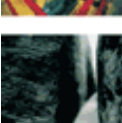


June 2005



E3 Consulting has Moved!

Due to our steady growth, E3 is movin' on up (or down actually) to a larger office space in our current building. On June 13, 2005, E3 Consulting moved into its new offices on the 5th floor of the Bannock Building. Our new address is:

E3 Consulting, LLC
3333 South Bannock Street, Suite 500
Englewood, CO 80110

**Our phone numbers, fax numbers, and email addresses will remain the same.*



E3 Consulting Serves as Independent Engineer on the Weston 4 Coal-Fired Project

With today's high cost of natural gas, a number of electric utilities are opting to build major coal-fired power plants because the cost of coal is sufficiently lower than the cost of natural gas to more than offset the greater capital cost of coal-fired plants.

Continuing load growth and generating unit retirements on the Dairyland Power Cooperative's (DPC) system created the need for a new generating resource in the 2008 time frame. In order to meet this need in the lowest cost manner, DPC negotiated with Wisconsin Public Service Corporation (WSPC) to acquire a 30 percent interest in the 530-MW Weston 4 Project. Permanent financing for DPC's share of the total project cost was obtained from CoBank, using the Rural Utilities Services (RUS) Lien Machine Process to provide security for CoBank's construction financing.

RUS has a first lien on all assets of DPC. In order to provide security for another lender, RUS must approve an accommodation of its lien. RUS has instituted a new procedure to provide a shared first lien under their mortgage to other lenders. This new procedure is titled the "Lien Machine Process" which is an expedited lien accommodation process for qualifying cooperative borrowers that is designed to take approximately 90 days. This Project is the first power facility to use the Lien Machine Process.

E3 provided a critical role in supporting the first application of the RUS Lien Machine Process by conducting the technical due diligence required for the CoBank construction financing. E3 worked closely with the RUS and CoBank to define each participant's needs and provided clear and con-

INSIDE THIS ISSUE

- 1 E3 Consulting has Moved!
- 1 E3 Consulting Serves as Independent Engineer on the Weston 4 Coal-Fired Project
- 3 E3 News & Information
- 2 A New Era for Energy Merchants?
- 4 Q1 Financial Results From Selected Power Companies
- 5 Simulation Analysis: The Best Method of Evaluating Risk in an Uncertain Environment

(Continued page 2)

(Continued from page 1)



Weston 4 unit under construction near Wausau, Wisconsin

cise information in an expedited manner. The E3 report was accepted by RUS without exceptions.

The Project is located at the existing WPSC Weston Generating Station in Marathon County, Wisconsin near Wausau. The Project will be the first new coal-fired supercritical plant constructed in the U.S. in nearly 20 years. The primary fuel for the Project is sub-bituminous coal from the Powder River Basin. The Weston 4 Project is expected to commence commercial operations in June 2008.

Mr. Jim Galambas was E3's project manager for the independent engineering review of the Weston Project. For further information on the Project, please contact Jim at 303-762-7072 or by email at jim.galambas@e3co.com.

A New Era for Energy Merchants?

The first quarter of 2005 saw generally improved, if uneven, financial performance by a number of independent power companies. In their conference calls to present first quarter earnings, several companies observed that they were nearing the end of restructuring programs, with Dynegy's President Bruce Williamson suggesting that we are entering a "New Era" for energy merchants. For Dynegy, which completed the previously announced restructuring of the Independence tolling agreement, settled a contentious class action suit, and placed its mid-stream gas assets up for sale, it was a pivotal quarter. As Williamson said, the company has successfully completed its "self restructuring" program and is now positioned for the "New Era" – which he suggests is an era of industry consolidation.

Other companies are at different stages in the transition to the New Era; however, by their actions it is not clear they are transitioning to the same destiny. AES reported strong revenue and earnings growth, and the company appears perched to continue its expansionist business model, albeit with a much stronger focus on operating efficiency, return on invested capital, and pursuing non-merchant opportunities.

Reliant observed that it is about half way through its program of repositioning the company, and it too is

planning to improve operating efficiencies and to strengthen its balance sheet. Its goal, however, is to become a strong competitor in what it sees as an increasingly competitive U.S. power marketplace resulting from continuing deregulation of the wholesale and retail electricity markets.

With a clean balance sheet and healthy stock price following its successful Chapter 11 restructuring, NRG Energy is poised for growth. In comments reminiscent of Dynegy's Williamson's self-restructuring mantra, NRG's President David Crane said the company cannot wait for better spark spreads or improved weather; instead, he intends to set goals that are within the company's own power to achieve and to grow the company to create greater shareholder value.

