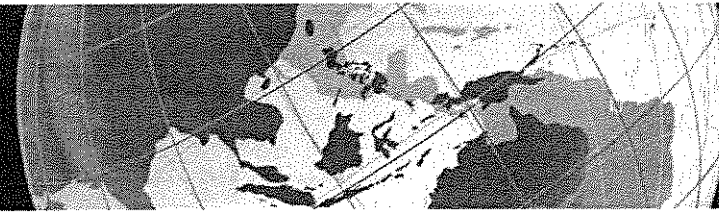
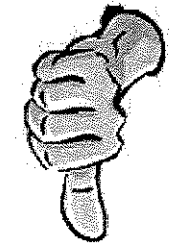


B-292

Macquarie
Equities Research



What the stock market is saying about utility regulated returns



Presentation to the Ontario Energy Board

Matthew Akman

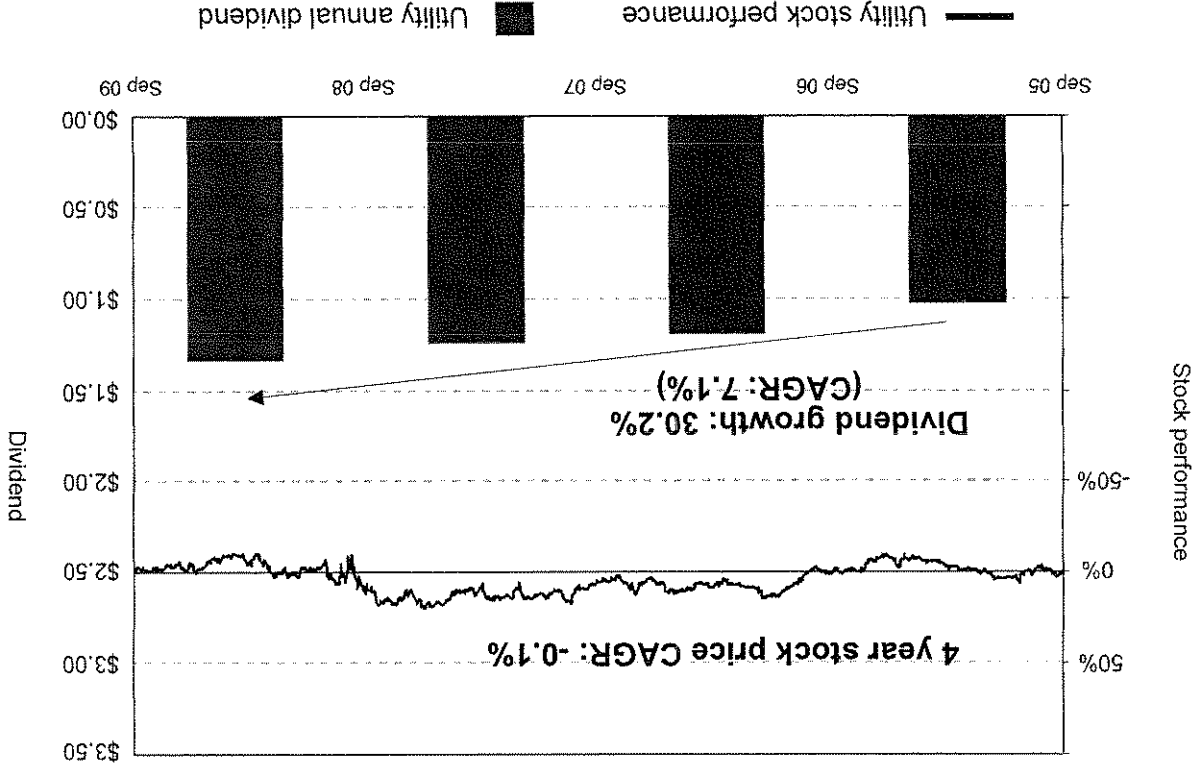
(416) 848-3510

September 21, 2009

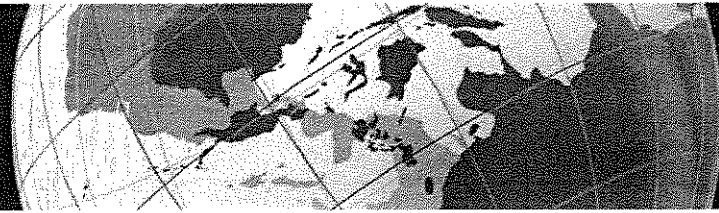
Régie de l'énergie
DOSSIER: R-3752-2011
DÉPOSÉE EN AUDIENCE Phase 2
Date: 19/Sept/2011
Pièces n°: B-292

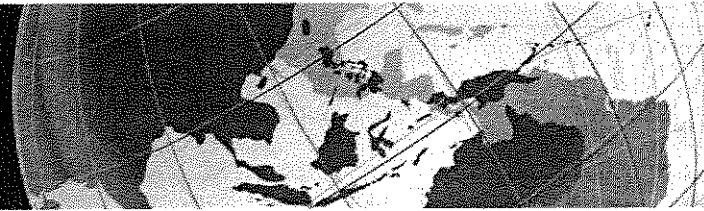
In preparing this research, we did not take into account the investment objectives, financial situation and particular needs of the reader. Before making an investment decision on the basis of this research, the reader needs to consider, with or without the assistance of an adviser, whether the advice is appropriate in light of their particular investment needs, objectives and financial circumstances. Please see disclaimer.

