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Explore Together



Understanding Privatization Potential

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Is Public Power for Sale?

Public Power Making the Headlines

NextEra's proposal to buy Santee Cooper includes partial refunds for customers

Vero Beach electric sale to Florida Power & Light clears major hurdle

Draft study on JEA sale: Utility has more 'net value' than ever before

Puerto Rico's Utility Moves Toward Privatization, With Strained Cooperation

Anchorage voters approve \$1B deal to merge muni with Chugach Electric





Is Public Power for Sale?

More Headlines Than Transactions

- ◆ Is This a Trend, or Just Isolated Incidents?
- ◆ How About Both?
- ◆ “It Takes Two” - for a Deal
 - *Motivated, “acquisitive” buyers – “The Trend”*
 - *Willing sellers – “The Isolated Incidents”*
- ◆ But it Only Takes One to Start the Discussion
 - *Maybe a long, painful, confusing, disruptive discussion*





Are There Buyers and Sellers?

◆ There are Definitely Interested Buyers

- What Do They Want?

◆ Many “Types” of Public Power Assets

- *Size: Buyers generally don't want small acquisitions*
- *Retail/Wholesale: Generation assets are not too appealing
Distribution and Transmission are*
- *Cost Structure: High-Costs can create selling pressure
Low-Costs should be a barrier to privatization
High debt requires costly cap structure replacement
Strong cash flow is **very** attractive*
- *Locations/Markets: Growth (>0.01%) is attractive
Strategic “Donut hole” and/or transmission corridors
Utility Regulator “friendliness”*





Are There Buyers and Sellers?

◆ The “Types” of Public Power Assets (cont.)

- *Utility Type:* *Electric assets are appealing*
Water, gas, telecom also attractive
Regulation and separation can be complex/costly
- *Governance/* *Joint action is complex*
Ownership: *Utility district “ownership” can be ambiguous*
State-owned utilities often lack customer alignment
City-owned utilities may have incentives to sell

◆ A Limited Subset of These Types Will be Attractive Targets



Are There Buyers and Sellers?

◆ The “Types” of Potential Buyers

- *Strategic: Regulated Electric Utilities*
Seeking growth in a very growth-constrained industry
Potential for resource and cost synergies
Addition to Rate Base is the primary driver
- *Financial: Pension Funds, Hedge Funds, Infrastructure Funds*
Looking for very long term assets in some cases
Regulated returns are attractive for relatively low risk assets
Targeting specific hurdle rate returns
Limited management and regulatory experience



Limited History of Public Power Privatization

- ◆ Buyers are not Exactly “Barbarians at the Gates”
 - But you can bet their M&A advisors have run the numbers
- ◆ Most Privatization Initiatives are Sell-Side Sourced
 - Often as a result of rate pressures or headlines
 - Increasingly as a result of “owner” initiatives (privatization, pensions)
- ◆ Strong, Historic Financial Headwinds to Privatization
 - Muni capital cost advantage in a capital intensive business
 - Low-cost, tax-exempt financing for munis
 - IOUs use taxable debt, high-cost equity and pay income tax
- ◆ But These Factors Have Changed Considerably



