

Joint Action Conference





APPA Joint Action Conference

Panel on New Privatization Threats

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PFM

Charlotte, NC

pfm.com



Topics

Recent Public Power Headlines

The Utility Landscape

IOU Merger Activity and Drivers

The Outlook



Recent Public Power Headlines

Is Public Power for Sale?





Public Power in the Headlines – Santee Cooper



Selling Santee Cooper won't be easy; lawmakers look at pros and cons of possible sale



Gov. McMaster continues push to sell Santee Cooper

The Post and Courier

FOUNDED 1803 WINNER OF THE PULITZER PRIZE

Weigh value, cost of lakes in Santee Cooper sale

SEP 9, 2018

The State

Inside the hurried effort to find a buyer for Santee Cooper



Public Power in the Headlines – Vero Beach

Miami Herald

State regulators override staff objection, approve FPL's acquisition of Vero Beach utility

TALLAHASSEE — State utility regulators Tuesday approved Florida Power & Light's acquisition of a city-run utility, overriding a staff proposal that could have scuttled the deal.

With a deal in the works for more than a decade, the Florida Public Service Commission approved FPL's purchase of the city of Vero Beach's electric system without accepting a downward "adjustment" recommended by staff that would have shaved about \$90 million off the \$185 million acquisition.



Group drops protest to FPL purchase of Vero electric utility, but three protests remain

Done deal: Vero Beach electric customers become Florida Power & Light Co. customers on Monday



Public Power in the Headlines - JEA

wjct **Evaluation: City Could Net As Much As \$6.4 Billion From Potential JEA Sale**

FIRSTCOAST NEWS **JEA Debate: Pros, cons and conditions of a potential sale**

The day after JEA leadership held a workshop to discuss a possible sale, and the day before City Council's Special Committee meets again to discuss a possible sale, a meeting was called for Wednesday afternoon to debate the pros and cons of a sale.

JACKSONVILLE BUSINESS JOURNAL **Breakdown: What selling JEA would look like**

The Florida Times-Union
jacksonville.com

Keep JEA and build on its success, council committee report says



Public Power in the Headlines - Anchorage

ANCHORAGE DAILY NEWS

Anchorage mayor proposes to sell ML&P to Chugach Electric in \$1 billion deal

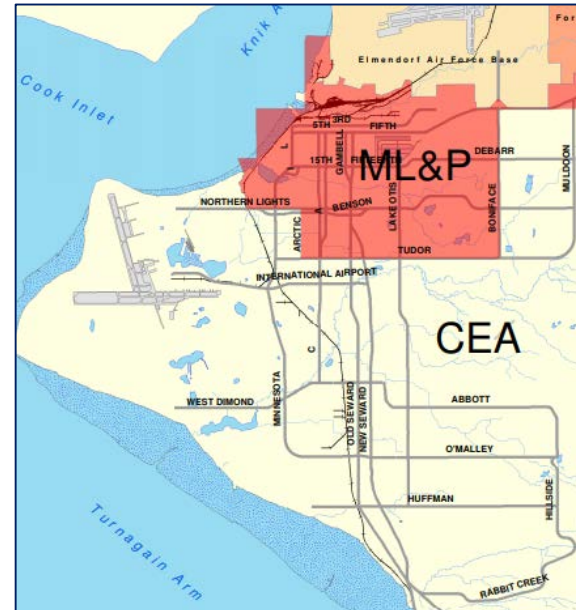
5 other companies expressed interest in buying Anchorage power company

Initial results show Anchorage voters allowing city to sell ML&P to Chugach Electric

ALASKA Journal of Commerce

Anchorage utilities, mayor announce \$1B consolidation deal

Anchorage Assembly approves sale of ML&P to Chugach Electric





Public Power in the Headlines - PREPA

Puerto Rico to privatize its hobbled electric power company  **NEWS**

THE BOND BUYER

Puerto Rico governor signs bill for partial privatization of PREPA

THE WALL STREET JOURNAL

Puerto Rico Power Utility Reaches Deal With Bondholders

BlueMountain Capital, Franklin Advisers and other bondholders agree to restructuring part of utility's \$9 billion debt



Public Power in the Headlines - Lafayette

Updated: Is Lafayette Utilities System for sale?

What's the future of Lafayette Utilities System?

LUS privatization deal includes 10 percent cut in customer bills, corporate HQ in Lafayette

NextGen rescinds offer to manage Lafayette Utilities System



Is Public Power for Sale?

◆ Is this an Industry Wide Trend?

