The Water Utility Industry is one of the smaller industries in the *Value Line* universe. Currently, there are only six companies in the group. They are: *American Water Works*, *American States Water*, *California Water*, *Essential Utilities*, *H2O America*, and *Middlesex Water*. All of these companies are regulated water utilities. The vast majority of water districts in the United States are run by states, cities, or independent water authorities.

Consolidation has been taking place in the industry for some time. We expect the pace of mergers and acquisitions to accelerate in the years ahead.

America's water infrastructure is not in good shape. Water districts had deferred making investments to upgrade aging pipelines and wastewater treatment facilities until around 2006. Over the two past decades, companies have notably ramped up capital expenditures while also increasing investment to meet regulatory standards.

The main attractions of these equities are their dividend yields and the potential for healthy growth in distributions.

INDUSTRY TIMELINESS: 78 (of 93)

Acquisition Updates

The acquisition of *Essential Utilities* by *American Water Works* is making progress towards completion. With several state regulatory approvals (Kentucky, Virginia, and Ohio) now under its belt, Texas appears to be the next state lined up to give the marriage the nod. On top of this, another hurdle, the waiting period under the HSR Antitrust Improvement Act, was recently satisfied. This paves the way for the roughly $63 billion deal to be finalized within the first quarter of 2027.

Keeping in mind that most water agencies in the United States are not owned by shareholders, but government agencies, the abovementioned merger (public to public) will probably be a one-off in the Industry for quite some time. That said, acquisition activity across the sector is likely to remain elevated, especially considering the vast number of independent water districts, as well as assets of municipalities that are open to selling their water operations. For example, *American Water Works*, in addition to the purchase of *Essential Utilities*, has snatched up the water and wastewater systems from the City of Neosho in Missouri. Similarly, *H2O America* is splashing nearly $450 million in cash to acquire Texas-based water utility company Quadvest. The deal received final regulatory approvals in August, and is slated to close within the next month or so. Indeed, small-scale asset purchases are expected to remain a key growth strategy within the Industry going forward.

Capital Spending Allocations

Over the past decade or so, water utilities have been ramping up investment spending, with a particular focus on infrastructure upgrades, namely aging pipeline and water main replacement, as well as water delivery system improvements. Most recently, an increased portion of capital spending budgets is being allocated toward improving water quality, specifically in regard to the removal of harmful contaminants (PFAS). To this point, while infrastructure upgrades are likely to continue to command the majority of investment funds, as regulators set stricter water quality requirements, we look for utilities to increase spending on treatment enhancements to meet compliance.

Dividend Growth Prospects

Indeed, one of the Industry's main draws is that all stocks here offer above-average dividend yields. This is due largely to a solid track record of annual increases to the quarterly distribution. In fact, *American States Water Company* recently lifted the quarterly dividend payment (+8%) for the 72nd consecutive year. Likewise, *Essential Utilities* kept its annual streak alive with a 5% hike to the payout. Adding it all up, the industry's noncyclical nature and steady profit outlook suggests that income-seeking investors will continue to reap the rewards of increasing shareholder returns for years to come.

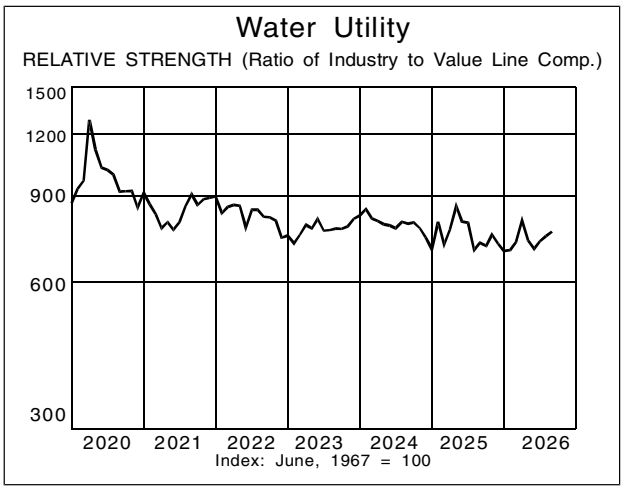
Regulatory Climate

Based on the recent acceleration of infrastructure-related project spending, regulators, who control the power to approve customer rate increase requests from utilities, have been largely accepting and willing to rubber stamp the applications. Looking forward, while there are always potential regulatory risks present, aggressive long-term spending plans by most water utilities are likely going to keep the pressure on regulators to approve future rate increases, within reason. Indeed, this augurs well for the companies' top- and bottom-line growth prospects in the years ahead.

Conclusion

The Water Utility Industry is best suited for patient, conservative investors looking to generate current income. Only one stock within the group (*American States Water*) is favorably ranked for relative year-ahead price action. The industry as a whole remains situated in the lower half of the *Value Line* universe at this juncture.

