

Dynegy, Inc.

Repurchases Are Just The Right Medicine

Solid 2Q but 2015 Guidance now at the low-end vs high-end as of 1Q

2015 adjusted EBITDA (\$825-\$1,025Mn) and FCF (\$100-\$300Mn) guidance was reaffirmed although management now expects to be at the bottom-end of the ranges vs the top-end last quarter. We look for further details on the 2016-2018 guidance first articulated at the June Analyst Day. 2015 PRIDE EBITDA and B/S targets were maintained at \$135Mn and \$165Mn, respectively, but mgmt added more to its realized/secured buckets. DYN reported 1Q15 adjusted EBITDA of \$193Mn ahead of both UBS/Consensus (\$142Mn/\$181Mn) with a strong \$157Mn from the newly acquired assets (vs +\$106Mn UBSe). Results were weighed down by unplanned coal outages and congestion at IPH.

Repurchase plan comes sooner and larger than expected; likely biased to '16

DYN announced the BoD authorized a \$250Mn purchase plan through YE16, representing 8% of the current market cap. We had expected this announcement with 3Q/EEI but mgmt opted to accelerate given the ~30% slide in the last few months. Furthermore, the repurchase size is larger than anticipated given DYN's 2015E FCF profile (guidance is for <\$200Mn) so we are biased to believe this is materially focused on 2016. Franklin Advisers still holds 9.2Mn shares (7% of shares O/S, or ~\$225Mn) as of 6/2 in a variety of income funds; while this is materially lower from just earlier this year, we see an opportunity for DYN to potentially address an investor 'overhang'.

Call at 9AM ET: Dial-in: 1-800-857-5215; Passcode: Dynegy

Topics: 1) Anticipated pace of repurchases given FCF profile and potential for private transactions; 2) Update on CA water solution; 3) Potential for partnering on Newton scrubber; 4) Latest taxpayer status; and 5) Latest view on MISO bilateral market.

Valuation: Reduce PT \$7; Accelerated repurchase plan > weaker '15 guidance

PT of \$30 is based on 2017E SOTP. We are reducing our base EV / EBITDA multiple assumption to 8x as we take a more cautious view on power markets after the recent slide. With a 14.4% 2016-2019 average FCF yield we still see 20%+ upside. The \$100Mn swing in our EBITDA may be hard to stomach but the accelerated buyback is just the right medicine, in our view.

Highlights (US\$m)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenues	1,293	1,466	2,497	3,898	5,371	5,386	5,611	5,461
EBIT (UBS)	(97)	(309)	(51)	470	722	804	1,072	1,085
Net earnings (UBS)	(224)	(359)	(278)	(31)	108	134	312	377
EPS (UBS, diluted) (US\$)	(2.24)	(3.59)	(2.78)	(0.24)	0.90	1.12	2.59	3.13
DPS (US\$)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net (debt) / cash	(1,067)	(1,149)	(6,226)	(6,035)	(5,822)	(5,353)	(4,903)	(4,444)
Profitability/valuation	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
EBIT margin %	-7.5	-21.1	-2.0	12.1	13.4	14.9	19.1	19.9
ROIC (EBIT) %	(2.8)	(8.9)	(0.7)	4.5	6.9	8.0	10.9	11.2
EV/EBITDA (core) x	27.7	14.9	12.6	9.9	7.6	7.2	5.9	5.9
P/E (UBS, diluted) x	(2.3)	(5.9)	(10.2)	(96.2)	26.0	21.0	9.0	7.5
Equity FCF (UBS) yield %	(62.8)	6.9	6.0	(21.7)	19.8	20.1	19.2	19.6
Net dividend yield %	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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\$23.39 on 06 Aug 2015 19:38 EDT

