STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

Research

Summary:

Ontario Power Generation Inc.

Primary Credit Analyst:
Stephen R Goltz, Toronto (1) 416-507-2592; stephen.goltz@standardandpoors.com

Secondary Contact:
Gerald F Hannochko, Toronto (1) 416-507-2589; gerald.hannochko@standardandpoors.com

Research Contributor:
Tavish Katyal, CRISIL Global Analytical Center, an S&P affiliate, Mumbai

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Summary:

Ontario Power Generation Inc.

Corporate Credit Rating	A-/Negative/--

Profile Assessments

BUSINESS RISK	STRONG	Vulnerable — Excellent
FINANCIAL RISK	AGGRESSIVE	Highly leveraged — Minimal

Initial Analytical Outcome ("Anchor") And Rating Result

Our 'A-' rating on Ontario Power Generation Inc. (OPG) is derived from:

- Our 'bb+' anchor, based on our "Strong" business risk profile and "Aggressive" financial risk assessments for OPG;
- A one-notch positive impact from the Rating Comparison modifier resulting in a 'bbb-' stand alone credit profile (SACP); and
- A three-notch positive impact, reflecting our assessment of a high likelihood of government support for OPG.

Rationale

Business Risk: Strong	Financial Risk: Aggressive
• OPG'S dominant position in a strong market and a diversified economy • Regulatory support for the company's nuclear assets and the bulk of its hydroelectric assets • A diversified portfolio of power-generating assets • Low-cost hydroelectric assets with diversified river systems	• Increasing proportion of regulated cash flows • Overall weak cash flow metrics • Substantial capital expenditure (capex) plans

Outlook: Negative

The negative outlook reflects Standard & Poor's Ratings Services' 'bbb-' SACP on the company, the negative outlook on the Province of Ontario, and the high likelihood of provincial support as defined under our criteria for government-related entities.

Downside scenario

We recognize that OPG's cash flow adequacy will be weaker in the next two years because of substantial capex on regulated and contracted projects. We could lower the SACP if we expect the company's adjusted funds from operations (AFFO)-to-total debt to fall below 9% on a sustained basis. This could result from unfavorable rate decisions, operational issues resulting in unexpected outages in OPG's generation facilities, or a move toward a more aggressive financial policy (including prolonged, substantial debt-financed capex). A decline in the SACP to 'bb+' would result in a downgrade on OPG.

Upside scenario

For the SACP to move a notch higher, OPG would need to improve significantly the level and stability of its cash flow comfortably above a 13% AFFO-to-total debt level. This could result from an equity injection from the province, which we consider highly unlikely. It could also result from some form of additional regulatory cash flow support during the upcoming period of high capital spending on large projects that we have seen for other Canadian utilities in a similar position.

We link our ratings on OPG and on the province through our enhanced government-related entity methodology. All else being equal, a one-notch downgrade on Ontario would result in a one-notch downgrade on OPG. An outlook revision on the province to stable could result in a similar outlook revision on the utility. A change in the relationship with the government shareholder, which includes changes in ownership, could move the ratings in either direction.

Standard & Poor's Base-Case Scenario

Assumptions

- Continuing capex related to the Lower Mattagami and Darlington refurbishment
- Issuance of new debt to fund the capex plans
- New regulated rates for 2014 and 2015 and the regulation of currently unregulated hydro assets

Key Metrics

	2013E	2014E	2015E
AFFO/Debt	9%-11%	12%-14%	12%-14%
Debt/EBITDA	7x-8x	5x-6x	5x-6x

E--Estimated.

Business Risk: Strong

OPG's strong business risk profile reflects its strong market position accounting for over 50% of Ontario's electricity generation in 2013, its large and diverse generation portfolio comprising nuclear, hydroelectric and thermal assets, and a strong regulatory environment. The company benefits from having about 90% of its EBITDA supported by regulated sources. These sources include nuclear and baseload hydroelectric assets that the Ontario Energy Board regulates, as well as regulated nuclear waste management. Assurance of cost recovery and a predictable, albeit moderate, return for these assets are a positive credit factor. The Ontario Ministry of Energy has proposed an amendment to the existing regulation to prescribe all of the 48 hydroelectric generation facilities that are unregulated and not under contract. This would enable these facilities to earn a regulated rate as opposed to the Ontario wholesale electricity prices beginning 2014. In our opinion, this will reduce cash flow volatility and further support OPG's strong business risk profile.

