



# Financing for the Future — Can We Afford It?

Mike Hardgrove

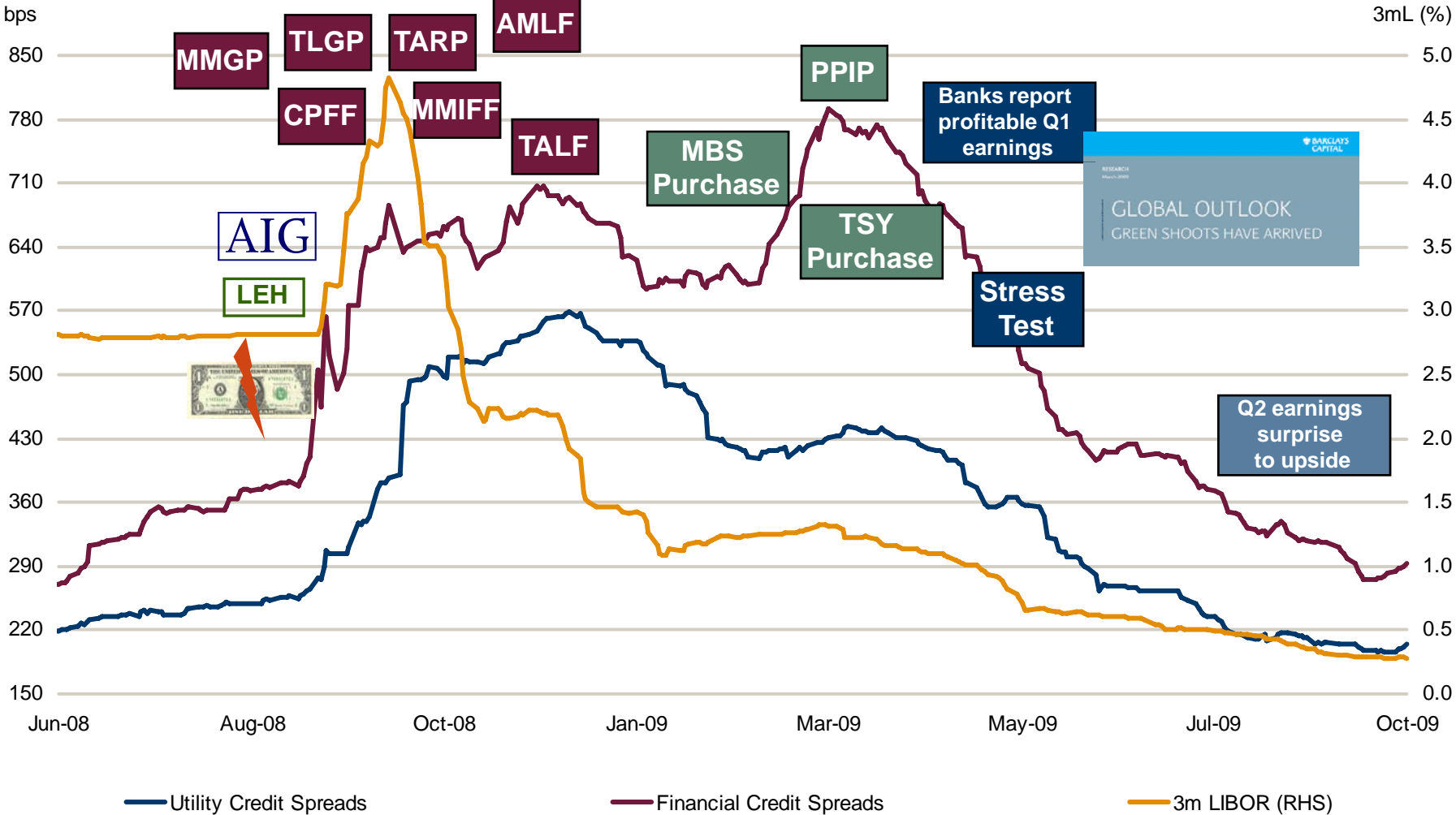
Bonbright Conference

October 9, 2009





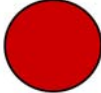
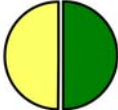
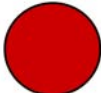




