

# UTILITIES DRESS UP FOR WALL STREET

GRAHAM FLEMING

NEW  
APPROACHES TO  
THE QUARTERLY  
EARNINGS CALL  
BY GARY M.  
STERN

Public utilities are caught in the vortex of change. Many utilities want to build new power plants to increase capacity and yet they face closer scrutiny of their financials and earnings. Others are looking to acquire another company or divest themselves of assets. These pressures converge when public utilities present their quarterly financial results to meet Securities and Exchange Commission requirements. »

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HOW ARE intensifying pressures affecting the quarterly financial presentations of public utilities? After the Enron fiasco, are utilities revealing bad news? *EnergyBiz* asked several energy analysts, investor relations managers and consultants to get some answers. Their responses suggested that some utilities are more open than ever before and some reveal as little as possible.

Over the last five years, Barry Abramson, a senior utilities' analyst at Gabelli Funds, based in Rye, N.Y., has seen utilities' quarterly financial reports become "longer and loaded with more details than ever before." Utilities are providing more detailed financial data on earnings than they have in the past, which he attributes to the effects of Sarbanes-Oxley (SOX) regulations. In fact, utilities are more forthcoming about their operations, the status of their power plants, and even how the weather is affecting their businesses, he suggested.

While SOX regulations have triggered much of this new financial openness, the U.S. Securities and Exchange Commission Regulation FD (Fair Disclosure) is also contributing to this more open atmosphere. Prior to Regulation FD's introduction in October 2000, analysts at larger financial firms or pension funds often had their questions answered earlier and more fully than analysts at smaller firms or individual investors, providing them with an advantage. Regulation FD levels the playing field and says all investors must have equal access to company news and financials, without any preference, or companies can face penalties and fines.

If Marshall McLuhan was right and the medium is the message, then technology is contributing to leveling the playing field and giving investors equal access to company news. Cutting-edge utilities now transmit these earnings calls via teleconferencing and webcasting to analysts, individual investors and large pension funds alike, noted Patty Bruner, Scottsdale, Ariz., managing director at Christensen, an investor relations consulting company, which works with several leading utilities.

But some utilities are revealing only the minimum about earnings and other financial results. Some utilities include "complete income statements in their earnings calls but some offer bare bones earnings releases," explained Justin McCann, a senior industry analyst on the equities side at Standard & Poor's in New York. Ironically, he said, "Some companies give you presentations that are so detailed with information that it becomes indigestible and some companies barely provide earnings statements." Other companies send out a brief press release with earnings and don't even make quarterly presentations, he added.

The companies that reveal little are damaging their reputations with analysts. McCann noted that, "For me, bare bones is much worse than an absence of a conference call. Unless the company is particularly attractive for its

earnings per share growth or its yield, one would be hesitant to recommend it to an investor." When a utility provides little information on earnings growth and future plans, analysts don't have enough data to recommend it. Hence, if investors follow the analysts' recommendation, utilities that reveal little are limiting their investor pool and shooting themselves in the foot.

When Enron's earnings were dipping, it concocted a series of false deals to cover up its losses. How are most utilities publicizing bad news in 2007? In reporting bad news, Abramson has seen a major shift for utilities in the post-Enron years. "Many utilities are much more forthcoming. It seems the one thing they want to avoid is a big unpleasant surprise and they would prefer that the market become aware of something negative at an early stage," he said. Analysts can then incorporate the "bad

news" into their earnings predictions and valuations, preventing any major devaluation.

For example, when American



▲ **Patty Bruner**, managing director at Christensen, an investor relations consulting company



► **Justin McCann**, a senior industry analyst on the equities side at Standard & Poor's in New York

Electric Power (AEP) in April 2006 suffered an initial setback in legal rulings by the Texas District Court regarding recouping \$1.8 billion in stranded recovery costs, it brought these issues out in the open in a press release and at a follow-up earnings call, said Julie Sloat, vice president of Investor Relations at AEP, based in Columbus, Ohio. "It's important for us to be transparent about new information and provide timely reporting. Bad news or good news, we handle them both the same," she added.

