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The Southern Company NYSE:SO

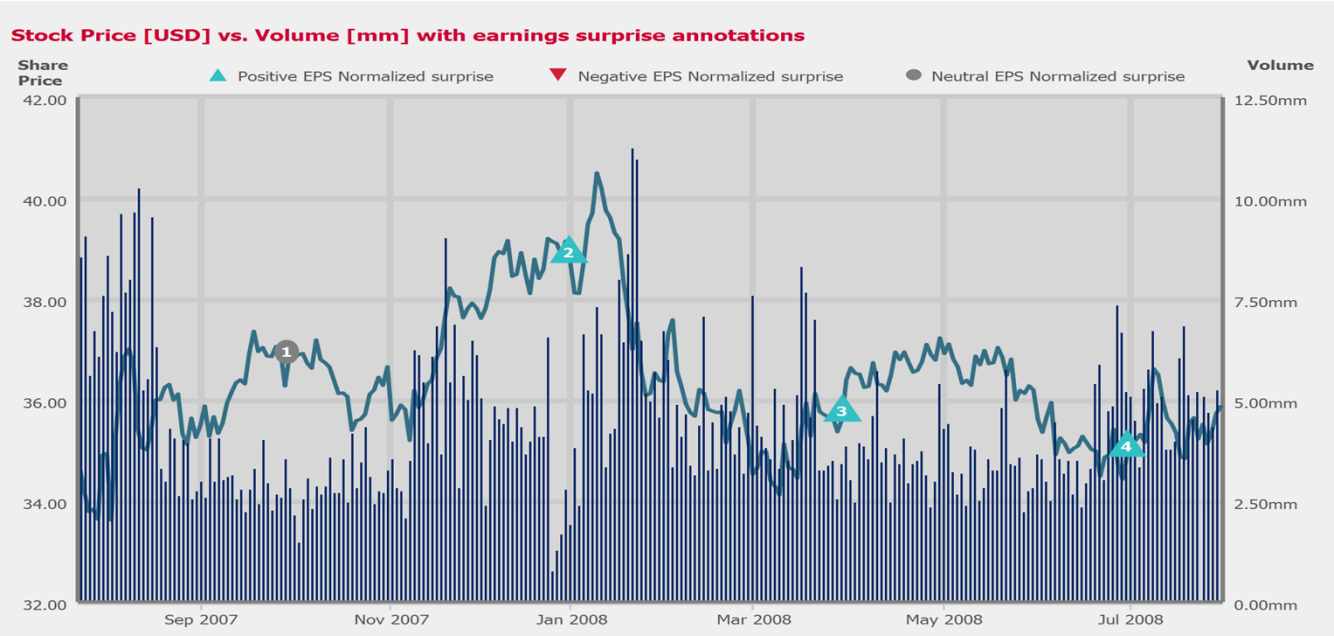
FQ2 2008 Earnings Call Transcripts

Wednesday, July 30, 2008 5:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2008-			-FQ3 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.57	0.63	▲10.53	1.02	2.34	2.46
Revenue (mm)	3861.79	4215.00	▲9.15	-	15955.87	16624.88

Currency: USD
Consensus as of Jul-30-2008 5:23 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2007	0.99	0.99	1 0.00 %
FQ4 2007	0.24	0.26	2 8.33 %
FQ1 2008	0.41	0.47	3 14.63 %
FQ2 2008	0.57	0.63	4 10.53 %

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Call Participants

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Jeff Coviello
Duquesne Capital

Leslie Rich
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Nathan Judge
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Steven Gambuzza
Longbow Capital

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Tom Arnel
Highbridge

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Presentation

Operator

Good afternoon. My name is Kimberly and I will be your conference operator today. At this time, I would like to welcome everyone to the Southern Company Second Quarter 2008 Earnings Call. (Operator instructions) Thank you.

I would now like to turn the call over to Mr. David Ratcliffe, President and Chairman and Chief Executive Officer. Please go ahead sir.

David Ratcliffe

Thank you, Kimberly. Good afternoon and thank you for joining us. I am pleased to be with you for our second quarter earnings call. Joining me today is Paul Bowers, our Chief Financial Officer.

Let me remind you that we will make forward-looking statements today in addition to providing historical information. There are various important factors that could cause actual results to differ materially from those indicated in the forward-looking statements, including those discussed in our Form 10-K and subsequent SEC filings.

The materials we released this morning show our continued strong performance and that we're on track to meet our earnings targets for the year. Our business model as you know is not tied to spark spread or to volatility in the price of natural gas and ours is not a merchant energy business. Nearly all of our earnings are produced from our franchise business and from long-term wholesale power agreements.

Our strategy is very straight forward and has produced positive concrete results for both customers and shareholders. In an environment of increasing cost from environmental expenditures, new generation to meet increase load and rising fuel cost, our retail prices remained below the average price in the Southeast region and approximately 15% below the national average.

