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BofA SECURITIES

North American Gas Utilities

Regulatory Flash: SR rate case clarification disappointing; SWX gets tracker recovery

Price Objective Change

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SR: MoPSC clarifies disappointing SR MO rate case order

The MoPSC clarified its final order in the Spire (SR) Missouri rate case, and *we find the clarification to be much more disappointing than we were expecting.* As a reminder, SR asked for clarification on two items, 1) treatment of capitalized overhead costs and 2) inputs the Commission intended for short-term debt. Staff and the OPC filed responses with the Commission earlier this week expressing their position.

Capitalized overhead; a period of drag as expenses do not equal revenues

The Commission ordered SR to *cease* capitalizing non-operational overhead costs. Previously recorded capitalized overhead costs, including those up to the test year (June 1, 2021), will remain in rate base and continue to earn a return, but, again, there will be a period of time where SR will be booking incrementally higher operational expenses with no revenue requirement increase to match, dragging on earnings. Staff stated that the prospective impact of the order serves as an incentive for SR to adjust its overhead accounting procedures. Staff would support a deferral mechanism for construction overhead costs where costs could be recovered at a later date (either through ISRS or general rate case), and stated that they would work expeditiously with SR and others on the matter. *While it seems there will be a short-term drag, we do not see this as a longer-term issue as we expect parties to act quickly to remedy the concerns.*

Inclusion of greater ST debt balance significantly lowers the equity layer

The Commission is using the OPC's calculation of SR's 13-month average debt and excluding the Winter Storm Uri impact (i.e. ST debt minus the ST assets related to Uri) – We had previously assumed that the full $250M in Uri debt would be excluded (i.e. ex-netting Uri-related assets). A lower equity layer leads to a lower revenue (rate) increase. Using the company's common equity and long-term debt balances and now including $218M of ST debt, <u>we see an equity layer of 50.5% (see page two for our calculations) vs 54.25% prior.</u> The argument for including short-term debt in the capital structure is that SR's ST debt balance consistently exceeds its ST asset balance, implying that ST debt is being used to support longer-term assets, and the argument for using a 13-month average is that SR refinanced short-term debt ahead of the true-up date, which in the Commission's view does not represent SR's true capital structure. The Commission is using actual equity and long-term debt balance at the date of true-up, but an average for ST debt – unclear if this opens a legal avenue for SR to argue.

Very disappointing decision, but see some ability to navigate

All said, disappointing outcome and we could see a lower EPS than we previously contemplated, but we await more detail on SR's next steps whether that be through rehearing on certain items or an appeal of the case – at this point, the record seems to favor the OPC and other intervenors, so it may be difficult for changes to the order. Optics of filing another case directly after the current case could be difficult as well.

We wait for more final terms to refine our estimate but the rate case view at this point would be negative for adjusted EPS, although BofAE is +5% 2022/+3% 2023 versus consensus already. Disappointing outcome; maintain Buy based on further capital spending opportunities. ***See page two for more on SR and SWX's tracker recovery approval.***

MoPSC: Missouri Public Service Commission

OPC: Office of Public Counsel

ISRS: Infrastructure System Replacement Surcharge

SR Docket: GR-2021-0108

SWX Docket: G-01551A-19-0055

Other Considerations?

We have seen examples of ratings agencies taking action with credit ratings given adverse regulatory outcomes (PNW in AZ), and we wonder if the MoPSC's order will drive agencies to lower SR's rating (currently Baa2/A- Stable) which would impact their ability to borrow at favorable rates.

Does this matter for the electric utilities? Not in our view because the electrics typically have much higher construction work-in-progress balances, and, therefore the short-term asset balance usually exceeds the level of short-term debt. We look for swift resolution in pending AEE Missouri rate case settlement in near-term to derisk this angle but watch this more around forthcoming EVRG case to be filed early in 2022– even here too not so concerned.

