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ELECTRIC UTILITIES

Research Comment

Rating: Maintain Hold

EXELON
(EXC-NYSE)

(Subsidiary Returns, Accounting Trends & Stand-alone Commonwealth Edison)

Exelon	1/10						
Price	61						
52-week range	64-51					Price	Yr.-end
Book value (9/30/06)	14.46	420%	p/b			1/10	% Chg.
Earnings - ongoing*						12 Mos.	% Chg.
2001 actual	2.22			Exelon	61	(2)	11
2002 actual	2.42	25.2	p/e	Phila. 22 Elec. Index	485	(2)	12
2003 actual	2.61	23.3	p/e	Dow Industrials	12,442	(0)	13
2004 actual	2.78	21.9	p/e	Shares-millions	676		
2005 actual	3.09	19.7	p/e	Equity Value -Bil.	41		
2006 guidance**	3.15	19.3	p/e	Analyst Coverage	19	58%	Buys
2007 guidance**	4.15	14.6	p/e				
Dividend	1.76	2.9	yield				

*GAAP earnings 2005-\$1.36 a share, 2004-\$2.78 a share, 2003-\$1.38 a share, 2002-\$2.11a share, 2001-\$2.21 a share.

**Midpoint of management guidance.

Overview

Exelon is scheduled to announce 2006 results on January 24th. Profits as per ongoing earnings should fall in the guidance range of \$3.15 - \$3.30 a share versus \$3.09 a share in 2005. The estimated return on common approaching 25% would be an even more impressive 36% if goodwill (\$3.99 a share - \$2,694 million) were deducted from book. Guidance for 2007 issued at the investor conference in December is \$4.00-\$4.30 a share (up 33%), and reflects the long-anticipated profit increase at Generation following expiration of the price freeze and end of the full power requirements contract at Commonwealth Edison. Consolidated return on book would rise to 30% in 2007 and approach 41% if the goodwill is written off.

Exelon remains a huge industry favorite. According to Bloomberg Financial Service, the company has 19 active sell side recommendations 11-buys, 8-holds and zero sells. Buys listed from the most recent dates include Dahlman Rose, Atlantic Equities, BMO Capital, Wachovia Securities, Merrill Lynch, Jefferies, HSBC and Lehman. Since 2001, Exelon's market performance has supported analysts' enthusiasm. For the 12-months year-to-date, Exelon share price increased 11%, in line or slightly less than the Philadelphia 22 electric stock index (12%) and Dow-Jones Industrials (13%), but that performance should be compared to the 5 years ended December 31, 2006, when Exelon gained 159%, triple the 49% increase posted by the Philadelphia index and over 6 times the 24% advance registered by the Dow Industrials. Perhaps more significant, in the last five calendar years, Exelon outperformed both indices in four and matched the percentage gain (16%) in one - 2006.

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See page 6 of report for Analyst's Certification, pages 6-7 for Important Disclosures and page 7 for Other Disclosures and Disclaimers

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At \$61, Exelon's 2007 price/earnings multiple of 14.6 times and yield of 2.9% is in line with the averages of the 20-largest electric companies we monitor. Street recommendations indicate that near-term uncertainties at Commonwealth Edison about rates will be either resolved or have minor influence on Exelon overall. But as a mostly unregulated energy supplier, whose margins will be based on the spreads of nuclear versus fossil fuels, Exelon's market performance should begin to mirror the cyclical nature of commodity pricing. We are maintaining a hold rating with an estimated trading range of \$57-\$65 a share.

The objectives of this piece are fourfold: 1) review earnings and returns by subsidiary for the 2003-5 period and estimates based on guidance for 2006 and 2007, 2) review how goodwill allocation at the formation of Exelon overstated asset values at Commonwealth Edison and led to creation of "appropriated retained earnings for future dividends" in the event retained earnings became negative, 3) review how understated asset value in Generation increased earnings via depreciation reductions from a lower investment base and life extensions, and 4) estimate shareholders equity, earnings power, earnings growth and dividend policy of a stand-alone Commonwealth Edison.

Earnings & Returns Profiles

Generation: Generation earned \$1.71 a share and a 29% return on common in 2005, compared to \$0.93 a share in 2004 and a 20% return. Based on management guidelines, earnings are expected to approach \$1.92 a share in 2006 and \$3.50 a share in 2007. Return on average book should reach 45% in 2007. Earnings in 2006 and 2007 reflect renegotiated sales prices effective January 1, 2006 and expiration of its full requirements contract with Commonwealth Edison, effective January 1, 2007.

