

Northeast Utilities

Minding the Northeast Infrastructure Gap

Set to Discuss 2018 Expectations at EEI – lending credibility to growth outlook

We expect NU to discuss categorical expectations for 2018 ratebase at the EEI conference next week, albeit without a year-by-year capex schedule (those details likely to be ready at the analyst day in early 2015). Beyond the Northern Pass project, we see updates regarding reliability upgrades for the greater Boston area (~\$500M) and gas system upgrades from NSTAR Gas after 2016 as strongly supportive of a 5%-6% EPS growth rate (~8% with NP). Further details regarding the recently announced partnership with Spectra for the Access Northeast pipeline project could add confidence around a potential \$3B investment (50% NU) that would be additive to earnings growth. All-in, detail will lend support to 6-8% 5-yr EPS growth range (from '12-'17).

Expect a new partner and customer for Access Northeast pipeline imminently

NU and Spectra expect to make an imminent announcement of a new partner/anchor customer for the proposed pipeline in the coming days (UIL?). Access Northeast will need firm commitments in place and a more precise amount for expected storage to be connected by mid-2015, before a FERC pre-application is initiated. Ultimately, the focus here remains on receiving a NESCOE (or similar) contract to pay for gas-fired generation. We also look for who wins Maine's gas procurement efforts following a legislative win (albeit volumes are likely to be quite modest still).

But RFP process on electric transmission side will remain key for Northern Pass

We suspect various RFP processes to improve electric transmission are not just a point of leverage for NU in its bid to construct Northern Pass, but are similarly a risk around competing merchant projects from Canada. While NESCOE's regional remains the largest wild card, we flag legislative approvals in both RI and CT authorize procurement of large hydro resources. The last piece is whether MA will resurrect an effort of its own

Valuation: Raise PT \$5 to \$55 on higher mult and part credit for gas pipe

Our PT is derived via utility-by-utility SOP. We now give 30% credit (~\$1) for the Access North pipeline, but suspect investors in NU will need to be patient as data points around further execution remain oriented towards ~2015.

Equities

Americas
Electric Utilities

12-month rating **Buy**

12m price target **US\$55.00**
Prior: **US\$50.00**

Price **US\$50.70**

RIC: NU.N BBG: NU US

Trading data and key metrics

| | |
|----------------------------|-----------------|
| 52-wk range | US\$50.83-40.91 |
| Market cap. | US\$16.1bn |
| Shares o/s | 317m (COM) |
| Free float | 89% |
| Avg. daily volume ('000) | 450 |
| Avg. daily value (m) | US\$20.9 |
| Common s/h equity (12/14E) | US\$9.93bn |
| P/BV (12/14E) | 1.6x |
| Net debt / EBITDA (12/14E) | 4.3x |

EPS (UBS, diluted) (US\$)

| | 12/14E | | | |
|--------|--------|------|-------|-------|
| | From | To | % ch | Cons. |
| Q1 | 0.76 | 0.76 | 0.00 | 0.76 |
| Q2E | 0.52 | 0.52 | 0.00 | 0.52 |
| Q3E | 0.73 | 0.72 | -0.43 | 0.75 |
| Q4E | 0.69 | 0.68 | -1.28 | 0.69 |
| 12/14E | 2.70 | 2.69 | -0.44 | 2.66 |
| 12/15E | 2.91 | 2.87 | -1.30 | 2.88 |
| 12/16E | 3.16 | 3.18 | 0.79 | 3.04 |

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| Highlights (US\$m) | 12/11 | 12/12 | 12/13 | 12/14E | 12/15E | 12/16E | 12/17E | 12/18E |
|---------------------------|---------|---------|---------|---------|---------|---------|---------|---------|
| Revenues | 4,466 | 6,274 | 7,301 | 7,262 | 7,464 | 7,594 | 7,654 | 7,649 |
| EBIT (UBS) | 836 | 1,118 | 1,529 | 1,592 | 1,757 | 1,841 | 1,880 | 1,867 |
| Net earnings (UBS) | 423 | 631 | 800 | 850 | 907 | 1,006 | 1,045 | 1,034 |
| EPS (UBS, diluted) (US\$) | 2.38 | 2.27 | 2.53 | 2.69 | 2.87 | 3.18 | 3.31 | 3.27 |
| DPS (US\$) | 1.10 | 1.31 | 1.45 | 1.57 | 1.69 | 1.81 | 1.93 | 2.05 |
| Net (debt) / cash | (5,369) | (9,120) | (9,360) | (9,660) | (9,700) | (9,684) | (8,920) | (7,622) |
| Profitability/valuation | 12/11 | 12/12 | 12/13 | 12/14E | 12/15E | 12/16E | 12/17E | 12/18E |
| EBIT margin % | 18.7 | 17.8 | 20.9 | 21.9 | 23.5 | 24.2 | 24.6 | 24.4 |
| ROIC (EBIT) % | 14.4 | 12.1 | 11.3 | 10.7 | 11.4 | 11.6 | 11.6 | 11.6 |
| EV/EBITDA (core) x | 10.0 | 10.9 | 10.6 | 11.4 | 8.7 | 8.4 | 8.2 | 8.3 |
| P/E (UBS, diluted) x | 14.3 | 16.5 | 16.7 | 18.9 | 17.7 | 15.9 | 15.3 | 15.5 |
| Equity FCF (UBS) yield % | (2.1) | (3.4) | 1.5 | 1.2 | 3.0 | 3.6 | 5.7 | 9.0 |
| Net dividend yield % | 3.2 | 3.5 | 3.4 | 3.1 | 3.3 | 3.6 | 3.8 | 4.0 |

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\$50.70 on 07 Nov 2014 19:37 EST

Investment Thesis

Northeast Utilities

Investment case

NU is one of the highest quality large regulated utilities and has positive catalysts on the horizon, such as Northern Pass and Hydro Quebec's potential CT contract. Management has been successful in mitigating customer switching risk in NH and has handled a mixed regulatory environment well. Successful execution on routing and contracting for Northern Pass will be essential in meeting long-term estimates. We expect the stock to outperform on greater confidence in 2014, based on being able to close the gap on project development. Whether Hydro Quebec will be awarded a contract in CT for at least some of the 1.2 GW of the transmission line's output remains a key issue. Our price target is based on a P/E sum-of-the-parts.

Upside scenario

We believe an upside scenario could include not only a premium multiple but added transmission EPS benefits from potential Boston/plant retirements in the New England area. NU also remains on track for its projected 3% cost-cutting reduction plan, though we flag real credibility to achieving this target for three years, given rising cost concerns elsewhere in the industry. Additionally, transmission rate-base growth could further increase our 2015 estimates. We see upside potential to \$58.

Downside scenario

Our downside scenario is predicated on a negative outcome at the FERC regarding the pending 206 complaint (more of a headline risk than financial at this point). We caution a decision on this outcome is still likely at least six-months out—and will almost certainly be appealed out to 2015 regardless. The threat of deregulation in NH remains a possibility, but we still believe full deregulation and the associated plant retirements are unlikely. We see downside potential to \$48 if Northern Pass is rejected and NU is unable to fill the associated earnings 'gap'.

