



***36<sup>th</sup> Annual PURC Conference  
Challenges in Energy Financing***

**Armando Pimentel  
Chief Financial Officer  
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# As we enter this period of significant capital investment in the power industry, there are several separate but inter-related challenges

## Challenges

- Significant capital requirements against the backdrop of a difficult economy
- The industry's financial strength and credit ratings are significantly lower than when it entered the last significant construction period in the 1980's
- Capital requirements will place upside pressure on customer rates at a time when customers are facing other economic pressures
- The capital markets are in turmoil, with unprecedented volatility negatively impacting the availability, terms and cost of capital
- Investor's are hesitant to deploy capital due to the uncertain economic future

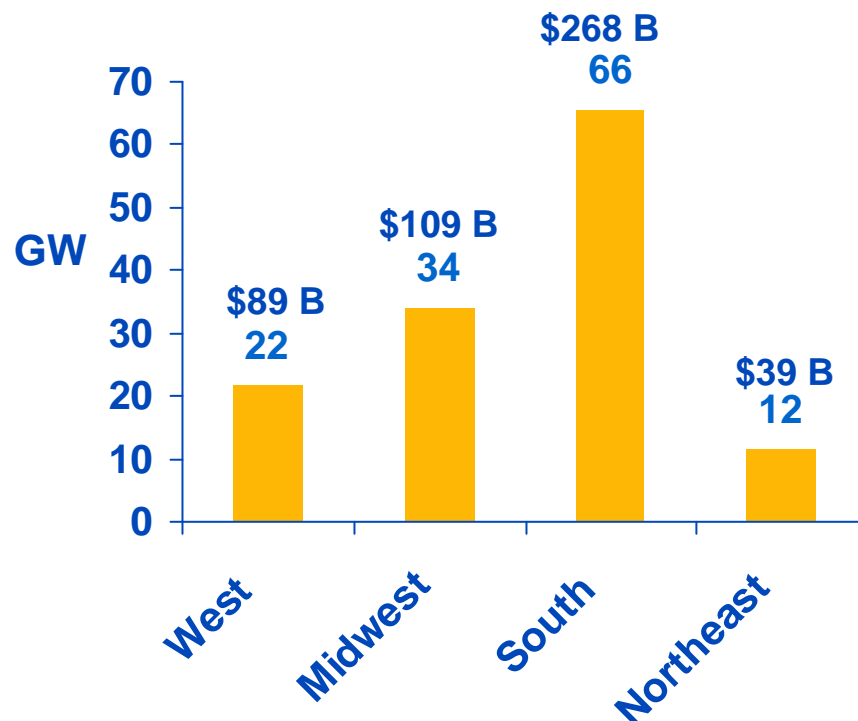
**Clear and supportive regulation will be required**

**Projected capital expenditures are substantial for the industry overall, with the southern region of the U.S. projecting the largest increase in capacity needs**

## **Capital Investment Through 2030**

Generation	\$505 Billion
Transmission	\$298 Billion
AMI and EE/DR	\$85 Billion
Distribution	\$582 Billion
<b>Total</b>	<b>\$1.470 Trillion</b>

## **Generation Capacity Additions By Region Through 2030**



**Adequate return on equity is essential to attract necessary capital**

Source: The Brattle Group “Transforming America’s Power Industry:  
The Investment Challenge 2010 – 2030, November 2008



