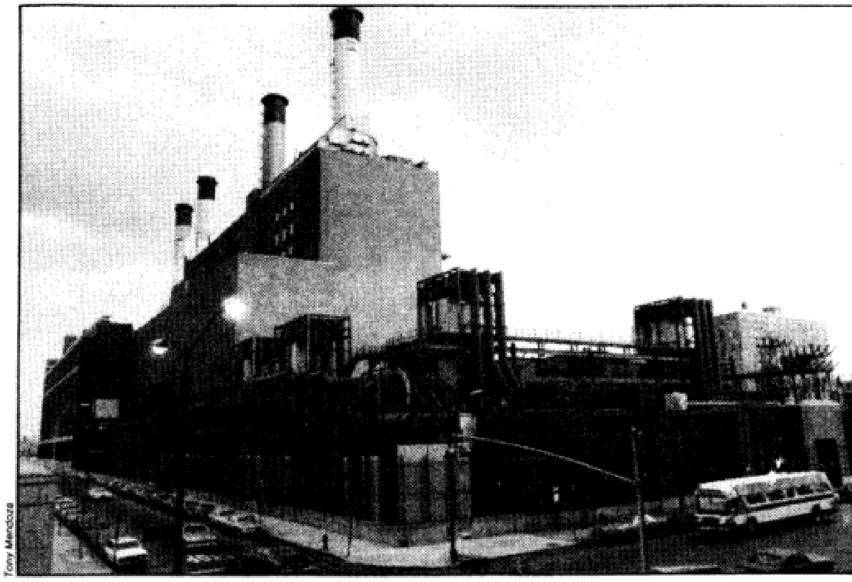
The Utility New Yorkers Love to Hate

But a Transformed Con Edison Is Generating Glowing Gains

By THOMAS WRONA

WHAT a difference a decade makes! Consider 1974, a dark 12 months in the annals of Consolidated Edison, the utility that serves New York City and Westchester County. Dependent on oil for 90% of its electrical power generation, the company watched helplessly as OPEC quadrupled the price and supplies dwindled. Although Con Ed is allowed to pass higher fuel costs on to its customers, such surcharges lag prices by about four months. And the very same customers, caught in the inflationary spiral themselves, were taking twice as long as usual to pay their bills. Although earnings for the year were good (they would show a 14.5% jump over '73's), the company faced a classic cash squeeze in the early part of '74. So the utility's top brass thought the unthinkable, and then did it: Con Ed omitted its dividend for the second quarter.



Tony Mendoza

A Con Ed generating plant in Manhattan: The utility will benefit from low load growth through the end of this century.

While passing a dividend to bolster cash flow is scarcely unique, it simply isn't done by utilities, which view it as akin to shooting a kid's dog to cut the family food bill. Con Ed was a leper to the institutions that buy utility stocks for the stability of their dividends, a villain to its small shareholders, who felt betrayed, a greedy giant to its customers, who are taught from birth to hate Con Ed, and an embarrassment to a not-easily-embarrassed industry. Its stock sank like a stone.

Now, consider 1983. Goldman Sachs analyst Ernie Liu says that Con Ed boasts the best balance sheet of any major power company. Earnings have been climbing from one new peak to another, dividends have been going up steadily and its stock has been setting new highs, thanks in no small part to decisions made in the mid-'Seventies.

To raise cash then, it couldn't sell bonds because its credit rating was nonexistent. Instead, it sold its Indian Point 3 and Astoria 6 generating plants to the Power Authority of the State of New York for $610 million. To obviate the need for expensive new generating capacity, the company launched a program of consumer education advocating energy conservation. Its customers, sick of paying bills that are among the highest in the nation, eagerly responded. Con Ed also completed plants under construction on time, avoiding the high construction and finance costs that still plague other utilities.

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Because of conservation and population shifts, the company will continue to benefit from low load growth, which it estimates will average just 1% a year through the end of the century, putting it in the unusual and enviable position for a utility of being able to meet the major portion of its financing needs from cash flow. Over the next three years, Con Edison plans to put a relatively modest $1.7 billion into capital investment, or about 21% of its $8 billion book value, vs. an estimated industry average of 44% for the same stretch.

Since the cash flow crisis of '74, Con Ed has sedulously filled its coffers and now has over $300 million in cash. Its bankers, like bankers everywhere, eager to lend money to anyone they're sure doesn't need it, have advanced it a $50 million line of credit.

The rating services have grown fond of Con Ed as well. Last year, Standard & Poor's raised its rating of the company's first mortgage bonds from A plus to AA, while Moody's hiked its rating of the company's first and refunding mortgage bonds to AA2 from A1. Con Ed hasn't enjoyed such rave notices from either service since the mid-'Sixties.

Last year's results bear the mark of the company's increasing efficiency. Operating revenues rose to $5.1 billion, up 4.1% over 1981's $4.9 billion. Operating income mounted 7.2% to $637 million, while net rolled ahead a healthy 8.7% to $492.6 million, or $3.55 a share. Con Ed gets 79.2% of its revenues from electric sales, which were up 0.9%, to $4 billion. Gas revenues, which constitute 13.7% of the total, expanded by 9.2%. The company also supplies steam to New York City apartment and commercial buildings, and sales of that rose last year by 1.5%, to $363 million, the first increase since 1973.

Commercial customers buy more than 58% of Con Ed's electricity, over twice the industry average. So the economic recovery should have a greater impact on Con Ed's earnings—which have improved in 13 of the past 17 years—than on those of many other utilities. A surge like 1981's 38% gain in per-share net, to $3.22 from a year-earlier $2.34 isn't likely, however; that was due largely to an unusually favorable rate hike granted that year.

