

Consolidated Edison

When Cash Flow and Earnings Don't Mix: Solar

ED provides critical insight into CF and net income profiles of renewable assets

Amidst substantial scrutiny of the scaling of the ED's investments in solar, mgmt provided a glimpse into the net income and cash flow projections for a hypothetical 100MWac renewable asset portfolio in its latest Conedison Development (CED) business update filing. ED indicates that CF returns are heavily weighted in the first 5 years before dropping significantly; while dependent upon tax appetite, we come out with a 14% levered IRR on the 20-yr contract period (~6% estimated unlevered IRR using 4% debt as a proxy for 45% debt capital structure), with corresponding \$0.10-0.18 EPS uplift through the period using a 55% equity layer (suggesting our ests. may be ~\$0.03-0.04 too high vs. this simplified renewables mini-model). We note the incremental EPS from investments has an initial 2.2% ROE, suggesting despite substantial capital spent, limited EPS. As such, the investments understate their uplift using the conventional P/E valuation methodology typically applied. We estimate a \$3/sh value to the Renewables biz using an NPV on existing assets or a projected P/E multiple on 2018e EPS from the business.

Heavy investment into renewables in 2016 and beyond delineated in 10k

ED provided guidance for 2016-2018 renewable investments, with \$900Mn expected to be deployed in 2016, and \$320Mn for 2017 and 2018 (largely placeholders now pending acquisitions). The key qn remains future tax appetite to absorb all projects.

But how big can ED scale its non-reg efforts? Appears capped out by PSC

Among the chief developments in the upcoming rate case will be discussion of imputed debt resulting from the scaling of non-utility investments. Given the current structure, we see this as a clear headwind to future scaling (not reflected in below tables); this is effectively a 'handicap' on economics as incremental leverage is treated as a headwind. That said, it appears there could yet be a wider deal struck on this point.

Valuation: Maintain PT and rating; focus on renewables enables mod

We rolled our valuation to 2018E following 4Q15 results, and we continue to use a P/E-based approach with a 5% discount. We attribute shares recent outperformance to a shift to defensive positioning in the utility sector; we maintain our bias that shares appear quite risky heading into a case with real authorized ROE risk.

Equities

Americas
Electric Utilities

12-month rating **Sell**

12m price target **US\$62.00**

Price **US\$71.57**

RIC: ED.N BBG: ED US

Trading data and key metrics

52-wk range	US\$73.61-57.21
Market cap.	US\$21.0bn
Shares o/s	294m (COM)
Free float	100%
Avg. daily volume ('000)	739
Avg. daily value (m)	US\$49.6
Common s/h equity (12/16E)	US\$13.8bn
P/BV (12/16E)	1.5x
Net debt / EBITDA (12/16E)	4.0x

EPS (UBS, diluted) (US\$)

	12/16E	
	UBS	Cons.
Q1E	1.27	1.26
Q2E	0.76	0.72
Q3E	1.39	1.51
Q4E	0.58	0.58
12/16E	4.00	4.04
12/17E	4.07	4.15
12/18E	4.19	4.29

