Talen Energy Corp
Deploying the War Chest

Equities
Americas
Electric Utilities

12-month rating	**Sell**
12m price target	**US$18.00**
Price	**US$17.31**
RIC: TLN.N **BBG:** TLN US	

Trading data and key metrics

52-wk range	US$23.48-16.95
Market cap.	US$2.22bn
Shares o/s	129m (COM)
Free float	100%
Avg. daily volume ('000)	603
Avg. daily value (m)	US$11.4
Common s/h equity (12/15E)	US$5.72bn
P/BV (12/15E)	0.4x
Net debt / EBITDA (12/15E)	3.9x

EPS (UBS, diluted) (US$)

	12/15E	
	UBS	Cons.
Q1	0.80	-
Q2E	(0.04)	0.02
Q3E	0.28	0.65
Q4E	0.53	0.11
12/15E	1.57	1.24
12/16E	1.60	1.30
12/17E	0.49	0.50

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Talen buys MACH Gen for $920Mn net of tax; $1/sh EV accretive but 3% yield

Monday (7/20) Talen announced the purchase of the three asset MACH Gen portfolio for $1.2Bn gross ($920Mn net of tax NPV) with economics largely in-line with our expectations in Monday's note 'Opening the War Chest'. We estimate the acquisition is ~$1/sh accretive assuming monetization of Harquahala at ~$100Mn and providing credit for the NPV of tax benefits. Although we see the transaction as a positive development for Talen given FCF accretion and fuel/geographic diversification, management utilizes precious debt capacity that reduces its probability of executing on future deals. The EV yield of 3% was a bit disappointing and with 5x net debt /adj EBITDA (2017E UBS pro-forma for Capacity Performance; 5.7x w/o CP) we see the balance sheet as largely tapped-out for now (expect equity for further deals).

Deal not as expensive as first meets the eye thanks to tax monetization

Similar to Dynegy's recent ECP/Duke transaction, accelerating tax attributes appears to be a key factor driving accretion for Talen's first acquisition. After peeling back the layers of the transaction (Harquahala and taxes primarily), mgmt estimates 2016E EV/EBITDA of ~6.3x based upon $120Mn EBITDA ($130Mn ex- Harquahala). We estimate $115Mn ($120Mn ex- Harquahala) assuming that mgmt can improve the capacity factor at Athens to ~55% from ~45% 5yr average, a ~$10Mn improvement.

How much leverage can management utilize in the next deal?

While it is tempting to focus on 'fixing' AZ as the path to value, we see the opportunity to access cheap gas via Constitution as the single largest potential positive catalyst from the fleet. Strong spark spreads in NY would push this deal from neutral/slightly accretive to a solid positive. For now investors have to wait and see in both AZ and NY.

Valuation: $18 Price Target and Sell Rating; Can Talen execute on further M&A?

Valuation is based on 2017E sum-of-the-parts. We are maintaining our $18 Price Target as our valuation already had a $1.50 placeholder for accretive M&A (previously for the 50% probability of AEP's GenCo which is substantially larger than MACH Gen's portfolio.) The spin mandated divestiture will unlock additional cash but will be offset by lost EBITDA; redeploying proceeds will be the next focus.

Highlights (US$m)	-	-	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenues	-	-	4,274	4,140	3,906	3,718	3,831	3,949
EBIT (UBS)	-	-	441	598	496	297	369	454
Net earnings (UBS)	-	-	139	202	209	66	125	192
EPS (UBS, diluted) (US$)	-	-	1.08	1.57	1.60	0.49	0.93	1.43
DPS (US$)	-	-	0.00	0.00	0.00	0.00	0.00	0.00
Net (debt) / cash	-	-	(3,931)	(3,963)	(3,860)	(3,788)	(3,768)	(3,585)

Profitability/valuation	-	-	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
EBIT margin %	-	-	10.3	14.4	12.7	8.0	9.6	11.5
ROIC (EBIT) %	-	-	-	6.0	4.9	2.9	3.6	4.5
EV/EBITDA (core) x	-	-	-	6.1	6.8	8.4	7.6	6.7
P/E (UBS, diluted) x	-	-	-	11.0	10.8	35.0	18.6	12.1
Equity FCF (UBS) yield %	-	-	-	12.9	11.7	10.1	8.4	15.9
Net dividend yield %	-	-	-	0.0	0.0	0.0	0.0	0.0

Source: Company accounts, Thomson Reuters, UBS estimates. UBS adjusted EPS is stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement. Valuations: based on an average share price that year, (E): based on a share price of US$17.31 on 20 Jul 2015 19:38 EDT

Investment Thesis

Talen Energy Corp

12-month rating **Sell**

12m price target **US$18.00**

Investment case

Talen is a coal and nuclear oriented IPP operating primarily in PJM created from the spin of PPL Energy Supply and Riverstone. The new IPP primarily has assets in PJM and ERCOT with a willingness to expand into other competitive power markets. The strategy is to grow cash flows in the capacity and energy markets both organically and via M&A. The investment case is premised on Talen earning additional capacity payments in PJM, extracting further synergies from its PPL/Riverstone deal, and being able to grow via debt-heavy power asset acquisitions. We see the stand-alone fundamental outlook as particularly weak with PJM East (in PSEG and PPL zones) consistently trading at a discount now to PJM West prices – and see further new plant entry only exacerbating these concerns.

Upside scenario

Our $26/sh upside case is based upon a 1x EV / EBITDA multiple premium, in-line with the multiple we apply to high-quality fleets, and also includes the capacity performance uplift at a higher multiple. This scenario is based upon higher realized capacity prices, ERCOT pricing at the offer cap (along with uplift in the forwards), and higher synergy realization. The higher stock price here would increase the probability of an accretive deal which we estimate being worth $5-6/sh. Ultimately we see upside to the mid-to-high-$20 range.

Downside scenario

Our $10/sh downside case is based upon a 1x EV / EBITDA multiple discount, no capacity performance uplift, and a 0% probability for accretive M&A. This scenario is premised on low capacity market expectations in PJM, continued weak realized pricing in ERCOT, inability to achieve synergy targets, and deterioration in the share price such that acquiring other power assets becomes challenging. Operational issues with Susquehanna and other assets could also pressure margins. We believe that the low-teens FCF yield would support shares in the low-$10 range.

