Southern Company
Doubling Down on Atlanta

SO gasses up the portfolio with largest gas LDC acquisition – strategic win
SO announced the acquisition of AGL Resources (GAS) for $12Bn ($8Bn equity/$4Bn debt assumed) with GAS shareholders receiving $66/sh cash. AGL's largest utilities by customer are in Illinois (2.2Mn), Georgia (1.5Mn), and Virginia (0.3Mn) with 70-80% of earnings via regulated utilities. Unregulated GAS operations include a ~1Mn customer retail business (IL and GA) and midstream investments. GAS invests in PennEast, Atlantic Coast, and Dalton lateral pipelines. We see the deal – and corresponding scale of potential gas investments as a meaningfully (albeit expected) strategic shift.

Immediately accretive to EPS without synergies; cost savings could be material
Transaction expected to be EPS accretive in 2017 and drive long-term EPS growth rate to 4-5% from 3-4% previously (standalone 6-9% CAGR for GAS driven primarily by safety-related distribution capex through pipeline replacement trackers). Deal will require SO issue debt ($5Bn) and equity ($3Bn) with equity issuances throughout 2019 with long-term credit plan to maintain ratings by 2019. Ex-synergies we estimate <1% accretion but given Atlanta headquarters overlap we would expect modest 4-6% savings overtime, potentially driving EPS accretion >2%.

Increased growth and added diversification a positive for shares
We view the accretive deal as a solid positive event for SO as it (1) increases the EPS growth rate back to a utility average 4-5% (without any synergies or further pipeline projects); (2) adds further opportunities for growth via direct gas midstream investments as well as safety-related spend; and (3) dilutes exposure to Kemper and Vogtle projects. SO had been cited as a potential acquirer of TECO but following the announced GAS acquisition we see that pairing as less likely although extended financing timeframe for GAS deal keeps the door open to further M&A.

Valuation: Maintain $41 Price Target; deal worth ~$1/sh on initial review
Valuation based on 2017E SOTP. Mgmt did not quantify synergies but we would expect improvement given Southeast territory overlap. Assuming ~60% debt financing and 6% synergies at GAS level we see potential run-rate EPS accretion of ~$0.07/sh driving ~$1/sh of value. Our higher '15/'16 ests reflect greater SO Power contributions.

Equities

Americas
Electric Utilities

12-month rating	**Sell**
12m price target	**US$41.00**
Price	**US$42.50**
RIC: SO.N **BBG:** SO US	

Trading data and key metrics

52-wk range	US$52.79-41.61
Market cap.	US$38.6bn
Shares o/s	908m (COM)
Free float	99%
Avg. daily volume ('000)	1,596
Avg. daily value (m)	US$69.7
Common s/h equity (12/15E)	US$20.8bn
P/BV (12/15E)	1.9x
Net debt / EBITDA (12/15E)	4.1x

EPS (UBS, diluted) (US$)

	12/15E			
	From	To	% ch	Cons.
Q1	0.56	0.56	0.00	0.56
Q2	0.71	0.71	0.00	0.71
Q3E	1.18	1.19	1.20	1.16
Q4E	0.40	0.44	8.84	0.41
12/15E	2.85	2.90	1.74	2.84
12/16E	2.93	2.99	2.18	2.94
12/17E	3.03	3.03	0.02	3.02

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Highlights (US$m)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenues	16,537	17,087	18,499	19,132	19,641	20,036	20,445	20,901
EBIT (UBS)	4,589	4,552	4,743	5,044	5,286	5,435	5,625	5,857
Net earnings (UBS)	2,331	2,377	2,516	2,646	2,733	2,771	2,857	2,964
EPS (UBS, diluted) (US$)	2.65	2.71	2.80	2.90	2.99	3.03	3.13	3.24
DPS (US$)	1.94	2.01	2.08	2.15	2.22	2.29	2.36	2.43
Net (debt) / cash	(21,806)	(22,636)	(25,558)	(29,506)	(31,538)	(32,466)	(32,755)	(32,944)

Profitability/valuation	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
EBIT margin %	27.7	26.6	25.6	26.4	26.9	27.1	27.5	28.0
ROIC (EBIT) %	13.5	12.7	12.6	12.3	11.8	11.6	11.6	11.9
EV/EBITDA (core) x	9.9	9.7	9.9	9.6	8.3	8.2	7.9	7.6
P/E (UBS, diluted) x	17.1	16.1	15.8	14.7	14.2	14.0	13.6	13.1
Equity FCF (UBS) yield %	(0.7)	0.6	(0.6)	(6.2)	(0.5)	2.5	4.3	4.7
Net dividend yield %	4.3	4.6	4.7	5.1	5.2	5.4	5.6	5.7

Source: Company accounts, Thomson Reuters, UBS estimates. UBS adjusted EPS is stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement. Valuations: based on an average share price that year, (E): based on a share price of US$42.50 on 25 Aug 2015 18:41 EDT

Investment Thesis

Southern Company

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 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 would have positive impacts and could drive valuation to $44.

Downside scenario

We remain concerned about the Kemper project schedule, as well as associated funding costs of a project timeline delay (estimated at ~$25M/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 $38 would involve continued delays for both Kemper and Vogtle projects along with associated unrecoverable spend/dilution.

