Dynegy, Inc.

Taking a Seat at the Negotiating Table

Equities

Americas
Electric Utilities

12-month rating	**Buy**
12m price target	**US$21.00**
Price	**US$16.60**
RIC: DYN.N **BBG:** DYN US	

Trading data and key metrics

52-wk range	US$34.00-7.43
Market cap.	US$1.66bn
Shares o/s	100m (COM)
Free float	100%
Avg. daily volume ('000)	862
Avg. daily value (m)	US$10.7
Common s/h equity (12/16E)	US$2.99bn
P/BV (12/16E)	0.7x
Net debt / EBITDA (12/16E)	5.7x

EPS (UBS, diluted) (US$)

	12/16E	
	UBS	Cons.
Q1E	0.21	(0.46)
Q2E	0.11	(0.54)
Q3E	0.68	0.43
Q4E	0.10	(0.54)
12/16E	1.08	(1.10)
12/17E	0.47	(1.02)
12/18E	2.19	0.87

Restructuring IPH GenCo a 2016 priority: $91Mn pre-interest negative FCF in '15

Management plans to initiate conversations with its non-recourse Illinois Power Holding (IPH) subsidiary creditors to bring resolution to the subsidiary either by restructuring the debt or transferring ownership of the assets to the credits. DYN provided enhanced disclosures to highlight how challenged the economics at IPH are. In 2015 prior to the allocation of $125Mn power supply agreement (PSA) subsidy the GenCo lost -$55Mn of adjusted EBITDA pre-corporate G&A ($21Mn) and lost $150Mn of FCF. Including the PSA subsidy the assets lost $25Mn pre-G&A indicating that there is room to negotiate a beneficial outcome for both equity and debt investors.

Closing 2.8GW of uneconomic MISO assets which did not clear the auction

Dynegy announced that it will close Baldwin Units 1 & 3 (1,220MW at CoalCo), Newton Unit 2 (615MW at IPH), and potentially an incremental unidentified 500MW. Including the previously announced Wood River retirement (465MW at CoalCo) collectively Dynegy could retire 2.8GW of coal-fired generation before the upcoming MISO auction in April 2017 (subject to MISO's reliability review). After failing to clear in the latest MISO capacity auction, these assets have negligible EBITDA and are FCF negative making it accretive to shut them. Dynegy discloses $205Mn of capex savings for these plants over the next five years ($41Mn annually) which could be reduced further if able to reduce spending for the $200Mn Newton scrubber.

How will MISO and IL react to the loss of at least 280 jobs? Focus on legislation

Dynegy reiterated that it views the design of MISO Zone 4 (Illinois) as flawed and now the focus will return now to the dual paths of potential reforms in the MISO stakeholder process and legislative reforms in Illinois. We see this as meaningfully improving odds for coal support in the legislature alongside any nuclear package. With weeks left and no budget, legislation has really become a 2017 discussion point.

Valuation: Maintain $21 Price Target; actions are constructive

Valuation is based on a 2018E sum-of-the-parts analysis. We are maintaining our EBITDA estimates and price target ahead of the call and a detailed model review to reflect the latest portfolio changes. Closing FCF negative coal assets and painting a path to extracting further equity value from IPH are both positive developments.

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Highlights (US$m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	1,466	2,497	3,870	5,106	4,993	5,249	5,022	5,027
EBIT (UBS)	(309)	(51)	218	729	652	958	894	870
Net earnings (UBS)	(359)	(278)	127	134	59	272	234	219
EPS (UBS, diluted) (US$)	(3.59)	(2.78)	1.27	1.08	0.47	2.19	1.88	1.76
DPS (US$)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net (debt) / cash	(1,149)	(6,226)	(6,784)	(6,424)	(6,153)	(5,860)	(5,633)	(5,432)

Profitability/valuation	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
EBIT margin %	-21.1	-2.0	5.6	14.3	13.1	18.3	17.8	17.3
ROIC (EBIT) %	(8.9)	(0.7)	2.2	7.5	6.8	10.2	9.5	9.2
EV/EBITDA (core) x	14.9	12.6	10.9	7.4	8.0	6.2	6.6	6.7
P/E (UBS, diluted) x	(5.9)	(10.2)	20.4	15.4	35.2	7.6	8.8	9.4
Equity FCF (UBS) yield %	6.9	6.0	(2.2)	25.5	16.4	17.6	13.7	12.1
Net dividend yield %	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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$16.60 on 03 May 2016 19:37 EDT

How did the 2016 guidance change?

