Moody's Stock Survey, April 16 1962

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MOODY'S STOCK SURVEY

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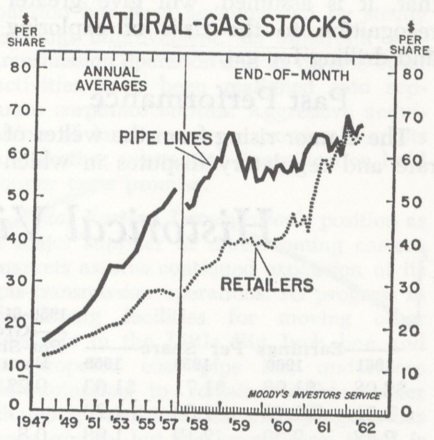
Some Gas Stocks Are Still Attractive

ON THE WHOLE, performance of the natural-gas equities continues to justify our regard for their investment stature. Stocks of retailers, and integrated companies, in particular, have shown a sustained upward movement in prices, dividends and earnings for the past five years. Last year their prices broke away and chalked up a handsome 32% advance, which sprang largely from investors' esteem for their defensive strength. Even with some moderate dips this year, yields—slightly below historical levels—are still relatively liberal. Producers, too, performed well in 1961. Issues of companies for which gas production is a major activity gained 32% in price on average. Thus all segments of the industry comfortably bettered the 23% rise of our 125 Industrials average.

Even though many of them are quite richly priced now, the stocks of regulated gas companies remain good income holdings. Among retailers and integrated companies, we favor ***Alabama Gas, Equitable Gas, Laclede Gas*** and ***National Fuel Gas*** for income. Our choices for income plus moderate appreciation are ***Columbia Gas, Lone Star Gas*** and ***United Gas.***

The most reasonable valuations, however, are to be found among the pipe lines, in our opinion. Their market action has slowed to a walk almost entirely because of investor impatience with regulatory red tape. As FPC roadblocks are cleared, we look for a gradual turnaround in sentiment. In the pipe line group we would hold ***Colorado Interstate*** and ***El Paso Natural Gas,*** and we would purchase for appreciation ***Mississippi River Fuel, Panhandle Eastern Pipe Line, Tennessee Gas Transmission*** and ***Texas Eastern Transmission.***

Among producers, we feel ***Delhi-Taylor, Hugoton Production*** and ***Western Natural Gas*** are fully priced now, though worth holding for the long pull. ***Coastal States Gas Producing*** has appeal as a high-risk speculation, and we would buy ***Aztec Oil, Pubco Petroleum*** and ***Shamrock Oil*** for their long-term growth potential.



RECENT EVENTS with the most far-reaching significance for future gains by the natural-gas industry probably are those stemming from the new Federal regulatory atmosphere. The vigor with which the new Federal Power Commission is tackling the enormous backlog of rate cases has won approval from all sectors of the industry. The long-pending cases involve mainly producers' rates, though a fair number relate to pipe lines. Retailers' problems have not been too serious, since the companies are regulated at the state level, and have generally been allowed to adjust rates automatically to rising costs, or otherwise get prompt relief.

Changing Formulas

The FPC attitude toward some major issues affecting industry earnings is still unclear. But one move hailed by the industry is the new FPC's strong endorsement of an area approach to producers' pricing. This rejects the company-by-company utility-type cost-of-service yardsticks that had formerly been tried. Area pricing fixes a ceiling on natural-gas prices related to costs within a defined producing area. Rates set below the ceiling are accepted by FPC with a minimum of processing. If the legality of this solution is upheld (two court cases are pending, and a U.S. Court of Appeals approved it in another), the present bottleneck of rate cases could be broken in two years, it is estimated. Reported earnings would then become a truer reflection of industry progress.

Besides innovations to speed up its

own machinery, the FPC is encouraging negotiated settlement of rate cases by disputants as a timesaver, subject to FPC approval.

The FPC has stirred criticism, nevertheless, by advocating broader controls that would restrict producers' and pipe lines' flexibility in previously unregulated transactions. Among these are direct sales by producer to end user and in-place purchases of gas, by which a pipe line takes the entire output of a field. Another point over which the industry and the FPC are still at loggerheads is that of allowable rate of return. But a new policy is evolving that, it is assumed, will give greater recognition to the risks of exploring and drilling for gas.

Past Performance

The clamor rising from the welter of rate and regulatory disputes in which the gas industry finds itself embroiled sometimes obscures the good performance of the natural-gas stocks.

