



# DELIVERING SUPERIOR SHAREHOLDER VALUE

## FINANCIAL OVERVIEW

Jim Hatfield



PINNACLE WEST  
CAPITAL CORPORATION

# FINANCIAL OVERVIEW AGENDA

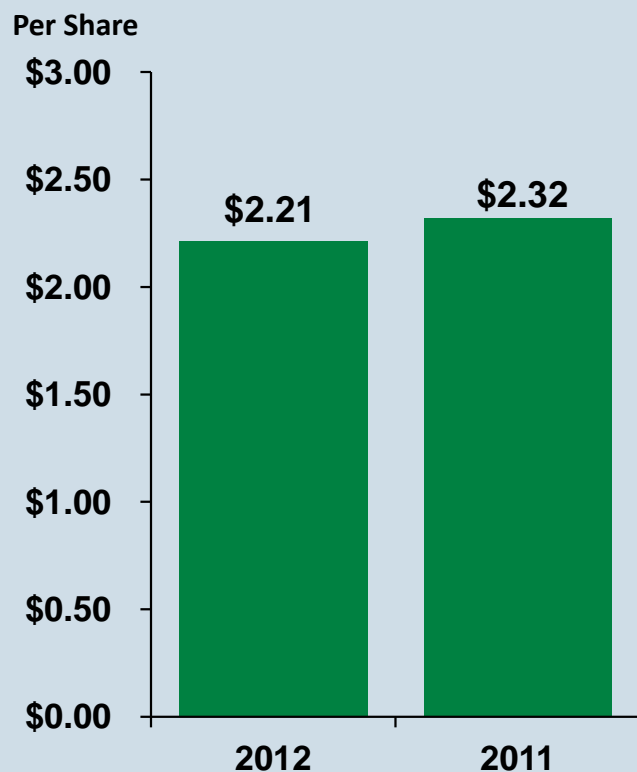
- **Third quarter earnings**
- **Financial objectives**
- **2012 – 2015 outlook**
  - **Capital expenditures**
  - **O&M cost management initiatives**
  - **Earnings guidance and dividend outlook**
  - **Debt and liquidity profile**
- **Value proposition**



