

Exelon Corp.*Company▲*

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Q2 2010 Earnings Call

Event Type▲

Jul. 22, 2010

*Date▲***MANAGEMENT DISCUSSION SECTION**

Operator: Good morning. My name is Cynthia and I will be your conference operator today.

At this time, I would like to welcome everyone to the Exelon Corporation Second Quarter Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]. Thank you.

I would now like to turn today's call over to Stacie Frank, Senior Vice President of Investor Relations. Please go ahead ma'am.

Stacie M. Frank, Vice President of Investor Relations

Good morning. Welcome to Exelon's second quarter 2010 earnings review and conference call update. Thank you for joining us today.

We issued our earnings release this morning. If you haven't received it, the release is available on the Exelon website at www.ExelonCorp.com.

Before we begin today's discussion, let me remind you that the earnings release and other matters we will discuss in today's call contain forward-looking statements and estimates that are subject to various risks and uncertainties, as well as adjusted non-GAAP operating earnings. Please refer to today's 8-K and our other filings for a discussion of factors that may cause results to differ from management's projections, forecasts, and expectations, and for a reconciliation of operating to GAAP earnings.

Leading the call today are John Rowe, Exelon's Chairman and Chief Executive Officer and Matthew Hilzinger, Exelon's Senior Vice President and Chief Financial Officer. They are joined by other members of Exelon's senior management team, who will be available to answer your questions.

I will now turn the call over to John Rowe, Exelon's CEO.

John W. Rowe, Chairman and Chief Executive Officer

Thank you, Stacie. Good morning, everyone.

As you all know from our press release, our second quarter performance exceeded both our own earlier expectations and your estimates.

Exelon turned in operating earnings of \$0.99 per share compared to our earlier estimates of 80 to \$0.90 per share. Matt will explain how we were able to do this in more detail, but constant attention to operating performance across all of our business units were a big part of the story, and so were improving power market conditions. The weather also helped, we've had so much heat in Philadelphia almost twice the normal level that Denis O'Brien who is bit of a skeptic looked to me the other day and said, "John, if this stays up I am going to believe that climate problem you've been working on is real". It is and we might even be seeing it. As a result of our strong first half, we are raising our operating earnings estimate for the year to \$3.80 to \$4.10 per share.

Now, normally on these calls, I spend most of my time talking about the highlights of the quarter. I'm going to leave that to Matt Hilzinger today and talk about the subject that most of you are asking us to address. That is our longer term earnings potential.

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Most of you tell us that you respect our operating performance. We appreciate that. I think we deserve it. Most of you describe our assets as a solid foundation for future earnings growth, that's true too. Most of you recognize that we have some upside next year as the full requirements contract expires between Exelon Generation and PECO. But you rightly question how two, three, four years from now, we will be able to prosper in a world of low gas prices and dimming prospects for carbon legislation. That is precisely what I want to address this morning.

Put simply, we expect some drop in 2012 earnings, but we believe by that time that the drop in our revenues will be nearing its end. This morning, I'm going to cover three reasons why we believe that. First, EPA regulations will affect both capacity and energy markets and will do so sooner than many think. Second, there are already tangible signs that power markets are recovering. And third, Exelon's investments and rate cases over the next few years give us further opportunities for income enhancement.

Exelon is not a passive beneficiary of changing circumstances. Our confidence in the long run value of our property and our operations is a product of envisioning a cleaner energy future and acting on that vision since we formed Exelon 10 years ago. These actions include forming Exelon Generation as a separate company, thereby giving our shareholders the upside, selling the ComEd fossil fleet, continuously upgrading our nuclear fleet, and most recently planning the retirement of fossil units at our Eddystone and Cromby stations.

Our approach is laid out in Exelon 2020, our path to a low carbon in future. While it is an efficacy piece, it is not just an advocacy piece. It is a way of capitalizing on Exelon's nuclear fleet and a way of positioning our investments to add value for our investors in a world that demands cleaner power.

Now let me start with what we see from EPA regulation. Slide three of our deck illustrates in a simplified form the welter of regulations that are coming to the nation's coal-fired generation fleet over the next few years. You all know – you've all made your own estimates of how much Exelon could benefit from climate change legislation and you all know that that is not very likely in the near term. But EPA regulation of traditional pollutants, regulations that are now being issued, regulations that are required by existing statutes and court decisions are far more imminent and far more certain and carry similar positive benefits to Exelon over the next few years.

In May, the EPA issued its proposed coal combustion waste rule making. Compliance with the final rule likely will be required by early 2015. Depending on the ultimate approach, EPA estimates compliance costs of up to \$20 billion.

In June, EPA issued new measurement and monitoring requirements for sulfur dioxide. It estimates that those requirements will cost the industry approximately \$1.5 billion. And in early July, EPA issued the CAIR Replacement Rule now called the Transport Rule to regulate NOx and SO2. Emission reductions are required as soon as 2012 with further reductions required by 2014 and 2015. EPA estimates a compliance cost of \$2.8 billion per year.

