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THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Investing with a Focus on Utilities, Telecom & Energy

RONALD J. SORENSON is Vice Chairman, Chief Executive Officer, Chief Investment Officer and Portfolio Manager at W.H. Reaves & Co., Inc. He joined the company in 1991. He was elected Vice Chairman and Chief Executive Officer in September, 2005 after previously holding the position of Chief Investment Officer. He is also responsible for portfolio management and development of private client accounts. Before joining W. H. Reaves, he was a co-owner and Portfolio Manager of an investment advisory firm, PVF Inc. He was also Director of the BMC Fund Inc., a closely held mutual fund. He has more than 24 years experience in the investment industry and has served as Chairman of the Board for American Life Insurance Company of New York. For nine years, he lived in London, England, where he was engaged, on behalf of private investors, in managing investments in the United States in both listed securities and private equity. Before moving to London, he practiced public accounting with Arthur Young & Co. where he gained experience with companies in a variety of industries, including energy and technology. He received an undergraduate degree from Stanford University and an MBA degree from Columbia University, where he concentrated in Accounting and Finance. He is a Certified Public Accountant.

SECTOR – GENERAL INVESTING

TWST: Would you start with an overview of W.H. Reaves?

Mr. Sorenson: W.H. Reaves & Company was founded by Bill Reaves in 1961 as a research boutique to provide independent research with respect to the utilities industry. Previous to that, he was with Kidder, Peabody as an electric utility analyst. He set up the firm, bought a seat on the New York Stock Exchange and, until May Day 1975, basically the firm prospered because of the quality of its independent research. After May Day 1975 when commissions became negotiable, he had to rethink his business model, because the number of people who were going to be willing to pay for research would be less and less every year.

In discussions with one of the companies that he had researched and knew well, Tampa Electric, they asked if he managed money, and he said, well no, but we manage our own Profit Sharing Trust. He showed them the performance of the Profit Sharing Trust — this is in 1977 — and he was immediately hired to manage a portion of their defined benefit pension plan. I am pleased to say that Tampa Electric was our first client and they're still a client after 31 years. The core of the business that we invest in and research has expanded somewhat from just the traditional electric utility and natural gas pipeline industry.

With the breakup of AT&T (T) into the Regional Bells, we added the telephone companies to our investment universe. Obviously, some of the major inputs to the utility sector is energy by way of coal, natural gas, oil and, not so much in the last decade or so, uranium. As a result we invest and research the traditional energy sector as well. One area of regulated utilities, which has a lot of promise, is the water sector. Historically there have been limited opportunities to invest in the water utility sector, but there are currently US-domiciled water utilities with a market capitalization in excess of $2 billion listed on the New York Stock Exchange.

Highlights

Ronald J. Sorenson manages portfolios concentrated on telephone companies, utilities and the major energy inputs to the utility sector, including coal, natural gas and oil. He looks for companies that are profitable, have good balance sheets, have a history of paying dividends and, most important, are raising their dividends over time. He does not pursue the highest dividend yields but looks for a combination of both moderate and predictable earnings growth and the dividend. Even though the portfolios are focused on telecom, electric utilities, gas utilities, water utilities and energy, there is great diversity within the group in terms of business models, market capitalization and geographic diversity. The utilities offer great value at the present time because of their valuation and offer a very competitive total return.

Companies discussed include: AT&T (T); Verizon (VZ); Exxon (XOM); Duke Energy (DUK); Exelon (EXC).

What's unique about these companies is that they really are true monopolies. With regard to what we look for when we invest in companies in these industries, we look for companies that are profitable, have good balance sheets, have a history of paying dividends and, most important, are raising their dividends over time. We also look for reasonable valuation and reasonable valuation can be reflected in price to book, p/e ratio and obviously the level of the dividend yield. We don't pursue the highest dividend yield because we're really focused on the best total return that we can achieve for our investors, and the best total return doesn't necessarily come from companies that pay the highest dividends. It's a combination of both moderate and predictable earnings growth together with the dividend, which provides the investment opportunities. One dimension of our research that I haven't mentioned so far that's critical to success in the utility space relates to regulation.

In the utility space, companies can be subject to regulation at the local, state and the federal level. You could classify that in general terms as an element of political risk. But if you don't do well in terms of following regulation, understanding it and incorporating that into your investment decision, you are not going to do as well as you should. In some cases you could suffer terrible investment disappointments. One aspect of the companies that we invest in is that, if you think about their products and services, they are largely non-discretionary.

