



**MACRUC Annual Conference
June 23, 2009
Hershey, PA**

**Attracting Capital for Energy &
Water Projects in an Uncertain Market**

**Richard W. Cortright, Jr.
Managing Director
Utilities & Infrastructure Practice**

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“If You Can Keep Your Rating When All About You Are Losing Theirs...”

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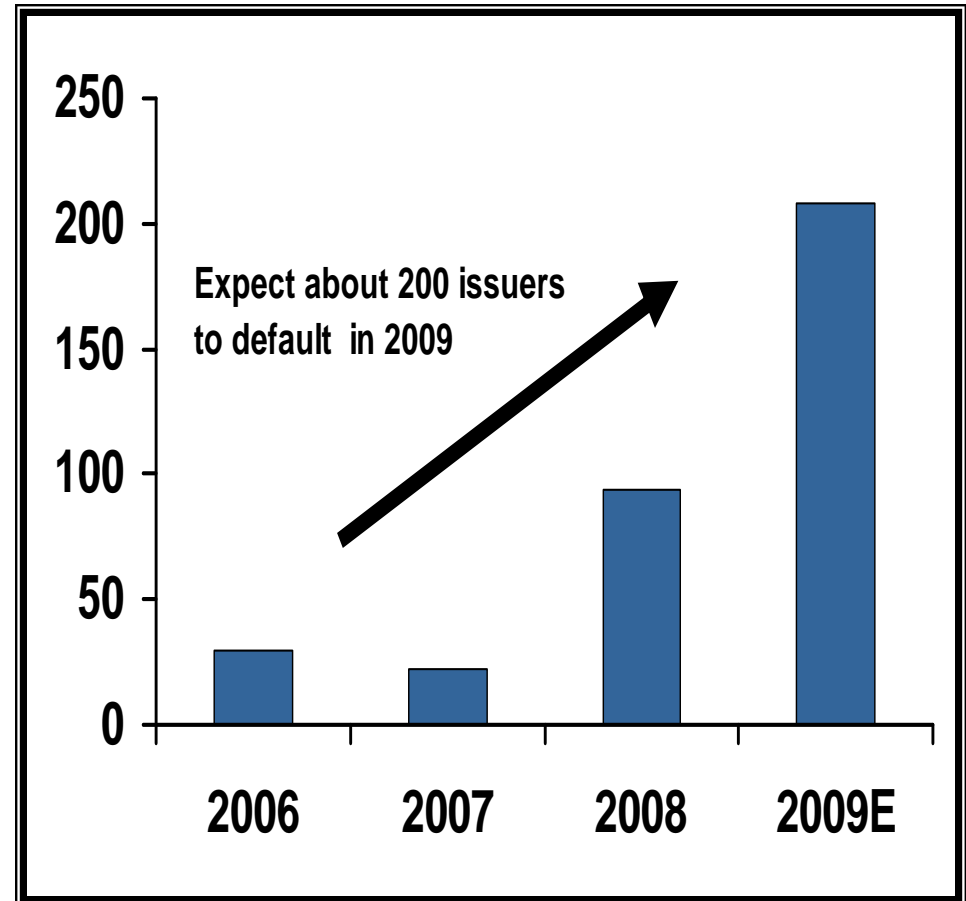
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Corporate Credit Quality 2009 – The Worst May Be Yet to Come

Credit Quality Continues to Deteriorate

- **Expect The U.S. Speculative Grade Corporate Default Rate To Increase To Over 14% In 2010, The Highest In 18 Years**
- **Global Defaults YTD Have Surpassed 2008 Total; 108 In U.S. As Of June 11 --- \$387 Billion**
- **Corporate Downgrades Have Outpaced Upgrades By More Than 10 to1 (YTD May 2009)**