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Equities

Americas
Electric Utilities

12-month rating **Buy**

12m price target **US\$30.00**
Prior: **US\$37.00**

Price **US\$23.39**

RIC: DYN.N BBG: DYN US

Trading data and key metrics

52-wk range	US\$34.76-23.39
Market cap.	US\$2.34bn
Shares o/s	100m (COM)
Free float	100%
Avg. daily volume ('000)	468
Avg. daily value (m)	US\$14.1
Common s/h equity (12/15E)	US\$4.14bn
P/BV (12/15E)	0.7x
Net debt / EBITDA (12/15E)	6.7x

EPS (UBS, diluted) (US\$)

	12/15E			
	From	To	% ch	Cons.
Q1	(0.69)	(0.69)	0.00	(1.49)
Q2	(0.78)	2.73	448.53	(0.37)
Q3E	0.84	0.83	-1.12	0.88
Q4E	0.73	(3.41)	-569.74	0.51
12/15E	0.11	(0.24)	-318.13	(0.02)
12/16E	0.84	0.90	7.45	1.98
12/17E	1.04	1.12	7.66	1.91

Julien Dumoulin-Smith

Analyst
julien.dumoulin-smith@ubs.com
+1-212-713 9848

Michael Weinstein

Associate Analyst
michael.weinstein@ubs.com
+1-212-713 3182

Paul Zimbardo

Associate Analyst
paul.zimbardo@ubs.com
+1-212-713 1033

For additional context, please refer links to relevant recent reports below:

[7/15/15 2Q Playbook: Summer Power Outage \(Page 81\)](#)

[6/26/15 Gassing up the Portfolio](#)

[4/15/15 Collecting on the Midwest Bid \(MISO Auction\)](#)

[2/25/15 Defining the Value Proposition](#)

[1/19/15 Another Round of the Waiting Game](#)

[11/7/15 Opportunities Abound: Sourcing Additional Upsides](#)

Other Initial Takeaways:

- **~14.5% Free Cash Flow key part of thesis:** With all of the IPPs having pulled back sharply in recent weeks we continue to emphasize the free cash flow stories at the names. Following Dynegy's announcement yesterday that it would begin repurchasing shares, four out of five IPPs are now repurchasing shares. Talen is the lone exception and management has stated that a near-term focus is M&A to expand the asset base. Dynegy's FCF yield is actually slightly below average compared with other IPPs but the 14.4% 2016-2019 yield still looks very respectable and worthy of investor attention. Dynegy's cash flow profile steps down in 2019 based on management's estimate that it will be a cash tax payer by this point; however, we see future M&A as potentially pushing this event further into the future.

Figure 1: Updated Dynegy Free Cash Flow

Dynegy Free Cash Flow Analysis	2014A	2015E	2016E	2017E	2018E	2019E	2020E
Adjusted EBITDA	932	898	1,170	1,240	1,498	1,507	1,507
Less: Interest Expense	(147)	(533)	(505)	(505)	(505)	(505)	(505)
Less: Taxes	No Cash Taxes Through At Least 2018E					(203)	(204)
FCF Pre-Capex (Proxy for FFO)	785	365	665	735	993	799	797
Less: Capital Expenditures	(123)	(275)	(360)	(315)	(410)	(338)	(338)
Plus/Minus: Other	27	5	5	5	5	5	5
Free Cash Flow	689	95	311	426	588	467	465
Guidance	\$10-\$60	\$100-\$300	~\$430	~\$430	~\$430		
Debt Profile (incl. ST Debt Balance)	\$7,106	\$7,106	\$7,106	\$7,106	\$7,106	\$7,106	\$7,106
Cash	\$880	\$1,071	\$1,284	\$1,753	\$2,203	\$2,662	\$3,121
Net Debt	\$6,226	\$6,035	\$5,822	\$5,353	\$4,903	\$4,444	\$3,985
Net Debt / EBITDA	6.7x	6.7x	5.0x	4.3x	3.3x	2.9x	2.6x
FFO / Gross Debt	11%	5%	9%	10%	14%	11%	11%
FCF Yield	22.2%	3.1%	10.0%	13.7%	18.9%	15.0%	15.0%

