

US Electric Utilities & IPPs

Lifting Expectations on New York Capacity

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Auction results this week to show material jump, including Lower Hudson zn

New York will release its first capacity auction results this week (likely Tuesday, 4/1 in the afternoon) reflecting the latest 'breaking out' of the Lower Hudson Valley (LHV) zone at substantially higher prices than when it was under the 'rest of state' pricing. Our latest modelling suggests summer prices for the zone could reach up to ~\$11-13/kW-month range for Summer 2014 (6-month period beginning May 1st), up from \$4.20/kW-month in the Rest of State (RoS) zone for Summer 2013. ETR and NRG are the two largest public entities in the zone, helping estimates for both companies (although their hedge positions are unclear). More notably NRG's position is through its GenOn Bowline unit (a welcome benefit for this distressed subsidiary). We believe ETR shares could continue their latest rally on this datapoint, however, we maintain our Sell rating on shares. We continue to substantially prefer NRG given opportunities in the state and LHV region to further contract its portfolio

Other regions in New York set to climb higher YoY as well

We suspect pricing in both NYC and the Rest of State regions will climb as well for Summer pricing to ~\$16 and ~\$7/kW-month YoY, respectively. The jumps primarily reflect the new demand curves put in place in the region following its triennial reset process (FERC Docket ER14-500). Other beneficiaries in the state from higher prices include NRG, ETR, as well as DYN and EXC.

This is as good as it gets: Pressure from New York to put lid on prices

We flag an all-out effort from New York State to limit consumer utility cost inflation, which is likely to lead to several new contracts for generator re-activations and additions nominally as part of its Indian Point 'contingency planning' (designed to enable the orderly retirement of the unit). Sen. Schumer directly lobbied against the latest the creation of the Lower Hudson Valley in a recent call to Chairwoman LaFleur (inserted into the docket last week). We also see merit to further transmission efforts later this year to temper pricing expectations. Looking into 2015, the HTP transmission line from NJ should also provide an incremental tranche (although its mitigated).

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Digging into the Forecast

We include our latest estimates below. We assume 2014 continues to climb for all regions with the latest demand curve implementation. We flag that 2015 is likely to see some compression as new resources are potentially included (repairing both Bowline and Danskammer once more to add units) as well as Astoria Generation in the city. Lastly, we understand HTP will begin contributing capacity into the NYC market in 2015 (or at least offering at its MOPR price floor) putting a lid on prices close to this figure. Taken altogether, it is clear 2014 is a medium term ceiling on prices, at least until Indian Point's retirement likely late in the decade (at the earliest).

We see upside to our NYISO estimates across all zones

Figure 1: UBS: NYISO Capacity Price Forecast

NYISO ICAP Forecast	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
NYC Forecast									
Summer ICAP (\$/kW-month)	12.37	6.50	6.75	12.90	13.54	11.70	14.80	15.89	14.00
\$/kW-yr	148.44	78.00	81.00	154.80	162.48	140.40	177.60	190.67	168.00
\$/MW-day	407	214	222	424	445	385	487	522	460
Winter ICAP (\$/kW-month)	5.67	1.91	2.79	4.65	4.60	2.70	4.50	7.54	8.54
\$/kW-yr	68.04	22.92	33.48	55.80	55.20	32.40	54.00	90.48	102.48
\$/MW-day	186	63	92	153	151	89	148	248	281
Annualized (\$/kW-yr)	100.72	52.22	60.96	105.20	105.04	90.00	121.88	140.58	129.24
\$/MW-day	276	143	167	288	288	247	334	385	354
NY - Rest of State (RoS)									
Summer ICAP (\$/kW-month)	2.25	2.67	3.01	2.47	0.55	1.25	4.20	6.00	4.00
\$/kW-yr	27.00	32.04	36.12	29.64	6.60	15.00	50.40	72.00	48.00
\$/MW-day	74	88	99	81	18	41	138	197	132
Winter ICAP (\$/kW-month)	2.50	1.91	1.77	1.75	0.39	0.15	0.82	2.58	3.58
\$/kW-yr	30.00	22.92	21.24	21.00	4.68	1.80	9.84	30.96	42.96
\$/MW-day	82	63	58	58	13	5	27	85	118
Annualized (\$/kW-yr)	27.32	27.20	28.64	22.60	5.16	9.74	33.64	51.48	45.68
\$/MW-day	75	75	78	62	14	27	92	141	125
Lower Hudson Valley Estimate									
Summer ICAP (\$/kW-month)								12.99	8.00
\$/kW-yr								155.84	96.00
\$/MW-day								427	263

