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MARKETS

Behind the Flattening Yield Curve: Fed Rate Increases and Tariff Fights

The yield gap between short- and long-term Treasurys is its narrowest in nearly 11 years

By Daniel Kruger

Updated July 5, 2018 10:32 p.m. ET

The gap between yields on short- and longer-term Treasurys has narrowed to nearly 11-year lows, a sign investors remain cautious about the outlook for economic growth even as they expect the Federal Reserve to continue raising interest rates.

The difference between the yields on two- and 10-year U.S. government notes on Thursday settled at 0.279, its narrowest since August 2007, according to data from Ryan ALM. Two-year yields typically climb along with investor expectations for tighter Fed interest-rate policy, while longer-term yields are more responsive to sentiment about the outlook for growth and inflation.

The dispersion between shorter-term and longer-term rates, known as the yield curve, is a crucial indicator of sentiment about the prospects for economic growth. Investors monitor the curve closely because short-term rates have exceeded longer-term ones before each recession since at least 1975—a phenomenon known as an inverted yield curve.

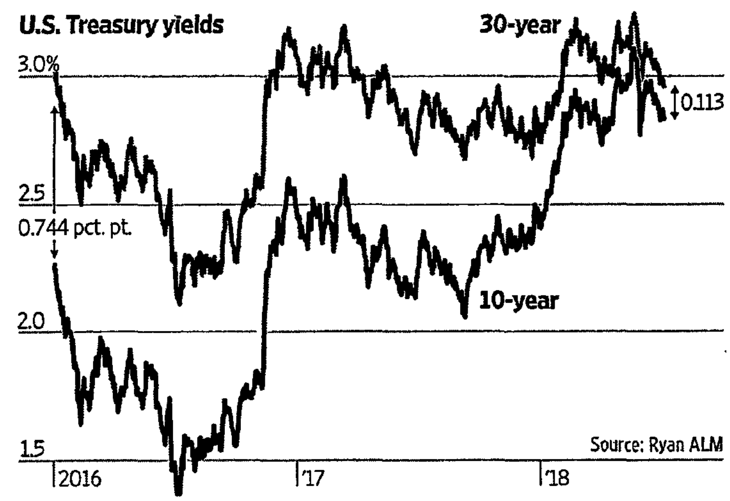
The flattening has occurred as U.S. economic growth remains steady and few analysts see signs of an imminent slowdown. That leaves many split on what the signal shows now.

Investors will be watching Friday's June jobs report from the Labor Department for signs a tight labor market is producing wage inflation, which could push long-term yields higher and steepen the curve. Low wage growth, in contrast, could drag longer-term yields down, flattening the curve further. Inflation poses a threat to the value of government debt, especially longer-dated bonds, because it erodes the purchasing power of their fixed payments.

For now, many analysts remain sanguine about the recent curve flattening. Two-year yields have climbed as policy makers have raised rates to normalize monetary policy following extraordinary stimulus undertaken in the wake of the financial crisis. They have signaled the possibility of two more rate increases this year.

That has kept upward pressure on short-term rates as the Treasury also is selling more short-term debt to fund tax cuts and government spending.

At the same time, the 10-year yield has retreated from a nearly seven-year high reached in May, weighed down by trade-war fears. The concern is that trade tensions will disrupt global



The yield on the 30-year bond has been falling recently, in part as companies buy long-dated debt to shore up pension funds.

growth, tempering expectations for an economic surge spurred by recent tax cuts. Investors also have bought Treasurys, a haven asset as tariff fears have rattled markets around the world.

Some observers contend those circumstances negate the traditional signal sent by a flattening yield curve. Following five of the past six periods in which the yield curve inverted, the economy tipped into recession within a year, according to data from the St. Louis Fed.

"It's a red flag, and you need to be cognizant of what's driving it," said Sean Simko, head of global fixed-income management at SEI Investments. Mr. Simko said his firm has placed trades that benefit from a flatter curve, and that he expects it to invert by year-end as trade restrictions slow growth and the Fed continues to raise interest rates.

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The 10-year yield reached 3.109% in May, propelled from 2.409% at the end of 2017 by a burst of investor optimism that tax cuts would lead to an acceleration of growth, wages and inflation. With trade tensions dimming those prospects, the 10-year yield probably has peaked for the year, Mr. Simko said.

One reason the curve has flattened is that long-term yields have been held down because capital spending hasn't picked up the way some forecasters expected after the 2017 tax cuts, said Krishna Memani, chief investment officer at OppenheimerFunds Inc.

"A couple more Fed tightenings and we're pretty much there" at a flat yield curve, Mr. Memani said.

Signs of inflation persist, however: The personal-consumption expenditures price index, the Fed's preferred inflation yardstick, rose 2.3% in May from a year earlier, its biggest annual rise since March 2012, the Commerce Department said Friday. That beats the Fed's 2% target.

Additionally, few observers see a recession on the horizon. The economic expansion likely will end in 2020 as Fed interest-rate increases cool off an overheating economy, according to forecasters surveyed by The Wall Street Journal. The survey was completed in May, before the Trump administration stepped up its tariff campaign.

Expectations that the Federal Reserve will keep raising interest rates have propped up short-term Treasury yields. PHOTO: PABLO MARTINEZ MONSIVAIS/ASSOCIATED PRESS

Yet recent escalations in trade tensions have spurred increased volatility in financial markets, making some investors more anxious. Doug Peebles, chief investment officer at Alliance Bernstein Fixed Income, said that has made risky assets including stocks and emerging-market bonds less attractive, and he recommends investors reallocate more funds to the safer assets such as Treasurys, he said.

Rather than serving as a gauge of future economic performance, the yield curve is "probably the most important tool we have in explaining the backdrop for risk-taking" in financial markets, he said.

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Appeared in the July 6, 2018, print edition as 'Yield Curve Squeezed From Both Sides.'

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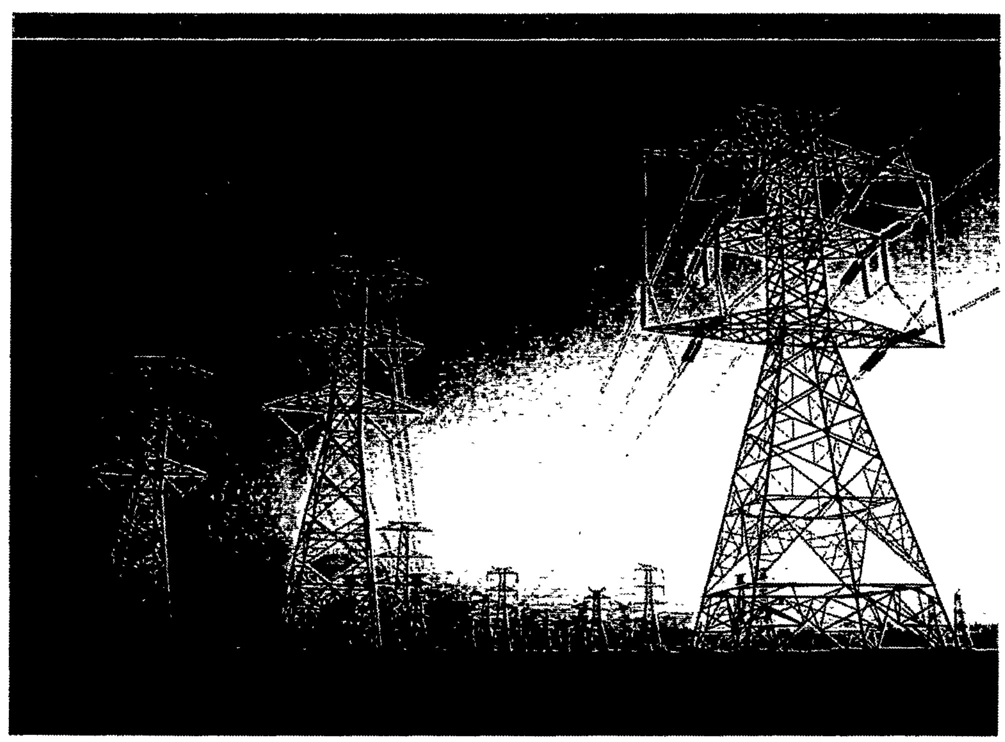
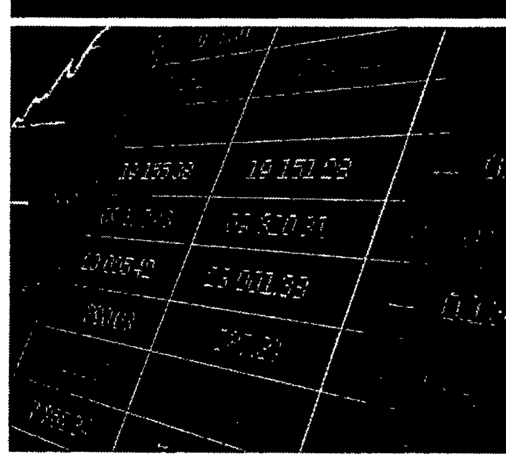
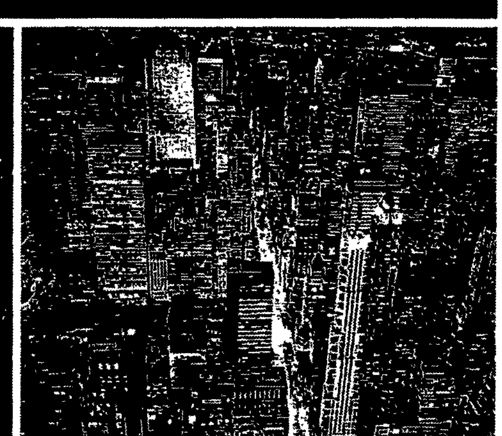






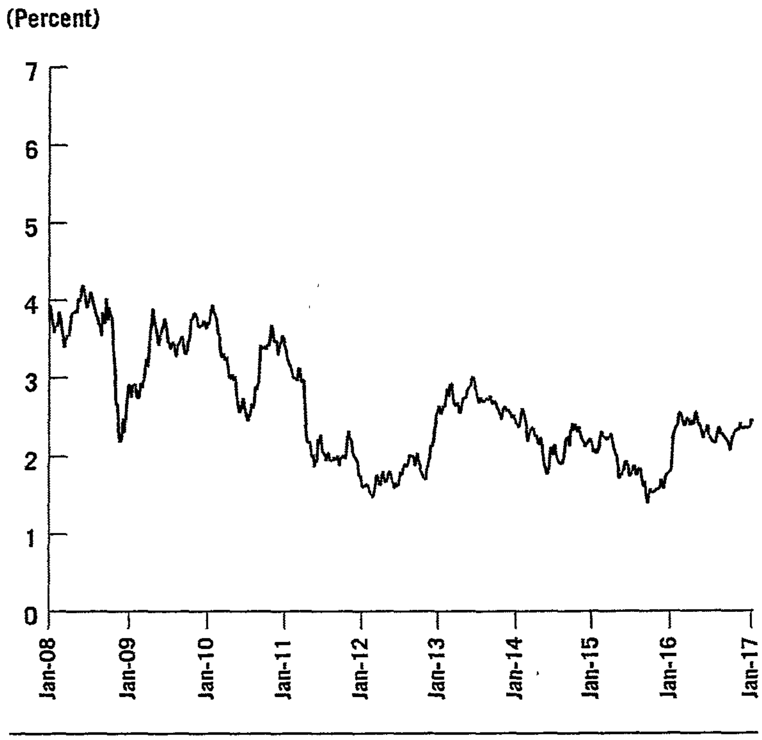
2017 Returns By Quarter

Index	Q1	Q2	Q3	Q4
EEI Index	6.1	2.4	2.7	0.1
Dow Jones Industrial Average	5.2	4.0	5.3	11.3
S&P 500	6.1	3.1	4.5	6.6
Nasdaq Composite*	9.8	3.9	5.8	6.3

Category	Q1	Q2	Q3	Q4
All Companies	5.2	2.5	3.2	0.2
Regulated	5.8	2.7	3.5	(0.7)
Mostly Regulated	3.9	2.0	2.5	2.5

* Price gain/loss only. Other indices show total return.
For the Category comparison, straight, equal-weight averages are used (i.e., not market-cap-weighted).
Source: EEI Finance Department, S&P Global Market Intelligence.

10-Year Treasury Yield
1/1/08 through 12/31/17



Source: U.S. Federal Reserve.

