UBS Global Research 11 May 2015

PPL Corporation

Adding a Jewel to the Crown

Equities

Americas
Electric Utilities

12-month rating	**Neutral**
12m price target	**US$33.00**
	Prior: US$34.00
Price	**US$33.90**

RIC: PPL.N **BBG:** PPL US

Trading data and key metrics

52-wk range	US$37.94-31.40
Market cap.	US$22.7bn
Shares o/s	669m (COM)
Free float	97%
Avg. daily volume ('000)	1,303
Avg. daily value (m)	US$44.1
Common s/h equity (12/15E)	US$14.3bn
P/BV (12/15E)	1.6x
Net debt / EBITDA (12/15E)	6.6x

EPS (UBS, diluted) (US$)

	12/15E			
	From	To	% ch	Cons.
Q1	0.71	0.77	8.60	0.77
Q2E	0.51	0.33	-35.02	0.48
Q3E	0.63	0.38	-40.08	0.56
Q4E	0.58	0.71	23.19	0.53
12/15E	2.40	2.19	-8.87	2.29
12/16E	2.28	2.24	-1.68	2.32
12/17E	2.09	2.21	5.70	2.31

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Swan song for PPL Supply as we transition to regulated-only estimates

In its last earnings call with PPL Supply we saw an overall positive update, particularly at the UK utilities but the immediate term focus will be on the Talen spin at the end of the month. We estimate that PPL's ownership of Talen is worth ~$1/sh but many investors have made the case that they are getting Talen for free. We tend to disagree with PPL trading at a 0.5x P/E premium when over half the EPS sits at the slower growth UK segment but at the very least this will ignite debates about the underlying utility values.

Outlook for UK growth improves as trading hedges today for uplift in 2017

The biggest updates were at the UK business where 2016/2017 repatriation targets were expanded and 2017 F/X hedges were added at a favorable rate. Increasing the cash payout from the UK addresses concerns about the business and firms up our valuation. Mgmt notes that if FY15 UK results stay ahead of expectations it could add up to another 20pp to its 2017E F/X hedge portfolios; the first 20% added during the quarter had a $0.02 cost, a relatively small price to pay to bolster the 2014-2017 CAGR. We continue to estimate an EPS growth closer to 3% but a recovery in the GBP to the $1.60/£ would drive us back into the LT guidance range.

Talen is CP eligible and confident in how its assets stack-up vs peers

With Talen set to begin trading in the upcoming weeks, we see the disclosure that the entire PPL Supply *and* Riverstone fleet is eligible for Capacity Performance as a key positive for the newest IPP. It appears that generators are increasingly comfortable with their fleet's ability to comply with CP—the question is how much of a premium will be reflected for taking the risk from each units. Net-net, we flag Lt Mth Bethel and Ironwood had previously been identified given gas availability concerns.

Valuation: Reduce PT $1 to $33 which includes $1 for partial TLN ownership

Our valuation is based on 2017E SOTP with $32/sh for the regulated utilities and another $1/sh for PPL's percent ownership of Talen. PPL has been particularly volatile YTD and we see no signs of that stopping as special situation investors focus more on Talen spin. We reiterate TLN will primarily trade around AEP merger expectations & PJM

Highlights (US$m)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenues	12,248	11,860	11,499	6,702	6,849	7,046	7,306	7,593
EBIT (UBS)	3,023	3,036	3,272	2,595	2,610	2,700	2,820	2,958
Net earnings (UBS)	1,417	1,591	1,629	1,470	1,521	1,506	1,542	1,588
EPS (UBS, diluted) (US$)	2.44	2.45	2.45	2.19	2.24	2.21	2.26	2.32
DPS (US$)	1.44	1.47	1.47	1.47	1.47	1.47	1.47	1.47
Net (debt) / cash	(20,128)	(21,608)	(21,857)	(21,943)	(23,081)	(24,226)	(26,131)	(27,905)

Profitability/valuation	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
EBIT margin %	24.7	25.6	28.5	38.7	38.1	38.3	38.6	39.0
ROIC (EBIT) %	10.0	9.4	9.4	7.2	7.0	6.9	6.8	6.8
EV/EBITDA (core) x	6.1	6.5	6.8	9.4	9.2	8.8	8.4	7.9
P/E (UBS, diluted) x	11.6	12.5	13.7	15.5	15.1	15.4	15.0	14.6
Equity FCF (UBS) yield %	3.9	1.4	2.4	1.9	2.0	2.3	0.1	0.9
Net dividend yield %	5.1	4.8	4.4	4.3	4.3	4.3	4.3	4.3

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$33.90 on 08 May 2015 19:38 EDT

Investment Thesis

PPL Corporation

12-month rating **Neutral**

12m price target **US$33.00**

Investment case

We believe fundamentally, PPL shares have exposure to the best UK distribution utility and solid US regulated jurisdictions, with the merchant exposure essentially upside, with minimal value ascribed in shares, given EPS break-even and a P/E driven share price. The company faces solid regulatory frameworks in all three of its jurisdictions but the lower growth profile of the UK along with weak F/X are headwinds. Our price target is derived via a business SOP analysis.

