# Business Case

## Proposed Merger

## between

## Kitchener Power Corp

## and

## Waterloo North Hydro Holding Corporation

**Summary Comments**

| | |
|---|---|
| **Prepared by:** | **Grant Thornton LLP** |
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## Project Background and Summary

Kitchener Power Corporation (KPC) and Waterloo North Hydro Holding Corporation (WNHHC) (collectively, the Participants) have jointly retained Grant Thornton LLP (GT) to act as independent financial advisor for evaluating a potential merger between the two entities, which operate as holding companies for Kitchener-Wilmot Hydro Inc., and Waterloo North Hydro Inc. (the Proposed Merger).

The senior management of both entities have been working together with GT to evaluate the financial as well as the business case benefits of merging the two utilities. These findings have been presented to the Boards and Shareholders who have separately retained financial and legal advisors to undertake a financial Peer Review of the work performed by GT and legal due diligence of the Proposed Merger.

## Peer Review

The PEER Review and financial due diligence activities began in early 2021 and were substantially completed in June 2021. The legal due diligence has significant work completed and is expected to be substantially complete by the end of 2021. The following is some of the key work undertaken during the PEER review and due diligence processes:

- Develop a twenty-year model to assess valuation and shareholder cash flows taking into account growth rates in each respective region.
- Model and study customer rate harmonization.
- The independent financial advisors:
    - Reviewed and scrutinized the financial business model;
    - Checked assumptions for reasonableness, and tested the model for technical accuracy.
- The independent legal advisors:
    - Reviewed legal documents including: minute books, contracts, agreements, insurances, litigation and environmental obligations to determine any potential liabilities.

## Efficiencies and Synergies

Management identified several opportunities across different functional areas of the business, which we would reasonably expect to generate significant efficiencies and cost savings. For the first 10 years (sit-out period), the merged utility would be able to pass on the cost savings to its shareholders. Beyond the 10 years, the cost savings will be passed on to customers.

Cost savings are expected to be realized primarily through voluntary employee retirement and attrition over the first three years, as well as the elimination of duplicate work and systems such as administrative, financial, and billing and collection systems. Further synergies are expected in the consolidation of Control Rooms, IT Networks, and Call Centres and the adoption of best practices of each utility. Management was able to identify approximately $2.9 million of potential annual cost savings.

## NewCo

The table below provides key metrics for each standalone entity, as well as what would be the combined LDC ("NewCo").

| $CAD (000s) | KWH | WNH | NewCo |
|---|---|---|---|
| **Distribution Revenue[1]** | 42,982 | 34,940 | **77,922** |
| **# of customers[1]** | 99,026 | 58,438 | **157,464** |
| **kWH sold (000s)[1]** | 1,836,454 | 1,439,103 | **3,275,557** |
| **KM of lines[1]** | 1,993 | 1,654 | **3,647** |
| **Service area (sq. km)[1]** | 425 | 683 | **1,108** |

[1]*Source: 2020 OEB Yearbook*

## Utility Size

A merger between the Participants would currently result in the seventh largest electricity distribution utility in Ontario by customer count and make it almost as large as Elexicon and London Hydro who rank fifth and sixth largest, respectively. An overview of Ontario LDCs, ranked by customer count, is presented in the chart below. (Source 2020 statistics from OEB Yearbook)

| Rank | Entity | Number of Customers | Distribution Revenue ($CAD) |
|---|---|---|---|
| 1 | Hydro One[1] | 1,361,102 | $1,571,292 |
| 2 | Alectra Utilities[1] | 1,062,040 | 567,145 |
| 3 | Toronto Hydro- Electric[1] | 779,176 | 711,740 |
| 4 | Hydro Ottawa Limited[1] | 346,347 | 183,817 |
| **5** | Elexicon Energy[1] | 169,489 | 78,645 |
| 6 | London Hydro Inc. | 162,140 | 70,124 |
| **7** | **NewCo** | **157,464** | **77,922** |
| 8 | Energy+ Inc. & Brantford Power Inc.[2] | 107,965 | 53,394 |
| 9 | EnWin Utilities Ltd. | 90,104 | 43,338 |
| 10 | Oakville Hydro | 74,001 | 42,017 |
| | All Other LDCs combined | 992,735 | 497,640 |