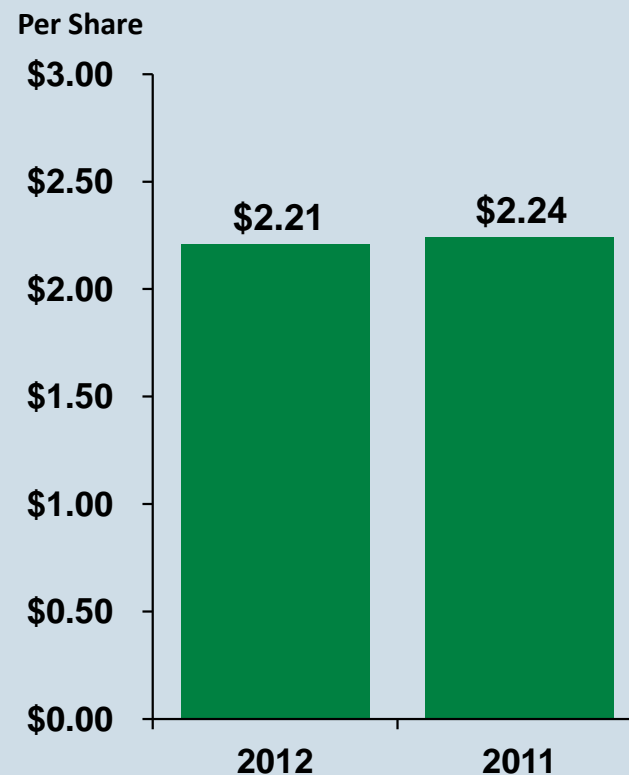
# CONSOLIDATED EPS COMPARISONS

3<sup>rd</sup> Quarter 2012 versus 3<sup>rd</sup> Quarter 2011

## *Net Income*



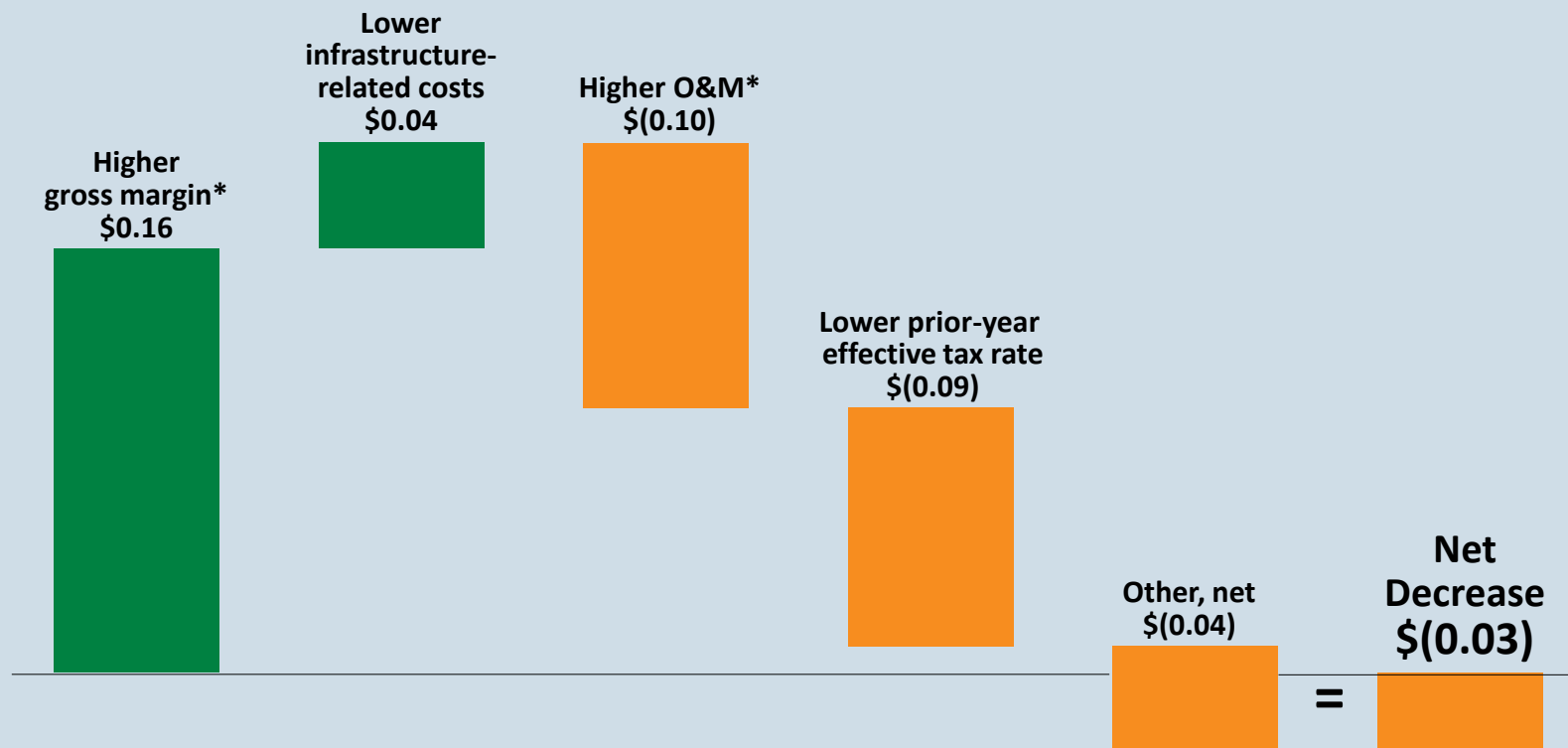
## *On-Going Earnings*



See non-GAAP reconciliation in appendix

# ON-GOING EPS VARIANCES

3<sup>rd</sup> Quarter 2012 versus 3<sup>rd</sup> Quarter 2011



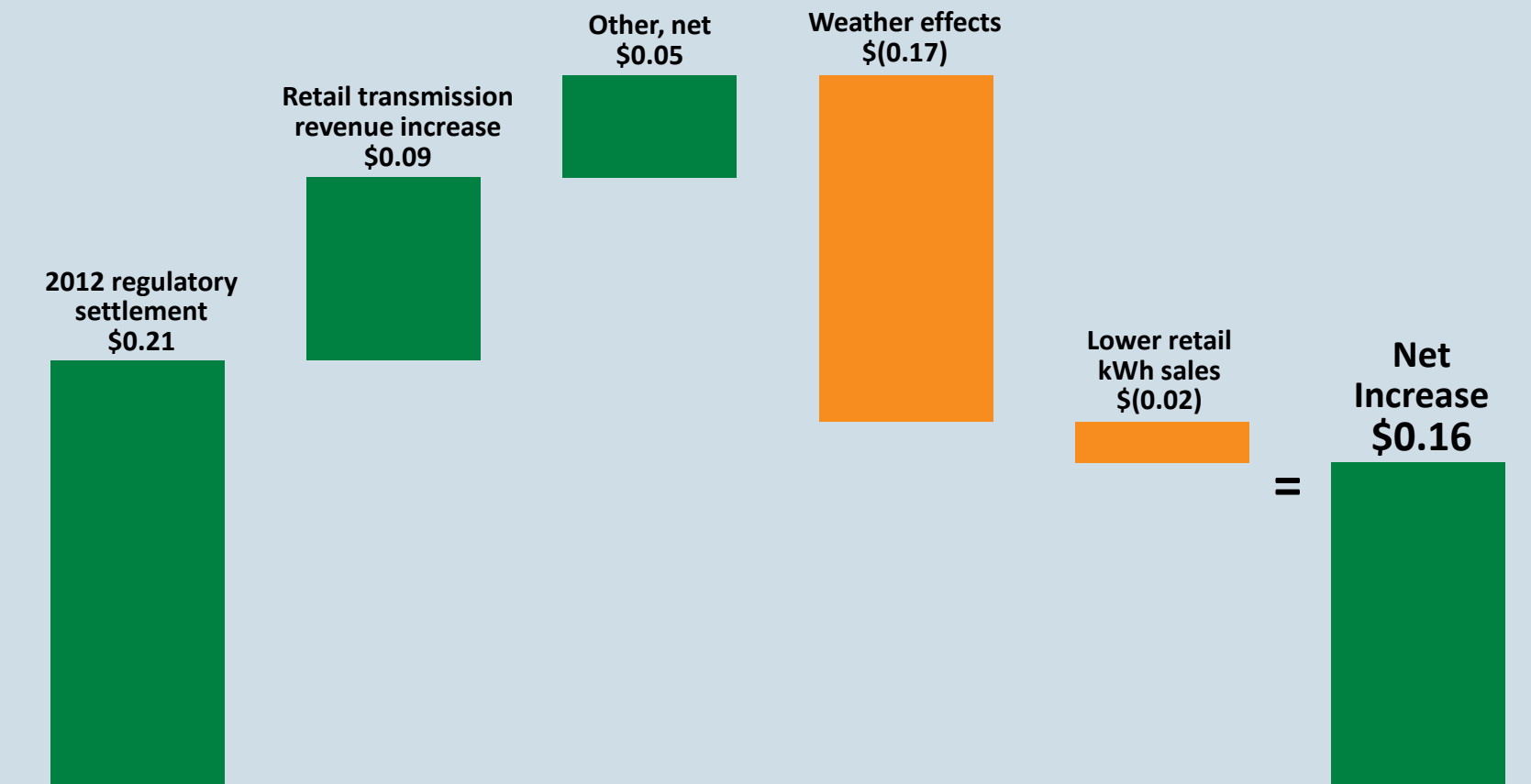
\* Excludes costs, and offsetting operating revenues, associated with renewable energy (net of AZ Sun), energy efficiency and similar regulatory program. See non-GAAP reconciliation for gross margin in appendix.





# GROSS MARGIN EPS DRIVERS

3<sup>rd</sup> Quarter 2012 versus 3<sup>rd</sup> Quarter 2011



See non-GAAP reconciliation in appendix

# LONG-TERM FINANCIAL OBJECTIVES

Our long-term goal is to provide continued superior returns to our shareholders.

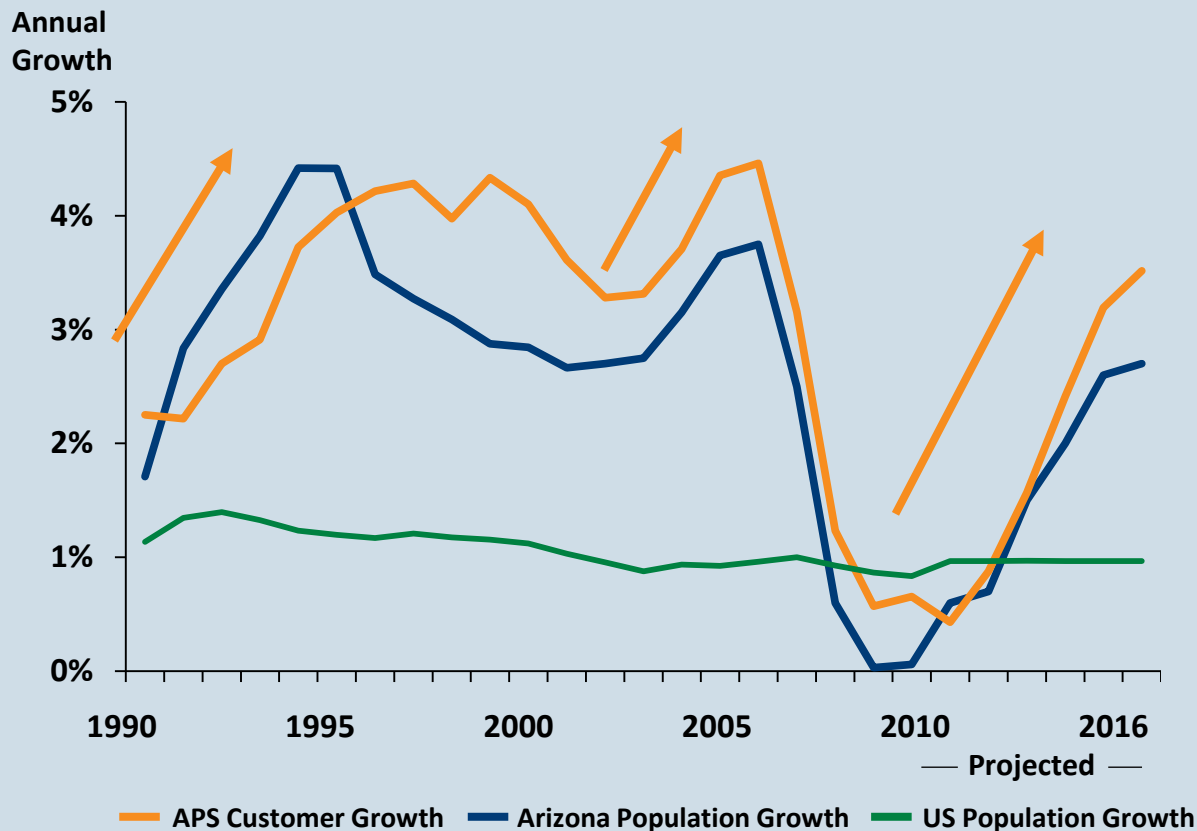
- **Deliver strong consistent total return**
- **Capitalize on dynamic service territory growth**
- **Emphasize capital and O&M budgeting disciplines**
- **Maintain solid investment-grade credit ratings**
- **Improve financial strength and agility**



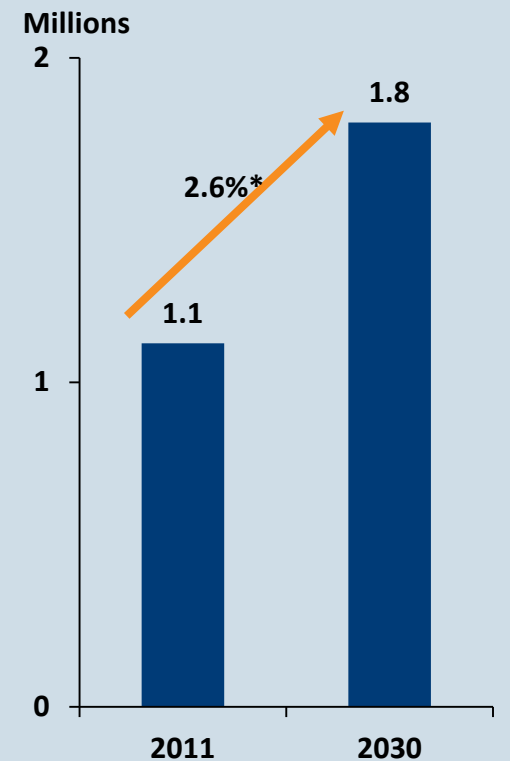
# POSITIVE LONG-TERM DEMOGRAPHICS

APS's customer growth generally outpaces U.S. and Arizona population growth.

