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**Progress Report**

**Prior CEG References**

Sum-of-the-Parts Earnings per Share Valuations - 9/27/07 - \$87 - Hold

Peer P/E Valuation - 4/2/08 - \$90 - Hold

P/Es Don't Support Sum-of-the-Parts Valuation - 8/7/08 - \$74 - Hold

**Rating: Maintain Hold**

**Constellation Energy**  
**CEG-NYSE-\$33**  
 (Estimated Trading Range – \$30-\$36)

CEG	9/30						
	33						
52-week range	33-15				Price	Y-t-d	12 Mos.
Book Value (6/30/09)	17.61	185%	P/B	Performance	9/30	%	%
EPS - Reported Cont.*				CEG	33	30	34
2005	2.89	11.3	P/E	Phil. El. Index	400	0	(10)
2006	3.61	9.0		Dow Industrials	9,742	11	(10)
2007	4.60	7.1		Coverage			
2008	3.57	9.1		Analyst Total	9		
2009 Est.	3.10	10.5		Buy	3	33%	
2010 Est.	2.65	12.3		Shares (mil.)	201		
2011 Est.	3.10	10.5		Market (\$Bil.)	7		
2012 Est.	3.25	10.0					
Dividend Per Share	0.96	3.0%	Yield				

GAAP EPS results were \$(7.34) in 2008 and \$4.50 in 2007.

\*Guidance - \$3.10-\$3.30 a share 2009; Guidance in 2010 excludes \$0.55-\$0.65 a share transfer profits.

**Recommendation**

Constellation Energy is a combination non-regulated generator (75% of earnings) and regulated utility (25%). The primary earnings driver is the direction of energy prices and management success in locking in profits via hedging strategies. In 2011 and 2012, for example, earnings growth is expected to stem from rising margins via the roll-off of below market hedges, not from increased volumes. The JV with EDF lowers risk and provides the financial muscle to grow nuclear generation. Without the JV, for example, the proposed nuclear expansion at Calvert Cliffs doesn't happen, despite it being on the short list for government guarantees.

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**See page 7 of report for Analyst's Certification, pages 7-8 for Important Disclosures and page 8 for Other Disclosures and Disclaimers**

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Since year end, Constellation Energy has sold assets, reduced risks and increased liquidity to a point where in August, both Moody's and Fitch affirmed its investment grade rating independent of whether the JV with Electricité de France (EDF) closes. The stock price performance mirrored that recovery, rising 30% and 34%, respectively, for the year to date and trailing 12 months. At \$32.50 a share, it's trading 3% off its 12-month high (\$33.37) with price/earnings multiples of 10.5x and 12.3x ongoing 2009 and 2010 earnings, respectively. The \$0.96 a share dividend represents a 36% payout and provides a 3.0% yield.

Constellation Energy's price recovery eliminated the price/earnings discount between it and its' peers in the independent power and quasi-utility companies. At \$33, the shares are at the mid-point of our expected trading range of \$30-\$36 a share. Near term the shares could benefit from approval on the JV with EDF and, of course, increases in energy prices. We are maintaining our Hold recommendation.

## Introduction

After avoiding bankruptcy in 2008, management's goal in 2009 was to reduce risk by exiting Portfolio Management and Trading (PMT) and completing the joint venture with Electricité de France (EDF). By mid year, the company was pretty much out of PMT, except for supporting existing generation. The company sold International Coal and Freight, Houston-based gas trading, International uranium marketing, and west power trading operations. It further booked a \$0.35 a share impairment charge for the pending sale of its international dry bulk shipping joint venture. At mid year, net available liquidity stood at \$5.0 billion, up from \$2.4 billion at year end and, in August, Moody's and Fitch affirmed Constellation's investment grade rating.

The EDF JV sharply reduces merchants' risk profile and strengthens balance sheet metrics. According to management, the debt component of capitalization, under S&P formulae, declines from 58% at mid year to 43% at year end, while common equity rises from 42% to 57%. The deleveraged balance sheet puts the company in position to grow the merchant business via selective acquisitions of generation and customer supply. Without the JV, merchant businesses growth beyond margin expansion and contraction would be tied to more modest-sized generation acquisitions. Also nuclear expansion at Calvert Cliffs doesn't happen.

