

Meeting Future Electric Needs

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Discussion Topics

- ◆ The Emerging Capital Cycle
- ◆ Cost of Capital Implications
- ◆ The Environment – What's Next



The Capital Cycle

Next Capital Cycle Ramping Up

Capital Expenditure Projections
Lehman's Regulated Coverage Universe

Capital Spending	2003A	2004A	2005E	2006E	2007E	2008E	2009E	2010E
Maintenance			\$25,162	\$26,839	\$29,290	\$30,031	\$30,902	\$31,476
Generation			\$3,126	\$3,995	\$5,641	\$5,754	\$8,230	\$12,766
Environmental			\$2,650	\$6,448	\$6,011	\$4,119	\$1,954	\$854
Transmission			\$2,817	\$4,856	\$5,225	\$4,978	\$4,733	\$4,723
Total	\$23,636	\$25,379	\$33,755	\$42,138	\$46,167	\$44,882	\$45,819	\$49,819
Y/Y Increase		7.4%	33.0%	24.8%	9.6%	-2.8%	2.1%	8.7%

Note: We estimate that this segment represents 70% of the spending of the utility sector as a whole.

Source: Lehman Brothers Survey, Factset.

- ◆ The capital cycle is ramping up. Growth in capex is driven by:
 - Environmental requirements – NOx and SOx
 - Transmission
 - Generation

Higher Rates Becoming A Reality

Projected Rate Increases⁽¹⁾

(\$ in millions)

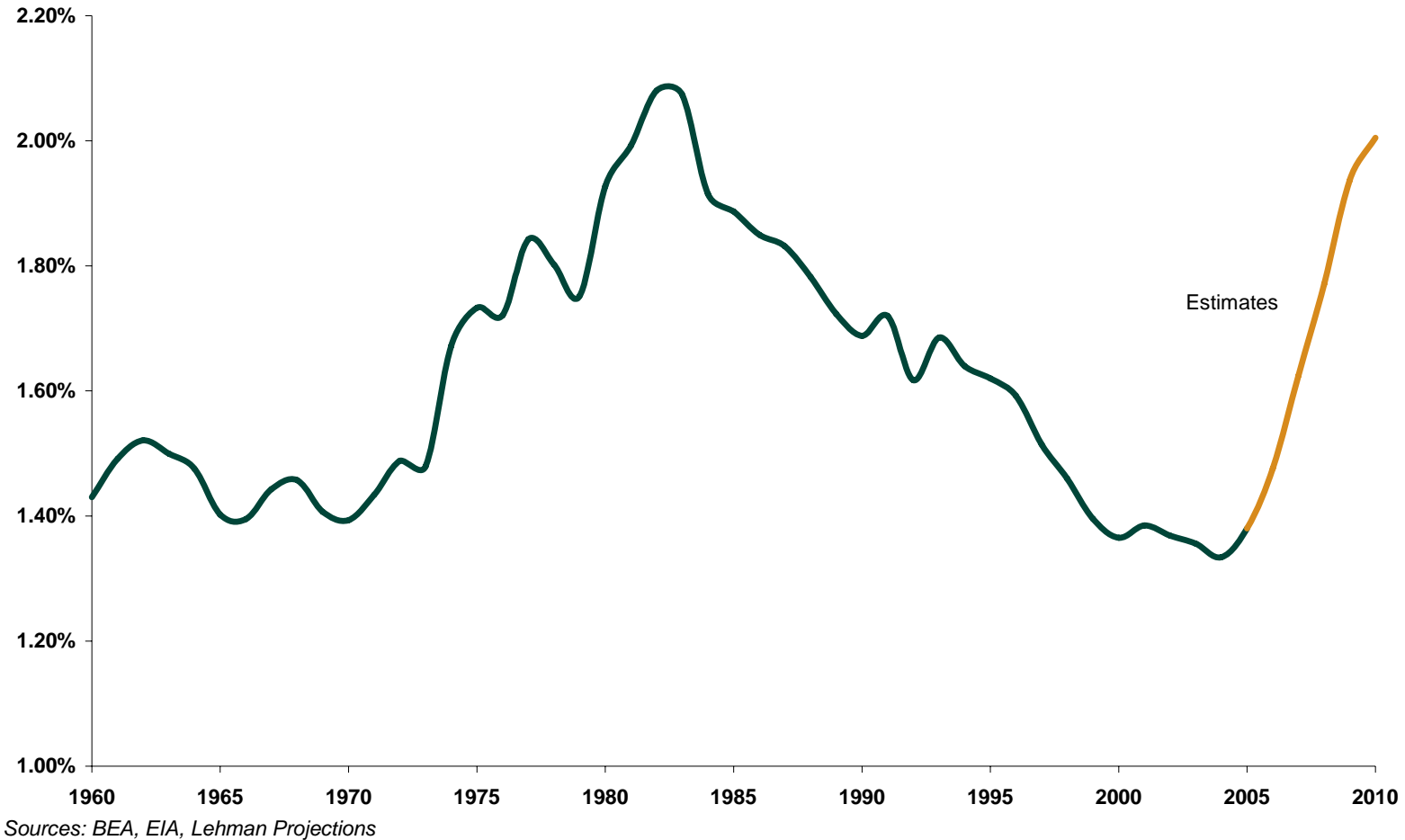
	2005	2006	2007	2008	2009	2010
Due to Fuel Costs	\$6,929	\$11,227	\$9,254	\$8,238	\$4,056	\$2,467
Due to Rate Base Investment	\$1,078	\$3,220	\$11,047	\$12,872	\$20,207	\$11,488
Total Rate Increases	\$8,007	\$14,447	\$20,301	\$21,110	\$24,263	\$13,955
Y/Y Increase	6.0%	10.1%	12.9%	11.9%	12.2%	6.3%
Cumulative vs. 2005		10.1%	24.4%	39.2%	56.2%	66.0%
% Increase Related to Fuel	86.5%	77.7%	45.6%	39.0%	16.7%	17.7%
% Increase Related to Rate Base Investment	13.5%	22.3%	54.4%	61.0%	83.3%	82.3%

(1) Lehman Brothers' regulated coverage universe.

