Expected Boom in Capital Spending – What Investors Expect From Regulation
March 15, 2011 - Sante Fe, New Mexico

Peter Kind | Macquarie Capital | (212) 231-1355
Remarks Summary

- **Financial Outlook**
  - Capital expenditures and cash flow implications
  - Recent returns on capital
  - Credit quality trends
  - Recent equity performance
  - Implications for capital raising

- **Investor Considerations**
  - Industry overall
  - Company specific

- **Introduction to Infrastructure Investor Class**
Capital Expenditures
U.S. SHAREHOLDER-OWNED ELECTRIC UTILITIES

US Electric IOU Capital Expenditures

Free Cash Flow (“FCF”) 2000-Present

Source: SNL Financial and EEI Finance Department
Return Trends – Authorized & Earned

Average Awarded ROE vs. Filed Rate Cases

U.S. Shareholder-Owned Electric Utilities

Source: SNL Financial/Regulatory Research Association, and EEI Rate Department

ROE Spread vs. Pre-Dividend FCF 1973-2013E

Pre-Div FCF in 2008 $'s
Actual less Allowed ROE

Note: Figures reflect Barclays Capital utility coverage scaled up by a factor of 1.08x to reflect companies not in the Barclays Capital coverage universe

Source: FactSet and Barclays Capital estimates
Earned Versus Allowed ROE

Vertically Integrated Utilities

<table>
<thead>
<tr>
<th>Company</th>
<th>Earned ROE</th>
<th>Under Earning (1)</th>
<th>Over Earning (2)</th>
<th>Authorized ROE</th>
</tr>
</thead>
<tbody>
<tr>
<td>CNL – Cleco</td>
<td>10.70%</td>
<td>10.80%</td>
<td>10.70%</td>
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<tr>
<td>EDE – Empire District Electric</td>
<td>13.25%</td>
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<td>NVE – NV Energy</td>
<td>10.00%</td>
<td>9.90%</td>
<td>11.00%</td>
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<tr>
<td>EE – El Paso Electric</td>
<td>10.70%</td>
<td>10.80%</td>
<td>10.70%</td>
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<tr>
<td>GXP – Great Plains Energy</td>
<td>11.00%</td>
<td>9.90%</td>
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<td>PNW – Pinnacle West</td>
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<td>NI – NiSource</td>
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<td>CMS – CMS Energy</td>
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<td>LNT – Alliant Energy</td>
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<td>IDA – IDACORP</td>
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<td>AVA – Avista</td>
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<td>SCG – SCANA</td>
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<td>PCG – PG&amp;E</td>
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<td>XEL – Xcel Energy</td>
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<td>WR – Westar</td>
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<td>NWE – Northwestern</td>
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<td>WEC – Wisconsin Energy</td>
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<td>VVC – Vectren</td>
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<td>SO – Southern Co</td>
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<tr>
<td>UNS – Unisource Energy</td>
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<tr>
<td>AWK – American Water Works</td>
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<td>SJW – San Jose Water</td>
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<td>AWR – American States Water</td>
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<td>MSEX – Middlesex Water</td>
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<td>ARTNA – Artesian Resources</td>
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<td>CTWS – Connecticut Water</td>
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<tr>
<td>CWT – California Water Services Group</td>
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<td>WTR – Aqua American</td>
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Source: SNL, Company Website, Research Reports. (1) Gap between earned and latest known allowed ROE
Credit Trends
U.S. SHAREHOLDER-OWNED ELECTRIC UTILITIES

S&P Bond Ratings December 31, 2001

- BBB+: 24%
- BBB: 26%
- BBB-: 8%
- A: 17%
- A-: 10%
- Below BBB-: 8%

S&P Bond Ratings December 31, 2010

- BBB+: 29%
- BBB: 23%
- BBB-: 10%
- A or higher: 6.0%
- A-: 19%
- Below BBB-: 8.0%

Direction of Rating Actions

Source: Fitch Ratings, Moody’s, and Standard & Poor’s

Source: Standard & Poor’s, SNL Financial, EEI Finance Department, and company annual reports
Industry Earned Returns Result in **BBB-Metrics**

<table>
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<tr>
<th>Median Utility Credit Metrics</th>
<th>BBB</th>
<th>A</th>
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<tbody>
<tr>
<td>FFO Interest Coverage</td>
<td>2.75x</td>
<td>4.25x</td>
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<tr>
<td>FFO to Total Debt</td>
<td>18%</td>
<td>27%</td>
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</tbody>
</table>

