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Market Update

Prior Review – July 10, 2008

Electric Utilities  
Non-Regulated Generators Price Performance  
Realities of Next Cycle

Table 1  
S&P Utilities  
Profile - Comparative Performance

Column	(1)	(2)	(3)	(4)	(5)	(6)
		Price				
		8/15	YTD	3-mos	6-mos	1-yr
			%	%	%	%
S&P 500	SPX	1,298	(12)	(9)	(4)	(10)
Philadelphia Index	UTY	493	(13)	(9)	(7)	(5)
S&P Utilities	XLU	37	(13)	(9)	(7)	(4)
Dow Ind.	INDU	11,660	(12)	(10)	(6)	(11)

Overview

Year to date, the major indices registered poor price performance. Utilities, the S&P 500 and Dow Industrials declined 12%-13%. Since July 9<sup>th</sup> however, performance diverged as the S&P Utilities and Philadelphia 22 Electric Stock indices declined 9%-10% versus gains of 4% and 5%, respectively, for the S&P 500 and the Dow Jones Industrials.

Share prices of primarily non-regulated electric generators dropped along with energy prices (Table 4): **Dynegy** (-26%-DYN-Not Rated), **Exelon** (-18%-EXC-Hold), **Entergy** (-18%-ETR-Not Rated), **PPL Corp.** (-15%-PPL-Hold), **AES Corp** (-15%-AES-Not Rated). **Constellation Energy** (-21%-CEG-Hold), already having a tough year, dropped another 21% since July 9<sup>th</sup> following release of its 10Q that doubled its collateral obligations should it be downgraded 2 notches to less than investment grade. It wasn't so much a fear of downgrade that troubles investors but the damage to management credibility caused by the restatement and drains on capital that could limit long-term growth. Other poor performers include **Questa** (-25%-STR-Not Rated), primarily an E&P company, and **Teco Energy** (-18%-TE-Hold) whose shares have benefited from its coal business. Of the 5-best performers in the S&P Utilities through July 9<sup>th</sup>, 4 were among the 5 worst since July 9<sup>th</sup>.

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Table 2  
Comparative Performance  
August 15 versus July 9

		8/15	7/9	%
S&P 500	SPX	1,298	1,245	4
Philadelphia Index	UTY	493	541	(9)
S&P Utilities	XLU	37	41	(10)
Dow Industrials	INDU	11,660	11,147	5

By contrast, the better performers since July 9<sup>th</sup> were traditional utilities with high yields and moderate-to-low sell-side sponsorship: **Pinnacle West Capital** (9%-PNW-Hold), **Nicor** (7%-GAS-Not Rated), **Progress Energy** (6%-PGN-Hold), **Consolidated Edison** (5%-ED-Hold) and **Xcel** (3%-XEL-Hold).

Table 3  
Performance Profile  
5 Best & Worst Performers  
August 15 vs. July 9 & Year-to-Date through July 9

Column		(1)	(2)	(3)	(4)	(5)	(6)		(7)	(8)	
8/15 vs 7/9		Mkt Val					Thru 7/9		Ytd	Mkt Val	
Best	Sym	8/15	7/9	%	Bias	\$-bil	Best	Sym	%	Bias	\$-bil
Pinnacle	Pnw	35	32	9	9	4	Questar	Str	23	57	11
Nicor	Gas	44	41	7	25	2	Teco	Te	19	36	4
Progress	Pgn	45	42	6	22	11	First Energy	Fe	14	75	25
Con. Ed.	Ed	41	39	5	8	11	Dynegy	Dyn	11	69	6
Xcel	Xel	21	20	3	25	9	Exelon	Exc	10	65	60
Worst							Worst				
Dynegy	Dyn	6	8	(26)	64	4	Pinnacle	Pnw	(24)	9	3
Questar	Str	49	66	(25)	57	8	Ameren	Aee	(23)	10	9
Constellation	Ceg	63	80	(21)	42	11	Allegheny	Aye	(23)	82	8
Exelon	Exc	73	90	(18)	63	49	Constellation	Ceg	(22)	42	14
Teco	Te	17	21	(18)	29	4	Con. Ed.	Ed	(20)	7	10

### Non-Regulated Performance

Weakness in non-regulated electric generators could reflect the end of the typical business cycle. Electric generators have been on the receiving line of several positive factors. Nuclear generators, in particular, have benefited from a low investment base that was written down or bought at fire sale prices, extended depreciation lives, improved capacity factors, and rising fossil fuel prices. Margins may expand under a cap and trade policy limiting carbon dioxide emissions (and reinstatement of Sox and Nox trading). That's a whole lot of leverage out of an existing investment base.

These circumstances are unlikely to be duplicated in the next cycle. Unlike integrated regulated companies, non-regulated generators have no identifiable customer, or regulatory safeguards to limit risk such as construction work in progress in rate base. For example, **Scana Corp** (SCG-Buy) and **Southern Company** (SO-Hold) should be able to finance new nuclear capacity without Federal guaranteed debt (their applications assume no government subsidy). For non-regulated generators, what lender would incur the risks during construction and at what rates, unless of course with a guarantee from Uncle Sam? If available, quasi non-regulated generators would hope to finance the project off balance sheet via project finance or leverage lease basis. Upon completion, the generator prices its product based on a levelized cost over the projects' life. Those options would of course be available to traditional integrated utilities.