Going forward, the Merchant businesses (75% of profits) are currently centered on hard generation assets in the PJM and New York State power pools. As generation becomes available, management plans to expand into the SERC and MISO pools. Baltimore Gas & Electric (25% of profits) earnings will stem from rate base growth plus an improved return on common. Consolidated operating earnings guidance is \$3.10-\$3.30 a share in 2009, versus \$3.57 a share in 2008. Guidance is \$2.45-\$2.85 a share in 2010, assuming the JV and excluding benefits of the below asset value transfer. Roll-off of below market hedges could raise earnings to \$2.90-\$3.25 a share and to \$3.10-\$3.45 a share in 2011 and 2012, respectively.

The \$0.96 a share dividend, down from a annual level of \$1.91 a share in 2008, represents 36% of 2010 mid-point guidance of \$2.65 a share and provides a 3.0% yield. Management hasn't revealed its dividend strategy. Assuming completion of the JV and an improved balance sheet, our estimates incorporate dividend growth of 4%-4.5% annually beginning in 2010.

## Background

Constellation Energy transitioned from an integrated utility to a 1) utility/non-regulated generator (deregulation in Maryland and purchase of nuclear capacity in New York), then to a 2) utility/non-regulated generator/non-regulated retail and wholesale supplier. During the process, commodities/energy trading evolved from a supportive function around existing generation into an aggressive Portfolio Management and Trading business. The strategy worked; commodity prices rose and earnings soared. Constellation's stock price increased from \$40 a share in January 2004, hitting a high of \$108 a share in January 2008. With growth came risks. The businesses, particularly PMT, are cyclical and require strong balance sheet support. In fairness, management recognized this risk and told investors it would seek to joint venture (JV) the merchant business, but as financial markets deteriorated in the summer of 2008, so too did potential partners such as Bear Stearns, Lehman Bros, Merrill Lynch, and CitiGroup.

Constellation's most visible blow was self inflicted. The 2008 second quarter 10Q revealed that management had mistakenly understated collateral requirements in the event of debt downgrades. Its credibility damaged, and the overall market in turmoil,

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the stock price plummeted from \$75 a share to a low of \$13 a share, and its credit ratings were cut by Moody's, Standard & Poor's and Fitch. The company lacked access to capital markets and management had no choice but to sell or partner. Time constrictions, absence of a firm second bid, plus an up-front \$1.0 billion cash infusion forced it to accept a \$26.50 a share (\$4.7 billion) offer from Mid-American Energy Holdings (MEHC), a non-publically traded subsidiary of Berkshire Hathaway.

Electricité de France (EDF) expressed interest in some type of affiliation during the crisis but the need to perform due diligence precluded a firm bid. In December 2008 (prior to the shareholder vote on the MEHC transaction), EDF offered \$4.5 billion (\$3.1 billion net of tax) for 49.99% of Constellation's nuclear generation plus a \$2.0 billion (pretax) put option for non-nuclear generation and a \$600 million back up line of credit. The MEHC deal was terminated and the EDF offer accepted. The Maryland Public Service Commission (MPSC) decision is scheduled to approve/disapprove the transaction in October, with the deal closing by year-end.

### EDF Joint Venture Hurdles

Investors have two concerns over potential derailment of the EDF JV. First, the Maryland Public Service Commission (MPSC) may not approve the transaction or it may impose onerous restrictions that would force the company to appeal to the courts. Management maintains the MPSC lacks jurisdiction, but its opposition and appeal process would create many uncertainties, making completion difficult or impossible. A second concern is speculation that Henri Proglio, new CEO at EDF, in an effort to strengthen the balance sheet, may want out.

**MPSC:** On Friday, September 25, 2009, the Maryland Public Service Commission (MPSC) announced that it would hold an additional hearing on Tuesday, September 29, 2009 and a status update on Friday, October 2, 2009. This action was in response to a petition by the Maryland Energy Commission, the Attorney General (AG) and the Peoples Counsel. The petition also included the Attorney General's request for a two-week delay in the MPSC goal to approve or disapprove the transaction in mid-October.

