Research Update:

Ontario Power Generation Inc. Rating Lowered To 'BBB+' From 'A-' On Province of Ontario Downgrade; Outlook Stable

Overview

- We are lowering our long-term corporate credit rating on Ontario Power Generation Inc. (OPG) to 'BBB+' from 'A-'.
- We are also affirming our 'A-1(Low)' Canada scale commercial paper rating on OPG.
- The rating action follows the downgrade to the Province of Ontario to 'A+' from 'AA-' on July 6.
- Our "strong" business risk profile and "aggressive" financial risk profile assessments have not changed.
- The stable outlook on OPG reflects our view of the company's 'bbb-' stand-alone credit profile and of the continued "high" likelihood of support from Ontario.

Rating Action

On July 7, 2015, Standard & Poor's Ratings Services lowered its long-term corporate credit ratings on Ontario Power Generation Inc. (OPG) to 'BBB+' from 'A-'. The outlook is stable. At the same time, Standard & Poor's affirmed its 'A-1(Low)' Canada scale commercial paper rating on OPG.

Rationale

The downgrade follows that on the Province of Ontario, OPG's parent, to 'A+' from 'AA-' on July 6. We link the rating on OPG to that on Ontario through our government-related entities (GRE) criteria. The combination of the 'A+' rating on Ontario, OPG's 'bbb-' stand-alone credit profile (SACP), and our continuing view of a "high" likelihood of support from the province results in a one-notch downgrade of the rating on OPG to 'BBB+'. From our perspective, the "high" likelihood the province would provide timely and sufficient extraordinary support to OPG in the event of financial distress has not changed.

Our assessment of OPG's business risk profile is still "strong," reflecting the utility's strong market position (which accounted for more than 50% of Ontario's electricity generation in 2014); its large and diverse generation portfolio comprising nuclear, hydroelectric, and thermal assets; and a supportive regulatory framework. We expect OPG will continue to generate about 90% of its EBITDA from regulated sources, recover its fixed and variable cost

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Rating Report

Ontario Power Generation Inc.

DBRS

Insight beyond the rating.

Tom Li
+1 416 597 7378
tli@dbrs.com

James Jung, CFA, FRM, CPA, CMA
+1 416 597 7577
jjung@dbrs.com

Ratings

Debt	Rating	Rating Action	Trend
Issuer Rating	A (low)	Confirmed	Stable
Unsecured Debt	A (low)	Confirmed	Stable
Commercial Paper	R-1 (low)	Confirmed	Stable

Rating Update

On April 6, 2016, DBRS Limited (DBRS) confirmed the Issuer Rating and Unsecured Debt rating of Ontario Power Generation Inc. (OPG or the Company) at A (low), and the Commercial Paper (CP) rating at R-1 (low), all with Stable trends. The confirmation was largely based on the continuing financial support from the Company's shareholder, the Province of Ontario (the Province; rated AA (low) by DBRS). The Province, through its agent the Ontario Electricity Financial Corporation (OEFC; rated AA (low) by DBRS), provides most of OPG's financing (approximately 63% of total debt). The Company's remaining debt is in the form of non-recourse project finance debt.

The Province announced in January 2016 that OPG will be moving forward with the refurbishment of the Darlington Nuclear Generating Station (the Darlington Refurbishment). The project has a final budget of $12.8 billion, and the refurbishment of the first unit is scheduled to begin in October 2016, with the last unit to be in-service by 2026. DBRS believes that given the complexity and scale of the Darlington Refurbishment, there is significant execution risk as well as the potential for cost overruns. The high capital expenditures (capex) required, albeit spread over a ten-year period, in addition to ongoing maintenance capex (total capex forecast of approximately $2 billion for 2016), are expected to pressure OPG's key credit metrics. Although the Company's cash flow-to-debt and debt-to-capital ratios have remained strong, DBRS expects leverage to increase to approximately 40% during this period of high capex. Additionally, profitability for OPG continues to be challenged as evidenced by the negative EBIT-interest coverage ratio for the year. DBRS notes that while the in-service of the Lower Mattagami River Project (LMRP) and the prescription of 48 previously unregulated hydroelectric facilities to regulated rates in late 2014 have helped improve OPG's EBITDA, the Company's reported corporate return on equity (ROE; 4.1% in 2015) remains far below the approved ROE of 9.3%. This has largely been due to the high cost base of OPG, which has resulted in several disallowances by the Ontario Energy Board (OEB) for the Company to recover forecasted compensation expenses.

OPG plans to submit a five-year application with the OEB later this year for new regulated rates effective 2017. The OEB has expressed that it expects prices for hydroelectric operations to be based on an incentive regulation (IR) ratemaking methodology, and that prices for nuclear operations be based on a multi-year forecast cost-of-service (COS) approach with IR features. DBRS believes that profitability for OPG could continue to be challenged following a switch to an IR framework, as the introduction of productivity and efficiency targets could further depress earnings. However, through its Business Transformation initiative, OPG has demonstrated its ability to improve efficiency by reducing regular headcount from continuing operations by approximately 2,700 personnel since 2011. Furthermore, earnings should also benefit from the growth in the rate base as Darlington Refurbishment pre-requisite projects are completed, and new regulated rates in 2017.

Financial Information

	For the year ended December 31				
(CAD millions)	2015	2014	2013	2012	2011
Cash flow/Total debt 1	33.2%	27.0%	22.9%	20.8%	28.9%
Total debt in capital structure 1, 2	35.9%	36.9%	38.9%	36.9%	36.8%
EBIT gross interest coverage (times) 3	(0.86)	0.24	(1.12)	0.66	0.02
EBITDA gross interest coverage (times) 3	2.89	2.75	2.21	3.15	2.71
(Cash flow - n.w.f.)/Total debt 4	27.5%	21.3%	16.5%	13.8%	21.1%

1 Including operating leases. 2 Adjusted for Accumulated Other Comprehensive Income. 3 Excluding earnings from nuclear fixed asset removal and nuclear waste management funds. 4 Included nuclear waste funding (n.w.f.) payments as they are not discretionary.

Issuer Description

Ontario Power Generation Inc. is an electricity generating company with a diverse portfolio of over 17,000 megawatts (MW) of in-service generating capacity. The Company is wholly owned by the Province of Ontario.

In-Year Revenue Performance

Total revenue in 2015–16 is estimated to be $126.5 billion. This is $2.2 billion, or 1.7 per cent, above the amount projected in the *2015 Budget*. The increase is largely due to higher net revenues from asset optimization in 2015–16, higher taxation revenues and stronger overall performance from GBEs, which also accounts for estimated Hydro One Limited (Hydro One) net income changes unrelated to the asset optimization strategy.

TABLE 3.9 Summary of Revenue Changes since the *2015 Budget*
($ Millions)

	Interim 2015–16
Asset Optimization	**1,149**
Other Revenue Changes	
Taxation Revenue	
Sales Tax	504
Land Transfer Tax	311
Personal Income Tax	(112)
All Other Taxes	(73)
Total Taxation Revenue	**630**
Total Government of Canada	**(17)**
Income from Government Business Enterprises	
Ontario Power Generation Inc./Brampton Distribution Holdco Inc./ Hydro One Ltd.	218
Ontario Lottery and Gaming Corporation	159
Liquor Control Board of Ontario	58
Total Income from Government Business Enterprises	**435**
Total Other Non-Tax Revenue	**(40)**
Total Revenue Changes since the *2015 Budget*	**2,157**

Note: Numbers may not add due to rounding.