US Electric Utilities & IPPs

The 'SMID Bid': The Context for Regulated M&A

Equities

Americas

Electric Utilities

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Small and medium cap names poised to outperform in 2015

We see a growing divide between the haves and have-not's emerging in the small and medium cap utility sector (SMID), with higher quality utilities poised to continue to benefit from sector consolidation whilst the slower growth and less nimble utilities attempt to leverage their currencies for the purpose of acquisitions. *Overall, we suspect the SMID cap sector will continue to do quite well into 2015*, benefitting from continued expectations for further sector consolidation amidst a wider slowing of growth prospects in the sector, particularly eastern-oriented large-cap utilities.

Who are the key candidates?

We see most of these as being oriented towards the Western footprint of the US, including PNW, POR, and PNM. Back East, we see ITC and UIL as particularly noteworthy candidates.

Who are the key acquirers?

We see quite a wide variety of utilities as possible acquirers, including not just another deal for NEE and EXC (both of which have pending deals), but also utilities aiming to bolster their underlying growth profiles and diversify away from merchant activities including ETR and FE. Among traditional large-cap utilities, we could very well see DUK, SO, ED, and PPL be involved. We see AEP as focused on spinning/selling its GenCo in 2015, but see it too as a future acquirer candidate. As for SO, we think management is likely to remain focused around new construction risk rather than exploring deals. Similarly, D is likely to be focused around opportunities amidst its utility-gas footprint, aside any tangential opportunities.

How to frame the consolidation opportunity: East meets West

Western utilities are generally poised to see capital expenditures accelerate in the coming years on the back of EPA needs to meet regional haze regulations, along with continued demographic trends towards wider migration to this area, and further investment in wind given the low cost of this energy (net of PTC, even without the existence of meaningful remaining RPS capacity). We emphasize that Western EPA spend will be substantially different from spending that has largely already occurred in the East under earlier MATS mandates. The generally lower-sulfur PRB coal which permeates the Western US coal-fired fleet was largely left untouched under these regulations. The combination of Regional Haze standards as well as more stringent one-hour standards for both SO_2 and NO_x could well trigger many of these plants to evaluate adding scrubbers, SCRs for NO_x control, or both. We see this as driving capex requirements for most Western utilities over the next three years as standards and rules become finalized, with spending likely ramping from 2017-2019, emphasizing opportunities for PNW and PNM, among others. Even XEL and ETR benefit on the margin from this trend, with the fate of ETR's White Bluffs plant in AR yet to be decided, while XEL's Tolk plant in TX (among others) remains litigated as well. In contrast, nearly every coal plant remaining in the Eastern US is largely scrubbed up at this point, with just a handful of additionally contemplated SCRs. With squeezed economics for Eastern coal, the question at this point is likely focused on whether to retire units – and replace with gas plants – rather than significant new control installations (SCRs are still palatable for some units at an install cost of ~$200/kW). Net-net, we see Eastern utilities now past the peak capex cycle after 2014.

Illustrating the discrepancy between West and East

In the table below, we highlight the ~1.7% EPS CAGR (UBSe 2014-2018) premium and half-turn 2017E P/E ratio that Western SMIDs enjoy above their large-cap Eastern cousins.

Figure 1: Growth Guidance Table (RB or EPS) and P/E, 2016E-2018E, West vs East Utilities

