

Xcel Energy Inc.

Too Much, Too Fast

Downgrade to Sell on earnings and ratebase growth uncertainty

As hinted at during the December analyst day, XEL's ratebase growth forecast from 2015-2020 was reduced -80 bps to 3.7% as a result of deferred taxes stemming from the recent 5-year extension of bonus depreciation. XEL now expects EPS to grow at 4-5% if it can improve the ROE outlook by 50bp. To offset, mgmt. increased potential "upside" capex to the base plan to \$2.5B from \$1.6B previously, with ratebase CAGR back up to prior upside guidance of ~5.5% if executed. Much of the increased potential is from renewables in the recently released energy future plan in Colorado, as well as solar in MN. Likewise, EPS growth in the upside scenario would recover to 5.5%-6.0% vs the prior upside guidance "upper half of 4%-6%". However, we note much of this new 'backfill' spend would be biased in 2018+ onwards, with CO PUC approval required, suggesting any acceleration is back-end weighted in a 5-yr outlook.

ROE improvement to 9.4% is baked into consensus expectations now

With earned utility ROE for 2015 at 8.91%, management continues to aim for 50 bps of improvement as a result of reduced regulatory lag in MN (~30 bps UBS) and other multi-year rate plan improvements. Excluding the mild weather, the 2015 ROE would have been 9.07%, with the improvement to 9.4% now increasingly baked into consensus expectations. Mgmt notes that reduced rate pressure from deferred tax benefits helps close the ROE gap.

After 10% outperformance since June, capital acceleration is now the story

With the \$2.5B of "upside" capital guidance originating from the MN and CO energy plans, the real question is whether XEL can accelerate spending early enough to keep EPS growth and investor confidence on track without back-end loading too much of the growth. The current NOL position and extension of renewable tax credits is also likely to postpone bonus depn benefits and could add to earnings growth delays.

Valuation: Reduce Price Target \$1 to \$36; expect pressure as Street repositions

We are reducing our 2017E EPS -\$0.05, cutting our SOTP PT to \$36, and downgrading to Sell. The key question going forward will be mgmt's ability to deploy the upside capex plan early enough to boost confidence. While executing well in '15, shares have seen after sharp outperformance and are poised to re-entrench given execution hurdles.

Highlights (US\$m)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenues	10,128	10,915	11,686	11,024	12,421	12,777	13,155	13,573
EBIT (UBS)	1,823	1,848	1,948	2,130	2,168	2,270	2,385	2,513
Net earnings (UBS)	905	948	1,021	1,063	1,123	1,181	1,242	1,323
EPS (UBS, diluted) (US\$)	1.85	1.91	2.03	2.09	2.20	2.30	2.40	2.55
DPS (US\$)	1.07	1.12	1.25	1.28	1.36	1.44	1.52	1.60
Net (debt) / cash	(10,922)	(11,843)	(12,697)	(13,437)	(13,922)	(14,240)	(14,589)	(15,239)
Profitability/valuation	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
EBIT margin %	18.0	16.9	16.7	19.3	17.5	17.8	18.1	18.5
ROIC (EBIT) %	9.0	8.6	8.4	8.5	8.3	8.4	8.5	8.7
EV/EBITDA (core) x	8.3	8.7	9.0	9.7	9.7	9.4	8.9	8.4
P/E (UBS, diluted) x	14.8	15.0	15.4	18.6	17.8	17.0	16.2	15.3
Equity FCF (UBS) yield %	(4.4)	(5.9)	(3.7)	(1.1)	0.6	1.7	1.7	1.0
Net dividend yield %	3.9	3.9	4.0	3.3	3.5	3.7	3.9	4.1

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\$38.98 on 02 Feb 2016 18:41 EST

www.ubs.com/investmentresearch

Equities

Americas
Electric Utilities

12-month rating **Sell**
Prior: Neutral

12m price target **US\$36.00**
Prior: US\$37.00

Price **US\$38.98**

RIC: XEL.N **BBG:** XEL US

Trading data and key metrics

52-wk range	US\$38.98-31.92
Market cap.	US\$19.8bn
Shares o/s	507m (COM)
Free float	100%
Avg. daily volume ('000)	1,104
Avg. daily value (m)	US\$39.7
Common s/h equity (12/15E)	US\$10.7bn
P/BV (12/15E)	1.8x
Net debt / EBITDA (12/15E)	4.1x

EPS (UBS, diluted) (US\$)

	12/15E			
	From	To	% ch	Cons.
Q1	0.46	0.46	0	0.46
Q2	0.39	0.39	0	0.39
Q3	0.84	0.84	0	0.84
Q4E	0.39	0.41	4	0.41
12/15E	2.07	2.09	1	2.09
12/16E	2.23	2.20	-2	2.22
12/17E	2.35	2.30	-2	2.34

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PIVOTAL QUESTIONS

Q: What are the prospects for increased capex, particularly solar in ratebase?

XEL's new \$2.5Bn 2016-2020E upside capex plan includes opportunities that span the risk spectrum including from grid modernization (higher probability of success) to ratebasing natural gas reserves (lower probability of success). We specifically focus on solar where we see the extension of the Investment Tax Credit (ITC) as benefitting unregulated developers who do not have to normalize the ITC and therefore can offer more attractive customer benefits. [more](#) →

Q: How does Xcel Energy's earnings profile compare to peers?

Xcel's adjusted EPS CAGR is below-average even based on its upside capex plan. XEL's base capital plan without ROE improvement points towards five-year EPS CAGR in the lower-half of the 4-5% guidance range, at the bottom-end of utilities we monitor. When incorporating a 50bp ROE improvement into the base plan management expects 4-5% EPS CAGR whereas the upside capex plan targets 5.5%-6.0% EPS CAGR. Based upon this guidance, even if XEL is successful in improving its earnings and spending more capital than originally expected, it will only have average earnings per share growth. 2015 operating company ROE was 8.9% and we assume that management will be able to close the majority of its under-earnings gap and achieve ~9.25% but we do not embed the full 50bp uplift that management is targeting. [more](#) →

UBS VIEW

While we have been impressed with the execution of regulatory strategy at XEL, we downgrade to Sell after 10% outperformance since June with the stock now trading in-line P/E multiple despite EPS growth pressure. Our Sell rating reflects the need for management to earn an in-line multiple though the execution of significant upside capex to offset the negative impact of bonus depreciation on ratebase and the slower build-up for competitive transmission. Specifically we see risk to the elements of the upside capital plan such as solar where XEL is at a disadvantage to independent developers.

