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**Rating: Hold**

**Constellation Energy**  
**CEG-NYSE- \$74**  
**P/Es Don't Support Sum-of-the-Parts Valuation**

	8/6						
	74						
52-week range	108-73				Price	Y-t-d	12 Mos
Book Value (6/30/08)	36.14	205%	P/b	Performance	8/6	%	%
Reported - Cont.				CEG	74	(28)	(13)
2005	2.89	25.6	P/e	Phil. El. Index	493	(13)	(5)
2006	3.61	20.5		Dow Industrials	11,656	(12)	(13)
2007	4.60	16.1		Coverage			
2008 Consensus*	5.50	13.5		Analyst Total*	12		
2009 Consensus*	6.40	11.6		Buys	6	50%	
2010 Estimate	7.00	10.6					
				Shares (mil)	178		
Dividend Per Share	1.91	2.6%	Yield	Market Val.(\$Bil)	13		

\*Bloomberg Financial Service

**Opinion**

Constellation Energy (CEG) shares hit a 12-month low of \$73.30 a share yesterday, closing at \$74 a share. Since year-end, CEG shares declined 28%, sharply underperforming both the Philadelphia 22 Electric Stock Index (-13%) and the Dow Jones industrials (-12%). According to Bloomberg Financial Service, CEG has 5 active buy recommendations with price objectives ranging from \$93 to \$111 a share: Citigroup, Lehman, Credit Suisse, Macquarie, and B-of-A. Jefferies issued a recent sell/underperform rating with a \$71 a share price objective.

We believe the current weakness reflects concerns over risks and diminished predictability in its non-regulated trading strategies. However, despite the price action, CEG price/earnings ratios are in line with comparable companies cited by management in its own sum-of-the-parts valuation guidelines, and represent a 7% discount versus the S&P Utilities index. We're maintaining a hold rating with an expected trading range of \$73-\$80 a share.

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See page 5 of report for Analyst's Certification, page 5 for Important Disclosures and pages 5-6 for Other Disclosures and Disclaimers

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### Sum-of-the-Parts

Back in a January 31, 2007 analysts meeting, E. Follin Smith, then Executive Vice President and Chief Financial Officer, suggested that Constellation Energy's valuation be based on EBITDA multiples (earnings before interest, income taxes, depreciation and amortization) of companies having similar business characteristics. Smith compared Fleet generation to merchant generators, Customer Supply to specialty insurers, Global Commodities to merchant banks. At Constellation Energy's "Analysts Day" presentation in August 2007, John Collins, the new Chief Financial Officer, reaffirmed Smith's approach. Not surprisingly, the business components of estimated EBITDA have Constellation Energy as significantly undervalued. Table 1 is the sum-of-the-parts valuation based on the second-quarter earnings call. Potential value works out to a range of \$108 to \$133 a share with a \$121 a share mid-point, and an upside potential of 47% to 80%.

Table 1  
Management Valuation  
Sum-of-the-Parts

Column	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
		Forecast 2008E	Multiple Range	Market			Market		
	Metric	\$-Mil		Low \$-Mil	High \$-Mil	Avg. \$-Mil	Low PS	High PS	Avg. PS
Unhedged Generation									
Fleet	EBITDA	3,142	7-8	21,994	25,136	23,565	123	141	132
NPV Hedges (net of Tax)					4,800			27	
Net Market				17,194	20,336	18,765	96	114	105
Customer Supply	EBITDA	456	4.5-6	2,052	2,736	2,394	11	15	13
Global Commodities	EBITDA	567	3.5-4	1,985	2,268	2,126	11	13	12
Gross	EBITDA	4,165	5.1-6.2	21,231	25,340	23,285	119	142	130
Less Merchant Debt					3,647			20	
Net Merchant				17,584	21,693	19,638	99	122	110
Utility	Net Inc.	127	14-16	1,778	2,032	1,905	10	11	11
Consolidated				19,362	23,725	21,543	108	133	121
<b>Value Versus Price</b>		<b>74</b>					<b>47%</b>	<b>80%</b>	<b>63%</b>

Source: CEG Management. Multiple ranges for Un-hedged Generation-Merchant Generators; Customer Supply-Specialty Insurers; Global Commodities-Merchant Banks.

Our problem with EBITDA is that it often has no relationship to profits. Case in point, Fleet generation probably lost money in 2006, yet it was the largest EBITDA component. Why not use comparative price/earnings ratios?

Official guidance for 2008 is a range of \$5.25 to \$5.75 a share and a 15% to 20% increase in 2009. Utility earnings of \$0.70 to \$0.75 a share and price/earnings ratios of 14-16 times produce market values of \$10 to \$12 a share. By subtraction, non-regulated market value of \$62 to \$64 a share and earnings of \$4.55 to \$5.00 a share represent price/earnings ratios of 12 to 14 times. Those non-regulated P/Es are in line with comparable companies cited in the sum-of-the-parts approach (Table 3).

According to the sum-of-the-parts approach using EBITDA multiples, implied price/earnings ratios of non-regulated businesses would about double to the 21-24 times range. Not many industries in corporate America command 20 plus P/Es on an ongoing earnings basis.

