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Morning Comment
Maureen Howe, Ph.D., Analyst (604) 257-7195
Fai Lee, CGA, Associate (604) 257-7662

PIPELINE AND GAS & ELECTRIC UTILITIES

Prices of U.S. Energy Companies Remain Weak as Canadian Group Reaches New Highs

EVENT

During the last several weeks the share prices of AES, Calpine, NRG, Mirant, El Paso, Enron, Dynegy and Williams have each hit their 52-week lows. While there has been modest recovery in the prices of several of these companies over the past several days on the heels of earnings confirmations, in general, the U.S. companies are still trading at discounts ranging from 45% to 85% from their previous 52-week highs. In comparison, the Canadian companies, with the exception of TransAlta, are trading at or near their 52-week highs. The attached price charts on the following pages illustrate the differences between the Canadian and U.S. energy companies. There are a number of contributing factors that account for the different valuations between Canadian and U.S. energy infrastructure stocks. We believe these factors have important implications for investors.

IMPLICATIONS

1. **The U.S. Energy Companies have greater commodity price exposure.**
   In comparison to the Canadian companies, the U.S. energy companies have much greater commodity price exposure. While several of the Canadian companies have benefited financially from selling excess power into the Alberta grid over the past year at exceptionally high prices, for the most part, the vast majority of their available power output is contracted under long-term agreements. In the case of the U.S. generators, the leverage to spot prices is much greater. Further, in the case of Williams and El Paso, commodity price exposure is not only to power through their generation businesses, but to oil and gas as well through their exploration and production businesses.

2. **U.S. Companies Derive a Greater Percentage of Their Earnings From Energy Marketing & Trading**
   As illustrated on the following chart, the U.S. energy companies are the largest energy marketers in North America. The profitability of energy trading operations is largely a function of the volatility in commodity prices. With the precipitous drop in energy commodity prices experienced over the past four months, volatility has also radically decreased. The impact on the various marketers will be a function of what percentage of their business is derived from pure trading as compared to more marketing oriented activities such as netback sales business and structured products. Nevertheless, we expect there will be significant reductions in most aspects of the energy marketing and trading

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operations of the U.S. energy companies. The only Canadian companies with material operations in the area of energy marketing and trading are TransAlta, TransCanada and Westcoast. TransCanada announced in May that it was exiting the natural gas marketing business and has treated this division as a discontinued item in its financial reporting. Westcoast's Engage Energy continues to operate in the area of energy marketing, however the focus of its operation is primarily towards structured products. For the first six months of 2001, TransAlta's energy marketing operation contributed $78.5 million to the total company EBIT of $263.2 million. We expect the earnings contribution to TransAlta from this area will decline significantly during the balance of the year and have reflected this view in our earnings forecast for the company.

Top 20 North American Gas Marketers (Bcf/d)

Company	Q2/01	Q2/00
1. Enron	24.6	22.4
2. Reliant	13.2	10.4
3. Duke Energy	12.8	11.7
4. BP	12.3	7.4
5. Mirant	11.8	7.7
6. Dynegy	10.9	9.3
7. Aquila Energy	10.3	10.0
8. Sempra	10.1	9.3
9. El Paso	9.2	6.1
10. American Electric Power	8.5	3.0
11. Coral Energy	8.3	9.4
12. Conoco	7.0	5.3
13. Entergy-Koch	7.0	6.5
14. Texaco	4.4	4.1
14. PG&E	4.4	4.7
16. Dominion Resources	3.8	2.1
17. Exxon	3.5	3.7
18. Anadarko Petroleum	3.4	1.7
19. TXU	2.7	4.0
19. Oneok	2.7	3.7

Top 20 North American Power Marketers (MWh)

Company	Q2/01	Q2/00
1. Enron	212.5	124.1
2. American Electric Power	134.5	114.2
3. Duke Energy	118.1	58.2
4. Reliant Resources	86.1	35.8
5. PG&E National Energy Group	73.2	51.3
6. Dynegy	70.1	26.2
7. Mirant	69.7	50.1
8. Aquila	66.3	39.6
9. Williams	63.4	23.9
10. Exelon Power Team	52.5	20.9
11. Dominion Resources	46.2	30.2
12. El Paso Merchant Energy	44.5	22.4
13. Constellation Power Source	32.3	27.4
14. Entergy-Koch Trading	26.4	27.6
15. BP Energy	24.9	1.2
16. CMS Energy Trading Group	24.8	1.3
17. Morgan Stanley Capital Group	22.4	N/A
18. Edison Mission Marketing & Trade	19.6	N/A
19. Coral Energy	13.4	7.9
20. Tractebel	11.1	9.2

Source: Natural Gas Week

3. Lack of Yield Support

Unlike the Canadian energy infrastructure group, the U.S. companies do not have the benefit of significant dividend yields to support their share prices. The U.S. companies pay little or no dividends. In contrast, the Canadian companies tend to trade like convertible bonds. When interest rates are low, as they currently are, the companies trade on their "bond value" and are supported by tax-efficient dividend yields. When the 10-year GOC yield rises above 6% to 6.5%, the Canadian companies trade on the basis of their underlying earnings and P/E. With dividend yields that range between 3.2% to 5.0%, the Canadian energy infrastructure companies provide attractive alternatives to fixed income instruments, particularly when the dividend tax credit is taken into consideration. To compete with these dividend yields on a tax-equivalent basis, fixed income instruments would need to yield between 4.0% to 6.3%.

4. Regulated Nature of Canadian Energy Infrastructure Operations

Although the regulated nature of Canadian energy infrastructure operations do not imply the same "sizzle" as the dynamic businesses of their U.S. cousins, the earnings that emanate from the regulated businesses tend to be very low risk and largely immune to fluctuations caused by economic cycles. As such, the earnings predictability provided the majority of companies in this group is highly valued by investors and provides a defensive position to portfolios. In contrast, the U.S. operations have a much smaller percentage (if any) of their bottom line performance derived from regulated operations. In addition, in the case of U.S. pipelines, which are generally regulated on a complaint basis, the companies are exposed to throughput risk unless they are willing to trigger a full revenue requirement hearing in the attempt to recover lost profits from volume reductions.