Utilities

Corey Malone
Justin Englund

Introduction

- Companies generally generate, distribute or produce gas and electricity.
- Makes up about 3.5%, 32 holdings
- Low, but stable returns compared to other sectors

Industries

- Electric Utilities
  - Makes up 55% of sector
  - Demand may double over next 25 years
- Gas Utilities
  - Makes up 3% of sector
  - Delivers natural gas to end users
- Multi-Utilities
  - Firms that offer more than one service
- Independent Power Producers and Energy Traders
  - Makes up only 2% of sector

Key Variables

- Interest Rates
  - Sensitive to hikes
- Electricity consumption correlated with strength of economy
- Natural gas prices closely correlated with commodities

Cyclical vs. Defensive

- Utilities sector not very sensitive to business cycles
  - Portfolio Beta = 0.5
- Investors use utilities as safe-haven
- Independent power producers and energy traders are more cyclical
  - Beta = 1.2

Global Impacts

- Very sensitive to changes in weather
  - Current drought
- Highly affected by changes in government policy
  - Large movement toward environmental friendliness
  - Regulation vs. deregulation of the industry
- Less impacted by poor global economic performance than market as a whole

Exelon

- "Through the Renewable Energy Credits (RECs) and Emission Free Energy Credit (EFEC) products, Exelon helps others engage in carbon reduction activities, supports the development of greener generation, and advocates for climate change as an issue of concern." **Exelon**

Industry Life Cycle

- Utilities sector is in the maturity stage
  - Been around for a long time
  - Unlikely to go into decline
- Very little threat to entry
  - Very capital-intensive
  - Requires regulatory approval
- Very low rivalry between competitors

Competitive Landscape

- Very high barriers to entry
- Buyers hold power
- No substitute for power
- Increasing competition for market share

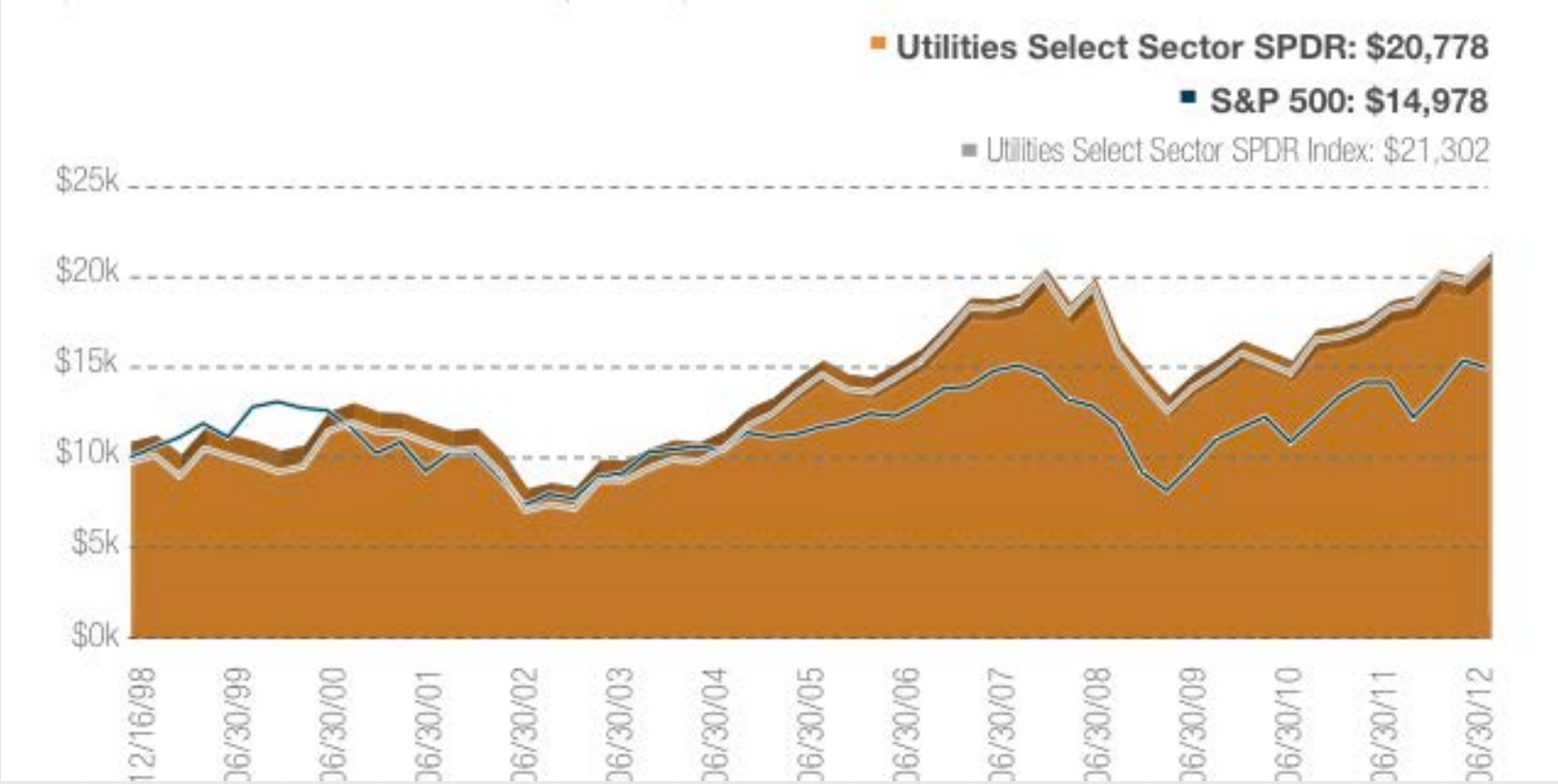
Common Valuation Methods

- P/E Ratio
  - XLU = 15.1
  - Some investors think this is too high
    - Was higher than the technology sector recently
- Dividend Yield
  - XLU = 3.72%
  - Very important to risk-averse investors seeking income

Common Volatility

- Not very volatile
  - Beta = 0.5
- Electricity Beta = 0.4
- Gas Beta = 0.7
- Independent Power Producers and Energy Traders
  - Beta = 1.2
- Multi-Utilities Beta = 0.5

Recent Performance



Conclusion

- Moving towards efficiency
- Moving towards environmental friendliness
- Safe-haven for risk-averse investors seeking steady income and steady capital gains

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