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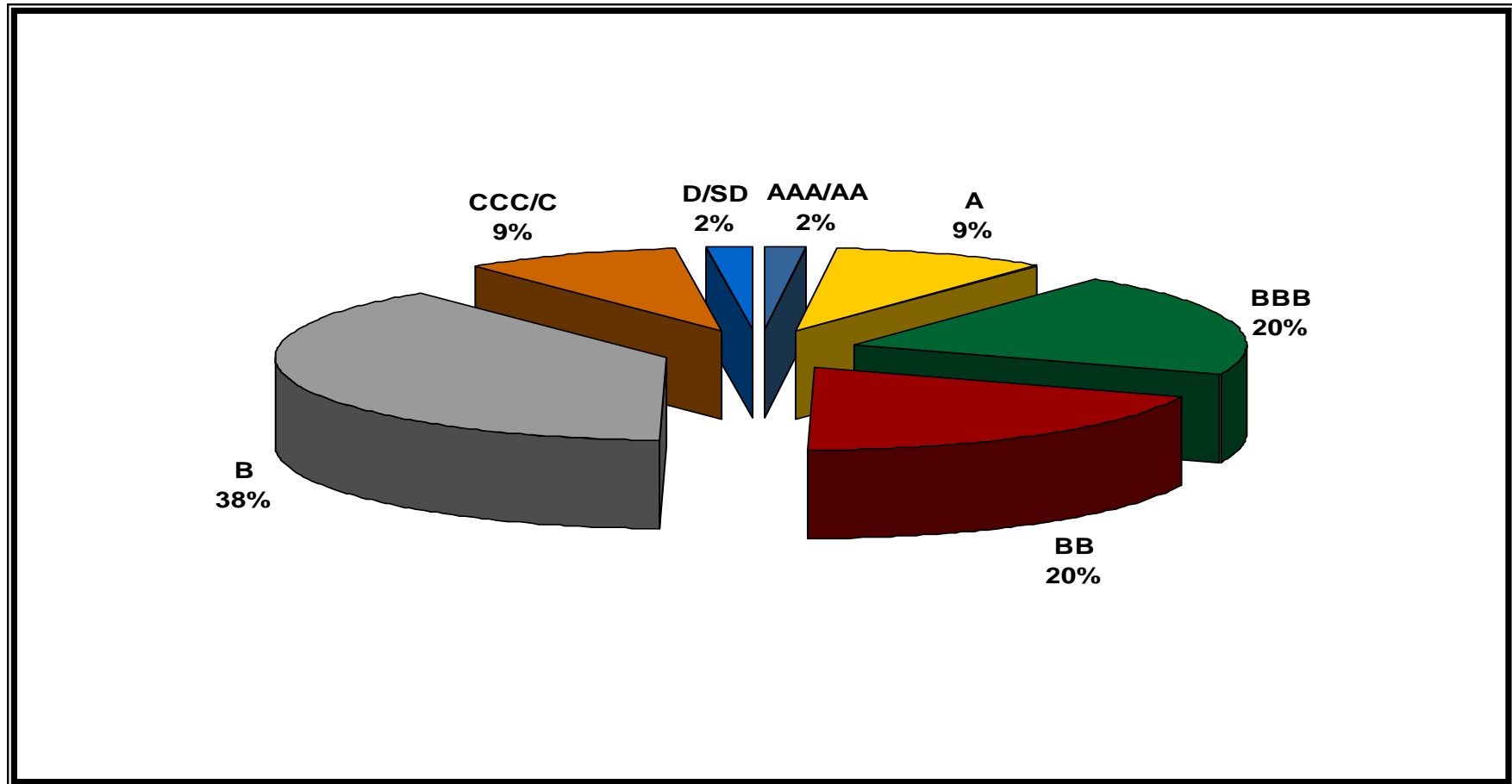
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Corporate Credit Quality – The Worst May Be Yet to Come

Ratings Distribution Of U.S. Corporate Ratings – Q1 2009

49% Are “B” And Below



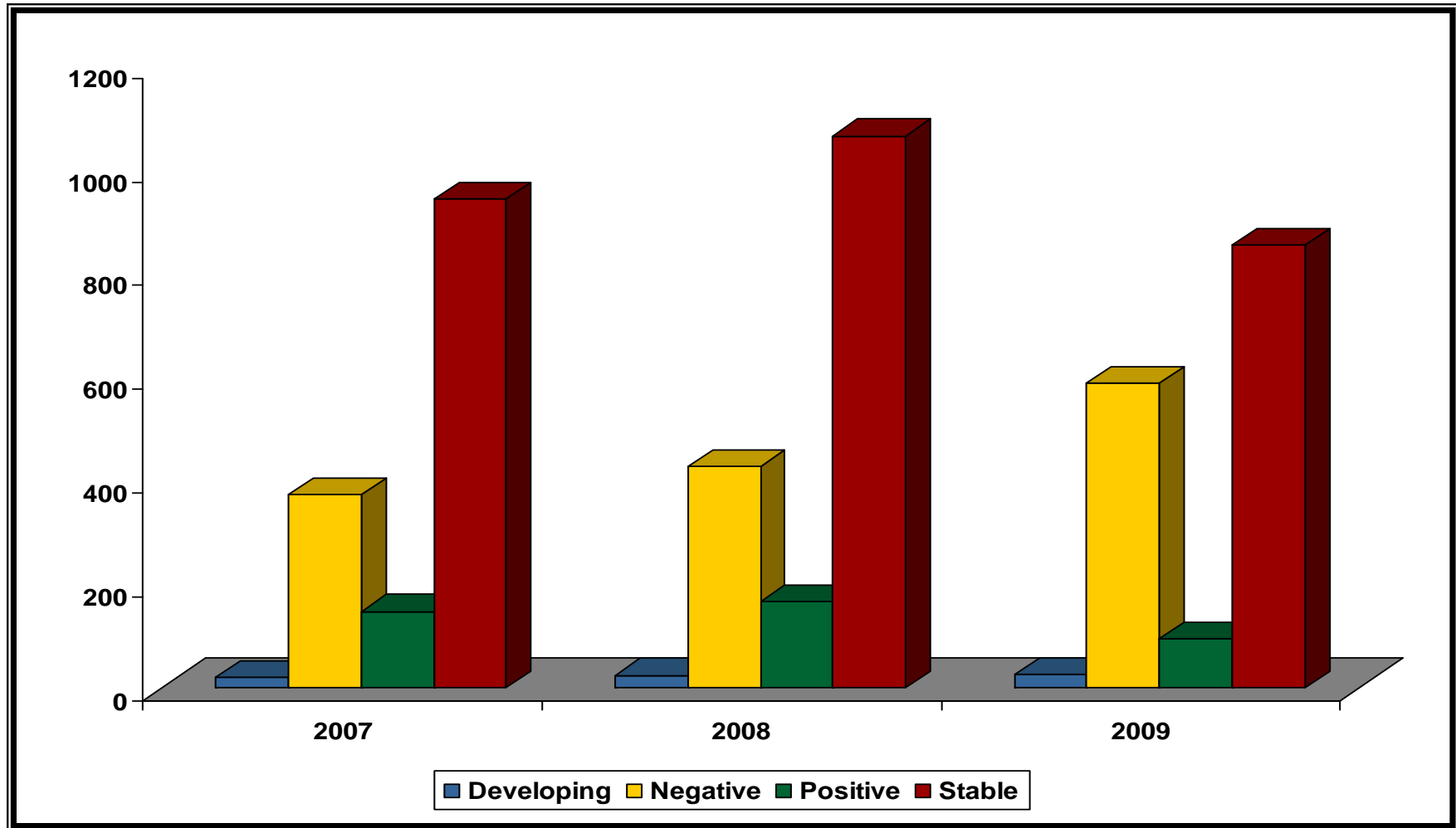
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Outlooks Are Increasingly Negative – Now 38%



