

PUBLIC UTILITIES
FORTNIGHTLY

40

**THE BEST
ENERGY
COMPANIES**

BY RICHARD STAVROS

Top honors in our first annual financial ranking go to those staying with the basics and to those dealing with soaring commodity prices.

Which is the best energy company?

What might have been a seemingly simple question to answer in the energy industry of 20 years ago is today fraught with difficulty. With the divestitures, spin-offs and convergence mergers of the late 1990s and early 2000s that were spurred by deregulation, no longer do we have cookie-cutter, vertically integrated utilities in all parts of the country (if we ever did).

Rather, some of what we do have today includes E&P (exploration and production) firms that own electric or gas utilities, pipelines that own power plants, and electric utilities that have entered the E&P business.

With the August signing of the Energy Policy Act of 2005, which includes repeal of the Public Utility Holding Company Act, many industry watchers say further consolidation is all but assured.

In fact, many predict the energy industry not only will consolidate, but will converge as well with outsiders such as investment banks, insurance companies, private equity firms, oil majors, and retailers. And it is this continued consolidation trend in the industry that demands a new *lingua franca* grounded in finance to discuss and identify industry performance and value.

One method, known as operational benchmarking analysis, while still effective at making comparisons of individual assets, has become increasingly difficult to use in comparing companies with ever-changing asset mixes. Thus, our readers have asked for a type of analysis that more truly communicates value to future investors, future owners, energy asset operators, regulators, and consumers.

With that aim, in this issue, *Public Utilities Fortnightly* introduces a new standard for excellence in the energy industry. Presenting the *Fortnightly 40* financial energy rankings of electric and gas utilities, pipelines and distribution companies: a benchmark that highlights the industry's leading companies—its brightest stars proven in performance and exceptional corporate management. (*Cont. on p. 32*)

Company	Public Utilities Fortnightly Ranking	3 Year Average Profit Margin 2002-2004	Rank 3 Year Average Profit Margin 2002-2004	3 Year Average Dividend Yield 2002-2004	Rank 3 Year Average Dividend Yield 2002-2004
Kinder Morgan Inc.	1	36.47%	1	1.88%	75
Progress Energy	2	27.34%	2	5.06%	20
Questar	3	12.29%	8	2.16%	74
Energen	4	12.33%	7	1.87%	76
Allete	5	12.53%	6	5.43%	13
Exelon	6	9.40%	17	3.03%	67
DPL Inc.	7	12.65%	5	4.80%	30
Equitable Resources Inc.	8	18.04%	3	2.47%	73
Southern Co.	9	12.82%	4	4.52%	40
PPL Corp.	10	9.66%	16	3.58%	54
EnergySouth	11	11.30%	11	3.32%	61
Edison International	12	8.37%	20	1.20%	77
PG&E	13	12.12%	9	0.00%	78
National Fuel Gas Company	14	8.34%	21	5.09%	19
Kinder Morgan Energy Partners	15	11.79%	10	3.86%	52
Sempra Energy	16	9.17%	18	3.43%	58
Great Plains Energy	17	7.03%	29	5.98%	10
MDU Resources	18	7.43%	27	2.61%	72
AGL Resources Inc.	19	11.07%	12	3.92%	51
South Jersey Industries	20	8.65%	19	3.21%	64
Central Vermont	21	6.97%	31	4.17%	46
Florida Public Utilities	22	6.36%	38	3.56%	55
FPL Group Inc.	23	7.82%	25	3.67%	53
Ameren Corp.	24	10.54%	13	5.59%	12
Entergy Corp.	25	6.61%	34	2.97%	68
NStar	26	6.21%	40	4.62%	34
MGE Energy	27	8.00%	24	4.35%	42
Otter Tail Corp.	28	5.67%	45	4.14%	49
ONEOK Inc.	30	5.29%	49	3.15%	66
Piedmont Natural Gas	30	6.60%	35	3.40%	59
Constellation Energy	31	6.09%	42	2.90%	69
Northwest Natural Gas	32	9.95%	15	4.21%	44
UGI	33	3.21%	70	4.60%	36
Cinergy Corp.	34	7.40%	28	4.87%	26
Vectren	35	6.96%	32	4.48%	41
Northern Border Partners	36	10.29%	14	4.93%	25
DTE Energy Company	37	7.62%	26	4.15%	47
MidAmerican Energy	38	5.74%	44	0.00%	78
Green Mountain Power	39	4.31%	60	2.82%	70
KeySpan	40	6.24%	39	4.80%	29
Average		6.64%		4.16%	

