



Outlook for the US Utility Industry for 2007

Trends to consider in Credit and Collections

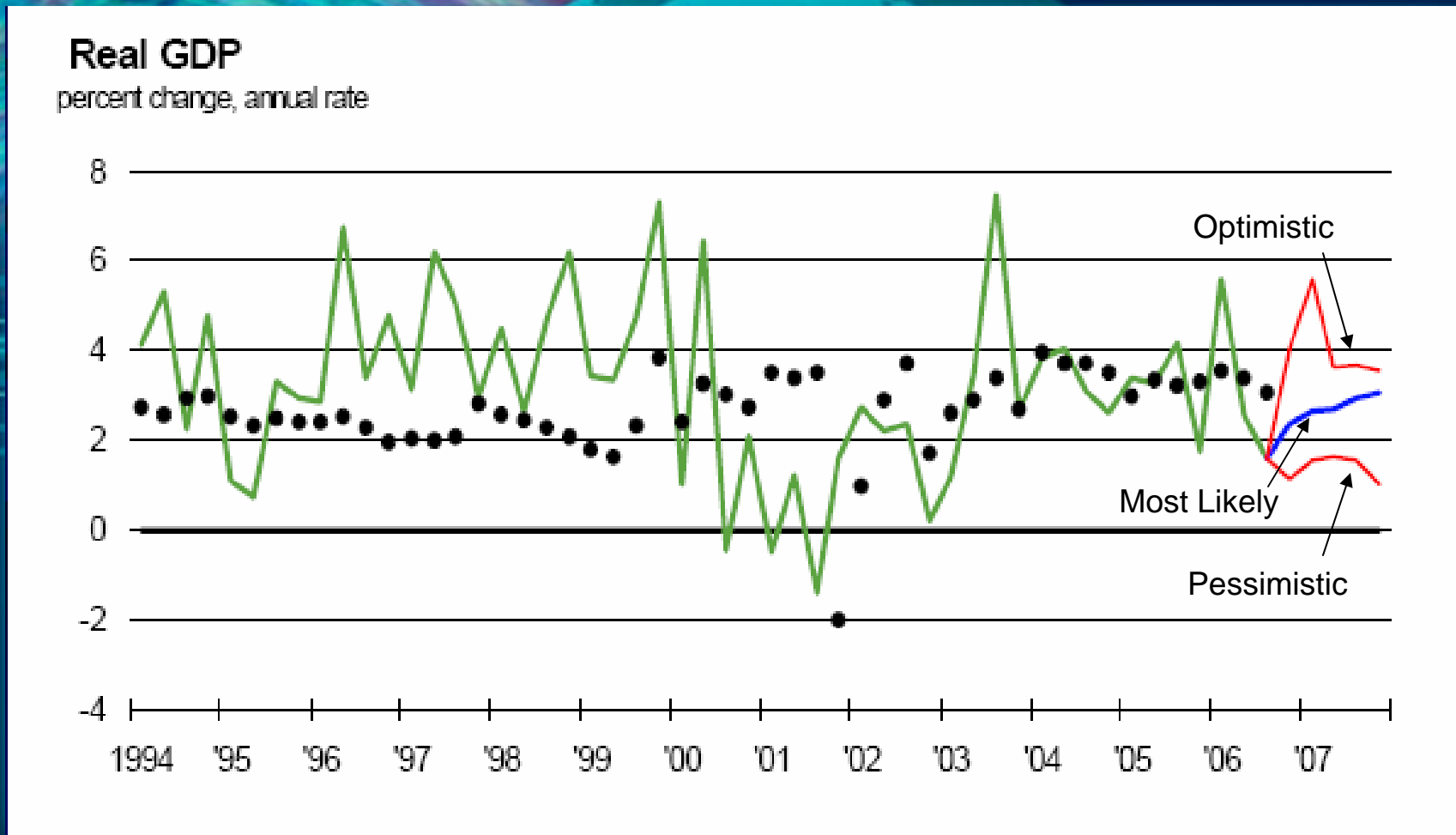
Presentation Outline

- U.S. Economic Outlook
- Utility Industry Outlook
- Supporting Developments
- Effect on Credit & Collections
- The Road Ahead

U.S. Economic Outlook

- According to the Federal Reserve Bank of Chicago, the US economic picture is only modestly improving:
 - GDP growth will increase from 2.4% to 3.1%
 - Unemployment will edge up from 4.6% to 4.9%.
 - Inflation is expected to decrease from 3.0% to 2.5%
 - Oil prices are forecast to flatten out from \$60 to \$59 per barrel.
 - Long-term interest rates are expected to rise slightly from 4.80% to 5.00%