Upside scenario

Our upside case is premised on continued solid execution at its regulatory jurisdictions and realization of its merchant asset value. If ROEs on UK fast-tracked entities hold and the traditional discount applied to this segment dissipates, we believe shares could trade up to $37.

Downside scenario

Our downside case is based on lower returns in its UK business and a larger valuation discount at that segment. Further inability to earn its allowed ROEs in Kentucky or Pennsylvania could constrain shares to trade at a discount to peers seeing downside to $31.

Upcoming catalysts

May 18	When-Issued Trading of Talen (TLN)
June 1	Formal Talen Dividend Spin
November	EEI Financial Conference

Pennsylvania Rate Case Preliminary Schedule	
June	Public Hearings
July-August	Submit testimony and Hearings Held
September	Briefs and Reply Briefs Due
October	ALJ Proposed Decision (PD)
December	PUC Final Decision

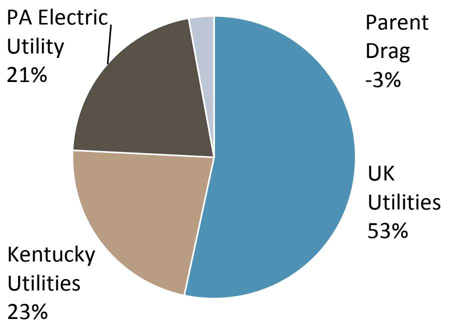
Business description

PPL Corp. has four primary business segments: Kentucky Regulated; Global Regulated; Pennsylvania Regulated; and Supply. The Kentucky Regulated segment consists of the LG&E and KU regulated utilities, which sell electricity to ~1.3m customers across KY, VA, and TN. The Global Regulated segment includes WPD, a regulated utility in the UK that serves ~7.8m customers. The Pennsylvania Regulated segment serves ~1.4m customers. The Supply segment has unregulated generation assets in PA, MT, CT, NY, IL, and ME; PPL plans to spin these assets into Talen Energy with Riverstone.

Industry outlook

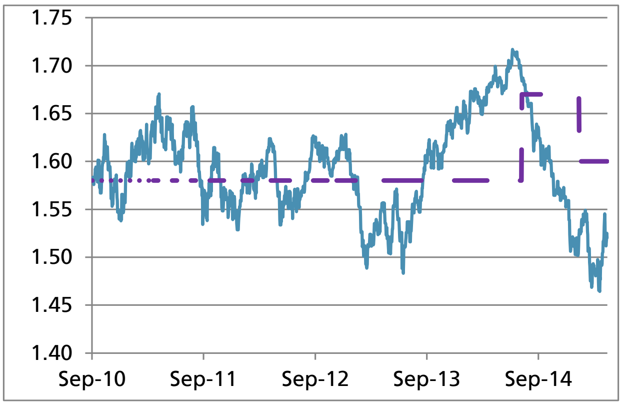
The electric utility industry is projected to experience weak or negative electric demand growth in coming years as a tepid economy and energy efficiency dampen demand. In the unregulated merchant power space, we see limited potential for a meaningful recovery from currently low power prices due to limited 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, 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 Segment (2017E %)



Source: Company Filings and UBS Estimates

GBP-to-USD Foreign Exchange Rate



Source: FactSet

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

[5/7/15 Bringing Home A UK Bounty (First Read)]
[2/6/15 Wait and See With GBP]
[12/30/14 Addressing The FX Crunch]
[11/5/14 Financial Planning To Reveal True Growth]
[10/6/14 PPL + PEG: Weighing The Merits of a Deal]
[10/1/14 Is Coal in Maryland's Future?]

Key Takeaways from PPL Corp. Earnings:

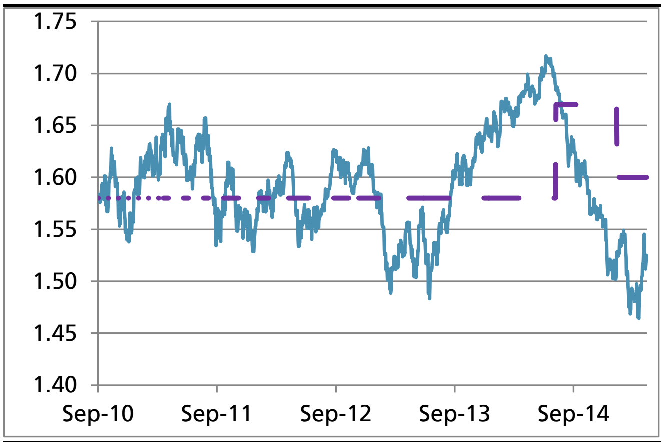
- **Two big steps forward on getting the UK business on track:** The most constructive updates for PPL centered on the much maligned UK business which (1) increased the cash repatriation guidance to $300-$500Mn range for 2016/2017, up from $260-$300Mn and (2) successfully added hedges in 2017 at $1.60/£. The UK business has been criticized for a lack of cash generation and we see the latest disclosures as addressing concerns.