As result of lower prices, power liability, superior customer service and a regulatory environment that has been constructive and stable, we should find ourselves in a period of relative stability for the next two and a half years.

A capital expenditure as we have committed for our retail business, some $13.3 billion through the end of 2010 either or are expected to be included in rate. The transparency in cost recovery and in our overall financial profile for the next two and half years, I believe distinguishes Southern Company and has contributed to our ability to produce consistent results in challenging economic conditions.

Our focus will continue to be on delivering reliability, low prices and superior customer service while at the same time providing our shareholders with effective risk-adjusted returns. I'm confident that we have the team in place to deliver these goals.

At this point, I will now turn the call over to Paul Bowers, our Chief Financial Officer, for a discussion of our financial highlights of the second quarter and our earnings guidance for the remainder.

Paul Bowers

Thank you, David. Our second quarter results were consistent with our business plan. In the second quarter of 2008, we reported $0.54 a share which compares to $0.57 a share or $0.03 a share below the second quarter of 2007. This includes a non-recurring after-tax charge of $67 million due to the changes in our assessment of a tax position associated with our leveraged lease transaction. It also includes our earnings from synthetic fuel investments in 2007. Excluding this two non-recurring items our earnings were $0.63 a share or $0.08 a share above our earnings from the second quarter of 2007.

Now let's turn to the major factors that drove our second quarter numbers. This discussion will exclude our synthetic fuel business and the one time charge for leveraged leases.

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First the negative factors. Increased depreciation and amortization due primarily to increasing environmental investment reduced our earnings by $0.04 a share compared to the second quarter of 2007.

Non-fuel O&M for our traditional operating companies had a negative impact of $0.03 a share on our earnings for the second quarter of 2008 compared with the prior period in 2007. This was primarily due to an increase in the number of planned outages.

Weather reduced our earnings about $0.01 a share in the second quarter of 2008. Weather was $0.02 above normal in the second quarter but was $0.03 above normal in the same period in 2007, so overall weather effect was a negative $0.01 a share.

Factors other than income taxes primarily related to franchise fees which track revenues reduced our earnings by $0.01 a share compared to second quarter of 2007. Increased expenses at Southern Power Company primarily due to maintenance outages at several of our plant reduced our earnings by $0.01 a share in the second quarter of 2008 compared with the second quarter of 2007.

Finally, an increase in the number of shares outstanding reduced our earnings about $0.01 a share in the second quarter of 2008 compared with the second quarter of 2007.

Turning now to the positive factors. The impact of positive revenue effects in our traditional business including customer growth, changes in retail rate plus additional revenue attributable to variable market response rate added $0.17 a share to our earnings in the second quarter compared with the second quarter of 2007.

Increased AFUDC attributable to our construction program added $0.01 per share to our earnings in the second quarter of 2008 compared with the second quarter of 2007. Lower expenses at the parent company added $0.01 a share to our earnings in the second quarter of 2008 compared to this prior period.

In conclusion, we had $0.19 of positive items offset by $0.11 of negative factors, so overall our quarter came in at $0.63 per share or $0.08 per share better than the second quarter of 2007 excluding both synfuel and charges related to our leasing businesses.

Before we turn into guidance for the remainder of 2008 and our estimate for the third quarter, I'd like to update you on a couple of items that impact our performance. First it's clear that customer growth had slowed particularly in the residential market in response to the downward trend in construction activity caused by excess inventory.

Customer growth while still positive is now 0.9% compared with the second quarter of 2007. Customer growth in the second quarter of 2007 was 1.6% compared with the second quarter of 2006. Building permits declined at a slower rate in the second quarter indicating that we may be nearing the bottom of the slowdown in new home construction.

Installation of new meter set may have also bottomed out in the second quarter at 5,700 per month compared with 5,000 meter sets in the month of February. Alabama Power actually reported an increase in meter set in June, suggesting that housing in Alabama may not be as overbuilt as the housing market in Georgia.

In commercial sector, non manufacturing employment growth continues exceed national trend at 1.2% compare with a 0.04% nationally. The oversupply of all those market in Atlanta saw a small increase and vacancy rate in the second quarter while gaining revenues in Coastal Mississippi dropped in April but rebounded in May.

In the industrial sector, the lowering of demand for new housing has impacted industrial sales in the stone, wood product and carpet manufacturing sectors. Overall, we have seen a decline sale of 1.8% as compared to the second quarter of 2007.

The majority of the reductions in industrial sales in the second quarter occurred in the month of May with significant reductions in operations over the Memorial Day period. However, sales to the coals and paper

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primarily metal and a fabricated metal sectors which represent approximately 25% of our industrial sales continues to produce at high level of activity.

In addition to above average job growth, we obtained an increase in economic development activity in both Alabama and Georgia which supports our contention that the Southeast should emerge more quickly from this economic slowdown than the US as a whole.

