

# US Electric Utilities & IPPs

## Can Cash Provide a Power Floor?

### Equities

Americas  
Electric Utilities

#### As EV / EBITDA breaks-down IPP investors are turning to cash for answers

Following the recent downturn in IPPs and compression in EV / EBITDA multiples, we look towards free cash flows (FCF) to help frame the investment cases for the names. In early 2Q trading IPPs have underperformed by ~17% on eroding power and capacity expectations. These declines have pushed average FCF yields meaningfully higher in just the past two months; specifically from ~12% in June to ~15% today on average. We believe that with FCF yields well into teens shares should offer support to shares, at least as we enter PJM auction season. Similarly 2017E weighted average EV / EBITDA for the IPPs was ~9x in June and has compressed to ~7x.

#### Where do they shake out? NRG top dog; TLN lags near-term but picks up in '19

NRG's has a 17% average 2016-2019 FCF yield today which expands to 20%+ by the end of the decade, far and away the highest in the IPP space (and higher yet ex-GenOn deficit at ~19% on average from '16-'19). AES, Calpine, and Dynegy are clustered around ~14% and Talen is at 13%, although Talen's yield improves materially in 2019. Admittedly, the cash-rich Reliant retail segment helps bolster NRG over peers.

#### Repurchases and dividend yield: Where the rubber meets the road

Dynegy became the most recent IPP to announce a repurchase plan (\$250Mn by YE16; on top of \$100Mn effective repurchase with DUK/ECP deal close) and now all power producers except Talen have made steps to repurchase their equity (Talen has stated that M&A is its top priority). Calpine leads the pack with \$425Mn already completed in 2015 (no explicit nominal guidance) while NRG has \$400Mn slated for 2015 followed by AES at \$325Mn repurchases (offsetting \$200-300 Mn in asset sales) along with \$345Mn debt paydowns. AES and NRG also offer meaningful dividend yields at ~3% versus regulated utilities at ~3.8%.

#### Power investors do not view cash as king, at least for now: How to play it

We see value in our two Buy Rated names: NRG and DYN for different reasons. NRG offers the strongest FCF yield that we believe compensate for risks around its GenOn assets (only ~\$1/sh in our valuation) and investor concerns continue to mount about the long-term viability of its YieldCo NRG Yield. Dynegy is highly levered to improving capacity and could benefit from potential nuclear retirements and . Talen also represents a way to play the upcoming PJM auction datapoints as it is the most concentrated in the region.

Figure 1: IPP Free Cash Flow Yield Analysis and 2015 Repurchases

IPP Free Cash Flow Yield Analysis								2015
Company	'16-'19 Avg	2015	2016	2017	2018	2019	2020	Repos
NRG Energy	18.1%	17.4%	15.6%	19.6%	14.0%	23.3%	24.1%	\$400
AES	14.4%	13.1%	13.1%	14.9%	16.0%	13.4%	13.4%	\$325
Calpine	14.4%	14.0%	11.8%	13.9%	14.9%	16.9%	16.9%	\$425
Dynegy	14.3%	6.1%	11.0%	13.9%	19.1%	13.3%	13.4%	\$350
Talen	13.4%	12.8%	13.7%	9.1%	11.2%	19.5%	20.6%	-
Average	14.9%	12.7%	13.0%	14.3%	15.0%	17.3%	17.7%	\$300

Source: Company Filings and UBS Estimates \*2015 DYN skewed by the partial-year contribution from M&A. Talen FCF is on a stand-alone basis but pre-mandated divestiture. Calpine repurchases represent completed as of 2Q15 results; other companies represents 2015 targets.

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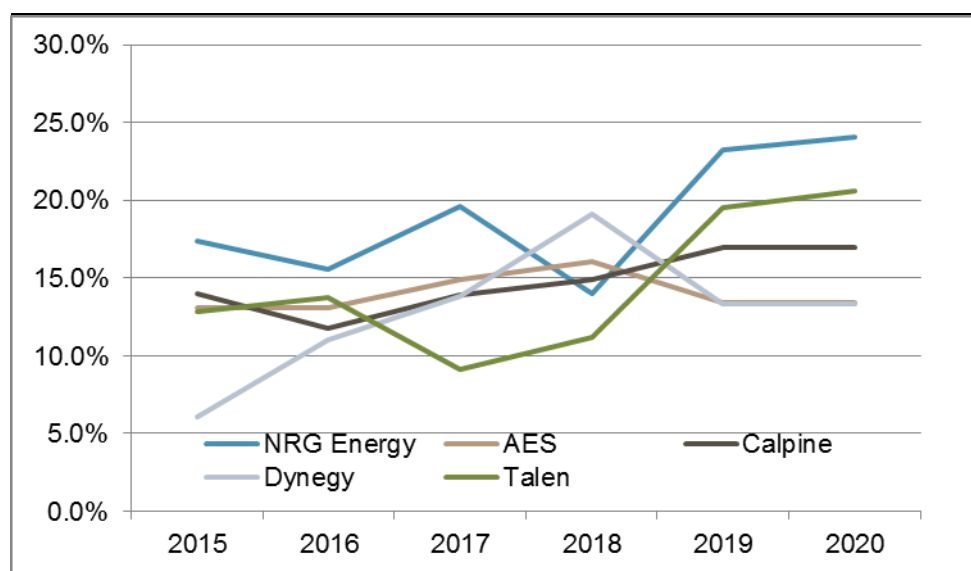
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## Following the Money:

