Southern Company
Still Struggling

Equities

Americas
Electric Utilities

12-month rating	**Sell**
12m price target	**US$47.00**
	Prior: US$43.00
Price	**US$49.46**

RIC: SO.N **BBG:** SO US

Trading data and key metrics

52-wk range	US$52.79-40.82
Market cap.	US$44.3bn
Shares o/s	896m (COM)
Free float	99%
Avg. daily volume ('000)	1,496
Avg. daily value (m)	US$73.5
Common s/h equity (12/14E)	US$21.0bn
P/BV (12/14E)	2.1x
Net debt / EBITDA (12/14E)	3.7x

EPS (UBS, diluted) (US$)

	12/14E			
	From	To	% ch	Cons.
Q1	0.66	0.66	0.00	0.66
Q2	0.68	0.68	0.00	0.68
Q3	1.09	1.09	0.00	1.09
Q4E	0.38	0.37	-1.09	0.38
12/14E	2.80	2.80	-0.28	2.80
12/15E	2.86	2.82	-1.41	2.87
12/16E	2.96	2.92	-1.41	2.97

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Another Kemper writedown and now Vogtle delays plaguing management

With another $45M cost increase for the $5B Kemper IGCC project (recovery capped at $2.88B) and the recent notification from the Vogtle consortium of up to 18-month delays for nuclear construction that could cost ~$0.5B ($720 Mn net of $240 Mn liquidated damages), we see SO as a bearer of significant risk. Settlement negotiations in Mississippi continue while Vogtle's issues are poised to become the subject of wider litigation between owners (including SO) and the Westinghouse/CBI consortium.

Guidance for 2015 reduced a ~nickel largely due to stock option dilution

SO reduced guidance for 2015 by -$0.04 to $2.76-$2.88 after issuing $200M more equity than expected in late 2014 as a result of a high stock price and employee exercise of options. Management maintained its 3%-4% long-term EPS growth rate, but now based off the diluted 2015 guidance. We've reduced our 2015 est from $2.86 to $2.82 (at the midpoint) and our estimates through 2018 reflect a 3.5% growth rate going forward. Further, we see a ~nickel earnings cliff at Southern Power in 2017 from a reduction in the solar ITC, as it is currently recognized in the year placed in-service. Mgmt's 1.3% sales growth projection for 2015 is notably more optimistic on residential and commercial growth, which has been flat in recent years.

Further expansion into solar, gas pipelines appear on the way

The rolling 3-year capex budget for unregulated affiliate Southern Power was increased by $1.7B (including $1.9B of placeholder expansion budget) from 2015-2017. The company plans to expand further into solar and perhaps wind and other types of projects as well (such as gas pipelines). Specifically, we would expect SO to follow NEE's lead in pursuing solar in FL (yet to own any). Mgmt emphasized SO's investment in new pipelines may take place at the utilities rather than independent; we suspect as carbon details are finalized, SO will delineate details in '15 to enable greater coal to gas switching required under these rules for the southeast (partnering with D?).

Valuation: PT Up $4 to $47 on higher multiples, Maintain Sell/cautious stance

Our valuation remains based on a 2016E utilities SOTP. The average 2016 utility P/E multiple has increased from 15.7x to 17.3x since our last report.

Highlights (US$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenues	17,657	16,537	17,087	18,460	18,747	19,107	19,513	19,943
EBIT (UBS)	4,344	4,589	4,552	4,885	4,978	5,126	5,326	5,550
Net earnings (UBS)	2,203	2,331	2,377	2,510	2,574	2,665	2,752	2,864
EPS (UBS, diluted) (US$)	2.55	2.65	2.71	2.80	2.82	2.92	3.01	3.13
DPS (US$)	1.87	1.94	2.01	2.08	2.15	2.22	2.29	2.36
Net (debt) / cash	(19,908)	(21,806)	(22,636)	(25,821)	(27,453)	(28,692)	(29,220)	(29,637)

Profitability/valuation	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
EBIT margin %	24.6	27.7	26.6	26.5	26.6	26.8	27.3	27.8
ROIC (EBIT) %	13.4	13.5	12.7	12.6	11.8	11.5	11.6	11.8
EV/EBITDA (core) x	9.4	9.9	9.7	10.1	10.2	9.1	8.9	8.5
P/E (UBS, diluted) x	15.9	17.1	16.1	17.7	17.5	17.0	16.4	15.8
Equity FCF (UBS) yield %	3.1	(0.7)	0.6	(5.4)	(0.2)	1.3	3.1	3.5
Net dividend yield %	4.6	4.3	4.6	4.2	4.4	4.5	4.6	4.8

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$49.46 on 04 Feb 2015 18:42 EST

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Investment Thesis

Southern Company

12-month rating **Sell**

12m price target **US$47.00**

Investment case

We remain modestly concerned over its Vogtle construction monitoring filings given the potential for upward revisions in new cost estimates. The Kemper County IGCC faced a plethora of delays and write-downs in 2013/4 and we believe there is a possibility for further project slippage and the use of the remaining contingency. We believe shares will continue to remain weak with its suggestion of downside below its long-term 4-6% EPS growth outlook in the back-half of the decade.

Upside scenario

Favorable regulatory outcomes in upcoming proceedings and the continued economic recovery of SO's service area should have positive impacts and drive shares to $52.

Downside scenario

We remain concerned about the Kemper project's schedule, as well as associated funding costs of a project timeline delay (estimated at ~$25 M/month), with additional costs over the ~$2.9bn cap not recoverable. Possible 18-month delays and issues at Vogtle (estimated at ~$40M/month), increased general O&M, and a slower economic recovery could push shares down. Downside case of $42 would involve continued delays for both Kemper and Vogtle projects along with associated unrecoverable spend/dilution.

Upcoming catalysts

1H16	In-service for Kemper (Delayed from YE14)
2Q19	In-service for Vogtle Unit-3 (possible 18-mo delay)
2Q20	In-service for Vogtle Unit-4 (possible 18-mo delay)

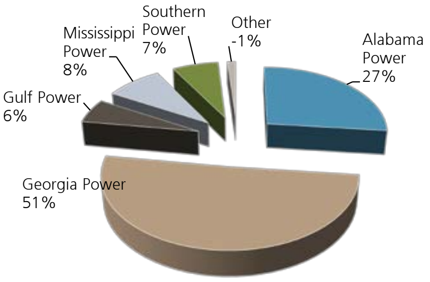
Business description

Atlanta-based Southern Company (SO) is one of the largest electricity generators in the nation, serving both regulated and competitive markets across the southeastern US. It owns more than 42,000 megawatts of electric generation. It serves over 4.4 million customers in Georgia, Alabama, and portions of Mississippi and Florida through four electric utilities. Southern Power, SO's competitive generation company, owns more than 7,700MW of generation. Other major subsidiaries include Southern Nuclear, SouthernLinc wireless, and Southern Telecom, a fiber-optic wholesaler in the Southeast.