Ticker	Rating	Market Cap. ($ in millions)	LT CAGR Guidance	EPS CAGR 2014-18 (UBSe)	P/E multiple 2016E	P/E multiple 2017E	P/E multiple 2018E
Western							
SRE	Buy	27,271	9-11% ('14-'19 EPS)	9.5%	20.7	19.5	16.2
PCG	Neutral	24,866	9% ('14-16 RB)	0.5%	14.6	15.0	14.6
EIX	Neutral	20,595	7-9% ('14-'17 RB)	1.1%	16.1	14.9	14.1
XEL	Neutral	17,320	4-6% EPS LT	5.1%	15.5	14.7	14.1
DTE	Buy	14,432	5-7% EPS LT	5.5%	16.3	15.2	14.5
WEC	Neutral	11,307	5-7% EPS Pro-Forma	2.9%	17.8	17.3	16.9
AEE	Neutral	10,302	7-10% ('13-'18 EPS)	7.1%	15.7	14.6	13.5
CMS	Buy	9,199	5-7% EPS LT	7.3%	16.6	15.5	14.1
PNW	Buy	7,128	6-7% ('14-18 RB)	4.8%	16.2	15.6	14.3
LNT	Not Rated	6,951	5-7% EPS LT	5.2%	16.4	15.6	14.7
WR	Neutral	5,118	5.5% ('14-'18 RB)	3.3%	15.6	15.0	14.4
GXP	Not Rated	4,066	4-6% ('14-'16 EPS)	7.2%	14.2	13.6	12.6
HE	Not Rated	3,373	9% ('14-16 RB)	6.1%	18.3	17.5	16.0
PNM	Not Rated	2,202	6-8% ('14-18 RB)	8.0%	15.2	14.5	13.8
AVA	Sell	2,084	4-5% EPS LT	4.2%	16.2	15.4	14.8
EDE	Neutral	1,218	~7% ('14-'19 RB)	4.7%	16.5	15.3	15.3
Average			6.1% - 7.5%	5.2%	16.4	15.6	14.6
Average for SMID <$15B Mkt Cap			5.7% - 7.1%	5.5%	16.3	15.4	14.6
Eastern							
DUK	Buy	57,390	4-6% ('13-'16 EPS)	4.7%	16.1	15.4	14.8
NEE	Buy	45,377	5-6% EPS LT	8.3%	15.7	14.4	14.0
SO	Sell	43,056	3-4% ('14-'16 EPS)	3.5%	16.3	15.6	14.9
D	Buy	42,456	5-6% EPS LT	8.1%	17.6	16.7	15.3
EXC	Neutral	30,734	NA	5.7%	13.0	12.8	12.0
AEP	Neutral	28,550	4% -6% EPS LT	4.1%	15.8	15.3	14.4
PPL	Neutral	23,402	>4% EPS LT	-0.1%	14.3	14.5	14.1
PEG	Neutral	20,720	N/A	1.7%	14.8	14.5	14.0
ED	Sell	18,675	N/A	2.3%	16.1	15.5	15.3
NU	Buy	16,448	6-8% EPS LT	5.0%	15.9	15.3	15.5
FE	Sell	15,754	N/A	2.9%	13.0	14.5	13.4
ETR	Neutral	15,092	5-7% EPS LT	-0.5%	14.9	15.0	14.7
SCG	Neutral	8,051	3-6% ('13-16 EPS)	3.4%	14.4	13.4	13.0
ITC	Buy	6,042	11-13% EPS ('14-'18)	10.4%	17.2	15.2	13.8
TE	Neutral	4,473	6-7% ('14-'17 RB)	8.6%	16.0	14.3	13.4
UIL	Not Rated	2,372	7.6% ('15-'19 RB)	3.2%	15.0	15.0	15.0
Average			5.3% - 6.7%	4.5%	15.4	14.8	14.2
Average for LCAP >$15B Mkt Cap			4.5% - 5.9%	3.8%	15.3	15.0	14.4
West SMID minus East LCAP			1.2% - 1.3%	1.7%	1.0	0.5	0.2

Source: Factset for NR companies, Company filings, UBS estimates

Where's the growth now? Stretching the definition of ratebase – but still looking towards M&A

While many utilities nationally continue to evaluate pursuing a wider definition of ratebase – including an expansion back into generation via renewables, pursuit of gas reserves in ratebase, and even competitive TransCo's – we see a trend in 2014 towards the wider consolidation of the sector's regulated utilities. In particular, we see a broader push for Eastern-oriented utilities to diversify westwards, which not only has greater growth prospects but also smaller cap utilities on average, making any such tuck in acquisitions more palatable. While recent deal premiums do not offset substantial accretion, aside for parent leverage employed to fund deals, they do provide platforms for future growth.

