INDUSTRY TIMELINESS: 50 (of 97)

All of the major electric utilities located in the western region of the United States are reviewed in this Issue; eastern electrics, in Issue 1; and the remaining utilities, in Issue 5.

The California government passed a law that will help address the problems that the state's electric utilities face from huge liabilities stemming from wildfires. However, this did not ameliorate problems electric companies are facing from past wildfires.

Several companies in this Issue are filing rate cases in order to recover capital spending, increased expenses, and earn an adequate return on equity.

Most electric utility stocks have performed extremely well in 2019. These equities continue to have a high valuation.

Wildfire Problems In California

In recent years, the two largest electric utilities in California have faced huge liabilities stemming from wildfires in their service area. The largest one, Pacific Gas and Electric (a subsidiary of PG&E Corporation), faced liabilities so large that in early 2019 the utility and its parent filed for protection under Chapter 11 of the Federal Bankruptcy Code. (As a result of this filing, we no longer cover the stock in *The Value Line Investment Survey*.) The problems faced by Southern California Edison (a subsidiary of *Edison International*) aren't nearly as severe, but are still significant. The company took a substantial charge in the fourth quarter of 2018 to establish a reserve for its estimate of the minimum wildfire liabilities it is facing. The third major utility in the Golden State, San Diego Gas & Electric (a subsidiary of *Sempra Energy*) hasn't had a major wildfire in its service area in recent years, but in the second quarter of 2016 wrote off costs associated with a 2007 wildfire after the company was unable to recover these costs in rates. The utilities' problems were exacerbated by California's inverse condemnation law. Under this law, a company may be found liable for damage caused by its equipment, even if the company is not found negligent.

In July, the California government enacted a law that is expected to lessen the financial problems that utilities would face from future wildfires. (The law does not affect past wildfires.) A $21 billion fund was formed, half of which has been paid for by the utilities based on their relative size. *Edison International* issued debt and common equity in order to finance its $2.4 billion share of this fund. (How the companies will account for these payments in their financial statements is yet to be determined.) Utilities will also benefit from a cost cap and a revised standard of prudence that is less burdensome, although the new law did not abolish inverse condemnation.

Electric utilities have increased their capital and operating budgets as they attempt to reduce the risks of wildfires and respond to them more quickly and effectively. Pacific Gas and Electric even shut down some power lines earlier this month in response to the risks, and received criticism for doing so. Some of the capital spending is recoverable in rates, but the companies will not earn an equity return on these expenditures. The cost of wildfire insurance has soared, which is hardly surprising, but the utilities are recovering these costs from customers.

Regulatory Matters

The wildfire matters mentioned above affect just two companies of the 12 covered in the Electric Utility (West) Industry in this Issue. By contrast, regulatory considerations affect every company in the Electric Utility Industry. Utility subsidiaries of *Avista* and *Hawaiian Electric Industries* have not earned an adequate return on equity in recent years, so the companies have come before the regulatory commissions frequently in recent years. The utilities owned by *Xcel Energy* are also frequent participants in the regulatory arena, especially as the company adds wind projects. *Black Hills* and *NorthWestern* also have rate cases pending.

Conclusion

Most electric utility stocks have turned in outstanding performances in 2019. The price of almost every issue in this Industry has risen more than 10%, and several increases have exceeded 30%. Interest-rate cuts by the Federal Reserve (and the possibility of additional easing) have increased investors' interest in these equities thanks to their generous dividends. This "reaching for yield" has sent these stocks to lofty valuations. Almost every utility equity covered in Issue 11 is trading at a market premium. The average dividend yield for the Electric Utility Industry is 3.1%. This figure is still comfortably above the median of all dividend-paying issues covered in *The Value Line Investment Survey*, which is 2.2%, but the gap has narrowed considerably this year.

We advise investors to take a cautious stance due to the group's high valuation. The 18-month Target Price Ranges shown on the full-page reports for each stock do not reflect dividends, but even when dividends are added to these estimates, they do not suggest attractive total returns for this time frame. We do provide total return projections for the 3- to 5-year period. These are not appealing, either. In fact, the recent quotations for most of these stocks are within their 2022-2024 Target Price Range, and in some cases (such as *IDACORP*), the price is above this range.

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