The best estimate is that profits will reach about $3.75-$3.80 in 1983, even though the first quarter is likely to dip below the year-earlier 92 cents a share. Reason: Con Ed's latest rate increase didn't take effect until March 15, and thus will be reflected in only two of the quarter's 13 weeks.

Rate increases have rarely come easily for Con Ed (although consumers would disagree), but on March 10, the New York State Public Service Commission granted it a $267 million boost. This was only about 56% of the $475 million the company requested, but industry observers nevertheless considered it favorable. Further, Con Ed won a new allowed rate of return on common equity of 15.2%, comfortably more than the utility's previous rate of 14.51% and over a full point higher than the industry's 14% average.

Con Ed must contend with one of the highest tax bills of any utility—19% of its gross goes to taxes other than federal. The firm is the biggest single taxpayer in both New York City and Westchester County, a distinction which "we did not seek and do not enjoy," as Chairman Arthur Hauspurg complains in the 1982 annual report. Hauspurg beefs, too, that New York City raised the tax rate on utility-owned prop-

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erty and also intends, over the next five years, to raise its assessment of the company's property about 40%. If Con Ed's challenge to the reassessment is unsuccessful, the utility will have to cough up another $40 million in property taxes this year.

New York State, by comparison, was downright compassionate, raising the company's tax liability by just $33 million through a surcharge to the state gross receipts tax. The state will spend the money in an attempt to keep subway, bus and rail fares down, presumably fearing that taxpayers would revolt against taxation without transportation. Westchester County, merely tweaking the dagger, merely doubled its sales tax, to 1.5%.

Con Ed at a Glance

	1982	1981	1980	1979	1978	1977	1976	1975	1974	1973
Revenues (millions)	$5,067	$4,866	$3,947	$3,333	$3,011	$3,023	$2,880	$2,668	$2,439	$1,736
Net (millions)	493	448	335	324	310	324	301	275	209	182
Earnings per share	3.55	3.22	2.34	2.26	2.15	2.27	2.09	1.87	1.34	1.17
Book value	26.32	24.57	22.89	21.94	20.95	19.93	18.68	17.39	16.31	15.51
Dividends	1.68	1.48	1.34	1.22	1.10	1.00	0.80	0.60	0.42½	0.90
Current ratio	1.8	1.6	1.5	1.9	2.1	2.2	2.1	3.0	1.4	1.0
Stock price										
High	21⅛	16⅞	13⅜	12½	12⅞	12⅞	10½	7½	10⅞	13
Low	15½	11⅜	9⅞	10½	10⅞	10½	7½	3⅞	3	9¼

However, the state giveth as well as taketh away (but with the state, unlike God, taketh usually takes precedence). One reason why Con Ed has been able to avoid capital spending on new plants in the past few years is that the state power authority has been selling electricity to it and other New York utilities at bargain rates. If the authority turns less generous, Con Ed may have to start a building program before the early- to mid-'Nineties, as it now anticipates. Until then, the company will probably be getting more help from the state, raising about $150 million a year for power lines, transmission equipment and the like through tax-free bonds issued by the New York State Energy Research & Development Agency.

Haunted by the '74 debacle when it saw its oil dwindle to an eight-day supply, Con Ed is fighting its petro-habit. It now generates just 37% of its electricity from oil, 22% from gas, 18% from nuclear and fuel and 23% from coal and hydroelectric power purchases. The company intends to further lessen its dependence on oil despite the fall in crude prices.

Con Ed has been burning high-sulfur oil experimentally to simulate the burning of coal at its Ravenswood plant in Queens. Switching to coal could trim its oil consumption by 15 million gallons annually. The utility says that Ravenswood can burn coal under federal clean air standards and without a $1 billion set of scrubbers that environmental agencies seem to think would be necessary. Without them, coal would be much cheaper than even post-OPEC oil. Regulatory approval could be forthcoming this year and the company could convert soon after a decision is made. Con Ed would then like to convert its Arthur Kill plant on Staten Island.

Another phase of the search for oil independence has run into a familiar problem—protests by anti-nuclear groups. Questioning the adequacy of the company's emergency evacuation plan, they've called for the shutdown of the Indian Point 2 plant. The Federal Emergency Management Agency is weighing the results of a March 8 test of the plan, which Con Ed officials believe went fairly well. The nuclear unit is experiencing some pipe corrosion, which the company says it has been monitoring closely. The pipes may have to be replaced as early as 1986 at a cost of about $130 million, not including outlays for replacement power purchased during the estimated one-year outage. Last year, Con Ed shelled out $33.7 million to reimburse customers who paid more for power during a previous shutdown.

It also paid out what it couldn't pay in 1974—dividends in all four quarters. The current quarterly of 47 cents was upped from 42 cents in January. (John Kellenyi, a Drexel Burnham analyst, believes Con Ed's dividends will rise 10% annually through the immediate future.) However, Con Ed's stock yield, around 9%, remains fairly low for a utility. Burned by its cash squeeze in '74, the company has disbursed only about half of its annual earnings in dividends, much less than the industry average of 80%. Stated another way, it paid out about 7% of its $26.32-per-share book value in dividends last year, vs. about 10% at the average utility. However, "over the long run we would expect to see our payout ratio rising," says John V. Thornton, a senior executive vice president and chief financial officer.

The low dividend ratio is one reason that Con Ed stock, which closed Friday at 22¼, sells at roughly 80% of book, vs. the industry average of 98%. Con Ed hasn't had to pay much heed to that disparity because, except for shares issued for dividend reinvestment, it hasn't sold any equity since 1974. Thornton says, "It is our aim to get our stock up to book value." In view of Con Ed's bright prospects, that doesn't stack up as an insuperable task. ■

Building Up Steam