

Make Infrastructure Great Again

Summary

The Trump Administration and the Democrats both have big plans for upgrading and building the nations infrastructure with the bid/ask between the two at \$137 billion to \$1 trillion. The projects include all types of critical infrastructure affecting all aspects of transportation, water/waste water, and notably, electricity. At this stage, details are scant on the financial mechanisms behind these private/public partnerships. In the Power & Utility space, the Atlantic Coast Pipeline easily made the cut, which would imply a smoother approval process for its joint owners, D, DUK, and SO. Earnings accretion from this project are already included in their respective company earnings guidance.

Key Points

Event: On January 24, the Trump Administration's top 50 priority infrastructure projects were circulated, giving the public a sneak preview of the first, of many, potential projects under review to receive federal funding in the near term. The priority list contains 50 projects covering a variety of sectors including electricity & transmission, water/waterways, highways & bridges, and airport infrastructure with estimated costs of \$137.5 billion in the first year and creation of hundreds of thousands of jobs. Trump kick-started the initiative with his executive order to simplify and expedite the environmental review process for the high priority projects. Concurrently, the Democratic Party released their "Blueprint to Rebuild America's Infrastructure" illustrating a series of problems and proposed infrastructure solutions that would require \$1 trillion federal investment and the creation of over 15 million new jobs in the United States. We have condensed the electricity & transmission and water projects with brief descriptions in table format in the body of this note.

Impact:

- Generally speaking, the effort seen in both the Democratic and Republican parties is positive for the progress and completion of these projects. Although there is still some debate between parties on how these projects will be funded and what the tax credits, if any, will look like, the movement forward is constructive for those currently involved or those that could be in later stages.
- Although, Trump has promised to reduce regulations in regard to climate change impact and more focus on fossil fuel production, among the priority electricity & transmission projects, are a series of proposals developing "clean" infrastructure using Wind, Hydro and Solar generation. These projects include the Champlain Hudson Power Express, The Chokecherry

Company	Symbol	Price (1/25)	Rating		PT
			Prior	Curr	
Duke Energy	DUK	\$77.08	-	Neutral	\$80.00
Edison International	EIX	\$71.73	-	Neutral	\$75.00
First Solar, Inc.	FSLR	\$32.90	-	Neutral	\$30.00
The Southern Company	SO	\$48.49	-	Neutral	\$52.00

Source: Bloomberg and Mizuho Securities USA

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and Sierra Madre Wind Energy Project and the Plains and Eastern Electric Transmission Line. This could be, in our view, an indicator that renewable energy still has a life in the Trump administration, although it may not be as pronounced as it was in the Obama era. Grid modernization and energy storage were on this list at priority number 49, and may be viewed as a disappointment by some.

- The Atlantic Coast Pipeline appearance at priority number 20 as the only Oil & Gas sector project is very constructive for Dominion, Duke Energy (owner of Piedmont Natural Gas) and Southern Company (owner of AGL Resources) as they continue to work their way through the regulatory process and completion of the pipeline. The project has received a draft EIS statement supporting the pipeline with a final EIS due in June. Trump Administration support should help pave a smoother path towards full approvals; if granted, construction is slated to begin in late 2017.
- Finally, the water utility sector could have the opportunity to flourish under this legislation. There is significant opportunity for larger water utility companies to engage with the smaller project developers and municipalities in these projects. With proposed spending of \$110B for water & sewer system rehabilitation, utilities could contribute their resources and regulatory standing to further support these projects in the longer term construction phases.

Earnings Impact:

- Most of the projects that are already engaged in the permitting and engineering process have already baked these infrastructure projects into their earnings numbers, and therefore will not see a notable earnings impact. The companies include D (Not Rated), DUK (Neutral, \$80 PT), and SO (Neutral, \$52 PT). The key metric that could change current projections is how much federal support is given to the projects and in what form.
- The Energy Storage and Grid Modernization project, backed by the CPUC, could be constructive for PCG (Buy, \$67 PT) and EIX (Neutral, \$75) who have invested resources into incorporating these aspects into their recent rate design proposals as well as the infrastructure spending for the Electric Transportation expansion proposals filed last week.

