From:	Zahn, Aaron F. - Interim Managing Director/CEO <zahnaf@jea.com>
Sent:	Monday, June 18, 2018 5:51 PM
To:	'ray.spitzley@morganstanley.com'
Cc:	Wannemacher, Ryan F. - Interim Chief Financial Officer; Charleroy, Melissa M. - Executive Assistant
Subject:	Follow Up
Attachments:	Morgan Stanley Presentation.pdf

Ray –
It was good to see you again at LPPC. I was wondering if we could have a follow up to the attached conversation?

Specifically, I was curious if MS could produce:

- regarding Pg 19 of the attached, the exact same chart for the REIT sector from 2001 to 2018? With a break out of an additional line for Retail REITs separate and apart from all REITs index
- Additionally, on a separate page which depicted the equity performance of major REITs that issued equity significant equity in 2005-2008 timeframe (e.g. something like maybe 10% of float – you can use judgement here) vs. those that did not issue any equity

Feel free to contact me if you have questions.
Thanks.
Aaron

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LPPC
LARGE PUBLIC POWER COUNCIL

Discussion Materials

June 11, 2018

Table of Contents

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SECTION 1

M&A Environment

U.S. Market Themes

Macro Themes

- Synchronous expansion globally provides strong market breadth
- Consumer confidence at all time high; housing equity finally past previous peak
- Rising interest rate environment; Fed will continue to gradually tighten as core inflation accelerates
- Capital spending strong given rising labor costs
- Current economic recovery 3rd longest in U.S. history
- Tax reform

Industry Trends

- Pace of change in the utility sector continues to accelerate with disruptive convergence on the rise
- Tax reform facilitates continued regulated capex programs across the industry in combination with the low commodity price environment
- However, stagnant demand growth is forcing utilities to redefine and expand their business model
- Grid modernization, storage, behind the meter services, data analytics and asset optimization provide avenues for growth
- “Electrification of transportation” represents a unique opportunity for incremental load growth and the potential to rate base charging infrastructure

M&A Themes

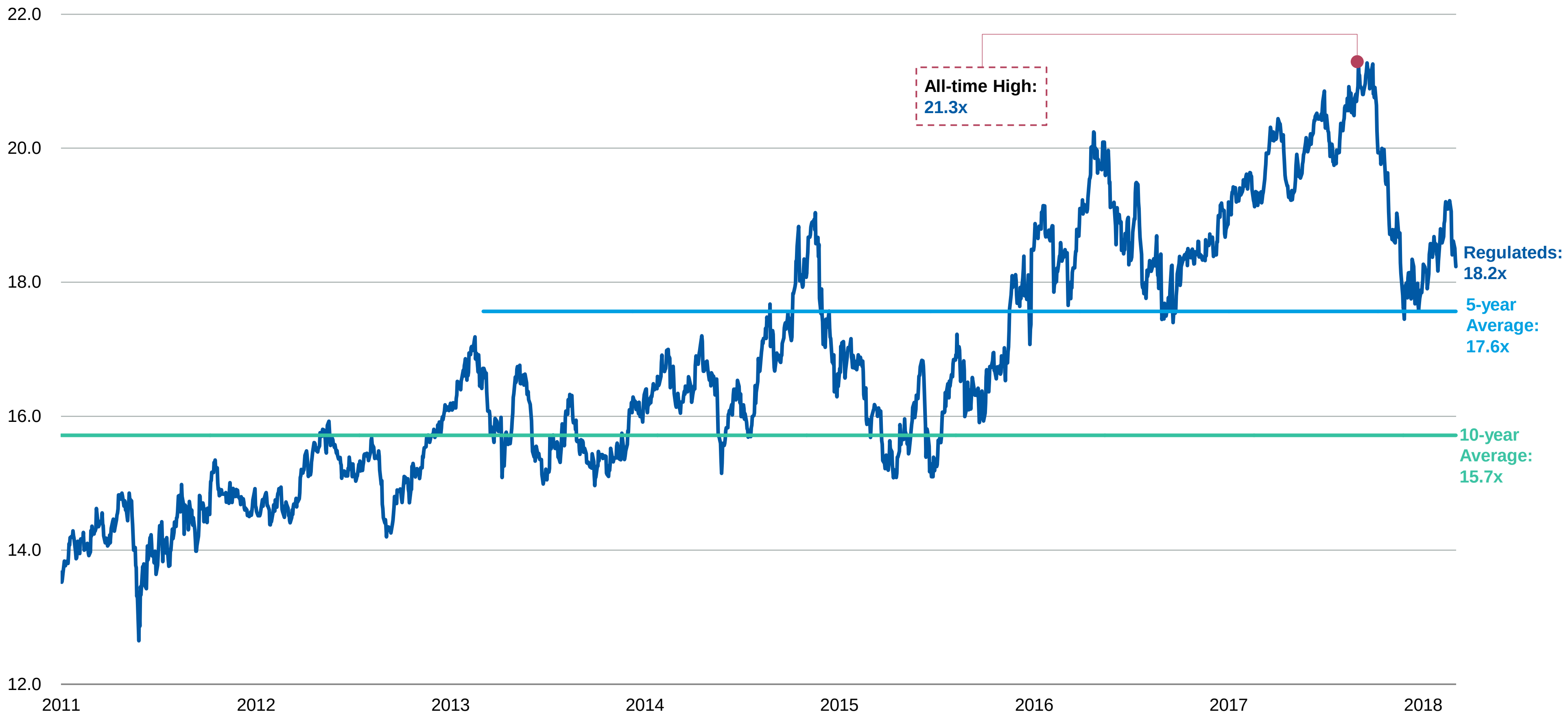
- Utility valuations off historic highs
- Tax reform has potential to create winners and losers
- “Base Erosion Anti-Abuse” tax impact on foreign investors
- “Black Swans” present opportunities
- Shift from cash to stock as merger consideration
- Modifying approach for dealing with state regulatory requirements
- Investors increasingly focused on transaction ROE/ROIC metrics
- ESG and traditional activism are here to stay

