

PPL is a utility holding company that primarily engages in the generation, transmission, and distribution of electricity. It operates through three geographical regulated segments: U.K., Kentucky, and Pennsylvania.

United Kingdom

- UK segment consists of the regulated electricity distribution operations of Western Power Distribution (WPD). WPD serves 7.9 million customers in central and southwest England and south Wales. This segment is responsible for approximately 28% of sales and 54% of earnings before corporate expenses for PPL during calendar year 2019.

Kentucky

- Kentucky segment consists primarily of the regulated electricity and natural gas operations of Louisville Gas and Electric Company and Kentucky Utilities company, which serve 1.3 million customers in Kentucky and Virginia and operate about 7,500 megawatts of regulated generating capacity. This segment was responsible for approximately 41.5% of sales and 23.5% of earnings before corporate expenses for calendar year 2019.

Pennsylvania

- Pennsylvania segment consists of the regulated electricity delivery operations of PPL Electric Utilities Corporation, which serves approximately 1.4 million customers in eastern and central Pennsylvania. This segment was responsible for approximately 30.5% of sales and 22.5% of earnings before corporate expenses during calendar year 2019.

Thesis and Transitional Strategy

PPL is a well-run regulated utility. It has focused on expanding its regulated businesses after spinning off its competitive generating assets in 2015. In recent years the company has focused on expanding its electrical transmission and distribution businesses in Pennsylvania, Kentucky and the U.K. The company plans to continue to make growth investments in transmission and distribution while adding to its renewable energy generation assets. The company's long history of dividend payments and superior customer service makes it a good potential holding for the portfolio.

PPL announced it had initiated the process to sell its U.K. business (WPD) during its second quarter earnings call on August 10, 2020. It expects the sale to be value accretive to shareholders and to better position the company for continued long-term value creation. Management believes WPD will command a premium

valuation. PPL is exploring both cash offers and the potential to exchange WPD for U.S. regulated utility assets. Management expects to announce a completed transaction in the first half of 2021.

PPL's management believes its share price has never appropriately reflected the value of its U.K. assets. By selling them, PPL will be a purely U.S. utility holding company with a less complex business mix. Management expects to use the proceeds (in the order of preference) to:

1. Strengthen PPL's balance sheet
2. Purchase U.S. regulated assets
3. Repurchase shares

The dividend could be adjusted after this significant reapportionment of assets. In the case of major divestitures/acquisitions, we do not consider a reduction in the dividend to be an automatic sell if the stock's yield remains competitive within the industry.

Positives

PPL has a strong commitment to its dividend. The company has paid a dividend for 298 consecutive quarters as of July 1st, 2020.

PPL management has long argued the U.K. business has been under-appreciated and under-valued by investors. Its sale could result in a higher multiple for the stock.

PPL plans to invest about \$14 billion (including WPD) in infrastructure over the next five years to build a smarter, more secure energy grid and in renewable generating assets. This should drive strong rate base growth.

PPL is an innovative company that has incorporated technological advances into its asset base. In its Pennsylvania utility during 2019 the company:

- Deployed a new distributed energy resource management system that enabled customer-owned renewables and energy storage connections to the grid
- Developed an innovative technology that automatically cuts power to downed power lines
- Substantially completed implementation of multi-year advanced meter project

PPL has a long history of providing superior customer service to its clients. Its U.S. utilities earned four J.D. Power customer satisfaction awards in 2019, raising its total to 51 since J.D. Power began assessing utility customer satisfaction in 1999. This is a sign of a well-run and reliable utility and contributes to a generally constructive relationship with its regulators.

Possible Risk(s)

- WPD generates over 50% of PPL's revenues and earnings. There is the potential for a lag between the sale of the U.K. assets and the purchase of new assets that could put some pressure on cash flows (although there would be plenty of cash on the balance sheet). It also could be difficult to replace the cash generated by WPD with purchased U.S. assets.

- PPL may be unable to sell WPD at an acceptable price.
- PPL may not be able to identify assets to purchase or may overpay for the assets it purchases.
- William Spence, PPL’s Chairman and Chief Executive Officer since 2012, retired as CEO in June 2020 and became Non-Executive Chairman of the Board. Vincent Sorgi, PPL’s President and Chief Operating Officer, became President and CEO. While there is always risk in any executive change, CEO Sorgi has been with the company for twelve years. In our opinion, an internal promotion generally is less disruptive for a company’s culture and operation.
- Increase in interest rates. Higher interest rates increase the cost of raising capital in the fixed income and equity markets.
- Inability to issue equity or fixed income securities to pay for capex program. PPL regularly accesses the capital markets to provide funding for its major capital expenditures.
- Weak economy/employment could result in lower electricity consumption and the inability of customers to pay bills for an extended period of time.

Valuation

PPL currently is trading below or near its five-year averages on the majority of the listed valuation metrics. We believe this makes the stock’s valuation attractive at the current time.

Valuation Summary

Valuation Measurement	Current	<u>Trailing 5 Year High, Low & Average</u>		
		High	Low	Avg
P/E (LTM)	12.4	19.4	7.7	14.0
P/E (NTM)	11.6	18.0	7.2	13.8
PEG (NTM)	4.6	140.8	1.6	7.5
P/BV	1.7	2.8	1.1	2.1
P/CF	8.2	11.1	5.6	8.7
P/Sales	2.8	3.7	1.7	2.9
EV/EBITDA	10.6	12.4	9.4	10.9
EV/Sales	5.8	6.4	4.0	5.7
Div Yld	5.8	9.1	3.8	4.9

Note:

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