Commonwealth Edison: Despite the rate freeze under transition legislation, Commonwealth Edison's returns were high through 2004, but declined in 2005 following renegotiation of the price component in its full power requirements contract with Generation. Return on average book value (including goodwill) declined from 13% in 2003 to 11% in 2004 and 8% in 2005. Return on book, assuming management guidelines, is expected to approach 11% in 2006 and decline to 2% in 2007. If goodwill were excluded from book, the 2005 return rises to 18% -- respectable but well below comparable returns of 38% in 2004 and 59% in 2003.

PECO Energy: PECO book of \$2.52 a share is net of a loan to the parent representing \$1.82 a share (\$1,242 million), that for accounting purposes is recorded as a charge to book. Return on average book was 30% in 2005, 40% in 2004 and 51% in 2003. The return is expected to decline to 19% in 2006 and to 17% in 2007. If the loan to the parent were normalized (it reverses in 2010), PECO's returns would approach 18% in 2005, 12% in 2006 and 11% in 2007.

Table 1, columns 3-5 lists ongoing earnings, average book values including and excluding goodwill and returns on average book for Exelon and subsidiaries for the 2005-3 period. Columns 1 & 2 take midpoint guidance for 2006 and 2007 and calculate returns on book. Book values for 2006 are as of September 30. For 2007, book is as of September 30, 2006, increased by 2007 earnings less dividends (80% paid by Generation, 20% PECO, 0% Commonwealth Edison).

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Table 1
Earnings, Book Values & Returns
2007-03

Column	(1)	(2)	(3)	(4)	(5)
	Guidelines	Guidelines	Actual		
Ongoing Earnings	2007	2006	2005	2004	2003
Exelon Per Share	4.15	3.15	3.09	2.78	2.61
% Change	32	2	11	7	8
Average Book	14.01	12.81	13.50	13.54	12.33
Return on Average Book	30%	25%	23%	21%	21%
Average Book less Goodwill	10.04	8.83	8.36	6.47	5.16
Return on Average Book net of Goodwill	41%	36%	37%	43%	51%
SUBSIDIARIES					
Generation Per Share	3.50	1.92	1.71	0.93	0.67
% Change	83	12	85	38	
Average Book	7.85	6.80	5.89	4.54	4.47
Return on Average Book	45%	28%	29%	20%	15%
Commonwealth Edison Per Share	0.14	0.77	0.77	1.15	1.21
% Change	(82)	1	(33)	(5)	
Average Book	7.33	7.26	9.46	10.01	9.21
Return on Average Book	2%	11%	8%	11%	13%
Average Book less Goodwill	3.36	3.27	4.32	2.98	2.04
Return on Average Book net of Goodwill	4%	24%	18%	38%	59%
PECO Energy Per Share	0.61	0.63	0.76	0.68	0.69
% Change	(4)	(17)	12	(2)	
Average Book	3.50	3.37	2.52	1.69	1.36
Return on Average Book	17%	19%	30%	40%	51%
Other	(0.10)	(0.17)	(0.14)	0.03	0.04
% Change	(41)	17	(552)	(26)	
Average Book	(4.67)	(4.61)	(4.37)	(2.69)	(2.70)
Return on Average Book	2%	4%	3%	-1%	-2%
Goodwill	2,694	2,694	3,475	4,705	4,719
Per Share	3.96	3.99	5.14	7.03	7.17
Average Shares	680	676	676	669	658

Goodwill Vis-à-Vis Generation and Commonwealth Edison

Exelon was formed October 1, 2000. The transaction was accounted for as a purchase with \$4.8 billion of goodwill placed on Commonwealth Edison's balance sheet. Goodwill created little concern for investors since impairment charges are disregarded as one-time and non cash. Also, absence of amortization (SFAS 142) raised ongoing earnings \$0.19 a share. Allocation of goodwill, however, did influence financial results and strategies at both Commonwealth Edison and Generation.

