Pinnacle West Capital Co.

Gearing up to Make Their Case

Equities

Americas
Electric Utilities

12-month rating	**Neutral**
12m price target	**US$73.00**
	Prior: US$69.00
Price	**US$68.25**

RIC: PNW.N **BBG:** PNW US

Trading data and key metrics

52-wk range	US$69.71-56.31
Market cap.	US$7.58bn
Shares o/s	111m (COM)
Free float	99%
Avg. daily volume ('000)	384
Avg. daily value (m)	US$24.9
Common s/h equity (12/16E)	US$4.76bn
P/BV (12/16E)	1.6x
Net debt / EBITDA (12/16E)	3.1x

EPS (UBS, diluted) (US$)

	12/16E			
	From	To	% ch	Cons.
Q1E	-	0.18	-	0.17
Q2E	-	1.33	-	1.22
Q3E	-	2.29	-	2.34
Q4E	-	0.23	-	0.26
12/16E	4.05	4.05	0	3.99
12/17E	4.19	4.19	0	4.18
12/18E	4.54	4.54	0	4.35

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PNW outlines highlights of approaching June 1st ratecase filing

A Jan 29th notice of intent highlighted major issues that PNW intends to address in the upcoming June 1st general ratecase filing. These include a revenue per customer decoupling mechanism to replace the current Lost Fixed Cost Recovery (LFCR) clause (on a trial basis until the next ratecase), a proposed universal demand rate, a shift of time-of-use rates (TOU) to later in the day to better match peak load around 5pm-6pm, and deferral of costs for the Four Corners SCRs and the Ocotillo peaker. Meanwhile, the separate docket on the value and cost of distributed generation is set to receive testimony on Feb 25th.

No equity through the end of the decade as bonus depreciation boosts cash

Management expects no change to forward EPS growth as a result of deferred taxes from the 5-year extension of bonus depreciation, bucking the trend. While 2018 ratebase is reduced by only $200M (to $9.2B), deferred tax is expected to provide $550M of cash benefit that allows the company to avoid secondary equity through the end of the decade. Management reiterated prior guidance for long-term EPS growth to be between their projection for 5% dividend growth and unchanged ratebase growth of 6%-7% through 2018.

Watching the UNS Elec ratecase as PNW files testimony

With hearings set to begin in the UNS Electric case in March (~6 months ahead of utility APS), we are watching this case for clues to treatment of distributed generation and rate design. APS has filed testimony in this case to support a three-part rate design which incorporates a fixed service charge and energy charge and a demand charge.

Valuation: Raise PT $4 to $73 on roll to 2018E P/E; good update but risks remain

We've rolled our valuation forward to an average peer 2018E P/E, but reduce to inline multiple given higher risks on upcoming filing and election cycle. With our estimates virtually unchanged, the higher PT is due entirely to a higher peer P/E in recent weeks. While management's significant beat for 2015 is impressive and the elimination of equity needs is a positive, too many risks leave us on the sidelines.

Highlights (US$m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	3,455	3,492	3,495	3,588	3,653	3,751	3,810	3,870
EBIT (UBS)	858	830	873	890	939	1,020	1,061	1,105
Net earnings (UBS)	406	398	437	451	466	506	518	527
EPS (UBS, diluted) (US$)	3.66	3.58	3.92	4.05	4.19	4.54	4.65	4.74
DPS (US$)	2.20	2.28	2.38	2.48	2.60	2.72	2.84	2.96
Net (debt) / cash	(3,480)	(3,555)	(3,780)	(4,110)	(4,605)	(4,820)	(5,033)	(5,260)

Profitability/valuation	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
EBIT margin %	24.8	23.8	25.0	24.8	25.7	27.2	27.9	28.5
ROIC (EBIT) %	11.9	11.6	12.2	11.9	11.7	12.0	11.9	11.7
EV/EBITDA (core) x	8.1	8.4	8.2	6.8	6.8	6.6	6.4	6.2
P/E (UBS, diluted) x	15.3	15.9	16.0	16.8	16.3	15.0	14.7	14.4
Equity FCF (UBS) yield %	8.4	9.2	7.1	5.0	3.1	7.1	7.4	6.1
Net dividend yield %	3.9	4.0	3.8	3.6	3.8	4.0	4.2	4.3

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$68.25 on 19 Feb 2016 19:40 EST

Proof is in the Pudding

Mgmt is earning its ROE – and without equity – could continue to grow near its ratebase growth trajectory of 6-7%

Management has achieved good trailing results, posting a 9.77% ROE after posting 9.6% in 2014. Further, without equity dilution in sight given the impact of bonus depreciation through 2020, mgmt appears poised to subtly raise EPS expectations through the medium-term, likely trending toward the higher end of its implicit 5-7% EPS guidance range (low end is tied to div growth and high end is driven by the 6-7% growth expected in ratebase). While admittedly maintaining the current higher earned ROEs could be a challenge in the near-term, through the rate-case cycle earning its authorized ROE is still a reasonable assumption. Moreover, there remains a wider question around improving structural lag questions in future cases. We suspect the LFCR mechanism, its efficiency tracker, will remain the pivotal and closely watched issue in the upcoming rate case (many observers remain confident the mechanism will hold up to wider challenges).