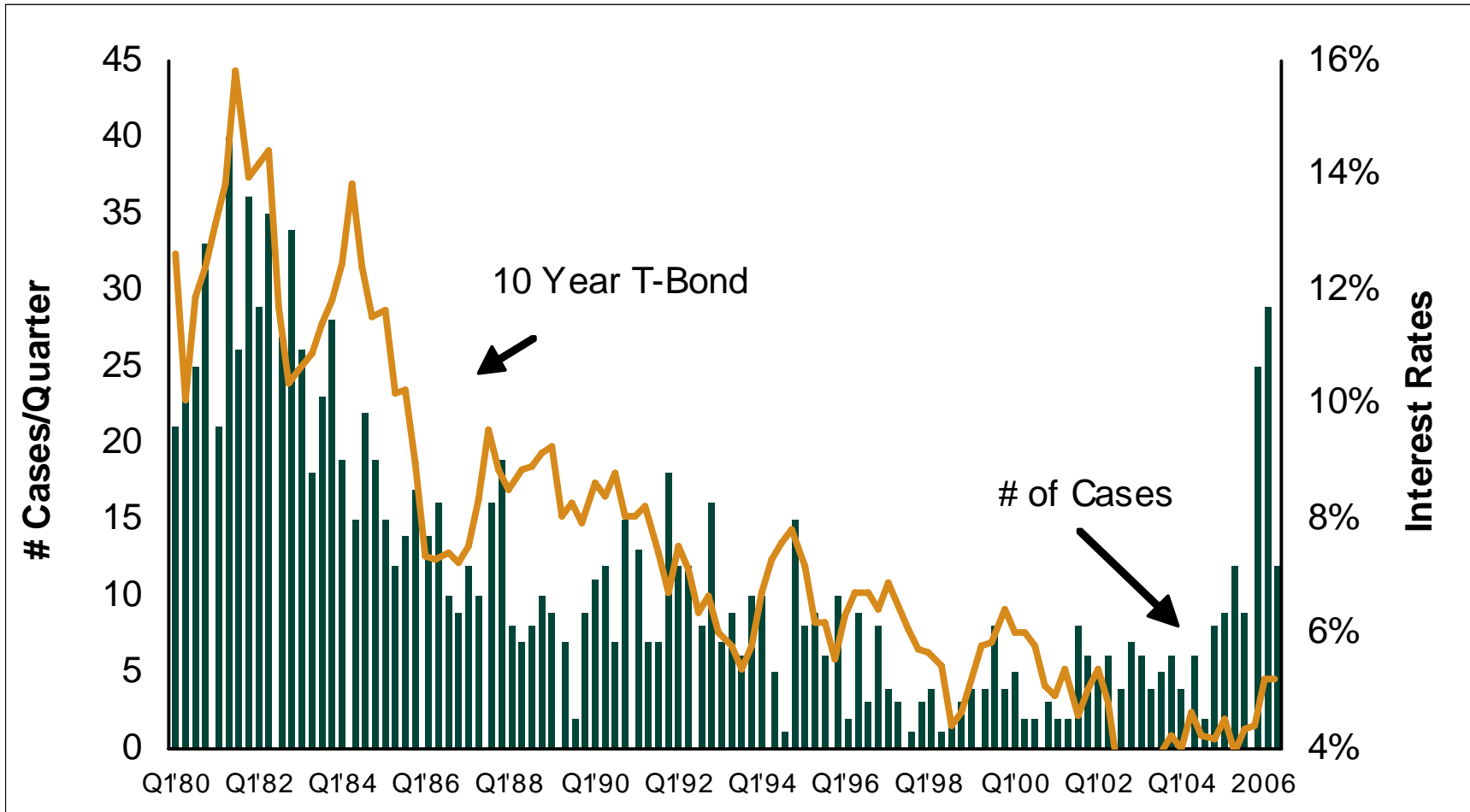
Source: Lehman Brothers Survey, FactSet.

Customers Will Be Likely Shocked

% of Consumer Wallet Spent on Electricity



Rate Cases On the Rise

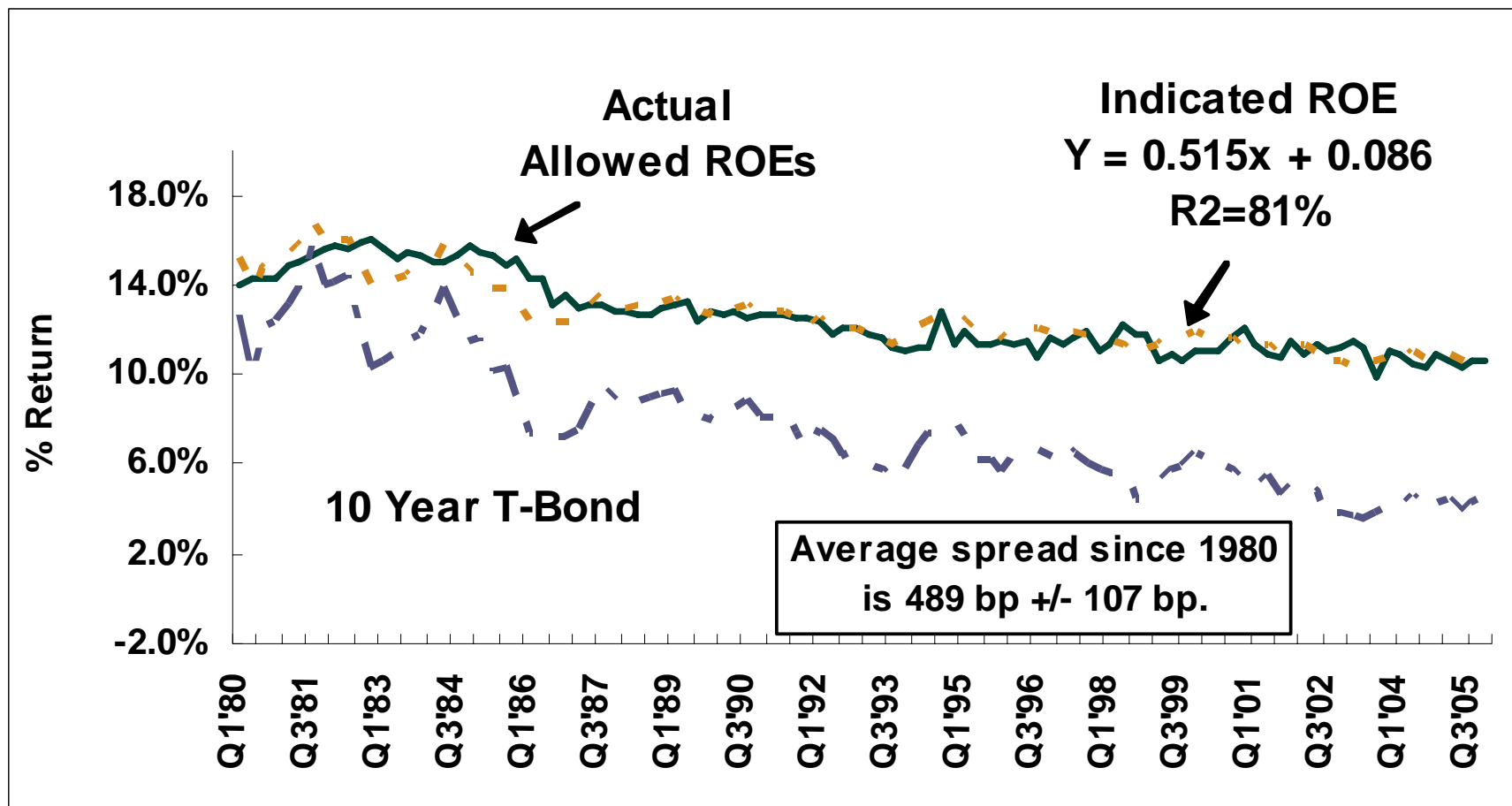


Source: Lehman Brothers, Regulatory Research Associates, and Bloomberg.