Source: Company Filings and UBS Estimates * 2014 and 2015 FCF Yields are impacted by the recent DUK/ECP transactions impacting comparability

- **Accelerated repurchase plan likely focused on 2016:** While management can begin repurchasing shares in the upcoming weeks to take advantage of shares trading well below their 52-week low, with ~\$100Mn UBSe Free Cash Flow (low-end of the \$100-\$300Mn range is management's revised guidance) for 2015 we believe the most material purchases will come next year. The FCF is also prior to \$63Mn growth spending for Baldwin transformer upgrades, Berks Hollow, and the development site purchase, and the uprate projects. Management could simply tap into its \$1.5Bn of 6/30 liquidity but the \$1.5-\$1.6Bn year-end target makes this less likely. The timing of repurchases does not have a material impact on our valuation but we would caution investors to temper their expectations on upcoming quarterly updates.

Timing of free cash flow generation makes us believe that the majority of repurchases will occur in 2016 rather than 2015

- **Freeing up Franklin:** The magnitude of Franklin's income-oriented fund ownership of non-yielding Dynegy has been an area of investor concern for years but position has declined meaningfully with Franklin finally falling to under 10% ownership as of 6/30. Dynegy's full repurchase plan is for \$250Mn, a similar size to Franklin's ~\$220Mn position and we would not be surprised to see a series of private transactions to facilitate a glide path for a smoother Franklin exit. Governance concerns may limit flexibility here but we see this as an avenue to reach a win-win.
- **Fixing up the Joppa restoration:** Management has completed the work on its Joppa 1-5 CT peakers (EEI plant) in Southern Illinois. The new 221MW capacity was completed for \$1.5Mn and can dispatch into MISO, TVA, and the Kentucky Utilities (KU) service territory. Although peakers in MISO might not have material value (likely unable to contract for capacity), at ~\$7/kW the investment threshold is quiet low, able to clip upside energy margin in periods of volatility potentially paying back their initial costs during a single period.
- **Although repurchase news was accelerated, investors still have to wait for latest version of PRIDE:** The plan previously communicated at the June Analyst Day was to discuss capital allocation plans and roll out the new PRIDE cost savings disclosures for the newly acquired plans (above and beyond the initial synergy targets) with 3Q but the repurchase news was pushed forward based on the stock's slide. As mentioned previously, the 2015 cumulative EBITDA and Balance Sheet targets were unchanged but now there is only \$23Mn of EBITDA savings unsecured, down from \$31Mn as of 1Q. Additionally Dynegy has completed its receivables financing and has pushed the remaining unsecured balance sheet target lower.
- **2015 income tax benefit swings net income to positive – what does this mean for tax payer status?:** While oft overlooked, Dynegy reported a surprise 2Q15 net income \$388Mn versus quarterly losses in 18 of the last 20 quarters. The driver was a \$501Mn income tax benefit reported in the quarter but the drivers were not described in the initial release materials. Dynegy has accordingly revised its 2015 net income expectation to \$89-\$269Mn from a net loss of (\$230Mn)-(\$50Mn) which simply reflects the YTD actual tax expense. We look for additional details before reflecting the significant tax item in our FY15 estimates. Most importantly, we expect an update on how/whether this impacts the NOL position. As a reminder, Dynegy guided to having no cash tax obligations "through at least 2018" due in part to its ~\$3.5Bn of federal NOLs as of YE14.
- **Layering more MISO sales but at a more measured pace:** In total Dynegy sold 243MW of capacity forward since last quarter, of which 40% was in Planning Year (PY) 2015/2016. The incremental sales generated an additional \$11Mn adjusted EBITDA while increasing the average price for the next three Planning Years while PY 18/19 and 19/20 saw slight erosion. These additional sales were also captured in the Analyst Day disclosure (as of 6/12).