What that means is, even in periods such as now when we've had a real economic setback and there are a lot of concerns about economic growth, concerns about lack of transparency, lack of visibility on future earnings, all the companies in our portfolio are still making money. Obviously there has been some demand disruption from industrial slowdown with respect to electric consumption. That's also true for natural gas and oil. In the telecom space, there's been some cutback on capital formation and capital investment. But the fact of the matter is all these companies continue to make money and, as I mentioned earlier, it's very important that they pay dividends. We expect half to two-thirds of the companies in our portfolios to increase their dividends or have the potential for increasing their dividends over the next year or two.[1] A number of them, AT&T in particular, have raised their dividends. When you think about the utility space, our disappointment is that the market doesn't really discriminate between the companies in the space.

I could give you examples of companies that are all classified as gas companies, and as businesses they are very, very different companies, not only with respect to the kinds of services that they provide, but their geographic location, the regulatory risk that they face, their earnings growth rate and the potential for growing the dividend.

If you want to step back for a second and look at our investment record, we've outperformed the S&P 500[2] over the period that we've been managing money for others. There was an article published some time ago entitled "The Greatest Return Stories Ever Told." That was a study, conducted without our participation, by the Ford Foundation and we were ranked very highly against a lot of outstanding investors who had a great variety of investment strategies.[3] That speaks to the fact that obviously we've been consistent with our investment process, but at the same time it also speaks to the value of the kinds of companies that we invest in.

gory called gas utilities, energy stocks, and we will also use water utilities. Historically the success of our performance record has been achieved by recognizing that in one of these sectors, there may be events that are going to make it difficult for the companies to continue to perform as well in terms of growing their earnings, whereas another sector has a much better outlook.

"We don't pursue the highest dividend yield because we're really focused on the best total return that we can achieve for our investors, and the best total return doesn't necessarily come from companies that pay the highest dividends. It's a combination of both moderate and predictable earnings growth together with the dividend, which provides the investment opportunities."

1-Year Daily Chart of AT&T

Chart provided by www.BigCharts.com

TWST: What about the portfolio itself? How is that made up? You said all-cap but how many large cap, how many small cap and how many holdings generally do you have in a portfolio?

Mr. Sorenson: Our top 10 holdings tend to represent 50% of the portfolio, and with the top 15 we might get up to 60%. The reason we can concentrate like that is that you have to remember how financially strong these companies are. In general, the mean market capitalization is about $51 billon, because we've got companies like AT&T, Verizon (VZ) and Exxon (XOM) in the portfolio or large capitalization utilities like Duke Energy (DUK) or Exelon Corp (EXC) in the portfolio. At the same time we're not going to pass up an excellent opportunity for a company with a $1 billion to $2 billion market cap, if we have great confidence in the management, the company pays a dividend, we understand the business and there's good growth potential for the company.

The make-up of the portfolio has been concentrated in the sectors of telecom, electric utilities, a very undiscriminating cate-

The classic example was in the late 1990s when we had roughly 38% of our portfolio in telecommunication stocks, which would have been companies such as AT&T, Bell Atlantic, SBC Communications and Ameritech. The 1996 Telecommunications Act was basically a piece of legislation that had a negative impact on the earnings outlook for the telephone companies. Throughout the last three or four years of the 1990s we were reducing our commitment to the telecoms, and we were fortunate enough that in the energy space the price of oil was extremely low. OPEC had made it very clear they were going to aggressively work to improve the price of oil by restricting production if necessary, and we were able to shift into the energy companies when the price of oil was moving from barely above $10, up to $20, $25 and higher. The ability to move between the different sectors to seize the opportunities, as well as discriminating among the companies within the sectors, provides great opportunities for us.

TWST: How has your portfolio been impacted by the turmoil in the markets and the economic downturn? What shifts in emphasis have you made over the last 12 months?

Mr. Sorenson: In our 31 years of managing money we've never seen basically a nine-month period like we've seen through March 31, 2009. Through the recent downturn, maybe we did a little better than the S&P 500, but that's on a relative basis, and as you know, you can't pay the bills with relative performance. We take great pride in absolute performance, but our stocks were a source of liquidity for a lot of investors.