Source: NYISO and UBS estimates

Lower Hudson Valley Zone

Despite the substantial scrutiny from the state (both NYPSC as well as political constituencies including both the Governor and Senators), we estimate clearing prices initially of the Lower Hudson Valley /New Capacity Zone of (NCZ) of ~\$11-13/kW-month when including all nominal capacity in the region as well as some modest assumption for imports into the region. Given the first time the region is being broken out, it remains exceptionally challenging to estimate, however, we would generally have a positive bias to this estimate. Further, it's important to recall that the region has NYC 'nested' within it such that dynamics that affect NYC going forward will also impact the LHV zone.

Our fundamental view suggests ~\$13/kW-month for Summer '14

A simple average of RoS and NYC would suggest a price of ~\$11

The wildcard remains transmission imports

We continue to expect significant pressure from New York State on the future of this zone. As such, we suspect 2014 is likely the 'top of the market', with pricing likely to substantially decline in future years on account of the following potential resources:

- **Danskammer:** Plant was retired plant (and was sold for demolition), however is now contemplated to return to market with contract with Central Hudson for

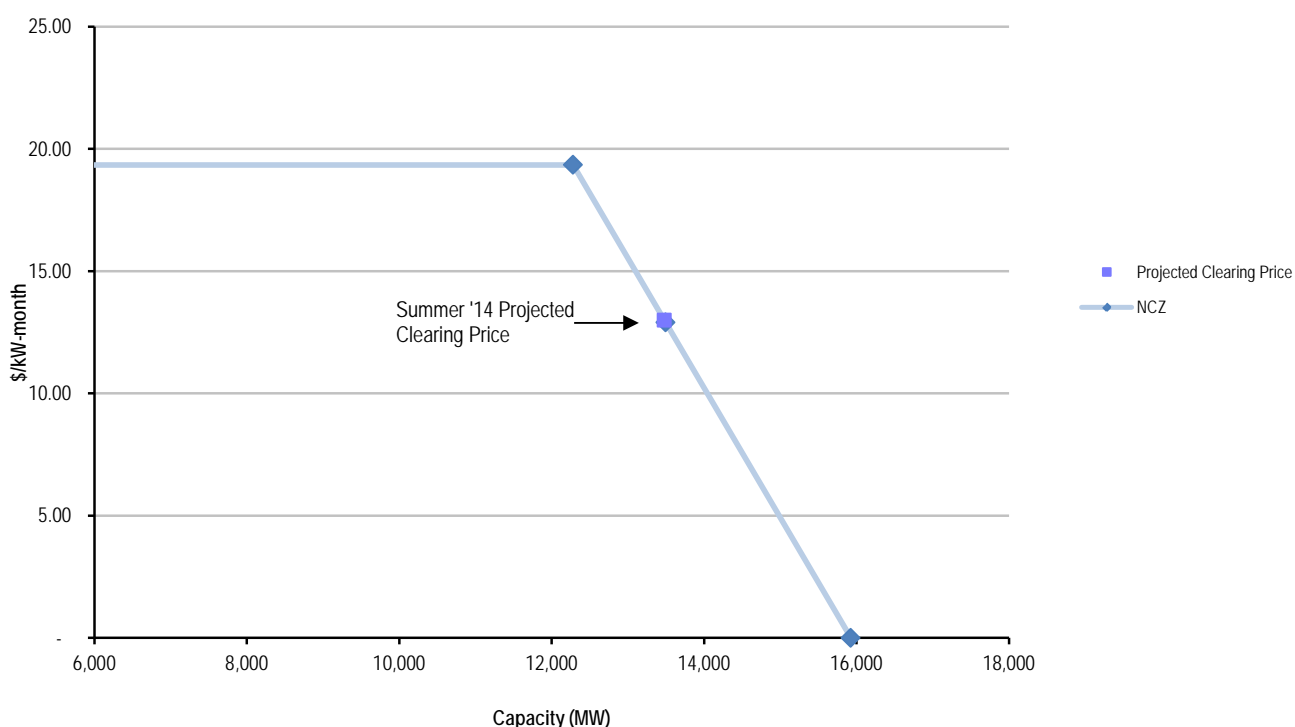
~500 MW. The unit was substantially flooded by Hurricane Sandy. Estimates around repair of the unit are likely not immaterial. If this plant is brought back in, would likely drive down significantly NYC capacity prices given its affect on altering in-city requirement.