Upcoming catalysts

| | |
|--------------|---|
| 2015 | Expected FERC ROE Decision |
| yearend 2014 | Merrimack Scrubber Case Resolution |
| Dec 2014 | CL&P rate decision |
| Yearend 2014 | NStar Gas files ratecase |
| 1H15 | NH decision on gen divestiture |
| Mar 2015 | Northern Pass EIS Study from EPA Expected |

12-month rating

Buy

12m price target

US\$55.00

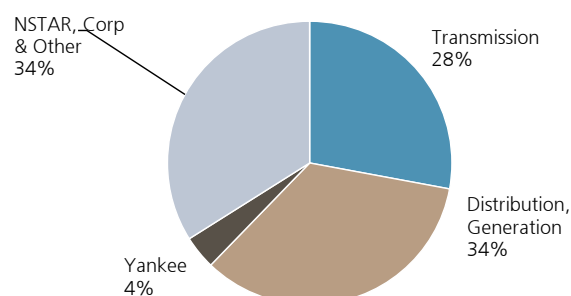
Business description

Northeast Utilities (NU) operates New England's largest utility system, serving 3.6 million electric and natural gas customers in Connecticut, Massachusetts, and New Hampshire, as well as providing retail and wholesale transmission. NU's biggest wholesale transmission project is a \$1.4 billion HVDC line, known as Northern Pass, from Quebec to New Hampshire, that is currently in late-stage development. Northern Pass is being built with subsidiary NSTAR; NU completed its merger with NSTAR in April 2012, which added 1.1 million electric and 300,000 gas customers to the combined entity.

Industry outlook

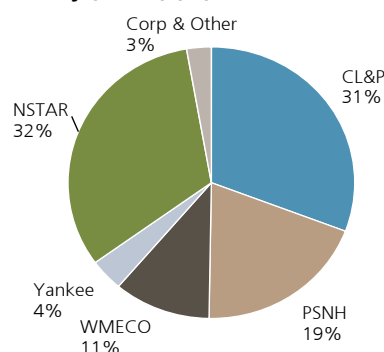
The electric utility industry is projected to experience weak or negative electric demand growth in coming years as a tepid economy and energy efficiency dampen demand. In the unregulated merchant power space, we see limited potential for a meaningful recovery from currently low power prices due to limited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

EBITDA by Subsidiary (2015E) (%)



Source: UBS estimates

EPS by Subsidiary (2015E) (%)



Source: UBS estimates

Long pipeline of opportunities through 2018 and beyond

New England remains a focal point on 'deficient' energy policy, with the retirement of 1,400 MW of non-gas fired generation this year and a significant increase in customer bills coming this winter that will create momentum for reform. Ultimately, we believe investors are likely to gain increasing comfort on not just NPT, but on pipeline opportunities as well. Our key regulated thesis remains to invest in firms in regions with transmission and renewable opportunities, overcoming any projected slowdown utility sales. With a revised estimated in-service date of 2H 2018, we look for an updated schedule and cost for Northern Pass with a new routing in 1H 2015, as part of its crucial NH Site Evaluation Committee (SEC) hearings following a draft Environmental Impact Statement (EIS) from DOE in 1Q15.

A glimpse of higher Capex and 2018 Ratebase at EEI, with formal update at Analyst Day in early 2015

At EEI, we expect to hear updates for 2018 Ratebase expectations based on ~\$500M of spending for Boston reliability, among other projects that will strongly support the 5%-6% EPS growth rate (albeit without a year-by-year breakdown until the Analyst Day). We also expect to hear more detail around the Access Northeast Pipeline partnership with Spectra, which is additive to the growth plan (not included yet).

Strong EPS growth, even without Northern Pass

Our over-arching thesis on shares remains its disproportionate growth profile of around ~6% EPS growth *without* NPT (and closer ~8% with it under our estimates) as we assume alternate investments are accelerated – and other capital redeployment opportunities exist such as the latest pipeline investments discussed. We continue to see Northern Pass as a 50/50 probability, with the need for continued compromise (and likely deal cutting through under-grounding, etc) to enable the project; per mgmt's comments, any deal remains more of a 2015 event after the latest project proposal. We emphasize the coming updates on capex at EEI and the Analyst Day as reiterating this expectation. NU's own disclosures incorporate 6-8% growth through the 5-year period 2012-2017 and 6-9% through the 3-year period 2012-2015. In a best case scenario, mgmt could even raise its growth rate CAGR to the 6-9% level through the 5-year period.

What do we think? *Shares appear interesting into next week's EEI update, but emphasize patience is key amidst a flurry of regulatory activity through the end of 1Q 2015 (including higher bills in January, CT rate case resolution in December, NH scrubber prudency in December, and finally EIS for the Northern Pass project in March)*

Interest will pick back up – can NU capitalize on the energy wave?

We look for interest in addressing the region's energy issues to mount once more, with this winter's rates set to spike on Jan 1st. The question is will NU be able to channel angst over higher bills into public policy support for greater infrastructure investment to address supply-oriented constraints. We see real efforts to contract for gas pipelines and electric transmission as kicking up again in 2015 – with the question as to whether NU can have its own projects *selected* in this process

proving the key piece. We see real competitors for both gas (Kinder's Northeast Energy Direct) as well as Blackstone's own Vermont TDI project (likely to push for contracts in both CT and RI among other potential counterparties). *The focus will be for management to channel all of the region's efforts into both contracting – and placing political pressure to move forward its two pending large-projects.*

Delay on Salem repowering just another piece to capex jigsaw?

We see the formalized (potentially multi-year) delay in the Salem repowering project of the coal plant into a CCGT by Footprint power in the Boston load pocket as potentially leading to a reliability-based backstop- with the projected deficit in the region likely in the ~100 MW magnitude. We suspect efforts to import more power into the Boston region to interconnect renewables procured recently, alongside efforts to address needs created by the delayed in-service of this plant. We suspect formal notification from ISO-NE around backstop efforts to trigger additional (if not just an acceleration) of NU's capex budget. *We caution this shift in timing of capex may not be fully reflected in management's update outlook as it appears to be purposefully avoiding articulating the timing of its budget between 2015-2019.*

Reaffirms 2014 guidance; we remain at low end of range for mild weather

For 2014, guidance of \$2.60-\$2.70 was reaffirmed vs UBSe \$2.70 and consensus \$2.67. As a reminder, NU's guidance includes this year's \$0.10 charge taken in anticipation of FERC's backdated treatment of lower New England ROE. Without the charge (which is excluded from our estimate and likely consensus as well), guidance is actually \$2.70-\$2.80.

Results for 4Q should be boosted by a \$0.07-\$0.08 annualized rate increase at CL&P, lower O&M, higher transmission ratebase, and gas sales at Yankee Gas have run strong this year, further helping the outlook. Going forward, our largely unchanged estimates are based on our assumption that CL&P will exit its ratecase earning in the mid-9's ROEs once they are recovering storm expense (see table). NU plans to reduce operating costs by 3%-4% annually through 2017. Despite tracking toward the low end, we do not expect the company to reduce 2014 guidance. We expect NU to initiate 2015 guidance in Feb 2015 on the 4Q call. As illustrated in the table below, We've tweaked our estimates to reflect the 6-month expected delay in bringing Northern Pass in-service, now set for mid-2018 (see below).

Figure 1: NU Earnings Estimates 2013A-2017E

| Annual EPS | 2013A | 2014E | 2015E | 2016E | 2017E |
|--|---------------|----------------------|---------------------------|---------------|---------------|
| Transmission | \$0.68 | \$0.71 | \$0.78 | \$0.81 | \$0.79 |
| Distribution, Generation | 0.95 | 0.88 | 1.06 | 1.09 | 1.10 |
| Yankee | 0.08 | 0.09 | 0.10 | 0.10 | 0.12 |
| NSTAR, Corp & Other | 0.82 | 1.00 | 0.92 | 1.18 | 1.29 |
| UBSe | \$2.53 | \$2.69 | \$2.87 | \$3.18 | \$3.31 |
| CL&P Dist ROE | 7.9% | 6.5% | 9.4% | 9.3% | 9.2% |
| Prior | | \$2.70 | \$2.91 | \$3.16 | \$3.32 |
| Consensus | \$2.53 | \$2.66 | \$2.87 | \$3.04 | \$3.21 |
| Guidance (excluding -\$0.10 T-charge) | | \$2.70-\$2.80 | 6% - 8% EPS Growth | | |

Source: Company filings, FactSet, and UBS estimates

Expect confident and positive CAPEX update at EEI

While NU will not likely release a year-by-year capex forecast through 2018, management does intend to release a forecast of 2018 ratebase (and composition). This should include ~\$500M of work for transmission upgrades around the greater Boston area as well as other reliability enhancement projects expected to be completed by 2018. These projects are expected to strongly support our estimated 8% EPS growth rate (still 5%-6% excluding Northern Pass), with upside from possible investment in the Access North Pipeline.

