Exhibit No.:
Issue: *Rate of Return*
Witness: *David Murray*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Surrebuttal Testimony*
Case No.: *ER-2012-0174*
Date Testimony Prepared: *October 8, 2012*

MISSOURI PUBLIC SERVICE COMMISSION

REGULATORY REVIEW DIVISION
UTILITY SERVICES

SURREBUTTAL TESTIMONY

OF

DAVID MURRAY

KANSAS CITY POWER & LIGHT COMPANY
Great Plains Energy, Incorporated

CASE NO. ER-2012-0174

Jefferson City, Missouri
October 2012

** ***Denotes Highly Confidential Information*** **

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Q. Please state your name.

A. My name is David Murray.

Q. Are you the same David Murray who previously prepared and caused to be filed in Case No. ER-2012-0174 the Rate of Return ("ROR") Section of the Staff's Cost of Service Report ("Staff's Report") and rebuttal testimony related to ROR?

A. Yes, I am.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal Testimony is to respond to the rebuttal testimonies of Samuel C. Hadaway and Kevin E. Bryant. Dr. Hadaway sponsors ROR testimony specifically as it relates to the cost of common equity ("COE") and return on common equity ("ROE"), on behalf of Kansas City Power & Light Company ("KCPL"). Mr. Bryant sponsors testimony specifically as it relates to KCPL's cost of debt and the appropriate capital structure.

EXECUTIVE SUMMARY

Q. What areas will you address in your surrebuttal testimony?

A. I will address some of the specific criticisms Dr. Hadaway provided in his rebuttal testimony regarding my COE analysis and the reasonableness of my ROE recommendation. Although I provided a comprehensive analysis in the Staff Report

evaluating utility growth as it compared to aggregate GDP growth, Dr. Hadaway's rebuttal testimony did not provide any substantive response to Staff's analysis. Staff provided a significant amount of industry and government data that shows that, at least on a dividend per share ("DPS") and earnings per share ("EPS") basis, regulated electric utilities have not grown at the same rate as U.S. nominal GDP growth. In fact, even on an aggregate basis, data published by the Bureau of Economic Analysis ("BEA") shows that the utility industry has been becoming a smaller part of the economy, which disproves Dr. Hadaway's assumption that the utility industry can grow in perpetuity at the same rate as GDP. Additionally, Staff has shown through industry data and academic references that because the electric utility industry does not retain earnings for reinvestment (i.e., a high dividend payout ratio), the average annual compound growth rate in EPS and DPS is about half that of the annual compound growth in utility aggregate earnings and aggregate dividends due primarily to the utility industry's need to issue common equity.

Considering the fact that Dr. Hadaway's COE estimates are heavily dependent on his theory that electric utility companies can grow DPS and EPS consistent with GDP growth in perpetuity, I had expected Dr. Hadaway would devote more time and effort to advancing the debate on this issue because it is the primary driver of his higher COE estimates. Perhaps, in this case, his lack of testimony on this subject is informative in and of itself. Dr. Hadaway simply has no empirical or practical evidence to support his theory.

Q. What primary reasons does Dr. Hadaway offer to suggest to the Commission that your COE estimates are unreasonable?

A. Dr. Hadaway suggests that my COE estimates are unreasonable because they are significantly below recent allowed ROEs. Dr. Hadaway also suggests that because I

continue to use growth rates consistent with those I used in KCPL's last rate case, Case No. ER-2010-0355, my DCF COE estimates should be rejected. He asserts that my approach is biased and any additional analysis I considered to test my approach is only an "ad hoc effort to find data that attempts to support [my] personal opinions..."

Q. What is your general reaction to Dr. Hadaway's criticisms?

A. Staff has continuously made efforts to respond to the Commission's Report and Orders when providing cost of capital estimates. Staff has done so with an understanding that its primary role in rate cases is to provide an objective, unbiased opinion of the COE to the Commission. While it is true that Staff continues to find information that corroborates Staff's opinion that the COE for regulated electric utilities is lower than allowed ROEs, this does not prove Staff is biased. In fact, it proves the opposite, because this support is from parties that are not influenced by the utility ratemaking process. In fact, Staff quite frequently discovers information from capital market experts that completely refutes theoretical assumptions, such as those made by Dr. Hadaway. Dr. Hadaway is an academic with "no skin in the game." He is trying to determine what those with "skin in the game" are doing, just as I am. He and I are not influential in the field of investing. We are not institutional investors and we do not provide professional investment advice. It is the opinions of capital market specialists and those that rely on them that influence the prices investors are willing to pay for stock. Consequently, his criticisms of Staff's "low" growth rates should not be the Commission's focus. The Commission's focus should be whether Staff's growth rates would be judged as reasonable by investment professionals. Based on the lower growth rates used by investment professionals, Staff's estimated growth rates would be considered biased on the high side, not the low side!

TRUE-UP CAPITAL STRUCTURE AND COST OF DEBT

Q. Have you received true-up data that allows Staff to provide an updated recommendation on the capital structure and cost of debt?

A. Yes.

Q. What is your recommended updated capital structure through August 31, 2012?

A. My recommended capital structure updated through August 31, 2012, is contained in the following table and Schedule DM-SUR-1 (dollars are in thousands):

Capital Component	Dollar Amount	Percentage of Capital
Common Stock Equity	** **	** **
Preferred Stock	** **	** **
Long-Term Debt	** **	** **
Short-Term Debt	-	0.00%
Total Capitalization	** **	100.00%

Q. Did you consider the inclusion of short-term debt in the true-up capital structure?

A. Yes. I evaluated monthly construction work in progress ("CWIP") and short-term debt balances for the 12-months ended through August 31, 2012 and short-term debt balances do not exceed CWIP balances on a consistent basis. Therefore, I do not recommend the inclusion of short-term debt in the ratemaking capital structure.

Q. What is your recommended embedded cost of debt through August 31, 2012?

A. 6.187% (*see* Schedule DM-SUR-2).

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Q. Did you make the same adjustments to the cost of debt you made in Staff's Report?

A. No. Due to Staff's discovery of additional data from the Company, Staff is now recommending different downward adjustments to the same three GPE debt issuances Staff adjusted in Staff's Report. Although Staff used point estimates for the cost of debt adjustments, Staff will discuss later in this testimony a recommended range of cost of debt adjustments for each debt issuance.

Q. What is your updated recommended ROR?

A. My updated ROR through August 31, 2012 is contained in the following table (*see also* Schedule DM-SUR-3):

			Weighted Cost of Capital Using Common Equity Return of:		
Capital Component	Percentage of Capital	Embedded Cost	8.00%	8.50%	9.00%
Common Stock Equity	** **	-----	4.20%	4.47%	4.73%
Preferred Stock	** **	** **	0.03%	0.03%	0.03%
Long-Term Debt	** **	** **	2.90%	2.90%	2.90%
Total	100.00%		7.13%	7.39%	7.65%

CORRECTIONS

Q. Do you have any corrections to make to the Staff Report?

A. Yes.

Q. What are your corrections?

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A. Section IV.G.2.a. of the Staff Report discusses the "Rule of Thumb" test of reasonableness of COE estimates. Page 59, lines 13-17 of Staff's Report indicates that adding the 3% risk premium to the average 'A' rated and 'BBB' rated 30-year utility bond yields of 4.92% and 5.52% results in an estimated COE range of 7.92% to 8.92%. This is not correct. The COE range should have been 7.92% to 8.52%. Staff also indicated that adding a 4% risk premium to these same yields results in a COE range of 8.52% to 9.52%. This is also not correct. The correct range is 8.92% to 9.52%.

Staff also discovered an error in its multi-stage DCF analysis. Schedules 13-2 through 13-4 show a first stage growth rate for Wisconsin Energy of 8.06%. This growth rate should have been the same as the 6.73% shown on Schedule 13-1. This correction decreases the average COE indication from the multi-stage DCF by less than 5 basis points in each scenario. Because Staff had already decided to recommend a higher ROE range than its indicated COE estimates, this does not change Staff's recommended ROE of 8% to 9%, with a point recommendation of 9%. I attached Corrected Schedules 13-2 through 13-4 to this testimony.

DR. HADAWAY'S UPDATED RECOMMENDATION

Q. Did Dr. Hadaway update his COE estimates in his rebuttal testimony?

A. Yes.

Q. Did Dr. Hadaway change his recommended ROE as a result of his updates?

A. Yes. Dr. Hadaway is now recommending an ROE of 10.30% (previously 10.40%) based on his updated COE range of 9.80% to 10.30%.

Q. What is the primary cause of Dr. Hadaway's lower ROE recommendation?

A. Dr. Hadaway lowered his terminal GDP growth rate to 5.70% from 5.80%. For purposes of his "GDP constant-growth DCF," this causes a 10 basis point reduction to his COE estimate. However, he also changed his proxy group and updated his stock prices, which caused a change to his dividend yield. While Dr. Hadaway relied on a dividend yield of 4.59% for his high-end estimate of 10.4% for purposes of his direct testimony, his dividend yield dropped to approximately 4.35% for purposes of his updated recommendation in his rebuttal testimony. The lower dividend yield coupled with the lower GDP growth rate resulted in a decline of 60 basis points for his "GDP constant-growth DCF" analysis. Consequently, this analysis went from supporting Dr. Hadaway's high-end estimate of 10.4%, to supporting his low-end estimate of 9.8%.

Q. Do any of the updates to the methodologies Dr. Hadaway used in his direct testimony support a COE estimate of 10.3%?

A. No. The following table shows the updated results of Dr. Hadaway's COE methods provided in his direct testimony:

Equity-Analyst Constant-Growth DCF	
Mean	9.80%
Median	9.80%
GDP Constant-Growth DCF	
Mean	10.01%
Median	10.00%
GDP Multi-Stage DCF	
Mean	9.90%
Median	9.90%
Risk Premium	
Projected Yield	10.14%
Current Yield	9.87%

Q. Then what support does Dr. Hadaway have for a COE estimate of 10.3%?

A. Dr. Hadaway introduced a new approach to estimate the COE that he didn't provide in his direct testimony. Incredibly, Dr. Hadaway then uses this new methodology as the primary basis to support his revised recommendation. Dr. Hadaway's introduction of an entirely new approach as part of Dr. Hadaway's update should be weighed by the Commission when considering Dr. Hadaway's credibility. Dr. Hadaway does not have independent 3rd party analysis to support his revised 10.3% COE estimate.

Q. Did Dr. Hadaway at least provide an explanation as to why he introduced this new methodology in his rebuttal testimony?

A. Yes. In fact, he uses my explanation of the cause for the increase in electric utility stock prices as justification for introducing his new approach. He claims that current "abnormal" market conditions are causing a traditional DCF analysis to yield unreliable results.

Q. Do you agree?

A. No. If anything, one would expect a contraction in utility P/E ratios if interest rates increase as Dr. Hadaway suggests. If investors expect interest rates to increase, then they would actually expect a contraction in utility stock prices, which would imply a lower expected return over the long-term.

ALLOWED ROES COMPARED TO THE COE

Q. Dr. Hadaway uses 2012 allowed ROE data to support his position that your COE estimates are unreasonable. What is the fallacy of Dr. Hadaway's comparison?

A. Dr. Hadaway equates allowed ROEs with the COE. As I will discuss in more detail later in my testimony, investment analysts do not equate allowed ROEs to the COE. In

fact, investment analysts actually expect commissions to authorize ROEs higher than the COE.

Q. Dr. Hadaway compares your ROE recommendation of 9.00% to the Regulatory Research Associates (RRA) published average of 10.09% for the first two quarters of 2012. He claims there has not been one quarter in the past five years when allowed ROEs for companies like KCPL have been as low as your recommendation or even the other parties' higher ROE recommendations. How do you respond?

A. The U.S. macroeconomic and capital market environment are in unprecedented territory. Interest rates are the their lowest levels in decades; the economic recovery from the worst recession since the Great Depression is so slow it can barely be labeled a recovery; unemployment is stubbornly high; there are concerns regarding the stability of economies within the Eurozone; and inflation is almost nonexistent. It is quite clear that we are in an environment that very few of us have ever experienced in our lifetimes.

Consequently, using allowed ROEs over the past five years as a benchmark to what is reasonable today is completely illogical. The cost to issue long-term debt has been steadily declining over this period, especially for investment grade utility bonds. In fact, it is becoming much more common for utility companies to be able to consistently issue long-term bonds at yields below 4%. For example, Ameren Missouri just issued 30-year secured debt at a coupon of 3.9% on September 11, 2012. Although there may be some lag before these lower capital costs are shared with ratepayers in a subsequent rate case, these lower costs of debt would eventually be reflected in the ROR charged to ratepayers. I am not aware of any situation in which a hypothetical higher cost of debt has been allowed because

of the current low interest rate environment. Such consideration is nonsensical, just as it is nonsensical, and more importantly unfair, to place a floor on the allowed ROE because of the current lower COE implied in utility stock prices.

Regardless of whether Dr. Hadaway wants to attribute this to current monetary policy, these are realized and observable lower costs of capital. Although the lower COE is not as easily observable as bond yields, it is definitely implied and should be reflected in rates. Considering we have been in our current low interest rate, low economic growth environment for at least three years and the Fed has announced it intends to keep short-term rates low for another three years through 2015, it would only be fair to ratepayers to reduce the allowed ROE so these lower capital costs can be shared with ratepayers.

Even if the cost of capital were to eventually increase, as Missouri electric utility companies have demonstrated in recent years, they are willing to file rate cases frequently if they believe it is necessary to recover higher costs.

Q. Does Dr. Hadaway acknowledge that regulated electric utility company stocks have performed quite well due to the current low interest rate environment?

A. Yes. On page 3, lines 6 through 12 of his rebuttal testimony, Dr. Hadaway directly cites Value Line commentary that discusses the increase in utility stock prices due to investors seeking yield in this low interest rate environment. However, instead of accepting the lower implied COE estimates such stock prices produce, Dr. Hadaway explains these lower COE estimates as "artificial" and will reverse when interest rates increase. As noted above, interest rates are expected to remain low over the next several years.

Q. Does Dr. Hadaway provide any information that shows when investors believe interest rates will begin to increase and regulated electric utility company stock prices will decrease?

A. No. Regardless, investors' expected changes in interest rates are already reflected in the price investors are willing to pay for regulated utility stocks. It would be foolish for an investor to purchase regulated electric utility stocks if he/she believed interest rates would increase dramatically in the near future. If this were to occur, then regulated electric utility company stocks would likely contract and these investors would experience capital losses.

Q. Dr. Hadaway indicates that DCF COE estimates for regulated electric utility stocks do not reflect the overall market's volatility and heightened risk aversion. He claims that this "anomaly makes it more difficult to interpret current DCF cost of equity estimates for utility companies.[1] Do you agree that it is currently more difficult to estimate the COE for regulated utility companies?

A. No. Regulated utility companies' valuation levels (P/E ratios) are tightly correlated to the level of interest rates (i.e. if interest rates decrease, utility stock prices increase). This directly explains the current situation in which regulated electric utility stocks have been trading at a premium, in terms of P/E ratios, to that of the S&P 500. In fact, although Dr. Hadaway's cited Value Line commentary discusses its concern about higher valuation levels, many capital market professionals appropriately recognize that the current valuation levels are consistent with the high correlation of regulated electric utility industry stock prices to bond yields.

[1] Hadaway Rebuttal, p. 10, ll. 20 – 26.

Almost all equity analyses of regulated utility stocks involve some form of comparison to the current level of interest rates when determining a fair value to pay for the stock. For example, Greg Gordon, lead Power & Utilities Research analyst for International Strategy and Investment Group Inc. ("ISI") and recent speaker at the Mid-America Regulatory Conference ("MARC") in June 2012, recently published a research report discussing this relationship.[2] Specifically, Mr. Gordon and his coauthors indicated the following (entire report is attached as Schedule DM-SUR-4):

> **The Balance of Risks vs. Bonds is More Favorable**
>
> **Our dividend/bond yield model suggests the balance of risks for the Regulated Utility sub-group is more positive,** even assuming the sunset of the 15% tax rate on dividends. We believe utility stock valuations are highly correlated to bond market conditions given their leverage and high dividend yields, which make them alternatives to fixed income instruments. Going back 40 years, utility dividend yields — and, by extension, P/E multiples — have shown an 80% correlation to both 10-year Treasury note yields and to BBB corporate bond yields. Investor appetite for a dividend income, and the assumption of how much that income will grow over time, is a valuation driver that expresses itself through a relationship to the bond market. (emphasis in the original)
>
> The fact that this correlation was high as it related to both Treasuries and corporate bonds was misleading. Since 1970 the BBB credit spread over Treasuries has averaged +/-210 bp. During the financial crisis when corporate credit markets imploded and government markets rallied the correlation to Treasuries broke down while the correlation to BBB credits stayed extremely high, leading utility stocks lower. At its apex (December 2008), the spread between Treasury yields and corporate bond yields peaked at ~600 bp. The average BBB credit spread over Treasuries is now approximately 329 bp.

Although the regulated electric utility industry's P/E ratios and dividend yields have not been as highly correlated with U.S. Treasury yields since the financial crisis in late 2008

[2] Greg Gordon, Jon Cohen, Bill Appicelli, and Dmitri Pchelintsev, Regulated Utilities: "Valuations Supported By Low Interest Rates; There Are Relative Values," January 9, 2012, International Strategy and Investment Group, Inc.

and early 2009, they continue to be highly correlated to corporate bond yields. Yields on investment grade corporate bonds have been quite low for some time because of the current low growth, low interest rate environment. Specifically, yields on utility bonds have been very low. This low corporate bond-yield environment has had a dramatic impact on regulated electric utilities' COE. This directly explains the significant increase in regulated electric utilities' stock prices over the last couple of years. While there may be some debate on how much the COE has dropped, there is no doubt it has dropped, which gives the Commission sufficient support for lowering the allowed ROE for KCPL to at least 9.50%, even though Staff's opinion is that KCPL's COE is much lower than this level.

Q. Is there any recent information provided by the Edison Electric Institute ("EEI") that further supports the fact that the COE for regulated electric utility companies is directly influenced by the decline in corporate bond yields over the last couple of years?

A. Yes. EEI provided the following commentary regarding the current valuation levels of regulated electric utility stocks:

> Stretched Valuations?
>
> Despite trailing the broad market averages during the first half of 2012, the EEI Index outperformed all major market sectors over the 12-month period ending June 30 (as shown in Table IX). This was due less to any change in the industry's prospects than to the **industry's status as a safe-harbor during macroeconomic turbulence.** The broad market fell more than 10% during Q3 2011 as the spectacle of the U.S. fiscal debt limit debate (and Standard & Poor's August 5, 2011 downgrade of U.S. debt from AAA to AA+) along with European leaders' equally contentious response to a flare-up of market stress over their continents' sovereign debt woes rattled investors.
>
> By late June 2012, most analysts observed that utility price/earnings ratios were near historical highs relative to the broad market, suggesting that the group's strength may be nearing an end. Conversely, given today's extraordinarily low interest rates, utility shares receive powerful support from the industry's roughly 4%

> dividend yield, double that of the S&P 500's dividend yield. When viewed as a bond substitute (offering bond-like yields with dividend growth potential), analysts observed that utility stocks could have room to rise given the very low yields available most everywhere else.
>
> To the extent that utility dividends remain perceived as stable and safe, and if interest **rates** remain very low, utility shares will likely receive an ongoing strong bid from investors. However if rates were to rise or if industry fundamentals were to worsen — such as the perception of difficulty executing capital investment programs or renewed fuel cost increases pressuring end-user rates, fostering a more contentious environment in rate cases — the group's stock market fortunes may take a turn for the worse.
>
> Recent years have delivered many tailwinds for the industry, independent of the hard work by companies to reform themselves around the traditional utility business model while implementing the strong public good aspect of their mission — that of ensuring safe, reliable and increasingly environmentally clean electricity within regulated service territories. It's likely that the values of utility shares in the immediate future will continue to be driven more by global macroeconomic issues outside of the industry's control than by changes in business strategies or fundamentals that managements can control. That is not to say that the month-to-month and year-to-year challenges that come with the management of shareholder-owned utilities are not significant, it's just that they are largely under control for now.[3] (emphasis added)

Although Dr. Hadaway acknowledges that current capital market conditions are quite favorable for regulated electric utilities in terms of a lower cost of capital, he seems to believe that the Commission should not reduce KCPL's previously allowed ROE of 10% to recognize the lower COE. While Dr. Hadaway's position is an allowed ROE below 10% would be lower than KCPL's COE, Staff believes the Commission needs to be aware that investment analysts do not view allowed ROEs in the 10% range as being reflective of the electric utility industry's COE. They consider the COE to be much lower than this, but expect commissions to allow ROEs higher than the COE.