◆ Likely Not

- *A lot of Smoke, but also a little Fire*
- *Each of the examples display unique circumstances*
- *And there is no common thread that is systemic to public power*
- *But some interesting industry backdrop*



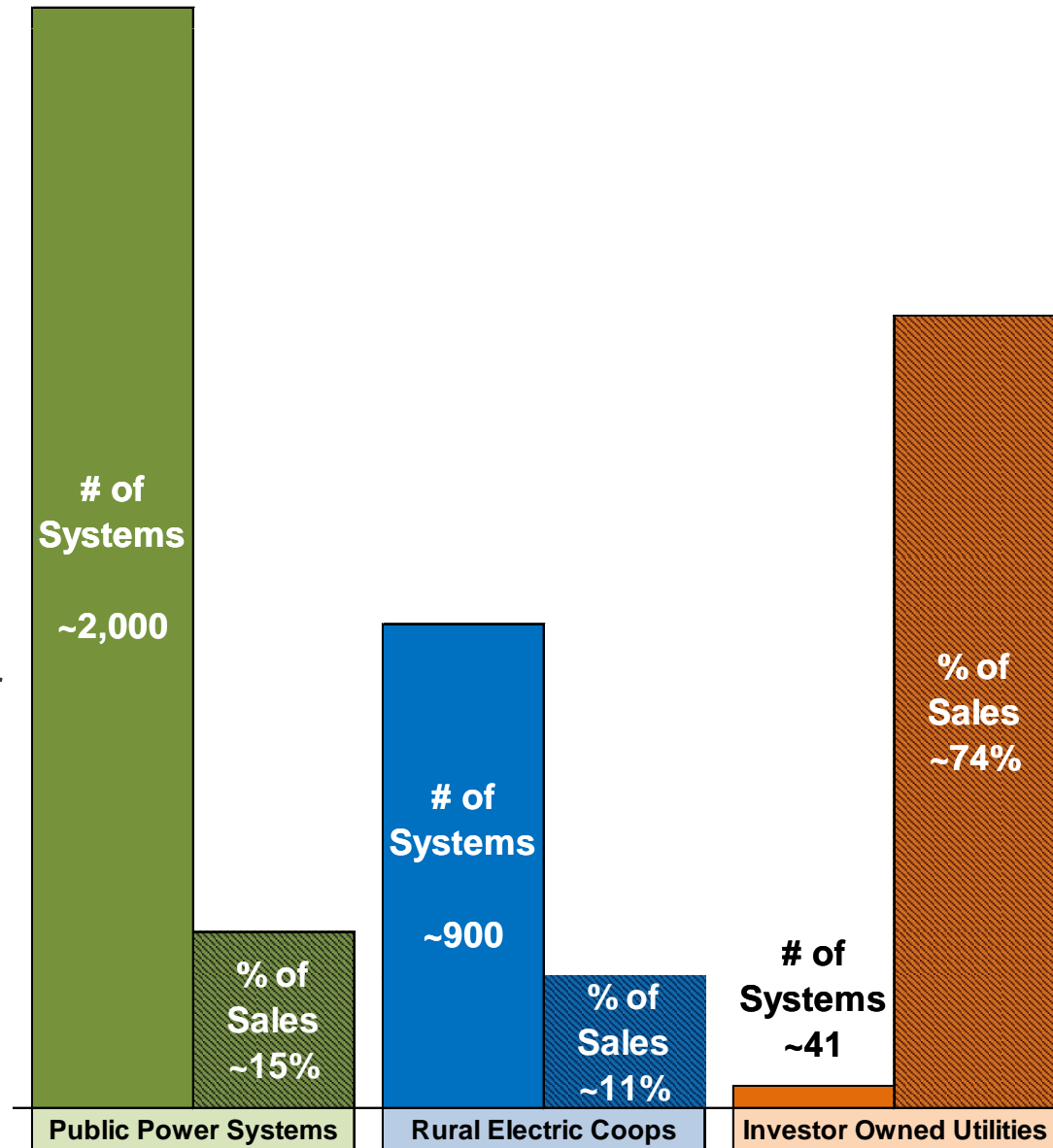


The Utility Landscape



Public Power Industry Position: # of Systems & kwh Sales

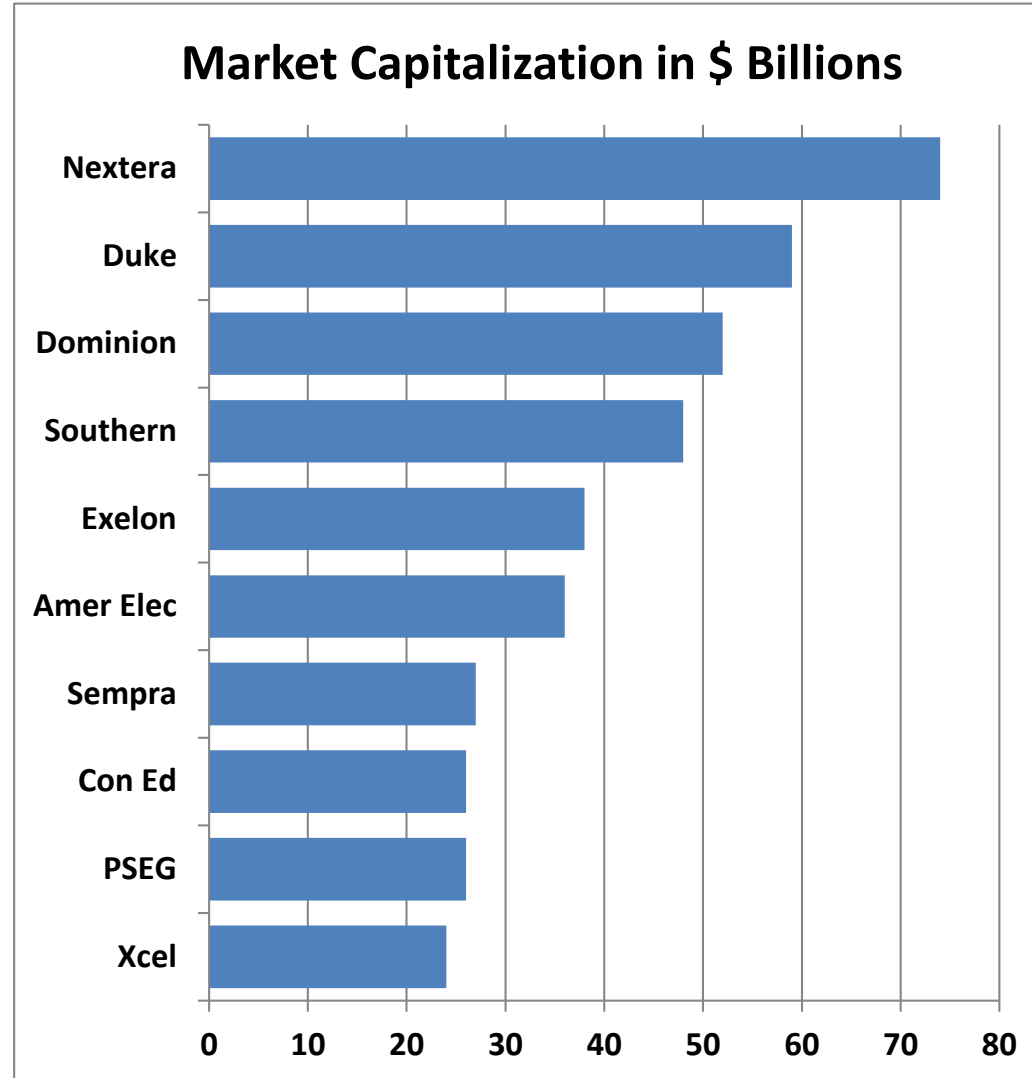
- *Very many small public power systems*
- *The number has not changed much in decades*
- *Similar landscape for Coops, who serve 56% of U.S. landmass*
- *Average IOU sells almost 250 times the energy of the average muni system*