Hedging update and repatriation could ease concerns around the forecasted the revenue gap in 2017/2018.

PPL restructured the UK utilities in October 2014 and created a single UK holding company structure to house its four utilities compared with a Southwest/South Wells legal entity and a separate Midlands entity. The objective was to create a stronger group entity with lower financing costs and a separate benefit is higher tax efficiency on repatriations. In conjunction with the intercompany loan structure, despite materially increasing the repatriation guidance PPL does not expect any incremental US taxes.

Cash sent back to the parent to repay the intercompany loan is largely not a taxable event.

Figure 1: USD-GBP Exchange Rate



Source: FactSet

Figure 2: PPL Hedging Profile and Sensitivities

FX Hedging			Decrease in Rate		
Year	Hedged %	FX Rate		($0.05)	($0.10)
2015	97%	1.60	2015	$0.00	$0.00
2016	72%	1.61	2015	($0.01)	($0.03)
2017	20%	1.60	2017	($0.04)	($0.07)

Repricing 2015 hedges at lower strike price was a $0.05 negative in the quarter but provided latitude for the 2017 hedging at an advantageous level.

Source: Company Filings and UBS Estimates

Our estimates are slightly higher due to the ~$0.05 increase in the exchange rate since our 1Q15 mark-to-market which more than compensates for the lower inflation rate assumption. The 2015 hedged rate dropped to $1.60 from $1.63, a $0.02 EPS negative ($22Mn) but our estimate is unchanged at $1.36 due to reduced financing costs and other expenses. As noted previously, the +$0.09 result in the first quarter did not drive a guidance revision as the first quarter still had legacy revenues. Mgmt did appear to take advantage of strength in 1Q to push out recognition of EPS to 2017, and acknowledged that it wasn't revising guidance yet given it was just 1Q results thus far.

- **...But one small step back: Lower inflation expectations:** The 2015/2016 RIIO revenues were based on a 2.6% expected inflation rate and the current RPI forecast is ~2% which has a $0.01/$0.02 gross negative impact on 2016/2017. Reduced inflation could be offset with lower expenses as well.

We assume that PPL will be able to mitigate some of the impact of the lower RPI forecast.

Figure 3: PPL UK Mini-Model using Ofgem projections from RIIO case

Net Income (£ Mn) - UK Year	**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/2020**	**2020/2021**	**2021/2023**
S-West	67	69	72	75	76	78	65
S-Wales	54	54	45	43	40	40	41
East Midlands	92	96	102	107	112	113	91
West Midlands	111	107	109	114	118	120	101
Total Net Income	**324**	**326**	**328**	**339**	**345**	**351**	**299**
Nominal RAV	9.9	10.4	11.0	11.6	12.2	12.8	13.6
PPL Guidance (Fiscal Year - affirmed 1Q15)	**10.3**	**10.9**	**11.5**	**12.2**	**12.8**		
FX Hedging							
Hedge Price	1.6	1.61	1.60	1.52	1.52	1.52	1.52
Hedge %	97%	72%	20%	0%	0%	0%	0%
Hedge Value (Excluded from Op. EPS)	*(25)*	*(21)*	*(5)*	-	-	-	-
Unadjusted Net Income ($ Mn)	**518**	**517**	**504**	**515**	**525**	**534**	**454**
Shares Outstanding	672	672	672	672	672	672	672
'Base' EPS	0.77	0.77	0.75	0.77	0.78	0.79	0.68
Real Growth of EPS		-0.2%	-2.6%	2.2%	2.0%	1.8%	-15.0%
Cumulative Inflation Factor	16.6%	19.8%	23.1%	26.5%	30.0%	33.6%	37.3%
Inflation		3%	3%	11%	14%	17%	
Cumulative Inflation ('12/'13)	86	86	84	86	87	89	76
Incremental Inflation	12	17	17	18	19	19	15
Total Inflation	86	88	91	101	114	133	134
	16.6%	17.1%	18.0%	19.6%	21.8%	25.0%	29.4%
Incremental Savings	6	6	6	6	6	7	7
US GAAP v UK GAAP	131	145	157	168	179	192	203
Incentives							
Fast-Track Award	25	25	25	25	25	25	25
Annual Performance Incentives from DPCR5	110	120	**60**	60	60	60	60
Efficiency Incentive from DPCR5	10	10	-	-	-	-	-
Total Incentives	145	155	85	85	85	85	85
Less: Corp Holding Company Interest	(27)	(27)	(27)	(27)	(27)	(27)	(27)
Adjusted NI - UK Year ($ Mn)	**885**	**906**	**821**	**847**	**883**	**924**	**856**
	2015	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Adjusted NI - US Year ($ Mn)	916	901	843	841	874	914	873
Incentive+Inflation EPS	**1.36**	**1.34**	**1.25**	**1.25**	**1.30**	**1.36**	**1.30**
EPS Growth Rate	*-1.1%*	*-1.7%*	*-6.5%*	*-0.2%*	*4.0%*	*4.5%*	*-4.5%*
Guidance (4Q14)	*1.34-1.42*	*1.31-1.42*					

Source: Company Filings, OFGEM, and UBS Estimates

What is the UK utility worth?

