Industry Overview

Equity | United States | Electric Utilities
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Japan nuclear crisis impact worsening for US nuclear

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Japan nuclear situation deteriorating

The situation for Japan's Fukushima nuclear plant has deteriorated recently with reports of a containment breach in Unit 2 and exposed spent fuel rods in Unit 4.

Initial benign political reaction on nuclear getting worse

Though initial reactions from politicians continued to support nuclear power in the aftermath of the crisis, recent developments in Japan have quickly caused many to ask for safety reviews. Senators Boxer and Feinstein in California have asked the NRC chairman to conduct a thorough inspection of the 2 CA nuclear plants' safety and emergency plans. In NY, Gov. Cuomo asked for a similar review for Indian Point, and said that he does not think the units should be relicensed.

EXC reviewing plans for nuclear uprates

EXC, the largest nuclear generator, is reassessing plans to add capacity to its existing nuclear plants. EXC was planning to add an additional ~1,300MW of capacity over the next 6 years. The company expects the NRC to increase safety reviews, including looking at back-up generators and spent-fuel storage pools.

Areas to watch: relicensing, new nuclear, earthquake exposed and non-regulated nuclear

We continue to remain more watchful of the following areas: 1) relicensing of nuclear plants (ETR); 2) new nuclear delays or higher costs (SCG, SO); 3) plants in earthquake prone areas (PCG, EIX); 4) non-regulated versus regulated nuclear, with non-regulated owners having to absorb higher costs (EXC, FE).

Reiterate Underperforms on ETR, EXC and SCG

We are reiterating our U/P ratings on non-regulated nuke owners ETR and EXC. We believe ETR will face significant headwinds in its upcoming relicensings for Vermont Yankee and Indian Point. We also believe ETR and EXC will face additional costs for safety regulations at their merchant nuclear plants which they will have to absorb. In addition, while SCG is building a new regulated nuclear plant, this project represents nearly all of SCG's rate base and earnings growth over the next 5 years, and thus deserves a higher risk premium than its other regulated peers.

Regulated nuclear plants offer better protection

To the degree that costs pressures rise as a result of the Japan event, we differentiate between regulated and non-regulated nuclear plants. The regulatory framework provides a backstop and we expect recovery of mandated additional costs and in a worst case, recovery of investment if a plant is shut down. To this end, we view the reaction to the CA utilities (PCG, EIX) as overdone.

Tables 1-3 show detail of nuclear ownership

Tables 1-3 highlight nuclear ownership in the US and nuclear plants facing relicensing over the next several years.

Table 1: Nuclear and non-nuclear utilities

Non-Regulated Nuclear			
Exelon Corp.	EXC	Constellation Energy	CEG
Entergy Corp.	ETR	Dominion Resources	D
FirstEnergy	FE	PPL Corp	PPL
PSEG	PEG	NextEra Energy	NEE
NRG Energy	NRG		
Regulated Nuclear			
Edison International	EIX	SCANA Corp.	SCG
Ameren Corp.	AEE	Xcel Energy	XEL
PG&E Corp.	PCG	DTE Energy	DTE
Pinnacle West Capital	PNW	Southern Company	SO
Duke Energy	DUK	Westar Energy	WR
Progress Energy	PGN	American Electric	AEP
No Nuclear			
CMS Energy	CMS	Portland General	POR
Wisconsin Energy	WEC	Hawaiian Electric	HE
Alliant Energy	LNT	Northeast Utilities	NU
NV Energy	NVE	CenterPoint Energy	CNP
TECO Energy	TE	Consolidated Edison	ED
American Water Works	AWK	NSTAR	NST
DPL Inc.	DPL	UIL Holdings	UIL

Source: BofA Merrill Lynch Global Research

Refer to important disclosures on page 8 to 10. Analyst Certification on Page 6. Price Objective Basis/Risk on page 5. Link to Definitions on page 6.11030620

Japan nuclear crisis impact worsening

We believe there are four areas to watch:
1. Relicensing of nuclear plants
2. New nuclear delay or higher costs
3. Plants in earthquake prone areas
4. Non-regulated v. regulated nuclear

We expect the Japan nuclear crisis to continue to have ramifications for the US nuclear industry, particularly around safety and emergency plans. To this end, we remain more watchful of the following areas: 1) relicensing of nuclear plants (ETR); 2) new nuclear delays or higher costs (SCG, SO); 3) plants in earthquake prone areas (PCG, EIX); 4) non-regulated versus regulated nuclear, with non-regulated owners having to absorb higher costs (EXC).