**Near-term positive around NU
growth outlook update at EEI**

3Q in-line on mild summer weather, higher transmission

NU reported 3Q14 adjusted EPS of \$0.75 versus UBSe \$0.73 and consensus \$0.74. As expected, the mild summer reduced total retail electric sales -4.5% for the quarter (-1.2% YTD). A dime of higher transmission earnings and \$0.07 of lower O&M at NSTAR electric also helped, but this was offset by -\$0.07 higher income taxes at the parent level.

Weather-adjusted electric retail sales for the YTD were down -0.9% yoy, while natural gas sales were up 3.6% after removing the effect of the polar vortex effect.

Current transmission program is on track

NU is on track to perhaps exceed its \$664M 2014 transmission capital program. The \$218M Interstate Reliability Project in CT, RI, and Southern Mass is now 60% complete and is still expected to be energized in late 2015. In 1Q15, NU expects to receive a positive report from NE ISO on system impacts for the \$350M Greater Hartford Central Connecticut (GHCC) projects, with the first set submitted shortly thereafter to the CT Siting Council. The GHCC is expected to be full built and in service by 2018.

What is the latest with the New England FERC ROE challenge? Much ado about nothing

NU currently has three ROE complaints pending before FERC. A final decision on the first complaint was issued on Oct 16th, setting the base ROE at 10.57%. A clarification request on this order is still pending. Settlement discussion for the second (largely similar) complaint were unsuccessful, with FERC assigning an ALJ in October, hearings scheduled for June 2015, and an initial decision expected on or before Oct 26, 2015. The third complaint was recently filed in July and all parties have agreed that if not dismissed, it should be rolled into the second pending complaint.

The latest battleground relates to the macro component of the two-step ROE with the New England Transmission Owners (NETO) challenging the GDP component. Specifically the NETO believes that (1) the growth rate is too low at 4.39% and (2) the weighting for GDP at one-third is too high, both of which they argue applies downward pressure on the ROE. The long-term (2017-2040+) GDP forecast comes from a third party consultant, the EIA, and Social Security Administration (SSA); in our latest mark-to-market exercise we consulted the latest available information from the EIA and SSA noting insignificant changes. For example, if the GDP growth assumption were increased by 10bp, the FERC 75th percentile would increase to 10.60% from 10.57%, a largely immaterial change. A 50bp move would drive a 10.74% ROE; however, such a material upward revision appears unlikely given the data presented.

Figure 2: ROE Analysis Summary

| ROE Analysis Summary | Low | Midpoint | High | FERC 75th % | "True" 75th % |
|---|------|----------|-------|-------------|---------------|
| Zone of Reasonableness (Original) | 7.03 | 9.39 | 11.74 | 10.57 | 9.77 |
| Zone of Reasonableness (1/4 GDP Weight) | 6.97 | 9.51 | 12.05 | 10.79 | 9.84 |
| Zone of Reasonableness (UBSe MTM) | 6.74 | 9.95 | 13.16 | 11.56 | 9.48 |
| Zone of Reasonableness (Adj. MTM) | 6.74 | 9.24 | 11.75 | 10.49 | 9.48 |

Source: Company Filings, Yahoo! Finance, and UBS Estimates

While this argument may have more weight, it is difficult to quantify the appropriate weights necessary for such a hypothetical analysis. If the weighting is shifted to be (3/4) for IBES Growth Rate [versus (2/3)] and (1/4) for GDP Growth Rate [versus (1/3)], the outcome would be a 22bp increase in the FERC ROE to 10.79%. While this is a more material increase than a minor tweaking of the GDP expectation, given the seemingly arbitrary split between IBES and GDP weighting in the first place, we would expect NETO struggling to provide a detailed analysis to justify such a change in methodology, especially at the eleventh hour.

For more background, see our previous note [6/19/14 Northeast Utilities "A New and Improved FERC ROE Methodology"](#).

Despite investor concerns over ROEs, the real impact is from new projects

With New England increasingly in dire need of new capacity, transmission, and fuel options, NU's value lies in its ability to continue to build desperately needed infrastructure over the next decade. This is especially true given the constraints exposed in the natural gas system this past winter, with the problem poised to worsen significantly after the planned shutdown/retirement of another 1,400 MW by yearend (including the 1,200-MW Vermont Yankee nuclear station). Even if FERC's recent reduction of transmission ROEs stands as-is, earnings are reduced only ~\$0.05-\$0.06 EPS without any material affect the company's projected EPS growth CAGR of 6%-8% from 2012-2017. We see continued merit to NU executing on its NPT line and while we remain somewhat skeptical of the NESCOE process, it undeniably highlights the presence of significant investment opportunities for NU, including the recently proposed Access Northeast pipeline in partnership with Spectra (see below).

NU's Connecticut ratecase settlement possible, but not this month

To the extent that a settlement is possible, we don't expect to hear of anything in Northeast Utilities' CL&P ratecase this month, although we think that a settlement of the case is somewhat more likely this time around without the former Attorney General Richard Blumenthal to knock down any deal. With a draft decision due December 1, any possible settlement would probably come in the Oct/Nov timeframe, earliest. A final decision is due December 17. In early August, the CT Office of Consumer Counsel (OCC) filed testimony recommending a \$143M increase (vs \$232M ask) based on an 8.9% ROE. We consider the 8.9% to be the low-end of expectations for a final outcome later this year, with a bid/ask midpoint of 9.55% a reasonable expectation vs the currently authorized 9.4%. We expect a ~150 bps rise in earned ROE beginning December 1, 2014 and beyond as a result of finally being allowed to recover and earn a return on \$286M of net deferred storm expense and resiliency investment. The returns on storm cost and investment should boost earned ROE to the mid-9%, allowing CL&P to earn its allowed ROE for only the second time since 2004 (it also achieved this milestone in 2011). We further note that under the earnings sharing mechanism, shareholders retain 50%

November could be quiet in CT.

We see resolution on the case as the key incremental datapoint for shares in 2H14

of all earnings above the authorized ROE and that state law allows the utility to over-earn by as much as 100 bps before a mandatory rate review.

What's the latest on Northern Pass?

Management continues to express confidence that following the polar vortex of this past winter, the tone is shifting to be more supportive of the project but investor concerns are still palpable. The final Environmental Impact Statement is more likely to be a 1Q15 event rather than December, followed by an application with the New Hampshire Site Evaluation Committee. As a result, Northern Pass is delayed from its original in-service 4Q17 by about 6 months into mid-2018, with major spending and earnings beginning in Summer 2016, when construction is expected to begin and a deposit (perhaps \$100M) is put down for the \$400M DC-AC converter substation in NH.

This six-month project delay comes from two sources:

- 1) a Federal EIS delay of about 3 months into March 2015; and
- 2) An extension of 3 months for NH state siting approval (now 12 month process vs 9 previously) that was embedded in the law that reconfigured the siting board down from 12 people to 9 people.