Dynegy reaffirmed its FY16 adjusted EBITDA and FCF as detailed below but (1) continues to exclude the partial year loss from Wood River [seemingly <+$10Mn savings for mid-2016 retirement]; (2) continues to include a full year for the previously mentioned Baldwin and Newton units; (3) reflect -$33Mn O&M and -$63Mn capex for MISO coal assets. Of the -$63Mn reduction in capex ~$50Mn of "discrete" spending was already excluded from the FCF guidance. Cost reductions at the MISO fleet helps DYN maintain its guidance by offsetting capacity revenue assumptions for assets that did not clear but the forward curves have also improved since the April 19th mark which should help the outlook. Management still expects the pending Engie transaction to close in 4Q16 and if the acquisition closes ahead of expectation that would represent upside to FY16 FCF. More importantly (and as expected) Dynegy is working on areas for further synergies above the initial $90Mn guidance.

Cost reductions at the MISO fleet helps DYN maintain its guidance but the forward curves have also improved since the April 19th mark which should help the outlook.

1Q16 adjusted EBITDA of $251Mn was light of UBSe ($299Mn) but modestly ahead of Consensus ($225Mn).

Figure 1: Comparison of 1Q16 and 4Q15 Guidance Details

Consolidated Dynegy	1Q16 Update	4Q15 Update	Changes
Adjusted EBITDA	**$1,000-$1,200**	**$1,000-$1,200**	**Unchanged**
Maintenance Capex	-$275	-$300	$25
Recurring Environmental Capex	-$20	-$20	$0
Cash Interest	-$515	-$515	$0
Other Cash	$10	$35	-$25
Free Cash Flow	**$200-$400**	**$200-$400**	**Unchanged**
Other Financing Costs	-$30	-$30	$0
Growth Capex	-$30	-$35	$5
Non-Recurring Environ. Capex	-$10	-$50	$40

Source: Company Filings

In Figure 2 we break-down Dynegy's enhanced disclosures for 2015A IPH and apply to 2016 broadly. In theory if the IPH subsidiary was managed independently of Dynegy it would lose the $125Mn Power Supply Agreement from Dynegy's retail business but would save $59Mn in interest and presumably a good portion of the $21Mn corporate G&A allocated to the business. Net-net FCF appears to be $45Mn higher for IPH when affiliated with Dynegy.

Figure 2: IPH Analysis

IPH Analysis	2015A	2016E
Adjusted EBITDA	-$55	-$25
Capex	-$36	-$46
FCF Pre-Interest	-$91	-$71
Interest Expense	-$59	-$59
G&A Allocation	-$21	-$21
FCF After G&A	-$171	-$151
PSA Subsidy	$125	$125
FCF with DYN	-$46	-$26
FCF w/out DYN	-$91	-$71
PSA - Int - G&A	$45	$45

Source: Company Filings and UBS Estimates

What are other key highlights?

We flag the following updates from the call as noteworthy datapoints and clarifications:

- **Ongoing costs:** Mgmt disclosed the ongoing costs of *running* the remaining units at each of the Baldwin and Newton sites (each has one remaining). This has been a focus of confusion this evening. <u>We think the next unit to close is likely Newton.</u>
  - The Scrubber costs are still seemingly reflected in guidance, enabling a further reduction in guidance expectations if Newton 1 is also closed.
  - Retirements do not appear to require any changes in the SO2 standards as MPS requirements are largely met via removal of uncontrolled units at both Dynegy Coal and IPH portfolios (Wood River and Newton 2, respectively)
- **EBITDA profile of assets closing is breakeven, but closing FCF negative assets.** We emphasize reducing future FCF losses on existing coal assets only shifts the story ever more towards a gas driven backdrop and improves near-term economics while ratcheting up pressure on legislation success in 2017 for a nuclear *and* coal deal.
- **IPH restructuring:** Following disclosure of both the retirements as well as full realization of the PSA contribution to the IPH segment level EBITDA, this would stand in contrast to the recent meaningful rally of IPH bonds.
- **Signing a toll?** The Good Energy deal for both capacity and energy a $4.40/kW-mo reflects the desire for both long-term capacity and energy hedges.