Technical challenges associated with key components of nuclear facilities have the potential to expose the units to lengthy outages, hurting cash flow performance and increasing capital demands. OPG's nuclear liability risk-sharing agreement with Ontario limits the company's used nuclear fuel liabilities and partially mitigates the operating challenges.

In implementing its energy policy favoring renewable energy generation to replace the less eco-friendly coal-fired generation facilities, the province had previously required OPG to shut down the remaining coal-fired plants by 2014. However, the remaining coal-fired units at the Lambton and Nanticoke generating stations were shut down by Dec. 31, 2013 as directed by the Ontario Ministry of Energy, in advance of the previous Dec. 31, 2014 deadline. Along with these directives, the Ontario government has provided ongoing support to OPG through loans from Ontario Electricity Finance Corp. (OEFC) and long-term power purchase agreements with the Ontario Power Authority to support OPG's other projects. It also provides OPG with a contingency support agreement that the company expects to be amended to recover actual costs that cannot reasonably be avoided or mitigated, during the period from the advanced shutdown date of the above facilities up to the end of 2014. Standard & Poor's regards these ongoing supports as important mitigating factors for the company's business risk profile.

Financial Risk: Aggressive

In our view, OPG's stand-alone financial risk profile is aggressive. Its stand-alone cash flow metrics are weak overall, partially as a result of material postemployment benefit (OEPB) adjustments and modest return on investments. The company is continuing with a number of projects that require a significant amount of capex in the next two years. We expect that the Darlington nuclear facility refurbishment, together with the Lower Mattagami project, will require approximately C$1.3 billion and C$1 billion in capital expenditures in 2014 and 2015, respectively. This is in addition to sustaining capex that the company must incur.

OPG's unregulated cash flows have been a constraining factor in the past because these are exposed to the wholesale electricity price as well as volume risk due to fluctuations in demand in Ontario.

Although the continued capex is expected to put pressure on the credit metrics, a gradual improvement is likely in the next three years resulting primarily from the following:

- Higher regulated rates for the regulated nuclear and hydroelectric generation as a result of new base rates for 2014/2015. This reflects inclusion of the completed Niagara tunnel as well as recovery of pension/OPEB and nuclear waste liabilities and recovery of Darlington maintenance.
- Regulation of currently unregulated non-contracted hydroelectric generation: The ability to earn regulated rates (anticipated to begin in 2014) as opposed to the Hourly Ontario Energy Price will minimize volatility and support cash flow stability.

Liquidity: Adequate

OPG's liquidity is "adequate", in our view. We believe liquidity sources will be adequate to cover uses more than 1.2x in the next 12 months. We expect that even if EBITDA declines by 15%, the company's sources of funds would still exceed its uses. We also believe OPG has sound relationships with its bankers and has prudent financial risk management.

Principal Liquidity Sources	Principal Liquidity Uses
• FFO of C$1.5 billion in 2014 • Available credit facilities of C$2.7 billion as of Sept. 30, 2013. The committed and available credit facilities comprise a C$1 billion facility maturing May 2018, a C$600 million bank credit facility to support initial construction of the Lower Mattagami project, a C$700 million OEFC facility for Lower Mattagami and C$400 million availability under the Niagara tunnel facility	• Substantial capex of C$1.7 billion in 2014

Other Modifiers

Standard & Poor's assesses the comparable rating analysis of OPG as "Favorable", which lifts the anchor by one notch to 'bbb-' from 'bb+'. OPG has a dominant market position in Ontario, as it significantly contributes to the province's power generation. In addition, the company benefits from a high proportion of regulated cash flow and regulatory support during the period of high capex.

Government Influence

We believe there is a "High" likelihood that OPG's owner, the Province of Ontario, would provide timely and sufficient extraordinary support to OPG in the event of financial distress. This is based on our view of a "Very Strong" link and an "Important" role in accordance with our government-related entity criteria.

Ratings Score Snapshot

Corporate Credit Rating: A-/Negative

Business risk: Strong

- Country risk: Very Low
- Industry risk: Very Low
- Competitive position: Satisfactory

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: bb+

Modifiers

- Diversification/Portfolio effect: Neutral
- Capital structure: Neutral
- Liquidity: Adequate
- Financial policy: Neutral
- Management and governance: Satisfactory
- Comparable rating analysis: Favorable (+1 notch)

Stand-alone credit profile: bbb-

- Likelihood of government support: High

Related Criteria And Research

Related Criteria

- Corporate Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Methodology And Assumptions: Liquidity Descriptors for Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010