Chartered Financial Analyst Equity Research Challenge:

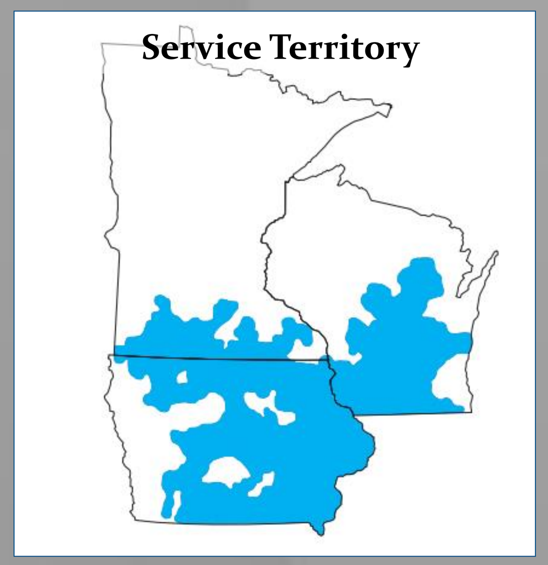
A Valuation of Alliant Energy

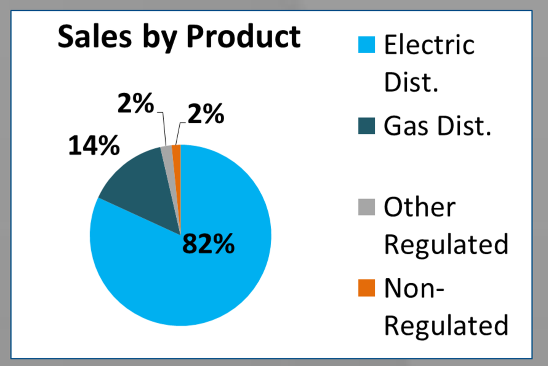
Hunter Sandidge, Sebastian Jacinto, Bryan Feraric, Bruno Siliceo

Department of Finance, Carthage College

Celebration of Scholars 2015: Exposition of Student & Faculty Research, Scholarship & Creativity

Summary Statistics		
Alliant Ticker (NYSE)		LNT
LNT Closing Price (1/1/2015)	$	68.34
Target Price	$	64.19
Difference	$	(4.15)
Percent Difference		-6.04%
LNT FY14 Return		29%
Utilities Industry FY14 Return		23.5%
10-Yr Utilities Average Return		11%
Recommendation		**SELL**





DuPont Analysis	2011	2012	2013	2014
Asset Turnover (x)	0.33	0.29	0.29	0.28
Profit Margin	0.09	0.10	0.11	0.11
Return on Assets	3.1%	3.0%	3.2%	3.1%
Equity Multiplier	3.01	3.23	3.19	3.30
Return on Equity	**9%**	**10%**	**10%**	**10%**

WACC Calculation	
Cost of Common Equity	
Risk-Free Rate	1.29%
Expected Market Return	7.75%
Beta	0.53
Cost of Common Equity	**4.74%**
Cost of Debt	
Expected Cost of Debt	4.82%
Effective Tax Rate	12.79%
After-Tax Cost of Debt	**4.20%**
Cost of Preferred Equity	
Expected Cost of P. Equity	5.10%
Cost of Preferred Equity	**5.10%**
Weighted Average Cost of Capital	
Common Equity	4.74%
Debt	4.20%
Preferred Equity	5.10%
Weighted Cost of Capital	**4.58%**

❖ Project Scope

The CFA Institute assigned our team Alliant Energy (LNT), an investor-owned utility-holding company headquartered in Madison, Wisconsin, to analyze. The company provides regulated electricity and natural gas services to residential, commercial, and industrial customers in Iowa, Southern Minnesota, and Southern and Central Wisconsin. The primary goal of our research was to determine the price at which LNT should be trading based on both exogenous and endogenous factors. At the date we concluded our research (1/15/2015), LNT was trading at $68.32. The following content are excerpts from our 30 page analysis.

