



North American Utilities & IPPs

Power Points: PNM, BE Refi, Covid Recovery, WEC, Financing

Industry Overview | 02 April 2020 | Equity | North America | Utilities & IPPs

Key takeaways

- PNM granted approval by PRC on securitization: solving key pos; moving onto next steps incl 4 Corners. De-risks outlook
- NV issues Covid tracking order - latest; expect more w focus on bad debt recovery. NY will true-up AGR for delayed rate inc
- BE: successfully refi's convert; WEC CFO hire a pos; PPL funding pos

CPUC - California Public Utility Commission

SCE - South California Edison

PNM: Abandonment approved, and onto the next one

Yesterday, PNM was granted approval by the NM Public Regulatory Commission (PRC) in two 5:0 votes for both abandonment and securitization of the San Juan facility. Next, PNM looks for approval of its replacement capacity plan. The PRC already recommended a partial decision to examine the power purchase agreements (PPAs) by April 30th to ensure PNM meets pricing / contract deadlines; the ownership portion of the replacement capacity would likely come by the actual deadline of Oct 1st. PNM in its press release discussing yesterday's PRC result noted that it is looking to get out of Four Corners as the next step. Whilst a smaller scale, we'd expect the same steps as San Juan (i.e. securitization / abandonment / replacement filings that the Energy Transition Act applies to and that pursues the lowest cost replacement option). Four Corners had a contract through 2031, and we interpret this statement as indicating PNM's intent to move forward ASAP. This upside is not factored into guidance yet. Maintain Buy.

Nevada issues COVID cost-tracking order; more coming?

The Public Utilities Commission of Nevada (PUCN) issued an order at an emergency meeting calling for utilities that have or will have prudently-incurred costs related to the suspension of termination, discontinuance, or disconnection of service to track such costs for review in future proceedings. The costs are to be recorded beginning Mar 12, reflecting the date when the Nevada governor declared a state of emergency due to COVID. Nevada joins Wisconsin, Texas, and Ontario in providing timely guidance as to cost tracking - we expect most other utility commissions to follow suit. As a follow up expect NY to allow for a true-up on lost revenues from a delayed implementation of AGR rate increase (we could expect other states to pursue the same). We expect other states and utilities to continue to establish these memo accounts seeing bad debt expenses as less clear cut than initially perceived. We anticipate Covid related dockets will principally address significant uptick in unrecoverable costs.

BE: Extending '20 convert into '21 with refinancing

On Mar 31, 2020, BE entered into an agreement to extend the maturity of the majority of its \$335mn 6% convertible notes to Dec 1, 2021, though required to repay \$70mn by Sept 1, 2020. The extended converts will be at a higher 10% interest rate. BE also raised an additional \$30mn convert debt as part of the extension. Additionally, BE also raised an additional \$70mn through 10.25% senior term loans, which will be used to repay the portion of the '20 converts due in 2020. Mgmt expresses mitigated refinancing risk for the its upcoming 2020 convert given capital market concerns of late. We see this as de-risking a key downside to shares given market backdrop; maintain Underperform nonetheless pending greater clarity from 10k on new set of disclosures (which adds to opacity of story following no reaffirmation of FY20 rev trajectory).

WEC: Xia Liu named CFO; we view this as a positive

Despite coming from troubled CNP following its div cut, we perceive news as incrementally constructive; current CFO Lauber promoted to COO.

PPL: Add'l Liquidity

On Friday and yesterday, PPL entered into three separate term loans with Cap Funding borrowing 400Mn. Proceeds are expected to be used to repay short term indebtedness and for other general corp purposes with the company borrowing the full amount. We maintain our Neutral rating on shares, seeing risk/reward as balanced.

Bond market activities from utilities

Edison International issued \$400m 4.95% senior notes due 2025 to repay its existing 2.125% senior notes due 2020 as well as to use it for general corp expenses. Moody's/S&P/Fitch issued ratings of Baa3/BBB-/BBB-, respectively.

NiSource Inc. executed \$850m term loan agreement maturing March 2021 to repay its existing \$850m debt

IDA subsidiary Idaho Power Co. is expected to reopen its existing series K secured medium-term notes on April 3, issuing \$230m 4.20% First Mortgage Bonds due 2048. The company is expected to use the proceeds to repay \$100m 3.40% first mortgage bonds due Nov. 1, 2020, besides funding capex and general corp expenses.

