

The Return of the Holding Company

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SURFA

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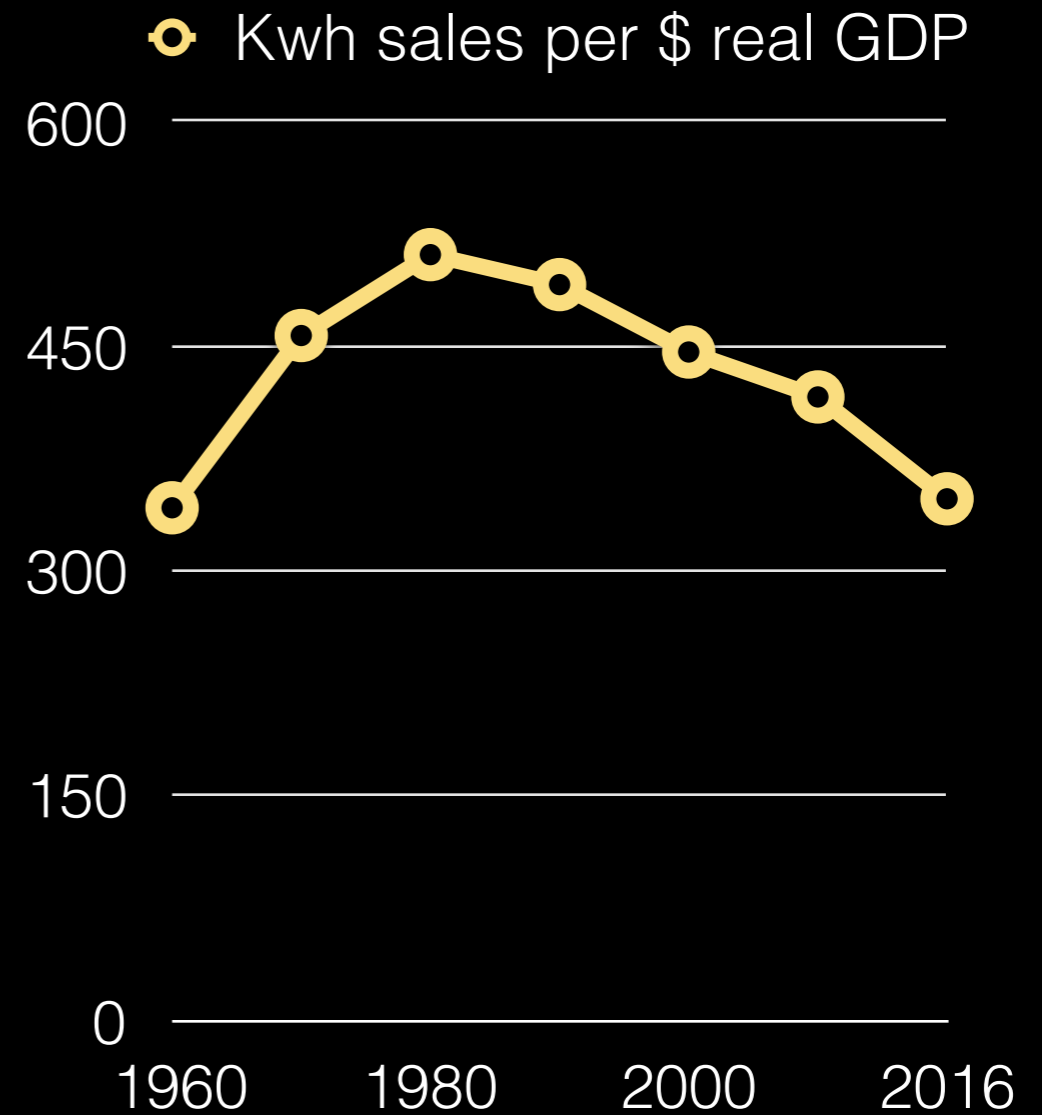
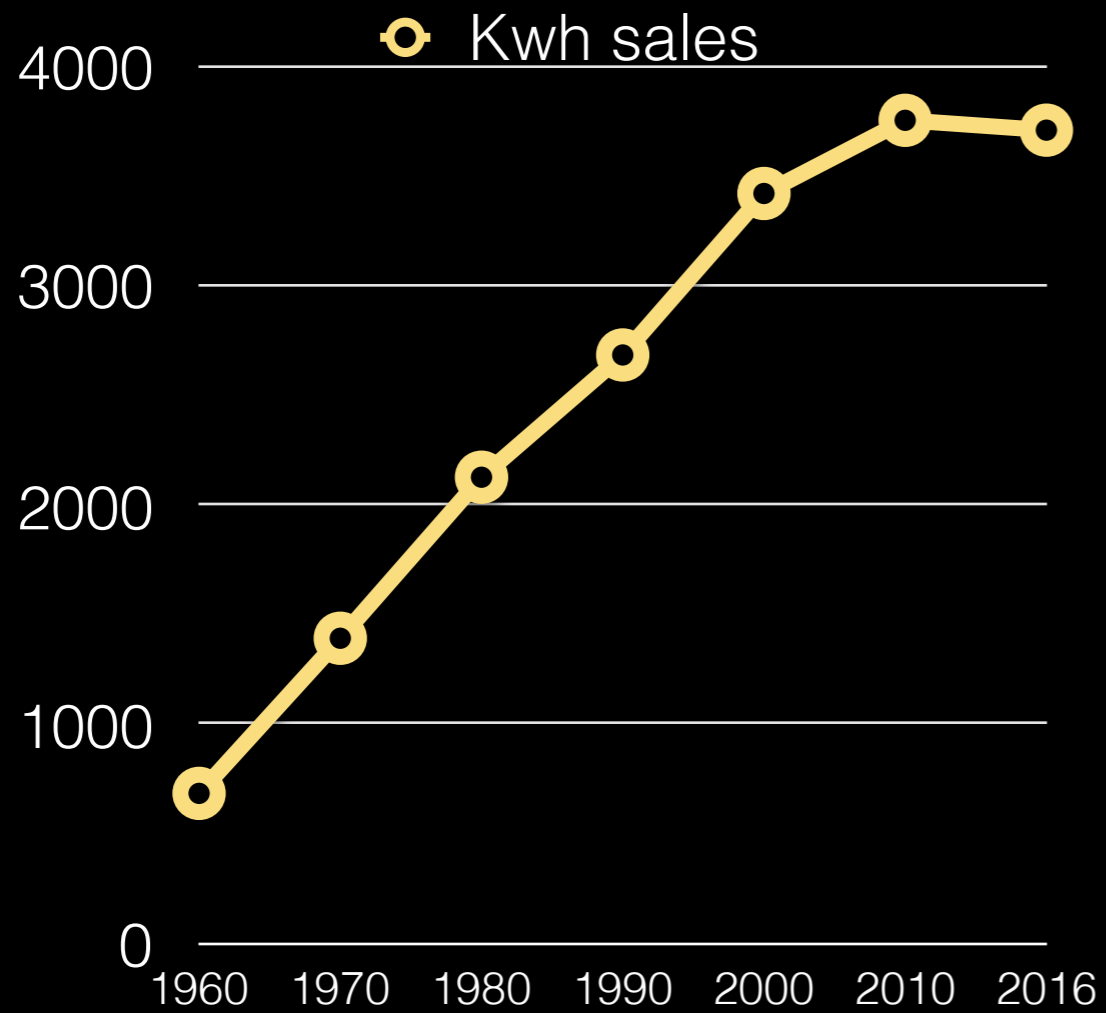


