

AES Corporation

Doing the Debt Walk

Deleveraging remains the focus as mgmt attempts to improve credit metrics

Management's focus shifted ever more towards a wider de-leveraging focus as mgmt made clear its intentions to continue to reduce debt ~\$100Mn/yr through the forecast period to achieve a 4.0-4.5x Parent Debt/Subsidiary Distributions, consistent with BB+ metrics in its mind. AES went so far as to describe its outlook as targeted 'Investment Grade' like metrics in an effort to talk up its analogy to peer utilities. Alongside continued dividend growth, mgmt continues to position itself as a utility-proxy, with not just improving debt, but also div growth in tandem with the 10% growth in proportional FCF. That said, we suspect the co. will shift towards a structurally slower growth trajectory, and see combination of div growth (~\$300 Mn) and debt paydown (~\$100 Mn+) as substantially latitude for meaningful equity investments (off ~\$600 Mn in net parent FCF), w/ \$200 Mn in equity investments would drive ~4% EPS growth.

What's the earnings trajectory? Estimates already reflect this pressure

The latest impact from commodities and F/X continues to pressure guidance, with the drop in 2016 guidance to \$0.95-1.05 ~\$0.05 worse than expected. Among the single bright spots remains mgmt's confidence in seeing ~16% YoY EPS growth (top end of 12-16% range) for '17 & '18, suggesting ~\$1.30 in '18 is still achievable. Success on expansions in the Philippines & Panama play into continued growth thru '20.

Don't look for expansion in Brazil; sales rather than re-leveraging on the way

Mgmt emphasized it would evaluate strategic options for its AES Sul business after injecting \$75 Mn into the biz to provide a new equity cushion. Mgmt expects to continue to pursue its trajectory of \$200-300Mn of asset sales per annum, seemingly inclusive of this asset. Further, we see little credibility to datapoints listing AES as evaluating any expansion in Brazil (either distribution or IPP assets).

Valuation: Maintain \$9 target (SOTP); see risk to downside following 4Q rally

We see shares as fully valued with AES once more trading back to ~10x historical P/E valuation; additionally given continued challenges in LatAm and unlikely near-term acquisition at Tiete, we see limited upside. DPL's petition for an ESP extension at 'above-market' rate could see pushback just like AEP/FE's efforts have. Moreover, with Maritza in Bulgaria still unclear into 2016, this remains an overhang (unexpected).

Equities

Americas
Electric Utilities

12-month rating **Neutral**

12m price target **US\$9.00**

Price **US\$9.87**

RIC: AES.N BBG: AES US

Trading data and key metrics

52-wk range	US\$13.94-8.54
Market cap.	US\$6.51bn
Shares o/s	660m (COM)
Free float	100%
Avg. daily volume ('000)	1,745
Avg. daily value (m)	US\$16.2
Common s/h equity (12/15E)	US\$4.40bn
P/BV (12/15E)	1.5x
Net debt / EBITDA (12/15E)	4.2x

EPS (UBS, diluted) (US\$)

	12/15E	
	UBS	Cons.
Q1	0.23	0.25
Q2	0.25	0.25
Q3	0.39	0.39
Q4E	0.36	0.34
12/15E	1.21	1.22
12/16E	1.05	1.06
12/17E	1.18	1.18

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Highlights (US\$m)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenues	19,232	15,891	17,146	19,307	19,026	19,163	19,189	19,363
EBIT (UBS)	1,537	2,484	3,107	3,284	2,989	3,136	3,195	3,366
Net earnings (UBS)	946	958	942	824	679	740	818	923
EPS (UBS, diluted) (US\$)	1.24	1.29	1.30	1.21	1.05	1.18	1.36	1.60
DPS (US\$)	0.16	0.16	0.25	0.40	0.44	0.49	0.54	0.59
Net (debt) / cash	(19,481)	(19,485)	(19,397)	(19,138)	(18,297)	(17,301)	(16,258)	(15,657)
Profitability/valuation	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
EBIT margin %	8.0	15.6	18.1	17.0	15.7	16.4	16.7	17.4
ROIC (EBIT) %	5.2	8.9	11.3	12.0	11.0	11.9	12.5	13.5
EV/EBITDA (core) x	11.0	7.8	7.1	5.9	6.3	6.2	6.2	5.9
P/E (UBS, diluted) x	9.6	10.0	11.0	8.2	9.4	8.3	7.3	6.2
Equity FCF (UBS) yield %	20.8	12.5	(3.4)	22.6	27.9	28.1	29.2	22.1
Net dividend yield %	1.3	1.2	1.8	4.1	4.5	5.0	5.5	6.0

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\$9.87 on 26 Feb 2016 19:42 EST

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What do we think of shares? Toppish

Why did shares trade up post-4Q results? We attribute this to confidence in forward looking EPS guidance, which is ultimately not *too* far from Street consensus. Given the sharp negative revisions in recent months, we suspect investors will be loath to look out too far – and place much confidence on these estimates. We suspect expectations remain sufficiently low as to place the onus on management to simply execute on its 2016 targets amidst a volatile F/X and commodity environment.

That said, valuation remains a story of two worlds, illustrative of the hybrid portfolio of utilities and IPP assets held within the AES Corporate umbrella. We see the ownership in DPL and IPALCO as among the most valuable assets, appreciating in recent months as the wider US and global utility valuations climbed. In contrast, its more contracted IPP assets (and some outright merchant IPP assets) continued to see both estimated and negative multiple revisions in recent periods. Our latest updates to the SOP reflect an equal offset to higher Net Debt and utility against lower values for the utility portfolio. We maintain our net \$9/sh value and see some near-term downside risk to shares off their current highs.

Historic and new distractions have cropped up to limit appreciation. We see the equity injection and sale of the AES Sul business as just the latest example of headwinds in the portfolio. We see a sale as helping to reduce the company's disproportionate sensitivity to the Brazilian market (despite its already limited equity ownership in the country).

Will management continue to grow the dividend? This remains a key question of confidence. Among the most notable datapoints is both the confidence in recovery of earnings, but also resilient views on FCF growth through this period of at least 10%. Further defining the sources of such confidence remain the upshot.

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

[12/22/2015: Another Embattled IPP](#)

[11/6/15 Feeling the Global Squeeze](#)

[9/8/15 Positioning for a Turnaround](#)

[4/2/15 Streamlining the Story](#)

[2/26/15 Dry Spell](#)

Thinking through the Economics of the New assets

We include our initial expectations for the latest growth projects. While the call included a formal decision to move forward with the Masinloc II project (contemplated for many years), the *real* new incremental datapoint included a recently awarded PPA to build out a new 350-MW CCGT in Panama fired via LNG imports. Overall, through 2020, new assets are estimated to contribute an incremental \$0.20 in EPS.

Figure 1: Growth Projects - \$0.20 in EPS with ~\$900Mn in Equity

Location	Panama	AES Southland	Philippines
Equity Investment (\$MM)	\$250	\$600	150
Expected Start Date	2019	2020	2019
ROE (%)	13%	13%	13%
NI (\$MM)	\$33	\$78	\$20
Shares Outstanding (UBSe)	635	635	635
EPS (\$)	\$0.05	\$0.12	\$0.03

Source: Company reports and UBSe

But more asset sales are coming nonetheless

Management remains committed to further asset sales, with ~half of the 2016 \$400 Mn buyback contemplated from ~\$180 Mn of asset sale proceeds. Generically, mgmt. has guided towards \$250-300 Mn/yr in asset sales, seeing ~\$1 Bn in total proceeds through 2018. We emphasize its modestly sized Elsa gas plant in the Netherlands has a call-option with Dow, which is expected to be executed in 2017.