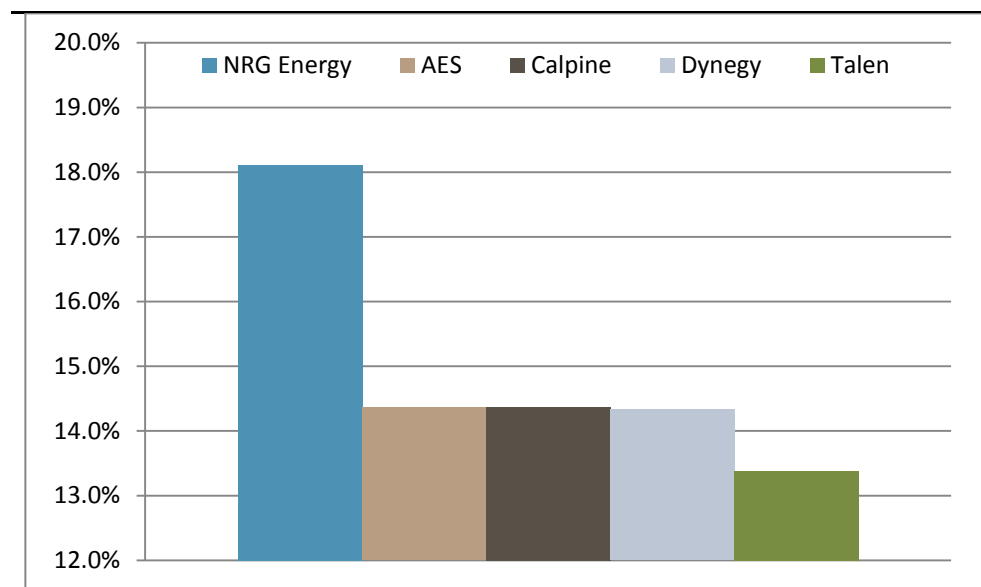
Below we show the annual free cash flow yields for each IPP which shows some volatility with NRG generally offering the highest yield. The forecasted step-down in Dynegy's free cash flow profile in 2019 is based on guidance that the company will be a cash taxpayer in 2019. Absent the ~\$250Mn cash tax payment in those years, the FCF yield would be in excess of 20%.

**Figure 2: IPP Free Cash Flow Yield 2016-2019**



Source: Company Filings, FactSet, and UBS Estimates

**Figure 3: IPP 2016-2019 Average Free Cash Flow Yield**



Source: Company Filings, FactSet, and UBS Estimates

## Calpine Corporation:

Figure 4: Calpine Free Cash Flow Analysis

Calpine FCF Analysis (UBSe)	2014	2015	2016	2017	2018	2019
UBS FCF Est. (\$Mn)	830	859	723	855	915	1,042
Management FCF Guidance (\$Mn)	800-850	840-940				
FCF per Share	2.03	2.42	2.21	2.86	3.38	4.29
Management FCF/Share Guidance	35 - \$2.10	\$2.20-2.50				
FCF Growth (YoY)	32%	20%	-9%	29%	18%	27%
CAGR off 2011 of \$1.01 FCF/shr	26.1%	24.5%	17.0%	19.0%	18.8%	19.8%
<b>FCF Yield</b>	<b>13.5%</b>	<b>14.0%</b>	<b>11.8%</b>	<b>13.9%</b>	<b>14.9%</b>	<b>16.9%</b>
Turbine Upgrade	(20)	0	0	0	0	0
Deer Park, TX (CT Addition)	(34)	0	0	0	0	0
Channel, TX (CT Addition)	(34)	0	0	0	0	0
Garrison, DE (New PJM CCGT)	(48)	0	0	0	0	0
York CCGT (New PJM CCGT)	(100)	(100)	0	0	0	0
Other Growth		(255)				
<b>Growth Capex</b>	<b>(236)</b>	<b>(355)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Growth & Acquisition Financing		650				
Projected Debt Amort/Swaps	(320)	(460)	(200)	(200)	(200)	(210)
<b>Remaining FCF</b>	<b>274</b>	<b>949</b>	<b>523</b>	<b>655</b>	<b>715</b>	<b>832</b>
Asset Sales	1,573	240	0	0	0	0
Starting Cash	941	717	717	717	717	717
Ending Cash	717	717	717	717	717	717
<b>Δ in Cash Balance</b>	<b>(224)</b>	<b>0</b>	<b>(0)</b>	<b>0</b>	<b>-</b>	<b>-</b>
<b>Deployable for Growth/Share Rep</b>	<b>2,071</b>	<b>1,189</b>	<b>523</b>	<b>655</b>	<b>715</b>	<b>832</b>
Share Repurchase Placeholder	(1,100)	(750)	(600)	(600)	(600)	(600)
Projected Avg. Shares O/S	409	355	327	299	271	243

