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Dow Jones Industrials - 12,542

Philadelphia Electric Index - 523

Follow up to FPL Wind Power Arithmetic - August 3, 2007

and FPL Wind Power Arithmetic II - August 9, 2007

Initiate Coverage: Hold

**FPL Group
(FPL-NYSE-\$64-Hold)
Wind Power Arithmetic III**

Price	2/15			Price	Y-t-d	12 Mos.	
52-week range	74-55			Performance	%	%	
Book 12/31/07	26.70	239%	P/book				
Adjusted Earnings*				Fpl Group	64	(6)	7
2005 Actual	2.63	24.2		Phil. Index	526	(8)	2
2006 Actual	3.04	21.0		Dow Industrials	12,377	(7)	(3)
2007 Actual	3.48	18.3		Analyst Total	17		
2008 Consensus	3.88	16.4		Buys	8		
2009 Consensus	4.25	15.0		Shares (mil.)	402		
Dividend	1.78	2.8%	Yield	Equity (bil.)	26		

*GAAP Earnings: 2007 - \$3.27 a share; 2006 - \$3.23 a share.

Introduction

FPL's business strategy is to increase the growing non-utility generation business, particularly wind. This review is a follow up to our August 2007 reports on Wind Power Arithmetic and covers the economic cycles of a typical 100 megawatt wind unit over a 25-year period. Although we haven't issued a formal report on FPL Group's overall business outlook, we are introducing coverage with a "Hold" rating.

FPL Group shares declined 6% year to date, but have gained 7% on a 12-month trailing basis, outpacing both the Philadelphia 22 electric stock index and the Dow Industrials. Trading at 16.4 times and 15.0 times 2008 and 2009 earnings, respectively, the shares are in line with the premium companies in the S&P Utility index. Its \$1.76 a share dividend represents a conservative 46% payout and provides a 2.8% yield. Non-utility adjusted earnings (FPL Energy) were \$1.56 a share in 2007, 45% of consolidated earnings of \$3.48 a share. In 2008, non-utility earnings are estimated at \$1.87 a share, 48% of consolidated mid-point guidance of \$3.88 a share.

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See page 7 of report for Analyst's Certification, pages 7-8 for Important Disclosures and page 8 for Other Disclosures and Disclaimers

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FPL Group's largest holders include: Wellington Management (22 million shares), Barclays (16 million), State Street Corporation (13 million), Capital Research (12 million), Pictet Asset Management (11 million), Vanguard (11 million) and Hotchkis & Wiley (11 million).

According to Bloomberg Financial Service, FPL Group has 17 active recommendations within the sell side community - 8 buys, 8 holds, 1 sell. Matrix USA is the sole sell. Buy or outperform ratings are maintained by Credit Suisse, BMO Capital, CitiGroup, Robert Baird, Edward Jones, BofA, Key Banc, and Argus.

Wind Economics

FPL Group, through its subsidiary FPL Energy, is the nation's largest wind provider with capacity totaling 5,077 megawatts at year-end 2007. Investors like the wind thesis, even though profits are relatively stable over the life a project and rising returns stem from a declining investment base as opposed to increased profits. Wind also has the support of the "greens," politicians, and regulators. What's not to like -- wind is renewable and carbon dioxide (CO₂) free. Support, however, even among the greens may hinge on where the project is located (think Hyannisport and Long Island). Opponents cite wind's cost, questionable returns, poor reliability, low load factors, noise and damage to the landscape.

Back in July 2007, Moray Dewhurst, FPL Group's Chief Financial Officer, equated 100 megawatts of wind to earnings of \$0.01 a share (\$4 million) to \$0.015 a share (\$6 million), cash on cash returns of 10% to 12%, and returns on equity in the high-teens to low-twenties. A few months earlier in April 2007, Dewhurst listed the key components of wind economics: 1) purchased power contracts of \$30-\$40 a megawatt-hour for 15-25 years; 2) production tax credits - \$20 per megawatt-hour escalating with inflation; 3) 2007 capital costs - \$1,650-\$1,850 per kilowatt; 4) accelerated depreciation - 5 years; 5) typical size - 50-150 megawatts; 6) capacity factors - 35%-43%; 7) production costs - \$3.8-\$4.2 a megawatt-hour; and 8) an initial capitalization profile of 50% debt - 50% equity. (Not listed was book depreciation of 25 years and pretax interest expense - 6.5%.)

Dewhurst's parameters are listed in Table 1, columns 1 and 2. Column 3 lists the midpoints (identical to our August 2007 report except depreciation life is cut from 40 to 25 years and interest expense was increased from 6.0% to 6.5%). Table 2 presents 1) income statements, 2) cash flows, 3) returns, and 4) cash flow coverage of interest for the periods covering years 1 to 10, year 11 and year 20.