Finally, we expect that the states of Alabama and Georgia will add nearly 280,000 new jobs by the year 2010. For now, the Southern Power, I'd like to update you on some recent development at our competitive generation subsidiary.

Yesterday, we find extension of our existing contract with GEMC, Georgia Electric Membership Corporations or EMC. Eight contracts were extended beginning in 2010 through 2031 and two contracts were extended beginning in 2013 through 2034. ENC currently projected to purchase 500 megawatts of power in 2008 under the existing agreement. Their purchases are projected to grow to a more than 1400 megawatts during this extension.

In another development in June our Franklin 3 unit went into commercial operations. Although the contract with Constellation Energy does not begin until January, we have (inaudible) for this unit and will contribute to our earnings or Southern Power this year.

Finally, we project that over 3,000 megawatts of new generating capacity will be needed in the Super Southeast between now and 2017. Our ability to bring new generation online at very competitive prices as well as our relationship with wholesale customers should enable us to be a successful participant in new bid opportunity.

Turning to guidance for 2008. It is clear that we are executing our strategy and that our businesses are performing well. As you know, we exceeded our second quarter estimate by $0.08 a share. However, given the variability of weather continued uncertainties surrounded the economy and the fact that we generally derive approximately 45% of our earnings in the third quarter. When we also see the most weather variability, we are maintaining our current earnings and guidance range of $2.28 to $2.36 per share. Following our estimate for the third quarter is $1.01 per share.

At this point, I'll turn the call back over to David for his closing remarks.

David Ratcliffe

As you can see from our report this afternoon, despite a challenging environment, we had a good first half of the year and we are on target to meet our operational and financial growth for 2008.

Speaking on a personal note, I was very pleased and honored to become Chairman of SO and Electric Institute in our annual convention last month. As an industry we have a number of challenges in front of us reducing emissions of carbon, filling new infrastructure and pressures from rise in commodity and fuel cost just to name a few.

I look forward to working with my colleagues in the industry as we well as policy makers, regulators, members of the financial community, and other stakeholders to achieve positive outcomes, only vicious.

Also, our industry through EI will be involved in the formulation of energy and environmental policies by new presidential administration in the new congress seeking to meet the expectations of the American people. We look forward to our role in this important of national debate.
At this point, Paul and I will be happy to take any questions you might have. Kimberly, we will now take the first question.

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Question and Answer

Operator

(Operator instructions) So our first question comes from the line of Leslie Rich of Columbia Management.

Leslie Rich
Columbia Management

Good afternoon.

David Ratcliffe

Hi, Leslie.

Leslie Rich
Columbia Management

I wondered if you could spend some time talking about your wholesale sales. Your volumes were up in the quarter as well as year-to-date but yet your net income for Southern Power is down quarter over quarter and also year-to-date so I wondered if you could just talk about why your margins are compressing that business.

David Ratcliffe

Sure, Leslie. One of the things that we will add is that with the event of Franklin 3 coming online, also Oleander in Florida coming online which has a contract attached to it plus Southern Power has a contract with (inaudible) on asset that they are selling out of his will, the volumes are up. We also had increased O&M and in Southern Power significant increase as most of the plant went through an outage under the long term service agreement that they have with UE. As you know, we have to take those out for maintenance every so often and these are tied to a number of sorts to take half with those units and this year we took most of our units out for maintenance.

Leslie Rich
Columbia Management

Okay and then separately could you talk about hydro conditions, last summer hydro was a big issue and the drought and all that. How are things looking this summer?

David Ratcliffe

Leslie, we begin this year in better shape than we did last year. Most of our reservoir were at full especially in Georgia and Alabama but as we got into June, we have a below normal weather in terms or rainfall for specifically in Alabama. Georgia is still maintaining a full pull position but Alabama is a little bit receding in terms of its full status.

We're up a little bit on our hydro production year over year compared to last year's extreme drought but still being very cautious as we go through this summer.

Paul Bowers

Les, I'll just add we budgeted about 50% in normal last year and this year and we're pretty much on budget at a 50% below our normal expectations, that's why we got by based to our forecast.

Leslie Rich
Columbia Management

Okay, so last year you saw you know hydro productions and gas production up. This year you'd expect it to be sort of a more normal balance?

David Ratcliffe

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No, it will still be below what we would consider to be normal but not as bad as last year.

Leslie Rich
Columbia Management

Okay. Thank you.

Operator

Your next question comes from the line of Nathan Judge of Atlantic Equities.

David Ratcliffe

Hey, Nathan.

Nathan Judge
Atlantic Equities

Good afternoon. I just wanted to ask a couple of questions. First, could you give us an update on any development with your trig [ph] technology, your IGCC, any new developments there and how is that going as see it today?