Julien Dumoulin-Smith

Analyst
julien.dumoulin-smith@ubs.com
+1-212-713 9848

Michael Weinstein

Associate Analyst
michael.weinstein@ubs.com
+1-212-713 3182

Paul Zimbardo

Associate Analyst
paul.zimbardo@ubs.com
+1-212-713 1033

Highlights (US\$m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	12,354	12,919	12,554	11,883	11,992	12,107	12,372	12,617
EBIT (UBS)	2,244	2,188	2,427	2,467	2,513	2,616	2,738	2,842
Net earnings (UBS)	1,115	1,051	1,193	1,190	1,223	1,266	1,344	1,408
EPS (UBS, diluted) (US\$)	3.79	3.57	4.05	4.00	4.07	4.19	4.43	4.62
DPS (US\$)	2.46	2.52	2.60	2.62	2.64	2.66	2.68	2.70
Net (debt) / cash	(11,751)	(12,292)	(13,330)	(14,837)	(15,620)	(16,367)	(15,800)	(15,037)
Profitability/valuation	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
EBIT margin %	18.2	16.9	19.3	20.8	21.0	21.6	22.1	22.5
ROIC (EBIT) %	8.6	8.2	8.6	8.4	8.0	8.0	8.2	8.5
EV/EBITDA (core) x	9.5	9.5	9.5	10.0	9.6	9.1	8.8	8.4
P/E (UBS, diluted) x	15.3	16.1	15.6	17.9	17.6	17.1	16.2	15.5
Equity FCF (UBS) yield %	1.3	3.3	3.8	(0.7)	(0.2)	0.5	7.3	8.2
Net dividend yield %	4.3	4.4	4.1	3.7	3.7	3.7	3.7	3.8

Source: Company accounts, Thomson Reuters, UBS estimates. UBS adjusted EPS is stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement. Valuations: based on an average share price that year, (E): based on a share price of US\$71.57 on 24 Feb 2016 19:43 EST

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The Latest Cash Flow and Net Income Disclosures

As discussed, we break down the CED disclosures below, and run the analysis on both the 100MW provided, and the 748MW operating portfolio at the end of 2015. We assume that the portfolio is 55% equity (per mgmt guidance), and assume value for 20 years. For the 740MW FY15 portfolio, we apply the incremental spend (to derive the annual EPS value) as disclosed by ED in the presentation, and assume the same rate of investment to net income as initially disclosed (ie: yr 1: 2.4/110 Mn equity = 2.2% ROE). *Bottom line, despite limited earnings – and hence P/E benefits – the cash IRRs remain attractive as long as tax attributes can be readily absorbed. We emphasize both the NPV of existing assets and P/E on 2018e suggest ~\$3/sh in value for the portfolio.*

Figure 1: ED Renewable Portfolio Cash Flow Analysis

	Investment	1	2	3	4	5	6	10	15	20
100 MW (= \$200Mn Cost)										
Net Income \$Mn	-110	2.4	2.5	2.5	2.5	2.6	2.7	2.9	3.3	3.7
ROE (%)		2.2%	2.2%	2.3%	2.3%	2.4%	2.4%	2.6%	3.0%	3.4%
Cash Flow \$Mn	-110	98	12	8.0	5.5	5.5	2.9	0.8	0.7	0.5
Unlevering	-90	7	7	7	7	7	7	7	7	7
Cash Flow (unlevered),UBSe	-200	105	19	15	12	12	10	7	7	7
748 MW (Current Portfolio)										
Net Income \$Mn	-814	18	18	19	19	19	20	22	24	28
Cash Flow \$Mn	-814	725	89	59	41	41	22	6	5	3
CF NPV for 748 MWs			921.8							
Disc. Rate			7%							
Value Creation Per Share			3.07							
IRR (Levered, as disclosed)			14%							
IRR (Unlevered, estimated)			6%							
Net Income Contributions & Projections										
						UBSe				
		2015	2016	2017	2018	2019	2020			
Incremental Spend \$Mn			900	320	320	320	320			
Incremental Net Income \$Mn			11	4	4	4	4			
Total Net Income \$Mn		28	39	43	47	50	54			
Shares Outstanding Mn		294	296	301	302	302	302			
EPS Contribution		0.10	0.13	0.14	0.15	0.17	0.18			
Using Group P/E Multiple					16 x					
Value using P/E Approach					2.47					

Source: Company Filings, UBSe

Existing Portfolio summary

ED offered greater transparency into the operating fleet of renewable assets as well, with the list provided below: We use a simple scaling in our assumptions above, ignoring the smaller wind contribution (~133 MWs).

