MarketWatch

Opinion: Xcel Energy’s best defense is its environmental strategy

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The utility is navigating regulations better than its peers

Utilities can be tricky companies for investors. Historically, utilities are dividend-yielding, capital-intensive and highly regulated companies with a low investment beta.

However, today, rapid technological change is transforming how energy is both produced and consumed, creating a new level of uncertainty for the energy sector. For example, evolving regulations aimed at fighting greenhouse gases and climate change pose ever-changing challenges, such as the potential for stranded assets, as the electric industry prepares for a new host of regulations.

From an investor perspective, one of the issues is understanding that “complacency” is not a great defensive strategy: Utilities, historically, have had virtually no competition compared to many other sectors, in part because the barriers to entry are high and operating territories are franchised by state authorities, typically set by a public-utility commission. This means utilities are not used to being nimble. Some, despite the regulatory shifts, seem stuck in gear.

Nevertheless, looking across a broad range of financial and environmental metrics, one company that looks to be navigating the future well is Xcel Energy Inc. XEL, -0.37%

The share price of the Minneapolis-based holding company, whose subsidiaries provide electricity and natural gas to customers in eight Midwest states, has risen steadily in the face of the past year’s market volatility, outperforming the Dow Jones Utility Index. It also offers a 3.6% dividend yield.

Moreover, at Entelligent, we have developed a scoring system we call our E-Score, which takes into account a company’s ability to manage risk and capitalize on new opportunities, and its past and projected future performance. The score also includes a rating of transparency in both nancial and environmental disclosures — something vital for the survival of energy companies, especially public utilities that are facing such threats as the municipalization of assets.

Xcel's E-Score is in the highest quartile and it touts its environmental strategy as part of its market defense. Our model predicts that regulated revenue growth will continue upward by more than 9% over the next ve years.

The company appears unusually committed to reducing its emissions and moving beyond the limitations of coal; the biggest factors, to be sure, are the age of coal- red power plants and the relative cheapness of natural gas. Xcel, however, has already committed to reducing its greenhouse gas emissions by more than 30% by 2020 compared with 2005 levels. And it is on track to meet, and possibly even exceed, that goal.

Thanks to improved ef ciency, Xcel also has been able to reduce its reliance on coal even while its customer base grows and uses more power during peak periods and its annual growth increases. Coal, which currently generates more than 60% of Xcel's electricity (excluding its purchased generation), will dip to around 55% in the next ve years.

And even though Xcel continues to have a large amount of coal generation that would be at risk under the EPA rules, the company may be favorably placed compared with other coal-burning utilities because it has already invested heavily in renewables, such as solar, wind and hydropower, in its service areas.

Xcel has already amassed more than enough Renewable Energy Credits (RECs) to comply with the renewable energy standards in the states where it operates.

This has given Xcel a head start when faced with new regulations on emissions coming down the pipeline in the form of the Clean Power Plan (CPP), which was announced by President Obama and the Environmental Protection Agency in August.

The upshot? Xcel is effectively managing the regulatory risks ahead, and could bene t from tighter regulations down the road, relative to its peers in the energy sector.

Of course, there are potential problems too. Just how the CPP will be implemented is unknown. Commodities prices are volatile, which can affect both revenues and expenses. And technological developments like home solar could nibble away at market share for many energy companies.

Then there are interest rate risks; utilities, generally, do not do their best in rising rate environments. Like all utilities, Xcel is in a capital-intensive business. An increased cost of capital hurts pro ts. However, this is one reason that utilities that have front-loaded investments into renewables may be at a clear advantage relative to the rest of the sector.

Xcel is clearly a market innovator and a sector leader that is working to address the challenges of the future. Investors looking for more power in their energy and utility portfolios should take a look.

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