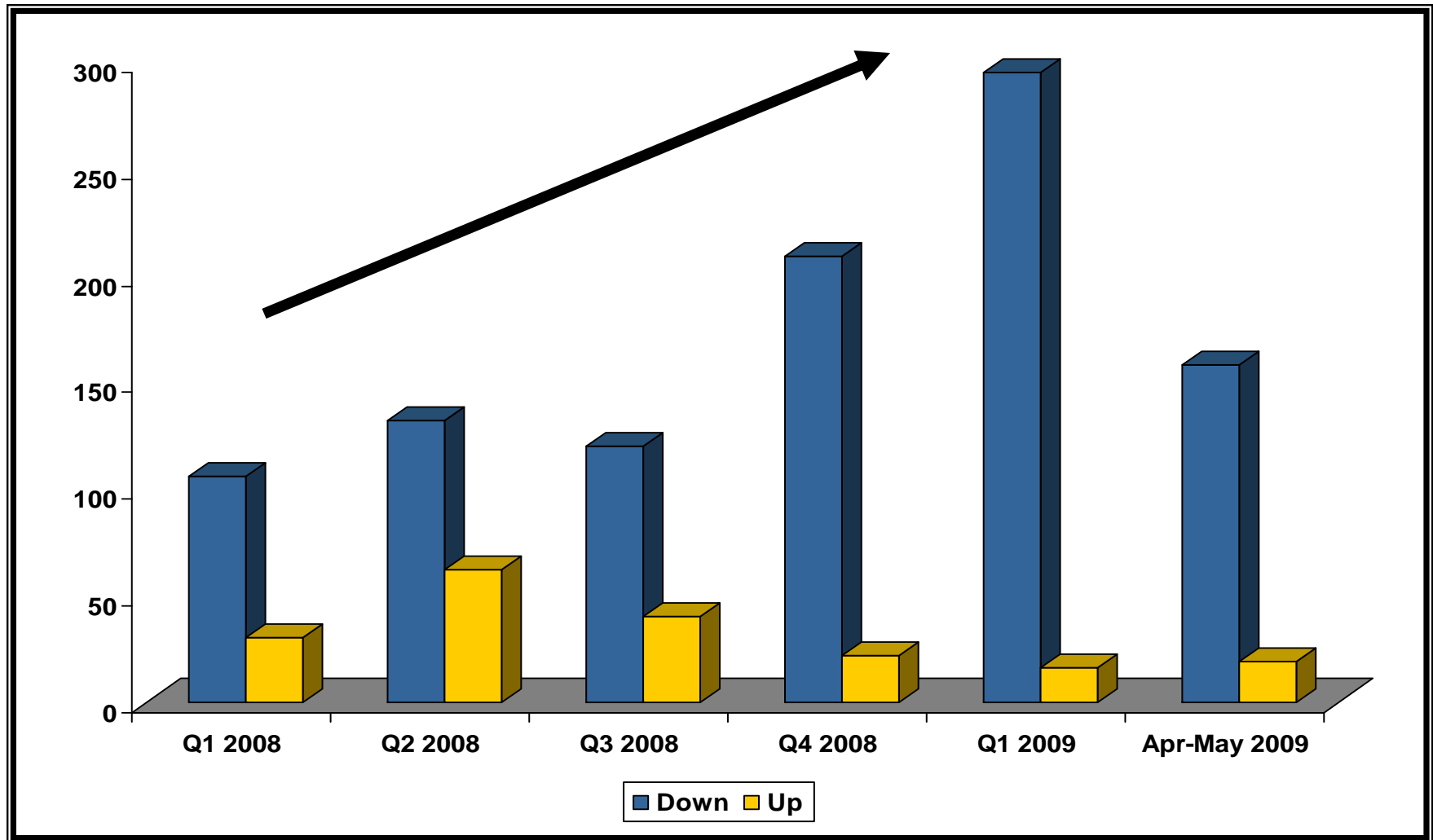
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Over 550 Downgrades in 2008; Over 450 YTD 2009



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“... You’ll Be A Utility, My Son!”

With Sincerest Apologies to Rudyard Kipling

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Standard & Poor's Ratings Matrix

<i>Financial</i> → <i>Vs.</i> <i>Business</i> ↓	Minimal	Modest	Intermediate	Significant	Aggressive	Highly Leveraged
Excellent	AAA	AA	A	A-*	BBB*	--
Strong	AA	A	A-	BBB	BB	BB-
Satisfactory	A-	BBB+	BBB	BB+	BB-*	B+
Fair	--	BBB-	BB+	BB	BB-*	B
Weak	--	--	BB	BB-	B+	B-
Vulnerable	--	--	--	B+	B	CCC+

