

Estimating the Cost of Capital in Today's Economic & Capital Market Environment

41st Financial Forum

Society of Utility and
Regulatory Financial Analysts

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Moody's Investors Service

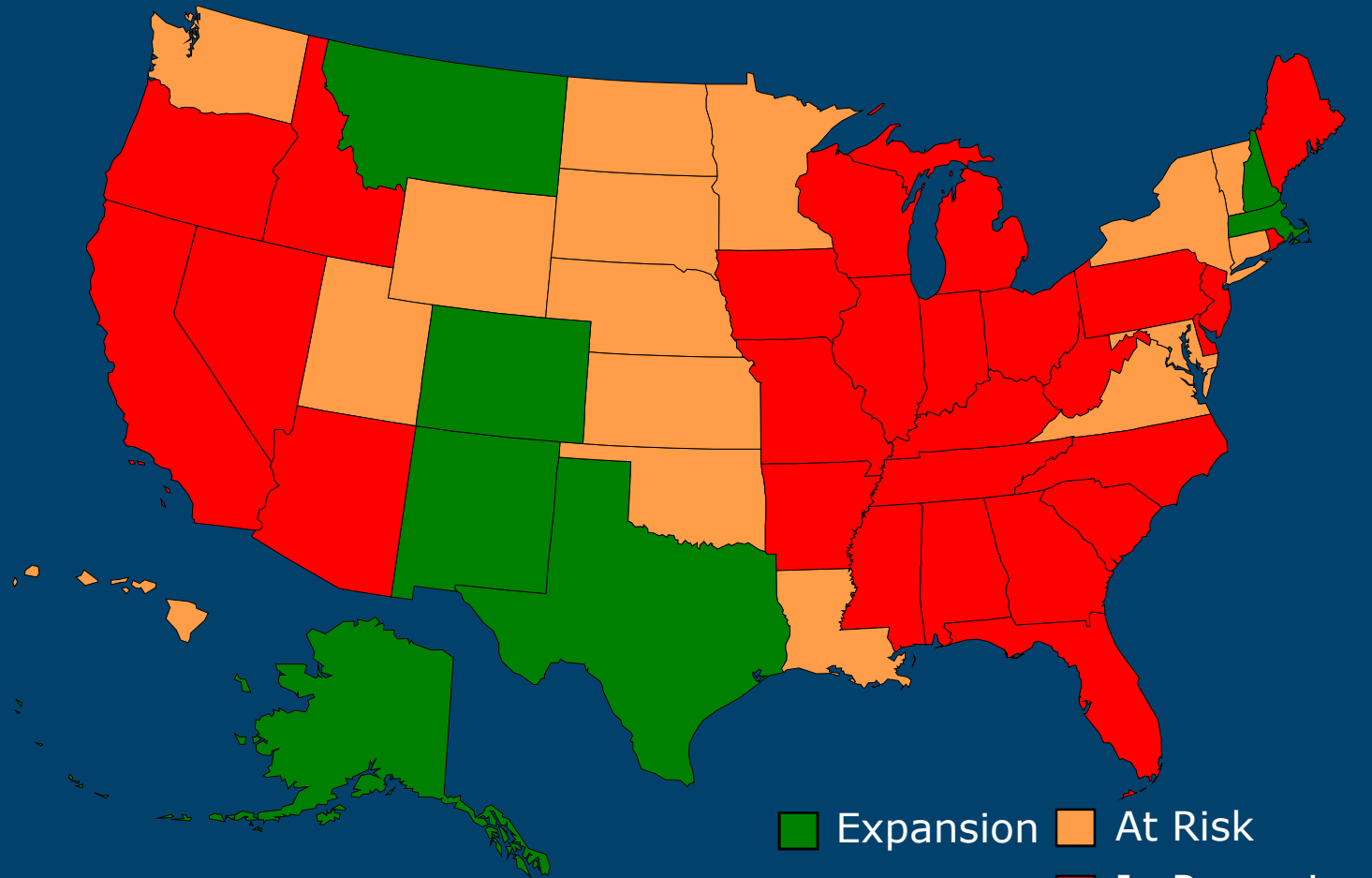
Status of Global Capital Markets

- **Unsettled times continue for the global financial markets**
 - No region / No sector immune
 - Losses within banking system
 - Firms forced to raise capital
- **US economy feeling effects from the credit crunch; declines in business and consumer confidence**
- **Yield spreads have widened throughout the credit markets**



