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January 22, 2002

Ms. Blanca S. Bayo, Director
Division of the Commission Clerk and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee FL 32399-0870

Dear Ms. Bayo:

RE: Docket No. 010949-EI

Enclosed are an original and fifteen copies of Gulf Power Company's Rebuttal Testimony to be filed in the above docket consisting of the following witnesses:

Robert A. Bell
Charles A. Benore
Francis M. Fisher, Jr.
M. W. Howell
J. Thomas Kilgore, Jr.
Ronnie R. Labrato
Richard J. McMillan
Robert G. Moore
Margaret D. Neyman
Donald S. Roff
R. Michael Saxon
Tony A. Silva and Scott C. Twery

DNS 00774-02 thru
00785-02

Sincerely,

Susan D. Ritenour
Assistant Secretary and Assistant Treasurer

lw

Enclosure

cc: Beggs and Lane
Jeffrey A. Stone, Esquire

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Request for rate increase by)
Gulf Power Company)
_____)

Docket No. 010949-EI

Certificate of Service

I HEREBY CERTIFY that a copy of the foregoing has been furnished
this 22nd day of January 2002 by U.S. Mail to the following:

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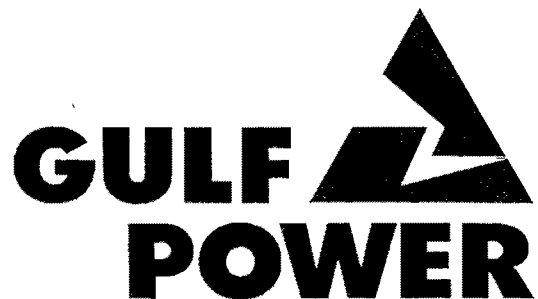


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**BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION**

DOCKET NO. 010949-EI

**REBUTTAL TESTIMONY AND EXHIBIT
OF
CHARLES A. BENORE**



A SOUTHERN COMPANY

DOCUMENT NUMBER-DATE

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FPSC-COMMISSION CLERK

1 GULF POWER COMPANY

2 Before the Florida Public Service Commission
3 Rebuttal Testimony Of

4 Charles A. Benore

5 Docket No. 010949-EI

6 Date of Filing: January 22, 2002

7

8 Q. Please state your name, address and occupation.

9 A. My name is Charles A. Benore and my business address is 125 West
10 Street, Bar Harbor, Maine 04609. I am President of Benore Financial
11 Consulting, Inc., a financial consulting company.

12

13 Q. Are you the same Charles A. Benore who provided direct testimony on
14 Gulf Power's behalf in this docket?

15 A. Yes.

16

17 Q. What is the purpose of this testimony?

18 A. The purpose of my testimony is to respond to the testimony of
19 Mr. James A. Rothschild.

20

21 Q. Have you prepared an exhibit that contains information to which you will
22 refer in your rebuttal testimony?

23 A. Yes. I have prepared Exhibit (CAB-2) consisting of 24 schedules
24 numbered Schedule 12 through Schedule 35.

25

Counsel: We ask that Mr. Benore's Exhibit (CAB-2) consisting
of 24 schedules numbered 12 through 35 be marked
for identification as Exhibit ____.

1 COMMENTS ON THE DIRECT TESTIMONY OF MR. ROTHSCILD

2

3 Q. Do you have any fundamental concerns about the return on common
4 stock equity recommended by Mr. Rothschild?

5 A. Yes, there are several.

6 1. Mr. Rothschild's return on common stock equity recommendation to
7 the Commission will not produce the growth rate and return that he
8 testifies investors require. By definition, therefore, his
9 recommendation is contradictory and flawed.

10 2. He ignored the comparable earnings test, which shows the return
11 on common stock equity expected by investors and embedded in
12 their growth and return expectations.

13 3. He did not recognize the relatively small size of Gulf Power
14 Company and its associated higher business risk in his
15 recommended return on common stock equity.

16 4. He ignored flotation costs even though such costs are real and
17 need to be recognized.

18 5. His schedules contain a number of errors, inconsistencies, and
19 misrepresentations of reasonable investor expectations. These
20 problems with his DCF and CAPM analyses are described in detail
21 later in my rebuttal testimony.

22

23

24

25

1 BROAD ISSUES

2
3 **Mr. Rothschild Made a Contradictory Recommendation to the Commission**

4 Q. Why is there a contradiction between Mr. Rothschild's recommended
5 return on common stock equity for Gulf Power Company (or the investor
6 required market return), and the return that his recommendation will
7 produce for investors?

8 A. Mr. Rothschild used a definition of the cost of common stock which he
9 does not fulfill in the return he recommends to the Commission. He notes
10 on page 21 beginning on line 4 that the cost of common stock is "the rate
11 of return that must be offered to a common equity investor in order for that
12 investor to be willing to buy the common stock." Common sense and
13 investment theory indicate that the return required by investors is the
14 return available to them from other comparable risk investments.
15 Moreover, as indicated by the DCF model, investors expect to have a
16 reasonable opportunity to earn their required market return through a
17 combination of growth in the common stock price that tracks the growth in
18 earnings/dividends plus the dividend yield on the stock.

19 Mr. Rothschild's recommendation stops short of fulfilling investor
20 expectations because he does not provide investors with an opportunity to
21 earn the 10.0% market return he testifies they require. For example, the
22 achievable market return for investors using Mr. Rothschild's 10.0%
23 regulatory return recommendation is only 7.3%. Data supporting this
24 calculation is shown on Schedule 12 of my rebuttal exhibit.

25 This is clearly an untenable outlook for investors. The achievable

1 market return of 7.3% is less than the yield on Moody's "A" rated utility
2 bonds of 7.66% (1/10/02), which are lower in risk. Mr. Rothschild's
3 recommendation of a regulatory return of 10.0% will produce a market
4 return to investors (7.3%) that is lower than the market return (7.7%) on
5 lower risk bonds with a rating comparable to Gulf Power Company. This
6 is an untenable investment prospect for investors.

7

8 Q. What are the expected consequences of adopting Mr. Rothschild's 10.0%
9 return on common stock equity recommendation for Gulf Power
10 Company?

11 A. Mr. Rothschild's 10.0% return on common stock equity recommendation, if
12 adopted by the Commission, would likely drive the stocks toward book
13 value. Based on data shown in Mr. Rothschild's Exhibit JAR 3, the stock
14 price of companies on the list of companies comparable to Gulf Power
15 would need to drop by 39% to reach book value. His recommendation
16 would therefore deprive investors of a reasonable return on their capital
17 and, therefore, repel rather than attract investors. This would in turn
18 jeopardize the ability of Gulf Power Company to attract capital and fulfill its
19 customer responsibilities. Clearly such a result is contrary to the public
20 interest.

21

22 Q. What regulatory return on common stock equity is necessary to fulfill
23 Mr. Rothschild's 10.0% achievable market return for investors?

24 A. The necessary regulatory return in order for investors to have an
25 opportunity to earn in the market the 10.0% return that Mr. Rothschild

1 testifies they require is 12.7%, before consideration of flotation costs, and
2 12.9% with flotation costs. Data supporting this calculation is shown in the
3 lower table on Schedule 12 of my rebuttal exhibit, and on Schedule 27 for
4 flotation costs.

5
6 **Mr. Rothschild Wrongly Ignores the Comparable Earnings Test**

7 Q. Please explain why you believe Mr. Rothschild erred by ignoring the
8 comparable earnings analysis in determining his recommended return on
9 common stock equity for Gulf Power Company.

10 A. Mr. Rothschild employed the sustainable growth rate method for
11 determining investor expected growth rates. In its simplest form, this
12 consists of multiplying the expected return on common stock equity ("r")
13 times the retention rate ("b"), which represents the earnings retained to
14 support future growth. It should be clear from the sustainable growth rate
15 formula ($r \times b$) that one of the two elements necessary to determine
16 the growth rate is the expected return on common stock equity.
17 Mr. Rothschild uses the expected return on common stock equity
18 (comparable earnings) for determining the earnings growth of the
19 comparable companies. Yet after concluding his DCF analysis, he
20 ignores the fact that his DCF recommendation relies on comparable
21 earnings to provide the rate of growth used in that analysis.

22 From another perspective, there is a difference between book and
23 market returns. Book returns, such as the return on common stock equity,
24 are generally not the same as market returns (the sum of the growth rate
25 and yield produced by the DCF model) except when stock prices are

1 comparable to book value. Nonetheless, the growth rate in the DCF
2 model is functionally related to the book return on common stock as
3 shown by the sustainable growth rate formula used by Mr. Rothschild.
4 The return allowed by regulators, which is represented by "r" (return on
5 common stock equity) in the sustainable growth rate model, is also a book
6 return. Therefore, the comparable earnings model provides an apple-to-
7 apple method of determining the appropriate regulatory return. The return
8 shown by the comparable earnings model is the return on common stock
9 equity expected by investors and embedded in their expected market
10 return (price growth that tracks "br" plus the yield on the stock).

11

12 Q. What are the strengths of the comparable earnings method?

13 A. The comparable earnings model provides a direct rather than indirect
14 method for assessing the investor expected return on common stock
15 equity. Market based models, such as the DCF model, calculate the
16 investor expected market return, which is different from the book return on
17 common stock equity (except when price and book value are comparable).
18 When stock prices are different from book value, as they are under current
19 market conditions, it is necessary to determine the appropriate book
20 regulatory return on common stock equity to produce the expected rate of
21 growth, and to provide investors with an opportunity to earn their required
22 market return. The comparable earnings method provides this
23 information.

24 From another perspective, the cost of common stock is not the
25 market return shown by the DCF, ERP, and CAPM models, but is the

1 book return the firm must earn in order to produce the investor required
2 market return. "Basic Financial Management," as cited on page 24 of my
3 direct testimony, notes:

4 The cost of common stock: The rate of return the firm must
5 earn in order for the common stockholders to receive their
6 required return.

7

8 **Mr. Rothschild Failed to Recognize that Gulf Power Company's Small Size**
9 **Increases Its Risk Relative to the Comparable Companies**

10 Q. Please explain why size is important in determining the cost of common
11 stock for companies like Gulf Power Company.

12 A. Smaller companies generally lack the resources of larger companies and,
13 therefore, are generally less able to cope with unforeseen events. Further,
14 experience shows that investor returns are materially higher for smaller
15 than larger companies, which is consistent with the proposition that their
16 risk is higher.

17 Ibbotson Associates, which has developed size premiums based on
18 market values, notes on page 107 of its "Valuation Edition, 2001
19 Yearbook," that:

20 One of the most remarkable discoveries in modern finance is
21 that of a relationship between firm size and return. The
22 relationship cuts across the entire size spectrum but is most
23 evident among smaller companies, which have higher returns
24 on average than larger ones.

25

1 Q. What is an appropriate size premium for Gulf Power Company?
2 A. Gulf Power Company's common stock equity is equal to about 4% of that
3 of its parent, Southern Company. Southern Company's market value
4 according to Value Line is \$15.8 billion, and at 4% Gulf Power Company's
5 is approximately \$630 million. The average market value of the
6 companies on the list of companies comparable to Gulf Power is
7 \$5.3 billion, as shown on Schedule 23 of my rebuttal exhibit. Based on
8 the Ibbotson size premium study, the higher return indicated for Gulf
9 Power Company is approximately 0.7%. It is my judgment, nonetheless,
10 that the higher business risk associated with the Company's smaller size
11 is mitigated to a substantial extent by constructive adjustment clauses for
12 fuel, purchase power, capacity, and environmental costs provided by the
13 Florida Public Service Commission. Consequently, the size premium for
14 Gulf Power Company is probably closer to 0.25% than 0.75% in quarter
15 point increments.

16 Although substantially mitigated by constructive regulatory policies,
17 size is still an important consideration, especially since Mr. Rothschild
18 suggests that his 10.0% recommended return would be closer to 9.75% if
19 the Commission chooses to consider the risk mitigation impact of its
20 adjustment clauses.

21

22 **Mr. Rothschild Ignored Flotation Costs Which Are Legitimate Costs That**
23 **Should Be Recognized**

24 Q. Did Mr. Rothschild recognize and make an adjustment for flotation costs?

25 A. No. Because monies invested by investors are reduced by the amount of

1 issuance costs, the amount shown on the balance sheet of Gulf Power
2 Company is less than the amount actually invested by investors.
3 Therefore, a higher return on the reduced amount of investment is
4 necessary in order for investors to have an opportunity to earn the return
5 considered fair by the Commission on the full amount of their investment.

6 Justification for a flotation cost adjustment is provided, and its
7 amount is shown, in Schedule 11 of the exhibit to my direct testimony, and
8 in the lower table on Schedule 27 of my rebuttal exhibit. The adjustment
9 is 0.19%, or 0.2% rounded.

10
11 SINGLE-STAGE DCF ISSUES
12

13 Q. Please describe the single-stage DCF model used by Mr. Rothschild.

14 A. The single-stage DCF model used by Mr. Rothschild employed a
15 sustainable growth rate ($br + sv$), with a yield based on the indicated
16 dividend per share adjusted by one-half of the growth rate. Flotation costs
17 and transformation were ignored. Using the average stock prices for the
18 year ending 11/30/01, Mr. Rothschild's result for the comparable group of
19 companies identified in my direct testimony was 8.86%, and his result for
20 Southern Company was 9.60%. Using stock prices for 11/30/01, his
21 results were 9.63% and 9.64% respectively.

22
23 Q. Please summarize the problems you found in Mr. Rothschild's single-
24 stage DCF analysis.

25 A. I found three categories of problems: data errors, inconsistencies, and

1 misrepresentations of reasonable investor expectations.

2

3 Q. Please identify the data errors you found in his analysis.

4 A. Using the latest Value Line reports (9/7/01 and 10/5/01) before the
5 11/30/01 prices shown in his study, I found the following data errors in
6 Mr. Rothschild's single-stage DCF calculations:

- 7 1. JAR 3, Page 1: The average price to book value using average
8 prices for the comparable group is 1.87 not 1.92.
- 9 2. JAR 3, Page 1: The 11/30/01 market to book value ratio for
10 Southern is 1.45 times instead of 1.71 times.
- 11 3. JAR 3, Page 1: The market to book value ratio for Southern based
12 on average for the year prices is 1.81 instead of 1.90.
- 13 4. JAR 8: The common shares outstanding are incorrect for Progress
14 Energy and TECO Energy.
- 15 5. JAR 8: The growth rate for common shares is incorrect.
- 16 6. JAR 8: Footnote [A] states that 0.40 was used for "s" but footnote
17 [J] on JAR 4 states that 0.30 was used for calculating the
18 sustainable growth rate.

19

20 Q. What inconsistencies did you find in Mr. Rothschild's analysis?

21 A. I found the following inconsistencies:

- 22 1. Mr. Rothschild used Southern Company for this single-stage
23 version of his DCF analysis, but not for his two-stage DCF model
24 analysis.

25

1 2. His two-stage DCF analysis used returns on common stock equity
2 of 12.0%, 13.0%, and 13.5% compared to 13.0% for his single-
3 stage, comparable company analysis.

4
5 Q. Why do you say that Mr. Rothschild's model contains misrepresentations
6 of reasonable investor expectations?

7 A. I say that because:

- 8 1. Mr. Rothschild used a book value for Southern Company that
9 apparently includes Mirant, a company that was spun-off from
10 Southern Company in April 2001, well before the preparation of his
11 testimony.
- 12 2. He based his analysis in part on an average of prices over the
13 twelve months ending 11/30/01, despite the efficient market theory
14 that indicates new information is reflected in stock prices almost
15 immediately.
- 16 3. He ignored investor return on common stock equity expectations
17 based on Value Line (13.5%) and Zacks' (14.85%) information and
18 substituted his own lower numbers.
- 19 4. He concluded that the investor required market return is 9.63%
20 based on 11/30/01 prices on JAR 4, page 1. This result cannot be
21 replicated using the DCF model with a sustainable growth rate,
22 which suggests that there may be errors or improper modeling on
23 JAR 4 page 1.

1 Use of Southern Company

2 Q. **The errors and inconsistencies** that you identified are straightforward.
3 Would you be more specific in your comments about the
4 misrepresentations of reasonable investor expectations that you found in
5 Mr. Rothschild's analysis?

6 A. In light of the fact that Mr. Rothschild used Southern Company data which
7 preceded the spin-off of Mirant in performing his single-stage DCF
8 analysis, I did not review his analysis of Southern Company. Another
9 reason for not including Southern Company in my review is that
10 Mr. Rothschild did not include Southern Company in his two-stage DCF or
11 CAPM analyses.

12

13 Representative Stock Prices

14 Q. Please explain why you believe it is inappropriate to use stock prices that
15 go back as far as December 1, 2000 to measure the cost of common
16 stock for Gulf Power Company in 2002.

17 A. Mr. Rothschild used average prices for the year-ending 11/30/01 for one
18 of his single-stage DCF analyses. It is generally conceded in this
19 electronic age that investors reflect new information into stock prices
20 almost instantaneously with its release. To assume that average prices
21 over the year ending 11/30/01 are representative of current investor
22 expectations is unreasonable, especially as the electric utility industry
23 incurs distortions associated with the structural change from monopoly to
24 competition. It is my judgment that the 11/30/01 price is the only one of
25 the two he used that is representative of investor expectations for his

1 single-stage DCF analysis.

2 Furthermore, Mr. Rothschild used the price-to-book ratio of 1.7
3 based on 11/30/01 prices for determining the investment cost of the cash
4 flows in his two-stage DCF analysis. It is inconsistent to use average year
5 prices in one part of the analysis and year-end prices in another part.

6

7 Use of Investor Expected Returns on Common Stock Equity Versus Those of
8 Mr. Rothschild

9 Q. You expressed a concern that Mr. Rothschild ignored investor expectation
10 data from Value Line and Zacks and substituted his own judgment about
11 the investor expected return on common stock equity in his sustainable
12 growth rate calculations. Please explain your concern.

13 A. Mr. Rothschild's single-stage DCF model is not based on the investor
14 expectations he shows on JAR 4, page 1. He developed his sustainable
15 growth rate using a return on common stock equity of 13.0% for the
16 comparable company group instead of using the 13.5%, 2004-06
17 normalized level shown by Value Line, and the 14.85% shown by Zacks
18 (footnote [A] on JAR 4, page 1). Presumably the 13.0% represents his
19 judgment after considering the lower returns on average common stock
20 equity for the comparable group in 1999 (12.4%) and 2000 (12.9%) that
21 are also shown on JAR 4, page 1.

22 The problem with Mr. Rothschild's choice of 13.0% is that it is
23 unrepresentative of investor expectations. Whatever informational value
24 investors find in short-term historical data is already embedded in their
25 projected returns on common stock equity. Therefore, weighing historical

1 and projected results essentially double-counts short-term historical
2 guidance. Moreover, short-term historical data adds little value to
3 determining longer-term expectations during abnormal conditions such as
4 those which exist today when the industry is progressing from a monopoly
5 to a more competitive industry structure, and material distortions to
6 earning assets, earnings, and dividends occur.

7 Therefore, Mr. Rothschild should have used investor expected
8 returns on common stock equity of 13.5% and 14.85% in his sustainable
9 growth rate calculations.

10
11 Inability to Replicate Mr. Rothschild's Single-Stage DCF Model Results

12 Q. Using the "br+sv" DCF model, were you able to replicate the 9.63%
13 investor required return shown for Mr. Rothschild's 11/30/01 single-stage
14 DCF growth analysis?