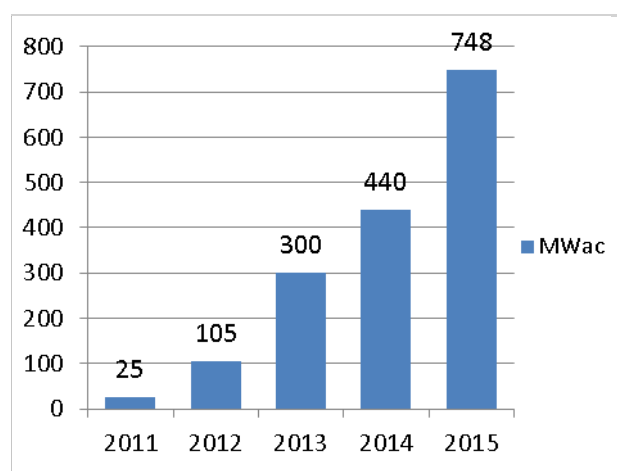
Figure 2: Coned Development Asset Summary

Name	Location	Technology	In-service Date	MWac
Wholly Owned				
Flemington	NJ	solar	2011	8
Frenchtown I,II,III	NJ	solar	2011-2013	14
PA Solar	PA	solar	2012	10
CA Solar 2	CA	solar	2014-2015	60
Oak Tree Wind	SD	wind	2014	20
Texas Solar 3	TX	solar	2015	6
Texas Solar 5	TX	solar	2015	95
Campbell County Wind	SD	wind	2015	95
Projects less than 5MW	various	solar	various	20
Total				328
Jointly Owned				
Pilesgrove	NJ	solar	2011	9
CA Solar	CA	solar	2012-2013	55
Mesquite Solar 1	AZ	solar	2013	83
Copper Mountain Solar 2	NV	solar	2013-2015	75
Copper Mountain Solar 3	NV	solar	2014-2015	128
Broken Bow II	NE	wind	2014	38
Texas Solar 4	TX	solar	2014	32
Total				420
Grand Total				748

Source: Company Filings

CED added over 300MW of operating assets in 2015, mainly solar. The company notes that at the end of 2014 they had the 6th largest fleet of solar assets in the US.

Figure 3: Coned Renewable Portfolio Over Time

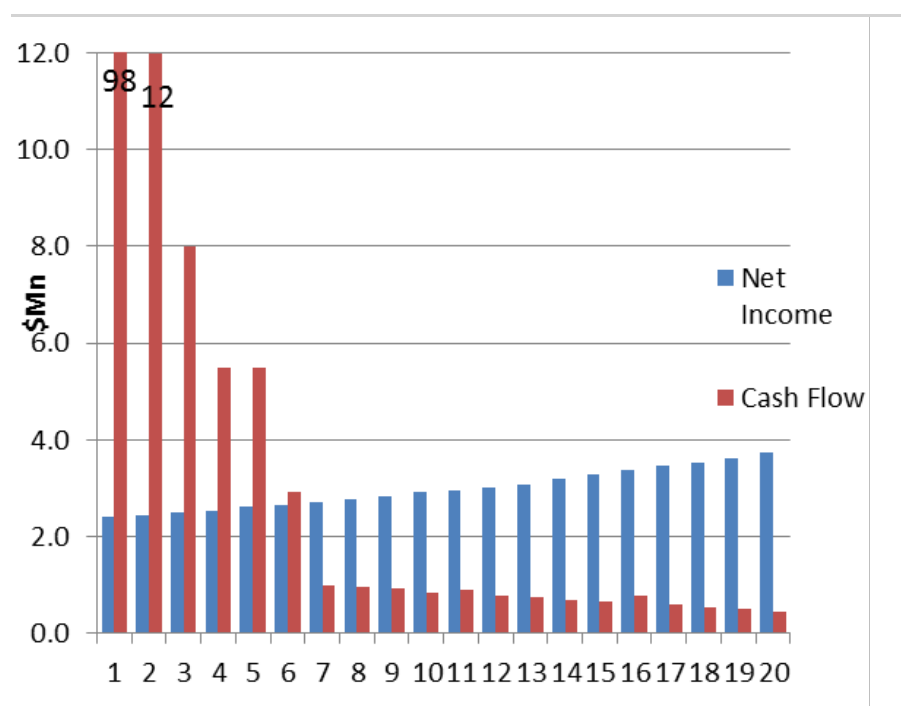


Source: Company Filings

Piecing together the cash flow disclosures

We provide the full CF and net income chart below from the slide deck. The value proposition is almost entirely front-end loaded.

