Final Report on the Feasibility Study Regarding Altering the Utility Situation in the United States Virgin Islands

Prepared on Behalf of:

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by:

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Table of Contents

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Introduction & Background

Praxis Consulting Group, Inc. (Praxis) is pleased to submit to the WAPA Buy Out Committee, Inc. (BOC) this Final Report on the Feasibility Study Regarding Altering the Utility Situation in the Territory of the United States Virgin Islands (USVI). The primary focus of this Feasibility Study is to evaluate and recommend ownership alternatives for the USVI Water and Power Authority (WAPA). This Final Report should be read together with the financial and strategic analysis prepared and submitted separately by Houlihan, Lokey, Howard, & Zukin (HLHZ) and dated March, 2004 (Houlihan Analysis).

WAPA is a utility providing both electric power and fresh water to citizens, businesses, and government agencies in the USVI. WAPA is currently an instrumentality of USVI Territorial Government (Government). WAPA's Board of Directors is appointed by the USVI Governor and the USVI Senate must approve of any changes in WAPA's ownership.

Over the years, the Government has occasionally considered altering the utility situation by partially or fully privatizing WAPA, through a sale or other disposal of some or all of its assets and liabilities to private concerns. Most recently, in 2000, the USVI Senate rejected a privatization proposal received from an affiliate of Southern Energy, Inc. (SEI), a U.S.-based investor-owned utility. The Senate majority expressed serious concerns regarding both the process and content of the SEI proposal

At the conclusion of that process, the Senate invited a group of concerned citizens, operating as the BOC, to submit an alternate proposal at their earliest convenience. The Hon. Charles Turnbull, USVI Governor, followed with his own invitation to the BOC to submit its offer as well. This Study, with the related Houlihan Analysis, is a response to the invitations from the Senate and from Governor Turnbull. This Study is funded under a grant from the U.S. Department of Interior, Office of Insular Affairs, secured with the assistance of the Hon. Donna Christian-Christensen, USVI Delegate to the United States Congress.

The BOC is a not-for-profit USVI corporation that was formed to sponsor this Study and to conduct public educational activities to publicize the issues and the results. The BOC will present this report to WAPA's constituents. The BOC will consider reactions to the findings and recommendations in this Study and will then determine whether it is advisable and realistic to proceed to prepare a formal purchase offer for WAPA. However, the BOC as an independent entity does not anticipate making such an offer directly itself. Following the completion and publicizing of this study and appropriate public review, the BOC will have fulfilled its original purpose. The BOC may then assist concerned citizens in forming a new entity for the purpose of preparing and presenting a purchase offer to the Government.

Purpose of this Study

WAPA's constituents include the Government, WAPA employees, WAPA ratepayers, and the general public that will be affected by any decision to alter the utility situation by changing WAPA's ownership. These constituents raised a number of concerns during the SEI purchase offer process, centered on two central questions:

1. Is it advisable for the government to sell or dispose of WAPA at all?

2. Only if the answer to the first question is "yes": what form of sale or disposition is most likely to protect the interests of the various constituents most effectively?

This Study addresses these two questions. This Study was not intended to and does not constitute an offer to purchase WAPA (or otherwise to acquire its assets and liabilities). Rather, this Study evaluates the goals, criteria, and alternatives involved in potentially changing WAPA's ownership structure, and makes recommendations for moving forward.

Organization of this Report

This Report is organized into six sections:

Section 1 presents the **Executive Summary, Findings & Recommendations** regarding next steps for future ownership of WAPA.

Section 2 summarizes the **Issues and Concerns**, raised by WAPA constituents during the course of this study, which need to be addressed by any successful ownership alternative.

Section 3 proposes **Threshold Decision Criteria** that any alternative ownership structure for WAPA should meet, based on the above issues and concerns, and subject to public review.

Section 4 describes and analyzes **Maintaining WAPA's Current Ownership Structure (Alternative 1)**.

Section 5 describes the primary **Other Ownership Alternatives** for privatizing WAPA, including selling WAPA to a conventional investor-owned utility, to a worker-owned utility, to a consumer cooperative utility, or to some hybrid alternative, and evaluates these alternatives against the Current Ownership Structure using the proposed Threshold Decision Criteria.

Section 6 provides the **Conclusion & Next Steps**.

Section 1: Executive Summary, Findings & Recommendations

1. This Feasibility Study Report does not constitute an offer to purchase WAPA from the Government. Rather, the purposes here are:
   a. To summarize the opinions of USVI stakeholders with respect to WAPA's future ownership;
   b. To recommend decision criteria that the Government should consider in evaluating the sale of WAPA; and
   c. To present and compare a number of the common ownership alternatives and make preliminary recommendations.

2. The sale of WAPA to a non-government entity is not a foregone conclusion. WAPA currently operates as an instrumentality of the Government and will continue to do so, so long as the Government chooses and is able to maintain its ownership. The Senate declined one notable recent offer, from SEI, and the Government has not insisted on the sale of WAPA in the interim.

3. The sale of WAPA to a non-governmental entity is viewed by many USVI observers as highly likely if not inevitable at some point in the mid-term future. The primary observed reason is the Government's ongoing need to address its own financial requirements. However, the sale of WAPA to an independently owned and managed entity could also provide substantial potential operating benefits to WAPA and the USVI community.

4. USVI constituents who were interviewed during the course of this Study have a range of goals and concerns for WAPA's future. In general, there is a broad consensus that the Government's financial health should be protected, that the Government should ensure the ongoing successful and improved operation of WAPA, and that control of WAPA should be maintained exclusively among USVI owners. There are different and conflicting opinions regarding whether, when, and how WAPA's ownership should change hands.

5. In anticipation of a potential future sale of some or all WAPA assets to a new, non-government entity, a key finding of this Study is that the Government and USVI community should articulate a series of threshold decision criteria with which to evaluate all future purchase offers. This Report proposes a preliminary list of such criteria, which should be subject to public review and comment. These criteria may of course evolve over time, so that what is appropriate currently may change in future years. However, the existence of current and public criteria would both send a signal to potential buyers about what constitutes an acceptable offer and also create a level and public playing field for all potential bidders.

The remaining Findings & Recommendations here are offered with reference to the threshold criteria suggested in this Report. If the USVI community should define different threshold criteria, the analysis that follows may need to be updated accordingly.

6. As would reasonably be expected, none of the alternatives reviewed in this Study would, by itself, perfectly address all of the threshold decision criteria. The essential remaining

question is: which alternative on its own, or what combination of alternatives, would provide the best mix of benefits relative to continued Government ownership of WAPA?

7. None of the alternatives considered in this Report addresses the underlying challenges facing GERS, which is a separate matter. These challenges are not specific to WAPA and are deserving of significant public attention apart from the issues relating to WAPA. However, current WAPA employees greatly value their GERS participation and generally fail to understand that promised GERS benefits may or may not be available, regardless of WAPA's future. All of the ownership alternatives for WAPA present different potential retirement packages for employees of NewWAPA going forward. However, GERS ability to fulfill accrued benefit commitments as well as to continue to accrue and pay future benefits are not addressed by any of the WAPA ownership alternatives.

8. A sale to outside investors, without substantial ongoing USVI community control of the successor utility to WAPA, could potentially address the Government's financial needs, but would fail to address almost all other critical criteria suggested in this Report.

9. A sale to an employee-owned, private utility, through an ESOP, would provide substantial benefits over a sale to outside investors, but would not address all of the threshold criteria. Such a sale might also benefit significantly from some form of partnership or joint venture with outside investors, and/or partnership with the Government or retention of certain WAPA assets by the Government in order to address certain of the threshold criteria. The ESOP is the only alternative that provides specific rewards and incentives to WAPA employees through long-term ownership in the NewWAPA.

10. A sale to a community-owned, private, non-profit utility, through a Coop, would provide a different and powerful combination of benefits both relative to a sale to outside investors and also relative to a sale to an ESOP. The Coop addresses many but not all of the threshold criteria. Unlike the other alternatives, the Coop would be eligible for continued FEMA coverage, would have access to preferential financing tools, and would provide access to substantial utility operations expertise. The Coop would provide different specific financing benefits than the ESOP, and would provide different specific future retirement planning benefits as well. The Coop may be less likely than the ESOP to be able to partner effectively with outside investors, but (in the best case) the Coop could provide essentially all of the benefits of outside investors without any associated loss of control to the USVI community.

11. Various combinations of these alternatives, including some form of continued Government participation in WAPA's ownership, may be possible, and of course there may be alternatives that are not considered in this Report. The specific combination that best addresses all of the threshold criteria will most likely emerge from a competitive bidding process in response to the Government's indication that WAPA is in fact available for sale to a purchaser that is able to meet its criteria.

Section 2: Issues and Concerns

- **Background and Methodology**

Praxis interviewed samples of all major stake-holding groups:

1. WAPA Employees – The team interviewed approximately eighty (80) employees individually and in private, confidential settings, and in small informal groups. The sample included employees on all three islands, all shifts, all departments, and all functions. The sample also included all levels, board members, senior executives, middle-management, front-line supervision, and the shop-floor.
2. Labor organizations
3. Business organizations – both business associations and individual business owners
   a. Chamber of Commerce
   b. Food and beverage
   c. Hospitality
   d. Retail
   e. Service
4. Citizens
5. Government officials

Praxis also reviewed relevant public documents such as the SEI proposal documents, Senate documents, media reports, and appeared, together with BOC members, on television and radio interview and call-in programs. The following discussion and observations are based on the data gathered through the above methodology.

- **Attitudes toward the privatization of WAPA**

1. <u>WAPA Employees</u>

Almost all WAPA employees expressed a preference for continued government ownership of WAPA, with some strong dissent among a small number of employees. This is common among employees in similar situations: there is a natural desire to retain the status quo, and simply "fix all the problems." While this outcome may not be realistic, it is essential not only to acknowledge employees' concerns, but also that any solution must be responsive to these concerns.

Many employees are concerned about the implications of privatization on a range of issues affecting both their personal security and also the security of WAPA and its ability to serve the community. The primary concerns voiced by employees include: job security; continuation of participation in the Government Employees Retirement System (GERS); FEMA eligibility, availability of capital for continued upgrading of generating capacity and reliability; expansion of electric transmission and distribution capacity; protection from physical risks, particularly hurricane damage; and expansion of water distribution capacity.

However, despite this preference for continued Government ownership, the overwhelming sentiment among employees interviewed for this Study is that the privatization of WAPA is inevitable.

The most common reasons offered by employees for this sense of inevitability were:

a. The Government's need for money will continue to grow. WAPA's assets represent an enormous opportunity for an infusion of cash that ultimately the government will be unwilling and unable to resist;
b. WAPA's rates are out of line with economic reality and will never be brought into line because of ongoing governmental and political meddling. Public resistance to recent rate increase requests (Spring, 2004) demonstrates that, even when oil prices are at an all-time high and rate adjustments are critical, these adjustments are necessarily viewed by many constituents in the light of WAPA's already higher-than-average rates. This leads to deep suspicion of WAPA's requests and significant public resistance. Employees generally believe that this situation can only be solved through privatizing WAPA;
c. Privatizing WAPA would result in reduced rates and improved reliability over time. High electric rates, combined with low reliability, are thought to be a drag on economic growth by discouraging investment and new business development. This sentiment is especially intense on St Croix.
d. WAPA is not operated as a business seeking efficiency and profit. As a direct result of its political governance structure, WAPA is run as a service with the best jobs and Board membership offered as rewards rather than based on technical or financial expertise. This lack of expert guidance from the Board results in poor planning and a lack of entrepreneurial intensity. The effect of this culture is a focus on short-term crises rather than strategic business planning and decision-making. Frequently cited examples are inventory aging and controls, the purchase of Unit #22 and the resulting loss of money trying to adapt the unit to St. Thomas power generation needs, and the leasing of a reverse osmosis (R/O) plant for providing water to St. John, at a cost of $320,000 per year, rather than repairing and using a WAPA owned R/O barge.
e. The proposed transaction by SEI raised WAPA's profile as a high quality target for a strategic or financial acquisition. Its assets are valuable, its markets for power and water are relatively protected from competition (vs. other acquisition opportunities in the marketplace), and the operation is run at far less than full efficiency. This creates a substantial opportunity for a careful buyer. The question is "when," not "whether," another acquisition offer will be made, and the key issues become who will control the decision and what are the criteria.

Therefore, while there is initial reluctance among WAPA's workforce to see the status of WAPA's ownership changed, this reluctance is offset by the common view that a change is inevitable. Once an assumption of inevitability is made, the great majority of WAPA's workforce is prepared to support privatization, provided that its chief concerns are addressed and that any changes in WAPA's ownership are driven locally and with significant input from the workforce and the larger USVI community.

In discussing the implications of privatization, the following concerns and issues were raised over and over and must be addressed if WAPA's workforce is to actively support privatization. These concerns and issues are:

1. Job Security

All members of the workforce want to be guaranteed that privatization is not going to result in layoffs of any sort. In fact, some employees believe that WAPA jobs are such valuable local assets that they also want protection against job attrition. Their belief is that any lessening in the number of WAPA jobs available to the community, now or in the future, lessens economic opportunity for members of the community.

This issue must be addressed through a combination of assurances against layoffs (guaranteeing current employees that they will not lose their jobs except for cause or acts of God), and education of how reductions in operating costs, if local ownership is maintained, is actually beneficial to employees, rate payers, and the larger USVI community over time. Because job attrition will almost certainly be a part of any effort to pare down operating costs, job attrition and resulting beneficial effects on rates and economic development must be made transparent to the workforce and how these effects will more than make up for the loss of future potential jobs.

The possibilities of future job growth, resulting from greater economic activity and/or new business initiatives, must also be part of the educational effort. Examples include: expanded water operations, and reductions in the current reliance on outside consultants for core maintenance and other operations. A newly privatized WAPA must have not only an operations cost reduction strategy but also a growth strategy.

2. Retirement Benefits: Continued participation in the Government Employees Retirement System (GERS)

Many members of the WAPA workforce cite the benefits of GERS as a major reason for coming to or staying with WAPA. Many are looking forward to early retirement and the start of second careers. Many believe that GERS benefits have been earned by working in hazardous conditions for prolonged periods of time. Additionally, many believe that participation in GERS is less risky than participation in private plans, citing the example of Enron over and over.

On the other hand, many members of the workforce also know that GERS is in serious financial and actuarial difficulty. The workforce does not seem able to admit that GERS will be forced to reduce benefits or to dramatically increase contributions (an additional 17% or $52 million per year based on the most recent actuarial report) in the near future if GERS is to avoid financial collapse. GERS financial and actuarial instability must be addressed even if there is no change to WAPA's ownership, and this will very likely and materially affect benefits to WAPA employees.

Assuming the privatization of WAPA, for discussion purposes only, it must be noted that any privatization that requires WAPA to withdraw from GERS and start funding a separate equivalent retirement plan, absent remedial action by GERS, could significantly accelerate the collapse of GERS. Such a collapse of GERS would harm current GERS retirees, future GERS retirees, USVI economic activity, and has the real potential to produce civil unrest. These scenarios are simply unacceptable. Any privatization of WAPA must take into account the impact on GERS and be structured to fairly and thoughtfully avoid or mitigate this impact while also being thoughtful and fair to the workforce of a newly privatized WAPA.

3. Bond Defeasance: on the recent bond issuance if WAPA is privatized.

In the normal course of obtaining outside financing to support its growth in the past, WAPA has obtained debt financing (through loans and bonds). The terms of some of these debt instruments provide certain benefits to WAPA as a public entity that are not available to privately-owned utilities. These terms also provide restrictions on the ownership structure of WAPA during the term of the financing, and may therefore limit the Government's ability to sell WAPA or its assets to private parties. The recent (2003) bond issue, for example, provides benefits to WAPA in its current ownership form, i.e. as an instrumentality of the Government. If this ownership structure were to change, through a privatization, these financing terms could be violated, potentially resulting in defeasance on the bond issue. Any alternative ownership structure must either remain within the limits required by the restrictions of all current bonds and other financing, or else provide a mechanism to replace such financing.

4. The workforce should share in the monies paid for WAPA in any transaction.

Many members of the workforce hold the view that WAPA is valuable in part because of their long time contributions. If WAPA is to be sold and privatized then those who put their sweat equity into the creation of the assets under WAPA's control should directly participate in the proceeds from its sale.

5. Board Expertise and Independence: Increasing the utility and financial expertise capacity of the WAPA Board and insulating the Board from the effects of political interference.

Any new Board of a privatized WAPA must have designated seats to represent utility and financial expertise as well as ratepayers, WAPA workforce, and the USVI Government. The appointment or election of Board members must be free of political considerations.

6. Access to Capital

A newly privatized WAPA must have the ability to generate and retain sufficient capital to fund new capital programs for growth, cost reduction, and reliability improvement strategies. Having this ability is a key concern raised in any discussion of employee ownership. The underlying, but misguided, fear is that in an employee ownership model,

employees will manage the company to maximize short-term compensation, sacrificing strategic capital requirements.

If employee ownership is to be a viable privatization strategy, an educational campaign is required to make transparent the differences between an "employee-owned" utility and an "employee-managed" utility, including how an ESOP is structured, governed, and managed. Furthermore, if the formation of an electric cooperative is to be a viable privatization strategy, a similar education effort is required focused on the structure, governance, and management of electric cooperatives. Education regarding how both models obtain capital for strategic and other projects is also needed.

7. Workforce Fragmentation: The WAPA workforce is too fragmented to effectively own a company or to effectively participate in the formation of an electric cooperative.

The workforce characterizes the WAPA work environment as one based on mistrust and resentment, with a culture based on faultfinding and blame holding. The WAPA workforce perceives itself as highly fragmented, e.g. management vs. union, operations vs. maintenance, power vs. water, line repair vs. power generation. Employees generally attribute this fragmentation to favoritism practiced at all levels of WAPA. Many in the workforce believe that nearly all hiring and nearly all advancements are based on personal relationships rather than on results, merit, or capabilities. It should be noted that this issue of workforce fragmentation must be addressed even if there is no change in the ownership status of WAPA.

If WAPA is privatized, the transition from one form of ownership to another is a window of rare opportunity to articulate a new organizational culture that emphasizes trust, open and early communications, transparency in all transactions, high levels of employee participation in improvement planning, decision making, and project implementation, fairness, and respect at all levels. While a change in the ownership structure of WAPA alone would not solve these problems, it would be a powerful opportunity for WAPA to reinvent its culture.

8. Employee Input: WAPA management does not generally seek input from its workforce nor listen to the workforce when its opinions are offered.

There are strong sentiments within the WAPA workforce that WAPA management is based on an authoritarian model. Information, communications, and decisions flow down the organization. Except for a pro-forma labor-management committee, there are no formal worker participation programs or structures in place. No formal problem solving, improvement planning, team building, communication, conflict management, or customer service training and education was reported by any of the employees interviewed. Informal planning and coordination mechanisms are also absent.

Given the industry and the reputed high costs of workers compensation it is unusual and surprising that WAPA lacks a comprehensive, formal joint union-management safety

program. High involvement programs and supports should be put into effect regardless of the ownership of WAPA. These programs would permit the tapping of the skills and creativity of the workforce as effective resources for improvement without the requirement of significant investment. These programs would be an important element of the change in organizational culture discussed above.

9. Training and Development: WAPA has a poor to non-existent training and development system

While formal lines of progression exist, most advancement is based on length of service or arbitrary considerations by supervisors. Tests for advancement are given in small numbers of classifications (e.g. control room operators), but the tests are given under less than rigorous conditions. Training received by employees is typically the result of individual initiative that is poorly encouraged and supported by the organization. The development and use of standard operating procedures (SOPs) is minimal.

Additionally, WAPA supervisors and mid-level management have not received training in supervisory skills. Supervisors require education and training in the social skills required to lead others, in addition to technical skill development. A typical supervisory social skill set includes:

a. Coaching
b. Team building
c. Providing feedback
d. Counseling and developing employees
e. How to issue formal discipline
f. Communications
g. Conflict management
h. Project planning and prioritizing

Once again, these training, education, and development issues are important and must be addressed even if there is no change to the ownership status of WAPA.

10. FEMA Coverage: A newly privatized WAPA must maintain the eligibility of the power transmission and distribution systems for FEMA coverage.

SEI's proposed transaction sought to privatize the water system and the power generation assets, with the Government retaining ownership of the hurricane-susceptible transmission and distribution systems, as this would permit WAPA to maintain FEMA coverage for those systems. Many in the USVI community saw this solution as inherently unfair, in that SEI would own the relatively less risk-prone physical assets, and the Government would own the riskier assets. Given this history, a fair and forthright solution to the FEMA coverage issue must be part of the privatization transaction. While the ultimate solution may reasonably include a combination of ownership structures for WAPA's various assets, the risk sharing must be perceived as appropriate and the issues must be more transparently communicated to the different constituencies.

11. Preferential Fuel Oil Pricing: Senior managers expressed concern that a privatized WAPA would no longer benefit from a discounted fuel pricing arrangement with Hovensa on St. Croix.

There is currently an agreement between the Government and Hovensa wherein Hovensa supplies fuel to WAPA at a discounted price. If the Government ceases to own WAPA, this agreement may also cease…. It must be determined if termination of government ownership of WAPA also terminates the agreement with Hovensa. If so, then it will have to be determined if the Hovensa discount agreement is valuable and if so, will Hovensa negotiate comparable terms with the new owners of WAPA.

12. Government Payment Terms: How to deal with the Government's inability to pay its power and water bills in a timely manner.

The Government currently represents about seventeen percent (17%) of WAPA revenues. The Government currently has substantial amounts of monies owed WAPA and past due. This situation will always be part of WAPA's reality and must be recognized by any future private entity.

The Government has always paid its power and water bills, eventually, but it is recognized as an extremely "slow payer." This means that WAPA carries significantly higher accounts receivable from the Government than comparable utilities. These amounts have recently ranged from $5-10 million, and in the past have risen to the $40 million range. Supporting this level of long-term receivables increases the pressure on WAPA's cash flow and increases its cost of short-term working capital financing.

New owners will need to address the short-term financing issue that currently exists, as well as insure that the Government's record of ultimately paying its bills does not degrade once it no longer owns WAPA.

13. Effective and Transparent Communications: The transaction to privatize WAPA must be developed transparently with effective and early participation by WAPA employees, ratepayers, community, and business representatives.

Many of the objections to the prior acquisition proposal from SEI were related to the secrecy with which the deal was prepared and presented, and the resulting (and seemingly deliberate) failure to involve the community in the process. This implies that a successful change in WAPA's ownership would be much more likely to succeed if the various constituencies were involved earlier and more deeply in the process.

The BOC has undertaken numerous specific initiatives both to include representatives of various constituencies in this Feasibility Study process. More importantly, following completion of this Study, both the formation of a formal buyout entity that would prepare a purchase offer, as well as the process for formulating this offer, will need to be substantially more responsive to this concern.

2. WAPA Ratepayers

WAPA ratepayers believe that WAPA, as currently structured, is hopelessly broken and out of control.

WAPA ratepayers are concerned with:

a. Stabilizing/reducing the prices charged by WAPA
b. Improving power reliability and eliminating power outages
c. Improving power quality by eliminating surges and brownouts
d. Improving customer service quality
    i. Significant reduction in time from new service order placement to meter installation
    ii. Significant reduction in time from first call to time of restoration of power
    iii. Significant reduction from first time call to time of actual repair
    iv. Significant improvement in meter reading accuracy and frequency
    v. Significant improvement in billing accuracy
    vi. Significant improvement in courteous and respectful service
e. Effective ratepayer representation on the WAPA Board

WAPA ratepayers are prepared to support an ownership structure that meets these concerns.

3. USVI Community

USVI community consensus (not a unanimous opinion but certainly an overall consensus) on the central elements of a transaction privatizing WAPA is:

a. The process of developing the transaction proposal must be open and transparent to the public from the start;
b. The transaction must produce a more expert, less political Board, that has effective ratepayer and community representation;
c. The transaction must not harm the Government Employees Retirement System
d. The transaction must pay a price that is absolutely fair;
e. The transaction must maintain local ownership and control of WAPA's assets;
f. The profits generated by WAPA must stay locally to stabilize/reduce rates;
g. The transaction must result in a power and water utility that can help drive economic development and job creation;
h. The transaction must include a clear strategy for dealing with the USVI Government's ongoing inability to pay its power and water bills in a timely manner.