Recessionary Pressures – August 2008

Based on employment and industrial production, August 2008



Expansion At Risk
Recovery In Recession

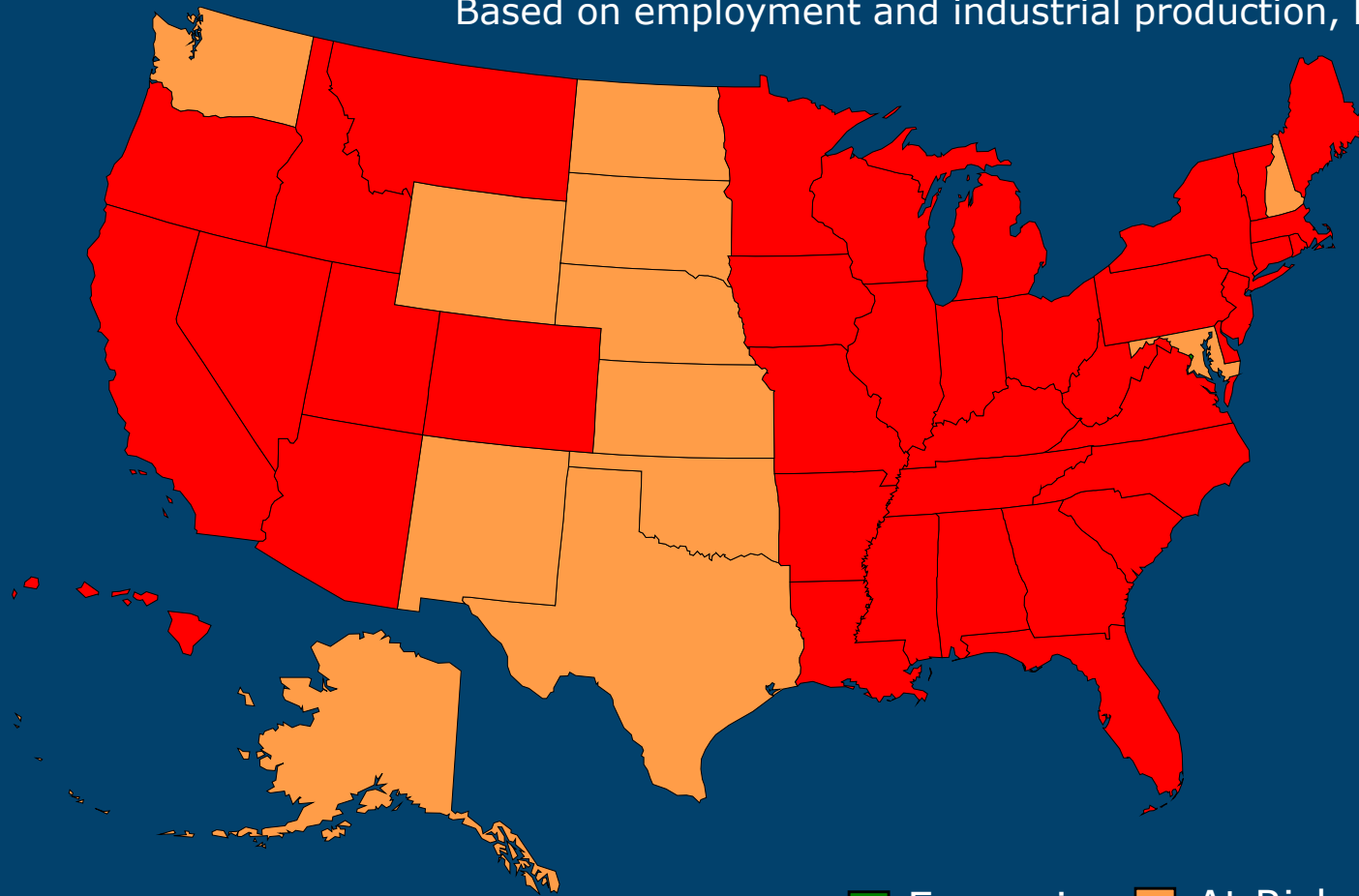
SOURCE: Moody's Economy.com



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Recessionary Pressures – November 2008