## Superior Growth



## APS Customer Growth



\*Compound Annual Growth Rate

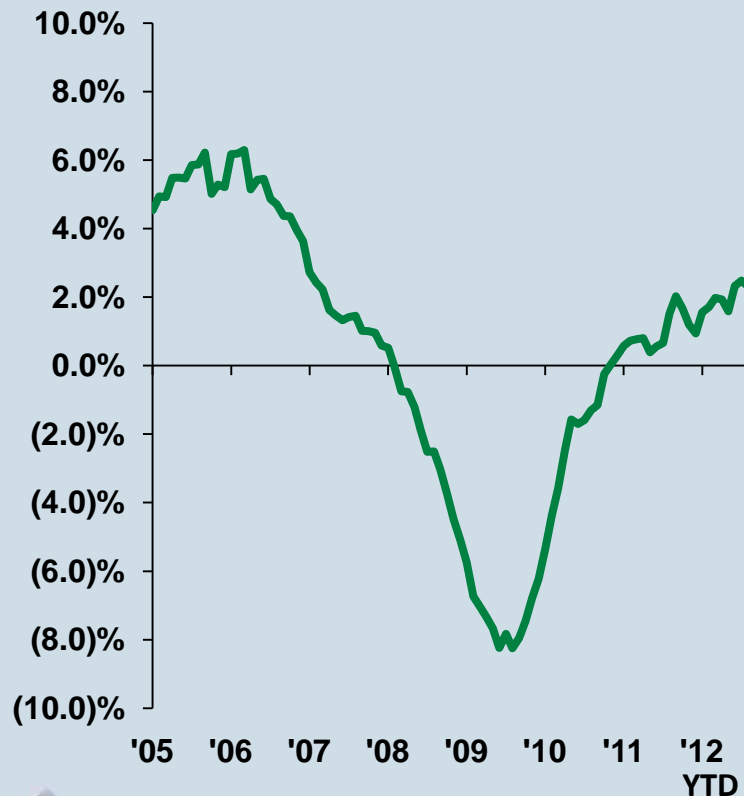


# POSITIVE NEAR-TERM TRENDS

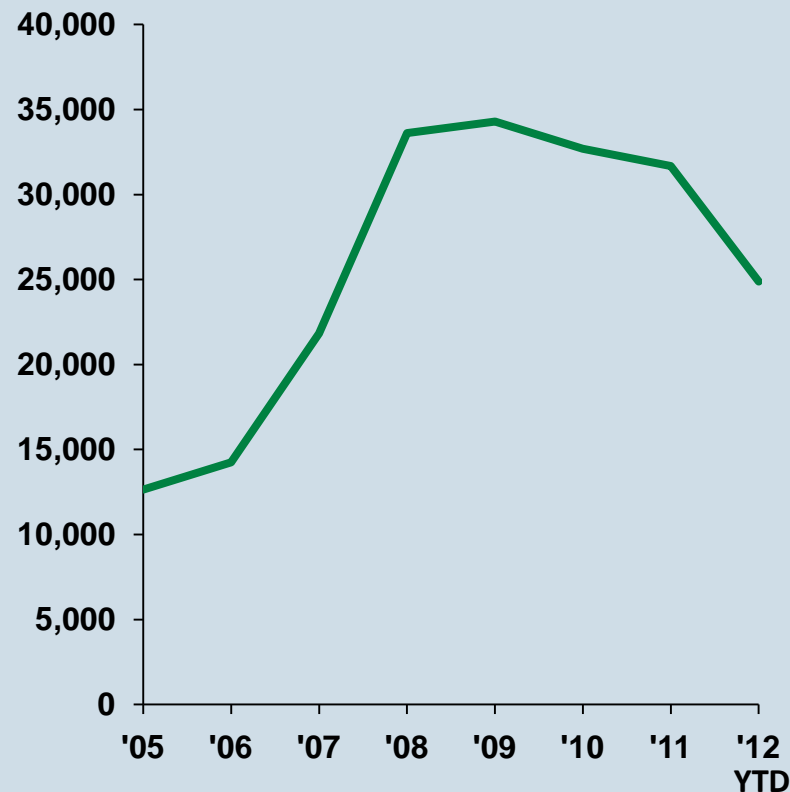
Arizona's economy is reflecting more sustained growth and activity.

## *Non-Farm Job Growth*

Year-Over-Year Change



## *Metro Phoenix Vacant Housing APS Service Territory*

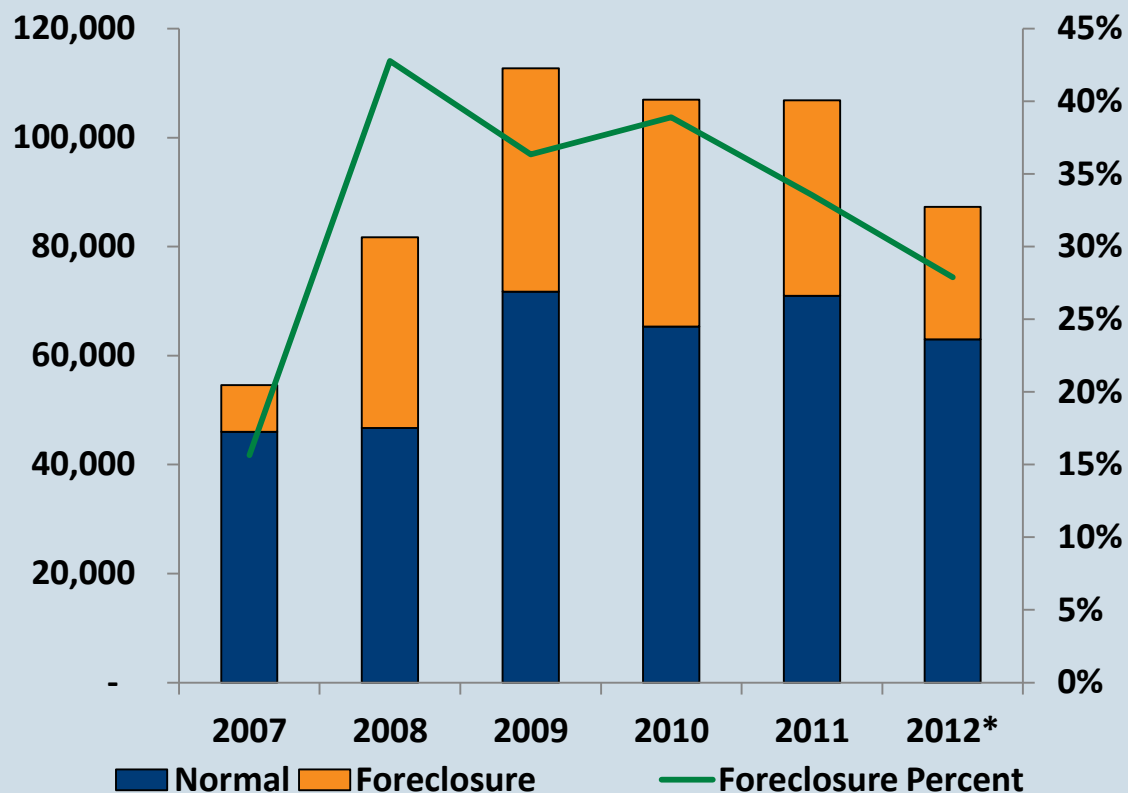




# FORECLOSURE HEADWINDS WINDING DOWN

Metro Phoenix home foreclosure sales are the lowest since 2007.

## Existing Single Family Home Sales



## Key Trends

- Existing home sales activity remains robust
- Investor interest peaked in Q1 2012
  - 20% of market Q1
  - < 15% in Q3
- Lender-owned sales down 70% in Q3 2012 vs 2011
- 190,000 homes have been sold through foreclosure since 2007

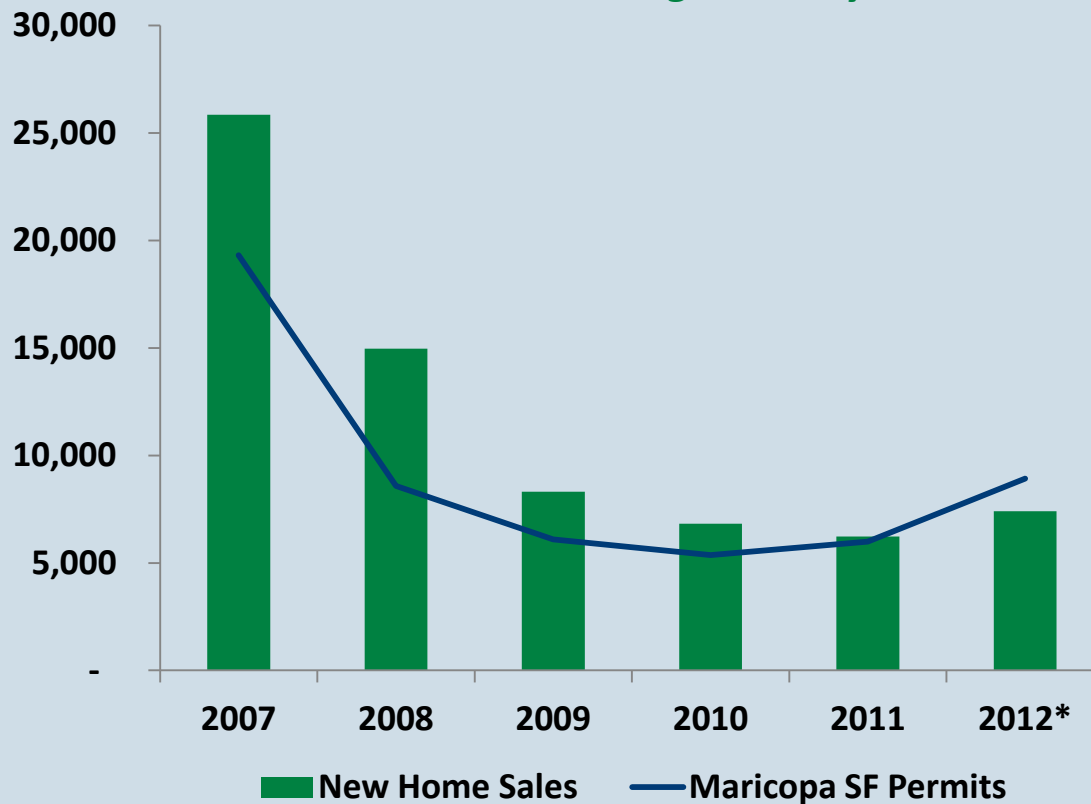
\* 4QE Sep 2012



# NEW HOME MARKET BREATHING AGAIN

Metro Phoenix new home construction beginning to see benefits from lower vacancies and higher prices in existing housing.

