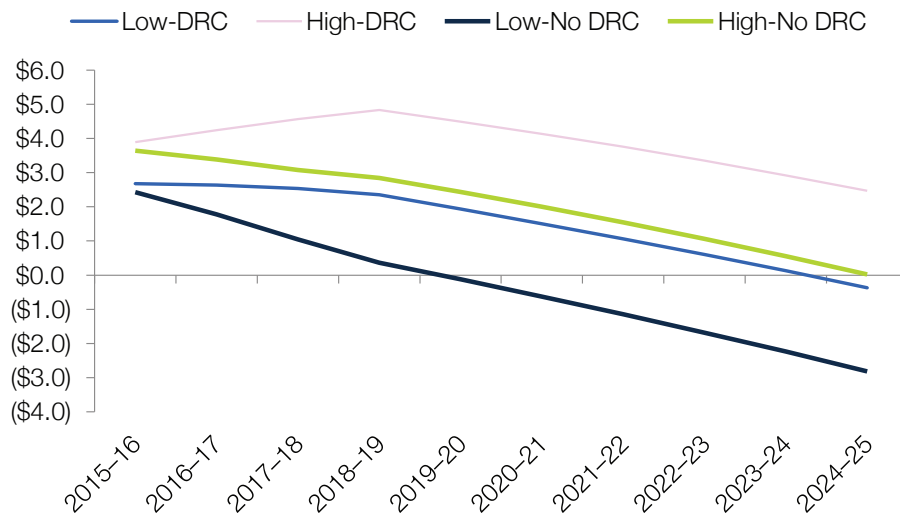
On the basis of the analysis presented here, legislators may wish to ask a number of questions about the proposed partial sale of Hydro One to better understand the economic and financial implications of the transaction.

Issue and Importance	Question
<p>The single most important unknown in the proposed transaction is the timing of sales after the initial 15 per cent sale in 2015–16. Timing would affect the Province’s budget balance (surplus/deficit), including possibly whether a balanced budget is achieved in 2017–18.</p>	<p>When does the Province plan future sales of Hydro One shares beyond the initial 15 per cent committed in 2015–16?</p>
<p>The Province has not announced how it expects the partial sale of Hydro One to impact the provincial budget balance. Relative to not selling Hydro One, FAO analysis suggests that the transaction would improve the Province’s budget balance with the initial 15 per cent sale, but it is unclear how the transaction would affect the budget balance in later years in which sales occur. Once 60% per cent of Hydro One has been sold, the FAO projects the Province would realize a permanent deterioration in budget balance as a result of the transaction.</p>	<p>What is the Province’s estimate of the fiscal impact of the sale of 60 per cent of Hydro One specifically over the next 10 years in terms of annual deficit/surpluses and net debt?</p>

3\2 Impacts on the Province's Net Debt

Assuming that the Province sells 15 per cent of Hydro One each year from 2015–16 to 2018–19, Ontario's net debt⁴⁸ would be reduced by the cash (gross) proceeds and Hydro One's tax gain, less the reduction in Ontario's ownership of Hydro One (an asset for the Province) (Figure 3-2). However, net debt would eventually increase as the costs of forgone revenues from Hydro One begin to exceed the initial benefits of the tax gain and net sale proceeds.

FIGURE 3-2: Cumulative Reduction in Provincial Net Debt from the Partial Sale of Hydro One, \$ Billions, 2015–16 to 2024–25



Source: FAO estimates

Note: Assumes the government sells 15 per cent of Hydro One each year from 2015–16 to 2018–19. Numbers may not add up due to rounding. Negative figures indicate an increase in net debt.

3\2\1 Assets

Hydro One is an asset on the Province's balance sheet valued⁴⁹ at \$8.3 billion in the second quarter of 2015.⁵⁰ Prior to the sale, Hydro One's equity would increase by \$2.6 billion due to the new investment from the Province. However, the departure tax payment would reduce the company's equity by \$2.6 billion. Also, the company divested Hydro One Brampton for \$0.5 billion and is returning \$0.8 billion in cash to the Province. The net effect is a decrease in Hydro One's asset value on the Province's balance sheet to \$7 billion.

⁴⁸ Net debt is defined as the Province's liabilities less its financial assets.

⁴⁹ This value is determined by accounting standards and is estimated on a different basis than market value.

⁵⁰ Hydro One's Q2 Consolidated Financial Statements. Total equity includes preferred shares.

After the sale, the gain on the deferred tax asset would increase the company's value, which is dependent on the FMV of assets. As the Province's stake in Hydro One is sold, the recorded value of this asset would be reduced proportionally.

Overall, the FAO estimates that the 15 per cent sale of Hydro One would result in a decrease of \$0.1 billion to an increase of \$0.6 billion in investment in government business enterprises, depending on the value of the tax gain (Section 4.5.2).⁵¹

3\2\2 Liabilities

The Province's debt is presented on its balance sheet in two segments: OEFC Debt and Debt Issued for Provincial Purposes. According to the Province's Public Accounts,

*this accounting reflects the legislative structure put in place to ensure OEFC's revenues are derived from the electricity sector ratepayer and not the taxpayer, and that these revenues can be used only to service and retire OEFC debt.*⁵²

While both OEFC debt and provincial purposes debt are combined in Ontario's consolidated debt, the allocation of the proceeds to each segment of the debt has different implications.

The allocation of the proceeds from the partial sale of Hydro One is governed by two laws:

- + The *Electricity Act, 1998* requires that a portion of the proceeds pay down the OEFC debt⁵³ (Section 2.2); and
- + The *Trillium Trust Act, 2014* requires that the net proceeds be credited to the Trillium Trust.

3\3 Trillium Trust

As noted in Section 1.1, the Trillium Trust is a dedicated revenue account of the Province created to finance infrastructure. The Province has committed to credit the net proceeds (gain on sale of investment) of the partial sale of Hydro One to the Trillium Trust. Section 3.1.2 estimated the net proceeds to be \$1.4–\$3.1 billion for the full 60 per cent sale of Hydro One. In addition, the Province has committed to credit the gain from the deferred tax asset to the Trillium Trust,⁵⁴ estimated by the FAO to be \$1.9–\$2.7 billion. As such the FAO estimates the total amount to be credited to the Trillium Trust as a result of the partial sale of Hydro One to be \$3.3–\$5.8 billion.

51 Section 4.5 of the Appendix provides more details and calculations.

52 2000–2001 Annual Report and Financial Statements, Province of Ontario

53 The OEFC is the legal continuation of Ontario Hydro (Section 54(1), *Electricity Act, 1998*), holding \$38.1 billion in liabilities in 1999 (Appendix 4.1). The difference between the assets and liabilities on the balance sheet of the OEFC is known as the unfunded liability. At March 31, 2014, the Province estimated the unfunded liability to be \$9.8 billion (2014 Ontario Economic Outlook and Fiscal Review, Government of Ontario, 2014).