Now EPA is also under court order to issue hazardous air pollution regulations which include both mercury and acid gas. It must do that by March of next year and compliance is mandated by late 2014. The hazardous air pollution regulations are likely to be the most challenging and most costly for coal generators to address.

Now these regulations benefit Exelon in two ways. First, when investments are made in Control Technology to address these regulations, they increase operating costs for the coal-fired generators and ultimately increase the clearing price for energy. And second, for many small units which cannot economically meet these requirements, they will have to shut down and the loss of this capacity should begin to be apparent in capacity auctions as early as next May.

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Now you all have seen estimates from various sources, so have we, that try to determine the magnitude of these impacts. The Petroleum Industry Research Association, which many of us use as a consultant, predicts that as many as 30 megawatt to 40,000 megawatts of coal generation will be retired. PIRA predicts that about 14,000 of these megawatts will be in PJM. Some of you have predicted that larger numbers will be retired.

After last year's capacity auction, the PJM Market Monitor concluded that over 11,000 megawatts of coal already did not recover its avoidable costs or their avoidable costs and that is even before the new EPA regulations take effect.

This leads to three obvious questions. How much coal will retire, particularly in PJM? How soon will those retirements occur? And what effect will these retirements have on capacity and energy markets. We know they will be substantial. We know they will be relatively soon. We know they will continue throughout most of the decade. The issue is just how much, how fast.

When we at Exelon look at these issues, we are mindful of the fact that these regulations must take into account the need to ensure continued reliability of this system. Localized transmission upgrades will be necessary in certain situations. There will be some short-term reliability must-run agreements, while upgrades are completed or new peaking capacity is installed, but we expect EPA to want those agreements to do what is necessary to keep capacity available and not to incent them to run excessively.

Reserve margins in PJM are generally sufficient to enable orderly retirement of coal generation, as these localized transmission issues are addressed. And while some of the EPA regulations will be challenged, this is very different than cap and trade. Cap and trade required congressional action to be effective. New EPA regulations will take effect unless Congress takes steps to stop them and neither political party wants to be against clean air.

Coal operators are already reacting to the scissors of low market prices and possibly new regulations. In PJM, coal generators have already announced close to 4,000 megawatts of retirements or restricted operations. These include our own Eddystone and Cromby units and several AEP units.

Outside the PJM, Xcel Energy and Progress have also announced substantial retirement plans. More tough decisions will be made in the near term and they will have to be made well in advance of the final compliance deadlines.

The next PJM capacity auction in May of 2011 covers the period from mid 2014 through mid 2015. That is precisely the period when coal ash, the transport regulations and hazardous air pollutant compliance will be required. This will have significant consequences to clearing prices and the upside to Exelon is unmistakable. Every \$50 per megawatt day as a change in capacity prices translates to almost \$350 million of additional capacity revenue for Exelon in 2014 and subsequent years.

Beyond the capacity market energy prices will also rise from higher operating costs for coal-fired generators. Coal-fired generators sets the margin in PJM around 50% of the time. Energy prices also rise from a change in the dispatch stack as coal is retired and replaced with natural gas. These changes add up quickly a \$5 per megawatt hour increase in energy prices would be 700 to \$800 million of incremental annual revenue to Exelon on an open basis. We expect that at least some of that upside will be realized in the next two to four years as operating costs increase for coal-fired generation. Some of that uplift will come in 2012 from the cost of new allowances for SO₂ and NO_x under the Transport Rule. Based on EPA's estimate of allowance pricing and EPA generally has the incentive to make its estimate low, these increases could be from \$2 to \$3 per megawatt hour as early as 2012 and 2013.

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Now calculating the effect on Exelon is not as simple as it is for a hypothetical level of carbon legislation. But all of this adds together to say Exelon's clean generation will grow in value in a relatively short time. We are of course positioning our portfolio to capture that value. We do this through continued top performance of our nuclear fleet. Chip Pardee and his team achieved a capacity factor of 94.8% in the second quarter. We do this through our nuclear upgrade program, which will add 1,300 to 1,500 megawatts of base load nuclear power and support reserve margins as coal plants begin to retire. Now we do that through our utilities industry-leading energy efficiency and Smart Grid programs.

Now, let me turn to the second reason why I have confidence, which is we are already seeing some signs of power market recovery. While natural gas is the least exciting area that we look at, natural gas prices on the forward curve are remaining consistent with Exelon's long term fundamental view. While we have seen lower spot market gas prices, we continue to believe that long term prices will need to reflect long run marginal costs and the uncertainties associated with that.

But more importantly, market implied heat rates in NiHub have already improved in the spot market. They have improved in the forward basis since last quarter, and we believe there is still modest upside in forward market heat rates. This means that even without changes in gas prices, forward energy prices at NiHub could increase by several dollars per megawatt hour for this reason alone.