Upcoming catalysts

Nov 16	Refund payment deadline
1H16	In-service for Kemper (Delayed from YE14)
2H16	Expected GAS acquisition closing
2Q19	In-service for Vogtle Unit-3 (possible 18-mo delay)
2Q20	In-service for Vogtle Unit-4 (possible 18-mo delay)

12-month rating	**Sell**
12m price target	**US$41.00**

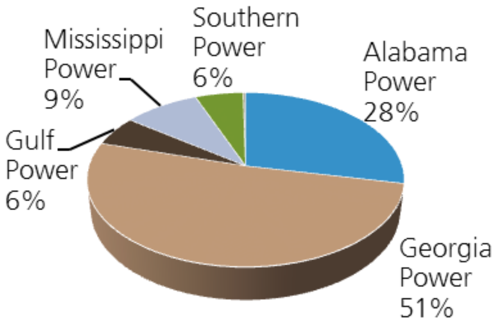
Business description

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

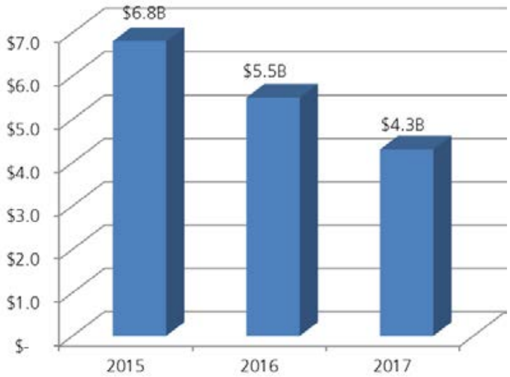
The electric utility industry is projected to experience weak or negative electric demand growth in coming years as a tepid economy and energy efficiency dampen demand. In the unregulated merchant power space, we see limited potential for a meaningful recovery from currently low power prices due to limited 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.

EPS Estimates by Subsidiary (2017E %)



Source: Company Filings and UBS Estimates

Capital Expenditure Projections (Mn)



Source: Company Filings

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For further context, please refer to our recent notes:

7/30/15 August Calendar Heating Up
7/15/15 2Q15 Preview: Power Outage (Page 170)
7/10/15 Getting Messy in Mississippi
4/30/15 Holding Our Breaths for a Deal
2/5/15 Still Struggling

What do we read of the transaction?

Looking through the meaningful leverage resulting from the transaction, we see the move to acquire AGL as aligning well with several key playbooks to driving value for large-cap utilities in the sector. First and foremost, pushing leverage up to drive a more competitive EPS growth profile is a net-win for investors through the low-interest rate cycle. While longer-term, the binge will come to an end, this deal brings both an immediate lift to long-term growth, new opportunities outside the utilities, a more regulated and lower risk profile, and the upfront EPS accretion from initial debt financing (expect equity check of $5 Bn to be spread ratably across 4.5 years).

*Nevertheless, we continue to keep a wary eye on significant execution risk remaining for both Kemper as well as Vogtle, as well as the possibility of a hostile turn in upcoming Mississippi commissioner elections in November. Furthermore, as we draw closer to a possible Fed rate increase, Southern Company has the highest negative correlation with rising interest rates on a two-year P/E basis over both the intermediate (2010-2015) and long-term (1990-2007) – further details are [**here**].*

Dividend implications: What is to come?

Mgmt anticipates raising its dividend target by $0.08/yr to reflect the accretion from the deal, a penny higher than its previous growth target of $0.07/yr. This places the dividend growth rate solidly in the 4%-5% range, with accretion and EPS growth keeping the payout ratio below the 75% target.

Synergies and gas infrastructure build opportunities not included (yet)

In NJ, the company is monitoring PEG's request for a long-term pipeline infrastructure program with an eye toward pursuing something similar for AGL's Elizabethtown Gas.

The EPS improvement from 3%-4% growth up to 4%-5% is *ex*-synergies and mostly driven by ratebase growth at AGL's utilities, largely the result of safety-related pipeline replacement programs that run under infrastructure trackers and experience little regulatory lag. This includes the 9-year (through 2023) "Investing in Illinois" program ($200M-$250M annual capex), multiple 4-8 programs expiring in 2017 in Georgia ($100M-$200M/yr), the 4-year AIR program in New Jersey that expires in 2017 ($30M/yr), and the 5-year SAVE program in Virginia that expires in 2017 ($25M/yr). In NJ, the company is monitoring PEG's request for a long-term pipeline infrastructure program with an eye toward pursuing something similar for AGL's Elizabethtown Gas in terms of an accelerated gas main replacement program.

While SO's growth projections already include the investments that are ahead of plan at Southern Power in 2015 and 2016, they do not include numerous pipeline expansion opportunities arising out of the AGL acquisition, including (but not

limited to) $200M for the Dalton Lateral, $220M for the PennEast Pipeline, $235M for the Atlantic Coast Pipeline, and the ongoing discussions for the proposed Prairie State Pipeline near Chicago.

Removing the "divot" at Southern Power

With the ITC decline looming in 2017, management appears increasingly confident that the corresponding earnings profile "divot" is being filled in through additional projects now projected to exceed the original "placeholder" guidance for both 2015 and 2016. With management also confident of achieving north of $200M earnings this year, we've raised our 2015 estimate for Southern Power from $172M to $217M, although we still show a significant drop in 2017 before growth resumes. We flag higher placeholder equity needs remain reflected in the status-quo plan despite the latest acquisition and equity plans. Our revised estimates largely indicate a ~flattish earnings profile YoY into 2017.

