Compensation
Advisory Partners

Industry Report // 2016-2017

Utility Industry

Compensation Advisory Partners (CAP) examined 2016 executive pay and company performance at 29 companies in the utility industry with median revenue of approximately $10B. The study focused on performance trends and external market factors affecting pay practices within the industry.

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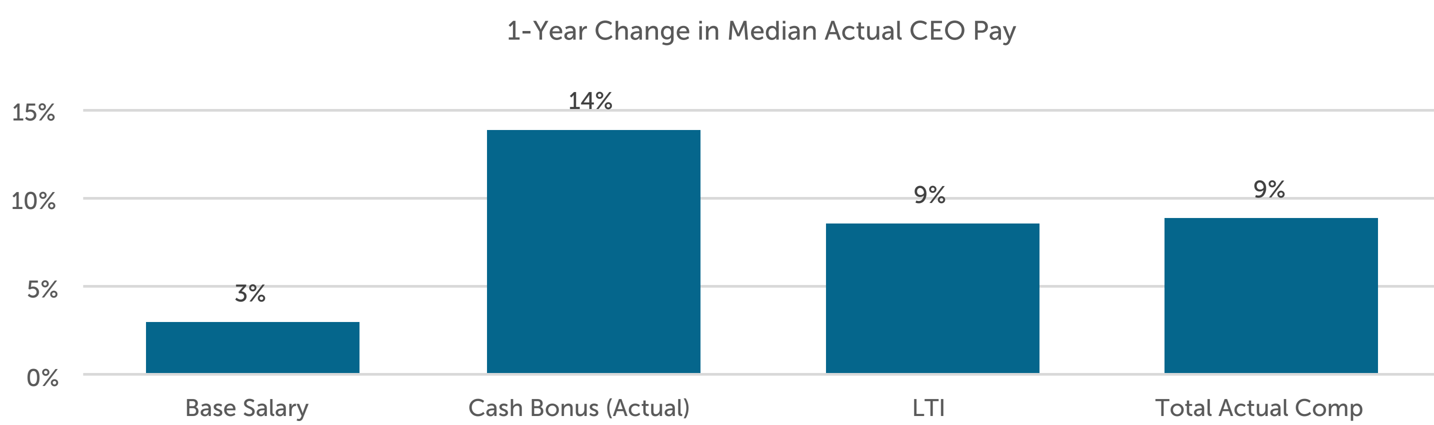
2016 Financial Performance

Overall, the utility sector performed well versus the broader market. Utilities saw strong total shareholder returns (TSR) of +19% for the year versus the S&P 500 index of +12% for 2016. The impact of the 2016 U.S. presidential election on the market helped drive the strong returns. Specifically, the potential for pro-growth policies related to economic stimulus, tax reform and reduced regulations, led to a significant impact on the shareholder returns of certain industries, such as financial services. However, the utilities industry underperformed the S&P 500 with TSR finishing out the year flat following the election compared to +5% gain for the S&P 500. This may be a result of investors repositioning their portfolios away from utilities, in anticipation of potential pro-growth policies from the Republican controlled government. Now, nearly midway through 2017, with some delays in potential regulatory changes, utilities TSR year to-date (as of 5/31/17) of +13% is outpacing the S&P 500 (+9%).

Several factors positively influenced 2016 financial results among utilities, including somewhat higher power prices, favorable weather conditions in parts of the country and regulatory rate increases. Reported (adjusted) earnings for the companies increased +6.1% in 2016 compared to +3.2% in 2015. Only four companies had declining growth in 2016 as compared with 2015, which saw nine companies with declining growth. Revenue growth was flat versus a -4.3% decline at median last year and ROIC was slightly lower year-over-year.