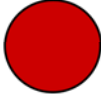

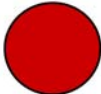


# Credit Market Has Come Full Circle

Government programs have helped normalize the credit market

**Last twelve month credit market performance**

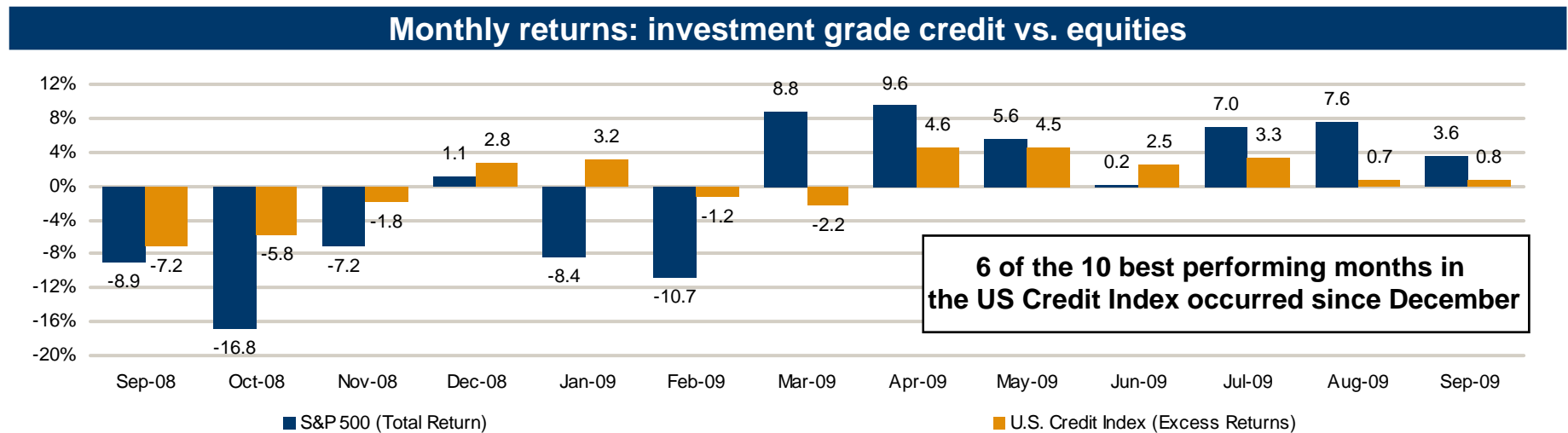


# State of the Capital Markets: Oct '09 vs Oct '08

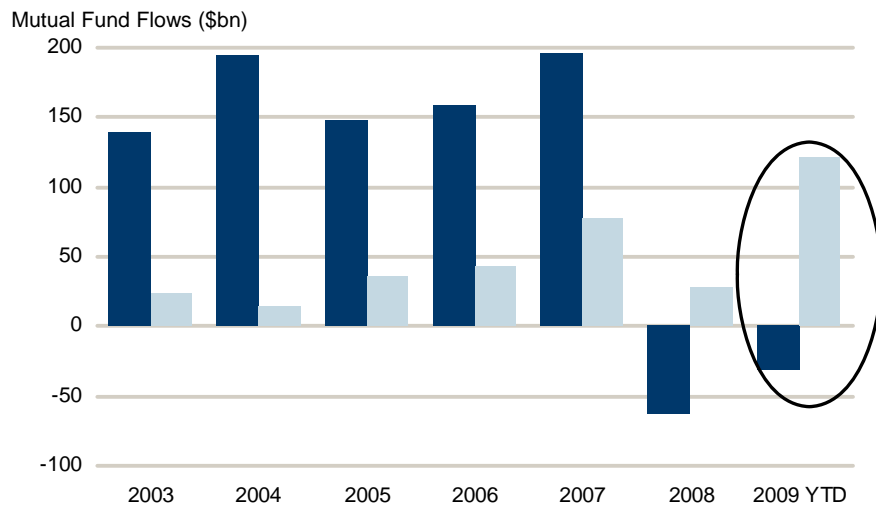
	October 2008	October 2009	Current Status
<b>Commercial Paper</b>			<ul style="list-style-type: none"> <li>Government programs stabilized the CP market and restored liquidity</li> <li>Tier 2 rates have recovered and Tier 1 rates remain extremely low</li> <li>CPFF usage is down over 75% from the peak in January 2009</li> </ul>
<b>High Grade Bond Market</b>			<ul style="list-style-type: none"> <li>Wide open across currencies for all sectors and ratings</li> <li>High investor cash levels driving demand technicals</li> <li>Notable increase in demand for short-dated paper as investors look for higher yielding assets in the front-end</li> </ul>
<b>Asset Backed</b>			<ul style="list-style-type: none"> <li>TALF improved ABS market tone, with new issues across asset classes</li> <li>Small / infrequent issuers have regained access to the market while larger / more infrequent issuers are seeing overwhelming demand</li> <li>Spreads have tightened significantly in primary and secondary markets; demand for subordinate paper has re-emerged</li> </ul>
<b>Convertibles</b>			<ul style="list-style-type: none"> <li>Market has re-opened in 2009 with strong investor appetite: Over 65 issues priced since mid-March for over \$20 bn</li> <li>Issuance has spanned all credits and industries</li> <li>Recent offerings have generated strong fundamental demand, been well over-subscribed, increased in size and have reflected enhanced terms</li> <li>Almost all transactions have traded up in the aftermarket</li> </ul>
<b>Equity Market</b>		 <b>Follow-ons</b>  <b>IPOs</b>	<ul style="list-style-type: none"> <li>While the IPO market selectively opened in 1H'09, 2H'09 is beginning to see broad activity across sectors</li> <li>2009 follow-on new issuance is \$121 billion (up 36% vs. 2008)</li> <li>Secondary issuance since May totaled over \$91 billion, with May representing the largest month since October 1999</li> <li>All industries have been able to access the equity capital markets</li> </ul>
<b>High Yield Bond Market</b>			<ul style="list-style-type: none"> <li>U.S. high yield bond market has re-opened across the credit spectrum</li> <li>212 deals done year to date for nearly \$93.4 bn, up almost 200% over 2008 levels</li> <li>Recent rally due to historic cash inflows in mutual funds</li> </ul>
<b>Loan Market</b>		 <b>High Grade</b>  <b>High Yield</b>	<ul style="list-style-type: none"> <li>High grade loan market open and capital is accessible at appropriate pricing levels</li> <li>For most of 2009, the primary leveraged loan market activity has been focused on ABLs, DIPs and "amend and extend" transactions</li> </ul>

# Attractive Relative Value Has Driven a Rotation into Credit... Helping Drive Record Returns...and Encouraging Further Cash Inflows

