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Rating: Hold

Exelon Corporation
(EXC-$66)
Next Cycle - Narrowing Margins

Exelon	9/16						
Price	66						
52-week range	92-62				Price	Ytd	1-Yr.
Book Value (6/30/08)	14.94	439%	P/B	Performance	9/16	%	%
EPS ongoing Non-GAAP		P/E	Return	Exelon	66	(20)	(14)
2003 Actual	2.61	25.1	16.9%	Phil. Electric Index	463	(19)	(13)
2004 Actual	2.78	23.6	19.6%	Dow Industrials	11,059	(17)	(18)
2005 Actual	3.09	21.2	22.9%				
2006 Actual	3.22	20.4	22.8%	Analyst Coverage	17	76%	Buys
2007 Actual	4.32	15.2	29.0%				
2008 Consensus	4.29	15.3	27.5%	Shares-millions	662		
2009 Consensus	4.46	14.7	27.5%				
Dividend Per Share	2.00	3.0%	Yield	Equity - $Billions	43		

*GAAP per share earnings - $4.05-2007, $2.35-2006, $1.36-2005, $2.78-2004, $1.38-2003

Performance

After hitting an all-time high of $92 a share in July, Exelon's price declined 30% to a low of $63 a share on September 9th. Year-to-date, Exelon's 20% price drop slightly exceeds the declines of the Philadelphia Electric Index (minus 19%) and the Dow Industrials (minus 17%). Events contributing to Exelon's retreat include: 1) weakness in the overall market, 2) declining energy prices that hurt shares of all non-regulated generators, despite highly-hedged portfolios, and 3) earnings guidance at a Lehman Bros. energy conference that was below consensus. (At that conference, management reasserted that 2011 earnings per share should represent 40% growth over 2008 guidance of $4.15-$4.30 a share, or $5.80-$6.00 a share.)

Street Opinion

Despite price pressures, Exelon enjoys exceptionally broad and strong support from the sell side. According to Bloomberg Financial Service, Exelon has 17 active recommendations - 13 buys, 3 holds, 1 sell. During September, 10 firms either reinforced or issued buy recommendations with price targets ranging from $81 to $100 a share: Jefferies-$83, Goldman Sachs-

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$96, Macquarie-$82, Bank of America-$95, BMO Capital-$95, Deutsche Bank-$100, Lehman-$81, Bernstein-$85, Credit Suisse-$99, Key Bank-$81. The only sell (specifically an underweight classification) was issued by Atlantic Equities with a price target of $56.

Recommendation

At $66 a share, Exelon trades at 14.7 times consensus 2009 earnings of $4.46 a share, a 22% premium to the S&P Utilities index of 12.1 times. The only higher multiples are Nicor (GAS-$47-not rated), primarily a natural gas distributor-18.0 times; PPL Corporation (PPL-$38-Hold), a business mix similar to Exelon-16.9 times, and Southern Co. (SO-$39-Hold), a traditional integrated utility at 15.8 times. (Independent power companies trade at 10 times 2009 consensus forecasts.) In our July 2008 market review, Exelon's price of $90 represented an 18.9 times price/earnings ratio on a 2009 consensus earnings estimate of $4.75 a share, a 34% price/earnings premium. The only higher P/Es were Dynegy (DYN-$4-not rated) at 22.9 times and PPL Corp. at 20.6 times.

In short, although Exelon's price/earnings premium has narrowed from 34% at its high to 21% currently, the shares don't appear particularly depressed. We are maintaining a Hold Rating, with an expected 12-month trading range of $60-$75 a share.

Structural Challenges of Next Cycle

Exelon and non-regulated nuclear generators in general have enjoyed the classic upside of a commodity boom. Nuclear generation was either written down and/or purchased at depressed prices; depreciation lives were extended; and margins exploded as fossil fuel prices skyrocketed and transition programs from cost-based purchased power to competitive pricing rolled off. Talk about a perfect storm.

Exelon Generation's capacity has been flat at roughly 25,000 megawatts (17,000 nuclear). Yet Generation earnings since 2003 have increased fivefold from $0.67 a share (26% of consolidated $2.61 a share) to $3.45 a share in 2007 (80% of consolidated $4.32 a share). Return on average book was 47% in 2007, up from 15% in 2003. (Exelon's consolidated return increased to 29%, up from 21%.) Exelon's next significant boost in earnings to $5.80-$6.00 a share is expected in 2011 with the roll off of PECO's purchase power agreement. Another possible earnings driver would stem from Cap & Trade legislation for greenhouse gas emissions, perhaps in the 2010/11period.