Selling down the Retail business exposure at DPL

In a relatively surprise move, DPL announced it was selling its retail business DPL-Energy Resources (DPL-ER) for ~\$75 Mn. Having posted ~\$10 Mn/yr in EBITDA in 2015 – and reflected once more at this level in 2016 guidance – this implies a ~7.5x EBITDA multiple. That said, with the segment having produced ~\$20-30 Mn in EBITDA in years past, we see the inflated multiple as a reflection of potential for margin expansion (it would appear margins have declined at the segment, rather than seeing volumetric declines). The selldown could also indicate a willingness to sell-down exposure.

Debt Metrics

Management discussed plans to continue to de-lever the overall business, targeting reductions in debt by ~\$100 Mn per annum in corporate debt, targeting a reduction off the \$4.7 Bn in corporate debt today down, coupled with improving parent FCF (estimated at least 10%/yr), off a current \$575 Mn. We show our projections below for wider de-leveraging at the subsidiary. We see management as keen to achieve a high BB+ metric, albeit not necessarily investment grade credit outright.

Is this the right call? We're surprised by the relative degree of de-leveraging contemplated given the desire to reduce leverage to just under investment grade. Given the potential new investors into the equity we're surprised the company doesn't 'go the distance' in this regard while focused on de-leveraging.

Please refer below the Parent FCF table and parent capital allocation, which matches the guidance

Figure 2: Parent FCF and Parent Debt Metrics

	2015A	2016E	2017E	2018E	2019E	2020E
Subsidiary Distributions	1,066	1,084	1,134	1,154	1,174	1,190
<i>Guidance</i>		1060-1160				
Parent Interest Expense	319	314	308	307	305	302
<i>Guidance</i>		300				
Corporate SG&A, etc	208	235	223	187	178	169
<i>Guidance</i>		235				
Parent FCF	539	535	603	660	691	719
<i>Guidance</i>		525-625				
Asset Sale Proceeds	537	71				
Dividend	(276)	(290)	(319)	(347)	(375)	(401)
Unallocated Discretionary Cash		171				
Investment in Subsidiaries	(114)	(330)	(200)	(200)	(200)	(200)
Share Repurchase Assumption	(481)	(79)	(79)	(79)	(79)	(79)
Remaining for Deployment/Debt Pay	65	78	5	34	37	39
Parent Debt	4,700	4,622	4,616	4,583	4,545	4,506
Parent "EBITDA" (FCF + Int Exp)	858	849	911	967	996	1,021
Parent Debt/EBITDA	5.5	5.4	5.1	4.7	4.6	4.4

Source: Company reports and UBS

Latest EPS Projections

We show below our estimates for AES, which have been updated to latest F/X and commodities; we also lower our AES Brazil expectations.

Mgmt maintained its 12-16% growth range, biasing towards the upper end of this range, suggesting 2018 is not far off the current outlook from consensus.

Figure 3: AES EPS estimates – Sticking it out towards high end of the range

	2015	2016E	2017E	2018E	2019E	2020E
EPS	1.22	0.99	1.13	1.29	1.44	1.60
EPS Growth %		-19%	14%	14%	12%	11%
Guidance - Low	1.18	0.95	1.12	1.25	1.40	1.57
Guidance - High	1.25	1.05	1.16	1.35	1.56	1.81
Consensus		1.00	1.19	1.33		
Previous EPS	1.21	1.05	1.18	1.36	1.60	

Source: Company data, FactSet and UBS estimates

DPL Projections

We reflect the latest projections for DPL below too vs. mgmt guidance. We estimate the ~\$350 Mn in EBITDA projected in slides is roughly ~\$50 Mn above market (~\$0.05 EPS). We include ESP 'above-market' contributions below to provide a sense of estimates relative to the ~\$350 Mn/yr guided by management. On ~13TWh, the \$20/MWh the AEP and FE contracts are above market would translate to ~\$250 Mn/yr; we assume only a third of that here.

Figure 4: DPL EBITDA estimates

DPL Inc. Mini-Model	2016	2017	2018	2019	2020
T&D	175	180	186	191	197
DPL-ER - A	24	24	24	24	24
Generation (Energy Margin + Capacity) - B	23	25	32	45	51
ESP	100	80	70	50	50
Legacy Rates Benefit	-	-	-	-	-
Hedges (UBSe)	-	-	-	-	-
Switched (avg)	0.00%	0.00%	0.00%	0.00%	0.00%
Legacy Book	12	12	12	12	12
Above Market (\$/MWh)	40	50	50	50	50
Total EBITDA	322	309	312	310	322
Guidance	\$360M per year				
Int. Exp	(109)	(102)	(94)	(87)	(77)
EPS	0.08	0.08	0.09	0.10	0.12
Interest Expense	109	102	94	87	77
Capex	133	129	131	130	131
FCF	79	77	87	93	114

Source: Company reports, Platts, UBSe

Valuation: Maintain \$9 PT; Neutral Rating

We embed our latest Sum of the Parts valuation below; we have marked-to-market our valuation to latest F/X and commodity prices. We also reflect market multiples for US IPPs (down to 6-7x) and Utilities (reflecting improved valuations). We emphasize the contrasting datapoints on valuation are offsets within our overall model. We also roll forward the model to reflect year-end 2015 financials (a modest improvement) as well as latest FY16 guidance on cash generation.

With shares trading back to ~\$10/sh, we perceive modest downside risk given continued pressures on LatAm and unlikely immediate acquisition at Tiete.

Figure 5: Summary SOP View for AES – Maintain PT at \$9

Summary SOP Valuation for AES Corp	% Owned by AES	Low	Base	High
Listed Latin American Subsidiaries		\$4.54	\$4.54	\$4.54
Latin American Utilities (Unlisted)		\$0.01	\$0.35	\$0.57
Latin American Generation (Unlisted)		\$2.40	\$3.26	\$4.12
North American Utilities		\$1.94	\$2.07	\$2.19
North American Generation		\$1.83	\$2.55	\$3.34
Asian Generation		\$1.00	\$1.14	\$1.27
European Generation		\$0.65	\$1.22	\$1.79
Summary SOP Valuation for AES Corp		Low	Base	High
Total Subsidiaries Equity Value		\$12.39	\$15.13	\$17.83
Other Adjustments (Parent Debt, etc)				
Parent Adjustments, Debt, and Corp/Other			(3,817)	
Shares Outstanding			659	
Parent Debt Outstanding and Cost Drag per Share			(\$5.79)	
AES Corp Total Equity Value per Share		\$6.60	\$9.33	\$12.03

