

**Exelon Corp.***Company▲***EXC***Ticker▲***Q3 2010 Earnings Call***Event Type▲***Oct. 22, 2010***Date▲***MANAGEMENT DISCUSSION SECTION**

Operator: Good morning. My name is Dorothy, and I will be your conference operator today. At this time, I would like to welcome everyone to the Exelon Third Quarter Earnings Review Conference Call. [Operator Instructions] After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] I will now turn the conference over to Stacie Frank, Vice President of Investor Relations. Miss Frank, you may begin.

**Stacie Frank, Vice President, Investor Relations**

Thank you, Dorothy, and good morning everyone. Welcome to Exelon's third quarter 2010 earnings conference call. Thank you for joining us today. We issued our earnings release this morning. If you have not received it, the release is available on the Exelon Web site at [www.exeloncorp.com](http://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. We've scheduled 60 minutes for the call this morning. I will now turn the call over to John Rowe, Exelon CEO.

**John W. Rowe, Chairman and Chief Executive Officer**

Good morning everyone. We are delighted to report that we had another good quarter, another quarter that beat consensus, at least until some of you changed that consensus earlier this week. Before I get to the quarter and some of the areas I want to comment on specifically, I'd like to spend just a minute reflecting.

This is the 10th anniversary of Exelon's creation. The merger of ComEd and PECO remains the largest and most successful merger in the recent history of the utility industry. Over that 10 years, our total shareholder return has been 107% compared to the S&P 500, which is only 2%, and the Philadelphia Utility Index at 76%. We have increased the dividend by almost 250%, from \$0.85 per share in 2001 to \$2.10 per share this year.

We have improved the operational performance of our nuclear fleet to capacity factors which have consistently averaged over 93% in recent years. Both ComEd and PECO have improved their reliability records, and ComEd has significantly improved its safety record to more or less catch up with PECO's.

We have generated strong earnings and cash flows, and continue to do so during a cyclical trough in the commodity markets. We have exhibited the financial discipline to maintain investment-grade bond ratings, even while the power markets are weak. The hedging approach of Power Team has created close to \$3 billion in incremental value over the past two years, as commodity prices have suffered. Now all of this is history, of course. But we think we have created that history while building what is absolutely the best platform for future upside in our business, and we think most of you agree with that.

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Turning to the quarter, as you saw in our announcement this morning, we reported operating earnings of \$1.11 per share. Our nuclear fleet attained a capacity factor of over 95% for the quarter. We were helped by a warm summer in both Chicago and Philadelphia, which contributed \$0.06 of favorability versus normal weather. But constant attention to cost control and constant efforts to lock in attractive hedge prices helped as well.

Our year-to-date results put us in a strong position for the full year. We are again adjusting our operating earnings guidance range, currently at \$3.80 to \$4.10, and raising it to the upper half of that range, or \$3.95 to \$4.10 per share. Hard work and a little good fortune have brought us a long way since the estimates we had back at the beginning of the year.

On the last quarterly earnings call, I outlined in detail one of the key elements of our value proposition. We simply have more, cleaner, lower carbon, lower air pollution power than anyone else in our industry. And we continue to believe that, that power will be rewarded by better prices, as EPA tightens its environmental regulations and as the combination of those tight environmental regulations and low gas prices affect the Energy and Capacity markets across PJM.

Let there be no doubt, EPA continues to move forward. Indeed, it is required to do so by orders of the Federal Courts, including the United States Supreme Court.

At the celebration of the 40th anniversary of the Clean Air Act last month, Administrator Lisa Jackson reiterated her commitment to move forward with hazardous air pollutants rules on schedule. The comment period for EPA's Transport Rule expired on October 1, clearing the way for EPA to move forward with developing its final rules on nitrogen oxides and sulfur oxides.

Now, of course, some of my colleagues in the industry contend that this timeline must shift, and there may be a case or two where that happens. But it is a very different thing to delay climate legislation than it is to prevent the enforcement of hazardous air pollutant regulations. Even Tea Party people don't like mercury in their tea.

We do not believe EPA's enforcement activities will be greatly delayed. A change in EPA's authority to regulate hazardous air pollutants would require congressional action to overturn the Clean Air Act. Absent that sort of congressional action, and absent its approval by the President, EPA's regulations go forward.

Now while many people say this cannot be, generators are already planning for the future. We have already seen announcements of more than 4,000 megawatts of coal to be retired or mothballed in PJM over the next five years. This, of course, includes our own units at Cromby and Eddystone, which will be retired by mid-2012. And we are progressing with FERC on the reliability must-run compensation until that time.

