BUDGET COMMITTEE **FEBRUARY 9, 2009**

UTILITY ASSET DISPOSITION RELATIVE TO THE INFRASTRUCTURE FUNDING GAP - PRELIMINARY ANALYSIS

Recommendation

The Deputy City Manager/Commissioner of Finance & Corporate Services recommends:

That the following report be received for information and discussion purposes.

Economic Impact

No financial impact is associated with this report as it is for information purposes only. However, the following report demonstrates various financial impacts associated with a potential future disposition of the municipal utility to fund future infrastructure repair and replacement requirements. Based on available information, the Infrastructure funding gap is estimated to be $130 million over the next 10 years or roughly $394 million over the next 20 years. The current value of the City's municipal utility is estimated to be approximately $325 million (including notes receivable).

Communications Plan

N/A

Purpose

To inform the Budget Committee as to how a potential future disposition of its interest in its municipal utility might positively impact the long term funding of infrastructure.

Background - Analysis and Options

At the December 4th, 2008 Budget Committee meeting a report on the infrastructure funding strategy was tabled and discussed. At this meeting staff presented the Infrastructure funding gap estimated to be $130 million over the next 10 years or roughly $394 million over the next 20 years. These figures are based on current trends, life-cycle planning, and assuming the current practice of funding the roads program through long-term debt is continued. As a result of this discussion, staff was directed to review opportunities on how the potential sale of its municipal utility asset might positively impact the long term funding of infrastructure. It should be noted that this report is based on very preliminary information and should the Budget Committee be interested in pursuing this option further a much more comprehensive report will be required. As a result, staff accumulated information on the valuation of PowerStream, including the impact of the Barrie merger, and has prepared various models based on certain assumptions and timeframes for disposition and utilization of the proceeds.

Valuation

The valuations and assumptions used for the various models are based on KPMG's Pro-Forma Fair Market Value Assessment of PowerStream as at December 31, 2008, for the purpose of the recent utility merger. Their findings were further validated by Crosbie & Company who completed a peer review of KPMG's valuation and was in agreement with KPMG's results and methodology. The results of the KPMG report are provided as attachment #1. For the purposes of this report our analysis is based on the discounted cash flow approach utilizing the KPMG's midpoint valuation of $197 million (Vaughan Holdings Inc.'s 45.315% ownership of $436.5m,). In addition, it was reported that past comparable local utility transactions received a premium of 20%-30% over the market value and therefore a mid point 25% premium above the $197 million value, roughly $50m, is incorporated bringing the amount to $247m. It is also assumed that 100% of

Vaughan Holdings Inc's shares would be sold and no tax implications would occur as a result of a transfer tax holiday. For analysis purposes the sale is assumed to close in 2009 and infrastructure funding would begin immediately.

Notes Receivables & Dividends

The City of Vaughan has an outstanding note receivable with PowerStream in the amount of $78 million earning an annual rate of 5.58%. The interest income from PowerStream is approximately $4.4 million which is currently used to fund the City's operating budget. For the purpose of this analysis, it is assumed that the note would be settled as part of the sale of Vaughan's share in PowerStream, as this is a very common industry occurrence, thus providing approximately $78 million in additional funding. Including the note increases the total proceeds of the sale to approximately $325 million.

The City of Vaughan, currently budgets for $1.75 million in PowerStream dividends annually and for this report the current $1.75 dividend amount will be used. These dividends are currently used to fund the City's general operations. The disposal of Vaughan's interest in PowerStream would result in the elimination of this funding source roughly equivalent to a 1.5% tax rate increase.

Operating Impacts

As noted above, the sale of PowerStream would result in a loss of dividend and interest income, approximately $6.2m, roughly a 5.5% tax increase. In order to mitigate this impact, our analysis assumes that a portion of the proceeds of the disposition or interest earned would be used to offset the loss of dividend and interest income currently used to fund general city operations. It should be noted that if the proceeds of the utility disposition are depleted a permanent source of funding to replace this amount will be required.