500 returned 21.8%. The broad market in 2017 was lifted by optimism about strengthening U.S. and global economic growth. U.S. real gross domestic product (GDP) rose 3.2% in Q3 and 3.1% in Q2 — the highest quarterly readings since Q1 2015 — up from a sluggish 1.2% gain in 2017's first quarter. Markets were also powered higher by improving global growth prospects, which solidified in 2017 following the economic stagnation in Europe and Japan, and broad-based concern about a weak global economy that weighed on markets early in 2016. By late in 2017, economists estimated global growth this year and next at a strong 3.6% to 3.7%. Euro-area economies, in particular, finally experienced an emerging wide-spread confidence after years of near-recessionary conditions, with 2%+ real GDP growth forecast for 2017 and 2018, up from 1.5% when the year began. U.S. corporate earnings are pegged to rise 9% to 10% in 2017 and 2018 while Euro-area corporate profits are set to gain more than 30% in 2017 and about 10% in 2018. Given these trends, most economic sectors outgained the EEI Index for the year with the economically sensitive technology (+37.3%), basic materials (+25.2%) and industrials (+24.6%) sectors as market leaders.

Despite the stronger economic growth, persistently low inflation was one factor that held down interest rates. U.S. and European inflation remained below 2% and in Japan it remained well below 1%. While U.S. longer-term yields failed to rise in 2017, they were still far higher than yields available in Europe and Japan, where bond yields broadly remained below 1% and short-term interest rates were below zero. These very low global yields outside the U.S. may have been one source of support for utility shares, as yield-starved investors sought the income available from utilities' sturdy dividends.

Q4 produced a separation of fortunes between utilities and the major averages. Utilities generally declined in December, partially giving up their year-to-date gains, and the EEI Index rose just 0.1% in Q4 compared to the Dow Jones 11.3% jump and the S&P and Nasdaq's 6%+ gains.

Industry Fundamentals Remain Healthy

The industry's stock performance in 2017 was something of a reflection of its strong fundamentals, which include healthy balance sheets, steady mid-single-digit earnings growth from capital investment programs and an industry average dividend yield just above 3%. Analysts noted several other supportive themes that colored 2017.

Natural gas prices and low-cost renewable power (mostly wind) have helped fuel costs remain low and have reduced pressure on customer bills that might otherwise be required to fund capex programs. Regulation in general remains constructive. Many utilities now have rate mechanisms in place that allow for more timely recovery of capital expenditures and address the impact of very slow to flat sales growth, bad debts and pension costs. Analysts also noted more states are implementing multi-year rate plans with fewer rate cases and better opportunities for utilities to earn their allowed return on equity.

Federal and state policymakers also offered support for baseload coal and nuclear plants through federal energy market reforms set for 2018 along with court rulings and state decisions that supported zero emission credits for nuclear plants, which could improve cash flow and ease concern about decommissioning liabilities. These moves in part supported share prices for select companies within the EEI Index's Mostly Regulated category, which returned 11.3% in 2017, nearly matching the Regulated category's 11.7% return even as natural gas spot prices held at multi-year lows, ranging from $2.50-3.00/mmBTU. And the natural gas futures curve was little changed from year-end 2016, remaining at the lowest levels of the past decade.

Such regulatory and policy support is crucial in an environment where power demand is virtually flat. Driven by the changing nature of the U.S. industrial economy and the impact of energy efficiency programs, nationwide demand in 2016 totaled 3.76 billion megawatthours, nearly the same as that of 2007. And power demand through October of 2017 (latest EIA data available) was down 2.7% year-to-year.

Top Gainers

AVANGRID (+38.1%) was the EEI Index's top gainer for 2017. The company reported profits that beat analysts' estimates for the first three quarters of the year and said it hopes to grow earnings 8% to 10% annually through 2020, mostly through regulated operations. The company said it plans to invest $9 billion in its utilities and competitive renewable operations through 2020. NextEra Energy (+34.4%) was the next-strongest gainer and likewise rose on strong growth prospects driven by a focus on renewable investment. In June 2017, management said it hopes to grow earnings at a 6-8% rate and dividends at a 12-14% rate between

Sector Comparison 2017 Total Shareholder Return

Sector	Total Return %
Technology	37.3%
Basic Materials	25.2%
Industrials	24.6%
Healthcare	22.9%
Consumer Services	20.4%
Financials	20.1%
Consumer Goods	17.1%
Utilities	12.5%
EEI Index	**11.7%**
Telecommunications	(0.2%)
Oil & Gas	(1.5%)

Source: EEI Finance Dept.; Dow Jones & Company, Yahoo! Finance.

MOODY'S
INVESTORS SERVICE

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Announcement: Moody's changes the US regulated utility sector outlook to negative from stable

18 Jun 2018

Key financial credit ratios have declined over the past 12 months, and are expected to decline further through 2019 before stabilizing and recovering

New York, June 18, 2018 -- Moody's Investors Service ("Moody's") has changed the fundamental sector outlook for the US regulated electric and gas utility industry to negative from stable. The change in outlook primarily reflects a degradation in key financial credit ratios, specifically the ratio of cash flow from operations to debt, funds from operations (FFO) to debt and retained cash flow to debt, as well as certain book leverage ratios. The change in outlook also reflects uncertainty with respect to the timing and extent of potential changes in regulatory recovery provisions, authorized returns and equity layers or self-help options by individual companies in response to lower cash flow.

"Regulated utilities will be exposed to a higher level of financial risk for the next 12 to 18 months" said Ryan Wobbrock, Vice President -- Senior Analyst. "For utility holding companies, the consolidated ratio of FFO to debt has been on a steady decline, from 19% in 2013 to 17% at year-end 2017, and we expect it to decline further toward 15% through 2019."

The change in fundamental sector outlook reflects a declining financial trend, which is a function of higher holding company debt levels incurred in the last few years and a lower deferred tax contribution to cash flow going forward due to tax reform. In aggregating sector financials, Moody's examined 42 of the largest US utility & power holding companies with at least 10 years of historical financial data.

To mitigate this declining financial trend, several holding companies are taking defensive measures in 2018 to strengthen their balance sheets. On average, however, we expect debt to capitalization ratios to stay around 54% (up from 49% in 2016), large capital spending plans to persist, and dividend growth to increase -- all at the same time that FFO is falling. This trend will also keep debt to EBITDA at a ten year high level of around 5.0x for the next several years.

"With respect to financial mitigation measures, we see more activity in the pursuit of regulatory cost recovery relief than we do with management teams executing material changes to financial policies," said Wobbrock. "Thus far, there has been no discernible adjustments to dividend policies and most utilities continue to incorporate a heavy reliance on debt financing for their sizable negative free cash flow funding needs."

Management teams' defensive efforts and a few initial signs of supportive regulatory responses to tax reform are important first steps in addressing the sector's increased financial risk. However, we believe that it will take longer than 12 -18 months for the sector to exhibit a material financial improvement from these actions.

The fundamental sector outlook could return to stable if Moody's expects that the sector's financial profile will stabilize at today's lower levels, with consolidated FFO to debt metrics remaining steady at 15%. A positive outlook could be considered if we expect a recovery in key cash flow metrics where consolidated cash flow starts to improve by roughly 15%-20% or the ratio of consolidated FFO to debt indicates a return to the 17%-19% range.

The fundamentals sector outlook could stay negative if the key cash flow ratios continue to decline, or if there are signs that a more contentious regulatory environment is emerging. A more contentious regulatory environment is one where litigation is the preferred path of regulatory proceeding (instead of settlements), or where the suite of authorized recovery mechanisms begins to become more limited. Lower authorized returns on equity do not, by themselves, signal a weakening regulatory relationship.

US utilities continue to be viewed as critical infrastructure assets, which means they have a roughly 3x lower probability of default than their non-financial corporate peers. From a liquidity perspective, Moody's incorporates a view that US investor owned regulated electric and gas utilities will maintain unfettered access to the capital markets. In addition, Moody's continues to view regulated utilities as a defensive investment alternative in the event of a wide-spread, short-duration financial market shock. These factors provide the sector with a strong, investment grade credit profile, which continues to be the case, notwithstanding the negative sector outlook.

The report, "Regulated Utilities -- US: 2019 outlook shifts to negative due to weaker cash flows, continued high leverage," is available to Moody's subscribers at

https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1128302

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CENTRAL BANKS

Federal Reserve Holds Rates Steady, Says Economy Is Strong

Central bankers' optimistic economic outlook points to a rate raise at their next meeting

Federal Reserve Chairman Jerome Powell testified at a Senate Banking Committee hearing in Washington on July 17. PHOTO: ALEX WONG/GETTY IMAGES

By Nick Timiraos

Updated Aug. 1, 2018 4:58 p.m. ET

WASHINGTON—The Federal Reserve held short-term interest rates steady Wednesday and offered an upbeat assessment of the economy's performance, suggesting another interest-rate increase is likely at its next meeting.

The Fed repeatedly emphasized the economy's strength in a statement released after its two-day policy meeting. It offered nothing to dispel market expectations that it would deliver its third interest-rate increase of the year when it meets in late September.

"Economic activity has been rising at a strong rate," the statement said. In all, the Fed's rate-setting committee used the word "strong"—or a derivative of it—six times to describe the economy and labor markets.

Officials voted in June to raise their benchmark rate to a range between 1.75% and 2%. They voted unanimously on Wednesday to leave it there for now.

Overall U.S. economic output expanded at a 4.1% annual rate in the second quarter, the best three-month increase since 2014, the Commerce Department reported last week. During the first half of the year, the economy expanded at a 3.1% annual rate, slightly better than the 2.8% median forecast for the full year submitted by Fed officials in June.

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The question looming over the Fed's meetings this spring and summer has centered on how much further officials believe they will need to raise rates over the next two years.

In June, Fed officials penciled in plans to raise rates two more times this year and three times next year, which would push their benchmark rate above 3%. Officials estimate that moving rates about that level would effectively be tapping brakes on economic growth.

Traders in futures markets largely agree with the Fed's outlook. On Wednesday, they placed a roughly 90% chance of a rate increase this September and a 70% chance of at least one more increase by December, according to CME Group .

The challenge for central bankers is to lift borrowing costs enough to prevent the economy from overheating but not so much that it tips into recession.

Inflation is close to the Fed's 2% target after undershooting it for many years. Consumer prices in June rose 2.2% from a year earlier. Excluding volatile food and energy categories, they rose 1.9%, according to the Fed's preferred inflation gauge. The Fed likes to maintain inflation around 2%, seeing it as a sign of a balanced economy.

The threat of trade disputes, meanwhile, has added another layer of uncertainty to the Fed's forecasts. Wednesday's statement made no mention of trade policy.

By raising goods prices, tariffs could result in slightly higher inflation, though Fed Chairman Jerome Powell has indicated the Fed would look past such one-time price increases. A stronger dollar could also offset some of these effects by making it cheaper for Americans to buy foreign goods, pushing down import prices.

A slowdown in global growth that spills back into the U.S., on the other hand, could prompt the Fed to reconsider its rate-rise plans.

"Although we believe the move toward protectionism is a material threat to corporate profits and the economy, we think the Fed's plan is unlikely to change," said Ron Temple, head of U.S. equities and co-head of multiasset investing for Lazard Asset Management.

Stronger U.S. economic growth over the past year hasn't resulted in accelerating price pressures even though unemployment has dipped to levels officials believe should force employers to raise wages and prices.

Mr. Powell offered a mostly bullish assessment over two days of congressional hearings last month. Pressed over whether inflation was more likely to be higher or lower than expected, he said he was "maybe slightly more worried about lower inflation," given the long period in which inflation defied Fed forecasts that predicted an imminent return to 2%.

The Labor Department is set to report on July hiring this Friday. In June, the unemployment rate ticked up from 3.8% in May despite strong employment gains, reflecting a surge of new workers who hadn't been actively looking for work.

This week's Fed meeting was the first since President Trump last month signaled his unhappiness with the Fed's rate-increase campaign, though Mr. Trump said he wouldn't interfere with their plans. Fed officials, including Mr. Powell, have said they won't react to political pressure and made no mention of it Wednesday.

Mr. Trump said on Twitter last month the Fed's efforts to slowly raise interest rates from unusually low levels "hurts all that we have done" to boost economic growth. In effect, Mr. Trump signaled his desire to enlist the Fed in his broader campaign to narrow trade deficits. Those efforts could be undermined if higher interest rates in the U.S. raise the value of the dollar against other currencies.