There have been other announcements as recently as those by AEP earlier this week of additional smaller and older units in PJM that have been identified by their operators as "fully exposed" to EPA regulations. I was wondering with my colleagues how one illustrates this the other day. And what came to mind was a picture of a '59 Cadillac. The kind of plants that we're talking about here from the late '40s and from the '50s are as antiquated as a '59 Cadillac would be today. And it should come as no great surprise that their life is nearing its end.

We think there are about 11,000 megawatts in PJM which are at significant risk to be retired as EPA moves forward with its Hazardous Air Pollutant regulations. We will be prepared at the financial conference to show you the form of our analysis of this in greater detail. But when these and other retirements occur; and when generators begin to incorporate the costs of additional requirements in their surviving plants, we expect to see both capacity and energy prices begin to rise.

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As we have discussed with you before, the price at which Exelon Generation sells power is fundamentally a product of three factors: natural gas prices, which we agree will be low for some time; energy prices; and capacity prices. And as you know, we have already seen some improvement in capacity prices in the PJM auction last May.

The upsides in future energy and capacity prices are clearly positive for Exelon and its long-term value. We don't know exactly how much or exactly when. If we did, we'd love to tell you. You don't know exactly how much or exactly when. But we know and you know that this is the fleet that is best positioned to prosper in the second half of this decade. That is why our operating performance, our healthy balance sheet, and the yield from our \$2.10 per-share dividend are all the more important now. Simply put, Exelon offers the best upside in our industry and a dividend yield of nearly 5% as we go forward.

Many of you recognize what a key value factor that dividend is. And in Bill Von Hoene's recent tour to visit you, many of you have asked, can you sustain it with the earnings pressure you're likely to experience in 2012 and 2013?

While ultimately our board is required to make a dividend decision each quarter, I have carefully reviewed our financial end market projections for the next two, three and five years with our boards at our most recent annual planning meeting. Our board shares my view that maintaining our dividend is extremely important.

Neither my management nor I nor our board see an early recovery in gas prices. We see the same shale gas pressures that you do. We see the same supply-and-demand factors that you do. But we don't need a big recovery in gas markets to maintain our dividend at its current level. And if gas prices stay where they're now forecasted, I believe we can maintain the dividend and continue our planned capital expenditure programs, as well, of course, as meeting our pension obligations.

My management team, my Board of Directors and I expect that our strong balance sheet, our careful hedging practices and our operating performance will enable us to maintain the dividend until power prices recover. And let me be absolutely clear: I personally will do everything I can do to make that happen.

Our financial strength also gives us the opportunity to invest in assets that align with our strategy to be clean in competitive markets. Our agreement to acquire John Deere Renewables during the third quarter is one example of that strategy. We have been looking at wind opportunities consistently over the past few years; and up until this one, we had not seen one that met our return on investment criteria.

The John Deere Renewables acquisition presented a very unique opportunity for us to enter the wind business without compromising the cold-blooded financial discipline you expect us to employ. This highly contracted portfolio provides a stable set of cash flows for the next 15 to 20 years. These cash flows are not dependent on merchant prices, which continue to be very challenging for wind operations. The acquisition gives us a credible voice as the owner of wind assets in the development of renewable energy policy, while protecting Exelon's value as the nation's largest nuclear operator. We have already completed the financing for the transaction at attractive rates, and we expect to close the transaction by the end of the year.

Turning to our Utilities, I have already mentioned the reliability that PECO and ComEd continue to sustain. But let me spend a minute or two on the regulatory and political landscapes of each. PECO has now procured the remaining 2011 energy supply for its customers, and reached settlements with the parties in its electric and gas distribution rate cases. The proposed rate case outcome is fair to PECO, thanks to the good work of Denis O'Brien, Paul Bonney and their team. There is only a modest rate increase of about 5% for the average residential customer, after 20 years without a

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distribution rate increase. I expect PECO will be in a good position to earn reasonable returns on its equity.

ComEd has a distribution rate case underway. We expect the first round of testimony from the ICC staff at intervenors next week.

Our regulatory and legislative position continues to improve in Illinois, but we must continue to work with the stakeholders in both the legislature and the Commission. To that end, ComEd filed a petition yesterday for re-hearing in the Appellate Court on the decision relating to its September 2008 rate order. At the same time, ComEd is pursuing other solutions with the Illinois Commerce Commission to allow it to go forward with its Smart Meter pilot program.

On the political side, we, along with everyone else, watch what must be one of the wildest elections in recent memory. We think there is a small chance of a short-term extension of the dividend tax cut during the lame-duck session. We are, of course, working with nearly all our E&I peers on that. The gubernatorial elections in Pennsylvania and Illinois are both close, but our leadership teams have good relationships with both candidates in both states.