David Ratcliffe

Nathan, as you know we have been working on the project that we called Comfort [ph] County over at Mississippi. Basically, we continue to work with the leadership in the State of Mississippi and Department of Energy to try to move the project forward. The next event will be Mississippi Powers filing of a jurisdiction and need for the capacity with the Mississippi Public Service Commission which will occur next month that will begin their review of the project and it's economics.

We also have other regulatory proceedings associated with some of the tax benefits that will move in parallel with that. So we're continuing to step through the processes required to get approval for that project.

Nathan Judge
Atlantic Equities

Has there of any other interest in that technology or everybody is still waiting or company is waiting on the sidelines and so there is some clarity in getting efficiency of that at sign up and running?

David Ratcliffe

As I was saying, people are still sort of standing on the sidelines, waiting to see if we're actually going to move to a commercial demonstration and sure some people will wait until it is up and running to begin to consider that as a technology choice.

Nathan Judge
Atlantic Equities

I will also like to hear your thoughts on the recent ruling about the share and the several sales courts and as you have noticed stocks those credit has fallen significantly in price. You give us how that would ultimately play out with the customer end in the Southeast.

David Ratcliffe

Let me make sure my understanding of the question, Nathan. Are you saying you don't understand how the financial impact on the price of the allowances would impact customers?

Nathan Judge
Atlantic Equities

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Are there two parts, I guess two parts to the question ultimately whether you see the resolution to the stocks Knox [ph] CARE issue under a new a president and timing etc if you have any insight there, that would appreciated. And also the financial implications for Southern Company plus customers in the region.

David Ratcliffe

Let me tell (inaudible) and then I'll let Paul talk about financial consequences to us. I don't have a particularly good crystal ball here. Certainly not better than anybody else's, I think the decision was not a good one because it creates more uncertainty at the time when we are all trying to get some certainty around what are the requirement is going to be.

I think there's going to be significant effort to try to either legislatively re-implement the CARE rule which my expectation is that will be difficult to do because there will be a lot of effort to create what's typically termed Pay Vote Bill which would include carbon monoxide legislation, that just makes two very complex legislative efforts with an order CARE and climate change put together to be extraordinarily complex. So I think we're going to model along here and hope that the congress would take the lead and simply pass a separate piece of legislation that would re-implement CARE rule and we have to deal with climate change and another legislative initiative but I real don't - I'm not sure of that, barely optimistic about that.

Paul Bowers

Nathan, hi. Associated with the financial implications of the - (inaudible) CARE. The thing that we have to remember is that we still have to comply with the National Ambient Air Quality Standards, the State Implementation Plan. So those are driving our compliance strategy. When you look at our SO2 allowances that we have purchased, we purchased those under a Compliance Strategy focus and go through the regulatory bodies to recover those calls for compliance.

So when we look at our intermediate needs, they now have been elongated because we have some extra allowances that CARE would have reduced the numbers of because of that two-for-one ratio but right now, when we look at it, we have to look at what does it mean to our intermediate group of plants? Do we have more allowances now to cover some of those? So that could have an effect on our capital and for the future.

Nathan Judge
Atlantic Equities

Thank you very much for that.

Operator

Your next question comes from the line of Steve Fleischman of Catapult.

Paul Bowers

Hi, Steve.

Steve Fleischman
Catapult Partners

Hi. Can you guys hear me?

Paul Bowers

Yes, Steve.

David Ratcliffe

Yes.

Steve Fleischman
Catapult Partners

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Okay. Hi, guys. Just to clarify, through the first half of the year, you've been in your own guidance by about $0.16 a share. So, from the standpoint of maintaining your guidance for the year, I know you tend to be pretty conservative and you don't know what things can come up in the third quarter and the like but is there anything fundamentally that would be holding you back?

Paul Bowers

Steve, when we look at the first quarter of last year, you have to remember that that was one of the record-setting heat waves for us. As a matter of fact, it was additional $0.06 last year relative to the weather and then, you have depreciation increased in O&M for this year. So, we're holding firm with the range that we have.

As you know, when I opened up these comments, this is 45% of our revenue in this quarter. So we need to get through this quarter first before we make any assessment for the future.

Steve Fleischman
Catapult Partners

Okay. Secondly, on the market response shelf, could you just talk a little bit more about what's been happening with those and maybe you could even break out within this quarter that revenue of - I think that you said $0.17; how that broke out between market response, growth and rate release and then just what to expect from the market responses going forward?

David Ratcliffe

I'm going to give you a little background on the market-based response rates and then Paul can talk about financial consequences for the quarter and then going forward. I'll just remind everybody that may have been familiar with it, these are rates that have been employed for over 15 years and it's primarily about 2,000 customers mostly in the state of Georgia, in Georgia Power's customer-based that have the opportunity to choose based on an hour ahead or day ahead price and the price has determined as function of the marginal cost to producing the energy.