Upcoming catalysts

July 30	2016/2017 PJM Transition Auction
August 6	2017/2018 PJM Transition Auction
August 11	2Q15 Earnings Call
August 21	2018/2019 PJM Base Capacity Auction
November	Expected 3Q15 Earnings Call with synergy update and guidance roll-forward
November	EEI Financial Conference
November 30	Talen Lock-Up Expires (35% of shares)
October	Decision Expected in AEP's ESP Filing
YE15	Expected Close of MACH Gen Acquisition

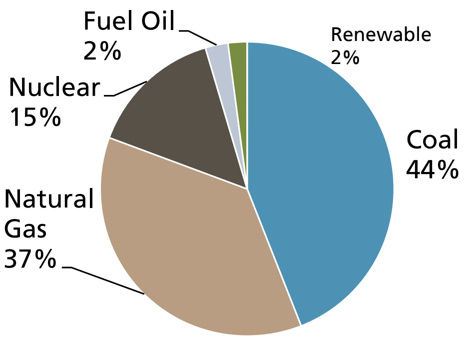
Business description

Talen Energy Corp (Talen) is a merchant independent power producer (IPP) of wholesale power and capacity in the Northeast (PA, MD, NJ, MA), Texas, and West (MT). Talen's generation portfolio consists of over 13,000 megawatts of base-load, intermediate, and peaking power plants fueled by a mix of coal, natural gas, fuel oil, and nuclear. Talen was formed in June 2015 from PPL Corp's spin-off of its unregulated business PPL Energy Supply and private equity firm Riverstone Holdings' contribution of the Raven, Sapphire, and Topaz portfolios. 65% of shares were distributed to PPL Corp shareholders.

Industry outlook

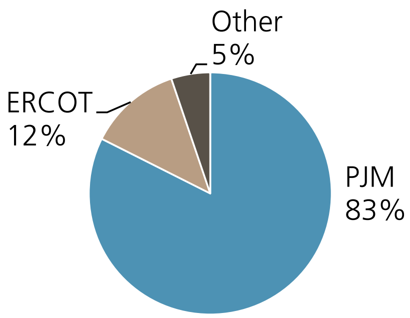
The electric utility industry is projected to experience weak or negative electric demand growth in coming years as a tepid economy and energy efficiency dampen demand. In the unregulated merchant power space, we see limited potential for a meaningful recovery from currently low power prices due to limited projected demand growth, growth of subsidized renewables, and potential for only modest further retirements. At regulated utilities, we believe rising interest rates and robust valuations are a challenge to the sector, particularly as earnings growth stalls once EPA-mandated growth capex slow mid-decade. We expect cost- cutting and strategic planning to be a key theme, with M&A at modest (at best) premiums designed to extract cost synergies. We believe utilities with high parent leverage will disproportionately suffer, as they are unable to recoup from rising interest rates.

Assets by Fuel Type (12/31/14) %



Source: Company Filings

Assets by Region (12/31/14) %



Source: Company Filings

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For more detail on these issues, please see our other recent reports:

7/20/15 Opening The War Chest?
7/15/15 2Q15 Preview: Power Outage (Page 174)
6/4/15 Initiation: Choppy Waters on the Susquehanna
5/22/15 The 10 Key Talen Debates

Further thoughts/takeaways from the call:

Below we present our updated thoughts on the MACH Gen portfolio following yesterday morning's call.

- **Tax benefits to the rescue:** The most significant update was that Talen will acquire favorable tax attributes from MACH Gen and use the tax shield to generate $245Mn NPV (TLN estimate). Talen's status as a cash taxpayer could help facilitate further deals via NOL/DTA monetization.

This factor alone causes ~2x EV/EBITDA improvement.

- **Will management pursue more deals after acquisition? Quite likely.** While leverage appears substantial, we see a credible argument for yet *another* transaction after MACH Gen is closed, particularly if employing an equity issuance to further expand its asset base. We continue to see the acquisition of AEP's merchant generation business as well as any deal with TCEH (TXU's competitive arm) as part of the ongoing TCEH restructuring as key focuses. Eventually, even a deal with DYN is credible following previously failed attempt during the spin process (there is a limitation on revisiting the transaction given the tax-free nature of the spin). Bottom line, TLN will continue to follow DYN's playbook in pursuing several iterations of transactions consecutively to gain scale. In the near term, the focus will be on the promised divestment promise which is required to be completed within a year a of the spin's closing (implying ~June, 2016).

- **Leverage: Using up the divestment proceeds already?** With the latest deal pushing management to the top end of its targeted 3-5x Net Debt/EBITDA range (4.9x 2016E management guidance), we see Talen as implicitly leveraging up its balance sheet in anticipation of meaningful proceeds from any deal. Given the potential size of divestment proceeds, we see the transaction as adding only limited incremental leverage (in the ballpark of~$500 Mn to the balance sheet, or just ~0.5x Net Debt/EBITDA).

- **2016 guidance provided, but 2017 is the real wildcard:** While Talen provided 2016 guidance for the portfolio, the real question remains how 2017 will play out amidst uncertainty over the basis improvement for a full-year as Constitution enters service late in 2016. Consistent with the EBITDA uplift we have seen for Dynegy's Independence CCGT in Western NY, we expect pricing for New York state to shift towards one as a modest premium to Dominion-South (likely $0.20-0.40c/MMBtu), as has been the experience with DYN's asset in recent quarters.

- **Forward guidance could be under pressure:** Management marked the new portfolio to market for commodity movements using curves as of July 8th but opted to not update its base portfolio (still using its 3/31). Power is modestly since that point (particularly in July) and investors expressed concern that management opted to neither update nor confirm guidance on the call.

- **Arizona market is even more challenged than we had thought:** We had estimated ~$5-10Mn negative annual EBITDA for the plant but thought it would have been closer to ~break-even FCF. Management laid out a range of strategies for the plant and while divesting to a regulated utility would likely be the most lucrative possibility that could take some time to materialize. Talen stated that it would provide an update later this year, seemingly indicating to us that a more immediate solution is likely such as selling the unit for parts. If management is successful in renegotiating its Long-Term Service Agreement (LTSA) to improve the profile we could see the plant having a longer life but in the absence of O&M relief Talen might not have the patience to hold for the long haul.

