

# US Regulated Electric Utilities

## 2Q16 Utility Preview: Coming to Terms with Rates

### Equities

North America  
Utilities

#### Opportunities abound in the sector – we're still on board

We see many emerging debates for regulated utilities as we enter 2Q16 earnings season with key datapoints upcoming for many companies such as Southern Company (SO- Kemper), Portland General Electric (PO - Carty), Duke Energy (DUK- International Sale timing), and PG&E (PCG- GRC Settlement and San Bruno criminal proceeding) which we detail later in the note. We see overhangs for POR, PCG, and DUK abating, providing value to those seeking opportunities across the sector. Overall, we continue to see upside to the sector amidst the low rate and global rate environment, seeing an opportunity for the sector to trade north of a 20% relative premium to the wider S&P as rate hike expectations moderate. While many are at the absolute level of valuations, but have failed to place utilities within the wider context of their ~15% premium to the S&P and meaningful 'Global' yield play at hand in the sector.

#### Crunch time for Southern and SCANA: Project execution is critical

July will be a critical construction month for SO's Kemper Country project based on the disclosed milestones targeted for both Trains A & B. SO disclosed first syngas production in mid-July and management is still committed to its previously communicated 3Q16 in-service target. : We look for further clarity on exactly when management will declare in-service and file the associated rate case with the Mississippi Public Service Commission (PSC) given the significant monthly costs associated with the plant. Separately we remain concerned about nuclear project slippage for both Southern's Vogtle and SCANA's VC Summer projects.

#### Pension concerns once again, but perhaps too early to focus on 2017?

The decline in US treasury rates could pressure earnings and increase obligations for many utilities with a handful more exposed than peers. We believe the pension mark-to-market weighs on FirstEnergy (FE) particularly hard and further complicates leverage story as it looks to improve its standing with the credit rating agencies. For FE we estimate a 25bp decrease in the discount rate would cause a \$292Mn increase in net periodic benefit costs. Another impacted company is Entergy (ETR) where we estimate a 100bp change in the discount rate could see a +/- \$0.06 EPS impact, relative to \$4.20-\$4.50 utility, parent, & other guidance. Peer merchant nuclear operator Exelon also has exposure to declining interest rates via its pension obligations. We estimate 50bp reduction in the discount rate would cause an \$113mn increase in pension & other postretirement benefit costs for 2015 while the total pension and other postretirement benefits obligation would increase \$1.3Bn

#### Rate cases in focus as interest rates decline; will ROEs follow?

ConEd, Ameren, and NextEra all have sizable rate cases pending which we believe could all be negatively impacted by the negative trend in US treasury yields. For ED the NY PSC Staff recommended an 8.6% ROE versus a 9.6% request. We had previously been comfortable with the potential for NextEra to maintain a flat ROE at the utilities but we now see greater risk. We see FERC ROE concerns are lingering as well alongside the potential for yet further complaints to be pancaked to drive rates lower.

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Figure 1: Changes to Ratings, Price Targets and Estimates

Company	RIC	Price		Rating		Price target		2016E EPS		2017E EPS		2018E EPS	
		19-Jul-16		New	Old	New	Old	New	Old	New	Old	New	Old
Ameren	AEE.N	52.34		Neutral	Neutral	53.00	49.00	2.48	2.48	2.78	2.80	2.95	3.00
Avista	AVA.N	43.38		Sell	Sell	39.00	36.00	2.06	2.06	2.13	2.13	2.23	2.22
CMS Energy	CMS.N	45.00		Neutral	Neutral	45.00	41.00	2.02	2.02	2.16	2.16	2.31	2.31
Consolidated Edison	ED.N	79.11		Sell	Sell	72.00	66.00	4.10	3.98	4.08	4.08	4.20	4.20
DTE Energy	DTE.N	98.05		Buy	Buy	108.00	104.00	4.93	4.93	5.35	5.35	5.83	5.83
Duke Energy	DUK.N	85.38		Buy	Buy	93.00	86.00	4.65	4.65	4.78	4.78	5.01	5.01
Edison International	EIX.N	77.11		Buy	Buy	79.00	79.00	3.88	3.88	4.16	4.16	4.35	4.35
Empire District	EDE.N	33.81		Neutral (CBE)	Neutral (CBE)	34.00	34.00	1.33	1.33	1.42	1.42	1.56	1.56
Eversource Energy	ES.N	58.09		Neutral	Neutral	61.00	61.00	2.98	2.98	3.08	3.08	3.26	3.26
ITC Holdings	ITC.N	46.24		Neutral (CBE)	Neutral (CBE)	48.00	46.00	2.05	2.05	2.30	2.30	2.52	2.52
PG&E Corp.	PCG.N	64.41		Neutral	Neutral	67.00	63.00	3.70	3.74	3.59	3.64	3.76	3.79
Pinnacle West Captl	PNW.N	79.68		Neutral	Neutral	80.00	74.00	4.00	4.05	4.16	4.19	4.52	4.54
Portland General	POR.N	44.05		Buy	Buy	49.00	46.00	2.19	2.19	2.40	2.40	2.60	2.60
PPL Corp.	PPL.N	37.17		Buy	Buy	41.00	41.00	2.33	2.34	2.41	2.43	2.49	2.55
Public Service Entrp	PEG.N	45.85		Buy	Buy	49.00	49.00	2.88	2.88	2.93	2.93	2.96	2.95
SCANA Corp.	SCG.N	73.70		Neutral	Neutral	72.00	72.00	3.95	3.95	4.19	4.19	4.38	4.38
Southern Company	SO.N	53.62		Sell	Sell	51.00	45.00	2.83	2.83	2.85	2.85	2.97	2.97
WEC Energy Group	WEC.N	64.17		Neutral	Neutral	63.00	58.00	2.94	2.94	3.12	3.12	3.33	3.33
Westar Energy	WR.N	56.34		Neutral	Neutral	60.00	60.00	2.40	2.40	2.53	2.53	2.65	2.65
Xcel Energy Inc.	XEL.N	43.79		Sell	Sell	42.00	39.00	2.20	2.20	2.30	2.30	2.40	2.40

Source: Company Filings and UBS Estimates.

# Latest Thoughts on Regulated Utility Space

*We present below key themes on the regulated space heading into 2Q results.*

- (1) **Valuations Supported by Global Rates:** Average relative and absolute P/E multiples are at or near all time highs for many of the regulated names but we see limited support for downside arguments in the face of plethora historic lows and negative rates around the world. This stands in contrast to largely [depressed power multiples](#). We note international rates have a less drastic correlation (-0.62 and -0.44 vs -0.72 in the US) of relative P/E to interest rates, but continue to hear evidence of foreign asset ownership in US power assets and by extension, US utility stocks.
- (2) **Capital Structure Increasingly Debt Heavy:** Investors continue to ask about potential risks to the capital structure for ratemaking purposes following the developments in states including Missouri, Louisiana, and Texas but we do not see a wide-spread trend. Companies are increasingly adding leverage to their consolidated capitalization structures; however, we note leverage is still lower than it was earlier in the decade, for context. We agree that there is risk that regulators increasingly 'look-through' to the Holding Company capital structure rather than just the Operating Company but see this as a lower probability event for most.

**Paying ever closer attention to credit metrics.** Overall, we sense investors are all the more apt compare FFO/Debt metrics across companies and are increasingly aware of relative positions of Holding company leverage. We think this focus will continue, particularly amidst efforts to re-rate risk profiles to drive 'required' minimums from the rating agencies lower. We emphasize agencies would appear open to 10% FFO/Debt for purely regulated companies (T&D) in low risk jurisdictions for investment grade metrics.

- (3) **What's the next move in the gas expansion story?** Following the latest move for Southern to enter the midstream space (after just closing on its gas utility acquisition, AGL), we see prospects for the sector to continue to 'gas up'. While we continue to see gas utilities as the most logical targets (with lower risk profiles, and above-average EPS growth profiles predicated on safety related spend), we see merits to continue this diversification into the gas midstream sector. We believe many more 'utilities' will be poised to redefine as diversified 'infrastructure' companies in coming years (SO and ED are just the latest examples). We caution that utility investors have largely ignored the underlying recontract and commodity risks embedded in the pipeline expansion. Further, we find it notable that assets that are eligible for tax-advantaged MLP structures are still ending up in taxable C-Corp utility structures. *Overall, we see no reason to expect this trend to slow as utilities maintain incremental leverage capacity to do acquisitive regulated deals.*
- (4) **Wind remains the focus, but limited details.** Following the latest IRS guidance on the 'start of construction' language extension out to 4-years after their 2016 expiration of Production Tax Credits (PTCs) for wind, we look for utilities to discuss their latest development plans. We note XEL and other regulated stories have discussed leveraging the repowering opportunity available to them by buying out PPAs poised to retire. The overarching

question remains the pace of RFPs/procurement alongside the potential to acquire existing regulated assets.

## (5) Pension in focus as interest rates take their latest step lower

**The pension mark-to-market weighs on FirstEnergy (FE) particularly hard and further complicates leverage story:** As of 12/31/15 FE's pension was only 61% funded versus a historical average of 75-80% for utilities. US treasury rates have declined 80-100bp since that point which will create even more earnings and funding pressure for management. Management disclosed in its 10K that it could meet the upcoming pension obligation with a combination of equity and cash; however, management previously indicated that it has no plans to meet the pension funding deficit with FE shares.

Figure 2: FE Pension Analysis

FE Pension Analysis (\$Mn)			
	2016	2015	Delta
Liability	(8,704)	(8,889)	185
Assets	5,338	5,822	(484)
Net Liability	(3,366)	(3,067)	(299)
2016 Min Funding	381	324	57
2017 Min Funding	N/A	555	N/A
Expected Return %	7.50%	7.75%	-0.25%
Discount Rate %	4.50%	4.25%	0.25%
*\$160Mn of the \$381Mn 2016 obligation contributed as of Feb			
<b>Increase in Net Periodic Benefit Cost Sensitivities</b>			
-25bp Discount Rate		292	
25bp Return		14	

Source: Company Filings

Figure 3: 30Yr US-Treasury Yield



Source: FactSet

Another impacted company is Entergy (ETR) where we estimate a 100bp change in the discount rate could have a +/- \$0.06 EPS impact, relative to \$4.20-\$4.50 utility, parent, & other guidance. We estimate a 25bp decrease in the discount rate would cause the 2015 qualified projected benefit obligation and accumulated postretirement benefit obligation to increase by \$228Mn and \$51Mn, respectively. Peer merchant nuclear operator Exelon also has exposure to declining interest rates via its pension obligations. We estimate a 50bp reduction in the discount rate would cause an \$113mn increase in pension & other postretirement benefit costs for 2015 while the total pension and other postretirement benefits obligation would increase \$1.3Bn. We believe declining interest rates also can increase nuclear retirement obligations and potentially compel additional capital/parent guarantees for any projected shortfalls in the nuclear decommissioning trusts (NDTs). [Further details are available here.](#)

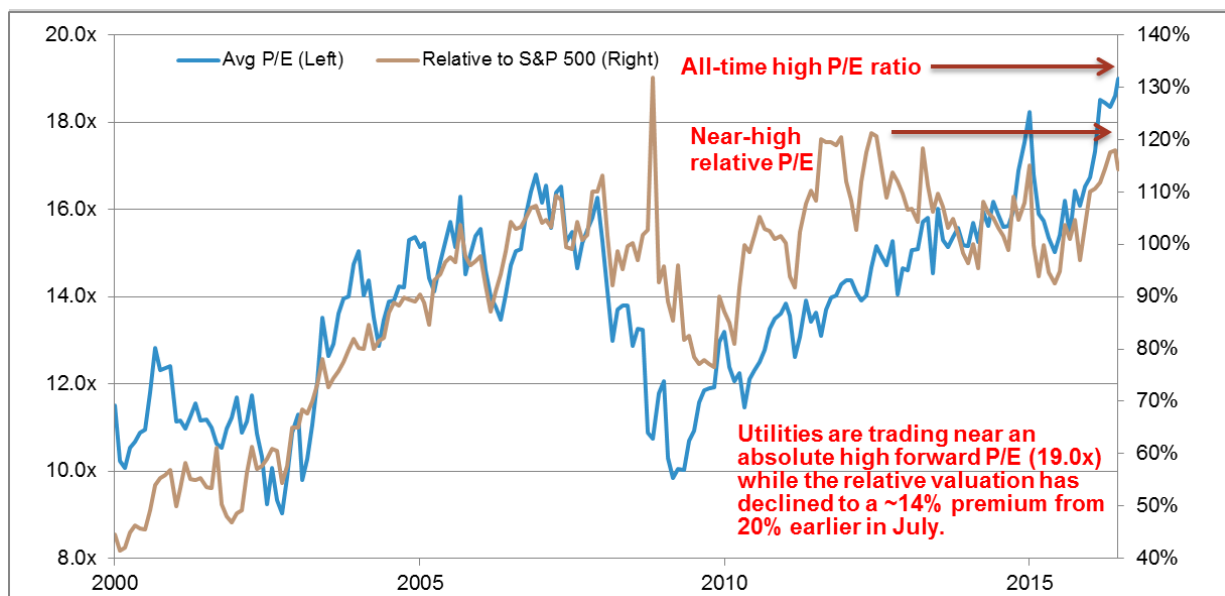
## Interest Rate Views and Macro Views

US utilities are now trading at 19.0x forward P/E after having rallied further following the UK Referendum vote but have pulled-back marginally recently. As we show later in the note, the majority of utilities we track hit new 52-week highs in the last few weeks but the relative valuation have started to decline as the S&P 500 has outpaced the group. For example utilities were trading at a 20% premium to the S&P 500 earlier in July but the relative premium has declined to 14%, still above average but a sharp-pull back.

We continue to see further upside to the regulated utility sector, seeing the lower rate environment as supportive of yet higher valuations vs. the ~20% peaks on a relative basis seen in 2011 and 2012.

[Please click here for further macro thoughts.](#)

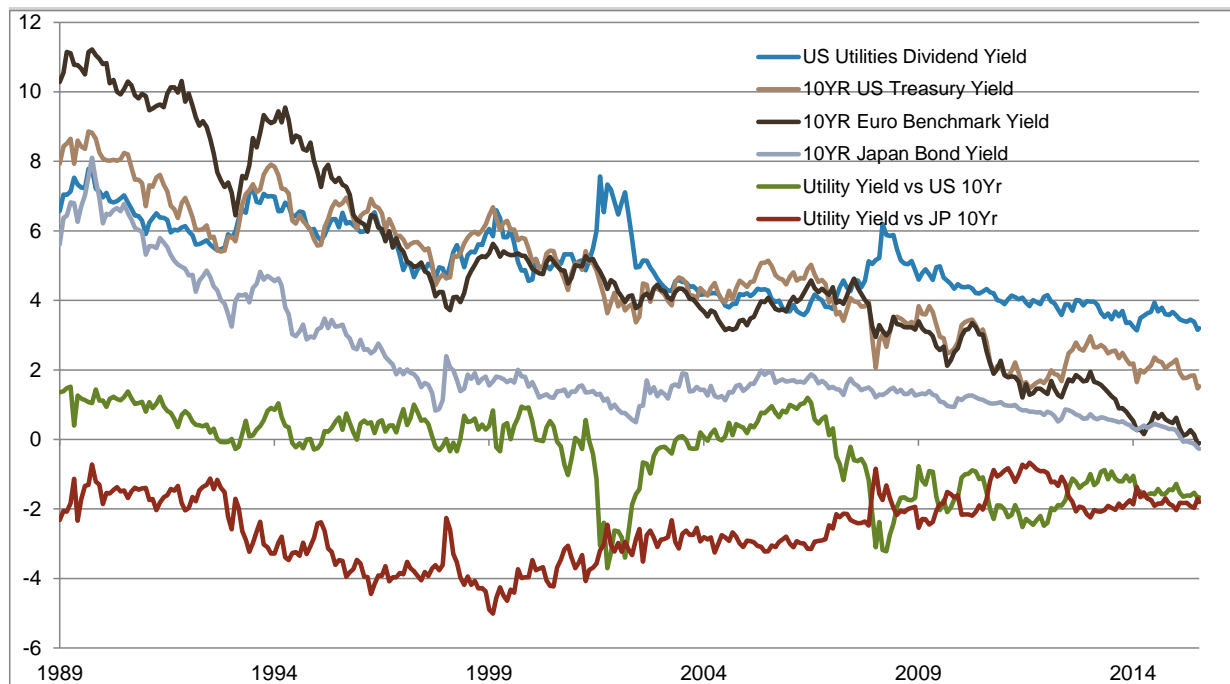
**Figure 4: Electric Utilities Absolute and Relative P/E Multiples**



Source: FactSet

## Approaching the debate from a global perspective

Figure 5: Comparison of US Utilities Dividend Yields Versus Global Benchmarks (%)



Source: FactSet

We start our analysis by comparing the dividend yield for US electric utilities to the ten-year government interest rates for United States, Euro Zone, and Japanese benchmarks. The dividend yield on US electric utilities has been below 4% consistently since 2012 but has been steadily declining with the yield rapidly approaching 3.0% today, among the lowest we have seen (only late 2014/early 2015 were lower). In examining the spread between dividend yield and the US treasury yield, we have seen a 150bp average premium for dividend yields over treasury yield since 2015, down from over 200bp in 2012. After the 'Leave' vote in the UK Referendum the spread expanded to 170bp; again, while this is above-average for recent history, it is not unprecedented.

Given that the historical linkage has been relatively robust we continue to expect this relationship to hold with utilities as a group trading largely as a function of interest rate expectations. Please see the correlation between relatively utility P/E and treasury yields in the next Figure. We include foreign interest rates as a comparison to show that even as the dividend yield on US utilities approaches an all-time low, it represents a premium to the local government benchmarks. For example, the spread for US treasury yields and for Japan bond yields versus US utilities dividends is quite similar (150-200bp).

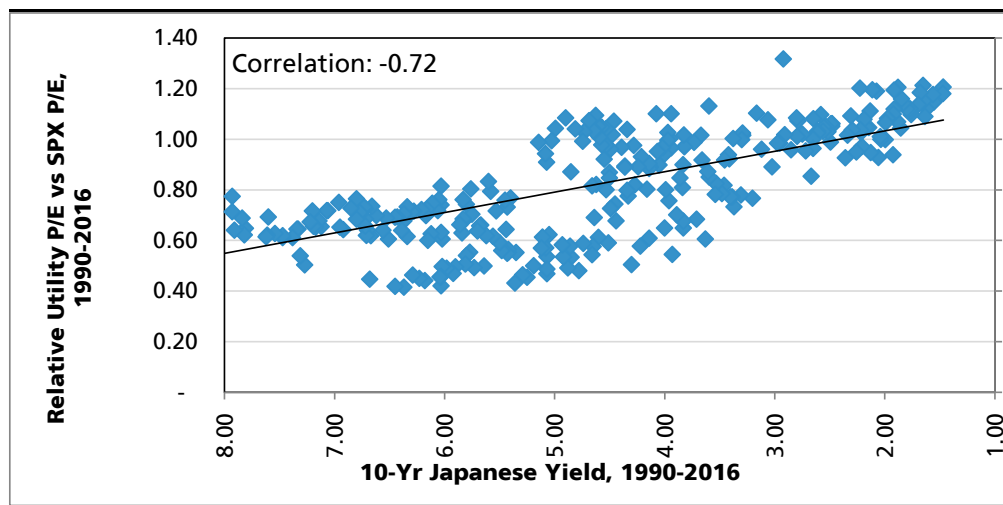
Global comparisons matter all the more: We argue that lower global rates contribute to finding renewed highs in utility valuations, with today's JPY yield levels materially below those below 2012, the period where US rates last hit their lows. We emphasize foreign capital continues to play a fairly explicit role in funding private equity investments in the Power sector for new gas plants in PJM, as well as in driving bids for select utilities (CNL for ex.). In contrast, explicit flows into US equity markets from global investors is much more opaque, effectuated via investments in US and foreign money managers alike. Net-net, equivalent

The dividend yield on US utilities has been steadily declining and is now solidly below 4%; however, the spread against US treasury yields has been relatively constant as the rates have largely moved in tandem recently.

Interestingly the spread vs US Treasuries and Japanese bonds has tightened as well over time.

valuations from 2012 should be higher vs. global peers even vs. a flat treasury environment.

**Figure 6: Average Relative Utility P/E (to SPX P/E) vs 10-Year Treasury Yield, 1990-2016**

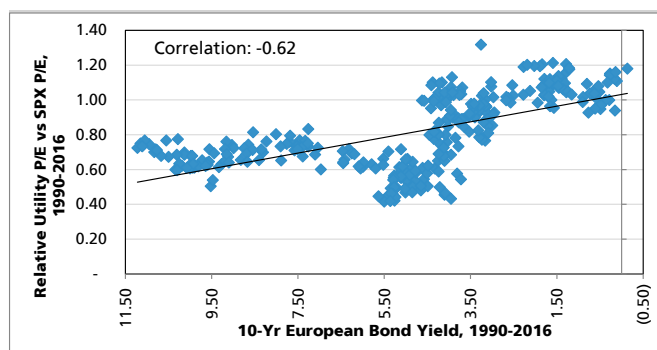


Source: FactSet

### Global rates matter as well

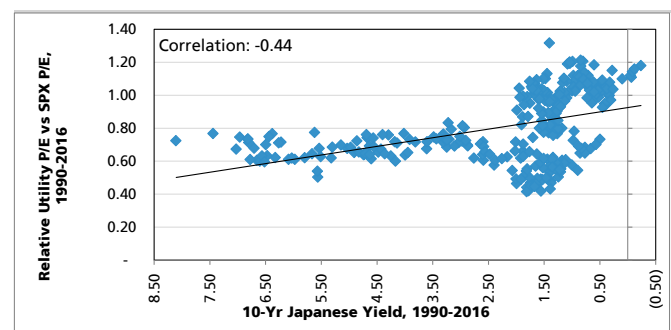
While domestic interest rates demonstrate significant historic correlation to relative P/E, we note further read-throughs from international bonds. We believe low or negative rates may be encouraging international investment in both US power assets and not some level of negative correlation between rates and outperformance, albeit to a lesser extent vs domestic rates. Japanese correlation is likely skewed given historic low interest rate environment but European bonds suggest higher correlation and stronger potential for flows into domestic US assets.

**Figure 7: Avg Utility P/E Vs 10 Yr European Bonds**



Source: FactSet

**Figure 8: Avg Utility P/E Vs 10 Yr Japanese Bonds**



Source: FactSet



## UBS House View: No US rate increase in September

The question is whether significant Federal Reserve tightening can occur following the UK's decision to leave the European Union. The UBS Macro team now believes that it is unlikely that the Federal Reserve will increase the Federal funds rate 25bp at its September 20-21 Federal Open Market Committee (FOMC) meeting but still believes the Fed will tighten 25bp at the December 13-14 FOMC meeting. Prior to the UK referendum the UBS House View was that the yield on the US 10-year Treasury would rise to 2.0% by year-end 2016 and to 2.3% by year-end 2017. Based on the strong historical correlation between the 10-year Treasury yield and relative utility pricing (see charts above), this implies a relative utility P/E to the S&P 500 P/E of **~1.07x by year-end 2016 and ~1.00x by year-end 2017, without adjusting for the global rate environment. Compared to the current 1.20x, this further implies -11% underperformance for regulated utilities vs the S&P 500 through year-end 2016 and -20% through year-end 2017.** Admittedly, this is a rough projection dependent on historical correlations that may not be fully realized given the wide spreads utility dividend yields currently enjoy vs government bonds. In other words, we continue to believe any future underperformance of utilities is likely to be tempered by dividend yield support until rates rise substantially.

On a fundamental basis the UBS team still expects 2% real GDP growth in the US for the balance of 2016 and 2.5% in 2017 with a stronger dollar and less export activity offset by lower long-term interest rates. A strong US economy similarly bodes well for electric sales growth in the US although we believe regions dependent on exports such as the southern US could be relatively disadvantaged.

**The latest from our Economics team are available below:**

[7/6/16 Global FX Atlas: Which views remain after Leave?](#)

[6/29/16 UK: Overwhelmed by Uncertainty \[GBP Forecasts\]](#)

While we believe the macro backdrop is positive for utilities, we discuss a strategy for those concerned about a sector rotation. When looking for attractive names among utilities we highlight equities trading at a discount including DTE and POR. We are less disposed to like regulated utilities trading at material premiums such as ED, SO, and XEL; however, we highlight that these are the traditional safety names. We believe another factor to consider is that companies with significant parent leverage could be challenged in a rising interest rate environment such as Entergy (ETR) and FirstEnergy (FE).

## What are the implications of the *continued* low interest rate environment?

After hitting recent lows in the 10-year treasury, we revisit the potential implications of what low rates mean for the sector: both good and bad.

**ROE Risks back on the table?** We see ongoing rate cases this year as subject to continued ROE risk. We reiterate ED as among the more exposed to this theme given the more formulaic approach taken by the New York Public Service Commission (PSC) staff. As we mentioned previously, Ameren and Exelon both have risks from lower ROEs in Illinois due to the EIMA. We think Ameren could see more risk here with a 3.2% 30-Yr Treasury yield embedded in its 2016 guidance (vs 2.1% today); we estimate every 50bp change would impact EPS by ~\$0.025 (1% of 2016E EPS). The long-term EPS guidance range of 5-8% through 2020E is also seemingly predicated on a recovery in US

**The UBS Macro team no longer expects a Fed hike at September FOMC meeting following the UK Referendum.**

**The Macro team sees downside to its GDP forecasts.**

**If appetite for risk returns, we believe large cap US utilities could be disproportionately impacted by rotation out of utilities including utilities such as Southern Company (SO).**

**Companies with FERC jurisdiction transmission assets could face more risk from declining interest rates given the multiple challenges we have seen to ROEs.**

Treasury yields, at least relative to reduced levels of late. We believe other large rate cases, such as NextEra's Florida Power & Light (FPL) rate case could be under scrutiny as well with its last case struck during a period of low rates as well. The national average authorized ROE in 2016 is ~9.7% and we believe there could be some incremental pressure lower. We see further risk in transmission, seeing yet another round of FERC reviews in New England (ISO-NE) as well as potentially MISO as adding to the risk factors. We believe the equities most exposed here include ITC Holdings (being purchased by Fortis), Eversource (ES), and Ameren.

### **What is the risk that the cost of capital is adjusted in California?**

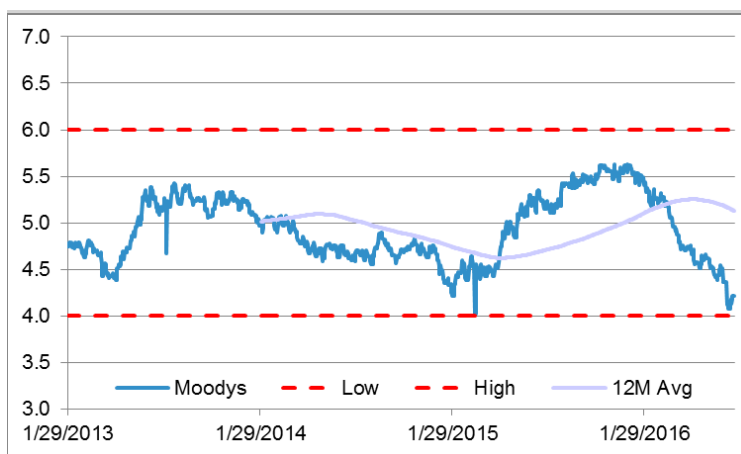
**We think unlikely before the April 2017 review.** Currently EIX's California Public Utilities Commission (CPUC) return on equity is 10.45% and will remain at that level unless the trailing-twelve month Moody's Baa index goes outside of the 4-6% band. While we do not believe that the index will go outside of the bands in the near-term, there is a risk intervenors could advocate for a lower return level and/or a more restrictive adjustment mechanism.

The Moody's index is currently at 4.54% and the trailing average is 5.2%, well above the 4% floor trigger but the absolute level is at its lowest point YTD. A joint petition was approved in February 2016 by the CPUC which extended the review period for the ROE mechanism by one-year. We think a further extension could be a possibility, particularly if Baa appears close.

**With the index average still over 5% we do not believe investors are pricing in a lower California return on equity. Additionally, following the recent joint petition to extend the ROE mechanism we believe that investors see another extension as a possibility**

**We emphasize a further delay in the California case would be a September datapoint**

**Figure 9: Moody's Baa Index Relative to 4-6% 'Bands'**

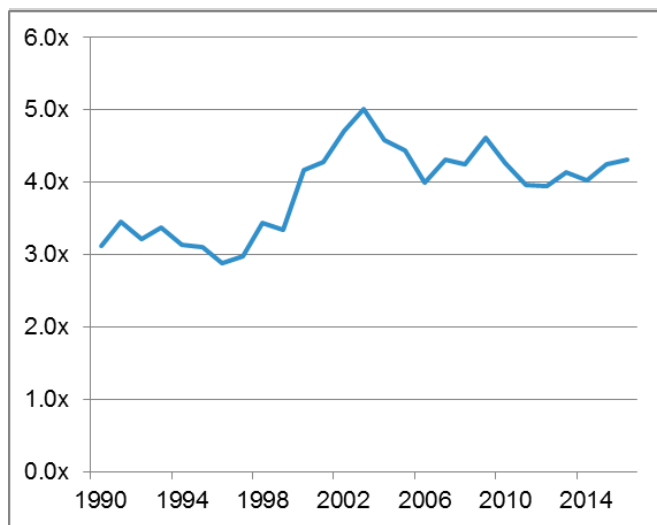


Source: FactSet and Company Filings

- **Capital structure likely remains untouched:** Investors continue to ask about potential risks to the capital structure for ratemaking purposes following the developments in states including Missouri, Louisiana, and Texas but we do not see a wide-spread trend. Companies are increasingly adding leverage to their consolidated capitalization structures; we put the trend in context below to show that leverage is still lower than it was earlier in the decade. We agree that there is risk that regulators increasingly 'look-through' to the Holding Company capital structure rather than just the Operating Company but see this as a lower probability event for most.

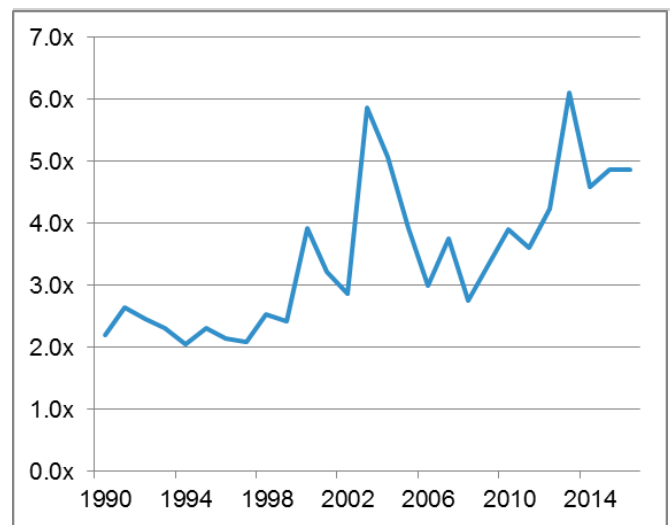
**The current environment remains largely devoid of conversation on adjustments to authorized equity ratios with a few notable exceptions.**

Figure 10: Utility Average Debt / EBITDA



Source: FactSet

Figure 11: DUK Debt / EBITDA

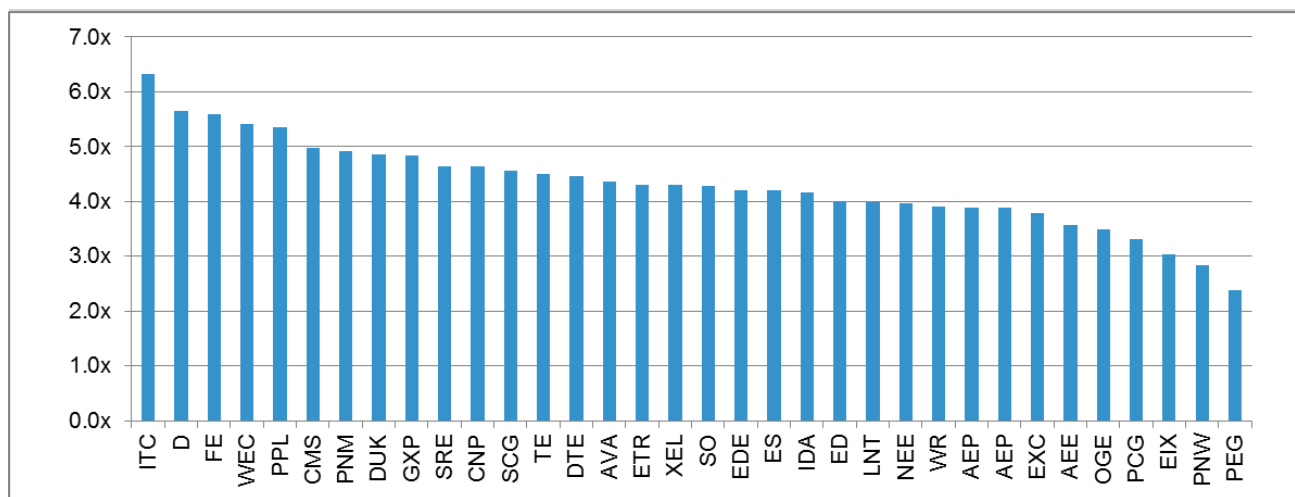


Source: FactSet

For example, Duke Energy has seen its debt / EBITDA leverage increase by 1.4x since 1990, among the most significant increases for regulated utilities as the company has executed on M&A during the period. Broadly we saw leverage increase in the early 2000s, peaking at 5x in 2003 before stabilizing around 4x.