Industry outlook

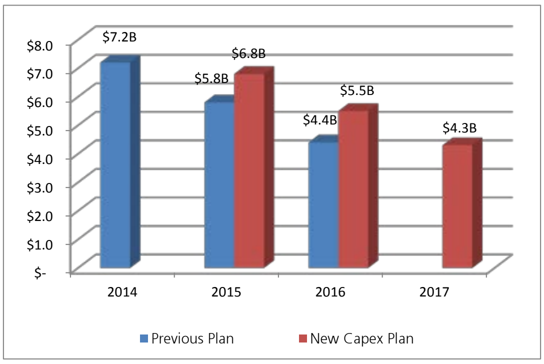
The electric utility industry is projected to experience weak or negative electric demand growth in coming years as a tepid economy and energy efficiency dampen demand. In the unregulated merchant power space, we see limited potential for a meaningful recovery from currently low power prices due to limited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

2015 EPS by Subsidiary (%)



Source: Company Filings and UBS Estimates

Capex by Year ($Mn)



Source: Company Filings and UBS Estimates

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The Power Line on SO

Our cautious view on SO prevails given continued writedowns at Kemper and the potential for as much as $0.5B of additional utility costs and major delays for Vogtle. While the company has reiterated its avoidance of secondary equity from 2015-2017, the rolled-forward capex plan is $800M higher but earnings are still expected to grow only 3%-4% through the same period, driven in part by ITC step-down beyond 2016 and declining capex spend. While clear '15 into '16 will be readily achievable, growth into '17 is the most relevant, albeit still above the 3% bottom end of its growth target.

We see the company on the precipice of entering a significantly more risky stage in the construction of its Vogtle nuclear plant, with concerns around whether the consortium will be successful in passing off any cost increases to SO, as well as if the GA PUC will continue to allow rate increases (its next VCM12 to be filed on Feb 27th should be closely watched). While delays up until now have been palatable (and actually an increase projected growth via added ratebase), the latest substantial slide in the schedule should shift focus away Kemper cost hikes driving recent inflation towards defining the maximum threshold for increases in GA will be. That said, even under the current delays, GA Power's rates would increase near the middle of its 6-8% range, rather than the 12% originally promised to the commission, suggesting further latitude.

While concerns have lingered around the financial commitment of its consortium sponsors, mgmt reiterated that Toshiba, the parent company to Westinghouse, had offered construction guarantees to both Westinghouse and Stone & Webster (CBI subsidiary) for project completion. With the broader question around further new nuclear development of AP1000's globally, the question remains to what extent Toshiba (via Westinghouse) will want to support the current build.

Southern Power is now sporting a major increase in capital spending plans, with the 2015-2017 outlook up to $3.1B (including a $1.9B growth placeholder) vs $1.4B that had been planned through 2016. That said, with limited EPS contributions from projects aside initial year, we don't expect a significant revision to long-term EPS trajectory (4-6%) associated with this update. Rather, this could yet bolster near-year EPS with immediate ITC benefits.

Our PT comes up $4 to $47 for a higher peer multiple, while we continue to apply a 7% discount to the average utility P/E. Economic conditions in SO's territory continue to improve slowly, clearly led by industrial optimism and strong sales while commercial and residential sales remain sluggish on lackluster income growth. Management's sales forecast for 2015 is notably more optimistic on residential and commercial sales.

Among all the large-cap utilities, we see the greatest risk to SO's current outlook, with downside predicated not just on further equity dilution but potential further disallowances (albeit modest) from the MS PSC on prudency (likely part of any forthcoming universal settlement). With Vogtle's scheduling and cost dispute ramping up to new levels, we see our discount to the average P/E as readily justified.

For additional context, please refer links to relevant recent reports below:
10/31/14 Pushing It Out Again

[8/1/14 Navigating the Uncertainty](#)
[5/5/14 Kemper Tantrums](#)

Updated EPS Estimates – A Bit Lighter

We have refined our earnings estimates to reflect the additional $200M equity in 2014 and the ITC earnings cliff in 2017 at Southern Power. We remain near the midpoint of revised guidance for 2015E. *Our revised estimates imply a 3-year earnings CAGR below the 3-4% contemplated long-term rate.*

Figure 1: UBS Estimates for SO 2014E-2018E – pushing down outlook

SO EPS Estimates	2014A	2015E	2016E	2017E	2018E
Alabama Power	$0.85	$0.82	$0.80	$0.84	$0.88
Georgia Power	$1.37	$1.47	$1.52	$1.58	$1.61
Gulf Power	$0.16	$0.17	$0.17	$0.18	$0.19
Mississippi Power	$0.25	$0.24	$0.26	$0.27	$0.29
Southern Power	$0.19	$0.20	$0.21	$0.17	$0.19
Other	($0.01)	($0.08)	($0.04)	($0.03)	($0.03)
SO, UBS Estimates	**$2.80**	**$2.82**	**$2.92**	**$3.01**	**$3.13**
		0.8%	**3.5%**	**3.3%**	**4.1%**
Guidance Range	2.72-2.80	2.76-2.88			
3-year EPS CAGR ('14-'17)		2.5%			
Long Term EPS CAGR Guidance		3-4%			
Prior UBSe	*$2.80*	*$2.86*	*$2.96*	*$3.09*	
Street Consensus	*$2.80*	*$2.87*	*$2.96*	*$3.07*	

Source: UBS estimates, Company filings, FactSet

Continued writedowns for Kemper

SO announced another $45M estimated cost increase for the Kemper IGCC project for operational readiness, start-up activities and fuel, and the completion of construction in its monthly project update to the MS PSC. While this increase was expected, it is toward the upper end of the $20M-$50M range that had been projected in the November regulatory status report. As a result, the company took a total $70M pretax ($43M after tax) charge to income in 4Q14, bringing the total charges to date to $2.05B pretax ($1.26B after tax). The total project cost is now estimated to be $4.93B but remains capped at $2.88B for regulatory recovery (net of $245M DOE grants and exceptions). The plant is expected to be online in 1H16. We note that for Kemper to qualify for Phase 2 investment tax credits, the plant must be in service by April 2016 and demonstrate 65% carbon capture for all the syngas that is produced.

This latest increase follows $25Mn on Jan 2 and $418Mn of cost increases last quarter. <u>We continue to be concerned about the potential for further write-downs due to delays in major milestones, flagging associated funding costs at ~$20-30 Mn/month (additional costs over the ~$2.9bn cap are not recoverable)</u>.

The only key milestone through February identified in the latest report was the back blow of the steam system scheduled for December, indicating that few concrete construction datapoints are likely in the next couple of months (gasifier air flow testing and first fire are up next). The focus now turns to the pre-commercial operations category where there is still in excess of $200Mn in spending scheduled (50% remaining).

With 3Q14 results CEO Tom Fanning explained that the Kemper management team is adopting a more methodical approach toward operations, design, work, and training at the site. A major reason for the recent delays is to increase focus on training, with a large portion of the plant's personnel cycling through other areas of the plant rather than just their own responsibilities in an effort to improve integration throughout the complex facility.

SO also believes that while the quality of work on the plant is outstanding, the approach toward forecasting and scheduling needs improvement.

Following a period of downplaying the potential for a global settlement in MS (including its first half construction phase), mgmt once more raised prospects for such a deal on its latest call, seemingly despite construction completion in 1H16.