4. USVI Government

The limited number of formal and informal interviews held with representatives of the USVI Government and the limited amount of information shared in those interviews does not permit us to report with any confidence the key concerns of the USVI Government. It is absolutely safe to

say the USVI Government shares many of the same concerns and issues as those reported earlier based on interviews with workforce, ratepayer, and community representatives.

- **Discussion**

This section has presented the issues and concerns identified through interviews with WAPA's multiple stakeholders. To provide useful input into future decision-making, this input must be digested and summarized as a series of criteria for evaluating any proposal for the future of WAPA. The following section presents Praxis' conclusions regarding the most important criteria that capture the concerns of the stakeholders, subject of course to public review.

Section 3: Threshold Decision Criteria

The issues and concerns raised in the prior section may be categorized into a series of decision criteria for any sale of WAPA. These criteria represent a "scorecard" that should be used to rigorously assess the fairness (to all key stakeholders), the desirability, the financial viability, and the potential for long-term success of any proposed transaction.

There are two levels of decision criteria. The first three criteria are **Primary Criteria**, those that represent the most critical objectives in any transaction. No proposal for the future of WAPA should be acceptable if is does not meet ***all*** of these **Primary Criteria**. The remaining seven criteria are **Additional Criteria**, those that represent essential considerations for any transaction, and that may need to be balanced against one another.

The best proposal for the future of WAPA will both meet ***all*** of the **Primary Criteria**, and also provide the ***best overall combination*** with respect to the **Additional Criteria**.

- **Primary Criteria**

1. Provide a fair price to the Government, utilizing a combination of:
   a. Cash
   b. Future benefits
      i. Methods for dealing with the realities of the Government's payment history and cash flow requirements. One idea may be the use of in-kind, fair-marked priced water and power in lieu of taxes and/or in lieu of cash purchase payments
      ii. Economic development plans and commitments

2. Preserve primary ownership and control of WAPA on the USVI
   a. Preserve local control of this critical economic asset
   b. Retain WAPA profits in the community
   c. Respect existing collective bargaining relationships

3. Increase service and delivery quality while concurrently maintaining or reducing rates and improving fiscal responsibility
   a. The goal of a privatized WAPA is to meet or exceed the best example, world wide, of any similarly situated water and power authority in terms of quality, reliability, service, innovation, economic development, and rates

- **Additional Criteria**

4. FEMA coverage
   a. The loss of FEMA coverage is absolutely a deal breaker.
   b. Any form of privatization must maintain this essential coverage or account for the cost of replacing it with fully comparable coverage.

5. GERS: avoid unduly stressing GERS' current financial predicament
   a. The possible loss of WAPA contributions to GERS must be studied for the impact on GERS current and future retirees and GERS ability to meet its liabilities and obligations. This study, and its findings and conclusions must be done transparently, rigorously, and with high levels of credibility.
   b. If it should be determined that GERS could financially withstand the near term or future loss of WAPA contributions without further stressing GERS' finances then a comparable plan, in terms of benefits and eligibility, must be developed and submitted to a rigorous cost benefit analysis for discussion and implementation.

6. Hovensa: maintain or reasonably replace the current fuel-oil pricing arrangement, by:
   a. Retention of the existing pricing arrangement
   b. Negotiation of a comparable pricing arrangement
   c. Development of a clear strategy that offsets any fuel oil price increases with improved operational efficiencies rather than through surcharges or other forms of rate increases.

7. Bond terms: retain or reasonably replace existing favorable financing terms
   a. Avoidance of bond defeasance is desired, but may not be possible.
   b. If this is not possible than any privatization proposal must detail the added expense of refinancing and how the additional costs will be offset.

8. Operating cash: provide adequate for:
   a. Daily operations
   b. Repayment of existing debt / bonds
   c. Capital expenditures for future growth and improved services

9. Expertise: provide additional governance and operational expertise
   a. The make up and functioning of the WAPA Board must be depoliticized;
   b. The operational considerations of WAPA must be insulated from the current short-term, micro-management impact of the political environment within which WAPA currently operates;
   c. Operational improvement, standardized operating procedures, effective training and development, testing and advancement strategies must be articulated in any privatization proposal.

10. Future growth: enable ongoing success by
    a. Articulating a strategic vision for WAPA and its role in promoting and enabling economic development on all three islands;
    b. Providing adequate financing to support this strategic vision;
    c. Providing adequate expertise to execute this strategic vision.

- **Analysis**

The above list represents Praxis' analysis and conclusions regarding how the issues and concerns identified in Section 2 may be translated into actionable decision criteria for evaluating proposals. These criteria must be aired and rigorously discussed. We recommend a series of public forums in a range of formats, e.g. town-hall meetings, press activities, etc., across the USVI and addressing all of the key stakeholders. Ultimately, the USVI community must confirm its priorities for the future of WAPA, and the Government must confirm whether and under what terms WAPA may be privatized.

Any changes in the content or priority of the decision criteria outlined in this section, following this public review process, will have a profound impact on the analysis and conclusions in the remainder of this Report. The following 2 sections, Maintaining WAPA's Current Ownership Structure, and Alternative Ownership Structures, provide an outline of the various alternatives. Each section also provides an analysis of the extent to which each alternative addresses the key Threshold Decision Criteria outlined here. Clearly, if the criteria change substantially as a result of the public review process, the remaining analysis and conclusions would need to be adapted accordingly.

Only when the priorities and decision criteria are clear and have been subject to public review will it be possible for potential buyers to craft appropriate proposals that represent the best possible balance of outcomes for the maximum number of the USVI community members. These proposals should be presented for public debate and for a decision by the USVI Senate and Governor's office.

Section 4: Maintaining WAPA's Current Ownership Structure (Alternative 1)

There are many possible ownership alternatives for WAPA. The goal of this Study is to address the range of possibilities in an objective and responsible manner. At opposite ends of the spectrum are two extremes. At one end of the spectrum is to "do nothing," i.e. retain the status quo by leaving WAPA's ownership unchanged in the hands of the Government. This is the benchmark against which all other alternatives are measured. The remainder of this section, **Maintaining WAPA's Current Ownership Structure**, reviews the ownership context within which WAPA operates. The next section of this report, **Section 5,** presents the primary **Other Ownership Alternatives** and their general benefits and limitations.

- **Current Legal Status**

First, it is helpful to review WAPA's legal status, because this affects the nature of any type of sale transaction. Currently, WAPA is owned by the Government. This means that there is no "stock" of WAPA, as there would be in a private business, so there is no stock that can be purchased by an outsider. WAPA is an "instrumentality" of the Government, meaning that it is a quasi-independent legal entity with a Board of Directors that is appointed and controlled by the Government. This entity itself can not readily be sold.

However, WAPA does have both assets and liabilities that can be sold to other parties. WAPA has different types of assets, both financial assets and physical assets. Physical assets include electricity and water production, transmission, and distribution equipment. Financial assets include cash and payments due from ratepayers that have not yet been collected (accounts receivable). One of WAPA's largest customers is the Government itself, and at various times the Government has delayed paying its power and water bills to WAPA. While this preserves the Government's cash, at least temporarily, it also places a burden on WAPA to operate without being paid promptly and dependably by its major customer.

WAPA also has liabilities (debts) to other parties. Primary among these are debts in the form of bonds that are scheduled to be repaid over an extended period of time. Some of these debts have been incurred under terms that may require WAPA to remain under some form of public ownership, or else the terms of the debts must be renegotiated. This means that some of the alternatives may require not only negotiations between the Government and the new buyer of WAPA, and not only new debt to finance the purchase, but also negotiations with existing debt-holders concerning the terms of their existing agreements.

Together, these assets and liabilities represent the parts of WAPA that might conceivably be sold to an outside party. Each of the alternatives essentially involves the Government agreeing to sell some or all of these assets to a third party, as well as that other party agreeing to assume some or all of these liabilities. The Government could elect to retain some of the assets and liabilities itself and form some type of operating relationship with the third party that purchases a portion of WAPA.

One example would be for the buyer to purchase only some of the assets and liabilities, for the Government to retain other assets and liabilities, and for the buyer and the Government to work

together under a long-term contract to provide the services that are now provided by WAPA. A related but different concept would be for the Government and the buyer to create and share ownership in a new entity that would purchase WAPA's assets and liabilities and operate the utility. In the first case, the buyer would in effect be a contractor to the Government, and in the second case, the Government and the buyer would be partners in a jointly-owned entity. These concepts have different advantages, which are reviewed below.

- **Operating Advantages under Government Ownership**

An important complication is that WAPA also has certain operating advantages that are available to it directly as a result of its ownership by the Government, and that may not be available to an outside buyer ("Operating Advantages"). These include, most notably:

1. The participation of WAPA employees in the Government Employees Retirement System (GERS);
2. The availability of disaster insurance for some of WAPA's assets through the Federal Emergency Management Agency (FEMA);
3. Long-term fuel purchase terms from Hovensa;
4. Favorable borrowing terms through Government bond issues.

For any alternative to be acceptable, it must address these key Operating Advantages. Possible strategies to do so include: securing the Operating Advantages in some other way, or providing for the additional cost of operating WAPA without one or more of the Operating Advantages, or simply and honestly acknowledging that the Government would be required to make up the difference. As noted, the original offer from SEI addressed these issues by simply requiring the Government to assume all of the costs of losing these Operating Advantages following the sale to SEI.

- **Accountability to the USVI Community**

One of the primary costs of continued Government ownership of WAPA is the perception of political influence on WAPA's operation. The scope of this study does not permit a thorough analysis of the degree to which governance of WAPA and the Board and management level is in fact subject to political influence by the Government. However, the perception is clear and virtually unanimous that the Government does routinely exercise such control and that this has a range of impacts on WAPA's performance, both for better and for worse.

On the positive side, Government influence is part of the point: WAPA exists to serve the needs of the USVI community, and the Government's role in this context is to ensure that WAPA fulfills this mandate. Ideally, the Government would appoint Board members who are qualified to oversee the management of an electric and water utility, and would provide funding sufficient for both current operations, anticipated maintenance, and future growth initiatives, such that WAPA would truly operate to best serve the interests of the community.

In practice, most of those interviewed believe that the Government's Board appointments, taken as a whole, are not primarily focused on improving WAPA's performance in delivering electric

service and water. Worse, there is a common perception that the Board members, individually and/or as a whole, often takes actions to protect business practices that may not best support WAPA's efficient operation. This tends to undermine management's authority, the public's confidence in WAPA's ability to operate free from excessive political pressure, and ultimately WAPA's ability to actually operate at the level of the best-managed domestic utilities.

However, simply removing WAPA's operations from any type of USVI community oversight would make WAPA beholden to interests that are not first and foremost concerned with the interests of the community. This is certainly one of the primary concerns with an off-island, for-profit buyer, and it was one of the primary challenges presented by the last SEI offer. The natural tension here is to find a way to maintain the accountability of WAPA both to its mission of serving the USVI community and to the need to operate efficiently and without undue political interference.

This problem is not unique to WAPA, and it is one of the classic criticisms of government ownership of utilities: both the perception and potential reality of political influence on business decisions can undermine the effectiveness of management in running the utility and can distract the utility from its primary focus. Freeing the utility from such influence while still maintaining public accountability is one of the driving forces behind at least some of the recent conversions of public utilities to consumer cooperative ownership, as discussed further below.

On all of these issues, the critical question becomes: what are the ownership alternatives, and which one(s) best meet the Government's and the USVI community's objectives, while also best retaining WAPA's current Operating Advantages?

- **Analysis of Continued Government Ownership**

The simplest alternative is to leave ownership and control of WAPA as they currently are. For the sake of comparison with the alternatives in the next section, this warrants some further clarification. The basic advantage is that WAPA would continue to operate in its current form, and would maintain all of the Operating Advantages outlined above. The basic disadvantage is that this alternative would not meet any of the Government's or the USVI Community's objectives for selling WAPA in the first place.

Furthermore, the analysis above illustrates the clear perception among many of WAPA's stakeholders that some change in WAPA's status is inevitable, both because WAPA itself needs to make certain changes to better serve the USVI community, and also because the Government will continue to require cash and WAPA is therefore destined to be sold to an outside party at some point. There are certainly some who discount this possibility, i.e. who believe that the United States government will continue to subsidize the USVI Government throughout the foreseeable future (for at least the next several decades), such that the Government will not actually require the potential cash that it could obtain by selling WAPA. A minority of observers also simply believe (without being able to cite any particular evidence) that some other source of funding for the USVI Government will become available and will remain stable over time. In either of these events, the Government's first objective, to raise cash, would be met and there would be no need for it to sell WAPA for this reason.

However, the Government has a second objective, to improve WAPA's operating performance, and this would not be met even if there were a stable and permanent source of external subsidy. Once again, there are a few observers who believe that WAPA is on the right track on its own, and that it will independently continue to make significant strides in improving performance of both the electric and the water systems. But these observers are clearly a small minority. Most observers, most notably including all of the WAPA leadership and middle management employees who were interviewed, agree that there is no reason to believe that WAPA will have either the funding or the independence from political influence to continue to make substantial and acceptable positive strides while it remains under exclusive Government ownership.

As a result, the sale of WAPA appears, to most observers, to be both virtually inevitable for financial reasons, and also substantially preferable for operational reasons.

Section 5: Other Ownership Alternatives

If Alternative 1 is "continued Government ownership," representing the benchmark at one end of the spectrum, at the other end of the spectrum is Alternative 2, "privatization controlled by an off-island party" along the lines of the original SEI offer. That specific offer was rejected by the Senate, although an offer that addresses some of the specific perceived shortcomings of the SEI offer may in fact have its merits and must at least be considered in this Study.

In between these extremes, there are two primary alternatives. A third alternative is an "employee buyout," i.e. privatization to a for-profit utility that would be owned by and operated on behalf of WAPA's employees, likely though an employee retirement trust called an Employee Stock Ownership Plan (ESOP). A fourth and final alternative is the "co-op" option, i.e. privatization to a not-for-profit consumer cooperative utility that would be owned by and operated on behalf of WAPA's ratepayers, the citizens, business community, and government agencies of the USVI. Either of these alternatives may (or may not) include some form of partnership with USVI or off-island financial investors.

There are of course many possible hybrid scenarios, and other alternatives could conceivably arise. The remainder of this section reviews the ownership context within which WAPA operates, and then each of the primary alternatives and their general benefits and limitations.

- **Alternative 2: Outright Sale to an Off-Island Investor**

A sale to an outside investor could take various forms. The SEI proposal, while deemed not to be in the best interests of the USVI community by the Senate several years ago, is not the only imaginable arrangement. In fact, opposition to selling WAPA to an outside investor was based not only on the concept that WAPA should remain owned and controlled in some way by the USVI community, but also significantly based on the particular terms of the SEI offer, which when finally made public were perceived to be highly unfavorable to the Government and to USVI community at large. Therefore, a full and fair examination of ownership alternatives must include a review of how such a sale might be structured in a way that would be more balanced and favorable to the Government and the community, while still being sufficiently attractive to the outside investor.

There were several critical elements in the SEI proposal that were particularly problematic. At the most basic level, the SEI proposal failed to address a number of the key criteria (as set out above) for any acceptable transaction. These issues were sufficient for the Senate to conclude that the specific offer from SEI was inadequate to justify the potential negative impact of selling WAPA under such terms. If SEI had seen an easy way to amend its offer, or if another off-island buyer had seen a better alternative structure to protect the Government and USVI community while achieving the basic sale objectives, one would expect to have seen a follow-up offer from one of these parties at some point over the past several years. The absence of any formal interest indicates that the uncertainty surrounding the Government's threshold criteria, along with the challenges of the SEI offer, create more risk than any other off-island buyer is willing or able to overcome.

Therefore, the best course of action for those who support soliciting another off-island offer may in fact be for the Government to publicly articulate "Threshold Criteria" for an acceptable offer. This document suggests a list of such criteria, but this list should of course be subject to appropriate changes following public comment and debate. This would create a clear and consistent path for potential buyers to move forward, and would remove the major stumbling block of uncertainty about the Government's goals and intentions.

At the same time, it is difficult to imagine how an off-island, for-profit buyer could address several of the core issues that plagued the SEI offer. For example, the bond debentures require continued Government ownership and the rate is not available to private-sector borrowers, FEMA coverage is simply not available to private sector purchasers (except consumer cooperatives, as discussed below), GERS coverage is substantially more costly than commercially competitive private pension plans, and the Hovensa fuel purchase contract is specifically tied to Government ownership.

As a result, a reasonable observer must imagine that any realistic third-party offer from a private sector buyer would require some form of partnership with the Government to maintain these Operating Advantages. In the absence of such a partnership, either the Government will be required to carry significant additional costs (as was the case in the fine print of the SEI offer), or WAPA's costs will simply rise substantially, leaving that much less cash available for the already substantial investment requirements outlined above and detailed in the Houlihan report.

- **Alternative 3: Sale to a For-Profit Employee-Owned Utility**

1. History & Background

The primary initiative for this Study was originally provided by the leadership of WAPA's largest union, WAPA Employees' Association (WEA), under the leadership of Mr. Hubert Turnbull, in close consultation with WAPA's other two unions as well as its non-union workforce and other interested parties in the USVI community. The original question posed by these parties was: how can employees best protect their own interests and the interests of the broader community by preventing the sale of WAPA to an off-island party under highly unfavorable terms? One potential solution would be for the employees to orchestrate a purchase of WAPA from the Government such that the utility would become owned by the employees.

During the course of ongoing examinations and through the course of this Study, the focus has changed to address the key questions outlined in the introduction. However, the notion of employee ownership is both powerful and potentially compelling, and is certainly one of the core alternatives that warrants careful review.

2. The Employee Ownership Model

Employee ownership in the United States takes many forms, and a full review of all forms is beyond the scope of this Study. A recent publication by the National Center for Employee Ownership (NCEO), "A Comprehensive Overview of Employee Ownership" (http://nceo.org/library/overview.html), reviews the different forms of employee ownership, how

they are being used in practice, the benefits and limitations of each, and the general circumstances under which each form may be advisable to create value for stakeholders.

The NCEO also provides a statistical profile of employee ownership, online at http://nceo.org/library/eo_stat.html. This provides more detail on how many firms use which form(s) of broadly-shared employee ownership. In summary, there are over 20,000 formal employee ownership plans in the U.S., with over 45 million participants (although some companies have more than one plan and in these cases the same employees may be included more than once). Through these plans, the NCEO estimates that "employees own, or have options to own, stock worth about $800 billion, or about 8% of all the stock in the U.S." These totals do not include either publicly traded or private companies in which employees simply purchase stock directly from the company and/or from one another. Those forms of ownership are not regulated and tracked in the same fashion, and there is no solid data available on how much additional employee ownership exists through these mechanisms. There are also ESOPs in the utility industry. For example, when the Puerto Rico Telephone Company was recently privatized, employees maintained a portion of the new company's equity ownership through an ESOP, and Houlihan served as one of the financial advisors in that transaction. Suffice it to say that employee ownership is a common and growing form of business ownership in the U.S.

Perhaps more importantly, there is a growing body of data to support the common view that combining employee ownership with active participation of employees in decision-making at appropriate levels leads to substantial improvements in company performance. Again, a full review of this data is beyond the scope of this Study. A summary of research findings may be reviewed at: http://nceo.org/library/corpperf.html.

This data illustrates that employee ownership of businesses in the U.S. is a substantial and growing trend, one which already offers millions of Americans, including utility employees, the opportunity to share in the success of the businesses in which they work. Employee ownership, when structured and implemented correctly, also improves company performance. For the purpose of this Study, we accept the proposition that WAPA, under employee ownership, would have significant potential to realize meaningful performance improvements for the benefit of all stakeholders, consistent with both the theory and the established research data on employee ownership. But this, by itself, does not make employee ownership the right answer for WAPA.

3. ESOP: a Form of Defined Contribution Pension Plan

When a business is for sale and employees are seeking to purchase it to protect their jobs and improve the business' performance in the long-run, the most common alternative is an Employee Stock Ownership Plan (ESOP). Other broad-based employee ownership alternatives do not lend themselves as well to this purpose. Accordingly, we will limit this review to the potential of an ESOP to meet the criteria for the sale of WAPA to another party.

An ESOP is a form of Defined Contribution pension plan, which is a subset of qualified retirement plans regulated under the primary U.S. pension regulation, ERISA. As in other qualified plans, under an ESOP the company sets up a trust and makes contributions to that trust

on behalf of eligible employees. The trust then invests those funds and pays the proceeds to participants once they reach retirement age or otherwise become eligible for a distribution.

In a Defined Contribution plan, the company sets the level of contributions each year, and the future value of payments to participants is based on whatever the value of the trust's investments happens to be. In other words, the company is defining the contribution level at the front end, but is not guaranteeing the benefit level at the back end, i.e. when employees retire. Other common types of Defined Contribution plans include Profit Sharing Plans, 401(k) Plans, and Stock Bonus Plans.

This Defined Contribution concept, of which ESOPs are one type, is fundamentally different from the other primary type of pension plan, a Defined Benefit plan, of which GERS is one type. In a Defined Benefit plan like GERS, the employer sets a future benefit level which participants are entitled to receive once they retire. The employer must then estimate what those benefits will be, and must also make contributions sufficient to pay benefits at that guaranteed level to participants who become eligible for a distribution in the distant future. The benefit formula is often based on participants' income during the last several years of employment.

From the perspective of employees who participate, the advantage of a Defined Benefit plan is that individuals are guaranteed a certain, predictable level of benefits after a certain predictable length of service. For employees whose employers are considering a change from an existing Defined Benefit plan, like GERS, to a Defined Contribution plan, like an ESOP, the disadvantage is they would no longer be guaranteed a certain benefit level in the future. Rather, their benefits would be based on the value of whatever investments the new plan makes. In an ESOP, this is the stock of the employer, so the participants' retirement benefits depend on the future performance of the employer's stock.

From the perspective of the employer, the disadvantage of a Defined Benefit plan is that the employer must estimate the current contribution levels necessary such that the promised funds will be available, after factoring in investment returns between the time that the contributions are made each year and the time that the participants will receive distributions in the future. This entire process is not only notoriously difficult, it is also subject to much interpretation, and sometimes to direct manipulation either by unscrupulous plan sponsors (employers) or by legitimate sponsors who simply do not have sufficient funds to contribute. Sponsors of these plans routinely prefer to use optimistic estimates of future investment returns, because this means that they do not need to contribute as much to the plans currently. When the stock market is doing very well, these optimistic assumptions may appear temporarily justified.

However, when the market turns down, and/or when contributions are not made at the required levels, a Defined Benefit plan may become "underfunded," meaning that the level of current investment, plus future contributions and expected investment returns, is not predicted to be able to fund the benefits that have been promised to participants. When this happens, either the company must make additional contributions, often at a very significant level, if it is able to do so, or the plan is simply unable to keep up with its commitments. There are penalties for permitting private-sector Defined Benefit plans to remain underfunded, and these can be quite severe. The complexity, the cost, and the risk associated with Defined Benefit plans has resulted

in a broad trend in the U.S. away from Defined Benefit plans and towards Defined Contribution plans.

This creates a real tension at WAPA, where eligible employees are currently covered by a Defined Benefit plan, GERS. Moving to an ESOP would almost certainly involve reducing contributions to GERS, because WAPA is unlikely to be able to afford to simply increase employee benefits by adding the cost of ESOP pension contributions without reducing other existing pension contributions. In effect, employees would be purchasing WAPA, using at least a portion of the funds that WAPA would otherwise have contributed to GERS and that GERS would have invested in other investments. They would be trading a retirement program with guaranteed payouts at more-or-less predictable levels, for a retirement program whose future value is based on the future value of WAPA itself, for better and for worse.

Of course, the benefits that employees perceive to be "guaranteed" from GERS are only as secure as GERS itself. As noted above, GERS faces serious questions about its own viability, specifically its ability to continue to pay promised benefit levels given its current limited contribution levels. On the one hand, this is not WAPA's problem, it is a larger GERS problem. On the other hand, the purposed of this Study is to assess what ownership alternative for WAPA would best serve the interests of the USVI Community. All else equal, an outcome for WAPA that substantially undermines GERS would not be favorable.

Within WAPA's workforce, there is also, understandably, significant discomfort to face such a change. Employees would prefer both to maintain GERS coverage and also own WAPA, though this does not appear to be financially feasible. However, the question of whether an ESOP would be preferable to GERS is the wrong question. Rather, the relevant question is whether any of the likely outcomes for WAPA will continue to include GERS pension benefits and/or some other combination of benefits, and how an ESOP might compare with these other likely outcomes.

