Growth From Subtraction

Impact of EPA Rules on Power Markets

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Prefer Cleaner Generators in Dirtier Markets

We see EPA rule making to limit conventional coal plant polluters as a potentially transformative event for the power sector and related industries. We assume:

- 60 GW of uncontrolled coal generation is closed
- Closures occur ratably from 2013-17, extending EPA mandated timelines
- $100 BN + of capex for remediation through retrofitting coal plants and building replacement generation
- The power market recovery is accelerated by 4 -5 years
- Coal demand could fall 157 – 324 MM tons
- Natural Gas demand could grow 1.8 – 3.7 TCF on a 22 TCF market
- Regulated utilities annual growth rates could rise by 1- 4%

We favor FE-AYE and RRI to take advantage of EPA action

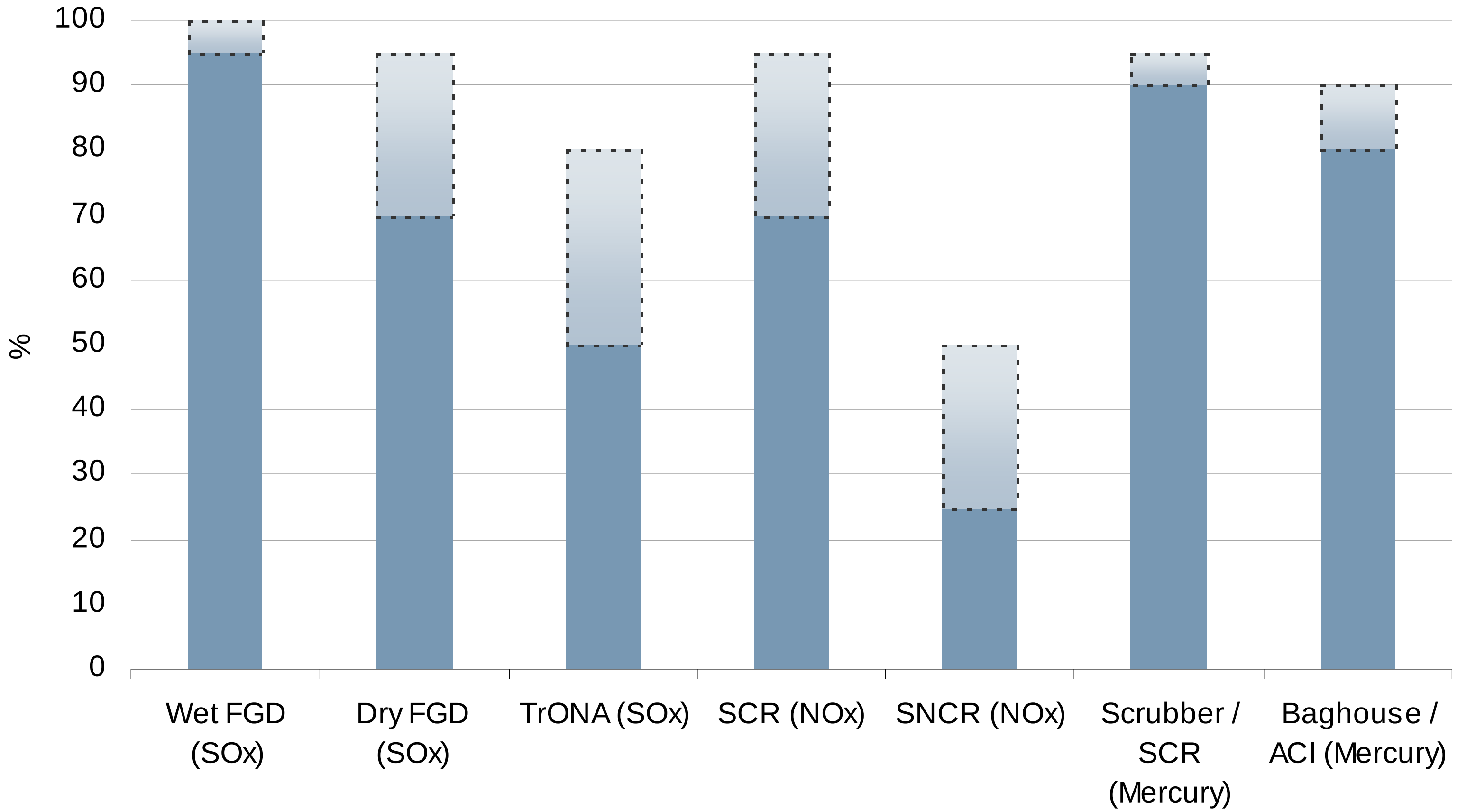
Source: Credit Suisse estimates, Factset

EPA Calendar

RPM Auction Year	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018	2018/2019	2019/2020
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
CATR		Apr 2011 Final Rule					
	7/10/2010 CATR proposed	Compliance Period				2 Year Extension Period	
Mercury MACT		3/16/2011 Draft Rule 11/16/2011 Final Rule	Compliance Period			2 Year Extension Period	

- We assume a 2 year "grace" period for compliance with new EPA rules, largely to support system reliability and logistical timing challenges of retrofit and newbuild programs

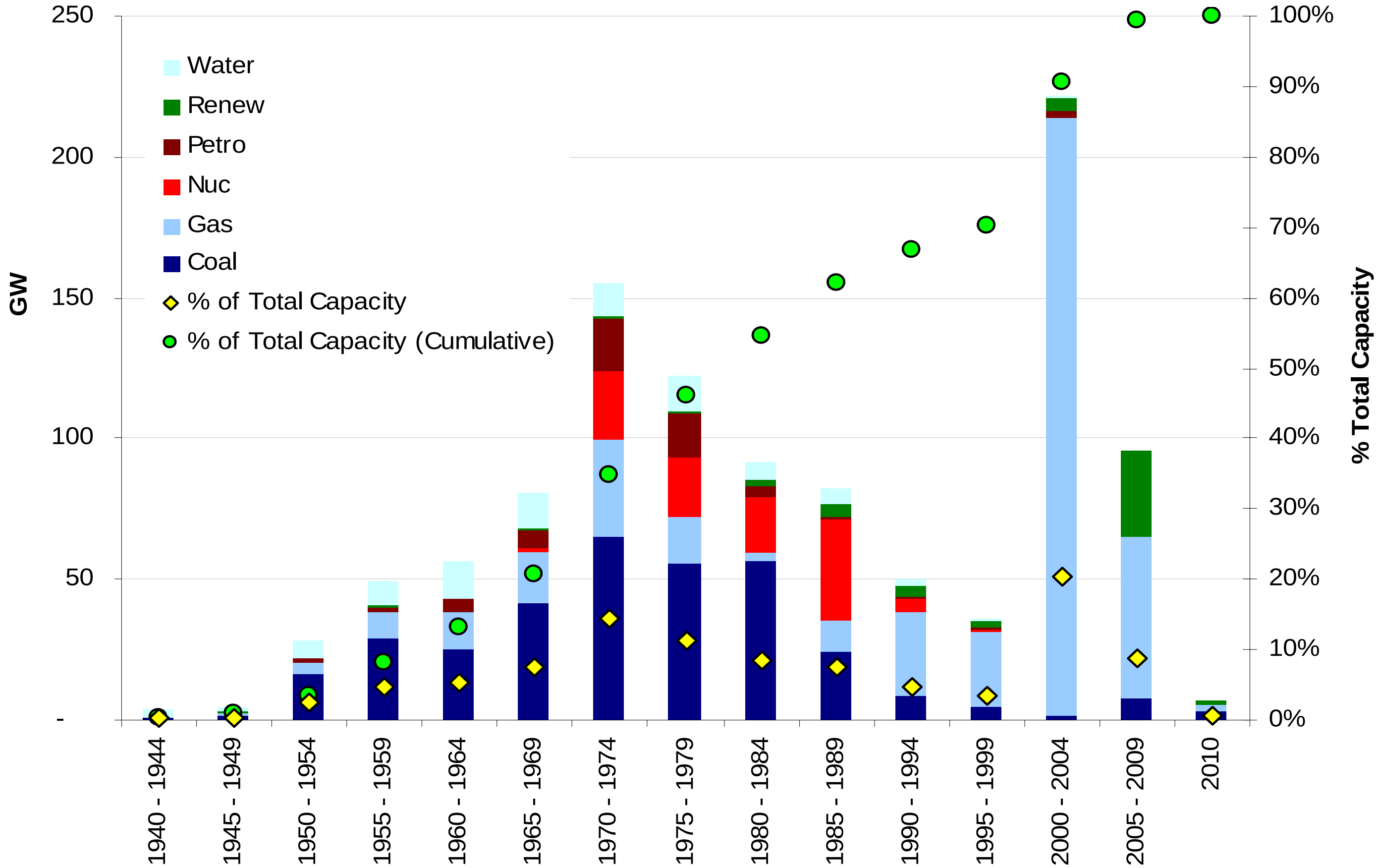
Emissions Compliance Options



- FGD (aka scrubbers) cost $300-500 / KW, SCR costs $200-300 / KW, SNCR costs $30-75 / kW, Baghouse Costs $150 / KW

Source: Credit Suisse estimates, Factset

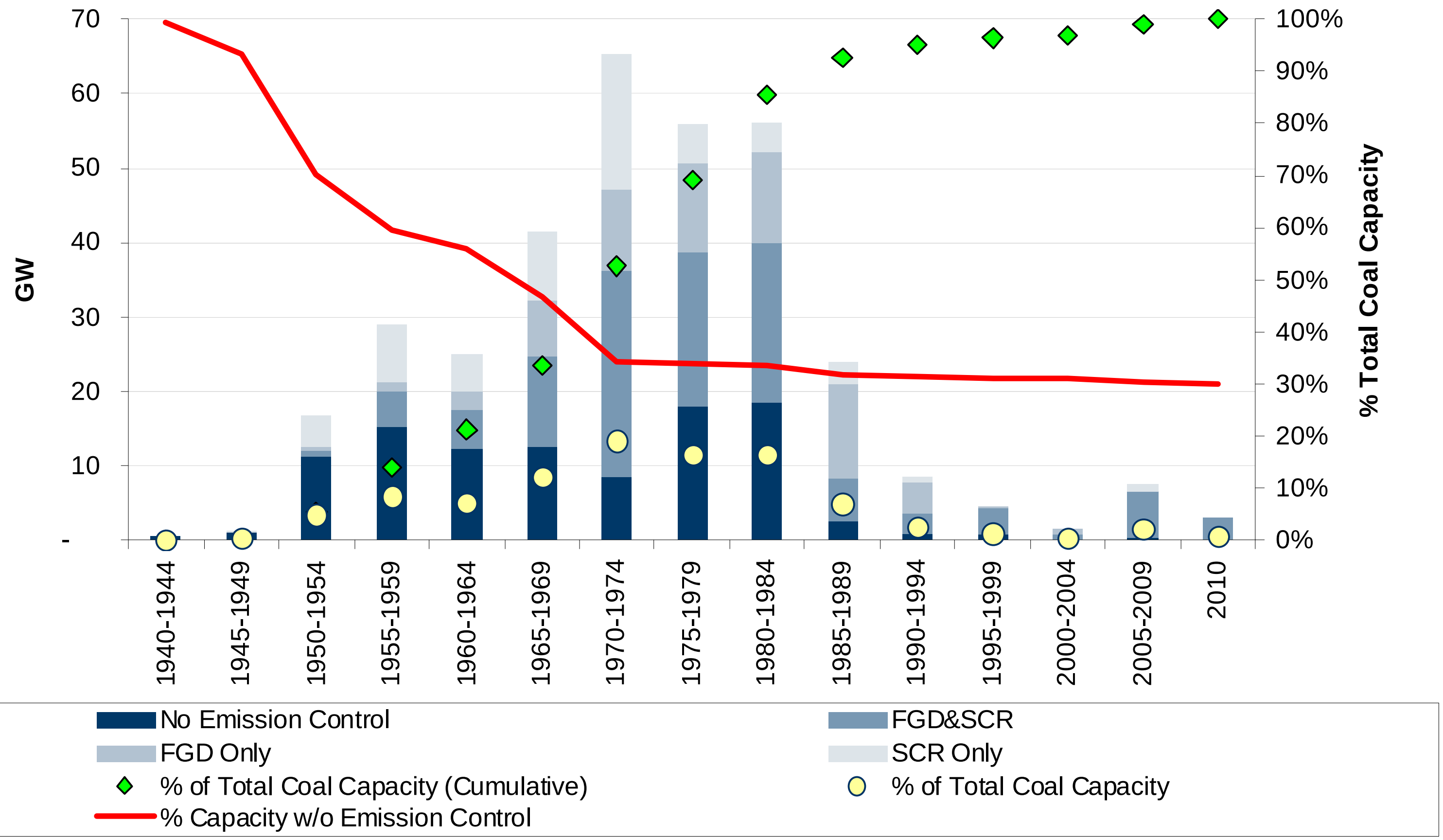
US Power Plants by Vintage and Fuel Type



- Average age of the US coal fleet is 36 years, older than the total fleet and closing in on full depreciable life
- Average age of US generation fleet is 26 years

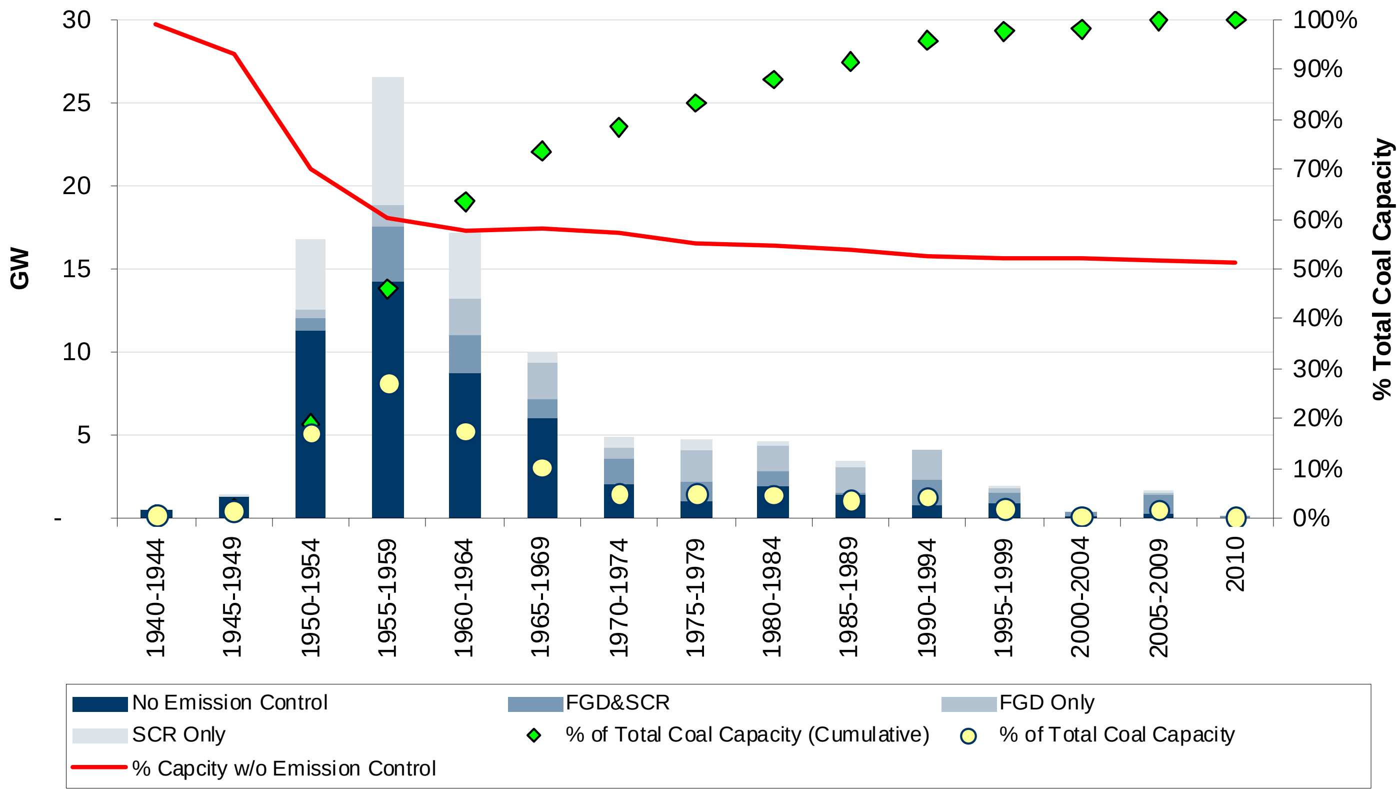
Source: Credit Suisse estimates, EnergyVelocity