How wide-ranging are their ambitions: <u>not</u> just the Southeast

Will Southern need to change its name given the wider geographic footprint?

We understand mgmt appears poised to broaden the business out *beyond* its core markets in the Southeast with both the utilities and prospective midstream investments seemingly across multiple geographies. AGL's non-regulated gas retail business SouthStar operates throughout the Eastern US and serves 1.4M customers on a capital base of $380M, pulling in revenue of $994M in 2014 and EBIT of $114M (net of minority interest). In our view, the sheer scale of the business could present intriguing cross-selling opportunities for renewable power should SO management decide to head in that direction.

Next steps in midstream?

We see mgmt as poised to provide an update in coming months still around its own (even standalone) midstream investment plans as it seeks to capitalize on growing needs in the Southeast (and elsewhere) on future natural gas needs arising out of the 111(d) regulations. We emphasize these opportunities are likely not necessarily limited to its position in its legacy Southeast footprint, with a litany of opportunities tied to AGL's portfolio of gas assets located in adjacent regions and states. Ultimately, the gas midstream strategy appears derived off leveraging the company's incumbent position as a purchaser of the supply via utility contracts.

From where is gas the cheapest? The Southeast Conundrum

Among key questions to be answered is how to think about gas where gas can be delivered cheapest to the Southeast – is it the Marcellus or from the historic oil & gas load centers across the Gulf and elsewhere? We suspect supply from directions will ultimately flow, with a clear potential this region becomes the premium gas basis market in the country.

However, Sequent may not be a great fit

AGL's non-regulated wholesale services business, Sequent, is projected to earn around $50M EBIT in 2015 (vs $422M in 2014 as a result of Polar Vortex opportunities), seeking to take advantage of natural gas commodity market volatility while providing management and optimization of affiliate and third-party utility pipeline and storage assets. As a trading business, its volatile earnings profile would appear to leave Sequent as the odd man out of a deal designed to boost SO's lower risk regulated profile.

Acquisition fits our Infrastructure model

We see the acquisition as fitting a broader strategic repositioning in the sector towards the renewable and midstream gas opportunities available to companies for prospective growth.

But does this take another company out of the running?

However, with the AGL deal announced, we see this as taking a key potential bidder for TECO out of the running. We still see others as potentially interested (and continue to expect conclusion of TECO's strategic review with a full bid). In some respects, the decision by Southern company to pursue a deal can be interpreted as confirming expectations for large-cap utilities to continue to pursue smid-cap acquisitions to bolder their growth rates.

Credit Implications are expected to be manageable

Leverage is front end loaded to maximize accretion

Management is confident of its ability to maintain credit ratings with the pledge to issue $1B of equity before closing and about $0.5B annually ('17-'19) after that to fund the $3Bn necessary for the acquisition. Most if not all of this could be funded through employee dribble programs over time (~$500 Mn/yr). While improving near-year accretion of the deal was a clear focus for management in employing greater leverage, the company also notes the delayed equity issuance should enable the company to tap equity capital markets beyond in-service of its Kemper CCGT in MS, hopefully side-stepping current ongoing risk around shares.

Emphasizing renewable opportunity set still robust

Still looking for upside on placeholder equity

Management remains adamant on emphasizing continued renewable opportunities alongside the gas infrastructure focus of late. Notably, mgmt remains confident in incremental opportunities beyond its current placeholder capex delineated for both 2015 and 2016; mgmt appears comfortable in issuing addt'l equity if **significant chunky** placeholder capex materializes beyond the current plan. We continue to expect more renewable datapoints in 2H going into 2016 expiration of the ITC. As a reminder, we see many of the renewable investment opportunities as of particular interest to SO due to the immediate benefits recognized in earnings (eg- projected completed through 2016).

Focusing on the Next Turnaround

AGL guides to an EBIT step-up in 2018/2019 based upon the completion of its investments in Dalton lateral, PennEast, and the Atlantic Coast pipelines. As mentioned on P1 our estimates of accretion are driven by the assumption of 6% O&M savings at AGL Resources with ~$0.01/sh accretion assuming zero accretion.

Figure 1: Initial Southern Company-AGL Resources Accretion Analysis – Assuming Staggered Equity

AGL Resources Transaction - Initial Accretion Analysis (Pro-Forma)					
Southern Company - Legacy	**2013A**	**2014E**	**2015E**	**2016E**	**2017E**
Pre-Transaction Net Income ($Mn) - *UBSe*	2,377	2,516	2,646	2,733	2,771
Pre-Transaction Shares (Mn) - *UBSe*	877	897.0	912.8	913.8	913.8
Pre-Transaction EPS	**$ 2.71**	**$ 2.80**	**$ 2.90**	**$ 2.99**	**$ 3.03**
GAS Adj. Net Income ($Mn)	313	482	355	362	371
Synergies ($Mn) - *UBSe*			57	57	58
GAS Shares Outstanding (Mn)	120.09				
	Deal Terms				
Total Consideration per Share	**$66.00**	**All cash**			
Financing ($Mn):		$7,926			
Debt		$4,914	Expected issuance 2Q/3Q 2016		
Equity		$3,012	Expected issuances across 2015-2019		
Total		**7,926**			
SO Share Price (as of 8/24/2015)		**$45.80**			
Increase in Shares Outstanding (Mn)		**65.8**	**16.44**	**16.44**	**16.44**
		Total			
Combined Net Income ($Mn)		2,998	3,001	3,095	3,142
Incremental After-Tax Interest Expense ($Mn) at ~4%			160	160	160
Synergies [6% of GAS O&M]			57	57	58
Pro-Forma Revised Combined Net Income ($Mn)			**2,898**	**2,993**	**3,041**
New Shares Outstanding			929.3	946.6	963.1
Pro-Forma Revised Combined EPS			**$ 3.12**	**$ 3.16**	**$ 3.16**
*Change in EPS (Accretion/Dilution)**			**$ 0.22**	**$ 0.17**	**$ 0.12**
% Change in EPS			*7.6%*	*5.7%*	*4.1%*

