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Hydro One to navigate choppy IPO market with fat payout

Attractive dividends at a bargain price are poised to make Hydro One Ltd. a smooth sell in a difficult market for initial public offerings when it prices this week, making it Canada's largest utility by market value. The greening of its home province may be an overlooked allure.

Ontario is seeking to raise as much as $1.87 billion by selling 15 percent of the provincially owned utility with shares priced at $19 to $21 apiece in what could be Canada's biggest IPO in 15 years. Royal Bank of Canada and Bank of Nova Scotia are leading the sale.

The electricity distribution and transmission company is set to hit the public market with the power system in Canada's most populous province in flux. The fragmented industry is ripe for consolidation while an increase in wind and solar power means the grid will need to expand to connect supply with demand.

"We're going to see less coal and more gas and renewables in the U.S. and Canada," Charles Fishman, a utilities analyst at Morningstar Inc. in Chicago, said by phone. "And this is going to be good for transmission utilities because the load is not where renewables are."

Utilities across North America are being forced to adjust to an electricity system that is becoming less centralized as large coal plants are shuttered in favor of renewable energy. That's creating an opportunity for companies to grow by expanding or rebuilding their existing network of power lines or taking over rivals.

Ontario has already closed down its coal power plants, including North America's largest, and replaced some of that capacity with a combination of more natural gas and renewable sources. That means more wires.

"These trends are good for investment in transmission," Fishman said.

Even at $19 apiece, Hydro One would have a market value of $11.3 billion, ahead of Fortis Inc. at about $11 billion and Canadian Utilities Ltd. at $9.4 billion, according to data compiled at Bloomberg. It would rank among the top 20 largest North American utilities.

The company's dominant size would provide it with a chance to buy up smaller competitors in Ontario. The province currently has about 70 smaller distribution competitors, many of which are owned by towns and cities across Ontario.

Daffyd Roderick, a spokesman at Hydro One, declined to comment.

"Hydro One will continue to evaluate local distribution company consolidation opportunities in Ontario in the future and intends to pursue those acquisitions which deliver value to the company and its shareholders," the utility said in its Sept. 17 prospectus. Hydro One also said it may consider "larger-

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scale acquisition opportunities or other strategic initiatives outside of Ontario" including transmission and distribution providers in Canada or the U.S.

"Prospects for new investment would drive the interest in these kinds of offerings," said Steven Paget, an analyst at FirstEnergy Capital Corp. in Calgary.

The company last year reported revenue of C$6.5 billion and net income of C$747 million. It owned C$23.2 billion worth of assets including about 29,000 kilometers (18,000 miles) of transmission lines as of June 30 and served about 1.3 million distribution customers, according to sale documents.

Hydro One's proposed annual dividend of 84 cents would yield about 4 percent, above the 3.3 percent average yield among its Canadian peers and 3.9 percent for the 13-company S&P 500 Electric Utilities Index, according to data compiled by Bloomberg.

Hydro One is pursuing an IPO at a difficult time, with volatile stock markets causing havoc for North American companies trying to raise funds. Canada has only had two other domestic IPOs above C$100 million in the past three months -- both special purpose acquisition corporations.

Initial sales for telecommunications firm exactEarth Ltd. and home builder Tricon Investment Partners Inc. were scrapped due to market conditions. CPI Card Group Inc., a payments card maker that dual listed in the U.S. and Canada, was forced to slash its IPO by half earlier this month due to "heightened volatility."

A volatility gauge for 60 of the largest, most liquid Canadian stocks surged as much as 27 percent in the first two weeks after Hydro One filed IPO documents with regulators, and is currently down 18 percent from the initial filing date.

Hydro One expects 4.2 percent annual growth in the rates charged to customers through 2019, according to a regulatory filing ahead of its share sale. The regulated rates cover 99 percent of the company's revenue.

Bruce Campbell, who manages about C$100 million at Stone Castle Investment Management Inc. in Kelowna, British Columbia, said the price range makes the valuation seem "pretty reasonable" when compared to its peers. At C$19 the company would have a price to earnings ratio of 16.3 for 2014, according to the sales documents. That compares with 21.5 for Fortis and 16.8 for Canadian Utilities in 2014, the documents show.

The IPO will likely sell out, Campbell said, based on conversations with other investors and those marketing the deal.

"They didn't think it was going to fly off the shelves and be five-times oversubscribed, but they felt it was going to be fully covered and go out the door, no problem, somewhere in the range," he said. He hasn't decided whether he will buy the shares.

INVESTORS PRESS FOR DETAILED PLANS FROM OIL PATCH

When oil and gas companies begin rolling out third-quarter results this week, investors will be more interested in what executives are planning to do in the future than what they actually did over the past months.

