

Equity Research

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FARGO

Price Target Change — November 6, 2023

Independent Power Producers

Constellation Energy Corporation (CEG)

CEG: Another Beat & Raise Ups Expectations — Reiterate OW

Our Call

How long will the good times last? CEG raised '23 EBITDA by over 10% as marketing margins continue to be robust. Per mgmt., healthy margins could persist into '25. We take up our estimates and increase our DCF PT to \$140 (vs. \$125). Reiterate OW.

Another Good Update. CEG increased '23 EBITDA guidance to \$3.8-4.0B vs. \$3.3-3.7B prior. The strong results are primarily driven by better-than-anticipated retail and wholesale marketing margins as these businesses continue to benefit from high prices & volatility. Mgmt. indicated recent auction results and C&I contracts support healthy margins into '25 (relative to historical margins of \$2-4/MWh). Notably, '24 gross margin guidance of \$9.45B does not contemplate a sustained level of volatility.

Sustainable Margins? After living through a decade+ of low power prices and little volatility, we are hesitant to assume that marketing margins will stay at these elevated levels. That said, CEG may be able to extract additional value for the company's product offerings given the growing appeal of carbon-free solutions. While this trend remains in the early stages, CEG has had some early success with zero-carbon hourly matching agreements with MSFT and EXC.

EBITDA Outlook. We increase our 23-25E EBITDA to/from \$3,900M/\$3,500M, \$4,250M/\$3,900M & \$4,450/\$4,145M. Our estimates include the recently acquired South Texas Project (STP), which is expected to contribute ~\$190M to EBITDA in '24. We continue to think that CEG has a path toward \$5B+ of EBITDA by '30 driven by additional organic growth opportunities (uprates, hydrogen), potential add'l nuclear asset acquisitions, opportunities to enhance retail margins and PTC inflation.

Raising the Bar. We attribute CEG's strong YTD performance (+45% vs. -10% for the S&P Utes) to materially exceeding EBITDA expectations (a revised '23 guidance midpoint of \$3.9B vs. ~\$3.1B originally). While we continue to think there is share price upside, we are increasingly focused on CEG's ability to sustain annual EBITDA of \$4B+, which will likely require successful execution on retail margin enhancement strategies and other growth initiatives. Bottom line: the bar has been set higher.

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Rating	Overweight
Ticker	CEG
Price Target/Prior:	\$140.00/\$125.00
Upside/(Downside) to Target	12.2%
Price (11/06/2023)	\$124.73
52 Week Range	\$71.16 - 118.67
Shares Outstanding	321,591,672
Market Cap (MM)	\$40,112
Enterprise Value (MM)	\$47,732
Average Daily Volume	2,530,324
Average Daily Value (MM)	\$316
Dividend (NTM)	\$0.00
Dividend Yield	0.0%
Net Debt (MM) - last reported	\$7,620
ROIC - Current year est.	NA
3 Yr EPS CAGR from current year (unless otherwise noted)	(344)%

\$	2022A	2023E	2023E	2024E	2024E
EBITDA (MM)		Curr.	Prior	Curr.	Prior
Q1 (Mar)	866.0 A	658.0 A	NC	-	NC
Q2 (Jun)	603.0 A	1.03B A	NC	-	NC
Q3 (Sep)	592.0 A	1.20B A	1,000.0E	-	NC
Q4 (Dec)	605.0 A	1.01B E	811.0E	-	NC
FY	2.67B A	3.90B E	3.50B E	4.25B E	3.90B E
EV/EBITDA	17.9x	12.2x		11.2x	

3 Yr EPS CAGR from current year (unless otherwise noted): Base year is 2022 Source: Company Data, Wells Fargo Securities estimates, and Refinitiv.
NA = Not Available, Volatility = Historical trading volatility

All estimates/forecasts are as of 11/6/2023 unless otherwise stated. 11/6/2023 18:45:30EST. Please see page 6 for rating definitions, important disclosures and required analyst certifications.