Source: Company Filings, FactSet, and UBS Estimates

## Dynegy:

Figure 5: Dynegy Free Cash Flow Analysis

Dynegy Free Cash Flow Analysis	2014A	2015E	2016E	2017E	2018E	2019E	2020E
Adjusted EBITDA	932	987	1,191	1,233	1,487	1,495	1,500
Less: Interest Expense	(147)	(533)	(505)	(505)	(505)	(505)	(505)
Less: Taxes	No Cash Taxes Through At Least 2018E					(256)	(260)
FCF Pre-Capex (Proxy for FFO)	785	454	686	728	982	734	735
Less: Capital Expenditures	(123)	(275)	(360)	(315)	(410)	(338)	(338)
Plus/Minus: Other	27	5	5	5	5	5	5
<b>Free Cash Flow</b>	<b>689</b>	<b>184</b>	<b>332</b>	<b>418</b>	<b>577</b>	<b>402</b>	<b>403</b>
<b>Guidance</b>	<b>\$10-\$60</b>	<b>\$100-\$300</b>	<b>~\$430</b>	<b>~\$430</b>	<b>~\$430</b>		
Debt Profile (incl. ST Debt Balance)	\$7,106	\$7,106	\$7,106	\$7,106	\$7,106	\$7,106	\$7,106
Cash	\$880	\$1,160	\$1,644	\$2,106	\$2,545	\$2,991	\$3,443
<b>Net Debt</b>	<b>\$6,226</b>	<b>\$5,946</b>	<b>\$5,462</b>	<b>\$5,000</b>	<b>\$4,561</b>	<b>\$4,115</b>	<b>\$3,663</b>
<b>Net Debt / EBITDA</b>	<b>6.7x</b>	<b>6.0x</b>	<b>4.6x</b>	<b>4.1x</b>	<b>3.1x</b>	<b>2.8x</b>	<b>2.4x</b>
<b>FFO / Gross Debt</b>	<b>11%</b>	<b>6%</b>	<b>10%</b>	<b>10%</b>	<b>14%</b>	<b>10%</b>	<b>10%</b>
<b>FCF Yield</b>	<b>22.8%</b>	<b>6.1%</b>	<b>11.0%</b>	<b>13.9%</b>	<b>19.1%</b>	<b>13.3%</b>	<b>13.4%</b>

Source: Company Filings, FactSet, and UBS Estimates

## Talen:

Figure 6: Talen Free Cash Flow Analysis

Talen Free Cash Flow Analysis	2015	2016	2017	2018	2019
Adjusted EBITDA	\$1,009	\$925	\$715	\$791	\$867
Nuclear D&A	\$151	\$155	\$157	\$158	\$160
Less: Interest Expense	(\$328)	(\$217)	(\$208)	(\$201)	(\$198)
Less: Taxes	(\$63)	(\$49)	(\$17)	(\$34)	(\$50)
FCF Pre-Capex (Proxy for FFO)	\$769	\$814	\$645	\$715	\$780
Capital Expenditures	(\$516)	(\$543)	(\$466)	(\$495)	(\$395)
<b>Free Cash Flow</b>	<b>\$253</b>	<b>\$271</b>	<b>\$179</b>	<b>\$220</b>	<b>\$385</b>
<b>Guidance</b>	<b>\$205-\$355</b>				
Debt Profile (incl. ST Debt Balance)	\$4,139	\$4,019	\$3,948	\$3,928	\$3,746
Cash	\$451	\$474	\$457	\$453	\$453
<b>Net Debt</b>	<b>\$3,688</b>	<b>\$3,544</b>	<b>\$3,491</b>	<b>\$3,475</b>	<b>\$3,293</b>
<b>Net Debt / EBITDA (3.5x-5.5x Target)</b>	<b>3.7x</b>	<b>3.8x</b>	<b>4.9x</b>	<b>4.4x</b>	<b>3.8x</b>
<b>FFO / Gross Debt</b>	<b>19%</b>	<b>20%</b>	<b>16%</b>	<b>18%</b>	<b>21%</b>
<b>FCF Yield</b>	<b>12.8%</b>	<b>13.7%</b>	<b>9.1%</b>	<b>11.2%</b>	<b>19.5%</b>
MACH Gen Free Cash Flow Analysis	2015	2016	2017	2018	2019
Adjusted EBITDA	\$131	\$112	\$112	\$117	\$114
Less: Interest Expense	(\$79)	(\$78)	(\$77)	(\$71)	(\$69)
Less: Capex	(\$25)	(\$25)	(\$25)	(\$25)	(\$25)
FCF (Pre-Tax)	\$27	\$9	\$10	\$22	\$20
Less: Taxes	(3)	1	0	(2)	(2)
<b>Plus: Tax Savings at Talen Corp</b>	<b>-</b>	<b>15</b>	<b>15</b>	<b>15</b>	<b>15</b>
<b>FCF (Post-Tax)</b>	<b>\$24</b>	<b>\$25</b>	<b>\$26</b>	<b>\$35</b>	<b>\$33</b>
<b>Guidance</b>	<b>\$30</b>				

