The Cost of Power: Assessing Hydro One's WACC

Presented to:

Christina | *Chief Equity Analyst, Kingisland Crest Asset Management*

Engagement

Determine Hydro One's fair-market WACC to support Kingisland Crest's valuation and investment decision

Analysts

Ivan & Edina, I&T Capital Advisory
Team F1 | I.C.B.C 2025 Finance Stream

Laying Out the Framework of Our WACC Coverage

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Topics Covered

Ivan

Edina

Executive Summary

We recommend a market-aligned WACC that balances regulation and Canadian sector

1 Calculation Thesis

5.1% WACC

Cost of Equity	5.8%
Cost of Debt (After-Tax)	4%
39% Debt	61% Equity

- Captures Hydro One's pure-play wires profile and below-average beta
- Anchors to fair-return lower bound amid sector overcompensation
- Reflects Canadian market dominance and stable policy environment

2 Recommendations for Christina

- A. Track Regulatory Signals
- B. Prepare for post-'27 ROE uncertainty
- C. Keep fair-return logic front-of-mind

Our WACC is market-aligned, regulator-defensible, and investor-ready

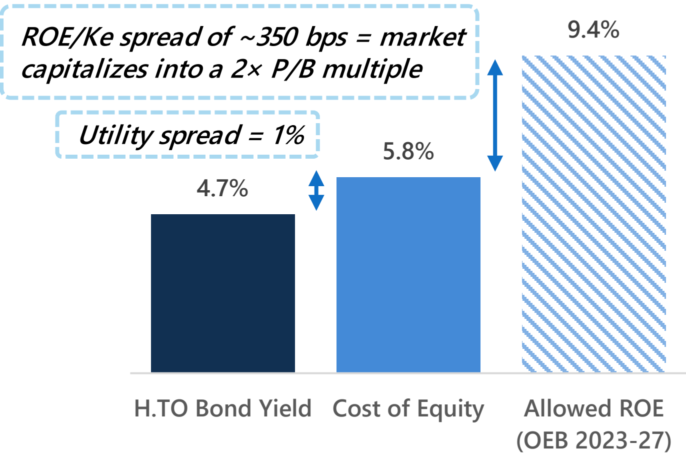
Hydro One Operates a Stable, Regulated Utility Model

Predictable earnings, low risk, and steady growth driven by a regulated rate base

1 A Pure-Play, Regulated Utility

- Largest transmitter & distributor in Ontario
- 99% of revenues are regulated
- No generation exposure to commodity prices