The new timeline below reflects "worst case" with events happening at the end of their predicted timing ranges:

- March 2015 Federal EIS issued
- April 2015 NU submits application to NH siting board (1 month)
- June/July 2015 Siting board reviews application for completeness (2 months)
- June/July 2016 Siting board approval
- July 2016 Construction begins, first deposit put down on AC/DC intertie transformer
- July 2018 In-service (two years)

The recently released DOE comments includes an analysis of alternate rounds, including undergrounding of certain 'sensitive' areas but management stated that none of the options would impact their schedule of ultimate regulatory approval in 2015 and project completion in mid-2018. As proposed currently, the project has eight miles of undergrounding (vs. 50+ miles for Blackstone subsidiary Transmission Developers Inc. [TDI]) and we would not be surprised to see management concede on further undergrounding in order to push the project past the final regulatory hurdles.

Despite the ongoing retirement of 1,400 MW of non-gas generating capacity (including Vermont Yankee) in 2014, it remains unclear where the electric transmission proposal stands and whether HQ will push NU to shift the contract back to a socialized option if possible, spread across all of New England's customers. While NPT is clearly in the lead, this complicating factor remains our primary concern over the viability of competing projects, such as the TDI proposal or the New England NALCO project. Overall, we think incremental electric transmission remains the clearest way to address the current shortfalls in the region.

Latest DOE comments suggest yet another route change is likely late this year with EIS

Expect updated cost estimate in January, 2015

Question remains how HQ will react to the offer to socialize transmission costs across ISO-NE

New Hampshire divestiture looks a little less likely with rates rising

The company has been generally supportive of HB 1602, which would have the PUC go through a docket to determine whether or not PSNH should divest its generation, beginning no later than Jan 1, 2015 and likely completing the review within a year. However, there may be second thoughts over the wisdom of divestiture with higher energy rates from the polar vortex set to rise on Jan 1 for non-NU utility bills (Liberty, Unitil) due to their reliance on gas generation contracts. We estimate that about 25% of New Hampshire customers (non-NU) will soon see their energy rate almost double to \$0.15/kWh and their total retail rate jump from \$0.15/kWh to \$0.22/kWh. National Grid customers will likely see their energy rate rise to \$0.13/kWh. More broadly speaking, other non-NU utility rates in CT, MA and NH are probably going to see energy rates rise from \$0.14 to \$0.23-\$0.24. CL&P's energy rate could rise to \$0.13 with a total retail rate of about \$0.225 (depends on the final CL&P rate order), and NSTAR's and WMECO's energy rate should rise to \$0.14-\$0.15, while Grid's Mass Elec to \$0.162 with a total retail rate of \$0.23-\$0.245. In contrast, PSNH's energy rate (applicable to roughly 75% of all NH customers) will likely stay flattish at \$0.09-\$0.095 with a total retail rate of \$0.17-\$0.175/kWh due to its unique reliance on cheaper, ratebase coal, biomass, and hydro. NU estimates that its customers saved over \$100M during the Polar Vortex, with even more benefits to come as rates rise in New England from its constrained gas market.

There may now be second thoughts over the wisdom of divestiture with higher energy rates from the polar vortex set to rise on Jan 1 for non-NU utility (Liberty, Unitil) bills due to their reliance on gas generation contracts.

Figure 3: Bills Heating Up This Winter in New England

| NU Winter 2014/2015 Pricing Expectations | | |
|--|-------------|---------------|
| Utilities | Energy | Total Bills |
| NSTAR & WMECO | \$0.14-0.15 | \$0.23-\$0.25 |
| CL&P | \$0.13 | ~\$0.23 |
| PSNH | \$0.10 | \$0.18 |

Source: Company Filings and UBS Estimates

On a percentage basis, energy rates should be averaging 50% higher on Jan 1 than they are today with some of the small NH utilities and Massachusetts Electric (Grid) up around 90%. In contrast, PSNH's total retail rate should actually decline a bit (flattish), CL&P's retail rate should increase "only" 15%-20%, while the small NH utilities will likely raise retail rates about 45%. We note that these higher rates would apply only to the 6-month winter period and that rates are likely to decline significantly for summer 2015.

Merrimack scrubber prudence decision coming this December

The PUC recommended to legislators not to begin a separate divestiture docket until they are finished with the Merrimack scrubber docket, which should go through the end of 2014, with hearings beginning October 14. NU has been generally supportive of the divestiture law, with the understanding that current statutes would protect the company from any potential stranding of the associated ratebase. In any event, the earliest a divestiture would actually take place is 2016, if at all.

We believe any decision on divestment appears only likely subsequent to a decision on how to address cost recovery on the associated scrubbers, with that docket wrapping up by year end. We flag that the latest winter shortages and extreme pricing may yet have driven an evolution in states' thinking both with regard to using the generation as a hedge *and* with regards to preserving more regional assets (although the latest run up makes Merrimack FCF positive once again on a

Worst case Merrimack represents only \$0.05 EPS impact

merchant basis). We believe asset value has substantially improved in recent months, suggesting some [very modest] proceeds from any sale (although the latest bump in capacity prices – and shift towards a sloped demand curve go a long way towards creating some value as indicated by NextEra's decision to retain its Maine generation), reiterating the need to establish a 'prudent' cost on the Merrimack scrubber. The coal plant is far and away the largest component of generation ratebase at 534MW, out of the 1.1 GW portfolio. We believe the key question remains around recovery on capital (ROE), not return of capital employed (D&A), although there is a separate ongoing process around the prudence of the Merrimack scrubber spend that remains pending, and a slight headwind. In a worst case outcome, we estimate this represents just a \$0.05 EPS impact, without any sale proceeds for the 1.1GW portfolio (likely meaningfully better following recent improvement in market outlook & following recent similar transactions). We also note that should the scrubber capex be approved into ratebase, the current deferral of \$70M-\$80M would likely be amortized over 5 years, and annual EPS would rise about \$0.03.

NESCOE process stalled but the pressure is rising as bills spike higher

The New England States Committee on Electricity (NESCOE) had been expected to provide a schedule for its RFP by September for the development of transmission and delivery of at least 1.2-3.5 GW of clean energy into New England. However, this is highly likely to remain postponed through the rest of this year as a result of the failure of Massachusetts to pass a Clean Energy Bill on July 31. The Bill would have allowed the state to enter into long-term contracts for ~19 TWhs of hydroelectricity from Hydro Quebec, essentially providing backstop financing for new power lines intended to be developed under a NESCOE RFP. Similar clean power procurement legislation already exists in Connecticut. Press reports indicated that environmental group opposition to hydropower in favor of wind and solar were a key factor in the Bill's demise. With no chance of any similar legislation this year, NESCOE's plan to file for two new tariffs to fund both electric transmission and new gas pipelines into New England have stalled as the states reconsider how to proceed. With elections finished, we don't see any RFP possible before the new year as both Mass and RI have new Governors. However, with last winter's polar vortex effect on energy prices just now starting to hit consumer bills, National Grid Mass rates are spiking higher beginning Nov 1, whereas NU's rates kick up on Dec 1. We expect newly elected Governor-elect Baker to begin addressing this problem soon after entering office, likely as a reaction to sharp criticism of higher bills. Furthermore, the problem will get even worse for Boston customers in June 2016 when sharply higher NEMA capacity prices work their way into bills as well.

Mass natural gas distribution work set to accelerate significantly

At the February Analyst Day, NU forecasted \$215M/yr of total natural gas distribution capex for the three years from 2015-2017. However, as a result of new Mass legislation, that projection is very likely to increase, perhaps by \$150M-\$160M for the period.

Gas main replacement riders: New legislation in MA was passed in June to expedite the replacement of cast iron and unprotected bare steel gas distribution mains and to expand the state's natural gas distribution network over the next 20 years. The law provides for separate carve-out investment recovery mechanisms. On Oct 31, 2014, NSTAR Gas filed its required Gas Stem Enhancement Program (GSEP) plan with the DPU; regulators will have 8 months to review and approve it.

We think NESCOE may be a dead-end for now

Without more gas, we emphasize the need for new electric transmission is all the more dire

With last winter's polar vortex effect on energy prices just now starting to hit consumer bills, the pressure will be on to find solutions.

