

First Read

US Electric Utilities & IPPs

Giving New Life to Nuclear In New England

Equities

Americas
Electric Utilities

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Latest efforts to save the nuclear industry expands to New England

Last Friday the CT Senate passed a bill unanimously to allow the study of a further procurement effort of 8.4TWh, open to new renewables, large-scale hydro, and most important nuclear in New England. While the solicitation for power would be nominally open to all forms of power, we believe the most likely winner would be existing nuclear generators, most notably D's 2.1GW Millstone 2-unit plant in CT. Total procurement amount would equal to ~1/2 of the plant's 16-17TWh, with the offtake arrangement likely priced at a modest disc. to the cost of new carbon-free wind (we see this as *least* ~\$60/MWh all-in). As such, we est. passage of this bill could be worth upwards of ~\$20/MWh (delta vs. Mass Hub market power prices of ~\$40/MWh) * ~8TWh, = to ~\$0.15 EPS for a 10-yr period. The offtake would be structured as a Renewable Energy Credit (REC) bought by the states' electric LDCs (current MA & CT Class I RECs are quoted at \$27/MWh from Karbone). The bill is available [here](#) and a Bill Analysis [here](#).

The bill is not drafted as a straight subsidy for nuclear

The sponsors are rebutting any claims to characterize the bill as a subsidy, effectively targeting to 'value' the carbon-free nature of the plant relative to other replacement sources of carbon-free emissions. As mentioned above, we estimate the lowest marginal cost of new wind would be ~\$60/MWh, even under more favorable capacity factor assumptions. As for large-scale hydro via transmission, this too would be eligible, but likely bid in at yet a higher price still (\$90/MWh?). Bottom line, while not a certainty to be selected, D's Millstone unit would appear the most likely outcome.

Key question is whether the bill will pass the House now too?

Having passed unanimously without a hearing in the Senate last week, the question remains whether the bill can get approved out of the CT House this week prior to session end on Wednesday evening. We note D reports 1Q results on Wed AM.

Will Massachusetts follow suit? Possibly.

We understand a similar effort may be undertaken in Mass as part of its Omnibus energy legislation under evaluation. We note the administration has taken a keen interest in expediting energy issues in the state of late and has already passed a bill to immediately address the Net Energy Metering caps for solar in the state. Based on feedback from a sector participant studying the pending Mass legislation, we think it's possible a nuclear procurement carve-out could eventually be included for NEE's 1.1GW single-unit Seabrook nuclear plant in NH. With session end in June, there's still time.

What about the concerns of discriminatory procurement? It's entirely open.

We note the structure does *not* require the plant to clear any corresponding energy or capacity auctions, but simply pays for the RECs generated; as such it would appear to steer clear of any of the Minimum Offer Price Rule (MOPR) considerations that have caused substantial pushback of other deals to contract with plants elsewhere.

Good step for D if successful in filling its 2017 and 2018 EPS needs

We see this as addressing in part pressure on D's 5-6% EPS growth following the slowdown in midstream development activities in the Marcellus and Utica via its Blue Racer JV as well as given the wider commodity backdrop from declining power.

What's the fate of nuclear regionally *without* these deals? Bleak.

We increasingly believe high fixed-cost structure solid fuel plants like nuclear will not be viable in a future New England market in which renewables add meaningful pressure to ATC power prices and with cheaper gas eventually migrating to the region. As such, we see implicit underlying concerns of eventual shutdown of these remaining units as quite credible (following a series of more costly plant retirements).

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Valuation Method and Risk Statement

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.

We value Dominion Resources on a SOTP. Risks to our estimates and price target for Dominion Resources include: unfavorable movements in commodity prices; mild weather in utility service territories; unfavorable regulatory outcomes; lower than expected natural gas or oil production; and unplanned disruptions at power generation facilities. Further risks include volumetric, credit, and collateral risk associated with its retail power and gas marketing business. Operational risk is present through the day to day operation of its large power fleet (both regulated and merchant), T&D assets, large gas midstream business, and marginal upstream assets.

Our valuation for NextEra Energy is based on a sum-of-the-parts approach. Risks for NextEra Energy include but are not limited to: (1) potential inability to deliver on its capital expenditure program; (2) unfavorable commodity movements [natural gas, power, etc.]; (3) adverse political/legal/regulatory actions; (4) decline in the demand for new wind and solar projects; (5) unfavorable weather and natural resources yield [sun radiance and wind generation]; (6) operational and construction risk; (7) inability to access the capital markets on attractive terms; (8) inability to re-contract assets after contract expiration; (9) declines in customer demand and population; (10) failure to close pending or prospective M&A transactions; (11) natural disasters or nuclear accidents; (12) losses at the retail marketing segment; (13) change in macroeconomics; and (14) other unforeseen changes.