Figure 4: ED Net Income and Cashflow Breakdown on 100MW (\$200Mn Cost)

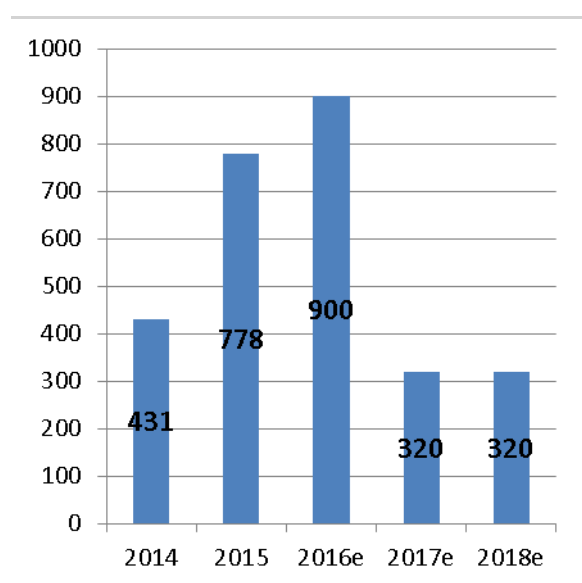


Source: Company Filings, UBS

Will these assumptions hold?

Additionally, ED provided guidance for further investments into CED, with 2016 looking to be a significant year.

Figure 5: CED Historic and Projected Investments



Source: Company Filings

Other Recent ConEd Notes

[2/19/2016: More Equity Please?](#)

[1/26/2016: 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](#)

[2/24/2015: ROE Risk Remains in Focus](#)

Consolidated Edison (ED.N)