According to the AG, Douglas Gansler, the amendments released September 21, 2009 (8K) appear to 1) lower the sales price to \$3.8 billion from \$4.5 billion. (The payment structure was changed, not the total. Payment includes \$3.8 billion plus \$0.7 billion up streamed from the JV). Other concerns included 2) increased EDF power in Constellation's corporate structure, 3) extended EDF control over the flow of power, 4) insulation of EDF from risks of a Constellation bankruptcy, 5) EDF priority in certain distributions from Constellation Nuclear, and 6) changes in the Maryland tax consequences. Management indicated that the amendments are designed to enable the JV to take advantage of tax benefits. The goal is to reduce that liability. Management indicated in hearings that the net of tax proceeds could rise to \$3.3 billion, up from the initial \$3.1 billion estimate. Also changes in the depreciation schedule would make available to the JV \$1.2 billion in tax savings over a 15-20 year period to be shared equally. The present value of Constellation's \$0.6 billion share is estimated at \$250 million.

**EDF:** EDF has taken on substantial debt with the JV deal and purchase of British Energy. Its debt has been downgraded to A+ from AA-. The financial press has speculated that the new Chief Executive Officer (Henri Proglio) will sell assets and pay down debt.

We have no unique insight into EDF but assume that the Constellation offer had to be sufficiently air tight in order for a near bankrupt company to cancel the firm MEHC bid. Moreover, EDF is already a partner in UniStar with Constellation Energy, and owns 17 million shares of common stock. The JV is also EDF's path into US nuclear generation and Calvert Cliffs#3 is on the short list for Nuclear Regulatory Commission approval, as well as government guarantees. That said, it's possible, but we doubt EDF will opt out. But delays beyond the December 17, 2009 termination date may give EDF that option.

A stand-alone Constellation Energy would survive. In August, both Moody's and Fitch indicated that its investment grade rating was not contingent on the JV. In the near-term, Constellation would report higher operating earnings, but size matters, and growth in merchant generation, particularly via acquisition, would be constrained with nuclear expansion at Calvert Cliffs impossible. Without the JV, Constellation Energy becomes a takeover candidate.

We assume the MPSC approves the transaction with minor stipulations and it closes by year end.

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**Accounting for \$350 million Earnings Transfer:** Assuming the JV is a go, CEG will convey on a present value basis \$700 million of below value assets to the JV (\$350 million, or \$1.05 a share to CEG shareholders). Accounting treatment is determined by the description of assets transferred; 1) If the transaction is recorded as transfer of existing contracts, it receives accrual treatment, or 2) If the transfer reflects newly executed below-market contracts or conveys existing underwater hedges, the derivatives are marked to fair value and booked as a one-time gain (\$1.05 a share). Management has structured the transaction to qualify as a transfer of existing purchase power contracts eligible for accrual treatment. From the accountants' standpoint, accrual earnings are treated as ongoing operations while a one-time earnings gain is non-recurring. The profit to CEG will be spread over two years -- \$0.55-\$0.65 a share in year one and \$0.50-\$0.40 a share in year two.

**Generation with JV:** In the second quarter earnings call, management forecast generation EBIT assuming no JV at \$642 million in 2010, \$756 million – 2011, and \$840 million - 2012. With the JV, EBIT numbers are reduced between \$350 million-\$370 million (\$1.80 a share) a year. The drop in EBIT would be offset by the cost reductions from deployment of \$3.1 billion (\$4.5 billion) net of tax proceeds from the sale. Assuming the \$3.1 billion is used to reduce debt averaging 6.5%, interest expense drops by \$200 million, or roughly \$1.00 a share. Bottom-line earnings attributable to the JV reduced Constellation Energy results by about \$0.50 a share.

**Table 1**  
**Generation EBIT Forecast**

Column	No JV			With JV		
	(1)	(2)	(3)	(4)	(5)	(6)
\$-millions	2010	2011	2012	2010	2011	2012
Output mm mwths	52	53	53	52	53	53
Un-hedged Gross Margin						
Nuclear	1,643	1,734	1,773	822	867	887
Non-nuclear	735	734	815	735	734	815
Total	2,378	2,468	2,588	1,557	1,601	1,702
Total Expenses						
Nuclear direct O&M	623	663	689	312	332	345
Non-nuclear direct O&M	333	332	322	333	332	322
Other Generation	246	242	241	246	242	241
Total	1,202	1,237	1,252	891	906	908
Un-hedged EBITDA	1,176	1,231	1,336	666	696	794
Hedges						
PPA/RSA	(117)	(161)	(123)	(59)	(81)	(62)
Other Hedges	(99)	31	(6)	(99)	31	(6)
Net Hedges	(216)	(130)	(129)	(158)	(50)	(68)
Hedged EBITDA	960	1,101	1,207	509	646	727
Depreciation & Amortization						
Non nuclear	128	139	141	128	139	141
Nuclear	190	206	226	95	103	113
Total Depreciation	318	345	367	223	242	254
EBIT	642	756	840	286	404	473

Source: Second Quarter Earnings and Management. Priced as of June 30, 2009.

