Innovative Financing: Pushing Beyond Best Practice

Case Study: Lower Mattagami Financing

October 2012
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OPG Overview

- OPG is an Ontario-based electricity generation company whose principal business is the generation and sale of electricity in Ontario.
- With a total in-service capacity of ~19,000 MW, OPG is one of the largest power generators in North America.
- OPG’s generating assets include:
  - 3 nuclear generating stations
  - 5 thermal generating stations
  - 65 hydroelectric generating stations
  - 2 gas fire generation stations with Partners
- Total revenues of $5.1 billion for FY2011
The Lower Mattagami River (LMR) Complex is composed of four stations on the Mattagami River in north eastern Ontario approximately 920 km (572 miles) north of Toronto, existing capacities are:

- Little Long (138 MW)
- Smoky Falls (52 MW)
- Harmon (142 MW)
- Kipling (154 MW)

Construction project includes full replacement of the Smoky Falls station and expansion of the other three generating stations in order to optimize water flow on the River.

- Cost of redevelopment is $2.56 billion
- Total project asset value ~$2.96 billion following redevelopment (combining both incremental and existing assets)
  - Incremental assets are new facilities located at the same sites
LMR Complex

• Upon project completion, total capacity will be 924 MW
  • 438 MW of renewable, clean energy at existing sites using river water more efficiently
• Moose Cree First Nation will have the opportunity to invest up to 25% equity partnership in the project
• Hydroelectric Energy Supply Agreement (“HESA”) with the Ontario Power Authority (“OPA”) provides a Revenue Stream similar to the model used for regulated utilities
APPROACH TO BEST PRACTICE
What is Best Practice?

- Best Practices – “proven, repeatable techniques that produce consistent results and are used as a benchmark”
What is Best Practice?

• We are “following” Best Practices
Moving Beyond Best Practices

• Require an awareness and mindset to break away from the pack
• Blue print/Baseline/Benchmark
  ➢ Use as reference and guideline
  ➢ One size does not fit all
• Best Practice – Floor not your ceiling
How do you break away from pack

• Determine your objectives and specific needs
• Assess the unique attributes of your project i.e., strengths, weaknesses, constraints
• Identify your stakeholders
• Determine Assessment Criteria vs Benchmark

• Ask the “Why Question”
  – It has never been done
  – It won’t be accepted
  – It is too complicated
• Focus on steps to mitigate or address the issues
LOWER MATTAGAMI CASE STUDY
Key Financing Objectives

The challenge was developing a financing platform that would:

• Raise sufficient capital to execute the Project
• Be flexible and responsive to the Project’s capital requirements throughout construction
• Maximize leverage and ROE returns
• Be cost effective, reducing overall financing costs
• Be accepted by a variety of stakeholders
Key Stakeholders

1. Communicate! Communicate! Communicate!
2. Understand each stakeholder’s perspective
3. Tailor message for each stakeholder group based on their “Lens”
4. Repeat and reinforce messaging to sustain buy-in
LMR Financing Constraints

Traditional Project Financing:
- Bank Financing – full up-front commitment required
- Bond Takeout – fully amortizing

Challenges specific to LMR Complex:
- 5-year construction
- Capacity for $2 billion amortizing debt
- Refinancing risk due to the 50-yr term of the Revenue Agreement
- Complex legal and asset arrangement

Strategy:
- Structuring
- Marketing
- Execution
- Review
Simplified Legal Structure

ONTARIO POWER GENERATION

GP

 GP

MOOSE CREE FIRST NATION

Development Company

LP

LMR Complex

“Issuer”
LME LP

(a limited partnership that owns the Existing Complex)

“Guarantor”
LM LP

(a limited partnership that will own the Incremental Complex)

Bondholders / Lenders

AFP® Annual Conference
THE STRATEGY
Strategic Approach

Short-Term Liquidity

- Project costs will be initially funded through the issuance of commercial paper ("CP"), periodically refinanced in the long term debt market over the construction period
- CP program rated investment grade, launched in September 2010
- Lower Mattagami Energy Limited Partnership ("LMELP") received an Issuer Rating of ‘A-high’ from DBRS and ‘A2’ from Moody's

Long-Term Financing

- Repositioned as “utility-like” entity vs Project
- Perpetual asset and “going concern” addresses refinancing risk
- Senior bullet bonds will be periodically issued in the private placement market, either to repay CP, or used to fund project costs directly
- Bonds are secured by Lower Mattagami assets and have recourse to OPG until assets are in-service, and recourse release conditions are met
Minimize Negotiations with Credit Providers

Capital Markets Platform

• All of LMELP’s debt (bank, CP, bonds) will rank pari passu under the Master Trust Indenture
• Bond structure to appeal to the broadest range of institutional investors through issue size, timing, term, repayment profile as well as spreading out refinancing risk for subsequent bond maturities
• Common security and covenants for all credit providers
• Bonds issued under distinct Supplemental Indentures
• In addition, LMELP may enter into hedging arrangements, also under this common platform
Execution