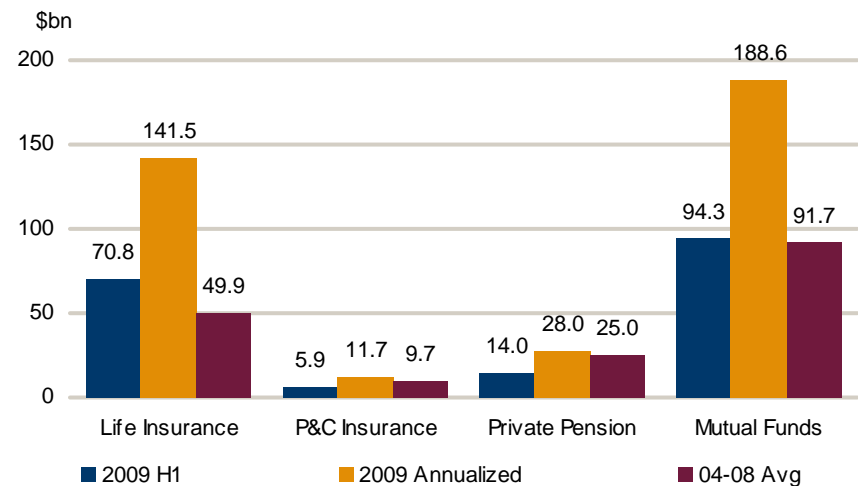
## IG credit outperformed during the crisis as investors flocked to safer assets



## Funds flowed into credit at the expense of equities



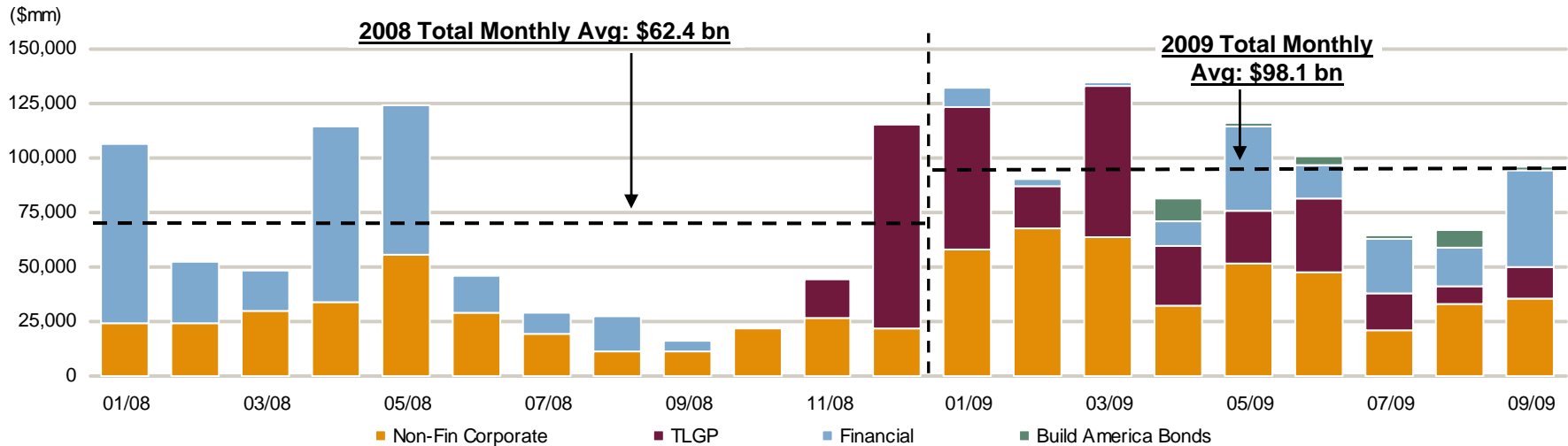
## Demand for credit across investor universe



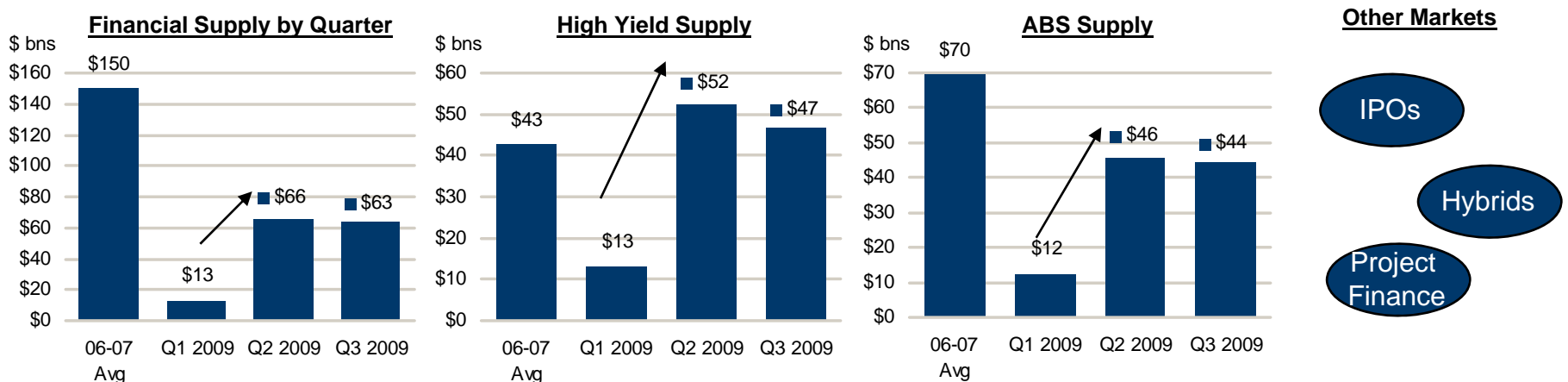
# Robust Debt Issuance in 2009

Issuers have taken advantage of the strong market, raising nearly \$100bn per month

