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Prior Recap October 28, 2008

Electric Utilities
Market Recap

"Don't Look Back, Something Might Be Gaining on You" – Leroy Robert "Satchel" Paige

Overall: Year to date, 3-months, 6-months and 12-months, if you're a wide-eyed, albeit broke optimistic, utilities' investors can cite the group as outperforming the S&P 500 and the Dow Industrials. Utilities investors survived the third-quarter reporting season, but were warned that 2008 results would fall at the lower end of management guidelines. Among the S&P Utilities, PPL Corporation (PPL-$33-Hold) posted the most disappointing results, leading to a 12% cut in 2008 consensus estimates ($2.30 to $2.01 a share) and a 14% reduction in 2009 forecasts ($2.20 to $1.89 a share). Management also reduced 2010 guidance to $3.60-$4.20 a share from $4.00-$4.60 a share. PPL's share price dropped on the announcement from $32 a share to $28 and has since recovered to $34. The sell side remains loyal. According to Bloomberg, PPL Corp. is followed by 11 analysts, 8 with buy/outperform ratings and 3 with hold.

Table 1
Comparative Performance

Column	(1)	(2)	(3)	(4)	(5)	(6)
		Price				
		Intraday 11/18	YTD %	3-mos %	6-mos %	1-yr %
S&P 500	SPX	857	(42)	(33)	(40)	(41)
Phila. Index	UTY	394	(31)	(20)	(27)	(29)
SPDR	XLU	29	(32)	(22)	(30)	(31)
Dow Ind.	INDU	8,364	(37)	(27)	(36)	(37)

Exelon Eyes NRG Energy: The most topical development in recent weeks is Exelon Corp.'s (EXC-$51-Hold) offer to exchange 0.485 shares of EXC for each share of NRG Energy's (NRG-$22-Not Rated) 233 million shares. The purchase price works out to $24.53 a share, a 13% premium versus a 37% spread before the offer became public. The premium over NRG's $23.39 a share book is 5%, but rises to 55% after deducting $7.67 a share of Goodwill. This past May 21st, NRG Energy offered to acquire Calpine Corporation (CPN-$9-Not Rated) for 0.534 shares of NRG (trading at $43 a share) for each Calpine Corp. share. But, as sometimes happens, the hunter becomes the hunted. Exelon Corporation bid $6 billion for NRG Energy on October 19, 2008.

Not surprisingly, NRG Energy spurned the offer and Exelon Corporation opted to go directly to NRG shareholders with its exchange offer that expires January 9, 2009.

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Exelon Generation is extremely profitable. Earnings based on mid-point guidance ($3.50 per Exelon Consolidated share) equate to $2,321 million, and a 42% return on common. Its $7.6 billion capitalization comprises 29% debt and 71% equity. For perspective, Exelon Generation earnings in 2008 should exceed the combined profits of the 6 independent power companies listed in Table 2. NRG Energy earnings in 2008 based on consensus would total $594 million, earning a return on common of about 11%. Its capitalization as of September 30, 2008 stood at $14.9 billion including 55.7% debt, 7.6% preferred and 36.6% common.

Table 2
Independent Power Producers

Column		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
		Price 11/14	% Ytd	EPS 2008C	EPS 2009C	P/E 2008	P/E 2009	Shares Mil.	Mkt. Val. $ Bil.	2009E $ Mil.
AES Corp.	AES	8	(61)	1.14	1.20	7.3	6.9	662	5	754
Calpine	CPN	9		0.38	0.57	22.9	15.3	429	4	163
Dynegy	DYN	2	(67)	0.12	0.24	20.2	9.9	503	1	59
Mirant	MIR	17	(56)	2.63	3.40	6.6	5.1	157	3	411
NRG Energy	NRG	23	(48)	2.55	2.49	8.9	9.1	233	5	594
Reliant Energy	RRI	4	(83)	0.13	0.28	34.7	15.8	350	2	45
Average		11		1.16	1.37	9.2	7.8			338

Source: Bloomberg Financial Service

Why would Exelon chase NRG Energy? Our opinion is that its needs to increase its investment base. Exelon Generation has had a great run, but almost all from margin expansion. Nuclear investment at Commonwealth Edison was written down by $2.5 billion ($4.1 billion pretax) coincident with the Unicom/PECO merger, depreciation lives extended 20 years from 40 to 60, and profit margins exploded as fossil fuel prices skyrocketed and transition from cost-based purchased power to competitive pricing rolled off. The next boost for generation will stem from the transition to market pricing in Pennsylvania in 2011 and perhaps cap and trade legislation.