Accelerating the rate of conversions in Massachusetts would be a big boost for NU with residential gas penetration still below 50%.

Through the program, pipe replacement capex is expected to grow from \$37M in 2014 to \$42M in 2015, \$47M in 2016, and eventually to \$62M in 2019, remaining at an accelerated level for at least 25 years. The program could add up to \$1.4B investment over the entire period.

Oil-to-gas conversion: The legislation also minimizes lag in oil-to-gas conversions and promote area gas charges that would help share costs of conversions and ultimately would be another catalyst towards the high-end of the long-term earnings growth rate for NU. The penetration for residential natural gas heating sits at 48% and 32% for MA and CT, respectively, far lower than that of neighboring New Jersey (72%), highlighting the scale of the opportunity here.

LNG Storage: NSTAR is working on a MA recovery mechanism for significant investment needed at its affiliate-owned 3.2 BCF Hopkinton LNG storage facility.

NSTAR Gas to file first ratecase in over 20 years: In May, NSTAR Gas notified the MA Department of Public Utilities (DPU) that it intends to file a ratecase **in December** (rates effective in 2016), the first case for them in more than 20 years.

Partnering with Spectra on Access Northeast to reduce NE gas constraints

NU and Spectra Energy (SE) announced a \$3Bn, 1+bcf/day Access Northeast natural gas JV which designed to address New England gas bottlenecks. The project is a combination of additional pipeline capacity/expansions & storage facilities which will interconnect with Spectra's existing assets. It is expected to generate much of its support from New England generators as well as LDCs and can be done in stages in order to accommodate a step-by-step approach to incremental demand. NU projects a total need for up to 1 bcf/d, which would cost about \$3B and potentially deliver enough gas to support up to 5,000 MW of additional generation in the region.

We expect to hear imminently about a partner/customer coming into the project.

Access North will need firm commitments in place and a more precise amount for expected storage to be connected by mid-2015, before a FERC pre-application is initiated. This will be followed in early 2016 with a full filing and FERC approval by 1H 2017. Construction would then begin and could be in service by Nov 2018. We expect to hear imminently about a partner/customer coming into the project.

NU and SE take the lead, but lack of generation offtakers is the real issue

Previously National Grid and UIL were involved in the proposed NESCOE solution but now Spectra and NU will be equal partners in the project "with the option of additional investors joining in the future;" we still look for partners to come aboard with NU/SE jointly sharing the excess. NU may view the utilities as a "natural solution" to solving gas constraints but the issue still remains as to whether the Electric Distribution Companies can recover FERC-approved tariffs from electric retail customers, seeing generators as unable to fund upgrades. As SE management has noted, market reforms are key to allow the recovery of cost of generation, with some potential for incremental gas LDC contracting. Reforms remain critical to projects materializing- and with NESCOE stalled – we sense a long road ahead for midstream gas developments.

Detailing the Potential Earnings Contribution

We include our initial estimate of the potential long-term EPS contribution, however, we caution NU/SE is likely to sell down incremental interests in the project in coming months (likely including UIL and National Grid, among other regional partners).

Figure 4: Estimated NU Uplift from Gas Pipe Investment (\$ Mn except EPS)

| | |
|---|------------|
| \$ Mn for Aggregate Project | 3000 |
| NU Portion | 1500 |
| Project Equity | 50% |
| Targetted equity return (UBSe) | <u>13%</u> |
| Net Income Opportunity for NU Project Share | 97.5 |
| Parent Debt (Funding Project Equity Contribution | 1500 |
| Assumed cost of Debt | 4% |
| HoldCo Interest Expense | <u>39</u> |
| Net Income Opportunity for NU (net of Parent Int Exp) | 58.5 |
| Shares O/S | 316 |
| EPS Opportunity | 0.19 |
| 2018E EPS | 3.27 |
| % Potential Uplift to LT (2018E) EPS | 5.7% |

Source: Company Filings and UBS estimates

Listing out the potential generation targets

We include a list from Spectra's letter to NESCOE, detailing potential candidates for subscription along its existing pipelines. The company articulated a 5GW target for the pipeline, building the pipeline to at least 1 bcf/d, in increments of 200 mcf/d. We reiterate our belief none of the plants below are likely candidates for any meaningful Firm Transportation deals, outside of the context of a new regulatory company for cost recovery.

Figure 5: Spectra Energy Served power plants: ~900,000MMbtu required on a peak day to serve top 5GW

| Assets | Owner | Heat Rate (MMBtu/KWh) | WinCap(MW) | Max Daily Qty (MMBTU) |
|------------------------------|-------------------------------|--------------------------|--------------|--------------------------|
| Spectra Energy Served | | | | |
| Westbrook | Calpine | 6,895 | 542 | 89,753 |
| Lake Road | ECP (Dynegy Deal Pending) | 6,945 | 841 | 140,230 |
| Casco Bay | Dynegy | 6,956 | 538 | 89,862 |
| Fore River | Exelon (Calpine Deal Pending) | 7,000 | 785 | 131,880 |
| Newington | Northeast Utilities | 7,040 | 520 | 87,789 |
| Tiverton | Emera Inc. | 7,092 | 278 | 47,295 |
| Kleen | EIF Management/O&G Industries | 7,100 | 620 | 105,648 |
| ANP Bellingham | GDF Suez | 7,388 | 538 | 95,394 |
| Manchester | Dominion | 8,024 | 495 | 95,329 |
| Total | | | 5,157 | 883,180 |
| Others | | | | |
| Millenium | MACH Gen LLC | 6,618 | 375 | 59,528 |
| ANP Blackstone | GDF Suez | 6,848 | 251 | 41,252 |
| Bridgeport Energy | Emera Inc. | 6,989 | 540 | 90,577 |
| Berkshire Power | EIF Management/Manulife Fin. | 7,035 | 246 | 41,582 |
| Total | | | 1,412 | 232,939 |

Source: Spectra Energy letter to NESCOE (see link below) and SNL Energy

[Please click here to read the letter from Spectra Energy to NESCOE re 'Enhancing Electric Reliability in New England'](#)

Valuation: Raise PT \$5 to \$55 on higher average utility peer 2016E P/E multiple and credit for new gas pipeline

Our valuation is based on a utilities sum-of-the-parts analysis. We continue to apply the peer multiple to the regulated electric/gas businesses as well as 1x and 1.5x premiums to Yankee Gas and NU Transmission, respectively. We attribute ~\$4/sh to the Northern Pass project and believe investors could more fully ascribe this in their valuations in 2014 as key project hurdles are achieved. As we discussed above, we believe a key for shares will be investors gaining comfort in estimates even without Northern Pass' contribution as there are other levers that management can pull to compensate such as gas investment opportunities in Massachusetts. We now give a 30% probability weighting to the proposed Access North Pipeline partnership with Spectra, worth ~\$1 in our valuation.

We see attractive value in shares given that shares trade at a slight discount for a company that appears particularly well positioned to see constructive capex revisions in coming months. With the story likely to diversify beyond just NPT, and with ~5-6% estimated EPS growth exclusive of NPT and Access North, the thesis looks increasingly attractive in a slowing growth environment.

