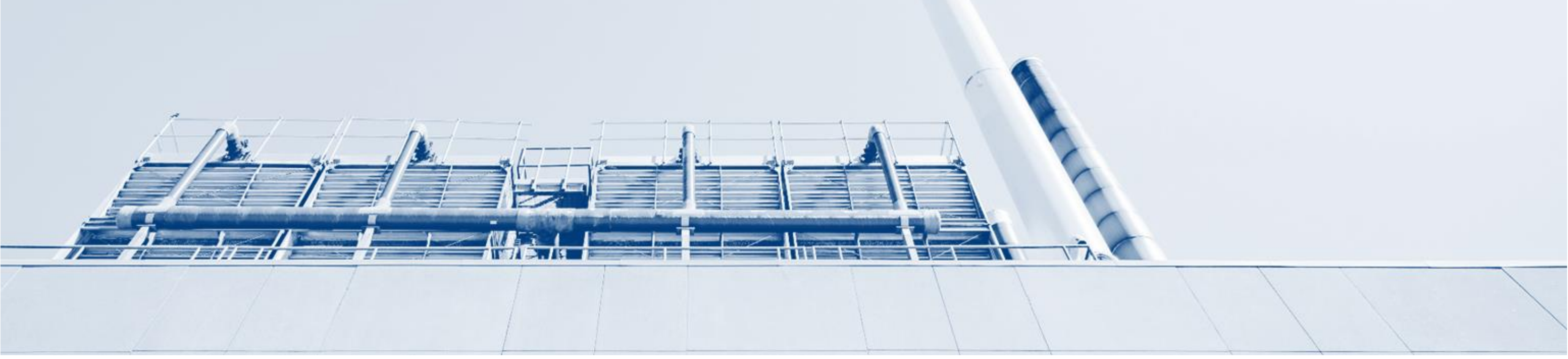
VISTRA ENERGY

A MISUNDERSTOOD REORG EQUITY MAKING ITS WAY INTO THE MAINSTREAM



OCTOBER 27, 2017

Highland co-founder and co-CIO Mark Okada recently spoke at the Sohn Conference in San Francisco, an event that gathers leading investors to share investment ideas while raising money for children's charities.

At the event, Okada presented Vistra Energy (NYSE:VST) as his investment idea, making the case for the upside potential that Highland anticipates in this reorg equity.

The following content is based on the October 4, 2017 presentation.

THIS REORG EQUITY COULD HAVE ROOM TO RUN

An Introduction to Vistra Energy

Vistra Energy is a reorg equity that listed on the New York Stock Exchange (NYSE) earlier this year. The company is uniquely positioned in the power market and stands out among its peers in a number of ways, yet Vistra's story appears to be largely underappreciated by the broader market.

That said, the company has started to get more attention recently. Going forward, we expect mainstream investors to become more familiar with the company, especially if key catalysts unfold in the coming weeks and months.

The following provides an overview of the Vistra story and highlights the biggest drivers behind Highland's outlook on the stock.

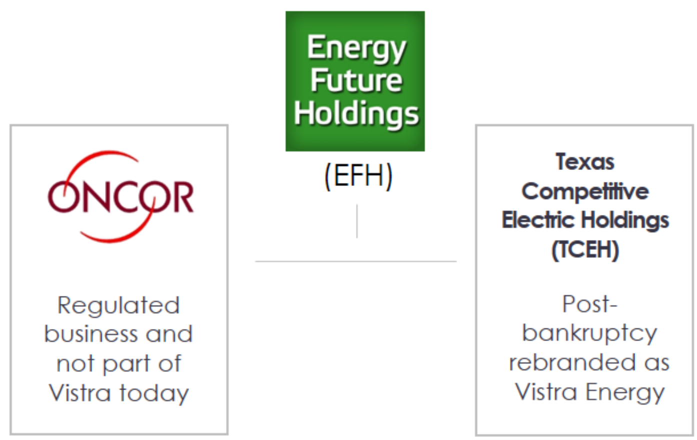
VISTRA'S HISTORY

Vistra's Journey to NYSE

In May of 2017 Vistra Energy began trading on the NYSE under the ticker VST. While the Texas power company joined the NYSE as an unfamiliar entity in the equity world, its journey to the public market received plenty of attention.