GDP is expected to increase



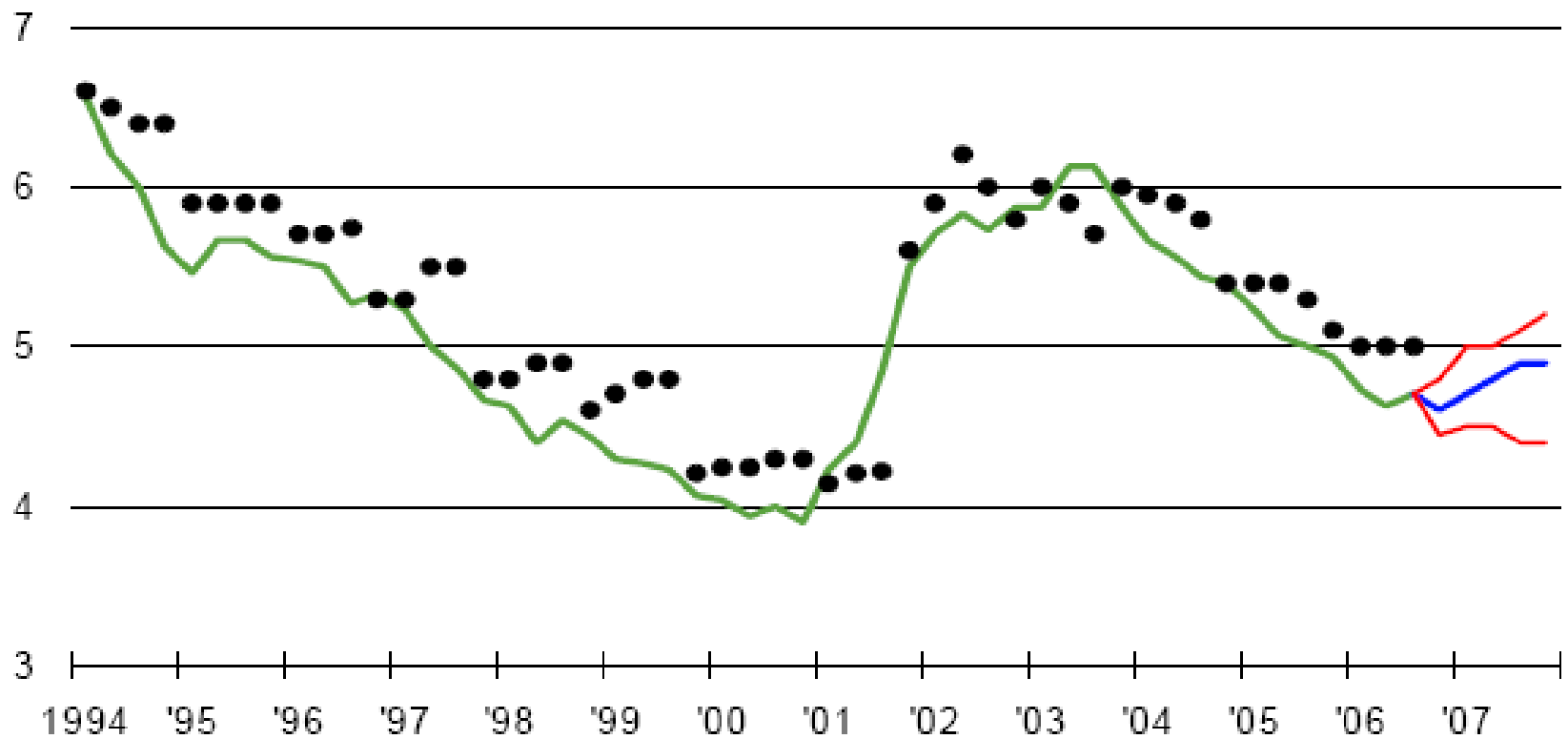
Source: Consensus forecast for 2007. Federal Reserve Bank of Chicago



Unemployment is also expected to increase slightly

Unemployment rate

percent



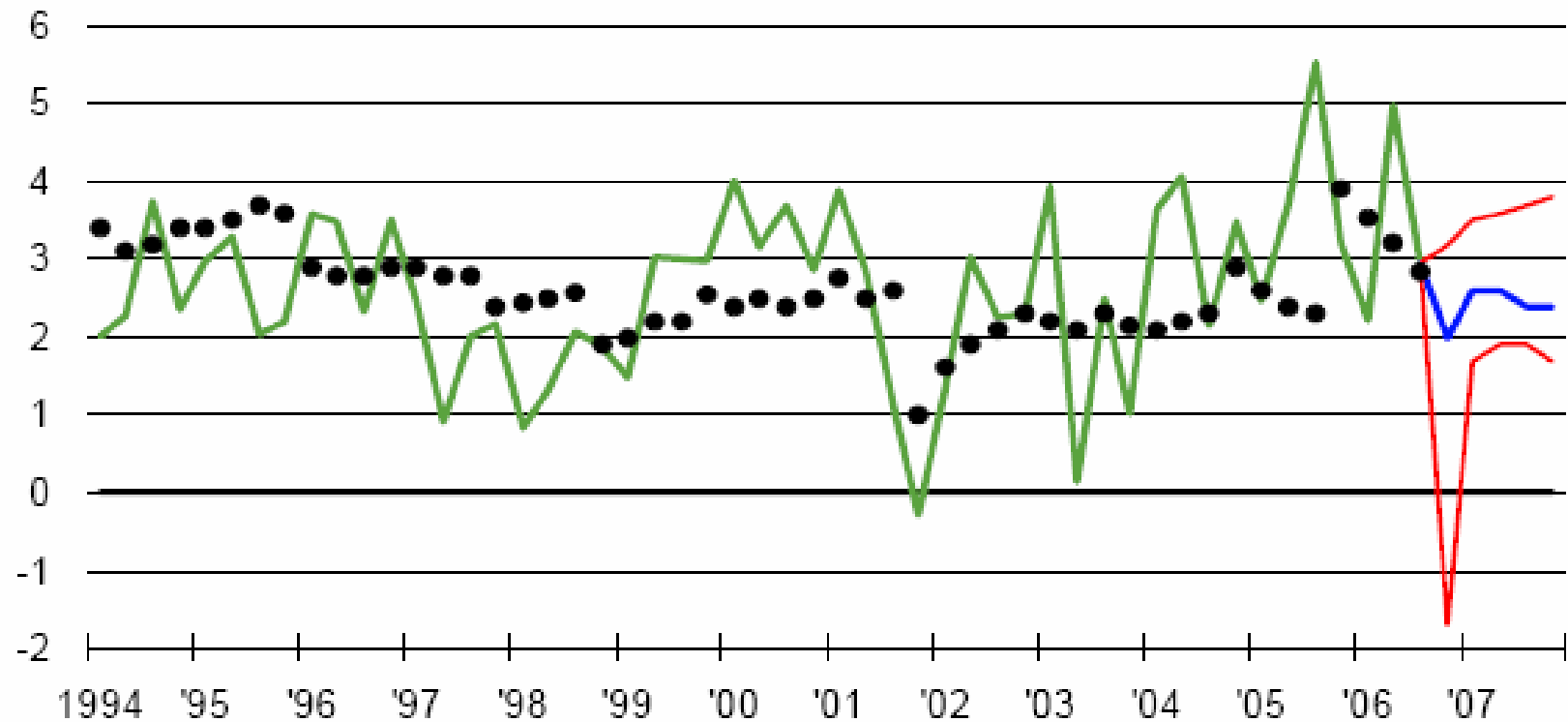
Source: Consensus forecast for 2007. Federal Reserve Bank of Chicago