Exhibit 1: SR MO Rate Case Capital Structure

We see an equity layer of 50.5% when adjusting for $218.3M

SR Capital Structure	Amount ($mm)	% of Total	Return
Common Equity	1,589.5	50.52%	9.37%
Short-term Debt	*272.5*		
Uri ST Debt	*250.0*		
Uri ST Assets	*195.8*		
Net ST Debt	218.3	6.94%	0.29%
Long-term Debt	1,338.7	42.55%	3.99%
Total Capital	**3,146.5**		

Source: BofA Global Research estimates, company filings

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SWX: VSP and COYL tracker reconciliation gets ACC nod

The Arizona Corporation Commission (ACC) granted Southwest Gas (SWG), a subsidiary of Southwest Gas Holdings (SWX), approval to start recovering past Vintage Steel Pipeline (VSP) and Customer-Owned Yardline (COYL) investment balances during its Nov. 2 open meeting. Staff's recommended order aligned with the company's request – the VSP has an associated revenue requirement of ~$60M to be recovered over three years while the COYL program's revenue requirement is ~$13M to be recovered only one year. The only adjustment made by the Commission is that the VSP recovery will begin in March '22 rather than November '21 as the Commissioners were focused on increased rates into the winter heating season.

Additionally, Commissioners were split on allowing recovery now vs waiting until the next rate case that will be filed at the end of this year. We note Chairwomen Peterson entertained the idea of disallowing recovery of investments related to Phase 2 and Phase 3 of the COYL program; however, the ACC previously ruled that the investments were prudent, so it would have caused a legal issue.

We find the recovery of the trackers to be positive in light of the very punitive backdrop in AZ – that said, the cases were very straightforward. Remember, in SWG's 2020 rate case, the ACC asked SWG to hold off on recovery of the investments given the pandemic and impact to customer bills. Reiterate Neutral following the modestly positive update on an otherwise negative regulatory backdrop. We continue to await additional detail on the backdrop for SWG from its upcoming rate case.

Price objective basis & risk

Southwest Gas Holdings (SWX, $71.52, B-2-7)

Our $72 PO is based on our 2024E Sum-of-the-parts (SOTP) analysis. We apply a 13.6x peer Gas LDC utility P/E to the utility EPS across the company's three major jurisdictions, which include Arizona, Nevada and California. We gross this peer multiple up by 5% to reflect capital appreciation across the sector. For AZ, we apply a 1.5x discount to the jurisdiction given lack of forward looking rate treatment/alternative rate making mechanisms. We apply a 1.0x discount to NV and CA as we take a more negative view on the jurisdictions' LT viability. Additionally, we value the FERC regulated Questar Pipelines and Pauite Pipeline separately on a midstream peer group average EV/EBITDA multiple of 9.5x and net out associated debt. We apply a 1x discount to Questar based on limited/no growth. For the infrastructure services segment, Centuri, we apply 8.5x EV/EBITDA multiple, which is in-line with the business' closest industrial comps despite Centuri's relatively lower exposure to broader infrastructure tailwinds. Lastly, for parent debt in the Corp & Other segment, we net out 50/50 weighting for re-capitalization and add back 50% of parent interest expense.

Risks to achieving the Price Objective are 1) M&A, 2) Activist shareholders, 3) infrastructure services performance, 4) construction margins, 5) regulatory outcomes, 6) ability to earn regulatory rates of return, 7) capital markets access, 8) rating agency actions.

Spire (SR, $63.18, A-1-7)

Our $70 PO for SR is based on a sum-of-the-parts analysis, applying a Gas LDC multiple of 13.5x on '24E with a 1x premium for Missouri and a 2x premium for Mississippi/Gulf and AL assets given their location and de-risked nature. For the midstream assets, we use a base 8.0x EV/EBITDA multiple with a 4x discount for storage given uncertainty, and a 4x discount for marketing due to volatility. We weight STL pipeline as 75% in our valuation given uncertainty with the pipe's future.

Upside risks: 1) improving regulatory relationships, 2) decrease in interest rates, 3) incremental capital spending, 4) constructive rate case outcomes, 5) less equity needs. Downside risks: 1) deteriorating regulatory relationship, 2) increase in interest rates, 3) less or deferred capital spending, 4) poor rate case outcomes, 5) more equity needs.

