

August 30, 2011

Research Update:

**Toronto Hydro Corp. Affirmed At
'A' On Excellent Business Risk
Profile; Outlook Stable**

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Research Update:

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Overview

- We are affirming our 'A' long-term corporate credit and senior unsecured debt ratings on Toronto Hydro Corp.
- We base the ratings affirmation on the stable regulatory compact in Ontario, which supports the company's excellent business risk profile.
- The stable outlook reflects our expectation that the company will maintain its capital structure in line with the regulatory deemed capital structure, even under the significant capital spending pressures related to its aging regulated infrastructure, and remain focused on its regulated electricity distribution business.

Rating Action

On Aug. 30, 2011, Standard & Poor's Ratings Services affirmed its 'A' long-term corporate credit and senior unsecured debt ratings on Toronto Hydro Corp. (THC or Toronto Hydro). The outlook is stable.

We base the ratings affirmation on what we view as a predictable and transparent regulatory regime, stable company operations, and no change in the business risk profile of THC's core electricity distribution operations within the Ontario market framework.

Rationale

The ratings on THC, an Ontario-based utility holding company, largely reflect Standard & Poor's view of the credit risk profile of its key subsidiary, Toronto Hydro-Electric System Ltd. (THESL; generating 97% of THC's consolidated net revenue). We believe THESL's excellent business risk profile reflects its monopoly, low-risk, regulated electricity distribution business and solid customer base. Offsetting these strengths is our view of THC's significant financial risk profile and sizable capital expenditure pressures related to aging infrastructure. Total reported debt outstanding as of June 30, 2011, was about C\$1.4 billion. Our ratings assume that the company will focus on its core regulated local electricity distribution company (LDC) business without any material investment in nonregulated renewable generation in the medium term.

In our view, THESL's monopoly position and the asset-intensive nature of electricity distribution limit competitive risk. The electricity distribution business carries relatively low operating risk. Operational efficiency and reliability are within provincial industry norms, avoiding regulatory risk

linked to poor performance. Toronto Hydro is one of Ontario's largest LDCs, with about C\$2.2 billion in capital assets and delivering almost 20% of the electricity used in the province.

We believe the Ontario Energy Board's (OEB) regulatory framework supports THESL's cash-flow stability. The framework allows for the recovery of prudent costs and the opportunity to earn a modest return. In our view, OEB's regulatory decisions are generally consistent and transparent. Electricity market design and a regulated commodity cost pass-through mechanism limit the company's exposure to commodity risk. Since the obligation to ensure an adequate electricity supply for its customers lies with the OPA, THESL's balance sheet is not burdened with power purchase contractual obligations. In our view, the OEB has exhibited increased scrutiny of THESL's requested cost increases and capital expenditures given heavy infrastructure spending in the sector and the associated rate pressure on customers. While we expect tempering rate increases will remain an important regulatory consideration, we believe the regulatory compact remains strong in the province and that the OEB will continue to honor its mandate to balance the needs of customer and the ability of the utilities to earn a modest return. The fact that there have been no material disallowances and that distribution costs typically represent about 25% of the total energy bill support this view.

Further supporting cash flow stability are THESL's solid customer base and the essential nature of the service provided. In our opinion, the Greater Toronto Area's economy is deep and well-diversified, although not immune to economic downturns. Finance, manufacturing, and business and professional services are the foundations of the city's economy. Exposure to large users, with a monthly peak demand of more than 5 megawatts (MW), represents less than 10% of gross revenue. Further protecting its customer base is the provision of an essential service and that the cost to residential customers of producing their own power remains economically inaccessible to most. Toronto is Canada's largest city and our long-term view is that it will weather economic slowdowns. New time-of-use rates facilitated by recently installed smart meters encourage customers to shift the time of consumption to reduce their commodity costs, but we don't expect these to materially affect THESL's net distribution revenues.

In our view, the stable and predictable, but highly-leveraged, asset-intensive business supports a significant financial risk profile. Debt maturities are well-spread and the company has had favorable access to debt capital markets. We expect significant capital spending related to its aging asset base in the next five-to-nine years, which will lead to an extended period of negative free operating cash flow. However, we believe that, if approved by the OEB, the company's strategy to pursue rate base resetting every year will allow it to moderate the negative impact somewhat. Should the regulator not allow this strategy, we believe that Toronto Hydro will adjust its capital expenditure downward and only spend pre-approved capital expenditure. The company's key financial metrics in 2011 were very similar to its historical range, in our view. Rolling 12-month adjusted funds from operations (FFO) interest coverage and adjusted FFO (AFFO)-to-total debt were steady at 3.5x and 15%,

respectively, as of June 30, 2011. Adjusted total debt-to-total capital was 60% (compared with 57% on a reported basis). We expect the company to achieve about 14%-15% of AFFO-to-total debt in 2011 and 2012 and that management will maintain its balance sheet consistent with the regulatory deemed structure.

We base our 'A' rating on Toronto Hydro's stand-alone credit risk profile and our opinion that there is "low" likelihood that its owner, the city, would provide timely and sufficient extraordinary support in the event of financial distress. We assess the company's stand-alone credit profile at 'a'. In accordance with our criteria, we view its role as of "limited importance" and the link between the utility and its owner as "limited."

Liquidity

We believe THC's liquidity is adequate to cover its needs in the near term, even in the event of an unforeseen earnings decline. In our assessment, we incorporate the following assumptions:

- The company's liquidity sources, including cash, our estimated FFO, and its revolving credit facility, will likely exceed uses by 1.2x or more in the next 12-18 months.
- We expect net sources to remain positive, even in the event of a highly unlikely EBITDA decline of more than 15%.
- Liquidity sources include our expectation of about C\$240 million-C\$250 million of annual FFO, access as of June 30, 2011, to a fully available C\$400 million revolving credit facility (expiring May 2013), and C\$120 million cash on hand as of June 30, 2011.
- Liquidity uses include an estimated annual capital expenditure of about C\$400 million, typical dividend payment of 50% of net income (about C\$35 million-\$40 million), and maturing debt of C\$245 million in December 2011.

Although its liquidity sources are sufficient to cover the upcoming debt maturity, we expect the company to refinance the senior unsecured debenture. The utility is well within the financial covenants applicable to its credit facility.

Outlook

The stable outlook reflects our expectation that the company will maintain its capital structure in line with the regulatory deemed capital structure, even under the significant capital spending pressures related to its aging regulated infrastructure, and remain focused on its regulated electricity distribution business. A material adverse regulatory ruling or energy policy change (such as assuming commodity risk) or sustained deterioration of financial measures (12% of AFFO-to-debt or less and 60% of reported total debt-to-total capital or higher), is likely to lead to a negative rating action. An upgrade is unlikely without a demonstrated, long-term, commitment to a much stronger balance sheet (less than 50% of adjusted total

debt-to-total capital) and deeper cash flow interest and debt coverage (greater than 30% of AFFO-to-total debt).

Related Criteria And Research

- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Key Credit Factors: Business And Financial Risks In The Investor-Owned Utility Industry, Nov. 26, 2008
- Criteria | Corporates | General:Methodology And Assumptions: Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010

Ratings List

Toronto Hydro Corp.

Ratings Affirmed

Corporate credit rating A/Stable/--

Senior unsecured debt A

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