A stronger greenback makes U.S. exports relatively more expensive in world markets. Mr. Trump regards bilateral trade deficits as important benchmarks of economic vitality, though most economists don't see it that way.

Mr. Trump's own policies also have contributed to the stronger dollar because they are boosting growth and raising budget deficits, which places upward pressure on the U.S. currency.

A Trump administration official told The Wall Street Journal last month the White House was comfortable with one more rate increase this year—but not two.

Write to Nick Timiraos at nick.timiraos@wsj.com

Appeared in the August 2, 2018, print edition as 'Fed Stays on Course For Interest Rates.'

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https://www.wsj.com/articles/an-inverted-yield-curve-may-not-portend-doom-1532989421

OPINION | COMMENTARY

An Inverted Yield Curve May Not Portend Doom

Today's global financial environment is highly unusual. The old rules don't necessarily apply.

By Burton G. Malkiel

July 30, 2018 6:23 p.m. ET

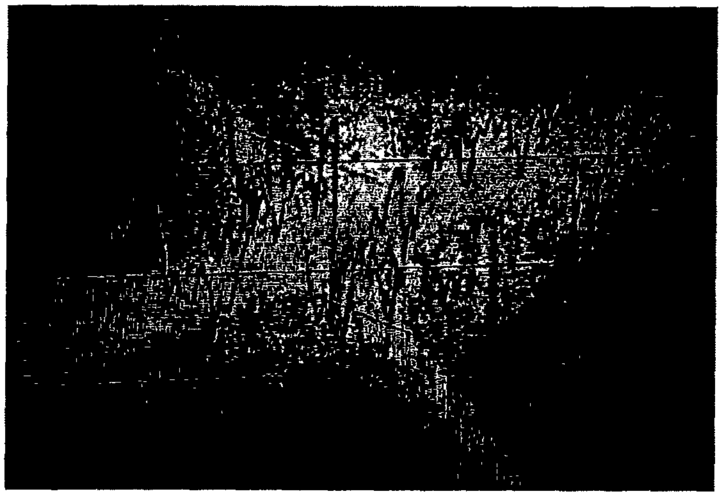
How worried should investors and policy makers be about the possibility of an inverted yield curve—a historical predictor of future recessions and bear markets in stocks?

The yield curve is the most widely used measurement of the relationship between interest rates of the U.S. government's debt obligations. Normally the curve is ascending, with more-volatile long-term bonds having higher yields than short-term obligations. But occasionally the curve inverts, with long-term bonds yielding less than Treasury bills. Recently, the curve has become noticeably flatter, with short-term rates rising and longer yields remaining stagnant. This has led many analysts to think that the curve will soon invert. But that does not mean a recession is imminent.

One strong influence on the shape of the yield curve is investor expectations regarding the course of future interest rates. Imagine that the yield curve were positively sloped, with long-term bond yields higher than T-bill yields. The positive slope would not necessarily prompt investors to prefer long-term bonds to T-bills despite their higher yields. That is because if yields were expected to rise in the future, bond prices would fall, and the longer the term to maturity of the bond, the more its price would decline.

Alternatively, suppose bonds yielded less than short-term obligations. Investors might still choose to invest in long-term bonds if they expect lower rates in the future since bond prices would eventually rise to reflect the lower yields. Thus, an inverted yield curve suggests that investors are expecting rates to fall.

The expectations analysis of the yield curve also explains why an inverted curve may forecast a coming recession. Consider the last time the yield curve inverted, in 2006-07. The Federal Reserve, moving aggressively to combat inflationary pressures in the overexuberant housing market, pushed short-term rates well above 5%, meaning real rates were over 3%. While long-



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term rates had also risen, they remained just below 5% and the curve inverted. Investors correctly anticipated that the Fed would be successful in its efforts to curb the inflationary pressures and that rates would fall in the future, as they ultimately did. Longer-term bonds were in fact an attractive investment.

But the air was not let gently out of the housing bubble. Home prices and economic activity collapsed. Again, the yield curve correctly forecast not only the course of future interest rates but a punishing recession and stock-market collapse as well. In general, inverted yield curves have always accompanied restrictive market conditions that were initiated to reduce inflationary excesses and to moderate economic activity.

How does the situation compare today? Both short-term and 10-year interest rates are below 3%. With inflation running at 2%, real interest rates are low (under 1%), and the yield curve has yet to invert. There appear to be few speculative excesses in the economy. Moreover, even if the Fed pushed short-term rates another percentage point higher, monetary policy would remain broadly accommodative. Restrictive monetary policy has often led to declines in economic activity. But today the Fed is trying only to normalize rates, not take the punch bowl away. Real interest rates remain at historically low levels.

It is always dangerous to say "this time is different." Even so, we need to consider how the increasingly globalized financial markets might make interpreting the yield curve difficult. The global environment today is highly unusual. Both the European Central Bank and the Bank of Japan have monetary policies opposite those of the U.S. Fed. Long-term interest rates in Europe and Japan have hovered near zero, or even below. These yields have made U.S. Treasury bonds extremely attractive, especially since the dollar has been increasing in value. Foreign investors have every reason to prefer U.S. bonds to their own, and undoubtedly the relative enticement of U.S. Treasurys has influenced their yields. Low long-term rates in this environment may emit a different signal than has been the case in the past.

Inflation appears to be well contained today, and the effect of platform marketing companies such as Amazon, robotic manufacturing technology and global sourcing of goods and services should continue to control price increases. The typical inflation imbalances in markets that have generated credit crunches in the past seem far less likely today.

I do not mean to imply that we have nothing to worry about with respect to either the economy or the stock market. The prospect of a global trade war should make us very cautious. Once we start down the road of tariff increases and threats of more to come, the dangers of retaliatory miscalculations are very real and very scary. But a flat yield curve, or even an inverted one, should not be on top of our worry list under today's accommodative monetary conditions.

Mr. Malkiel is author of "A Random Walk Down Wall Street," whose 12th edition is forthcoming.

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TEXAS-NEW MEXICO POWER COMPANY'S RESPONSES TO COMMISSION CITIES' - LK 1-1 THROUGH LK 1-10

LK 1-4 Please provide copies of all articles, regulatory commission orders, rating agency reports, and other supporting documentation cited and relied upon by Mr. Hevert in his Direct Testimony and exhibits. Include copies of all articles, reports, and other documents cited in the footnotes.

Prepared by: Joshua Kaushansky

Sponsored by: Robert Hevert

Attachment: TNMP 48401_LK 1-4 Attachment A Index.xls; TNMP 48401 LK 1-4 Attachment B (Voluminous).pdf; TNMP 48401 LK 1-4 Attachment C.pdf; TNMP 48401 LK 1-4 Attachment D.pdf; TNMP 48401 LK 1-4 Attachment E.pdf; TNMP 48401 LK 1-4 Attachment F.pdf; TNMP 48401 LK 1-4 Attachment G.pdf; TNMP 48401 LK 1-4 Attachment H.pdf; TNMP 48401 LK 1-4 Attachment I.pdf; TNMP 48401 LK 1-4 Attachment J.pdf; TNMP 48401 LK 1-4 Attachment K (Voluminous).pdf

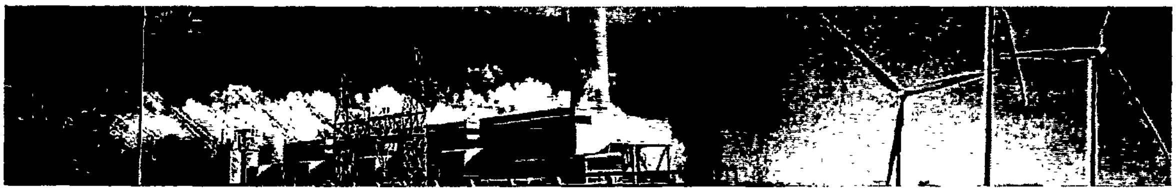
RESPONSE:

Attachments LK 1-4 B and LK 1-4 K responsive to this request are voluminous and are available for inspection at TNMP's Voluminous Room, Jackson Walker L.L.P., 100 Congress Avenue, Suite 1100, Austin, Texas 78701, during normal business hours, by making arrangements with Pamela Collins, (214) 953-5973.

Please see attachments TNMP 48401_LK 1-4 Attachments A through K for Mr. Hevert's cited material.

FitchRatings **What Investors Want to Know**

Special Report — Corporates / U.S.A.



Tax Reform Impact on the U.S. Utilities, Power & Gas Sector

Tax Reform Creates Near-Term Credit Pressure for Regulated Utilities and Holding Companies

Regulatory Support Key to Mitigating Downward Migration in Ratings

Near-Term Pressure on Credit Metrics: The Tax Cuts and Jobs Act signed into law on Dec. 22, 2017 has negative credit implications for regulated utilities and utility holding companies over the short to medium term. A reduction in customer bills to reflect lower federal income taxes and return of excess accumulated deferred income taxes (ADIT) is expected to lower revenues and FFO across the sector. Absent mitigating strategies on the regulatory front, this is expected to lead to weaker credit metrics and negative rating actions for issuers with limited headroom to absorb the leverage creep.

Significant Hit to FFO: To analyse the impact of the tax reform bill across our utility coverage, Fitch Ratings studied a sample of 140 regulated operating subsidiaries and utility holding companies. We estimate that regulated utility subsidiaries will, on average, see an approximately 6% reduction in net revenues if tax changes are reflected in customer bills right away. Fitch has assumed that a substantial portion of the excess ADIT will be returned to customers over the life of the utility property. The lower revenue translates to an approximately 15% reduction in FFO that drives an approximately 45 basis point increase in FFO-adjusted leverage across our sample.

Regulatory Response and Financial Policy Key: State regulators have begun to examine the impact of tax reform on regulated utilities in their states. While most state regulators will seek to provide some sort of rate relief to customers, they may be open to a negotiated outcome that also preserves the creditworthiness of the utilities. Management actions to defend their credit profiles are also important in assessing the future rating trajectory of an issuer. Overall, Fitch expects rating actions to be limited and on a case-by-case basis. Holding companies are more vulnerable given the elevated leverage profile for many, driven by past debt-funded acquisitions.

Longer-Term Positive: Over a longer-term perspective, Fitch views tax reform as modestly positive for utilities. The sector retained the deductibility of interest expense, which would have otherwise significantly impacted cost of capital for this capital-intensive sector. The exemption from 100% capex expensing is also welcome news for the sector, which has seen years of bonus depreciation inflate ADIT, which is netted from the rate base in most state regulatory jurisdictions. The excess ADIT will be recorded as a regulatory liability, which will amortize over time, leading to rate base and earnings growth. Finally, the reduction in federal income taxes lowers cost of service to customers, providing utilities headroom to increase rates for capital investments.

In this report, Fitch Ratings addresses the following frequently asked questions from investors:

- How does tax reform affect regulated utilities?
- What is the impact of tax reform on utility holding companies and nonregulated businesses?
- What is the magnitude of FFO reduction and leverage increase for the sector?
- Does Fitch expect to take widespread rating actions driven by tax law changes?
- Which issuers does Fitch consider most at risk for negative rating actions?

How Does Tax Reform Affect Regulated Utilities?

The Tax Cuts and Jobs Act has negative credit implications for the regulated utilities and several utility holding companies over the short to medium term. A reduction in customer bills to reflect lower federal income taxes and return of excess ADIT to customers is expected to lower revenues and FFO across the sector. Absent mitigating strategies on the regulatory front, this is expected to lead to weaker credit metrics and negative rating actions for those issuers that have limited headroom to absorb the leverage creep. The end of bonus depreciation or the "interest-free loan" from the federal government and reduced FFO at a time when capex budgets are elevated will necessitate greater reliance on equity and debt funding for the utility subsidiaries. This could lead to higher costs of capital for the sector, especially if regulators require an immediate reduction in customer bills to reflect the tax law changes.