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### Baltimore Gas & Electric

Baltimore G&E revenues of \$3,704 million in 2008 were derived \$2,680 million (72%) from electric transmission and distribution, \$1,024 million (28%) in 2008. Ongoing earnings increased 15% to \$0.85 a share (24% of consolidated \$3.57 a share), up from \$0.74 a share and return on average common was 9.4%.

Rate base totaled \$3,453 million in 2008, including \$2,164 million electric distribution (63%of total), \$433 million electric transmission (13%) and \$856 million gas distribution (25%). Capital expenditures of \$2.0 billion for the five years ending 2013 would increase rate base approximately 4% annually. Assuming the company maintains a 9.4% return on common and a 47% common equity component, earnings would fall in the \$0.80-\$0.89 a share area over the 2009 to 2012 period. Guidance for 2009 is \$0.70- \$0.80 a share and \$0.60-\$0.75 a share in 2010. For 2011 and 2012, we estimate earnings of \$0.80-\$0.85 a share.

### Earnings Snapshot

**Outlook 2009/12:** Guidance in highly-hedged 2009 and 2010 is \$3.10-\$3.30 a share for 2009 and \$3.05-\$3.45 a share in 2010. The 2010 forecast includes \$0.55-\$0.65 a share in accruals from below asset value transfers to the JV. Apples to apples comparisons would have earnings in the \$2.45-\$2.85 a share range in 2010. Longer term, management believes base line earnings in a "trough" commodity price environment should be in the \$3.00 a share area for 2011 and beyond. Earnings in the less hedged 2011 and 2012 period are expected to benefit from the roll-off of underwater hedges and widening dark spreads. Generation EBIT is forecast to increase by \$119 million pretax (\$0.59 a share) in 2011 or \$73 million net of taxes (\$0.37 a share). The increase in 2012 is \$69 million pretax (\$0.34 a share) and \$42 million net of tax (\$0.21 a share).

Table 2  
Generation  
Changes in EBIT  
2011-2012

Column	(1)	(2)	(3)	(4)
	2011		2012	
\$-Millions	\$-mil	PS	\$-mil	PS
Changes				
Un-hedged Gross Margin				
Nuclear	46	0.23	20	0.10
Non-nuclear	(1)	(0.00)	81	0.40
Total	45	0.22	101	0.50
Expenses	15	0.07	2	0.01
Un-hedged EBIT	30	0.15	99	0.49
Depreciation & Amortization	19	0.09	12	0.06
Net Before Hedges	11	0.05	87	0.43
Hedge Values	108	0.54	(18)	(0.09)
EBIT	119	0.59	69	0.34
Net of Taxes @38%	73	0.37	42	0.21

Source: Table 24-Second Quarter Earnings Call, adjusted for Joint Venture.  
Values as of June 30, 2009.

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**Earnings Components:** Table 3 lists management guidelines for 2009/10 and our forecasts for 2011/12. We assume Merchant earnings growth is attributable to generation with customer supply flat. The earnings breakdown is approximately 75% merchant and 25% utility.

**2009:** Guidance is \$3.10 - \$3.30 a share in 2009, down 10% (based on mid-point) compared to \$3.57 a share in 2008. Merchant and other profits are forecast at \$2.20-\$2.50 a share, off 13% versus \$2.69 a share in 2008. Utility guidance is \$0.70-\$0.80 a share compared to \$0.85 a share in 2008, down 12%. Shares outstanding increase 12% to 200.6 million, reflecting 20 million shares issued in the MEHC transaction.

**2010:** Management guidance of \$3.05-\$3.45 a share in 2010 includes an accrual of \$0.55-\$0.65 a share stemming from below value assets (\$1.05 a share total) transferred to the JV. An apples to apples comparison, excluding accruals, has earnings at \$2.45-\$2.85 a share, down 23%-11% from mid-point 2009 guidance. Merchant results of \$1.70-\$2.05 share are off 28%-15% from 2009 mid-point. Baltimore G&E earnings decline to \$0.60-\$0.75 a share in 2010 versus \$0.70-\$0.80 a share.