Our price average of 30 stocks (including distributors, pipe lines and integrated companies) has increased at a compounded annual rate of 9½% since 1956, compared with 13% for electric utilities and 6% for industrials. Dividend increases have come at a 5½% yearly rate, vs. 4% for the electric issues and 1% for the industrials. Though yields have dropped to 3.7% on average, they still surpass the 3.0% of the electric utilities and the 3.1% average for industrials. Average earnings figures do not have much significance for the group, since the vagaries of weather produce year-to-year swings. But the earnings uptrend has been sufficiently persistent to permit confidence in dividends.

Behind this good market performance is tremendous physical development of the gas industry, which has forged ahead amid all the regulatory confusion. Though this growth has been almost altogether a postwar phenomenon, the industry's $23-billion gross plant now puts it seventh among all U.S. industries, and the $1.8 billion which it spent on construction last year was the sixth largest outlay of any industry.

Continuing Growth

Since 1950, gross plant has tripled, the number of customers and the volume of gas sold have more than doubled, and revenues have quadrupled.

The momentum characteristic of a new industry probably will not continue indefinitely, but annual gains are still measuring up well to the averages of earlier growth years. In the last ten years, customers increased an average of 3% annually, sales 7%, and revenues 10½%. In 1961, a year of partial recession, customer gain was 2½%, sales were up 3% and revenues, 7½%.

Historical View of 30 Regulated Natural-Gas Stocks

Earnings Per Share 1961	1960	1959	1958	1956-61 Annual Growth Per-Sh. Earn.	1956-61 Annual Growth Dividends		Indicated Dividend	1960-62 Price Range	Recent Price	Yield Current	Yield '57-'61 Avg.	Price-Earnings Ratios Current (on Latest Earn.)	Price-Earnings Ratios '57-61 Avg.
						Pipe Lines							
$2.08	$1.96	$1.71	$1.63	9.2%	4.8%	Colorado Interstate Gas..	$1.25	56 –33¼	50	2.5%	2.6%	24.0	[1]
1.51	[2]1.46	1.33	1.29	...	8.6	El Paso Natural Gas....	1.30	35⅝ –21¼	24	5.4	4.0	15.9	18.6
2.42	2.30	2.19	1.96	0.8	2.0	Mississippi River Fuel...	1.60	42⅞ –30	40	4.0	4.6	16.5	16.0
2.08	1.85	1.93	1.62	3.3	3.9	Northern Natural Gas....	1.50	48⅝ –26⅜	47	3.2	4.6	22.6	16.1
4.04	3.16	3.33	2.82	7.8	4.3	Panhandle Eastern	2.00	59¼ –39⅜	55	3.6	3.8	13.6	15.4
2.86	2.20	2.10	2.55	4.0	1.6	Southern Natural Gas....	2.00	49⅞ –33⅜	47	4.3	5.0	16.4	16.7
1.40	1.35	1.14	1.23	7.6	9.2	Tennessee Gas Trans.....	1.12	26 –20½	24	4.7	4.4	17.1	17.3
0.97	1.04	0.74	1.17	...	1.5	Texas Eastern Trans.....	0.80	19⅝ –13	17	4.7	4.9	18.5	14.7
2.38	2.59	2.33	2.06	1.9	8.7	Texas Gas Transmission ..	1.60	45¾ –29⅜	45	3.6	4.3	18.9	12.7
1.30	1.18	1.23	1.17	5.4	7.4	Transcontinental Gas ...	1.00	27 –19⅜	27	3.7	4.8	20.8	16.2
						Integrated							
$2.10	$1.97	$1.82	$1.59	6.0%	7.6%	American Natural Gas...	$1.20	55¼ –22⅝	50	2.4%	4.0%	23.8	15.2
1.76	1.62	1.71	1.27	17.7	15.8	[3]Arkansas Louisiana Gas..	1.00	44⅞ –29¼	41	2.4	3.1	23.3	17.8
1.55	1.43	1.32	1.35	...	3.5	Columbia Gas System....	1.10	30 –18⅜	29	3.8	5.0	18.7	14.7
2.85	3.19	3.23	3.25	...	6.2	Consolidated Natural Gas.	2.30	67½ –42¼	63	3.7	4.2	22.1	15.6
2.46	2.32	2.59	2.39	1.3	3.9	Equitable Gas	1.85	48⅞ –32⅜	46	4.0	4.9	18.7	15.1
1.07	1.29	1.20	1.13	...	3.8	Lone Star Gas	1.00	29⅜ –17⅛	25	4.0	4.5	23.3	17.9
1.84	1.86	1.74	1.78	12.3	13.0	National Fuel Gas........	1.20	33¼ –21⅝	30	4.0	5.2	16.3	13.3
3.01	3.43	2.64	3.03	1.1	3.7	Pacific Lighting.........	2.40	65¼ –46⅝	58	4.1	4.7	19.3	16.8
2.25	2.14	1.99	1.54	8.7	6.8	Peoples Gas Light	1.50	58⅜ –48	50	3.0	4.0	22.2	15.5
2.16	2.02	2.27	2.41	...	...	[4]United Gas	1.60	41⅞ –27⅝	38	4.2	4.2	17.6	15.2
						Retailers							
$2.36	$2.45	$1.96	$2.89	...	2.0%	Alabama Gas	$1.70	41⅜ –27⅛	39	4.4%	5.3%	16.5	13.5
1.65	1.59	1.53	1.46	5.2%	6.9	Brooklyn Union Gas	1.20	45 –22⅜	41	2.9	4.5	24.9	16.1
2.52	2.21	2.81	2.31	5.6	4.8	Gas Service............	1.80	45 –25⅝	44	4.1	5.0	17.5	13.1
1.51	1.55	1.10	1.30	4.5	7.2	Laclede Gas	1.05	34⅝ –18¼	28	3.8	4.5	18.5	15.9
1.99	1.87	1.77	1.57	3.7	3.1	Mountain Fuel Supply...	1.40	44¼ –23¼	38	3.7	4.7	19.1	15.4
1.66	1.51	1.38	1.28	10.0	10.0	New Jersey Natural Gas..	1.00	44¼ –20½	41	2.4	3.9	24.7	15.8
2.24	2.04	1.80	1.41	9.2	11.0	Northern Illinois Gas	1.40	68 –28⅝	68	2.1	3.6	30.4	17.5
1.54	1.45	1.30	1.18	9.9	12.5	South Jersey Gas	1.20	49½ –22⅜	41	2.9	3.8	26.6	18.2
3.69	3.42	3.39	3.15	8.5	3.7	United Gas Improvement.	2.64	82 –46½	78	3.4	4.5	21.1	15.3
1.81	1.82	1.75	1.69	3.5	4.2	Washington Gas Light...	1.32	43 –22⅜	37	3.6	5.2	20.4	15.1

