Exhibit No.:	
Issue:	*Rate of Return*
Witness:	*Shana Atkinson*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Surrebuttal Testimony*
Case No.:	*ER-2010-0130*
Date Testimony Prepared:	*April 23, 2010*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

SHANA ATKINSON

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2010-0130

Jefferson City, Missouri
April 2010

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3 **SHANA ATKINSON**

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1 **SURREBUTTAL TESTIMONY**

2 **OF**

3 **SHANA ATKINSON**

4 **THE EMPIRE DISTRICT ELECTRIC COMPANY**

5 **CASE NO. ER-2010-0130**

6 Q. Please state your name.

7 A. My name is Shana Atkinson.

8 Q. Are you the same Shana Atkinson who has previously filed rebuttal testimony
9 in this proceeding for the Staff of the Missouri Public Service Commission (Staff)?

10 A. Yes. I filed rebuttal testimony on April 2, 2010.

11 Q. What is the purpose of your surrebuttal testimony?

12 A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony
13 of Dr. James H. Vander Weide and the rebuttal testimony of William L. Gipson, both of
14 whom sponsored testimony on behalf of The Empire District Electric Company
15 ("Empire" or "Company").

16 **EXECUTIVE SUMMARY**

17 Q. Please summarize your surrebuttal testimony.

18 A. Dr. Vander Weide addresses issues in his rebuttal testimony ranging from the
19 size of Staff's proxy group, the Discounted Cash Flow model (DCF), projected growth rates,
20 and an alleged adjustment that should be made to Staff's CAPM analysis results because of
21 Empire's size. Mr. Gipson addresses the disallowance of $1.6 million paid to bondholders in

1 order to obtain consents needed to amend their mortgage bond indenture. I will address each
2 of these points.

3 **CORRECTIONS**

4 Q. After reviewing Dr. Vander Weide's Rebuttal Testimony regarding certain
5 mistakes he believes Staff made in its testimony, does Staff need to make any corrections to
6 its testimony in this case?

7 A. Yes. On page 4, lines 1 through 6 of Dr. Vander Weide's
8 surrebuttal testimony, he says that Staff mistakenly eliminated NSTAR and DTE from its
9 proxy group. "Staff eliminates NSTAR because it apparently believes that NSTAR reduced
10 its dividend since 2006, and Staff eliminates DTE because it apparently believes that DTE is
11 not classified as a "regulated" utility by the Edison Electric Institute ("EEI"). Contrary to
12 Staff's belief NSTAR has not reduced its dividend since 2006; and DTE is classified as a
13 "regulated" utility by EEI." Dr. Vander Weide is correct that DTE is classified as a
14 "regulated" utility by EEI.

15 Q. Did Staff make a mistake regarding NSTAR's dividend reduction since 2006,
16 as alleged by Dr. Vander Weide?

17 A. No. According to the February 26, 2010, Value Line Investment Survey:
18 Ratings & Reports for NSTAR, dividends declared per share in 2006 were $1.54 and
19 decreased to $1.33 in 2007.

20 Q. Would Staff have selected DTE after it made the correction of the mistake
21 identified by Dr. Vander Weide?

1 A. No. DTE would have still been eliminated because it does not meet the criteria
2 of having at least 70 percent of revenues from electric utility operations.

3 **RESPONSE TO DR. VANDER WEIDE'S REBUTTAL TESTIMONY**

4 Q. On page 6, in his rebuttal testimony, Dr. Vander Weide discusses his concern
5 with Staff's proxy group selection criteria. What is Staff's response?

6 A. Staff's criteria for proxy group selection are as follows:

7 1. Classified as an electric utility company by Value Line;
8 2. Stock publicly traded;
9 3. Classified as a regulated utility by Edison Electric Institute ("EEI");
10 4. At least 70 percent of revenues from electric operations as classified
11 by AUS;
12 5. Ten-year Value Line historical growth data available;
13 6. No reduced dividend since 2006;
14 7. Projected growth available from Value Line and Reuters;
15 8. At least investment grade credit rating; and
16 9. Company-owned generating assets

17 Staff used these criteria to improve the risk comparability of its proxy group.
18 Companies incur two types of risk, business risk and financial risk. The financial risk of an
19 entity is driven by the amount of fixed obligations created by issuing debt. Some analysts will
20 attempt to screen their comparable companies for financial risk by selecting companies with a
21 certain common equity percentage in their capital structure. I controlled for this type of risk
22 by selecting companies that have at least an investment grade credit rating. The business risk
23 of an entity is primarily driven by the dominant operations of the company. The best way to
24 select companies that face similar business risk is to select companies that are in the same
25 business as the operations being evaluated. In common finance textbooks, this approach is
26 commonly referred to as the "pure play method." According to the January 2010 AUS
27 monthly report, Empire has 86 percent of revenues from electric utility operations. Empire is

1 also listed as a regulated electric utility by EEI. Therefore, Staff considers these selection
2 criteria to be appropriate for selecting a proxy group that is comparable to Empire's regulated
3 electric utility operations.