Though analyst McCann won't identify the utility, he recalled one company with European operations, which was rumored to be lowering its dividend. It came to New York, presented its case to analysts, denying the dividend would be cut, and then six months later cut the dividend

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by 80 percent. Its stock was slammed. "It left them with considerable egg on their face," McCann noted. He is quick to add that many leading utilities are forthcoming about revealing bad news, which helps them in the long run.

AEP has expanded what it reveals in earnings calls. During the Enron scandals, AEP, which also did futures trading, received its share of scrutiny and some negative press. Learning from that incident, AEP has focused on "communicating information as transparently as possible to investors so they can make a sound investment decision," Sloat noted. AEP includes quarterly updates on "what level of earnings/revenue was associated with mark to market contracts and the credit quality of counter parties," she said.

Analysts want to know about major business developments, suggested Becky Johnson, manager of Investor Relations at Alliant Energy, based in Madison, Wis. Over the last few years, Alliant "has been streamlining our portfolio of regulated businesses and engaging in asset sales," she said. Alliant keeps analysts informed of the progress of sales and what the utility will do with the proceeds.

Even with utilities that are open at releasing data, analysts and investors still dig deeper into issues such as capital expenditures. For example, Abramson noted that capital-spending programs often trigger many questions about how much money was spent on construction this quarter and the next three quarters. Analysts invariably ask how much progress has been made, and when completion is expected. Was the utility able to obtain the necessary equipment and skilled labor because of the severe competition over them?

For example, when AEP announced that it was investing \$3.8 billion in construction of new power plants and maintenance of power plants in 2007, analysts probed the status and progress of its investments. Analysts "want to track the progress of the construction and want to know our ability to earn a return on the capital investment," Sloat noted.

Since analysts base their forecasts on growth projections, they are constantly seeking guidance on future revenues in the next quarter and beyond, Abramson said. "Just reporting results from this quarter isn't enough. Analysts want to look ahead and seek additional explanations for next quarter's projections," he said.

Concerning those future projections, Bruner, who has consulted for Portland General Electric, MDU Resources, and Carolina Power & Light, said utility executives are extremely careful about their future earnings. Most utilities forecast growth in a range, for example, of 5 to 7 percent increases in the next quarter, Bruner said. CEOs and CFOs recognize that if the utility doesn't meet these projections, "they can get punished for not performing as they communicated," Bruner said, suggesting that the stock price will dip if revenue predictions aren't met.

Anticipating an analyst's questions is critical for a utility during these earnings calls. Sloat noted that at AEP, senior

executives anticipate what questions will be asked on a chart and prepare answers prior to the presentation. For example, when AEP recently faced a regulatory issue in Indiana regarding a court's rejection of depreciation rates for its plants and equipment, which would have an impact on earnings in the future, AEP explained how much this cut into earnings.

In presenting their quarterly financials, most utilities focus on the key drivers of results and earnings, Bruner said. What is driving the revenue, and what new forces are operating? Did a hot summer cause more people to use air conditioning, which spiked quarterly revenues? Have stock options expensing affected revenue this quarter? Were there any major news announcements, such as an acquisition or divestiture, that boosted or lowered earnings this quarter?

While most acknowledge that what happened with Enron could occur again, the odds of it happening again are slimmer. "Companies are not going to manipulate any numbers. They realize that the risk is too great," Abramson said.

## MOST UTILITIES ARE DOING A GOOD JOB OF KEEPING US INFORMED ...

The effects of SOX and Regulation FD are now incorporated into how most utilities present earnings at these quarterly updates, said Alliant Energy's Becky Johnson. "The major sea change occurred five years ago. Since that time, we've become better at becoming transparent and providing the appropriate level of financial information. Now it's business as usual."

Ultimately, what do analysts want to learn from these quarterly earnings calls? Anything that will change or affect future earnings and the stock price, Abramson said. He focuses on two major factors: unearthing "any potential negative events and understanding their magnitude and knowing any potential positive surprises, such as a merger or divestiture, higher earnings or a new transaction."

Analyst McCann said that the best utilities provide considerable data on what analysts really want to know: how nuclear operations are performing, the status of their hedging contracts, a schedule for proposed rate hikes and what percentage of revenue is attributable to renewable energy. "Most utilities are doing a good job of keeping us informed about their capital expenditures and plans," he said. His concerns are with the utilities that send out a skimpy press release on earnings, without revealing much information. ☺





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