

First Read

NRG Energy Inc.

New York: Coal's Unsung Hero?

NRG will receive contract to convert its Dunkirk coal station in NY to gas

Governor Cuomo announced Sunday that NRG and the NY Power Authority came to a \$150Mn, 10 year agreement to convert the 435MW Dunkirk plant with natural gas in Chautauqua County NY (Units 2,3,4). The contract will go into effect following the conclusions of RMR status on Unit 2 (75MW) in May, 2015. While NYPSC approval remains pending, the sudden announcement, makes contract details the next question (NYPSC Docket 12-E-0577); it is unclear whether the 'reliability' contract will be deemed as capacity, energy or neither (supplemental) at this point in time. It also remains unclear if the plant will be mitigated from participating in the NY capacity market (although it would appear given the low conversion cost, it would likely 'clear').

Conversions likely to cost ~\$50-80/kW, plus ~\$15 Mn for gas pipeline lateral

We estimate the conversion is likely to cost ~\$50 Mn all-in, with ~\$35 Mn to convert the plant, and ~\$15 Mn for gas pipeline lateral, with the plant is ~10-15miles away from the nearest pipeline from what we can tell. Assuming the plant is not mitigated, we estimate the plant would garner ~\$15-20 Mn/yr in EBITDA assuming the plant can clip capacity (~\$20 Mn/yr) and NYPA payment (~\$15 Mn/yr) offset by ~\$15 Mn/yr O&M

More contracts to come? Political push to save coal plant tax rev's

NRG's repowering win comes at the expense of National Grid who was proposing a transmission solution to the problem. The political will to save 40% of the town of Dunkirk's tax base as well as ~\$8 Mn/yr in tax rev's (primarily property) drove the contract for ~\$15 Mn/yr from NYPA. We believe comparable discussions are likely next year to save EXC's Ginna nuclear station as its contract with NYPA rolls off in mid-2014. Similarly, negotiations for a contract (& EPA wavier) to re-light the Danskammer coal plant (as coal) appear under way in a bid to push down capacity prices (not NRG').

Valuation: Reiterate Buy and \$33 PT; first of further repowerings?

We view the contract positively for NRG shares, and anticipate further updates in 2014 on other organic plant additions/contracts for both Astoria and Encina repowering, as well as potentials for other conversions (Portland, EME) and contracts (Bowline in NY). Our PT is derived via a SOTP analysis.

Equities

Americas
Electric Utilities

12-month rating **Buy**

12m price target **US\$33.00**

Price **US\$27.86**

RIC: NRG.N BBG: NRG US

Trading data and key metrics

52-wk range US\$30.11-22.59
Market cap. US\$9.11bn
Shares o/s 327m (COM)
Free float 100%
Avg. daily volume ('000) 665
Avg. daily value (m) US\$18.6
Common s/h equity (12/13E) US\$10.4bn
P/BV (12/13E) 0.8x
Net debt / EBITDA (12/13E) 5.2x

EPS (UBS, diluted) (US\$)

	12/13E	
	UBS	Cons.
Q1	0.00	(1.02)
Q2	0.00	0.39
Q3E	0.00	0.37
Q4E	0.00	0.23
12/13E	0.78	1.99
12/14E	1.47	1.88
12/15E	1.24	1.03