**Note: The companies anticipate closing the deal in 2H16. 2015/2016 accretion is illustrative.*

P/E Multiples	**2013**	**2014**	**2015**	**2016**	**2017**
SO	16.9x	16.3x	15.8x	15.3x	15.1x
GAS	18.4x	11.9x	16.2x	15.9x	15.5x
Pro-Forma SO + GAS (SO at $45.8)			14.7x	14.5x	14.5x
Regulated Average		*17.2x*	*16.0x*	*15.2x*	*15.2x*
GAS Takeout Implied P/E		16.4x	22.3x	21.9x	21.4x

Source: Company Filings, FactSet and UBS Estimates. *GAS estimates are via FactSet

Below we show a hypothetical accretion scenario with upfront equity issuances showing $0.07 annual accretion with 6% representing more of a run-rate level.

Figure 2: Initial Southern Company-AGL Resources Accretion Analysis – Assuming Upfront Equity

AGL Resources Transaction - Initial Accretion Analysis (Pro-Forma)					
Southern Company - Legacy	**2013A**	**2014E**	**2015E**	**2016E**	**2017E**
Pre-Transaction Net Income ($Mn) - *UBSe*	2,377	2,516	2,646	2,733	2,771
Pre-Transaction Shares (Mn) - *UBSe*	877	897.0	912.8	913.8	913.8
Pre-Transaction EPS	**$ 2.71**	**$ 2.80**	**$ 2.90**	**$ 2.99**	**$ 3.03**
GAS Adj. Net Income ($Mn)	313	482	355	362	371
Synergies ($Mn) - *UBSe*			57	57	58
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Total Consideration per Share	**$66.00**	**All cash**			
Financing ($Mn):		$7,926			
Debt		$4,914	Expected issuance 2Q/3Q 2016		
Equity		$3,012	Expected issuances across 2015-2019		
Total		**7,926**			
SO Share Price (as of 8/24/2015)		**$45.80**			
Increase in Shares Outstanding (Mn)		**65.8** Total	**65.8**	**-**	**-**
Combined Net Income ($Mn)		2,998	3,001	3,095	3,142
Incremental After-Tax Interest Expense ($Mn) at ~4%			160	160	160
Synergies [6% of GAS O&M]			57	57	58
Pro-Forma Revised Combined Net Income ($Mn)			**2,898**	**2,993**	**3,041**
New Shares Outstanding			978.6	979.5	979.5
Pro-Forma Revised Combined EPS			**$ 2.96**	**$ 3.06**	**$ 3.10**
*Change in EPS (Accretion/Dilution)**			**$ 0.06**	**$ 0.06**	**$ 0.07**
% Change in EPS			*2.2%*	*2.2%*	*2.4%*

**Note: The companies anticipate closing the deal in 2H16. 2015/2016 accretion is illustrative.*

P/E Multiples	**2013**	**2014**	**2015**	**2016**	**2017**
SO	16.9x	16.3x	15.8x	15.3x	15.1x
GAS	18.4x	11.9x	16.2x	15.9x	15.5x
Pro-Forma SO + GAS (SO at $45.8)			15.5x	15.0x	14.8x
Regulated Average		*17.2x*	*16.0x*	*15.2x*	*15.2x*
GAS Takeout Implied P/E		16.4x	22.3x	21.9x	21.4x

Source: Company Filings, FactSet and UBS Estimates. *GAS estimates are via FactSet

We include basic details on the AGL portfolio showing that the utilities are earning near their allowed ROEs with room for improvement at the largest utility (Atlanta Gas Light) with a 10.16% earned ROE against a 10.75% allowed ROE. At the AGA Conference this May management guided to "rate case filings in multiple jurisdictions over the next several years".

Figure 3: AGL Resources Utilities Overview

AGL Resources	Allowed ROE	Earned ROE	Rate Base ($mn)	Customers ('000)
Nicor Gas	10.17%	10.24%	1,561	2,195
Atlanta Gas Light	10.75%	10.16%	2,315	1,560
Virginia Nat Gas	10.00%	8.77%	590	287
Elizabethtown Gas	10.30%	11.52%	519	281
Florida City Gas	11.25%	8.41%	182	105
Chattanooga Gas	10.05%	11.19%	104	63
Total/Average		**10.12%**	**5,271**	**4,491**

Source: Company Filings

Gas distribution continues to be the main source of growth with GAS management guiding towards 75% EBIT distribution growth by 2019, up for 73% in 2015. Retail is expected to compress to 14% from 21% with midstream expected to materialize at 6%.