Free Cash Flow as a % of Revenue Average	Free Cash Flow as a % of Revenue 2002-2004	3 Year Average ROE 2002-2004	Rank 3 Year Average ROE 2002-2004	3 Year Average ROA 2002-2004	Rank 3 Year Average ROA 2002-2004	3 Year Average Sustainable Growth 2002-2004	Rank 3 Year Average Sustainable Growth 2002-2004
35.49%	2	15.13%	12	3.99%	17	9.68%	9
3.07%	45	33.19%	1	10.22%	1	25.94%	1
8.29%	13	14.45%	17	5.54%	5	9.36%	10
7.26%	18	14.49%	16	5.41%	7	10.75%	7
11.58%	8	14.63%	15	6.43%	4	5.85%	25
11.97%	6	16.34%	7	3.45%	22	8.55%	12
11.66%	7	15.93%	10	3.55%	21	3.63%	37
-4.05%	75	23.13%	2	6.95%	3	15.85%	3
5.21%	31	15.11%	13	4.09%	14	4.58%	28
8.34%	12	16.11%	9	3.18%	30	6.93%	16
4.47%	35	13.26%	20	4.84%	9	6.60%	18
7.23%	20	18.22%	5	2.77%	47	16.78%	2
1.73%	53	12.65%	24	3.93%	18	12.65%	5
6.15%	23	13.57%	19	4.25%	11	6.04%	24
5.25%	30	19.67%	3	7.60%	2	0.77%	66
1.08%	58	18.67%	4	3.22%	29	13.14%	4
9.73%	10	14.81%	14	4.11%	13	3.47%	38
3.48%	41	11.97%	27	5.24%	8	8.60%	11
2.97%	49	13.03%	22	2.89%	39	6.26%	20
0.08%	65	11.93%	28	5.43%	6	4.97%	27
7.23%	19	9.92%	47	3.89%	19	6.13%	22
-4.07%	76	16.32%	8	3.99%	16	10.30%	8
6.22%	22	10.65%	39	2.82%	46	4.46%	30
5.02%	33	10.37%	42	3.29%	27	1.22%	64
6.85%	21	9.85%	49	2.91%	38	5.47%	26
5.41%	27	12.95%	23	2.69%	50	4.39%	31
-6.08%	77	11.50%	30	4.30%	10	2.49%	47
1.61%	56	12.01%	26	4.22%	12	3.93%	33
7.90%	16	11.46%	31	2.54%	54	6.39%	19
2.02%	51	11.16%	33	3.87%	20	2.86%	44
3.79%	38	10.57%	40	2.86%	41	6.69%	17
1.63%	55	8.99%	54	2.93%	37	2.58%	46
5.03%	32	18.18%	6	3.03%	32	8.43%	13
3.06%	46	11.13%	35	2.87%	40	2.46%	48
-0.36%	66	11.11%	36	3.32%	24	3.22%	40
36.24%	1	6.19%	68	2.09%	60	-18.46%	80
0.78%	59	10.49%	41	2.57%	52	3.71%	36
1.34%	57	11.35%	32	2.40%	58	11.35%	6
2.42%	50	11.14%	34	3.30%	25	7.31%	15
-1.01%	70	11.66%	29	2.98%	34	3.83%	34
3.91%		10.21%		2.91%		3.08%	

On Top of the Energy World

What did it take to make it to this year's list? We looked at hundreds of performance measures and settled on a handful of highly touted metrics. We then shared our model with some of the greatest energy finance minds, tweaked it, and this is the result.

Being on the 40 means the company is among the highest in profit margin, dividend yield, free-cash flows as a percentage of revenue, return on equity, and return on assets. (See *Sidebar, A New Performance Standard*, p. 33.)