Assets of T&D businesses of Commonwealth Edison and PECO would/should not support high risk projects of non-regulated generation. Generation net plant of $8 billion is modest when compared with the potential $15-$20 billion investment required for a two-unit nuclear plant in Texas. Even assuming government guarantees, it's difficult to envision investors assuming the risk during construction, particularly without a customer upon completion. Acquisition of NRG Energy is accretive or neutral on earnings but it raises Generation net plant to $20 billion.

S&P Utilities

Best & Worst – Year to Date – 12 months trailing: The best performing S&P Utilities stocks include modest-sized and often overlooked natural gas distribution businesses: Nicor-(GAS-not rated) and Integrys (TEG-Hold). Southern Company (SO-Hold), PG&E Corp (PCG-Not rated) and Con Edison (ED-Hold) are large traditional utilities that typically outperform in tough times.

The worst performer, Constellation Energy (CEG-Not Rated), not too long ago an analyst favorite, traded over $108 a share in January 2008, but imploded in the recent credit crunch and saw its price drop to $13 a share, forcing the company to sell itself. Mid-American Energy Holdings stepped up, offering $26.50 a share, scoring another one for Mr. Buffet. Declining energy prices more than offset the favorable analyst ratings of Dynegy (DYN-Not Rated), AES Corp. (AES-Not Rated), Allegheny Energy (AYE-Not Rated) and Questar (STR-Not Rated).

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Table 3
S&P Utilities
Best & Worst
Year to Date & 12-months Trailing

Column		(1)	(2)	(3)			(4)	(5)	(6)
Company	Sym	Intraday 11/18	Ytd %	Bias %	Company	Sym	Intraday 11/18	1-yr %	Bias %
Best					Best				
Nicor	GAS	40	(6)	13	Nicor	GAS	40	(5)	13
Southern	SO	35	(9)	33	Southern	SO	35	(5)	33
PG&E	PCG	37	(14)	50	Integrys	TEG	43	(15)	57
Integrys	TEG	43	(16)	57	Con. Edison	ED	39	(17)	0
DTE Energy	DTE	36	(17)	10	PG&E	PCG	37	(17)	50
Worst					Worst				
Constellation	CEG	24	(76)	8	Constellation	CEG	24	(75)	8
Dynegy	DYN	2	(68)	64	Dynegy	DYN	2	(72)	64
AES Corp.	AES	8	(62)	63	AES Corp.	AES	8	(63)	63
Allegheny	AYE	30	(54)	100	Allegheny	AYE	30	(49)	100
Questar	STR	29	(47)	71	Questar	STR	29	(47)	71

Most Loved versus Least Loved: In up markets, analysts' favorites tend to outperform. But in turbulent markets, the analysts' influence beyond the macro forecasts (financial crises, swings in energy prices) is minimal, and perhaps, nonexistent. Table 4, Column 4 calculates the percentage of buy/outperform ratings to total ratings. Allegheny Energy, with a 100% approval rating, under performed for both year to date and 12-months trailing, while Con. Edison, with a zero approval, outperformed in both periods.

Table 4
S&P Utilities
Most/Least Loved
Comparative Performance

Column		(1)	(2)	(3)	(4)
Company	Sym	Intraday 11/18	Ytd %	12-Mos. %	Bias %
Most Loved					
Allegheny	AYE	30	(54)	(49)	100
CMS	CMS	10	(40)	(37)	86
First Energy	FE	54	(25)	(20)	77
Sempra	SRE	42	(33)	(31)	77
CenterPoint	CNP	12	(30)	(33)	75
Least Loved					
Con. Edison	ED	39	(20)	(17)	0
Constellation	CEG	24	(76)	(75)	8
Pinnacle	PNW	29	(31)	(32)	9
Ameren	AEE	34	(38)	(37)	10
DTE Energy	DTE	36	(17)	(25)	10

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S&P Components: The following table lists the 31 components of the S&P, and arrays them based on weightings.

Column 2: Prices - intraday on 11/18.

Columns 3-6: Year to date, 3-months, 6-months and 12-months price performance.

Column 7: Analyst biases as measured by the percentage of buy/outperform ratings as a percentage of total recommendations.