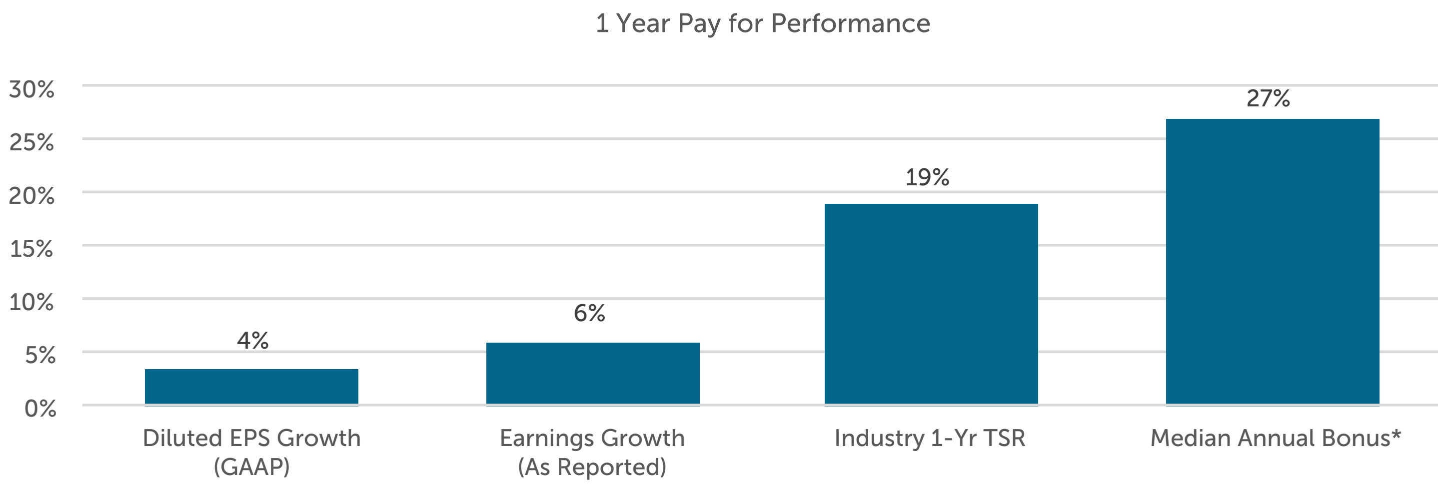
Industry Group	2016 Median Company Performance		
	Revenue Growth	Diluted EPS Growth	TSR
Utility Cos. (n=29)	+ 0.5%	+ 3.5%	+ 18.9%
S&P 500	+ 2.9%	+ 3.7%	+ 13.4%

2016 CEO Pay For Performance: Pay Aligned With Performance



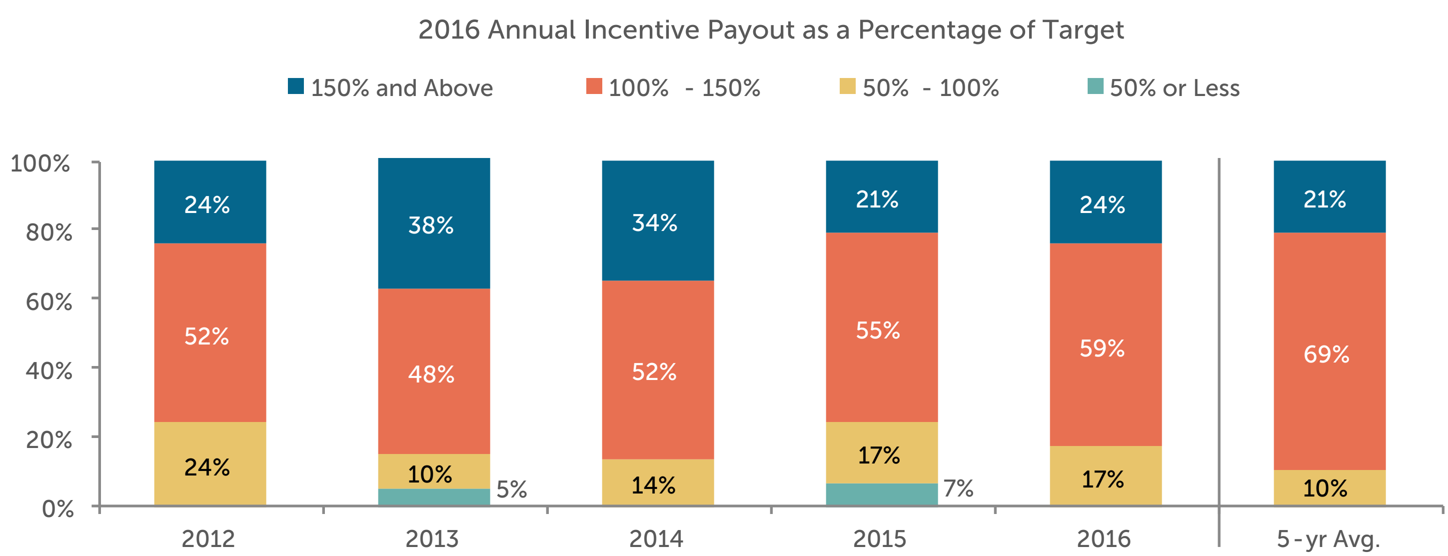
Our study examined the annual change in actual total compensation for CEOs who have been in this role for both 2015 and 2016. Actual total compensation for 2016 is defined as the sum of 2016 salary, 2016 bonus payout (paid Q1 2017) and the grant date value of 2016 long-term incentives (LTI). Total compensation grew by approximately 9%, driven by increases in both cash and LTI compensation.