SETTING THE STAGE



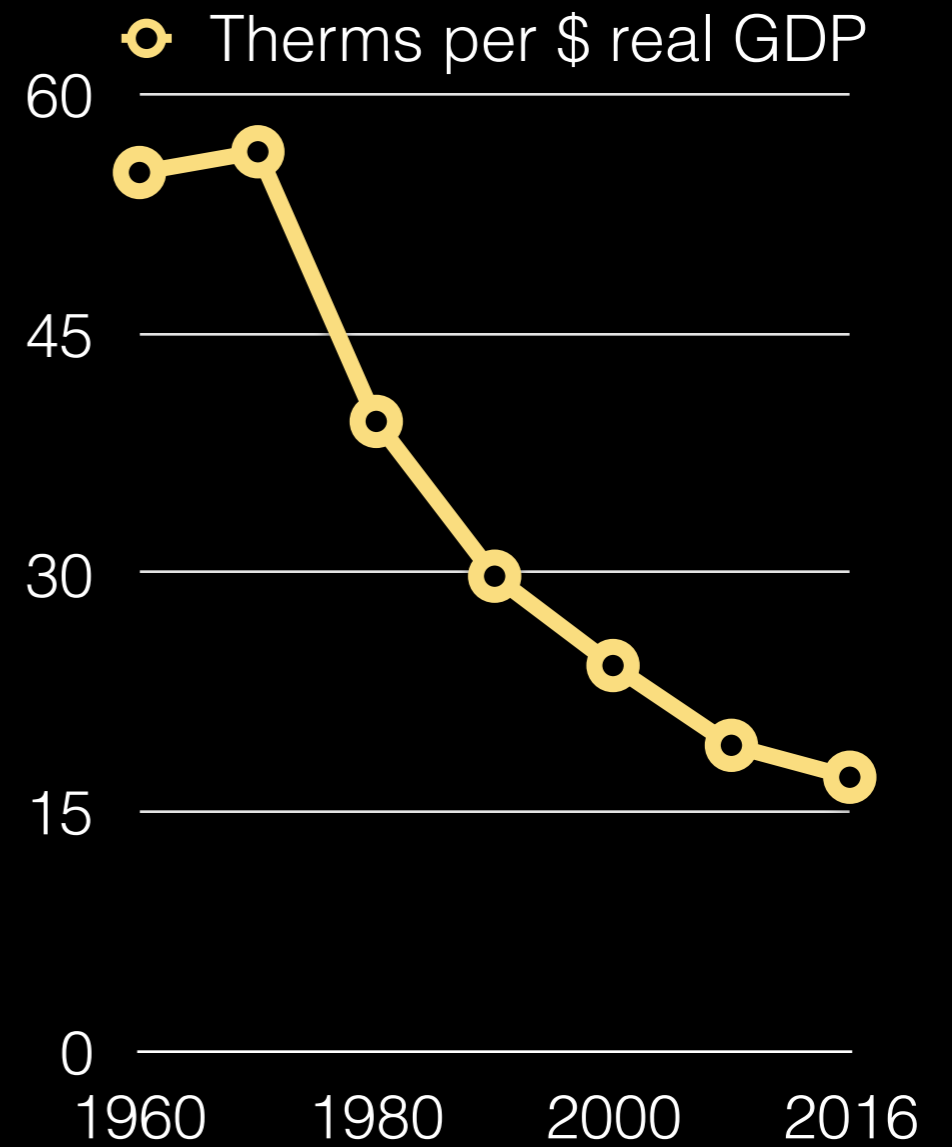
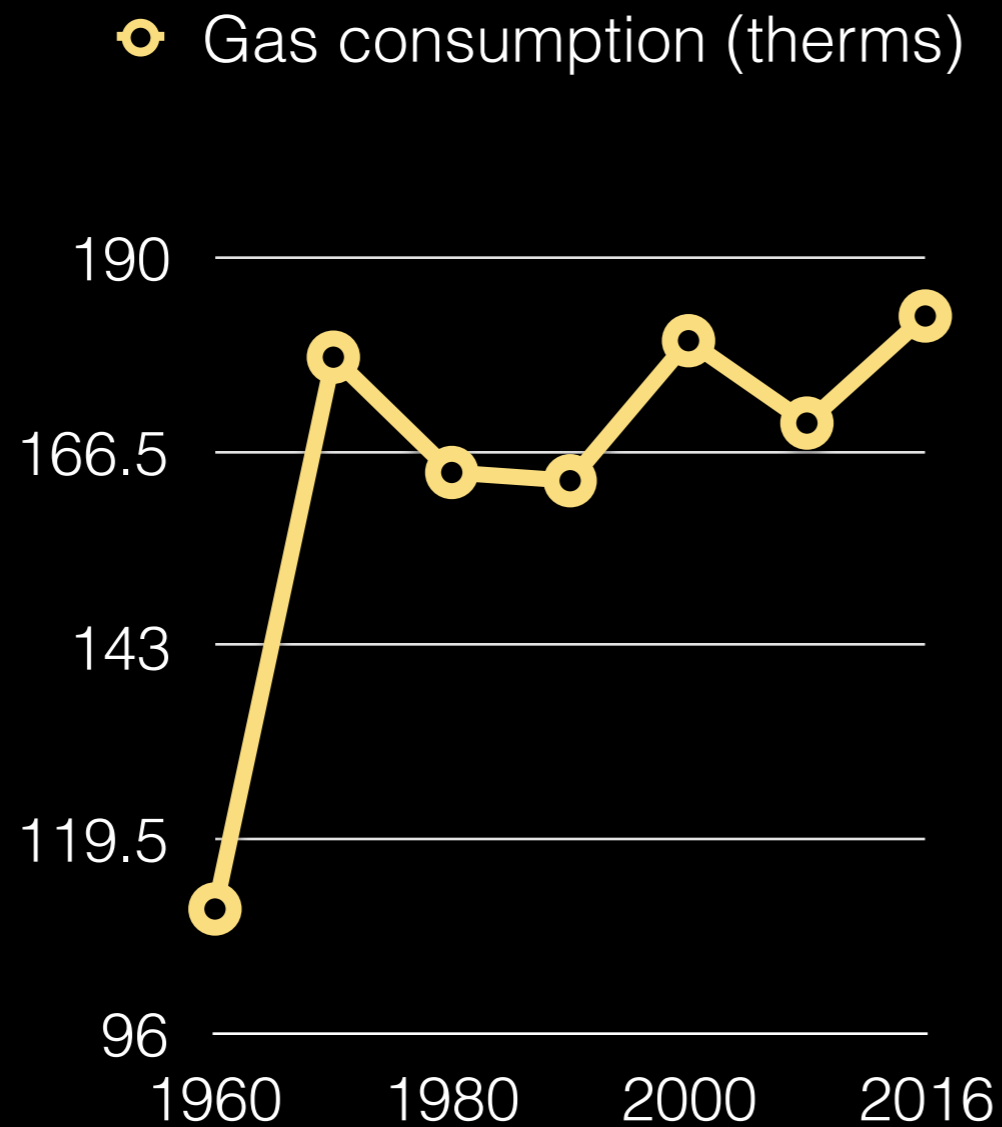
Product in decline

