Special Report
The Smart Way to Ride the Energy Roller Coaster

By Investing Daily Analysts

Natural gas has emerged as a primary source of energy for home heating for millions of Americans. Almost 300,000 natural gas wells and underground pipelines, which extend 1.5 million miles, are used to transport and deliver natural gas throughout all 50 states in the U.S.

Below are six of the best natural gas-related stocks, all with promising reserve potential. As you’ll see, we prefer stocks that have claims on potentially large new reserve plays.

First, let’s examine the tailwinds that make natural gas such a promising long-term growth trend for investors.

Natural gas provides approximately 30% of the total energy used in the U.S. By 2025, demand for natural gas is expected to rise by more than 50%, and natural gas may surpass oil as the world’s most important energy source. Industry experts predict that more than $100 billion may be invested into natural gas during the next decade.

Natural gas is the cleanest and most efficient fossil fuel, and natural gas reserves are more widely dispersed and more abundant than oil reserves on a global scale.

Natural gas has become an important source of energy, and the future will make it even more significant as the world’s petroleum reserves dwindle. But when most investors think of energy, the commodity that comes to mind is crude oil.

It seems the public and many market pundits alike are fascinated by every twist and turn in the oil market. However, natural gas is at least as important to the world’s economies.

Natural gas has long been ignored as a poor cousin to crude oil. In fact, for many years, most natural gas was flared off as it was produced — oil producers literally burned off their excess natural gas, a nuisance product produced as crude oil was pumped.

But times have changed. The days of simply flaring off gas as a “useless” by-product of oil production are over.

The Department of Energy estimates that U.S. natural gas supplies will be insufficient to meet demand in coming years and much of that additional supply will be met by liquefied natural gas (LNG).

LNG involves cooling natural gas until it turns into liquid, allowing tanker ships from remote foreign locations to transport the liquid. Since 1996, natural gas-fired power plants relying on LNG have become an increasingly important part of total energy supply.

Let’s take a closer look at our natural gas recommendations.

1) UGI (NYSE: UGI)

UGI is a holding company that not only distributes propane both domestically and internationally, but it also operates natural gas and electric utilities, manages midstream assets, and engages in energy marketing. Compared to its peers, UGI has little debt, trades at more attractive multiples, is more diversified, and confers greater safety. Further, UGI boasts three decades of consecutive dividend increases.

Gas distributors are heavily regulated and tend to retain more of their cash flow than master limited partnerships (MLPs), which means they don’t need to sell as much equity or debt to finance growth.

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So why have these turtles dramatically outperformed the MLP hares over the last few years? There’s an easy answer for those willing to step into the uncomfortable shoes of the typical acquirer, a predominantly electric utility.

There has been no growth in U.S. power demand for the last decade. Some of that was the result of the ongoing efficiency gains in the commercial and residential sectors from newer appliances and the like. Industrial demand, meanwhile, has flagged notably.

Natural gas consumption trends and demand forecasts have been brighter, helped by the low prices prevailing in recent years. Electrical utilities also are confronting the prospect of “disruption” as the improving efficiency of solar panels and power storage technologies threatens to turn the centralized electric grid into a relic.

One by one, the gas distributors are getting gobbled up and shares of the ones that haven’t yet are among the market’s strongest.

But UGI is more than an LDC; it’s also a trans-Atlantic marketer of propane as well as a Marcellus midstream player.

With a dividend yield of 1.92%, UGI remains an attractive long-term investment and a potential acquisition target. The average analyst expectation is for UGI to generate a five-year earnings growth rate of 8%, on an annualized basis.

2) PBF Logistics (NYSE: PBFX)

There is no commercial value chain in which you wouldn’t want your customers feeling flush and suppliers desperate. That pretty much explains our attraction to the downstream energy sector, which predates the oil crash but has only grown since the oil price recovery.

Crude refiners tend to do well when the price of their raw material is low, especially if it’s not low because the economy’s in the tank. That’s because low fuel prices can really pump up demand. And what’s good for refiners is also good for their logistics providers, as well as fuel wholesalers, retailers and shippers.

The market doesn’t disagree, which is why the prices of refiners and other downstream businesses are on a lasting upward trajectory.

If you can find a relatively new downstream asset that’s maybe gotten lost in the shuffle and still offers both a solid yield and the high certainty of rapid near-term growth, you really might have something. We think we do with PBF Logistics.