*Median Utility/Corporate Rating

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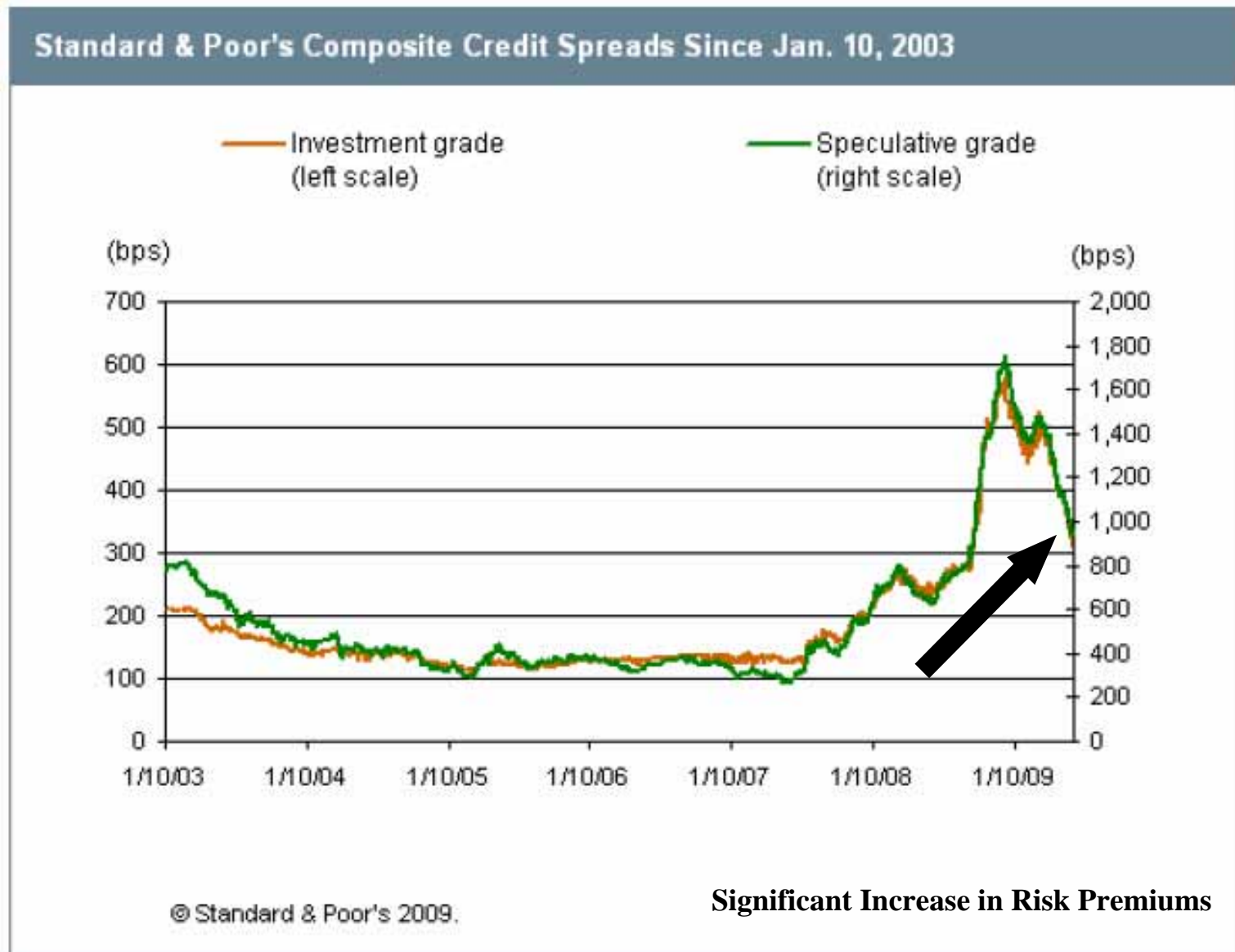
Current Credit Pressures

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Historical Composite Credit Spreads