Source: Company Filings, FactSet, and UBS Estimates

Figure 6: SOP View for AES

Sum of the Parts Analysis - Hedged Analysis - UBSe								
Latin America Listed Subsidiaries						Low	Base	High
	AES Tiete	AES Tiete	AES	AES	AES			
Listed Subsidiaries	(Common, GETI3)	(Pfd, GETI4)	(Common, Eletropaulo)	(Pfd, Eletropaulo)	Gener			
UBS Price Target	20.00	20.00	7.26	8.00				
Current Share Price	13.20	14.55	6.84	7.54	316.10			
% Upside	52%	37%	6%	6%				
Ownership %	32.96%	14.94%	35.95%	3.41%	67.00%			
Shares O/S	197	184	67	101	8,070			
F/X Rate	3.96	3.96	3.96	3.96	690.70			
Market Value Stake	217	101	41	7	2,474		2,841	
UBS-Implied Equity Stake	329	139	44	7	2,474		2,993	
Premium PN/ON	10%		10%		Brazil		519	0.78737521
Shares Outstanding				reduce o		659	659	659
Implied Equity Value of Foreign Listed Subsidiaries (per Share)						4.54	4.54	4.54
AES Gener						\$3.76	\$3.76	\$3.76
AES Tiete						\$0.71	\$0.71	\$0.71
AES Eletropaulo						\$0.08	\$0.08	\$0.08
Latin American Utilities		2016 EBITDA	EV/EBITDA Multiple		Enterprise Value			
					Low	Base	High	
Sul	72	-1.0x	0.0x	1.0x	(72)	-		72
El Salvador	76	5.0x	6.0x	7.0x	378	453		529
Total LatAm Utilities (Non-Listed) EV	147	2.1x	3.1x	4.1x	306	453		600
Net Debt								
Sul - Equity Infusion Pending Sale of Company							75	
El Salvador							(299)	
Total LatAm Utilities Equity Value						82	229	376
Shares Outstanding						659	659	659
Total LatAm Utility Value Per Share (Non-Listed)						\$0.12	\$0.35	\$0.57
Sul						\$0.01	\$0.11	\$0.22
El Salvador						\$0.00	\$0.23	\$0.35
		2016 EBITDA	EV/EBITDA Multiple		Enterprise Value			
Latin American Generation					Low	Base	High	
Private Subsidiaries								
Uruguaiana CCGT	1	5.0x	6.0x	7.0x	7	9		10
Argentina Generation Portfolio	176	5.0x	6.0x	7.0x	882	1,059		1,235
Panama Generation Portfolio (AES Interest)	228	5.0x	6.0x	7.0x	1,140	1,368		1,596
Dominican Republic Portfolio	162	5.0x	6.0x	7.0x	808	969		1,131
Total LatAm Generation (Non-Listed) EV	568	5.0x	6.0x	7.0x	2,838	3,405		3,973
Net Debt								
Argentina Generation Portfolio							(210)	
Panama Generation Portfolio							(836)	
Dominican Republic Portfolio							(200)	
Total LatAm Generation Equity Value						1,592	2,159	2,727
Shares Outstanding						659	659	659
Total LatAm Generation Value Per Share (Non-Listed)						\$2.42	\$3.28	\$4.14
Uruguaiana CCGT						\$0.01	\$0.01	\$0.02
AES Argentina						\$1.02	\$1.29	\$1.56
AES Panama						\$0.46	\$0.81	\$1.15
AES Dominican Republic						\$0.92	\$1.17	\$1.41

Source: Company Filings, FactSet, and UBS Estimates

Figure 7: SOP View for AES

North American Utilities					Enterprise Value		
	2017 Net Income		P/E Multiple		Low	Base	High
DPL							
T&D Utility	68	15.3x	16.3x	17.3x	1,044	1,112	1,181
	Peer Multiple =		16.8x				
	Premium/Discount =		-0.5x				
Add: Back Hypothetical Debt					650	650	650
T&D Utility EV					1,694	1,762	1,831
	2016 EBITDA (Gen)						
Generation (excludes ESP uplift)	23	6.0x	7.0x	8.0x	136	159	181
DPL-ER	24	4.0x	5.0x	6.0x	96	120	144
Merchant EV					232	279	325
ESP Rates (Nonby passable, NPV) - Estimated Contribution @ 50% Prob					87	87	87
Total DPL Debt (DP&L and Inc.)					(2,294)	(2,294)	(2,294)
DPL Equity Value					(281)	(166)	(51)
	2017 Net Income		P/E Multiple				
IPL (Indianapolis Power & Light)	116	15.8x	16.8x	17.8x	1,830	1,946	2,062
	Peer Multiple =		16.8x				
	Premium/Discount =		0.0x				
IPALCO Ownership post-Selldown					70%	70%	70%
AES' Equity Value in IPL					\$1,281	\$1,362	\$1,443
Total US Utility Equity Value					\$1,281	\$1,362	\$1,443
Shares Outstanding					659	659	659
Total US Utility Value Per Share					\$1.94	\$2.07	\$2.19
DP&L (Dayton Power & Light)					-\$0.43	-\$0.25	-\$0.08
IPL (Indianapolis Power & Light)					\$1.94	\$2.07	\$2.19

Source: Company Filings, FactSet, and UBS Estimates

Figure 8: SOP View for AES

<u>European Generation</u>	2016 EBITDA	EV/EBITDA Multiple			Low	Base	High
<i>Private Subsidiaries</i>							
AES Bulgaria (Maritza Lignite Plant)	241	4.0x	5.0x	6.0x	965	1,206	1,447
Kazakhstan	61	6.0x	7.0x	8.0x	366	427	488
UK Gen (Ballylumford CCGT and Kilroot Coal)	44	6.0x	7.0x	8.0x	264	308	352
Jordan (CCGT)	28	5.0x	6.0x	7.0x	139	166	194
<i>Total European Generation EV</i>	<i>379</i>	<i>4.7x</i>	<i>5.7x</i>	<i>6.7x</i>	<i>1,764</i>	<i>2,143</i>	<i>2,522</i>
Net Debt							
AES Bulgaria (Maritza Lignite Plant)						(1,015)	
AES Hungary (Tisza II Plant)						-	
Kazakhstan						(22)	
UK Generation (Ballylumford CCGT and Kilroot Coal)						(2)	
Jordan (CCGT)						(262)	
Total Net Debt						(1,462)	
Total European Generation Equity Value					426	805	1,184
Shares Outstanding					659	659	659
Total European Generation Value Per Share (Non-Listed)					\$0.65	\$1.22	\$1.80
<i>AES Bulgaria (Maritza Lignite Plant)</i>					<i>-\$0.08</i>	<i>\$0.29</i>	<i>\$0.66</i>
<i>AES Hungary (Tisza II Plant)</i>					<i>\$0.00</i>	<i>\$0.00</i>	<i>\$0.00</i>
<i>Kazakhstan</i>					<i>\$0.52</i>	<i>\$0.61</i>	<i>\$0.71</i>
<i>UK Generation (Ballylumford CCGT and Kilroot Coal)</i>					<i>\$0.40</i>	<i>\$0.46</i>	<i>\$0.53</i>
<i>Jordan (CCGT)</i>					<i>-\$0.19</i>	<i>-\$0.15</i>	<i>-\$0.10</i>
<u>Asian Generation</u>	2016 EBITDA	EV/EBITDA Multiple			Low	Base	High
<i>Private Subsidiaries</i>							
Philippines (Masinloc), 51% Interest	60	6.0x	7.0x	8.0x	362	422	482
Vietnam (Mong Duong), in-service	128	7.0x	7.0x	7.0x	894	894	894
Sri Lanka (Kelantissa)	29	6.0x	7.0x	8.0x	174	203	232
<i>Total Asian Generation EV</i>	<i>217</i>	<i>6.6x</i>	<i>7.0x</i>	<i>7.4x</i>	<i>1,430</i>	<i>1,520</i>	<i>1,609</i>
Net Debt							
Philippines (Masinloc), 51% Interest						(205)	
Vietnam (Mong Duong), In-service in 2016 - \$809Mn 51% owned						(565)	
Sri Lanka (Kelantissa)						-	
Total Net Debt						(770)	
Total Asian Generation Equity Value					660	750	839
Shares Outstanding					659	659	659
Total Asian Generation Value Per Share (Non-Listed)					\$1.00	\$1.14	\$1.27
<i>Philippines (Masinloc)</i>					<i>\$0.24</i>	<i>\$0.33</i>	<i>\$0.42</i>
<i>Vietnam (Mong Duong), in-service in 2016</i>					<i>\$0.50</i>	<i>\$0.50</i>	<i>\$0.50</i>
<i>Sri Lanka (Kelantissa)</i>					<i>\$0.26</i>	<i>\$0.31</i>	<i>\$0.35</i>