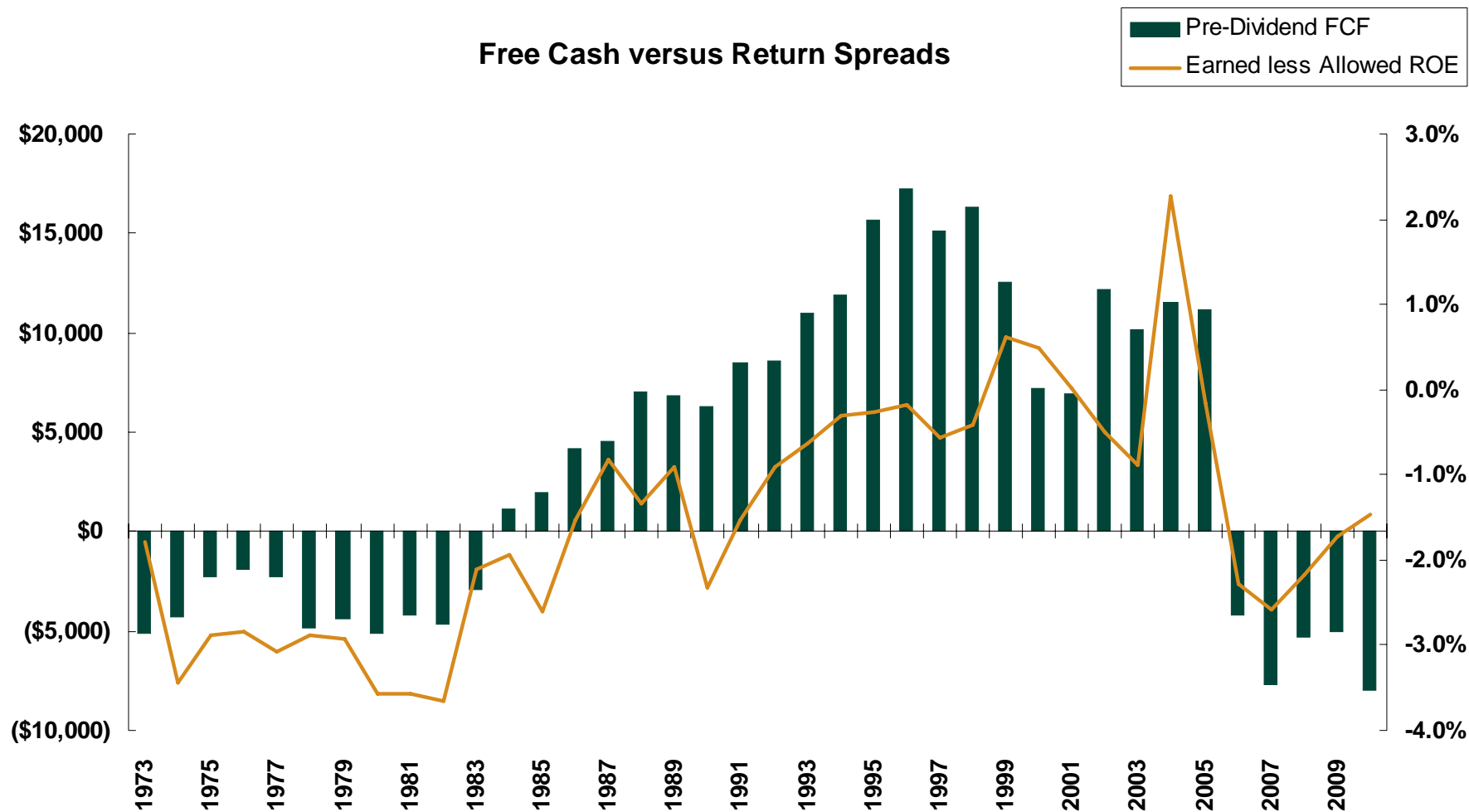
Cost of Capital Implications

Regulatory Risk Returns: Historical Allowed Returns Declining



Source: Regulatory Research Associates, FactSet, Lehman Brothers

Regulatory Risk Returns: Regulatory Lag Expected



Source: FactSet, Lehman Brothers Estimates

Financing Risk Returns: Capital Requirement Increasing

Capital Projections All Shareholder Owned Utilities

	2004A	2005A	2006E	2007E	2008E	2009E	2010E
Debt	\$310,871	\$303,508	\$323,763	\$345,684	\$365,660	\$386,123	\$410,444
Equity	\$219,628	\$229,941	\$242,626	\$258,737	\$274,563	\$290,715	\$308,040
Total Capital	\$530,499	\$533,449	\$566,388	\$604,422	\$640,222	\$676,838	\$718,484
Equity %	41%	43%	43%	43%	43%	43%	43%
Retained Earnings less Dividends		\$10,241	\$10,434	\$10,631	\$10,832	\$11,036	\$11,244
Debt Issued (Retired)		(\$7,363)	\$20,255	\$21,922	\$19,975	\$20,463	\$24,321
Equity Issued (Retired)		(\$7,291)	\$2,251	\$5,480	\$4,994	\$5,116	\$6,080