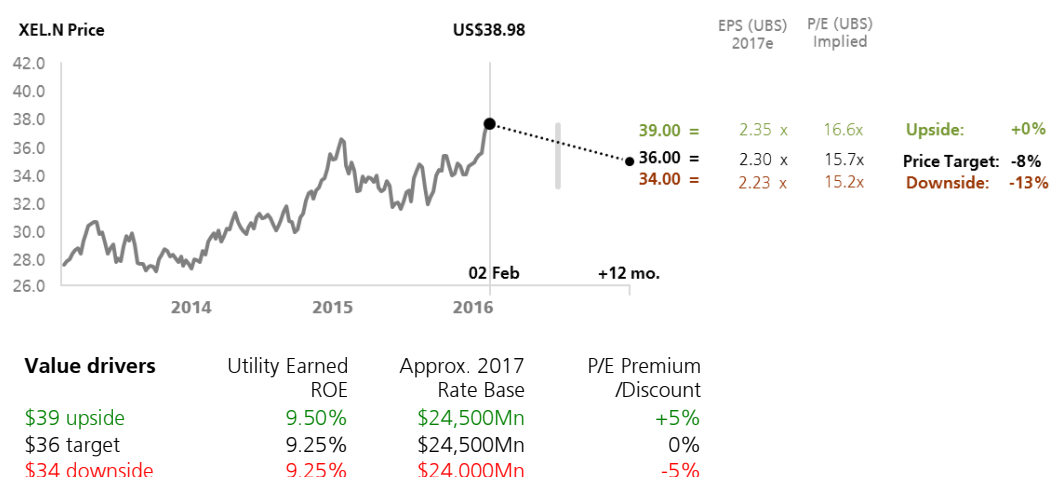
EVIDENCE

Trading at a full-average multiple despite execution challenges: Based upon our analysis of utilities with disclosed EPS growth targets, the mean/median is 6%. Below we highlight where XEL's earnings targets compare to the broader peer group. While XEL has improved its outlook with favorable regulatory outcomes and legislation in multiple jurisdictions, our conclusion is that management still has to take action to improve earnings to the peer average growth rate.

WHAT'S PRICED IN?

Investors are buying into the turnaround story but shares have never traded at a meaningful premium: Shares are trading essentially in-line with regulated peers (+/- 0.2x P/E) despite below-average earnings per share growth and its multi-state jurisdiction footprint. This implies that investors are giving credit for material ROE improvement or the upside capex program. [more](#) →

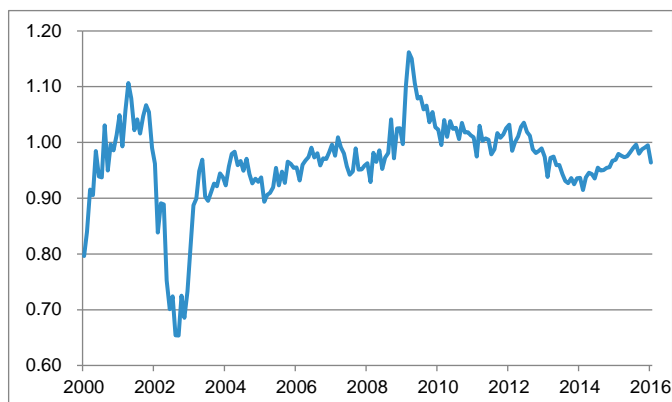
UPSIDE / DOWNSIDE SPECTRUM

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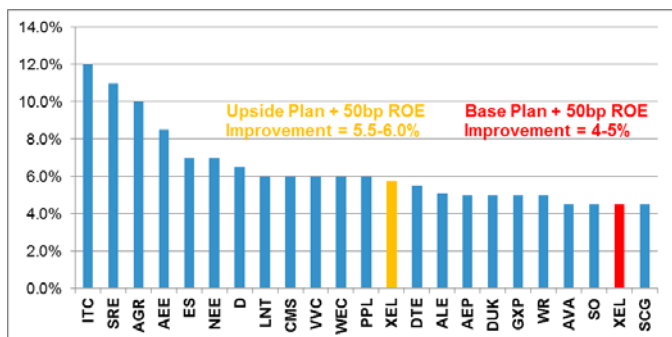
COMPANY DESCRIPTION

Xcel Energy, through its regulated subsidiaries, provides energy services to 3.4 million electric customers and 1.9 million natural gas customers. Its service territory spans eight states and the company primarily operates in the West and Midwest region. [more](#) →

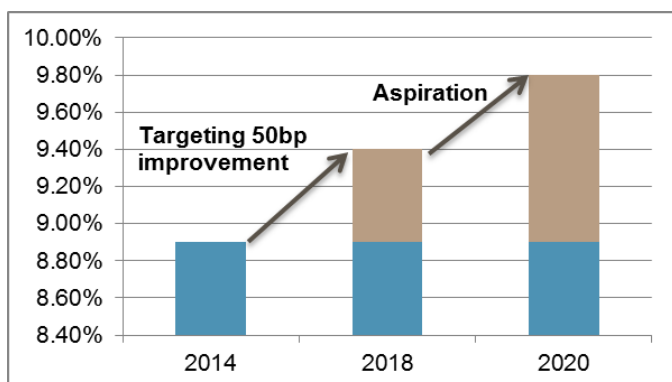
OUR THESIS IN PICTURES

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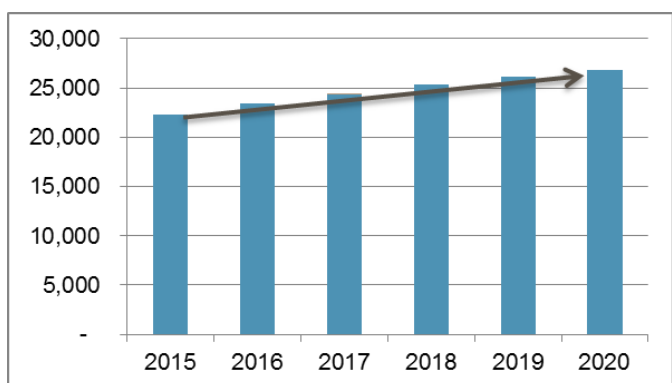
Xcel's relative P/E has expanded to an ~in-line multiple despite operating in multiple jurisdictions...