It is important to note that the negative impact on cash flows and leverage metrics is primarily being driven by timing-related differences. Due to availability of 100% and 50% bonus depreciation on qualified property in recent years, most utilities have not been paying cash taxes and have seen a sharp buildup in ADIT. This situation would have reversed over time, and our financial forecasts did reflect a hit to FFO for most utilities as they returned to full cash taxpaying status by 2020–2021. With tax reform, utilities cannot claim bonus depreciation anymore, the ADIT has to be recalculated at the new 21% rate, the future ADIT also builds at the 21% rate, and the excess ADIT has to be refunded to customers, leading to lower FFO expectation compared to prior Fitch estimates. Since federal income taxes are included in a utility's cost of service, this is typically a straight pass-through cost. With most utilities not paying cash taxes, the reduction in revenue requirement due to lower federal taxes does not have an equivalent offset. Hence, past bonus depreciation benefits have exacerbated the situation for utilities, leading to unanticipated near-term pressure on FFO.

Over a longer-term perspective, Fitch views tax reform as modestly positive for utilities. The sector retained the deductibility of interest expense, which would have otherwise significantly impacted cost of capital for this capital-intensive sector. The exemption from 100% capex expensing is also welcome news for the sector, which has seen years of bonus depreciation benefits supress rate base (for most states, ADIT reduces the rate base on which a utility earns a return). Finally, the reduction in federal income taxes lowers cost of service to customers, providing utilities headroom to increase rates for capital investments. Fitch estimates that electric utility customers could, on average, see approximately 3%–5% reduction in their bills due to tax law changes.

What Is the Impact of Tax Reform on Utility Holding Companies and Nonregulated Businesses?

At the holding company level, the reduction in utility subsidiaries' cash flows will weaken the consolidated cash flow profile, leading to higher leverage unless mitigated by holdco debt reduction. In addition, there continues to be limited clarity surrounding the deductibility of holding company interest, in particular the methodology to allocate consolidated interest expense between regulated and nonregulated businesses. Until resolved, these issues will continue to weigh on the financial policies of holding companies.

There is no ambiguity in how interest expense will be treated for regulated and nonregulated entities. Regulated subsidiaries will be able to fully deduct interest expense for tax purposes, and nonregulated businesses, similar to other corporations, will be subject to the 30% of EBITDA limitation (which changes to 30% of EBIT in 2022). Calculating interest deductibility for holding companies gets complicated. For holdcos such as NextEra Energy, Inc., which has distinct regulated and nonregulated debt issuing entities, the analysis is straightforward. However, for other holdcos such as Dominion Energy, Inc., which issues debt for nonregulated businesses at the holdco level, or even for holdcos such as Exelon Corporation and FirstEnergy Corporation, which issue debt at their nonregulated entities, it is not clear how the consolidated interest expense will be allocated between regulated and nonregulated businesses. Several managements we spoke to seem to believe that asset-based allocation, such as that used for allocation of interest for foreign corporations, will be applicable. As a broader issue, we are most concerned with allocation of holdco interest expense to regulated businesses to claim full deductibility of interest expense, since regulated subsidiaries already meet their prescribed capital structure. We expect uncertainty to prevail until the U.S. Treasury department issues guidance in this regard.

For nonregulated businesses, the reduction in federal income taxes is positive because the benefit accrues straight to the bottom line. Fitch expects renewable business to be negatively impacted since the federal renewable tax credits are less valuable at the lower tax rate, thus making renewable economics less favorable. Fitch also expects less tax equity to be available as a source of financing, which is likely to hit the small renewable developers disproportionately. In this regard, solar developers may be more significantly impacted than wind developers due to the large upfront solar investment tax credit (ITC) that needs to be absorbed versus a 10-year life of wind production tax credits (PTCs). A lower tax rate also lowers the net present value of accumulated renewable tax credits and accumulated net operating losses by extending the time period over which these will be used.

What Is the Magnitude of FFO Reduction and Leverage Increase for the Sector?

We have analyzed the cash flow impact for the sector while admitting that tax and accounting nuances overlaid by the complexity of regulatory accounting makes the exercise challenging. After analyzing a sample of 140 regulated operating subsidiaries and utility holding companies, we estimate that regulated utility subsidiaries will, on average, see an approximately 6% reduction in net revenues if the tax reform changes are reflected in rates right away. This reduction in revenues translates to an approximately 15% reduction in FFO and an approximately 45 basis point increase in FFO-adjusted leverage across our sample.

Key inputs and assumptions incorporated in our analysis include:

- **Immediate reduction in customer bills to reflect the cut in federal tax rate to 21% from 35%:** Under cost-of-service regulation, federal and state income taxes are treated as an expense that is recoverable in regulatory tariffs. The reduction in federal income tax rate will lower the income tax expense, thus leading to lower revenue requirement for a regulated utility. As highlighted above, due to prior bonus depreciation benefits, most utilities are not paying cash taxes. As a result, immediate reduction in customer bills to reflect the lower revenue requirement will lead to lower FFO.
- **95% of ADIT, as reported on LTM basis, was assumed to be protected:** Based on our survey of regulated utilities, it appears a vast majority of the ADIT reported on the balance sheet pertain to public utility property and arise from accelerated federal tax depreciation and investment tax credits on that property, and, therefore, are protected by IRS normalization requirements. As a rough rule of thumb for our sample, we assumed that 95% of ADIT is protected and 5% unprotected, while recognizing that actual amounts may vary by utility.
- **Return of the excess protected ADIT over 30 years and excess unprotected ADIT over five years:** Section 203(e) of the Tax Reform Act of 1986, also known as the Average Rate Assumption Method (ARAM), provided for the reduction in protected ADIT due to the reduction in the tax rate to be spread over the life of the related property. Fitch has assumed that similar ARAM will be applicable for the Tax Cuts and Jobs Act, which seems consistent with the approach that most utilities are taking. The average life of utility property varies by utility, but 30 years serves as a good approximation. The return of unprotected ADIT is not subject to IRS normalization rules and, hence, will be subject to discretion of the regulators. While the regulatory approach with respect to unprotected ADIT varied across states in 1986, for the purpose of our exercise, we have assumed that regulators will require excess unprotected ADIT to be returned to customers over a five-year period.
- **Net PPE-based allocation methodology for holding company interest:** For the purpose of our exercise, we have allocated the consolidated interest expense between regulated and nonregulated businesses using net PPE as a proxy.
- **No adjustments made for bonus depreciation:** We have not made adjustments for the loss in bonus depreciation for years 2018 and 2019 (versus prior benefits at 40% and 30% for property placed in service in 2018 and 2019, respectively). The negative impact will be partially offset by bonus depreciation on capex incurred until Sept. 29, 2017 for property placed in service in 2018.

Does Fitch Expect to Take Widespread Rating Actions Driven by Tax Law Changes?

Fitch's rating actions will be guided by both the regulatory and management responses. A majority of states have opened dockets or requested all utilities in the state to submit an analysis on the implications of the tax reform. While regulators will be keen to provide some sort of rate relief for customers, such actions could take many forms and vary in time frame. Some jurisdictions may be open to a negotiated outcome that focuses more on benefits of rate stability and creditworthy utilities rather than immediate rate reductions. In the former, many tools could be employed, including the following:

- Deferral of lower tax expense to use as an offset to expected future rate increases either from the recovery of regulatory deferrals or rate base growth
- Return of excess unprotected ADIT over a longer-term horizon
- Increase in authorized equity ratio and/or return on equity
- Accelerated depreciation on some assets
- Lower capex

The time frame for regulatory action is an important consideration and will be varied. Some jurisdictions have asked for tax savings to be returned to customers immediately, thereby creating a decline in cash flow on day one. Some jurisdictions have directed utilities to segregate the effect of lower taxes to consider in future ratemaking procedures, and therefore result in no near-term change to cash flow. Some companies are in the middle of multiyear rate plans or rate settlements that do not provide for changes in tax rate, while other rate arrangements have incorporated mechanisms for lower taxes. Lastly, managements' responses to defend their credit profiles in the face of prospective lower cash flow will be key. If Fitch sees a credible path for credit metrics to be restored commensurate with the existing rating level, no rating actions may be warranted.

Holding companies are more vulnerable to negative rating actions given the elevated leverage profile for many, driven by past debt-funded acquisitions. The cash flow profile of holdcos will be weaker than prior expectations due to regulated utility subsidiaries bearing the brunt of tax law changes, leading to lower cash tax and possibly lower dividend distributions to parent holding companies. Moreover, funding needs at regulated subsidiaries will increase with the elimination of bonus depreciation. Conversely, the nonregulated subsidiaries will benefit from tax reform, which will be positive for parent holding companies.

Which Issuers Does Fitch Consider Most at Risk for Negative Rating Actions?

Issuers with limited headroom at the current rating level that are close to their negative rating triggers as established by Fitch are more vulnerable to negative rating actions. The most susceptible issuers are those that already have a Negative Outlook or are on Negative Rating Watch.

Key Rating Triggers for Select Issuers on Negative Outlook or Rating Watch

Issuer	IDR	Outlook/ Watch	Pre-Tax Reform FFO-Adjusted Leverage 2018F (x)	Key Downgrade Trigger	Key Upgrade Trigger
DTE Energy Co.	BBB+	Negative Outlook	4.6	Material delays associated with permitting and constructing the NEXUS pipeline, along with FFO-adjusted leverage sustaining > 4.5x.	Sustained FFO-adjusted leverage to 4.0x or better.
Duke Energy Corp.	BBB+	Negative Outlook	5.4	Inability to recover coal ash costs and sustained FFO-adjusted leverage > 5.1x by 2019.	Unlikely in medium term.
Georgia Power Co.	A	Negative Rating Watch	4.4	Proceeding with construction of new nuclear units while retaining material exposure to further costs and schedule overruns, and FFO-adjusted leverage > 4.3x on a sustained basis.	Unlikely in medium term.
SCANA Corp.	BB+	Negative Rating Watch	8.1	Material unrecoverable costs for the abandoned new nuclear project, constrained liquidity and adjusted debt/EBITDAR > 5.5x.	Constructive resolution of the stranded new nuclear project and adjusted debt/EBITDAR < 4.5x.
Southern Company	A–	Negative Rating Watch	5.2	Downgrade of Georgia Power Co. and FFO-adjusted leverage sustaining > 4.7x by 2019.	Unlikely in medium term.
WGL Holdings, Inc.	A–	Negative Rating Watch	4.2	Ownership by a weaker parent after acquisition is completed, and FFO-adjusted leverage > 4.0x.	Unlikely in medium term.

Source: Fitch

Related Research

Fitch 2018 Outlook: U.S. Utilities, Power & Gas (Supportive Regulation and Low Commodity Costs Support Stable Outlook) (November 2017)
U.S. Utility Parent Companies Handbook (A Detailed Review of Utility Parent Companies — Third Edition) (November 2017)
U.S. Competitive Generators Handbook (A Detailed Review of Competitive Generation Companies) (October 2017)
U.S. Regulated Utility Parent Holding Companies Peer Comparison (October 2017)
U.S. Integrated Electric Utilities Handbook (A Detailed Review of Integrated Electric Utilities) (August 2017)
U.S. Transmission and Distribution Utilities Handbook (Detailed Review of Electric and Gas T&D Utilities — Third Edition) (May 2017)

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S&P Global
Market Intelligence

March 19, 2018
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RRA Financial Focus
Utility Impact of the Tax Cuts and Jobs Act

- Investor-owned gas and electric utilities are preparing to return billions to ratepayers nationwide as provided for in the Tax Cuts and Jobs Act of 2017. Some $91.4 billion could be flowed back as utilities' excess deferred income tax liabilities are normalized in state regulatory proceedings, according to our latest analysis of Regulatory Research Associates' utility universe.
- Utility cash flows are expected to be reduced due to the return of excess deferred taxes and refunding of over-collections that occur until new rates are in place and because the lower tax rate reduces revenue requirements on an ongoing basis.
- Credit rating agencies have warned that utility credit metrics will be strained as a result of decreasing cash flows. Several utility holding companies and diversified utilities with competitive generation segments have announced plans to raise capital through equity and debt issuances or plans to reduce capital expenditures to maintain credit metrics.
- Our analysis concludes the average RRA utility decreased its total deferred income tax liability at Dec. 31, 2017 by 43%, compared to the year before. This follows several years of escalating balances.
- Rate base growth is expected across the sector as a result of the Tax Act, as lower deferred income tax liabilities reduces the offset to rate base in most states. Based on our analysis, utilities, including Edison International, Eversource Energy, OGE Energy, Pinnacle West Capital and ONE Gas are likely to benefit the most from tax-reform-related rate base growth.