**Since 2012 we have seen a steady 10bp annual increase in leverage for the group to 4.3x today from 3.9x.** Below we show consolidated Debt / EBITDA for select companies.

Figure 12: Utility Debt / EBITDA: 4.3x Average



Source: FactSet

- **Deal-making could continue to happen:** With the low rate environment continuing longer than some had predicted, we believe the conditions that supported the high degree of M&A activity we saw in 2014-2016 remain present. We would expect companies interested in M&A that have not executed on a deal could still be searching for candidates. Although premiums have been rich with deals being executed at 20-22x forward P/E, access to cheap debt capital can help boost returns.

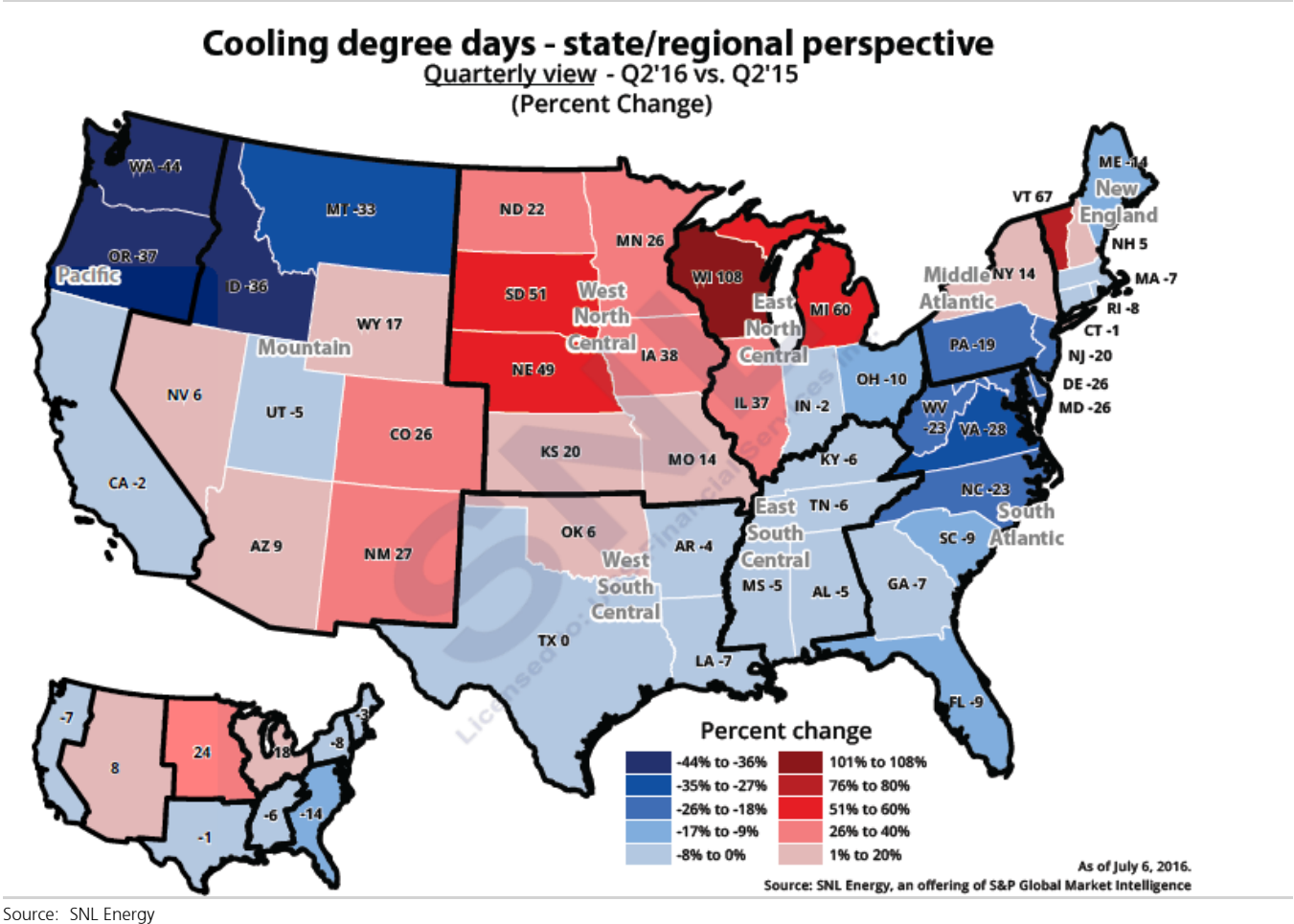
**We would expect that bidders who have been unsuccessful would remain interested in any subsequent M&A opportunities.**

We caution that while some companies had taken cursory looks, the risk remains for further deals to transact. We would continue to expect small-and-mid cap (SMids) to continuing trading at premium valuation versus their peer large-caps. [Further details are available here.](#)

### Weather: Less of a factor but a net negative in East/Positive in Central

As shown below cooling degree days (CDDs) were lower across YoY in 2Q16 across most of the east coast while the midwest saw a solid increase in temperatures in June. We caution that in the Central some of the higher CDDs observed in the quarter are partially offset by lower gas demand earlier in 2Q16 for companies with both electric/gas exposure.

Figure 13: Quarterly Weather Map: Cooling Degree Days 2Q16 vs 2Q15: State/Regional Perspective (% change)



Source: SNL Energy

## Regulatory Update

### Key Rate Cases to Watch:

Figure 3: Select Pending Electric Rate Cases

Company	Parent Company Ticker	State	Case Identification	Service	Case Type	Rate Increase (\$M)	Return on Equity (%)	Action Likely By
Florida Power & Light Co.	NEE	Florida	D-160021-EI	Electric	Vertically Integrated	1,337.7	11.50	10/27/2016
Pacific Gas and Electric Co.	PCG	California	A-13-12-012 (GT&S)	Natural Gas	Transmission	548.0	NA	9/30/2016
Consolidated Edison Co. of NY	ED	New York	C-16-E-0060	Electric	Distribution	479.6	9.75	12/31/2016
Arizona Public Service Co.	PNW	Arizona	D-E-01345A-16-0036	Electric	Vertically Integrated	433.4	10.50	6/1/2017
DTE Electric Co.	DTE	Michigan	C-U-18014	Electric	Vertically Integrated	344.0	10.50	2/1/2017
Northern States Power Co. - MN	XEL	Minnesota	D-E-002/GR-15-826	Electric	Vertically Integrated	297.1	10.00	6/1/2017
Brooklyn Union Gas Co.	-	New York	C-16-G-0059	Natural Gas	Distribution	290.0	9.94	12/31/2016
Pacific Gas and Electric Co.	PCG	California	A-15-09-001 (Elec)	Electric	Vertically Integrated	270.5	NA	12/31/2016
Consumers Energy Co.	CMS	Michigan	C-U-17990	Electric	Vertically Integrated	225.4	10.70	3/1/2017
Massachusetts Electric Co.	-	Massachusetts	DPU-15-155	Electric	Distribution	211.3	10.50	9/30/2016
Union Electric Co.	AEE	Missouri	C-ER-2016-0179	Electric	Vertically Integrated	206.4	9.90	4/30/2017
DTE Gas Co.	DTE	Michigan	C-U-17999	Natural Gas	Distribution	182.9	10.75	12/19/2016
KeySpan Gas East Corp.	-	New York	C-16-G-0058	Natural Gas	Distribution	174.7	9.94	12/31/2016
Consolidated Edison Co. of NY	ED	New York	C-16-G-0061	Natural Gas	Distribution	158.9	9.75	12/31/2016
Pennsylvania Electric Co.	FE	Pennsylvania	D-R-2016-2537352	Electric	Distribution	158.8	11.30	1/27/2017
Oklahoma Gas and Electric Co.	OGE	Oklahoma	Ca-PUD201500273	Electric	Vertically Integrated	149.5	10.25	7/31/2016
New Jersey Natural Gas Co.	NJR	New Jersey	D-GR-15111304	Natural Gas	Distribution	147.6	11.00	8/17/2016
Jersey Cntrl Power & Light Co.	FE	New Jersey	D-ER-16040383	Electric	Distribution	142.1	11.20	1/27/2017
Metropolitan Edison Co.	FE	Pennsylvania	D-R-2016-2537349	Electric	Distribution	140.2	10.90	1/27/2017
Commonwealth Edison Co.	EXC	Illinois	D-16-0259	Electric	Distribution	139.6	8.64	12/9/2016
Northern IN Public Svc Co.	NI	Indiana	Ca-44688	Electric	Vertically Integrated	126.6	10.75	7/27/2016
Potomac Electric Power Co.	EXC	Maryland	C-9418	Electric	Distribution	126.6	10.60	11/15/2016
Public Service Co. of NM	PNM	New Mexico	C-15-00261-UT	Electric	Vertically Integrated	123.5	10.50	9/1/2016
Tucson Electric Power Co.	FTS	Arizona	D-E-01933A-15-0322	Electric	Vertically Integrated	109.5	10.35	1/1/2017
United Illuminating Co.	-	Connecticut	D-16-06-04	Electric	Distribution	100.2	9.92	12/31/2016
West Penn Power Co.	FE	Pennsylvania	D-R-2016-2537359	Electric	Distribution	98.2	10.90	1/27/2017
Kansas City Power & Light	GXP	Missouri	C-ER-2016-0285	Electric	Vertically Integrated	90.1	9.90	4/30/2017
Potomac Electric Power Co.	EXC	District of Columbia	FC-1139	Electric	Distribution	85.5	10.60	7/31/2017
Atlantic City Electric Co.	EXC	New Jersey	D-ER-16030252	Electric	Distribution	84.4	10.60	12/22/2016
Public Service Co. of OK	AEP	Oklahoma	Ca-PUD201500208	Electric	Vertically Integrated	84.4	10.50	8/31/2016
Duke Energy Progress LLC	DUK	South Carolina	D-2016-227-E	Electric	Vertically Integrated	79.0	10.75	12/15/2016
South Carolina Electric & Gas	SCG	South Carolina	D-2016-224-E	Electric	Limited-Issue Rider	74.2	NA	10/27/2016
Southwestern Public Service Co	XEL	Texas	D-45524	Electric	Vertically Integrated	71.9	10.25	1/31/2017
Dayton Power and Light Co.	AES	Ohio	C-15-1830-EL-AIR	Electric	Distribution	65.8	10.50	9/30/2016
El Paso Electric Co.	EE	Texas	D-44941	Electric	Vertically Integrated	63.3	10.10	7/31/2016
Delmarva Power & Light Co.	EXC	Delaware	D-16-0649	Electric	Distribution	62.8	10.60	5/17/2017
Pacific Gas and Electric Co.	PCG	California	A-15-09-001 (Gas)	Natural Gas	Distribution	62.6	NA	12/31/2016
UGI Utilities Inc.	UGI	Pennsylvania	D-R-2015-2518438	Natural Gas	Distribution	58.6	11.00	10/19/2016
Columbia Gas of Pennsylvania	NI	Pennsylvania	R-2016-2529660	Natural Gas	Distribution	55.3	11.00	12/19/2016

Source: SNL Energy

#### What are the next key rate case developments?

- **Settlements:** We flag Con Edison and PG&E could see rate case settlements in coming weeks. PG&E has communicated it in discussions already, while ConEd Edison typically attempts to settle their cases during the current period. We believe a potential PG&E deal could help shares continue to re-rate from lower regulatory risk *despite* the pending criminal case.

## Appendix:

[Macro-Strategy Key Issue](#) - It's 'Leave' - Implications for UK, Europe & markets

[European Equity Strategy](#) - UK LEAVES: market, sectors & stock impact

[US Equity and Derivatives Strategy](#) - It's 'Leave' – what it means for the US

[US Economic Comment](#) - It's 'Leave' – Brexit Delays Fed Tightening

For more information, see our recent UBS macroeconomic notes:

[6/17/16: 1-family housing pickup likely; multifamily less so](#)

[6/17/16: What to Watch in the Week Ahead](#)

[6/16/16: Is there a preference for pessimism?](#)

[6/16/16: Core CPI up at a 2 ½% annual rate so far this year](#)

[6/15/16: FOMC: Take the summer off, we are.](#)

[6/15/16: Weak IP, but signs of rebound & of pricing power](#)

[6/14/16: Booming consumption despite jobs](#)

Figure 14: Regulated Utilities Comp Sheet

	Price 7/19/2016	Dividend Yield	Short Interest	Days to Cover	P/E Multiple			
					2016E	2017E	2018E	2019E
<b>REGULATED INTEGRATED UTILITIES</b>								
<b>Large Cap</b>	<b>Price</b>	<b>Yield</b>	<b>Short</b>	<b>Days</b>	<b>2016E</b>	<b>2017E</b>	<b>2018E</b>	<b>2019E</b>
Ameren Corp.	52.25	3.25%	2.2%	3.3	21.0	18.7	17.4	16.3
Alliant Energy Corp.	39.46	2.98%	2.9%	1.1	20.8	19.6	18.6	17.8
CenterPoint Energy Inc	23.92	4.31%	3.2%	3.1	20.8	19.7	18.5	17.9
CMS Energy Corporation	44.88	2.76%	3.5%	3.7	22.2	20.8	19.4	18.2
Consolidated Edison	78.90	3.40%	4.0%	4.9	19.8	19.4	18.8	17.8
DTE Energy Co.	97.70	3.15%	1.4%	2.3	19.8	18.3	16.8	15.3
Duke Energy	85.21	4.01%	2.9%	5.6	18.3	17.8	17.0	16.3
Edison International	76.96	2.49%	1.5%	2.7	19.8	18.5	17.7	16.3
Eversource Energy	57.93	3.07%	1.4%	2.4	19.5	18.8	17.8	16.7
PG&E Corporation	64.42	3.04%	0.9%	1.3	17.2	17.7	17.0	16.1
Pinnacle West Capital Co.	79.44	3.15%	3.2%	4.5	19.6	19.0	17.5	17.1
PPL Corporation	37.11	4.10%	1.1%	1.0	15.8	15.2	14.6	14.1
SCANA Corp.	73.63	3.12%	4.1%	4.9	18.6	17.6	16.8	16.2
Southern Company	53.59	4.18%	2.2%	3.1	18.9	18.8	18.0	17.4
WEC Energy Group Inc.	64.03	2.66%	3.2%	4.0	21.8	20.6	19.2	18.2
Xcel Energy Inc.	43.73	3.11%	2.3%	3.2	19.9	19.0	18.2	17.1
<b>Average</b>		<b>3.30%</b>	<b>2.5%</b>	<b>3.2</b>	<b>19.6</b>	<b>18.7</b>	<b>17.7</b>	<b>16.8</b>
<b>Small and Mid-Caps</b>	<b>Price</b>	<b>Yield</b>	<b>Short</b>	<b>Days</b>	<b>2016E</b>	<b>2017E</b>	<b>2018E</b>	<b>2019E</b>
ALLETE	63.55	3.27%	2.1%	3.4	19.9	18.0	17.7	16.5
Avista Corp	43.37	3.16%	3.1%	4.6	21.1	20.4	19.5	18.6
Black Hills Corp	62.02	2.71%	10.0%	13.1	20.6	17.5	16.0	na
El Paso Electric Co.	46.77	2.65%	1.8%	2.2	18.7	17.8	17.0	16.0
Great Plains Energy	30.07	3.49%	3.2%	2.2	17.5	16.6	15.7	15.0
Idacorp, Inc.	80.03	2.55%	2.0%	2.4	20.6	19.9	19.5	na
MGE Energy	56.10	2.10%	2.4%	5.2	24.4	22.9	22.0	21.2
NorthWestern Corp	61.02	3.28%	2.5%	3.5	18.6	17.8	16.6	15.8
Portland General Electric Company	43.92	2.91%	2.7%	4.2	20.0	18.3	16.9	15.9
PNM Resources Inc.	33.99	2.59%	3.6%	4.2	21.3	18.1	16.4	15.8
Spire Inc	68.19	2.87%	4.4%	7.0	20.1	19.3	19.0	17.3
OGE Energy Corp	31.91	3.45%	2.5%	3.7	18.1	16.9	15.7	15.0
Vectren Corp	51.59	3.10%	1.2%	2.2	20.9	19.3	18.3	na
<b>Average</b>		<b>2.93%</b>	<b>3.2%</b>	<b>4.5</b>	<b>20.1</b>	<b>18.7</b>	<b>17.7</b>	<b>16.7</b>
<b>Regulated Average</b>		<b>3.14%</b>	<b>2.8%</b>	<b>3.8</b>	<b>19.9</b>	<b>18.7</b>	<b>17.7</b>	<b>16.8</b>

Source: Company Filings, UBS Estimates, and FactSet. \*Unrated companies are FactSet exclusively.

# Ameren Corp.

Despite its discount, we see continued risks that AEE may see negative impacts in the lower rate cycle due its 30-year treasury exposure, pending Missouri rate case, as well as MtM impact from ongoing FERC ROE complaints.

We forecast 2Q16 adjusted EPS of **\$0.50** vs \$0.58 in 2Q15 and \$0.53 Consensus.

2Q would have been approximately flat YoY if not for the impact of the Callaway outage.

- **Key Drivers:** Higher revenue from transmission investments and rate relief provide the foundation for YoY growth but this is fully offset by the Spring nuclear outage and lost sales due to Noranda and energy efficiency.
- **Wildcard Factors:** (1) Negative impact of the decline in US Treasuries on the IL Electric business [management booked to a 2.95% ROE in 2Q15 vs ~2.1% today] and [datapoints on FERC transmission ROEs](#) [9.7%]; (2) mitigation of lost Noranda load; and (3) impact of energy efficiency – AEE expects to book some of the expected ~\$19Mn performance incentive later in 2016 (likely 2H16) to help offset the effects of the program in 2016.

Figure 15: AEE 2Q16E Earnings Walk

Ameren Corp 2Q16 Earnings Walk		EPS
<b>2Q15A Adjusted EPS</b>	<i>Notes</i>	<b>\$0.58</b>
Weather vs Normal in 2Q15	<i>Return to Normal Weather; Flat vs Normal</i>	0.00
Weather vs Normal in 2Q16	<i>Degree Days in Current Year; Near-Normal</i>	0.00
MO Electric: New Rates	<i>\$122Mn Increase Effective May 30, 2015</i>	0.01
MO Electric: Energy Efficiency Impact	<i>\$19Mn of performance incentive (2H16E); flattish sales in 2016</i>	(0.02)
IL Electric: Higher Rates (Formulaic)	<i>\$106Mn Increase Effective January 2016; 30Yr Treasuries ↓</i>	0.01
ATX and IL Transmission	<i>Avg Ratebase increase YoY for FERC Trans. is \$700M Higher in '16</i>	0.04
IL Gas: Higher Rates	<i>\$45Mn Increase Effective Late December 2015; ~50bp ROE ↑</i>	0.02
Interest Expense	<i>Issued \$350Mn (2.7%) and \$350Mn (3.65%) at Parent on Nov. 24</i>	(0.01)
Effective Tax Rate	<i>~37-38% ETR for 2Q-4Q16; ~37% in 2Q15 from tax position</i>	(0.00)
Callaway Refueling Outage	<i>Impact of Callaway Nuclear Refueling Outage During Spring 2016</i>	(0.09)
Impact of Noranda	<i>Forgone sales net of mitigation; ceased operations</i>	(0.03)
Absence of 1Q15 ICC Power Usage Item	<i>Removing Impact of ICC Recovery</i>	0.00
Change in O&M, D&A, and Other	<i>Organic cost inflation offset by lean initiatives in Missouri</i>	0.00
Dilution	<i>Minimal impact</i>	(0.00)
<b>2Q16E Adjusted EPS</b>		<b>\$0.50</b>
<b>2Q16 Consensus</b>		<b>\$0.53</b>
<b>2016 UBSe EPS</b>		<b>\$2.48</b>
<b>2016 Consensus</b>		<b>\$2.51</b>
<b>2016 Guidance</b>		<b>\$2.40-\$2.60</b>

Source: Company filings, FactSet, UBS estimates

For additional context, please refer links to relevant recent reports below:

[5/12/16 Leaving The Door Open](#)

[4/20/16 Well Positioned](#)

[3/10/16 Working Together This Time](#)

[11/6/15 Solid Execution Continues](#)

[8/4/15 Following The Regulatory Path to Illinois Growth](#)

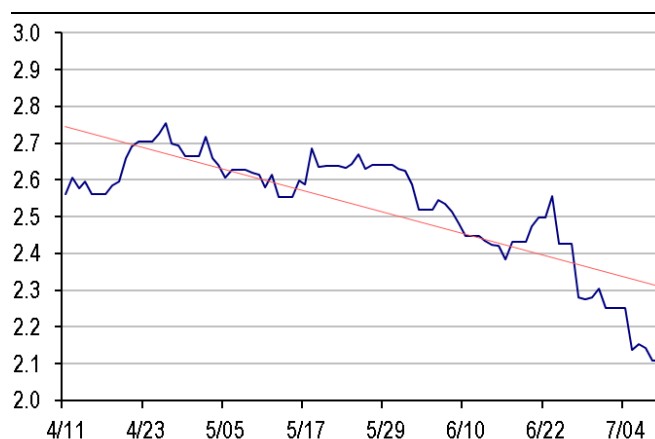


**Figure 16: 30-Year Treasury Rate (Long-Term)**



Source: FactSet

**Figure 17: 30-Year Treasury Rate (Trailing Three Months)**



Source: FactSet

## What are the key updates for AEE?

- Among the most exposed company to lower ROE trend via both T&D rates:** Ameren is one of the most exposed companies in our view to the evolving negative rate environment, both given its exposure to MISO ROEs (via FERC ratebase, for which an explicit ROE assumption is not provided) as well as via its formulaic ROEs in Illinois (tracked to 30-year treasuries: 3.2% 2016 assumption in guidance vs. 2.6% YTD average and ~2.1% at present). Despite an above-average EPS growth rate of 5-8%, we see pressures through the medium-term as management seemingly indicated that the high-end of its EPS growth target was based on higher authorized ROEs for Illinois electric.

For example in its current Illinois electric rate case AEE is requesting an 8.64% ROE based on the 580bp + 30Yr Treasury formula versus a 9.14% ROE in the previous case. This request implies a 2.84% average 30Yr Treasury yield in contrast to ~2.1% today. With ratebase increasing and a roll-off of charges for prior under-recovery, we would expect a lower impact on earnings.

- Missouri in focus with two new rate cases:** On July 1<sup>st</sup> both GXP and AEE filed rate increase requests with the Missouri Public Service Commission (PSC) with 9.9% ROEs. This contrasts with a 9.53% authorized in the April 2015 for Ameren and 9.5% authorized in September 2015 for GXP. We see risk to the ROEs with Ameren's expert utilizing a "near-term" projected 30Yr Treasury yield of 3.08% vs ~2.1% today and 2.65% "current" when the testimony was prepared. The companies' requests involve significant rate inflation with GXP requesting a +7.5% rate increase and AEE asking for +7.8% base rate increase. With interest rates Ameren's \$206Mn annual revenue request increase includes +\$51Mn for lower sales volume and is requesting to amortize \$81Mn of lost fixed cost recovery related to Noranda over ten years. Investors have expressed an increased interest in Ameren lately based on the perception that the regulatory construct in Missouri is improving and these two cases will be a key barometer. As we show below, ROEs have been trending lower in Missouri while Ameren has requested \$900Mn of high revenues in its last four rate cases covering a six-year period.

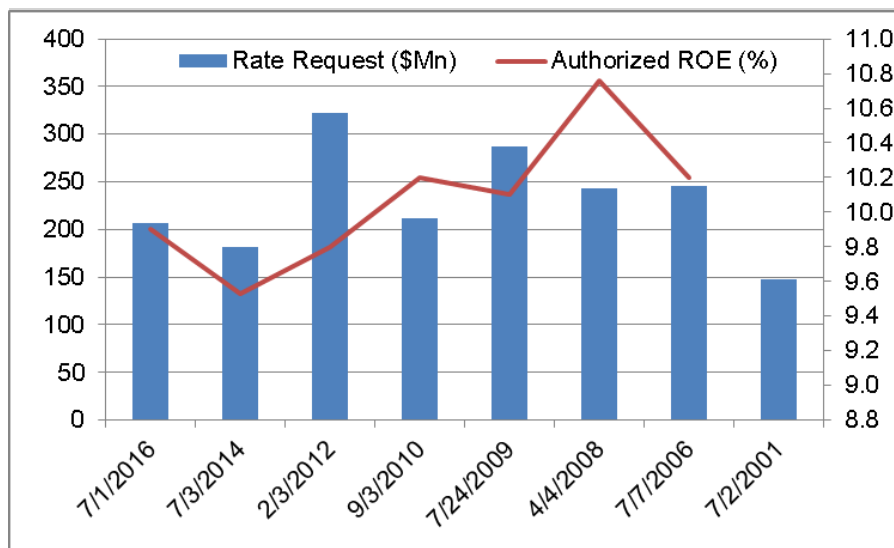
We estimate every 50bp reduction in ROEs could result in a **-\$0.025 EPS impact on a full-year basis in Illinois where allowed ROEs are tied to 30Yr US Treasury yields**

The latest IL rate case has a rate decrease due in part to lower ROE assumptions.

Between its latest MO rate case, the formula electric rates in Illinois, and FERC transmission, we see AEE is one of the more sensitive companies to interest rates.



Figure 18: Ameren Missouri Electric Rate Requests



Source: SNL Energy. \*2016 ROE is requested

- Not throwing in the towel after failed legislative effort in Spring 2016:**  
 Although the effort to pass supportive energy legislation in Missouri were ultimately unsuccessful earlier this year, we see two efforts currently ongoing as potentially improving the investment construct in the state. In the legislation the state Senate has formed the Senate Interim Committee on Utility Regulation and Infrastructure Investment to review the construct for electric and gas utilities in the state relative to peer states to see if there are areas for improvement. The committee is expected to draft a report by the end of the year with recommendations going to the president of the state Senate. At the PSC there is a working case with a similar objective of reviewing the investment construct for electric utilities. Stakeholders have been providing comments and the Staff is expected to issue a report with recommendations by October 17<sup>th</sup> with a final report due by December 1<sup>st</sup> with possible PSC actions to take.

## Reducing EPS Estimates

We are reducing our EPS estimates in light of the latest step-down in US treasury yields as discussed above which directly impacts IL electric and FERC transmission assets as well as indirectly being a factor in the pending MO electric rate case.

**Figure 19: Ameren EPS Estimates**


Consolidated EPS Projections	2014A	2015A	2016E	2017E	2018E	2019E	2020E	CAGR 'Adj.16-'20E
Ameren Missouri	1.60	1.62	1.39	1.56	1.60	1.63	1.66	2.3%
Ameren Illinois	0.82	0.88	0.94	1.03	1.12	1.24	1.38	9.9%
ATXI	0.06	0.13	0.22	0.26	0.30	0.33	0.37	13.9%
Other	(0.07)	(0.07)	(0.07)	(0.07)	(0.07)	(0.07)	(0.08)	
<b>Total EPS</b>	<b>2.40</b>	<b>2.56</b>	<b>2.48</b>	<b>2.78</b>	<b>2.95</b>	<b>3.13</b>	<b>3.33</b>	<b>6.1%</b>
Prior	2.40	2.56	2.48	2.80	3.00	3.20	3.43	
YoY Growth Rate	15%	6%	-3%	12%	6%	6%	6%	
<b>Consensus</b>	<b>2.40</b>	<b>2.56</b>	<b>2.51</b>	<b>2.79</b>	<b>3.00</b>	<b>3.21</b>		
<b>Projected ROEs, by Utility (regulatory basis)</b>								
Missouri	10.56%	10.58%	9.00%	9.89%	9.93%	9.94%	9.92%	
Illinois (wtd avg Utes & Transmission)	<u>9.13%</u>	<u>9.71%</u>	<u>9.71%</u>	<u>9.56%</u>	<u>9.34%</u>	<u>9.23%</u>	<u>9.14%</u>	
Weighted Average ROE Earned (regulatory)	10.06%	10.25%	9.22%	9.79%	9.74%	9.72%	9.67%	
<b>Guidance 5%-8% off normalized 2016 \$2.63 (excludes lost -\$0.13 from Noranda)</b>								
Low Implied Guidance Range (5%) off normalized 2016 \$2.63			2.40	2.76	2.90	3.04	3.20	
High Implied Guidance Range (8%) off normalized 2016 \$2.63			2.60	2.84	3.07	3.31	3.58	
'16-'20 UBSe EPS CAGR off normalized 2016 \$2.63							6.1%	

Source: Company filings, FactSet, UBS estimates

## Valuation: Increase Price Target to \$53 from \$49

Our valuation is based on a 2018E sum-of-the-parts. We are increasing our price target by \$4 which is driven by the 2x-turn improvement in regulated utilities (to ~18x from 16x). The +\$5/sh increase for the peer multiple expansion is offset by the -\$1/sh due to lower forward EPS estimates.

**Figure 20: AEE Sum-of-the-Parts Valuation**

Ameren Sum of the Parts Valuation - 2018E UBSe 									
All figures in \$Mn except per share									
	EPS		P/E Multiple				Equity Value		
	Low	High	Peer Multiple	Prem /Disc	Base	High	Low	Base	High
Ameren Missouri	1.60	16.8x	17.8x	0.0x	17.8x	18.8x	\$6,544	\$6,934	\$7,323
Ameren Illinois	1.12	17.3x	17.8x	0.5x	18.3x	19.3x	\$4,726	\$4,999	\$5,273
Ameren Transmission (ATXI)	0.30	18.3x	17.8x	1.5x	19.3x	20.3x	\$1,317	\$1,389	\$1,461
Parent Unallocated Items	(0.07)	16.8x	17.8x	0.0x	17.8x	18.8x	(\$286)	(\$303)	(\$320)
<b>Total / Implied Utilities</b>	<b>2.95</b>	<b>17.1x</b>			<b>18.1x</b>	<b>19.1x</b>	<b>\$12,302</b>	<b>\$13,019</b>	<b>\$13,737</b>
2018E Number of Shares Outstanding (Mn)							244	244	244
<b>Equity Value per Share</b>							<b>\$50.00</b>	<b>\$53.00</b>	<b>\$56.00</b>
<b>Upside/(Downside)</b>							<b>-5%</b>	<b>1%</b>	<b>7%</b>

Source: Company filings, FactSet, UBS estimates

# Avista Corp.

Avista is currently trading at ~20x 2018E, a 2x-turn premium to even SMid peers and is the second most expensive utility we track (MGE Energy trades at 22x) and we continue to believe there are more attractive return opportunities elsewhere given the approximately average 4-5% EPS growth target.