15 A. No. The numbers don't add up. Using stock prices on 11/30/01,
16 Mr. Rothschild claims that the investor required market return is 9.63%.
17 However, when running the 13.0% return on common stock equity, with
18 2001 book value of \$22.76, dividends per share (DPS) of \$1.85, and yield
19 of 5.32% on the forward dividend with an external growth rate of 0.14%,
20 the indicated investor required market return is 10.3%. The calculations
21 supporting this result are shown in the upper table on Schedule 13 of my
22 rebuttal exhibit. Of course, as I explained earlier, the 13.0% return that
23 Mr. Rothschild inputs into his model is not representative of investor
24 expectations in any event.

1 Alternative Measures of the Investor Required Return for Gulf Power Company's
2 Comparable Companies

3 Q. If Mr. Rothschild had used the average of the Value Line and Zacks'
4 projected returns on common stock equity of 14.2% (13.5% and 14.85%)
5 for his sustainable growth rate approach, what would Mr. Rothschild's
6 single-stage DCF analysis show as the investor expected market return?

7 A. Using a 14.2% return on common stock and the book value for 2001,
8 which better corresponds with the 11/30/01 common stock prices than
9 2000 book value, the indicated investor required market return is 11.5%
10 before flotation costs and transformation. Supporting data is shown in the
11 table at the bottom of Schedule 13 of my rebuttal exhibit.

12
13 Q. If Mr. Rothschild had used the average of the five-year earnings growth
14 rates provided by four vendors, and recent, representative stock prices,
15 what investor required market return is shown?

16 A. As noted in the response to Staff Production of Document Request Item
17 No. 55, which requested updated information on the cost of equity, the
18 indicated investor required market return using the most recent data is
19 12.1%, before flotation costs and transformation. This calculation is
20 shown in Schedule 27 of my rebuttal exhibit.

21
22 TWO-STAGE DCF MODEL ISSUES

23
24 Q. Please describe the two-stage DCF model used by Mr. Rothschild.

25 A. Mr. Rothschild's two-stage DCF model determined the present value of

1 investor cash flows, or dividends per share plus the terminal price
2 40 years after initiating the investment. For the first five years, he used
3 the dividends projected by Value Line, and for the next 35 years he
4 essentially used the sustainable growth rate method (br+sv) employing
5 returns on common stock equity of 12.0%, 13.0%, and 13.5%. He then
6 determined the discount rate that equated the cash flows with the
7 purchase price. The discount rate is the market rate of return required by
8 investors.

9
10 Q. Did you find any problems with his two-stage DCF analysis?

11 A. Yes. Again I have categorized the problems as data errors,
12 inconsistencies, and misrepresentations of reasonable investor
13 expectations.

14 Errors:

- 15 1. Mr. Rothschild did not use either the year-to-date average price, or
16 the 11/30/01 price for his analysis, but instead used an artificial
17 price (approximately the ratio of 1/30/01 prices to 2000 book value
18 times 2001 book value).
- 19 2. He used an incorrect 2005 book value for Ameren which caused
20 the average book value for that year to be incorrect.
- 21 3. The previously cited data errors on his Schedule JAR 8 also
22 affected his second-stage DCF analysis.
- 23 4. He erroneously used the retention rate for the first year of the
24 stage-one analysis (41.33%) rather than the retention rate for the
25 last year of that analysis (47.39%) as the rate carried forward into

1 stage two.

2 Inconsistencies:

3 1. He used Southern Company for his single-stage version of his DCF
4 analysis but not for his two-stage DCF model analysis.

5 2. His two-stage DCF analysis used returns on common stock equity
6 of 12.0%, 13.0%, and 13.5%, compared to 13.0% for his single-
7 stage analysis.

8 Misrepresentation of Reasonable Investor Expectations:

9 1. He used his expected returns on common stock equity rather than
10 those of investors.

11

12 Q. Please explain the fourth item that you identified in your list of errors.

13 A. The first stage portion of Mr. Rothschild's analysis used Value Line
14 investor expected data inputs that resulted in a terminal retention rate of
15 47.39% for 2005. In 2006, however, when Mr. Rothschild begins his
16 second stage, he drops the retention rate to the 2001 level of 41.33%.
17 This error effectively institutes a new dividend policy for the comparable
18 companies.

19

20 Mr. Rothschild Used His Own Expected Returns on Common Stock Equity

21 Instead of Those of Investors

22 Q. Did Mr. Rothschild use his interpretation of investor expected returns on
23 common stock equity instead of those provided by investors, as shown by
24 Value Line and Zacks?

25 A. Yes. Mr. Rothschild used expected returns on common stock equity of

1 12.0%, 13.0%, and 13.5% in his analysis in lieu of those provided by
2 investors of 13.5% by Value Line and 14.85% by Zacks. He notes that
3 historical returns were lower and that analysts' estimates have an upward
4 bias in justifying the write down of investor expectations. This is clearly
5 wrong, because in concluding what future returns on common stock equity
6 are expected to be, whatever guidance is provided by short-term historical
7 results would already be embedded in investors' future expectations.
8 Moreover, it is unlikely that investors would pay much heed to short-term
9 historical results as the industry undergoes a structural change from
10 monopoly to competition. Further, investors invest based on their
11 expectations and not on after-the-fact results.

12
13 Q. If Mr. Rothschild had used the correct values for actual current stock
14 prices, investor expected returns on common stock equity provided by
15 Value Line and Zacks, and investor expected dividend policy, what would
16 his two-stage DCF analysis show the investor expected market return to
17 be?

18 A. Using the 13.5% investor expected return on common stock equity
19 provided by Value Line, the indicated market return expectation by
20 investors using a combined internal and external growth rate of 6.54% is
21 11.4% before flotation costs and transformation. Supporting data is
22 shown on Schedule 14 of my rebuttal exhibit.

23 Using Zack's 14.85% investor expected return on common stock
24 equity indicates an investor required market return of 12.0%, using a
25 combined internal and external growth rate of 7.18%. Supporting data is

1 shown on Schedule 15 of my rebuttal exhibit.

2

3

DCF MODEL CONCLUSIONS

4

5 Q. What are your conclusions about Mr. Rothschild's single-stage DCF
6 analysis for the list of companies comparable to Gulf Power?

7 A. Mr. Rothschild's single-stage DCF analysis contained a number of factual
8 errors, misrepresentations of investor expectations, and the numbers
9 shown on his JAR 4, page 1 for 11/30/01 stock prices do not add up. This
10 analysis is badly flawed, and I recommend it not be considered in
11 determining the regulatory return on common stock equity for Gulf Power
12 Company.

13 Using the average sustainable growth rate based on Value Line
14 and Zacks' expected returns on common stock equity, the investor
15 expected market return is 11.5% as shown on Schedule 13 of my rebuttal
16 exhibit.

17 Using an alternative measure based on projected five-year growth
18 rates and representative stock prices, Mr. Rothschild's single-stage DCF,
19 based on the update to my DCF analysis, would show an investor
20 expected market return of 12.1% (see Schedule 27 of my rebuttal exhibit).

21 The 11.5% (Schedule 13) to 12.1% (Schedule 27) investor market
22 return expectations are substantially higher than the 9.63% shown on
23 Mr. Rothschild's JAR 4, page 1, for the list of companies comparable to
24 Gulf Power.

25

1 Q. What are your conclusions about Mr. Rothschild's two-stage DCF analysis
2 for the list of companies comparable to Gulf Power?

3 A. Mr. Rothschild's two-stage DCF analysis contained a number of errors,
4 and misrepresented investor expectations. The most serious of the
5 problems with his analysis is the use of his judgment about expected
6 returns on common stock equity rather than those of investors, artificial
7 rather than actual stock prices for the comparable companies, and the use
8 of an erroneous dividend policy for the second stage of the analysis rather
9 than a continuation of one already in place determined by investors.

10 After correcting these problems, and using the appropriate investor
11 expected returns on common stock of 13.5% from Value Line, and 14.85%
12 from Zacks, the two-stage DCF model indicates an investor expected
13 market return of 11.4% (Schedule 14) and 12.0% (Schedule 15)
14 respectively, before flotation costs and transformation. These expected
15 market returns that are representative of investor expectations are
16 materially higher than the 9.80% shown by Mr. Rothschild on his Schedule
17 JAR 2.

18

19 Q. What is your overall conclusion about Mr. Rothschild's DCF analysis?

20 A. Mr. Rothschild's DCF analysis is badly flawed primarily because he chose
21 to use his judgments about investor expected returns on common stock
22 equity rather than those of investors. Had he used investor expected
23 returns on common stock equity and several other assumptions consistent
24 with reasonable investor expectations, he would have found that the
25 required investor market return was considerably higher than shown in his

1 testimony.

2 Corrected for infirmities, his DCF analysis shows an investor
3 required market return of 11.5% for his single-stage DCF, and a range of
4 11.4% to 12.0% (with a midpoint of 11.7%) for his two-stage DCF
5 analysis, before flotation costs and transformation.

6

7 Q. What regulatory return is necessary so that investors can earn the 11.7%
8 market return indicated by the recalculated two-stage DCF analysis?

9 A. In order for investors to have a reasonable opportunity to earn the 11.7%
10 market return, a regulatory return of 14.2% is necessary. Supporting data
11 is shown on Schedule 16 of my rebuttal exhibit.

12

13 EQUITY RISK PREMIUM ISSUES

14

15 **CAPM, Version One**

16 Q. Please explain the first of two versions of the CAPM used by
17 Mr. Rothschild.

18 A. Mr. Rothschild's first version of the CAPM determined the investor
19 expected rate of inflation (2.0%) to which he added the historic, real
20 market return (6.6% to 7.2%) to determine the investor expected nominal
21 market return of 8.9%, the midpoint of 8.6% to 9.2%.

22 Schedule JAR 9 extends the analysis beyond the stopping point in
23 JAR 2 using the standard form of the CAPM. The real market return of
24 6.6% to 7.2% (not the nominal market return of 8.9%) is reduced by the
25 nominal debt return of 1.33% (not the real debt return of -0.67%) to

1 determine the market equity risk premiums of 5.27% to 5.87%. The
2 5.27% to 5.87% market equity risk premiums were adjusted for the lower
3 risk of the list of companies comparable to Gulf Power compared to the
4 market by using the Value Line beta of 0.52, which indicated an equity risk
5 premium of 2.75% to 3.06%, or what Mr. Rothschild describes as the risk
6 adjusted equity premium. Normally this risk adjusted equity risk premium
7 is added to the debt return to show the market return required by
8 investors. Had this been done, his analysis would show a required market
9 return for the list of companies comparable to Gulf Power of 4.08% to
10 4.39% (2.75% plus 1.33% and 3.06% plus 1.33%), which is of course
11 unreasonable on its face.

12 From another perspective, the last line on his Schedule JAR 9
13 shows a midpoint risk premium applicable to electric companies of 6.23%.
14 To this one would add the debt return, which he shows as 1.33%. The
15 sum, or investor required market return, is 7.56%. In either event, the
16 results are untenable since single A rated utility bonds, which are lower in
17 risk, currently yield 7.66% (Moody's 01/10/02).

18

19 Q. What problems did you observe on his Schedule JAR 9?

20 A. There are several.

21 1. Mr Rothschild was inconsistent on line 9 of his analysis on
22 Schedule JAR 9 when he adjusted the *real* market return by the
23 *nominal* interest rate. It is not appropriate to mix apples and
24 oranges (real and nominal rates) in developing the investor
25 expected, nominal equity risk premium.

1 2. He shows a different conclusion on Schedule JAR 2 than on his
2 Schedule JAR 9.

3 3. He produced untenable results using the standard version of the
4 CAPM.

5

6 Q. What is your overall conclusion about Mr. Rothschild's inflation adjusted,
7 real return method to determine the investor expected market return for
8 the CAPM?

9 A. The analysis is seriously flawed and, therefore, should not be used for
10 determining the investor required market return for Gulf Power Company.

11

12 **CAPM, Version Two**

13 Q. Please describe the second CAPM used by Mr. Rothschild.

14 A. Mr. Rothschild's second CAPM method determined that the historical
15 equity risk premium for common stocks versus long-term Treasury bonds
16 was 4.0%, instead of the 7.3% shown by Ibbotson using the arithmetic
17 average for 1926-2000. Using geometric average returns, he showed
18 1926-1999 returns for various debt securities. He then adjusted these
19 returns by subtracting the long-term Treasury bond return and another
20 amount which he calculated was required to maintain consistency with his
21 equity risk premium of 4% over long-term Treasury bonds.

22 Mr. Rothschild properly acknowledged the problems using Treasury
23 bond yields (flight to quality and perhaps scarcity premiums in Treasury
24 note and bond yields) and therefore used long-term corporate bonds for
25 his analysis. His analysis showed an investor required market return for

1 the list of companies comparable to Gulf Power of 8.94%, before flotation
2 costs and transformation, and a required return of 10.62% for the market.
3 It is not clear why Mr. Rothschild uses the market return for the upper end
4 of his analysis.

5
6 Q. Did you note any errors, inconsistencies, or misrepresentations of
7 reasonable investor expectations, which you believe are present in
8 Mr. Rothschild's CAPM analysis?

9 A. I did not note any errors in Mr. Rothschild's CAPM analysis, but there are
10 some inconsistencies and misrepresentations of investor expectations
11 which are noted below.

12 Inconsistencies:

- 13 1. Mr. Rothschild's yield on JAR 9 for Treasury bills is 1.33% versus
14 1.60% on JAR 10.
- 15 2. He used short-term Treasury bills for his CAPM Version One
16 versus long-term corporate bonds for his Version Two.

17 Misrepresentations of Reasonable Investor Expectations:

- 18 1. Mr. Rothschild inappropriately used the geometric average instead
19 of the arithmetic average Ibbotson Associates' data to determine
20 investor expectations.
- 21 2. He inappropriately used a 4 percentage point equity risk premium
22 relative to long-term Treasury bonds to represent investor
23 expectations.
- 24 3. He failed to recognize that empirical studies show the standard
25 CAPM model understates the investor expected return for low beta

1 stocks and also for small stocks, both of which apply to Gulf Power
2 Company.
3 4. He improperly represented data from the Credit Suisse First Boston
4 (CSFB) study in supporting his analysis.
5

6 The Arithmetically Derived Equity Risk Premium Provides the Correct
7 Assessment of Investor Expected Returns

8 Q. Why is it wrong to use geometric measures of historical returns to reflect
9 investor future return expectations?

10 A. Ibbotson Associates, the source of Mr. Rothschild's data, states on
11 page 61 of its "Valuation Edition 2001 Yearbook":

12 The equity risk premium data presented in this book are arithmetic
13 average risk premia as opposed to geometric average risk premia.
14 ***The arithmetic average equity risk premium can be***
15 ***demonstrated to be most appropriate when discounting future***
16 ***cash flows.*** For use as the expected equity risk premium in either
17 the CAPM or the building block approach, ***the arithmetic mean or***
18 ***the simple difference of the arithmetic means of stock market***
19 ***returns and riskless rates is the relevant number.*** This is
20 because both the CAPM and the building block approach are
21 additive models, in which the cost of capital is the sum of its parts.
22 The geometric average is more appropriate for reporting past
23 performance, since it represents the compound average return.
24 [Emphasis added.]
25

1 Morin in "Regulatory Finance," page 298, states:

2 This appendix shows why arithmetic rather than geometric means
3 should be used for forecasting, discounting, and estimating the cost
4 of capital. Similar treatments and demonstrations are available
5 from Brealey and Myers (1991), Ibbotson Associates (1993), and
6 Litzenberger (1984). This appendix draws from the three
7 aforementioned sources, particularly the latter.

8
9 By definition, the cost of equity capital is the annual discount rate
10 that equates the discounted value of expected future cash flows
11 (from dividends and the sale of the stock at the end of the investor's
12 investment horizon) to the current market price of a share in the
13 firm. The discount rate that equates the discounted value of future
14 expected dividends and the end of period expected stock price to
15 the current stock price is **a prospective arithmetic**, rather than a
16 prospective geometric mean rate of return. Since future dividends
17 and stock prices cannot be predicted with certainty, the "expected"
18 annual rate of return that investors require is an average "target"
19 percentage rate around which the actual, year-by-year returns will
20 vary. **This target rate is, in effect, an arithmetic average.**

21 [Emphasis added.]

22
23 From still another perspective, if the utility was expected to earn
24 10% on its common stock equity, after two years one would expect
25 (assuming no dividends or external financing) that its common stock

1 equity would have grown by 21%. However, if the actual rate of growth
2 were 0% in the first year and 20% in the second year, its common stock
3 equity would have increased by only 20%, not 21%.

4 The geometric rate of growth in the second outcome (0% and 20%)
5 is 9.54%. Had one wanted the utility to earn 9.54%, therefore, one would
6 have had to allow a return of 10.0%. Therefore, it is essential that
7 arithmetic returns be used to set returns on common stock equity. Use of
8 the geometric mean return will produce a downward bias in the return on
9 equity necessary to fulfill investor expectations.

10
11 Q. Nonetheless, Mr. Rothschild's position is that the arithmetic mean
12 overstates actual returns received by investors (page 82, lines 4-5), and
13 cites numerous examples (page 83 - 85) that he alleges support the use of
14 the geometric mean to measure the cost of common stock for Gulf Power
15 Company. Please comment.

16 A. Mr. Rothschild is right as far as his supporting evidence goes, but all that
17 evidence relates to the use of geometric returns for presenting historical
18 results, not for estimating expected future results.

19 In my three decades of experience in working with individual and
20 institutional investors, I have never talked to an individual investor who
21 asked me about geometric averages on either a historic or prospective
22 basis. I cannot recall an institutional investor that looked at historical
23 returns calculated with the geometric mean to determine expected future
24 returns. This experience is supported by Value Line which shows even
25 historic returns based on the arithmetic mean.

1 Value Line shows the arithmetic and not the geometric total return
2 in its reports to investors. Value Line notes:
3 We are adding a new box to show "Total Return." On every report,
4 in a box in the lower right hand corner of the stock price chart, we
5 will now show total return for each stock (appreciation or
6 depreciation of the stock plus cash dividends) for the past 1 year,
7 3 years, and 5 years. We will also show the total return of the stock
8 market for the same time periods. The market measure used will
9 be the **Value Line Arithmetic Index**, which is representative of the
10 stock market as a whole, and is an equally weighted price index of
11 all stocks covered in The Value Line Investment Survey.
12 [Emphasis added.]

13
14 Mr. Rothschild Erred by Selecting the Lowest, Round Number Equity Risk
15 Premium Possible Over 1926-2000

- 16 Q. Mr. Rothschild determined that the equity risk premium was declining
17 based on a 30 year moving average of historic equity risk premiums, and
18 provided alleged supporting citations from Federal Reserve Chairman
19 Greenspan and a Credit Suisse First Boston report to investors. Please
20 explain why you believe he erred in using a 4% equity risk premium.
- 21 A. A review of arithmetic, historical equity risk premiums shown in Ibbotson's
22 "Valuation Edition 2001 Yearbook," pages 208-209, for long-term
23 government bond total returns, and pages 198-199, for large company
24 stocks total returns, shown on Schedule 17 of my rebuttal exhibit,
25 indicates that the time period used by Mr. Rothschild for his equity risk

1 premium is the lowest, using the 30 year moving average, for 1926-2000.