Why do we still like shares? Our Favorite IPP of the Bunch.

We think Dynegy is the best positioned IPP through the medium term with clear upside on financing assumptions and real potential to improve its outlook via IPH restructuring and further asset retirements. We suspect the magnitude of the total closures to force real change before MISO (reforms expected this July) and the legislature (don't expect a deal this summer, but prospects are real for 2017 alongside EXC's retirement of its MISO unit, Clinton). While cost cuts to maintain the 2016 EBITDA guidance range are less than ideal, we see further latitude to outperform on '16 expectations. The story remains the best positioned credit play (vs. its direct peers with restructuring themes TLN and NRG).

Forecast returns

Forecast price appreciation	+26.5%
Forecast dividend yield	0.0%
Forecast stock return	+26.5%
Market return assumption	5.8%
Forecast excess return	+20.7%

Valuation Method and Risk Statement

Risks to our investment thesis, valuation, and estimates include but are not limited to: 1) actual commodity prices differing significantly from our assumptions; 2) adverse political, legislative, and/or regulatory changes; 3) reduction in end-user electric demand; and 4) inability to realize stated synergy or cost-savings targets. Other investment risks include abrupt changes in weather pattern, sharp slowdown in economic demand, interest rate risks, and disruption of trading activity in power markets. Valuation is based on sum-of-the-parts analysis.

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Buy	FSR is > 6% above the MRA.	49%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	26%
Sell	FSR is > 6% below the MRA.	14%	19%
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Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	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 31 March 2016.
1:Percentage of companies under coverage globally within the 12-month rating category.
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UBS Securities LLC: Julien Dumoulin-Smith; Michael Weinstein; Paul Zimbardo.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Dynegy, Inc.[4, 16]	DYN.N	Buy	N/A	US$16.60	03 May 2016

Source: UBS. All prices as of local market close.
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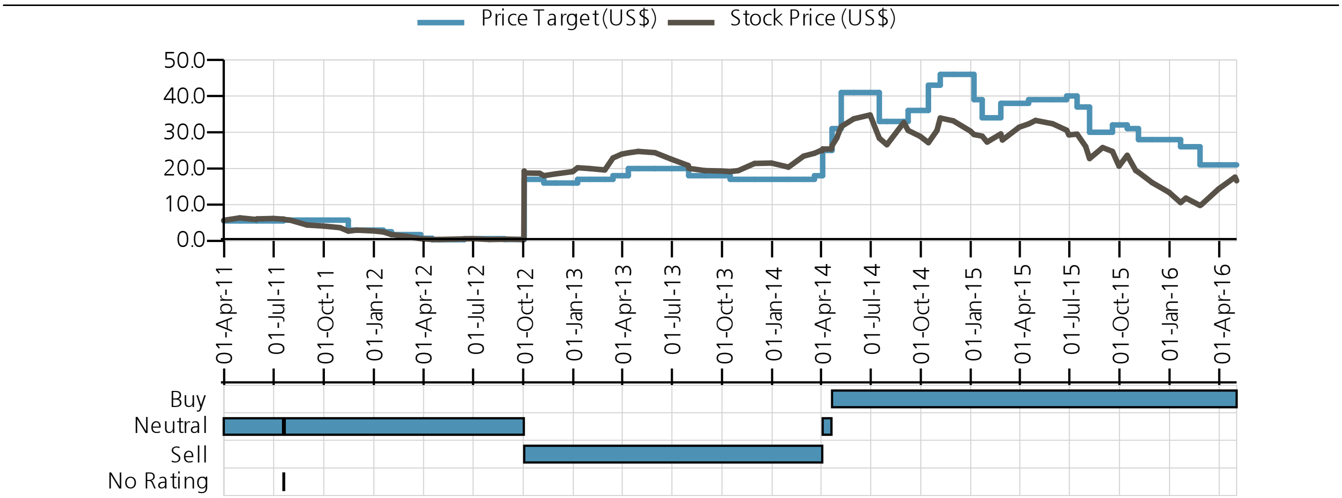
Dynegy, Inc. (US$)



Source: UBS; as of 03 May 2016

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