	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
Income statement (US\$m)										
Revenues	12,354	12,919	12,554	11,883	-5.3	11,992	0.9	12,107	12,372	12,617
Gross profit	8,301	8,405	8,838	9,010	1.9	9,242	2.6	9,485	9,732	9,956
EBITDA (UBS)	3,269	3,259	3,557	3,729	4.8	3,872	3.8	4,062	4,239	4,398
Depreciation & amortization	(1,025)	(1,071)	(1,130)	(1,263)	11.7	(1,360)	7.7	(1,446)	(1,501)	(1,556)
EBIT (UBS)	2,244	2,188	2,427	2,467	1.6	2,513	1.9	2,616	2,738	2,842
Associates & investment income	14	41	24	24	0.0	24	0.0	24	24	24
Other non-operating income	0	0	0	0	-	0	-	0	0	0
Net interest	(720)	(592)	(653)	(660)	-1.0	(739)	-12.0	(778)	(786)	(765)
Exceptionals (incl goodwill)	0	0	0	0	-	0	-	0	0	0
Profit before tax	1,538	1,637	1,798	1,831	1.9	1,798	-1.8	1,862	1,976	2,101
Tax	(476)	(586)	(605)	(641)	-5.9	(575)	10.2	(596)	(632)	(693)
Profit after tax	1,062	1,051	1,193	1,190	-0.2	1,223	2.7	1,266	1,344	1,408
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	0	0	0	0	-	0	-	0	0	0
Extraordinary items	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	1,062	1,051	1,193	1,190	-0.2	1,223	2.7	1,266	1,344	1,408
Net earnings (UBS)	1,115	1,051	1,193	1,190	-0.2	1,223	2.7	1,266	1,344	1,408
Tax rate (%)	31.0	35.8	33.6	35.0	4.0	32.0	-8.6	32.0	32.0	33.0
Per share (US\$)										
EPS (UBS, diluted)	3.79	3.57	4.05	4.00	-1.4	4.07	1.7	4.19	4.43	4.62
EPS (local GAAP, diluted)	3.61	3.57	4.05	4.00	-1.4	4.07	1.7	4.19	4.43	4.62
EPS (UBS, basic)	3.79	3.57	4.05	4.00	-1.4	4.07	1.7	4.19	4.43	4.62
Net DPS (US\$)	2.46	2.52	2.60	2.62	0.8	2.64	0.8	2.66	2.68	2.70
Cash EPS (UBS, diluted) ¹	7.27	7.20	7.89	8.24	4.4	8.59	4.3	8.98	9.37	9.72
Book value per share	41.61	42.81	44.43	46.24	4.1	48.22	4.3	50.19	52.03	54.11
Average shares (diluted)	294.30	294.75	294.40	297.84	1.2	300.69	1.0	302.12	303.55	304.98
Balance sheet (US\$m)										
Cash and equivalents	674	699	944	206	-78.2	192	-6.6	114	300	682
Other current assets	3,217	3,155	2,892	2,724	-5.8	2,734	0.4	2,744	2,787	2,827
Total current assets	3,891	3,854	3,836	2,930	-23.6	2,926	-0.1	2,858	3,087	3,510
Net tangible fixed assets	27,795	29,326	31,133	32,808	5.4	34,518	5.2	36,132	36,416	36,645
Net intangible fixed assets	429	429	429	429	0.0	429	0.0	429	429	429
Investments / other assets	8,532	10,699	10,244	11,229	9.6	11,589	3.2	11,949	12,323	12,697
Total assets	40,647	44,308	45,642	47,396	3.8	49,462	4.4	51,368	52,255	53,281
Trade payables & other ST liabilities	2,794	2,421	2,452	2,103	-14.2	2,111	0.4	2,106	2,128	2,151
Short term debt	1,936	1,360	2,268	2,260	-0.35	2,260	0.00	2,260	2,260	2,260
Total current liabilities	4,730	3,781	4,720	4,363	-7.6	4,371	0.2	4,366	4,388	4,411
Long term debt	10,489	11,631	12,006	12,783	6.5	13,552	6.0	14,221	13,840	13,459
Other long term liabilities	13,183	16,311	15,855	16,479	3.9	17,039	3.4	17,619	18,234	18,909
Preferred shares	0	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	28,402	31,723	32,581	33,625	3.2	34,962	4.0	36,205	36,463	36,779
Common s/h equity	12,245	12,585	13,061	13,771	5.4	14,500	5.3	15,162	15,793	16,501
Minority interests	0	0	0	0	-	0	-	0	0	0
Total liabilities & equity	40,647	44,308	45,642	47,396	3.8	49,462	4.4	51,368	52,255	53,281
Cash flow (US\$m)										
Net income (before pref divs)	1,062	1,051	1,193	1,190	-0.2	1,223	2.7	1,266	1,344	1,408
Depreciation & amortization	1,025	1,071	1,130	1,263	11.7	1,360	7.7	1,446	1,501	1,556
Net change in working capital	498	2	278	(181)	-	(2)	98.8	(15)	(20)	(17)
Other operating	(32)	666	676	629	-7.0	565	-10.2	585	621	680
Operating cash flow	2,553	2,790	3,277	2,901	-11.5	3,145	8.4	3,281	3,445	3,626
Tangible capital expenditure	(2,339)	(2,239)	(2,562)	(3,053)	-19.2	(3,184)	-4.3	(3,175)	(1,900)	(1,900)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	0	0	0	0	-	0	-	0	0	0
Other investing	(320)	(520)	(1,095)	(875)	-	(250)	-	(250)	(264)	(264)
Investing cash flow	(2,659)	(2,759)	(3,657)	(3,928)	-7.4	(3,434)	12.6	(3,425)	(2,164)	(2,164)
Equity dividends paid	(721)	(739)	(733)	(780)	-6.5	(794)	-1.7	(804)	(814)	(799)
Share issues / (buybacks)	(8)	(10)	1	300	NM	300	0.0	200	100	100
Other financing	(6)	(17)	(19)	0	-	0	-	0	0	0
Change in debt & pref shares	1,122	719	1,376	769	-44.11	769	0.00	669	(381)	(381)
Financing cash flow	387	(47)	625	289	-53.8	275	-4.7	65	(1,095)	(1,080)
Cash flow inc/(dec) in cash	281	(16)	245	(738)	-	(13)	98.2	(78)	187	382
FX / non cash items	(1)	41	0	0	-	0	-	0	0	0
Balance sheet inc/(dec) in cash	280	25	245	(738)	-	(13)	98.2	(78)	187	382

