FPL GROUP

In order to "buy low," sometimes we invest in companies that are temporarily out of favor. It's not that we're immune to the buzz surrounding the latest hot idea. Instead, we recognize that it's very hard to make profitable investments based on ideas that are so popular they constantly grab headlines. By the time the whole world gets excited about something, the prices of companies related to that phenomenon are often dramatically higher, reflecting a gold-rush mentality. However, we are sometimes able to mesh our love for a bargain with a popular trend. FPL Group provides a good example of this.

FPL isn't your average utility company. While it produced over 22,000 megawatts of conventional power in 2008, it has aspirations far beyond simply producing traditional power and prodding regulators for the occasional rate hike. In fact, FPL is the largest producer of ***renewable*** energy in the United States, with nearly 17,000 megawatts in operation last year. The company offers a unique opportunity to enjoy the solid operations of a financially strong utility company, while participating in the undeniable shift toward low carbon-emitting, renewable energy.

FPL's renewable division, NextEra, provides wholesale energy in 25 states. It specializes in wind power but also has solar and nuclear production facilities. Not bound by price regulators, NextEra is very attractive, offering both excellent growth and good profitability (30% year-over-year revenue growth and a mid-double digit net profit margin last quarter). In order to meet increased demand, NextEra plans to build facilities adding more than 6,600 megawatts of renewable energy by 2012, and it will likely add more capacity via acquisitions of smaller producers. Going forward, it's likely that the stellar rate of growth will taper off to some degree, but with wind power accounting for less than 2% of domestic energy consumption (we'd need to double our usage just to match the average European country), we see the potential for continued high growth.

Florida Power and Light is FPL's conventional utility division. It serves more than 4.5 million customers in the state of Florida and produces energy mostly from natural gas, with only 2% created from coal. Utilities sometimes aren't great investments, due to rate regulation and the high amounts of debt used to finance production facilities. While the inability to control prices is unattractive, it appears FPL has a good relationship with regulators, so we're optimistic it will receive fair returns on production. And FPL has a lower debt level than many utilities. Although the recession and falling home prices have slowed new account growth and overall power usage is down, we think the long-term population growth trend for the state of Florida remains attractive. Further, the potential for new applications, such as electricity-powered cars, could increase demand significantly.

While the future of renewable power generation is not completely clear, FPL's management team has successfully navigated the changing landscape of power generation. Very few companies have moved so quickly and successfully into renewable energy. Overall, FPL has established itself as an innovative leader in renewable energy, and its ongoing investment in new technologies suggests it is likely to maintain, and possibly increase, this advantage. In addition to its forward-looking reputation, FPL's management continues to operate in a conservative fashion, especially in regards to maintaining a solid balance sheet. For example, despite the current disarray in the credit markets, FPL recently issued several hundred million dollars in new bonds at what appear to be very attractive prices. Few companies currently possess the sort of investor confidence necessary for this kind of financing. We also like it that management owns nearly 6% of all shares outstanding, and 14 consecutive years of annual dividend increases illustrates management's shareholder focus.

In terms of valuation, we estimate that FPL currently trades around 12 times what we consider to be normalized earnings for 2009. In looking at the company's two segments, we believe the traditional utility side deserves a modest multiple of at least 11 to 12 times earnings. NextEra, however, is capable of significant double-digit revenue and earnings growth over the next several years. This type of growth should translate into a much higher multiple. Given that revenues are about evenly split, we feel that 8-10% annual earnings-per-share growth can be achieved and some expansion of the earnings multiple is likely. Combining this growth with the current dividend, which we view as solid, the potential for attractive returns seems compelling.

In short, we're always looking for an attractively priced investment with a relatively stable operating history, a strong balance sheet, above average management and a powerful position relative to favorable economic trends. Sometimes, it just happens to be part of the "next big thing."

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We have provided abbreviated descriptions of certain companies in order to help readers better understand the basic operations and investment considerations of these companies. Readers should note that these descriptions are not intended to be complete analyses or to be investment recommendations. Company situations are always subject to change. There are risks associated with all forms of investment, including the stocks of the companies we describe. Further, at sufficiently high prices, the stocks of even the best companies may become overpriced, and at sufficiently low prices, the stocks of even struggling companies may be underpriced.

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