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Ratings

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Summary:

Ontario Power Generation Inc.

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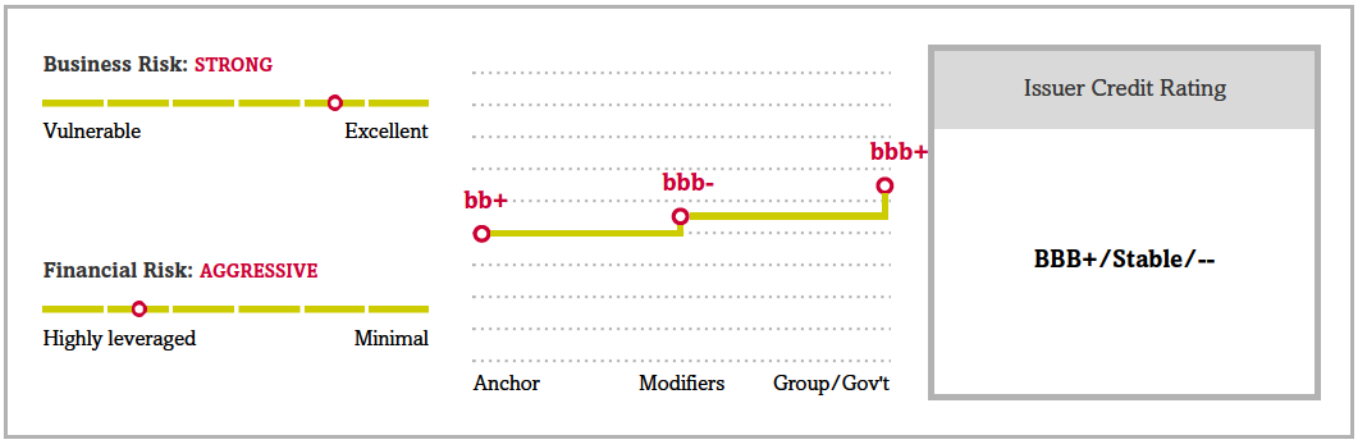
Summary:

Ontario Power Generation Inc.



Rationale

Business Risk: Strong	Financial Risk: Aggressive
• Ontario Power Generation Inc.'s (OPG) dominant market position in Ontario, which has a well-diversified economy • A strong and diverse service territory with modest population growth • OPG's diverse portfolio of power-generating assets • The company's multiple river systems, which partially mitigate its hydro risk exposure	• S&P Global Ratings assesses OPG's financial measures using moderate financial ratio benchmarks, reflecting the company's low-risk utility operations • We expect adjusted funds from operations (AFFO) to debt of about 13% for the 2019-2020 period • We expect large capital spending over the next several years • We exclude the Fair Hydro Trust (FHT) debt from our financial risk assessment for OPG

Outlook: Stable

The stable outlook reflects S&P Global Ratings' expectation that OPG will continue to generate the vast majority of its revenues from regulated generation, which provides stable and predictable cash flows, and that the company will not experience any adverse regulatory decisions. In addition, our outlook reflects no material delays and cost overruns associated with the Darlington refurbishment plan. Furthermore, our outlook reflects a stable relationship between OPG and the Province of Ontario. A one-notch deterioration in either OPG's stand-alone credit profile (SACP) or our rating on the province would not affect our rating on the utility.

During our two-year outlook period, we expect adjusted funds from operations (AFFO)-to-debt to range from 10%-11% in 2018 before rising to about 13% in 2019 and 2020.

Downside scenario

We could take a negative rating action if both our SACP on OPG and our rating on Ontario fell one notch. An unexpected deterioration in the relationship between OPG and the province could also result in a negative rating action.

Alternatively, we could take a negative rating action if OPG's credit metrics deteriorate significantly, specifically AFFO-to debt approaching 7% with no prospects of improvement. This could happen if the company experiences significant operational outages with its generation fleet, incurs material delays and cost overruns related to the Darlington refurbishment, or receives adverse regulatory decisions.

Upside scenario

We could take a positive rating action on OPG if the utility demonstrates financial improvement, with sustained AFFO-to-debt approaching 13%. A one-notch improvement to our SACP on the company, all else being equal with the province, would result in a one-notch upgrade to the utility. However, we view this as unlikely during our outlook period, given that OPG's rates are regulated and the company has a large capital spending program for the next several years, including the multibillion-dollar Darlington nuclear plant refurbishment project.

Our Base-Case Scenario

Assumptions

- OPG will continue to focus on its regulated electricity generation business
- The Ontario Energy Board, the provincial regulator, will continue to operate in a transparent, stable, and predictable manner
- The utility will not experience any adverse regulatory decisions
- Capital spending will average about C$1.9 billion per year, including the Darlington refurbishment project, which we expect will not incur material cost overruns and delays
- OPG's share of funding Fair Hydro Trust (FHT) will not change, at about 5%

Key Metrics

	2017A	2018E	2019E
AFFO/debt	9.25%	10%-11%	13%-14%

AFFO--Adjusted funds from operations. A--Actual. E--Estimated.