Utility Market Valuations Off of All-Time Highs…

May 16, 2011–May 16, 2018

Regulated Utility NTM P/E Multiples [1]

5/16/2011–5/16/2018 (X)



Source : Capital IQ

1. Based on I/B/E/S forward earnings estimates, as of May 16, 2018

… And Interest Rates Continuing to Rise, Creating the Potential for Continued Downward Pressure on Utility Valuations

As of May 16, 2018

Treasury Yield

10-Year UST; 1/1/2016 – 12/30/2018 (%)

… And Utility Sector Balance Sheet Repair as a Result of Tax Reform Creating Industry "Winners" and "Losers"

- Tax reform had a negative impact on cash flows for pure play regulated IOUs, making it more difficult to acquire a municipal utility in the near term

Influence of Key U.S. Tax Reform Provisions on U.S. Regulated Utilities and Holding Companies

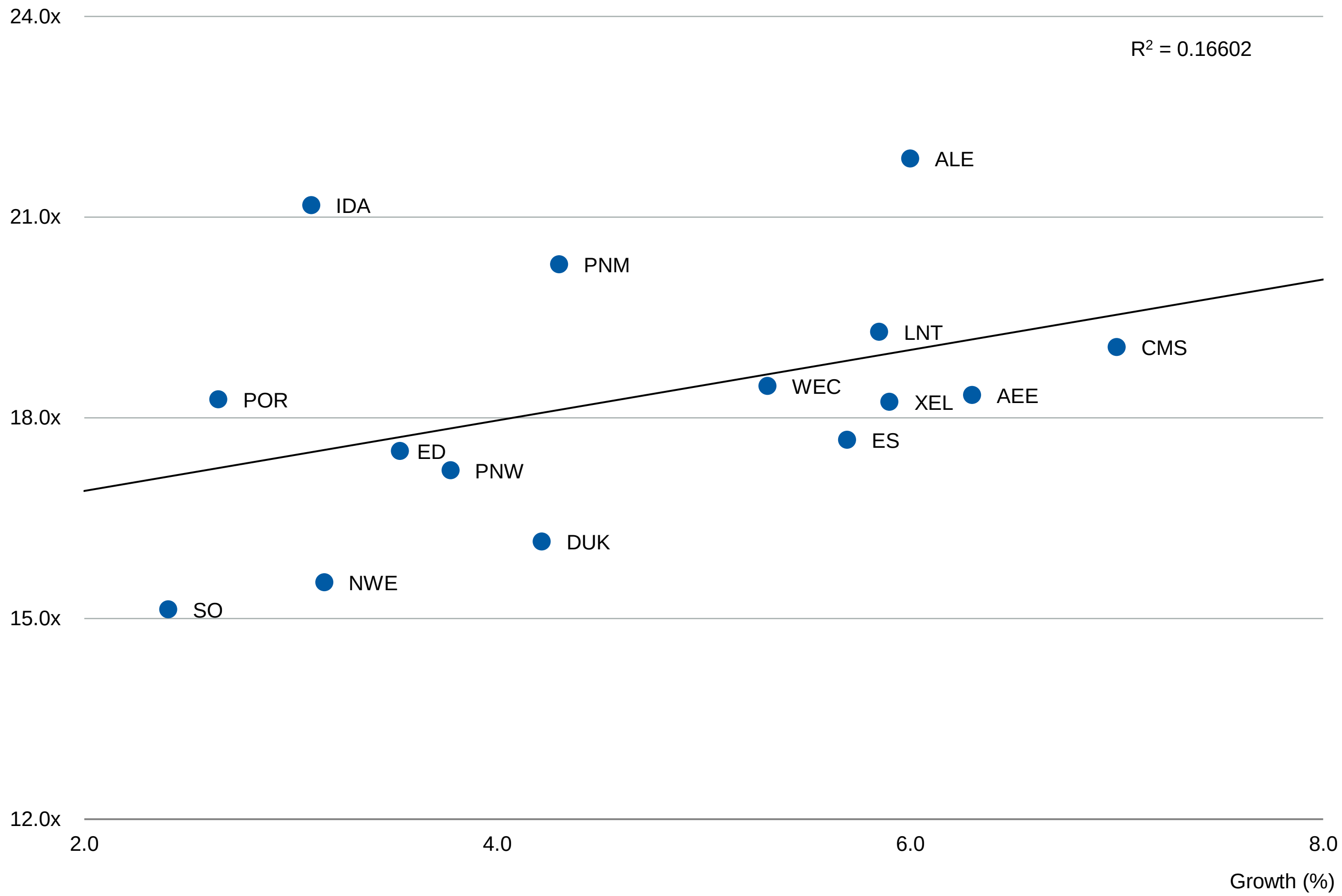
TAX PROVISION	PRIMARY RELEVANCE TO UTILITY OR HOLDING COMPANY?	EFFECT
Lower Corporate Tax Rate	Both	✓ Revenue requirement is reduced ✗ Holding companies lose the cash flow from the difference between statutory rate and effective rate ✗ Interest expense deduction negatively impacts EPS
Loss of Accelerated Deductibility of CapEx	Both	✗ Utility loses the opportunity to gain cash flow from tax-based stimulus. Holding Company depends on mix of utility and non-utility operations ✓ Positive for rate base growth
Elimination of Tax on Foreign Earnings	Holding Company	✓ Benefit limited to the few that have overseas investments
Deemed Tax on Previously Earned Profits held Overseas	Holding Company	✗ Burden (limited to eight years) to the few that have overseas investments
Limit on Interest Deduction	Both	✓ Utilities not burdened (exempted). Holding companies are not burdened if they allocate a portion of their debt to utility operations but method unclear