So, the customer has the right to choose or to buy price protection products to cover their choices so their choice's function is basically the function of their economic reality and their production capability and their ability to move their production around during off-peak periods. So, it really gives them a lot of flexibility to choose what to do. On an average, this has been a very attractive rate for these customers over its history.

Paul Bowers

Steve, one of the things that I want to add to descriptions, it is an optional rate. Customers like to be on this rate and if approved by the Commission in terms of the structure, the marginal portion that David described is just that, that those customers, if they can manage their loads, they'd buy on the margin.

As we start checking out our resource requirement, that marginal piece is not taken into consideration because it's a variable load that comes and goes based on those customers.

From a financial standpoint, I'll break it down. Primarily for this quarter, $0.07 of our earnings per share were attributable to the market response rate. Now, for the third quarter going forward, we have projected higher rates for these customers given the norm that we'd always see higher cost in the summer. So, that's embedded in our estimates going forward.

Steve Fleischman
Catapult Partners

Okay.

David Ratcliffe

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Steve, I hope you have a sense that it's pretty hard to project much of that because it's such function of the customer's situation, the economic activity with regards to their particular industry, our generation availability and stack and that's why it's a real-time rate because it's pretty hard to project much.

Steve Fleischman
Catapult Partners

Sure. I have one last question which is just to get an update on the new nuclear proposal in Georgia.

Paul Bowers

Yes. It's much like the comments that I made about the Kemper County project, the IGCC in Mississippi. It's simply stepping through the regulatory process. We've made the SEC filing and the COL filing with the NRC. The good news about the COL filing and the NRC response was that it was complete, meaning we don't have to go back and add anything else. They will begin to evaluate it so it should be on a good try.

We will present the certification process to the Georgia Public Service Commission next month in August as a part of the future needs for the plant and they have until March of next year to decide. They can decide earlier but they have until March to decide whether or not to certify that capacity if they give us a green light and agreed that we should build Vogtle 3 and 4 then we'll move quickly to move forward with the construction.

Steve Fleischman
Catapult Partners

Great. Thank you.

Operator

Your next question comes from the line of Angie Storozynski of Macquarie.

Angie Storozynski
Macquarie

Hi. I have a question. Given the recent slowdown in the power demand growth in your service price rate and the fact that you know it's going to have any substantial rate piece over the next three years, could we assume that your realized ROEs will soon be dropped or in other words, how the recent growth in the kilowatt hour sales differ from your projection of sales that you have in recent like cases of settlement?

David Ratcliffe

Let's go back and maybe make sure we are on the same wavelength because I made the comments about the relatively stable regulatory environment. We have mechanisms in place in both Alabama and Mississippi and to some degree in Georgia to make periodic filings for both base rate increases and rate increases necessary to recover capital cost associated with either new capacity in some cases and or environmental cost.

So there are rate mechanisms that are in place. What I was saying was because those are in place, we expect a relatively stable period of time from a regulatory standpoint. That does not mean that prices will not go up during that period of time. The only place where that's not true for base rate is at Georgia Power where we are on a basically three-year cycle and we would expect to file again in 2010 in Georgia. We have to under that agreement with the Georgia Public Service Commission. I don't believe that this time we have any plans in the Gulf jurisdiction to make a filing but we could during this period of time.

We don't expect and I think we said it in the economic data that we produced. We don't expect any continued erosion of revenues. In fact our revenue growth still remains positive overall. We continue to have significant immigration of new customers into our territory.

We have pretty strong economic expansion and some of the primary industrial sectors that Paul mentioned, the primary metals and metal fabrication, the automotive industry continues to expand. So we think we're getting to the bottom of the housing crisis situation with our new leaders set at the residential

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level sort of bottoming up. At least we hope so. So, I think we believe that we're in pretty good shape for the next two and a half years.

Operator

Your next question comes from the line of Ashar Khan of SAC Capital.

Ashar Khan
SAC Capital

Good afternoon. I was trying to get a sense of the residential and industrial sales decline, is that all Georgia and Alabama? I'm trying to track that down to the subs.

Paul Bowers

Well, Ashar, from a residential standpoint, I would say that majority would be in Georgia. Primarily when you look at the decline because of the inventory and the number of vacancies, Alabama had a slight decline, Gulf had a moderate decline but it's primarily Georgia that is driving some of the residential sales. When you look at the vacancy rates, our normal is about 2.5%. We're running around 3.5% on vacancy rates. That means we have roughly 130,000 residential structures without people in them.

Ashar Khan
SAC Capital

Okay.

David Ratcliffe

Let me add something to that, Ashar. I think it's - we need to make sure we understand. We're trying to make sure we understand what we're reporting here to you. When a person leaves a residence for some reason, whether it's foreclosure or whatever, and the meter is still connected, we don't count that as a lost customer. That's still a customer but there's nobody using energy on the other side of the meter.