Q. Have you provided such supporting information in past rate cases?

[3] Edison Electric Institute's Second Quarter 2012 Financial Update, p. 7 (Schedule DM-SUR-2).

A. Yes. Staff has provided supporting documentation for this position in recent utility rate cases in Missouri and specifically in KCPL's last rate case, Case No. ER-2010-0355. The most obvious and relevant example is the information Goldman Sachs provided directly to GPE in May 2009. GPE hired Goldman Sachs as a Joint Book-Running Manger in conjunction with its May 2009 issuance of equity units and common equity. On April 6, 2009, Goldman Sachs made a Presentation to GPE's Board of Directors. The materials from that presentation are attached to this testimony as Schedule DM-SUR-5. Page 11 of the presentation compared the COE in early 2009 to that of the COE in May 2007. In making this comparison Goldman Sachs specifically stated the following:

** _____
_____
_____
_____
_____ **

According to Goldman Sachs, the range of COE estimates during the tighter capital market conditions in early 2009 was ** _____ _____ **, whereas the COE in May 2007 was only ** _____ _____ **.

Q. What was the median P/E ratio for the Utility and Power Sector in April 2009?

A. ** ____ **.

Q. What have the P/E ratios been for the regulated electric utility industry in general through the end of 2011?

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A. Regulated electric utility company stocks have been trading over 16.0x the estimated EPS for 2012.[4]

Q. What does this imply from the Goldman Sachs' estimates?

A. That Goldman Sachs' would estimate the current implied COE to be between ** _____ ** based on the P/E ratios it reviewed at the time it made its presentation to the GPE Board of Directors.

Q. This seems rather low compared to COE estimates provided by ROR witnesses. Do you think it is plausible that investors' required returns for utility company stocks are this low?

A. Yes. It is actually quite logical in today's capital market environment, but Staff will provide additional corroborating support for this notion later when it discusses the basic characteristics of regulated electric utility stocks.

Q. Regardless, could GPE request Goldman Sachs to provide a current COE estimate for purposes of evaluating the reasonableness of the various ROR witnesses' COE estimates in this case?

A. Yes. In KCPL's last rate case, for purposes of his surrebuttal testimony, KCPL witness Michael W. Cline requested Goldman Sachs provide documents explaining the cost of GPE's equity units.[5] Goldman Sach's provided this presentation for Mr. Cline even though it had been at least a year and a half since GPE had hired Goldman Sachs as its Joint Book-Running Manger for purposes of issuing both common equity and equity units in May 2009.

[4] David A. Paz and Steve Fleishman, Great Plains Energy: "Goodness gracious Great Plains of fire; reinstate at Neutral," July 18, 2012, Bank of America Merill Lynch.
[5] Case No. ER-2010-0355, Hearing Tr. pp. 2898-2899.

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Consequently, it appears that GPE has an ongoing working relationship with Goldman Sachs that would allow it to request Goldman Sachs to provide a presentation offering its updated opinion on the COE for the regulated electric utility industry. Considering the current higher valuation levels of regulated electric utility stocks, Staff believes Goldman Sachs' COE estimate would be much lower than not only Dr. Hadaway's estimate, but the other ROR witnesses' estimates as well (including mine).

Q. ** _____
_____
_____ **

A. ** _____
_____
_____
_____
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_____
_____ **

Q. Are you aware of any other 3rd party capital market specialists that have the same view as ** _____ **?

A. Yes. In fact, based on the following commentary from Greg Gordon of ISI, it appears that investors expect commissions to eventually lower allowed ROEs to narrow the

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gap, which is being caused by a decline in the COE. Greg Gordon specifically stated the following:

> At present, we are monitoring all three fronts [Assets, Allowed Returns and Capital Ratios]. **The spread between authorized returns on equity and the cost of equity appears wide by historical standards**, although we believe the equity risk premiums may in fact be hire [sic] than they appear given that low interest rates are being driven by sovereign credit risk. We are watching the regulatory backdrop closely but so far ROE's have come down at a moderate pace... (emphasis added)

Investors are now expecting allowed ROEs to eventually decline and/or bond yields to increase to cause the historical spread between allowed ROEs and the COE to revert back to historical average spreads. Because economic forecasters have consistently projected interest rates to increase over the last several years, but this has not materialized, Staff urges the Commission to start recognizing the lower COE by lowering the allowed ROE.

Multi-Stage DCF

Q. Is there anything else in Mr. Gordon's report that is relevant to this proceeding?

A. Yes. Considering the fact that Dr. Hadaway, Mr. Gorman and I use the multi-stage DCF methodology, it is especially relevant to explore the valuation approach used by Mr. Gordon's firm, ISI, which is also a multi-stage DCF approach. Before Staff delves into the details of Mr. Gordon's approach, it is important to compare and contrast the purpose for which ROR witnesses use a multi-stage DCF and the purpose for which investment analysts use a multi-stage DCF approach.

Investment analysts often use both absolute valuation methodologies and relative valuation methodologies when evaluating a fair price to pay for a stock. Relative valuation methodologies focus on the P/E ratios for the subject company as it compares to the industry.

Absolute valuation methodologies are those that analyze specific cash flow estimates to the shareholder and then discount these cash flows by a discount rate (i.e., the COE). The investment analyst and/or investor uses a COE that he/she believes is consistent with the risks of the cash flows expected from the company. The unknown variable the investor is solving for when he/she uses an absolute valuation model, such as the multi-stage DCF methodology, is the fair price to pay for the stock. The variable the ROR witness is attempting to solve for is the discount rate (i.e., the COE) investors are using to estimate a fair price to pay for the stock. Although investment analysts may have some variance in their opinion on the proper COE to use when discounting projected future cash flows (just as they will differ on their projected growth rates in cash flows and earnings), Staff's experience has been that equity analysts' COE rates have been in the range of 7% to 9% even before the recent decline in corporate bond yields and corresponding increase in regulated electric utility stock prices. Although Staff is not aware of any source that publishes securities analysts' consensus COE estimates, if one follows the logic that investors follow the advice of these analysts, then the consensus COE of the analysts is that which is embodied in stock prices.

Q. Where does Mr. Gordon explain the ISI multi-stage DCF methodology in the January 9, 2012, research report (*see* Schedule DM-SUR-4 attached to this testimony)?

A. On pages 17 to 18 of the report.

Q. ISI characterizes its multi-stage DCF as a dividend discount model ("DDM"). Is the DDM the same methodology as the DCF as used in the utility ratemaking?

A. Yes. The DDM more properly specifies the DCF used in utility ratemaking. A DCF analysis can refer to the discounting of a variety of different cash flow proxies, but as used in utility ratemaking, the DCF is referring to dividends as the expected cash flows.

Q. What are the key areas of ISI's multi-stage DCF analysis that are relevant to evaluating the reasonableness of assumptions made by the various ROR witnesses in this case?

A. The most obvious is the assumed perpetual growth rate of 2% starting in year 21. This is much more in line with the perpetual growth rates Staff has observed in other investment analyses. Dr. Hadaway takes issue with the mid-point of my assumed perpetual growth rate of 3.5% because it is below the average annual rate of growth in the Consumer Price Index ("CPI") of 3.7% over the past 60 years and only slightly above the average annual rate of growth in the GDP Price Deflator of 3.4% over the past 60-years. Apparently, Dr. Hadaway believes it is illogical for long-term annual growth in EPS and DPS for the regulated electric utility industry to be below the expected rate of inflation.

Q. Is it appropriate to rely on the 60-year historical period Dr. Hadaway uses to project inflation on a going-forward basis?

A. Only if used for a high-end estimate. Inflation reached double digits in the late 1970s and early 1980s, and continued at a high level through much of the 1980s. While it is always possible that inflation could unexpectedly increase, it is not factored in security prices at this time. The spread between 30-year Treasury Inflation Protected Securities ("TIPS") and 30-year non-inflation protected U.S. Treasury bonds has not exceeded 2.41% for any given month in 2012. Although most economists project an increase in the GDP Price Deflator of approximately 2.0% over the long-term, measuring the spread between

TIPS and traditional 30-year Treasury bonds provides a gauge of the compensation investors' are currently requiring for potential inflation.

Q. Regardless of the absolute level of the estimated inflation rate, is it logical, practical and supported by empirical evidence to expect total returns from regulated electric utilities to be driven primarily by expected dividend returns rather than the growth in stock prices?

A. Yes. It is important to remember the basic characteristics of regulated utility company stocks when evaluating the reasonableness of ROR witnesses' COE estimates. Investors buy utility stocks for the dividend, not capital appreciation. In a recent research report, Hugh Wynne, a utility equity analyst for Bernstein Research, provided information for the period 1974 to 2010 showing that 68% of the total return for S&P Electric Utilities came from dividends, while only 32% was from capital appreciation. Dr. Hadaway's "equity analyst constant-growth DCF" analysis suggests that investors expect to receive approximately 56% of their total return from capital appreciation. Dr. Hadaway's "GDP constant-growth DCF" suggests that investors expect to receive approximately 57% of their total return from capital appreciation. Dr. Hadaway's new approach introduced in his rebuttal testimony to support his recommendation of 10.3%, suggests that investors expect to receive approximately 59% of their total return from capital appreciation. These implied growth rates in regulated electric utility stock prices is completely contrary to the basic and long-held characteristics of regulated utility stocks. Dr. Hadaway's assumed growth rates imply that regulated utility stocks' return profiles are consistent with the S&P 500. Even the most novice investors would recognize that this is inconsistent with the utility equity asset class.

If the ratio of dividend return to total return ratio of 68% continues to hold true in the future, then the implied growth in stock price for a regulated electric utility may only be 2.05% using Dr. Hadaway's updated average dividend yield of 4.35% on page 2 of Schedule SCH-12 (4.35%/68 %= 6.40% and then, 6.40% - 4.35% = 2.05%). Not surprisingly, this implied growth rate is very close to the expected inflation rate, which is consistent with Staff's understanding of the long-term growth embedded in regulated electric utility stock prices. It is also consistent with Mr. Gordon's 2% perpetual growth rate used to estimate a fair price to pay for regulated electric utility stocks.

Q. ** _____
_____
_____ **

A. **_____
_____
_____
_____
_____ **

Q. If regulated electric utility stock prices are only expected to generate capital appreciation at or slightly below expected inflation, does this mean utility investors will not earn a real return on their electric utility investments?

A. No. To the extent the DPS increases by the rate of inflation, then the real return of the investor is simply the dividend yield received from the investment. For example, if the dividend yield is 4.3% and the growth in DPS is 2.5% and inflation is 2.5%, then the investor would achieve a real return of approximately 4.3%.

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Q. Back to ISI's multi-stage DCF methodology, what are some of the other key areas that are relevant to evaluating assumptions made by the various ROR witnesses in their multi-stage DCF analyses?

A. The fact that the first two stages occur over a 20-year period rather than a more conventional 10-year period. The longer transition period would cause more sensitivity in the estimated value of the stock if the assumed rate base growth was significantly higher than the perpetual rate base growth of 2%. However, because ISI indicates that the rate base growth for years 6 through 20 should be consistent with a long-term estimate for the company or the industry, its example shows a relatively conservative 3% compound average growth in rate base for the second period.

Another relevant aspect of ISI's multi-stage DCF methodology for purposes of understanding investor assumptions and expectations is the fact that ISI assumes that dividend growth will be driven by rate base growth. Apparently, because of a utility company's monopoly status, ISI makes the assumption that it will be able to continuously raise rates to pay for rate base investment. In past rate cases, Staff estimated the long-term growth rate by using demand growth plus an inflation factor. While Staff is aware of other investment firms, such as BMO Capital Markets, that had estimated perpetual growth rates by using projected demand growth rates, using rate base growth is logical assuming these investments are allowed in rates.

An additional significant area of interest is the assumed allowed ROE in the model. As can be seen, for the long-term, the model assumes an allowed ROE of 10.5%. This assumed allowed ROE is very close to long-term averages of commission allowed ROEs in recent years. However, it is important to understand that investment analysts do not equate

allowed ROEs with the COE as is often assumed by certain ROR witnesses. For example, both Mr. Gorman and Dr. Hadaway assume allowed ROEs are equal to the COE for purposes of their risk premium analyses. ISI's report makes it very clear that they consider commission allowed ROEs to be higher than the COE for utilities.

As Staff discussed earlier, investment analysts are aware that the spread between allowed ROEs and the COE are currently high. This is mainly due to the fact that commissions have not reduced allowed ROEs to reflect the decrease in the COE. However, as Staff indicated before, it appears that investment analysts do not expect, or for that matter desire, commissions to set the allowed ROE equal to the COE. If commissions set the allowed ROE as low as the COE reflected in regulated electric utility stock prices, then allowed ROEs would be closer to the 7% to 8% range.

Q. Dr. Hadaway indicates because the Public Service Commission of Wisconsin ("Wisconsin Commission") has not allowed ROEs consistent with Steven Kihm's[6] COE estimates, this means the Commission did not find his COE estimates to be credible. Do you agree with Dr. Hadaway's interpretation?

A. No. Dr. Hadaway seems to have missed the point. Mr. Kihm did not recommend the Wisconsin Commission adopt his COE estimates. He actually recommended the Wisconsin Commission authorize an ROE higher than the COE. Mr. Kihm correctly concluded that allowed ROE's are higher than the COE, but he indicates in his article that commissions across the country "might be doing the right thing, but for the wrong reason." His article's focus was not trying to convince commissions that they should set the allowed ROE equal to the COE, but rather voice his concern that utility companies were equating the

[6] Holds a Chartered Financial Analyst ("CFA") designation and is currently a research director at the Energy Center of Wisconsin. Previously served on the Wisconsin Public Service Commission Staff.

allowed ROE equal to the COE for purposes of investment decisions. Staff has reviewed utility companies' internal investment analysis in the past and Staff can assure the Commission that at least Missouri utility companies have not been assuming the allowed ROE is equal to the COE when making strategic investment decisions.

Long-Term Realized Electric Utility Growth

Q. Dr. Hadaway claims that the data you provide from a proxy group of Value Line *Central Region* electric utilities for the period of 1968 through 1999 is of questionable value. Why does he consider this data to be of questionable value?

A. Dr. Hadaway indicates this information isn't helpful because it includes companies that are no longer in existence and is only for the period 1968 through 1999.

Q. In estimating a growth rate based on historical data from an industry proxy group does it matter whether the companies within that industry are constant?

A. No. Investment analysts are constantly analyzing growth rates of various customized or generic indices. For example, much research has been published on the long-term growth of the S&P 500, but Staff can assure the Commission that the companies underlying the S&P 500 are in a constant state of flux. This does not render analysis of historical trends in the S&P 500 irrelevant. The same is true for analyzing an index of electric utilities. Staff chose its own custom index to analyze. While companies such as St. Joseph Light & Power Company, Kansas City Power & Light Company, and Union Electric Company are no longer stand-alone companies, this does not mean an analyst cannot glean informative data from the history of these companies.

As far as the Staff's decision to use the period 1968 through 1999, Staff believes this period is entirely logical considering it captures a full construction cycle for the electric

utility industry and extends almost to the beginning of the next construction cycle that started around 2005.

Q. Why didn't you extend the data through 2005?

A. As Staff explained in the Staff Report, the individual company data for the period from 2000 through 2005 seems to be distorted by the restructuring that occurred within the industry when certain states deregulated generating markets. While Staff did not use data past 1999 because of various disruptions in company-specific data due to restructuring of the electric utility industry, Staff's further evaluation of aggregate utility GDP data confirms that the industry as a whole was declining through 2005. Consequently, inclusion of this data would have only caused the calculated growth rates to be lower.

Q. Are there important differences in this construction cycle for the electric utility industry versus the construction cycle that started in the 1970s?

A. Yes. The first construction cycle was driven by the need for additional capacity because of strong demand growth that had been occurring in the two to three decades preceding this period. The second construction cycle has not been driven by demand, but by environmental requirements, replacement of aging infrastructure, energy efficiency measures and other non-capacity related issues.

Because the first construction cycle was driven by demand growth, it is only logical to conclude that utilities' achieved growth rates over this period should be considered as a high-end estimate for long-term projected growth for utilities during the second construction cycle. Because usage is not expected to increase much over the second cycle, the only way utility companies will be able to recoup the costs of this additional investment is to charge

higher rates for the customers remaining on the system. This would seem to place some constraint on potential future growth for the electric utility industry.

Q. You indicated that some of the companies in the proxy group you used to analyze long-term realized growth included Missouri electric utilities?

A. Yes.

Q. What were these companies?

A. Empire, Kansas City Power and Light Company and SJL&P.

Q. Why wasn't Union Electric included?

A. Staff removed Union Electric due to its merger with CIPSCO in 1997, but since Staff has data on Union Electric through 1997 and it does not appear that the merger with CIPSCO caused a significant change in the data in 1998 and 1999, Staff believes reviewing the actual growth rates of Missouri's major electric utilities could provide a reality check on potential growth for at least Missouri electric utility companies.

Q. What were the actual achieved growth rates in EPS, DPS and BVPS for Missouri's major publicly-traded electric utilities for the time period of 1969 through 1999?

A. As shown on Schedule DM-SUR-6, the average of the 10-year compound growth rates for DPS, EPS and BVPS were 3.59%, 3.11% and 2.57%, respectively, with an overall average of 3.09% for all indicators.

Q. Are you proposing to use these growth rates as a proxy for perpetual growth in your multi-stage DCF analysis?

A. No. Staff is just providing this information to show the actual realized growth of Missouri's major electric utilities. However, these growth rates do support the reasonableness of Staff's long-term growth rates.

GDP Growth Rates

Q. Dr. Hadaway takes issue with relying on long-term economic projections from 3rd party sources because he believes they "use estimates of permanently low inflation and lower real growth rates that do not reflect the long-term U.S. economy." How do you respond?

A. GPE considered this information to be reliable for its own internal financial analysis. Despite Dr. Hadaway's testimony in the last rate case, Case No. ER-2010-0355, that the Congressional Budget Office's ("CBO") was not a reliable source, GPE has continued to rely on this source for purposes of its own internal financial analysis. If Dr. Hadaway has not convinced the Company that hired him to use his growth rates, then I am not sure why the Commission should rely on his growth rates for purposes of setting the allowed ROE. Of course, this assumes the Commission accepts the argument that aggregated nominal GDP growth should be used as a proxy for perpetual growth for regulated electric utilities.

RESPONSE TO KEVIN E. BRYANT'S REBUTTAL TESTIMONY

Q. What areas of your testimony does Mr. Bryant address in his rebuttal testimony?

A. Mr. Bryant primarily addresses my downward adjustments to the cost of the GPE debt issuances made for purposes of providing proceeds to GMO. Mr. Bryant explains why be believes that even if GMO had been able to issue the debt directly rather than through GPE, the costs would probably not have been lower than the actual incurred costs. Mr. Bryant also suggests that even if the Commission were to accept my position that there

should be a downward adjustment to the cost of debt, my proposed methodology should not be relied upon because it does not consider other factors that would cause a higher cost.

Q. Even if GMO had been able to issue the debt at costs similar to that of GPE, would you still have recommended a downward adjustment to this cost of debt?

A. Yes. Assuming GMO had to issue the debt at a higher cost due to the lingering financial effects of the Aquila legacy debt, this would be an appropriate adjustment. Although GPE's financial guarantee has allowed GMO to have an investment grade credit rating, this rating is still below the level at which Aquila committed to assess hypothetical costs to Missouri ratepayers.

Q. When did Aquila make these commitments to the Commission regarding the cost of debt that would be charged to Missouri ratepayers?

A. In Case No. EF-2003-0465, both Jon R. Empson and Rick Dobson submitted testimony that indicated Missouri ratepayers would only be charged debt costs consistent with a 'BBB' rating. Staff notes this because Mr. Bryant describes certain circumstantial issues that have not allowed GMO to issue debt, at least economically, if not at all. Consequently, it has had to rely on its new parent company, GPE, to issue debt on its behalf. While GPE has an investment grade credit rating, it is one notch below 'BBB'. Considering GMO's assets are high quality, regulated utility assets, much the same as KCPL's assets, there is no reason that GMO ratepayers should pay a cost higher than that consistent with a 'BBB' rating, especially considering the fact that GMO ratepayers had no control over the Aquila failure and subsequent corporate structure issues caused by the divestiture of such assets. Using the 'BBB' rating is also consistent with the commitments made by Aquila to insulate the regulated operations from the non-regulated financial failures.

Q. Was the treatment of Aquila debt costs addressed in the Report and Order in GPE's and Aquila's Application to merge, Case No. EM-2007-0374?

A. Yes. GPE initially proposed to recover Aquila's actual debt costs, but later withdrew this request. At page 156 of the Commission's Order in Case No. EM-2007-0374 it is stated that "...the Applicants have withdrawn their request with respect to Aquila's actual debt interest based on past commitments made by Aquila with respect to certain specific debt issues" (Exhibit 38, Cline Additional Supplemental Direct, pages 1-5—see footnote 609 at page 156 of the Commission's Order in Case No. EM-2007-0374).