We are maintaining our 1x-turn discount to regulated US peers due to the lack of growth over the investment horizon. With the business able to dividend up $500Mn to the parent the implied yield is 4.3%, not dissimilar from PPL at 4.5% and 50bp higher than the average US regulated utility. For comparison, Southern Company has the lowest EPS guidance growth rate out of utilities we monitor at 3-4% and is currently yielding ~5%. Further details are available in our Valuation. The enhanced payout at the UK will reduce the reliance on the US utilities to support the dividend payment.

Figure 4: Utility Dividend Yields

Utility Sub-Sector	Avg Yield
COMPETITIVE INTEGRATED	3.8%
REGULATED INTEGRATED	3.8%
REGULATED T&D UTILITIES	3.4%

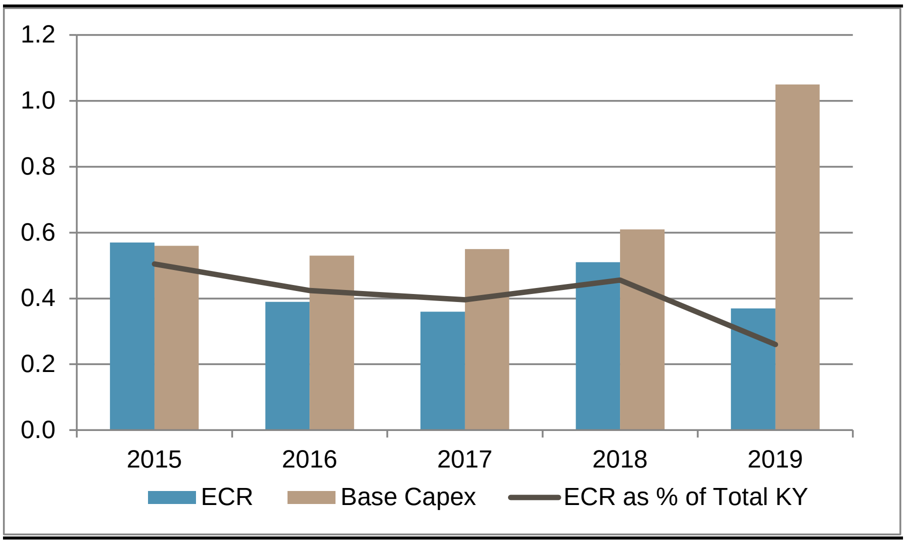
Source: Company Filings, FactSet, & UBS Estimates

- **US utilities earnings tread water in quarter as manage rate cases:** The Kentucky ($0.16) and Pennsylvania ($0.13) utilities were flat in the first quarter and the maintained segment guidance only calls for $0.01 fluctuations for each segment. Aside from earnings both jurisdictions had significant rate case activity with KY approaching the end of its case with a settlement and PA launching a new case.

- **Kentucky – Reach settlement on $132Mn increase without a set ROE:** PPL reached settlements in April for its pending Louisville Gas and Electric (LG&E) and Kentucky Utilities (KU) rate cases with $132Mn of annual revenue increases versus a $198Mn request. The settlement is silent on base ROE but PPL originally requested a 10.5% ROE. The settlement does include a 10% ROE for the Environmental Cost Recovery mechanism (ECR) and gas line trackers, an important detail as management sees the "bulk" of the capex flowing through the mechanisms. Over the next four years the ECR capex averages about $500Mn per year, or about 45% before declining to 25% of total Kentucky capex due to a combination of base increasing and environmental declining.

~Half of forecasted spending in Kentucky through 2018E will be via the Environmental Cost Recovery mechanism which has a 10% ROE.

Figure 5: Kentucky Estimated Capital Spending ($Bn except ECR %)



Source: Company Filings

Management also had requested to increase the monthly fixed charge to $18/$19 in the various jurisdictions but no changes to the fixed charges will be implemented. We estimate that the EPS is largely immaterial but the settlement reduces the ROE risk outstanding for PPL and attention can turn to the pending $167.5Mn Pennsylvania case. For 2015 rates are expected to go into effect July 1st with a half-year contribution this year, a factor contributing to the penny increase in segment guidance.

Our EPS estimates reflect a ~$0.02/sh annual EPS increase for 2016E-2018E with a penny boost in 2015 due to a half-year of rate case uplift.