Coal Fleet by Vintage and Environmental Controls



- Of the 340 GW US coal fleet:
- 103 GW (33%) has no emission controls
- 65 GW has only SCR but no scrubber
- 70% of coal fleet is over 30 years old
- 114 GW (33%) is over 40 years old

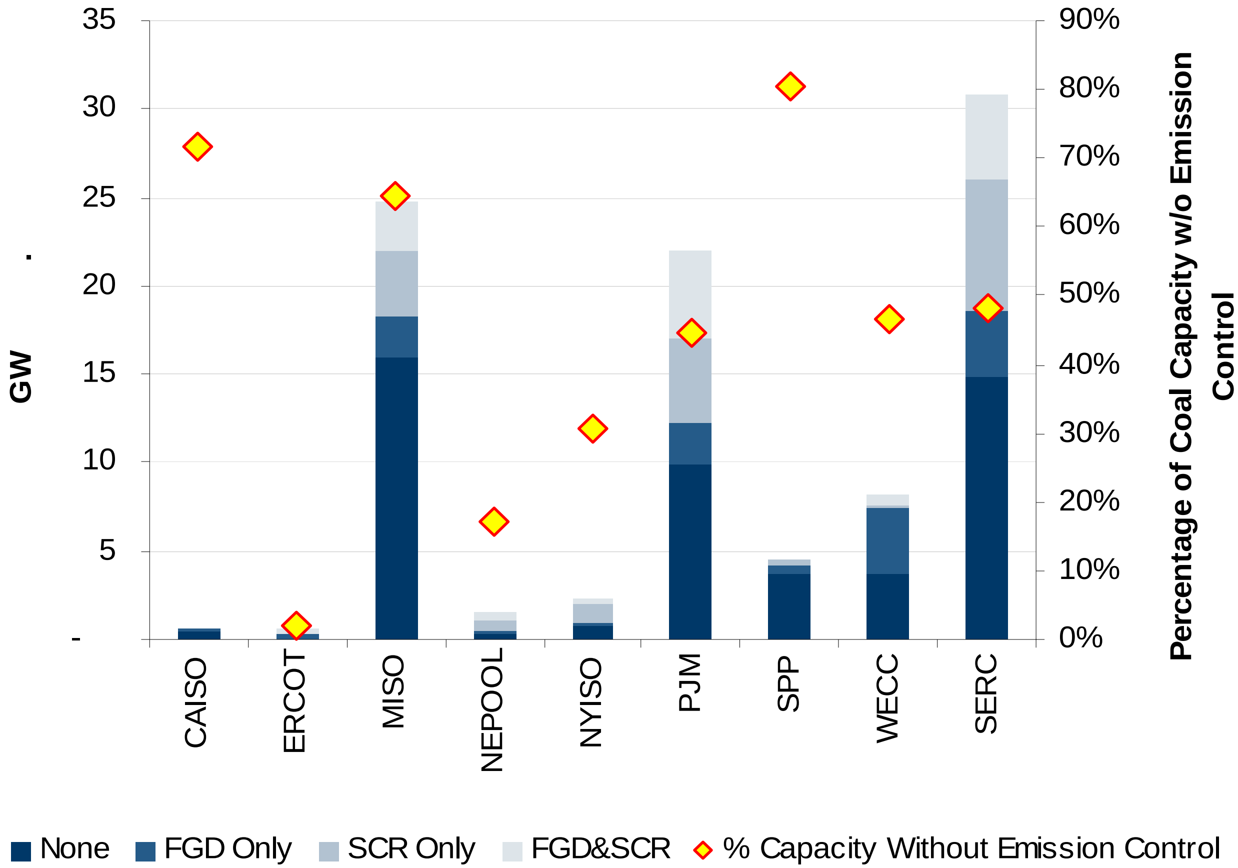
Small Coal Plant (Unit Size < 300 MW) Vintage



- More than 70% of small coal plants (72 GW) were built over 40 years ago and should be mostly depreciated
- 50% lack any control equipment (50 GW) versus 30% for all US coal plants
- 19 GW lack scrubbers leaving even more exposure to mercury

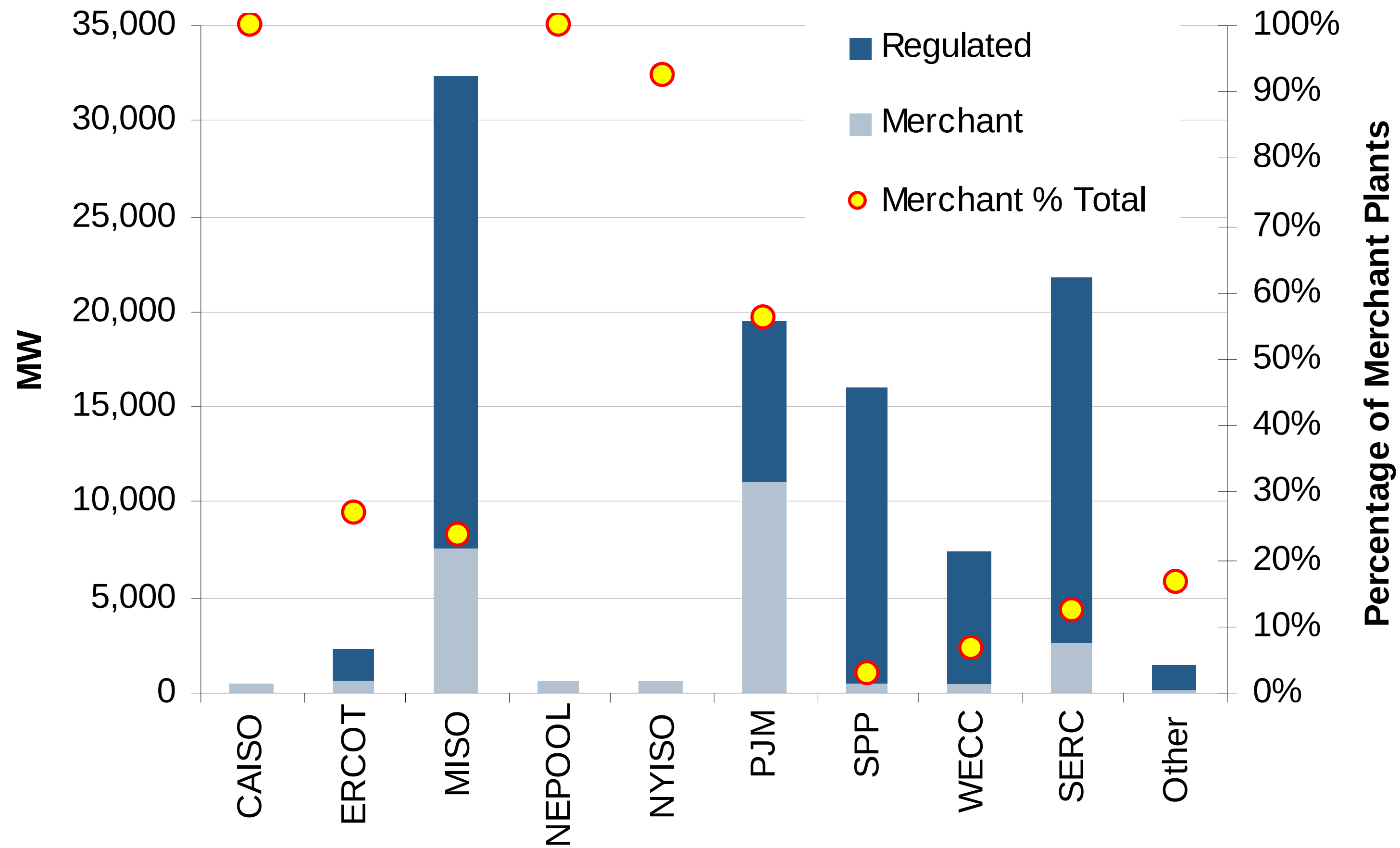
Source: Credit Suisse estimates, EnergyVelocity

Small Coal Plant Capacity by Emission Control



- MISO and SERC have most plants at risk
- MISO and SPP are the dirtiest in terms of relative uncontrolled capacity

Coal Plants Without Emission Controls: Regulated vs Merchant Capacity



- Merchant coal market retirements are most concentrated in Western PJM and Eastern MISO, representing most actionable markets for EPA policy investing

Our Coal Plant Closure Assumptions

- 60 GW: Our Base Case of closures, equating to all of the <300 MW coal plants lacking any environmental controls and half of the <300 MW just lacking a scrubber
- 35 GW: Our Low Case assumes half of all small plans lacking scrubbers (69 GW) are closed
- 100 GW: Our High Case assumes all plants lacking any control equipment (scrubbers and SCR) are closed

For earnings estimates we also ran a 60 GW closure scenario that used mark-to-market (MTM) commodity prices to put impact into today's context

We should note our closure assumptions will still require a significant portion of the US Coal fleet to require environmental capex to meet EPA emissions targets

Source: Credit Suisse estimates, Factset

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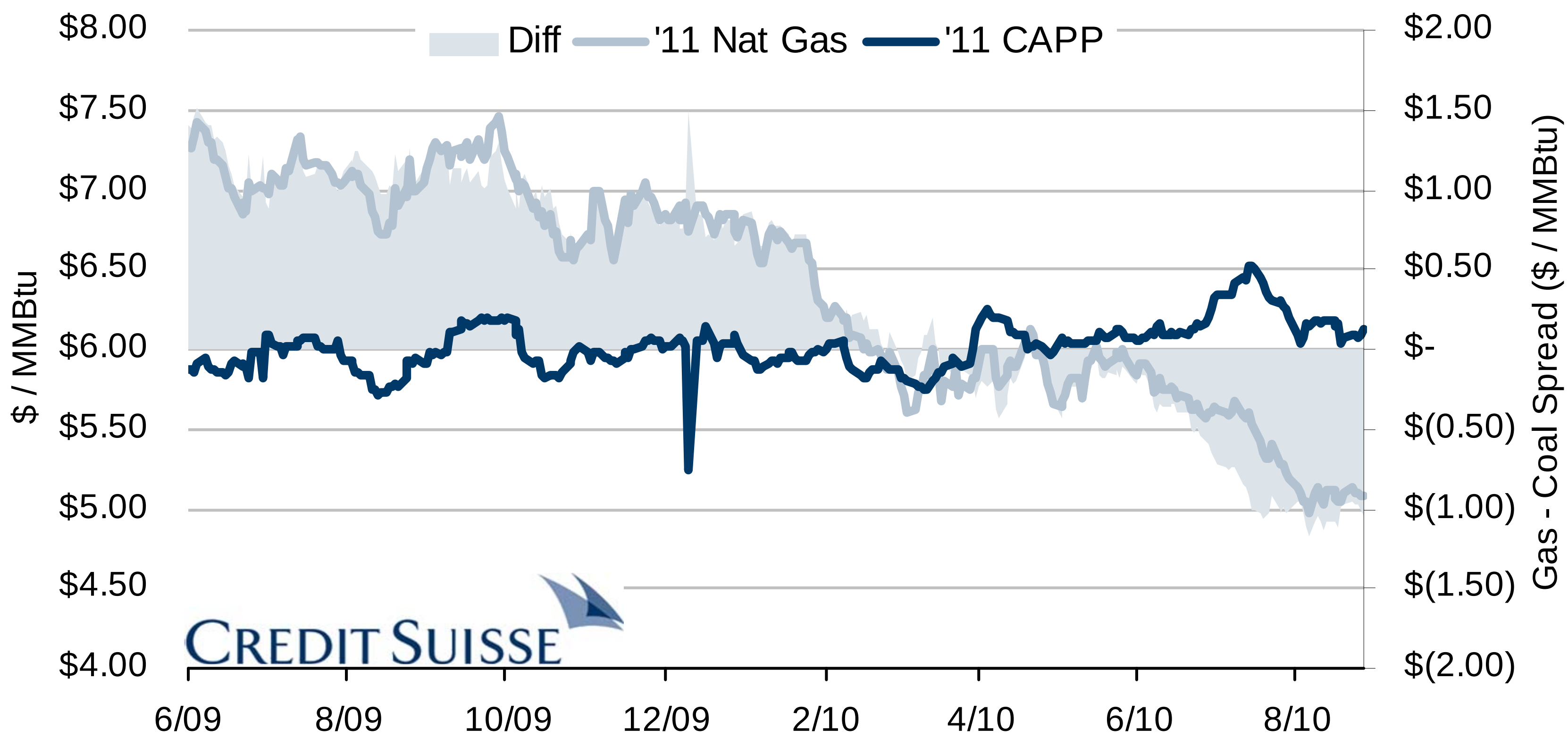
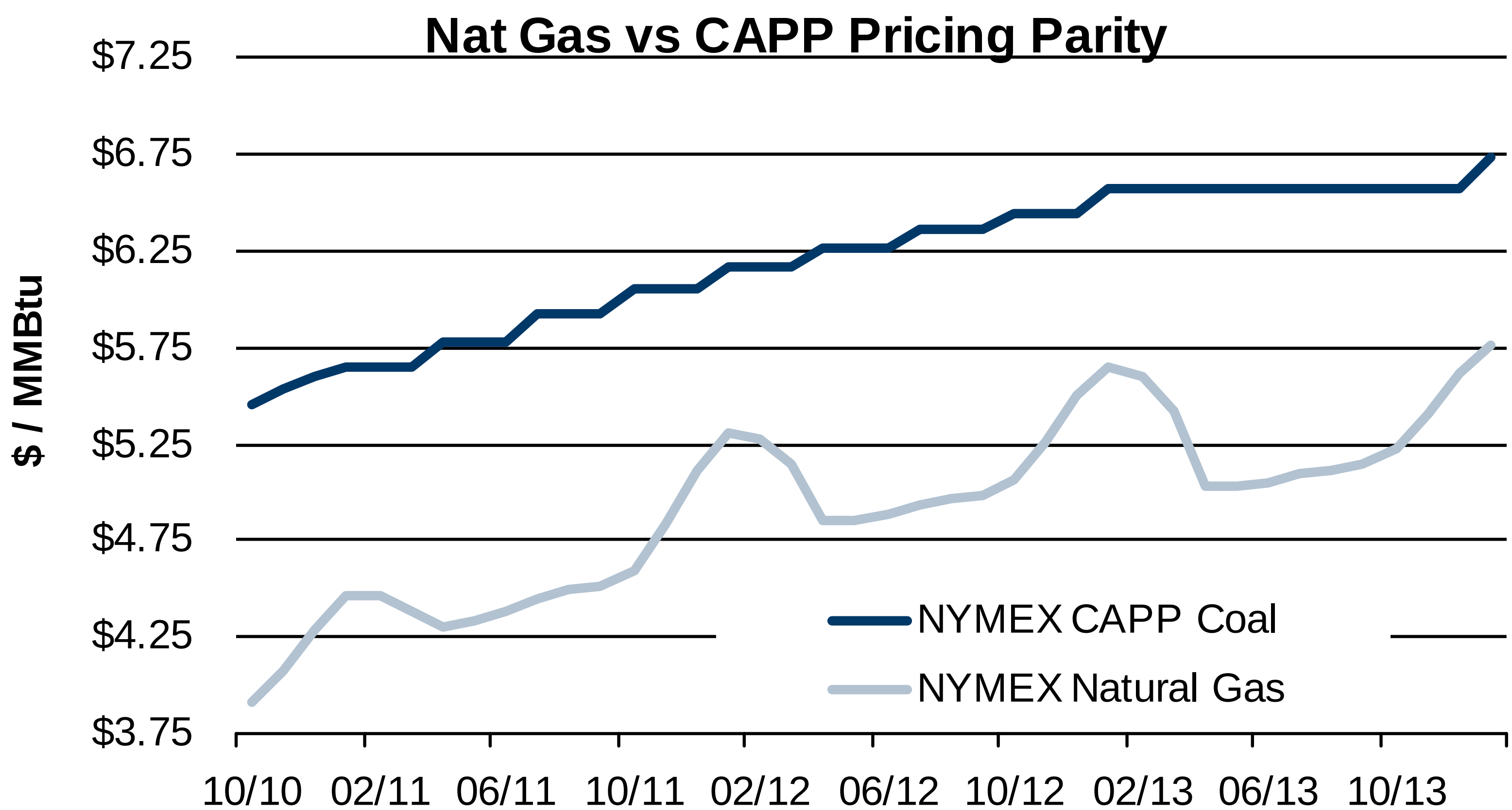
- We assume a 2 year “grace” period for compliance with new EPA rules, largely to support system reliability and logistical timing challenges of retrofit and newbuild programs
- Compliance delay arguments are heavy on ‘myth’ – Presidential 2-year delay, Congressional action, EPA discretion