Inflation is expected to fall

Inflation rate (CPI)

percent change, annual rate

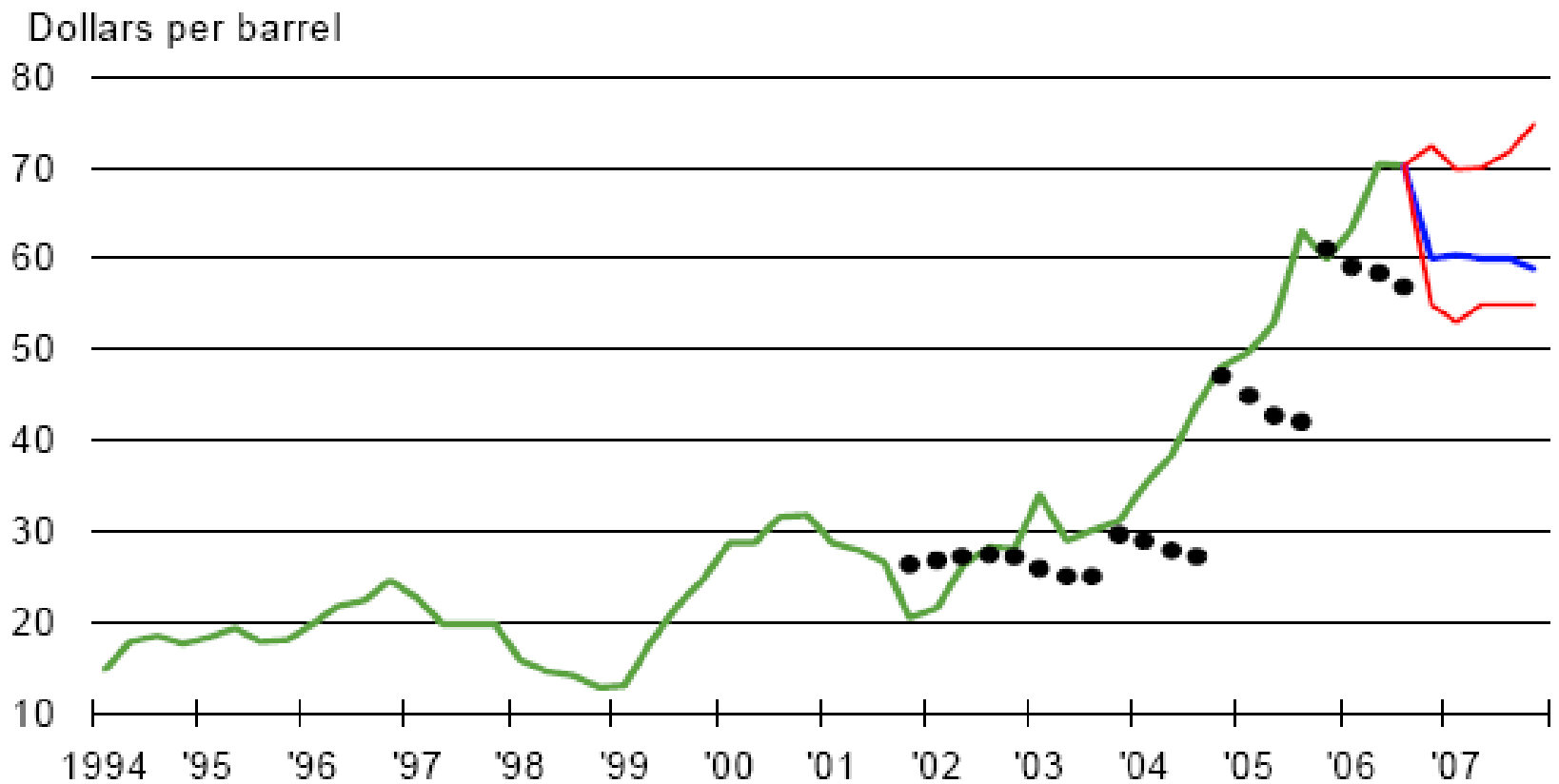


Source: Consensus forecast for 2007. Federal Reserve Bank of Chicago



Oil prices will remain stable

Oil prices - West Texas Intermediate

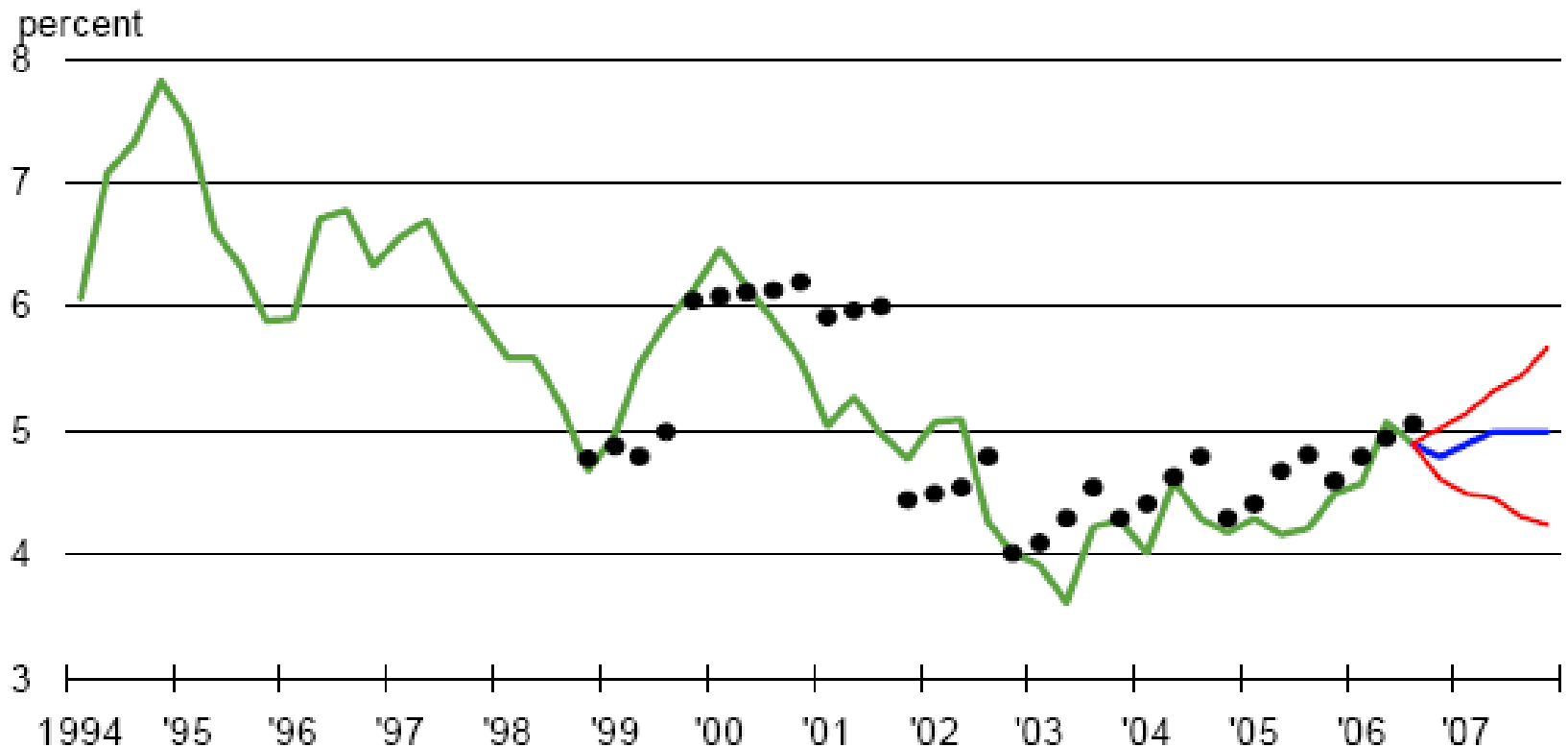


Source: Consensus forecast for 2007. Federal Reserve Bank of Chicago



Ten-year treasury rates are increasing

Treasury ten-year rate

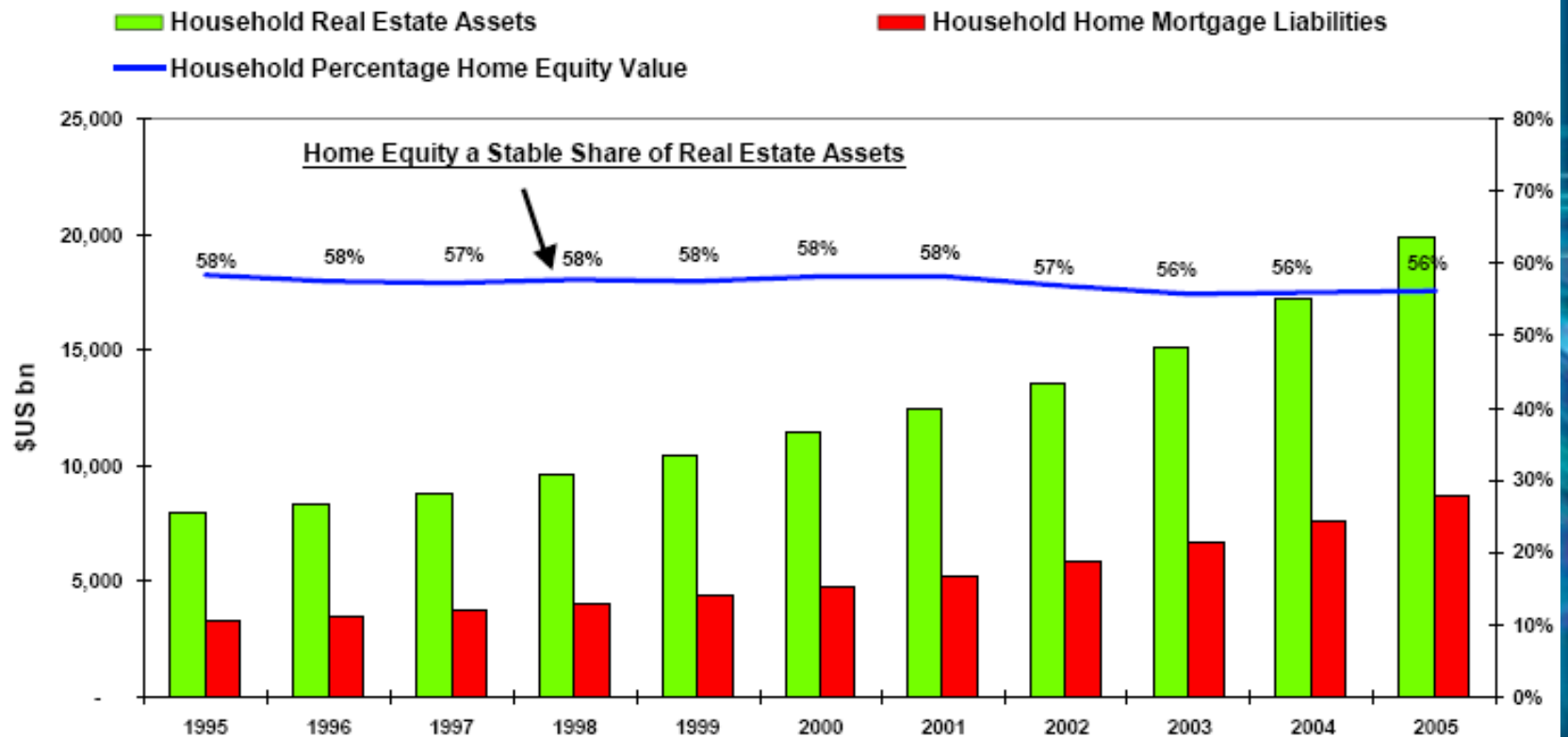


Source: Consensus forecast for 2007. Federal Reserve Bank of Chicago



Real estate value as a % of debt is remaining constant

US Household Sector Real Estate Assets and Home Mortgage Liabilities, 1985-2005

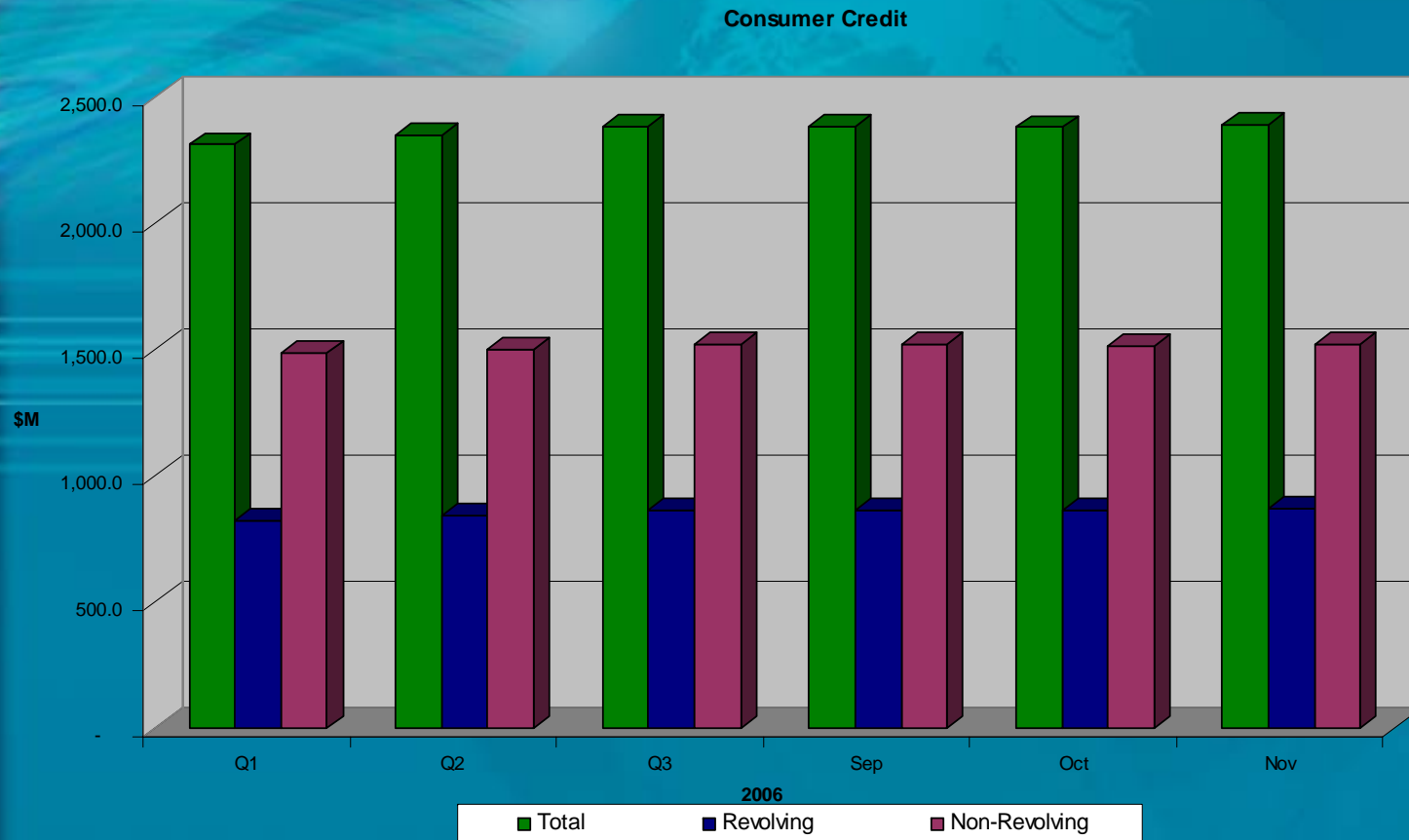


Source: Federal Reserve Flow of Funds Accounts

Source: Institute for International Economics, July 2006



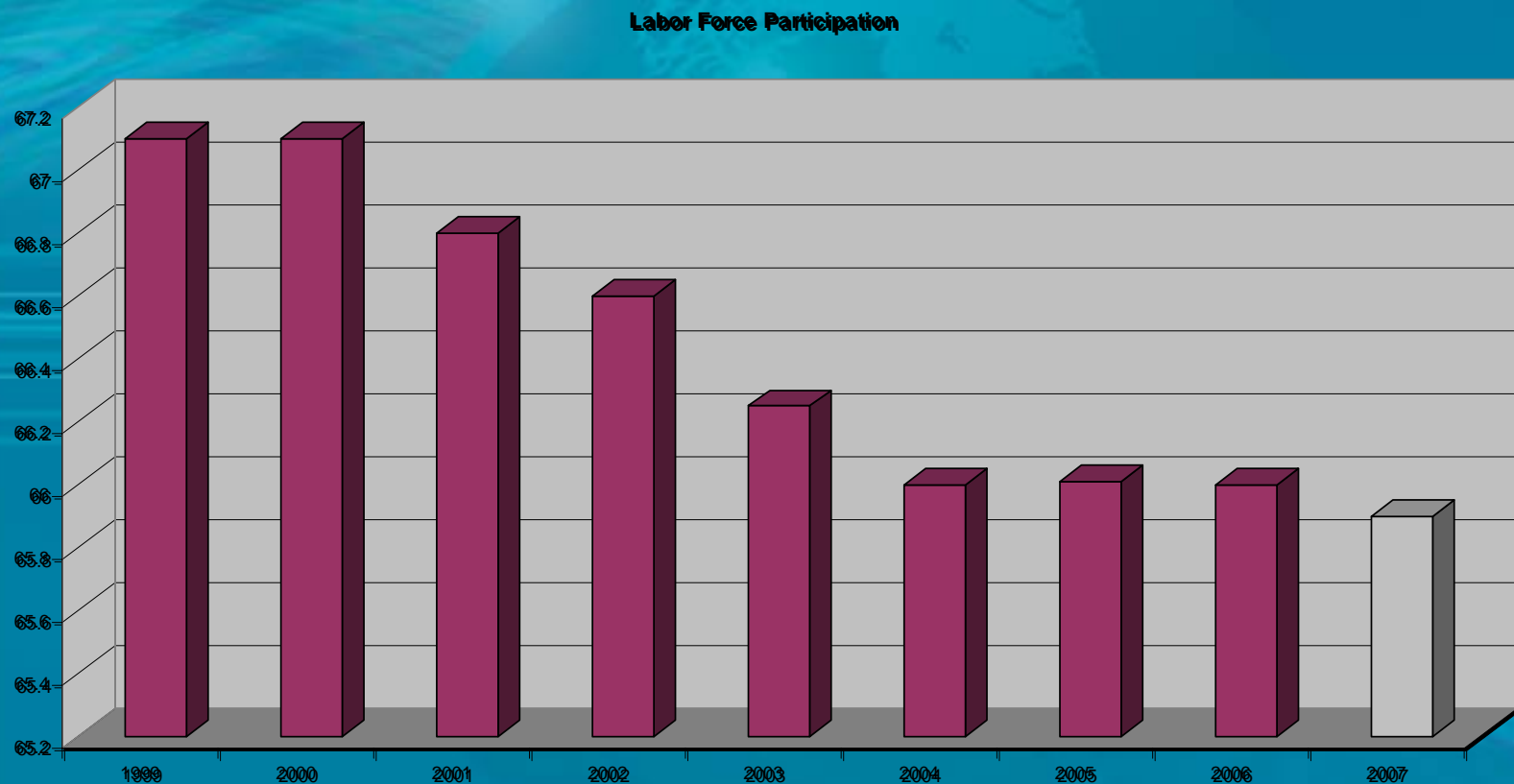