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

Consolidated Edison (ED.N)

Valuation (x)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
P/E (local GAAP, diluted)	16.0	16.1	15.6	17.9	17.6	17.1	16.2	15.5
P/E (UBS, diluted)	15.3	16.1	15.6	17.9	17.6	17.1	16.2	15.5
P/CEPS	8.0	8.0	8.0	8.7	8.3	8.0	7.6	7.4
Equity FCF (UBS) yield %	1.3	3.3	3.8	(0.7)	(0.2)	0.5	7.3	8.2
Net dividend yield (%)	4.3	4.4	4.1	3.7	3.7	3.7	3.7	3.8
P/BV x	1.4	1.3	1.4	1.5	1.5	1.4	1.4	1.3
EV/revenues (core)	2.5	2.4	2.7	3.1	3.1	3.1	3.0	2.9
EV/EBITDA (core)	9.5	9.5	9.5	10.0	9.6	9.1	8.8	8.4
EV/EBIT (core)	13.9	14.1	14.0	15.1	14.8	14.2	13.6	13.1
EV/OpFCF (core)	12.6	12.6	12.3	12.7	12.1	11.4	10.8	10.3
EV/op. invested capital	1.2	1.2	1.2	1.3	1.2	1.1	1.1	1.1
Enterprise value (US\$m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Market cap.	17,029	16,864	18,577	21,042	21,042	21,042	21,042	21,042
Net debt (cash)	11,332	12,022	12,811	14,084	14,084	14,084	14,084	14,084
Buy out of minorities	0	0	0	0	0	0	0	0
Pension provisions/other	3,203	2,821	3,413	2,911	2,911	2,911	2,911	2,911
Total enterprise value	31,563	31,706	34,800	38,036	38,036	38,036	38,036	38,036
Non core assets	(461)	(816)	(884)	(884)	(884)	(884)	(884)	(884)
Core enterprise value	31,102	30,890	33,916	37,152	37,152	37,152	37,152	37,152
Growth (%)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenue	1.4	4.6	-2.8	-5.3	0.9	1.0	2.2	2.0
EBITDA (UBS)	-0.8	-0.3	9.1	4.8	3.8	4.9	4.4	3.7
EBIT (UBS)	-4.1	-2.5	10.9	1.6	1.9	4.1	4.7	3.8
EPS (UBS, diluted)	1.2	-5.9	13.6	-1.4	1.7	3.0	5.7	4.2
Net DPS	1.7	2.4	3.2	0.8	0.8	0.8	0.8	0.7
Margins & Profitability (%)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Gross profit margin	67.2	65.1	70.4	NM	NM	NM	NM	NM
EBITDA margin	26.5	25.2	28.3	31.4	32.3	33.5	34.3	34.9
EBIT margin	18.2	16.9	19.3	20.8	21.0	21.6	22.1	22.5
Net earnings (UBS) margin	9.0	8.1	9.5	10.0	10.2	10.5	10.9	11.2
ROIC (EBIT)	8.6	8.2	8.6	8.4	8.0	8.0	8.2	8.5
ROIC post tax	5.9	5.3	5.7	5.4	5.4	5.4	5.5	5.7
ROE (UBS)	9.2	8.5	9.3	8.9	8.7	8.5	8.7	8.7
Capital structure & Coverage (x)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Net debt / EBITDA	3.6	3.8	3.7	4.0	4.0	4.0	3.7	3.4
Net debt / total equity %	96.0	97.7	102.1	107.7	107.7	107.9	100.0	91.1
Net debt / (net debt + total equity) %	49.0	49.4	50.5	51.9	51.9	51.9	50.0	47.7
Net debt/EV %	37.8	39.8	39.3	39.9	42.0	44.1	42.5	40.5
Capex / depreciation %	NM	NM	NM	NM	NM	NM	126.6	122.1
Capex / revenue %	18.9	17.3	20.4	25.7	26.6	26.2	15.4	15.1
EBIT / net interest	3.1	3.7	3.7	3.7	3.4	3.4	3.5	3.7
Dividend cover (UBS)	1.5	1.4	1.6	1.5	1.5	1.6	1.7	1.7
Div. payout ratio (UBS) %	64.9	70.7	64.2	65.6	64.9	63.5	60.5	58.5
Revenues by division (US\$m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Others	12,354	12,919	12,554	11,883	11,992	12,107	12,372	12,617
Total	12,354	12,919	12,554	11,883	11,992	12,107	12,372	12,617
EBIT (UBS) by division (US\$m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Others	2,244	2,188	2,427	2,467	2,513	2,616	2,738	2,842
Total	2,244	2,188	2,427	2,467	2,513	2,616	2,738	2,842