Source: Company Filings, FactSet, and UBS Estimates

## NRG Energy:

Figure 7: NRG Energy Free Cash Flow Analysis (EX-NYLD)

EBITDA to Cash Flow Analysis	2014	2015	2016	2017	2018	2019
<b>NRG:</b>						
EBITDA	3,128	3,289	2,956	2,713	2,749	2,874
Interest	(1119)	(1,084)	(1,060)	(1,021)	(980)	(838)
Income Tax	7	(50)	(50)	(50)	(50)	(50)
Collateral / Working Capital	(320)	(70)	41	30	(307)	(16)
Other / Deferred Taxes	(186)	-	-	-	-	-
<b>CFO</b>	<b>1,510</b>	<b>1,947</b>	<b>1,817</b>	<b>1,699</b>	<b>1,409</b>	<b>1,897</b>
Maintenance Capex	(254)	(540)	(475)	(375)	(375)	(375)
Enviro Capex	(254)	(300)	(250)	(5)	(15)	(20)
Pfd Div	(9)	(9)	(9)	(9)	(9)	(9)
<b>FCF Pre-Growth Capex</b>	<b>993</b>	<b>1,098</b>	<b>1,083</b>	<b>1,310</b>	<b>1,010</b>	<b>1,493</b>
<i>Guidance</i>		1,100-1,300				
CAFD from NYLD		(234)	(305)	(355)	(358)	(363)
<b>Amortization Schedule - Non-NYLD</b>						
Agua Caliente		28	29	30	31	31
CVSR		25	25	26	27	28
Viento		22	23	23	24	25
NRG Peaker		20	20	20	20	21
Cedro Hill		8	9	9	9	9
NRG - Other		19	19	20	21	21
<b>Debt Amortization</b>		<b>121</b>	<b>124</b>	<b>128</b>	<b>132</b>	<b>135</b>
Less: Non-Owned Distributable Cash flow from NYLD	(57)	(105)	(137)	(160)	(161)	(163)
Less: Other	15					
<b>FCF net of NYLD and Debt Amortization</b>	<b>951</b>	<b>993</b>	<b>945</b>	<b>1,150</b>	<b>849</b>	<b>1,329</b>
Plus: Non-Cash Lease Amortization		80	80	80	80	80
Less: Minimum Lease Payment		(166)	(211)	(207)	(196)	(195)
<b>Adjusting for GenOn Leveraged Leases</b>		<b>(86)</b>	<b>(131)</b>	<b>(127)</b>	<b>(116)</b>	<b>(115)</b>
Market Cap		6,590				
Less NYLD Stake		1,366				
Market Cap (ex-NYLD)		5,224				
<b>FCF net of NYLD, Debt Amort, and Leveraged Leases</b>		<b>907</b>	<b>814</b>	<b>1,023</b>	<b>733</b>	<b>1,215</b>
<b>Implied FCF Yield (with NYLD)</b>		<b>14%</b>	<b>12%</b>	<b>16%</b>	<b>11%</b>	<b>18%</b>
<b>Implied FCF Yield (without NYLD)</b>		<b>17%</b>	<b>16%</b>	<b>20%</b>	<b>14%</b>	<b>23%</b>
<b>GenOn EBITDA</b>		<b>543</b>	<b>370</b>	<b>299</b>	<b>334</b>	<b>354</b>
Interest Expense		(262)	(262)	(262)	(282)	(302)
Maintenance Capex		115	110	115	115	115
Environmental Capex		7	-	-	-	-
<b>Total Capex</b>		<b>122</b>	<b>110</b>	<b>115</b>	<b>115</b>	<b>115</b>
<b>Free Cash Flow (Pre-Leveraged Lease)</b>		<b>158</b>	<b>(2)</b>	<b>(79)</b>	<b>(64)</b>	<b>(63)</b>
Net Leveraged Lease Impact (Debt Amort)		(86)	(131)	(127)	(116)	(115)
<b>Free Cash Flow (Pre-Leveraged Lease)</b>		<b>72</b>	<b>(133)</b>	<b>(206)</b>	<b>(180)</b>	<b>(178)</b>
<b>FCF net of NYLD, Debt Amortization and GenOn</b>		<b>1,151</b>	<b>943</b>	<b>1,072</b>	<b>785</b>	<b>1,266</b>
<b>FCF net of NYLD and Debt Amortization (without GenOn)</b>		<b>993</b>	<b>945</b>	<b>1,150</b>	<b>849</b>	<b>1,329</b>
<b>Uses</b>						
Organic Growth Capital		900	500	500	-	-
Total Capex		1740	1,225	880	390	395
Assumed Share Repurchases		437	-	-	-	-
Projected Common Dividend		182	182	182	182	182
<b>Remaining for Debt Paydown, etc.</b>		<b>(1,261)</b>	<b>(324)</b>	<b>248</b>	<b>438</b>	<b>916</b>