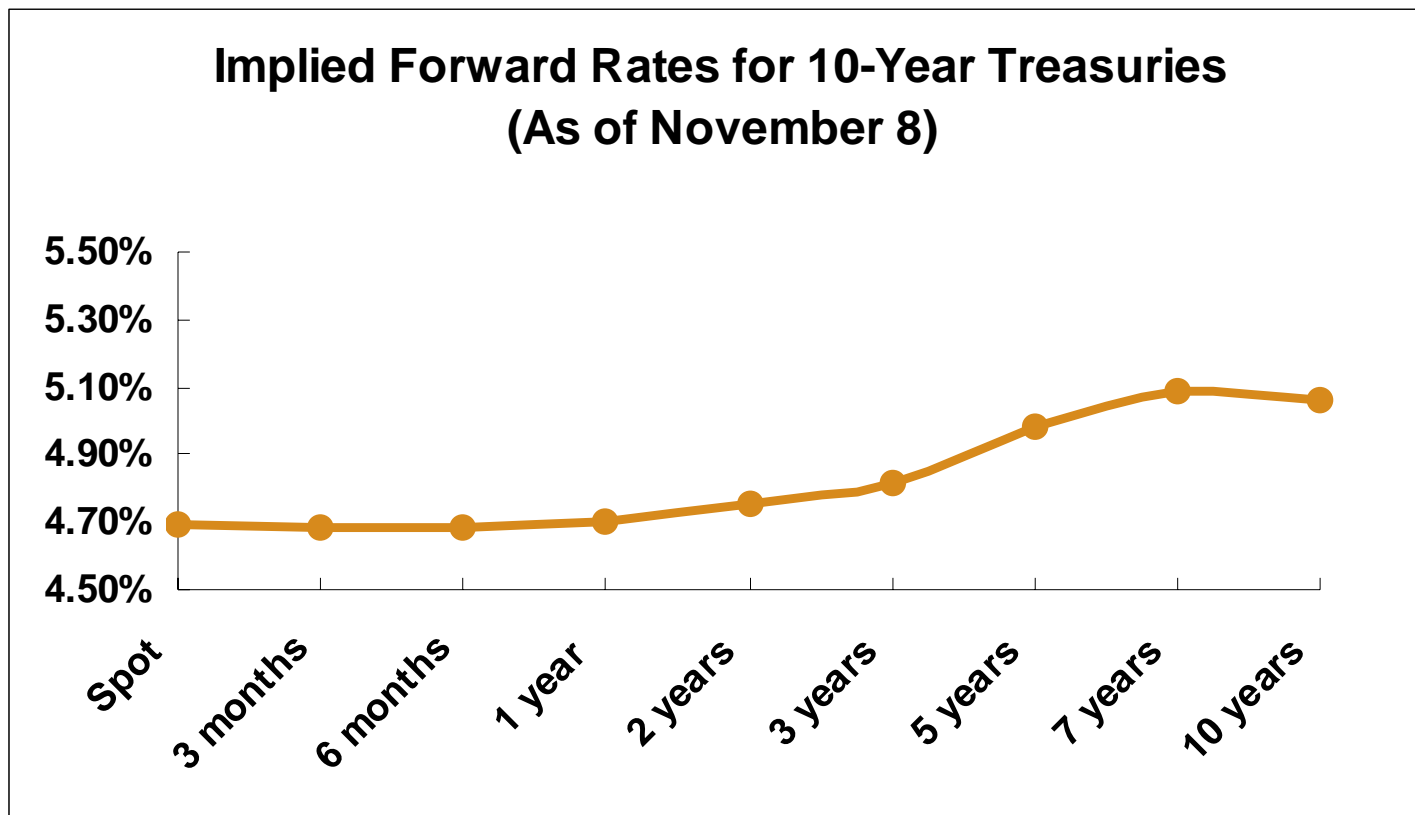
<i>Growth %</i>								
Retained Earnings			2%	2%	2%	2%	2%	4-Year CAGR
Cash from Operations			2%	2%	2%	2%	2%	4-Year CAGR
CapEx			25%	10%	-3%	2%	9%	LEH Estimates
Dividends			2%	2%	2%	2%	2%	LEH Estimates
Cash from Operations	\$57,400	\$49,900	\$50,842	\$51,801	\$52,779	\$53,775	\$54,789	
CapEx	(\$40,900)	(\$46,500)	(\$58,047)	(\$63,597)	(\$61,829)	(\$63,118)	(\$68,630)	
Dividends	(\$13,100)	(\$15,000)	(\$15,300)	(\$15,606)	(\$15,918)	(\$16,236)	(\$16,561)	
Free Cash, Post Div.	\$3,400	(\$11,600)	(\$22,505)	(\$27,402)	(\$24,969)	(\$25,579)	(\$30,401)	

Proportion Returned to (Drawn from) Debt	100%	90%	80%	80%	80%	80%
Proportion Returned to (Drawn from) Equity	0%	10%	20%	20%	20%	20%

Source: EEI Financial Review.

Financing Risk Returns: Interest Rates are Rising

- ◆ Typically, a 10 basis point move in Treasury yields equates to a 1.4% change in value for the utility group



Source: Lehman Brothers.

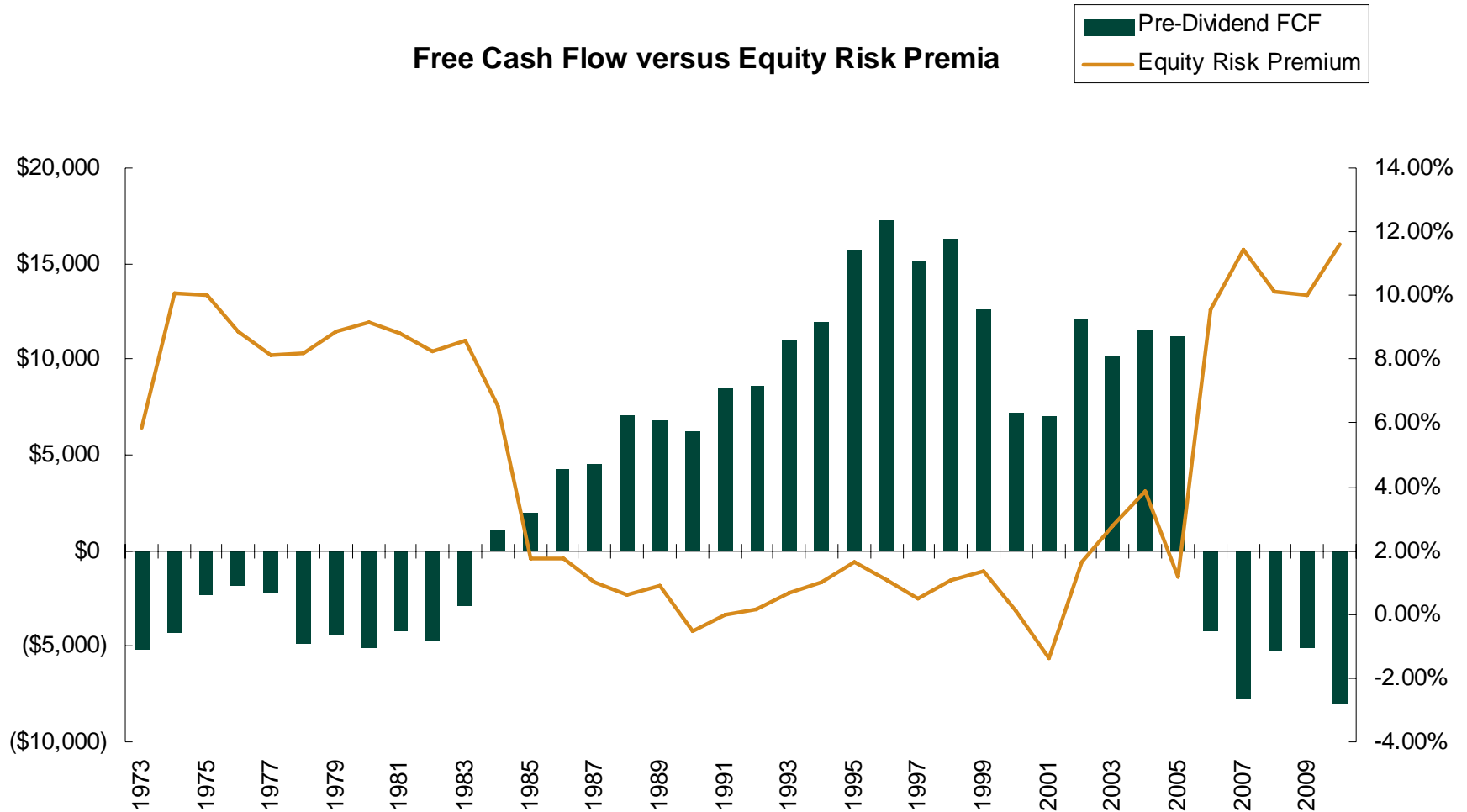
Financing Risk Returns: Tax Policy Uncertain