Figure 6: NU Sum-of-the-Parts Valuation

| Valuation | | | Low Case | | Base Case | | High Case | |
|--|---------------|--------|-----------|----------------|---------------|----------------|-----------|----------------|
| | | | Valuation | (\$s MM) | Valuation | (\$s MM) | Valuation | (\$s MM) |
| Business Segment | Metric | 2016E | Multiple | Value | Multiple | Value | Multiple | Value |
| Regulated Business | | | | | Peer Multiple | 16.2x | | |
| NU Franchised Electric | P/E | \$1.09 | 15.2x | \$5,243 | 16.2x | \$5,588 | 17.2x | \$5,933 |
| NU Transmission | P/E | \$0.81 | 16.7x | \$4,280 | 17.7x | \$4,536 | 18.7x | \$4,792 |
| NU Yankee Gas | P/E | \$0.10 | 16.2x | \$533 | 17.2x | \$566 | 18.2x | \$599 |
| NSTAR | P/E | \$0.95 | 15.7x | \$4,731 | 16.7x | \$5,033 | 17.7x | \$5,334 |
| Northern Pass EPS, Discounted 2-Yr | P/E | \$0.22 | 16.7x | \$1,164 | 17.7x | \$1,233 | 18.7x | \$1,303 |
| Access North Pipeline, Discounted 2-Yr | P/E, 30% Prob | \$0.17 | 4.3x | \$227 | 5.3x | \$280 | 6.3x | \$332 |
| NU Equity Value | | | | \$16,178 | | \$17,236 | | \$18,293 |
| Fully Diluted Outstanding Shares (2016E) | | | | 316 | | 316 | | 316 |
| NU Equity Value per Share | | | | \$51.16 | | \$54.51 | | \$57.85 |

Source: Company filings and UBS estimates

Agreeing to keep the lights on in New England for another winter

New England getting more serious about LT solution but approving another 'one-off' winter

In September the FERC approved ISO-New England's (ISO-NE) request to once again implement a winter reliability plan (the Plan) for the upcoming 2014-2015 winter to incentive enough procurement of primarily oil to ensure adequate reserves. Although the Commission agrees that an out-of-market plan will be necessary this year, FERC argues that it is "closer to a market based solution" than it was previously. Oil will be compensated at \$18/barrel for generators that enter the winter with either less 85% fuel capacity or ten days of fuel. 2013-2014's program led to the procurement of three million barrels of oil with ~90% being utilized with this year's Plan increasing inventories by 500k barrels. Other reforms include tweaks to the dual-fuel incentives and a move to a March 15th measurements. In the past the FERC has encouraged ISO-NE to begin a stakeholder process for a longer-term solution; however, this year appears to be more serious about finding an answer by mandating that ISO-NE begin a stakeholder process by year-end with bimonthly reporting requirements. The ISO also announced that it plans to begin the process within the next ~two months, well ahead of the mandate; a meeting schedule is required by October 9th.

Docket ER14-2407-000

LNG imports into New England? Unlikely to materialize in any real volume

The Plan also 'incentivizes' the procurement of up to 6 bcf of LNG with compensation at \$3/MMBTU, essentially in-line with oil, the latter much to the dismay of GDF Suez. United Illuminating (UIL) proposed compensation at \$8/MMBTU but ISO-NE pushes back that "it is not economically practical to pay more for LNG than for oil", effectively taking the standpoint that it will not fully compensate generators who opt for a more expensive fuel source. In a similar vein, FERC fully acknowledges that the Plan is not fuel neutral and does not provide the same compensation to nuclear or hydro operators who cannot simply stock-up on additional fuel (points argued again by PEG and EXC). We fully expect PEG, EXC, and other 'disadvantaged' generators to push for a more beneficial solution before the Pay-for-Performance system is implemented in June 2018.

Northeast Utilities (NU.N)