What's the holdback? It's tricky with the upcoming election cycle

We suspect the upcoming election cycle could prove particularly turbulent for shares as we expect substantial funds to flow into both more pro-solar and pro-utility PACs; following the latest anti-solar decision in NV, the debate in AZ will be all the more vigorous. The primary election cycle will be key to watch – with the Republican nominees selected in August; this summer should prove the height of the regulatory uncertainty cycle. While not explicitly deciding on any solar policies per se, the three seats up for election (or re-election) could prove decisive in upcoming rate cases. We see a decision late this year in the Unisource case – and corresponding decisions in the solar docket – as effectively setting the stage for the APS case, to be decided by mid-2017.

West Waiting for a Better 2H16

11/2/15: Shifting towards the Rate Case Cycle

10/30/15: Hot Summer Meets Expectations

10/26/15: Catching Some Shade

9/17/15: Charting Its Own Course

7/31/15: Holding the Line on Costs

6/18/15: Sunrise after the Slide

5/4/15: Maintaining a Low Profile

Strong beat for 2015 on lower O&M but no change to 2016-2018 guidance

PNW reported 4Q15 EPS of $0.37 vs UBSe and cons $0.25 to finish the year at $3.92 vs UBSe $3.78 and cons $3.80. Primary driver was $0.21 lower operations and maintenance expense (O&M) vs our estimate of $0.09, largely the result of fewer planned maintenance outages in the quarter. Nevertheless, guidance for 2016 was maintained at $3.90-$4.10 vs UBSe $4.05 and cons $3.99, with management still confident of achieving at least a 9.5% ROE for the utility. O&M guidance for 2016 is unchanged at $825M-$845M. The outlook for 2016-2018 is

also unchanged at 2%-3% retail customer growth offset by conservation, energy efficiency, and distributed gen to reach about 0.5%-1.5% net sales growth.

The key remaining sources of uncertainty going forward include the upcoming ratecase filing on June 1 as we watch the UNS Elec ratecase for clues (hearings in March) amid recent changes at the Arizona Corporation Commission. A key component of the case is now expected to be a request for full revenue decoupling from sales as an improved replacement for the current Lost Fixed Cost Recovery (LFCR) clause (partial-decoupling on sales to offset about 2/3 of the revenues lost as a result of distributed generation).

Figure 1: Unchanged PNW FY16 Guidance

2016 Guidance	
Electric Gross Margin	$2.34B-2.39B
Retail cust growth	1.5-2.5%
Weather norm retail elec sales	0-1.0%
O&M *	$825M-$845M
Other (D&A, 4 Corn deferrals, TOTI)	$645M-$665M
Interest expense (& AFUDC)	$155M-$165M
NI fo non-controlling interests	~$20M
Eff tax rate	34-35%
Average diluted common shares outstanding	~112M
EPS	$3.90-$4.10
UBSe EPS	$4.05
Consensus EPS	$3.99

* Excludes O&M of $114 million, and offsetting revenues, associated with renewable energy and energy efficiency programs.

Source: Company Filings, UBS estimates

No equity need through 2020 keeps earnings intact as '18 ratebase is reduced $200M

Management had previously highlighted that 2016 guidance assumes extension of bonus depreciation and a corresponding reduction of required secondary equity issuances. The guided ratebase CAGR from 2014-2018 remains 6%-7%, although 2018 is now projected to include $7.4B of gen and dist ratebase vs $7.6B previously as a result of bonus depreciation. However, the company now sees no need for equity issuance through the end of the decade as a result of the cash benefits from the effects of bonus deferred taxes. As a result, management expects no net effect on earnings growth from bonus depreciation through the planning horizon (2018). Projected capex was increased $95M for 2016 ($1.2B) and is unchanged in 2017 ($1.3B), with 2018 initiated at ~$160M below 2018 levels ($1.1B). Management expects EPS growth to be between dividend growth of 5% and ratebase growth of 6%-7%. Our estimates result in a 2014-2019E CAGR of 5.5%.

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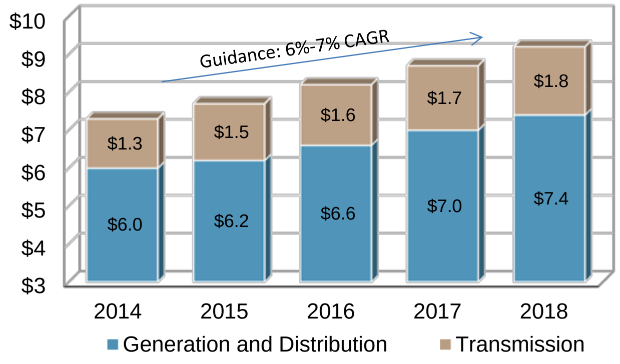
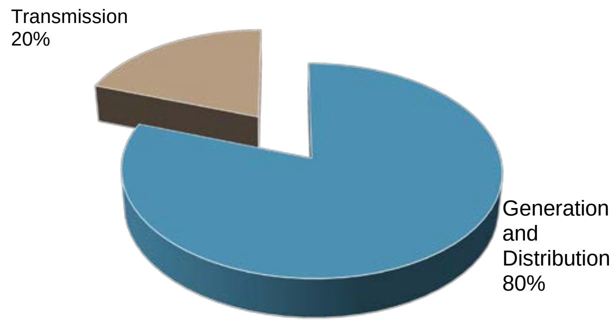
Figure 2: PNW Ratebase Growth, 2014-2018E



