

Buy/Sell Rating: 2 – Buy
 S&P 500: 1217

Exelon Corporation

Undervalued Nuclear Electric Generation

<i>Symbol</i>	<i>Price (\$/sh)</i>	<i>26-Jun 2001</i>	<i>Shares (mm)</i>	<i>Market Cap (\$mm)</i>	<i>Net Present Value (\$/sh)</i>	<i>Debt/ Present Value</i>	<i>McDep Ratio</i>	<i>EV/ Sales NTM</i>	<i>EV/ Ebitda NTM</i>	<i>P/E NTM</i>	<i>Div'd NTM (%)</i>	<i>PV/ Ebitda NTM</i>
EXC	63.64	324	20,600	55.30	0.51	1.07	2.6	7.5	13.8	2.7	7.0	

McDep Ratio = Market cap and Debt to present value of oil and gas and other businesses

EV = Enterprise Value = Market Cap and Debt:

\$mm 39,100

Ebitda = Earnings before interest, tax, depreciation and amortization:

\$mm 5,200

NTM = Next Twelve Months Ended March 31, 2002; P/E = Stock Price to Earnings

PV = Present Value of energy businesses:

\$mm 36,400

Summary and Recommendation

We recommend current purchase of the common shares of Exelon Corporation because the company is the largest owner of nuclear power plants whose value is increasing sharply with deregulation of electric generation. Formed less than a year ago by the merger of the regulated electric utilities serving the areas around Chicago and Philadelphia, the company owns some 5% of U.S. generating capacity, a third of it nuclear-fueled. Electricity price at the generation level is already deregulated in Illinois and Pennsylvania subject to phasing out of fixed obligations. Free market values of EXC's generating plants in 2005 may be multiples of current values. At the same time the value of transmission and distribution may not appreciate as much because of continued regulation. Yet financial leverage that is conservative for a power company magnifies the benefit to support a possible EXC stock price four times the current level. The upside potential is great enough to put up with political, economic, financial and business risk.

Value in Unpopular Plants

A potential four-fold movement in stock price implies a gain in market cap of a little more than \$60 billion by, say, 2005. That implies a gain in Ebitda of more than \$7 billion annually presuming a multiple of EV/Ebitda of eight times. EXC generates some 120 million Megawatt-hours annually of electricity from nuclear plants that would have to be priced at an incremental \$60/MWh to generate the implied Ebitda. Our

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hypothetical power environment for 2005 is \$100/MWh and the current price of nuclear electricity may be about \$30/MWh.

The irony is that so far in their history, nuclear power plants probably have not justified their original investment costs. As initially conceived forty years ago, a high capital cost seemed readily offset by low fuel, or operating cost. As a result, power companies supported by regulators binged on nuclear construction. With all the negative political heat directed toward oil and gas producers, plants made from domestic steel and concrete and employing local labor seemed a preferred alternative. Along the way a few environmental issues received greater attention. Changes in regulatory requirements and inflation drove construction costs out of sight. Who will ever forget the bankruptcy of a project by Washington Public Power Systems known by the acronym "Whoops"? Then some operating lapses occurred at places like Three Mile Island, not to mention a well-known tragedy in Ukraine.

In a free market, historical costs do not matter. The costs are sunk as oil and gas producers say. In fact, a fine old nuclear, or coal-fired, power plant in a free market is like an oil well or a gas well in a fine old field. The good ones generate cash forever it seems, possibly at an increasing rate. The value is in the future cash flow, which has little to do with historic cost.

The environmental issue with existing plants is settled for now in our opinion. With a power shortage lurking, the value of current production is too high to shut it down if there is no immediate evidence of a safety concern. .

As for building new plants, the environmental questions are still too open-ended to be overcome at today's power prices. Should \$100/Mwh become the everyday power price in 2005, new nuclear plants may have a chance of being started. Finally, at \$100/MWh, the construction costs of the past decades will have been justified.

Exelon Generation Plans Ambitious Growth

Taking great pride in operating to high standards, Exelon has actually acquired nuclear plants from previous owners at low prices. An affiliate of the company acquired Oyster Creek, the first commercial nuclear plant in the U.S. Similarly Exelon has acquired ownership in a unit of the aforementioned Three Mile Island facility.

The company is also actively building and acquiring fossil fuel fired plants. It has an option to buy the half it does not already own of Sithe, an early innovator in deregulated power generation. Some of the electricity powering the computer recording the keystrokes detailing this analysis may be coming from a Sithe plant in the Boston area.

