Company Overview

Based in Atlanta, Southern Company serves 9 million customers primarily across Georgia, Alabama and Mississippi. The primary nonregulated business is Southern Power, which owns and operates non-regulated power plants.

Primary Subsidiaries Include

Alabama Power
Georgia Power

This opinion does not apply to bonds of Mississippi Power (which is addressed in its own report)

Parent Credit Ratings

Moody’s..................................... Baa2/Negative
S&P................................................ A-/Negative
Fitch............................................. BBB+/Stable

Financial Data

Debt/Capital.............................................. 65%
Debt/EBITDA............................................ 5.6x

U.S. Recommended Corporate Bond Sector Weightings

- Financial (30%- 45%)
- Utilities (10%- 25%)
- Industrial (35%- 55%)

U.S. Recommended Bond Ladder

- Short-term (up to 5 years)
  30%- 40%
- Intermediate-term (6-15 years)
  40%- 50%
- Long-term (16+ years)
  15%- 25%

Appropriate for Income

Recommendation

We consider bonds of Southern Company (and its subsidiaries) to be an appropriate holding for Edward Jones clients who seek Income as an objective within a well-diversified portfolio.

Edward Jones Credit Strength Assessment

<table>
<thead>
<tr>
<th>Low</th>
<th>Below Average</th>
<th>Average</th>
<th>Above Average</th>
<th>High</th>
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</table>

Investment Summary

Southern's earnings are primarily produced by the company's regulated businesses, and the company has a lengthy track record of solid performance. Southern possesses a leveraged but solid balance sheet, a robust capital-spending program (which leads to an expanding rate base, and thus, future earnings power), and the ability to raise both debt and equity capital to fund its growth. Southern has enjoyed generally favorable relationships with its various regulatory bodies, as well. In our view, Southern Company is a sound corporate credit with the ability to meet its current and future debt obligations.

Bond Strengths

- We believe Southern's business model, which consists of regulated utility subsidiaries, coupled with Southern Power (a nonregulated power generation company) and the relatively small unregulated businesses acquired in its acquisition of AGL Resources will enable Southern to continue to produce consistent cash flows.
- Southern primarily operates in states that have historically provided constructive regulatory environments.
- Southern has a robust capital-spending program that will likely add to the company's rate base. Growth in earnings associated with its larger rate base would help in servicing debt-related obligations.

Bond Weaknesses

- Given its plan to invest significantly in capital expenditures in coming years, any deterioration in Southern's currently relatively strong regulatory relationships could be a concern. In addition, debt-related measures can deteriorate if a company relies too heavily on debt as its means of financing a project.
- There is the potential for unrecoverable cost overruns with respect to new power plant construction, especially Georgia Power's two nuclear units.
- Southern will have to raise additional capital over the next several years to fund capital expenditures for system upgrades and building new power plants. Measures of interest to bondholders could erode somewhat if the company does not issue new equity.
Recent News and Analysis

8/8/18: Southern Company posted second-quarter operating EPS of $0.80, which was above the $0.69 analyst consensus estimate and up from $0.73 in the second quarter of 2017. The company raised its 2018 operating EPS guidance to a range of $2.95 to $3.05. However, the company also took a $1.1 billion charge related to increased costs to build the two nuclear units at Plant Vogtle in which it has ownership stakes. The company posted nice second-quarter results that benefited from favorable regulatory decisions and more favorable weather at the utilities, but also due to improved results at its Southern Power unregulated unit. However, the bigger news was the relatively large charge taken to account for increased cost expectations at its nuclear project. The company has been having trouble hiring and retaining skilled laborers for the project at the costs it previously had expected to incur. Southern is trying to provide additional benefits for the positions it needs most (primarily electricians and pipe-fitters) to acquire and retain this talent, but this will increase costs. Of the $1.1 billion of increased costs, the company indicated it will not seek recovery for $700 million of this amount, but it seemingly left open the possibility of trying to recover the remaining $400 million at a later date. Southern is clearly focusing on maintaining its historically constructive relationship with the Georgia Public Service Commission by bearing a large portion of this charge in order to keep customer rates lower. Positively for bondholders, the company indicated it plans to issue equity to help improve its financial position, which would otherwise have deteriorated somewhat from the charge for the nuclear units. Building nuclear units is rarely easy, and we expect this to be an ongoing risk for Southern Company, but the company believes it remains on schedule to meet its November 2021 and November 2022 targets for in-service dates on the two units. We continue to consider bonds of Southern Company (and its subsidiaries) to be an appropriate holding for Edward Jones clients who seek Income as an objective within a well-diversified portfolio.