## New Home Sales & Single Family Permits



\* 4QE Sep 2012

## Key Trends

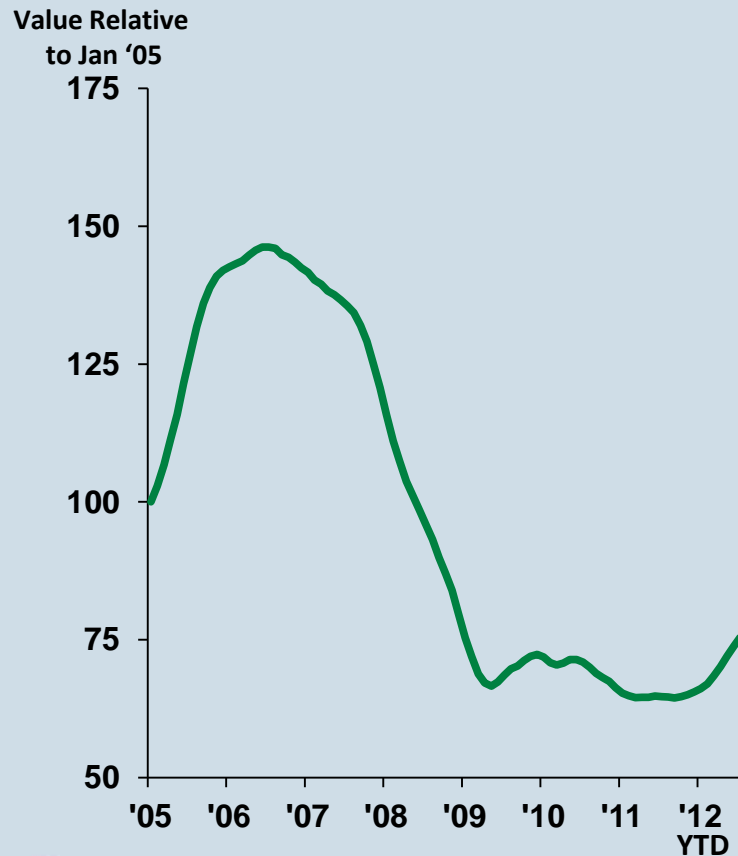
- After three very weak sales years, Metro Phoenix new home construction is turning up
- Q3 2012 new home sales at highest level in two years
- Single family permits up 40% over prior year
  - Total housing permits up 20%
- Increasing demand reflects declining value gap with existing homes



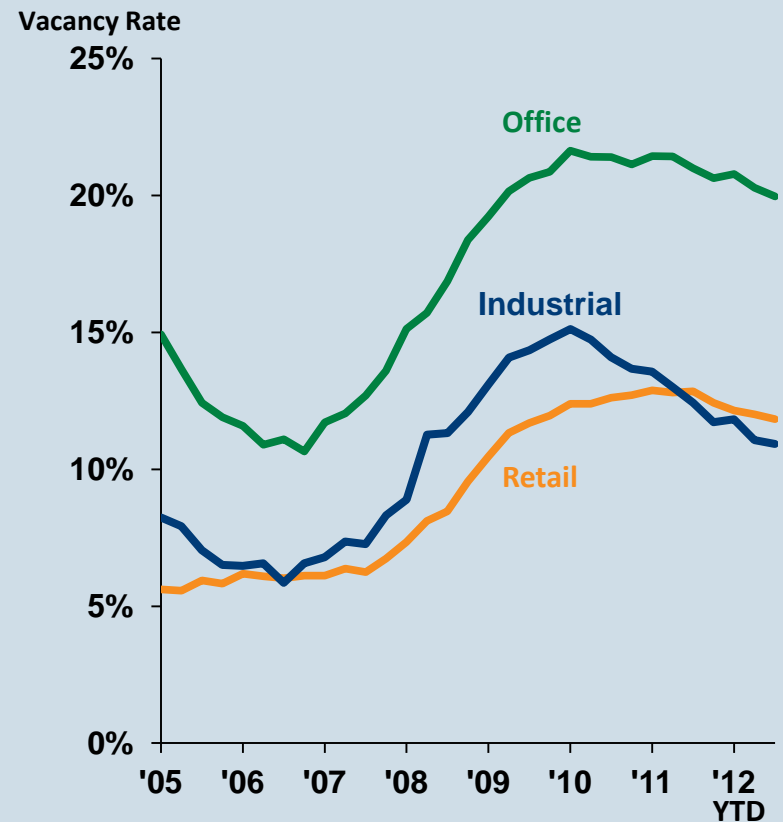
# POSITIVE NEAR-TERM TRENDS

Housing and non-residential sectors are showing steady improvement.

## Home Prices



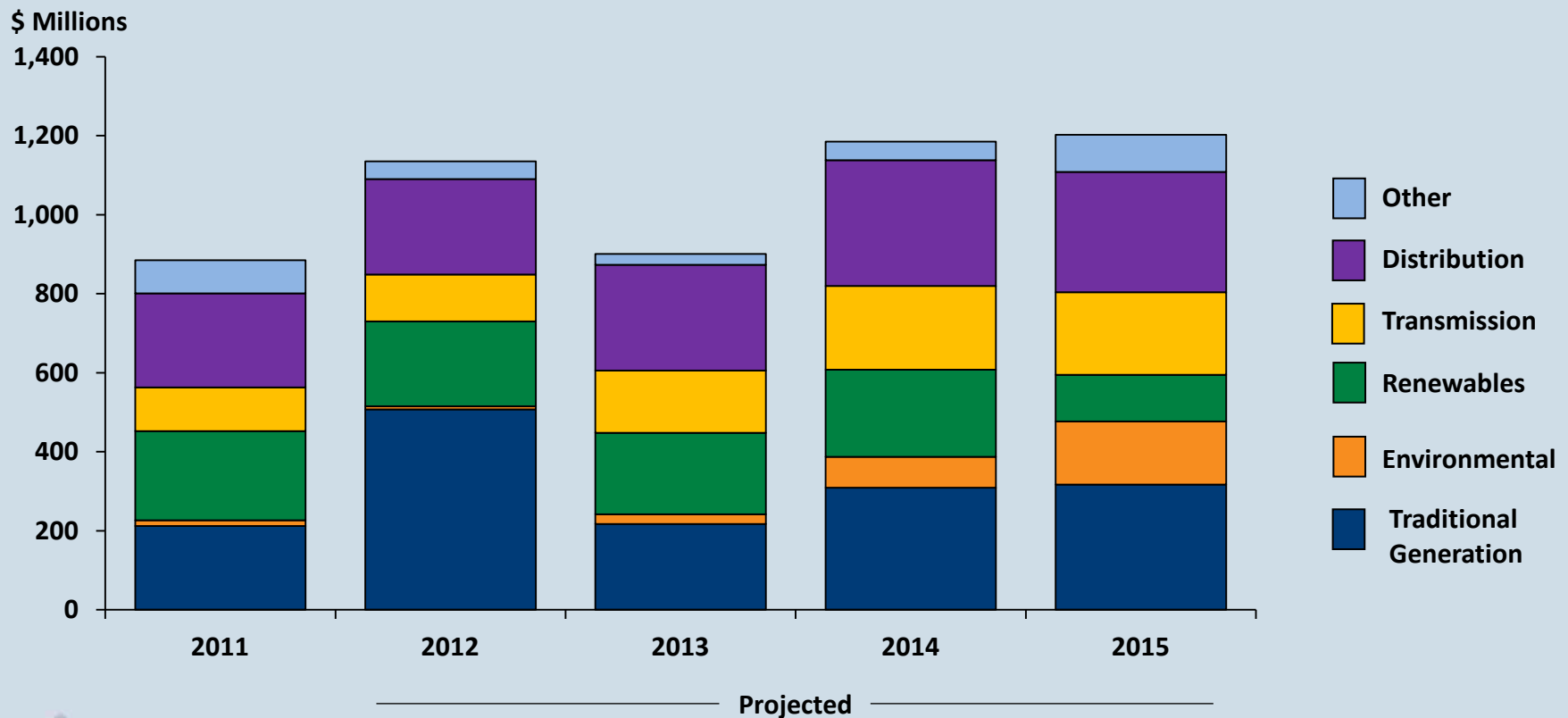
## Nonresidential Building Vacancy



# LONG-TERM GROWTH DRIVES CAP EX

Investment is required throughout the business to meet expected demand growth.