And finally and most tangibly, the PJM capacity auction results announced in May show that the competitive markets are working. About half of our capacity is in the Eastern zones of PJM. Prices there increased by \$100 per megawatt days just since last year. In the Midwestern, RTO ranges prices started much lower but they increased about \$10 per megawatt hour. The demand forecast was up by 1.7% over last year's auction and net demand increased by 2000 megawatts as a result of First Energy's entry into PJM. The higher clearing prices across PJM translates to about \$400 million in incremental annual revenue to Exelon as compared to the auction a year prior.

Looking ahead, we project that the May 2011 RPM auction will result in further increases in price across our region. In other words, an even better price than 2010. Exelon generation is of course poised to capture that value.

Our hedging program protects the cash flows of the company so that we can invest in the system, support the dividend, maintain our investment-grade ratings, all of which are critical to maximizing the value of our utilities and our nuclear fleet. But we also retained the most upside to recovery of any merchant generator. Our 2012 open position is still 50% larger than that of the next largest merchant generator and to further capitalize on our fundamental view of heat rate expansion. While protecting ourselves against decreases in underlying commodities, we use both gas and power put options approximately 10% of our expected generation in 2011 and 7% in 2012.

Our third reason for optimism is our plan for organic growth. You are all familiar with our nuclear upgrade program. In the second quarter, we brought about 30 additional megawatts online at our Quad Cities Nuclear Station. In transmission, we continue to evaluate and invest in projects that improve reliability and relieve congestion.

Exelon Generation has an agreement with Ameren to install a new transformer in early 2012 that will relieve congestion around our Clinton Station and improve pricing for our Midwest fleet in 2012 and beyond. Ameren has already made the requisite FERC filing for the upgrades and we expect FERC approval later this summer.

Exelon Transmission and various other participants in what is called the "SMART Study" have completed the first phase of an analysis which identifies three alternatives for high-voltage transmission lines to connect from Illinois eastward in PJM. Going forward, the Exelon

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Transmission team will tighten its focus on near-term projects and continue to assess where transmission value can best be captured within Exelon.

ComEd filed with the Illinois Commerce Commission last month to invest \$178 million in reinforcements to our Downtown Chicago Transmission System. These would ensure reliability in the event of equipment failures and also in the event some generating units serving the loop are shut down.

PECO is already pursuing about 70 million of transmission upgrades near Eddystone and Cromby stations which are necessary to ensure localized reliability after these units retire. And at our utilities, we are following our respective state policies and developing a balanced approach to our smart grid spend.

In Pennsylvania, we are required to build out a complete system. In Illinois, we are trying to do very substantial demonstration projects and to seek to understand the technology and its effect on our distribution network and customers.

Both PECO and ComEd are pursuing new base rates in their distribution business. We expect that these rate filings along with reasonable load growth over time will position both utilities to continue to achieve earned returns on equity in the 10% range. In sum, whether one is taking a hard look at future EPA regulations, acting on what is happening in the power markets today or pursuing a disciplined organic investment approach to our system, Exelon has and is taking advantage of the best upside position in our industry.

I will now turn the call over to Matt who will talk in greater detail about our financial performance for the quarter and our outlook for the remainder of 2010.

Matthew F. Hilzinger, Senior Vice President and Chief Financial Officer

Thank you, John, and good morning, everyone. As John mentioned, I will provide an overview of the results for the quarter and highlight a few key drivers compared to our earnings guidance and how we expect the results will affect us for the rest of the year. I will also give a brief update on our hedging activity and load forecast. The key messages for today's call can be found on slide six.

I echo John's sentiment on this quarter's performance, it was exceptional. We've recorded operating earnings of \$0.99 per share, well above our guidance for the quarter, primarily due to two drivers. First, higher rev net fuel at ExGen mainly attributable to increased nuclear volumes and improved market conditions and second, favorable weather at PECO and ComEd.

Our second quarter results were achieved despite incurring \$0.03 per share of costs for severe storms that hit the ComEd and PECO service territories. With respect to the storms, thousands of dedicated employees under the leadership of Denis O'Brien, Frank Clark and Anne Pramaggiore worked tirelessly to repair damage resulting from severe storm activity in late June. ComEd restored 90% of the 800,000 plus customer outages resulting from two waves of storms within 24 hours. PECO mobilized its emergency response organization to restore service to the 330,000 customers affected by one storm that lasted 30 minutes. Both ComEd and PECO continued to raise the bar for rapid storm response and delivering on our commitment to keep the lights on.

Our quarter-over-quarter drivers for the operating companies can be found on slides eight, nine, and 10. In lieu of walking through the quarter-over-quarter results, I will spend my time providing additional insight into the two drivers that led to the second quarter earnings being above our guidance.

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Starting with PECO on slide 11, PECO's demand was higher than our plan for the quarter due to favorable weather. During the quarter, PECO's actual cooling days were approximately 77% above normal. On a weather-normalized basis, PECO's second quarter results – load result for the Large C&I class was above our last forecast with most of the improvement coming from the manufacturing segment, primarily steel and petroleum.