Source: Company Filings, FactSet, and UBS Estimates

Figure 9: SOP View for AES

<u>North American Generation</u>	2016 EBITDA	EV/EBITDA Multiple			Low	Base	High
Southland (Contracted Gas in CA)	119	4.0x	5.0x	6.0x	474	593	711
Warrior Run (Contracted Coal in MD)	66	6.0x	7.0x	8.0x	398	464	530
Shady Point (Contracted Coal in OK)	27	6.0x	7.0x	8.0x	162	189	216
Hawaii (Contracted Coal in HI)	47	4.0x	5.0x	6.0x	188	235	282
Puerto Rico (Contracted Coal in PR)	148	5.0x	6.0x	7.0x	740	887	1,035
Merida (Contracted CCGT in Mexico)	37	6.0x	7.0x	8.0x	222	259	296
TEG/TEP (Contracted Coal in Mexico)	77	4.0x	5.0x	6.0x	310	387	465
Total North American Generation EV	521	4.8x	5.8x	6.8x	2,494	3,015	3,536
Net Debt							
Southland						(152)	
Warrior Run						(103)	
Shady Point						(34)	
Hawaii						(241)	
Puerto Rico						(449)	
Merida						(8)	
TEG/TEP						(352)	
Total Net Debt						(1,338)	
Total North American Generation Equity Value					1,156	1,677	2,198
Shares Outstanding					659	659	659
Total North American Generation Value Per Share (Non-Listed)					\$1.75	\$2.55	\$3.34
Southland					\$0.49	\$0.67	\$0.85
Warrior Run					\$0.45	\$0.55	\$0.65
Deepwater					\$0.00	\$0.00	\$0.00
Red Oak					\$0.00	\$0.00	\$0.00
Ironwood					\$0.00	\$0.00	\$0.00
Shady Point					\$0.19	\$0.24	\$0.28
Hawaii					\$0.00	-\$0.01	\$0.06
Beaver Valley					\$0.00	\$0.00	\$0.00
Puerto Rico					\$0.44	\$0.67	\$0.89
Merida					\$0.33	\$0.38	\$0.44
TEG/TEP					-\$0.06	\$0.05	\$0.17

Source: Company Filings, FactSet, and UBS Estimates

Figure 10: SOP View for AES

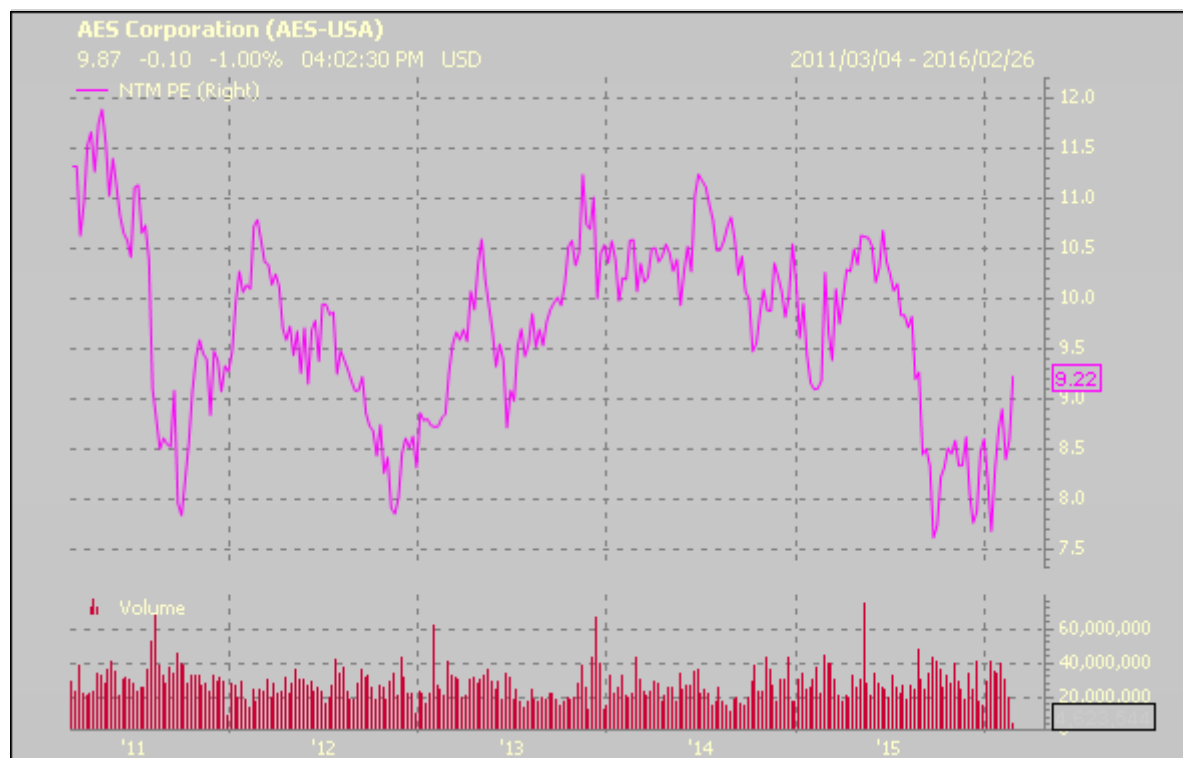
Parent Adjustments, Debt, Etc							
	2016 EBITDA	EV/EBITDA Multiple					
Corp/"Other" businesses (EBITDA)	65	6.0x	7.0x	8.0x	\$389	\$454	\$519
	2017 Net Income						
Equity Investments	50	7.0x	8.0x	9.0x	\$350	\$400	\$450
NPV of NOLs						\$230	
<u>Other Non-Recourse Debt (Corp/Other)</u>							
Other Wind Projects, Euro/African Utes, etc						(\$269)	
<u>Recourse Debt (using latest reported 10K numbers)</u>							
Unsecured Notes						(\$5,015)	
Less Current Maturities						\$0	
Secured Debt / Term Loans						\$0	
Total Recourse Debt						(\$5,015)	
Total Cash (incl. Subsidiaries), FY15						\$1,262	
Exclude Subsidiary Cash, FY15						(\$755)	
Net Debt (FY15)						(\$4,508)	
Parent FCF (mid point of guidance)						\$575	
Investment in Subsidiaries						-\$330	
Shareholder Dividends						-\$290	
Expected Share Buyback						-\$79	
Incremental Cash Generation FY16 to FY17						-\$124	
Parent Adjustments, Debt, and Corp/Other						(3,817)	
Shares Outstanding						659	
Parent Debt Outstanding and Cost Drag						(\$5.79)	
AES Corp Total Equity Value per Share					\$6.60	\$9.33	\$12.03

Source: Company Filings, FactSet, and UBS Estimates

Where is AES Trading Relative?