2 It is clear that a 4% geometric average return (the chart shows
3 higher equity risk premiums based on arithmetic returns) is not
4 representative of the thirty year moving average over 1926-2000, and
5 Mr. Rothschild should not expect investors to make a similar conclusion.
6 The range of equity risk premiums is 3% to 13% with a range midpoint of
7 8%. The range midpoint of about 8% is a more reasonable investor
8 expectation. It is also reasonably close to the average of the arithmetic
9 equity risk premiums for 1926-2000 of 7.3% based on total return, and
10 7.8% based on the income return.

11

12 Mr. Rothschild Failed to Observe that Empirical Studies Show that the Standard
13 CAPM Understates Investor Required Returns for Low Beta Stocks and Small
14 Companies Like Gulf Power Company

15 Q. Why do you conclude that the standard CAPM understates investor
16 required returns for companies like Gulf Power?

17 A. Virtually all empirical studies of standard CAPM model results show that
18 the CAPM understates the investor required market return for low beta
19 stocks like Gulf Power Company. Additionally, empirical research
20 indicates that the standard CAPM understates expected market returns for
21 small company stocks, which also includes Gulf Power Company. Please
22 see citations on Schedule 9, pages 3 and 4, of the exhibit to my direct
23 testimony.

24 Additionally, electric utility stocks have detached themselves from
25 the market since regulatory restructuring concerns surfaced in 1993.

1 Electric utility stocks have moved sideways as selling pressures
2 overwhelmed buying and caused the stocks to dramatically under-perform
3 the market on a risk adjusted basis. The resulting lower beta does not
4 reflect lower risk, but the adjustment for higher risk. This can be viewed
5 on Schedule 22 to my rebuttal exhibit. This is confirmed by the rising risk
6 assessment for single A utility bonds shown on Schedule 3, page 2 of the
7 exhibit to my direct testimony.

8 Therefore, the beta used by Mr. Rothschild understates the relative
9 risk of the list of companies comparable to Gulf Power compared to the
10 market, and therefore understates the indicated investor required market
11 return.

12

13 The Credit Suisse First Boston Report Does Not Support Mr. Rothschild's Claim
14 that the Market's Expected Equity Risk Premium is 3.7%.

15 Q. Mr. Rothschild cites a Credit Suisse First Boston (CSFB) report to
16 investors that shows an equity risk premium relative to government bonds
17 of 3.7%. Please comment.

18 A. The CSFB report identifies a current market risk premium of 5.3%. The
19 3.7% figure cited by Mr. Rothschild is based on a CSFB "stress test"
20 which assumes that earnings per share growth returns to the post 1948
21 trend, which is described as a conservative assumption. CSFB does not
22 state whether or not it has adjusted for the flight to quality and Treasury
23 buy-back premiums in the yields for Treasury securities at this time, or the
24 unprecedented efforts by the Federal Reserve to mitigate the recession in
25 the U.S. economy through lower interest rates.

1 Accordingly, insufficient information is available from the study to
2 assess whether or not the 5.3% market equity risk premium is
3 representative of reasonable investor expectations. Other issues that are
4 important to assessing the reasonableness of the 5.3% estimate is
5 CSFB's use of the earnings yield as part of the estimation process, an
6 input that CSFB describes in another section of its report as a flawed
7 model, and their assumption that earnings per share will grow after five
8 years at only a 5% rate. This is roughly one-half the rate over the last
9 economic cycle, and investor expectations for the next five years.

10
11 Q. Mr. Rothschild also notes that Federal Reserve Chairman Greenspan
12 expects the equity risk premium to decline. Please comment.

13 A. Because the equity risk premium is volatile from year to year, it is
14 reasonable to consider that Chairman Greenspan may have been thinking
15 of an average of several years. For example, if one thought of the equity
16 risk premium as the average over the last five years, and then moved
17 backward in time adding one year to each new measurement period
18 (5 years, then 6 years, etc.), the results show an equity risk premium for
19 the last five years of about 11%. This method of measurement gives the
20 most recent data more weight than earlier data. It is also clear from the
21 chart showing this method for calculating the equity risk premium that the
22 equity risk premium has been sharply increasing in the 1990s. Perhaps
23 Chairman Greenspan's reference was to these equity risk premiums.
24 Supporting data is shown in Schedule 18 of my rebuttal exhibit.

25 Nonetheless, had he been referring to the equity risk premiums for

1 1998 or 1999 (his comments were made in 1999 according to
2 Mr. Rothschild), the Ibbotson equity risk premium for 1999 was 30.0% and
3 for 1998 was 15.5%. I agree that equity risk premiums were likely to
4 decline, and that is why I have used a much lower level to reflect
5 reasonable investor expectations in my testimony.

6

7 Q. What equity risk premium do you believe investors are using at this time?

8 A. Based on Value Line projections for the Value Line Composite of about
9 1,700 common stocks, the projected total return is 16.9%. Using three
10 different investor growth rate estimates, the expected total return for the
11 S&P 500 is 14.4%. The normalized yield on long-term governments is
12 currently 6.2%. These inputs indicate an expected equity risk premium
13 that averages 9.5%. Supporting data is shown on Schedules 31 and 33 of
14 my rebuttal exhibit.

15

16 Q. If Mr. Rothschild had used Ibbotson's long-term, arithmetic equity risk
17 premiums using both the total return and income return, as well as the
18 projected market returns you noted, what would his CAPM test show the
19 investor required return to be for the list of companies comparable to Gulf
20 Power Company?

21 A. The standard CAPM result would be 10.6% before flotation costs and
22 transformation. It would also be necessary to consider the disconnect of
23 electric stocks from the market which I referenced earlier, and the
24 empirical research that shows beta understates risk for low beta stocks
25 and stocks of small companies.

Accordingly, it is appropriate to use the empirical CAPM shown in my testimony that indicates a required market return by investors of 11.6%, before flotation costs and transformation. Supporting data for the CAPM results are shown on Schedule 33 of my rebuttal exhibit.

CAPM CONCLUSIONS

Q. Please state your conclusions about Mr. Rothschild's CAPM analyses.

A. As stated earlier, Mr. Rothschild's CAPM Version One is seriously flawed and, as presented, does not provide useful guidance for determining the investor required return for Gulf Power Company. His CAPM Version Two is biased downward for the reasons previously stated. When corrected to show representative investor expectations, the standard CAPM shows an investor required market return of 10.6% before consideration of the understatement by beta of risk for low beta stocks and stocks of small companies, both of which apply to Gulf Power Company. The empirical CAPM, which partially adjusts for the beta understatement, shows an investor required return of 11.6% before consideration of flotation costs and transformation.

Q. What regulatory return is necessary to produce the average return of 11.1% shown by the standard and empirical CAPMs in your updated testimony?

A. The necessary regulatory return to yield or produce an 11.1% market return to investors is 13.5%. Supporting data is shown in Schedule 19 of

1 my rebuttal exhibit.

2

3

OVERALL CONCLUSIONS ABOUT THE RESULTS

4

OF MR. ROTHSCHILD'S DCF AND CAPM RESULTS

5

6 Q. What are your overall conclusions about the results of Mr. Rothschild's
7 DCF and CAPM analyses for Gulf Power Company?

8

9 **DCF and CAPM Conclusion**

10 A. Mr. Rothschild's DCF and CAPM analyses are flawed from an investor
11 perspective for the reasons noted in the foregoing analysis. Using
12 investor expected returns on common stock equity, his single-stage DCF
13 analysis shows an investor required market return of 11.5%. His two-
14 stage DCF model, with appropriate modifications, shows the investor
15 required market return using Value Line's expected return on common
16 stock equity is 11.4%, and Zacks' 12.0%. My updated DCF analysis for
17 Gulf Power Company using the investor projected five-year growth rate
18 shows an investor required market return of 12.1%. These estimates are
19 before flotation costs and transformation.

20 In order for investors to have a reasonable opportunity to earn the
21 range midpoint of his two DCF model results shown above, or 11.7%, the
22 necessary regulatory return is 14.2%, as shown on Schedule 16 of my
23 rebuttal exhibit.

24 Mr. Rothschild's CAPM Version One has serious fundamental
25 flaws. Therefore, I recommend it not be considered for determining the

1 cost of common stock for Gulf Power Company. His CAPM Version Two
2 when corrected for its infirmities shows an investor required market return
3 of 11.1% before flotation costs and transformation. The necessary
4 regulatory return to produce an 11.1% market return for investors is 13.5%
5 as shown on Schedule 19 of my rebuttal exhibit.

6 Overall, Mr. Rothschild's testimony when amended to reflect
7 reasonable investor expectations, supports an allowed regulatory return
8 for Gulf Power Company of 13.5% to 14.2%, or an average of 13.9%.

9
10 **RESPONSE TO MR. ROTHSCHILD'S COMMENTS ON MY DIRECT TESTIMONY**
11

12 **Transformation, or the Process of Providing Investors with an Opportunity**
13 **to Earn Their Required Return so that Capital Attraction and Reliable**
14 **Customer Service Can Reasonably Occur**

15 Q. Do you agree with the rationale stated in FERC and FCC decisions cited
16 by Mr. Rothschild at page 17 of his testimony for rejecting the use of
17 transformation in setting regulatory returns?

18 A. No. FERC's argument assumes an ability to control the price-to-book
19 value ratio, and that doing so is in the customers' interest. Controlling the
20 price-to-book ratio would be difficult, and would require frequent rate
21 adjustments and administrative costs.

22 More importantly with respect to capital access, when interest rates
23 decline, it reduces the cost of capital not only for electric power companies
24 like Gulf Power Company, but for all securities. This causes prices for all
25 securities to rise. If investors were confronted with two investment

1 opportunities -- one that was going to rise because interest rates are
2 declining, while the other would not because the return and earnings
3 would be reduced in response to the lower cost of capital - - it is clear
4 what the investors' response would be. They would buy the stock
5 expected to rise and reject the stock that is expected to decline in price to
6 its book value. Since declines in interest rates can span several years,
7 capital attraction for regulated utilities could be jeopardized for a
8 considerable period of time.

9 From an investor perspective, this is not an attractive investment
10 proposition. If interest rates are flat, the investor can earn the expected
11 return and is not disadvantaged relative to other stocks. However, interest
12 rates are seldom flat. If interest rates decline, the utility can seek rate
13 relief, and after regulatory lag, presumably increase rates to compensate
14 for the increase in the cost of common stock. Conversely, non-regulated
15 companies can presumably raise prices to offset capital cost increases.
16 On the other hand, if the cost of capital declines, the utility investor will
17 suffer an opportunity cost loss because other common stocks benefit from
18 the decline in interest rates, while it is taken away from investors in utility
19 stocks. Utility stock investors could even experience negative returns if the
20 price decline to book value exceeds the stock's yield.

21 Therefore, there is a serious capital attraction issue with FERC's
22 argument. Because of the indispensable nature of electric service to
23 commerce, jobs, and the quality of life for Gulf Power Company's
24 customers, I believe it is important for the utility to have continuing access
25 to the capital markets in both easy and difficult conditions. This is, I

1 believe, a prerequisite for reliable customer service at reasonable rates in
2 the future. Setting rates at levels that would potentially repel rather than
3 attract investor capital does not in my view serve the public interest.
4

5 Q. Mr. Rothschild's testimony indicates that when stocks are trading above
6 book value, it is reasonable to drive the stocks downward in price to book
7 value? Do you agree?

8 A. Definitely not. He notes on page 19 of his testimony that "If the stock price
9 exceeds book value, a reasonable result of the new rate determination
10 could be for the stock price to decline." Based on three decades of
11 working with investors, I can safely report that investors will not buy a
12 stock that is expected to decline in price.
13

14 Q. Do investors expect regulated utility stock prices to drop in price or to their
15 book values?

16 A. No. If they did, the stocks would already be selling at the lower expected
17 price, or at a price-to-book ratio of 1.0 times.
18

19 Q. Mr. Rothschild also cites a FCC decision on the same issue. Please
20 comment.

21 A. The FCC decision cited by Mr. Rothschild essentially makes the same
22 argument as FERC, and concludes that even though the price of the stock
23 declines, that the Bluefield/Hope criteria are still met. Since interest rates
24 can decline over a considerable period of time when investors would be
25 attracted to stocks other than regulated companies, capital access could

1 be jeopardized which would be adverse to customer interests.

2 As noted in my response to the FERC order, denying investors an
3 opportunity to earn a prospective return comparable to companies of
4 similar risk will repel rather than attract investors, and jeopardize the ability
5 of Gulf Power Company to attract capital and fulfill its customer
6 responsibilities.

7
8 Q. Mr. Rothschild also quotes from the U.S. Supreme Court's Hope decision
9 and notes that the common stock price is the end product of the rate
10 making process, not the front end, and therefore, a reduction in value
11 does not invalidate regulation. Please comment.

12 A. I do not believe the U.S. Supreme Court would sanction a method that
13 would deprive investors on a prospective basis of a reasonable
14 opportunity to earn their required return. To do so would impede the
15 utility's ability to attract capital, ultimately harming the customers it serves.
16

17 Q. What has been the response of regulators to the argument presented by
18 Mr. Rothschild?

19 A. As price-to-book value ratios have risen from about parity in 1985,
20 regulators have been allowing higher returns on common stock equity
21 than indicated by strict application of market-based models, as shown in
22 Schedule 5 of the exhibit to my direct testimony. Over the last several
23 years, the allowed regulatory returns have exceeded the DCF indicated
24 return by 1 to 3 percentage points using the earnings-per-share growth
25 rate version of the model. Regulatory commissions, by allowing higher

1 returns than indicated by market based models, do not appear to have
2 followed Mr. Rothschild's recommendation to deny investors an
3 opportunity to earn a fair market return on their investment by setting rates
4 designed to drive stock prices down toward book value.

5

6 Q. Mr. Rothschild's remaining comments on your testimony begin with a
7 summary on page 63. There he notes that your DCF analysis using the
8 investor expected five-year growth rate is valid only if the growth rate for
9 book value, earnings and dividends are constant. Please comment.

10 A. Mr. Rothschild assumes a degree of specificity that is beyond the normal
11 scope of investor practice. Based on my experience, investors typically
12 use a five-year earnings growth rate in assessing expected market
13 returns.

14 The use of earnings versus dividends is confirmed by a survey of
15 investor practices cited on page 6 of Schedule 7 of the exhibit to my direct
16 testimony. The survey shows that earnings was the top choice among
17 cash flow, book value, earnings, and dividends for the most important
18 variable in valuing a security. Of 297 respondents, only three respondents
19 chose dividends, and only five chose book value. Both dividends and
20 book value were at the bottom of the list among the four choices. If
21 constancy of book value and dividend growth was important to investors in
22 their valuation process one would expect them to be as important as
23 earnings to investors.

24 Moreover, if investors ignored the five-year earnings growth rate
25 because of the lack of growth constancy, and relied instead on the

1 sustainable growth rate favored by Mr. Rothschild, one would reasonably
2 expect that First Call, I/B/E/S, Value Line, and Zacks would all provide
3 sustainable rates of growth. The fact of the matter is that they all supply
4 five-year earnings growth rates. Only Value Line provides a sustainable
5 growth rate, which is based on year-to-year data, and is, therefore, not
6 meant to be applicable to the long-term future.

7 Based on my experience, the sustainable growth rate method,
8 which in its simplest form, consists of just two variables, does not provide
9 investors with the detail they require for making investment decisions.

10 Nonetheless, the difference between using the investor practice, or
11 five-year earnings growth rate, versus the sustainable growth rate
12 preferred by Mr. Rothschild using investor expected returns on common
13 stock equity, is not substantial enough in my view to justify his objection to
14 investor practice.

15
16 Q. If Mr. Rothschild had used the same method as investors for determining
17 expected total return, or investor five-year earnings growth expectations
18 plus the yield, what would the analysis show the investor required market
19 return to be?

20 A. The indicated investor required return would be 12.1%, as shown in my
21 updated DCF analysis on Schedule 27 of my rebuttal exhibit. This result
22 is not substantially different from the 11.5% shown by Mr. Rothschild's
23 single-stage DCF analysis using investor expected returns on common
24 stock equity rather than his, and 11.4% to 12.0% for his two-stage DCF
25 analysis when again using investor return on common stock equity

1 expectations.

2

3 Q. Mr. Rothschild states that use of the five-year growth rate can lead to ever
4 increasing returns on common stock equity. Please comment.

5 A. Mr. Rothschild states that if the earnings per share grow more rapidly than
6 book value, the return on common stock equity will increase. This is true,
7 but the reverse is also true. Further, after determining the investor
8 expected market return, I have used the sustainable growth rate method
9 for the transformation process. Therefore, Mr. Rothschild's concern that
10 the return on common stock equity would continually rise if earnings grow
11 more rapidly than book value, and fall when earnings grow less rapidly
12 than book value is not relevant. Moreover, when using a number of
13 companies instead of just one, as Mr. Rothschild did, there is a chance for
14 offsetting outcomes regarding this issue, since more rapid growth in
15 earnings than book value by one company may be offset by the reverse in
16 another company.

17 From still another perspective, the DCF model results using either
18 the investor return on common stock equity expectation (11.5% using his
19 single-stage DCF, and 11.4% to 12.0% using his two-stage DCF results),
20 or the investor five year earnings growth rate expectation (12.1% shown in
21 the update on Schedule 27 to my rebuttal exhibit) are similar.

22

23 Q. Mr. Rothschild alleges that you failed to take into account a downward
24 trend in risk premiums. Please comment.

25 A. Whether or not one finds a downward trend in risk premiums depends on

1 the data one chooses to examine. The 1926-2000 Ibbotson data shows
2 that equity risk premiums have been rising from about 4 percentage points
3 in the early 1970s to about 11% for the most recent five years ending in
4 2000. Supporting data is charted in Schedule 18 of my rebuttal exhibit.
5 Mr. Rothschild, on the other hand, uses a 30-year moving average as
6 shown in Schedule 17 of my rebuttal exhibit. The latter shows for the
7 most recent 30 years an equity risk premium about 4% in the mid-1990s.

8 Overall, it is best to use the long-term, arithmetic equity risk
9 premium results for the stock market versus long-term governments,
10 which is 7.3% using total returns, and 7.8% using income returns. This is a
11 less arbitrary method than Mr. Rothschild uses. The data go back in time
12 as far as quality inputs are available, and includes many event types that
13 could be considered by investors to the extent that they use long-term,
14 historical data to determine expected equity risk premiums.

15
16 Q. Please respond to Mr. Rothschild's comments on the process that you call
17 transformation in your testimony.

18 A. The problem with Mr. Rothschild's objection is that he does not recognize
19 the difference between book and market returns and improperly equates
20 the investor required market return to the return that the Commission
21 should allow for regulatory purposes. The investor return is a market
22 return and the regulatory return is a book return. When stock prices are
23 materially above book value, as they now are, using the investor required
24 market return as the book regulatory return will not produce the investor
25 required market return. Accordingly, investor expectations will not be

1 fulfilled, and knowledgeable investors will invest their capital elsewhere.
2 This in turn will jeopardize the ability of Gulf Power Company to attract
3 capital and fulfill its customer responsibilities.

4 In fact, Mr. Rothschild is not true to his own analysis of investor
5 required returns. For example, he determined that the investor required
6 market return was 10.0%, but as shown on Schedule 12 of my rebuttal
7 exhibit, a 10.0% return on common stock equity will produce only a 7.3%
8 achievable market return to investors. Therefore, his recommendation
9 contradicts his analysis, since the return he recommends for Gulf Power
10 Company will not enable investors to have an opportunity to earn the
11 return he testifies they require. This is explained in greater detail along
12 with a mathematical example on pages 13-20 of my direct testimony.