We forecast 2Q16 adjusted EPS of **\$0.46** vs \$0.40 in 2Q15 and \$0.43 Consensus.

**No contribution from the ERM was recognized in 2Q15.**

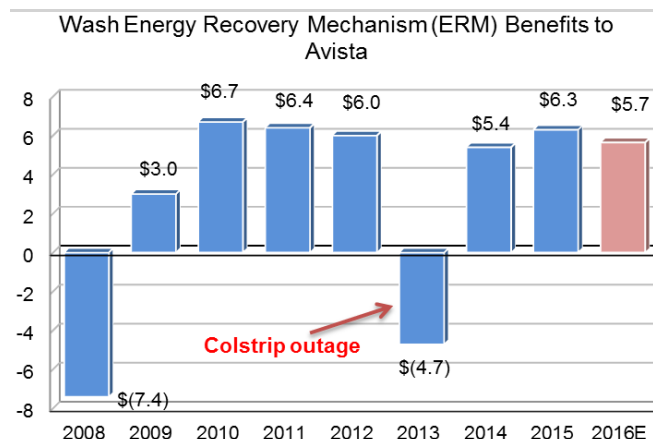
- **Key Drivers:** The 2015 Washington rate case drives the majority of the earnings improvement but this is offset by meaningful regulatory lag even with a slower rate of capex in 2016 compared with 2015A.
- **Wildcard Factors:** (1) On the 1Q16 call management revised its 2016E Energy Recovery Mechanism [ERM] expectations to be in 75%/25% sharing band [\$4M-\$10M of pretax benefits before sharing] vs. prior expectation of being "within the \$4M benefit deadband; and (2) magnitude of volume growth with Avista being one of dwindling group of utilities expecting customer/load growth to be a noticeable positive factor [-1%]

**Figure 21: AVA 2Q16E Earnings Walk**

Avista Corp 2Q16 Earnings Walk	EPS
<b>2Q15A Adjusted EPS</b>	<b>\$0.40</b>
Weather vs Normal in 2Q15	\$0.00
Weather vs Normal in 2Q16	\$0.00
Sales Benefit	\$0.02
ERM Impact	\$0.02
Rate Relief	\$0.08
AERC	\$0.00
O&M	(\$0.02)
D&A	(\$0.04)
Interest	(\$0.01)
Dilution	\$0.00
Other	\$0.00
<b>2Q16E Adjusted EPS</b>	<b>\$0.46</b>
<b>2Q16 Consensus</b>	<b>\$0.43</b>
<b>2016 UBSe EPS</b>	<b>\$2.06</b>
<b>2016 Consensus</b>	<b>\$2.04</b>
<b>2016 Guidance</b>	<b>\$1.96-\$2.16</b>

Source: Company Filings, FactSet, and UBS Estimates

**Figure 22:**



Source: Company Filings and UBS Estimates

*For additional context, please refer links to relevant recent reports below:*

[5/4/16 Improved Hydro Expectations](#)

[3/18/16 Expecting Some Runoff \(d/g to Sell\)](#)

[2/26/16 Aiming for a Longer Rateplan](#)

[2/23/16 Searching for Clues in Utility M&A](#)

[8/7/15 Steady Progress on Ratecases](#)

## What are the key updates for AVA?

### We examine the latest rate case developments

- **Washington:** The current multi-year electric and gas rate cases were filed in February with a 9.9% ROE on 48.5% equity. Under the plan, AVA is requesting new rates on January 1, 2017 (\$38.6M elec and \$4.4M gas) followed by a second step-up in 2018 (\$10.3M elec and \$0.9M gas), with a rate increase stayout stipulating no new rate filing for rates effective prior to July 1, 2018. A settlement conference was held earlier this month and another one is set for the end of August, following intervenor and Commission Staff testimony due by August 17<sup>th</sup>. The Attorney General's Office of Public Counsel is appealing (Court of Appeals) the attrition in the previous 2015 rate case and we believe it would be unusual for them to settle in the current rate case on that issue in the interim. In the past AVA has been able to reach settlements with other parties and a partial settlement is always a possibility.
- **Idaho:** The case requesting a +\$15Mn revenue increase (9.9% ROE) was just filed on May 26<sup>th</sup> and testimony is not expected until October 2016.
- **Oregon:** Management expects to file its next natural gas rate case in 2H16 given the magnitude of capital spending in the jurisdiction. The previous rate case (D-UG 288) was fully litigated and a +\$4.5Mn revenue increase was authorized earlier this year with a 9.4% ROE which included a decoupling mechanism.
- **Alaska:** Avista has continually stated since it purchased Alaska Electric Light & Power Company (AEL&P) that it was evaluating a rate case and it finally appears that management is approaching a filing with the catalyst being the investment in a diesel generator later this year. The last rate case was fully litigated in 2011 with a +\$7Mn revenue increase based on a 12.88% ROE and 54% equity ratio.

A settlement without Public Counsel and/or a partial settlement are always possibilities.

A multi-year case could help reduce regulatory lag that has perpetually reduced earnings.

Rate cases are possible in the next approximate six-month window for Oregon and Alaska.

Figure 23: Avista Rate Case Status

Avista Rate Case Status							
State	Service	Filing Date	Request (\$Mn)	ROE (%)	Equity (%)	Timeline	Case #
Idaho	Electric	5/26/2016	\$15.4	9.9%	50.0%	October (Testimony & Settlement Conference)	C-AVU-E-16-03
Washington	Electric	2/19/2016	\$48.9	9.9%	48.5%	August (Testimony & Settlement Conference)	D-UE-160228
Washington	Gas	2/19/2016	\$5.3	9.9%	48.5%	August (Testimony & Settlement Conference)	D-UG-160229
Oregon	Gas	Management is evaluating the need for a rate case filing; guided to 2H16 filing					
Alaska	Electric	Management is evaluating the need for a rate case filing; potential around YE16 based on investment timing					

Source: SNL

- **Alaskan opportunities slower to develop in the new oil price environment:** We look for details on the call if there are any updates on the Juneau LDC as management continues to evaluate the potential in the lower priced oil environment. If Avista ultimately moves forward with this endeavour management indicated that it could represent a potential \$130Mn opportunity Separately Salix was selected as a finalist in the Alaska Industrial Development and Export Authority (AIDEA) RFP to develop an LNG plant but AIDEA still needs to grant final approval. For both Salix and the LDC opportunity, Avista is evaluating what kind of regulatory mechanisms are available to make the conversions more affordable and potential alternatives.
- **Colstrip settlement achieved:** Avista and the other joint owners reached a proposed settlement to release liability and lead to retirement of Units 1 & 2

AVA owns 15% of Units 3/4 & 4.

by 2022 with the dismissal of Units 3 & 4 claims. The question remains what the precise coal ash liabilities will be associated with the plant.

## EPS estimates slightly adjusted

In 1Q16 management issued \$27Mn of equity and still intends to issue an additional \$28Mn during the balance of the year. The 1Q16 equity issuance was a contributing factor in the equity ratio increasing to 48.1% as of March 31<sup>st</sup> compared with 46.9% as of year-end 2015. \$155Mn of long-term debt is also expected to be issued during the year, in part to refinance a \$90Mn debt maturity for this year. There are no maturities in 2017 but \$273Mn comes due in 2018.

**Figure 24: AVA EPS Estimates**

Avista EPS Estimates	2015A	2016E	2017E	2018E	2019E
<b>Segment EPS</b>					
Avista Utilities (WA, ID, OR)	\$1.81	\$1.98	\$2.05	\$2.13	\$2.24
AEL&P Utility (AK)	\$0.11	\$0.11	\$0.11	\$0.12	\$0.13
Other	(\$0.03)	(\$0.03)	(\$0.03)	(\$0.03)	(\$0.03)
<b>UBS Estimates</b>	<b>\$1.89</b>	<b>\$2.06</b>	<b>\$2.13</b>	<b>\$2.23</b>	<b>\$2.33</b>
Prior UBS estimate	\$1.89	\$2.06	\$2.13	\$2.22	\$2.33
<b>Consensus</b>		<b>\$2.05</b>	<b>\$2.13</b>	<b>\$2.22</b>	<b>\$2.32</b>
<b>Guidance</b>		<b>\$1.96-\$2.16</b>			
<b>Guidance EPS: 4-5% LT CAGR</b>				<b>UBSe</b>	<b>4.3%</b>
Earned ROE (8.6%-9.2%, w/ 60-70 bps lag)		8.9%	8.9%	8.9%	8.9%

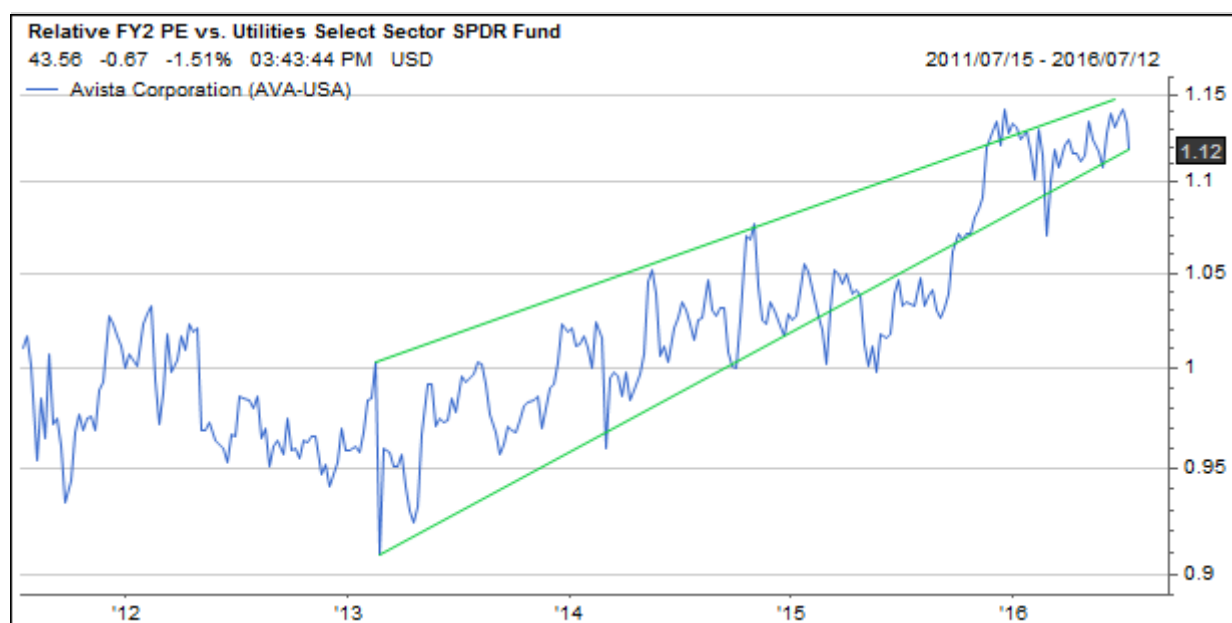
Source: Company Filings, FactSet, and UBS Estimates

## Valuation: Increase Price Target \$3 to \$39

Our valuation remains based on a 2018E peer utility P/E with an in-line multiple. Avista is currently trading at ~20x 2018E, a 2x-turn premium to even SMid peers and is the second most expensive utility we track (MGE Energy trades at 22x) and we continue to believe there are more attractive return opportunities elsewhere given the approximately average 4-5% EPS growth target.

**The 12% premium to peers compared with an approximately average multiple during 2013-1H2015.**

Figure 25: AVA Relative FY2 PE Multiple



Source: FactSet

Figure 26: AVA P/E Valuation

Avista P/E Valuation (2018E)		Low Case		Base Case		High Case	
		Multiple	\$Mn	Multiple	\$Mn	Multiple	\$Mn
				Peer	17.7 x		
Consolidated Net Income	\$146	15.2 x	\$2,219	17.7 x	\$2,583	20.2 x	\$2,948
Fully Diluted Outstanding Shares (2018E)			65.6		65.6		65.6
AVA Equity Value per Share			\$34.00		\$39.00		\$45.00

Source: Company filings, FactSet, UBS estimates

# CMS Energy Corporation

The prospects of new energy legislation in Michigan appears off-the-table in the near-term following the June recess. The challenge for 2017 will be educating new Representatives after the election cycle this Fall. Despite this setback, CMS has continued to outperform and still trades at a 10% premium, among the highest in the group due to management's track record of delivering on its above-average EPS growth rate in different cycles. We continue to see CMS as among the best positioned to maintain an above-average EPS growth rate, seeing valuation as our principle concern.

We forecast 2Q16 adjusted EPS of **\$0.33** vs \$0.25 in 2Q15 and \$0.29 Consensus.

- **Key Drivers:** The 2015 electric and gas rate cases continue to be the primary drivers of earnings improvement in 2016. In 1Q16 there was +\$0.13 improvement (+\$0.10 electric and +\$0.03 gas) but the revenue increase should decline QoQ due primarily to the ~\$40Mn rate reduction agreed to for mid-April 2016 around the 'classic seven' coal retirements.
- **Wildcard Factors:** (1) Magnitude of O&M saving efforts with management announcing an incremental +\$0.13 cost reduction plan in 1Q16 to offset mild winter weather. 2Q16 weather appears largely consistent with the historical average and CMS has commented that there is further flexibility on maintenance and other spending to help the company to achieve its FY16 EPS guidance.

CMS discussed levers it can pull to offset the challenging 1Q16 weather, above the typical rate reduction efforts the company strives to achieve.

Figure 27: CMS 2Q16E Earnings Walk

CMS Energy 2Q16 Earnings Walk	EPS
2Q15A Adjusted EPS	<b>\$0.25</b>
<b>Utilities</b>	
Weather	
Weather vs Normal in 2Q15 Near Normal	<b>\$0.02</b>
Weather vs Normal in 2Q16 Near Normal	\$0.01
Revenues	
2015 Electric Case: \$165Mn December 2015	\$0.04
2015 Gas Case: \$40Mn January 2016	\$0.01
2016 Electric Case: \$225Mn w ./ \$38Mn for '17	\$0.00
O&M	
Low er O&M: Attrition, smart meters, etc.	\$0.02
Low er Pension costs and other savings	\$0.03
DIG Maintenance Outage: Fall 2015 -\$8Mn	\$0.00
Interest Expense	\$0.00
Investment Costs: D&A, Property Taxes, etc.	<b>(\$0.06)</b>
<b>Enterprise</b>	\$0.01
<b>Interest and Other</b>	\$0.00
Dilution	\$0.00
<b>2Q16E Adjusted EPS</b>	<b>\$0.33</b>
<b>2Q16 Consensus</b>	<b>\$0.29</b>
<b>2016 UBSe EPS</b>	<b>\$2.02</b>
<b>2016 Consensus</b>	<b>\$2.02</b>
<b>2016 Guidance</b>	<b>\$1.99-\$2.02</b>

Source: Company Filings, FactSet, and UBS Estimates

*For additional context, please refer links to relevant recent reports below:*

[5/3/16 In-Line with Plan](#)

[2/10/16 Leaning Into Their Bonus](#)

[10/30/15 Delivering on Plan](#)

[10/26/15 Tapping the Brakes](#)

[10/26/15 Positioning the Quality Premium for Regulated Utilities](#)

[7/24/15 Gain with No Pain](#)

## **What are the key updates for CMS?**

- **Resetting expectations for MI legislation:** The Michigan state legislature entered their summer recess in early June without holding a vote on the energy legislation. When the bill was up for debate media reports indicated that there were multiple aspects of the potential legislation being debated such as the ultimate terms for consumer choice/switching and renewables mandate/goal. Importantly, Senate Energy and Technology Committee Chair Senator Mike Nofs (R) will remain in the legislation and continue to advocate for legislation. The challenge for next year will be that there is expected to be an education period for any new Representatives which could make the process more challenging.
- **Multi-year electric rate case takes the stage this summer with Staff testimony in late July:** CMS filed its latest electric ratecase on March 1<sup>st</sup> \$225Mn over a three year period (2017-2019) based on a 10.7% ROE. The majority of the request is to recover for capital investments (\$161Mn, 72%) and \$17Mn relates to lower peak customer delivery sales. The delta between the 10.7% ROE request and the 10.3% authorized is \$25Mn. PSC Staff testimony is scheduled to be filed on July 22<sup>nd</sup> with rebuttal testimony by August 26<sup>th</sup>. Hearings are scheduled to take place beginning September 7<sup>th</sup> with a Proposed Decision expected by December 16<sup>th</sup>. (Docket C-U-17990)

Separately CMS expects to file its next gas rate case in the near future where management continues to advocate for more tracker-like mechanisms to reduce the need for perpetual rate cases to recovery spending.

- **Palisades update still to be determined:** We continue to look for updates from Entergy who owns and operates the Palisades nuclear plant which is contracted with CMS' Consumers. Entergy management has continued express its desire to become more regulated and this would be another step down that road. Given the above-market contract, we believe there could be an opportunity for a mutually-beneficial outcome for all parties.
- **New Independent added to the PSC:** On July 6<sup>th</sup> Michigan Governor Rick Snyder appointed Rachael Eubanks (I) to the Michigan Public Service Commission to serve the remainder of John Quackenbush's term through July 2017. The appointment is still subject to Senate confirmation.

**The question is how much turnover will occur in the House – if there are significantly more new Representatives this lack of continuity could make the process more challenging in 2017.**



## EPS estimates unchanged

We are maintaining our EPS estimates through 2019 are unchanged and remain largely in line with consensus. As mentioned 1Q16 weather creates a headwind but management has conservatively established a 'reinvestment' contingency. With -\$0.31 of "investment costs" in the guidance for 2016, we note that a portion of this is opportunistic (some maintenance work, tree trimming, donations, etc.) that could be reduced if needed or increased if possible. Bottom line is that CMS seems highly confident in its 6%-8% long-term EPS growth rate. For example CMS raised its 2016E guidance on February 4<sup>th</sup> when it reported FY15 earnings which incorporated preliminary mild weather data for the winter.

**We are maintaining our estimates at 7% annual earnings growth (midpoint of the recently updated 2017+ 6-8% target) through 2017**

**Figure 28: CMS EPS Estimates (2014A-2019E)**

<b>CMS EPS Breakdown</b>	<b>2014A</b>	<b>2015A</b>	<b>2016E</b>	<b>2017E</b>	<b>2018E</b>	<b>2019E</b>
<b>Consumers Electric</b>	\$1.40	\$1.43	\$1.41	\$1.50	\$1.59	\$1.68
<b>Consumers Gas</b>	\$0.65	\$0.69	\$0.68	\$0.72	\$0.77	\$0.81
<b>DIG Cogen Merchant Unit</b>	\$0.02	\$0.04	\$0.06	\$0.05	\$0.03	\$0.02
<b>EnerBank</b>	\$0.07	\$0.07	\$0.08	\$0.09	\$0.09	\$0.10
<b>Parent Drag and Other</b>	(\$0.37)	(\$0.33)	(\$0.22)	(\$0.20)	(\$0.17)	(\$0.14)
<b>Total CMS EPS UBSe</b>	<b>\$1.77</b>	<b>\$1.89</b>	<b>\$2.02</b>	<b>\$2.16</b>	<b>\$2.31</b>	<b>\$2.46</b>
<b>UBSe Prior</b>			<b>\$2.02</b>	<b>\$2.16</b>	<b>\$2.31</b>	<b>\$2.46</b>
<b>UBSe EPS CAGR 2016-2019</b>						7.1%
<b>Management Guidance - EPS Growth 2017+ (%)</b>			<b>\$1.99-\$2.02</b>			<b>6%-8%</b>
<b>Street Consensus EPS</b>			<b>\$2.02</b>	<b>\$2.18</b>	<b>\$2.33</b>	<b>\$2.49</b>

Source: Company filings, FactSet, UBS estimates

## Valuation: Increase PT from \$41 to \$45

Approximately \$2/sh (probability-weighted) of our valuation is linked to energy legislation in Michigan; we have reduced the probability to 50% from 75% previously due to the failure of the legislative session to act in 1H16. We still believe that there could be a material probability that beneficial energy policy will be adopted eventually given the aging coal infrastructure and growing support for renewables.

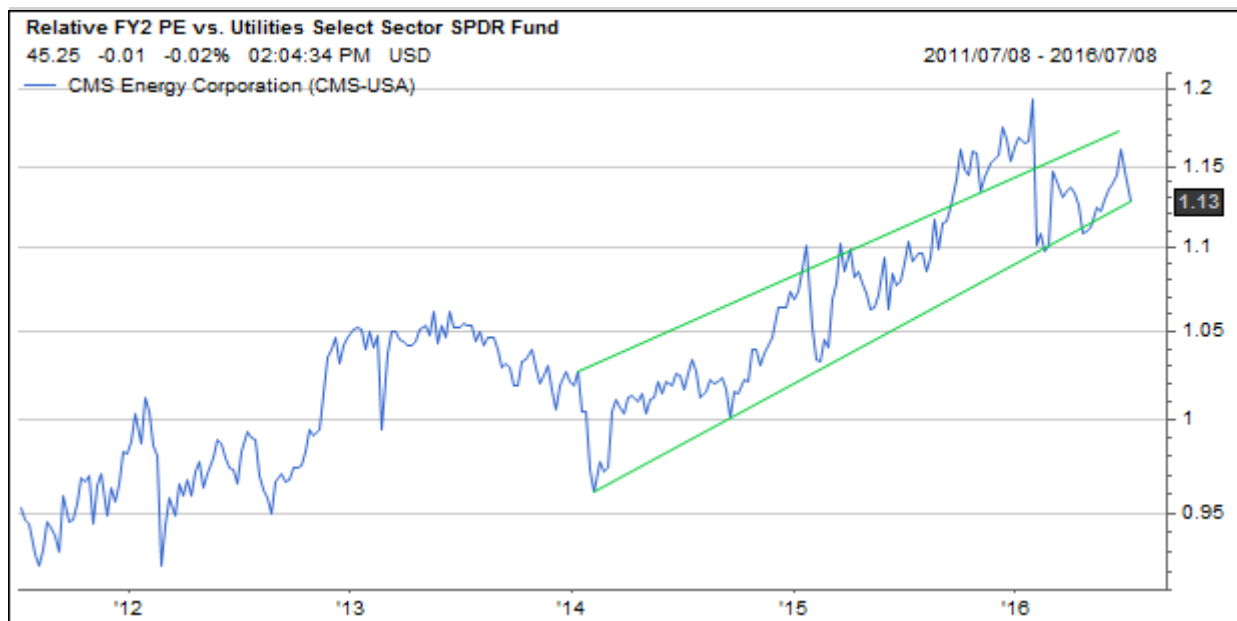
Figure 29: Updated CMS Energy Sum-of-the-Parts Valuation

Business Segment	Valuation Metric	2018	Low Case		(\$ MM) Value	Base Case			(\$ MM) Value	High Case		(\$ MM) Value	
			Valuation Multiple			Valuation Multiple		Valuation Multiple					
Regulated Entities													
						Peer Multiple	Prem/(Disc) to Peer	Base Multiple					
Consumers Electric - Base Capex	P/E	\$1.51	17.0x		\$7,121	18.0x	0.5x	18.5x		\$7,750	19.5x	\$8,169	
Consumers Gas	P/E	\$0.77	17.0x		\$3,621	19.0x	0.0x	19.0x		\$4,047	20.0x	\$4,260	
Incremental Opportunities	P/E			Probability					Probability		Probability		
Elimination of ROA		\$0.11	17.0x	0%	\$0		0.0x	18.0x	50%	\$271	19.0x	100%	\$572
Renewables - Wind		\$0.07	17.0x	0%	\$0			18.0x	50%	\$183	19.0x	100%	\$387
Palisades PPA Expiration		\$0.09	17.0x	0%	\$0			18.0x	50%	\$222	19.0x	100%	\$468
MCV PPA Expiration		\$0.11	17.0x	0%	\$0			18.0x	50%	\$265	19.0x	100%	\$560
Regulated, Equity Value (\$Mn)					\$10,742						\$12,737	\$14,415	
Regulated, Equity Value (\$/sh)					\$38.60						\$45.77	\$51.79	
Unregulated and Parent Businesses													
EnerBank	P/E	\$0.09	11.0x		\$278			12.0x		\$304	13.0x	\$329	
Dearborn Industrial Generation (DIG)	\$kW	770	278		\$214			328		\$252	378	\$291	
Parent & Other	P/E	(\$0.17)	19.5x		(\$921)		18.5x			(\$874)	17.5x	(\$826)	
Unregulated, Equity Drag (\$Mn)					(\$428)						(\$317)	(\$206)	
Unregulated, Equity Drag (\$/Sh)					(\$1.54)						(\$1.14)	(\$0.74)	
CMS Equity Value					\$10,314						\$12,420	\$14,209	
Fully Diluted Outstanding Shares (2017E)					278						278	278	
CMS Equity Value per Share					\$37.00						\$45.00	\$51.00	

Source: Company filings, FactSet, UBS estimates

CMS' premium relative to the group has continued to expand and is now ~15%.

Figure 30: CMS Relative FY2 PE Multiple



Source: FactSet

# Consolidated Edison

We expect a modest miss in the quarter as a number of positive impacts roll off versus last year, such as a 5 cent reserve release (storm costs and 18A assessment), a one cent tax break and a 2 cent amortization benefit. The rate case remains in focus and recent pushback of the hearing timeline suggests settlement talks are progressing as ED has historically done. We also look to the recently released REV track 2 document for indications of future rate structure, which includes both positive incentives and a mandated 10 year depreciation schedule for assets.

**Key Drivers:** Higher O&M, D&A, and net interest expense more than offset the YoY changes to rate plans. More generally 2015 was a difficult comp year and positive contributions from ConEd Solutions are not likely to continue. Overall we see a ~10 cent miss this quarter as 2016 proves more challenging overall.

**Wildcard Factors:** Primary unknowns revolve around competitive energy business and to what extent last year's tough comp is offset by any other unknowns. Our ~8 cents of adjustments to CECONY are a substantial contributor to the miss in the quarter but are largely attributable to known positives from 2015.

Figure 31: ED 2Q16E Earnings Walk

ConEd 2Q16 Earnings Walk	EPS
<b>2Q15A Adjusted EPS</b>	<b>\$0.75</b>
<b>Con Edison of New York (CECoNY)</b>	
Changes in Rate Plans	0.07
Impact of Steam in 2Q15	0.00
Impact of Steam in 2Q16	0.00
O&M Inflation and Normalization	(0.03)
D&A and Property Taxes	(0.04)
Net Interest Expense	(0.02)
Oil-to-Gas Conversion	0.01
Other	(0.08)
<b>Orange &amp; Rockland Electric and Gas (O&amp;R)</b>	
Changes in Rate Plans	0.02
O&M	(0.01)
Other	(0.00)
<b>Competitive Energy Businesses</b>	
ConEd Solutions (CES) Ex-MtM	(0.03)
ConEd Development (CED) Ex-LILO	0.01
ConEd Transmission (CET):	0.00
ConEd Energy (CEE)	0.00
<b>Parent &amp; Other (Dilution, Taxes, etc.)</b>	<b>(0.03)</b>
<b>2Q16E Adjusted EPS</b>	<b>\$0.62</b>
<b>2Q16 Consensus</b>	<b>\$0.72</b>
<b>2016 UBSe EPS</b>	<b>\$3.98</b>
<b>2016 Consensus</b>	<b>\$4.00</b>
<b>2016 Guidance</b>	<b>\$3.85-\$4.05</b>

Source: Company filings, FactSet, UBS estimates

## Rate Case Update: Settlement Likely Again

Current staff recommendation for CECONY \$45M (1%) rate increase with 8.6% ROE compares to ED request for ~\$480M increase and 9.6% ROE, although about half of the difference in rate base increase is due to lower recommended ROE. The other half is due to staff's NOI adjustments (test period electricity, O&M, depreciation, etc). As for the gas utility, staff recommendation argues for -\$25M

We continue to see shares as pricey, with much of the bid attributable to a 'Yield trade'.

Our concerns remain tied to the risks in midstream execution and ROE downside out of the case...

Potential for a rate case settlement bodes well in the near term

Uncertain factors:

1. Retail sale, finally?
2. REV Proceedings = More or Less capex?

rate reduction (8.6% ROE) compares to ConEd request for \$159M increase on 9.75% ROE. Rockland Electric rate case filed May 13 is seeking 10.2% ROE and \$9.6M rate increase. We had previously calculated likely staff recommendation of 8.34% as shown below:

**Figure 32: Our Previous Est for Staff ROE**

Required Equity Return	
Constant Growth DCF Methodology	8.95
Three-Step DCF Methodology	8.58
Discounted Cash Flow Methodology (2/3rd Weight)	8.77
CAPM Methodology (1/3rd Weight)	7.49
<b>Required Equity Return</b>	<b>8.34</b>

Source: Company Filings, FactSet, Bloomberg, Yahoo Finance!, and UBS Estimates

Recently it appears that the PSC Staff has been somewhat hesitant to support multi-year deals given the evolving push to reform the regulatory paradigm in the state. All four rate case decisions in 2015 had 9% ROEs (Central Hudson Gas & Electric, CECONY Electric, O&R Gas, and O&R Electric), down from 9.1-9.3% in 2014. Although we expect a relatively flat ROE importantly ED will be able to recover for higher gas inspection related expenses that have significantly impacted the earned ROE at that subsidiary (7.3% actual TTM 9/30/15 vs 9.3% allowed).

#### Key Date to Watch:

**8.17.16** (previously 7.20): hearings begin in rate case. We note hearings postponement likely implies settlement talks are ongoing.

**Hearings were postponed as settlement talks progress**

#### Previous timeline

7.20.16: hearings begin

8.29.16 – initial briefs due

9.19.16 – reply briefs due

#### ED/CEQP: What's going on with Stagecoach?

Our [MLP colleagues](#) recently spoke with Crestwood Equity Partners (CEQP) management to get an update on the new Stagecoach Consolidated Edison (ED) joint venture opportunities. CEQP has discussed the MARC II pipeline in the past and a decision is expected in the near-term. The 700MMcf/day potential project would help connect MARC I with the PennEast Pipeline and cost \$225-\$250Mn, implying \$30-\$35Mn of adjusted EBITDA assuming a 7x EV / EBITDA. When we met with ED recently they said the return targets for Stagecoach were dependent on finding growth/expansion opportunities but few concrete details were available at the time. We look for tangible updates like MARC II to help solidify the growth plan. We believe that in order for the joint venture to be accretive for ED it needs to have further growth materialize beyond just MARC II with management emphasizing double-digit growth in gas demand from Northeast gas utilities (rather than producer-push projects).

**When ConEd makes non-utility investments its goal is to earn ROEs at-least equal to the utility (8-9%) – we think this is an easier task for pipeline investments than renewables given the different economic models.**

Further information on ConEd and Stagecoach is available below:

[5/16/16 Anticipating Northeast Gas Demand](#)

[4/21/16 Another Utility Branching Out Further into Gas](#)

**Hitting a snare on the sell-down of the retail biz?:** Based upon our recent conversations with management the company remains committed to the sale of this business – despite some apparent issues in executing. We note interest in retail continues to grow, suggesting some modestly improved prospects. We note the outsized EPS in 2015 could help boost a sale price. We note recent transactions remains in the ~5x EBITDA range, dilutive to ED assuming continued positive EPS; that said, the limited contribution and volatility introduced into its earnings profile does not fit with the contracted and consistent EPS desired by ConEd investors.

A number of competitive generators have discussed a desire to increase their retail presence to better hedge their volume following reduced liquidity in the commodity markets

### Renewables in New York?

We await details later this month on the NY PSC's parallel efforts to update the RPS in the state. We note an ongoing debate in the REV proceeding has been to what extent Con Ed in particular can be invested directly in these generation assets (either via utility ownership or third party affiliated). While we're biased to believe they will be largely prohibited, this could provide a further angle of investment if successful. In contrast, we see developments in New York as meriting greater attention for the renewable community.