Figure 2: Franklin Ownership

Franklin Ownership		
Date	Shares (M)	Percent
9/30/13	29.93	29.9%
12/31/13	28.93	28.9%
3/31/14	25.87	25.8%
6/30/14	18.93	18.9%
9/30/14	18.93	18.9%
12/31/14	16.93	13.8%
3/31/15	13.93	11.2%
6/30/15	9.23	7.2%

Source: FactSet

What does the surprise \$500Mn tax benefit and associated net income mean for Dynegy's status as a cash taxpayer?

Updated EBITDA estimates

Our adjusted EBITDA estimates reflects management's latest guidance for 2015 (low-end of the ranges) as a result of sustained weaker power prices as well as some operational challenges for the fleet (unplanned outages and congestion).

Figure 3: Dynegy Adjusted EBITDA Estimates

Dynegy EBITDA Breakdown (UBSe)	2014A	2015E	2016E	2017E	2018E	2019E
Midwest	114	91	169	178	221	270
West	52	66	62	36	42	42
Northeast	187	166	151	152	175	171
Illinois Power Holdings	79	123	78	100	152	156
Duke Midwest	0	217	324	305	415	438
Energy Capital Partners	0	242	352	394	418	356
PRIDE Reloaded & Other Synergies	0	118	165	205	205	205
Consolidated G&A and Other	(85)	(125)	(130)	(130)	(130)	(130)
Recurring Adjusted EBITDA	347	898	1,170	1,240	1,498	1,507
<i>Previous</i>	<i>347</i>	<i>987</i>	<i>1,187</i>	<i>1,222</i>	<i>1,464</i>	<i>1,474</i>
Growth	59%	159%	30%	6%	21%	1%
Consensus (8/6/15)	\$364	\$985	\$1,270	\$1,246		
Mgmt Guidance: Adj EBITDA	\$300-\$350	\$825-\$1,025	\$1,300	\$1,300	\$1,300	
<i>Capital Spending</i>	<i>-\$160</i>	<i>-\$285</i>				
<i>Cash Interest</i>	<i>-\$145</i>	<i>-\$425</i>				
<i>Other Cash Impacts</i>	<i>\$15</i>	<i>-\$15</i>				
<i>Free Cash Flows</i>	<i>\$10-\$60</i>	<i>\$100-\$300</i>	<i>~\$430</i>	<i>~\$430</i>	<i>~\$430</i>	

Source: Company Filings, ThomsonReuters, and UBS Estimates

Valuation: Reduce Price Target \$7 to \$30

Valuation remains based on 2017E sum-of-the-parts. The decision to reduce our valuation multiple is due to less optimism on the power and capacity landscapes given the commodity landscape of late. Changes are driven by the following factors:

- Incorporating the \$250Mn repurchase plan: +\$1/sh
- Reflecting latest commodity mark-to-market: +\$1/sh
- Lowering valuation multiple to more conservative 8x from 9x: -\$9/sh