4 Q. On page 7 of his rebuttal testimony, Dr. Vander Weide criticizes Staff's
5 comparable company criteria of companies being classified as "Regulated" by EEI. Does
6 Staff have evidence that companies in EEI's "Regulated" asset group have less risk than
7 companies in EEI's "Mostly Regulated" and "Diversified" groups?

8 A. According to Value Line, the average beta for the companies in EEI's
9 "Regulated" asset group is .71 (Eight of the forty-four companies listed by EEI in the
10 Regulated group were not listed on Value Line). The average beta for the "Mostly
11 Regulated" asset group is .79 (One of these nineteen companies was not listed on Value Line).
12 The average beta for the "Diversified" group is .83 (One of these six companies was not listed
13 on Value Line.). Beta is a measure of the volatility, or systematic risk, of a security or a
14 portfolio in comparison to the market as a whole. A beta of 1 indicates that the security's
15 price will move with the market. A beta of less than 1 means that the security will be less
16 volatile than the market. A beta of greater than 1 indicates that the security's price will be
17 more volatile than the market. Therefore, the Value Line betas are evidence that companies in
18 EEI's "Regulated" asset group have less risk than companies in EEI's "Mostly Regulated"
19 and "Diversified" groups.

20 Q. On page 10 of his rebuttal testimony, Dr. Vander Weide states that Staff
21 estimates Empire's cost of equity using both a single-stage annual DCF method and a
22 multi-stage annual DCF method. Which methodology was the primary driver of Staff's
23 estimated cost of common equity in this case?

1 A. Staff relied primarily on its multi-stage annual DCF model in estimating
2 Empire's cost of equity. Staff attempted to estimate the cost of common equity for Empire by
3 initially performing its traditional constant-growth DCF analysis. However, due to Staff's
4 concerns about being able to reliably estimate a sustainable constant-growth rate for the
5 electric utility industry, Staff decided a multi-stage DCF analysis better reflects the current
6 characteristics of the electric utility industry.

7 Q. On pages 12 through 15 in his rebuttal testimony, Dr. Vander Weide discusses
8 a variety of matters regarding the growth rates Staff analyzed when performing Staff's
9 constant-growth DCF analysis. What is Staff's response?

10 A. Staff clearly stated in the Rate of Return ("ROR") Section of the Cost of
11 Service Report in this case that Staff determined the historical and projected data that Staff
12 reviewed made it difficult to estimate a reliable constant-growth rate for a single-stage DCF
13 cost of equity estimate. Staff believes it is rather pointless to analyze this data to determine a
14 growth rate that Staff would hesitate to give much weight in context of a constant-growth
15 DCF estimate. This is why Staff decided that a multi-stage DCF analysis would provide a
16 more reliable cost of common equity estimate.

17 Q. At page 18, lines 1 through 15 of Dr. Vander Weide's rebuttal testimony, he
18 criticizes Staff's opinion that analysts' projected growth rates for electric utilities are not
19 sustainable in the long run. What is Staff's response?

20 A. Dr. Vander Weide believes that Staff should use equity analysts' five-year
21 earnings per share ("EPS") growth forecasts whether or not investors consider these growth
22 forecasts as "sustainable". He also believes that Staff fails to recognize that investor growth
23 forecasts affect stock prices so Staff should adjust the stock prices for the companies in Staff's

DCF analyses as well as the growth forecasts if Staff believes that five-year EPS growth forecasts are irrational. In contrast, Staff believes that if a growth rate estimate does not reflect rational expectations, then an analyst is justified in rejecting that growth rate estimate. According to *The Cost of Capital - A Practitioners Guide* by David Parcell, pg. 8-5, "The DCF method assumes that investors evaluate stocks in a classical economic framework and buy and sell securities rationally at prices which reflect that value assessment. Classical economic, or valuation, theory maintains that the value of a financial asset is determined by its earning power, or its ability to generate future cash flows. As a result, DCF theory assumes that the stock price of a firm fully considers and reflects the return expected by stockholders." This assumption underlying the DCF approach shows that there is no need to adjust the stock price, in attempting to estimate what a rational investment market would use in evaluating a utility stock. Dr. Vander Weide is incorrect in assuming that rational investors would rely on equity analysts' five-year EPS forecasts for a sustainable long-term growth rate in valuing a stock.

Near term projected growth rates for the electric industry are higher than the projected long-term economic growth rates provided in the Congressional Budget Office's *2010 The Budget and Economic Outlook.* As Staff already stated in its Cost of Service Report, according to an article in the October 2004 issue of *Public Utilities Fortnightly* entitled "The Dividend Yield Trap," regulated electric utilities' long-term growth expectations should not be much more than one to three percent.

These lower expected long-term growth rates are also consistent with many of the perpetual growth rates used by equity analysts when performing DCF analysis for purposes of determining a fair price to pay for electric utility stocks, and more specifically for Empire. In

response to Staff Data Request No. 204.2, Empire provided a February 9, 2009, Jesup & Lamont equity research report (Attachment A) covering Empire that used a perpetual growth rate of 3 percent for purposes of discounting Empire's expected dividends in the context of the dividend discount model, which is commonly referred to as the DCF model in utility regulatory ratemaking proceedings.