Investors Reward Higher Growth

- The market places a greater premium on growth, i.e. utilities that grow faster tend to outperform their peers

P/E Multiple vs. Growth Rate [1]

Investor Owned Utilities (P/E (x))



1. As of May 16, 2018

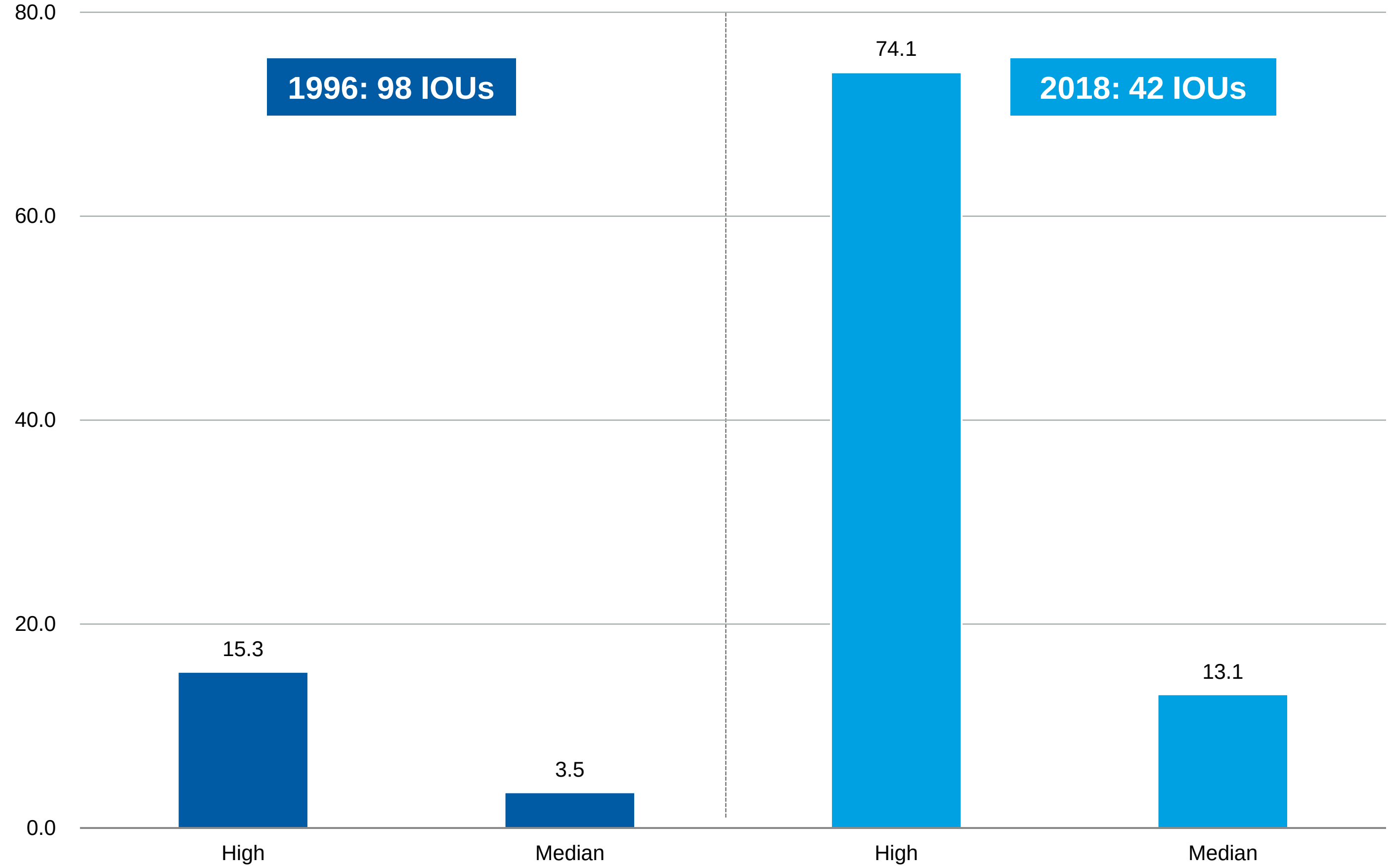
Reduced Opportunities for Utility Consolidation