54 Ontario Newsroom: Asset Optimization – Broadening Ownership of Hydro One

4\ Appendix

4\1 Overview of Ontario Hydro Restructuring

This section provides a brief and relevant overview of the historical background to the partial sale of Hydro One.

The 1997 White Paper “Direction for Change: Charting a Course for Competitive Electricity and Jobs in Ontario”, along with its enabling legislation, the *Energy Competition Act, 1998*, set out the Province’s plan to restructure Ontario’s electricity industry. The plan called for the restructuring of Ontario Hydro and the elimination of its longstanding monopoly on electricity production with the introduction of competition to Ontario’s electricity sector. The belief underlying the plan was that a competitive market environment is the key to restoring the financial soundness and viability of Ontario’s electricity sector. Subsequently, the Province broke up Ontario Hydro into five successor companies.⁵⁵ Hydro One inherited Ontario Hydro’s transmission and distribution assets in 1999.

The restructuring of Ontario Hydro was intended to ensure that⁵⁶:

- + Electricity prices are kept as low as possible
- + The successor companies are provided with a solid financial footing and investment-grade capital structures
- + Maximum value is retained within the electricity sector until Ontario Hydro’s debt is retired
- + Any residual stranded debt is recovered from the electricity sector, without recourse to Ontario’s taxpayers
- + The new financial structure was announced on April 1, 1999, when Ontario Hydro ceased operations and its assets and liabilities were transferred to five successor corporations together with their subsidiaries.

As the legal continuation of Ontario Hydro, the Ontario Electricity Financial Corporation (OEFC) became responsible for ensuring the prudent and efficient management of \$38.1 billion (as of April 1, 1999) in debt, derivatives and other liabilities of the former Ontario Hydro.

Two commercial companies, Hydro One Inc. (HOI), formerly the Ontario Hydro Services Company Inc., and Ontario Power Generation Inc. (OPG), together with their subsidiaries, received the majority of Ontario Hydro’s assets and in return issued a total of \$17.1 billion of debt to the OEFC.

⁵⁵ Annual Report, April 1, 1999, to March 31, 2000, of the Ontario Electricity Financial Corporation (OEFC), http://www.oefc.on.ca/pdf/oefcar_e.pdf

⁵⁶ *ibid*

To achieve commercially viable capital structures, HOI and OPG entered into debt-for-equity swaps with the Province of Ontario. In exchange for \$3.8 billion of equity in HOI and \$5.1 billion of equity in OPG, the Province of Ontario assumed \$8.9 billion of the debt issued to the OEFC by the successor corporations. The Province is the sole shareholder of the two commercial companies.⁵⁷

In March of 2002, the Province filed a preliminary prospectus for an initial public offering of its common shares; however, it did not proceed with the sale.

In 2015, the Premier's Advisory Council on Government Assets (the council) recommended that the Province sell up to 60 per cent of Hydro One, with an initial sale of 15 per cent.⁵⁸ The council estimated the value of Hydro One at \$13.5–\$15 billion.⁵⁹ The 2015 Budget confirmed the Province's intention to proceed with these recommendations. In October 2015, Hydro One's prospectus implied an estimated value of the company at \$11.3–\$12.5 billion.⁶⁰

2015 Ontario Budget Announcement

"The Council has now finalized its analysis on maximizing value for Ontarians and providing enhanced protection to ratepayers, and is recommending that the Province move forward with an IPO of approximately 15 per cent of the common shares in Hydro One, with additional shares being made available in subsequent years, over time totaling up to 60 per cent of the Province's common shares in Hydro One. By law, the Province would retain 40 per cent of its initial common shares in Hydro One, following the IPO and subsequent share offerings...

As part of an effort to strengthen long-term performance and unlock the benefit for all Ontarians, the government accepts the Council's recommendation and intends to broaden ownership in Hydro One. Accordingly, the Province is planning to launch an IPO for approximately 15 per cent of Hydro One common shares in fiscal 2015–16."

Source: 2015 Ontario Budget (pp. 78-79)

57 Taken from Annual Report, April 1, 1999 to March 31, 2000, of the Ontario Electricity Financial Corporation (OEFC), http://www.oefc.on.ca/pdf/oefcar_e.pdf

58 Striking the Right Balance: Improving Performance and Unlocking Value in the Electricity Sector in Ontario, Premier's Advisory Council on Government Assets, 2015 (p. 4)

59 Striking the Right Balance: Improving Performance and Unlocking Value in the Electricity Sector in Ontario, Premier's Advisory Council on Government Assets, p. 23. This estimate excludes the value of Hydro One Brampton Networks Inc. and represents the fully distributed equity value of Hydro One, which is the value assessed if shares are already publicly traded. The council also recommended proceeding with a sale or merger of Hydro One Brampton, with an estimated value of about \$600 million.

60 Hydro One's amended and restated preliminary base PREP prospectus, p. 15, October 9, 2015. The FAO has estimated the \$11.3–\$12.5 billion value using the anticipated share price of \$19–\$21 multiplied by the number of shares of 595 million. This figure is based on a pricing range for marketing purposes that is not on the same basis as the fully distributed equity value. For example, this figure excludes the \$800 million special dividend issued to the Province that would be a part of the Council's original estimate. Note that Hydro One has the option to sell 15 per cent of the company through exercising the over-allotment option as defined in the prospectus.

4\2 Fair Market Value

This section discusses in more detail the FAO estimate of fair market value of Hydro One.

4\2\1 Fair Market Value of Equity

The fair market value (FMV) of Hydro One's equity⁶¹ is a critical variable in determining the cash (gross proceeds) that the Province would receive for the partial sale of the company. The FAO compared the FMV of equity of publicly traded companies that have similar operations to Hydro One to estimate a range of FMV of equity of Hydro One. This approach is known as a comparable trading multiples approach, and is the standard approach in market valuation.

Comparable Trading Multiples

The first step in trading multiple valuation is to select a group of comparable companies. The primary selection criterion was to identify companies that operate regulated electricity transmission and distribution assets. Companies with significant exposure to other business lines, which include power generation, were excluded. The secondary selection criterion was to identify companies that operate primarily in Canada, given the unique investment risks specific to the region, which may impact share prices and valuation. Emera Inc. and Fortis Inc. met both selection criteria. However, these companies failed to meet a tertiary selection criterion, in that both companies demonstrated a consistent history of purchasing other companies, which increases measures of growth and may increase the FMV. Note that while Hydro One has recently made some smaller corporate acquisitions, the company has not purchased assets that were material in size. To account for similar growth rates, two companies from the United States were included, Eversource and FirstEnergy, because each company has demonstrated a growth rate that is similar to Hydro One's growth rate. Each company also operates regulated electricity transmission and distribution assets, although investment risks may not necessarily represent the unique investment risks of a Canadian company. As a whole, the four comparable companies may be considered a balanced representation of the factors that would impact the FMV of Hydro One.