[1]Not available. [2]Excludes 46c nonrecurring tax credit. [3]1958 and 1959 do not include Consolidated Gas Utilities, Southwest Natural Gas and Mid-South Gas, merged in 1960 and 1961. [4]1960 and 1961 reflect effect of reduction in revenues from disposition of rate proceedings before the FPC.

Demand on the Rise

The nature of the demand for gas is obviously crucial to the question of growth, and on this score the industry does not look vulnerable. Natural gas is profiting both from the burgeoning population and at the expense of older energy sources. It has doubled its share of the energy market from about 14% just after World War II to 28% at the present time. The industry's expectation that gas will account for 35% of the energy market by 1970 may well prove out.

Since the industry has now captured 70% of the space-heating market, population rise will probably play a more dominant role in future growth. With residential sales accounting for 35% of total volume and space heating for about 65% of all residential sales, the preponderance of heating sales also means that the unpredictable effects of weather on yearly results will continue.

New uses for gas in lighting, in commerce, in the fuel cell, and in gas turbines could stimulate growth, and other sources of revenue are likely to emerge from the industry's vigorous research. Potential here, of course, may be affected by FPC attitudes toward the end uses of gas, if efforts to obtain greater regulatory control of such uses are successful.

Adequate Supply

Always in the background of any discussion of the natural-gas industry is the specter of dwindling supply. While new discoveries are being added to proved reserves each year, and undrilled and unexplored areas are still extant, no final answer is obtainable on gas reserves.

The outlook is not unhopeful, however. Theoretically, a 20 years' supply of natural gas is now on hand, which is sufficient to permit long-range growth prospects to materialize. Each year to date, the volume of proved recoverable reserves added to the total has exceeded the volume consumed. For instance, at the end of 1961, proved recoverable reserves were estimated at 268 trillion cubic feet, a net gain of 4 trillion cubic feet in the year, vs. 1.2 trillion in 1960, despite production of 13 trillion cubic feet. These figures do not include reserves now in Canada and Mexico, which are beginning to be tapped for use in the U.S. Looking farther back, in the past ten years 172 trillion cubic feet have been added to proved recoverable reserves, while 100 trillion cubic feet have been used up—for a net gain of 72 trillion.