As of May 16, 2018

- Consolidation driven by investors seeking returns via inorganic growth

Top 40 U.S. Utilities by Market Cap

($Bn)

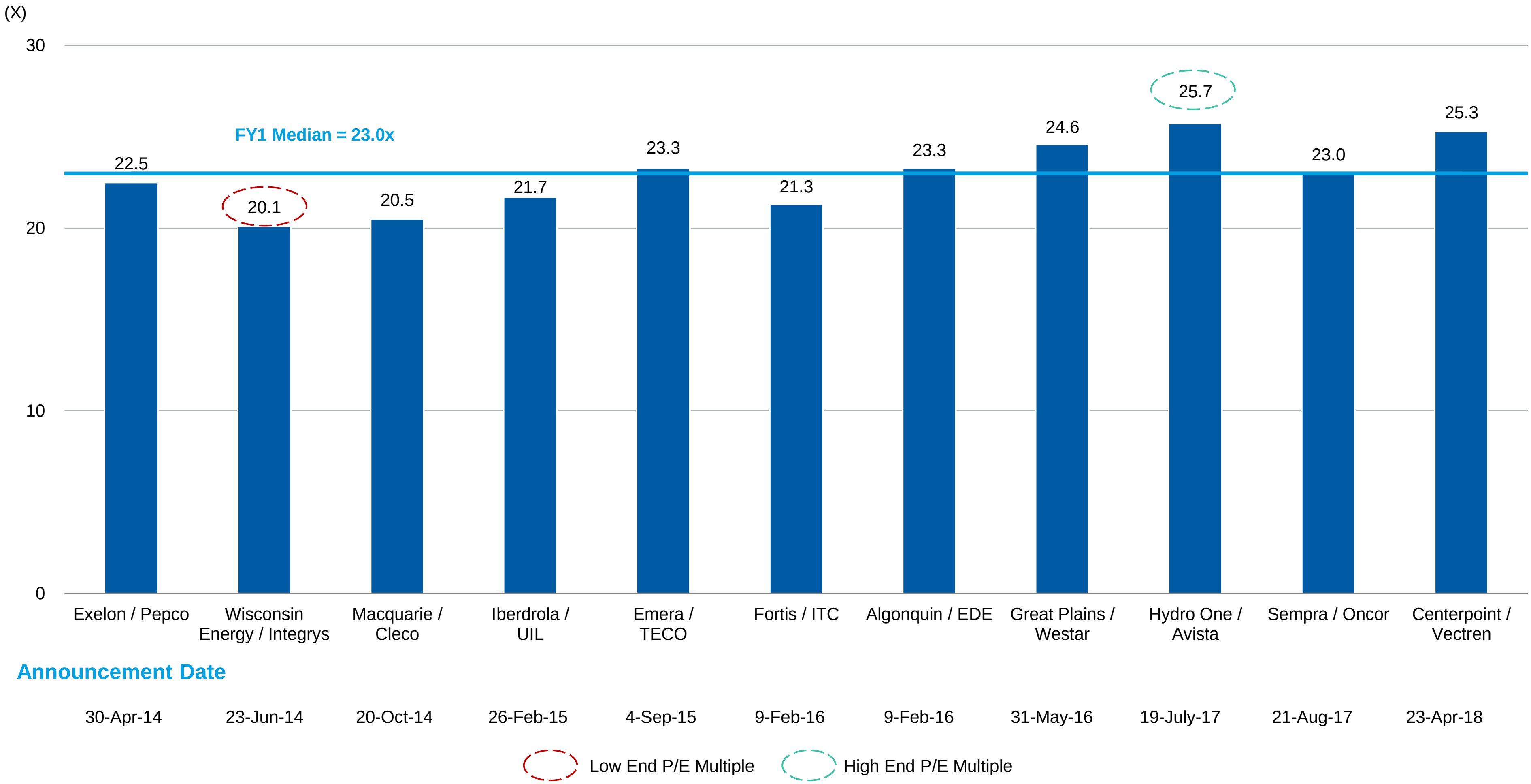


Source: Capital IQ

Selected Precedent Electric Utility Transactions

Since January 2014 [1]

