

**Confidential**

TRANSACTION ADVISORY  
SERVICES

VALUATION

# **Gulf Power Company**

**Valuation Analysis of a Spare Refurbished  
General Electric 7FA turbine Rotor**

**As of March 31, 2008**

 **ERNST & YOUNG**

*Quality In Everything We Do*

March 21, 2008

Ms. Connie Erickson  
Comptroller  
Gulf Power Company  
One Energy Place  
Pensacola, Florida 32520

Dear Ms. Erickson:

Pursuant to your request, Ernst & Young LLP (“Ernst & Young”) has performed a valuation analysis of a refurbished General Electric (“GE”) class FA combustion turbine rotor (the “Rotor”) removed from Unit 3 of the Lansing Smith Generating Plant (“Generating Plant”) owned by Gulf Power Company (“Gulf Power” or the “Company”).

We understand that our valuation analysis will be used solely for the purpose of cost allocation for a potential affiliate transaction between Gulf Power, Georgia Power and Southern Power as outlined in subsection 3(d) of Florida Public Service Commission Rule 25-6.1351 of the Florida Administrative Code under the following guidelines:

*... when an asset used in regulated operations is transferred from a utility to a non-regulated affiliate, the utility must charge the affiliate the greater of market price or net book value.*

We have assumed a transaction date of March 31, 2008 (the “Valuation Date”) for our valuation analysis.

***Standard of Value***

For the purpose of our valuation analysis, we have assumed *market price* is equivalent to fair market value which is defined as:

*...the price at which an entity (asset) would change hands between a willing buyer and willing seller, neither being under compulsion to buy or sell and both having reasonable knowledge of all relevant facts as of the Valuation Date.*

***Scope of Services***

We utilized the following procedures for our valuation of the Rotor:

- Conducted telephone interviews with Company management, the GE Contract Performance Manager – Gulf Power, and personnel at the GE Houston Service Center to understand the history and key metrics of the components, the nature of the refurbishment, and the current replacement cost of the components;
- Confirm and support the replacement cost estimates and apply the direct cost approach;
- Estimate and apply physical deterioration to the replacement cost using the age-life method, which requires effective ages and useful lives;
- Consider and apply functional and economic obsolescence, as appropriate; and
- Preparation of this report (“Report”) summarizing the methodologies employed in our analysis, the assumptions on which our analysis was based, and our recommendations of fair market value. Per the Uniform Standards of Professional Appraisal Practice (“USPAP”), this Report is considered a restricted use appraisal report and is limited to use by the Company and its auditor for the identified purpose and cannot be relied upon by a third-party. This limitation is based on the fact that our recommendations may not be properly understood without additional information contained in our workpaper files.

***Recommendations of Fair Market Value***

Based on our analysis, the recommended fair market value of the Rotor as of March 31, 2008, is reasonably represented as follows:

Summary	Fair Market Value
<b><u>Rotor Component</u></b>	
Flared Compressor	\$ 3,100,000
Universal Distance Piece	610,000
Unbucketed Turbine Rotor	6,200,000
Marriage Fees	120,000
<b>Rotor Total</b>	<b>\$10,030,000</b>

Our valuation analysis was based on information and financial data provided by Gulf Power and Southern management and other relevant sources, and is subject to the attached Certification and Statement of Limiting Conditions. We did not independently investigate or otherwise verify the data provided and do not express an opinion or offer any other form of assurance regarding its accuracy and completeness.

Gulf Power Company  
Ms. Connie Erickson

March 21, 2008  
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The advice contained herein was not intended or written by Ernst & Young to be used, and cannot be used, by the recipient or any other taxpayer for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax laws.

We appreciate the opportunity to have provided Ernst & Young's valuation services to Gulf Power Company. Please contact Jon Mason at (312) 879-3738 or Adam Hill at (312) 879-6910 if you have any questions or if we may be of further assistance.

Very truly yours,

*Ernst & Young LLP*

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**COMMONLY REFERRED TO TERMS AND ACRONYMS**

ASA	American Society of Appraisers
Ernst & Young	Ernst & Young LLP
FPSC	Florida Public Service Commission
GE	General Electric
Gulf Power	Gulf Power Company
RCNLD	Replacement Cost New Less Deterioration
RCN	Replacement Cost New
SOLC	Statement of Limiting Conditions
Southern	The Southern Company
USPAP	Uniform Standards of Professional Appraisal Practice

## I. INTRODUCTION

Pursuant to your request, Ernst & Young LLP (“Ernst & Young”) has performed a valuation analysis of a refurbished General Electric (“GE”) class FA combustion turbine rotor (the “Rotor”) removed from Unit 3 of the Lansing Smith Generating Plant (“Generating Plant”) owned by Gulf Power Company (“Gulf Power” or the “Company”).