### What Else are We Looking for in the 10-Q?

- Any updates on NY TransCo process
- PSC review of the harlem explosion
- ConEd solutions sales process

### Digging into the REV:

#### Earnings Adjustment Mechanism in REV has multiple angles

Among the most intriguing aspects of the latest Track out of the REV process is the possibility for the NY PSC to award a so-called 'Earnings Adjustment Mechanism' (EAM) to ConEd. This would authorize upwards of 100bp of ROE only to qualifying assets meeting certain criteria. On these projects, largely focused on distributed resources and more novel approaches to solving grid congestion, the project life amortization would be just 10-years rather than conventional utility assets at 20-40+ years. While initially it would appear a novel idea, we caution the short-life of these assets substantially limits their attractiveness.

REV earnings adjustment mechanism could award 100bps incentives, but mandates a 10 year depreciation period

#### Multiple Other Options Under Rev

On May 19, the NY Public Utility Commission approved Track 2, which is focused on a rate structure to align more closely with REV program goals. Implementation of market-based approaches and proper incentives are key debates as this is rolled out. The plan implements four possible methods for utilities to achieve earnings.

- Traditional Cost-of-Service
- Earnings Tied to achievement of alternatives to reduce capex and benefit consumers
- **Earnings from market-facing platform activities:** This seems to be a particular contentious aspect of the plan since in most cases utilities will be unable to control the outcome directly. The order specifically states that outcome based goals (including mechanisms the utilities do not control) are the most effective methods.

- Transitional Earnings Adjustment Mechanisms: **This is what matters in the near term**, with some rollouts already started at ED.

As part of the REV, ED is already rolling out portions of the program – most notably in the Brooklyn-Queens Demand Management Program (BQDM), which is billed as the rationale behind deferral of construction for \$1B electrical substation in favour of solar, batteries, and energy efficiency. Staff has cautioned that this is focused on a *single project*, whereas the program generally is focused on developer markets. Actual BQDM program goals as laid out include ~41MW of customer sited resources:

**Figure 33: BQDM Goals**

	2016	2017	2018	Total
Customer Side Solutions	9	23	9	41
Utility Side Solutions	3	8	0	11
<b>Total</b>	<b>12</b>	<b>31</b>	<b>9</b>	<b>52</b>

Source: Company Filings, UBSe

### Fleshing out the EAM's

EAM's will be implemented primarily as a transition mechanism towards more mature markets without this level of incentives, and the plan is to implement at the utility either in the next rate filing or as provided in an existing multi year plan. System efficiency, energy efficiency, interconnection (for solar), and customer engagement are key tenants of the EAMs. Additionally, initial bounds on the first round of EAM's specifies a ~100bp max earnings bucket, though this could change over time.

### Key Dates to watch:

July 29: ED-specific deadline to file proposal for advanced metering infrastructure and specifically data related to it.

July 31: For ConEdison specifically, the company must add offset tariff and reliability provisions to current rate case – to be implemented Jan 1, 2017 in the case of the reliability credit.

August 1, 2016: Interconnection - proposal for survey process and EAM

October 1, 2016: Clean Energy Advisory Council will propose metrics and targets for **energy efficiency**

November 30: supplemental Distributed System Implementation Plan (DSIP) is due

December 1, 2016: All utilities must file an EAM: Deadline to file peak reduction and load factor targets

### Ongoing Filings, no specific date:

Customer engagement

Clean Energy Standard: if Commission adopts Clean Energy Standard, Staff must initiate stakeholder process within 90 days.


*For additional context, please refer links to relevant recent reports below:*

[5/16/16 Anticipating Northeast Gas Demand](#)  
[2/25/16 When Cash Flow and Earnings Don't Mix: Solar](#)  
[2/19/16 More Equity Please?](#)  
[1/26/16: What Lies Behind the Defensive Veneer](#)  
[10/9/15 Fitting Renewables Into the Mix](#)  
[8/13/15 A Green Lining in the Clouds](#)  
[5/05/15 Consolidating Edison](#)  
[2/24/15 ROE Risk Remains in Focus](#)

## Valuation: Increase price target to \$72 from \$66

Our valuation remains based on 2018 P/E methodology. We continue to apply a 5% discount to shares given the lack of load growth, below-average earned ROEs, and lingering uncertainty around the March 2012 Harlem blast. The increase in our price target is driven entirely by the 1.5x-turn improvement in the regulated peer multiple.

**Figure 34: Consolidated Edison Valuation**

Consolidated Edison Valuation 			
Regulated 2018 P/E Multiple	18.0x		
	Downside	Base Case	Upside
2018 EPS	\$4.10	\$4.20	\$4.30
x P/E Multiple	18.0x	18.0x	18.0x
(Discount)/Premium	-10%	-5%	10%
<b>Valuation</b>	<b>\$66.00</b>	<b>\$72.00</b>	<b>\$85.00</b>
<b>Upside/(Downside)</b>	<b>-17%</b>	<b>-9%</b>	<b>7%</b>
Assumed CECONY ROE	8.7%	8.9%	9.1%

Source: Company filings, FactSet, UBS estimates

# DTE Energy Co.

Shares have been steadily outperforming since the March lows as confidence on the unregulated business outlook has grown, despite the failure of Michigan energy legislation to be approved. We continue to see DTE as attractively positioned.

We forecast 2Q16 adjusted EPS of **\$0.85** vs \$0.76 in 2Q15 and \$0.88 Consensus.

- **Key Drivers:** The revenue decoupler amortization is the most significant headwind, similar to 1Q16, but the electric rate implementation should more than compensate for the unfavorable comparison. Continued growth at the unregulated business should also contribute to YoY improvement.
- **Wildcard Factors:** (1) Magnitude of O&M saving efforts to offset the mild winter weather. The decision to implement the 'lean' vs 'reinvestment' plan typically occurs later in the year but the 1Q16 weather headwind was particularly large; (2) performance of the volatile trading business which was +\$3Mn in 2Q15; (3) timing of any tax items

**CMS discussed levers it can pull to offset the challenging 1Q16 weather, above the typical rate reduction efforts the company strives to achieve.**

**Figure 35: DTE 2Q16E Earnings Walk**

DTE Energy 2Q16 Earnings Walk	EPS
2Q15A Adjusted EPS	\$0.76
<b>Regulated Utilities</b>	<b>\$0.08</b>
Weather vs Normal in 2Q15 -\$4Mn Electric & Gas	\$0.02
Weather vs Normal in 2Q16	\$0.02
2015 DTE Electric Case: +\$243Mn in Dec. 2015	\$0.18
2016 DTE Electric Case: +245Mn in Aug. 2016	\$0.00
2016 DTE Gas Case: +103Mn in Nov. 2016	\$0.00
Revenue Decoupler Amortization	(\$0.11)
Electric Sales Growth: 0.0%-0.5%	\$0.00
Gas Sales Growth	\$0.00
O&M: Reinvestment vs. Lean Initiatives	\$0.00
Property Taxes, Depreciation, & Other	(\$0.03)
<b>Unregulated Businesses</b>	<b>\$0.01</b>
P&I: Volume at REF sites; weighted in 2H	\$0.01
Midstream: Continued investment in gathering system	\$0.01
Trading: +\$3Mn in 2Q15; assume is flat	(\$0.02)
<b>Corporate &amp; Other</b>	<b>(\$0.00)</b>
Taxes: Timing	\$0.00
Dilution	(\$0.00)
<b>2Q16E Adjusted EPS</b>	<b>\$0.85</b>
<b>2Q16 Consensus</b>	<b>\$0.88</b>
<b>2016 UBSe EPS</b>	<b>\$4.93</b>
<b>2016 Consensus</b>	<b>\$4.95</b>
<b>2016 Guidance</b>	<b>\$4.80-\$5.05</b>

Source: Company Filings, FactSet, and UBS Estimates

*For additional context, please refer links to relevant recent reports below:*

[4/27/16 A Confident Stride](#)

[2/12/16 Running Leaner on Less Equity](#)

[10/26/15 Tooling Up for More in 2016 after Strong 3Q](#)

[9/30/15 Upbeat Analyst Day Saves More for Next Year \(2016\)](#)

[7/27/15 Votes of Confidence](#)



## What are the key updates for DTE?

- **Resetting expectations for MI legislation:** The Michigan state legislature entered their summer recess in early June without holding a vote on the energy legislation. When the bill was up for debate media reports indicated that there were multiple aspects of the potential legislation being debated such as the ultimate terms for consumer choice/'switching' and renewables mandate/goal. Importantly, Senate Energy and Technology Committee Chair Senator Mike Nofs (R) will remain in the legislation and continue to advocate for legislation. The challenge for next year will be that there is expected to be an education period for any new Representatives which could make the process more challenging.
- **Staff positions in electric and gas come in:** DTE's electric and gas rate cases continue to progress with the PSC Staff having made recommendations recently. In the electric case the PSC Staff recommended a +\$189Mn rate increase (10% ROE) versus DTE's request of +\$344Mn (10.5% ROE). In the previous rate case the PSC Staff and ALJ also recommended a 10% ROE and the final authorized ROE was 10.3%. The electric rate case has had a higher profile than typical rate cases due to the MI Attorney General Bill Schuette's intervenor filing regarding bill inflation. In the gas case the PSC Staff recommended a +\$123Mn (10% ROE) revenue increase compared with +\$182Mn (10.75% ROE). Management has filed to implement a +\$144Mn increase which is +\$103Mn net of the Infrastructure Recovery Mechanism.

ALJ Proposed Decisions are expected in October (Gas) and November (Electric) with self-implementation in November (Gas) and August (Electric).

Docket C-U-18014 (Electric) and Gas (C-U-17999)

- **New Independent added to the PSC:** On July 6<sup>th</sup> Michigan Governor Rick Snyder appointed Rachael Eubanks (I) to the Michigan Public Service Commission to serve the remainder of John Quackenbush's term through July 2017. The appointment is still subject to Senate confirmation.
- **NEXUS takes another step forward with draft EIS; overcoming the doubts:** On July 8<sup>th</sup> the FERC staff released the draft Environmental Impact Statement (EIS) for the DTE's jointly-owned NEXUS pipeline which concludes that if mitigation measures are implanted there would not be significant permanent environmental impacts. This important milestone is key for the 1.5BCf/day project to achieve its 4Q17 in-service date. Although investors will not have true visibility into the 1.75BCF/day of incremental interconnection agreements, management has confidence enough to order compressors for the additional capacity. As a reminder of the primary 1.5BCF/day capacity, 3/4th is contracted (half shippers/half LDCs).

When we last met with management, DTE stated that it was in the process of 'firming-up' yet another LDC gas deal with an Ohio utility (already short-listed with an MOU), adding to its existing firm offtakes from a range of MI and Ontario based utilities. Further, management emphasized progress is clear on the offtake from the Oregon CCGT, among the largest incremental gas users in the Ohio footprint for the pipe. Lastly, despite seemingly making statements otherwise, DTE emphasized NRG continues to evaluate a gas lateral to reach its Avon Lake coal plant as part of an option to move the plant to partial service. We emphasize the conversion would have limited total usage but was

The question is how much turnover will occur in the House – if there are significantly more new Representatives this lack of continuity could make the process more challenging in 2017.

NEXUS progressing forward with higher volumes

a recent seeming loss when the project appears to have recommitted itself to burning low-sulfur PRB as part of its MATS compliance strategy.

- **Bolt-on acquisitions remain under consideration but no progress yet.** DTE is actively looking at possible acquisitions of existing projects, although no specific projects have yet met management's strict investment criteria yet, despite the distress of many of the midstream companies. We see capital market weakness for MLPs as possibly limiting competition for assets while also possibly removing any remaining incentive for management to consider an MLP structure for itself (or to sell its assets to one).
- **Addressing the expected 2020 falloff in tax credits for P&Is.** Reduced Emission Fuel (REF) business, which is currently operating in nine sites. Additionally, DTE is now operating a third-party REF facility with an operating agreement through 2020. Management continues to "work towards further optimization" of this segment, with the goal of generating significant cash flows to fund other non-utility growth projects. Emphasis for this segment remains on the CHP (Combined Heat and Power) opportunities in a cheap gas price environment, positioned to provide an array of products on a 'behind the meter' basis.

On the 4Q call, guidance for 2019 was reduced \$25M to \$120M (mostly lower Industrial Energy Services income) and the REF business is expected to experience a \$30M (\$0.15/sh) drop in tax credits in 2020 with the remainder rolling-off in 2022.

## UBS estimates unchanged

Figure 36: UBS Earnings Estimates, 2014A-2020E

DTE Energy EPS Estimates	2014A	2015A	2016E	2017E	2018E	2019E	2020E
DTE Electric	\$2.99	\$3.12	\$3.26	\$3.52	\$3.67	\$3.81	\$3.93
Incremental Generation Capex Opportunities			\$0.00	\$0.10	\$0.19	\$0.36	\$0.42
DTE Gas	\$0.79	\$0.77	\$0.77	\$0.82	\$0.88	\$0.95	\$0.98
Midstream	\$0.46	\$0.56	\$0.61	\$0.68	\$0.75	\$0.83	\$0.92
Power & Industrial Projects	\$0.51	\$0.56	\$0.53	\$0.59	\$0.65	\$0.71	\$0.56
Trading	\$15.85	\$0.11	\$0.00	\$0.00	\$0.00	(\$0.00)	(\$0.00)
Parent & Other	(\$0.74)	\$0.24	(\$0.24)	(\$0.35)	(\$0.32)	(\$0.28)	(\$0.25)
<b>DTE Energy</b>	<b>\$4.60</b>	<b>\$4.82</b>	<b>\$4.93</b>	<b>\$5.35</b>	<b>\$5.83</b>	<b>\$6.38</b>	<b>\$6.57</b>
Prior UBSe		\$4.82	\$4.93	\$5.35	\$5.83	\$6.38	\$6.57
<b>DTE Energy without incremental opt'y</b>	<b>\$4.60</b>	<b>\$4.82</b>	<b>\$4.93</b>	<b>\$5.25</b>	<b>\$5.63</b>	<b>\$6.02</b>	<b>\$6.15</b>
Street Consensus	\$4.60	\$4.82	\$4.95	\$5.26	\$5.63	\$5.98	\$6.20
Midpoint of mgmt guidance 5%-6% from 2016 \$4.93 to 2020			\$4.93	\$5.20	\$5.48	\$5.78	\$6.10
Management guidance			\$4.80-\$5.05				

Source: Company Filings, FactSet, and UBS Estimates

## Valuation: Increase Price Target \$4 to \$108

Our valuation is now based on a utilities 2018E sum-of-the-parts with a half turn premium P/E multiple for the electric utilities and a 1x premium for the gas utility. We assign EV/EBITDA for the unregulated businesses. Similar to CMS, we have lowered the probability of incremental Retail Open Access (ROA) and renewables related capex to 50% from 75%; this change offsets approximately half of the uplift provided by a 1.5x-turn improvement in the regulated utility peer multiple since our last mark-to-market.

### What's changed in our PT?

**-\$5/sh: Lowered probability of near-term incremental spending**  
**+9/sh: 1.5x-turn increase in regulated utility peer multiple**

Figure 37: DTE Sum-of-the-Parts Valuation on 2018E

Business Segment	Prob	Valuation Metric	2018E	Low Case Valuation Multiple	(\$s MM) Value	Base Case Valuation Multiple	(\$s MM) Value	High Case Valuation Multiple	(\$s MM) Value
<b>Regulated</b>									
DTE Electric		P/E	\$3.66	17.5x	\$11,648	Regulated Peer Multiple 18.0x			
Incremental ROA, Renewables Capex	50%	P/E	\$0.19	17.5x	0	18.5x	\$2,314	19.5x	\$12,979
Incremental 2020-2024 New Generation	50%	P/E	\$0.24	17.5x	0	18.5x	626	19.5x	1,320
DTE Gas		P/E	\$0.88	18.0x	2,873	19.0x	399	19.5x	1,680
<b>Regulated, Equity Value</b>					<b>\$14,521</b>		<b>\$16,371</b>		<b>\$19,171</b>
<b>Unregulated Business</b>									
Power Projects		EV/EBITDA	\$252	8.0x	\$2,016	10.0x	\$2,520	11.0x	\$2,772
Midstream		EV/EBITDA	\$238	10.0x	2,384	12.0x	2,860	13.0x	3,099
Trading		EV/EBITDA	\$1	3.0x	3	5.0x	5	6.0x	6
Parent & Other Overhead		EV/EBITDA	\$88	8.0x	704	10.0x	880	11.0x	968
Less: Parent Debt, Net (2018E)					(2,967)		(2,967)		(2,967)
<b>Unregulated, Equity Value</b>					<b>\$2,140</b>		<b>\$3,299</b>		<b>\$3,878</b>
<b>DTE Equity Value</b>					<b>\$16,660</b>		<b>\$19,669</b>		<b>\$23,049</b>
Fully Diluted Outstanding Shares (2018E)					182		182		182
<i>DTE Equity Value per Share without incremental opportunities</i>					<i>\$92.00</i>		<i>\$102.36</i>		<i>\$110.50</i>
<b>DTE Equity Value per Share including incremental opportunities at probability</b>					<b>\$92.00</b>		<b>\$108.00</b>		<b>\$127.00</b>

Source: Company Filings, FactSet and UBS Estimates

# Duke Energy

Investors continue to debate whether DUK deserves a premium to peers – we continue to believe yes as it moves to a pure-play regulated utility and meets the demand for ‘cheaper’ defensive utility plays. Pricing on the Latin American divestiture is an important datapoint but we perceive the most investor caution around coal ash spending and the subsequent regulatory treatment. We think clarity here could be a significant driver for shares. We believe favorable regulatory treatment for coal ash could push the EPS growth profile towards the higher end of its 4-6% seemingly YoY later in the decade.

We forecast 2Q16 adjusted EPS of **\$1.05** vs \$0.95 in 2Q15 and \$1.00 Consensus.

- **Key Drivers:** 1Q16 O&M was -\$0.05 drag relative to plan due to storm expenses which drove the regulated utilities down -\$0.01 YoY excluding weather. We expect a normalization of O&M and +\$0.07 improvement at the utilities excluding weather, consistent with the original FY16 guidance. The net weather comparison is a headwind but 2Q16 heat could be a partial offset.
- **Wildcard Factors:** (1) [Improvements in the hydrology conditions](#) should more than offset unfavorable F/X and crude comparisons; (2); Timing of taxes at international where management guided to “a modest” reversal of the +\$0.11 recorded in 1Q16 in the balance of 2016E; (3) Better wind production YoY [renewables segment was actually down YoY in 2Q15 despite more capacity].

**A ‘normal’ level of O&M at the regulated utility, net improvement in the Brazilian hydro situation, and more renewables with better resources should help deliver +\$0.10 EPS improvement YoY and a solid beat versus Consensus.**

**Figure 38: DUK 2Q16E Earnings Walk**

Duke Energy 2Q16 Earnings Walk	
<b>2Q15A Adjusted EPS</b>	<b>\$0.95</b>
<b>Regulated Utilities</b>	
Weather vs Normal in 2Q15 +\$65Mn Pre-Tax Impact	<b>(\$0.06)</b>
Weather vs Normal in 2Q16	<b>\$0.02</b>
Capital Investments: +\$0.08 riders YoY for FY16	<b>\$0.02</b>
O&M: Commentary to reduce in 2016 vs 2015	<b>\$0.02</b>
Load: Growth (+~0.60bp with 100 bps ≈ \$0.10 EPS FY)	<b>\$0.01</b>
Wholesale Growth: \$0.01-\$0.03 incremental in 2016 vs \$0.10 in 2015	<b>\$0.00</b>
Purchased NCEMPA July 31, 2015 for \$1.25Bn (full quarter YoY)	<b>\$0.03</b>
Accretion from Piedmont Transaction: Expected to close in 4Q16	<b>\$0.00</b>
Depreciation, property taxes, interest, and other	<b>(\$0.02)</b>
<b>Commercial: Renewables &amp; Midwest Generation</b>	
Absence of Midwest Generation: Transaction closed 4/2/15	<b>\$0.00</b>
Reversal of 2Q15 below-average renewable generation	<b>\$0.02</b>
Renewables - expect \$1B-\$2B incremental investment 2015-2017	<b>\$0.02</b>
<b>International and Other</b>	
Brazil: Impact of F/X (~\$0.015 annualized for 10% change)	<b>(\$0.01)</b>
NMC: Impact of Brent Crude (~\$0.015 annualized for \$10/bbl change)	<b>(\$0.00)</b>
Hydro: Improving hydro/reservoir conditions (Long in '16 vs Short '15)	<b>\$0.04</b>
Timing of taxes: Reversal of portion of 1Q16 benefit	<b>(\$0.01)</b>
Impact of Accelerated Stock Repurchase Program	<b>\$0.00</b>
<b>2Q16E Adjusted EPS</b>	<b>\$1.05</b>
<b>2Q16 Consensus</b>	<b>\$1.00</b>
<b>2016 UBS<sub>E</sub> EPS</b>	<b>\$4.65</b>
<b>2016 Consensus</b>	<b>\$4.59</b>
<b>2016 Guidance</b>	<b>\$4.50-\$4.70</b>

Source: Company Filings, FactSet, and UBS Estimates

*For additional context, please refer links to relevant recent reports below:*

[5/5/16 In Search of a Latin Suitor](#)

[2/22/16 Holding The Line on Growth](#)

[12/22/15 Brighter Setup for 2016; Upgrade to Buy](#)

[11/8/15 A Samba Reset](#)

[10/26/15 The Duke of North Carolina](#)

[8/10/15 Targeting a Samba Surprise](#)

[5/5/15 Even More Cash Coming](#)

## **What are the key updates for DUK?**

### **Regulated:**

- **Finding a path to low risk coal ash classification:** On June 30<sup>th</sup> the North Carolina legislation passed House Bill (HB) 630 by a vote of 82-32 which would result in a lower risk classification for some of Duke Energy's (DUK) coal ash pits. Specifically more basins could be classified as "low" risk rather than "intermediate" risk and be allowed to have 'cap-in-place' treatment rather than excavation. We view this development as a positive for DUK shares as investors had been growing increasingly concerned by the potential for significant rate inflation from more costly coal ash treatment (and in turn limited equity return on spend). The Governor has subsequently signed the bill into law.

The current asset retirement obligation is a probability-based assessment of what management estimates the clean-up/retirement costs will be on a discounted basis.

- **SC rate case includes material rate inflation:** Duke Progress filed for a +\$79Mn revenue increase request with the Public Service Commission of South Carolina (PSCSC) with a **10.75% ROE** and 53% equity ratio. The majority of the request relates to new capital (67%) while O&M represents 25% of the step-up in revenue. The latest ROE datapoints in South Carolina are SCANA's (SCE&G) settlement in June 2015 (**10.5%**) and Duke's settlement in September 2013 (**10.2%**). Given the declines in interest rates and Duke's settlements in South Carolina and Indiana (see below), we expect pressure on the authorized ROE in this case.

*Timing and size of future rate cases across the Carolinas remains among the most substantial uncertainties in confidence towards the 4-6% EPS growth rate. We believe shares could trade up even if the lower end of the 4-6% growth rate is reiterated given low expectations.*

- **\$1.4Bn Indiana grid modernization settlement approved without change:** The Indiana Utility Regulatory Commission (IURC) approved the grid modernization on June 29<sup>th</sup> without any further changes. As part of the agreement Duke reduced the cost of the plan to \$1.4Bn from \$1.827Bn, ~\$200Mn of which relates to deferring smart meter investments that Duke can re-propose at a later date. Additionally the ROE on trackers will be set at 10% rather than the 10.5% requested (no change to ratebase at 10.5%).

NC legislation could reduce the capex required for coal ash remediation, thus limiting bill inflation (and in turn limited equity return on spending).

Only approved capex for high-risk basins is included in Duke's plan today

DUK is requesting a +\$17/monthly increase (14.5%)

- **Drawing closer to the finish line with Piedmont:** Duke filed settlements with intervenors in June with the North Carolina Utilities Commission (NCUC) in the pending Piedmont acquisition. Parties include the NCUC Staff, consumer groups, and environmental parties. Hearings on the proposed merger are set for July 18<sup>th</sup> and management still is confident that it can close the transaction by year-end. Duke completed the equity component of the financing on March 7<sup>th</sup> when it closed the forward sale of 10.64Mn shares at \$72Mn, raising gross proceeds of \$766Mn; this is likely at the top-end of the \$500-\$750Mn after fees. Duke plans to finance the balance of the transaction with holding company debt.

**DUK and PNY have reached settlements with various parties in North Carolina – the last remaining state left to opine on the proposed transaction.**


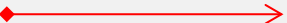
### Commercial/Unregulated:

- **Getting closer to an international exit:** The last update from management was that they opened a dataroom in late March and was hopeful that it could provide more updates soon. We continue to perceive a sense of urgency in the process (1) with Petrobras stating that it intends to divest its own local generation assets [i.e. avoid competition] and (2) a desire to complete the deal by year-end. The improvement in foreign exchange rates should help improve the prospects for an attractive price but we still expect meaningful dilution (~\$0.20/sh).
- **Beyond Piedmont, management discusses other potential opportunities:** As management gets closer to resolution for the Piedmont acquisition and the discussed international sale, we see management focusing on growing its natural gas platform. Management has stated that it is looking for assets with (1) minimal/no commodity exposure; (2) long remaining contract life with high quality counterparty; (3) attractive valuation from a distressed owner in need of liquidity. This is consistent with comments from companies including NextEra Energy and Southern Company. Duke has continually stated that acquiring Piedmont was the first step in forming the 'core' of its gas business and we expect management to be active going forward.

## EPS Estimates

Below we present our latest EPS estimates which excludes Piedmont and includes international. EPS accretion from Piedmont is expected to be \$0.12-\$0.15 through 2020E which could contribute 50bp to the EPS CAGR. Along with in-service of the Atlantic Coast Pipeline (ACP), we see the longer-term picture for DUK as brighter in comparison to the near-term potential for dilution from any Latin American divestiture.

**Figure 39: Duke Adjusted EPS Estimates**

Duke Energy EPS	2013A	2014A	2015A	2016E	2017E	2018E	2019E
UBS Estimates	\$4.35	\$4.55	\$4.54	\$4.65	\$4.78	\$5.01	\$5.22
<i>UBSe International</i>	<i>\$0.60</i>	<i>\$0.61</i>	<i>\$0.32</i>	<i>\$0.31</i>	<i>\$0.30</i>	<i>\$0.28</i>	<i>\$0.28</i>
Prior UBS Estimates	\$4.35	\$4.55	\$4.54	\$4.65	\$4.78	\$5.01	\$5.22
Consensus			\$4.54	\$4.59	\$4.75	\$4.99	\$5.13
Guidance		\$4.55-\$4.65		\$4.50-\$4.70		16-'20 Core	
UBSE 2016-2019 Core CAGR (ex-international and ex-PNY)				\$4.34			4.4%
UBSE 2016-2019 Core CAGR (w/o international and with PNY)				\$4.34			5.2%

Source: Company Filings, FactSet, and UBS Estimates

## Valuation: Increase Price Target to \$93 from \$86

Our valuation is based on a 2018E P/E methodology with a 5% premium on EPS adjusted for our estimate of the international (Lat Am) divestiture and accretion from the pending Piedmont transaction. The \$7/sh increase in our price target is driven by the rally in US utilities with the peer multiple expanding to ~18.0x from ~16.7x in early May when we last reviewed Duke's valuation.

The 1.5x increase in utility valuations since our last MtM drives our price target up 9%.

Figure 40: Updated Duke Energy Valuation

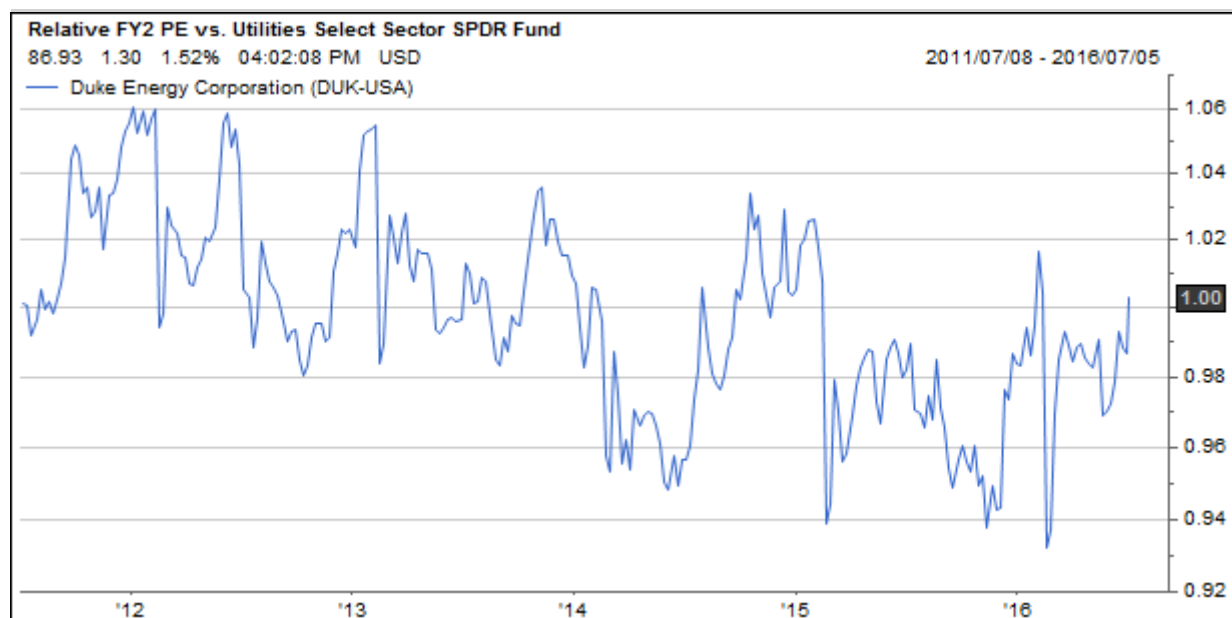
Duke Energy Valuation: P/E Derived on 2018 EPS					
Downside Case		Base Case		Upside Case	
2018 EPS	\$5.01	2018 EPS	\$5.01	2018 EPS	\$5.01
Minus: Lat Am Dilution	(\$0.27)	Minus: Lat Am Dilution	(\$0.24)	Minus: Lat Am Dilution	(\$0.19)
Plus: Piedmont Accretion	\$0.09	Plus: Piedmont Accretion	\$0.12	Plus: Piedmont Accretion	\$0.15
Total	\$4.84	Total	\$4.89	Total	\$4.98
P/E Multiple	17.0x	P/E Multiple	18.0x	P/E Multiple	19.0x
Premium/(Discount)	-5%	Premium/(Discount)	5%	Premium/(Discount)	10.0%
<b>Value</b>	<b>\$78.00</b>	<b>Value</b>	<b>\$93.00</b>	<b>Value</b>	<b>\$104.00</b>

Source: Company Filings, FactSet, and UBS Estimates

**Can it be a premium story? Yes.** We think Duke could return to a premium following several years of a re-rating lower given the volatility associated with the LatAm business (between F/X and hydrology). We emphasize with a 1-year forward view that Street will increasingly shift out to 2019E/2020E EPS, which bodes relatively *better* for Duke given the in-service timing of the Atlantic Coast Pipeline among other assets as well as lumpy nature of ratecase timing in the Carolinas.

We expect EPS growth will be trending towards the higher end of its 4-6% seemingly YoY later in the decade.

Figure 41: DUK Relative FY2 P/E Valuation



Source: FactSet

# Edison International

Potential for SONGs case reopening remains one of the key questions in the near term but we see risk of a prolonged outcome as relatively limited. No substantial surprises are expected in the quarter and we see a relatively in line earnings number.

**Key Drivers:** 31 cent tax benefit last year makes YoY comp challenging but we believe productivity/financing benefits and ratebase growth provide some mitigation in the quarter.

**Wildcard Factors:** Earnings Ex-Songs remains somewhat-untested territory, while negative parent items proved more influential than our expectations last quarter. We think tax shifts due to the Tax Accounting Memorandum Account (TAMA) could shift the quarter further.