13

14 Q. Do you agree with Mr. Rothschild's claim that when transformation is used
15 the higher the stock price, the higher the return on common stock equity
16 that would be recommended?

17 A. No. Mr. Rothschild's claim is wrong, and illustrates that he either does not
18 understand the transformation process, or is unwilling to provide investors
19 with an opportunity to earn their required market return. This is clearly
20 shown in the side-by-side example on Schedule 20 of my rebuttal exhibit,
21 which shows why transformation is necessary. In the first of two
22 examples, or "Price Up-Constant ROE," the expected market return is
23 10.7% based on a return on common stock equity expectation of 13.0%, a
24 price of \$35 for the stock, and a book value of \$25, as shown in Column A.

25 If the price of the stock rises from \$35 to \$40, the investor required

1 market return declines to 10.0% as shown in Column B. The investor
2 expected return on common stock equity in this example does not change,
3 and the required regulatory return continues at 13.0%, instead of
4 increasing as indicated by Mr. Rothschild.

5 Concurrently, if the investor expected return on common stock
6 equity declines to 12.5% from 13.0% in the second example in Column F,
7 while the price also rises from \$35 to \$40, the investor expected market
8 return becomes 9.5% and is consistent with the lower expected return on
9 common stock equity of 12.5% as shown in Column H.

10

11 Q. Are earnings necessarily excessive when prices are above book value?

12 A. No. Mr. Rothschild assumes that earnings are excessive when prices are
13 above book value, and that transformation perpetuates excessive
14 earnings. Mr. Rothschild may think that earnings are excessive, but
15 investors do not, or they would not pay more than book value for regulated
16 utility stocks. Based on investor expectations, the stocks are fairly valued
17 and fairly reflect future cash flows. Cutting the return and earning power,
18 such that common stock prices are driven down to book value would
19 damage investor confidence, repel rather than attract investors, and hurt
20 Gulf Power Company's financial integrity and ability to serve its
21 customers.

22

23 Q. Does transformation protect investors from stock price declines?

24 A. No, transformation does not insulate investors from market risks, but
25 simply provides them with an opportunity to earn their required return.

1 Transformation avoids driving stock prices to book value, thereby
2 enhancing the ability of investors to earn their required return, so that Gulf
3 Power can attract the capital necessary to continue providing reliable
4 electric service in the future.

5

6 **CAPM Analysis**

7 Q. On page 79, Mr. Rothschild raises five objections to your CAPM analysis.
8 Please respond.

9 A. I have previously responded to all but one of these objections earlier in
10 this rebuttal testimony. With regard to the appropriate bond return to use
11 in the CAPM, Mr. Rothschild prefers to use Treasury bills rather than
12 Treasury bonds. However, his CAPM analysis using the Treasury bill
13 results in a return below that of single A utility bonds, which is an
14 untenable conclusion. Investors favor the use of long-term not short-term
15 debt for investment purposes. In my judgment, this is because the long-
16 term Treasury bond better matches the perpetuity term of common stocks,
17 is much more stable than Treasury bill yields, and is much less controlled
18 by the Federal Reserve. The latter point is particularly relevant at this
19 time. Treasury bill yields are very low at this time because of
20 unprecedented rate reductions by the Federal Reserve to mitigate the
21 recession underway in the U.S. economy.

22

23 Q. Mr. Rothschild objects to the use of a five year growth rate in the CAPM
24 because he claims that the base year for establishing the growth rate was
25 a recession year when earnings would be depressed. Please comment.

1 A. Mr. Rothschild fails to recognize that the year 2000 was not a recession
2 year.

3

4 Q. Mr. Rothschild on page 90 reiterates his position that equity risk premiums
5 have been declining using the 30 moving average of Ibbotson's 1926-
6 1999 returns, and that your historic equity risk premium is too high.
7 Please comment.

8 A. Equity risk premiums have been rising as previously noted in my
9 testimony. Comparisons of one method versus that used by
10 Mr. Rothschild are provided on Schedules 17 and 18 of my rebuttal
11 exhibit, both of which employ the same data. Relevant to this issue is the
12 investor expected, market equity risk premiums shown in the update to my
13 testimony on Schedule 33. Investor expected equity risk premiums based
14 on projected market returns for the Value Line Composite and S&P 500
15 (using three different growth rate estimates) average 9.5%, which is
16 almost double the equity risk premium that Mr. Rothschild believes
17 investors expect.

18

19 Q. On page 91, Mr. Rothschild states that Treasury bonds are not risk free
20 since they do not have a zero beta. Do you agree?

21 A. Mr. Rothschild is correct that longer-term investments such as Treasury
22 bonds have more risk than Treasury bills, or higher than a zero beta -- that
23 is, if one can believe that there is no reinvestment risk for Treasury bill
24 investors. Bill versus bond investors must continually roll over their
25 investments, and when interest rates are declining so are bill rates.

1 Meanwhile, the value of the bond is rising as investor required returns
2 decline. The reverse is also true.

3 Even if one assumes that Treasury bonds have more risk than
4 Treasury bills, it is long-term bonds not short-term Treasury bills that
5 investors primarily use. This is because investors prefer comparisons with
6 long-term not short-term bonds because they better match the duration
7 risk of stocks than short-term investments such as Treasury bills.
8 Treasury bill yields are primarily controlled by the Federal Reserve and not
9 investors, and therefore, are not always indicative of investor
10 expectations. For example, not many months ago bill yields were 6%
11 compared to less than 2% currently. Bill yields are also much more
12 volatile than Treasury bond yields. From an investor perspective,
13 therefore, Mr. Rothschild's criticism is without merit.

14

15 Q. Mr. Rothschild's next concern is that your CAPM analysis using a 5.4%
16 yield on long-term Treasury bonds would show an investor expected
17 market return of 9.3% to 10.2%. Do you agree?

18 A. I do not agree that the 9.3% to 10.2% is representative of investor
19 expectations because of the flight to quality and scarcity premiums now
20 present in long-term Treasury bond yields. This is covered in Schedule 8,
21 pages 3 to 6 of the exhibit to my direct testimony.

22 Mr. Rothschild appears to agree. He notes on page 14 and 15 of
23 his testimony:

24 While I normally have made a specific adjustment to the lower the
25 indicated cost of equity for risk specific reasons, in the current

1 marketplace the yields on long-term bonds already reflect the flight
2 to quality caused by uncertain economic times and stimulating
3 effects of the Federal Reserve Board.

4 Again, due to current economic conditions, there are temporarily
5 problems with using treasury securities in a risk premium analysis
6 based upon historic risk premium relationships. Therefore, I have
7 only summarized the results of a risk premium analysis based upon
8 long-term corporate bonds.

9

10 **Comparable Earnings**

11 Q. Mr. Rothschild states that you used higher risk industrial companies for
12 your comparable earnings analysis. Do you agree?

13 A. No. Schedule 10, page 6, of the exhibit to my direct testimony clearly
14 shows that this is not so.

15

16 Q. Please respond to Mr. Rothschild's suggestion that the comparable
17 earnings method does not provide useful information to the Commission.

18 A. As previously noted in Schedule 10 of my direct testimony, and in my
19 comments about transformation in this testimony, the growth rate used by
20 investors is fundamentally tied to their return on common stock equity
21 expectation. When denying the validity of comparable earnings, therefore,
22 one is also denying the growth rate in the DCF model, or the results of the
23 DCF model. Mr. Rothschild should not expect to have it both ways –
24 using the investor expected return on common stock equity, or “r” in his
25 “br+sv” method for his DCF analysis while denying its validity in the

1 comparable earnings method. It is necessary for Gulf Power Company to
2 have a regulatory return comparable to investor expectations so that its
3 common stock can provide investors with the market return they require.
4

5 Q. Does your comparable earnings method overlook the capital attraction
6 standard?

7 A. No. Mr. Rothschild argues that capital is raised at the price of common
8 stock and not its book value, which is correct. However, the price of the
9 stock reflects investor expectations of the cash flows (using the DCF
10 model) they expect to receive. As Mr. Rothschild's testimony clearly
11 shows, these cash flow expectations are driven by the return on common
12 stock equity and the retention rate in the simple form of the sustainable
13 growth rate model. This is clearly shown on Mr. Rothschild's Exhibit
14 JAR 5.
15

16 Q. What is the linkage between the return on common stock equity and the
17 growth rate in the DCF model?

18 A. Each of the transformation schedules accompanying my market based
19 models show the relationship between the return on common stock equity
20 and the growth rate ("br" growth rate, where "b" is the retention rate and "r"
21 the return on common stock equity). The connection or interrelationship is
22 also shown on Mr. Rothschild's JAR 5. Mr. Rothschild states that in
23 implementing his two-stage DCF model on page 46 of his testimony, he
24 "determined future earnings in the second stage of the non-constant DCF
25 model by multiplying the future book value per share by the future

1 expected earned return on book equity.” This statement is itself evidence
2 of the linkage that he later claims does not exist.

3

4 **Flotation Costs**

5 Q. Mr. Rothschild states that any flotation costs are more than offset by the
6 accretion to book value from the sale of common stock above book value.
7 Do you agree?

8 A. No. The companies on the list of Gulf Power's comparable companies
9 have not always sold above book value. Furthermore, the accretion to
10 book value is part of the growth rate expected by investors according to
11 the testimony of Mr. Rothschild, who uses the “br+sv” form of the
12 sustainable growth rate method. Clearly, if it is part of growth rate
13 expectations it cannot also be flotation costs.

14

15 Q. Do you agree that a 0.2% allowance for flotation cost must be excessive?

16 A. No. Mr. Rothschild develops an exaggerated example in an attempt to
17 show that financing costs are almost 50% of the new equity raised. His
18 example is flawed because his \$984,000 relates to all previous stock
19 issuances. The flotation cost for a \$2 million new issuance at 3% would
20 be only \$60,000.

21

22 **MODEL UPDATE**

23

24 Q. Mr. Rothschild's testimony makes reference to a number of reports and
25 sources of data that are more recent than those you relied on in your

1 direct testimony. Have you updated your analysis?

2 A. Yes. In response to Staff's Production of Documents Request No. 55,
3 I have updated my DCF results, equity risk premium analysis, CAPM
4 model and comparative earnings model using the most recent information
5 on stock prices, bond yields, Value Line earnings and dividends
6 projections and other data. Updated schedules reflecting this information
7 are attached as Schedules 21 through 35 of my rebuttal exhibit.

8

9 Q. Did you make any other changes when you updated your schedules?

10 A. Yes. It came to my attention that the bond ratings provided by C.A.Turner
11 in two instances were incorrect at the time my testimony was prepared.
12 The senior, utility debt rating for Progress Energy by S&P is "BBB+" and
13 for TECO Energy "A." The relevance of the incorrect bond ratings is that
14 Progress Energy with a "BBB+" bond rating would not have met the
15 selection criteria noted on Schedule 6, page 6, of the exhibit to my direct
16 testimony for inclusion on the list of comparable companies. Further, the
17 indicated risk of the comparable companies relative to Gulf Power
18 Company, based on the bond rating comparison, would have been
19 understated. My updated exhibits, therefore, exclude Progress Energy
20 from the comparable company group.

21

22 Q. What was the impact of the change to your analysis?

23 A. There was a slight increase in the indicated cost of common stock when
24 deleting Progress Energy from the comparable company group. This
25 increase would be mitigated by the higher than previously acknowledged

1 risk of the comparable companies relative to Gulf Power Company based
2 on a bond rating comparison.

3

4 Q. Do you believe that the change to your comparable group of companies,
5 therefore, would have a meaningful impact on the cost of common stock
6 estimate for Gulf Power Company?

7 A. No.

8

9 Q. What are the updated results of your recommended return on common
10 stock equity for Gulf Power Company?

11 A. The updated results show a moderate increase in the cost of common
12 stock for Gulf Power Company. The average of the four tests used show
13 an average cost of common stock of 13.6%, and the midpoint of the
14 13.2% to 14.2% range is 13.7%. Supporting data is summarized on
15 Schedule 21 and detailed supporting data appears on Schedules 22-35 of
16 the exhibit to my rebuttal testimony. Recognizing the slightly higher risk
17 difference between Gulf Power Company and its comparable companies
18 than apparent in my direct testimony, its lower financial risk, all electric
19 revenue derivation, higher regulatory ranking, and its relatively small size,
20 it is my judgment that Gulf Power's cost of common stock is slightly higher
21 than the 13.0% previously recommended. Nonetheless, basing my
22 recommendation on the nearest one-quarter of a percentage point, the
23 updated cost of common stock for Gulf Power Company continues to be at
24 least 13.0%.

25

1 Q. Does that conclude your rebuttal testimony?

2 A. Yes, it does.

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**Mr. Rothschild's 10.0% Recommended Regulatory Return
Results in Only a 7.3% Return to Investors**

| | | |
|------------------------------|---------------|-------|
| 1 Price | 34.80 | JAR-3 |
| 2 2001 Book Value | 22.76 | JAR 5 |
| 3 Regulatory Return | 10.00% | |
| 4 EPS (2X3) | 2.28 | |
| 5 DPS | 1.85 | JAR 5 |
| 6 DPS Payout (5/4) | 81.28% | |
| 7 Retention Rate (1.0-6) | 18.72% | |
| 8 Internal Growth Rate (3X7) | 1.87% | |
| 9 External Growth (a) | 0.14% | |
| 10 Yield (5/1) | 5.32% | |
| 11 Investor Return (8+9+10) | 7.33% | |

(a) $SV = 0.40 \times (BV/P)$

**A Regulatory Return of 12.7% is Necessary to Provide
Investors with an Opportunity to Achieve the 10.0%
Market Return that Mr. Rothschild Testifies
Investors Require**

| | | |
|------------------------------|---------------|-------|
| 1 Price | 34.80 | JAR-3 |
| 2 2001 Book Value | 22.76 | JAR 5 |
| 3 Regulatory Return | 12.70% | |
| 4 EPS (2X3) | 2.89 | |
| 5 DPS | 1.85 | JAR 5 |
| 6 DPS Payout (5/4) | 64.00% | |
| 7 Retention Rate (1.0-6) | 36.00% | |
| 8 Internal Growth Rate (3X7) | 4.57% | |
| 9 External Growth (a) | 0.14% | |
| 10 Yield (5/1) | 5.32% | |
| 11 Investor Return (8+9+10) | 10.03% | |

(a) $SV = 0.40 \times (BV/P)$

**A 13.0% Return on Common Stock Equity of the
Comparable Companies' Book Value Shows
an Investor Expected Market Return of 10.3%**

| | | |
|------------------------------|---------------|-------|
| 1 Price | 34.80 | JAR-3 |
| 2 2001 Book Value | 22.76 | JAR-5 |
| 3 Regulatory Return | 13.00% | |
| 4 EPS (2X3) | 2.96 | |
| 5 DPS | 1.85 | JAR-5 |
| 6 DPS Payout (5/4) | 62.53% | |
| 7 Retention Rate (1.0-6) | 37.47% | |
| 8 Internal Growth Rate (3X7) | 4.87% | |
| 9 External Growth (a) | 0.14% | |
| 10 Yield (5/1) | 5.32% | |
| 11 Investor Return (8+9+10) | 10.33% | |

(a) $SV = 0.40 \times (BV/P)$

**Investor Expected Market Return Is 11.5% Using
Investor Expected Returns on Common Stock Equity**

| | | |
|------------------------------|---------------|-------|
| 1 Price | \$ 34.80 | JAR-3 |
| 2 2001 Book Value | 22.76 | JAR-5 |
| 3 Regulatory Return | 14.20% | |
| 4 EPS (2X3) | 3.23 | |
| 5 DPS | 1.85 | JAR-3 |
| 6 DPS Payout (5/4) | 57.24% | |
| 7 Retention Rate (1.0-6) | 42.76% | |
| 8 Internal Growth Rate (3X7) | 6.07% | |
| 9 External Growth (a) | 0.14% | |
| 10 Yield (5/1) | 5.32% | |
| 11 Investor Return (8+9+10) | 11.53% | |

(a) $SV = 0.40 \times (BV/P)$

**With a 13.5% Return on Common Stock Equity
the Investor Expected Market Return is 11.4%**

| | | Book Value(a) | EPS(a) | DPS(a) | Disc. Rate 11.4% | Cash Flow Present Value |
|-----------|------|---------------|--------|--------|---------------------|----------------------------|
| Stage One | 2001 | 22.76 | 3.11 | 1.83 | | -34.80 |
| | 2002 | 24.03 | 3.36 | 1.85 | 1.1140 | 1.66 |
| | 2003 | 25.48 | 3.53 | 1.92 | 1.24 | 1.55 |
| | 2004 | 26.93 | 3.70 | 1.98 | 1.38 | 1.43 |
| | 2005 | 28.64 | 3.88 | 2.04 | 1.54 | 1.32 |
| Stage Two | 2006 | 30.51 | 4.13 | 2.17 | 1.72 | 1.27 |
| | 2007 | 32.51 | 4.40 | 2.32 | 1.91 | 1.21 |
| | 2008 | 34.63 | 4.69 | 2.47 | 2.13 | 1.16 |
| | 2009 | 36.90 | 5.00 | 2.63 | 2.37 | 1.11 |
| | 2010 | 39.31 | 5.33 | 2.80 | 2.64 | 1.06 |
| | 2011 | 41.88 | 5.67 | 2.98 | 2.94 | 1.01 |
| | 2012 | 44.62 | 6.05 | 3.18 | 3.28 | 0.97 |
| | 2013 | 47.54 | 6.44 | 3.39 | 3.65 | 0.93 |
| | 2014 | 50.65 | 6.86 | 3.61 | 4.07 | 0.89 |
| | 2015 | 53.96 | 7.31 | 3.84 | 4.53 | 0.85 |
| | 2016 | 57.49 | 7.79 | 4.10 | 5.05 | 0.81 |
| | 2017 | 61.25 | 8.30 | 4.36 | 5.63 | 0.78 |
| | 2018 | 65.26 | 8.84 | 4.65 | 6.27 | 0.74 |
| | 2019 | 69.53 | 9.42 | 4.95 | 6.98 | 0.71 |
| | 2020 | 74.07 | 10.04 | 5.28 | 7.78 | 0.68 |
| | 2021 | 78.92 | 10.69 | 5.62 | 8.66 | 0.65 |
| | 2022 | 84.08 | 11.39 | 5.99 | 9.65 | 0.62 |
| | 2023 | 89.58 | 12.14 | 6.38 | 10.75 | 0.59 |
| | 2024 | 95.44 | 12.93 | 6.80 | 11.98 | 0.57 |
| | 2025 | 101.68 | 13.77 | 7.24 | 13.34 | 0.54 |
| | 2026 | 108.33 | 14.68 | 7.72 | 14.86 | 0.52 |
| | 2027 | 115.41 | 15.64 | 8.22 | 16.56 | 0.50 |
| | 2028 | 122.96 | 16.66 | 8.76 | 18.45 | 0.47 |
| | 2029 | 131.00 | 17.75 | 9.33 | 20.55 | 0.45 |
| | 2030 | 139.57 | 18.91 | 9.94 | 22.89 | 0.43 |
| | 2031 | 148.70 | 20.14 | 10.59 | 25.50 | 0.42 |
| | 2032 | 158.42 | 21.46 | 11.28 | 28.41 | 0.40 |
| | 2033 | 168.78 | 22.87 | 12.02 | 31.65 | 0.38 |
| | 2034 | 179.82 | 24.36 | 12.81 | 35.25 | 0.36 |
| | 2035 | 191.58 | 25.95 | 13.65 | 39.27 | 0.35 |
| | 2036 | 204.11 | 27.65 | 14.54 | 43.75 | 0.33 |
| | 2037 | 217.46 | 29.46 | 15.49 | 48.74 | 0.32 |
| | 2038 | 231.68 | 31.39 | 16.50 | 54.29 | 0.30 |
| | 2039 | 246.83 | 33.44 | 17.58 | 60.48 | 0.29 |
| | 2040 | 262.98 | 35.63 | 18.73 | 67.38 | 0.28 |
| | 2041 | 280.18 | 37.96 | 19.96 | 75.06 | 0.27 |
| | 2042 | 298.50 | 40.44 | 21.26 | 83.62 | 0.25 |
| | 2043 | 318.02 | 43.08 | 22.65 | 93.15 | 0.24 |
| | 2044 | 338.82 | 45.90 | 24.13 | 103.77 | 0.23 |
| | 2045 | 360.98 | 48.90 | 25.71 | 115.60 | 0.22 |
| | 2046 | 384.59 | 52.10 | 27.39 | 128.78 | 0.21 |
| | 2047 | 409.74 | 55.51 | 29.19 | 143.46 | 0.20 |
| | 2048 | 436.53 | 59.14 | 31.09 | 159.81 | 0.19 |
| | 2049 | 465.08 | 63.01 | 33.13 | 178.03 | 0.19 |
| | 2050 | 495.50 | 67.13 | 35.29 | 198.32 | 0.18 |
| | 2051 | 527.91 | 71.52 | 37.60 | 220.93 | 0.17 |