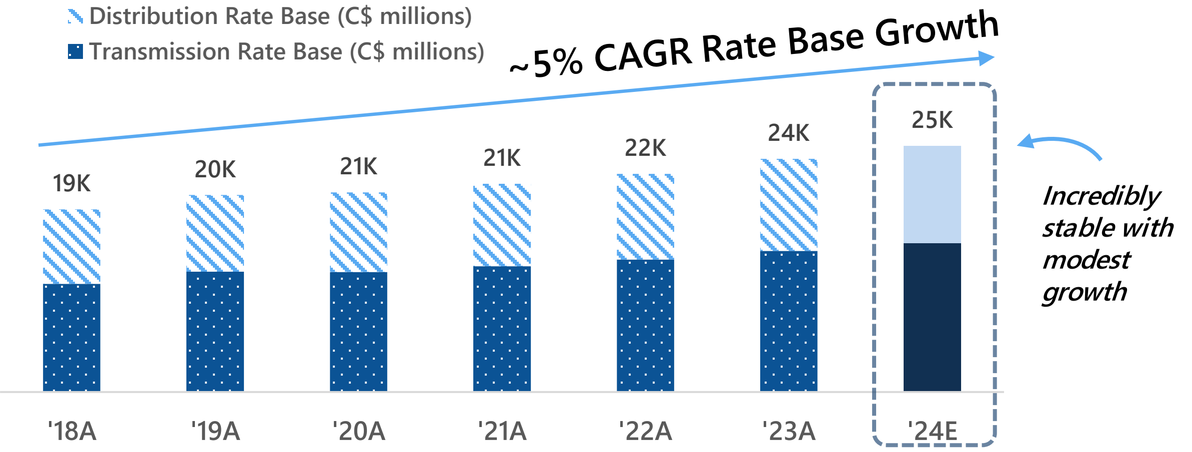
2 Fair Return Standard & Allowed ROE



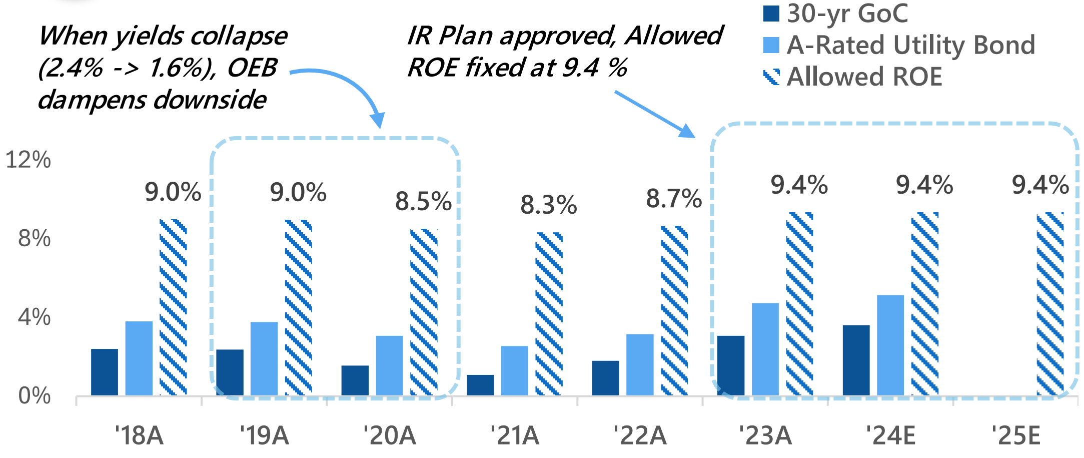
- P/B = 2.1x
- β = 0.44
- Payout = 75%
- ROE – Ke = 3.6%

= Bond-proxy equity

3 Predictable returns with low risk



4 OEB Anchors Returns Despite Rate Volatility



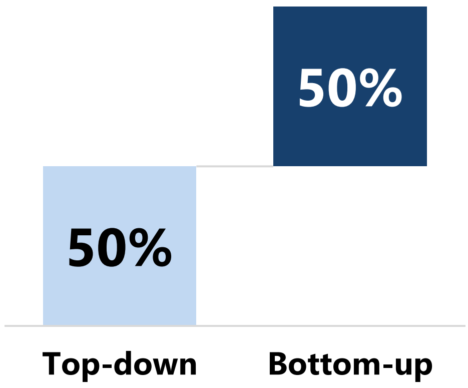
CAPM Validates a Low Risk Canadian Cost of Equity

Rooted in Canadian data and aligned with Kingsland's investment horizon

1 Deriving Ke Using Market-Reflective Inputs

	Risk Free Rate	3.4%	Matches Kingisland's 10yr Horizon
+ x (	Beta	0.44	Bottom Up & Top Down
	Mkt Premium	4%	Weighted between historical, survey, and forecast)
=	Derived Target Cost of Equity	5.1%	

2 Blended Beta Best Explains Utility Risk



- A) Top-down Reflects History
- B) Bottom-up Reflects Current
- C) Blended Combines Both Benefits

3 10-Year GoC Aligns with Kingisland

We recognize 30 yr GoC is used by OEB, but selected 10 yr GoC for alignment with Kingisland; difference(< 10 bps) is immaterial

4 MRP Anchored to Today's Environemnt

Historical ~6%	Weighted 10%
Survey ~5%	Weighted 45%
Forecast ~3%	Weighted 45%

Canada | Nominal | Arithmetic | Weighted Blend

4.0% Market Risk Premium

Bonds to Dividends: Deriving through premiums and growth

Hydro One's fair return balances market risk spreads with dividend sustainability under OEB logic