Based on employment and industrial production, November 2008



- Expansion
- Recovery
- At Risk
- In Recession

SOURCE: Moody's Economy.com



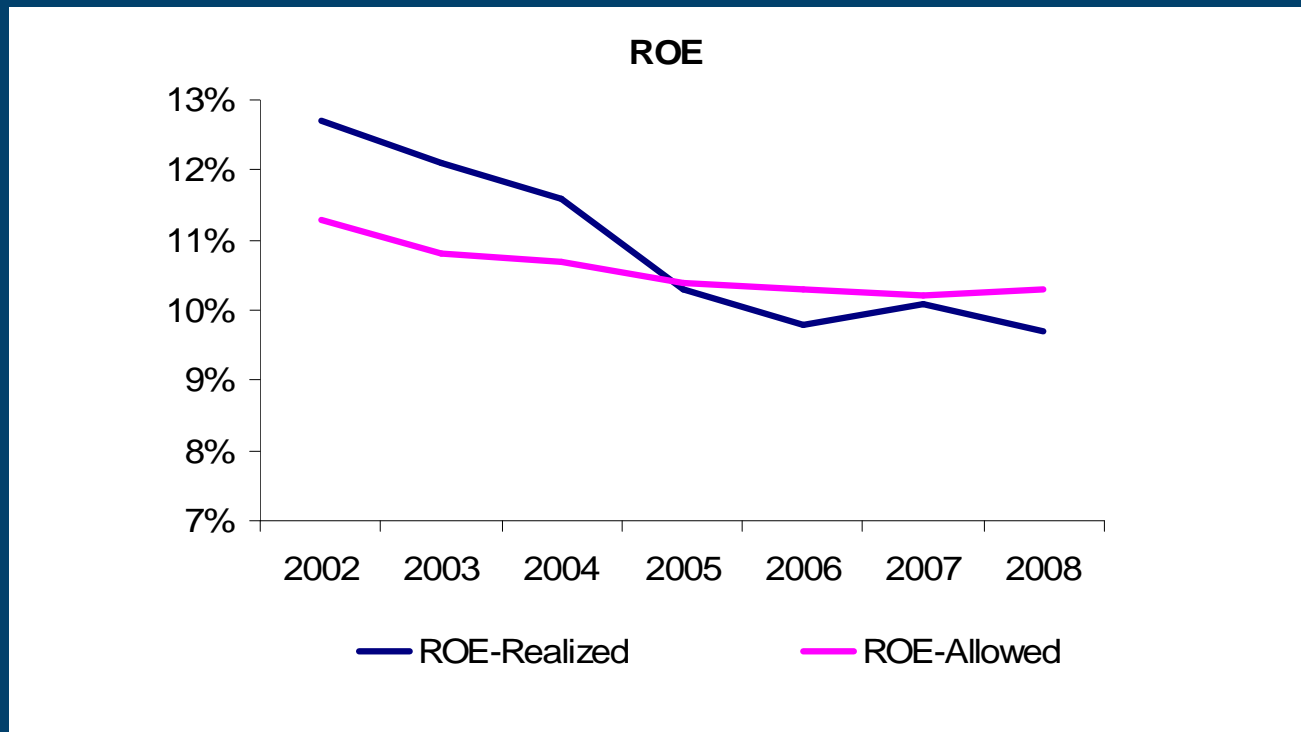
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Outlook / Ratings Change Drivers

- **Near term**
 - **Liquidity remains a key focal point of concern**
 - **Continued access to capital markets? At what cost?**
 - **Political uncertainties / Support of regulatory environment – impact of higher interest rates?**
- **Intermediate to longer term**
 - **Growing environmental awareness – fuel diversity**
 - **Reserve margins / uneconomic plants**
 - **New nuclear plants – extension of weaker metrics**
 - **Event risks – further consolidation?**