Here in Chicago, we will elect a new mayor in February. I should say very clearly that the entire business community, and particularly myself, will miss Mayor Daley. He has done his absolute best to be a fair and productive man, and we'll just all miss him. But there are a number of very qualified candidates, and we have relationships with most of them. I'm confident that we'll be able to work with whoever wins the race.

Whatever the politics around us, Exelon will remain focused. We are focused on good operations and constantly improving those operations. We are focused on financial discipline and delivering value for you. We are focused on our earnings and our cash flow, and will continue to be. That focus has enabled us to deliver good earnings in each quarter this year. It has enabled us to improve our estimate for the whole year. And I am confident that focus will enable us to continue to perform through the trough that we are experiencing in commodity prices.

And with that, I'll turn this over to Matt Hilzinger to go over the financial drivers in more detail.

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


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Thank you, John. And good morning everyone. This morning I will provide an overview of the results for the third quarter and highlight a few key drivers and our expectations for the remainder of the year. I will also give a brief update on the recent events in Illinois, and an update on our hedging and load forecast. The key messages for today are on Slide 7.

Our financial results for the quarter are shown on Slide 8. As John mentioned, Exelon delivered strong results again this quarter. We recorded operating earnings per share of \$1.11, just above the top of our earnings guidance range. Our strong earnings performance was a result of volumes, driven by weather and higher capacity pricing at ExGen, which increased on June 1st.

The key earnings drivers on a year-over-year comparison basis for each operating company are listed on Slides 9, 10 and 11. I won't step through each driver during today's call as the drivers are pretty straightforward.

I will call your attention to ComEd load on Slide 12. Based on our normal weather results, total load for ComEd in the third quarter was 1.1%, which was a bit lower than we had expected.

Nevertheless, our positive load was led by strong growth in the Large C&I customer class, primarily in the Auto and Steel sectors. We are pleased to see continued growth in the large C&I class as this is a positive sign that manufacturing is still growing in the region.

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The number of residential customers grew slightly over last year, but residential was down from the prior year. We are still projecting year-over-year growth in ComEd's load. However, we have revised our full-year load growth projection downward from 0.8% to 0.4% to reflect the actual results for the third quarter, and our updated view of a slower recovery.

Let me now address the recent ruling from the Illinois Appellate Court. Earlier this month, the Illinois Appellate Court issued its ruling in response to appeals filed by various stakeholders regarding the ICC's 2008 order for ComEd's distribution rate case filing on two issues. The first issue relates to the ICC Order granting ComEd a rate increase on a rate base that included pro forma capital additions, net of depreciation for assets that were placed in service after the test year, but prior to the effective date of the new rates.

On appeal, the Illinois Attorney General and others argued that ComEd's rate base should be decreased by accumulated depreciation for all plant during the pro forma period. Despite a number of prior cases where the same pro forma adjustments have been made, the Court ruled in favor of the Attorney General. With respect to this matter, we expect to record a pre-tax reserve of \$18 million in the fourth quarter of this year, and a pre-tax reserve of about 30 million in the first half of next year to reflect revenues that are potentially subject to refund.

The second issue from the Appellate Court ruling relates to the ICC's original order allowing ComEd to recover costs for its Smart Meter pilot via a separate rider. On appeal, the Court found that the use of a rider for recovery of discretionary capital spending constituted single issue rate-making, and therefore it was impermissible. As a result, ComEd recorded a pre-tax charge of \$4 million in the third quarter that could potentially reduce pre-tax earnings by 7 million in the first half of 2011.

We anticipate that the Court's opinion will affect ComEd's distribution rate case currently under review with the ICC. If, as expected, the ICC were to treat pro forma period accumulated depreciation consistent with the Illinois Appellate opinion, we estimate that our request for a \$396 million increase in revenue would be lowered by approximately \$85 million.

In response to the Appellate Court ruling, ComEd filed a request for re-hearing yesterday at the Appellate Court to reverse the Court's September 30th ruling. ComEd is also evaluating other regulatory alternatives and developing plans to address potentially un-recovered revenues in its pending rate case.

Moving to PECO load trends on Slide 13, PECO's weather-normal activity is up 0.5% this quarter compared to the same quarter last year, and about where we expected it to be in the third quarter. The favorable load activity this quarter was primarily driven by an increase in residential customers' average usage, with the small and large C&I classes showing flat-to-negative growth.