For example, the SEI proposal included maintaining GERS coverage for current employees, but creating a new, private pension plan within SEI (or its affiliates) to cover new employees. Of course, SEI would not provide full funding for ongoing GERS coverage, and it required that the Government (not SEI) would guarantee that GERS funding and benefits would be maintained. In effect, part of the purchase price received by the Government would have been used to provide ongoing GERS coverage, so that the Government would not actually retain the full value of the SEI offer. This was one of the gaping holes in that original approach.

4. Conversion to an ESOP

The section illustrates the potential outline of an ESOP at WAPA. The new buyer would likely be a new corporation established for the purposes of purchasing WAPA assets and operating WAPA. That corporation, which will be called "NewWAPA" for the sake of this discussion, would issue stock to its shareholders in return for cash investment. The ESOP, using NewWAPA's assets and guarantee as collateral, would borrow funds from banks or other financial institutions and would pay this cash to NewWAPA. In return, the ESOP would receive NewWAPA stock. NewWAPA would pay the cash to the Government in return for the specific

assets and liabilities that it is purchasing, and would begin to operate what used to be WAPA, now under independent ownership.

Because there is no public market for WAPA, federal regulations require that the value of the assets and liabilities acquired by the ESOP be determined through an independent appraisal. This process has the distinct advantage that it requires an objective and legally defensible valuation methodology on behalf of the ESOP as the purchaser. The disadvantage, from the Government's perspective, is that the ESOP is not permitted to pay more than fair market value to the Government. This means that if an outside party were willing and able to pay substantially more than the fair market value, as determined by the ESOP appraisal process, the ESOP would not be permitted to match the other buyer's offer.

To the extent that the Government receives offers that are significantly above market value from other parties, it will receive more from such parties than from the ESOP. However, the only offer received to date, from SEI, appears to have been at or below fair market value to begin with, so that the ESOP would be offering a comparable price. The pricing of any future offer from the ESOP would of course depend on which assets and liabilities the ESOP purchases, and on a complex range of other terms and conditions of sale. At the very least, the ESOP provides a mechanism to benchmark the fair market value.

There are many different specific ways to structure the details of the purchase transaction, and these are beyond the scope of this Study. The point here is that stock would end up in the ESOP, as owner of NewWAPA; NewWAPA would hold the appropriate operating assets and liabilities to operate the electric and water utilities; and the Government would receive cash payments and would no longer own WAPA's operations. WAPA's employees would become employees of NewWAPA, and other contracts and agreements would be assumed or recreated between NewWAPA and its customers and vendors.

Within the ESOP, the NewWAPA stock would remain in a holding account, generally called a "Suspense Account," until the loans were repaid in the future. Each year, NewWAPA would make tax-deductible cash retirement contributions to the ESOP, which the ESOP would use to repay its loans. ESOP participants would receive stock in their accounts in proportion to their payroll (or other formula meeting federal non-discrimination requirements). Over time, participants would receive more and more stock, and the stock should grow in value if NewWAPA performs well. Participants who leave NewWAPA due to death, disability, retirement, or other termination, would receive the cash value of the NewWAPA stock in their accounts under the ESOP's formal distribution policy, comparable to manner in which participants receive retirement distributions under other Defined Contribution plans.

5. How Well Does the ESOP Meet the Decision Criteria?

There are two levels of Decision Criteria outlined in Section 2, Primary Criteria and Additional Threshold Criteria.

An ESOP addresses all of the Primary Criteria directly and effectively:

a. It provides the Government with cash, and it provides a mechanism to establish a fair and public value for the assets and liabilities to be transferred.
b. It maintains ownership of WAPA in the USVI, in the hands of NewWAPA's employees.
c. It provides a strong opportunity for WAPA to increase service quality and decrease costs, consistent with the research and actual experience of successful ESOP companies. However, the ESOP does not add any external access to additional utility expertise per se.

However, the ESOP, by itself, fails to fully address the Additional Threshold Criteria:

d. FEMA: The ESOP does not solve the FEMA issue. NewWAPA under a conventional ESOP would be an investor-owned utility (with the ESOP being the investor) that, at least at face value, would not qualify for FEMA coverage. This would require the Government to partner with ESOP in some form to maintain ownership of FEMA-covered assets.
e. GERS: This issue is addressed in detail above. The ESOP would not provide a ready ability for employees to retain GERS coverage going forward, though it would not necessarily reduce benefits that have already been accrued. Nor would the ESOP address the broader challenges facing GERS. The ESOP would provide a separate retirement benefit to NewWAPA employees going forward, based on the performance of NewWAPA itself as an investment.
f. Hovensa: The ESOP would not necessarily maintain fuel-purchase terms with Hovensa. It is certainly possible for the Government and the ESOP together to negotiate with Hovensa to maintain the current contract terms with WAPA's new owner. The fact that the ESOP represents on-island ownership of the utilities certainly provides some incentive, and Hovensa would certainly face public pressure not to provide inferior terms that would hurt NewWAPA's ability to serve the community. But this is not the same as an assurance that the current terms would be maintained.
g. Current debt and financing for the purchase: The ESOP does in effect make some or all borrowing tax deductible to NewWAPA. This is certainly an advantage relative to other for-profit investor-owned utilities. However, relative to Government ownership or a not-for-profit cooperative, which do not pay income taxes, this does not add value. The ESOP would also not likely qualify for the debt terms currently available to WAPA as an instrumentality of the government. The purchase would need to be carefully structured so as not to result in "defeasance" on WAPA's existing bonds. This issue is reviewed in further detail in the Houlihan report.
h. Operating cash: The ESOP by itself is not a source of cash (though it does provide a tax-advantaged way to borrow, as noted). The transaction would also require working capital sufficient to meet NewWAPA's needs (i.e. cash that would stay in NewWAPA and not be paid to the Government). It is not yet clear whether this could be raised relying strictly on debt capital through the ESOP, though this would be very unusual. Typically, ESOPs purchase a portion of a company at one time using debt, or they purchase 100% of a company in some form of financial partnership with other investors using both debt and outside equity. The Houlihan report addresses these issues in further detail.
i. Operating expertise: The ESOP does not provide any particular access to management resources to improve existing operations. While the existing management team is perceived to be strong is certain areas, a full assessment of leadership requirements for

NewWAPA is well beyond the scope of this Study. Whatever future management needs may be, the ESOP does provide a reward structure but otherwise does not provide any particular external expertise.

j. Future growth: Similarly, the ESOP does not provide any specific means or resources for growth in WAPA's core businesses beyond improving quality of current operations. On the financing side, this includes, for example, funding major capital expansions on the electric side, or exploring expansion of the water business. Again, to the extent that such investments are deemed appropriate, the ESOP does provide a tax-advantaged means to finance the debt incurred, but it does not provide equity capital, nor does it provide expertise to lead future growth initiatives.

6. Conclusion

An ESOP achieves all of the Primary Criteria for a sale of WAPA. Relative to a sale to a conventional off-island investor, the ESOP provides a far better solution with respect to the Primary Criteria. However, the ESOP leaves a number of the Additional Threshold Criteria unanswered. The specifics are simply different from the compromises in selling to a conventional off-island investor: each alternative appears superior in certain respects. The ESOP provides financial and tax benefits, but does not provide either equity capital or outside business expertise for current operations and future growth. Neither the ESOP nor the third-party sale retains the critical Operating Advantages noted above, including the FEMA, GERS, Hovensa, and public bond financing issues.

It is likely that an ESOP, by itself, may not be able to meet all of the criteria needed to effect an ownership transfer. However, the benefits of the ESOP are powerful, and it may be best viewed as one component of an offer including other parties. This possibility is explored in further detail below (see "e. Potential Hybrids").

- **Alternative 4: Sale to a Not-For-Profit Consumer Cooperative Utility**

1. History & Background

During the early efforts to respond to the perceived disadvantages of the SEI offer, a number of USVI residents suggested a different model of utility ownership: the not-for-profit consumer electric cooperative ("Coop"). There are of course many different types of cooperatives serving many different types of needs in the U.S. and around the world. For the purposes of this Study, the word Coop refers specifically to cooperatives in the utility sector.

As defined by the National Rural Electric Cooperative Association (NRECA):

"Electric cooperatives are:

- private independent electric utility businesses,
- owned by the consumers they serve,

- incorporated under the laws of the states in which they operate,
- established to provide at-cost electric service,
- governed by a board of directors elected from the membership, which sets policies and procedures that are implemented by the cooperatives' professional staff

Distribution cooperatives deliver electricity to the consumer. Generation and transmission cooperatives (G&Ts) generate and transmit electricity to distribution co-ops."

(Source: http://nreca.org/nreca/About_Us/Our_Members/Statistics/Statistics)

Coops are extremely common in the U.S., most commonly (but not exclusively) in rural areas where the population density is much lower than in urban areas. As a consequence, the generation, transmission, and/or distribution of electricity is much more expensive. Conventional investor-owned utilities, whose primary purpose is to generate financial returns for their investors, can not serve these areas cost-effectively. Coops have emerged to meet this important need: Coops exist to provide services to their members at cost, not to generate a profit. They also have certain financing and operating advantages that reduce their operating costs. There are Coops in certain urban areas (e.g. New York City) where particular facts and circumstances dictate that a Coop can provide services more effectively than its for-profit counterparts. However, in most urban areas with higher population densities, lower per-customer costs, and sophisticated integration into the larger electric grid, investor-owned and public utilities dominate.

Coops may be particularly advantageous in island environments, where the cost of providing utility service is by its nature substantially higher than in the mainland environment. The primary factor driving costs up is the fact that island electricity producers are not linked to a larger electrical grid and can not balance their loads by relying on the resources of the grid. They require more capacity to meet peak demand and must adjust their equipment to run at different rates resulting in lower production efficiency and higher costs. Other challenges typically include higher fuel costs due to the isolated location of many island communities, and the difficulty of attracting and retaining top quality talent. These are inherent operating inefficiencies that are not a function of poor operations or management, but rather result from the nature of the island environment. This particular discussion is specifically not directed at WAPA per se, but rather is intended to provide a brief framework for why Coops have naturally gained a foothold in island communities. The USVI and WAPA face some of these challenges, and have certain advantages over other island communities in other respects, as discussed further below.

A brief statistical overview of the Coops sector follows, again from NRECA:

"Facts at a glance:

- 865 distribution and 65 G&T cooperatives serve:
    - 37 million people in 47 states.

- 16 million businesses, homes, schools, churches, farms, irrigation systems, and other establishments in 2,500 of 3,100 counties in the U.S. (80% of the nation's counties)
- 12 percent of the nation's population.

To perform their mission, electric cooperatives:

- own assets worth $82 billion,
- own and maintain 2.4 million miles, or 43%, of the nation's electric distribution lines, covering three quarters of the nation's landmass,
- deliver 10 percent of the total kilowatt-hours sold in the U.S. each year,
- generate 5 percent of the total electricity produced in the U.S. each year,
- employ 63,000 people in the United States.
- Co-ops pay more than $707 million in state and local taxes (last year of data)"

(Source: http://nreca.org/nreca/About_Us/Our_Members/Statistics/Statistics)

There are a number of Coops in island communities. A prominent recent example of a conversion of another electric utility to a Coop is on the Hawaiian island of Kaua'i. The formerly private electric utility was converted into a Coop, the Kaua'i Island Utility Cooperative (KIUC, http://www.kiuc.coop), in 2002. This situation was different from WAPA's in that the seller was an investor-owned utility, i.e. it was a for-profit business rather than a governmental entity. Therefore the mechanics of the acquisition are somewhat different from the mechanics by which WAPA may be privatized. More importantly, KIUC has been successful both in purchasing and in operating the utility as a Coop for several years.

Clearly, Coops are a major force in the U.S. market for producing and delivering electricity. But would the natural advantages of cooperative ownership address the needs of the USVI community in considering a sale of WAPA?

2. The Electric Coop Model

Many Coops are "distribution coops," meaning that they do not produce electricity but rather carry it to end users, both residential and business. Other Coops are "generation and transmission coops," (G&Ts), which produce electricity and transmit it to the distribution network. In some cases, several distribution coops band together to form a central G&T coop that can produce power efficiently for distribution to different users through the different distribution coops. In effect, many of these G&T coops, on the mainland, are "cooperatives of cooperatives." In other cases, a single Coop provides all services, generation, transmission, and distribution.

The governance structure of Coops varies, but follows a general pattern. The owners of the Coop, by definition, are its consumers, both business and residential. There may be different

types of members with different types of Board representation. The Board's primary responsibility is to protect the interests of the members, who are the utility's customers. This is profoundly different from both the investor-owned utility model and the governmental ownership model. In a private investor-owned utility, the Board's primary responsibility is to its shareholders. In a government-owned utility, the Board in principle represents the citizens as a whole. In practice, these Boards are often subject to precisely the type of political influence faced by WAPA. As noted above, this is a powerful benefit, to the extent that "political influence" translates into accountability of the utility to the community. As noted, any change in WAPA's ownership requires some means for ensuring accountability to the community. The challenge of government ownership in this regard is that it also creates the mechanism for various forms of interference that may prevent the utility from achieving its optimal performance, and this certainly appears to be the case at WAPA.

In the Coop model, the Board is accountable neither to private shareholders nor to a public political process. It is accountable to its community, because its members are by definition members of the communities that the Coop serves. A Coop is particularly accountable for performance in delivering service to members, rather than profit to investors or other political benefits to the community at large.

This accountability applies not only to ongoing operations, but also to future ownership. Unlike a for-profit utility, or even a government entity, a Coop can not easily be sold to an outside party. (Of course, it is theoretically possible that the Board could determine that the interests of the members would be best served by selling to another party, but this would be very unusual.) In practice, the Coop structure by its nature provides more ownership stability than other ownership forms, so long as the Coop continues to operate successfully. Those who believe that WAPA will inevitably be sold to some other party, at some point in time, may be particularly interested in this stability that is inherent in the Coop form of ownership.

3. Conversion to a Coop

As a not-for-profit organization, a Coop does not have the ability to sell shares to private investors to raise cash. This presents a significant challenge, both in terms of raising capital to purchase WAPA and also for ongoing operating purposes and future expansion efforts. However, Coops have access to unique debt financing programs through the U.S. Department of Agriculture's Rural Utilities Service (RUS) and other programs.

As a result, a conversion to Coop ownership would likely be structured with a significant reliance on low-cost debt capital, rather than equity. In principle, this is very similar to what a private investor with little cash might prefer, i.e. to invest very little of its own cash and borrow virtually all necessary funds. In the private sector, this type of highly leveraged transaction is very difficult to implement, because few lenders are willing to provide such significant debt without investor equity at risk. Furthermore, even if it were possible, this type of transaction would be extremely expensive, because the cost of debt generally rises substantially as the level of debt to equity increases. For both reasons, it is not likely that a private investor would be able to present an offer relying almost exclusively on debt financing.

The Coop is different. The lenders to Coops are specialty lenders who understand the not-for-profit cooperative business model and whose legislative purpose is to assist Coops. This eliminates, at least in principle, both barriers to relying on debt financing. Coops routinely borrow virtually all investment capital, and they do so at rates that are well below market to the extent that the specialty Coop lenders are willing to advance such funds.

Furthermore, unlike other non-governmental utilities, Coops are specifically eligible under applicable US law for coverage through FEMA. This provides a substantial benefit in contrast to all other ownership alternatives, and erases one of the key disadvantages to privatizing WAPA.

In practice, it is impossible to predict with any certainty whether NewWAPA (in this case, a new Coop established to purchase WAPA from the Government) would qualify for some or all of these financing benefits. Under this Study, preliminary conversations with key Coop lenders have indicated that NewWAPA would clearly meet some of the key lending criteria, but a number of challenges remain and could not be resolved until NewWAPA is ready to approach the lenders with a bona fide offer. Furthermore, coverage by FEMA is routinely provided to Coops, and this Study assumes that FEMA would extend coverage to an appropriate structured Coop in this case as well.

4. <u>How Well Does the Coop Meet the Decision Criteria?</u>

How well would a Coop address the key Decision Criteria for a sale of WAPA? A Coop addresses all of the Primary Criteria directly and effectively:

a. It provides the Government with cash. It does not provide the same independent mechanism as the ESOP alternative to establish a fair and public value for the assets and liabilities to be transferred. However, the purchase price would certainly be subject to substantial public review, unlike the proposed SEI deal, and could therefore be reasonably expected to achieve a balance between providing cash to the government while not inappropriately overburdening the new Coop.
b. It maintains ownership of WAPA in the USVI, in the hands of the Coop's constituent members and their elected Board representatives. In fact, this alternatives may provide both the strongest legal control for the USVI community as well as the broadest public sense of community ownership of any of the alternatives. However, the process of defining the Board's membership and selection process will necessarily be a somewhat political process, and may therefore become subject to some of the same political interference that has characterized WAPA under government ownership.
c. It provides a particularly strong opportunity for WAPA to increase service quality and decrease costs. As noted, the Coop community has both a public interest and a strong track record in providing assistance to its member utilities to insure their long-term success. A Coop conversion would open up this new source of technical expertise to WAPA, consistent with experience in other Coop conversions.

The Coop model provides one substantial advantage over all other alternatives to Government ownership:

d. FEMA: Unlike all other alternatives, the Coop does appear to solve the FEMA issue, and NewWAPA would qualify for FEMA coverage in principle. However, the determination of eligibility for FEMA coverage would be made by FEMA itself at a later date and would be subject to the Coop meeting all applicable FEMA criteria. Assuming that this process is successful, as it has been in other utility Coops, this would avoid the challenge of requiring the Government to partner with NewWAPA to maintain ownership of FEMA-covered assets, and therefore gives NewWAPA substantially more flexibility than other alternatives.

However, the Coop model fails to address other Additional Threshold Criteria:

e. GERS: Like the ESOP model, the Coop would not provide a ready ability for employees to retain GERS coverage going forward. Again like the ESOP, it would not necessarily reduce benefits that have already been accrued. The Coop would also fail to address the broader challenges facing GERS. However, the Coop system does provide its own package of sophisticated retirement benefits, which could be put into place at the time of the transaction and would cover NewWAPA employees going forward. A full analysis of the relative merits of the Coop retirement alternatives is beyond the scope of the Study. The point is that the Coop would not address the GERS issues, but it would provide a new package of retirement benefits for NewWAPA.
f. Hovensa: The Coop would not necessarily maintain fuel-purchase terms with Hovensa. As with the ESOP, it is certainly possible for the Government and the Coop together to negotiate with Hovensa to maintain the current contract terms with WAPA's new owner. The fact that the Coop represents broad-based USVI community ownership of the utilities certainly provides some incentive, and again similar to the ESOP, Hovensa would certainly face public pressure not to provide inferior terms that would hurt NewWAPA's ability to serve the community. But once again this is not the same as an assurance that the current terms would be maintained.
g. Current debt and financing for the purchase: The Coop provides specific borrowing tools that are not available to other purchasers. This is an advantage relative to other for-profit investor-owned utilities, and even relative to the ESOP – provided that the debt sources commonly used in other Coops are in fact readily available in this case. Key Coop subsidized lending programs are very attractive, but also generally fall under direct or indirect control of the US Government, and availability is therefore subject to both financial and political considerations. The Coop would also not likely qualify for the debt terms currently available to WAPA as an instrumentality of the government. As with the ESOP, the purchase would need to be carefully structured so as not to result in "defeasance" on WAPA's existing bonds, or else to provide sufficient debt capacity to defease the bonds and provide other needed financing for future capital and growth requirements.
h. Operating cash: The Coop by itself is not a source of cash (though it does provide a particularly attractive borrowing pools, as noted). The transaction would also require working capital sufficient to meet NewWAPA's needs (i.e. cash that would stay in NewWAPA and not be paid to the Government). It is not yet clear whether this could be raised relying strictly on debt capital through the available Coop lending programs, and different Coop experts have provided somewhat different opinions.

5. Conclusion

A Coop achieves all of the Primary Criteria for a sale of WAPA. In addition, it appears to address both the critical FEMA coverage issue and also the issue of access to borrowing for current and future financing requirements – though neither of these benefits can be confirmed at this early stage. However, the Coop does not fully address a number of the Additional Threshold Criteria. In particular, the issues around GERS, Hovensa, and public bond financing would need to be addressed.

It is likely that a Coop, by itself, may be able to meet many but not all of the criteria needed to effect an ownership transfer. Like the ESOP, the benefits of the Coop are powerful, and it too may be best viewed as one component of an offer including other parties. This possibility is explored in further detail below (see "e. Potential Hybrids").

- **Potential Hybrid Alternatives: the Best of All Worlds?**

It is at least possible in principle to combine various aspects of the above alternatives in a way that would address all of the criteria. The potential combination are complex and are well beyond the scope of this Study. However, a few illustrations may be helpful at this stage. These do not constitute recommendations, as all would require substantial further study. Rather, these are simply illustrations of possible concepts that begin to combine the benefits of various alternatives discussed above:

1. Continued Government Ownership of Some WAPA Assets

The Government could retain certain WAPA assets under its direct ownership, or it could participate in the ownership of NewWAPA in some proportion that would be appropriate to maintain several of the key benefits associated with ongoing Government ownership. The goal would be to permit the Government to continue accessing FEMA coverage, to continue to employ WAPA employees for GERS coverage (though it would not address the underlying GERS underfunding challenge), and to continue to negotiate directly with Hovensa to insure favorable fuel pricing. These terms were in fact included in the original SEI proposal. The problem in that case was that such terms were substantially less favorable to the government, and were not originally subject to a public oversight process. However, the concept of ongoing partial Government ownership of WAPA is at least potentially beneficial.

2. Continued Participation of WAPA Employees in GERS

Employees would clearly prefer to retain their perceived GERS benefits. This Study does not offer an opinion about whether such benefits are likely to be paid in the future based on the health of GERS as a standalone entity. Assuming for this discussion that GERS can fulfill its commitments, there are different ways to maintain GERS coverage for current WAPA employees. This could be accomplished as noted above, or through some other political solution that explicitly permits NewWAPA to contribute to GERS and NewWAPA employees to retain GERS coverage going forward. This may require that NewWAPA be structured either as an

organization that is itself eligible for GERS participation, or that the GERS regulations be amended as part of this initiative. This may or may not be advisable as a matter of public policy for the USVI. The point here is that it is at least conceivable that NewWAPA could be structured to permit GERS participation.

3. Partial Sale to Private Investors in Partnership with ESOP or Coop

As noted above, private investors do bring certain powerful benefits. One potential combination would be a sale to employees or to the community in partnership with outside investors, either USVI-based or off-island. The former would provide the USVI private investment community with the opportunity to purchase an ownership interest in WAPA directly. The latter would look more similar to the SEI offer, with strategic and/or purely financial investors providing capital and possible operating expertise in conjunction with a sale to the community. This would provide additional equity capital, both for its own sake, and also to position NewWAPA to secure further debt financing. A strategic partner would also potentially provide access to external utility expertise. Either of these approaches would address important limitations of the ESOP model.

Neither approach would be as useful in the Coop context – provided that the common benefits available in other Coops are in fact made available to a Coop at NewWAPA. In fact, the presence of outside investors could potentially prohibit the Coop from obtaining some of the benefits that cooperative ownership may otherwise provide, depending on the specifics. Therefore, a hybrid combination including outside investors may be less advisable or likely in the event of a Coop conversion.

The external investors' roles and powers would clearly need to be very carefully defined so as to provide the necessary protections for the USVI community while still being sufficiently beneficial to attract and retain the external investment in the first place. This applies to governance of the utilities, to sharing of financial risks and benefits, and also to operating practices, i.e. the need to bring as much operating expertise as possible in-house over time.

4. ESOP & Coop Partnership

It is possible in principle for NewWAPA to be partially owned by an ESOP on behalf of its employees and partially owned by a Coop on behalf of the broader UVSI community. This combination has the strong emotional appeal of providing both a special stake for employees and also grounding NewWAPA ownership in the community as a whole. However, this alternative would require careful coordination of the legal structures to maintain various benefits of each approach, as both the ESOP and Coop models are subject to substantial government regulation and oversight.