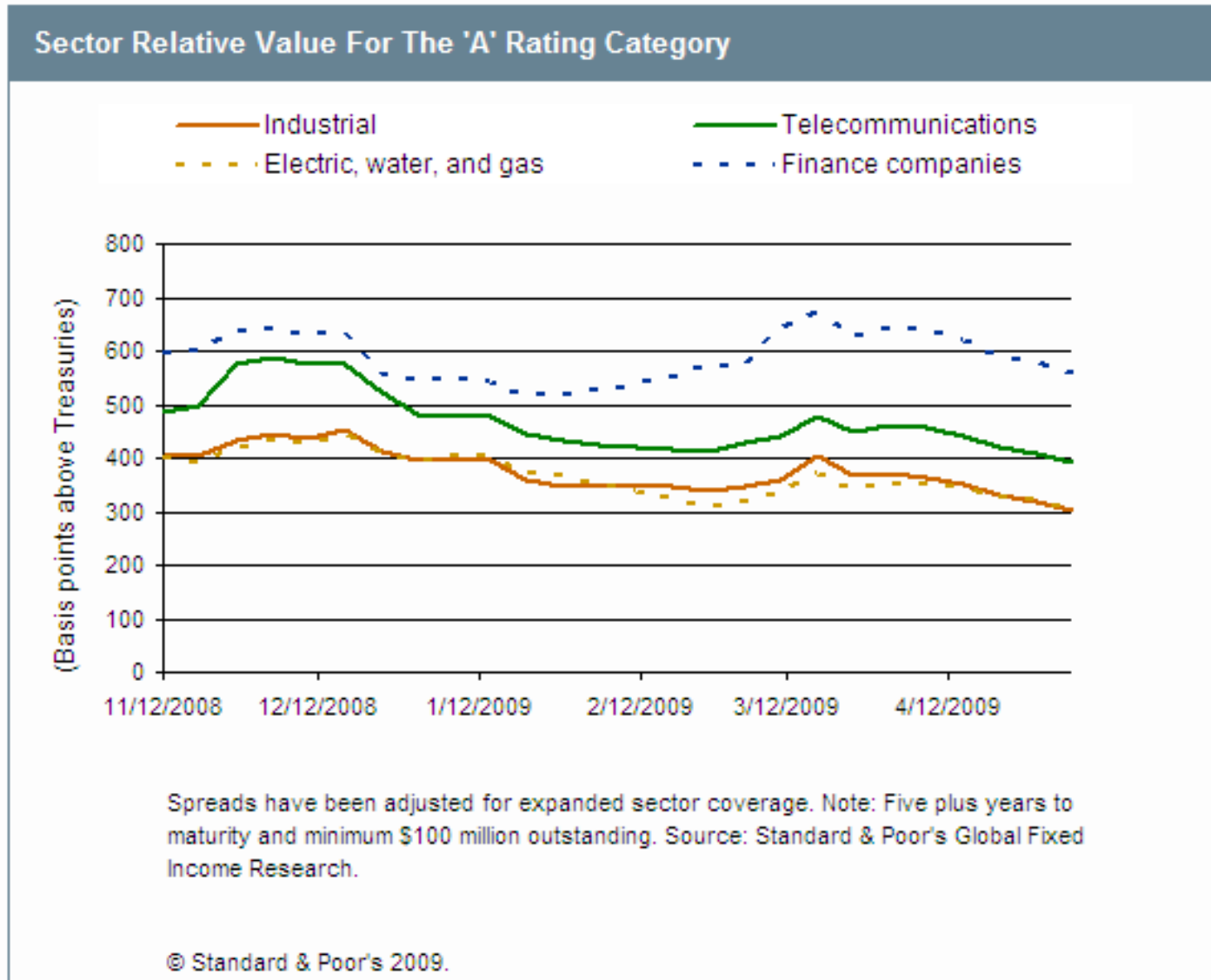


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Sector Relative Value For The 'A' Rating Category



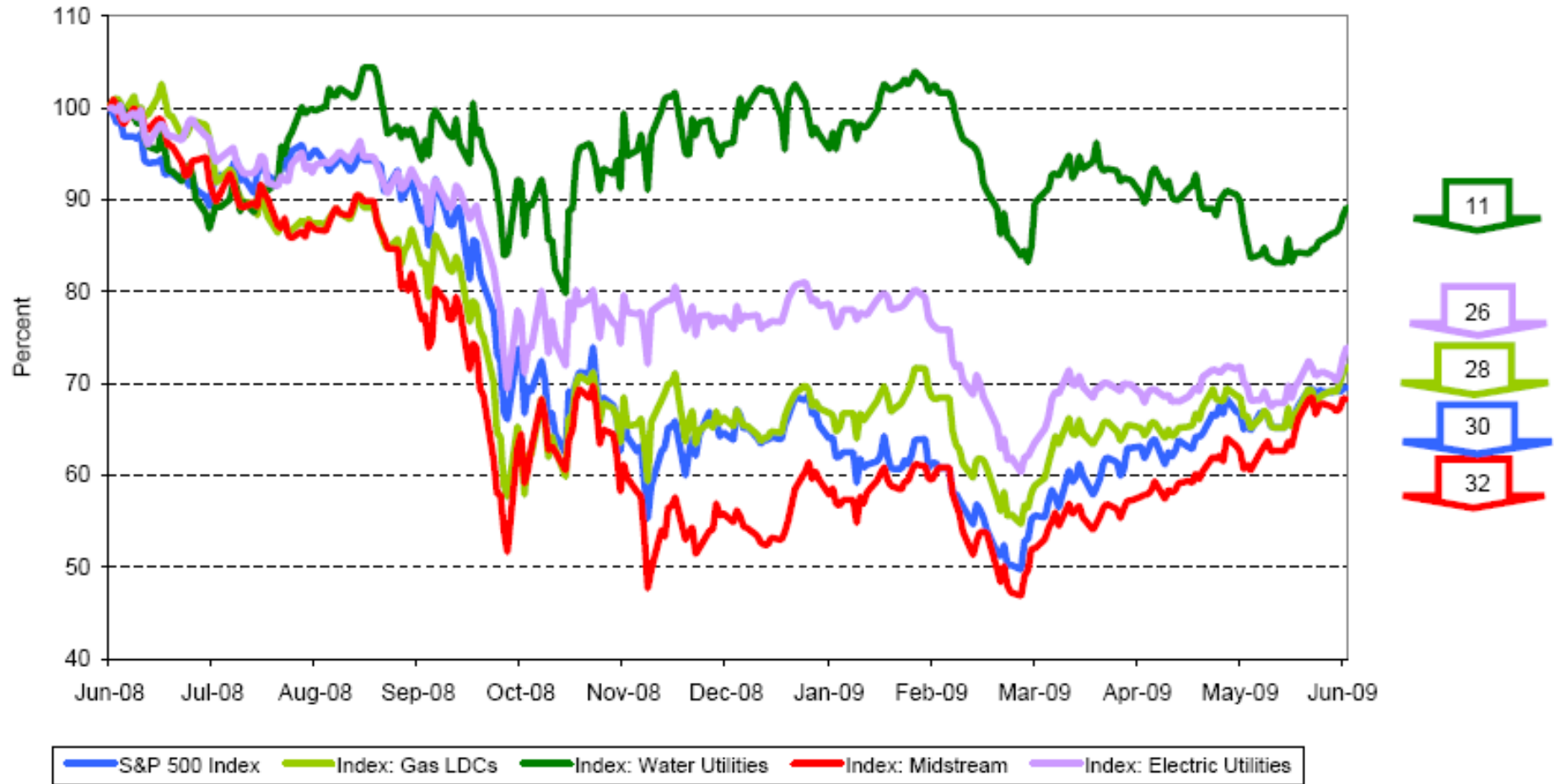
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Utility Shareholder Value Is Not Immune To Market Conditions

12-month Performance of Standard & Poor's Utility & Infrastructure Practice



Source: Capital IQ, Standard & Poor's Ratings Services.