Table 1
Wind Power Matrix
(Based on April 30, 2007 First-Quarter Earnings Call - Slide 16)

Column	(1)	(2)	(3)
Company Input	High	Low	Average
Capital Costs 2007 Kilowatts (Kw)	1,850	1,650	1,750
Typical Wind Size 50-150 Megawatts (Mw)	150	50	100
Investment \$-millions	278	83	175
Tax Depreciation 5-years	56	17	35
Capacity Factor (35-43%)	43%	35%	38%
Purchase Power Mwh -15 to 25 years	40	30	35
Revenue \$-mil	15.1	9.2	11.7
Production Cost per Mwh	4.2	3.8	4.0
\$-Millions	1.6	1.2	1.3
Production Tax Credit (PTC) \$20 Mwh.	20	20	20
\$-Millions	7.5	6.1	6.7
Capital Structure			
Debt	50%	50%	50%
Equity & other	50%	50%	50%
Estimated Debt Cost	6.5%	6.5%	6.5%
Annual Depreciation 25-years	11.1	3.3	7.0

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Income Statement: Revenues are based on purchase power agreements @\$35.00 a megawatt hour and a 38% capacity factor. Production costs are 4.0 cents mwh and depreciation is straight line over 25-years.

The \$175 million investment is financed 50/50 debt/equity with interest costs 6.5%. Debt is retired over 15-years, \$5.8 million annually.

Deferred income taxes of \$9.8 million annually in years 1 to 5 total \$49 million. Deferrals represent the \$28 million difference between 5-year accelerated amortization (\$35 million) and straight line depreciation (\$7 million) multiplied by the 35% tax rate. In year 6 deferrals reverse from \$9.8 million to a negative \$2.5 million.

Net income taxes are pretax income per books multiplied by a 35% rate.

Production tax credits assume a \$20 tax credit for each mwh generated. Production tax credits escalate with inflation, but in this exercise are held steady.

Cash generated is net income plus (minus) deferred taxes plus depreciation. Cash proceeds are applied first to debt retirement. Cash in excess of debt retirement is up-streamed to the parent in the form of dividends. Change in equity is beginning common equity plus net income less cash paid to parent.

Return on common is net income divided by average equity. Return on investment is operating income less income taxes divided by average investment.

Cash coverage of debt is cash generated plus interest divided by interest.

Observations

Wind profits stem from the largeness of Uncle Sam via production tax credits (PTCs). During the first 10-years, PTCs account for 127% to 89% of annual earnings.

The life cycle for a wind project falls in three parts: 1) years 1 to 5 - the boom period with benefits from 5-year accelerated amortization and production tax credits, 2) years 6 to 10 - accelerated depreciation reverses, but production tax credits maintain earnings and 3) years 10 to 25 - the absence of both accelerated amortization and production tax credits reduce earnings, cash flows and returns.

Cycle 1 – Years 1 to 5

Deferred taxes of \$9.8 million represent the difference between 5-year amortization of \$35 million and straight line depreciation of \$7 million multiplied by a 35% tax rate. Cash flow totals \$22.0 million in year 1 (net income - \$5.2 million, deferred income taxes - \$9.8 million, depreciation - \$7.0 million). Our worksheet assumes the \$16 million of cash flow in excess of debt retirement (\$5.8 million) is up-streamed in the form of dividends. For the 5-years, cash flow in excess of debt retirement totals \$84 million. The common equity component is cut by 63% from \$87.5 million to \$32.5 million

Although earnings grow moderately (\$5.2 million to \$6.2 million), return on common increases from 6.4% to 16.4%, reflecting the lower common equity component. Production tax credits exceed net income each year.

Cash available for interest coverage is 5.01 times in year 1 and rises to 6.77 times in year 5.

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Cycle 2 – Years 6 to 10

Years 6 to 10 benefit from the 5-year accelerated amortization reversal. The \$49 million in cash flow deferrals accumulated in years 1 to 5 decline from a positive \$9.8 million to negative \$2.5 million over the 20-year remaining life. PTCs continue through year 10 and account for 96% of earnings.

Cash flow drops 52% in year 6 from \$23.0 million to \$11.0 million. For the 5-years cash flow totals \$58 million. Debt retirement and cash to the parent total \$29 million each. Return on common averages 19.5%. Cash flow coverage of interest declines in year 6 from 6.77 times in year 5 to 4.05 times. Interest coverage improves steadily through year 10 as debt outstanding drops from \$52.7 million in year 6 to \$29.5 million in year 10.