Precedent Utility Transactions Price / Earnings [2]



1. Selected public target utility transactions since January 2014; excludes Dominion / SCANA transaction
2. For transactions announced on or before June 30 in a given year, FY1 represents the fiscal year in which the transaction is announced. For transactions announced after June 30 in a given year, FY1 represents the fiscal year following the year in which the transaction is announced

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SECTION 2

Investor Interest

Potential Buyers Benefits and Considerations

	Benefits	Considerations
Strategic Buyers	✓ Strategic buyers typically able to be more aggressive on price ✓ Economies of scale could further drive ability to pay high valuation while not impacting customer rates ✓ Large utilities with prior M&A experience could execute a transaction quickly	– Accretion / dilution impact will be key driver of purchase price offered – Municipal utility management team may not be retained in full – Headcount reduction may be considered but could be contractually avoided
Financial Buyers	✓ Financial buyers have raised significant capital in the past several years to deploy in the infrastructure space ✓ Strong appetite for stable cash flows provided by regulated utility ✓ Likely to maintain significant portion of workforce given lack of operating expertise	– Financial parties have limited experience operating utilities in the U.S. – In last 10 years, Macquarie and its investment partners have been only financial parties to fully own and operate electric utilities in the U.S. – Limited investment time horizon

Infrastructure Fund Investments in the Utility Space

Financial Buyers Have Shown Appetite for Large Utility Investments

Region	Acquirer	Target	Size	Date	Description
North America	John Hancock, bcIMC, Macquarie	Cleco	$4.7Bn	2014	Sale of 100% stake in Cleco Corporation to Macquarie led consortium including BcIMC and John Hancock
North America	bcIMC, Macquarie	Aquarion	$860MM	2007	Sale of 100% of Aquarion to Macquarie led consortium
North America	AIMCo, bcIMC, CPP Investment Board, Macquarie	PSE Puget Sound Energy	$7.4Bn	2007	Sale of 100% stake in Puget Sound Energy to Macquarie led consortium including Canadian pension funds
Europe	Allianz, VER, Macquarie	Elenia	€3.6Bn	2017	Sale of 100% of Elenia Group to Macquarie Infrastructure, Allianz Capital Partners and State Pension Fund of Finland
Europe	Allianz, CPP Investment Board	gasNatural fenosa	€13.9Bn	2017	Sale of 20% of Gas Natual Fenosa's Spanish gas distribution business to Alianz and CPPIB
Europe	Covalis, J.P.Morgan Asset Management, Swiss Life Asset Managers, Abu Dhabi Investment Council	edp naturgas energia	€2.6Bn	2017	Sale of 100% of Naturgas Energia Distribución to a consortium of long-term infrastructure investors
Europe	Caisse de dépôt et placement du Québec, suez	GE Power & Water Water & Process Technologies	€3.2Bn	2017	Sale of 100% of GE Water & Process Technologies to SUEZ Group and Caisse de Dépôt et Placement du Québec
Europe	Groupe Caisse des Dépôts, CNP Assurances	Rte Le réseau de l'intelligence électrique	$4.35Bn	2016	Sale of 49% stake in Le Réseau de L'Intelligence Électrique to Caisse des Dépôts et Consignation and CNP Assurances
Europe	Allianz Capital Partners, Hermes, China Investment Corporation, Amber Infrastructure, Macquarie, Qatar Investment Authority, Dalmore Capital	nationalgrid	€2.9Bn	2016	Sale of 61% of National Grid's National Grid Gas Distribution business via tender offer to a consortium of financial buyers
Europe	Global Infrastructure Partners	gasNatural fenosa	$4.3Bn	2016	Sale of 20% in Gas Natural SDG SA to Global Infrastructure Partners
Europe	Gingko Tree Investment Ltd, PGGM, EDF	Madrileña Red de Gas	€2.2Bn	2015	Sale of 100% of Madrileña Red de Gas to EDF Invest, Gingko Tree and PGGM

Gas Distribution | Electricity Distribution | Water Infrastructure | Electricity Transmission | Integrated Utility

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SECTION 3

Regulatory Framework Comparison

Ratemaking Methodologies

Investor Owned Utility v. Municipal Utility

Key Differences

- Municipal owned utility primary basis for rates is **Cash Flow Based** vs. Investor Owned Utilities which are **Cost of Service Based**