But what about the 'global settlement' – still on drawing board

Conversations ongoing on settlement with MS PSC

We continue to await developments from Southern Company and the Mississippi PSC on a universal settlement to potentially address prudency of initial period spending through the period ending March 2013. While management has discussed this for several quarters, developments had been slow to materialize given the dynamic situation around the plant beyond (R&D tax issues, bonus depreciation). This could yet result in a negative revision to the agreed upon cap of ~$2.88Bn as prudency for the first period is addressed, although this would also remove uncertainty. Prudency for the second half of construction would presumably only be addressed once the unit was in-service.

Westinghouse/CB&I Consortium notifies Southern Company of significant nuclear delays

Even assuming 18 months of delays and $720M of extra costs (minus $240M of liquated damages), management estimates that rate increases would easily remain near the midpoint of 6%-8% vs the originally contemplated 12%.

While not accepted by SO as a finalized and guaranteed schedule, the construction consortium for Plant Vogtle Units 3 & 4 notified Georgia Power last week of its "revised forecast" for completion, with an 18-month delay to 2Q19 for Unit 3 and 2Q20 for Unit 4. SO specifically states that it has not yet agreed to any changes to the guaranteed substantial completion dates and that it believes that further effort may be possible to mitigate these delays to some extent.

Under SO's engineering, procurement and construction (EPC) agreement, the project is largely fixed costs, with the Consortium bearing its own incremental costs for any delays. However, as the owner, SO is still responsible for the cost of its own oversight employees as well as insurance, property taxes, compliance, and other "owner's costs." <u>These are estimated to be about $10M/month in incremental capital and $30M/month for incremental financing expense (a potential total of $720M over the 18 months)</u>. For comparison, the total forecasted construction and capital costs for Georgia Power as reported to regulators for November is $6,759M (including $2B of CWIP financing cost in ratebase and $582M of escalation), so delay costs potentially add 11% to the burden on ratepayers in the state. <u>We also note that $720M is equivalent to ~$0.40/sh after tax (discounted) or roughly 80 bps of market capitalization.</u>

SO is currently in litigation proceedings with the Consortium over previous claims and under the terms of the EPC agreement, SO believes that it would be <u>entitled to recover about $240M of liquidated damages</u> for the cumulative delays beyond the currently guaranteed substantial completion dates of April 2016 (Unit 3) and April 2017 (Unit 4). <u>Seeing the project as ~3-years delayed, we estimate the liquidated damages as being ~$80 Mn/yr or ~$7 Mn/mo</u>. The finalization of schedule, delays, and bearing of costs remains under negotiation and litigation and SO plans to provide an update in the Feb 27th semi-annual construction monitoring report (VCM 12) filed with the Georgia Public Service Commission. The question

remains whether SO will be able to recoup the latest cost increases – or whether they will begin suffering from inability to pass along further overruns, as has been the case with its Kemper example in MS. We emphasize the greatest risks around the project are still likely much later in the process once the plant begins its ITAAC process to put the plant into service, much as Kemper and Duke's own IGCC suffered in-service issues.

Even assuming 18 months of delays and $720M of extra costs (minus $240M of liquated damages), management estimates that rate increases would easily remain near the midpoint of 6%-8% vs the originally contemplated 12%. The offset of late remains the mild interest environment, into which the company continues to borrow substantially below budgeted rates.

Separately, we also await a new schedule for SCANA's VC Summer project from the same Consortium. At the EEI conference in November, management suggested that negotiations with the VC Summer nuclear construction consortium would likely go into 1Q15. SCG would like to avoid litigation and says that so far discussions with the Consortium have been productive. Recall that on Oct 2, the consortium provided a preliminary cost estimate related to delays as it continues the process of re-baselining the Unit 2 and Unit 3 construction schedules. The estimate pertains only to the contract's non-fixed/non-firm portion (roughly 1/3 of the total), with the fixed portion (2/3rds of the total) borne by the consortium and thus unchanged as far as owners SCE&G and Santee Cooper are concerned. SCE&G's 55% portion of this preliminary estimate is approximately $660M for extra non-fixed costs borne by the consortium under the contract. This estimate does not include escalation from 2007 dollars, although we note that as of the Nov 10th 2014 BLRA report, the project was still forecast to come in $516M under the 2009 budget due to improved escalation factors (i.e., inflation continues to be lower than originally expected). Importantly, both owners SCE&G and Santee Cooper accept neither the preliminary revised schedule nor the extra cost impact from the delay, with both now subject to negotiation before SCE&G makes a special BLRA filing for recoupment, if any.

Hearings for VCM 11 took place on December 16th; vote on Feb 19th

The PSC is scheduled to vote on February 19th for the approval of VCM 11 costs. It is important to note that when a six-month VCM is approved, the Commission is approving actual costs to date, placing the burden of proof for imprudence on past expenditures on Staff and other adversaries. **Typically after the hearings Southern and the Staff file rebuttal testimony but management did not file any for this report and is expecting a timely favorable vote on VCM 11**. As a reminder, the 10th Vogtle Construction Monitoring report (VCM) was approved on Aug 19th in a 5-0 vote. Docket # 29849

Southern Power: Solar competition reducing margins but raising capex

Capex increases expected for both SO Power and GA Power (as mentioned above) with 4Q results in Feb

Discussing Southern Power's solar development/acquisition goals, management has noted that margins for solar projects are becoming significantly tighter for new PPAs in an increasingly competitive market. With a new $3.1B 3-year capital plan in place through 2017, the question remains whether mgmt will continue to find palatable new investments to fill its placeholder despite the higher competition.

- Look for a focus outside of the southeast for them on the next solar deals

- Mgmt was optimistic on continuing to find solar delays beyond 2016 step down of the ITC to 10%.
- Question is whether SO can follow NEE in Florida in pursuing new investment in solar within its Gulf Power subsidiary to meet future load at attractive price. Thus far, they have simply contracted with other parties in FL, specifically for deals at DoD sites.
- Still not positive on YieldCo angle: Management reiterated it saw this as a show term trend as long as renewables did not benefit from a permanent tax structure upside (ie – MLP or REIT).
- We wouldn't count out SO as an eventual seller to YieldCo's: While management emphasized they viewed assets within the SO Power subsidiary as contributing positive cash flow (and through the prism of 'Economic Value Add' or EVA) – given the limited EPS and cash flow profiles of these assets beyond their initial 5-year tax period, we wouldn't be surprised if the company opts to sell or offer these assets to a YieldCo.

SolarGen project a solid win – now online

Southern Power most recently announced the acquisition of 150-MW SolarGen 2 from First Solar for $508M on Oct 23rd. The project went online in December and is selling output to SDG&E under a 25-year PPA after coming on-line before year-end 2014. First Solar will remain the operator of the site. This announcement follows close on the heels of Southern Power's winning bid for 100 MW of solar projects in the Georgia Power RFP.

