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ELECTRIC UTILITIES

Industry Comment

Financing Nuclear Generation Utility versus Non-Regulated

Integrated Utilities

A few months back there were no fewer than 24 applications for US Nuclear Reactors, but details such as capital commitments, completion dates, etc., remain sparse. Projects that appear furthest along are headed by traditional integrated utilities with participation by traditional public power entities: **SCANA Corp.'s (SCG-\$35-Buy)** South Carolina Electric & Gas and **Southern Company's (SO-\$35-Hold)** Georgia Power. (Progress Energy's (PGN-\$41-Hold) Florida Power Corporation is close, but has yet to provide the detail of either SCANA or Southern Company.)

SCE&G, with a total capitalization of \$5.2 billion as of year-end 2007, estimates capital costs of its 55.0% share of a two-unit plant totaling 2,234 megawatts at \$6,313 million (\$5,137 a kilowatt). Georgia Power's 45.7% interest in a two-unit 2,300 megawatt plant works out to 1,051 megawatts, and an all-in investment of \$6,400 million (\$6,089 a kilowatt). Despite safeguards implied in negotiated agreements with manufacturers and regulators, those estimates should prove conservative.

For SCE&G, the proposed investment represents 121% of capitalization and 241% of common equity. At Georgia Power, exposure is large, but no where near as great as SCE&G. Its construction forecast represents 47% of 2007 year-end capitalization and 99% of common equity. SCE&G risks are mitigated by inclusion of Construction Work in Progress (CWIP) in rate base -- in effect paying for financing costs on an as-you-go basis. Georgia Power will capitalize financing charges via allowance for funds used during construction (AFUDC) entries.

For integrated utilities, few doubt the ability to finance. Utilities have regulatory support and customers for the output once the project is completed. In return for reduced risk, utilities are granted lower returns but are able to raise capital. Financing charges during construction, including equity returns, are either 1) collected during construction if CWIP is included in rate base, or 2) added to the cost of investment and recovered over the life of the investment. The project can be financed by the traditional method, i.e., on balance sheet or off balance sheet via a project and/or leveraged leased vehicles.

In marked contrast to non-regulated nuclear generators, neither SCE&G nor Georgia Power requires Federal subsidies such as production tax credits, loan guarantees or government-backed insurance.

Nuclear Non-Regulated

Up to now, non-regulated nuclear generators enjoyed the good life. Generation was purchased or set apart from T&D investment at depressed values as 1) deregulation programs incorporated write-downs of stranded investment paid by regulated consumers, 2) assets were written-down coincident with merger, 3) lower depreciation rates increased earnings as operating licenses were extended 20 years, and 4) sales prices reflected strategy based on higher-cost fossil fuels.

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Nuclear margins on existing units are expected to widen as looming carbon legislation raises fossil fuels costs and Congress enacts a cap & trade program for emission credits. Longer term, nuclear proponents cite declining reserve margins, rising public and political support, and the prospect of even higher fossil prices.

Why then are so called "free markets" advocates seeking Federal assistance to finance new generation? Plants are expensive and non-regulated nuclear generators are small relative to capital needs. Investment in a 1,000 megawatt plant as per SCE&G and Georgia Power is in the \$6.5 billion area with estimates of other projects in the \$7 to \$10 billion range. Compare these numbers to the Country's largest, and what many consider the premier, non-regulated nuclear generator, Exelon Generation, a subsidiary of **Exelon Corp. (EXC-\$85-Hold)**. At 2007 year-end, Exelon Generation's capitalization totaled \$7.9 billion, including \$4.4 billion equity. The company owned 17,000 megawatts of nuclear capacity and earned a 41% return on common.

Should an Exelon Generation risk shareholder capital on a long-term capital intensive project that doubles its size for a 1,000 megawatt (6%) increase in nuclear capacity? What about 3,000 megawatts? Exelon has announced its intention to file a combined construction and operating license application (COL) for two 1,500 megawatts units in Victoria County, Texas (\$21 billion?).

In their purest form, non-regulated nuclear generators should attract high/risk high reward investors. But non-regulated generation lacks support of/or oversight of state regulators, has no identifiable customer and sells the output at market prices. Balance sheets and income statements couldn't sustain the project during the construction cycle. Interest charges might be capitalized, but equity issues would severely dilute earnings. Off balance sheet project financing is impossible without an identifiable and compensatory revenue stream or debt guarantees by a viable entity. One solution may be for the non-regulated generator to line up purchase power arrangements prior to moving dirt. The downside is that the purchaser, presumably a regulated utility, would impose potential sales price ranges that would sharply dampen profit potential. Another option may be acquisition by larger energy concerns such as oil giants.

Non-regulated and nuclear generators are petitioning Congress to expand and extend the role of Federal Loan Guarantees (Uncle Sam being a viable third party). The Energy Policy Act of 2005 allows the Department of Energy to allocate \$18.5 billion that could cover 100% of the debt portion of the project provided it doesn't exceed 80% of total project costs. The act further provided for 1) \$18 megawatt-hour in production tax credits on up to 6,000 megawatts, totaling \$1.0 billion annually for 8 years, and 2) Federal standby support of \$2 billion also for the first six plants. Guarantees totaling \$18.5 billion, however, represent only a small portion of capital needs. The NRC expects applications for 32 reactors in 2008. Assuming \$7.5 billion per reactor, the \$18.5 billion represents only 8% of \$240 billion of required capital needs. Any change in the Federal guarantee program will be decided by the next Administration.

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Table 1
Estimated Capital Cost of Nuclear Projects

| Column | (1) | (2) | (3) |
|----------------------|-------------------------------|--------------------------------------|--------------------------------|
| | Scana SCE&G \$-Millions | Southern Ga. Power \$-Millions | Progress FPC \$-Millions |
| Plant | | | 14,000 |
| Transmission & Other | | | 3,000 |
| All-in Costs | 6,313 | 6,400 | 17,000 |
| % Ownership | 55.0% | 45.7% | 100.0% |
| Capacity (mw share) | 1,229 | 1,051 | 2,200 |
| Cost per mw | 5,137 | 6,089 | 7,727 |
| Capitalization 2007 | | | |
| Debt | 2,480 | 6,853 | 3,173 |
| Preferred | 106 | 265 | 34 |
| Common | 2,622 | 6,435 | 4,735 |
| Total | 5,208 | 13,553 | 7,942 |
| Capital Structure | | | |
| Debt | 47.6% | 50.6% | 40.0% |
| Preferred | 2.0% | 2.0% | 0.4% |
| Common | 50.3% | 47.5% | 59.6% |
| Total | 100.0% | 100.0% | 100.0% |
| Investment | | | |
| % Common Equity | 241% | 99% | 359% |
| % Capitalization | 121% | 47% | 214% |

Source: Company Releases

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.

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| | | % Investment Banking |
|------|-----|----------------------|
| Buy | 17% | 0% |
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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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