So, what we're seeing, we think, it's Paul point about the increased houses available in the market place or houses where nobody's using electricity so usage is down. I suspect we're also seeing some simple economic reality of people deciding to turn some things off and use less so I think it's a grand combination of both of those things on the residential side.

Ashar Khan
SAC Capital

Okay and Paul, what have you assumed for 2008 versus 2007 for growth? Could you remind us in your budgeting?

Paul Bowers

Right now for growth, around 2% energy sales wise.

Ashar Khan
SAC Capital

A 2% growth in energy sales wise?

Paul Bowers

Yes.

Ashar Khan
SAC Capital

So right now, if I look at - we are at zero point year-to-date, am I right? So, the total retail sales are up 0.2%? Am I right? So, that your initial planning was 2%. Am I looking apples to apples to that number?

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Paul Bowers

When you look at our overall sales total for retail, we are roughly at a 0.1% increase over last year.

Ashar Khan
SAC Capital

Right and you were predicting 0.2%.

Paul Bowers

That's right.

Ashar Khan
SAC Capital

And so, if it was 0.2% versus the 0.1%, what would be the additional earnings? Could you just tell us the variance? What the higher earnings would have been if we were running at 0.2%?

Paul Bowers

Ashar, I think I might have to go offline with you on that and ask our guys to give you a callback and get into that level of detail, if that's all right with you.

Ashar Khan
SAC Capital

Okay. Okay, fine. Okay, thank you.

David Ratcliffe

Okay. Ashar, obviously we have to make some assumption about the mix of customers and the margin associated with the different customer rates so it needs a little bit work to give you a good number.

Ashar Khan
SAC Capital

Okay, thank you.

Operator

Your next question comes from the line of Tom Arnel of Highbridge.

Tom Arnel
Highbridge

Good morning. Just curious if you could give an update on your coal inventory situation and then the upcoming fuel filings we should expect?

Paul Bowers

Okay. Yesterday, we received approval of a fuel case in Gulf Power so that was the last fuel case that we have found in the system. So, that's moving forward and I think those rates come in effect on September 1.

We have a target inventory of 40 days. Right now, we're at 36 days as we sit here. We've had some interruptions and some supplies due to the flooding in the mid-west and as gas prices were higher, we had some increase born so we - from invoice standpoint, we're in good shape.

Tom Arnel
Highbridge

Great. Thanks.

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Operator

Your next question comes from the line of Jeff Coviello of Duquesne Capital.

Jeff Coviello
Duquesne Capital

Good afternoon.

David Ratcliffe

Hello, Jeff.

Jeff Coviello
Duquesne Capital

I have a follow up question on CARE. You mentioned that probably the most hopeful thing that could happen was that the U.S. Congress passed some sort of simple enabling legislation that let CARE be reinstated and it's been like you're optimistic about but I was wondering if there was any - should we be watching the House or the Senate for that and if it was going to happen, when do you think it would be the most likely?

David Ratcliffe

Well, Jeff, that's a great question but I can't tell you where to look or when to expect that notice. There were hearings yesterday in the Senate. I think on Senate Energy and Commerce or maybe Environment and Public Works but there are people testifying about the need for some uncertainties so it's getting some play but when you get to the practicality of moving legislation in this Congress knowing that they're out of town on Friday, not back until Labor Day and you got to get through the elections, I just don't give as much hope for moving this thing forward. I wouldn't say it's impossible but I'm not sure you can get it done.

Jeff Coviello
Duquesne Capital

Okay.

David Ratcliffe

Again, like I said, I think when it begins to move, there is a very good likelihood that there'll be a lot of folks trying to talk a bunch of different things only, they always do. Remember that the court actually remanded the decision through EPA to adopt a rule that was consistent with the opinion. So, there is some chance that EPA could try to move forward to do something but it's also difficult for EPA to adopt the ruling in this environment.

Jeff Coviello
Duquesne Capital

It sounds like as the congress isn't going to be able to anything until after Labor Day at the earliest and the politics of the-

Paul Bowers

I think that's for certain.

Jeff Coviello
Duquesne Capital

Yes. Okay, that's helpful. Thank you very much.

Operator

Your next question comes from the line of Steven Gambuzza of Longbow Capital.

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Steven Gambuzza
Longbow Capital

Hello.

Paul Bowers

Hello.

Steven Gambuzza
Longbow Capital

Hi, I'm just wondering if you could explain how it is that you're on plan in terms of earnings guidance when sales have been so far below expectation in a retail standpoint. Is it that the market base response rate - do those essentially benefit from lower, the sale you sell under market base response rate. Could they essentially benefit from lower retail load gross so that earnings there are offsetting. What normally would have been retail revenues?

David Ratcliffe

Now there, I think there are two things going on here, one is it market base rates benefits from prior gas prices and higher marginal fuel prices and that is one of the line this drove the second quarter contribution. The other thing is that we talked about this earlier that if in going in to January, we saw the implementation of rate increases in Alabama and Georgia and Mississippi that had been approved by the public service commission, so that prices were actually higher going end of this year.