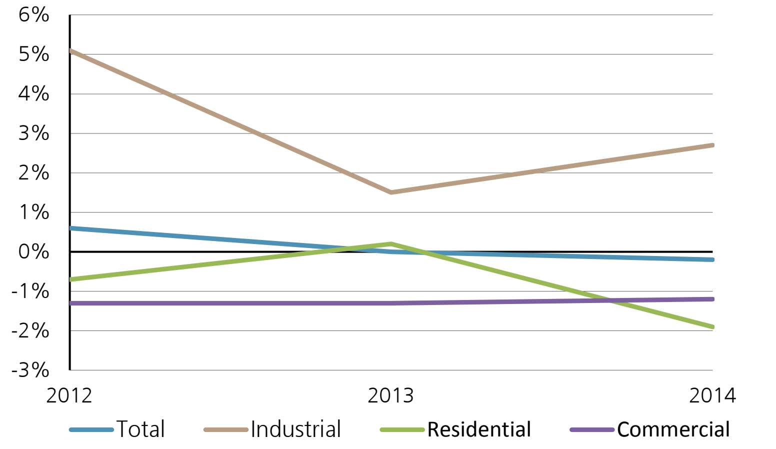
Figure 6: Pending Rate Case Settlements – No changes to fixed rates

Revenue Req.	Request	Settlement	Fixed Charge Request
Louisville Gas	30	7	To $19 from $13.50
Louisville Electric	14	-	To $18 from $10.75
Kentucky Utilities	153	125	To $18 from $10.75
Total	**198**	**132**	
Estimated EPS	*0.02*	*0.02*	

Source: Company Filings and UBS Estimates

If PPL had been successful in increasing the base fixed charges it would have been a solid positive as the jurisdiction has faced declining load growth in recent years. Industrial sales have been a bright spot but the higher margin residential sales were negative in 2012/2014 and only broke-even in 2013. The Kentucky economy remains challenged relative to other states which likely explains the opposition to increasing the fixed rate increase.

Figure 7: YoY Weather Normalized Regulated Sales Trends



Source: Company Filings

1Q15 Weather Normalized Sales:
Residential: Down 0.4%
Commercial: Down 0.5%
Industrial: Down 0.2%
Total: Down 0.5%

The negative sales trend continued in 1Q with residential down 0.4% and overall weather normalized sales declining 0.5%. Management attributes this to quarter's results to a weather normalized 'breakdown' given the extreme weather but it is consistent with the longer-term trend.

PPL reiterated its expectation of 0.5% annual load growth despite another negative print.

Turning to the Pennsylvania utility briefly, overall weather-normalized retail sales were down 1.2% during the quarter (-2% for retail) but we concur with management about attributing this to volatile weather.

- **Pennsylvania – Filing for ~11% ROE, similar to peers:** At the end of March PPL filed for a $167Mn rate increase premised on a 10.95% ROE and 51.7% equity ratio. Exelon (PECO) similarly filed for a $190Mn base rate increase with a 10.95% ROE and 53.4% equity ratio. Decisions in both cases are expected by year-end with new rates effective for the start of 2016. For PPL specifically we see testimony with hearings this summer and briefs in the Fall, although Exelon's case should follow a similar path. There are few datapoints on ROE available as the eight rate cases completed since 2013 have been settled with ROE requests between 10.90-11.25%. PPL, Exelon, and NiSource (Columbia Gas) have all requested rate increases with identical 10.95% ROEs and similar equity ratios. For context in 2014 the average authorized ROE was 9.91% according to SNL RRA and PPL received a 10.4% in its last 2012 rate case.

Figure 8: PPL Rate Case Timeline

PPL Rate Case Timeline: R-2015-2469275	
Month	**Milestone**
April	Discovery Phase Begins
June	Public Hearings
July-August	Testimony and Hearings
September	Briefs and Reply Briefs Due
October	ALJ PD
December	PUC Final Decision

Source: Company Filings

Assuming the 11% ROE holds, the rate increase we estimate the rate increase would contribute ~$0.03 of EPS growth in 2016; every 50bp change in the ROE is worth ~$0.01

Figure 9: Pending PPL and Pennsylvania Rate Cases

State	Company	Ticker	Case ID	Service	Case Type	Filing	Rate Inc. ($Mn)	Rate Inc. (%)	ROE (%)	Equity (%)	Ratebase	Action By
All PA Pending Cases												
PA	Columbia Gas	NI	D-R-2015-2468056	Gas	Distribution	03/15	46.2	8.63	11	52.21	1,325	12/15
PA	PECO Energy Co.	EXC	D-R-2015-2468981	Electric	Distribution	03/15	190.1	4.4	11	NA	4,104	12/15
PA	PPL Electric Utilities	PPL	D-R-2015-2469275	Electric	Distribution	03/15	167.5	NA	11	51.66	3,156	12/15

Source: SNL RRA

In addition to its base rate increase, Exelon has requested $274Mn under for its five-year plan (2016-2020) under the Distribution System Improvement Charge (DSIC) rider, thereby reducing regulatory lag and accelerating investment recovery. We expect the DSIC to play an increasingly large role for PA utilities with FirstEnergy evaluating whether it will utilize the rider in the future. PPL was a leader here and has ~$150-$200Mn of annual capex under the mechanism from 2015E-2019E in its forecast.