Regulated nuclear plants better off

Regulated nuclear plants are better protected as they can get recovery of higher costs or in a worst case, shut-down

To the degree that costs pressures rise as a result of the Japan event, we differentiate between regulated and merchant nuclear plants. Regulated nuclear plants are better protected as they can get recovery of higher costs through the regulatory process. In addition, in a worst case scenario where a plant is forced to shut down, we expect recovery of book value of the plant in rate base. Conversely, merchant plants have to absorb these costs - which is particularly challenging in the current weak power market environment.

California risk is overdone

CA risk is overdone; we expect PCG and EIX to recover any increased costs

PCG and EIX have fallen by 7.7% and 6.3%, respectively on fears that their regulated nuclear plants (Diablo Canyon and San Onofre, respectively) in earthquake-prone California may be shut down or subject to increased costs. We believe this reaction is overdone as we expect PCG and EIX to be able to recover any increased costs or investment in the plant if the state or regulators mandate additional spend.

Successful recovery of costs in the past

EIX decommissioned and retired San Onofre Unit 1 in 1992 and was able to recover its costs through the CPUC. In addition, the California utilities successfully recovered their stranded costs post electric industry restructuring in the late 1990s.

Plants are not significant part of rate base

PCG's 2,240MW Diablo Canyon is ~$1.9B in rate base. On earnings, this is about $0.29/share. This earnings contribution is about 7% of long-term earnings. EIX owns 78% of the 2,150MW San Onofre plant and is $728M of rate base, with an earnings contribution of ~$0.12/share. This is about 4% of regulated earnings (SCE + parent drag). Sempra's SDG&E owns 20% of San Onofre with $175M of rate base, $0.04/sh of earnings and less than 1% of long-term earnings. While we expect PCG, EIX and SRE to recover all of its investment in the plants and any additional spend, we note that the overall impact of the plants is small compared to overall rate base and earnings.

Power market impact?

To the extent that some nuclear plants do shut down, it could help the current weak power markets

To the extent that some nuclear plants do shut down (due to regulated pressure or lack of relicensing), it could help the current weak power markets by lessening baseload supply. However, we would expect that if regulated nuclear power was shut down, it would likely be replaced by new natural gas generation.

Tables highlight nuclear ownership and plants facing relicensing

Table 2 highlights nuclear ownership by utility; for diversifieds we also give % merchant generation

Table 2 highlights nuclear ownership by utility in the United States. For diversifieds, we also distinguish between merchant and regulated nuclear generation. As we stated above, we believe regulated nuclear plants have better protection for higher costs than merchant nuclear generation.

