Utilities

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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
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
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

Utilities Select Sector SPDR: $20,778
S&P 500: $14,978
Utilities Select Sector SPDR Index: $21,302
Moving towards efficiency

Moving towards environmental friendliness

Safe-haven for risk-averse investors seeking steady income and steady capital gains
References

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