But *Fortnightly* didn't stop there. The winners also are companies that are g-r-o-w-i-n-g. Most utility executives told the *Fortnightly* that it shouldn't be enough to pay a large dividend and then go home. There must be a viable business with evidence of future growth, they said. The story of Sempra Energy illustrates the type of company that made it to our rankings. Neal E. Schmale, executive vice president, chief financial officer and a member of the board of directors of Sempra Energy (No. 16), recalls the days before his company became a super conglomerate.

"When Sempra was first formed back in 1998 we were paying out effectively almost 100 percent of our earnings as dividends. One of the things we did in 2000 is we simultaneously repurchased stock and lowered the dividend – that in turn preserved some of the cash that was being generated internally for reinvestment, which in turn allowed us to make the type of investments that have succeeded," he says.

Like Sempra, many of the companies that made the 40 are companies that effectively tapped in to new revenue and new businesses following the restructuring of the industry.

"If you look at the \$895 million in earnings we had last year, almost exactly half of that was from [utilities] San Diego Gas & Electric and SoCal Gas combined. The other half was from businesses that were developed since the merger in 1998," says Schmale. The Sempra CFO explains that its successful investments in energy trading and the generation business now make up more than half of earnings. But such success hasn't stopped the company from looking ahead. Sempra, he says, also is investing heavily in liquefied natural gas terminals, which he believes has a lucrative future.

"... The trading business is closer to a \$200 million per-year business. LNG certainly has the capability to be in the \$150 million per-year range. It could be many, many years from now [Sempra's LNG terminals do not come on line until 2008]. But it has the potential to be in the same league as the generation business and maybe the commodity business," he says. Certainly, Schmale has good reason to believe in the future prospects of imported natural gas. Those companies that had natural gas to sell or move this year, danced all the way to the

bank, and dotted the top ranks of this year's *Fortnightly* 40.

A Gas Man Prospers

Keith O. Rattie, chairman, president and CEO of Questar (No. 3), is having a good year. In Questar's second quarter 2005, the company reported net income was up 43 percent compared to a year ago. "The key drivers were higher production and realized prices for natural gas, oil and natural gas liquids and increased volumes and improved margins in gas gathering and processing," said an earnings release.

Rattie believes that his company's current success comes from the transformation the company has gone through over the last 10 years.

"We anticipated that the fundamentals for natural gas were strong and it was likely that it was going to be better to be a producer of energy than a pure consumer," he explains in an exclusive interview. Questar, he says, is viewed today largely as an E&P company. But that was not always the case. "Investors thought of Questar as a utility that also had a fledgling E&P business. Today, many investors see us as an E&P company that also owns an interstate pipeline and a regulated utility," Rattie notes.

Moreover, the CEO says that soaring natural gas prices are not going to his head. He points out that at the end of the day the winners are going to be those companies that consistently generate the best returns on reinvested capital: "Companies that run their businesses mindful that natural gas is a commodity business," he warns.

"To be successful in the commodity business you have to understand that high prices don't last forever. I think some companies are sowing the seeds of their own demise by betting that energy prices are going to remain high," predicts Rattie.

He notes that in the 150 years of history in the gas industry there never has been a period of time that prices have moved as far and as fast without crashing. "High prices cause new supply, discourage demand and ultimately cause prices to retreat. It happened every time in the past and I think it will happen in the future," he says, dryly.

He believes Questar's more conservative risk management, and a portfolio including pipeline and utility businesses makes the company more stable than others. "We are offering investors ... better potential for return and growth and long-term price appreciation than pure utilities. But less commodity price risk and exposure to falling commodity prices than pure E&P companies."

Geoffrey S. Chatas, executive vice president and chief financial officer of Progress Energy (No. 2), also attributes some of his company's high earnings in the last few years to natural gas operations. "We have very niche operations in natural gas.

A NEW PERFORMANCE STANDARD

Developing the *Fortnightly 40*.