Table 2: Nuclear Ownership by Regulateds, Diversifieds and IPPs

Regulated	Ticker	% Nuclear Capacity	% Merchant Nuclear Capacity	Nuclear (MW)	Total (MW)
PG&E Corp. (1)	PCG	33%	0%	2,240	6,799
Pinnacle West Capital	PNW	18%	0%	1,147	6,423
Duke Energy	DUK	14%	0%	5,354	37,528
Progress Energy	PGN	13%	0%	3,016	22,964
SCANA Corp.	SCG	11%	0%	650	5,898
Xcel Energy	XEL	10%	0%	1,693	17,802
DTE Energy	DTE	9%	0%	1,139	12,041
Southern Company	SO	8%	0%	3,665	44,269
Westar Energy	WR	8%	0%	559	7,046
American Electric	AEP	6%	0%	2,191	37,104
CMS Energy	CMS	0%	0%	0	7,662
Wisconsin Energy	WEC	0%	0%	0	6,224
Alliant Energy	LNT	0%	0%	0	6,116
NV Energy	NVE	0%	0%	0	6,065
TECO Energy	TE	0%	0%	0	4,762
DPL Inc.	DPL	0%	0%	0	3,965
Portland General	POR	0%	0%	0	2,714
Hawaiian Electric	HE	0%	0%	0	1,750
Northeast Utilities	NU	0%	0%	0	1,169
CenterPoint Energy	CNP	N/A	0%	NC	NC
Consolidated Edison	ED	N/A	0%	NC	NC
NSTAR	NST	N/A	0%	NC	NC
UIL Holdings	UIL	N/A	0%	NC	NC
Diversified					
Exelon Corp.	EXC	67%	100%	17,045	25,303
Entergy Corp.	ETR	33%	50%	10,219	30,657
FirstEnergy	FE	30%	100%	3,989	13,302
PSEG	PEG	23%	100%	3,662	16,215
Constellation Energy	CEG	22%	100%	1,958	9,096
Dominion Resources	D	21%	44%	5,771	27,106
PPL Corp	PPL	21%	100%	2,268	10,983
Edison Intl (1)	EIX	15%	0%	2,304	15,490
NextEra Energy	NEE	13%	47%	5,569	43,681
Ameren Corp.	AEE	7%	0%	1,240	16,889
IPP					
NRG Energy	NRG	5%	100%	1,126	23,822
Calpine	CPN	0%	0%	0	28,836
Dynegy	DYN	0%	0%	0	12,551
GenOn Energy	GEN	0%	0%	0	24,738

Source: SNL Energy; BofA Merrill Lynch Global Research
Notes: NC = No significant ownership of capacity
(1) A large percentage of generation for CA utilities is from purchased power which is not included in Total MW of generation owned

In Table 3 we highlight nuclear plants facing relicensing over the next 15 years

In Table 3 we highlight nuclear plants facing relicensing over the next 15 years. Shaded rows represent merchant nuclear plants. As shown, Entergy faces the most relicensing risk over the next few years.

Table 3: License expiration date by nuclear power plant

Unit Name	License Expiration	Gross Capacity (MW)	Primary Owner/Operator	State	Age Years
Vermont Yankee	3/21/2012	510	ETR	VT	39
Pilgrim	6/8/2012	685	ETR	NY	39
Praire Island 1	8/9/2013	551	XEL	MN	37
Indian Point 2	9/28/2013	1,020	ETR	NY	37
Kewaunnee	12/21/2013	556	D	WI	37
Praire Island 2	10/29/2014	545	XEL	MN	36
Indian Point 3	12/12/2015	1,025	ETR	NY	35
Salem Unit 1	8/13/2016	1,174	PEG/EXC	NJ	34
Crystal River Unit 3	12/3/2016	838	PGN	FL	34
Davis-Besse Unit 1	4/22/2017	893	FE	OH	34
Salem Unit 2	4/18/2020	1,130	PEG/EXC	NJ	30
Sequoyah Unit 1	9/17/2020	1,148	TVA	TN	31
Sequoyah Unit 2	9/15/2021	1,126	TVA	TN	30
San Onofre 2	2/16/2022	1,070	EIX	CA	29
LaSalle Unit 1	4/17/2022	1,118	EXC	IL	29
San Onofre 3	11/15/2022	1,080	EIX	CA	28
LaSalle Unit 1	12/16/2023	1,120	EXC	IL	27
Columbia Generation Station	12/20/2023	1,190	Energy NW	WA	27
Callaway	10/18/2024	1,236	AEE	MO	26
Limerick 1	10/26/2024	1,134	EXC	PA	26
Byron, Unit 1	10/31/2024	1,164	EXC	IL	26
Grand Gulf	11/1/2024	1,297	ETR	MS	26
Diablo Canyon 1	11/2/2024	1,151	PCG	CA	26
Waterford 3	12/18/2024	1,250	ETR	LA	26
Fermi, Unit 2	3/20/2025	1,122	DTE	MI	26
Palo Verde, Unit 1	6/1/2025	1,335	PNW	AZ	26
Diablo Canyon 2	8/26/2025	1,151	PCG	CA	26
River Bend	8/29/2025	989	ETR	LA	25

Source: NRC, BofA Merrill Lynch Global Research
Shaded rows represent merchant nuclear plants