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Buy	FSR is > 6% above the MRA.	49%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	26%
Sell	FSR is > 6% below the MRA.	14%	19%
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 March 2016.

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UBS Securities LLC: Julien Dumoulin-Smith; Michael Weinstein; Paul Zimbardo; Jeremiah Booream.

Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Dominion Resources ^{2, 4, 5, 6a, 6b, 6c, 7, 16}	D.N	Neutral	N/A	US\$72.10	02 May 2016
NextEra Energy ^{4, 5, 6a, 6c, 7, 16}	NEE.N	Buy (UR)	N/A	US\$118.06	02 May 2016

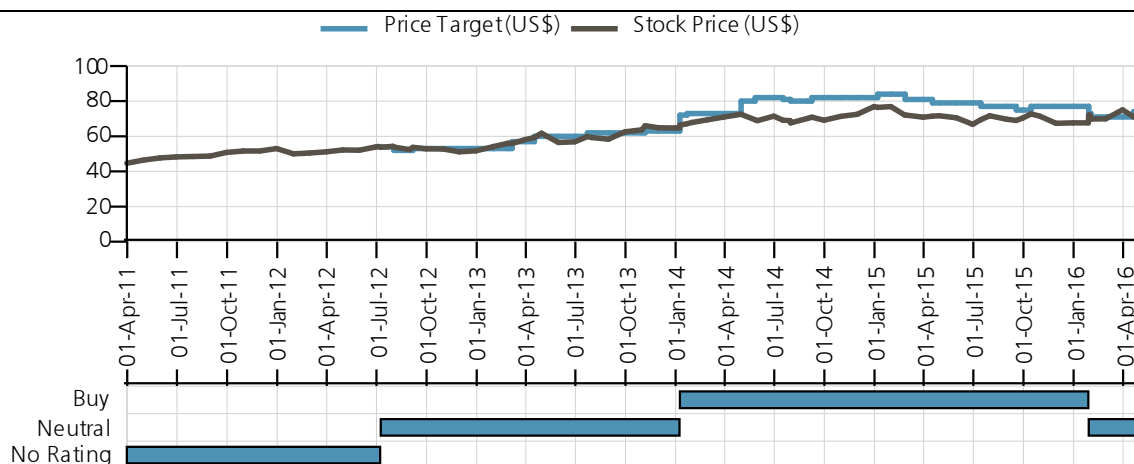
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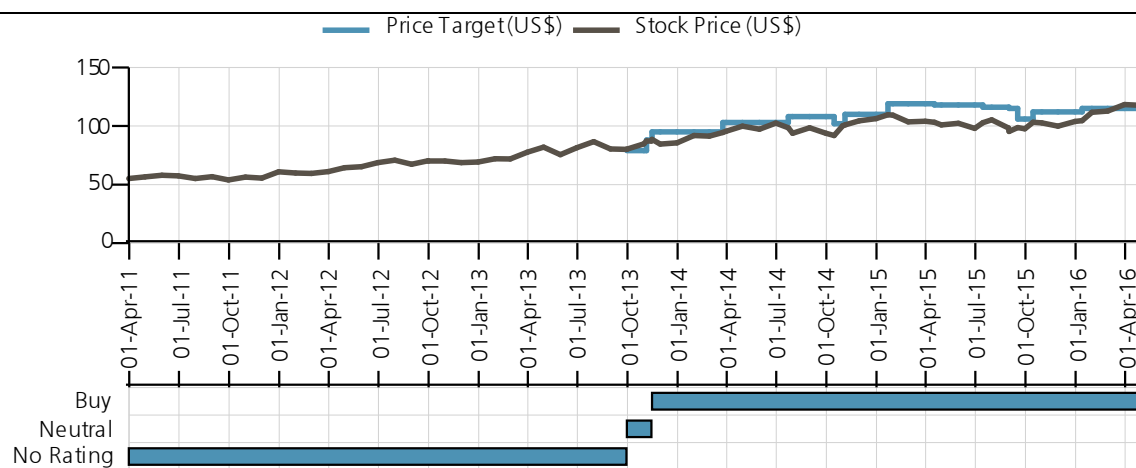
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Dominion Resources (US\$)



Source: UBS; as of 02 May 2016

NextEra Energy (US\$)



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