Figure 4: AGL Resources EBIT by Segment

$mm	2012	2013	2014	2015E	2019E
Gas Distribution	532	549	573	591	750
Retail Energy Ops.	99	116	125	133	140
Wholesale Services	(3)	35	23	24	50
Midstream	10	3	3	5	60
Total EBIT	637	705	729	762	~1000

Source: Company Filings

Estimates: Raising Estimates for Southern Power

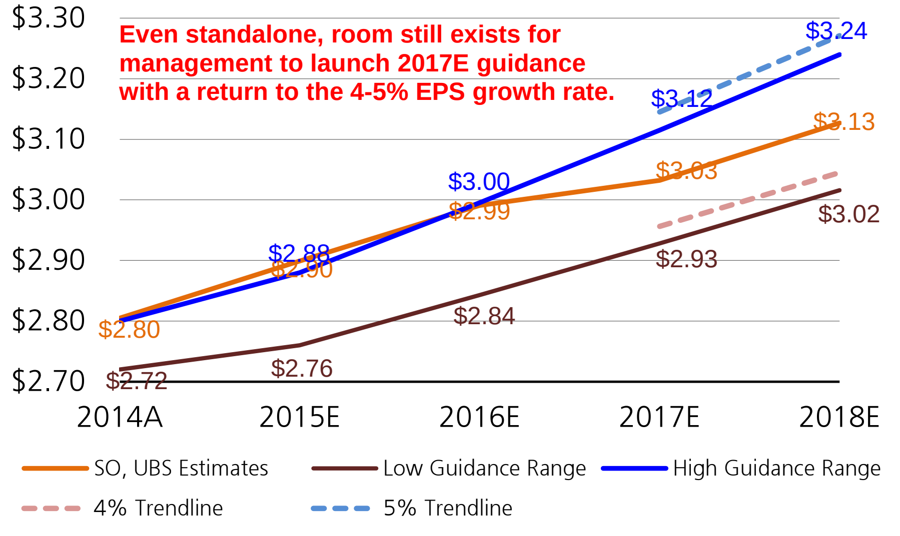
Our FY15 EPS estimate remains above the midpoint on the strength of 1H15 weather but the actual outcome could be pulled down closer toward the midpoint if sales growth does not gravitate higher towards the guidance level. *Our estimates imply a 3-year earnings CAGR at the midpoint of 3-4% contemplated long-term rate from the midpoint of 2015 guidance $2.82.*

Figure 5: UBS Estimates for SO 2014E-2018E

SO EPS Estimates	2014A	2015E	2016E	2017E	2018E
Alabama Power	$0.85	$0.82	$0.82	$0.86	$0.90
Georgia Power	$1.37	$1.46	$1.51	$1.56	$1.58
Gulf Power	$0.16	$0.16	$0.16	$0.17	$0.18
Mississippi Power	$0.25	$0.23	$0.24	$0.27	$0.29
Southern Power	$0.19	$0.24	$0.26	$0.17	$0.19
Other	($0.01)	($0.00)	($0.01)	($0.01)	($0.01)
SO, UBS Estimates	**$2.80**	**$2.90**	**$2.99**	**$3.03**	**$3.13**
		3.4%	**3.2%**	**1.4%**	**3.1%**
Guidance Range		2.76-2.88			
3-yr EPS CAGR off '15 $2.82 guidance		3.5%			
Long Term EPS CAGR Guidance		3-4%			
Prior UBSe		*$2.85*	*$2.93*	*$3.03*	*$3.13*
Street Consensus		*$2.84*	*$2.94*	*$3.02*	*$3.15*

Source: UBS estimates, Company filings, FactSet

Figure 6: Updated UBSe EPS Estimates Relative to Guidance Expectations



Source: UBS estimates, Company filings

Valuation: Maintain $41 Price Target

Valuation remains based on standalone 2017E SOTP with significant discounts applied to the subsidiaries with elevated regulatory and execution risks for Vogtle and Kemper projects. While we acknowledge the AGL deal's potential improvement to consolidated risk metrics (a more regulated profile that dilutes higher risk projects such as Kemper), given the continued uncertainty and significant capital involved, we maintain our Sell on shares. We suspect shares could prove constructive in coming weeks as the full impact and ancillary implications on future/indirect midstream opportunities are internalized by the market. While mgmt's playbook appears increasingly designed to play to the wider sector themes of renewables and midstream, alongside capitalizing on its currency and balance sheet to make accretive deals, we emphasize a discounted valuation vs peers remains appropriate. The addition of a meaningful portfolio of gas LDCs should enable the company to add to its overall relative P/E position vs peers (although it clearly paid for this right via the premium to shares paid).

Figure 7: SO valuation table (based on 2017E earnings)

Southern Company Valuation (UBSe)		Low Case			Base Case		High Case	
Business Segment	2017E EPS	Valuation Multiple	Per Sh. Value	Prem/ Discount	Valuation Multiple	Per Sh. Value	Valuation Multiple	Per Sh. Value
Regulated Business								
Alabama Power	$0.86	13.7x	$11.79	0.00x	14.7x	$12.65	15.7x	$13.51
Georgia Power	$1.56	12.2x	$19.07	-1.50x	13.2x	$20.63	14.2x	$22.20
Gulf Power	$0.17	13.7x	$2.34	0.00x	14.7x	$2.51	15.7x	$2.68
Mississippi Power	$0.27	11.2x	$3.06	-2.50x	12.2x	$3.34	13.2x	$3.61
Southern Power (Contracted Merchant)	$0.17	12.7x	$2.20	-1.00x	13.7x	$2.38	14.7x	$2.55
Other	($0.01)	13.7x	($0.13)	0.00x	14.7x	($0.13)	15.7x	($0.14)
Southern Company Total/Implied	**$3.03**	***12.5x***	**$38.00**		***13.5x***	**$41.00**	***14.5x***	**$44.00**
Shares Outstanding (2017E Mn)				914	*Overall discount*			
Regulated Peer Group Multiple				14.7x	**-8.0%**			

Source: UBS estimates

What about timing on the deal?