**Figure 42: EIX 2016E UBS Quarterly Estimates**

	Ex-SONGS EPS Distribution				Total
	Q1	Q2	Q3	Q4	
2009 EPS distribution	24%	24%	34%	18%	
2015 EPS distribution	22%	28%	28%	21%	
Average Ex-SONGS EPS Distribution	23%	26%	31%	20%	
UBSe 2016 Estimate Distribution					
Ratebase	0.88	1.00	1.18	0.76	3.82
Reduce ratebase for bonus depn		(0.01)	(0.01)	(0.02)	(0.05)
Add Pole Loading ratebase		0.02	0.03	0.04	0.09
O&M reduction		0.04	0.05	0.07	0.17
Edison Energy Group		-	-	-	-
Energy efficiency		-	-	0.05	0.05
Parent & other	(0.05)	(0.05)	(0.05)	(0.04)	(0.18)
UBSe 2016 (basic)	0.83	1.01	1.20	0.86	3.90
UBSe 2016 (diluted)	0.82	1.00	1.19	0.85	3.88
Consensus		1.01	1.19	0.87	3.89
Core Basic EPS Guidance					3.81-4.01

Source: UBS estimates, company filings, FactSet

The next table illustrates our estimates for year-over-year quarterly EPS impacts.

**Figure 43: EIX 2016E UBS Quarterly Estimates**

2016 vs 2015 Delta (diluted)	Q1	Q2	Q3	Q4	Total
2015A (diluted)	0.89	1.15	1.15	0.87	4.08
Ratebase growth (w/Pole Loading)	0.04	0.07	0.09	0.05	0.28
Productivity and financing benefits in 2016		0.04	0.05	0.03	0.17
O&M & Severance	(0.04)	0.02	0.03	(0.09)	(0.08)
Change in uncertain tax positions		(0.31)			(0.31)
Higher utility taxes under TAMA	(0.02)	-	(0.11)	(0.05)	(0.18)
Generator settlements in 2015		0.03			0.03
Property tax refund in 2015		0.01			0.01
Parent & Other	(0.05)	(0.02)	(0.02)	0.04	(0.05)
2016E UBSe, diluted)	0.82	1.00	1.19	0.86	3.88

Source: UBS estimates, company filings, FactSet



## What are the Key Issues for EIX?

### SONGS: Will the filing reopen?

#### TURN and ORA Filed Response Briefs

TURN and ORA filed intervenor testimony as part of the ongoing inquiry as to whether to formally [reopen the record](#) into the 2014 San Onofre Nuclear Generating Station cost recovery settlement. The most punitive position came from TURN, which advocates 50%+ of \$2Bn ratebase should be removed in the event the case is not reopened given their position that the premature retirement was attributable to imprudence at SCE. Specifically, TURN suggests the burden falls on SCE to demonstrate the defective steam generators (responsible for the shutdown) were *not* the result of imprudence on the company's part. ORA focused more narrowly on the difference between its litigated position and settlement which would imply a ~\$383M ratepayer refund (likely tax deductible). Both intervenors suggested the \$25M allocated to Greenhouse Gas research at UC should be refunded and TURN further advocated for ~\$87M refund to account for the time when SONGS could run without installing the defective equipment (effectively implementing the PD). **Reading between the lines: neither party overly emphasizes full re-opening**

TURN's filing includes extensive sections on *alternatives* to re-opening the settlement, further ORA simply asks for its full litigated position. We see expedited resolution as a wider positive. The [alternative](#) appears to be full litigation of phase 3, and finalization of Phases 1 & 2 per the already established records. Note: No settlements would be possible if SONGS is fully re-opened

**Was the settlement reached following commission standards?** The intervenors are focused on the argument that ex parte discussions disadvantaged their bargaining position which shifted the dynamics of the settlement negotiations. The key point of the arguments hinges on the retraction of support from the settlement by both TURN and ORA after ex parte revelations and that it disadvantaged them, but the commission has already noted the more favourable outcome, as we discussed in our [previous note](#) vs. prior positions.

### CPUC Reforms: More to Come

Governor Brown and Senators Jerry Hill (D) and Mark Leno (D) announced a CPUC reform package on 6/27/16, which will be introduced to the Legislature in the following months. The plan appears largely supportive of the CPUC's governing power for utilities, allowing for a closer focus

Some of the key points include:

- Governance: Move a number of transportation-related responsibilities to the California State Transportation Agency for the purpose of helping the CPUC's focus elsewhere.
- Governance: several initiatives to help hiring and employee retention and leverage outside work
- Governance: Allow Alternative Proposed Decisions at any point before the vote (as opposed to simultaneously with the main PD)

- Accountability: barring former utility executives from serving at CPUC for 2 years and allowing any California agency to participate without official party status
- Accountability: Authorization for the California Attorney General to bring legal charges against CPUC employee that violates ex parte communication requirements.
- Transparency: A number of measures related to ex parte communications. Failure to log communications online promptly will result in a penalty (enforced by CPUC or AG), but meetings with members of the public are unrestricted
- Transparency: CPUC lobbyists will be required to register as such
- Transparency: allow more ratesetting deliberations, even if no hearing has been held
- Oversight/Safety: Creation of an “Ethics Ombudsperson” as a point of contact
- Oversight/Safety: Expedite SONGS spent fuel relocation

*For additional context, please refer links to relevant recent reports below:*

[8/7/16 Same SONGS, Different Tune](#)

[3/4/16 The ‘How Can Utilities Be So Great Again?’ Conference Deluge \(p. 27\)](#)

[2/24/16 Taking the Pole Position](#)

[11/30/15 Accounting for Tax Benefits](#)

[11/5/15 At the 1-Yard Line: A Mostly Final Ratecase Order](#)

[10/28/15 Looking Through the Transmission Delays](#)

[9/21/15 Rebasing the Power Trade](#)

[8/10/15 Less Settled, But Still Intact](#)

[8/3/15 SONGS Enters New Stanza with \\$7.6B Arbitration](#)

# Empire District Electric Company

*EDE and Algonquin have made important steps towards completing their pending merger with approval in Oklahoma and a settlement in Arkansas. The timeline in Kansas and Missouri is a bit longer-dated but we expect the companies to continue working with stakeholders to try and proactively address any issues.*

**EDE does not intend to host an earnings calls at this time.**

*For additional context, please refer links to relevant recent reports below:*

[2/23/16 Searching For Clues in Regulated M&A](#)

[2/10/16 Acquiring an Empire](#)

[12/13/15 Evaluating Alternatives](#)

[11/3/16 Ratecase Double Header](#)

[9/28/15 Approaching Ratecase Season](#)

[8/11/15 Show Me The Ratecase](#)

[5/11/15 Stuck in a Growth Quagmire](#)

[2/10/15 Structurally Lagging?](#)

## **What are the key updates for EDE?**

- **What is the status of the pending Algonquin transaction?** We spoke with management regarding the current status of their merger with Algonquin Power and Utilities (AQN). As it stands, the Oklahoma Corporation Commission (OCC) and the FERC has approved the merger, while a decision is still pending in Kansas, Missouri and Arkansas but a settlement was filed in Arkansas in late June. We do not see any significant obstacles left for Empire to overcome as management commented Algonquin has been proactive in addressing regulators' concerns the larger issues off the table in their discussions with regulators.

**EDE has guided to a 1Q16 close while Algonquin has been more precise in stating it expects a January 2017 close.**

We summarize the status below:

- **FERC:** Approval received
- **EDE Shareholder Vote:** Approval received
- **Oklahoma:** Approval received
- **Other Federal Approvals:** Pending but management does not anticipate any roadblocks here
- **Kansas:** Late November/Early December hearing
  - 300-Day statutory calendar implies resolution approximately in mid-January
- **Arkansas:** Settlement filed in June with related conference
  - Stipulation precludes the combined company from filing a rate case until 12-months post the merger closing but there is an opportunity to request recovery for Riverton 12 via a rider
- **Missouri:** Discovery process underway

With respect to financing the \$2.4B deal, Algonquin has secured C\$1.15B convertible debentures, is assuming \$900M in debt and only has to complete the \$600M private placement.

- **Reaching settlement in MO rate case with 9.5-9.9% ROE range:** On June 20<sup>th</sup> EDE filed a unanimous settlement with the Missouri Public Service Commission (PSC) with a +\$20Mn revenue increase in its pending rate case which is primarily related to the Riverton CC project. The settlement includes an ROE range of 9.5-9.9% compared with EDE's 9.9% ROE request and the PSC Staff's recommendation for a 9.75% ROE. A final Missouri PSC decision is expected by September when management expects to have new rates effective.

The ROE range has read-throughs for AEE and GXP which each have rate case requests pending with the MO PSC with 9.9% requests.

Figure 44: 2016 EDE Ratecase Filing

Rate Case Revenue Requirement Drivers: ER-2016-0023		
Requested Items	Revenue Req.	% of Total
Riverton Unit 12 CC Conversion	27.4	82.0%
Asbury True-Up	2.1	6.3%
Effect of Depreciation Study	-1.0	-3.0%
ROE / Capital Structure	-3.2	-9.6%
Other Normal Plant Additions	6.0	18.0%
Administrative Costs	2.1	6.3%
<b>Total Increase Request</b>	<b>33.4</b>	
<b>Settlement Increase</b>	<b>20.4</b>	
<b>9.9% Requested ROE; 9.5-9.9% Settlement ROE</b>		

Source: Company filings

Figure 45: 2014 EDE Ratecase Filing

Rate Case Revenue Requirement Drivers: ER-2014-0351		
Requested Items	Revenue Req.	% of Total
Asbury Environmental	19.8	81.5%
Property Taxes	2.9	11.9%
RTO Transmission Charges	1.0	4.1%
Maintenance Contract	3.9	16.0%
Other (SPP and Int. Exp Savings)	-3.3	-13.6%
<b>Total Increase Request</b>	<b>24.3</b>	
<b>Approved Settlement Increase</b>	<b>17.1</b>	
<b>10.15% Requested ROE</b>		

Source: Company filings

## What is the true potential of ratebase growth?

- **Algonquin indicates that EDE ratebase growth could accelerate above 4% but timing is likely longer-dated:** In Algonquin's March 2015 presentation, the company disclosed their outlook for ratebase growth. Among the four main opportunity areas are:
  - Active pursuit of coal replacement/displacement with new ratebase renewables
  - Replacement of energy sourced through PPA with ratebased generation
  - Further conversion of coal assets to natural gas co-generation
  - Joint IT infrastructure investments

Aside from the fourth item relating to IT spending we view the opportunity areas as longer-dated and beyond the scope of the current investment horizon. For example the first PPA to expire is in 2025.

We agree with AQN that there are ratebase growth opportunities related to environmental policies but do not expect any material changes to the capex forecast before 2020

## Valuation: Maintain Price Target

Valuation is based on the full \$34 takeout price. EDE has been trading very close to this level indicating that investors are ascribing a high probability of the pending transaction closing.

# Eversource Energy

We remain on the sidelines upon our latest review of shares, seeing too much uncertainty around the upcoming Supreme Judicial Court (SJC) decision for Access Northeast. Following the latest delay to the Northern Pass project, we see risk around negative EPS revisions heading into 2Q.

We forecast 2Q16 adjusted EPS of **\$0.63** vs \$0.65 in 2Q15 and \$0.66 Consensus.

- **Key Drivers:** Higher transmission earnings are a positive for the quarter but we believe this could be offset by the impact of the negative comparison with the PURA accumulated deferred income taxes in the quarter.
- **Wildcard Factors:** (1) Ability to control costs to offset with 2-3% annual reduction in guidance but the comparison in 2Q15 will be challenging because last year was unusually low; (2) magnitude of regulatory lag [depreciation, property taxes]

Figure 46: ES 2Q16E Earnings Walk

Eversource Energy 2Q16 Earnings Walk	EPS
<b>2Q15A Adjusted EPS</b>	<b>\$0.65</b>
Weather vs Normal in 2Q15	\$0.01
Weather vs Normal in 2Q16	\$0.00
Electric Transmission: \$485Mn ↑ Ratebase	\$0.02
Electric Distribution & Generation	
Sales Growth: 0.0%-0.5%	\$0.01
PURA ADIT Settlement	(\$0.02)
Natural Gas Distribution	
NSTAR Gas Case: +\$15.8Mn	\$0.00
Customer Growth: +800 customers YoY	\$0.00
Utilities Cost Structure	
Non-Tracked O&M: 2-3% Reduction	(\$0.01)
Property Taxes, Depreciation, & Other	(\$0.02)
Parent & Other	(\$0.02)
Dilution	\$0.00
<b>2Q16E Adjusted EPS</b>	<b>\$0.63</b>
<b>2Q16 Consensus</b>	<b>\$0.66</b>
<b>2016 UBSe EPS</b>	<b>\$2.98</b>
<b>2016 Consensus</b>	<b>\$2.98</b>
<b>2016 Guidance</b>	<b>\$2.90-\$3.05</b>

Source: Company data, UBS estimates, company filings

O&M typically represents a net saving for YoY for Eversource but there was an unusually low level of spending in 2Q15 which causes a YoY drag for the quarter.

*For additional context, please refer links to relevant recent reports below:*

- [7/12/16 Passing on Gas?](#)
- [7/8/16 Ticking Towards High Noon in New England](#)
- [5/11/16 Just Passing Through, with Added Urgency](#)
- [3/30/16 Dousing the New England Grid](#)
- [3/23/16 Benefiting from Anomalous Conditions, for Now](#)
- [2/5/16 Adding to New England Import Prospects](#)
- [1/15/16 How Green Can New England Get?](#)
- [12/31/15 Picking a Price for the New England Auction](#)
- [12/14/15 Going Eye to Eye with the Public on NPT](#)
- [11/5/15 Enhancing the Grid](#)
- [8/18/15 Tunnelling Through to an Approval](#)
- [8/3/15 Pipe & Wire Plans Moving Right Along](#)
- [7/22/15 A Thumbs Up for Northern Pass](#)

## **What are the key updates for ES?**

- **Will Northern Pass and Access Northeast projects be approved and contribute to growth?:** We think successfully executing on the two projects appears more ambiguous of late. While Northern Pass actually appears to be gaining traction from a contracting perspective, we see risk around citing considerations before the Site Evaluation Committee in New Hampshire following a near year-long delay in that process with the final review now expected in 2H17 at the earliest, which would potentially facilitate construction beginning later in 2017. While we actually have some degree of confidence arising from our recent conversations that a pathway towards a compromise on route and terms can be found for Northern Pass. Citing considerations are also relevant as the project is in front of the NH Supreme Court with regards to routing on public access highways.

For the proposed ~900mcf/d Access Northeast gas pipeline, contracts in MA and RI are under regulatory review, with CT poised to release an RFP and NH will review contracts this year as well. ES and partners Spectra Energy and National Grid plan to submit a full FERC filing later this year as demand firms up, with the goal of having major sections online by the winter of 2018/19. We continue to see a need to accomplish at least one of these projects to achieve the low end of management's 5%-7% earnings CAGR target through 2019, while achieving both would allow the company to reach the high end.

- Earlier this week, ES was successful in getting contingent approval from Maine on procurement from Access Northeast, pending approval from other New England states. Coordination remains key.
- **Survey shows clear discrepancy between industry and investor expectations:** We recently polled investors and industry participants on expectations for success of ES' two core projects heading into a critical period for both. We note investors polled largely continue to expect success for each at 68% and 79%, respectively for Access Northeast and Northern Pass, respectively, albeit on a smaller sample size. This is notably different from industry expectations which pinned the odds at 34% and 54% for each project, respectively. We read the more sober expectations on gas contracting from industry relative to investors, in addition to our own doubts, as a further cautious datapoint. Further details are available here: [7/12/16 Passing on Gas?](#)
- **How meaningful is Mass energy legislation remains the offsetting potential?:** While the focal point will be the meaningful renewable procurement authorized (and in turn likelihood of contracting for these resources via long-term contracts on transmission for hydro), we see potential for other avenues to be broached (two bills passed need to be reconciled by July 31) with a positive read-through to ES on further nascent off-shore wind for instance. Further, should Access Northeast fail, we see a particularly acute pressure to provide greater grid resilience from electric imports during peak winter months to alleviate gas shortage concerns. Ultimately, given existing shortages already experienced and inability to connect new gas customers, we believe energy imports remain an inevitability (with other projects aside these two a possibility).

We emphasize shares could see some pressure in the near-term from a negative SJC decision given the ~\$0.20/sh estimated project contribution once fully in-service in 2019.

We are rapidly shifting our concerns from a focus on whether the project will be contracted (we see the Mass legislation as potentially poised to contract for the entire project). Rather, we see the ongoing NH SEC process as well as key efforts before the NH Supreme Court over citing along public access routes as ever more critical. The region appears willing to contract for it, but can it get done?

We emphasize ES' long-term prospects arising out of not just the latest legislation in MA, but the wider backdrop of ambitious energy policy in the region remains quite real.

- **Prospects for Balance Sheet Deployment? Look for Fall update:** With a late 2016 review contemplated around capital allocation decisions, we expect a busy 2H for ES management as they evaluate a range of potential investment opportunities to offset the projected excess cash balance in 2017 resulting from the forced divestment of ratebase generation in NH. We would interpret a decision to repurchase shares at current levels as among the least attractive opportunities, seeing this as a cautious datapoint.

[Share buybacks: just how much coming? This remains a central question in expectations.](#)

The New Hampshire Public Utility Commission recently approved the settlement between Eversource and state regulators regarding the asset sale of Eversource's remaining rate base assets. Eversource will be allowed to recover from ratepayers the \$415.5 million invested into the scrubber at the Merrimack plant from ratepayers or via a third-party transaction. Focus will be on mgmt to execute and find new projects to potentially backfill and replace any lost projects, including not just nascent community solar projects, but project efforts to address regional offshore or renewable desires.

- **Rate Cases Coming Up:** Raising Risks into 2017: We see the next round of cases as offsetting the potential improvements into next year, given cases in several of its key utilities in MA and CT. While we do not see immediate risks tied to these cases, this increases the prospective risk profile and interest rate sensitivity. We believe the core stories will continue to revolve around execution the two key projects.

**Figure 47: Upcoming Rate Cases**

Jurisdiction	Company	Commentary
Massachusetts	NSTAR Electric	Base rates frozen through 12/31/2015
	WMECO	Base rate cases filed in 2017
	NSTAR Gas	\$15.8 million base rate increase effective 1/1/2016
Connecticut	CL&P	Next case: 2nd half of 2017, effective 12/1/2017
	Yankee Gas	Need to file by 2019
New Hampshire	PSNH	Next distribution rate request will no occur before 7/1/2017

Source: Company Filings

## Estimates Unchanged

### We include a 50% probability for each Northern Pass and Access Northeast.

Overall, our latest estimates point to the lower end of the 5-7% EPS range, with mgmt now talking up buybacks, we're a bit cautious. We continue to see a need to accomplish at least one of these projects to achieve the low end of management's 5%-7% earnings CAGR target through 2019, while achieving both would allow the company to reach the high end.

Figure 48: ES Estimates vs Consensus, 2014A-2019E

Annual EPS	2014A	2015A	2016E	2017E	2018E	2019E
Transmission	0.93	0.96	1.04	1.12	1.22	1.26
Distribution, Generation	1.48	1.60	1.65	1.64	1.65	1.72
Yankee + NSTAR Gas	0.23	0.23	0.29	0.30	0.30	0.31
Northern Pass @ 0% probability	0.01	0.01	0.01	0.02	0.05	0.10
Access Northeast @ 0% probability	0.00	0.00	0.01	0.03	0.07	0.10
Corp & Other	0.00	0.01	(0.03)	(0.03)	(0.03)	(0.03)
<b>UBSe</b>	<b>\$2.65</b>	<b>\$2.81</b>	<b>\$2.98</b>	<b>\$3.08</b>	<b>\$3.26</b>	<b>\$3.48</b>
CL&P Dist ROE	8.6%	8.0%	6.8%	7.8%	8.6%	9.5%
PSNH Dist ROE	9.3%	8.7%	8.7%	9.7%	6.1%	6.4%
Prior			\$2.99	\$3.17	\$3.40	\$3.60
<b>Consensus</b>			<b>\$2.99</b>	<b>\$3.19</b>	<b>\$3.38</b>	
<b>Guidance</b>			<b>\$2.90-\$3.05</b>			
<b>5%-7% EPS growth from 2016 \$2.90-\$3.05 to 2019</b>			<b>UBSe 2016-19 CAGR</b>		<b>5.3%</b>	

Source: Company Filings, UBS Estimates, FactSet; 2014 and 2013 represent GAAP.

## Valuation: Maintaining \$61 Price Target

The Northern Pass and Access Northeast projects are valued by discounting their earnings in 2020e and 2019e, respectively, to the valuation year and applying the average peer 2018E P/E (with a 1.5x premium for transmission and a 1.0x premium for gas transportation). We attribute a modest \$2/sh today for both.

Figure 49: ES Sum of the Parts Valuation on 2018E P/E

Sum of the Parts 2018E	Valuation	Low Case		Base Case		High Case	
		Valuation (\$s MM)	Multiple	Valuation (\$s MM)	Multiple	Valuation (\$s MM)	Multiple
<b>Business Segment</b>	<b>Metric</b>	<b>2018E</b>	<b>Multiple</b>	<b>Value</b>	<b>Multiple</b>	<b>Value</b>	<b>Multiple</b>
<b>Regulated Business</b>							
					Peer Multiple		18.0x
					Premium :		
PSNH, WMECO, NSTAR Distribution	P/E	\$1.08	17.5x	\$6,028	0.5x	18.5x	\$6,372
CL&P Distribution	P/E	\$0.57	17.0x	\$3,057	0.0x	18.0x	\$3,237
Transmission	P/E	\$1.22	17.5x	\$6,790	1.5x	19.5x	\$7,567
Yankee & NSTAR Gas	P/E	\$0.30	18.0x	\$1,739	1.0x	19.0x	\$1,835
Parent	P/E	(\$0.03)	17.0x	(\$149)	0.0x	18.0x	(\$157)
					Probabilities		
Northern Pass 2020 EPS, Discounted 2-Yr	P/E at 50% prob	\$0.09	18.5x	\$0	50%	19.5x	\$275
Access Northeast Pipeline 2019 EPS, Discounted 1-Yr	P/E at 50% prob	\$0.10	18.0x	\$0	50%	19.0x	\$296
<b>NU Equity Value</b>				\$17,466			\$19,425
Fully Diluted Outstanding Shares (2018E)				318			318
<b>NU Equity Value per Share</b>				<b>\$55.00</b>			<b>\$61.00</b>
							<b>\$66.00</b>

Source: Company Filings, UBS Estimates, FactSet



# ITC Holdings Corp.

Fortis has secured a minority investor for Fortis and is progressing with the regulatory approval process. The FERC review process is expected to be more critical than the state processes where the attention will be on intervenor filings.

*For additional context, please refer links to relevant recent reports below:*

[7/11/16 Can Transmission ROEs Go Up?](#)

[7/1/16 Tide Going Out for Transmission ROEs Still](#)

[4/29/16 Transmitting the Latest Policy Signals](#)

[4/13/16 Electing to Get a Bonus?](#)

[2/23/16 Searching For Clues in Regulated M&A](#)

[2/10/16 Fortisified](#)

[12/1/15 Exploring an Exit](#)

[9/30/15 Perfect Storm](#)

[12/19/14 The SMID Bid: The Context for Regulated M&A](#)

## What are the key updates for ITC?

- **Fortis agreed to sell the top-end of the percentage range (19.9%) for ITC but ~\$100Mn below the top-end of the valuation range:** On April 20<sup>th</sup> Fortis announced that it had agreed with GIC Private Limited (GIC; a sovereign wealth fund in Singapore with \$100+Bn AUM) to purchase 19.9% in ITC Holdings (ITC) for \$1,228Mn as part of the Fortis-ITC acquisition announced in February. At the announcement of the transaction Fortis guided to selling 15-19.9% of ITC at a valuation of \$1.0-\$1.4Bn USD. With Fortis trading at \$30.74 USD the minority interest transaction represents a ~13% discount to where shares were trading in late April when announced and a ~19% discount to mid-July pricing.

**Can ITC keep the independence adder?** While it is unclear how the FERC will decide on this topic, if neither Fortis nor GIC operate within the same regional transmission footprint as ITC, an argument could be made that ITC should be able to keep the 50bp independence ROE incentive.

- **Regulatory approval process expected to begin in June at the latest:** All five states and the FERC filing have been made and management still expects the transaction to close by year-end. The FERC has 180 days to review the transaction indicating a possible decision by early December. Fortis expects to receive state approval from Illinois, Kansas, Missouri, Oklahoma, and Wisconsin by the Fall where ITC has commented that the approval process is progressing well. Both ITC and Fortis shareholders have approved of the transaction.
- **Decision on Erie expected in upcoming months:** A final decision whether ITC will proceed with its Lake Erie transmission project is expected to be made in 2H16. When deciding whether it will invest in the project ITC has stated that the transmission line would need to be significantly contracted with risk commensurate with the reward.

Following the minority interest investment Fortis shares declined 3.5% to close the week but is approximately in-line with the broader utilities index (XLU).

Fortis agreed to sell the top-end of the percentage range (19.9%) but ~\$100Mn below the top-end of the valuation range.

State regulatory approvals are required in IL, KS, MO, OK and WI (not in IA, MI or MN). Only FERC has any direct rate authority over ITC

Mgmt has stated that the Lake Erie project development is going well but there is no update available yet.

- **We see a positive evolution possible in peer group establishing FERC ROEs:** We performed our latest mark-to-market analysis of transmission ROEs in early July to understand where ROEs could trend in future periods on the back of the latest MISO Proposed Decision (PD). See our [initial write up](#) and case developments [here](#). We emphasize that while the ALJ's PD pointed 9.7% ROE for the six-month period through November, we see a more recent period ending through June 2016 would find an ROE of 9.4% without Avangrid, but a more likely, constructive outcome of 10.5% with Avangrid (full peer group tables below). We see the relevant peer group and the inclusion and exclusion of several key companies as critically swinging this analysis, primarily Avangrid (AGR) which was formed on 12/16/15 when the merger of UIL and Iberdrola USA was completed.

## Valuation: Increase Price Target \$2 to \$48

Our valuation is based on the acquisition offer from Fortis which is a combination of cash (\$22.57) and Fortis shares. The \$2/sh increase in our Price Target is driven by the appreciation of Fortis shares which lifts the stock component of the transaction.

**Figure 50: ITC Valuation**

Base Case: Takeout Price Update Calculation	
FTS-TSE Price (C\$)	Cd\$43.30
FTS-TSE Price (USD)	USd\$33.47 (A)
ITC Price	USd\$46.52
Cash Consideration	\$22.57 (C)
FTS Stock	0.7520 (B)
<b>Current ITC Valuation</b>	<b>\$48 (A)*(B)+(C)</b>
<b>Current ITC Market Cap</b>	<b>USd\$7,113</b>
<b>Minority Interest (19.9%)</b>	<b>\$1,228</b>
<b>Implied Value per Share</b>	<b>\$39.87</b>
<b>Discount</b>	<b>-16%</b>

Source: Company Filings, FactSet, and UBS Estimates

# PG&E Corporation

PCG continues to have an above-average risk profile today but we see a path towards real improvement as the company progresses through some of the more critical regulatory issues. For example, the possibility of a settlement in the 2017 General Rate Case (GRC) in coming weeks could meaningfully reduce regulatory risk. While the Butte fire, Diablo Canyon retirement, and San Bruno criminal cases are overhangs, the company is slowly moving in the right direction on a risk front; we believe investors underestimate the risk of the latest Diablo Canyon deal risk. Ultimately we believe a discount to local peers is warranted, investors could continue to flock to the less expensive utilities amidst the latest group outperformance.

We forecast 2Q16 adjusted EPS of **\$0.86** vs \$0.91 in 2Q15 and \$0.100 Consensus.

- **Key Drivers:** Growth in ratebase forms the foundation for PCG earnings but in 2Q16 this is offset by the impact of a nuclear refuelling outage. Consensus is seemingly including estimates which have retroactive GT&S revenue
- **Wildcard Factors:** (1) Recognition of GT&S revenue [see below]; (2) miscellaneous items which have ranged from +/- \$0.09 historically; and (3) timing of taxes which largely nets-out for the full year but introduces additional uncertainty

Figure 51: PCG 2Q16E Earnings Walk

PG&E Corp. 2Q16 Earnings Walk	EPS
2Q15A Adjusted EPS	<b>\$0.91</b>
Growth in Ratebase Earnings	0.05
Timing of Taxes	(0.03)
Disposition of SolarCity Stock	0.00
Nuclear Refueling Outages	(0.05)
Timing of GT&S Cost Recovery: 4Q Item?	-
Regulatory and Legal Matters	(0.02)
Energy Efficiency Incentive Revenues	0.00
Miscellaneous	0.03
Dilution	(0.03)
<b>2Q16E Adjusted EPS</b>	<b>\$0.86</b>
<b>2Q16 Consensus</b>	<b>\$1.00</b>
<b>2016 UBSe EPS</b>	<b>\$3.74</b>
<b>2016 Consensus</b>	<b>\$3.72</b>
<b>2016 Guidance</b>	<b>\$3.65-\$3.85</b>

Source: Company Filings, FactSet, and UBS Estimates

Management is included the higher earnings from the GT&S case in its 2016E guidance; however, the timing is unclear for earnings recognition. On its 4Q16 earnings call PCG indicated that it would record the 2016 retroactive GT&S earnings after a final decision was received (2015 earnings would be excluded from operating earnings). Given the uncertainty in the alternative proposed decision, we expect management to wait until the final order is received before recognizing the associated revenues. A final decision is expected within 90-days of the alternative proposed decision (October 12<sup>th</sup>).

We are increasingly positive on California overall as the 'value' play on the utility sector

When PCG received the 'final-final' decision in the GT&S case it can record substantially all of the retroactive catch-up except for the 36-month window for amortization.

PCG includes a "reasonable outcome" in the GT&S rate case in its 2016 guidance.

*For additional context, please refer links to relevant recent reports below:*

[6/29/16 Finding a New Groove](#)

[5/23/16 Raising the Dividend and Ending an Era](#)

[5/6/16 A Good Decision for GT&S](#)

[5/5/16 Biting off a Bit More Equity for Butte](#)

[2/19/16 Still a Full Plate for 2016](#)

[1/29/16 Holding Our Horses](#)

[10/29/15 Still Waiting for Resolution](#)

[7/30/15 Pushing it Out](#)

## **What are the key updates for PCG?**

- **GT&S alternative proposed decision gives more clarity but final decision could take until October:** PG&E received a revised alternate proposed decision (PD) on June 23<sup>rd</sup> in the 2015 Gas Transmission and Storage (GT&S) rate case which still includes key variables. The outcome is more nuanced but broadly clears the decks on its largest regulatory item. On one hand the proposed decision has ~\$700Mn of additional capex removed from the 2011-2014 period but \$576Mn of that spending could ultimately be approved at a later date. Conversely the treatment of the \$850Mn San Bruno penalty could vary with a capex disallowance impacting the long-term earnings power of the company whereas expense treatment could result in material immediate customer savings (yet maintain PG&E ratebase prospects). These two points are contrasting to management's latest ratebase projections with its 8K disclosure.

PCG's 2016 weighted average ratebase guidance for gas transmission is \$3.0-\$3.4Bn which assumed (1) the San Bruno penalty was treated predominately as shareholder-funded capital expenditures [~\$689Mn] – i.e. lower rate base and (2) recoverability of \$696Mn of 2011-2014 excess capex above the 2011 GT&S decision. If the San Bruno penalty is treated as an expense rather than disallowed capex we think these two items could offset with minimal net impact to 2016 ratebase; we emphasize the high degree of uncertainty. A further complicating factor is that the **ex-parte penalty is variable** and calculated as five months (42%) of the annual revenue requirement after adjusting for the San Bruno penalty. As a result, if more of the San Bruno penalty is shifted towards expense classification, this would reduce the ex-parte penalty (double benefit). We would expect this to be a potentially positive near-term revision. The customer rate impact delta is 6% vs 16% making expensing a political expedient option.

Further clarity should be available in the fall: briefs are due July 7<sup>th</sup> with reply briefs due July 14<sup>th</sup> and a decision expected within 90-days (October 12<sup>th</sup>); however, PG&E can implement interim rates on August 1<sup>st</sup>. Further, audit proceeding on capex spent above the allowable GRC levels in last rate case period (2011-2014) could yet take some time – suggesting this could be a future reduction (full recovery is assumed at top end of ratebase guidance range, taking below the range if fully lost). The 2011-2013 spending audit will begin as soon as is practicable but no clear timeline exists yet.