1 BYPRP through the Pinkerton Method

Bond Yield	4.7%	Weighted bond yield as credit base
+		
x (Total Beta - Beta	0.6	Company-specific risk spread derived from Pinkerton Model
Mkt Premium	4%	Weighted)

= **Derived BYPRP Target Ke** 7.1%

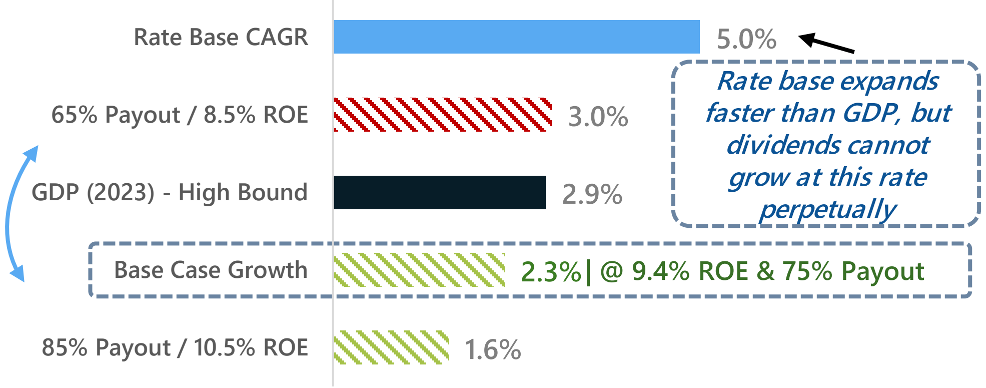
2 DDM Grounded in Sustainable Growth

Dividend Yield	2.96%	Based on latest dividend of $1.17, grown by 2.3%, then divided by $40.60 share price
+		
Growth Rate	2.3%	Applied sustainable growth formula @ 75% payout & 9.4% allowed ROE; Upper bound at nominal GDP

= **Derived DDM Target Ke** 5.3%

3 Sustainable Growth Cannot Outpace GDP

Sustainable dividend growth ranges 1.6–2.9%, and remains capped by nominal GDP



Rate base expands faster than GDP, but dividends cannot grow at this rate perpetually

4 Payout Ratio Drives DDM Sensitivity

DDM Ke is 2x sensitive to payout ratio compared to allowed ROE

	Cost of Equity (%)				
	Payout Ratio				
Allowed ROE	65%	70%	75%	80%	85%
8.4%	5.9	5.5	5.0	4.6	4.2
8.9%	6.1	**5.6**	**5.2**	**4.7**	4.3
9.4%	6.3	**5.8**	**5.3**	**4.8**	4.3
9.9%	6.4	**5.9**	**5.4**	**4.9**	4.4
10.4%	6.6	**6.1**	**5.5**	**5.0**	4.5

~.1/.2% Intervals for ROE

~.4/.5% intervals for Payout

Three Models, One Cost of Equity

Each model offers a different lens. Together, they form a defensible midpoint at 5.8%

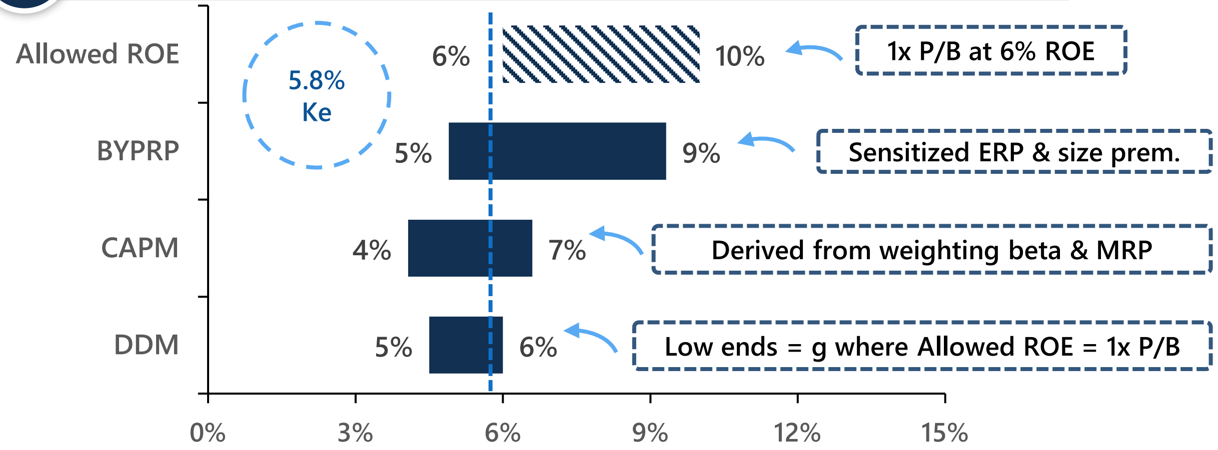
1 Hedge Estimation Risk, Average the Big Three