Actual bonus payouts were up 14% compared to 2015, which is aligned with earnings growth and stock price performance (TSR).



**Reflects median performance payout of 127% of target*

Similar to prior years, 2016 annual bonus payouts have generally been above target; at least 75% of companies have paid out above target each year during this time. Our analysis indicates that utilities have a tendency to payout above target, with median payouts in 2016 at 127% and the median 5 year payout around 130%. In fact, nearly 20% of companies paid out above 125% for each of the last 5 years. While most sectors have paid out above target during this time, it is less common for companies to pay out above 125% for five years in a row. The higher payout levels may be a result of challenges in predicting power prices, plus the inherent challenges in predicting weather. Coupled with the utility sector tendency to set somewhat tighter goal ranges than other sectors, these challenges may lead to more predictable outcomes given some of the volatility is removed.



Annual Incentive Plans – Adjustments

The most common metric among utilities is adjusted earnings as it is more directly related to the ongoing operations of the business. Management uses it as a primary indicator for evaluating performance, allocating resources, and planning and forecasting future periods.

Adjustments made to GAAP earnings for incentive plan design purposes may factor into the above target payouts. When determining adjustments, companies must decide to what degree management should be protected from events and items outside of their control, but that can still ultimately affect shareholders. Adjusting a metric for too many variables can lead to a disconnect between pay and performance, while not adjusting can create a sense that the financial performance driving compensation is outside of management's control and not a true reflection of operational performance. To that end, our study finds that 86% of utility companies adjust GAAP earnings for purposes of determining annual incentive plan payouts.

The difficulty in projecting certain reconciliation items for future periods may make business plan forecasting and incentive plan goal setting particularly difficult for utilities. As a result of this, common adjustments made by utility companies include mark-to-market hedging, closing of plants, merger/integration costs, cost saving initiatives, regulatory charges, operations and maintenance expenses, and nuclear decommissioning trust.

CAP found utility companies, on average, make a reasonable amount of adjustments. These adjustments with incentive plan goal setting result in the ranges between threshold to target and target to maximum being narrower as some of the volatility is removed.