The second quarter results for the residential and Small C&I classes were less than our last forecast due to continued high employment and the impact of PECO's Act 129 Energy Efficiency Program. After updating the full year load forecast to reflect second quarter results, PECO's full year load growth estimate is now 0.1%, which still reflects second half load growth largely consistent with what we told you in our last earnings call in April.

Turning to ComEd's load update on slide 12, ComEd's territory also experienced warmer than normal weather conditions. As a result, ComEd's actual results for the quarter were above plan with cooling degree days for the quarter at almost 40% above normal. ComEd's weather-normalized consumption total for the second quarter was slightly better than our last forecast. Load activity for the Large C&I and residential classes was more positive than expected driven by continued recovery in the steel and auto segments for Large C&I. Based on what we saw in the second quarter and our outlook for the remainder of the year, we are maintaining our full year forecast of 0.8% at ComEd with the second half load growth largely consistent with what we told you in April.

Moving to Generation, Generation increased in rev net fuel for the quarter as compared to plan, as a result of exceptional nuclear performance and improved market conditions. Generation's plants achieved a 94.8% capacity factor for the quarter, the best quarterly factor since the first quarter of 2009.

Market conditions were better than our plan for the quarter, particularly in the Midwest where spot prices were higher than plan, which enabled us to benefit from sales of our open position. Since last year, we have held the view that there is upside opportunity in Midwest power prices. We continue to see signs of that view materializing. Slide 13 gives visibility to that upside that we expected.

The NiHub and PJM West 2011 and 12 off-peak energy prices increased since the first quarter. At the same time, we're seeing coal prices stabilize. We believe that the combination of stabilizing coal prices and the modest load recovery is contributing to the upside in prices, particularly off-peak prices.

During the second quarter, we continued to execute on our ratable hedging plan. Our portfolio is now 86 to 89% hedged for 2011 and 57 to 60% hedged for 2012. In comparison to the first quarter, the mid-Atlantic reference price increased by three to \$5 and Midwest reference prices increased by two to \$3, and our open gross margin band in 2012 is up \$350 million.

During the quarter, we sold more in the mid-Atlantic to capture the higher increase in ATC Energy prices compared to the Midwest through various wholesale and retail channels. We are optimistic about further upside in energy prices for many reasons, including the improving market conditions that I just spoke about and the clear signs of recovery John spoke of including heat rate expansion and the 2013, 14 PJM capacity results. Slide 14 provides a visual of the capacity price results which were very positive for Exelon given our significant capacity at the eastern zones of PJM.

Turning now to regulatory and legislative matters, ComEd filed its electric distribution rate case on June 30. This is the first case filing in almost three years at ComEd. We were able to defer filing rate cases during the recession largely due to our work to tightly manage costs in conjunction with our work with stakeholders in Illinois to institute riders like the bad debt rider effective earlier this year.

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In a separate filing later this summer, ComEd will provide an alternative regulation structure for incremental investments in projects that are outside of the traditional rate proceeding such as further investment in Smart Grid. We expect the new rates as a result of both of these filings to be effective in June 2011.

PECO also continues with this rate cases in preparation for its transition at year's end. During the second quarter, PECO completed its third of four-plant procurement events for post-2010 supply. The next and final procurement event for 2011 electricity needs will occur in September.

Let me now turn to recent news regarding the newly passed financial reform bill and its potential impact to the clearing and margin requirements of transactions commonly used in our industry to hedge commercial risk. On that point, we are confident that the hedging transactions we enter into to manage our commercial risk will be exempted from the clearing and margin requirements and we have measures in place to manage our liquidity now and in the future to support a substantial hedging program.

I'd like to discuss and address one item that impacted GAAP earnings this quarter but is excluded from our non-GAAP operating earnings. In the second quarter, Exelon reported a \$65 million after-tax charge reducing GAAP earnings by \$0.10 per share associated with the re-measurement of income tax uncertainties related to ComEd's 1999 sale of fossil generating assets previously referred to as the involuntary conversion and the like-kind exchange positions and potential CTCs received by ComEd and PECO from 1999 through 2001.

Based on the status of settlement discussions with the IRS this quarter, we've concluded that there is sufficient new information for the involuntary conversion and the CTC positions to require of change in measurement of our reserves, in accordance with applicable accounting standards and the charge to earnings this quarter reflects our view of these settlements of these issues.

With respect to the fourth position, the like-kind exchange matter, we continue to believe that we will not be able to reach a settlement on that position and that the like-kind exchange matter will be fully litigated. Our 10-Q to be filed later today provides more information on the financial implications of these tax matters.

Moving to slide 15, you can see our projected sources and uses of cash for the year. We continue to be on track for 2010 with anticipated cash from operations of \$4.6 billion.

Turning to Slide 16, for an update on our 2010 full year earnings guidance, we are raising our full year earnings guidance range up to \$3.80 to \$4.10 per share from \$3.70 to \$4 per share. We are confident that the favorability we realized in the first half of the year coupled with our positive outlook for solid financial and operational performance during the remainder of the year support this new guidance. In comparison to the first half of the year, our second half of the year earnings will benefit from fewer planned nuclear refueling outages, increased RPM capacity revenue, while maintaining a continued focus on cost control. With respect to the third quarter, we expect our earnings to be in the range of \$1 to a \$1.10 per share which assumes normal weather.