Having disposed of much of its merchant business, Aquila is continuing to divest operations to pay down debt, focusing on its regulated business. Tampa Electric and Allegheny are pursuing generally similar paths.

And then there is Calpine. Calpine had a poor quarter, reporting an operating loss of \$169 million. However even before it could report its first quarter loss, Calpine came under pressure following release of a letter to Calpine's Board by a fund investor alleging

(Continued page 3)

(Continued from page 2)

breach of certain of its indenture covenants. Calpine's share price dropped significantly, as did the secondary market prices of its debt securities. At one point, trading in Calpine's shares was suspended on the NYSE and the company was obliged to issue a public statement on April 22nd stating that market rumors were false, that the company was in compliance with its corporate and project indentures, and "further, the company assures the market that it has no plans to file for bankruptcy."

Calpine followed up on its April 22nd press release with a preview of its first quarter results, noting "the first quarter financial results were in-line with our expectations and that we remain on track to achieve our 2005 earnings." The company also reported that its unrestricted cash position was \$800 million, essentially unchanged from December 2004.

Following the company's first quarter earnings call, where company officials seemed dismayed by market events, Calpine announced new strategic initiatives at its annual shareholders meeting. These initiatives were presented as "an aggressive plan aimed at strengthening the company's financial and competitive position." This new initiative, which targets an accelerated debt reduction program of more than \$3 billion by the end of 2005 plus annual cost savings of \$275 million in interest expense and an approximately \$200 million in operating

costs, seemed to reflect a belated recognition by company officials of the limits to debt funded growth. In presenting this initiative to shareholders, Calpine also said it was considering mothballing underperforming power plants and selling other plants (in addition to its previously announced plans to sell its U.K. Saltend plant and U.S. natural gas assets).

Calpine's stated goal is to reduce its debt to approximately 6 times EBITDA, which the company suggests is \$15 billion, as compared to over \$18 billion as of March 31st. It is interesting to contrast this with Reliant's repositioning goal to bring down its net debt to a level equal to 3 times EBITDA, which is even below NRG's forecast of 2005 net debt to EBITDA of approximately 3.5 times. Reliant's goal is based on an assessment that it will need to achieve an investment grade credit rating in order to compete in the expanding competitive marketplace. Calpine, on the other hand, is focused on maintaining sufficient confidence in the financial community to refinance its debt and survive a weak power market.

This focus on EBITDA reflects the conventional financial wisdom that EBITDA is a good measure of internal cash flow, which in turn is a reasonable basis on which to estimate enterprise value. There are, how-

(Continued page 4)

E3 News & Information

Employee Profile

Mark Clements has 35 years experience in the electric utility and management consulting sector, including 15 years experience in generation expansion planning and production cost modeling and 15 years experience in transmission planning and system operations. Mark has helped US and International clients with long term generation expansion plans and with transmission system planning. Mark is also experienced with network service evaluations and with RTO and FERC transmission pricing policies, transmission transfer path evaluation and expansion studies. Mark is an acknowledged expert in transmission issues and has testified for clients at FERC and in transmission litigation matters. Mark has been active in the development of RTO's and has served on the Board of Directors for the Western Regional Transmission Association.

Mr. Clements brings to E3 Consulting unique and broad based experience in power generation, transmission technologies and planning, and RTO and FERC policy experience.

Mark can be contacted at 303.762.7079 or by email at mark.clements@e3co.com.

(Continued from page 3)

ever, reasons to question the reliability of EBITDA in the merchant power industry.

AES for example reported healthy and improved EBITDA; however distributions from its subsidiaries were down marginally as compared to the first quarter of 2004; \$195 million vs. \$204 million in 1Q04. As a holding company, these subsidiary distributions are the primary source for repayment of the company's recourse debt of approximately \$5 billion. To the extent that subsidiary funds are used and/or retained at its subsidiaries, AES' liquidity could be constrained. Of particular concern is the abysmal returns from its South American operations; these operations account for approximately 45% (\$1.2 billion) of the company's reported first quarter revenues, but less than 1% of subsidiary distributions (\$3 million).