...and now having a below-average EPS growth trajectory



Management is attempting to improve its average earned ROE above 8.9%



Ratebase is expected to grow at 3.7% under the base plan

Sources for exhibits above: Company data, FactSet, and UBS Research

PIVOTAL QUESTIONS

[return](#) ↑**Q: What are the prospects for increased capex?**

UBS VIEW

XEL's new \$2.5Bn 2016-2020E upside capex plan (up from \$1.6Bn at the December Analyst Day) includes opportunities that span the risk spectrum including from grid modernization (higher probability of success) to ratebasing natural gas reserves (lower probability of success). We specifically focus on solar where we see the extension of the Investment Tax Credit (ITC) as benefitting unregulated developers who do not have to normalize the ITC and therefore can offer more attractive customer benefits. **We see it as increasingly challenging to execute on ratebase solar capex for all utilities following the ITC extension, with XEL among the few poised recently reflecting it in their plans.**

If fully implemented through 2020, this would drive ratebase growth back up to ~5.5% and EPS growth 5.5%-6.0% off a 2015 \$2.10 base (still assuming a 9.4% ROE). This would be in-line with the previous upside-case forecast for ~5.6% ratebase growth and 5%-6% EPS growth. However, with much of the upside spending in 2018 and beyond, this leaves management with slower near-term EPS growth and a "show-me" story for 2018+ to justify the average utility multiple XEL now trades at. More specifically, the latest Oct 2nd update to the Minnesota Integrated Resource Plan (IRP) includes (among other things) 800 MW of new wind and 400 MW of new solar by 2020. Likewise, the recent Colorado energy plan includes 600 MW of wind and 400 MW of solar. Of these totals, only a portion is expected to be ratebased, with the \$2.5B (~100-150 bps of growth) inclusive of about 200 MW of wind and 100 MW of solar in MN and another 300 MW of wind and 200 MW of solar in Colorado.

EVIDENCE

Independent developers such as NextEra Energy (NEE) have proved successful in underbidding local utilities with PPA offerings and we expect this trend to pressure the ability of incumbents to capture the full extent of renewables in ratebase. [Further details on the tax normalization are available from our recent call with PwC here.](#) At its recent Analyst Day management also seemingly downplayed the extent of the transmission opportunities: we think this was prudent as its core territories sit atop the much discussed SPP and MISO regions.

Many other utilities have opted to pursue third-party affiliates to pursue renewables – and specifically solar given challenges to make it competitive in ratebase. XEL is among the few continuing to push via ratebase. While we wouldn't discount an attempt to pursue third-party affiliates, mgmt remained resilient to this idea for a range of potential infrastructure projects as recently as its latest Analyst Day and 4q call where expansion into such structures appeared off the table, at least for midstream affiliates.

WHAT'S PRICED IN?

The market appears less willing to give management the benefit of the doubt for improving the capex/ratebase profile compared with the ROE uplift. Based upon Consensus EPS projections we see the market as pricing in ~\$24.0-\$24.5Bn of ratebase for 2017E, consistent with management's guidance of \$24.3Bn.

UBS ratebase forecast is reduced, with back-end-loaded recovery

We've reduced our ratebase growth forecast through 2020 from a 5.0% CAGR to 4.8%, although it now tracks along at the base plan's 3.7% through 2018, with a \$1.3B pickup from "upside" capex in 2019 and 2020. The result of this new pattern is to reduce our estimates by about -\$0.05 through 2018 with a recovery back toward our original 2020 estimate as the additional spending fills the hole created by bonus depreciation.

We continue to assume 5% ratebase growth and 5.3% EPS CAGR through 2018.

Figure 1: XEL Ratebase Growth, UBSe vs Base Plan 3.7% Guidance

Projected Ratebase Growth (Mn)							5-yr
	2015	2016	2017	2018	2019	2020	CAGR
UBSe							
NSPM	9,369	9,815	10,118	10,500	11,129	11,768	4.7%
PSCo	8,916	9,225	9,504	9,785	10,242	10,852	4.0%
SPS	2,882	3,101	3,400	3,644	3,817	3,946	6.5%
NSPW	1,097	1,172	1,258	1,365	1,452	1,547	7.1%
Total UBSe	22,265	23,313	24,281	25,294	26,640	28,113	4.8%
Previous UBSe	22,180	23,514	24,746	26,035	27,248	28,332	5.0%
Base Plan Guidance (New)	22,300	23,400	24,300	25,300	26,200	26,800	3.7%
Base Plan Guidance (Previous)	22,300	23,600	24,600	25,900	27,000	27,800	4.5%
Delta (UBSe-Mgmt)	(35)	(87)	(19)	(6)	440	1,313	

Source: Company filings, UBS Estimates

Upside capex: Incremental capital program from 2016-2020 of a total potential \$2.5B would increase ratebase CAGR to ~5.5%. This is driven by five broad categories disclosed at the Analyst Day, including:

- **Clean Power Plan**, including a small portion of the NSP-MN Integrated Resource Plan (IRP). Only 200 MW of wind and 100 MW of solar in Minnesota are included in this \$2.5B vs the IRP filing for 800 MW of wind and 400 MW of solar through 2020. See below for IRP details. This is a component of the upside case at ~\$500 Mn. The Colorado "Our Energy Future" plan calls for 1,000MW of renewables which drives the latest \$900Mn increase in the upside plan following the Analyst Day.
- **Implementation of grid modernization** plans through rider recovery in MN. Initial installation of Advanced Metering Infrastructure (AMI) across the system. This appears further scalable off the current base, but the economics are less attractive given the \$300 Mn allocated would replace existing AMR meters (which already do not involve meter readers).
- **Ratebasing of natural gas reserves** for 25% of Colorado LDC requirements over 10 years for about \$300M. XEL is exploring the possibility of ratebasing natural gas reserves as well as pipelines for both its natural gas utility as well as its generating fleet in order to capture the current low price environment for customers. PSCo filed an application with Colorado regulators and management expects potential investment in 2H16; this would be done in conjunction with STR's Wexpro unit in UT. In contrast to Questar, XEL's PSCo unit would be limited to an ROE tied +/-100bp vs. their authorized ROE. The Colorado Commission has 240 days to reach a decision on the regulatory framework. *We sense this is the upside in the capex with the relative least likelihood.* Roughly \$300 Mn was allocated to this bucket in the upside vs.

What are some of the components of the upside plan?

**\$300Mn natural gas reserve
\$900Mn of incremental Colorado renewables
Majority of remainder is Minnesota – primarily renewables**

\$500 Mn now disclosed for the 10-year period (ratable deployment would suggest ~\$300 Mn is an appropriate approximation for current 5-year outlook).

- **"Steel for fuel":** the acquisition of existing Power Purchase Agreements (PPA) for inclusion in ratebase for the benefit of customers over the long run with minimal price impacts. For example, Cortenay, Rocky Mt., Blue Spruce. Xcel received approval from both the Minnesota and North Dakota Commissions for its proposed Courtney wind project, which can now be included in the rate base as opposed to a PPA framework and is now under construction for yearend 2016 in-service. We emphasize Calpine would arguably be a good candidate to continue to see assets eventually sold into ratebase as well following its recent success in expanding its Mankato facility (price is the key question). *\$300 Mn was allocated here as an upside acquisition placeholder.*

How expensive is wind and solar? Management estimates that wind PPAs are currently being signed at ~mid-\$20's/MWh and solar in the ~\$75/MWh context. The utility will attempt to own ~50% of the opportunity, albeit we suspect an explicit deal on ownership remains challenging.

