INDUSTRY TIMELINESS: 39 (of 98)

Equities in the Natural Gas Utility Industry have strengthened a bit in price over the past several months. This can be attributed partially to a generally better performance in the financial markets, reflecting improved corporate earnings reports and enticing valuations, among other factors.

Still, considerable stock-price fluctuations have occurred, from time to time, given uncertainty surrounding the outcome of the sovereign debt crisis in Europe and concerns that the economy in China is headed for a harder landing. The tepid economic situation in the United States does not help matters, either. But even under those conditions, the equities in our Industry have tended to hold up relatively well. Indeed, their healthy levels of dividend income have provided a measure of much-needed stability.

State of the Domestic Economy

During the second quarter of 2012, U.S. GDP grew at a lukewarm 1.7%, revised upward from 1.5%. Unfortunately, the economy remains constrained by a struggling housing sector and persistently high unemployment rate (hovering around 8% at present). The lingering European debt crisis has added more fuel to the fire. It is also important to mention that there are some tax hikes and spending cuts that are set to take effect by yearend unless the current Congress acts to postpone these disruptions until the new Congress can take control and, hopefully, address these issues. In this difficult operating environment, customers have been focusing on energy conservation, which, of course, acts as a restraint on the revenues of the companies included in the Natural Gas Utility Industry.

What is the Weather?

Weather is a factor that affects the demand for natural gas, particularly from small commercial businesses and consumers. Not surprisingly, earnings for utilities are susceptible to seasonal temperature patterns, with consumption normally at its highest level during the winter heating months. Unseasonably warm or cold weather can create substantial volatility in quarterly operating results. But some companies strive to counteract this exposure through temperature-adjusted rate mechanisms, which are available in a number of states. Therefore, investors interested in utilities with more-stable profits from year to year are advised to look for companies that hedge this risk.

Effect of Low Gas Prices on the Industry

Contrary to what some believe, a low gas price environment is generally good for regulated utility operations. That's partly because it may lead to reduced prices for customers, which could lessen bad-debt expense. Moreover, there is an increased possibility that homeowners will switch from alternative fuel sources, such as oil or propane, to natural gas. Even so, the companies in our category also possess nonregulated businesses, including energy marketing and trading, which tend to underperform when gas prices are in a slump.

Dividends

The main attraction of utility equities is their generous levels of dividend income. At the time of this writing, the average yield for the 11 companies in our group was about 3.7%, considerably higher than the *Value Line* median of 2.3%. Standouts include *AGL Resources*, *NiSource Inc.*, *Laclede Group*, and *WGL Holdings*. When the financial markets are turbulent, which seems to be more common these days, healthy dividend yields tend to act as an anchor, so to speak, in this category.

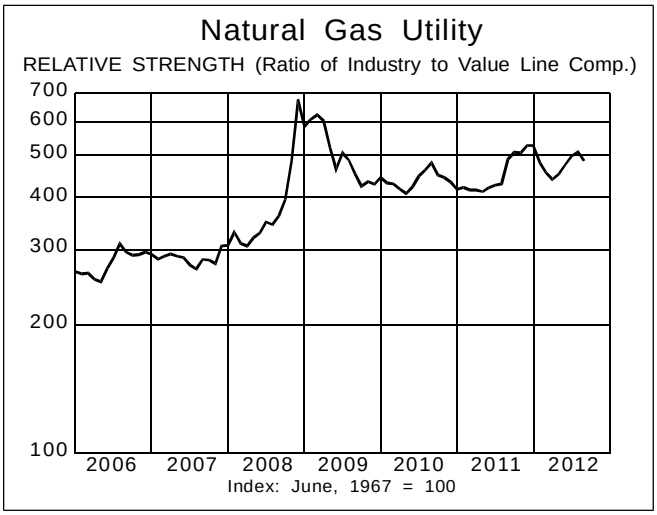
Conclusion

Stocks in the Natural Gas Utility Industry are most appropriate for income-oriented investors with a conservative bent (given that a number of these issues are ranked favorably for Safety and earn high marks for Price Stability). It should be noted, however, that companies with larger nonregulated operations may offer a higher potential for returns, but profits could be more volatile than companies with a greater emphasis on the more stable utility segment. As always, our readers are advised to carefully examine the following reports before making a commitment.

Frederick L. Harris, III

Composite Statistics: Natural Gas Utility

2008	2009	2010	2011	2012	2013		15-17
44207	34910	34089	24291	***30000***	***36000***	Revenues ($mill)	***50000***
1694.2	1677.6	1769.4	1202.8	***1750***	***2275***	Net Profit ($mill)	***3500***
35.7%	33.8%	34.0%	33.7%	***33.0%***	***35.0%***	Income Tax Rate	***37.0%***
3.8%	4.8%	5.2%	5.0%	***5.8%***	***6.3%***	Net Profit Margin	***7.0%***
50.6%	49.9%	46.7%	46.5%	***49.0%***	***49.0%***	Long-Term Debt Ratio	***49.0%***
49.4%	50.1%	53.3%	53.5%	***51.0%***	***51.0%***	Common Equity Ratio	***51.0%***
32729	33974	33144	24264	***32500***	***35300***	Total Capital ($mill)	***48000***
35342	37292	39295	28166	***35550***	***38600***	Net Plant ($mill)	***52000***
6.7%	6.5%	6.9%	5.6%	***7.0%***	***8.0%***	Return on Total Cap'l	***9.0%***
10.5%	10.0%	10.0%	8.4%	***10.5%***	***12.5%***	Return on Shr. Equity	***14.5%***
10.5%	10.0%	10.0%	8.4%	***10.5%***	***12.5%***	Return on Com Equity	***14.5%***
4.3%	3.8%	4.0%	2.9%	***3.5%***	***4.0%***	Retained to Com Eq	***5.0%***
59%	61%	61%	66%	***65%***	***65%***	All Div'ds to Net Prof	***68%***
13.9	12.8	14.0	17.9	***Bold figures are Value Line estimates***		Avg Ann'l P/E Ratio	***15.0***
.83	.85	.90	1.13			Relative P/E Ratio	***1.00***
4.2%	4.8%	4.3%	3.7%			Avg Ann'l Div'd Yield	***4.5%***
358%	381%	402%	387%	***390%***	***395%***	Fixed Charge Coverage	***410%***



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