Source: UBS estimates, company filings

Figure 3: PNW 2018E Ratebase Breakdown



Source: UBS estimates, Company filings

<u>What's new at PNW?</u>

- **Arizona rate case to be filed June 1:** With four other rate cases expected to be executed in 2016, APS' would be at least the fifth in a series of rate decisions appears likely to be resolved in mid-2017 under the auspices of three new ACC commissioners (only Doug Little and Tom Forese will remain on the ACC). A notice of intent was filed on Jan 29th, which included the following parameters:

  - Will propose new rates go into effect July 1, 2017 based on a test year ended Dec 31, 2015 (with some post-test year adjustments)

  - Will propose universal demand rates with an emphasis on residential rate design. Will propose shifting time-of-use rates (TOU) to later in the day to better <u>match peak demand in the 5pm-6pm period experienced in the last year as solar has already shifted the peak-time hours.</u> Just as this is the key risk for solar economics in California, we suspect implementation of TOU rates and shift in compensation could prove a similar dynamic in AZ/ **At the current net metering rate, an APS filing in October estimated the monthly "cost shift" for rooftop solar customers is ~$67.** According to the utility, residential solar customers only pay for 36% of the cost of transmitting electricity to their homes. More generally, we note that each side is calling out the other's credibility on an issue that could get 'ugly' before a final decision is made.

  - Will propose a revenue per customer decoupling mechanism that will be adjusted annually to replace the existing Lost Fixed Cost Recovery (LFCR) mechanism. The decoupling clause will be proposed on a trial basis through the next ratecase as a rate stabilizing mechanism during the transition to a new overall rate structure.

  - Will request the deferral of $900M costs related to the SCRs at Four Corners (in service 2018) and the fast-ramping nat gas modernization project at Ocotillo (in service 2019). For the SCR's, the utility will propose a step mechanism for this next ratecase to reflect the deferred SCR costs similar to the treatment of the Four Corners acquisition.

- **We will be watching the proceedings for the UNS Electric** ratecase to get a read on sentiment in the state following recent turnover at the Arizona Corporation Commission. PNW has filed testimony in this case to participate early in the discussion on rate design issues, with support for a three-part rate design which incorporates a fixed service charge and energy charge and a demand charge. PNW notes that this concept was proposed and supported by both UNS Electric and the ACC staff. The UNS case is ~6 months ahead of PNW's:
  - Staff and Intervenor Direct Testimony-except Rate Design due in November 2015.
  - Staff and Intervenor Direct Testimony-Rate Design due in December 2015.
  - UNS Electric Rebuttal Testimony due in January 2016.
  - Staff and Intervenor Surrebuttal Testimony due in February 2016.
  - **Hearings commence March 1, 2016.**
  - Open Meeting May/June 2016.

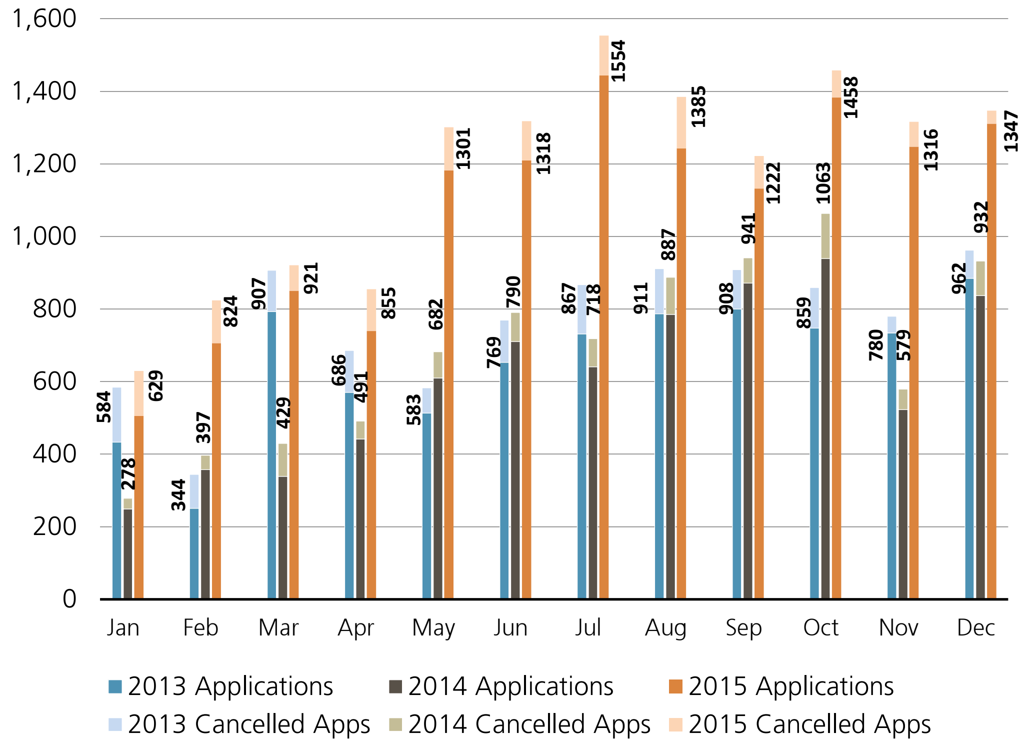
PNW has filed testimony in this case.