## Investment grade new issuance is well ahead of 2008's pace



## Issuance has also picked-up for riskier assets



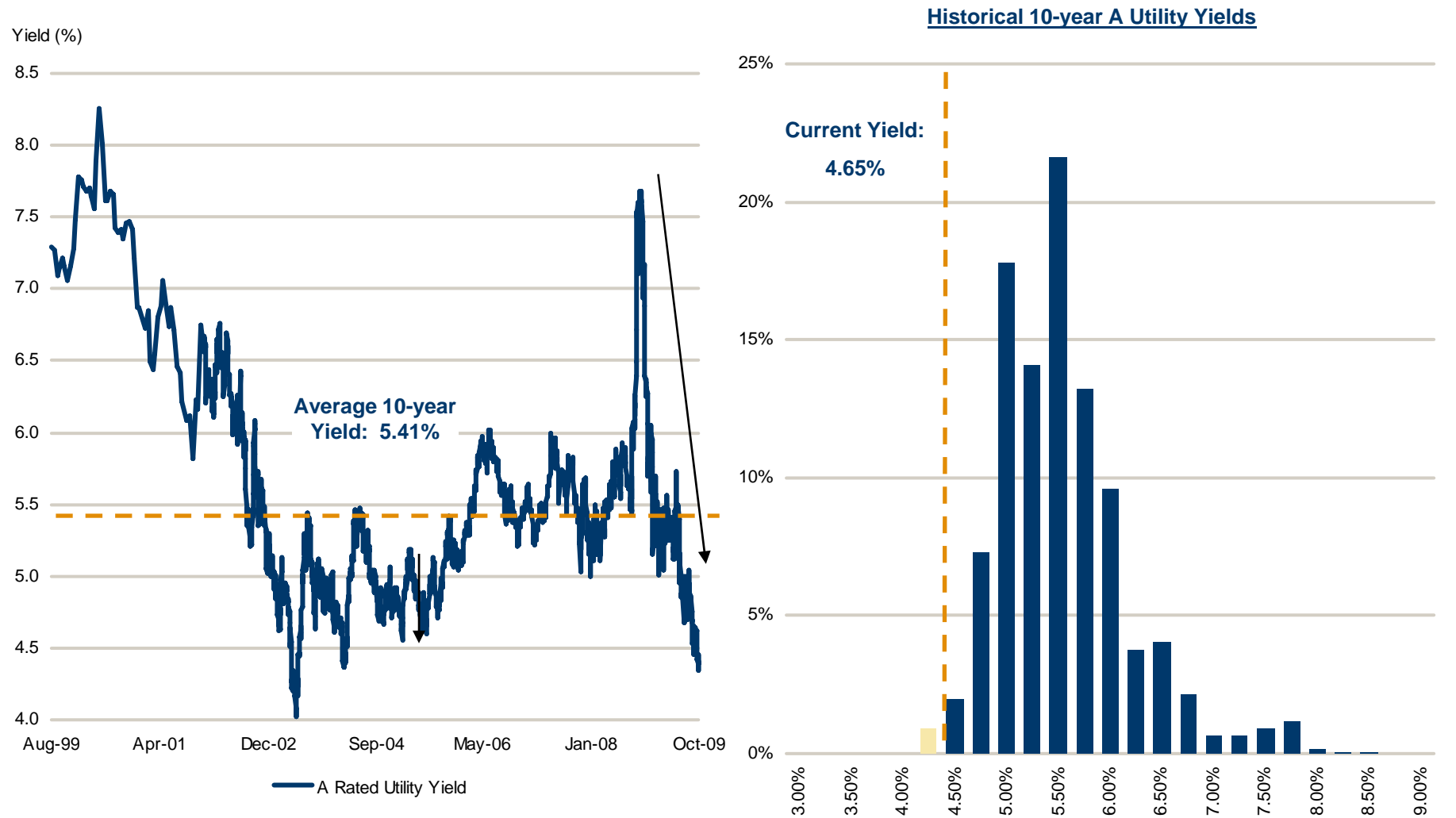
Source: Barclays Capital as of October 5, 2009.

