Stocks within *Value Line's* Natural Gas Utility Industry have continued to increase in price in 2018. We believe these movements stem partially from better profits, compared to last year's tallies. Contributing factors include new rates, customer growth, and heightened consumption levels. Another plus here is the generous dividends, which are well covered by corporate earnings. At the time of this writing, no equities were ranked to outpace the market in the year ahead. But that comes as no surprise, since historical price movements of this typically defensive group have tended to be steady.

INDUSTRY TIMELINESS: 79 (of 97)

Weather Conditions

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

Natural Gas Prices

Natural gas quotations are nowhere close to the highs achieved late last decade, and the picture might not brighten too much for some time. Even though that situation does not augur well for companies that produce this commodity, regulated utility units generally benefit. That's partially because lower gas pricing tends to lead to diminished prices for customers, which may bring down bad-debt expense. Furthermore, there is an increased possibility that homeowners will convert from alternative fuel sources, such as oil or propane, to natural gas. (At the current time, it's estimated that more than 50% of all households within the United States use natural gas.) It is important to state, however, that companies in our category also possess nonregulated operations (see below), which tend to underperform when gas prices are at subdued levels.

Nonregulated Segments

Some of the companies in our group have devoted considerable resources to the nonregulated arena, including pipelines and energy marketing & trading, and we believe that trend will persist in the future. Indeed, these businesses offer opportunities for utilities to diversify their revenue streams. What's more, the fact that nonregulated units can provide potential upside to earnings per share is notable, given that the return on equity is established by the regulatory state commissions (generally in the 10%-12% range) on the regulated divisions. The Tax Cuts and Jobs Act has had a positive impact there, too.

Business Prospects Out To 2021-2023

We are generally upbeat about the sector's operating performance during the coming three to five years. Natural gas should continue to be abundant in the United States, made possible partly by new technologies, so a shortage does not appear probable anytime soon. Furthermore, there are limited alternatives for the services the companies in this category offer. Too, it's a challenge for new entrants in the market, given such factors as the size of existing competitors and the substantial initial capital outlays that are required. Finally, the country's population (now numbering over 320 million) ought to stay on a steady, upward trajectory, which augurs well for future demand for utility services.

Generous Payouts

The primary attraction of utility equities is their dividend income, which tends to be well covered by corporate earnings. (It's important to mention that the Financial Strength ratings for the 10 companies in our universe continue to be no lower than B+.) At the time of this industry review, the average yield for the group was 2.6%, relative to the *Value Line* median of 2.0%. Standouts include *South Jersey Industries*, *Northwest Natural Gas*, *Spire Inc.*, and *NiSource Inc.* When the financial markets face heightened volatility (which seems to be more often the case lately), solid dividend yields tend to provide a measure of stability.

Conclusion

Stocks within *Value Line's* Natural Gas Utility Industry should draw the attention of income-seeking investors with a conservative bent, since these good-yielding issues boast high marks for Price Stability and most are ranked 1 (Highest) or 2 (Above Average) for Safety. It's important to keep in mind that companies possessing more-established nonregulated operations might offer a higher potential for returns, but profits could be more volatile than for firms with a greater emphasis on the more stable utility segment. As always, our subscribers are advised to carefully examine the following reports before committing funds.

Frederick L. Harris, III