

# SMITH BARNEY SHEARSON

A **PRIMERICA** Company

## SITHE ENERGIES, INC#. (SYT-NYSE)

Independent Power Producers

Release date: September 15, 1993

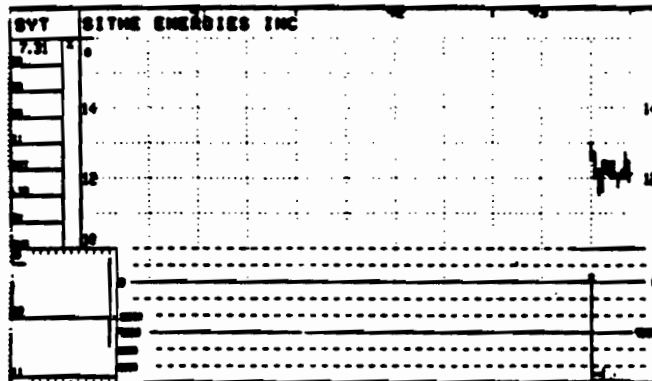


Chart Courtesy of Mansfield Chart Service

- Initiating coverage

- Analysts' Opinion:  
2 Outperform  
M Medium Risk

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Price (9/8/93)	\$12	1994 P/E Rel. to S&P 500	220%
52-Week Price Range	\$13-\$12	Dividend/Yield	Nil
EPS 1994E	\$0.30	Book Value Per Share (June)	\$3.04
EPS 1993E	\$0.00	Cash Flow Per Share 1992A	\$1.17
EPS 1992A	\$0.49	ROE 1992A	9.6%
EPS 93-98E Annual Growth Rate	25%	Debt as % of Total Cap. (June)	87%
Price/1994E	36.7x	S&P 500 (9/8/93)	456.65
Price/1993E	NM	Shares (million)	55.2

NM - Not Meaningful

### INVESTMENT OPINION AND SUMMARY

- Sithe, one of the largest independent power producers, has 540 MW in 21 operating generation projects and an additional 1,229 MW in three generation projects currently under construction.
- Earnings should grow rapidly through 1995 in our opinion, as projects under construction enter commercial operation and begin selling power. Additional development projects are likely.
- Sithe trades at 9.3x our 1995 EPS estimate (\$1.30) and compares with our expected P/E of 11.4x, based on a discount to comparable company multiples, suggesting a target price of \$14-\$15, relative to the current \$12 price. Initiating coverage with a 2M (Outperform, Medium Risk)

## SUMMARY AND INVESTMENT THESIS

Sithe Energies Inc. (Sithe) is an operating Independent Power Producer (IPP). The company primarily operates natural gas-fired and hydroelectric generating facilities. Sithe has maintained an average availability factor of more than 90% for its gas-fired plants since 1988, the year it began operating gas-fired generating facilities. A combination of strong management and focus on efficiency is required to operate generating plants this successfully. This is important because, unlike an electric utility, Sithe, as an IPP, produces electricity for sale into the wholesale market and makes a profit on the sale of each kilowatt hour. If there is no product (electricity) to sell into the wholesale markets, the company does not make profit on its investment. Furthermore, as an efficient plant produces more electricity, more profit is produced, assuming that the additional electricity can be sold.

With this successful track record, the company has been able to grow both revenues and earnings (excluding nonrecurring charges) over the last few years. Since 1990, gross profits of Sithe have grown by more than 20% annually. Sithe currently operates 21 generating plants that generate, in the aggregate, 540 megawatts (MW), averaging about 25 megawatts per project. Currently, the projects range in size from less than 10 MW to 79 MW. With the larger projects currently under construction, we expect that profits will continue to grow rapidly over the next few years. The company's largest plant, the Independence project in Oswego, New York, is currently under construction. The 1,000-MW facility is a natural gas-fired combined cycle combustion turbine that is expected to enter commercial operation in January 1995. The Cardinal and AG Energy plants are also under construction and will add 150 MW and 79 MW, respectively, to aggregate capacity.

Sithe continues to explore other projects both domestically and worldwide to continue to add to its portfolio. Importantly, unlike the utility business, IPPs must continue to develop projects or earnings growth declines markedly. The company continues to focus on North America, but is expanding efforts to develop an expertise in a few other countries. Our EPS estimates for 1993 through 1995 are \$0.00, \$0.30 and \$1.30, respectively. Table 1 shows summary financial statements for the years 1991 through 1995. We believe that our 1995 estimates are more likely to increase than to decrease over time. Importantly, the Independence project is expected to provide almost 60% of consolidated net income in 1995. The company has no plans to pay a common dividend in the foreseeable future.

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Table 1  
**Sithe Energies, Inc. - (SYT - NYSE)**  
 Summary Financial Statements, 1991-95E  
*(in thousands of dollars, except per-share figures)*

	1991	1992	1993E	1994E	1995E
<b>Income Statement:</b>					
Revenue.....	\$189,021	\$233,355	\$268,747	\$351,888	\$795,300
Total Cost of Sales.....	148,586	176,165	200,620	262,089	553,114
Gross Profit.....	40,435	57,190	68,127	89,799	242,186
Operating Profit.....	32,427	32,314	57,183	78,054	229,922
Income From Continuing Operations.....	13,103	6,900	623	13,920	72,007
Net Income.....	12,916	21,641	623	13,920	72,007
Earnings per Share.....	\$0.29	\$0.49	\$0.01	\$0.25	\$1.30
Earnings per share before neg. interest arbitrage...	0.29	0.49	0.28	0.33	1.30
<b>Cash Flow Statement:</b>					
Operating Cash Flow.....	\$28,474	\$32,129	\$39,406	\$48,572	\$122,198
per share.....	\$0.64	\$0.72	\$0.79	\$0.88	\$2.21
<b>Balance Sheet:</b>					
Plant in Service.....	\$256,745	\$282,418	\$459,286	\$615,255	\$1,352,665
Total Assets.....	546,297	839,789	1,570,007	1,608,027	1,699,241
Project Debt.....	269,331	486,015	1,227,435	1,239,888	1,252,685
Equity.....	61,661	71,817	211,992	225,912	297,919
Total Liabilities & Common Stock Equity.....	546,297	839,789	1,570,007	1,608,027	1,699,241
Price to earnings ratio.....	41.7	24.9	43.4	36.9	9.3
Price to cash flow ratio.....	18.9	16.8	15.3	13.8	5.5

Note: 1991 and 1992 net income include non-operating gains from arbitration settlements regarding the Stockton plant that the company sold in 1992.

NM = Not Meaningful

CGR = Compound Growth Rate

Source: Smith Barney Shearson.

With a strong operating track record, good management, project backlog and growing earnings, Sithe appears to be well positioned over the next few years relative to other IPP companies. *Importantly, however, we do not believe that the current stock price reflects this.* However, as the Independence project (the company's largest project) is not expected to enter commercial operation until early in 1995, a full reflection of this position is likely to evolve over the next 12-18 months, in our opinion.