Q. On page 11, line 8 through 16, in his rebuttal testimony, Dr. Vander Weide criticizes Staff for not using the quarterly compounding version of the DCF model as he did. How do you respond?

A. Value Line does not publish quarterly projected dividends. It provides projected dividends on an annual basis. The dividend yield provided by Value Line in its Ratings and Reports tear sheets is based on the expected dividend for the next year without quarterly compounding. The following definition of "dividend yield" is contained in the *Value Line Investment Survey for Windows: User's Manual,* © 1995 through 2002:

> The common dividends declared per share expressed as a percentage of the average annual price of the stock. Dividend yield = common dividends declared per share divided by the average annual price of a stock. The year-ahead estimated dividend yield (shown in the top right-hand corner of the Value Line page) is the estimated total of cash dividends to be declared over the next 12 months, divided by the recent price of the stock.

Staff believes that investors make their investment decisions primarily based upon the annual dividend assumption, and for that reason it is appropriate to recommend ROE estimations to the Missouri Public Service Commission ("Commission") based on that assumption.

Additionally, it is interesting to note that Dr. Vander Weide determined that there currently is no need to make an upward adjustment to his annual DCF cost of equity estimate for purposes of quarterly compounding. Dr. Vander Weide stated on page 22, line 21 through

1 page 23, line 2 of his direct testimony that he employs the quarterly DCF model throughout
2 his calculations, even though the results of the quarterly DCF model for his companies are
3 approximately equal to the results of a "properly" applied annual DCF model.

4 Q. On page 12, lines 1 through 11, in his rebuttal testimony, Dr. Vander Weide
5 criticized Staff's use of Value Line to estimate the dividends expected amount over the next
6 year in order to calculate the dividend yield in Staff's DCF analysis. What is
7 Staff's response?

8 A. Dr. Vander Weide claims that Staff's approach is not consistent with the
9 assumption that dividends will grow at the same constant rate forever. Empire is a good
10 example of why Dr. Vander Weide's argument in this case is not consistent with the reality of
11 investor expectations. In Staff's opinion it is unreasonable to believe that investors expect to
12 receive an annual dividend next year that is higher than Empire's current annual dividend of
13 $1.28. Empire has paid this same dividend amount since 1993 and has been unable to earn
14 this dividend in eleven of the years since 1993. The inability of Empire to earn higher than its
15 dividend is evidence that investors are not likely to expect Empire to have the earnings
16 capacity to allow it to increase its dividend per share ("DPS"). Value Line does not anticipate
17 that Empire will increase its dividend next year and this is most likely the investors'
18 expectation as well, which is what rate of return witnesses should be trying to evaluate.[1]

19 Q. On page 17, lines 9 through 13 of Dr. Vander Weide's rebuttal testimony, he
20 criticized Staff's multi-stage growth assumptions for Staff's multi-stage DCF Model. What is
21 Staff's response?

[1] It should be noted that Staff made the simplifying assumption in its multi-stage DCF analysis that Empire would be able to grow its DPS by 6 percent per year for the next five years, hence the higher cost of equity indication when making simplifying assumptions that aren't consistent with actual investor expectations.

1 A. Dr. Vander Weide states that he believes Staff's multi-stage growth
2 assumptions seem to reflect its own view of investors' growth expectations rather than being
3 based on any studies or analysis. Staff explained its multi-stage growth rate assumptions on
4 page 26 of the ROR section of Staff's Cost of Service Report. It is advisable to use a
5 multi-stage DCF analysis because the electric industry is in a non-constant growth situation
6 due to increased capital expenditure programs.

7 Also, as previously discussed, Staff is aware of a February 9, 2009, Jesup & Lamont
8 equity research report that used a perpetual growth rate of 3 percent for Empire. This
9 followed a five-year period of 0 percent growth for Empire's DPS, as referenced in the
10 Jesup & Lamont report, which calls into question the appropriateness of assuming the
11 EPS growth rate is always an accurate predictor of DPS growth, which is what the
12 DCF method is supposed to discount. This verifies the reasonableness of Staff's 3.35 percent
13 perpetual growth rate used in Staff's multi-stage DCF analysis.

14 Q. On page 21, lines 3 through 18 of his rebuttal testimony, Dr. Vander Weide
15 supports his belief that risk premium estimates should be based on using arithmetic means
16 rather than use of geometric means in its CAPM analysis. Do you have a simple example to
17 illustrate why Staff does not believe investors use arithmetic means when determining the
18 amount of risk premium they will require on a given stock or a portfolio of stocks?