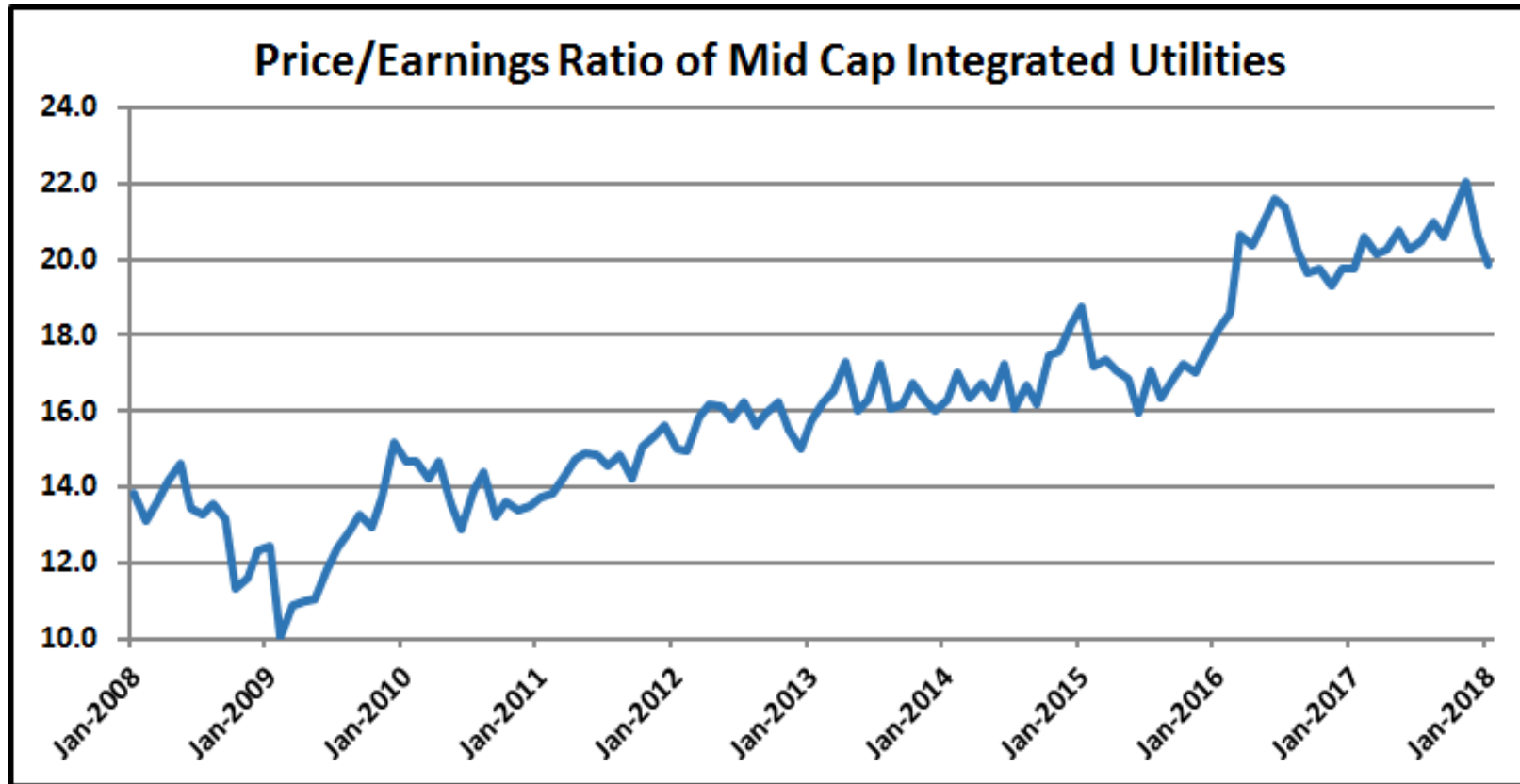
Market and Industry Forces May Trigger Change

- ◆ The Industry is No Longer Capital Intensive
 - Many utility balance sheets are shrinking
- ◆ IOU After-Tax Debt Costs can be Lower than Muni Costs
 - IOUs issuer shorter debt and trade close to Treasuries = <4% debt
- ◆ Real Cost of IOU Equity is Much Lower than Regulated ROE
 - *PE Ratios were above 20X earlier this year, compared to 14X in 2012*
 - *IOU stocks are “Low-Beta”, requiring lower market returns*



Utility Industry Valuation Trends:

- ◆ Recent Very High Values for Utility Stocks and Assets
 - *Stock prices: absolute and relative to earnings (Price/Earnings Ratio)*





Utility Industry Valuation Trends:

Recent Very High Values for Utility Assets

- *Merger & Acquisition activity provide price and metric comparables*

Buyer	Sempra	Hydro One	Great Plains	Fortis	Dominion	Duke	Emera	Wider Industry Averages
Sold	Oncor	Avista	Westar	ITC	Questar	Piedmont	TECO	
Date	Aug-2017	Jul-2017	Jul-2017	Feb-2016	Feb-2016	Oct-2015	Sep-2015	
Total Value	\$18.7 Bn	\$5.3 Bn	\$11.6 Bn	\$11.3 Bn	\$6.0 Bn	\$6.7 Bn	\$10.4 Bn	
Cash Flow Multiple	10.5 X	11.8 X	11.0 X	13.8 X	9.6 X	14.9 X	9.8 X	~12 X
P/E Ratio	27.9 X	24.2 X	21.5 X	22.0 X	19.4 X	30.5 X	28.4 X	~25 X
Rate Base Multiple	1.7 X	1.7 X	1.8 X	2.0 X	2.2 X	2.5 X	1.7 X	~2 X



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 - *IOU Stocks are “Low-Beta”, requiring lower market returns*
- ◆ IOUs Use Acquisition Discount Rates as Low as 5%
 - While many munis assume funding costs close to 5%
- ◆ IOU Tax Rates are Lower – Effective Tax Rates Even Lower