# Yields on Term Debt Are Attractive on an Historical Basis

## Current yields provide attractive funding levels on an historical basis

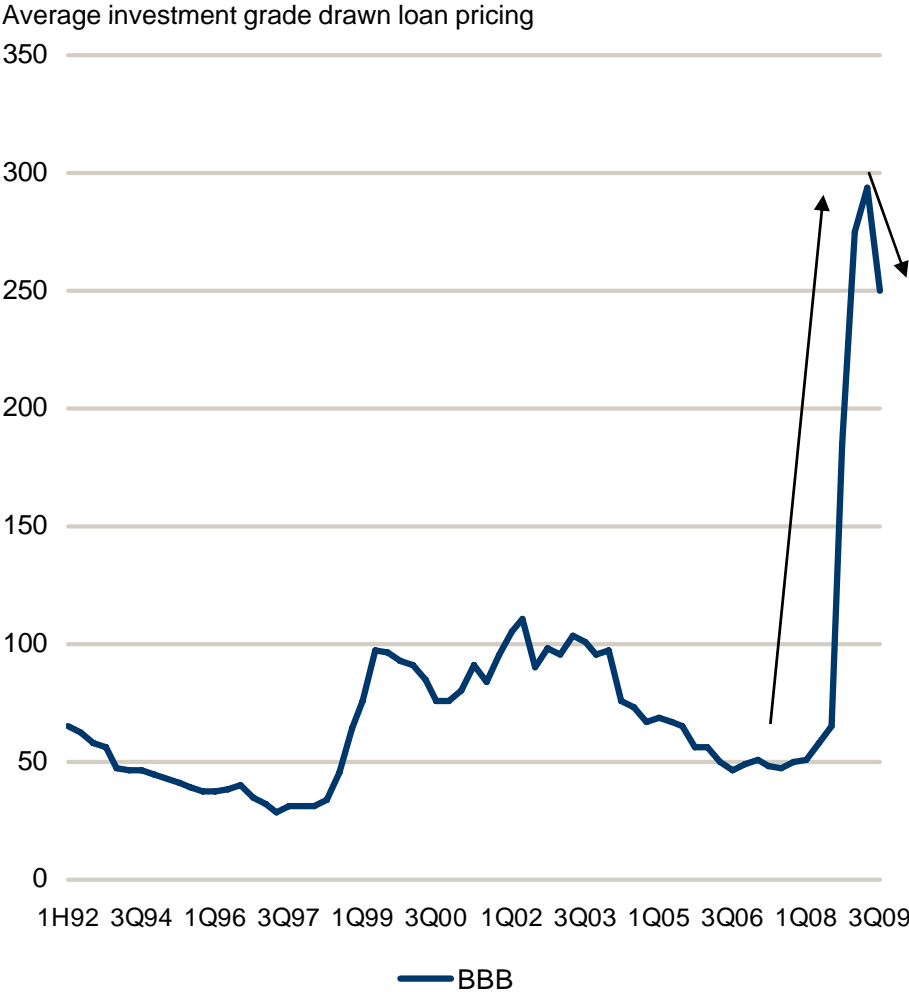
Current yields stand more than 75 bps below the 10-year average and well below recent wides

Over the past decade, 10-year A Utility yields have been higher than current levels 98% of the time