The journey began in 2007 with the leveraged buyout (LBO) of Energy Future Holdings, the largest LBO in history. Many well-known players in the space took what was then known as TXU Corporation private for $45 billion.

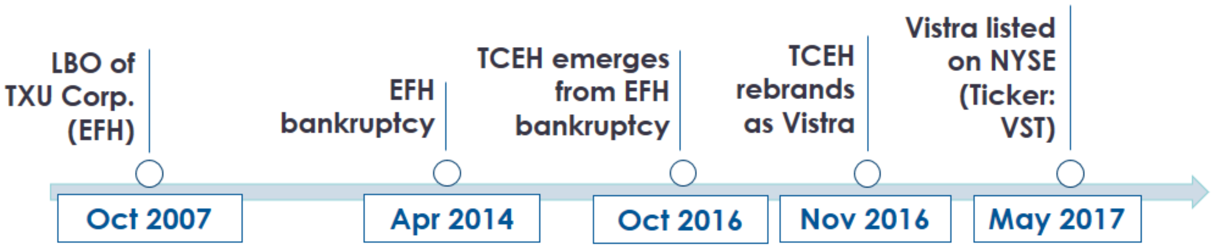
ORIGINAL STRUCTURE: PRE-BANKRUPTCY ENTITIES



The buyout left Energy Future Holdings with $40 billion in debt. Within a few years, the company struggled to sustain that debt burden amid declining power prices and strained free cash flow, and in an all-too-familiar series of events, Energy Future Holdings filed for Chapter 11 bankruptcy in 2014.

In October 2016, the company emerged from bankruptcy. The following month, Texas Competitive Electric Holdings (TCEH), the unregulated side of the business, rebranded as Vistra Energy.

TIMELINE



VISTRA TODAY

As a reorg equity, Vistra was relatively unknown to the public equity market when it listed on the NYSE. Its previous lenders comprise a limited shareholder mix, and the company has minimal sell-side analyst coverage.

> Vistra's clean post-bankruptcy balance sheet makes it stand out in the IPP space where excessive leverage is prevalent

With its NYSE listing, Vistra became the fourth publicly traded independent power producer (IPP). However, the private equity takeover of Calpine Energy announced in August means there will soon only be three listed IPPs.

Assuming the Calpine deal closes, the total IPP market cap will be $17 billion. At $8 billion, Vistra is poised to represent nearly half of the publicly traded IPP market.[1]

This market share puts Vistra in a favorable situation. Additionally, the company's clean post-bankruptcy balance sheet makes it stand out in the IPP space, which has a reputation for being a highly levered group.

There are also a number of market and industry dynamics at work in Vistra's favor that we think provide a compelling long-term outlook.

THREE AREAS OF POTENTIAL UPSIDE FOR VST

We see three potential upside opportunities in Vistra today. Below we review these three opportunities and explore how and when they may come to fruition.

[1] Source: Bloomberg, as of 9/28/2017

1) MARKET & INDUSTRY POSITION

Integrated Business Lines

Vistra is comprised of two business lines:

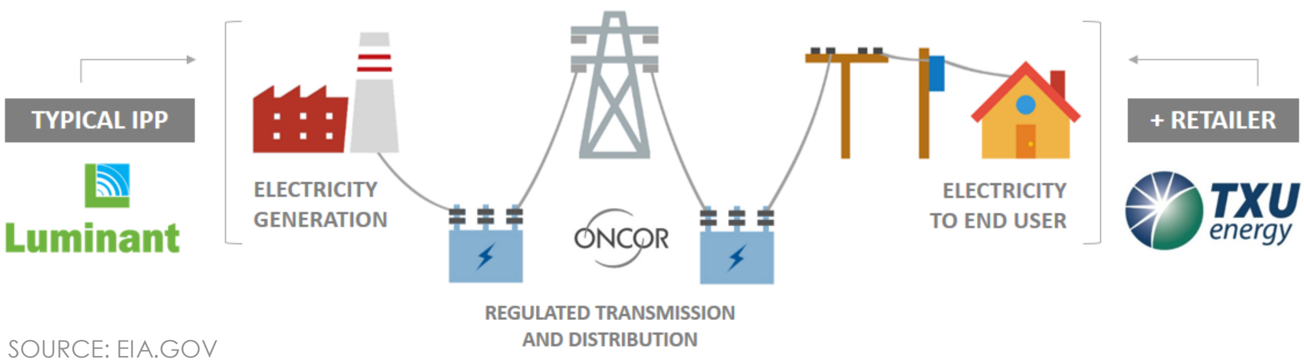
Luminant is the power generation side of the business. It accounts for 15% of the power generation capacity in Texas, or 18,000 megawatts of generation.[2] Being on the generation side, this business can be driven, in part, by commodity prices.