Coincident with the completion of year-end 2017 accounting, the utility industry has written down billions in deferred tax liabilities associated with the reduction in the corporate income tax rate to 21% from 35%, and adjusted earnings guidance based on tax law changes. Investors now are focused on further implications of the Tax Cuts and Jobs Act of 2017, or TCJA, including credit ratings and near-term cash flow impacts. Also being evaluated are longer-term earnings expansion prospects given expected growth in utility rate base from lower deferred taxes.

Overall, tax reform — as RRA sees it — is near-term negative, but longer-term positive for regulated utilities. Longer-term, the reduction in deferred federal income taxes is expected to lead to increased rate base growth among electric and gas utilities, given that most states deduct accumulated deferred income taxes, or ADIT, in calculating rate base. Therefore, carrying a smaller ADIT balance should, all else being equal, increases rate base. Utilities should also have more "headroom" in proceedings seeking added capital investment before state regulators as customer rates decline nationwide, all else equal, due to the lower corporate tax rate. For our earlier analysis on tax reform read: Tax reform bill promises big changes for utilities, power producers.

Credit rating agencies have cautioned that the lower corporate tax rate could pressure utility credit metrics, as the reduction in deferred tax liabilities resulting from their revaluation to reflect the lower tax rate, together with the loss of bonus depreciation, will impact operational cash flows. S&P Global Ratings suggests that holding companies taxed on a consolidated basis are

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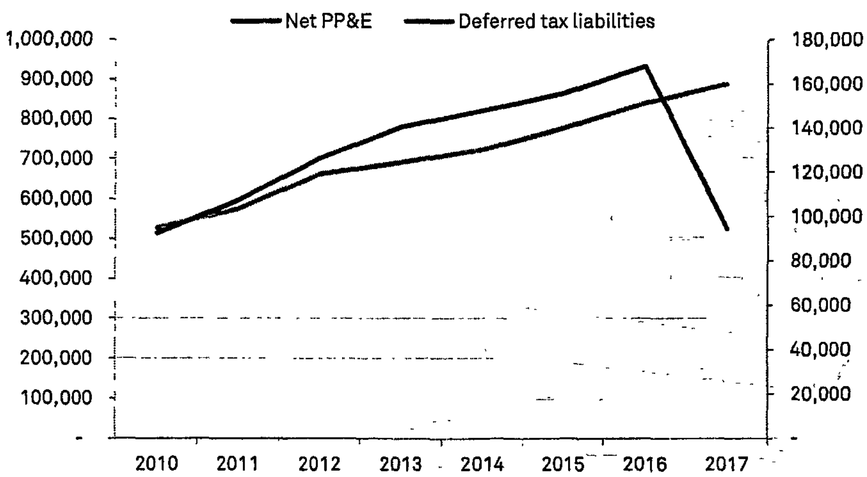
more likely to experience credit pressure than standalone utilities. Several utility holding companies and diversified utilities with unregulated generation segments have recently disclosed plans to issue new equity or debt or reduce capital investment in order to offset impacts to capital structures and improve cash flow.

Utilities re-measured ADIT given the lower tax rate and recorded excess ADIT as a regulatory liability on their balance sheets at the end of 2017. In rate making proceedings, excess deferred tax balances are classified as either protected by the Internal Revenue Code or unprotected. Protected excess ADITs are subject to normalization procedures, whereby they are subtracted from rate base and returned to ratepayers over an agreed upon amortization schedule, typically the remaining life of the assets. Unprotected excess deferred income taxes are not subject to normalization and their treatment is subject to determination of the governing regulatory agency. Most state regulatory commissions and FERC have opened proceedings into tax reform impacts and treatment of utility jurisdictional rate bases and rates. See map below to see tax reform proceedings by state.

Tax act causes write-off of tax liabilities ($M)



As of Dec. 31, 2017.
Note: Includes data for 43 investor-owned utility holding companies.
IOUs that did not have deferred tax liability data available excluded.
Source: S&P Global Market Intelligence

Looking at the entire utility sector as represented by the RRA universe, the chart at the left shows the steep drop in deferred tax liabilities at Dec. 31, 2017, following years of accumulation made possible with the help of bonus depreciation and intensive capital investment.

The average RRA utility decreased its total deferred income tax liability at Dec. 31, 2017 by 43%, compared to the year before. Utilities that slashed their deferred income tax liability most included South Jersey Industries, FirstEnergy and ALLETE. Those that decreased the liability the least include Sempra Energy, UGI Corp and Spire Inc. See table at end of report for a company-by-company breakdown.

Regulatory liabilities up $1.7 billion on average

In an effort to benchmark RRA-covered gas and electric utilities against potential cash flow and rate base impacts, RRA has compiled data that addresses regulatory liabilities specifically resulting from re-measurement of deferred taxes required by the TCJA. This data was typically disclosed in corporate Form 10-Ks and 10-Qs. Of the 54 investor-owned utilities that had made those filings as of March 16, the total increase in regulatory liabilities resulting from the re-measurement, which could be returned to ratepayers nationwide was $91.4 billion. The average amount of increase in regulatory liabilities per company for the Tax Act was about $1.7 billion.

The Tax Cuts and Jobs Act of 2017, enacted in December 2017, represents the first major overhaul of the U.S. tax code in 30 years. Many ramifications of the new law will have far reaching impacts on the utility sector and the energy industry. Under SEC guidelines, companies are required to finalize and record the tax effects of the TCJA by Dec. 31, 2018. Many issues addressed in this report are complex and impact accounting from financial and regulatory perspectives. RRA expects clarifications and revisions to be ongoing regarding the outlook for the sector. Additionally, state regulatory investigations are under way nationwide, and RRA recommends that clients pay careful attention to those developments as they unfold. The assumptions and projections made in this report are intended to provide clarity for clients on these complicated issues; however, in some instances data may be incomplete and the conclusions drawn are a "best estimate."

In the table below, RRA benchmarked the sector based on tax-related regulatory liabilities, cash flow and net property, plant and equipment, or PP&E, in service at year-end 2017. Potential cash flow impacts are estimated using a ratio of regulatory liabilities to operating cash flow. The lower the ratio, the less corporate cash flow is expected to decline relative to the sector by the normalization of excess ADIT, in our view. The higher the ratio, the more cash flow is expected to decrease by the return of excess ADIT over time. Utilities with the highest ratio of regulatory liabilities to operating cash flow include NiSource Inc. and ONE Gas Inc. Those with the lowest ratios include AES Corp., National Fuel Gas Co. and UGI Corp.

Potential rate base impacts are calculated using a ratio of regulatory liabilities to net PP&E in service at Dec. 31, 2017. In this context, RRA uses net PP&E as a proxy for rate base, although rate base can only be determined by state regulatory commissions and typically includes items besides net PP&E. The higher the ratio, the more likely rate base will be favorably impacted by the reduction in ADIT, based on our analysis. The lower the ratio, the less likely rate base will benefit relative to the sector. Utilities with the highest ratio include Edison International, Eversource Energy, OGE Energy, Pinnacle West Capital and ONE Gas. Utilities with the lowest ratio include, UGI Corp., Unitil Corp., IDACORP Inc. and AES Corp.

RRA notes that operating cash flow and net PP&E in service data from S&P Global Market Intelligence are corporate consolidated results and not reflective exclusively of the results of regulated utility segments. Diversified utility holding companies may have unregulated merchant generation operations that are also included. More broadly-diversified utility holding companies might have non-utility operations, i.e., construction services or banking segments, also reflected in the data. Excluding these operations would typically have the effect of reducing both cash flow from operating activities and net PP&E in service and increase both ratios.

Potential cash flow and rate base impacts of Tax Act on Utilities

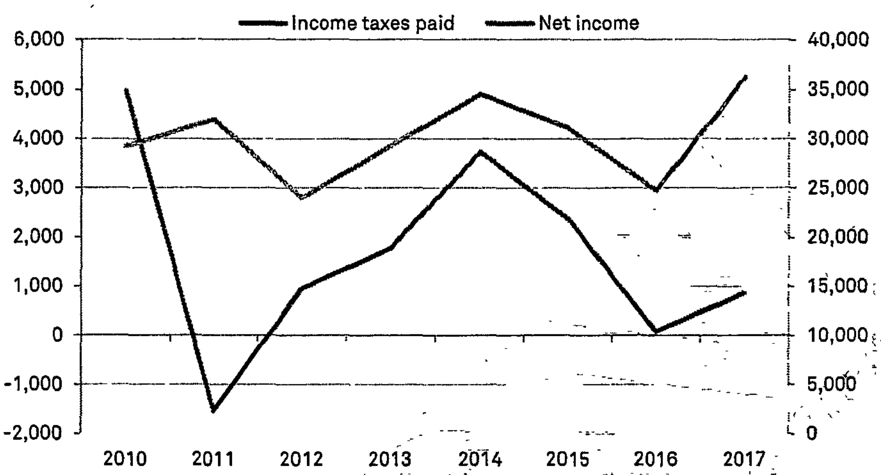
Company	Ticker	Increase in regulatory liabilities ($M)[1]	Cash flow from operations (2016) ($M)[2]	Regulatory liabilities to cash flow ratio (x)	Net utility plant (2016) ($M)[2]	Regulatory liabilities to net utility plant ratio (x)	Disclosed need for additional capital as a result of the tax act
AES Corp.	AES	253.0	593.4	0.43	4,504.0	0.06	
ALLETE Inc.	ALE	393.6	199.3	1.97	3,123.5	0.13	
Alliant Energy Corp.	LNT	885.9	841.0	1.05	9,419.5	0.09	
Ameren Corp.	AEE	2,204.0	2,093.1	1.05	18,059.1	0.12	Y
American Electric Power Co. Inc.	AEP	4,400.0	2,931.8	1.50	37,988.3	0.12	
Atmos Energy Corp.	ATO	746.2	798.4	0.93	7,980.2	0.09	
Avangrid Inc.	AGR	NA	798.5	NA	8,725.1	NA	Y
Avista Corp.	AVA	442.0	337.8	1.31	3,678.5	0.12	Y
Black Hills Corp.	BKH	301.0	214.2	1.41	2,567.0	0.12	
CenterPoint Energy Inc.	CNP	1,300.0	638.4	2.04	7,051.6	0.18	
Chesapeake Utilities Corp.	CPK	98.5	104.1	0.95	313.1	0.31	Y
CMS Energy Corp.	CMS	1,500.0	1,673.4	0.90	13,785.4	0.11	
Consolidated Edison Inc.	ED	3,700.0	3,201.0	1.16	32,065.1	0.12	Y
Dominion Energy Inc.	D	3,600.0	3,271.5	1.10	26,412.2	0.14	
DTE Energy Co.	DTE	1,700.0	1,689.8	1.01	14,340.8	0.12	
Duke Energy Corp.	DUK	8,313.0	6,999.6	1.19	66,401.7	0.13	Y
Edison International	EIX	5,000.0	3,523.7	1.42	33,834.9	0.15	
El Paso Electric Co.	EE	275.3	232.3	1.19	2,713.4	0.10	
Entergy Corp.	ETR	2,900.0	2,112.3	1.37	24,296.5	0.12	Y
Eversource Energy	ES	575.0	1,975.4	0.29	18,025.4	0.03	
Exelon Corp.	EXC	4,734.0	5,716.1	0.83	46,763.5	0.10	
FirstEnergy Corp.	FE	2,300.0	2,579.1	0.89	25,682.4	0.09	
Great Plains Energy Inc.	GXP	794.6	795.8	1.00	8,849.5	0.09	
Hawaiian Electric Industries Inc.	HE	285.0	417.7	0.68	4,081.9	0.07	
IDACORP Inc.	IDA	194.0	309.9	0.63	3,969.5	0.05	
MDU Resources Group Inc.	MDU	285.5	240.8	1.19	1,607.5	0.18	
MGE Energy Inc.	MGEE	103.5	146.5	0.71	1,009.8	0.10	
National Fuel Gas Co.	NFG	337.0	86.1	[illegible]	1,265.8	0.27	
New Jersey Resources Corp.	NJR	228.0	172.3	1.32	1,757.5	0.13	
NextEra Energy Inc.	NEE	4,500.0	4,152.3	1.08	32,886.9	0.14	
NiSource Inc.	NI	1,500.0	423.3	3.54	5,120.1	0.29	Y
Northwest Natural Gas Co.	NWN	213.3	201.4	1.06	1,648.4	0.13	
NorthWestern Corp.	NWE	231.7	320.2	0.72	3,898.4	0.06	
OGE Energy Corp.	OGE	955.5	568.1	1.68	7,415.2	0.13	Y
ONE Gas Inc.	OGS	519.4	168.0	3.09	3,742.3	0.14	
Otter Tail Corp.	OTTR	149.1	129.4	1.15	1,307.3	0.11	
PG&E Corp.	PCG	3,859.0	4,313.9	0.89	45,102.3	0.09	Y
Pinnacle West Capital Corp.	PNW	1,500.0	987.2	1.52	12,262.2	0.12	
PNM Resources Inc.	PNM	549.0	384.3	1.43	4,419.0	0.12	
Portland General Electric Co.	POR	357.0	548.8	0.65	5,547.1	0.06	
PPL Corp.	PPL	3,350.0	1,930.0	1.74	18,915.5	0.18	
Public Service Enterprise Group Inc.	PEG	2,100.0	1,918.8	1.09	20,782.7	0.10	
SCANA Corp.	SCG	1,076.0	920.8	1.17	11,802.9	0.09	
Sempra Energy	SE	2,402.0	1,296.1	1.85	12,057.5	0.20	
South Jersey Industries Inc.	SJI	264.0	143.0	1.85	1,952.9	0.14	
Southern Co.	SO	6,900.0	5,032.5	1.37	54,001.4	0.13	Y
Southwest Gas Holdings Inc.	SWX	430.0	598.4	0.72	3,680.0	0.12	
Spire Inc.	SR	264.1	380.5	0.69	5,767.5	0.05	Y
UGI Corp.	UGI	303.9	106.6	2.85	1,246.9	0.24	
Unitil Corp.	UTL	48.9	42.5	1.15	386.0	0.13	
Vectren Corp.	VVC	333.4	183.0	1.82	1,791.6	0.19	
WEC Energy Group Inc.	WEC	2,450.0	1,244.2	1.97	12,323.6	0.20	
Westar Energy Inc.	WR	845.2	951.8	0.89	8,978.6	0.09	
WGL Holdings Inc.	WGL	NA	211.5	NA	3,286.8	NA	
Xcel Energy Inc.	XEL	3,800.0	3,059.0	1.24	31,172.3	0.12	Y