Sithe trades at 9.3x our 1995 earnings estimate while its peer group (shown in Table 2) trades at an average P/E of 12.7x 1995 earnings. Once the Independence project enters commercial operation and other development projects are investigated and back-logged, we believe that Sithe will be awarded a P/E ratio similar to that of AES Corporation (13.4x) or California Energy (13.2x), suggesting a fair value for Sithe of \$16-\$17, relative to the current price of \$12. This represents upside potential of between 33% and 42%. More conservatively, however, if we assume a 10% discount of the P/E to comparable company multiples due to the asset concentration of SYT (Independence will represent 45% of assets and 60% of net income in 1995; see Risks Section), the fair value would be \$14-\$15, still more than 15% above current prices. Recognizing that our calculated fair value is likely to be realized over the next 12-18 months as construction and development benchmarks are realized, we are initiating coverage of Sithe Energies with a 2M (Outperform, Medium Risk) rating.

# SYT- 4

Lastly, but importantly, we would like to point out that *Sithe* is not an electric utility. As an IPP, *Sithe* is a wholesaler of electricity to distributors (utilities). *Sithe* takes the risk of delivery and makes a profit on the sale of each kilowatt hour through the efficient operation of the generating assets as well as the use of relatively more financial leverage than utilities. Electric utilities are facing more competition at the generation level of the business from companies like *Sithe*. *Certainly, relative to the electric utility industry and, in our view, relative to the S&P 500 and other IPP companies, Sithe represents attractive value at current prices.*

**Table 2**  
**Sithe Energies, Inc. - (SYT - NYSE)**  
**Valuation Table**

Company	Ticker	-- Earnings per Share (1) --			Est.(2)	Price	Common Shares	Market Cap	1995 P/E	Average Volume	Year to Date Perform
		1993E	1994E	1995E	5 yr Growth						
Sithe Energies, Inc	SYT	\$0.00	\$0.30	\$1.30	25.0%	\$12.13	55.2	\$669.3	9.3	27,250	-6.7%
AES Corporation	AESC	1.93	2.14	2.37	18.5%	31.75	47.4	1,505.0	13.4	95,608	14.4%
California Energy	CE	1.14	1.29	1.39	16.2%	18.38	35.4	650.9	13.2	88,380	9.7%
Destec	ENG	1.59	1.80	1.75	13.0%	17.38	62.0	1,076.5	9.9	42,171	7.8%
Magma Power	MGMA	2.11	2.44	2.75	17.0%	38.75	23.1	894.9	14.1	151,100	20.2%
Average (excluding SYT):								1,031.8	12.7		13.0%

Note: SYT began trading after its IPO on June 23, 1993. Further, there are only about 12 million shares of float.

(1) Earnings estimates for comparable companies are based on consensus estimates from First

(2) Estimated 5-year growth rates for comparable companies are based on consensus estimate First Call.

Source: IDD Information Services/Tradeline and Smith Barney Shearson.

## VALUATION

We are initiating our coverage of *Sithe Energies Inc.* with a 2M (Outperform, Medium Risk) rating. The stock currently trades at 9.3x our 1995 earnings estimate. We are valuing *Sithe* based on a 10% discount to the average P/E of the comparable company group. Table 2 shows the comparables. The discount to the comparables reflects *Sithe's* asset concentration risk. The Independence project will represent almost 45% of assets and 60% of net income in 1995. Based on an average P/E of 12.7x, a 10% discount is a P/E of 11.4x, which implies a price of \$14-\$15. This compares with the current price of \$12 and represents better than 15% appreciation potential. As *Sithe* adds more projects to its portfolio, thereby reducing the asset weighting of the Independence project, the stock should experience a P/E multiple expansion toward the group average. Ultimately, based on a group average of 12.7x 1995 earnings estimates, the fair value for SYT is closer to \$16-\$17. This represents appreciation potential ultimately of between 33% and 42%. Importantly, however, we believe that the P/E multiple expansion is likely to occur at or after the commercial operation of the Independence project in January 1995.

Since the initial public offering in June, *Sithe* has underperformed both its peer group and the market. The stock is down 7% relative to a peer group, that is up 6% (2% when Magma Power is excluded) and the S&P 500, which is up 4%. At current prices, we believe that *Sithe* is attractive relative to a peer group of independent power producers, the S&P 500, and, certainly, relative to electric utilities that are facing little, if any, growth as well as increasing competition at the generation level. This competition is coming from companies like *Sithe*.

From a trading perspective, we believe that Sithe's stock price will react to the announcement of new projects, indicating additional earnings growth in the intermediate term as well as news regarding the progression and cadence of construction at Independence. Further, we also believe that Sithe will react to news on the long-run avoided costs (LRACs) filed by New York utilities, specifically, Consolidated Edison# and Niagara Mohawk Power# as the purchasers of the power produced by Independence. LRACs are filed quarterly by the utilities and are a close proxy for the ultimate price that Sithe will be paid for the electricity produced by the project. The New York Public Service Commission (NYPSC) is likely to announce the new (June) LRACs on September 29, 1993. LRACs that are higher than the previous (March) quarter are likely to be viewed positively. It is important to remember that the Independence partnership will not be paid on the basis of LRACs, but rather, based on a filed tariff designed to reflect the actual avoided cost of production.

### **Introduction: An IPP**

An independent power producer (IPP), is a non-utility generator of electricity, generally for wholesale. Largely created under the Public Utilities Regulatory Policy Act of 1978 (PURPA), IPPs are alternative generators of electricity. PURPA provides exemption from utility regulation for qualified facilities (QFs). A QF has to provide both electricity and some other form of thermal energy simultaneously. This technology is widely known as cogeneration. With QF status, a utility has to purchase the electricity produced by the QF at the utility's avoided cost. Avoided cost is defined as the equivalent cost to the utility to produce a similar amount of electricity or capacity. The avoided cost issue is significant due to the relative cost advantages that IPPs have over utilities. Importantly, a utility can not own more than 49% of a QF status generator. Further, as competition increases, QFs are less likely to be paid avoided cost. This is in part due to competitive bidding for generation.

IPPs, including QFs, generally have advantages over utilities that enable them to produce electricity at a lower cost. These advantages include increased financial leverage, higher asset utilization and increased siting flexibility. As nonregulated entities, IPPs can generally employ more financial leverage than utilities can. On average, utilities have an equity capitalization of about 45%, while IPPs average closer to 20%. The lower cost of debt relative to equity is very significant in a capital-intensive business such as electric generation.

IPPs generally have a higher asset utilization rate, as these nonregulated companies generally sell all of their electricity, while utilities must maintain a reserve margin to allow for demand spikes or unexpected supply shortfalls. Simplistically, comparing two 1,000 MW systems – an IPP and a utility – the IPP is likely to have between 7.9 billion and 8.3 billion kwhs to sell, while the utility is likely to have between 6.7 billion and 7.1 billion kwhs to sell<sup>1</sup>. The fixed costs of the IPP are spread over a larger number of kwhs, thereby reducing the cost. As a regulated monopoly, electric utilities continue to operate under an obligation to serve. IPPs are not obligated to serve and do not need to maintain any reserve margins, increasing the asset utilization of most IPPs relative to electric utilities.

Further electric utilities, as a regulated monopoly, are generally given franchise territories to serve. The utility will generally need to construct its generating facilities within this franchise territory. IPPs have no such restriction, obligation or inclination. The unregulated wholesaler builds a plant wherever supply is needed and a suitable site can be secured for generation. This siting flexibility, combined with the other advantages discussed above, generally allow IPPs to produce electricity (all other factors being

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<sup>1</sup> The reserve margin utilities need to keep is the difference between the IPP and the utility. The example assumes equally efficient operation of the assets, but assumes that the utility keeps a 15% capacity reserve margin.

equal) at a lower cost than their utility brethren. Open wholesale transmission access, as provided in the Energy Policy Act of 1992 (EPA), increases this flexibility.