- **Traveling without a Compass:** The earnings call was silent on discussion of the $4-6Bn Compass transmission project which was announced last Summer and the last update we received was in November 2014 when management commented that its conversations with stakeholders were progressing. Assuming that project receives the greenlight it would not start construction until 2017 and would not have a material impact on the 2014-2017 growth profile. The near-term question remains whether PPL can achieve positive milestones to prove the viability of the project to investors who largely appear to avoid prescribing value to the project. If successful here, this could be the centerpiece of post-Talen earnings to support the next period of growth for the fully-regulated company.

  Incorporating the increase in capex for 'blocking-and-tackling' T&D capex (routine upgrades and smart meters) with 4Q results such as, we continue to estimate an 8% EPS CAGR.

Industry sentiment remains exceptionally skeptical of large-scale projects in PJM as demand slowdown continues to reduce the need for future reliability projects

- **New Chair takes over in PA with renewables and EE focus:** The new Democratic Governor Tom Wolf appointed Commissioner Gladys Brown as the Pennsylvania PUC Chairman with former Chairman Robert Powelson (R) serving as a Commissioner. Brown joined the PUC in late 2013 and it remains to be seen how she will influence the Commission. When appointing Brown, Governor Wolf specifically mentioned a few priority areas: Development of natural gas infrastructure, renewables, and energy efficiency.

New Democratic PUC Chair could emphasize on renewables.

Talen set to take flight later this month

PPL announced that its spinoff of PPL Supply with Riverstone's generation assets into Talen Energy Corp (TLN) via a dividend will take place on June 1st with when-issued trading on May 18th. This is consistent with our previous expectations given management's' desire to launch the new public company on the 1st of a month.

Talen Estimates: $600Mn+ in 2017E

Below we present our Talen estimates and we continue to caution that our estimates below largely reflect the original disclosures and the latest hedging data

will be a key wildcard in our estimates. On a pro-forma basis Talen appears to be the most exposed equity to PJM capacity revenues and trading could be particular volatile around the recently delayed upcoming PJM auction given the sensitivity to capacity prices.

Key question for Talen remains how it will trade? We believe shares of the spin will revolve around its ability to engage in M&A, particularly with the pending AEP GenCo sales process; given it's relatively less levered balance sheet post-spin, the company will be positioned somewhat akin to DYN post-bankruptcy with meaningful financial leverage to deployment up to a level consistent with peers. Additionally, with EFH also coming out of bankruptcy in ~2016 (timing dependent on finalization of the process), there appears at least a nominal interest in the portfolio (we emphasize a DYN deal remains much more logical ultimately).

Investors have drawn parallels to early 2014 Dynegy that traded as a function of an accretive acquisition.

We see the stand-alone outlook as particularly weak with PJM East (in PSEG and PPL zones) consistently trading at a *discount* now to PJM West prices – and see further new plant entry only exacerbating these concerns. We also see consolidation as important in order to mute likely continued concerns around asset concentration around the Susquehanna nuclear plant. Management is constructive that it has found an answer to consistent blade cracking along its lower-pressure steam turbine blades. We see a merger to gain scale in the Talen business as particularly relevant given its historic operational issues; we believe this M&A likelihood could manifest itself in the form of a premium valuation vs. the stand-alone view for a PJM portfolio.

Figure 10: Updated Talen Adjusted EBITDA Estimates

Talen Adjusted EBITDA ($Mn) UBSe	**2014E**	**2015E**	**2016E**	**2017E**
Raven	$103	$95	$84	$60
Jade	$0	-$12	-$25	-$20
Sapphire	$41	$49	$45	$37
RJS Power EBITDA	$144	$133	$104	$77
PPL Energy Supply EBITDA	$738	$660	$551	$370
Total EBITDA	$881	$794	$656	$447
Prior UBSe	*$881*	*$759*	*$736*	*$557*
Guidance (as of May 7th, 2014)		*$912*		
Services / HQ	$0	$64	$85	$101
Operating	$0	$53	$70	$83
Run-Rate Annual Synergies ($155Mn)	$0	$116	$155	$184
Adjusted EBITDA	**$881**	**$910**	**$811**	**$631**
PPL Supply Hedge Value	**$114**	**$95**	**$39**	**$0**
"Model Year" Adjusted EBITDA		$949		
Guidance (as of May 7th, 2014)		*$1,067*		
Interest Expense		($244)	($244)	($244)
Capex		($423)	($423)	($423)
FCF (pre-tax)		**$243**	**$144**	**-$36**
D&A		$586	$563	$540
EBT		$80	$4	-$153
Taxes @ 40% Rate		($32)	($2)	$61
FCF (post-tax)		**$211**	**$142**	**$25**

Source: Company Filings, Platts, and UBS Estimates

Other Talen Considerations:

Could PPL follow Dynegy's synergy playbook?

