RBC Resources LLC

Pensacola Energy

Customer Acquisition

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Synopsis

RBC Resources was engaged in February 2019 to provide consulting services to Pensacola Energy. These services were specifically directed to the following:

- Research the possibility of acquiring approximately 200 residential and small commercial customers served by Okaloosa Gas District in Escambia County.
- Review options for determining the appropriate value of these customers.
- Provide guidance to Pensacola Energy concerning asset valuation and process for acquisition.
- Support contract negotiations.
- Assist with contract preparation and execution if agreement is reached with Okaloosa Gas District on customer transfer.

Rationale

The transfer of these accounts is sound and reasonable based on the long-term provision of safe and efficient utility services to customers in Escambia County as described below:

- Pensacola Energy and Okaloosa Gas District both provide service in this area, creating the likelihood of customer confusion concerning the appropriate service provider for emergencies and routine service requests.
- Okaloosa Gas District does not hold a franchise within Escambia County to provide utility service. Therefore, new homes and businesses in this area could not be served by Okaloosa Gas District and unless infrastructure was duplicated, residents would go without essential utility services.
- Pensacola Energy's existing assets in the vicinity will facilitate safe and reliable public services that will be enhanced through shorter response times for emergencies and other requirements.

Acknowledging these conditions, it is prudent to transfer these customers to the Pensacola Energy system for the long-term safety, reliability, and availability of service.

To determine a fair value for the transfer of customers, four forms of capital expenditure evaluations were utilized to produce a range of possible solutions. They are:

- Present value of future revenue or cash flow.
- Comparison to recent small acquisitions in the region.
- New construction replacement cost.
- Maximum Allowable Capital Contribution which is a “rule of thumb” measure utilized by Florida Public Service Commission to determine appropriate capital expenditures for new customer acquisitions.

Below each method is summarized and the appropriate value is established:

Net Present Value (NPV)

Using data provided by Okaloosa Gas District, it was determined that actual active customer count was 167 residential and 8 small commercial customers. Additionally, these customers represented approximately $67,641 in annual revenue. From public data available we also determined that annual operating and maintenance expense for these customers was approximately $13,520. Normally, a multiple of earnings before depreciation, interest, amortization, and taxes is applied. Given the municipal nature of both the acquiring and selling parties, we opted to substitute a Net Revenue (revenue less operating expense) measurement as the basis for our NPV valuation. It was determined that Net Annual Revenue of the customer group was approximately $54,021. Utilizing a discount factor of 4.5%, expected revenue growth of 1.5%, and expense growth of 1.0%, it was calculated that the expected 10yr NPV of Net Revenue would be approximately $427,748.

Market Acquisition Comparison

The two most recent small scope acquisitions in the State of Florida are the purchase of the Fort Meade (Municipal) and Indiantown (Investor Owned) natural gas systems. Both acquisitions were by Florida Public Utilities and public data was used to determine approximate valuations. The Fort Meade system was valued at approximately $1,100 per customer and Indiantown was valued at $1,690 per customer. When reviewing documentation and interviewing industry professionals, it was concluded that significant capital was invested to bring the systems up to current codes and standards. Applying these adjustments and utilizing customer counts, it was determined that an approximate comparison value would be $354,375.

Construction Cost Replacement

An estimation of replacement cost to duplicate the existing system was accomplished by Pensacola Energy personnel and confirmed by consultant. Costs would include $46,000 in materials, $336,763 in outside contractor and equipment costs, $180,000 in meter and service installation for a total of $562,763. This does not account for the additional construction oversight and internal fixed charges that would likely add approximately 10%.

Maximum Allowable Capital Contribution (MACC)

The Florida Public Service Commission has utilized this as a rule of thumb measure to determine the appropriate capital expenditure for small projects and main extensions. It commonly is comparable to a simplified return of capital. Most Florida based investor owned utilities operate under a MACC of 5-6 times annual revenue. Applying the MACC to the annual revenue of this customer group would provide a valuation range of $338,210 to $405,852.

Summary of Analysis

Acquisition Valuation Options

Acquisition Comparison		**Total**	**Per Customer**
5 Year MACC		$354,375	$1,772
6 Year MACC			
		$338,210	$1,691
		$405,852	$2,029
10 Year NPV Net Revenue			
		$427,748	$2,444
MACC, NPV and Acquisition Average			
		$381,546	**$1,908**
Recommended Purchase			
	Lower End	**$338,210**	**$1,933**
	Normal	**$427,748**	**$2,444**
New Construction Replacement Estimation		**$562,763**	**$3,370**

Conclusions

As discussed above, the range of expected value for the assets that have been identified is $354,375 to $562,763. The valuation methodology that is most appropriate for this situation is the Net Present Value of future cash flows. It is an industry standard measurement and the valuation that it produces is within those produced by the other methodologies.

Recommendation

Pensacola Energy should enter negotiations with Okaloosa Gas District to acquire the approximate 175 customers located in Escambia County. The payment of $427,748 would be adequate to ensure Okaloosa Gas District receives fair recompense for their assets and ensures that Pensacola Energy will add customers at a lower than new construction cost.

Because the two parties operate in different environments from a natural gas commodity and operations perspective, there is a current rate differential between Okaloosa Gas and Pensacola Energy. Therefore, these customers should transition to Pensacola Energy rates gradually using a rate equivalent to Okaloosa Gas for the first two years and then gradually shift them into Pensacola Energy's rate structure over the next two years.

Assuming the recommendations above are implemented and that no additional personnel will be required at Pensacola Energy, the capital required for this acquisition will be recovered in no more than eight years. This is well within the reasonable period for normal utility investment recovery.