Funding Options

This report considers the following two main options:

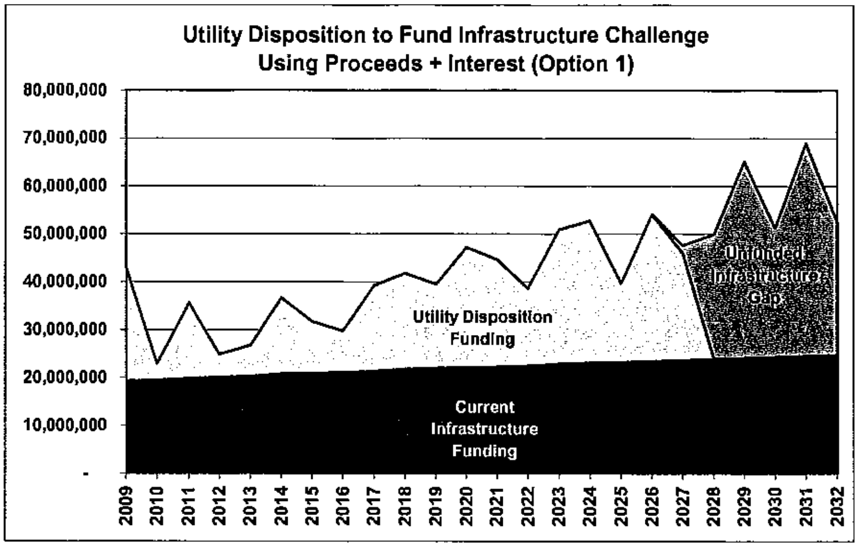
Option 1A – Immediate Disposition and utilizing the proceeds plus any interest income to immediately fund the annual infrastructure funding gap.

Option 2A – Immediate Disposition and only utilizing the interest earned on the proceeds to fund annual infrastructure funding gap. Under this option, the investment stays whole and funding continuous.

In addition to the above, options 1B and 2B are analyzed based on the disposition being deferred by 5 and 10 years.

Option 1A – Immediate Disposition and use proceeds to fund the infrastructure gap

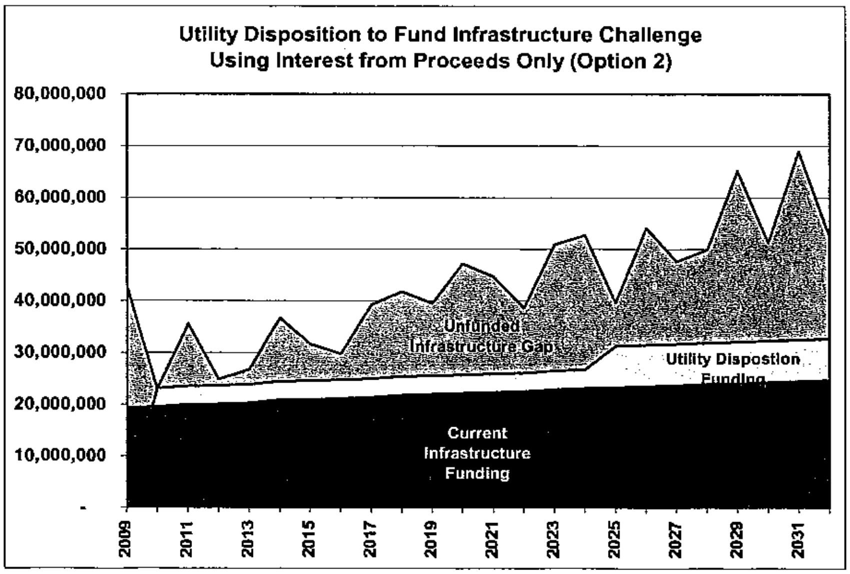
The full amount of the proceeds, approximately $325m plus interest earned at 3% per annum is used to fund the annual infrastructure funding gap requirements. A portion of interest income earned (approximately $6.2 million) has been used to offset the loss of dividend and interest income to the operating budget as a result of the sale. Based on the Long Range Financial Planning model, the funds from the sale would eventually be depleted by approximately 2027. At that time a replacement source of funding would be required to continue to fund the infrastructure gap. In 2028 the annual funding shortfall would be in the neighborhood of $45m. It would be prudent to develop a funding strategy over the 20 year period to address this significant financial challenge, which will be inherited by future generations. The following graph illustrates the impact of this option on the infrastructure funding gap.



For comparison purposes, obtaining an annual interest rate of 5% significantly impacts the results. At a 5% annual interest rate, proceeds from the sale would be extended 5 – 6 years generating an additional $144 million to fund the infrastructure gap. However, funds would eventually be depleted and continuous funding sources would be required in excess of $45m per year.