Top 10 IOUs by Market Capitalization

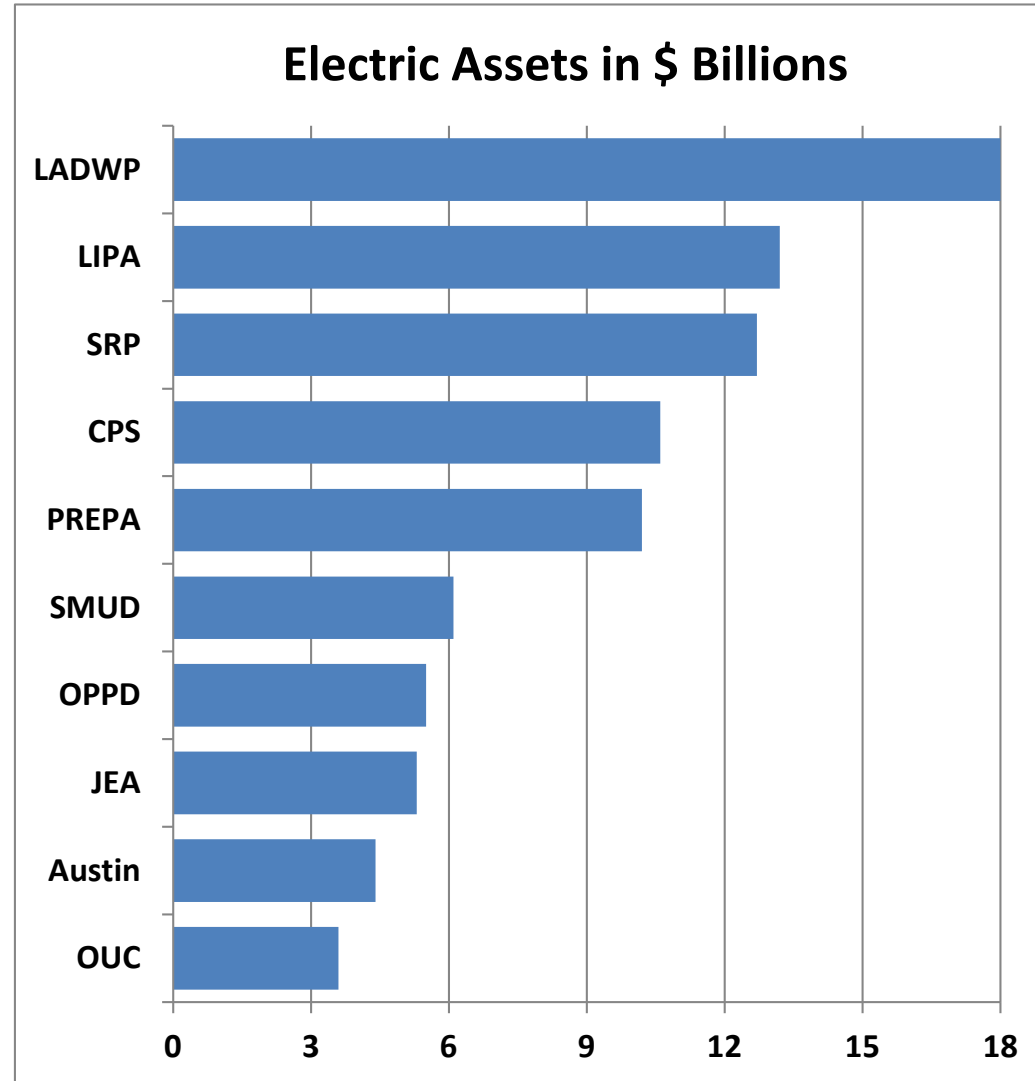
- *Top 10 IOUs have a total of ~\$380 billion of market capitalization*
- *Making up 53% of the IOU industry market cap*
- *There were almost 100 IOUs 20 years ago*
- *Now there are 40*
- *Largest (NEE) is 5X as big as the largest from 20 years ago*
- *Median IOU is 4X from 20 years ago*