## *APS Capital Expenditures by Function*

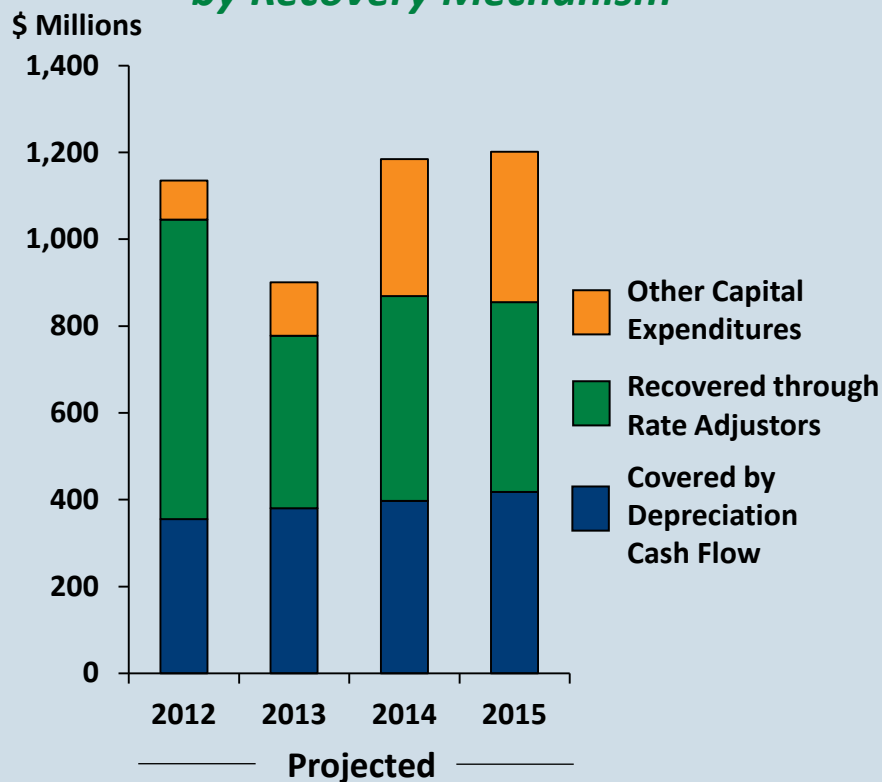


# SOLID CAPITAL RECOVERY AND STRONG RATE BASE GROWTH

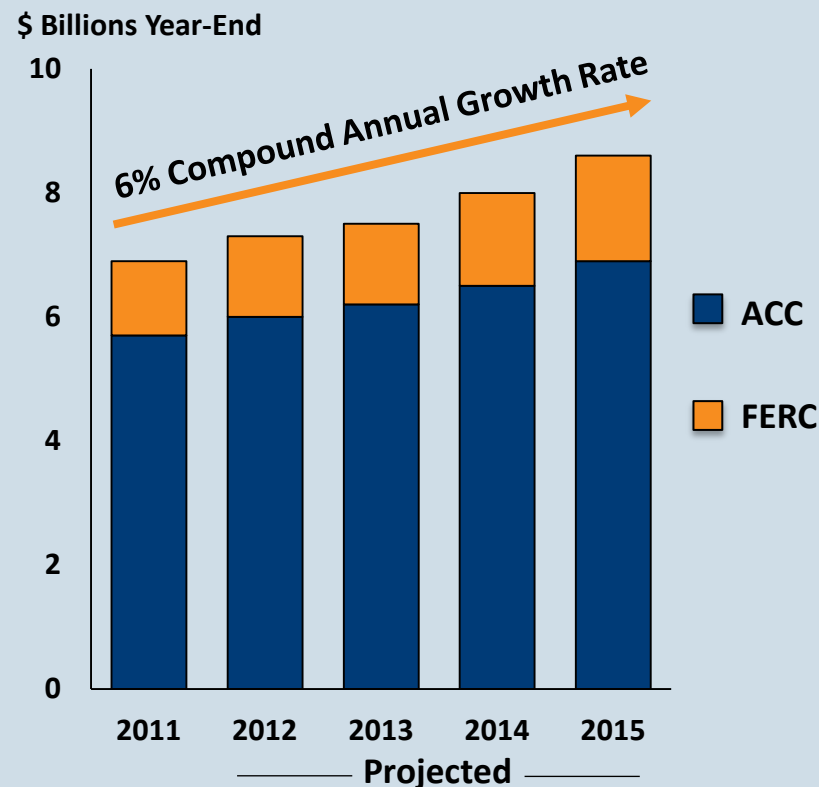
13

We expect our rate base will grow 6% per year on average, and we have constructive recovery of capital expenditures.

*APS Capital Expenditures  
by Recovery Mechanism*



*APS Rate Base Growth*





# RATE ADJUSTORS COMPLEMENT BASE RATE INCREASES

14

Regulatory structure provides support for gross margin growth throughout base rate stay-out period.

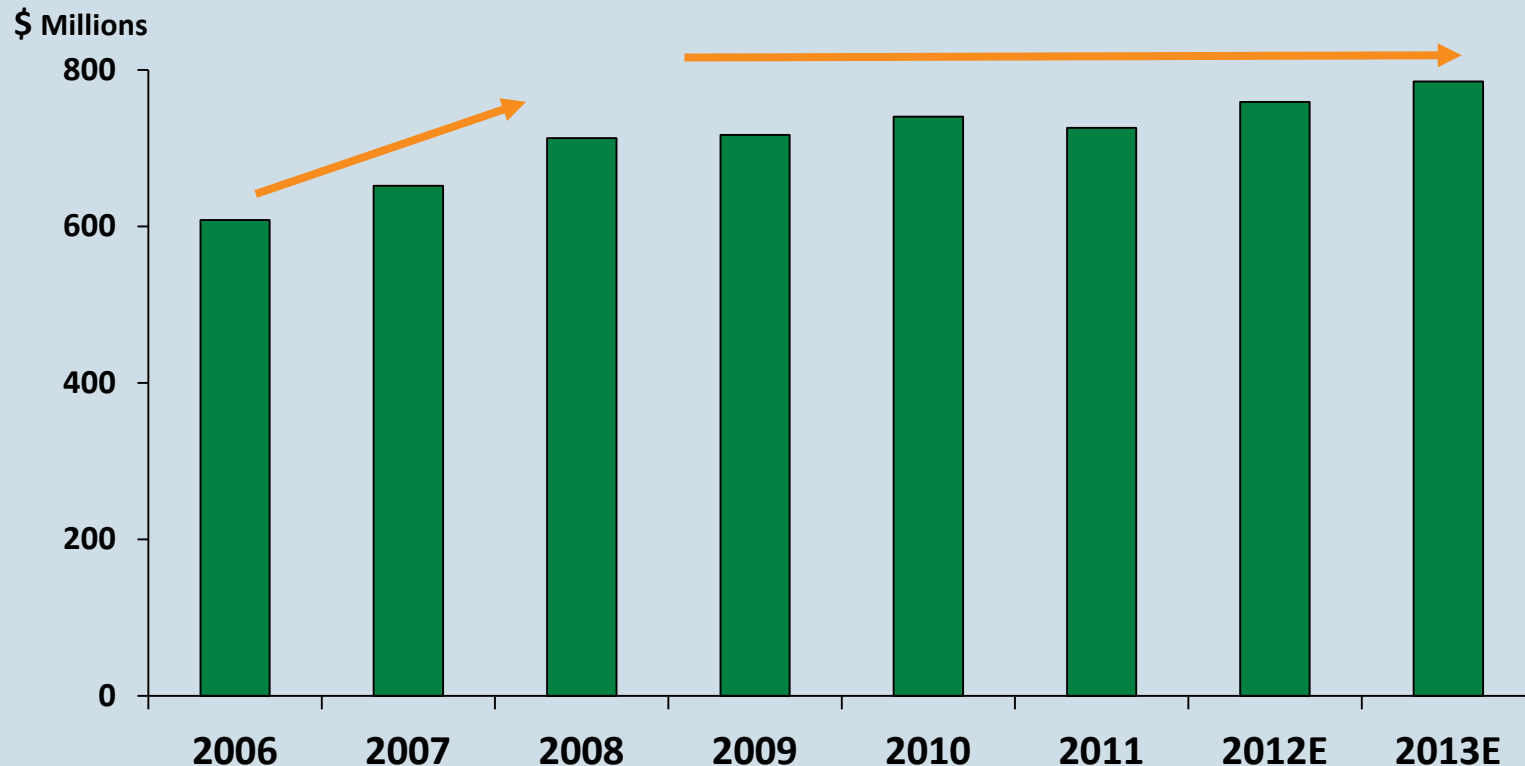
|  | 2012 | 2013 | 2014 | 2015 |
|--|------|------|------|------|
| <b>Base Rate Increase</b>                  | 55%  | 45%  | —    | —    |
| <b>Four Corners</b>                        | —    | 55%  | 45%  | —    |
| <b>Transmission Cost Adjustor</b>          | X    | X    | X    | X    |
| <b>AZ Sun</b>                              | X    | X    | X    | X    |
| <b>Lost Fixed Cost Recovery</b>            | X    | X    | X    | X    |
| <b>Environmental Improvement Surcharge</b> | —    | —    | X    | X    |



# STRONG COST MANAGEMENT FOCUS

Our goal is to keep O&M growth in line with retail sales growth.