Although never optimistic on the Southwest market, outlook is even bleaker than we originally estimated.

- **Can Talen execute on a commercial arrangement in AZ?** Following years without success in Arizona to find an off-taker for the plant's capacity, there remains an open question as to whether TLN will be more successful in monetizing the portfolio, if only via deconstructing the site and adding it elsewhere. We would not doubt the Harquahala site could well be deconstructed, with the turbine lifted and placed in the PJM footprint at management's existing brownfield expansion sites (all use the same turbines) already. We suspect this is the first of many credible efforts to literally un-construct and rebuild at an estimated cost of $500/kW (accretive to do so in PJM at these prices). Without an arrangement, we would expect the -$10 Mn Harquahala EBITDA drag to persist beyond 2016 until the LTSA is renegotiated at a minimum (the cash burn will remain); in fact, we see potential for a further acceleration of this burn.

- **Light on synergies but could squeeze Siemens:** We did not anticipate material cost savings for the privately owned fleet that has recently gone through bankruptcy, particularly for the AZ asset – we assume low-$20/kW-yr already. Negotiating the cost of the LTA discussed above could deliver savings at MACH Gen as well as Talen's other assets utilizing 501G technology (Ironwood and Lower Mount Bethel). An update could be forthcoming later this year with RJS-PPL Supply synergies where we see the potential for wider cost rationalization.

Among the acquisition rationales is the widespread use of Siemens 501G turbines at MACH Gen -this complement's the existing use of these turbines at both Ironwood and Lower Mt Bethel

- **Structurally hedging up the business with gas:** Consistent with the logic announced at the time of the spin, we see the MACH Gen portfolio as successfully executing on diversification strategy towards gas generation – in competitive markets. We see the deal as consistent on the goal of providing diversity to other competitive markets, reducing TLN's substantial sensitivity to shifts in PJM capacity payments. While we generally see capacity payments as 'topping out' this year across all three markets (PJM, New England and New York), we expect substantially less correlation between PJM and New England/New York prospectively. Rather, we expect both New York and New England to prove relatively stable in future periods.

What's our view on Talen overall? Maintain Sell rating

We maintain our Sell rating on shares given the continued lack of diversification, at a premium to peers. While admittedly, forthcoming PJM capacity auctions should drive some positive revisions – and the latest deal does enable some strategic expansion – we see less dry powder. Discounted deal price for the New York and New England assets reflects longer-term regulatory risks, particularly in New York. We see gas basis benefits as real, and a core thesis to latest acquisitions.

Still prefer peers DYN and NRG

Diving into the Portfolio

We detail out thoughts on the natural gas-fired MACH Gen portfolio below. The MACH Gen assets are all 2001-2004 vintage natural-gas fired plants including the 1.2GW Athens (NY - Zone G), Harquahala (AZ - Palo Verde), and Millennium Power (MA - Mass Hub).

Acquisition provides needed geographic and fuel diversification.

Figure 1: MACH Gen Portfolio

MACH Gen Portfolio							
Power Plant Name	Dipatching ISO Zonal	Owned	Fuel Type	Plant Type	Year First	State	'17E
Athens	NY Zone F/G	1,080	Nat Gas	CCGT	2003	NY	$91
Harquahala	Palo Verde	1,092	Nat Gas	CCGT	2004	AZ	($8)
Millennium Power	Mass Hub	360	Nat Gas	CCGT	2001	MA	$26
Totals		2,532					$109

Source: Company Filings, SNL Energy, and UBS Estimates

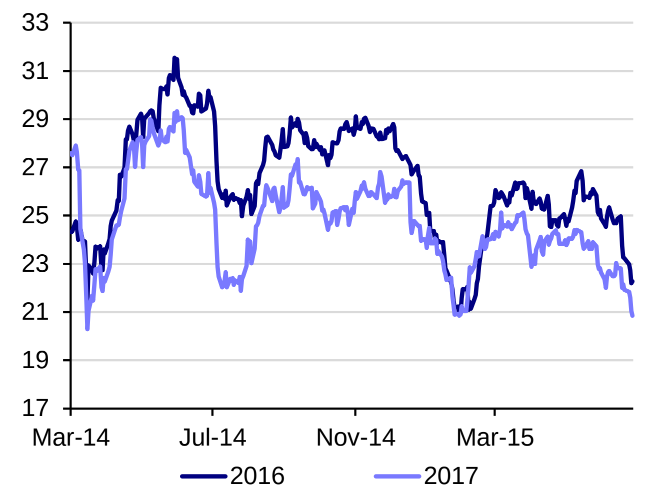
Athens: Gas prices coming down in Upstate New York?

As we highlighted in our earlier note and management emphasized on the call, there could be significant fuel cost savings for this upstate New York unit. It remains to be seen whether gas plants in Zone F (The Capital zone) will benefit from improving gas prices into the region resulting from the in-service of the Constitution Pipeline in 2H16. If the Athens plant can secure access to Dominion-South gas at sub-$2.50/mmbtu versus TransCo Zone 6 at ~$4/mmbtu there could be significant fuel savings, potentially ~$60Mn (7,100 heat rate and ~55% capacity factor assumption). This is the playbook for the CPV Valley plant which will benefit from the cheaper gas available off the Millennium pipe, pricing seemingly at only a slight premium to cheap Dom-South (Marcellus) delivered cost. Management also stated that there are transmission limitations for the plant which could limit the ultimate sparks realized here.

Spark spreads could expand ~$10/MWh for Athens.

