Why do Canadian Utilities buy US Utilities?

- Higher P/E Ratios
- Availability
- Barriers to Asset Investment

Per Bloomberg, for the year to March, 2016:

US P/E ratios varied from 14 to 18 (average about 16)

Canadian P/E ratios varied from 20 to 34 (average about 27)

P/E Illustration

- Assume two utility companies with identical share structure, Canco and USco. They each have 10,000,000 million shares outstanding. Each trades at U$100 per share with the average P/E ratio per country.
- Each company has a market value of U$1 billion
- USco's earnings are:

  (10,000,000 shares times $100 divided by 16) = $62,500,000
- Canco's earnings are:

  (10,000,000 shares times $100 divided by 27) = $37,000,000

P/E Illustration (cont’d)

- Canco issues 10,000,000 shares in equal trade for all of USco‘s shares
- USCanco’s earnings are ($62,500,000 + $37,000,000) = $99,500,000
- If USCanco considered a Canadian utility company the shares are worth ($99,500,000 times 27) = $2,686,500,000
- Shares have a market value of ($2,686,500,000/20,000,000) = U$134

P/E Conclusions

- Canco could pay a premium of up to $68 per share and all would be kept whole.
- The US ROE is slightly higher than the Canadian ROE, but reverse P/E
- Does not support Canadian utilities request for higher ROE's
- With recent market appetite for utility stocks will US P/E ratios remain?
- Build-up of goodwill?

Availability

- Small market of utility companies in Canada
- Want to stay in the business they know
- Diversification (geographical and aspect)
  - Get out of aspect seen as more risky, (TCP selling electricity utility and buying Mexican pipeline)
  - Expand (Enbridge buying offshore power)

Barriers to Asset Investment

- Greater scrutiny in Canada (pipelines for Tar Sands Oil)
- Muddying of jurisdictions (NEB and Cabinet)
- “Social Contract” argument
- Parties adding jurisdiction not in legislation
- Duty to consult