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	Ameren Corporation	AEE	AEE US	Julien Dumoulin-Smith
	American Electric Power	AEP	AEP US	Julien Dumoulin-Smith
	Black Hills Corporation	BKH	BKH US	Julien Dumoulin-Smith
	CenterPoint Energy	CNP	CNP US	Julien Dumoulin-Smith
	Cheniere Energy Inc	LNG	LNG US	Julien Dumoulin-Smith
	CMS Energy	CMS	CMS US	Julien Dumoulin-Smith
	Dominion Energy	D	D US	Julien Dumoulin-Smith
	Emera Inc	YEMA	EMA CN	Dariusz Lozny, CFA
	Enphase Energy	ENPH	ENPH US	Aric Li
	Entergy	ETR	ETR US	Julien Dumoulin-Smith
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	Exelon	EXC	EXC US	Julien Dumoulin-Smith
	First Solar, Inc.	FSLR	FSLR US	Julien Dumoulin-Smith
	FirstEnergy	FE	FE US	Julien Dumoulin-Smith
	Hydro One	YH	H CN	Dariusz Lozny, CFA
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	NextEra Energy	NEE	NEE US	Julien Dumoulin-Smith
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	NRG Energy	NRG	NRG US	Julien Dumoulin-Smith
	OGE Energy Corp	OGE	OGE US	Julien Dumoulin-Smith
	Ormat Technologies	ORA	ORA US	Julien Dumoulin-Smith
	PG&E Corporation	PCG	PCG US	Julien Dumoulin-Smith
	Portland General Electric Company	POR	POR US	Julien Dumoulin-Smith
	Public Service Enterprise Group	PEG	PEG US	Julien Dumoulin-Smith
	ReNew Power	RNW	RNW US	Julien Dumoulin-Smith
	SolarEdge Technologies	SEDG	SEDG US	Aric Li
	South Jersey Industries	SJI	SJI US	Julien Dumoulin-Smith
	Southern Company	SO	SO US	Julien Dumoulin-Smith
	Spire	SR	SR US	Julien Dumoulin-Smith
	Sunnova Energy	NOVA	NOVA US	Julien Dumoulin-Smith
	SunRun	RUN	RUN US	Julien Dumoulin-Smith
	TransAlta Corporation	YTA	TA CN	Dariusz Lozny, CFA
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	Xcel Energy Inc	XEL	XEL US	Julien Dumoulin-Smith
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	Ameresco	AMRC	AMRC US	Julien Dumoulin-Smith
	Atlantica Sustainable Infrastructure	AY	AY US	Julien Dumoulin-Smith
	Atmos Energy Corporation	ATO	ATO US	Julien Dumoulin-Smith
	Bloom Energy	BE	BE US	Julien Dumoulin-Smith
	ChargePoint Holdings	CHPT	CHPT US	Ryan Greenwald
	Duke Energy	DUK	DUK US	Julien Dumoulin-Smith
	Edison International	EIX	EIX US	Julien Dumoulin-Smith
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	Eversource Energy	ES	ES US	Julien Dumoulin-Smith
	EVgo Inc.	EVGO	EVGO US	Ryan Greenwald
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	Idacorp	IDA	IDA US	Julien Dumoulin-Smith
	Maxeon Solar Technologies	MAXN	MAXN US	Julien Dumoulin-Smith
	NorthWestern Corporation	NWE	NWE US	Julien Dumoulin-Smith
	PPL Corporation	PPL	PPL US	Julien Dumoulin-Smith
	Sempra Energy	SRE	SRE US	Julien Dumoulin-Smith
	Southwest Gas Holdings	SWX	SWX US	Julien Dumoulin-Smith
	Tellurian Inc	TELL	TELL US	Julien Dumoulin-Smith
	TransAlta Renewables Inc.	YRNW	RNW CN	Dariusz Lozny, CFA
	WEC Energy Group Inc	WEC	WEC US	Julien Dumoulin-Smith
UNDERPERFORM				
	American Water Works	AWK	AWK US	Julien Dumoulin-Smith
	Avangrid	AGR	AGR US	Julien Dumoulin-Smith