Historically we thought the great strength of our portfolio was the companies' large capitalization and their liquidity, but the fact that they paid dividends and were always profitable turned out to make them the most desirable targets for sale when institutional investors were desperate for liquidity. Many investors needed to raise a lot of money in a hurry because they were leveraged, or in some cases defined benefit plan participants had commitments to private equity that they had to meet. Sometimes they had other leverage strategies that they would call up and say, I have to have multiples of tens of millions of dollars within three or four days. If you're going to raise that kind of money you have to look to those stocks that have a lot of liquidity and are traded on the New York Stock Exchange, like AT&T or Exxon. We saw a very meaningful multiple contraction because of the persistent selling when there wasn't any tremendous deterioration in the underlying earnings of the companies involved in the portfolio.

There's one point I would like to make. Everybody just looks at the net asset value of their portfolio. As you know, up until recently, dividends were not considered a particular source of investment return.

We all know that just under 50% of the investment returns to equities over the last 50 or 60 years came from dividends. I took one of our portfolios that didn't withdraw any funds in this period and asked, well what's the income to the portfolio or what was the income to the portfolio at June 30, 2008, and it was $2,800,000[4]. Obviously the portfolio has declined significantly between then and March 31, and I looked at the expected annual income from dividends on March 31, and it's $3 million. To someone who is looking for a dependable, high-quality income stream that's rising, that's what our type of portfolios, which are focused on telcos, utilities and energy companies, provide.

If you look at your balance sheet, which is your account value, you'll say, "Oh, it's terrible," but if you look at your income statement from your portfolio, there are a couple of good things that you have. Number one, your income has gone up. Number two, your advisory fees have gone down because obviously what you pay your investment manager is a function of the asset value, so you've had a very nice improvement in your income statement and the income stream is rising because the companies such as AT&T, Verizon, Exxon, Sempra (SRE) and the others that make up the core of our portfolios are all raising their dividends, so how bad is that?

"Our largest holding, AT&T, has a very modest p/e ratio, the dividend yield is, I believe, around 6.5% at the present time. If you are an individual investor, that may be qualified dividend income, which would be taxed at a maximum rate of 15% at least through 2010. You can buy Treasury bills yielding 0.05%, which are taxed at the full federal marginal rate, or you can buy AT&T, which is raising its dividend with a 6.5% yield, growing its earnings, and your dividends may be taxed at a 15% marginal rate."

1-Year Daily Chart of Verizon

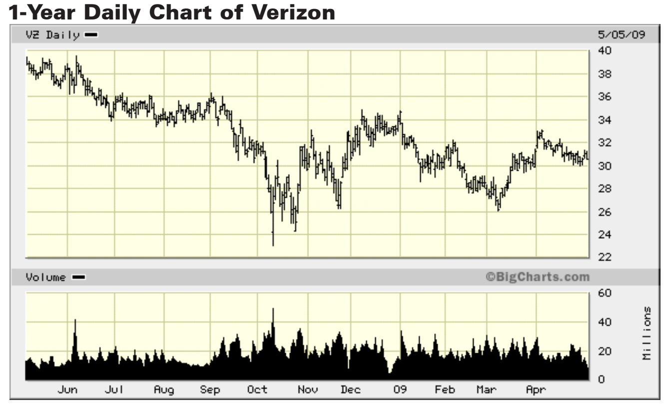

Chart provided by www.BigCharts.com

TWST: Do you have any examples in your portfolio of the energy, utilities and telecom areas that are representative of your investment approach and process?

Mr. Sorenson: The classic example, I guess, would be in the telecom space, and it's our largest holding, AT&T. It has a very modest p/e ratio, the dividend yield is, I believe, around 6.5% at the present time. By the way, don't forget that if you are an individual investor, that may be qualified dividend income, which would be taxed at a maximum rate of 15% at least through 2010. You can buy Treasury bills yielding 0.05%, which are taxed at the full federal marginal rate, or you can buy AT&T, which is raising its dividend with a 6.5% yield, growing its earnings, and your dividends may be taxed at a 15% marginal rate.