Steven Gambuzza
Longbow Capital

I guess but didn't those rate increases, had been taken to account on expected level of load growth - it didn't actually transpire?

David Ratcliffe

That's correct and the market based rate contribution rate contribution help make up some of that.

Steven Gambuzza
Longbow Capital

Okay, but I guess you - all things being equal, are you able to sell more power at market based rates when retail load is lower than normal?

Paul Bowers

No.

Steven Gambuzza
Longbow Capital

Okay. Thank you very much.

Operator

Your next question comes from the line of Timothy Yee of KeyBanc.

Timothy Yee
KeyBanc

Could you talk just a little bit more about Franklin 3 you had mentioned that it had come into service. How much capacity is that and you had filled from the output? What's your earnings impact contribution for the year and what is that contemplated in guidance?

Paul Bowers

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Well when you look at, I'll go to the last point of your question first there was some contemplation of Southern Power having Franklin 3 owned early. So, we project out Southern Power earnings we had assumed certain portion of Franklin 3 in that number.

Now Franklin 3 is a 640 megawatts combined cycle gas unit that was (inaudible) back in 2003-2004 timeframe. This unit originally sold to Donna G [ph]. And that contract was bought out of from Donna G and at 2004 period we involve unit through search for additional capacity contract for it. In depth filling the capacity to progress ventures who in turn sold it to Constellation Energy, and that contract comes in to play in January of 2009 and when we go to a (inaudible) or a stored plant there are some anticipated issues with shaking out, the construction shaping up the unit for the unit.

And what we tried to do is brining on early to see if had any shake down if you will and the unit right now is doing quite well and our folks in Southern Power went forward to the market and sold from the capacity house and it has some contributions to margin but its also contemplated in the $135 million, net income target for that company.

Timothy Yee
KeyBanc

Okay, thank you.

Operator

Your next question comes from the line of Andrew Levi of Brent Corp

Andrew Levi
Brent Corp

Thank you very much.

Paul Bowers

Hello.

Andrew Levi
Brent Corp

I'm all set. Thank you very much.

Paul Bowers

Okay. Thank you.

Operator

Your next question comes from the line of Dan Jenkins of State of Wisconsin Investments

Dan Jenkins
State of Wisconsin Investments

Hi, good afternoon.

Paul Bowers

Hey, Dan.

Dan Jenkins
State of Wisconsin Investments

I just want to clarify a little bit on I think you said earlier on the $.017 benefit from retail non-fuel that's $0.07 of that was from market response rate of that.

Paul Bowers

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That is correct Dan.

Dan Jenkins
State of Wisconsin Investments

And then so I was curious then of the remaining $0.10, how much of that is due to the rate increases that went in effect and how much is saved from customer growth?

Paul Bowers

Well, one part is from customer growth and the remaining part of that just rate increases.

Dan Jenkins
State of Wisconsin Investments

Okay. And then I was also wondering if you could give us an update on where you are at on your CapEx spending and at the budgets are the same as you projected at the beginning of the year for CapEx.

Paul Bowers

Yes, we're pretty much right on budget Dan as it relates to our CapEx expand as you know we have three year CapEx stand for our operating company that $13.3 billion. We are basically right on target with that.

Dan Jenkins
State of Wisconsin Investments

Okay and then as far as any debt that you might need to issued and I know you have about $700 million comes due on the second half for the year I just wondered if you could give us some guidance on your debt plans for the second half.

Paul Bowers

We don't financial a spot to $1.2 billion through remaining part of this year.

Dan Jenkins
State of Wisconsin Investments

Okay, thank you that's all I have.

Paul Bowers

Okay, thanks Dan.

Operator

(Operator instructions) Your next question was a follow-up from Leslie Rich of Columbia Management.

Leslie Rich
Columbia Management

I wondered if I could circle back to the leveraged lease charge and have you walk through an explanation of that.

Paul Bowers

Sure we can, what do you want to understand about it last time, can you narrow it a little bit - what it was.

Leslie Rich
Columbia Management

What are these, are this tax benefit that you took that you had reserve or?

Paul Bowers

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That's basically correct.

Leslie Rich
Columbia Management

Is this related to SILO/LILO lease accounting or this is something different?

Paul Bowers

That's right, I mean it was three SILOs that were retained by Southern Company as part of the spent out of merit in 2001.

Leslie Rich
Columbia Management

Is that the extent of it? The issue is now over?

Paul Bowers

I mean what we did was decided to go ahead and take a charge because of the IRS success and certain other cases and the accounting recommendation that we go ahead and booked of what we did, we still on litigation with the IRS overt the issue with regard to our leases that may affect some settlement with them in the future.

Leslie Rich
Columbia Management

Okay but the charge that you took covers a 100% of the amount of per debate or there's potentially more?