- **Transmission asset growth**, chiefly through a robust OpCo pipeline. With SPS no longer providing retail electric service in Kansas and Oklahoma, XEL took the opportunity to seed its independent Transcos with ~\$100M of 345-kV line (230 miles). A final approval on transfer from various state and Federal agencies is expected to take a year. Management hopes the assets will add gravitas to the Transcos in future FERC 1000 competitive bidding. The company continues to downplay incremental competitive opportunities, with projects only materializing in the ~4Q16 timeline for MISO at the earliest. Bottom line, projects contemplated are strictly reflective of what is already approved.

At the recent analyst day, transmission did not feature as prominently within the capex budget and growth opportunities as previous presentations – and seemingly rightly so. We give management credit for not setting forward transmission capex expectations too high given its core territories sit atop the much discussed SPP and MISO regions.

No cash taxes through at least 2018 – and no material impact from bonus either

Longer-term, management expects no material impact to EPS growth through 2018 considering the company's NOL tax position and the impact of multi-year rate plans. With XEL today not a cash tax payer, balance sheet benefits from lower taxes would only begin to accrue in 2018, although this is prior to incremental wind build in ratebase that could delay cash benefits from bonus depreciation even further.

XEL still does not anticipate issuing any additional equity and will even fund its dividend reinvestment program and benefit programs from share repurchases through the period. A "modest" level of equity could be needed to fund the \$2.5B "upside" capital program, although even this could be unnecessary given the cash benefits from the extension of bonus depreciation. XEL has authorized purchases of up to 3M shares for stock compensation plan settlements. *The company emphasized that any upside capex would likely be a backend weighted in 2018+, suggesting and possible corresponding equity would also be backend weighted.*

No equity at all through 2020 under base capital program

PIVOTAL QUESTIONS

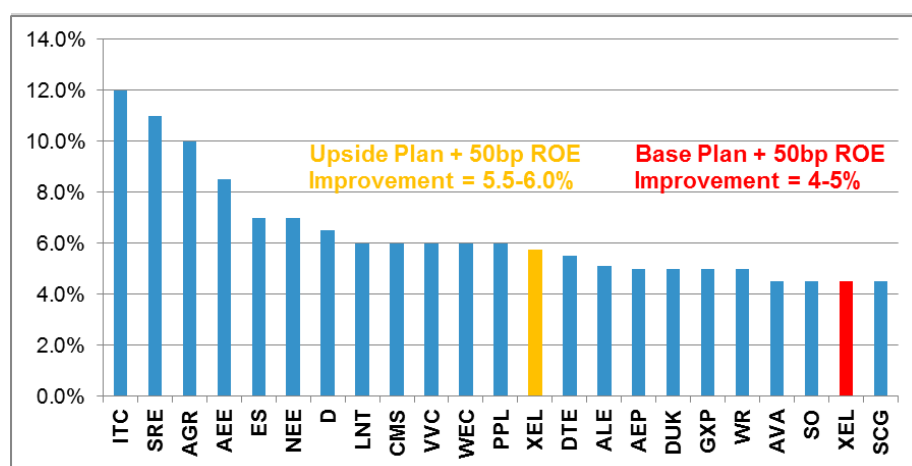
[return](#) ↑**Q: How does Xcel Energy's earnings profile compare to peers?**

UBS VIEW

Xcel's adjusted EPS CAGR is *below*-average even based on its upside capex plan. XEL's base capital plan without ROE improvement expects five-year EPS CAGR of below 4-5%, at the bottom-end of utilities we monitor. When incorporating a 50bp ROE improvement into the base plan management expects 4-5% EPS CAGR whereas the upside capex plan expects 5.5%-6.0% EPS CAGR. Based upon this guidance, even if XEL is successful in improving its earnings and spending more capital than originally expected, it will only have average earnings per share growth.

EVIDENCE

Based upon our analysis of utilities with disclosed EPS growth targets, the mean/median is 6%. Below we highlight where XEL's earnings targets compare to the broader peer group. While XEL has improved its outlook with favorable regulatory outcomes and legislation in multiple jurisdictions, our conclusion is that management still has to take action to improve earnings to the peer average growth rate.

Figure 2: Comparison of Utilities Stated EPS CAGR

Source: Company Filings

WHAT'S PRICED IN?

Shares are trading essentially in-line with regulated peers (+/- 0.2x P/E) despite below-average earnings per share growth and its multi-state jurisdiction footprint. This implies that investors are giving credit for material ROE improvement or the upside capex program.

PIVOTAL QUESTIONS

[return](#) ↑**Q: Can Xcel Energy's earned ROEs improve?**

UBS VIEW

2015 operating company ROE was 8.9% and we assume that management will be able to close the majority of its under-earnings gap and achieve ~9.25% but we do not embed the full 50bp uplift that management is targeting.

EVIDENCE

Management expects to earn 9.4% by 2018 and 'aspires' to earn the average allowed ROE of 9.8%. XEL expects to achieve this via cost cuts (0-2% annual growth in O&M), targeting no equity issuances, and natural reduction of lag from new legislation. While we see a path to improving the ROE as we mentioned above, XEL operates in jurisdictions have historically been challenging and we believe it is too optimistic to embed the full uplift. Furthermore, we see it as somewhat aggressive to assume that XEL can earn its ROE in 2017 when management has pointed towards a 2018 target.

WHAT'S PRICED IN?

Based upon 2017 adjusted EPS Consensus of \$2.33, investors appear to be pricing in closer to a 50bp ROE improvement (if not more).

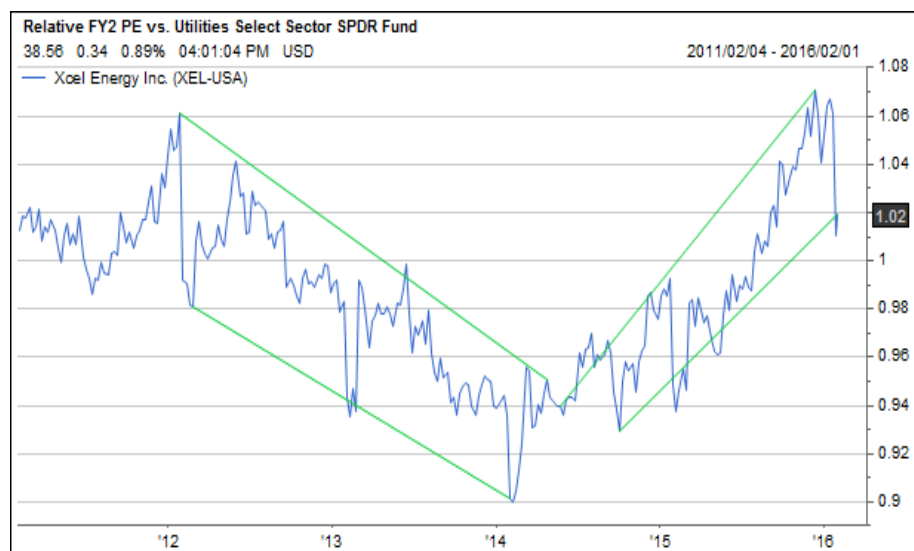
2016 guidance unchanged, although less AFUDC equity