Coal-Gas Parity: 2011 Forwards



- On an electricity equivalent basis, looking out the forward curve coal prices at a premium to natural gas for the fist sustained period in time

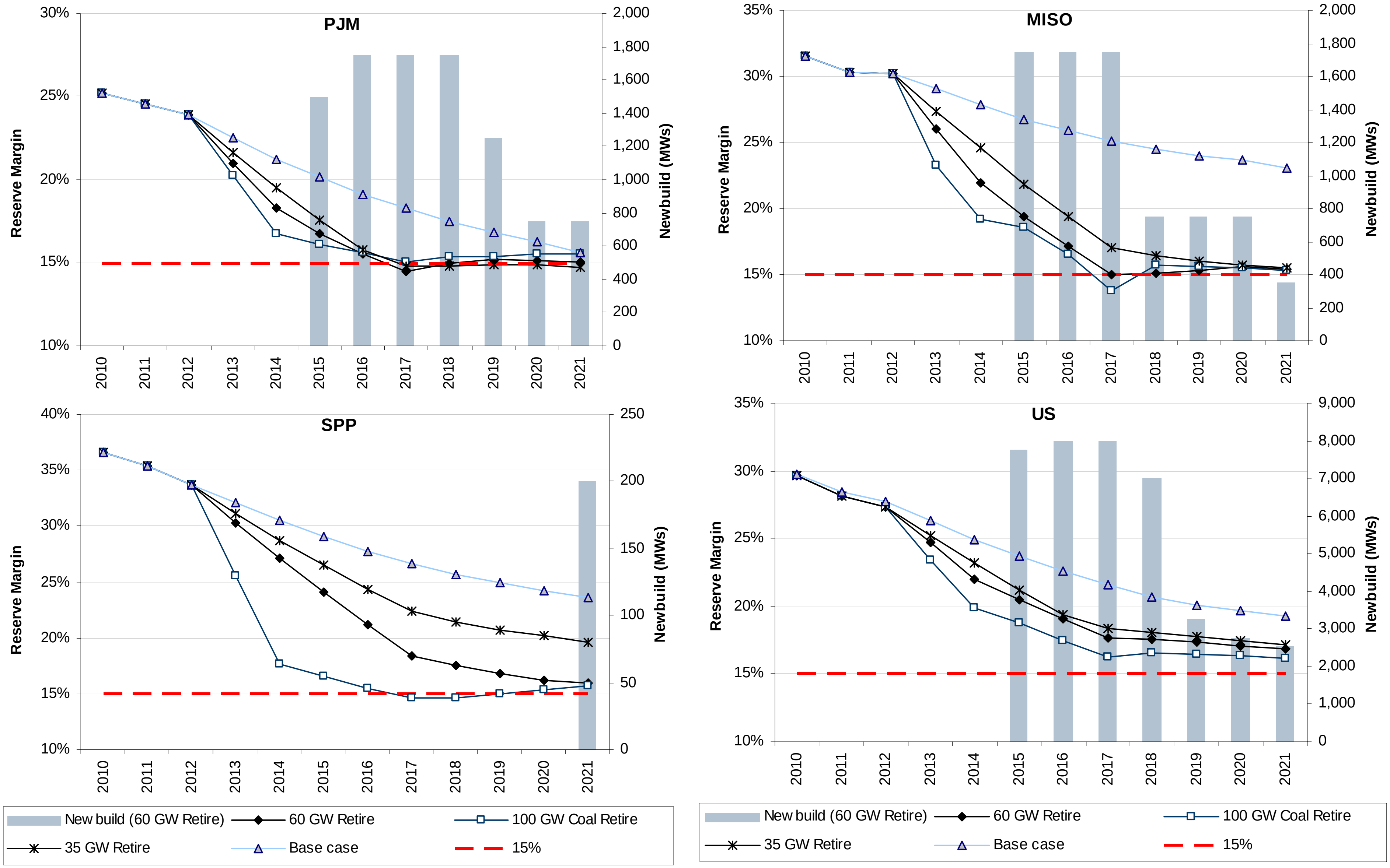
Coal-Gas Parity (2010 – 13)



- Looking out the forward curve coal prices at a sustained premium to natural gas, showing reasonable doubt about the profitability of conventional coal generators

Source: Credit Suisse estimates, Factset

Regional Reserve Margins



- EPA policy looks to accelerate market recovery by 4-5 years vs do nothing outlook

Source: Credit Suisse estimates, Factset

Newbuild Generation Forecast (2013 – 17)

Capacity (GW)	Retirement (2013-17)			Newbuild Projection (2013-17)		
MW to Retire	60 GW	35 GW	100 GW	60 GW	35 GW	100 GW
PJM	24	12	20	5	1	11
ERCOT	0	0	2	0	0	0
ISO New England	1	0	1	0	0	0
ISO New York	1	1	1	0	0	0
MISO	18	9	32	5	0	19
SERC	19	9	22	14	5	24
SPP	4	2	16	0	0	10
US	**60**	**30**	**103**	**24**	**6**	**65**

- We forecast new generation construction to meet some lost capacity needs, although replacements will likely be well below retirements as 20%+ reserve margins are inevitably tightened
- Our 60 GW retirement scenario would require 24 GW of newbuild to support regional reserve margins at 15%

Capex: CCGT Newbuild versus Retrofit

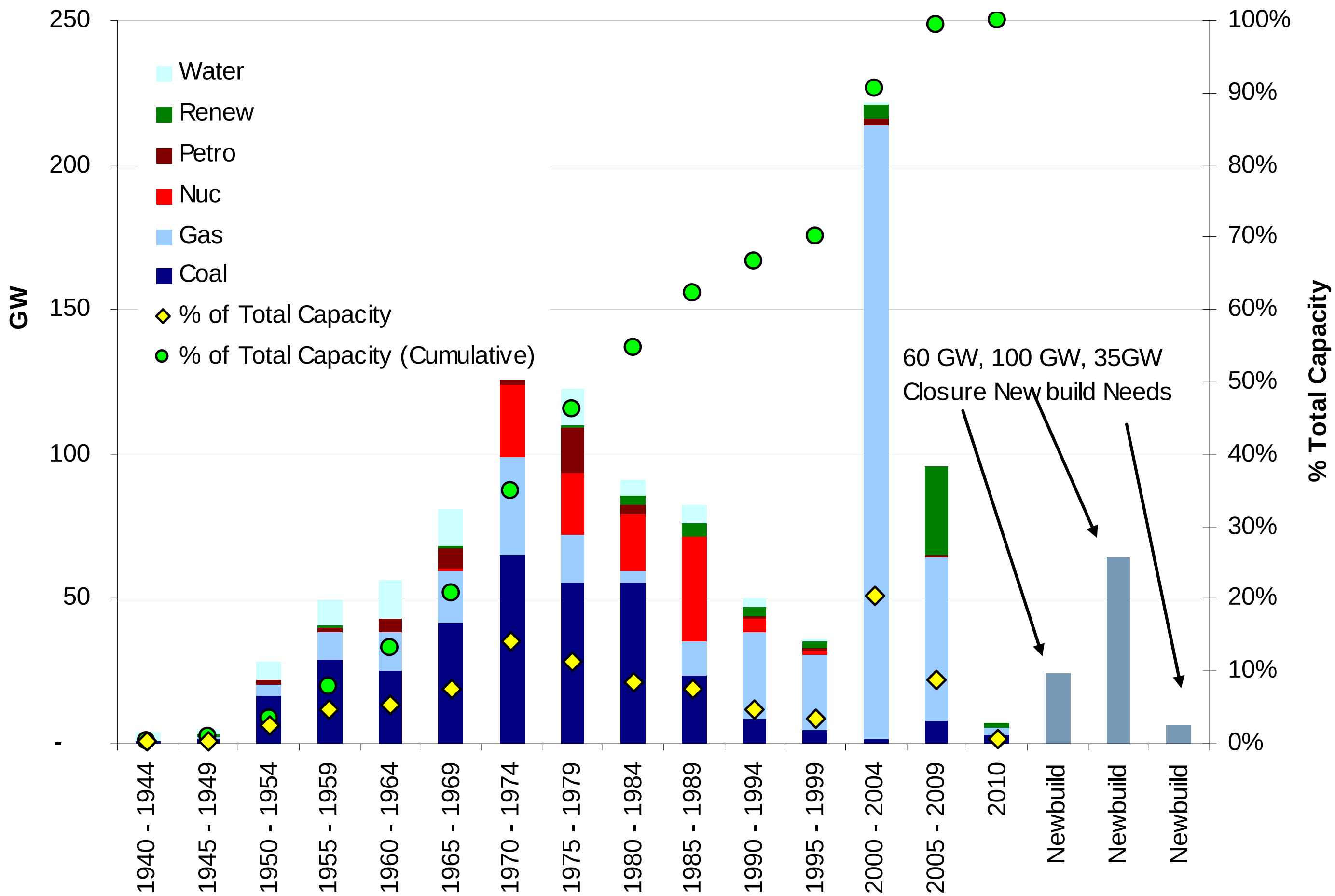
$ BN	% of Coal Plants with No Emission Control to be Scrubbed					
Blended Emission Control Cost	$/KW	0%	25%	50%	75%	100%
	300	115	96	77	57	38
	350	115	97	80	62	45
	400	115	99	83	67	51
	450	115	101	86	72	57
	500	115	102	89	77	64
	550	115	104	93	81	70
	600	115	105	96	86	77
	650	115	107	99	91	83
	700	115	109	102	96	89

- Retrofitting all plants without any emission controls would could $40-90 BN; replacing with CCGTs would cost $115 BN

$ BN	SCR				
FGD	$/ KW	75	150	225	300
	300	54	65	75	86
	350	61	72	83	93
	400	68	79	90	100
	450	75	86	97	108
	500	83	93	104	115
	550	90	101	111	122
	600	97	108	118	129
	650	104	115	126	136
	700	111	122	133	144

- Retrofit all plants lacking a scrubber or a SCR would cost $80 – 110 BN

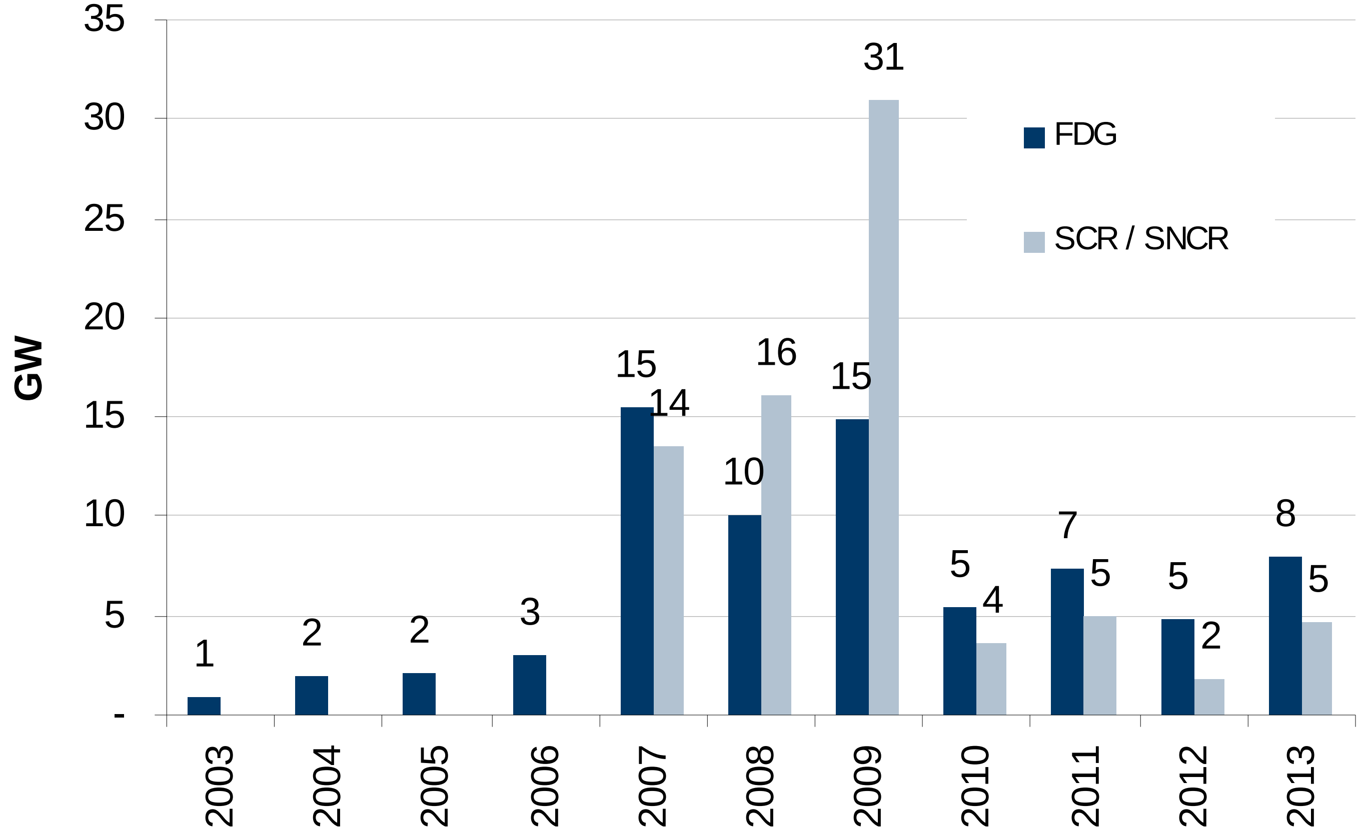
Putting in Context: Newbuild Needs vs History



- Newbuild requirements to support 15% reserve margins after EPA impacted plant closures looks manageable over the next 5-7 years after huge construction programs throughout the last decade

Source: Credit Suisse estimates, Factset

Emission Control Construction Activity



- Active construction cycle for environmental equipment before ramping to address the remaining uncontrolled US generation fleet

Revenue Requirement: CCGT versus Retrofit

Gas Price ($ / MMBtu)	Coal Price ($/ton) 50	55	60	65	70	75	80	85	90	95
4.0	(3.2)	(5.3)	(7.4)	(9.5)	(11.6)	(13.7)	(15.8)	(17.9)	(20.0)	(22.1)
4.5	0.2	(1.9)	(4.0)	(6.1)	(8.2)	(10.3)	(12.4)	(14.5)	(16.6)	(18.7)
5.0	3.6	1.5	(0.6)	(2.7)	(4.8)	(6.9)	(9.0)	(11.1)	(13.2)	(15.3)
5.5	7.0	4.9	2.8	0.7	(1.4)	(3.5)	(5.6)	(7.7)	(9.8)	(11.9)
6.0	10.4	8.3	6.2	4.1	2.0	(0.1)	(2.2)	(4.3)	(6.4)	(8.5)
6.5	13.8	11.7	9.6	7.5	5.4	3.3	1.2	(0.9)	(3.0)	(5.1)
7.0	17.2	15.1	13.0	10.9	8.8	6.7	4.6	2.5	0.4	(1.7)
7.5	20.6	18.5	16.4	14.3	12.2	10.1	8.0	5.9	3.8	1.7
8.0	24.0	21.9	19.8	17.7	15.6	13.5	11.4	9.3	7.2	5.1
8.5	27.4	25.3	23.2	21.1	19.0	16.9	14.8	12.7	10.6	8.5
9.0	30.8	28.7	26.6	24.5	22.4	20.3	18.2	16.1	14.0	11.9

For Regulated Utilities:

- At current commodity forwards, a newbuild CCGT is cheaper than retrofit for rate payers
- If the gas price is over $7 / MMBtu, retrofit could be economically more attractive

Retrofit Economics (Eastern Coal)