TXU Energy is the retail business, which serves one in every four residential customers in its markets.[3] This business is less sensitive to commodity exposure than the power generator.

CURRENT STRUCTURE:
VISTRA POST-BANKRUPTCY

Collectively Vistra is the largest power generator and retailer in the state of Texas and therefore is a key provider of critical energy infrastructure in one of the strongest power markets in the country.[4]

OPERATING AT BOTH ENDS OF THE POWER STRUCTURE



SOURCE: EIA.GOV

Unregulated, integrated business lines can help provide cash flow stability, as the retailer (TXU Energy) can mitigate potential commodity price volatility affecting the IPP (Luminant).

[2] Source: Vistra Company Presentations
[3] Source: Vistra Company Presentations
[4] Source: Vistra Company Presentations

In addition to its market position, Vistra's integrated business model sets it apart from other IPPs. The complementary retail business (TXU Energy) can act as a natural hedge to the power generation business (Luminant), which is subject to volatility from commodity prices and supply/demand dynamics.

Of course, even with this model Vistra is not immune to commodity price risk, so the generation business still feels the effects of a subdued price environment; however, the integration of TXU Energy, the retail business, provides more downside protection than a typical IPP would have. So between its integrated business and low leverage, Vistra has the resources in place to withstand weak power prices.

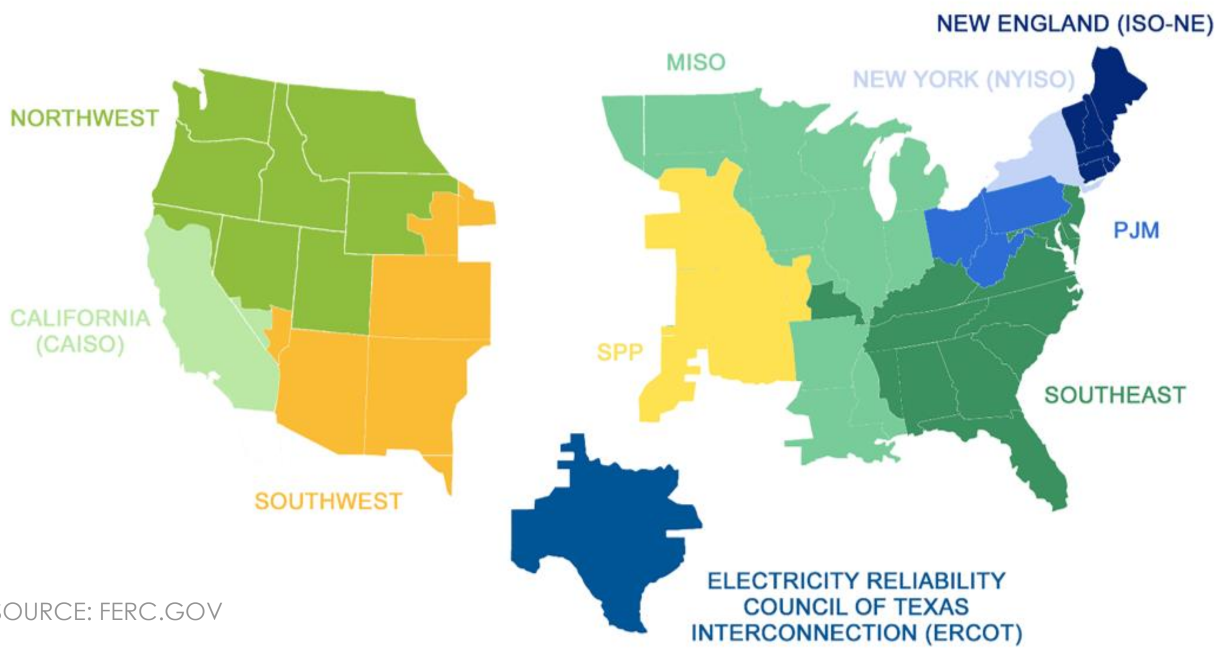
Growth in Texas has clearly translated into power demand

Demand Advantage: Everything's Bigger in Texas

The Texas power market has a number of advantages over other areas in the country. Because Vista is the largest power generator and retailer in Texas and since the company exclusively operates within the state, the advantages of the Texas market are direct benefits to Vistra.