Option 2A – Immediate Disposition and use interest income to fund the infrastructure gap

This option assumes that only the interest on the proceeds from the disposition is used to fund the infrastructure gap. It is assumed that these funds would be re-invested and earn approximately 3% per year. Based on these assumptions, the City would earn approximately $9.8 million per year in interest income. A portion of interest income earned (approximately $6.2 million) has been used to offset the loss of dividend and interest income to the operating budget as a result of the sale. This would leave approximately $3.6 million that could be used towards funding infrastructure gap. Our analysis demonstrates that this level of funding would not be sufficient to meet our annual infrastructure funding gap requirements; however the level of funding would be permanent and only fluctuate as a result of interest rates. A funding strategy to address the significant gap would still be required. The following graph illustrates the impact of this option on infrastructure funding gap.



Note - The term of the outstanding note is 20 yrs, expiring in 2024. A requirement to fund the lost interest component would exist regardless of the disposition and therefore the interest component of funds received is redirected to fund infrastructure after 2025.

For comparison purposes, obtaining an annual interest rate of 5% significantly impacts the results. At 5% the City would earn approximately $16.2 million per year in interest income. Approximately $10 million after netting off the portion of interest income used to offset the loss of dividend and interest income as a result of the disposition. Our analysis demonstrates that this level of funding would still not be sufficient to meet our annual infrastructure funding gap, but would be ongoing.

Deferral of Disposition by 5 and 10 years

The financial impact of deferring the potential disposition of PowerStream 5 or 10 years was also analyzed. Our analysis assumed that the value of PowerStream would grow by 5% each year. The analysis demonstrates that in either case, the City would not have enough funds to maintain its infrastructure indefinitely. This option also raises the issue of what happens in the meantime (until the disposition occurs) to our infrastructure and service levels? Until funding is received, the infrastructure funding gap will continue to grow as there is insufficient funding to meet our current requirements. The following two scenarios demonstrate the impact of disposing of Vaughan's interest in PowerStream in 5 or 10 years.

Scenario 1B – Disposition in 5 years (2013)

In scenario 1B, it is assumed that PowerStream would be sold in 2013 and that the City of Vaughan would receive approximately $378 million. That would result in an increase of approximately $53 million in proceeds from the sale. In relation to Option 1B funds would eventually be depleted by approximately 2031, and annual continuous funding sources would be required in excess of $35m per year thereafter. In relation to Option 2 investment income would increase by $1.5m. However, it is necessary to recognize that a funding shortfall of approximately $54 million between 2009 and 2013 would still exist and require a funding solution. A five year 3% annual tax increase would generate roughly $45m over a five year period. Failing to address the immediate funding gap need may have a significant impact on the City's service levels and quality of life.

Scenario 2B – Disposition in 10 years (2018)

In scenario 2B, it is assumed that Vaughan's interest in PowerStream would be disposed of in 2018 and that the City of Vaughan would receive approximately $461 million. That would result in an increase of approximately $137 million in proceeds from the sale. In relation to Option 1 funds would eventually be depleted by approximately 2038, and annual continuous funding sources required in excess of $35m per year. In relation to Option 2 investment income would increase by $4m, still not enough to meet infrastructure funding gap requirement. However, it is necessary to recognize that a funding shortfall of approximately $127 million between 2009 and 2018 would still exist and require a funding solution. A 10 year 2% annual tax increase would generate roughly $110m over a 10 year period, 3% roughly $165m. Failing to address the immediate funding gap need may have a significant and serious impact on the City's service levels and quality of life.

Relationship to Vaughan Vision 2020

The study addresses three main goals identified under management excellence in the Vaughan Vision 2020:

1. Maintain Assets and Infrastructure
2. Ensure Financial Stability

Regional Implications

There are no Regional implications associated with this report.

Conclusion

As requested, staff reviewed opportunities on how the potential disposition of Vaughan's interest in its municipal utility asset might positively impact the long term funding of infrastructure repair and replacement. As a result, staff have presented two main options 1) using the proceeds of the disposition plus interest earned to fund the infrastructure funding gap and 2) using only the interest earned on the proceeds of the disposition to fund the infrastructure funding gap.

This analysis demonstrates that disposition of the City of Vaughan's investment in its municipal utility under option 1 will not provide a complete solution for the infrastructure funding challenge. Although there would be a large injection of funds initially, it does not provide a permanent funding solution. Eventually the proceeds of the disposition will be depleted only deferring the infrastructure challenge to future generations. Option 2, however does generate an additional continuous funding source, but unfortunately not enough to eliminate the annual infrastructure funding challenge. Therefore an infrastructure funding strategy would be required.