All is not well in utility-land

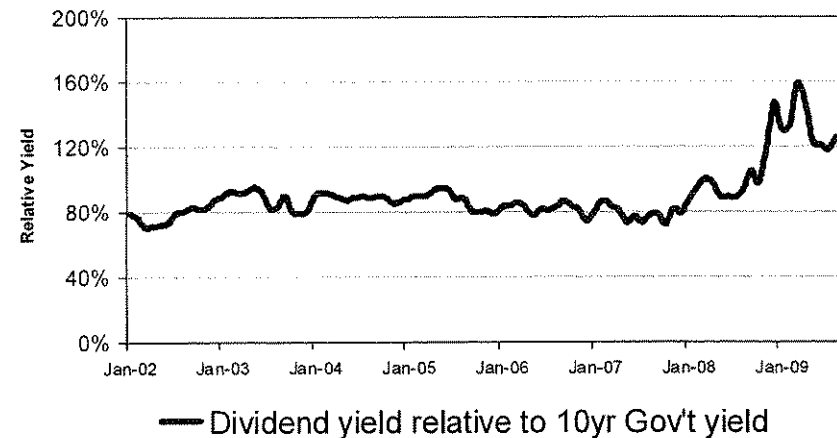
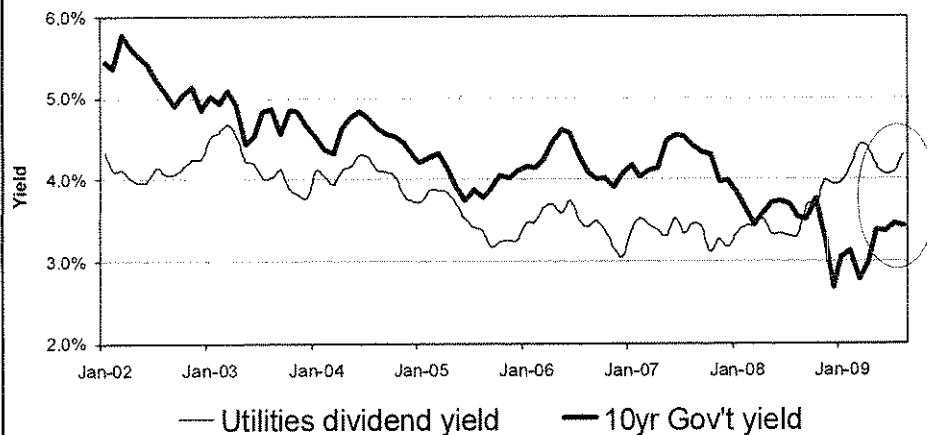


Note: Utility stocks comprised of a weighted average of TRP, ENB, CU, TA, FTS and EMA
Source: Bloomberg, Macquarie Research, September 2009