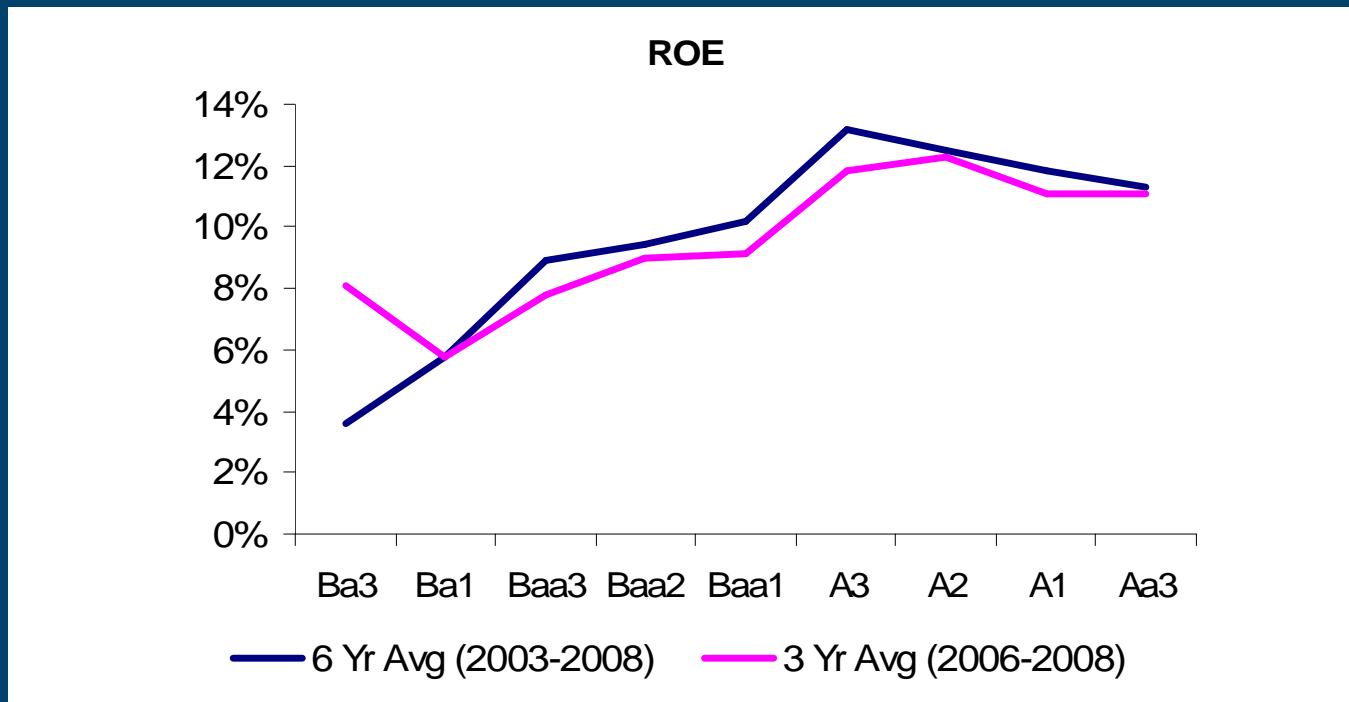
ROE's for 53 regulated utilities



Source: ROE-Realized: Moody's; ROE-Allowed: SNL RRA



ROE's by rating category



Regulatory Relationship is Key

- **Moody's incorporates a view:**
 - **Utilities will receive reasonably timely recovery of prudently incurred costs and investments...**
 - **With a reasonable return to provide "just and reasonable" rates...**
 - **Within the confines of the legislation and based on the record.**



Do Challenges Exist to Timely Recovery?

- **Cost pressures are likely to result in substantial increases in electric prices**
- **The era of an extended period of flat or declining electric rates is behind us**
- **Willingness and ability to raise rates is increasingly important in the current environment**
- **Economic recession adds an obstacle to cost recovery as some customers struggle financially**