### A. PURPOSE AND SCOPE OF ANALYSIS

We understand that our valuation analysis will be used solely for the purpose of cost allocation for a potential affiliate transaction between Gulf Power, Georgia Power and Southern Power as outlined in subsection 3(d) of Florida Public Service Commission Rule 25-6.1351 of the Florida Administrative Code under the following guidelines:

*... when an asset used in regulated operations is transferred from a utility to a non-regulated affiliate, the utility must charge the affiliate the greater of market price or net book value.*

We have assumed a transaction date of March 31, 2008 (the “Valuation Date”) for our valuation analysis.

#### ***Standard of Value***

For the purpose of our valuation analysis, we have assumed market price is equivalent to fair market value which is defined as:

*...the price at which an entity (asset) would change hands between a willing buyer and willing seller, neither being under compulsion to buy or sell and both having reasonable knowledge of all relevant facts as of the Valuation Date.*

We utilized the following procedures for our valuation of the Rotor:

- Conducted telephone interviews with Company management, the GE Contract Performance Manager – Gulf Power, and personnel at the GE Houston Service Center to understand the history and key metrics of the components, the nature of the recent refurbishment, and the current replacement cost of the components;
- Confirm and support the replacement cost estimates and apply the direct cost approach;
- Estimate and apply physical deterioration to the replacement cost using the age-life method, which requires effective ages and useful lives;
- Consider and apply functional and economic obsolescence, as appropriate; and
- Preparation of this report (“Report”) summarizing the methodologies employed in our analysis, the assumptions on which our analysis was based, and our recommendations of fair market value. Per the Uniform Standards of Professional

Appraisal Practice ("USPAP"), this Report is considered a restricted use appraisal report and is limited to use by the Company and its auditor for the identified purpose and cannot be relied upon by a third-party. This limitation is based on the fact that our recommendations may not be properly understood without additional information contained in our workpaper files.

Our valuation analysis was based on information and financial data provided by Gulf Power and Southern management and other relevant sources, and is subject to the attached Certifications and Statement of Limiting Conditions. We did not independently investigate or otherwise verify the data provided and do not express an opinion or offer any other form of assurance regarding its accuracy and completeness.



## II. VALUATION METHODOLOGY

### A. OVERVIEW

There are three approaches to value that are referred to as the (i) cost approach, (ii) the market comparable approach, and (iii) the income approach. In the valuation of a business or its assets, each approach should be considered to the extent feasible and relevant.

### B. COST APPROACH

The *cost approach* relies upon the principle of substitution and recognizes that a prudent investor will pay no more for an asset than the cost to replace it new with an identical or similar unit of equal utility. The first step in the cost approach is to determine the current replacement cost new or cost of reproduction new for the subject assets.

- Replacement Cost New ("RCN") - Replacement cost new is defined as the current cost of producing or constructing a similar new item having the nearest equivalent utility as the property being valued.
- Cost of Reproduction New ("CRN") - Cost of reproduction new is the current cost of duplicating an identical item new. It is the current cost of producing an exact replica. This cost is based on current market prices plus an allowance for freight and the cost of installation.

Under this approach, fair market value is determined by adjusting the reproduction/replacement cost new by the loss in value due to physical, functional and economic obsolescence for each asset. The definitions of these are as follows:

- Physical Deterioration - A reduction in value caused by wear and tear, decay, deterioration due to age, and loss not prevented by current maintenance.
- Functional Obsolescence - The loss in value or usefulness of a property caused by inefficiencies or inadequacies inherent in the property, when compared to a more efficient or less costly property that new technology has developed.
- Economic Obsolescence - The loss in value caused by adverse conditions external to the property, such as poor market demand for the product, industrial reorientation, unavailability of transportation, and excessive governmental regulations.

### C. MARKET APPROACH

The *market comparable approach* is based on market conditions and transactions. Fair market value is determined by comparing recent sales of similar assets and adjusting these comparables based on factors such as age, condition and type of sale. In the market

comparable approach, physical, functional and economic obsolescence are reflected and measured by the market. However, the market does not recognize the contributory value of certain special assets and attachments that were added as part of the ongoing business enterprise.

**D. INCOME APPROACH**

The *income approach* estimates value by determining the present value of anticipated future cash flows. The cash flows are forecast over the relevant time horizon and discounted to their present value. The discount rate used in the present value determination should reflect the cost of funds, inflation, and risk inherent in the ownership of the asset.

**E. SELECTED METHODOLOGY**

With respect to the identified Rotor in our analysis, we utilized the cost approach in estimating the fair market value.

### III. VALUATION OF THE ASSETS

#### A. DESCRIPTION OF THE ASSETS

For the purpose of this valuation, we are recommending fair market values for certain components of a refurbished General Electric ("GE") class FA combustion turbine rotor (the "Rotor") previously installed at Unit 3 of the Company's Lansing Smith Generating Plant. The Rotor, serial number 297516, was recently refurbished by GE Energy Gas Turbine Repair Services Center located in Houston, Texas, and is currently a viable spare.