- **Removing overhead has been the name of the game in power transactions:** PPL has shied away from updating the explicit synergy target instead qualitatively discussing progress. When operating as a standalone entity we fully expect additional cost saving opportunities to be uncovered and delineation shortly after the IPO.

- **Entire Talen fleet to qualify for PJM CP – Expecting a "reasonably sized price differential":** On a previous call PPL stated that it might not commit its two gas CCGT units in PA, Ironwood and Lower Mt Bethel, alongside potential smaller gas-only CTs based upon an earlier version of the Capacity Performance (CP) rules but clarified on the 1Q15 call that all of its PPL Supply and Riverstone assets would qualify based upon the current CP standards. The only caveat is that the hydro facilities would have a de-rate. We understand the two units cited had previously been concerned around gas-supply availability rather than EFORd of the underlying units. Management appears quite confident in it the quality of its portfolio as far as EFORd is concerned and ability to ramp to meet CP requirements even on its steaming units.

  Looking at CP more broadly at the market, management anticipates some owners having difficulty predicting potential penalties on more challenged coal assets could yet bid in meaningful risk premiums – and drive up CP prices. <u>Bottom line, it's not whether assets qualify in the auction, it's about bidding strategy out in the auction, and how additional premium are (permitted to) bid.</u>

What will distinguish Talen from peer IPPs?

- **What is the growth strategy? Development and/or M&A:** PPL has previously acknowledged it had several brownfield sites it could yet opt to pursue new development in the PJM footprint. Specifically cited were the following examples of new build sites. While we remain relatively skeptical of any real efforts given its existing market position – these are worth watching.

  - <u>Bruner Island</u>: This site can also seemingly accommodate a new CCGT expansion. The focus in the near-term will remain whether the unit is converted to gas to accommodate forthcoming new NO_x regulations as well as depressed coal dark spread economics.

  - <u>Martin Creek</u>: While not clear on what kind of configuration the plant would benefit from, the economics would clearly be oriented towards brownfield structures. Despite being a steaming unit, the 1.7GW unit dispatches during critical periods at near baseload levels.

  - <u>2-3 further sites in Texas</u>: While remaining cryptic on which site it could yet seek to develop in the state, we continue to see a meaningful trend towards brownfield retrofits to meet incremental resources. Given the slew of new build announcements in recent months, we see this as low probability

- **Successfully layering in more Eastern hedges:** PPL Supply Eastern hedges increased 5% which drove a $1/MWh increase in the overall Eastern hedged price to $44/MWh. Intermediate peaking expected generation increased to 12.8GWh from 9.7GWh with 23pp life in hedges.

Figure 11: Changes in Hedging Activities

2016 Hedging Update	4Q14	1Q15
Expected Generation	45.4	45.5
East	41.6	41.6
West	3.9	3.9
Current Hedges		
East	22%	27%
West	49%	49%
Average Hedged Energy ($/MWh)		
East	$43.0	$44.0
West	$40.0	$40.0
Peaking Generation (TWh)	9.7	12.8
Hedges	9%	32%

Source: Company Filings

Updated EPS Estimates: Taking the suPPLy out of PPL

We present our updated EPS estimates below and our formal EPS estimates now exclude the core operations of PPL Energy Supply. We look forward to standalone PPL balance sheet and cash flow disclosures with 2Q15 results to refine our model and credit metrics accordingly. We remain materially below mgmt's contemplated 4-6% EPS growth rate. The question remains how to reconcile this growth rate amidst uncertainty over the UK RIIO bonus revenue outlook and parent cost structure post TLN spin. We believe cost cuts to achieve targets could yet be forthcoming given mgmt's adamant view on hitting targets.

Figure 12: Updated Regulated-Only EPS Estimates (Reg + Parent)

PPL Pro Forma EPS (UBSe)	2014A	2015E	2016E	2017E	2018E	14A-'17E CAGR
UK Utilities	1.37	1.37	1.34	1.24	1.24	-3%
Kentucky Utilities	0.47	0.48	0.50	0.53	0.55	4%
PA Electric Utility	0.40	0.43	0.48	0.50	0.52	8%
Retained Supply Corp. & Other	(0.21)	(0.10)	(0.07)	(0.07)	(0.06)	
Total	**2.03**	**2.19**	**2.24**	**2.21**	**2.26**	**3%**
Prior UBSe	***2.03***	***2.17***	***2.24***	***2.19***	***2.21***	
Guidance		***$2.05-$2.25***				

Source: Company Filings, FactSet and UBS Estimates

Valuation: Reducing Price Target $1

Our valuation is based on 2017E and the increase in our international estimates is offset by lower domestic utility estimates. Our regulated utility value is $32 which includes $1/sh for our estimate of PPL's ownership in Talen. As discussed previously, we apply a 1x-discount to the international utilities given the lack of growth and we apply a 0.5x-discount to Kentucky operations due to the stagnant load growth. The Pennsylvania utilities are ascribed a 1x-premium due to the favorable regulatory construction and above-average EPS growth. Our lower Price Target is driven by a further 0.5x contraction in the peer multiple.