Consumer credit continues to increase



Source: Federal Reserve Statistical Release, January 8, 2007



Labor force participation rates are declining



Source: Institute for International Economics, July 2006



Summary of the Economic Outlook

- With unemployment and long-term rates expected to rise, creditors will be under pressure to stay on top of marginal and high-risk accounts.
- A slow-down in growth in the value of real estate predicts a tightening of available consumer purchasing power
- Growth in outstanding consumer credit may lead to adverse payment behaviors
- An aging and shrinking labor force will pressure employers to be more operationally effective

Utility Industry Outlook

- High-level outlook:
 - Regulatory actions will take center stage
 - Base-load generation growth will continue to fall short of anticipated demand predicting wholesale price increases
 - Rate case activity will continue as distribution companies face a backlog of delayed capital investment
 - Most of the financial uncertainty is behind the industry
 - Utility focus on the core business has stabilized balance sheets
 - However, overall focus on costs will continue due to rising inflation, costlier financing, infrastructure replacement and rising fuel prices

Regulatory innovation

- Companies will need to find ways to produce financial results while satisfying regulators that customer interests are being protected.
 - Focus will be capital investments in system reliability and information management

Transitioning from fixed costs to variable

- Rising costs across wholesale fuels, labor rates, and infrastructure replacement will place an emphasis on turning fixed costs to variable
 - Technologies will continue to focus on labor productivity and process automation
 - Large-scale outsourcing activity will increase

Supporting Developments

- AMI and Meter Data Management
- Revenue Assurance
- Notification Services
- Business Process Outsourcing

AMI and Meter Data Management

- Recent developments in Advanced Metering and Meter Data Management will have significant benefit in collections.
 - Identify consumption abnormalities (zero-usage meters, unknown users, etc)
 - Remote disconnect and reconnect minimizing field service costs

Revenue Assurance

- Metering and CIS companies are offering diagnostic capabilities tied to MDM to identify revenue assurance opportunities
 - RA opportunities are estimated at 5% to 7% of a utilities revenue stream
 - In addition to energy theft, other RA opportunities include
 - Administrative – unknown user, bad billing information, wrong rate,...
 - Operational – stuck meters, fast meters, bad meter multipliers,...