Other:

- The Fort Mojave solar project, backed by First Solar (FSLR, Neutral, PT: \$30) and the Alaska Pipeline & LNG Project were in the original Top 50 but removed at the last minute. This suggests the two projects maintain elevated status, but perhaps not for immediate consideration.

Infrastructure Proposals

Trump Infrastructure Projects						
PROJECT	SECTOR	PRIORITY	COST/JOB ESTIMATES	STATE	COMPANY	BRIEF DESCRIPTION
Plains and Eastern Electric Transmission Lines	Electricity & Transmission	9	Cost: \$2.5 billion Jobs: 3,300 direct	OK	Clean Line Energy Partners (relationship with National Grid); Sediver; General Cable; Pelco Structural	The project consists of a 720-mile overhead direct current (DC) transmission line currently under development, that will move 4,000 megawatts of low-cost wind power from the Oklahoma Panhandle region to utilities and customers in Tennessee, Arkansas, and other markets in the Mid-South and Southeast. Project will deliver enough low-cost energy for more than 1 million homes in the region.
Project Clean Lake, Cleveland	Water	10	Cost: \$3 billion Jobs: 2,150 direct	OH	Northeast Ohio Regional Sewer District	The projects consists of construction of seven new water tunnels to provide relief to Cleveland's current water system.
South Carolina Dams Accelerated Repairs	Water	11	Cost: \$850 million Jobs: 2,200 direct	SC	US Army Corps of Engineers	Dam repairs needed as a result of heavy rains in 2015.
Cadiz Water Conveyance Project	Water	15	Cost: \$250 million Jobs: 5,900 direct	CA	Cadiz, Inc.	The Cadiz Valley Water Conservation, Recovery and Storage Project is designed to capture and conserve billions of gallons of renewable native groundwater flowing beneath the California's Mojave Desert.
TransWest Express Transmission	Electricity & Transmission	16	Cost: \$3 billion Jobs: 3,000 direct; 4,000 indirect	CA, NV, AZ	TransWest Express LLC, wholly owned affiliate of the Anschutz Corporation (private)	The TransWest Express Transmission Project will provide the transmission infrastructure and 3,000 MW of capacity to deliver approximately 20,000 GWh/yr of electric energy generated in Wyoming to the Desert Southwest region, including Arizona, Nevada and Southern California.
Chokecherry and Sierra Madre Wind Energy	Electricity & Transmission	17	Cost: \$5 billion Jobs: 1,000 direct	WY	Power Company of Wyoming LLC, wholly owned affiliate of the Anschutz Corporation (private)	Project consists of a 1,000-turbine wind farm to be located south of Sinclair and Rawlins in Carbon County, Wyoming. This will generate up to 3,000 megawatts of clean energy.
Atlantic Coast Pipeline	Oil & Gas	20	Cost: \$4.5-5 billion Jobs: 10,000 direct	VA, NC	Dominion; Duke Energy; Piedmont Natural Gas; AGL Resources (Southern Company)	The project consists of an interstate natural gas transmission pipeline that would serve multiple public utilities and their growing energy needs in Virginia and North Carolina.
Champlain Hudson Power Express	Electricity & Transmission	21	Cost: \$2.2 billion Jobs: 1,000 direct	NY	Transmission Developers Inc (Blackstone) - support of HydroQuebec	The Champlain Hudson Power Express project will bring up to 1,000 megawatts (MW) of clean, renewable power to the New York metro area. The project will run from the U.S.-Canadian border to the New York metro area.
Augustin Plains Ranch	Water	29	Cost: \$600 million Jobs: 600 direct	NM	Augustin Plains Ranch LLC	The main goal of the project is to bring water back to New Mexico through hydropower and solar energy. The project will also create a new and plentiful source of water independent of other states.
Hungtinton Beach Desalination Plant	Water	44	Cost: \$350 million Jobs: 400 direct	CA	Poseidon Water; Mesa Consolidated Water District	Project to provide a safe and reliable water supply to Orange County.
Energy Storage and Grid Modernization	Electricity & Transmission	49	Cost: Variable Jobs: Variable	National		These projects are backed primarily by the California Public Utilities Commission, with the intention of increasing grid reliability and energy storage capacity.
Fort Mojave Solar Project (a)	Electricity & Transmission			AZ	First Solar	Proposed by Tribal Solar, a wholly-owned subsidiary of First Solar. This project involves construction and operation of up to 332 MW alternating current solar PV. First Solar PV panels will be used for construction.
Alaska Pipeline & LNG Project (a)	Electricity & Transmission			AK	Alaska Gasline Development Corp. (recently dropped by ConocoPhillips Co and Exxon Mobil)	Proposed LNG terminal with three liquefaction trains.