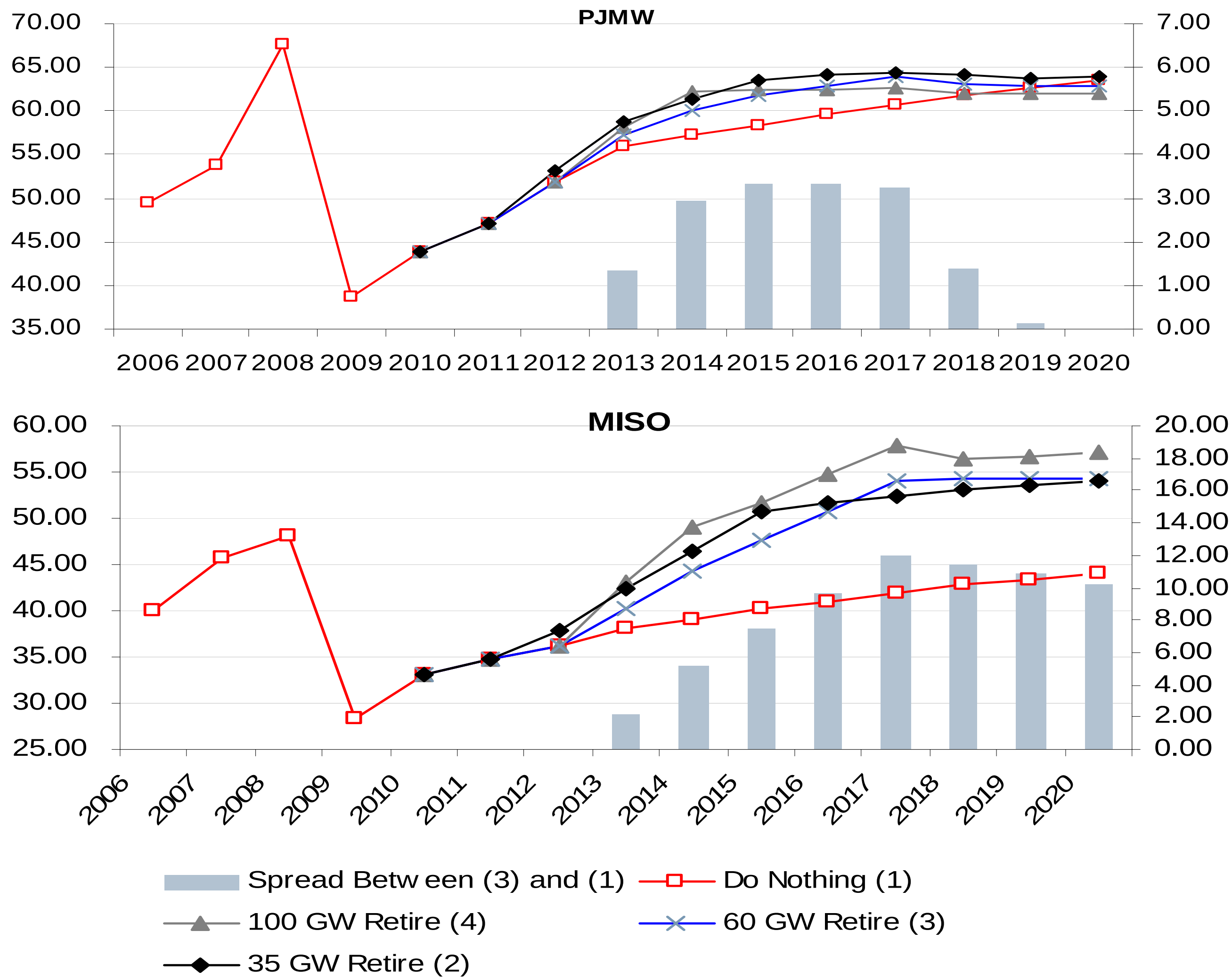
Retrofit Capex $/KW	Remaining Life							
	5	10	15	20	25	30	35	40
300	26.5	21.4	19.7	18.9	18.4	18.1	17.8	17.6
400	31.9	25.2	23.0	21.8	21.2	20.7	20.4	20.2
500	37.4	29.0	26.2	24.8	23.9	23.4	23.0	22.7
600	42.8	32.8	29.4	27.7	26.7	26.0	25.6	25.2
700	48.3	36.5	32.6	30.7	29.5	28.7	28.1	27.7
800	53.8	40.3	35.8	33.6	32.3	31.4	30.7	30.2

Retrofit Capex $/KW	Capacity Payment ($ / MW- Day)							
	25	50	75	100	125	150	175	200
300.0	20.4	18.9	17.4	16.0	14.5	13.1	11.6	10.2
400.0	23.3	21.8	20.4	18.9	17.5	16.0	14.6	13.1
500.0	26.2	24.8	23.3	21.9	20.4	19.0	17.5	16.0
600.0	29.2	27.7	26.3	24.8	23.3	21.9	20.4	19.0
700.0	32.1	30.7	29.2	27.7	26.3	24.8	23.4	21.9
800.0	35.1	33.6	32.1	30.7	29.2	27.8	26.3	24.9

To earn a 12% ROE on non-regulated environmental retrofits would require:

- At $50 / MW – Day capacity price, $25 / MWH dark spread is required to make retrofit of economic
- At $ 200 / MW – Day, dark spread still needs to be in the high teens

Power Prices



- Plant closures will drive power prices appreciably higher ($5-10 / MWH) to provide an economic return that attracts new investment

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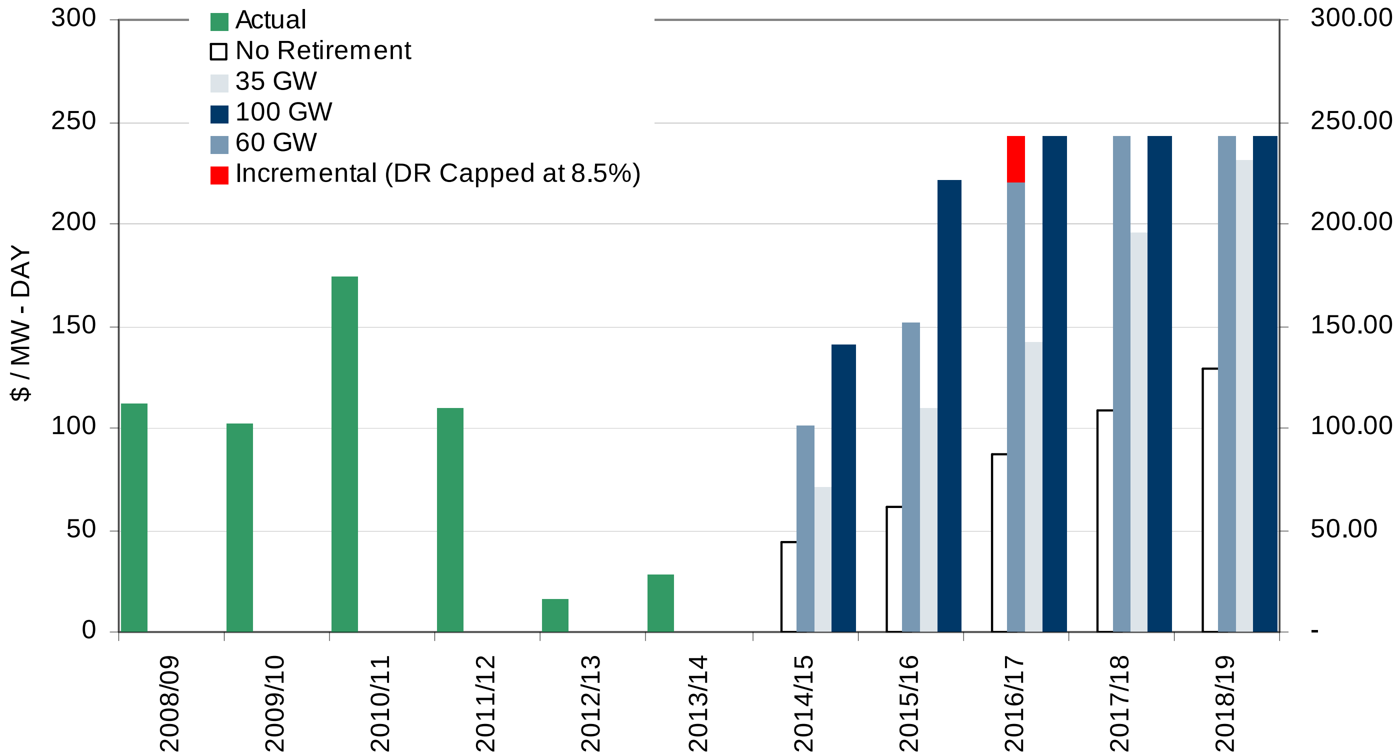
Source: Credit Suisse estimates, Factset

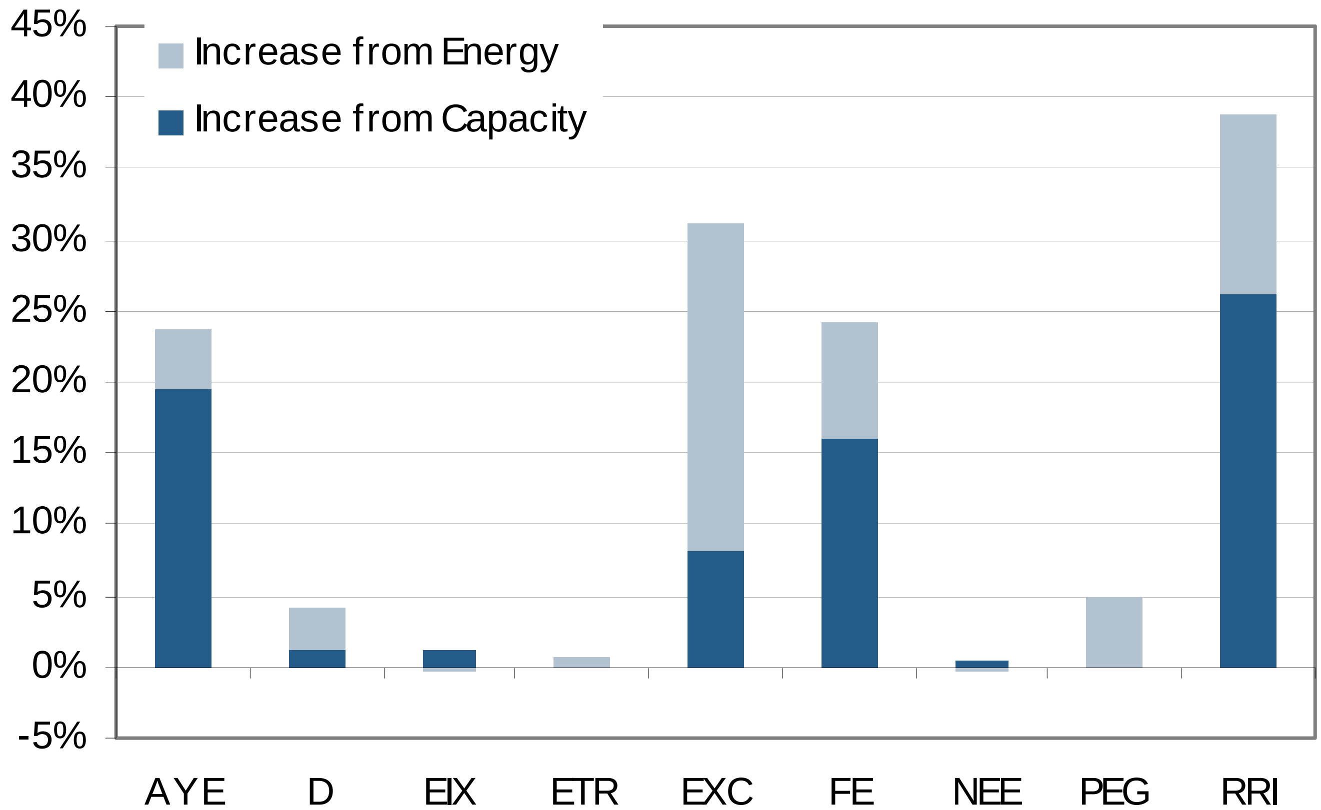
PJM-RTO Capacity Price Forecasts



- Depending on plant closure scenario, RTO capacity prices should rally significantly over coming auctions to attract needed new investment
- Interestingly, capacity prices converge on similar levels within a couple auction cycles highlighting the acceleration of recovery created by EPA policy
- We assumed 10% demand response market share; current proposals would limit at 8.5% for RTO which would reshape our forecasts (see red bar)

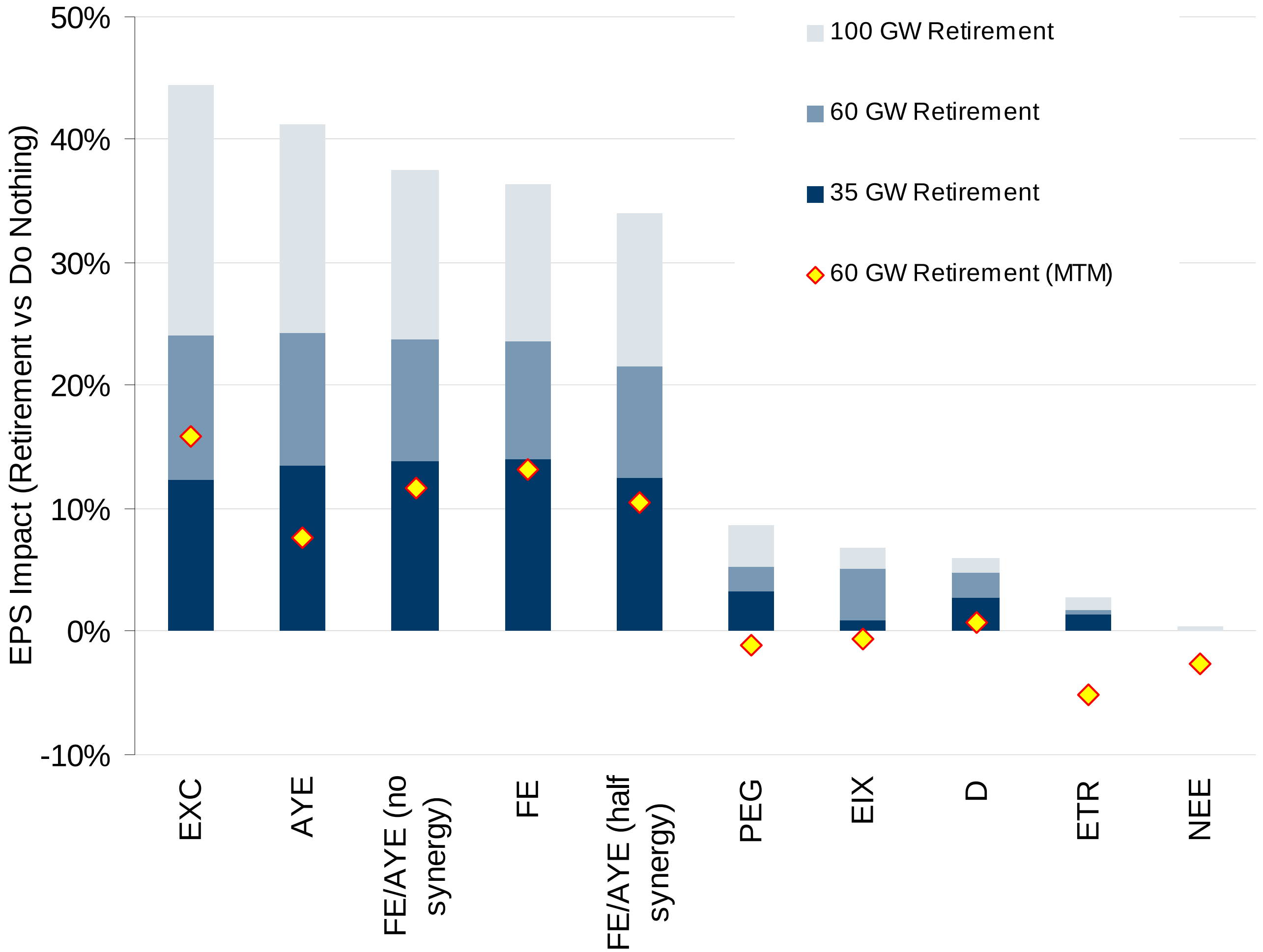
Source: Credit Suisse estimates, Factset

2015 EBITDA Impact – Energy vs Capacity Breakdown



- A significant component of earnings upside will come from higher capacity prices in RTO; this is hardly just an energy pricing conversation