In addition to the above options consideration was given to the deferral of a potential disposition. Although there is also a significant increase in asset value there is also a corresponding immediate unfunded infrastructure gap that may potentially impact service levels and ultimately the quality of life for Vaughan residents. Therefore an infrastructure funding strategy would be required to address the immediate unfunded infrastructure gap.

In conclusion there is no doubt that the City of Vaughan holds a significant investment through its shares in PowerStream. It is also clear that the investment, if disposed of in whole or in part can contribute significantly towards funding Vaughan's infrastructure gap. The impact will differ depending if the full proceeds are used until depleted or only the investment income earned from the proceeds is utilized.

The challenge is meeting the current infrastructure funding gap that is increasing as the City grows and ages, with the timing of any potential disposal of Vaughan's interest in PowerStream.

Attachments

Attachment No. 1: PowerStream Inc. and Barrie Hydro Distribution Inc. – Pro-Forma Assessment of the Relative Fair Market Value of Shares as at December 31, 2008

Report prepared by:
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Respectfully submitted,

Clayton D. Harris, CA
Deputy City Manager/
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ATTACHMENT #1

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TRANSACTION ADVISORY SERVICES

PowerStream Inc. and Barrie Hydro Distribution Inc. – Pro-Forma Assessment of [illegible] Relative Fair Market Valu[illegible] As at December 31, 200[illegible]

Executive Summary – August 22, 2008

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Summary of Relative Fair Market Value of Shares – Relative Valuation Opinion

- Based upon the scope of our review and subject to the assumptions and restrictions outlined in this report, it is our opinion that the fair market value of the shares of PowerStream Inc. ("PowerStream") will fall in the range of 79% to 82% of the combined share value of the two entities as at December 31, 2008 (the "Valuation Date"), and that the fair market value of the shares of Barrie Hydro Distribution Inc. ("Barrie Hydro") will fall in the range of 18% to 21% of the combined share value of the two entities as at December 31, 2008.
- Our opinion of relative value is supported by our fair market value determinations as presented on the following two pages – using the discounted cash flow approach and the multiple of rate base approach.
- Our valuation opinion assumes that there will not be any significant changes in the economic, regulatory, political, internal operations and capital markets environment between the report date of July 25, 2008 and the Valuation Date of December 31, 2008. Further, our valuation opinion assumes that the actual December 31, 2008 balance sheet positions of both PowerStream and Barrie Hydro will approximate respective management's projected balance sheet positions at that date.
- Our valuation opinion is also subject to the key assumptions listed on page 4, as well as other assumptions and limitations as outlined in our comprehensive valuation report dated July 25, 2008.

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Summary of Relative Fair Market Value of Shares – Discounted Cash Flow Approach

- We utilized the discounted cash flow approach as our primary valuation approach in determining the relative fair market value of the two LDCs as at December 31, 2008.
- Using the discounted cash flow approach and based upon the scope of our review and subject to the assumptions and restrictions outlined in our comprehensive valuation report, we have determined that the fair market value of the shares of PowerStream will fall in the approximate range of $329.9 million to $375.5 million as at December 31, 2008. The midpoint of this fair market value range is $352.7 million.
- We have also determined that the fair market value of the shares of Barrie Hydro will fall in the approximate range of $79.7 million to $87.9 million as at December 31, 2008. The midpoint of this fair market value range is $83.8 million.
- As shown in the table below, the relative post-merger share ownership percentages approximate 80.8% for PowerStream and 19.2% for Barrie Hydro based on the midpoint of the fair market value range.

($ millions)		DCF Approach Low	High	Midpoint
Fair market value of shares - PowerStream Inc.	$	329.9	375.5	352.7
Fair market value of shares - Barrie Hydro Distribution Inc.		79.7	87.9	83.8
	$	409.6	463.4	436.5
Relative share value - PowerStream Inc.		80.6%	81.0%	80.8%
Relative share value - Barrie Hydro Distribution Inc.		19.4%	19.0%	19.2%
		100.0%	100.0%	100.0%

- The summary of the relative fair market value of shares as presented above, combined with our sensitivity analyses and other investigations, supports the conclusion that the relative fair market value of the shares of PowerStream and Barrie Hydro will fall in the approximate range of 79% to 82% and 18% to 21%, respectively, as at the Valuation Date.