North American oil last traded above $100 (U.S) per barrel on July 30, 2014, and the fallout from the declining price has already nailed many companies. But as the pain intensifies, shareholders are seeking more information on debt levels, the tolerance of bankers, cost-cutting and hedging programs.

Today's low prices mean that just about every decision going forward will have consequences. Companies forced to put assets on the block to shore up balance sheets may have to accept that potential buyers with deep pockets can outlast them, forcing troubled operators to sell projects for less than their perceived worth. Further, while scores of companies are set to renegotiate debt covenants, extending their chances of survival, bankers will be able to extract something in return, like higher interest rates.

Investors monitoring this round of earnings will be weighting the value of all of these types of trade-offs.

"We care more about the future," said Laura Lau, a senior vice-president at Brompton Funds in Toronto. Hedges are a big one on her list. "I expect very little hedging," she said. "I call it locking in defeat."

The average future price for a barrel of oil in 2018 is $55.33, Ms. Lau noted. In 2019, the average rings in at $57.26 per barrel and prices for 2021 reach to around $60 per barrel.

"Sixty dollars – a lot of people view as the magic number for when you can start drilling again," she said. "And we're not to $60 [per barrel] yet for many years."

Impairment charges, also known as write-downs, are expected to litter third-quarter earnings reports. Analysts at Barclays PLC expect Encana Corp. to post a pre-tax write-down of about $2.88-billion, according to a research note. To put that in perspective, the Canadian company's stock market value totalled $7.13-billion on the New York Stock Exchange, the analysts noted in their Oct. 21 report.

They also expect Apache Corp., Chesapeake Energy Corp., Devon Energy Corp., Encana, Newfield Energy Corp. and Southwestern Energy Corp. to collectively post roughly $20-billion in write-downs for the quarter.

"The extent of accounting and reserve write-downs could be magnified as companies re-evaluate future drilling plans," the analysts said. If the plans do not include drilling on proved undeveloped land within five years, those reserves will need to be written down as well, Barclays said. While Barclays' analysis reflects large-cap firms, the same pain will extend to smaller outfits.

Teck Resources Ltd. serves as an example of the extent of potential write-downs. Last week, the Vancouver-based mining company wrote down its 20-per-cent stake in the Fort Hills oil-sands mining project to the tune of $400-million (Canadian). Suncor Energy Inc. leads the $15-billion Fort Hills effort, controlling 50.8 per cent. France's Total SA owns the remaining 29.2 per cent. Suncor has said it is committed to building the mine.

Indeed, in September it spent $310-million to buy 10 per cent of Fort Hills from Total. The partners do not expect to produce until late 2017.

While write-downs look ugly, they generally have not been the key to driving down share prices, Barclays said. Investors expect companies to write down assets given the weakness of oil and gas prices over the past 15 months.

Companies may detail further cuts related to their work force, ranging from more layoffs to fewer benefits. Ms. Lau has urged Cenovus Energy Inc. and Encana to ditch their so-called golden Fridays – a policy that allows employees to take off a certain number of Fridays per month with pay.

“We are reviewing all of the company’s compensation, benefits and time-off practices to ensure they align with current and anticipated market conditions,” Cenovus spokesman Brett Harris said last week.

Encana’s Friday policy is safe, according to spokesman Jay Averill. “We recently reviewed our vacation practice, including the first and third Fridays off, and found that the benefit is still a competitive practice across the industry,” he said last week.

ONTARIO LIBERALS PAID $10,000 TO HAVE GAS PLANT DATA ERASED

Wiped data connected to cancellation of 2 gas power plants

IT consultant Peter Faist, who is the spouse of former Ontario premier Dalton McGuinty’s deputy chief of staff, was paid $10,000 by the Liberal caucus to wipe data off approximately 20 government computers, police claim.

The allegation, unproven in court, comes from an Ontario Provincial Police Information to Obtain document released by the Ontario Superior Court on Thursday. The document was used to get a search warrant, which was executed at a government office in late November.

The data Faist is said to have deleted relates to the cancellation of two gas plants in the Toronto-area prior to an election campaign. Police suspect the data were internal email conversations regarding the cancellation of the gas plants.

David Livingston, McGuinty’s chief of staff, is accused of ordering the deletion of the emails.

Laura Miller, currently executive director of the B.C. Liberal Party, is one of several senior aides to former Ontario premier Dalton McGuinty who joined the B.C. Liberals after McGuinty stepped down in early 2013.

Police allege that Livingston, in emails, requested information on how to delete emails permanently and ultimately gave Faist access to the computers.

Faist told police he did not have a contract for the work.

His company, however, had been previously employed by the province, completing more than $50,000 worth of contract work, the documents reveal.