The transaction requires state approvals from GA, IL, NJ, MD, and VA with financial close expected in 2H16; GAS does not currently have any pending rate cases. We suspect regulatory approval in each of these jurisdictions may well entail rate case stayouts (rather than ability to earn in excess of authorized levels) given earned ROEs are near allowed levels across most jurisdictions.

Southern Company (SO.N)

Income statement (US$m)	12/12	12/13	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
Revenues	**16,537**	**17,087**	**18,499**	**19,132**	*3.4*	**19,641**	*2.7*	**20,036**	**20,445**	**20,901**
Gross profit	10,936	11,116	11,822	12,455	*5.4*	12,964	*4.1*	13,359	13,768	14,224
EBITDA (UBS)	**6,376**	**6,453**	**6,682**	**7,164**	*7.2*	**7,532**	*5.1*	**7,776**	**8,035**	**8,337**
Depreciation & amortization	(1,787)	(1,901)	(1,939)	(2,120)	*9.3*	(2,246)	*6.0*	(2,341)	(2,410)	(2,480)
EBIT (UBS)	**4,589**	**4,552**	**4,743**	**5,044**	*6.4*	**5,286**	*4.8*	**5,435**	**5,625**	**5,857**
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	(859)	(824)	(840)	(932)	*-11.0*	(1,042)	*-11.8*	(1,134)	(1,192)	(1,262)
Exceptionals (incl goodwill)	0	0	0	0	-	0	-	0	0	0
Profit before tax	**3,730**	**3,728**	**3,903**	**4,112**	*5.4*	**4,244**	*3.2*	**4,301**	**4,432**	**4,594**
Tax	(1,334)	(1,285)	(1,319)	(1,398)	*-6.0*	(1,443)	*-3.2*	(1,462)	(1,507)	(1,562)
Profit after tax	**2,396**	**2,443**	**2,584**	**2,714**	*5.0*	**2,801**	*3.2*	**2,839**	**2,925**	**3,032**
Preference dividends	(65)	(66)	(68)	(68)	-	(68)	-	(68)	(68)	(68)
Minorities	0	0	0	0	-	0	-	0	0	0
Extraordinary items	19	(733)	(274)	(18)	*93.4*	0	-	0	0	0
Net earnings (local GAAP)	**2,350**	**1,644**	**2,242**	**2,628**	*17.2*	**2,733**	*4.0*	**2,771**	**2,857**	**2,964**
Net earnings (UBS)	**2,331**	**2,377**	**2,516**	**2,646**	*5.2*	**2,733**	*3.3*	**2,771**	**2,857**	**2,964**
Tax rate (%)	35.8	34.5	33.8	34.0	*0.6*	34.0	*0.0*	34.0	34.0	34.0

Per share (US$)	12/12	12/13	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
EPS (UBS, diluted)	2.65	2.71	2.80	2.90	*3.4*	2.99	*3.2*	3.03	3.13	3.24
EPS (local GAAP, diluted)	2.67	1.88	2.50	2.88	*15.2*	2.99	*3.9*	3.03	3.13	3.24
EPS (UBS, basic)	2.69	2.71	2.80	2.90	*3.4*	2.99	*3.2*	3.03	3.13	3.24
Net DPS (US$)	1.94	2.01	2.08	2.15	*3.4*	2.22	*3.3*	2.29	2.36	2.43
Cash EPS (UBS, diluted)[1]	4.69	4.88	4.97	5.22	*5.1*	5.45	*4.4*	5.59	5.76	5.96
Book value per share	21.74	22.43	22.26	22.82	*2.5*	23.56	*3.3*	24.30	25.07	25.88
Average shares (diluted)	878.84	876.75	897.00	912.82	*1.8*	913.76	*0.1*	913.76	913.76	913.76

