



M&A activity in the electric utility sector

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September 20, 2005

Merger and Acquisition defined

Merger:

- (1) Acquisition in which all assets and liabilities are absorbed by the buyer
- (2) More generally, any combination of two companies

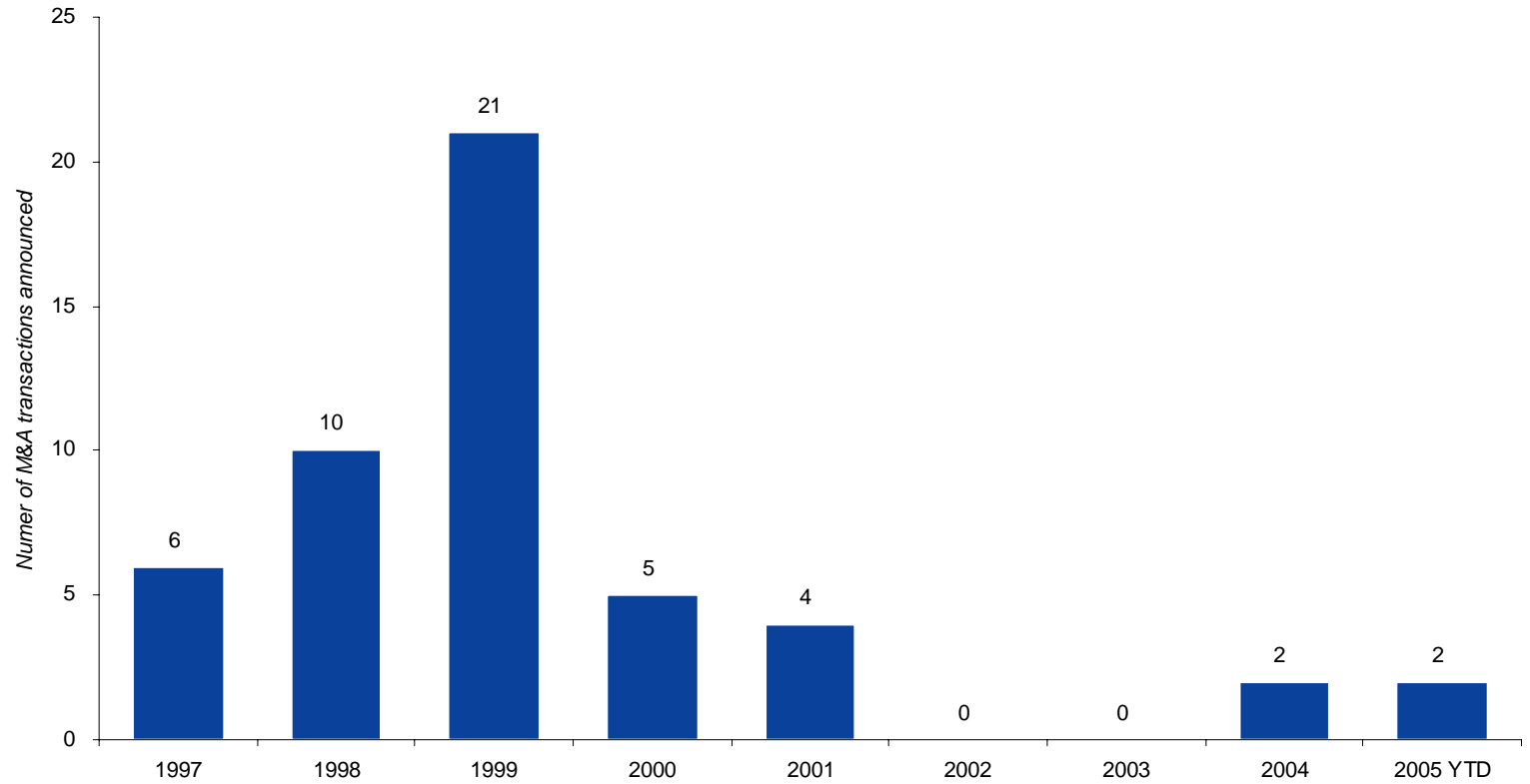
Acquisition:

When one firm buys another firm

Source: Campbell R. Harvey's Hypertextual Finance Glossary, Fuqua School of Business, Duke University

Major electric utility M&A transactions

Annual number of M&A transactions



Note: Transactions recorded as of date of announcement
Source: Deutsche Bank

Recent M&A activity in the U.S.

- July 25, 2004: PNM Resources to buy TNP
- December 20, 2004: Exelon to merge with PSEG
- May 9, 2004: Duke Energy to merge with Cinergy
- May 24, 2005: Berkshire Hathaway to acquire PacifiCorp.

Recent M&A activity in Europe

- August 10, 2005: Suez buys remaining Electrabel stake
- September 6, 2005: Gas Natural launches hostile bid for Endesa
- September 7, 2005: E.ON announces considering Scottish Power bid
- September 12, 2005: Petronas buys 4% stake in Centrica

Wall Street's view: Mixed but improving

- History suggests deals are difficult to complete on average and execution risk is high
- Regulation has been neutral to negative
- Social issues have driven a lot of deals

But.....