How does the GT&S revised alternate proposed decision impact the earnings outlook? PC&G has had a busy summer but we believe the company has made positive strides lately.

Fine: Will this be a reduction to ratebase or expensed. We believe this would be a lower impact on consumers if immediately expensed (to limit rate shock), but this would conversely help PG&E.

Audit for 2011-2014 capex above GRC levels: Remains a medium – dated overhang on ratebase.

**Figure 52: Pacific Gas & Electric Company 2015 Gas Transmission & Storage Rate Case**

<b>Pacific Gas &amp; Electric Company 2015 Gas Transmission &amp; Storage Rate Case</b>					
	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
PCG Requested Revenue Requirement	548	1,263	1,346	1,488	N/A
Adopted Revenue Requirement	715	1,046	1,110	1,220	1,324
Less: San Bruno (SB) Penalty Estimate		<b>850 Maximum</b>			
Less: Ex-Parte Penalty Placeholder		<b>(138) Subject to change based on SB</b>			
<b>Revenue Requirement pre-SB penalty</b>		<b>908</b>	<b>1,110</b>	<b>1,220</b>	<b>1,324</b>
Proposed Decision Revenue Requirement		1,109	1,183	1,309	
<i>Delta vs Adopted Revenue Req. (Not Comparable)</i>		(63)	(73)	(89)	N/A
Approved Annual Attrition Increase		331	64	110	104
Requested Annual Attrition Increase			83	142	
Actual GTS Revenue		550			
Annual Capex Midpoint		750	750	750	750
<b>Weighted Average Ratebase Excluding San Bruno</b>		<b>2,900</b>	<b>3,300</b>	<b>3,600</b>	<b>4,200</b>
1Q Guidance <u>Including San Bruno</u>			<b>3,000-3,400</b>		
2011-2014 Capex Disallowed Permanently		120			
2011-2014 Capex Subject to Audit		576			
<b>2011-2014 Capex Removed</b>		<b>696</b>	<b>Included in guidance</b>		

Source: Company Filings and UBS Estimates

- **Criminal Case is yet another near-term headline risk:** Separately the San Bruno federal criminal proceedings are underway where federal prosecutors have argued that the company intentionally utilized a loophole in the pipeline standard which led to the explosion and eight deaths. PG&E is charged with obstruction of the National Transportation Safety Board (NTSB) investigation and twelve violations of the Natural Gas Pipeline Safety Act (NGPSA). The original 2014 indictment charged the company with 27 violations. Any penalties in the federal case are separate from the state penalties. Federal prosecutors are seeking an alternate fine of \$562Mn compared with a \$1.1Bn original alternative penalty and the statutory maximum of \$6.5 (\$500,000 per count).
- **M&A: Remains a clear and present backdrop to gas case resolution:** Management has highlighted in its 10K that there is a risk that an adverse outcome in the pending federal criminal case related to the San Bruno explosion could require the company to separate its natural gas and electric utilities. With the CPUC President previously commenting on the potential need to address underlying perceived cultural and operational issues, we see this as a non-trivial element of the story, particularly given recent management turnover. If PCG decided it needed to pursue some type of financial restructuring, we believe that there would be interested counterparties, as evidenced by other potential transactions reported in the media (e.g., Oncor).

Based upon the original timetable the criminal case could end late July/early August but is difficult to predict.

While the Safety Culture OII is not an enforcement proceeding, the ultimate report to the CPUC could influence a decision to separate the businesses.

- **Diablo Canyon – Can PG&E get full recovery as requested?** As proposed the closure of the nuclear plant would not impact near-term earnings, albeit simply represents a short depreciable life on remaining rate base that would need to be replaced. A high capex budget is necessarily offset quickly depreciating asset base. Further, full recovery on all items appears tricky with interveners. We emphasize the approval from the State Lands Commission to extend the operating license to 2025 from 2018 is a positive development. We perceive some, albeit low, degree of risk around earnings from the Diablo Canyon nuclear asset with \$2.0Bn of projected ratebase that management intends to recover/earn-on by its retirement in 2024/2025. [Further details on the Diablo Canyon announcement are available here.](#)
- **What do CPUC reforms bring? Not as concerning- and could be positive:** California Governor Brown recently announced reforms to the California Public Utilities Commission (CPUC) to improve oversight and transparency but the ultimate impact on the public electric utilities is hard to assess at this juncture. We see a clear desire by all parties to reduce risk (whether real or perceived) at the CPUC and allow it to return to focusing on the core issues. We see greater, more committed staffing levels with wider public confidence as a clear positive. See meeting [takeaways](#).
- **Ongoing settlement discussion in PG&E rate case bodes well:** The timeline for the 2017 GRC has been extended twice amidst ongoing settlement discussions. We emphasize this provides a potentially constructive backdrop to the story amidst our ongoing concerns of the pancaking of two substantial rate increases on consumers. We note the next update on the schedule is due in early August suggesting a further update (either delay for further settlement discussions or outright settlement). Resolution (particularly settlement) on its latest GRC rate case could meaningfully reduce the underlying risk profile.
- **DRP and the outlook for Demand Energy Resources:** We see the latest developments around developing a new structure to compensate utilities for ratebase and opening up investments to 'outside' parties could yet result in a reduction in the total capex opportunity in the state. We see Commissioner Florio's latest comments around this issue as concerning given the focus on ROE and suggestion there is some 'excess' return (which presumably could be culled from authorized ROEs at a later point). Bottom line, the \$450 Mn in DRP spend reflected in the outlook remains a principle source of risk to budget; we expect EIX to provide a wider range than usual around its own efforts given this uncertainty.

The wider backdrop remains limiting rate shock considerations amidst the series of increases imposed on consumers. For instance, we see some risk to the Diablo Canyon case as retirement costs (case would be resolved by year-end 2017) appear to be costly for ratepayers.

Can a reasonable settlement be found, with a more limited consumer bill impact. We suspect rate moderation and gradual increase in rates remains the key to the multi-year rate case outlook.

## EPS Estimates slightly trimmed

Our EPS estimates have been trimmed for the latest capex disallowance but we have not changed our associated equity issuance assumption at this time. 2016E guidance includes \$600-\$800Mn of equity issuance assumptions but this could be impacted by this 2011-2014 disallowed capital (~\$700Mn), record keeping fine (<\$100Mn incremental), and ultimate San Bruno penalty treatment.

We continue to expect ~\$0.40 of annualized unrecovered GT&S revenue to be retroactively recognized in 2016 once a final decision is received (expected by October 2016) once the first phase decision is reached (revenue requirements).

Further charges for disallowed capital have a 30% 'multiplier' for further equity issuances based on guidance.

Figure 53: PCG Sum-of-the-Parts Valuation

PCG EPS Estimate Summary	2014A	2015A	2016E	2017E	2018E	2019E
EPS Estimates	\$3.50	\$3.12	\$3.70	\$3.59	\$3.76	\$3.96
Prior UBSe	\$3.50	\$3.12	\$3.74	\$3.64	\$3.79	\$3.99
Consensus	\$3.50	\$3.12	\$3.72	\$3.68	\$3.86	\$4.07
Guidance	-	-	3.65-3.85	-	-	-

Source: Company Filings, FactSet, and UBS Estimates

## Valuation: Increase Price Target to \$67 from \$63

Our price target remains based on a 2018E P/E and the \$4 increase in our price target is driven almost entirely by the expansion of the utilities P/E peer multiple to 17.8x from 16.7x. PCG is currently trading at a ~3% discount to regulated peers, at the low-end of its 5-13% discount range over the past three years. Investors continue to gravitate to the name when the discount has touched 10% as it screens 'cheap' but we still believe the discount is deserved to account for regulatory uncertainties as noted above. We attribute the latest outperformance since mid-May at least in part to the [macro trade where investors have rotated into utilities](#) with large cap names trading at discounts such as PG&E benefitting.

We struggle to see PCG sustainably trading at any meaningful premium over the horizon, particularly given the challenging regulatory climate.

Figure 54: PCG Sum-of-the-Parts Valuation

PG&E Corp Valuation	UBS	Low Case	Base Case	Upside Case
Ongoing EPS - 2018E	\$3.77	\$3.77	\$3.77	\$3.77
Group P/E	16.8x	17.8x	18.8x	18.8x
(Discount)/Premium	(5.0%)	0.0%	5.0%	5.0%
Valuation Scenarios	\$60.00	\$67.00	\$75.00	\$75.00
Upside/(Downside)	-7%	4%	16%	16%

Source: Company Filings, FactSet, and UBS Estimates

In contrast we apply 1x-turn premiums to Edison International (SCE) and Sempra (SDG&E and SoCal Gas) which are growing the utilities without public equity and have fewer regulatory overhangs.

An important distinction between PCG and peers is that the PCG's equity dampens the translation from above-average ratebase growth to EPS growth.

## Pinnacle West

We expect weather-driven expectations are largely too optimistic due to recent headlines around June heat wave and/or lower O&M expense, which could negatively impact the quarter in the 5-10 ¢ range versus expectations. However, recent shift to heat-wave in June-July could support the most important 3Q results and reduces risk to guidance. Expected decision in UNS rate case for July could provide read-throughs to PNW's [July 1 filed rate case](#), and we look to [value of solar docket](#) to provide potential framework for proper solar remuneration – which could affect the outcome of PNW's sweeping changes proposed in the rate case. Overall, uncertainty heading into the election season and three vacancies on the ACC suggest increased possibility of an outlier outcome for APS's rate case.

- **Key Drivers:** Relatively steady positive impacts from transmission cost adjustment, LCFR, and sales growth continue in the quarter although AZ sun benefit is set to roll of next Q since the program was largely finished 3Q'15. Although uncertain, we think plant outages will likely have an outsized effect on the quarter. This drives O&M impact down from ~17 cents in Q1 to our est of 9 cents, offset by a number of minor items.
- **Wildcard Factors:** (1) Despite extreme weather in June, April/May appear anecdotally to be more mild vs historic average, which could offset benefit in June. (2) Planned plant outages at Four Corners (Unit 4 and 5) and Palo Verde nuclear station continued from Q1 into Q2 but we expect maintenance was largely completed in time for summer - mid/early May, but shifts on timing could have a significant impact on O&M expense. Consensus is baking in either higher weather benefit or lower plant outage O&M expense, which seems too optimistic in our view.

Figure 55: PNW 2Q'16E Earnings Walk

2Q15A EPS	EPS
<b>Reported 2Q15 Adj. EPS</b>	<b>\$1.10</b>
Normal Weather	\$0.03
<b>Normalized 2Q15 Adj. EPS</b>	<b>\$1.13</b>
Weather vs. Norm	\$0.01
Transmission TCA	\$0.02
LCFR	\$0.02
kWh Sales	\$0.01
AZ Sun	\$0.01
O&M	(\$0.09)
D&A	\$0.01
Other, net	\$0.01
Dilution	(\$0.00)
<b>UBSe 2Q16 Adj. EPS</b>	<b>\$1.13</b>
<i>Consensus</i>	<i>\$1.21</i>
<b>2016 Guidance</b>	<b>\$3.90-\$4.10</b>
<b>UBSe 2016</b>	<b>\$4.05</b>
<b>Consensus 2016</b>	<b>\$3.99</b>

Source: Company Filings, Factset, UBSe



## What are the Key Issues to Watch at PNW?

- **Data points on the Company's First Rate Case in 5 years:** While we would not expect concrete progress towards a settlement before intervenor testimony, schedule expected late July should provide clarity around timeline, while UNS decision is expected to provide some read-throughs to overall outcome and most importantly, PNW's controversial overhaul of residential rate design. We expect shift to reduced variable bill component and potential demand charge will prove particularly contentious with the pro-solar crowd and could maintain a relatively contentious relationship between camps going into an uncertain election season.
- **No Compromise with National Solar – Now What?** Previously discussed compromise with SCTY/RUN appears to be largely off the table now, as we expect PNW was more concerned with bringing local installers on board with the plan. Recent indications suggest some small businesses are shifting resources away from solar and more towards HVAC or energy efficiency businesses, using the utility as a potential partner instead – this will make it marginally more difficult for solar advocates to galvanize anti-APS sentiment.
- **ACC Election is Key – More Uncertain than Usual:** The terms of three ACC Commissioners terminate in January 2017, and if two Democrat candidates were to be elected, we could see more support for pro-solar policies, which could shift decisions in the rate cases or value of solar docket. For example, former ACC Commissioner Bill Mundell (1999-2008 (R)) is running for re-election as a Democrat on a campaign that's been publicly critical of APS. This remains one of the largest uncertainties into the back half of the year.

## ACC primaries could have significant implications

The ACC primary election cycle will be key to watch in our view. The three seats up for election (or re-election) – while not explicitly deciding on any solar policies per se – could prove influential in upcoming rate cases. So far, two Democratic candidates – Bill Mundell and Tom Chabin – have signalled their intentions to run. On the Republican side, five candidates – Boyd Dunn, Robert Burns, Al Melvin, Rick Gray, and Andy Tobin – have announced their intentions to run.

In mainly red-state Arizona, the outcome of this election could be polarizing.

## Value of Solar Case Could Set the Tone

The Arizona Value of Solar (Docket E-00000J-14-0023) general docket has started with hearings in April/early-May and could be decided on an accelerated timeline (3Q) potentially providing important read-throughs for PNW's rate case. The outcome of the case will likely set the tone for solar-customer compensation: low value would support reducing net metering rate or increasing fixed charges to levels closer to those that PNW has previously asked for, but initial evidence is thin and a decision to the contrary (high value finding) would likely further intensify the solar debate in Arizona. Given recent ACC staff opinions in other dockets, we see a constructive outcome read-through for PNW as the more likely scenario, although we note the outcome of elections could shift opinions and outcomes materially.

- **History:** Last year regulators voted 4-1 (then-Chairman Bitter-Smith dissenting) to move forward with a combined generic docket to consider both cost of service and the value of solar ahead of the APS rate case. The docket considers

**PNW management stated that the outcome from the generic solar docket could change the compensation level for net metering included in its rate case.**

topics including methodologies for determining the cost to serve customers with solar and the value of solar. This follows APS' withdrawal of a request to increase the interim \$20/mo fixed charge for solar customers and the company's recommendation to discuss the issues generically in the near-term in order to speed up the rate case proceeding next year.

**How high will the demand charge be raised?** Under the current solar tariff, customers pay roughly \$5/mo for an average system (assuming 7kW \* \$0.70/kW). With the previous proposal in the state having been closer to \$20/mo, we think a compromise is likely to be struck closer to the higher figure (albeit still below). Following the federal ITC extension, we envisage lessened concern over the impact of higher fixed tariffs. The thought process in the initial \$5/mo rate appears to have been tied to an 'incremental' approach, effectively reducing subsidies to the industry gradually.

## Looking at the First Cut of the Rate Structure

We enclose below the three pieces of the proposed rate structure. It would appear that solar constituencies are keen to see more of a fixed charge rather than demand charges to blunt the impact of higher consuming households. We continue to see rate design as the critical element of the rate case rather than rate recovery, albeit see potential for an alignment of interests between solar constituencies and other interest groups advocating for energy efficiency including AARP among others desiring less fixed/demand charges overall. *We include the initial proposal from APS below; we see this as simply a proposal, with clear potential for significant evolution.*

**Figure 56: APS Solar Customer Rate Proposal**

Solar Customer Rate Details (R-3)			
Section of Bill		Charge	Calculation
<b>1 - Fixed</b>	Basic Service Charge	\$0.789	Daily
		Summer	Winter
<b>2 - Demand</b>	On Peak Demand (\$/kW)	\$16.40	\$11.50
<b>3 - Energy</b>	On Peak Energy (\$/kWh)	\$0.09090	\$0.06670
	Off Peak Energy (\$/kWh)	\$0.05475	\$0.05475

Source: APS Rate Case Filing, UBS

## Solar Rate is Clearly Designed to Minimize Offset

As shown in the summary below, R-3 is clearly biased towards demand charges and basic service charges, with the lowest energy charges by far. Since a solar system will be unable to affect the fixed or demand portion of the bill (since demand is likely set in the evening for a typical customer), this will make the lost energy revenue for PNW much less than other options (from behind the meter generation – lower demand).

**Figure 57: R-3 (Solar Tariff) has the lowest energy charge and the highest Demand Charge**

Solar Customer Rate Details (R-3)				Rate R-1		Rate R-2	
Section of Bill		Charge	Calculation	Charge	Calculation	Charge	Calculation
<b>1 - Fixed</b>	Basic Service Charge	\$0.789	Daily	\$0.789	Daily	\$0.477	Daily
		Summer	Winter	Summer	Winter	Summer	Winter
<b>2 - Demand</b>	On Peak Demand (\$/kW)	\$16.40	\$11.50	\$6.60	\$6.60	\$8.40	\$8.40
<b>3 - Energy</b>	On Peak Energy (\$/kWh)	\$0.09090	\$0.06670	\$0.15160	\$0.12730	\$0.15160	\$0.12730
		Off Peak Energy (\$/kWh)	\$0.05475	\$0.05475	\$0.08070	\$0.08080	\$0.08080

Source: Company Filings

## EPS Estimates

We are adjusting our estimates down by a nickle to account for continued O&M expense at Palo Verde and Four Corners plants.

**Figure 58: PNW EPS Estimates**

UBS Estimates (\$/share)	2014A	2015A	2016E	2017E	2018E	2019E	2020E
UBSe EPS	\$3.58	\$3.92	\$4.00	\$4.16	\$4.52	\$4.63	\$4.71
Guidance				\$3.90-4.10			
Previous Ests			\$4.05	\$4.19	\$4.54	\$4.65	\$4.74
Consensus			\$3.99	\$4.20	\$4.42	\$4.56	

Source: Company Filings, Factset, UBSe

## Valuation: Increasing PT from \$74 to \$80

We raise our PT from \$74 to \$80 based on ~1.5GX multiple expansion for the peer group. We emphasize risk to the multiple largely hinges on continued uncertainty on the rate case as well as lack of clarity around elections.

**Figure 59: PNW Price Target**

Pinnacle West Valuation: P/E Derived on 2018EPS					
Valuation		Price Target		Valuation	
2018EPS	\$4.52	2018EPS	\$4.52	2018EPS	\$4.52
P/E Multiple	17.8x	P/E Multiple	17.8x	P/E Multiple	17.8x
Premium/(Disc.)	-10%	Premium	0%	Premium	5%
Value	\$72.00	Value	\$80.00	Value	\$84.00

Source: Company Filings, UBSe

*For additional context, please refer links to relevant recent reports below:*

[6/7/16: The Sun Rises in the West](#)

[5/4/16: Taking the High Road on Solar](#)

[1/22/16: Gearing up to Make Their Case](#)

[1/7/16: West Waiting for a Better 2H16](#)

[11/2/15: Shifting towards the Rate Case Cycle](#)

[10/30/15: Hot Summer Meets Expectations](#)

[10/26/15: Catching Some Shade](#)

[9/17/15: Charting Its Own Course](#)

[7/31/15: Holding the Line on Costs](#)

[6/18/15: Sunrise after the Slide](#)

# Portland General Electric

*Key questions remain focused around ultimate outcome for the Carty plant and whether POR's next renewables RFP (towards the ~50% by 2040 standard) can yield a fourth-in-a-row win for the company. Management's contingency plan in the event Carty is delayed appears solid and we continue to see value accrual from the recently passed renewables mandate in the state. Shift in tax policy could add some complications to the ~2018 target for a build-and-transfer timeline for new wind; we note a more challenging start to the RFP process given the effort for an expedited effort (before year-end 2016 to qualify for 100% PTC) as also garnering some doubts. Regardless, this remains more of a timing issue and see a compelling reason for the commission to adopt an expedited framework to make use of the mutually beneficial 100% PTC (qualifies at 80% PTC beginning in 2017).*

We forecast 2Q'16 EPS of \$0.46 vs \$0.44 last year and \$0.44 consensus.

Largely quiet quarter with a slight beat should be driven by reduced weather impact and steady growth on sales and ratebase. We believe tax rate shift YoY if wind was favorable could provide a further bump.

- **Key Drivers:** ~\$200M ratebase growth this year offset by commensurate opex and D&A growth should continue forward from Q1 while ~1% sales growth and somewhat reduced (but still negative) weather impact should improve the quarter somewhat. Incremental AFUDC impact is minimal now but July 31 Carty decision remains the biggest impact to look for next quarter.
- **Wildcard:** (1) 30% tax rate largely due to variances in wind production (less wind = less tax offset) could shift down to a more normalized 20-25% in the quarter, particularly if wind production turns out to be better than expected (1) PCAM adjustment could be less of an offset vs last year's relatively minimal ~\$400K positive, versus ~\$1M above the baseline in 1Q.

**Figure 60: POR 2Q16E Earnings Walk**

POR Earnings Walk	
POR 2Q15A EPS	0.44
Weather Effect	0.07
Weather Normalized 2Q15A EPS	0.51
Weather 2Q16	(0.05)
Weather norm sales growth @ 1.0% projection for 2016	0.04
Decline in supplemental tariffs	(0.02)
PCAM vs Baseline	-
Ratebase Growth	0.03
O&M and G&A	(0.04)
D&A	(0.03)
AFUDC	0.01
Interest Benefit	0.01
Income Taxes (20%-25% for 2016 vs 30% in 2Q15)	0.05
Other	-
Dilution	(0.04)
<b>2Q16 EPS</b>	<b>0.46</b>
2Q16 Consensus	\$0.44
2016 EPS	2.05-2.20
2016 UBSe	\$2.19
2016 consensus	\$2.11

Source: Company Filings, Factset, and UBSe

## What to Watch for at POR

### Stock sets up well into August as investor doubts run rampant on plant startup

We think the stock sets up well despite heightened investor concerns on shares into a 7/31 startup deadline for the Carty CCGT gas plant. We emphasize investor expectations already know of cost overruns in shifting E&C provider mid-construction and risk of (small) delay in timeline vs. mandated July end deadline. While mgmt recently reiterated confidence it could still achieve this target, even a small delay would be perceived positively. We perceive an inflection nearing as risks abate on timeline – and answers on recovery strategy are more fully fleshed out.

**Bottom line, we perceive the Street as relatively focused on near-term risks on Carty – and see a clear positive skew to the story around any resolution. We think successful execution 'on time' would be perceived particularly well despite recent affirmations from management they remain on pace (albeit behind vs. initial schedule) to meet the final deadline of July 31st.**

### Carty First Fire on June 23. Capex on Track?

We note recent first fire on June 23 indicates the company continues to make progress on the 440MW natural gas base load Carty Generation Station, but is it enough? Complications arising from work performed by Abeinza, the previous contractor, could make finishing on time and/or on budget challenging, but the implications for POR are substantial enough that the company has committed to

an 8-K update in the event the timeline changes. Recall management has guided to \$635-670M capex targets yet general rate case authorization includes \$514M of recovery, which is a ~0.02 EPS impact. Most importantly, the July 31 target in service date remains the key date to meet in order to keep Carty in the most recent ratecase. While we continue to believe the July 31 date is achievable, we caution the balance between time, quality, and cost of the plant remain delicate, and the company would need to execute seamlessly to meet the goal.

### **Could POR benefit from a new ratecase for Carty? We see merits to recovery**

The company has suggested it will seek recovery of net excess costs, but uncertainty around the insurance claim could complicate matters in the near term. We think POR could argue convincingly for recovery of cost overruns in light of Abengoa's selection through a Oregon PUC-approved process; recall total plant capex est. at \$635-670M vs. authorized recovery of \$514M, but does not include potential ~\$145.6 pending insurance claims. While a credible case seeing the commission authorized recovery under same set of datapoints as POR (discounted projected had known risks both POR and OR PUC underwrote). The company's willingness to file a new rate case is likely mitigated in large part today by (1) ongoing litigation against insurance companies and (2) desire to maintain regulatory relationship at the PUC following prior effort to avoid consecutive rate asks. Bottom line, we see limited uncollectables, making this more of a matter of transient under-recovery than long-term impact on '18+ EPS ests.

### **What Happens if the Plant is Delayed?**

*We don't necessarily see a binary outcome as the only option*

While achieving the goal is clearly option 1, delaying the project to 17 or going through a regular RFP remain on the table in the event that Carty is delayed beyond the July 1<sup>st</sup> target date. Further, we think the most likely option in the event of delay remains an attempt to amend the rate case terms to reflect a delayed in –service date without changing the cost structure or impacting customer prices. This would potentially be achieved if the company were to go beyond the target date by a relatively short amount of time – POR could attempt to work with the relevant customer groups and the Oregon PUC to get an extension. *To us this would appear to be the most likely option.* In the event this is rejected, the company would file a general rate case to recover the incremental costs associated with bringing Carty on-line. Management also would consider filing a deferred accounting application allowing them to defer costs between the period of when the plant goes in service and when they would be able to recover the costs at the customers' price.

### **Still Waiting for a Renewables RFP – Hashing out the Details**

We continue to anticipate POR's request to the Oregon Public Utilities Commission (PUC) for approval of an all-source renewable RFP for up to 175MW of renewables, with accelerated process and timelines – which could be worth approximately \$1 billion according to management, assuming 33% capacity factor, \$2,000/kw cost, and 525MWs nameplate capacity.

Small timing-related risk. Previously, POR was arguing for expedited RFP processing in light of PTC eligibility through 2018 only, but start of construction guidance allowing 4 years of leeway (through 2020 in this case) could add complications to the argument if the PUC were to scrutinize closely. We believe many large

**Awaiting feedback on the process form IPPs and other parties – as push for expedited schedule**

contractors have already reserved turbines for PTC compliance this year so there could be risk to the argument that POR needs to expedite the process accordingly. POR downplays this specific concern on timing of the RFP as project would still need to be selected by year-end 2016, it's just a matter of asset in-service. There's a credible argument to suggest ratable increases rather than lumpy long-term procurement of wind around PTC expiration.

The question is whether POR can push forward with an expedited RFP as well as succeed in winning an arrangement under a build and transfer structure to wind the award. Other parties involved have existing 'merchant' wind that could yet participate into the RFP, making details on what exactly qualifies for the RFP all the more critical.

### **Can POR and Developers Agree on RFP?**

We note POR's relatively slow pace of RFP submission is likely due in part to negotiations with developers and other interested parties who are pushing the language towards criteria less favourable to build and transfer only. POR has won the last three RFPs in a row and we expect other parties will use potential leverage at the commission (in light of Carty issues) to advocate for differing RFP frameworks and non-utility ownership of projects. On the other hand, POR would likely look to ratebase renewable projects and incorporate costs into customer prices when in-service data is reached. Historically, POR's renewable projects have raised customer prices 2-3%.

### **Pacificorp is ahead of Portland with its own RFP**

In a perhaps bold move, POR's sister utility to the West is pursuing its own procurement of additional renewables *without* seeking commission approval first. We emphasize this willingness to move forward on procurement without earlier consent illustrates the cost effectiveness of projects under the PTC and bodes well for POR's comparable efforts. That said, Pacificorp was a first mover and seemingly has their pick of the most 'economic' sites in the state.

### **We see confidence in Renewable RFP timeline as Pacificorp leads the way**

Although POR appears to be structuring the RFP to account for independent developer concerns and maintain a level playing field, we note the company maintains a good deal of flexibility in driving RFP design. PGE has won each of the last 3 RFPs and while Carty related issues may garner increased scrutiny around any ratebased power facilities, we think the renewable (likely wind) opportunity appears tilted in the company's favor at this stage. We expect an RFP to be launched in '16 could drive a project by year-end '18 via a build-and-transfer project. Further, Pacificorp is actually pursuing an RFP without first seeking commission approval, a sign of confidence cheap wind w/ PTCs will ultimately be deemed prudent irrespective of upfront review.

*For additional context, please refer links to relevant recent reports below:*

[7/12/16 Racing to the Finish Line](#)

[5/5/16 Putting New Wind in the Earnings Sail](#)

[3/24/16 Going to Court as Sureties Balk](#)

[3/18/16 Zoning in on Renewables](#)

[2/16/16 Legislative Opportunity Looms](#)

## EPS Estimates – Why We're Above Street

Below we present our latest EPS estimates. We emphasize our estimates continue to reflect a build of multiple assets not yet in mgmt's formal capex, explaining our above-Street forward estimates. We admit near-term downside to 2016/2017 estimates from a delay in the Carty plant but emphasize with Street focused on 2018 & 2019 for valuation purposes we see this largely as transitory; the bigger deal here is whether the ongoing Carty project would involve any unrecoverable disallowances over time (in our view unlikely and limited if so given ongoing surety claims already).

**Figure 61: Portland General Electric Key Estimates**

	2014A	2015A	2016E	2017E	2018E	2019E	2020E
<b>UBS EPS estimates</b>	<b>\$2.18</b>	<b>\$2.04</b>	<b>\$2.19</b>	<b>\$2.40</b>	<b>\$2.60</b>	<b>\$2.76</b>	<b>\$2.87</b>
UBSe CAGR off 2015 weath norm \$2.20							6.9%
<b>Prior UBS EPS estimates</b>			<b>\$2.19</b>	<b>\$2.40</b>	<b>\$2.60</b>	<b>\$2.76</b>	
Street Consensus EPS (FactSet)			\$2.11	\$2.37	\$2.48	\$2.66	
Management Guidance - EPS			2.05-2.20				
DPS	\$1.12	\$1.18	\$1.26	\$1.35	\$1.44	\$1.54	\$1.64
DPS Growth (quarterly, usually in 2Q)			\$0.020	\$0.0225	\$0.0225	\$0.025	\$0.025
Dividend Payout Ratio (UBSe)	51%	58%	57%	56%	55%	56%	57%
Management Guidance - Payout			50-70%				
DPS growth	2%	5%		7%	7%	7%	7%
Management Guidance - Dividend growth			5-7%				

Source: Company Filings, Factset, UBSe

## Valuation: Update PT from \$46 to 49

We are rolling forward our valuation from \$46 to \$49 based on ~1.5x PE expansion in the peer group, with 1X premium. We continue to ascribe a 1x premium to a 2018E peer P/E to account for both smid-cap bias, less leverage (no holding company borrowings) as well as improved growth outlook vs. peers. We continue to see POR as among the most attractively priced smid-cap stocks.

**Figure 62: POR Valuation**

Business Segment	Valuation Metric	2018 EPS	Low Case		Base Case			High Case	
			Valuation Multiple	(\$ MM) Value	Base Valuation Multiple	(\$ MM) Value		Valuation (\$ MM) Multiple	Value
Portland General Electric Company	P/E	\$2.60	16.8x	\$44	Peer Multiple	Prem/(Disc) to Peer	Base Multiple	20.8x	\$54
					17.8x	1.0x	18.8x		

Source: Factset, UBSe



# PPL Corporation

PPL has been the largest laggard among regulated utilities in 2016 (-10% underperformance) which is expected given its significant UK concentration. We believe the most significant challenge for investors right now is that investing in PPL inherently involves making a call on the GBP foreign exchange rate. We continue to believe that the story deserves to trade at a discount but we believe the sell-off is overdone but caution that investors will likely be slow to return to shares, particularly with the guidance at risk today.

We forecast 2Q16 adjusted EPS of **\$0.50** vs \$0.49 in 2Q15 and \$0.52 Consensus.

- **Key Drivers:** We expect the UK business to decline again in 2Q and as the RIIO-ED1 rate transition's YoY comparison finally starts to fade we expect growth in 2H16 relative to last year. We believe the PA and KY utilities still benefit from higher margins following their recent rate cases as well. The weather largely appears to be a non-factor YoY.
- **Wildcard Factors:** (1) Impact of any currency re-strikes; management stated in March that it did not expect any additional activity prior to the UK referendum but that could have changed; (2) Load trends where Kentucky has been particularly vulnerable to declining sales.

PPL's quarter appears a tad weak relative to Consensus but the real debate is around the long-term outlook for the UK business.