5/21/18: Southern Company has agreed to sell a number of Florida-based assets, including Gulf Power (a regulated electric utility), Florida City Gas (a regulated gas utility) and two nonregulated power plants, to Nexter Energy for nearly $6.5 billion. We believe this is a compelling transaction for Southern Company and beneficial to bondholders. While this is a somewhat small collection of businesses being sold relative to the size of Southern Company as a whole (the regulated utilities included in the deal only account for about 5% of regulated earnings), the price the company is receiving for the assets is strong, in our opinion. Further, the use of proceeds is expected to benefit bondholders because the company is expected to pay down debt to improve its financial position somewhat. We believe this transaction also allows management to sharpen its focus on its businesses that will likely be more meaningful to the long-term success of the company, including Georgia Power, Alabama Power and its regulated gas utilities. We continue to consider bonds of Southern Company (and its subsidiaries) to be an appropriate holding for Edward Jones clients who seek Income as an objective within a well-diversified portfolio.

Company Outlook

Southern Positioned to Partake in Industry Growth – We expect Southern to grow essentially in line with utility industry competitors over the next several years. In addition to continued investments in environmental projects, transmission and distribution lines, and retrofits of existing power plants, Southern has already committed to several major projects that will take several years to complete and will likely add to the company’s rate base. Overall, we expect Southern to spend over $8 billion on capital projects in 2018. (Please see Figure 1 below for capital spending figures.) The company’s Georgia Power subsidiary owns 46% of two new nuclear power units being constructed at the existing Vogtle plant site near Waynesboro, Georgia.

Figure 1

These incremental power supplies will be classified as regulated, as opposed to the power generated by Southern’s Southern Power subsidiary. Southern Power engages in competitive power generation, although most power is sold under long-term contracts to Southern's utilities, as well as other utilities and municipalities. Southern Power has recently implemented an increased focus on renewables including solar and wind power in this segment. Southern Power represents roughly 10% of overall earnings. Southern’s addition of AGL resources in 2016 diversifies its cash flow by adding gas distribution utilities and is likely to improve Southern's long-term growth rate modestly.

Relationships With Regulators - Southern’s electric utility subsidiaries operate under franchised electric rights free from competition. We do not anticipate that any of the states served by Southern will deregulate their electricity markets in the near future. This favorable regulatory outlook lowers the competitive risks for the company.

For a regulated utility, favorable relationships with regulatory bodies can be a very important factor in the success of a company, just as abrasive relationships can lead to lower allowed returns. We believe the regulatory environments in which Southern operates are generally better than average. Rate cases have typically gone smoothly, and allowed returns have been above average overall.
Southern's high customer satisfaction ratings and retail electric rates that are below the national average help the company keep positive relationships with its regulators. We believe continued maintenance of these relationships will be key as Southern continues to invest heavily in system upgrades and power plant construction.

**Strong Credit Rating Supported by Healthy Cash Flow** – Southern's attractive credit ratings and solid credit profile within the utility industry position it well for continued access to capital markets, which is important given it will likely choose to finance a significant portion of its capital expenditure plans by issuing debt. Southern periodically raises equity, as well, in order to maintain a reasonable capital structure and support its current credit rating.

In 2017, Southern generated cash flow from operations of $6.4 billion. (Please see Figure 2 below demonstrating Southern’s cash flow.)

Figure 2

The company does spend a significant amount on capital expenditures, and we expect this to persist for the foreseeable future as the company continues to maintain and modernize its transmission and distribution network and add generation capacity, especially on the “clean energy” front (renewables and nuclear). Despite this ongoing investment, Southern has produced sufficient cash flows to raise its dividend each year since 2001.

**Industry Outlook**

Our outlook for the electric utility sector is positive overall, with an improved growth outlook relative to the recent past. This improved outlook primarily reflects our expectations for more spending on utility infrastructure after many years of neglect. The need for additional power plants and transmission lines appears large, and we expect will continue for many years to come. Some estimates suggest the costs to update and expand the nation's utility infrastructure could be several hundreds of billions of dollars over the next two to three decades.