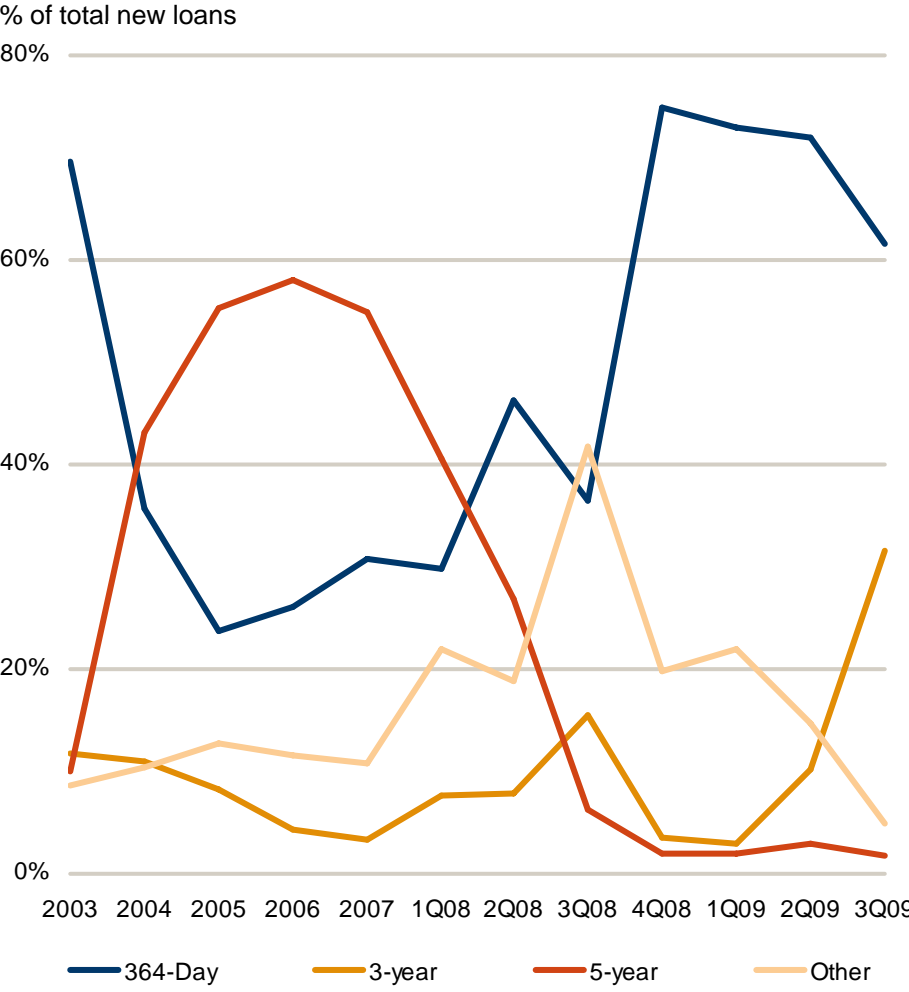


# Bank Market Has Lagged the Broader Recovery as Capital Has Become a Scarcer Resource

## Loan pricing has increased dramatically...



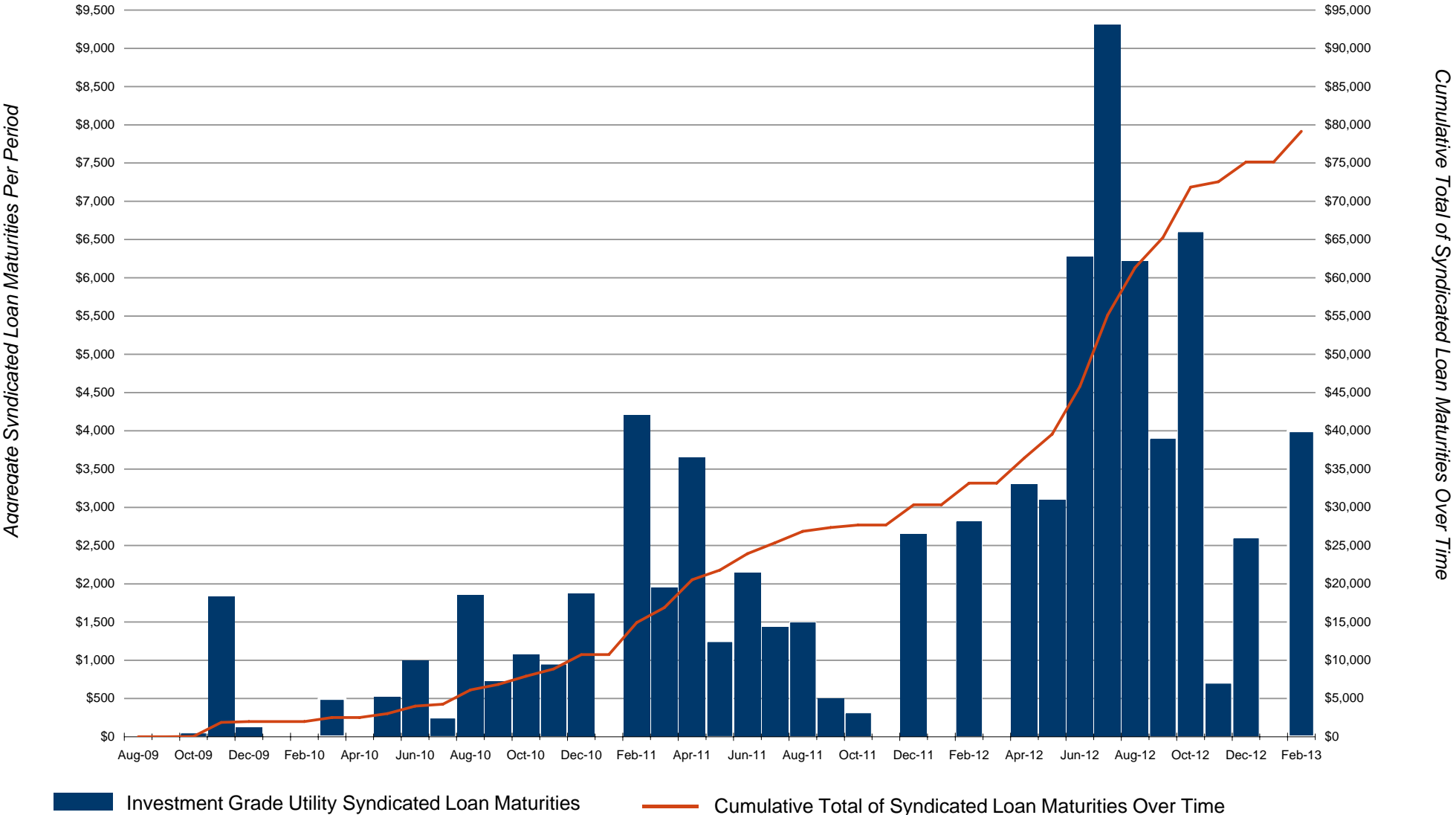
## ...while tenor has shortened significantly



Source: Loan Pricing Corporation (Thompson Reuters)