At page 248 of the Commission's Order in Case No. EM-2007-0374 concerning the "Conclusions of Law Regarding Actual Debt Cost Recovery" it is stated:

> The Applicants have withdrawn their request that the Commission permit recovery of Aquila's actual debt interest costs in a future rate case. Instead, they propose to follow the debt cost recovery procedure that the Commission used in Aquila's recent Missouri rate cases. Because Applicants have withdrawn their request for recovery of the actual debt interest costs of Aquila, the Commission will not address this issue in this proceeding. The Commission will review the proper ratemaking treatment of Aquila interest costs in future Aquila rate cases. With regard to this proceeding, there is no creditable evidence in the record that this alternative proposal would negatively affect the credit-worthiness of KCPL or Aquila and no evidence that approval of the merger utilizing this alternative proposal would be detrimental to the public interest.
>
> [footnotes omitted]

Q. Would it be fair for GMO ratepayers to pay higher debt costs incurred because GMO could not issue debt consistent with its risk profile due to corporate structural issues?

A. No. The failure of Aquila's non-regulated operations and GPE's subsequent acquisition of the Missouri regulated utility assets, which included the assumption of Aquila legacy debt, are a result of corporate decisions. Nothing has changed with the GMO

regulated assets. They were high quality, low-risk assets while they were owned by Aquila and they are still high quality, low-risk assets now that they are owned by GPE. If the Missouri assets had been held in a separate, ring-fenced subsidiary throughout this entire process, then it would have been possible for the Missouri assets to be acquired without the assumption of debt issued for non-regulated operations.

Q. What reason does Mr. Bryant provide for GPE's decision to issue debt with only a 3-year tenor for purposes of providing funding to GMO?

A. Mr. Bryant claims that GPE did so to "provide flexibility to refinance the debt at the utility operating company level once the requisite historical financial statements were available." Apparently, a minimum of three years of audited financial statements are required for an entity to issue public debt. Because Aquila did not hold the GMO assets in a separate legal subsidiary registered with the Securities and Exchange Commission ("SEC"), GPE's newly created subsidiary, GMO, does not have the required three years of audited financial statements.[7]

Q. Is this the same reason GMO provided in response to Staff Data Request No. 0251?

A. No. In response to Staff Data Request No. 0251, GMO indicated that GPE chose the 3-year tenor because GPE's business plans at the time were to merge KCPL and GMO. GPE believed refinancing this debt at the combined company would allow for a lower cost because the combined company would have a higher credit rating.

GMO's response to this data request is consistent with the reason provided in ** _____ **.

[7] MPS and L&P were divisions of Aquila. Aquila maintained separate financial statements for both internal and regulatory purposes.

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Q. Does this at least provide support for using a consolidated cost of debt for KCPL and GMO?

A. Yes. GPE's financing decisions for its two subsidiaries have not been determined by stand-alone considerations for each subsidiary. This is one of the most obvious examples of GPE's financing decisions being made in the best interest of GPE and not its subsidiaries. Although GPE has now put the merger of KCPL and GMO on hold, Staff believes GPE's financing decisions continue to be primarily focused on what is best for GPE, rather than for each subsidiary. For example, when KCPL recently issued $400 million of 30-year debt, according to information from the GPE Board of Directors meetings on August 1 and 2, 2011, GPE's support for issuing the 30-year debt was that it would ** _____ _____ _____ ** This proves that GPE is not financially managing each entity on a stand-alone basis, but rather as a portfolio, which supports a consolidated cost of debt approach.

Q. Does Mr. Bryant take issue with the methodology you used to make adjustments to the three GPE debt issuances assigned to GMO?

A. Yes.

Q. Do you believe the methodology used will necessarily require some informed judgment?

A. Yes.

Q. Has Staff been required to recommend hypothetical debt costs for the GMO properties for several years?

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A. Yes. Aquila's financial difficulties since at least 2002, have required Staff and other parties to use hypothetical debt costs to help ensure that ratepayers would not indirectly pay higher rates due to Aquila's failed non-regulated business ventures. Usually the cost of debt in a rate case proceeding is fairly non-controversial because it can be determined by a mechanical calculation based on debt that is priced based on the business and financial risk of the regulated utility. Although not fail-safe, it is helpful for utility assets to be held in a separate subsidiary, but this was not how Aquila was organized. Its utility assets were operating divisions of the parent company so any debt issued at the parent company was attached to the utility assets. Experience proved that this corporate structure allowed for utility assets to be directly used for leverage to pursue other non-regulated investment opportunities.

Consequently, it has been impossible to simply perform a mechanical calculation to provide a cost of debt that is appropriate for the risk of Missouri's regulated utilities. Staff's methodology necessarily changed over time to adapt to the changes in Aquila's financial condition and the fact that Aquila was raising capital by selling assets rather than issuing debt and/or equity. As the years passed, the cost of debt assigned to the Missouri properties became much less based on actual costs and more based on hypothetical assumptions.

Fortunately, GMO no longer has debt on its books that was issued when Aquila was non-investment grade. This debt was retired on July 2, 2012. However, this does not mean that GMO's debt costs are free from the influence of creative financing techniques required to finance GMO's Missouri utility assets. These techniques would not be required if it were not for the previous corporate structure of Aquila and its failed non-regulated investments. Consequently, Staff still believes certain hypothetical costs must be assumed.

Q. Does Mr. Bryant believe GMO could have realized a lower cost of debt if it had been able to issue the debt directly rather than through GPE?

A. Mr. Bryant indicates that even if GMO had issued the debt, because GMO does not have a minimum of three years of audited financial statements, it would have needed a GPE guarantee in order to issue the debt. Consequently, the cost of debt would have been based on GPE's ratings profile. This is interesting because it implies that even if GMO had been owned by an 'AA' rated entity, a very strong credit rating, the debt issued by GMO would have required a guarantee from GPE, and therefore, the required return would have been based on GPE's rating profile. In this hypothetical situation, the debt assumed by GPE would have been priced consistent with an 'AA' rating, but any debt issued subsequent to GPE's acquisition would be based on a 'BBB-' rating without regard to the previous stand-alone credit profile of the prior entity. Ideally, the cost of capital for any specific business segment should be based on the risk profile of the assets in that segment, not the risk profile of the consolidated entity that owns the segment. This was the rationale for not charging GMO ratepayers for debt costs higher than those consistent with a 'BBB' rating. If GMO's assets had been acquired without the accompanying Aquila legacy debt, there is no rational reason to believe GMO would have been rated any lower than KCPL, which is rated 'BBB'. Consequently, costs of debt issued by GPE on behalf of GMO should be consistent with this rating as well.

Q. What methodology disagreement does Mr. Bryant have with your proposed adjustment to GPE's August 15, 2010, 3-year, $250 million debt offering?

A. Mr. Bryant claims that my use of the average utility bond yield for 3-year bonds for the month of August 2010, the month in which GPE issued these bonds, does not

consider factors such as a new issue concession of approximately 20-25 basis points and the fact that GMO currently has a split rating from S&P and Moody's for its senior unsecured debt.

While Staff acknowledges that GMO does currently have a split rating from Moody's (Baa3) and S&P (BBB), as Staff has explained, the focus should not be on GMO's current rating, but the commitment made to not charge costs for a rating below 'BBB' and the rating GMO could have absent the lingering effects of Aquila legacy debt. Consequently, Staff does not believe consideration should be given for GMO's current split rating.

Staff discovered some information from GPE's Board of Directors materials during an onsite visit on September 25, 2012, that provides GPE's own view of an approximate cost of debt differential between debt issued by GPE as opposed to debt issued by KCPL. Considering that KCPL currently has a senior unsecured credit rating by both Moody's (Baa2) and S&P (BBB) consistent with the rating in which GMO's debt costs should be based, the estimated cost of debt differential between KCPL and GPE is a reasonable proxy for a fair and reasonable adjustment. Based on indicative pricing estimates provided at the following GPE Board Meetings: August 6 – 7, 2012, April 30 – May 1, 2012 and February 6 – 7, 2012, GPE estimated the cost differential between a KCPL 3-year debt issuance and a GPE 3-year debt issuance was approximately ** ___ ** basis points. Consequently, Staff believes a cost of debt adjustment of approximately ** — ** basis points would be reasonable, although Staff considers an adjustment anywhere between ** ___ _** basis points to be just and reasonable.

Q. What are Mr. Bryant's specific concerns with your adjustment to GPE's May 16, 2011, 10-year, $350 million debt offering?

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A. Mr. Bryant repeated his concerns regarding GMO's split rating and the new issue concession. Mr. Bryant believes these considerations would eliminate Staff's proposed downward adjustment of 15 basis points based on the May 2011 average yield for similar tenor utility bonds. However, subsequent to the filing of Staff' Report, Staff received indicative pricing information Scotia Capital provided to KCPL for purposes of assessing the potential cost of 30-year debt it ultimately issued in September 2011. This indicative pricing sheet indicated that KCPL could expect to pay a coupon of 5.95% on its 30-year unsecured debt. KCPL ultimately paid a coupon of 5.30%. Considering that Scotia Capital indicated a potential coupon of 4.45% if KCPL had issued 10-year unsecured debt, it overestimated the coupon of the 30-year debt by 65 basis points., Staff considered an assumed 4.00% cost of debt for the May 16, 2011 debt issuance to be reasonable as compared to its actual coupon of 4.85%.

Q. Did the GPE Board of Directors' information you discussed earlier provide additional information useful for considering a fair and reasonable adjustment to this debt issuance?

A. Yes. The approximate indicative spread between GPE 10-year debt and KCPL 10-year debt was approximately ** ___ ** basis points. Consequently, Staff supports a cost of debt adjustment to the 4.85% debt issuance in the range of ** ___ _** basis points.

Q. Does Mr. Bryant express concern about your adjustment to the coupon rate of 5.292% offered with the March 19, 2012 GPE 10-year debt issuance?

A. Yes.

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Q. What is his primary point of contention about your proposed adjustment to this debt issuance?

A. Mr. Bryant claims that because GPE was contractually required to issue this debt because it was a remarketing of subordinated debt underlying the GPE equity units issued in May 2009, it was not even possible for GMO to issue this debt directly. Therefore, an adjustment for the hypothetical assumption that GMO could have issued this debt at a 'BBB' rating is not relevant.

Q. Does Mr. Bryant's logic illustrate part of the problem with deciding what is fair and reasonable for the cost of debt for Missouri's regulated utility assets?

A. Yes. Mr. Bryant's position for what is appropriate is driven by restrictions imposed on GPE when it decided to issue the equity units, not on what is appropriate for GMO. GPE decided to assign this remarketed debt to GMO, even though GMO's assets did not cause the need for GPE to issue the equity units. If GMO could issue debt based on the quality of its assets, absent the repercussions of Aquila legacy debt attached to these assets, it could have issued solid investment grade debt. Because this has not been possible for several years, hypothetical debt costs consistent with a 'BBB' rating were supposed to be assigned to these assets. The same still holds true. The costs caused by contractual restrictions faced by GPE are costs to be incurred by GPE, not utility ratepayers.

Q. What was the coupon rate on the debt GPE issued for remarketing purposes?

A. 5.292%.

Q. Is this the cost GPE is requesting be included in the cost of debt in this case?

A. No. After consideration of the premium at which the debt was issued and the issuance expenses, the current cost that is included in the embedded cost of debt is

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approximately 5.112%. According to the April 30, 2012 and May 1, 2012 Board of Directors meeting materials, this debt was priced to yield at ** ____ **, which is the indicative market cost of this debt. Because this was the effective market yield on this debt, this rate is the most relevant when considering the reasonableness of the cost of this debt.

Q. How much of an adjustment to the cost of this debt issuance did you recommend in the Staff Report?

A. Approximately 104 basis point reduction due to Staff's assumed coupon of 4.25%, which was the average monthly yield on 'BBB' ten-year utility bonds at the time GPE remarketed this debt.

Q. Why was the cost of the GPE debt so much higher than the average yields in the market at the same time GPE made this debt offering?

A. According to the April 30, 2012 and May 1, 2012 GPE Board of Directors meeting materials, the cost of this debt was approximately ** _____ _____ **. Consequently, GMO would be paying a higher cost for this parent company level debt just because it was connected with the remarketing of the notes underlying the equity units. Again, this is a cost that should be incurred by GPE, not Missouri ratepayers. Additionally, considering that the GPE Board of Director materials showed a spread between the indicative cost of debt for KCPL and GPE to be ** _____ **, this would support a downward adjustment of approximately ** _____ ** basis points to the cost of this debt issuance.

SUMMARY AND CONCLUSIONS

Q. Please summarize the conclusions of your surrebuttal testimony.

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A. Dr. Hadaway's rebuttal testimony is severely lacking any substantive debate on the appropriateness of using GDP growth as a proxy for perpetual growth in a DCF analysis for a regulated electric utility company. Considering this assumption is primary to Dr. Hadaway's COE estimates, this lack of substantive discussion of this issue should be noted by the Commission. Staff has provided extensive industry and government data that refutes this theory. This information is both empirical and practical in nature.

Additionally, considering Dr. Hadaway's attack on Staff's objectivity, even though Staff has considerable 3rd party corroboration for its position, it is incredible that Dr. Hadaway introduced an entirely new approach to support a 10.3% ROE recommendation. Absent this new approach to the DCF methodology, the highest ROE Dr. Hadaway could support is approximately 10%.

Dr. Hadaway provides an explanation as to why he believes a long-term growth rate consistent with expected inflation is not reasonable. However, he provides no practical or empirical information to support his explanation. Staff provides empirical and practical support for the high probability that investors expect utility stocks to appreciate at a rate consistent with inflation. Staff also provided information from ** _____

_____

_____ **

Although the use of more reasonable perpetual growth rates results in an implied COE that is lower than Staff's ROE recommendation, these implied COE indications are quite logical considering the current low yield environment. Investors view utility stocks as alternative investment to bonds. The dramatic increase in regulated electric utility stock prices over the last couple of years, despite low economic growth over the same period, is a

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direct reflection of this relationship. Staff provided information from the investment community that indicates that investors currently view the spread between allowed ROEs and the COE to be higher than historical standards. Consequently, Staff urges the Commission to keep this in mind when using historical allowed ROEs to test the reasonableness of ROE recommendations in this case.

Although Staff believes commissions will continue to allow ROEs higher than the COE, because of the widening spread caused by a decline in the COE, Staff believes it is fair to share these lower capital costs with ratepayers through an allowed ROE lower than that previous authorized for KCPL.

Finally, Staff continues to believe adjustments should be made to debt GPE issued for purposes of financing GMO's operations.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.

Kansas City Power & Light Company
Case No. ER-2012-0174

Multiple-Stage Discounted Cash Flow (DCF) Estimated Costs of Common Equity for the Comparable Electric Utility Companies

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Company Name	Annualized Quarterly Dividend	Growth Years 1-5	6	7	Growth Years 8	9	10	Growth in Perpetuity	Cost of Equity
Alliant Energy	$1.80	6.13%	5.69%	5.25%	4.81%	4.38%	3.94%	3.50%	8.52%
American Electric Power	$1.88	3.95%	3.88%	3.80%	3.73%	3.65%	3.58%	3.50%	8.74%
Cleco Corp.	$1.25	5.50%	5.17%	4.83%	4.50%	4.17%	3.83%	3.50%	7.21%
Great Plains Energy	$0.85	5.36%	5.05%	4.74%	4.43%	4.12%	3.81%	3.50%	8.44%
IDACORP, Inc.	$1.32	3.75%	3.71%	3.67%	3.63%	3.58%	3.54%	3.50%	6.95%
Pinnacle West Capital	$2.10	5.38%	5.07%	4.75%	4.44%	4.13%	3.81%	3.50%	8.62%
Southern Company	$1.89	5.27%	4.98%	4.68%	4.39%	4.09%	3.80%	3.50%	8.34%
Westar Energy, Inc.	$1.32	6.39%	5.91%	5.43%	4.95%	4.46%	3.98%	3.50%	9.34%
Wisconsin Energy	$1.20	6.73%	6.19%	5.65%	5.12%	4.58%	4.04%	3.50%	7.76%
Xcel Energy	$1.04	5.54%	5.20%	4.86%	4.52%	4.18%	3.84%	3.50%	8.06%
									8.20%

Sources: Column 1 = The Value Line Investment Survey: Ratings & Reports, February 24, March 23, and May 4, 2012.
Column 2 = Reuters.com on May 1, 2012.
Column 8 = See range of averages from Schedules 14-1 through Schedules 14-4 and Schedule 15.

CORRECTED SCHEDULE 13-2

CORRECTED SCHEDULE 13-2

Kansas City Power & Light Company
Case No. ER-2012-0174

Multiple-Stage Discounted Cash Flow (DCF) Estimated Costs of Common Equity for the Comparable Electric Utility Companies

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Company Name	Annualized Quarterly Dividend	Growth Years 1-5	6	7	Growth Years 8	9	10	Growth in Perpetuity	Cost of Equity
Alliant Energy	$1.80	6.13%	5.77%	5.42%	5.06%	4.71%	4.35%	4.00%	8.89%
American Electric Power	$1.88	3.95%	3.96%	3.97%	3.98%	3.98%	3.99%	4.00%	9.10%
Cleco Corp.	$1.25	5.50%	5.25%	5.00%	4.75%	4.50%	4.25%	4.00%	7.61%
Great Plains Energy	$0.85	5.36%	5.13%	4.91%	4.68%	4.45%	4.23%	4.00%	8.81%
IDACORP, Inc.	$1.32	3.75%	3.79%	3.83%	3.88%	3.92%	3.96%	4.00%	7.36%
Pinnacle West Capital	$2.10	5.38%	5.15%	4.92%	4.69%	4.46%	4.23%	4.00%	8.99%
Southern Company	$1.89	5.27%	5.06%	4.85%	4.64%	4.42%	4.21%	4.00%	8.71%
Westar Energy, Inc.	$1.32	6.39%	5.99%	5.59%	5.20%	4.80%	4.40%	4.00%	9.69%
Wisconsin Energy	$1.20	6.73%	6.28%	5.82%	5.37%	4.91%	4.46%	4.00%	8.14%
Xcel Energy	$1.04	5.54%	5.28%	5.03%	4.77%	4.51%	4.26%	4.00%	8.44%
									8.57%

Sources: Column 1 = The Value Line Investment Survey: Ratings & Reports, February 24, March 23, and May 4, 2012.
Column 2 = Reuters.com on May 1, 2012.
Column 8 = See range of averages from Schedules 14-1 through Schedules 14-4 and Schedule 15.

CORRECTED SCHEDULE 13-3

Kansas City Power & Light Company
Case No. ER-2012-0174

Multiple-Stage Discounted Cash Flow (DCF) Estimated Costs of Common Equity for the Comparable Electric Utility Companies

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Company Name	Annualized Quarterly Dividend	Growth Years 1-5	6	7	Growth Years 8	9	10	Growth in Perpetuity	Cost of Equity
Alliant Energy	$1.80	6.13%	5.82%	5.52%	5.21%	4.91%	4.60%	4.30%	9.11%
American Electric Power	$1.88	3.95%	4.01%	4.07%	4.13%	4.18%	4.24%	4.30%	9.33%
Cleco Corp.	$1.25	5.50%	5.30%	5.10%	4.90%	4.70%	4.50%	4.30%	7.85%
Great Plains Energy	$0.85	5.36%	5.18%	5.01%	4.83%	4.65%	4.48%	4.30%	9.04%
IDACORP, Inc.	$1.32	3.75%	3.84%	3.93%	4.03%	4.12%	4.21%	4.30%	7.60%
Pinnacle West Capital	$2.10	5.38%	5.20%	5.02%	4.84%	4.66%	4.48%	4.30%	9.21%
Southern Company	$1.89	5.27%	5.11%	4.95%	4.79%	4.62%	4.46%	4.30%	8.94%
Westar Energy, Inc.	$1.32	6.39%	6.04%	5.69%	5.35%	5.00%	4.65%	4.30%	9.91%
Wisconsin Energy	$1.20	6.73%	6.33%	5.92%	5.52%	5.11%	4.71%	4.30%	8.38%
Xcel Energy	$1.04	5.54%	5.33%	5.13%	4.92%	4.71%	4.51%	4.30%	8.67%
									8.80%

Sources: Column 1 = The Value Line Investment Survey: Ratings & Reports, February 24, March 23, and May 4, 2012.
Column 2 = Reuters.com on May 1, 2012.
Column 8 = See range of averages from Schedules 14-1 through Schedules 14-4 and Schedule 15.

