

US Electric Utilities & IPPs

The Storage Cycle Starts in California

Equities

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SoCal Ed announces results of inaugural storage procurement (as well as gas)

Contracts with counterparties under SCE (EIX) were announced today under its long-term procurement plan (LTPP), which included not just gas assets but also so-called 'preferred' resources. This includes 262 MW of energy storage—and at least five new gas plants, alongside competitively procured renewables, energy efficiency, and even demand response — the push for procurement was driven in response to SCE's procurement to backstop the retirement of its SONGS nuclear plant. While pricing was not disclosed, the SCE RFP is the largest thus far of energy storage assets, kick-starting the rush to develop a wide array of solutions. We suspect returns on storage assets is likely in excess of conventional returns (likely garnering DOE loan guarantees, etc), generating mid-to-high teen opportunities as an initial estimate (on admittedly only modest total capital commitments). Notably, the latest also likely involves ~20-year contracts on most procured assets, reversing a prior trend for 10-year deals. We show complete list of awarded contracts on Pg 2.

AES is the primary beneficiary from latest contract awards- gas and storage

As expected, AES is key beneficiary with two contracts for 1.3GW of combined cycle gas and one contract for 100MW battery storage. We think these contracts were likely for Huntington Beach and Alamitos projects. Huntington Beach recently received approval from the CEC to construct the 939 MW 3x1 CCGT last week, with the timing seemingly working well for a contract award with SCE. At a total projected cost of ~\$1 Bn (likely conservative), we estimate the project as driving *at least* an incremental ~\$0.06-0.10 in EPS to our 2019 estimate – and contributing to achieving a higher long-term EPS CAGR for the company. We flag this will all likely be eligible to be sold into a YieldCo structure.

Meanwhile NRG comes out ahead too, with thermal, storage, etc

NRG disclosed this AM it had received a contract to repower the Mandalay site with a 262 MW contract (with a seemingly further smaller contract still pending announcement per the SCE release below). Meanwhile, it was also awarded 178MW of preferred resources (~100MW EE and ~75 MW DR), illustrating its commitment to a shifting business model. The award follows its recent award of the 600MW Carlsbad CCGT in recent weeks by SDG&E. All of this likely will be fed into NRG Yield.

Contract award should also solidify AES' position in storage biz

We believe SCE project awards illustrate AES' competitive positioning in the energy storage area, which is poised to see a multitude of (small) project awards in the state and elsewhere. Their two PJM sites (Mt. Laurel in W Va and DPL location) remain the two most discussed projects. We believe nearly all IPPs and many diversified utilities will increasingly look to develop these niche businesses both within the context of competitive markets (PJM), as well as within contracted build (California), and even under ratebase, as we are likely to hear from APS (PNW) in subsequent quarters).

Julien Dumoulin-Smith

Analyst

julien.dumoulin-smith@ubs.com

+1-212-713 9848

Michael Weinstein

Associate Analyst

michael.weinstein@ubs.com

+1-212-713 3182

Paul Zimbardo

Associate Analyst

paul.zimbardo@ubs.com

+1-212-713 1033

Please click on the links below to see some of our recent notes on this topic:

[Re-Opening the DOE's Loan Guarantee Program](#)

[Extracting 3Q Nuggets Learned \(where we discuss California contacts on pgs 2/3\)](#)

[The Storage Opportunity](#)

[Digging Deeper into Storage](#)

We suspect these project awards will feature prominently tomorrow around 3Q results on Thursday, and remove AES from our Least Preferred list given our previous concerns around weaker results/'14 guidance commentary.

We include below the complete list of the resources type and sellers that were selected as part of a Local Capacity Requirement (LCR) RFO process for incremental capacity in the West LA Basin and Moonpark area.

Figure 1: Resources Selected for the West LA Basin

Seller	Resource Type	MWs	Number of Contracts
NRG	Energy Efficiency	103	8
Onsite Energy Corporation	Energy Efficiency	11	11
Sterling Analytics LLC	Energy Efficiency	17	7
NRG	Demand Response	75	7
SunPower Corp.	Behind-the-Meter Renewable	44	4
Ice Energy Holdings, Inc.	Behind-the-Meter Thermal Energy Storage	26	16
Advanced Microgrid Solutions	Behind-the-Meter Battery Energy Storage	50	4
Stem	Behind-the-Meter Battery Energy Storage	85	2
AES	In-Front-of-Meter Battery Energy Storage	100	1
AES	Combined Cycle Gas Fired Generation	1,284	2
Stanton Energy Reliability Center	Peaking Gas Fired Generation	98	1
TOTAL:		1,892	63

Source: Southern California Edison

Figure 2: Resources Selected for the Moonpark Area

Seller	Resource Type	MWs	Number of Contracts
Onsite Energy Corporation	Energy Efficiency	6	6
SunPower Corp.	Behind-the-Meter Renewable	6	2
NRG Energy, Inc.	In-Front-of-Meter Battery Energy Storage	0.5	1
NRG Energy, Inc.	Peaking Gas Fired Generation	316	2
TOTAL:		328.5	11

Source: Southern California Edison

AES Huntington Beach Upside: Big Contract Award.

