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Subject: Credit Assessment - CH0007
Date: Thursday, September 12, 2013 11:54:26 AM
Attachments: _.png
Exposure Analysis Final.xlsx

Hi Derrick,

The purpose of this email is to document the credit decision related to the proposed candidate to be awarded contract CH0007. Key members of the Treasury and Risk department (Rob Hull, Scott Pelley, and Andrew Sinnott) have worked with Jim Meaney and the LCP team to conduct a detailed review of the contract and other information available from and about the proposed proponent.

Conclusion

The proponent is credit worthy based on our established criteria and has posted an acceptable performance security package, and we will be recommending acceptance from a creditworthiness perspective. **However, in reaching this decision, decision makers should be "eyes open" to any of the risks noted below in the key findings.**

Key Findings

1. Overall credit score is 63%, caused largely by higher levels of leverage, but is creditworthy within our approved framework. The proponent has diversified revenue streams outside of Italy and cash flow/earnings have been stable.

2. Performance security consists of a $100 million letter of credit with a Canadian Schedule 1 bank and a $150 million performance bond. There is also an up-front payment of 10% of contract value from Nalcor to the proponent, which is fully secured by a separate letter of credit from a Canadian Schedule 1 bank. Our exposure to default by the proponent at various stages of completion is provided in the table attached below (using certain data provided by LCP related to costs to complete and remobilization costs considered reasonable by LCP) and reflects exposure **before other costs that may become apparent due to delay**. As you can see, the exposure is highest at the beginning of the contract period, and is eliminated towards the end of the construction period. I reviewed my spreadsheet with LCP and they are in agreement with the methodology I used.

3. Additionally, LCP has arranged a 10% hold back bond, which minimizes risks of work stoppage due to subcontractor claims.

4. Liquidated damages are also provided on schedule and key personnel. This provides an adequate incentive to the proponent to complete the work in a timely manner. Additionally, liquidated damages of up to 7.5% are available against delay costs.

5. Liability is unlimited if the proposed proponent walks away. In the event of default, including insolvency, liability limited to 50% of the contract value. This appears reasonable as compared to the exposures noted in my table and provides a reserve for other costs of delay, including IDC. However, we would be chasing this in court as against an insolvent party...what we may recover is uncertain, but contractually we have sufficient coverage it appears.

6. The economic outlook for Italy (D&B report states sovereign risk for Italy is moderate, with outlook as

deteriorating) is not favourable. The proponent has significant exposure to Italian banks. However, the proponent has mitigated exposure by employing a strategy of obtaining committed facilities to support project construction activities, and their debt maturity profile is medium to long-term, minimizing short-term maturity risk.

Exposure Analysis Final.xlsx

<u>Other</u>

Treasury and Risk has asked for the following to be provided prior to final decision as part of our due diligence activities:

1. An explanation as to why we have not pursued obtaining security over the batch plant in the event of default...we understand that was rejected and would like to understand why...on the surface, it would provide more value and also likely to reduce time and cost if the proponent had to be replaced.

2. We understand that the Canadian subsidiary is the counterparty, and they have not provided financial statements...while we have parental assurances and we expect no issues, we should insist of seeing the financial statements of the actual counterparty as a standard due diligence requirement...they were incorporated in February 2012 and therefore financial statements should be available.

3. An understanding of the financing strategy to be employed for Muskrat construction, and in particular whether the strategy is to obtain a committed facility as per their normal practice.

Rob

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Contract Value ($billions):			$ 1.10						
% complete	Billings remaining under contract	New contract (scaled from total bid of $1.7 billion)	Performance Security	Net	Paid under existing contract	Total to completion	Original contract value	Remobilization costs	Exposure before delay costs ($ billions)
0.10	0.99	1.53	(0.25)	1.28	0.11	1.39	1.10	0.10	**0.39**
0.20	0.88	1.36	(0.25)	1.11	0.22	1.33	1.10	0.10	**0.33**
0.30	0.77	1.19	(0.25)	0.94	0.33	1.27	1.10	0.10	**0.27**
0.40	0.66	1.02	(0.25)	0.77	0.44	1.21	1.10	0.10	**0.21**
0.50	0.55	0.85	(0.25)	0.60	0.55	1.15	1.10	0.10	**0.15**
0.60	0.44	0.68	(0.25)	0.43	0.66	1.09	1.10	0.10	**0.09**
0.70	0.33	0.51	(0.25)	0.26	0.77	1.03	1.10	0.10	**0.03**
0.80	0.22	0.34	(0.25)	0.09	0.88	0.97	1.10	0.10	**NA**
0.90	0.11	0.17	(0.25)	(0.08)	0.99	0.91	1.10	0.10	**NA**