# Industry credit ratings are declining while capital expenditures are increasing

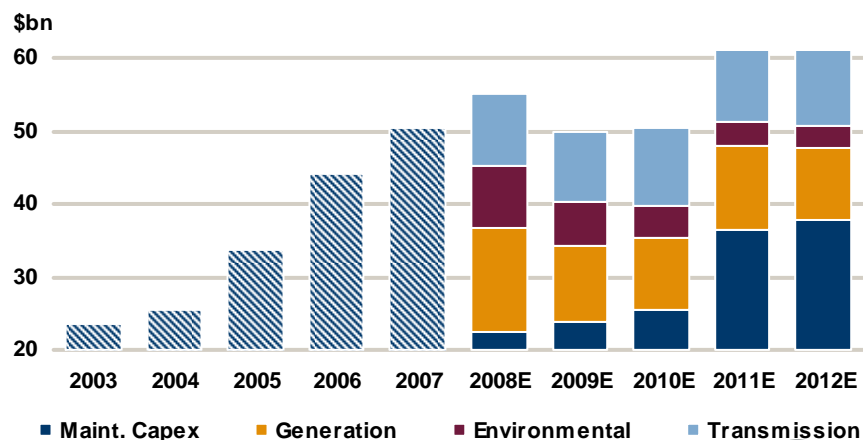
## Power Sector Outlook

- Only 30% of the industry has a rating of A or better
- In the last 30 years over 60% of the industry has been downgraded to below A
- Increasing capital expenditures will put pressure on capital structures and credit ratings
- Now is the time when utilities need strong balance sheets against difficult economic conditions
- Investors will require sufficient returns to deploy capital

### Long-Term Debt Ratings <sup>1</sup>

	1970	1980	1990	2000	2007