| | 12/11 | 12/12 | 12/13 | 12/14E | % ch | 12/15E | % ch | 12/16E | 12/17E | 12/18E |
|---|----------------|----------------|----------------|----------------|-------------|----------------|--------------|----------------|----------------|---------------|
| Income statement (US\$m) | | | | | | | | | | |
| Revenues | 4,466 | 6,274 | 7,301 | 7,262 | -0.5 | 7,464 | 2.8 | 7,594 | 7,654 | 7,649 |
| Gross profit | 2,885 | 4,189 | 4,818 | 4,806 | -0.3 | 4,997 | 4.0 | 5,121 | 5,174 | 5,163 |
| EBITDA (UBS) | 1,138 | 1,637 | 2,140 | 2,257 | 5.5 | 2,447 | 8.4 | 2,550 | 2,605 | 2,599 |
| Depreciation & amortisation | (302) | (519) | (611) | (665) | 8.9 | (689) | 3.7 | (709) | (726) | (733) |
| EBIT (UBS) | 836 | 1,118 | 1,529 | 1,592 | 4.1 | 1,757 | 10.4 | 1,841 | 1,880 | 1,867 |
| 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 | (223) | (310) | (295) | (307) | -3.9 | (355) | -15.6 | (356) | (353) | (349) |
| Exceptionals (incl goodwill) | 0 | 0 | 0 | 0 | - | 0 | - | 0 | 0 | 0 |
| Profit before tax | 613 | 808 | 1,234 | 1,286 | 4.1 | 1,403 | 9.1 | 1,484 | 1,526 | 1,518 |
| Tax | (185) | (275) | (427) | (428) | -0.3 | (488) | -14.0 | (470) | (473) | (476) |
| Profit after tax | 429 | 533 | 807 | 857 | 6.2 | 914 | 6.7 | 1,014 | 1,053 | 1,042 |
| Preference dividends | 0 | 0 | 0 | 0 | - | 0 | - | 0 | 0 | 0 |
| Minorities | (6) | (7) | (8) | (8) | 0.0 | (8) | 0.0 | (8) | (8) | (8) |
| Extraordinary items | 0 | 0 | (14) | (42) | -207.2 | 0 | - | 0 | 0 | 0 |
| Net earnings (local GAAP) | 423 | 526 | 786 | 807 | 2.7 | 907 | 12.3 | 1,006 | 1,045 | 1,034 |
| Net earnings (UBS) | 423 | 631 | 800 | 850 | 6.2 | 907 | 6.7 | 1,006 | 1,045 | 1,034 |
| Tax rate (%) | 30.1 | 34.0 | 34.6 | 33.3 | -3.7 | 34.8 | 4.5 | 31.7 | 31.0 | 31.4 |
| Per share (US\$) | | | | | | | | | | |
| EPS (UBS, diluted) | 2.38 | 2.27 | 2.53 | 2.69 | 6.2 | 2.87 | 6.7 | 3.18 | 3.31 | 3.27 |
| EPS (local GAAP, diluted) | 2.38 | 1.89 | 2.49 | 2.55 | 2.7 | 2.87 | 12.3 | 3.18 | 3.31 | 3.27 |
| EPS (UBS, basic) | 2.39 | 2.27 | 2.53 | 2.69 | 6.2 | 2.87 | 6.7 | 3.18 | 3.31 | 3.27 |
| Net DPS (US\$) | 1.10 | 1.31 | 1.45 | 1.57 | 8.3 | 1.69 | 7.6 | 1.81 | 1.93 | 2.05 |
| Cash EPS (UBS, diluted)* | 4.08 | 4.14 | 4.46 | 4.79 | 7.4 | 5.05 | 5.4 | 5.43 | 5.60 | 5.59 |
| Book value per share | 22.72 | 29.45 | 30.42 | 31.40 | 3.2 | 32.60 | 3.8 | 34.00 | 36.85 | 39.66 |
| Average shares (diluted) | 177.80 | 277.99 | 316.21 | 316.21 | 0.0 | 316.21 | 0.0 | 316.21 | 316.21 | 316.21 |
| Balance sheet (US\$m) | | | | | | | | | | |
| Cash and equivalents | 7 | 46 | 43 | 66 | 51.5 | 274 | 317.1 | 398 | 1,162 | 2,460 |
| Other current assets | 1,351 | 2,182 | 2,044 | 2,424 | 18.6 | 2,484 | 2.5 | 2,523 | 2,541 | 2,540 |
| Total current assets | 1,357 | 2,227 | 2,087 | 2,490 | 19.3 | 2,758 | 10.8 | 2,921 | 3,703 | 5,000 |
| Net tangible fixed assets | 10,403 | 16,605 | 17,576 | 18,487 | 5.2 | 19,401 | 4.9 | 20,320 | 20,972 | 21,100 |
| Net intangible fixed assets | 288 | 3,519 | 3,519 | 3,519 | 0.0 | 3,519 | 0.0 | 3,519 | 3,519 | 3,519 |
| Investments / other assets | 3,599 | 5,951 | 4,613 | 4,551 | -1.3 | 4,521 | -0.7 | 4,491 | 4,461 | 4,431 |
| Total assets | 15,647 | 28,303 | 27,796 | 29,048 | 4.5 | 30,200 | 4.0 | 31,252 | 32,655 | 34,050 |
| Trade payables & other ST liabilities | 1,299 | 1,760 | 1,649 | 1,749 | 6.1 | 1,754 | 0.3 | 1,758 | 1,758 | 1,759 |
| Short term debt | 649 | 1,884 | 1,626 | 1,245 | -23.45 | 1,110 | -10.84 | 1,093 | 1,093 | 1,093 |
| Total current liabilities | 1,948 | 3,644 | 3,276 | 2,994 | -8.6 | 2,864 | -4.3 | 2,851 | 2,851 | 2,852 |
| Long term debt | 4,727 | 7,282 | 7,777 | 8,481 | 9.1 | 8,864 | 4.5 | 8,989 | 8,989 | 8,989 |
| Other long term liabilities | 4,840 | 7,984 | 6,976 | 7,487 | 7.3 | 8,005 | 6.9 | 8,505 | 9,007 | 9,513 |
| Preferred shares | 0 | 0 | 0 | 0 | - | 0 | - | 0 | 0 | 0 |
| Total liabilities (incl pref shares) | 11,515 | 18,910 | 18,028 | 18,962 | 5.2 | 19,734 | 4.1 | 20,345 | 20,848 | 21,354 |
| Common s/h equity | 4,016 | 9,237 | 9,612 | 9,930 | 3.3 | 10,310 | 3.8 | 10,751 | 11,652 | 12,541 |
| Minority interests | 116 | 156 | 156 | 156 | 0.0 | 156 | 0.0 | 156 | 156 | 156 |
| Total liabilities & equity | 15,647 | 28,303 | 27,796 | 29,048 | 4.5 | 30,200 | 4.0 | 31,252 | 32,655 | 34,050 |
| Cash flow (US\$m) | | | | | | | | | | |
| Net income (before pref divs) | 423 | 526 | 786 | 807 | 2.7 | 907 | 12.3 | 1,006 | 1,045 | 1,034 |
| Depreciation & amortisation | 302 | 519 | 611 | 665 | 8.9 | 689 | 3.7 | 709 | 726 | 733 |
| Net change in working capital | 88 | (111) | (307) | (281) | 8.4 | (55) | 80.6 | (36) | (17) | 1 |
| Other operating | 136 | 184 | 566 | 573 | 1.3 | 549 | -4.2 | 529 | 533 | 536 |
| Operating cash flow | 948 | 1,118 | 1,656 | 1,764 | 6.5 | 2,090 | 18.5 | 2,209 | 2,286 | 2,303 |
| Tangible capital expenditure | (1,077) | (1,472) | (1,457) | (1,576) | -8.2 | (1,603) | -1.7 | (1,629) | (1,377) | (861) |
| Intangible capital expenditure | 0 | 0 | 0 | 0 | - | 0 | - | 0 | 0 | 0 |
| Net (acquisitions) / disposals | 44 | (31) | (52) | 0 | - | 0 | - | 0 | 0 | 0 |
| Other investing | 14 | 36 | 68 | 0 | - | 0 | - | 0 | 0 | 0 |
| Investing cash flow | (1,019) | (1,468) | (1,441) | (1,576) | -9.4 | (1,603) | -1.7 | (1,629) | (1,377) | (861) |
| Equity dividends paid | (195) | (375) | (463) | (496) | -7.3 | (534) | -7.6 | (572) | (153) | (153) |
| Share issues / (buybacks) | 0 | 0 | 0 | 0 | - | 0 | - | 0 | 0 | 0 |
| Other financing | (13) | 0 | (33) | 0 | - | 0 | - | 0 | 0 | 0 |
| Change in debt & pref shares | 239 | 721 | 271 | 323 | 19.20 | 248 | -23.22 | 108 | 0 | 0 |
| Financing cash flow | 31 | 346 | (225) | (173) | 22.8 | (286) | -65.1 | (464) | (153) | (153) |
| Cash flow inc/(dec) in cash | (39) | (4) | (10) | 15 | - | 201 | NM | 116 | 757 | 1,290 |
| FX / non cash items | 22 | 43 | 8 | 8 | 0.0 | 8 | 0.0 | 8 | 8 | 8 |
| Balance sheet inc/(dec) in cash | (17) | 39 | (2) | 22 | - | 208 | NM | 124 | 764 | 1,297 |

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts. *Cash EPS (UBS, diluted) is calculated using UBS net income adding back depreciation and amortization.

Northeast Utilities (NU.N)