Florida Public Service Commission
Docket No. 010949-EI
GULF POWER COMPANY
Witness: C. A. Benore
Exhibit No. ____ (CAB-2)
Schedule 14
Page 2 of 2

| | Book Value(a) | EPS(a) | DPS(a) | Disc. Rate 11.4% | Cash Flow Present Value | |
|---------------|---------------|---------|----------|---------------------|----------------------------|---------------------|
| 2052 | 562.43 | 76.20 | 40.06 | 246.12 | 0.16 | |
| 2053 | 599.21 | 81.18 | 42.68 | 274.18 | 0.16 | |
| 2054 | 638.40 | 86.49 | 45.47 | 305.43 | 0.15 | |
| 2055 | 680.15 | 92.14 | 48.45 | 340.25 | 0.14 | |
| 2056 | 724.64 | 98.17 | 51.62 | 379.04 | 0.14 | |
| 2057 | 772.03 | 104.59 | 54.99 | 422.25 | 0.13 | |
| 2058 | 822.52 | 111.43 | 58.59 | 470.39 | 0.12 | |
| 2059 | 876.31 | 118.72 | 62.42 | 524.01 | 0.12 | |
| 2060 | 933.62 | 126.48 | 66.50 | 583.75 | 0.11 | |
| 2061 | 994.68 | 134.75 | 70.85 | 650.30 | 0.11 | |
| 2062 | 1059.73 | 143.57 | 75.48 | 724.43 | 0.10 | |
| 2063 | 1129.04 | 152.96 | 80.42 | 807.02 | 0.10 | |
| 2064 | 1202.88 | 162.96 | 85.68 | 899.02 | 0.10 | |
| 2065 | 1281.55 | 173.62 | 91.28 | 1001.50 | 0.09 | |
| 2066 | 1365.36 | 184.97 | 97.25 | 1115.67 | 0.09 | |
| 2067 | 1454.65 | 197.07 | 103.61 | 1242.86 | 0.08 | |
| 2068 | 1549.79 | 209.96 | 110.39 | 1384.55 | 0.08 | |
| 2069 | 1651.15 | 223.69 | 117.61 | 1542.39 | 0.08 | |
| 2070 | 1759.13 | 238.32 | 125.30 | 1718.22 | 0.07 | |
| 2071 | 1874.18 | 253.90 | 133.50 | 1914.09 | 0.07 | |
| 2072 | 1996.75 | 270.51 | 142.23 | 2132.30 | 0.07 | |
| 2073 | 2127.34 | 288.20 | 151.53 | 2375.38 | 0.06 | |
| 2074 | 2266.46 | 307.05 | 161.44 | 2646.18 | 0.06 | |
| 2075 | 2414.69 | 327.13 | 172.00 | 2947.84 | 0.06 | |
| 2076 | 2572.61 | 348.52 | 183.24 | 3283.90 | 0.06 | |
| 2077 | 2740.86 | 371.32 | 195.23 | 3658.26 | 0.05 | |
| 2078 | 2920.11 | 395.60 | 208.00 | 4075.30 | 0.05 | |
| 2079 | 3111.09 | 421.47 | 221.60 | 4539.89 | 0.05 | |
| 2080 | 3314.55 | 449.04 | 236.09 | 5057.43 | 0.05 | |
| 2081 | 3531.32 | 478.41 | 251.53 | 5633.98 | 0.04 | |
| 2082 | 3762.27 | 509.69 | 267.98 | 6276.25 | 0.04 | |
| 2083 | 4008.33 | 543.03 | 285.51 | 6991.75 | 0.04 | |
| 2084 | 4270.47 | 578.54 | 304.18 | 7788.81 | 0.04 | |
| 2085 | 4549.76 | 616.38 | 324.08 | 8676.73 | 0.04 | |
| 2086 | 4847.31 | 656.69 | 345.27 | 9665.88 | 0.04 | |
| 2087 | 5164.33 | 699.64 | 367.85 | 10767.79 | 0.03 | |
| 2088 | 5502.07 | 745.39 | 391.91 | 11995.31 | 0.03 | |
| 2089 | 5861.91 | 794.14 | 417.54 | 13362.78 | 0.03 | |
| 2090 | 6245.28 | 846.08 | 444.85 | 14886.14 | 0.03 | |
| 2091 | 6653.72 | 901.41 | 473.94 | 16583.16 | 0.03 | |
| 2092 | 7088.87 | 960.36 | 504.93 | 18473.64 | 0.03 | |
| 2093 | 7552.49 | 1023.17 | 537.96 | 20579.63 | 0.03 | |
| 2094 | 8046.42 | 1090.09 | 573.14 | 22925.71 | 0.02 | |
| 2095 | 8572.65 | 1161.38 | 610.62 | 25539.24 | 0.02 | |
| 2096 | 9133.31 | 1237.33 | 650.56 | 28450.71 | 0.02 | |
| 2097 | 9730.62 | 1318.26 | 693.10 | 31694.09 | 0.02 | |
| 2098 | 10367.01 | 1404.47 | 738.43 | 35307.22 | 0.02 | |
| 2099 | 11045.01 | 1496.32 | 786.73 | 39332.24 | 0.02 | |
| 2100 | 11767.35 | 1594.18 | 18842.23 | 43816.12 | 0.43 | 34.99 |
| Price to Book | 1.53 | | | | | 2100 DPS 838.18 |
| Market Price | 18004.05 | | | | | 2100 Price 18004.05 |
| | | | | | | 2100 Cash 18842.23 |

(a) Sustainable Growth Rate: $(13.5\% \cdot 0.474) + (0.4 \cdot 0.35) = 6.54\%$ for Stage Two

**With a 14.85% Return on Common Stock Equity
the Investor Expected Market Return is 12.0%**

| | | Book Value(a) | EPS(a) | DPS(a) | Disc. Rate 12.0% | Cash Flow Present Value |
|-----------|------|---------------|--------|--------|---------------------|----------------------------|
| Stage One | 2001 | 22.76 | 3.11 | 1.83 | | -34.80 |
| | 2002 | 24.03 | 3.36 | 1.85 | 1.1200 | 1.65 |
| | 2003 | 25.48 | 3.53 | 1.92 | 1.25 | 1.53 |
| | 2004 | 26.93 | 3.70 | 1.98 | 1.40 | 1.41 |
| | 2005 | 28.64 | 3.88 | 2.04 | 1.57 | 1.30 |
| Stage Two | 2006 | 30.70 | 4.16 | 2.19 | 1.76 | 1.24 |
| | 2007 | 32.90 | 4.46 | 2.34 | 1.97 | 1.19 |
| | 2008 | 35.26 | 4.78 | 2.51 | 2.21 | 1.14 |
| | 2009 | 37.79 | 5.12 | 2.69 | 2.48 | 1.09 |
| | 2010 | 40.51 | 5.49 | 2.89 | 2.77 | 1.04 |
| | 2011 | 43.42 | 5.88 | 3.09 | 3.11 | 1.00 |
| | 2012 | 46.53 | 6.30 | 3.31 | 3.48 | 0.95 |
| | 2013 | 49.88 | 6.76 | 3.55 | 3.90 | 0.91 |
| | 2014 | 53.46 | 7.24 | 3.81 | 4.36 | 0.87 |
| | 2015 | 57.29 | 7.76 | 4.08 | 4.89 | 0.84 |
| | 2016 | 61.41 | 8.32 | 4.37 | 5.47 | 0.80 |
| | 2017 | 65.82 | 8.92 | 4.69 | 6.13 | 0.76 |
| | 2018 | 70.54 | 9.56 | 5.02 | 6.87 | 0.73 |
| | 2019 | 75.61 | 10.24 | 5.39 | 7.69 | 0.70 |
| | 2020 | 81.04 | 10.98 | 5.77 | 8.61 | 0.67 |
| | 2021 | 86.85 | 11.77 | 6.19 | 9.65 | 0.64 |
| | 2022 | 93.09 | 12.61 | 6.63 | 10.80 | 0.61 |
| | 2023 | 99.77 | 13.52 | 7.11 | 12.10 | 0.59 |
| | 2024 | 106.94 | 14.49 | 7.62 | 13.55 | 0.56 |
| | 2025 | 114.62 | 15.53 | 8.16 | 15.18 | 0.54 |
| | 2026 | 122.85 | 16.64 | 8.75 | 17.00 | 0.51 |
| | 2027 | 131.67 | 17.84 | 9.38 | 19.04 | 0.49 |
| | 2028 | 141.12 | 19.12 | 10.05 | 21.32 | 0.47 |
| | 2029 | 151.25 | 20.49 | 10.77 | 23.88 | 0.45 |
| | 2030 | 162.11 | 21.96 | 11.55 | 26.75 | 0.43 |
| | 2031 | 173.75 | 23.54 | 12.38 | 29.96 | 0.41 |
| | 2032 | 186.23 | 25.23 | 13.26 | 33.56 | 0.40 |
| | 2033 | 199.60 | 27.04 | 14.22 | 37.58 | 0.38 |
| | 2034 | 213.93 | 28.98 | 15.24 | 42.09 | 0.36 |
| | 2035 | 229.29 | 31.06 | 16.33 | 47.14 | 0.35 |
| | 2036 | 245.75 | 33.29 | 17.50 | 52.80 | 0.33 |
| | 2037 | 263.40 | 35.68 | 18.76 | 59.14 | 0.32 |
| | 2038 | 282.31 | 38.25 | 20.11 | 66.23 | 0.30 |
| | 2039 | 302.58 | 40.99 | 21.55 | 74.18 | 0.29 |
| | 2040 | 324.31 | 43.94 | 23.10 | 83.08 | 0.28 |
| | 2041 | 347.59 | 47.09 | 24.76 | 93.05 | 0.27 |
| | 2042 | 372.55 | 50.47 | 26.54 | 104.22 | 0.25 |
| | 2043 | 399.30 | 54.09 | 28.44 | 116.72 | 0.24 |
| | 2044 | 427.97 | 57.98 | 30.48 | 130.73 | 0.23 |
| | 2045 | 458.69 | 62.14 | 32.67 | 146.42 | 0.22 |
| | 2046 | 491.63 | 66.60 | 35.02 | 163.99 | 0.21 |
| | 2047 | 526.93 | 71.39 | 37.53 | 183.67 | 0.20 |
| | 2048 | 564.76 | 76.51 | 40.23 | 205.71 | 0.20 |
| | 2049 | 605.31 | 82.00 | 43.12 | 230.39 | 0.19 |
| | 2050 | 648.77 | 87.89 | 46.21 | 258.04 | 0.18 |
| | 2051 | 695.35 | 94.20 | 49.53 | 289.00 | 0.17 |

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| | Book Value(a) | EPS(a) | DPS(a) | Disc. Rate 12.0% | Cash Flow Present Value | |
|---------------|---------------|---------|----------|---------------------|----------------------------|---------------------|
| 2052 | 745.28 | 100.97 | 53.09 | 323.68 | 0.16 | |
| 2053 | 798.79 | 108.22 | 56.90 | 362.52 | 0.16 | |
| 2054 | 856.14 | 115.99 | 60.98 | 406.03 | 0.15 | |
| 2055 | 917.62 | 124.31 | 65.36 | 454.75 | 0.14 | |
| 2056 | 983.50 | 133.24 | 70.05 | 509.32 | 0.14 | |
| 2057 | 1054.12 | 142.81 | 75.08 | 570.44 | 0.13 | |
| 2058 | 1129.80 | 153.06 | 80.47 | 638.89 | 0.13 | |
| 2059 | 1210.92 | 164.05 | 86.25 | 715.56 | 0.12 | |
| 2060 | 1297.86 | 175.83 | 92.45 | 801.43 | 0.12 | |
| 2061 | 1391.05 | 188.45 | 99.08 | 897.60 | 0.11 | |
| 2062 | 1490.93 | 201.98 | 106.20 | 1005.31 | 0.11 | |
| 2063 | 1597.98 | 216.49 | 113.82 | 1125.95 | 0.10 | |
| 2064 | 1712.71 | 232.03 | 121.99 | 1261.06 | 0.10 | |
| 2065 | 1835.69 | 248.69 | 130.75 | 1412.39 | 0.09 | |
| 2066 | 1967.49 | 266.55 | 140.14 | 1581.87 | 0.09 | |
| 2067 | 2108.75 | 285.68 | 150.20 | 1771.70 | 0.08 | |
| 2068 | 2260.16 | 306.20 | 160.99 | 1984.30 | 0.08 | |
| 2069 | 2422.44 | 328.18 | 172.55 | 2222.42 | 0.08 | |
| 2070 | 2596.37 | 351.74 | 184.94 | 2489.11 | 0.07 | |
| 2071 | 2782.79 | 377.00 | 198.22 | 2787.80 | 0.07 | |
| 2072 | 2982.60 | 404.07 | 212.45 | 3122.34 | 0.07 | |
| 2073 | 3196.75 | 433.08 | 227.70 | 3497.02 | 0.07 | |
| 2074 | 3426.27 | 464.17 | 244.05 | 3916.66 | 0.06 | |
| 2075 | 3672.28 | 497.50 | 261.57 | 4386.66 | 0.06 | |
| 2076 | 3935.95 | 533.22 | 280.35 | 4913.06 | 0.06 | |
| 2077 | 4218.55 | 571.51 | 300.48 | 5502.62 | 0.05 | |
| 2078 | 4521.44 | 612.54 | 322.06 | 6162.94 | 0.05 | |
| 2079 | 4846.08 | 656.52 | 345.18 | 6902.49 | 0.05 | |
| 2080 | 5194.03 | 703.66 | 369.97 | 7730.79 | 0.05 | |
| 2081 | 5566.96 | 754.18 | 396.53 | 8658.48 | 0.05 | |
| 2082 | 5966.67 | 808.33 | 425.00 | 9697.50 | 0.04 | |
| 2083 | 6395.08 | 866.37 | 455.52 | 10861.20 | 0.04 | |
| 2084 | 6854.24 | 928.58 | 488.22 | 12164.55 | 0.04 | |
| 2085 | 7346.38 | 995.25 | 523.28 | 13624.29 | 0.04 | |
| 2086 | 7873.85 | 1066.71 | 560.85 | 15259.21 | 0.04 | |
| 2087 | 8439.19 | 1143.30 | 601.12 | 17090.31 | 0.04 | |
| 2088 | 9045.12 | 1225.39 | 644.28 | 19141.15 | 0.03 | |
| 2089 | 9694.56 | 1313.37 | 690.53 | 21438.09 | 0.03 | |
| 2090 | 10390.63 | 1407.67 | 740.11 | 24010.66 | 0.03 | |
| 2091 | 11136.68 | 1508.74 | 793.26 | 26891.93 | 0.03 | |
| 2092 | 11936.29 | 1617.07 | 850.21 | 30118.97 | 0.03 | |
| 2093 | 12793.32 | 1733.17 | 911.26 | 33733.24 | 0.03 | |
| 2094 | 13711.88 | 1857.62 | 976.68 | 37781.23 | 0.03 | |
| 2095 | 14696.39 | 1990.99 | 1046.81 | 42314.98 | 0.02 | |
| 2096 | 15751.59 | 2133.95 | 1121.97 | 47392.78 | 0.02 | |
| 2097 | 16882.56 | 2287.16 | 1202.53 | 53079.91 | 0.02 | |
| 2098 | 18094.73 | 2451.38 | 1288.87 | 59449.50 | 0.02 | |
| 2099 | 19393.93 | 2627.39 | 1381.41 | 66583.44 | 0.02 | |
| 2100 | 20786.41 | 2816.04 | 33283.81 | 74573.45 | 0.45 | 34.70 |
| Price to Book | 1.53 | | | | | 2100 DPS 1480.60 |
| Market Price | 31803.21 | | | | | 2100 Price 31803.21 |
| | | | | | | 2100 Cash 33283.81 |

(a) Sustainable Growth Rate: $(14.85\% \times .474) + (0.4 \times .38) = 7.18\%$ for Stage Two