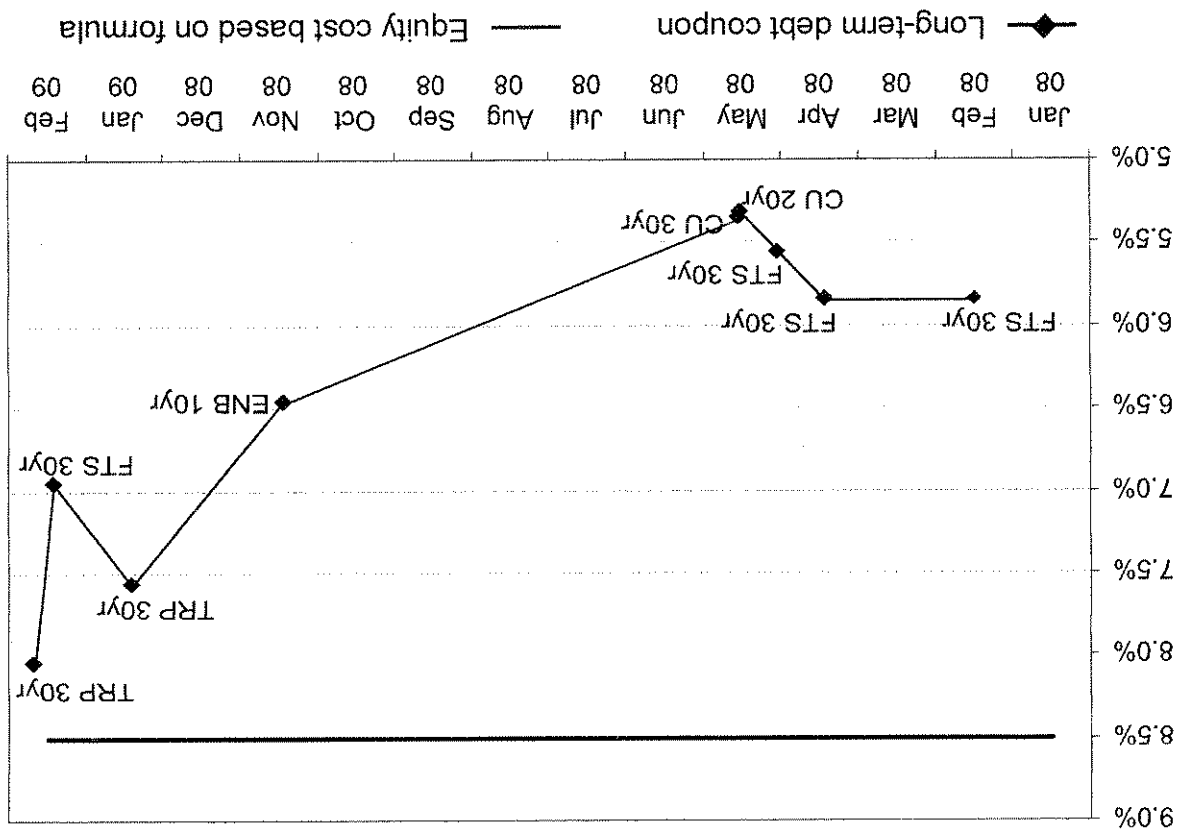


Dividend yield and government bond yield not correlated

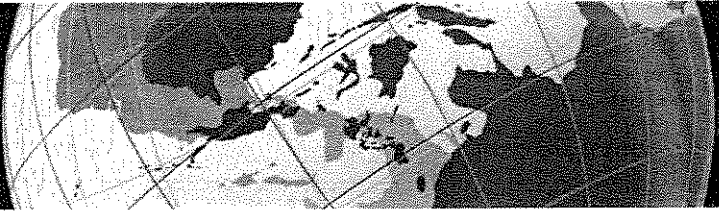


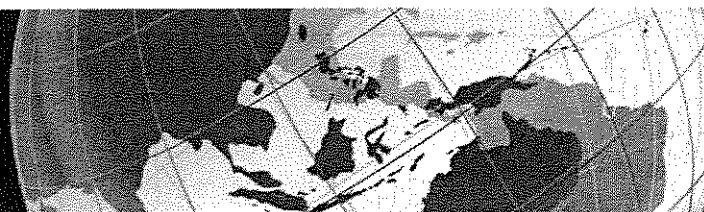
Note: Utilities dividend yield comprised of a weighted average of TRP, ENB, CU, TA, FTS and EMA
Source: Bloomberg, Macquarie Research, September 2009

The chaos of '08 – coming together is not always a good thing



Source: Company data, Macquarie Research, September 2009





Utility equity issues are common

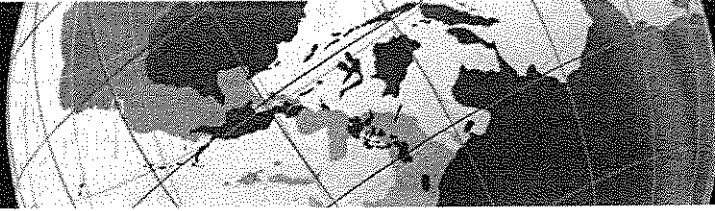
Company	Announcement date	Proceeds (\$b)	Issue price	Discount to 52 week high	Premium to 52 week low
TransCanada Corp.	06-Feb-07	\$1.7	\$38.00	-6.9%	22.8%
Fortis Inc.	26-Feb-07	\$1.2	\$26.00	-12.9%	25.3%
Enbridge Inc.	16-Jan-07	\$0.5	\$38.75	-6.0%	21.3%
Inter Pipeline Fund	01-Jun-09	\$0.2	\$8.73	-15.9%	45.5%
Pembina Pipeline	29-Apr-09	\$0.2	\$14.08	-24.6%	19.9%
Fortis Inc.	03-Jan-07	\$0.1	\$29.00	-2.8%	39.8%
Fortis Inc.	10-Feb-05	\$0.1	\$18.66	-1.1%	29.8%
AltaGas Income Trust	29-May-08	\$0.1	\$26.20	-7.1%	13.9%
Average:				-9.7%	27.3%

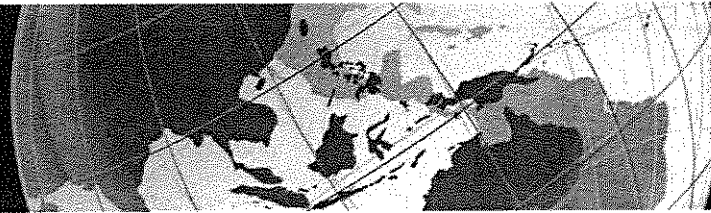
Source: Company data, Macquarie Research, September 2009

But at what cost, equity?

Company	date	Proceeds (\$b)	Issue price	Discount to 52 week high	Premium to 52 week low
Royal Bank of Canada	08-Dec-08	\$2.3	\$35.25	-33.6%	-1.1%
Manulife Financial Corporation	02-Dec-08	\$2.3	\$19.40	-53.5%	8.6%
Silver Wheaton Corporation	31-Jan-08	\$1.6	\$14.50	-23.1%	36.7%
Canadian Imperial Bank of Commerce	14-Jan-08	\$1.5	\$62.75	-41.2%	-6.3%
Canadian Imperial Bank of Commerce	14-Jan-08	\$1.4	\$67.05	-37.2%	0.1%
The Toronto-Dominion Bank	24-Nov-08	\$1.4	\$39.50	-47.3%	-4.4%
Bank of Montreal	15-Dec-08	\$1.0	\$30.00	-48.4%	-7.4%
Great-West Lifeco Inc.	09-Dec-08	\$0.6	\$20.75	-43.7%	1.0%
Canadian Pacific Railway Limited	27-Jan-09	\$0.5	\$36.75	-50.7%	-2.5%
<i>Average:</i>					
				-42.1%	3.3%
TransCanada Corporation	16-Jun-09	\$1.8	\$31.50	-22.0%	8.1%
TransCanada Corporation	05-May-08	\$1.3	\$36.50	-10.3%	1.9%
TransCanada Corporation	17-Nov-08	\$1.2	\$33.00	-18.9%	6.5%
Fortis Inc.	02-Dec-08	\$0.3	\$25.65	-13.8%	16.2%
AllGas Income Trust	27-Jan-09	\$0.1	\$16.50	-39.6%	13.1%
<i>Average:</i>					
				-20.9%	9.1%

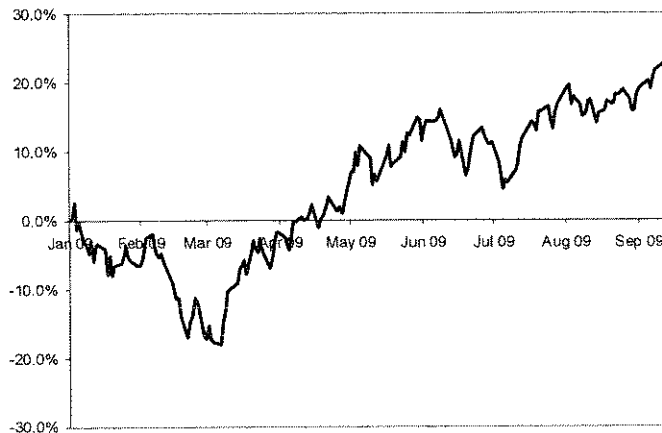
Source: Company data, Macquarie Research, September 2009





Happy days are here again!