Illustrative Bond Issuances During Construction

- LMELP is a Semi-frequent issuer – “Going Concern”
- Bullet bond portfolio vs single amortizer
- Planned principal amortization equivalent to 65% of asset depreciation
- Principal amortization achieved through:
  - Periodic refinancing of certain long-term bonds with CP; and
  - Regular reduction in the amount of CP outstanding
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• Refinancing risk due to the 50-yr term of the Purchase Agreement
• Complex legal and asset arrangement

Characteristics of the “Hybrid” Project Financing Plan:
- Unique legal structure with broad capital markets platform
- Periodic financing rather than upfront financing, thus eliminating negative carry and reducing upfront commitment and financing fees
- Short term financing by way of cost effective CP, with periodic bond refinancing structure
- Cost effective bullet bonds rather than amortizing bonds
Role of Advisors / Dealers

• Selecting advisors
  ➢ More than one firm
  ➢ Potentially opposing views of best practices and trends in financial markets will allow you to make better informed decisions

• Managing advisors
  ➢ Tension is healthy

• Who drives the bus / takes ownership of the risks
  ➢ Advisor and client balance
Marketing Experience

• CP program well received, with spreads continually tightening on subsequent issuances

• May 2011 (inaugural launch) bonds issued in both 10-year and 30-year terms to appeal to a broader investor base and to establish a yield curve
  - More than 3x oversubscribed, which significantly contributed to spreads narrowing. Deal upsized from $400 M to $475 M
  - Transaction attracted a widespread domestic investor base, >50 large institutional buyers, demonstrating strong liquidity and market appetite for future bond issues

<table>
<thead>
<tr>
<th>Issuer: Lower Mattagami Energy Limited Partnership</th>
<th>Issuer: Lower Mattagami Energy Limited Partnership</th>
</tr>
</thead>
<tbody>
<tr>
<td>Description: 4.331% Bonds, Series 2011-3 May 18, 2021 (pp)</td>
<td>Description: 5.139% Bonds, Series 2011-4 May 18, 2041 (pp)</td>
</tr>
<tr>
<td>Size: $225,000,000 / 225,000,000 domestic</td>
<td>Size: $250,000,000 / 250,000,000 domestic</td>
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<tr>
<td>Launch: May 12, 2011</td>
<td>Launch: May 12, 2011</td>
</tr>
<tr>
<td>Settlement: May 17, 2011</td>
<td>Settlement: May 17, 2011</td>
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<tr>
<td>Retail Price: $100.0000</td>
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</tbody>
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|Yield (s.a.): 4.331% | Yield (s.a.): 5.139% |
|Spread (bps): 112.00 | Spread (bps): 152.00 |
|Benchmark: Int. 3.50% 06/20 & 3.25% 06/21 | Benchmark: C4.00% 06/41 (3.169%) |
|Call (bbps): 28.00 | Call (bbps): 38.00 |
|Term (yrs): 10 | Term (yrs): 30 |
Marketing Experience

- April 2012 bonds issued in 40-year term to take advantage of low rates and flat yield curve
  - More than 2x oversubscribed in a tight credit market. Deal upsized from $200 M to $225 M
  - 25 large institutional buyers with 9 new participants

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<tr>
<th>ISSUER: Lower Mattagami Energy Limited Partnership</th>
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<td>DESCRIPTION: 4.175% Bonds, Series 2012-1 April 23, 2052 (pp)</td>
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<tr>
<td>SIZE: $225,000,000 / 225,000,000 domestic</td>
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<tr>
<td>LEAD: CIBC World Markets Inc. / BMO Capital Markets</td>
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<td>LAUNCH: April 16, 2012</td>
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<td>SETTLEMENT: April 23, 2012</td>
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<td><strong>YIELD (s.a.):</strong> <strong>4.175%</strong></td>
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<td><strong>SPREAD (bps):</strong> <strong>160.00</strong></td>
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<td><strong>BENCHMARK:</strong> C4.00% 06/41 ($129.10-2.574%)</td>
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<tr>
<td><strong>CDA CALL (bps):</strong> 40.00</td>
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<td><strong>TERM (yrs):</strong> 40</td>
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<td><strong>INTEREST PAYMENT:</strong> Oct 23, Apr 23</td>
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<td><strong>DBRS RATING:</strong> A(h)</td>
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<td><strong>S&amp;P RATING:</strong> NR</td>
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AFP Pinnacle Grand Prize 2011

• OPG won in Corporate Finance & Capital Markets category of Association for Financial Professionals 2011 Pinnacle Awards

• Recognized Lower Mattagami Project’s creative financing structure

• Recognized by Sustainable Electricity Awards as Company of the Year on strength of innovative financing of the Lower Mattagami Project, and partnership with First Nations.
SUMMARY
Moving Beyond Best Practices

1. Best Practices - Baseline/Floor not your ceiling
2. Assess the unique attribute and specific needs of your project
   • One size does not fit all
3. Take ownership of the risks
   • Drive the bus
4. Manage and communicate with Stakeholders
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QUESTIONS