Platforms still exist in the East – these are likely candidates too

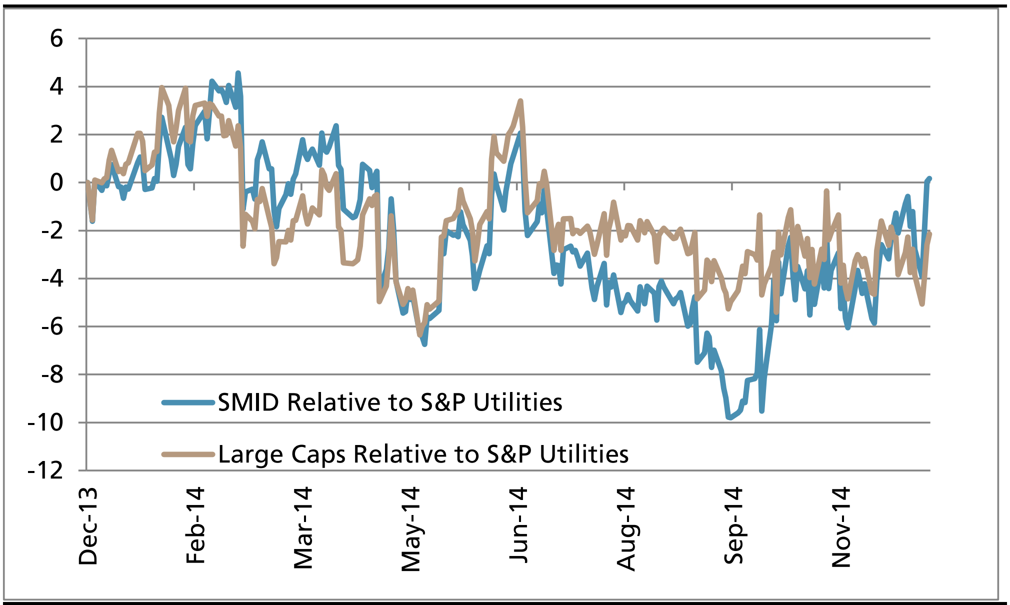
While the basis of our thesis focuses on the accelerating growth opportunity in the Western US, we see two acquisition opportunities in the East: ITC and UIL. Both provide above-average ratebase growth vs. peers as well as recently failed acquisitions of their own. Further, we see their relative proximity to Eastern peer utilities to be well received in any deal.

Not just a Western story – ITC and UIL could be candidates.

It's not as if the smids have outperformed all that much anyways…

We look at the relative performance of the two has been significant, with ~2% outperformance by smid, only in 4Q. We suspect this trend will continue into 2015 – with the potential for an acceleration as the 'de-integration' thesis takes the next step.

Figure 2: SMID and Large Cap Relative Performance in 2014



Source: FactSet and UBS Estimates

So who is not going to benefit from the "smid-bid"?

We view a number of Midwest and Central US smid-cap utilities as less likely to benefit from a takeout bid including EDE, GXP, and WR among others, emphasizing in particular the relatively new CEOs in place in each of these cases. Moreover, AVA is another standout with more limited growth – which is unlikely to benefit from a takeout. Rather, we think AVA appears more of an acquirer than a seller.

Part 2 of the De-integration thesis will see regulated M&A

Structural separation from IPP subsidiaries creates new vehicles for M&A

While the ability for IPP consolidation is closer to its limits (i.e. market power concerns), there is still room on the regulated side.

Over the last several years, we have noticed many 'integrated' utilities (owning both regulated T&D businesses as well as IPP units as trending towards breaking themselves up (mostly through the spinning of their IPP business a la PPL or through the outright sale a la Duke). Either way, the last two-year period has seen a wave of IPP deals that have helped to provide realize tangible cost synergies in the power side – benefitting these equities. As of yet, we have yet to note any deals arising out of this trend from the remaining regulated utilities, but generally see the possibility for such deals to materialize (with an emphasis on leveraging these pure play platforms for deals – seeing both PPL and DUK as more likely acquirers). Bottom line, the de-integration thesis creates a variety of new platforms which had previously focused their strategies around the IPP – and are likely now re-repositioning their stories and growth prospects towards their remaining regulated businesses can provide.

AEP, DUK, EXC, FE, PPL, PEG continue to position towards regulated M&A

Integrated utilities could continue to dilute their ownership stakes

<u>Even remaining integrated utilities could yet be involved in further regulated M&A</u>, seeking to dilute their merchant businesses. In particular, we see EXC (as exemplified by its POM deal), FE, and ETR as fitting this category. In this case, management would need to make a call not just on its utility currency, but also a call on the outlook and valuation of its power business; we're biased to think many utilities have structurally more sober views on the underlying outlooks of their IPP businesses, suggesting a broader bias to dilute.