CORRECTED SCHEDULE 13-4

SCHEDULE DM-SUR-1,

SCHEDULE DM-SUR-2

AND

SCHEDULE DM-SUR-3

HAVE BEEN DEEMED

HIGHLY CONFIDENTIAL

IN THEIR ENTIRETY

ISI INTERNATIONAL STRATEGY & INVESTMENT GROUP INC.

MONDAY JANUARY 09, 2012

POWER & UTILITIES RESEARCH
REGULATED UTILITIES

REGULATED UTILITIES

Valuations Supported By Low Interest Rates; There Are Relative Values

We Reiterate Our Buy Ratings on AEP and PCG & Are Upgrading PNW & WR from Hold to Buy. We Are Downgrading ED to Sell.

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- **Our 18 Stock Regulated Electric Utilities Universe Returned 20.9% in FY '11** versus a flat S&P 500 return. Stock performance was highly correlated with the S&P500 until mid-August '11, when the stocks became extremely cheap to the bond market, with their yield profile causing a Q3 bounce versus the S&P 500 that persisted through year-end.

- **Investment Thesis: Own Large Cap Value Over Quality and Overweight Mid-Cap Yield Names:** Our target prices are up on average 10%, with the Regulated Utilities trading 5% cheap—on average—assuming a 12-month holding period and offering total return prospects of 8.5% This reflects an average target P/E multiple of 14.5x '13 EPS, vs. our prior target which averaged 13.5x. This is supported by the persistently low interest rate backdrop and the assumption of a stable regulatory profile over the next year. If anything, we see an upside bias to our targets if interest rates stay persistently accommodative. **We continue to recommend investors own value over quality in the large-cap regulated universe, with our Buy rated stocks being AEP and PCG. We are upgrading PNW, WR from Hold to Buy** as we think they offer superior relative yield opportunities and improving risk profiles which should allow for multiple expansion. **We are lowering ED from Hold to Sell**, as the stock trades at a premium valuation but could face regulatory headwinds if they fail to achieve a rate settlement prior to their expected March 2012 rate filing.

- **Stock Selection Will Be Key To Performance This Year:** In all but two years since 1990 it was possible to beat the market in this sub-group. Last year, it was a macro call, with only *one* stock, PCG, lagging the market, as Regulated Utilities returned >20% on average. This year will be much more difficult. Bond market conditions continue to be supportive of a higher average valuation for the group, but meaningful price appreciation and/or relative performance should be skewed to stocks that still have a combination of attractive yield characteristics and improving regulatory/economic risk profiles that allow for multiple expansion. Our Buy rated portfolio trades at an average P/E multiple of 13.2x '13 EPS with a dividend yield averaging 4.6%, offering total return prospects of 17% over the next twelve months. The most fully valued stocks in the group today, D, DUK, ED, SO, WEC, trade at 14.5x-15.5x '13 EPS and an average dividend yield of 4% due to their perceived "quality" and/or the "safety" of their regulatory and economic outlook (and therefore the dividend). A potential change in the story is needed to prompt a "Sell" rating (our view on ED).

- **Top Down View: Balance of Risks appears Supportive Despite High Valuation vs. Stocks:** Regulated utility valuations look full vs. stocks but less so versus bonds. 2013 consensus P/E sits at 13.9x, with a relative P/E vs. the S&P 500 of 1.23x, through the last high in November 2008. Relationships to the bond market do look more favorable, with our dividend yield/corporate bond yield model showing modestly positive risk/reward under the assumption of an extended period of depressed Treasury note yields and stable/tightening of BBB corporate bond yields.

- **Bottom Up View: Is the Backdrop "As Good As It Gets?"** The last several years have generally been a constructive "bottom up" environment for regulated utilities. On the regulatory front state governments have allowed authorized returns on equity to fall, on average, slower than interest rates, in part because the rate impact has been muted as customers have benefited from the pass through of lower fuel costs (lower natural gas prices) and the overall lack of inflation has blunted the impact of cost recovery. The balance sheet and cash flow profile of the group has remained resilient due to this backdrop driving easy access to the capital markets, and cash inflows from economic stimulus (like bonus depreciation). While we may be closer to the "end of the runway," continued declines in gas pricing, low inflation and a measured approach to ratemaking vis-à-vis authorized ROE's appear to set the stage for a balanced bottom up profile once again in 2012.

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Exhibit 1
Summary of Ratings, Target Prices & Investment Theses

Ticker	ISI Rating	Target Price NEW	Target Price Prior	Current Price	One Yr Total Rtn	Summary of Investment Thesis
PCG	**BUY**	**48.00**	**45.00**	**41.05**	**21.4%**	The stock has been pummeled by the continued financial overhang from last year's pipeline explosion, negative EPS revisions for '12 due to other un-related headwinds, and increased CA regulatory risk in '13 due to the increasing certainty of a lower ROE and equity ratio being granted. We think these risks are priced-in, as PCG has underperformed its peers by ~29% over the past year, trading at 13.5x '13. The stock appears to discount almost $1.5 billion of value destruction in excess of our estimate. We think that is extreme.
AEP	**BUY**	**46.00**	**42.00**	**40.98**	**16.7%**	The financial outlook has been inscrutable for the last 18 months due to a panoply of regulatory and political uncertainties, particularly in Ohio. We believe the stock overly discounts the risks. The current price discounts no growth in earnings through 2014 and that the company never breaks a 10% ROE at its core utility business. As AEP resolves some of the issues or gets more clarity on them over the next 12 months, the risk premium in the stock will dissipate.
WR	**BUY**	**31.00**	**27.00**	**28.26**	**14.2%**	We think the resolution of WR's pending base rate case by April 2012 will validate both their near term earnings outlook and a stable regulatory regime, allowing WR to trade to a higher valuation. WR will grow rate-base at >8% annually between '10 and '15, with capital committed to environmental retrofits at coal plants and transmission infrastructure. After equity needs, we expect 5% EPS growth over that period, with the dividend growing in line with earnings.
PNW	**BUY**	**52.00**	**46.00**	**47.15**	**14.7%**	We think the resolution of PNW's pending rate case settlement in Q2 2012 will validate both their near term earnings outlook and a stable regulatory regime, allowing PNW to trade to a higher valuation. Our base case assumes earnings growth post 2012 may be challenging between rate cases (due to regulatory lag) unless the economic recovery in AZ accelerates and/or PNW secures the majority of the provisions in its pending rate request. However, investors are being "paid to wait" with an above average dividend yield and the balance of risks appears favorable for PNW at current levels.
NVE	HOLD	**17.50**	15.50	16.05	12.1%	NVE's stock price has risen over the last 18 months as the time approached for the filing of a rate case for their southern Nevada subsidiary, because investors have become comfortable that the regulatory environment in Nevada is now balanced enough to discount a rational outcome. The stock has upside to an economic recovery, but appears fully valued under our base case.
NST	HOLD	**48.50**	44.50	44.80	12.1%	Since our launch, NST shares look more rationally priced, having discounted some execution risk on their capital program and the regulatory front. Our forecast assumes the pending merger between NU and NSTAR closes by YE '11, so we value NST at 1.312 our $33.50 target price for NU
DTE	HOLD	**57.00**	51.00	53.52	10.9%	DTE is a bit more diversified than most of its peers. Gas storage/pipelines, an unregulated power and industrial projects unit and energy trading round out the mix. For DTE to achieve its 5-6% EPS growth target through '15 DTE will need stable authorized returns in MI and is counting on significant growth at the P&IP unit and the gas business. We have a hard time betting against DTE as they are sound operators and allocators of capital, but they have a marginally higher risk profile given the business mix.
NU	HOLD	**37.00**	34.00	34.51	10.7%	Since our launch, NU shares look more rationally priced, having discounted some execution risk on their capital program and the regulatory front. Our forecast assumes the pending merger between NU and NSTAR closes by YE '11, increasing NU's EPS growth potential from '10-15 to 7% from 6% annually assuming: 1) They hit transmission development goals, 2) Merger synergies help NU operating subs to earn better ROE's, and 3) NST negotiates a constructive multi-year rate deal to replace the one expiring YE '12.
TE	HOLD	**20.00**	18.50	18.95	10.0%	TECO's core utilities have only 2.5% growth in rate base expected from '10-'15. TE has reduced legacy utility investments in Guatemala so their significant non-utility exposure is at TECO Coal. The investment case hinges on: 1) How cash rich they become over the next few years as they consume parent NOL's and capture increased profits from met-coal before global supply conditions improve, and; 2) what they do with the money.

Source: ISI Research

Exhibit 2

Summary of Ratings, Target Prices & Investment Theses

Ticker	ISI Rating	Target Price NEW	Target Price Prior	Current Price	One Yr Total Rtn	Summary of Investment Thesis
SRE	HOLD	59.00	57.00	55.88	8.9%	SRE is capable of reaching its EPS growth aspiration of 6-8% annually, given rate base growth at its core CA utilities, growth projects at its pipeline and storage segment, and the contribution from its solar power development pipeline. At a 23% discount to the peer group it appears interesting. However, the earnings expected to come from investment tax credits (15% by 2015) is an issue, as is increased exposure to South America through buying 100% ownership of utilities in Peru and Chile.
D	HOLD	53.50	50.00	51.36	8.0%	Skeptics look at Dominon's recent outperformance and high relative P/E versus the peer group and conclude the stock is overvalued. We conclude that this is only partly true and that a premium is to a large degree justified, driven by the superior return and growth profile of the utility and gas infrastructure segments over the forecast period.
CMS	HOLD	22.00	19.50	21.73	5.1%	In Mid-2010, CMS materially increased the dividend and laid out a capital expenditure program that support EPS growth from '10-'15 of between 5-7%. This presumes consistent treatment by the Michigan regulators and an absence of equity financing needs over the forecast period. All in all, CMS has become a lower risk investment with a balanced total return profile. While CMS offers an EPS and total return profile consistent with other regulated names, the discount is driven to some degree by its higher leverage/lower credit profile relative to its peers.
WEC	HOLD	34.50	31.50	34.50	3.0%	WEC is concluding a seven year infrastructure growth cycle through. The company will be cash rich over the next several years but lacks investment opportunities at its core utility, so they will return value to shareholders through increasing the dividend payout ratio to 60% over '12-'15 and buying back $300m of stock from mid-'11 through '13.
XEL	HOLD	27.00	23.75	27.22	3.0%	We expect EPS growth to decelerate to 5% through 2015, with dividend growth averaging around 3%. The key to XEL hitting the higher end of its 5-7% EPS growth aspiration and achieving P/E multiple expansion is showing an improving ROE trend at its core utility business
PGN	HOLD	53.50	49.75	54.53	2.7%	The proposed merger with DUK appears value enhancing as it creates customer benefits through rate mitigation, while a modest level of synergies retained by the combined company could drive less regulatory lag than we had forecasted given their aggressive cap-ex plan and nuclear issue in FL.
SO	HOLD	43.50	38.00	44.95	0.9%	Southern has the building blocks in place to achieve the high end of their 5-7% EPS growth aspiration through 2015, while earning an above-industry average ROE and looks like an execution story over the next 24-36 months, but this largely appears reflected in the stock price.
DUK	HOLD	20.50	19.00	21.47	0.1%	The proposed merger with PGN appears value enhancing for DUK shareholders as it creates tangible customer benefits through rate mitigation, while a modest level of operating synergies retained by the combined company could help Duke's Carolina and Indiana regulated returns on equity lag less than we had forecasted given their aggressive cap-ex plan and cost over-run issues. This—among other factors—improves the odds that the combined company will be able to achieve it LT EPS growth aspiration of 4-6% off 2011 EPS.
ED	SELL	56.00	51.50	59.27	-1.5%	ED's premium valuation is driven by its inherent "defensiveness" as a conservatively operated, predictable dividend payer with a rate certainty through mid-'13 but looks overvalued on our base case forecast. We think that ED's stock will be more influenced short-term by exogenous factors as its defensive premium will dissipate if U.S. economic conditions improve and the market begins embracing risk.

Source: ISI Research, Company Data

Exhibit 3

Summary Regulated Comp Sheet – PE Valuation

Ticker	Company Name	1/9/12 Price	ISI Rating	Shares Out	Market Cap	2012 Div Yld	2012 Payout	ISI EPS Estimate 2012	2013	2014	P/E Multiple 2012	2013	2014	'11-'15 EPS Growth	Price to Book	Prem. to Group
PGN	Progress Energy Inc	$54.53	HOLD	296	16,135	4.5%	79%	3.13	3.28	3.28	17.4x	16.6x	16.6x	2.0%	1.6x	20%
NST	NStar	$44.80	HOLD	104	4,659	3.9%	64%	2.75	2.85	2.95	16.3x	15.7x	15.2x	3.9%	2.4x	13%
SO	Southern Company Inc	$44.95	HOLD	861	38,720	4.3%	71%	2.75	2.90	3.10	16.3x	15.5x	14.5x	6.7%	2.4x	11%
ED	Consolidated Edison Inc	$59.27	SELL	294	17,442	4.1%	65%	3.75	3.90	3.95	15.8x	15.2x	15.0x	3.3%	1.6x	9%
WEC	Wisconsin Energy Corp	$34.50	HOLD	235	8,123	3.5%	53%	2.25	2.35	2.40	15.3x	14.7x	14.4x	4.4%	2.0x	6%
D	Dominion Resources Inc	$51.36	HOLD	575	29,508	4.0%	63%	3.30	3.55	3.70	15.6x	14.5x	13.9x	5.5%	2.3x	4%
DUK	Duke Energy Corp	$21.47	HOLD	1,333	28,609	4.7%	70%	1.45	1.48	1.57	14.8x	14.5x	13.7x	5.2%	1.3x	4%
XEL	Xcel Energy Inc	$27.22	HOLD	486	13,216	3.9%	59%	1.82	1.92	2.02	15.0x	14.2x	13.5x	5.4%	1.6x	2%
NU	Northeast Utilities	$34.51	HOLD	178	6,129	3.8%	54%	2.40	2.50	2.70	14.4x	13.8x	12.8x	5.1%	1.6x	-1%
WR	Westar Energy Inc	$28.26	BUY	119	3,369	4.7%	68%	1.95	2.05	2.15	14.5x	13.8x	13.1x	5.7%	1.4x	-1%
DTE	DTE Energy Co	$53.52	HOLD	171	9,149	4.5%	65%	3.75	3.95	4.10	14.3x	13.5x	13.1x	3.9%	1.3x	-3%
PNW	Pinnacle West Capital Corp	$47.15	BUY	110	5,166	4.6%	64%	3.40	3.50	3.55	13.9x	13.5x	13.3x	5.6%	1.4x	-3%
PCG	PG&E Corp	$41.05	BUY	402	16,499	4.4%	56%	3.25	3.05	3.55	12.6x	13.5x	11.6x	1.4%	1.5x	-3%
TE	Teco Energy Inc	$18.95	HOLD	215	4,077	4.7%	64%	1.40	1.45	1.50	13.5x	13.1x	12.6x	2.8%	1.9x	-6%
CMS	CMS Energy Corp	$21.73	HOLD	262	5,699	4.4%	61%	1.57	1.67	1.79	13.9x	13.0x	12.2x	6.8%	2.0x	-6%
NVE	NV Energy	$16.05	HOLD	237	3,806	3.3%	42%	1.25	1.29	1.34	12.8x	12.4x	12.0x	13.9%	1.1x	-11%
AEP	American Electric Power Co Inc	$40.98	BUY	482	19,764	4.5%	58%	3.20	3.35	3.45	12.8x	12.2x	11.9x	3.4%	1.5x	-12%
SRE	Sempra Energy	$55.88	HOLD	242	13,518	3.4%	43%	4.50	5.20	5.25	12.4x	10.7x	10.6x	7.1%	1.5x	-23%
Regulated Group Average						**4.2%**	**61%**				**14.5x**	**13.9x**	**13.3x**	**5.1%**	**1.7x**	
Regulated Group Max						4.7%	79%				17.4x	16.6x	16.6x	13.9%	2.4x	
Regulated Group Min						3.3%	42%				12.4x	10.7x	10.6x	1.4%	1.1x	

Source: ISI Research and FactSet

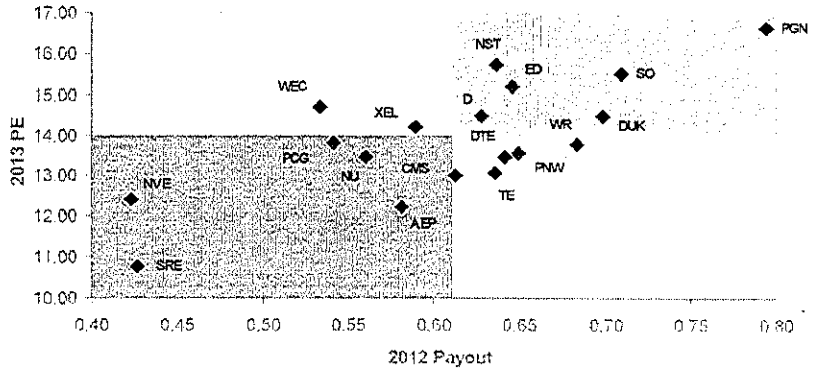
- **"Quality" is at a premium 14.5-15.5x 2013 EPS: SO, ED, WEC, D**
- **"Value" is at a discount, 11-13.5x 2013 EPS: AEP, CMS, NVE, PCG, SRE, TE**
- **"Second Tier Quality" in the middle: DTE, DUK, NU, PNW, WR, XEL**

Stocks We Like Look Relatively Cheap With Catalysts

Investment Thesis: As one could glean from reading the summary's above, all the stocks we like appear to have improving fundamental outlooks with catalysts over the next twelve months that should drive an upward absolute/relative valuation within the peer group. Our Buy rated portfolio trades at an average P/E multiple of 13.2x '13 EPS with a dividend yield averaging 4.6%, offering total return prospects of 17% over the next twelve months. In comparison the most fully valued stocks in the group today, D, DUK, ED, SO, WEC, trade at 14.5x-15.5x '13 EPS and an average dividend yield of 4% due to their perceived "quality" and/or the "safety" of their regulatory and economic outlook (and therefore the dividend).

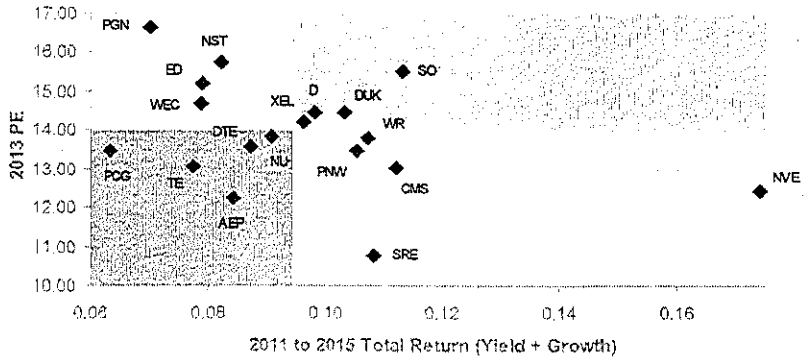
Valuation: P/E Ratio Often Correlates To Payout Ratio, Without Considering Total Return Profile

Exhibit 4
2013 Price to Earnings vs. 2012 Payout Ratio



Source: ISI Research, Company Data

Exhibit 5
'13 P/E vs. '11-'15 Total Return (Yield + Growth)



Source: ISI Research, Company Data

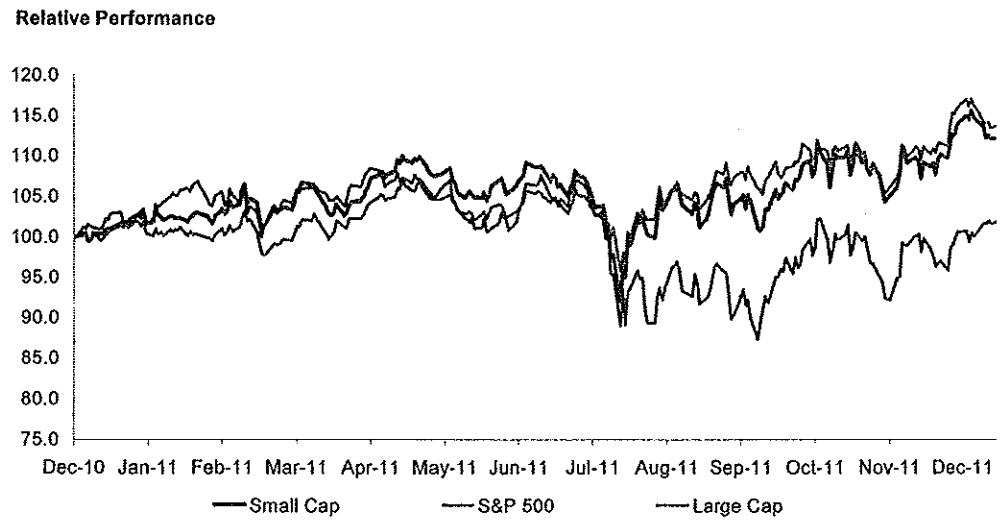
- **There appears to be a correlation between P/E ratio and payout ratio**
- **PNW & WR offer above average total return prospects at a discount to the peer group**
- **AEP trades at a significant discount to its large cap peer group based on our EPS growth forecast and the current dividend**
- **PCG doesn't look cheap using this particular screen, as its earnings and dividend growth potential recalibrate in 2014**

Regulated Utilities Have Outpaced the Market

Investment Thesis: After beating the market in 2010 Regulated Utility stocks performed in line with the S&P500, more or less, until early August. It is interesting perspective to note that the majority of the groups 20.9% outperformance vs. the S&P500 happened in Q3 '11, when they rallied against the stock market in our view because they became very cheap relative to bond yields (see page 10 for more details).