Electricity



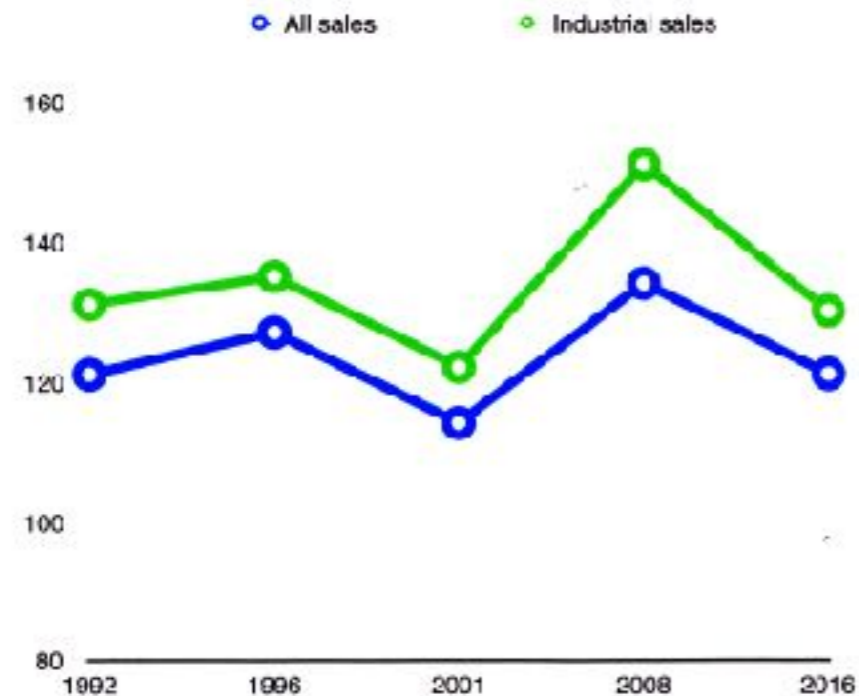
Product in Decline

Natural gas excluding for electric generation

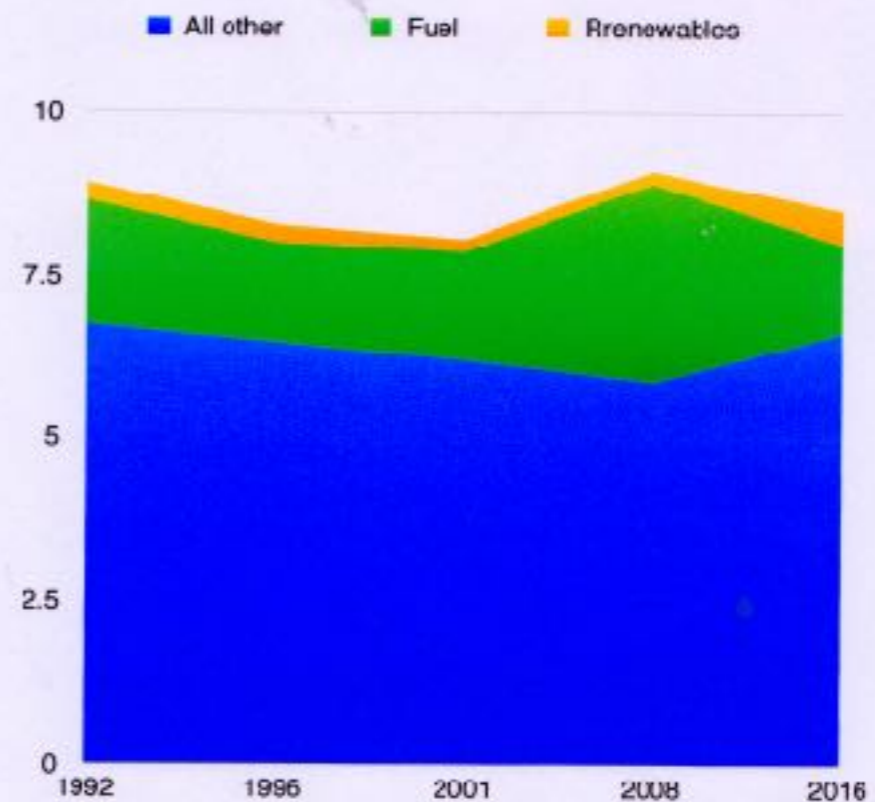


Deregulation did not change the picture