❖ Sell Recommendation

Although our financial analysis indicates that LNT is in healthy financial condition due to favorable regulatory treatment and its natural monopolistic power, we believe the stock to be overvalued due to external market forces. LNT tracks the performance of the investor-owned utilities industry with a .88 correlation. This industry yielded a 27.4% dividend-adjusted return for FY14, 12.5% over its 10-year historic average. The sector outperformed the S&P500 by ~12%. We believe global contractions and instability, investment spending trends, and expectations on interest rates increased demand for the regulated and stable nature of the sector. Additionally, the dividend-paying nature of this sector made it more attractive in a low-interest rate environment. We feel that these factors are causing a price premium in the sector. As these exogenous factors stabilize over FY15, the price premium LNT's stock is currently trading at is expected to dissipate. We expect the stock to depreciate by 6.04% (DCF model), with a minimum price decrease of 3.67% (EVA model) and a maximum decrease of 11.28% (P/E model).

❖ Limited Potential

LNT is subject to a regulatory-imposed return on equity (ROE) cap. The allowed ROE cap for the industry has been gradually decreasing over the past 15 years and is expected to continue declining. With current equity levels, this cap prevents EPS from exceeding $3.80, stunting earnings growth potential. Conversely, due to the nature of LNT's business, it is against the public's best interest to allow the firm to earn below its breakeven point. Therefore, a regulatory safety net ensures an EPS no less than $0.

❖ Low Interest Rates Cause Migration to Dividends

LNT is a strong, blue-chip stock for dividend-seeking investors. Historically, LNT has held a payout ratio of 60%, consistent with the industry average. The ratio has been steadily increasing and is expected to reach 69% within the next five years. With the Fed holding interest rates a near-zero levels, dividend-yielding companies, especially within the utilities sector, have become an attractive option for investors. The resultant low opportunity cost of investing in blue-chip stocks caused an additional migration of investors to LNT, boosting the price premium. We believe this price premium will dissipate as interest rates are anticipated to increase within the next year.