Top 10 Public Power Systems by Assets

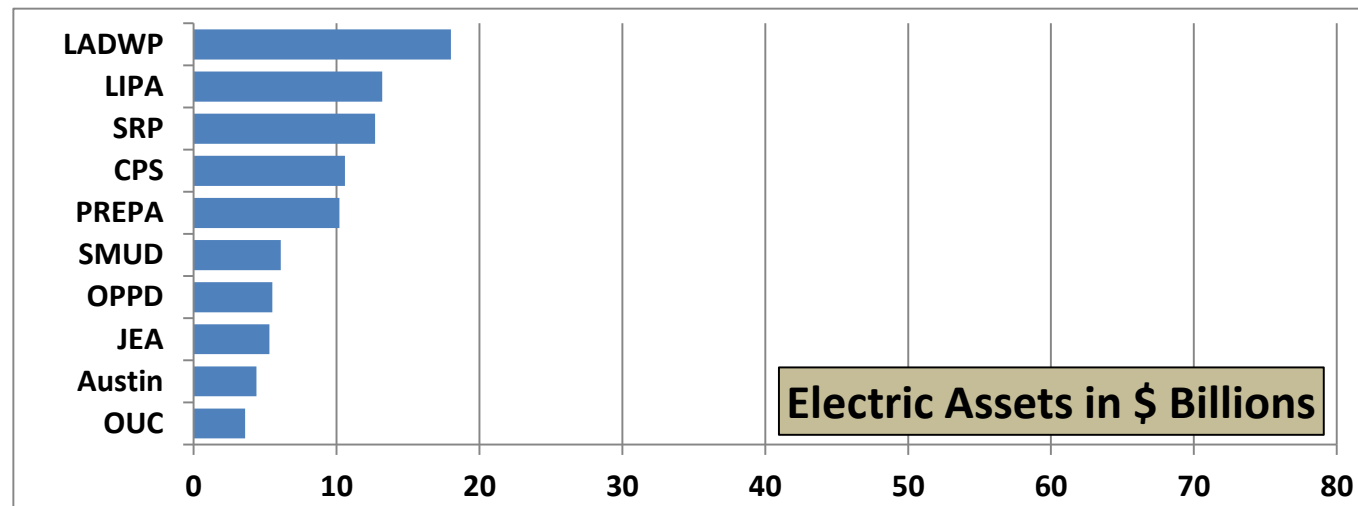
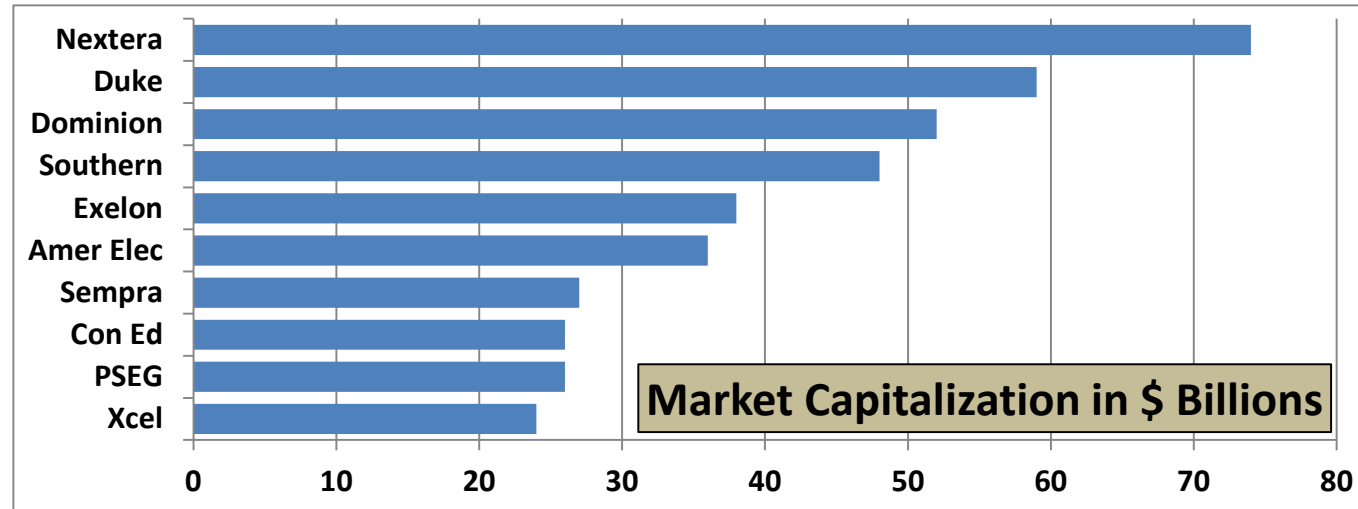
- *Top 10 Muni systems have a total of ~\$90 billion of assets*
- *Roughly same number of systems as 20 years ago*
- *Assets have grown, but not nearly as much as IOU group*