The next step in the valuation approach is to calculate the trading multiple, in which the FMV of a company is divided by a measure of its financial performance such as earnings. The FAO calculated three different trading multiples for each of the four companies (Table 4-1). The FAO then multiplied the average of each trading multiple (calculated from the comparators) to the related measure of financial performance for Hydro One to estimate the company's FMV. Using this approach the FMV of Hydro One is \$11–\$14.3 billion (Table 4-2). Note that trading multiple valuations are currently above the historical average (Table 4-3). The FAO estimate of the FMV of Hydro One excludes the value of Hydro One Brampton⁶².

⁶¹ Equity represents the amount of money paid by owners to purchase ownership in the company.

⁶² The net income, earnings before interest, taxes, depreciation and amortization (EBITDA) and book value of equity of Hydro One Brampton have been excluded from the financial items of Hydro One that were multiplied to the comparable trading multiples. The financial measures for Hydro One Brampton have been obtained from Hydro One's prospectus, and are estimated to be \$12 million in annual net income, \$44 million in annual EBITDA and \$450 million for the book value of equity.

TABLE 4-1: Trading Multiples of Publicly Traded Peers

Fair Market Value of Equity	Peer	Canada		United States	
Comparable Trading Multiples	Average	Emera	Fortis	Eversource	FirstEnergy
	\$ Millions				
Market Capitalization	11,548	6,371	10,588	16,081	13,150
Net Debt	11,506	3,536	10,881	8,932	22,676
Total Enterprise Value	23,054	9,907	21,469	25,013	35,826
Book Value of Equity	9,116	4,000	9,747	10,185	12,531
EBITDA	2,074	891	2,066	2,436	2,903
Net Income	624	401	666	993	436
	Ratios				
Price to Book Value of Equity (PB)	1.3	1.6	1.1	1.6	1.0
Total Enterprise Value to EBITDA (TEV/EBITDA)	11.0	11.1	10.4	10.3	12.3
Price to Earnings (PE)	19.5	15.9	15.9	16.2	30.2

Source: Company reports, Yahoo! Finance Canada, FAO estimates

Note: Numbers may not add up due to rounding. The financial figures of Eversource and FirstEnergy are presented in US dollars. Share prices last updated on October 6, 2015. Financials represent trailing 12-month figures.

TABLE 4-2: Estimated Fair Market Value of Hydro One using Comparable Trading Multiples, \$ Millions

Hydro One Fair Market Value	Price	TEV	Price
Comparable Trading Multiples	Book	EBITDA	Earnings
Average Peer Multiple	1.3	11.0	19.5
Multiplied by: Hydro One's Financial Item	9,398 ¹	1,957 ²	733 ³
Total Value Before Debt Adjustments	12,470	21,586	14,321
Less: Value of Net Debt	0	(10,555)	0
Estimated FMV of Hydro One	12,470	11,030	14,321

1: Book value of equity

2: Earnings before interest, taxes, depreciation and amortization

3: Net income

Source: Company reports, Yahoo! Finance Canada, FAO estimates

Note: Numbers in parentheses are negative. Numbers may not add up due to rounding and are in Canadian dollars unless otherwise stated.

TABLE 4-3: Historical Trading Multiples of Comparable Firms

Historical Fair Market Value	2010	2011	2012	2013	2014	Average	Today
Price to Book							
Emera	1.4	1.8	1.7	1.4	1.3	1.5	1.6
Fortis	1.0	1.1	1.0	1.0	0.8	1.0	1.1
Eversource	1.1	1.3	1.0	1.3	1.4	1.2	1.6
FirstEnergy	1.1	1.0	1.3	1.2	1.1	1.1	1.0
Average	1.2	1.3	1.2	1.2	1.2	1.2	1.3
TEV / EBITDA							
Emera	10	12	11	11	9	11	11
Fortis	9	9	9	9	10	9	10
Eversource	8	9	11	10	10	10	10
FirstEnergy	7	10	9	10	15	10	12
Average	8	10	10	10	11	10	11
Price to Earnings							
Emera	13	13	16	17	11	14	16
Fortis	13	14	15	15	19	15	16
Eversource	11	13	18	16	17	15	18
FirstEnergy	12	16	21	38	46	27	30
Average	12	14	18	21	23	18	20

Source: Company reports, Yahoo! Finance Canada, FAO estimates

Note: Numbers may not add up due to rounding.

Discounted Cash Flow

Another approach to estimate the FMV of equity is known as a discounted cash flow (DCF) approach. Given that the focus of the report is to estimate the immediate financial impact of the proposed divestiture, the focus for the range in valuation estimates is to use the comparable trading multiple approach. This approach is more commonly used by investors and provides a more appropriate method to estimate the amount of gross proceeds to be received by the Province.⁶³

4\2\2 Fair Market Value of Depreciable Assets

Upon the sale of at least 10 per cent of Hydro One, the company must reassess the fair market value (FMV) of its depreciable assets for tax purposes, which impacts the amount of the taxes paid by the company. However, Hydro One has not yet disclosed the FMV of its depreciable assets.

The FMV of Hydro One's depreciable assets must be estimated to determine the company's tax payments after the sale. To estimate the depreciable assets, the FAO uses the fact that the sum of a company's equity and liabilities must equal its assets.

63 Valuing and pricing IPOs, Peter Roosenboom, 2012; Information Content of Equity Analyst Reports, Paul Asquith, Michael B. Mikhail, Andrea S. Au, 2003

Table 4-4 adds the estimated FMV of Hydro One (i.e. its equity) to the company's FMV of debt and book value (BV) of other liabilities to arrive at the FMV of total equity and liabilities, which is equal to the FMV of total assets post-sale.

The FAO also assumes that the entire appreciation in the value of Hydro One's total assets is attributed to its depreciable assets, which the FAO assumes to be equal to the value of property, plant and equipment. Therefore, the FMV of Hydro One's depreciable assets is the FMV of its total assets less the book value⁶⁴ of its non-depreciable assets.

TABLE 4-4: Fair Market Value of Depreciable Assets Estimate, \$ Millions

	Low	High
FMV Equity	11,030	14,321
FMV Debt	10,695	10,695
BV Other Liabilities	5,620	5,620
Total Liabilities and Equity	27,345	30,636
FMV of Total Assets	27,345	30,636
BV of Other Assets	(6,679)	(6,679)
FMV of PPE	20,666	23,957

Source: Company reports, FAO estimates

4\3 Taxes

4\3\1 Departure Tax

The departure tax⁶⁵ is revenue for the Province. Based on the federal *Income Tax Act* and the *Electricity Act, 1998*, Hydro One is subject to the departure tax as a one-time payment under the PILs system.⁶⁶ When Hydro One is sold, it must re-value its assets for tax purposes.⁶⁷ The departure tax is applied if the value of the company's assets after the sale is estimated to be higher than the value the company currently records for tax purposes.

Under a regulation of the *Electricity Act*,⁶⁸ the Minister of Finance may consent to an amount of departure tax a company would pay, based on a reasonable approximation. The company's prospectus disclosed that the Minister of Finance consented to a departure tax of \$2.6 billion.

While this amount is revenue to the Province as a PIL, the company faces an equivalent reduction in its net income. Since both PILs and Hydro One's net income are revenues to the Province, these two impacts offset one another.