The Energy Policy Act of 1992 provided two very significant changes to the electricity generation business. The EPA created a new class of generators, exempt wholesale generators (EWGs), and gave the Federal Energy Regulatory Commission (FERC) the ability to mandate open wholesale transmission access. The creation of EWGs is significant, as it takes PURPA one step further, allowing larger, better-capitalized companies to participate in electric generation. EWG status generators are exempt from the restrictive laws of the Public Utility Holding Company Act (PUHCA). Importantly, PURPA was designed to encourage alternative suppliers of electricity. EWGs under EPA were created to increase competition at the generation level of the electricity business. The ability for FERC to mandate open wholesale transmission access provides an avenue for wholesalers to get their product (electricity) to market.

### Sithe Energies: Building Power

Sithe is a significant player in the independent power generation business. The company has interests in 21 operating projects, representing about 540 megawatts (MW), with an additional three projects under construction, representing 1,229 MW. All of the projects are currently in North America. Including the projects under construction, Sithe is one of the largest non-utility affiliated Independent Power Producers (IPP), measured by net ownership of generating capacity. Table 3 shows the company's operating projects as well as the projects currently under construction.

Table 3  
Operating Plants & Plants Under Construction

#### Operating Plants

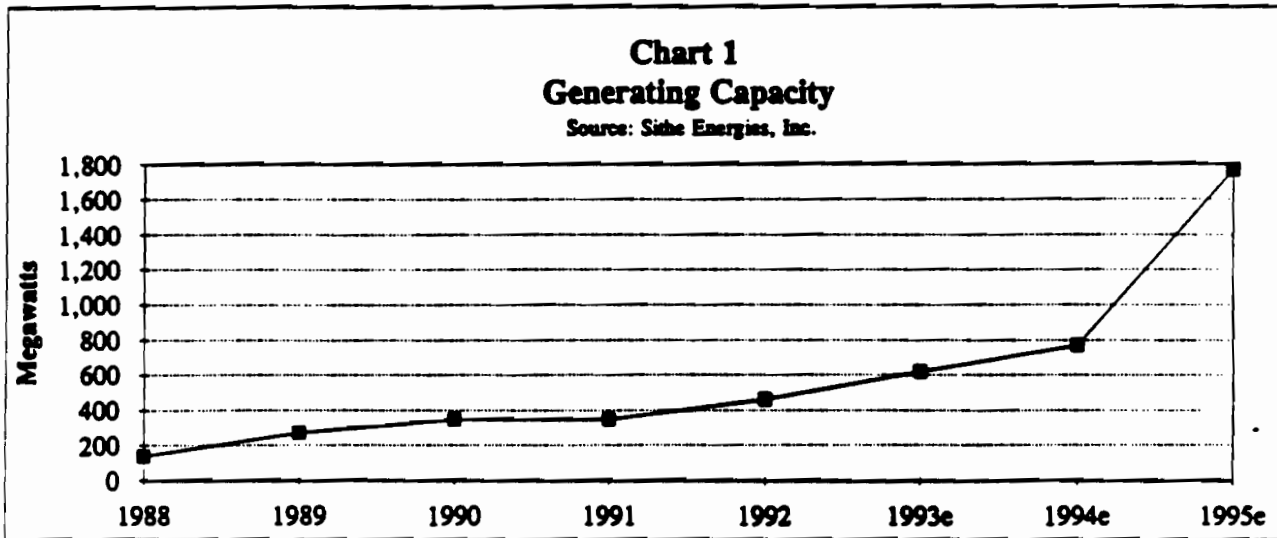
Name	Location	% Ownership	MW	Original Cost (in millions)	Date of Commercial Operation	Power Sale To
Navy	San Diego, CA	100%	105	129.0	3Q89	SDO
Alcoa	Massena, NY	70%	79	77.7	Apr-93	NMK
Greeley	Greeley, CO	100%	72	61.5	Nov-88	PSR
Sterling	Sherrill, NY	100%	57	63.0	Jan-92	NMK
Batavia	Batavia, NY	90%	55	71.3	Sep-92	NMK
Oxnard	Oxnard, CA	100%	47	50.0	Jun-90	SCE
Allegheny 8&9	Armstrong County, PA	100%	32	96.0	Dec-90	NYSEG
Other Hydro			27			IDA, PCG, CPL
Kenilworth	Kenilworth, NJ	100%	25	35.0	Jul-89	Schering, JCP&L
Feather River	Marysville, CA	100%	17	18.4	Jun-88	PCG
Allegheny 5&6	Armstrong County, PA	100%	16	51.5	late 89	West Penn Pwr
P&N	West Carthage, NY	75%	8	9.4	Oct-88	NMK

#### Projects Under Construction

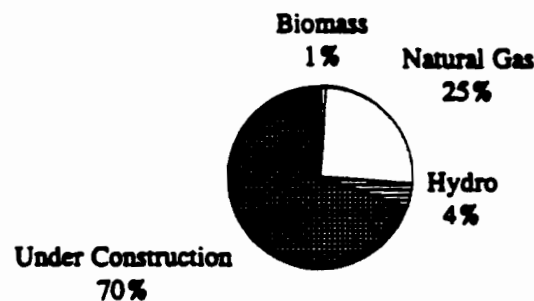
Name	Location	% Ownership	MW	Original Cost (in millions)	Date of Commercial Operation	Power Sale To
Independence	Oswego, NY	100%	1000	NM	early 1995	NMK, ED
Cardinal	Cardinal, Ontario	50%	150	NM	late 1994	Ontario Hydro
AG Energy	Ogdensburg, NY	85%	79	NM	late 1993	NMK

Source: Sithe Energies, Inc.

Of the 21 operating projects, 10 are hydro projects and 10 are natural gas-fired generating projects, while one is a biomass-fueled plant. The hydro projects average about 8 MW, while the natural gas-fired projects average 45 MW. The biomass project is a 17 MW facility in California<sup>2</sup>. More important, however, the three projects under construction will significantly increase the company's generating capacity. As stated above, the three projects represent 1,229 MW and are all natural gas-fired facilities. Clearly, with the current back-logged development, we are witnessing this IPP "coming of age." Chart 1 shows the aggregate generation by year since 1988.



**Chart 2**  
**Current and Future Generating Capacity: By Fuel Type**



Note: All generation under construction (3 projects) is natural gas-fired.  
Source: Sithe Energies, Inc.

<sup>2</sup> Feather River, the biomass-fueled facility in California is under contract to be sold by the company. Prior to the company's initial public offering in June, Sithe wrote-down the book value of Feather River to net realizable value. The executed contract could allow Sithe to book a small gain on the write-down book value in 1994.

The largest of the projects under construction is the Independence project. *Independence should be, by far, the strongest of several growth engines for Sithe over the next few years.* The project is a 1,000 MW natural gas-fired generating facility in Oswego, New York. The power from the project is sold under long-term contract to local utilities. The project is a QF status facility as defined under PURPA. The plant will probably represent about 45% of the consolidated assets of Sithe and about 60% of the consolidated net income. In general, the company focuses on generation from environmentally friendly natural gas and hydro resources. Chart 2 shows the fuel mix of the operating plants as well as the plants under construction.