## *APS O&M Expense Trends*



Excludes RES and demand-side management costs. 2011 also excludes \$28 million related to prior-period transmission rights-of-way settlement.



# SUSTAINABLE COST MANAGEMENT INITIATIVE ("SCMI")

16

Continued success requires a more rigorous, standardized approach to running the business.

## Motivation

- **Recognize combined challenges**
  - Costs
  - Capital
  - Sales growth
  - Stayout
- **Improve organizational efficiencies**
- **Strengthen governance and clarify accountability**
- **Refine understanding of cost structure to better identify opportunities**

## Sustainable Changes

**Tiered Metrics**

**Business Planning**

**Corporate Resources Operating Model ("CROM")**

**Centralize Financial Planning and Analysis**

**Centralize Information Technology**

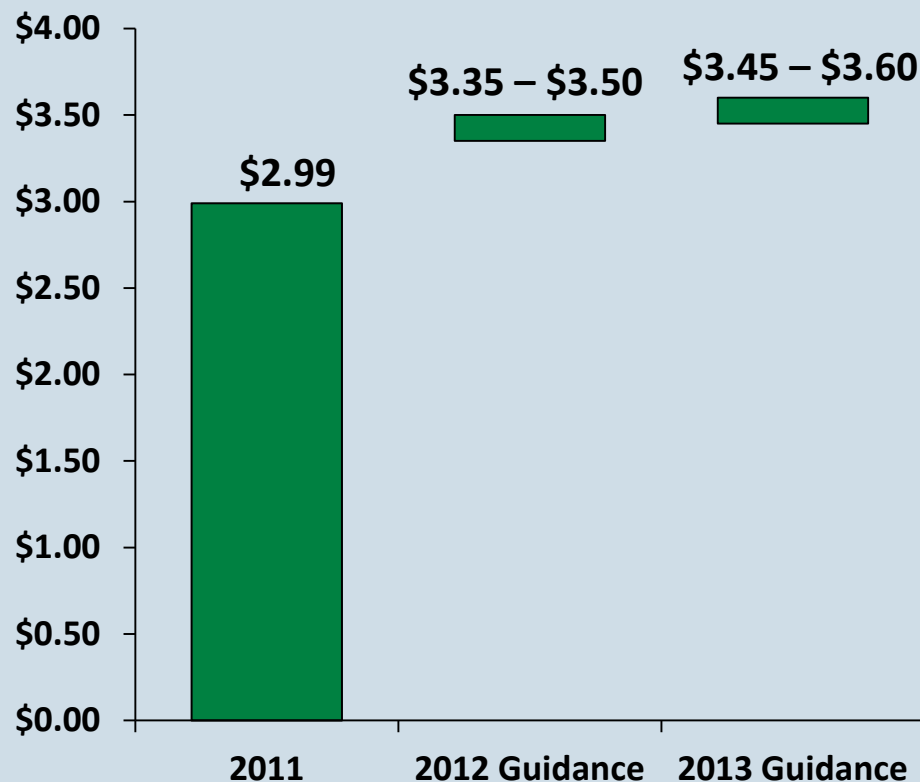
**Enterprise Process Improvement**



# CONSOLIDATED FINANCIAL OUTLOOK

Our strategies and financial performance are producing earnings growth.

## On-Going EPS



## Outlook Through 2015

- 6% rate base growth,\* but regulatory recovery not perfect
- Adjustment mechanisms provide substantial recovery during stay-out, but incomplete
- Limited sales growth
- EPS expected to grow somewhat below rate base growth

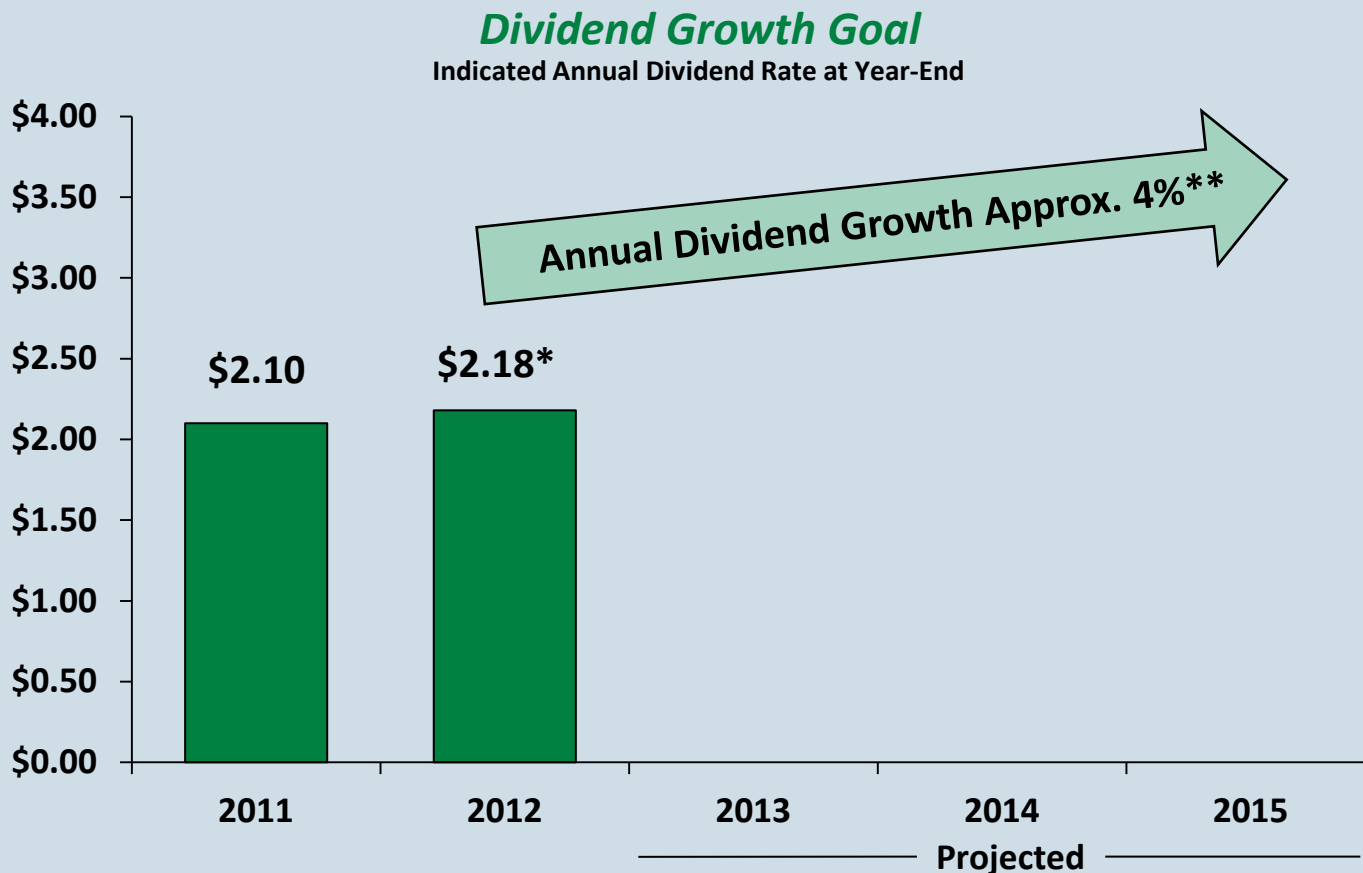
Guidance as of November 9, 2012  
See key factors and assumptions in appendix

\* Compound annual growth rate



# CONSOLIDATED FINANCIAL OUTLOOK

Our financial results facilitate growing cash returns to our shareholders.