Figure 63: PPL 2Q16E Earnings Walk

PPL Corp 2Q16E Earnings Walk		EPS
<b>2Q15A Adjusted EPS</b>		<b>\$0.49</b>
<b>U.K. Regulated (PPL UK)</b>		<b>(\$0.02)</b>
Gross Margins: New RIIO-ED1 Rates began April 2015		0.01
O&M		0.02
Depreciation		(0.01)
Financing		(0.00)
Income Taxes & Other		(0.04)
<b>Kentucky Regulated (LG&amp;E and KU)</b>		<b>\$0.02</b>
Gross Margins: New Rates Effective July 2015		0.04
O&M		(0.00)
Financing		(0.01)
Income Taxes & Other		(0.01)
<b>Pennsylvania Regulated (PPL EU)</b>		<b>\$0.02</b>
Gross Margins: New Rates Effective Jan 2016		0.03
O&M		0.01
Depreciation		(0.01)
Income Taxes & Other		(0.02)
<b>Parent &amp; Other</b>		<b>(\$0.01)</b>
Corporate Restructuring, Taxes, & Other		(0.00)
Dilution		(0.01)
<b>2Q16E Adjusted EPS</b>		<b>\$0.50</b>
<b>2Q16 Consensus</b>		<b>\$0.52</b>
<b>2016 UBSe EPS</b>		<b>\$2.32</b>
<b>2016 Consensus</b>		<b>\$2.34</b>
<b>2016 Guidance</b>		<b>2.25-2.45</b>

Source: Company Filings, FactSet, and UBS Estimates

*For additional context, please refer links to relevant recent reports below:*

[6/24/16 How the UK 'Leave' Vote Impacts US Utilities](#)

[4/29/16 All Quiet On The Western Front](#)

[2/8/16 Enjoying the Regulated Life](#)

[2/4/16 Rolling to 2018 at 5-6%](#)

[10/30/15 Adding to the Momentum](#)

[9/17/15 Charting Its Own Course \[Upgrade to Buy\]](#)

[8/17/15 Growing Like Blue Grass](#)

[7/1/15 Peering Across the Pond: Ofgem's RIIO \[Transcript w. Ofgem\]](#)

[6/8/15 Utilities Stand Alone](#)

## **What are the key updates for PPL?**

- **How can PPL manage the UK headwind?** We believe the most significant challenge for investors right now is that investing in PPL inherently involves making a call on the GBP foreign exchange rate. We utilize ~1.32 in our estimates and valuation and the UBS forecast predicts 1.29/1.20 for YE16/YE17. Management has highlighted that if there is an increase in inflation that would be a positive for revenue but the net impact of the lower exchange rate overwhelms.

Management has emphasized that it does not expect an operational impact as a result of the UK referendum but that does not change the fact that earnings translated to USD from the segment will be significantly lower based on the latest GBP/USD exchange rate. Although PPL benefits from above-market hedges today, investors are focused on the 2019E impact when the book is substantially open.

**The latest from our Economics team are available below:**

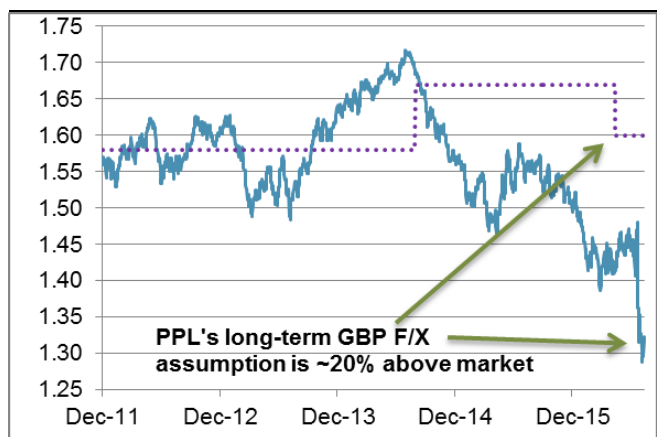
[7/6/16 Global FX Atlas: Which views remain after Leave?](#)

[6/29/16 UK: Overwhelmed by Uncertainty \[GBP Forecasts\]](#)

- **What is the dividend power now?** The current \$300-\$500Mn USD annual dividend guidance was based on a 1.60 GBP exchange rate and at a 1.30 exchange rate the new dividend range is closer to \$240- \$400Mn. While the impact on the dividend is relatively minor in the scheme of the \$1Bn annual dividend payments, we see the reduced dividend power as directly impacting the valuation for the segment. Management previously said the top-end of its repatriation guidance was unsustainable given its tax situation while the midpoint or lower was sustainable.
- **Will PPL adjust its heading methodology?** Ahead of the UK vote management layered in additional F/X hedges and has been diligent in the past to reduce currency volatility but investors are largely looking-through the hedge value today. The question is whether PPL will try to establish a new lower hedge baseline or focus less on this area with investors seemingly not giving credit.

Management has previously discussed hosting an Analyst Day following the UK referendum but is now waiting until it sees some stability in the foreign exchange market.

Figure 64: USD/GBP F/X Rate



Source: FactSet

Figure 65: PPL Hedging Profile

FX Hedging			Decrease in Rate		
Year	Hedged %	FX Rate			
2015	100%	1.57	2015	(\$0.05)	(\$0.10)
2016	93%	1.54	2016	\$0.00	\$0.00
2017	89%	1.58	2017	(\$0.01)	(\$0.01)
2018	41%	1.56	2018	(\$0.03)	(\$0.06)

Although PPL benefits from above-market hedges today, investors are focused on the 2019E impact when the book is substantially open.

Source: Company Filings

- **Quiet on the home front:** There is little new to report on the domestic front with management's capex review still ongoing as part of the business planning cycle to explore areas to accelerate deployment of bonus depreciation tax savings. PPL highlighted opportunities across the board - gas, solar, and T&D spending acceleration. Perhaps most interestingly was the discussion of gas growth in Kentucky as management has not historically focused there. We would not be surprised to see management ultimately explore gas reserves in ratebase in Kentucky, particularly if it does add more gas capacity at the electric utility. Based on recent datapoints in other states (Florida and Colorado) we believe regulatory approval will be challenging but this is likely a smaller piece of the story.
- **Compass review is going slower than expected but management is still optimistic:** The first segment of the Project Compass transmission proposal interconnects with Consolidated Edison's O&R service territory and ED is still reviewing the proposal as the transmission operator's technical review but the two companies are not joint venture partners. New York is still in the early steps of reviewing the technical aspects of PPL's proposal and the full process is expected to span all of 2016. Management has commented that the review process is progressing slower than expected but there have been no unforeseen challenges.

**We look for an update later this year but it remains to be seen if management will attempt to push-up this update to help offset the lower earnings projections at the UK business.**

**PPL stated it was open to a JV partner on the ~\$500 Mn project (Phase I only) but it did not necessarily see any reason to bring in an outside player unless there was a strategic rationale.**

## Reducing EPS estimates for F/X mark-to-market

We present our latest EPS estimates below which reflect 1.32 GBP foreign exchange rate. Due to the presence of hedges the EPS impact is more material further in the future. The domestic growth story is still strong but using the current F/X assumptions we now estimate a -1.5% EPS CAGR for the UK which pulls down the US outlook. We still believe that Consensus estimates are too high

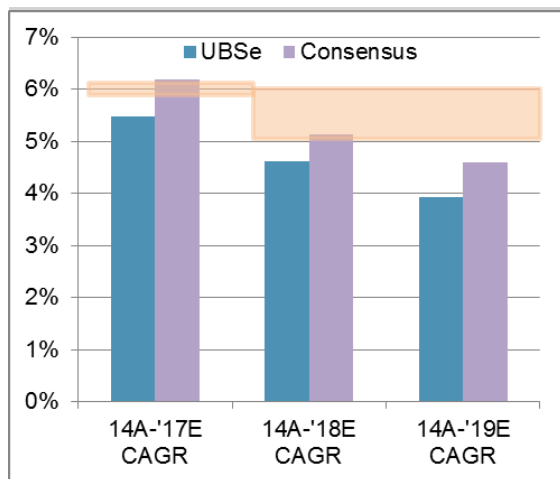
**Figure 66: Updated PPL Earnings Estimates**

PPL Standalone EPS (UBSe)	2014A	2015A	2016E	2017E	2018E	2019E	14A-'17E CAGR	14A-'18E CAGR	14A-'19E CAGR
UK Utilities	1.37	1.44	1.40	1.39	1.32	1.27	0.4%	-0.9%	-1.5%
PA Electric Utility	0.40	0.37	0.46	0.52	0.60	0.66	9.3%	10.5%	10.5%
Kentucky Utilities	0.47	0.51	0.56	0.59	0.62	0.63	8.0%	7.1%	6.1%
Retained Supply Corp. & Other	(0.21)	(0.12)	(0.10)	(0.12)	(0.11)	(0.10)			
<b>Total</b>	<b>2.03</b>	<b>2.21</b>	<b>2.31</b>	<b>2.38</b>	<b>2.43</b>	<b>2.46</b>	<b>5.5%</b>	<b>4.6%</b>	<b>3.9%</b>
Prior UBSe	2.03	2.21	2.34	2.43	2.55	2.63			
Consensus (7/13/16)	2.03	2.21	2.34	2.43	2.48	2.54	6.2%	5.1%	4.6%
Guidance	2.03	2.15-2.25	2.25-2.45	2.42	2.52		6.0%	5.6% (5-6%)	
FFO (CFO pre-W/C) / Total Debt		14%	16%	16%	15%	13%			

Source: Company Filings, FactSet, and UBS Estimates

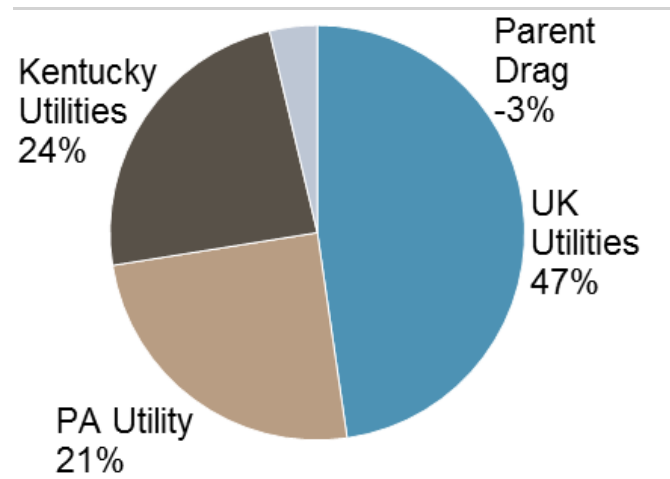
On the 4Q15 call (1.46 GBP on February 4<sup>th</sup>) management stated that if there was no improvement in the exchange rate, no restrikes exercised (as mentioned, restrikes have occurred), and no further incremental O&M savings then the EPS CAGR through 2018E would be in the bottom-half of the 5-6% range. As we indicate, we no longer see either the 2014-2017 6% EPS CAGR or the 2014-2018 5-6% EPS CAGRs as achievable.

**Figure 67: Comparison of EPS CAGRs (UBSe vs Consensus vs Guidance)**



Source: Company Filings and UBS Estimates. Pink bars indicate management guidance

**Figure 68: 2019E EPS Breakdown**



Source: Company Filings and UBS Estimates

## Valuation: Maintain Price Target

Our valuation is based on a 2018E sum-of-the-parts. We have historically valued the UK at a ~1.0x-turn discount due to its below-average cash flows, flat EPS profile, foreign currency risks, and leverage. Following the UK referendum using the latest foreign exchange rate we now predict a declining EPS profile versus flat/slightly positive. As a result we have increased the discount to 3.0x.

We summarize the changes below:

- Increase in regulated utilities peer multiple to ~18.2x from 16.3x: **+\$5/sh**
- Reduction in UK EPS estimates: **-\$2/sh**
- Expansion of UK P/E discount to -3x from -1x: **-\$3/sh**

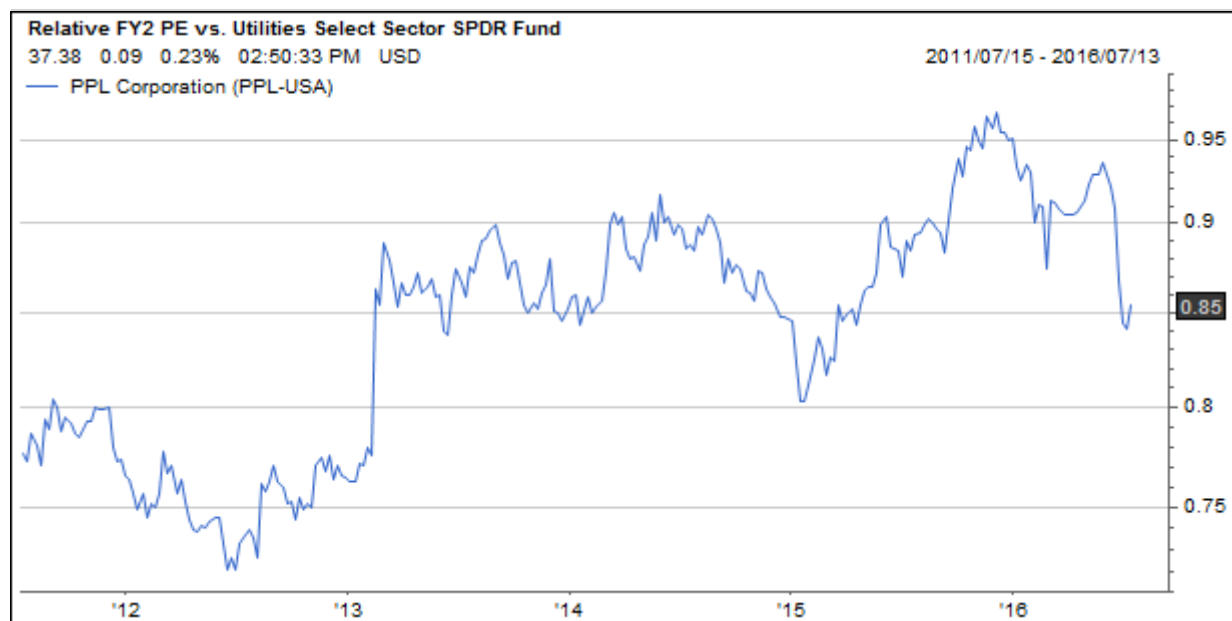
**Figure 69: PPL Sum-of-the-Parts Valuation**

PPL Sum-of-the-Parts (UBSe)	2018E	P/E Multiples					Enterprise Value		
		Prem/							
	P/E	Low	Peer	Disc.	Base	High	Low	Base	High
International (UK) Utilities	\$1.37	13.5x	18.2x	-3.0x	15.2x	17.2x	\$12,600	\$14,239	\$16,113
UK Hedge Value	-\$0.05	13.5x	18.2x	-3.0x	15.2x	17.2x	-\$446	-\$504	-\$571
Domestic Regulated Utilities									
PPL Electric Utilities (PA T&D)	\$0.60	17.7x	18.2x	1.0x	19.2x	20.2x	\$7,208	\$7,819	\$8,226
PPL Kentucky (KU/LG&E)	\$0.62	16.7x	18.2x	0.0x	18.2x	19.2x	\$7,054	\$7,688	\$8,110
Parent Interest Expense Drag	-\$0.11	16.7x	18.2x	0.0x	18.2x	19.2x	(\$1,211)	(\$1,320)	(\$1,392)
PPL Equity Value							\$25,205	\$27,922	\$30,486
Shares Outstanding (2018E Mn)							682	682	682
Total PPL Equity Value Per Share	\$2.43	15.2x			16.8x	18.4x	\$37.00	\$41.00	\$45.00
Implied P/E							15.2x	16.8x	18.4x
Premium/(Discount) to Group							-3.0x	-1.4x	0.2x

Source: Company Filings, FactSet, and UBS Estimates

PPL's discount versus the XLU had been steadily declining in 2015 but began expanding again as concerns around the UK referendum grew before significantly falling after the vote.

**Figure 70: PPL 2Yr Forward P/E Ratio**



Source: FactSet

# SCANA Corp.

Following our latest call with the SC PSC Office of Regulatory Staff and the latest disclosures about the VC Summer nuclear construction projects, we remain concerned about the construction timeline, particularly in light of the nuclear PTC eligibility. The availability of the fixed price option and continued regulatory support for the project are both positives but we think it is still pre-mature to believe that the story fully re-rates in 2016. That said, we still see the potential for a settlement with ORS and SCANA heading into the Fall hearings on the Fixed Price contract.

We forecast 2Q16 adjusted EPS of **\$0.67** vs \$0.69 in 2Q15 and \$0.71 Consensus.

- **Key Drivers:** Higher electric margin from the BLRA-related revenue for the VC Summer nuclear construction is the primary catalyst for earnings growth. There should again be a modest pick-up YoY from the 2015 depreciation study but this will likely be offset by higher financing costs for the quarter.
- **Wildcard Factors:** (1) O&M control following a challenging 1Q16 for both electric and gas; (2) sales volume trends with management still expecting slight erosion compared with positive trends. We believe that management remains conservative here.

**Figure 71: SCG 2Q16E Earnings Walk**

SCANA Corp. 2Q16 Earnings Walk	EPS
<b>2Q15A Adjusted EPS</b>	<b>\$0.69</b>
Weather vs Normal in 2Q15	(\$0.06)
Weather vs Normal in 2Q16	\$0.00
Other Electric Margin & Income	
Sales Growth (co guid -0.20% decline in 2016)	\$0.00
Base Load Review Act (BLRA)	\$0.05
Gas Margin	
E&G Gas Rate Stabilization Case	\$0.00
O&M Expense: 2% Growth in 2016	(\$0.01)
Other Taxes	(\$0.02)
Interest Expense, net of AFUDC	
Hybrid debt paydown from CGT proceeds	\$0.01
Issued \$500M debt in May 5.1%	(\$0.03)
Tax rates (32% for 2015 and 2016 vs 32% in 2014)	\$0.00
Depreciation	\$0.03
Dilution	(\$0.00)
<b>2Q16E Adjusted EPS</b>	<b>\$0.67</b>
<b>2Q16 Consensus</b>	<b>\$0.71</b>
<b>2016 UBSe EPS</b>	<b>\$3.95</b>
<b>2016 Consensus</b>	<b>\$3.95</b>
<b>2016 Guidance</b>	<b>\$3.90-\$4.10</b>

Source: Company Filings, FactSet, and UBS Estimates

*For additional context, please refer links to relevant recent reports below:*

[7/18/16 Expecting Some Slippage](#)

[5/2/16 Fixing the Summer by June](#)

[2/22/16 Considering the Options](#)

[11/4/15 Reducing Risk on all Fronts](#)

[8/20/15 Demand Growth Paints Paler Pic of Economy](#)

[8/5/15 Settling a Nuclear Deal](#)

[6/30/15 A Sweeter Summer](#)

## What are the key updates for SCG?

- **Digging back into the VC Summer project math raises some flags:** We remain on the sidelines for the shares, but could see an opportunity to revisit once a firm schedule update is provided from Fluor to Westinghouse and SCANA. In the near term we see risk around the VC Summer schedule as Fluor fully vets its latest outlook. While the election of the fixed price option is pending before the PSC, the critical items to complement the further price increase on the project are both clarity on a fully vetted schedule from Fluor and execution of its hiring ramp. We expect clarity in the coming months, likely necessary prior to any final PSC election. This data point could prove a low for shares in ~2H16, with clarity on both the latest budget and schedule enabling another settlement on the fixed price deal.
- **Clarity will likely lead to a further delay in projects, driving near-term concerns:** Following the latest commentary in Georgia, we perceive similar concerns in South Carolina over further delays for the project, emphasizing productivity metrics would need to dramatically improve to achieve the current schedule (now trending 1.5-2.0x vs. slated initial project timeline). With 3 years left, this suggests real risk of a material delay notwithstanding substantial productivity improvements. Delay of the later Unit 3 could well put it at risk for collection of PTCs, an \$18/MWh benefit (for 8-year period). Bottom line, we see a clear bias for at least one of the units to miss this PTC eligibility date, with possible risk for both. Although with the benefit capped at \$125Mn/yr per site, this could offset some concern if just one unit didn't meet the deadline.
- **... But the big offset is nuclear PTCs could get an extension from IRS:** We believe the IRS could extend Production Tax Credits (PTCs) for the nuclear industry, currently slated to expire if not deemed in-service by the end of 2020. This would follow similar relief recently provided by the IRS for renewables, with 'start of construction' language clarification for eligibility. Several projects owners continue to advocate for this.
- **Ambiguity around what is "in-service" to qualify for PTC:** We perceive continued uncertainty on exactly what is required to meet the standard. This could be among the tweaks in the rules to enable an implicit extension.
- **Other key points on the nuclear construction:**
  - **Fluor needs to establish a vetted schedule.** This remains the key point, as all parties need clarity from Fluor as part of its full project re-evaluation since taking over. We think this is a gating item to getting approval of its fixed price option, from what we can tell (notwithstanding substantial caveats that would likely be embedded otherwise).
  - **Rehiring under way:** Fluor continues to ramp on hiring new staff to enable the schedule. This is not yet complete and is a major executional task in getting the project under way and a sense for the new schedule.
  - **Change orders are still pending:** Estimates of ~\$50 Mn pending change orders remains a further source of project scrutiny as execution on shifts in the plan remains uncompleted. SCANA appears confident that the uncertainty in the scope of these costs is modest.

With rate impact concerns critical to regulatory support of the project, we think receipt of PTCs is a key risk factor to project execution. Technically this item is a pass through to consumers to bring down the total costs and technically is not an earnings headwind per se, but its loss could meaningfully add to the pressure to accommodate a lower ROE as part of a settlement.

- **There are actually two schedules that matter:** *Integrated Resource Plan* vs. *Construction Payments Milestones*. Both schedules are to support a substantial completion date. Parties have indicated they could pursue dispute resolution on the later piece and would expect this to be part of a package before the commission *seemingly* before the final approval of the settlement in November. While such an election could happen as early as July 1, the subsequent resolution period would be 60-days.
- **Integrated Resource Plan is the key follow-up:** The last substantial update was in 2014 from Westinghouse and the prior consortium. The next will be the first with the new consortium with Fluor sub-contracting. While this may not be ready in time for the fixed price option, it would be integral to any subsequent review of the project costs.
- **Settlement is still possible on Fixed Price deal:** The testimony is slated for September 1st, and hearings would still likely take place on October 5. The further nuance this time is whether any settlement with the ORS would include agreements on an updated project schedule, given the risk stemming from the fact that the dispute resolution process has not necessarily started (and hence it is unclear if a schedule update will be made available by the late Summer).
- **Nascent worries emerging on project scrutiny and BLRA:** We note some recent concerns from interveners around further pushback on the project given project cost increases and potential for the Base Load Review Act (BLRA) to receive greater scrutiny at the State legislature. We would expect any potential changes in the BLRA in SC would likely be prospective only in order to mitigate the risk to the existing project, but even a more robust discussion on the BLRA at the legislature would sound a cautious note, in our view.



## Maintain EPS Estimates

We have not yet reflected any possible benefit from higher nuclear capex and CWIP pending the final outcome of milestone planning with the consortium (and whether the company picks a fixed-cost option). We continue to see some incremental cost pressure to 2017 and 2018 EPS projections on the back of the delayed nuclear schedule and the stated intention to avoid electric rate cases during construction.

Figure 72: SCANA EPS Estimates

SCANA EPS by Segment	2014A	2015A	2016E	2017E	2018E
Carolinas	\$3.23	\$3.41	\$3.30	\$3.47	\$3.70
PSNC (Gas Utility)	\$0.39	\$0.41	\$0.44	\$0.49	\$0.50
Parent/ GA Retail	\$0.17	(\$0.01)	\$0.21	\$0.23	\$0.17
<b>Consolidated</b>	<b>\$3.79</b>	<b>\$3.81</b>	<b>\$3.95</b>	<b>\$4.19</b>	<b>\$4.38</b>
<i>Consensus 2015 CAGRs</i>	<i>\$3.79</i>	<i>\$3.81</i>	<i>\$3.95</i>	<i>\$4.15</i>	<i>\$4.44</i>
<i>Prior UBS Estimates</i>	<i>\$3.79</i>	<i>\$3.81</i>	<i>\$3.95</i>	<i>\$4.19</i>	<i>\$4.38</i>
<i>Growth Rate</i>	<i>11.9%</i>	<i>0.6%</i>	<i>3.6%</i>	<i>6.0%</i>	<i>4.5%</i>
<b>Mgmt Guidance</b>	<b>\$3.70-\$3.90</b>	<b>\$3.60-\$3.80</b>	<b>\$3.90-\$4.10</b>		
<b>Long-Term Guidance (3-6% Range)</b>					
High	3.60	3.82	4.05	4.29	4.55
Med	3.55	3.71	3.88	4.05	4.24
Low	3.50	3.68	3.82	3.98	4.14

Source: Company Filings, FactSet, and UBS Estimates

## Valuation: Maintain \$72 Price Target

We continue to value SCG on a SOTP basis, applying a discount to the 2018E peer utility P/E.

Figure 73: SCG Sum of the Parts on 2018E

SCANA Corp Valuation		UBS		Low Case		Base Case		High Case	
Business Segment	Valuation Metric	2018	Valuation Multiple	(\$s MM) Value	Peer Multiple	Prem/ Discount	Valuation Multiple	(\$s MM) Value	Valuation (\$s MM) Multiple
<b>Regulated Business</b>									
SCE&G Franchised Electric	P/E	\$3.70	15.5x	\$8,255	17.7x	-7%	16.5x	\$8,789	17.5x
PSNC	P/E	\$0.50	17.7x	1,286	18.7x	0%	18.7x	1,359	19.7x
<b>SCG Utilities Equity Value</b>				<b>\$9,542</b>				<b>\$10,148</b>	<b>\$10,755</b>
Georgia Retail (Net of Corporate)	EV / EBITDA	\$47	4.0x	\$187			5.0x	\$234	6.0x
<b>Total</b>				<b>\$187</b>				<b>\$234</b>	<b>\$281</b>
Low & High Cases (See Below) in \$/sh Terms				(\$5.81)					\$3.72
<b>SCG Equity Value</b>				<b>\$8,890</b>				<b>\$10,383</b>	<b>\$11,572</b>
Fully Diluted Outstanding Shares (2018)				144				144	144
<b>SCG Equity Value per Share</b>				<b>\$62.00</b>				<b>\$72.00</b>	<b>\$80.00</b>
<b>Low Case: Disallow ance on PTC Loss - Liquidated Damages</b>									
Loss of Full Production Tax Credit @ 100% S/h impact (SCE&G Portion)				(1,400)					
Offset by Liquidated Damages				372					
Net Impact to Shareholders under Scenario				(1,028)					
Discount back 3-years from 2020 in-service				(839)					
\$/sh Impact				(\$5.81)					
<b>High Case: Higher Costs Fully Recovered</b>									
Current SCE&G Capex								7,601	
Potential Increase (%)								10%	
Higher Recoverable Capex								760	
EPS Benefit								0.28	
Value using Group P/E Multiple								\$4.55	
Discount back 3-years from 2020 in-service								\$3.72	

Source: Company Filings, FactSet, and UBS Estimates

# Southern Company

On a longer-term basis the question is whether large cap traditional safety names will begin to lose their reputation as safe havens as the earnings mix continues to evolve. While the latest M&A has been significant for Southern, we still see investors' attention focused on the large capital projects (Kemper IGCC and Vogtle nuclear) with Kemper entering a particularly critical month ahead of its target in-service later in 3Q.

We forecast 2Q16 adjusted EPS of **\$0.72** vs \$0.71 in 2Q15 and \$0.71 Consensus.

- **Key Drivers:** Higher rates in Alabama and Mississippi form the foundation of growth in 2016; however, much of the gains could be offset by higher expenses, primarily D&A and O&M.
- **Wildcard Factors:** (1) Sales growth in the south due to exposure to export activity and (2) magnitude of O&M change following mild winter

SO is guiding to an approximately flat quarter YoY as higher expenses offset

Figure 74: SO 2Q16E Earnings Walk

Southern Company 2Q16 Earnings Walk	EPS
2Q15A Adjusted EPS	\$0.71
Weather vs Normal in 2Q15	(0.03)
Weather vs Normal in 2Q16	0.01
Retail Sales Growth	0.01
Wholesale Operations	(0.01)
Rate Relief	
GA: Base Rate Step-Up Jan 2016	0.02
GA: Nuclear Cost Recovery Tariff	0.00
MS Power: Rate increase Jan 2016	0.03
MS Power: Performance Evaluation Plan	0.00
MS Power: AFUDC on Kemper	0.00
Gulf Power: Capacity and Environ.	0.01
Alabama Power: Rate CNP Compliance	0.04
Alabama Power: Rate Stabilization	0.00
Southern Power	0.02
Interest Expense	(0.01)
Non-fuel O&M: 3.0-3.5% YoY Increase	(0.04)
Other Income and Deductions	(0.01)
D&A	(0.03)
Share Dilution	(0.01)
2Q16E Adjusted EPS	\$0.72
2Q16 Guidance	\$0.70
2Q16 Consensus	\$0.71
2016 UBSe EPS	\$2.83
2016 Consensus	\$2.85
2016 Guidance	\$2.76-\$2.88

Source: Company Filings, FactSet, and UBS Estimates

For additional context, please refer links to relevant recent reports below:

[7/11/16 The Twin Juggernauts Strike A Deal](#)

[4/28/16 Managing the Risks](#)

[2/5/16 More Cash But a Lower Profile](#)

[11/3/15 Focus on Mississippi Elections](#)

[8/26/15 Doubling Down on Atlanta](#)

[7/30/15 August Calendar Heating Up](#)

[7/10/15 Getting Messy in Mississippi](#)

## What are the key updates for SO?

- **Southern under scrutiny on the Kemper project grows:** On July 5<sup>th</sup> the New York Times published an article focusing on Southern Company, specifically its Plant Ratcliffe (Kemper County) Integrated Coal Gasification Combined Cycle (IGCC) project. The report includes statements made by a former engineer at the plant who was, per the OSHA, wrongfully terminated by SO. The employee has alleged that the public disclosures about the construction were inaccurate and misleading. Southern has responded to the report saying that it investigated claims and the article has a “pre-determined objective and tone”. We believe that the latest high-profile allegations in addition to the SEC investigation will further raise regulatory scrutiny of the project. In the recently released May status report the estimated project cost increased by \$10Mn while two key milestones were delayed (see Figure). July will be a critical construction month based on the disclosed milestones targeted for both Trains A & B.

Mgmt stated it was expecting syngas production by July 15<sup>th</sup> and achieved that milestone via a press release. With the earnings call set for July 27<sup>th</sup> we expect material updates on where construction stands and if there are further delays.

Figure 75: Kemper IGCC Monthly Status Reports: Milestone Delays

Kemper IGCC Monthly Status Reports					
Key 90-Day Milestones	Dec 2015	Feb 2016	March 2016	Apr 2016	May 2016
Lignite Dryers Ready for First Lignite Feed	February 2016	May 2016	May 2016	June 2016	June 2016
LDF Non-Dome	February 2016	April 2016	May 2016	May 2016	July 2016
WSA Commissioning	N/A	May 2016	June 2016	July 2016	July 2016
AGR Commissioning - Train A	April 2016	May 2016	July 2016	July 2016	July 2016
Refractory Cure - A	April 2016	July 2016	July 2016	July 2016	July 2016
First Lignite Feed - A	April 2016	July 2016	July 2016	July 2016	July 2016
First Syngas Production - A	April 2016	July 2016	July 2016	July 2016	July 2016
Reliable/Clean Syngas Available - A	N/A	July 2016	Aug 2016	Aug 2016	Aug 2016
First Syngas Production - B	N/A	May 2016	June 2016	July 2016	July 2016
AGR Commissioning - Train B	N/A	May 2016	June 2016	June 2016	July 2016
Reliable/Clean Syngas Available - B	N/A	June 2016	June 2016	July 2016	July 2016

Source: Company filings, MPSC Docket 2009-UA-0014

Recall that SO previously announced further delays to the target in-service date to August 31, 2016 (from June 30) for the Kemper IGCC plant with an additional \$110M of unrecoverable costs. Delays beyond August 31<sup>st</sup> are expected to incur ~\$25-\$35Mn monthly ‘base costs’ (subject to the cost cap) and ~\$15Mn expenses not subject to the cost cap. (Docket 2015-UN-0080)

- **Timing of the Mississippi rate case will be the next key issue:** We look for further clarity on exactly when management will declare in-service and file the associated rate case with the Mississippi Public Service Commission (PSC) given the significant monthly costs associated with the plant. Management has indicated that despite a targeted in-service date of August 2016, the associated rate case filing could be made approximately 3-5 months following formal in-service. We see this ‘lag’ as being used to address any issues with the plant and allowing the plant to reach a more ‘normal’ production level. For example, Duke’s Edwardsport plant was nominally placed into service the plant suffered from consistent low capacity factors on its ability to use syngas generated for a protracted period, ultimately driving pressure from the IURC to disallow certain operating costs. We expect stakeholders to focus not just on the nominal capacity factor but how often the plant is running on syngas compared with traditional fuels.