Figure 13: Updated PPL Valuation – Regulated Only Approach using Just P/E multiple

PPL Sum-of-the-Parts Valuation	2017E	P/E Multiples					Enterprise Value		
	P/E	Low	Peer	Prem/ Disc.	Base	High	Low	Base	High
International (UK) Utilities	$1.24	12.9x	14.9x	-1.0x	13.9x	15.9x	$10,959	$11,809	$13,508
Domestic Regulated Utilities									
PPL Electric Utilities (PA T&D)	$0.50	14.9x	14.9x	1.0x	15.9x	16.9x	$5,103	$5,445	$5,788
PPL Kentucky (KU/LG&E)	$0.53	13.4x	14.9x	-0.5x	14.4x	15.4x	$4,821	$5,181	$5,541
Parent Interest Expense Drag	-$0.07	13.9x	14.9x	0.0x	14.9x	15.9x	($632)	($677)	($722)
PPL Equity Value							$20,251	$21,758	$24,113
Shares Outstanding (2017E Mn)							683	683	683
PPL Utility Equity Value Per Share							$30.00	$32.00	$35.00
Plus PPL Slice of Talen Energy (65%) per Share							$0.63	$1.20	$1.82
Total PPL Equity Value Per Share							$31.00	$33.00	$37.00

Source: Company Filings, FactSet, and UBS Estimates

Forecast returns

Forecast price appreciation	-2.7%
Forecast dividend yield	4.3%
Forecast stock return	+1.6%
Market return assumption	5.6%
Forecast excess return	-4.0%

Statement of Risk

Factors that could negatively impact our estimates and price target include: a negative change in demand for power in the domestic and international delivery operations, adverse political or regulatory events regarding the domestic operations or in countries where the company has operations, higher fuel costs, higher emission allowance costs, scrubber availability, natural gas/competing fuel prices within the supply business, weather, and unfavorable environmental legislation or regulation. Further risks include volatile commodity (power, natural gas, coal, and uranium) prices impacting Supply generation margins. PPL EnergyPlus, its retail marketing segment, is further exposed to volumetric, credit, and collateral-related risk of serving load-following contract (primarily) across the PJM footprint.

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Buy	FSR is > 6% above the MRA.	45%	37%
Neutral	FSR is between -6% and 6% of the MRA.	43%	33%
Sell	FSR is > 6% below the MRA.	12%	20%
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 31 March 2015.
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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
PPL Corporation[2, 4, 6a, 6b, 7, 16]	PPL.N	Neutral	N/A	US$33.90	08 May 2015

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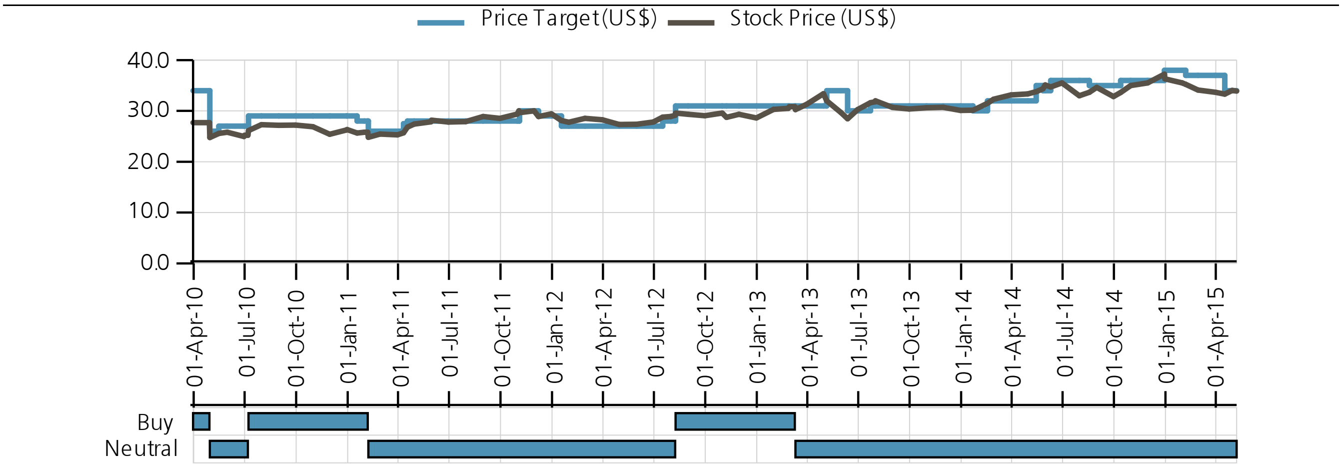

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