Source: Company Filings, FactSet, and UBS Estimates

## AES Corporation:

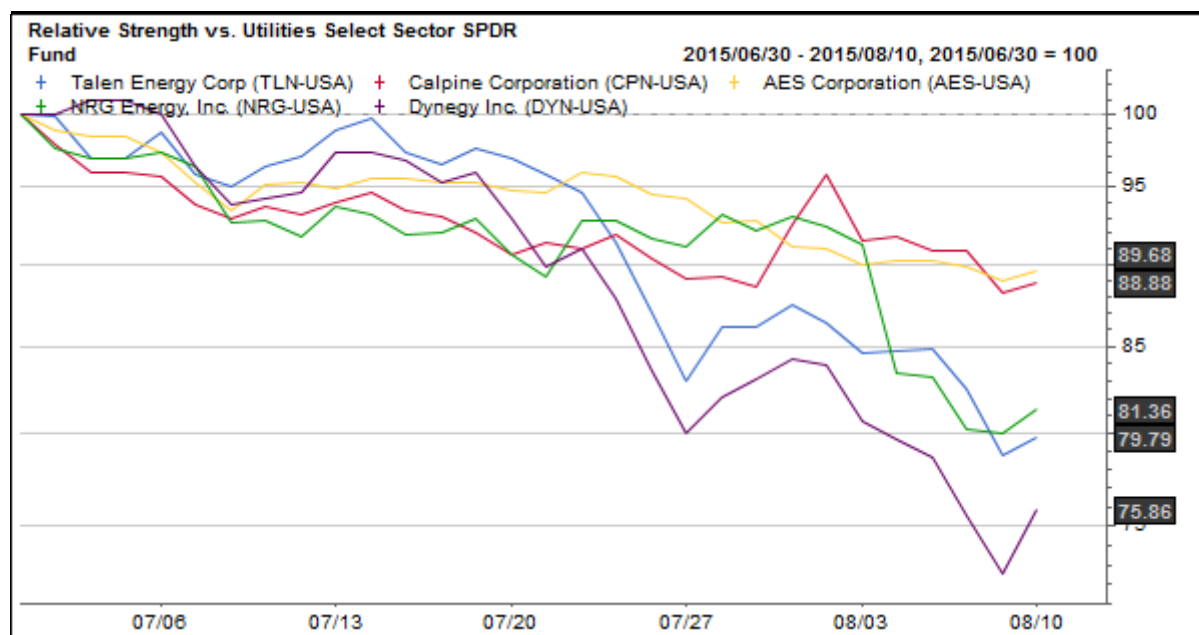
Figure 8: AES Corporation Free Cash Flow Analysis