- ◆ Current tax policy outlook is stable
- ◆ Current dividend tax rate of 15% expires in 2010
 - Next presidential election cycle will likely determine its fate
- ◆ We estimate that 8-12% of the value of the group is dependent on maintenance of this policy

Execution Risk Returns:

- ◆ Total cost estimates being revised 10-20% or more
 - CCGT estimates up 42%
 - Scrubbers up 20%
 - Nuclear estimates up 100%
- ◆ In service dates slipping 6 to 12 months
 - Coal plants are being cancelled

Conclusion: We May Repeat the 70's



Source: FactSet, Lehman Brothers Estimates



The Environmental Conundrum: The Elephant in the Corner

The Emerging Environmental Picture

Status of Emissions/Pollutant Regulation

Pollutant / Emission	Also Known As	Currently Regulated?
Nitrogen Oxides (NOx)	Smog	Yes
Sulfur Dioxides (SOx)	Acid Rain	Yes
Fine Particulates	Soot	Yes
Mercury (Hg)	Mercury	Yes
Carbon Dioxide (CO ₂)	Greenhouse Gas / Global Warming	No

Source: Lehman Brothers.

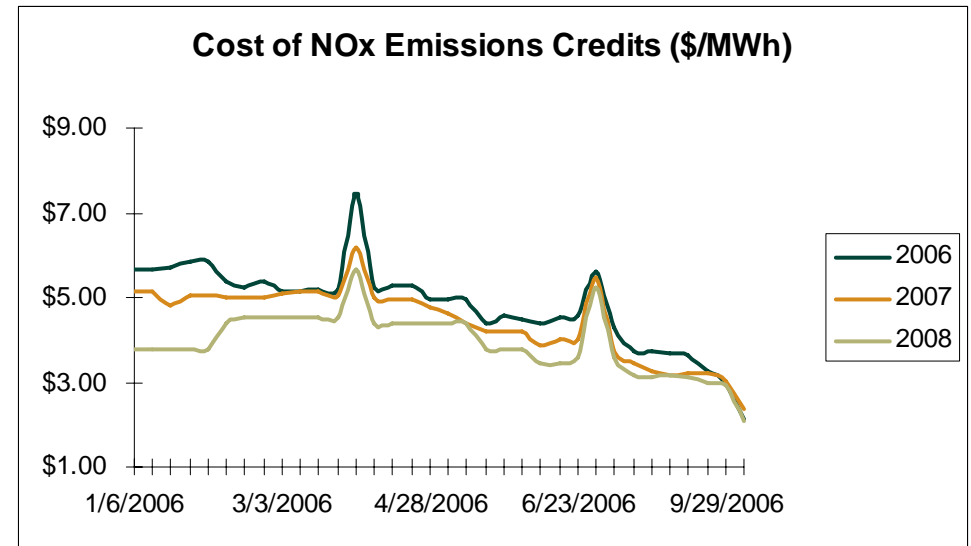
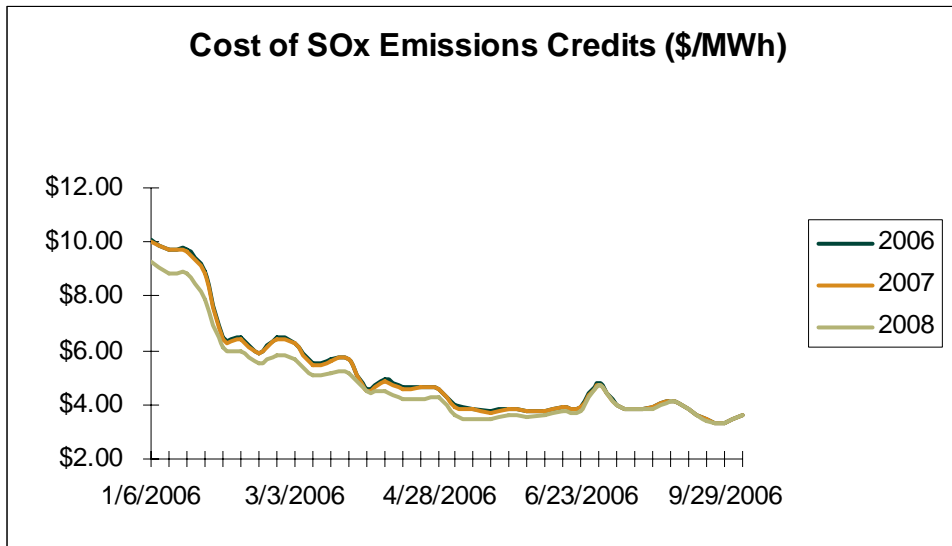
- ◆ More aggressive regulation began with the Clean Air Act of 1990, continued through Clean Air Interstate Rule and Clean Air Mercury Rule
- ◆ Emissions that have been regulated are down substantially
 - Likelihood that CO₂ rules have similar effect when implemented?