Exhibit 6

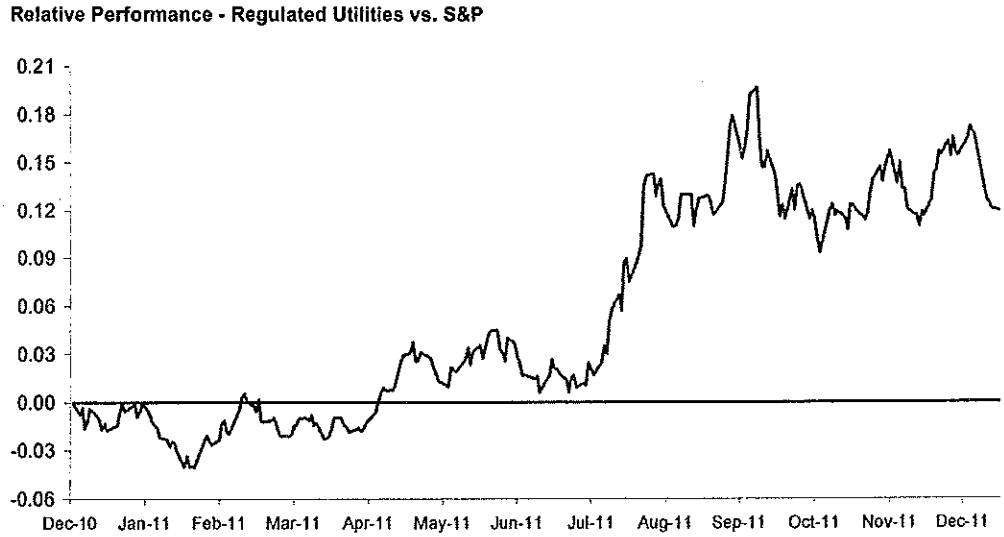
Absolute & Relative Performance vs. the S&P 500: Regulated Utilities: The Stocks Have Outperformed



Source: ISI Research FactSet

Exhibit 7

Relative Performance of Regulated Utilities vs. the S&P 500 since 1/1/11



Source: ISI Research, FactSet

This Performance Is Consistent With History

Regulated utilities tend to outperform in downturns but do not necessarily underperform in the period after a recovery... Regulated Utilities beat the S&P 500 on a total return basis in each of the last five contractions, including the "Great Recession." Interestingly, they also outperformed the market subsequent to the end of four of the last five cycles.

Exhibit 8
Utility Performance Through The Business Cycle

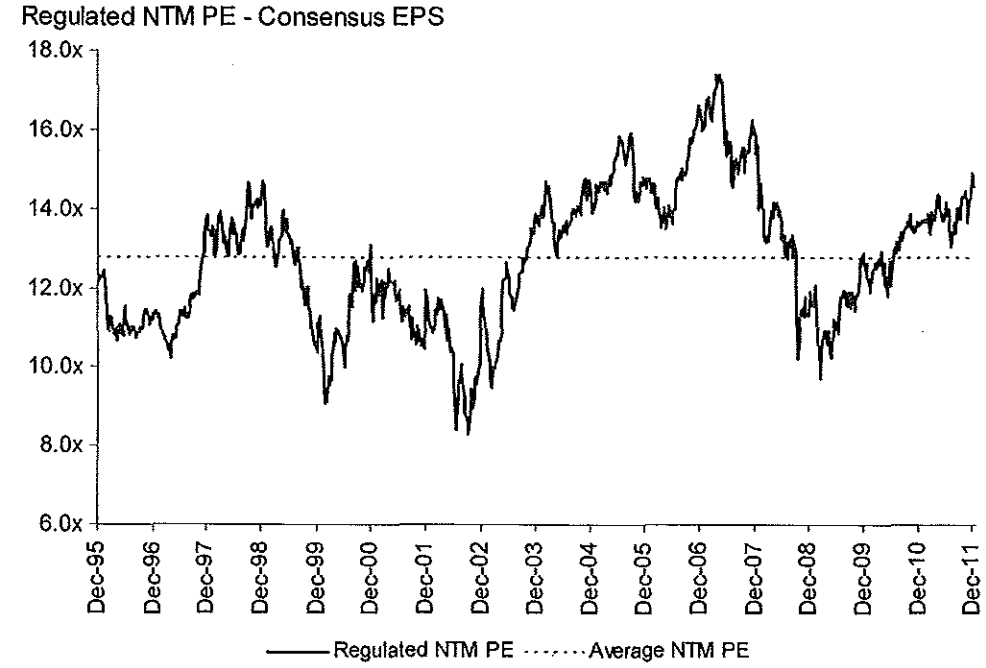
	Business Cycle Periods			Total Return				
Business Contractions	Previous Trough	Start Date (Peak)	End Date (Trough)	No Recession Trough to Pk	During Recession	12 Months Post Trough	24 Months Post Trough	30 Months Post Trough
1980 Contraction	Mar-75	Jan-80	Jul-80					
S&P 500				NA	6.5	12.9	-5.4	22.4
Utilities Large Cap1				NA	16.7	7.4	31.1	58.6
Utilities Small Cap2				NA	16.4	5.8	24.8	50.9
Defensive Utilities Avg				NA	17.5	7.8	32.3	62.4
Utility Out / (Under) Performance				**NA**	**11.0**	**-5.1**	**37.6**	**40.1**
1981 Contraction	Jul-80	Jul-81	Nov-82					
S&P 500				12.9	4.4	20.8	23.6	32.7
Utilities Large Cap1				7.4	39.3	35.1	57.5	83.6
Utilities Small Cap2				5.8	35.0	28.1	56.1	62.1
Defensive Utilities				7.8	41.6	32.4	54.7	76.8
Utility Out / (Under) Performance				**-5.1**	**37.2**	**11.6**	**31.0**	**44.0**
1990 Contraction	Nov-82	Jul-90	Mar-91					
S&P 500				164.3	3.5	11.4	19.3	25.0
Utilities Large Cap1				329.4	10.1	20.8	55.4	68.6
Utilities Small Cap2				289.7	5.1	12.1	45.0	63.4
Defensive Utilities				316.7	9.6	17.3	47.7	62.6
Utility Out / (Under) Performance				**152.4**	**6.1**	**5.9**	**28.3**	**37.6**
2001 Contraction	Mar-91	Mar-01	Nov-01					
S&P 500				235.0	-12.7	-16.9	-3.1	2.1
Utilities Large Cap1				206.6	12.8	-15.7	1.4	9.3
Utilities Small Cap2				162.7	-7.1	-29.0	-6.8	-1.4
Defensive Utilities				184.6	2.4	-16.8	3.8	11.6
Utility Out / (Under) Performance				**-50.4**	**15.0**	**0.1**	**6.8**	**9.4**
2007 Contraction	Nov-01	Dec-07	Jun-09					
S&P 500				36.6	-37.9	12.1	43.7	36.8
Utilities Large Cap[1]				78.4	-17.7	19.6	46.3	67.7
Utilities Small Cap[2]				73.6	-18.4	24.1	65.3	80.9
Defensive Utilities				84.2	-18.6	21.1	57.1	75.2
Utility Out / (Under) Performance				**47.6**	**19.4**	**9.0**	**13.4**	**38.5**

Source: ISI Research, FactSet, Company Data
1) Includes SO, DUK, PCG, AEP, PGN, ED, XEL, DTE
2) Includes WEC, NST, PNW, CMS, TE, NVE, WR

Valuation vs. The S&P 500 Looks Stretched

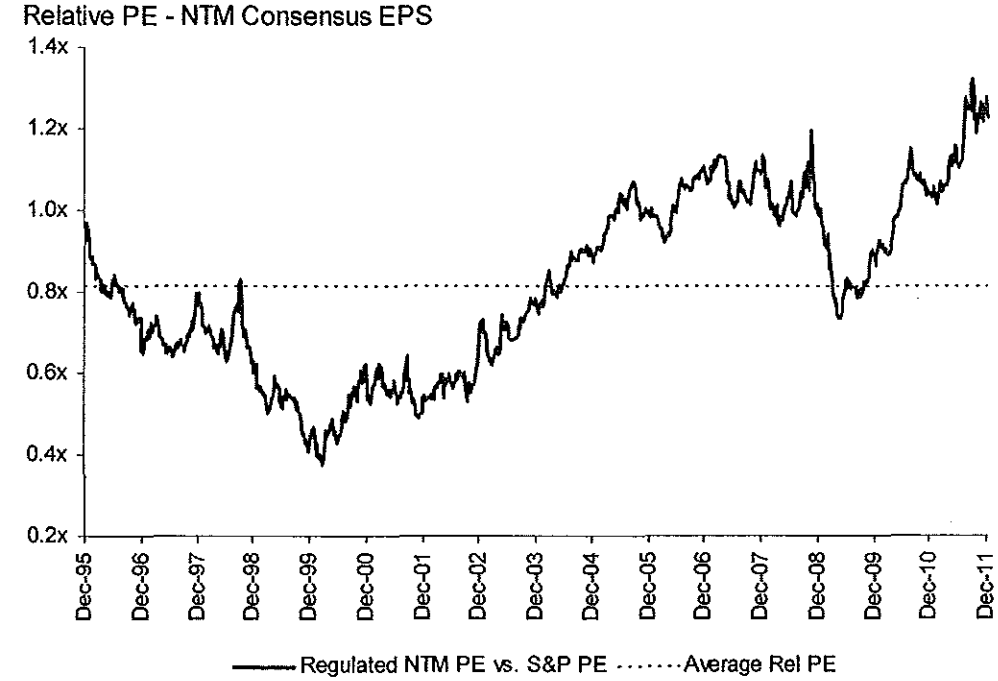
While the stocks don't look particularly expensive on an absolute P/E multiple basis, they are trading at high's vs. the S&P 500 one year forward P/E multiple on consensus EPS.

Exhibit 9
While Absolute P/E's Don't Look Stretched...



Source: ISI Research, FactSet

Exhibit 10
...Relative P/E on 1-Year Forward Consensus EPS Is Near Recent Highs



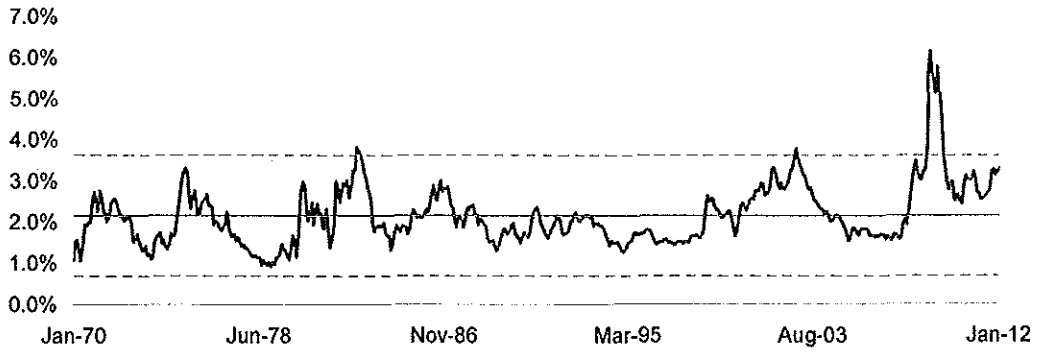
Source: ISI Research, FactSet

The Balance of Risks vs. Bonds is More Favorable

Our dividend/bond yield model suggests the balance of risks for the Regulated Utility sub-group is more positive, even assuming the sunset of the 15% tax rate on dividends. We believe utility stock valuations are highly correlated to bond market conditions given their leverage and high dividend yields, which make them alternatives to fixed income instruments. Going back 40 years, utility dividend yields — and, by extension, P/E multiples — have shown an 80% correlation to both 10-year Treasury note yields and to BBB corporate bond yields. Investor appetite for a dividend income, and the assumption of how much that income will grow over time, is a valuation driver that expresses itself through a relationship to the bond market.

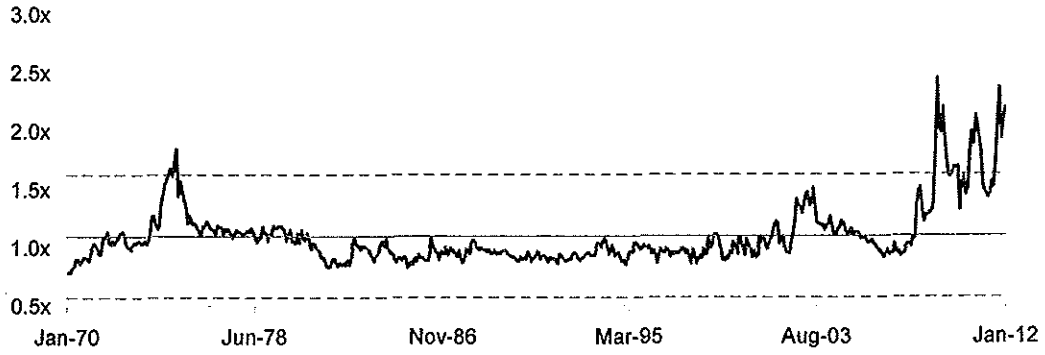
The fact that this correlation was high as it related to both Treasuries and corporate bonds was misleading. Since 1970 the BBB credit spread over Treasuries has averaged +/-210 bp. During the financial crisis when corporate credit markets imploded and government markets rallied the correlation to Treasuries broke down while the correlation to BBB credits stayed extremely high, leading utility stocks lower. At its apex (December 2008), the spread between Treasury yields and corporate bond yields peaked at ~600 bp. The average BBB credit spread over Treasuries is now approximately 329 bp.

Exhibit 11
BBB Corporate Bond Spread to 10-Year Treasuries—Still Wide



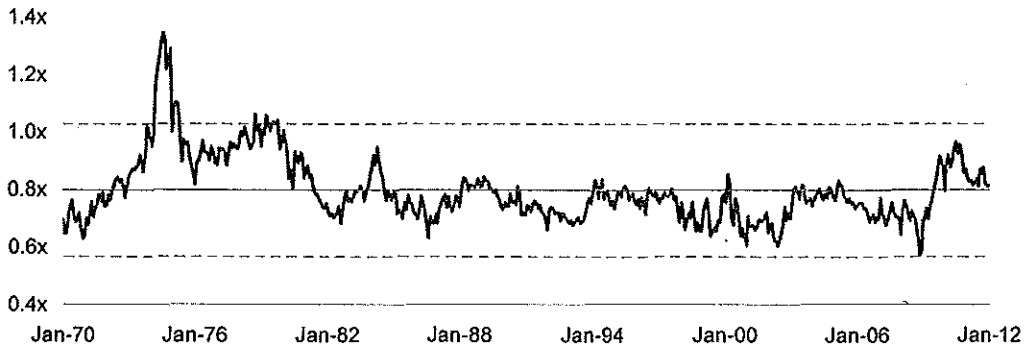
Source: ISI Research, FactSet

Exhibit 12
Dividend Yield Premium to 10-Year Treasury Yield—Still Blown Out.....



Source: ISI Research, FactSet

Exhibit 13
Dividend Yield to BBB Bond Yield Ratio: Supportive But Not Definitively Cheap

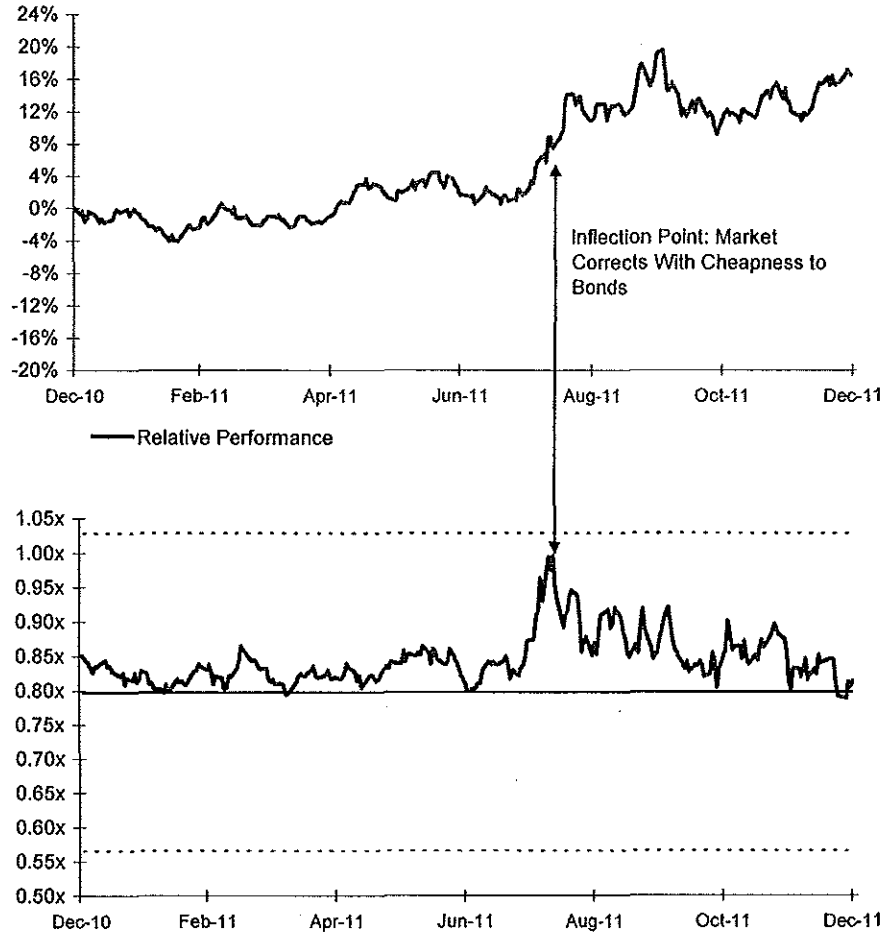


Source: ISI Research, FactSet

Rally in Q3 2011 Began When Utilities Become Oversold To the Bond Market

The vast majority of the outperformance of regulated utilities vs. The S&P500 occurred in Q3 subsequent to the group trading to at 68% confidence interval vs. the corporate bond market, based on our regression model.

Exhibit 14
Relative Utility Performance vs. Dividend Yield / Corporate BBB Relationship



Source: ISI Research, FactSet

We stress test our model for different tax rate as well as interest rate assumptions. One of the factors in the model that we adjust for is the varying tax treatment for dividends over the 1970–2010 period, with income tax rates from 1970–2003 and the 15% flat tax on dividends from 2004-present. We have added an algorithm to our model that allows us to flatten after tax yields. We also make an adjustment for the percentage of individual vs. institutional investors that own the shares of the regulated utility group (our view is that individuals change their behavior based on tax rates, while institutions do not, at least directly).

In our view the regulated names look cheap—on average—to the current interest backdrop. They price in rising Treasury bond yields & tightening corporate bond spreads. If the market begins to discount lower rates for longer and low tax rates the average multiple could trade to 16X. Under a higher rate scenario with rising tax rates, the group could see 5%+ absolute downside from its current valuation. We assume the 10-year Treasury rises to 3.5% by year-end 2013.

We have run four sensitivities using our regression model. Our assumptions are as follows:

- 3.5% 10YR Treasury, 6% BBB, 33% tax

high interest rate, low tax scenario (HR/LT):

- 3.5% 10YR Treasury, 6% BBB, 15% tax

low interest rate, high tax scenario (LR/HT):

- 2% 10YR Treasury, 5.3% BBB, 33% tax

low interest rate, low tax scenario (LR/LT):

- 2% 10YR Treasury, 5.3% BBB, 15% tax

Moving the dividend tax from 15% to the income tax rate affects the P/E on the group by ~1x.

Exhibit 15

Valuation Sensitivity to Dividend Tax/Interest Rate Assumption: Bond Correlations. Bear Case 12x. Bull Case 14.5x '12 EPS. Our target is 13.5x '12 EPS.