Various equity research analysts and Wall Street bankers often have pointed out that more than three quarters of a typical utility's valuation can be attributed to interest rates, dividend policy, and the company's regulatory environment. Furthermore, Mother Nature on occasion has been known to exert an even greater influence on quarterly or even annual corporate results. That is why an effective industry benchmark must filter out what is out of management's control. After having confronted many costly hurricanes in Florida, Geoffrey S. Chatas, executive vice president and chief financial officer of Progress Energy (No. 2), shares the same view as many other executives. He believes there has long been a need for a performance standard that filters out the short-term volatility of the market and other factors, and takes into account more precisely management's contribution to the business over time.

"We argue that you need to take a longer term view in looking at consistency in performance over time than this sort of one quarter thing, which the markets tends to do," Chatas says. Neal E. Schmale, executive vice president, chief financial officer and a member of the board of directors for Sempra Energy, echoes a similar sentiment.

"You just can't run a large industrial company the way you run a portfolio of stocks," he says. Schmale explains that making quality investments takes years of laying foundations, understanding the business environment, building, and then expanding on an identified niche. "It takes years to develop the people and the institutional knowledge," he adds.

That explains why the *Fortnightly 40* chose to rank companies on performance over a three-year period. That allowed us to a large degree to factor out the various short-term price fluctuations in stocks, commodities, weather and even impacts of regulatory decisions.

But a result of using a longer-term horizon means that some companies seen as likely to head up the list actually fell short. Most notably, American Electric Power and Duke Energy did not make the list, owing to losses in unregulated businesses incurred over the last several years.

"Some companies that didn't place in the *Fortnightly 40* this year were impacted by their past telecom, merchant power plant, energy trading and international losses that are captured in the three year time frame [2002-04] of the model," explains Jean Reaves Rollins, managing partner, at the C Three Group LLC.

"That's why in the next few years many companies that were able to repair their balance sheets from that time period will most likely rank higher," adds Reaves Rollins, whose company exclusively provided the financial data for the *Fortnightly 40*.

Furthermore, while some companies who were considered didn't make it to the *40*, others were disqualified as a result of having reported net losses for at least two of the three years falling within the time frame covered by the analysis. Familiar names like Dynegy, Allegheny Energy, CMS, and TECO Energy, for example, are excluded. Without question, these companies suffered the most from the meltdown of merchant and energy trading seen during the early 2000s, and still are looking to recover completely from those dark days.

Meanwhile, today's *Fortnightly 40* is a ranking that reflects those companies that stuck to their knitting over the last three years, says Daniel Anglin, managing partner of the McLean, Va.-based private equity firm, Prince Henry Group LLC. Furthermore, Anglin, who aided in the development of the *Fortnightly 40*, says that the DuPont hybrid model that underpins the ranking is the most straightforward model to evaluate corporate performance (See sidebar, *The Fortnightly 40: Model Characteristics*, p. 36).

At Heart: A DuPont Hybrid Model

The core of the benchmark used to develop the *Fortnightly 40* is called a hybrid DuPont Model. It is based on the 80-year old DuPont model that has been growing in favor with the energy finance set, as it can include a series of growth measures that they say makes the model more effective in the 21st century. Developed originally in 1919 by a finance executive at E.I. du Pont de Nemours and Co., of Wilmington, Delaware, the DuPont system of financial analysis is used by many companies to evaluate and visualize the critical building that contributes to return on equity and hence shareholder value.

The DuPont model uses certain inputs such as sales, cost of sales, fixed assets and current assets. At successive stages they are added, subtracted, divided or multiplied until return on equity is reached. The model forms an easy to use and understandable framework with which to investigate the root cause of insufficient value creation. Furthermore, the model can be instructive on ways to increase return on investment: increase sales—either by increasing the price or by selling more units, or decrease cost of sales, fixed assets and current assets. That is why within asset- (Cont. on p. 34)

These are all efficient operations with proven reserves. We have about 225 billion cubic feet of proven reserves." But unlike Questar, he says, the biggest contributor to the bottom line is Progress Energy's electric utility operations, in North Carolina, South Carolina and Florida, which have some of the highest growth rates in the country. The other contributor

to the company's earnings is the synthetic-fuel business. Chatas also says his company's ability to avoid many of the "melt down scenarios" that others did not, has contributed to the company's overall financial health.

Certainly, it is the conservative approach to operating assets that distinguishes many of the winners, even when their earn-

intensive businesses, such as utilities, the model has particular significance.