Guidance for 2016 was left unchanged at \$2.12-\$2.27 vs UBSe \$2.23 and consensus \$2.21, although the expected decline in AFUDC equity was reduced from \$5M-\$10M to \$10M-\$15M (a -\$0.01 impact). Key sensitivities are +/- \$0.05 for each 100 bps change in retail electric sales and +/- \$0.03 for each 100 bps O&M expense. Mild weather in 2015 reduced earnings -\$0.04 vs normal.

FY 2015 results in-line with consensus after a mild 4Q

XEL reported FY15 EPS of \$2.09 vs. UBSe for \$2.07 and street consensus \$2.10 (mgmt. guidance range was \$2.05-2.15). For the quarter, XEL reported 4Q15 at \$0.41 vs. UBSe \$0.39 and street consensus for \$0.43. We had expected a weather-driven 4Q miss. Although weather was a 7 cents drag year-over-year (-\$0.04 vs normal), results were positively impacted by higher elec margins (+\$0.06 for 4Q vs. last year and +\$0.31 for FY15) and lower conservation. Weather normalized electric sales were down -0.2% for the year.

WHAT'S PRICED IN?

[return](#) ↑

Relative P/E has expanded as the outlook has improved but we see the valuation as stretched at this point.

Investors give credit for the full extent of the ROE improvement

Shares are trading essentially in-line with regulated peers ($\pm 0.2x$ P/E) despite below-average earnings per share growth and its multi-state jurisdiction footprint. This implies that investors are giving credit for at least material ROE improvement or the upside capex plan. While management might be able to be successful on both the earnings and capital metrics, we do not believe that should be the market's base case.

UPSIDE / DOWNSIDE SPECTRUM

[return](#) ↑

XEL is trading at
US\$38.98 (as of
February 2nd).

Value drivers	Utility Earned ROE	Approx. 2017 Rate Base	P/E Premium /Discount
\$39 upside	9.50%	\$24,500Mn	+5%
\$36 target	9.25%	\$24,500Mn	0%
\$34 downside	9.25%	\$24,000Mn	-5%

Risk to the current share price is skewed to the downside

XEL is trading at **US\$38.98** (as of February 2nd).

Upside (US\$39): The upside case is premised on improving the ROE to 9.5%. Alternatively XEL could deploy additional capital into ratebase and have a higher average 2017 ratebase without improving its ROE as significantly. In this scenario we could see XEL trading at a 5% P/E premium to the group.

Base (US\$36): Our base case assumes a 9.25% ROE and ~\$24,300Mn ratebase in 2017 with a slight discount to the average regulated P/E.

Downside (US\$34): The downside case is premised on minimal ROE improvement with a 9% earned ROE versus 8.9% in 2015.

Valuation, Estimates and View:

As we note above, our ratebase projection and estimates have been reduced through 2018 with a \$1.5B ratebase pickup from upside spending in 2019 and 2020. While we have been impressed with the execution of regulatory strategy at XEL, we downgrade to Sell after 10% outperformance since June with the stock now trading in-line with peers despite EPS growth pressure. Our Sell rating reflects the need for management to earn an in-line multiple though the execution of significant upside capex to offset the negative impact of bonus depreciation on ratebase growth and the slower build-up for competitive transmission.

We continue to acknowledge that last year's multi-year settlement in Colorado, and legislation passed in Minnesota significantly reduce regulatory risk, with ~68% of ratebase now under multi-year rate plans. Currently earning an overall utility 8.91% ROE (12MT Dec 2015), the company plans to further reduce regulatory lag through recently passed legislation in Minnesota and Texas, particularly in Minnesota where ~75% of such lag originates.

Figure 3: UBS Estimates for XEL, 2014A-2018E

UBS Estimates (\$/share)	2014A	2015E	2016E	2017E	2018E	2019E	2020E
PSCo	\$0.90	\$0.95	\$0.96	\$0.98	\$1.01	\$1.06	\$1.11
NSPM	0.80	0.87	0.87	0.89	0.92	0.95	1.01
SPS	0.26	0.26	0.31	0.36	0.40	0.43	0.48
NSPW	0.14	0.14	0.16	0.18	0.19	0.20	0.22
XEL Parent	(0.08)	(0.14)	(0.10)	(0.10)	(0.11)	(0.10)	(0.09)
UBSe EPS	\$2.03	\$2.09	\$2.20	\$2.30	\$2.40	\$2.55	\$2.74
CAGR 2015 \$2.10 (mdpt guide) - 20XX					4.6%		5.5%
Guidance			2.12-2.27				4-6%
Previous Ests			\$2.23	\$2.35	\$2.45		
Consensus			\$2.21	\$2.33	\$2.46	\$2.60	\$2.75

Source: Company Filings, FactSet, and UBS Estimates

Guidance remains unchanged

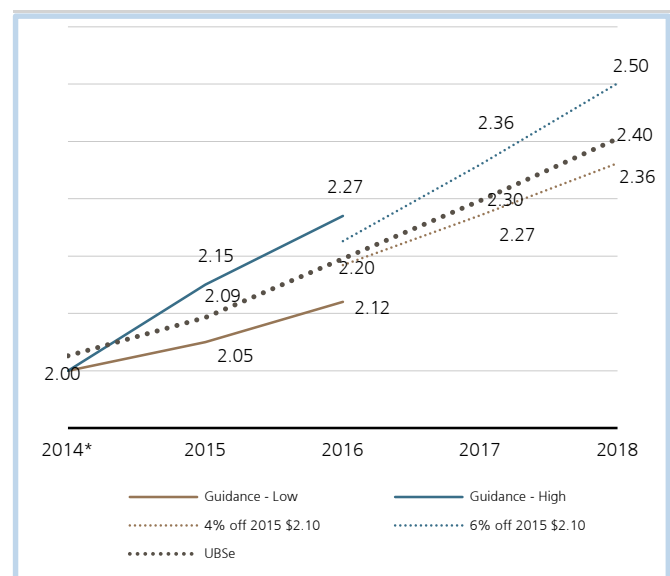
At the analyst day in December, management rebased the 4%-6% EPS growth projection off the \$2.10 midpoint of 2015 guidance (vs the prior weather normalized \$2.00 for 2014). This rebasing didn't change the midpoints of projections through 2018, but it did have the effect of narrowing the range somewhat beyond 2016. Our reduced estimates are now toward the lower end of the range through 2018.