	Investor Owned Utility	Municipal Utility
Primary Basis for Rates	• **Cost of Service Based** • Rates set to provide the utility with the opportunity to earn its authorized ROE	• **Cash Flow Based** • Rates set to provide adequate cash flow to meet debt service coverage requirements
Debt	• The cost of debt represents interest payments to creditors, and is typically reflected in rates at the utility's embedded cost of debt • Debt is typically provided at a lower cost than equity, but a utility cannot fund its entire operations and capital improvement programs solely with debt	• Debt service included in rates includes interest and principal repayment • Municipalities typically fund capital improvements with a mix of debt, cash from operations, and cash reserve accounts • Rates also typically include incremental cash cushion to meet certain debt service coverage requirements from creditors
Equity	• The cost of equity represents the return required by equity shareholders in order to provide their capital to the utility • Equity shareholders' claims on the company are subordinate to those of debt providers, and equity participants hold residual risk in the company	• Municipal utilities are not required to pay a return to equity holders

Illustrative Investor Owned Utility Revenue Requirement

Assumptions:

- O&M and fuel & purchased power costs equivalent for IOU and municipal utility, growing annually at 2% inflation factor
- $100MM capex annually growing by $1MM each year
- 25 remaining useful life on existing assets
- 40 year useful life on new build
- 60% / 40% debt / equity funded
- 3.5% pre-tax cost of debt
- 9.0% return on equity
- 21% federal tax rate

Illustrative Investor Owned Utility Revenue Requirement

($MM)

	2018	2019	2020	2021	2022
Beginning Rate Base	1,000	1,060	1,118	1,175	1,231
(+) Capex	100	101	102	103	104
(-) D&A	(40)	(43)	(45)	(48)	(50)
Ending Rate Base	**1,060**	**1,118**	**1,175**	**1,231**	**1,285**
Implied Equity	412	436	459	481	503
Implied Debt	648	683	717	750	782
Allowed ROE	9.0%	9.0%	9.0%	9.0%	9.0%
Implied Net Income	**37**	**39**	**41**	**43**	**45**
Taxes	10	10	11	12	12
EBT	**47**	**50**	**52**	**55**	**57**
Interest	22	23	24	25	26
EBIT	**69**	**73**	**76**	**80**	**84**
Depreciation & Amortization	40	43	45	48	50
EBITDA	**109**	**115**	**121**	**128**	**134**
O&M Expenses	50	51	52	53	54
Net Revenue	**159**	**166**	**173**	**181**	**188**
Fuel Costs	150	153	156	159	162
Total Revenue Requirement	**309**	**319**	**330**	**340**	**350**

Illustrative Municipal Utility Revenue Requirement

Assumptions:

- O&M and fuel & purchased power costs equivalent for IOU and municipal utility, growing annually at 2% inflation factor
- $100MM capex annually growing by $1MM each year
- 25 remaining useful life on existing assets
- 40 year useful life on new build
- 4.0% interest rate
- 20-year amortizing bonds
- 2.0x debt service coverage ratio
- Debt financing as % of total capex sized to maintain minimum cash requirement
- No transfer payments to municipality

Illustrative Municipal Utility Revenue Requirement

($MM)

