

From: Cherry, Brian K
Sent: 3/25/2011 9:16:23 AM
To: mpl@cpuc.ca.gov (mpl@cpuc.ca.gov)
Cc:
Bcc:
Subject: FW: US smart grid - Opting-out ain't cheap

FYI

From: Andrew Weisel [mailto:andrew.weisel@macquarie.com]
Sent: Friday, March 25, 2011 8:26 AM
To: Investor Relations (mailbox)
Subject: US smart grid - Opting-out ain't cheap

MACQUARIE RESEARCH

Friday, 25 March, 2011

UNITED STATES

US smart grid - Opting-out ain't cheap

Event

- We remain cautiously optimistic on the near-term outlook for the smart metering industry. Though CA media and a small minority of ratepayers are demonizing the technology over disproven health concerns, utility demand is strong as demonstrated by our November utility survey. Opt-out programs are costly (~US\$600/customer), so they shouldn't meaningfully inhibit industry growth.
- Yesterday, PG&E released details on the costs for customers to opt out of its smart metering program.

Impact

- **Opting-out ain't cheap:** Following a mandate by CA regulators (the CPUC), PG&E proposed a plan on how the utility's residential ratepayers can opt out of the SmartMeter program. To participate in this "radio-off" option, the customer will have to pay a hefty price – importantly, the utility should be financially indifferent. The fee has three components: an upfront fee, a monthly fee and an undisclosed "exit" fee if/when the customer moves. Ratepayers have some flexibility, as they can choose higher upfront fees but lower monthly fees (US\$135 and US\$20/mo or US\$270 and US\$14/mo), and can have fixed or volumetric monthly fees.
- **Small but vocal minority:** PG&E estimates that only ~145,800 of its 15m customers will choose to opt out for an aggregate cost of US\$84.4m. Despite representing < 1%, these ratepayers have been extremely vocal, raising concerns over health issues and the accuracy of these meters. Importantly, these concerns have been scientifically refuted. Still, the CPUC feels the need to appease this very vocal minority, as was emphasized in our recent meetings with the Commissioners.
- **Opt-out programs shouldn't inhibit industry growth:** We remain cautiously optimistic on the near-term outlook for the smart metering industry. While a deceleration from the current rampant pace of deployment seems inevitable, long-term growth should remain attractive. Given the high cost of opting out, we don't expect other utilities or their regulators to follow the Northern California example, at least not in a major way. Exceptions include PA and ME.

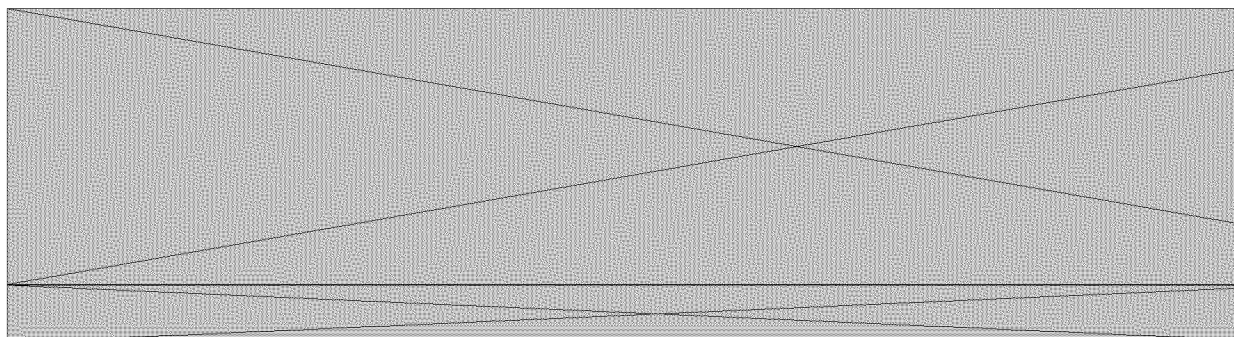
Outlook

- **Elster (ELT, Outperform)** is our top pick of smart metering companies, as we see it as the most attractive publicly-traded company in the space. We believe ELT has a better growth than Itron, a better earnings mix than diversified peers as more of the business comes from the smart grid, and is attractively priced at a 10% discount vs. metering peers.
- We remain cautious on **Itron (ITRI, Neutral)** given our concerns about the company's competitive position and declining market share. Still, the valuation seems reasonable at this level given the historical premium vs. metering peers has disappeared.

Analyst

Andrew Weisel, CFA +1 212 231 1159 andrew.weisel@macquarie.com
Angie Storzynski +1 212 231 2569 angie.storzynski@macquarie.com
Cleo Zagrean, CFA +1 212 231 1749 cleo.zagrean@macquarie.com

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UNITED STATES

Companies covered in this report

ELT (US\$15.5)
Outperform
TP:
US\$20.00
ITRI (US\$52.0)
Neutral
TP:
US\$58.00
PCG (US\$43.6)
Outperform

TP:
US\$50.00

Note: Share prices as of close of 24 March 2011.

Source: CFA, March 2011.

Andrew Weisel, CFA +1 212 231 1159
andrew.weisel

Angie Storzynski +1 212 231 2569
angie.storzynski

Cleo Zagrean, CFA +1 212 231 1749
cleo.zagrean@

25 March 2011

US smart grid

Opting-out ain't cheap

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[PDF \(257 KB, 5 pages\)](#)

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