Summary of Relative Fair Market Value of Shares – Multiple of Rate Base Approach

- We also determined the fair market value of the shares of PowerStream and Barrie Hydro using the multiple of rate base approach, which is based upon a review of the valuation multiples implicit in buy-sell transactions involving comparable LDCs in Ontario, as well as other regulated utilities. This was a supporting valuation approach.
- Using the multiple of rate base approach and based upon the scope of our review and subject to the assumptions and restrictions outlined in our comprehensive valuation report, we have determined that the fair market value of the shares of PowerStream will fall in the approximate range of $316.1 million to $370.1 million as at December 31, 2008. The midpoint of this fair market value range is $343.1 million.
- We also determined that the fair market value of the shares of Barrie Hydro will fall in the approximate range of $81.4 million to $96.3 million as at December 31, 2008. The midpoint of this fair market value range is $88.9 million.
- As shown in the table below, the relative post-merger share ownership percentages approximated 79.4% for PowerStream and 20.6% for Barrie Hydro based on the midpoint of the fair market value range.

($ millions)		Based on 2008 Rate Base Low	High	Midpoint
Fair market value of shares - PowerStream Inc.	$	316.1	370.1	343.1
Fair market value of shares - Barrie Hydro Distribution Inc.		81.4	96.3	88.9
	$	397.5	466.4	432.0
Relative share value - PowerStream Inc.		79.5%	79.3%	79.4%
Relative share value - Barrie Hydro Distribution Inc.		20.5%	20.7%	20.6%
		100.0%	100.0%	100.0%

- Similar to the DCF approach, the summary of the relative fair market value of shares as presented above, combined with our sensitivity analyses and other investigations, supports the conclusion that the relative fair market value of the shares of PowerStream and Barrie Hydro will fall in the approximate range of 79% to 82% and 18% to 21%, respectively, as at the Valuation Date.

Summary of Relative Fair Market Value of Shares – Summary of Key Assumptions

- In arriving at our opinion of value, we assumed, in addition to the assumptions noted elsewhere in this report, that:
  - **The Valuation Date is December 31, 2008 – the proposed merger date. The accuracy of management's projections for calendar 2008, including the pre-merger balance sheet position at December 31, 2008, is vitally important to the valuation opinion contained herein.**
  - The integrated financial projections prepared by management of PowerStream and Barrie Hydro for the year ending December 31, 2008, as well as for the ten year period from January 1, 2009 to December 31, 2018, represent management's best estimate of future events and operating results.
  - A debt-to-equity ratio of 60%/40% was appropriate for determining the relative fair market value of shares, which is consistent with the debt-to-equity requirements of the OEB. In order to achieve this debt-to-equity ratio, it will be necessary for Barrie Hydro to recapitalize its balance sheet through the payment of a special dividend, estimated by management at $25.7 million, to its shareholder prior to December 31, 2008.
  - The shareholder loan payable balances will not be equitable between PowerStream and Barrie Hydro as at December 31, 2008. Specifically, the two municipal shareholders of PowerStream will hold $162.5 million of shareholder loans whereas the City of Barrie will hold $20.0 million of shareholder loans (before any increase, if any, due to the recapitalization of its balance sheet). This shareholder loan imbalance does not impact upon the relative share valuations outlined herein.
  - The benefit of any excess income tax shield provided by opening UCC and CECA balances represents an asset that benefits the customers of PowerStream and Barrie Hydro rather than the shareholders or debt holders of the two companies. Accordingly, for purposes of this relative valuation, the opening tax and accounting values of fixed assets were assumed to be equal.
  - In the near term, there will not be any significant changes to the current regulatory environment or rates of return available to Ontario LDCs such as PowerStream and Barrie Hydro.

Key Valuation Considerations for PowerStream and Barrie Hydro

Valuation Considerations - PowerStream:

- PowerStream has strong prospects for long-term sustainable growth due to significant developable green space and intensity of use opportunities within its service area;
- There are several special development projects before PowerStream that will enable the company to increase its rate base;
- PowerStream builds and owns most of its own transformer stations;
- PowerStream has a track record of strong financial performance;
- Much of PowerStream's distribution system is relatively new and therefore in good physical condition; and,
- PowerStream's operations have no economic dependence on one customer or industry sector due to the diversified economic base of the Aurora, Markham, Richmond Hill and Vaughan areas.