Section 6: Conclusion & Next Steps

It is not possible to recommend a specific final alternative for WAPA's ownership and thereby to resolve the utility situation in the USVI without a clear set of public criteria accepted by the Government and the USVI community. In the course of this Feasibility Study, Praxis has interviewed key stakeholders across a broad range of USVI constituencies and has consolidated the concerns expressed by these stakeholders into a proposed list of threshold decision criteria for consideration and approval by the USVI community.

This report then evaluates and compares a number of common ownership alternatives based on these draft criteria, with the understanding that this analysis is provisional, pending formal clarification and adoption of the proposed decision criteria. Key alternatives include: continued Government ownership, sale to an off-island investor, privatization to an employee-owned utility through an ESOP, privatization to a community-owned non-profit utility through a Coop, and several combinations. No single alternative perfectly addresses all of the proposed key criteria, but several appear at face value to be substantially preferable in various respects.

Next steps following submission of this report should include:

1. Public dissemination and discussion of this Report and its Findings and Recommendations.

2. A public process to consider the proposed threshold decision criteria, to modify these as appropriate, and then to formally adopt and publish criteria for evaluating any offer to purchase WAPA or its assets.

3. Formal determination by the Government regarding whether WAPA is currently for sale, subject to offers meeting the public criteria;

4. Solicitation and review of purchase offers through a public process as required by current USVI law and WAPA bylaws.

Virgin Islands Water and Power Authority

MAY 2005

Confidential

Final Report to the WAPA Buyout Committee

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Table of Contents

Overview

Overview

INTRODUCTION

- The Buyout Committee (the "Committee" hereinafter) of the U.S. Virgin Islands Water and Power Authority (the "Company" or "WAPA" hereinafter) has engaged Houlihan Lokey Howard & Zukin Financial Advisors, Inc. ("Houlihan Lokey") to act as its financial advisor to provide certain financial advisory services in connection with a detailed study of the feasibility of altering the utility situation in the U.S. Virgin Islands ("USVI" or the "Virgin Islands").
- We understand that the Committee is reviewing alternative ownership structures for WAPA. We understand that the Committee is comprised of individuals that are employed by WAPA, the Committee is not affiliated with WAPA and the Committee's funding was arranged by the U.S. Department of Interior.
- Our engagement ("Study" hereinafter) consisted of i) a preliminary fair market valuation analysis, ii) a feasibility analysis and iii) an analysis of appropriate capital structure alternatives of the Company that will be utilized by the Committee to analyze alternative ownership structures for WAPA.
- This Study should be read together with the report prepared by Praxis Consulting Group, Inc. ("Praxis") which provides an evaluation and recommendation regarding various ownership alternatives for WAPA.

Overview

INTRODUCTION (CONTINUED)

- This report will address the following:
  - the scope of the engagement;
  - the current state of the Water and Power Authority;
  - the economic overview of the U.S. Virgin Islands;
  - our methodology;
  - our preliminary indications of value; and
  - identification and evaluation of feasible alternative ownership structures for WAPA.

Overview

BACKGROUND

- WAPA, an instrumentality of the Government of the Virgin Islands, operates the island's electric power and distribution facilities (the "Electric System") and water production and distribution facilities (the "Water System").
- In 1997, the Governor of the Virgin Islands initiated certain actions to explore the possibility of selling all or a portion of the Authority and its Electric System and Water System.
- During 1998, 1999, and portions of 2000, the Governor of the Virgin Islands and Southern Energy Virgin Islands, LLC ("SEI"), entered into negotiations regarding the purchase of a controlling stake in WAPA.
- Ultimately the proposal from SEI was declined by the Legislature.
- Shortly thereafter, the Committee was formed to explore strategic alternatives for WAPA ownership.

Overview

SCOPE OF ENGAGEMENT

- In valuing a business enterprise, several different methodologies are generally used (these methodologies will be explained in more detail later) including:
  - Market approach – valuation is implied by trading multiples of comparable public companies and purchase multiples paid in acquisition of comparable companies;
  - Income approach – valuation is implied by discounting to present value future free cash flow generated by a company, and adding to this amount, the present value of the proceeds from the sale of a company in the future; and
  - Replacement cost – valuation implied by the net value of a company's assets.
- In general, these methodologies create an implied enterprise value, from which debt is deducted to derive an equity value.
- For purposes of this report, in valuing WAPA, Houlihan Lokey utilized only the market approach as complete and detailed financial projections were not provided for both Systems.
- Further, for purposes of this report, Houlihan Lokey has analyzed the value of the Company based on its historical financial performance without adjustment. In doing so, no consideration has been given to the affect, if any, on the Company's financial performance resulting from changes in its ownership or capital structure. Additionally, Houlihan Lokey has not taken into consideration the existing underfunded pension liability.
- The preliminary valuation analysis has been performed using financial information available as of June 30, 2003.
- As with any valuation, there are inherent limitations, as valuation does not necessarily address what a motivated buyer may be willing to pay, or the willingness of a buyer to purchase at the implied valuation. For example, Houlihan Lokey valued WAPA on a stand-alone basis and did not factor in synergies that a potential strategic buyer may benefit from or negative synergies that may impact valuation to a potential strategic buyer. Further, valuation conclusions could vary depending on potential strategic alternatives that may be available to the Company but are not considered in this report.

Overview

SCOPE OF ENGAGEMENT (CONTINUED)

- In connection with this valuation, we have made such reviews, analyses and inquiries as we have deemed necessary and appropriate under the circumstances. Among other things, we have:
  - met with certain members of the senior management of the Company to discuss the operations, financial condition, future prospects and projected operations and performance of the Company;
  - visited certain facilities and business offices of the Company;
  - reviewed the Company's audited financial statements for the five fiscal years ended from June 30, 1999 to the period ended June 30, 2003, which the Company's management has identified as being the most current financial statements available;
  - reviewed certain publicly available financial data for certain companies that we deem comparable to the Company; and
  - conducted such other studies, analyses and inquiries as we have deemed appropriate.

Overview

SUMMARY OF VALUE INDICATIONS

Based on the investigation, premises, provisos, and analyses outlined herein, we have estimated, on a preliminary basis, that the enterprise value and equity value of the Electric and Water Systems can be reasonably stated in the ranges as follows:

($ millions)

	Low	High
Electric System		
Enterprise Value	$185.109	$194.184
Equity Value	$16.276	$25.351
Water System		
Enterprise Value	$71.934	$94.506
Equity Value	$37.328	$59.900

WAPA Overview

WAPA Overview

WAPA Overview

- WAPA, established in 1964 as an instrumentality of the Government of the Virgin Islands, was created to develop, utilize, and aid in the development of adequate water and electric power systems for the Virgin Islands.
- WAPA operates both the Electric System and Water System (the "Systems") in the U.S. Virgin Islands.
- The Electric and Water System share dual-purpose plants for the production of electricity and water. However, the Systems are maintained under separate accounts and financial statements.
  - The Systems are separately financed, with the revenue from each System pledged to the repayment of each System's indebtedness.
  - Historically, the majority of long-term capital funding needs for each System has been met through the U.S. municipal tax-exempt bond market.
- The Company's Governing Board consists of nine members:
  - Six governing members are non-governmental members appointed by the Governor of the Virgin Islands, each serving a three-year term; and
  - Three government members serve at the pleasure of the Governor and may be removed from the Governing Board without losing their government positions.

WAPA Overview

WAPA Overview (continued)

- The Company employs approximately 575 employees, of which approximately 492 were assigned to the Electric System. The majority of the employees are represented by one of three labor unions:
  - The Professional and Technical Employees Union ("P&T") represents approximately 51 professional and technical employees;
  - The Virgin Islands Workers Union represents approximately 65 supervisory employees; and
  - The WAPA Employee's Association ("WEA") represents approximately 381 non-supervisory employees.

WAPA Overview

ELECTRIC SYSTEM OVERVIEW

- With the exception of a limited number of large power users, which generate part of all of their energy requirements independently, WAPA is the sole producer, supplier, and distributor of electrical power for the United States Virgin Islands.
- WAPA's Electric System generates, transmits and sells electricity to over 50,000 residential, commercial, and industrial customers, including the Government of the Virgin Islands as well as public street lighting and private outdoor lighting customers.
- The Electric System consists of two principal generating facilities, one on the island of St. Thomas and the other on the island of St. Croix, in addition to a small, back-up generating facility on the island of St. John (St. John is primarily supplied via underwater cable from St. Thomas).
  - The facilities consist of steam, diesel and gas turbine generators with an installed capacity of 261.2 megawatts.
- As with most utilities, WAPA's transmission and distribution facilities are not covered by private insurance, as commercially available insurance at reasonable rates is not available.

WAPA Overview

WATER SYSTEM OVERVIEW

- WAPA's Water System operates and maintains water production and storage facilities, including wells and seawater desalination equipment and distribution facilities that supply a portion of the potable water requirements to approximately 10,000 customers.
  - Total capacity is approximately 8.25 million gallons per day.
  - Most residential and commercial customers connected to the WAPA Water System rely on rainwater collection and cistern storage as their primary water source and use the Water System as a supplemental source of water supply.
- The majority of WAPA's potable water production is achieved by multi-stage flash distillation.

U.S. Virgin Islands

U.S. Virgin Islands

U.S. Virgin Islands Economic Overview[1]

- The U.S. Virgin Islands consist of 70 small islands, islets, and cays located to the east and the northeast of the British Virgin Islands, with a total population of approximately 110,026. St. Thomas is the second most populous Virgin Island behind St. Croix, with approximately 51,822 residents.

- St. Thomas is the most popular cruise ship destination in the world and is the dominant island for tourism in the USVI. St. Thomas and St. John combined accounted for over 91% of visitor arrivals in 2002.

- The Gross Territorial Product ("GTP") of the USVI totaled approximately $2.5 billion in 2002. Tourism is the largest sector of the economy, with expenditures totaling $1.24 billion in 2002.

- In 2002, the Virgin Islands experienced some weakening in tourism, reflecting the general downturn in the U.S. economy and the lingering effects of September 11, 2001. Visitor arrivals totaled 2,336,668 or 6.6% lower than the 2,501,035 count in calendar year 2001.

- Civilian employment peaked in 2001 and decreased from 2001 to 2002 by 2.7%, primarily attributable to the downturn in tourism. Further, the unemployment rate rose sharply in 2002 to 8.7% in 2002 up from 7.1% in 2001. For comparison purposes, the five-year average unemployment rate was 6.7% from 1997 to 2001.

- Over the last decade, the Government of the Virgin Islands has experienced substantial fluctuations in revenues and expenditures, resulting in deficits in year-end balances and the Government continued to experience financial challenges in fiscal year 2003.

[1] *Sources: U.S. Virgin Islands Bureau of Economic Research; CIA World Fact Book 2002; Economy.com.*

U.S. Virgin Islands

U.S. Virgin Islands Economic Overview (continued)

- On April 28, 2003, the Governor announced that the Government was experiencing a severe revenue shortfall, with revenues running approximately 19% below the fiscal year 2002 levels and a projected fiscal year deficit of $115 million.

- As a result, the Government is currently considering a number of expenditure reductions and revenue enhancements to help improve the fiscal conditions.

Valuation Methodologies

Valuation Methodologies

INTRODUCTION

- The fair market value of a business enterprise is defined as being equal to the value of the capital employed in the business or, alternatively, as the earning power of the assets employed in the business enterprise, where such assets include both tangible and intangible assets. The fair market value of a company's equity is derived by deducting the value of interest-bearing liabilities from its enterprise value.

- The fundamental premise on which all investment decisions are based is that value to a potential investor is equal to the present worth of future benefits. This basic concept can be applied to the valuation of an entire company, as well as particular securities comprising the capital structure of that company. In each instance, it is a matter of identifying the future returns to the investor that the company can be reasonably expected to generate and determining their present value in the context of the uncertainty associated with realizing these returns.

- There are two bases on which to determine the value of a company: going-concern and liquidation. In the case of a company expected to continue operating well into the future, the prospective investor will evaluate the risks and expected returns of the investment on a going-concern basis. The primary concern is not with the individual values of enterprise assets, but with their ability to generate the returns expected in the future. Only secondarily is the investor interested in individual asset values, and this from the standpoint of security or collateral for the investment if for any reason the company should choose to liquidate. In such a case, liquidation values for the assets, as well as all costs associated with liquidation, would prevail.

- When determining the value of a business enterprise, there are three general approaches available to the valuation professional: the market approach, the income approach, and the asset approach. These are also commonly referred to as the market capitalization, discounted cash flow, and adjusted book value approaches, respectively. The choice of which approach to use in a particular situation will depend upon the specific facts and circumstances associated with the company, as well as the purpose for which the valuation analysis is being conducted.

Valuation Methodologies

MARKET CAPITALIZATION APPROACH

- The market capitalization approach is a useful method of determining the fair market value of a company that is currently profitable and is expected to remain profitable in the future. It is particularly applicable in the event that the subject company is closely held because it can be used to determine what the company or the particular security would be worth in the public market.

- The approach is one of determining a level of earnings considered to be representative of the future performance of the company, and capitalizing this figure by an appropriate risk-adjusted rate. This approach provides an indication of value for the security corresponding to the particular earnings figure being capitalized (for example, capitalizing net earnings available to common stockholders would yield an indication of value for the common stock). There are several different forms of "earnings" used in the market capitalization approach, because each form isolates particular nuances of the company's operating performance.

- Hence, the various "earnings" figures used throughout this report, which include earnings before interest, taxes, depreciation and amortization ("EBITDA") and earnings before interest and taxes ("EBIT"), are all just variations of the conventional net income figure determined according to generally accepted accounting principles.

- The capitalization rate is an expression of what investors believe to be a fair and reasonable rate of return for the particular security, given the inherent risks of ownership. It incorporates expectations of growth and rests on the implicit assumption that some level of earnings will be generated by the enterprise into perpetuity. The most common means of obtaining capitalization rates is through the market comparison method, whereby companies having their stock traded in the public market are selected for comparison purposes and used as a basis for choosing reasonable capitalization rates for the subject company.

Valuation Methodologies

MARKET CAPITALIZATION APPROACH (CONTINUED)

- Capitalization rates obtained in this manner are generally expressed as ratios of the various earnings figures, and are referred to as "market multiples." Another common method of obtaining such multiples is to examine companies that have recently been sold in the public marketplace. For this method, the total price paid for the company is related to earnings figures yielding implied transaction multiples. The acquired company is then compared with the subject company on the basis of risk and expected return, and its transaction multiples are used as a basis for selecting appropriate multiples for the subject company.

- Market multiples are categorized as either "leveraged" or "debt-free" depending on whether or not the earnings figures being capitalized are net of interest expense. The most common leveraged multiple is the price/earnings ("P/E") ratio, which relates the price paid for the common stock of a company with that company's earnings per share. The multiple is considered to be "leveraged" because earnings per share is net of any interest expense, and capitalization of this figure effectively incorporates the impact of any debt the company has into the final value for the equity. Another leveraged market multiple is the price/cash flow ("P/CF") ratio, where cash flow equals net earnings plus depreciation expense. The P/CF multiple is used primarily in instances where the operating assets of the business, and the resulting depreciation expense, are large relative to total assets, total revenues, and net earnings. This multiple tends to compensate for differences in the depreciation practices of companies, which could result in differing P/E multiples when the P/CF multiples are more comparable. A third form of the leveraged market multiple, which is used in very specific instances, is the price/net book value ("P/NBV") ratio. This form is typically employed for businesses with substantial investments in tangible assets and for which operating earnings provide a reasonable return on investment. Examples of such businesses include banks, savings & loans, and insurance companies, where a majority of the company's assets are financial in nature.

Valuation Methodologies

MARKET CAPITALIZATION APPROACH (CONTINUED)

- Debt-free market multiples relate the value of the company's enterprise value ("EV"), or equity plus debt (net of cash), to earnings figures from which no interest expense has been deducted. The more common debt-free multiples are EV/EBITDA and EV/EBIT. The use of these multiples may be appropriate when comparing companies that have substantially different amounts of financial leverage, because the multiples are based on total company value, which is generally independent of the amount of leverage in the company's capital structure. Their use effectively separates the issue of company valuation from the specific financing decisions made to operate the business. In general, the debt-free methods reduce distortions in P/CF and P/E multiples that might be present due to differences in financial leverage or income taxes among firms. Another debt-free multiple is the enterprise value/revenue ("EV/R") ratio, which may be particularly applicable to professional service organizations, such as accounting, consulting, legal, and architectural/engineering firms.

- Both leveraged and debt-free multiples must be determined by giving consideration to the relative level of value indication intended by any analysis. Multiples derived using prices observed in public markets provide indications of the value of a marketable minority interest in a company. Scaling the prices of comparable publicly traded companies by an appropriate control premium produces multiples that indicate the value of a controlling interest in the subject company. Multiples applied as representative of either a marketable minority interest or a controlling interest yield pricing indications at a commensurate relative level of value.

Valuation Methodologies

DISCOUNTED CASH FLOW APPROACH

- The discounted cash flow ("DCF") approach is another popular method of determining the fair market value of a closely held company. The approach is one of estimating the present value of the projected future cash flows to be generated from the business and theoretically available (though not necessarily paid) to the capital providers of the company. In the DCF approach, the counterpart to the market multiple described above is the discount rate applied to the projected future cash flows to arrive at the present value.

- The discount rate is intended to reflect all risks of ownership and the associated risks of realizing the stream of projected future cash flows. It can also be interpreted as the rate of return that would be required by providers of capital to the company to compensate them for the time value of their money, as well as the risk inherent in the particular investment. Unlike the market multiple, however, the discount rate employed in the DCF approach contains no implicit expectations of growth for the cash flows. Instead, the projected cash flows themselves reveal growth expectations, while allowing for a great deal more flexibility in projecting such growth rates.

- In contrast to the "cash flow" figures used in the market capitalization approach, the figure used in the DCF approach more accurately represents the true cash flow being generated by the operations of the business. In short, it incorporates cash expenditures on working capital and fixed assets, while also recognizing the non-cash expenses contained in earnings figures. The cash flows are typically projected over a limited number of years, which will depend on the planning horizon of the specific firm and other factors related to the particular industry and the general economy. As a result, it is necessary to compute a terminal value as of the end of the last period for which cash flow is projected.

- This terminal value is essentially an estimate of the enterprise value as of that future point in time, and it incorporates the assumptions of perpetual operations and implicit growth found in the market capitalization approach. Discounting each of the projected future cash flows and the terminal value back to the present, and summing the results, yields an indication of value for the enterprise as a whole.

Valuation Methodologies

ADJUSTED BOOK VALUE APPROACH

- The adjusted book value ("ABV") approach also provides meaningful indications of value for a closely held company, although its applicability is generally limited to specific situations in which the market capitalization and DCF approaches are less suitable.

- The ABV approach differs from the market capitalization and DCF approaches in two important ways. First, it focuses on individual asset and liability values from the company's balance sheet, which are adjusted to fair market value. In contrast, the market capitalization and DCF approaches focus on the aggregate returns generated by all the company's assets. Second, the ABV approach can be applied in situations where liquidation is imminent. The market capitalization and DCF approaches have very limited applicability in a liquidation scenario.

- The ABV approach can also be used in going-concern situations to provide an additional indication of value. The approach may be appropriate in instances where the subject company has a heavy investment in tangible assets or where operating earnings are insignificant relative to the value of the underlying assets, such as in real estate holding companies and start-up businesses. Furthermore, the ABV approach may not be the best approach in instances where the company has substantial operating earnings relative to the value of the underlying assets. In such cases, the residual equity value resulting from the ABV approach may not reflect the value inherent in the company's superior cash-generating capability.

Valuation Methodologies

SELECTION OF VALUATION APPROACH

- In our analysis of WAPA, we have taken into consideration the income and cash-generating capability of the Company. Typically, an investor contemplating an investment in a company with income and cash-generating capability similar to WAPA will evaluate the risks and returns of the investment on a going-concern basis. Accordingly, we have considered the going-concern valuation approaches outlined above.

- Since WAPA's management did not provide detailed financial projections for the Electric and Water Systems, we have not utilized the DCF methodology in our preliminary analysis. Instead, we have relied on the various debt-free and leveraged forms of the market capitalization approach in our analysis using latest-twelve months ("LTM") and 3-year historical average multiples.

- Additionally, since the public comparable companies are U.S. companies taxed as U.S. C-Corporations and WAPA is effectively taxed at 10%, in deriving our preliminary value estimates we have included the present value of tax savings associated with operating in the lower tax jurisdiction.

Other Considerations

Other Considerations

General Considerations

Premium for Controlling Interest

Non Operating Assets and Liabilities

General Considerations

The valuation of closely held securities requires consideration of all pertinent factors that would influence the value of securities. These factors are outlined in various guidelines used by appraisers, and include Revenue Ruling 59-60 and the proposed Department of Labor Adequate Consideration Guidelines.

REVENUE RULING 59-60

Revenue Ruling 59-60 has served as a general guideline for the valuation of closely held securities since 1959. Although this Ruling specifically addresses stock valuations for estate and gift tax purposes, the principles set forth may be applied to a wide spectrum of valuation problems, including those related to employee stock ownership plans, stockholder buy/sell agreements, mergers and acquisitions, corporate reorganizations, marital dissolutions, and bankruptcies. Revenue Ruling 59-60 requires the appraiser to consider the following factors:

- The nature and history of the business enterprise
- The economic outlook in general and the condition and outlook of the company's industry in particular.
- The financial condition of the business and the book value of its stock.
- The earnings capacity of the business.
- The dividends paid or the dividend-paying capacity of the business.
- The nature and value of the tangible and intangible assets of the business.
- Prior sales of stock of companies engaged in the same or similar lines of business, having their stocks actively traded in a free and open market.
- Stock restrictions that are binding in nature and impose limitations on transfers of ownership.

Other Considerations

General Considerations

Premium for Controlling Interest

Non Operating Assets and Liabilities

Premium for Controlling Interest

PREMIUM FOR CONTROLLING INTEREST

A control premium is defined as the additional consideration that an investor would pay over a marketable minority equity value in order to own a controlling interest in the common stock of a company. It is usually expressed as a percentage of the marketable minority price per share. Hence, a minority interest discount is the inverse of a control premium, and is usually expressed as a percentage of the pro-rata controlling interest price per share.

Control premiums and minority interest discounts may be applicable to the valuation of a block of common stock, depending upon the percentage of total voting rights represented by the particular block. The owner of a controlling block of stock will generally have the power to:

- Change the corporate bylaws.
- Determine corporate strategy.
- Alter the company's capital structure.
- Influence the company's operations, including discretionary operating expenditures.
- Acquire or divest assets, including nonoperating assets.
- Effect dividends and distributions.
- Appoint and discharge officers.

Owners of minority interests, by themselves, generally do not have these powers or the prestige that comes with control. Consequently, a controlling interest is generally considered to be worth more per share than a minority interest.

Premium for Controlling Interest

PREMIUM FOR CONTROLLING INTEREST/DISCOUNT FOR MINORITY INTEREST (CONTINUED)

The magnitude of a control premium or minority interest discount will often depend on several factors related to the particular company, including:

- The nature and magnitude of nonoperating or extraneous assets held by the company, including excess cash.
- The nature and magnitude of discretionary expenses, including excess/under compensation.
- The degree of financial leverage in the company.
- The overall quality and depth of management and whether they will remain with the company following its sale.
- The nature and magnitude of business opportunities not currently being exploited by incumbent management (e.g., potential streamlining, consolidation of operations, improvements in manufacturing capabilities, inventory reductions, and cash flow improvements).
- Conditions in the financial markets (e.g., availability of capital to finance acquisitions).
- The quality of information regarding the company available to the respective investors (minority vs. control).

A measure of the difference in value between a controlling interest in a company and a minority interest can be found in successful public tender offers where the investor acquired a control position. The market price of the stock prior to the tender offer is related to the higher price at which the transaction closed, resulting in the premium paid for the control position.

Premium for Controlling Interest

PREMIUM FOR CONTROLLING INTEREST/DISCOUNT FOR MINORITY INTEREST (CONTINUED)

However, most of these transactions involve "strategic buyers" who pay higher premiums for particular businesses that offer benefits to the acquirer in the form of "synergies." The definition of "fair market value" upon which our conclusions are based does not allow for the consideration of particular parties to a transaction, such as strategic buyers. Accordingly, the choice of an appropriate control premium for WAPA must consider only what a financial investor would pay, and ignore any benefits that might accrue to an investor purely as a result of operational synergies.

Based upon our analysis of these data and consideration of relevant qualitative factors, we concluded that an appropriate control premium for WAPA was 10.0 percent.

