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Commentary : Power Lines

Warren Buffett Feels the Power

By [Christopher Edmonds](#)

Special to [TheStreet.com](#)

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Warren Buffett is ready to seize power but only if the rules of the game are changed.

Almost as if to introduce a plot into the annual Buffett gawkfest otherwise known as the **Berkshire Hathaway** ([BRK^A:NYSE - news](#)) annual meeting that convenes Saturday, Buffett again said he is ready to invest billions into electric utilities if a federal law is repealed that imposes restrictions on utility investments.

He may get his wish. On Tuesday, the **Senate Banking Committee** voted to repeal the **Public Utility Holding Company Act**, or PUHCA, a

Depression-era law designed to prevent undue market power in the electric power business. PUHCA established a myriad of restrictions on utility ownership, especially for nonutility holding companies such as Berkshire Hathaway.

And, additional legislative action is more likely than ever as **Congress** looks for ways to address the California conundrum and the general perception that action is needed to prompt investment in the country's electric infrastructure.

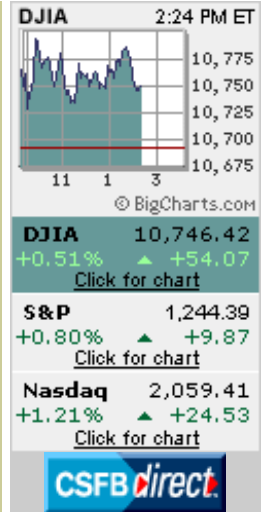
Buffett's interest in the power business [surfaced in 1999](#) when he and longtime confidant and Berkshire board member Walter Scott Jr. purchased **MidAmerican Energy** in a partnership with MidAm CEO David Sokol. Berkshire's initial investment for 76% of the equity interest was about \$2 billion. However, PUHCA restrictions prohibited him from gaining voting control. Berkshire holds less than 10% of the voting power, with control resting with Scott.

With the move, Buffett first telegraphed the depth of his interest in the power biz. "Though there are many regulatory constraints in the utility industry, it's possible that we will make additional commitments in the field," Buffett wrote in Berkshire's 1999 annual report. "If we do, the amounts involved could be large."

Sokol: Flush With Cash, Hunting for Bargains

In December, I caught up with Sokol after his keynote presentation at the **UBS Warburg Global Power Conference**. He made it clear that Buffett wanted to grow the business and he had access to all the capital he needed -- and then some. "[Buffett] has given us more than we can spend," Sokol said about the directives from his boss to grow the utility business.

At the time, Sokol questioned the valuations of many utilities, especially those with market gains from the promise of surging profits from unregulated businesses. Once a high-flying, rapid-growth-promising CEO of an independent power producer in his own right, Sokol was beginning to sound more and more like a Buffett convert looking for value in mundane industries with real



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earnings and cash flow. In fact, providing possible insight into Buffett's power plays to come, he suggested future value would be found in the regulated portion of the business, not today's market darling -- the independent generation and power trading business.

One thing is for certain: Buffett and his disciples walk their talk. Buffett's most recent power investment -- **GPU Inc.** ([GPU:NYSE - news](#)) -- is a sleepy utility focused on delivering power to customers in Pennsylvania and New Jersey. GPU has agreed to merge with **First Energy** ([FE:NYSE - news](#)), an Ohio-based utility. While GPU has an interest in nonregulated and international power projects, its focus remains the traditional, regulated operations in the power business: transmitting and delivering electricity to the end user.

While that business may not provide the sex appeal of the trappings of a **Calpine** ([CPN:NYSE - news](#)), **AES** ([AES:NYSE - news](#)) or **Enron** ([ENE:NYSE - news](#)), the traditional utility business does meet Buffett's steady criteria of a business that is easily understood, has scale and provides predictable earnings and cash flow. And, delivering an essential product to captive consumers makes the business potentially even more stable than Buffett's flock of insurance and consumer goods companies.

Enlightened Investments: Who's Next?

With reports putting Buffett's next-generation interest in the utility business in the \$10 billion to \$15 billion range, how he spends the money is subject to both speculation and even advice. A handful of analysts have gone so far as to recommend utilities Buffett should consider, an almost sure sign they are companies that won't be gobbled up by Buffett anytime soon.

That said, a look at the electric utility industry leads to a couple of interesting conclusions. Of the 60-plus publicly traded utilities, only a handful are out of reach to Buffett's billions, with fewer than a dozen touting market caps greater than \$10 billion. And, many are easy Berkshire targets, with more than half of the companies sporting market values of \$2 billion or less and nearly three-quarters at or below \$5 billion.

So, which utilities would Buffett choose to add to Berkshire's powerful stable? Buffett is known for his surprises and enjoys [ridiculing journalists](#) for their often wrong-headed assumptions about Berkshire and its chairman. However, a quick look at Buffett's past actions and the comments of Sokol, his utility guru, provide some insight into possible interests.