The Texas power market, managed by Electricity Reliability Council of Texas (ERCOT), is essentially an island, operating independently from other power regions. That means it has its own level of regulation and its own supply and demand dynamics, both of which are favorable relative to elsewhere in the country right now. This business-friendly

THE ERCOT POWER ISLAND



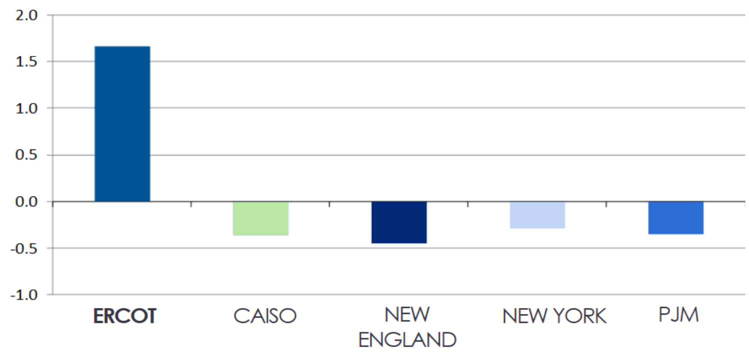
SOURCE: FERC.GOV

regulatory environment and the rapid growth fueling power demand, among other things, make Texas an appealing market for power companies like Vistra.

More people moved to Texas than to any other state last year, and the Texas economy, which is already the second largest in the U.S., is likewise growing rapidly.[5] That growth has clearly translated into additional power demand.

When it comes to demand, ERCOT stands in stark contrast to other power markets, which are facing structural headwinds from energy conservation, demographic trends and other factors.

2012-2016 SUMMER PEAK LOAD CAGR (%)



SOURCE: SNL; SUMMER MONTHS ARE JUN., JUL., AUG, SEPT.

Additionally, power is relatively cheap in Texas compared to elsewhere in the U.S., which means there is less of a need to pursue efficiency thereby increasing overall consumption. ERCOT also has the advantage of the Texas climate, which brings high summer temperatures and subsequently spikes in power demand.

On the other hand, *some* Texas weather can present risk for power companies in the state. (For example, the recent hurricane in the Gulf Coast was detrimental to power companies operating in the Houston market.) As a pure-play on Texas, this type of extreme weather can disproportionately affect Vistra; however, outside of infrequent severe weather events, the typical climate tends to work in Vistra's favor as it provides a demand advantage that power markets in colder regions lack.

Supply Advantage: Imminent Supply Rationalization

In addition to the demand benefits, the outlook for Vistra appears attractive from the supply side of the equation.

As the below chart shows, excess supply of power as a percentage of demand (the reserve margin) is in the mid-teens today and is on track to rise, staying above the Public Utility Commission of Texas (PUCT) target of 13.75%. This official reserve margin is forecast by the

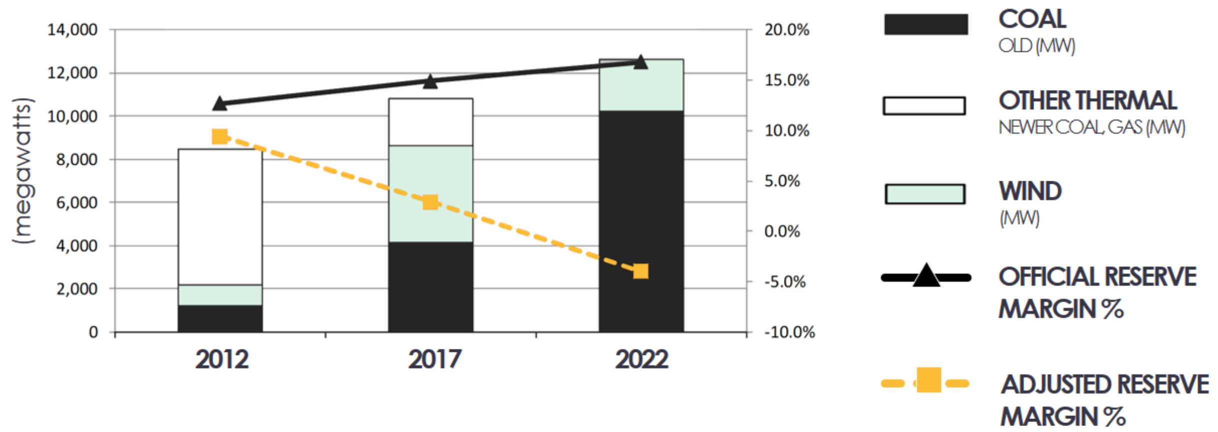
> Looking at the composition of the reserve margin in ERCOT, the supply dynamic appears favorable for Vistra