For the balance of the year, we are estimating relatively moderate load growth, primarily in the Residential Customer class. Our economic view and forecast for the year is consistent with our view of a continued slow recovery in the Philadelphia region, and we expect full-year growth for 2010 to be about 0.2%.

With respect to PECO's rate cases, PECO reached settlement during the third quarter with all interested parties on its Electric and Gas distribution rate cases. The settlements reached provide for an overall increase of 225 million in the electric rates and 20 million in gas rates. The settlement is subject to review by the administrative law judge, which we anticipate will be completed in the next few weeks. Final approval from the Commission should follow by mid-December.

PECO's transition to market rates will be completed when the new delivery and energy rates are effective on January 1st of 2011.



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Moving to Exelon Generation, our detailed hedging disclosures can be found on Slides 17 through 26. However, on Slide 14, you can see an analysis of where we stand today compared to our ratable plan. Many of you know that we regularly evaluate our hedging decisions to ensure that we are responding to what we are seeing in the market, while also protecting our balance sheet and cash flows.

Our hedging plan affords us the opportunity to add value to the portfolio through timing of our sales, regional allocation, product selection and leveraging the Wholesale and Retail channels. At the conclusion of the second quarter, we were hedged about 57% to 60% in 2012, which was about 11% ahead of ratable plan.

There are a couple of reasons why we were ahead of ratable plan. First, in the second quarter, we saw Mid-Atlantic prices rise by 8% compared to the end of the first quarter, and more so than in the Midwest region. That pricing was attractive to us, so we executed more hedges in the Mid-Atlantic region, and slowed down in the Midwest region to capture that increase. By the end of the third quarter, we have seen prices at PJM-West decline by about 8%.

Second, we continue to pursue value-added, load-following products that leverage the load-following capability of our Generation portfolio. These opportunities are typically in the form of agreements of up to three years in duration, and they are in-line with our three-year ratable hedging plan. These agreements, which are driven in large part by our customers' desire to lock in longer-term contracts, are procured through various wholesale utility solicitations and our retail affiliate, Exelon Energy.

As of the end of the third quarter, we slowed down our hedging for 2012, and we are now 62% to 65% hedged, which is about 8% above our ratable plan.

During the third quarter, we continue to see a low spot gas price environment place downward pressure on forward prices. Although natural gas and power prices have been decreasing, prices are approaching a level where we believe there is potential upside in energy prices, driven by impending environmental regulations.

As a result of potential upside, and because of our current above-ratable position, we slowed down our hedging in the third quarter and we expect that we will be closer to ratable level by year-end. As you would expect, we will continue to evaluate market opportunities while we monitor forward fuel and power prices and the status of EPA regulations.

Moving to Slide 15, which summarizes our sources and uses of cash, you can see we continued to generate significant positive operating cash flow. Our latest forecast for the year reflects our pending acquisition of John Deere Renewables company, which we financed with an Exelon Generation bond offering this quarter.

In addition, the Small Business Job Act, which was signed into law last month, extends the effective period for the bonus depreciation tax benefit. In fact, we expect to see an after-tax cash flow benefit in the range of 300 million to \$350 million, with approximately 140 million in the fourth quarter of this year and the remainder in 2011.

As a result of the bonus depreciation, we reassessed our financing needs for the year and determined that the \$250 million debt issuance previously planned at ExGen is no longer needed. Our updated forecast reflects a year-end cash position of approximately 300 million, which we plan to use to help fund our pension obligations next year.

I'm also very proud to tell you that today we closed on a \$94 million credit facility with 29 community and minority banks, representing a \$27 million increase over last year. This partnership is very

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important to Exelon because it allows us to combine our financial goals with our commitment to diversity, and strengthen our community relationships.

Before I close, I'll review a couple of items excluded from operating earnings but included in GAAP earnings. First, we took a \$0.05 non-cash charge in the third quarter for the impairment of certain SO2 allowances as a result of the proposed Clean Air Transport rule. This EPA rule proposes a new emission allowance trading plan that severely restricts the use of existing SO2 allowances currently used in the Acid Rain Program and replaces it with new trading allowances. As a result, the value of our old SO2 allowances is close to zero.

As it relates to the second matter, I'm pleased to announce that we settled the involuntary conversion and CPC matters with the IRS this quarter. The terms are consistent with the IRS's offer extended during the second quarter, so there is no additional charge to the income statement as the settlement terms are consistent with our prior reserves. As a result of the settlement, we expect to pay tax and interest totaling approximately \$200 million, with a \$500 million payment in the first half of 2011, partially offset with a refund of approximately \$300 million by the end of 2013.