We include a NTM P/E chart below reflecting consensus estimates relative to stock move. We don't necessarily see more longer-dated EPS estimates as relevant for AES given the volatility in its earnings stream. We see AES shares nearly back to its historical valuation levels of late – despite the wider backdrop of macro issues and continued discrete issues at Maritza and in Brazil.

Figure 11: AES Historical Next-12-Months (NTM) P/E



Source: FactSet

Tracking F/X & Commodity Moves

Where has 2016 guidance trended since it was launched?

We show below the annualized 2016 impact, consistent with mgmt's statements that the MtM of late was approximately ~\$0.10, with a corresponding ~\$0.03 offset from hedges.

Figure 12: Annualized 2016E EPS impact using delta b/w mgmt's 2016 average rates assumption vs. actuals

FX Exposure		Brazilian			Kazakhstan	Colombian	
	Argentine Peso	Real	Euro	British Pound	Tenge	Peso	
Average 2016 rate assumed by mgmt	14.17	4.13	1.14	1.54	315.20	2988.00	
Rate as on 01/15/2016	13.37	4.05	0.91	1.43	361.10	3292.50	
% change	-5.6%	-1.9%	-19.9%	-7.1%	14.6%	10.2%	
Correlation	-ve	-ve	-ve	-ve	-ve	-ve	
Assumed sensitivity	0.005	0.005	0.005	0.005	0.005	0.01	
2016 EPS impact	0.0028	0.0010	0.0100	0.0035	-0.0073	-0.0102	
2016 EPS Sensitivity	0.28%	0.09%	0.98%	0.35%	-0.71%	-1.00%	
Commodity Exposure							
		Rotterdam			Henry Hub	UK NBP	
	NYMEX Coal	Coal	WTI Crude	Brent Crude	Nat Gas	Nat Gas	PJM AD Hub
Average 2016 rate assumed by mgmt	45.0	48.0	50.0	54.0	2.8	0.4	33.0
Rate as on 01/15/2016	42.23	45.35	29.42	28.94	2.1	0.32	28.6
% change	-6.2%	-5.5%	-41.2%	-46.4%	-25.0%	-20.0%	-13.4%
Weighting	52%	48%	25%	75%	75%	25%	
Correlation		-ve		+ve		+ve	+ve
Assumed sensitivity	0.015	0.015	0.010	0.010	0.010	0.010	0.020
2016 EPS impact		0.0088		-0.0451		-0.0238	-0.0268
2016 EPS Sensitivity		0.86%		-4.42%		-2.33%	-2.63%
Total MtM Impact to EPS		MtM currency impact	MtM commodity impact	Total New Impact (EPS)	Total New Impact (\$ Mn's)	% Change in EPS	
2016 EPS UBSe		-0.0002	-0.0869	-0.09	(83)	-108.5%	

Source: Company reports, FactSet, and UBS estimates, Bloomberg

Currency Exposures: A Continuing Headwind

We include charts of currency affecting AES. Across all major regions with exposure for AES, we continue to see material YoY appreciation of the USD. We flag most currencies remain a headwind for the company, with further inflation of late in the Kazakhstan Tenge and Argentine Peso. Meanwhile YoY comparisons for the Colombian Peso, Brazilian Real, Euro, and Pound all remain problematic.

Figure 13: F/X Rate for USD / Brazilian Real



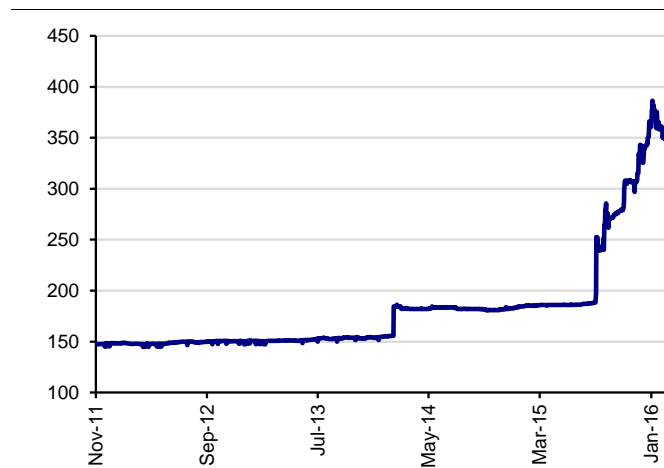
Source: FactSet

Figure 14: F/X Rate for USD / Euro



Source: FactSet

Figure 15: US Dollar per Kazakhstan Tenge



Source: Factset

Figure 16: US Dollar per GBP



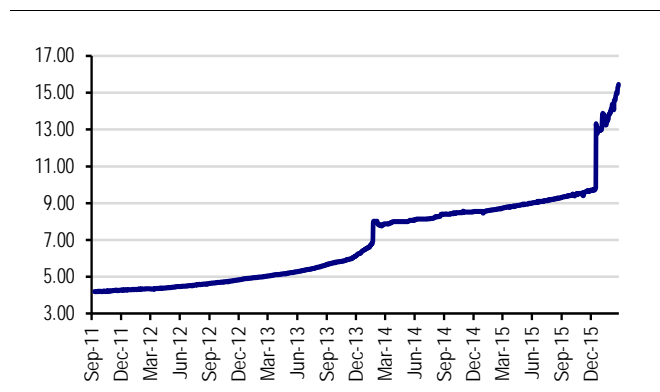
Source: Factset

Figure 17: US Dollar per Colombian Peso



Source: Factset

Figure 18: F/X Rate for USD / Argentine Peso



Source: Factset

Underlying International Commodity Performance

International coal prices have been declining since the beginning of the year and domestic coal prices after having had a decent upward run at the start of the year, are now south of \$60/t.

Figure 19: Rotterdam Coal (\$/ton), International Coal Proxy



Source: FactSet

Figure 20: NYMEX CAPP Coal (\$/ton), Domestic Coal Proxy



Source: FactSet

Comparing the Forward Gas Months: US vs. Europe

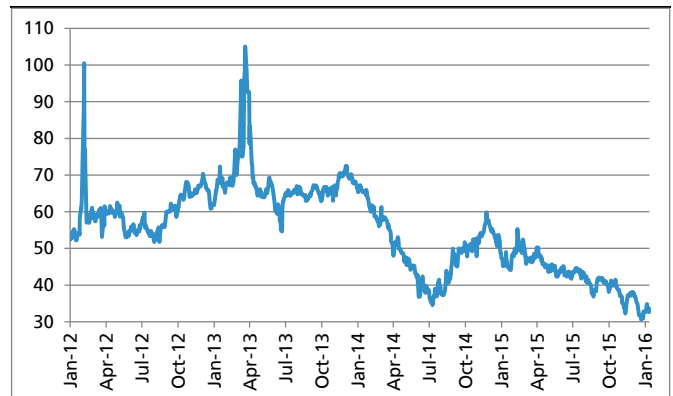
Henry Hub natural gas rose from August '13 lows of ~\$3.23/MMBtu to a high of ~\$6.15 on February 19th 2014. It has been declining steadily since then and is trading ~\$2.3 as of now; down -19% over 2015. Meanwhile, European gas prices have experienced decline of -33% over 2015. We see reversal of coal to gas switching at prices at or above \$4.50/MMBtu as meaningfully capping upside to gas demand over the intermediate term.