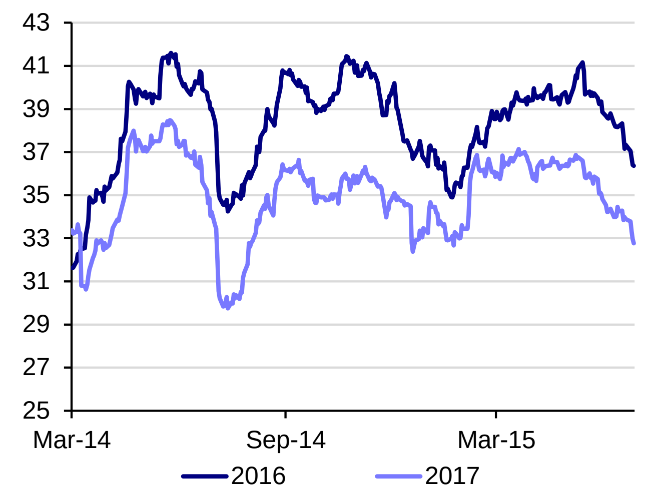
Premiums to Dom-South pricing in NY could range from $0.10-0.40/MMBtu by our estimates w/ the Constitution pipe in-service

Figure 2: Spark Spreads: NY Zone G - Transco 6 ($MWh)



Source: Platts

Figure 3: Spark Spreads: NY Zone G - Dom South ($MWh)



Source: Platts

A further corollary to the Athens upside remains to what extent power prices will be negatively impacted in the region given the cheaper availability of gas to all nearby plants. While there will likely be negative pressure to a certain extent, prices are likely to be largely supported given the regional interconnections to New England – and continued higher gas prices in this adjacent power market.

The primary change to estimates for the MACH Gen fleet comes at Athens where we have increased the capacity factor assumption to 55% from ~45% five-year average based upon management's guidance for improved dispatch operations; however, we stop short of improving the fuel cost assumptions yet.

Figure 4: Athens Mini Model

Athens Mini Model	2015	2016	2017	2018	2019
Capacity (MW)	1,080	1,080	1,080	1,080	1,080
Capacity Factor, UBSe	44.0%	55.0%	55.0%	55.0%	55.0%
NYISO Zone F ($/MWh), Bias for Super-Peak	$54	$48	$46	$45	$45
Heat Rate, UBSe	7,100	7,100	7,100	7,100	7,100
Variable Cost ($/MWh)	($30)	($30)	($31)	($32)	($32)
Energy Margin ($MWh)	$23	$18	$15	$14	$14
Generation (TWh)	4.2	5.2	5.2	5.2	5.2
Energy Margin ($Mn)	$98	$93	$80	$71	$72
NY ROS Capacity Payment ($/MW-day)	$112	$104	$102	$103	$103
Capacity Revenue ($Mn)	$42	$39	$38	$38	$38
O&M ($/kW-yr), UBSe	$25	$25	$25	$25	$25
O&M ($ Mn)	$27	$27	$27	$27	$27
EBITDA	**113**	**105**	**91**	**82**	**84**

Source: Company Filings, SNL, Platts and UBS Estimates

In a scenario with Dominion-South fuel cost, EBITDA could rise significantly although we view this as likely the top of the zone of reasonableness for expectations. Any improvement in spark spreads would offer upside to the accretion estimates.

Figure 5: Athens Mini Model – Dominion-South Spark Spread Scenario

Athens Mini Model	2015	2016	2017	2018	2019
Capacity (MW)	1,080	1,080	1,080	1,080	1,080
Capacity Factor, UBSe	55.0%	55.0%	55.0%	55.0%	55.0%
NYISO Zone F ($/MWh), Bias for Super-Peak	$54	$48	$46	$45	$45
Heat Rate, UBSe	7,100	7,100	7,100	7,100	7,100
Variable Cost ($/MWh)	($16)	($16)	($18)	($19)	($19)
Energy Margin ($MWh)	$38	$32	$28	$26	$26
Generation (TWh)	5.2	5.2	5.2	5.2	5.2
Energy Margin ($Mn)	$198	$169	$145	$135	$137
NY ROS Capacity Payment ($/MW-day)	$112	$104	$102	$103	$103
Capacity Revenue ($Mn)	$42	$39	$38	$38	$38
O&M ($/kW-yr), UBSe	$25	$25	$25	$25	$25
O&M ($ Mn)	$27	$27	$27	$27	$27
EBITDA	**213**	**181**	**156**	**147**	**148**

Source: Company Filings, SNL, Platts and UBS Estimates

Harquahala: Finding a Solution

Given the substantial regional ramp-up in renewable resources and continued investment in generation capacity in recent years, we continue see the Arizona power market dynamics as more distressed. Management painted scenarios for this Arizona asset that ranged from selling the units for salvage value ($50Mn TLN estimate) to relocating the asset ($500/kW cost for brownfield) to transacting with a regulated utility (>$150Mn TLN estimate with comps $400+/kW). Without the supporting of a tolling or other commercial arrangement to secure a fixed price for the plant's output, we largely expect a declining FCF profile for assets in the Southeast (including SoCal), as we expect renewable penetration growth to continue to meaningfully exceed power demand growth.

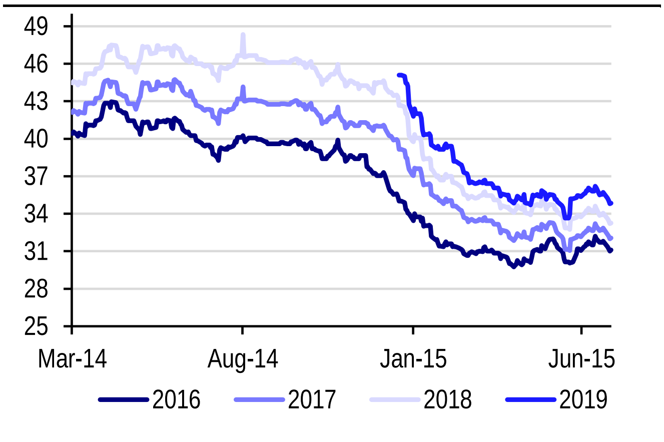
FERC rejected the previous attempted sale of Harquahala in March 2013 on concerns about market power in the Arizona Public Service area despite proposed mitigation citing "dramatic failures of the market [power] screens".

Following a previous failed attempt to sell the plant, we believe the plant's end-game likely remains more oriented towards finding an off-taker in need of the capacity and energy products rather than necessarily a new buyer. Under IPP ownership (with regulated utility knowledge) there is a higher probability that Talen could secure a contract via an RFP than the previous private equity owners but it is not likely that this would be enough to reverse the fortunes of the plant fully. We maintain our view that incumbent utilities in the state, including most notably Pinnacle West (PNW) will continue to acquire merchant assets in lieu of new construction to add to its ratebase.

Structural concern over spark spreads in SW given increasing renewable penetration.