In addition, Exelon expects to receive a separate refund of approximately 300 million by the end of 2011, principally relating to the settlement of the 2001 tax accounting method change for indirect costs. The agreement is subject to final approval of all terms and calculations by Exelon and the IRS.

The remaining tax position associated with the 1999 sale of ComEd's fossil generating assets, referred to as the like-kind exchange matter, has not changed. We continue to expect that this matter will be litigated.

In closing, we are very confident that we will end the year with operating earnings in the range of \$3.95 to \$4.10 earnings per share. Maintaining strong operating performance, coupled with a close eye on our costs, will position us to close out another year with strong results.

We look forward to speaking with many of you again in a couple of weeks during the annual EEI Financial Conference. As a reminder, our 2011 earnings guidance will not be rolled out during the conference. However, we will provide you substantial information to assist you in your valuations including our updated hedge disclosures, which will reflect activity through 2013.

With that, we are now ready to take your questions.

**QUESTION AND ANSWER SECTION**

Operator: [Operator Instructions] Your first question comes from the line of Greg Gordon with Morgan Stanley.

**<Q – Greg Gordon>**: Thank you.

**<A – John Rowe>**: Good morning, Greg.

**<Q – Greg Gordon>**: Good morning. Thank you very much. Two questions. The first is, as you look out across the forecast horizon, over which you feel that the dividend is maintainable, can you comment on your view of where your credit metrics trend if you're in a sustained low-gas environment, and whether you envision having to do anything to maintain them that's different from the current financing plan?

And then the second question is, you've had an extremely active M&A backdrop here this year, both consolidation of merchant generation and consolidation of regulated infrastructure. And what you see as any sort of predilection on the part of Exelon to participate or not participate in that activity?

**<A – John Rowe>**: Let me hit the first part first. We consider maintaining our investment-grade credit rating as the most important constraint on our ability to pay the dividend. And when we did the modeling that I described and reviewed it with our board, we believe that we will be able to sustain a 30% ratio on S&P's key funds flow from operations over debt requirements metric. We think there might be room to sustain investment-grade ratings if you fell below that to, say, 25% even in a stress case, in a particular stress year, as long as S&P felt that, that wouldn't last for more than a year's time. But one wouldn't like to plan on that.

In looking at our ability to sustain the dividend, we've not only looked at what's happening with gas prices, and some variations around that, we've looked at our ability to adjust our capital programs and our continued ability to manage our costs. And in that context, we do not foresee having to issue equity to sustain those credit ratings. Now, you can run as many different models as we do, and you can always find one model that might require something like that. But that's not our expectation or anticipation.

And the point I was trying to make very, very carefully is in this environment, payout ratio doesn't concern me much, but maintaining an investment-grade credit rating concerns me a great deal. Now, I'm committed to doing that, but I don't believe it will require any extraordinary new capital actions to do that. I think the place you should look for us to try to adapt is in some of our capital expenditure plans.

Now switching to M&A, I mean, by now you all really know me. I've been around longer than moss on oak trees. I'm always looking because I think consolidation is a good thing and an important thing. I continue to believe that good deals remain hard to get and hard to execute. God knows we've tried. But we will continue to look, and we'll continue to be absolutely rabid that it has to add near-term value for you, our investors, if we're going to do anything.

We believe more scale will be good. We would like to have some assets that are more counter-cyclical with our merchant generation. We'd like to have more merchant generation if we can get it at a low enough price. But when we look, we look first at the financial returns; second at how we can do it consistent with maintaining our investment-grade rating; third, whether it diversifies our own risks. And we're just very bloody careful, like we have been for a very long time. You all know I'm willing to try, you all know I'm willing to fail before I'm willing to pay too much. I'm not going to change on that.



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**<Q – Greg Gordon>**: Thank you.

Operator: Your next question comes from the line of Jonathan Otto (sic) [Arnold] from Deutsche Bank.

**<A – John Rowe>**: Good morning, Jonathan.

**<Q – Jonathan Arnold>**: Hi. Good morning. Can you hear me?

**<A – John Rowe>**: We can hear you just fine.

**<Q – Jonathan Arnold>**: I just wanted to clarify one thing, John, you had said in describing the John Deere acquisition. You said it would give you a credible voice in development of renewable policy, and also protecting Exelon's value as the largest nuclear operator. Can you give us a little more insight into what you mean by how this helps to protect value?

**<A – John Rowe>**: Sure. If the government is going to continue to require people to buy wind beyond its apparent economic value, we want to be in a place to sell. On the other hand, we also want to be in a place where we can look a congressman or a legislator in the eye and say, look, we're on both sides of this table. We can make money selling, but we don't want our customers to have to pay too much buying. And we think we have more credibility by being at the table.