Sithe was formed by William Kriegel, the current chief executive officer of the company, in concert with Compagnie Generale des Eaux, the French water company and the largest water company in the world, and a partner of Mr. Kriegel, Paris Mouratoglou, in 1984. The company was formed to own and operate non-utility generators, in order to sell electricity into the wholesale market. The laws forged under PURPA and the recently passed Energy Policy Act of 1992 (EPA) exempt non-utility generators (under certain circumstances) from regulation as a public utility. Sithe's goal is to remain exempt from regulation as a public utility through adherence to the laws defined under PURPA and EPA. CGE remains the largest shareholder, owning 62% of Sithe Energies. Management owns 18% of the stock.

Sithe plans to continue to focus on natural gas and hydro generation projects. The environmental appeal and operational expertise that the company has accumulated over almost 10 years is a solid foundation for development, in our opinion. The company's international effort will continue to be limited to the countries or areas that Sithe knows well. These include the United States, Canada and Mexico. Other countries will be added over time. Importantly, the company is not interested in a "shotgun" approach to participating in the worldwide electric generation market.

### **The Independence Project**

The biggest portion of the earnings growth that we are expecting comes from the Independence project. The Independence project is the largest project Sithe is involved with and should be the largest non-utility affiliated IPP-owned generating facility in the nation when the plant becomes commercial in January 1995. The project is a 1,000 MW natural gas-fired, combined cycle combustion turbine generating station located in Oswego, New York. The plant will employ General Electric Frame 7FA turbines<sup>3</sup> with combined cycle technology. Construction began in November of 1992 and the plant is expected to be complete and ready to enter commercial operation in January 1995. Sithe has contracted with General Electric and EBASCO for construction of the plant. The contractors have taken on most of the construction and delivery risk. The contract provides operating performance standards under which Sithe can seek remedy if not attained. All current indications suggest that the plant is on schedule to be commercially operational in January 1995.

The power from the project will be sold to Consolidated Edison of New York (Con Ed) and Niagara Mohawk (NiMo). A small amount of the generated power will be sold to the plant's steam host, Alcan Aluminium Ltd. By selling thermal energy to Alcan, the project is a qualified facility (QF) as defined in the PURPA of 1978. The electricity sold from Independence will be priced based on the actual avoided costs of generation for the purchasing utility; in this case, Con Ed and NiMo. The actual avoided cost rates for the utilities are tariff rates that must be filed with and approved by the New York

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<sup>3</sup> The new GE Frame 7FA turbine is a new model of the previous 7F model turbine. Currently, there are none of the new turbines in commercial operation. However, Florida Power & Light will be the first to bring one into commercial operation in late 1993. Importantly, the Frame 7F and 7FA model turbines are significantly based on six generations of Frame 7 turbines.



Public Service Commission (NYPSC). Con Ed's price will include both an energy charge based on actual avoided costs of production and a capacity charge. The output sold to NiMo is on an energy-only basis. The electricity and steam sold to Alcan Aluminium is essentially at cost. An abbreviated income statement forecast for the Independence project's contribution to consolidated earnings is shown in Table 4. Our estimates use the companies' (Con Ed and NiMo) filed long-run avoided cost estimates (LRACs) as a proxy for the actual avoided cost that will be charged in 1995 and beyond when the plant is supplying electricity.

The power sale to Con Ed is a 40-year contract for about 740 MW of power. Under the contract, Con Ed is obligated to purchase the capacity at its avoided cost. Most of the fixed charges are recovered in the first 6.6 billion kwhs sold<sup>4</sup> through the capacity charge. Sales to Con Ed beyond this level are largely sold on an energy-only basis. The avoided cost charge is based on the actual avoided cost of energy tariff filed with the NYPSC (SC-21 of PSC No. 8 - Electricity). The LRACs is a forecast of actual avoided costs that the utilities must file with the NYPSC on a quarterly basis. The LRACs filed over the next 18 months will continue to send indications of what the project will actually be paid for the electricity sold. The next LRACs are due to be approved by the NYPSC in September.

Table 4  
 Sibte Energies, Inc. - (SYT - NYSE)  
 Independence Project Income Forecast, 1995E-96E  
 (in thousands of dollars, except per-share figures)

	1995E	1996E	% Chg.
<b>Revenues:</b>			
Consolidated Edison of NY.....	343,179	351,551	2.4%
Niagara Mohawk.....	29,141	29,857	2.5%
Alcan Aluminium.....	11,980	13,102	9.4%
<b>TOTAL.....</b>	<b>384,300</b>	<b>394,510</b>	<b>2.7%</b>
<b>Costs of Service:</b>			
Fuel.....	205,006	220,544	7.6%
Operation & Maintenance Cost.....	16,304	16,970	4.1%
General & Administrative.....	5,638	5,969	5.9%
Other.....	14,393	14,681	2.0%
<b>TOTAL.....</b>	<b>241,341</b>	<b>258,164</b>	<b>7.0%</b>
<b>Operating Profit.....</b>	<b>142,959</b>	<b>136,346</b>	<b>-4.6%</b>
<b>Other Expenses</b>			
Interest Costs.....	76,676	64,735	-15.6%
Income Taxes.....	23,199	25,064	8.0%
Other.....	0	0	NM
<b>TOTAL.....</b>	<b>99,875</b>	<b>89,799</b>	<b>-10.1%</b>
<b>Net profit.....</b>	<b>43,084</b>	<b>46,547</b>	<b>8.0%</b>
<b>Average Shares Outstanding.....</b>	<b>55,185</b>	<b>55,185</b>	<b>0.0%</b>
<b>Earnings per SYT Common Share.....</b>	<b>\$0.78</b>	<b>\$0.84</b>	<b>8.0%</b>

NM = Not Meaningful

CGR = Compound Growth Rate

Source: Smith Barney Shearson.

<sup>4</sup> 740 MW converts into 6.2 billion kwhs at a capacity factor of 95%. (740 MW x 365 days x 24 hours x 95% capacity factor.)

The power sale to Niagara Mohawk is on more favorable terms to the utility, as the project is not obligated to sell any electricity. The contract is for not more than 300 MW, at an energy-only rate. The energy rate is based on NiMo's actual avoided cost of energy (SC-8 of PSC No. 207 - Electricity). *Importantly, this offers some of the potential upside for the project.* At an energy-only rate, the sale to NiMo is only moderately profitable. Further, under the contract, NiMo is obligated to purchase the power delivered (up to 300 MW); however, the partnership is not obligated to sell any power to NiMo. If the partnership can sell the power to another entity, the sale is likely to be on more profitable terms than the NiMo contract (a long-term firm supply arrangement would likely include a capacity payment, much like the Con Ed agreement). Importantly, our earnings numbers are based on the sale of power to Niagara Mohawk.

The natural gas supply for the project is being supplied by Enron Corp. under a 20-year agreement. Originally, the price for the gas was fixed for the first five years, with pricing based on Con Ed's avoided cost of energy for the remainder of the agreement. There is a tracking account to record the difference between the spot price of gas and the price paid to Enron. Sithe is in the process of renegotiating the price of gas in the first five years of the contract. The renegotiation will have the effect of allowing a smoother escalation across the time frame 1995 through 1999. The price changes keep the aggregate amount paid to Enron the same on a present value basis. Importantly, Enron and Sithe have an agreement in principal for this renegotiation.

The income statement shown in Table 4 is based on some projections made by R.W. Beck for the IPO underwriters. We have adjusted the projections to include a modestly higher capacity factor, an estimate of the renegotiated natural gas prices and modestly higher operation, maintenance and administrative costs. Further, the revenues are based on the current LRACs filed by Con Ed and NiMo. The statements show that in 1995, Independence could contribute 60% of net income. The increase in net income at the project in 1996 is the result of a higher capacity factor and lower interest expenses.