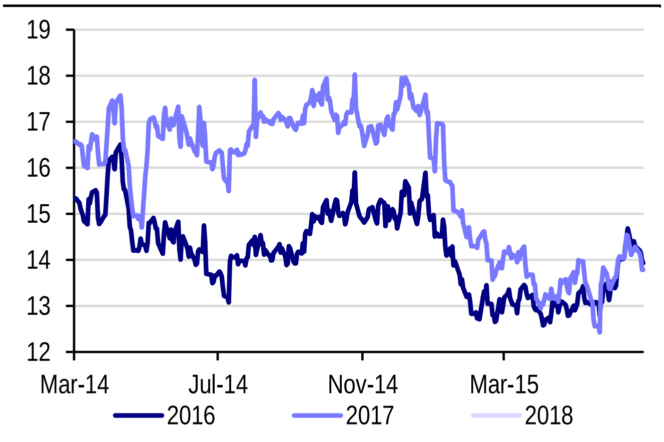
Although a low probability event if Harquahala could export its power into a more lucrative market such as California (SP-15 2017 peak power is ~$38/MWh vs ~$32/MWh Palo Verde peak power) or even Mexico; however, the associated transmission costs would likely make this cost prohibitive.

Figure 6: Palo Verde On-Peak Power ($MWh)



Source: Platts

Figure 7: Spark Spreads : Palo Verde – SoCal ($MWh)



Source: Platts

Rejection of AZ fail previously represents rare use of FERC market power: We flag the previous decision (EC13-11) by FERC to reject the sale by its previous equity owner, Wayzata to Saddle Mountain given the vertical market power screens employed by the agency. Most interestingly, market mitigation measures proposed were rejected, with FERC seeing even the plant's dispatch turned over to a third party on a 12-month rolling basis.

We see the outlook for spark spreads as credibly orienting themselves towards low single digits or lower such that marginal gas plants will eventually opt to mothball. We understand that placing this asset into seasonal mothball is unlikely due to the constraints of regional heat, employee base, and significant LTSA fixed cost

Figure 8: Harquahala Mini Model

Harquahala Mini Model	2015	2016	2017	2018	2019
Capacity (MW)	1,092	1,092	1,092	1,092	1,092
Capacity Factor, UBSe	13.3%	13.3%	13.3%	13.3%	13.3%
Palo Verde On-Peak ($/MWh)	$32	$31	$32	$33	$34
Heat Rate, UBSe	7,100	7,100	7,100	7,100	7,100
Variable Cost ($/MWh)	($24)	($24)	($25)	($26)	($26)
Energy Margin ($MWh)	$8	$7	$7	$7	$7
Generation (TWh)	1.3	1.3	1.3	1.3	1.3
Energy Margin ($Mn)	$10	$9	$8	$9	$9
O&M ($/kW-yr), UBSe	$15	$15	$15	$15	$15
O&M ($ Mn)	$16	$16	$16	$16	$16
EBITDA	**-$6**	**-$7**	**-$8**	**-$8**	**-$7**

Source: Company Filings, SNL, Platts and UBS Estimates

Millennium: Small New England plant diversifying fleet

One negative for this asset is that it does not have dual fuel capabilities. The Millennium Power plant in Massachusetts appears to be a "standard" small gas plant capitalizing on the strong spark spreads and capacity price trends in New England. Similar to Athens above there is the possibility to see fuel cost improvement from enhanced pipeline access in the region.

Figure 9: Millennium Power

Millennium Power Mini Model	2015	2016	2017	2018	2019
Capacity (MW)	360	360	360	360	360
Capacity Factor, UBSe	61.1%	61.1%	61.1%	61.1%	61.1%
Mass Hub ATC ($/MWh)	$53	$49	$46	$46	$47
Heat Rate, UBSe	6,975	6,975	6,975	6,975	6,975
Variable Cost ($/MWh)	($39)	($39)	($35)	($36)	($36)
Energy Margin ($MWh)	$14	$10	$11	$10	$10
Generation (TWh)	1.9	1.9	1.9	1.9	1.9
Energy Margin ($Mn)	$28	$19	$22	$19	$20
ISO-NE Capacity Payment ($/MW-day)	$98	$100	$152	$266	$265
Capacity Revenue ($Mn)	$12	$12	$19	$33	$33
O&M ($/kW-yr), UBSe	$40	$40	$40	$40	$40
O&M ($ Mn)	$14	$14	$14	$14	$14
EBITDA	**25**	**17**	**26**	**38**	**39**

Source: Company Filings, SNL, Platts and UBS Estimates

Updated EBITDA and Free Cash Flow Estimates

Estimates for EBITDA are relatively constant with improvements in ISO-NE capacity prices benefitting the Millennium Power asset approximately offsetting declining energy margin in New York. As mentioned previously, improvements in the dispatch and spark spread assumptions for Athens would reverse the slide and cause EBITDA improvement throughout the period off of a 2016E base.

Figure 10: Updated MACH Gen Adjusted EBITDA Estimates

MACH Gen EBITDA Summary	2015	2016	2017	2018	2019
MACH Gen EBITDA					
Athens	$113	$105	$91	$82	$84
Harquahala	($6)	($7)	($8)	($8)	($7)
Millennium Power	$25	$17	$26	$38	$39
Total EBITDA	**$132**	**$114**	**$109**	**$112**	**$116**
Guidance		*$120*			

Source: Company Filings, SNL, Platts and UBS Estimates

We present our free cash flow estimates for Talen using management's estimates for interest expense and capex. The acquisition will be financed entirely with debt and management anticipates $565Mn of MACH Gen debt remaining. The financing assumption appears on the high-end ($81Mn 2016E guidance on $1,175Mn implies ~7% interest expense) compared to Talen's bonds (7%) so there could be savings there.