DTE Electric issued \$600m 2.625% 2020 series C mortgage bonds due March 1, 2031 to repay \$300m 3.45% 2010 series B senior notes due 2020 and \$32.4m 2008 series KT variable rate senior notes due 2020, besides using the rest of the proceeds to repay ST borrowings, for capex and other general corp purposes.

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SRE: Taps former Cheniere Analyst for LNG position

SRE hired Chris Pedersen as an LNG analyst. Mr. Pedersen was a senior LNG market analyst for 1.5yrs and was at WoodMac for 1yr prior to that. This comes following the recent departure of SRE President Bilicic, which we perceived to be around LNG-driven growth rather than asset sales (where we remain confident in closure). We continue to sense there was walking back of LNG related development opportunities at the Analyst Day, and continue to see LNG-related growth as excluded from shares at this point. Maintain Neutral rating on shares.

Table 1: Stocks mentioned

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
BE	BE US	Bloom Energy	US\$ 4.46	C-3-9
EIX	EIX US	Edison Intl	US\$ 51.27	B-2-8
PNW	PNW US	Pinnacle West Capit	US\$ 70.84	A-2-7
PPL	PPL US	PPL Corp.	US\$ 22.9	B-2-7
SRE	SRE US	Sempra Energy	US\$ 103.71	A-2-7
WEC	WEC US	WEC Energy Group Inc	US\$ 83.52	A-3-7

Source: BofA Global Research

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Price Objective Basis & Risk

Bloom Energy (BE)

We arrive at our \$3.50 price objective as follows. We remove the contribution from stock-based compensation from Free Cash Flow (FCF) from 2019 through 2030, further reduced by debt amortization to arrive at Free Cash Flow to Equity (FCFE). We then discount FCFE by our estimated cost of equity of 13%. Given the high growth nature of the business, we assign a 6x exit multiple on terminal cash flows and discount it back using a WACC of 13%. We net out the recourse debt, more than offset by 2018 year end cash and IPO proceeds, to arrive at our PO of \$3.50

Downside risks: (1) execution risks around cost reductions, deployment growth, margins, (2) risks around necessity of current subsidy schemes including the fuel cell investment tax credit (ITC) as well as state incentives (3) risk to margins as Bloom expands into new geographies with lower electricity rates to compete against as well as potentially less incentives, notably international markets where the company will need to expand to reach targets.

Upside risks: allocation of future cash flow generated towards accretive purposes, further acceleration under ITC than contemplated, and further subsidies globally to encourage fuel cell adoption- including extension of ITC.

Edison International (EIX)

Our \$61 PO is based on SOTP, applying a 3x disc to the FERC and CPUC jurisdictional subsidiaries, and the parent/other segment (vs peer P/E of 16.2x (previously 19.6x) on 2022E, grossed up by 5% to 19.8x to reflect capital appreciation across the sector). The disc reflects CA ongoing wildfire risk despite the improved construct through AB1054. We apply 10x 2022E P/E to the Edison Energy segment to reflect uncertainty in the nascent biz. We net out ongoing contribution to the fund on an NPV basis. Lastly, we assume equity financing to fund '17/18 wildfire claims.

Downside risks: 1) Regulatory outcomes less favorable than expected. 2) Natural disasters or catastrophic events can affect system reliability and are subject to regulatory cost recovery risk. 3) Interest rate risk. 4) Non-reg businesses are inherently more risky and subject to both execution risk and commodity variation. 5) CA has specific risks given the differentiated regulatory regime. 6) CA wildfires.

Upside risks: rate case outcome above what's embedded in companies' guidance and BofA estimates, lower interest rates, more constructive regulatory / legislative outcomes to address wildfire risk

Pinnacle West (PNW)

Our price objective of \$105 is based on a peer utility 2022E P/E multiple of 20.5x with a -1.5x discount to account for PNW's risk around its pending rate case as well as headline risk related to disconnect policy review. Electric and gas peer P/E mult is grossed up for a year to 2020 by 5% to reflect capital appreciation across the sector. We ascribe an in-line premium despite clear renewable capex backdrop given ongoing regulatory risk associated with the company's upcoming rate filing and 2020 election risk.

Upside risks: 1) Regulatory relationships/outcomes could improve, including changes at the elected commission 2) load growth in territory above expectations 3) Riders and capital trackers could help achieve ROE 4) positive weather helps earnings 5) interest rate risk changes cost of capital - lower rates could improve 6) Consumer advocates or utility staff could become focused on issues that improve ROE

Downside risks: 1) Regulatory relationships/outcomes could decline, including changes at the elected commission 2) load growth in territory below expectations 3) Riders and capital trackers could hurt ROE 4) negative weather hurts earnings 5) interest rate risk changes cost of capital - higher rates could worsen 6) Consumer advocates or utility staff could become focused on issues that hurt ROE 7) Solar advocates in the state have engaged in public confrontations with the utility, which could change public relations in the future.