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Wells Fargo Express Takeaways

Constellation Energy Corporation (CEG) | Rating: Overweight | Price Target: \$140.00

Analyst: Neil Kalton

Financials

FY (Dec)	2022A	2023E	2024E
\$			
ESTIMATES			
EBITDA (MM)			
Q1	866.0 A	658.0 A	-
Q2	603.0 A	1,038 A	-
Q3	592.0 A	1,208 A	-
Q4	605.0 A	1,018 E	-
AN	2,678 A	3,908 E	4,258 E
EPS	(0.49) A	5.68 E	6.40 E
EBIT (MM)	495.0 A	2,682.3 E	2,960.2 E
Rev. (MM)	24,440.0 A	9,896.1 E	10,515.5 E
DPS	0.56 A	1.13 E	1.24 E

WELLS FARGO vs. CONSENSUS

Consensus Estimate	2,667.00 A	3,581.51 E	4,031.53 E
Difference from Consensus		8.9%	5.4%

VALUATION

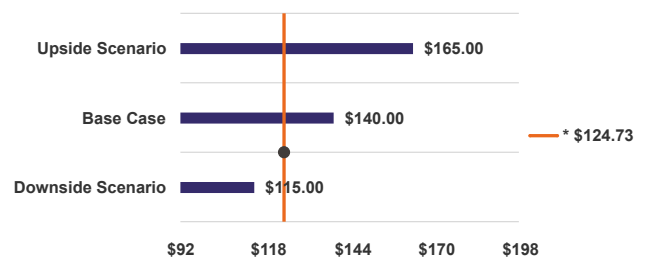
EV/EBITDA	17.9x	12.2x	11.2x
P/E	NM	22.0x	19.5x
EV/EBIT	96.4x	17.8x	16.1x
EV/Revenue	2.0x	4.8x	4.5x

Consensus Estimate: Consensus EBITDA estimate; Source: FactSet
Source: Company Data, Wells Fargo Securities estimates, and Refinitiv.
NA = Not Available, NE = No Estimate

Investment Thesis

In our view, CEG is uniquely positioned to capitalize on the long-term trend toward decarbonization. We consider nuclear to be an important part of the nation's future power generation mix, as the country trends toward net zero carbon by 2050. We have also been encouraged by growing policy support, as evidenced by the federal PTC along with subsidy regimes in several states (IL, NJ, and NY). We do not think CEG's share price adequately reflects the potential long-term value of the nuclear fleet.

Risk vs. Reward – Upside/Downside Price Target Scenarios



*As of 11/06/23
Source: Wells Fargo Securities, LLC estimates and Refinitiv.

Base Case | \$140.00

Our \$140/sh forward price target is based on a DCF analysis and results in a EV/ EBITDA multiple of 12X our 24E EBITDA of ~\$4.3B. Key assumptions include: (1) 80-yr nuclear asset lives, (2) long-term FCF power at the minimum PTC level with 2% annual escalation, (3) a WACC of ~7% including an 8% cost of equity, (4) no use of excess cash other than stated organic growth investment ('23-25) and (5) contingency capex of \$2B in '30, '40 & '50 to reflect unexpected major repair needs.

Upside Scenario | \$165.00

Our upside price target is \$165/sh. Changes to our base case include higher annual sustainable FCFF post '30 (+\$350M), PTC annual escalation of 2.5% and \$1B of contingency capex in '30, '40 & '50.

Downside Scenario | \$115.00

Our downside price target is \$115/sh. Changes to our base case include lower annual sustainable FCFF post '30 (-\$400M), \$13B of contingency capex in '30, '40 & '50 and a modestly higher WACC (7.0% vs. 6.8%) reflecting a higher assumed cost of equity (8.3% vs. 8.0%).

Upcoming Catalysts

Initial '24 earnings guidance and other updated financial disclosures (early '24)

Clarity from the U.S. Treasury on qualifying for hydrogen PTC.

Company Description

Constellation Energy is headquartered in Baltimore, MD. The company is the largest nuclear owner in the U.S. (22 GW). In addition, the company's retail marketing operations provide ~215 TWh of power to commercial & industrial customers throughout the Midwest, Northeast, Mid-Atlantic & Texas.