SO Power wins ~100 MW from GA Power – drives another ITC benefit in 2015

Expect another +$0.02 ITC benefit from the Decatur project in 2015 for Southern Power

For the RFP, Georgia Power announced the winners of its 70-MW Advanced Solar Initiative (ASI) and 425-MW utility-scale ASI Prime RFPs on Oct 14. ASI Prime was upsized a bit to 438.67 MW to ensure a best-cost portfolio was selected and all PPA's will still require Georgia PSC approval, probably by year-end. Ten projects (6 utility-scale ASI Prime and 4 ASI) were selected from 5,100 MW of bids through 142 unique proposals and 56 different bidders. The winners include The Decatur County and the Decatur Parkway Solar Projects, totalling about 100 MW that will exercise their rights under their PPAs to sell their projects to Southern Power.

Despite the heavy redaction of competitive information in regulatory filings, it was also disclosed that the four smaller ASI projects were procured at an average cost of less than $0.065/kWh, which is $0.02 below the cost achieved in the 2013 RFP. It might be reasonable to conclude that the larger utility-scale contracts priced even lower, as some media speculation would suggest. The ASI Prime projects are expected to come on-line in two buckets; 210 MW by the end of 2015 and the remaining 229 MW by the end of 2016.

What's the long-term trajectory for SO Power?

An ITC earnings cliff of about -$0.04 in 2017

Management sees Southern Power continuing to contribute ~$160-170 Mn in net income in the medium term, ramping to ~$200 Mn by late in the decade, although specific projects were not specified; we suspect 2017 sees a step down to the $160-170 Mn range as ITC step-down. We emphasize that the earnings profile of solar projects is particularly low, seeing much of the economics of such projects extracted in the immediate year through extraction of ITC benefits. With the expected reduction in ITC benefits in 2017 from 30% down to 10%, we

expect the impact on net income to be a reduction of about 2/3 of the $40M-$50M one-time tax benefit (about -$0.04 to -$0.05 within our revised estimates).

But what's the Net Income contribution of solar projects? Not much

Value of solar is in the ITC benefit upfront, with limited ongoing EPS

We caution while solar investments provide immediate EPS benefits in the current year in which completed, we see very limited EPS contributions in subsequent years. As such, we see much of the ongoing solar efforts as having a limited effect on our long-term EPS trajectory. We note the greater willingness across the sector to develop solar projects in utilities with taxable income, but valued on a P/E as a nascent trend elsewhere. The key further question remains how companies like Southern, Dominion, and Duke can compete for projects again YieldCo's as well.

Going Midstream?

Following large-cap peers in the Southeast, it appear SO is poised to announce a midstream effort following D, DUK, and NEE's efforts. It appears this could be structured under its existing utilities, a different approach than peers. With the region set to see a significant shift towards gas in coming years, we look for the company to be an offtake on incremental pipelines from the Marcellus region into its territory. This could include an extension from D/Duke's proposed Atlantic Coast pipeline into GA.

Industrial sales lead SE economic improvement

SO reported 4Q14 adj EPS of $0.38 ex-Kemper, compared to UBSe and street both at $0.38; FY14 adj EPS $2.80 vs UBSe and consensus at $2.80. Management characterized economic growth in 2H14 as "especially strong", led by manufacturing and exports. Excluding the effects of weather and last year's polar vortex, retail industrial sales led the way +3.3% for FY14 YoY, while residential was flat and commercial sales contracted slightly -0.4%. For 2015, management's sales forecast assumes some "catchup" in residential and commercial sales growth, with 1.0% and 1.4% growth, respectively, while industrial sales are expected to improve a more tempered 1.7%. We note that economic activity in SO's territory is driven by a combination of domestic consumption (70%) and export-driven manufacturing (30%). While the strong dollar has had some negative impact on exports, this is expected to be offset by stronger consumer activity as a result of lower energy prices and less expensive imports. On the commercial side, SO largest customers include big-box retailers and other large suburban office users, with vacancy rates still a comparatively high 18% currently vs pre-recession levels of 10%-11% (management expects to see a noticeable impact once below 15%).

Figure 2: Year-over-Year Weather Adj KWhs, 2014A vs 2015 Guidance

Year-over-Year Weather Adj KWhs	1Q14	2Q14	3Q14	4Q14	2014A	2015E
Residential	1.2%	-0.6%	-0.3%	-0.2%	0.0%	1.0%
Commercial	-0.2%	0.0%	-1.1%	-0.3%	-0.4%	1.4%
Industrial	2.8%	3.0%	4.8%	2.3%	3.3%	1.7%
Total Retail	1.3%	0.9%	1.0%	0.6%	0.9%	1.3%

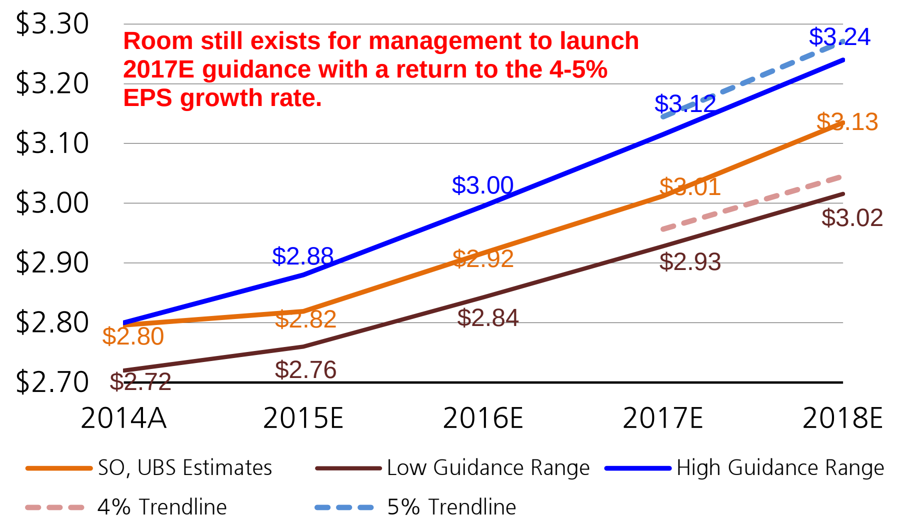
Source: Company filings

2015 Guidance a nickel low on higher dilution; 3%-4% growth in-tact

Still possible for acceleration in 2017.

We've reduced our 2015E EPS estimate from $2.86 to $2.82 (consensus $2.87) for higher dilution from shares issued under compensation plan option exercises during the strong rise in utility stock prices in 4Q. We remain at the midpoint of 2015 guidance that was also reduced -$0.04 to $2.76-$2.88. The company reiterated its expectation for 3%-4% long-term EPS growth off the new 2015 guidance, which we've charted below. As we further illustrate in the chart, there is adequate room to increase the projected growth rate to 4%-5% in 2017, despite our expectation for a -$0.04 cliff at Southern Power once the solar investment tax credit (ITC) is reduced from 30% to 10%. Aside from the visible rate relief in 2015, we also expect continued increases in O&M, albeit it at a slower rate given that 2014 was a 'catch-up' year.