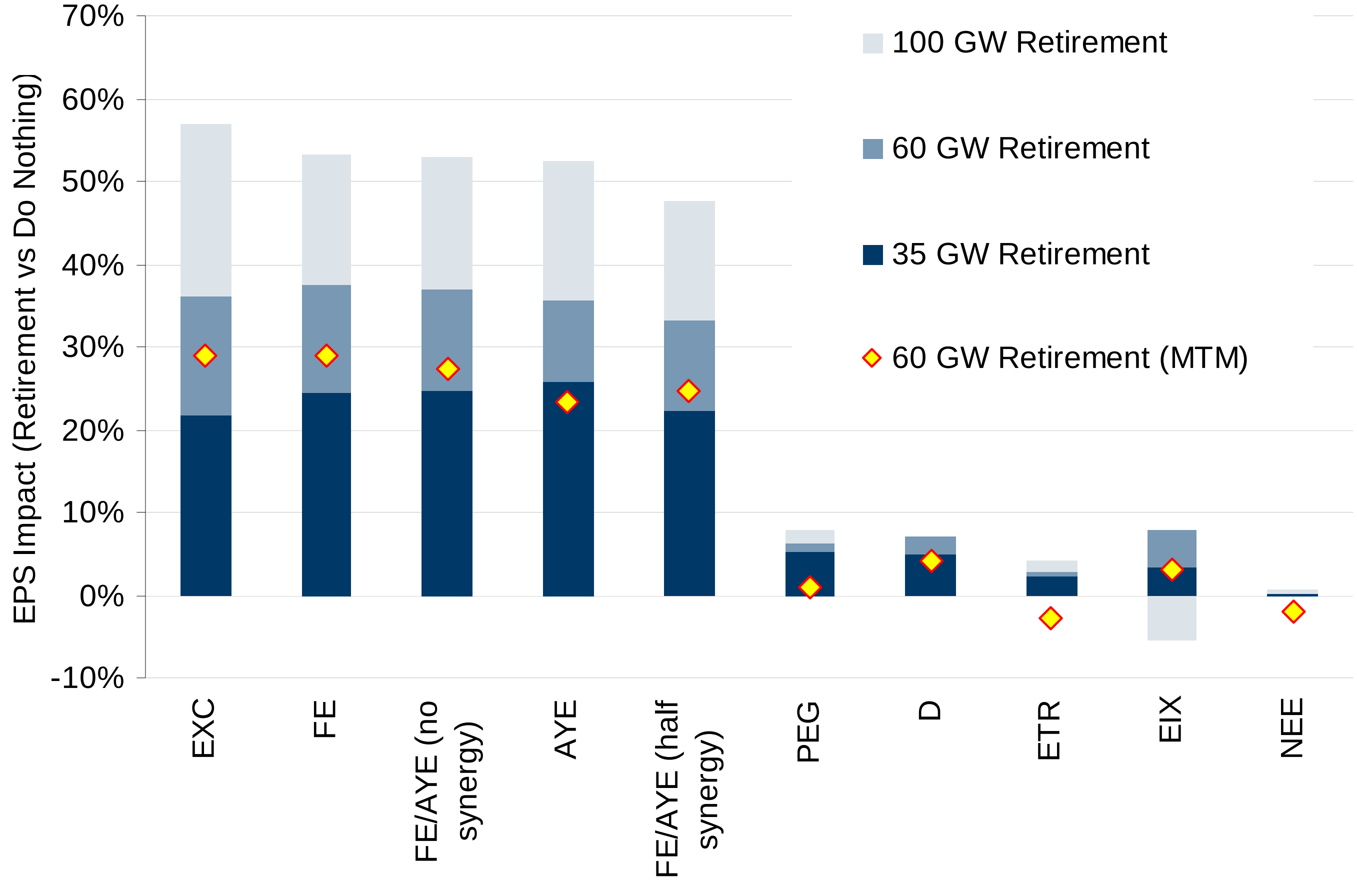
2014 EPS Impact from Coal Plant Retirements



- EPS leverage to different retirement scenarios for PJM-West players could be 15-30% realistically

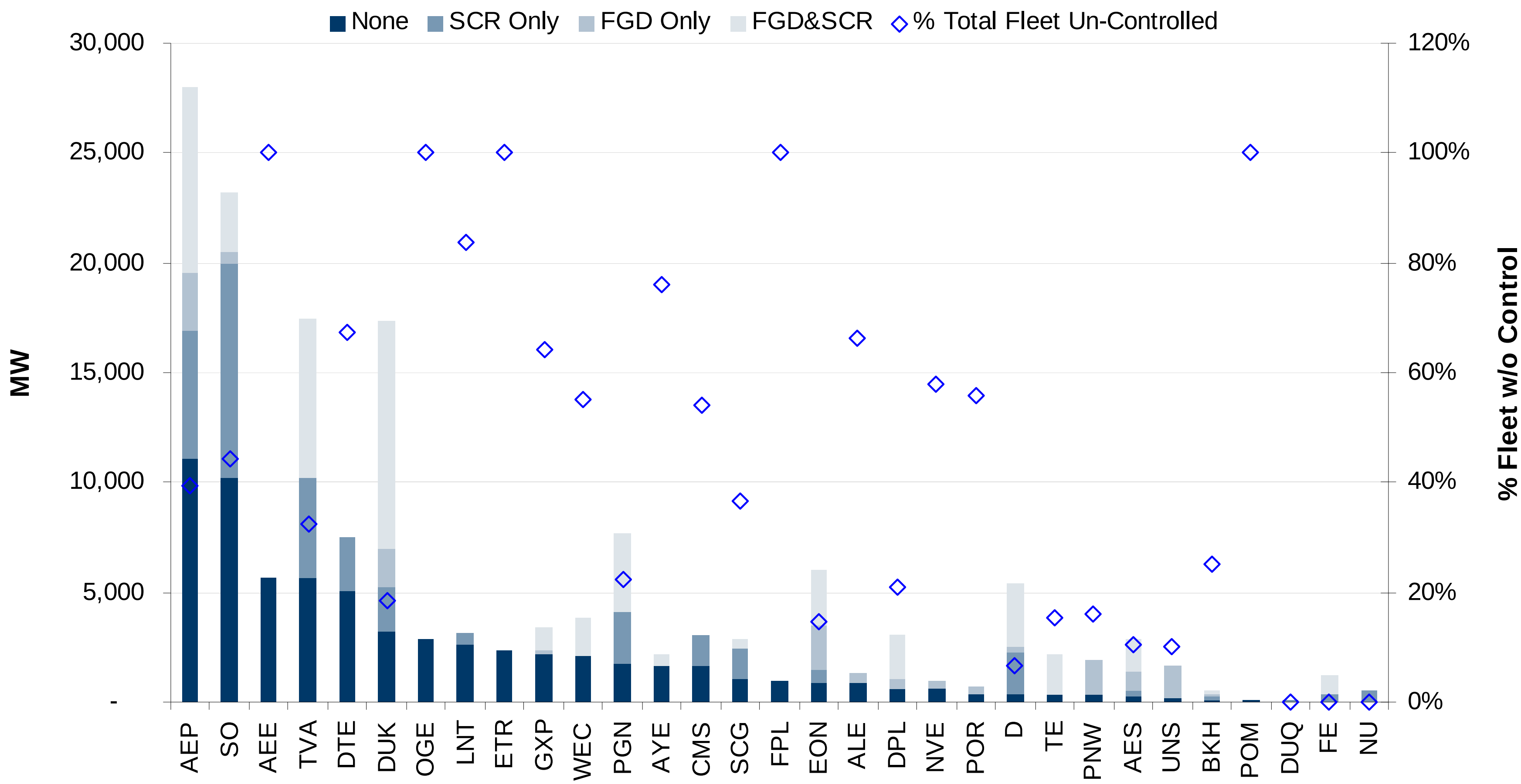
Source: Credit Suisse estimates, Factset

2015 EPS Impact from Coal Plant Retirements



- EPS leverage to different retirement scenarios for PJM-West players could be 25-50% realistically

Regulated Utilities Coal Plant By Emission Control



- Regulated Utilities have significant coal plant retirement exposure
- As a percentage of capacity, AEE, OGE and DTE have work to do

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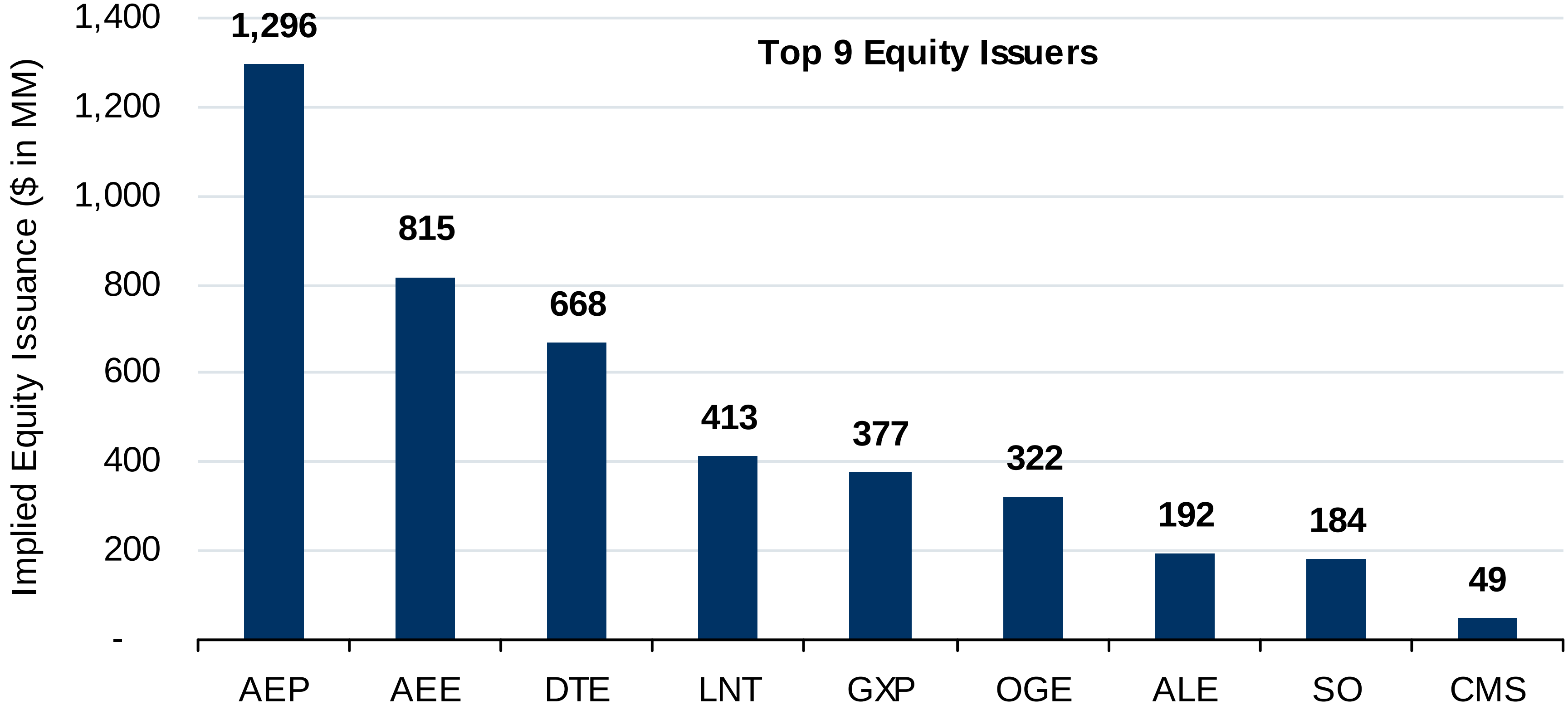
Source: Credit Suisse estimates, Factset

Regulated Utilities: Prospective Capex and EPS Growth

	Generation Mix		Implied Capital Expenditures				EPS Impact			
	Un-Scrubbed Plant (Not Inc. Planned Emission Ctrl)		Replace Small Plant with CCGT $900/kW	Retrofit Big Plant $600/kW	Total Implied Capex	% Net PPE	Incremental Diluted EPS	5-Year EPS CAGR	7-Year EPS CAGR	Cumulative Earnings Growth
Ticker	**Small (MW)**	**Large (MW)**	**$MM**	**$MM**	**$MM**	**(%)**	**$ / Share**	**%**	**%**	**%**
ALE	518	365	466	219	685	42%	0.83	3.8%	2.7%	20.6%
GXP	759	1,400	683	840	1,523	23%	0.46	3.1%	2.2%	16.5%
LNT	1,210	1,425	1,089	855	1,944	33%	0.75	3.1%	2.2%	16.5%
OGE	-	2,854	-	1,712	1,712	29%	0.76	3.1%	2.2%	16.4%
AEE	564	5,090	508	3,054	3,561	20%	0.63	3.1%	2.2%	16.3%
DTE	1,661	3,391	1,495	2,034	3,530	28%	0.91	3.0%	2.1%	15.9%
AEP	4,402	6,632	3,962	3,979	7,941	23%	0.72	2.7%	2.0%	14.5%
SO	5,259	4,970	4,733	2,982	7,715	20%	0.43	2.7%	1.9%	14.1%
WEC	1,715	419	1,543	251	1,794	20%	0.70	2.6%	1.9%	13.9%
CMS	1,236	404	1,112	242	1,355	14%	0.25	2.6%	1.8%	13.5%
EON	443	446	399	268	667	1%	0.02	2.4%	1.7%	12.5%
SCG	1,061	-	955	-	955	11%	0.36	2.2%	1.6%	11.7%
NVE	576	-	518	-	518	6%	0.11	2.2%	1.6%	11.4%
DPL	414	230	373	138	511	18%	0.21	2.2%	1.6%	11.4%
POR	-	391	-	234	234	6%	0.15	2.1%	1.5%	11.0%
AYE	532	-	479	-	479	5%	0.14	2.1%	1.5%	10.9%
UNS	173	-	156	-	156	6%	0.19	2.0%	1.4%	10.5%
ETR	2	2,352	2	1,411	1,413	6%	0.37	2.0%	1.4%	10.3%
DUK	2,657	560	2,391	336	2,727	7%	0.10	2.0%	1.4%	10.3%
AES	302	-	271	-	271	1%	0.02	2.0%	1.4%	10.3%
PGN	747	964	672	579	1,251	6%	0.21	1.9%	1.3%	9.8%
TE	326	-	294	-	294	5%	0.07	1.9%	1.3%	9.8%
BKH	125	-	112	-	112	5%	0.14	1.9%	1.3%	9.7%
PNW	312	-	281	-	281	3%	0.13	1.8%	1.2%	9.1%
NEE	-	952	-	571	571	2%	0.07	1.7%	1.2%	8.9%
D	367	-	330	-	330	1%	0.03	1.5%	1.1%	7.6%
TVA	5,634	-	5,071	-	NA	NA	n/a	n/a	n/a	n/a
Total	**31,872**	**36,961**	**28,685**	**22,177**	**45,791**	**10%**		**2.3%**	**1.6%**	**11.9%**

Source: Credit Suisse estimates, Factset

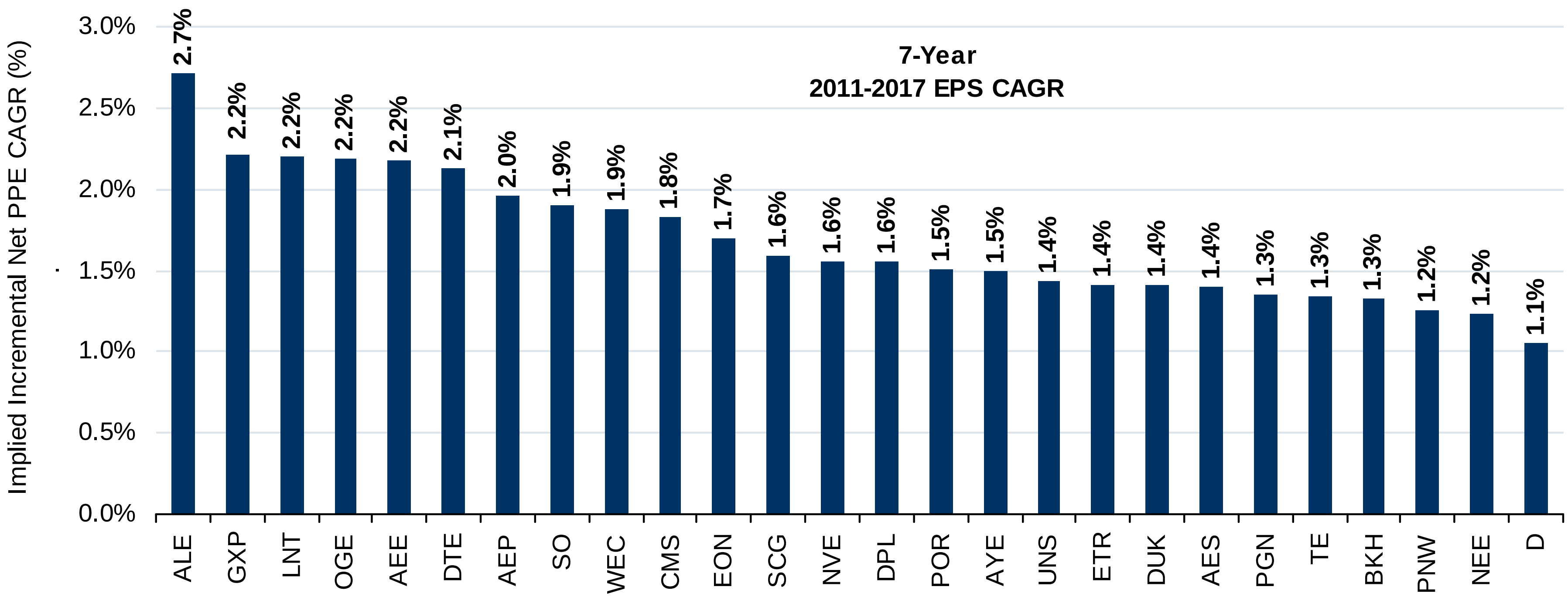
Funding Capex: Top 9 Equity Issuers (Absolute)