But let me say that that's just a factor in all of this. I mean, what really motivates me here is we could make a really very safe investment in what is in many ways a more speculative field. But as I look at the economics evolving down the road – and I've said this in many speeches – gas is just plain queen for the foreseeable future. And almost all the purely economic decisions would be gas. My political friends on the left want to subsidize wind and solar; my political friends on the right want to subsidize nuclear and carbon sequestration for coal. And meanwhile, the market says gas, gas, gas.

But as we go down the road five, 10 years, some of those factors are going to change. I think the economics of solar continue to improve. And it seems to me there are possibilities, not so much in the next year or two but in five to 10, that we have very economical packages of wind and gas or wind, solar and gas. And I would like Exelon to be positioned to do that when it's an opportunity for either political or economic reasons.

**<Q – Jonathan Arnold>**: Thank you. And if I could just follow-up on another topic. I noticed it looked like you trimmed the spending on uprates a little. But what exactly are you doing in terms of keeping those on track, given some of what you've said about pricing and -

**<A – John Rowe>**: I'd like Chris to answer that.

**<Q – Jonathan Arnold>**: -- concerns about CapEx in general?

**<A – John Rowe>**: Chris, would you pick that up? Chris Crane.

**<A – Christopher Crane>**: Yes, I think what we're looking at right now is some timing, moving some projects around. But as we described, we continue to evaluate the projects. As the phases of engineering are further defined on each specific one, the cash flows will be advanced and the timing will come into play. I think we'll update in a lot more detail at EEI when we go through our presentation there. But this is just project timing.

**<Q – Jonathan Arnold>**: Yes, but they still make economic sense if you're keeping them in the plan, I guess?

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**<A – Christopher Crane>:** Yes, we're still positive on them. They're still making sense. There will be refinements as we go along, and that's why we gave a range on how much we want to invest on each specific asset.

**<A – John Rowe>:** I mean, we have stress-tested these projects against a very wide variety of assumptions, and they continue to make sense. But if we should get an even worse gas price scenario than we foresee, you'd have to say delaying some of these things might make more sense if the choice was delaying them or cutting the dividend. Well, we simply don't want to cut that dividend. It's pretty clear what we think we owe you on that, and we'll do our level best to keep that.

Now, where this all gets tied in with the prior question, Jonathan, is that as we look at this, you could get to a point of saying, well, should we come to you and say it's worth issuing some equity to sustain the EPU program? Well, we might do that if it comes to that, but that's not what we foresee at the present time.

**<Q – Jonathan Arnold>:** Okay. That's very helpful. Thank you for the clarity. Could I just ask one other slightly unrelated topic, but which has really been intriguing us? In the numbers, you said at PECO you had 29% above-normal cooling days. And you said that was worth about 20 million after tax to the bottom line versus normal. And last year in Q3, weather was about 6% below normal and 19 million negative. It just seems somehow, these numbers don't quite compute. I know weather adjustment is not, obviously, an exact science. But it feels like there should have been either less of an impact attributed to weather in Q3 last year, or considerably more benefit from weather in Q3 this year. Could you help us understand that a bit better?

**<A – Matthew Hilzinger>:** Yeah. This is Matt Hilzinger. Yes, there is some fluctuations, particularly as you get – remember, last year we had a particularly cool summer; and this summer we had a particularly hot summer. And I think there are some, there's always some anomalies in the calculation. But I think as we look at this year, I think there's a total of around \$0.11 year-over-year on the quarter, and about \$0.06 on a normal basis. So I don't know whether Phil had anything to add to that, but that's how we see it.

**<A>:** You pretty much covered it. I think it does have to do with more of the extreme weather conditions. The weather normalization is primarily done over a 30-year weather normal average. And what we saw last year was extreme mild conditions, and what we're seeing this year is extreme hot conditions.

**<Q – Jonathan Arnold>:** Okay. I just thought 6% last year wasn't that extreme, and 30% this year was extreme. Let's follow up off line on that one. Thank you for your time.

**<A – Stacie Frank>:** Thanks, Jonathan. Dorothy, we'll take the next question.

Operator: Your next question comes from the line of Paul Patterson from Glenrock Associates.

**<Q – Paul Patterson>:** Good morning.

**<A – John Rowe>:** Hi, Paul.

**<Q – Paul Patterson>:** I wanted to sort of just ask you on this coal plant retirement issue, do you see this impact of the regulations actually in the forward curve? And if not, why not? Is it because we're seeing new generation in terms of alternatives and regulated generation coming on line or demand response or energy efficiency? What do you see actually happening in the market with respect to the forward curve and these planned retirements?