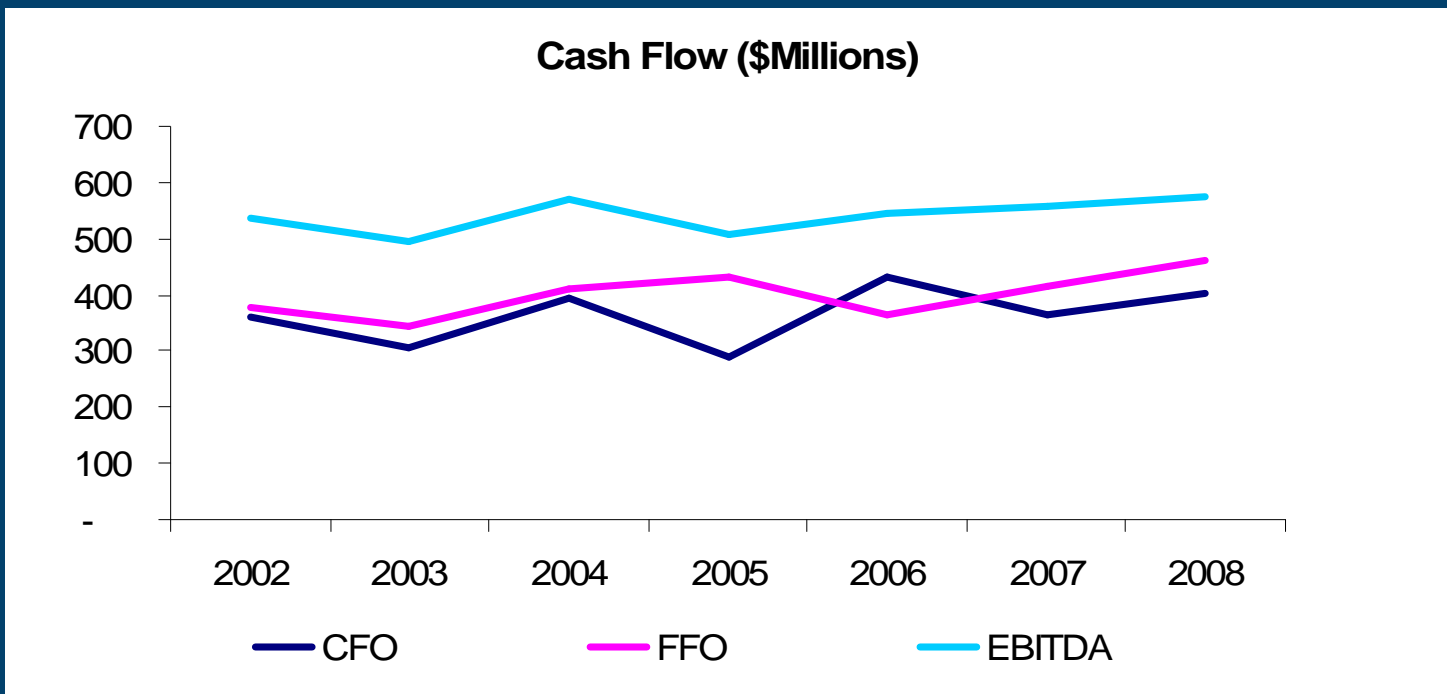


Is utility risk increasing or decreasing?

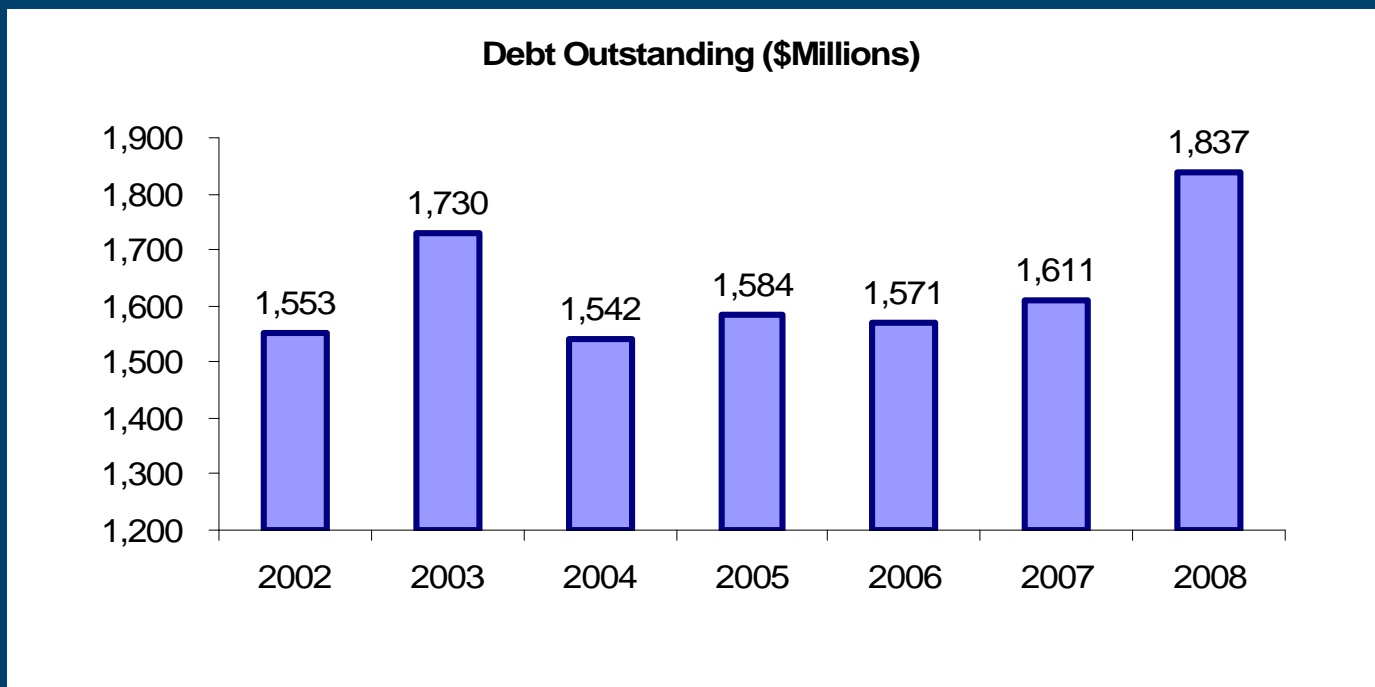
- **What is relative risk profile of utility sector?**
 - **Timely recovery, bolstered by numerous “trackers”**
 - **Assumes carbon costs are recoverable, but concerns over crowding out rate base**
 - **Political outreach has been effective**
 - **Cash flows are keeping pace**