- Funding higher growth rates will require additional outside equity for many over the 7 year time horizon

Source: Credit Suisse estimates, Factset

Regulated Growth: 2011-2017 EPS CAGR



- Coal plant retirement related spending will likely boost EPS growth rates for many Regulated Utilities by 1-3% annually
- AEE, DTE, AEP, and SO will be stocks to watch

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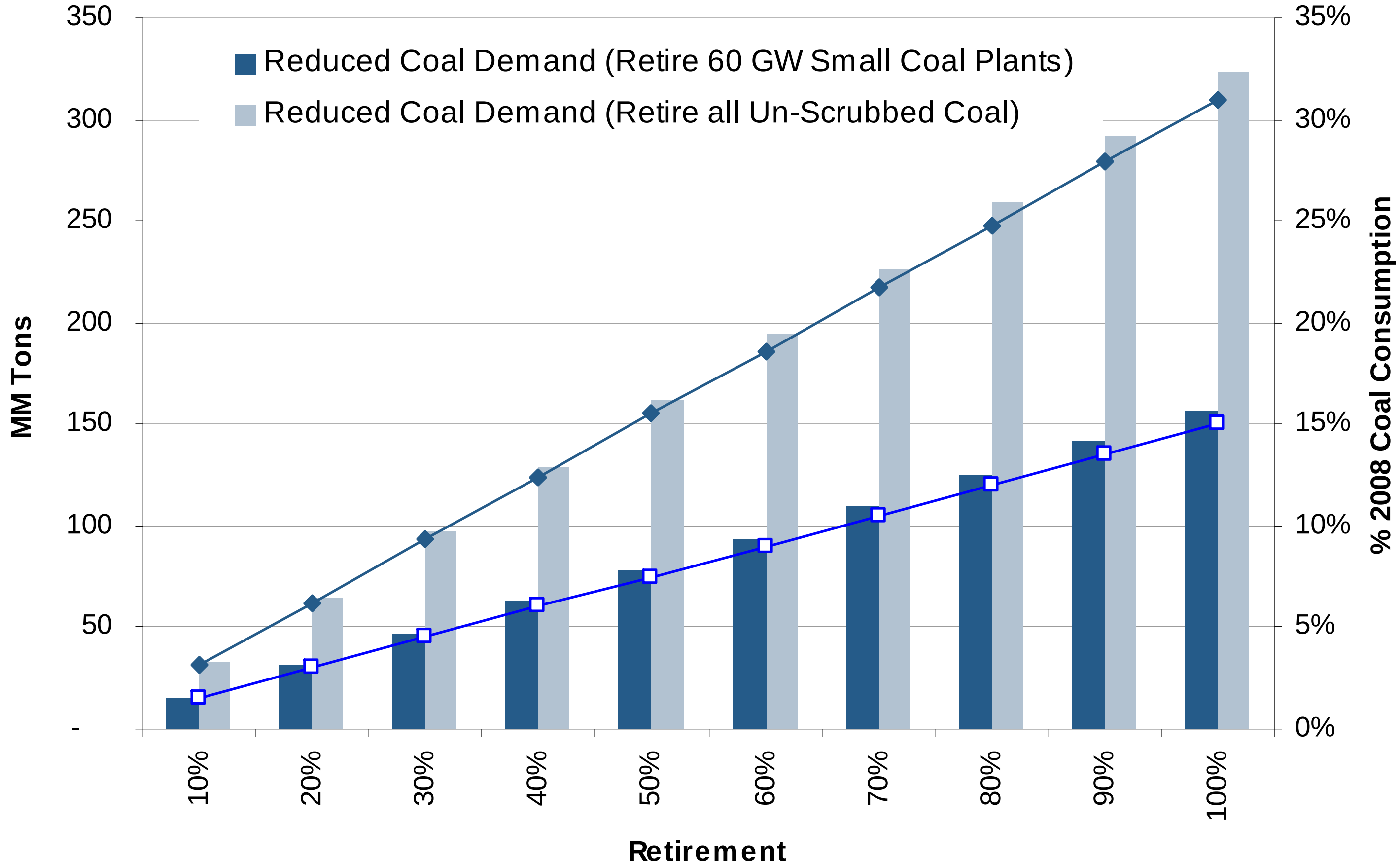
Source: Credit Suisse estimates, Factset

Impact on Coal Demand from Coal Plant Retirement



- Steam coal demand could fall by 157-324 MM tons annually (15-31%) depending on retirement assumptions

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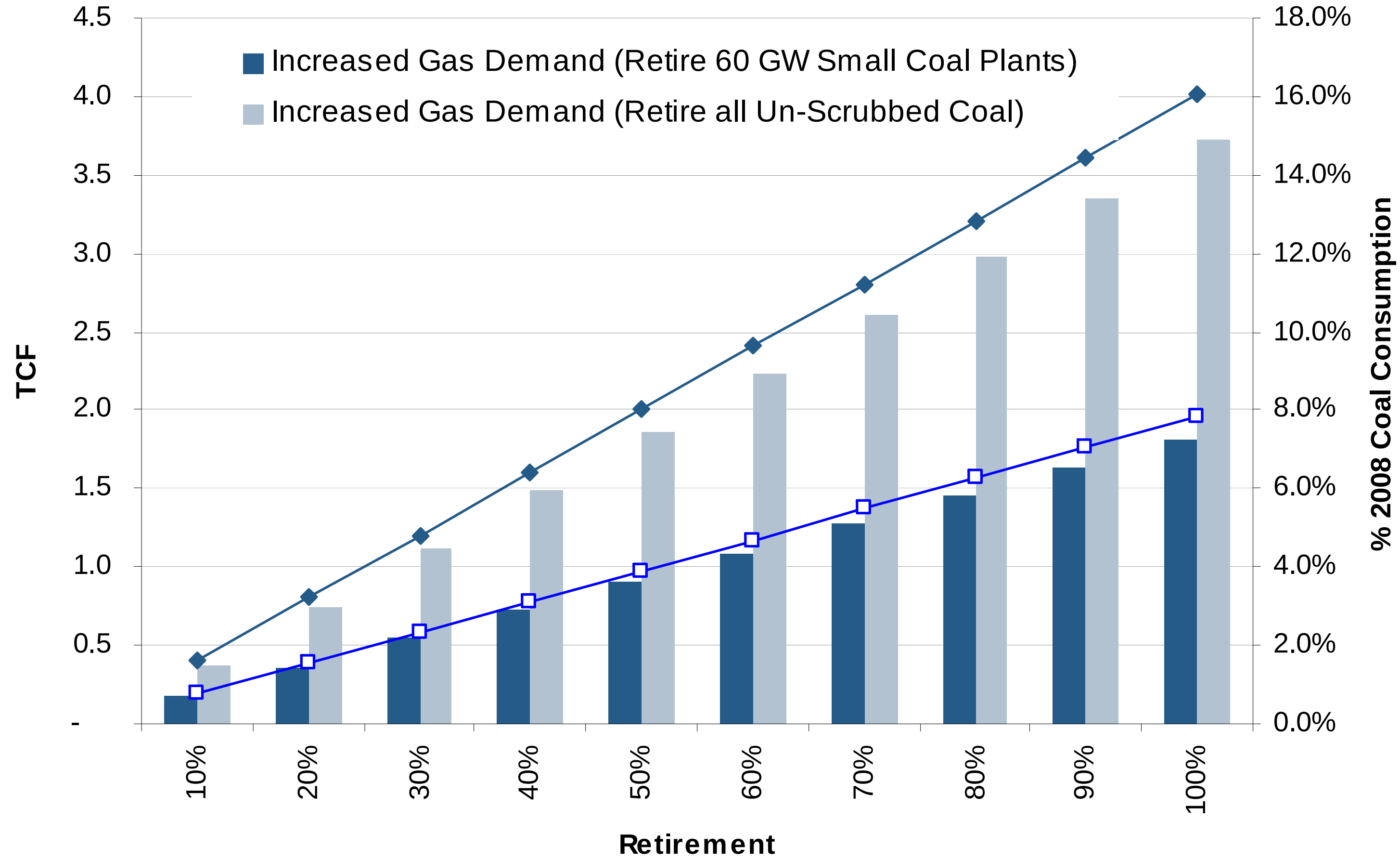
Source: Credit Suisse estimates, Factset

Impact on Gas Demand from Coal Plant Retirement



- Natural gas demand could grow by 2.0-4.0 TCF annually to replace electricity produced from retiring coal plants

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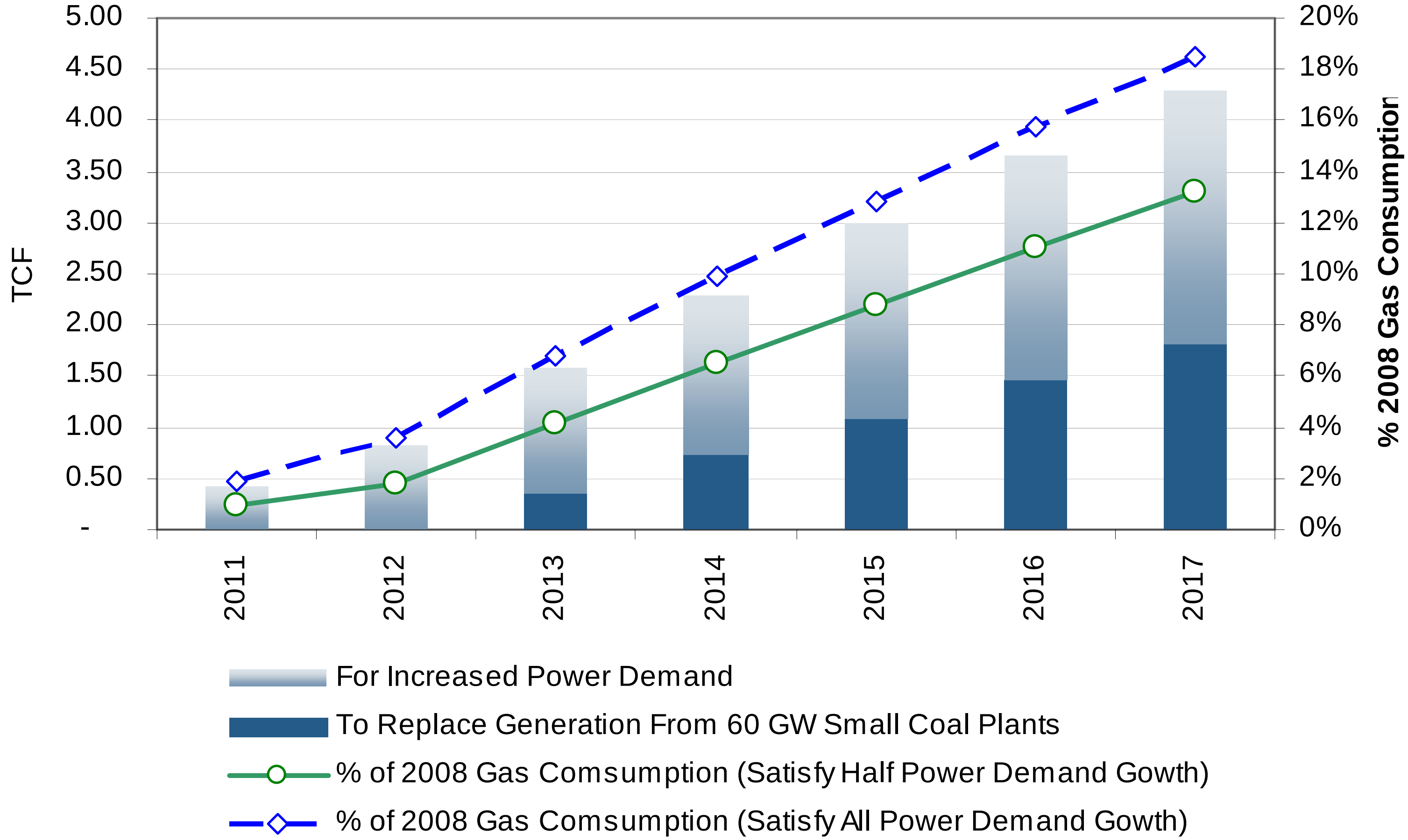
Source: Credit Suisse estimates, Factset

Gas Demand Growth: Replacement plus Consumption



- Layering a reasonable coal plant closure scenario with sustained power demand growth served by gas generation could see growth of 3.5-4.5 TCF annually

Source: Credit Suisse estimates, Factset

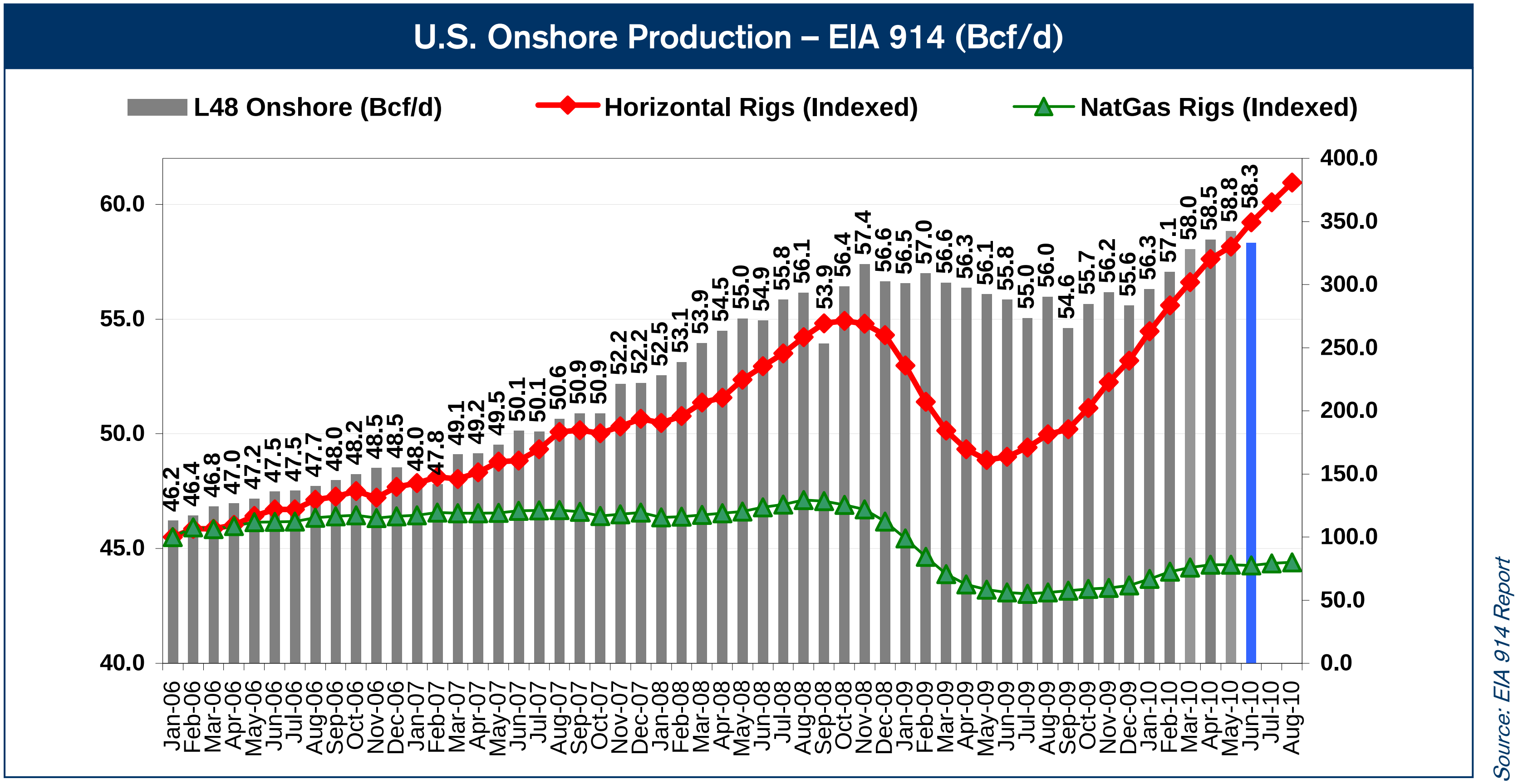
Impact of shale on natural gas market

- **The U.S. is Now 'Long' Natural Gas:** Emergence of **numerous prolific shale basins** (*Barnett, Haynesville, Marcellus*) has expanded the U.S. natural gas reserve base and changed perception of U.S. being 'short' natural gas to U.S. being 'long' natural gas.
  - Natural gas reserve life has risen substantially
  - The Industry is building 'trust' on ability to deliver supply reliably
  - We expect substantial future demand growth as gas is 'cheap' to coal and offers environmental benefits
  - LNG import story has taken a back-seat as U.S. has become self-sufficient
- **The U.S. Gas Cost Curve Has Fallen:** Increasing production of natural gas from shales is lowering the cost curve as **shale gas is the lowest cost domestic source of natural gas.**
  - F&D costs are materially lower for shale gas producers
  - Most shale plays generate a reasonable return (*15% ATAX*) under $6.00 per MMBtu
  - Current over-investment (*140% of internal cash flow*) and slack demand causing weak prices
- **IOC's and NOC's Making U.S. Shale Push:** International players are attracted by low risk nature of big U.S. shale reserves, easy reserve replacement.

