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	3/23/06*	% Change Year-to-date	% Change 12 months
Dow Industrials	11,274	5	8
Philadelphia Electric Index	424	(1)	11
Exelon Corporation	55.29	4	26

*Intra-day

EXELON CORPORATION (EXC)
NYSE-$56-Hold

Commonwealth Edison Divestiture Could Raise Risk for CWE Investors

During last year's controversy over the fuel procurement program that will follow the expiration of Commonwealth Edison's rate freeze as of 12/31/06, John Rowe, Exelon Chief Executive Officer, played hard ball. Rowe threatened bankruptcy or the spin-off of Commonwealth Edison. He also severed management ties between the parent and Commonwealth Edison and hired at least one investment-banking firm to advise on restructuring at Commonwealth Edison.

In a research comment issued on March 15, 2006, we indicated that a spin-off would pose little risk to Exelon shareholders. Commonwealth Edison earnings power could drop to $0.55 a share in 2007, down from $0.77 a share in 2005 and $1.21 a share in 2003. Based on consensus 2007 earnings of $4.32 a share, Commonwealth Edison earnings would represent only 13% of consolidated results. By contrast, two years ago, Commonwealth Edison accounted for 46% of consolidated profits and, in a report issued in September 2004, we estimated its return on distribution equity rate base at over 28%, including CTC revenues and 20% excluding CTC receipts.

Spin-off or sale, however, could create difficulties for Commonwealth Edison investors. The merger creating Exelon (Unicom and PECO Energy) produced $5 billion in goodwill, all of which was allocated to Commonwealth Edison's balance sheet. SFAS 142 states that goodwill is to be assigned to those businesses that benefit from consolidation. It's obvious that SFAS 142 allows the accountants significant leeway in interpreting where benefits of consolidation are derived. In this case Generation represented zero value added. After recent impairment charges, Commonwealth Edison goodwill stood at $5.14 a share ($3,475 million) at year-end.

A problem with divestiture is that although the Commonwealth Edison balance sheet includes all the goodwill, impairment is measured by the cash flow generated in the entire distribution business, including Peco Energy. Peco rates are sheltered by the Pennsylvania transition agreement through 2010 and, in 2005, Peco earned a 30.1% return on common (17.8% after adjusting for a receivable from the parent). If spin-off or sale of Commonwealth Edison severs the link between Commonwealth and Peco, Commonwealth Edison could incur further impairment charges. Also since Peco earnings are about equal to Commonwealth Edison profits, impairment might lead to write off of most or possibly all the remaining goodwill on Commonwealth Edison's balance sheet.

If goodwill were entirely written off, Commonwealth Edison book declines 54% to $4.32 a share ($2,922 million), from $9.46 a share ($6,397 million). Common equity as a percent of total capitalization drops to 42.7%, from 62.0%. If regulators in the pending rate case were to approve the lower equity ratio and a 10% return, Commonwealth Edison earnings power equates to $0.43 a share ($291 million). Full write-off increases retained earnings from negative $81 million at year-end to a pro forma negative of $3,556 million.

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Commonwealth Edison
2005 Capitalization and Pro Forma Goodwill Write Off

Capitalization	12/31/05 $-mil	% Total	Impairment $-mil	Pro Forma $-mil	% Total
Total Debt	3,926	38.0%		3,926	57.3%
Preferred	0	0.0%		0	0.0%
Common Equity					
Common Stock	1,588	15.4%		1,588	23.2%
Paid In Capital	4,890	47.4%		4,890	71.4%
Unappropriated Retained Earnings	(1,180)	-11.4%	3,475	(4,655)	-68.0%
Appropriated Retained Earnings	1,099	10.6%		1,099	16.0%
Net Retained Earnings	(81)	-0.8%		(3,556)	-51.9%
Total Common Stock	6,397	62.0%		2,922	42.7%
Total Capitalization	10,323	100.0%		6,848	100.0%
Shares – Average Diluted	676				
Book Value	9.46			4.32	

Management has anticipated the prospect of negative retained earnings. In 2003 as insurance against negative retained earnings, the company set aside reserves for future dividend payments. It created an item titled "Appropriated Retained Earnings." The accounting entry reduced unappropriated retained earnings (debit), transferring it to appropriated retained earnings for future dividends (credit). Dividends could be paid out of appropriated retained earnings, despite an overall negative balance. Appropriated retained earnings totaled $1,099 million at year-end, roughly equivalent to just under four years of earnings power ($291 million) of a stand-alone Commonwealth Edison.