- Recent transactions have been more focused
- Stock prices have reacted more favorably
- PUCHA repealed in Energy Policy Act of 2005
- Regulatory review COULD get more accommodative

Historically deals have been difficult

- Regulatory approval has generally taken 14-18 months, and in some cases more than two years
- Acquirer's stock price has generally underperformed after a major transaction closes
- Companies have rarely immediately exploited competitive advantages and best practices
- Overall, execution risks of mergers in the electric utility industry have been high

Regulation has been challenging

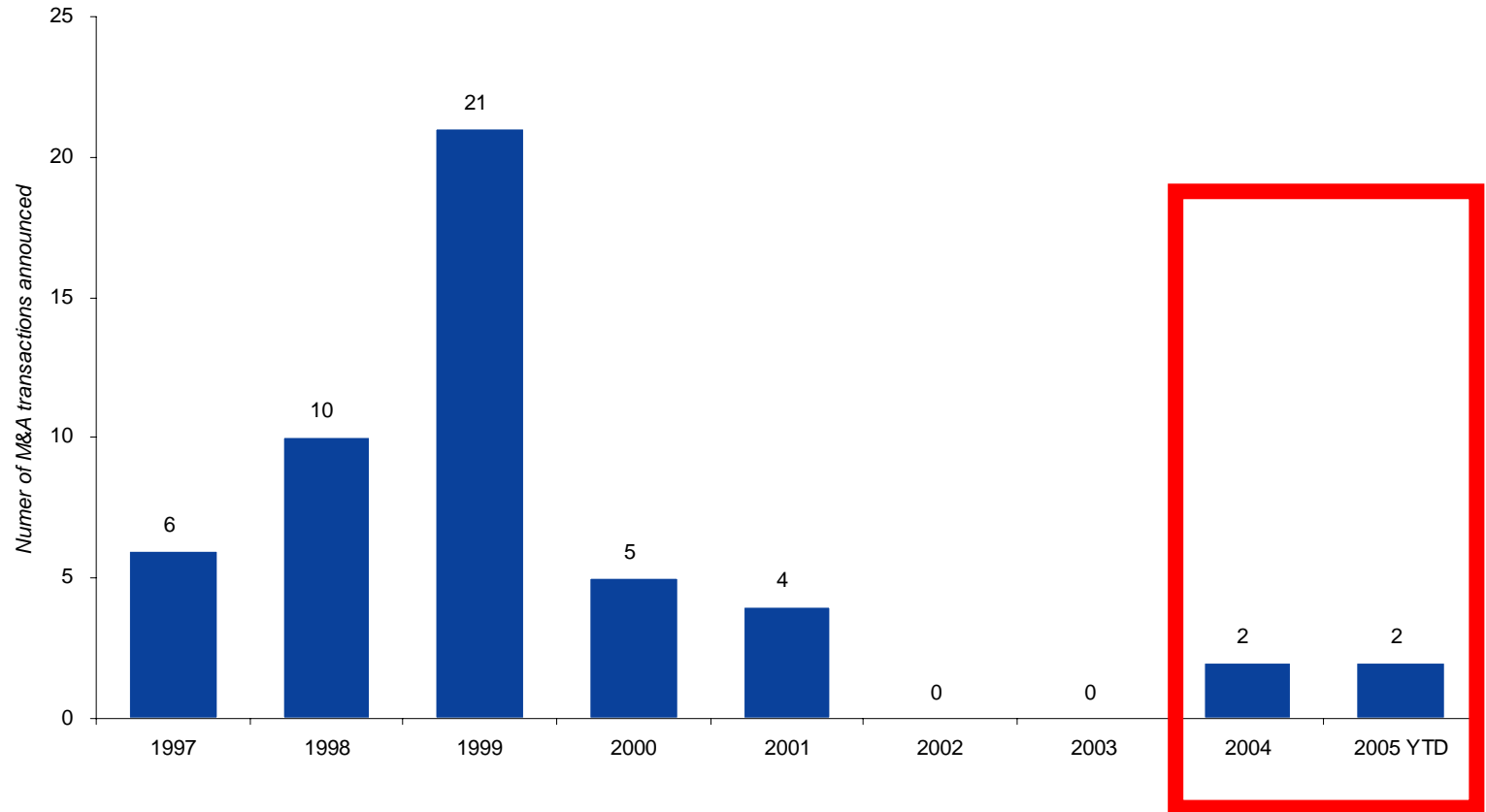
- Time from announcement to close has been long
- Front-end loading of merger benefits generally required
- PUCHA interconnection requirements
- FERC versus State issues on deregulation and RTO's

Social issues have driven deals

- Old or retiring CEO
- Contiguous “next-door neighbor”
- Opportunistic transactions limited

Major electric utility M&A transactions

Annual number of M&A transactions



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Renewed trend of M&A likely to continue

- New breed of managers are increasingly focused on competitive advantages and value creation
- Rising commodity prices and a new wave of capital spending will force managers to look at strategic alternatives
- After the industry's "bust" of 2002, investors will support and applaud focused consolidation that relies on competitive advantage
- PUCHA repeal will increase the number of potential buyers