S&P/TSX Composite Index



Select recent equity issues

Company	Announcement date	Proceeds (\$b)	Issue price	Discount to 52 week high	Premium to 52 week low
Barrick Gold Corporation	08-Sep-09	\$4.4	\$39.30	-1.8%	116.6%
Fairfax Financial Holdings Limited	08-Sep-09	\$0.9	\$377.93	-5.9%	66.8%
Brookfield Properties Corporation	10-Aug-09	\$0.6	\$10.26	-55.5%	77.8%
Silver Wheaton Corp.	08-Sep-09	\$0.3	\$11.59	-9.1%	259.9%
Fairfax Financial Holdings Limited	08-Sep-09	\$0.2	\$377.93	-5.9%	66.8%
Enerplus Resources Fund	19-Aug-09	\$0.2	\$22.59	-50.9%	32.0%
Thompson Creek Metals Company Inc.	25-Aug-09	\$0.2	\$14.99	-11.3%	358.4%
Crescent Point Energy Corp.	24-Aug-09	\$0.2	\$35.90	-8.5%	91.0%
WestJet Airlines Ltd.	09-Sep-09	\$0.1	\$11.70	-20.9%	35.4%
Central Fund of Canada Limited	07-Aug-09	\$0.1	\$12.29	-21.9%	31.6%
Dundee Real Estate Investment Trust	19-Aug-09	\$0.1	\$19.19	-40.6%	162.9%
Silver Standard Resources Inc.	11-Aug-09	\$0.1	\$18.27	-36.5%	135.1%
Transat A.T. Inc.	10-Sep-09	\$0.1	\$14.09	-18.6%	110.3%
Calloway Real Estate Investment Trust	13-Aug-09	\$0.1	\$15.82	-25.8%	89.2%
Average:				-22.4%	116.7%

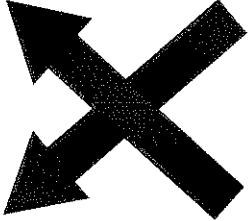
Source: Bloomberg, Company data, Macquarie Research, September 2009

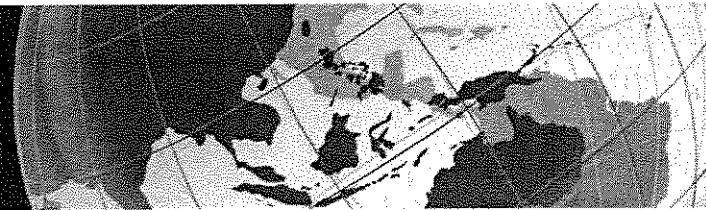


The losers become winners – and vice versa

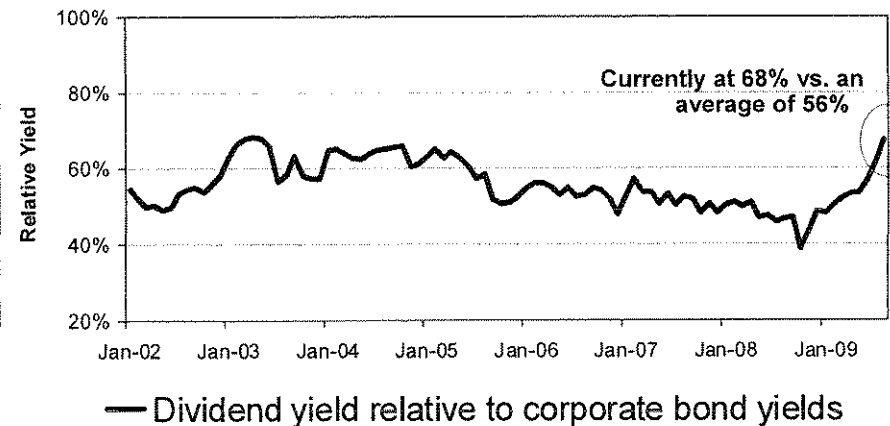
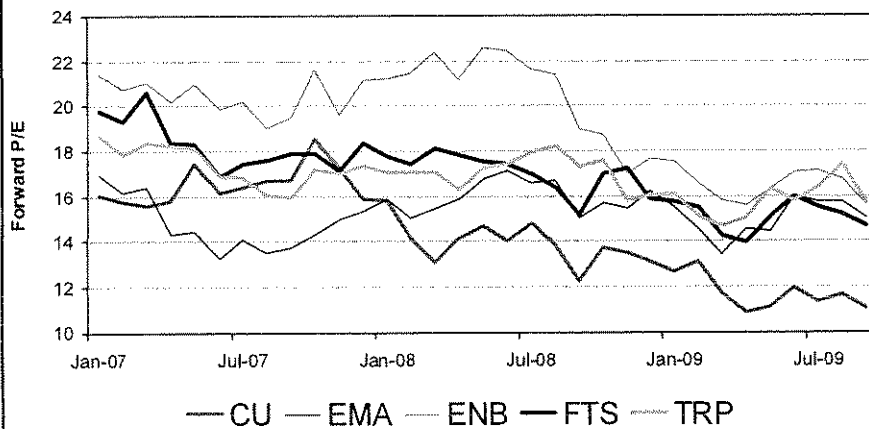
S&P/TSX 60 performance
ranking - 2008

S&P/TSX 60 performance
ranking - 2009YTD

#9 - Enbridge Inc	#17 - Fortis Inc	#20 - TransCanada Corp	#27 - TransAlta Corp	#58 - Inmet Mining Corp	#59 - First Quantum Minerals Ltd	#60 - Teck Resources Ltd
<hr/>						
						