Table 4: Companies mentioned list

BofA ML Ticker	Name of the company	Price	Q-R-Q
PCG	PG&E Corp.	42.47	A-1-7
EIX	Edison Int'l	35.49	B-2-7
ETR	Entergy Corp.	66.65	B-3-7
SO	Southern Company	36.80	A-1-7
SCG	SCANA Corp.	38.08	B-3-7
EXC	Exelon Corp.	39.95	B-3-7
FE	FirstEnergy	36.59	B-3-7
PEG	Public Service	30.32	B-1-7
NRG	NRG Energy	20.21	B-2-9

Source: BofA Merrill Lynch Global Research

Price objective basis & risk

Edison International (EIX)

Our EIX price objective is $40. We value SCE at $40/share, based on 11.75x 2013E earnings, a discount to the industry average to reflect CA regulation concerns and the pending rate case overhang. We see zero equity value at EME at current power prices even before adding environmental capex at the coal plants. For EME, in our view, the company cannot be worth negative value to EIX, but we also see a slim chance of material positive value barring a dramatic power market recovery. The downside risk for EIX is an unforeseen negative turn in California regulation. On the upside, a strong power market recovery could cause EME to be worth more than we currently expect.

Entergy (ETR)

Our price objective for ETR is $74. We use an average utility multiple of 13x 2012E utility earnings and 8x 2012E adjusted EBITDA for nuclear. Our average utility multiple represents steady regulated growth and improving jurisdictions. Our discount generation multiple results from increased risk of delays in relicensing for Vermont Yankee and Indian Point. Upside risks: 1) faster-than-expected economic recovery, 2) faster-than-expected power price recovery, and 3) better-than-expected regulatory actions.

Exelon (EXC)

Our $38 price objective is based on our sum-of-the-parts valuation, where we assume a 13x P/E multiple for our 2012 EPS estimates for EXC's regulated utility businesses. We value EXC's generation business in our sum-of-the-parts analysis using an 9x EBITDA multiple for our 2012 adjusted EBITDA estimate for the generation business, which adjusts for the company's in-the-money hedges. Our valuation also includes $1.5 billion in potential carbon value. Upside risks to our price objective and rating are a stronger- and sooner-than-expected turnaround in Midwest and MidAtlantic power prices. In addition, a more stringent and quicker implementation of potential environmental legislation would also pose an upside risk to our price objective and rating. Downside risks to our $38 EXC price objective are operational and regulatory risks. EXC's generation fleet largely consists of nuclear power plants with their operations subject to strict regulatory oversight. Any extended and unplanned outage at EXC's nuclear generation assets, either due to an operational issue or at the behest of government regulatory authorities, could pressure EXC shares.

FirstEnergy (FE)

Our $36 price objective is based on a diversified group average 2013 P/E multiple applied to our 2013 earnings estimate. The pending merger with AYE appears on track to close within the next few months assuming the remaining regulatory approvals are obtained. Downside risks to our PO are outcomes of merger regulatory approvals, execution on synergy targets, and commodity prices. Upside risks are a rebound in the economy and power prices.

NRG Energy (NRG)

Our $22 price objective is primarily based on our sum-of-the- parts valuation, which uses an 9.0x EBITDA multiple to our adjusted 2012 EBITDA estimate. Our EBITDA estimate used in our sum of-the-parts valuation adjusts downward for NRG's in the money hedges. Our valuation also adjusts for the impact of potential carbon legislation and our estimates for the company's remaining environmental spending needs. Downside risks to our PO are NRG's exposure to volatile natural gas and power prices. In addition, an earlier or more stringent-than-expected implementation of carbon or other environmental legislation currently being contemplated would be likely to negatively affect NRG shares.

PG&E Corporation (PCG)

Our $50 price objective assumes an average P/E of 12.5x 2013E earnings, in line with the regulated utility average. Risks to our outlook are: 1) approval of the settlement in the 2011 general rate case and 2) Any unforeseen changes to California regulation.