Notes:

(a) Fort Mojave Solar Project and Alaska Pipeline & LNG Project were recently removed from the top 50 projects.

Source: Mizuho Securities USA Inc., Democratic Congressional Blueprint, McClatchy Report, Project Websites

Price Target Calculation and Key Risks

Duke Energy

We value DUK on a P/E methodology based on its core EPS of \$4.74 (ex. LatAm operations). We also triangulate our valuation using a sum of the parts methodology, P/Book, Single Stage DDM, and Yield support methodologies to arrive at our \$80 target. The relative P/E basis method is consistent with the valuation methodologies of its large-cap (>\$10.0 billion) peers. Premium valuations are ascribed for regulatory and better transparency when predicting earnings, while discounted valuations include heightened regulatory, construction, and operational/execution risks. Typically, businesses outside the core, in this case DUK's International unit, will tend to weigh more on the shares when trouble arises. This is known as the "dog wagging the tail" issue and DUK's International businesses consume a disproportionate amount of investor interest. We look at Yield support and Price to Book as indicators of future stock potential. DDM methodologies are highly dependent on underlying risk premiums, and DPS growth projections, which can swing valuations considerably and as shown below.

The key risks for DUK include regulatory risk in six states, from rate regulation to operation of coal and nuclear units. Environmental regulation remains omnipresent and DUK's February 2014 coal ash spill at the Dan River facility has heightened regulatory risk around the company. DUK is active in building a renewables business and has done a good job doing so – nearly 2,000MW of owned and/or equity interest in both wind and solar. building regulatory General economic conditions, changes in state and/or Federal regulation, environmental compliance, execution risk with new plant builds, weather, ongoing business operational risk, broader macroeconomic conditions, and interest rate movements are among the key risks to our rating and expected stock performance.

Edison International

Our 12-month \$75 per share price target for EIX is primarily based on a relative P/E basis and we adjust our multiples accordingly based on the inherent growth and risk profile. We look at single-stage and two-stage dividend discount models for valuation triangulation purposes. A two-stage model may be a tough argument given the call by TURN. A sum of the parts analysis is problematic given the integrated model and lack of desire to spin out the FERC-regulated transmission business.

General economic conditions, changes in state and/or Federal regulation, environmental compliance, execution risk with new plant builds, weather, ongoing business operational risk, broader macroeconomic conditions, and interest rate movements are among the key risks to our rating and expected stock performance.

First Solar, Inc.

Our \$30 per share, 12-month price target for Neutral rated FSLR is derived as the arithmetic mean of three valuation methodologies, EV/Sales, EV/Book, and P/E Multiple.