Figure 3: Updated Southern EPS Estimates Relative To Guidance Expectations

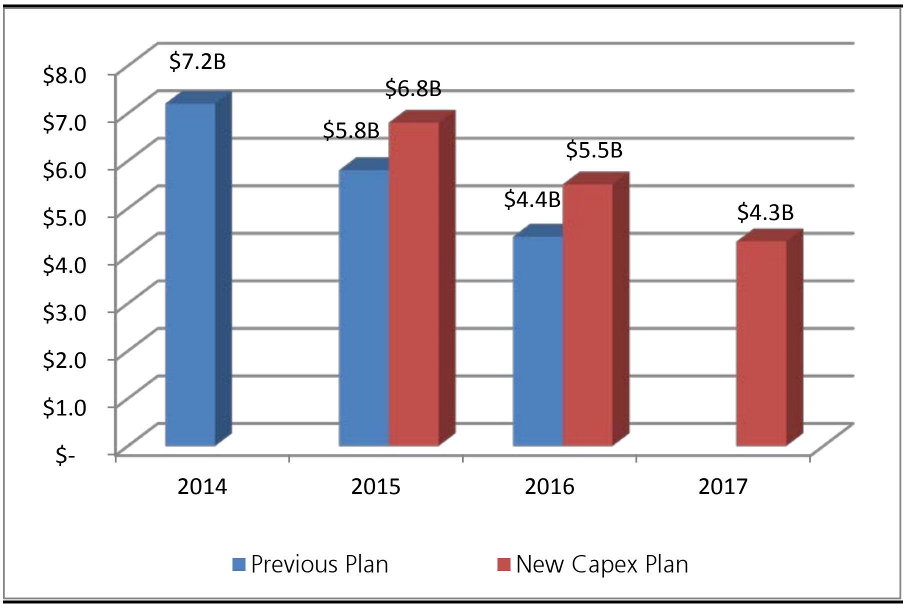


Source: Company Filings and UBS Estimates

Higher profile for Southern Power in extended capital plan

SO released a $16.6B capex plan from 2015-17, which includes $1.2B of base spending at Southern Power and another $1.9B placeholder for expansion there. The overall three-year plan is $800M lower than the previous 2014-2016 plan and remains backwardated.

Figure 4: Capex Plan, 2015-2017 vs Previous 2014-2016



Source: Company filings

No additional equity needed through 2017

Management has emphasized that their capital plan already envisioned some built-in contingency for additional Kemper costs and that no additional equity would be required in light of the recent announcements. Considering the Kemper and Vogtle are expected to throw off significant cash flow upon completion, <u>the company is inclined to ride out the interim charges with short-term debt funding</u>. However, a significant increase in Southern Power's investment budget could require an incremental equity boost.

There is no change to the plan to issue no new equity in 2015 or 2016 at this time, although a significant increase in Southern Power's investment budget could require an incremental equity boost.

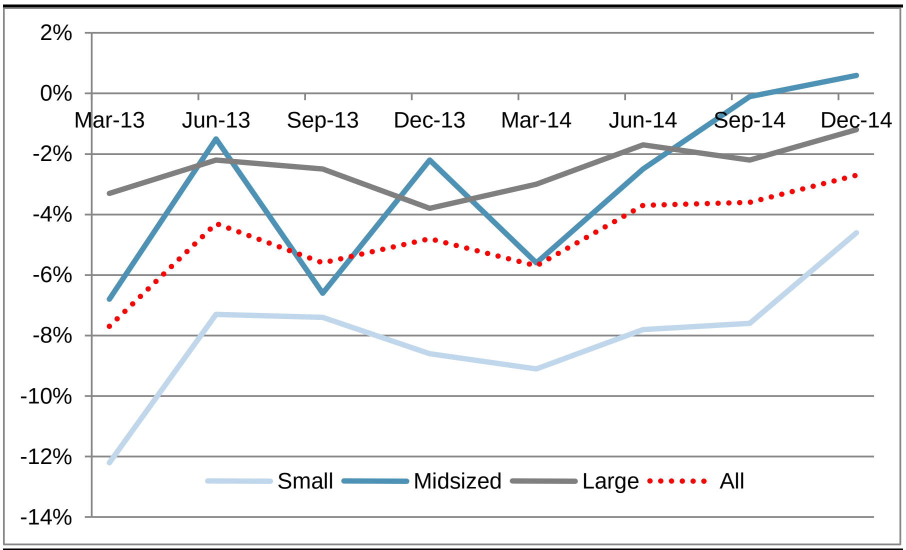
With SO's stock price rising in 4Q, the company issued $800M of equity through employee stock option exercises, which was $200M more than expected. The company also had additional bonus depreciation that had not been expected in 4Q.

Local economy continues to strengthen: export risk grows but offset is lower oil prices & lower import prices

SO's economic roundtable expects regional GDP growth of 3% in 2015 (unchanged from 2H14 expectations), which directly benefits the utility with residential hook-ups increasing. <u>Residential load continues to lag from weak usage due to lackluster income growth and an uptick in lower-usage multi-family housing</u>; however, industrial sales growth remains strong. Segments with the strongest growth include primary metals (10.3%), transportation (6.7%) housing-related segments of stone, clay, and glass (5.2%), and lumber (6%).

Industrial sales and residential customer growth on SE economic improvement

Figure 5: Atlanta Fed Survey of Sales Above/Below "Normal"



Source: Atlanta Federal Reserve

On the topic of local economic growth, SO believes that in the current global accommodative monetary environment, the US Fed is constrained from tightening by the likely negative effect on exports. In recent years, exports have become an increasingly important driver of the US economy due to low US cost of capital, energy prices, and even an increasingly competitive labor market. SO's territory is sensitive to exports with 25% of regional economic activity tied here (i.e., through Savannah). While the trends above are positive, there does remain a risk that exports could decline given the strength of the dollar relative to other currencies. An offsetting factor would be the lower oil prices which should increase disposable income for consumers, providing leeway for increased spending on energy.

Long-Term View of Future

EPA 111D could drive new opportunities…but need to wait to see

At our EEI meeting with management the company highlighted its view of the post-election political landscape and the future potential for "dramatic change" in the company's capex profile primarily as a result of potential EPA 111D outcomes and follow-on State Implementation Plans (SIP) Generally the rule as written requires major fixes just to withstand expected legal challenges, especially in regards to a likely extension of the glide path (by an additional five years, for example) as well as the required mix of resources envisioned. Assuming a final rule is able to pass in the next legislative session; states are then likely to follow with their SIPs, although the Republican Congress is also likely to fight the rule. In the meantime, the creation of SIPs would be the green light SO is waiting for to provide its own implementation plan to regulators for approval, with the first hints of incremental capital spending for new generation, transmission, coal ash remediation, pollution controls, gas transportation infrastructure, and renewables possibly showing up within Georgia Power's Jan 2016 Integrated Resource Plan. Ultimately SO could also attempt to partner with a pipeline developer to bring more gas to its territory to serve additional future gas generation requirements.

Bottom line is that Southern should capture more environmental spending towards the back-half of the decade, consistent with discussion of an earnings reacceleration in that window.

With gas-fired generation a top priority for the company, management noted the possible opportunity that may exist should EPA's carbon rule 111d ultimately require significant additions. By EPA's own calculation, SO could conceivably be required to build over 5,000 MW of CCGTs by 2020, although even the company calls that impractical and unrealistic.

EPA could drive significant capital spend down the line

Southern remains a substantial beneficiary from required spending to comply with EPA rules, however, it's beneficial rate compact given corresponding impact on consumers (particularly when coupled with high-cost ongoing build efforts in MS and GA).