Finally, I want to tell you about a change and when we will announce earnings guidance. We plan to introduce full year earnings guidance in the beginning of each year and we expect this will be our practice going forward. This timing is better aligned with our planning and budgeting processes and to that end 2011 earnings guidance will be introduced in early 2011, not at the November EDI conference. We will continue to update our hedging activity on a quarterly basis, which as you know drives a significant piece of our earnings.

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To summarize, we are very encouraged about the financial and operating results this quarter and our outlook for the remainder of the year. The performance I spoke about and combined with the future perspective I shared, illustrates small changes in market conditions can make a big difference to Exelon's bottom line. This quarter our earnings benefited from incremental improvements in load, nuclear volumes and market conditions. We are very well positioned to benefit from continued economic recovery and imminent EPA actions.

I'll now turn the call back over to the operator for Q&A.

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions]. Your first question comes from the line of Hugh Wynne with Sanford Bernstein.

<Q – Hugh Wynne>: Good morning. I wanted to ask a question about the estimated impact of the Clean Air Transport Rule that you outline in your first slide and I guess my question is this, how would you expect the impact to capacity prices to materialize, particularly in Western PJM where we see some coal-fired power plants owned by Edison and Ameren and Dynegy to be particularly vulnerable to closure. And the reason I ask is because it seems to me that the scale of potential retirements in the Western PJM is sufficiently large that they probably can't be permitted by PJM and maintain desired levels of reliability and measures will have to be taken there forward to augment capacity. It might include some of the transmission upgrades that you've mentioned, also RMR contracts such as you've mentioned and maybe demand side management initiatives as well. And I guess my question is could you please walk us through how the capacity impacts would play out given that some of these measures may not in and of themselves actually lead to the withdrawal of this capacity from the auctions?

<A – John Rowe>: Thank you Hugh and good morning. We see it about like you do, the short answer to your three questions are yes, yes and yes. The way we look at it is there will be very substantial impacts in the Illinois, Indiana, Missouri area that you described in your comments, that those impacts will be mitigated by combinations of transmission RMR and demand management activities, we still see very substantial benefit here for the values of Exelon's Generation. And I want to ask both Ken Cornew and Joe Dominguez to supplement my answer because we worked very hard when we developed our Eddystone and Cromby RMR proposals to make certain that we weren't asking for things that were anti-market or anti-green. There are ways to do this that help in both regards. So let me first ask Joe to comment with his insights on your question and then I'll ask Ken to bat cleanup here.

<A – Joseph Dominguez>: Thanks John. You -- let me break this into pieces. First, talking about the Transport Rule, we don't see the Transport Rule as a driver for retirements, not in its present version. I think what John referenced in his earlier remarks is that the combination of two provisions in the Transport Rule. One that it begins in 2012 and two that it eliminates the value of historical SO₂ and NO_x allowances in the bands that exist, will create a new allowance market in 2012, which based on the pricing we've seen in EPA's power price modeling, we would anticipate will have an effect of two to \$3 on market prices beginning in 2012. That does not occur as -- that's in the energy market, that's not the capacity market.

Turning to the capacity market, we have looked at a number of the analyses of retirements that we'd expect in that market, yours as well as Ira's and many others that exist. Across the country if we look at all of the RTOs, there is about 100 gigawatts of excess capacity above and beyond the NERC reliability requirements. So that if we see all of the retirements that are predicted even in some of the more severe scenarios, we would not see a shortage of capacity that would put the system in jeopardy from an overall capacity reserve margin basis. We will see and John alluded to this some hot spots where transmission upgrades will have to be made before units are allowed to retire, but the timing is important here.

Because the capacity auction looks three years forward, unless the RMR lasts for three years or more, you would not affect the next capacity pricing cycle. So for example in the case of our Cromby and Eddystone RMR, we will have to run those units for half a year and an additional year-and-a-half. But they don't affect capacity prices because we would not bid them into the capacity auction, it wouldn't be available for the capacity auction that would be three years forward. And as a general matter what we've seen in terms of our RMR agreement with regard to Cromby and Eddystone and our agreement with the environmental authorities, there are two important points to make, one is that the units and there is two precedents for this, there is the Potomac River Case

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and now our case. The environmental authorities typically do not allow you to run the units in the normal dispatch curve, what they expect unit owners to do is run them for reliability purposes only. That means units in RMR status will run fewer hours of the year and will not have the effect of the stored in power price impacts and allow market price signals to reflect the actual need for replacement generation.

Secondly, under the PJM rules, units that have not cleared in the capacity auction aren't required to bid into the capacity auction and therefore they are not treated as price takers, so while you may have a number of units in RMR status at different points in time, they would not be reflected in capacity pricing because they wouldn't be bid into that market under the existing tariff and under the specific agreements that exist in the FERC precedent.