Scenarios:	Low Rates / Low Taxes	High Rates / Low Taxes	Low Rates / High Taxes	High Rates / High Taxes	Current Outlook
Rate Assumptions					
10 Year Treasury Yield	1.96%	3.50%	1.96%	3.50%	1.96%
Assumed BBB Bond Yield	5.25%	6.00%	5.25%	6.00%	6.00%
Tax Assumptions					
Tax Rate Levelized at Ordinary Income Tax Rate[1]			✓	✓	
Tax Rate Levelized at 15% Income Tax Rate[2]	✓	✓			Market Multiple
Target 2013 PE	**16.1x**	**14.2x**	**15.0x**	**13.1x**	**13.9x**
Target 2012 Dividend Yield	3.6%	4.1%	3.9%	4.4%	4.2%
Upside to our Target Multiple of 14.5x	11.2%	-2.0%	3.4%	-9.8%	
Upside to Current Market Multiple of 13.9x	16.0%	2.2%	7.9%	-5.9%	

Source: ISI Research, FactSet

Note: Averages based on our regulated universe excluding CMS, NVE, and WEC

1) Assumes a positive adjustment to post 2003 dividends in our regression series by approximately 7%. This represents the delta between the current 15% dividend tax rate and an assumed rate of 33%, adjusted by our assumption that 40% of shareholders are individual taxpayers. The sensitivity to the PE multiple from a 1% change in the assumed tax rate is 0.1x. The sensitivity to the PE multiple from a 10% change in our assumption relating to the proportion of tax-paying shareholders is 0.1x

2) Assumes a negative adjustment to pre 2003 dividends in our regression series by approximately 11%. This represents the delta between the current 15% dividend tax rate and a pre-2003 assumed rate of 33%, reduced by our assumption that 60% of shareholders were individual tax payers. The sensitivity to the PE multiple from a 1% change in the assumed tax rate is 0.1x. The sensitivity to the PE multiple from a 10% change in our assumption relating to the proportion of tax-paying shareholders is 0.1x

The Bottom Up Backdrop Has Been Favorable: But It Could Be "As Good As It Gets"

The utility industry's ability to sustain earnings and dividend growth is predicated on the ability to negotiate recovery of and on its investment in infrastructure while earning the highest achievable return over its cost of equity, all while mitigating growth in customer rates. This is not an easy task, but the economic backdrop over the last several years has generally allowed the utility industry to prosper by reducing the challenges associated with maintaining this virtuous cycle.

Rate base growth, which drives earnings growth, has been robust, while customer bills have been mitigated by low inflation and the steep drop in natural gas prices as electric power fuel, due to what we call the "shale gas dividend." As a result, authorized returns on equity have remained generally attractive. Therefore, capital markets have been amenable to funding utility investment and acquisitions. The industry has been aided by stimulus related cash flows associated with bonus depreciation and in some cases companies leaning on legacy NOL or AMT tax credit positions to help fund spending.

One of our concerns prospectively is that this environment, one way or another, will change for the worse. If the economy re-accelerates and/or we enter an inflationary, rising rate environment that is bad for utility stocks on multiple fronts. That does not appear to be a risk over the course of the next 12 months as the economy is growing but at a measure pace (The ISI forecast for GDP growth is 2% for 1H '12 and 2% for FY '12, while natural gas prices and to a lesser degree coal prices continue to fall, which flows through to customer bills.

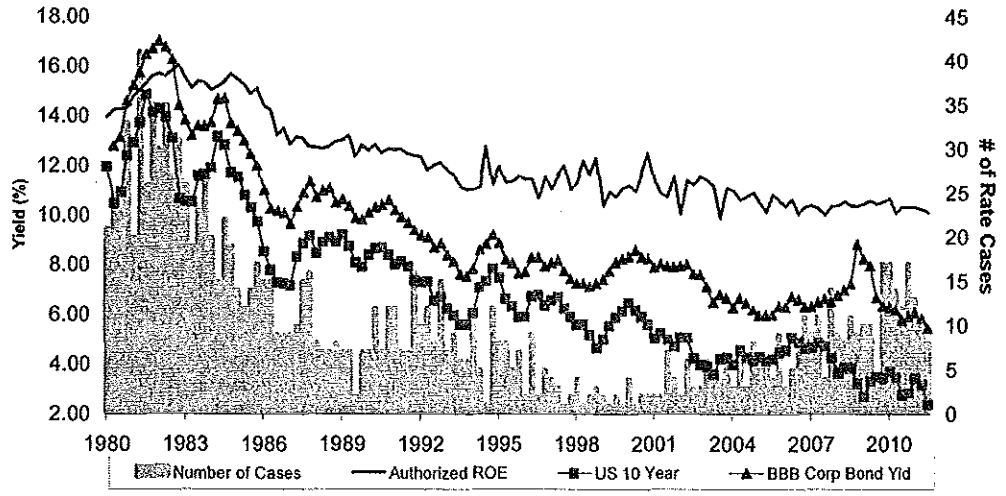
If we are in a prolonged low interest rate, low inflation environment it could boost valuation for some period of time but we think the state regulators will continue to moderate authorized ROE's. As long as this process is deliberate and not abrupt, we think it is generally a manageable risk for the industry and for stock price valuations.

Our 14.5x average P/E multiple target for the group on '13 EPS consciously takes in to account both this bottom up risk (potential for modest EPS revisions if ROE's moderate) as well as the top down risk associated with higher interest rates and/or the sunset of the dividend tax. Because, as we showed earlier, the current interest rate backdrop is supportive of even higher valuations, all things equal.

Exhibit 16
Utility Regulation "Circle of Life"

Source: Southern Company, 2011 Analyst Meeting

Exhibit 17
Authorized Returns on Equity Have Come Down Slower Than Interest Rates



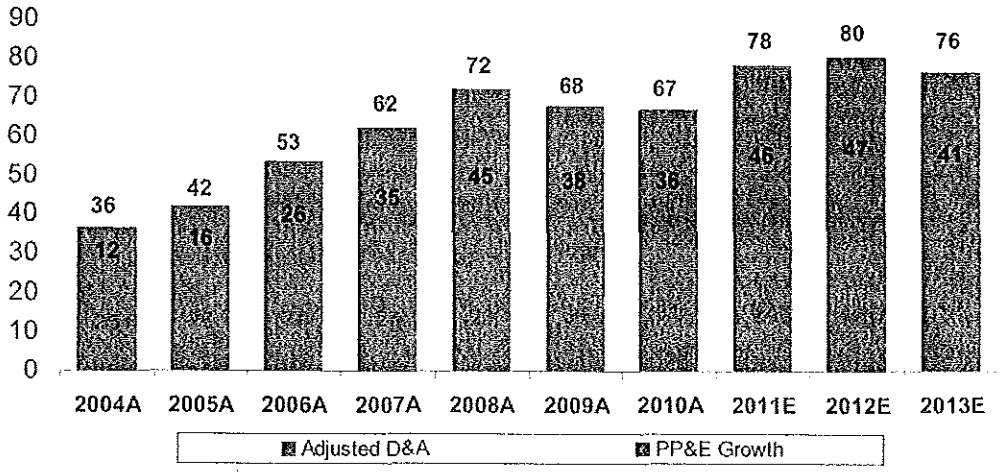
Source: ISI Research, SNL Research

Exhibit 18
2013 Target Multiple expands with a 50bps decrease in authorized ROEs

Ticker	'13 EPS ($)	Proforma '13 EPS ($)	'13 Payout	Proforma '13 Payout	Δ in '13 OCF ($m)	Δ in '13 TD/Cap (bps)	Target Mult	Proforma Target Mult	Multiple Δ
NST	2.85	2.75	63.2%	65.4%	-10	8	17.0x	17.6x	0.6x
PGN	3.28	3.11	75.6%	79.6%	-52	7	16.3x	17.2x	0.9x
PCG	3.05	2.90	59.7%	62.8%	-65	10	15.7x	16.6x	0.8x
WR	2.05	1.94	68.2%	72.0%	-15	-1	15.4x	16.2x	0.8x
PNW	3.50	3.26	64.6%	69.3%	-13	-151	14.9x	15.9x	1.1x
SO	2.90	2.81	69.8%	72.1%	-82	4	15.0x	15.5x	0.5x
D	3.55	3.46	61.7%	63.3%	-55	6	15.1x	15.5x	0.4x
NU	2.50	2.40	56.0%	58.4%	-32	0	14.8x	15.4x	0.6x
XEL	1.92	1.77	58.2%	63.3%	-76	14	14.1x	15.3x	1.2x
WEC	2.35	2.27	55.3%	57.2%	-51	15	14.7x	15.2x	0.5x
ED	3.90	3.73	62.6%	65.4%	-50	0	14.4x	15.0x	0.6x
DTE	3.95	3.80	64.2%	66.7%	-27	8	14.4x	15.0x	0.6x
AEP	3.35	3.18	56.9%	59.9%	-81	0	13.7x	14.5x	0.7x
DUK	1.48	1.42	69.4%	72.5%	-137	4	13.8x	14.4x	0.6x
NVE	1.29	1.22	44.1%	46.8%	-18	0	13.5x	14.4x	0.8x
TE	1.45	1.40	64.1%	66.5%	-11	0	13.8x	14.3x	0.5x
CMS	1.67	1.60	61.8%	64.6%	-91	-126	13.2x	13.8x	0.6x
SRE	5.20	5.09	36.9%	37.8%	-28	5	11.3x	11.6x	0.3x
Average			**60.7%**	**63.5%**			**14.5x**	**15.2x**	**0.7x**

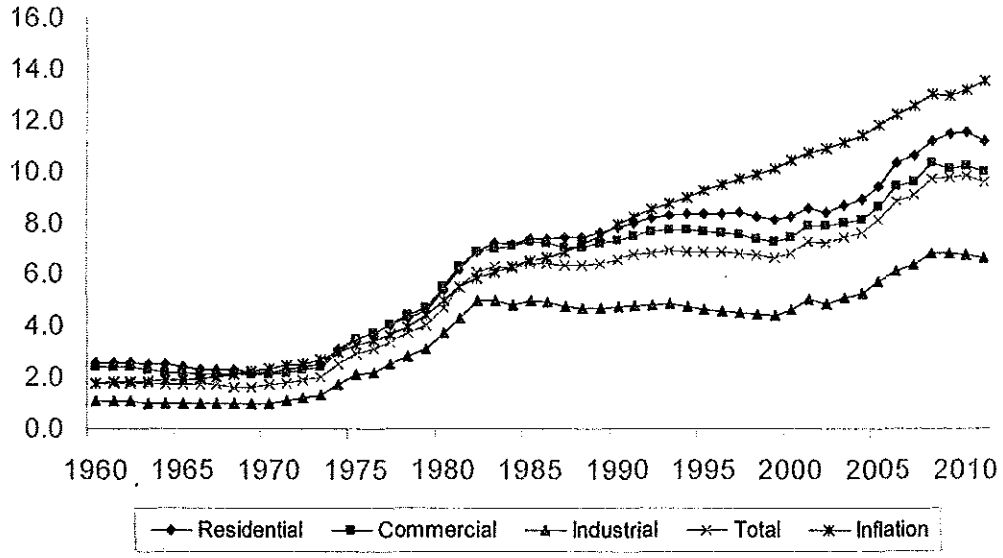
Source: ISI Research, Company Data

Exhibit 19
Rate Base Growth/Capital Spending Has Been Strong (Billions)



Source: SNL Research "Capital Expenditure Report" dated May 6, 2-11, Based on sample of 44 companies
Total Capex shown in grey numbers above bar chart, equals Adjusted D&A plus PP&E Growth

Exhibit 20
Average Utility Rates (c/ KWh) vs. Inflation



Source: ISI Research, EIA and Bureau of Labor Statistics

The Regulated Value Proposition Is A Function Of Asset Growth, Allowed Returns & Capital Ratios

The value proposition in a regulated utility stock is driven by the perception of its long term earnings power and ability to distribute dividends to shareholders. Our primary valuation tool is therefore a dividend discount/residual income model. The factors that drive the ability of a utility to create value that are ultimately inputs in to this tool can be boiled down to a three factor model.

Exhibit 21
Regulated Utilities: Key Value Drivers

Earnings = *f* (Assets, Allowed Returns, Capital Ratios)

Category	Driver	Recent Impact	Commentary
Assets	Rate Base Growth	Positive	T&D Upgrades needed to improve system reliability and move renewable energy to loads and install the "smart grid". Capex for generation assets. Environmental retrofits needed to meet tightening regulatory standards.
Allowed Returns	Rate Cases	Neutral/Positive	Allowed ROEs have been generally stable. Recessionary pressures have not driven confiscatory decisions in most states
Capital Ratios	Rate Cases	Neutral	Equity Ratio is determined by regulators and companies manage to prescribed levels. These have remained stable due to regulators being mindful of credit metrics.

Source: ISI Research

We are concerned about the level of authorized returns on two fronts and see the risk of decelerating rate base growth.

Of the value drivers discussed above, the one that has by far the biggest impact on earnings and valuation is allowed (and earned) ROEs. While rate base growth and capital ratios are important, they have a second order impact on valuation. Rate base growth and higher equity layers do lead to earnings growth however they must be financed with equity issuances, thus blunting the impact to valuation.

The other assumption which of course is a key determinant of value is the equity discount rate. As we will discuss below, it is the spread between these two parameters (earned returns over the cost of equity) which drives value.

At present, we are monitoring all three fronts. The spread between authorized returns on equity and the cost of equity appears wide by historical standards, although we believe that equity risk premiums may in fact be hire than they appear given that low interest rates are being driven by sovereign credit risk. We are watching the regulatory backdrop closely but so far ROE's have come down at a moderate pace. As is shown above, projected rate base growth looks to already be slowing. The level of capital spending witnessed over the past 4 years will be hard to sustain short run, although environmental capital costs will accelerate circa '14-'15.

How Our Proprietary DDM Model Works

Our dividend discount model guides us to our target PE multiple given the following inputs:

1) The group's current equity discount rate, based on the current risk-free rate (10 year US Treasury bond), the current adjusted beta of the regulated utility group (average of a subset of regulated utilities vs. the S&P 500 over the past 3 years, trending toward one), and an assumed equity risk premium

2) An estimate of near term and longer term earned returns on equity (ROEs) and equity ratios *from the valuation date.*

3) An estimate of near-term and longer term rate base growth *from the valuation date*

Our model discounts a hypothetical stream of residual cash flows to the equity holder based on the above parameters, assuming incremental rate base growth is financed with equity issuances above the total level of debt allowed by the regulators. To simplify the modeling, we assume equity cash flow is approximately equal to net income, plus D&A, plus incremental debt issuance less capex.

We consider three "stages" for these inputs. The first stage encompasses the first 5 years of our valuation period (Years 1 to 5). We assume a certain rate base growth trajectory, and assume that the earned ROE's remain constant over that time period.

In the second stage we adjust both the rate base growth and earned ROE projections up or down to reflect what we believe to be a reasonable longer-term estimate for the company or industry over the next 15 years (years 6 to 20). This presumes a level of mean reversion to the regulated utility industry regarding both the rate of growth as well the earned returns on equity.

Finally, we assume a modest perpetuity growth rate (2%) for the final year of cash flows (from year 20) to derive a terminal value

The annual equity cash flows from stages 1 and 2 as well as the terminal value is discounted back to a valuation date, and expressed as a multiple of first year's (Year 1's) net income.

Exhibit 22

Example of ISI's Proprietary DDM Valuation Approach

	Period	Rate Base	EPS	Total Debt	Total Equity	Equity FCF	Dscnt FCF	Rate Base Growth	ROE	Equity Ratio
Stage 1	0	18.2	1.00	9.09	9.09			4.0%	11.0%	50.0%
	1	18.9	1.04	9.45	9.45	0.68	0.62	4.0%	11.0%	50.0%
	2	19.7	1.08	9.83	9.83	0.70	0.60	4.0%	11.0%	50.0%
	3	20.5	1.12	10.23	10.23	0.73	0.58	4.0%	11.0%	50.0%
	4	21.3	1.17	10.64	10.64	0.76	0.55	4.0%	11.0%	50.0%
	5	22.1	1.22	11.06	11.06	0.79	0.53	4.0%	11.0%	50.0%
Stage 2	6	22.8	1.20	11.39	11.39	0.66	0.54	3.0%	10.5%	50.0%
	7	23.5	1.23	11.73	11.73	0.69	0.51	3.0%	10.5%	50.0%
	8	24.2	1.27	12.09	12.09	0.72	0.49	3.0%	10.5%	50.0%
	9	24.9	1.31	12.45	12.45	0.74	0.46	3.0%	10.5%	50.0%
	10	25.6	1.35	12.82	12.82	0.97	0.44	3.0%	10.5%	50.0%
	11	26.4	1.39	13.21	13.21	1.00	0.42	3.0%	10.5%	50.0%
	12	27.2	1.43	13.60	13.60	1.03	0.40	3.0%	10.5%	50.0%
	13	28.0	1.47	14.01	14.01	1.06	0.38	3.0%	10.5%	50.0%
	14	28.9	1.52	14.43	14.43	1.09	0.36	3.0%	10.5%	50.0%
	15	29.7	1.56	14.86	14.86	1.13	0.34	3.0%	10.5%	50.0%
	16	30.6	1.61	15.31	15.31	1.16	0.33	3.0%	10.5%	50.0%
	17	31.5	1.66	15.77	15.77	1.20	0.31	3.0%	10.5%	50.0%
	18	32.5	1.71	16.24	16.24	1.23	0.30	3.0%	10.5%	50.0%
	19	33.5	1.76	16.73	16.73	1.27	0.28	3.0%	10.5%	50.0%
	20	34.5	1.81	17.23	17.23	1.31	0.27	3.0%	10.5%	50.0%
Stage 3	20					20.92	4.29	2.0%		
	Sum of Discounted Equity Free Cash Flow						13.00			
	Expressed as a Multiple of Year 1 Net Income						12.5x			

Stage One (Years 1 to 5) Assumptions for Rate Base Growth, ROE and Equity Ratio

Stage Two (Years 6 to 20) Assumptions for Rate Base Growth, ROE and Equity Ratio

Terminal Growth rate for Year 20 Equity Free Cash Flow

Source: ISI Research

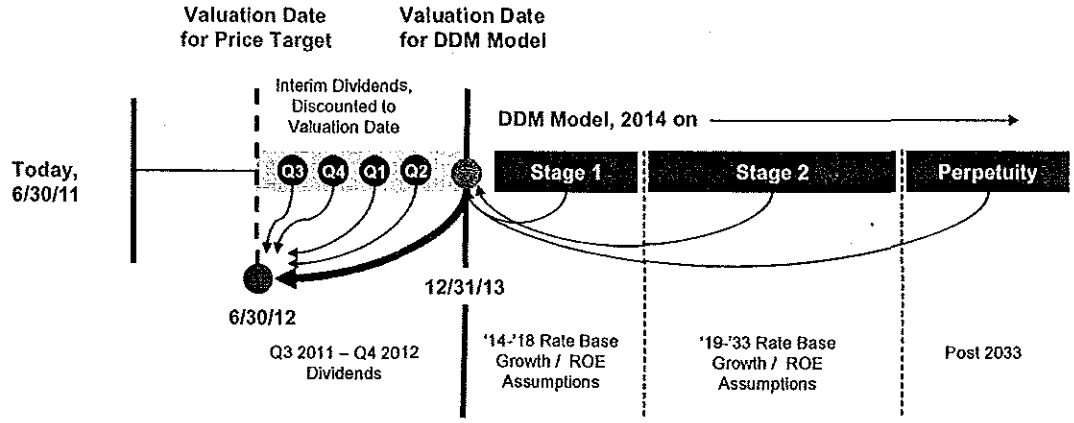
In our valuation approach, we actually use 2014 as our base valuation year, with a year-end 2013 valuation date. We argue that if we have the ability to model a company's structural earnings power out that far, we can see through near term issues and potentially have an edge on the longer term value proposition.

The P/E multiple target we derive in this approach tells us what multiple the stock should trade to by YE '13, which we can then easily discount back to where the stock should trade 12 months from today, which is our target price.

In addition, any dividends received between our price target date and our DDM valuation date (year end 2013), must be discounted back to our price target valuation date and added to our valuation.

In the exhibit below, we illustrate how to derive a one year forward price target using the principles discussed.