- **Cost of service docket testimony due Feb 25th**. Regulators voted 4-1 (Chairman Bitter-Smith dissenting) to move forward with a combined generic docket to consider both cost of service and the value of solar ahead of the next ratecase filing, expected on June 1, 2016. The docket will consider topics including methodologies for determining the cost to serve customers with solar and the value of solar. This follows APS' withdrawal of a request to increase the interim $20/mo fixed charge for solar customers (up from $4.90/mo currently) and the company's recommendation to discuss the issues generically in the near-term in order to speed up the ratecase proceeding next year. APS is focused on attempting to generate a Commission decision on these issues by March 2016 so that they can use the results in the rate case.
  - **How high will the demand charge be raised?** Under the current solar tariff, customers pay roughly $5/mo for an average system (assuming 7kW * $0.70/kW). With the previous proposal in the state having been closer to $21/mo, we suspect a compromise is likely to be struck closer to the higher figure (albeit still below). Following the latest federal ITC extension, we perceive less concern over the impact of higher fixed tariffs. The thought process in the initial $5/mo rate appears to have been tied to an 'incremental' approach, effectively reducing subsidies to the industry gradually.
  - **Workshop on solar should yield 'methodology':** Ultimately, we continue to expect relatively little out of the solar workshop, expecting simply a 'methodology' on how to calculate the cost shift to be determined. This in our mind would establish rough frameworks on the 'value of solar' to the distribution network. We increasingly perceive this to be a complicated question as small penetrations appear to defer the need for grid upgrades, while greater penetrations would appear to drive higher estimates. We look for California to perform its own calculation on the value of solar, seemingly through the latest Distribution Resource Plan (DRPs) filed by utilities to illustrate both the merits and necessary investments to accommodate growing distributed solar penetration. Only with this clarity does the commission appear to feel comfortable in having

adequate clarity to meaningfully move from the current compensation scheme.

- **Preliminary residential solar applications through Dec 2015 are up 73%** year over year at 14,130 as monthly totals in July and October reached record highs, eclipsing the previous records in May and June (see table below for a month by month comparison). AZ rooftop solar applications in 4Q15 were 71% higher year over year at nearly 3,950, with over 37,000 residential photovoltaic (PV) systems installed in APS's territory at yearend '15 (281 MW). While residential solar applications remain strong, we still expect PNW to achieve at least 9.5% ROE through the next rate increase.

Figure 4: Residential PV Applications in APS Territory, 2013-2015



Source: Company filings, www.arizonagoessolar.org

- **The utility's AZ Sun solar program** announced the completion of two 10-MW projects under a utility-scale pilot. Ultimately, we see APS as agnostic to either utility-scale (e.g., its 20MW solution at the Redhawk CCGT in the desert) or its more novel distributed solution. While both options have comparable cost (~$3,250/kW), we see the bigger issue as being whether the ACC determines there is need for the capacity to fulfill its obligations. The doubt relates to the current penetration of DG in the state, which is ahead of the targets, as well as projected load growth statistics for the state.

- **APS announced a partnership with the Department of the Navy** to develop a 25-MW microgrid project at Marine Corps Air Station Yuma. The utility also plans to install a 40-MW solar facility this year on behalf of some larger customers. Both projects are reflected in the 2016 capex budget.

- **The APS Solar Partner residential rooftop solar program** is more than halfway toward its goal of 1,500 APS-owned installations (expected to be

complete by mid-2016), with the first installation completed in 3Q15. APS will install and own residential rooftop solar systems on 1,500 homes, reaching ~10 MW in cumulative capacity. APS will use this program to evaluate the interaction of DG solar with the grid, in collaboration with the Electric Power Research Institute (EPRI). Contingent on the results, we expect this pilot to be scaled at some point in 2016-2017 after all initial systems are installed and evaluated, although we don't anticipate any real scaling of this effort to compete with 'private' solar developers. We suspect its pilot program could well be expanded to a full-scale program as the company attempts to push through another avenue for revenue and ratebase growth. While its current program is not competitive against third party leasing providers, we believe any additional effort would likely craft a program that would be competitive.

- **Launched the Solar Innovation Study**, a 75-home demand rate "laboratory" to study the optimal integration of various energy saving and renewable/distributed technologies, such as solar panels, battery storage, smart thermostats, and high efficiency HVAC systems. Customers in the study will be on the utility's existing residential demand rate to study the use of technology to manage peak demand and reduce bills.

- **In May, APS' self-build expansion option at Ocotillo (3 GE 102-MW turbines) was chosen** in the RFP for 300 MW of dispatchable peaking capacity by the summer of 2018 or 2019. At the same time, the cost estimate for the project was reduced to $500M from a previous estimate of $600M-$700M. The in-service date was pushed out a year too to 2019.