Opportunities Ahead

For the long pull, the natural-gas stocks thus seem to offer the investor growth opportunities. Though growth will not maintain the breathless pace of the postwar period, it should be vigorous enough to satisfy all but the most impatient. Problems such as the rising cost of gas, competition, and supply will persist, but they are not sufficiently overpowering to warrant a negative position toward the industry. Regulation certainly won't disappear, but a more enlightened and cooperative era of regulation could signal a turnaround in investors' attitudes, at least toward the pipe line segment of the industry.

The Pipe Lines

Aside from the brightening regulatory horizon, one of the most promising developments in the affairs of the pipe line companies has been the increasing tendency toward diversification. This could offset the inevitable slowdown in the rate of pipe line growth. A growing awareness of the potential in transporting products other than gas in pipe lines should assist earnings over the long term. Finally, increasing integration by the pipe line companies can be noted, as they acquire control of gas reserves in an effort to escape the price squeeze.

All these tendencies have been exhibited by the companies dealt with below, which we feel offer the investor good value now.

Mississippi River Fuel is a diversified company whose backbone is a profitable natural-gas pipe line serving the St. Louis market. Other interests include oil and natural gas exploration and production; an oil-well drilling-mud sales subsidiary, and more than 625,000 shares of the Class A common of the Missouri Pacific Railroad. Its pipe line is likely to maintain a modest growth trend, but its greatest hope for earnings improvement lies in further aggressive diversification.

Panhandle Eastern Pipe Line's recent satisfactory conclusion of litigation with a gas utility customer has paved the way for further important expansion. Several production and transmission subsidiaries are now making improving contributions to earnings, and Panhandle has a considerable investment in National Distillers & Chemical, which is joining it in helium production. Regulatory assessment of Panhandle's large reserves at current value would help earnings still further. Meanwhile, the $2 dividend appears quite safe.

Tennessee Gas Transmission's rapid expansion has been accompanied by steady earnings improvement. Its important gas-transmission operation and its diverse other activities have been realigned into separate corporate entities. Aggressive acquisition of large reserves, growing markets and further substantial diversification hold longer term promise.

Texas Eastern Transmission's position as a major supplier of mushrooming eastern markets assures continued expansion of its gas-transmission operations. Its progress in developing facilities for moving other products in the Little Big Inch line and its proposed coal pipe line underscore determination to remain flexible under changing conditions. Earnings progress has been erratic, but the longer term trend is upward. All gas-purchase and sales-contract disputes have been settled, and prices are now on firm levels approved by the FPC.

The Retailers

The favorable demand forecasts for natural gas are a direct index to the prospects of retailers and integrated companies. Ultimately, it is they who fill the consumers' wants. The lack of any long-standing rate problems, compared with the troubles of the pipe lines and the producers, lends strength to the group, too. At any given period, of course, variations exist in the growth potentials of the areas they serve, and the basic investment reliability of the group is more marked in some issues than in others.

Investors' awareness of these stocks' above-average long-term dependability is reflected in currently full valuations for most of them, however. But those mentioned on page 633 look relatively reasonably priced now.

The Producers

Continuing high demand for natural gas remains uppermost among factors shaping the longer outlook for the gas producers. The long-term price trend for natural gas thus would seem to be upward, though regulation may slow its rate of growth.

With this demand continuing to expand at a higher rate than that for crude oil, the higher price-earnings ratios of the gas stocks, compared with the oils, appear to be warranted. We would not expect higher market valuations of earnings, however, in view of the still unsolved regulatory problems. Market advances for such stocks will depend more on their individual earnings growth prospects than on rising industrywide price-earnings multiples.

While the natural-gas producers whose stocks are discussed here are not the largest, their fortunes are more closely interwoven with the gas industry than those of many larger companies whose oil business heavily outweighs their gas output.

Aztec Oil & Gas' earnings appear to be at a plateau, as production from its Aneth field in Utah levels off. Per-share earnings last year were close to the $1.77 peak attained in 1959, and earnings this year are likely to be modestly above that. New sources of gas must be tapped to support this uptrend, and Aztec's holdings show promise. The company has major reserves in the lively San Juan Basin in New Mexico, where, however, marketing problems are currently hampering earnings. It also has extensive leases in the Rocky Mountains and smaller holdings in Louisiana, Alaska and Canada. We feel the stock is attractive for long-term appreciation.

Coastal States Gas Producing has attained a remarkable rate of growth by specializing in gathering and reselling gas from independent wells. Its long-run contracts with escalation and take-or-pay clauses have established secure earnings patterns. And it has increased its own reserves by employing otherwise taxable income to do drilling. It has varied sources of income in gas-processing plants, office rentals and an interest in a cement company. On the basis of its long-term contracts, estimates of earnings indicate a possibility that they will double over the next three years. Despite these bright prospects, the currently high valuation and the uncertainties of regulation make the stock a high-risk purchase.