⁶⁴ Hydro One's second quarter 2015 management, discussion and analysis.

⁶⁵ The term "departure tax" is unofficial, but is in common use among those dealing with PILs and Hydro One. The tax consists of the CT/PILs treatment of changes in the value of depreciable and eligible capital property assets.

⁶⁶ Section 16.1 of Ontario Regulation 207/99 and 149(10) of the *Income Tax Act*

⁶⁷ Section 149 (10) of the *Income Tax Act*

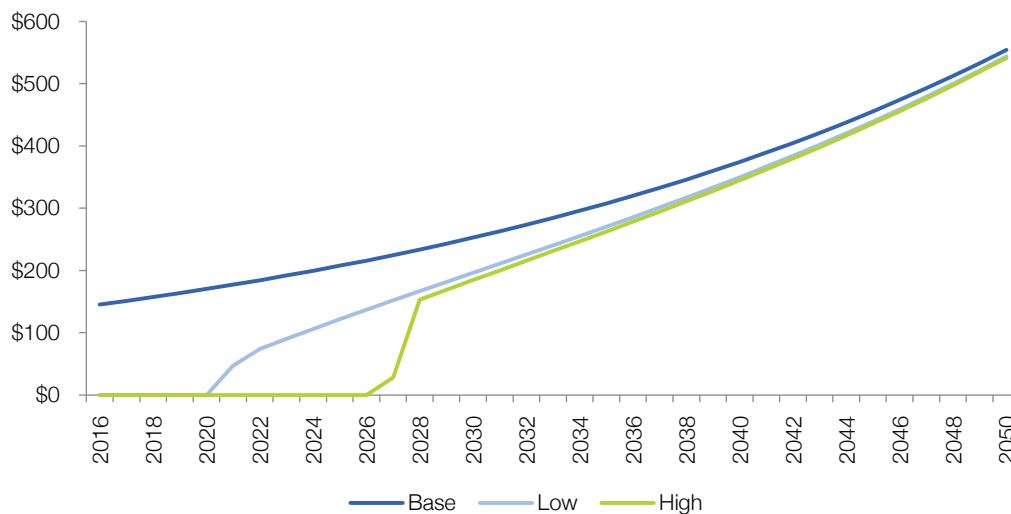
⁶⁸ Section 16.1 of Ontario Regulation 207/99

4\3\2 Corporations Tax

Corporations tax (CT) is revenue for the Province. Hydro One is currently exempt from paying corporations tax because it is wholly owned by the Province.⁶⁹ However, once the Province sells 15 per cent of Hydro One, the company would be subject to federal and provincial CT,⁷⁰ which would increase provincial CT revenues.

However, when Hydro One becomes a taxable company under the federal *Income Tax Act*, it would be considered a new company for tax purposes. The FMV of its depreciable assets, which the FAO assumes to be the value of property, plant and equipment, is estimated to increase to \$20.7–\$24 billion (Section 4.2.2). These assets are eligible for capital cost allowance, which reduces income for tax purposes and, in turn, reduces the corporations tax that the company must pay. Given the large size of the FMV of Hydro One’s depreciable assets, the FAO estimates that Hydro One would not be required to pay corporations tax until between 2020 and 2026, depending on its valuation (Figure 4-1).

FIGURE 4-1: Estimated Total Corporate Taxes and PILs Paid by Hydro One, \$ Millions



Source: FAO estimates.

Note: The Base line represents the FAO’s estimate of Hydro One’s future PILs payments if the company was not sold by the Province. The Low and High lines represent the FAO’s estimates of Hydro One’s future corporate tax payments if the company was sold by the Province for the low valuation and high valuation scenarios, respectively.

69 Section 149 (10) of the *Income Tax Act*. Hydro One is also subject to payments-in-lieu of additional municipal and school taxes. Section 92 (1) of the *Electricity Act, 1998* requires that Hydro One continue to pay these municipal PILs after divestiture.

70 Section 149 of the *Income Tax Act* states that a corporation is exempt when the Crown owns 90 per cent or more of its shares. Hydro One may also be subject to Ontario’s corporate minimum tax.

Assuming the OEB does not require Hydro One to pass on savings to consumers, the sum of the anticipated tax savings generated by the IPO would be recorded on Hydro One's balance sheet as a deferred income tax asset, which is reduced over time as the taxes are paid. The company's prospectus reports \$1.2 billion in deferred income tax assets, which is subject to change depending on the value of Hydro One after the IPO.⁷¹ Given the FAO's estimate of the FMV of Hydro One, the FAO estimates the deferred income tax assets to be \$1–\$1.8 billion under the low and high valuation scenarios respectively. The deferred income tax assets are combined with the reversal of the deferred income tax liability (due to the exit of the company from the PIL system) to generate a one-time increase in the company's equity of between \$2.2–\$3.2 billion.

Impact of Tax Effects on Valuation

The impact of Hydro One's deferred tax asset on the company's market value is unclear. The reduced future corporate income tax payments would create additional cash flow and increase the market value under a discounted cash flow valuation approach. In the past, regulated revenues have been both adjusted and unadjusted by the Ontario Energy Board (OEB) for changes in tax payable from changes in tax treatments.* It is unclear how the board would react to the impact of the departure tax and reduced corporate tax from the Hydro One divestiture.

*Source: 2006 Electricity Distribution Rate Handbook, Ontario Energy Board; Ontario Energy Board Submission EB-2009-0408, Great Lakes Power Transmission Inc., 2009

This one-time increase in equity on the company's balance sheet would be recorded as income, which would in turn increase the Province's revenue from the net income of Hydro One by \$1.9-\$2.7 billion (Section 3.1.4).

4\4 Debt Retirement Charge

4\4\1 OEFC Stranded Debt and Residual Stranded Debt

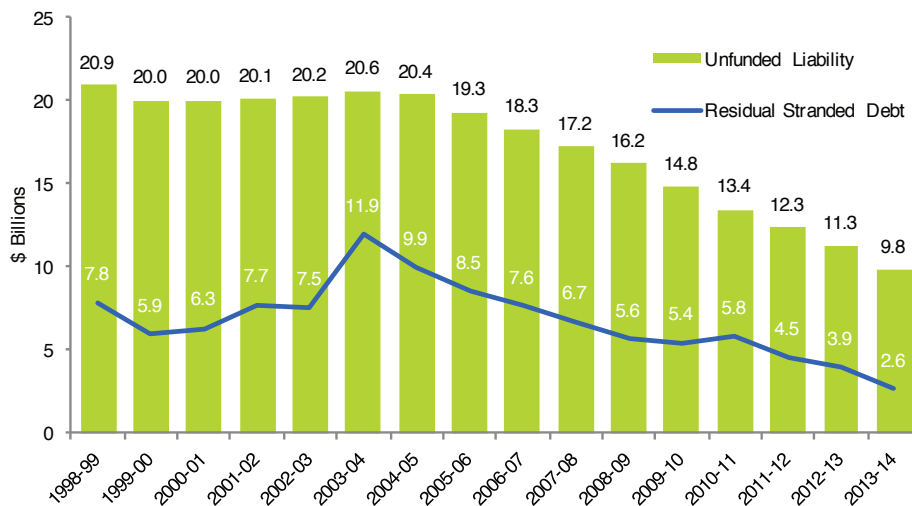
The Ontario Electricity Financial Corporation (OEFC) is the legal continuation of Ontario Hydro,⁷² holding \$38.1 billion in liabilities in 1999. The OEFC transferred the majority of its assets to four other Ontario Hydro successor companies in return for \$17.2 billion in debt issued to OEFC (representing an asset) from those companies. The Province assumed \$3.8 billion of Hydro One's debt owed to OEFC in return for full equity in Hydro One. The difference between the total liabilities of OEFC and the financial notes owed to it by the Province and the successor companies is the initial unfunded liability of OEFC, valued at \$20.9 billion in 1999.