Acronyms

C&I - Commercial & Industrial

PTC - Production Tax Credit

Financials

CEG Earnings Model									
(\$ millions except per share data)									
	2022	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Revenues	\$24,440	\$9,896	\$10,515	\$10,775	\$10,248	\$10,763	\$11,330	\$11,745	\$11,842
Expenses									
Purchased Power & Fuel	17,462	695	742	738	754	770	786	803	819
Other O&M	4,841	4,935	5,080	5,129	5,221	5,315	5,411	5,509	5,603
Depreciation & Amortization	1,091	1,185	1,256	1,298	1,337	1,347	1,358	1,370	1,384
Other	551	400	477	491	506	521	537	553	570
Total Expenses	\$23,945	\$7,214	\$7,555	\$7,656	\$7,818	\$7,953	\$8,092	\$8,236	\$8,377
EBIT	\$495	\$2,682	\$2,960	\$3,119	\$2,430	\$2,811	\$3,238	\$3,509	\$3,466
EBITDA	\$1,586	\$3,867	\$4,216	\$4,417	\$3,767	\$4,158	\$4,596	\$4,879	\$4,850
Adjusted EBITDA	\$2,667	\$3,900	\$4,250	\$4,450	\$3,800	\$4,295	\$4,800	\$5,084	\$5,054
Other Income	(786)	0	0	0	0	0	0	0	0
Interest Expense	(251)	(266)	(327)	(329)	(332)	(371)	(398)	(452)	(507)
Income Taxes	(388)	604	658	697	524	610	710	764	740
Tax Rate	70%	25%	25%	25%	25%	25%	25%	25%	25%
Earnings									
Income from Continuing Operations	\$495	\$2,682	\$2,960	\$3,119	\$2,430	\$2,811	\$3,238	\$3,509	\$3,466
Nonrecurring	0	0	0	0	0	0	0	0	0
Adjustment for Non-Controlling Interest	(7)	0	0	0	0	0	0	0	0
Net Income	(\$167)	\$1,837	\$2,000	\$2,117	\$1,598	\$1,933	\$2,283	\$2,446	\$2,372
Avg. Diluted Shares Outstanding	328	323	312	299	286	272	257	240	223
EPS	(\$0.49)	\$5.68	\$6.40	\$7.06	\$5.56	\$7.07	\$8.85	\$10.16	\$10.57
Non-Recurring	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Ongoing EPS	(\$0.49)	\$5.68	\$6.40	\$7.06	\$5.56	\$7.07	\$8.85	\$10.16	\$10.57
Q1 EBITDA	866	658A							
Q2 EBITDA	603	1031A							
Q3 EBITDA	592	1199A							
Q4 EBITDA	605	1,012							

CEG Supplemental Information									
	2022	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Dividend Information									
Dividends Per Share - YE Rate	(\$0.56)	(\$1.13)	(\$1.24)	(\$1.36)	(\$1.50)	(\$1.65)	(\$1.82)	(\$2.00)	(\$2.20)
Dividends Paid Per Share	(0.56)	(1.11)	(1.22)	(1.33)	(1.47)	(1.60)	(1.77)	(1.91)	(2.14)
Payout Ratio	116%	20%	19%	19%	26%	23%	20%	19%	20%
Cash Flow & Balance Sheet Items									
Capital Expenditures (millions)	\$0	(\$2,675)	(\$2,540)	(\$2,515)	(\$1,640)	(\$1,689)	(\$1,740)	(\$1,792)	(\$1,846)
Book ROE	-1.5%	16.0%	17.2%	18.7%	14.9%	20.9%	26.6%	40.2%	43.4%
FFO/Debt	0%	65%	62%	63%	54%	53%	59%	50%	51%
Debt/EBITDA	3.3x	2.0x	1.8x	1.7x	1.9x	1.9x	1.7x	2.0x	2.0x
Common Equity as % of Total Capitalization	66%	60%	61%	60%	60%	53%	52%	38%	36%

Source: Wells Fargo Securities, LLC estimates and company filings

Investment Thesis, Valuation and Risks

Constellation Energy Corporation (CEG)

Investment Thesis

In our view, CEG is uniquely positioned to capitalize on the long-term trend toward decarbonization. We consider nuclear to be an important part of the nation's future power generation mix, as the country trends toward net zero carbon by 2050. We have also been encouraged by growing policy support, as evidenced by the federal PTC along with subsidy regimes in several states (IL, NJ, and NY). We do not think CEG's share price adequately reflects the potential long-term value of the nuclear fleet.

