

Entergy Corp.

Kickstarting the Exit Process

ETR inks deal to sell New England CCGT as part of likely nuclear unwind

ETR inked a deal yesterday to sell its 583MW RISEC CCGT unit in RI to Carlyle Power Partners at a price of \$490M (\$840/kW). ETR bought the unit for \$346M (\$593/kW) in Dec 2011 from NEE. We see the deal as a reasonably good sale price, bolstering regional gas plant prices despite implying a reasonable EV/EBITDA multiples (see table below) as both capacity and sparks remain elevated. We see the exit as reasonably well timed, with the New England market topping out at least for capacity pricing. The deal is expected to close in 4Q15 subject to working capital and FERC & HSR approval. No cash taxes will be paid given ETR's existing NOL.

Why sell? Latest step in corporate strategy evolution away from nuclear

In a further data point on winding down the Nuclear biz, mgmt's decision to sell the RISEC unit shortly after its acquisition in 2011 reiterates our expectations to shut down its only remaining New England nuclear unit, Pilgrim, after a similar decision to retire its Vermont Yankee unit last year. We continue to expect a strategic update on the outlook for its remaining nuclear business with the EEI conference in November, including a potential retirement of its Fitzpatrick unit in New York in addition to Pilgrim.

Why had mgmt acquired RISEC to begin with? Hedging purposes principally

Mgmt had originally acquired the unit as part of a risk mitigation effort around hedging its two nuclear units given their relatively higher forced outage statistics. Without a corresponding strategic need for the gas unit with both seemingly retiring (VY closed last year, with Pilgrim likely through the next few years prior to any significant maintenance capex being required to be invested)

Valuation: Maintain Sell & \$59 PT: Good move, but strategy revision ahead

While a strong sale price, the decision to pull out is a leading indicator of a potential further strategic evolution of the company. We suspect higher costs to extricate the company from nuclear in part could yet drag on results. It remains unclear whether ETR will hold onto IP as the only remaining IPP asset; we expect meaningful EEI updates.

Equities

Americas
Electric Utilities

12-month rating **Sell**

12m price target **US\$59.00**

Price **US\$67.67**

RIC: ETR.N BBG: ETR US

Trading data and key metrics

52-wk range	US\$91.16-61.53
Market cap.	US\$12.1bn
Shares o/s	180m (COM)
Free float	100%
Avg. daily volume ('000)	545
Avg. daily value (m)	US\$36.6
Common s/h equity (12/15E)	US\$10.4bn
P/BV (12/15E)	1.2x
Net debt / EBITDA (12/15E)	6.1x

EPS (UBS, diluted) (US\$)

	12/15E			
	From	To	% ch	Cons.
Q1	1.68	1.68	0	1.68
Q2	0.83	0.83	0	0.83
Q3E	2.23	2.12	-5	2.10
Q4E	0.68	0.60	-13	0.68
12/15E	5.42	5.22	-4	5.33
12/16E	4.85	4.71	-3	5.05
12/17E	4.81	4.85	1	5.16

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Highlights (US\$m)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenues	10,302	11,391	12,495	12,036	12,644	13,017	13,301	13,678
EBIT (UBS)	1,740	1,913	2,287	1,907	1,979	2,144	2,107	2,155
Net earnings (UBS)	1,108	957	1,051	941	850	875	836	850
EPS (UBS, diluted) (US\$)	6.23	5.36	5.83	5.22	4.71	4.85	4.64	4.71
DPS (US\$)	3.32	3.32	3.32	3.32	3.39	3.52	3.66	3.81
Net (debt) / cash	(21,050)	(21,740)	(22,261)	(21,837)	(22,111)	(22,416)	(22,717)	(22,995)
Profitability/valuation	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
EBIT margin %	16.9	16.8	18.3	15.8	15.7	16.5	15.8	15.8
ROIC (EBIT) %	9.5	9.9	11.6	9.9	10.2	10.8	10.3	10.3
EV/EBITDA (core) x	5.7	5.2	4.6	4.6	4.5	4.2	4.2	4.1
P/E (UBS, diluted) x	10.8	12.2	12.7	13.0	14.4	13.9	14.6	14.4
Equity FCF (UBS) yield %	0.6	5.3	10.0	10.4	3.8	2.5	2.8	3.3
Net dividend yield %	4.9	5.1	4.5	4.9	5.0	5.2	5.4	5.6

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\$67.67 on 08 Oct 2015 19:38 EDT

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Selling at a Good Price

Management successfully traded its RISEC plant in for \$490 Mn after buying the plant in December 2011 for \$346 Mn. While the sale price is meaningfully higher than acquisition, the implied EBITDA multiple appears to be still somewhat modest (vs ~8-9x for other transaction), likely on account of some historic operational issues at the plant.