More power deals are less likely in 2015

As we discussed in our recent note on the limited ability for further IPP consolidation given market power considerations, we would not be surprised to see future deals shift towards a regulated bias (despite the lower realizable synergies between companies as regulators seek to extract these benefits as part of deal approvals). We maintain our view of an eventual tie-up between EFH's TCEH competitive business and Dynegy in ~2016 timeframe upon EFH's exit from bankruptcy as it seeks to improve diversity

So what about SMID acquisitions: How much of a premium can be offered?

We see the SMID cap sector as benefitting disproportionately from the low interest rate environment, with their premiums vs. the large-cap stocks in part dictated by the ability for large-caps to employ parent HoldCo leverage to finance acquisitions accretively. Applying generic assumptions, we see deals levered with ~20-30% holdco leverage. For example, TE financed its $950M purchase of New Mexico Gas Company (NMGC) with $188M of parent cash and ST debt (20%) as well as $292M of equity, $200M of assumed NMGC debt, and the private placement of an additional $270M debt at the NMGC/I levels.

Figure 3: Scenario Analysis - Highest Possible Acquisition Premiums Under 20%-30% Parent Leverage

	Price	NI	Shares Out	EPS	P/E	Debt	Debt/EBT
Acquirer	$ 30.00	$ 200.0	100.0	$ 2.00	15.0x	$ 1,538	5.0x
Target	$ 28.00	$ 200.0	100.0	$ 2.00	14.0x	$ 1,538	5.0x
Scenario #1	Target EV	Goodwill & % Premium	Equity	Debt&Cash	Parent Leverage	Acquirer Shares Issued	Incremental Interest Expense
Financing	$ 4,338	$ 1,102	$ 1,632	$ 2,720	$ 1,088	54.4	$ 90.8
		25%	30%	50%	20%		4%
					This is the highest premium possible while avoiding dilution		
		NI	Out	EPS			
Proforma		$ 309.2	154.4	$ 2.00			
Accretion				$ 0.00			
Accretion %				0%			
Scenario #2	Target EV	Goodwill & % Premium	Equity	Debt&Cash	Parent Leverage	Acquirer Shares Issued	Incremental Interest Expense
Financing	$ 4,338	$ 1,423	$ 1,152	$ 2,881	$ 1,728	38.4	$ 122.8
		33%	20%	50%	30%		4%
					This is the highest premium possible while avoiding dilution		
		NI	Out	EPS			
Proforma		$ 277.2	138.4	$ 2.00			
Accretion				$ 0.00			
Accretion %				0%			

Source: UBS Estimates (Hypothetical Acquirer and Target)

How much of a premium can be paid? Still quite meaningful.

In the table above we calculate the maximum acquisition premium possible for a hypothetical deal where the Acquirer enjoys a 1.0x turn premium P/E ratio over the Target under two scenarios: (1) 20% parent leverage is used and (2) 30% parent leverage is applied. In both cases, this parent leverage displaces equity funding (from a 50% base assumption). Interest on incremental debt is assumed to be 4%. Hypothetically, the acquirer could pay a premium as high as 25%-33% considering these advantages. We further acknowledge that smid-caps tend to trade at a premium to targets, making payables in this scenario of 15-20% the more likely range.

Rising rates puts big premiums at risk

That said, we acknowledge that a turnaround in interest rates could well limit outperformance of the SMID sector. While higher interest rates could be a constraint, we believe that the higher-growth from the SMIDs would likely still cause them to have a premium valuation.

So how does the SMID sector stack up?

We see several key metrics around 'ideal' SMID takeout candidates in the sector:

- **Underlying Ratebase growth:** The core question initially remains whether the company can be added as a platform addition to the acquirer and the degree of a premium growth rate for the target. For example, despite HE's risk profile around solar, NEE appears to have made the bid, seeing it as among the few targets it could pursue that would actually exceed the growth opportunities for its own utility.

Avenue to grow earnings faster

- **EPS growth & secondary equity needs**: Presumably if the utility was able to grow its ratebase without issuing secondary equity – and without significant rate lag – SMID stocks could grow net income in-line with ratebase growth. With many large-cap stocks enjoying significant latitude in their credit metrics to deploy more capital, we see any funding needs as largely addressed from organic/parent FCF. That said, a further differentiator in the growth between ultimate EPS and ratebase is the interest expense created from parent holdco debt (either existing or added as part of any deal).