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Will There Be Too Much New Capacity?

It seems that so many new power plants are being built that one might readily question whether there will be a glut of new capacity. The answer is not that simple because the value of capacity can vary so sharply depending on the peaks of electricity use. We don't take a strong stand on whether there will be a glut of generation capacity.

More important to us is fuel cost. All the new capacity is designed to use higher cost fuel. We are practically certain that natural gas supply will not expand to cover incremental demand from new generation capacity. Instead the generators will outbid inefficient users for the fuel.

Eventually there may be too much new capacity. Then the generation profit in converting natural gas to electricity may be non-existent. Excess capacity is good for consumers. That is the justification of deregulation, to allow competition to drive down margins.

The generation capacity we most want to own in deregulation is the old, low cost, capital-intensive plant. The regulated price has been below the market. As the regulations come off, all generators will receive market prices set by the cost of the marginal supplier. Even if new generating capacity is free, the cost of electricity during times of normal load will still be at least equal to the cost of natural gas. We reckon that during the past twenty years the price of natural gas has been as low as cheap electricity less than ten percent of the time. We don't see the low natural gas prices of the past twenty years returning.

Transmission and Distribution is Exelon's Main Business Today

As excited as we may be about likening an unregulated generating plant to an oil well, generation accounts for just a third of Exelon's current cash flow (see table on page 6). To carry the analogy further, Exelon is more of a refiner/marketer than it is a producer. Thus the question then becomes, "Will higher profits from generation be lost to transmission and distribution?" The answer should be "No." Yet there is the risk of a squeeze in downstream margins. In Illinois, for example, Exelon has fixed obligations to supply existing customers through 2005. In Philadelphia, the obligation extends to 2010. In Illinois Exelon must share any extraordinary profits in the next few years with customers and has the option of applying for price relief if profits decline too much. In Philadelphia Exelon is busily contracting with other suppliers to meet the fixed obligation. We hope that means laying off the obligation to other suppliers to use a colloquial expression of traders.

Meanwhile about a third of customers have switched to an alternate supplier. That is good from the point of view of relieving Exelon of the obligation to supply at a regulated price. Of course, Exelon continues to deliver the electricity generated by another supplier.

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Back to the analogy again, refining/marketing is relatively unregulated. We think the multi-year cycle favors a higher level of profitability for companies in that business for the next several years. Because transmission and distribution remain regulated, the implication is that those operations should be moderately profitable if managed reasonably well. There are obvious risks that regulators and political leaders will take extreme self-destructive action as has occurred in California. Exelon's operations are concentrated primarily in two states thereby implying some political diversification.

Trading Complements Physical Assets

Deregulation of interstate power sales has opened up profitable opportunities for companies like **Enron** to earn a fee on arranging purchases and sales among utilities. Enron makes a point of minimizing its ownership of assets and maximizing its ownership of intellectual capital and information. Yet, trading margins can be fleeting. The profits quickly attract competitors.

Exelon approaches trading with the intention of doing enough to match the needs of customers in its franchise territories. No point in giving away that business to someone else. Exelon further does enough trading to cover the sales of electricity from its own generating plants. As a result we hope that Exelon is smart enough on the downside to avoid a margin squeeze in generation, transmission or distribution and on the upside to capture any unusual profit on the commodity it produces.

Lowest McDep Ratio Among Large Cap Power Companies

Exelon stock fits well in our recommended energy investment strategy to own low McDep Ratio stocks. EXC ranks lowest on that measure among eleven companies (see Tables L-1 and L-2). We believe that low McDep Ratio stocks will provide superior total returns, risk-adjusted, compared to peers. Ideally one buys a low McDep Ratio stock and watches it move up in the ranking. Sometimes it doesn't happen and low McDep Ratio stocks stay low for a long time. It rarely happens that a low McDep Ratio stock has acutely negative relative performance.

The McDep Ratio depends on cash flow, also known as Ebitda, earnings before interest, tax, depreciation and amortization. We capitalize Ebitda to get present value, the denominator of the McDep Ratio. Present value is the amount that a businessperson, as opposed to a securities investor, would pay for a stream of future cash flow. We estimate present value for EXC at the multiple of next twelve months Ebitda that we use for Mega Cap energy companies, the largest international integrated oil companies. We concede higher multiples of cash flow to some other power companies, but not as high as enterprise value implies.