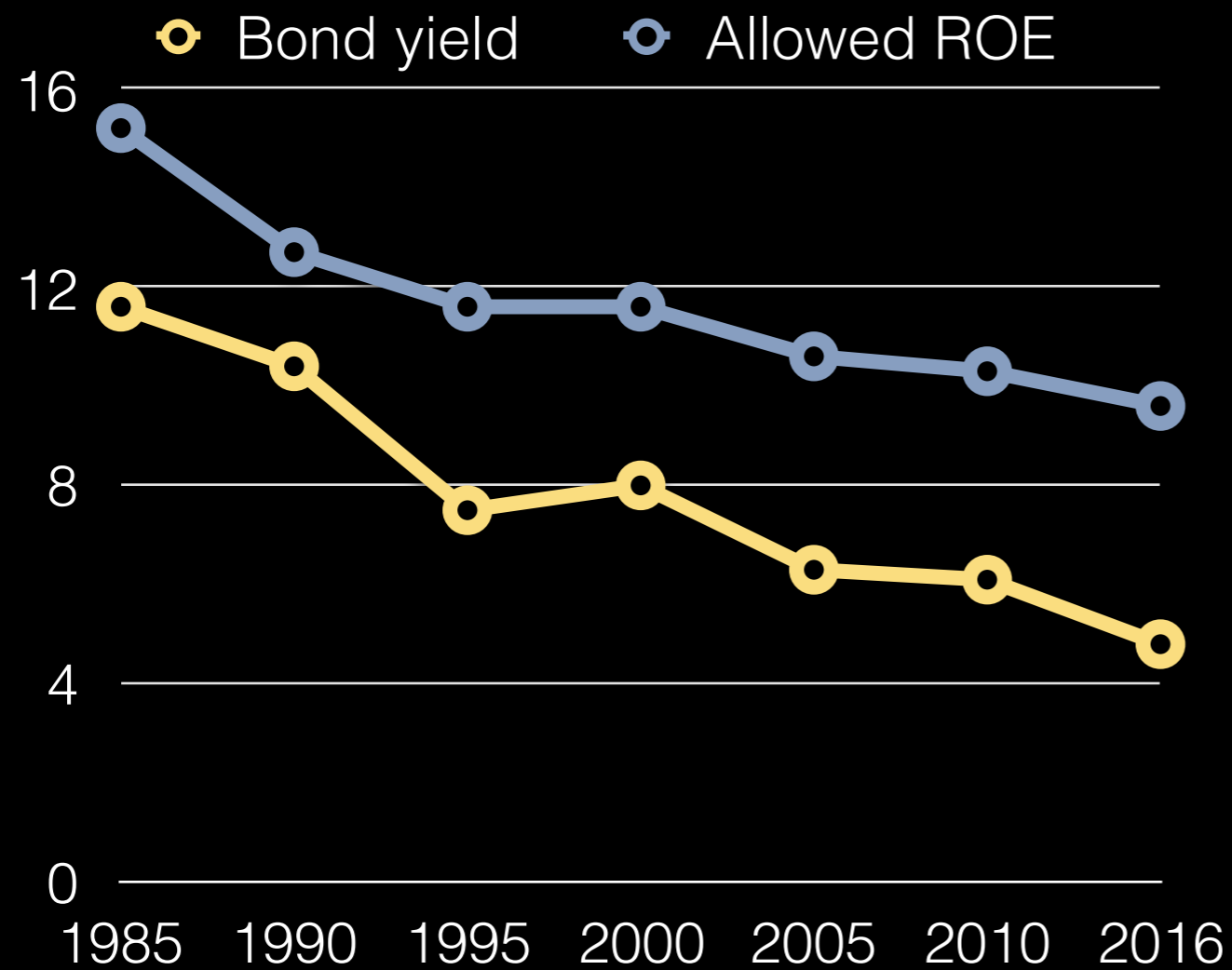
Average price of electricity sold to all and to industrial ultimate customers in deregulated states as a percentage of average price sold to all and to industrial ultimate customers in the USA (%)