- **We expect another RFP in March 2016 for end-of-decade generation needs**, to include solutions for the expiration of the Gila River and Arlington contracts from 2017-2019. Ratebasing the plants might be one possible pathway. The company also has two 10-year heat rate option contracts expired at the end of 2015 (500 MW and 150 MW) that have been used for hedging but as generic instruments, these have never matched load very efficiently. *We continue to see asset acquisitions around the next rate case as a real potential; timing of any deal would likely be in 1H16 given the desire to minimize lag on any investment. This would be incremental to our estimates.*

  Management remains quiet on its prospects heading into what is likely to be a competitive process.

- **Timing of need for new resources?** With a high-20% reserve margin, mgmt does not appear poised to invest in new plant additions to replace either the Heat Rate Call Options (which weren't that useful anyway) or even immediately as expiring tolls for Gila River and Arlington roll off. As such, it does not appear likely the company will be pursuing additional plant acquisitions in rate base, akin to the effort to acquire the Four Corners coal plant recently.

- **APS is upgrading IT systems to enable** participation in the California ISO energy imbalance market as well as the integration of advanced metering and an improved customer interface.

  - **APS declared its intention to join the western interconnect Energy Imbalance Market** in mid-May. Utility APS announced plans to join the western interconnect Energy Imbalance Market (EIM) in Oct 2016, with systems ready by next summer.

- **We also flag POR** (Portland General) has recently indicated its willingness to join this group.
- **More efficiency in integrating Western renewables into the grid?** Given the expected sharp intermittency issues introduced by growing renewable penetration into the grid, we see EIM as helping to reduce the 'cost' of backstopping generation to work around greater wind and solar. EIM penetration appears to save greater sums *prospectively.*
- **It appears the ACC's concerns are more oriented towards the cost of EIM** implementation, rather than underlying jurisdictional concerns of associating with the CAISO (and potential for FERC intervention).

- **Following similar moves in California, we expect an RFP in 2016 for 10 MW of grid-scale storage to be in service by end of 2018**. This follows petitions in the Ocotillo case by RUCO (APS signed a settlement) to evaluate batteries as an alternative. PNW intends to develop a grid-scale storage proposal to develop MWs to effectively meet 'peak' load needs in lieu of additional peak capacity. While still preliminary, we think these investments would indeed be eligible for ratebasing, potentially additive to its current investment plan. This remains relatively long-dated.
- With concerns around solar the clearest overhang on shares, we emphasize many investors have largely ignored the corresponding question of reliability in high penetration of distributed resources. Akin to California, we suspect the story's **capital deployment may yet evolve towards greater investment opportunities in upgrades** to the grid to accommodate higher levels of distributed resources. Further, we would downplay concerns around grid 'defection' given the significant reliability characteristics demanded by customers – and corresponding costs to achieve under a truly independent scheme. We don't believe investors would be wise to be negative on PNW on the thesis of grid defection given real reliability needs.
- **Where do the commissioners stack up on solar issues?** If there were to be a spectrum, voting records would appear to suggest that Commissioner Bob Burns is likely the least pro-utility, particularly following his petition to push APS for public disclosure of campaign donations to Political Action Committees (PACs). In contrast, we perceive new Chair Little as being towards the middle of remaining of commissioners. Tobin has a limited track record of views on energy off which to judge his position. It's notable that the Chairwoman, Susan Bittersmith, was targeted by a solar industry group '*Checks and Balances*' despite her modestly more pro-solar attitudes. She ultimately had to resign after the efforts started by the group clouded out her ability to act effectively in her multiple roles.
- **Solar policy likely to be revised with higher demand charges:** Following the trend of adjacent states (CA and NV), Arizona is likely to change its compensation structure for residential solar as part of its next series of rate cases. We would expect the precedent on how to address compensation (whether its fixed charges or shift in NEM rate, and new magnitude) to be established prior to the APS case in the TEP case to be resolved likely in ~late 2016. We suspect the new approach is likely to reflect higher demand charges for all customers, rather than just solar customers (under the current $0.70/W rules imposed as part of the last settlement).

Estimates largely unchanged

Our estimates are largely unchanged, with $200M lower ratebase in 2018 as a result of bonus depreciation offset with the elimination of equity issuances through the end of the decade. We had *previously* assumed a $225M equity issuance in 2017.

No equity issuances through the end of the decade.

Figure 5: PNW EPS

	2013A	2014A	2015A	2016E	2017E	2018E	2019E
UBS estimates	$3.66	$3.58	$3.92	$4.05	$4.19	$4.54	$4.65
CAGR 2014-2019E							5.4%
Guidance				$3.90-$4.10		~5% DPS growth	
Previous UBSe	$3.66	$3.58	$3.78	$4.05	$4.19	$4.54	$4.67
Consensus	$3.66	$3.58	$3.79	$3.99	$4.19	$4.37	$4.45
ROE Guidance			**9.70%**	**Expect ~9.5% or better in 2016+ vs. 10% Auth**			

Source: Company Filings, UBSe

Valuation: Raise PT $4 to $73 for higher peer P/E multiple as roll forward to 2018E P/E

We're rolling forward our peer P/E-based valuation to a 2018E P/E and raise our PT $4 for a higher utility peer P/E in recent weeks. <u>We are removing our premium valuation to a peer multiple to reflect our concerns that regulatory risks exist around the composition of any new commission</u>; we emphasize risk will likely increase through the 12-month period beginning June 1st around its rate case filing.