Figure 11: Updated MACH Gen Free Cash Flow Estimates

MACH Gen Free Cash Flow Analysis	2015	2016	2017	2018	2019
Adjusted EBITDA	$132	$114	$109	$112	$116
Less: Interest Expense	($79)	($78)	($77)	($71)	($70)
Less: Capex	($25)	($25)	($25)	($25)	($25)
FCF (Pre-Tax)	$28	$12	$7	$17	$21
Less: Taxes	(4)	0	1	(1)	(2)
Plus: Tax Savings at Talen Corp	-	15	15	15	15
FCF (Post-Tax)	**$24**	**$27**	**$23**	**$31**	**$34**
Guidance		**$30**			

Source: Company Filings, SNL, Platts and UBS Estimates

Assessing Accretion

We apply EV / EBITDA multiples to the NY and MA assets but given the ~break-even EBITDA at the AZ asset, we apply a $/kW-based valuation framed by a worst case scenario of scrapping the plant for $50Mn. With 100% debt financing assumption, we initially estimate $1/sh accretion using the same 8x EV / EBITDA multiples that we do for the balance of Talen's fleet.

Figure 12: Potential Talen Acquisition Target

Pending MACH Gen Acquisition - 2017E							
		EV/EBITDA Multiples			Enterprise Value		
	EBITDA	Low	Base	High	Low	Base	High
Athens	91	7.0x	8.0x	9.0x	$635	$726	$817
Millennium Power	26	7.0x	8.0x	9.0x	$183	$210	$236
	KW	$/kW Multiples			Enterprise Value		
Harquahala	1,092	$50	$100	$250	$55	$109	$273
Total					**$873**	**$1,045**	**$1,325**
Net Purchase Price					$1,162	$1,162	$1,162
Less: Tax NPV					($123)	($245)	($245)
Net Adjusted Acquisition					$1,040	$917	$917
Incremental EV					($166)	$128	$408
Incremental EV per Share					**($1.25)**	**$0.96**	**$3.08**
EV / EBITDA (All Assets)					*9.5x*	*8.4x*	*8.4x*
EV / EBITDA (Ex-Arizona)					*8.9x*	*7.8x*	*7.8x*
EV Yield					2%	3%	3%
Pre-Transaction Net Debt / Adj EBITDA (with Capacity Performance)						*4.3x*	
Transaction Net Debt / Adj EBITDA						*10.7x*	
Pro-Forma Net Debt / Adj EBITDA (with CP)						***5.0x***	
Pro-Forma Net Debt / Adj EBITDA (w/out CP)						*5.7x*	

Source: SNL Energy and UBS Estimates

We include a comp set of recent Western transactions but Talen's disclosures confirms our prior beliefs that recent the Arizona transactions are inflated due to involvement of regulated utilities as purchasers.

Figure 13: Recent Western Power Plant Comparable Transactions

Western Power Comps						
Asset	**Location**	**Fuel**	**Date**	**MW**	**$/kW**	**Value ($Mn)**
Mesquite Power I	Maricopa, AZ	Gas	2013	625	594	$371
Mesquite Power I	Maricopa, AZ	Gas	2015	625	591	$370
Gila River 3	Maricopa, AZ	Gas	2013	550	398	$219
West Valley	Salt Lake, UT	Gas	2014	189	249	$47
Arizona Average				600	533	$320

Source: SNL Energy, Company Filings, and UBS Estimates

Talen Energy Corp (TLN.N)

Income statement (US$m)	-	-	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
Revenues	-	-	**4,274**	**4,140**	-3.1	**3,906**	-5.6	**3,718**	**3,831**	**3,949**
Gross profit	-	-	2,591	2,771	7.0	2,644	-4.6	2,430	2,525	2,632
EBITDA (UBS)	-	-	**915**	**1,008**	10.1	**909**	-9.8	**716**	**790**	**876**
Depreciation & amortization	-	-	(474)	(410)	-13.5	(413)	0.7	(419)	(421)	(422)
EBIT (UBS)	-	-	**441**	**598**	35.6	**496**	-17.0	**297**	**369**	**454**
Associates & investment income	-	-	0	0	-	0	-	0	0	0
Other non-operating income	-	-	0	0	-	0	-	0	0	0
Net interest	-	-	(219)	(328)	-49.9	(217)	33.9	(209)	(201)	(198)
Exceptionals (incl goodwill)	-	-	0	0	-	0	-	0	0	0
Profit before tax	-	-	**222**	**270**	21.4	**279**	3.4	**88**	**167**	**256**
Tax	-	-	(83)	(67)	18.8	(70)	-3.4	(22)	(42)	(64)
Profit after tax	-	-	**139**	**202**	45.4	**209**	3.4	**66**	**125**	**192**
Preference dividends	-	-	0	0	-	0	-	0	0	0
Minorities	-	-	0	0	-	0	-	0	0	0
Extraordinary items	-	-	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	-	-	**139**	**202**	45.4	**209**	3.4	**66**	**125**	**192**
Net earnings (UBS)	-	-	**139**	**202**	45.4	**209**	3.4	**66**	**125**	**192**
Tax rate (%)	-	-	37.4	25.0	-33.1	25.0	0.0	25.0	25.0	25.0

Per share (US$)	-	-	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
EPS (UBS, diluted)	-	-	1.08	1.57	45.4	1.60	1.7	0.49	0.93	1.43
EPS (local GAAP, diluted)	-	-	1.08	1.57	45.4	1.60	1.7	0.49	0.93	1.43
EPS (UBS, basic)	-	-	1.08	1.57	45.4	1.60	1.7	0.49	0.93	1.43
Net DPS (US$)	-	-	0.00	0.00	-	0.00	-	0.00	0.00	0.00
Cash EPS (UBS, diluted)[1]	-	-	4.77	4.76	-0.1	4.76	-0.1	3.65	4.05	4.55
Book value per share	-	-	44.83	44.53	-0.7	45.34	1.8	44.83	44.80	45.95
Average shares (diluted)	-	-	128.50	128.50	0.0	130.68	1.7	132.81	134.86	134.86