[5] Source: Bureau of Economic Analysis

PUCT, so according to the regulators, everything is fine today as well as for the next five years.

When you break down the actual sources of power that go into that forecast, however, the supply outlook is much different. Much of the reserve margin comes from older coal that is not economically sustainable. As such, we expect a lot of that older coal to come out of the system in the near future.

ERCOT SUMMER RESERVE MARGIN COMPOSITION



SOURCE: ERCOT, HIGHLAND ESTIMATES; ADJUSTED RESERVE MARGIN = (CAPACITY LESS AT-RISK COAL LESS WIND LESS PEAK DEMAND) / CAPACITY AS OF LATEST "CAPACITY, DEMAND AND RESERVES REPORT – MAY 2017" PUBLISHED BY ERCOT ON 5/2/2017

In addition to coal, wind represents a portion of the reserve margin, and at peak demand periods during the summer in Texas, wind is not a reliable energy source. Taking into account the composition of the reserve margin, a much different picture emerges.

As you can see in the adjusted reserve margin estimates above, removing these two unreliable sources of power (wind and older coal) puts the current reserve margin in low single digits. And the five-year forecast shows a *negative* reserve.

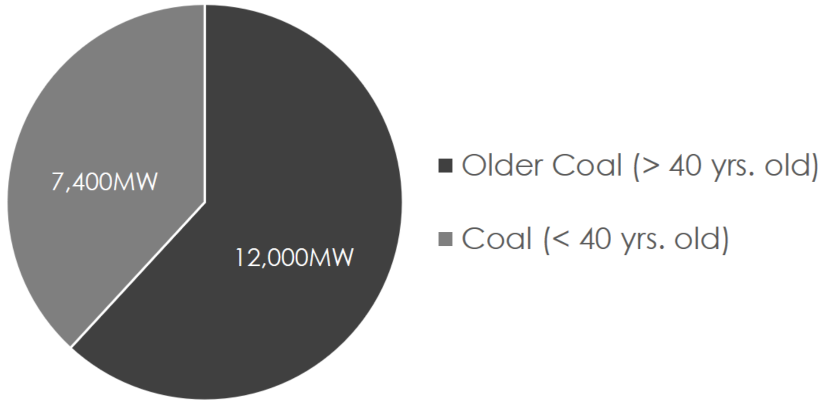
Stepping Up in Supply Rationalization

How will this reserve deficit get resolved? We think Vistra will be the market leader in announcing the rationalization of some of its older, higher cost coal capacity.

Of the 19,400 MW of coal capacity in ERCOT, an estimated 12,000 MW is older, high cost coal that is burning cash at current power prices.[6]

Vistra owns roughly half of that older coal, meaning the company alone could cut the reserve margin in half by shutting down its less profitable operations.

TOTAL CURRENT COAL CAPACITY IN ERCOT



SOURCE: ERCOT, HIGHLAND ESTIMATES; CAPACITY AS OF LATEST "CAPACITY, DEMAND AND RESERVES REPORT – MAY 2017" PUBLISHED BY ERCOT ON 5/2/2017

Just this month Vistra announced it was taking more than 4,200 MW of older coal offline. This move is likely to improve the pricing dynamic for Vistra going forward, as cutting older coal capacity should raise power prices while simultaneously leaving Vistra with a more concentrated, profitable fleet.

Of course, by shutting down coal operations Vistra is reducing both the overall capacity and scale of its operations; however, we think this "shrink to grow" strategy will ultimately benefit the company in the long run because of the potential price effect as well as the renewed focus on profitable operations.

2) CURRENT VALUATION

Cash Is King

In addition to the favorable market and industry dynamics, we find Vistra attractive because of the current valuation.