Top 10 System Comparison

- *Market Cap compared to Assets*

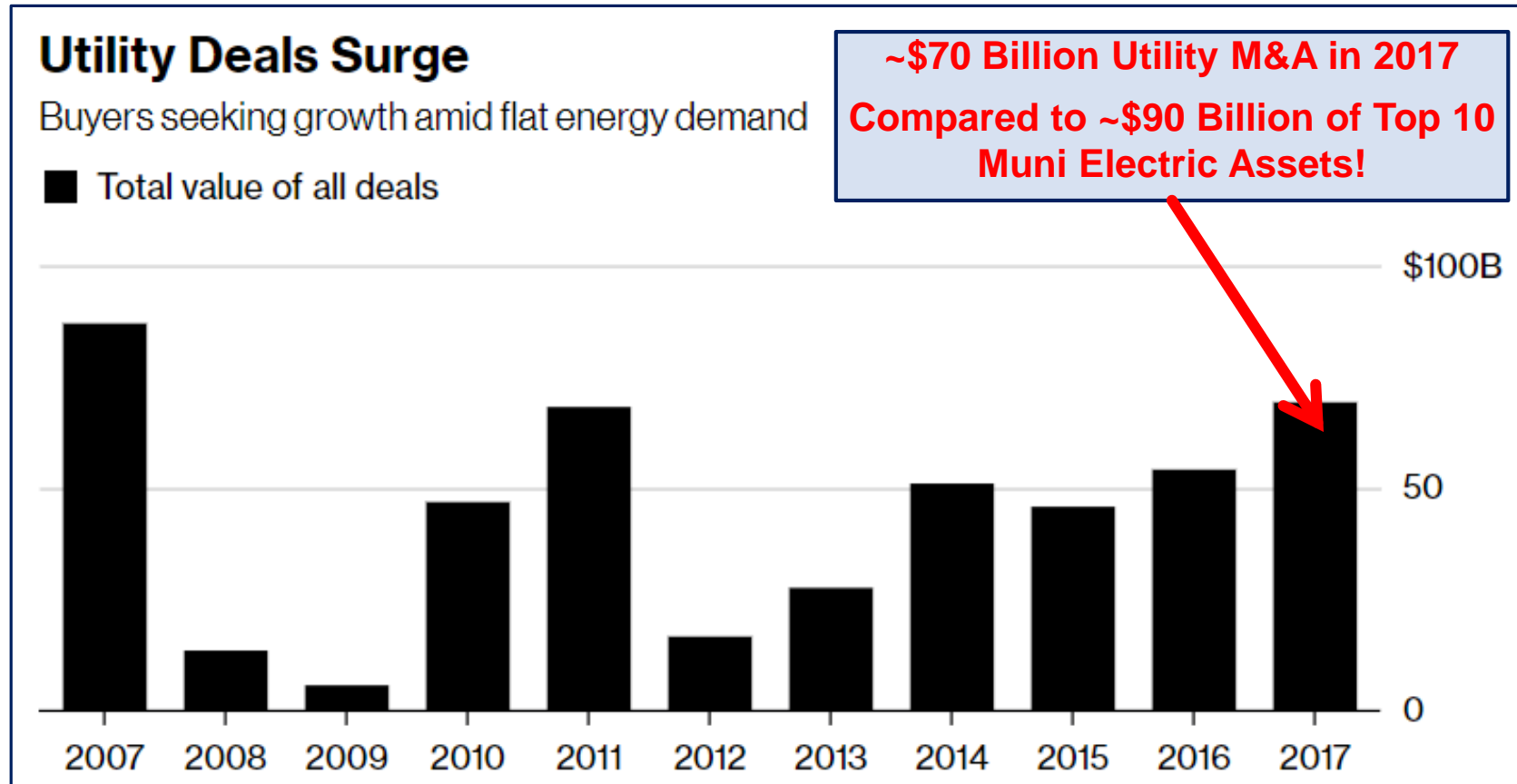




IOU Merger Activity and Drivers



History of IOU Consolidation



◆ Three Deals Announced in 2018

Dominion/SCANA (\$15BN) Centerpoint/Vectren (~\$8BN) NextEra/GulfPower (~\$6BN)



Strong Pace of IOU Consolidation

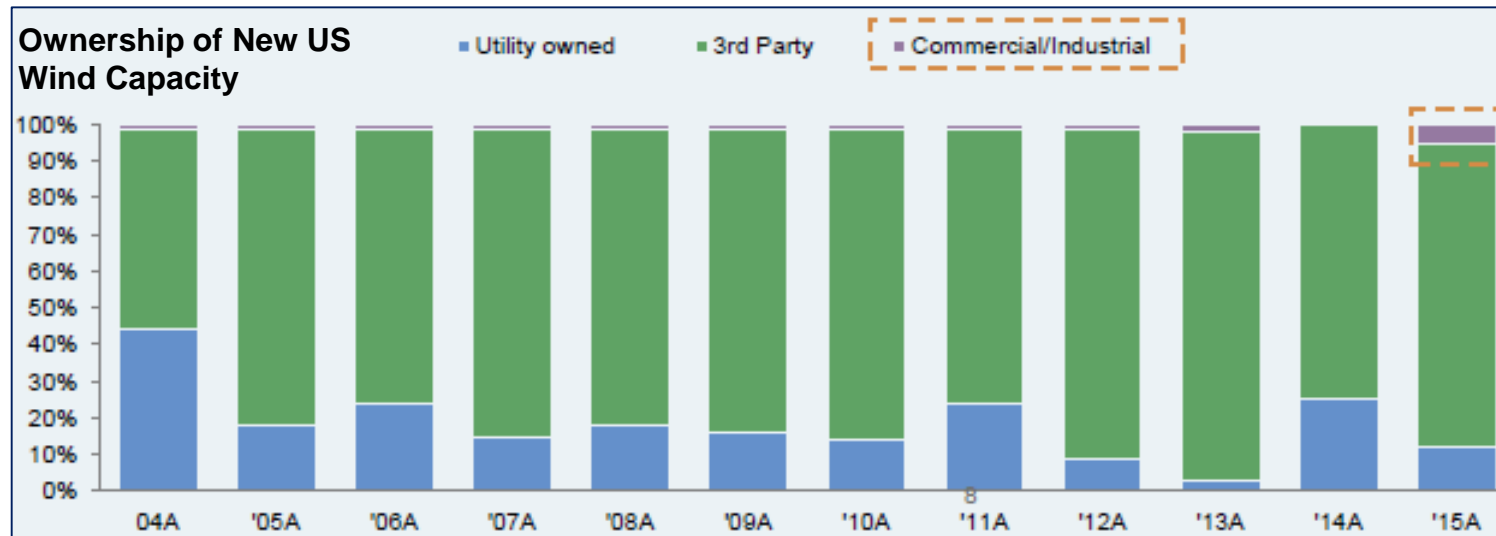