Methodology	Rate	Weight
CAPM	5.1%	1/3
DDM	5.3%	1/3
BYPRP	7.1%	1/3

5.8% Ke

Equal weighting avoids over-reliance on one model

2 Where Each Method Lands (Range View)



3 Sensitivity Matrix: Beta and Policy Rate Impacts

We tested plausible shifts in policy returns and market risk.
Derived Ke varies <30 bps.

		Cost of Equity				
		Beta				
		0.35	0.40	0.45	0.50	0.55
Allowed ROE	8.5%	5.7%	5.7%	5.8%	5.9%	5.9%
	9%	5.7%	5.8%	5.8%	5.9%	6.0%
	9.5%	5.7%	5.8%	5.8%	5.9%	6.0%
	10%	5.8%	5.9%	5.9%	6.0%	6.1%
	10.5%	5.8%	5.9%	6.0%	6.0%	6.1%

4 Different Worlds: Regulator vs Kingisland Lens

Regulator

- 30Yr GoC
- Additional Cost for Capital Raise
- D/E = 1.5
- Objective: Rate stability & capital access

Kingisland

- 10Yr GoC
- No Added Cost for Capital Raising
- D/E = 0.7
- Objective: Market-priced hurdle for valuation

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Cost of Debt & Capital Structure

Our anchor points to calculate a defensible and market viewed WACC

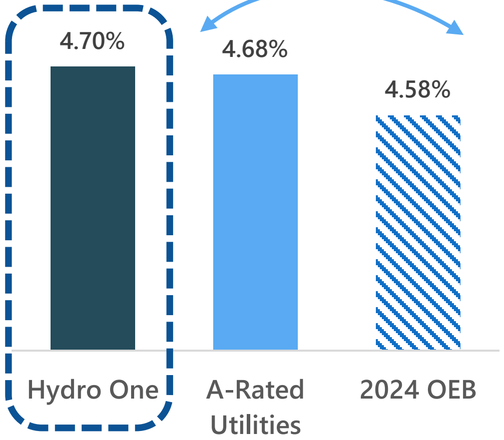
1 Cost of Debt Through Stable Bond Yields

Hydro One Yield	4.7%	Weighted Average of Various Long-Term Bonds
x (1-Tax Rate)	(1-.14)	Selected 2023 Income Tax Rate (14%)