*Importantly, we want to point out that our projections probably have more room for upside surprise than downside surprise if the plant enters commercial operation on time.* The variables include the actual avoided cost tariffs or which the partnership will be paid, the capacity factor and the heat rate<sup>3</sup>. Two of these alone could swing the earnings per share contribution by about \$0.15. For every \$0.001 change in the LRACs rate (assuming that LRACs accurately reflect actual avoided costs), earnings are impacted by about \$0.08 per share. A change in the capacity factor from 93% to 95% would add about \$0.05 per share. Additionally, but less quantifiable, the heat rate could be lower than currently forecasted, which would indicate a more efficient unit (inverse relationship between heat rate and efficiency). Longer term, the Independence project site has room for an additional 500 MW of capacity. All these variables combine to suggest that earnings could be higher than we currently expect in 1995 and 1996, resulting from our conservative assumptions.

### Other Projects under Construction

Beyond the Independence project, Sithe is currently constructing two other natural gas-fired generation projects. The two projects are Cardinal and AG Energy. Table 3 shows the projects currently under construction. The *Cardinal* project is a 150 MW plant where Sithe is a 50% partner with Husky Power Ltd, a subsidiary of Husky, a Canadian oil and gas concern. The project is located in Cardinal, Ontario, and expected to begin commercial operation in the third quarter of 1994. The plant will sell electricity

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<sup>3</sup> The capacity factor is a measure of the plant's output relative to its designed capacity. The heat rate is a measure of efficiency of the plant, indicating its efficiency of converting BTUs of heat into electricity.

to Ontario Hydro under a 20-year contract and steam to Canada Starch Operating Company, a subsidiary of CPC International. The price of electricity will be based on the long-run avoided costs of Ontario Hydro. Avoided costs are currently about \$0.045. Natural gas for the plant will be supplied by Husky under long-term contract.

The *AG Energy* project is a 79 MW natural gas-fired cogeneration plant. Sithe is an 85% partner in the project and Iroquois Power (one of the gas transporters for the project) is a 15% limited partner in the project. The power from the project will be sold to Niagara Mohawk under a 25-year contract. The price for electricity is fixed for the first 15 years of the contract. Importantly, due to a project-tracking provision<sup>6</sup> in the contract, the contract is unlikely to last more than 15-years (see Risks – Project Tracking). The gas for the project is provided under a 15 year, scheduled price agreement with Home Oil Company, Limited.

### Operating Projects

Table 3 lists the projects currently in operation. As discussed above, Sithe has 21 operating generation projects that aggregate 540 MW. Ten of the projects are hydro facilities, ten of the projects are natural gas-fired and one is a biomass-burning facility. Below is a brief discussion of the company's seven largest natural gas-fired generation projects.

**Alcoa** – This is a 79 MW plant in Massena, New York in which Sithe owns a 70% interest. The other partners in the project include Sundance and Husky Gas Marketing (the gas provider for the project). The plant is a QF status generator under PURPA, supplying electricity to Niagara Mohawk under a 20-year contract and steam to Alcoa Aluminium. The plant entered commercial operation in April 1993 after a six-month delay. The payment by the contractor (a subsidiary of Zurn Industries) of a penalty provided under the contract for the delay is currently being negotiated. Natural gas is being supplied under a 15-year contract by Husky. Importantly, the project does have a tracking mechanism in the contract to ensure that the cost of electricity does not exceed the utility's actual avoided cost of energy. The project tracking mechanism is likely to limit the life of the Alcoa project to 15-years (see Risks – Project Tracking).

**Batavia** – This is a 55 MW natural gas-fired cogeneration project in Batavia, New York. The plant has QF status under PURPA by supplying electricity to Niagara Mohawk and steam to O-AT-KA Milk Products Cooperative. Sithe owns a 90% stake in the project. The electricity is sold to Niagara Mohawk under a 15-year contract. Prices for the electricity output are fixed for the first four years of the contract and then increase over the remaining life. Similar to Alcoa, Batavia has a project-tracking mechanism in the contract to ensure that the payments to the owners not exceed the utility's actual avoided cost of energy. This is likely to limit the contract to 15 years (see Risks – Project Tracking).

**Greeley** – This plant is a 72 MW natural gas-fired cogeneration project on the grounds of the University of Northern Colorado and owned by a wholly owned subsidiary of Sithe. The plant began commercial operation in November 1988. The electricity is sold to Public Service Company of Colorado (PSR), while thermal energy is provided to the University. The price of electricity is tied to the operating costs of one of PSR's generating plants, along with a fixed capacity charge. The thermal energy is provided

<sup>6</sup> Project tracking provisions have been negotiated into some of the power sale contracts. These provisions permit the tracking of prices paid to the partnership versus the purchasers' actual avoided cost of power. In the event of a positive balance at the end of a stated period, the purchaser will be reimbursed the balance, or the contract will no longer be effective. A positive balance suggests the partnership was paid more for electricity than the actual avoided cost of power. Along with AG Energy, Sterling, Batavia and Alcoa have project-tracking provisions in the contracts. All estimates are premised on the shortest possible life under contract.

as lease payment for the land on which the project is built. Natural gas for the facility is provided under a 15-year contract with Associated Natural Gas Associates. A royalty payment is paid annually to the unaffiliated, original project developer. The payment is based on the cash flow of the project.

**Kenilworth** – This is a 25 MW natural gas-fired cogeneration plant in Kenilworth, New Jersey. The plant entered commercial operation in July 1989. The plant sells the electricity generated to Jersey Central Power & Light (JCP&L), a subsidiary of General Public Utilities#. Being non-contiguous to the site, Public Service Electric & Gas Company# wheels the power from Kenilworth to JCP&L's system. The steam from the plant is sold to the Schering-Plough pharmaceutical corporation under a 15-year contract. Natural gas for the plant is supplied by Elizabethtown, the local distributor, under a 10-year contract. The fixed prices extend until October 1993, with market-based pricing thereafter. In 1989, the plant was sold and leased back under a 15-year operating lease.

**Navy Plants** – This project is the combination of three leased natural gas-fired cogeneration facilities on three Navy bases in the San Diego, California, area. The three plants are: San Diego Naval Station (46 MW), North Island Naval Air Station (36 MW) and Naval Training Center/Marines Corps Recruit Depot (23 MW). Each of the plants were sold and leased back under a 22-year operating lease. Most of the electricity generated is sold to San Diego Gas & Electric under 30-year Standard Offer 4 contracts. The Standard Offer contract pays for electricity based on San Diego Gas & Electric's avoided cost of energy. All three plants began commercial operation in 1989. The thermal energy produced by the plant is provided to the Navy. The plant has QF status as defined under PURPA. The Navy has agreed to purchase the amount of steam necessary for the three plants to maintain their QF status. Natural gas is provided under a short-term contract from a broker at spot market prices. Since higher natural gas prices would, at some point, increase the avoided cost of energy, there is somewhat of a natural hedge in the payment. However, the hedge is likely to operate on a significant lag from the market price of natural gas. Further, revenues from this plant are likely to decline markedly in 1999, due to the contract basis. Separately, but importantly, although originally included on a list of potential base closures, the Navy bases in San Diego will remain open.