Goodwill consisted primarily of two components: 1) the premium paid over Commonwealth Edison book as of September 30, 2000 (\$2.3 billion), and 2) \$2.3 billion from the fair value adjustment accompanying the \$4.3 billion writedown of net utility plant. Commonwealth Edison's gross nuclear investment, in particular, was cut 76% to \$2.0 billion (\$10.5 billion from \$13.8 billion). The writedown gave Generation a lower base to measure returns and an immediate \$0.20 a share (\$215 million pretax) boost to

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Exelon's ongoing 2001 earnings from reduced depreciation charges. The writedown also appeared to contradict both management and investor growth expectations. Generation, particularly the nuclear fleet, was expected to be the largest beneficiary of consolidation. In its November 2000 presentation to the investment community, Exelon management stressed opportunities in Generation including life extensions, increases in capacity factors (90.6% in 2000 to 93.5% in 2003) and production costs declines (15.52 cents a megawatt-hour to 13.46 cents). The accountants, whose job was to match revenues with expenses apparently disagreed. When financial statements in 2001 were restructured according to Delivery, Generation and Enterprises (other non-regulated businesses), the \$4.8 billion goodwill remained on the balance sheet of Commonwealth Edison, a fully regulated delivery company. In other words, the benefits of consolidation would accrue entirely to the delivery business of Commonwealth Edison. (Management maintains that prior to the ring fencing at Commonwealth Edison, the goodwill impairment would be measured by all the delivery revenues including PECO Energy. Perhaps, but no goodwill was ever allocated to PECO's balance sheet.)

SFAS 142 states "goodwill shall be assigned to reporting units of acquiring entity that are expected to benefit from the synergies of the combination."

In reality, the writedown of generation that accompanied the formation of Exelon left accountants with no choice but to assign goodwill to Commonwealth Edison, thus overstating asset values at Commonwealth Edison and understating Generation. Another example of undervalued assets at generation was illustrated by Nuclear Regulatory Commission approval of life extension of nuclear plants in 2002/3, raising ongoing Exelon earnings by \$0.22 a share annually.

Commonwealth Edison and Appropriated Retained Earnings

If the accountants believed Commonwealth Edison could bear the goodwill burden, it was short lived. As early as 2003, management set aside reserves to pay dividends by establishing a \$709 million reserve titled "Appropriated Retained Earnings for Future Dividends." Under Illinois law, dividends cannot be paid out of negative retained earnings, but may be paid from appropriated retained earnings. From 2003 through September 30, 2006, Commonwealth Edison transferred \$2,220 million to appropriated retained earnings.

During 2006, prior to Commonwealth Edison's third-quarter goodwill impairment, management transferred 100% of reported earnings (\$340 million) to appropriated retained earnings, effectively bypassing traditional retained earnings. The third quarter impairment created an overall loss at Commonwealth Edison for 2006, preventing further transfers. However, the clock is reset as of January 1, 2007.

Table 2
Commonwealth Edison
Transfers to Appropriated Retained Earnings for Future Dividends

Column	(1)	(2)	(3)	(4)
			CWE Retained Earnings Year-end \$-mil.	Exelon Retained Earnings Year-end \$-mil.
Commonwealth Edison	Debit \$-mil.	Credit \$-mil.	Year-end \$-mil.	Year-end \$-mil.
Retained Earnings Balance 2002			577	2,042
Un-appropriated Retained Earnings 2003	709			
Un-appropriated Retained Earnings 2004	676			
Un-appropriated Retained Earnings 2005	495			
Un-appropriated Retained Earnings (9/30/06)	340			
Appropriated Retained Earnings for Future Dividends-2003		709	883	2,320
Appropriated Retained Earnings for Future Dividends-2004		676	1,102	3,353
Appropriated Retained Earnings for Future Dividends-2005		495	(81)	3,206
Approp. Retained Earnings for Future Dividends YTD 9/30/06		340	(406)	3,130
Cumulative	2,220	2,220		

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Stand-Alone Commonwealth Edison

Extension of Commonwealth Edison rate freeze could create losses of \$1.4 billion annually, a figure that would wipe out shareholder equity in 2 ½ years. The impact on Exelon shareholders would be modest since management has separated Commonwealth Edison's management and operating functions ("ring fenced"). Earnings will account for 3% of consolidated 2007 results and only 12% on a normalized basis assuming a 10% return. Political obstacles combined with Commonwealth Edison's modest profit contribution make it a divestiture candidate.

If a stand-alone Commonwealth Edison earned a 10% return on common, profits would equal \$0.50 (\$340 million) per Exelon share. Under Illinois law dividends may be paid out of current earnings or, if retained earnings are negative, "appropriated retained earnings for future dividends." A dividend of \$0.25 a share (\$170 million) and reinvestment of \$170 million would grow book roughly 3.5% to 4% annually. A stock price based on a 10 times multiple would be \$5.00 per Exelon share and the yield 5%. Total return as measured by yield plus dividend growth would approximate 9% to 10% annually.