Market and Industry Forces May Trigger Change

- ◆ The Result: IOUs Can Pay Big \$\$ For Muni Cash Flow
- ◆ Potential Labor/Resource Synergies Cushion Rate Impacts
 - *Labor “synergies” will mean layoffs*
 - *Regulators typically allocate merger synergies to customers over time*
- ◆ The Historically Unthinkable is Now Possible:
In some cases, Buyers could pay large up-front prices for muni assets, pay off debt, and freeze/lower rates in the short run.
- ◆ Utility Speak “Up-Front and Short Run” Can Equal “Long-Term” to Most Humans



Muni Acquisitions Could be Great for IOUs

- ◆ IOU Shareholders Favor Growth (NextEra PE Multiples)
- ◆ There are Limited Organic Growth Opportunities for Utilities
- ◆ There are Several Big Acquirers, With Fewer Targets
 - # of publicly traded IOUs reduced by almost half over the last ~20 years
 - Ave Market cap of Top 40 IOUs up from \$3.5Bn to \$13.1Bn
- ◆ The Trend Could Lead to Buy-Side Initiatives in the Future
- ◆ Target Muni Utility Candidate Profile

<i>med/large</i>	<i>strategic location</i>	<i>low debt</i>
<i>cash flow</i>	<i>cap ex</i>	<i>some growth</i>
<i>City-owned</i>	<i>friendly regulation</i>	
- ◆ *Regulated Rate Base Growth is a Top Priority*



Privatization Can Meet “Owner” Objectives

- ◆ Public Power Often Viewed as Having “Ratepayer Owners”
 - But This is Not Necessarily Accurate
- ◆ Owners may be Governmental Bodies for which...
Ratepayers ≠ Decision Makers ≠ Taxpayers ≠ Voters
- ◆ There Will be Overlap and Mutual Interest, but not 100%
- ◆ Sale Proceeds (up-front) can Plug Budget/Pension Holes
 - Many pension valuations assume above market returns
- ◆ Revenue/MwH-based PILOTs/Transfers are Less Certain
 - Taxes may partially offset PILOT/Transfer elimination in sale
- ◆ This Can Create Motivated Owner/Seller
 - *A sale could actually be in the best economic interest of taxpayers*



But What About Those Ratepayers?

- ◆ The IOU Quest for Regulated Rate Base Doesn't Align with Ratepayer Long-Term Best Interest
- ◆ IOU's/Investors Will Pay ~2X Rate Base for the Ability to “Arbitrage” Rate Base
 - Regulated ROEs have been almost 2X market yields for low risk stocks
 - Future CapEx can add to the Rate Base Machine
 - CapEx will be the preferred answer to many IRP questions
- ◆ The Muni Utility Focus has Been Long-Term Cost of Service
- ◆ The Cost Curves Will Diverge With IOU vs. Muni Focus
 - All things equal, lower rates for muni ownership



Who is “At Risk”?

- ◆ At Risk to What? Noise and/or a Real Threat?
- ◆ Noise? Same old Story
 - High Rates, Reliability ?s, Headlines, Privatization Initiatives
- ◆ Real Threat?
 - Well- Managed, Valuable Assets, Conservative Finances
 - In Cities that Need \$\$
- ◆ Basically, the Model Public Power Utility
 - Not Necessarily a Near-Term Risk
 - But a lot of Public Power has been inadvertently “prepping for sale”
 - Paying down debt, with strong cash flow
 - Rates maybe higher than currently needed



Key IOU vs Public Power Difference

- ◆ IOU “Faith in the System” – the Regulatory System
 - Maximize Rate Base and Return
 - Depreciate less, invest more, keep Rate Base up
 - Willing to pay to retire plants, if cost is Rate Based
 - Leverage is OK
 - Less concern for fuel cost and diversity

- ◆ Muni Concern – Industry Change and Future Cost Recovery
 - Depreciate quickly
 - Invest cautiously
 - Keep cash flow up
 - Pay down debt
 - Maintain fuel flexibility

- ◆ Whose Ratepayer Would You Rather Be in the Long Run?