Reducing exposure to long-dated on PRB coal

With up to 9,000 MW of coal fired generation potentially "at risk" through 2030 from EPA 111D, SO continues a process of shortening its average contract life for PRB. Coal piles are currently just under target levels but should be in shape for the Winter.

Rate based solar ramping up at Georgia Power: Adding more

The utility has announced three new solar projects at US Army bases throughout Georgia (Forts Benning, Gordon, and Stewart) totalling 90 MW, making these the largest solar generating stations on any US military base. Another 30 MW array at Kings Bay Submarine Base is expected to be approved in June as well. These projects are expected to increase Georgia Power's solar fleet to 900 MW by 2016. Further expansion to other military bases throughout the Southeast are potential opportunities as well.

New nuclear possibilities; "just looking" for now

EIA has estimated the new nuclear could cost up to 5x more than a comparable gas plant.

While management has indicated an interest in exploring the possibility of new nuclear development, after Vogtle, we emphasize that these considerations are very early stage at this time, without much in the way of concrete steps. Nevertheless, we believe that should the company target a mid-2020's in-service date, early planning steps would have to be initiated soon. While site(s) of potential further plants have not been identified formally (of the ~8 possible locations), we would suspect Georgia Power would remain the host for additional units given its size among the SO family. With construction work likely a late-decade or early 2020 datapoint, spend remains outside of the current view, but could well mesh to drive continued earnings growth in the long-term, a key concern for many shareholders. To the extent the company is successful in laying the ground work in this direction in coming years, this could speak to the aggressiveness of the company's corresponding dividend policy through the decade (which is slated to see a pick up through the slower earnings growth projected in the back half of the current decade); management's formal target has been to maintain its current $0.07/sh annual growth despite a slower EPS trajectory.

Is this part of a trend in the industry? Quite possibly to replace retiring nukes.

The broader question arising from SO's datapoint is to what extent the country intends to replace nuclear units that will see their 60-year licenses being expiring en masse in the late part of the 2020's. We see this issue as becoming a much more prevalent issue in coming ~3-4 years, as the subject gains greater clarity with regulated utilities (although discussion of 80-year licenses remains a rumbled concept in the nuclear world, albeit with additional retrofits needed).

Valuation: Raising PT $4 to $47 on higher multiples but maintain Sell

Figure 6: Sum of the Parts Valuation, UBSe 2016: Reduced Discounts for GA, MS, and SP

Southern Company Valuation (UBSe)			Low Case		Base Case			High Case	
Business Segment	Valuation Metric	2016	Valuation Multiple	Per Sh. Value	Prem/ Discount	Valuation Multiple	Per Sh. Value	Valuation Multiple	Per Sh. Value
Regulated Business									
Alabama Power	P/E	$0.80	16.30x	$13.01	0.00x	17.30x	$13.81	18.30x	$14.61
Georgia Power	P/E	$1.52	14.80x	$22.46	-1.50x	15.80x	$23.97	16.80x	$25.49
Gulf Power	P/E	$0.17	16.30x	$2.84	0.00x	17.30x	$3.01	18.30x	$3.18
Mississippi Power	P/E	$0.26	13.80x	$3.52	-2.50x	14.80x	$3.78	15.80x	$4.03
Southern Power (Contracted Merchant)	P/E	$0.21	15.30x	$3.20	-1.00x	16.30x	$3.41	17.30x	$3.62
Other	P/E	($0.04)	16.30x	($0.61)	0.00x	17.30x	($0.64)	18.30x	($0.68)
Southern Company Total/Implied		**$2.92**	***15.23x***	**$44.42**		***16.23x***	**$47.33**	***17.23x***	**$50.25**

Source: UBS estimates, Company filings

We are raising our Price Target $4 to $47 due to expansion in the average peer 2016E P/E multiple. While continuing to apply discounts to Georgia Power and Mississippi Power for execution risk, we recently reduced these discounts by half a turn to reflect management's significant extension of the Kemper in-service date and associated writedowns. The outcome of our sum-of-the-parts below is a 1.0x or a 6.6% discount to the average group P/E.

The key question remains whether SO deserves a discounted P/E versus peers given its slowing capex profile and recent execution issues with Kemper, despite its constructive regulatory regime? Historically, Southern has traded at a meaningful premium over its regulated utility peers; however, that advantage has evaporated.

GA Power and MS Power are where the risk are to be found

Our valuation below ascribes an explicit P/E discount of -1.5x and -2.5x to its Georgia Power and Mississippi Power businesses to account for the execution risk for both companies. For Georgia, we note a -2.0x discount currently being applied to SCG in South Carolina, but we now think that SO's turnkey, fixed price contract with the consortium may somewhat less risky to SO's project, justifying a slightly reduced discount at only -1.5x. For Mississippi, we have also reduced the discount to 2.5x from 3.0x previously to account for the extra time management has now built into the schedule (from 2H15 to 1H16) as well at the latest writedowns that reflect the far end of this timeline.

Giving credit for future growth at SO Power, now.

We have also reduced the regulated utility P/E discount we apply to Southern Power to -1.0x from -2.0x to reflect our expectation that management will not only meet its $1.4B, 3-year capex plan, but is apparently poised to upsize it in Feburary on the yearend conference call. Southern Power receives a discount for its greater risk profile versus the rate regulated businesses. We had applied a -2.0x P/E multiple initially to reconcile with EV/EBITDA valuation methodologies for conventional contracted generation assets.

What's lower risk? Alabama Power and Gulf Power.

As for Alabama Power and Gulf Power, we apply an average multiple with no premium to account for the slower investment and load growth profile of these states despite the favorable regulatory environments and overall earned ROE. We do not anticipate rate activity for some time at either jurisdiction given their

formulaic rate construct in AL and stayout through 2017 in FL. We're incrementally comfortable with FL following the November election update.

Southern Company (SO.N)

Income statement (US$m)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Revenues	**17,657**	**16,537**	**17,087**	**18,460**	8.0	**18,747**	1.5	**19,107**	**19,513**	**19,943**
Gross profit	10,787	10,936	11,116	11,867	6.8	12,153	2.4	12,513	12,919	13,349
EBITDA (UBS)	**6,061**	**6,376**	**6,453**	**6,950**	7.7	**7,114**	2.3	**7,348**	**7,618**	**7,911**
Depreciation & amortisation	(1,717)	(1,787)	(1,901)	(2,066)	8.7	(2,136)	3.4	(2,221)	(2,292)	(2,361)
EBIT (UBS)	**4,344**	**4,589**	**4,552**	**4,885**	7.3	**4,978**	1.9	**5,126**	**5,326**	**5,550**
Associates & investment income	0	0	0	0	-	0	-	0	0	0
Other non-operating income	0	0	0	0	-	0	-	0	0	0
Net interest	(857)	(859)	(824)	(857)	-4.0	(944)	-10.1	(1,017)	(1,085)	(1,141)
Exceptionals (incl goodwill)	0	0	0	0	-	0	-	0	0	0
Profit before tax	**3,487**	**3,730**	**3,728**	**4,027**	8.0	**4,034**	0.2	**4,110**	**4,241**	**4,409**
Tax	(1,219)	(1,334)	(1,285)	(1,450)	-12.8	(1,392)	4.0	(1,377)	(1,421)	(1,477)
Profit after tax	**2,268**	**2,396**	**2,443**	**2,578**	5.5	**2,642**	2.5	**2,733**	**2,820**	**2,932**
Preference dividends	(65)	(65)	(66)	(68)	-	(68)	-	(68)	(68)	(68)
Minorities	0	0	0	0	-	0	-	0	0	0
Extraordinary items	0	19	(733)	(274)	62.6	0	-	0	0	0
Net earnings (local GAAP)	**2,203**	**2,350**	**1,644**	**2,235**	36.0	**2,574**	15.2	**2,665**	**2,752**	**2,864**
Net earnings (UBS)	**2,203**	**2,331**	**2,377**	**2,510**	5.6	**2,574**	2.6	**2,665**	**2,752**	**2,864**
Tax rate (%)	35.0	35.8	34.5	36.0	4.4	34.5	-4.2	33.5	33.5	33.5