Other Considerations

General Considerations

Premium for Controlling Interest

Non Operating Assets and Liabilities

Non Operating Assets and Liabilities

- Nonoperating assets and liabilities have been treated separately in our analysis because they represent a portion of total firm value not adequately captured in a market capitalization or discounted cash flow valuation approach. The specific nonoperating assets and liabilities that we considered are described below.
  - The Company's nonoperating assets represent tax benefits associated with operating in the U.S. Virgin Islands. The estimated present value of these tax benefits has been treated as a nonoperating asset.
  - For purposes of this report, Houlihan Lokey has not addressed any non-operating liabilities such as the underfunded pension liability.

Valuation Analysis

Valuation Analysis

Electric System Valuation

Water System Valuation

Electric System Valuation

VALUATION SUMMARY

($ millions)

Enterprise Value Indication from Operations

Market Approach	Low		High
Market Multiple Methodology (1)	$177.696	--	$186.771

Results Summary

Enterprise Value from Operations	$177.696	--	$186.771
Nonoperating Assets/Liabilities:			
Add: Cash and Cash Equivalents Balance as of 06/30/03	$4.513	--	$4.513
Add: Nonoperating Assets (2)	$2.900	--	$2.900
Less: Nonoperating Liabilities (3)	$0.000	--	$0.000
Total Nonoperating Assets/Liabilities	$7.413	--	$7.413
Enterprise Value	**$185.109**	**--**	**$194.184**
Less: Total Debt	$168.833	--	$168.833
Less: Preferred Stock	$0.000	--	$0.000
Aggregate Value of Controlling Interests	**$16.276**	**--**	**$25.351**

Footnotes:
(1) Includes a Control Premium of 10.0%.
(2) Figure represents the present value of tax savings associated with operating in the U.S. Virgin Islands.
(3) For purposes of this analysis, we have not taken into consideration any nonoperating liabilities (e.g., underfunded pension obligations).

Electric System Valuation

MARKET MULTIPLE APPROACH

($ millions)

	Representative Level	Selected Multiple Range			Total Debt	Preferred Stock	Indicated Enterprise Value Range		
LTM									
EBITDA	$17.516	6.3 x	--	8.5 x			$110.300	--	$149.220
EBIT	$5.975	10.6 x	--	13.2 x			$63.060	--	$78.820
Net Income	($0.633)	NA	--	NA	$168.833	$0.000	NMF	--	NMF
Cash Flow	$10.908	4.2 x	--	5.7 x	$168.833	$0.000	$214.900	--	$231.160
Total Assets (1)	$306.683	0.7 x	--	1.0 x			$219.700	--	$297.250
Net Book Value	$94.581	1.4 x	--	1.8 x	$168.833	$0.000	$297.170	--	$342.470
3-Year Average									
EBITDA	$18.098	7.6 x	--	10.2 x			$136.840	--	$185.140
EBIT	$8.224	12.8 x	--	17.3 x			$105.440	--	$142.650
Net Income	$0.507	15.9 x	--	21.5 x	$168.833	$0.000	$176.890	--	$179.740
Cash Flow	$10.381	5.0 x	--	6.8 x	$168.833	$0.000	$221.150	--	$239.610
Median							$176.890	--	$185.140
Mean							$171.717	--	$205.118
Selected Enterprise Value Range, on a Minority Interest Basis							**$176.890**	**--**	**$185.140**
Less: Total Interest-Bearing Debt							168.833	--	168.833
Less: Preferred Stock							0.000	--	0.000
Aggregate Value of Minority Interest, as if Marketable							**$8.057**	**--**	**$16.307**
Add: Control Premium @ 10.0%							0.806	--	1.631
Value of Total Equity, on a Controlling Interest Basis							**$8.863**	**--**	**$17.938**
Add: Total Interest-Bearing Debt							168.833	--	168.833
Add: Preferred Stock							0.000	--	0.000
Enterprise Value Range, on a Controlling Interest Basis (2)							**$177.696**	**--**	**$186.771**

Footnotes:

(1) Net of Cash & Cash Equivalents.

(2) The public comparable companies are U.S. companies taxed as U.S. C-Corps., whereas WAPA is effectively taxed at 10%. For valuation, purposes, WAPA is treated as a taxable C-Corp. and the benefits from a lower tax jurisdiction are calculated separately.

Electric System Valuation

MULTIPLE SELECTION

LTM	Range Low	Range High	Mean	Median	Selected Range			Percent of Median		
EBITDA	5.6 x	9.4 x	7.2 x	7.4 x	6.3 x	--	8.5 x	85.0%	--	115.0%
EBIT	8.7 x	14.6 x	11.4 x	10.6 x	10.6 x	--	13.2 x	100.0%	--	125.0%
Net Income	3.5 x	19.5 x	11.7 x	10.9 x	NA	--	NA	NA	--	NA
Cash Flow	1.9 x	10.1 x	5.5 x	5.0 x	4.2 x	--	5.7 x	85.0%	--	115.0%
Total Assets (1)	0.56 x	1.23 x	0.86 x	0.84 x	0.7 x	--	1.0 x	85.0%	--	115.0%
Net Book Value	1.16 x	2.36 x	1.67 x	1.60 x	1.4 x	--	1.8 x	85.0%	--	115.0%
3-Year Average										
EBITDA	5.6 x	11.0 x	8.4 x	8.9 x	7.6 x	--	10.2 x	85.0%	--	115.0%
EBIT	8.2 x	18.2 x	14.5 x	15.1 x	12.8 x	--	17.3 x	85.0%	--	115.0%
Net Income	9.2 x	23.5 x	16.9 x	18.7 x	15.9 x	--	21.5 x	85.0%	--	115.0%
Cash Flow	2.9 x	9.5 x	6.3 x	5.9 x	5.0 x	--	6.8 x	85.0%	--	115.0%

Footnotes:
(1) Net of Cash & Cash Equivalents.

Electric System Valuation

REPRESENTATIVE LEVELS

($ millions)

	3-Year Average	As of June 30, 2001	2002	2003
Reported Revenue	**$119.506**	**$115.957**	**$111.496**	**$131.065**
Less: Operating Expenses		104.852	103.903	125.090
Add: Depreciation and Amortization		8.311	9.768	11.541
Add: Adjustments (1)		0.000	0.000	0.000
Adjusted EBITDA	**$18.098**	**$19.416**	**$17.362**	**$17.516**
Less: Depreciation and Amortization	9.873	8.311	9.768	11.541
Adjusted EBIT	**$8.224**	**$11.105**	**$7.593**	**$5.975**
Less: Interest Expense, net	7.257	7.749	7.357	7.030
Adjusted Pre-tax Income		$3.356	$0.236	($1.055)
Less: Taxes @ 40.0%		1.342	0.094	(0.422)
Adjusted Net Income	**$0.507**	**$2.014**	**$0.141**	**($0.633)**
Add: Depreciation and Amortization		8.311	9.768	11.541
Adjusted Cash Flow	**$10.381**	**$10.324**	**$9.910**	**$10.908**
Net Book Value (tangible)	**$91.686**	**$88.343**	**$92.134**	**$94.581**
Total Assets (2)	**$259.751**	**$234.939**	**$237.631**	**$306.683**

Footnotes:

(1) Adjustments:

Operating One-Time Charges/(Gains)	$0.000	$0.000	$0.000
Non-Operating Recurring Expenses/(Income)	0.000	0.000	0.000
Other Adjustments	0.000	0.000	0.000
Total Adjustments	**$0.000**	**$0.000**	**$0.000**

(2) Net of Cash & Cash Equivalents.

Electric System Valuation

COMPARABLE COMPANY MULTIPLES

	Price / Earnings		Price / Book Value	Price / Cash Flow		EV / Total Assets (1)	EV / EBITDA		EV / EBIT	
	LTM	3-Year Average	LTM	LTM	3-Year Average	LTM	LTM	3-Year Average	LTM	3-Year Average
Cap Rock Energy Corporation	3.5 x	9.2 x	2.0 x	1.9 x	2.9 x	1.03 x	7.2 x	9.9 x	10.8 x	18.2 x
Empire District Electric Co.	11.0 x	23.5 x	1.5 x	6.6 x	9.5 x	0.97 x	7.8 x	11.0 x	10.3 x	16.9 x
Green Mountain Power Corporation	10.7 x	17.2 x	1.3 x	4.4 x	4.7 x	0.72 x	5.9 x	6.3 x	10.3 x	13.5 x
Maine & Maritimes Corporation	9.6 x	9.7 x	1.2 x	5.0 x	5.3 x	0.65 x	5.6 x	5.6 x	8.7 x	8.2 x
MGE Energy, Inc.	19.5 x	20.2 x	2.4 x	10.1 x	9.0 x	1.23 x	9.4 x	8.9 x	13.7 x	14.6 x
Unitil Corporation	15.9 x	21.8 x	1.7 x	5.0 x	6.5 x	0.56 x	7.7 x	8.9 x	14.6 x	15.5 x
Low	3.5 x	9.2 x	1.2 x	1.9 x	2.9 x	0.56 x	5.6 x	5.6 x	8.7 x	8.2 x
High	19.5 x	23.5 x	2.4 x	10.1 x	9.5 x	1.23 x	9.4 x	11.0 x	14.6 x	18.2 x
Median	10.9 x	18.7 x	1.6 x	5.0 x	5.9 x	0.84 x	7.4 x	8.9 x	10.6 x	15.1 x
Mean	11.7 x	16.9 x	1.7 x	5.5 x	6.3 x	0.86 x	7.2 x	8.4 x	11.4 x	14.5 x

Footnotes:
* Excluded from the Range.
Source: Compustat.
NA - Not Available.
NMF - Not Meaningful Figure.
LTM - Latest Twelve Months.
EV - Enterprise Value.
EBIT - Earnings Before Interest and Taxes.
EBITDA - Earnings Before Interest, Taxes, Depreciation and Amortization.
(1) Net of cash and cash equivalents.

Electric System Valuation

RISK RANKINGS

Size (Revenue, millions)	
MGE Energy, Inc.	$386.0
Empire District Electric Co.	$348.8
Green Mountain Power Corporat	$278.0
Unitil Corporation	$213.0
WAPA Electric System	**$131.1**
Cap Rock Energy Corporation	$79.8
Maine & Maritimes Corporation	$44.0

Size (Enterprise Value, millions)	
Empire District Electric Co.	$980.5
MGE Energy, Inc.	$791.5
Unitil Corporation	$273.4
Green Mountain Power Corporat	$220.3
Cap Rock Energy Corporation	$207.3
Maine & Maritimes Corporation	$84.9

Historical Growth (2-Year Revenue)	
Empire District Electric Co.	8.1%
WAPA Electric System	**6.3%**
MGE Energy, Inc.	3.5%
Cap Rock Energy Corporation	1.5%
Unitil Corporation	1.5%
Green Mountain Power Corpora	-0.5%
Maine & Maritimes Corporation	-24.9%

Historical Growth (1-Year Revenue)	
Cap Rock Energy Corporation	40.5%
WAPA Electric System	**17.6%**
Empire District Electric Co.	15.1%
MGE Energy, Inc.	4.0%
Green Mountain Power Corpora	-3.1%
Unitil Corporation	-9.0%
Maine & Maritimes Corporation	-11.3%

Projected Growth (1-Year Revenue)	
Cap Rock Energy Corporation	4.0%
Empire District Electric Co.	*NA*
Green Mountain Power Corpora	*NA*
Maine & Maritimes Corporation	*NA*
MGE Energy, Inc.	*NA*
Unitil Corporation	*NA*
WAPA Electric System	*NA*

Historical Growth (2-Year EBITDA)	
Green Mountain Power Corporat	23.0%
Cap Rock Energy Corporation	15.2%
Maine & Maritimes Corporation	9.6%
Empire District Electric Co.	5.9%
Unitil Corporation	4.3%
MGE Energy, Inc.	-2.9%
WAPA Electric System	**-5.0%**

Historical Growth (1-Year EBITDA)	
Cap Rock Energy Corporation	38.1%
Empire District Electric Co.	26.3%
Maine & Maritimes Corporation	9.2%
Unitil Corporation	5.4%
MGE Energy, Inc.	2.0%
WAPA Electric System	**0.9%**
Green Mountain Power Corporat	-7.1%

Projected Growth (1-Year EBITDA)	
Green Mountain Power Corpora	*NA*
Maine & Maritimes Corporation	*NA*
MGE Energy, Inc.	*NA*
Unitil Corporation	*NA*
WAPA Electric System	*NA*
Empire District Electric Co.	13.2%
Cap Rock Energy Corporation	-20.1%

Projected Growth (5-Year EPS)	
Empire District Electric Co.	10.0%
Cap Rock Energy Corporation	N/A
Green Mountain Power Corpora	N/A
Maine & Maritimes Corporation	N/A
MGE Energy, Inc.	N/A
Unitil Corporation	N/A
WAPA Electric System	N/A

Profitability (EBIT to Revenue)	
Empire District Electric Co.	27.4%
Cap Rock Energy Corporation	24.0%
Maine & Maritimes Corporation	22.2%
MGE Energy, Inc.	15.0%
Unitil Corporation	8.8%
Green Mountain Power Corpora	7.7%
WAPA Electric System	**4.6%**

Profitability (EBITDA to Revenue)	
Cap Rock Energy Corporation	36.3%
Empire District Electric Co.	36.1%
Maine & Maritimes Corporation	34.4%
MGE Energy, Inc.	21.9%
Unitil Corporation	16.8%
Green Mountain Power Corporat	13.5%
WAPA Electric System	**13.4%**

Relative Depreciation (Depreciation to EBITDA)	
WAPA Electric System	**65.9%**
Unitil Corporation	47.7%
Green Mountain Power Corporat	42.9%
Maine & Maritimes Corporation	35.5%
Cap Rock Energy Corporation	33.9%
MGE Energy, Inc.	31.5%
Empire District Electric Co.	24.1%

Internal Investment (Capital Expenditures to Revenue)	
MGE Energy, Inc.	27.4%
Empire District Electric Co.	25.3%
WAPA Electric System	**14.3%**
Maine & Maritimes Corporation	12.6%
Unitil Corporation	11.1%
Green Mountain Power Corpora	6.7%
Cap Rock Energy Corporation	2.7%

Liquidity (Current Ratio)	
Maine & Maritimes Corporation	1.1
WAPA Electric System	**1.1**
Cap Rock Energy Corporation	1.0
MGE Energy, Inc.	0.9
Green Mountain Power Corpora	0.9
Empire District Electric Co.	0.8
Unitil Corporation	0.6

Leverage (Debt to EV)	
MGE Energy, Inc.	30.1%
Maine & Maritimes Corporation	39.0%
Green Mountain Power Corpora	45.9%
Empire District Electric Co.	49.3%
Unitil Corporation	54.8%
Cap Rock Energy Corporation	85.4%

Electric System Valuation

OPERATING PERFORMANCE PARAMETERS

($ millions)

	LTM Operating Indications					LTM Margins				2-Year Compound Annual Growth Rates			
	Revenue	Adjusted EBITDA	Adjusted EBIT	Adjusted Net Income	Adjusted Cash Flow	Adjusted EBITDA	Adjusted EBIT	Adjusted Net Income	Adjusted Cash Flow	Revenue	Adjusted EBITDA	Adjusted EBIT	Adjusted Net Income
Cap Rock Energy Corporation	$79.8	$29.0	$19.2	$11.5	$21.4	36.3%	24.0%	14.5%	26.8%	1.5%	15.2%	39.8%	*NMF*
Empire District Electric Co.	$348.8	$125.8	$95.5	$45.4	$75.8	36.1%	27.4%	13.0%	21.7%	8.1%	5.9%	10.6%	5.4%
Green Mountain Power Corporation	$278.0	$37.5	$21.4	$11.3	$27.4	13.5%	7.7%	4.1%	9.9%	-0.5%	23.0%	115.0%	*NMF*
Maine & Maritimes Corporation	$44.0	$15.1	$9.8	$5.7	$11.1	34.4%	22.2%	13.0%	25.3%	-24.9%	9.6%	4.9%	11.1%
MGE Energy, Inc.	$386.0	$84.3	$57.8	$29.0	$55.5	21.9%	15.0%	7.5%	14.4%	3.5%	-2.9%	2.3%	3.3%
Unitil Corporation	$213.0	$35.7	$18.7	$7.8	$24.8	16.8%	8.8%	3.6%	11.6%	1.5%	4.3%	-1.0%	-1.2%
Low	$44.0	$15.1	$9.8	$5.7	$11.1	13.5%	7.7%	3.6%	9.9%	-24.9%	-2.9%	-1.0%	-1.2%
High	$386.0	$125.8	$95.5	$45.4	$75.8	36.3%	27.4%	14.5%	26.8%	8.1%	23.0%	115.0%	11.1%
Median	$245.5	$36.6	$20.3	$11.4	$26.1	28.1%	18.6%	10.3%	18.1%	1.5%	7.8%	7.8%	4.3%
Mean	$224.9	$54.6	$37.0	$18.5	$36.0	26.5%	17.5%	9.3%	18.3%	-1.8%	9.2%	28.6%	4.7%
WAPA Electric System	$131.1	$17.5	$6.0	($0.6)	$10.9	13.4%	4.6%	-0.5%	8.3%	6.3%	-5.0%	-26.6%	*NMF*

Footnotes:
* Excluded from the Range.
Source: Compustat.
NA - Not Available.
NMF - Not Meaningful Figure.
LTM - Latest Twelve Months.
EBIT - Earnings Before Interest and Taxes.
EBITDA - Earnings Before Interest, Taxes, Depreciation and Amortization.
DFNI - Debt Free Net Income
DFCF - Debt Free Cash Flow

Electric System Valuation

BALANCE SHEET STATISTICS

($ millions)

	Total Assets	EBIT ROA	Net Income ROE	Current Ratio	Quick Ratio	Inventory Turnover	A/R Days	A/P Days	Net Working Capital	Other LT Liab/EV	Leverage: Debt/ EBITDA	Leverage: Debt/ Total Assets	Leverage: Debt/ Equity	Leverage: Interest Coverage (2)
Cap Rock Energy Corporation	$210.944	9.0%	121.3%	1.0	0.5	18.1	28.3	20.9	$21.325	2.0%	6.1 x	83.9%	8.8 x	4.9 x
Empire District Electric Co.	$1,017.499	9.9%	14.1%	0.8	0.2	7.0	24.1	51.3	$40.825	15.9%	3.8 x	47.5%	1.5 x	*NMF*
Green Mountain Power Corporation	$308.983	6.8%	11.3%	0.9	0.5	55.9	20.9	8.7	$2.394	39.8%	2.7 x	32.7%	1.1 x	5.6 x
Maine & Maritimes Corporation	$133.615	7.1%	12.5%	1.1	0.9	47.6	35.8	80.8	$0.926	57.2%	2.2 x	24.8%	0.7 x	164.4 x
MGE Energy, Inc.	$652.503	9.6%	12.4%	0.9	0.4	9.2	26.3	37.6	$32.059	16.6%	2.8 x	36.5%	1.0 x	6.9 x
Unitil Corporation	$488.130	4.4%	9.2%	0.6	0.3	64.2	28.8	36.3	$12.041	85.9%	4.2 x	30.7%	2.0 x	4.9 x
Low	$133.615	4.4%	9.2%	0.6	0.2	7.0	20.9	8.7	$0.926	2.0%	2.2 x	24.8%	0.7 x	4.9 x
High	$1,017.499	9.9%	121.3%	1.1	0.9	64.2	35.8	80.8	$40.825	85.9%	6.1 x	83.9%	8.8 x	164.4 x
Median	$398.556	8.1%	12.5%	0.9	0.4	32.8	27.3	37.0	$16.683	28.2%	3.3 x	34.6%	1.3 x	5.6 x
Mean	$468.612	7.8%	30.1%	0.9	0.5	33.6	27.4	39.3	$18.262	36.2%	3.6 x	42.7%	2.5 x	37.3 x
WAPA Electric System	$311.196	1.9%	-0.7%	1.1	0.5	*NA* (3)	*NA* (3)	*NA* (3)	$5.459	*NA*	9.6 x	54.3%	1.8 x	2.5 x

Footnotes:
* Excluded from the Range.
Source: Compustat.
NA - Not Available.
NMF - Not Meaningful Figure.
EV - Enterprise Value.
MVE - Market Value of Equity.
EBIT - Earnings Before Interest and Taxes.
EBITDA - Earnings Before Interest, Taxes, Depreciation and Amortization.
ROA - Return on Assets.
ROE - Return on Equity.
A/R - Accounts Receivable.
A/P - Accounts Payable.
(1) Represents Total Interest-Bearing Debt to Market Value of Equity.
(2) Represents EBITDA to Net Interest Expense.
(3) Figure not calculated since identification of expenses specific to cost of sales was not provided.

Valuation Analysis

Electric System Valuation

Water System Valuation

Water System Valuation

VALUATION SUMMARY

($ millions)

Enterprise Value Indication from Operations

Market Approach	Low		High
Market Multiple Methodology (1)	$60.801	--	$83.373

Results Summary

Enterprise Value from Operations	$60.801	--	$83.373
Nonoperating Assets/Liabilities:			
Add: Cash and Cash Equivalents Balance as of 06/30/03	$8.332	--	$8.332
Add: Nonoperating Assets (2)	$2.800	--	$2.800
Less: Nonoperating Liabilities (3)	$0.000	--	$0.000
Total Nonoperating Assets/Liabilities	$11.132	--	$11.132
Enterprise Value	**$71.934**	**--**	**$94.506**
Less: Total Debt	$34.605	--	$34.605
Less: Preferred Stock	$0.000	--	$0.000
Aggregate Value of Controlling Interests	**$37.328**	**--**	**$59.900**

Footnotes:
(1) Includes a Control Premium of 10.0%.
(2) Figure represents the present value of tax savings associated with operating in the U.S. Virgin Islands.
(3) For purposes of this analysis, we have not taken into consideration any nonoperating liabilities (e.g., underfunded pension obligations).

Water System Valuation

MARKET MULTIPLE APPROACH

($ millions)

	Representative Level	Selected Multiple Range			Total Debt	Preferred Stock	Indicated Enterprise Value Range		
LTM									
EBITDA	$5.699	10.3 x	--	13.9 x			$58.480	--	$79.120
EBIT	$3.177	13.5 x	--	18.3 x			$42.970	--	$58.130
Net Income	$0.365	20.4 x	--	27.6 x	$34.605	$0.000	$42.040	--	$44.660
Cash Flow	$2.887	11.3 x	--	15.4 x	$34.605	$0.000	$67.360	--	$78.920
Total Assets (1)	$71.894	0.8 x	--	1.1 x			$58.360	--	$78.960
Net Book Value	$36.748	1.9 x	--	2.6 x	$34.605	$0.000	$105.230	--	$130.150
3-Year Average									
EBITDA	$6.039	11.0 x	--	14.9 x			$66.550	--	$90.030
EBIT	$3.580	15.5 x	--	20.9 x			$55.340	--	$74.880
Net Income	$0.573	21.8 x	--	29.5 x	$34.605	$0.000	$47.100	--	$51.510
Cash Flow	$3.031	10.9 x	--	14.8 x	$34.605	$0.000	$67.760	--	$79.460
Median							$58.420	--	$78.940
Mean							$61.119	--	$76.582
Selected Enterprise Value Range, on a Minority Interest Basis							**$58.420**	**--**	**$78.940**
Less: Total Interest-Bearing Debt							34.605	--	34.605
Less: Preferred Stock							0.000	--	0.000
Aggregate Value of Minority Interest, as if Marketable							**$23.815**	**--**	**$44.335**
Add: Control Premium @ 10.0%							2.381	--	4.433
Value of Total Equity, on a Controlling Interest Basis							**$26.196**	**--**	**$48.768**
Add: Total Interest-Bearing Debt							34.605	--	34.605
Add: Preferred Stock							0.000	--	0.000
Enterprise Value Range, on a Controlling Interest Basis (2)							**$60.801**	**--**	**$83.373**

Footnotes:
(1) Net of Cash & Cash Equivalents.
(2) The public comparable companies are U.S. companies taxed as U.S. C-Corps., whereas WAPA is effectively taxed at 10%. For valuation, purposes, WAPA is treated as a taxable C-Corp. and the benefits from a lower tax jurisdiction are calculated separately.

