All major companies in the Electric Utility (Central) Industry reported first-quarter financial results and are reviewed in this Issue.

Since our last review of the Electric Utility (Central) Industry three months ago, nearly all of the stocks we cover have declined in value.

Utility stocks have experienced high volatility over the past several months due to market concern, the interest rate environment, and increased costs. Many of these stocks are currently trading at double-digit discounts to historical valuations, and as the gap between the average utility dividend yield and the 10-year treasury yield closes, investors likely will become increasingly interested in the Electric Utility Industry.

Challenging Market Conditions Remain

The recent macroeconomic environment has remained a challenge for most utility stocks. Indeed, almost all of the utilities we cover in the Electric Utility (Central) dropped in value since our March report. Notably, *Otter Tail* and *Fortis* outperformed their peers, both rising more than 5% over that interim. For the other companies, however, inflationary pressure, rising interest rates, and high commodity prices continue to negatively impact performance. Too, the rising interest rate environment remains a burden by increasing borrowing costs, which is especially significant for utilities as they generally have low returns on total capital and rely on heavy debt borrowings. While inflationary pressures are leading to higher operational costs and fuel prices, these companies are usually able to pass on expenses to customers, although the regulatory process can cause a lag in recovering the higher costs.

Rate relief should continue to act as a main driver of earnings growth, as the number of filings has increased. Indeed, almost all of the equities covered in the Electric Utility (Central) Industry possess subsidiaries that have recently approved or have pending rate cases. *Evergy Inc.* just filed its first rate requests in the Kansas corporation Commission in five years, on the heels of receiving approval in both of its Missouri general rate cases.

Dividends Closing The Gap On Treasury Yield

The attractive Treasury market has created competition for utilities over the past couple of months. The gap between the 10-year yield and the industrywide dividend payout has begun to narrow recently, and income-oriented investors are likely to become increasingly attracted to utilities. The interest rate environment has given income accounts an alternative for return of capital investments and as the gap closes, many will return to the Electric Utility sector.

Energy Legislation

Lawmakers are working on a deal to overhaul the U.S. permit process for energy projects as part of the debt ceiling legislation. The agreement would ease the process of building the interstate transmission lines necessary to carry clean electricity across the United States. The deal would also make changes to the National Environmental Policy Act, which requires the federal government to analyze the environmental impact of proposed actions. The deal would likely provide utilities with an improved, quicker process to carry clean electricity for energy projects, as well as help with the goal of reaching net-zero emissions by 2050.

INDUSTRY TIMELINESS: 67 (of 93)

Return On Capital VS. Return Of Capital

The dividend remains the most notable feature for many utilities. Indeed, the industrywide payout average of 3.6% sits well above the *Value Line* median yield of 2.4%. As the macroeconomic environment remains challenging, investors may be increasingly attracted to conservative, high-yielding investments. Note, the Federal Open Market Committee is scheduled for its next rate-setting meetings later this month. At this point, we expect conservative accounts to focus more on return of capital rather than return on capital. Also, the annual industry dividend growth projected average sits just below 5.0% and many companies remain committed to dividend hikes.

Conclusion

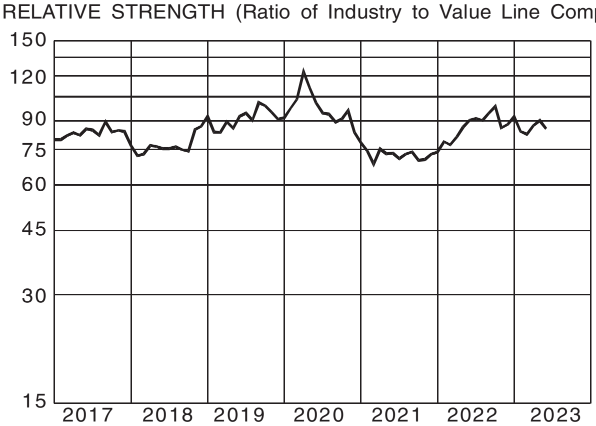
The industry's average dividend yield remains attractive, and is the most notable feature of utility stocks. Too, income-oriented accounts, which have increasingly entered the bond market over the past half year, are becoming more attracted to utility stocks as the gap between the average dividend yield and the 10-year Treasury yield closes.

Long-term capital appreciation potential, however, is still unattractive, and many utility stocks currently trade within our 18-month and 3-to 5-year Target Price Range. The macroeconomic environment, including inflationary pressure, rising interest rates, and high commodity energy prices are likely to remain a burden, and negatively impact results in the near-term. On the other hand, utilities are being aided by rate relief and potential legislation that will ease the process of energy projects, facilitate the transportation of electricity across the United States, and help reach the Biden Administration's goal of net-zero emissions by 2050.

Zachary J. Hodgkinson

Electric Utility

RELATIVE STRENGTH (Ratio of Industry to Value Line Comp.)



Index: June, 1967 = 100