Figure 4: Guidance Assumptions, 2015 & 2016

Guidance	2016
Weather adjusted retail elec sales	0.5%-1.0%
Weather adjusted nat gas sales	flat
Capital rider revenue	\$70 to \$80Mn Inc.
O&M expense	0%-2%
Depreciation expense	\$200Mn Inc.
Property tax expense	\$40 to \$50Mn Inc.
Interest (net of AFUDC debt)	\$40 to \$50Mn Dec.
AFUDC - Equity	\$10 to \$15Mn Inc.
Effective Tax Rate	34% - 36%
Average C/S Outstanding	509Mn
Operating EPS Growth Rate	5.0% to 7.0%
Annual Operating EPS Guidance	\$2.12 to \$2.27
Dividend Growth Rate	5.0% to 7.0%

Source: Company filings

Figure 5: UBS Estimates vs Guidance, 2015E-2018E



Source: UBS Estimates, Company filings

Valuation: Reducing Price Target \$1 to \$36

Our SOP is based on a 2017E average utility P/E methodology with a premium ascribed to Wisconsin for its above-average ROEs (1.0x-turn) and a discount for the Southwest. We have increased the Southwest discount to 1.0x-turn from 0.5x-turn previously due to the relative regulatory lag and uncertainty at the subsidiary.

Figure 6: XEL Valuation

Business Segment	Valuation Metric	2017 EPS	Low Case		Base Case			High Case	
			Valuation Multiple	(\$/Share) Value	Premium/Discount	Valuation Multiple	(\$/Share) Value	Valuation Multiple	(\$/Share) Value
Regulated Business					Regulated Peers: 16.0x				
Northern States Pow er - Minnesota	P/E	\$0.89	15.0x	\$13.32	0.0x	16.0x	\$14.21	17.0x	\$15.10
Northern States Pow er - Wisconsin	P/E	\$0.18	16.0x	\$2.81	1.0x	17.0x	\$2.99	18.0x	\$3.16
Public Service Colorado	P/E	\$0.98	15.0x	\$14.65	0.0x	16.0x	\$15.63	17.0x	\$16.60
Southw estern Pow er Service	P/E	\$0.36	14.0x	\$5.03	-1.0x	15.0x	\$5.39	16.0x	\$5.75
HoldCo									
Parent & Other Overhead Expense	P/E	(\$0.12)	15.0x	(\$1.74)		16.0x	(\$1.86)	17.0x	(\$1.97)
XEL Equity Value per Share		\$2.28	14.9x	\$34.00		15.8x	\$36.00	17.1x	\$39.00

Source: Company Filings, FactSet, and UBS Estimates

What's changed in our Price Target?

- Reduced EPS Estimates ~\$0.05: **--\$1/sh**
- Increased discount at SPS: **--\$0.50/sh**
- Improvement in the regulated peer multiple to 16x from 15.7x: **+~\$0.75/sh**

Figure 7: XEL Sensitivity Analysis

XEL Sensitivity Analysis							
	2017 Ratebase						
	23,000	23,500	24,000	24,500	25,000	25,500	
Earned ROEs	8.50%	\$1.95	\$2.00	\$2.04	\$2.09	\$2.13	\$2.18
	8.75%	\$2.01	\$2.06	\$2.11	\$2.15	\$2.20	\$2.24
	9.00%	\$2.07	\$2.12	\$2.17	\$2.22	\$2.26	\$2.31
	9.25%	\$2.14	\$2.18	\$2.23	\$2.28	\$2.33	\$2.38
	9.50%	\$2.20	\$2.25	\$2.30	\$2.35	\$2.40	\$2.44
	9.75%	\$2.26	\$2.31	\$2.36	\$2.41	\$2.46	\$2.51
	10.00%	\$2.32	\$2.37	\$2.42	\$2.47	\$2.53	\$2.58

Upside/Downside Spectrum	EPS	P/E	Value
Downside Case	\$2.22	15.2x	\$34
Base Case	\$2.28	15.8x	\$36
Upside Case	\$2.35	16.8x	\$39

Source: Company Filings, FactSet, and UBS Estimates

- **Revised Integrated Resource Plan (IRP) filed; early shutdown of Sherco Units 1&2.** The plan would reduce carbon emissions by 60% in 2030 vs 2005 levels, with 63% of NSP system energy carbon-free by 2030. Instead of running the Sherco coal units through 2030 as originally planned, XEL announced that Unit 2 will cease operating as a coal-fired unit in 2023 and Unit 1 will stop coal-fired generation in 2026 (combined nameplate capacity of about 1,530 MW). We see the closures as positive for incremental capex, with the two coal units accounting for ~20% of Minnesota's fleet capacity. The company still plans to add 1,800 MW of wind and 1,400 MW of solar by 2030, now including 800 MW of wind and 400 MW of solar by 2020. Sherco coal units will be replaced with a 780MW CCGT by 2026 and the company also plans to add another ~230MW CCGT in North Dakota by 2025. Additionally, XEL intends to operate both of its Monticello and Prairie Island nuclear plants through their current licensed period expire in 2030. We suspect the update around its latest IRP will feature prominently with EEI updates as the company positions around an accelerating capex profile. Following years of pressure on its consolidated EPS growth rate, we see company as increasingly in a position to capitalize on its higher growth rate trajectory. *See below for details.*
 - For the renewable resources alone, we suspect this could add ~\$1 Bn of capex (50% Self-Owned * 1.5/kW on Wind and 50% Self-Owned * 400 MW on Solar @ \$1.5/W). Ideally management would target 100% ownership, however recent RFPs have yielded 50%.
- **MN rate case filed at just 3-years.** Management filed on Nov 2 for a 3-year deal in MN rather than the full 5-years it could conceivably file for under the new legislation there, seemingly in an attempt to make it more palatable to interveners skeptical of the process. Recall while management will lock in base rates, it will have access to riders to allow for other spend-recovery (principally renewables). The plan is driven by capital investment and includes interim rates for both 2016 and 2017, with a final decision expected in 1Q2017.
 - **Can MN implement interim rates still?** OAG is pushing back of late on a further interim rate step-up in 2017; interim rates however for 2016 will continue to be implemented as expected.
 - **However, with a history of settlements,** management expects a settlement or other mediation to ultimately shorten the timeline for a final decision. The case reflects investments made in rate base and PPA wind parks, for which the legislation there should allow the company to establish a baseline for a formula approach. At a minimum, with no real issues relating to development of the wind parks, the case should prove less controversial than the latest case with the cost over-runs relating to Monticello nuclear uprate. Moreover, with its authorized ROE recently revised to 9.72%, downside risk is more limited.
- **Reduced regulatory lag – eventually – under new legislation in Minnesota.** With the bill signed into law on June 13, we estimate that its provisions will improve XEL's overall regulatory lag by roughly 30 bps (by 2018) as a result of longer plans, more formulaic rider mechanisms, recovery of O&M based on a price index, the implementation of interim rates during rate cases, the use of the nuclear depreciation surplus to smooth out revenue fluctuations and mitigate increases, and other protections. As a reminder, XEL historically experiences ~100 bps of regulatory lag overall, with ~75 bps from Minnesota, ~20 bps from SPS, and the remainder amongst the remaining jurisdictions. We

2016 guidance embeds a low-9's ROE assumption, with little improvement in regulatory lag next year.

note, however, that 2016 guidance embeds a low-9's ROE assumption, with little improvement in regulatory lag next year.

