

A Bond Investor's View on Utilities

Camput – April 2008

Bond Background

- Bonds and other fixed borrowing typically make up 60-70% of utility balance sheets
- Utilities have traditionally been one of the few sectors able to raise 30-year debt
- Generally utilities have been able to raise funds cheaper than many other sectors
 - Stable regulatory environment critical in maintaining cost pass through and capital structure
- Significant capital programs will require significant new financing

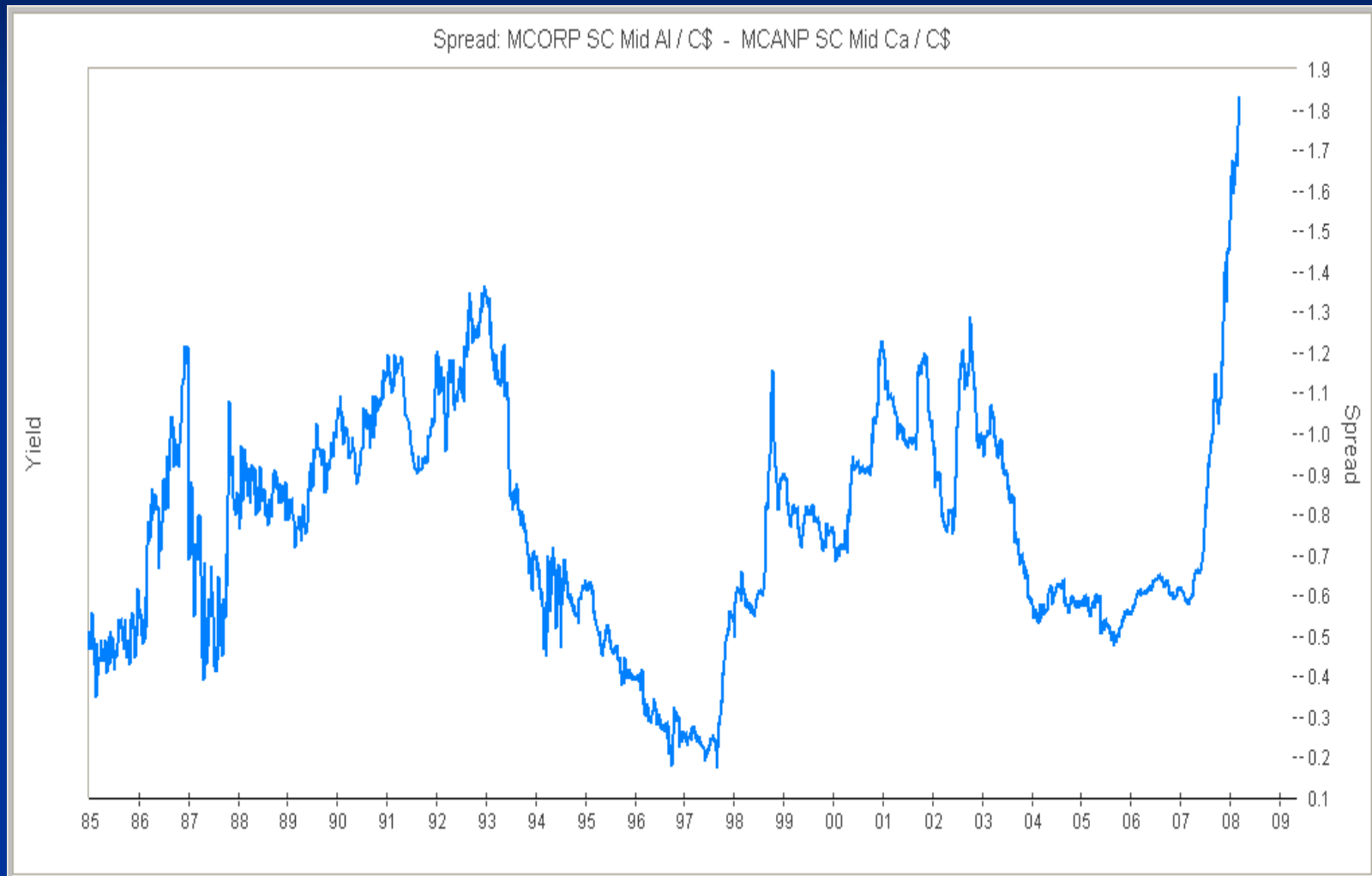
Bond Investor and Regulator Interests Are Similar

- Stable companies for the long-term
- Reasonable compensation for reasonable levels of risk
- Companies incented to invest for the long-term and maintain current assets
- Ability to raise funds at a cheaper cost
- Ability to access capital when needed
 - Both requiring the need to maintain minimum credit ratings