What are the wider implications of the deal? Private buyers put bid out.

With Calpine having acquired its Fore River plant at \$650/kW in August of last year ([see full report](#)), we see the latest sale price as indicating a continued improving trend in this market. While slightly off the highs we see embedded in the ECP-DYN transaction at ~\$800-900/kW: Full deal note here: [Super-Sizing the Portfolio](#). we emphasize that private market valuations have **not** significantly retracted despite the public IPP valuation shifts. We see this and TLN's asset sale prices as broadly supportive of the IPP sector.

Figure 1: Rhode Island CCGT – Projected Adj EBITDA

Rhode Island CCGT	2015E	2016E	2017E	2018E	2019E	2020E
Capacity (MW)	583	583	583	583	583	583
Generation (Mn MWh)	3.06	3.06	3.06	3.06	3.06	3.06
Capacity Factor (%)	60%	60%	60%	60%	60%	60%
<i>Implied On-Peak Heat Rates</i>						
ISO-NE Onpeak Prices (\$/MWh)	62.35	53.25	51.45	51.20	51.70	52.20
Algonquin Delivered Gas (\$/MMBtu)	4.81	4.81	4.38	4.51	4.81	5.11
Spark Spread (\$/MWh)	22.43	17.78	19.18	19.18	19.18	19.18
Variable O&M (\$/MWh)	2.00	2.00	2.00	2.00	2.00	2.00
Discount to Peak Pricing	5%	5%	5%	5%	5%	5%
Energy Margin (\$ Mn)	62.60	48.37	52.65	52.65	52.65	52.65
Capacity Payments	20.05	19.84	35.22	56.48	49.71	39.88
Gross Margin	82.65	68.21	87.87	109.13	102.35	92.52
O&M	17.49	17.49	17.49	17.49	17.49	17.49
O&M (\$/kW-yr)	30	30	30	30	30	30
EBITDA	65.16	50.72	70.38	91.64	84.86	75.03
<i>Implied Acquisition Multiple @ \$346M</i>						
Implied Divestment Multiple @ \$490M	5.3x	6.8x	4.9x	3.8x	4.1x	4.6x
	7.5x	9.7x	7.0x	5.3x	5.8x	6.5x
D&A	12	12	12	12	12	12
EPS Contribution	0.19	0.14	0.21	0.29	0.26	0.23

Source: Company filings, Platts, UBSe

What are the deployment options?

Below we show potential impact on EPS under three different scenarios of using the proceeds from the asset sales; we note the most accretive scenario is assuming entire proceeds are used for share buy backs, and the least accretive scenario is all proceeds used to paydown debt (assuming 1% interest rate).

Management states it will use the proceeds to reinvest back in the business, which we calculate is modestly dilutive to long-term EPS. That said, the repositioning of capital back towards regulated operations is likely to be well perceived by investors keen to see ETR and its diversified utility peers bring back their assets towards regulated operations.

In addition some debt could yet be paid down, with mgmt still slightly above its corporate debt target of 18-20% at 20.4% as of the end of 2Q.

Figure 2: Analysing EPS impact from different use of sale proceeds

Entergy Sale of RISEC	
Proceeds from asset sales (\$mn)	490.0
Scenario #1: Impact assuming proceeds invested	
ROE	10%
Equity	50%
EPS Impact	0.14
Scenario #2: Impact assuming proceeds used for share buybacks	
Current share price (\$)	68.0
Share buyback (# of shares)	7.2
EPS Impact	0.23
Scenario #3: Impact assuming 100% debt pay down at 1% interest rate	
Total Impact	3.185
EPS Impact	0.02

Source: UBS estimates

Earnings Projections

We show below our earnings estimate; and reiterate that we think Street remains meaningfully too high for forward year EPS, in our view, particularly in 2018 and 2019. We maintain our robust estimates on 2015.