- **Bowline:** NRG (GenOn's) Bowline unit could yet see its deliverable capacity improved back to its nameplate as the unit is repaired (adding ~400 MW)
- **Cricket Valley:** New CCGT new IP rated at ~1GW.

Other Moving Pieces:

- **EXC's Ginna Nuclear plant:** Will NY contract for this plant to keep it around? Yes, if it's serious on either its carbon or inflation efforts. We believe a contract with the state could yet be announced in 2Q.
- **AC Transmission upgrades:** We suspect proposed transmission upgrades by Con Edison could yet result in a relative lowering of LHV prices later in the decade (depending on final approval).

Figure 2: Estimated Demand Curve and Clearing Price for the new Lower Hudson Valley (LHV) zone



Source: NYISO and UBS estimates

So what about Indian Point?

In the long-term, we believe the focus on cost inflation is all part of making a phase-out of Indian Point palatable (as this would have a sizable effect on the market). Most notably, we believe a near term focus on gas deliverability could derail any attempts to accelerate the timeline for retirement of both Indian Point units – particularly with any replacements to be gas-fired. We have yet to hear any datapoints on efforts from NY state (akin to New England) to expand regional pipeline to feed incremental generation demand. With Entergy biased to reach a

settlement with the state, we continue to see a long-term, planned retirement reached with the state (although timing on this is likely to prove protracted akin to the Oyster Creek deal in NJ and Exelon (~2020 shutdown timeline). We expect contracting efforts for backstop capacity and expansion of regional transmission system to pick up once more this fall following NY's upcoming gubernatorial elections. Specifically, we would not be surprised to see the Cricket Valley plant assigned a contract for development, as well as either Bowline or Danskammer. We see any further efforts for NYC gas plant development as a ~2015 effort earliest. Despite the glacial pace of developments thus far, the state's leverage over Indian Point is only increasing as it steadily executes on necessary infrastructure (generation and transmission) to result in the plant's retirement.

What's the Exposure to the State?

We include a table with exposures in capacity (MW) to the state by zone. Despite the substantial focus on NRG in recent years from Texas, its position as the dominant generator in the Northeast has continued to drive marginal improvement in EBITDA.

Figure 3: New York State Capacity Exposure by IPP

<u>Exposures</u>	<u>DYN*</u>	<u>NRG</u>	<u>EXC</u>	<u>ETR</u>	<u>CPN*</u>
Rest of State (RoS)	1,064	2,015	2,339	838	
New York City (NYC)		1,355			
Lower Hudson Valley (LHV)		756		2,069	
Long Island (LI)					290
Total	1,064	4,126	2,339	2,907	290

Source: Company reports and UBS estimates

*DYN: Independence CCGT is contracted with a capacity deal through November 2014

*CPN: The bulk of its exposure is contracted with long-term offtake arrangements limiting its market exposure

*EXC: This includes all three nuclear plants: Nine Mile 1&2 and Ginna

*ETR: This includes Fitzpatrick in the Rest of State and Indian Point in LHV

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Risks for Utilities and Independent Power Producers (IPPs) primarily relate to volatile commodity prices for power, natural gas, and coal. Risks to IPPs also stem from load variability, and operational risk in running these facilities. Rising coal and, to a certain extent, uranium prices could pressure margins as the fuel hedges roll off Competitive Integrations. Further, IPPs face declining revenues as in the money power and gas hedges roll off. Other non-regulated risks include weather and for some, foreign currency risk, which again must be diligently accounted in the company's risk management operations. Major external factors, which affect our valuation, are environmental risks. Environmental capex could escalate if stricter emission standards are implemented. We believe a nuclear accident or a change in the Nuclear Regulatory Commission/Environment Protection Agency regulations could have a negative impact on our estimates.