PPL Corporation (PPL)

Our \$36 price objective is based on a sum of the parts methodology applying respective premium/discounts to the 2022E peer group multiple of 20.6x. Electric peer P/E multiple is grossed up by 5% to reflect capital appreciation across the sector. We apply a 1.3x RAV multiple in our base case for our Western Power Distribution (WPD) RAV approach, seeing the higher ROEs relative to other distribution networks commanding a premium valuation. We apply a 2.0x multiple to the US utilities.

Downside risk to our price objective is exposure to FX rates. Since the UK segment represents a significant portion of PPL's earnings, a Federal Reserve decision to raise interest rates could produce a fall in the GBP/USD currency rate that would adversely affect our estimates and valuation for PPL. Also, like all utility stocks, PPL has historically underperformed if bond yields rise. Upside risks are a rising \$/pound (GBP) price, positive regulatory outcomes, and decreasing treasury yields.

Sempra Energy (SRE)

Our \$125 PO is based on a SOTP valuation based on 2022E net income. We apply a 1x discounted multiple to SDG&E and no premium multiple to SoCal

Gas earnings (vs peer multiples of 16.5x and 16.2x, respectively). We use an in-line multiple for TX utility business given uncertain regulatory outlook despite T&D upside. For the LatAm business we value post-tax est for both sale of Peru & Chilean utilities. We value Cameron using a DCF at a 10.0% discount using a CAPM approach off its adjusted beta. We run a DCF on other LNG development and probability weight for project execution. We value the balance of the midstream segment using an EV/EBITDA approach using a 10.0x multiple as the Cameron import pipeline EBITDA doesn't step up until 2020. We further adj. for HoldCo debt & parent drag.

Downside risks: 1) negative reg risk from CA regulatory changes & int'l govts where SRE operates 2) incremental costs associated with Aliso canyon, 3) unanticipated cost overruns or delays for the Cameron LNG & other large organic growth projects 4) Capital markets or execution risk around the proposed Oncor transaction 5) rising rates, volatile natural gas prices & FX risks for SRE's int'l businesses Upside risks: 1) positive regulatory outcomes, 2) higher capex, 3) execution on Cameron ahead of our expectations, 4) lower interest rates.

WEC Energy Group Inc (WEC)

Our \$95 PO is based on a 2022E SoTP analysis, based on the large cap electric group multiple of 20.2x and the gas regulated multiple of 19.4x. Both electric and gas peer P/E multiples are grossed up for a year to reflect capital appreciation across the sector.

We apply a 2.0x premium to WEC's electric subs to compensate for surety in earnings growth for the next two years following the Commissions affirmation of the recent settlement on above average ROE's of 10%+. We apply a 0.5x premium to the gas utilities, including Peoples Gas and North Shore Gas with the Gas System Modernization Program (GSMP) and capex forecasts de-risked following the ICC order. We ascribe a 2x premium vs. the group at ATC to account for the steady nature of earnings growth as well as above average ROE's that are set at a federal level by FERC. We give Power the Future (PTF) a 2.0x premium multiple given the ROE is set indefinitely on historical and new investments. We ascribe an in line multiple for the parent accounting for the interest expense which finances overall utility operations. For the HoldCo adjustment to debt, we net out 50% of HoldCo debt from equity valuation and adjust to add back the parent drag on interest expense.

Upside Risks to achieving our price objective include 1) stronger than expected execution 2) accelerating capital opportunities and 3) favorable ratecase outcomes

