NorthWestern Corporation

NWE - ALERT: Regulators Gone Wild?

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We believe Montana regulation bears watching, particularly for NWE. Recent developments at the commission suggest commissioners (particularly free market advocate Commissioner Travis Kavula) may be leaning toward regulatory positions that could present challenges. Among the issues being discussed are moves to revisit PURPA contracts, to which Kavula is promoting the idea utility owned generation be subject to a reevaluation after five or 10 years. Additionally, related to the implementation of Montana Bill 193 (looks at recovery of supply costs), discussion has come up where the commission could look at earned returns of NWE's Montana generation assets (overearning) in isolation from the transmission and distribution assets (which are underearning). Kavula seems to be spearheading these efforts and is termed out after 2018. We also believe some of the proposed ideas run counter to legislative intent of the 2007 reregulation of generation and principle of leveling the field among Montana utilities with regard to supply cost recovery under Bill 193.

Recent Montana Regulatory Trends. We believe regulatory risk in Montana has been trending higher for NWE. We think the commission has been chipping away at the Company in an effort to have the Company file a rate case after adding the sizable hydro assets to rate base outside of a traditional rate case. We believe several recent developments should be monitored for the potential to further degrade the regulatory landscape.

Reexamination of PURPA QF Contracts Could Expand to Utility Generation. The Public Utility Regulatory Reform Act is a federal requirement that utilities must purchase power from small qualifying facilities (QFs) at the utilities' avoided cost, with significant deference to states around contract terms. With a flood of small renewables qualifying, many utilities are being required to sign contracts for power that is neither necessarily needed nor the optimal match for system needs. The Montana commission is looking at lowering the contract price and shortening terms of the contract from the typical 20-25 years to 5-10 years with a potential repricing after the initial term. Commissioner Kavula suggests a similar construct for future utility owned generation, which we view as a significant deviation from the traditional model of building a long-lived asset with assured recovery over the 30- to 40-year life of the plant.

Bill 193 Implementation Could Look at Other Issues. The recently enacted Bill 193 looks at the recovery of supply costs through tracker mechanisms. It was designed to put the utilities in the state on equal footing. NWE has historically been meaningfully short generation and had more straightforward recovery mechanism. As part of the process of studying how to implement this bill, the commission has discussed looking at NWE's returns and has initiated a process to potentially do so. NWE will make its oral arguments on July 28, when we expect it to advocate for its previously announced plan to file a rate case in 2018. The commission is expected to render a decision sometime thereafter, with one outcome being that the commission could require NWE to file data (by September 30) with regard to returns at the supply segment. This is significant in that NWE's generation assets are overearning, with transmission and distribution assets underearning (with blended returns slightly underearning).

Developments Concerning, but May Prove Challenging. We view these recent developments at the commission as concerning. NWE has a long-term plan to fill its short generation position with up to $1.3 billion of capital expenditures. Clearly, the higher risk of retroactive looks at generation asset prudence would likely cause NWE to rethink this capital. Additionally, the idea of cherry-picking asset classes to undergo effective rate cases is troublesome. However, we expect the implementation of these policy could face headwinds. The Montana legislature in 2007 specifically enacted legislation to encourage utility ownership of generation after Montana's disastrous foray into deregulation. As such, we expect the legislature could weigh in on this matter. We also question whether the commission could prevent NWE from filing what would effectively be a full rate case, including its entire rate base, not just its generation portfolio, when it does file. Lastly, Commissioner Kavula is termed out after 2018. Given our view that he is driving much of the agenda, we think the rhetoric could die down after that time.

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NorthWestern Corporation - NWE

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Three-Year Rating and Price Target History

Rating and Price Target History for: NorthWestern Corporation (NWE) as of 07-10-2017

Rating Disclosures

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July 10, 2017
Paul T. Ridzon
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Sector Weight - We expect the stock to perform in line with the analyst's coverage sector over the coming 6-12 months.

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