Water System Valuation

REPRESENTATIVE LEVELS

($ millions)

	3-Year Average	As of June 30, 2001	2002	2003
Reported Revenue	**$27.137**	**$28.906**	**$25.832**	**$26.672**
Less: Operating Expenses		24.984	22.190	23.495
Add: Depreciation and Amortization		2.385	2.468	2.522
Add: Adjustments (1)		0.000	0.000	0.000
Adjusted EBITDA	**$6.039**	**$6.307**	**$6.110**	**$5.699**
Less: Depreciation and Amortization	2.458	2.385	2.468	2.522
Adjusted EBIT	**$3.580**	**$3.922**	**$3.642**	**$3.177**
Less: Interest Expense, net	2.626	2.681	2.627	2.569
Adjusted Pre-tax Income		$1.241	$1.015	$0.608
Less: Taxes @ 40.0%		0.496	0.406	0.243
Adjusted Net Income	**$0.573**	**$0.745**	**$0.609**	**$0.365**
Add: Depreciation and Amortization		2.385	2.468	2.522
Adjusted Cash Flow	**$3.031**	**$3.129**	**$3.076**	**$2.887**
Net Book Value (tangible)	**$34.855**	**$32.414**	**$35.405**	**$36.748**
Total Assets (2)	**$75.509**	**$82.531**	**$72.103**	**$71.894**

Footnotes:

(1) Adjustments:

Operating One-Time Charges/(Gains)	$0.000	$0.000	$0.000
Non-Operating Recurring Expenses/(Income)	0.000	0.000	0.000
Other Adjustments	0.000	0.000	0.000
Total Adjustments	**$0.000**	**$0.000**	**$0.000**

(2) Net of Cash & Cash Equivalents.

Water System Valuation

COMPARABLE PUBLIC COMPANY MULTIPLES

	Price / Earnings		Price / Book Value	Price / Cash Flow		EV / Total Assets (1)	EV / EBITDA		EV / EBIT	
	LTM	3-Year Average	LTM	LTM	3-Year Average	LTM	LTM	3-Year Average	LTM	3-Year Average
American States Water Co.	22.4 x	18.6 x	1.8 x	10.6 x	10.1 x	0.95 x	9.7 x	9.2 x	13.9 x	12.3 x
Artesian Resources	24.0 x	33.9 x	2.1 x	13.9 x	18.0 x	0.96 x	11.4 x	14.4 x	14.6 x	18.8 x
California Water Service	36.6 x	28.2 x	2.4 x	13.5 x	12.9 x	0.92 x	13.6 x	13.0 x	21.8 x	19.3 x
Connecticut Water Service, Inc.	25.4 x	25.9 x	2.9 x	15.3 x	16.2 x	1.11 x	14.5 x	13.8 x	20.3 x	18.2 x
Consolidated Water Co., Inc.	39.0 x	43.4 x	6.7 x	25.7 x	28.8 x	2.64 x	30.8 x	38.6 x	46.7 x	NMF
Middlesex Water Co.	22.3 x	25.7 x	2.1 x	13.3 x	14.3 x	1.05 x	12.2 x	13.0 x	15.9 x	17.4 x
Pennichuck Corporation	18.4 x	18.9 x	2.3 x	10.5 x	10.3 x	1.03 x	9.5 x	8.2 x	13.3 x	11.1 x
Southwest Water Co.	28.1 x	25.2 x	2.6 x	11.8 x	12.0 x	0.79 x	12.1 x	12.8 x	19.2 x	19.5 x
Low	18.4 x	18.6 x	1.8 x	10.5 x	10.1 x	0.79 x	9.5 x	8.2 x	13.3 x	11.1 x
High	39.0 x	43.4 x	6.7 x	15.3 x	18.0 x	2.64 x	14.5 x	14.4 x	21.8 x	19.5 x
Median	24.7 x	25.8 x	2.3 x	13.3 x	12.9 x	0.99 x	12.1 x	13.0 x	15.9 x	18.2 x
Mean	27.0 x	27.5 x	2.9 x	12.7 x	13.4 x	1.18 x	11.9 x	12.1 x	17.0 x	16.7 x

Footnotes:
* Excluded from the Range.
Source: Compustat.
NA - Not Available.
NMF - Not Meaningful Figure.
LTM - Latest Twelve Months.
EV - Enterprise Value.
EBIT - Earnings Before Interest and Taxes.
EBITDA - Earnings Before Interest, Taxes, Depreciation and Amortization.
(1) Net of cash and cash equivalents.

Water System Valuation

RISK RANKINGS

Size (Revenue, millions)	
California Water Service	$261.7
American States Water Co.	$210.4
Southwest Water Co.	$147.5
Middlesex Water Co.	$63.2
Connecticut Water Service, Inc.	$46.6
Artesian Resources	$36.2
WAPA Water System	**$26.7**
Pennichuck Corporation	$21.6
Consolidated Water Co., Inc.	$14.2

Size (Enterprise Value, millions)	
California Water Service	$788.8
American States Water Co.	$615.7
Connecticut Water Service, Inc.	$294.9
Middlesex Water Co.	$256.4
Southwest Water Co.	$218.0
Artesian Resources	$177.8
Consolidated Water Co., Inc.	$135.0
Pennichuck Corporation	$94.3

Historical Growth (2-Year Revenue)	
Artesian Resources	12.1%
Southwest Water Co.	11.7%
Consolidated Water Co., Inc.	11.5%
American States Water Co.	6.6%
Middlesex Water Co.	6.6%
California Water Service	3.7%
Connecticut Water Service, Inc.	2.1%
Pennichuck Corporation	-0.5%
WAPA Water System	**-3.9%**

Historical Growth (1-Year Revenue)	
Southwest Water Co.	13.2%
Artesian Resources	8.2%
Consolidated Water Co., Inc.	8.0%
California Water Service	6.6%
American States Water Co.	5.9%
Middlesex Water Co.	3.8%
WAPA Water System	**3.3%**
Pennichuck Corporation	2.9%
Connecticut Water Service, Inc.	1.0%

Projected Growth (1-Year Revenue)	
American States Water Co.	*NA*
Artesian Resources	*NA*
California Water Service	*NA*
Connecticut Water Service, Inc.	*NA*
Consolidated Water Co., Inc.	*NA*
Middlesex Water Co.	*NA*
Pennichuck Corporation	*NA*
Southwest Water Co.	*NA*
WAPA Water System	*NA*

Historical Growth (2-Year EBITDA)	
Artesian Resources	17.2%
Consolidated Water Co., Inc.	10.4%
Middlesex Water Co.	10.3%
American States Water Co.	4.8%
Southwest Water Co.	2.6%
Connecticut Water Service, Inc.	1.3%
California Water Service	0.8%
WAPA Water System	**-4.9%**
Pennichuck Corporation	-8.3%

Historical Growth (1-Year EBITDA)	
California Water Service	18.5%
Artesian Resources	14.5%
Consolidated Water Co., Inc.	4.1%
Middlesex Water Co.	3.9%
Connecticut Water Service, Inc.	2.7%
American States Water Co.	-1.6%
Southwest Water Co.	-3.6%
WAPA Water System	**-6.7%**
Pennichuck Corporation	-10.1%

Projected Growth (1-Year EBITDA)	
California Water Service	25.6%
Artesian Resources	16.9%
American States Water Co.	-4.0%
Connecticut Water Service, Inc.	*NA*
Consolidated Water Co., Inc.	*NA*
Middlesex Water Co.	*NA*
Pennichuck Corporation	*NA*
Southwest Water Co.	*NA*
WAPA Water System	*NA*

Projected Growth (5-Year EPS)	
Consolidated Water Co., Inc.	12.0%
Artesian Resources	8.0%
Middlesex Water Co.	7.0%
Southwest Water Co.	7.0%
American States Water Co.	3.0%
California Water Service	3.0%
Connecticut Water Service, Inc.	3.0%
Pennichuck Corporation	N/A
WAPA Water System	**N/A**

Profitability (EBIT to Revenue)	
Artesian Resources	33.6%
Pennichuck Corporation	32.8%
Connecticut Water Service, Inc.	31.3%
Middlesex Water Co.	25.5%
American States Water Co.	21.1%
Consolidated Water Co., Inc.	20.4%
California Water Service	13.8%
WAPA Water System	**11.9%**
Southwest Water Co.	7.7%

Profitability (EBITDA to Revenue)	
Pennichuck Corporation	45.7%
Connecticut Water Service, Inc.	43.6%
Artesian Resources	42.9%
Middlesex Water Co.	33.4%
Consolidated Water Co., Inc.	30.9%
American States Water Co.	30.2%
California Water Service	22.1%
WAPA Water System	**21.4%**
Southwest Water Co.	12.2%

Relative Depreciation (Depreciation to EBITDA)	
WAPA Water System	**44.3%**
California Water Service	37.4%
Southwest Water Co.	37.1%
Consolidated Water Co., Inc.	34.0%
American States Water Co.	30.1%
Connecticut Water Service, Inc.	28.4%
Pennichuck Corporation	28.3%
Middlesex Water Co.	23.6%
Artesian Resources	21.6%

Internal Investment (Capital Expenditures to Revenue)	
Artesian Resources	44.0%
California Water Service	38.9%
Connecticut Water Service, Inc.	31.3%
Pennichuck Corporation	30.4%
Middlesex Water Co.	25.0%
American States Water Co.	17.8%
Southwest Water Co.	17.3%
Consolidated Water Co., Inc.	16.6%
WAPA Water System	**3.8%**

Liquidity (Current Ratio)	
WAPA Water System	**2.3**
Pennichuck Corporation	1.6
Southwest Water Co.	1.2
Middlesex Water Co.	0.9
Consolidated Water Co., Inc.	0.9
Connecticut Water Service, Inc.	0.7
American States Water Co.	0.7
Artesian Resources	0.7
California Water Service	0.4

Leverage (Debt to EV)	
Consolidated Water Co., Inc.	20.2%
Connecticut Water Service, Inc.	25.4%
Pennichuck Corporation	29.0%
Southwest Water Co.	38.2%
American States Water Co.	38.2%
Artesian Resources	38.3%
Middlesex Water Co.	38.4%
California Water Service	40.8%

Water System Valuation

Operating Performance Parameters

($ millions)

	LTM Operating Indications					LTM Margins				2-Year Compound Annual Growth Rates			
	Revenue	Adjusted EBITDA	Adjusted EBIT	Adjusted Net Income	Adjusted Cash Flow	Adjusted EBITDA	Adjusted EBIT	Adjusted Net Income	Adjusted Cash Flow	Revenue	Adjusted EBITDA	Adjusted EBIT	Adjusted Net Income
American States Water Co.	$210.4	$63.5	$44.4	$17.0	$36.1	30.2%	21.1%	8.1%	17.2%	6.6%	4.8%	3.3%	0.9%
Artesian Resources	$36.2	$15.5	$12.2	$4.6	$8.0	42.9%	33.6%	12.8%	22.0%	12.1%	17.2%	18.5%	31.4%
California Water Service	$261.7	$57.8	$36.2	$12.7	$34.3	22.1%	13.8%	4.8%	13.1%	3.7%	0.8%	-2.1%	-7.0%
Connecticut Water Service, Inc.	$46.6	$20.3	$14.6	$8.7	$14.4	43.6%	31.3%	18.6%	31.0%	2.1%	1.3%	0.2%	3.9%
Consolidated Water Co., Inc.	$14.2	$4.4	$2.9	$2.9	$4.4	30.9%	20.4%	20.1%	30.6%	11.5%	10.4%	8.0%	3.5%
Middlesex Water Co.	$63.2	$21.1	$16.1	$7.4	$12.3	33.4%	25.5%	11.7%	19.5%	6.6%	10.3%	14.0%	22.0%
Pennichuck Corporation	$21.6	$9.9	$7.1	$3.7	$6.5	45.7%	32.8%	17.1%	30.0%	-0.5%	-8.3%	-8.9%	-2.4%
Southwest Water Co.	$147.5	$18.1	$11.4	$4.8	$11.5	12.2%	7.7%	3.3%	7.8%	11.7%	2.6%	-1.2%	11.4%
Low	$14.2	$4.4	$2.9	$2.9	$4.4	12.2%	7.7%	3.3%	7.8%	-0.5%	-8.3%	-8.9%	-7.0%
High	$261.7	$63.5	$44.4	$17.0	$36.1	45.7%	33.6%	20.1%	31.0%	12.1%	17.2%	18.5%	31.4%
Median	$54.9	$19.2	$13.4	$6.1	$11.9	32.1%	23.3%	12.2%	20.8%	6.6%	3.7%	1.8%	3.7%
Mean	$100.2	$26.3	$18.1	$7.7	$15.9	32.6%	23.3%	12.1%	21.4%	6.7%	4.9%	4.0%	8.0%
WAPA Water System	$26.7	$5.7	$3.2	$0.4	$2.9	21.4%	11.9%	1.4%	10.8%	-3.9%	-4.9%	-10.0%	-30.0%

Footnotes:
* Excluded from the Range.
Source: Compustat.
NA - Not Available.
NMF - Not Meaningful Figure.
LTM - Latest Twelve Months.
EBIT - Earnings Before Interest and Taxes.
EBITDA - Earnings Before Interest, Taxes, Depreciation and Amortization.
DFNI - Debt Free Net Income.
DFCF - Debt Free Cash Flow.

Water System Valuation

BALANCE SHEET STATISTICS

($ millions)

	Total Assets	EBIT ROA	Net Income ROE	Current Ratio	Quick Ratio	Inventory Turnover	A/R Days	A/P Days	Net Working Capital	Other LT Liab/EV	Leverage: Debt/ EBITDA	Leverage: Debt/ Total Assets	Leverage: Debt/ Equity	Interest Coverage (2)
American States Water Co.	$650.122	6.6%	8.3%	0.7	0.2	72.8	18.7	50.4	($2.229)	27.0%	3.7 x	36.2%	1.1 x	3.5 x
Artesian Resources	$187.104	6.7%	9.0%	0.7	0.3	30.0	24.5	72.7	($0.297)	33.1%	4.4 x	36.4%	1.3 x	3.4 x
California Water Service	$855.264	4.5%	7.3%	0.4	0.3	46.3	39.5	81.4	($13.769)	34.7%	5.6 x	37.6%	1.7 x	3.2 x
Connecticut Water Service, Inc.	$265.582	5.8%	11.4%	0.7	0.4	28.4	38.7	56.6	$5.481	35.6%	3.7 x	28.2%	0.9 x	4.5 x
Consolidated Water Co., Inc.	$55.215	7.2%	12.4%	0.9	0.5	11.9	48.5	61.5	$4.088	0.1%	6.2 x	49.4%	1.1 x	9.4 x
Middlesex Water Co.	$251.153	6.6%	9.7%	0.9	0.6	27.6	35.8	38.4	($9.977)	18.2%	4.7 x	39.3%	1.3 x	4.1 x
Pennichuck Corporation	$92.425	7.9%	10.2%	1.6	1.2	20.7	38.2	23.5	$1.549	33.9%	2.8 x	29.6%	0.9 x	5.0 x
Southwest Water Co.	$276.672	4.5%	7.3%	1.2	0.8	*NMF*	44.2	9.2	$11.844	42.1%	4.6 x	30.1%	1.1 x	4.2 x
Low	$55.215	4.5%	7.3%	0.4	0.2	11.9	18.7	9.2	($13.769)	0.1%	2.8 x	28.2%	0.9 x	3.2 x
High	$855.264	7.9%	12.4%	1.6	1.2	72.8	48.5	81.4	$11.844	42.1%	6.2 x	49.4%	1.7 x	9.4 x
Median	$258.367	6.6%	9.4%	0.8	0.5	28.4	38.5	53.5	$0.626	33.5%	4.5 x	36.3%	1.1 x	4.1 x
Mean	$329.192	6.2%	9.5%	0.9	0.5	33.9	36.0	49.2	($0.414)	28.1%	4.5 x	35.8%	1.2 x	4.7 x
WAPA Water System	$80.226	4.0%	1.0%	2.3	1.8	*NA* (3)	*NA* (3)	*NA* (3)	$3.449	*NA*	6.1 x	43.1%	0.9 x	2.2 x

Footnotes:
* Excluded from the Range.
Source: Compustat.
NA - Not Available.
NMF - Not Meaningful Figure.
EV - Enterprise Value.
MVE - Market Value of Equity.
EBIT - Earnings Before Interest and Taxes.
EBITDA - Earnings Before Interest, Taxes, Depreciation and Amortization.
ROA - Return on Assets.
ROE - Return on Equity.
A/R - Accounts Receivable.
A/P - Accounts Payable.
(1) Represents Total Interest-Bearing Debt to Market Value of Equity.
(2) Represents EBITDA to Net Interest Expense.
(3) Figure not calculated since identification of expenses specific to cost of sales was not provided.

Feasibility of Alternative Ownership Structure

Feasibility of Alternative Ownership Structure

Overview of Key Issues

Strategic Alternatives

Overview of Key Issues

INTRODUCTION

- In assessing the feasibility of an alternative ownership structure for WAPA, WAPA's constituents should consider the following key issues and the impacts on the projected financial performance and capital structure of the Company under the various potential ownership structures:
  - FEMA / Insurance Coverage;
  - Regulation / Rates;
  - Outstanding Revenue Bonds;
  - Pension Obligation / Expense and funding status of pension plan;
  - Government Receivables;
  - Taxes; and
  - Access to Capital.
- A summary of these key issues is presented on the following pages.

Overview of Key Issues

FEMA / Insurance Coverage

- Tasked with responding to, planning for, recovering from and mitigating disasters, the Federal Emergency Management Agency ("FEMA") is an independent agency of the federal government, reporting to the President of the United States. The agency became part of the new Department of Homeland Security in March 2003.
- FEMA's Public Assistance Program provides supplemental Federal disaster grant assistance for the repair, replacement, or restoration of disaster-damaged, publicly owned facilities and the facilities of certain Non-Profit organizations.
  - Eligible Private Non-profit Facilities ("PNP") must be open to the public and perform essential services of a governmental nature and include utilities, such as water, sewer, and electrical power systems.
- FEMA historically has provided grants for 90% or more of the restoration cost necessary for WAPA's distribution system and 90% of the deductible portion of other insured property losses in the event of declared disasters.
- Privately held, investor-owned companies are not eligible for FEMA coverage.
- The risks and costs of an ownership structure without FEMA coverage should be evaluated in assessing the merits of the potential ownership structures.

Overview of Key Issues

REGULATION / RATES

- Pursuant to the General Resolution, WAPA has covenanted, among other things, to establish rates and charges for electric service in each fiscal year so as to provide net electric revenues in amounts at least sufficient to pay 1.25 times the annual Aggregate Debt Service Requirement for each fiscal year on all revenue bonds outstanding.
  - The Public Service Commission ("PSC") has regulatory jurisdiction and authority to approve, modify, or deny any changes to WAPA's rates and charges.
- On April 2, 3003, the PSC confirmed its support for a Debt Service ratio equal to at least 1.75 times the Aggregate Debt Service Requirement.
- It is possible that under certain of the various potential ownership structures, the capital structure as well as the interest rate on any debt would be different than currently exists. As such, it is possible that the Debt Service Requirement could be different than currently exists.
- Therefore, the impact, if any, on established rates should be analyzed for each of the various potential ownership structures.

Overview of Key Issues

OUTSTANDING BONDS

- In evaluating the Company's strategic ownership alternatives, WAPA's existing indebtedness would also need to be considered. A privately held, investor-owned utility could not assume the outstanding revenue bonds. Rather, such an entity would require adequate capital or access to the capital markets in order to defease the outstanding revenue bonds.
- Electric Bonds
  - As of June 30, 2003, the outstanding principal on the Electric System revenue bonds was $163.5 million.
- Water System Bonds
  - As of June 30, 2003, the outstanding principal on the Water System revenue bonds was $34.6 million.

Overview of Key Issues

Pension Obligation / Expense and Pension Benefits

- WAPA employees' pension benefits are part of the Government Employee Retirement System ("GERS").
  - Per law, WAPA employees contribute 10% of pre-tax compensation to GERS.
  - Per law, WAPA contributes 14.5% of pre-tax compensation to GERS.
- GERS is extremely under-funded (by more than $700 million as of 2001).
- In evaluating the strategic alternatives, WAPA employees' continuing participation in GERS, their level of contributions to and benefits within GERS must be considered.
- Any contemplated ownership structure that requires WAPA employees to withdraw from GERS and participate in a new retirement plan may have a significant impact on the viability of GERS. Therefore, any alternative must consider the impact on GERS.

Overview of Key Issues

GOVERNMENT RECEIVABLES

- The Government of the U.S. Virgin Islands represents a significant customer of WAPA.
- As of June 30, 2003, accounts receivable due from the Government amounted $7.5 million and $5.4 million for the Electric and Water Systems, respectively. Combined, these amounts account for over 48% of total accounts receivable.
- A portion of these amounts were in arrears at the time of this analysis.

Overview of Key Issues

TAXES

- WAPA is required to make a payment in lieu of taxes ("PILOT") to the Government equal to 10% of the Company's combined net revenue (defined by WAPA as net income less other expenses, including debt service expenses) or $500,000, whichever is greater.
- As a privately held, investor-owned utility, WAPA might become a taxable entity.
- However, the USVI government offers various tax incentives to promote industrial and economic development in the Virgin Islands. As described by the Virgin Islands Department of Commerce, ten-year exemptions up to 90% of the corporate income tax and 100% exemption from property, gross receipts and excise taxes are available to qualified corporate investors.
  - The industrial legislation permits a 90% income tax reduction, resulting in a maximum tax rate of less than 4% on income for approved operations.
  - To qualify for tax incentives, investors must invest at least $50,000, exclusive of inventory, in an eligible business and employ at least 10 Virgin Island residents full-time.
- Under a subchapter-S corporation or a qualified cooperative, WAPA would not be a taxable entity.
- Therefore, the tax structure for WAPA under each of potential ownership structures must be analyzed and the impact, if any, on the value of WAPA understood.

Overview of Key Issues

FINANCING / RAISING CAPITAL

- Access to the capital markets may be required for defeasance of the outstanding revenue bonds.
- Furthermore, in addition to internally generated funds, access to the capital markets may be required periodically to fund capital improvement projects.
- Therefore, access to the capital markets should be evaluated under each of potential ownership structures.

Feasibility of Alternative Ownership Structure

Overview of Key Issues

Strategic Alternatives

Strategic Alternatives

INTRODUCTION

- Various strategic alternatives include, but are not limited to, the following:
  - **Maintain Status Quo:** Maintain current operating strategies, capital structure and ownership structure.
  - **Refinancing / Recapitalization:** Incur borrowings (senior debt or a combination of senior and subordinated debt) and/or raise equity to fund growth and capital improvements.
  - **Sale (or Merger) of the Company:**
    - Strategic investor: Sale /partnership of a company, in whole or in part, to an industry player or company in related industry.
    - Financial investor: Sale/partnership of a company, in whole or in part, to a financial (non-synergistic) investor or an Employee Stock Ownership Plan.
    - Cooperative: Sale of a company to a qualified Cooperative.

Strategic Alternatives

STRATEGIC ALTERNATIVE 1 - STATUS QUO

Advantages

- Least disruptive alternative.
- Retention of control by a USVI entity.
- Maintains current levels of employment.

Disadvantages

- Does not achieve financial goals (e.g., Government financing requirements, GERS, etc.).
- Requires significant commitment of management and Board to effectively execute strategy (e.g., improve reliability, reduce rates, generate profit, fund retirement obligations).
- Limited financial flexibility.

Strategic Alternatives

STRATEGIC ALTERNATIVE 2 – REFINANCING / RECAPITALIZATION

Advantages

- Retention of control by a USVI entity.
- Maintains current levels of employment.
- May provide adequate capital to fund operating and capital improvement requirements.

Disadvantages

- Does not achieve financial goals (e.g., Government financing requirements, GERS, etc.).
- Capital markets may not provide sufficient capital to pursue operational objectives (e.g., improve reliability, reduce rates, generate profit, fund retirement obligations).
- May only be a stop-gap solution until another strategic alternative would need to be pursued.
- Financing can be expensive and dilutive.

Strategic Alternatives

STRATEGIC ALTERNATIVE 3 – SALE TO STRATEGIC BUYER

Advantages

- May provide maximum valuation for the Company.
- Profit motivation may result in increased system reliability and lower rates through increased efficiency.