Figure 6: PNW Price Target

Pinnacle West Valuation: P/E Derived on 2018EPS					
Valuation		**Price Target**		**Valuation**	
2018EPS	$4.54	2018EPS	$4.54	2018EPS	$4.54
P/E Multiple	16.0x	P/E Multiple	16.0x	P/E Multiple	16.0x
Premium/(Disc.)	-10%	'Premium	0%	'Premium	5%
Value	**$65.00**	**Value**	**$73.00**	**Value**	**$76.00**

Source: Company Filings, UBSe

Pinnacle West Capital Co. (PNW.N)

Income statement (US$m)	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
Revenues	**3,455**	**3,492**	**3,495**	**3,588**	*2.6*	**3,653**	*1.8*	**3,751**	**3,810**	**3,870**
Gross profit	2,359	2,312	2,394	2,397	*0.1*	2,462	*2.7*	2,560	2,619	2,679
EBITDA (UBS)	**1,273**	**1,247**	**1,367**	**1,314**	*-3.9*	**1,370**	*4.3*	**1,457**	**1,506**	**1,558**
Depreciation & amortisation	(416)	(417)	(494)	(424)	*-14.3*	(430)	*1.5*	(437)	(445)	(453)
EBIT (UBS)	**858**	**830**	**873**	**890**	*2.0*	**939**	*5.6*	**1,020**	**1,061**	**1,105**
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	(187)	(185)	(179)	(171)	*4.4*	(197)	*-15.2*	(217)	(240)	(268)
Exceptionals (incl goodwill)	0	0	0	0	-	0	-	0	0	0
Profit before tax	**671**	**644**	**694**	**719**	*3.6*	**743**	*3.3*	**803**	**822**	**837**
Tax	(231)	(221)	(238)	(252)	*-5.9*	(260)	*-3.3*	(281)	(288)	(293)
Profit after tax	**440**	**424**	**456**	**467**	*2.5*	**483**	*3.3*	**522**	**534**	**544**
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	(34)	(26)	(19)	(16)	*12.9*	(16)	*0.0*	(16)	(16)	(16)
Extraordinary items	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	**406**	**398**	**437**	**451**	*3.1*	**466**	*3.4*	**506**	**518**	**527**
Net earnings (UBS)	**406**	**398**	**437**	**451**	*3.1*	**466**	*3.4*	**506**	**518**	**527**
Tax rate (%)	34.4	34.2	34.3	35.0	*2.2*	35.0	*0.0*	35.0	35.0	35.0

Per share (US$)	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
EPS (UBS, diluted)	3.66	3.58	3.92	4.05	*3.4*	4.19	*3.4*	4.54	4.65	4.74
EPS (local GAAP, diluted)	3.66	3.58	3.92	4.05	*3.4*	4.19	*3.4*	4.54	4.65	4.74
EPS (UBS, basic)	3.66	3.58	3.92	4.05	*3.4*	4.19	*3.4*	4.54	4.65	4.74
Net DPS (US$)	2.20	2.28	2.38	2.48	*4.2*	2.60	*4.8*	2.72	2.84	2.96
Cash EPS (UBS, diluted)[1]	7.42	7.33	8.35	7.86	*-5.9*	8.06	*2.5*	8.47	8.65	8.81
Book value per share	37.85	39.35	41.30	42.76	*3.6*	44.35	*3.7*	46.17	47.99	50.67
Average shares (diluted)	110.81	111.18	111.55	111.29	*-0.2*	111.29	*0.0*	111.29	111.29	111.29

Balance sheet (US$m)	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
Cash and equivalents	10	8	39	202	*NM*	232	*14.7*	317	604	877
Other current assets	1,034	966	851	839	*-1.4*	848	*1.0*	860	868	788
Total current assets	**1,044**	**973**	**891**	**1,041**	*16.9*	**1,079**	*3.7*	**1,177**	**1,472**	**1,666**
Net tangible fixed assets	9,900	10,145	10,628	11,421	*7.5*	12,250	*7.3*	12,919	13,580	14,312
Net intangible fixed assets	283	241	241	241	*0.0*	241	*0.0*	241	241	241
Investments / other assets	2,282	2,954	3,268	3,268	*0.0*	3,268	*0.0*	3,268	3,268	3,268
Total assets	**13,509**	**14,314**	**15,028**	**15,972**	*6.3*	**16,839**	*5.4*	**17,606**	**18,561**	**19,487**
Trade payables & other ST liabilities	925	1,028	1,085	1,124	*3.6*	1,143	*1.7*	1,170	1,187	1,077
Short term debt	694	531	358	325	*-9.11*	325	*0.00*	300	300	300
Total current liabilities	**1,619**	**1,559**	**1,442**	**1,449**	*0.5*	**1,468**	*1.3*	**1,470**	**1,487**	**1,377**
Long term debt	2,796	3,031	3,462	3,987	*15.2*	4,512	*13.2*	4,837	5,337	5,837
Other long term liabilities	4,753	5,204	5,404	5,641	*4.4*	5,788	*2.6*	6,025	6,261	6,498
Preferred shares	0	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	**9,168**	**9,794**	**10,309**	**11,077**	*7.5*	**11,768**	*6.2*	**12,332**	**13,085**	**13,712**
Common s/h equity	4,194	4,367	4,584	4,759	*3.8*	4,936	*3.7*	5,139	5,340	5,639
Minority interests	146	152	136	136	*0.0*	136	*0.0*	136	136	136
Total liabilities & equity	**13,509**	**14,314**	**15,028**	**15,972**	*6.3*	**16,839**	*5.4*	**17,606**	**18,561**	**19,487**