The Environmental Angle

- ◆ Clean-air and greenhouse gas concerns are shaping the direction of future generation and capital spending decisions
- ◆ Carbon rules are arriving in Northeast, California
 - Impact on electricity prices
 - Impact on coal generators
 - Impact on new build for coal
 - Final shape of regional rules to be determined – much still to be decided
 - CO₂ credits granted versus bought?
 - Pricing for credits
- ◆ We believe Federal legislation is inevitable in 2009

Cost of SOx and NOx Emissions

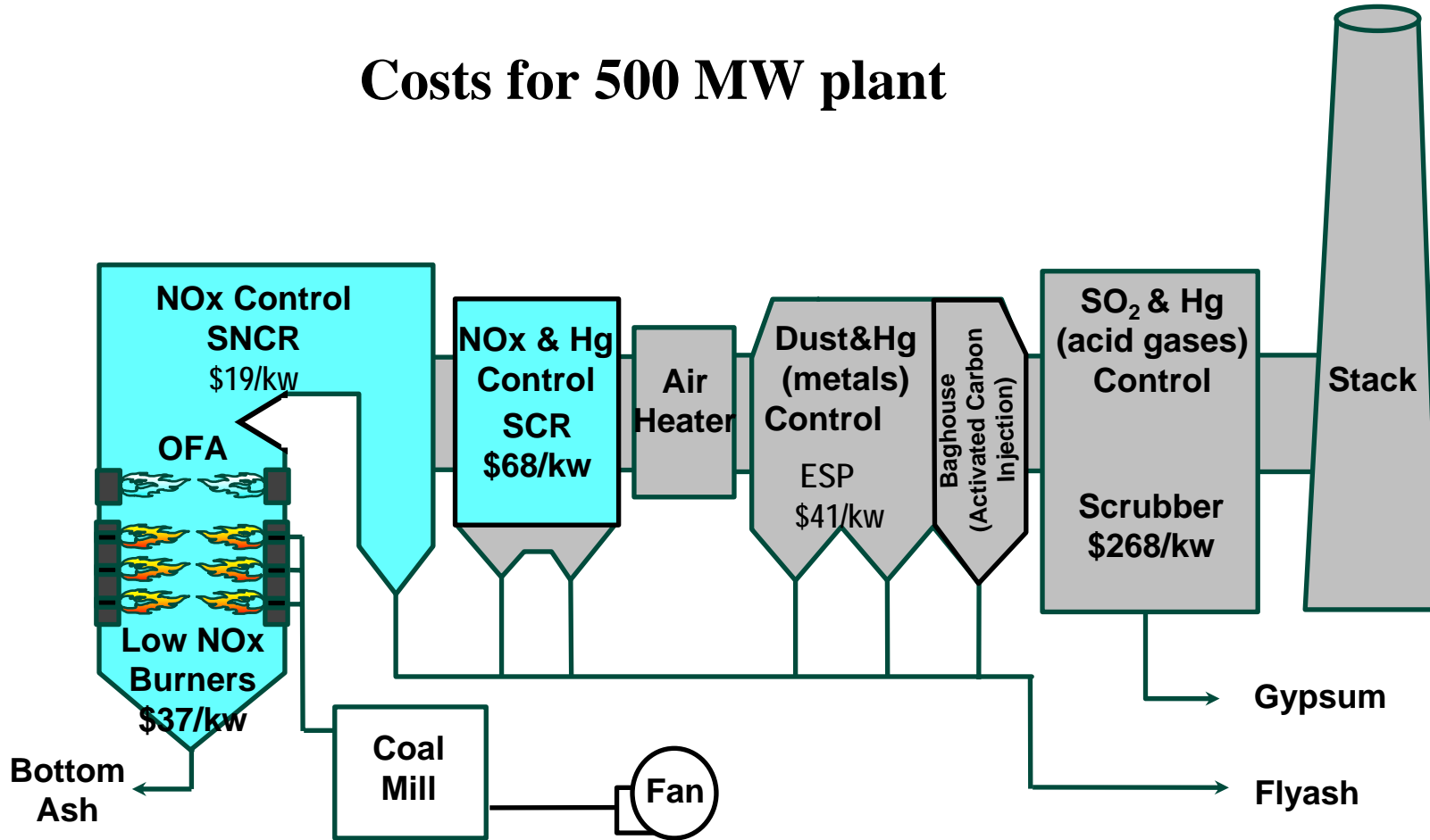
- ◆ SOx credits ease as we move out the curve, reflecting the market's understanding of the likelihood of a majority of coal plants having scrubbers installed by that point
- ◆ The weakening in the emissions markets was broadly consistent with commodities pricing through the year



Source: Bloomberg, Lehman Brothers.

The Cost of Compliance

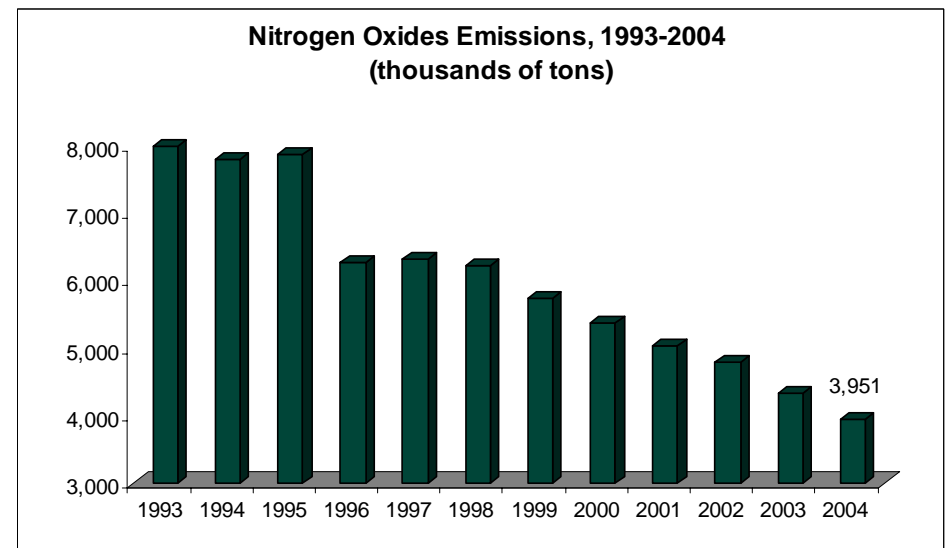
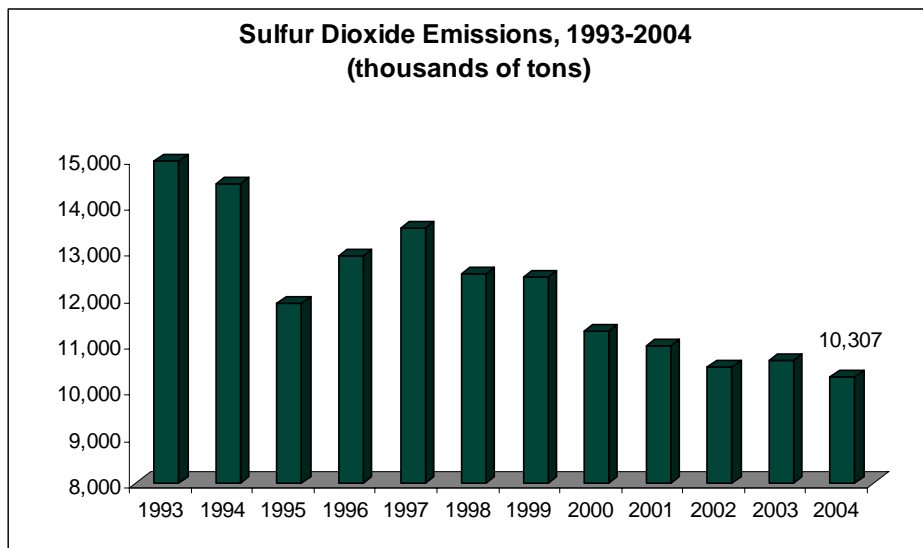
Costs for 500 MW plant