19 A. Yes. Suppose that an investor makes a $1 stock investment over a three-year
20 period. If an investor pays $1 for a stock in year 1 and in year 2 the stock increases to $1.50,
21 then the investor would have a 50 percent growth rate. In year three the price of the stock
22 decreases by 50 percent to $.75. If an investor performed a simple arithmetic average of these
23 two returns, then they would think that they received 0 percent [(50 percent + -50 percent)/2]

1 growth in the investment over the three-year period. However, in reality the investor actually
2 had a 25 percent decline in the investment over this three-year period. This is why using the
3 arithmetic mean as advocated by Dr. Vander Weide produces questionable results.

4 Q. On page 23, lines 5 through 12, in his rebuttal testimony, Dr. Vander Weide
5 claims an adjustment should be made to Staff's CAPM result because of Empire's small size.
6 What is Staff's response?

7 A. Dr. Vander Weide uses an Ibbotson Associates study that was based on all of
8 the stocks in the New York Stock Exchange, the American Stock Exchange and the
9 NASDAQ National Market, which is not a utility specific study. If Dr. Vander Weide were
10 concerned about small size in estimating the cost of equity for Empire, then
11 Dr. Vander Weide shouldn't have followed his standard methodology of estimating the cost
12 of equity by using market-weighted cost of equity averages, which gives large company cost
13 of equity estimates more weight in his recommendation.

14 Q. Has Staff been able to perform any additional research that supports the
15 reasonableness of its cost of equity estimate?

16 A. Yes. The February 9, 2009, Jesup & Lamont report covering Empire provided
17 in response to Staff Data Request 0204.2, stated the following in the Valuation section of the
18 report:

19 Our dividend discount analysis [same thing as the DCF in utility
20 regulatory terminology] results in a valuation of $19 per share. Our
21 projections assume that EDE will be able to pay its dividend in the
22 short-term and will not raise its dividend over the next five years.
23 Beyond the next five years, we estimate a dividend growth rate of 3%
24 annually, based in large part on our assumptions for future Missouri
25 rate decisions.
26

1 Staff calculated the Internal Rate of Return (IRR), i.e. the cost of common equity, based on
2 the assumptions of Jesup & Lamont's dividend discount analysis and Staff found the IRR to
3 be 9.08 percent. The IRR is the discount rate that makes the present value of all future cash
4 flows equal to the cost of the initial investment. The 9.08 percent verifies the reasonableness
5 of Staff's recommendation.

6 **RESPONSE TO MR. GIPSON'S REBUTTAL TESTIMONY**

7 Q. Mr. Gipson's rebuttal testimony addresses Staff's disallowance of $1.6 million
8 of Empire's debt costs. What is Staff's position regarding this debt disallowance?

9 A. Staff disallowed $1.6 million of debt expenses associated with Empire's choice
10 to amend its mortgage bond indenture because Empire amended the indenture in order to
11 allow it to maintain its current dividend per share of $1.28.

12 Q. Mr. Gipson states that the amendment was executed in support of the
13 Company's overall financing plan, not just to benefit shareholders and that the amendment
14 was done in order to provide investors some comfort that Empire understood the importance
15 of the dividend to shareholders. What is Staff's response?

16 A. Empire stated that they had to amend the Indenture because its retained
17 earnings balance dropped to $17.2 million and the Indenture, before the amendment, did not
18 allow Empire to pay dividends with essentially a negative retained earnings balance. As
19 previously discussed, Empire has not earned their dividend in eleven of the past seventeen
20 years. Ratepayers should not be burdened with explicit costs associated with Empire's desire
21 to continue to pay the current dividend level to its shareholders.

1 Q. Mr. Gipson implies in his rebuttal testimony that if Empire were unable to pay
2 its dividend that Empire's cost of equity would be higher. Have any other Missouri utilities,
3 such as Ameren and Great Plains Energy, requested a higher cost of equity after reducing
4 their dividends?

5 A. No.

6 **SUMMARY AND CONCLUSIONS**

7 Q. Please summarize the conclusion of your surrebuttal testimony.

8 A. Staff's criteria for its proxy group improves the comparability of its proxy
9 group. Staff's multi-stage growth assumptions are reasonable for its multi-stage DCF model
10 and the Jesup & Lamont equity research report supports the reasonableness of Staff's
11 3.35 percent perpetual growth rate, as well as the overall reasonableness of Staff's estimated
12 cost of common equity. Also, Staff believes that its debt disallowance is necessary and
13 appropriate at this time. In conclusion, Staff continues to believe its testimony provides a
14 reliable estimate of the cost of common equity.

15 Q. Does this conclude your surrebuttal testimony?

16 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of The Empire District Electric Company for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Missouri Service Area of the Company	))))	Case No. ER-2010-0130

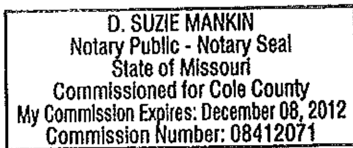
AFFIDAVIT OF SHANA ATKINSON

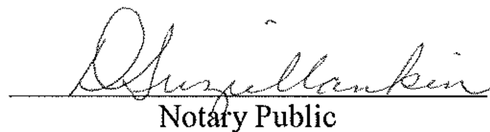
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Shana Atkinson, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 12 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.