Balance sheet (US$m)	12/12	12/13	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
Cash and equivalents	628	659	710	1,092	*53.8*	2,210	*102.4*	3,607	3,118	3,229
Other current assets	5,534	4,940	5,660	5,898	*4.2*	6,046	*2.5*	6,161	6,280	6,412
Total current assets	**6,162**	**5,599**	**6,370**	**6,990**	*9.7*	**8,256**	*18.1*	**9,768**	**9,397**	**9,641**
Net tangible fixed assets	48,390	51,208	54,868	59,318	*8.1*	62,343	*5.1*	64,272	65,581	66,821
Net intangible fixed assets	0	0	0	0	-	0	-	0	0	0
Investments / other assets	8,597	7,739	9,685	9,685	*0.0*	9,685	*0.0*	9,685	9,685	9,685
Total assets	**63,149**	**64,546**	**70,923**	**75,994**	*7.1*	**80,284**	*5.6*	**83,724**	**84,664**	**86,147**
Trade payables & other ST liabilities	3,854	3,585	4,556	4,017	*-11.8*	4,055	*0.9*	4,095	4,136	4,178
Short term debt	3,160	1,951	4,411	2,278	*-48.36*	2,278	*0.00*	2,278	2,278	2,278
Total current liabilities	**7,014**	**5,536**	**8,967**	**6,295**	*-29.8*	**6,333**	*0.6*	**6,373**	**6,414**	**6,456**
Long term debt	19,274	21,344	20,841	27,304	*31.0*	30,454	*11.5*	32,779	32,579	32,879
Other long term liabilities	17,482	17,527	19,775	20,175	*2.0*	20,575	*2.0*	20,975	21,375	21,775
Preferred shares	0	0	1,016	1,016	*0.00*	1,016	*0.00*	1,016	1,016	1,016
Total liabilities (incl pref shares)	**43,770**	**44,407**	**50,599**	**54,790**	*8.3*	**58,378**	*6.5*	**61,143**	**61,384**	**62,126**
Common s/h equity	19,004	19,764	19,949	20,828	*4.4*	21,530	*3.4*	22,206	22,905	23,647
Minority interests	375	375	375	375	*0.0*	375	*0.0*	375	375	375
Total liabilities & equity	**63,149**	**64,546**	**70,923**	**75,994**	*7.1*	**80,284**	*5.6*	**83,724**	**84,664**	**86,147**

Cash flow (US$m)	12/12	12/13	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
Net income (before pref divs)	2,415	1,710	2,310	2,696	*16.7*	2,801	*3.9*	2,839	2,925	3,032
Depreciation & amortization	1,787	1,901	1,939	2,120	*9.3*	2,246	*6.0*	2,341	2,410	2,480
Net change in working capital	(451)	152	614	(777)	-	(110)	*85.9*	(75)	(78)	(90)
Other operating	789	1,937	877	155	*-82.3*	155	*0.0*	155	155	155
Operating cash flow	**4,540**	**5,700**	**5,740**	**4,193**	*-26.9*	**5,092**	*21.4*	**5,260**	**5,412**	**5,577**
Tangible capital expenditure	(4,809)	(5,463)	(5,977)	(6,600)	*-10.4*	(5,300)	*19.7*	(4,300)	(3,750)	(3,750)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	0	0	0	0	-	0	-	0	0	0
Other investing	(359)	(279)	(431)	0	-	0	-	0	0	0
Investing cash flow	**(5,168)**	**(5,742)**	**(6,408)**	**(6,600)**	*-3.0*	**(5,300)**	*19.7*	**(4,300)**	**(3,750)**	**(3,750)**
Equity dividends paid	(1,693)	(1,762)	(1,866)	(1,967)	*-5.4*	(2,031)	*-3.3*	(2,095)	(2,159)	(2,223)
Share issues / (buybacks)	(33)	675	801	200	*-75.0*	0	-	0	0	0
Other financing	(448)	(597)	(524)	(683)	*-30.33*	(756)	*-10.67*	(816)	(855)	(901)
Change in debt & pref shares	1,205	820	1,677	4,330	*158.20*	3,150	*-27.25*	2,325	(200)	300
Financing cash flow	**(969)**	**(864)**	**88**	**1,880**	*NM*	**363**	*-80.7*	**(586)**	**(3,214)**	**(2,824)**
Cash flow inc/(dec) in cash	**(1,597)**	**(906)**	**(580)**	**(527)**	*9.3*	**155**	-	**374**	**(1,551)**	**(996)**
FX / non cash items	910	937	631	908	*43.9*	963	*6.0*	1,023	1,062	1,108
Balance sheet inc/(dec) in cash	**(687)**	**31**	**51**	**382**	*NM*	**1,118**	*192.8*	**1,397**	**(489)**	**112**

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)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
P/E (local GAAP, diluted)	17.0	23.3	17.7	14.8	14.2	14.0	13.6	13.1
P/E (UBS, diluted)	17.1	16.1	15.8	14.7	14.2	14.0	13.6	13.1
P/CEPS	9.5	9.0	8.9	8.1	7.8	7.6	7.4	7.1
Equity FCF (UBS) yield %	(0.7)	0.6	(0.6)	(6.2)	(0.5)	2.5	4.3	4.7
Net dividend yield (%)	4.3	4.6	4.7	5.1	5.2	5.4	5.6	5.7
P/BV x	2.1	1.9	2.0	1.9	1.8	1.7	1.7	1.6
EV/revenues (core)	3.8	3.6	3.6	3.6	3.2	3.2	3.1	3.0
EV/EBITDA (core)	9.9	9.7	9.9	9.6	8.3	8.2	7.9	7.6
EV/EBIT (core)	13.8	13.7	14.0	13.7	11.8	11.7	11.3	10.9
EV/OpFCF (core)	13.8	13.7	14.0	13.7	11.8	11.7	11.3	10.9
EV/op. invested capital	1.9	1.7	1.8	1.7	1.4	1.4	1.3	1.3