Faist is the spouse of Laura Miller, who was employed as McGuinty’s deputy chief of staff and is currently executive director of the B.C. Liberal Party.

The ITO contained more than 72 pages of information on the alleged data deletion.

The cancellation of the two gas plants cost the province an estimated $1.1-billion, according to the province’s auditor general. The controversial cancellations were announced in 2012 by the former McGuinty administration. McGuinty stepped down in early 2013.

“It really tells the tale of why the premier and the government was not in any way shape or form allow the truth to come out,” said Progressive Conservative house leader Steve Clark.

“We’re seeing what many of us feared was happening was that it was the Liberal party using taxpayers’ dollars for their own politically-motivated decisions.”

The New Democrats said the Liberals on the justice committee voted to shut down the public hearings because they knew more damaging testimony would come from Faist and Miller.

The Liberals issued a statement saying that Faist’s services with the party were terminated last March, after Wynne became premier.

“The ITO released today clearly states that staff in Liberal Caucus Service Bureau was not aware of what specific work was done by Mr. Faist, beyond IT services,” said the party statement.

The search warrants served last month sought the entire email boxes and backup tapes for Livingston and Miller from May 2012 until Feb. 11, 2013, the day Kathleen Wynne was sworn in

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as premier, replacing McGuinty.

Police allege in the court application that Livingston allowed a non-government employee, Faist, to use a special administrative password to install and use software to wipe data on 24 computer hard drives in the premier's office.

Court documents from an earlier search warrant served at another Ontario government office in Mississauga last February alleged that Livingston brought Faist in to erase files from computers despite concerns raised by the secretary of cabinet, Peter Wallace, the province's top civil servant.

"Mr. Wallace was concerned by this request (for an administrative password) since it could potentially be used to destroy or alter data," wrote Det.-Const. Andre Duval, who wrote the application.

Ontario's privacy commissioner and the OPP both concluded that Livingston sought out advice from the government's chief information officer and others on how to permanently wipe data from computers.

"He learned that if emails are double deleted, they cannot be retrieved," wrote Duval. "He also learned that back-up tapes in the premier's office have never been used to satisfy a freedom of information request."

McGuinty, who was interviewed by police last April, said staff in his office kept few records.

"Mr. McGuinty took the opportunity during the interview to speak about the overwhelming verbal nature of communications inside his office," Duval wrote last spring.

OFFSHORE LNG INFRASTRUCTURE FACING HEAVY DUTY FEES

AltaGas could be stuck with $100 million federal customs duty bill for floating gas plant

If Canadian liquefied natural gas projects are to avoid the cost overruns that Australia experienced, they might need to have some of the fabrication done offshore, rather than try to build everything on site, according to a recent analysis by KPMG.

But one company that's trying to do just that has had a $100 million hurdle placed in its path by the federal government in the form of a customs duty on a floating LNG plant, and as a result is postponing a final investment decision.

AltaGas Ltd. (TSX:ALA) is among the companies considered to be front-runners in the race to get an LNG plant built in B.C.

The company had planned to make a final investment decision by the end of this year on its Douglas Channel LNG project in Kitimat.

The project has several advantages as a low-cost LNG producer, including an agreement to buy gas from an existing pipeline. (Typically, a pipeline constitutes 10% of the capital expenditure on an LNG project.) AltaGas also has a willing First Nations partner – the Haisla.

But at a recent LNG in BC Conference, the company told reporters it will delay its final investment decision pending the outcome of an appeal of a federally imposed customs duty on a floating LNG plant that one of its partners, Belgium's Exmar NV, is building.

At US$300 million, the floating LNG plant represents more than half of the $600 million capital cost of the Douglas Channel LNG project. A 25% duty would increase the project's cost by $100 million.

"That's a lot of money," said Dirk Lever, an AltaCorp Capital analyst who covers AltaGas. "It starts to make the economics not work."

Stephen Brown, president of the Chamber of Shipping of BC, explained that the customs duty slapped on the Douglas Channel floating LNG terminal was designed to protect Canada's shipbuilding industry.

The floating LNG plant that AltaGas plans to bring to Kitimat might float, but it's not a ship, Brown said. And even if it could be classified as a ship, it's not the sort of thing that any Canadian shipyard could build.

"Because it's a floating platform, it sounds like they're classifying it as a ship, even though it's actually a platform," Brown said.

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terminals have been built in South Korea – one of the few countries with the capacity to build them.

The one that Exmar NV is having built for Douglas Channel LNG would likely be built in China by Wison Offshore & Marine, which previously won the contract to build a floating LNG plant for Exmar for a project in the Caribbean.

“They are highly sophisticated, and most certainly [with] the expertise and capacity that we have in our yards now, there is no way you could get one of these built in Canada,” Brown said. “It’s a very outdated regulation, and it should not apply in this case because there is no way that a Canadian shipyard could construct a vessel of this sophistication.”