What is going on in the Markets

- Crisis of confidence in the financial systems
 - Generally aggressive underwriting over the past few years, in part as risk was being off loaded
 - Subprime, LBO, CDO, ABS CP etc. etc.
 - Leveraged entities begin to fail (hedge funds etc.) leading to counterparty risk and asset liquidation
 - Banks unwilling to lend to each other and credit investors not very interested in buying more corporate debt
 - Forced the Central Banks to cut rates aggressively and take historic liquidity measures

Current Spreads



All In Funding Costs

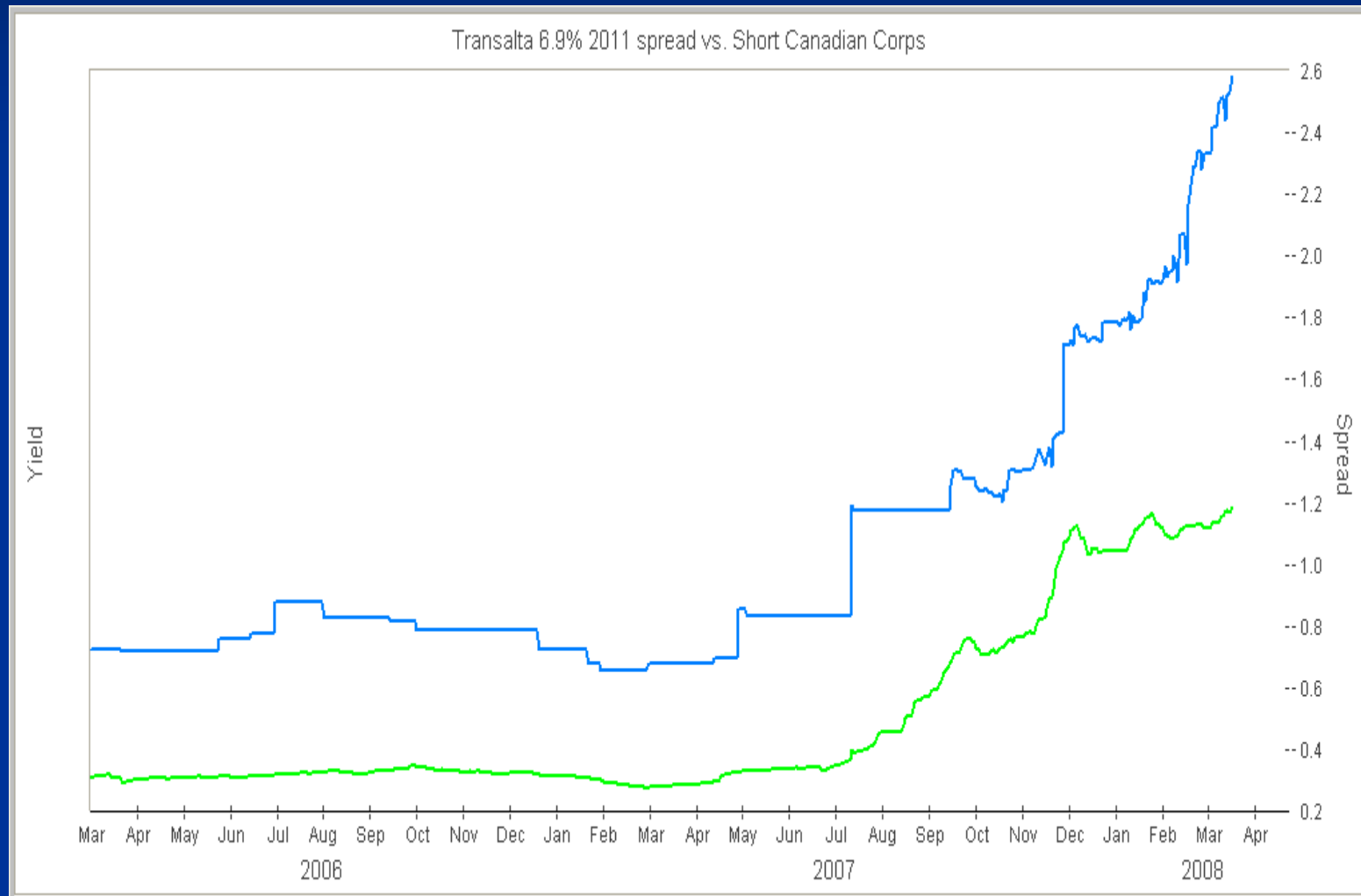
	June 2007	March 2008
5-Year Utility	5.10% (55)	3.95% (115)
30-Year Utility	5.70% (110)	5.50% (150)

All in yield (spread)