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And then just related to that, as you know there's a FERC note for demand response that has caused some in the generation community a lot of concern. How do you see that potentially impacting power prices? Just your thought process on that.

And on the positive side with respect to power pricing, the PJM scarcity pricing proposal, if you could just give us a flavor as to how you think those two things might affect you guys, and just the forward curve, and the sort of \$64 question as to whether or not we're seeing this retirement issue showing up or not?

**<A – John Rowe>:** My own view is that we haven't seen very much of it in the forward curve yet. But the fact that it's real probably explains why the forward curve for electricity markets isn't following the gas curve down, literally.

But you asked three parts to the question, and I'm trying to keep you on generalities while Ken Cornew gets his wits together to actually answer them.

On demand management, we have a very clear position. If demand management is real, verifiable and deliverable, and cheaper than generation, great. But our principal concern at both FERC and PJM is to make certain that, that which is bid is that which is delivered, and penalties are proportionate if it is not.

So with that partial answer to your question, Ken, do your best and then maybe, Joe Dominguez, if you think Ken and I missed anything, because there were three very different pieces to his question.

**<A – Kenneth Cornew>:** Paul, on the first question. If you look at the line of forward prices in '11, you see a price that's close to \$30; and in 2015, you see a price that's close to \$40. There are a lot of things driving that, and it always is difficult to break down what components of price increase are driven by what elements of the market.

But as John indicated, the forward curve doesn't represent a great deal of price increase from the environmental impact of EPA regulation. It likely does represent some element of it on a risk-adjusted basis, and that is supporting a price increase of \$10 over the five years, along with all the other fundamental elements that are going on in the market. So again, a small piece, but it probably is in there on a risk-adjustment basis.

On demand response and the FERC note, a couple of points. Of course, the more demand response that's introduced into the market tends to clip volatility in the market, and that impact power prices. Our position on demand response is that, to the extent it's economic and competitive with other sources of generation, we're all for it. To the extent policy drives uneconomic decisions to increase demand response, I think that would be bad for market and bad for competition.

Another thing I'd say about demand response is that PJM and other RTOs are very carefully analyzing the saturation point of demand response products to make sure that the system runs reliably. And I think when you look at the demand response, it's actually cleared in the last capacity market. They're starting to push closer and closer to that saturation point. PJM looks at that saturation point as something around 8.5% of the capacity market. So demand response will have its limits associated with reliability, as well as what's going on with the FERC note.

Finally, on scarcity pricing. Scarcity pricing we think is essential for a competitive market. When there is scarcity, we should see uplift in spot power prices to incent new generation to come on line, particularly peaking and capacity resources. Scarcity pricing needs tight supply and demand. And so in the near term, we haven't seen that kind of tight supply and demand that would result in a lot of scarcity pricing, even if the policies and the PJM system moved in that direction. With what's happening and what we expect to happen in the capacity market, any energy market, associated

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with natural tightening of supply and demand and EPA regulations driving more retirement, we would expect to see scarcity pricing have a bigger positive impact on power prices in the future.

**<Q – Paul Patterson>:** Okay. But I guess what I was wondering here is just a few things. I guess it sounds to me like you guys are not opposed to full LMP pricing for demand response? It's just a question of whether it's verifiable. Is that sort of what we're talking about? And in terms of the PJM, I was talking about the scarcity pricing proposal that they have forward. I mean, if that were to be implemented, do you see a substantial potential of price increase if that pricing proposal is, in fact, enacted, if FERC goes along with that?

**<A – Kenneth Cornew>:** On the first point, we are opposed to full LMP compensation for demand response. Demand response should be compensated based on LMP minus the cost of the -

**<Q – Paul Patterson>:** Okay.

**<A – Kenneth Cornew>:** -- the original generation. So that's the LMP minus [inaudible]

**<Q – Paul Patterson>:** Right. Right. Okay.

**<A – Kenneth Cornew>:** And that's what makes sense, and that's what economically competitive.

**<Q – Paul Patterson>:** Right. But if they go with the full LMP, which is what the FERC note says, do you see a potential negative impact on power prices as a result of this? And can you give us a flavor for that, I guess?

**<A – Kenneth Cornew>:** To the extent it introduces uneconomic and more demand response, yes, it'll have an impact downward on power prices. The saturation point on the reliability side will keep that limited though.