Supply has grown fast, but demand outlook is positive

- **Shales have improved productivity vs. conventional drilling. Also helping supply are:**
  1) **Horizontal Drilling.** A record high horizontal rig count (*up 60% in 2010*) which adds supply at 3.0x+ the rate of traditional vertical drilling,
  2) **Externally Funded Spending.** Capex running 140% of internal hedged cash flow (*170% unhedged*) helped by hospitable equity and debt markets and cash infusions from JVs with large international companies, and
  3) **Drilling to Hold Leases.** Aggressive lease capture (*'HBP'*) strategies which is forcing low rate of return drilling (*'use it or lose it'*)
- **Longer-term, U.S. cost curve is falling due to exploitation of low-cost shale gas…**
- **…But rising demand from the power sector could require an additional 6.0 Bcf/d by 2015, marking a fresh source of secular growth for U.S. gas demand.**
- **Our $6.50 per MMBtu long-term natural gas price provides sufficient cash to balance a growing market.**

Onshore U.S. production tracking horizontal rig surge



- June 2010 onshore U.S. production up 4.4% or 2.5 Bcf/d yr/yr
- Production continues to rise from shale gas

Horizontal Rigs: 912 as of 9/17/10 and 40% above the 2008 peak of 650 set on 10/31/08.

Gas Rig count now at 982 as of 9/17/10, up 48% from 2009 trough of 665 on 7/17/09.

Source: Credit Suisse estimates, Factset

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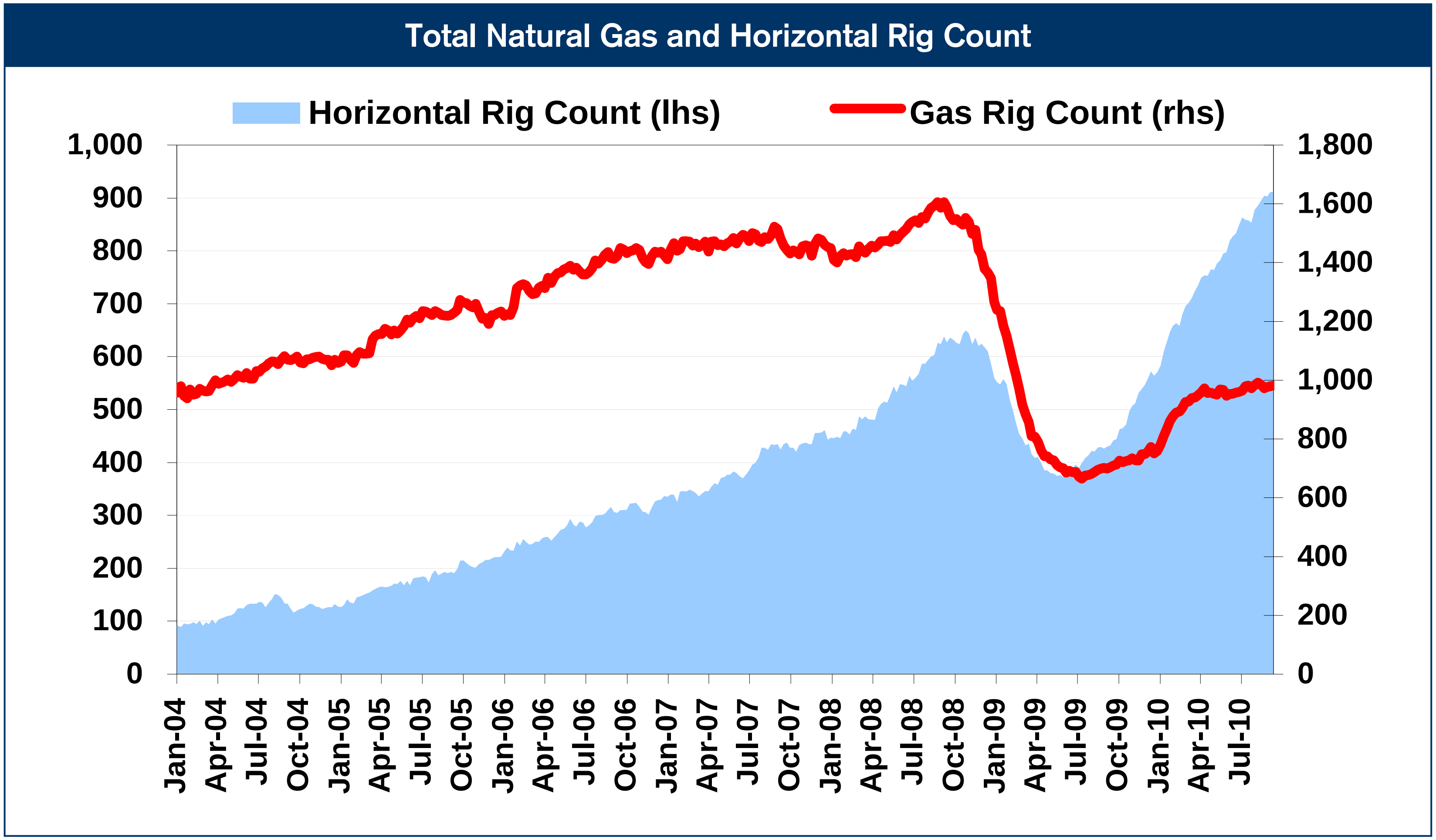
Gas rig count off peak, horizontal at highs

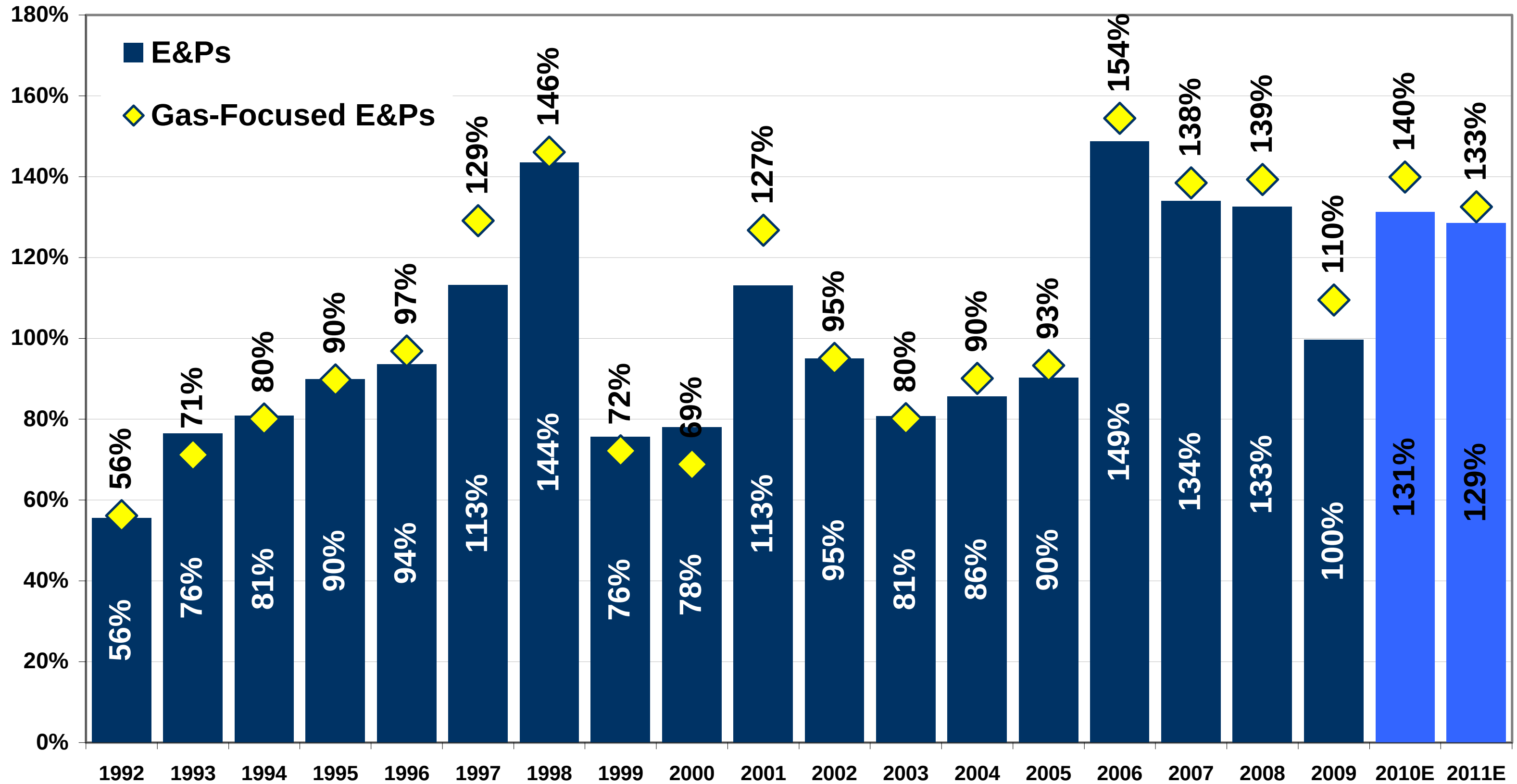


Source: Baker Hughes

- Horizontal Rigs: 912 as of 9/17/10 and 40% above the 2008 peak of 650 set on 10/31/08.
- Gas Rig count now at 982 as of 9/17/10, up 48% from 2009 trough of 665 on 7/17/09.

Overinvestment hurting U.S. gas prices

Historical E&P Plowbacks (Organic Plus Unproved Acquisition %)

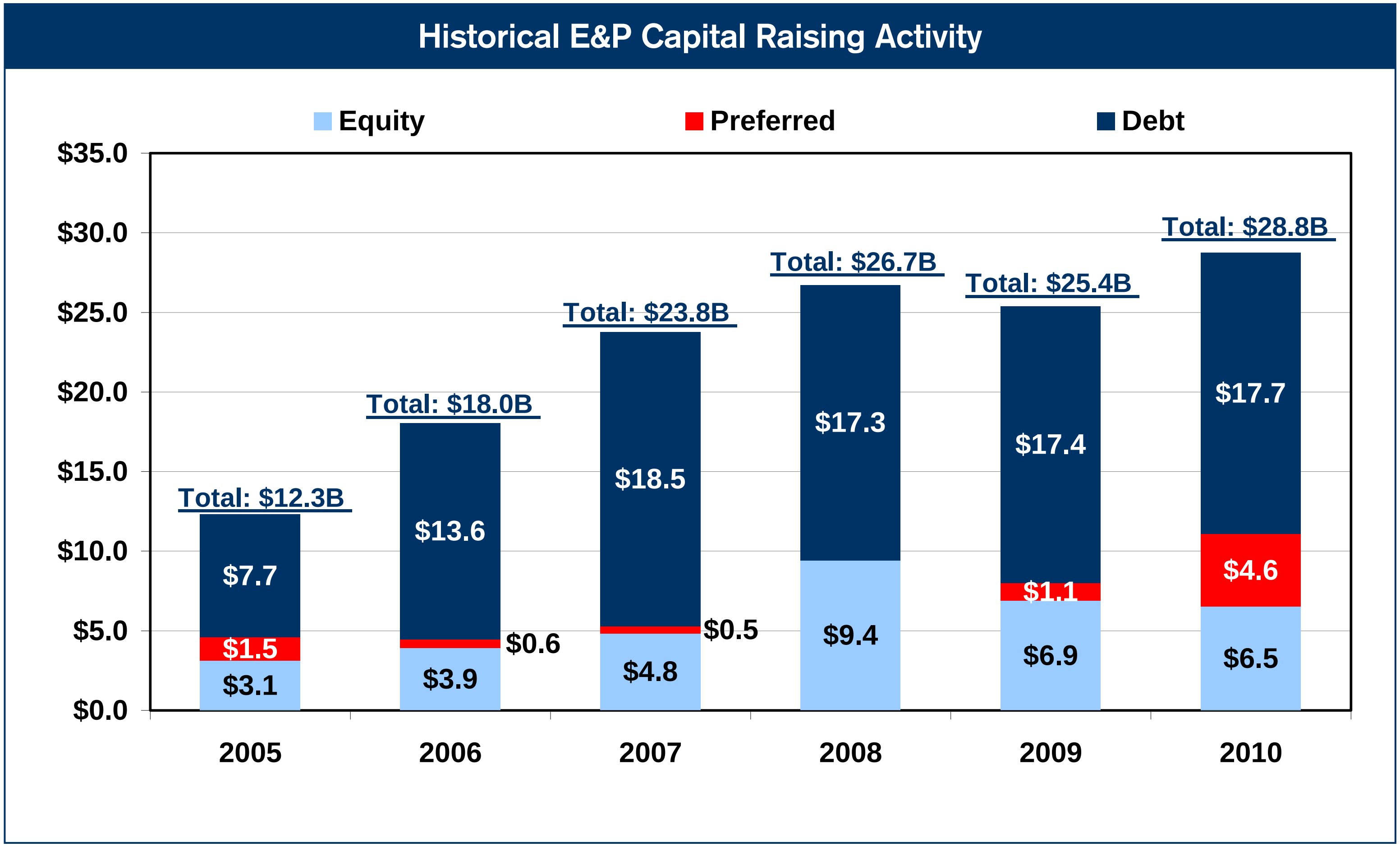


*Represents Exploration & Development (organic) and unproved acquisition capital expenditures as a percent of Cash Flow from Operations

*Based on Credit Suisse pricing of $76.98/$4.72 in 2010 and $72.50/$5.25 in 2011

Source: Company Data, Credit Suisse estimates

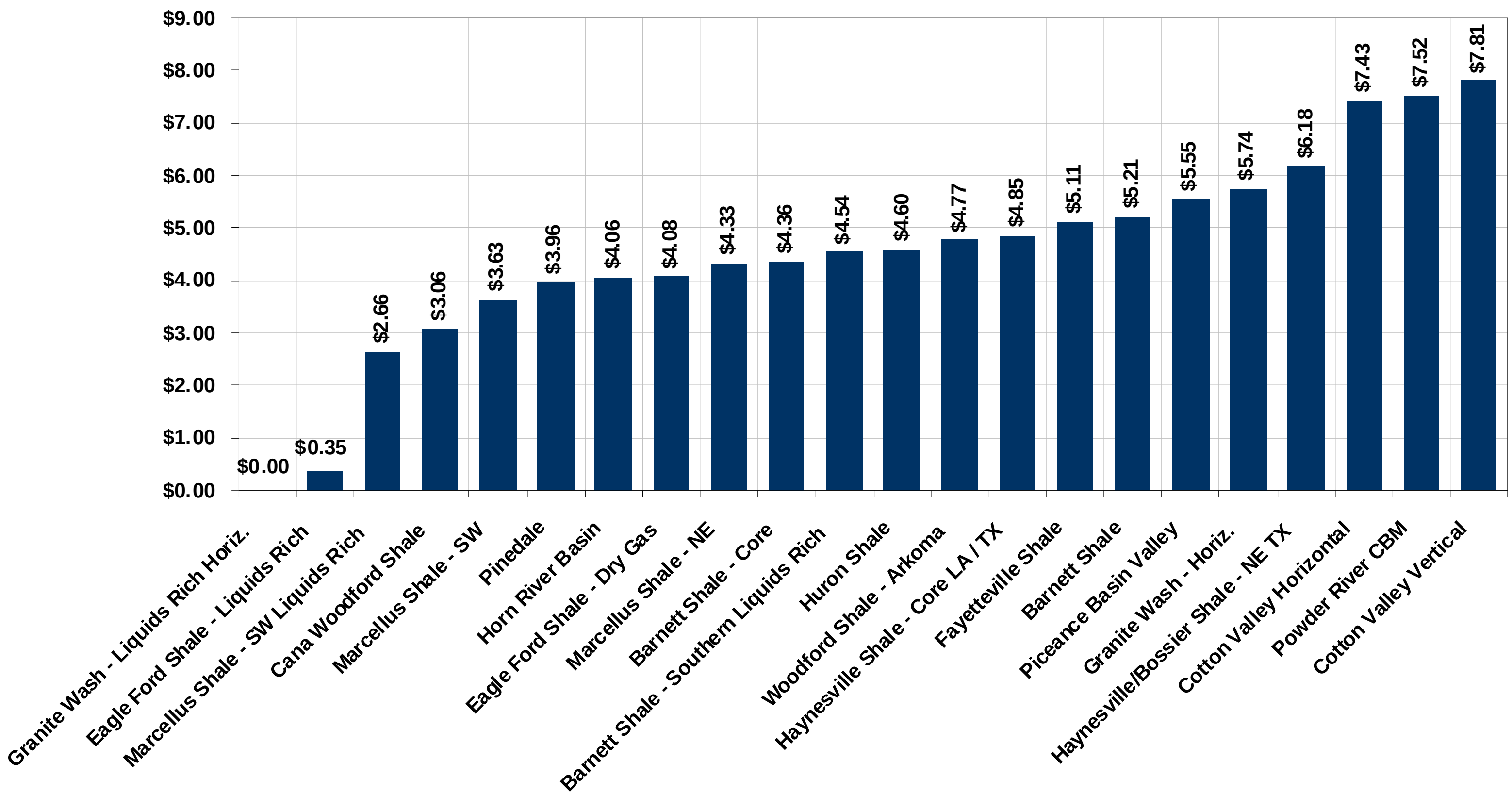
Equity and debt markets have been funding E&Ps