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Highlights (US\$m)	12/10	12/11	12/12	12/13E	12/14E	12/15E	12/16E	12/17E
Revenues	9,210	8,326	8,422	9,801	10,020	9,756	9,785	9,704
EBIT (UBS)	1,676	924	967	1,600	1,796	1,526	1,550	1,483
Net earnings (UBS)	476	(70)	579	244	431	338	364	343
EPS (UBS, diluted) (US\$)	1.87	(0.29)	2.47	0.78	1.47	1.24	1.41	1.41
DPS (US\$)	0.00	0.00	0.18	0.48	0.48	0.48	0.48	0.48
Net (debt) / cash	(6,508)	(8,976)	(14,042)	(13,353)	(12,845)	(12,389)	(11,922)	(11,509)
Profitability/valuation	12/10	12/11	12/12	12/13E	12/14E	12/15E	12/16E	12/17E
EBIT margin %	18.2	11.1	11.5	16.3	17.9	15.6	15.8	15.3
ROIC (EBIT) %	20.2	9.6	6.5	8.9	10.3	9.1	9.6	9.5
EV/EBITDA (core) x	2.0	5.0	6.2	6.3	5.6	6.1	5.9	6.1
P/E (UBS, diluted) x	11.6	(75.0)	7.5	35.7	18.9	22.5	19.7	19.7
Equity FCF (UBS) yield %	16.4	(21.1)	(50.4)	9.8	11.6	10.9	11.0	10.3
Net dividend yield %	0.0	0.0	0.9	1.7	1.7	1.7	1.7	1.7

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\$27.86 on 16 Dec 2013 19:42 EST

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Forecast returns

Forecast price appreciation	+18.4%
Forecast dividend yield	1.8%
Forecast stock return	+20.2%
Market return assumption	5.3%
Forecast excess return	+14.9%

Statement of Risk

Risks to our investment thesis include: 1) actual commodity prices differing significantly from our assumptions; 2) political and regulatory intervention to change the structure of competitive markets in response to high power prices and insufficient new build; 3) the current state of credit markets that has limited the companies' flexibility to return excess cash to shareholders; and 4) unknown impact from a potential carbon legislation (likely a modest negative). Other investment risks include abrupt changes in weather patterns, sharp slowdown in economic demand, interest rate risks, large renewable/transmission buildout across TX, and disruption of trading activity in power markets.

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Buy	FSR is > 6% above the MRA.	44%	32%
Neutral	FSR is between -6% and 6% of the MRA.	46%	32%
Sell	FSR is > 6% below the MRA.	10%	19%
UBS 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 30 September 2013.

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UBS Securities LLC: Julien Dumoulin-Smith.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
NRG Energy Inc. ¹⁶	NRG.N	Buy	N/A	US\$27.86	16 Dec 2013

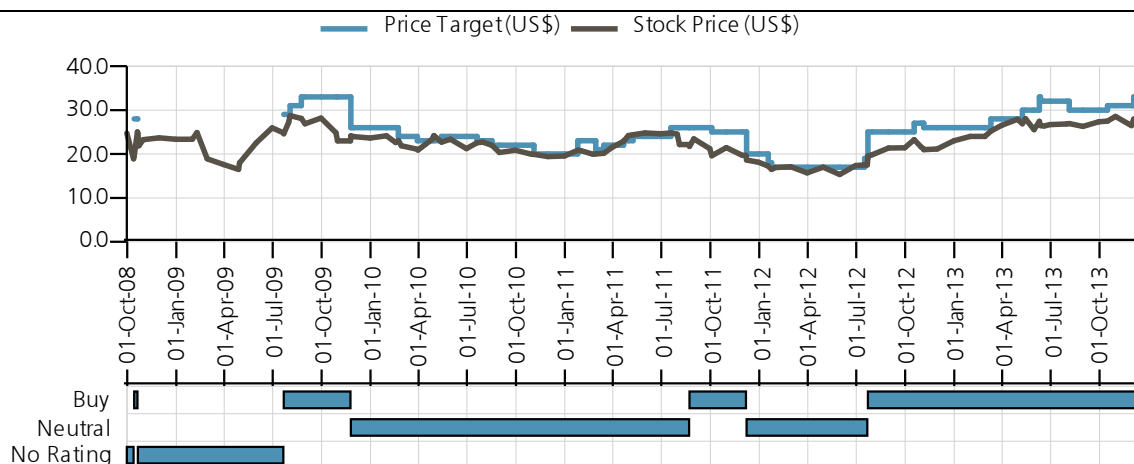
Source: UBS. All prices as of local market close.

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NRG Energy Inc. (US\$)



Source: UBS; as of 16 Dec 2013

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