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**S&P Utilities**

Table 4 presents the 31 companies in the S&amp;P Utilities Index sorted by weightings and prices as of August 15, 2008.

**Columns 4-8:** Percentage price changes from 7/9/08, year to date, 3-months, 6-months, and 1-year.**Column 9:** Buy recommendations as percentage of total as per Bloomberg Financial Service.**Column 10:** Equity market capitalization.**Columns 11-12:** Consensus 2009 EPS and P/E as per Bloomberg Financial Service.**Columns 13-14:** Dividend and yields.

**Table 4**  
**S&P Utilities**  
**Sorted by Weighting**

Column	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
Company	sym	Wt 8/15	7/9- 8/15	7/9- 815	ytd	Price 3-mos	6-mos	1-Yr	Bias %	Mkt Val \$bil	EPS 2009c	P/E 2009c	Div. PS	Yield %
Exelon	exc	11.96	73	(18)	(10)	(14)	(7)	3	63	49	4.71	15.6	2.00	2.7
Southern	so	7.13	37	1	(3)	2	5	4	39	28	2.47	15.2	1.68	4.5
Dominion	d	6.11	43	(9)	(10)	(7)	(0)	(3)	26	28	3.36	12.6	1.58	3.7
FPL	fpl	6.05	60	(11)	(12)	(7)	(8)	(0)	59	24	4.23	14.1	1.78	3.0
First Engy	fe	5.41	72	(14)	(1)	(7)	0	14	83	22	5.44	13.2	2.20	3.1
Duke	duk	5.15	18	(1)	(12)	(4)	(2)	(3)	26	22	1.35	13.2	0.92	5.2
PS Ent.	peg	4.94	39	(13)	(20)	(8)	(16)	(7)	60	20	3.28	11.9	1.29	3.3
Entergy	etr	4.78	101	(18)	(16)	(16)	(6)	1	50	20	7.94	12.7	3.00	3.0
PPL Corp	ppl	4.10	44	(15)	(15)	(10)	(9)	(8)	73	17	2.28	19.4	1.34	3.0
AEP Corp	aep	3.86	39	(6)	(17)	(11)	(11)	(17)	53	15	3.41	11.3	1.64	4.3
Edison Intl.	eix	3.64	45	(14)	(16)	(16)	(14)	(16)	57	15	4.55	9.8	1.22	2.7
Sempra	sre	3.57	57	2	(8)	(3)	3	6	85	15	4.57	12.5	1.40	2.5
PG&E	pcg	3.52	40	(1)	(8)	(2)	(1)	(13)	71	14	3.21	12.3	1.56	3.9
Progress	pgn	2.91	45	6	(8)	6	1	(5)	22	11	3.16	14.1	2.46	5.5
Contellaton	ceg	2.81	63	(21)	(38)	(24)	(35)	(24)	42	11	6.40	9.9	1.91	3.0
Con. Ed.	ed	2.78	41	5	(17)	(2)	(4)	(11)	8	11	3.15	12.9	2.34	5.7
AES Corp	aes	2.57	15	(15)	(28)	(23)	(21)	(17)	88	10	1.28	11.9		0.0
Xcel	xel	2.23	21	3	(9)	(4)	(0)	(0)	25	9	1.63	12.6	0.95	4.6
Ameren	aee	2.20	42	0	(23)	(9)	(5)	(17)	10	9	3.43	12.2	2.54	6.0
Questar	str	2.14	49	(25)	(9)	(27)	(9)	3	57	8	3.80	13.0	0.49	1.0
Allegheny	aye	1.90	45	(8)	(29)	(14)	(16)	(13)	91	7	3.40	13.3	0.60	1.3
DTE	dte	1.71	42	(5)	(5)	(5)	(0)	(13)	20	7	3.33	12.5	2.12	5.1
CentPt	cnp	1.31	16	(1)	(8)	(0)	4	(1)	63	5	1.35	11.8	0.73	4.6
PEPCO	pom	1.25	25	(5)	(16)	(6)	(6)	(4)	70	5	2.10	11.8	1.08	4.4
NiSource	ni	1.15	17	(8)	(12)	(9)	(8)	(12)	25	5	1.33	12.4	0.92	5.6
Integrays	teg	0.99	51	(1)	(1)	1	6	1	71	4	3.99	12.9	2.68	5.2
Teco	te	0.92	17	(18)	0	(11)	12	9	29	4	1.50	11.6	0.80	4.6
Pinnacle	pnw	0.89	35	9	(18)	2	(5)	(14)	9	4	2.56	13.7	2.10	6.0
CMS	cms	0.76	13	(5)	(24)	(13)	(16)	(17)	79	3	1.31	10.2	0.36	2.7
Dynegy	dyn	0.74	6	(26)	(17)	(36)	(26)	(27)	64	4	0.36	16.4		
Nicor	gas	0.51	44	7	4	12	16	3	25	2	2.61	16.9	1.86	4.2
Average			40		(14)	(9)	(7)	(6)	49	14	3.14	12.8	1.41	3.5

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Buy	11%	0%
Hold	89%	0%
Sell	0%	0%

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