**Oxnard** – This 47 MW cogeneration facility is located in Oxnard, California. The plant began commercial operation in June 1990. The plant is a QF status-generating facility as defined under PURPA. The electricity generated is sold to Southern California Edison, a subsidiary of SCEcorp#. The sale is for 30 years based on a modified Standard Offer 2 contract. The price paid to the partnership is based on SCE's short-run avoided cost of energy. Steam is sold to Boskovich Farms, a vegetable packer. Boskovich has agreed to purchase the minimum amount of steam necessary to maintain the plant's QF status. Gas for the plant is purchased on the spot market. Similar to the Navy plants, there is a natural hedge to rising gas prices, as the partnership is paid based on SCE's short-run avoided cost. This hedge is likely to be modestly more responsive to changes in gas prices than the Navy plant.

**Sterling** – This is a 57 MW gas-fired cogeneration facility that the company leases and operates located in Oneida County, New York. The facility is a QF status generator and sells the steam output to Oneida, the largest tableware manufacturer in the nation. The plant entered commercial operation in January 1992. The electricity is sold to Niagara Mohawk under a 20-year contract based on a fixed price for the first six years and at an increasing price thereafter. Similar to Alcoa and Batavia, Sterling has a project-tracking mechanism in the contract to ensure that the payments to the owners do not exceed the utility's actual avoided cost of energy. This is likely to limit the contract to 15 years (see Risks – Project Tracking). About 90% of the gas for the plant is purchased under a 15-year contract with Louis Dreyfus Gas Sales, with the remainder purchased on the spot market.

### **Projects under Development**

As discussed earlier, IPPs must continue to add new generating projects in order to sustain earnings growth in the intermediate to longer term. Assuming a basically fixed price for electricity across the contract life and high-efficiency operation of the plant, there are few ways to increase profits without adding new projects; therefore, Sithe is constantly evaluating new projects. It is important to remember that the company reviews many potential projects in the hope of securing a few very good projects for development.

Sithe has stated that it will evaluate projects in the international arena, although not in a "shotgun" approach. The company will concentrate in North America, including Mexico and Canada. Other select international areas will be included; however, the company wants to understand and feel comfortable with the government in every location considered for a project.

The company currently has four projects in advance stages of development. It is important to remember that although the projects are considered to be in development, there is still uncertainty regarding when or whether the projects will actually come to fruition. The projects include Mississippi 26R, an 80 MW hydroelectric project on the Mississippi River; Bayside, a 50 MW gas-fired cogeneration facility in San Diego, California; Phoenix, a 44 MW gas-fired peaking cogeneration facility located at the company's Greeley plant in Greeley, Colorado; and Uncompaghre, a 40 MW hydroelectric project in southwest Colorado.

### **The Electric Power Market**

From a macro point of view, the United States is expected to need over 80,000 MW of additional capacity over the next 10 years. Although the need depends largely on the growth in peak load and is highly correlated with economic growth, it does suggest that in the intermediate to longer term, there is opportunity to develop projects in the United States. However, competition is stiff, due to both regulatory pressure toward competitive bidding as well as the increasing competition in the utility industry. The combination of these two are driving many non-utility generators into the international arena. However, it is important to recognize that although returns are higher internationally, so is the risk associated with development.

As developing economies expand, the need for power internationally is far in excess of that for the United States. The world (excluding the United States) is expected to need over 300,000 MW of additional capacity over the next 10 years. International power demand probably has less to do with peak load growth and more to do with economic growth. As developing countries expand, the population is likely to demand gas to cook with, telephones to communicate with, water to wash with and electricity to light their homes with. Therefore, increasing global prosperity is more likely to mandate additional electric generation development.

Importantly, opportunities exist in both domestic and international markets for both utility affiliated and non-utility (IPP) developers and producers of electricity. Sithe will be attempting to add one or two additional projects a year, with a large-scale project (Independence-size) approximately every three years.

### **Earnings Growth**

Tables 5-7 illustrate our earnings forecast for Sithe through 1995. Our earnings estimates are \$0.00, \$0.30 and \$1.30 in the years 1993 through 1995. We assume commercial operation of AG Energy in late 1993, Cardinal in late 1994 and Independence in early 1995. We anticipate that additional projects

will be added across the 1993-96 time frame, which could increase earnings in the 1995 or 1996 time frame. We assume that the capacity factor will remain consistent with recent history for the company, around 94%. For Independence, we use LRACs as a proxy for the actual avoided cost tariff the partnership will be paid when the plant enters commercial operation.

Across the forecast horizon, revenues grow at a compounded annual rate of about 50%, while operating profits grow at a rate of about 90% annually. The revenue growth is driven by the commercial operation of the projects discussed above. The operating leverage stems from efficient operations. Operating costs (including fuel) grow at only at about 45% annually across the forecast horizon.

As a factor of the increased development and construction, interest expenses increase across the forecast period at an annual rate of about 75%. Most of the financing is non-recourse to the corporate entity, however. Additionally, the company will move toward the statutory tax rate by 1995. Therefore, income tax expense should be increasing by about 83% annually over the forecast horizon. The bottom-line impact of these conflicting items will allow net income to grow at an annual rate of about 42% through 1995. Our forecast assumes a constant amount of common shares outstanding after 1993. Admittedly, additional development could foster the need for additional equity in the 1995 to 1997 time frame.

From a cash flow standpoint, the increased earnings and depreciation allow operating cash flow to increase at a compound annual rate of 32% through 1995. Impacting earnings (but not cash flow) is the issue of negative interest arbitrage for Independence. This charge to earnings relates to an accounting rule that makes Sithe expense the interest cost difference between the rate paid on the unutilized proceeds of Independence debt and the rate at which the unutilized funds are invested. Specifically, the company floated project debt to fund the construction of the Independence project. The amount was sufficient to fund capital and interest costs across the construction period. The indenture requires that the funds be invested in very liquid and high-quality fixed income instruments during the interval between receipt of the funds and utilization of the funds in their entirety. Accounting rules make the company expense the difference between the interest paid and the interest earned on the unutilized balance. It is important to recognize that there is no cash flow impact from the charge as the interest on the debt is being funded by the debt itself until commercial operation of the Independence project in early 1995. This does retard earnings by about \$0.25 per share in 1993 and about \$0.10 per share in 1994. Our earnings estimates include the effect of this accounting anomaly.

The balance sheet exhibits continual improvement across the forecast horizon. Immediately after the initial public offering, the company had about 87% debt. By the end of 1995, the debt is below 80%. Although slightly higher than other IPPs and generally higher than the average industrial company, most of the debt is project debt, which is nonrecourse to the entity, Sithe Energies. Further, with an above-average earnings growth rate, the equity component of the balance sheet will be growing rapidly across the forecast horizon. The company does not anticipate paying common dividends in the foreseeable future.

The return on equity (not surprisingly) accelerates explosively in 1995 to more than 24% from 7% in 1994 and 0% in 1993. The return statistics are shown in Table 7 under the forecasted balance sheet. The ROE acceleration is due to the commercial operation of the Independence project in January 1995 and the Cardinal project in late 1994. Independence will ultimately represent almost 60% of earnings and about 45% of the aggregate asset base in 1995 (see Risks - Asset Concentration).

