All major electric utilities located in the western region of the United States are reviewed in this issue; eastern electrics, in Issue 1; and the remaining utilities, in Issue 5.

With oil and natural gas prices at elevated levels, we examine how this affects companies in the Electric Utility Industry.

Electric utility stocks have turned in a mixed performance so far in 2022. As is to be expected, the equities in this industry have been less volatile than the overall market.

High Prices Of Oil And Natural Gas

This year, the price of a barrel of oil rose above $100 for the first time since 2014. Natural gas prices rose above $6/mmbtu in early April. Investors might understandably wonder how this affects the companies whose stocks we cover in the Electric Utility Industry.

For most electric companies, oil is not a significant source of power generation. Some utilities have peaking units that run on oil or can operate on oil or gas. Among the companies whose stocks are covered in this industry, only the three utility subsidiaries of Hawaii Electric Industries use oil to generate a significant proportion of their electricity. The company has warned customers that they can expect a rise of 10%-20% in their bills due to the surge in oil prices. For most electric companies, some combination of coal, natural gas, nuclear, and purchased power is the source of their electricity. Renewable energy is increasing its share, but for most utilities, this is still below 10%.

High oil prices have a positive effect on companies that directly or indirectly have the oilpatch as part of their industrial customer base. This includes Sempra Energy, Xcel Energy, PNM Resources, CenterPoint Energy, American Electric Power, OGE Energy, and Energy. (Sempra is based in California, but has an 80% equity interest in Oncor, a distribution utility in Texas.) Nobody knows how long these high oil prices will persist, but increased economic activity will boost these utilities' kilowatt-hour sales. This might well lead to an acceleration in customer growth, as well.

The high price of natural gas has much more effect on utilities. Most utilities use gas to generate a portion of their power. Gas prices also affect the price of merchant (uncontracted) power. Many utilities also have gas distribution operations. Among those in Issue 11, Avista, Black Hills, NorthWestern, Sempra, and Xcel Energy distribute natural gas. Given that utilities are usually able to pass their fuel and power costs through to customers, this might not seem like a problem. However, fuel and power costs are subject to a prudency review. The Minnesota regulators are reviewing a surge in fuel costs for a subsidiary of Xcel that followed a cold spell in February of 2021. A disallowance cannot be ruled out. In 2020, NorthWestern took a charge because the Montana commission disallowed some power costs that were incurred in a previous year. As is normally the case with utilities, the company had deferred these expenses in anticipation of eventual recovery.

There are other negative effects of high gas costs over and above the risk of a disallowance. Utilities file general rate cases from time to time to place capital in the rate base, recover higher costs, or make adjustments to their cost of capital. When gas prices are falling, requesting an increase in base rates (while never easy) is less challenging because the decline in the cost of gas will offset some of any hike in base rates. Thus, rising gas and power costs, by contrast, make obtaining rate relief more difficult. Another problem for companies with gas distribution operations arises from the increased working capital needed to pay for the gas that is injected into storage during the summer. Utilities don't get that cash back until the peak months after customers pay their bills.

Conclusion

Electric utility stocks turned in a mixed performance in the first several weeks of 2022 before rallying in late March and early April. As is to be expected from this group, the equities have been less volatile than the overall market. The average Safety rank for issues in the Electric Utility Industry is 2 (Above Average), and most sport high marks for Price Stability. Because utility equities have outperformed the broader market averages, the gap between the Electric Utility Industry's dividend yield (3.1%) and the median yield of all dividend-paying stocks under our coverage (2.0%) is smaller than usual.

Interest rates have climbed lately, in anticipation of tightening by the Federal Reserve. The yield on the 10-year U.S. Treasury note reached levels that haven't been seen since 2019. Nevertheless, this hasn't hurt utility stocks because the market has anticipated rising rates.

There haven't been a lot of outliers among utility stocks so far this year, but Sempra Energy is one. The price has risen more than 25% as investors have focused on the company's presence in liquefied natural gas exporting. Pinnacle West, up more than 10% in price, has made a partial recovery after being the worst-performing utility equity in 2021 due to an unfavorable rate order for its utility subsidiary, Arizona Public Service.

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