Disadvantages

- Loss of control, loss of governance on island.
- Potentially disruptive to employee base, customers and/or operations.
- Financial flexibility may be limited due to increased leverage
- Loss of FEMA coverage.
- Company's location, financial performance and condition limits the potential universe of strategic buyers.
- Transaction most likely structured as an asset deal due to underfunded pension liability. Liability would most likely remain an obligation of the government.

Strategic Alternatives

STRATEGIC ALTERNATIVE 4 – SALE TO FINANCIAL BUYER

Advantages

- Opportunity for management to maintain a large measure of operational control.
- Opportunity for government to participate in the future of the Company if a partial sale is considered.
- Profit motivation may result in increased system reliability and lower rates through increased efficiency.

Disadvantages

- New owners may exercise operational influence absent industry experience.
- Potential loss of control, loss of governance on island
- Financial flexibility may be limited due to increased leverage.
- Loss of FEMA coverage.
- Company's financial performance and condition limits the potential universe of financial buyers.
- Transaction most likely structured as an asset deal due to underfunded pension liability. Liability would most likely remain an obligation of the government.

Strategic Alternatives

STRATEGIC ALTERNATIVE 5 – SALE TO ESOP

Advantages

- Tax advantages to ESOP may increase sale price.
- Ability to complete partial sale of the Company's equity to the ESOP and sell additional equity to the ESOP in future transactions. Potential for government to retain certain level of ownership and participate in future of the business.
- Maintains local control, local governance.
- Employees gain incentive based on Company performance.

Disadvantages

- ESOPs are financial buyers and may not pay as much as a strategic buyer.
- Transaction size is limited by the Company's debt capacity.
- Loss of FEMA coverage.
- Does not address GERS financing goals. Liability would most likely remain an obligation of the government.

Strategic Alternatives

STRATEGIC ALTERNATIVE 6 – SALE TO COOPERATIVE

Advantages

- Cooperative may provide industry experience and best practices.
- Maintains local control, local governance on the island.
- Maintains FEMA coverage.
- Non-Profit motivation may result in increased system reliability and lower rates.

Disadvantages

- Financial flexibility will be limited due to increased leverage.
- Transaction value likely to be less than that realized in a strategic sale.
- Does not address GERS financing goals. Liability would most likely remain an obligation of the government.

Strategic Alternatives

STRATEGIC ALTERNATIVES SCORECARD

Strategic Alternatives Scorecard

Strategic Alternatives	On-Island Governance Maintained	Addresses GERS Issues	Provides Adequate Insurance Coverage	Provides Operational Flexibility	Provides Financial Flexibility	Impact on Core Business
Status Quo	●	◑	●	◑	◑	◑
Refinancing / Recapitalization	●	◑	●	◑	○	◑
Sale to Strategic Buyer	○	◑	○	◑	○	◑
Sale to Financial Buyer	○	◑	○	◑	○	◑
Sale to ESOP	●	◑	○	◑	○	◑
Sale to Cooperative	●	◑	●	◑	◑	●

Positive: ● **Neutral:** ◑ **Negative:** ○

Summary

Summary

- Based on the analyses outlined herein, we have estimated, on a preliminary basis, that the enterprise values of the Electric and Water Systems are approximately $190.0 million and $80.0 million, respectively.
- Various feasible alternative ownership structures have been identified and evaluated.
- Evaluation of the various alternatives by WAPA's constituents should consider the key issued discussed herein as well other criteria outlined by the Praxis Consulting Group, Inc. which provided its own report under separate cover.

Appendices

Appendices

Electric System Historical Financial Statements
Water System Historical Financial Statements
Comparable Electric Company Synopses
Comparable Water Company Synopses
Overview of Houlihan Lokey

Electric System Historical Financial Statements

COMPARATIVE BALANCE SHEET: ASSETS

Fiscal Year Ended, June 30	1999	2000	2001	2002	2003 (1)
Capital Assets:					
Utility Plant in Service	$256,858,184	$249,905,804	$269,714,624	$317,244,885	$321,347,245
Less: Accumulated Depreciation	(116,258,872)	(110,160,242)	(120,835,303)	(132,968,087)	(146,630,916)
Property-related gains, net	(27,734,672)	(25,304,081)	(23,003,955)	(20,601,410)	(20,548,328)
Net Utility Plant in Service	112,864,640	114,441,481	125,875,366	163,675,388	154,168,001
Construction in Progress	17,747,008	34,936,242	34,820,237	6,702,659	16,085,965
Net Capital Assets	130,611,648	149,377,723	160,695,603	170,378,047	170,253,966
Current Assets:					
Cash & Cash Equivalents	5,336,278	8,232,688	14,542,624	12,603,360	4,513,048
Accounts Receivable:					
Customers & Other, Net	7,903,149	9,831,877	11,002,815	14,667,205	11,383,746
Virgin Islands Government, Net	13,818,999	11,826,659	12,576,226	5,998,490	7,483,752
Due (to) from Water System	0	2,040,487	2,903,804	1,688,463	0
Deferred Fuel	1,005,531	12,033,215	11,263,873	756,861	9,932,899
Inventories					
Fuel Oil	1,743,840	4,176,658	4,037,943	3,538,144	6,031,697
Materials & Supplies	10,930,211	10,197,061	9,643,489	10,103,792	11,071,788
Prepayments and Other Current Assets	1,700,050	1,104,628	878,607	1,379,038	1,431,685
Total Current Assets	42,438,058	59,443,273	66,849,381	50,735,353	51,848,615
Restricted Assets:					
Cash	35,809,015	18,476,978	13,289,105	6,755,478	1,247,123
Investments	145,440	0	6,096,000	20,023,705	2,764,115
Accrued Interest Receivable	0	0	274,068	138,873	50,205
Subtotal	35,954,455	18,476,978	19,659,173	26,918,056	79,457,010
Unamortized Debt Issue Costs / Deferred Charges	2,426,938	2,352,242	2,277,494	2,202,747	6,967,606
Unamortized Regulated Assets					2,668,945
Total Noncurrent Assets	38,381,393	20,829,220	21,936,667	29,120,803	89,093,561
Total Assets	$211,431,099	$229,650,216	$249,481,651	$250,234,203	$311,196,142

Footnote:
(1) Unaudited figures.

Electric System Historical Financial Statements

COMPARATIVE BALANCE SHEET: LIABILITIES

Fiscal Year Ended, June 30	1999	2000	2001	2002	2003 (1)
Net Assets:					
Invested in Capital Assets, Net of Related Debt			$54,954,601	$65,275,309	$66,937,066
Restricted			4,832,934	13,977,752	17,404,256
Unrestricted			28,555,030	12,881,200	10,239,231
Total Net Assets	65,356,736	74,902,865	88,342,565	92,134,261	94,580,553
Long-Term Debt	101,902,159	107,835,702	106,844,245	92,162,788	163,533,057
Current Liabilities:					
Accounts Payable	5,575,839	9,038,484	5,143,871	3,577,086	10,665,330
Accrued Liabilities	13,588,899	9,940,647	12,950,622	13,856,657	15,274,602
Lines of Credit	0	0	6,750,000	18,000,000	0
Deferred Fuel	0	0	0	0	0
Customer Deposits	13,062,624	13,815,343	14,899,858	15,120,410	15,936,514
Other	565,396	0	0	0	0
Due to F.E.M.A.	5,300,000	5,300,000	5,300,000	5,300,000	5,300,000
Total Current Liabilities	38,092,758	38,094,474	45,044,351	55,854,153	47,176,446
Current Liabilities Payable from Restricted Assets:					
Current Installments of Bonds Payable	3,140,000	3,580,000	3,755,000	3,945,000	4,140,000
Accrued Interest Payable	2,939,446	2,952,760	2,783,220	2,755,758	2,657,133
Insurance Surcharge Reserve	0	2,284,415	2,712,270	3,382,243	0
Subtotal	6,079,446	8,817,175	9,250,490	10,083,001	6,797,133
Total Liabilities	146,074,363	154,747,351	161,139,086	158,099,942	217,506,636
Total Liabilities & Net Assets	$211,431,099	$229,650,216	$249,481,651	$250,234,203	$312,087,189

Footnote:
(1) Unaudited figures.

Electric System Historical Financial Statements

COMPARATIVE INCOME STATEMENT

	1999	2000	2001	2002	2003 (1)
Kilowatt Hours Sold	645,903	648,195	678,948	712,516	727,689
Electric Revenues:					
Residential	$26,048,929	$26,908,636	$27,137,460	$27,739,966	$27,381,817
Commercial	15,442,303	15,768,460	16,437,430	16,485,637	15,958,185
Large Power	30,140,019	30,911,402	32,487,832	36,302,166	33,332,985
Street Lighting	1,850,078	1,870,066	1,853,528	1,859,439	2,140,154
Waste Heat Recovery Boiler Surcharge	1,291,795	1,296,620	1,357,890	1,390,897	1,443,507
Payment in Lieu of Taxes	0	0	0	0	739,626
Fuel Escalator (Levelized Energy Adj. Clause)	(74,962)	17,416,094	31,475,136	22,540,240	45,518,591
Emergency Surcharge	1,351,100	1,377,551	1,442,772	1,480,626	1,138,316
Self-Insurance Surcharge	1,280,370	1,304,532	1,366,429	1,403,170	1,436,418
Asbestos Surcharge	576,331	587,753	615,440	631,581	53,229
Other	1,093,597	1,414,268	1,782,965	1,662,403	1,922,272
Total	$78,999,560	$98,855,382	$115,956,882	$111,496,125	$131,065,100
Operating Expenses:					
Fuel	31,825,265	52,756,434	69,080,538	59,206,131	74,514,761
Operating	4,344,938	3,218,202	3,119,669	4,700,443	6,197,055
Maintenance	10,008,681	12,758,572	11,920,945	12,372,062	14,079,189
Subtotal Other	14,353,619	16,109,176	15,040,614	17,072,505	20,276,244
Allocated to Water System	(5,020,918)	(7,752,256)	(9,175,272)	(5,723,283)	(6,022,637)
Total Production Expenses	41,157,966	61,113,354	74,945,880	70,555,353	88,768,368
Operating	3,398,018	3,419,795	3,456,622	3,351,186	4,691,613
Maintenance	2,592,216	2,387,848	2,656,989	2,859,955	3,057,489
Distribution Expenses	5,990,234	5,807,643	6,718,532	6,211,141	7,749,102
Customer Service	3,739,258	3,699,221	3,887,503	3,977,324	4,146,254
Administrative & General Expenses	11,791,178	10,443,220	10,989,427	13,390,789	12,884,940
Costs Recovered from Emergency Surcharge	0	0	0	0	0
Total Operating Expenses	62,678,636	81,063,438	96,541,342	94,134,607	113,548,664
Earnings before Depreciation & Amort.	16,320,924	17,791,944	19,415,540	17,361,518	17,516,436

Footnote:
(1) Unaudited figures.

Electric System Historical Financial Statements

COMPARATIVE INCOME STATEMENT (CONTINUED)

	1999	2000	2001	2002	2003 (1)
Earnings before Depreciation & Amort.	16,320,924	17,791,944	19,415,540	17,361,518	17,516,436
Depreciation	9,018,856	7,920,355	8,310,669	9,768,392	11,298,438
Amortization of Regulated Assets					242,631
Operating Income	7,302,068	9,871,589	11,104,871	7,593,126	5,975,367
Interest Expense	(7,256,881)	(6,981,775)	(7,748,788)	(7,357,396)	(7,030,256)
Investment Earnings	2,080,570	1,530,933	1,235,570	941,478	698,530
Allow. for Borrowed Funds Used During Construction	41,322	358,378	577,139	621,008	0
Total Other Revenue (Expense)	(5,134,989)	(5,092,464)	(5,936,079)	(5,794,910)	(6,331,726)
Net Operating Income	$2,167,079	$4,779,125	$5,168,792	$1,798,216	($356,359)
Payment in Lieu of Taxes					35,630
Capital Grants	492,602	400,823	8,270,909	1,993,479	177,332
Special Items					1,698,578
Increase in Net Assets	$2,659,681	$5,179,948	$13,439,701	$3,791,695	$1,555,181

Footnote:
(1) Unaudited figures.

Appendices

Electric System Historical Financial Statements

Water System Historical Financial Statements

Comparable Electric Company Synopses

Comparable Water Company Synopses

Overview of Houlihan Lokey

Water System Historical Financial Statements

COMPARATIVE BALANCE SHEET: ASSETS

Fiscal Year Ended, June 30	1999	2000	2001	2002	2003 (1)
Capital Assets:					
Utility Plant in Service	$81,519,521	$82,007,278	$87,723,097	$88,670,820	$89,296,153
Less: Accumulated Depreciation	(32,008,565)	(34,317,452)	(36,745,343)	(39,256,055)	(41,821,558)
Property-related gains, net	(479,395)	(436,244)	(393,093)	(349,942)	(306,791)
Net Utility Plant in Service	49,031,561	47,253,582	50,584,661	49,064,823	47,167,804
Construction in Progress	1,533,647	4,397,872	2,975,169	2,360,128	2,893,461
Net Capital Assets	50,565,208	51,651,454	53,559,830	51,424,951	50,061,265
Current Assets:					
Cash & Cash Equivalents	785,703	5,078,135	3,486,041	14,637,692	8,332,136
Accounts Receivable:					
Customers & Other, Net	2,906,965	3,119,284	3,358,417	2,457,244	2,229,803
Virgin Islands Government, Net	15,022,999	10,794,578	14,019,889	7,690,767	5,350,070
Deferred Fuel	0	2,277,679	1,216,417	0	1,575,271
Inventories					
Water	257,478	258,240	381,607	401,327	166,404
Fuel Oil					
Materials & Supplies	464,943	523,744	501,783	449,565	408,920
Prepayments and Other Current Assets	596,301	56,953	98,248	129,764	2,591,570
Total Current Assets	20,034,389	22,108,613	23,062,402	25,766,359	20,654,174
Restricted Assets:					
Cash	6,184,211	5,449,734	5,611,369	1,291,678	
Investments	2,617,657	2,949,213	2,660,000	7,209,771	
Accrued Interest Receivable		0	88,195	56,498	
Subtotal	8,801,868	8,398,947	8,359,564	8,557,947	8,585,498
Unamortized Debt Issue Costs / Deferred Charges	1,121,887	1,078,400	1,034,914	991,428	925,332
Unamortized Regulated Assets					
Total Noncurrent Assets	9,923,755	9,477,347	9,394,478	9,549,375	9,510,830
Total Assets	$80,523,352	$83,237,414	$86,016,710	$86,740,685	$80,226,269

Footnote:
(1) Unaudited figures.

Water System Historical Financial Statements

COMPARATIVE BALANCE SHEET: LIABILITIES

Fiscal Year Ended, June 30	1999	2000	2001	2002	2003 (1)
Net Assets:					
Invested in Capital Assets, Net of Related Debt			$9,960,290	$12,580,046	
Restricted			7,271,071	7,510,454	
Unrestricted			15,182,328	15,314,489	
Total Net Assets	24,500,204	29,507,614	32,413,689	35,404,989	36,747,593
Long-Term Debt	49,308,557	43,330,527	42,244,454	36,111,333	34,605,259
Current Liabilities:					
Accounts Payable	1,586,389	2,130,490	1,915,393	2,439,986	2,515,626
Accrued Liabilities	3,818,262	3,526,785	3,060,877	2,929,596	3,470,643
Lines of Credit	0	0	750,000	2,000,000	0
Deferred Fuel	79,892	0	0	1,993,825	0
Due to Electric System	0	2,040,487	2,903,804	1,688,463	0
Other	0	0	0	1,400,000	2,887,150
Due to F.E.M.A.	0	0	0	0	0
Total Current Liabilities	5,484,543	7,697,762	8,630,074	12,451,870	8,873,419
Current Liabilities Payable from Restricted Assets:					
Current Installments of Bonds Payable	0	1,565,000	1,640,000	1,725,000	0
Accrued Interest Payable	1,230,048	1,136,511	1,088,493	1,047,493	0
Insurance Surcharge Reserve	0	0	0	0	0
Subtotal	1,230,048	2,701,511	2,728,493	2,772,493	0
Total Liabilities	56,023,148	53,729,800	53,603,021	51,335,696	43,478,678
Total Liabilities & Net Assets	$80,523,352	$83,237,414	$86,016,710	$86,740,685	$80,226,271

Footnote:
(1) Unaudited figures.

Water System Historical Financial Statements

COMPARATIVE INCOME STATEMENT

	1999	2000	2001	2002	2003 (1)
Operating Revenues:					
Water sales to customers	$13,243,949	$12,873,595	$13,457,198	$12,517,505	$23,545,460
Water sales to Virgin Island Government	12,326,342	13,569,159	12,752,695	11,558,389	0
Payment in Lieu of Taxes	0	0	0	0	1,721,199
Fuel Escalator (Levelized Energy Adj. Clause)	(540,000)	2,277,679	2,696,093	1,756,107	1,271,520
Other	0	0	0	0	133,806
Total	25,030,291	28,720,433	28,905,986	$25,832,001	$26,671,985
Operating Expenses:					
Production cost of water distributed	9,550,647	12,991,907	13,835,532	10,417,781	
Operations and maintenance	4,409,058	4,678,915	4,726,715	5,689,791	
Customer service	1,134,914	1,051,440	1,101,019	1,054,926	
Administrative and general	3,961,665	2,430,121	2,935,943	2,559,755	
Total Operating Expenses	19,056,284	21,152,383	22,599,209	19,722,253	20,972,876
Earnings before Depreciation & Amort.	5,974,007	7,568,050	6,306,777	6,109,748	5,699,109
Depreciation	2,411,538	1,680,086	2,384,684	2,467,562	2,522,351
Operating Income	3,562,469	5,887,964	3,922,093	3,642,186	3,176,758
Interest Expense	(3,080,154)	(2,668,547)	(2,680,989)	(2,627,476)	(2,569,045)
Investment Earnings	652,796	510,457	548,372	371,614	344,805
Allow. for Borrowed Funds Used During Construction	82,661	4,867	80,885	0	0
Total Other Revenue (Expense)	(2,344,697)	(2,153,223)	(2,051,732)	(2,255,862)	(2,224,240)
Net Operating Income	1,217,772	3,734,741	1,870,361	$1,386,324	$952,518
Payment in Lieu of Taxes	0	0	0	0	(95,252)
Capital Grants	0	0	1,035,769	1,604,976	485,339
Special Items	0	0	0	0	0
Increase in Net Assets	$1,217,772	$3,734,741	$2,906,130	$2,991,300	$1,342,605

Footnote:
(1) Unaudited figures.

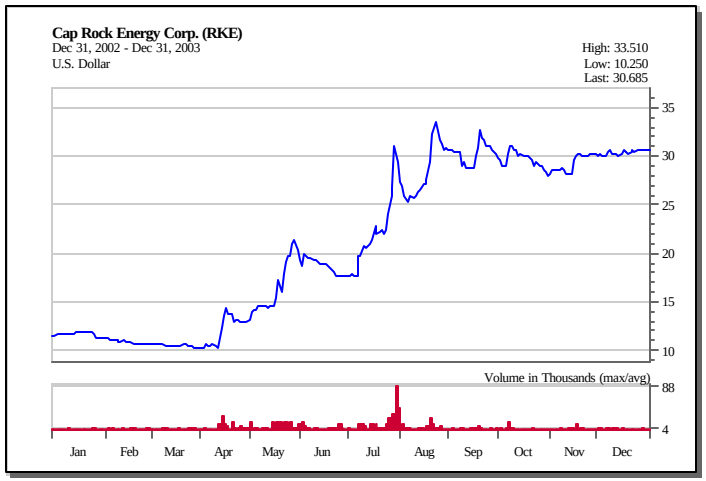
Appendices

Electric System Historical Financial Statements
Water System Historical Financial Statements
Comparable Electric Company Synopses
Comparable Water Company Synopses
Overview of Houlihan Lokey

Comparable Electric Company Synopses

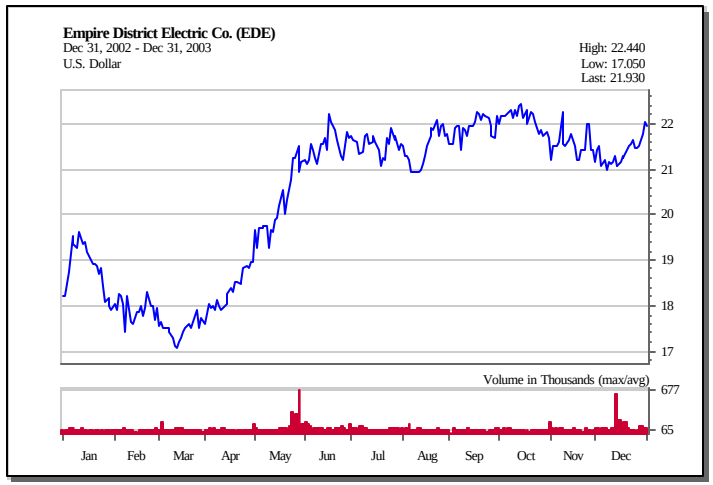
Cap Rock Energy Corporation

Cap Rock Energy Corporation is an electric distribution company operating in various non-contiguous areas in the State of Texas. The company provides service to over 35,000 meters in 28 counties in Texas. Its customers are located in the Midland-Stanton area of West Texas, the Central Texas area around Brady and in Northeast Texas in Hunt, Collin and Fannin Counties. It also provides management services to the Farmersville Municipal Electric System, which services nearly 1,700 meters in Farmersville, Texas.



Empire District Electric Company

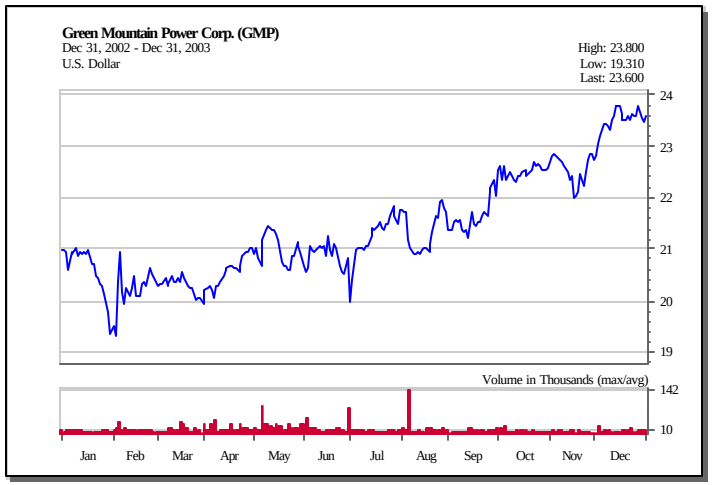
The Empire District Electric Company is an operating public utility engaged in the generation, purchase, transmission, distribution and sale of electricity in parts of Missouri, Kansas, Oklahoma and Arkansas. The company also provides water service to three towns in Missouri, and has investments in several non-regulated businesses.



Comparable Electric Company Synopses

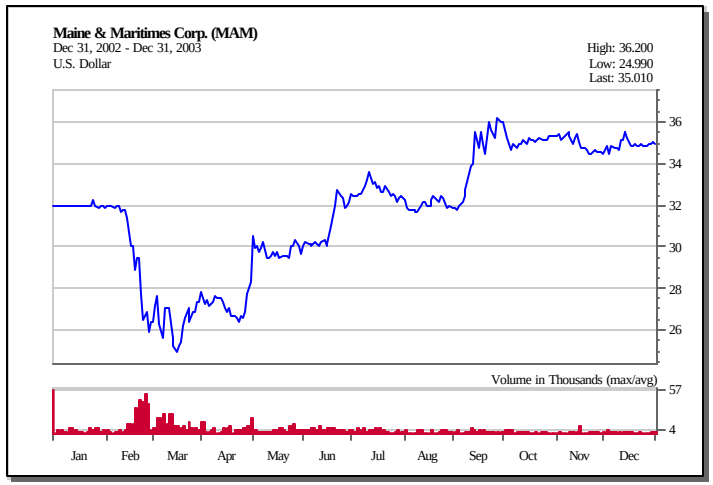
Green Mountain Power Corporation

Green Mountain Power Corporation is a public utility operating company engaged in supplying electrical energy in the State of Vermont. The company's principal service territory is an area roughly 25 miles in width extending 90 miles across north central Vermont. The company also distributes electricity in four separate areas located in southern and southeastern Vermont. The company serves approximately 88,000 customers. The company also supplies at wholesale a portion of the power requirements of several municipalities and cooperatives in Vermont.