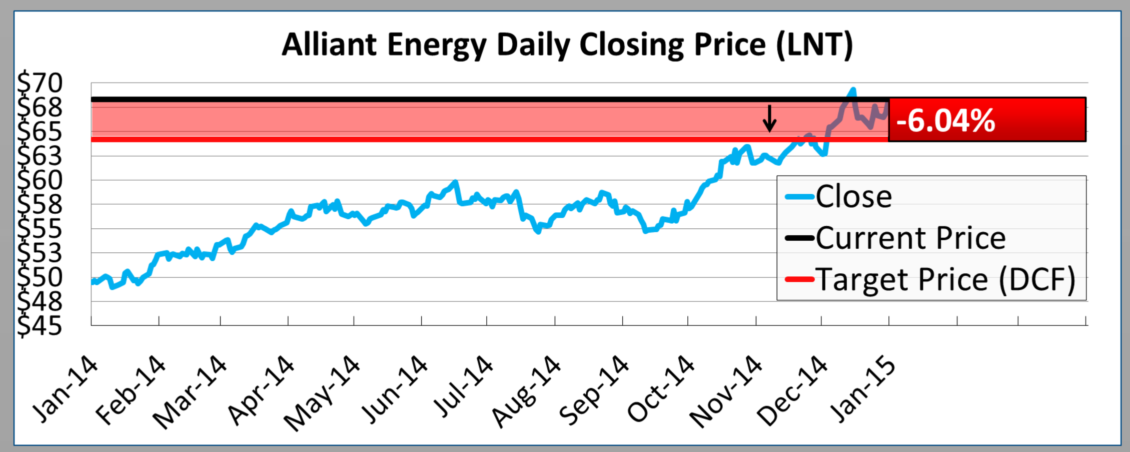
❖ Utility Industry and Momentum Effect

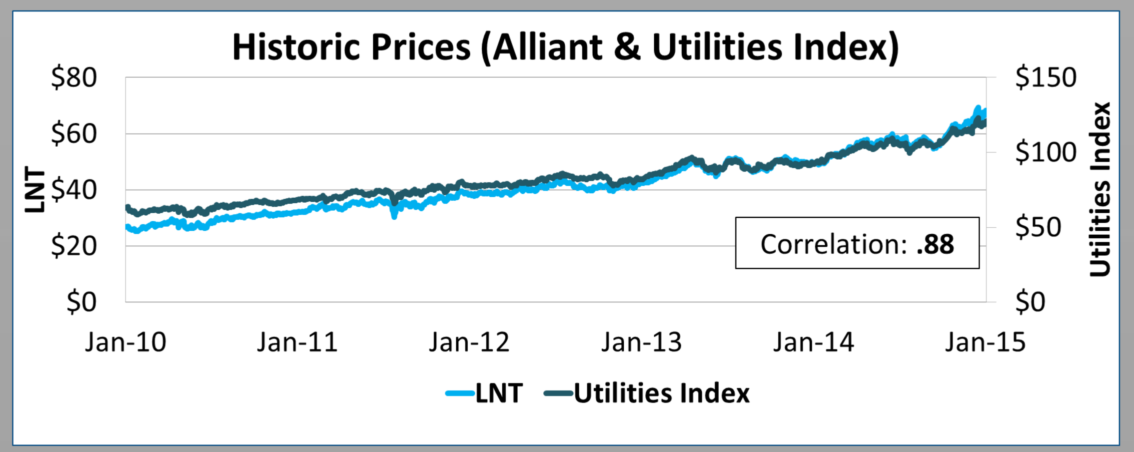
The US utilities industry is currently overvalued due to economic market forces resulting in a short-term price premium. As natural monopolies, utility companies are heavily regulated, protected, and pay high dividends, thus making the industry appreciate in times of economic contraction and volatility as investors flee to less-risky investments. Current economic conditions have given rise to a momentum effect, in which individual companies within the sector increase in value due to the nature of their industry, resulting in a capital gains growth of 11% in FY13 and 23% in FY14 for the sector as a whole.