Method to deploy excess capital/balance sheet latitude

- **Parent leverage:** On the subject of leverage, we see *less* levered SMIDs as benefitting, with potential acquirers seeing the opportunity to 'layer-on' holdco debt as part of any prospective deal. Notably, we see regulators as less likely to 'impute' this holdco debt into the authorized equity ratio of subsidiary utility companies once part of a broader portfolio of utility companies.

  For further background, please consult our earlier note **'In Search of Parent Leverage'** which highlights the likes of TE and CMS as having significant parent debt in the SMID space.

- **Jurisdiction Breadth:** We see single jurisdiction and single-state utilities found across the West as most likely to benefit from M&A. Best examples continue to include PNW, PNM, and POR. Meanwhile, we emphasize utilities like EDE and AVA are comprised of multiple jurisdictions with smaller customer counts. In some respects, the hassle of acquiring sub-scale utility jurisdictions is not worth it.

Simple is better – single-state Western utilities are ideal

- **And last, but not least, a willing seller is critical:** M&A remains a fundamentally social issue. We see the prospects around utilities with aging CEOs as particularly noteworthy. We list below the age and tenure of many of the CEOs leading the SMID sector. ITC, HE, and UIL stand out well. Meanwhile AVA and WEC are also well tenured.

CEO tenure could be a good metric for a seller

Figure 4: Age and Tenure of SMID CEOs

Company	Name	Title	Age (yrs)	Tenure as CEO (~yrs)
Ameren Corp	Warner L. Baxter	Chairman, President and Chief Executive Officer	52	0.7
Avista Corp	Scott L. Morris	Chairman, President and Chief Executive Officer	53	9.5
CMS Energy	John G. Russel	President and Chief Executive Officer	56	4.6
DTE Energy	Gerard M. Anderson	Chairman and Chief Executive Officer	56	4.2
Empire District Electric	Bradley P. Beecher	President and Chief Executive Officer	49	3.5
Great Plains Energy	Terry Bassham	Chairman, President and Chief Executive Officer	53	2.5
Hawaiian Electric	Constance H. Lau	President and Chief Executive Officer	62	8.6
ITC Holdings	Joseph L. Welch	Chairman, President and Chief Executive Officer	65	11.0
Alliant Energy	Patricia Leonard Kampling	Chairman, President and Chief Executive Officer	54	2.7
PNM Resources	Patricia K. Collawn	Chairman, President and Chief Executive Officer	55	4.8
Pinnacle West	Donald E. Brandt	Chairman, President and Chief Executive Officer	59	5.7
Scana Corp	Kevin Marsh	Chairman and Chief Executive Officer	58	3.0
TECO Energy	John Ramil	President and Chief Executive Officer	58	4.3
UIL Holdings Corp	James P. Torgerson	President and Chief Executive Officer	61	8.4
Wisconsin Energy	Gale E. Klappa	Chairman and Chief Executive Officer	63	10.6
Westar Energy	Mark A. Ruelle	President and Chief Executive Officer	52	3.3

Source: Company sources, Bloomberg

And what about the long-term outlook for the West? Some final thoughts.

Medium and Long-term looks good for Western US

While the medium-term outlook through the balance of the decade provides premium growth opportunities, we see sustained longer-term opportunities given not just constructive demographic trends, with disproportionate migration *towards* these areas, but also structural investment opportunities in renewables and greater grid interconnection across the Western interconnection to accommodate their intermittency as well as export opportunities into California. We see the nascent trend towards a more integrated Energy Imbalance Market (EIM) in the West as further supporting transmission investments too under the guise of improving overall dispatch efficiency with operating at least energy dispatch across multiple jurisdictions.