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Table 5  
 Sitr Energy, Inc. - (SYT - NYSE)  
 Forecast Income Statement, 1991-95E  
 (in thousands of dollars, except per-share figures)

	1991	1992	1993E	1994E	1995E	CGR 92-95E
Revenue.....	\$189,021	\$233,355	\$268,747	\$351,888	\$795,300	50.5%
Cost of Sales:						
Fuel.....	65,920	82,523	104,983	146,774	379,497	66.3%
Operating & Maintenance.....	35,363	42,579	40,964	50,795	87,086	26.9%
Operating Lease Expense.....	34,627	34,751	35,300	35,300	35,300	0.5%
Depreciation & Amortization.....	12,676	16,312	19,373	29,220	51,231	46.4%
Total Cost of Sales.....	148,586	176,165	200,620	262,089	553,114	46.4%
Gross Profit.....	40,435	57,190	68,127	89,799	242,186	61.8%
Other Operating Expenses:						
General and Administrative.....	5,126	5,811	9,600	10,400	10,920	23.4%
Provision for project impairments.....	1,237	17,720	0	0	0	-100.0%
Goodwill Amortization.....	1,645	1,345	1,344	1,345	1,344	0.0%
Total.....	8,008	24,876	10,944	11,745	12,264	-21.0%
Operating Profit.....	32,427	32,314	57,183	78,054	229,922	92.3%
Interest Expense and Other:						
Project and Corporate Borrowings.....	14,808	19,697	31,415	43,852	107,904	76.3%
Payable to Affiliates of CGE.....	5,109	4,991	0	0	0	-100.0%
Independence Negative Arbitrage.....	0	0	20,450	6,471	0	NM
Other Expense (Income), net.....	(6,087)	(9,111)	(1,330)	(1,500)	(500)	-62.0%
Total.....	13,830	15,577	50,535	48,823	107,404	90.3%
Income From Continuing Operations Before Income Taxes.....	18,597	16,737	6,648	29,231	122,518	94.2%
Income Tax Provision.....	3,311	7,313	2,819	11,300	45,000	83.2%
Minority Interests, net.....	2,183	2,524	3,206	4,011	5,511	29.7%
Income From Continuing Operations.....	13,103	6,900	623	13,920	72,007	118.5%
Discontinued Operation, Net of Income Tax.....	187	5,088	0	0	0	-100.0%
Income Before Cum Effect of Acct. Change.....	12,916	1,812	623	13,920	72,007	241.2%
Cum Effect of Acct. Change.....	0	19,829	0	0	0	-100.0%
Net Income.....	12,916	21,641	623	13,920	72,007	49.3%
Average Shares Outstanding.....	44,385	44,385	49,785	55,185	55,185	
Earnings per Share.....	\$0.29	\$0.49	\$0.01	\$0.25	\$1.30	38.8%
Earnings per share before neg. interest arbitrage.....	\$0.29	\$0.49	\$0.28	\$0.33	\$1.30	38.8%

Note: 1991 and 1992 net income include non-operating gains from arbitration settlements regarding the Stockton plant that the company sold in 1992.

NM = Not Meaningful

CGR = Compound Growth Rate

Source: Smith Barney Shearson.

Table 6

Sithe Energies, Inc. - (SYT - NYSE)

Forecast Balance Sheet, 1991-95E

(in thousands of dollars, except per-share figures)

	1991	1992	1993E	1994E	1995E
<b>Assets:</b>					
Plant in Service.....	\$256,745	\$282,418	\$459,286	\$615,255	\$1,352,665
Construction in Progress.....	160,978	345,489	579,984	757,845	22,971
Goodwill.....	59,585	48,240	55,656	54,312	52,968
Other Assets.....	68,989	163,642	475,081	180,615	270,637
Total Assets.....	546,297	839,789	1,570,007	1,608,027	1,699,241
<b>Liabilities and Equity :</b>					
Project Debt.....	269,331	486,015	1,227,435	1,239,888	1,252,685
Payable to Affiliates.....	62,747	116,558	12,000	12,000	12,000
Corporate Borrowings.....	12,445	27,495	0	0	0
Other Liabilities.....	89,406	86,733	65,383	69,190	80,827
Deferred Gains on Sale/Leaseback Transactions.....	50,707	51,171	48,787	46,403	44,019
Minority Interests.....	NA	NA	4,410	14,634	11,791
Equity.....	61,661	71,817	211,992	225,912	297,919
Total Liabilities & Common Stock Equity.....	546,297	839,789	1,570,007	1,608,027	1,699,241
<b>Capitalization Ratios:</b>					
Debt.....	82.0%	87.7%	85.3%	84.6%	80.8%
Equity.....	18.0%	12.3%	14.7%	15.4%	19.2%
<b>Financial Ratios &amp; Statistics:</b>					
Debt to Equity Ratio.....	7.9	3.8	5.8	5.5	4.2
Return on Assets.....	5.10%	2.44%	0.14%	2.26%	5.32%
Return on Equity.....	21.25%	9.61%	0.29%	6.16%	24.17%
Effective Tax Rate.....	17.8%	43.7%	42.4%	38.7%	36.7%
G&A as a % of Revenue.....	2.7%	2.5%	3.6%	3.0%	1.4%
Gross Profit Margin.....	21.4%	24.5%	25.3%	25.5%	30.5%
Operating Profit Margin.....	17.2%	13.8%	21.3%	22.2%	28.9%
Net Profit Margin.....	6.8%	9.3%	0.2%	4.0%	9.1%
Price to earnings ratio.....	41.67	24.87	43.38	36.91	9.29
Price to cash flow ratio.....	18.90	16.75	15.32	13.78	5.48

NM = Not Meaningful

CGR = Compound Growth Rate

Source: Smith Barney Shearson.

**1993 versus 1992**

The earnings decline in 1993, due to the effects of negative interest arbitrage, increased administrative costs and the sale of the Stockton plant, which had provided earnings in 1992. These effects are slightly offset by the operation of the Alcoa and Sterling plants, both of which did not provide income in 1992. As stated above, we are anticipating a break-even year in 1993 versus earnings of \$0.49 per share in 1992. However, 1992 results included a gain of \$0.45 per share due to the adoption of FAS 109 relating to income taxes. Excluding this one-time gain, earnings were \$0.04 in 1992 versus our \$0.00 expectation for 1993 results.



Table 7

## Sithe Energies, Inc. - (SYT - NYSE)

Forecast Cash Flow Statement, 1991-95E

(in thousands of dollars, except per-share figures)

	1991	1992	1993E	1994E	1995E	CGR 92-95E
Net Income.....	\$12,916	\$21,641	\$623	\$13,920	\$72,007	49.3%
Depreciation & Amortization.....	12,676	16,312	19,373	29,220	51,231	46.4%
Goodwill Amortization.....	1,645	1,345	1,344	1,345	1,344	0.0%
Amortization of deferred sales/leaseback gains.....	0	(5,060)	(2,384)	(2,384)	(2,384)	-22.2%
Provision for project impairments.....	1,237	17,720	0	0	0	NM
Independence Negative Arbitrage.....	0	0	20,450	6,471	0	NM
Other.....	0	(19,829)	0	0	0	NM
<b>Operating Cash Flow.....</b>	<b>28,474</b>	<b>32,129</b>	<b>39,406</b>	<b>48,572</b>	<b>122,198</b>	<b>56.1%</b>
per share.....	\$0.64	\$0.72	\$0.79	\$0.88	\$2.21	45.2%

Note: 1991 and 1992 net income include non-operating gains from arbitration settlements regarding the Stockton plant that the company sold in 1992.

NM = Not Meaningful

CGR = Compound Growth Rate

Source: Smith Barney Shearson.