Column 8: Equity market capitalization.

Columns 9-10: Consensus 2009 earnings and price/earnings ratios as per Bloomberg Financial Service.

Columns 11-12: Dividends and yields.

Table 5
S&P Utilities
Sorted by Weighting

Column	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
		Intraday		Price			Bias	Mkt. Val	EPS	P/E	Div.	Yield
Company	Sym	11/18	ytd	3-mos	6-mos	1-Yr	%	$bil.	2009C	2009C	PS	%
Exelon	EXC	52	(37)	(30)	(39)	(35)	75	35	4.25	12.2	2.10	4.1
Southern	SO	35	(9)	(6)	(4)	(5)	33	27	2.46	14.4	1.68	4.8
Dominion	D	36	(24)	(15)	(21)	(21)	26	24	3.31	10.9	1.58	4.4
FPL	FPL	46	(32)	(23)	(28)	(32)	65	18	4.11	11.3	1.78	3.8
Duke	DUK	16	(23)	(13)	(16)	(20)	25	20	1.31	11.9	0.92	5.9
First Energy	FE	54	(25)	(24)	(30)	(20)	77	17	5.19	10.4	2.20	4.1
Entergy	ETR	78	(35)	(22)	(35)	(34)	69	15	7.65	10.2	3.00	3.9
PS Ent.	PEG	30	(40)	(24)	(31)	(36)	50	15	3.14	9.4	1.29	4.4
PG&E	PCG	37	(14)	(8)	(8)	(17)	50	13	3.19	11.6	1.56	4.2
AEP Corp.	AEP	31	(34)	(21)	(30)	(34)	63	12	3.32	9.2	1.64	5.4
PPL Corp.	PPL	33	(38)	(26)	(34)	(34)	73	12	1.89	17.2	1.34	4.1
Edison Intl.	EIX	33	(38)	(26)	(37)	(39)	57	11	4.26	7.8	1.22	3.7
Con. Edison	ED	39	(20)	(5)	(6)	(17)	0	10	3.17	12.3	2.34	6.0
Progress	PGN	39	(20)	(13)	(8)	(18)	25	10	3.12	12.4	2.46	6.3
Sempra	SRE	42	(33)	(28)	(30)	(31)	77	11	4.47	9.3	1.40	3.4
Ameren	AEE	34	(38)	(20)	(27)	(37)	10	7	3.34	10.1	2.54	7.6
DTE Energy	DTE	36	(17)	(14)	(17)	(25)	10	6	3.30	11.0	2.12	5.8
AES Corp.	AES	8	(62)	(46)	(59)	(63)	63	5	1.17	7.0		0.0
Allegheny	AYE	30	(54)	(34)	(44)	(49)	100	5	3.20	9.2	0.60	2.0
Questar	STR	29	(47)	(41)	(58)	(47)	71	5	3.44	8.3	0.50	1.7
Xcel	XEL	18	(19)	(12)	(15)	(18)	25	8	1.55	11.8	0.95	5.2
Constellation	CEG	24	(76)	(60)	(71)	(75)	8	4	5.37	4.6	1.91	7.8
CenterPoint	CNP	12	(30)	(24)	(25)	(33)	75	4	1.31	9.1	0.73	6.1
PEPCO	POM	17	(40)	(30)	(34)	(35)	70	3	2.01	8.7	1.08	6.2
Integrys	TEG	43	(16)	(16)	(15)	(15)	57	3	3.94	11.0	2.68	6.2
NiSource	NI	12	(38)	(30)	(35)	(35)	18	3	1.25	9.4	0.92	7.8
Pinnacle	PNW	29	(31)	(17)	(15)	(32)	9	3	2.51	11.6	2.10	7.2
Teco	TE	12	(30)	(29)	(38)	(30)	50	3	1.36	8.8	0.80	6.7
CMS	CMS	10	(40)	(21)	(31)	(37)	86	2	1.26	8.3	0.36	3.4
Nicor	GAS	40	(6)	(10)	2	(5)	13	2	2.55	15.6	1.86	4.7
Dynegy	DYN	2	(68)	(61)	(75)	(72)	64	2	0.24	9.5		
Average		31	(34)	(24)	(31)	(33)	48	11	2.99	10.3	1.47	4.8

Source: Bloomberg Financial Service

Analyst's Certification

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		% Investment Banking
Buy	12%	0%
Hold	88%	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.

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