[1] Increase in regulatory liabilities at Dec. 31, 2017, resulting from remeasurement of deferred taxes requred by the Tax Cuts and Jobs Act of 2017.
[2] Includes only cash flow, assets net of depreciation of regulated utility operations if FERC data provided by utility
Data excludes results of non utility/power businesses or non-U.S. utility operations
Sources: Form 10-Ks; investor presentations; earnings call transcripts; FERC

Most utilities have not paid cash taxes for several years using a build-up of deferred tax liabilities generated by bonus depreciation and similar incentives to shield cash flow. But the end of bonus depreciation following 2019 and the drop in deferred tax liabilities is expected to reduce utility cash flow and make them cash taxpayers sooner than previously forecast.

Shielded from paying taxes for years, utilities have been reporting net operating losses, or NOLs, that can continue to be carried forward, albeit under less favorable terms pursuant to the new tax law. Companies in the RRA coverage universe paid $864 million in cash income taxes in 2017, according to available S&P Global Market Intelligence data, and posted net income of $36.2 billion.

Utility sector income taxes paid remains low ($M)



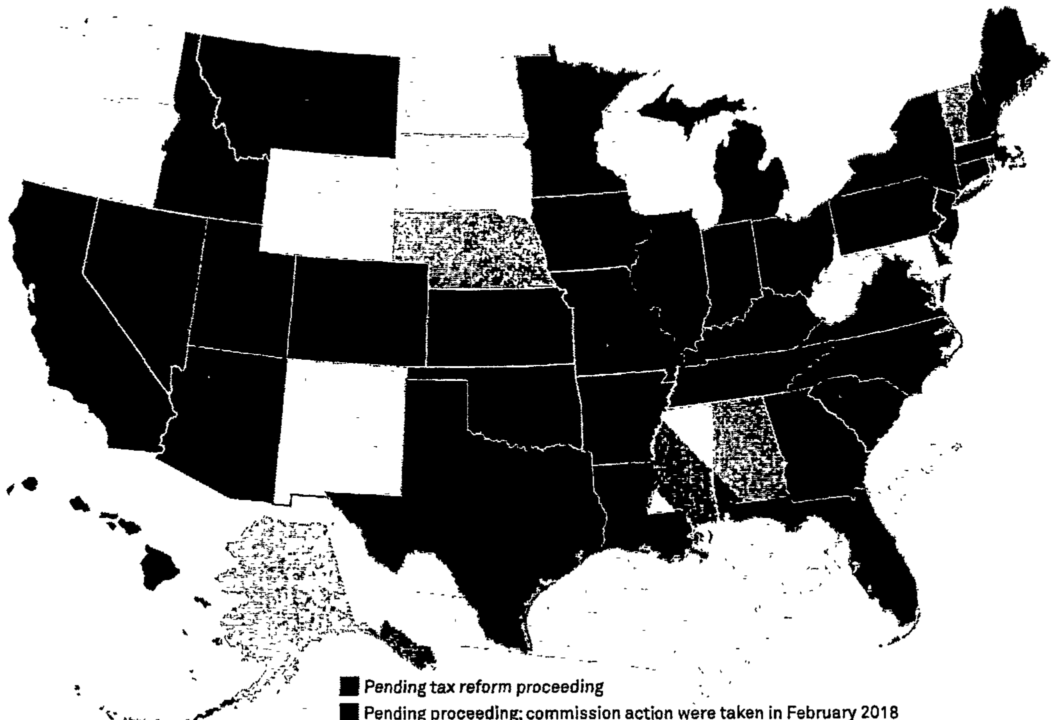
Note: Represents consolidated results of 55 public utilities and utility holding companies.
Source: S&P Global Market Intelligence

Income taxes paid by RRA utilities took a steep dive in 2011 as net operating losses were generated primarily from the bonus depreciation deduction allowed under the Tax Relief Act of 2010. The act provided for 100% depreciation deduction for qualified property placed into service in late 2010 and through 2011. Income taxes paid accelerated the following few years and then took another steep dive after bonus depreciation was extended through the Protecting Americans from Tax Hikes Act of 2015, or PATH Act.

Taxes paid rose slightly in 2017 and should accelerate further as bonus depreciation is phased out at the end of 2019. Still, many utility holding companies have NOL balances that can allow them to remain non-cash-paying taxpayers for several years. Edison International management indicated in its latest earnings call that the company expects not to be a cash taxpayer until 2025. NiSource management indicated the company has a federal NOL carryforward that will preclude the company from paying cash taxes beyond 2025. PG&E management disclosed that the TCJA will likely require the company to become a federal taxpayer in 2020, a year earlier than its previous expectation. Sempra Energy does not expect to be a federal taxpayer for the next five years. AES management indicated that the company will move toward a taxable position over the next two to three years, as its NOL balance decreases.

The following is company-specific commentary on tax reform impacts taken from earnings calls, annual reports and presentations. We expect that these plans will be subject to change in coming months depending on the outcome of state regulatory matters as well as from final determinations of certain tax issues.

Tax reform proceedings



Data as of Feb. 28, 2018.
Source: Regulatory Research Associates, an offering of S&P Global Market Intelligence

Regulated electric/gas utilities:

ALE: The re-measurement of deferred taxes required by the TCJA increased regulatory liabilities by about $394 million. The provisional amount may change as ALE receives additional clarification and implementation guidance. The Minnesota and Wisconsin utility commissions both opened dockets to address ratemaking treatment and mechanisms to pass benefits of tax reform to ALE utility ratepayers. ALE's unregulated operations, which accounting for less than 10% of consolidated revenue, will benefit from lower income tax expense going forward. ALE boosted 2018 earnings guidance by 10 cent per share, or $5.1 million, due to anticipated benefits of TCJA.

ATO: TCJA resulted in the re-measurement of the net deferred tax liability included in ATO's rate base. The excess deferred tax balance, estimated at $746 million, will be returned to utility customers in accordance with regulatory requirements. ATO anticipates the reduction in operating cash flow from lower customer bills, combined with the return of regulatory liabilities establishing connection with implementing tax reform, will increase estimated financing needs through fiscal 2022 by approximately $500 million to $600 million.

EE: El Paso recorded an increase in regulatory liabilities of $275 million as a result of the TCJA. Following the enactment of the TCJA and the reduction of the federal corporate income tax rate, revenues collected from EE customers in 2018 will be reduced by an amount that approximates the savings in tax expense. This reduction in revenues is expected to negatively impact EE cash flows by about $26 million to $31 million during 2018.

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NWN: The utility's deferred tax liability re-measurement resulted in a $213.3 million regulatory liability as tax reform is expected to benefit customers. The utility is "working closely with the Oregon commission and other stakeholders on several significant dockets, including the best way to return TCJA benefits to customers through an Oregon general rate case, which we filed in December 2017." NWN expects to see a net increase in cash flows as a result of TCJA over the longer term, as taxes are a pass through to customers and lower deferred tax liabilities and no bonus depreciation are expected to increase regulatory returns.

POR: POR's net regulatory liability was increased by $357 million, as the company deferred the impact of re-measuring accumulated deferred income taxes pursuant to enactment of the TCJA. POR plans to use the average-rate-assumption-method to account for the refund to customers. The unprotected portion of the re-measurement is not subject to tax normalization rules and will be amortized over time. POR proposes to defer for future refund the 2018 expected net benefits as part of an application filed with the Oregon Public Utilities Commission on Dec. 29, 2017. If approved as requested, any refund to customers of the net benefits associated with the TCJA in 2018 would be subject to an earnings test and limited by the company's previously authorized regulated ROE.

WR: Regulatory liabilities increased $845 million primarily due to the TCJA. WR indicates amortization of the liability will lower prices for customers over a period generally corresponding to the life of WR plant assets. The TCJA, including elimination of bonus depreciation and a lower accumulated deferred income tax, results in approximately 4% compounded annual rate base growth through 2022. Management indicates cash flow "headwinds" are expected, which may decrease WR's FFO-to-debt ratio by 100 to 200 basis points. WR indicates that in its pending rate case it proposes to implement a $1.6 million first-step rate decrease in September to reflect the tax change.

Holding company with regulated utilities:

LNT: The TCJA reduced deferred tax liabilities and increased regulatory liabilities by $885.9 million. Tax reform is not forecasted to have a material impact on LNT's 2018 earnings. LNT utilities are working with state utilities commissions to determine the amount and appropriate mechanism to provide these benefits to their customers. LNT currently is unable to quantify cash flow from operations, credit ratings, liquidity, and capital needs impacts.

AEE: AEE booked a $2.2 billion increase in noncurrent regulatory liabilities as result of TCJA at its two operating utilities. AEE expects a decrease in operating cash flows of approximately $1 billion from 2018 through 2022 — Ameren Missouri, $0.3 billion and Ameren Illinois, $0.4 billion— as a result of the TCJA, and expects an increase in rate base of approximately $1 billion over the same time period —Ameren Missouri, $0.3 billion and Ameren Illinois, $0.5 billion. Over the next five years, AEE may be required to issue incremental debt and/or equity to fund this reduction in operating cash flows, with the long-term intent to maintain strong financial metrics and an equity ratio around 50%, as calculated in accordance with ratemaking frameworks.

AVA: Recorded a $442 million liability to be returned to customers. AVA expects to report an annual reduction in earnings of $0.05 to $0.06 per share and a reduction in operating cash flows from the loss of bonus depreciation and the return of excess deferred taxes to customers. As a result, AVA indicates it may need to raise additional capital.

BKH: Recorded a $301 million regulatory liability that will generally be amortized over the remaining life of the related assets using the normalization principles as specifically prescribed in the TCJA. From a cash flow perspective, BKH expects cash flows to be negatively impacted by $35 million to $45 million annually, due to the lower revenue collection as tax reform benefits flow to customers through the regulatory process. BKH expects tax reform to impact 2018 earnings minimally, as the reduced tax benefit on holding company debt will be largely, but not completely, offset by the reduced tax expense on the company's nonutility earnings

CNP: CNP recorded $1.3 billion in excess deferred taxes at its regulated utilities, as a result of the TCJA. Changes in tax depreciation at the lower federal rate are expected to increase forecasted year-end 2019 average rate base by about $300 million. The change in tax depreciation expense at the lower tax rate reduces the tax shield, thereby reducing near-term cash flows, and the timing of the return of excess deferred taxes may reduce near-term cash flows. CNP's unregulated business is expected to benefit from the lower tax rate, boosting earnings by $0.10 per share, or $43 million, in 2018.