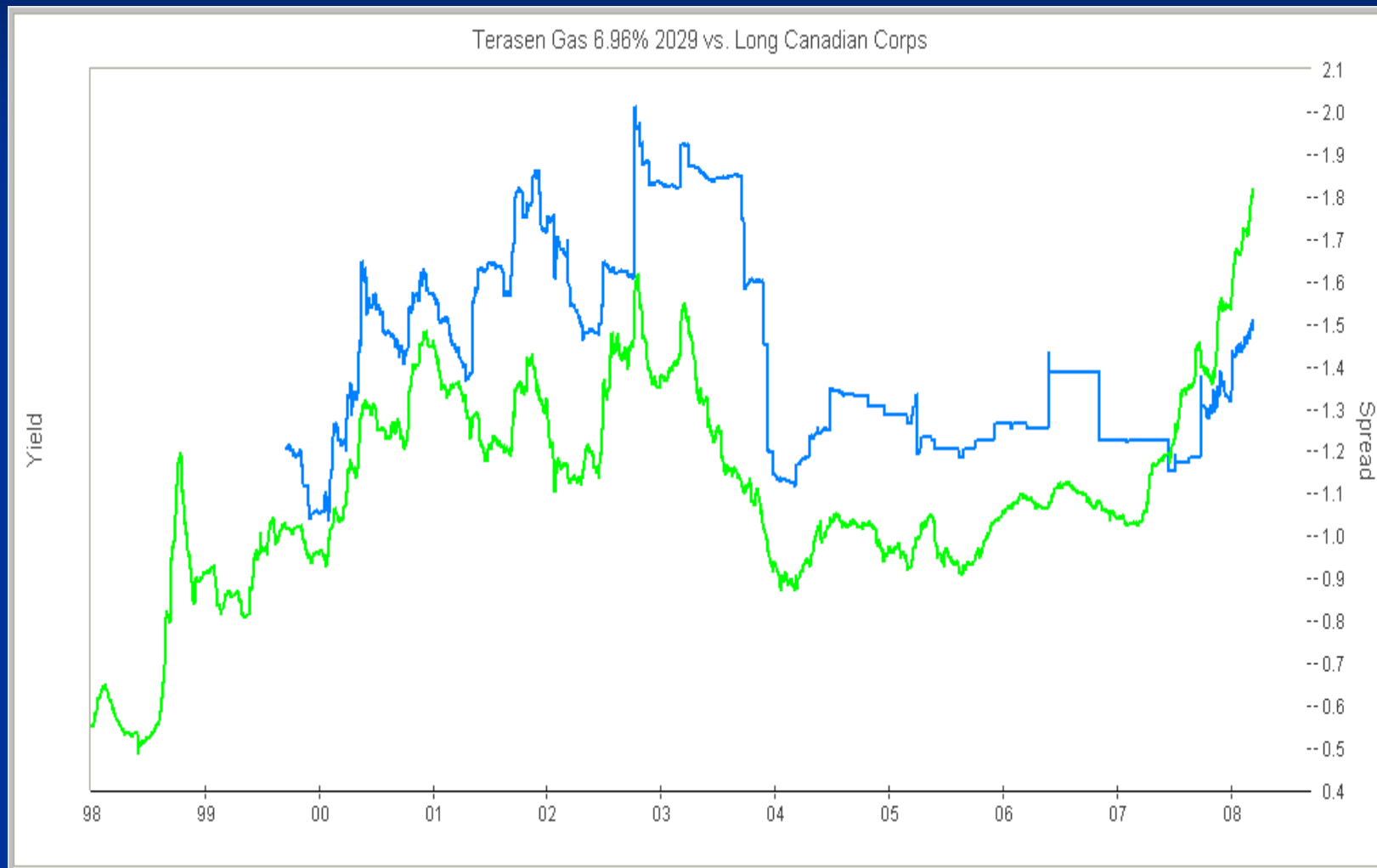
Bond Investor Issues

- ROEs too low
- Leverage is too high
 - Impact of both is that low returns at the operating company level incents more risk being taken at the holding company level
 - Could incent less investment in current or future assets
- Regulators don't look to the impact of the owner and the strain that could put on the utility

Takeover/Leverage Risk Impact on Spreads



Takeover/Leverage Risk Impact on Spreads (Cont'd)



What Covenants Can Help?

- Maximum debt/capital with all debt being accounted for
- Change of Control with Canada calls (not just at par)
- Coverage tests (interest coverage, dividend coverage)
- Step-ups (interest rates increase as ratings go down)

What Do We See in Other Regulatory Markets that Helps?

- Minimum credit rating levels at the operating company (ie. Maintenance of investment grade rating, normally low A or high BBB)
- Longer decision periods (3-5 years)
- Incentive regulation that is achievable
- Explainable and consistent decision making