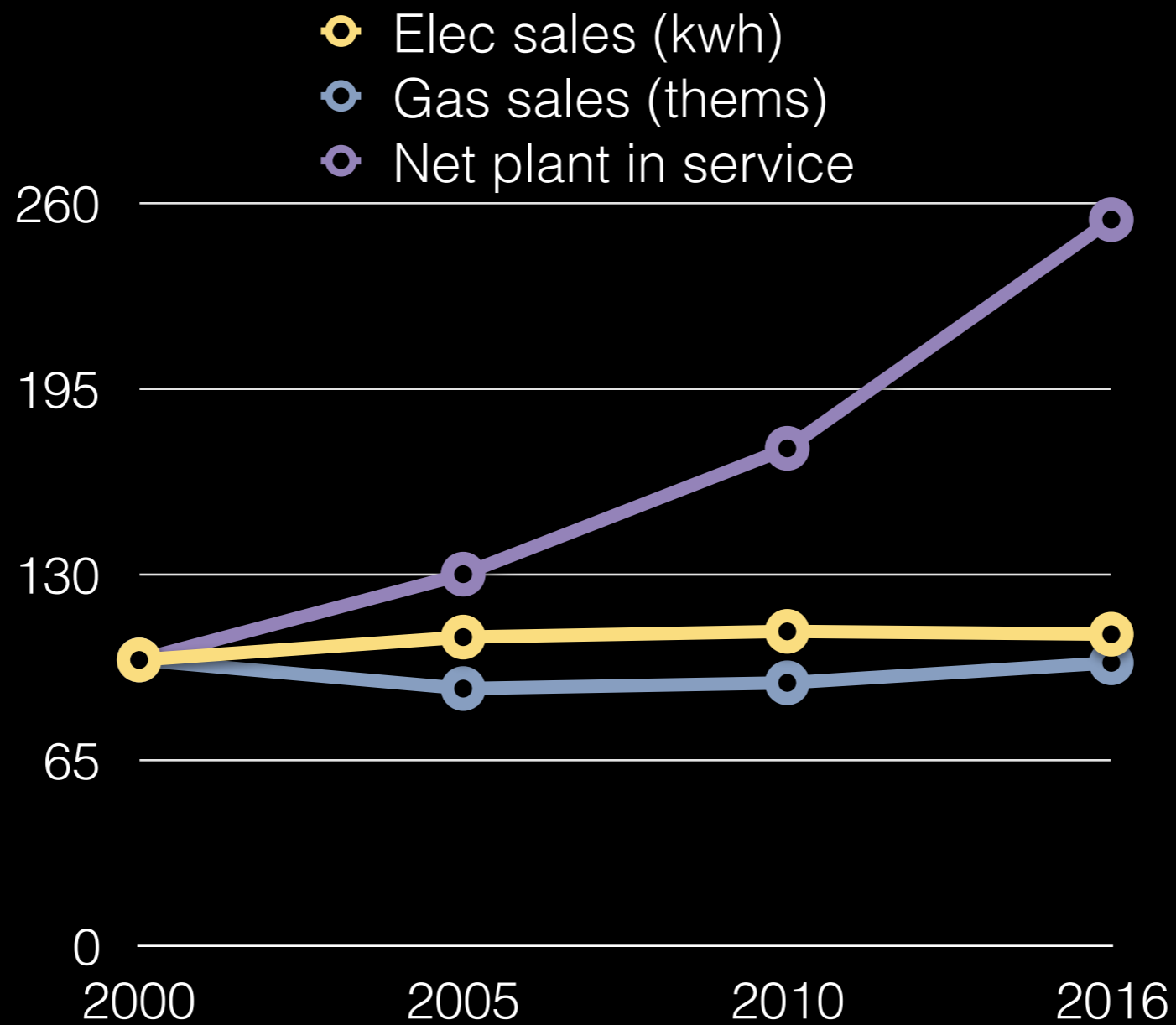
Real price of electricity by component costs (2005 €)