Figure 21: US Natural Gas (Hub), \$/MMBtu Front Month



Source: FactSet; 4Q11 Guidance (2012) = \$3.2/MMBtu

Figure 22: European Natural Gas (NBP), pence/therm



Source: Bloomberg; 4Q11 Guidance (2012) = £0.57/therm

Oil Prices: US vs. Europe

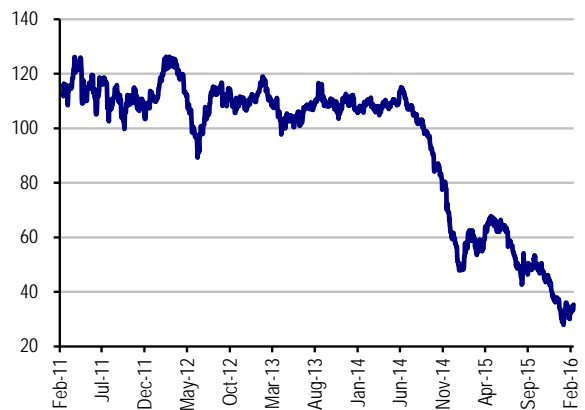
Meanwhile, domestic and international oil both continue to decline. Both WTI and Brent are trading at the sub \$35 level at the moment; and were down -30% and -35% respectively over 2015. We note here that according to mgmt. estimates for 2016, a 10% increase in WTI or Brent will result in a ~\$0.01 increase in 2016 EPS (note they are positively correlated).

Figure 23: Crude Oil (WTI), \$/Bbl



Source: FactSet

Figure 24: Crude Oil (IPE Brent), \$/Bbl



Source: FactSet

Brazil Update: Less Acquisition Chances

We continue to track potential opportunity from generation asset sales in Brazil. We think we may finally see some action in 1H2016. Mgmt has already stated it will likely go in along with a local partner and local debt; rather than using capital from AES core – we think AES could deploy its ~\$500Mn debt capacity at AES Tiete as part of any acquisition. This re-leveraging of the subsidiary could prove particularly accretive with assets trading at 5-6x EBITDA (pre-synergies, of which mgmt. suggest there will be).

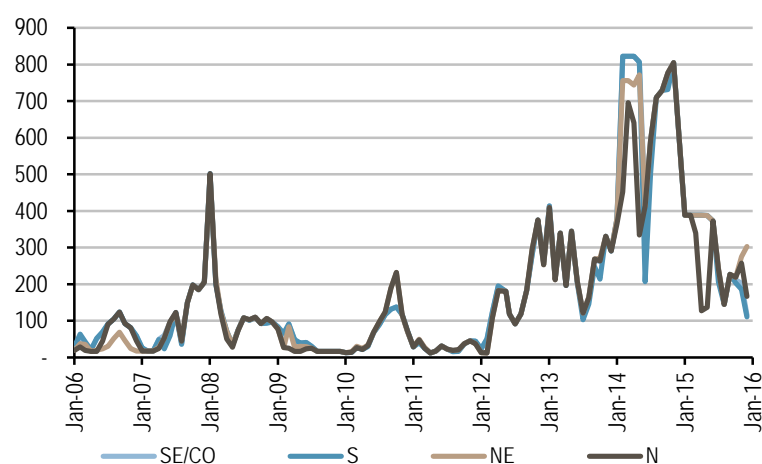
We don't see AES as poised to lever up this business anymore

2016 power price under pressure: UBS reiterates long-term power prices >R\$150/MWh

UBS LatAm utility analyst Lilyanna Yang recently highlighted ([read the report here](#)) that there seems to be no consensus where prices are headed, with estimates ranging from R\$30 to R\$180/MWh. Energy price for 2016 will be highly dependent on rainfall from Dec. 2015 to April 2016 plus demand behavior. Downward pressure on prices is driven by (i) weather reversal to mean, (ii) flattish demand in 2016 YoY, and (iii) start-up of new capacity.

We show below evolution of spot market prices; given mostly hydro matrix, Brazil's spot prices stay at very low levels during normal years, but spike rapidly in dry years – current average spot price is R\$216/MWh in all four Brazilian grids.

Figure 25: Brazilian spot market prices remain volatile (R\$/MWh, in real terms, Sep. 2015 prices)



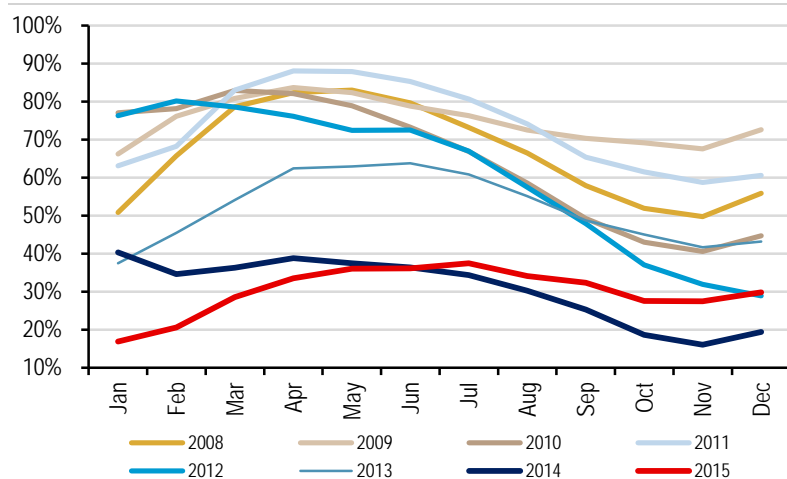
Source: CCEE, UBS

Latest data points show contracts were signed at R\$148/MWh avg. price for 2016-18e vs. UBSe modelling assumption of R\$150/MWh; and AES Tiete sold 90MWavg at R\$142 (and now has not yet contracted 7%, 14%, 41% of its capacity for years 2016, 17, 18 respectively). AES Tiete has guided for long-term power prices of R\$160-180/MWh vs. R\$155/MWh UBS estimate. While contract prices are down versus a few months and quarters ago, UBS remains comfortable with the R\$155/MWh assumption for not-yet-sold energy because: (i) current contract prices are already at above R\$155/MWh average; (ii) 3Q15-signed contracts for existing energy point to R\$160-170/MWh for delivery in 2017+ for 3-year to 5-year tenures; (iii) marginal cost of the expansion is rising on high execution risks and environmental issues (today the regulatory caps and actual bids are at >R\$200/MWh); (iv) we see rising indirect sector costs and strong migration of regulated clients to the free market; (v) the drought of the past 2 years in the SE and 4 years in the NE has better incentivized free customers to sign longer-term contracts.

Hydrology Update

Reservoir levels today are better than one year ago but this is due to a high level of dispatch of thermoelectricity plants. Reservoir levels in Brazil remain low. Rainfall at 85% of long term average (LTA) can drive reservoirs to a risky low, 10% level by the end of Nov (UBS' Brazil utilities team expects this to drive spot prices closer to the cap R\$388/MWh). If rainfall were to be at 100% of LTA, reservoirs level would reach ~40% level of total capacity by the end of Nov. (spot prices might bottom R\$30/MWh level in this scenario).