⁷¹ This value is based on the pro forma financial statements provided for illustrative purposes only, based on a valuation of assets assumed to have occurred on January 1, 2014.

⁷² Section 54(1), *Electricity Act, 1998*

The Province dedicated revenues to pay OEFC, consisting of payments-in-lieu of taxes, the cumulative net income from OPG and Hydro One in excess of the interest cost of Province's original investment in these companies, and the debt retirement charge.⁷³ In 2013–14, the net present value of these projected future dedicated income streams was estimated by the Province to be \$7.2 billion.⁷⁴

FIGURE 4-2: OEFC Residual Stranded Debt



Source: 2014 Economic Outlook and Fiscal Review, FAO

Estimated to be \$2.6 billion at March 31, 2014, the RSD is the difference between the unfunded liability and the net present value of OEFC's dedicated income streams (Figure 4-2). The government is able to levy the DRC until the Minister of Finance deems the RSD is retired.⁷⁵ In the 2014 Fall Economic Statement, and repeated in the 2015 Budget, the Province estimated that the RSD would be retired and the DRC eliminated by the end of 2018. The DRC would raise approximately \$600 million annually beginning in 2016–17, after taking into account the elimination of the residential portion after 2015.

73 The 2014 Budget announced that the DRC will be eliminated for residential users after December 31, 2015. The residential portion of the DRC is estimated to be one-third of total DRC revenues, which was reported as \$948 million in 2014–15.

74 Future income streams included in this projection excludes the debt retirement charge.

75 Section 85 of the *Electricity Act, 1998*.

4\4\2 Proceeds to be Paid to OEFC

The *Electricity Act, 1998*⁷⁶ requires that all proceeds from the Hydro One divestiture be paid to OEFC less certain deductions:

1. Any amount that the Minister considers advisable in connection with the acquisition of the securities, debt obligations or interest, including the amount of the purchase price; any obligations assumed and any other costs incurred by the Crown
2. Any amounts which have been allocated by the Crown to the Financial Corporation (i.e. OEFC) in respect of the securities⁷⁷
3. The amount of any costs incurred by the Crown in disposing of the securities, debt obligation or interest⁷⁸

Table 4-5 estimates the amount of deductions from the gross sale proceeds that are to be allocated to the OEFC. The total amount associated with the acquisition of Hydro One includes (1) the original purchase of \$3,759 million, which is recorded on OEFC's balance sheet as *Notes and Loans Receivable* and the new investment of \$2,600 million announced in Hydro One's prospectus.⁷⁹

The total amounts allocated to the OEFC (2) are the cumulative net income of Hydro One (less the Province's interest costs of acquiring Hydro One), which is dedicated to the OEFC. OEFC's balance sheet contains an asset, *Due from Province of Ontario*, which reflects the cumulative net incomes of both Ontario Power Generation (OPG) and Hydro One, less interest. Since the cumulative net income of OPG (after deducting interest costs of investment), is negative from 2000–2014, the FAO attributes the entire asset to Hydro One, which is equal to \$4,903 million. The FAO also takes into account Hydro One's estimated year-to-date net income, which includes the impacts of the tax gain and departure tax.

When the Province sells the initial 15 per cent in 2015–16, a similar portion of these amounts are deducted from the payment that the Province is required to make to OEFC. The subtotal of the proportional amounts of these deductions is \$1,677–\$1,785 million. Finally, the transaction costs (3) associated with the sale have been reported to be approximately \$65 million,⁸⁰ which all combine to total deductions of \$1,742–\$1,850 million.

⁷⁶ Section 50.3 of the *Electricity Act, 1998*.

⁷⁷ The Ministry of Finance indicated that these amounts represent the cumulative net income from Hydro One (less interest costs).

⁷⁸ The Ministry of Energy has noted that these costs are estimated to be approximately \$60 million

⁷⁹ Hydro One's amended and restated preliminary base PREP prospectus, p. 102

⁸⁰ Official Report of Debates (Hansard), Standing Committee on Estimates, September 29, 2015, p. E-420

TABLE 4-5: Estimated Deductions from Gross Sale Proceeds to the OEFC, \$ Millions

Proceed Deductions	Low	High
Notes Receivable reported by OEFC	3,759	3,759
New Investment in Hydro One	2,600	2,600
(1) Total Amount Associated with Acquisition of Hydro One	6,359	6,359
Due from Province	4,903	4,903
Hydro One Portion	100%	100%
Hydro 2014	4,903	4,903
Hydro Tax Gain	2,133	2,853
Hydro Departure Tax	(2,600)	(2,600)
Hydro Net Income to Nov, 2015	382	382
(2) Total Amounts Allocated to OEFC	4,818	5,538
Sub-Total of (1) and (2)	11,177	11,897
Portion Sold	15%	15%
Sub-Total of (1) and (2) Proportional to the Sale	1,677	1,785
(3) Transaction Cost	65	65
Total Deductions	1,742	1,850

Source: FAO estimates

4\3 Impact on Residual Stranded Debt

RSD is the unfunded liability less the net present value of OEFC's dedicated income streams. Table 4-6 estimates the amount of foregone future dedicated income, which includes Hydro One's net income and PILs, as a result of the 15 per cent sale. Hydro One's forecasted net income for 2015 is \$727 million (\$509 million net of interest costs of investment), is grown and discounted to its present value of \$3,917 million.⁸¹ The FAO estimates that a 15 per cent sale of ownership would result in approximately \$588 million in foregone revenues to the OEFC.

Similarly, Hydro One's PIL payment of \$106 million in 2015, which is fully lost upon the sale,⁸² is grown and discounted to arrive at a present value of \$816 million. The NPV of Hydro One's net income and PIL dedicated to the OEFC combine to \$1,404 million, which would be forgone due to the sale, and by itself, increase the estimated RSD.

81 The FAO has applied a discount rate that is consistent with the OEFC's historical financial statements. The FAO estimates the implicit discount rate of 13 per cent by dividing OEFC's reported electricity sector income and PILs by the OEFC's reported net present value of this future income and PILs, averaged from 2010 to 2014.