Enterprise value (US$m)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Market cap.	39,438	38,263	39,422	38,590	38,590	38,590	38,590	38,590
Net debt (cash)	20,857	22,221	24,097	27,532	30,522	32,002	32,002	32,002
Buy out of minorities	375	375	375	375	375	375	375	375
Pension provisions/other	2,540	1,461	2,432	2,432	2,432	2,432	2,432	2,432
Total enterprise value	**63,210**	**62,320**	**66,326**	**68,929**	**71,919**	**73,399**	**73,399**	**73,399**
Non core assets	0	0	0	0	(9,685)	(9,685)	(9,685)	(9,685)
Core enterprise value	**63,210**	**62,320**	**66,326**	**68,929**	**62,234**	**63,714**	**63,714**	**63,714**

Growth (%)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenue	-6.3	3.3	8.3	3.4	2.7	2.0	2.0	2.2
EBITDA (UBS)	5.2	1.2	3.5	7.2	5.1	3.2	3.3	3.8
EBIT (UBS)	5.6	-0.8	4.2	6.4	4.8	2.8	3.5	4.1
EPS (UBS, diluted)	4.0	2.2	3.5	3.4	3.2	1.4	3.1	3.7
Net DPS	3.7	3.6	3.5	3.4	3.3	3.1	3.1	3.0

Margins & Profitability (%)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Gross profit margin	66.1	65.1	63.9	65.1	66.0	66.7	67.3	68.1
EBITDA margin	38.6	37.8	36.1	37.4	38.3	38.8	39.3	39.9
EBIT margin	27.7	26.6	25.6	26.4	26.9	27.1	27.5	28.0
Net earnings (UBS) margin	14.1	13.9	13.6	13.8	13.9	13.8	14.0	14.2
ROIC (EBIT)	13.5	12.7	12.6	12.3	11.8	11.6	11.6	11.9
ROIC post tax	8.7	8.3	8.4	8.1	7.8	7.6	7.7	7.8
ROE (UBS)	12.5	12.3	12.7	13.0	12.9	12.7	12.7	12.7

Capital structure & Coverage (x)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Net debt / EBITDA	3.4	3.5	3.8	4.1	4.2	4.2	4.1	4.0
Net debt / total equity %	112.5	112.4	125.8	139.2	144.0	143.8	140.7	137.1
Net debt / (net debt + total equity) %	52.9	52.9	55.7	58.2	59.0	59.0	58.5	57.8
Net debt/EV %	34.5	36.3	38.5	42.8	50.7	51.0	51.4	51.7
Capex / depreciation %	NM	NM	NM	NM	NM	183.7	155.6	151.2
Capex / revenue %	29.1	NM	NM	NM	27.0	21.5	18.3	17.9
EBIT / net interest	5.3	5.5	5.6	5.4	5.1	4.8	4.7	4.6
Dividend cover (UBS)	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Div. payout ratio (UBS) %	72.2	74.2	74.2	74.3	74.3	75.6	75.6	75.0

Revenues by division (US$m)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Others	16,537	17,087	18,499	19,132	19,641	20,036	20,445	20,901
Total	**16,537**	**17,087**	**18,499**	**19,132**	**19,641**	**20,036**	**20,445**	**20,901**

EBIT (UBS) by division (US$m)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Others	4,589	4,552	4,743	5,044	5,286	5,435	5,625	5,857
Total	**4,589**	**4,552**	**4,743**	**5,044**	**5,286**	**5,435**	**5,625**	**5,857**

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

Forecast returns

Forecast price appreciation	-3.5%
Forecast dividend yield	5.2%
Forecast stock return	+1.7%
Market return assumption	5.6%
Forecast excess return	-3.9%

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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12-Month Rating	**Definition**	**Coverage**[1]	**IB Services**[2]
Buy	FSR is > 6% above the MRA.	45%	36%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	13%	20%
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 June 2015.
1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category. 4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 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$42.50	25 Aug 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

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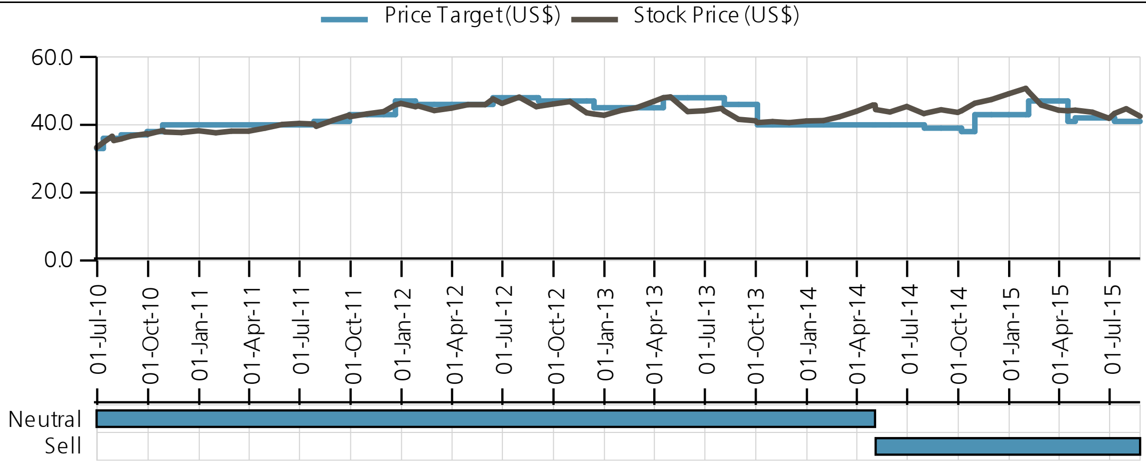
Southern Company (US$)



Source: UBS; as of 25 Aug 2015

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