#1 - Teck Resources Ltd	#2 - First Quantum Minerals Ltd	#3 - Inmet Mining Corp	#34 - Enbridge Inc	#36 - Fortis Inc	#40 - TransCanada Corp	#53 - TransAlta Corp

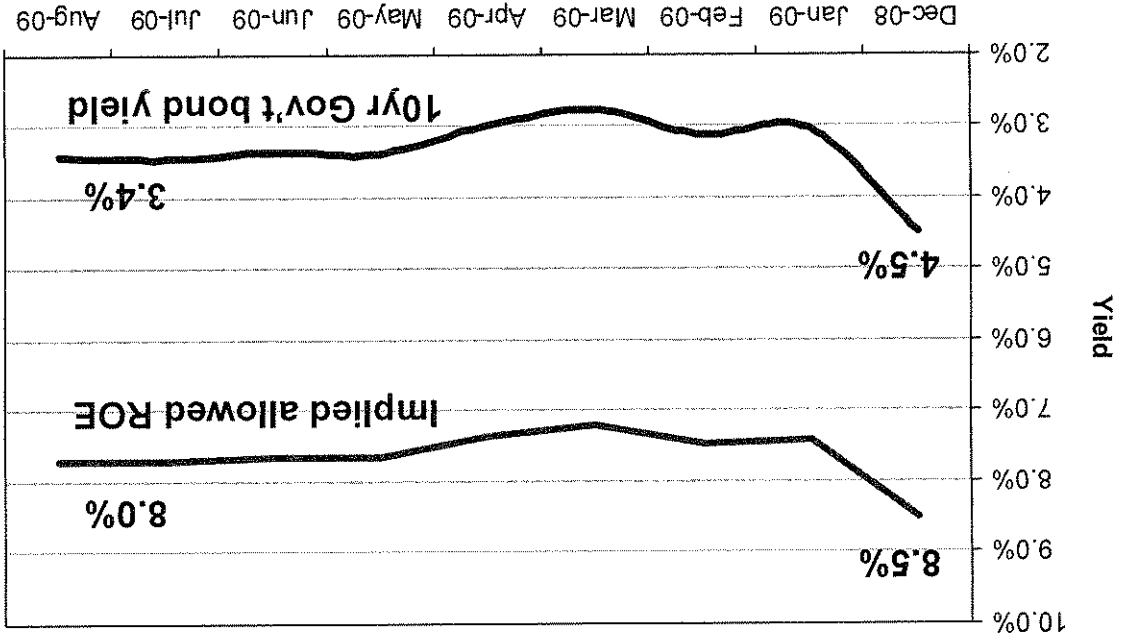


Utilities are still getting cheaper

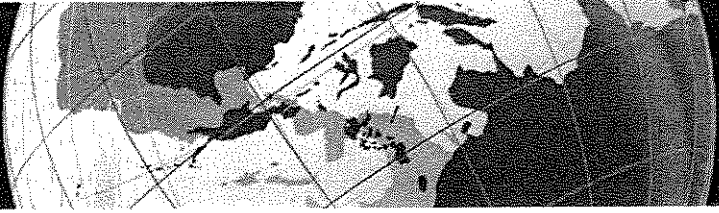


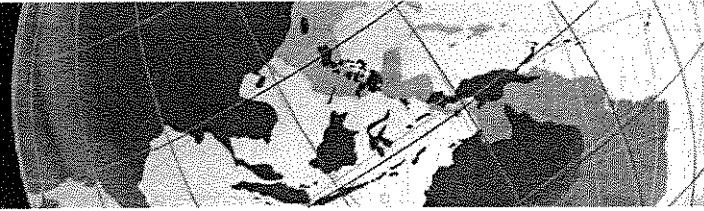
Note: Utilities dividend yield comprised of a weighted average of TRP, ENB, CU, TA, FTS and EMA
Source: Bloomberg, Macquarie Research, September 2009

And things could get worse if regulators maintain status quo



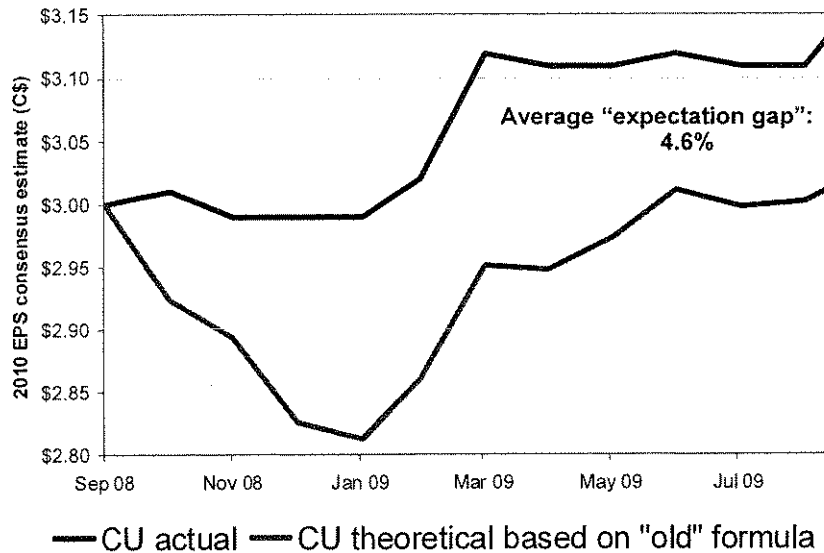
Source: Bloomberg, Macquarie Research, September 2009