Maine Public Service Co.

Maine Public Service Co. provides transmission services to wholesale energy customers and transmission and distribution services to retail customers in the service territory. Its service territory is approximately 120 miles long and 30 miles wide, with a population of approximately 72,000. Until 1947, it was a subsidiary of Consolidated Electric & Gas Company.



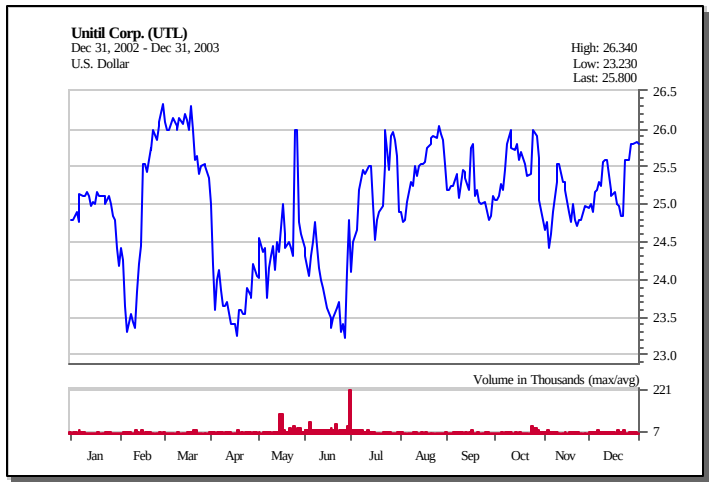
Comparable Electric Company Synopses

MGE Energy, Inc.

MGE Energy, Inc., through its principal subsidiary, Madison Gas and Electric Company ("MGE"), operates in two business segments, Electric operations and Gas Operations. Electric operations involve generating and distributing electricity, while Gas operations involve purchasing and distributing natural gas. MGE has physical interconnections with ANR Pipeline Company and Northern Natural Gas Company. MGE's primary service territory, which includes

Unitil Corporation

Unitil Corporation sells and distributes electricity and related services in several cities and towns in the seacoast and capital city areas of New Hampshire, and both electricity and gas and related services in north central Massachusetts, through its two wholly owned retail distribution utility subsidiaries, Unitil Energy Systems, Inc. ("UES") and Fitchburg Gas & Electric Light Co. The company's wholesale electric power utility subsidiary, Unitil Power Corp., provides all the electric power supply requirements to UES for resale at retail.



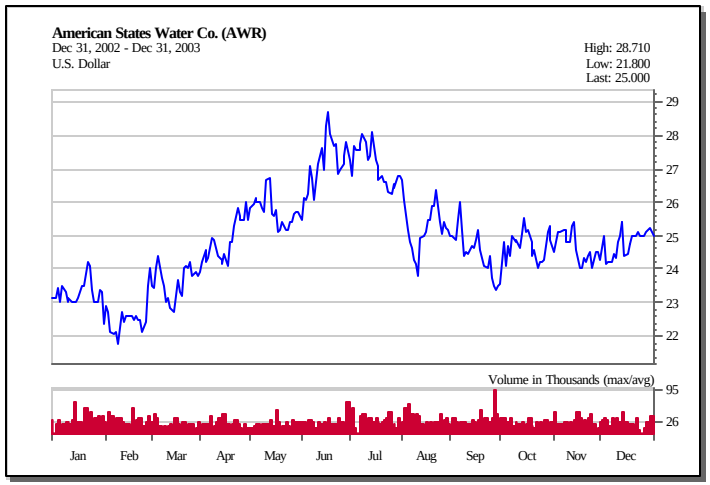
Appendices

Electric System Historical Financial Statements
Water System Historical Financial Statements
Comparable Electric Company Synopses
Comparable Water Company Synopses
Overview of Houlihan Lokey

Comparable Water Company Synopses

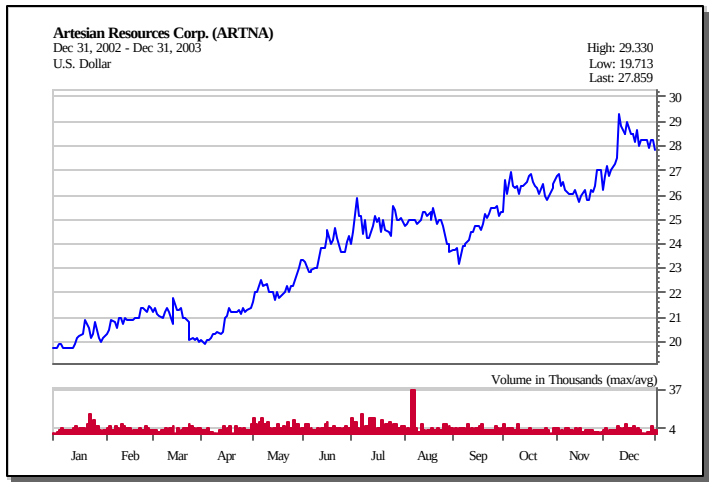
American States Water Co.

American States Water Co. operates as a holding company that invests primarily in the stock of utility companies. Through its subsidiaries, the company provided, at Dec. 2, 2003, water service to 1 out of 30 Californians located within 75 communities throughout 10 counties in northern, coastal and southern California



Artesian Resources Corporation

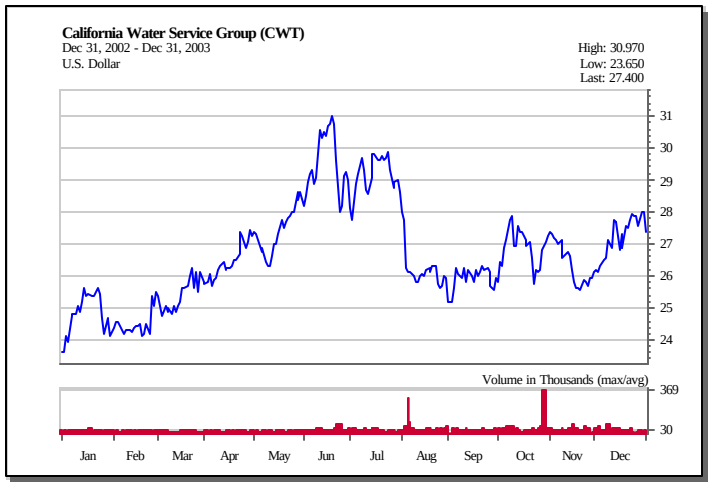
Artesian Resources Corporation is a non-operating holding company, whose income is derived from the earnings of its four wholly owned subsidiary companies and its one-third interest in AquaStructure, a Limited Liability Corporation whose primary activity is marketing wastewater services. Artesian Water Company, Inc. ("Artesian Water"), its principal subsidiary, is the oldest and largest public water utility in Delaware. The company distributes and sells water to residential, commercial, industrial, governmental, municipal and utility customers throughout Delaware.



Comparable Water Company Synopses

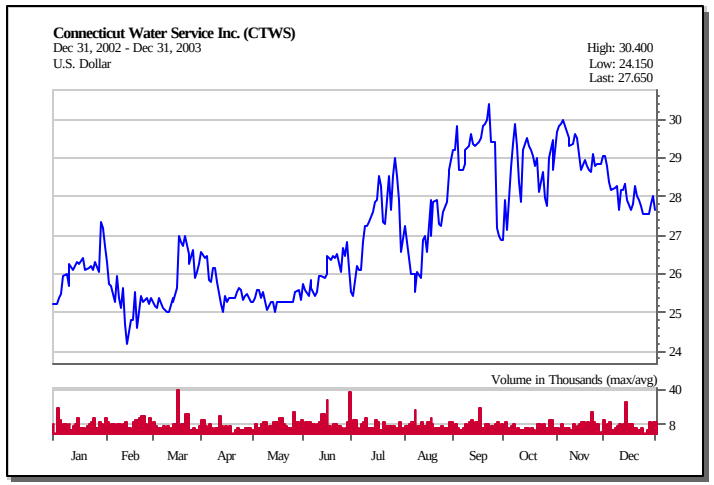
California Water Service Group

California Water Service Group ("CWT") operates through its subsidiaries as a public utility company. The company has four operating subsidiaries: California Water Service Company (Cal Water), New Mexico Water Service Company, Washington Water Service Company and CWS Utility Services. CWT's business consists of the production, purchase, storage, purification, distribution and sale of water for domestic, industrial, public and irrigation uses, and for fire protection. It also provides water related services under agreements with municipalities and other private companies.



Connecticut Water Service, Inc..

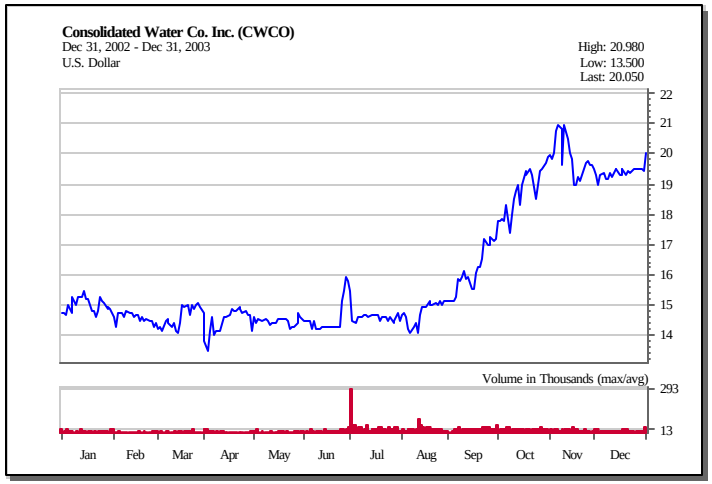
Connecticut Water Service, Inc. ("CTWS") is a non-operating holding company, whose income is derived from the earnings of its subsidiary companies. The company operates via three segments: water activities, real estate transactions, and services and rentals. The water segment comprises the core regulated water activities to supply water to customers. In 2002, approximately 90% of the company's earnings were attributable to water activities carried out within its five regulated water companies:



Comparable Water Company Synopses

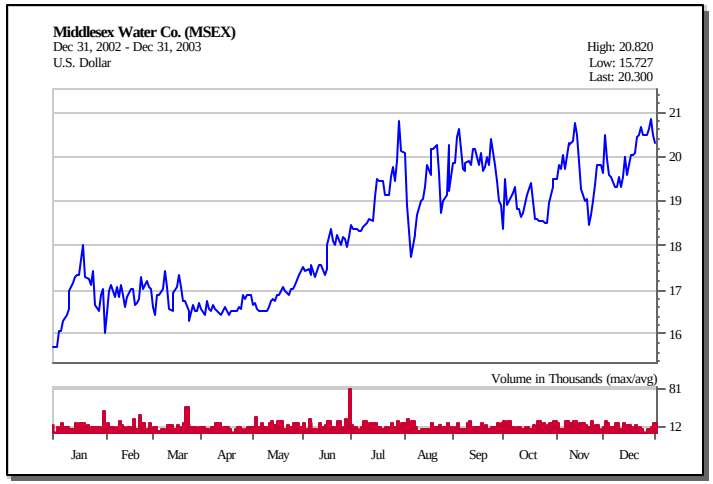
Consolidated Water Co. Ltd.

Consolidated Water Co. Ltd. ("CWCO"), using reverse osmosis technology to produce freshwater from seawater, processes and supplies water to customers in the Cayman Islands, Belize, Barbados, the British Virgin Islands and the Commonwealth of the Bahamas. CWCO sells water to a variety of customers, including public utilities, commercial and tourist properties, residential properties and government facilities.



Middlesex Water Co.

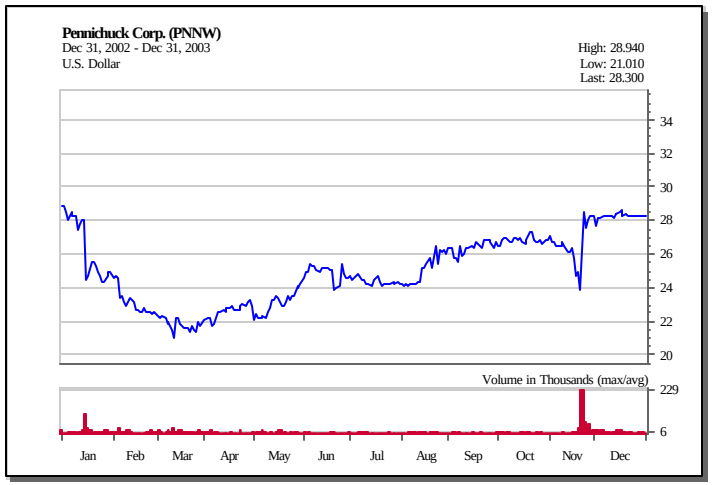
Middlesex Water Co. operates water utility systems in central and southern New Jersey and Delaware as well as a wastewater utility in southern New Jersey. The Middlesex System treats, stores and distributes water for residential, commercial, industrial and fire prevention purposes.



Comparable Water Company Synopses

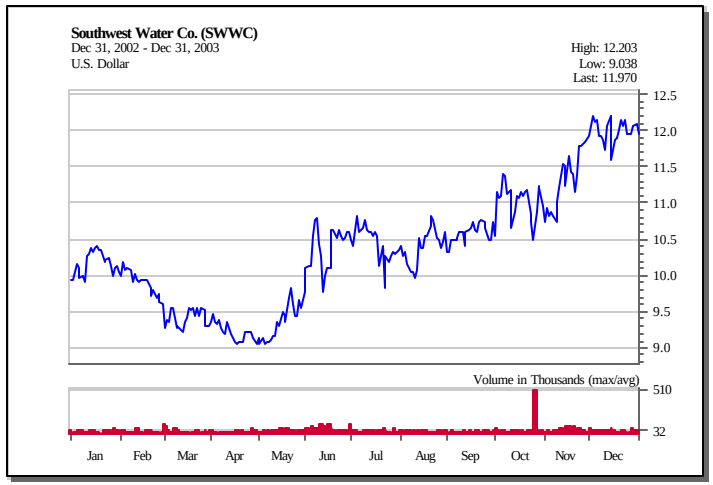
Pennichuck Corporation

Pennichuck Corporation, based in Nashua, NH, operates through subsidiaries that are engaged primarily in the collection, storage, treatment, distribution and sale of potable water throughout southern and central New Hampshire. The subsidiary corporations: Pennichuck Water Works, Inc., Pennichuck East Utility, Inc., and Pittsfield Aqueduct Co., Inc. are each engaged in business as a regulated public utility, subject to the jurisdiction of the New Hampshire Public Utilities Commission. They collectively serve about 28,800 residential and commercial and industrial customers.



Southwest Water Co.

Southwest Water Co. provides a broad range of services including water production and distribution, wastewater collection and treatment, public works services, customer billing and service, and utility submetering. Southwest Water provides service for more than two million people in 31 states from coast to coast. The company's business is operated by its subsidiaries and is segmented into two operating groups: the Utility Group, which owns and operates regulated water and wastewater utilities; and the Services Group, which manages the company's non-regulated businesses.



Appendices

Electric System Historical Financial Statements
Water System Historical Financial Statements
Comparable Electric Company Synopses
Comparable Water Company Synopses
Overview of Houlihan Lokey

Overview of Houlihan Lokey

WE ARE A LEADING INDEPENDENT INVESTMENT BANKING FIRM. . .

- Founded almost 35 years ago, Houlihan Lokey Howard & Zukin ("Houlihan Lokey") is a leading investment banking firm providing a broad range of services to its clients.

Financial Advisory

- Fairness Opinions
- Solvency Opinions
- Tax and Financial Reporting
- Business & Securities Valuation
- Dispute Analysis & Litigation Support
- Financial Consulting

#1 Provider of Fairness Opinions

Leading Provider of Solvency Opinions

Investment Banking

- Sellside M&A
- Buyside M&A
- Leveraged Transactions
- Private Debt and Equity Placement
- Management Buyouts and ESOP Financing
- PIPE Financing

#1 Advisor in Transactions Under $500 Million

#5 Advisor for All Announced U.S. Transactions

Restructuring

- Chapter 11: Planning through Confirmation
- Restructuring Debt and Equity
- Debtor-In-Possession Financing
- Exchange Offers
- IPO Plans of Reorganization
- Distressed Mergers & Acquisitions

#1 Restructuring Investment Banking Firm In U.S. (Based on Creditor Assignments)

Overview of Houlihan Lokey

WITH A DOMINANT POSITION IN THE MIDDLE-MARKET . . .

Ranked #1 M&A Advisor for All Announced Transactions under $500 Million in 2004
Ranked #5 M&A Advisor for All Announced Transactions in 2004
Completed 129 M&A Transactions — Totaling over $17.5 Billion in 2004
Ranked among Top 20 M&A Advisors for 13 Consecutive Years
Ranked #1 Provider of Fairness Opinions for Five Consecutive Years
Placed over $5 Billion in Private Capital over the Past Four Years
Advised on over $50 Billion of ESOP Transactions over the Past 11 Years
Ranked #1 Restructuring Investment Banking Firm in the U.S. *

Sources: Thomson Financial Securities Data, Mergers & Acquisitions Journal, The Deal.
* Based on number of creditor assignments.

2004 M&A Advisory Rankings
All U.S. Announced Deals

Rank	Advisor	Number of Deals	Market Share (%)
1	Citigroup	162	1.9
2	Goldman Sachs & Co	153	1.8
3	Morgan Stanley	140	1.7
4	JP Morgan	138	1.7
5	**Houlihan Lokey Howard & Zukin**	**129**	**1.6**
6	Credit Suisse First Boston	115	1.4

2004 M&A Advisory Rankings
U.S. Announced Deals Under $500 Million Value

Rank	Advisor	Number of Deals	Market Share (%)
1	**Houlihan Lokey Howard & Zukin**	**69**	**2.4**
2	Morgan Stanley	68	2.3
3	Citigroup	67	2.3
4	Lehman Brothers	59	2.0
5	Goldman Sachs & Co	57	2.0
6	JP Morgan	56	1.9
7	Banc of America Securities LLC	52	1.8
8	Credit Suisse First Boston	51	1.8
9	Merrill Lynch & Co Inc	43	1.5
10	Keefe Bruyette & Woods Inc	38	1.3
11	UBS	37	1.3
12	Jefferies & Co Inc	35	1.2
13	Sandler O'Neill Partners	32	1.1
14	Deutsche Bank AG	31	1.1
15	Bear Stearns & Co Inc	27	.9
16 *	CIBC World Markets Inc	26	.9
16 *	Lazard	26	.9
18	Robert W Baird & Co Inc	23	.8
19 *	Wachovia Corp	19	.7
19 *	RBC Capital Markets	19	.7
19 *	Piper Jaffray Cos	19	.7
22	William Blair & Co	14	.5
23 *	Friedman Billings Ramsey Group	13	.4
23 *	Thomas Weisel Partners LLC	13	.4
25 *	KeyCorp/McDonald Investments	12	.4
25 *	Duff and Phelps	12	.4
25 *	Needham & Co Inc	12	.4

** Denotes tie.*
Source: Thomson Financial

Overview of Houlihan Lokey

We Have a Team of Over 600 Employees Across the United States and Europe . . .

Overview of Houlihan Lokey

CORPORATE FINANCE

- ***Over 100 Corporate Finance Professionals Worldwide***

  Houlihan Lokey's Corporate Finance Group is made up of over 100 professionals across nine offices in North America and Europe.

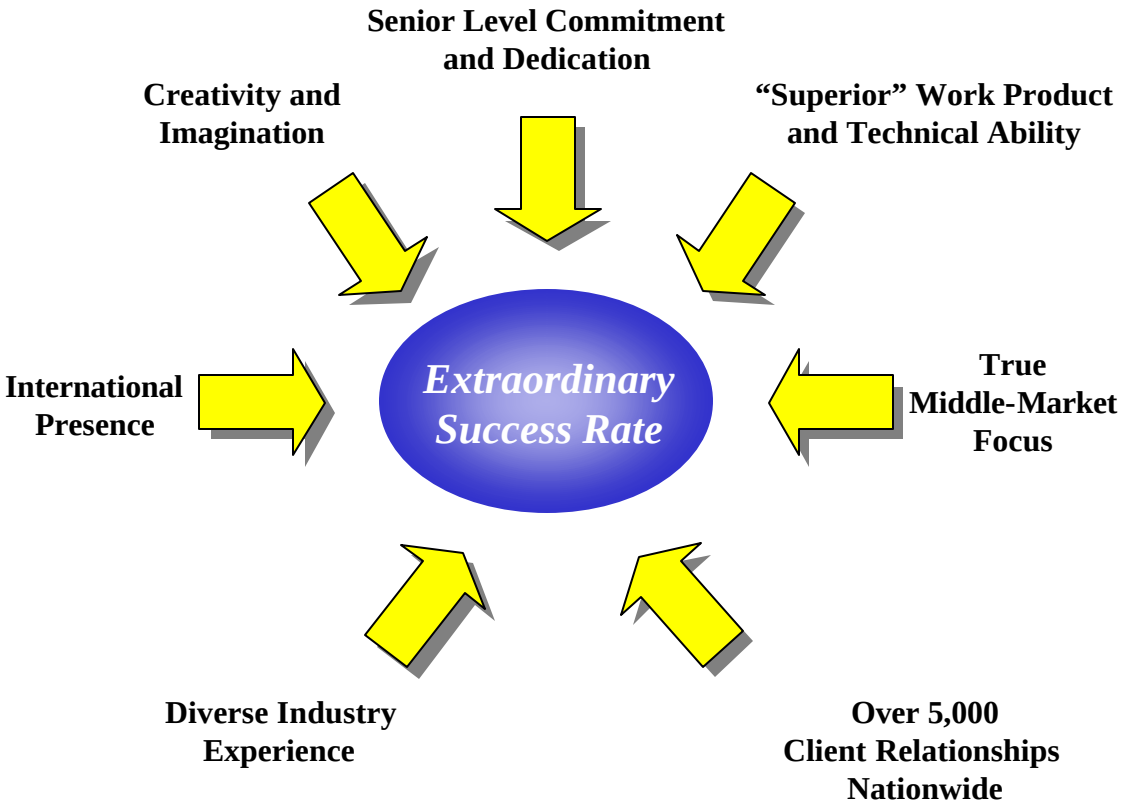
- ***Full Range of Corporate Finance Services for the Middle-Market Company***

  Houlihan Lokey focuses its corporate finance services on a diverse range of clients and offers the advantage of experience gained through years of involvement in highly sophisticated transactions. Areas of expertise include:

  - Initiating and closing mergers and acquisitions
  - Structuring and financing leveraged transactions
  - Raising equity and debt capital
  - Structuring and financing ESOPs/management buyouts
  - Arranging strategic domestic and cross-border corporate partnerships
  - Issuing fairness opinions

Overview of Houlihan Lokey

STRENGTHS OF THE INVESTMENT BANKING GROUP



Overview of Houlihan Lokey

FINANCIAL ADVISORY

- ***Full-Service Valuation Capabilities***

  Houlihan Lokey provides valuation services in a broad array of situations and for a wide range of transactions, both in type and size. The general categories of such services include:

  - Business Valuations
  - Purchase Price Allocations
  - IPO Advisory
  - Solvency Opinions
  - Litigation Support
  - ESOP Analysis

- ***Recognized Market Leader in Valuation Opinions***

  The firm's valuation opinions are used for numerous purposes, including: shareholder liquidity alternatives; private company valuations; restructurings and reorganizations; ESOPs; corporate redemptions; management stock plans; and estate, gift and income planning.

- ***A Leading Provider of Solvency Opinions***

  By utilizing highly complex financial methodologies, Houlihan Lokey has become a leading provider of solvency opinions and has been able to provide both lenders and boards of directors with the comfort level necessary to enable them to proceed forward with a leveraged transaction.

- ***Extensive Legal Support Services***

  Houlihan Lokey has worked closely with litigation teams in providing expert valuation and financial advice and testimony in major lawsuits. The firm has been retained to define valuation issues, analyze the fairness of transactions, critique the work of opposing experts and provide expert testimony.

- ***IPO Advisory***

  Houlihan Lokey assists companies in evaluating the merits and feasibility of a public offering. If a decision is made to go forward, we will assist in determining the optimal underwriter(s), developing the business plan, creating a competitive environment for the opportunity, and streamlining the time requirements of management.