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Regulation Will Continue To Be A Significant Credit Driver

➤ **Rate Cases Will Likely Be A Sustained Characteristic Of Utility Activity For Several Years**

➤ 42, 46, And 48 Rate Cases Filed in 2008, 2007, and 2006

➤ **Regulators Will Be Challenged To Achieve The “Right” Balance Among Various Conflicting Goals:**

➤ Customer Protection/Rate Constraint

➤ Upward Cost Pressures

➤ Depressed Economic Conditions

➤ Reliability of Service

➤ *Financially Healthy And Solvent Utilities*

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Principal Credit Themes We See Affecting Regulated Utilities

Regulatory Challenges In “Normal” Times:

- **Need for Substantial Infrastructure Spending**
 - Aging Infrastructure, Environmental Mandates
- **Increasing Labor/Benefits And Volatile Material Costs**

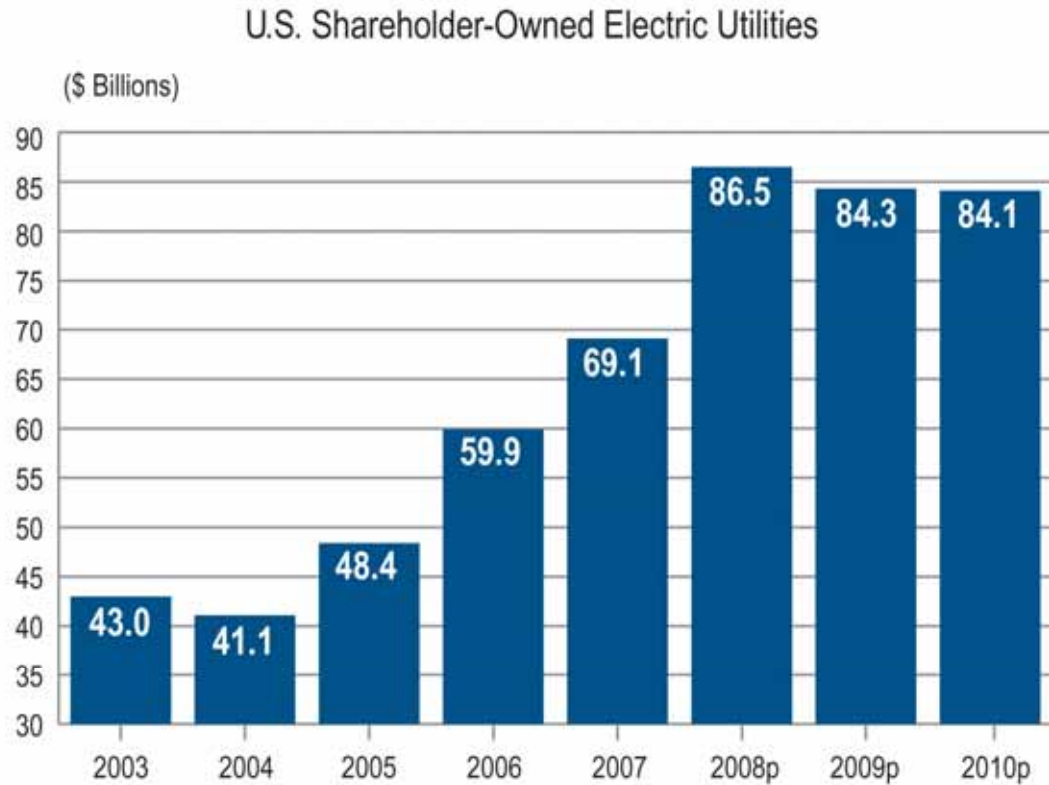
... Augmented By A Global Recession:

- **Stagnation And Even Decline In Customer Growth, At Least In Near Term**
- **Shrinking Capital Availability**
 - Uncertainty Of Liquidity/Borrowing Availability
 - Spiking Risk Premiums
- **Rising Bad Debt Expense**
- **Increasingly Underfunded Pension Plans**

One Consequence: Backlash To Ongoing Rate Hikes Is A Certainty, Increasing Pressure On Regulators To Lower ROEs, And Perhaps Encourage Deferral of Capex And Costs

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EEI Estimate Of Future Capital Spending



p = projected

Sources: EEI Finance Department, Company Reports, and SNL Financial.

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Characteristics Of Credit-Supportive Regulation

- **Consistency And Predictability Of Decisions**
- **Use Of Forward-Looking Measures**
- **Timeliness Of Rate Orders**
- ***Use Of Adjustment Clauses/Trackers***
 - ***Pass-through Of Purchased Power, Gas, And Water Costs***
 - ***Construction Work In Progress (CWIP)/Infrastructure Surcharges***
 - ***Decoupling***
 - ***Pre-Approval Of Significant Capital Outlays***
 - ***Environmental Mandates***
 - ***Conservation Expenses***
 - ***Demand Side Management***
 - ***Bad Debt Expense***
 - ***Pension Costs***
 - ***Et al***

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Investor-Owned Utility Ratings In The Late 1970's