Shana Atkinson

Subscribed and sworn to before me this 22nd day of April, 2010.





Notary Public

Jesup & Lamont
Established 1877

Quarterly Update | **Electric Utility Research**

Member FINRA, SIPC

February 9, 2009
Timothy M. Winter, CFA
Senior Analyst
(314) 238-1203
twinter@jesuplamont.com

Empire District Electric (EDE)

Current Price: $17.65

Solid Fourth Quarter Results

Hold

Revenues and Earnings	F2007A	F2008E	F2009E	F2010E
Sales ($ mil.)	**$490.1**	**$518.2**	**$557.9**	**$593.1**
1Q	$125.0	$136.0		
2Q	$106.4	$110.1		
3Q	$141.6	$137.5		
4Q	$113.9	$134.6		
EPS	**$1.09**	**$1.17**	**$1.45**	**$1.45**
1Q	0.15	0.21		
2Q	0.19	0.14		
3Q	0.76	0.59		
4Q	-0.01	0.23		
Current Annual Dividend:	**$1.28**	**Current Yield:**	**7.2%**	
P/E (x)	16.3	15.2	12.3	12.3
Book Value	$16.04	$15.96	$16.16	$16.57
ROE	6.9%	7.3%	9.0%	8.9%

Stock Data	
52-Week Range	$14.9 – $23.5
Shares Outstanding (mil.)	33.95
Market Capitalization (mil.)	$560.1
Enterprise Value (mil.)	$1,237.7
Debt to Capital	40.0%
Insider Ownership	0.5%
Institutional Ownership	46.5%
Short Interest (mil. shares)	1.16
Average Daily Volume	96,708

Company Description. Headquartered in Joplin, Missouri, EDE is a small, regulated utility that provides electric service to customers in southwest Missouri (89% of electric revenue), southeastern Kansas (6%), northeastern Oklahoma (3%), and northwestern Arkansas (3%).

*****See Last Page for Disclosure*****

Highlights

- Empire District Electric (EDE-Hold) reported 2008 EPS results of $1.17 vs. $1.09 in 2007. Our 2008 EPS estimate was $1.15.

- The electric utility business contributed $1.11 in 2008 vs. $1.04 in 2007 and the gas utility business contributed $0.05 vs. $0.03. Full year-2008 results benefited from a Missouri rate increase of $22 million, or 7%, on August 23, 2008 based on a 10.8% ROE. The company was finally allowed to implement a fuel adjustment clause (FAC) on September 1, 2008. Higher fuel and purchased power costs hurt results by ($0.29) in 2008, but were actually a neutral in the fourth quarter as a result of the fuel clause.

- Importantly, fourth quarter results were $0.23 vs. a loss of ($0.01) last year. The new rate plan helped boost results in the fourth quarter and is encouraging for 2009.

- Our 2008, 2009, 2010 and 2011 EPS estimates are $1.15, $1.45, $1.45 and $1.80, respectively. We forecast flat EPS growth in 2010 as financing costs and regulatory lag hamper growth. Continued constructive Missouri regulatory treatment is paramount to achievement of "full EPS power" of $1.80 in 2011.

- EDE plans to invest roughly $325 million in regulated utility infrastructure in 2009 and 2010, including its share of 100 megawatts (MW) of one coal-fired power plant (Iatan 2) and 50 MW of another coal-fired power plant (Plum Point Energy Station). Both plants remain on schedule for mid-2010 commercial operation.

- We expect these investments to receive rate treatment in mid-to-late 2010 and assuming constructive treatment result in 2011 EPS power of roughly $1.80. Our 2011 EPS estimate results in an earned ROE of 10.7%, "ZERO" external financing needs and a dividend payout ratio of 71%.

2008 EPS Results Were $1.17 vs. $1.09

Fourth Quarter Results Were $0.23 vs. ($0.01)

EDE Reports Solid Fourth Quarter Results

On February 6, Empire District Electric (EDE-Hold) reported 2008 EPS results of $1.17 vs. $1.09 in 2007. Our 2008 EPS estimate was $1.15. Importantly, fourth quarter results were $0.23 vs. a loss of ($0.01) last year. Last year's fourth quarter was negatively impacted by a major outage at the Asbury generating station.

The electric utility business contributed $1.11 in 2008 vs. $1.04 in 2007 and the gas utility business contributed $0.05 vs. $0.03. Full year-2008 results benefited from a Missouri rate increase of $22 million, or 7%, on August 23, 2008 based on a 10.8% ROE. The company was finally allowed to implement a fuel adjustment clause (FAC) on September 1, 2008. Higher fuel and purchased power costs hurt results by ($0.29) in 2008, but were actually a neutral in the fourth quarter as a result of the fuel clause. The new rate plan helped boost results in the fourth quarter and is encouraging for 2009.