Exhibit 23
Proprietary DDM Illustration



Source: ISI Research

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>+10%	>+15%	>+20%
Hold Low Risk ETR	**Hold Medium Risk ETR**	**Hold High Risk ETR**
0% to +10%	-5% to +15%	-10% to +20%
Sell Low Risk ETR	**Sell Medium Risk ETR**	**Sell High Risk ETR**
<0%	<-5%	<-10%

ISI has assigned a rating of BUY to 46% of the securities rated as of 12/31/11.
ISI has assigned a rating of HOLD to 51% of the securities rated as of 12/31/11.
ISI has assigned a rating of SELL to 3% of the securities rated as of 12/31/11

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Stock Performance

Q2 2012
FINANCIAL UPDATE

QUARTERLY REPORT
OF THE U.S. SHAREHOLDER-OWNED
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Stock Performance	SEC Financial Statements (Holding Companies)
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Future EEI Finance Meetings

47th EEI Financial Conference
November 11-14, 2012
JW Marriott Desert Ridge Resort and Spa
Phoenix, Arizona

For more information about EEI Finance Meetings, please contact Debra Henry, (202) 508-5496, dhenry@eei.org

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Washington, D.C. 20004-2696
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www.eei.org

The 59 U.S. Shareholder-Owned Electric Utilities

The companies listed below all serve a regulated distribution territory. Other utilities, such as transmission provider ITC Holdings, are not shown below because they do not serve a regulated distribution territory. However, their financial information is included in relevant EEI data sets, such as transmission-related construction spending.

ALLETE, Inc. (ALE)
Alliant Energy Corporation (LNT)
Ameren Corporation (AEE)
American Electric Power Company, Inc. (AEP)
Avista Corporation (AVA)
Black Hills Corporation (BKH)
CenterPoint Energy, Inc. (CNP)
Central Vermont Public Service Corporation (CV)
CH Energy Group, Inc. (CHG)
Cleco Corporation (CNL)
CMS Energy Corporation (CMS)
Consolidated Edison, Inc. (ED)
Dominion Resources, Inc. (D)
DPL, Inc. (DPL)
DTE Energy Company (DTE)
Duke Energy Corporation (DUK)
Edison International (EIX)
El Paso Electric Company (EE)
Empire District Electric Company (EDE)
Iberdrola USA
Energy Future Holdings Corp. (formerly TXU Corp.)
Entergy Corporation (ETR)
Exelon Corporation (EXC)
FirstEnergy Corp. (FE)
Great Plains Energy Incorporated (GXP)
Hawaiian Electric Industries, Inc. (HE)
IDACORP, Inc. (IDA)
Integrys Energy Group, Inc. (TEG)
IPALCO Enterprises, Inc.
MDU Resources Group, Inc. (MDU)
MGE Energy, Inc. (MGEE)
MidAmerican Energy Holdings Company
NextEra Energy, Inc. (NEE)
NiSource Inc. (NI)
Northeast Utilities (NU)
NorthWestern Corporation (NWE)
NV Energy, Inc. (NVE)
OGE Energy Corp. (OGE)
Otter Tail Corporation (OTTR)
Pepco Holdings, Inc. (POM)
PG&E Corporation (PCG)
Pinnacle West Capital Corporation (PNW)
PNM Resources, Inc. (PNM)
Portland General Electric Company (POR)
PPL Corporation (PPL)
Progress Energy (PGN)
Public Service Enterprise Group Inc. (PEG)
Puget Energy, Inc.
SCANA Corporation (SCG)
Sempra Energy (SRE)
Southern Company (SO)
TECO Energy, Inc. (TE)
UIL Holdings Corporation (UIL)
UniSource Energy Corporation (UNS)
Unitil Corporation (UTL)
Vectren Corporation (VVC)
Westar Energy, Inc. (WR)
Wisconsin Energy Corporation (WEC)
Xcel Energy, Inc. (XEL)

Companies Listed by Category
(as of 12/31/11)

Please refer to the Quarterly Financial Updates webpage for previous years' lists.

Given the diversity of utility holding company corporate strategies, no single company categorization approach will be useful for all EEI members and utility industry analysts. Nevertheless, we believe the following classification provides an informative framework for tracking financial trends and the capital markets' response to business strategies as companies depart from the traditional regulated utility model.

Regulated	80%+ of total assets are regulated
Mostly Regulated	50% to 80% of total assets are regulated
Diversified	Less than 50% of total assets are regulated

Categorization of the 52 publicly traded utility holding companies is based on year-end business segmentation data presented in 10Ks, supplemented by discussions with company IR departments. Categorization of the seven non-publicly traded companies (*shown in italics*) is based on estimates derived from FERC Form 1 data and information provided by parent company IR departments.

The EEI Finance and Accounting Division continues to evaluate our approach to company categorization and business segmentation. In addition, we can produce customized categorization and peer group analyses in response to member company requests. We welcome comments, suggestions and feedback from EEI member companies and the financial community.

Regulated (39 of 59)

ALLETE, Inc.
Alliant Energy Corporation
Ameren Corporation
American Electric Power Company, Inc.
Avista Corporation
Central Vermont Public Service Corporation
CH Energy Group, Inc.
Cleco Corporation
CMS Energy Corporation
Consolidated Edison, Inc.
DPL, Inc.
DTE Energy Company
Edison International
El Paso Electric Company
Empire District Electric Company
Iberdrola USA
Entergy Corporation
Great Plains Energy Incorporated
IDACORP, Inc.
Integrys Energy Group
IPALCO Enterprises, Inc.
Northeast Utilities
NorthWestern Energy
NV Energy, Inc.
PG&E Corporation
Pinnacle West Capital Corporation
PNM Resources, Inc.
Portland General Electric Company
Progress Energy
Puget Energy, Inc.
Southern Company
TECO Energy, Inc.
UIL Holdings Corporation
UniSource Energy Corporation
Unitil Corporation
Vectren Corporation
Westar Energy, Inc.
Wisconsin Energy Corporation
Xcel Energy, Inc.

Mostly Regulated (17 of 59)

Black Hills Corporation
CenterPoint Energy, Inc.
Dominion Resources, Inc.
Duke Energy Corporation
Exelon Corporation
First Energy Corp.
MGE Energy, Inc.
MidAmerican Energy Holdings
NextEra Energy, Inc.
NiSource Inc.
OGE Energy Corp.
Otter Tail Corporation
Pepco Holdings, Inc.
PPL Corporation
Public Service Enterprise Group, Inc.
SCANA Corporation
Sempra Energy

Diversified (3 of 59)

Energy Future Holdings
Hawaiian Electric Industries, Inc.
MDU Resources Group, Inc.

Note: Based on assets at 12/31/11

The following companies were removed from the consolidated financial statements for 2009 and 2010 because they did not file Form 10-K with the SEC: Duquesne Light Holdings, Green Mountain Power, KeySpan, Kentucky Utilities, Louisville Gas and Electric and Niagara Mohawk Power.

Q2 2012

Stock Performance

HIGHLIGHTS

- While the EEI Index trailed the major averages for the first half of 2012, the year's first two quarters were mirror opposites and reflected the influence of global macroeconomic developments far more than any significant change in industry fundamentals.
- Interest rates continued to decline. The 10-year Treasury yield fell from a high of about 2.4% in late March to below 1.5% by mid-June. Historically low interest rates have offered an important source of support for utility shares in recent years.
- The EEI Index outperformed all major market sectors over the 12-month period ending June 30. By late June, most analysts observed that utility price/earnings ratios were near historical highs relative to the broad market. However, given today's extraordinarily low interest rates, utility shares receive powerful support from the industry's roughly 4% dividend yield, double that of the S&P 500's dividend yield. Industry business fundamentals remain reasonably healthy and analysts continue to expect mid-single-digit earnings growth for many utilities driven by sizeable ongoing capital investment programs.

COMMENTARY

The EEI Index trailed all three major market indices for the first half of 2012, returning 5.2% versus the Dow Jones Industrials' 6.8%, the S&P 500's 9.5% and the more volatile and tech-heavy Nasdaq Composite Index's strong 12.7% gain. However, the final tally for the six-month period was less illuminating than its composition on a quarter-to-quarter basis. The year's first two quarters were mirror opposites and reflected the influence of global macroeconomic develop-

I. Index Comparison (% Return)

Index	2006	2007	2008	2009	2010	2011	2012*
EEI Index	20.8	16.6	-25.9	10.7	7.0	20.0	5.2
Dow Jones Inds.	19.1	8.9	-31.9	22.7	14.1	8.4	6.8
S&P 500	15.8	5.5	-37.0	26.5	15.1	2.1	9.5
Nasdaq Comp.^	9.5	9.8	-40.5	43.9	16.9	-1.8	12.7

Calendar year returns shown for all periods, except where noted. / *Through 6/30
^Price gain/loss only. Other indices show total return.
Full year, except where noted.
Source: EEI Finance Department

II. Category Comparison (% Return)

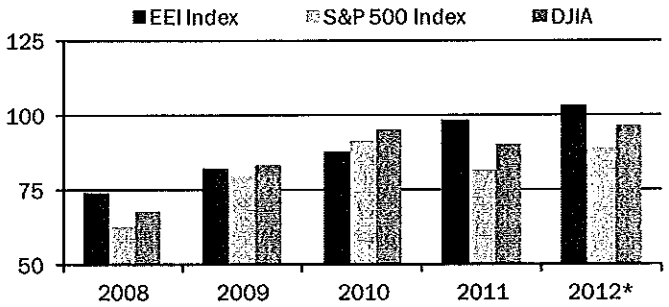
U.S. Shareholder-Owned Electric Utilities

Index	2006	2007	2008	2009	2010	2011	2012*
All Companies	22.5	9.8	-20.9	14.1	11.9	21.4	5.0
Regulated	22.6	7.8	-15.6	14.2	15.8	22.3	5.4
Mostly Regulated	22.4	9.9	-27.0	15.6	8.5	19.5	4.6
Diversified	22.2	18.5	-33.9	8.1	-5.2	21.4	6.3

Calendar year returns shown for all periods except where noted. / *Through 6/30
Returns shown here are unweighted averages of constituent company returns. The EEI Index return shown in Table I above is cap-weighted.
Source: EEI Finance Department, SNL Financial and company annual reports.

III. Total Return Comparison

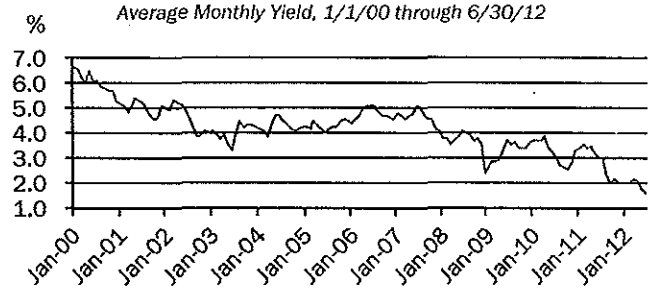
Value of $100 invested at close on 12/31/2007



Note: Year end, except where noted. / *Through 6/30
Source: EEI Finance Department

IV. 10-Year Treasury Yield — Monthly

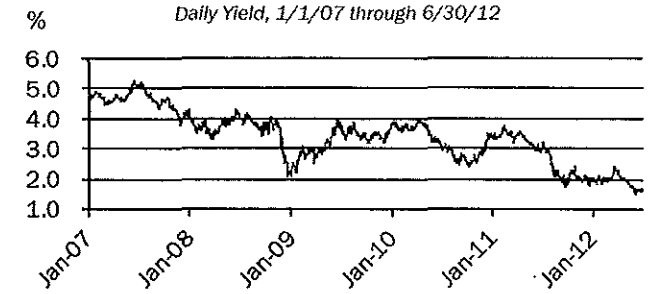
Average Monthly Yield, 1/1/00 through 6/30/12



Source: U.S. Federal Reserve

V. 10-Year Treasury Yield — Daily

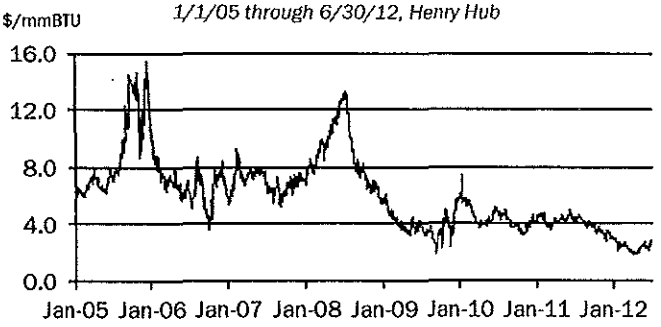
Daily Yield, 1/1/07 through 6/30/12



Source: U.S. Federal Reserve

VI. Natural Gas Spot Prices

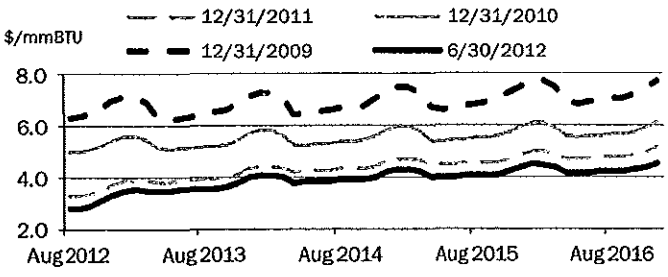
1/1/05 through 6/30/12, Henry Hub



Source: SNL Financial

VII. NYMEX Natural Gas Futures

August 2012 through December 2016, Henry Hub



Source: SNL Financial

VIII. Returns by Quarter

U.S. Shareholder-Owned Electric Utilities

Index	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2
EEI Index	5.5	8.0	-2.5	-3.7	12.6	1.3	2.9	5.7	1.8	8.4	-1.4	6.6
Dow Jones Ind.	15.8	8.1	4.8	-9.4	11.1	8.0	7.1	1.4	-11.5	12.8	8.8	-1.8
S&P 500	15.6	6.0	5.4	-11.4	11.3	10.7	5.9	0.1	-13.9	11.8	12.6	-2.8
Nasdaq Comp.^	15.7	6.9	5.7	-12.0	12.3	12.0	4.8	-0.3	-12.9	7.9	18.7	-5.1

^Price gain/loss only. Other indices show total return.

Category*	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2
All Companies	9.0	9.0	0.3	-3.7	12.1	3.3	4.8	5.9	-0.3	9.7	-0.6	5.6
Regulated	9.6	9.6	1.3	-2.7	12.0	4.8	5.4	6.4	-1.0	10.2	-0.5	5.9
Mostly Regulated	8.9	8.3	-0.8	-5.2	13.7	1.5	3.6	4.7	1.1	9.0	-1.0	5.6
Diversified	5.6	8.0	-2.6	-7.1	5.1	-0.2	8.9	6.1	-3.6	8.9	1.0	5.2

* Returns shown here are unweighted averages of constituent company returns. The EEI Index return shown above is cap-weighted.
Source: EEI Finance Department, SNL Financial and company annual reports.

IX. Sector Comparison, Trailing 12 mo. Total Return

For the twelve-month period ending 6/30/12

Sector	Total Return
EEI Index	15.8%
Consumer Services	13.3%
Telecommunications	12.7%
Utilities	12.4%
Technology	10.9%
Healthcare	10.1%
Consumer Goods	6.8%
Financials	0.3%
Industrials	-1.0%
Oil & Gas	-9.0%
Basic Materials	-15.9%

Note: Sector Comparison page based on the Dow Jones U.S. Indexes, which are market-capitalization-weighted indices. Find more information at http://www.djindexes.com/mdsidx/downloads/fact_info/Dow_Jones_US_Indexes_Industry_Indexes_Fact_Sheet.pdf

X. Sector Comparison, Q2 2012 Total Return

For the three-month period ending 6/30/12

Sector	Total Return
Telecommunications	12.2%
EEI Index	6.6%
Utilities	4.6%
Healthcare	2.1%
Consumer Services	0.7%
Consumer Goods	-2.4%
Industrials	-4.3%
Financials	-5.0%
Oil & Gas	-6.9%
Basic Materials	-7.5%
Technology	-8.0%

Note: Sector Comparison page based on the Dow Jones U.S. Indexes, which are market-capitalization-weighted indices. Find more information at http://www.djindexes.com/mdsidx/downloads/fact_info/

XI. Market Capitalization at June 30, 2012 (in $ Mil.)

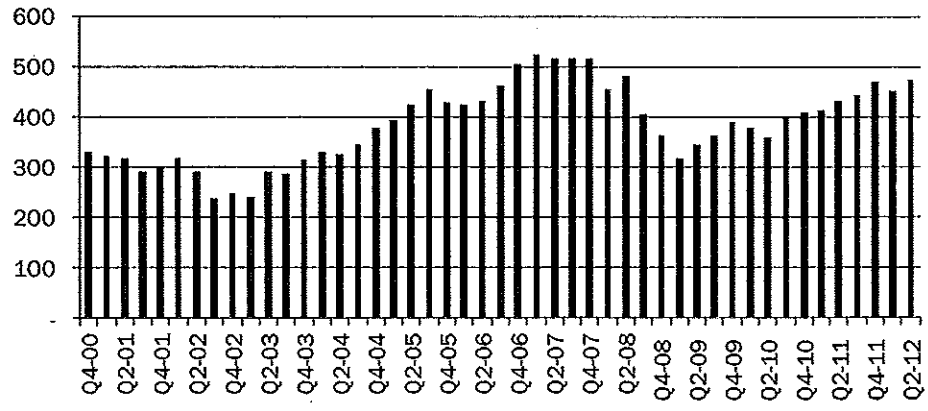
U.S. Shareholder-Owned Electric Utilities

Company	Stock Symbol	$ Market Cap	% Total	Company	Stock Symbol	$ Market Cap	% Total
Southern Company	SO	40,136	8.45%	Integrys Energy Grp. Inc.	TEG	4,470	0.94%
Duke Energy Corporation	DUK	30,844	6.49%	Pepco Holdings, Inc.	POM	4,462	0.94%
Dominion Resources, Inc.	D	30,807	6.48%	NV Energy, Inc.	NVE	4,149	0.87%
NextEra Energy, Inc.	NEE	28,370	5.97%	MDU Res. Group, Inc.	MDU	4,080	0.86%
Exelon Corporation	EXC	26,526	5.58%	TECO Energy, Inc.	TE	3,863	0.81%
FirstEnergy Corp.	FE	20,561	4.33%	Westar Energy, Inc.	WR	3,789	0.80%
American Elec. Power Co.	AEP	19,305	4.06%	Great Plains Energy Inc.	GXP	2,907	0.61%
PG&E Corporation	PCG	18,742	3.94%	Hawaiian Elec. Ind., Inc.	HE	2,745	0.58%
Consolidated Edison, Inc.	ED	18,213	3.83%	Cleco Corporation	CNL	2,527	0.53%
Progress Energy, Inc.	PGN	17,870	3.76%	Vectren Corporation	VVC	2,419	0.51%
Sempra Energy	SRE	16,573	3.49%	IDACORP, Inc.	IDA	2,098	0.44%
Public Svc. Ent. Grp. Inc.	PEG	16,445	3.46%	Portland Gen. Elec. Co.	POR	2,011	0.42%
PPL Corporation	PPL	16,092	3.39%	UIL Holdings Corporation	UIL	1,818	0.38%
Edison International	EIX	15,061	3.17%	Avista Corporation	AVA	1,564	0.33%
Xcel Energy Inc.	XEL	13,846	2.91%	PNM Resources, Inc.	PNM	1,560	0.33%
Entergy Corporation	ETR	12,007	2.53%	ALLETE, Inc.	ALE	1,538	0.32%
DTE Energy Company	DTE	10,086	2.12%	UniSource Energy Corp.	UNS	1,461	0.31%
Wisconsin Energy Corp.	WEC	9,121	1.92%	Black Hills Corporation	BKH	1,407	0.30%
CenterPoint Energy, Inc.	CNP	8,809	1.85%	NorthWestern Corp.	NWE	1,333	0.28%
Ameren Corporation	AEE	8,137	1.71%	El Paso Electric Company	EE	1,323	0.28%
NiSource Inc.	NI	7,002	1.47%	MGE Energy, Inc.	MGEE	1,093	0.23%
Northeast Utilities	NU	6,910	1.45%	CH Energy Group, Inc.	CHG	978	0.21%
SCANA Corporation	SCG	6,232	1.31%	Empire District Elec. Co.	EDE	887	0.19%
CMS Energy Corporation	CMS	6,007	1.26%	Otter Tail Corporation	OTTR	823	0.17%
Pinnacle West Cap. Corp.	PNW	5,651	1.19%	Unitil Corporation	UTL	289	0.06%
OGE Energy Corp.	OGE	5,091	1.07%				
Alliant Energy Corp.	LNT	5,045	1.06%	Total Industry		475,083	100.00%