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

Forecast returns

Forecast price appreciation	-13.4%
Forecast dividend yield	3.7%
Forecast stock return	-9.7%
Market return assumption	5.8%
Forecast excess return	-15.5%

Valuation Method and Risk Statement

Risks for Consolidated Edison (ED) include but are not limited to: (1) potential inability to deliver on its capital expenditure program; (2) unfavorable commodity movements; (3) adverse political/legal/regulatory actions; (4) decline in the demand for new wind and solar projects; (5) unfavorable weather and natural resources yield [sun radiance and wind generation]; (6) operational and construction risk; (7) inability to access the capital markets on attractive terms; (9) inability to re-contract assets after contract expiration; (10) declines in customer demand and population; (11) failure to close pending or prospective M&A transactions; (12) natural disasters; (13) losses at the retail marketing segment; (15) change in macroeconomics; and (16) other unforeseen changes.

Valuation is based on a forward P/E methodology.

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12-Month Rating	Definition	Coverage ¹	IB Services ²
Buy	FSR is > 6% above the MRA.	48%	36%
Neutral	FSR is between -6% and 6% of the MRA.	39%	28%
Sell	FSR is > 6% below the MRA.	12%	22%
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.	<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 December 2015.

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Consolidated Edison ^{2, 4, 5, 6, 16}	ED.N	Sell	N/A	US\$71.57	24 Feb 2016

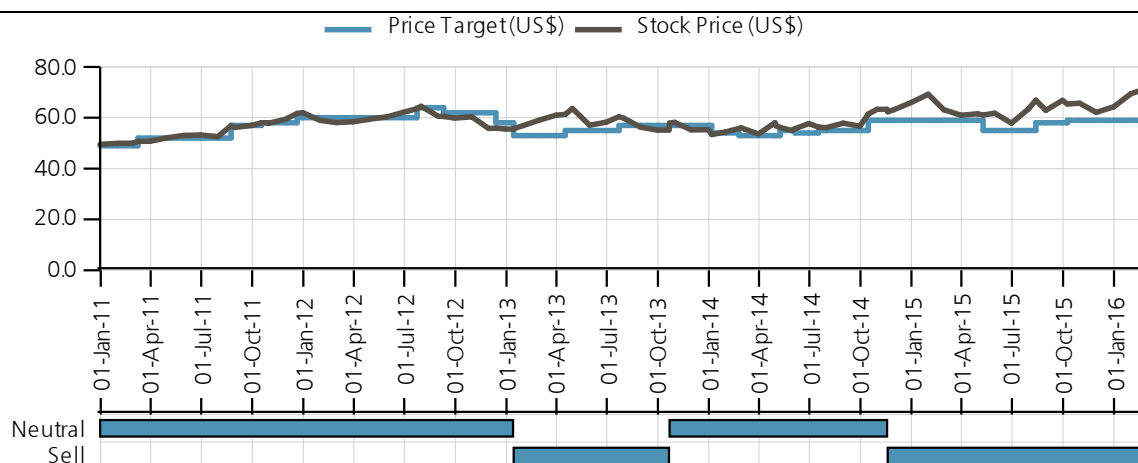
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Consolidated Edison (US\$)



Source: UBS; as of 24 Feb 2016

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