Notification Services

- Not necessarily a new technology, notification services will increase as a percentage of overall contact methods:
 - More full service providers will offer messaging in conjunction with collection services.
 - First Data
 - West
 - The economics of messaging will continue to be more favorable than other contact types

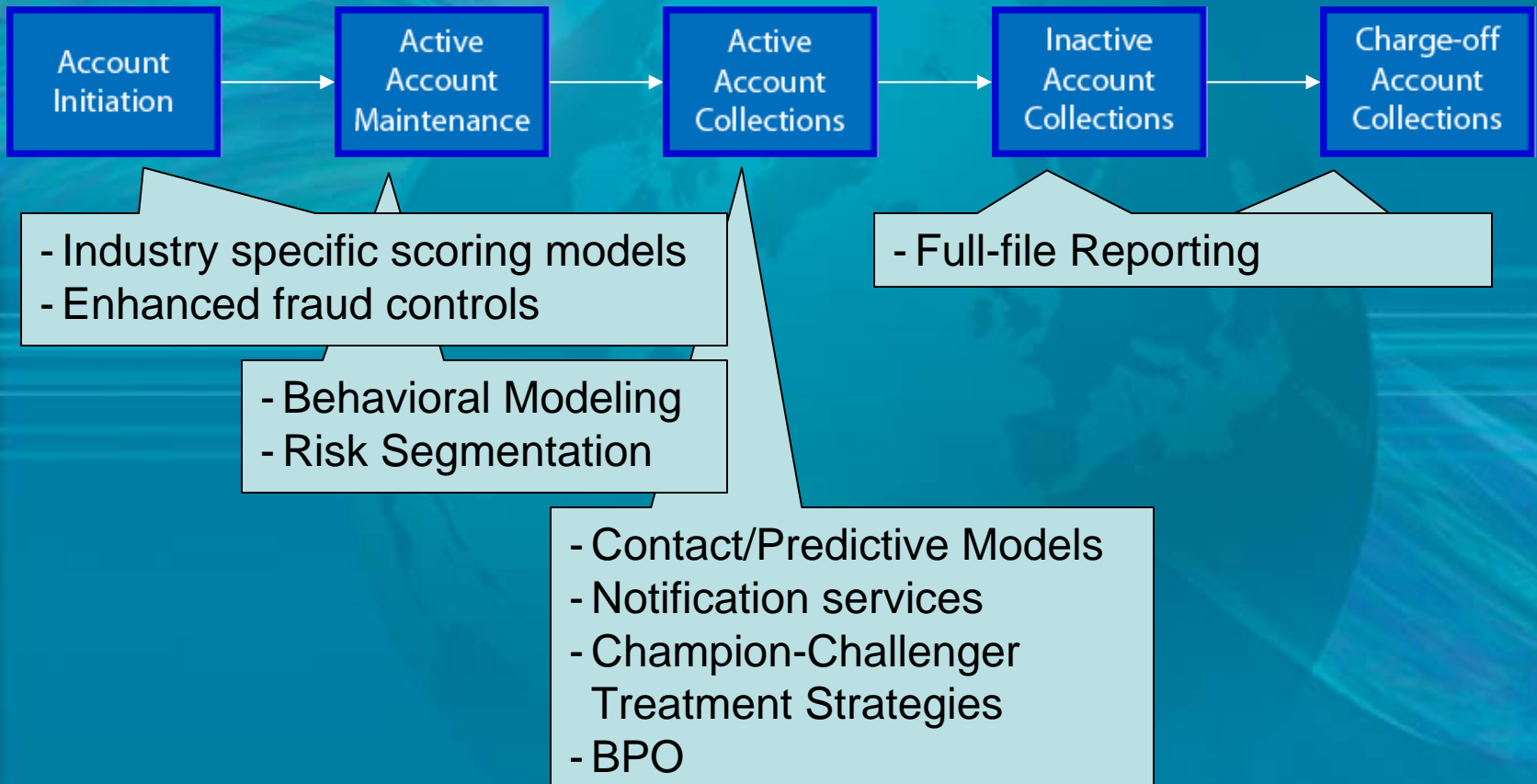
Business Process Outsourcing

- Utility management seeking to make costs more variable will seek to outsource more.
 - New full service entrants such as IBM and First Data will pressure executives to consider large-scale BPO opportunities

Effect on Credit & Collections

- Overall portfolio management approach is needed to ensure that services and technologies are deployed in the right manner.
 - Opportunities in the credit life-cycle
 - Understanding costs and recovery rates
 - Behavioral modeling
 - Champion-Challenger treatment strategy