Abbreviated Cash Flow Projections	2012A	2013A	2014A	2015E	2016E	2017E	2018E	2019E
Adjusted Gross Margin								
Latin America Generation	1,927	1,901	1,741	1,806	1,728	1,985	2,057	2,211
Latin American Utilities	589	745	577	813	664	690	730	773
North American Generation	537	608	588	528	544	571	512	521
North American Utilities	790	792	781	852	834	798	825	850
Europe Generation	469	480	478	441	418	418	418	417
Asia Generation	219	171	142	131	263	266	269	272
Corporate/Elim. and Other	40	77	77	77	65	77	77	77
<b>Total Adj. Gross Margin (EBITDA)</b>	<b>4,570</b>	<b>4,774</b>	<b>4,385</b>	<b>4,649</b>	<b>4,516</b>	<b>4,805</b>	<b>4,888</b>	<b>5,123</b>
Consensus EBITDA Projection	5,114	5,133						
Guidance (Gross)	4725-4925							
Proportional Interest	(1,181)	(1,261)	(1,022)	(1,238)	(980)	(1,076)	(1,110)	(1,171)
Proportional Adj. Gross Margin	3,389	3,513	3,363	3,411	3,536	3,729	3,778	3,951
(Net) Interest Expense	(1,223)	(1,207)	(1,106)	(1,235)	(1,235)	(1,203)	(1,150)	(1,152)
Other, incl. W/C Adjustments	735	409	(466)	(19)	(226)	(276)	(272)	(652)
<b>Cash flow from Operating Activities</b>	<b>2,901</b>	<b>2,715</b>	<b>1,791</b>	<b>2,156</b>	<b>2,076</b>	<b>2,250</b>	<b>2,355</b>	<b>2,147</b>
Guidance - consolidated				1900-2700				
Guidance (Proportional)	1925-2125	1650-1950	1650-1950	1000-1300				
Capital Expenditures								
Maintenance Capex	(800)	(760)	(666)	(666)	(600)	(625)	(650)	(675)
Environmental Capex (All)	(88)	(211)	(241)	(134)	(134)	(134)	(134)	(134)
Proportional Reductions: Maintenance Capex	-	-	7	(200)	(200)	(200)	(200)	(200)
<b>Total Operational Capex</b>	<b>(888)</b>	<b>(971)</b>	<b>(900)</b>	<b>(1,000)</b>	<b>(934)</b>	<b>(959)</b>	<b>(984)</b>	<b>(1,009)</b>
Guidance (Proportional)	800-950	750-1050	500-800	450-750				
<b>FCF</b>	<b>2,013</b>	<b>1,744</b>	<b>891</b>	<b>1,156</b>	<b>1,142</b>	<b>1,291</b>	<b>1,371</b>	<b>1,138</b>
<b>FCF Per Share</b>	<b>2.65</b>	<b>2.34</b>	<b>1.23</b>	<b>1.66</b>	<b>1.66</b>	<b>1.89</b>	<b>2.03</b>	<b>1.70</b>
<b>FCF Yield</b>		<b>18%</b>	<b>10%</b>	<b>13%</b>	<b>13%</b>	<b>15%</b>	<b>16%</b>	<b>13%</b>

Source: Company Filings, FactSet, and UBS Estimates

## IPP Relative Performance

Figure 9: IPP Relative Performance



Source: FactSet

### Statement of Risk

Risks for Utilities and Independent Power Producers (IPPs) primarily relate to volatile commodity prices for power, natural gas, and coal. Risks to IPPs also stem from load variability, and operational risk in running these facilities. Rising coal and, to a certain extent, uranium prices could pressure margins as the fuel hedges roll off Competitive Integrators. Further, IPPs face declining revenues as in the money power and gas hedges roll off. Other non-regulated risks include weather and for some, foreign currency risk, which again must be diligently accounted in the company's risk management operations. Major external factors, which affect our valuation, are environmental risks. Environmental capex could escalate if stricter emission standards are implemented. We believe a nuclear accident or a change in the Nuclear Regulatory Commission/Environment Protection Agency regulations could have a negative impact on our estimates. Risks for regulated utilities include the uncertainty around the composition of state regulatory Commissions, adverse regulatory changes, unfavorable weather conditions, variance from normal population growth, and changes in customer mix. Changes in macroeconomic factors will affect customer additions/subtractions and usage patterns.

## Required Disclosures

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### UBS Investment Research: Global Equity Rating Definitions

12-Month Rating	Definition	Coverage <sup>1</sup>	IB Services <sup>2</sup>
Buy	FSR is > 6% above the MRA.	45%	36%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	13%	20%
Short-Term Rating	Definition	Coverage <sup>3</sup>	IB Services <sup>4</sup>
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 30 June 2015.