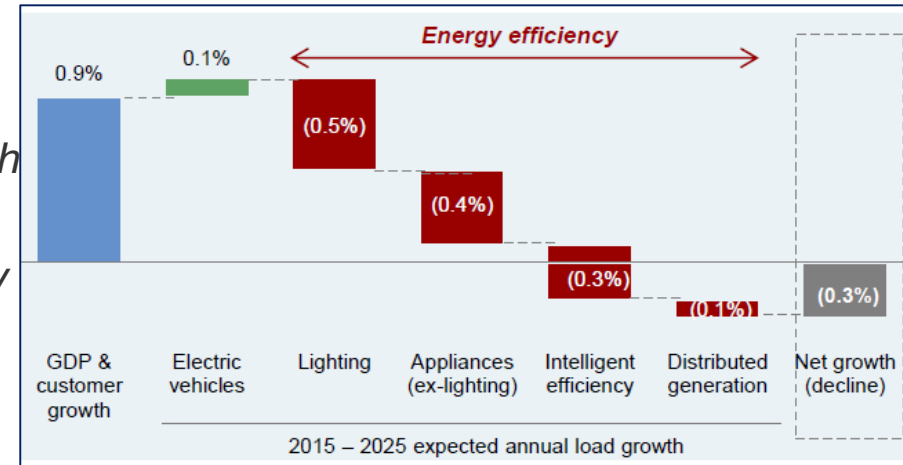
- ◆ Strong Overall M&A Market Conditions – until very recently
 - *Cash on balance sheets*
 - *Low interest rates and high equity prices*
 - *Investors are supportive of M&A – vast capital access*
 - *Large base of strategic and financial buyers of all assets*
 - *Demand both internationally and domestic*
 - *But consolidation has been the primary driver*