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Neutral	FSR is between -6% and 6% of the MRA.	45%	35%
Sell	FSR is > 6% below the MRA.	11%	23%
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Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	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 2013.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Entergy Corp. ¹⁶	ETR.N	Sell	N/A	US\$66.65	28 Mar 2014
NRG Energy Inc. ¹⁶	NRG.N	Buy	N/A	US\$31.55	28 Mar 2014

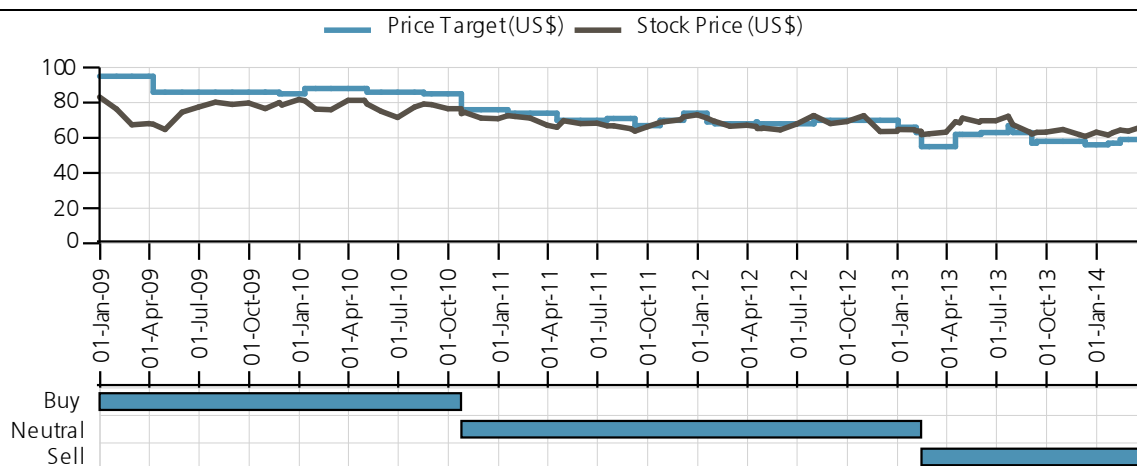
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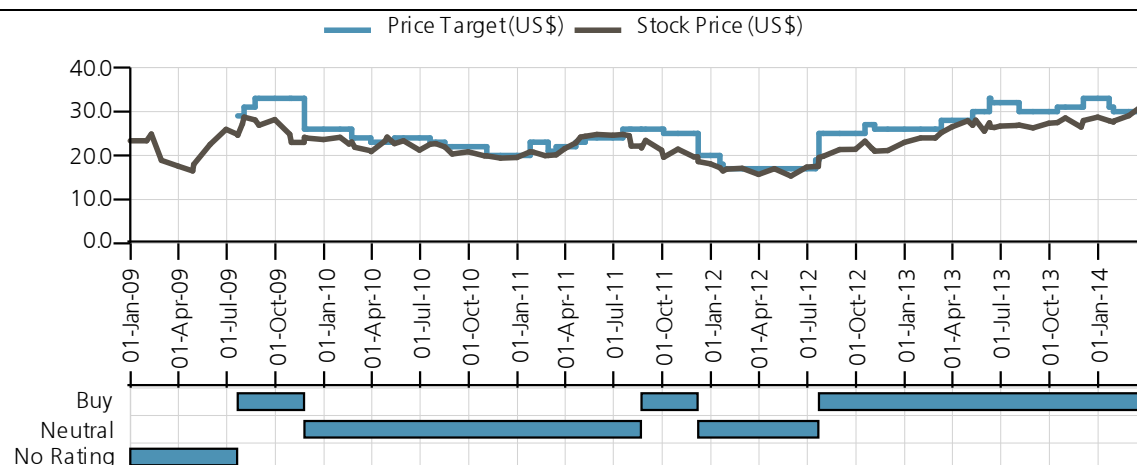
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Entergy Corp. (US\$)



Source: UBS; as of 28 Mar 2014

NRG Energy Inc. (US\$)



Source: UBS; as of 28 Mar 2014

Additional Prices: Exelon Corp., US\$33.29 (28 Mar 2014); Dynegy, Inc., US\$24.74 (28 Mar 2014); Source: UBS. All prices as of local market close.

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