Message

From:	Erling, Jonathan M [/O=KPMG/OU=CA/CN=RECIPIENTS/CN=CA13722]
Sent:	5/9/2011 3:22:22 PM
To:	Rockx, John [/O=KPMG/OU=CA/CN=RECIPIENTS/CN=CA17786]; Herhalt, John M [/O=KPMG/OU=CA/CN=RECIPIENTS/CN=CA17803]
CC:	Neale, Cindy L. L [/O=KPMG/OU=CA/CN=RECIPIENTS/CN=CA17680]
Subject:	FW: Initial Questions
Attachments:	Power Fin WS 09-13pils(act10finaladj2013adj).xls; Sol Budget 11(act10adj).xls

FYI

I don't think Tim Fryer is on board with this study. Perhaps I'll suggest a call with Ed and Tim together.

Jonathan

Jonathan Erling, Managing Director, P.Eng. | KPMG LLP | Bay Adelaide Centre, 333 Bay Street, Suite 4600, Toronto, Ontario M5H 2S5 CANADA

tel +1 (416) 777-3206 | fax +1 (416) 777-3515 | email: <jerling@kpmg.ca> | internet <www.kpmg.ca>

From: Tim Fryer [mailto:tfryer@collus.com]
Sent: Monday, May 09, 2011 2:49 PM
To: Erling, Jonathan M
Subject: RE: Initial Questions

Hi Jonathan: Please see below.

Thanks

Tim

From: Erling, Jonathan M [jerling@kpmg.ca]
Sent: Monday, April 25, 2011 7:37 PM
To: Ed Houghton; Tim Fryer
Cc: Rockx, John; Herhalt, John M; Neale, Cindy L. L
Subject: Initial Questions

Hi Ed and Tim:
We have gone through the various materials provided and have some questions of clarification and some initial thoughts.
In the financial projections, I see that Net Income After Tax declines steadily through to 2013. I was surprised not to see an increase in 2013 as a result of the assumption that rates will be rebased (and target ROE restored). Can you provide more information regarding your assumptions about rebasing? We were considering the possibility of not rebasing in 2013. In preparation for the Business Plan completion we have updated for the re-based (estimate) return for 8 months in 2012. The attached Financial worksheets incorporate this. These also have the actual 2010 amounts now inputted, so these should be the worksheets you put to use from now on. I also am attaching a copy of the Power and Solutions audited (draft) statements.
Overall, we still don't have a clear picture of the financial transactions that occur among Collus, the Collingwood Public Utility Board (CPU), and the Town, and of any operating profits that are associated with these transactions. For example:
- The summary sheet outlining cash and in-kind services to the Town doesn't tie with the numbers shown in the Financial Statements. How do we reconcile? There are only a couple of the amounts on the summary

sheet that tie directly to the FS. I didn't think this was going to be such an in-depth analysis. My understanding from Ed was this was just going to be a general overview. It would take a great deal of my time to go through this in detail

- Do amounts charged equal direct costs? No
- The summary sheet noted above shows the provision of in-kind services valued at $280,000 to the Town for administrative assistance. Is there an offsetting revenue amount and, if not, what is the rationale for providing these services? Is it considered an "in-kind" dividend payment? The employees that provide the services are paid for by the water department, but do specific work for the Town. The Town doesn't reimburse the CPU for it.
- In 2009, the F/S show $811,881 billed to CPU. Is this the allocation of the costs of Solutions Corp. employees (i.e. the 60%/40% split between the LDC and water that we have talked about)? That is the total charges paid by the CPU for labour, benefits and other expenses that Solutions paid for the CPU and billed them back for.
- CPU paid the Town $200,000 for the Operations Centre rental in 2009, according to the summary sheet. However, the F/S shows that Collus paid CPU $317,000 for the lease of the operations centre and computers. Does this mean that Collus rent to the Town was flowed through CPU and that CPU made a profit on the transaction? Shouldn't some of the costs remain with CPU for its use of space? What is the basis of the amounts paid? (Both with respect to the $317k and the $200k?) $200,000 for operations centre lease and $117,000 for computer rent. Based on fair market value calculations and the Power share of each.

By implication, I think we need to get an assessment of the additional costs in water and/or at the Town if the LDC was sold and operated independently. However, we will have to rely on you for making this assessment, given our lack of direct knowledge of your operations. Can you put some thought to this? As noted above I do not have planned any time to go over this in depth. We are just about to go live on the MDMR production system and I will need to prioritize my time on this.

Conversely, I think that we should consider how the LDC's direct operating costs might be reduced if you were purchased by a larger utility. This would speak to synergies that may be available to a buyer (and which could be a factor in a sale price). In the longer term, synergies should be passed through to consumers as lower rates. Potential areas where costs could be reduced are as follows:

- Submission of rate applications. (Your 2009 rate application included costs of $160,000 for the regulatory process. This is a meaningful amount, but doesn't seem prohibitive if incurred only every 4 years.) I agree that the applications aren't excessive to recover on.
- Planning for the Smart Grid. (Dollar amount?) I have not been advised of any specific spending plans for this.
- Billing and collection. (Costs in this area seem to have risen sharply in F2009 and F2010. Is there a particular reason?) Additional staff to deal with increased requirements as well as some for succession planning.
- Others?

Some broader questions that I think are worth further discussion with yourself and Ed.

- If the Town is looking for funds, could this be achieved simply by converting the Note Payable to an external loan? Could be, but they would lose the annual interest payment.
- In the same vein, it appears that the utility has somewhat more equity than would be consistent with the OEB's deemed capital structure. Is this an opportunity to increase leverage or is there a concern about upcoming capital expenditures (especially for the Creemore substation)? We have been conservative and trying to keep borrowing to as low a level as possible so that if the OEB makes the LDC borrow for the mega projects like Smart Grid, we don't end up over the debt to equity structure.
- One of the key issues going forward relates to the potential for employee turnover as a result of the aging workforce and imminent retirements. Should we just treat this as a qualitative issue or is there a financial impact that can be identified? No financial analysis has been done on this.

- Given the synergies between the LDC and water services, does it make more sense to sell these services as a combined entity, rather than just selling the LDC, if a sale transaction is contemplated? However, this would also open up some restructuring issues with respect to water that I think are out of scope of our terms of reference. (As an alternative, perhaps you could just sell the function of operating the water utility, rather than just the water utility assets themselves. Thoughts?) I don't know that selling the water is being considered.
- What are the options with respect to the future of the Operations Centre, and how do they map against options for the LDC?An expansion of the facility was completed 2 years ago. I don't believe there are any major plans for the facility in the next while.

Perhaps we could schedule a call later in the week to touch base on these items? Alternatively, would it make sense to schedule a meeting in person? As noted I expect the next few weeks to be excessively hectic so I am hoping I have provided some information that you can apply.

Jonathan

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