Table 3, Column 1 lists the components of Commonwealth Edison common equity as of September 30, 2006. Total book of \$6,082 million includes \$2,694 million of goodwill and a negative retained earnings balance of \$406 million. Write off of goodwill would reduce shareholder equity to \$3,388 million and raise negative retained earnings to \$3,100 million. Under our assumed 10% return level and 50% payout, the dividend cushion represented by the \$1,439 million of appropriated retained earnings would represent about 10 years. Column 5 assumes Commonwealth Edison would be able to reorganize (purely conjecture on our part) and simplify shareholder equity. We assumed negative retained earnings are eliminated by the transfer of paid-in capital to retained earnings up to a zero balance.

Table 3
Commonwealth Edison
Pro Forma Equity
As of September 30, 2006

Column	(1)	(2)	(3)	(4)	(5)
Commonwealth Edison Shareholders Equity as of 9/30/06	9/30/06 \$-Mil	Impairment \$-Mil	Adjusted \$-Mil	Reorganization \$-Mil	Pro Forma \$-Mil
Common stock	1,588		1,588		1,588
Other paid-in capital	4,902		4,902	(4,539)	363
Retained earnings					
Appropriated	1,439		1,439		1,439
Un-appropriated	(1,845)	2,694	(4,539)	4,539	0
Net Retained Earnings	(406)		(3,100)		1,439
Accumulated other comprehensive loss,	(2)		(2)		(2)
Total shareholders equity	6,082		3,388		3,388
Shares Outstanding Exelon - millions	671				
Book Value	9.06		5.05		5.05
Retained earnings per share					
Appropriated	2.14		2.14		2.14
Un-appropriated	(2.75)		(6.76)		0
Net Retained Earnings	(0.61)		(4.62)		2.14

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 Exelon reports issued by me are: 8/30/06 (\$60) - Hold; 8/2/06 (\$59) - Hold; 4/27/06 (\$58) - Hold; 3/23/06 (\$55) - Hold; 3/15/06 (\$56) - Hold; 1/26/06 (\$58) - Hold; 10/4/05 (\$53) - Sell; 8/4/05 (\$54) - Sell; 3/8/05 (\$47) - Sell.

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.

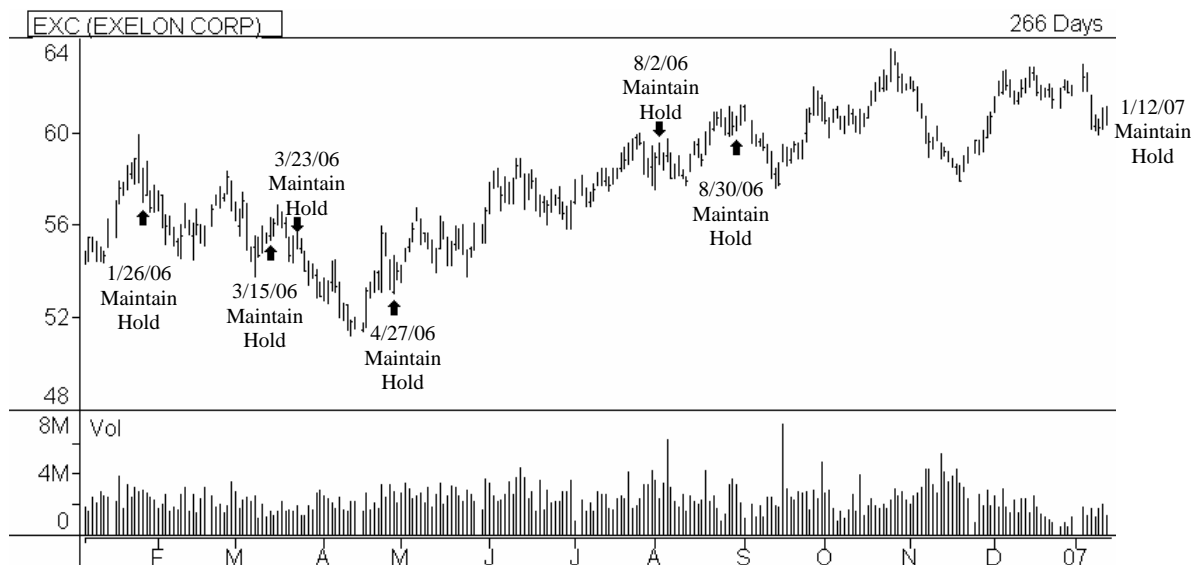
Market Perform & Hold Total return is expected to equal the average total return of the analyst's industry coverage universe over the next 12 months.

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	12%	0%
Hold	82%	0%
Sell	6%	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



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