Figure 3: Entergy EPS Estimates – Tweaked Down

EPS by Segment	2012A	2013A	2014A	2015E	2016E	2017E	2018E	2019E
Regulated Utility	5.50	4.80	4.64	5.66	5.59	5.87	6.06	6.38
EWC/Nuclear	1.49	1.47	2.19	0.69	0.28	0.20	(0.33)	(0.51)
Other	(0.76)	(0.91)	(1.00)	(1.12)	(1.15)	(1.21)	(1.09)	(1.14)
Consolidated	6.23	5.36	5.83	5.23	4.72	4.86	4.64	4.72
Previous	6.23	5.36	5.83	5.42	4.85	4.81	4.96	5.05
Consensus				5.33	5.06	5.16	5.42	5.33
Guidance Range				5.10-5.90				
EPS CAGR (2013A-2016E)		Guidance	2-4%	UBSe	-4.12%			
EPS CAGR (2013A-2017E)		Also	2-4% --->		UBSe	-0.93%		
EPS Guidance -Regulated Utility				5.70		5.80-6.10		

Source: UBS estimates

Earnings preview for 3Q15: Expect a Bit of a Miss

We show below a breakdown of our EPS walk for this quarter. Despite stronger weather in the quarter, we see several headwinds including ANO expenses and the MtM impact from hedges as driving a rolloff in expectations. We further flag mgmt's guidance calls for negligible contributions from EWC in 2H, further reiterating our point.

We est \$2.12 vs Street of \$2.10.

Figure 4: ETR 3Q15 Earnings Walk

Entergy Corp. Earnings Walk	EPS
3Q14A EPS	\$1.68
Entergy Wholesale Commodities (EWC)	
VY Going Away (EBITDA Impact) - Rebalancing	0.09
NDT Gain Recognized - Net Expense	0.02
Outage Days (~35 Days in 3Q15 vs ~55 Days in 3Q14)	0.06
O&M - EWC (excl VY impact)	(0.10)
MtM on Hedges for 3Q YoY	(0.23)
Utility	
Weather vs. Normal 3Q15	0.10
Weather vs. Normal 3Q14 (Reversal)	0.11
Sales (3%+ Growth or less?)	0.04
Rate Changes	
Texas (Ninemile 6) Rate Increase = Jan, 1 2015, offset by AFUDC	0.02
Mississippi Rate Increase	0.01
Texas Rate Increase	0.00
O&M, Depreciation, and Interest - <i>Running ahead of guidance in 1H</i>	(0.14)
Tax Item- Benefits in 2H15	0.23
Tax Reversal	(0.06)
3Q15E Adjusted EPS	\$1.86
3Q15 Consensus	\$2.12
2015 Guidance	5.10-5.90
2015 UBSe	\$5.42
2015 Consensus	\$5.33

Source: Company sources, UBS estimates, Factset

Revised New York Capacity Price Forecast

We include the latest cleared prices in the New York capacity auction below. As we wrote earlier ([read full report here](#)), we now expect modestly lower price projections for at least for subsequent winters – however slightly higher summer prices in 2017 on account of expectations for ETR's own Fitzpatrick plant to retire. We suspect prices across the state will decline substantially on account of the in-service of the CPV Valley plant. With just Indian Point left within its portfolio, we see tracking New York capacity prices as among the principle commodity sensitivities (alongside Northeast gas prices into New York, which remain likely to fall with the in-service of the Constitution pipeline in mid-2017).

Figure 5: New York capacity price forecasts – projecting a modest slide in prices

NYISO ICAP Forecast	2010	2011	2012	2013	2014	2015	2016E	2017E	2018E
NYC Forecast									
Summer ICAP (\$/kW-month)	12.90	13.54	11.70	14.80	16.24	15.50	15.50	15.50	15.50
\$/kW-yr	154.80	162.48	140.40	177.60	194.88	186.00	186.00	186.00	186.00
\$/MW-day	424	445	385	487	534	510	510	510	510
Winter ICAP (\$/kW-month)	4.65	4.60	2.70	4.50	7.54	8.45	6.67	6.67	6.67
\$/kW-yr	55.80	55.20	32.40	54.00	90.48	101.40	80.04	80.04	80.04
\$/MW-day	153	151	89	148	248	278	219	219	219
Annualized (\$/kW-yr)	105.20	105.04	90.00	121.88	144.50	140.14	133.02	133.02	133.02
\$/MW-day	288	288	247	334	396	384	364	364	364
NY - Rest of State (RoS)									
Summer ICAP (\$/kW-month)	2.47	0.55	1.25	4.20	5.15	3.50	4.25	4.75	3.25
\$/kW-yr	29.64	6.60	15.00	50.40	61.80	42.00	51.00	51.00	39.00
\$/MW-day	81	18	41	138	169	115	140	140	107
Winter ICAP (\$/kW-month)	1.75	0.39	0.15	0.82	2.58	2.90	1.25	1.00	1.10
\$/kW-yr	21.00	4.68	1.80	9.84	30.96	34.80	15.00	12.00	13.20
\$/MW-day	58	13	5	27	85	95	41	33	36
Annualized (\$/kW-yr)	22.60	5.16	9.74	33.64	47.02	35.10	32.50	31.70	26.30
\$/MW-day	62	14	27	92	129	96	89	87	72
Lower Hudson Valley Estimate									
Summer ICAP (\$/kW-month)					9.96	8.50	8.07	8.07	3.25
\$/kW-yr					119.52	102.00	96.81	96.81	39.00
\$/MW-day					327	279	265	265	107
Winter ICAP (\$/kW-month)					-	5.90	3.73	3.73	1.10
\$/kW-yr					-	70.80	44.76	44.76	13.20
\$/MW-day					-	194	123	123	36
Annualized (\$/kW-yr)					-	86.40	70.78	70.78	26.10
\$/MW-day					-	237	194	194	72