<A – Kenneth Cornew>: Hugh, Joe and John, I think addressed pretty well the retirement situation, also consider the costs associated with continuing to operate nuclear plant, coal plants and those costs ending up in the bidding structure in the capacity markets for plants that actually exist.

Finally, we also have to consider declining energy benefits from these plants as historical energy benefits decline, that results in higher costs to bid in the capacity construct, both driven by gas prices being lower and incremental and variable costs dispatching these coal plants. So it's not only retirement it's also the cost structure that defines the cost base bid for existing capacity that are likely to be pushed higher.

<Q – Hugh Wynne>: Great, that's actually very helpful. I appreciate it.

<A – John Rowe>: Thanks Hugh.

Operator: Your next question comes from the line of Daniel Eggers with Credit Suisse.

<Q – Daniel Eggers>: Hey, good morning. John, I appreciate the dialogue and I guess if you were to take the conversation a little further and you think about mercury and any other impacts, and what it would do to plant closures and necessary rises in capacity revenues and energy revenues and that sort of thing. How do you deal with the regulators by way of managing through the magnitude of rate increases that would presumably come with the sort of earnings transferred you see out on the horizon and in particular as you look at Illinois, the power authority and their ability to contract outside of traditional auction mechanisms, is there a risk that some of this value transferred never ends up to you, because the regulators get in the way?

<A – John Rowe>: There is always risk, but I would point out that we have a lot of room for upside in 12 and 13 and 14 before power prices get back to the levels in total – in absolute levels or the levels of increases that we were talking about in the 2006 and 07 period.

But, yes of course there is risk and Joe and Darryl Bradford and Bill Von Hoene and Paul Bonney and a whole lot of other people will both be working on managing that risk and also working on ways of handling contractual negotiations so that these increases are feathered in an orderly way – we've been fairly good at finding ways to come up with long-term agreements that soften this volatility on a year-to-year basis. And we will continue to hunt for those ends.

<Q – Daniel Eggers>: I guess one other question John. You've had a more outspoken view on where the markets are going to go because of these policy events. Are you seeing assets out in the market that seem underpriced ahead of what could be a significant recovery as you see the market going?

<A – John Rowe>: Yeah, it's funny. We always see assets overpriced compared to companies. And I don't think we are seeing a lot of underpriced assets out there. We keep looking but the

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people who have the assets that we think will flourish best in this environment, continue to carry pretty good prices for those assets, so we find that shopping is still work for parsimonious people.

<Q – Daniel Eggers>: Okay. Thank you.

Operator: Your next question comes from the line of Jonathan Arnold with Deutsche Bank.

<Q – Jonathan Arnold>: Hi.

<A – John Rowe>: Good morning Jonathan.

<Q – Jonathan Arnold>: My question has to do with just trying to reconcile some of the comments you've made about your optimism in terms of seeing signs of recovery in the market and then just how much additional hedging you put on during the quarter.

<A – John Rowe>: Sure.

<Q – Jonathan Arnold>: It looks like you added the best part of 10% and when I do the math on, what ratable would mean in terms of getting to a 90% type range for 2012, you would – you wouldn't have had to add anything like that much so can you help us reconcile the amount of hedging you did and your comments on the market outlook which seemed in my view to imply optimism around the near term as well as the longer term?

<A – John Rowe>: Yeah, I will do my best. We have lots of reasons to hedge and I'll -- of course I will ask Ken to supplement this, one of which is to protect the dividend and the credit ratings and downside scenarios, another is that the further you go out the less liquid markets are and we don't want to be in a position where we have issues over illiquid markets.

But as I said in my opening comments, we try to soften the effect of the hedging by using put options where we can so we kind of hedge the downside on the basic commodities, but keep a chance to get the spread that we think will be there. It's a constant conundrum for us and if we ever abandon the basic ratable approach, we will let you all know.

But right now we think we should more or less stick with ratable, we do think the upside is real and if – as we become more confident of that, Ken will take it into account in what he does. Ken, can you pick that up from there? Because the tension you describe is clear and it's just that we want to have some absolute protection on the downside.

<A – Kenneth Cornew>: Sure. Jonathan. John highlighted the reason we hedge and how we align our hedging with our financial policies and you've heard that before. And he also highlighted the size of our Merchant Generation Portfolio and how the three year ratable hedging program tends to allow us in an orderly fashion sell our portfolio in an orderly strategic way. Two and three years out, the portfolio still has substantial upside from the open position as he has indicated.

Another comment, we haven't talked about as much in the past is our customers like to buy power in that type of time range also. The competitive retail business is typically a two to three year business. POLR auctions are typically two to five years with full requirements products being in the two to three year range and then block products going out five years in which we have an opportunity to get some upside from environmental regulation.

And finally, there are plenty of wholesale customers out there that are much more interested in having Generation in a forward sense than in a spot sense. Don't forget the price uncertainties that still exist in this marketplace. Economic recovery, obviously spot gas prices still tend to be weaker than forwards and we have to watch that and be sensible about that. And you know the generation supply stack doesn't react that quickly and John talked a lot about what's going to happen to the

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generation supply stack in the future. But it is slow to react and likely not in this three-year timeframe significantly and we have weather uncertainty.