NA Utilities, Alt Energy, Charging Infrastructure and LNG Coverage Cluster

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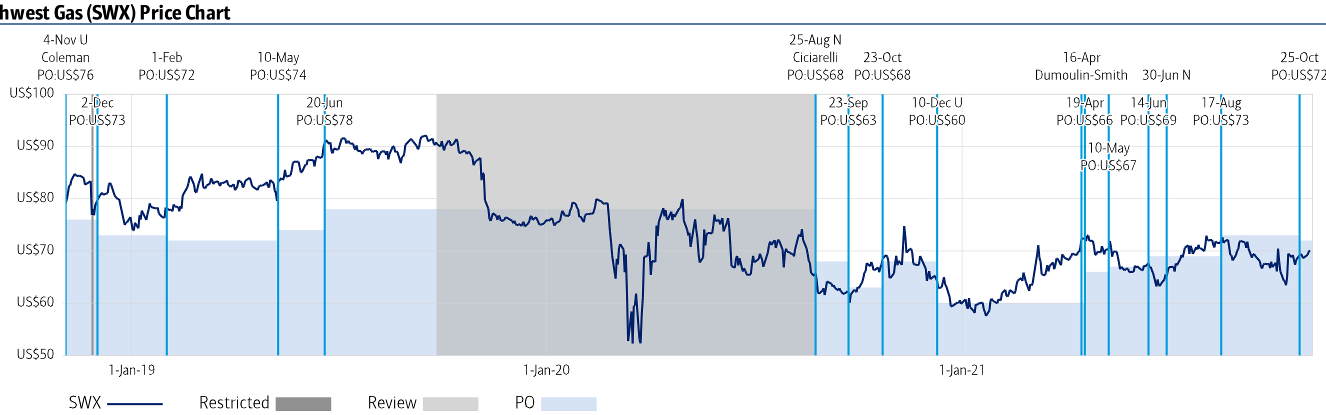
	Consolidated Edison	ED	ED US	Julien Dumoulin-Smith
	DTE Energy	DTE	DTE US	Julien Dumoulin-Smith
	Fortis	YFTS	FTS CN	Dariusz Lozny, CFA
	Fortis Inc	FTS	FTS US	Dariusz Lozny, CFA
	Hannon Armstrong	HASI	HASI US	Julien Dumoulin-Smith
	MGE Energy	MGEE	MGEE US	Julien Dumoulin-Smith
	New Jersey Resources Corp	NJR	NJR US	Julien Dumoulin-Smith
	NextEra Energy Partners	NEP	NEP US	Julien Dumoulin-Smith
	Northwest Natural Holdings	NWN	NWN US	Julien Dumoulin-Smith
	ONE Gas, Inc.	OGS	OGS US	Julien Dumoulin-Smith
	Pinnacle West	PNW	PNW US	Julien Dumoulin-Smith
	SunPower Corp.	SPWR	SPWR US	Julien Dumoulin-Smith
	TPI Composites	TPIC	TPIC US	Adhok Bellurkar
	Unitil Corporation	UTL	UTL US	Julien Dumoulin-Smith
RSTR				
	Algonquin Power & Utilities Corp	AQN	AQN US	Julien Dumoulin-Smith
	Algonquin Power & Utilities Corp	YAQN	AQN CN	Julien Dumoulin-Smith
	Clearway Energy	CWENA	CWEN/A US	Julien Dumoulin-Smith
	Clearway Energy	CWEN	CWEN US	Julien Dumoulin-Smith

Disclosures

Important Disclosures

Southwest Gas (SWX) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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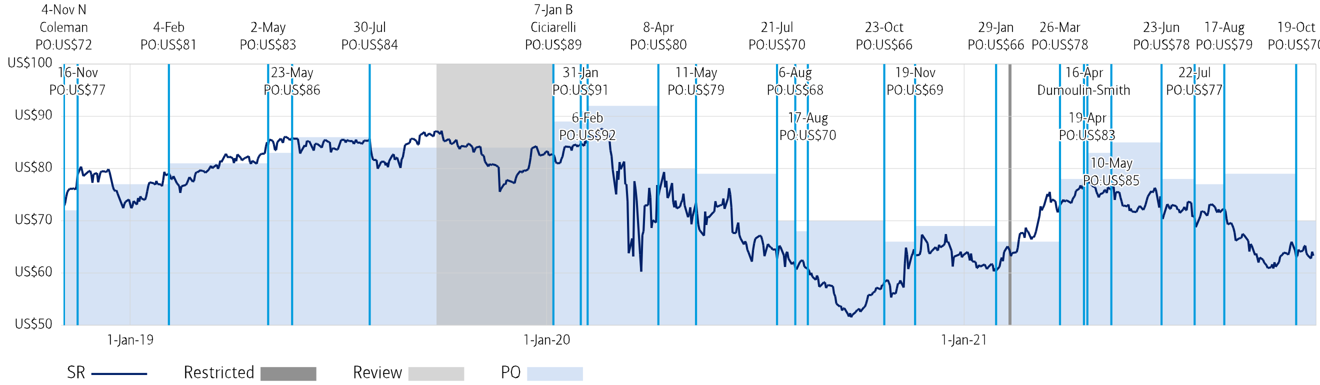
Spire (SR) Price Chart



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Buy	79	50.32%	Buy	56	70.89%
Hold	37	23.57%	Hold	30	81.08%
Sell	41	26.11%	Sell	27	65.85%

Equity Investment Rating Distribution: Global Group (as of 30 Sep 2021)

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Sell	669	20.23%	Sell	343	51.27%

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