Transactions more focused recently

- Exelon – PSEG
 - Exelon’s nuclear expertise
 - PSEG’s distribution expertise

- Duke Energy – Cinergy
 - Cinergy’s commodity expertise
 - Duke’s Midwest generation

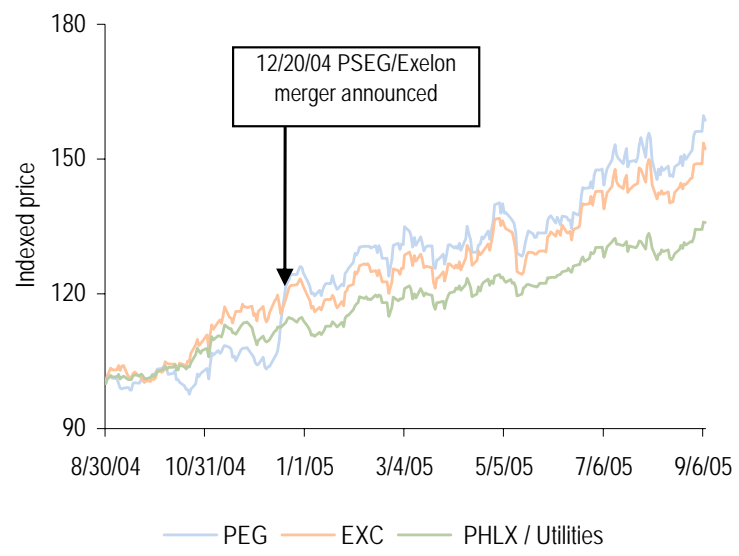
- Berkshire Hathaway – PacifiCorp.
 - Scale and U.S. ownership

Rising retail electric prices lead to consolidation

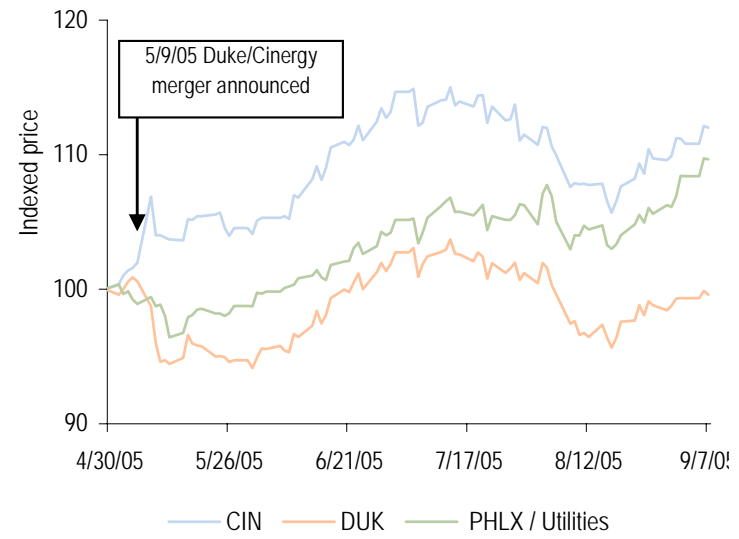
- High fuel prices, rising labor and pension costs and increasing capital expenditures are likely to lead to rising retail electricity prices over the next several years
- Importantly, with a benign inflation outlook, retail electricity prices are likely to rise at a rate significantly faster than inflation
- As regulators have enjoyed a period of very few real price increases in the period 1985-2000, it is questionable how regulators will react to steadily rising real electricity prices
- If consolidation can control or mitigate price increases through best practices, core competencies and economics of scale, we believe regulators may become more constructive towards additional consolidation in the US electric industry

Stock price reaction has been positive

Exelon and PSEG



Duke and Cinergy



Source: FactSet Research Systems, Inc

Implications of PUCHA repeal and 2005 Energy Bill

- The Energy Policy Act of 2005 repeals PUCHA, among other things, and is likely to support the trend of consolidation in the US electric utility industry by eliminating:
 - reporting requirements of “registered holding companies”
 - geographic restrictions and interconnection requirements
 - restrictions on investments in less regulated businesses
- Without PUCHA, more non-utility companies, including financial firms, industrial concerns and foreign utility companies are likely to seriously explore investments in the sector
- The Energy Policy Act also gives FERC broadly more authority to regulate the industry
 - more M&A approval authority
 - reliability oversight and enforcement authority
 - authority over market transparency, enforcement and consumer protection
- The Energy Policy Act eliminates the qualifying facility ownership restrictions under PURPA, which could also promote M&A activity

Conclusions

- Wall Street views of consolidation in the electric utility industry are improving
- Successful mergers should be properly financed, exploit competitive advantages for corporate constituents, and help moderate the rising real price of electricity
- Rising price of electricity in real terms could cause regulators to be more accommodating of industry consolidation
- REMEMBER: MANAGERMENTS actively create value, M&A offers managements value creation opportunities
- ALL CONSTITUENTS need to avoid the “herd” mentality