Source: Lehman Brothers, Southern Company

SO_x and NO_x Emissions 1993-2004

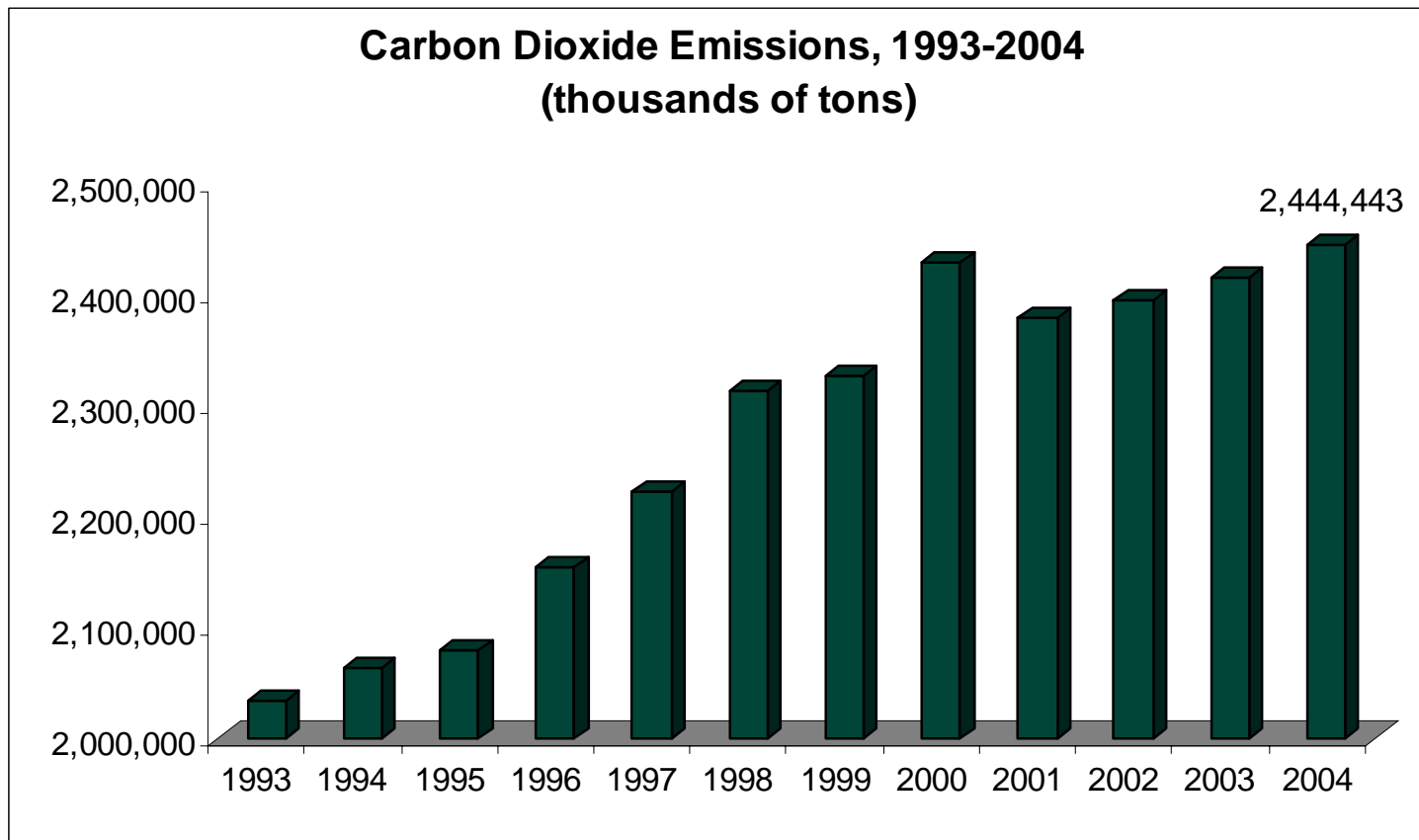
- ◆ With the increasing use of flue gas desulfurization (FGD) and selective catalytic reduction (SCR) devices to limit SO_x and NO_x emissions, respectively, the aggregate level of emissions since clean air legislation was enacted has dropped notably



Source: Energy Information Administration.