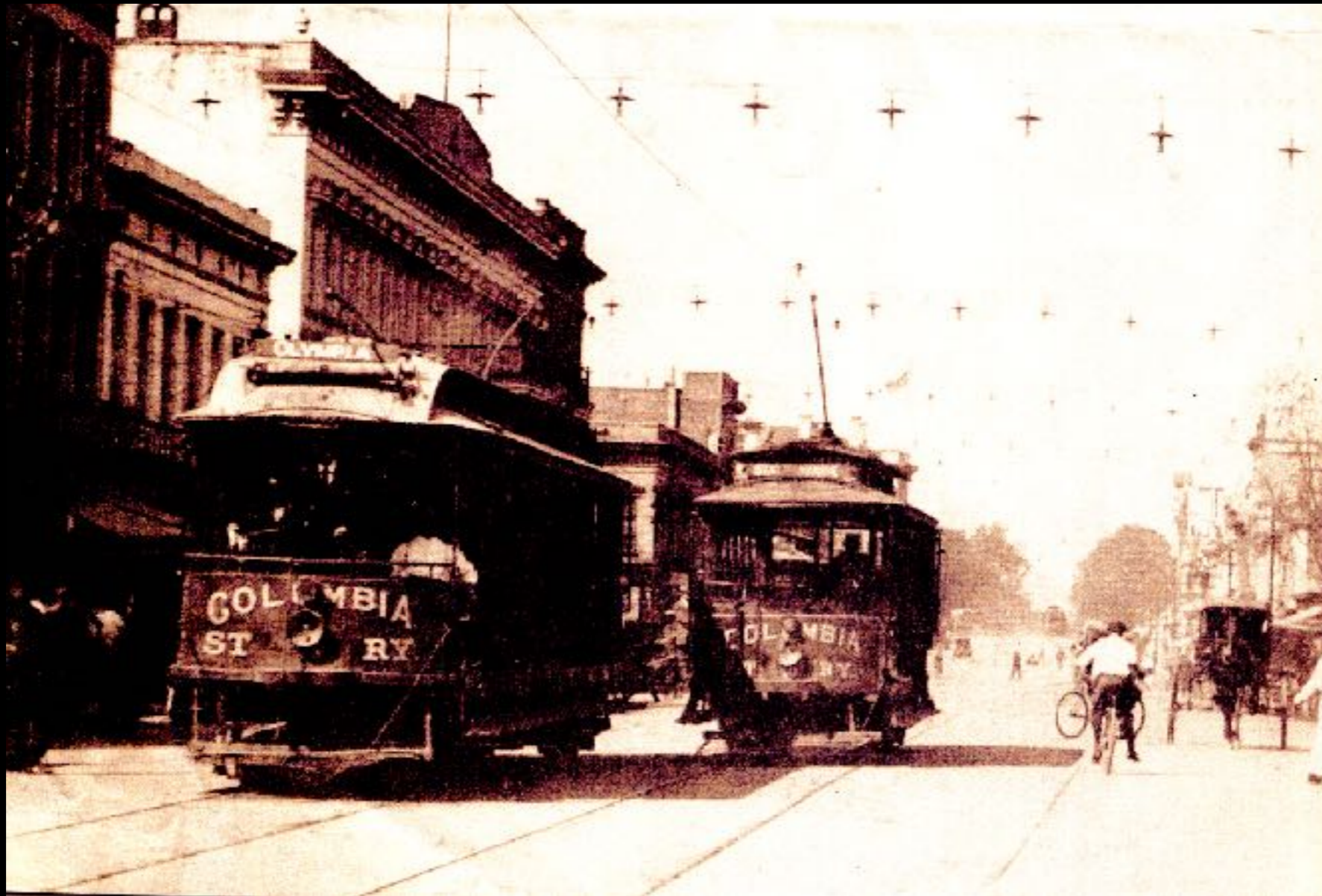
Desperate searchers for income find it



Chosen path: spend on rate base



Is this the industry business model?



INVESTMENT AND BUSINESS STRATEGY FOR A NO- GROWTH BUSINESS



For investors:

- Essentially a leasing business
- Earn more than cost of capital
- Leverage the investment
- Meets long term needs of investor
- Beats bond yields
- Current income vs future risks

For managements:

- Add to rate base
- Growth via acquisition
- Leverage to acquire (“EPS accretive”)



Are there issues?

- Do mergers/ acquisitions pay for buyer?
- Economies of scale and operating rationale for merger/ acquisition
- Holding co as purely financial vehicle
- Leverage at holding company level
- Holding co drain asset for its benefit
- What if interest rates rise?
- Foreign control of asset

DIFFICULTIES FOR REGULATOR



Utility as tradeable commodity?

- Affects relationships
- Affects motivations and incentives
- Short term or long term
- Disposable if cash needed elsewhere (parent?)



Holding company

Question: subsidiary cap vs sub cap using parent cap to determine cost of sub equity vs consolidated cap structure
(It happened all the time in Bell system days.)