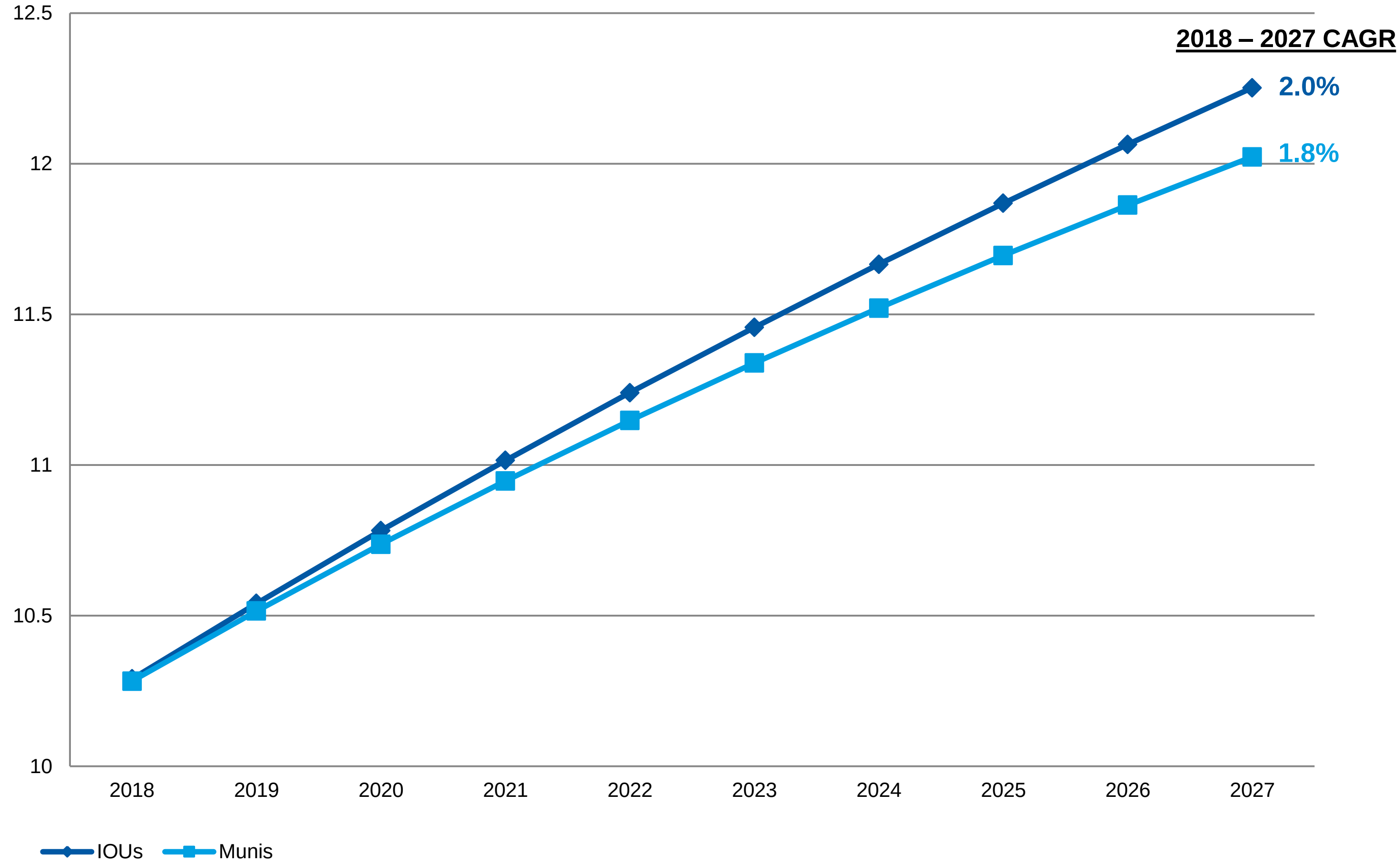
	2018	2019	2020	2021	2022
O&M Expenses	50	51	52	53	54
Fuel & Purchased Power Cost	150	153	156	159	162
Total Operating Costs	**200**	**204**	**208**	**212**	**216**
Interest	27	28	28	28	28
Principal	27	30	32	35	37
Debt Service Coverage	54	57	60	63	66
Total Revenue Requirement	**309**	**319**	**329**	**338**	**348**
Fuel & Purchased Power Cost	150	153	156	159	162
O&M Expenses	50	51	52	53	54
D&A	40	43	45	48	50
Interest Expense	27	28	28	28	28
Taxes	0	0	0	0	0
Net Income	**41**	**45**	**47**	**50**	**53**
(+) Depreciation & Amortization	40	43	45	48	50
Cash from Operations	**81**	**87**	**93**	**98**	**103**
Capex	(100)	(101)	(102)	(103)	(104)
Cash from Investing	**(100)**	**(101)**	**(102)**	**(103)**	**(104)**
(+) New Debt Issued	46	44	42	40	38
(-) Debt Repaid	(27)	(30)	(32)	(35)	(37)
Cash from Financing	**19**	**14**	**10**	**5**	**1**
Increase (Decrease) in Cash	**0**	**0**	**0**	**0**	**0**

Customer Rate Comparison

- Municipal customer rates will typically grow at a lower rate than customer rates for an IOU

Customer Rate Projections

(US cents / kWh)