# Upcoming Utility Loan Maturities

Refinancing maturing bank loans will be an industry focus in coming years

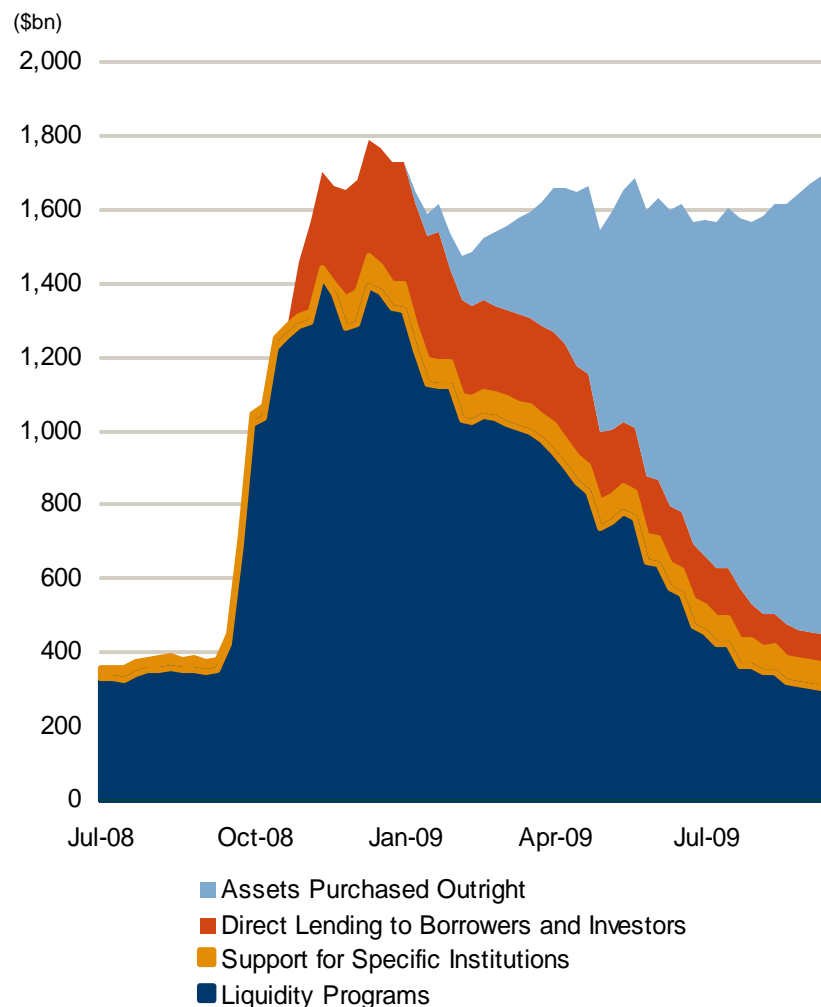


Source: Loan Pricing Corporation, Public Filings, Credit Documents.

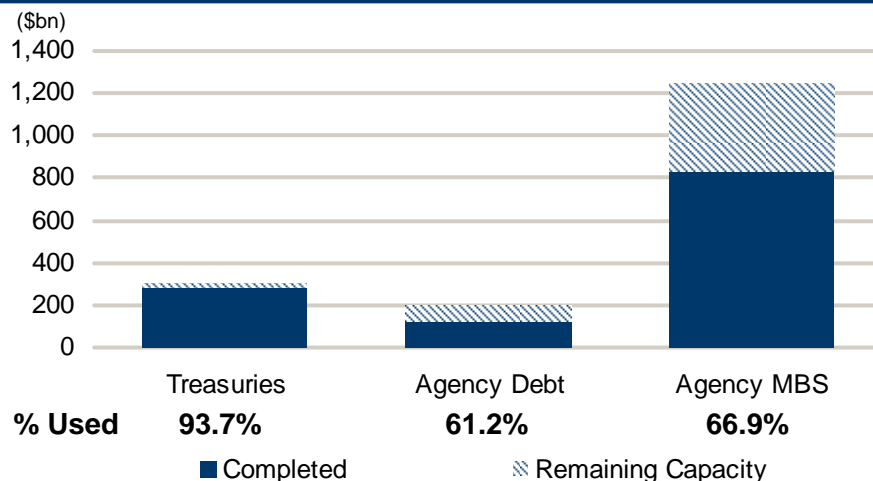
# Waning off Government Support will be a Challenge, Especially in Light of Increased Treasury Supply

## Government programs provided a boost but will wind-down over the coming months

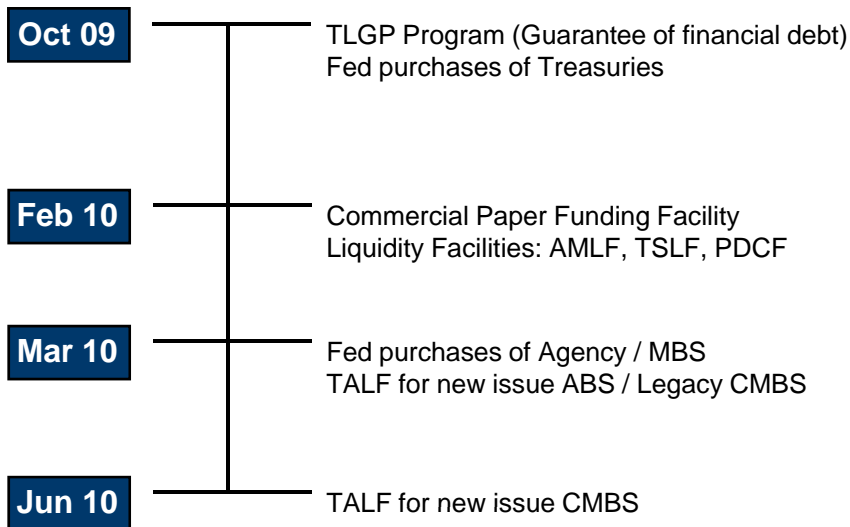
### Expansion of Fed balance sheet



### Fed asset purchase programs



### Expiration of government support programs



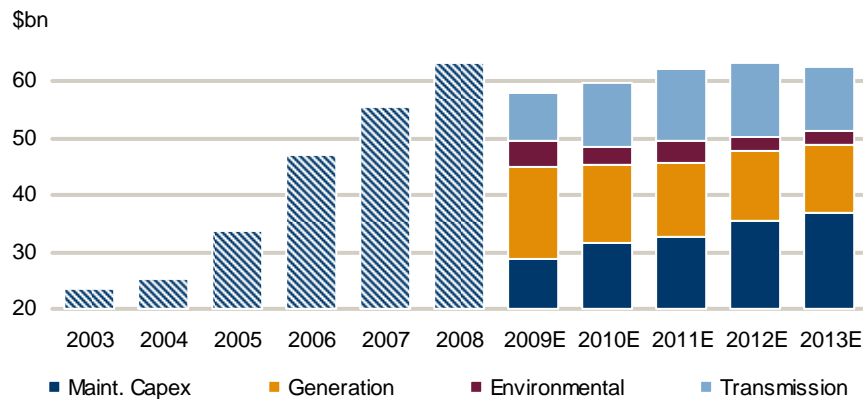
Source: Barclays Capital, Bloomberg, Federal Reserve.