On August 23, 2008, EDE Implemented a $22.0 million, or 6.7%, Annual Revenue Increase

Fuel Adjustment Clause Effective September 1, 2008

	EPS Results	
	Quarter	**Full year**
Period ended 12/31/2007	**($0.01)**	**$1.09**
Revenues		
Electric	0.25	0.48
Gas	0.10	0.12
Other		(0.03)
Expenses		
Fuel & purchased power	0.06	(0.29)
Electric operating expenses		(0.02)
Maintenance & reparis	(0.02)	0.08
Depreciation	0.02	(0.02)
Tax rate	(0.03)	(0.04)
Interest expense	(0.03)	(0.09)
AFUDC	0.03	0.11
Share dilution	(0.02)	(0.11)
Other	**(0.12)**	**(0.11)**
Year-to-year Change	**0.24**	**0.08**
Period ended 12/31/2008	**$0.23**	**$1.17**

Higher electric revenues were driven by the August 2008 rate increase, higher wholesale sales (which flow back through the fuel adjustment clause) and modest customer growth. The $21 million, or 5%, increase in revenues was partially offset by a ($2.8) million negative weather impact. Higher AFUDC associated with higher capital expenditures positively impacted results by $0.11 per share. However, the lack of fuel clause through eight months of the year negatively impacted results by roughly ($0.29). Lower maintenance expenses aided bottom line results by $0.08 for the year primarily due to the absence of severe 2007 ice storms as well cost control efforts. Share dilution and higher interest expense associated with the capital investment program negatively impacted results by ($0.11) and ($0.09) per share.

EPS Outlook

Our 2008, 2009, 2010 and 2011 EPS Estimates are $1.15, $1.45, $1.45 and $1.80

Our 2009, 2010 and 2011 EPS estimates are $1.45, $1.45 and $1.80, respectively. We were encouraged by the strong fourth quarter EPS report as it reflected the recent rate increase and fuel adjustment clause.

Our 2009 EPS Estimate Results in a Below-Average Earned ROE of 9.2%

We expect the rate increase and FAC to boost EPS to $1.45 in 2009. We note that our 2009 forecast assumes roughly $12 million in non-cash allowance for funds used during construction (AFUDC). In addition, we forecast roughly 2.5% retail sales growth as a return to normal weather more than offsets the relatively weak economy. However, our 2009 estimate results in a below-average earned ROE of 9.2% due to financing costs associated with a heavy capital expenditure budget not recognized in the recent rate case.

Continued constructive Missouri regulatory treatment is paramount to achievement of "full EPS power" of $1.80 in 2011.

EDE to File a General Rate Case in early January 2010 With New Rates Effective in November 2010 and Result in 2011 EPS Power of Roughly $1.80

EDE is in the midst of a multiyear infrastructure investment plan driven by ownership interests in two coal-fired plants currently under construction and scheduled for mid-2010 in-service dates. EDE plans to invest roughly $325 million in regulated utility infrastructure in 2009 and 2010, including its ownership share of 100 megawatts (MW) of one coal-fired power plant (Iatan 2) and 50 MW of another coal-fired power plant (Plum Point Energy Station). Both plants remain on schedule for mid-2010 commercial operation. We forecast roughly $200 million of external financing needs in 2009-2010 (we modeled $150 million of long-term debt in 2009 and $60 million of common stock in 2010).

EDE Adding Roughly 200-Megawatts of Coal-Fired Generation to be in Operation By Mid-to-Late 2010

We forecast flat EPS growth in 2010 as financing costs and regulatory lag will hamper growth. We expect EDE to file a general rate case in early January 2010 with new rates effective in November 2010. Following the rate request true-up date, new rates cannot be implemented for three months. The accrual of noncash AFUDC earnings (roughly $12 million in 2010) associated with Plum Creek and Iatan 2 end when the plants go into service and the expensing of depreciation, operating and maintenance costs and property taxes begin upon commercial operation. We assume 1.5% retail sales growth in 2010.

The 2009-2011 Capital Budget Totals $375 Million including $175 Million in 2009, $118 Million in 2010 and $80 Million in 2011

We expect these investments to receive final rate treatment in November of 2010 and, assuming constructive treatment, result in 2011 EPS power of roughly $1.80. Based on the current forecasted capital expenditure budget (which falls dramatically in late 2010), and improved regulatory environment, which includes a fuel adjustment clause, we optimistically believe EDE's 2011 financial situation can be described as relatively "clear sailing". Our 2011 EPS estimate results in an earned ROE of 10.6%, "ZERO" external financing needs and a dividend payout ratio of 71%.

Capital Expenditures Budget Heavy Through Mid-2010

EDE's 2008 capital budget totaled $211 million and reflect Plum Point Unit 1 and Iatan 2, as well as the payments for the capitalized portion of the December 2007 ice storm.

We Forecast Roughly $200 Million of External Financing Needs in

The 2009-2011 capital expenditure (excluding AFUDC and expenditures to retire assets) budget totals roughly $375 million, including $174.8 million in 2009, $117.5 million in 2010 and $79.5 million in 2011. EDE's share of Plum Point and Iatan 2 are

2009-2010

Common Equity Ratio is 44%

Our 2011 EPS Estimate of $1.80 Results in an Earned ROE of 10.6%, "ZERO" External Financing Needs & Payout Ratio of 71%

estimated at $103 million and $225 million, respectively.