**<Q – Paul Patterson>:** Okay.

**<A – Stacie Frank>:** Paul, we'll follow up with you -

**<Q – Paul Patterson>:** Okay. I don't mean to take up time. Thank you.

**<A – Stacie Frank>:** Thank you. Dorothy, we'll take another question.

Operator: Your next question comes from the line of Hugh Wynne with Sanford Bernstein.

**<Q – Hugh Wynne>:** Hi. I just wanted to follow up on the discussion of the balance sheet and the dividend. When I look at your margin – I'm sorry, your hedging disclosures from year-end and compare them to those at September 30, I see that the estimate of Exelon Generation's open gross margin was about 5.8 billion for '11 and '12 at year-end. And now it's about 4.8 billion for those same years, so down about \$1 billion. One consequence of that might be an effort by the company to reduce its debt commensurately so you can maintain that investment-grade rating through those years when the hedges have rolled off.

But it seems from reviewing your balance sheet and cash flow statement that, although you've generated about \$1 billion this year after your CapEx and after your dividend, there's no commensurate reduction in the total debt, at least not when I take into account what you're going to spend for Deere. So what am I to read from that? Do you feel that your total debt is at the right level already in an environment where earnings are no longer sustained by the hedges? Or would you plan to bring it down significantly over the next several years?

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**<A – Matthew Hilzinger>:** Hugh, this is Matt Hilzinger. So when we look at kind of our debt level to capitalization, we look at it over our planning horizon. And there are, as you know, in '12 and '13, those are challenged years. I think the numbers, the 5.8 and the 4.8, are on an open basis. And so we have been hedging, and so there's not quite that same reduction in cash flows that you would normally impute through just a pure, open basis.

And we have what I consider to be adequate balance sheet capacity right now. We're projecting our FFO-to-debt metric at the end of the year to be about 35%. As John said, we target a range between 30 and 35, and so there's some room to take on even a little bit more debt, or take on a few or lower cash flows as we kind of go through that planning period. And we spend a lot of time looking at that and evaluating it, and it does go into a lot of the conversation that John had raised. But, no, we don't expect to see our debt come down at all. But we do expect to have and stay within the FFO-to-debt metric of 30 and 35%.

**<A – John Rowe>:** Matt, I think what the numbers Hugh laid out might overlook is the amount of money we put into pension this year.

**<A – Matthew Hilzinger>:** That's true.

**<A – John Rowe>:** I think that might be the reconciling factor. I'm getting a couple of nods around the table.

**<Q – Hugh Wynne>:** No, I actually included pension.

**<A – John Rowe>:** The 31-month extension is in effect for doing debt.

**<Q – Hugh Wynne>:** I included pension and OPEB in that calculation. If you just look at net debt at year-end to September 30, including pension and OPEB, I think it's down by the better part of \$1 billion dollars. But if you subtract out the cash you raised for John Deere, then there's not that much change. So I think the takeaway, if I understood you correctly, is that you believe the current level of debt is sustainable in the long term, even after the current hedges roll off; and that you have no intention to bring it down from these levels, therefore. Is that it in a nutshell?

**<A – Matthew Hilzinger>:** Yeah. That's right, Hugh. And I would also say that – but we're also putting on hedges going forward, right? So it's not just having the current hedges roll off and being exposed to complete open market. As we go through a planning period, we do evaluate kind of our hedging and putting on ratable hedging positions to protect those cash flows.

**<A – Kenneth Cornew>:** And, Hugh, the '11 and '12 open gross margins have been heavily impacted quarterly by our hedging program. When you look at out-years and you see NiHub prices increasing up near \$40 by '15, and PJM and West Hub prices getting over \$50, those open gross margin calculations are going to be going up also.

**<Q – Hugh Wynne>:** Right. Okay. Thank you very much.

**<A – John Rowe>:** Thanks, Hugh.

**Stacie Frank, Vice President, Investor Relations**

Dorothy, I think we'll let John make some closing remarks and then conclude the call.



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## John W. Rowe, Chairman and Chief Executive Officer

Well, thank you everybody. We are very pleased with the quarter that just finished. We think this year will finish much better than it looked when we began it. As I said earlier, that's due to an awful lot of hard work by all of my colleagues here, and a little bit of good fortune on the weather.

We are planning, as you would expect, for continued soft economy and continued soft gas prices. We think we can give you another good year next year. And what we're really focusing on is how to make '12 and '13 a little better than either your models or our models would forecast them. I'm confident that we'll find ways to do that. And also that we're very focused on managing our cash and resources so we can sustain that dividend. I mean, we think 4.9% dividend plus some 2015 upside is a very unique value proposition and we're going to do our best deliver it for you.

Well, thank you very much.

Operator: This concludes today's conference call. You may now disconnect.

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