Valuation Considerations – Barrie Hydro:

- Barrie Hydro operates in a growth-oriented area, (i.e. the City of Barrie's population grew by almost 20% over the past five years) and future population growth in Barrie Hydro's service areas is expected to be robust over the next seven or eight years;
- Barrie Hydro just had its rate filing approved by the OEB in 2008;
- Barrie Hydro has a track record of strong financial performance;
- Barrie Hydro's operations have no economic dependence on one customer or industry sector due to the diversified economic base of its service areas; and,
- In the past, Barrie Hydro has had a debt-to-equity ratio below the current long-term mandate of 60% / 40% and has had the capacity to take on more debt. A one-time special dividend, estimated at $25.7 million, is proposed to recapitalize Barrie Hydro's debt-to-equity ratio to the industry standard of 60%/40% at the time of the merger.

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Comparable LDC Transactions [3]

Utility Acquired	Purchaser	Date of OEB Filing	Share Purchase Price	Enterprise Value (EV) (Note 2)	Book Value of Invested Capital (BV)	EV / BV	Number of Customers	EV Per Customer
			($ 000's)	($ 000's)	($ 000's)		(000's)	($'s)
Brampton Hydro	Hydro One Inc.	3-Nov-00	260,934	246,463	187,513	1.31	84,000	2,934
Richmond Hill Hydro	Markham Hydro (50%) & Hydro Vaughan (50%)	3-Nov-00	143,500	128,157	92,625	1.38	37,250	3,440
Aurora Hydro	PowerStream	24-Mar-05	35,239	29,788	23,326	1.28	16,000	1,862
St. Catharines Hydro [1]	Horizon Utilities	25-Nov-04	87,242	81,168	65,790	1.23	50,000	1,623
Industry								
Median			115,371	104,663	79,208	1.30	43,625	2,398
Average			131,729	121,394	92,314	1.30	46,813	2,465
PowerStream	**Estimated FMV - DCF**	**31-Dec-08**	**352,700**	**711,600**	**504,900**	**1.41**	**236,377**	**3,010**
Barrie Hydro	**Estimated FMV - DCF**	**31-Dec-08**	**83,800**	**182,900**	**139,400**	**1.31**	**68,222**	**2,681**
PowerStream	**Estimated FMV - Rate Base**	**31-Dec-08**	**343,100**	**702,000**	**504,900**	**1.39**	**236,377**	**2,970**
Barrie Hydro	**Estimated FMV - Rate Base**	**31-Dec-08**	**88,900**	**186,400**	**139,400**	**1.34**	**68,222**	**2,732**

Notes

[1] The purchase price of St. Catharines Hydro is a notional value as it was used in a merger transaction with no cash exchanging hands.

[2] Enterprise value represents the value of equity plus long-term debt.

[3] The information on this page has been obtained from public sources including filings with the Ontario Energy Board.

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PowerStream Inc. and Barrie Hydro [illegible] Review of Sy[illegible]

August 22, 2008

AUDIT • TAX • ADVISORY

Background

- On April 30, 2008, PowerStream Inc. ("PowerStream") and Barrie Hydro Distribution Inc. ("Barrie Hydro") announced a proposed merger of their respective operations in order to provide ongoing value to their shareholders and customers.

- PowerStream and Barrie Hydro have asked KPMG to:
  - Obtain and review the preliminary analysis of merger synergies as prepared by the Companies;
  - Assess the reasonableness and achievability of the proposed merger synergies, based on supporting documentation and analyses and on our understanding of utility operations generally;
  - Consider functional areas such as facilities, human resources, information technology, customer care and billing, finance, engineering, procurement etc. for possible operating and capital synergies;
  - Consider ongoing merger costs such as increased wage and benefits from the harmonization of remuneration levels; and,
  - Consider one-time transition costs and savings.

- This document summarizes our scope of work, and our findings and conclusions.

Work Undertaken as Part of this Review

- In the course of our work, KPMG undertook the following tasks:
  - Attended meetings of the Working Group Co-ordinating Committee on June 5th and June 12th to participate in initial reviews of synergy estimates
  - Met with Finance staff on July 3rd to understand the then current version of the Savings Synergy Model
  - Reviewed the calculations contained within the Savings Synergy Model
  - Reviewed the supporting documentation for projected savings in each function and developed questions for follow-up as necessary
  - Had discussions with representatives of each of the functional subgroups
  - Reviewed information from recent rate submissions by other Ontario LDCs in an effort to identify potential staffing benchmarks
  - Reviewed the final draft Savings Synergy Model provided on July 24th and tracked changes from the initial model reviewed
  - Had additional discussions with subgroup members as required.