Investors who pay attention to stock price charts may notice that EXC is trading on its rising 200 day moving average. A stock is in a rising price trend by definition if the price stays above the moving average. The current price is the lowest one could pay if the

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stock continues in a rising price trend. If we are surprised and the stock drops in price to break the rising trend, investors would fear that momentum was broken and the rising trend was turning to a declining trend. We think charts are interesting, but do not give us near the confidence to act as does fundamental analysis.

Exelon also looks attractive on the most widely used valuation indicator, earnings. The current P/E is modest at 14 times and management projects growth of 10% annually for the next three years in a declining power price environment. The ratio of P/E to growth rate of 1.4 indicates prospects of superior return. Growth would be a lot higher in the power environment we envision.

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Exelon Quarterly Results

	<i>Q1</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Next</i>
	<i>3/31/01</i>	<i>6/30/01</i>	<i>9/30/01</i>	<i>12/31/01</i>	<i>2001E</i>	<i>3/31/02</i>	<i>6/30/02</i>	<i>Twelve</i>
								<i>Months</i>
Generation sales (GWh)	48,254							
Price (\$/MWh)	34							
Revenue (\$mm)								
Generation	1,628				6,400			
Energy Delivery	2,501				9,600			
Other	(306)							
Total Revenue	3,823	3,211	4,626	3,214	14,874	4,014	3,372	15,226
Expense	2,504	2,104	3,030	2,106	9,744	2,630	2,209	9,975
Ebitda								
Generation	386				3,600			
Energy Delivery	951							
Other	(18)							
Total Ebitda	1,319	1,108	1,595	1,109	5,130	1,384	1,163	5,251
Deprec., Deplet., & Amort.								
Generation	93							
Energy Delivery	269							
Other	16							
Total D.D.&A.	378	378	378	378	1,512	378	378	1,512
Other Non Cash								
Ebit								
Generation	293				1,000			
Energy Delivery	682				2,500			
Other	(34)							
Total Ebit	941	730	1,217	731	3,618	1,006	785	3,739
Interest	283	283	283	283	1,132	283	283	1,132
Ebt	658	447	934	448	2,486	723	502	2,607
Income Tax	272	185	387	185	1,028	299	208	1,079
Net Income (\$mm)	386	262	548	262	1,458	424	294	1,529
Shares (millions)	324	324	324	324	324	324	324	324
Per Share (\$)	1.19	0.81	1.69	0.81	4.50	1.31	0.91	4.72
Ebitda Margin	34%	34%	34%	34%	34%	34%	34%	34%
Tax Rate	41%	41%	41%	41%	41%	41%	41%	41%

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Table L-1
Mega Cap and Large Cap Energy Companies
Rank by McDep Ratio: Market Cap and Debt to Present Value

	<i>Symbol/ Rating</i>	<i>Price (\$/sh) 26-Jun 2001</i>	<i>Shares (mm)</i>	<i>Market Cap (\$mm)</i>	<i>Net Present Value (\$/sh)</i>	<i>Debt/ Present Value</i>	<i>McDep Ratio</i>
Mega Cap							
Exxon Mobil Corporation	XOM	88.56	3,510	311,000	74.30	0.09	1.17
BP PLC	BP	52.95	3,720	197,000	48.90	0.17	1.07
TOTAL Fina Elf S.A.	TOT	73.19	1,400	103,000	72.00	0.16	1.01
Royal Dutch/Shell	RD	60.09	3,580	215,000	60.80	0.09	0.99
Chevron (incl. Texaco)	CHV	94.70	1,060	100,400	103.40	0.15	0.93
	<i>Total or Median</i>			<i>926,000</i>		<i>0.15</i>	<i>1.01</i>
Power							
Enron Corp.	ENE	44.19	814	36,000	16.90	0.68	1.52
Dynegy Inc.	DYN	42.00	338	14,200	20.60	0.56	1.46
AES Corporation	AES	41.55	538	22,400	15.80	0.73	1.45
Mirant Corporation	MIR	31.95	353	11,300	11.70	0.75	1.44
Calpine Corporation	CPN	38.70	313	12,100	21.40	0.48	1.42
Duke Energy Corporation	DUK	39.84	752	30,000	20.90	0.62	1.35
El Paso Corporation	EPG	52.60	521	27,400	30.00	0.57	1.32
Williams Companies	WMB	32.40	485	15,700	16.60	0.69	1.29
American Electric Power Co. Inc.	AEP 2	45.99	324	14,900	25.90	0.73	1.21
Southern Company	SO	23.35	683	15,900	16.90	0.54	1.17
Exelon Corporation	EXC 2	63.64	324	20,600	55.30	0.51	1.07
	<i>Total or Median</i>			<i>221,000</i>		<i>0.62</i>	<i>1.35</i>
Natural Gas and Oil							
Anadarko Petroleum Corp.	APC	57.03	263	15,000	66.30	0.24	0.89
Occidental Petroleum	OXY	27.82	370	10,300	35.60	0.46	0.88
Burlington Resources, Inc	BR 2	40.35	215	8,700	56.30	0.19	0.77
ENI S.p.A.	E	64.88	800	51,900	91.90	0.10	0.73
Conoco Inc.	COC.B	29.81	623	18,600	48.00	0.21	0.70
Phillips (incl. Tosco)	P	57.88	379	21,900	102.10	0.27	0.68
	<i>Total or Median</i>			<i>126,000</i>		<i>0.22</i>	<i>0.75</i>
Service							
Halliburton Company	HAL	41.13	430	17,700	27.20	0.13	1.45
Schlumberger Ltd.	SLB	54.52	581	31,700	37.70	0.14	1.38