- **Texas electric rate case – no forward looking test year treatment yet.** On Dec 17, SPS received an order to reduce electric rates -\$4M based on a historic 2014 test year and a 9.7% ROE on 51% of \$1.4B ratebase. This follows the Administrative Law Judge (ALJ) recommendation in Oct for a rate increase of ~\$1.2M, based on ROE of 9.7% and an equity ratio of 53.97% on a historic test year against XEL's request of a \$42M increase based on a 10.25% ROE on \$1.56B of rate base. New rates are effective in January but retroactive to June 11, 2015. We note that the company had initially filed the case to take advantage of forward-looking test year treatment as allowed under new legislation.
- **Another Texas case to ensure forward test year recovery.** Management intends to refile for another new case in 2016 to make use primarily of the new legislation with a forward test year. Expect the real uplift from legislation to accrue in 2017 rather than 2016 (and hence not reflected in its latest EPS guidance).
- **Further background on Texas: Legislation to reduce regulatory lag in Texas was signed into law** in June 2015. While not as impactful on ROEs as the Minnesota legislation, provisions include the ability to implement temporary rates or surcharge 155 days after rate case filing date and the addition of post-test year capital additions up to 30 days before rate case filing date. New natural gas generation may be included in rate base as long as it is in service before the proposed effective rate date.
- **Increase authorized in Wisconsin electric/gas rate case.** On Dec 3, the PSCW approved an electric/gas rate increase of \$7.6M/\$4.2M, somewhat below the Oct Staff recommendation of \$10.4M/\$3M, but based on the same Staff ROE of 10% and equity ratio of 52.5%. NSP-WI's had requested a \$27M electric and \$6M gas rate increase based on a 10.2% ROE and 50.59% equity on \$1.2B electric rate base and \$114M gas rate base. New rates are effective from January 1, 2016 and are based on a 2016 test year.
- **New Mexico 2015 Electric rate case refiled; appealed to Supreme Court against NMPRC's dismissal of rate filed in June 2015.** In Oct 2015, SPS filed a new \$24.35M electric rate increase with the New Mexico Public Regulation Commission (NMPRC), which includes \$45.4M non fuel base rate increase, offset by a -\$21.1M base fuel decrease. The filing was based on a 10.25% ROE on 53.97% equity for \$734M rate base on a June 30, 2015 historic test year. Meanwhile, SPS appealed to Supreme Court against NMPRC's dismissal of previous rate filing, filed in June 2015 for a \$31.5M electric rate increase, offset by a -\$30.1M base fuel decrease. The June filing was based on a 10.25% ROE on 53.97% equity for \$777.9M rate base on a 2016 future test year. A final decision from the NMPRC is expected in 2H16.
- **Colorado gas ratecase final decision on January 27th adopted the ALJ recommendation for a \$18.1M increase.** The company's revised request includes a \$108M increase based on a 10.1% ROE on 56% equity and \$1.26B-\$1.36B ratebase. This includes a \$40.5M base rate increase for 2015 followed by \$14.6M in 2016 and another \$16.8M in 2017. XEL also requested increases for the Pipeline System Integrity Adjustment rider (PSIA) of \$14.7M in 2016 and \$21.7M in 2017. In Oct, the ALJ proposed decision was for a 9.5% ROE on

XEL has filed for a rehearing of the case and we expect a new Texas filing in 1Q16.

Timing is unclear on resolution; likely 2H 2016

Final decision in Colorado was in-line with the ALJ recommendation.

56.5% equity, rejecting the multi-year plan and recommending a historic test year with average ratebase. The ALJ also recommended a 3-year extension of the PSIA. This is marginally better than the June 24th Staff recommendation for a -\$6.3M rate decrease based on a 9% ROE and 47.04% equity and the Office of Consumer Counsel (OCC) recommendation for a \$5.8M increase based on a 9% ROE and 52.7% equity. Both staff and OCC oppose the multi-year step increases proposed by XEL for 2016 and 2017. Staff recommends continuing the PSIA rider through 2017 and OCC recommended terminating it in June 2016.

In other Colorado news, we increasingly suspect the state will move to roll back the Net Energy Metering (NEM) across its various service territories. While controversial, we suspect a new scheme could yet emerge that supports Community Solar over rooftop NEM; Colorado is increasingly emerging alongside Massachusetts as the focal point for Community Solar efforts.

- **XEL continues to advocate for utility scale solar** as more cost effective for consumers than more distributed solutions, including solar rooftop and solar gardens, which require heavy subsidization from non-participants. Most recently, Minnesota limited the size of contiguous solar gardens to 1 MW after some developers attempted to bypass the 1MW max rule with multiple contiguous facilities.

Accelerating renewables under revised resource plan

On Oct 2 XEL announced a revision to its long term resource plan, initially released in March. Relative to the initial expansion plan, the company will now accelerate acquisition of 400 MW of utility scale solar and an additional 200 MW of wind resulting in a total 400 MW of large solar and 800 MW of wind over 2018 -20. Also under the new plan, XEL will now cease operations at Sherco (Unit 2 of the coal-fired Sherburne plant) in 2023; and Sherco 1 by 2026 vs. the Sherco units operational until 2030 under the earlier plan. Notably, recovery of renewable spend could be potentially executed on a little used fuel clause rider, rather than waiting for a full rate case to enable recovery of these modest increments. We expect more on this in coming quarters closer to execution

The plan includes addition of a CC unit at Sherco which may be required for system stability, and potentially converting a Sherco Unit to use natural gas; and also a CT unit in North Dakota. We show below the capacity additions under the revised long term resource plan as well as the generation mix now and in 2030 envisioned in this plan (in the table below, XEL shows the North Dakota CT coming on line in 2023 for planning).