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Table 2  
2008 Guidance  
P/E Comparisons  
Current and Sum-of-the-Parts

Column	(1)	(2)	(3)
	Guidance 2008		
Earnings Per Share	Low	High	Mid
Regulated	0.70	0.75	0.73
Non-regulated	4.55	5.00	4.78
Consolidated	5.25	5.75	5.50
Regulated p/e	14	16	15
Utility Value	10	12	11
Non-regulated	64	62	63
Consolidated Price	74	74	74
Non-regulated p/e	14.1	12.4	13.2
Sum of Parts (table 1)			
Non-regulated	99	122	110
Implied p/e	21.6	24.3	23.0

Table 3 lists the components in the sum-of-the-parts valuation as of mid-year. Also listed are latest 3-months market performance, earnings per share consensus and price/earnings ratios for 2008 and 2009, dividends, yields, shares outstanding and market values. The average 2008 price/earnings multiple for Merchant Generators is 13.9 times (11.8 times, excluding the 38.1 P/E of out of bankruptcy Calpine), 18.5 times for Specialty Insurers (modest growth customer supply business) and 12.9 times for the 2 merchant banks (Global Commodities). In short, those multiples are in line with CEG's current valuation. Moreover, since initial presentation of its sum-of-the-parts valuation, management included Calpine, an emerging out of bankruptcy work out with an unusually high price/earnings ratio. Global Commodities (then called Risk Management and Investing) initially included Bear Stearns and Lehman Bros., both of which were replaced by Deutsche Bank AG.

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**Table 3  
Management Comparables**

Column		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
		Price	3 mos	EPS	EPS	P/e	P/e	Ind.	Yield	Shs	Mkt.Val.
		8/6	%	2008	2009	2008	2009	Div.	%	Mil	\$-Bil
<b>Merchant Gen.</b>											
Calpine	cpn	16	(22)	0.42	0.70	38.1	22.7			421	7
Mirant	mir	29	(31)	2.95	3.88	9.7	7.3			207	6
NRG Energy	nrg	34	(22)	2.43	2.96	14.0	11.5			236	8
Reliant Energy	rri	17	(31)	1.09	1.31	15.6	13.0			349	6
<b>Average</b>		24		1.72	2.21	13.9	10.8				
<b>Specialty Ins.</b>											
RLI Corp.	rli	56	15	4.47	4.14	12.5	13.5	1.00	1.8	21	1
Safeco	saf	67	0	6.07	5.95	11.0	11.3	1.60	2.4	90	6
WR Berkley	wrb	24	(10)	3.34	3.38	7.2	7.1	0.24	1.0	168	4
White Mtn. Ins.	wtm	425	(8)	17.00	29.10	25.0	14.6	8.00	1.9	10	4
<b>Average</b>		143		7.72	10.64	18.5	13.4	5.51	3.9		
<b>Mer.Banks</b>											
Deutsche Bank	db	96	(21)	4.53	8.71	21.2	11.0	5.51	5.7	519	50
Goldman Sachs	gs	180	(9)	16.77	19.72	10.7	9.1	1.40	0.8	394	71
<b>Average</b>		138		10.65	14.22	12.9	9.7	3.45	2.5		
<b>Utilities</b>											
Duke	duk	17	(7)	1.28	1.36	13.6	12.8	0.92	5.3	1,265	22
Energen	egn	56	(18)	4.58	5.36	12.2	10.4	0.48	0.9	72	4
Nstar	nst	32	(4)	2.22	2.36	14.4	13.6	1.40	4.4	107	3
PG&E	pcg	38	(7)	2.97	3.21	12.7	11.8	1.56	4.1	357	14
Southern Co.	so	36	(3)	2.34	2.47	15.2	14.4	1.68	4.7	770	27
<b>Average</b>		36		2.68	2.95	13.4	12.1	1.21	3.4		

Source: Bloomberg Financial Service

## Analyst's Certification

I Raymond E. Moore certify that the views expressed in this research report accurately reflect my personal views about the subject companies and their securities. I also certify that I have not been and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendations in this report. Other Constellation Energy reports issued by me are: 2/24/06 (\$58) - Hold; 1/9/06 (\$58) - Hold; 9/13/05 (\$60) - Hold; 5/12/05 (\$54) - Hold; 1/26/07 (\$71) - Hold; 9/27/07 (\$87) - Hold; 4/2/08 (\$90) - Hold.

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**Buy** Total return is expected to exceed significantly the average total return of the analyst's industry coverage universe over the next 12 months.

**Market Perform & Hold** Total return is expected to equal the average total return of the analyst's industry coverage universe over the next 12 months.

**Sell** Total return is expected to significantly under perform (15% plus) the total return of the industry coverage universe over the next 12 months.

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		% Investment Banking
Buy	17%	0%
Hold	83%	0%
Sell	0%	0%

The principal risks to the achievement of our price targets include general market trends, disappointing earnings and lower energy prices and adverse regulatory developments

Our target prices are based on projected earnings for the following calendar year, and an assumed price/earnings ratio in line with the company's historical valuation or those of other companies with similar businesses and prospects.



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