**2011/12:** Management trough earnings guidelines appear reasonable. Table 3 grows Merchant earnings by the expected roll-off of underwater hedges and assumes a modest rebound in Baltimore G&E. Consolidated results in 2011, excluding the below asset value transfer, work out to a \$2.92-\$3.27 a share range (\$3.10 a share mid-point). Earnings in 2012 rise to \$3.13-\$3.48 a share (\$3.30 a share mid-point).

Table 3  
Earnings per Share Profile 2012-2008

Column	(1)	(2)	(3)	(4)	(5)	(6)
	2012 Est.	2011 Est.	2010 Guid.	2009 Guid.	2008 Act.	2007 Act.
Merchant	2.28 - 2.63	2.07 - 2.42	1.70 - 2.05	2.20 - 2.50	2.69	3.77
Utility	0.80	0.80	0.60 - 0.75	0.70 - 0.80	0.85	0.74
Other non-regulated	0.05	0.05	0.04 - 0.06	0.02 - 0.04	0.03	0.09
Adjusted Pre Allocation	3.13 - 3.48	2.92 - 3.27	2.45 - 2.85	3.10 - 3.30	3.57	4.60
JV PPA Transfer	0.00	0.40 - 0.50	0.55 - 0.65			
Total Ongoing	3.13 - 3.48	3.32 - 3.77	3.05 - 3.45	3.10 - 3.30	3.57	4.60

Source: 2009-10 guidelines; 2011-12 Shields' estimates. Valued as of June 30, 2009.

## 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; 8/7/08 (\$74) - Hold.

## Important Disclosures

### Guide to Investment Ratings:

**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.

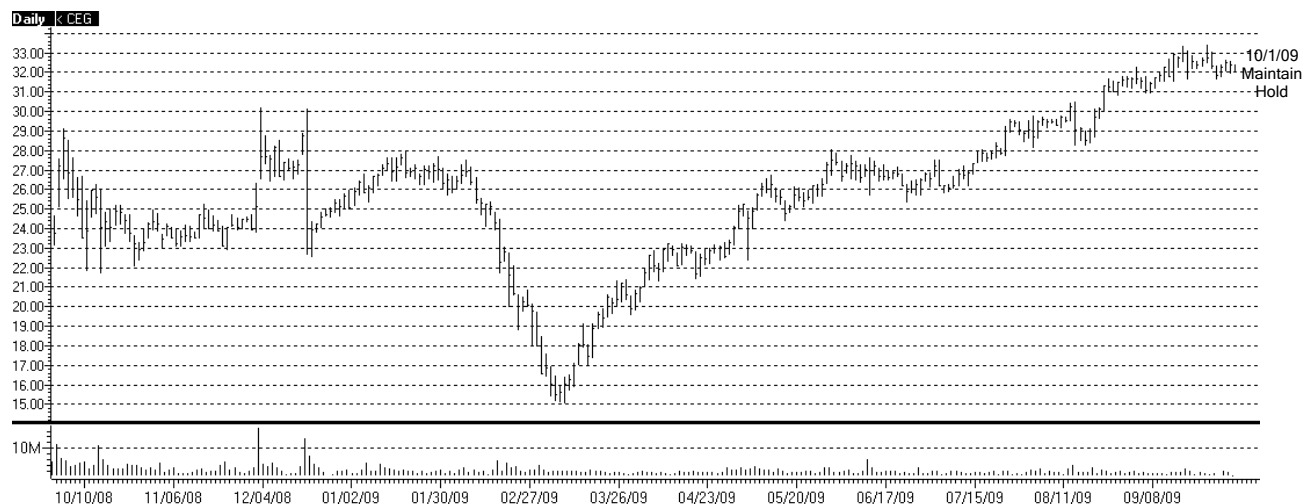
**Sell** Total return is expected to significantly under perform (15% plus) the total return of the industry coverage universe over the next 12 months.

### Analyst's Ratings Distribution

		% Investment Banking
Buy	25%	0%
Hold	75%	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.



## Important Disclosures, continued

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