Strong Pace of IOU Consolidation

Utility M&A Drivers

- Investors crave and reward growth
- Zero to negative organic customer growth
- Depreciation erodes rate base
- Renewable PPAs cannibalize opportunity
- Acquisitions provide growth opportunity
- Fewer targets every year
- Buy or be bought





Utility Industry Valuation Drivers

◆ Financial Markets Make a Case for Rate Base Growth

Regulated Returns on Equity Exceed Market Cost of Equity

Regulated Utility P/E Multiples

NTM P/E #s over 20X imply a 5%-ish market cost of equity

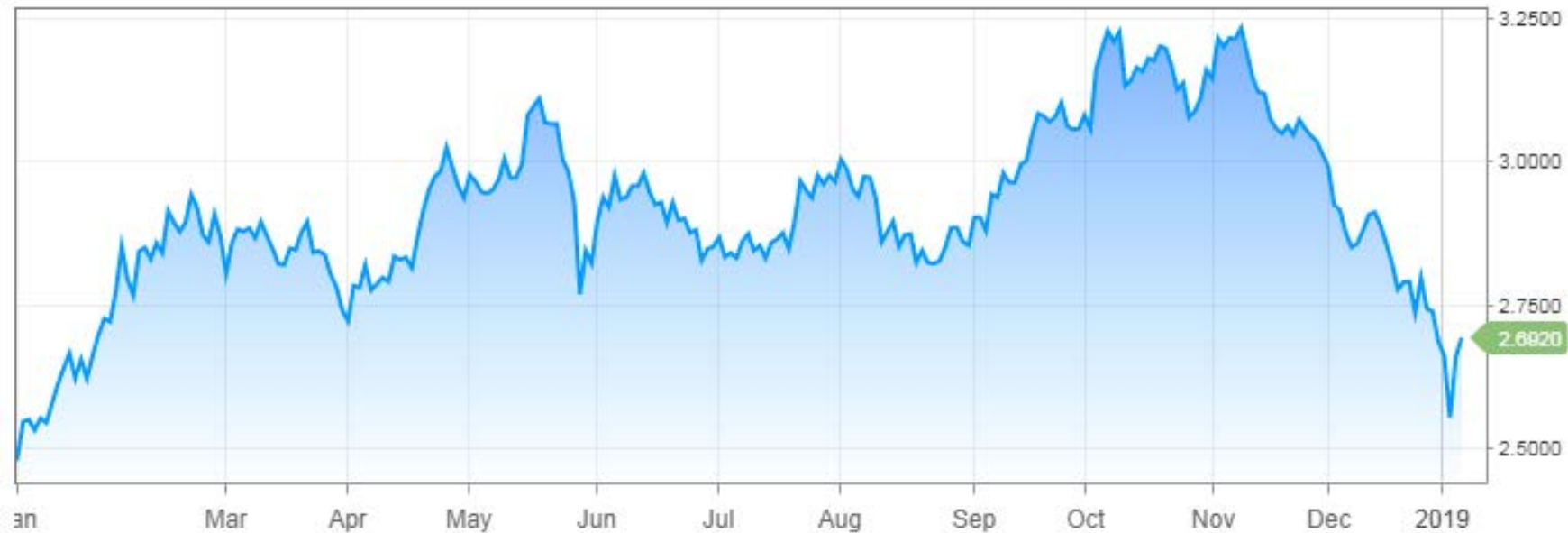




Utility Industry Valuation Drivers

- ◆ Interest Rates Coming Off All Time Lows
 - Utilities still have access to sub 4% debt

