UNITED STATES

ATOMIC ENERGY COMMISSION

WASHINGTON, D.C. 20545

JUL 29 1974

A. Giambusso
Deputy Director for Reactor Projects
Directorate of Licensing

CONSUMERS POWER COMPANY: MIDLAND UNITS 1 AND 2 - DOCKET NOS. 50-329 and 50-330

Reference is made to your letters of May 29 and June 12, 1974 to Consumers Power Company requesting current information on the company's financial condition and financial plans for the purpose of determining its financial qualifications with respect to the Midland facilities. Analysis of the company's responses indicated that a meeting between the Staff and the company's financial experts would accelerate the examination of the company's financial qualifications. The meeting was held on July 25 at the Bethesda offices. Based on information presented by the company at the meeting and its responses to your requests for financial data, together with data generally available to the financial analyst, we have concluded that Consumers Power Company has reasonable assurance of obtaining the funds necessary to continue and complete construction of the subject facility.

As stated in the attached financial analysis, the company's construction program including the subject facility requires a level of earnings substantially higher than current earnings if adequate amounts of capital are to be obtained from outside financing and internal sources.

Bruce M. Hurt
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Electric Utility Specialist
Office of Antitrust & Indemnity
Directorate of Licensing

Attachment

CC: D. Vassallo, L:LWR 1-1
L. Engle, L:LWR 2-3
S. MacKay, L:LWR 2-3
V. Moore, L:LWR 2
A. Schwencer, L:LWR 2-3
E. Goulbourne, L:LWR 2-3
D. Kartalis, OGC
A. Braitman, L:OAI

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## FINANCIAL ANALYSIS

Based on our review of the financial information presented by Consumers Power Company and consideration of the financial data generally available to the financial analyst, we have concluded that Consumers Power Company has reasonable assurance of obtaining the funds necessary to continue and complete construction of the Midland Units 1 and 2. However, the company will require higher earnings at levels which will result in sufficient internally generated funds and which will permit external financing of its construction program and its operational requirements at reasonable cost.

Our conclusion is based on the following facts and considerations:

1. Construction of the subject facility will be financed as an integral part of the applicant's total construction program. Such financing is obtained from internally generated funds (retained earnings plus depreciation, tax deferrals, and other non-cash items), from sale of debt and equity securities, and from short-term bank loans. The applicant's construction expenditures for 1974 are estimated at $360.3 million after giving effect to a retrenchment program which eliminated approximately $60.0 million from the 1974 construction budget. Construction expenditures for 1972 and 1973 amounted to $373.1 million and $360.9 million, respectively, and are therefore greater

than the proposed 1974 expenditures. Internally generated funds provided 25% and 31% of the funds required for the 1972 and 1973 construction expenditures. During the twelve months ended May 31, 1974, the corresponding figure is computed at 26% and is comparable to the 25% contribution made by internally generated funds to total construction expenditures in 1972, although lower than the 1973 contribution of 31% and accordingly indicative of the greater reliance presently being assigned to outside financing.

The subject facility required construction expenditures of $104.1 million prior to 1974; will require $101.0 million for 1974, or 28% of total 1974 construction expenditures; and $734.9 million after 1974. Total construction expenditures for the years 1974-78 are estimated to average $440.0 million each year. During the past 5-year period (1969-73) construction expenditures averaged $285.3 million each year. This upward movement in estimated construction expenditures will require higher levels of earnings and greater amounts of outside financing.

2. The earnings coverage provisions of the applicant's indenture covering its First Mortgage bonds require for the issuance of additional mortgage bonds, except for certain refunding purposes, minimum earnings coverage before income taxes of two times pro forma annual interest charges on bonds. For the twelve months ended May 31, 1974, the

coverage is computed at 2.01 versus the required 2.00. Higher earnings will be required if additional mortgage bonds are to be issued in the future.

3. In April 1974 the applicant submitted an application to the Michigan Public Service Commission to increase its electric rates by not less than $72.2 million annually and at the same time requested partial and interim relief in the amount of $54.7 annually. The application for the $72.2 million rate increase is in the hearing stage which is 50% complete. If the partial and interim relief of of $54.7 annually had been in effect during the twelve months ended June 30, 1974, earnings available for common stock would have increased from $47.0 million to $73.9 million assuming a net Federal and state income tax rate of 50.9%. Annual dividend requirements of $52.5 million ($2 per average common share outstanding) would have resulted in a payout ratio of 71%, which is identical to the average payout ratio recently experienced by forty electric utilities each, like the applicant, with operating revenues over $170.0 million.

4. On June 27, 1974 the applicant reported earnings of $1.79 per share of common stock outstanding for the twelve months ended May 31, 1974 compared with $2.77 for the same period ended May 31, 1973. The applicant's board of directors on June 25, 1974 declared the regular quarterly

dividend of 50¢ per common share.