Derived Cost of Debt 4%

Tax rates influence effective cost, but market yield aligns with OEB benchmark

2 Yields Match A-Rated Peers & OEB Benchmark

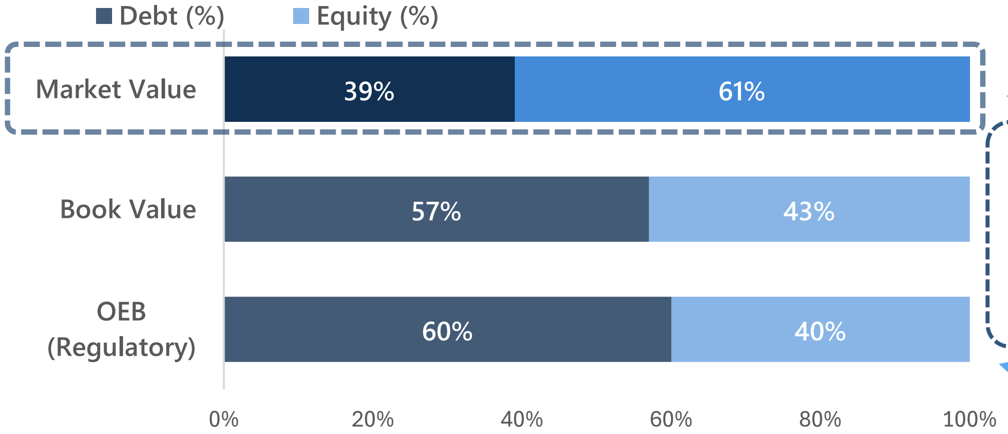


H.TO Yield = actual embedded cost of long-term debt

No structural risk premium differential *(~10bps)*

Hydro One yield adopted as pre-tax cost of debt

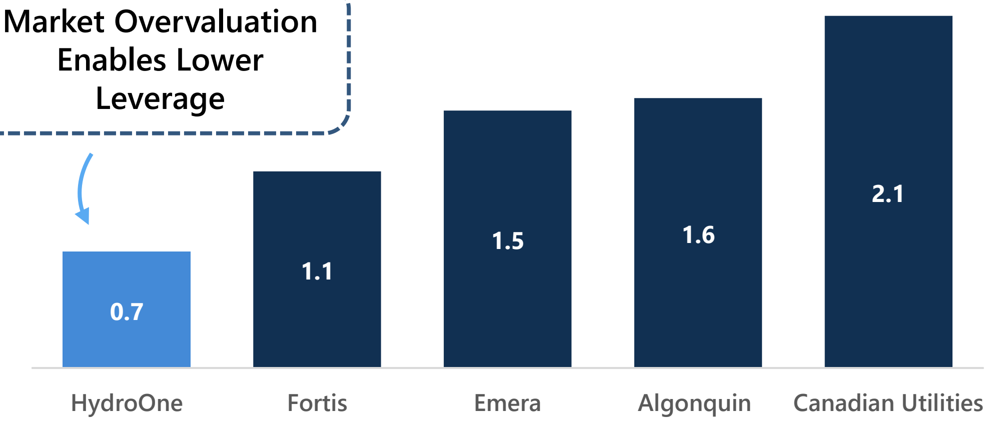
3 Market D/E Flips from OEB's Book View



Market valuation inflates equity share, reversing the regulatory leverage mix

4 Lowest D/E Amongst Peers, And It's Not Close

Market Overvaluation Enables Lower Leverage



Our WACC Calculation is Market-Aligned & Regulator-Defensible

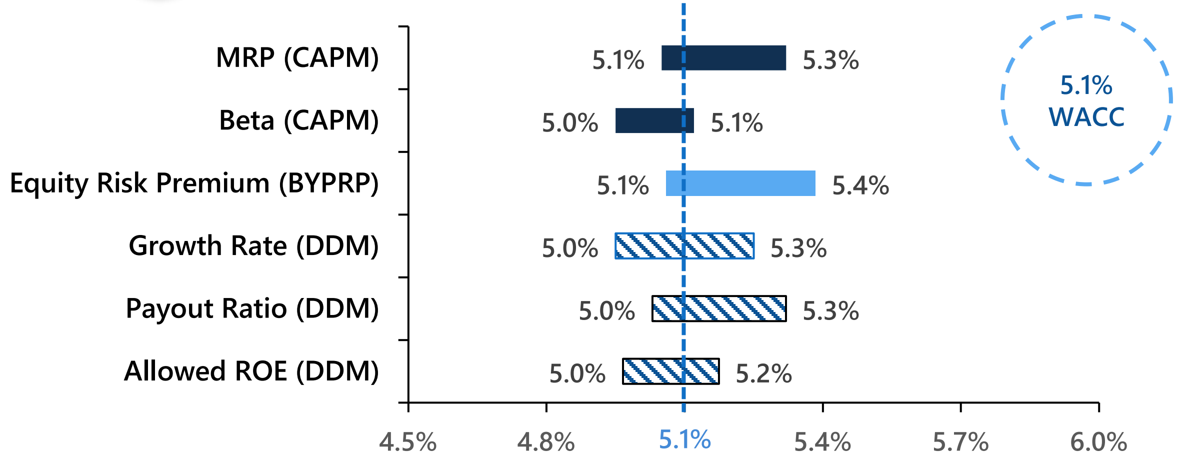
Weighted by market capital structure, using Canadian, relevant market data