Balance sheet (US$m)	-	-	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
Cash and equivalents	-	-	1,079	451	-58.2	474	5.2	458	455	455
Other current assets	-	-	2,368	2,341	-1.1	2,313	-1.2	2,271	2,304	2,338
Total current assets	-	-	**3,447**	**2,792**	-19.0	**2,787**	-0.2	**2,729**	**2,758**	**2,792**
Net tangible fixed assets	-	-	7,546	8,450	12.0	8,580	1.5	8,627	8,701	8,674
Net intangible fixed assets	-	-	1,602	1,602	0.0	1,602	0.0	1,602	1,602	1,602
Investments / other assets	-	-	1,311	1,339	2.1	1,355	1.2	1,371	1,387	1,403
Total assets	-	-	**13,906**	**14,183**	2.0	**14,324**	1.0	**14,329**	**14,449**	**14,472**
Trade payables & other ST liabilities	-	-	1,928	1,942	0.7	1,941	-0.1	1,948	1,957	1,966
Short term debt	-	-	1,219	1,228	0.76	1,173	-4.54	1,153	1,152	1,082
Total current liabilities	-	-	**3,147**	**3,170**	0.7	**3,113**	-1.8	**3,101**	**3,108**	**3,048**
Long term debt	-	-	2,888	2,911	0.8	2,865	-1.6	2,812	2,793	2,680
Other long term liabilities	-	-	2,492	2,379	-4.5	2,421	1.8	2,463	2,505	2,547
Preferred shares	-	-	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	-	-	**8,527**	**8,461**	-0.8	**8,399**	-0.7	**8,376**	**8,407**	**8,275**
Common s/h equity	-	-	5,379	5,722	6.4	5,925	3.6	5,954	6,042	6,197
Minority interests	-	-	0	0	-	0	-	0	0	0
Total liabilities & equity	-	-	**13,906**	**14,183**	2.0	**14,324**	1.0	**14,329**	**14,449**	**14,472**

Cash flow (US$m)	-	-	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
Net income (before pref divs)	-	-	139	202	45.4	209	3.4	66	125	192
Depreciation & amortization	-	-	474	410	-13.5	413	0.7	419	421	422
Net change in working capital	-	-	91	40	-55.8	27	-33.6	49	(24)	(25)
Other operating	-	-	(541)	151	-	155	2.9	157	158	160
Operating cash flow	-	-	**163**	**803**	392.7	**804**	0.1	**690**	**681**	**749**
Tangible capital expenditure	-	-	(460)	(516)	-12.2	(543)	-5.2	(466)	(495)	(395)
Intangible capital expenditure	-	-	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	-	-	0	0	-	0	-	0	0	0
Other investing	-	-	39	(16)	-	(16)	-	(16)	(16)	(16)
Investing cash flow	-	-	**(421)**	**(532)**	-26.4	**(559)**	-5.1	**(482)**	**(511)**	**(411)**
Equity dividends paid	-	-	0	0	-	0	-	0	0	0
Share issues / (buybacks)	-	-	423	0	-	0	-	0	0	0
Other financing	-	-	895	(924)	-	(175)	81.06	(172)	(154)	(224)
Change in debt & pref shares	-	-	(537)	23	-	(47)	-	(53)	(19)	(113)
Financing cash flow	-	-	**781**	**(900)**	-	**(222)**	75.4	**(225)**	**(173)**	**(338)**
Cash flow inc/(dec) in cash	-	-	**523**	**(629)**	-	**23**	-	**(16)**	**(3)**	**0**
FX / non cash items	-	-	-	1	-	0	-	0	0	0
Balance sheet inc/(dec) in cash	-	-	**-**	**(628)**	-	**23**	-	**(16)**	**(3)**	**0**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.[1]Cash EPS (UBS, diluted) is calculated using UBS net income adding back depreciation and amortization.

Talen Energy Corp (TLN.N)

Valuation (x)	-	-	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
P/E (local GAAP, diluted)	-	-	-	11.0	10.8	35.0	18.6	12.1
P/E (UBS, diluted)	-	-	-	11.0	10.8	35.0	18.6	12.1
P/CEPS	-	-	-	3.6	3.6	4.7	4.3	3.8
Equity FCF (UBS) yield %	-	-	-	12.9	11.7	10.1	8.4	15.9
Net dividend yield (%)	-	-	-	0.0	0.0	0.0	0.0	0.0
P/BV x	-	-	-	0.4	0.4	0.4	0.4	0.4
EV/revenues (core)	-	-	-	1.5	1.6	1.6	1.6	1.5
EV/EBITDA (core)	-	-	-	6.1	6.8	8.4	7.6	6.7
EV/EBIT (core)	-	-	-	10.3	12.4	20.3	16.2	12.9
EV/OpFCF (core)	-	-	-	19.5	20.2	NM	23.7	13.3
EV/op. invested capital	-	-	-	0.6	0.6	0.6	0.6	0.6

Enterprise value (US$m)	-	-	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Market cap.	-	-	-	2,224	2,224	2,224	2,224	2,224
Net debt (cash)	-	-	2,877	3,947	3,947	3,824	3,778	3,677
Buy out of minorities	-	-	0	0	0	0	0	0
Pension provisions/other	-	-	1	1	1	1	1	1
Total enterprise value	**-**	**-**	**-**	**6,172**	**6,172**	**6,049**	**6,003**	**5,902**
Non core assets	-	-	(30)	(30)	(30)	(30)	(30)	(30)
Core enterprise value	**-**	**-**	**-**	**6,142**	**6,142**	**6,019**	**5,973**	**5,872**

Growth (%)	-	-	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenue	-	-	-	-3.1	-5.6	-4.8	3.0	3.1
EBITDA (UBS)	-	-	-	10.1	-9.8	-21.3	10.4	10.9
EBIT (UBS)	-	-	-	35.6	-17.0	-40.2	24.2	23.2
EPS (UBS, diluted)	-	-	-	45.4	1.7	-69.1	88.2	53.2
Net DPS	-	-	-	-	-	-	-	-

Margins & Profitability (%)	-	-	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Gross profit margin	-	-	60.6	66.9	67.7	65.3	65.9	66.6
EBITDA margin	-	-	21.4	24.3	23.3	19.2	20.6	22.2
EBIT margin	-	-	10.3	14.4	12.7	8.0	9.6	11.5
Net earnings (UBS) margin	-	-	3.3	4.9	5.4	1.8	3.3	4.9
ROIC (EBIT)	-	-	-	6.0	4.9	2.9	3.6	4.5
ROIC post tax	-	-	-	4.5	3.7	2.2	2.7	3.3
ROE (UBS)	-	-	-	3.6	3.6	1.1	2.1	3.1