AAA	14.0%	0.0%	0.0%	0.0%	0.1%
AA	65.6%	32.9%	27.4%	14.1%	1.7%
A	17.4%	43.8%	34.2%	54.6%	28.8%
<b>A or above Total</b>	<b>97.0%</b>	<b>76.7%</b>	<b>61.6%</b>	<b>68.7%</b>	<b>30.6%</b>
BBB	3.0%	21.9%	34.3%	26.6%	42.4%
BB or lower	0.0%	1.4%	4.1%	4.7%	27.1%
<b>BBB or lower Total</b>	<b>3.0%</b>	<b>23.3%</b>	<b>38.4%</b>	<b>31.3%</b>	<b>69.5%</b>

### Utility Capital Expenditures <sup>1</sup>



<sup>1</sup> Source: Barclays Bank  
Standard & Poor's

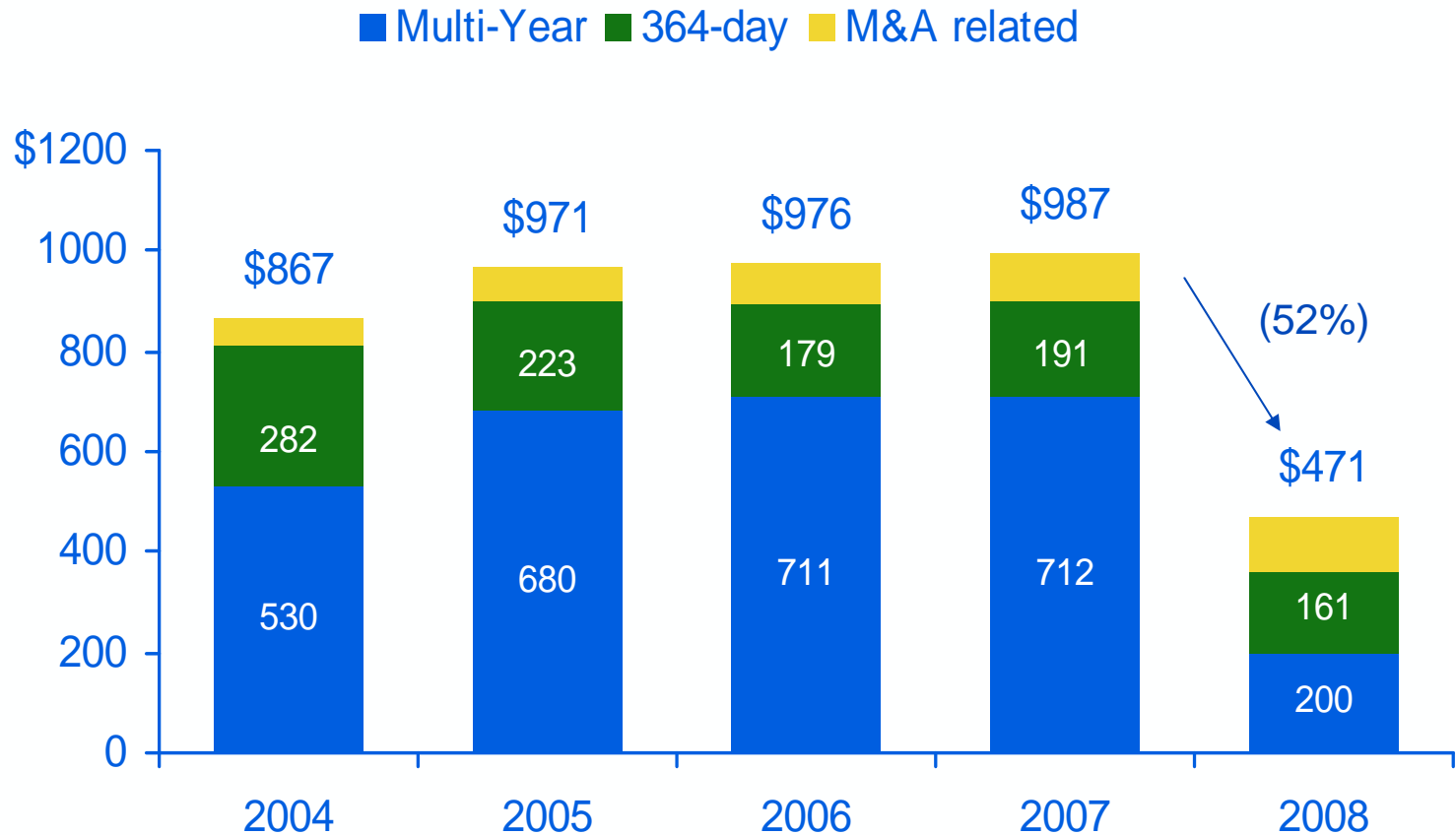
# The industry's traditional sources of capital are shrinking