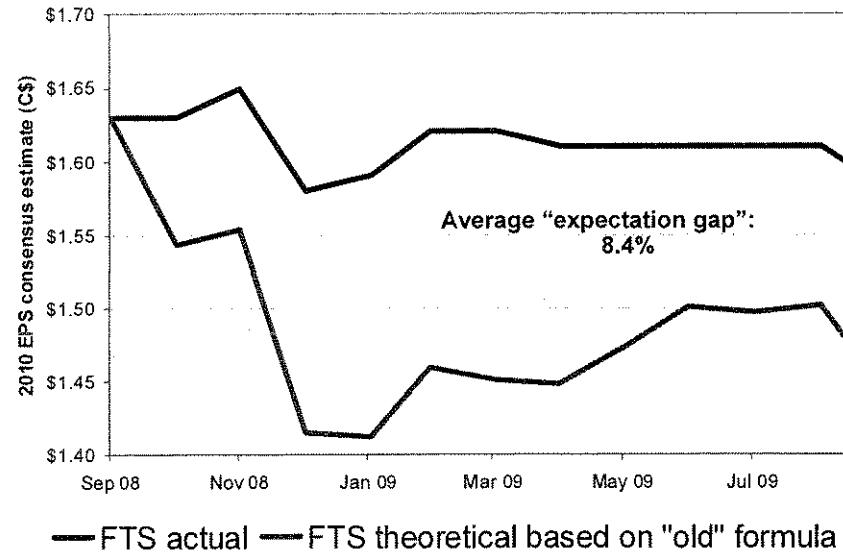


Status quo ROE would disappoint market

**Canadian Utilities 2010E EPS
"expectation gap"**



Fortis 2010E EPS "expectation gap"



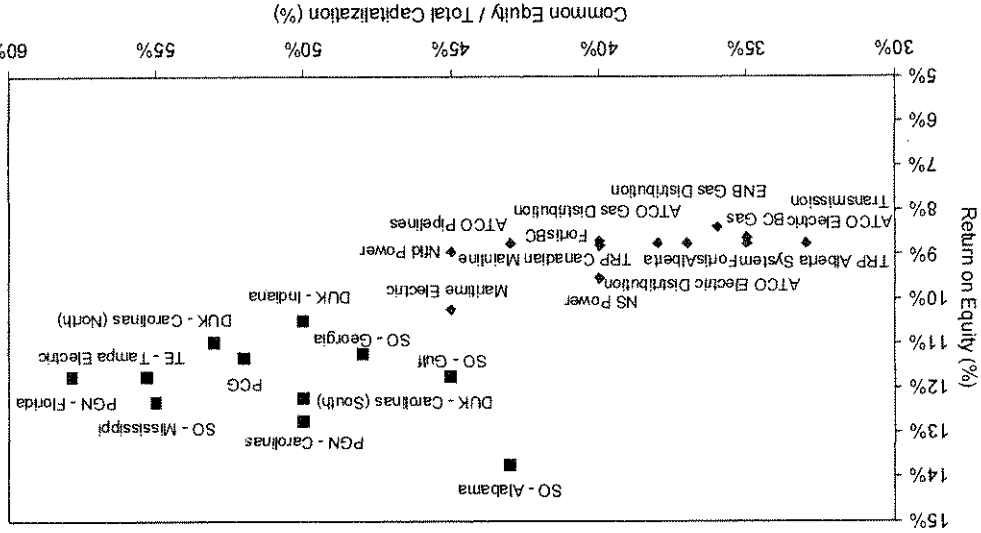
Source: Bloomberg, Macquarie Research, September 2009



US returns remain above Canadian...

US/international ownership in Canadian regulated utility companies

Allowed returns in Canada vs. U.S.



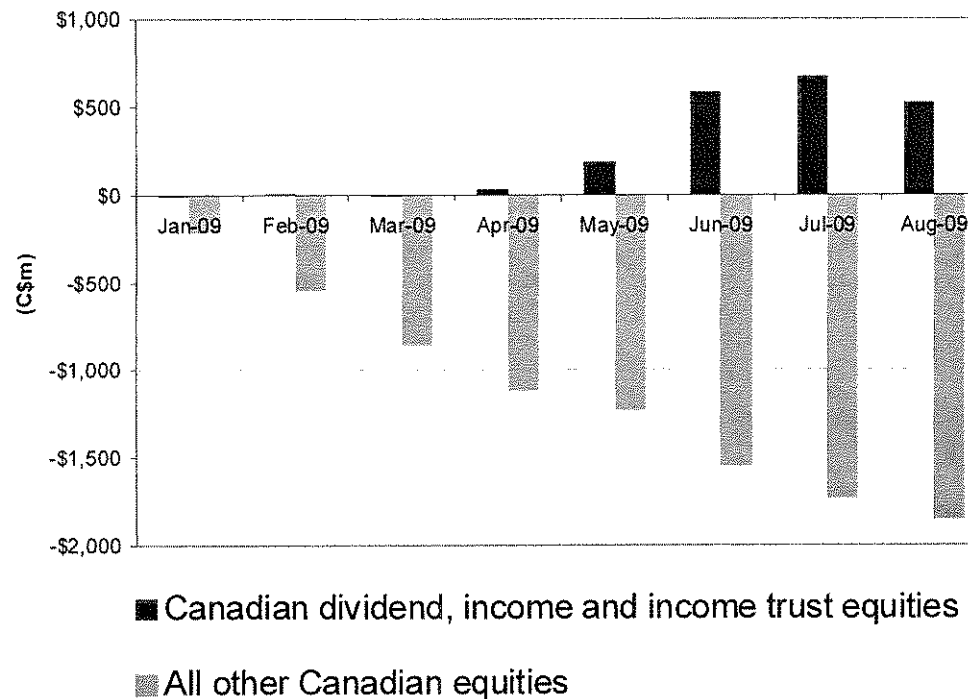
Company	Return on Equity (%)
Fortis Inc.	5%
Canadian Utilities Ltd.	3%
ATCO Ltd.	2%
Emera Inc.	1%