1 Calculating Hydro One's WACC

Cost of Equity	5.8%	*Mean of CAPM, DDM, BYPRP*
x Weight Mkt Equity	61%	Weight of Market Equity
+ Cost of Debt (After-Tax)	4%	After-Tax H.TO Weighted Bond Yield (4.7%)
x Weight Mkt Debt	39%	Weight of Market Debt

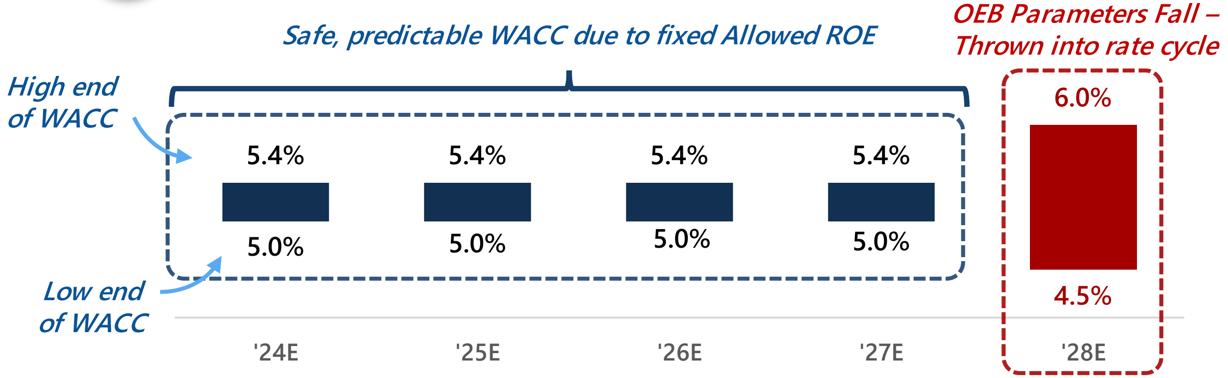
Derived WACC 5.1%

2 WACC Sensitivity Across Every Variable



Sensitized every variable across all 3 methodologies low range WACC of 5%, high at 5.4%

3 Stability Through 2027, Sensitivity Post-'27



4 Key Takeaways for Christina

5.1% WACC

1. WACC holds at ~%5, can fall further from domino effect
2. Post '27 ROE revisions could materially alter cost of capital

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Risk Management & Implementation Plan

Ensuring defensible valuation and highlighting uncertainty

1 Key Risks & Mitigations

	Risk	Mitigation
A	**Policy uncertainty** 99% of Hydro One's revenues are regulated, shifts can alter FCFF	Apply a staged valuation framework
B	**Peer comparability risk** Our bottom-up beta peers have both Canada & global presence	Average bottom-up & top-down beta
C	**Duration mismatch** Our 10 Year GoC RF matches a shorter investment horizon	Match risk-free rate to investment horizon
D	**Risk overestimation** BYPRP may double count company's specific risks	Average out 3 methods

2 Christina's Implementation Roadmap

Valuation Stage	Apply the base discount rate	5.1% WACC
	Staged valuation framework	Present-2027 2027-Perpetual
	Watch for Comparable Sets' US & Global Presence	Hydro One Solely Serves ON
Portfolio Management Stage	Define Update Triggers	Sharp Δ in Interest rate or Allowed ROE
	Watch for Allowed ROE, rate volatility, & regulation	Uncertain post '27

2027 is a re-benchmarking point, recalibrate WACC, and set update triggers as allowed ROE and rates evolve.