Buffett's Power Buffet							
An Eclectic List of Electrics That May Look for Partners							
Company/Ticker	Recent Price	Market Cap (\$ Bil)	Earnings Estimates		P/E Analysis		Dividend Yield
			2001	2002	2001	2002	
Ameren (AEE:NYSE)	\$41.75	5.73	\$3.42	\$3.62	12.21	11.53	6.11%
CLECO (CNL:NYSE)	45.20	1.01	2.94	3.26	15.37	13.87	3.84
DPL (DPL:NYSE)	29.89	3.82	1.85	2.05	16.16	14.58	3.20
DTE Energy (DTE:NYSE)	42.25	6.03	3.58	3.99	11.80	10.59	4.91
El Paso Electric (EE:Amex)	13.50	0.69	1.20	1.35	11.25	10.00	Nil
Empire District Electric (EDE:NYSE)	19.25	0.34	1.10	1.55	17.50	12.42	6.74

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IDACORP (IDA:NYSE)	39.30	1.47	2.83	3.08	13.89	12.76	4.79
Kansas City Power & Light (KLT:NYSE)	26.42	1.63	2.11	2.05	12.52	12.89	6.36
Madison Gas & Electric (MDSN:Nasdaq)	22.25	0.37	1.63	NA	13.65	NA	5.92
OGE Energy (OGE:NYSE)	21.72	1.69	2.07	2.20	10.49	9.87	6.24
Utilicorp United (UCU:NYSE)	35.00	3.94	2.32	2.62	15.09	13.36	3.39
Wisconsin Energy (WEC:NYSE)	21.16	2.50	2.13	2.26	9.93	9.36	3.80
WPS Resources (WPS:NYSE)	34.00	0.90	2.60	2.78	13.08	12.23	6.15
Industry Averages					16.33	12.67	4.11%

Prices as of Close April 24, 2001

Source: First Call, Company Reports, UBS Warburg

Previous acquisitions provide little insight as to the size of possible acquisitions. In the past three years, he has made acquisitions ranging from just hundreds of millions of dollars to the \$22 billion deal for **General Re**. However, it isn't likely Buffett will find an uncomplicated acquisition in the \$10 billion range. Hence, the table above includes utilities in the middle range, from \$300 million to about \$6 billion in market cap.

Second, if Sokol's December comments and Buffett's recent investment in GPU are an indication, Buffett will focus on electric utilities engaged in the generation, transmission and distribution of power to a captive audience. Hence, our list above contains a group of utilities that may have ancillary, unregulated operations, but are focused on the traditional electric power business. That said, Buffett's acquisitions of MidAmerican contained a large unregulated power business -- **CalEnergy** -- that remains a significant player in both domestic and international power projects.

Finally, the list above assumes that Buffett, through Mid-American would start by looking at opportunities in his back yard, because integration of geographically contiguous utilities would provide the best synergies with MidAmerican's Iowa base. Hence, companies such as **Ameren** ([AEE:NYSE - news](#)), **Empire District Electric** ([EDE:NYSE - news](#)), **Kansas City Power & Light** ([KLT:NYSE - news](#)) and **Utilicorp** ([UCO:NYSE - news](#)) in Missouri; **Madison Gas & Electric** ([MDSN:Nasdaq - news](#)), **WPS Resources** ([WPS:NYSE - news](#)) and **Wisconsin Energy** ([WEC:NYSE - news](#)) in Wisconsin; and **OGE Energy** ([OGE:NYSE - news](#)) in Oklahoma all make geographic sense. In addition, all are companies that likely will be in play once PUHCA is repealed.

That doesn't mean that Buffett won't look elsewhere. Thus, a handful of other names on the list are companies that have either hinted or been hinted at as possible acquisition candidates. While not inclusive, the list provides a starting point for investors who want to begin searching for utilities that are partner candidates in the new environment.

And, two more caveats. While Buffett continues to say he is growing more inclined to purchase businesses rather than invest in them, he could invest billions in the industry by taking positions similar -- albeit larger stakes would be allowed if PUHCA is repealed -- to his investment in GPU. In that case, even the bigger names in the sector might become beneficiaries of Buffett's float.

And, finally, while a long shot, it is possible Buffett might target large electric cooperatives looking to convert from membership to investor ownership in order to raise capital to expand.

Whatever the path, Buffett's reacknowledgement of his proclivity toward power has rekindled interest in the sector and is certain to provide buzz at this weekend's Capitalist Woodstock in Omaha.

Coming Next: A preview of the Berkshire annual meeting. And, next week, a look at the other implications the repeal of PUHCA would have on the utility industry and power investors.

Christopher S. Edmonds is president of Resource Dynamics, a private financial consulting firm based in Atlanta. At time of publication, neither Edmonds nor his firm held positions in any securities mentioned in this column, although holdings can change at any time. Under no circumstances does the information in this column represent a recommendation to buy or sell stocks. While Edmonds cannot provide investment advice or recommendations, he welcomes your feedback and invites you to send it to [Chris Edmonds](mailto:Chris.Edmonds).

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