Nicholas Patrikis



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Stocks within *Value Line's* Natural Gas Utility Industry have held up reasonably well since our last report in May. But that should not be surprising, since historical price movements of this typically defensive sector have tended to be on the steady side. It's also important to mention that the main appeal here is these equities' reliable, healthy amounts of dividend income.

INDUSTRY TIMELINESS: 88 (of 94)

Rate Filings

Rate cases are a very important factor for natural gas utilities. Federal authorities establish wholesale service tariffs, and state regulators determine retail distribution rates. Adequate returns on common equity are necessary to keep these businesses viable. Higher rates are sought to pay for such key items as the cost of expansion, storm damage, and/or to cover the expenses of maintaining reliable service. In order to promote healthy relationships with customers and regulators, managements endeavor to keep operating and service costs as low as possible. At times, though, political pressure can compel authorities to limit rates of return, to the detriment of utility companies. But for the most part, regulators aim to strike an equitable balance between the interests of shareholders and customers. When the regulatory environment is fairly quiet, utilities might place greater emphasis on expense-reduction measures and nonregulated operations (which include pipelines and energy marketing & trading services).

Weather

Climate is a factor that impacts the demand for natural gas, particularly from consumers and small commercial businesses. Not surprisingly, profits for utilities are susceptible to seasonal temperature patterns, with consumption normally at its peak during the winter heating months (typically defined as the period from October through March). Unseasonably warm or cold weather, which seems to be more often the case these days, can cause substantial volatility in quarterly operating results. But some companies strive to counteract that exposure via temperature-adjusted rate mechanisms, which are available in a number of states. So, investors interested in utilities with more-stable earnings from one year to the next are advised to seek companies that are able to hedge this risk.

Interest Rates

On May 22nd, Kevin Warsh succeeded Jerome Powell as chairman of the Federal Reserve. (Notably, Mr. Warsh served as a member of the Federal Reserve Board of Governors from 2006-2011.) At the July Federal Open Market Committee (FOMC) meeting, the central bank decided to keep interest rates steady, as inflation remained a concern. So, this begs the question, "How are the participants in the Natural Gas Utility Industry affected by the direction of interest rates?" In a falling interest rate environment, borrowing costs decrease, an especially important factor because these companies tend to maintain substantial levels of debt. Furthermore, diminished interest rates may make bonds less attractive to conservative, yield-hungry investors, the very ones who are typically drawn to utility stocks. Of course, the opposite applies to natural gas utilities in a rising interest rate climate.

Generous Payouts

The main appeal of utility equities is their dividends, which tend to be sufficiently covered by corporate profits. (It is worth stating that the Financial Strength ratings for the majority of the nine companies in our universe are a solid B++, and the remainder are an A.) At the time of this industry report, the average yield for the group was approximately 3.4%, relative to the *Value Line* median of 1.9%. Standouts include *UGI Corp.*, *New Jersey Resources*, *Northwest Natural Holding*, and *Spire Inc.* When the financial markets experience heightened volatility, which seems to be more often the case these days, healthy dividend yields act like an anchor, so to speak.

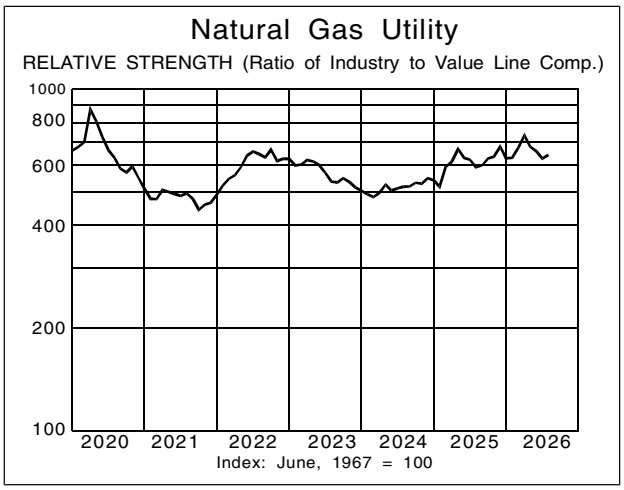
Prospects Out To 2029-2031

We are upbeat, overall, about the industry's long-term operating performance. Natural gas ought to continue to be an abundant resource in the U.S., supported partially by new technologies, so a shortage does not seem likely in the years ahead. (Presently, it's estimated that roughly half of all domestic households use that energy source.) Too, there are limited alternatives for the services the companies in this sector offer. Moreover, 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 nation's population, now numbering more than 340 million, ought to stay on a steady, upward trajectory, which augurs well for future demand for utility services.

Conclusion

None of the equities in our group stand out for Timeliness. Moreover, there is a lack of alluring choices for capital appreciation potential over the 3- to 5-year horizon. Nonetheless, income-oriented investors with a conservative bent may want to take a look, given that these good-yielding equities boast high grades for Price Stability, and the majority hold a 2 (Above Average) Safety rank. As always, we suggest that subscribers carefully examine the reports that follow before committing funds.

Frederick L. Harris, III



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