That being said, we've stayed ratable and we've gotten ahead -- we stayed ahead of ratable with our options as we did last quarter. If you look at that hedge disclosure, we're probably slightly behind the ratable pace in the second quarter in '11, slightly ahead in '12. And we did a lot of hedging in '12 in the Eastern part of our portfolio and very little in the Midwest part of our portfolio. So we've tried to balance that and keep some upside. So we continue to look at different products and locations and timing just try to keep as much upside as we can for you.

<A – John Rowe>: I would particularly note Ken's comments that some of his longer-term contracts include some premium for the environmental issues we see.

<Q – Jonathan Arnold>: Could I ask a related follow-up? When you look at the forward curve for power out through PJM and NiHub and you see the kind of uptick there is in the 2014 curve, to -- what do you attribute that to and what -- when you're trying to deconstruct the curve, is there -- how much of that is the upside that you're describing and how much of it is just illiquidity or whatever else in the curve?

<A – John Rowe>: Jonathan, it's obviously challenging to deconstruct. But my opinion is the majority of the movement in heat rates and power prices has been driven by spot prices and what we've actually seen this year relative to last year. We've seen much improvement in spot prices year-over-year. Congestion is significantly less year-over-year. We see some demand recovery particularly off-peak in industrial sectors in the Midwest. And we've actually got some normal weather and a little better weather. So I believe most of what you've seen so far is related to the spot market kind of rationalizing the forward prices.

<Q – Jonathan Arnold>: Thank you.

Operator: Your next question comes from the line of Michael Lapides with Goldman Sachs.

<Q – Michael Lapides>: Yeah. Two questions, not necessarily related to each other. First, demand, your weather adjusted demand trends during the quarter were pretty different, meaning ComEd pretty strong, PECO not so strong. Can you just talk about drivers of that and what you expect, not just kind of going forward near term, but next few years, meaning what are going to be the biggest drivers of demand differences across the two different regions?

<A – John Rowe>: I'll let Denis O'Brien from PECO and Anne Pramaggiore from ComEd pickup on this. But, let me say that you accurately described the second quarter. But in the first quarter, PECO had a better pickup. And on the whole, we're looking at demand growth between 0 and 1% this year, probably a little better in PECO going into the out years. ComEd continuing in that vein unless of course the air quality enrichment program that's going on around the country leads to consistently higher weather. But we see very soft recovery. We tend to see our very large customers coming back, a little improvement in our residential load. But what we would call the small commercial and industrial sectors remain very depressed. And with that, first Denis, then Anne.....or

<A – Denis O'Brien>: Yeah, a couple of more comments. Philadelphia has had a rather unique weather year with the first quarter having 70 inches of snow, snowiest winter in history, a three snowstorms that snowed the region in, interesting enough. And June is the hottest month in Philadelphia in 137 years of record keeping. So when you try to do your weather correction, you're dealing in some pretty unique space. If you put the first quarter and the second quarter together for us, residential growth is at 0% for us for the first half of the year. We see just a moderate growth from there, about a 0.5% growth for the second half of the year. And a Small C&I that the second quarter did not look good, when you put the two quarters together, it's about just under negative 3%

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growth. We saw the Small C&I drop last year in the third quarter, so as we profile it from here on out, it's about a negative 0.5% from here. We see Small C&I very slow in coming back. I think we're near the bottom there, but it's going to be a long way in terms of coming back. And then in the Large C&I, the first half is at 1.4% growth as Matt said driven by the manufacturing sector. We've seen steel and petroleum and particular being strong, that's been about rebuilding inventory and some benefit we've seen from consolidation of plant activities and more load coming into our region.

The load that's coming to the region from the consolidation of plants, we see that continuing on, building of inventory, we do not -- we see that trailing off unless we see the economy turn significantly. And when you add them together with some known information we have from the pharmaceutical sector, we see the large C&I pretty flat for the second half of the year in terms of -- in comparison to '09. So all-in-all staying with our estimates, pretty flat for the rest of the year.

<Q – Michael Lapides>: Got it. Unrelated question, lots of the PJM assets are either going to incur significantly more cost, aka the unscrubbed coal units or shut down. When you look outside of PJM, meaning the states to your north, to your west and even some to your south, lots of -- have you looked at how many of those coal plants are actually being scrubbed and whether those coal plants can wheel power into Northern Illinois?

<A – John Rowe>: Joe Dominguez will take that.

<A – Joseph Dominguez>: Sure. Obviously because of the imports into PJM, we look at retirements not just within PJM, but in MISO and to a lesser extent within SERC. So we have taken all of that into consideration, I think those are the three areas, you put your finger on that are going to see the greatest impact in terms of the coal retirements. This is certainly not a situation that's unique to PJM. I'd say there are three NERC reliability regions that are going to be most affected and that's going to be PJM or RFC, how it's called in NERC space, MISO and SERC are going to be see similar numbers of retirements as a result of these new regulations and we have considered that in our modeling space.