Company Description

OPG is an Ontario-based electricity generation company whose principal business is in the generation and sale of electricity in Ontario. The utility supplies about half of the electricity in the province and is wholly owned by the Province of Ontario, which also holds a majority of the company's long-term debt. The company is the largest clean energy generator in Ontario, with an in-service capacity of about 16,218 megawatts.

Business Risk: Strong

Our business risk assessment on OPG reflects the company's strong market position in electricity generation, which accounted for about 50% of Ontario's total electricity production in 2017, and a generally supportive regulatory framework. We expect the utility will continue to generate about 95% of its EBITDA from regulated sources, to recover prudently incurred fixed and variable costs.

In addition, OPG has a diverse portfolio of generation assets comprising four nuclear (including Bruce) stations, 66 hydroelectric stations, two biomass stations, one thermal station, and one wind turbine asset. Although the company's hydroelectric assets are exposed to hydrology risk, its multiple river systems partially mitigates this.

Further supporting our assessment of OPG's business risk is the utility's service territory, Ontario. The province has a strong and diverse economy with modest population growth, partially offset by ongoing demand conservation programs.

Due to the nature of the electricity framework, OPG does not directly collect from ratepayers and does not have a large and diverse customer base. The utility's main counterparty is the Independent Electricity System Operator, a

Crown agent, which remits monthly electricity sales revenue to OPG in the subsequent month.

Financial Risk: Aggressive

We assess OPG's financial measures using moderate financial ratio benchmarks, reflecting the company's low-risk utility operations. Virtually all of the utility's cash flows come from regulated electricity generation.

Our assessment of OPG's financial measures excludes the senior secured debt issued by FHT as part of the Fair Hydro Plan (FHP), which is consolidated into OPG's balance sheet. This primarily reflects our view that this debt is secured by future cash flow from the Clean Energy Adjustment, is guaranteed by the Ontario government, and is nonrecourse to OPG.

The company has a large capital program over the next several years, primarily related to the Darlington refurbishment program. We expect this capital spending will continue to stress OPG's credit metrics, resulting in negative free operating cash flows. Under our base-case scenario, which includes capital spending of about C$1.9 billion per year, rate adjustments from the most recent rate decision in December 2017, and the financing commitment to the FHP, we expect AFFO-to-debt of 10%-11% in 2018 and about 13% in 2019-2020, reflecting the upper end of OPG's financial risk profile category.

Liquidity: Adequate

We assess OPG's liquidity is adequate. We expect sources will be sufficient to cover uses more than 1.1x over the next 12 months. We further expect that, in the event of a 10% decline in EBITDA, the company's sources of funds would still exceed its uses. In addition, OPG has sound relationships with its banks and generally prudent financial risk management.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash and liquid investments available of about C$315 million as of March 31, 2018 • Cash FFO of about C$ 1.4 billion over the next 12 months • Committed credit facility availability of about C$1.04 billion as of March 31, 2018	• Debt maturities of about C$520 million, including short-term borrowings of C$260 million, as of March 31, 2018 • Sustaining capital expenditures of about C$670 million over the next 12 months • Dividend payments of about C$200 million

Other Modifiers

We include a positive comparable rating analysis modifier in our analysis of OPG, reflecting credit metrics that we expect to reflect the higher end of the company's financial risk profile category during our forecast period.

Government Influence

Our ratings on OPG incorporate a high likelihood that OPG's provincial owner, the Government of Ontario, will provide extraordinary support to the utility during periods of financial distress. OPG plays an important role to Ontario because it supplies about half of the province's electricity. In addition, the utility plays a vital role to Ontario's energy and environmental policies. Furthermore, the province has a track record of providing support, both directly and indirectly, to the utility. For these reasons, we view the likelihood of extraordinary government support for OPG as high, which provides two-notch rating enhancement to the 'bbb-' SACP.

Ratings Score Snapshot

Issuer Credit Rating

BBB+/Stable/--

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 (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Positive (+1 notch)

Stand-alone credit profile : bbb-

- **Likelihood of government support:** High (+2 notches from SACP)

Issue Ratings--Subordination Risk Analysis

Capital structure

OPG's capital structure consists of about C$6.3 billion in long- and short-term debt, excluding the senior secured debt at the FHT level, of which about C$2.0 billion is secured with the remaining C$4.3 billion unsecured as of March 31, 2018.

Analytical conclusions

We rate the senior unsecured debt 'BBB+', the same as the issuer credit rating on the utility, because priority debt is less than 50% of total consolidated debt.

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	Significant	**Aggressive**	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	**bb+**	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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