## Reasons

- **Unprecedented consolidation of institutions in the banking industry is resulting in a reduction in available credit**
- **The banking industry (weakened by substantial write-offs) is reducing leverage to meet regulatory capital requirements**
- **As a result, financial institutions have become much more selective about who they extend credit to**
- **The cost of bank credit is increasing dramatically**

# Financial institutions are reducing leverage

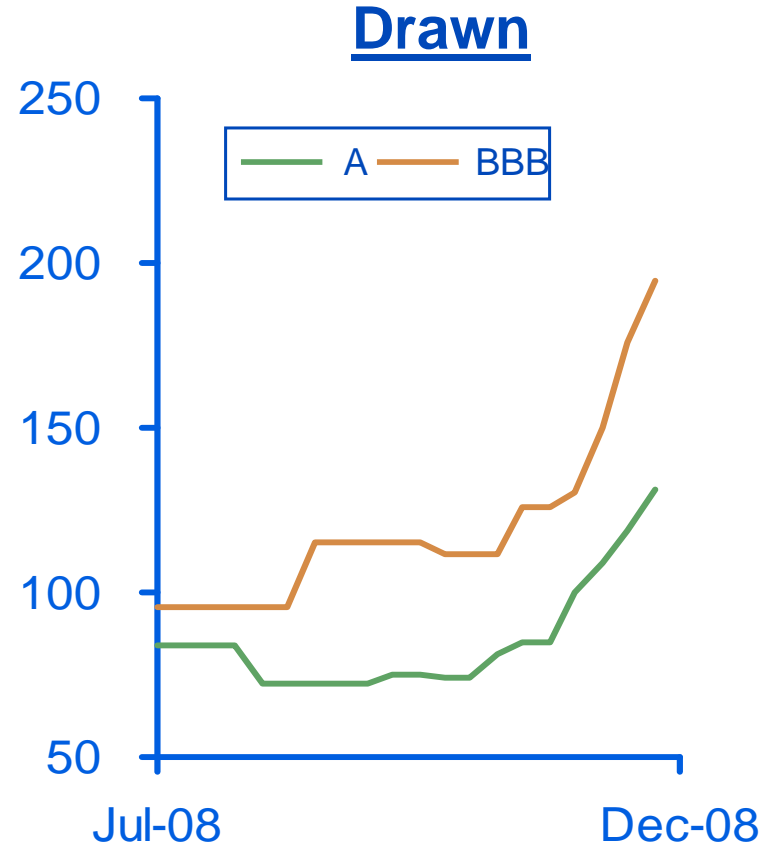
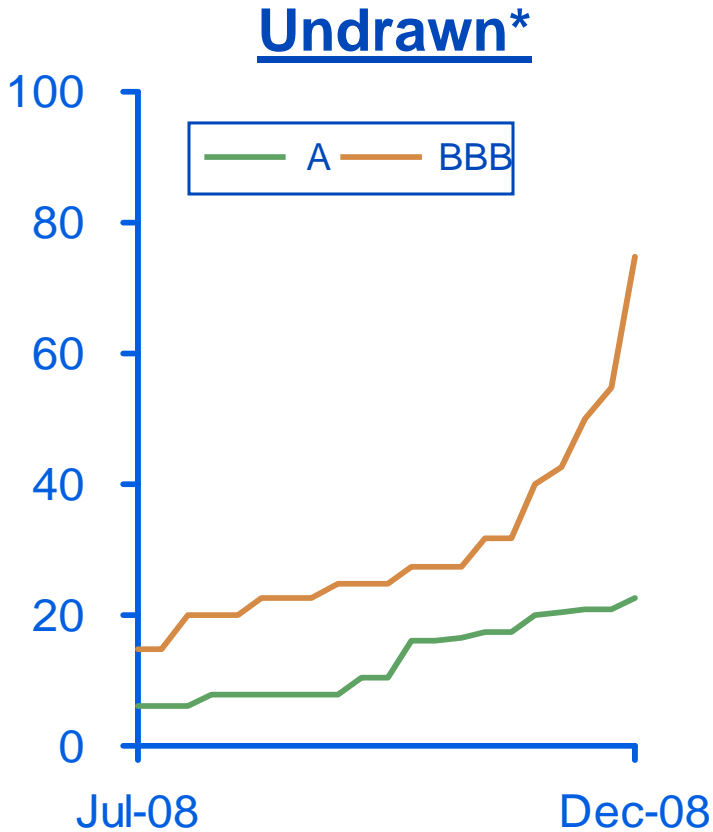
## U.S. High Grade Credit Facilities (\$ B)