<Q – Michael Lapides>: Are you likely to see a fundamental difference in the number of plants across scale or size that gets scrubbed in the states where honestly those plants are under rate -- traditional rate making processes versus those that are in competitive markets and how would that impact kind of the NiHub market?

<A – Joseph Dominguez>: I think there are two view points out there, one is -- and I've read one view that regulated space will use this as an opportunity to retire plants and build new plants, and the plants that are retired are generally older plants that don't have a lot of rate base value, so they will use this essentially as a tool to reshape the regulatory compact in those states and obviously there is another school of thought that they will hold on a little bit longer in regulated space.

The reality is that the costs associated with all of these environmental regulations, I'm not just talking about air here, but layering on coal combustion waste and potential water regulations, it's going to be difficult for folks to pay for the plants that they want to keep open, the ones that aren't really marginally economic, but the ones that they really like and would like to retrofit to make compliant with all the environmental regulations. When you add on really putting on controls and doing that sort of thing on plants that are economically marginal, I don't think you are going to see behaviors that are radically different in monopoly markets as opposed to competitive markets.

<A – John Rowe>: I would just like to add to this, and then I'll let Ken and Joe, correct me if they think I'm wrong. I guess I see the picture in Wisconsin, Iowa, Missouri, Southern Illinois, the adjacent areas a little bit more like some of the suppositions in Hugh Wynne's earlier questions. The big new units that are most compliant, most valuable tend to be in turf like Southern, Duke, AEP, Dominion. And I think if you look at Wisconsin, Iowa, Missouri, Southern Illinois, you tend to

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see a pretty large percentage of the older and unscrubbed, units that would have the largest compliance burden. I say that based on both things I've seen and anecdotes. But Ken, did I overstate that?

<A – **Kenneth Cornew**>: No, John, I think you said it perfectly and one more comment I would add is regulated states and regulated entities don't typically build or maintain generation to export to other regions, they do it for their customers. So Michael I would think that impact would be minimal from that perspective.

<A – **Stacie Frank**>: Cynthia, I think we have time for one more question please.

Operator: Your final question today comes from the line of Brian Chin with Citigroup.

<Q – **Brian Chin**>: Actually my question was asked and answered. Thank you.

Operator: Your next question comes from the line of Steve Fleishman with Banc of America.

<Q – **Steve Fleishman**>: Yeah, hi John. Can you hear me?

<A – **John Rowe**>: Sure Steve.

<Q – **Steve Fleishman**>: Hi. Yeah, just I guess in – with the commentary you made about positioning on the environmental rules, what does this mean if anything for how you are looking at kind of M&A? And I guess maybe are you still the hyena or are you more of a gentle elephant right now?

<A – **John Rowe**>: Steve, you've known me for much of the last two decades and you know I am always careful. I just – we've been calling Hilzinger here El Toro because of his optimism, but I doubt if anybody is going to start calling me the elephant anytime soon. Where we remain very value driven, we always look, we stay oriented towards cleaner fleets rather than less clean fleets. But we believe that this is an industry where you need consolidation, but to make it, make sense for investors, it has to be earnings accretive in relatively early time periods, and it has to be consistent with our need to maintain investment grade credit rating. So, no you're not going to hear a lot more trumpeting, trunk waving or roaring around here. We're constantly looking for how you add real value and that isn't going to change as long as I sit here.

<Q – **Steve Fleishman**>: Okay. But it also sounds like your more focus still is on, if at all on value in the Generation side as opposed to the regulator side.

<A – **John Rowe**>: Well, I wouldn't say that, because we'd like some of the additional diversity that having more regulated business would give us. The problem is that the regulated integrators are in my view on an up cycle in their market valuation and the commodity driven companies are at the low end of the cycle. So you have to be very careful about using your own paper which has more upside potential in the future to buy somebody who is more regulated and may already be higher. We'd like to have a little more balance, but it's very difficult to find one that meets our valuation criteria.

<Q – **Steve Fleishman**>: Okay. No, that's very helpful. Thank you.

Stacie M. Frank, Vice President of Investor Relations

Cynthia, I would like to turn the call back to John Rowe for a couple of closing remarks.

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John W. Rowe, Chairman and Chief Executive Officer

Just to wrap up, Exelon as you all know is just different than other folks. We are two-thirds to three quarters a commodity business and one-third to one-quarter a regulated set of T&D companies. And when you think about that, we kept our earnings well over \$4 last year in the worst recession in decades. We are beating our expectations this year. And if you look at our earnings range, you can see that we think we have a shot at something in the 3.90s or perhaps even over 4 this year. We should do a little better next year. As we've said '12 is a little tougher, but I think you see growth again in '13 and '14 and I just leave you with this. There are very, very few commodity-driven companies that can hold earnings that well and give you the kind of upside that we can give you. And we are committed to making it happen. Thanks everybody.

Operator: Ladies and gentlemen, that concludes today's conference. You may now disconnect.

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