Source: NYISO, UBS estimates

Major Items of Note

- **Retail sales growth not materializing yet – how will 3Q fair?.** For 2Q, weather adjusted retail sales were down -0.5% despite customer growth of 1.1%, with residential sales +0.7% offset by -0.2% commercial and -1.5% industrial sales. YTD total retail sales continue to slip at only +0.6% (vs +1.5% at 1Q15) vs management's prior (EEl) expectation for 2.7% in 2015 and 3.25%-3.75% CAGR through 2017. Expansions and new industrial projects have been ramping, but less than expected as a result of delays, while refiners experienced seasonal outages due to macro factors (back to normal in June though). Chlor-alkali outages and macro factors have also contributed to lower industrial sales growth than expected, with weakness here expected to continue; the question remains whether these retooling outages have extended into 3Q?. Management's overall focus remains on ratebase growth *rather* than sales growth of late, assuaging investor concerns around the latest slowdown.
- **Merger executed in Louisiana:** With the deal behind the company, its latest combined FRP indicated the company was at the low end of its authorized ROE indicating no required increase.
- **Texas: Looking at another rate case?** We suspect mgmt could be evaluating another case in early ~2016 to account for the states' exit from the System Agreement in late 2016. Rate case cycle in the state has a mandatory 180-day clock suggesting a decision is still several months out. An update to the tariff in lieu of a full case appears an avenue currently being explored.

- **Union station acquisition:** With a settlement in hand in New Orleans, this IPP acquisition appears largely de-risked through the acquisition process.
- **Further gas plant additions?** Management has two pending generation RFPs, one in TX and another in AR. With bids due in November and December respectively (and projected for in-service in 2020 and 2021), this remains a key driver to continued ratebase growth.
- **How will mgmt fair with CPP?** Among the key questions for all utilities will be compliance strategies around carbon regulations. With states like TX poised to push back substantially, it remains unclear how management will position the capex opportunity. With affordability a readily apparent issue, the question remains how to manage corresponding inflation. We flag ETR-AR signed its first PPA for 81MW in the quarter for a solar PPA project.

Valuation: Keeping Target at \$59/sh

Following our latest updates to our estimates, we are slightly tweaking our target to reflect the latest commodity curves. While shares reacted positively to the asset sale divestment, it remains unclear to what extent the divestment was accretive.

- We strip out positive FCF contributions from RISEC from 2016-2020 from our NPV (~\$250 Mn), making the sale \$1/sh accretive vs. this NPV approach. This *offsets* the latest pressure on commodity curves of -\$1/sh.
- From a pure P/E perspective, it appears slightly dilutive, particularly given the delay in deploying cash proceeds back into the business.

Where's the downside?

1. Netting out *debt* instead of interest expense multiple.
2. Added costs from nuclear plant retirements could add an unknown figure.
3. Continued collapse in New York capacity and power prices coincident with additional cheap gas and new capacity entering the Lower Hudson market.
4. Inability to earn ROEs across utility platform as sales growth underwhelms.

Figure 6: Updated ETR Valuation – Keeping PT at \$59/sh despite shift in composition on IPP with RISEC