Figure 26: Brazil hydrology: reservoir level data



Source: ONS, UBS Brazilian utility team estimates

Is AES too correlated to Brazil?

We see a clear desire from mgmt to reduce AES' correlation to the Brazilian Bovespa, given many investors see the company as too tightly correlated to the wider Brazilian market despite its minority stake in multiple businesses (Tiete/Electropaulo).

Eletropaulo: Latest on Brazilian Utilities

We include Lily Yang's initial 4Q15 views on Eletropaulo, dated February 24, 2016

[Please click here for the full report](#)

How did 4Q15 results compare with expectations?

4Q15 was impacted by several extraordinary items in the revenue and cost lines plus accounting changes that made EBITDA comparison difficult. All-in, we see 4Q15 as weak and a miss to both UBSe and consensus estimate. Net income of R\$11m (R\$0.06/sh, down 96% from R\$276m prior year) was below UBSe of R\$65m and below consensus of R\$44m. The miss is mainly explained by R\$48m provision for fines related to the low quality of the service and several non-cash effects (this comes on top of the R\$105m provision for the same reason, booked in 3Q15). Reported EBITDA of R\$411m was a beat to UBSe of R\$300m and consensus of R\$289m but when adjusting for a R\$194m non-cash gain related to monetary gains of the regulatory asset base it was a 28% miss to UBSe and 25% miss to consensus. Eletropaulo announced 25% payout or R\$42m in dividends for 2015FY (0.26/sh for ELPL4, 3.3% yield), in line with UBSe.

What were the most noteworthy areas of the results?

Disco demand was weak, down 5.9% YoY (in line with UBSe) due to strong economic deceleration. With GDP expected to contract in 2016 by -3.8%, we expect continued profitability squeeze. Eletropaulo reported negative free cash flow of R\$166m in 4Q15, despite positive inflows of R\$151m in regulatory receivables. Leverage increased to >5x EBITDA when including pension debt and dividends payable, but company's reported leverage is below that, at 3.47x. Note that the R\$194m in not-yet-cash gains helped the company be within covenant requirements of up to 3.50x net debt to EBITDA.

Has the company's outlook/guidance changed?

Not much. We expect cash flow situation and leverage to improve slowly in the coming quarters, thanks to R\$1,070m (vs R\$1,221m in 3Q15) in regulatory receivables that are expected to be cashed in the next 12 months. The key valuation driver for the stock is however the off-balance sheet liabilities (click here for details in our downgrade note, and here for our Balance Sheet/Leverage Scorecard sector report).

Valuation: unchanged SOTP/DCF based R\$8 PT (9% Ke) and Sell rating

With very high leverage, potential new liabilities, high off-balance sheet disputes and uncertain M&A upside, we would avoid Brazilian discos including Eletropaulo on high beta to Brazil's uncertain but deteriorating macroeconomic outlook

Tiete: Latest on Brazilian Generation

We include our colleague Lily Yang's latest view son 4Q15 on AES' Brazilian generation, dated February 24, 2016.

[Please click here for the full report](#)

How did 4Q15 results compare with expectations? In line with UBSe

4Q15 net income of R\$233m (R\$0.61/sh, vs. a R\$76m loss prior year) was strong and in line with UBSe of R\$223m. EBITDA of R\$404m (vs. a R\$37m loss prior year) was slightly off UBSe of R\$421m. The stronger 4Q15 was due to lower costs with lower hydro generation shortfall (less severe drought vs. 2014). Looking at consensus, 4Q15 was a miss to R\$536m estimate, but we note only 6 contributions from Bloomberg. Tiete announced R\$463.8m in 2H15 dividends (R\$1.21/Unit, 8% yield), totalling R\$720m in 2015 99% payout (15% yield based on 2015FY). We expect a positive reaction on the disclosure that Tiete sold 50MWavg at good R\$170/MWh prices.

What were the most noteworthy areas of the results? Good selling prices

Tiete sold 140MWavg in 4Q15 (3-year contracts) at an average price of R\$152/MWh. The positive news was the selling price: 50MWavg sold to free customers at c.R\$170/MWh (new news), on top of the 90MWavg that was sold to the regulated market in the Dec. 2015 pool auction at R\$142/MWh (old news). By comparison, we expect prices to be lower in 2016-18e, at respectively R\$50-100-150/MWh.

Has the company's outlook/guidance changed? Not much, but remains positive

We see as a small positive Tiete's commercialization strategy and the higher than anticipated prices of new contracts. As a small offset, Tiete informed that the energy allocation strategy for 2016 was to concentrate more energy volumes in 1Q16 (note low spot prices of R\$30/MWh YTD) as opposed to the remaining of the year (we expect prices to increase in 2H16 and onwards). Tiete's valuation remains sensitive to long-term (as opposed to spot) power prices, though: every R\$10 change in long term energy price assumptions (our base case is R\$150/MWh for 2018 and onwards, for the not-yet-contracted energy) means R\$1/sh change in our fair value estimate.

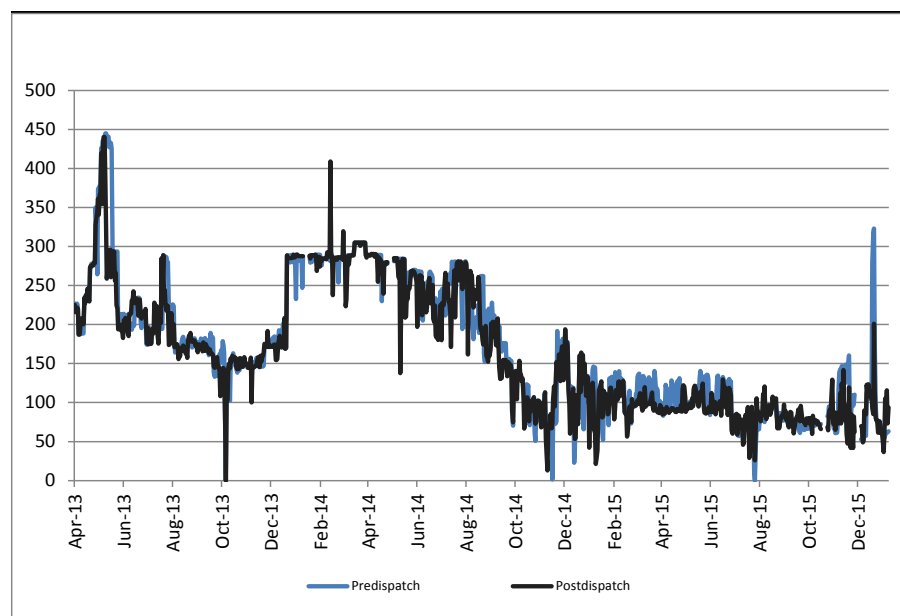
Valuation: Buy TIET11 with DCF-based R\$20 PT

At 12-8x P/E, 6-5x EBITDA and 9-13% yields for 2016-18e, Tiete remains attractive with estimated 12% IRR in real BRL terms, benefitting from predictable cash flows, opex/capex discipline, and unlevered/clean balance sheet with improved growth outlook post-corporate/organizational restructuring and now that many distressed players are divesting.

Panamanian Hydro Disclosures

Following significant scrutiny in 2013 of hydro levels across Central America, we include recent spot prices following the significant drought conditions experienced recently. Hydrology in Panama has also improved significantly following a severe drought in 2013 similar to others in South America. On its 2Q15 call AES Management mentioned that they were observing a return to normal hydrology; with spot prices at \$100/MWh which was one-third of prices seen last year.