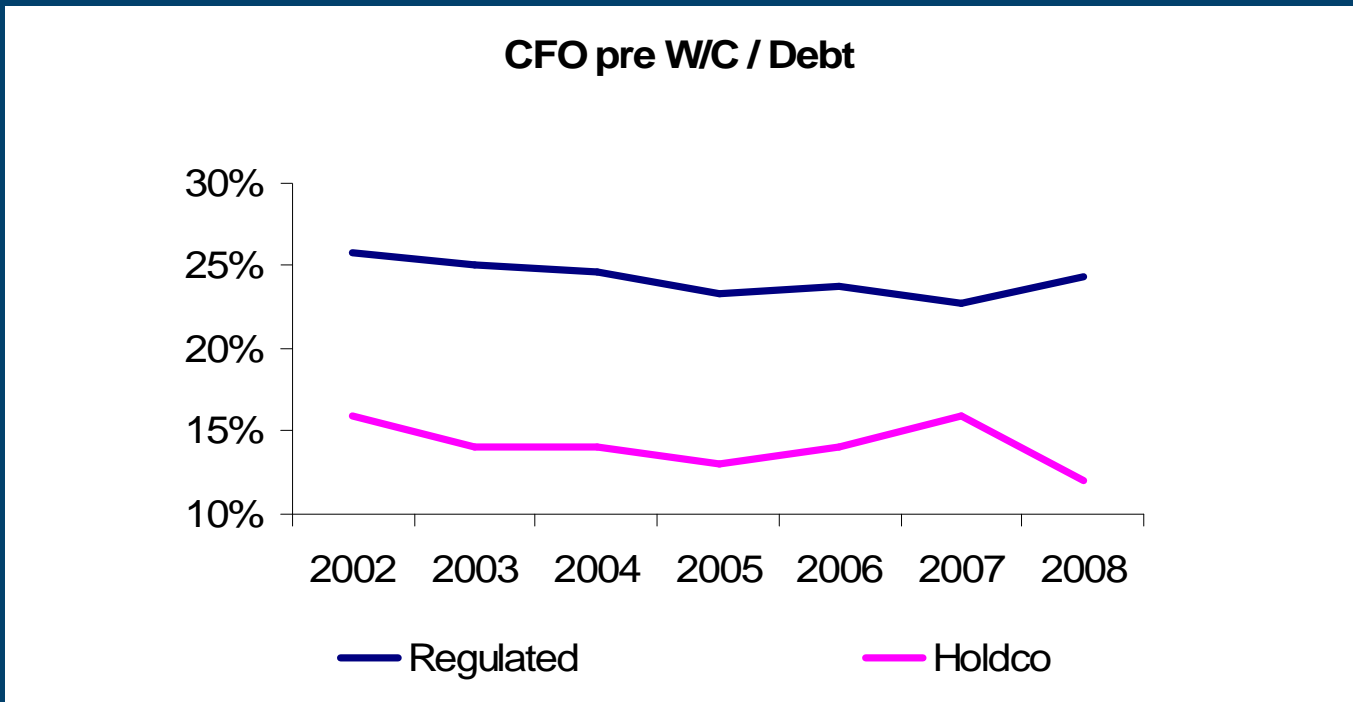
Median cash flows for 53 regulated utilities