**A 14.2% Return on Common Stock Equity
Provides Investors a Market Return of 11.7%**

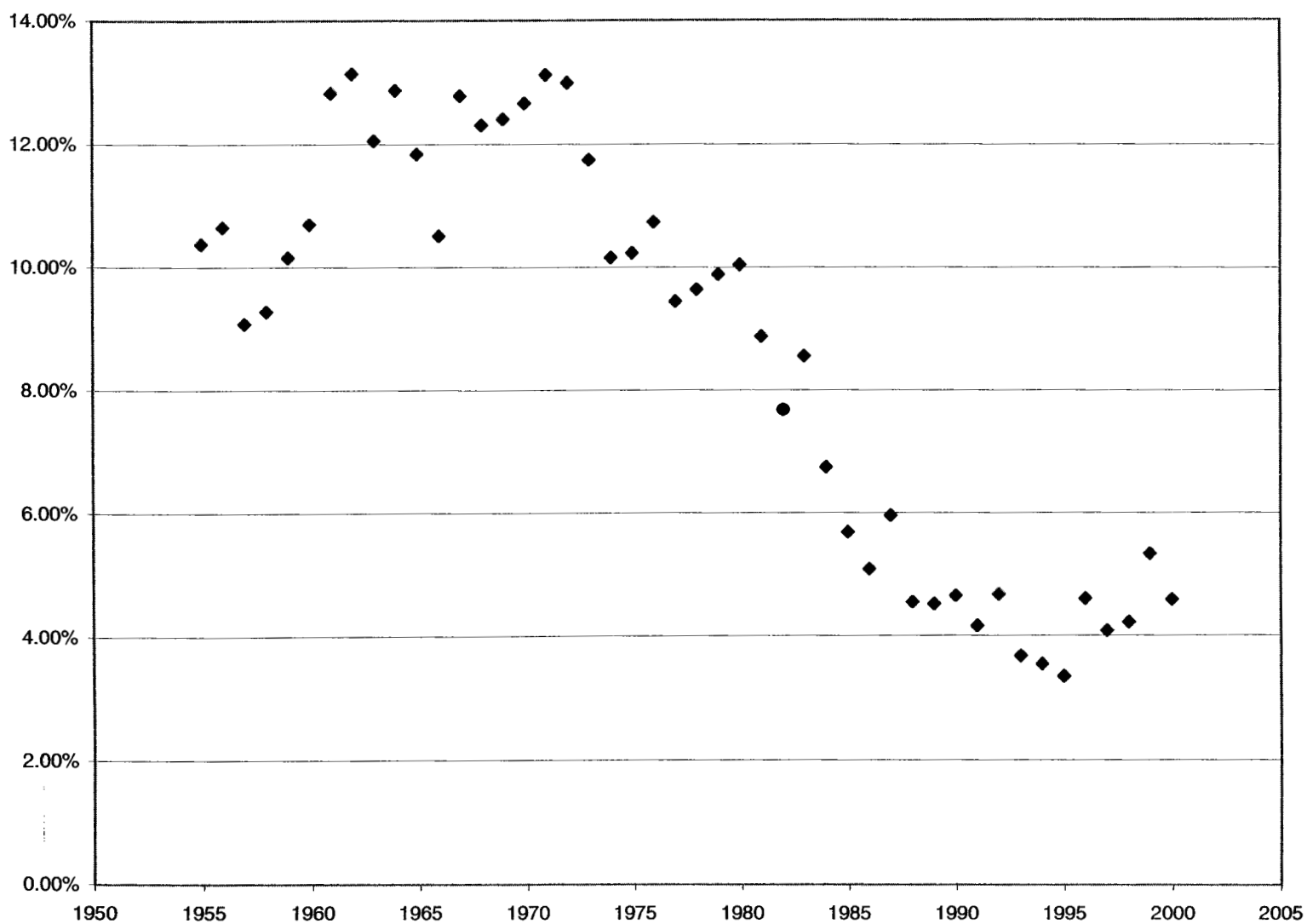
| | | Book Value(a) | EPS(a) | DPS(a) | Disc. Rate 11.7% | Cash Flow Present Value |
|-----------|------|---------------|--------|--------|---------------------|----------------------------|
| Stage One | 2001 | 22.76 | 3.11 | 1.83 | | -34.80 |
| | 2002 | 24.03 | 3.36 | 1.85 | 1.1170 | 1.66 |
| | 2003 | 25.48 | 3.53 | 1.92 | 1.25 | 1.54 |
| | 2004 | 26.93 | 3.70 | 1.98 | 1.39 | 1.42 |
| | 2005 | 28.64 | 3.88 | 2.04 | 1.56 | 1.31 |
| Stage Two | 2006 | 30.61 | 4.15 | 2.18 | 1.74 | 1.25 |
| | 2007 | 32.71 | 4.43 | 2.33 | 1.94 | 1.20 |
| | 2008 | 34.96 | 4.74 | 2.49 | 2.17 | 1.15 |
| | 2009 | 37.36 | 5.06 | 2.66 | 2.42 | 1.10 |
| | 2010 | 39.93 | 5.41 | 2.84 | 2.71 | 1.05 |
| | 2011 | 42.67 | 5.78 | 3.04 | 3.02 | 1.01 |
| | 2012 | 45.60 | 6.18 | 3.25 | 3.38 | 0.96 |
| | 2013 | 48.73 | 6.60 | 3.47 | 3.77 | 0.92 |
| | 2014 | 52.08 | 7.06 | 3.71 | 4.21 | 0.88 |
| | 2015 | 55.66 | 7.54 | 3.96 | 4.71 | 0.84 |
| | 2016 | 59.48 | 8.06 | 4.24 | 5.26 | 0.81 |
| | 2017 | 63.57 | 8.61 | 4.53 | 5.87 | 0.77 |
| | 2018 | 67.94 | 9.20 | 4.84 | 6.56 | 0.74 |
| | 2019 | 72.60 | 9.84 | 5.17 | 7.33 | 0.71 |
| | 2020 | 77.59 | 10.51 | 5.53 | 8.18 | 0.68 |
| | 2021 | 82.92 | 11.23 | 5.91 | 9.14 | 0.65 |
| | 2022 | 88.62 | 12.01 | 6.31 | 10.21 | 0.62 |
| | 2023 | 94.71 | 12.83 | 6.75 | 11.41 | 0.59 |
| | 2024 | 101.21 | 13.71 | 7.21 | 12.74 | 0.57 |
| | 2025 | 108.17 | 14.65 | 7.70 | 14.23 | 0.54 |
| | 2026 | 115.60 | 15.66 | 8.23 | 15.90 | 0.52 |
| | 2027 | 123.54 | 16.74 | 8.80 | 17.76 | 0.50 |
| | 2028 | 132.03 | 17.89 | 9.40 | 19.84 | 0.47 |
| | 2029 | 141.10 | 19.11 | 10.05 | 22.16 | 0.45 |
| | 2030 | 150.79 | 20.43 | 10.74 | 24.75 | 0.43 |
| | 2031 | 161.15 | 21.83 | 11.48 | 27.64 | 0.42 |
| | 2032 | 172.22 | 23.33 | 12.27 | 30.88 | 0.40 |
| | 2033 | 184.05 | 24.93 | 13.11 | 34.49 | 0.38 |
| | 2034 | 196.69 | 26.65 | 14.01 | 38.53 | 0.36 |
| | 2035 | 210.21 | 28.48 | 14.97 | 43.03 | 0.35 |
| | 2036 | 224.65 | 30.43 | 16.00 | 48.07 | 0.33 |
| | 2037 | 240.08 | 32.53 | 17.10 | 53.69 | 0.32 |
| | 2038 | 256.58 | 34.76 | 18.28 | 59.97 | 0.30 |
| | 2039 | 274.20 | 37.15 | 19.53 | 66.99 | 0.29 |
| | 2040 | 293.04 | 39.70 | 20.87 | 74.83 | 0.28 |
| | 2041 | 313.17 | 42.43 | 22.31 | 83.58 | 0.27 |
| | 2042 | 334.69 | 45.34 | 23.84 | 93.36 | 0.26 |
| | 2043 | 357.68 | 48.46 | 25.48 | 104.29 | 0.24 |
| | 2044 | 382.25 | 51.79 | 27.23 | 116.49 | 0.23 |
| | 2045 | 408.51 | 55.34 | 29.10 | 130.12 | 0.22 |
| | 2046 | 436.58 | 59.15 | 31.10 | 145.34 | 0.21 |
| | 2047 | 466.57 | 63.21 | 33.23 | 162.35 | 0.20 |
| | 2048 | 498.62 | 67.55 | 35.52 | 181.34 | 0.20 |
| | 2049 | 532.88 | 72.19 | 37.96 | 202.56 | 0.19 |
| | 2050 | 569.49 | 77.15 | 40.56 | 226.26 | 0.18 |
| | 2051 | 608.61 | 82.45 | 43.35 | 252.73 | 0.17 |

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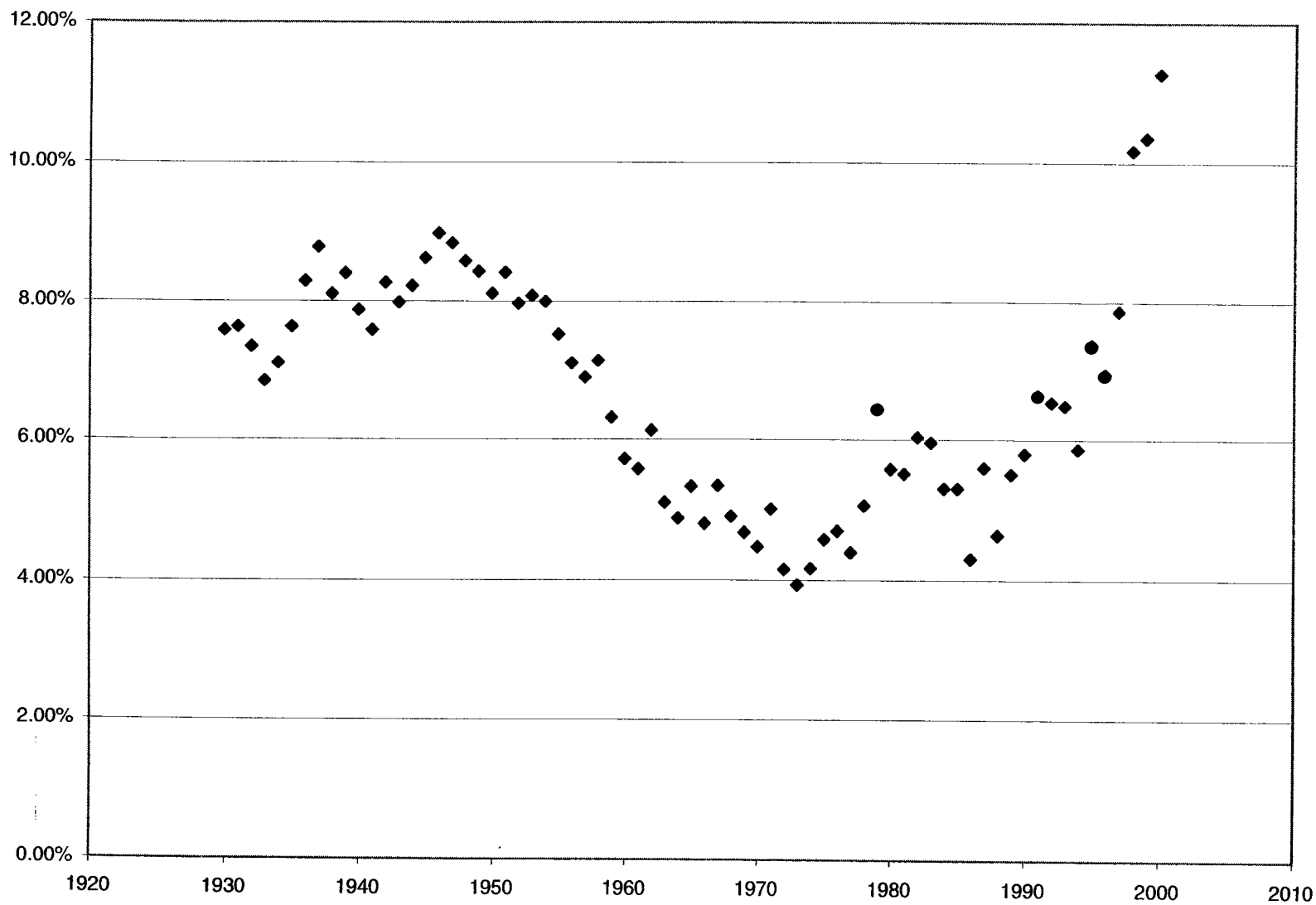
| | Book Value(a) | EPS(a) | DPS(a) | Disc. Rate 11.7% | Cash Flow Present Value | |
|---------------|---------------|---------|----------|---------------------|----------------------------|---------------------|
| 2052 | 650.42 | 88.12 | 46.33 | 282.30 | 0.16 | |
| 2053 | 695.11 | 94.17 | 49.51 | 315.33 | 0.16 | |
| 2054 | 742.86 | 100.64 | 52.91 | 352.22 | 0.15 | |
| 2055 | 793.90 | 107.55 | 56.55 | 393.43 | 0.14 | |
| 2056 | 848.44 | 114.94 | 60.43 | 439.47 | 0.14 | |
| 2057 | 906.72 | 122.84 | 64.59 | 490.88 | 0.13 | |
| 2058 | 969.02 | 131.28 | 69.02 | 548.32 | 0.13 | |
| 2059 | 1035.59 | 140.30 | 73.76 | 612.47 | 0.12 | |
| 2060 | 1106.73 | 149.93 | 78.83 | 684.13 | 0.12 | |
| 2061 | 1182.76 | 160.23 | 84.25 | 764.17 | 0.11 | |
| 2062 | 1264.02 | 171.24 | 90.03 | 853.58 | 0.11 | |
| 2063 | 1350.86 | 183.01 | 96.22 | 953.45 | 0.10 | |
| 2064 | 1443.66 | 195.58 | 102.83 | 1065.00 | 0.10 | |
| 2065 | 1542.84 | 209.02 | 109.90 | 1189.61 | 0.09 | |
| 2066 | 1648.84 | 223.38 | 117.45 | 1328.79 | 0.09 | |
| 2067 | 1762.11 | 238.72 | 125.51 | 1484.26 | 0.08 | |
| 2068 | 1883.17 | 255.12 | 134.14 | 1657.92 | 0.08 | |
| 2069 | 2012.54 | 272.65 | 143.35 | 1851.89 | 0.08 | |
| 2070 | 2150.80 | 291.38 | 153.20 | 2068.56 | 0.07 | |
| 2071 | 2298.56 | 311.40 | 163.72 | 2310.59 | 0.07 | |
| 2072 | 2456.47 | 332.79 | 174.97 | 2580.92 | 0.07 | |
| 2073 | 2625.23 | 355.65 | 186.99 | 2882.89 | 0.06 | |
| 2074 | 2805.59 | 380.09 | 199.84 | 3220.19 | 0.06 | |
| 2075 | 2998.33 | 406.20 | 213.57 | 3596.95 | 0.06 | |
| 2076 | 3204.32 | 434.10 | 228.24 | 4017.80 | 0.06 | |
| 2077 | 3424.45 | 463.93 | 243.92 | 4487.88 | 0.05 | |
| 2078 | 3659.71 | 495.80 | 260.68 | 5012.96 | 0.05 | |
| 2079 | 3911.14 | 529.86 | 278.59 | 5599.48 | 0.05 | |
| 2080 | 4179.83 | 566.26 | 297.73 | 6254.62 | 0.05 | |
| 2081 | 4466.99 | 605.16 | 318.18 | 6986.41 | 0.05 | |
| 2082 | 4773.87 | 646.74 | 340.04 | 7803.82 | 0.04 | |
| 2083 | 5101.83 | 691.17 | 363.40 | 8716.86 | 0.04 | |
| 2084 | 5452.33 | 738.65 | 388.36 | 9736.74 | 0.04 | |
| 2085 | 5826.90 | 789.40 | 415.04 | 10875.93 | 0.04 | |
| 2086 | 6227.21 | 843.63 | 443.56 | 12148.42 | 0.04 | |
| 2087 | 6655.02 | 901.59 | 474.03 | 13569.78 | 0.03 | |
| 2088 | 7112.22 | 963.53 | 506.60 | 15157.45 | 0.03 | |
| 2089 | 7600.83 | 1029.72 | 541.40 | 16930.87 | 0.03 | |
| 2090 | 8123.01 | 1100.46 | 578.59 | 18911.78 | 0.03 | |
| 2091 | 8681.06 | 1176.07 | 618.34 | 21124.46 | 0.03 | |
| 2092 | 9277.45 | 1256.86 | 660.82 | 23596.02 | 0.03 | |
| 2093 | 9914.81 | 1343.21 | 706.22 | 26356.75 | 0.03 | |
| 2094 | 10595.95 | 1435.49 | 754.74 | 29440.49 | 0.03 | |
| 2095 | 11323.90 | 1534.10 | 806.59 | 32885.03 | 0.02 | |
| 2096 | 12101.85 | 1639.50 | 862.00 | 36732.58 | 0.02 | |
| 2097 | 12933.24 | 1752.13 | 921.22 | 41030.29 | 0.02 | |
| 2098 | 13821.76 | 1872.50 | 984.51 | 45830.84 | 0.02 | |
| 2099 | 14771.31 | 2001.14 | 1052.15 | 51193.05 | 0.02 | |
| 2100 | 15786.10 | 2138.62 | 25277.17 | 57182.63 | 0.44 | 34.91 |
| Price to Book | 1.53 | | | | | 2100 DPS 1124.43 |
| Market Price | 24152.74 | | | | | 2100 Price 24152.74 |
| | | | | | | 2100 Cash 25277.17 |

(a) Sustainable Growth Rate: $(14.2\% \cdot .474) + (0.4 \cdot .35) = 6.87\%$ for Stage Two

Arithmetic S&P 500 Total Return Less Return Long-Term T-Bonds (30 Yr. Mov. Avg.)



Equity Risk Premium for S&P 500 Versus Long-Term Treasury Bonds



**A 13.5% Return on Common Stock Equity
Provides Investors a Market Return of 11.1%**

| | Book Value(a) | EPS(a) | DPS(a) | Disc. Rate 11.1% | Cash Flow Present Value |
|------|---------------|--------|--------|---------------------|----------------------------|
| 2001 | 22.76 | 3.11 | 1.83 | | -34.80 |
| 2002 | 24.01 | 3.28 | 1.93 | 1.1110 | 1.74 |
| 2003 | 25.34 | 3.46 | 2.04 | 1.23 | 1.65 |
| 2004 | 26.73 | 3.65 | 2.15 | 1.37 | 1.57 |
| 2005 | 28.21 | 3.85 | 2.27 | 1.52 | 1.49 |
| 2006 | 29.76 | 4.07 | 2.39 | 1.69 | 1.41 |
| 2007 | 31.40 | 4.29 | 2.52 | 1.88 | 1.34 |
| 2008 | 33.13 | 4.53 | 2.66 | 2.09 | 1.27 |
| 2009 | 34.96 | 4.78 | 2.81 | 2.32 | 1.21 |
| 2010 | 36.88 | 5.04 | 2.97 | 2.58 | 1.15 |
| 2011 | 38.91 | 5.32 | 3.13 | 2.87 | 1.09 |
| 2012 | 41.06 | 5.61 | 3.30 | 3.18 | 1.04 |
| 2013 | 43.32 | 5.92 | 3.48 | 3.54 | 0.98 |
| 2014 | 45.71 | 6.25 | 3.68 | 3.93 | 0.94 |
| 2015 | 48.23 | 6.59 | 3.88 | 4.37 | 0.89 |
| 2016 | 50.88 | 6.95 | 4.09 | 4.85 | 0.84 |
| 2017 | 53.69 | 7.34 | 4.32 | 5.39 | 0.80 |
| 2018 | 56.65 | 7.74 | 4.55 | 5.99 | 0.76 |
| 2019 | 59.77 | 8.17 | 4.81 | 6.65 | 0.72 |
| 2020 | 63.06 | 8.62 | 5.07 | 7.39 | 0.69 |
| 2021 | 66.53 | 9.09 | 5.35 | 8.21 | 0.65 |
| 2022 | 70.20 | 9.59 | 5.64 | 9.12 | 0.62 |
| 2023 | 74.07 | 10.12 | 5.96 | 10.13 | 0.59 |
| 2024 | 78.15 | 10.68 | 6.28 | 11.26 | 0.56 |
| 2025 | 82.46 | 11.27 | 6.63 | 12.51 | 0.53 |
| 2026 | 87.00 | 11.89 | 7.00 | 13.89 | 0.50 |
| 2027 | 91.79 | 12.54 | 7.38 | 15.44 | 0.48 |
| 2028 | 96.85 | 13.23 | 7.79 | 17.15 | 0.45 |
| 2029 | 102.19 | 13.96 | 8.22 | 19.05 | 0.43 |
| 2030 | 107.82 | 14.73 | 8.67 | 21.17 | 0.41 |
| 2031 | 113.76 | 15.54 | 9.15 | 23.52 | 0.39 |
| 2032 | 120.03 | 16.40 | 9.65 | 26.13 | 0.37 |
| 2033 | 126.64 | 17.30 | 10.18 | 29.03 | 0.35 |
| 2034 | 133.62 | 18.26 | 10.74 | 32.25 | 0.33 |
| 2035 | 140.98 | 19.26 | 11.34 | 35.83 | 0.32 |
| 2036 | 148.75 | 20.33 | 11.96 | 39.81 | 0.30 |
| 2037 | 156.94 | 21.45 | 12.62 | 44.23 | 0.29 |
| 2038 | 165.59 | 22.63 | 13.31 | 49.14 | 0.27 |
| 2039 | 174.71 | 23.87 | 14.05 | 54.59 | 0.26 |
| 2040 | 184.34 | 25.19 | 14.82 | 60.65 | 0.24 |
| 2041 | 194.50 | 26.58 | 15.64 | 67.38 | 0.23 |
| 2042 | 205.22 | 28.04 | 16.50 | 74.86 | 0.22 |
| 2043 | 216.52 | 29.59 | 17.41 | 83.17 | 0.21 |
| 2044 | 228.45 | 31.22 | 18.37 | 92.41 | 0.20 |
| 2045 | 241.04 | 32.94 | 19.38 | 102.66 | 0.19 |
| 2046 | 254.32 | 34.75 | 20.45 | 114.06 | 0.18 |
| 2047 | 268.34 | 36.67 | 21.58 | 126.72 | 0.17 |
| 2048 | 283.12 | 38.69 | 22.76 | 140.79 | 0.16 |
| 2049 | 298.72 | 40.82 | 24.02 | 156.41 | 0.15 |
| 2050 | 315.18 | 43.07 | 25.34 | 173.78 | 0.15 |
| 2051 | 332.55 | 45.44 | 26.74 | 193.06 | 0.14 |