CMS: For CMS, excess deferred tax liabilities related to the TCJA are estimated at $1.5 billion. The repeal of the alternative minimum tax, or AMT, allows CMS to monetize substantial AMT credits over the next four years to the tune of about $125 million in the first year, which partially offsets the likely near-term operating cash flow reduction at the utility. CMS parent interest expense will be largely offset by the interest income generated by EnerBank, its industrial bank subsidiary.

DTE: DTE estimates that, as a result of the TCJA, $1.7 billion of excess deferred tax liabilities will need to flow back to ratepayers. DTE management estimates two-third of this balance is protected vs unprotected. DTE's earnings guidance was increased by $0.10 per share tied to the lower tax rate on nonutility business. DTE's utilities are expected to begin to contribute to EPS growth in the latter part of the next five-years, as the utilities transition from funding rate base growth through cash generated by deferred taxes to a higher mix of equity relative to debt. DTE expects to issue incremental equity of $300 million 2018-2020 as a result of tax reform impacts. Consequently, in the latter portion of the five-year period, EPS accretion from tax reform actually grows to — in the range of 13 cent per share ($23 million).

ED: Excess deferred income taxes of approximately $3.7billion, including $3.5 billion for subsidiary Consolidated Edison of New York, were recorded as regulatory liability related to the TCJA. The TCJA is expected to result in decreased cash flows from operating activities, and require increased cash flows.

ES: Tax reform is expected to increase ES rate base by $575 million by 2020. The refund of excess accumulated deferred federal income tax will slightly reduce cash flows, but ES does not expect to need to issue equity. ES recorded about $2.9 billion of regulatory liabilities related to the TCJA. New distribution rates that took effect recently in Massachusetts reflect about $56 million of annual benefits from the reduction of the federal corporate tax rate. Similarly, a three-year settlement reached recently in subsidiary Connecticut Light and Power's distribution rate case is expected to reflect between $45 million and $50 million of annual customer benefits from the lower tax rate.

EIX: The implementation of tax reform at Southern California Edison resulted in a reduction of deferred tax liabilities and a corresponding increase in regulatory liabilities of about $5 billion. The company expects that by 2020, the TCJA will effectively increase rate base $400 million. There will be a smaller tax shield from interest on EIX parent debt, but that will largely be offset with other items. In the near term, SCE expects tax reform to lower rates charged to customers, but not to have a meaningful impact to SCE's earnings. EIX expects to be a cash taxpayer in 2025.

GXP: GXP estimates that excess accumulate deferred tax liabilities refundable through future rates will amount to $795 million. GXP expects to return approximately $100 million in annual tax savings to Missouri and Kansas customers. The company anticipates an ongoing decrease in annual cash flow of about $100 million and 1% to 2% decrease in cash flow to debt metrics.

IDA: IDA calculates that, as a result of the TCJA, excess accumulated deferred income taxes of $194 million will need to be flowed back to customers. Proceedings are pending in Idaho and Oregon o address tax reform-related issues.

NI: The re-measurement of NI's deferred tax liabilities increased regulatory liabilities by about $1.5 billion, which will flow back to customers. The TCJA will cause near-term adjustments to cash flow that NI management indicated it will "need to navigate." NI expects its NOL carryforward will provide a cash tax benefit to NI that extends beyond 2025.

NWE: The company recorded an estimated regulatory liability of $320 million for the change in regulated utility deferred taxes as a result of the TCJA. NWE expects a $15 million to $20 million loss of cash from operations in 2018 and beyond due to the TCJA. NOLs are now anticipated to be available into 2020, versus 2021 expected previously.

OGE: OGE has recorded a $955.5 million non-current regulatory liability associated with income taxes will be refundable to customers. While interest expense deductibility remains at the utility, OGE has no significant holding company debt, making limitations on interest deductibility a non-factor. The company will see some impact from other provisions related to non-deductible expenses, but those items are not expected to be material with respect to 2018.

OGS: OGS is working to determine the amounts of regulatory liabilities arising from the TCJA that will be refunded each year, but expects to return approximately $400 million to customers over the next 25 to 30 years. OGS deferred $519 million as a regulatory liability for ratemaking purposes associated with TCJA. OGS expects its rate base will increase in 2018 on slightly higher capital spending and as a result of the effects of tax reform. OGS expects its ROE to improve in future years as it normalizes the impact of tax reform through regulatory filings. However, the reduction in operating cash flows, combined with the return of regulatory liabilities recorded in conjunction with tax reform, is expected to increase OGS' estimated financing needs through 2022 by about $150 million to $200 million.

PCG: PEG recorded an almost $3.9 billion regulatory liability to reflect the change in net deferred tax liabilities associated with the TCJA. The utility currently anticipates an annual reduction to revenue requirements of about $500 million starting in 2018, and increases to rate base of about $500 million in 2018 and $300 million in 2019, as a result of the Tax Act. Through 2019, PCG now expects rate base growth of approximately 7.5% to 8% annually compared to the 6.5% to 7% previously forecasted. Revenues collected from customers are expected to decline by $500 million annually, impacting cash flows. PG&E expects to become a federal cash taxpayer in 2020, a year earlier than previously forecasted.

PNW: PNW recorded a $1.5 billion regulatory liability related to excess accumulated deferred taxes flowing from the TCJA. The majority of these excess deferred taxes are subject to IRS normalization provisions. From a rate base perspective, PNW's preliminary estimates show incremental rate base of about $150 million per year in 2018 and 2019 as a result of both the lower tax rate and legislative changes related to tax depreciation.

PNM: The TCJA resulted in a $549 million net increase in regulatory liabilities at PNM's utilities. Cash flows will be reduced in the near term, as the benefits of the reduced corporate income tax rate are passed on to ratepayers, without a corresponding reduction in income taxes paid due to PNM having an NOL carryforward for income taxes purposes. In addition, the income tax benefit of net losses for the unregulated activities of PNM Resources, primarily interest expense on holding company debt, will be negatively impacted by the reduced rate.

SR: The adjustment to deferred tax liabilities as result of TCJA at Spire Missouri and Spire Alabama was $264 million combined. SR anticipates that the TCJA will reduce cash flows in the future as customers' bills are lowered, thus impacting credit metrics. SR does not expect restrictions on deductibility of interest at the holding company level to have a material impact on future earnings.

UTL: UTL recorded a regulatory liability in the amount of $48.9 million as a result of the TCJA. Subject to regulatory approval, UTL will pass back to ratepayers the excess accumulated deferred tax balance, using the average rate assumption method. UTL expects its distribution revenue to decrease by about $7.5 million across all regulated entities, offset by an equal amount of tax expense reductions. Consequently, there will be no material effect on net income. Cash flow will be negatively impacted, but UTL's credit metrics are expected to remain strong. Rate base growth is now expected near the high end of its previous 6%-8% range.

WEC: WEC recorded a $2.45 billion change in deferred taxes for its regulated utilities due to the enactment of the TCJA. Management now expects WEC's FFO-to-debt metric to be in the range of 16% to 18%. WEC does not expect the limitation on interest deductions to materially adversely impact earnings. WEC indicated revaluation of its deferred tax assets and liabilities is subject to further clarification of the new law and the ultimate impact cannot be estimated at this time.

XEL: Estimated accounting impacts of the TCJA at XEL included $2.7 billion, $3.8 billion grossed-up for taxes, of reclassifications of plant-related excess deferred taxes to regulatory liabilities. XEL expects tax reform to be mildly accretive to earnings over the next five years, adding $1.3 billion to rate base. The tax law changes will reduce cash from operations and adversely impact credit metrics. In response, XEL expects to scale back its five-year capital expenditure plan by $500 million and issue up to $300 million of additional equity.

Diversified utilities:

AEP: As a result of the TCJA, AEP recorded total excess regulated deferred federal income taxes to be returned to utility ratepayers of $4.4 billion, including a normalized or "protected" portion of excess accumulated deferred income tax of $3.2 billion and a non-depreciation portion of $1.2 billion. AEP raised its annualized rate base growth forecast for the years 2018 through 2020 to 9% vs. 8% previously. The impact of the new law's changes to interest deductibility should be marginal, as parent company debt is minimal. Reduced operating cash flow, from the flow-through of tax benefits to ratepayers, is not expected to require incremental issuances, but AEP has cut its capital spending forecast for 2018-2020 by $500 million.

AGR: AGR is still reviewing the impacts of the TCJA and the appropriate methodology for ensuring that benefits flow to ratepayers. AGR projects increased financing costs and a need to issue debt to offset the related reduction in cash flow. AGR's renewables business is expected to benefit from the lower tax rate. Overall, AGR expects a $0.05 per share, or $15 million, benefit from tax reform.

CPK: For CPK's regulated businesses, the TCJA-related change in deferred income taxes of $98.5 million was recorded as an offset to a regulatory liability, some portion of which may ultimately be subject to refund to customers. CPK indicates that it may need to access additional debt and equity capital to meet financing needs due to lower operating cash flows from its regulated energy businesses.

D: The company recorded a $3.6 billion increase in regulatory liabilities at its regulated operations — Virginia Electric and Power and Dominion Energy Gas — associated with TCJA. Dominion is awaiting guidance from the U.S. Treasury Department with respect to the deductibility of interest expense at its unregulated businesses. Regulated utilities continue to work with their respective regulatory commissions to determine the amount and timing of the flow-through of TCJA-related benefits to customers. The ultimate resolution with regulators could be material to D's operating cash flows.

DUK: Duke expects the revaluation of accumulated deferred taxes under the TCJA to add about $3.5 billion to its rate base by 2021, resulting in a 7% CAGR, a 1% increase compared to its previous forecast. The rate reductions resulting from tax reform are also expected to provide additional headroom in customer bills, allowing for increased capital investment. The company recorded a net regulatory liability related to income taxes of $8 billion at Dec. 31, 2017. In addition, the lower tax shield at the holding company level is expected to reduce earnings. In order to strengthen its balance sheet to mitigate the impact of lower expected cash flows, DUK plans to issue $2 billion in common stock during 2018, including its previous plan to issue $350 million annually beginning in 2018, and reduce its capital expenditures during 2018-2022 by about $1 billion.

ETR: The company recognized a regulatory liability of $2.9 billion due to a re-measurement of deferred tax assets and liabilities resulting from the income tax rate change. ETR estimates the unprotected portion of excess accumulated deferred income taxes at $1.4 billion, which will be returned to customers over time through refunds, cash investments in new assets, accelerated depreciation or other options approved by regulators. The protected portion of excess ADIT is subject to normalization, and will be amortized over the remaining lives of the associated assets. Over the next three years, ETR expects its rate base to grow a little over $1 billion due to TCJA. It plans to issue about $1 billion in equity before the end of 2019 to stabilize the balance sheet, and plans to counter reduced operating cash flow through a combination of utility company debt, parent debt, internal cash generation and external equity.

EXC: The company recorded $4.7 billion in net regulatory liabilities, including $3 billion subject to normalization rules and $1.7 billion that will be amortized over a time period set by state regulators. EXC projects rate base growth of 7.4% versus 6.5% previously, as a result of the TCJA-relate revaluation of accumulated deferred tax balances. Tax reform is estimated to increase rate base by about $1.7 billion by 2020, relative to previous expectations. EXC expects "much stronger free cash flow" from its merchant business, which will more than offset additional equity needs of the utilities. The lower tax rate and 100% expensing of depreciation at the merchant business will improve EPS by $0.10 per share, or $97 million.

FE: Almost all of the company's $2.3 billion in excess of accumulated deferred tax balance is considered protected and subject to normalization provisions; these amounts will be refunded to ratepayers over the life of its assets. FE forecasts a $400 million uplift in rate base with the elimination of bonus depreciation in two years. The company expects that the TCJA will reduce the FFO-to-debt ratio by between 1% and 1.5%, and that the FFO ratio will remain at 13% through 2021. FE also expects to lose some tax shield due to limitations on interest deductibility.