82 The Province's revenues from Hydro One's corporations tax after the sale is not dedicated to OEFC.

TABLE 4-6: Estimated Foregone NPV of Income to OEFC, \$ Millions

Foregone NPV of Income	
Hydro Income	727
Less: Interest Cost	(218)
Hydro ESDI	509
Divided: Rate	13%
Lost Income	3,917
Portion Sold	15%
NPV of Foregone Hydro One Net Income	588
Hydro PILs	106
Divided: Rate	13%
NPV of Foregone PILs	816
NPV of Foregone Dedicated Income	1,404

Source: FAO estimates

The Province's 2014 Fall Economic Statement estimated the RSD to be \$2.6 billion as of March 31, 2014,⁸³ and estimated that the RSD would be retired by the end of 2018,⁸⁴ implying an average reduction of \$0.5 billion per year. Overall, the FAO estimates the current value of the RSD to be approximately \$1.7 billion (Table 4-7). However, the estimated amount of RSD is subject to uncertainty, which includes the forecast of the net present value of future income.

TABLE 4-7: Estimated Current Value of Residual Stranded Debt, \$ Millions

Residual Stranded Debt	
RSD 2013–14	2,600
RSD 2018–19	0
Difference	2,600
Years	4.75
Annual Reduction	547
Years: 2014 to Now	1.6
Reductions to Date	668
Beginning RSD	2,600
Deductions	(867)
RSD on Nov. 1, 2015	1,733

Source: FAO estimates, OEFC Annual Report

83 2014 Ontario Economic Outlook and Fiscal Review, Government of Ontario, 2014.

84 *ibid*

Table 4-8 estimates the impact to the residual stranded debt as a result of the sale of 15 per cent of Hydro One. The previously estimated deductions are applied towards the gross proceeds from the sale under both the low and high valuation scenarios. In addition, the \$2.6 billion departure tax payment and \$200 million in additional PILs⁸⁵ are allocated to the OEFC.⁸⁶ The estimated foregone NPV of future income is applied to increase the RSD. The overall impact is then compared to the current estimated value of the RSD.

If the estimated reductions are greater than the current value, the RSD is estimated to be eliminated. Overall, the FAO estimates that the RSD would be retained under both valuation scenarios. However, the estimates are subject to uncertainties, which include the NPV of future income calculation. As such, the FAO has presented financial impact scenarios that include and exclude the DRC revenues to the Province.

TABLE 4-8: Estimated Impact to the Residual Stranded Debt, \$ Millions

RSD Impact	Low	High
Gross Proceeds	(1,655)	(2,148)
Less: Deductions	1,742	1,850
Payment (as per <i>Electricity Act</i>)	87	(299)
Add: Departure Tax	(2,600)	(2,600)
Add: Additional PILs	(200)	(200)
Unfunded Liability	(2,713)	(3,099)
Less: NPV Income	1,404	1,404
RSD Impact	(1,309)	(1,695)
RSD Base Case	1,733	1,733
RSD Remaining after Partial Sale	424	38

Source: FAO estimates

Note: The departure tax has a fiscally neutral impact to the OEFC. While the departure tax is paid to the OEFC, Hydro One's net income would be reduced by a corresponding amount.

⁸⁵ Ontario Newsroom: Asset Optimization – Broadening Ownership of Hydro One

⁸⁶ The FAO has not assumed any allocation of potential proceeds from the sale of Hydro One Brampton to the OEFC.

4\5 Forecasted Financial Impact Tables

This section presents the FAO estimates of the impact of the 60 per cent sale of Hydro One on the financial position of the Province. Specifically, the impact on the Province's budgetary balance and net debt position for each of the four scenarios over the next 10 years.

4\5\1 Impact on the Province's Budget Balance

TABLE 4-9: Estimated Financial Impact to the Province's Budget Balance, DRC Retained, \$ Millions

Low Valuation	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Revenue										
Gain on Sale	605	262	266	270	0	0	0	0	0	0
Corporations Tax	9	0	(0)	0	(0)	0	19	30	36	42
Electricity PILS	137	(149)	(151)	(154)	(159)	(165)	(173)	(182)	(189)	(197)
Departure PIL	2,600	0	0	0	0	0	0	0	0	0
Debt Retirement Charge	0	0	0	0	0	0	0	0	0	0
Hydro Tax Gain	1,933	0	0	0	0	0	0	0	0	0
Hydro Departure Tax	(2,600)	0	0	0	0	0	0	0	0	0
Hydro One Income	(49)	(242)	(378)	(524)	(545)	(567)	(590)	(613)	(638)	(663)
Total Revenue Impact	2,635	(129)	(263)	(408)	(704)	(733)	(744)	(766)	(791)	(818)
Expenses										
Interest	(40)	(99)	(167)	(233)	(299)	(304)	(310)	(317)	(323)	(330)
Total Expense Impact	(40)	(99)	(167)	(233)	(299)	(304)	(310)	(317)	(323)	(330)
Surplus / Deficit	2,675	(30)	(96)	(175)	(406)	(428)	(434)	(449)	(468)	(487)

High Valuation	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Revenue										
Gain on Sale	1,098	639	653	667	0	0	0	0	0	0
Corporations Tax	9	0	(0)	0	(0)	0	0	0	0	0
Electricity PILS	137	(149)	(151)	(154)	(159)	(165)	(173)	(182)	(189)	(197)
Departure PIL	2,600	0	0	0	0	0	0	0	0	0
Debt Retirement Charge	0	0	0	0	0	0	0	0	0	0
Hydro Tax Gain	2,653	0	0	0	0	0	0	0	0	0
Hydro Departure Tax	(2,600)	0	0	0	0	0	0	0	0	0
Hydro One Income	(49)	(242)	(378)	(524)	(545)	(567)	(590)	(613)	(638)	(663)
Total Revenue Impact	3,849	247	124	(11)	(704)	(733)	(763)	(795)	(827)	(860)
Expenses										
Interest	(40)	(116)	(202)	(288)	(374)	(382)	(391)	(399)	(408)	(417)
Total Expense Impact	(40)	(116)	(202)	(288)	(374)	(382)	(391)	(399)	(408)	(417)
Surplus / Deficit	3,889	363	326	277	(331)	(351)	(372)	(396)	(419)	(444)

Source: FAO estimates

TABLE 4-10: Estimated Financial Impact to the Province's Budget Balance, DRC Foregone, \$ Millions