But after decades of use, many in the finance industry gravitated to more complex modeling techniques with growth measures. For example, the most well known of these is the famed EVA framework (economic value added) offered by Stern Stewart & Co. EVA has won popularity in corporate circles by correlating favorable results with decisions that produce returns that exceed cost of capital—a formula for creating shareholder value. Furthermore, proponents of EVA say the DuPont model is flawed in that there is inherent guesswork in generally accepted accounting principles that creates room for shortsighted decisions.

But many academics disagree that the DuPont model significantly is more vulnerable to manipulation than newer methods. They add that valuations by rival methodologies based on EVA also can involve subjective guessing because cash flows must be estimated in the future. Furthermore, many of the other bell-and-whistle methods involve a significant number of calculations and create opportunities for manipulation, say proponents of DuPont modeling. On the other hand, critics of the old DuPont model also say that the model fails to predict future earnings or track costs.

This explains why the reemergence of the DuPont model comes from financial executives who have found new value in adding growth measures to return on investment calculations. Of course, there never will be a performance benchmark that pleases everyone all the time. And many finance executives say that the decision to use the DuPont method or a

version of EVA mostly can be attributed to personal preference or corporate culture. Furthermore, many energy finance executives say they use such models in tandem to achieve the most comprehensive results. [On page 38 of this issue, Accenture performs its own shareholder value analysis (SVA) of the energy industry. We believe that both results offer valuable insights into the corporate management of the utility industry.]

Sustainable Growth Predictions: Art more than Science?

The DuPont sustainable growth rate used in our calculations has its criticisms. We acknowledge limitations in ROE analysis; it is susceptible, for example, to variability in dividend payout, interest expenses, and business cycles. Also, any measure of sustainable growth can be affected by consolidated (rather than segment) reporting, accounting issues, interest expense, structural change, and industry competitiveness. But other growth models have been found also to lack consensus among those in the industry, and have their own sets of problems in application. Moreover, many of our finance experts find many of the issues with the DuPont sustainable growth rate are rendered moot in combination with the larger model characteristics of the *Fortnightly 40*.

C. Park Shaper, president of Kinder Morgan, Inc, offers his opinion on the sustainable growth quotient in the *Fortnightly 40* model.

“The truth is as long as you do everybody the same on those metrics I don’t think it matters. I think the way that you’ve selected it is the easiest way to do it—the same for everybody. On your growth

measure, I think it would be interesting. Sustainable growth implies what is going to happen in the future. This gets a little bit more subjective. [But] there’s not really an objective way to estimate that,” he says.

Shaper notes that the DuPont sustainable growth-rate calculation assumes a company must reinvest in order to grow. “I think that’s true for a lot of entities.”

Naturally, he says, it always is going to be awkward to put all companies in the same position. “You have to make some assumptions and simplify some things. I think what you have started off with is great and I’m sure you’ll continue to make it better. My guess is you’ll find some things that you say, hey, this is imprecise in our model but there is just nothing that you can do about it,” he explains.

At the *Fortnightly*, we welcome suggestions or discussion to help us place our model in an even more proper context. We invite industry-wide feedback on how to improve the model further.—**RS**

Credits

Special thanks go to Daniel Anglin, managing partner of the private equity investment firm, The Prince Henry Group LLC, who was vital to the development of the financial and mathematical underpinnings of the *Fortnightly 40* model. Also special thanks to Jean Reaves Rollins, managing partner, the C Three Group LLC, the company that is the *Fortnightly 40*’s exclusive financial data provider. Finally, we are grateful to the many Wall Street experts and utility chief financial officers that anonymously offered their expertise and insights over the last six months on building the *Fortnightly 40*—the new standard of excellence in the energy industry.

ings are anything but. Just listen to what we heard from this year’s *Fortnightly 40* winner.

Enter the Transporter

Kinder Morgan, No. 1 in this year’s ranking, bills itself on its Website as, “A Different Kind of Energy Company.” Certainly, the company’s financial performance distinguishes itself from its peers. It hasn’t been just different, but effective at produc-

ing a high return on investment.