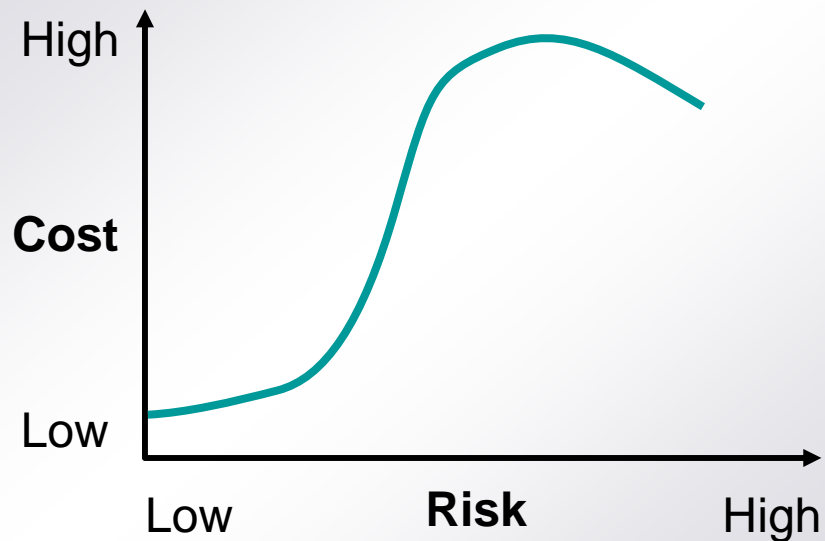
Opportunities in the credit life-cycle



Understanding costs and recovery rates

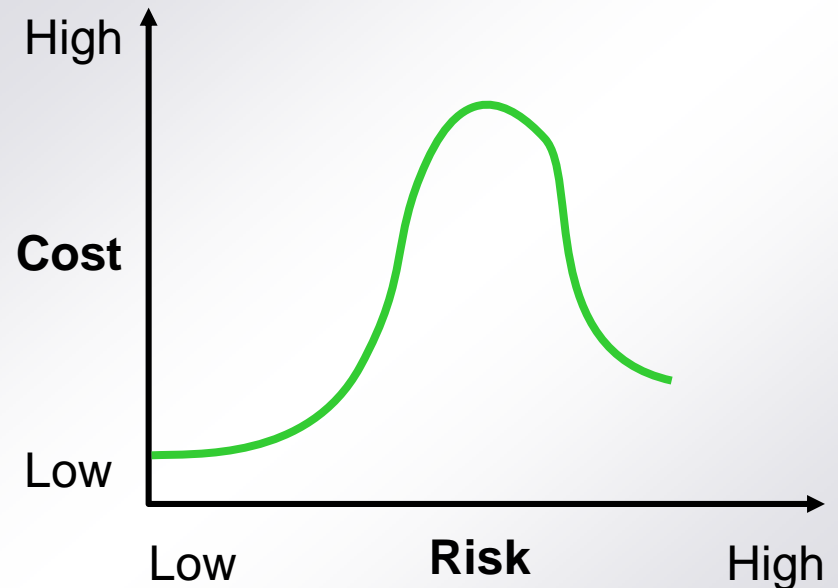
Allocating costs across risk segments would result in this graph:

Typical cost allocation



Efficient allocation *should* look like this:

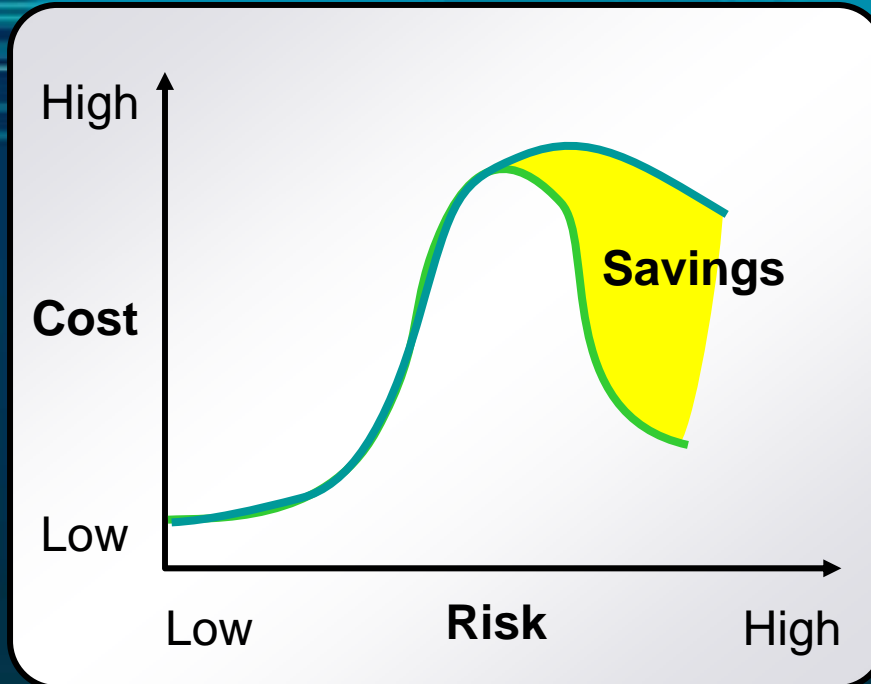
Efficient cost allocation



The cost of customer behavior

- **Analyze customer behavior to determine:**

- Who will pay you and who won't
- Which recovery tactics work which ones don't
- Which customers are under financial stress
- Which customers are just slow payers
- If a customer is about to file bankruptcy



With a clear picture of customer behavior you can allocate resources to the appropriate customers

Behavioral Modeling

- Using statistical methods to predict the likelihood that an account will make a payment, reach a later stage of delinquency, or eventually charge-off
 - Helps allocate resources by identifying customer segments for collections prioritization
 - May be combined with contact modeling to determine the most effective treatment for a particular segment
 - Models can be built, bought or outsourced

Champion-Challenger Treatment Model

- Typically, Champion-Challenger models are used to increase competition among collection agencies.
 - The agency with the best performance will gain more accounts while the worst performer loses accounts
- Champion-Challenger may also be used on processes
 - By creating a test group, different treatment strategies can be tested for performance uplift

Champion-Challenger Treatment Model

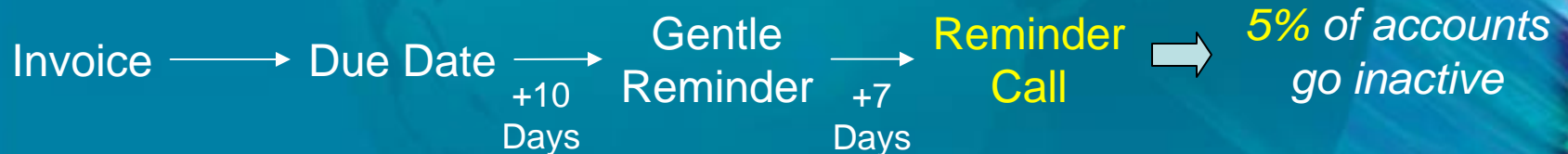
- How it works:
 - Measure the performance of the current treatment streams
 - Evaluate customer segment performance
 - Roll rates, charge-offs, bankruptcy rates
 - This becomes your initial Champion group
 - Assign customers to a test group (Challenger)
 - Revise the treatment strategies within that group and measure performance
 - Adopt positive changes and reject negative changes in performance
 - If a certain treatment strategy slows the roll rate, adopt the new treatment strategy

Champion-Challenger Treatment Model

Current Stream (Champion)



Test Stream (Challenger)



By making a reminder call instead of a firm reminder letter, more accounts recover leading to fewer accounts going inactive. In this case, the Challenger stream yields better results and should be adopted.

The Road Ahead

- 2007 will be a year of fine-tuning the credit & collections strategy
- It is imperative that a clear view of the overall process and underlying costs is gained
- Mergers and acquisitions in this industry is a fact of life, don't be distracted by the executives playing the dating game
- New tools are available to make you much more efficient and effective

Thank you

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