For additional thought on M&A in the sector, please refer to our previous notes:

After Hawaii, Who's Next? -- *A brief look at Smid cap targets*

Reaching the Limits of IPP Consolidation *Examining limits of market power for IPP deals*

US IPP Power Shock Top 10 Utility Themes for the Balance of '14

YieldCo to DealCo: the building M&A surge - *Looking at Renewable consolidation*

Utility M&A Trends and More on De-integration

The Next Big Deal

Another Day, Another Deal

Summertime Excitement Continues

M&A Focus Returns to Utilities over Midstream

UBS Utilities: Annual Outlook - The Top 14 Themes into 2014

Utilities: Week Ahead: M&A Back on the Tape

Understanding Power M&A Market Power: Conference Call Transcript

Appendix I: Acquiring Utilities which trade at a premium P/E multiple

Looking at the ability to pay a premium in M&A, we see a 15-22% potential premium payable for a deal while employing 20-30% parent leverage.

Figure 5: Scenario Analysis - Potential Premium for Smid-Cap Trading @ 1x P/E Premium

	Price	NI	Shares Out	EPS	P/E	Debt	Debt/EBT
Acquirer	$ 30.00	$ 200.0	100.0	$ 2.00	15.0x	$ 1,538	5.0x
Target	$ 32.00	$ 200.0	100.0	$ 2.00	16.0x	$ 1,538	5.0x

Scenario #1	Target EV	Goodwill & % Premium	Equity	Debt&Cash	Parent Leverage	Acquirer Shares Issued	Incremental Interest Expense
Financing	$ 4,738	$ 711	$ 1,635	$ 2,725	$ 1,090	54.5	$ 91.0
		15%	30%	50%	20%		4%

This is the highest premium possible while avoiding dilution

	NI	Out	EPS
Proforma	$ 309.0	154.5	$ 2.00
Accretion			$ (0.00)
Accretion %			0%

Scenario #2	Target EV	Goodwill & % Premium	Equity	Debt&Cash	Parent Leverage	Acquirer Shares Issued	Incremental Interest Expense
Financing	$ 4,738	$ 1,042	$ 1,156	$ 2,890	$ 1,734	38.5	$ 123.5
		22%	20%	50%	30%		4%

This is the highest premium possible while avoiding dilution

	NI	Out	EPS
Proforma	$ 276.5	138.5	$ 2.00
Accretion			$ (0.00)
Accretion %			0%

Source: Company reports and UBS estimates

Appendix II: In the table below we summarize completed deals in the regulated utilities space since 2009.