Coverage Cluster

North American Utilities, Alternative Energy & LNG Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY	AES	AES	AES US	Julien Dumoulin-Smith
	Alliant Energy Corporation	LNT	LNT US	Julien Dumoulin-Smith
	AltaGas	YALA	ALA CN	Julien Dumoulin-Smith
	Ameren Corporation	AEE	AEE US	Julien Dumoulin-Smith
	American Electric Power	AEP	AEP US	Julien Dumoulin-Smith
	Atlantica Yield	AY	AY US	Julien Dumoulin-Smith
	Atmos Energy Corporation	ATO	ATO US	Richard Ciciarelli, CFA
	Avista	AVA	AVA US	Richard Ciciarelli, CFA
	Black Hills Corporation	BKH	BKH US	Julien Dumoulin-Smith
	Cheniere Energy Inc	LNG	LNG US	Julien Dumoulin-Smith
	Clearway Energy	CWENA	CWEN/A US	Julien Dumoulin-Smith
	Clearway Energy	CWEN	CWEN US	Julien Dumoulin-Smith
	CMS Energy	CMS	CMS US	Julien Dumoulin-Smith
	Emera Inc	YEMA	EMA CN	Julien Dumoulin-Smith
	Entergy	ETR	ETR US	Julien Dumoulin-Smith
	Evergy, Inc	EVRG	EVRG US	Julien Dumoulin-Smith
	Exelon	EXC	EXC US	Julien Dumoulin-Smith
	FirstEnergy	FE	FE US	Julien Dumoulin-Smith
	Hannon Armstrong	HASI	HASI US	Julien Dumoulin-Smith
	Idacorp	IDA	IDA US	Julien Dumoulin-Smith



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NextEra Energy	NEE	NEE US	Julien Dumoulin-Smith
NiSource Inc	NI	NI US	Julien Dumoulin-Smith
NRG Energy	NRG	NRG US	Julien Dumoulin-Smith
PNM Resources Inc.	PNM	PNM US	Julien Dumoulin-Smith
Portland General Electric Company	POR	POR US	Julien Dumoulin-Smith
Public Service Enterprise Group	PEG	PEG US	Julien Dumoulin-Smith
Spire	SR	SR US	Richard Ciciarelli, CFA
Sunnova Energy	NOVA	NOVA US	Julien Dumoulin-Smith
SunRun	RUN	RUN US	Julien Dumoulin-Smith
Vistra Energy	VST	VST US	Julien Dumoulin-Smith
Vivint Solar	VSLR	VSLR US	Julien Dumoulin-Smith

NEUTRAL

Algonquin Power & Utilities Corp	AQN	AQN US	Julien Dumoulin-Smith
Algonquin Power & Utilities Corp	YAQN	AQN CN	Julien Dumoulin-Smith
CenterPoint Energy	CNP	CNP US	Julien Dumoulin-Smith
Consolidated Edison	ED	ED US	Julien Dumoulin-Smith
Dominion Energy	D	D US	Julien Dumoulin-Smith
DTE Energy	DTE	DTE US	Julien Dumoulin-Smith
Duke Energy	DUK	DUK US	Julien Dumoulin-Smith
Edison International	EIX	EIX US	Julien Dumoulin-Smith
Essential Utilities	WTRG	WTRG US	Julien Dumoulin-Smith
First Solar, Inc.	FSLR	FSLR US	Julien Dumoulin-Smith
Fortis	YFTS	FTS CN	Julien Dumoulin-Smith
Fortis Inc	FTS	FTS US	Julien Dumoulin-Smith
NextDecade	NEXT	NEXT US	Julien Dumoulin-Smith
NextEra Energy Partners	NEP	NEP US	Julien Dumoulin-Smith
OGE Energy Corp	OGE	OGE US	Julien Dumoulin-Smith
Pinnacle West	PNW	PNW US	Julien Dumoulin-Smith
PPL Corporation	PPL	PPL US	Julien Dumoulin-Smith
Sempra Energy	SRE	SRE US	Julien Dumoulin-Smith
Southern Company	SO	SO US	Julien Dumoulin-Smith
Tellurian Inc	TELL	TELL US	Julien Dumoulin-Smith
Xcel Energy Inc	XEL	XEL US	Julien Dumoulin-Smith

UNDERPERFORM

American Water Works	AWK	AWK US	Julien Dumoulin-Smith
Avangrid	AGR	AGR US	Julien Dumoulin-Smith



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Bloom Energy	BE	BE US	Julien Dumoulin-Smith
Eversource Energy	ES	ES US	Julien Dumoulin-Smith
Hawaiian Electric Industries	HE	HE US	Julien Dumoulin-Smith
NorthWestern Corporation	NWE	NWE US	Julien Dumoulin-Smith
ONE Gas, Inc.	OGS	OGS US	Richard Ciciarelli, CFA
South Jersey Industries	SJI	SJI US	Richard Ciciarelli, CFA
SunPower Corp.	SPWR	SPWR US	Julien Dumoulin-Smith
Unitil Corporation	UTL	UTL US	Julien Dumoulin-Smith
WEC Energy Group Inc	WEC	WEC US	Julien Dumoulin-Smith



RSTR

El Paso Electric Company	EE	EE US	Julien Dumoulin-Smith
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Analyst Certification

I, Julien Dumoulin-Smith, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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Credit Market Strategist

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