Paul Bowers

Actually what we expect our exposure to be.

Leslie Rich
Columbia Management

Okay great. And just secondly, separately on your coal, David I would be interested to hear your thoughts on the coal market since you're such a large consumer of coal and it's a coal market -

David Ratcliffe

Well, I'm really disappointed Leslie, We're paying 130 bucks for Central Appalachian coal, you remember part of my background was managing that back in the 80's for the Southern Company and that's a long way from where we were then I think -our hope is that some of the supply out of Australia and other parts of the world comes back and by this time next year we're back at something closer to what I would consider being normal price which maybe $50-$60 term of Central App.

The Columbian sources that we draw on are also ordinarily expensive at $135 or have been. So we're seeing significant increase cost like everybody else. Our river basin is not quite as volatile so there's some good news and we're allowed a good bit of that for us.

Leslie Rich
Columbia Management

And have you indicated publicly how - are you fully contracted for 2009. And I know you tend to do lots of very long term contract and layered in from multiple different supply basins with multiple different contract length but do I need to worry about '09 or -?

David Ratcliffe

Not more than and I do.

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Paul Bowers

Leslie, as you know our contract strategy for the current year is to try to be at 95 to 99% covered and second year out if you will for next year, it would be 60 to 70% third year out, would be around 40%-50%. Right now, we have taken that strategy up in terms of locking in reliability supply and for next year were at 99% committed.

Leslie Rich
Columbia Management

And you have feel past through in all your jurisdiction right?

Paul Bowers

Correct, Les.

Leslie Rich
Columbia Management

Okay, great. Thank you.

Operator

Your final question comes from the line of Annie Tsao of AllianceBernstein.

Annie Tsao
AllianceBernstein

Good afternoon. Can you hear me?

Paul Bowers

Yes.

Annie Tsao
AllianceBernstein

Hi, just questioning going back to your kilowatt sales. When you 0see the commercial and also of industrial general about 2% or more than 2% as well. Can you break it down in terms of if in this from Georgia or Alabama and what the trend that you see going forward for your kilowatt sales?

David Ratcliffe

We talked a good bit about the residential situations, I think. I think that's pretty clear.

Annie Tsao
AllianceBernstein

Yes.

David Ratcliffe

The commercial business is slowing but still positive year-to-date. The industrial business was down in a quarter. We talked about fact that we think that most of that occurred in May when some of our major industrial customers decided to take their annual maintenance cycle which around Memorial Day where they take a week. So I think what we got to do at the end of this quarter and see if the industrial production is back to a normal level. Annie, we have also had the Chevron Refinery in Mississippi out for an extensive time associated with an expansion at that facility. So we anticipate that we come back online during this quarter, maybe fourth quarter.

Annie Tsao
AllianceBernstein

Okay. So you think for the rest of the year, it might be a little bit better or you see the trend will continue?

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David Ratcliffe

Our expectation is that we still have the weaknesses in those industry segments that are attached to the housing market and we still see growth coming out of the primary metals transportation fabricated metal where we have had growth in the past. Anticipation is the target, if realized would go forward.

Annie Tsao
AllianceBernstein

Well, last question has to do with the economy with the economy slow down. Can you comment on your uncollectible?

David Ratcliffe

Sure, Annie. We keep close eye on that at any time when you are in an uncertain economic time but we have not seen a discernable increase in any of our charge or in our rears, in fact got better from March ’08 to June of ’08.

Annie Tsao
AllianceBernstein

All right. Thank you.

David Ratcliffe

You’re welcome.

Operator

And we have a follow up question from Steve Gambuzza of Longbow Capital

Steven Gambuzza
Longbow Capital

Hello. A quick question on the coal where it sounded like you’ve actually gone a little a bit ahead of your - in the first day you are a little bit ahead of where you normally be for 2009 in your profile?

David Ratcliffe

That’s correct.

Steven Gambuzza
Longbow Capital

Okay. I guess when listening to you on the comments about being hopeful that supply situation would work itself out then we’d see something approaching more normal for instance by 2009. I take it from your heads position that you don’t really put a lot of - you’re absolutely sure that hope is going to be met? Is that fair and -?

Steven Gambuzza
Longbow Capital

As I get back to that - who is to write a book to hope that is not a strategy. We decided to go ahead and make sure we are covered for next year.

Paul Bowers

Some of that are those contracts have a market openers. So it gives us the visibility to the market to the prices of coal but we wanted to purchase based on reliability.

Steven Gambuzza
Longbow Capital

Thank you very much.

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Operator

At this time there are no further questions. I will turn the call back over to Mr. Ratcliffe in the closing comment.

David Ratcliffe

Kimberly, I don’t have anything except thanks for everybody for everybody for joining us today. We look forward to seeing you on the third quarter call. Thank you.

Operator
Ladies and gentleman, this concludes today’s conference. You may now disconnect.

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