◆ Canadian utilities
■ U.S. utilities

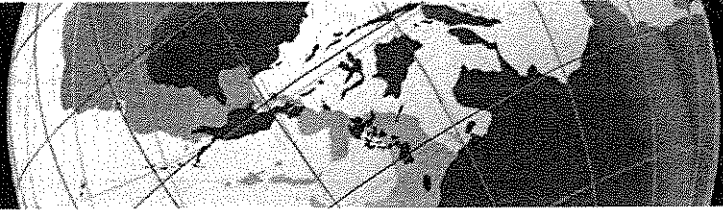
...so getting international investors interested in Canada is a major challenge

Canadian dividend crowd on its own has potential to support the stocks

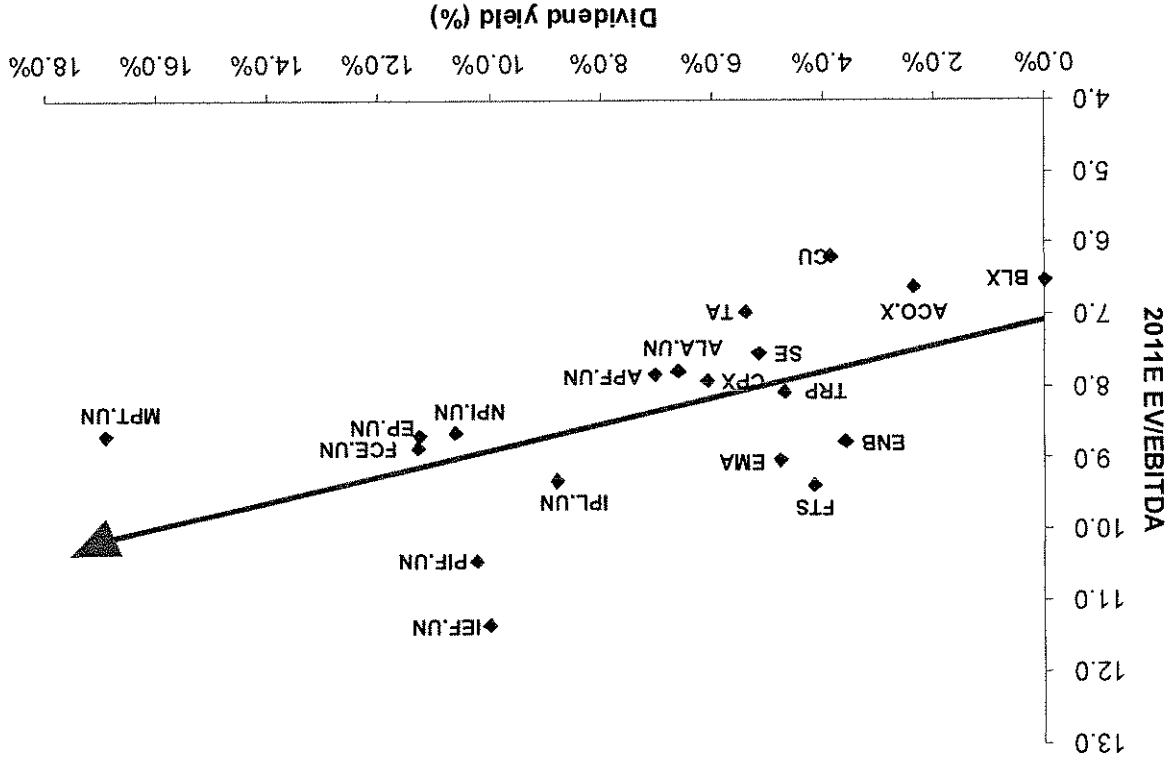
Year-to-date fund flow – Net sales

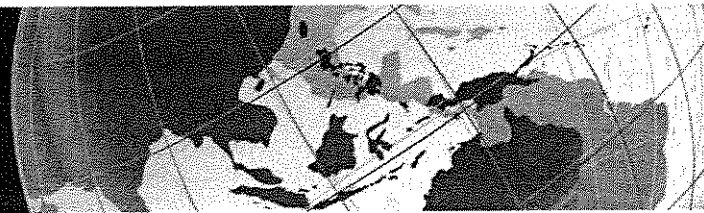


Source: IFIC, Macquarie Research, September 2009



But all Canadian investors seem to care about these days is yield

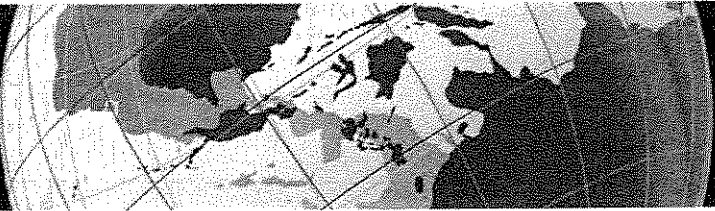


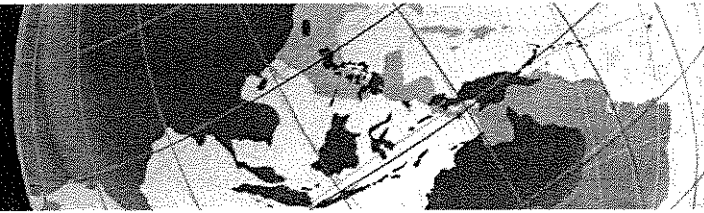


You know you are in trouble when...