Annual Incentive Plans – Goal Setting

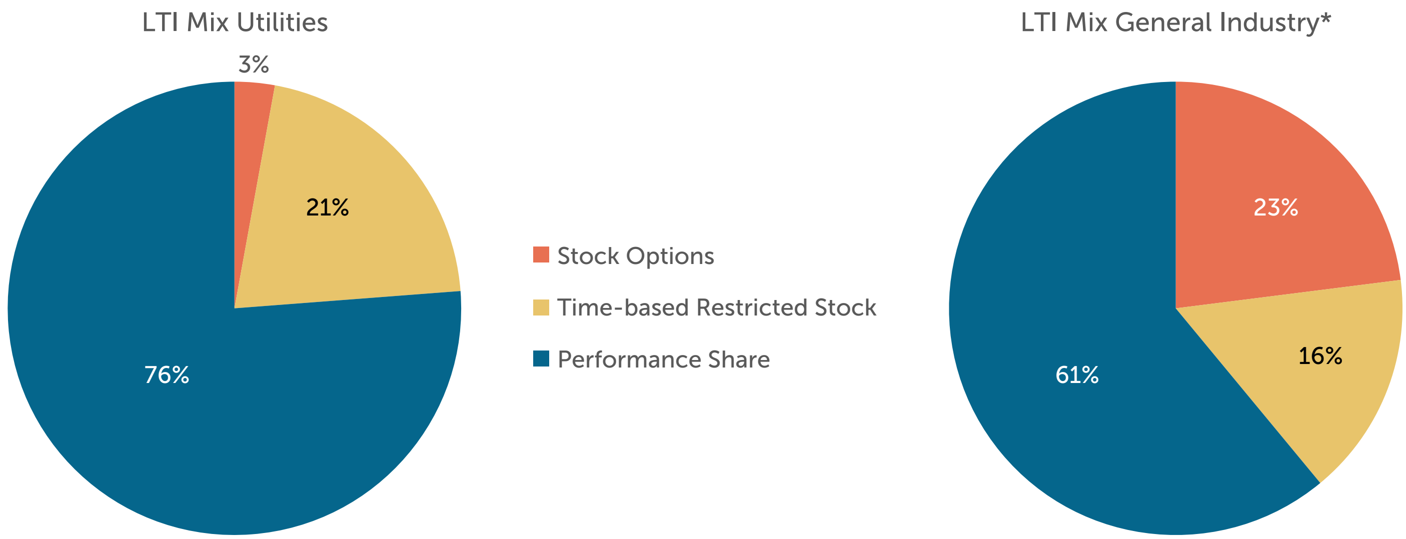
While profitability measured on a GAAP basis was up +3.5%, on a reported basis, earnings increased +6.1%, which validates the increase in bonuses year-over-year. This also suggests that the use of non-GAAP metrics may be a more accurate picture of company performance and provide for more consistency to previous year(s) financial results since TSR was also strong.

When setting goals, it is common among utilities to set targets lower than the prior year target or actual performance, given the dynamics in the industry that are beyond the control of management (e.g., declining prices, changes in demand, etc.). This area continues to be a concern to proxy advisory groups; although, given the nature of the industry, always increasing performance can be challenging and setting unachievable targets can negate the effectiveness of any incentive.

Among the utility companies, 40% set 2016 targets lower than 2015 targets and 44% set targets below prior year actual performance. For companies whose 2016 targets were lower than 2015 targets, median payout was 136% of target and for companies whose 2016 targets were lower than prior year actual, median payout was 116%; therefore payouts are at least trending in the right direction. The difference between the two may help explain why when setting targets, management is able to have a better sense of the more predictable adjustments; however, actual performance may be reflective of the volatility of business and unpredictable outcomes not foreseen in setting the targets.

Long-Term Incentives – Emphasis On Longer Term Performance Plans

All utility companies in our study use a long-term performance plan, with all but one company placing at least 50% weight on a performance plan. Utility companies tend to put more emphasis on performance plans and time-based restricted stock than the general industry. Options continue to have limited use versus the broader market and on average, represent only 3% of the LTI mix (three companies grant options) compared to 23% of the LTI mix among the broader market.