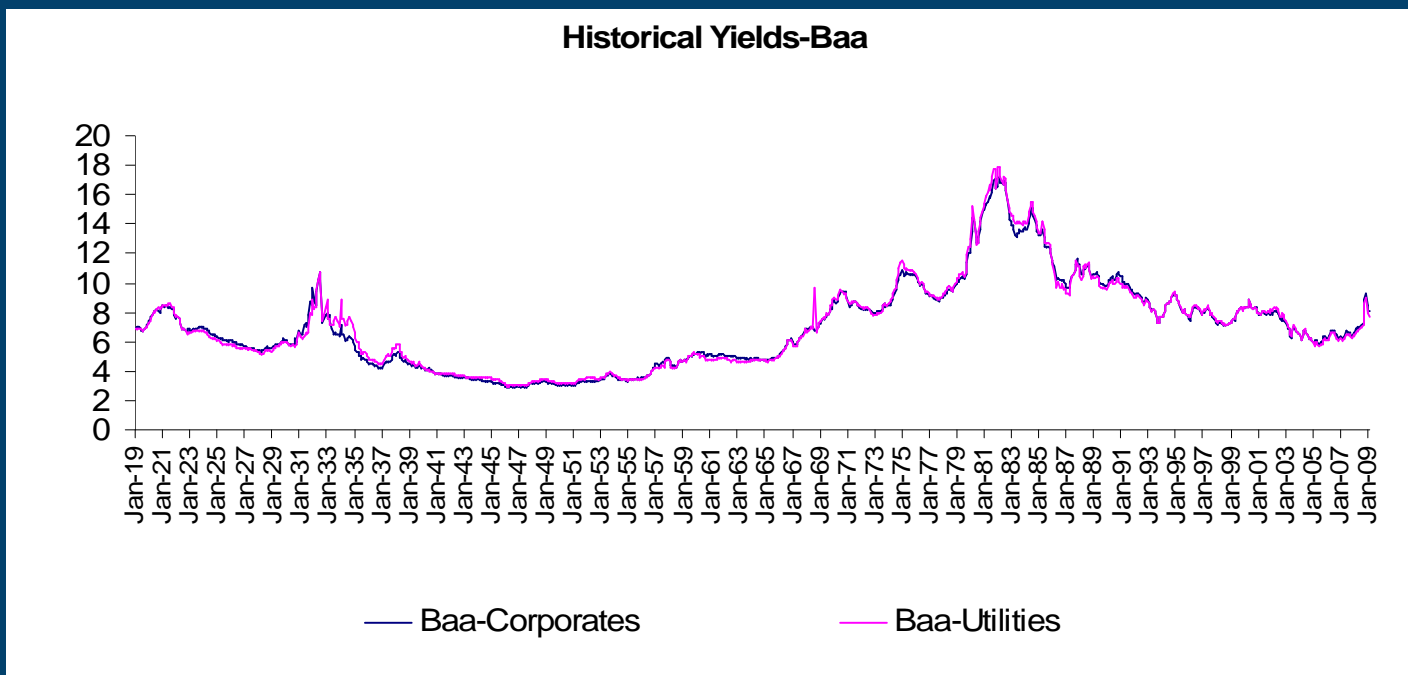
Average debt outstanding for 53 regulated utilities



Cash Flow Debt Coverage for 53 regulated utilities



Yields since 1919



Climate Issues Affecting Generation Decisions

- **Climate issues impacting feasibility of new coal generation & possible shut-down of older plants**
- **Renewables are gaining traction; Everybody wants to include them in “the mix”**
- **Nuclear renaissance – Is it sustainable? How will it be financed?**
- **Demand side management seems more feasible**
- **Increase reliance on natural gas will lead to more fuel cost volatility**



CP Issuer Liquidity Evaluation

- **Evaluated 111 electric & gas utilities in the U.S.**
- **Comprised 38 P-1 rated issuers, 64 P-2 rated issuers, and 9 P-3 rated issuers**
- **Included interviews and/or questionnaires and the analysis of financial statements, credit agreements, and financial projections**
- **Our assessment of forward-looking liquidity profile incorporates expectations of issuer financial performance over next 12 months**



Key Findings are Positive

- **All utilities that issue CP currently have adequate alternative liquidity arrangements**
- **All of our Prime rated issuers have sufficient committed credit lines to repay currently outstanding CP balances**
- **When cash balances are considered as well, many Prime rated utilities demonstrate robust ability to fully repay outstanding CP balances**