Approach to the Review

- To assess the reasonableness and achievability of merger synergies, KPMG considered and applied the following tests:
  - **For Excel spreadsheets**:
    - Are calculations laid out in a consistent and logical manner?
    - Do calculations match the supporting text documentation?
    - Has care been taken to avoid double-counting?
    - Are there gaps in the savings or cost estimates?
  - **For savings and cost estimates:**
    - Is there an identified source or basis for the savings and cost figures provided?
    - Do estimates of staffing reductions appear reasonable given the nature of the work and the potential for synergies in the context of a merger?
    - Do synergy estimates appropriately take into account all of the circumstances of the merger? Key considerations:
      - The relative sizes of the two utilities and their geographic location
      - Differences in system attributes (voltage levels, use of TS, billing practices, technical standards)
      - Differences in levels of contracting out.
    - Are savings attributable to the merger and not to some other cause?
    - Does it appear that all of the potential synergies or costs have been addressed?

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Key Findings

- The synergies identified and the approach taken are similar to those of other merger transactions that we have been involved in.
- Calculations in the Savings Summary Model are easy to follow, and logically laid-out.
- Model appropriately identifies key elements of savings, and associated transition costs.
- The projected savings appear reasonable and achievable.
- Savings estimates rightfully take into account both existing costs and those that will be avoided in the merger.
- Transition costs appear to have been appropriately considered and identified.

SUMMARY OF SYNERGIES AND COSTS

Total Annual Operating Savings - Initial	5,080,000
Total annual Operating Savings - Ultimate	5,580,000
Capital Savings - Annual	392,000
Capital Savings One - Time	5,302,000
Total Transition Costs	(4,650,000)

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Other Observations

- Compared to existing budgets, savings are relatively greatest in support and overhead functions such as Finance, IT, and Regulatory. This seems reasonable in light of where economies of scale would normally be expected in a merger of two entities.
- Savings are more limited in the operations areas, and this appears reasonable in light of the utilities' geographic separation and need to maintain the same physical infrastructure as before.
- Avoided IT and project costs are a major source of savings. This is appropriate given the large fixed costs associated with major systems and initiatives. (e.g. ERP, GIS and CIS, and IFRS conversion)
- Additional savings may accrue in the future from the joint implementation of new initiatives or projects that are not today foreseen. The potential for such additional savings has not been captured in the analysis.
- Lack of an inflation allowance in future savings projections provides an additional element of conservatism.
- Costs of integration are some of the most difficult to estimate, but appear to have been appropriately accounted for in corporate transition costs and in the timing of some FTE savings.
- In some cases, Barrie Hydro has performed in-house some functions that are outsourced at PowerStream. This has affected relative staffing levels and personnel utilization on a stand-alone basis.
- Some merger savings result from better staff utilization through smoothing of peaks and valleys in a larger entity.
- Synergy savings estimates incorporate some judgmental factors, but these factors seem reasonable. Examples:
  - Savings from bimonthly billing are arguably not merger related. A discount of 50% has been applied to these savings to reflect this.
  - Transaction costs reflect those that will be incurred after approval of the merger. Costs to date are treated as a "sunk cost" for decision-making purposes.
- Savings calculations assume, in general, maintenance of equivalent service levels. One exception is the move to bimonthly billing, which could be perceived by some as a lower level of service.
- The merged entity may ultimately be able to implement new technologies sooner than the two individual utilities alone and, hence, may offer higher levels of service.

Restrictions and Limitations

- We have not independently confirmed or verified the data that were provided by PowerStream and Barrie Hydro and that are the basis of the projected merger results.
- Achievement of the projected synergies is dependent on the successful execution by management of the merger plan. Actual savings and transition costs may differ if management plans change.
- Projected saving and costs are dependent on future circumstances, which may differ from those foreseen today. Hence, achieved synergies may be higher or lower than forecast.
- This synergy review has been prepared solely for use by the management and directors of PowerStream and Barrie Hydro to assist them, and their respective Boards and shareholders, in determining the benefits of proceeding with a merger and may not be used or relied upon by any other parties without the express prior written consent of KPMG. KPMG will assume no responsibility for losses incurred by PowerStream, Barrie Hydro, their shareholders, directors, or any other parties as a result of the circulation, publication, reproduction or use of this report contrary to the provisions of this paragraph.