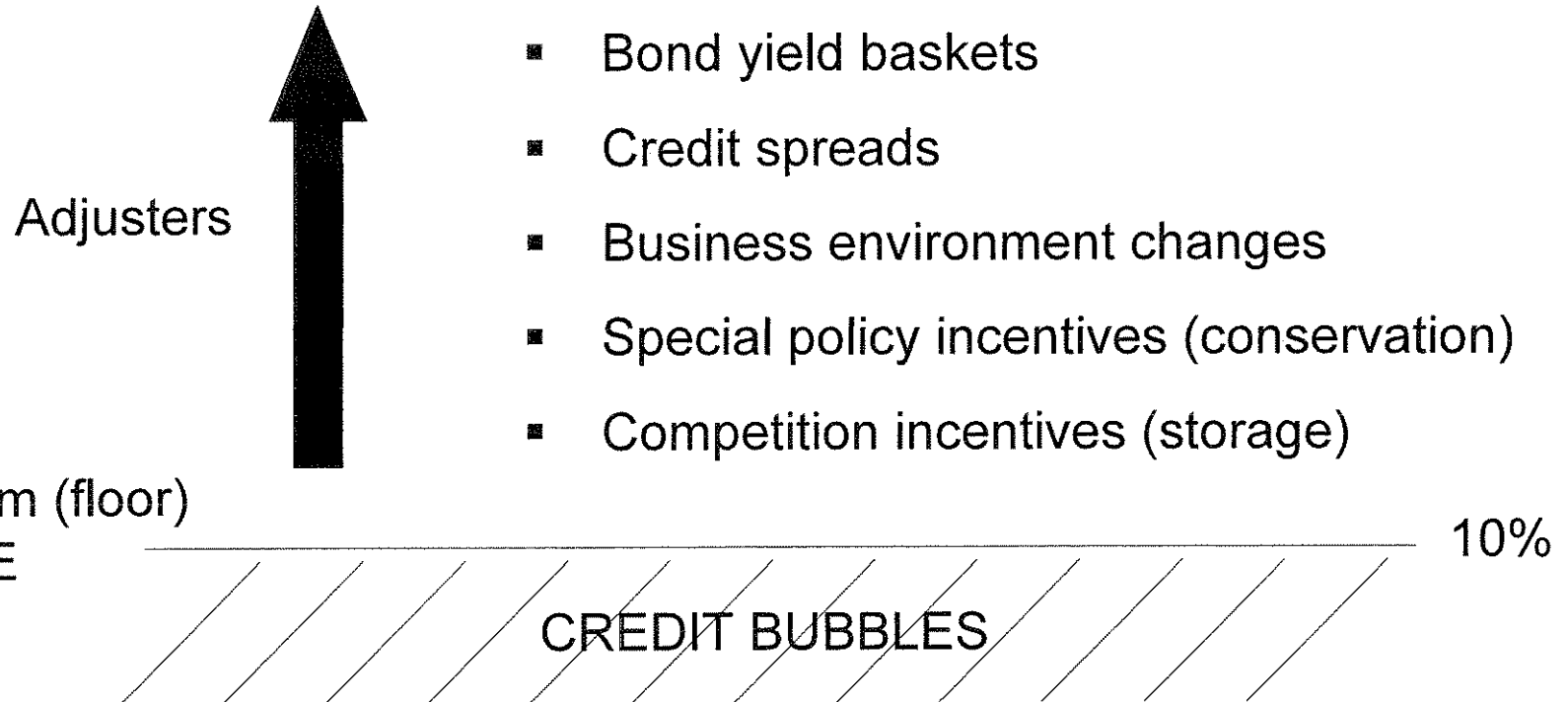
- A) Your stock stagnates while the market rallies hard.
- B) Consensus estimates and your stock along with them are likely to fall further unless you get an increase in your allowed return.
- C) Your US peers get a much higher return than you.
- D) US investors don't care about your stock even though you have significant US investments.
- E) Your core Canadian investors seem to want you to pay out all your cash instead of reinvesting it in the business.
- F) All of the above.

Recommendation





Time for a change – introducing the “minimum guaranteed ROE”

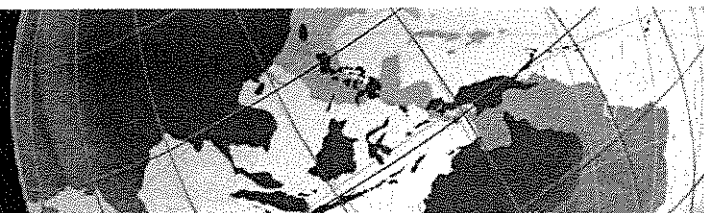


Top 5 reasons for recommendation

- 1) Simplicity avoids prolonged and resource-intensive regulatory process.
- 2) Investor certainty over multi-year periods should contain the cost of capital.
- 3) The comparable US utility group ROE never seems to go below 10%, even in an extremely low interest rate environment.
- 4) At a 70% payout ratio, a 10% ROE drives only 3% organic growth rates, which are already lower than market expectations.
- 5) There is a psychological attraction for investors in knowing the returns are "double-digits".

Source: Macquarie Research, September 2009





Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand

Outperform – return >5% in excess of benchmark return (>2.5% in excess for listed property trusts)
Neutral – return within 5% of benchmark return (within 2.5% for listed property trusts)
Underperform – return >5% below benchmark return (>2.5% below for listed property trusts)

Macquarie – Asia/Europe

Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected <-10%

Macquarie First South - South Africa

Outperform – return > 10% in excess of benchmark return
Neutral – return within 10% of benchmark return
Underperform – return > 10% below benchmark return

Macquarie - Canada

Outperform – return > 5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return > 5% below benchmark return

Macquarie - USA

Outperform – return > 5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return > 5% below benchmark return

Recommendation – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Volatility index definition*

This is calculated from the volatility of historic price movements.

Very high–highest risk – Stock should be expected to move up or down 60-100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40-60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30-40% in a year.

Low–medium – stock should be expected to move up or down at least 25-30% in a year.

Low – stock should be expected to move up or down at least 15-25% in a year.

* Applicable to Australian/NZ stocks only

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense

Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / efpowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation definitions – For quarter ending 30 June 2009

	AU/NZ	Asia	RSA	USA	CA	EUR
Outperform	40.38%	48.53%	40.00%	44.02%	57.42%	40.20%
Neutral	39.25%	17.08%	45.00%	37.45%	32.90%	39.21%
Underperform	20.38%	34.40%	15.00%	18.53%	9.68%	20.59%



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