Delhi-Taylor's profits are still geared closely to prices of refined oil products, despite increasing petrochemical business and natural gas output. An above-average debt-to-equity ratio also has kept earnings erratic. And increased writeoffs, higher interest charges and lower product prices kept 1961 earnings in line with 1960's, though gross revenues rose 15%. Intensified product marketing competition will limit near-term earnings, but the company's large undeveloped acreage in Australia, plus recurrent merger interest, should keep speculative interest alive.

Hugoton Production has achieved fairly stable earnings through long-term contracts for the output of its wells in the Kansas section of the Hugoton Field. Its sales, solely within the state of Kansas, are not subject to FPC jurisdiction, and Hugoton has shown no inclination to take advantage of its large acreage position and seek contracts farther afield that would bring it under FPC rules. Earnings were $1.84 a share in 1961 and $1.81 in 1960. Some upward push in results could follow from renegotiation of contracts which expire within two years. Hugoton is financially strong, with no debt or preferred. Its conservative drilling activity is reflected in a high income-tax rate, which in 1961 was about 35% of pretax earnings. Without more aggressive marketing, earnings are likely to remain flat and the stock would appear to be amply valued now.

Pubco Petroleum celebrated its tenth anniversary last year by posting record sales and earnings. Though gas sales went higher, natural-gas revenues were only 37% of total income, vs. 50% in 1960, as crude-oil income rose by 165%. These results reflected stepped-up production from the company's holding in the Sleepy Hollow Field in Nebraska, where additional development this year should boost earnings to another peak. Beyond 1962 a leveling off in earnings can be expected, unless new sources of oil and gas production are developed. In this regard, several promising prospects among Pubco's more-than-600,000 leased acres are to be tested this year. The stock is reasonably priced now, and offers attractive appreciation possibilities over the longer term.

Shamrock Oil & Gas's revenues from oil actually are triple those from natural gas, and its earnings decline in the first quarter from 62c to 54c a share largely reflected poor petroleum prices. But large gas reserves and new gas contracts signed last year herald new importance for gas in over-all results. Earnings for the current fiscal year should improve to about $2.20 a share, vs. $1.93 in fiscal 1961, on the strength of benefits from new gas contracts. A modest start in petrochemicals is slated for late this year, when a new ammonia plant is put on stream. Shamrock's better than average profit margins seem to be a consequence of operating compactness (in a seven-state area) that allows tight cost control.

Western Natural Gas got 17.2% of its revenues from gas sales in 1960, but gas will bulk larger as full-contract deliveries from the Brown-Bassett Field in Texas (jointly owned with Socony Mobil) are made in 1962. Significant discoveries of gas and oil in its New Mexico and Colorado acreage should lift production revenues further. Earnings of 50c a share have been reported for 1961, vs. 11c in 1960, and a substantial increase is expected for 1962, based on the higher gas sales and better oil prices. Western recently sold its Canadian and Venezuelan properties, which leaves it solely a domestic producer. The stock appears fully priced on near term prospects.

Seven Growing Gas Producers

	1961 Sales (mill.)	Earnings per Share 1961	1960	1959	1958	Indicated Dividend	1960-62 Price Range	Recent Price	Yield Current	Yield '57-'61 Avg.	Ratic of Price to Latest Earn.
Aztec Oil & Gas	$9.7	$1.74	$1.56	$1.77	$0.72	[1]	27⅞–13⅝	24	...	...	13.8
[2]Coastal States Gas Producing	24.6	0.51	0.27	0.23	0.17	Nil	34 –10	26	...	...	51.0
Delhi-Taylor Oil	113.1	0.62	0.72	0.51	0.30	Nil	17⅞– 8	13	...	...	21.0
Hugoton Production	6.8	1.84	1.81	2.03	1.77	$1.50	47½–37	45	3.3%	3.9%	24.5
[3]Shamrock Oil & Gas	64.2	1.93	2.40	2.11	2.10	1.50	50⅜–23⅜	41	3.7	4.2	21.2
Pubco Petroleum	4.5	0.56	0.21	0.16	0.13	Nil	17⅛– 6½	13½	...	...	24.0
Western Natural Gas	32.4	0.50	0.11	0.40	0.33	0.25	20⅝– 9½	15½	1.6	...	31.0

[1]Stock dividend only. [2]Fiscal years end June 30. [3]Fiscal years end September 30.