Source: EEI Finance Department and Wall Street Journal

XII. EEI Index Market Capitalization (at Period End)

U.S. Shareholder-Owned Electric Utilities

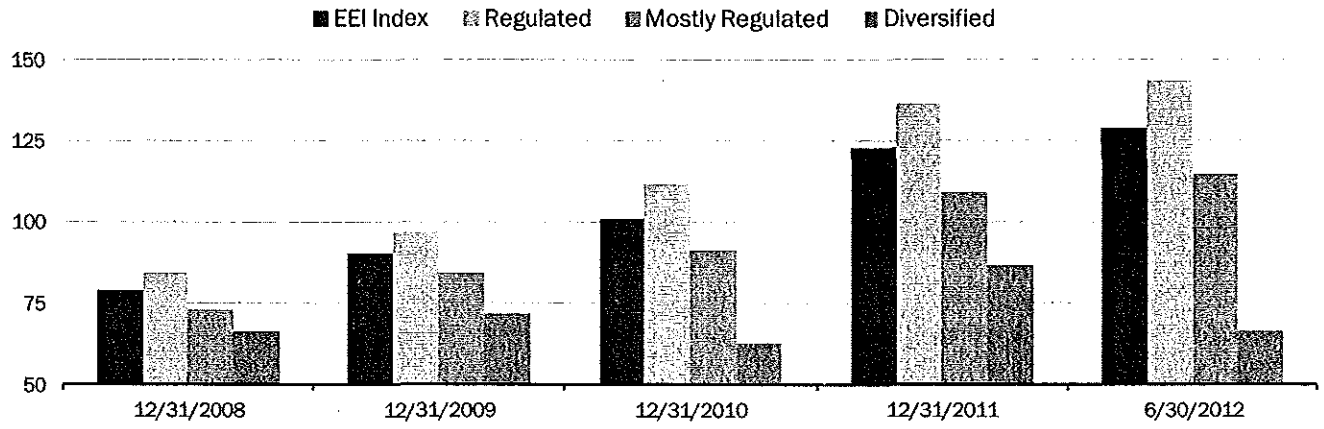


Note: Change in EEI Index market capitalization reflects the impact of buyout and spin-off activity in addition to stock market performance.
Source: EEI Finance Department and Wall Street Journal

EEI Index Market Cap (In $Billions)			
Q3-01	291,035	Q1-07	525,088
Q4-01	300,200	Q2-07	515,565
Q1-02	317,668	Q3-07	514,946
Q2-02	292,238	Q4-07	514,486
Q3-02	238,331	Q1-08	456,711
Q4-02	249,553	Q2-08	482,024
Q1-03	240,598	Q3-08	404,472
Q2-03	289,454	Q4-08	361,921
Q3-03	288,073	Q1-09	316,070
Q4-03	314,324	Q2-09	343,844
Q1-04	329,601	Q3-09	363,185
Q2-04	323,193	Q4-09	389,672
Q3-04	342,460	Q1-10	377,281
Q4-04	380,305	Q2-10	360,044
Q1-05	395,663	Q3-10	402,014
Q2-05	425,989	Q4-10	407,275
Q3-05	454,727	Q1-11	411,164
Q4-05	428,825	Q2-11	433,236
Q1-06	422,899	Q3-11	442,352
Q2-06	432,848	Q4-11	471,635
Q3-06	464,281	Q1-12	450,597
Q4-06	503,858	Q2-12	475,083

XIII. Comparative Category Total Annual Returns

U.S. Shareholder-Owned Electric Utilities, Value of $100 invested at close on 12/31/2007



		2008	2009	2010	2011	2012*
EEI Index Annual Return (%)		-20.9	14.1	11.9	21.4	5.0
EEI Index Cumulative Return ($)	100	79.1	90.2	100.9	122.5	128.6
Regulated EEI Index Annual Return		-15.6	14.2	15.8	22.3	5.4
Regulated EEI Index Cumulative Return	100	84.4	96.4	111.6	136.5	143.9
Mostly Regulated EEI Index Annual Return		-27.0	15.6	8.5	19.5	4.6
Mostly Regulated EEI Index Cumulative Return	100	73.0	84.4	91.6	109.4	114.5
Diversified EEI Index Annual Return		-33.9	8.1	-5.2	21.4	6.3
Diversified EEI Index Cumulative Return	100	66.1	71.4	62.7	86.7	66.6

Calendar year returns shown, except where noted. / * at 6/30
Returns are unweighted averages of constituent company returns.

ments on investors' preferences far more than any significant change in industry fundamentals.

As shown in Table VIII, the major market indices surged higher during the first quarter as aggressive global central bank moves to support market liquidity (particularly in Europe) trumped investors' fears of slowing U.S. economic growth, signs of outright recession in peripheral European economies, and indications that strength in emerging market economies was also fading. The EEI Index returned -1.4% as investors favored companies whose earnings outlooks are more leveraged to a monetary policy induced recovery in economic strength.

The market's bullish spirits faded to a worried caution in Q2, deflated by the recognition — as has often followed the bouts of optimism since the crisis of 2008/2009 — that central banks can supply economies with easy money but cannot make them grow. The EEI Index returned 5.6% in the second quarter, considerably outperforming the -2% to -3% losses produced by the Dow and S&P 500 and the Nasdaq's -5.1% decline.

XIV. EEI Index Top Ten Performers

For the 12-month period ending 6/30/12

Company	Category	% Return
Sempra Energy	MR	27.6
NextEra Energy, Inc.	MR	15.1
Wisconsin Energy Corporation	R	15.0
CH Energy Group, Inc.	R	14.4
FirstEnergy Corp.	MR	13.6
Edison International	R	13.2
PG&E Corporation	R	12.1
Cleco Corporation	R	11.5
DTE Energy Company	R	11.3
Hawaiian Electric Industries, Inc.	D	10.3

Note: Return figures include capital gains and dividends.
R = Regulated, MR = Mostly Regulated, D = Diversified
Source: EEI Finance Department

Another trend evident in the EEI Index's performance during the year's first half is the relative similarity of returns among the constituent groups. As shown in the bottom half of Table VIII, the Regulated, Mostly Regulated and Diversified company categories clustered around near-zero returns in Q1 and 5% to 6% gains in Q2. The market now perceives most utilities — whether they are fully or only mostly regulated — as essentially stable businesses with strong dividends, offering a safe harbor in turbulent times from exposure to the riskier, more competitively exposed and more economically leveraged earnings streams found in other economic industries.

Macro Forces Drive Shares

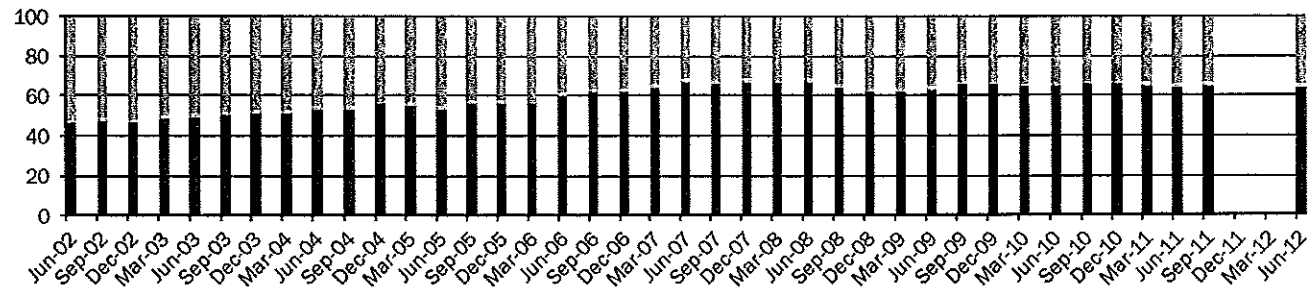
There has been very little change in the industry's fundamental picture in recent years. Since the middle of the last decade, most utilities have focused their strategies around the traditional regulated business model (emphasizing either regulated transmission and distribution businesses or vertically integrated regulated businesses that include ownership of generation in rate base) or some combination of regulated businesses and competitive generation within an overall holding company (i.e., the "Mostly Regulated" model). In fact, at year-end 2004 there were 11 companies in EEI's Diversified category (out of 72 total companies), where regulated assets total less than 50% of total holding company assets. By year-end 2011, the Diversified Group's total had been reduced to only three companies (out of a total of 61). As a result, the Diversified category's stock performance has lost much of its significance as a referendum on the market's evaluation of the competitive business model.

The phrase "back to basics" was often used to describe the early years of this migration. And indeed the appeal of utility stocks today resembles to a large degree that of the years before deregulation: businesses capable of producing reasonably steady and dependable earnings streams with slow but steady earnings growth and slowly rising dividends.

Yet given this backdrop, trends that utility managements cannot control have been as forceful shapers of recent stock market performances as those they can. The two primary ones have been the persistent decline in interest rates and in the level of natural gas prices. Utilities are often seen as bond substitutes — income-producing investments with potential for growth in the income stream through dividend increases — whose value rises as interest rates decline. Following the competitive generation build-out during the previous decade, competitive power market prices were often set by natural gas as the marginal price setting fuel. The long-

XV. Share Ownership by Investor Category (% of total)

U.S. Shareholder-Owned Electric Utilities



	Mar-04	Jun-04	Sep-04	Dec-04	Mar-05	Jun-05	Sep-05	Dec-05	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07
Institutional	51.4	53.1	53.5	55.6	54.9	53.3	56.1	55.9	55.6	60.2	61.8	61.7	63.4	66.9	65.7	66.7
Insider	1.7	1.7	1.7	1.7	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.7	1.7	1.5
Retail	47.1	45.4	45.1	43.0	43.3	44.9	42.2	42.3	42.7	38.0	36.4	36.5	34.8	31.4	32.6	31.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

	Mar-08	Jun-08	Sep-08	Dec-09	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Jun-12
Institutional	66.4	66.7	64.0	61.8	61.9	63.0	65.4	65.7	64.7	64.8	65.4	65.5	64.7	64.1	64.6	63.5
Insider	1.5	1.5	1.5	1.4	1.4	1.4	1.4	1.3	1.2	1.2	1.2	1.2	1.9	1.9	1.9	1.7
Retail	32.1	31.8	34.5	36.9	36.7	35.6	33.2	33.0	34.0	34.0	33.4	33.3	33.4	34.0	33.4	34.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: SNL Financial and EEI Finance Department. Note: Institutional figures represent end-of-quarter, unweighted average of the 55 publicly traded EEI Index companies. Insider data reported annually. Retail data defined as 100% - (Institutional data % + Insider %). Totals may not add to 100 due to rounding.
Note: Data unavailable for Dec-11, Mar-12

term decline in both metrics has surprised economists and industry analysts alike.

Historically Low Interest Rates

As shown in Charts IV and V, the 10-year Treasury yield (an adequate, albeit imperfect, proxy for market interest rates) has declined from the 5% to 6% range during 2006-2007 to under 2% in the second quarter of 2012. Federal Reserve policy to push interest rates lower in support of economic growth has been the primary cause of this decline, while the sluggish economic recovery has offered a counterpoint in the real economy in the form of generally weak loan demand. Most economists have predicted rising rates now for several years, and these prognostications have been continually thwarted. During the second quarter of 2012, the 10-year Treasury yield fell from a high of about 2.4% in late March to below 1.5% by mid-June, firming at quarter end up to 1.7%. Historically low interest rates have unquestionably offered an important source of support for utility shares in recent years by reducing the significant interest expense component of utilities' cost structure and elevating the value of the dividend stream for investors. Eventually, if history is any guide, the trend will reverse and rates will begin a long-term rise. With the economy now mired in politically unacceptable weakness and the Federal Reserve apparently set on its zero short-term rate policy for two more years, such a prospect does not appear imminent. But when the trend reverses, it will mark the end of one of the major macro themes that has supported the performance of utility stocks for many years.

Natural Gas Price Collapse

The collapse in natural gas prices due to the emergence of low-cost drilling for shale gas has had a less straightforward impact on utility shares. Many regulated companies have arguably benefitted — not directly, since changes in fuel costs are usually passed through to ratepayers and lower fuel costs don't mean higher profits — but indirectly, since lower fuel costs have helped keep customer rates down despite rising capital investment and the need to recover other rising costs in rates.

Competitive generators however, which are often subsidiaries of holding companies with regulated operations, have been hard hit. It would have been nearly inconceivable from 2005 through 2008, when natural gas spot price ranged from roughly $6-$12/mmBtu, to contemplate a near future in which prices would stagnate below $3 with no end in sight. And early in the second quarter of 2012, spot gas even dipped below $2. Competitive power prices have likewise eroded, considerably diminishing earnings outlooks for competitive generators whose price hedges, put in place when market prices were much higher, are now rolling off. This has acted as a countervailing force, operating opposite to that of falling interest rates, on the shares of utilities with significant competitive operations.

Analysts today seem reasonably unanimous in the belief that new shale gas drilling techniques and the abundance of reserves will keep natural gas prices low for the forseeable future. Chart VII shows just how sharply price forecasts have declined in recent years, with the natural gas futures curve now fairly steady at slightly over $4/mmBTU after falling from a range of $6 to $8 only two-and-a-half years ago. Perhaps the most confident statement one can make about the natural gas market at mid-year 2012 is that it appears to have little room to fall further, although the prospect of any recovery, which over the past few years has always seemed a year or two way, still seems a year or two away.

Stable Business Fundamentals

General business conditions in the industry at mid-year 2012 remain reasonably strong, with the big picture narrative little changed from that of recent years. Utilities are undertaking sizeable and wide-ranging capital investment programs that include distribution network upgrades, Smart Grid investments, a significant boost in the pace of transmission investment, rising emissions-related capex driven by the need to comply with EPA regulations, and generation investments in select power markets. All told, the construction cycle has supported mid-single digit earnings growth for much of the industry over the past six or seven years.

Despite the prospects for only tepid electricity demand growth going forward (due in part to energy efficiency technologies and wider use of demand side management programs), estimated at 0% to 1% annual gains nationwide, analysts expect the industry's ongoing capital spending to drive mid single-digit earnings growth for many utilities over the next several years. Much of this investment is going into rate base, with a state regulatory backdrop that most analysts say is constructive and supportive of the need for such investment. The value to investors of such a predictable, if not placid, business environment is seen in Chart III, which shows that an investment in the EEI Index made at the end of 2007 and indexed to 100 would have outperformed both the S&P 500 and the Dow Jones Industrial Average if held through June 30, 2012. This period includes the severe decline and wild volatility of the 2008/9 financial crisis, the strong subsequent market recovery and recent sideways progression of the markets since early 2011 — offering a diverse macroeconomic and market backdrop in which to evaluate the industry's emphasis on core regulated and competitive electricity businesses.

Stretched Valuations?

Despite trailing the broad market averages during the first half of 2012, the EEI Index outperformed all major market sectors over the 12-month period ending June 30 (as shown in Table IX). This was due less to any change in the industry's prospects than to the industry's status as a safe-harbor during macroeconomic turbulence. The broad market fell more than 10% during Q3 2011 as the spectacle of the U.S. fiscal debt limit debate (and Standard & Poor's August 5, 2011 downgrade of U.S. debt from AAA to AA+) along with European leaders' equally contentious response to a flare-up of market stress over their continents' sovereign debt woes rattled investors.

By late June 2012, most analysts observed that utility price/earnings ratios were near historical highs relative to the broad market, suggesting that the group's strength may be nearing an end. Conversely, given today's extraordinarily low interest rates, utility shares receive powerful support from the industry's roughly 4% dividend yield, double that of the S&P 500's dividend yield. When viewed as a bond substitute (offering bond-like yields with dividend growth potential), analysts observed that utility stocks could have room to rise given the very low yields available most everywhere else.

To the extent that utility dividends remain perceived as stable and safe, and if interest rates remain very low, utility shares will likely receive an ongoing strong bid from investors. However if rates were to rise or if industry fundamentals were to worsen — such as the perception of difficulty executing capital investment programs or renewed fuel cost increases pressuring end-user rates, fostering a more contentious environment in rate cases — the group's stock market fortunes may take a turn for the worse.

Recent years have delivered many tailwinds for the industry, independent of the hard work by companies to reform themselves around the traditional utility business model while implementing the strong public good aspect of their mission — that of ensuring safe, reliable and increasingly environmentally clean electricity within regulated service territories. It's likely that the values of utility shares in the immediate future will continue to be driven more by global macroeconomic issues outside of the industry's control than by changes in business strategies or fundamentals that managements can control. That is not to say that the month-to-month and year-to-year challenges that come with the management of shareholder-owned utilities are not significant, it's just that they are largely under control for now.■

SCHEDULE DM-SUR-6

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN IT'S ENTIRETY

KANSAS CITY POWER & LIGHT COMPANY
CASE NO. ER-2013-0174

Missouri-Only Utility Proxy Group
DPS, EPS, BVPS & GDP
10-Year Compound Growth Rate Averages (1968-1999)

DPS		*EPS*		*BVPS*		Average	*GDP*	
Years	10 yr compound growth rate avgs	Years	10 yr compound growth rate avgs	Years	10 yr compound growth rate avgs	DPS, EPS and BVPS	Years	10 yr compound growth rate avgs
1968-70 to 1978-80	2.34%	1968-70 to 1978-80	1.14%	1968-70 to 1978-80	1.81%	1.76%	1968-70 to 1978-80	10.05%
1969-71 to 1979-81	2.20%	1969-71 to 1979-81	1.21%	1969-71 to 1979-81	1.38%	1.60%	1969-71 to 1979-81	10.41%
1970-72 to 1980-82	2.23%	1970-72 to 1980-82	2.10%	1970-72 to 1980-82	1.13%	1.82%	1970-72 to 1980-82	10.42%
1971-73 to 1981-83	2.50%	1971-73 to 1981-83	3.83%	1971-73 to 1981-83	1.14%	2.49%	1971-73 to 1981-83	10.22%
1972-74 to 1982-84	2.97%	1972-74 to 1982-84	5.81%	1972-74 to 1982-84	1.45%	3.41%	1972-74 to 1982-84	10.03%
1973-75 to 1983-85	3.45%	1973-75 to 1983-85	6.92%	1973-75 to 1983-85	2.02%	4.13%	1973-75 to 1983-85	9.96%
1974-76 to 1984-86	3.75%	1974-76 to 1984-86	6.71%	1974-76 to 1984-86	2.61%	4.36%	1974-76 to 1984-86	9.77%
1975-77 to 1985-87	3.88%	1975-77 to 1985-87	6.02%	1975-77 to 1985-87	2.97%	4.29%	1975-77 to 1985-87	9.34%
1976-78 to 1986-88	3.96%	1976-78 to 1986-88	5.55%	1976-78 to 1986-88	3.11%	4.21%	1976-78 to 1986-88	8.80%
1977-79 to 1987-89	4.20%	1977-79 to 1987-89	6.03%	1977-79 to 1987-89	3.26%	4.50%	1977-79 to 1987-89	8.32%
1978-80 to 1988-90	4.48%	1978-80 to 1988-90	5.60%	1978-80 to 1988-90	3.50%	4.53%	1978-80 to 1988-90	7.92%
1979-81 to 1989-91	4.73%	1979-81 to 1989-91	5.22%	1979-81 to 1989-91	3.80%	4.58%	1979-81 to 1989-91	7.38%
1980-82 to 1990-92	4.83%	1980-82 to 1990-92	3.57%	1980-82 to 1990-92	3.93%	4.11%	1980-82 to 1990-92	7.06%
1981-83 to 1991-93	4.68%	1981-83 to 1991-93	1.64%	1981-83 to 1991-93	3.80%	3.38%	1981-83 to 1991-93	6.72%
1982-84 to 1992-94	4.34%	1982-84 to 1992-94	0.23%	1982-84 to 1992-94	3.46%	2.68%	1982-84 to 1992-94	6.49%
1983-85 to 1993-95	3.96%	1983-85 to 1993-95	-0.31%	1983-85 to 1993-95	3.01%	2.22%	1983-85 to 1993-95	6.12%
1984-86 to 1994-96	3.72%	1984-86 to 1994-96	0.03%	1984-86 to 1994-96	2.62%	2.12%	1984-86 to 1994-96	5.89%
1985-87 to 1995-97	3.53%	1985-87 to 1995-97	0.26%	1985-87 to 1995-97	2.31%	2.03%	1985-87 to 1995-97	5.81%
1986-88 to 1996-98	3.27%	1986-88 to 1996-98	0.67%	1986-88 to 1996-98	2.17%	2.03%	1986-88 to 1996-98	5.73%
1987-89 to 1997-99	2.82%	1987-89 to 1997-99	0.06%	1987-89 to 1997-99	1.98%	1.62%	1987-89 to 1997-99	5.63%
Average	**3.59%**	**Average**	**3.11%**	**Average**	**2.57%**		**Average**	**8.10%**

Average of 10-year Rolling Averages EPS, DPS and BVPS **3.09%**

Source: Value Line Investment Survey

Average EPS, DPS and BVPS as a percentage of average GDP: 38.16%

SCHEDULE DM-SUR-7

SCHEDULE DM-SUR-7

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Kansas City Power & Light Company's Request for Authority to Implement A General Rate Increase for Electric Service	))))	Case No. ER-2012-0174

AFFIDAVIT OF DAVID MURRAY

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

David Murray, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 40 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

David Murray

Subscribed and sworn to before me this 5th day of October, 2012.

Notary Public

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 08, 2012
Commission Number: 08412071