Cash flow (US$m)	12/13	12/14	12/15	12/16E	% ch	12/17E	% ch	12/18E	12/19E	12/20E
Net income (before pref divs)	406	398	437	451	*3.1*	466	*3.4*	506	518	527
Depreciation & amortisation	416	417	494	424	*-14.3*	430	*1.5*	437	445	453
Net change in working capital	(166)	111	(160)	35	-	11	*-70.0*	15	9	(31)
Other operating	879	565	798	675	*-15.4*	612	*-9.3*	702	710	639
Operating cash flow	**1,535**	**1,491**	**1,570**	**1,585**	*1.0*	**1,519**	*-4.2*	**1,659**	**1,682**	**1,588**
Tangible capital expenditure	(1,016)	(911)	(1,076)	(1,205)	*-12.0*	(1,285)	*-6.6*	(1,124)	(1,124)	(1,124)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	0	0	0	0	-	0	-	0	0	0
Other investing	7	(12)	10	(10)	-	(10)	-	(10)	(10)	(10)
Investing cash flow	**(1,009)**	**(923)**	**(1,066)**	**(1,215)**	*-14.0*	**(1,295)**	*-6.6*	**(1,134)**	**(1,134)**	**(1,134)**
Equity dividends paid	(235)	(217)	(260)	(276)	*-6.1*	(289)	*-4.8*	(303)	(316)	0
Share issues / (buybacks)	17	(247)	19	0	-	0	-	0	0	0
Other financing	(17)	(20)	(35)	0	-	0	-	0	0	0
Change in debt & pref shares	74	73	279	492	*76.06*	525	*6.71*	300	500	500
Financing cash flow	**(161)**	**(411)**	**4**	**216**	*NM*	**236**	*9.1*	**(3)**	**184**	**500**
Cash flow inc/(dec) in cash	**365**	**157**	**507**	**586**	*15.6*	**460**	*-21.6*	**522**	**732**	**954**
FX / non cash items	(382)	(159)	(475)	(424)	*10.9*	(430)	*-1.5*	(437)	(445)	(682)
Balance sheet inc/(dec) in cash	**(17)**	**(2)**	**32**	**163**	*NM*	**30**	*-81.7*	**86**	**287**	**273**

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.

Pinnacle West Capital Co. (PNW.N)

Valuation (x)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
P/E (local GAAP, diluted)	15.3	15.9	16.0	16.8	16.3	15.0	14.7	14.4
P/E (UBS, diluted)	15.3	15.9	16.0	16.8	16.3	15.0	14.7	14.4
P/CEPS	7.5	7.7	7.5	8.7	8.5	8.1	7.9	7.7
Equity FCF (UBS) yield %	8.4	9.2	7.1	5.0	3.1	7.1	7.4	6.1
Net dividend yield (%)	3.9	4.0	3.8	3.6	3.8	4.0	4.2	4.3
P/BV x	1.5	1.4	1.5	1.6	1.5	1.5	1.4	1.3
EV/revenues (core)	3.0	3.0	3.2	2.5	2.5	2.6	2.5	2.5
EV/EBITDA (core)	8.1	8.4	8.2	6.8	6.8	6.6	6.4	6.2
EV/EBIT (core)	12.0	12.6	12.9	10.0	9.9	9.5	9.1	8.7
EV/OpFCF (core)	12.0	12.6	12.9	10.0	9.9	9.5	9.1	8.7
EV/op. invested capital	1.4	1.5	1.6	1.2	1.2	1.1	1.1	1.0

Enterprise value (US$m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Market cap.	6,168	6,292	6,983	7,576	7,576	7,576	7,576	7,576
Net debt (cash)	3,434	3,518	3,668	3,945	4,358	4,712	4,712	4,712
Buy out of minorities	146	152	136	136	136	136	136	136
Pension provisions/other	514	454	481	481	481	481	481	481
Total enterprise value	**10,262**	**10,415**	**11,267**	**12,138**	**12,550**	**12,905**	**12,905**	**12,905**
Non core assets	0	0	0	(3,256)	(3,256)	(3,256)	(3,256)	(3,256)
Core enterprise value	**10,262**	**10,415**	**11,267**	**8,882**	**9,294**	**9,649**	**9,649**	**9,649**

Growth (%)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenue	4.6	1.1	0.1	2.6	1.8	2.7	1.6	1.6
EBITDA (UBS)	1.0	-2.0	9.6	-3.9	4.3	6.4	3.4	3.4
EBIT (UBS)	0.2	-3.2	5.1	2.0	5.6	8.6	4.1	4.1
EPS (UBS, diluted)	4.6	-2.4	9.6	3.4	3.4	8.4	2.4	1.9
Net DPS	3.8	3.6	4.4	4.2	4.8	4.6	4.4	4.2