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| | Book Value(a) | EPS(a) | DPS(a) | Disc. Rate 11.1% | Cash Flow Present Value | |
|---------------|---------------|--------|---------|---------------------|----------------------------|--------------------|
| 2052 | 350.87 | 47.94 | 28.21 | 214.49 | 0.13 | |
| 2053 | 370.20 | 50.59 | 29.77 | 238.30 | 0.12 | |
| 2054 | 390.60 | 53.37 | 31.41 | 264.76 | 0.12 | |
| 2055 | 412.12 | 56.31 | 33.14 | 294.14 | 0.11 | |
| 2056 | 434.83 | 59.42 | 34.96 | 326.79 | 0.11 | |
| 2057 | 458.79 | 62.69 | 36.89 | 363.07 | 0.10 | |
| 2058 | 484.07 | 66.14 | 38.92 | 403.37 | 0.10 | |
| 2059 | 510.74 | 69.79 | 41.07 | 448.14 | 0.09 | |
| 2060 | 538.88 | 73.63 | 43.33 | 497.89 | 0.09 | |
| 2061 | 568.58 | 77.69 | 45.72 | 553.15 | 0.08 | |
| 2062 | 599.91 | 81.97 | 48.23 | 614.55 | 0.08 | |
| 2063 | 632.96 | 86.49 | 50.89 | 682.77 | 0.07 | |
| 2064 | 667.84 | 91.26 | 53.70 | 758.55 | 0.07 | |
| 2065 | 704.63 | 96.28 | 56.66 | 842.75 | 0.07 | |
| 2066 | 743.46 | 101.59 | 59.78 | 936.30 | 0.06 | |
| 2067 | 784.42 | 107.19 | 63.07 | 1040.23 | 0.06 | |
| 2068 | 827.65 | 113.09 | 66.55 | 1155.69 | 0.06 | |
| 2069 | 873.25 | 119.32 | 70.21 | 1283.97 | 0.05 | |
| 2070 | 921.37 | 125.90 | 74.08 | 1426.49 | 0.05 | |
| 2071 | 972.13 | 132.84 | 78.16 | 1584.84 | 0.05 | |
| 2072 | 1025.70 | 140.15 | 82.47 | 1760.75 | 0.05 | |
| 2073 | 1082.21 | 147.88 | 87.01 | 1956.20 | 0.04 | |
| 2074 | 1141.84 | 156.03 | 91.81 | 2173.33 | 0.04 | |
| 2075 | 1204.76 | 164.62 | 96.87 | 2414.57 | 0.04 | |
| 2076 | 1271.14 | 173.69 | 102.21 | 2682.59 | 0.04 | |
| 2077 | 1341.18 | 183.26 | 107.84 | 2980.36 | 0.04 | |
| 2078 | 1415.08 | 193.36 | 113.78 | 3311.18 | 0.03 | |
| 2079 | 1493.05 | 204.02 | 120.05 | 3678.72 | 0.03 | |
| 2080 | 1575.32 | 215.26 | 126.66 | 4087.06 | 0.03 | |
| 2081 | 1662.12 | 227.12 | 133.64 | 4540.72 | 0.03 | |
| 2082 | 1753.70 | 239.63 | 141.01 | 5044.74 | 0.03 | |
| 2083 | 1850.33 | 252.84 | 148.77 | 5604.71 | 0.03 | |
| 2084 | 1952.28 | 266.77 | 156.97 | 6226.83 | 0.03 | |
| 2085 | 2059.85 | 281.47 | 165.62 | 6918.01 | 0.02 | |
| 2086 | 2173.35 | 296.97 | 174.75 | 7685.90 | 0.02 | |
| 2087 | 2293.10 | 313.34 | 184.38 | 8539.04 | 0.02 | |
| 2088 | 2419.45 | 330.60 | 194.53 | 9486.87 | 0.02 | |
| 2089 | 2552.77 | 348.82 | 205.25 | 10539.92 | 0.02 | |
| 2090 | 2693.42 | 368.04 | 216.56 | 11709.85 | 0.02 | |
| 2091 | 2841.83 | 388.32 | 228.50 | 13009.64 | 0.02 | |
| 2092 | 2998.42 | 409.71 | 241.09 | 14453.71 | 0.02 | |
| 2093 | 3163.83 | 432.29 | 254.37 | 16058.07 | 0.02 | |
| 2094 | 3337.95 | 456.11 | 268.38 | 17840.52 | 0.02 | |
| 2095 | 3521.87 | 481.24 | 283.17 | 19820.82 | 0.01 | |
| 2096 | 3715.92 | 507.76 | 298.78 | 22020.93 | 0.01 | |
| 2097 | 3920.67 | 535.73 | 315.24 | 24465.25 | 0.01 | |
| 2098 | 4136.70 | 565.25 | 332.61 | 27180.89 | 0.01 | |
| 2099 | 4364.63 | 596.40 | 350.93 | 30197.97 | 0.01 | |
| 2100 | 4605.12 | 629.26 | 7416.10 | 33549.95 | 0.22 | 34.54 |
| Price to Book | 1.53 | | | | | 2100 DPS 370.27 |
| Market Price | 7045.83 | | | | | 2100 Price 7045.83 |
| | | | | | | 2100 Cash 7416.10 |

(a) Sustainable Growth Rate: $(13.5\% \cdot 39.8\%) + (0.4 \cdot 35) = 5.51\%$

**When Interest Rates Decline, the Investor Expected Return is Likely to Decline.
Since the Investor Expected Return is Lower, It Is Not
Necessary to Increase the Regulatory Return on Common Stock Equity**

| | Price Up, Constant ROE | | | | Price Up, ROE Down | | | |
|---|------------------------|----------------|-----------|----------|--------------------|--------------|-----------|----------|
| | A | B | C | D | E | F | G | H |
| | 13.0% ROE | Price Up | 10.0% | 13.0% | 13.0% ROE | Price Up | 9.5% | 12.50% |
| | Investor | Required Retn. | Produces | Produces | Investor | ROE Down | Produces | Produces |
| | Expectation | Declines | Only 7.0% | 10.0% | Expectation | 12.5% & \$40 | Only 6.5% | 9.50% |
| 1 Current Price (Given) | \$ 35.00 | \$ 40.00 | \$ 40.00 | \$ 40.00 | \$ 35.00 | \$ 40.00 | \$ 40.00 | \$ 40.00 |
| 2 Book Value (Given) | \$ 25.00 | \$ 25.00 | \$ 25.00 | \$ 25.00 | \$ 25.00 | \$ 25.00 | \$ 25.00 | \$ 25.00 |
| 3 Expected Return on Common Stock Equity | 13.00% | 13.00% | 10.00% | 13.00% | 13.00% | 12.50% | 9.50% | 12.50% |
| 4 Earnings Per Share (2 * 3) | \$ 3.25 | \$ 3.25 | \$ 2.50 | \$ 3.25 | \$ 3.25 | \$ 3.13 | \$ 2.38 | \$ 3.13 |
| 5 Given; Dividends Per Share (4 * 6) | \$ 2.00 | \$ 2.00 | \$ 2.00 | \$ 2.00 | \$ 2.00 | \$ 2.00 | \$ 2.00 | \$ 2.00 |
| 6 Dividend Payout Ratio (5 / 4) | 61.54% | 61.54% | 80.00% | 61.54% | 61.54% | 64.00% | 84.21% | 64.00% |
| 7 Earning Retention Rate for Growth [1.0 - 6] | 38.46% | 38.46% | 20.00% | 38.46% | 38.46% | 36.00% | 15.79% | 36.00% |
| 8 Sustainable Growth Rate (3 * 7) | 5.00% | 5.00% | 2.00% | 5.00% | 5.00% | 4.50% | 1.50% | 4.50% |
| 9 Current Yield (5 / 1) | 5.71% | 5.00% | 5.00% | 5.00% | 5.71% | 5.00% | 5.00% | 5.00% |
| 10 Investor Achievable Market Return (8+9) | 10.71% | 10.00% | 7.00% | 10.00% | 10.71% | 9.50% | 6.50% | 9.50% |

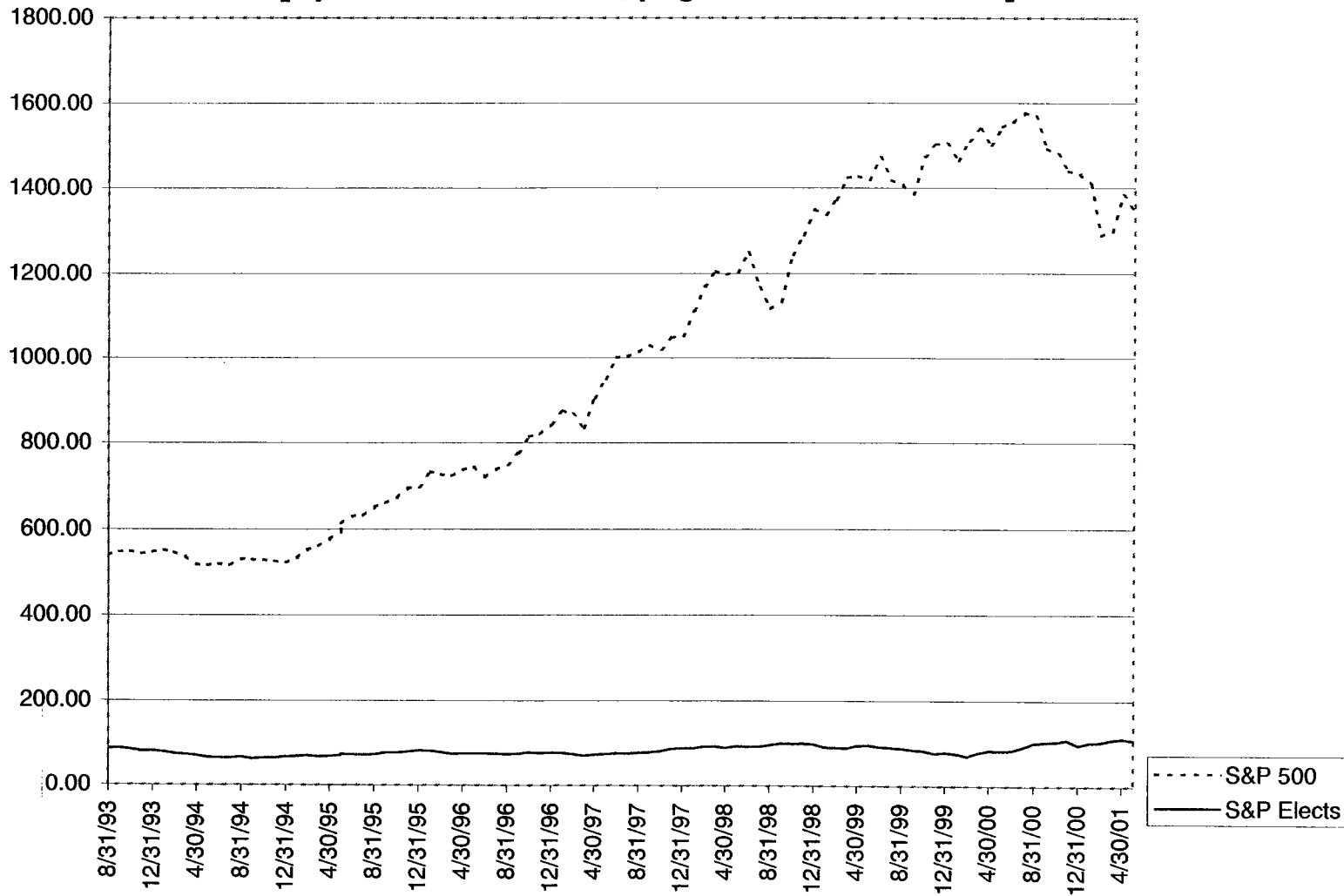
Summary of Test Results to Determine the Appropriate
Regulatory Allowed Return for
Gulf Power Company's Common Stock Equity
[Update to Schedule 1a of Exhibit CAB-1]

| Tests | Gulf Power Comparable Companies (a) | Reference |
|---|--|------------------|
| 1. DCF | | |
| Standard DCF (assumes 1.0 price/book) | 12.1% | Schedule 27 |
| Transformed DCF | 14.2% | Schedule 28 |
| 2. Equity Risk Premium (assumes 1.0 price/book) | 11.2% | Schedule 30 |
| Transformed Equity Risk Premium | 13.3% | Schedule 30 |
| 3. CAPM | | |
| Average Standard CAPM (assumes 1.0 price/book) | 10.6% | Schedule 33 |
| Average Empirical CAPM (assumes 1.0 price/book) | <u>11.6%</u> | Schedule 33 |
| Average Standard and Empirical CAPM's | 11.1% | Schedule 33 |
| Transformed CAPM | 13.2% | Schedule 34 |
| 4. Comparable Earnings Test | 13.5% | Schedule 35 |
| Average of Four Tests | 13.6% | |
| Range of Four Tests | 13.2% to 14.2% | |
| Midpoint of Four Test Range | 13.7% | |
| Recommended Return on Common Stock Equity for Gulf Power Company | At Least 13.0% | |

(a) All estimates except for the "at least 13.0%" recommended return on common equity exclude flotation costs of 0.2%

Performance of Electric Stocks Versus Market Has Been Very Poor

[Update to Schedule 3, page 1 of Exhibit CAB-1]



**Risk Indicators for Gulf Power Company's Comparable Companies
and Southern Company
[Update to Schedule 6, page 6 of Exhibit CAB-1]**

| Company | 1 Predominately Regulated Company | 2 S&P Business Profile | 3 VL Safety Rank | 4 VL Beta | 5 S&P Bond Rating | 6 Competitive Position | 7 Val Line Regulation | 8 Debt to Capital % | 9 Mkt. Cap. \$ Bil. |
|-------------------------|--|---------------------------------|------------------------|-----------------|-------------------------|------------------------------|-----------------------------|---------------------------|---------------------------|
| Allegheny Energy, AYE * | Yes | 5 | 1.0 | 0.55 | A+ | Under \$0.05 kWh | Avg. | 57.0% | 6.5 |
| Alliant Energy, LNT | Yes | 5 | 2.0 | 0.55 | A+ | Under \$0.05 kWh | Avg. | 51.0% | 2.3 |
| Ameren Corp., AEE | Yes | 5 | 1.0 | 0.55 | A+ | Under \$0.05 kWh | Avg. | 46.0% | 5.9 |
| Cinergy Corp., CIN | Yes | 5 | 2.0 | 0.55 | A- | Under \$0.05 kWh | Abv. Avg. | 49.0% | 5.4 |
| FPL Group, FPL | Yes | 5 | 2.0 | 0.40 | AA- | Under \$0.05 kWh | Abv. Avg. | 39.0% | 10.1 |
| TECO Energy, TE | Yes | 5 | 1.0 | 0.50 | A | Under \$0.05 kWh | Abv. Avg. | 48.0% | 4.3 |
| Wisconsin Energy, WEC* | Yes | 4 | 2.0 | 0.50 | AA- | Under \$0.05 kWh | Abv. Avg. | 65.0% | 2.8 |
| Average | Yes | 4.9 | 1.6 | 0.51 | A/A+ | Under \$0.05 kWh | Avg/AbvAvg | 50.7% | 5.3 |
| Gulf Power Company | Yes | 4 | NA | NA | A+ | Under \$0.05 kWh | Abv. Avg. | 41.5%(b) | NA |
| Southern Company, SO | Yes | 4 | 2.0 | NA | A+(a) | Under \$0.05 kWh | Avg. | 38.0% | 15.8 |

1. Predominately an Electric Company Followed by Bloomberg, C.A.Turner, and Value Line
2. S&P Business Profile 4 or 5, where integrated companies are generally expected to be 5 or 6 on a 1 is best scale of 1-10
3. Value Line Safety Rank 1 or 2 on a scale of 1 to 5 where 1 is lowest risk: Value Line recommends 1 or 2 for conservative investors
4. Value Line Beta 0.60 or less
5. S&P Credit Rating A- or better, C.A.Turner
6. Industrial Rates Under \$0.05 as a Measure of Competitive Position
7. Value Line Regulation Ranking
8. Debt Ratio, Value Line, or 2001 Long-Term debt as a Percent of Total Capital
9. Market Value of Common Stock
10. Mergers were also considered; Potomac Electric Power was excluded because of proposed merger with Conectiv

* Allegheny and Wisconsin Energy were excluded because of non-representative results, and as a result, the DCF and other tests are based on a truncated average.