Figure 6: Regulated sector deals announced since 2009, $ Mn

Buyer Name/ Target Name	Target Regulatory Industry	Deal Announcement Date	Completion/ Termination Date	Deal Consideration	Deal Value (Reported)	Deal Value, As-reported (Reported)	Deal Value per Share (Reported)	Transaction Value (Reported)	Transaction Value/ EBITDA (x)
Laclede Group, Inc. (The)/ Alabama Gas Corporation	Gas Utility	4/7/2014	8/31/2014	Cash, Debt Assumed	1,324.12	1,350.00	NA	1,600,000	10.6
Balfour Beatty plc/ Upper Peninsula Power Company	Electric	1/20/2014	8/28/2014	Cash	298.80	298.80	NA	NA	NA
TECO Energy, Inc./ New Mexico Gas Intermediate, Inc.	Gas Utility	5/28/2013	9/2/2014	Cash, Debt Assumed	750.00	750.00	NA	950,000	11.1
Algonquin Power & Utilities Corp./ New England Gas Company	Gas Utility	2/11/2013	12/20/2013	Cash, Debt Assumed	54.50	54.50	NA	74,000	NA
Laclede Group, Inc. (The)/ Missouri Gas Energy	Gas Utility	12/17/2012	9/1/2013	Cash, Debt Assumed	975.00	975.00	NA	NA	NA
Laclede Group, Inc. (The)/ New England Gas Company	Gas Utility	12/17/2012	12/20/2013	Cash, Debt Assumed	40.50	NA	NA	60,000	NA
Sempra Energy/ Willmut Gas & Oil Company	Gas Utility	1/3/2012	5/31/2012	Cash, Debt Assumed	19.00	NA	NA	29,000	NA
Gaz Métro Limited Partnership/ Central Vermont Public Service	Electric Utility	7/12/2011	6/27/2012	Cash, Debt Assumed	477.72	472.00	35.25	704,152	9.9
Energy Transfer Equity, L. P./ Southern Union Company	Gas Utility	6/16/2011	3/26/2012	Cash, Common Stock, Debt Assumed	5,632.78	5,700.00	44.16	9,202,472	11.6
AES Corporation/ DPL Inc.	Electric	4/20/2011	11/28/2011	Cash, Debt Assumed	3,532.64	3,500.00	30.00	4,613,236	7.2
Duke Energy Corporation/ Progress Energy, Inc.	Electric	1/10/2011	7/2/2012	Common Stock, Debt Assumed	13,628.07	13,700.00	46.48	25,717,069	8.4
AGL Resources Inc./ Nicor Inc.	Gas Utility	12/7/2010	12/9/2011	Cash, Common Stock, Debt Assumed	2,394.99	2,400.00	52.59	3,098,890	6.6
SteelRiver Infrastructure Fund / T.W. Phillips Gas and Oil Co.	Gas Utility	11/10/2010	5/24/2011		NA	NA	NA	NA	NA
GIC / Duquesne Light Holdings, Inc.	Electric Utility	9/29/2010	9/12/2011	Cash	360.00	360.00	NA	NA	NA
Energy West, Incorporated/ Cut Bank Gas Co	Gas Utility	4/6/2010	4/6/2010	Cash	0.10	0.10	NA	NA	NA
Emera Inc./ Maine & Maritimes Corporation	Electric	3/12/2010	12/21/2010	Cash, Debt Assumed	75.78	78.00	45.00	117,385	16.7
FirstEnergy Corp./ Allegheny Energy, Inc.	Electric	2/11/2010	2/25/2011	Common Stock, Debt Assumed	4,721.59	4,700.00	27.84	9,273,188	7.7
Hunt Consolidated, Inc./ Cap Rock Energy Corporation	Electric	12/17/2009	7/13/2010	Cash	221.50	221.50	NA	NA	NA
China Investment Corporation/ AES Corporation	Electric	11/6/2009	3/15/2010	Capital Contribution, Debt Assumed	NA	NA	12.60	NA	NA
Cloverland Electric Cooperative/ Edison Sault Electric Company	Electric	10/29/2009	5/4/2010	Cash	61.49	61.49	NA	NA	NA
Chesapeake Utilities Corporation/ Florida Public Utilities Company	Gas Utility	4/20/2009	10/28/2009	Common Stock, Debt Assumed	76.25	74.39	12.47	150,718	7.9

Source: SNL

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 Integrateds. 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.

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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
Ameren Corp.[6a, 16]	AEE.N	Neutral	N/A	US$45.01	18 Dec 2014
American Electric Power, Inc.[4, 5, 6b, 7, 16]	AEP.N	Neutral	N/A	US$59.98	18 Dec 2014
Avista Corp[2, 4, 5, 6a, 6c, 7, 16]	AVA.N	Sell	N/A	US$34.90	18 Dec 2014
CMS Energy Corporation[6a, 16]	CMS.N	Buy	N/A	US$34.55	18 Dec 2014
Dominion Resources[2, 4, 5, 6a, 6b, 6c, 7, 16]	D.N	Buy	N/A	US$75.33	18 Dec 2014
Duke Energy[2, 4, 5, 6a, 16]	DUK.N	Buy	N/A	US$83.01	18 Dec 2014
Empire District Electric Company[16]	EDE.N	Neutral	N/A	US$29.03	18 Dec 2014
Entergy Corp.[16]	ETR.N	Neutral	N/A	US$88.70	18 Dec 2014
Exelon Corp.[4, 5, 6a, 6c, 7, 16]	EXC.N	Neutral	N/A	US$37.53	18 Dec 2014
FirstEnergy Corp.[16]	FE.N	Sell	N/A	US$38.79	18 Dec 2014
Pinnacle West Capital Co.[2, 4, 6a, 16]	PNW.N	Buy	N/A	US$67.29	18 Dec 2014
SCANA Corp.[4, 5, 6a, 16]	SCG.N	Neutral	N/A	US$59.75	18 Dec 2014
TECO Energy Inc.[5, 16]	TE.N	Neutral	N/A	US$19.85	18 Dec 2014
Westar Energy, Inc.[4, 6a, 16]	WR.N	Neutral	N/A	US$40.53	18 Dec 2014
Wisconsin Energy Corp.[16]	WEC.N	Neutral	N/A	US$51.97	18 Dec 2014

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