C. Park Shaper, president of Kinder Morgan, Inc., attributes the company’s success not only to the company’s assets, which include pipelines, terminals, gas distribution and gas-fired power plants, to name a few, but also to the structure of the company itself. Kinder Morgan is one of the first companies to make effective use of a corporate structure known as the master limited partnership (MLP).

“Back in 1997, [founders Rich Kinder and Bill Morgan] made a conscious decision to try something different. They wanted to use a master limited partnership as a growth vehicle,” Shaper says, explaining that at the time it was an unusual choice.

According to a report written in early July by Gary M. Vasey, vice-president, trading and risk management, UtiliPoint International, MLPs were created by Congress in the 1980s primarily to stimulate oil and gas exploration.

He writes that the MLP corporate structure is designed to allow energy companies to spin off their production and transportation assets in separately managed companies. By creating an MLP, the energy company benefits by raising cash to pay down debt or invest in other businesses, he writes, and the assets packaged in an MLP generally are considered to be a slow-growth or even declining-value asset, but with a steady cash flow, such as producing properties, pipelines or gathering systems.

“Since the MLP pays out all of its earnings to MLP unit holders, the corporation therefore pays no taxes on those future earnings. Essentially, the MLP structure allows companies to sell their assets to investors at a market price in return for a promise to pay out the cash flow, after maintenance expenses, while maintaining a degree of control over the assets,” writes Vasey. He also notes the advantage of an MLP is that it only pays taxes once at the unit-holder level. By contrast, most corporations are taxed twice, once at the corporate level, and once at the shareholder level.

But in the beginning, Kinder Morgan’s Shaper says the very reason people thought an MLP structure wouldn’t work was because, “the MLP actually pays out all of its cash flows to its partners every quarter... So, the question is where does the cash come from for new investment?”

Shaper says that essentially [Kinder Morgan] believed that it would be able to raise capital for new investment projects from the capital markets if the assets were attractive, and demonstrated that it could be done.

Moreover, in addition to having a “low-cost” corporate structure, Shaper says his company’s high-quality assets are

the reason for Kinder Morgan’s performance.

“The growth comes largely from just normal internal growth. It comes from increased utilization of our assets, which is largely driven by incremental demand for the products we handle. Demand for refined products (gasoline, diesel fuel, and jet fuel) across the nation generally grows at about 2 percent. We tend to serve higher growth areas on the West Coast—California, Arizona and Nevada. We tend to get three-percent volume growth out of those assets,” he says.

In addition, Shaper says growth at the company comes from tariff increases from the pipeline business. “We’ll get four percent growth in revenue every year,” he says of the pipeline business. Vasey point out in his report that an MLP usually contains assets generally that are of diminishing value, so an MLP usually maintains growth by acquiring more assets.

“We [do] also look to expand our assets. Whether that is build a new pipeline, expand a storage facility, add tanks, add a terminal facility, generally with contracts from customers that support that investment. So, that is the other component of that growth,” says Shaper.

In fact, in early August, Kinder Morgan dominated the headlines after announcing plans to buy Canada’s Terasen Inc.

TABLE 1				
SELECTED GENERATION METRICS				
TOTAL GENERATION CAPACITY				
Holding Company Name	Year	Net Capacity (MW)	Net Generation (GWh)	Total Production (\$/MWh)
American Electric Power Co. Inc.	2004	35,361	199,360	20.85
Southern Co.	2004	34,301	177,881	23.62
Entergy Corp.	2004	21,821	80,608	32.91
Progress Energy Inc.	2004	21,039	91,724	28.35
FPL Group	2004	18,625	89,673	40.75
TOTAL GENERATION				
Holding Company Name	Year	Net Generation (GWh)	Net Capacity (MW)	Total Production (\$/MWh)
American Electric Power Co. Inc.	2004	199,360	35,361	20.85
Southern Co.	2004	177,881	34,301	23.62
Progress Energy Inc.	2004	91,724	21,039	28.35
FPL Group	2004	89,673	18,625	40.75
Duke Energy Corp.	2004	89,366	18,158	18.14
PRODUCTION COSTS				
Holding Company Name	Year	Production Costs (\$/MWh)	Total Electric Generation (GWh)	Total Capacity (MW)
AES Corp (The)	2004	17.25	16,725	3,232
Great Plains Energy Inc.	2004	17.85	20,605	4,060
Duke Energy Corp.	2004	19.44	89,241	18,158
Westar Energy Inc.	2004	22.32	27,342	5,843
Scottish Power plc	2004	23.79	50,938	8,233

Source: Energy Velocity

in a \$5.6 billion deal that would expand the company's natural gas and petroleum-pipeline operations in North America.