Natural Gas Minister Rich Coleman said earlier this month that his government plans to lobby for “remission” of the duty on the Douglas Channel LNG project.

“The province has contacted the federal government to support duty remission for the proposed Douglas Channel LNG facility,” Coleman said in a written statement. “Once [the] federal election is completed and a new government forms, we look forward to continuing these discussions.”

The customs duty being applied on the Douglas Channel floating LNG plant raises the spectre of other duties being applied to other LNG-related components.

Most of the companies planning to build LNG plants in B.C. have international partners, many of which have expertise in the LNG business, so there might be some components of LNG plants that companies plan to have fabricated offshore.

Whether those components would have duties applied would depend on the countries of origin and trade agreements, said Mary Hemmingsen, KPMG’s LNG, power and utilities leader.

“For example, Canada has a number of trade treaties with various countries that would provide relief from various import taxes.”

LNG PLANT NEAR SQUAMISH CLEARS FIRST HURDLE IN ENVIRONMENTAL ASSESMENT

Squamish mayor disputes projected benefits of Woodfibre LNG plant proposed for her community

The Woodfibre LNG planted proposed for Squamish has cleared its first regulatory hurdle after being granted an environmental assessment certificate by the B.C. government.

The certificate includes 25 conditions meant to mitigate the negative impacts construction and operation of the plant will have on things like marine life and water quality.

Squamish mayor Patricia Heintzman opposes the Woodfibre project and says she has questions about the certificate, including the conclusion the plant will generate $21-million per year in municipal taxes.

“Our analysis isn’t anywhere close to that so I’m not sure how they’re doing that math,” Heintzman told CBC.

“There is significant potential for tax revenue, but our estimates are in the $5-million to $7-million range so I’m curious how the government based their decision on $21-million,” she said.

However, a spokesperson for Woodfibre LNG says the mayor may be comparing apples and oranges and that the estimated annual economic impact of $21 million is for the entire province, not just the district of Squamish.

The certificate trumpets other provincial and community benefits including:

- 100 full-time-equivalent positions during operations
- Construction expenditures of approximately $342-million that would be spent in B.C.
- $80-million per year in provincial taxes
- $98-million per year in federal taxes

Heintzman noted that there is strong opposition to Woodfibre LNG throughout Howe Sound communities.

“Everyone from West Vancouver to Bowen Island to Lions Bay and Gibsons,” said Heintzman. “People see the marine environment in Howe Sound returning. They’re concerned about super tankers in a narrow fjord.”

Whales, dolphins, salmon, herring and shell fish have slowly been repopulating Howe Sound since the closure of the Woodfibre pulp mill in 2006, and the upgrading of waste water treatment plants at the Port Mellon pulp mill and Britannia Beach mine site.

The certificate’s reasons for decision notes that the seawater cooling system proposed by Woodfibre LNG “has the potential to harm marine fish, particularly Pacific herring,” but that “based on the available information, we understand that the effects to fish and fish habitat have been minimized to the extent practicable...”

The project still needs federal approval and a separate environmental assessment certificate for a 52 kilometer FortisBC gas pipeline to power the plant.

Heintzman describes her community as ‘pretty divided’ over Woodfibre LNG.

“It’s not a huge plant so there’s not a huge amount of jobs here in Squamish,” she said.

However, Woodfibre LNG says its project would create more than a hundred local jobs making it one of the larger private-sector employers in Squamish.

DEVON CANADA CUTS 15 PER CENT OF STAFF TO COPE WITH FALLING CRUDE PRICES

Devon Energy Corp.’s Canadian unit has laid off 15 per cent of its staff in the latest job cuts to hit the oil patch as it chops spending to cope with the collapse in crude prices.

About 200 positions have been cut by Devon Canada, a subsidiary of the Oklahoma City-based independent oil and gas producer, spokeswoman Nadine Barber said.

The move comes after the company completed construction of the most recent phase of its Jackfish oil sands project in Northern Alberta.

“In the past two years, Devon has seen a significant reduction in capital spending in Canada as major projects, like Jackfish, have been completed,” Ms. Barber said in an email. “We expect capital to remain at lower-than-historic levels for the foreseeable future.”

In the summer, the Canadian Association of Petroleum Producers pegged job losses in the industry this year at 35,000, and there have been numerous layoffs announced since then as crude prices have languished under $50 (U.S.) per barrel.

Meanwhile, companies have repeatedly slashed spending. On Tuesday, Royal Dutch Shell PLC announced it was shutting down construction of its multibillion-dollar Carmon Creek oil sands project in the Peace River, Alta., area, blaming weak crude prices and insufficient pipeline capacity to export its output.

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