Within the utility space, there is a small cap gas company based here in New Jersey, which is classified as a gas utility. I am going to mention it because I think it emphasizes a couple of things about how we invest. First of all the company fulfills our criteria for a very good balance sheet and management that we trust and know very well. They pay a good dividend, we expect them to raise their dividend and we see positive earnings growth. What's unique about this company is that, number one, they do an excellent job of managing their regulatory relationships in the State of New Jersey. When I look across the investment opportunities in the utility universe, I am constantly amazed at the number of companies that do a very bad job of managing their regulatory relationships, and if you don't do a good job of managing your regulatory relationships, it ends up hurting you in terms of your ability to grow your earnings and get the support and rates that you need for your capital investments. Another aspect that is worth mentioning is that by doing our own research and following this company we realize that they have a non-regulated aspect to their business, which is extremely profitable and is entirely within their sphere of competence. This is a unique company with a market capitalization of nearly $1 billion and it's been an excellent investment for us; we're not going to pass it up just because of the market cap.

In the energy space, we own Exxon. I guess everybody thinks that you don't need to know much to own Exxon; this is arguably one of the best-managed companies in the world. They are constantly buying back their stock, which we like. They raise their dividend every year. They are extremely profitable. One aspect of owning a company like Exxon is you can't just buy the stock, sit there and collect the dividends and look at the stock buybacks for your total return. We pay very close attention to the companies in our portfolio for two reasons. Number one is because we do have concentrated positions, but number two, we'll take advantage of the volatility in the marketplace to trade around a core position like Exxon. That's one aspect that we feel has historically added to the returns that you can achieve from the kinds of companies that we invest in, which don't have rapid growth, but they do tend to have predictable, consistent, moderate earnings growth.

TWST: Are water utilities going to be beneficiaries of the infrastructure spending that's coming?

Mr. Sorenson: Yes. If we were to start from the 5,000-foot level to talk about the utility industry, there is one thing that we see that's extremely important. There's been a real change in what I would call the regulatory climate in this country; there is a recognition that our infrastructure is dilapidated and suffers from underinvestment. That applies to electric utilities, the gas pipeline industry, and it certainly applies to the water utilities. I'd like to repeat that: the water utilities are true monopolies, whereas there is some degree of unregulated businesses in many of the other companies that we invest in. Water is also the most capital intensive of all the utility industries, and the majority of the assets still reside at the municipal level.

"Exxon is arguably one of the best-managed companies in the world. They are constantly buying back their stock, which we like. They raise their dividend every year. They are extremely profitable. One aspect of owning a company like Exxon is you can't just buy the stock, sit there and collect the dividends and look at the stock buybacks for your total return. We'll take advantage of the volatility in the marketplace to trade around a core position like Exxon."

1-Year Daily Chart of Exxon

Chart provided by www.BigCharts.com

I believe in the Economic Recovery Act there's something like $10 billion that's been set aside for funding of essential investments, and some of that money will go to municipalities. There is a recognition that investment is needed. It isn't enough for the utility to understand the water mains are perilously close to breaking or that they need to upgrade a filtration plant. Public utilities can't do it unless the regulators are willing to give them the increase in rates that they need to fund that investment. Remember, as I mentioned, it's one of the most capital intensive of all the utility businesses. That means they have to periodically access the capital markets, either through debt or in some cases, their subsidiaries, tax-exempt securities, and they have dividend reinvestment programs (DRIP) in order to get additional equity capital, and from time to time they do issue equity. From a traditional investment point of view, you would say, maybe these aren't great investments because they generally have negative cash flow each year, but on the other hand, they steadily grow their earnings, pay the dividends and some companies have a terrific record of raising their dividends.

If you have a municipally owned water utility, they don't pay any property taxes. But once a public company buys the water assets of a municipality, all of a sudden there's an income stream from property taxes that didn't exist before. The potential for public companies to grow their assets through acquisition may be looking up, as municipalities that are strapped for cash can sell them. In many cases they can't afford to make the investment that's needed to meet the EPA or other water quality standards, so they may just be forced to sell them. I know there are a number of places where property taxes are actually going down. For example, due to the decline in residential property values, homeowners are able to get a reduction in their property tax rates. If you're a municipality, where are you going to get the additional property tax revenues? You may remember in the aftermath of the Enron crisis that California's PG&E went into bankruptcy. It came as a great shock to the State of California when it came time for the company to pay its property taxes at the end of the first quarter; they were the largest single property taxpayer in Northern California. The property taxes paid by our utilities are an important contributor to the economic well-being of the states and the jurisdictions where they operate.