Figure 34: Revised Proposal Expansion Plan (MW Additions)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	Total
Large Solar	-	-	-	200	-	200	100	100	100	100	100	100	-	400	-	-	1,400
Wind	-	-	-	-	800	-	-	200	200	-	400	200	-	-	-	-	1,800
North Dakota CT	-	-	-	-	-	-	-	-	232	-	-	-	-	-	-	-	232
Sherco Gas Conversion/CT	-	-	-	-	-	-	-	-	-	-	562	-	-	-	-	-	562
Sherco CC	-	-	-	-	-	-	-	-	-	-	-	778	-	-	-	-	778
CT	-	-	-	-	-	-	-	-	-	-	-	464	-	-	-	-	464
CC	-	-	-	-	-	-	-	-	-	-	-	-	778	-	-	-	778
Total MWs	-	-	-	200	800	200	100	300	532	100	1,062	1,542	778	400	-	-	6,014

Source: Xcel Energy filing (Docket No. E002/RP-15-21)

COMPANY DESCRIPTION

[return](#) ↑

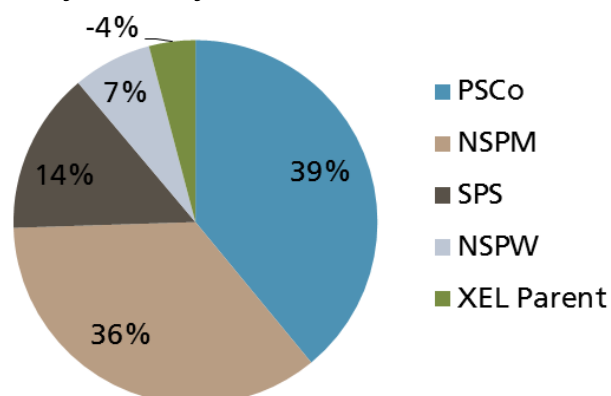
Market Cap	US\$20bn
Shares Outstanding	508m (COM)
Industry and outlook	Regulated Utility
Region	Americas
Website	http://www.xcelenergy.com/

Xcel Energy, through its regulated subsidiaries, provides energy services to 3.4 million electric customers and 1.9 million natural gas customers. Its service territory spans eight states and the company primarily operates in the West and Midwest region.

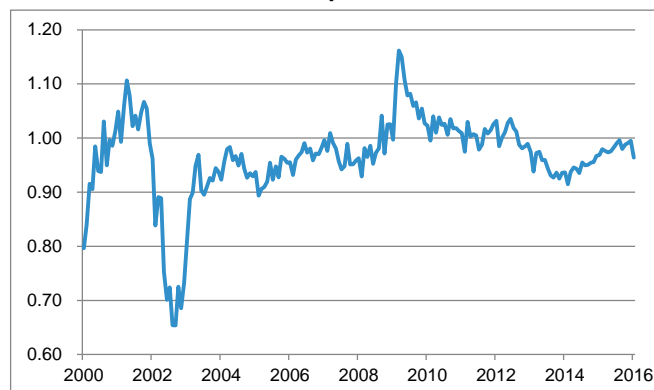
Industry outlook

The electric utility industry is projected to experience weak or negative electric demand growth in coming years as a tepid economy and energy efficiency dampen demand. In the unregulated merchant power space, we see limited potential for a meaningful recovery from currently low power prices due to limited projected demand growth, growth of subsidized renewables, and potential for only modest further retirements. At regulated utilities, we believe rising interest rates and robust valuations are a challenge to the sector, particularly as earnings growth stalls once EPA-mandated growth capex slow mid-decade. We expect cost-cutting and strategic planning to be a key theme across both regulated and competitive companies, with M&A at modest (at best) premiums designed to extract cost synergies. We believe utilities with high parent leverage will disproportionately suffer, as they are unable to recoup from rising interest rates

EPS by Subsidiary (%)



Relative Forward P/E Multiple



Forecast returns

Forecast price appreciation	-7.6%
Forecast dividend yield	3.5%
Forecast stock return	-4.1%
Market return assumption	5.8%
Forecast excess return	-9.9%

Valuation Method and Risk Statement

Price target based on SOTP. Primary risk factors impairing Xcel's regulated subsidiaries from achieving our earnings, cash flow and price target objectives include: adverse regulatory decisions by regulators in MN, ND, SD, CO, MI, WI, TX, and NM, including rate case decisions, cost of capital proceedings, or restrictions placed on the utilities by regulators on the movement of funds between the utilities and parent to meet its debt service and other financial obligations and to pay dividends on its common stock. Additional risks include interest rate and capital market risk; operational issues with the company's nuclear plants; slowdown in the regional economy; threat of municipalization; execution of capital expenditure plan; adverse market performance requiring unplanned contributions to the pension plans and other post retirement benefit plans are other significant risks, among others.

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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.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Xcel Energy Inc. ^{6, 7, 16}	XEL.N	Neutral	N/A	US\$38.98	02 Feb 2016

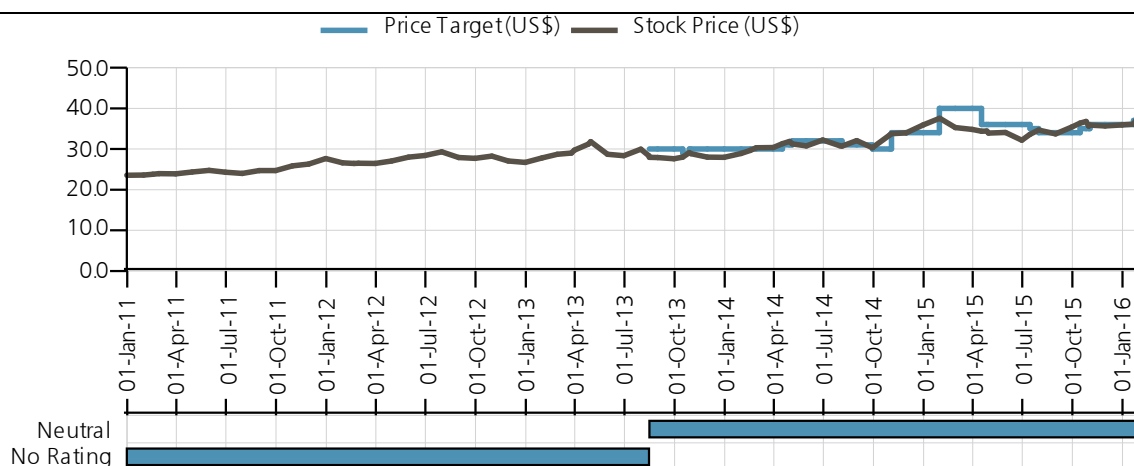
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Xcel Energy Inc. (US\$)



Source: UBS; as of 02 Feb 2016

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