Continuance of the annual dividend rate of $2.00 per common share is necessary if equity capital is to be obtained on economic terms. Reduction of the dividend rate would lower the market value of the applicant's common stock and render the sale of additional common stock extremely difficult. The applicant's earnings available for common stock amounted to $47.0 million for the twelve months ended May 31, 1974 versus annual dividend requirements of $52.5 million based on an annual dividend rate of $2.00 per average common shares of 26,233,838. Adjusting the $47.0 million for non-cash items (depreciation and amortization, deferred income taxes, investment tax credit, allowance for funds used during construction, and undistributed earnings of subsidiaries) results in cash earnings of $146.8 million or $94.3 million above the $52.5 million of common dividends based on an annual rate of $2.00 per share. If the adjustment for depreciation and amortization ($87.3 million) is excluded, the cash earnings would be $59.5 million or $7.0 million above the $52.5 million of common dividends on an annual basis. Based on reported earnings for the twelve months ended June 30, 1974, similar types of calculations would indicate cash earnings of $134.6 million ($56.3 million excluding the adjustment for depreciation and amortization) versus $52.5 million of common dividends on an annual basis.

5. The record of the applicant's operations during 1971-73 shows that operating revenues increased from $651.6 million in 1971 to $835.0 million in 1973; net income increased from $71.8 million to $80.9 million; and net investment in utility plant increased from $2,021.0 million to $2,604.6 million. However, the number of times total interest charges were earned declined from 2.3 to 2.1. Moody's Investors Service rates the Applicant's first mortgage bonds as A (upper medium grade bonds), reflecting a downward revision as of July 9, 1974 from Aa (high grade bonds). The Applicant's current Dun & Bradstreet rating is 5A1, the highest rating.

More recent data based on the twelve months ended June 30, 1973 and June 30, 1974 indicates that operating revenues increased from $793.8 million for the twelve months ended June 30, 1973 to $926.8 million for the twelve months ended June 30, 1974; net operating income declined from $124.7 million to $119.5 million; net income fell from $85.4 million to $69.5 million; and income available for common stock declined from $71.2 million ($2.77 per average common share outstanding) to $47.0 million ($1.79 per average common share outstanding). However, as noted above, the applicant's cash earnings are greater than its annual dividend requirements.

A summary analysis reflecting various ratios and other pertinent data is attached.

CONSUMERS POWER COMPANY

FINANCIAL ANALYSIS

DOCKET NOS. 50-329 and 50-330

| | (dollars in millions) Calendar Year Ended December 31 | | |
|---|---|---|---|
| | 1973 | 1972 | 1971 |
| Long-term debt | $1,222.3 | $1,132.5 | $1,029.2 |
| Utility plant (net) | 2,604.6 | 2,323.4 | 2,021.0 |
| Ratio - debt to fixed plant | .47 | .49 | .51 |
| Utility plant (net) | 2,604.6 | 2,323.4 | 2,021.0 |
| Capitalization | 2,300.7 | 2,066.9 | 1,817.5 |
| Ratio of net plant to capitalization | 1.13 | 1.12 | 1.11 |
| Stockholders' equity | 1,078.4 | 934.4 | 788.3 |
| Total assets | 2,844.8 | 2,530.6 | 2,217.8 |
| Proprietary ratio | .38 | .37 | .36 |
| Earnings available to common equity | 63.1 | 66.9 | 64.7 |
| Average common equity | 723.6 | 678.2 | 632.1 |
| Rate of earnings on average common equity | 8.7% | 9.9% | 10.2% |
| Net income | 80.9 | 78.2 | 71.8 |
| Stockholders' equity | 1,078.4 | 934.4 | 788.3 |
| Rate of earnings on stockholders' equity | 7.5% | 8.4% | 9.1% |
| Utility operating income | 124.7 | 114.1 | 101.4 |
| Average utility plant (net) | 2,444.5 | 2,172.2 | 1,925.2 |
| Return on avg. utility plant (net) | 5.1% | 5.3% | 5.3% |
| Net income before total interest charges | 154.9 | 143.4 | 127.4 |
| Total interest charges | 74.0 | 65.3 | 55.6 |
| No. of times total interest charges earned | 2.1 | 2.2 | 2.3 |
| Net income | 80.9 | 78.2 | 71.8 |
| Utility operating revenues | 835.0 | 750.5 | 651.6 |
| Net income ratio | .10 | .10 | .11 |
| Oper. exp., depr., taxes other than income | 665.6 | 596.8 | 512.6 |
| Utility operating revenues | 835.0 | 750.5 | 651.6 |
| Operating ratio | .80 | .80 | .79 |
| Utility plant (gross) | 3,219.1 | 2,914.9 | 2,576.9 |
| Utility operating revenues | 835.0 | 750.5 | 651.6 |
| Ratio of plant investment to revenues | 3.86 | 3.88 | 3.95 |

| | 1973 | | 1972 | |
|---|---|---|---|---|
| Capitalization: | Amount | % | Amount | % |
| Long-term debt | $1,222.3 | 53.1% | $1,132.5 | 54.8% |
| Preferred stock | 347.6 | 15.1 | 217.9 | 10.5 |
| Common stock & surplus | 730.8 | 31.8 | 715.4 | 34.7 |
| Total | $2,300.7 | [illegible] | $2,066.9 | [illegible] |

Moody's Bond Rating: A

Dun & Bradstreet Credit Rating: 5A1

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