Per share (US$)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
EPS (UBS, diluted)	2.55	2.65	2.71	2.80	3.1	2.82	0.8	2.92	3.01	3.13
EPS (local GAAP, diluted)	2.55	2.67	1.88	2.49	32.8	2.82	13.2	2.92	3.01	3.13
EPS (UBS, basic)	2.59	2.69	2.71	2.80	3.1	2.82	0.8	2.92	3.01	3.13
Net DPS (US$)	1.87	1.94	2.01	2.08	3.5	2.15	3.4	2.22	2.29	2.36
Cash EPS (UBS, diluted)[1]	4.54	4.69	4.88	5.10	4.5	5.16	1.2	5.35	5.52	5.72
Book value per share	21.21	21.74	22.43	23.38	4.2	23.86	2.1	24.54	25.26	26.03
Average shares (diluted)	864.00	878.84	876.75	897.50	2.4	913.17	1.7	913.76	913.76	913.76

Balance sheet (US$m)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Cash and equivalents	1,315	628	659	91	-86.3	1,259	NM	720	1,742	2,875
Other current assets	4,957	5,534	4,940	5,482	11.0	5,565	1.5	5,669	5,787	5,912
Total current assets	**6,272**	**6,162**	**5,599**	**5,572**	-0.5	**6,824**	22.5	**6,389**	**7,529**	**8,787**
Net tangible fixed assets	45,010	48,390	51,208	55,957	9.3	58,747	5.0	60,951	62,454	63,888
Net intangible fixed assets	0	0	0	0	-	0	-	0	0	0
Investments / other assets	7,985	8,597	7,739	7,539	-2.6	7,539	0.0	7,539	7,539	7,539
Total assets	**59,267**	**63,149**	**64,546**	**69,069**	7.0	**73,109**	5.9	**74,878**	**77,521**	**80,214**
Trade payables & other ST liabilities	4,001	3,854	3,585	3,774	5.3	3,808	0.9	3,842	3,878	3,915
Short term debt	2,576	3,160	1,951	2,181	11.79	2,940	34.80	2,940	2,940	2,940
Total current liabilities	**6,577**	**7,014**	**5,536**	**5,955**	7.6	**6,748**	13.3	**6,782**	**6,818**	**6,855**
Long term debt	18,647	19,274	21,344	23,731	11.2	25,772	8.6	26,472	28,022	29,572
Other long term liabilities	15,383	17,482	17,527	18,027	2.9	18,427	2.2	18,827	19,227	19,627
Preferred shares	0	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	**40,607**	**43,770**	**44,407**	**47,713**	7.4	**50,947**	6.8	**52,081**	**54,067**	**56,054**
Common s/h equity	18,285	19,004	19,764	20,981	6.2	21,788	3.8	22,422	23,080	23,785
Minority interests	375	375	375	375	0.0	375	0.0	375	375	375
Total liabilities & equity	**59,267**	**63,149**	**64,546**	**69,069**	7.0	**73,109**	5.9	**74,878**	**77,521**	**80,214**

Cash flow (US$m)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Net income (before pref divs)	2,268	2,415	1,710	2,303	34.7	2,642	14.7	2,733	2,820	2,932
Depreciation & amortisation	1,717	1,787	1,901	2,066	8.7	2,136	3.4	2,221	2,292	2,361
Net change in working capital	573	(451)	152	(353)	-	(49)	86.0	(70)	(82)	(88)
Other operating	1,014	789	1,937	510	-73.7	200	-60.8	200	180	180
Operating cash flow	**5,572**	**4,540**	**5,700**	**4,526**	-20.6	**4,928**	8.9	**5,084**	**5,210**	**5,385**
Tangible capital expenditure	(4,525)	(4,809)	(5,463)	(6,900)	-26.3	(5,000)	27.5	(4,500)	(3,850)	(3,850)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	25	0	0	0	-	0	-	0	0	0
Other investing	317	(359)	(279)	0	-	0	-	0	0	0
Investing cash flow	**(4,183)**	**(5,168)**	**(5,742)**	**(6,900)**	-20.2	**(5,000)**	27.5	**(4,500)**	**(3,850)**	**(3,850)**
Equity dividends paid	(1,601)	(1,693)	(1,762)	(1,893)	-7.4	(1,967)	-3.9	(2,031)	(2,095)	(2,159)
Share issues / (buybacks)	723	(33)	675	600	-11.1	200	-66.7	0	0	0
Other financing	(642)	(448)	(597)	(617)	-3.29	(686)	-11.32	(744)	(789)	(826)
Change in debt & pref shares	111	1,205	820	2,617	219.15	2,800	6.99	700	1,550	1,550
Financing cash flow	**(1,409)**	**(969)**	**(864)**	**707**	-	**347**	-51.0	**(2,075)**	**(1,334)**	**(1,435)**
Cash flow inc/(dec) in cash	**(20)**	**(1,597)**	**(906)**	**(1,666)**	-83.9	**275**	-	**(1,490)**	**26**	**100**
FX / non cash items	888	910	937	1,098	17.2	893	-18.6	951	996	1,033
Balance sheet inc/(dec) in cash	**868**	**(687)**	**31**	**(568)**	-	**1,168**	-	**(539)**	**1,022**	**1,133**

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

Southern Company (SO.N)

Valuation (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
P/E (local GAAP, diluted)	15.9	17.0	23.3	19.9	17.5	17.0	16.4	15.8
P/E (UBS, diluted)	15.9	17.1	16.1	17.7	17.5	17.0	16.4	15.8
P/CEPS	8.8	9.5	9.0	9.7	9.6	9.2	9.0	8.6
Equity FCF (UBS) yield %	3.1	(0.7)	0.6	(5.4)	(0.2)	1.3	3.1	3.5
Net dividend yield (%)	4.6	4.3	4.6	4.2	4.4	4.5	4.6	4.8
P/BV x	1.9	2.1	1.9	2.1	2.1	2.0	2.0	1.9
EV/revenues (core)	3.2	3.8	3.6	3.8	3.9	3.5	3.5	3.4
EV/EBITDA (core)	9.4	9.9	9.7	10.1	10.2	9.1	8.9	8.5
EV/EBIT (core)	13.1	13.8	13.7	14.4	14.6	13.0	12.7	12.2
EV/OpFCF (core)	13.1	13.8	13.7	14.4	14.6	13.0	12.7	12.2
EV/op. invested capital	1.8	1.9	1.7	1.8	1.7	1.5	1.5	1.4