Other significant factors ignored by EBITDA are the financial impact of hedging activities and the extensive capital investment requirements of many companies. Reliant, for example, had \$130 million in unrealized energy derivative gains in the first quarter; a gain which largely off-sets unrealized losses reported in 2004. Although Reliant and other companies present an Adjusted EBITDA with their financial

results, removing unrealized hedging gains and losses to provide more meaningful comparisons of performance between periods, it remains difficult to assess the recurring impact of hedging activities on earnings and EBITDA, not to mention the cost of collateral to support trading activities.

As a capital intensive industry, maintenance capital expenditures have a significant impact on company cash flows. Especially for companies with older, solid fuel assets, these costs are likely to go up considerably, making valuations based on EBITDA—even if adjusted for prior year's capital expenditures—problematic.

Of course, at the end of the day, valuation—like beauty—is in the eye of the beholder. Duke is seen by many to have paid dearly in agreeing to acquire Cinergy for \$9.1 billion plus assumed debt; a purchase price in excess of 10 times EBITDA. This merger may validate Williamson's view of industry consolidation; however it might not validate similar valuations for Dynegy—reportedly an NRG acquisition target—or other power companies.

For additional details on the project, you can contact Richard Garcia at (203) 662-6613 or richard.garcia@e3co.com.

Selected Power Companies

1st Quarter 2005 Financial Results

EARNINGS	Notes	AES	Calpine	Dynegy	RRI	NRG	Allegheny	Aquila	TECO
Revenues		2,645	2,213	1,449	1,937	601	754	651	685
% Δ from Q01 2004		17%	9%	-13%	16%	0%	3%	18%	11%
Operating Income	(a)	350	74	(324)	73	46	180	52	80
% Δ from Q1 2004		74%	64%	NM	240%	-62%	7%	NM	54%
Net Income (Loss)		133	(169)	(262)	(25)	23	43	1	33
% Δ from Q1 2004		177%	NM	NM	NM	-25%	28%	NM	1208%
EBITDA	(b)	950	244	(243)	59	154	261	98	206
% Δ from Q1 2004		18%	-19%	NM	-49%	-40%	48%	NM	22%
EBITDA / Revenues		36%	11%	NM	3%	26%	35%	15%	30%
EBITDA / Interest Expense		2.03	0.70	NM	0.56	2.76	2.76	1.68	2.73

(a) Source: Wall Street Journal.

(b) Reported Adjusted EBITDA, except for AES and TE which are calculated from reported income statements.

Simulation Analysis: The Best Method of Evaluating Risk in an Uncertain Environment

In the recent past energy companies and their banks invested in projects that had a much higher probability of failure than was reflected in their analysis. Their analysis underestimated the likelihood of a bust occurring after the 1990's boom cycle. The bust did happen, which destroyed many of the company's credit ratings and made it impossible for many projects to generate sufficient cash flows to service debt requirements.

The industry decision-makers relied on a "Base Case plus several Sensitivity Cases" methodology that failed to produce a true picture of the risk profile facing the capital providers. Decisions were based on a few select snap-shots of possible outcomes without understanding the relative likelihood of the occurrence of those outcomes.

The go-forward decision shouldn't be based solely on the combination of:

- *an expected case that meets target requirements, and*
- *downside sensitivity case scenarios that are trumped by the expected/best cases.*

Simulation Analysis would have produced a truer picture of the risk profiles of those projects and lead to better decisions. As compared to the "worst-expected-best" case scenarios, the simulation outcomes:

- *are likely to be different, and, more importantly*
- *should be more correct since uncertainty associated with key input variables has been much more rigorously defined.*

Simulation Analysis will objectively and more accurately depict the probability distribution of possible outcomes (i.e., the project's risk profile) to:

- *(especially during the boom time) avoid participation in projects whose objective risk profile is unattractive, and*
- *(especially during the bust) avoid the divestiture of assets (at a considerable loss) who have an attractive NPV probability distribution as compared to prevailing market prices.*

The Simulation Analysis results are easier to understand than those from a traditional analysis because a probability distribution is a graph - you can see the probabilities and get a feel for the risks involved. Decision-makers for capital providers should see the probability distribution of all the likely outcomes to understand the risk profile of the investment.

Capital providers should now consider performing simulation analysis on existing investments to provide a clearer picture of the portfolio's risk profile.

Joe Mendez, Executive Consultant with E3, has developed simulation analysis for a number of single and multi-asset valuations. A presentation on simulation analysis is available on E3's website (<http://www.e3co.com/Simulation Analysis.ppt>) or by contacting Joe directly at 713-956-1142 (Houston).