\* Increase effective 4<sup>th</sup> quarter 2012

\*\* As of November 9, 2012

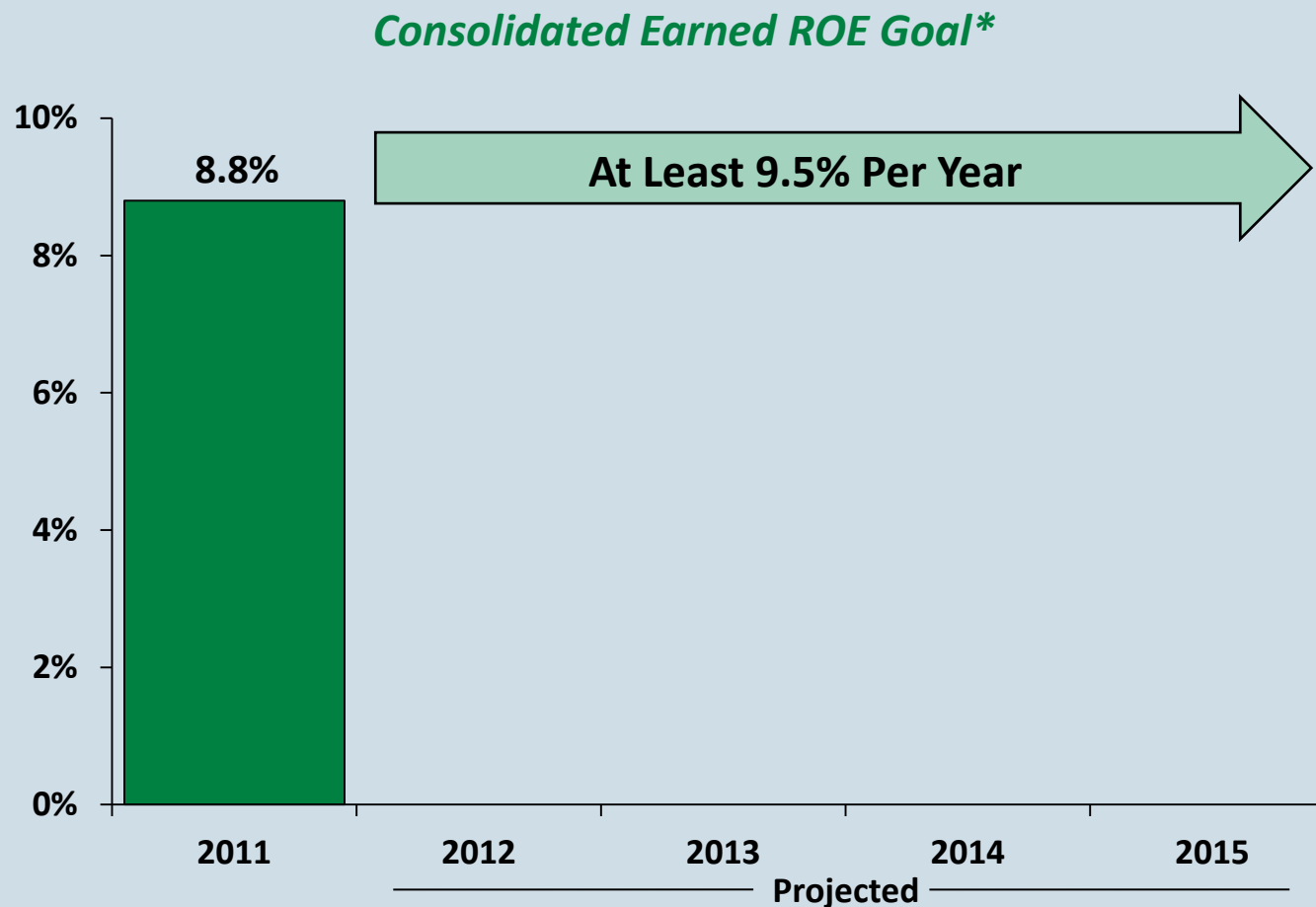
Future dividends subject to declaration  
at Board of Directors' discretion





# CONSOLIDATED FINANCIAL OUTLOOK

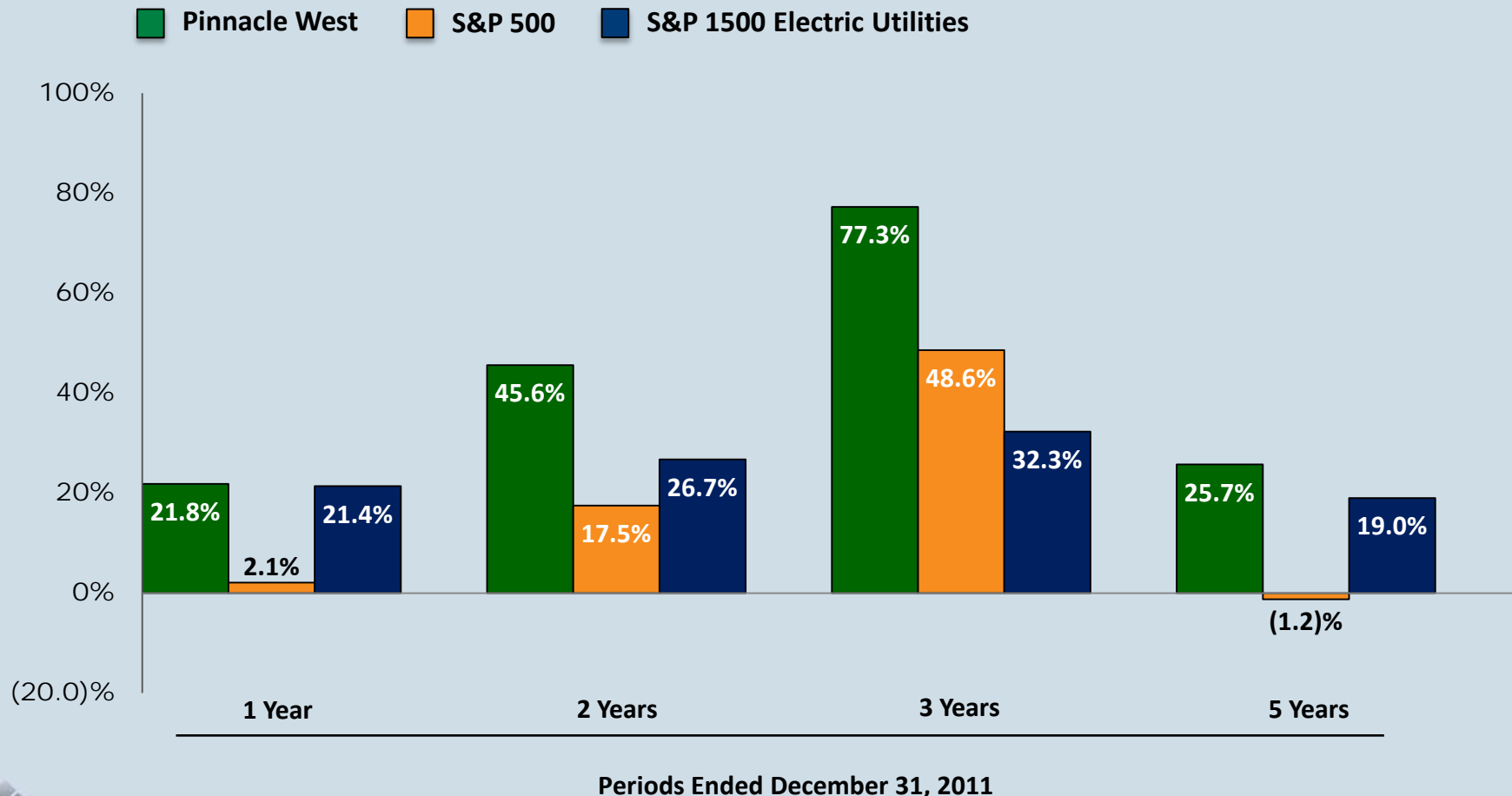
Our goal is to consistently earn a competitive return on average common equity.



\* As of November 9, 2012

# SUPERIOR SHAREHOLDER RETURNS

Our total return to shareholders has outperformed our industry and the broad market over the past five years.



# READY ACCESS TO CAPITAL

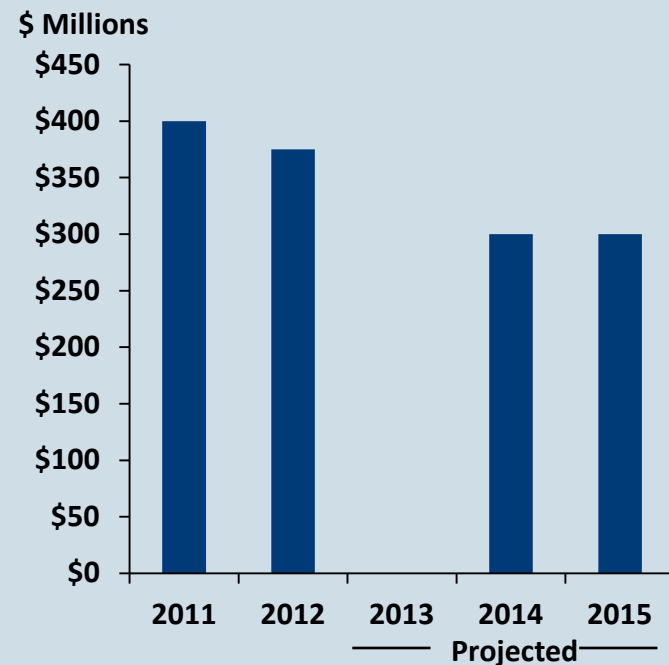
Strong access to capital resources is supported by solid credit ratings, manageable debt maturities and ample liquidity.

## *2012 Major Financing Activities*

- **\$375M APS senior notes refinancing\***
- **Remarketing of \$32MM Maricopa 2009B tax-exempts – VRDN mode with L/C \***
- **Remarketing of \$38.15MM Navajo 2009A tax-exempts – 2-year put mode\***
- **\$90M redemption of Maricopa 2002A tax-exempts\***
- **APS potential new debt issuance**

\*Completed

## *APS Long-Term Debt Maturities*



# SOLID CREDIT RATINGS

Available liquidity remains substantial and our credit ratings have improved.