Margins & Profitability (%)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Gross profit margin	68.3	66.2	68.5	66.8	67.4	68.3	68.7	69.2
EBITDA margin	36.9	35.7	39.1	36.6	37.5	38.8	39.5	40.3
EBIT margin	24.8	23.8	25.0	24.8	25.7	27.2	27.9	28.5
Net earnings (UBS) margin	11.8	11.4	12.5	12.6	12.8	13.5	13.6	13.6
ROIC (EBIT)	11.9	11.6	12.2	11.9	11.7	12.0	11.9	11.7
ROIC post tax	7.8	7.6	8.0	7.7	7.6	7.8	7.7	7.6
ROE (UBS)	9.9	9.3	9.8	9.7	9.6	10.0	9.9	9.6

Capital structure & Coverage (x)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Net debt / EBITDA	2.7	2.8	2.8	3.1	3.4	3.3	3.3	3.4
Net debt / total equity %	80.2	78.7	80.1	84.0	90.8	91.4	91.9	91.1
Net debt / (net debt + total equity) %	44.5	44.0	44.5	45.6	47.6	47.7	47.9	47.7
Net debt/EV %	33.9	34.1	33.6	46.3	49.6	50.0	52.2	54.5
Capex / depreciation %	NM	NM	NM	NM	NM	NM	NM	NM
Capex / revenue %	29.4	26.1	NM	NM	NM	30.0	29.5	29.0
EBIT / net interest	4.6	4.5	4.9	5.2	4.8	4.7	4.4	4.1
Dividend cover (UBS)	1.7	1.6	1.6	1.6	1.6	1.7	1.6	1.6
Div. payout ratio (UBS) %	60.0	63.8	60.7	61.2	62.1	59.9	61.1	62.5

Revenues by division (US$m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Others	3,455	3,492	3,495	3,588	3,653	3,751	3,810	3,870
Total	**3,455**	**3,492**	**3,495**	**3,588**	**3,653**	**3,751**	**3,810**	**3,870**

EBIT (UBS) by division (US$m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Others	858	830	873	890	939	1,020	1,061	1,105
Total	**858**	**830**	**873**	**890**	**939**	**1,020**	**1,061**	**1,105**

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

Forecast returns

Forecast price appreciation	+7.0%
Forecast dividend yield	3.7%
Forecast stock return	+10.7%
Market return assumption	5.7%
Forecast excess return	+5.0%

Valuation Method and Risk Statement

Factors that could negatively impact our estimates and price target include greater than expected fuel or general cost escalation; unfavorable regulatory outcomes with regard to current rates cases or fuel cost adjustment clauses; unplanned plant or transmission outages; unfavorable weather; interest rates; and higher than anticipated slowdown in real estate activity.

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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.
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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Pinnacle West Capital Co.[6, 16]	PNW.N	Neutral	N/A	US$68.25	19 Feb 2016

Source: UBS. All prices as of local market close.
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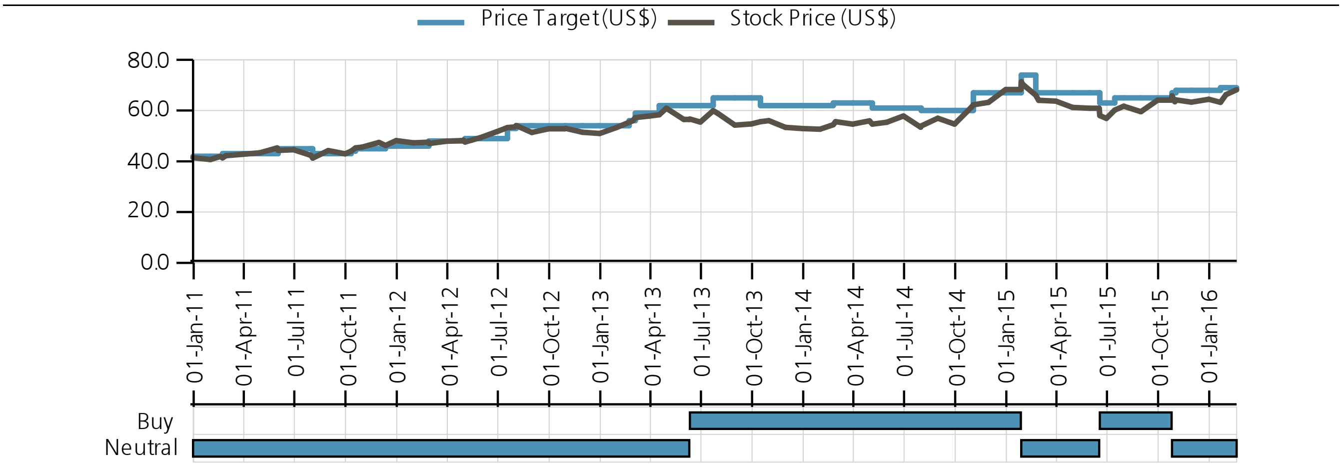
Pinnacle West Capital Co. (US$)



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