Additionally, environmental concerns resulting from the issue of global warming are driving increased spending to reduce emissions from existing power plants. Investments in renewable energy (especially windpower), new nuclear plants, and modifications to existing coal-fired plants (scrubbers) are proving to be quite costly.

**Financial Strength**

We believe Southern's financial condition is solid. The company weathered the storm of the most recent recession relatively unscathed, with no material decline in profits or cash flows, and was able to issue debt at its Alabama Power subsidiary in November 2008 as the corporate debt markets closed to many lower-quality issuers during the financial crisis. The company finished 2017 with over $2 billion in cash on its balance sheet. Southern has not experienced any problems raising new debt or rolling over existing debt in the credit markets. As is the case with many utilities, Southern will also require equity infusions over time in order to keep its capital structure relatively constant, and investors have shown an ongoing willingness to invest in the company's shares. We expect continued healthy capital spending in order to maintain and upgrade current transmission and distribution infrastructure, as well as finance construction of the aforementioned new power plants. We also anticipate that Southern will continue to increase its dividend to shareholders, although we see the payout ratio gradually declining toward the desired target of 70% of earnings. In our view, Southern's credit profile has become modestly weaker with the addition of AGL due to the debt-heavy manner by which Southern financed the acquisition.

Southern Company Subsidiary Municipal Bond Offerings - Southern's subsidiaries are permitted to offer tax-free municipal bonds through affiliates. These bonds are not explicitly listed as Southern Company bonds, but are obligations of the company's operating subsidiaries, may be secured by a pledge of revenues, and are typically rated equal to or slightly higher than Southern Company's corporate debt by rating agencies.

**Edward Jones Credit Strength Assessment**

We believe Southern Company's credit strength assessment is average. The company earns its income primarily from regulated utility operations, which tend to provide income stability. Southern also benefits from operating mainly in states that have historically had quite constructive regulatory environments. Offsetting these positives are the large expenditures and the associated risk that Southern is incurring by building two new nuclear units at Georgia Power. Nuclear plants are often subject to large cost overruns.
The table lists the percent of corporate credits we follow globally in each of the equivalent rating categories. We do not assign a “Buy” rating to any corporate credits. Investment banking services indicate the percentage of those subject companies that have been investment banking clients within the last 12 months.

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<th>Corporate Credits</th>
<th>Appropriate for Income</th>
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<th>89%</th>
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<tr>
<td>Investment Banking</td>
<td>Appropriate for Income</td>
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<td>21%</td>
<td>0%</td>
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### Required Research Disclosures

**Initiated Coverage (Appropriate for Income) 7/15/10**

**Analyst Certification**

- I certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers; and no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report. Mike Doyle, CFA

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- Edward Jones trades as principal in the debt securities that are the subject of this research report.

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- Edward Jones limits inventory positions for fixed income securities. This security may currently be subject to these internal limits; however, this should not be considered contrary to our current recommendation.
- This opinion is based on information believed reliable but not guaranteed. The foregoing is for INFORMATION ONLY. Additional information is available on request. Past performance is no guarantee of future results.
- This issuer may have issued bonds in both large and small offering sizes. Bonds which are part of small offerings are generally less liquid, which may cause the price you receive in the secondary market to be lower than prices received by investors in large issues of the same issuer's bonds.
- If you sell this security prior to maturity, you may receive more, less, or the same dollar amount you originally invested because the security’s market value may fluctuate over time due to various market factors (e.g., interest rates).
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- Edward Jones Credit Strength Assessment: Low —Our opinion is these credits are of low financial quality. We believe these credits are the most likely to default and experience the most financial hardship. Below Average — Our opinion is these credits are of below-average financial quality. We believe these credits are more likely to default or experience financial hardship than the average. Average — Our opinion is these credits are of average financial quality. We believe these credits have a low probability of default or low chance of experiencing financial hardship. Above Average — Our opinion is these credits are of above-average financial quality. We believe these credits are less likely to default or experience financial hardship than the average. High — Our opinion is these credits are of the highest financial quality. We believe these credits have the lowest probability of default and will experience the least financial hardship.
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