All of the major electric utilities located in the eastern region of the United States are reviewed in this Issue; western electrics, in Issue 11; and the remaining utilities, in Issue 5.

Tax reform has been a topic of interest in many utility holding companies' fourth-quarter earnings conference calls. We discuss some potential changes, and how they would affect some companies in this industry.

Utilities are known for their generous dividends. For many companies, the first quarter is when the board of directors reviews the payout for a possible increase.

After a strong showing in 2016, most of these stocks have generally not had a notable movement in either direction in early 2017. Most of them remain expensively priced, in our view.

Tax Reform

With a new administration in the White House, the topic of tax reform is being raised. Among changes that have been unofficially proposed, one is a simple reduction in the corporate tax rate from 35% to 15%. Another is a cut to 20%; an end to the deductibility of interest expense; and treating capital expenditures as a deductible expense, instead of depreciating these assets over time. This raises additional questions—for instance, would the change to interest deductibility apply to interest on current debt or only on debt issued after the law takes effect? A separate concern for some companies is that tax incentives for renewable energy will be scaled back or even abolished. However, *NextEra Energy*, which has significant investments in wind and solar power, believes retroactive changes are unlikely to the tax laws that provided these incentives.

How would these changes affect electric utilities, their parent companies, and their nonutility affiliates? For the regulated business, it is highly likely that any effects of tax reform will be passed through to ratepayers. This is what happened some 30 years ago, following the tax changes that resulted from a 1986 law. Unfortunately, for utility holding companies as a whole, we cannot provide a better answer than "it depends." *NextEra* stated that (off a 2020 baseline), a cut to a 15% tax rate would boost earnings by $0.30-$0.40 a share. On the other hand, the other possible change would reduce profits by $0.10-$0.15 a share. *Dominion Resources* "would expect to be somewhat earnings neutral" if a tax bill is passed into law. *PPL Corporation* thinks the latter proposal we mentioned would reduce its earning power by $0.10 a share annually, but believes it could mitigate the negative effect.

Dividend Increases

Utilities have long been known for their generous dividends. This has become even more important for many investors in this era of extremely low interest rates, which provide negligible returns on cash. Many income-oriented investors focus on utility stocks because these provide attractive dividend yields. But investors don't just want dividend income, they want annual and predictable growth in the payout, as well. Accordingly, most utility stocks provide yearly growth in the disbursement, as long as this is feasible from a cash and payout-ratio standpoint.

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Among the utilities covered in this Issue, *Consolidated Edison*, *Dominion Resources*, *Eversource Energy*, and *PPL* have already boosted the dividend in 2017. We think *NextEra*, *Public Service Enterprise Group*, and *SCANA* raised or will raise dividends shortly after this report went to press. *Duke Energy*, *Exelon*, and *Southern Company* will probably hike the payout later in 2017. In fact, among the 12 electric utility equities reviewed in this Issue, only *AVANGRID* and *FirstEnergy* are unlikely to increase their disbursements this year.

Many companies have a specified dividend policy, seeking to maintain an annual growth rate, a payout ratio, or both. For instance, *Eversource*'s goal is to raise the dividend by 5%-7% each year. *AVANGRID* wants to have a payout ratio in a range of 65%-75%. Its payout ratio is now well above this range, which explains why a hike in the disbursement is unlikely this year, and perhaps for a few years after that, too.

Conclusion

As a group, electric utility stocks had an excellent return in 2016, with a total return of 17.4%. This was a reversal from a poor showing in 2015, when the industry's total return of -3.9%. (These data were provided by the Edison Electric Institute, a trade group representing investor-owned electric companies.) So far this year, there have been few noteworthy movements in this group. One exception is *Dominion*, which lost 6% of its value at the start of February when the company's earnings guidance for 2017 was disappointing for Wall Street.

We continue to believe that most equities in this industry are expensively priced. Historically, electric utility stocks have traded at a discount to the market because utilities generally don't grow fast. Last year, however, several stocks had price-earnings ratios that were at or even above the broader market. And many of these issues have recent prices within their 2020-2022 Target Price Range. The industry's average dividend yield is 3.6%.

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