> Even without other catalysts, we find Vistra attractive based on the free cash flow picture alone

Vistra has a clean balance sheet, yet manages to carry a double-digit free cash flow yield. Management has expressed their intention to increase Vistra's leverage to create a more optimal capital structure.

With strong cash flow at Vistra's current minimal leverage of 2x, the optimized capital structure of around 3.5x leverage

[6] Sources: Vistra Company Presentations; ERCOT

that management is targeting—still be well below the industry average of 6x—should boost the cash flow yield further. That increase could go to buybacks, dividends, growth opportunities and other activities that serve shareholders well.

Utilities typically struggle with free cash flow, so the current levels and outlook for Vistra make the company unique. If nothing else happens, we find Vistra attractive simply because of its potential to generate and deploy free cash flow.

STRONG FREE CASH FLOW YIELD EVEN WITH LOW LEVERAGE LEVELS

	Leverage	FCF Yield
VISTRA TODAY	2.0x	10%
VISTRA UNDER OPTIMAL CAPITAL STRUCTURE	3.5x	13%

SOURCE: HIGHLAND ESTIMATES; VST FCF BASED ON MIDPOINT OF COMPANY'S 2017 GUIDANCE, AS OF 9/28/2017

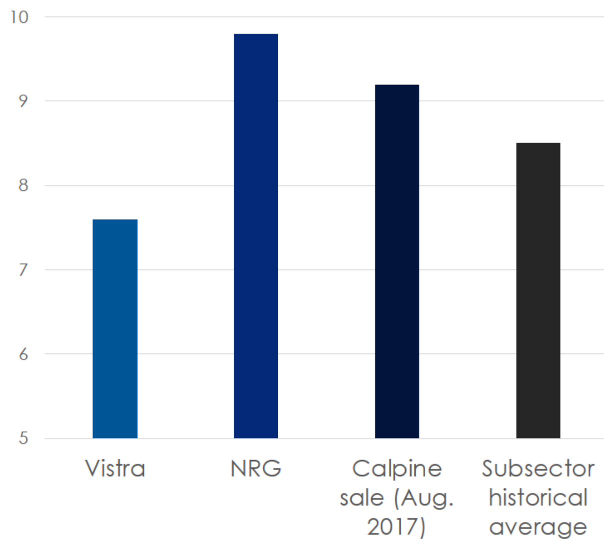
Valuation Benefits Beyond Free Cash Flow

In addition to the attractive valuation on a free cash flow to equity basis, we think Vistra looks undervalued on an enterprise value to EBITDA basis. The company trades at 7.6x the midpoint of its 2017 guidance, which is lower than every other company in the S&P 500 Utilities Index.[7]

Vistra also looks cheap compared to the subsector's historical average, which is 8-9x EBITDA. Of note, Calpine Energy sold for 9.2x 2017 EBITDA and NRG, another company in the space, is currently trading at 9.8x.[8]

On a standalone basis, we believe Vistra has the potential to approach the trading levels of its peers and the subsector's historical average, given the strength of the company post-bankruptcy, among other positive characteristics. However, beyond

EV/EBITDA: VST VS. PEERS



SOURCE: BLOOMBERG, AS OF 9/28/2017

[7] Sources: Vistra Company Presentations, Bloomberg, as of 9/28/2017
[8] Source: Bloomberg, as of 9/28/2017

Vistra's individual potential, we see opportunity for the company based on our expectations for improvement within the subsector overall.

Going forward, we believe the IPP space as a whole will begin to look less like over-levered natural gas trading proxies and assume a more stable and integrated business model. Under that assumption, Vistra's valuation disconnect versus utilities and other infrastructure sectors should narrow.

3) POTENTIAL M&A OPPORTUNITY

A Shifting Industry Landscape

The final reason we find Vistra attractive is the potential for M&A given the recent trends in the industry. This segment has faced a challenging market environment over the past several years. Weak electricity prices caused by oversupply in natural gas and the rise of renewables, along with chronic overleverage and misallocated capital, all translated into poor equity performance from companies in this space. But pressure can create change, and the industry has since transitioned into a beneficial period of consolidation and strategic realignment.

THE IPP LANDSCAPE

This is evident in the recent interest in and activity around the major players in this space:

Talen Energy, which operates in the Northeast, Mid-Atlantic and some areas in the Southwest, was recently acquired by private equity firm Riverstone Holdings. Talen stopped trading in December 2016 when that deal closed.