	2017E EPS/EBITDA		EV/EBITDA and P/E Multiple				Equity Value per Share		
	2017 EPS	Low	P/E Multiple			High	Low	Base	High
			Prem/Discount	Base	High				
Regulated Utilities			2017 Peers	14.5x					
System Energy Resources, Inc. (SERI)	0.80	13.5x	0.0x	14.5x	15.5x		10.78	11.57	12.37
Entergy New Orleans	0.20	12.5x	-1.0x	13.5x	14.5x		2.54	2.74	2.95
Entergy Mississippi	0.85	12.5x	-1.0x	13.5x	14.5x		10.65	11.51	12.36
Entergy Louisiana	1.62	12.5x	-1.0x	13.5x	14.5x		20.21	21.83	23.44
Entergy Gulf States (Louisiana Only)	0.99	12.5x	-1.0x	13.5x	14.5x		12.39	13.39	14.38
Entergy Texas	0.59	12.5x	-1.0x	13.5x	14.5x		7.35	7.94	8.53
Entergy Arkansas	0.95	12.5x	-1.0x	13.5x	14.5x		11.90	12.86	13.81
Other	(0.14)	13.5x	0.0x	14.5x	15.5x		(1.83)	(1.97)	(2.10)
Regulated Utility (Consolidated)	5.87						73.99	79.86	85.73
Interest Expense	(0.38)	15.5x	0.0x	14.5x	13.5x		(5.82)	(5.44)	(5.07)
Parent Preferred Income	(0.70)	15.5x	0.0x	14.5x	13.5x		(10.92)	(10.21)	(9.51)
Other Parent Exp (non-Pfd)	(0.25)	15.5x	0.0x	14.5x	13.5x		(3.84)	(3.59)	(3.34)
Utility Value: T&D Segments	4.54	15.5x	13.1x	13.4x	16.1x		59.24	60.62	72.88
Total Utility Equity Value per Share							\$59.24	\$60.62	\$72.88
Merchant Generation Equity Value/(Drag): NPV of FCF from 2016-2020							(1,213)	(755)	(194)
RISEC Sale								490	
Mn Shares Outstanding (2017E)							180	180	180
Merchant Generation Equity Value per Share							(\$6.73)	(\$1.47)	\$1.64
Total Equity Value per Share							\$53.00	\$59.00	\$75.00

Source: Company reports and UBS estimates

Forecast returns

Forecast price appreciation	-12.8%
Forecast dividend yield	5.0%
Forecast stock return	-7.8%
Market return assumption	5.6%
Forecast excess return	-13.4%

Statement of Risk

At the regulated utility, Entergy is exposed to potential unfavorable regulatory decisions at both the state and the federal level. In addition, Entergy's earnings may be impacted by weather (above or below normal levels) and unreasonable regulatory/legislative decisions (particularly given the number of state jurisdictions in which it falls under). Entergy is also subject to macro-economic risks such as lower than expected GDP growth and rising interest rates. As a nuclear operator, Entergy is also subject to headline risk. We believe a nuclear accident (even in a non-Entergy nuclear plant) or a change in the Nuclear Regulatory Commission/Environment Protection Agency regulations could have a negative impact on our estimates. Earnings from Entergy's merchant nuclear fleet (in the northeast) are highly dependent on forward power prices (primarily in the NYISO and NE-ISO RTO markets) and rising uranium costs.

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Buy	FSR is > 6% above the MRA.	49%	33%
Neutral	FSR is between -6% and 6% of the MRA.	40%	26%
Sell	FSR is > 6% below the MRA.	12%	18%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 30 September 2015.

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Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Entergy Corp. ¹⁶	ETR.N	Sell	N/A	US\$67.67	08 Oct 2015

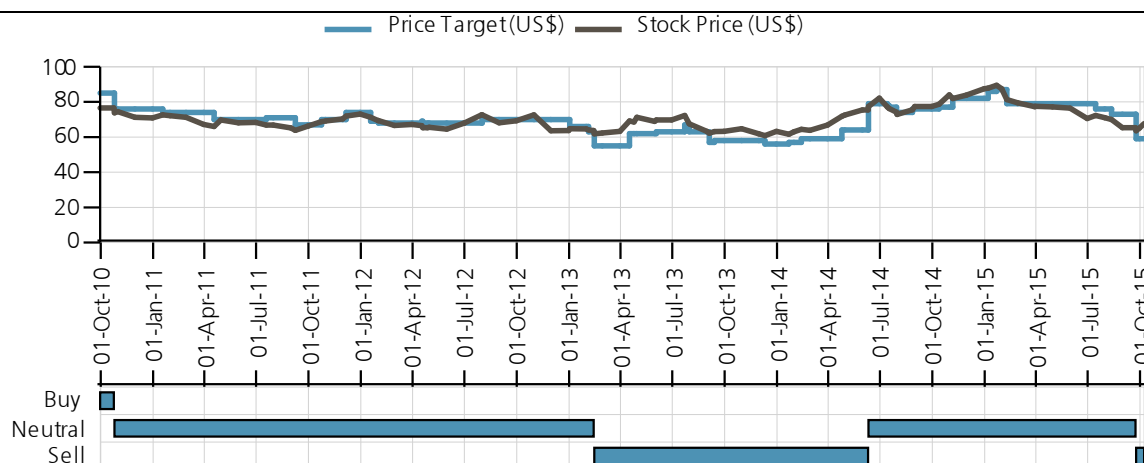
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Entergy Corp. (US\$)



Source: UBS; as of 08 Oct 2015

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