Target Price Valuation for CEG: \$140.00 from \$125.00

Our \$140/sh forward price target is based on a DCF analysis and results in a EV/EBITDA multiple of 12X our 24E EBITDA of ~\$4.3B. Key assumptions include: (1) 80-yr nuclear asset lives, (2) long-term FCF power at the minimum PTC level with 2% annual escalation, (3) a WACC of ~7% including an 8% cost of equity, (4) no use of excess cash other than stated organic growth investment ('23-25) and (5) contingency capex of \$2B in '30, '40 & '50 to reflect unexpected major repair needs.

Risks to Our Price Target and Rating for CEG

Key risks include poor capital allocation decisions, lack of policy support beyond the 2032 expiration of the federal PTC, operational issues at one or more nuclear facilities along with potential retail marketing risks related to hedging activities.

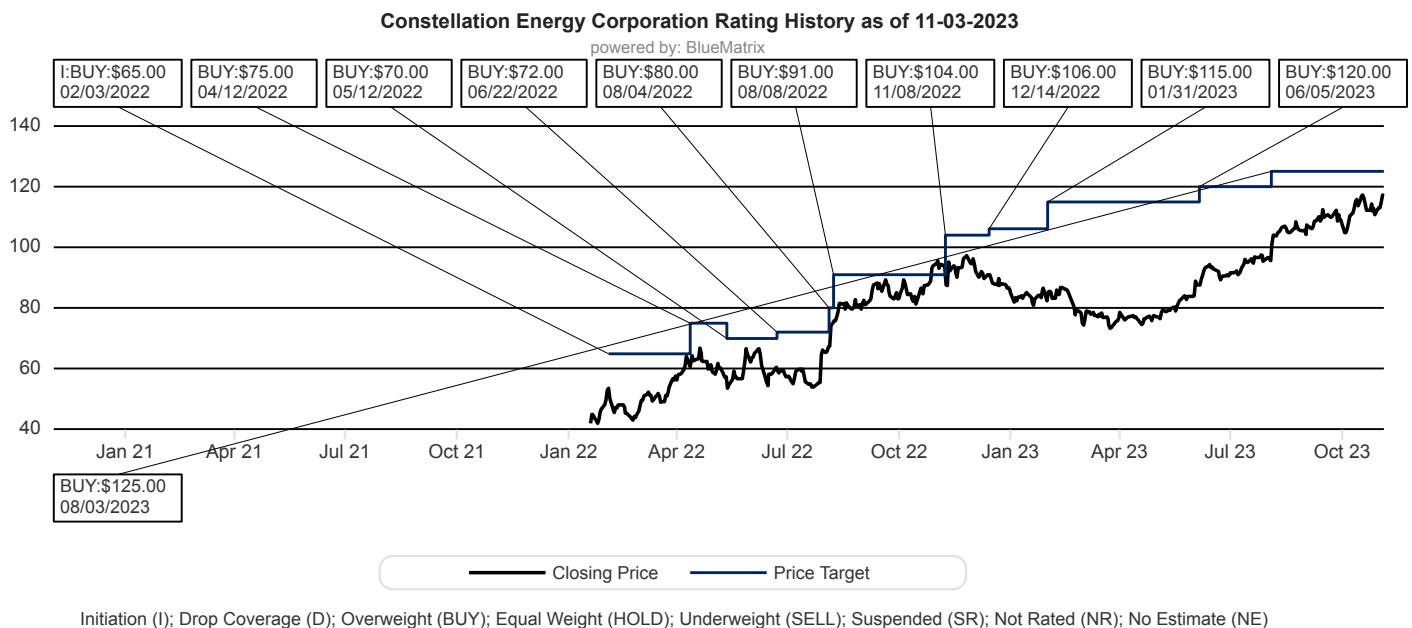
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