Buy/Sell rating after symbol: 1 - Strong Buy, 2 - Buy

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Table L-2
Mega Cap and Large Cap Energy Companies
Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.

	<i>Symbol</i>	<i>Price (\$/sh) 26-Jun 2001</i>	<i>EV/ Sales 2001E</i>	<i>EV/ Ebitda NTM</i>	<i>P/E NTM</i>	<i>Dividend or Distribution NTM (%)</i>	<i>PV/ Ebitda NTM</i>
Mega Cap							
Exxon Mobil Corporation	XOM	88.56	1.5	8.2	16	2.0	7.0
BP PLC	BP	52.95	1.3	7.5	12	2.6	7.0
TOTAL Fina Elf S.A.	TOT	73.19	1.1	7.1	17	1.5	7.0
Royal Dutch/Shell	RD	60.09	1.5	6.9	15	2.3	7.0
Chevron (incl. Texaco)	CHV	94.70	1.1	5.6	11	2.7	6.0
	<i>Median</i>		<i>1.3</i>	<i>7.1</i>	<i>15</i>	<i>2.3</i>	<i>7.0</i>
Power							
Enron Corp.	ENE	44.19	0.3	15.2	25	1.1	10.0
Dynegy Inc.	DYN	42.00	0.4	13.1	20	0.7	9.0
Calpine Corporation	CPN	38.70	3.7	12.8	19	-	9.0
AES Corporation	AES	41.55	4.1	11.6	21	-	8.0
Mirant Corporation	MIR	31.95	0.7	11.5	16	-	8.0
Duke Energy Corporation	DUK	39.84	0.9	10.8	16	2.8	8.0
Williams Companies	WMB	32.40	3.3	10.3	14	1.9	8.0
El Paso Corporation	EPG	52.60	0.7	9.3	16	1.6	7.0
American Electric Power Co. Inc.	AEP	2 45.99	0.7	8.4	13	5.2	7.0
Southern Company	SO	23.35	2.7	8.2	14	5.7	7.0
Exelon Corporation	EXC	2 63.64	2.6	7.5	14	2.7	7.0
	<i>Median</i>		<i>0.9</i>	<i>10.8</i>	<i>16</i>	<i>1.6</i>	<i>8.0</i>
Natural Gas and Oil							
Burlington Resources, Inc	BR	2 40.35	3.0	5.4	8	1.4	7.0
Anadarko Petroleum Corp.	APC	57.03	2.4	5.4	9	0.4	6.0
Occidental Petroleum	OXY	27.82	1.3	5.3	8	3.6	6.0
Conoco Inc.	COC.B	29.81	0.6	4.2	8	2.5	6.0
Phillips (incl. Tosco)	P	57.88	0.7	4.1	7	2.3	6.0
ENI S.p.A.	E	64.88	1.1	3.7	7	2.5	5.0
	<i>Median</i>		<i>1.2</i>	<i>4.7</i>	<i>8</i>	<i>2.4</i>	<i>6.0</i>
Service							
Halliburton Company	HAL	41.13	1.4	11.6	28	1.2	8.0
Schlumberger Ltd.	SLB	54.52	2.8	9.7	27	1.4	7.0

EV = Enterprise Value = Market Cap and Debt; Ebitda = Earnings before interest, tax, depreciation and amortization; NTM = Next Twelve Months Ended March 31, 2002; P/E = Stock Price to Earnings; PV = Present Value of oil and gas and other businesses