Recall that its current rate agreement would allow the company to defer costs even after it reaches in-service (depreciation) into the pending case.

Management estimates that after a 15% rate increase in December (plus refund checks), another sizeable rate increase will be necessary once in-service, although this could be offset with tax credits and grants.

- **Georgia PSC Staff views project schedule as “extremely challenging”:**

The leaders of the Georgia Public Service (PSC) Staff oversight of Vogtle 3 & 4 (Independent Construction Monitor; ICM) indicated that it sees a high probability that Southern will not be able to achieve the in-service data for Units 3 (June 2019) and 4 (June 2020) in its testimony from June 17<sup>th</sup>. Production for January – May 2016 has not been achieved per the ICM and it does not believe that the assumption of future mitigation is supported. The ICM Dr. Jacobs recently visited the Sanmen nuclear development project in China which is ~2 year ahead of Vogtle’s timeline where Dr. Jacobs noted that it appears challenging to compensate for lost time with additional resources due to limited physical space to conduct work. The ICM also believes that it is “highly unlikely” that Southern will complete Unit 4 by year-end 2020, putting the nuclear tax credits at risk.

*“We conclude that the Company has not demonstrated to Staff that the current CODs [commercial operation dates] have a reasonable chance of being met. It is our opinion that there exists a strong likelihood of further delayed operation dates for both Units.” - Georgia Public Service (PSC)*

**Staff Independent Construction Monitor**

The ICM recommends the approval of the \$160Mn of expense for Vogtle Construction Monitoring (VCM) report 14 expenses. The Georgia PSC approved Southern’s full \$148Mn request on February 19 for the VCM 13 report covering 1H15 expenses. (Docket 29849)

Specific areas for risk mentioned in the report include the containment equipment.

- **Latest report shows higher costs but stable timeline:** In contrast to the ICM’s testimony, on April 5<sup>th</sup> Georgia Power submitted a Supplemental Information Report (SIR) for Vogtle arguing that all costs incurred for the projects through the April 5<sup>th</sup> filing were prudent and that management believes the forecasted costs are “reasonable”. Although Georgia Power’s share of the total project costs have increased to \$5.44Bn from \$4.42Bn originally, going forward SO estimates that the total rate increase for Vogtle will be 6-7% with ~4.5% already included in rates versus up to 12% excluding CWIP originally forecasted. The ultimate consumer bill impact could be greater if the units are not eligible for tax credits as the ICM warns.

The VCM 14 report includes a +\$395Mn cost due primarily to the EPC settlement.

It remains to be seen how the Commission will treat and rule on the Westinghouse settlement

- **Recertification of the higher cost structure is a management goal:** Georgia Power has been working behind-the-scenes with the Georgia PSC Staff on the schedule review and an update is expected by mid-October. Management would like for the Commission to recertify the latest estimated project cost of \$5.4Bn versus the \$4.4Bn original capex forecast. Recertifying the latest project estimate would help reduce the risk but the high potential for further timeline slippage is a greater concern in our view.

**Figure 76: Capital Forecast at Georgia Power Company Ownership Percentage (\$Mn)**

Capital Forecast at Georgia Power Company Ownership Percentage (\$Mn)			
<b>Original Capital Forecast</b>		<b>\$4,418</b>	
Changes through VCM 13		627	(A)+(B)
<b>Currently Field Capital Forecast</b>		<b>\$5,045</b>	
Proposed VCM 14 Changes: EPC Scope Change			
Settlement		326	
Cyber Security		46	
Resolution of Open Notices of Change		23	
<b>Total Proposed Changes for VCM 14 with Settlement</b>		<b>395</b>	(C)
<b>Capital Forecast Proposed for VCM 14</b>		<b>\$5,440</b>	

Change Including Escalation			
Capital Cost Category (\$Mn)	VCM 1-8	VCM 12	VCM 14
Power Block and Support Structure			
Construction	\$24	\$17	\$0
Federal Regulation Changes	32	25	21
Settlement	0	0	350
Taxes and Fees	50	53	0
Operational Readiness	91	48	24
Owners Quality and Compliance	152	75	0
Legal/Environmental Permit/Misc.	12	29	0
Transmission	19	0	0
<b>Total Changes from Original Certification</b>	<b>\$380</b>	<b>\$247</b>	<b>\$395</b>
	(A)	(B)	(C)

Source: Company Filings

- **KMI and SO Agree to \$4.15B JV for SNG:** Kinder Morgan (KMI) and Southern Company (SO) announced an agreement on Sunday for KMI to sell a 50% stake in its Southern Natural Gas (SNG) pipeline system to SO. KMI will continue to operate the system and the two companies have committed to work together in pursuit of specific growth opportunities to develop natural gas infrastructure for the strategic venture. Following SO's recent AGL acquisition, SO is now a ~50% customer on the system and as a partner is well incentivized to work with KMI in pursuit of growth opportunities. The transaction has an estimated EV of \$4.15B implying the \$1.47B value for SO's 50% share of the equity interest and \$1.2B of debt. According to FERC, SNG EBITDA in 2015 was ~\$400mm which implies ~10.4x 2015 EV / EBITDA 2015.
- **How accretive is the deal to SO? Looks reasonable on P/E too.** Without disclosing leverage and prospective FCF/Earnings of the acquired asset, we rely on \$148 Mn in 2015 FERC Net Income per Form 2 Data (~\$75Mn @ 50%). This would imply ~20x trailing P/E without accounting for further SO holding company leverage. The \$4 Bn disclosed EV and above net income includes \$1.2 Bn of asset level leverage. We think the deal is likely a good one for SO, with the peer group trading in-line at 20x 2016E P/E already. Further with \$328 Mn in '15 CFO, we see ~\$400Mn+ in additional HoldCo leverage capacity off a ~mid-teens FFO/debt target (\$600 Mn of OpCo leverage exists already at 50%). As such, we see the equity piece for SO initially at ~\$1 Bn. Note historical results have been stable, consistent with contracted asset base.

In the last year we have seen SO invest in gas LDCs (\$8Bn for AGL), its unregulated Southern Power business focused on gas and solar (\$2.5+Bn equity in Southern Power), and the Kinder Morgan transaction is the latest move in that direction.

## EPS Estimates unchanged

Below we present our EPS estimates which do not formally include any potential accretion from the AGL Resources acquisition but we show illustratively the estimated accretion. Further details on the accretion profile are available in our previous note [‘Doubling Down on Atlanta’](#).

Figure 77: Southern Company EPS Estimates

SO EPS Estimates	2014A	2015E	2016E	2017E	2018E	2019E
Alabama Pow er	\$0.85	\$0.88	\$0.86	\$0.87	\$0.95	\$1.00
Georgia Pow er	\$1.37	\$1.40	\$1.44	\$1.48	\$1.53	\$1.59
Gulf Pow er	\$0.16	\$0.16	\$0.19	\$0.19	\$0.19	\$0.20
Mississippi Pow er	\$0.25	\$0.25	\$0.27	\$0.28	\$0.30	\$0.34
Southern Pow er	\$0.19	\$0.24	\$0.24	\$0.20	\$0.16	\$0.10
Other	(\$0.01)	(\$0.04)	(\$0.18)	(\$0.17)	(\$0.16)	(\$0.15)
SO, UBS Estimates	\$2.80	\$2.89	\$2.83	\$2.85	\$2.97	\$3.08
		3.0%	-2.0%	0.8%	4.2%	3.5%
Guidance Range	\$2.76-\$2.88		\$2.76-\$2.88			
3-Yr EPS CAGR off 2016E Midpoint (\$2.82) without AGL						3.0%
Estimated Potential Accretion from AGL & Staggered Equity				\$0.12	\$0.07	\$0.07
3-Yr EPS CAGR off 2016E Midpoint (\$2.82) with AGL						3.7%
Prior UBSe			\$2.83	\$2.85	\$2.97	\$3.08
Standalone guidance midpt (adj for bonus and dilution)			\$2.82	\$2.83	\$2.93	\$3.03
Street Consensus			\$2.84	\$2.97	\$3.08	\$3.17

Source: Company filings, FactSet, UBS estimates

## Valuation: Increase Price Target \$6 to \$51

Our valuation is based on a 2018E sum-of-the-parts analysis. The increase in our Price Target is driven by the expansion of the regulated utility peer group P/E to 17.7x from ~16x previously. We continue to apply significant discounts to the subsidiaries with elevated regulatory and execution risks (Vogle and Kemper).

Figure 78: Southern Company Sum-of-the-Parts Valuation

Southern Company Valuation (UBSe)		Downside Case		Base Case		Upside Case	
Business Segment	2018E EPS	Valuation Multiple	Per Sh. Value	Prem/Discount	Valuation Multiple	Per Sh. Value	Valuation Multiple
<b>Regulated Business</b>							
Alabama Power	\$0.95	16.7x	\$15.87	0.00x	17.7x	\$16.82	18.7x
Georgia Power	\$1.53	15.2x	\$23.27	-1.50x	16.2x	\$24.80	17.7x
Gulf Power	\$0.19	16.7x	\$3.25	0.00x	17.7x	\$3.45	18.7x
Mississippi Power	\$0.30	14.2x	\$4.29	-2.50x	15.2x	\$4.59	17.7x
Southern Power (Contracted Merchant)	\$0.16	15.7x	\$2.50	-1.00x	16.7x	\$2.65	17.7x
Other	(\$0.16)	16.7x	(\$2.72)	0.00x	17.7x	(\$2.88)	18.7x
Potential Accretion from AGL	\$0.07	15.7x	\$1.10	-1.00x	16.7x	\$1.17	18.7x
<b>Southern Company Total/Implied</b>	<b>\$3.04</b>	<b>15.8x</b>	<b>\$48.00</b>		<b>16.8x</b>	<b>\$51.00</b>	<b>18.1x</b>
Shares Outstanding (2018E Mn)				942	Overall discount		
Regulated Peer Group Multiple				17.7x	-5.3%		

Source: Company filings, FactSet, UBS estimates

# WEC Energy Group Inc.

With no material rate cases expected in the near-term (WI no longer anticipated in 2016), the focus remains on incremental capex opportunities to address the capex 'cliff' in 2018 which management has committed to updating the outlook by EEI (November). While we do not expect a quantitative update on the capex 'backlog' on the 2Q call, we expect a continued discussion on the opportunity set available to offset the impact of bonus depreciation (already approximately half addressed).

We forecast 2Q16 adjusted EPS of **\$0.58** vs \$0.59 in 2Q15 and \$0.58 Consensus.

- **Key Drivers:** We expect the Integrys transaction to be a net drag on the quarter given the seasonality of the gas-focused utility. Historically only 10-15% of Integrys' earnings are in the second quarter (earnings are weighted towards the winter months) but there could be a full quarter of dilution from the transaction financing. We see this as a primary reason why earnings are forecasted to decline YoY despite the TEG transaction and incremental rate relief in Wisconsin.
- **Wildcard Factors:** (1) How conservative is guidance? Historically WEC has beaten both its guidance range and Consensus expectations in quarters without significantly unfavorable weather and we expect results to beat guidance once again; (2) Magnitude of cost reductions/merger initiatives and O&M discipline to more than offset organic increases in overhead

After navigating a warm winter in 1Q16, we a relatively quiet 2Q but highlight the Integrys acquisition has skewed the earnings profile away from 2Q/3Q and into 1Q/4Q.

Figure 79: WEC 2Q16E Earnings Walk

WEC Energy 2Q16 Earnings Walk	EPS
<b>2Q15A Adjusted EPS</b>	<b>\$0.59</b>
Weather vs Normal in 2Q15	\$0.00
Weather vs Normal in 2Q16	\$0.01
Sales Growth: ~30bp	\$0.00
Rate Relief	
Michigan Gas - MI	\$0.00
Wisconsin Public Service Corp - WI	(\$0.01)
Minnesota Energy Resources - MI	\$0.01
WEPCO & Wisconsin Gas - WI	\$0.04
O&M and Other Benefit Reductions	\$0.00
American Transmission Co. (ATC)	\$0.01
Power The Future (PTF)	\$0.01
Interest Expense (Ex. TEG)	\$0.00
D&A (Ex. TEG)	(\$0.01)
Net Contribution from Integrys	\$0.08
Dilution from Integrys	(\$0.16)
Parent	\$0.00
<b>2Q16E Adjusted EPS</b>	<b>\$0.57</b>
<b>2Q16 Consensus</b>	<b>\$0.58</b>
<b>2Q16 Guidance</b>	<b>\$0.51-\$0.55</b>
<b>2016 UBSe EPS</b>	<b>\$2.94</b>
<b>2016 Consensus</b>	<b>\$2.93</b>
<b>2016 Guidance</b>	<b>\$2.88-\$2.94</b>

Source: Company Filings, FactSet, and UBS Estimates



*For additional context, please refer links to relevant recent reports below:*

[5/9/16 Upgrade to Neutral on Capex and Valuation](#)

[2/16/16 Integrating Integrys](#)

[11/6/15 Inflection in Spend](#)

[10/26/15 Letting Out Some Steam \[Downgrade\]](#)

[7/30/2015 New Beginnings](#)

[5/16/2015 Running Towards the Finish Line](#)

## **What are the key updates for WEC?**

- **Accelerating capex to offset bonus depreciation:** Management announced \$500Mn of higher capital spending for 2016/2017 on its 1Q16 call as WEC continues to explore opportunities to deploy the ~\$1Bn of deferred tax cash benefits from the five-year extension of bonus depreciation. In our recent meeting with management it was stressed that management was confident it could replace any projects that were pulled forward (i.e. spending would be incremental to the base plan). While management was confident that it could find attractive capital spending opportunities, we think an alternative option is to reduce higher-coupon borrowings to improve the earnings outlook in that manner. We believe possible areas for additional spending include (1) the potential acquisition of approximately 30bcf of gas storage facilities in Wisconsin that are currently leased [unquantified today]; (2) spending on gas storage safety [~\$30Mn]; and (3) investment in Enterprise Resource Planning (ERP) and other accounting systems [\$100-\$150Mn]. A further area is additional spending under the accelerated pipeline replacement program (AMRP), currently \$250-\$280Mn annually, but management has commented that there are natural limitations on how much road work can be feasibly be conducted in a given time period.

- **Potential to stay-out of rate cases due to merger initiatives:** On the 1Q16 call management announced that it would not file a rate case in 2016 (2017 test year) for its Wisconsin utilities, subject to action by the Public Service Commission of Wisconsin. Management is still evaluating the timing of the next rate cases in the state but is hopeful that it can avoid increasing customer base rates by executing on its merger initiatives. For example management has highlighted opportunities in areas ranging from operations, IT, and reducing staffing levels to lower O&M costs. As part of the Integrys merger Wisconsin Gas and Wisconsin Electric each agreed to three years of earnings sharing such that if the utilities over-earn, the first 50bp will be shared equally with customers.

Minnesota Energy Resources filed a \$15Mn case in September 2015 and implemented rates in January subject to refund. Peoples Gas and North Shore Gas have base rate freezes through July 2017 as part of the merger conditions. With the majority of the spending in Illinois recoverable under the AMRP, we believe the base rate freeze to continue.

- **Resolution in Peoples Gas investigations:** In May WEC agreed to pay \$19Mn to settle legacy claims relating to allegations of misleading statements regarding the cost estimates for the AMRP in Illinois and management has reported better coordination with the city and an improvement relationship. Overall we are encouraged by the fact that People's Gas earned its allowed ROE in 2015 (9.05%) and we look to see if management can deliver repeat performance in 2016.

With the benefit of time to work on its capex schedule incorporating bonus depreciation cash we expect WEC to move 'backlog' projects into its base plan

WEC broadly discussed staffing, IT, supply chain, customer service, and operations as areas of focus following the TEG merger but has not quantified

We continue to include 3% non-fuel O&M savings in our run-rate estimates (\$0.15-\$0.20 of O&M).

As a reminder the latest target cost is now ~\$6.8Bn through 2030 and ~\$7.8Bn through 2040



## EPS estimates: Capex updates to firm up visibility

We show below our earnings forecast with WEC standalone in 2014/2015 and combined WEC+TEG in 2016+. Our estimates continue to be largely in-line with Consensus and reflect a ~6% CAGR 2016-2020, in-line with the midpoint of the guidance range. We recently adjusted our dividend per share estimates to be more consistent with estimated earnings growth, also consistent with commentary from management. We assume that management will keep the payout ratio towards the midpoint of the 65-70% payout ratio range (67-68%); however, Consensus implied payout ratio in 2019E is 70%.

Management expects its utilities to earn their allowed ROEs as they did in calendar 2015

Figure 3: WEC EPS estimates vs. pro-forma for the merger with TEG, 2014A-2020E

WEC Energy Group Inc. EPS	2014A	2015A	2016E	2017E	2018E	2019E	2020E	CAGR '16-'20
<b>UBSe Combined Entity</b>	<b>\$2.65</b>	<b>\$2.73</b>	<b>\$2.94</b>	<b>\$3.12</b>	<b>\$3.33</b>	<b>\$3.52</b>	<b>\$3.70</b>	<b>6.2%</b>
UBSe (Prior)	\$2.65	\$2.73	\$2.94	\$3.12	\$3.33	\$3.52	\$3.70	
Consensus			\$2.93	\$3.11	\$3.30	\$3.48	\$3.70	
Embedded synergies assumption % of O&M (UBSe)		-0.5%	0.5%	1.0%	1.5%	2.0%	3.0%	
Embedded synergies assumption (UBSe)		\$0.00	\$0.03	\$0.05	\$0.08	\$0.11	\$0.16	
<b>EPS Guidance</b>			<b>\$2.88-\$2.94</b>		<b>5-7% EPS Growth beyond 2016</b>			
Low-End of Guidance Range (5%)			\$2.88	\$3.02	\$3.18	\$3.33	\$3.50	
High-End of Guidance Range (7%)			\$2.94	\$3.15	\$3.37	\$3.60	\$3.85	
Midpoint of Guidance Range (6%)			\$2.91	\$3.08	\$3.27	\$3.47	\$3.68	6.0%
Dividend (UBSe)	\$1.56	\$1.83	\$1.98	\$2.10	\$2.23	\$2.36	\$2.50	
Dividend Growth		17.3%	8.2%	6.0%	6.0%	6.0%	6.0%	
Payout Ratio	59%	67%	79%	67%	67%	67%	68%	
<b>Dividend Guidance</b>			<b>Targeting 65%-70% payout; grow dividend in-line with earnings</b>					

Source: Company filings, FactSet, UBS estimates

## Valuation: Increase Price Target \$5 to \$63

Our valuation is based on a 2018E P/E methodology with a 5% premium. The increase in our valuation is driven by the expansion of the peer P/E multiple to ~18.0x from ~16.7x when we conducted our last mark-to-market for WEC.

Figure 80: Updated WEC Energy Valuation

WEC Energy Group Valuation: P/E Derived on 2018 EPS			UBS
Downside Case	Base Case	Upside Case	
<b>Valuation</b>	<b>Price Target</b>	<b>Valuation</b>	
2018 EPS 3.18	2018 EPS 3.33	2018 EPS 3.37	
Low-end of 5-7% EPS CAGR	Using UBSe Estimate	High End of 5-7% EPS CAGR	
Regulated Utility	Regulated Utility	Regulated Utility	
Group P/E Multiple 17.9x	Group P/E Multiple 17.9x	Group P/E Multiple 17.9x	
Premium 0%	Premium 5%	Premium 15%	
<b>Value \$57.00</b>	<b>Value \$63.00</b>	<b>Value \$69.00</b>	
**Rounded			

# Westar Energy

The upcoming report (July 25<sup>th</sup>) from the Missouri PSC regarding the pending transaction will be a critical datapoint for the merger and pro-forma company outlook. We do not forecast any significant difficulty with Kansas approval but broader questions remain about the ability to retain \$150+Mn annual synergies in the long-run.

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

[5/31/16 Connecting in Kansas](#)

[5/5/16 Unlikely to Buy into Kingman](#)

[2/29/16 Bonus Blows Away Some Wind Growth](#)

[1/25/16 Winning With Wind?](#)

[11/5/15 Fair Winds into 2016](#)

[10/8/15 A Compassionate Clean Power Plan](#)

[8/6/15 Where will the ROE Land?](#)

## What are the pivotal questions for WR?

- **Significant synergies on tap:** On June 28<sup>th</sup> Great Plains Energy (GXP) and Westar Energy (WR) filed with the Kansas Corporation Commission (KCC) for merger approval starting the 300-day statutory clock and initiating what we believe will be the key regulatory approval in the transaction. The companies estimate significant synergies with \$150Mn net savings in 2019 (\$124Mn O&M and \$25Mn capital) and \$175Mn in 2021+. In our note [analysing the transaction](#) we assumed 4% of combined O&M could be retained by GXP (\$50Mn) and the critical factor will be how long the combined company will be able to go without a rate case before the lower cost structure is reflected in rates. On a standalone basis we expected Westar to file its next full rate case in mid-to-late 2018 to recover the costs associated with its wind acquisitions.

Westar and Great Plains are forecasting significant synergies in the transaction: the question is how much of the benefits will be retained by shareholders and for how long.

The transaction is expected to close in the Spring of 2017 based on the statutory clock in Kansas.

Docket 16-KCPE-593-ACQ

Figure 81: GXP-WR Net Merger Savings (\$Mn)

GXP-WR Net Merger Savings (\$Mn)					
	2017	2018	2019	2020	2021+
Non-Fuel O&M					
Generation	\$0	\$6	\$33	\$70	\$80
T&D / CS	\$5	\$5	\$5	\$5	\$5
Shared Services	\$5	\$21	\$22	\$23	\$25
Supply Chain	\$3	\$21	\$64	\$64	\$65
<b>Total Non-Fuel O&amp;M</b>	<b>\$13</b>	<b>\$53</b>	<b>\$124</b>	<b>\$162</b>	<b>\$175</b>
Capital	\$3	\$11	\$25	\$36	N/A
<b>Total</b>	<b>\$16</b>	<b>\$64</b>	<b>\$149</b>	<b>\$198</b>	<b>\$175</b>

Source: Company Filings

- **What will Missouri require?** Separately, attention in the merger relates to the Missouri PSC investigation into the transaction where a report is expected by July 25<sup>th</sup>. The PSC Staff requested that the docket be opened to assess the potential impact on Missouri customers as part of the GXP/WR merger. Many investors remain concerned about the potential for the PSC to adjust the utility rates due to the higher level of pro-forma parent leverage in the transaction.

Ringfencing appears to be the immediate focus with the regulatory seemingly concerned about any negative perceived impacts of the acquisition. The wider question remains whether the transaction highlights the limited opportunity to reinvest in the state – will either the PSC or the legislature act to bring an opportunity for an accelerated spending schedule in the state remains the key wild card for many investors.

Docket: EM-2016-0324

The shareholders meetings are expected to be in late 3Q/early 4Q.

# Southern Company

## Lifting Price Target with Group P/E Expansion

### Southern under regulatory scrutiny on the Kemper project grows

On July 5<sup>th</sup> the New York Times published an article focusing on Southern Company, specifically its Plant Ratcliffe (Kemper County) Integrated Coal Gasification Combined Cycle (IGCC) project. The report includes statements made by a former engineer at the plant who was, per the OSHA, wrongfully terminated by SO. The employee has alleged that the public disclosures about the construction were inaccurate and misleading. Southern has responded to the report saying that it investigated claims and the article has a "pre-determined objective and tone". We believe that the latest high-profile allegations in addition to the SEC investigation will further raise regulatory scrutiny of the project.

### Timing of the Mississippi rate case will be the next key issue

We look for further clarity on exactly when management will declare in-service and file the associated rate case with the Mississippi Public Service Commission (PSC) given the significant monthly costs associated with the plant. Management has indicated that despite a targeted in-service date of August 2016, the associated rate case filing could be made approximately 3-5 months following formal in-service.

### Georgia PSC Staff views project schedule as "extremely challenging"

The leaders of the Georgia Public Service (PSC) Staff oversight of Vogtle 3 & 4 (Independent Construction Monitor; ICM) indicated that it sees a high probability that Southern will not be able to achieve the in-service data for Units 3 (June 2019) and 4 (June 2020) in its testimony from June 17<sup>th</sup>. Production for January – May 2016 has not been achieved per the ICM and it does not believe that the assumption of future mitigation is supported

### Valuation: Increase PT to \$51 (from \$45) due to peer multiple expansion

Our valuation is based on a 2018E sum-of-the-parts analysis. The increase in our price target is driven by the expansion of the regulated utility peer group P/E to 17.7x from ~16x previously. We continue to apply significant discounts to the subsidiaries with elevated regulatory and execution risks (Vogtle and Kemper).

### Equities

Americas  
Electric Utilities

12-month rating **Sell**

12m price target **US\$51.00**  
*Prior: US\$45.00*

Price **US\$53.62**

RIC: SO.N BBG: SO US

### Trading data and key metrics

52-wk range	US\$54.44-41.98
Market cap.	US\$48.7bn
Shares o/s	908m (COM)
Free float	99%
Avg. daily volume ('000)	1,752
Avg. daily value (m)	US\$89.3
Common s/h equity (12/16E)	US\$22.5bn
P/BV (12/16E)	2.2x
Net debt / EBITDA (12/16E)	4.3x

### EPS (UBS, diluted) (US\$)

	12/16E			
	From	To	% ch	Cons.
Q1	0.58	0.58	0	0.58
Q2E	0.71	0.72	2	0.69
Q3E	1.13	1.13	NM	1.11
Q4E	0.42	0.41	-3	0.49
12/16E	2.83	2.83	0	2.84
12/17E	2.85	2.85	0	2.97
12/18E	2.97	2.97	0	3.08

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Highlights (US\$m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	17,087	18,499	17,527	18,203	18,708	19,248	19,801	20,451
EBIT (UBS)	4,552	4,743	4,834	5,142	5,366	5,617	5,893	6,081
Net earnings (UBS)	2,377	2,516	2,628	2,626	2,688	2,802	2,901	2,979
EPS (UBS, diluted) (US\$)	2.71	2.80	2.89	2.83	2.85	2.97	3.08	3.16
DPS (US\$)	2.01	2.08	2.15	2.22	2.29	2.36	2.43	2.50
Net (debt) / cash	(22,636)	(25,558)	(27,377)	(32,285)	(33,180)	(34,105)	(34,383)	(34,486)
Profitability/valuation	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
EBIT margin %	26.6	25.6	27.6	28.2	28.7	29.2	29.8	29.7
ROIC (EBIT) %	12.7	12.6	12.1	11.7	11.3	11.5	11.7	11.9
EV/EBITDA (core) x	9.7	9.9	10.2	9.4	9.4	8.9	8.5	8.2
P/E (UBS, diluted) x	16.1	15.8	15.6	18.9	18.8	18.0	17.4	17.0
Equity FCF (UBS) yield %	0.6	(0.6)	(3.3)	(6.2)	2.2	2.2	3.7	4.2
Net dividend yield %	4.6	4.7	4.8	4.1	4.3	4.4	4.5	4.7

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of US\$53.62 on 19 Jul 2016 18:43 EDT

### **Southern Company Investment case**

Southern has underperformed YTD and now investor attention is on the latest with Kemper and Vogtle construction. We believe that Southern deserves a discount given these material construction risks and questions about timing and magnitude of the associated rate recovery. Most recently in Georgia the independent project monitor has cautioned that the latest timeline does not appear to be supported.

### **Valuation Method and Risk Statement**

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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<b>Buy</b>	FSR is > 6% above the MRA.	47%	32%
<b>Neutral</b>	FSR is between -6% and 6% of the MRA.	38%	25%
<b>Sell</b>	FSR is > 6% below the MRA.	15%	21%
Short-Term Rating	Definition	Coverage <sup>3</sup>	IB Services <sup>4</sup>
<b>Buy</b>	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
<b>Sell</b>	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 30 June 2016.

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.

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**UBS Securities LLC:** Julien Dumoulin-Smith; Paul Zimbardo; Jeremiah Booream, CFA.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
<b>Ameren Corp.</b> <sup>16</sup>	AEE.N	Neutral	N/A	US\$52.34	19 Jul 2016
<b>Avista Corp.</b> <sup>4, 6b, 7, 16</sup>	AVA.N	Sell	N/A	US\$43.38	19 Jul 2016
<b>CMS Energy Corporation</b> <sup>16</sup>	CMS.N	Neutral	N/A	US\$45.00	19 Jul 2016
<b>Consolidated Edison</b> <sup>2, 4, 5, 6a, 16</sup>	ED.N	Sell	N/A	US\$79.11	19 Jul 2016
<b>DTE Energy Co.</b> <sup>2, 4, 5, 6a, 7, 16</sup>	DTE.N	Buy	N/A	US\$98.05	19 Jul 2016
<b>Duke Energy</b> <sup>2, 4, 5, 6a, 6b, 7, 16</sup>	DUK.N	Buy	N/A	US\$85.38	19 Jul 2016
<b>Edison International</b> <sup>7, 16</sup>	EIX.N	Buy	N/A	US\$77.11	19 Jul 2016
<b>Empire District Electric Company</b> <sup>16, 19</sup>	EDE.N	Neutral (CBE)	N/A	US\$33.81	19 Jul 2016
<b>Entergy Corp.</b> <sup>16</sup>	ETR.N	Sell	N/A	US\$80.39	19 Jul 2016
<b>Eversource Energy</b> <sup>16</sup>	ES.N	Neutral	N/A	US\$58.09	19 Jul 2016
<b>Exelon Corp.</b> <sup>6a, 7, 16</sup>	EXC.N	Neutral	N/A	US\$36.58	19 Jul 2016
<b>FirstEnergy Corp.</b> <sup>7, 16</sup>	FE.N	Neutral	N/A	US\$36.18	19 Jul 2016
<b>ITC Holdings Corp.</b> <sup>16, 19</sup>	ITC.N	Neutral (CBE)	N/A	US\$46.24	19 Jul 2016
<b>NextEra Energy</b> <sup>2, 4, 5, 6a, 6b, 7, 16</sup>	NEE.N	Buy	N/A	US\$128.09	19 Jul 2016
<b>PG&amp;E Corporation</b> <sup>16</sup>	PCG.N	Neutral	N/A	US\$64.41	19 Jul 2016
<b>Pinnacle West Capital Co.</b> <sup>6a, 16</sup>	PNW.N	Neutral	N/A	US\$79.68	19 Jul 2016
<b>Portland General Electric Company</b> <sup>16</sup>	POR.N	Buy	N/A	US\$44.05	19 Jul 2016
<b>PPL Corporation</b> <sup>2, 4, 5, 6a, 6b, 7, 16</sup>	PPL.N	Buy	N/A	US\$37.17	19 Jul 2016
<b>SCANA Corp.</b> <sup>2, 4, 5, 6a, 7, 16</sup>	SCG.N	Neutral	N/A	US\$73.70	19 Jul 2016
<b>Southern Company</b> <sup>2, 4, 5, 6a, 6b, 7, 16</sup>	SO.N	Sell	N/A	US\$53.62	19 Jul 2016
<b>WEC Energy Group Inc.</b> <sup>16</sup>	WEC.N	Neutral	N/A	US\$64.17	19 Jul 2016
<b>Westar Energy, Inc.</b> <sup>6a, 16</sup>	WR.N	Neutral	N/A	US\$56.34	19 Jul 2016

Source: UBS. All prices as of local market close.

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