Public Service Enterprise Group Inc. (PEG)

We have a $38 price objective for PSEG. We value the utility operations at 13x 2012E earnings and PSEG Power and Energy Holdings at 9x adjusted EBITDA. For PSEG Power, we subtract the value of above-market hedges in 2012 of about $12M, but add back the NPV of these hedges going forward as cash. Finally, we add about $1.50/sh to account for the uplift in capacity values in 2013/2014 and about $1/sh to account for the potential upside of carbon legislation. We assign a 25% probability of carbon pricing at $5/ton on the nuclear long position of about 30.5 TWh. Risks to our price objective are further declines in power prices and declines in locational premiums for its generation.

SCANA Corp. (SCG)

Our $38 price objective is based on a P/E of 12x 2012E earnings of $3.19. The P/E multiple is about an 8% discount to our regulated utility average due to the new nuclear concentration risk at the company. The upside risk to our price objective is a strong economic recovery, leading to higher sales at the utility business.

Southern Company (SO)

We value SO at a premium to reflect its high quality history. Our price objective is $41 based on 15x 2012E utility earnings (a premium to the group to account for high quality) and 9x 2012E EBITDA at Southern Power. Risks are: 1) better/worse-than expected economic recovery. 2) better/worse-than expected regulatory risk. 3) execution risk for Vogtle nuclear plant and Ratcliffe IGCC plant.

Link to Definitions

Energy

Click here for definitions of commonly used terms.

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Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
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	American Water Works	AWK	AWK US	Steve Fleishman
	CenterPoint Energy, Inc.	CNP	CNP US	Steve Fleishman
	GenOn Energy, Inc.	GEN	GEN US	Ameet I. Thakkar
	NextEra Energy	NEE	NEE US	Steve Fleishman
	NV Energy	NVE	NVE US	Steve Fleishman
	PG&E Corporation	PCG	PCG US	Steve Fleishman
	Public Service Enterprise Group Inc.	PEG	PEG US	Steve Fleishman
	Southern Company	SO	SO US	Steve Fleishman

US - Electric Utilities/Competitive Power Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
	Westar Energy	WR	WR US	Steve Fleishman
	Wisconsin Energy	WEC	WEC US	Alex Kania
	Xcel Energy	XEL	XEL US	Steve Fleishman
NEUTRAL				
	Alliant Energy	LNT	LNT US	Steve Fleishman
	American Electric Power	AEP	AEP US	Steve Fleishman
	Calpine	CPN	CPN US	Ameet I. Thakkar
	CMS Energy	CMS	CMS US	Steve Fleishman
	Consolidated Edison	ED	ED US	Steve Fleishman
	Constellation Energy Group	CEG	CEG US	Ameet I. Thakkar
	Dominion Resources	D	D US	Steve Fleishman
	Duke Energy	DUK	DUK US	Steve Fleishman
	Edison International	EIX	EIX US	Steve Fleishman
	Northeast Utilities	NU	NU US	Steve Fleishman
	NRG Energy	NRG	NRG US	Ameet I. Thakkar
	NSTAR	NST	NST US	Steve Fleishman
	Pinnacle West	PNW	PNW US	Steve Fleishman
	Portland General Electric Company	POR	POR US	Steve Fleishman
	PPL Corporation	PPL	PPL US	Steve Fleishman
	TECO Energy	TE	TE US	Steve Fleishman
	UIL Holdings	UIL	UIL US	Steve Fleishman
UNDERPERFORM				
	Ameren Corp	AEE	AEE US	Steve Fleishman
	DPL Inc.	DPL	DPL US	Steve Fleishman
	DTE Energy	DTE	DTE US	Steve Fleishman
	Entergy	ETR	ETR US	Steve Fleishman
	Exelon	EXC	EXC US	Steve Fleishman
	FirstEnergy	FE	FE US	Steve Fleishman
	Hawaiian Electric Industries	HE	HE US	Steve Fleishman
	SCANA Corp.	SCG	SCG US	Steve Fleishman

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Buy	74	39.57%	Buy	30	46.15%
Neutral	56	29.95%	Neutral	33	63.46%
Sell	57	30.48%	Sell	17	33.33%

Investment Rating Distribution: Global Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2011	53.86%	Buy	874	48.31%
Neutral	925	24.77%	Neutral	444	52.30%
Sell	798	21.37%	Sell	276	36.75%

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