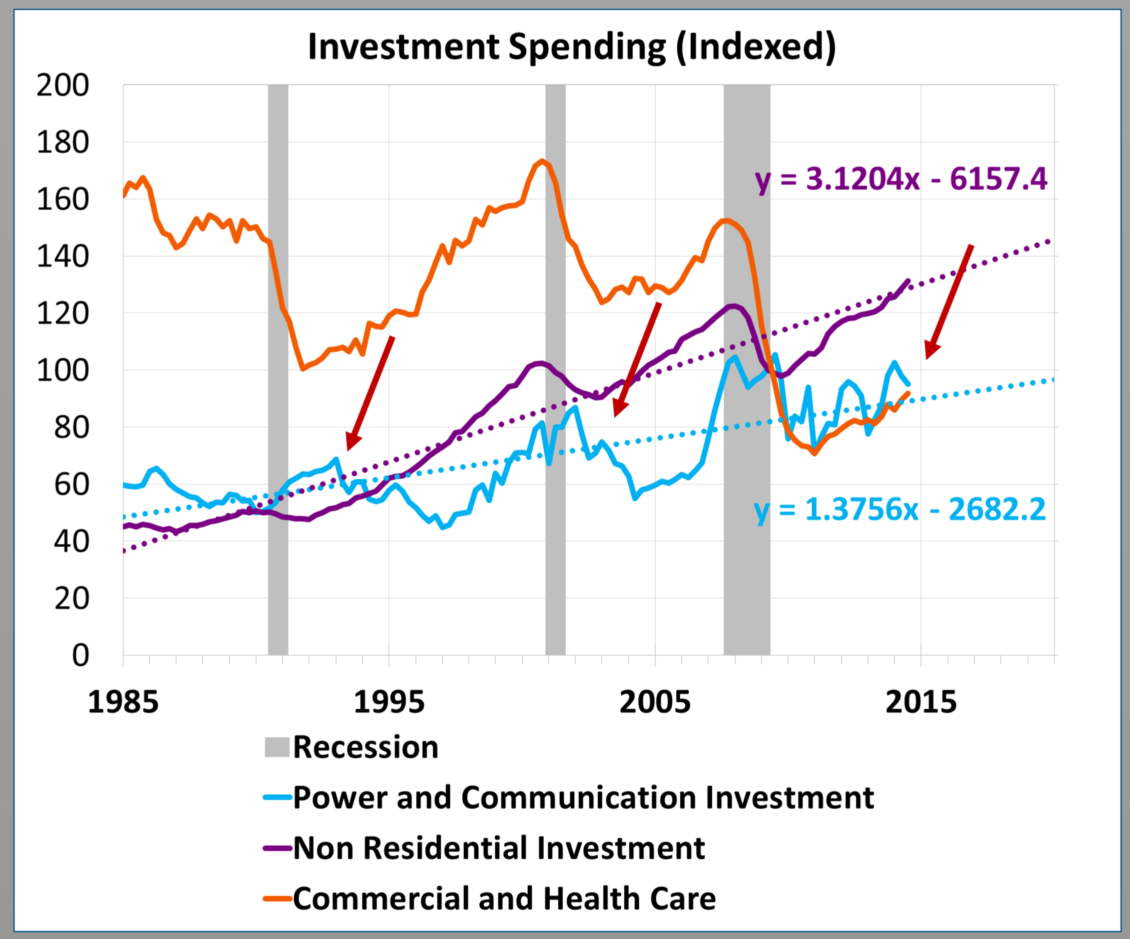
❖ Valuation Models

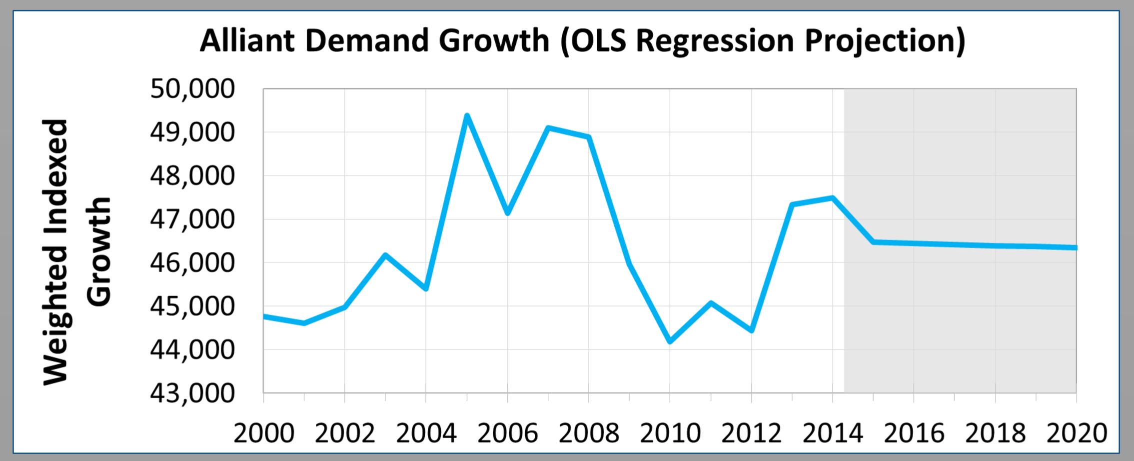
We utilized a two-stage discounted cash flow (DCF) model to generate our target price per common share. This model presupposes expected future free cash generated from operations, after adjusting earnings for noncash related gains/losses, expenses, and debt, to establish the value of a firm. In the first stage of the model, we forecasted five years of pro-forma financials and discounted each expected cash flow by the firm's weighted-average cost of capital and a factor of time. In the second stage, we assumed a constant long-run growth rate to establish a projected terminal value.