Source: Bloomberg, Company data, Credit Suisse estimates

Most shale gas plays work below $6.00 per MMBtu

Basin by Basin Natural Gas NYMEX Breakeven Prices for 15% ATAX ROR ($ per MMBtu)

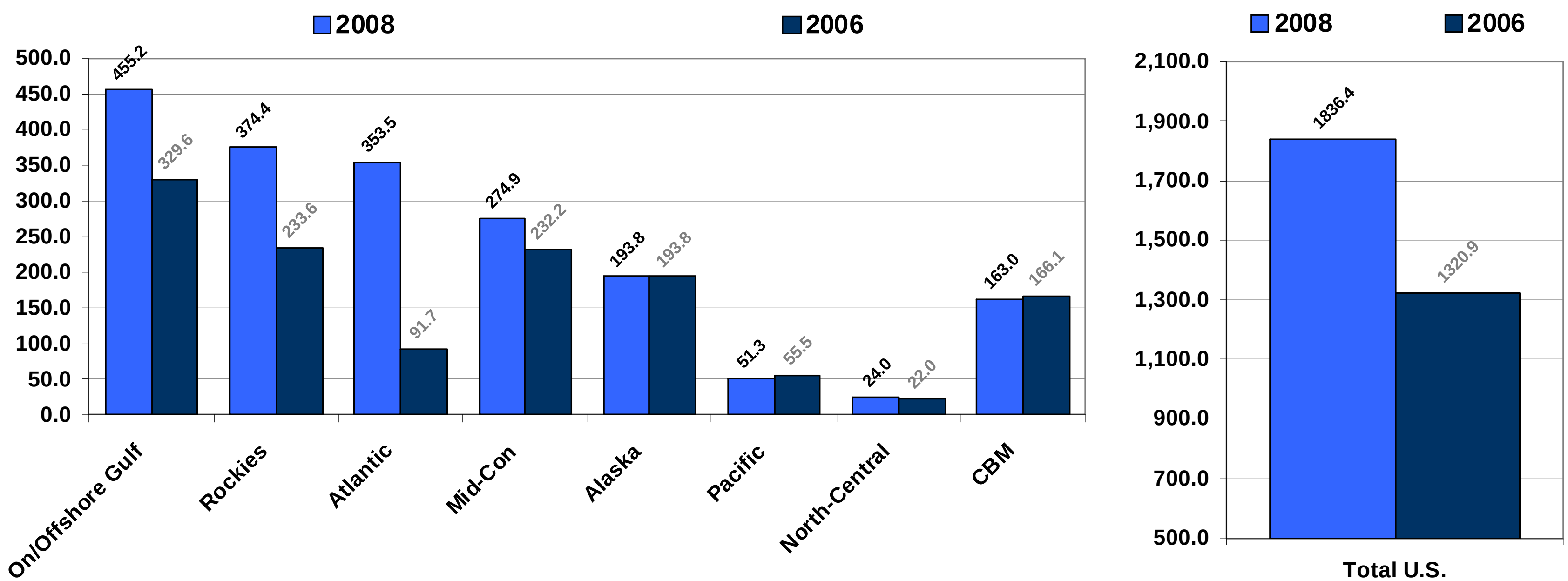


Note: Using $80 per Bbl Crude Oil

Source: Company data, Credit Suisse estimates

U.S. resource base much larger than proved reserves

U.S. Natural Gas Resource Potential (Tcf)

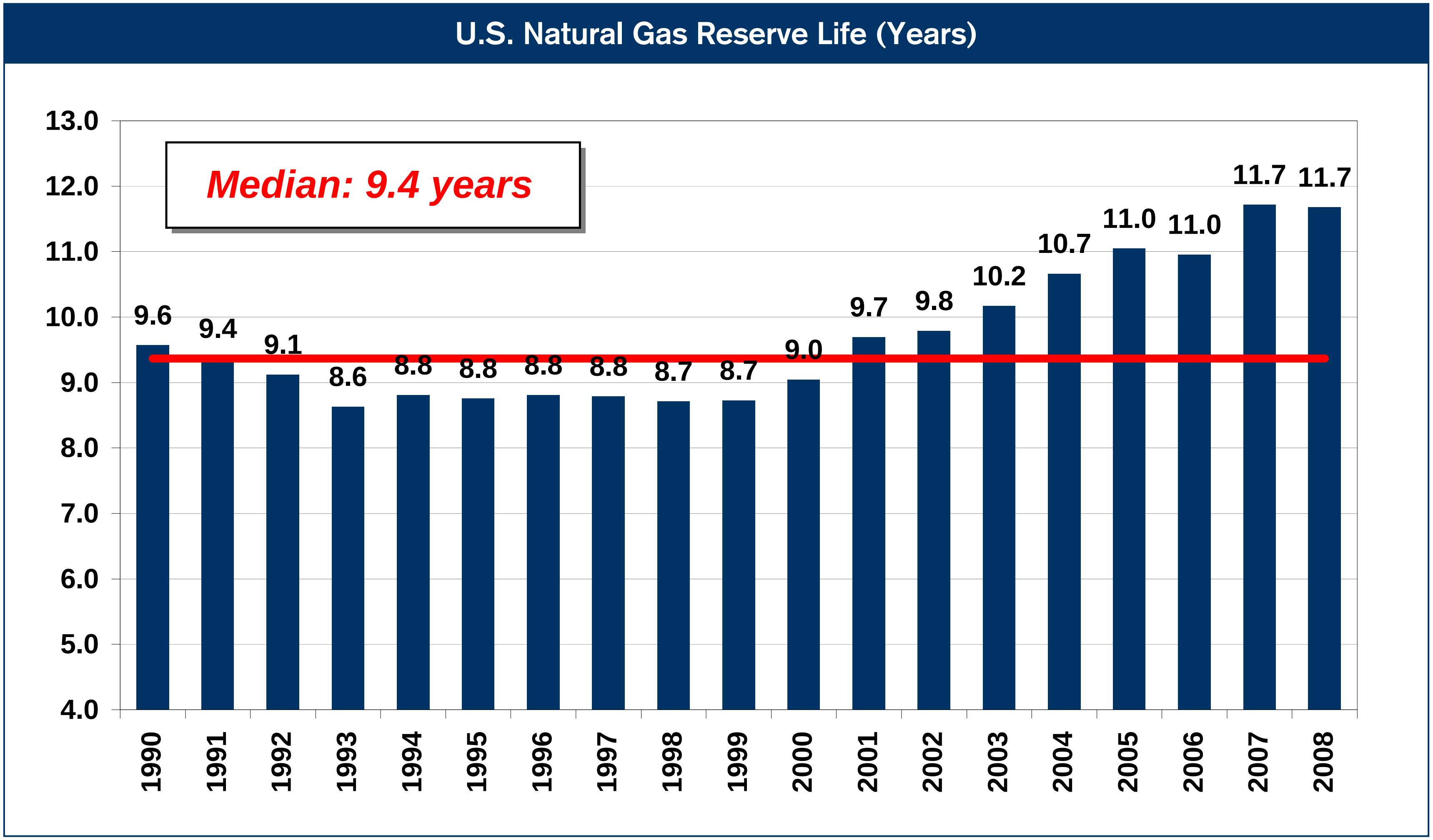


* Mean values of total resources for the seven areas are *not* arithmetically additive in deriving Total U.S. Traditional Resources.
** Latest available figure is for year-end 2007.
Note: Totals are subject to rounding and differences due to statistical aggregation of distributions.

Source: Potential Gas Committee

- U.S. natural gas as a proved reserve life of 11.6 years based on current dry gas production and 84.8 years when including unproved reserves.

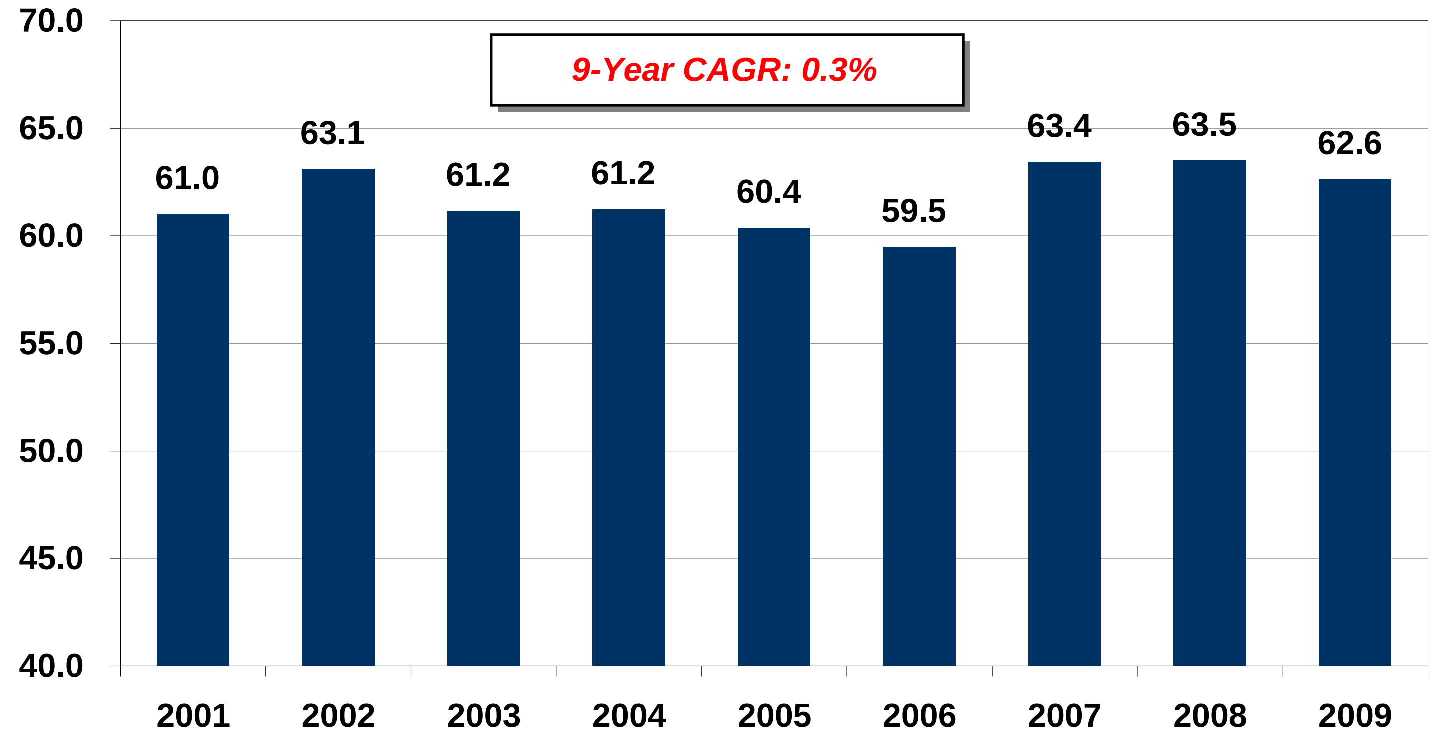
Natural gas reserve lives up on shale development



Source: EIA

Total gas demand has been flat since 2001

Historical Total Natural Gas Demand (Bcf/d)



Source: EIA

Prefer Cleaner Generators in Dirtier Markets

We see EPA rule making to limit conventional coal plant polluters as a potentially transformative event for the power sector and related industries. We assume:

- 60 GW of uncontrolled coal generation is closed
- Closures occur ratably from 2013-17, extending EPA mandated timelines
- $100 BN + of capex for remediation through retrofitting coal plants and building replacement generation
- The power market recovery is accelerated by 4 -5 years
- Coal demand could fall 157 – 324 MM tons
- Natural Gas demand could grow 1.8 – 3.7 TCF on a 22 TCF market
- Regulated utilities annual growth rates could rise by 1- 4%

We favor FE-AYE and RRI to take advantage of EPA action

Source: Credit Suisse estimates, Factset

Disclosures

Companies Mentioned ***(Price as of 29 Sep 10)***

Allegheny Energy Inc. (AYE, $24.29, OUTPERFORM, TP $28.00)
Alliant Energy Corp. (LNT, $36.36)
Ameren Corp. (AEE, $28.37)
American Electric Power Co., Inc. (AEP, $36.72, OUTPERFORM, TP $40.00)
Black Hills Corporation (BKH, $31.18)
CenterPoint Energy, Inc. (CNP, $15.84)
Central Vermont Pub Serv (CV, $20.20)
CMS Energy (CMS, $18.02, OUTPERFORM [V], TP $17.50)
Con Edison (ED, $48.50, NEUTRAL, TP $48.00)
Constellation Energy Group Inc. (CEG, $32.56, RESTRICTED)
Dominion Resources (D, $44.19, NEUTRAL, TP $39.00)
DPL (DPL, $26.19)
DTE Energy (DTE, $45.98, NEUTRAL, TP $47.00)
Duke Energy (DUK, $17.94, NEUTRAL, TP $17.00)
Edison International (EIX, $34.77, NEUTRAL, TP $37.00)
El Paso Electric Co (EE, $23.63)
Entergy Corporation (ETR, $77.56, NEUTRAL, TP $81.00)
Exelon Corporation (EXC, $43.04, NEUTRAL, TP $47.00)
FirstEnergy (FE, $38.34, OUTPERFORM, TP $43.00)
Great Plains Energy (GXP, $18.81)
Integrys Energy Group Inc. (TEG, $52.27)
ITC Holdings Corp (ITC, $62.48, OUTPERFORM, TP $63.00)
Minnesota Power Inc. (ALE, $36.28)
NextEra Energy Inc. (NEE, $55.01, OUTPERFORM, TP $58.00)
Northeast Util (NU, $29.81)
NSTAR (NST, $39.59)
NV Energy Inc (NVE, $13.02, NEUTRAL, TP $13.00)
OGE (OGE, $40.11)
Pepco Holdings Inc. (POM, $18.75, RESTRICTED)
PG&E Corporation (PCG, $45.55, NEUTRAL, TP $45.00)
Pinnacle West Capital Corp. (PNW, $41.69, OUTPERFORM, TP $40.00)
Progress Energy (PGN, $44.72, NEUTRAL, TP $40.00)
Public Services New Mexico (PNM, $11.49)
Public Svc Ent (PEG, $33.14, OUTPERFORM, TP $36.00)
RRI Energy Inc. (RRI, $3.59, OUTPERFORM [V], TP $6.00)
SCANA Corporation (SCG, $40.46)
Sempra Energy (SRE, $53.93)
Southern Company (SO, $37.52, NEUTRAL, TP $37.00)
TECO Energy (TE, $17.40, NEUTRAL, TP $16.00)
Unisource Energy Corp (UNS, $33.48, NEUTRAL, TP $34.00)
Wisconsin Energy (WEC, $58.46)

Disclosure Appendix

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Neutral (N): The stock's total return is expected to be in line with the relevant benchmark* (range of ±10-15%) over the next 12 months.

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***An analyst's coverage universe consists of all companies covered by the analyst within the relevant sector.*

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Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.

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	Global Ratings Distribution	
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Restricted	2%	

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