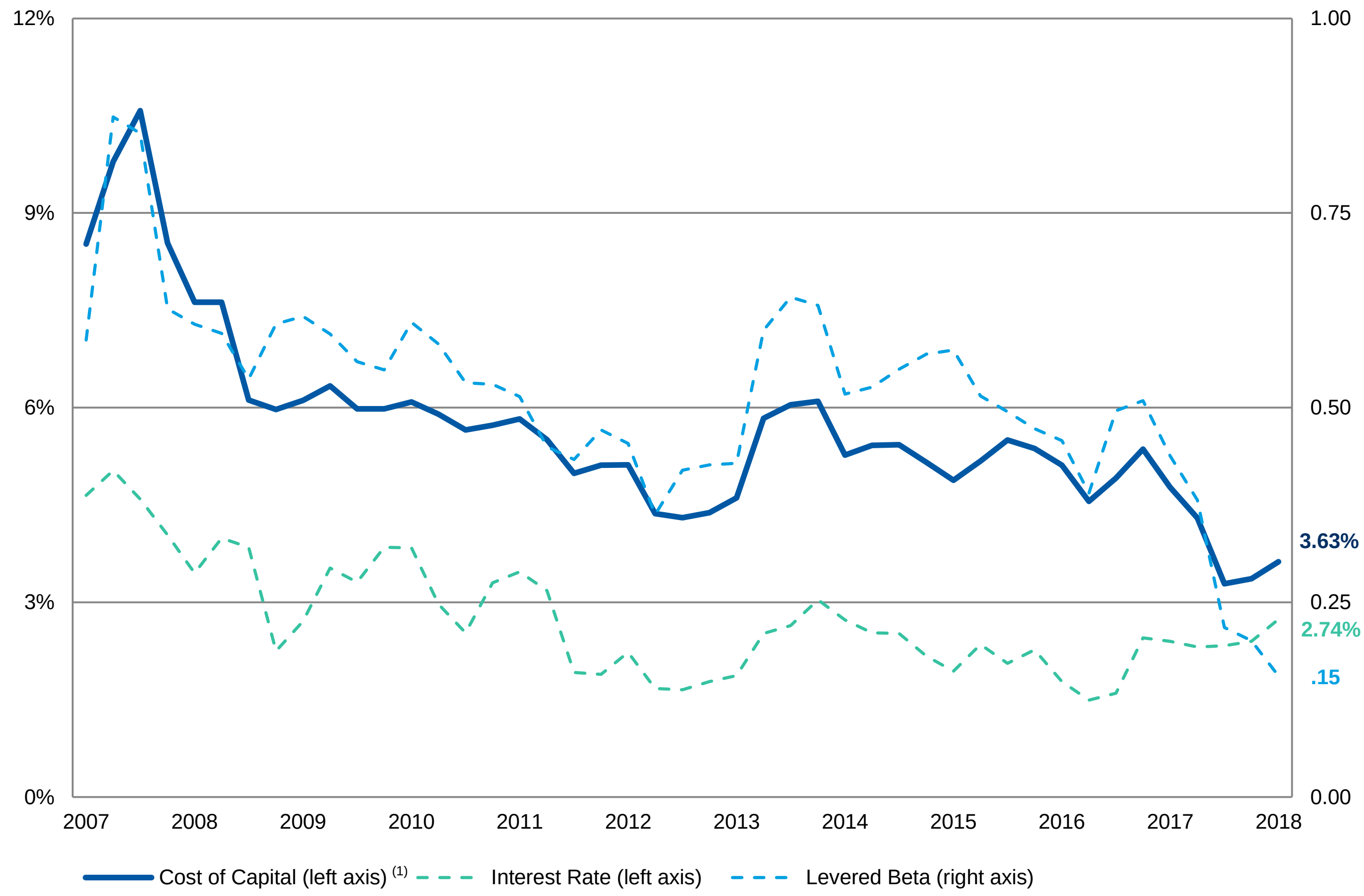


Cost of Capital Over Time

- The weighted average cost of cost of capital for IOUs has been decreasing over the past 10 years

Cost of Capital Over Time

(%)



1. Reflects average weighted average cost of capital for NEE, DUK, D, SO

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SECTION 4

Will Privatization Become a Trend?

Summary of Privatization Considerations

Key Objectives					
Economic and Financial	**Workforce and Employment**	**Social and Public Policy**	**Risk-Related**	**Safety and Operational**	**Governance / Oversight and Other**
• Maximize proceeds • Minimize costs and customer rates • Annual revenues to City (franchise fees, taxes) • “Upside potential” to City (including margin enhancement) • Funding pension and other obligations	• Job preservation • Continuity of benefits/wages • Retention of workforce • Job creation • Training and development of sustainable workforce	• Continuation of existing discount programs • Continuation of existing hardship fund and energy efficiency programs • Offering additional programs (e.g., targeting economic development) • City’s economic development	• Transfer operating risks • Retention of institutional knowledge (potential retirements) • Manage liability exposure (e.g., pensions and environmental)	• Preserve safety standards • Infrastructure improvements (as means of reducing costs, attracting business to the city, creating jobs	• Maintaining breadth of governance/oversight, including City Council involvement • Maintaining presence in the city (e.g., headquarters) • If sale, city representation in acquirer’s business (e.g., Board) • Comparative benefits of alternative ownership structures other than a sale

What Will Drive Private Interest in Public Power?

- Buyers are more likely to lean in when:
  - The underlying fundamentals of the utility are strong
  - The utilities finances can be cleanly separated from the municipality
  - There is strong political will to pursue a privatization process

Attractive Target

- Strong growth profile
- Ability to cleanly disentangle from municipal finances
- Attractive regulatory environment

Motivated Seller

- Large future funding requirements at utility
- Municipal budget constraints
- Political support

Aggressive Buyer

- Significant private capital available with limited opportunities to deploy
- Low cost of capital drives ability to pay high valuation
- Certainty to close and ability to effectively manage and quantify risks

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