Dividends may be up-streamed to Exelon but the prospect of divestiture makes that action unlikely and politically dangerous. Also a stand-alone Commonwealth Edison would be unlikely to exacerbate an already weakened financial structure by drawing on that reserve. The company might be able to pay dividends out of current earnings. Dividends, assuming a 50% payout ratio, would total $145 million. Reinvestment of the remaining $145 million would erase the negative $4,655 million in unappropriated retained earnings in thirty-two years, assuming of course write-offs incurred from normal business practices are avoided. It's reasonable to assume the rating agencies would be critical of the absence of financial flexibility.

All this is why corporate managers hire investment bankers, lawyers and accountants, to fix things. We don't know of any solutions, only questions. Perhaps the accountants who credited all the goodwill to Commonwealth Edison can perform some other magic? Maybe the Illinois Legislature could provide relief?

Why not spin-off and/or sell Commonwealth Edison and Peco Energy as a package? It seems clear that the distribution businesses are no longer integral to management growth strategy.

Maybe Commonwealth Edison should be sold to a public authority (AKA Long Island Lighting Company to the Long Island Power Authority)?

Or, perhaps the more likely scenario is to retain Commonwealth Edison within the Exelon system?

Range of Formal Recommendations 15 total 1-buy-13-holds-1 sell

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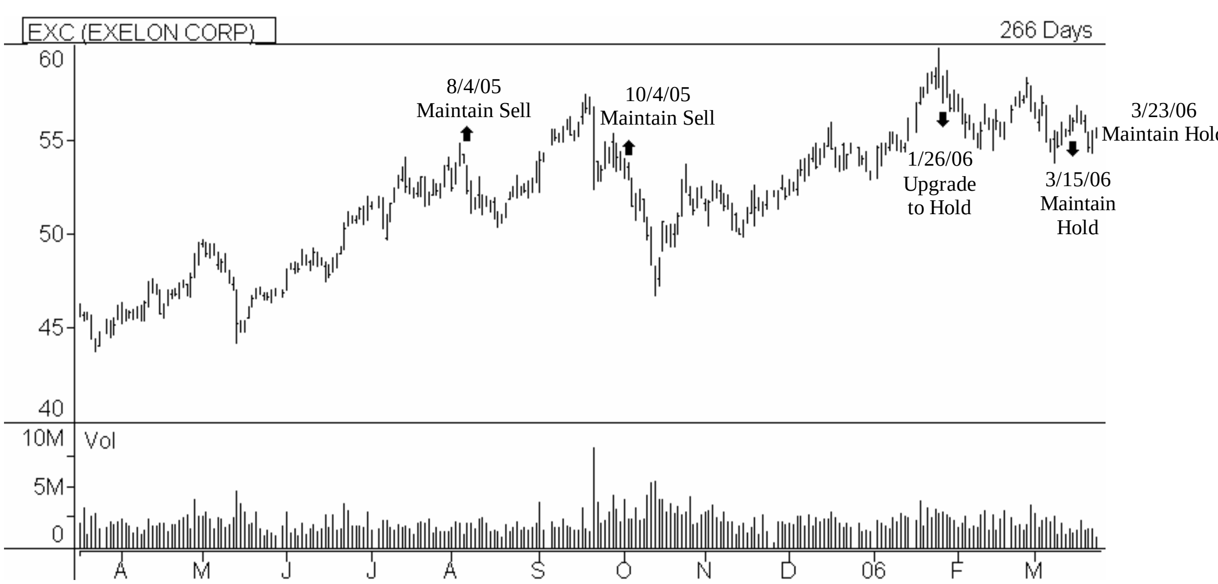
Buy Total return is expected to exceed significantly the average total return of the analyst's industry coverage universe over the next 12 months.
Market Perform & Hold Total return is expected to equal the average total return of the analyst's industry coverage universe over the next 12 months.
Under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