Cycle 3 – Year 11

Production tax credits disappear. Earnings drop to \$1.0 million in year 11 versus \$7.4 million in year 10. Cash flow is cut in half to \$5.5 million from \$12.0 million. Return on average common falls to 2.6%.

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Table 2
Income Cash Flow & Returns
Typical 100 Megawatt Unit

Guidelines	4/1/07	Years					Years					Years	
		1-5					5-10					11	20
Column	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
Year	No Tax Benefits	1 AD	2 AD	3 AD	4 AD	5 AD	6	7	8	9	10	11	20
Income		PTC	PTC	PTC	PTC	PTC	PTC	PTC	PTC	PTC	PTC		
	\$-Mil	\$-Mil	\$-Mil	\$-Mil	\$-Mil	\$-Mil	\$-Mil	\$-Mil	\$-Mil	\$-Mil	\$-Mil	\$-Mil	\$-Mil
Revenues	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7
Total Operating Exp.	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7
Production	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Depreciation	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0
Operating Exp.	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3
Oper.Inc.	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Int. Exp.	5.7	5.5	5.1	4.7	4.4	4.0	3.6	3.2	2.9	2.5	2.1	1.7	0.0
Pre-Tax	(2.4)	(2.2)	(1.8)	(1.4)	(1.0)	(0.7)	(0.3)	0.1	0.5	0.8	1.2	1.6	3.3
Taxes @ 35%													
Deferred Tx.		9.8	9.8	9.8	9.8	9.8	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)
Taxes Payable		(10.5)	(10.5)	(10.3)	(10.3)	(10.3)	2.3	2.5	2.6	2.7	2.9	3.1	3.7
Net Taxes	(0.8)	(0.8)	(0.7)	(0.5)	(0.4)	(0.2)	(0.1)	0.0	0.2	0.3	0.4	0.6	1.2
PTCs	0.0	(6.7)	(6.7)	(6.7)	(6.7)	(6.7)	(6.7)	(6.7)	(6.7)	(6.7)	(6.7)	0.0	0.0
Total Taxes	(0.8)	(7.4)	(7.4)	(7.2)	(7.0)	(6.9)	(6.8)	(6.6)	(6.5)	(6.4)	(6.2)	0.6	1.2
Net Inc.	(1.5)	5.2	5.6	5.7	6.0	6.2	6.5	6.7	7.0	7.2	7.4	1.0	2.2
Cash Gen.													
Net Income	(1.5)	5.2	5.6	5.7	6.0	6.2	6.5	6.7	7.0	7.2	7.4	1.0	2.2
Def (pbles)	0.0	9.8	9.8	9.8	9.8	9.8	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)
Depreciation	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0
Cash After Int.	5.5	22.0	22.4	22.5	22.8	23.0	11.0	11.3	11.5	11.8	12.0	5.5	6.7
Paid Parent		16.2	16.6	16.7	17.0	17.2	5.2	5.5	5.7	6.0	6.2	(0.3)	6.7
Debt Ret.		5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	0.0
Total		22.0	22.4	22.5	22.8	23.0	11.0	11.3	11.5	11.8	12.0	5.5	6.7
Investment													
Debt	87.5	81.7	75.9	70.1	64.3	58.5	52.7	46.9	41.1	35.3	29.5	23.7	
Equity	87.5	76.5	65.5	54.5	43.5	32.5	33.8	35.0	36.3	37.5	38.8	40.1	22.8
Total	175.0	158.2	141.4	124.7	107.8	91.0	86.4	81.9	77.3	72.8	68.2	63.7	22.8
Profitability													
Return Com.	-1.8%	6.4%	7.8%	9.6%	12.2%	16.4%	19.5%	19.5%	19.5%	19.5%	19.5%	2.6%	9.5%
Op. Inc. net txs.	4.1	10.7	10.7	10.5	10.3	10.2	10.1	9.9	9.8	9.7	9.6	2.8	2.2
Return Inv.	2.4%	6.4%	7.1%	7.9%	8.9%	10.3%	11.4%	11.8%	12.3%	12.9%	13.5%	4.2%	7.9%
Coverage													
Cash for Int.	11.1	27.5	27.5	27.3	27.1	27.0	14.6	14.5	14.4	14.2	14.1	7.3	6.7
Interest @ 6.5	5.7	5.5	5.1	4.7	4.4	4.0	3.6	3.2	2.9	2.5	2.1	1.7	0.0
Coverage	1.96	5.01	5.36	5.75	6.22	6.77	4.05	4.48	5.03	5.74	6.70	4.21	Na
EPS	(0.00)	0.01	0.01	0.01	0.01	0.02	0.02	0.02	0.02	0.02	0.02	0.00	0.01
PTC - PS		0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.00	0.00
Shares out. mil.	401												

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Sale of Differential Partnership Interest

At its year-end earnings call, management announced that it sold differential partnership interests in approximately 600 megawatts (12% of year-end capacity) for \$700 million (\$1,170 a kilowatt) for approximately 10 years. Cash flows before interest expense for the typical 100 megawatt unit average \$27 million annually (\$134 million total) in years 1-5 and \$15 million (\$73 million total) in years 6-11. For the 10 years, combined cash flow averages \$21 million (\$207 million total). For years 11-25, cash flow drops dramatically, averaging \$8 million annually (\$117 million total).