Figure 4: Updated Dynegy Sum-of-the-Parts Valuation

Dynegy Inc - 2017E	EBITDA	EV / EBITDA Multiples					
		Low	Base	High	Low	Base	High
Legacy Dynegy	366	7.0x	8.0x	9.0x	\$2,563	\$2,929	\$3,295
Illinois Power Holdings (IPH)	100	6.0x	7.0x	8.0x	\$601	\$701	\$802
Duke Midwest	305	7.0x	8.0x	9.0x	\$2,137	\$2,442	\$2,747
EquiPower	394	7.0x	8.0x	9.0x	\$2,756	\$3,150	\$3,543
Less: West Peaking & Brayton Point	(25)	7.0x	8.0x	9.0x	(\$177)	(\$202)	(\$228)
Plus: Capacity Performance	79	0.0x	0.0x	3.0x	\$0	\$0	\$236
Synergies, Corp. Overhead, & Other	75	7.0x	8.0x	9.0x	\$525	\$600	\$675
Total Unregulated EV	1,215	6.9x	7.9x	9.1x	\$8,405	\$9,620	\$11,071
Net Debt Ex-Capacity Performance							
Dynegy Inc.					\$6,386	\$6,386	\$6,386
Illinois Power Holdings (IPH)					\$825	\$825	\$825
Plus: NPV NOL Shield & West Peaking					(\$240)	(\$537)	(\$587)
Cash and 2015/2016 FCF					(\$950)	(\$1,036)	(\$1,701)
Total Net Debt					\$6,021	\$5,638	\$4,924
<i>Net Debt / Adjusted EBITDA</i>					<i>5.3x</i>	<i>4.96x</i>	<i>4.3x</i>
Total Equity Value					\$2,384	\$3,982	\$6,147
<i>Implied FCF Yield</i>					<i>18%</i>	<i>11%</i>	<i>7%</i>
Shares Outstanding					133	133	133
Dynegy Valuation					\$18.00	\$30.00	\$46.00
Upside/(Downside)					-23%	28%	97%
Price Target Gross EV/EBITDA Multiple					6.8x	7.8x	8.9x
Current Price Implied Gross EV/EBITDA Multiple					7.3x	6.96x	6.4x

Source: Company Filings and UBS estimates

Forecast returns

Forecast price appreciation	+28.3%
Forecast dividend yield	0.0%
Forecast stock return	+28.3%
Market return assumption	5.7%
Forecast excess return	+22.6%

Statement of Risk

Risks to our investment thesis, valuation, and estimates include but are not limited to: 1) actual commodity prices differing significantly from our assumptions; 2) adverse political, legislative, and/or regulatory changes; 3) reduction in end-user electric demand; and 4) inability to realize stated synergy or cost-savings targets. Other investment risks include abrupt changes in weather pattern, sharp slowdown in economic demand, interest rate risks, and disruption of trading activity in power markets.

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Sell	FSR is > 6% below the MRA.	13%	20%
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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%

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Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Dynegy, Inc. ^{2, 4, 5, 6, 16}	DYN.N	Buy	N/A	US\$23.39	06 Aug 2015

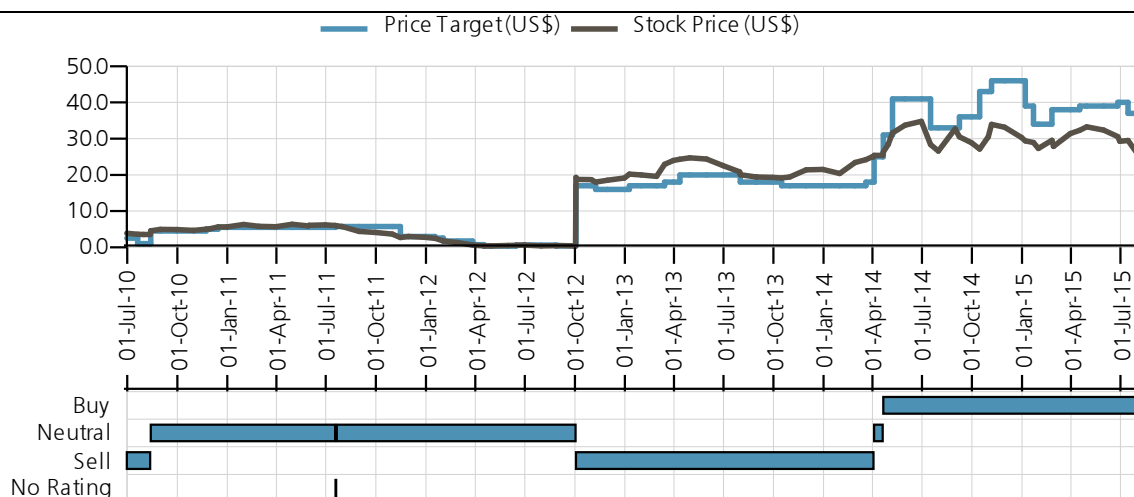
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Dynegy, Inc. (US\$)



Source: UBS; as of 06 Aug 2015

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