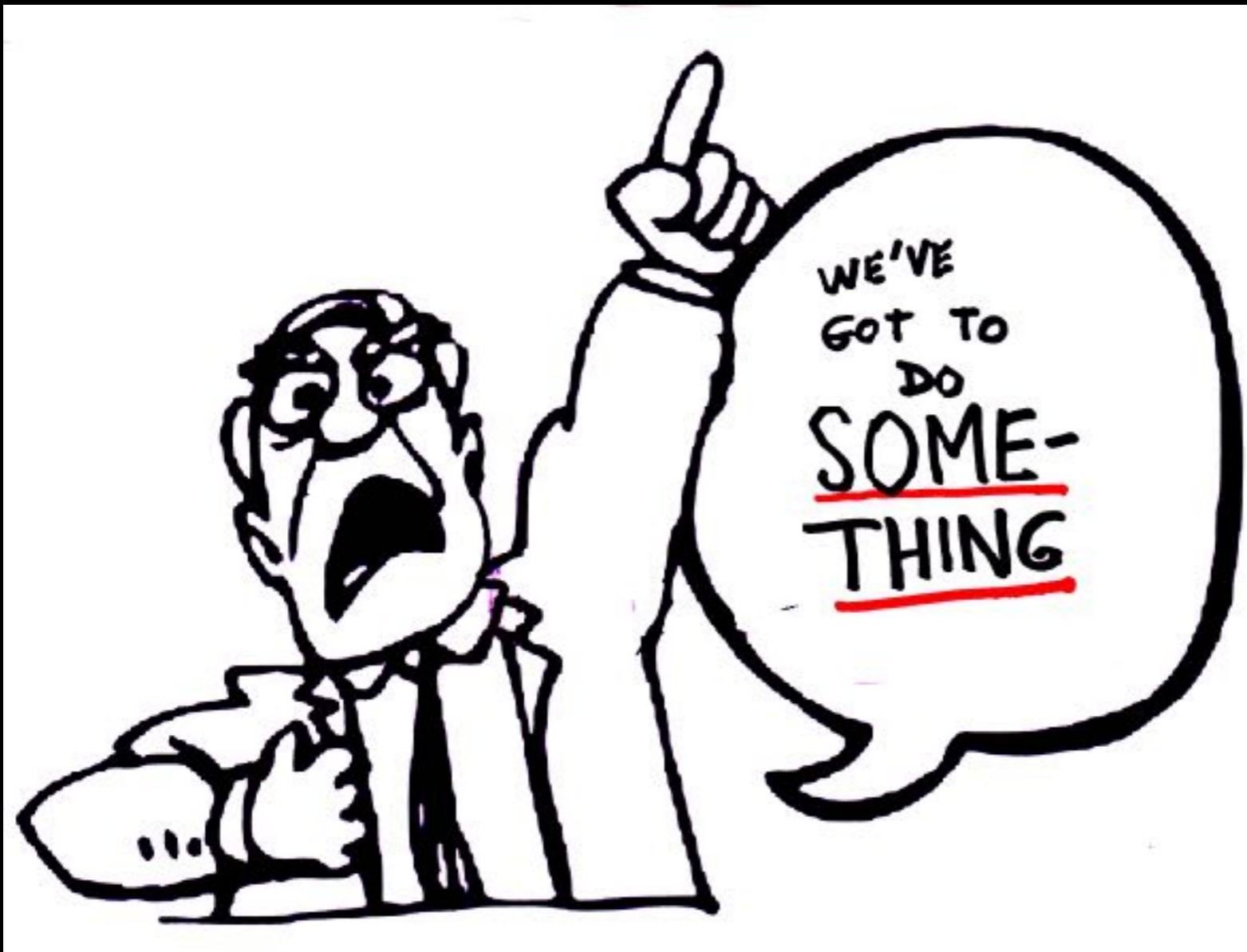
Answer: Use judgment. Plenty of precedent for that.

Question: what about size of comparable companies?
(Are you still worrying about this?)

Answer: If utility is of such suboptimal size that its cost of capital is noticeably higher, why allow utility to inflict these costs on consumers? Beyond that, can you demonstrate that cost of capital diminishes significantly with size?

Serious Issues

- How to encourage non-capital intensive and economic policies that benefit consumer and alleviate possibility of future financial difficulties
- How to maintain the viability of the grid as an option while encouraging new technologies
- Is depreciation adequate considering technological threats to dominance of grid?
- What does holding co bring to table to solve these real issues?



**LIKE
WHAT?**

Practical advice?

- To investor, if holding co wants to buy, then sell.
Don't assume they know something that you don't.
- To regulator, set credit standards, ring fence to protect cash flows and authorize forward looking depreciation because in the future cash will count more than ROR

THE END