Table 3
Cash Flows before Interest
100 Megawatts

	Years			
	1-5	6-10	1-10	11-25
Cash Flow Pre Interest	\$mil	\$mil	\$mil	\$mil
Operating Income	17	17	33	50
Deferred Taxes	49	(12)	37	(38)
Depreciation	35	35	70	105
Production Tax Credits	33	33	67	0
Total	134	73	207	117
Average Annual	27	15	21	8

Benefits to the buyer are obvious: a predictable cash flow stream that can be discounted to yield a desired return. FPL receives up front cash in return for foregoing earnings and cash flows during the project's peak years. The transaction implies that the \$700 million proceeds can be invested more profitably. A reinvestment rate of 4% to 6%, net of taxes would replace lost wind profits.

FPL agreed to purchase the assets at the end of the period at fair market value. By year 11, FPL has 5-15 years remaining on the PPA, and depreciation charges reduce investment by 40%. Expiration of production tax credits reduce earnings in year 11 by 86% to \$1.0 million versus \$7.4 million. Return on average common declines from 19.5% to 2.6% and the return doesn't exceed 10% until year 22 when the equity component is only \$14 million.

Carbon Credits

Wind is CO₂ free and renewable. Legislation allowing carbon credits to trade could be an additional source of profits. For example, a 100 megawatt wind project at a 38% capacity factor would displace approximately 307,000 tons per year of CO₂ if the avoided emissions were coal and about 128,000 versus natural gas. (In the southeast, the typical capacity factor for wind is 28% and displacement is closer to 230,000 tons and 95,000 tons, respectively, for coal and natural gas.)

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 FPL Group reports issued by me are: 1/9/06 (\$42) – Not Rated; 8/3/07 (\$56) – Not Rated; 8/9/07 (\$63) – Not Rated.

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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.

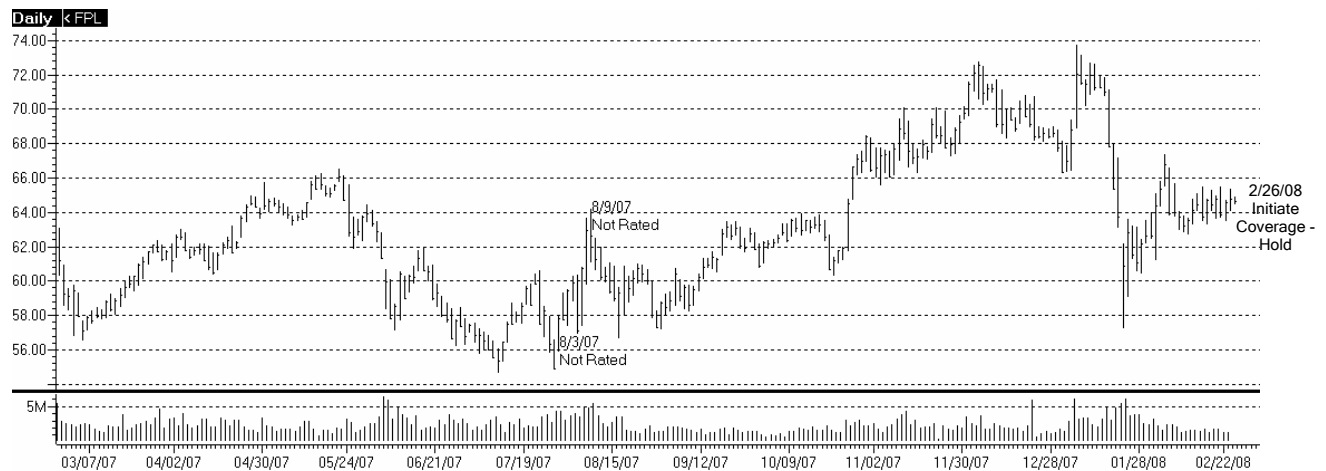
Sell Total return is expected to significantly under perform (15% plus) the total return of the industry coverage universe over the next 12 months.

Analyst's Ratings Distribution

		% Investment Banking
Buy	17%	0%
Hold	83%	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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