

# FINANCIAL FOCUS

INDUSTRY STUDY

April 1, 2010

## ELECTRIC UTILITY QUALITY MEASURES: Rankings and Trends Calendar Years 2005-2009

Slower sales in a weak economy and added pressure from mild summer weather in many regions, combined with weak wholesale prices, contributed to continued erosion of utility financial quality in 2009, as gauged by the statistics in this report. Average earnings per share (EPS) in 2009 for our universe of 47 companies were up only slightly from year-earlier levels. Profits in 2008 were essentially unchanged from those posted in 2007. Recall that robust EPS growth ranging from 6% to 9% annually was experienced during the three-years 2004 through 2006. (See Appendix B for details).

The profit decline in 2009 occurred in spite of industry-wide cost-cutting and significant rate cases. Electric base rate hikes for the industry totaled \$4.1 billion, considerably higher than the \$2.9 billion in 2008 and the \$1.4 billion to \$1.5 billion annual levels in 2005-2007. Gas base rate increases, which traditionally are below electric increases by a wide margin, totaled \$475 million in 2009, representing a sharp drop from \$885 million and \$813 million in 2008 and 2007, respectively. (See the Special Report, Major Rate Case Decisions-January--December 2009 for details).

The industry's average earned return on equity, which held fairly steady around 12% for the three years 2005 through 2007, slipped to 11.4% in 2008, and fell further to 10.9% for the 12-month period ended December 31, 2009. Despite recent income statement and related ROE erosion, the financial health of the industry remains well above that experienced in the years 2000-2002, when most ratios deteriorated meaningfully in response to competitive problems and higher-risk investments.

This report is largely based on information contained in the SNL Energy database, which is compiled from the 10-K, 10-Q, and FERC Form 1 filings of utility parent and subsidiary companies. In some cases, certain utilities provide less detail in these federal filings than we need for all of our calculations. Where possible, we fill voids with alternative calculations. If not possible, we mark the data n.a. or n.m. Tables I through XI utilize consolidated holding company data in computing the various quality measures for 47 companies. Therefore, the resulting qualitative statistics are impacted by the positive or negative effects of non-utility activities.

Regarding the consolidated earnings included in our calculations, the effects of non-recurring items, such as discontinued operations, write-offs, mark-to-market valuation changes, prior-period tax settlements, or other one-time accounting adjustments, are generally removed. These "adjusted" earnings are compiled from Thompson First Call and represent a consensus of analyst estimates. Note that earnings for utility subsidiaries are also adjusted for most non-recurring items using the SNL database. However, due to limitations caused by SEC reporting practices, subsidiary earnings are not adjusted for period tax settlements. Subsidiary earnings also do not reflect subjective one-time adjustments.

The following paragraphs include discussions of the specific measures covered in this report. Financial ratio definitions and clarifications are shown in Appendix A. Annual EPS that provide a basis for our consolidated income calculations are shown in Appendix B.

Table I - Financial Statement Data - This table provides the basic dollar statistics, in millions, that were used to calculate the current quality measures listed in Tables II and IV - XI. The 47-company totals, shown at the bottom of Table I in billions of dollars, represent a proxy for total industry financial statistics as of December 31, 2009.

Table II - Summary of Quality Rankings - This two-page table summary displays the current utility rankings for eight quality measures. Data for these measures are presented in greater detail in Tables IV through XI.

Table III - Alphabetical Listing - Three-Year Growth Rates - This table shows the rankings of three-year growth rates for dividends per share, EPS, and book value per share.

Table IV - Pretax Interest Coverage - This is perhaps the most important measure utilized by rating agencies and bond analysts in determining credit quality. The average interest coverage stood at 3.21x for the 12 months ending December 31, 2009, down from the calendar-2008 level of 3.34x, and considerably lower than the 3.52x for calendar-2007. Average interest coverages were higher during the 1990's, declined during

**Appendix A****FINANCIAL RATIO DEFINITION AND CLARIFICATIONS**

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Tables II and III: The Growth Rates contained in these tables were calculated on a compound basis for dividends per share and on an average annual basis for earnings per share and book values per share

Tables IV and XII: **Pretax Interest Coverage:**  
$$\frac{\text{Net Income} + \text{Gross Interest} + \text{Income Taxes}}{\text{Gross Interest}}$$

Tables V and XII: **Overall Fixed Charge Coverage:**  
$$\frac{\text{Net Income} + \text{Gross Interest}}{\text{Gross Interest} + \text{Pfd. Dividends}}$$

Tables VI and XII: **Cash Flow Coverage of Dividend:**  
Net for Common + Depr. + Amort.  
$$\frac{+ \text{Def. Taxes} + \text{Deferred ITC}}{\text{Common Dividends Declared}}$$

Tables VII and XII: **Dividend Payout Ratio:**  
$$\frac{\text{12 month Trailing Dividends Paid as per Cash Flow statement}}{\text{Net for Common as per Adjusted First Call Earnings}}$$

Tables VIII and XII: **Return on Average Common Equity:**  
$$\frac{\text{Net for Common}}{\text{Average Beginning and End of Period Common Equity}}$$

Tables IX and XII: **Return on Total Capital:**  
$$\frac{\text{Net Income (bef. Pfd. Div.)}}{\text{Total Capital (incl. S-T debt)}}$$

Tables X and XII: **Capital Structure Data:** Capital components are based upon percentages of total capital including short term debt. Short term debt component includes long term senior capital due within one year.

Table XI: **Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA):**  
Revenues - (Energy Expenses + Cost of Gas Sold + Total O&M + Non-income Taxes)