Capital structure & Coverage (x)	-	-	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Net debt / EBITDA	-	-	4.3	3.9	4.2	5.3	4.8	4.1
Net debt / total equity %	-	-	73.1	69.3	65.2	63.6	62.4	57.9
Net debt / (net debt + total equity) %	-	-	42.2	40.9	39.4	38.9	38.4	36.6
Net debt/EV %	-	-	-	64.5	62.8	62.9	63.1	61.1
Capex / depreciation %	-	-	137.7	125.9	131.5	111.3	117.5	93.6
Capex / revenue %	-	-	10.8	12.5	13.9	12.5	12.9	10.0
EBIT / net interest	-	-	2.0	1.8	2.3	1.4	1.8	2.3
Dividend cover (UBS)	-	-	-	-	-	-	-	-
Div. payout ratio (UBS) %	-	-	-	-	-	-	-	-

Revenues by division (US$m)	-	-	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Others	-	-	4,274	4,140	3,906	3,718	3,831	3,949
Total	**-**	**-**	**4,274**	**4,140**	**3,906**	**3,718**	**3,831**	**3,949**

EBIT (UBS) by division (US$m)	-	-	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Others	-	-	441	598	496	297	369	454
Total	**-**	**-**	**441**	**598**	**496**	**297**	**369**	**454**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Forecast returns

Forecast price appreciation	+4.0%
Forecast dividend yield	0.0%
Forecast stock return	+4.0%
Market return assumption	5.7%
Forecast excess return	-1.7%

Statement of Risk

Factors that could negatively impact our estimates and price target include: a negative change in demand for power, decline in power prices, adverse political or regulatory events, higher fuel and operational costs, inability to achieve synergy and other financial guidance, inability to execute on potential M&A, higher capital market issuance costs, higher environmental compliance costs, natural gas/competing fuel prices, weather, new nuclear compliance standards, and unfavorable environmental legislation or regulation. Further risks include volatile commodity (power, natural gas, coal, and uranium) prices impacting generation margins. EnergyPlus, its retail marketing segment, is further exposed to volumetric, credit, and collateral-related risk of serving load-following contract (primarily) across the PJM footprint

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12-Month Rating	Definition	Coverage[1]	IB Services[2]
Buy	FSR is > 6% above the MRA.	45%	36%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	13%	20%
Short-Term Rating	**Definition**	**Coverage[3]**	**IB Services[4]**
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 30 June 2015.
1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category. 4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

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Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
American Electric Power, Inc.[2, 4, 6a, 6b, 7, 16]	AEP.N	Neutral	N/A	US$55.54	20 Jul 2015
Talen Energy Corp[16]	TLN.N	Sell	N/A	US$17.31	20 Jul 2015

Source: UBS. All prices as of local market close.
Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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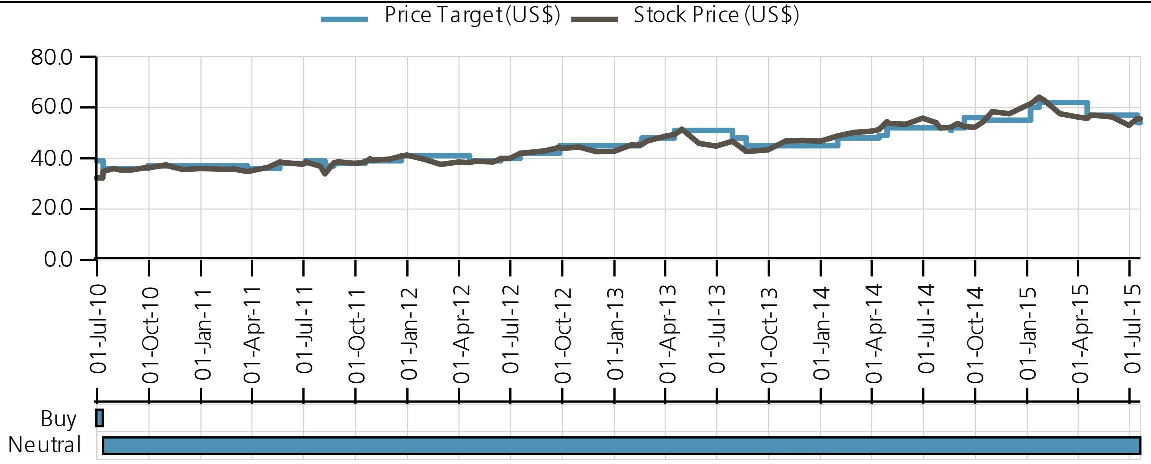
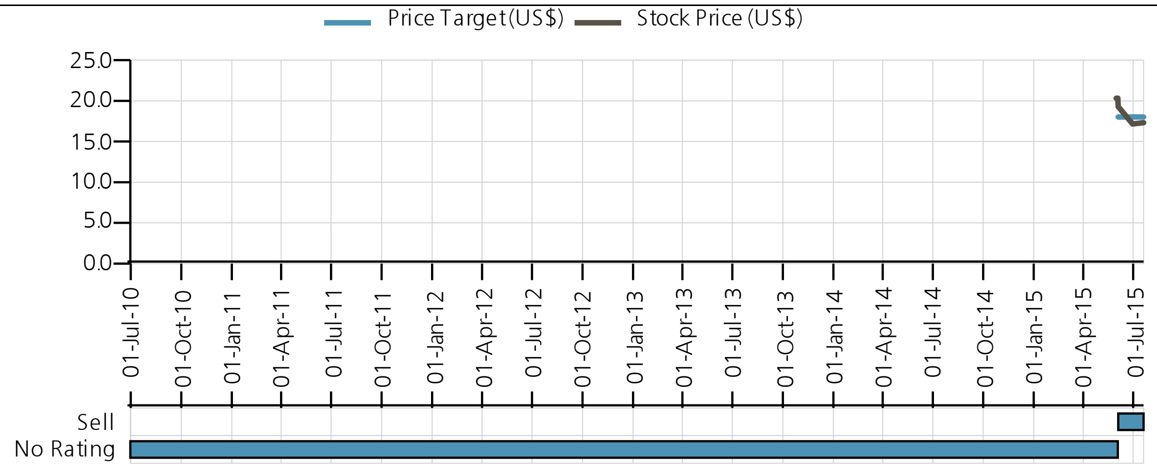
American Electric Power, Inc. (US$)



Source: UBS; as of 20 Jul 2015

Talen Energy Corp (US$)



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