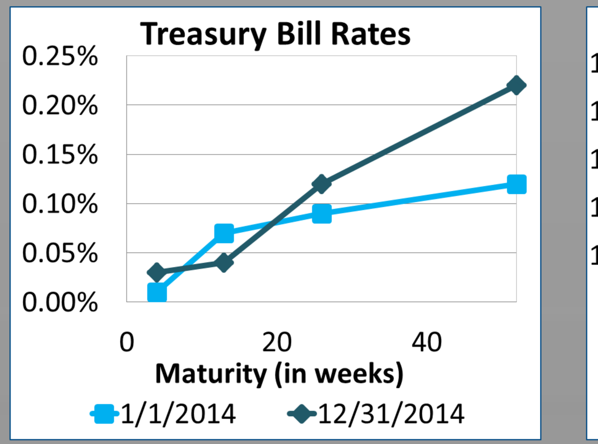
Additionally, we utilized an Economic Value Added, Price to Earnings NTM Multiplier, Enterprise Value over Earnings Before Interest , Tax, Depreciation, and Amortization Multiplier, and Monte Carlo Simulation models to build a range of prices to reaffirm our DCF valuation.

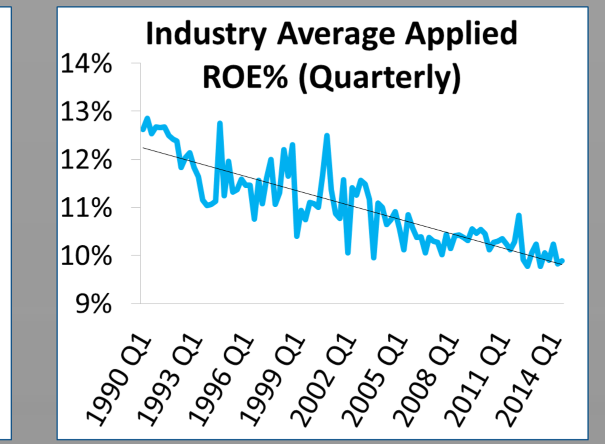






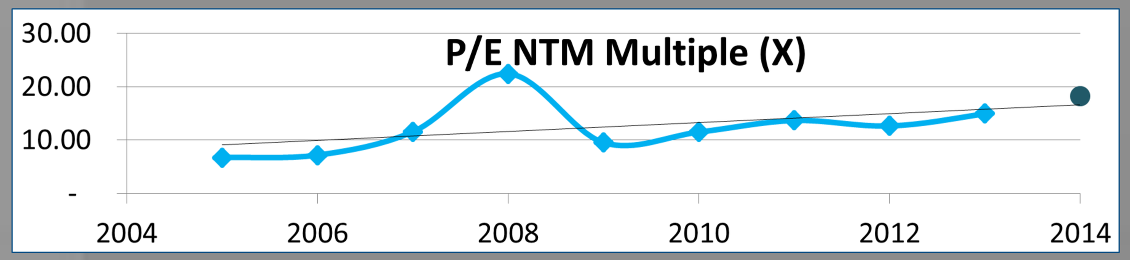






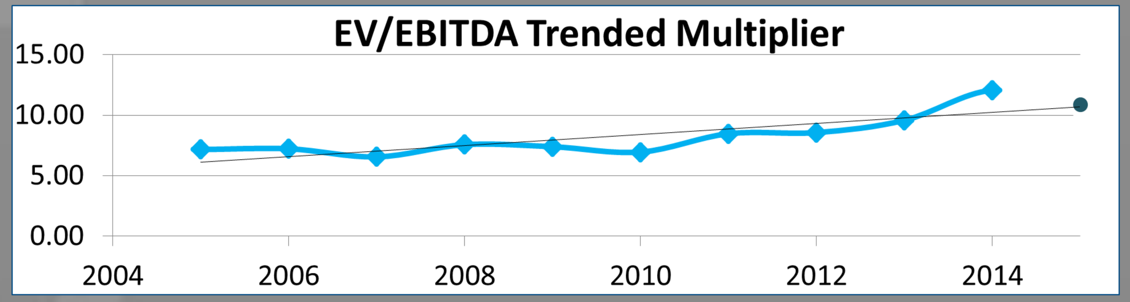
Discounted Cash Flow Valuation Model	12/31/2015	12/31/2016	12/31/2017	12/31/2018	12/31/2019
EBIT	$ 628.8	$ 675.5	$ 632.7	$ 679.2	$ 678.3
Effective Tax Rate	12.8%	12.8%	12.8%	12.8%	12.8%
EBIAT	**548.4**	**589.1**	**551.8**	**592.3**	**591.6**
Depreciation & Amortization	412.1	446.1	423.4	452.2	452.6
EBIATDA	**960.5**	**1,035.1**	**975.2**	**1,044.6**	**1,044.2**
Capital Expenditures	1,075.0	1,100.0	1,070.0	955.0	830.0
Change in Working Capital	(48.0)	(91.6)	(226.2)	(102.1)	(75.1)
Free Cash Flow	**(66.5)**	**26.7**	**131.4**	**191.7**	**289.3**
Time	0.9	1.9	2.9	3.9	4.9
Discount Rate	1.0	0.9	0.9	0.8	0.8