We estimate operating cash flow after common dividends will represent 30%, 60% and 100% of capital expenditures in 2009, 2010 and 2011, respectively. A combination of short-term debt, proceeds of sales of long-term debt and/or common stock (including various internal plans) to finance the remainder. Effective August 15, 2008, EDE maintained a $400 million shelf registration covering common stock, unsecured debt securities, preference stock, first mortgage bonds and trust preferred

Balance Sheet

Common equity represented 44% of total capitalization as of September 30, 2008. S&P and Moody's corporate credit ratings are BBB-/Baa2 (S&P has a Stable outlook and Moody's has a Negative outlook). We forecast roughly $200 million of external financing needs in 2009-2010 (we modeled $150 million of long-term debt in 2009 and $60 million of common stock in 2010).

Valuation

Shares Offer a High 7.7% Yield on $1.28 Dividend

We Believe Shares are Fairly Valued

Our comparative P/E multiple analysis results in a twelve-to-eighteen month fair value estimate of $19 per share. We apply a regulated power company median P/E multiple of 10.7 X our estimated 2011 EPS of $1.80. Based upon the timing of rate increases, large capital projects coming online in late 2010, we believe our 2011 EPS estimate is most representative of the future earnings power of EDE. The P/E multiple is equal to the median 2009E P/E for the regulated utility peer group, but note that the current peer group average is at the bottom end of the historical group range of 10-17X. We consider Missouri regulation to be average, customer growth to be in-line with other utilities and long-term EPS growth to be "about average", we believe an industry-average multiple is warranted.

Our dividend discount analysis results in a valuation of $19 per share. Our projections assume that EDE will be able to pay its dividend in the short-term and will not raise its dividend over the next five years. Beyond the next five years, we estimate a dividend growth rate of 3% annually, based in large part on our assumptions for future Missouri rate decisions.

Empire District Electric
2005-2011 Financial Summary

Operating Revenues	2005	2006	2007	2008E	2009E	2010E	2011E
Electric	359.1	382.6	425.1	448.2	485.3	518.4	565.5
Gas	0.0	25.1	59.9	65.4	67.4	69.4	71.5
Water	1.4	1.8	1.9	5.0	5.2	5.3	5.5
Non-regulated	2.3	2.5	3.2	0.0	0.0	0.0	0.0
Total Revenues	**362.8**	**412.2**	**490.1**	**518.2**	**557.9**	**593.1**	**642.5**
Operating Expenses							
Fuel-Electric	112.8	94.0	113.6	cf	cf	cf	cf
Purchased power	52.7	66.3	77.7	246.7	227.6	237.9	248.7
Fuel cost/KWH	0.0308	0.0294	0.0336	0.0429	0.0386	0.0398	0.0409
Cost of natural gas	0.0	15.3	37.6	37.6	37.6	37.6	37.6
Regulated-other	54.2	60.1	71.4	65.0	67.0	69.6	72.4
Maintenance	20.9	23.2	32.1	27.0	26.0	27.3	28.7
Loss on plant disallowance	0.0	0.8	0.0	0.0	0.0	0.0	0.0
Gain on sale of assets	0.0	0.0	-1.2	0.0	0.0	0.0	0.0
Depreciation	34.7	38.4	52.6	54.0	55.0	59.3	63.9
Income taxes	12.6	21.9	14.4	0.0	0.0	0.0	0.0
Other taxes	19.4	21.0	24.9	25.8	26.7	27.6	28.6
Total operating expenses	**308.8**	**342.4**	**424.6**	**447.2**	**441.6**	**461.1**	**481.7**
Operating income	**54.0**	**69.8**	**65.5**	**71.0**	**116.3**	**132.0**	**160.8**
Other income							
AFUDC	0.3	1.4	2.9	6.1	6.2	4.0	1.5
Interest income	0.3	0.4	0.3	0.0	0.0	0.0	0.0
Total other income	**-0.3**	**0.8**	**2.3**	**6.1**	**6.2**	**4.0**	**1.5**
Interest charges							
Long-term debt	23.9	25.9	31.1	31.1	31.1	31.1	31.1
New long-term debt	0.0	0.0	0.0	3.3	12.0	17.4	17.4
Note payable	4.3	4.3	4.3	4.3	4.3	4.3	4.3
AFUDC	-0.3	-2.9	-4.7	-6.1	-6.2	-4.0	-1.5
Short-term debt	0.2	2.3	2.9	3.7	5.1	5.9	5.8
Other	0.5	1.0	1.1	1.0	0.0	1.0	1.0
Interest charges	**28.7**	**30.6**	**34.6**	**37.2**	**46.2**	**55.7**	**58.1**
Pre-tax income	**37.6**	**62.0**	**47.6**	**39.9**	**76.3**	**80.3**	**104.2**
Income taxes	**12.6**	**21.9**	**14.4**	**14.0**	**26.7**	**28.1**	**36.5**
	33.5%	**35.4%**	**30.3%**	**35.0%**	**35.0%**	**35.0%**	**35.0%**
Income from continuing operatior	25.0	40.0	33.2	25.9	49.6	52.2	67.7
Discontinued operations	-1.2	-0.7	0.1	0.0	0.0	0.0	0.0
	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net income	**23.9**	**39.3**	**33.2**	**39.7**	**49.6**	**52.2**	**67.7**
Wtd average shs out.	25.9	28.3	30.6	33.8	34.2	35.9	37.6
Actual shs. out.	26.1	30.3	33.6	34.1	34.3	37.5	37.7
EPS	**$0.92**	**$1.39**	**$1.09**	**$1.17**	**$1.45**	**$1.45**	**$1.80**
Dividends	$1.28	$1.28	$1.28	$1.28	$1.28	$1.28	$1.28

