

# UTILITY INDUSTRIES REVIEW

## 1. ELECTRIC'S

- The electric utility industry has been undergoing rapid structural changes. These include, but are not limited to:
  - regulatory methodology changes, from ROE rate control to price controls with unlimited ROE permitted.
  - upcoming competition. Wheeling will soon be permitted in most utility markets. This may cause havoc with some utilities if they are not prepared for this event, particularly the high cost utilities.
  - Will the regulators allow the utilities to recover the sunk costs of plants already built, and who will absorb this cost?? The shareholders or the rate payors?
  - Nuclear changes: nuclear plant life estimates may have been too rosy, the older plants are beginning to break down, especially for the less maintained facilities. Also, decommissioning costs are becoming much higher than originally estimated, making it less expensive to keep a plant running than shutting down, even if the energy produced is at a higher cost than the utilities average rate.
- **STRATEGY:** Invest in utilities that are already reshaping themselves for the upcoming competition environment. Find utilities that have non-regulated subsidiaries. Yield is still something to look for, but a particularly high yielding equity may be hiding problems. For nuclear utilities, look for ones with a good safety rating (NRC homepage on the net).

## 2. TELECOMMUNICATIONS:

- The phone industry is undergoing rapid changes in both regulatory and competitive issues. Changes include:
  - Open competition for local service, to be provided by companies other than the local Bell operators.
  - Competition from unlikely sources, mainly the cable TV industry and the wireless communications sector.
  - AT&T is returning with a vengeance: the purchase of McCaw cellular will give it a foothold in the local market, in addition to its tie in with Time Warner Cable.
  - Long distance rate wars seem to be nearing the end.
- **STRATEGY:** Look for companies that are in tune to improving service and equipment (a major problem for the cable companies). Who has the most fiber optic laid (Ameritech), who will suffer most from competition (Pacific Telesis ??). Who is at the most rate disadvantaged (Alltel??).

## 3. WATER UTILITIES:

- The water industry has an advantage as far as the regulated utilities are concerned.... It is not possible to Wheel water... i.e., the water systems are not interconnected. It is not possible for town A's water system to compete with town B's supplier because A would have no way to deliver water to B's customers.
- The clean water act has caused many utilities to increase capital spending. But this can be a good factor since the more financially secure companies now have takeover candidates that are priced low (namely the municipal water companies, which make up 85% of the industry). These better run companies can take over the smaller ones and cut costs on the procedure areas, such as billing and office support. Combining systems may be prohibitively expensive, however. See previous bullet point.
- Companies pay a high yield, but free cash flow is virtually non-existent for this industry.