Present Value of FCF	**$ (63.8)**	**$ 24.5**	**$ 115.2**	**$ 160.7**	**$ 231.9**
Valuation Assumptions	WACC: 4.58%		Long-Term Constant Growth: 2.13%		

Valuation	
Sum of Discounted FCFs:	$ 468.5
Perpetuity Value:	$ 12,069.5
Discount Rate:	0.8
P.V. of Perpetuity:	**$ 9,675.2**
Value of Firm:	**$ 10,143.7**
Less Market Value of Debt:	$ 3,049.5
Plus: Value of Cash:	$ 35.2
Equity Value:	**$ 7,129.4**
Shares Outstanding:	111.07
Intrinsic Value	**$ 64.19**
Terminal FCF Multiple:	40.85

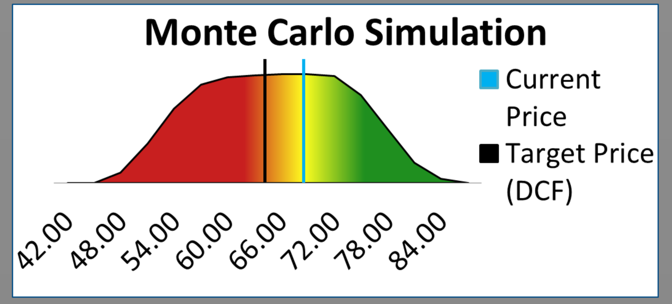


P/E NTM Model	
FY15 Forecasted EPS	3.64
Trend Multiplier	0.84
Trend Intercept	(1,682.6)
Implied Multiple	**16.64**
Price Target	**$ 60.61**

Monte Carlo Statistics	
Sample	15000
Mean	63.71
St. Dev	8.09
Prob. < Current Price	71%



EV/EBITDA Trended Model	
Forecasted EBITDA	1,041
Trend Multiplier	0.44
Intercept	(906)
Implied Multiple	10.59
Implied EV	11,021
Target Price:	**$ 65.63**



Acknowledgments

We, The Machine, would like to specially thank Professor Cassie Lau for her incredible leadership and insight. Without her, this 1,500+ hour journey would not have been possible. Siempre Adelante.