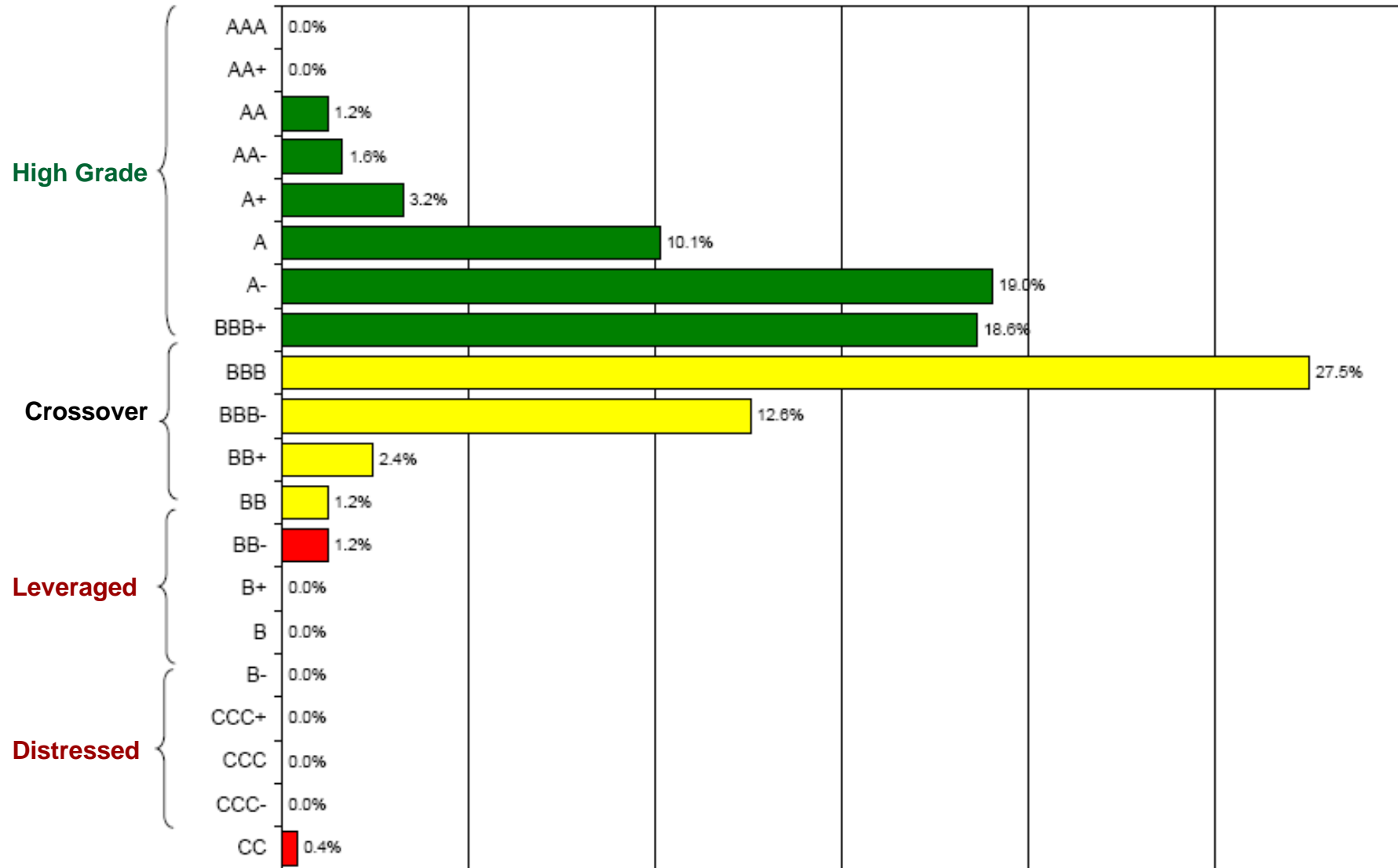
At The Beginning Of The Last Major Utility Generation Construction Cycle, Utility Senior Debt Ratings Were Typically In The **AA and A Category. Today, In Advance Of Another Major Capital Expenditure Period, Ratings Are Much Lower...**

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U.S. Utility Sector Ratings Distribution



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Ratings as of June 8, 2009

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U.S. Electric Utilities – Rating Trends

Stable Ratings Trend Are Supported By Expectations Of:

- Responsive Regulatory Actions
- Continued Access To Capital Markets
- Delay In New Base Load Construction (A Perverse Positive)
- A Relatively Smooth Transition To Deregulated Market Status (Contrast Illinois and Maryland With Ohio and Pennsylvania)

Longer Term, Higher Credit Ratings May Be Limited By:

- Substantial And Sustained Capital Expenditures
 - Regulatory Lag
- Recessionary Pressure on Cash Flow and Debt Balances
- Carbon Debate (Federal And ---Versus? --- State)
- Extracurricular Political Interference

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General Conclusions On The Utility Industry