The refurbishment consisted of the following procedures:

- Rotor inspection;
- Compressor rotor unstack and re-blade;
- NDT inspection; and
- Additional inspections and repairs consisting of:
  - Turbine rotor – blend, polish and peen for S1 turbine wheel;
  - Turbine rotor – blend, polish and peen for S2 turbine wheel; and
  - Gas Turbine BPP Replication performed in conjunction with BPP on S1 and S2 turbine wheels.

#### B. VALUATION ANALYSIS PROCEDURES

The procedures employed in our valuation analysis included:

- receipt from Gulf Power of key characteristics of the Rotor;
- development of replacement cost new estimates for the Rotor;
- calculation of physical deterioration based on actual fired hours versus total expected fired hours;
- consideration of functional and economic obsolescence;
- development of our recommendations of fair market value; and
- preparation of this Report and related schedules.

The methods and procedures used to perform this valuation are intended to conform to the standards promulgated by the American Society of Appraisers and the Uniform Standards of Professional Appraisal Practice.

#### C. APPLICATION OF THE COST APPROACH

A direct cost approach was utilized to determine the replacement cost new for the Assets. Deductions were then considered and made, where appropriate, for physical deterioration, functional obsolescence, and economic obsolescence to determine fair market value.

***Replacement Cost New***

The replacement cost new ("RCN") was estimated based on replacing the Rotor in kind. We were provided with a copy of a GE invoice dated May 2007, which quoted a new price for each of the major components. We confirmed with GE that the quoted rotor represented an exact duplicate of the subject Rotor. We relied on this quotation as the basis of RCN of the Rotor.

***Physical Deterioration***

Due to the fact that assets have been in use over varying periods of time, it is reasonable to assume that the value of those assets is something less than RCN. Therefore, an allowance has been made for physical deterioration.

**Calculation of Physical Deterioration**

The Rotor's replacement costs were adjusted for physical deterioration, which results in a Replacement Cost Less Deterioration ("RCNLD"), and the amount of physical deterioration applied to the Rotor was quantified using its actual versus estimated total usage expectancy. Actual use was established by the number of fired hours currently on the Rotor. The total use expected of the Rotor was based on the typical total fired hours for a turbine rotor. Gulf Power's GE Contract Performance Manager assessed the hours on the unit, and we were provided the inspection documentation stating there are 30,286 fired hours on the Rotor out of a total of 144,000 hours expected. This implies approximately 80% of the useful life of the Rotor remains. Therefore a 20% physical deterioration adjustment was applied to the RCN to calculate the RCNLD.

***Functional Obsolescence***

Functional obsolescence was considered in our analysis. The refurbished Rotor is functionally equivalent to a current replacement turbine rotor and therefore no adjustment was necessary for any loss of value due to functional obsolescence.

***Economic Obsolescence***

Economic obsolescence was considered in our analysis. Since the Rotor will be returned as a spare, economic obsolescence is not applicable.

**XII. SUMMARY RECOMMENDATIONS OF VALUE**

Based on our analysis, the recommended fair market value of the Rotor, as of March 31, 2008, is reasonably represented as follows:

Summary	Fair Market Value
<b><u>Rotor Component</u></b>	
Flared Compressor	\$ 3,100,000
Universal Distance Piece	610,000
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Marriage Fees	120,000
<b>Rotor Total</b>	<b>\$10,030,000</b>

Our valuation analysis was based on information and financial data provided by Gulf Power management and other relevant sources, and is subject to the attached Certification and Statement of Limiting Conditions. We did not independently investigate or otherwise verify the data provided and do not express an opinion or offer any other form of assurance regarding its accuracy and completeness.

The advice contained herein was not intended or written by Ernst & Young to be used, and cannot be used, by the recipient or any other taxpayer for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax laws.

**APPENDIX I - PERSONAL PROPERTY CERTIFICATION**

The undersigned hereby certify that the members of our engagement team have no direct or indirect financial interest in the property that is the subject of this assignment, nor do they have any direct or indirect personal interest with respect to the property or parties involved in the assignment. The members of our engagement team did not perform an inspection of the Rotor. Neither our employment nor our compensation in connection with the Report is in any way contingent on the recommendations reached or values estimated, and this Report sets forth all of the assumptions and limiting conditions affecting the analysis, values, and recommendations contained herein. This Report is intended to have been prepared in conformity with, and is subject to, the requirements of the Principles of Appraisal Practice and Code of Ethics of the American Society of Appraisers ("ASA") and the Uniform Standards of Professional Appraisal Practice ("USPAP") as set forth by the Appraisal Standards Board ("ASB") of the Appraisal Foundation. All Senior Members, Fellows, and Life Members of the ASA who have participated in the preparation of this Report are either in compliance with the mandatory recertification requirements of the ASA or are exempt from those requirements. No person other than the undersigned or those acknowledged below prepared the analysis, values, or recommendations set forth in this Report, and, to the best of our knowledge and belief, the statements of fact contained in this Report are true and correct.