Enterprise value (US$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Market cap.	34,079	39,438	38,263	44,316	44,316	44,316	44,316	44,316
Net debt (cash)	20,107	20,857	22,221	24,229	26,637	28,073	28,956	28,956
Buy out of minorities	375	375	375	375	375	375	375	375
Pension provisions/other	2,442	2,540	1,461	1,461	1,461	1,461	1,461	1,461
Total enterprise value	**57,002**	**63,210**	**62,320**	**70,381**	**72,789**	**74,225**	**75,108**	**75,108**
Non core assets	0	0	0	0	0	(7,539)	(7,539)	(7,539)
Core enterprise value	**57,002**	**63,210**	**62,320**	**70,381**	**72,789**	**66,686**	**67,569**	**67,569**

Growth (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenue	1.2	-6.3	3.3	8.0	1.5	1.9	2.1	2.2
EBITDA (UBS)	10.7	5.2	1.2	7.7	2.3	3.3	3.7	3.8
EBIT (UBS)	9.7	5.6	-0.8	7.3	1.9	3.0	3.9	4.2
EPS (UBS, diluted)	8.1	4.0	2.2	3.1	0.8	3.5	3.3	4.1
Net DPS	3.9	3.7	3.6	3.5	3.4	3.3	3.1	3.1

Margins & Profitability (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Gross profit margin	61.1	66.1	65.1	64.3	64.8	65.5	66.2	66.9
EBITDA margin	34.3	38.6	37.8	37.6	37.9	38.5	39.0	39.7
EBIT margin	24.6	27.7	26.6	26.5	26.6	26.8	27.3	27.8
Net earnings (UBS) margin	12.5	14.1	13.9	13.6	13.7	13.9	14.1	14.4
ROIC (EBIT)	13.4	13.5	12.7	12.6	11.8	11.5	11.6	11.8
ROIC post tax	8.7	8.7	8.3	8.1	7.7	7.7	7.7	7.8
ROE (UBS)	12.5	12.5	12.3	12.3	12.0	12.1	12.1	12.2

Capital structure & Coverage (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Net debt / EBITDA	3.3	3.4	3.5	3.7	3.9	3.9	3.8	3.7
Net debt / total equity %	106.7	112.5	112.4	120.9	123.9	125.9	124.6	122.7
Net debt / (net debt + total equity) %	51.6	52.9	52.9	54.7	55.3	55.7	55.5	55.1
Net debt/EV	34.9	34.5	36.3	36.7	37.7	43.0	43.2	43.9
Capex / depreciation %	NM	NM	NM	NM	NM	NM	168.0	163.1
Capex / revenue %	25.6	29.1	NM	NM	26.7	23.6	19.7	19.3
EBIT / net interest	5.1	5.3	5.5	5.7	5.3	5.0	4.9	4.9
Dividend cover (UBS)	1.4	1.4	1.3	1.3	1.3	1.3	1.3	1.3
Div. payout ratio (UBS) %	72.4	72.2	74.2	74.5	76.4	76.2	76.1	75.4

Revenues by division (US$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Others	17,657	16,537	17,087	18,460	18,747	19,107	19,513	19,943
Total	**17,657**	**16,537**	**17,087**	**18,460**	**18,747**	**19,107**	**19,513**	**19,943**

EBIT (UBS) by division (US$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Others	4,344	4,589	4,552	4,885	4,978	5,126	5,326	5,550
Total	**4,344**	**4,589**	**4,552**	**4,885**	**4,978**	**5,126**	**5,326**	**5,550**

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

Forecast returns

Forecast price appreciation	-5.0%
Forecast dividend yield	4.4%
Forecast stock return	-0.6%
Market return assumption	5.5%
Forecast excess return	-6.1%

Statement of Risk

Factors that could prevent Southern from achieving our earnings, cash flow, and price target objectives include: adverse weather conditions; changes in the regional power regulatory environment; adverse regulatory decisions in its various states jurisdictions (primarily GA, AL, MS, FL) as well as from the federal regulator, FERC; interest rate & capital market risks; slowdown in regional economy; risks associated with operating nuclear units; more stringent environment regulation; and the impact that changes in commodity prices could have on the unhedged portion of its competitive generation operations, Southern Power. An added risk is the corresponding construction and financial risk associated with its proposed new nuclear unit at Vogtle.

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UBS Investment Research: Global Equity Rating Definitions

12-Month Rating	Definition	Coverage[1]	IB Services[2]
Buy	FSR is > 6% above the MRA.	47%	37%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	11%	21%
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 31 December 2014.
1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category. 4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

KEY DEFINITIONS: Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months. **Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium). **Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation. **Short-Term Ratings** reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case. **Equity Price Targets** have an investment horizon of 12 months.

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UBS Securities LLC: Julien Dumoulin-Smith; Michael Weinstein; Paul Zimbardo.

Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Southern Company[2, 4, 6, 16]	SO.N	Sell	N/A	US$49.46	04 Feb 2015

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

2. UBS AG, its affiliates or subsidiaries has acted as manager/co-manager in the underwriting or placement of securities of this company/entity or one of its affiliates within the past 12 months.
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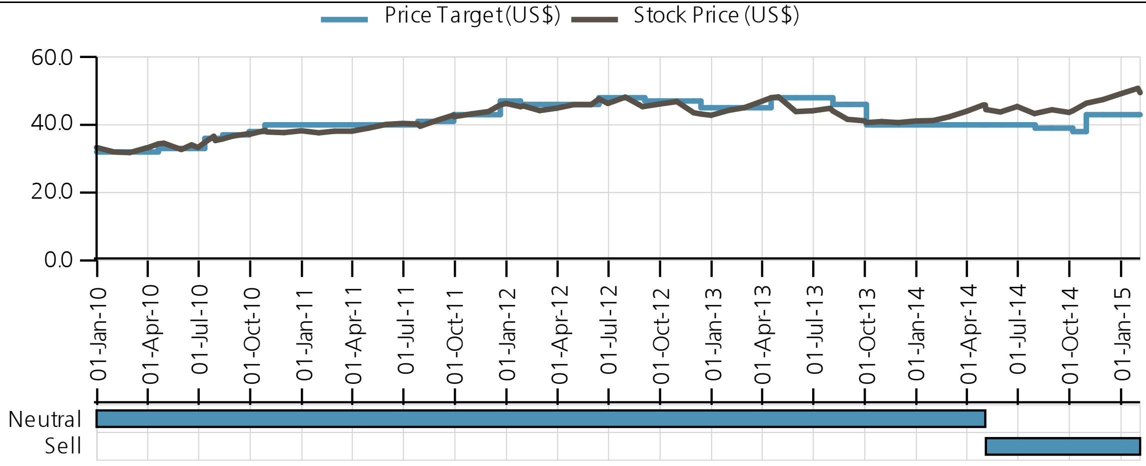
Southern Company (US$)



Source: UBS; as of 04 Feb 2015

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