**Utilities will need to develop alternative sources of liquidity**

# Market based pricing and 364-day facilities are the new standard

## Pricing trends for 364-day facilities

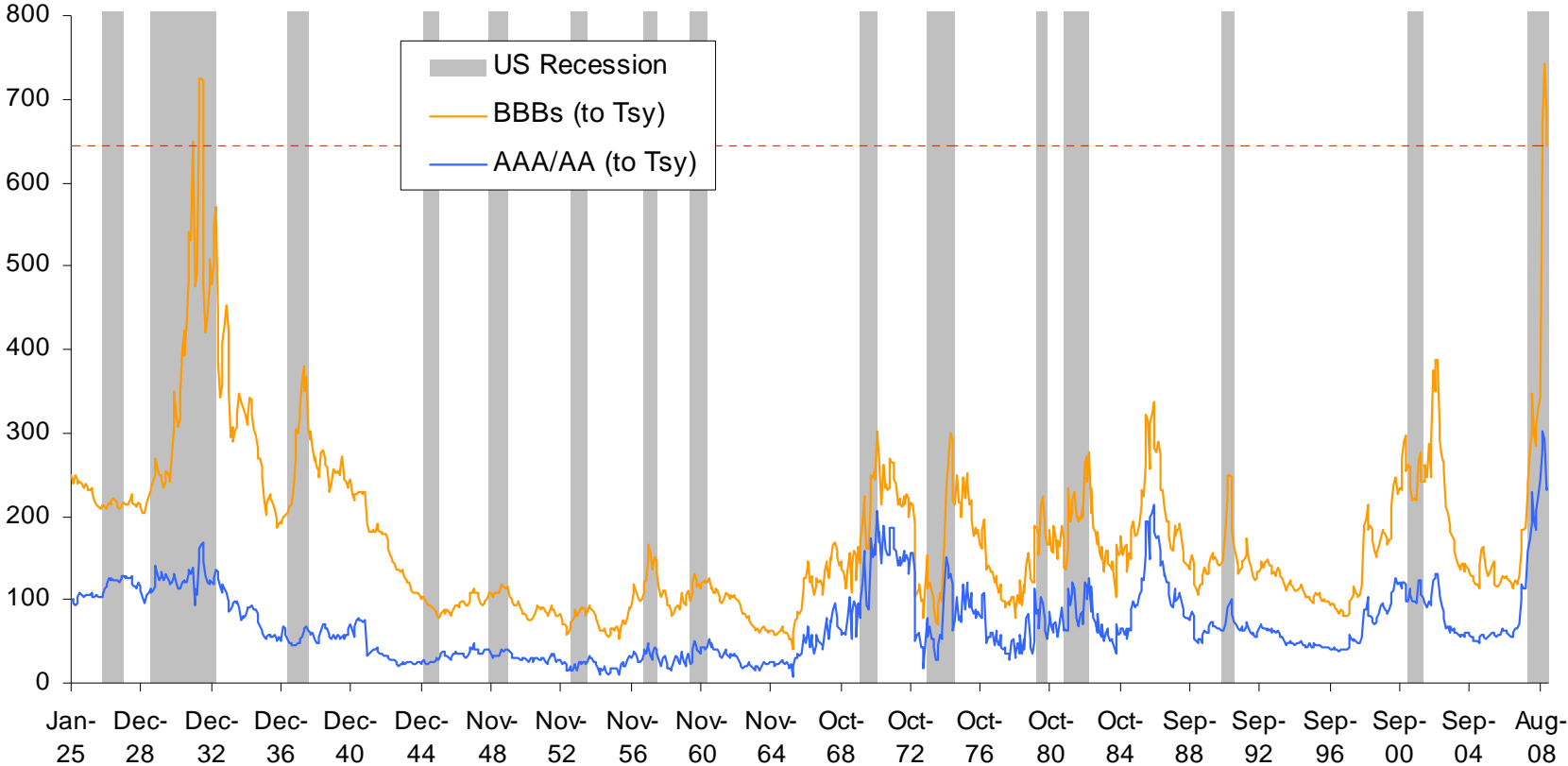


\*Commitment fees and upfronts combined  
Source: JP Morgan MBP Database

# Credit spreads have not been this wide since the Great Depression

## Spread to Treasury (bp)

Spread to Tsy (bp)