CO₂ Emissions 1993-2004

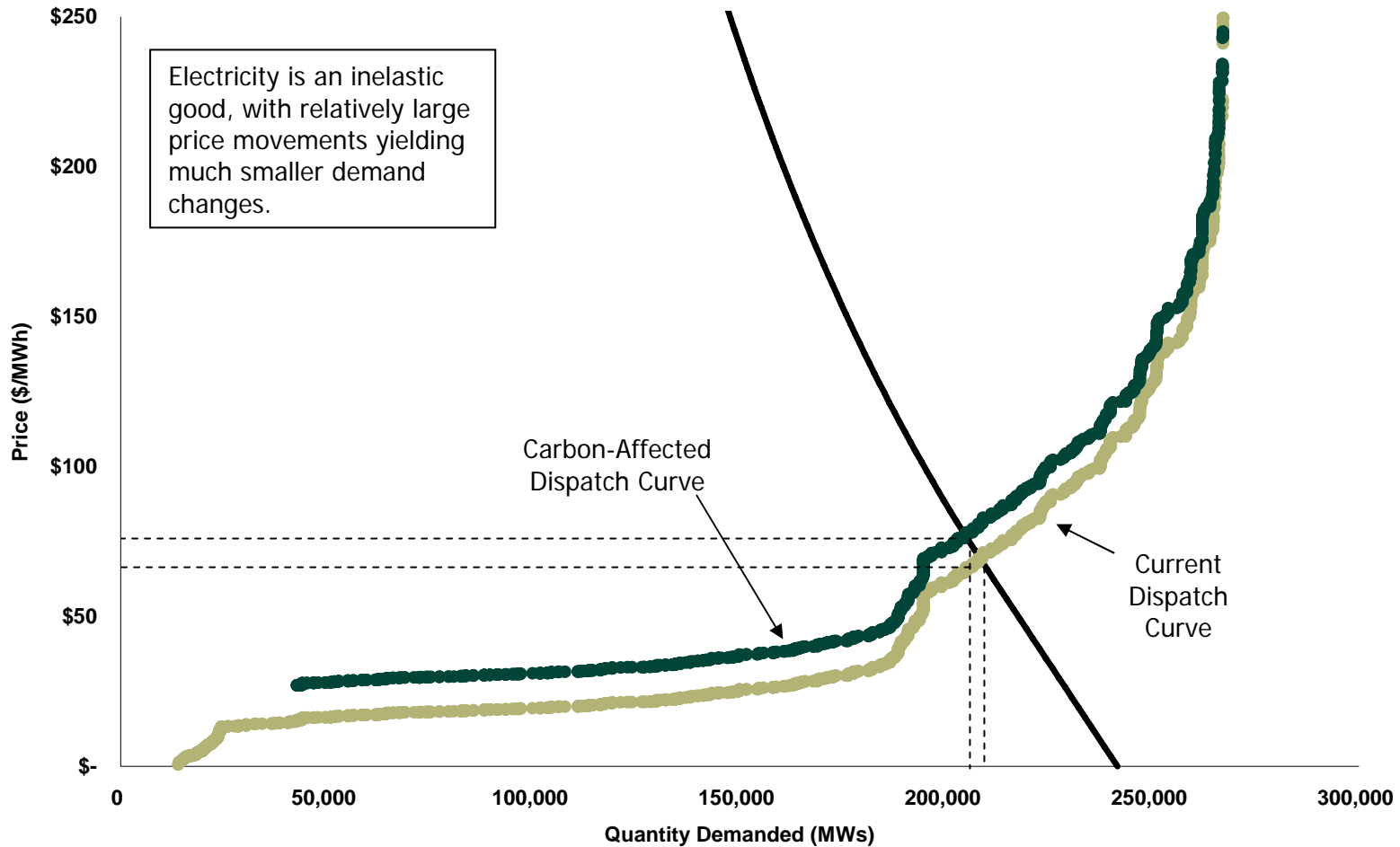
- ◆ The growth in CO₂ emissions – still unregulated in the U.S. – when juxtaposed against the successful efforts in curtailing other pollutants, provides a strong case for the coming regulatory schemes



Source: Energy Information Administration.

What Will Carbon Taxes Mean?

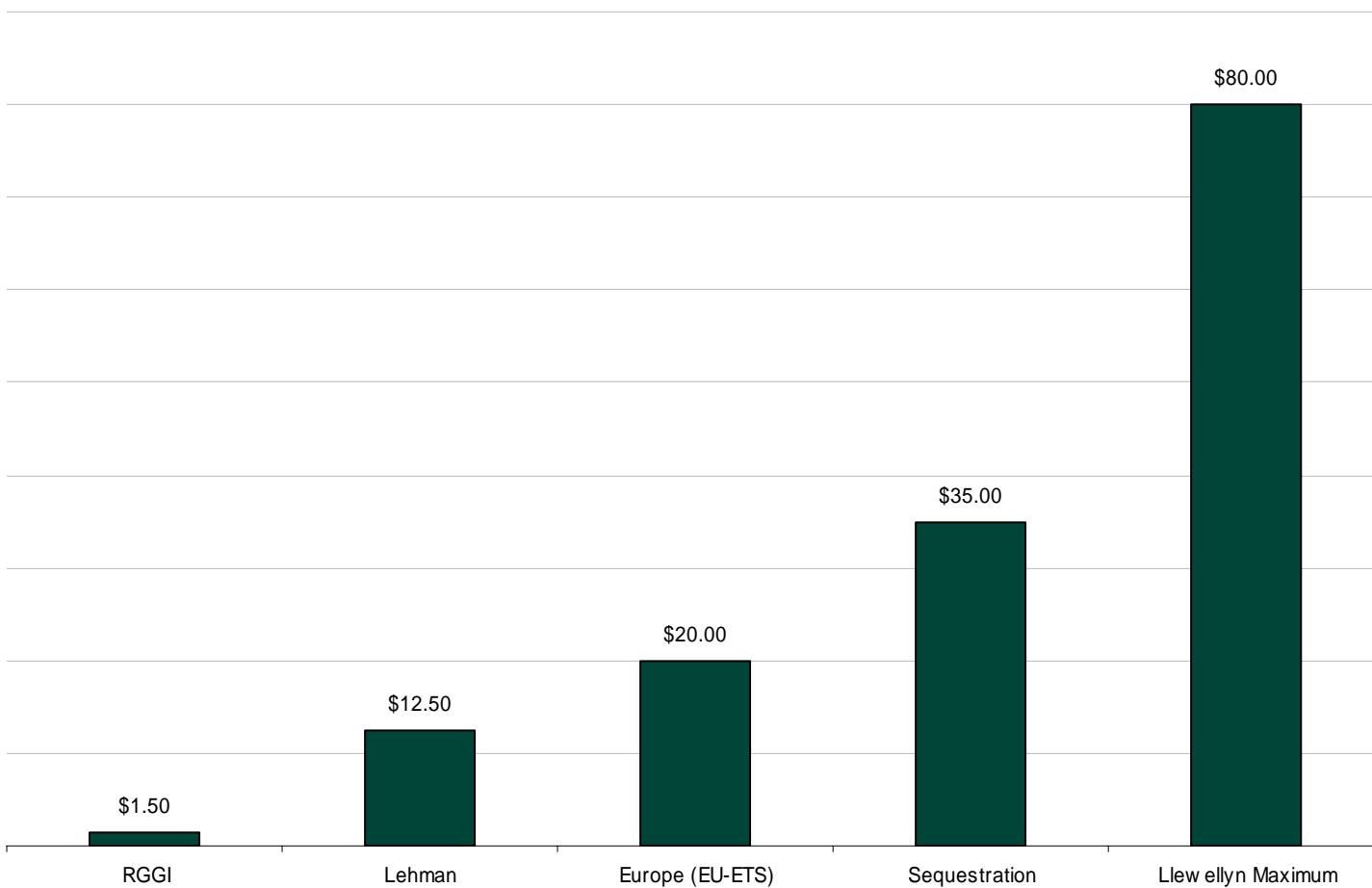
Impact of CO₂ Emissions on Electricity Supply & Demand



Source: SNL Energy, Lehman Brothers.

A Wide Range of Cost Outcomes

Estimated Cost per Ton of CO2



Sources: RGGI documents, Lehman Brothers estimates, Bloomberg, U.S. DOE, EPRI, Powerspan

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