Figure 27: Panama Spot Prices- Pre/Post-Dispatch (Generation MWh per Unit System) – Slightly off the recent highs



Source: Company Reports

Forecast returns

Forecast price appreciation	-8.8%
Forecast dividend yield	4.5%
Forecast stock return	-4.3%
Market return assumption	5.8%
Forecast excess return	-10.1%

Valuation Method and Risk Statement

AES's stock could be negatively affected by weather; weak wholesale power prices; economic downturn in its regulated service territories; interest rate risks; negative regulatory decisions for both its regulated and merchant subsidiaries; and disruption of trading activity in power markets. The company is also exposed to risks from its international operations including adverse changes in foreign exchange rates; international regulations; and economic, social and political instability. Its United States Generation business is exposed to unfavorable regulatory developments from the FERC and state utility commissions. Further, AES is subject to stringent environmental laws and regulations by federal, regional, state and local authorities, international treaties and foreign government authorities. Its business remains exposed to commodity, power and capacity price volatility. Our AES Corp valuation is based on SOTP methodology. Our Eletropaulo valuation is derived using a DCF/SOTP blend. Our AES Tiete valuation is based on DCF methodology.

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12-Month Rating	Definition	Coverage ¹	IB Services ²
Buy	FSR is > 6% above the MRA.	48%	36%
Neutral	FSR is between -6% and 6% of the MRA.	39%	28%
Sell	FSR is > 6% below the MRA.	12%	22%
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.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 December 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
AES Corporation ¹⁶	AES.N	Neutral	N/A	US\$9.87	26 Feb 2016
AES TIETE	TIET11.SA	Buy	N/A	R\$14.70	26 Feb 2016
ELETROPAULO ²⁰	ELPL4.SA	Sell (CBE)	N/A	R\$7.31	26 Feb 2016

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

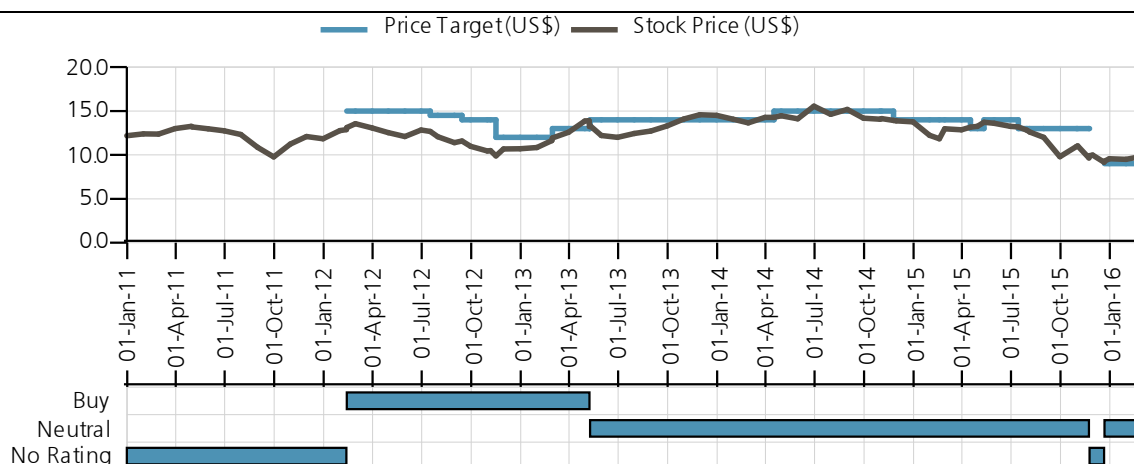
Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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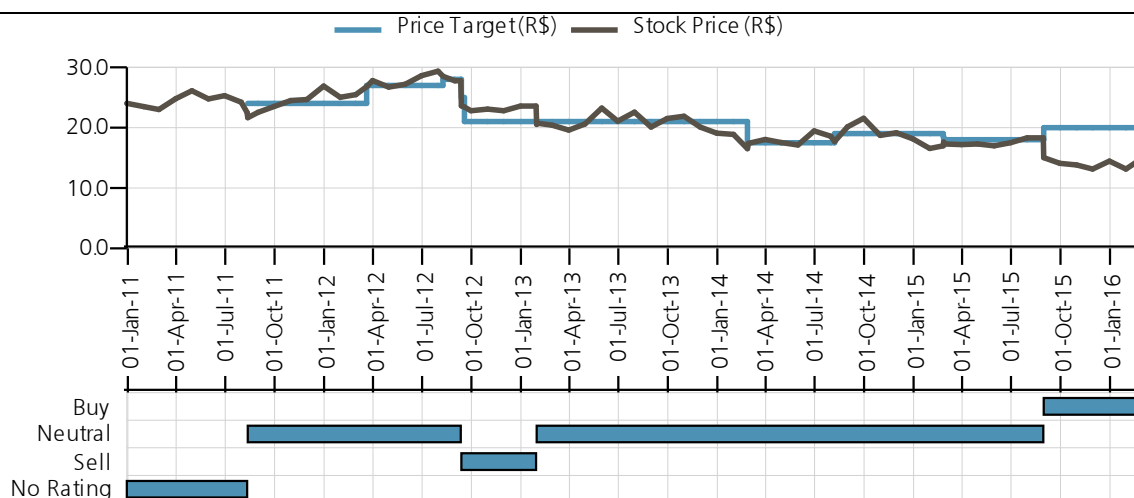
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AES Corporation (US\$)



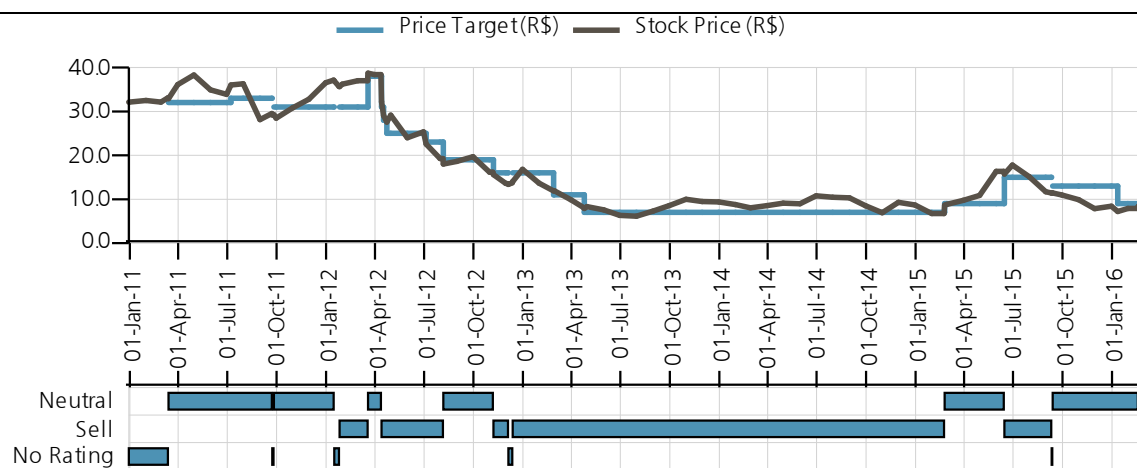
Source: UBS; as of 26 Feb 2016

AES TIETE (R\$)



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ELETPAULO (R\$)



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