"Dividends are extremely important to the investment case in the companies that we invest in. Throughout the 1990s dividends were disparaged. People in the 1990s told me I was a buggy whip manufacturer because I believed that dividends mattered to the investment process. It's an emphasis that perhaps other investors don't always value."

TWST: What are the reasons that would trigger an exit from your portfolio? What is the sell process?

Mr. Sorenson: Obviously a very important forward-looking consideration is the regulatory outlook. To the extent that a company needs increases in rates in order to maintain its profitability and sustain its capital investment but, for whatever reason, the political climate has become hostile — that would lead us to exit. Another thing that's extremely important to us is the dividend. If we see a broken promise with respect to the dividend, the likelihood is you are not going to be happy with what you experience going forward. A break in the dividend policy would lead us to exit. Obviously we do the same thing that anybody else does with regard to researching these industries, looking at the strength of the balance sheet, their credit ratings, their earnings growth, the quality of the earnings, and the management. That's not different from many other capital-intensive industries, but perhaps more than a lot of other investment managers or analysts, we place an emphasis on the dividend policy and the regulatory climate. We stay very close to the companies that we own. We are constantly communicating with the management and we look for deterioration in any of the factors I just mentioned.

Sometimes we actually sell things because they do well. If we have 5% in the portfolio and we get substantial price appreciation, we'll cut back on the weighting in that portfolio. Then valuation — we all know that the stock market tends to go to extremes, and we really don't believe there are many companies that are worth 20 times earnings over an extended period of time. So excessive valuation is another reason.

TWST: What gives your investment approach its edge? What do you bring to the table in your investing in energy utilities and telecom that other peer companies or large money management firms might not?

Mr. Sorenson: First of all, we are focused. If you were looking for a reason not to invest with us, you could say, well they only look at four or five sectors. We mentioned telecom, electric utilities, gas utilities, water and energy. But that's an over-simplification in that, within each of those sectors, there is great diversity in terms of the business model, market capitalization and geographic diversity. Classically, money has been managed along the lines of boxes and our firm's products do not easily fit in anybody's style box. There tends to be an allocation of assets along weightings in the Standard & Poor's 500. You can say, "Well, for example, utilities are only a relatively small percentage of the S&P 500, so we really don't need to pay much attention to that. We can own Exelon Corp. and Duke, two of the largest companies, and there's no particular expertise required there. We've got a representation in the space." We are much more discriminating in terms of our view of the companies that we follow.

"When you buy quality utilities, you've got growing earnings, the underlying net asset value is growing because the companies are investing in their business, you're getting a dividend that you can count on, which is almost competitive with bonds in many cases, and you get a rising income stream. If you are an individual investor, you may have a preferential tax rate on dividend income as opposed to interest income."

1-Year Daily Chart of Duke Energy

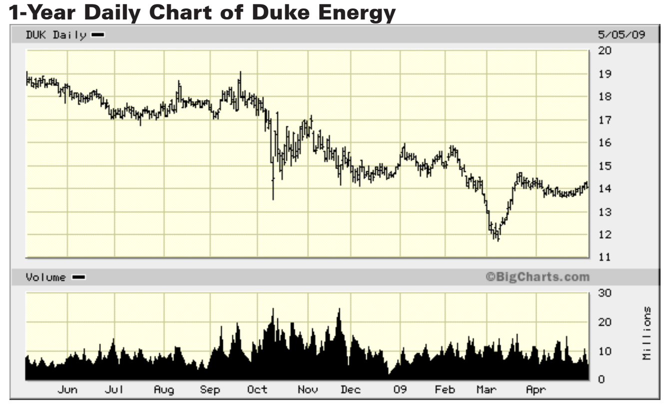

Chart provided by www.BigCharts.com

I think another reason that we do well is clearly our focus on dividends, and dividends are extremely important to the investment case in the companies that we invest in. Throughout the 1990s dividends were disparaged. People in the 1990s told me I was a buggy whip manufacturer because I believed that dividends mattered to the investment process. It's an emphasis that perhaps other investors don't always value.

There is also the fact that we pay so much attention to the regulatory process, and it takes time and energy to do that. By way of example, when we were looking at investing in a very much out of favor Nevada utility, we flew out to Reno, Nevada, to speak to the regulators. It turned out that it was extremely worthwhile to go from New Jersey to Reno, Nevada. To sit down and spend a day talking with regulators requires an input of time and energy that a lot of other investors might not make in our space.