Low Valuation	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Revenue										
Gain on Sale	605	262	266	270	0	0	0	0	0	0
Corporations Tax	9	0	(0)	0	(0)	0	19	30	36	42
Electricity PILS	137	(149)	(151)	(154)	(159)	(165)	(173)	(182)	(189)	(197)
Departure PIL	2,600	0	0	0	0	0	0	0	0	0
Debt Retirement Charge	(250)	(600)	(600)	(450)	0	0	0	0	0	0
Hydro Tax Gain	1,933	0	0	0	0	0	0	0	0	0
Hydro Departure Tax	(2,600)	0	0	0	0	0	0	0	0	0
Hydro One Income	(49)	(242)	(378)	(524)	(545)	(567)	(590)	(613)	(638)	(663)
Total Revenue Impact	2,385	(729)	(863)	(858)	(704)	(733)	(744)	(766)	(791)	(818)
Expenses										
Interest	(40)	(90)	(137)	(181)	(229)	(232)	(236)	(239)	(243)	(248)
Total Expense Impact	(40)	(90)	(137)	(181)	(229)	(232)	(236)	(239)	(243)	(248)
Surplus / Deficit	2,425	(639)	(726)	(677)	(476)	(500)	(508)	(526)	(548)	(570)

High Valuation	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Revenue										
Gain on Sale	1,098	639	653	667	0	0	0	0	0	0
Corporations Tax	9	0	(0)	0	(0)	0	0	0	0	0
Electricity PILS	137	(149)	(151)	(154)	(159)	(165)	(173)	(182)	(189)	(197)
Departure PIL	2,600	0	0	0	0	0	0	0	0	0
Debt Retirement Charge	(250)	(600)	(600)	(450)	0	0	0	0	0	0
Hydro Tax Gain	2,653	0	0	0	0	0	0	0	0	0
Hydro Departure Tax	(2,600)	0	0	0	0	0	0	0	0	0
Hydro One Income	(49)	(242)	(378)	(524)	(545)	(567)	(590)	(613)	(638)	(663)
Total Revenue Impact	3,599	(353)	(476)	(461)	(704)	(733)	(763)	(795)	(827)	(860)
Expenses										
Interest	(40)	(107)	(172)	(236)	(304)	(310)	(316)	(322)	(328)	(334)
Total Expense Impact	(40)	(107)	(172)	(236)	(304)	(310)	(316)	(322)	(328)	(334)
Surplus / Deficit	3,639	(245)	(304)	(225)	(401)	(423)	(447)	(474)	(499)	(526)

Source: FAO estimates

4\5\2 Impact on the Province's Net Debt

TABLE 4-11: Estimated Financial Impact to the Province's Net Debt, DRC Retained, \$ Millions

Low Valuation	As At March 31									
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Liabilities										
OEFC Debt	(2,737)	149	151	154	159	165	173	182	189	197
Departure Tax	(2,600)	0	0	0	0	0	0	0	0	0
DRC	0	0	0	0	0	0	0	0	0	0
Additional PIL	(200)	0	0	0	0	0	0	0	0	0
Electricity PILs	63	149	151	154	159	165	173	182	189	197
Gross Proceeds less Deductions	0	0	0	0	0	0	0	0	0	0
Provincial Purpose	(86)	(2,092)	(2,055)	(2,015)	(325)	(332)	(357)	(375)	(389)	(403)
Special Dividend	(800)	0	0	0	0	0	0	0	0	0
New Investment	2,600	0	0	0	0	0	0	0	0	0
Gross Proceeds less OEFC Payments	(1,655)	(1,688)	(1,721)	(1,756)	0	0	0	0	0	0
Dividends - Ongoing	(10)	(25)	(25)	(26)	(27)	(28)	(28)	(28)	(29)	(31)
Dividends - Sale Impact	(163)	(280)	(142)	0	0	0	0	0	0	0
Interest Savings	(58)	(99)	(167)	(233)	(299)	(304)	(329)	(346)	(360)	(373)
Total Liabilities Impact	(2,823)	(1,943)	(1,905)	(1,861)	(166)	(167)	(184)	(193)	(200)	(207)
Assets										
Investment in GBE's	(147)	(1,973)	(2,000)	(2,036)	(572)	(595)	(617)	(642)	(667)	(694)
One-Time Impacts	1,124	0	0	0	0	0	0	0	0	0
Tax Asset	1,933	0	0	0	0	0	0	0	0	0
Departure Tax	(2,600)	0	0	0	0	0	0	0	0	0
New Investment	2,600	0	0	0	0	0	0	0	0	0
Recapitalization	(809)	0	0	0	0	0	0	0	0	0
Decrease from Sale	(1,067)	(1,463)	(1,471)	(1,485)	0	0	0	0	0	0
Sold Book Value	(1,050)	(1,425)	(1,455)	(1,485)	0	0	0	0	0	0
Impact to Retained Earnings	(17)	(38)	(16)	0	0	0	0	0	0	0
Ongoing Impacts	(204)	(510)	(530)	(550)	(572)	(595)	(617)	(642)	(667)	(694)
Net Income	(194)	(485)	(504)	(524)	(545)	(567)	(590)	(613)	(638)	(663)
Dividends	(10)	(25)	(25)	(26)	(27)	(28)	(28)	(28)	(29)	(31)
Net Debt	2,675	(30)	(96)	(175)	(406)	(428)	(434)	(449)	(468)	(487)
Cumulative	2,675	2,645	2,549	2,374	1,968	1,540	1,107	657	190	(297)

As At March 31										
High Valuation	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Liabilities										
OEFC Debt	(3,090)	(247)	(288)	(330)	159	165	173	182	189	197
Departure Tax	(2,600)	0	0	0	0	0	0	0	0	0
DRC	0	0	0	0	0	0	0	0	0	0
Additional PIL	(200)	0	0	0	0	0	0	0	0	0
Electricity PILs	63	149	151	154	159	165	173	182	189	197
Gross Proceeds less Deductions	(353)	(396)	(439)	(484)	0	0	0	0	0	0
Provincial Purpose	(227)	(2,217)	(2,165)	(2,110)	(400)	(410)	(420)	(430)	(440)	(450)
Special Dividend	(800)	0	0	0	0	0	0	0	0	0
New Investment	2,600	0	0	0	0	0	0	0	0	0
Gross Proceeds less OEFC Payments	(1,796)	(1,796)	(1,796)	(1,796)	0	0	0	0	0	0
Dividends - Ongoing	(10)	(25)	(25)	(26)	(27)	(28)	(29)	(31)	(32)	(33)
Dividends - Sale Impact	(163)	(280)	(142)	0	0	0	0	0	0	0
Interest Savings	(58)	(116)	(202)	(288)	(374)	(382)	(391)	(399)	(408)	(417)
Total Liabilities Impact	(3,316)	(2,463)	(2,454)	(2,439)	(241)	(244)	(247)	(248)	(250)	(253)
Assets										
Investment in GBE's	573	(2,100)	(2,127)	(2,163)	(572)	(595)	(619)	(644)	(670)	(697)
One-Time Impacts	1,844	0	0	0	0	0	0	0	0	0
Tax Asset	2,653	0	0	0	0	0	0	0	0	0
Departure Tax	(2,600)	0	0	0	0	0	0	0	0	0
New Investment	2,600	0	0	0	0	0	0	0	0	0
Recapitalization	(809)	0	0	0	0	0	0	0	0	0
Decrease from Sale	(1,067)	(1,590)	(1,598)	(1,612)	0	0	0	0	0	0
Sold Book Value	(1,050)	(1,552)	(1,582)	(1,612)	0	0	0	0	0	0
Impact to Retained Earnings	(17)	(38)	(16)	0	0	0	0	0	0	0
Ongoing Impacts	(204)	(510)	(530)	(550)	(572)	(595)	(619)	(644)	(670)	(697)
Net Income	(194)	(485)	(504)	(524)	(545)	(567)	(590)	(613)	(638)	(663)
Dividends	(10)	(25)	(25)	(26)	(27)	(28)	(29)	(31)	(32)	(33)
Net Debt	3,889	363	326	277	(331)	(351)	(372)	(396)	(419)	(444)
Cumulative	3,889	4,252	4,578	4,855	4,524	4,173	3,801	3,405	2,985	2,542