Exelon's next challenge will be to maintain returns on a growing investment in a cost plus environment, as opposed to increasing returns on a stable investment? The future poses greater risks, less visibility and narrower margins.

Grow or Shrink

Management could opt to grow or shrink capitalization, maximizing returns on existing investment and eventually ceding its status as the largest US nuclear operator. In its September announcement of a $1.5 billion common stock buyback, John Rowe, Exelon's Chairman and Chief Executive Officer, cited the company's strong balance sheet and the ability to explore growth opportunities and return value to shareholders. In other words, investment opportunities at compensatory returns are lacking.

Nuclear operators have aggressively assumed the mantra of global warming with new nuclear generation as part of the solution. But it's been the competitive generators, not integrated utilities, who demand subsidies from Uncle Sam in the form of government guarantees, production tax credits and insurance protection. Exelon filed for a Construction and Operating License (COL) for a 2-unit, 3,000 megawatt nuclear plant in Victoria County, Texas in September. But the filing doesn't commit to construction, nor contain construction estimates. All it does is place the company in the queue for any potential Federal subsidies. Exelon has been vocal in the need for Federal support.

Balance Sheet Exposure

The reality is that estimates of costs are premature and probably grossly understated, but as a starting point (reactors are different than proposed by Exelon), SCANA Corp.'s (SCG-$39-Buy) estimate is $4,949 a kilowatt (excluding AFUDC and including transportation costs) and Southern Co.'s is $6,089 a kilowatt (including AFUDC). Those numbers applied to Exelon's 3,000 megawatt project indicate a capital commitment range of $15 to $18 billion.

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At 2007 year end, Exelon's consolidated net plant in service was $20.6 billion, capitalization $21.8 billion, and common equity $10.1 billion. Generation alone, excluding non-nuclear financing and regulated T&D businesses at Commonwealth Edison and PECO Energy, had net plant in service of $5.0 billion (24% of consolidated), capitalization of $7.9 billion (36%), and common equity of $4.4 billion (43%). Would it make any economic sense to more than double Generation's capitalization and triple net plant in service for an 18% increase in nuclear capacity?

Table 1
Exelon vs. Generation
2007

Column	(1)	(2)	(3)
	Exelon $-Mil	Generation $-Mil	Generation % Total
Net Plant in Service*	20,594	4,994	24
Capitalization	21,802	7,856	36
Common Equity	10,137	4,369	43

*Excludes Nuclear Fuel

Risk Mitigation

Neither the SCANA nor Southern Co. COL filings rely on Federal subsidies. The projects can be financed based on traditional integrated utilities having 1) an identifiable customer base, 2) regulatory and legislative pacts providing for review of cost escalations, possibly construction work in progress in rate base, and 3) the opportunity to earn a reasonable, albeit a utility, return on investment once completed. Competitive generators have no identifiable customer and assume risks of an out of the market project. Guarantees could alleviate some investor concern but further risk mitigation is likely, making the non-regulated generators look a lot like a utility. Exelon could spread risks in any one project by seeking partners. Also it might opt to sign purchase power agreements (PPA) and establish an identifiable revenue source upon completion. Unlike the current cycle, the purchaser would be in a position to negotiate rates and perhaps rates of return parameters. All opportunity and little risk are more a characteristic of the current cycle.

Earnings Profile

Exelon's 2007 earnings of $4.32 a share (ongoing) were derived 80% from non-regulated generation - $3.45 a share, 7% Commonwealth Edison - $0.30 a share, 17% PECO - $0.75 a share. Consolidated return on book was 29.1% in 2007, including 47.3% for Generation. By contrast, in 2003 Exelon's largest contributor to earnings of $2.61 a share was Commonwealth Edison at $1.21 a share (46% of total), followed by PECO at $0.69 a share (26%) and Generation at $0.67 a share (26%).

Table 2
Earnings-Return Profile
2007 vs. 2003

Column	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
			2007					2003		
	EPS	% Tot.	Book	% Tot.	% Ret.	EPS	% Tot.	Book	% Tot.	% Ret.
Exelon	4.32		14.87		29.1	2.61		12.33		21.2
Generation	3.45	80	7.29	49	47.3	0.67	26	4.47	36	15.1
ComEd.	0.30	7	9.49	64	3.2	1.21	46	9.21	75	13.1
PECO	0.75	17	2.77	19	27.1	0.69	26	1.36	11	51.0
Other	(0.16)	(4)	(4.67)	(31)	3.4	0.04	2	(2.70)	(22)	(1.6)

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: 4/10/07 ($72) – Hold; 1/12/07 ($61) – Hold; 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	11%	0%
Hold	89%	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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