1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category. 4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

**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.



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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
<b>AES Corporation</b> <sup>16</sup>	AES.N	Neutral	N/A	US\$12.68	10 Aug 2015
<b>Calpine Corporation</b> <sup>2, 4, 6, 13, 16</sup>	CPN.N	Neutral	N/A	US\$17.05	10 Aug 2015
<b>Dynegy, Inc.</b> <sup>2, 4, 5, 6, 16</sup>	DYN.N	Buy	N/A	US\$23.66	10 Aug 2015
<b>NRG Energy Inc.</b> <sup>16</sup>	NRG.N	Buy	N/A	US\$19.85	10 Aug 2015
<b>Talen Energy Corp</b> <sup>16</sup>	TLN.N	Neutral	N/A	US\$14.60	10 Aug 2015

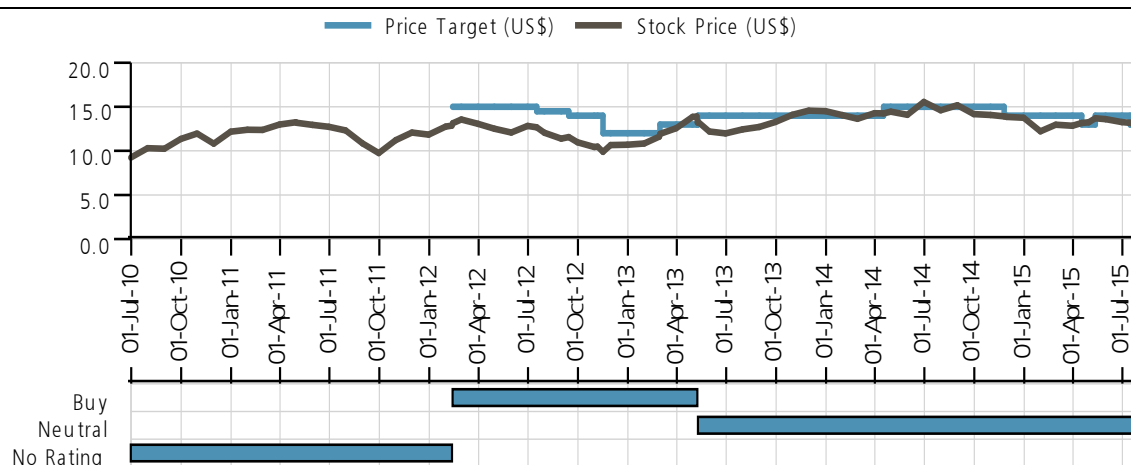
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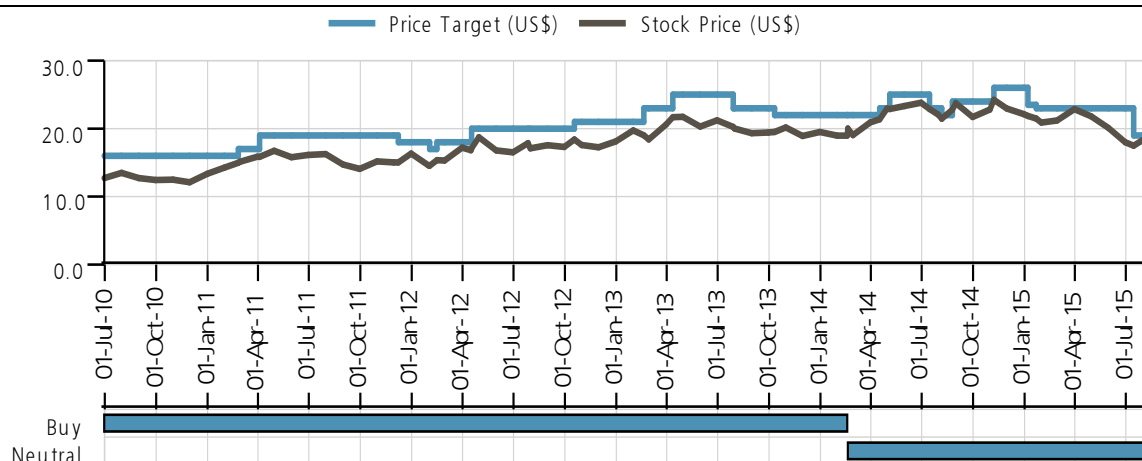
Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