Source: FAO estimates

TABLE 4-12: Estimated Financial Impact to the Province's Net Debt, DRC Foregone, \$ Millions

Low Valuation	As At March 31									
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Liabilities										
OEFC Debt	(2,487)	749	751	604	159	165	173	182	189	197
Departure Tax	(2,600)	0	0	0	0	0	0	0	0	0
DRC	250	600	600	450	0	0	0	0	0	0
Additional PIL	(200)	0	0	0	0	0	0	0	0	0
Electricity PILs	63	149	151	154	159	165	173	182	189	197
Gross Proceeds less Deductions	0	0	0	0	0	0	0	0	0	0
Provincial Purpose	(86)	(2,083)	(2,025)	(1,963)	(256)	(260)	(282)	(297)	(309)	(321)
Special Dividend	(800)	0	0	0	0	0	0	0	0	0
New Investment	2,600	0	0	0	0	0	0	0	0	0
Gross Proceeds less OEFC Payments	(1,655)	(1,688)	(1,721)	(1,756)	0	0	0	0	0	0
Dividends - Ongoing	(10)	(25)	(25)	(26)	(27)	(28)	(28)	(28)	(29)	(31)
Dividends - Sale Impact	(163)	(280)	(142)	0	0	0	0	0	0	0
Interest Savings	(58)	(90)	(137)	(181)	(229)	(232)	(254)	(269)	(280)	(290)
Total Liabilities Impact	(2,573)	(1,334)	(1,275)	(1,359)	(96)	(95)	(109)	(115)	(120)	(124)
Assets										
Investment in GBE's	(147)	(1,973)	(2,000)	(2,036)	(572)	(595)	(617)	(642)	(667)	(694)
One-Time Impacts	1,124	0	0	0	0	0	0	0	0	0
Tax Asset	1,933	0	0	0	0	0	0	0	0	0
Departure Tax	(2,600)	0	0	0	0	0	0	0	0	0
New Investment	2,600	0	0	0	0	0	0	0	0	0
Recapitalization	(809)	0	0	0	0	0	0	0	0	0
Decrease from Sale	(1,067)	(1,463)	(1,471)	(1,485)	0	0	0	0	0	0
Sold Book Value	(1,050)	(1,425)	(1,455)	(1,485)	0	0	0	0	0	0
Impact to Retained Earnings	(17)	(38)	(16)	0	0	0	0	0	0	0
Ongoing Impacts	(204)	(510)	(530)	(550)	(572)	(595)	(617)	(642)	(667)	(694)
Net Income	(194)	(485)	(504)	(524)	(545)	(567)	(590)	(613)	(638)	(663)
Dividends	(10)	(25)	(25)	(26)	(27)	(28)	(28)	(28)	(29)	(31)
Net Debt	2,425	(639)	(726)	(677)	(476)	(500)	(508)	(526)	(548)	(570)
Cumulative	2,425	1,786	1,060	383	(92)	(592)	(1,101)	(1,627)	(2,175)	(2,745)

As At March 31										
High Valuation	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Liabilities										
OEFC Debt	(2,840)	353	312	120	159	165	173	182	189	197
Departure Tax	(2,600)	0	0	0	0	0	0	0	0	0
DRC	250	600	600	450	0	0	0	0	0	0
Additional PIL	(200)	0	0	0	0	0	0	0	0	0
Electricity PILs	63	149	151	154	159	165	173	182	189	197
Gross Proceeds less Deductions	(353)	(396)	(439)	(484)	0	0	0	0	0	0
Provincial Purpose	(227)	(2,208)	(2,135)	(2,058)	(331)	(338)	(345)	(353)	(360)	(367)
Special Dividend	(800)	0	0	0	0	0	0	0	0	0
New Investment	2,600	0	0	0	0	0	0	0	0	0
Gross Proceeds less OEFC Payments	(1,796)	(1,796)	(1,796)	(1,796)	0	0	0	0	0	0
Dividends - Ongoing	(10)	(25)	(25)	(26)	(27)	(28)	(29)	(31)	(32)	(33)
Dividends - Sale Impact	(163)	(280)	(142)	0	0	0	0	0	0	0
Interest Savings	(58)	(107)	(172)	(236)	(304)	(310)	(316)	(322)	(328)	(334)
Total Liabilities Impact	(3,066)	(1,855)	(1,824)	(1,937)	(171)	(172)	(172)	(171)	(170)	(170)
Assets										
Investment in GBE's	573	(2,100)	(2,127)	(2,163)	(572)	(595)	(619)	(644)	(670)	(697)
One-Time Impacts	1,844	0	0	0	0	0	0	0	0	0
Tax Asset	2,653	0	0	0	0	0	0	0	0	0
Departure Tax	(2,600)	0	0	0	0	0	0	0	0	0
New Investment	2,600	0	0	0	0	0	0	0	0	0
Recapitalization	(809)	0	0	0	0	0	0	0	0	0
Decrease from Sale	(1,067)	(1,590)	(1,598)	(1,612)	0	0	0	0	0	0
Sold Book Value	(1,050)	(1,552)	(1,582)	(1,612)	0	0	0	0	0	0
Impact to Retained Earnings	(17)	(38)	(16)	0	0	0	0	0	0	0
Ongoing Impacts	(204)	(510)	(530)	(550)	(572)	(595)	(619)	(644)	(670)	(697)
Net Income	(194)	(485)	(504)	(524)	(545)	(567)	(590)	(613)	(638)	(663)
Dividends	(10)	(25)	(25)	(26)	(27)	(28)	(29)	(31)	(32)	(33)
Net Debt	3,639	(245)	(304)	(225)	(401)	(423)	(447)	(474)	(499)	(526)
Cumulative	3,639	3,393	3,089	2,864	2,463	2,041	1,594	1,120	621	94

Source: FAO estimates

About This Document

This Financial Accountability Office of Ontario (FAO) report was prepared as an initiative of the Financial Accountability Officer. In keeping with the FAO's mandate to provide the Legislative Assembly of Ontario with independent analysis, this report makes no recommendations.

The analysis was prepared by Matthew Stephenson and Luan Ngo, under the direction of Peter Harrison and David West. Patrick Baud of the FAO and Jason Jacques, formerly with the FAO, also provided helpful advice.

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The report is available on the FAO's website, fao-on.org.



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