Key Risks The key risks include uncertainty regarding incentive mechanisms in the key markets; macroeconomic conditions driving power demand growth; access to capital markets; changes in environmental regulation; changes in state and/or Federal regulation; customer concentration; technology associated with competing PV products; legal, regulatory, and supply side risks with using Cadmium (a highly toxic compound); falling poly prices or PV modules pricing, among other things.

The Southern Company

Our \$52 price target is calculated using the group average multiple on our 2018E. We utilize group multiples for the various components when we triangulate valuation using sum of the parts, DDM, DCF analysis. Execution risk with the development of two large generating facilities is a key risk, as are potential changes in environmental compliance and regulation both the Federal and state levels. The moves in underlying Treasury securities is statistically significant with movement in utility share prices.

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RS:	Rating Suspended - rating and price objective temporarily suspended.
NR:	No Rating - not covered, and therefore not assigned a rating.

Rating Distribution

(As of 1/25)	% of coverage	IB service past 12 mo
Buy (Buy)	45.55%	42.19%
Hold (Neutral)	51.25%	37.50%
Sell (Underperform)	3.20%	44.44%

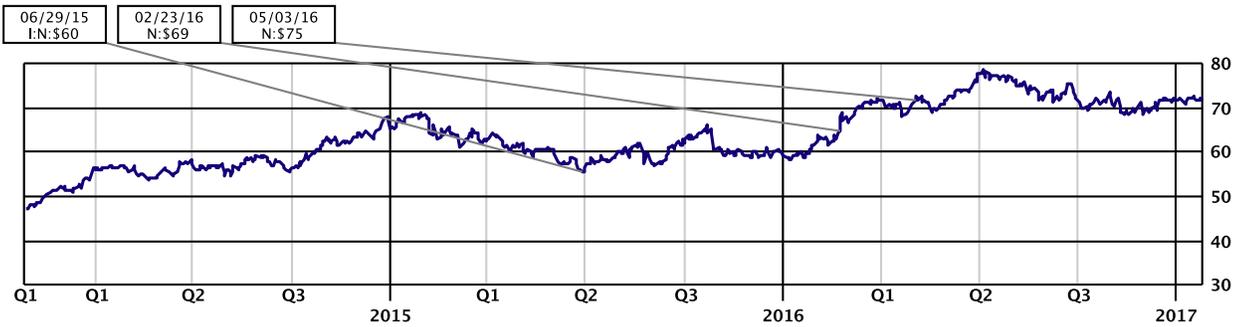
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Rating and Price Target History for: Duke Energy (DUK) as of 01-25-2017



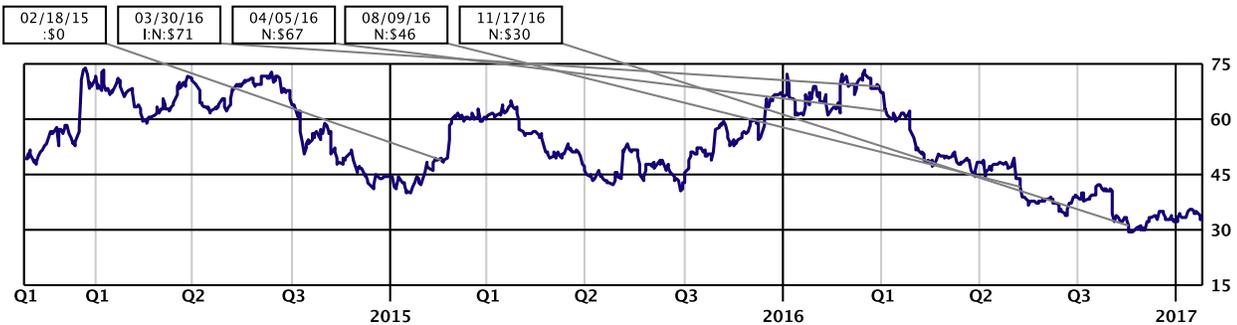
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Rating and Price Target History for: First Solar, Inc. (FSLR) as of 01-25-2017



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