## Credit Facilities and Liquidity\*

| <u>Borrower</u>    | <u>Capacity<br/>(\$ Millions)</u> | <u>Maturities</u> |
|--------------------|-----------------------------------|-------------------|
| APS                | \$ 500                            | Feb. '15          |
| APS                | 500                               | Nov. '16          |
| PNW                | <u>200</u>                        | Nov. '16          |
| Consolidated       | 1,200                             |                   |
| Cash               | <u>79</u>                         |                   |
| Total<br>Liquidity | <u><u>\$1,279</u></u>             |                   |

\*As of September 30, 2012

## Corporate Credit Ratings

Moody's

S&P

Fitch

## Senior Unsecured

Moody's

S&P

Fitch

## Outlook

Moody's

S&P

Fitch

| APS      | Parent   |
|----------|----------|
|          |          |
| Baa1     | Baa2     |
| BBB      | BBB      |
| BBB      | BBB      |
|          |          |
| Baa1     | -        |
| BBB      | -        |
| BBB+     | -        |
|          |          |
| Stable   | Stable   |
| Positive | Positive |
| Stable   | Stable   |

We are disclosing these ratings to enhance understanding of our sources of liquidity and the effects of our ratings on our costs of funds.



# PINNACLE WEST: OUR VALUE PROPOSITION

Our commitment to investors...

## Delivering Superior Shareholder Returns







# Financial Overview Appendix



PINNACLE WEST  
CAPITAL CORPORATION

# 2012 ON-GOING EPS GUIDANCE

## Key Factors and Assumptions as of November 9, 2012

- **Electricity gross margin\*** (operating revenues, net of fuel and purchased power expenses) about \$2.13 billion to \$2.18 billion
  - Retail customer growth about 1%
  - Weather-normalized retail electricity sales volume slightly below prior year taking into account effects of customer conservation and energy efficiency and distributed renewable generation initiatives
  - Actual weather for first 9 months of year and normal weather patterns for remainder of year
- **Operating expenses\*** (operations and maintenance, depreciation and amortization and taxes other than income taxes) about \$1.32 billion to \$1.35 billion (which was previously \$1.33 billion to \$1.36 billion)
- **Interest expense**, net of allowances for borrowed and equity funds used during construction, about \$180 million to \$190 million
- **Net income attributable to noncontrolling interests** about \$30 million to \$35 million
- **Effective tax rate** about 35%

\* Excludes O&M of \$127 million, and offsetting operating revenues, associated with renewable energy and energy efficiency programs



# 2013 ON-GOING EPS GUIDANCE

## Key Factors and Assumptions as of November 9, 2012

- **Electricity gross margin\* (operating revenues, net of fuel and purchased power expenses) about \$2.20 billion to \$2.25 billion**
  - Retail customer growth about 1.5%
  - Weather-normalized retail electricity sales volume about flat to prior year taking into account effects of customer conservation and energy efficiency and distributed renewable generation initiatives
  - Normal weather patterns
- **Operating expenses\* (operations and maintenance, depreciation and amortization and taxes other than income taxes) about \$1.36 billion to \$1.39 billion**
- **Interest expense, net of allowances for borrowed and equity funds used during construction, about \$190 million to \$200 million**
- **Net income attributable to noncontrolling interests about \$30 million to \$35 million**
- **Effective tax rate about 35%**

\* Excludes O&M of \$132 million, and offsetting operating revenues, associated with renewable energy and energy efficiency programs





# 2012 – 2015 FINANCIAL OUTLOOK

## Key Drivers and Assumptions as of November 9, 2012

### 2012 retail rate settlement effective July 1, 2012

- **Revenue provisions**
  - Retail base rate changes effective July 1, 2012
  - Adjustment mechanisms
    - Four Corners acquisition
    - AZ Sun additions to flow through RES until next base rate case
    - Lost Fixed Cost Recovery (LFCR) mechanism assumed to offset 30-40% of revenues lost due to ACC-mandated energy efficiency and distributed renewable generation initiatives
    - Environmental Improvement Surcharge (EIS) assumed to recover up to \$5 million annually of carrying costs for government-mandated environmental capital expenditures
- **Cost mitigation provisions**
  - Power Supply Adjustor (PSA) – 100% pass-through
  - Potential property tax deferrals – assume 60% of property tax increases relate to tax rates, therefore, will be eligible for deferrals
    - Deferral rates: 25% in 2012; 50% in 2013; 75% in 2014 and thereafter

(continued)

# 2012 – 2015 FINANCIAL OUTLOOK

## Key Drivers and Assumptions as of November 9, 2012 (continued)

- Modestly improving Arizona and U.S. economic conditions; specifically, no major disruptions to the on-going national economic recovery [resulting from political action or inaction]
- Retail customer growth to average 2% annually
- Weather-normalized retail electricity sales volume growth:
  - Relatively flat after customer conservation and energy efficiency and distributed renewable generation initiatives
  - Average 2.5% annually before customer conservation and energy efficiency and distributed renewable generation initiatives
- Rate base growth to average 6% annually
- AZ Sun Program – additional 150 MW placed into service in 2012-2015
- Transmission rate increases (FERC formula rates and retail adjustor)
- Four Corners cost deferrals between dates acquired and included in retail rates
- Company-wide operating and capital cost management
- Financing to maintain balanced capital structure and support credit ratings
- Interest rates
- Normal weather (except actual for first 9 months of 2012)





# NON-GAAP EPS RECONCILIATION

## Consolidated On-Going EPS Guidance

|   | <b><u>Year 2011<br/>Actual</u></b> | <b><u>Year 2012<br/>Guidance*</u></b> | <b><u>Year 2013<br/>Guidance*</u></b> |
|---|------------------------------------|---------------------------------------|---------------------------------------|
| <b>Net income attributable<br/>to common shareholders</b>   | <b>\$ 3.09</b>                     |                                       |                                       |
| <b>Less income (loss) from<br/>discontinued operations:</b> |                                    |                                       |                                       |
| <b>Real estate</b>  | <b>(0.01)</b>                      |                                       |                                       |
| <b>Energy services business</b>                             | <b><u>0.11</u></b>                 |                                       |                                       |
| <b>On-going EPS</b>   | <b><u>\$ 2.99</u></b>              | <b><u>\$ 3.35 - \$ 3.50</u></b>       | <b><u>\$ 3.45 - \$ 3.60</u></b>       |

\*As of November 9, 2012



# S&P CREDIT METRICS

Our key credit metrics have been improving.

|                       | 2007  | 2008  | 2009  | 2010  | 2011  |
|-----------------------|-------|-------|-------|-------|-------|
| <b>APS</b>            |       |       |       |       |       |
| FFO / Debt            | 17.2% | 22.1% | 22.8% | 22.3% | 20.8% |
| FFO / Interest        | 4.1x  | 5.1x  | 4.8x  | 4.6x  | 4.6x  |
| Debt / Capitalization | 55.2% | 57.4% | 56.8% | 53.0% | 53.0% |
| <b>Pinnacle West</b>  |       |       |       |       |       |
| FFO / Debt            | 15.7% | 18.0% | 18.4% | 22.5% | 20.3% |
| FFO / Interest        | 3.7x  | 4.3x  | 4.0x  | 4.6x  | 4.5x  |
| Debt / Capitalization | 57.0% | 59.4% | 59.8% | 55.1% | 54.5% |

Source: S&P Credit Stats



# NON-GAAP EPS RECONCILIATION

3rd Quarter 2012 vs. 3rd Quarter 2011

|   | <u>3rd Qtr<br/>2012</u> | <u>3rd Qtr<br/>2011</u> | <u>Change</u>           |
|---|-------------------------|-------------------------|-------------------------|
| <b>EPS as reported</b>                              | <b>\$ 2.21</b>          | <b>\$ 2.32</b>          | <b>\$ (0.11)</b>        |
| <b>Less income from<br/>discontinued operations</b> | <b>-</b>                | <b>(0.08)</b>           | <b>0.08</b>             |
| <b>On-going EPS</b>                                 | <b><u>\$ 2.21</u></b>   | <b><u>\$ 2.24</u></b>   | <b><u>\$ (0.03)</u></b> |



# NON-GAAP MEASURE RECONCILIATION

3rd Quarter 2012 vs. 3rd Quarter 2011 Gross Margin

| \$ millions pretax, except per share amounts  | Three Months Ended<br>September 30, |               | EPS<br>Change  |
|---|-------------------------------------|---------------|----------------|
|   | 2012                                | 2011          |                |
| Operating revenues*   | \$ 1,110                            | \$ 1,125      |                |
| Fuel and purchased power expenses*  | (303)                               | (338)         |                |
| Gross margin  | 807                                 | 787           | \$ 0.11        |
| Less:   |                                     |               |                |
| Renewable energy (excluding AZ Sun), energy<br>efficiency and similar regulatory programs | (35)                                | (44)          | 0.05           |
| Gross margin - adjusted   | <u>\$ 772</u>                       | <u>\$ 743</u> | <u>\$ 0.16</u> |

\* Line items from Consolidated Statements of Income.