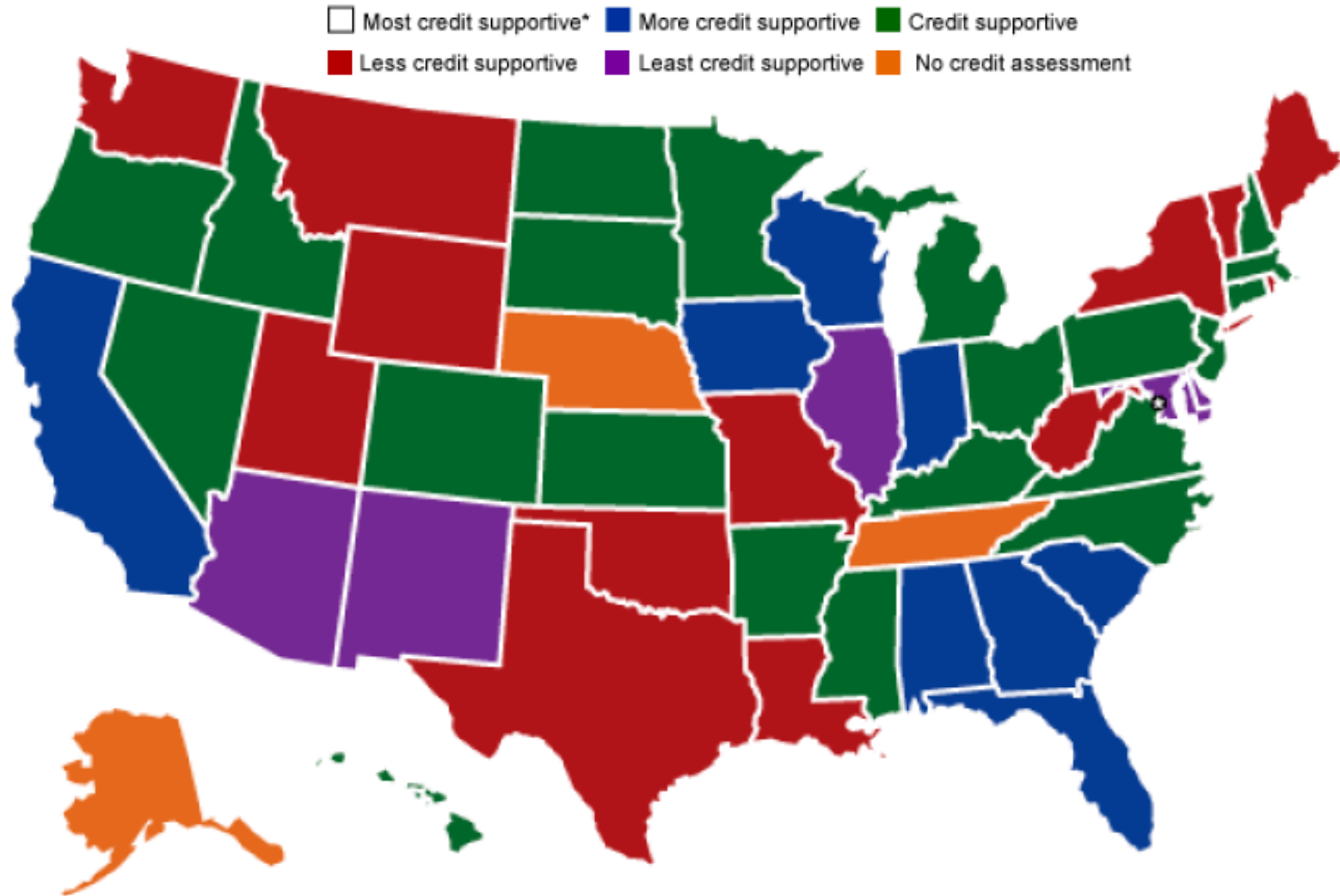
- **Regulated Utilities Appear As Well Positioned As Any Market Sector To Contend With The Currently Clogged Credit Markets**
- **The Liquidity That Utilities Secured During The Go-Go Years Of The Credit Push Should Serve Them Well**
 - **But Credit Will Become More Costly For An Indeterminate Period Of Time --- Permanently? --- And Refinancing Terms Will Be Dictated By The Banks**
- **Projects Will Be Delayed Where Possible, Which May Eventually Increase Longer-Term Threat To Reliability When The Economy Recovers**
- **Investors --- Fixed Income And Equity --- Are Signaling A Strong Focus On The Relationship Between Utilities And Their Commissions As Closely As They Ever Have**

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Standard & Poor's Assessment of State Regulatory Climates



Standard & Poor's Assessment Of MACRUC Jurisdictions Range From 'Credit Supportive' To 'Least Credit Supportive'

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Appendix

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Factors Reviewed for the Regulatory Climate Assessments

➤ **Ratemaking Factors**

- Cost Recovery And Earned Returns
- Ratemaking Timeliness
- Resource Procurement Process
- Oversight Of Large Capital Commitments, And
- Nontraditional Ratemaking Practices

➤ **Political Factors**

- Method Of Commissioner Selection
- Record Of Political Influence, And
- Behavior Of Influential Interveners

➤ **Financial Stability Factors**

- Rate Treatment Of Large Capital Expenditures
- Rate Treatment Of Large Expenses
- Cash Flow Metrics Of Regulated Utilities, And
- Rate Design

The assessments are of the whole jurisdiction, not just the regulatory body.

The assessments are done on an absolute basis, not on a relative scale.

The assessments are made from a credit perspective.

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Standard & Poor's Role in the Capital Markets

Investors And Issuers Use Credit Ratings Because They Provides Investors, Traders And Counterparties...

- ***An Independent, Objective And Forward Looking Opinion Of Creditworthiness***
- ***A Global Benchmark For Investors To Evaluate Risk/Reward Metrics And Compare Credit Risk Among Peers***

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What Is A Credit Rating?

A Credit Rating Represents An Opinion Regarding ...

- The Likelihood That An Issuer Will Default On Its Financial Obligations
- The Capacity And Willingness Of An Issuer Or Obligor To Make Timely Payments In Accordance With The Terms Of The Obligations
- **Credit Analysis Resulting In Assignment Of A Rating Opinion Is An Art, Not Science**
- **A Credit Rating Is The Result Of Qualitative And Quantitative Assessments, As Well As Historic And Prospective Data And Analysis**
- **It Is One Of Many Tools Used By Investors To Make Investment Decisions**

While A Rating Is The Result Of Independent, Objective Analysis

...

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What Is A Credit Rating Not?

***It Is Not a Recommendation to Buy, Sell
or Hold a Security***

***It Is Not an Audit of Obligors' Financial
Statements***

It Is Not An Indicator Of Investment Merit

It Is Not A Guaranty Of Credit Quality

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