Calpine Energy was another private equity target. Energy Capital Partners announced its takeover of Calpine in August, which means it too will leave the publicly traded space once the deal closes.

NRG was an activist target. In January Elliott Management revealed its major stake in NRG and launched an activist campaign, pushing major strategic and operational changes that would reduce NRG's debt and increase shareholder value.

That leaves Vistra and Dynegy as the last two power companies in the mix, and we think a merger between the two makes a lot of sense.

Strategic Rationale for a Potential Merger

Dynegy operates throughout the Northeast, Mid-Atlantic and Midwest, but it also has notable operations in parts of Texas. In May, the *Wall Street Journal* reported that Vistra approached Dynegy with a takeover offer. At the time, talks were apparently in early stages, but just this week the *Journal* published an update reporting that the companies could announce a deal as soon as next week, according to sources familiar with the situation. This timing would be logical as it coincides with the companies' third quarter earnings calls, both scheduled for the end of next week.

While we do not know exactly where things stand between the two, we think the merger makes a lot of sense and would create a significant amount of shareholder value for Vistra.

Looking at both companies' management teams, there is clearly leadership in place to see a merger through successfully. Vistra's CEO Curt Morgan came from Energy Capital Partners (ECP), the company buying Calpine. In addition to the Calpine deal, ECP has a large equity investment in Dynegy.

THE WSJ REPORTS ADVANCED MERGER TALKS

Vistra Energy Nears Deal to Buy Dynegy

The Texas power companies, each with enterprise values north of $10 billion, could announce a deal as soon as next week

Updated Oct. 25, 2017 6:03 p.m. ET

Beyond this familiarity with Dynegy from ECP, Morgan's private equity background makes him well suited to execute on any potential M&A that could arise.

Dynegy CEO Bob Flexon has successfully transformed that business after it emerged from bankruptcy in 2012. That said, we think he relied heavily on the use of leverage throughout the transformation, leaving Dynegy's leverage well above Vistra's current level.

As such, a merger would help Vistra increase its leverage to the more optimal range targeted by Vistra management, while simultaneously reducing Dynegy's.

A CLOSER LOOK AT VISTRA'S POTENTIAL

Opportunity in Impending M&A

The strategic rationale for a merger is compelling. With one transaction Vistra management could transform the company into the largest power generator in the country with an integrated footprint, a Texas focus and a prudent amount of leverage.

In addition to the optimized capital structure, Vistra shareholders should benefit from both the combined synergies and the upgrades to the company's ERCOT portfolio. The ERCOT upgrades would make Vistra better positioned to control the supply dynamics amid coal plant shutdowns, enabling the company to focus on profitable power generation. All these improvements could boost the current share price, which we view as undervalued today.

Opportunity from Other Catalysts

While the M&A prospects are exciting, the value we see in Vistra comes from the fact that the potential merger is only one of the distinct catalysts on the horizon, each with the potential to independently affect share price.

In other words, this is not a binary event-driven trade, and if merger talks between Vistra and Dynegy fall apart, we still see opportunity both in Vistra's current valuation and in the company's position within the industry and ERCOT market.

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With Vistra's stronghold in Texas, a growing, business-friendly state with a warm climate – all characteristics that benefit electricity demand and power operations – the company is well positioned to capitalize on trends both within its market and within the industry as a whole.

We believe this industry is bottoming, and post-bankruptcy, Vistra has the balance sheet and the market advantage to rise above its peers over the course of a recovery in the power business.

Further, the composition of Vistra's assets, as well as those of ERCOT, gives the company significant control over the supply dynamic in the state. As such, we think Vistra will be able to shape the reserve margin outlook in its favor going forward.

All that being said, if neither the industry and market opportunities nor the merger prospects come to fruition, we still see potential upside from a valuation standpoint alone.

Vistra has attractive free cash flow and low leverage, yet is trading below industry comps. We believe this is, at least in part, due to the lack of familiarity with the company within the broader market. Therefore, we believe the valuation normalization alone could provide potential upside for shareholders as the market begins to fully appreciate Vistra's story.

Vistra's third quarter earnings call takes place next week, and we expect management to report progress on the call related to these three catalysts. And as recent headlines have started to move Vistra into to the mainstream, we know we will not be the only ones paying close attention.

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