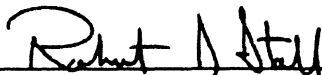


Adam D. Hill, ASA  
Senior Manager  
American Society of Appraisers  
Accredited Senior Appraiser  
Machinery and Technical Specialties



Jon S. Mason  
Executive Director

Review Appraiser:



Robert J. Stall, ASA  
Principal  
American Society of Appraisers  
Accredited Senior Appraiser  
Machinery and Technical Specialties

## APPENDIX II - STATEMENT OF LIMITING CONDITIONS

1. Nothing has come to our attention to cause us to believe that the facts and data set forth in this Report are not correct.
2. Provision of valuation recommendations and considerations of the issues described herein are areas of regular valuation practice for which we believe that we have, and hold ourselves out to the public as having, substantial knowledge and experience. The services provided are limited to such knowledge and experience and do not represent audit, advisory or tax-related services that may otherwise be provided by Ernst & Young LLP. Notwithstanding this limitation, the advice contained herein was not intended or written by Ernst & Young to be used, and cannot be used, by the recipient or any other taxpayer for the purposes of avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax laws.
3. No investigation of the title to the subject company and subject assets has been made, and the owner's claim to the subject company and subject assets is assumed to be valid. To the extent that Ernst & Young LLP's services include any analysis of assets, properties or business interests, Ernst & Young LLP assumes no responsibility for matters of legal description or title, and Ernst & Young LLP shall be entitled to make the following assumptions: (i) title is good and marketable, (ii) there exist no liens or encumbrances, (iii) there is full compliance with all applicable Federal, state, local and national regulations and laws (including, without limitation, usage, environmental, zoning and similar laws and/or regulations), and (iv) all required licenses, certificates of occupancy, consents, or legislative or administrative authority from any Federal, state, local, or national government, private entity or organization have been or can be obtained or renewed for any use on which Ernst & Young LLP services are to be based.
4. This Report has been prepared solely for the purpose stated, and may not be used for any other purpose. Neither this Report nor any portions hereof may be copied or disseminated through advertising, public relations, news, sales, Securities and Exchange Commission disclosure documents or any other public (or private) media without the express prior written approval of Ernst & Young LLP.
5. The recommendations of fair market value contained herein are not intended to represent the values of the subject assets at any time other than the effective date that is specifically stated in this Report. Changes in market conditions could result in recommendations of value substantially different than those presented at the stated effective date. We assume no responsibility for changes in market conditions or for the inability of the owner to locate a purchaser of the subject assets at the values stated herein.
6. No responsibility is assumed for information furnished by others, including management, and such information is believed to be reliable.
7. In the course of our analysis, we were provided with written information, oral information, and/or data in electronic form, related to the structure, operation, and financial performance of the subject company and subject assets. We have relied upon this information in our analyses and in the preparation of this Report and have not independently verified its accuracy or completeness.

8. Certain historical financial data used in our valuation were derived from audited and/or unaudited financial statements and are the responsibility of management. The financial statements may include disclosures required by generally accepted accounting principles. We have not independently verified the accuracy or completeness of this data provided and do not express an opinion or offer any form of assurance regarding its accuracy or completeness.
9. The estimates of cash flow data included herein are solely for use in the valuation analysis and are not intended for use as forecasts or projections of future operations. We have not performed an examination or compilation, nor have we performed an agreed-upon procedures engagement with regard to the accompanying cash flow data in accordance with standards prescribed by the American Institute of Certified Public Accountants, and, accordingly, do not express an opinion or offer any form of assurance on the accompanying cash flow data or their underlying assumptions. Furthermore, there will usually be differences between estimated and actual results because events and circumstances frequently do not occur as expected, and those differences may be material.
10. We assume no responsibility for any financial and tax reporting judgments, which are appropriately those of management. It is our understanding that management accepts responsibility for any financial statement and tax reporting issues with respect to the assets covered by our analysis, and for the ultimate use of our Report.
11. Ernst & Young LLP is not required to furnish additional work or services, or to give testimony, or be in attendance in court with reference to the assets, properties, or business interest in question or to update any Report, recommendation, analysis, conclusion or other document relating to its services for any events or circumstances unless arrangements acceptable to Ernst & Young LLP have been separately agreed with the Company.
12. We have not made any determination of what constitutes a violation under fraud and abuse laws and regulations. The Company should consult with its legal counsel for that determination.



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