[1] *Denotes entities who have previously undergone consolidation*

[2] *Assumes that a MAAD application for the proposed merger of Energy+ Inc. and Brantford Power Inc. is filed and approved by the OEB*

## Customer Benefits

The Proposed Merger would result in the following benefits for customers:

1) **Retaining Local Ownership**

   By merging the two utilities, a strong local solution, with municipal ownership, will ensure local workers are employed and the company is well positioned to meet the challenges and opportunities of the future.

2) **Cost Effectiveness**

   Savings from reduced operating costs and an increased customer base can be used to ensure the local distribution system remains reliable, efficient and up-to-date.

3) **Ten-year rate stability**

   During the first ten-years (Sit-out Period), each utility would continue with its current rate zones which will grow at an annual inflationary rate established by the Ontario Energy Board (OEB). This provides rate stability to all customers.

4) **Gradual phase-in to rate harmonization after Sit-out Period**

   It is a key commitment that customer rates will be carefully harmonized to ensure that all customers benefit from a merger as compared to where they would have otherwise been had the LDCs utilities operated in the status quo.

## Innovation and Technology Developments

By leveraging a stronger balance sheet, the merged utility will have the ability to dedicate significant resources, leadership, and focus towards innovation and future growth. This will allow the new utility to become a stronger energy and infrastructure partner for local businesses and communities.

## Shareholder Outcomes

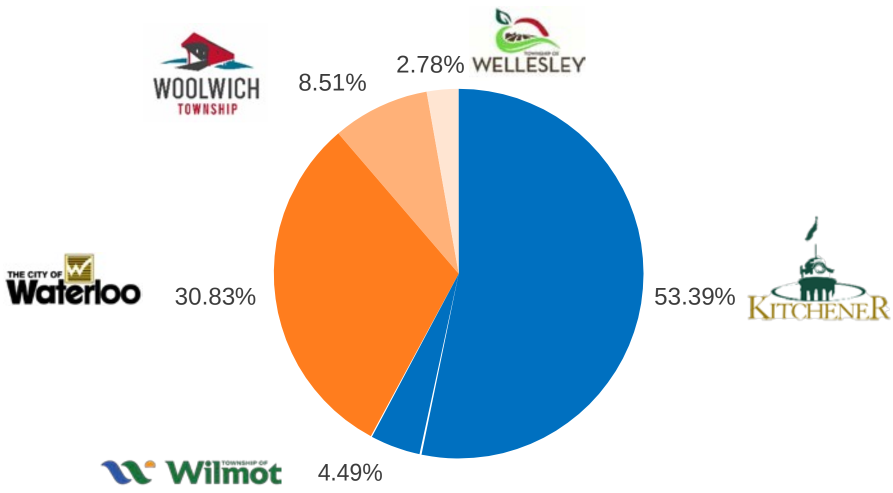
Our work looked at total Shareholder cash flows, and not just dividends. Shareholder cash flows are generated in the form of both interest income (received from shareholder loans) and dividends. Total Shareholder cash flows for all Shareholders are expected to increase under the Proposed Merger.

Based on our model developed in collaboration with Management and subsequently reviewed by the financial advisors, the Proposed Merger shows increased cash flows to each shareholder which in turn are reinvested into each municipality. The estimated increase in cash flows to each Shareholder over the first 20 years post-merger are presented below:

| | |
|---|---|
| City of Kitchener | $9,600,000 |
| City of Waterloo | $3,100,000 |
| Township of Woolwich | $1,200,000 |
| Township of Wellesley | $279,000 |
| Township of Wilmot | $806,000 |

## Valuations - Ownership

The below chart shows the ownership for each shareholder based on relative valuations of the utilities and their respective holding companies.




## Conclusion

Based on the work undertaken by GT and the due diligence done by independent advisors, the business case outlines that merging the two utilities gains considerable benefits (both qualitative and quantitative) for customers and shareholders.