PBF’s dividend yield hovers at a hefty 8.65%. The average analyst expectation is for PBF to generate a five-year earnings growth rate of 2.4%, on an annualized basis.

3) Capital Product Partners (NSDQ: CPLP)

Capital Products Partners provides marine transportation services in Greece. The stock yields roughly 10%, even as it continues to re-charter its ships at higher rates. Most of next year’s capacity has been locked up, providing visible support for planned distribution growth.

Capital Products Partners’ vessels are capable of carrying a range of cargoes, including crude oil, refined oil products such as gasoline, diesel, fuel oil and jet fuel, edible oils and certain chemicals, such as ethanol, as well as dry cargo and containerized goods.

Capital Products Partners doesn’t have any “committed growth projects” it hasn’t already financed. CPLP has added several new fuel tankers that are already committed to long-term charters, which should boost its cash flow in future quarters.

CPLP’s concentration in the healthy markets for products and crude tankers also adds to the investment’s appeal.

The company’s five-year historical dividend growth rate exceeds 12%. What’s more, for the past five years, the stock has traded above the broader transport-ship market.

The average analyst expectation is for CPLP to generate a five-year earnings growth rate of 3%, on an annualized basis.
4) DCP Midstream Partners (NYSE: DPM)

One midstream company with a sizable presence in the prolific Permian basin is DCP Midstream Partners. Its general partner, DCP Midstream (NYSE: DCP), is a 50/50 joint venture of Phillips 66 (NYSE: PSX) and Spectra Energy (NYSE: SE).

In aggregate with DPM, DCP Midstream is the largest producer of NGLs in the U.S., as well as the largest natural gas processor. DPM gathers or processes about 12% of the U.S. gas supply.

DCP Midstream has 18,610 miles of natural gas and NGL gathering lines and transmission systems just in the Permian. It also has 19 processing plants in the basin with an aggregate capacity of 1.5 billion cubic feet per day of natural gas and 115,000 barrels per day of NGL production.

DCP Midstream didn’t escape the carnage in the MLP space during the energy price recession, as its unit price dropped along with its peers. However, the underlying performance of the business has been strong. During the gas price slump, DPM managed to increase production while reducing costs. This meant the company generated enough cash to more than adequately fund its distribution.

The average analyst expectation is for DPM to generate a five-year earnings growth rate of 2%, on an annualized basis. The dividend yield hovers at a robust 8.25%.

5) Southwest Gas Holdings (NYSE: SWX)

Las Vegas-based Southwest Gas Holdings supplies gas to its glitzy hometown as well as Phoenix and Tucson to the south.

The company operates in two segments, Natural Gas Operations and Construction Services. Arizona accounts for a little over half of the company’s two million customers and utility profits, while Nevada delivers 35% of the regulated bottom line and eastern California the remainder. Southwest also operates a large pipe construction subsidiary.

The company's strengths include solid share price performance, increasing net income, healthy cash flow from operations, a largely stable financial position with reasonable debt levels by most measures, and growth in earnings per share.

The dividend yield hovers at 2.4% and cash from operations net of dividends cover about 97% of capital expenditures.

The average analyst expectation is for SWX to generate a five-year earnings growth rate of 4%, on an annualized basis.

6) Alerian MLP Exchange Traded Fund ETF (NYSE: AMLP)

If you like the idea of participating in the growth of natural gas consumption in the years to come but don’t feel comfortable buying individual stocks, then the Alerian MLP exchange-traded fund offers a low-cost way to gain broad diversification and professional portfolio management. The fund owns a share of two dozen midstream energy companies, most of which are in the business of transporting and storing natural gas.

There are other advantages to owning a fund instead of an individual MLP besides the two mentioned above. Because it’s a mutual fund the quarterly dividend is treated as ordinary income and reported on a regular Form 1099, and not on a more complicated K-1. And since it’s ordinary income, the dividend does not include any of the “unrelated business taxable income” that most MLPs generate and which might be taxable in a retirement account depending on the amount.

The disadvantage to owning a fund is that you own a little bit of everything, making it virtually impossible for you to outperform the sector average when the fund is designed to capture the index average. But that’s okay if you aren’t too greedy and will be satisfied with what this sector as a whole has to offer, which is lots of income with constrained risk.
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