10 Year US Treasury Bond Yields
over the Past Year





Merger Math: the Discount Rate

- ◆ The Capital Cost Advantage has Eroded – and might be non-existent

- ◆ IOU Acquisition

Discount Rate Build Up

Risk free rate ¹		2.5%	
Equity risk premium	5.50%	–	6.50%
Levered beta	0.20	–	0.75
Cost of equity	3.6%	–	7.4%
Pre-tax cost of debt		4.0%	
Post-tax cost of debt		3.2%	
Debt/total cap target		40.0%	
Calculated discount rate	3.4%	–	5.7%
Selected discount rate	4.25%	–	4.75%

- ◆ Discount Rate is Below Most Public Power Long-Term Planning Interest Rate Assumptions, and Well Below Allowable ROEs
- ◆ This “Arbitrage” Explains Very High Multiples to Book and to Rate Base



Utility Industry Valuation Drivers

◆ Simple Math:

*If You Earn ~10% on Rate Base,
and Can Fund Rate Base Purchases at ~5% (or less),
then You Will Pay More for Rate Base than Rate Base.*

◆ Result:

*Pay Big P/E and EBITDA Multiples in Acquisitions
Remarkably High Multiples of Book Value*



The Outlook



Utility Industry Acquisition Valuation Outlook

◆ Acquisition Interest Likely to Remain High

◆ Yet There are Fewer IOU Opportunities

◆ Could Public Power be Next?

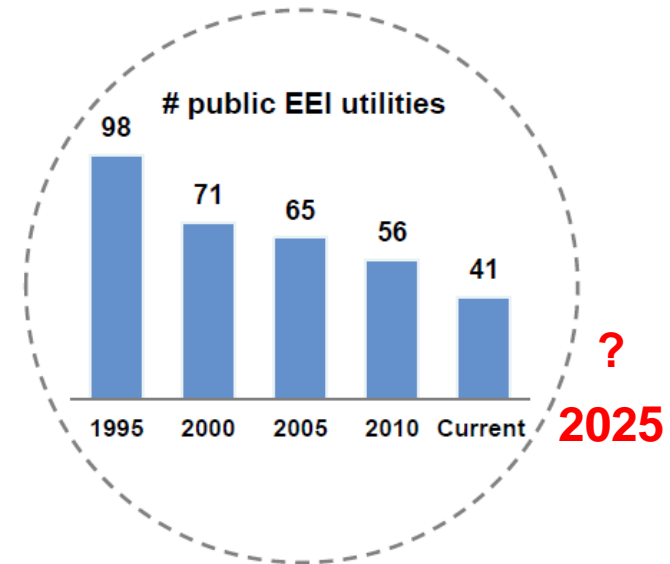
◆ Muni Merger Case Studies:

- Not initiated by IOU interest
- But by individual unique circumstances

◆ *Could that Change?*

◆ *Could the Math Ever Work?*

- *Muni historical cost advantages: Capital Cost, Taxes, Non-Profit*
- *The utility industry is not nearly as capital intensive as it was*





Differing Approach to Rates and the Business

- ◆ Major Difference Between IOUs and Public Power
 - *IOU faith in the regulatory rate recovery system*
 - *Public Power concern for rate competitiveness and demand*
- ◆ Much of Public Power Wants to Shrink the Balance Sheet, While IOUs Seek Ways to Grow It
- ◆ It Leads to Very Different Approaches to the Business
 - *Sometimes like the difference between Defense and Offense*
- ◆ And Could Lead to Big Changes in the Future



Is Public Power a Takeover Target?

- ◆ Some of Public Power is VERY Attractive
 - *Would need to be big enough to make a difference*
 - *Several hundred million of Rate Base Assets*
 - *Low debt to asset ratio*
 - *Solid free cash flow*

This Describes some Very Good Public Power Systems

- ◆ Smaller than the Top 100 are Probably not IOU Targets
 - *But could be Coop consolidation targets*
- ◆ *Larger Public Power and Combined Utility Customer Bases, and Customer Contact have Great Potential Value*



Comments and Questions