Source: Standard & Poor’s

### Example

- Rate Base = $100
- Debt/Capital = 56.5%
- Depreciation Rate = 3%
- Interest Cost = 5.5%
- Authorized ROE = 10%

```
“Authorized” Credit Metrics at Current Interest Rates
- FFO Interest Coverage = 3.4x
- FFO to Total Debt = 18.5%
```

```
“Realized” Credit Metrics at Current Interest Rates
- FFO Interest Coverage = 3.1x
- FFO to Total Debt = 16.9%
```

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“Realized” Credit Metrics at Normalized Interest Rates*
- FFO Interest Coverage = 2.4x
```

*Normalized Interest Rate of 7% assumed
Utility Sector 10-Year Performance

PHLX UTILITY SECTOR vs. S&P 500
Indexed Price Performance March 4, 2001 - March 4, 2011

- PHLX / Utility
- S&P 500

Price Returns (not annualized)

10 Year Annualized Total Return (Dividend Reinvested)
- PHLX Utility: 5.6%
- S&P 500: 2.6%

Source: FactSet, Bloomberg
Implications for Future Capital Raising
WHY THE FUTURE WILL BE DIFFERENT

- Utility industry fundamentals have consistently declined over time
- Utilities lag markets during economic recovery
  - See graph on left
- Significant capital needs (e.g. new generation, retrofits) will put pressure on credit ratings, credit availability and cost of capital
- Boards will be focused on fiduciary responsibilities and past industry history during capital expenditures booms
  - i.e. disallowances, dilutive capital raising and chapter XI's

Source: FactSet, Bloomberg
Market / Book Value Over Time

Dec-00 to Dec-10

Market / Book Value

PNM Resources  Pinnacle West  NV Energy
## Investor Perspectives on Utility Sector and Coming Boom

### Industry Considerations

**Lenders**
- Policy direction impacting future energy supply and investment
  - e.g. HAPS, renewables, etc…
- Economic growth and impact on energy usage and pricing considerations
- Adequacy of regulatory model to support public policy goals

### Company Specific Considerations

- Liquidity needs of business
  - Financial returns and risk concentration to banks on provision of liquidity
- Stability of credit
  - Quality, stability and transparency of regulatory environment
    - Are cost/investment trackers in place to mitigate regulatory lag?
  - Business risk of LOB’s and management tolerances in business plan
  - Achieving stable credit metrics and earning a reasonable ROIC

**Infrastructure Investors**
- Same as Lenders

### Company Specific Considerations

- Regulator support for private capital ownership, including transparency of regulation and process
- Ability to earn ROE consistent with financial model
  - Stable returns
  - Ability to earn authorized returns
  - Ability to minimize regulatory lag
- Opportunity to grow capital base consistent with market return expectations
## Infrastructure Investment Class

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Earn stable investment returns over a long-term investment horizon</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investors</td>
<td>Predominantly pension/retirement funds, seeking stable returns to support pension obligations</td>
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<tr>
<td>Example of Asset Class</td>
<td>Utilities</td>
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<tr>
<td></td>
<td>Airports</td>
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<td>Toll roads</td>
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<td>Parking</td>
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<tr>
<td>Utility Attributes Sought</td>
<td>Qualifying utility operations and service areas</td>
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<td>Constructive regulatory environment</td>
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<td>Investment grade quality business</td>
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<td>Growth capital deployment opportunities</td>
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Macquarie’s Utility Expertise Worldwide

Macquarie Capital Funds has ownership interests in 32 utility and energy assets around the world with a value in excess of $25 billion. Macquarie Capital Advisors has advised Macquarie Capital Funds on all of its acquisitions in addition to numerous third-party clients in the industry worldwide.

### Macquarie Capital Fund Assets

- Waste Industries
- NMRE
- TanQuid Oil Storage
- EPR (Europe) Wind Portfolio
- CLP Envirogas
- Thames Water
- Bippin & Holleben Windfarms
- Wales & West Gas Distribution Network
- Biomass Renewable Portfolio
- Capital Meters
- NRE Gas & Electricity Distribution**
- Obregas Net
- Renewable Energy Systems
- Waste Industries
- Thermal Chicago
- Chicago Thermal
- Alberta Transmission
- Grid Acquisition
- Puget Energy
- Puget Energy
- Chapais Biomass Facility
- Erie Shores Windfarm
- The Gas Company
- Cardinal Power
- Aquarion Water Company
- Duquesne Light
- Kelvin Power
- Alinta Gas Networks
- South Australian Transmission
- West Sea Power/ West Sea Gas
- Multinet Gas Distribution
- SK Energy Services

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**Note:** The table and diagram illustrate the various utilities and energy assets managed or advised by Macquarie Capital Funds and Advisors.