| Valuation (x) | 12/11 | 12/12 | 12/13 | 12/14E | 12/15E | 12/16E | 12/17E | 12/18E |
|---|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| P/E (local GAAP, diluted) | 14.3 | 19.8 | 17.0 | 19.9 | 17.7 | 15.9 | 15.3 | 15.5 |
| P/E (UBS, diluted) | 14.3 | 16.5 | 16.7 | 18.9 | 17.7 | 15.9 | 15.3 | 15.5 |
| P/CEPS | 8.3 | 9.1 | 9.5 | 10.6 | 10.0 | 9.3 | 9.1 | 9.1 |
| Equity FCF (UBS) yield % | (2.1) | (3.4) | 1.5 | 1.2 | 3.0 | 3.6 | 5.7 | 9.0 |
| Net dividend yield (%) | 3.2 | 3.5 | 3.4 | 3.1 | 3.3 | 3.6 | 3.8 | 4.0 |
| P/BV x | 1.5 | 1.3 | 1.4 | 1.6 | 1.6 | 1.5 | 1.4 | 1.3 |
| EV/revenues (core) | 2.5 | 2.8 | 3.1 | 3.5 | 2.9 | 2.8 | 2.8 | 2.8 |
| EV/EBITDA (core) | 10.0 | 10.9 | 10.6 | 11.4 | 8.7 | 8.4 | 8.2 | 8.3 |
| EV/EBIT (core) | 13.6 | 16.0 | 14.8 | 16.2 | 12.2 | 11.6 | 11.4 | 11.5 |
| EV/OpFCF (core) | 13.6 | 16.0 | 14.8 | 16.2 | 12.2 | 11.6 | 11.4 | 11.5 |
| EV/op. invested capital | 2.0 | 1.9 | 1.7 | 1.7 | 1.4 | 1.3 | 1.3 | 1.3 |
| Enterprise value (US\$m) | 12/11 | 12/12 | 12/13 | 12/14E | 12/15E | 12/16E | 12/17E | 12/18E |
| Market cap. | 6,020 | 10,448 | 13,273 | 16,066 | 16,066 | 16,066 | 16,066 | 16,066 |
| Net debt (cash) | 5,247 | 7,245 | 9,240 | 9,510 | 9,680 | 9,692 | 9,692 | 9,692 |
| Buy out of minorities | 116 | 156 | 156 | 156 | 156 | 156 | 156 | 156 |
| Pension provisions/other | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total enterprise value | 11,383 | 17,848 | 22,668 | 25,732 | 25,902 | 25,914 | 25,914 | 25,914 |
| Non core assets | 0 | 0 | 0 | 0 | (4,521) | (4,491) | (4,461) | (4,431) |
| Core enterprise value | 11,383 | 17,848 | 22,668 | 25,732 | 21,381 | 21,423 | 21,453 | 21,483 |
| Growth (%) | 12/11 | 12/12 | 12/13 | 12/14E | 12/15E | 12/16E | 12/17E | 12/18E |
| Revenue | -8.8 | 40.5 | 16.4 | -0.5 | 2.8 | 1.8 | 0.8 | -0.1 |
| EBITDA (UBS) | 2.6 | 43.8 | 30.7 | 5.5 | 8.4 | 4.2 | 2.2 | -0.2 |
| EBIT (UBS) | 4.5 | 33.7 | 36.8 | 4.1 | 10.4 | 4.8 | 2.1 | -0.7 |
| EPS (UBS, diluted) | 8.4 | -4.6 | 11.5 | 6.2 | 6.7 | 11.0 | 3.9 | -1.1 |
| Net DPS | 7.3 | 19.4 | 10.4 | 8.3 | 7.6 | 7.1 | 6.6 | 6.2 |
| Margins & Profitability (%) | 12/11 | 12/12 | 12/13 | 12/14E | 12/15E | 12/16E | 12/17E | 12/18E |
| Gross profit margin | 64.6 | 66.8 | 66.0 | 66.2 | 66.9 | 67.4 | 67.6 | 67.5 |
| EBITDA margin | 25.5 | 26.1 | 29.3 | 31.1 | 32.8 | 33.6 | 34.0 | 34.0 |
| EBIT margin | 18.7 | 17.8 | 20.9 | 21.9 | 23.5 | 24.2 | 24.6 | 24.4 |
| Net earnings (UBS) margin | 9.5 | 10.1 | 11.0 | 11.7 | 12.1 | 13.3 | 13.7 | 13.5 |
| ROIC (EBIT) | 14.4 | 12.1 | 11.3 | 10.7 | 11.4 | 11.6 | 11.6 | 11.6 |
| ROIC post tax | 10.1 | 9.6 | 7.4 | 7.1 | 7.4 | 7.9 | 8.0 | 8.0 |
| ROE (UBS) | 10.8 | 9.5 | 8.5 | 8.7 | 9.0 | 9.6 | 9.3 | 8.5 |
| Capital structure & Coverage (x) | 12/11 | 12/12 | 12/13 | 12/14E | 12/15E | 12/16E | 12/17E | 12/18E |
| Net debt / EBITDA | 4.7 | 5.6 | 4.4 | 4.3 | 4.0 | 3.8 | 3.4 | 2.9 |
| Net debt / total equity % | 129.9 | 97.1 | 95.8 | 95.8 | 92.7 | 88.8 | 75.5 | 60.0 |
| Net debt / (net debt + total equity) % | 56.5 | 49.3 | 48.9 | 48.9 | 48.1 | 47.0 | 43.0 | 37.5 |
| Net debt/EV | 47.2 | 51.1 | 41.3 | 37.5 | 45.4 | 45.2 | 41.6 | 35.5 |
| Capex / depreciation % | NM | NM | NM | NM | NM | NM | 189.7 | 117.5 |
| Capex / revenue % | 24.1 | 23.5 | 20.0 | 21.7 | 21.5 | 21.4 | 18.0 | 11.3 |
| EBIT / net interest | 3.8 | 3.6 | 5.2 | 5.2 | 5.0 | 5.2 | 5.3 | 5.3 |
| Dividend cover (UBS) | 2.2 | 1.7 | 1.7 | 1.7 | 1.7 | 1.8 | 1.7 | 1.6 |
| Div. payout ratio (UBS) % | 46.1 | 57.9 | 57.3 | 58.4 | 58.9 | 56.9 | 58.4 | 62.7 |
| Revenues by division (US\$m) | 12/11 | 12/12 | 12/13 | 12/14E | 12/15E | 12/16E | 12/17E | 12/18E |
| Others | 4,466 | 6,274 | 7,301 | 7,262 | 7,464 | 7,594 | 7,654 | 7,649 |
| Total | 4,466 | 6,274 | 7,301 | 7,262 | 7,464 | 7,594 | 7,654 | 7,649 |
| EBIT (UBS) by division (US\$m) | 12/11 | 12/12 | 12/13 | 12/14E | 12/15E | 12/16E | 12/17E | 12/18E |
| Others | 836 | 1,118 | 1,529 | 1,592 | 1,757 | 1,841 | 1,880 | 1,867 |
| Total | 836 | 1,118 | 1,529 | 1,592 | 1,757 | 1,841 | 1,880 | 1,867 |

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

Forecast returns

| | |
|-----------------------------|--------|
| Forecast price appreciation | +8.5% |
| Forecast dividend yield | 3.2% |
| Forecast stock return | +11.7% |
| Market return assumption | 5.5% |
| Forecast excess return | +6.2% |

Statement of Risk

Investors should be aware of the following risk factors relating to NU shares: the potential impact of mild weather on regulated utility sales; unreasonable or unexpected regulatory / legal decisions; adverse FERC decisions regarding returns on transmission assets; adverse regulatory decisions for its distribution subsidiaries; and unexpected changes to the financial health of the company that could result in debt downgrades and collateral calls from counter parties. Given its aggressive transmission growth, we further highlight capital market access (both debt and equity) as imperative to its ability to execute on its plan.

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| 12-Month Rating | Definition | Coverage ¹ | IB Services ² |
|-------------------|---|-----------------------|--------------------------|
| Buy | FSR is > 6% above the MRA. | 47% | 34% |
| Neutral | FSR is between -6% and 6% of the MRA. | 42% | 28% |
| Sell | FSR is > 6% below the MRA. | 11% | 21% |
| 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 2014.

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.

KEY DEFINITIONS: **Forecast Stock Return (FSR)** is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months. **Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium). **Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation. **Short-Term Ratings** reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case. **Equity Price Targets** have an investment horizon of 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 |
|--|---------|-----------------|-------------------|-----------|-------------|
| Northeast Utilities ^{13, 16} | NU.N | Buy | N/A | US\$50.70 | 07 Nov 2014 |

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

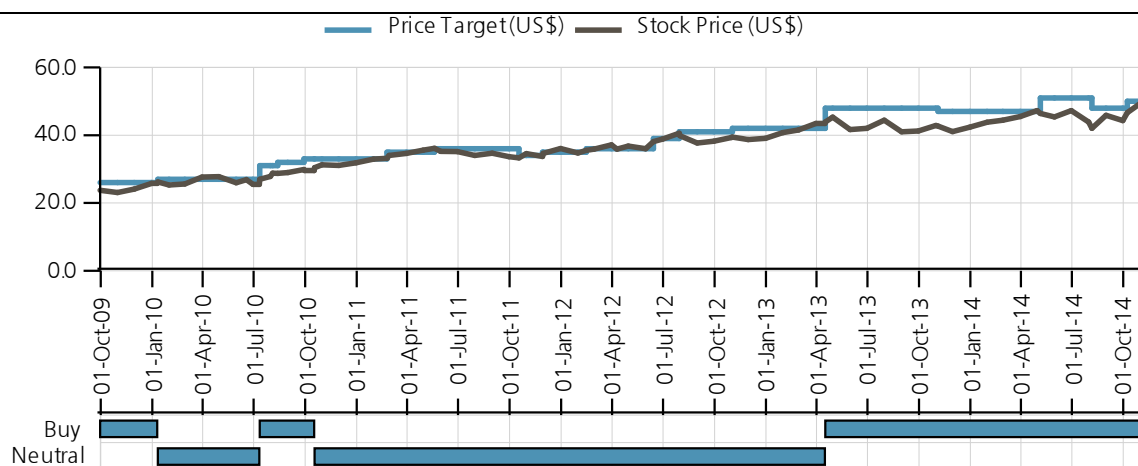
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Northeast Utilities (US\$)



Source: UBS; as of 07 Nov 2014

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