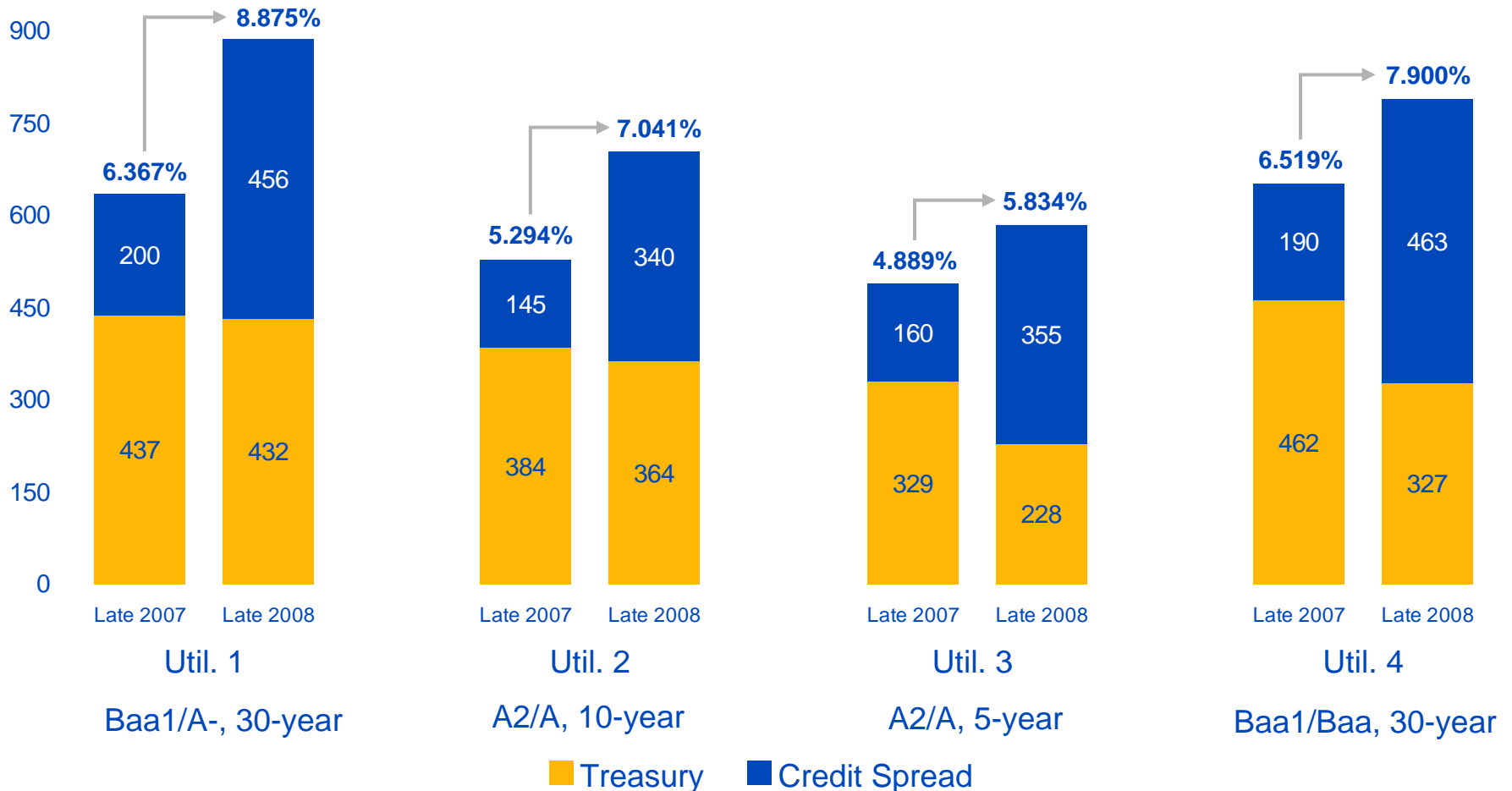


Source: Morgan Stanley



# All-in funding costs have increased

## Selected Utility Bond Issuance

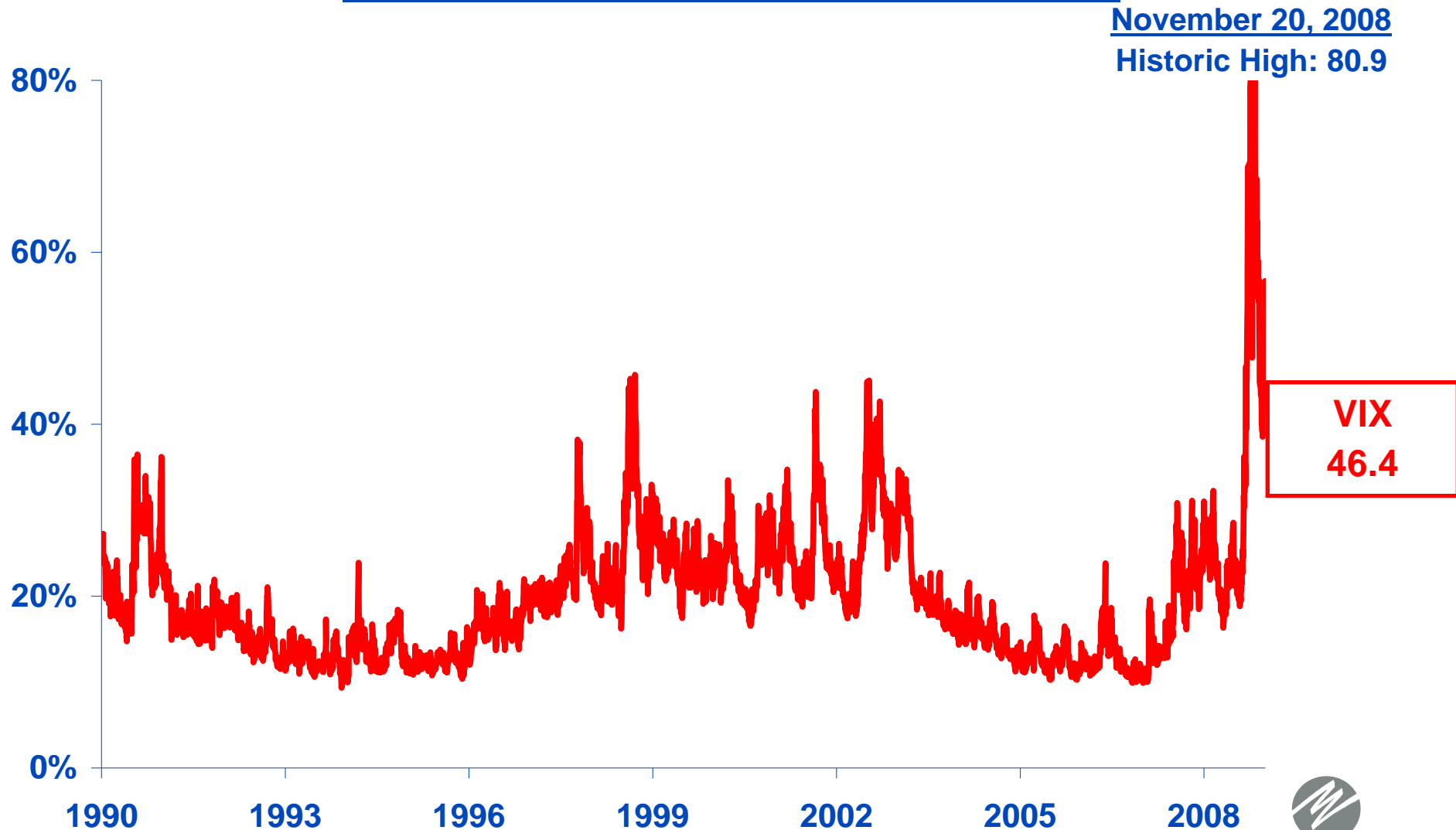


Source: Morgan Stanley



# Volatility in the equity markets remains near historic highs

## Chicago Board of Exchange Volatility Index Performance January 22, 1990 – January 21, 2009



10 Source: FactSet

Note: Historic high represents highest closing value throughout the period



# Rating agencies are increasingly focused on regulators willingness to support the credit quality of utilities through appropriate equity capitalization and authorized returns in a difficult economic environment

## Rating Agency Comments

### Moody's

- “Our primary concern is that as total revenue requirements rise, so does the risk of a consumer backlash that could prompt legislative intervention or a more contentious atmosphere between utilities and their regulators.”<sup>1</sup>

### Standard & Poor's

- “Regulators' willingness to recognize the higher cost of capital through overall returns is important for credit quality.”<sup>2</sup>

### Fitch Ratings

- “Fitch is concerned that absent a meaningful up-tick in authorized ROE, the industry may have difficulty attracting adequate capital to fund new reliability, infrastructure and renewable energy projects in light of the significant change in capital market conditions and investor expectations.”<sup>3</sup>

<sup>1</sup> Moody's U.S. Investor-Owned Electric Utilities dated January 2009.

<sup>2</sup> Standard & Poor's Top 10 Investor Questions for the U.S. Electric Utilities dated January 22, 2009.

<sup>3</sup> Fitch U.S. Utilities, Power and Gas 2009 Outlook dated December 22, 2008.

# Both regulators and utilities are taking steps to foster creditworthiness and manage the current capital and credit market situation

## Utility Actions

- Draw down credit facilities to increase liquidity and improve cash position
- Pre-fund capital expenditures to ensure access to capital when needed
- Defer capital expenditures where possible while maintaining reliability

## Commission Tools

- Including Construction Work-In-Process in rate base
- Incentive returns
- Policies which improve the certainty of recovery for capital expenditures

## **In conclusion.....**

- **Maintaining strong credit ratings is more important than ever, given the significant capital requirements facing the industry**
- **Adequate returns are essential to attract capital in today's environment**
- **A strong balance sheet will provide for continued access to capital during challenging economic conditions**

**A strong balance sheet and a regulatory environment that fosters stable revenues and cash flows are cornerstones to maintaining reliable electric service for our customers**