# Funding Needs Will be Significant

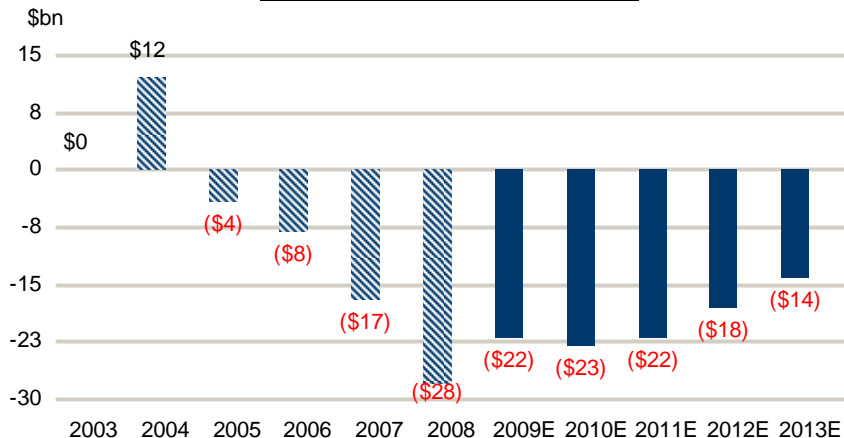
Utilities have significant capital expenditure needs and will need to maintain strong ratings

## Utilities will rely on capital markets to fund capex

**Capital Expenditure Forecast**



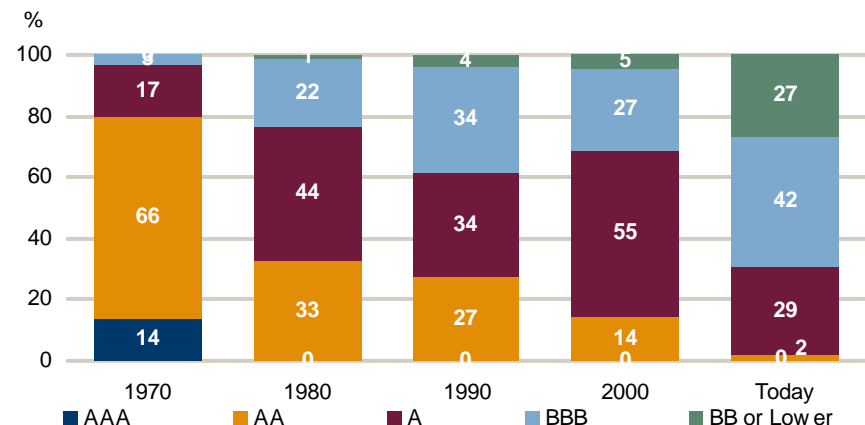
**Free Cash Flow Forecast**



## Rating agency views on integrated utilities

- Moody's:** Views regulated utilities as relatively well insulated from economic turmoil but cites some concerns in the long-term:
  - Unfettered access to capital markets may not be able to be assumed
  - Maintenance of a supportive regulatory environment
  - Under-funded pension obligations
- Believes companies in the space need to be more proactive about strengthening their balance sheets
- S&P:** Regulated electric utilities poised for generally stable ratings for the next 18 months
  - Economic weakness resulting in slack demand in some service territories, pressuring cash flows and debt balances
  - For companies with significant merchant exposure, S&P will potentially benchmark versus its "industrial" credit scale – a much higher watermark

## Utility credit ratings have deteriorated over time



S&P Ratings based on 73 independent electric companies, unweighted

# Summary Conclusions

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**Capital markets have largely recovered from the aftermath of the credit crisis**

- **Short-term credit markets largely repaired**
- **Long-term credit markets are again readily available**
  - ▶ **Record issuance volumes for investment grade corporates**
  - ▶ **Yields near historical lows**
  - ▶ **High yield market reopened across credit spectrum**
- **Liquidity in the bank market remains tighter, although improving**
- **Equity markets open although stock prices have not fully recovered**
  - ▶ **Hybrid and equity-linked markets are reopening**
  
- **Key risks:**
  - ▶ **Pullback of government programs**
  - ▶ **Interest rate changes, especially in Treasury market**
  - ▶ **Shifts in asset allocation**
  - ▶ **Rising default rates (housing, consumer, corporate)**
  - ▶ **Commercial mortgage-backed securities**
  - ▶ **Inflation**

# Implications for Corporates

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- **While many markets have returned quicker than expected to stability, increased volatility may be with us for some time**
  - ▶ **Timing and strength of economic recovery remain uncertain**
  - ▶ **Financial markets still facing number of risks**
  
- **Access to liquidity and capital has returned to companies across sectors and ratings, but implication on cost and capacity varies**
  - ▶ **Term debt markets at very attractive levels**
  - ▶ **Unlikely to see return to era of cheap bank debt**
  - ▶ **Cost of equity is higher**
  
- **Value of credit ratings, scale and access to capital will remain important going forward**
  
- **Corporate responses**
  - ▶ **Reducing reliance on short-term debt and bank credit**
  - ▶ **Taking advantage of attractive yields to term out capex sooner**
  - ▶ **Proactive approach to liability management and capital raising -- no more "just in time financing"**
  - ▶ **More conservative capitalization -- less leverage, more equity**

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