### AES Corporation (US\$)



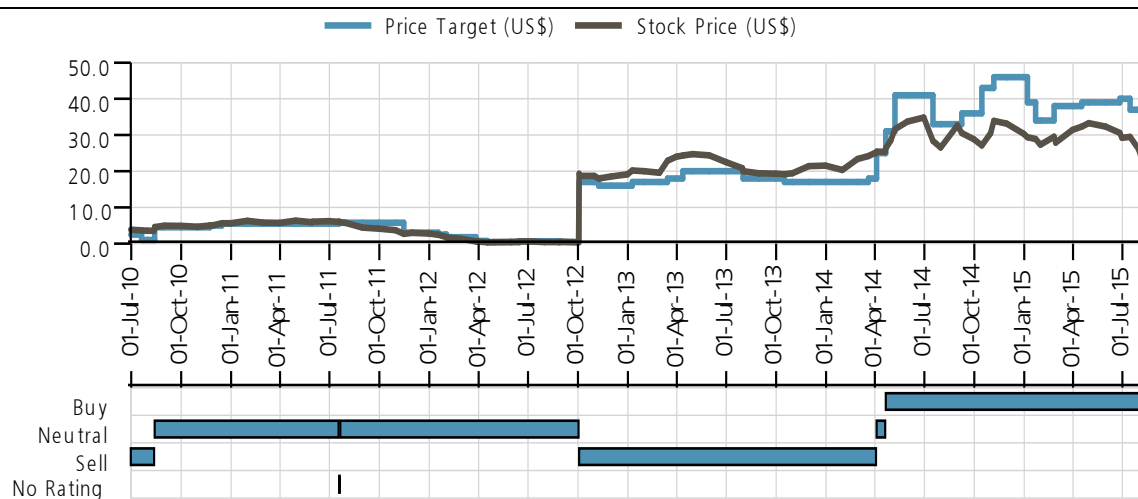
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## Calpine Corporation (US\$)



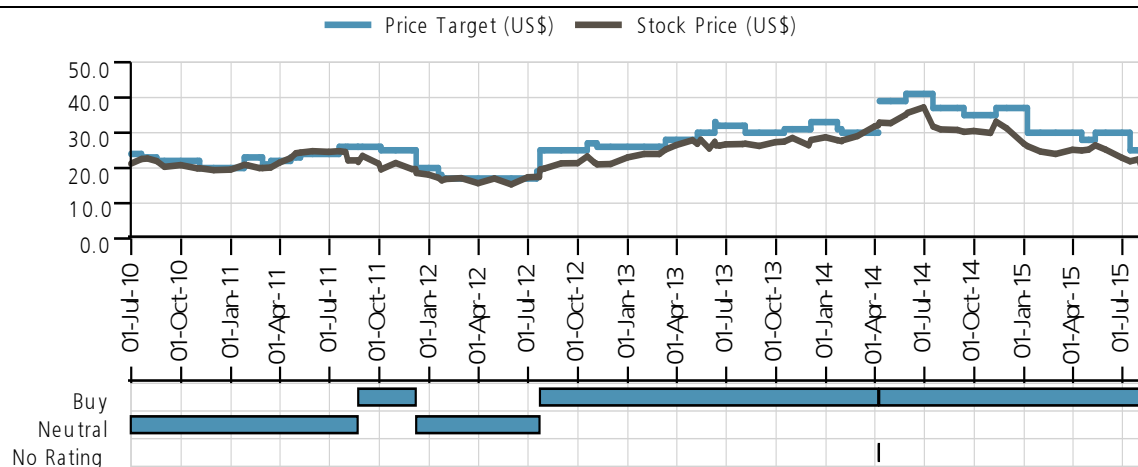
Source: UBS; as of 10 Aug 2015

## Dynegy, Inc. (US\$)



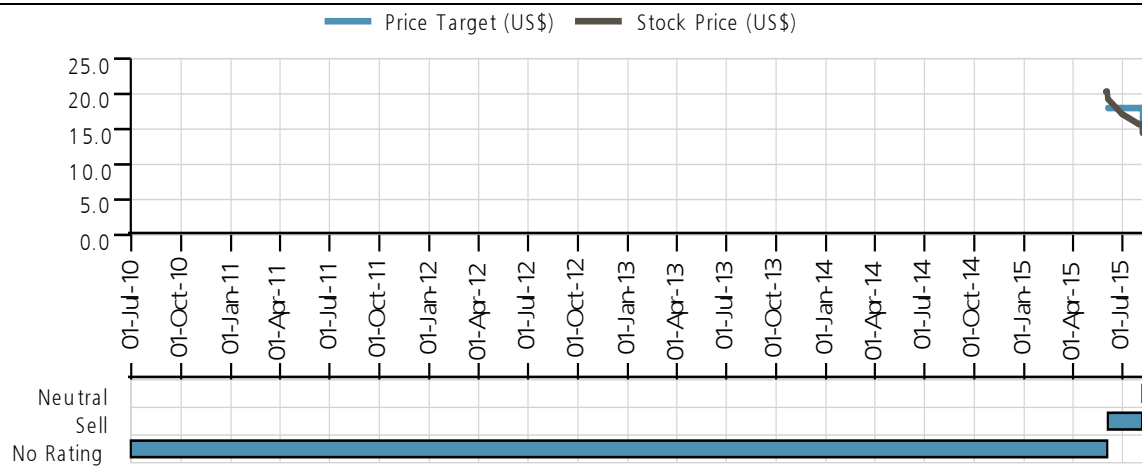
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## NRG Energy Inc. (US\$)



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