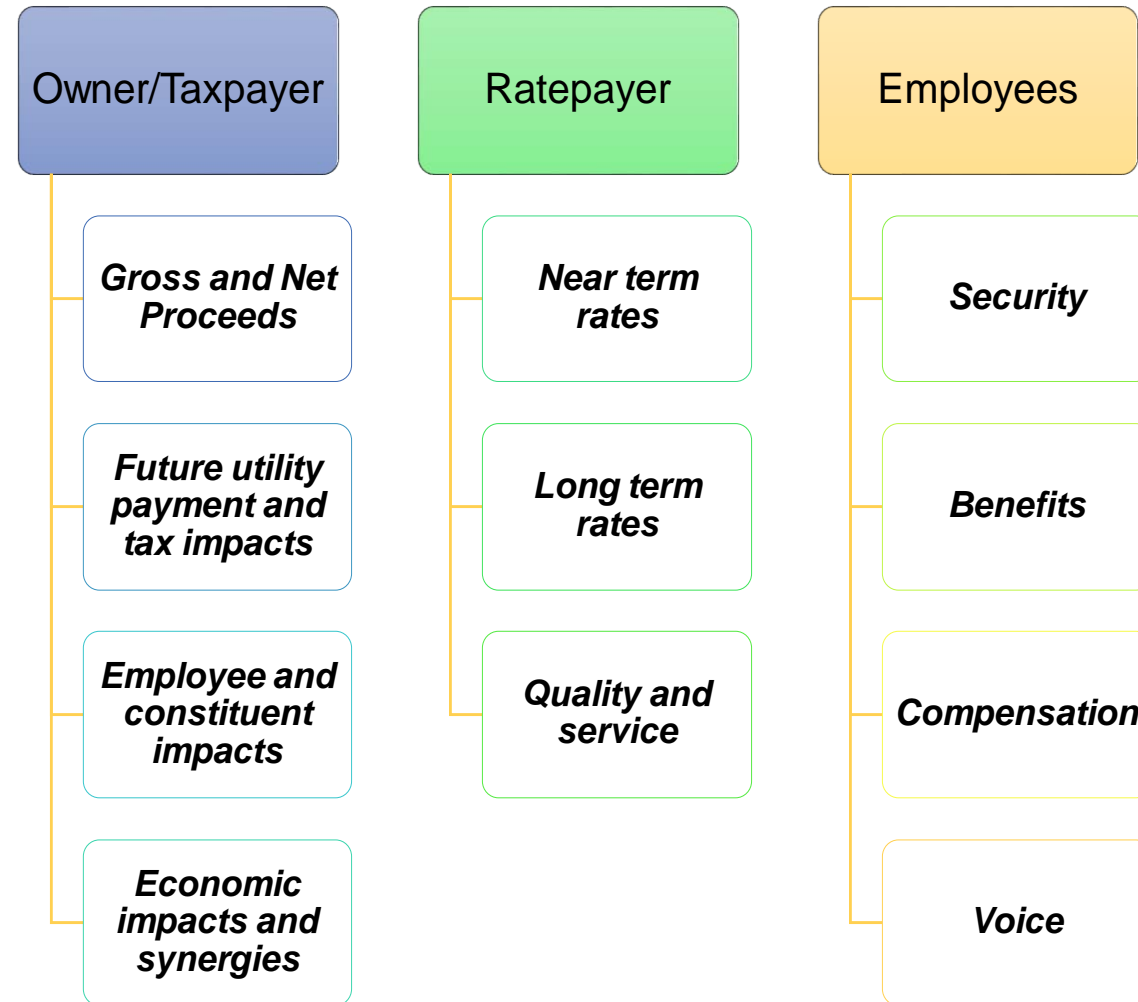


How to Respond to a New Environment

- ◆ Cut Rates?, Lever Up?, Shed Assets?
- ◆ Probably Not, But Understand the Impacts of the Opposite
- ◆ Revised and Tailored Messaging to Constituents
 - Owners (Governmental, Taxpayers, Voters)
 - Customers
 - Employees



Understand and Address Different Priorities





The Important Public Power Considerations

- ◆ **Future Utility Rates – Moving to a Regulated Environment**
- ◆ **Employment and Workforce**
- ◆ Pension/OPEB Liabilities and Benefits
- ◆ **Future Financial Flexibility (don't eat the Golden Goose)**
- ◆ **Transfer Payments vs. Private Owner Taxes**
- ◆ **Local Economic Impacts, Efficiencies and Econ Development**
- ◆ Service, Responsiveness and Performance
- ◆ Policy and Priorities
- ◆ **FEMA Aid Eligibility**
- ◆ Privatization Study/Execution - Complexity and Cost



Takeaways

- ◆ Challenges to the Public Power Financial Model are Real
 - Though not imminent
 - And not systemic
- ◆ The Current Path Could Intensify Challenges
 - Public Power financial direction
 - Government-owner cost pressures
 - Attractiveness of regulated Rate Base to Investors
 - Long-Term utility market disruption
- ◆ Informed Constituents Will be Public Power Advocates
 - Education is not easy
 - Proactive is better than reactive