**Compensation Advisory Partners 100 Company Database*

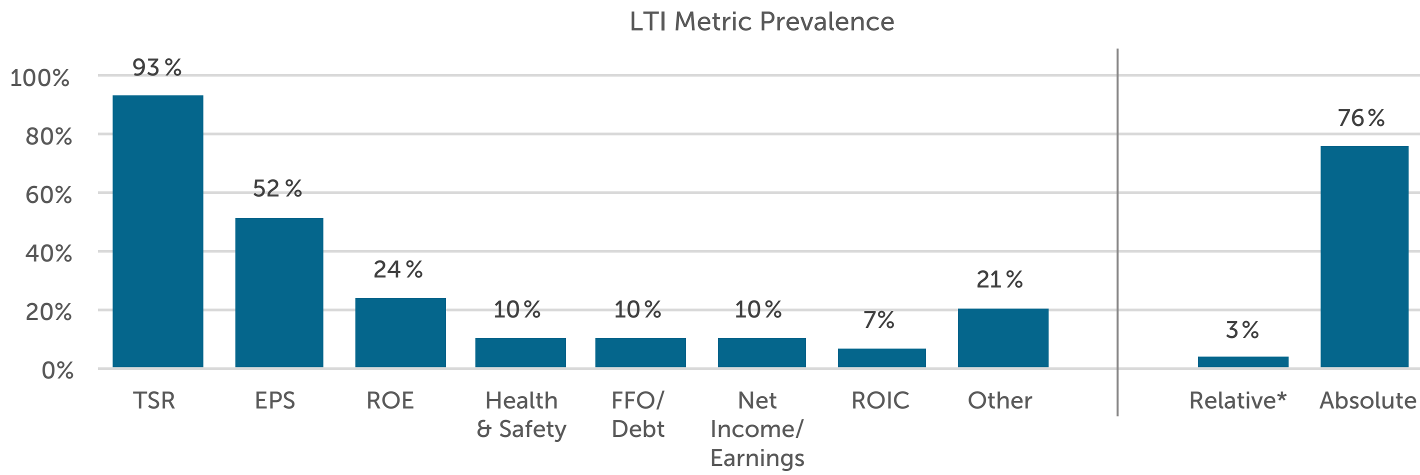
All companies use a 3-year performance period, which is the de facto standard across most industries. As a result, companies are linking executive pay with performance, measured most often by relative TSR or EPS vs. plan. All but two companies use relative TSR in their long-term incentive plans. The most common comparator group for relative TSR is the compensation peer group.

TSR Comparator Group

Comparator Group	Prevalence (% of companies)
Compensation Peer Group	26%
Performance Peer Group	22%
Philadelphia Utility Index	22%
S&P 500 / S&P 1500 Utilities	19%
Edison Electric Institute	11%

Due to the regulated and relatively steady nature of the industry, TSR tends to move within a tight range and in the same direction for all companies. Comparatively small movements in TSR can have a meaningful impact on a company's position relative to their TSR peer group.

Of the 15 companies with EPS in their long-term incentive program, 53% also use it as a metric in their short-term incentive program. This double-use can be an area of concern for select shareholders and is often raised by proxy advisors, especially when pay and performance are misaligned. However, these companies typically use different targets for the metric when both annual operating targets and long-term strategy are key areas of focus.



**Excludes relative TSR metrics*

Conclusion

Similar to other industries, there is uncertainty on how the current administration's policies will affect the utility industry. Regardless of any regulatory changes, the utility industry is in a period of transformation. Large investments, labor and other factors (i.e. upgrading infrastructure, natural gas pipelines, storage and distribution, and grid modernization) have contributed to rising costs. Further, under the Clean Power Plan, companies have started retiring coal plants; however, President Trump has pledged to restore the coal industry, vowing to bring jobs and production back to the sector. This may be an opportunity to explore other resources or invest in generation, transmission and distribution assets. Lastly, under the proposed corporate tax plan, the current administration is considering placing a tax on carbon emissions, which would help fund the corporate tax cuts. This would have positive implications for nuclear and renewable generation and would have a negative impact on fossil fuel generation.

Management and Boards must monitor the regulatory environment in the upcoming years to understand how changes will impact the company's goals, strategy, operations and reliability to serve its customers. From a compensation perspective, companies will need to ensure that the appropriate behaviors and results are being rewarded, performance targets are reflective of the business plan and that any adjustments to GAAP are truly reflective of what management cannot control.

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List of Utility Companies

Alliant Energy Corporation
Ameren Corporation
American Electric Power Company, Inc.
Black Hills Corporation
CenterPoint Energy, Inc.
CMS Energy Corporation
Consolidated Edison, Inc.
Dominion Resources, Inc.
DTE Energy Company
Duke Energy Corporation
Edison International
Entergy Corporation
Eversource Energy
Exelon Corporation
FirstEnergy Corp.
Hawaiian Electric Industries, Inc.
MDU Resources Group, Inc.
NextEra Energy, Inc.
NiSource Inc.
OGE Energy Corp.
PG&E Corporation
Pinnacle West Capital Corporation
Portland General Electric Company
PPL Corporation
Public Service Enterprise Group Inc.
Sempra Energy
The Southern Company
Vectren Corporation
Xcel Energy Inc.