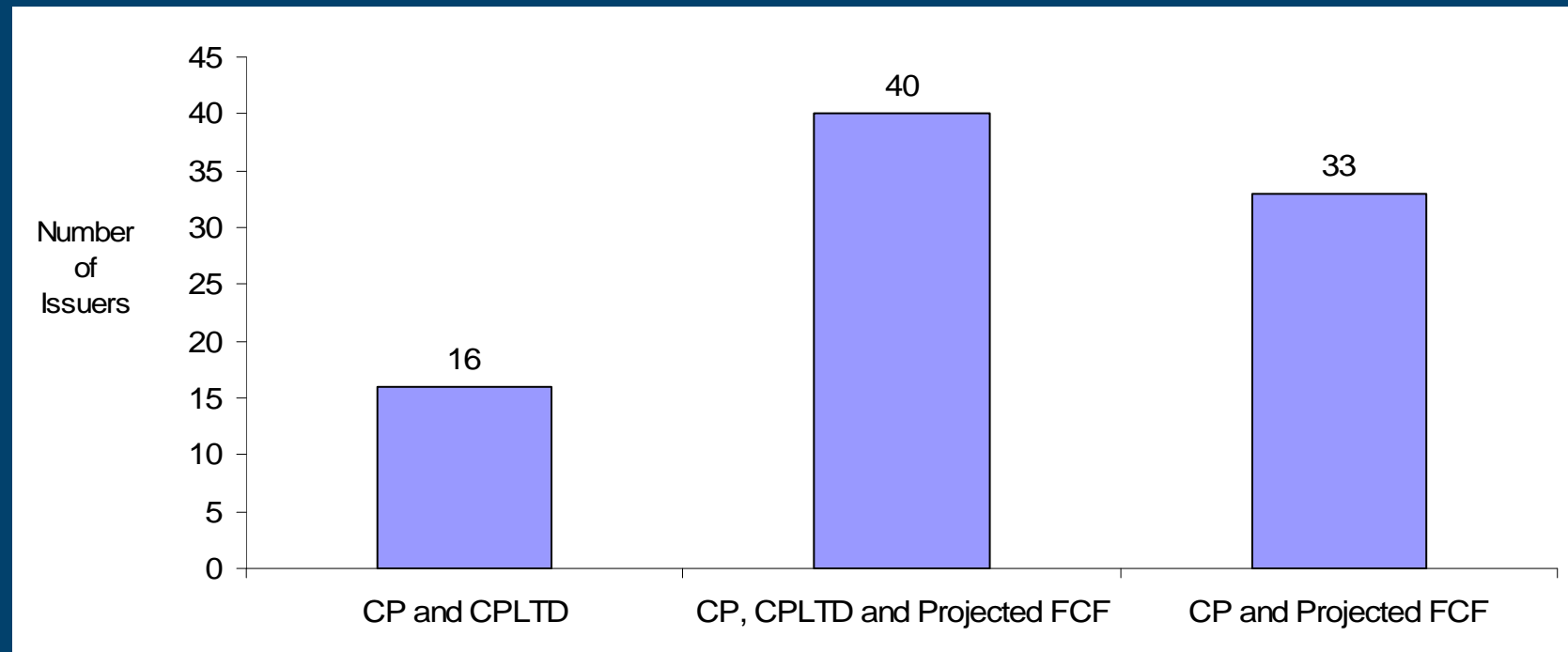


Broader Liquidity Position Also Examined

- **Conditionality of borrowing under credit facilities**
- **Maturities of credit facilities**
- **Short-term debt maturities in addition to CP**
- **Other potential claims on cash**
- **Projected free cash flow, if any**
- **Covenants**



of Issuers Without Cash/RC Capacity to Meet:



Utilities Less Affected than Other Sectors

- **Flight to quality has helped some Prime-1 utility issuers**
- **Greatest concentration of CP outstanding is overnight or a few days, some issuers out longer**
- **Prime-2 issuers were most severely affected,**
- **Federal Reserve's Commercial Paper Funding Facility (CPFF) has helped the Prime-1 CP market**



Quality of CP Backstop Facilities Has Improved

- **Utilities have been able to negotiate favorable terms in recent years**
- **Benefited from competitive banking conditions**
- **Multi-year credit facilities the norm**
- **Material adverse change clauses are rare**
- **Little conditionality to draws**



But Pendulum Swinging in Other Direction

- **Credit facilities will have shorter average tenor**
- **Terms may be subject to greater conditionality**
- **Lower number of banks with more of them seeking to conserve capital**
- **Substantial increases in pricing, as banks view usage of such facilities as more likely**
- **Too much conditionality could weaken the reliability of credit facilities as a timely source of cash or CP backup**



Q & A



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