There's one other aspect of what we do, and it's the way the firm is structured. We are an employee-owned firm. Our analysts are compensated based on the profitability of the firm, not on the amount of their ideas that are in the portfolio. I think what that means is that the natural gas pipeline analyst will sit down and work with our analysts who are working on the exploration E&P companies that are drilling and producing natural gas to discuss the investment merits of an idea in an individual company. I think the classic example where there is a very bright line was when Williams Companies figured out a decade or so ago that their right of way for their pipeline was an extremely valuable asset for the purposes of stringing fiber optic cable for the telecommunications industry. Our natural gas pipeline analyst didn't hesitate to sit down and spend time with our telecom analyst to assess whether this was a really good investment or not. There was no concern of how do I get compensated if I spend time working on your idea; it has to do with the overall profitability of the firm. I think that that's one of our competitive advantages.

TWST: Is there anything else that you'd like to mention?

Mr. Sorenson: I know I am talking our own book here, but I think you don't have to take my word for it. Rob Arnott was recently interviewed on Bloomberg, and if you go to our Website (www.reavesassetmanagement.com), you can access that interview. He is a highly regarded observer of the investment industry. He manages about $30 billion for PIMCO, and in the interview he talked about investing in bonds. The merit of investing in bonds at this time is derived from the fact that if you look at investment grade bonds, the coupon is probably 400 basis points more than the dividend yield on the common stock, and the only reason that you would buy the common stock over the bond is if you expect the earnings and dividends growth to consistently exceed 4%. He then went on to mention that when investing in equities, your return depends a lot on the price you pay when you enter. To my great joy, he mentioned that utilities offer great value at the present time because of their valuation. We're looking at companies with single digit p/e's with dividend yields anywhere from 4% to north of 6% that are growing their dividends and are going to grow their earnings. There's a very competitive total return available from utilities at the present time.

The other aspect I hear all the time is that investors are panicked because their portfolios have been decimated. They say, well, I need income, I am going to go buy bonds. Everybody is talking about buying bonds, but the dilemma when you buy a bond is that number one, your coupon is fixed, and number two, you don't have the prospect of growth of capital value, the principal amount of the bond. If it all works out, you'll get paid back to you the same price you paid for it and you're subject to inflation.

If you look at what you get when you buy quality utilities, you've got growing earnings, the underlying net asset value is growing because the companies are investing in their business, you're getting a dividend that you can count on, which is almost competitive with bonds in many cases, and you get a rising income stream. If you are an individual investor, you may have a preferential tax rate on dividend income as opposed to interest income.

In summary, to me, this is the most compelling case I've ever seen for investing in utilities. And then to go back to where we started, the macroeconomic climate, in terms of regulatory support in Washington at the legislative level, the Federal Energy Regulatory Commission is very constructive.

TWST: Thank you. (PS)

Note: Opinions and recommendations are as of 4/28/09

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Footnotes

1 Unless otherwise stated all references to performance and holdings information is the W. H. Reaves & Co., Inc. ERISA Composite, as of 03/31/09.

2 The S&P 500 Index is a capitalization-weighted, composite index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The typical W.H. Reaves portfolio includes a significant percentage of assets that are also found in the S&P 500 Index. However, Reaves portfolios are far less diversified, resulting in higher sector concentrations than found in the broad-based S&P 500 Index.

3 The independent Ford Foundation report "The Greatest Return Stories Ever Told" was published in the summer of 2001 in the Journal of Investing. It was a risk-adjusted study conducted from January 1980 through March 2000.

4 The account referenced is an ERISA pension account with assets under management of $64 million as of 03/31/09.

Additional Disclosures

Securities sited in this interview may also be owned directly by Ronald J. Sorenson or indirectly through the W.H. Reaves Profit Sharing Trust. W.H. Reaves files quarterly holdings reports (13F) with the S.E.C.

W.H. Reaves & Co., Inc.
Top 10 Holdings 03/31/09[1]

AT & T INC. (NEW) T
SEMPRA ENERGY COM SRE
TOTAL S.A. ADRS TOT
EQT CORP COM EQT
EXXON MOBIL CORP XOM
SOUTH JERSEY IND SJI
ONEOK INC NEW COM OKE
NATIONAL GRID PLC SPON ADR NEW NGG
NSTAR COM NST
WILLIAMS COS INC COM WMB