We include our initial estimate of Net Income, EBITDA, and FCF for the project. We initially estimate the project will only have a 10-year off-take agreement with SCE, enabling a 10-year amortization profile for the debt (and in turn limiting the FCF contribution of asset). We also initially assume ~6% cost of debt in our 'build up' to the EBITDA of ~\$125 Mn/yr through the 10-year period. We believe initial year EBITDA and FCF could yet be higher to reflect greater discounting of the long-term outlook in the region. We emphasize there is likely another asset within the Southland portfolio that received a contract (Alamitos), however details are still pending.

Figure 3: AES Huntington Beach - Estimated Cash Flow Profile

Huntington Beach Repowering	
Capacity MW	939
Fuel	Gas - 3x1 CCGT
Total Investment \$mr	1,000
Leverage	70%
Total Debt	700
AES Ownership	100%
AES' Equity \$mm	300
ROE	14%
Net Income	42
EPS	0.06
Tax Rate	25%
EBT	56
Interest %	6%
Interest	42
EBIT	98
Tenure	40
Depreciation	25
EBITDA (\$ Mn)	123
FCF (\$ Mn)	11

Source: CEC, Company reports, and UBS estimates

Statement of Risk

Risks for Utilities and Independent Power Producers (IPPs) primarily relate to volatile commodity prices for power, natural gas, and coal. Risks to IPPs also stem from load variability, and operational risk in running these facilities. Rising coal and, to a certain extent, uranium prices could pressure margins as the fuel hedges roll off Competitive Integrations. Further, IPPs face declining revenues as in the money power and gas hedges roll off. Other non-regulated risks include weather and for some, foreign currency risk, which again must be diligently accounted in the company's risk management operations. Major external factors, which affect our valuation, are environmental risks. Environmental capex could escalate if stricter emission standards are implemented. We believe a nuclear accident or a change in the Nuclear Regulatory Commission/Environment Protection Agency regulations could have a negative impact on our estimates. Risks for regulated utilities include the uncertainty around the composition of state regulatory Commissions, adverse regulatory changes, unfavorable weather conditions, variance from normal population growth, and changes in customer mix. Changes in macroeconomic factors will affect customer additions/subtractions and usage patterns.

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Source: UBS. Rating allocations are as of 30 September 2014.

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UBS Securities LLC: Julien Dumoulin-Smith; Michael Weinstein; Paul Zimbardo.

Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
AES Corporation ^{2, 4, 6, 16}	AES.N	Neutral	N/A	US\$13.76	04 Nov 2014

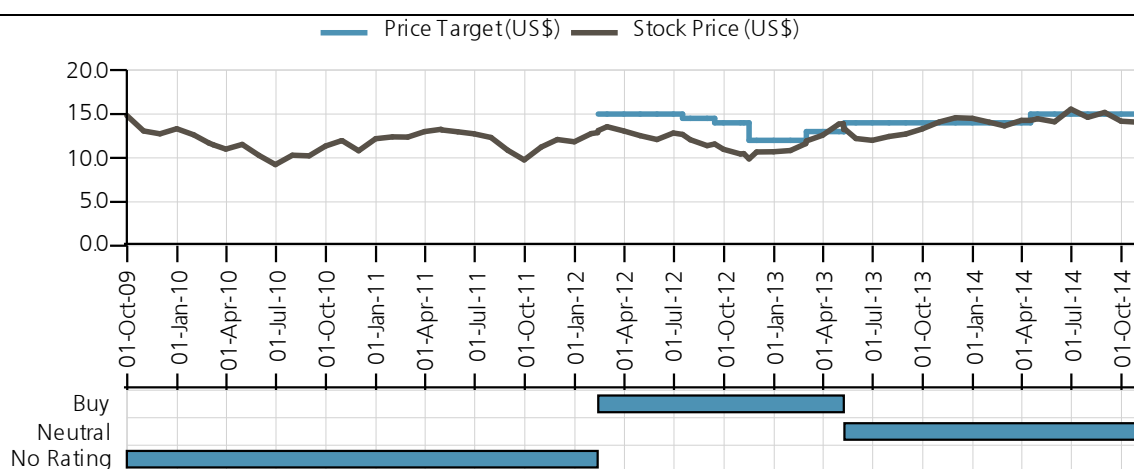
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AES Corporation (US\$)



Source: UBS; as of 04 Nov 2014

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