LDC Purpose Drives Strategy, Not Ownership

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Opening Remarks

- A **tsunami of disruptive forces** is cross cutting all sectors of our economy.
- To name but a few; **digitization to the internet of things, to mobile network applications, shifting environmental and social policy, renewable energy, aging populations and increasing urbanization.**
- These mega forces **challenge the sustainability of the current LDC paradigm** and the principles that support it, from ownership to the viability of the monopoly of a hard wired distribution network. Municipalities are increasingly confronted with the question, " is ownership the best path forward?"
- **Determination of the future purpose of the LDC, not ownership, should drive the optimal LDC strategy.**
- My comments will touch on the forces of LDC change and spotlight EPCOR…. a case study in the principle, " **Purpose Drives Strategy**."

Disruptive Forces Are Kick Starting LDC's

- **Technology-** California LDC's rate basing $100M super chargers, inductive road charging in the lab, smart grid peak harvesting, off grid technology less than $30K- Power storage-Tesla’s energy wall and solar tiles.
- **Acceleration of urbanization**; 72% growth of urban centres by 2025, 85% plus of population living in urban centres. Municipal balance sheets face competing demands for capital to fund LDC's as well as maintain and build new roads, bridges, mass transport and other critical infrastructure.
- **Rate payers and tax payers increasingly cynical of manipulation and subsidies that mask underlying cost of service.** This cost squeeze is emerging as a major incentive to go off grid, behind the fence or micro grids. Leaving the grid adds financial pressure on those that remain.
- **Demographics of aging workforce** and scarcity of talent, by 2050, 65>14. Capitol/technology partially close the gap.

LDC ownership, is it relevant?

Myth

- Allows the municipality to set the rates, level of service and return on their investment.
- Ownership can protect municipalities from disruptive market forces.
- Is vital for the delivery and advocacy of essential service
- The LDC is a natural monopoly, no one would ever rewire a city.

Reality

- The OEB does this through a regulatory construct. Balances costs, returns and benefit.
- Maybe for the short term but you can not deny customers the reality of better alternatives. CRTC struggles to control internet.
- telecom, internet, natural gas; all essential and have alternate non municipal providers.
- Telecoms copper networks vs fibre and wireless, taxis did too. Roads vs drones.

Core: LDC Purpose drives Strategy

- **Table stakes** for a LDC is to provide customers access to competitively priced electricity, in a safe and reliable manner. The regulatory compact balances the need to satisfy the financial returns of owners, with rates and service levels.
- **The starting point for LDC owners is , "What is your future purpose of owning this asset?"**
  1. **Status quo**- slow road to harvesting value
  2. **Divest**- redeploy capital to higher value purpose.
  3. **Grow**- an engine of value generation and service delivery.

  Path selection depends on municipality's view of the future balanced with risk and opportunity assessment.

EPCOR’s LDC Model-Case Study

- **Trigger,1998 Power market deregulation**- severe risk to COE’s generation investment and dividend.
- After careful study**, purpose of LDC re-affirmed to be an engine of growth and prosperity to the community, balancing service delivery with commercial growth**.
- Sell, compete or slowly harvest the business., **Decision to compete through retention of the asset and adoption of a different business model** to transfer governance, strategy and leadership to an arms length entity.
- In 1998 dividend of $67M and by 2013, $138M. From $1.7B in assets to $4.5 B. Largest private water/waste water operator in U.S. SW. & Canada.
- S&P A low, DBRS A , 100% standalone funding, 60/40 ,no additional equity or debt from COE post 1998.

Governance is Critical

- **Competent and credible Board of Directors** to oversee and guide the execution of EPCOR's strategy.
- **Avoidance of conflicts, real or perceived vital**. All Directors independent, more than half from outside the City, several from Toronto, Vancouver, Calgary and the USA. Diversity and skills are essential.
- **MSA delegated major roles and responsibilities to the Board while COE retained 100% ownership**. Sale of a material part of the company, appointment of Directors and external auditors, COE reserved but which the Board recommended.
- **The Deal**; Deliver quality dividend growth or COE takes back control.
- All rates and terms of service are regulated by AEUB, not COE.

Battle Plan

- **Purpose: Positioned company/brand as a commercial entit**y. High value job creator, dividend producing, tax paying company, vital to the health of the community. Not your parent’s monopoly. Earned right to serve daily.
- **SWAT revealed risk/return in power generation** . Water did not have critical mass nor was capital competitive due to FX and market.
- **Outflanked LDC incumbents** hiding behind regulation and strategy of hope.
- **Fast fish eat the slow ones.** Strategy, financing, billing and governance.
- **Focused on profitable growth, no big bets**, a few pilots. We could not make a mistake. Humble, not perfect.
- **Core values;** people, safety, transparency & trust

How Governance and Strategy Worked.

- **Nose in, fingers out.**
- **Shareholder approached the company the same way they would third party service providers**.
- **CEO and Chair kept Mayor and council briefed** “Never a surprise, the truth and despite robust dialogue never lost mutual respect"
- **Ability to raise capital ,manage the dividend and enter into major transactions key for growth.** Credit rating agencies fear of cash sweep.
- **EPCOR pays all taxes** and governed by a 100% independent arms length Board. **Quarterly results on SEDAR and public AG**M.
- **COE best shareholder. Never a confidentiality agreement breached.**

Lessons Learned

- **Determination of purpose is key**, a crisis helps to focus on this.
- **Direct control of LDC not essential** to achieve competitive service levels and a healthy investment return .
- **Ownership enabled growth strategy but not an end in itsel**f.
- **Strategy is not enough, it must work and cash is king**
- **Courageous Directors and a skilled Chairperson are table stakes.**
- **Full independence not critical** but increasingly skills and the potential for conflict and political interference, real or perceived is the issue.
- **Pressure on the municipalities balance sheet is unrelenting**.
- **Dilemma of divesting is how to replace the foregone revenue?**
- **Listen to your critics but remember who pays the bills.**

Closing Thoughts

- **The Chairman and CEO own culture and to**ne. The mayor must continually reinforce the roles between the board, councillors , management and customers.
- **Think the unthinkable and strive to be a disrupter**.(paranoid/positive)
- **Never be greedy.**
- **Have the best cost platform**, be technology heavy, people friendly. Do not be overly dependent on regulated markets or government policy for your core business.
- To achieve top performance **LDC's must step outside their franchise.**
- **Governance, strategy and leadership are the key enablers of LDC performance**