The transaction is the second-biggest U.S. buy of a Canadian firm behind Duke Energy's \$8.2 billion acquisition of Westcoast Energy in September 2001, according to Thomson Financial. Will this acquisition keep Kinder Morgan on the top of the 40 next year? Certainly, the MLP structure will be very competitive with other types of corporate structures. In 2004, total returns for pipeline MLPs were 23 percent, while the Standard & Poor's 500 was up 11 percent, according to SmartMoney.com.

Of course, the result of financial performance of this type is that many utility CEOs may be thinking of changing their corporate structure.

Unfortunately, most utilities thinking of becoming an MLP simply can't. Shaper points out that *retail* sales of electricity or gas do not qualify for MLP treatment. (According to experts, the Internal Revenue Service has very specific guidelines over

what type of assets will qualify.) Shaper, meanwhile, seems set on the concept.

"In terms of total return to shareholders," Shaper explains, "MLPs offer a very attractive proposition," But will that be enough to keep his company atop the 40 in 2006?

Many industry watchers say that with the completion of mergers such as that of Duke Energy-Cinergy, Exelon-PSEG and MidAmerican-PacifiCorp, plus other expected consolidations, it may be difficult for Kinder Morgan to hold on to the crown. Furthermore, many companies that have fixed their balance sheets and gone back-to-basics after the merchant overbuild of the early 2000s have been gaining momentum on the financial tables. As for Shaper, we know whom he's betting on. Watch these pages to find out who makes next year's *Fortnightly* 40. ■

Richard Stavros is executive editor of Public Utilities Fortnightly. Contact him at stavros@pur.com.

THE FORTNIGHTLY 40—MODEL CHARACTERISTICS

Time Frame: 3-year average.

Stock Price Analysis: 3-year average.

Universe: 100 largest investor owned power and gas utilities and natural gas pipeline companies.

Components:

1. **Profitability** = Margin = Net Income/Total Revenues.
2. **Dividend Yield** = Annual Declared Dividends/Year-End Stock Price.
3. **Free Cash Flow** = (Operating Cash Flow – Capital Expenditures)/Total Revenues.
4. **DuPont ROE 5 Ratio Model:**
 - a. Earnings after taxes (EAT) = Net Income;
 - b. Earnings before taxes (EBT) = Net Income + Income Taxes;
 - c. Earning before interest and taxes = Net Income + Income Taxes + Interest;
 - d. Revenues = Total Revenues;
 - e. Assets = Total Assets; and
 - f. Equity = Total Common

Shareholders Equity.

5. DuPont ROE =

$(EAT/EBT) * (EBT/EBIT) * (EBIT/Revenues) * (Revenues/Assets) * (Assets/Equity)$.

6. DuPont ROA =

$(EAT/Revenue) * (Revenue/Assets)$.

7. Sustainable Growth = DuPont ROE * (1 - Dividend Payout Ratios).

8. Fortnightly Index

Each company was forced ranked on the above measures from 1 through 100, with 1 being the highest ranking. Each measure was weighted equally. The six measures were then averaged with the highest average given a ranking of 1 and the lowest, 100.

9. Companies excluded:

- a. Companies that had a negative shareholder equity value during any of the three years in the analysis were excluded (mathematically the DuPont model can not contemplate a negative shareholder value). These include AES, Mirant, and Northwestern.

b. Companies that reported net losses for at least two of the three years in the time-frame of the analysis: These include:

- Allegheny Energy
- Aquila
- CenterPoint Energy
- CMS
- Dynegy
- El Paso Corp.
- Energy West
- Reliant Resources
- Semco Energy
- Sierra Pacific
- TECO Energy.

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