Book value year-end	$15.08	$15.49	$16.04	$15.96	$16.16	$16.57	$17.11
Book value-average		$15.29	$15.77	$16.00	$16.06	$16.36	$16.84
ROE	#DIV/0!	9.1%	6.9%	7.3%	9.0%	8.9%	10.7%

	2005	2006	2007	2008E	2009E	2010E	2011E
Operating Cash Flow							
Net income	23.8	39.3	33.2	39.7	49.6	52.2	67.7
Depreciation	39.2	43.0	57.3	54.0	55.0	59.3	63.9
Pension	6.4	5.7	9.5	0.0	0.0	0.0	0.0
Deferred income taxes	7.1	0.8	18.7	0.0	0.0	0.0	0.0
AFUDC	(0.3)	(1.4)	(2.9)	(6.1)	(6.2)	(4.0)	(1.5)
Operating Cash Flow	**76.1**	**71.4**	**103.7**	**87.6**	**98.4**	**107.5**	**130.1**
Investing Activities	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	0.0
Capital expenditures	(68.6)	(112.6)	(178.5)	(189.3)	(174.8)	(117.5)	(79.5)
Acqusition of gas properties	0.0	(103.2)	0.0	0.0	0.0	0.0	0.0
Non-regulated	(1.9)	(2.6)	(4.9)	0.0	0.0	0.0	0.0
Sale of ppty plant & equipment	0.0	1.1	4.5	0.0	0.0	0.0	0.0
	(71.2)	**(217.7)**	**(178.9)**	**(189.3)**	**(174.8)**	**(117.5)**	**(79.5)**
Financing activities	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	0.0
Long-term debt	(3.1)	54.2	78.8	90.0	150.0	0.0	0.0
Pmt of interest rate derivatives	(1.4)	0.0	0.0	0.0	0.0	0.0	0.0
Common stock	6.6	79.3	71.7	8.0	5.0	60.0	5.0
Short-term debt	31.0	46.1	(44.0)	25.0	0.0	(22.0)	(10.0)
Dividends	(33.2)	(36.1)	(39.0)	(43.3)	(43.8)	(45.9)	(48.1)
Other	(0.5)	(0.5)	(0.5)	0.0	0.0	0.0	0.0
Financing activities	0.4	142.7	67.0	79.7	111.2	(7.9)	(53.1)
Stock price issuance	0	0	0	18.0	18.5	19.1	19.7
Long-term debt	0	0	0	45.0	165.0	240.0	240.0
Short-term debt	0	0	0	12.5	25.0	14.0	(2.0)
Net change in cash	5.4	-3.6	-8.3	-22.0	34.8	-18.0	(2.5)
Cash at beginning of year	12.5	17.9	14.3	6.0	-16.0	18.9	0.9
Cash at end of year	**17.9**	**14.3**	**6.0**	**-16.0**	**18.9**	**0.9**	(1.6)

	2005	2006	2007	2008E	2009E	2010E	2011E
Common equity	393.4	468.6	539.2	543.6	554.4	620.7	645.3
Preferred equity	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Short-term debt	31.6	77.2	33.2	58.2	58.2	36.2	26.2
Long-term debt	409.9	462.4	541.9	631.9	781.9	781.9	781.9
Total capitalization	**834.9**	**1,008.2**	**1,114.2**	**1,233.7**	**1,394.5**	**1,438.8**	**1,453.4**
Common equity	**47.1%**	**46.5%**	**48.4%**	**44.1%**	**39.8%**	**43.1%**	**44.4%**
Short-term debt	3.8%	7.7%	3.0%	4.7%	4.2%	2.5%	1.8%
Long-term debt	49.1%	45.9%	48.6%	51.2%	56.1%	54.3%	53.8%

Empire District Electric (EDE) – 3 Year Price Chart

Price Target and Ratings Changes over the Past 3 Years:

Date	Stock Price	Rating	Target Price	Initiation
12/10/2008	$16.22	Hold	NM	X

Companies Mentioned in Report:

- None

Analyst Disclosure

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