MGEE: MGEE recorded a $130.5 million increase in regulatory liabilities as a result of the TCJA. Tax reform is generally expected to result in lower operating cash inflows in future years, as a result of the elimination of bonus depreciation and lower customer rates as tax-related benefits are passed on to ratepayers

NFG: NFG recorder an approximate $337 million deferred regulatory liability as a result of the TCJA. NFG management is still awaiting details on certain aspects of tax reform, such as potential limitations on the deductibility of interest expense and executive compensation. NFG management indicates that the company still has a "decent-sized NOL that will offset any tax payments for this year."

NJR: NJR recorded $228 million as a noncurrent regulatory liability to be refunded to ratepayers as a result of the lower tax rate. The lower tax rate is expected to boost non-regulated net income by between $0.04 and $0.08 per share, or between $3.5 million and $7 million.

NEE: The company's Florida Power & Light, or FPL, subsidiary revalued deferred income tax liabilities to the new 21% corporate income tax rate. The majority of the reduction in income tax liability, totaling $4.5 billion, has been reclassified as a regulatory liability that is expected be amortized over the underlying assets' remaining useful lives. Tax reform is generally expected to result in lower operating cash flows for NEE, as FPL uses tax savings to recover the Irma storm surcharges, but NEE does not expect an impact on credit metrics. The impact to NEE's unregulated Energy Resources subsidiary is expected to be significantly accretive to earnings, increasing NEE's adjusted EPS by roughly $0.45 per share, or $212 million, in 2018.

PEG: For PEG, excess accumulated deferred taxes related to TCJA total about $2.1 billion. About 70% are deemed protected under the IRS normalization rules, which require that protected deferred tax balances be returned to customers over the remaining lives of the associated assets. The remaining 30%, or about $600 million, some of which were recognized in PEG's Jan. 12, 2018, distribution base rate filing, are to be returned to customers over a time frame that will be determined in discussions with the New Jersey Board of Public Utilities and with FERC. According to the company, TCJA impacts on cash flow and credit metrics are manageable given PEG's business mix and the strength of balance sheet. The earnings boost expected from the reduced tax burden for its unregulated businesses is expected to be $0.16 per share, or $81 million, in 2018.

SCG: SCG recorded accumulated deferred income taxes of about $1.1 billion, which includes excess deferred income taxes arising from re-measurement of deferred income taxes upon enactment of the Tax Act.

SRE: For SRE, regulatory liabilities recorded as result of the Tax Act were $2.4 billion. The one-time reparation of SRE's foreign subsidiary earnings partially mitigates the credit impact of the flow-through ratepayers of lower utility taxes. SRE plans to repatriate about $1.6 billion from 2018-2022. Tax reform is expected to decrease earnings per share by between $0.25 and $0.30 in 2018, as SRE is impacted by the lower tax shield on corporate interest, but long-term the impact is expected to be neutral.

SO: Southern recorded a nearly $7 billion deferred tax liability, of which $5.7 billion is protected and $1.3 billion is unprotected. Management has indicated that cash flow is expected to be adversely affected at SO's state-regulated utilities and, "absent mitigation, lower FFO to debt ratios" will result. Southern Power, SO's unregulated business, is expected to benefit from the lower tax rate by $15 million to $20 million.

SJI: SJI expects experience a benefit at its South Jersey Gas subsidiary, due to a higher rate base, as accumulated deferred tax offsets are reduced, with the amount dependent upon regulatory action and timing of base rate cases. SJI reported excess accumulated deferred income taxes of $264 million. For its non-utility operations, SJI saw a $13.5 million one-time benefit associated with the revaluation of its net deferred tax liabilities, expects ongoing benefits beginning in 2018 that will rise to $10 million annually beginning in 2020. Cash flows are expected to decrease by between $20 million and $40 million per year due to the return of excess deferred taxes to ratepayers and the elimination of bonus depreciation.

UGI: UGI recorded $304 million in excess accumulated deferred income taxes resulting from the tax law, and a proceeding is pending in Pennsylvania to determine how this balance and other TCJA-related benefits will flow through to ratepayers. UGI has extensive non-regulated and foreign operations. The company indicated that the TCJA boosted EPS for the first quarter of fiscal 2018, i.e. the quarter ended Dec. 31, 2017, by $0.12 per share. The company expects a net full-year benefit related to tax policy of $0.15 to $0.25, including the negative impact of changes in French tax law.

Broadly-diversified utilities:

AES: The company's U.S. utilities recorded an increase in deferred income tax liabilities of $241 million, due to the revaluation of deferred taxes associated with the tax rate change. AES also repatriated foreign earnings under the reduced tax rate provided for in the Tax Act. AES expects a "meaningful limitation" on interest expense deductions. Also under new global intangible income rules, un-repatriated foreign earnings above a certain threshold can now be subject to U.S. tax. AES expects these issues will impact near-term earnings by between $0.05 and $0.08 per share annually, or $33 million to $53 million. Management indicates it has taken actions to offset these impacts and will continue to evaluate additional tax planning opportunities. AES continues to have a significant NOL position.

HE: The company reclassified $285 million in net excess accumulated deferred taxes as a regulatory liability that will be returned to customers through rates. While tax reform will result in higher financing needs in the future for HE's utility due to the loss of bonus depreciation, HE does not expect to need any additional external equity or equity from the company's dividend reinvestment program during 2018. Net interest income from HE's banking unit will "more than cover holding company interest expense. So interest expense deductibility will not be an issue," according to management. American Savings Bank is expected to see increased dividend and earnings capacity.

MDU: MDU continues to work with the various regulators on a plan flow TCJA-related savings to customers. This resulted in the creation of a regulatory liability refundable to customers of $285.5 million. MDU's non-regulated construction business is expected to benefit from the TCJA. MDU's construction materials businesses reported $46.2 million higher earnings in 2017 as result of tax reform.

OTTR: OTTR booked a $149 million increase in regulatory liabilities associated with excess accumulated deferred income taxes. OTTR expects its rate base to grow by about an additional $100 million over its five-year planning horizon as a result of the Tax Act. No material impact on equity needs foreseen and the company expects to no negative impact credit ratings. OTTR's 2018 guidance assumes an uplift of $0.05 per share, or $2 million, related to the tax reform impact on its manufacturing platform and corporate cost center.

PPL: PPL recorded a net increase in regulatory liabilities as a result of TCJA at its U.S. utilities of almost $3.4 billion. PPL now projects its combined regulated rate base to grow by 6.4% through 2020, increasing to $31 billion. PPL added an additional equity issuance into its financing plan for 2018 and expects increased cash distributions from its U.K. business to mitigate the impact of the lower corporate tax rate on earnings and cash flow. The company anticipates about $0.05 per share of incremental dilution from the planned issuance of an additional $650 million of equity relative to its prior assumptions.

SWX: SWX estimates that excess deferred taxes to be passed back to utility customers will total $430 million; related proceedings are underway in Arizona, California and Nevada. The Tax Act is expected to provide a direct benefit to SWX's non-regulated construction services business.

VVC: The TCJA resulted in $333 million in excess federal deferred income taxes for VCC's utility group. Statewide proceedings related to the Tax Act have begun in Indiana and Ohio. While tax reform reduces cash from operations, additional cash available from VVC's nonutility businesses help fund utility capital spending.

Independent Power Producers:

Independent power producers, or IPPs, including NRG Energy Inc., Vistra Energy Corp., and Dynegy Inc., continue to examine the TCJA, and its overall impact to the bottom line. Under SEC rules, companies are required to finalize and record the tax effects of the TCJA by Dec. 31, 2018. RRA expects the sector to be a net beneficiary of the law given the permanent lower tax rate and full expensing for certain capital investments, which could support cash flows.

With regard to net operating losses, or NOLs — created when operating expenses exceed operating revenues at a particular business unit, and are used to offset taxable income — existing NOLs can continue to be utilized at 100% of taxable income with a 20 year carryforward, while NOLs incurred after the 2017 tax year are limited to 80% of taxable income with an indefinite carryforward, potentially weakening IPPs' "tax shield" against future taxable income. The TCJA also repealed the alternative minimum tax, or AMT, and it also limits the deduction of net business interest expense to 30% of adjusted taxable income. For NRG and Dynegy, reductions to the companies' deferred tax asset balances due to the lower tax rate were offset through valuation allowances, a balance established when it is likely that all or a portion of net deferred tax assets will not be utilized.

DYN: DYN recorded a $394 million reduction to its net deferred tax assets, including the federal benefit of state deferred taxes, that was fully offset by a decrease in its valuation allowance for the year ended Dec.31, 2017. The Houston-based power generator and electric retailer also recorded a $223 million current tax benefit and long-term tax receivable in 2017 related to the expected refund of its existing AMT credits. DYN expects the related refunds to total $112 million in 2019; $56 million in 2020; $28 million in 2021; and the remainder in 2022. At year-end 2017, Dynegy had $4.6 billion of federal NOLs and $3.6 billion of state NOLs that can be used to offset future taxable income, with the federal NOLs expiring between 2024 and 2037. In the near-term, DYN expects greater utilization of its NOLs to offset the limit of net business interest expense.

NRG: NRG recorded a $733 million reduction to its net deferred tax assets that was offset by a valuation allowance of $660 million, and the company recorded a long-term receivable of $64 million related to the expected refund of its existing AMT credits, expected to be received between 2019 and 2020. At year-end 2017, the company had domestic federal NOL carryforwards of $2.8 billion, which begin expiring in 2026, and state NOL carryforwards of $2.2 billion. With more than $3 billion expected from asset sales and a leaner balance sheet as part of its broader strategic transformation plan announced in 2017, NRG's cash position and resultant financial flexibility appear to be on solid footing for the foreseeable future. The company expects cash flow from operations in 2018 in a range of approximately $2.02 billion to $2.2 billion, compared with $1.39 billion in 2017, and adjusted free cash flow in a range of $1.55 billion to $1.75 billion, compared with $1.30 billion in 2017.

VST: VST recorded an approximately $451 million reduction to its deferred tax asset balance for the year ended Dec. 31, 2017; however, considering its expectation that its deferred tax assets will be fully utilized to offset future taxable income, the company did not recognize a valuation allowance. At year-end 2017, the company had no federal NOL carryforwards, and no AMT credit carryforwards. Excluding the impacts from its pending acquisition of Dynegy, VST expects 2018 adjusted free cash flow in a range of $600 million to $750 million. The company expects to update guidance upon closing of the Dynegy acquisition.

Change in deferred income tax liabilities ($000)

	2017	2016	
South Jersey Industries Inc.	86,884	343,549	-75%
FirstEnergy Corp.	1,359,000	3,765,000	-64%
ALLETE Inc.	197,700	521,300	-62%
Otter Tail Corp.	100,501	226,591	-56%
Westar Energy Inc.	815,743	1,752,776	-53%
Great Plains Energy Inc.	621,700	1,329,700	-53%
Southern Co.	6,842,000	14,092,000	-51%
NiSource Inc.	1,292,900	2,528,000	-49%
NextEra Energy Inc.	5,754,000	11,101,000	-48%
OGE Energy Corp.	1,227,800	2,334,500	-47%
IDACORP Inc.	660,940	1,244,250	-47%
Hawaiian Electric Industries Inc.	388,430	728,806	-47%
Vectren Corp.	491,300	905,700	-46%
Avista Corp.	466,630	840,928	-45%
PNM Resources Inc.	491,479	884,633	-44%
Portland General Electric Co.	376,000	669,000	-44%
Xcel Energy Inc.	3,845,000	6,784,319	-43%
PG&E Corp.	5,822,000	10,213,000	-43%
Pinnacle West Capital Corp.	1,690,805	2,945,232	-43%
ONE Gas Inc.	599,945	1,038,568	-42%
WEC Energy Group Inc.	2,999,800	5,146,600	-42%
MGE Energy Inc.	225,130	383,813	-41%
Eversource Energy	3,297,518	5,607,207	-41%
NorthWestern Corp.	340,729	575,582	-41%
Chesapeake Utilities Corp.	135,850	222,894	-39%
PPL Corp.	2,462,000	3,889,000	-37%
Sempra Energy	2,767,000	3,745,000	-26%
National Fuel Gas Co.	891,287	823,795	8%
New Jersey Resources Corp.	514,708	473,847	9%
UGI Corp.	1,357,000	1,212,400	12%
Spire Inc.	707,500	607,300	16%
WGL Holdings Inc.	868,067	726,763	19%
AES Corp.	1,006,000	804,000	25%

As of Dec. 31, 2017.
Note: Nine utilities or utility holding companies without data available excluded.
Source: S&P Global Market Intelligence

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