NA: Not Available (a) Simple Average of Five Electric Subsidiaries--weighted by size A; (b) 2000 SO 10K

Sources: Latest Value Line Reports When Preparing Testimony

**Stock Prices for Gulf Power Company's
Comparable Companies
[Update to Schedule 7, page 13 of Exhibit CAB-1]**

| | AYE | LNT | AEE | CIN | FPL | TE | WEC |
|----------|-------|-------|-------|-------|-------|-------|-------|
| 11/27/01 | 35.00 | 28.45 | 40.99 | 30.64 | 55.44 | 26.84 | 22.44 |
| 11/28/01 | 34.21 | 28.24 | 40.30 | 29.90 | 54.60 | 26.33 | 22.00 |
| 11/29/01 | 34.01 | 28.55 | 40.63 | 29.65 | 55.25 | 26.50 | 22.01 |
| 11/30/01 | 34.85 | 28.10 | 40.88 | 29.48 | 55.40 | 26.42 | 21.90 |
| 12/3/01 | 34.86 | 28.28 | 41.06 | 29.70 | 55.22 | 26.34 | 21.92 |
| 12/4/01 | 35.50 | 28.62 | 41.20 | 29.60 | 55.75 | 26.62 | 22.15 |
| 12/5/01 | 35.70 | 28.51 | 41.28 | 29.50 | 55.55 | 26.50 | 21.90 |
| 12/6/01 | 35.41 | 28.45 | 40.49 | 29.12 | 55.00 | 26.18 | 22.10 |
| 12/7/01 | 36.04 | 28.75 | 40.88 | 29.56 | 55.75 | 26.24 | 22.01 |
| 12/10/01 | 35.75 | 28.90 | 40.10 | 29.02 | 55.22 | 25.96 | 21.81 |
| 12/11/01 | 34.97 | 28.50 | 39.32 | 28.70 | 54.00 | 25.25 | 21.65 |
| 12/12/01 | 35.13 | 28.54 | 39.67 | 29.15 | 54.29 | 25.08 | 21.80 |
| 12/13/01 | 35.23 | 28.60 | 40.00 | 29.95 | 55.15 | 25.24 | 21.71 |
| 12/14/01 | 34.56 | 28.88 | 40.32 | 30.74 | 54.74 | 25.24 | 21.85 |
| 12/17/01 | 33.25 | 28.80 | 40.06 | 30.84 | 54.15 | 24.94 | 21.55 |
| 12/18/01 | 33.91 | 29.17 | 40.94 | 31.58 | 54.40 | 25.80 | 21.69 |
| 12/19/01 | 35.12 | 30.28 | 41.80 | 32.49 | 55.70 | 26.39 | 22.00 |
| 12/20/01 | 34.90 | 29.82 | 41.27 | 31.75 | 55.70 | 26.28 | 22.00 |
| 12/21/01 | 34.96 | 30.15 | 41.13 | 31.77 | 55.67 | 25.45 | 22.51 |
| 12/24/01 | 35.50 | 30.00 | 41.78 | 32.22 | 56.45 | 25.73 | 22.77 |
| 12/26/01 | 35.83 | 30.42 | 42.30 | 32.84 | 56.45 | 25.76 | 22.79 |
| 12/27/01 | 36.39 | 30.59 | 42.30 | 33.07 | 56.51 | 25.92 | 22.70 |
| Average | 35.05 | 29.03 | 40.85 | 30.51 | 55.29 | 25.96 | 22.06 |

Source: American Online

**Projected First Year Dividend for Gulf Power Company's
Comparable Companies
[Update to Schedule 7, page 14 of Exhibit CAB-1]**

| Company | Q4'01 | Q1'02 | Q2'02 | Q3'02 | DPS1 | Growth Rate |
|-----------------------|--------------|--------------|--------------|--------------|-------------|------------------------|
| | \$ | \$ | \$ | \$ | \$ | % |
| Allegheny Energy, AYE | 0.4756 | 0.4756 | 0.4756 | 0.4756 | 1.90 | 10.6% |
| Alliant Energy, LNT | 0.5245 | 0.5245 | 0.5245 | 0.5245 | 2.10 | 4.9% |
| Ameren Corp., AEE | 0.6629 | 0.6629 | 0.6629 | 0.6629 | 2.65 | 4.4% |
| Cinergy Corp., CIN | 0.4784 | 0.4784 | 0.4784 | 0.4784 | 1.91 | 6.3% |
| FPL Group, FPL | 0.5958 | 0.5958 | 0.5958 | 0.5958 | 2.38 | 6.4% |
| TECO Energy, TE | 0.3450 | 0.3736 | 0.3736 | 0.3736 | 1.47 | 8.3% |
| Wisconsin Energy, WEC | 0.2108 | 0.2108 | 0.2108 | 0.2108 | 0.84 | 5.4% |
| Average | | | | | 1.89 | 6.6% |

Sources: Wall Street Journal and Value Line along with Schedule 26

**Projected Growth Rates for Gulf Power Company's
Comparable Companies
[Update to Schedule 7, page 15 of Exhibit CAB-1]**

| Company | Value | Projected IBES Growth | Projected Zacks Growth | Projected First Call Growth | Average Proj'd Gwth |
|-----------------------|-------------------------------|-----------------------------|------------------------------|-----------------------------------|---------------------------|
| | Line Proj 5 Yr EPS Gwth | | | | |
| Allegheny Energy, AYE | 14.0% | 9.2% | 9.0% | 10.0% | 10.6% |
| Alliant Energy, LNT | 6.5% | 4.0% | 5.0% | 4.0% | 4.9% |
| Ameren Corp., AEE | 4.0% | 4.9% | 3.8% | 5.0% | 4.4% |
| Cinergy Corp., CIN | 6.0% | 6.3% | 5.7% | 7.0% | 6.3% |
| FPL Group, FPL | 4.5% | 6.8% | 7.2% | 7.0% | 6.4% |
| TECO Energy, TE | 7.0% | 8.5% | 8.8% | 9.0% | 8.3% |
| Wisconsin Energy, WEC | 8.5% | 4.7% | 4.5% | 4.0% | 5.4% |
| Average | 7.2% | 6.3% | 6.3% | 6.6% | 6.6% |

Sources: Value Line; Bloomberg, Zacks Investment Research, and First Call

**Standard, or P/B = 1.0, DCF Investor Required Market Return for
Gulf Power Company's Comparable Companies
[Update to Schedule 7, page 16 of Exhibit CAB-1]**

| Company | DPS1(\$) | Price (\$) | Yield | Yld with 3% Flo. Costs | Proj. Gwth | DCF w/o FloC | DCF w Flo C |
|-----------------------|----------|------------|-------|------------------------------|---------------|-----------------|----------------|
| Allegheny Energy, AYE | 1.90 | 35.05 | 5.42% | 5.59% | 10.6% | 16.0% | 16.19% |
| Alliant Energy, LNT | 2.10 | 29.03 | 7.23% | 7.46% | 4.9% | 12.1% | 12.36% |
| Ameren Corp., AEE | 2.65 | 40.85 | 6.49% | 6.69% | 4.4% | 10.9% | 11.09% |
| Cinergy Corp., CIN | 1.91 | 30.51 | 6.26% | 6.45% | 6.3% | 12.6% | 12.75% |
| FPL Group, FPL | 2.38 | 55.29 | 4.30% | 4.44% | 6.4% | 10.7% | 10.84% |
| TECO Energy, TE | 1.47 | 25.96 | 5.66% | 5.84% | 8.3% | 14.0% | 14.14% |
| Wisconsin Energy, WEC | 0.84 | 22.06 | 3.81% | 3.93% | 5.4% | 9.2% | 9.33% |
| Average | 1.89 | 34.11 | 5.60% | 5.77% | 6.61% | 12.21% | 12.38% |

Flotation Costs

| | |
|-------------------------------|--------------------|
| | Gulf Pw. Comps. |
| Yield with Flotation Costs | 5.77% |
| Yield without Flotation Costs | 5.60% |
| Flotation Costs | 0.17% |

**Standard, or P/B = 1.0, Truncated DCF Investor Required Market Return for
Gulf Power Company's Comparable Companies
[Update to Schedule 7, page 16 of Exhibit CAB-1]**

| Company | DPS1(\$) | Price (\$) | Yield | Yld with 3% Flo. Costs | Proj. Gwth | DCF w/o FloC | DCF w Flo C |
|---------------------|----------|------------|-------|------------------------------|---------------|-----------------|----------------|
| Alliant Energy, LNT | 2.10 | 29.03 | 7.23% | 7.46% | 4.9% | 12.1% | 12.36% |
| Ameren Corp., AEE | 2.65 | 40.85 | 6.49% | 6.69% | 4.4% | 10.9% | 11.09% |
| Cinergy Corp., CIN | 1.91 | 30.51 | 6.26% | 6.45% | 6.3% | 12.6% | 12.75% |
| FPL Group, FPL | 2.38 | 55.29 | 4.30% | 4.44% | 6.4% | 10.7% | 10.84% |
| TECO Energy, TE | 1.47 | 25.96 | 5.66% | 5.84% | 8.3% | 14.0% | 14.14% |
| Average | 2.10 | 36.33 | 5.99% | 6.17% | 6.06% | 12.05% | 12.23% |

Flotation Costs

| | |
|-------------------------------|--------------------|
| | Gulf Pw. Comps. |
| Yield with Flotation Costs | 6.17% |
| Yield without Flotation Costs | 5.99% |
| Flotation Costs | 0.19% |

**Transformed DCF Test for
Gulf Power Company's
Comparable Companies (a)
[Update to Schedule 7, page 17 of Exhibit CAB-1]**

Standard DCF Model Results:

Book Value
Regulatory Return
Earnings Per Share
Dividend Per Share
Dividend Payout Ratio
Retention Rate
Sustainable Growth Rate
Current Yield
Market Return to Investors

| Gulf Pw. Comp. Co's | |
|--------------------------------|--------|
| | 26.04 |
| | 12.1% |
| | 3.15 |
| \$ | 2.10 |
| | 66.65% |
| | 33.35% |
| | 4.04% |
| | 5.99% |
| | 10.0% |

**Necessary Regulatory Return on
Common Stock for Investors to
Earn Required Market Return:**

Book Value
Regulatory Return
Earnings Per Share
Dividend Per Share
Dividend Payout Ratio
Retention Rate
Sustainable Growth Rate
Current Yield
Market Return to Investors

| Gulf Pw. Comp. Co's | |
|--------------------------------|--------|
| | 26.04 |
| | 14.2% |
| | 3.70 |
| \$ | 2.10 |
| | 56.79% |
| | 43.21% |
| | 6.14% |
| | 5.99% |
| | 12.1% |

(a) Excludes flotation costs

Representative Yield for Long-Term
U. S. Treasury Bonds
[Update to Schedule 8, page 12 of Exhibit CAB-1]

| <u>Date</u> | Moody's Aaa Corporates |
|--------------------|---------------------------------------|
| 11/27/01 | 7.12% |
| 11/28/01 | 7.12% |
| 11/29/01 | 7.00% |
| 11/30/01 | 7.02% |
| 12/3/01 | 7.01% |
| 12/4/01 | 6.98% |
| 12/5/01 | 7.11% |
| 12/6/01 | 7.20% |
| 12/7/01 | 6.88% |
| 12/10/01 | 6.88% |
| 12/11/01 | 6.70% |
| 12/12/01 | 6.63% |
| 12/13/01 | 6.69% |
| 12/14/01 | 6.73% |
| 12/17/01 | 6.78% |
| 12/18/01 | 6.66% |
| 12/19/01 | 6.61% |
| 12/20/01 | 6.59% |
| 12/21/01 | 6.60% |
| 12/24/01 | NA |
| 12/26/01 | 6.66% |
| Average | 6.85% |
| Normalization Adj. | -0.64% |
| Norm. T-Bond Yield | 6.21% |

Source: St. Louis Federal Reserve, and
Schedule 8

**P/B=1.0 Equity Risk Premium Results for
Gulf Power Company's Comparable Companies
[Update to Schedule 8, page 14 of Exhibit CAB-1]**

| | |
|---|-------------|
| Equity Risk Premium | 5.0% |
| Long-term Interest Rates for Treasury Bonds | <u>6.2%</u> |
| P/B=1.0 ERP Investor Required Market Return | 11.2%(a) |

(a) Excludes Flotation Costs

**Transformed ERP Test for
Gulf Power Company's Comparable Companies (a)
[Update to Schedule 8, page 14 of Exhibit CAB-1]**

| <u>Standard ERP Model Results</u> | | <u>Gulf Pw. Comp. Co's</u> |
|--|----|---------------------------------------|
| Book Value | \$ | 26.04 |
| Regulatory Return | | <u>11.2%</u> |
| Earnings Per Share | \$ | 2.92 |
| Dividend Per Share | \$ | \$ 2.10 |
| Dividend Payout | | 72.00% |
| Retention Rate | | 28.00% |
| Sustainable Growth Rate | | 3.14% |
| Current Yield | | 5.99% |
| Market Return to Investors | | <u>9.1%</u> |

| <u>Necessary Regulatory Return on Common Stock for Investors to Earn Required Market Return</u> | | <u>Gulf Pw. Comp. Co's</u> |
|--|----|---------------------------------------|
| Book Value | \$ | 26.04 |
| Regulatory Return | | <u>13.3%</u> |
| EPS | \$ | 3.46 |
| Dividend Per Share | \$ | \$ 2.10 |
| Dividend Payout Ratio | | 60.64% |
| Retention Rate | | 39.36% |
| Sustainable Growth Rate | | 5.24% |
| Current Yield | | 5.99% |
| Market Return to Investors | | <u>11.2%</u> |

(a) Excludes flotation costs

Sources: Value Line, IBES, Zacks, and American Online

Investor Expected Market Returns for the
Value Line Composite and S&P 500 Composite
[Update to Schedule 9, page 12 of Exhibit CAB-1]

Value Line Composite

| | |
|--------------------------------------|--------------|
| Growth Plus Yield: | |
| Value Line Projected EPS Growth Rate | 15.5% |
| Current Yield on DPS1 | 1.4% |
| Required Return | <u>16.9%</u> |

S&P 500 Composite

| | |
|--------------------------------------|--------------|
| IBES Projected EPS Growth Rate | 12.9% |
| Value Line Projected EPS Growth Rate | 15.4% |
| Zacks' Projected EPS Growth Rate | <u>10.3%</u> |
| Average | 12.9% |
| Current Yield on DPS1 | <u>1.5%</u> |
| Required Return | 14.4% |

Sources: Value Line, First Call, IBES, Zacks, and Standard & Poor's

Value Line Betas for Gulf Power Company's
Comparable Companies
[Update to Schedule 9, page 14 of Exhibit CAB-1]

| Company | Gulf Pw. Comp Co's | Truncated Gulf Pw. Comp Co's |
|-----------------------|-------------------------------|---|
| Allegheny Energy, AYE | 0.60 | |
| Alliant Energy, LNT | 0.55 | 0.55 |
| Ameren Corp., AEE | 0.55 | 0.55 |
| Cinergy Corp., CIN | 0.55 | 0.55 |
| FPL Group, FPL | 0.45 | 0.45 |
| TECO Energy, TE | 0.50 | 0.50 |
| Wisconsin Energy, WEC | 0.50 | |
| Average | 0.53 | 0.52 |

Source: Latest Value Line Reports

**Standard and Empirical, P/B = 1.0, CAPM Cost of Common Stock for
Gulf Power Company
[Update to Schedule 9, page 15 of Exhibit CAB-1]**

| | Standard Gulf Pw. Comps | Emprical Gulf Pw. Comps |
|--|-------------------------------|-------------------------------|
| Long-Term Historical Tests | | |
| Ibbotson Long-Term Historical Total Return Premium | 7.3% | 7.3% |
| Beta | 0.52 | 0.52 |
| Equity Risk Premium | 3.8% | 3.8% |
| Empirical CAPM (.75* Miss. Pw. Comp's equity risk premium of 3.8%) | | 2.8% |
| Yield on 30 Year U.S. Treasury Bonds | 6.2% | 6.2% |
| Empirical CAPM (.25*market equity risk premium of 7.3%) | | 1.8% |
| Investor Required Market Return | 10.0% | 10.9% |
| Ibbotson Long-Term, Historical Yield Risk Premium | 7.8% | 7.8% |
| Beta | 0.52 | 0.52 |
| Equity Risk Premium | 4.1% | 4.1% |
| Empirical CAPM (.75* Miss. Pw. Comp's equity risk premium of 4.1%) | | 3.0% |
| Yield on 30 Year U.S. Treasury Bonds | 6.2% | 6.2% |
| Empirical CAPM (.25*market equity risk premium of 7.8%) | | 2.0% |
| Investor Required Market Return | 10.3% | 11.2% |
| Projected Tests | | |
| Value Line Indicated Total Return (Growth plus Yield) | 16.9% | 16.9% |
| Yield on 30 Year U.S. Treasury Bonds | 6.2% | 6.2% |
| Market Equity Risk Premium | 10.7% | 10.7% |
| Beta | 0.52 | 0.52 |
| Equity Risk Premium | 5.6% | 5.6% |
| Empirical CAPM (.75* Miss. Pw. Comp's equity risk premium of 5.6%) | | 4.2% |
| Yield on 30 Year U.S. Treasury Bonds | 6.2% | 6.2% |
| Empirical CAPM (.25*market equity risk premium of 10.7%) | | 2.7% |
| Investor Required Market Return | 11.8% | 13.0% |
| S&P 500 Indicated Total Return (Growth plus Yield) | 14.4% | 14.4% |
| Yield on 30 Year U.S. Treasury Bonds | 6.2% | 6.2% |
| Market Equity Risk Premium | 8.2% | 8.2% |
| Beta | 0.52 | 0.52 |
| Equity Risk Premium | 4.3% | 4.3% |
| Empirical CAPM (.75* Miss. Pw. Comp's equity risk premium of 4.3%) | | 3.2% |
| Yield on 30 Year U.S. Treasury Bonds | 6.2% | 6.2% |
| Empirical CAPM (.25*market equity risk premium of 8.2%) | | 2.1% |
| Investor Required Market Return | 10.5% | 11.4% |
| Average of Historical CAPM Tests | 10.1% | 11.0% |
| Average of Projected CAPM Tests | 11.1% | 12.2% |
| Average of All CAPM Tests | 10.6% | 11.6% |
| Average of Standard and Empirical CAPM Tests | | 11.1% |

Sources: Value Line, IBES, S&P, Zacks and Federal Reserve

Transformed CAPM Test for
Gulf Power Company's
Comparable Companies (a)
[Update to Schedule 9, page 16 of Exhibit CAB-1]

| <u>Standard & Empirical CAPM Model Results</u> | | Gulf Pw. Comp. Co's | |
|---|----|--------------------------------|--------|
| Book Value | \$ | | 26.04 |
| Regulatory Return | | | 11.1% |
| Earnings Per Share | \$ | | 2.89 |
| Dividend Per Share | \$ | \$ | 2.10 |
| Dividend Payout | | | 72.65% |
| Retention Rate | | | 27.35% |
| Sustainable Growth Rate | | | 3.04% |
| Current Yield | | | 5.99% |
| Market Return to Investors | | | 9.0% |

| <u>Necessary Regulatory Return on Common Stock for Investors to Earn Required Market Return</u> | | Gulf Pw. Comp. Co's | |
|--|----|--------------------------------|--------|
| Book Value | \$ | | 26.04 |
| Regulatory Return | | | 13.2% |
| EPS | \$ | | 3.44 |
| Dividend Per Share | \$ | \$ | 2.10 |
| Dividend Payout Ratio | | | 61.09% |
| Retention Rate | | | 38.91% |
| Sustainable Growth Rate | | | 5.14% |
| Current Yield | | | 5.99% |
| Market Return to Investors | | | 11.1% |

(a) Excludes flotation costs

Value Line Projected Book Values, and Returns on
Year-End Common Stock Equity
[Update to Schedule 10 of Exhibit CAB-1]

| Gulf Power Company's Comparable Companies | 2004-2006 | Truncated | 2004-2006 | Truncated |
|--|------------|-----------|-----------|-----------|
| | Book Value | 2004-2006 | ROE | 2004-2006 |
| Allegheny Energy, AYE | 36.10 | | 16.0% | |
| Alliant Energy, LNT | 29.25 | 29.25 | 10.0% | 10.0% |
| Ameren Corp., AEE | 28.25 | 28.25 | 13.5% | 13.5% |
| Cinergy Corp., CIN | 23.20 | 23.20 | 13.5% | 13.5% |
| FPL Group, FPL | 33.50 | 33.50 | 15.0% | 15.0% |
| TECO Energy, TE | 16.00 | 16.00 | 15.5% | 15.5% |
| Wisconsin Energy, WEC | 25.50 | | 11.0% | |
| Average | 27.40 | 26.04 | 13.5% | 13.5% |

Source: Latest Value Line Reports