Earnings in the first half of 1993 have been slightly disappointing due to higher general and administrative costs (G&A). Lower-than-expected waterflows at hydroelectric projects during this time period were offset by better-than-expected operations at the natural gas-fired facilities. In the second half of 1993, we are anticipating overall better results. With most of the increases in G&A behind, the effects of higher revenue relating to the Alcoa and Sterling plant operations should drive results. Seasonal variances tend to make the third quarter the strongest of any during the year. Our quarterly estimates for the third and fourth quarters of 1993 are \$0.06 and a loss of \$0.02, respectively. Our quarterly earnings model is shown in Table 8. The company operates on a calendar fiscal year.

## Risks

**Asset Concentration** -- Although the company has contracts for electricity sales and construction of the generating projects, the asset concentration in a few projects is high. This is particularly true in the case of Independence. The project will represent about 45% of assets and about 60% of net income in 1995. We offer a discount to comparable companies in our valuation to account for this risk. Further, we have no indication to date that there are any problems in the construction at Independence. In the near to intermediate term, Sithe's common stock is likely to trade significantly on news regarding the progress and cadence of construction at the Independence project.

Table 8

## Sithe Energies, Inc. - (SYT - NYSE)

Forecast Quarterly Income Statement, 1992-93E

(in thousands of dollars, except per-share figures)

	1992 Q1	1992 Q2	1992 Q3	1992 Q4	1993 Q1	1993 Q2	1993E Q3	1993E Q4
Revenue.....	\$53,032	\$55,973	\$70,216	\$54,134	\$55,742	\$66,895	\$73,887	\$65,113
Cost of Sales:								
Fuel.....	20,962	18,264	21,176	22,121	21,955	24,495	24,767	27,440
Operating & Maintenance.....	9,611	10,189	10,107	12,672	8,068	10,164	11,449	10,008
Operating Lease Expense.....	8,720	8,714	8,674	8,643	8,635	8,632	8,647	8,645
Depreciation & Amortization.....	4,361	3,849	4,141	3,961	4,132	5,678	5,479	5,436
Total Cost of Sales.....	43,654	41,016	44,098	47,397	42,790	48,969	50,342	51,529
Gross Profit.....	9,378	14,957	26,118	6,737	12,952	17,926	23,545	13,584
Other Operating Expenses:								
General and Administrative.....	1,275	1,296	1,324	1,916	2,633	2,382	2,292	2,293
Provision for project impairments.....	1,083	2,579	97	13,961	0	0	0	0
Goodwill Amortization.....	336	336	337	336	336	336	336	336
Total.....	2,694	4,211	1,758	16,213	2,969	2,718	2,628	2,629
Income from Operations.....	6,684	10,746	24,360	(9,476)	9,983	15,208	20,917	10,955
Interest Expense and Other:								
Interest Expense.....	5,549	5,733	6,355	7,051	12,453	14,575	13,299	11,797
Other Income (expense).....	(226)	(101)	(7,793)	(991)	(601)	(646)	(563)	(563)
Total.....	5,323	5,632	(1,438)	6,060	11,852	13,929	12,736	11,234
Income From Continuing Operations								
Before income taxes.....	1,361	5,114	25,798	(15,536)	(1,869)	1,279	8,181	(279)
Income Tax Provision.....	521	1,959	9,881	(5,048)	(1,289)	1,006	3,927	(134)
Minority Interests, net.....	590	484	545	905	786	619	796	1,019
Income From Continuing Operations.....	250	2,671	15,372	(11,393)	(1,366)	(346)	3,458	(1,164)
Discontinued Operation, Net of Income Taxes:								
Loss From Equity Investment.....	110	129	167	1,226	0	0	0	0
Provision for Disposition of Investment.....	0	0	0	3,456	0	0	0	0
Income Before Cum Effect of Acct Change .	140	2,542	15,205	(16,075)	(1,366)	(346)	3,458	(1,164)
Cum Effect of Acct Change.....	19,829	0	0	0	0	0	0	0
Net Income.....	19,969	2,542	15,205	(16,075)	(1,366)	(346)	3,458	(1,164)
Average Shares Outstanding.....	44,385	44,385	44,385	44,385	44,385	45,215	55,185	55,185
Earnings per Share.....	0.45	0.06	0.34	(0.36)	(0.03)	(0.01)	0.06	(0.02)

NM = Not Meaningful

CGR = Compound Growth Rate

Source: Smith Barney Shearson.

**Curtailment** – Under PURPA, utilities purchasing electricity from QF status generators can curtail the purchase under certain adverse circumstances. Niagara Mohawk and Con Ed, in New York, have initiated proceedings with the NYPSC to curtail power purchases from some QFs, including those owned by Sithe. A decision in NiMo cases is expected in the fourth quarter of 1993. Importantly, in a renegotiation with Con Ed in April, Sithe settled any possibility of curtailment at the Independence plant beyond that negotiated in the contract. Further, as NiMo is purchasing power from Independence at an energy-only rate, it is unlikely that the purchase would be curtailed. Five other projects sell power in New York to Niagara Mohawk and could realize a reduction in revenues resulting from curtailment, depending on the outcome of the pending request.

**LRACs** – As discussed above, the long-run avoided costs (LRACs) are filed with the NYPSC on a quarterly basis. These represent the utilities' estimate of avoided costs in the future. The power purchase from the Independence project will be priced on tariff rates representing the actual avoided cost of production. However, LRACs are a close proxy or estimate for what the ultimate actual avoided costs may look like in 1995, when Independence enters commercial operation. We do believe that to some degree, Sithe will trade on news regarding the trend or direction of LRACs as reported quarterly.

**Project Tracking** – Three of the power purchase contracts include a project-tracking mechanism. The mechanism is designed to track the actual costs paid for power relative to the purchasers' actual avoided cost of production. The contracts provided that after a certain period (usually 15 years), the account would be reviewed, and, if a positive balance remained, the supplier would need to provide some remedy. In the cases of Batavia, Sterling and Alcoa, the project-tracking mechanism is likely to limit the contact lives of these plants to 15 years. AG Energy, a project currently under construction, also has a similar project-tracking provision in the power sales contract. Similarly, the life of the project is likely to be limited.

Companies mentioned in this report:

AES Corporation-AESC (OTC-31 3/4)  
 Alcan Aluminium-AL (NYSE-19 3/4)  
 Alcoa Aluminium-AA (NYSE-71 5/8)  
 CPC International-CPC (NYSE-37)  
 California Energy-CE (NYSE-18 3/8)  
 Consolidated Edison#-ED (NYSE-44 3/4)  
 DESTEC Energy-ENG (NYSE-17 3/8)  
 Enron Corp.-ENE (NYSE-35 1/8)  
 General Electric-GE (NYSE-96 1/4)  
 General Public Utilities#-GPU (NYSE-33 7/8)  
 Home Oil Company, Ltd.-HO (ASE-15 1/8)  
 Magma Power-MGMA (OTC-38 3/4)  
 Niagara Mohawk Power#-NMK (NYSE-25)  
 Public Service Company of Colorado-PSR (NYSE-32 1/4)  
 San Diego Gas & Electric-SDO (NYSE-26 7/8)  
 SCEcorp#-SCE (NYSE-25 1/4)  
 Schering-Plough-SGP (NYSE-60 1/4)

Stocks priced as of the close on September 8, 1993.

Additional information is available upon request.