

A Broad View on Utilities

Specialty or sector funds aren't famous for the diversification they provide, but the Eaton Vance Utilities Fund has found a way to avoid concentration. With a very broad view on what the utility sector is, the manager Judith A. Saryan also invests in telecom and renewable energy companies when the macro environment is favorable. A significant international exposure further reduces the sector risk and provides a larger investable universe.

Q: What are the core beliefs behind your money management?

A: We manage the fund with a focus on total return, which represents a combination of dividend income and capital appreciation. Our goal is to provide above-average total return relative to the utility group with below-average risks.

We believe in long-term investing and we evaluate companies based on our expectations for the next one to three years, not based on their performance over the next one or two quarters. It is difficult for any investor to time the market and we don't try to predict the near-term volatility because that's a dangerous game. We'd rather look at the core qualities of the companies to see whether they're undervalued or overvalued.

We don't try to chase market momentum. If we make sound investment decisions and buy quality companies selling at a discount to intrinsic value, the strategy should provide good total return over time.

We believe in diversification across the utilities sub-sectors and we have a broad view on the sector. For most people, utilities mean just electricity. In our prospectus utility groups include electric, natural gas distribution, telecommunication, both long-distance and

wireless, cable, and renewable energy companies.

We invest both domestically and internationally, and international investing is an important part of our philosophy. We believe that the diversification reduces the risk and improves the performance over time. It also gives us a larger opportunity set to choose from.

Q: What are the core qualities of the companies that you consider worth investing?

A: We look for the leaders in their respective field. It might be the leaders in terms of geography, as in the case with distribution companies, or the leaders in terms of product, distribution, or customer base. We also look for companies with good quality fundamentals, strong balance sheets, and companies that can grow their dividends over time.

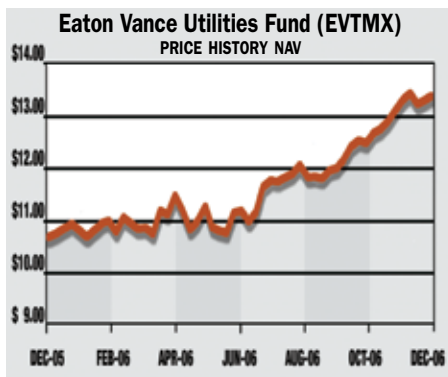
We look for companies with above-average dividend growth potential.

Good quality balance sheets for us means long-term debt/total capitalization ratio of less than 55%. Cash flow generation is another important element. We not only look for companies that can consistently generate free cash flow, but also for companies moving into positive free cash flow positions.



JUDITH SARYAN CFA is a Vice President of Eaton Vance Management and Portfolio Manager of Eaton Vance Utilities Fund. She also co-manages Eaton Vance Tax-Managed Dividend Income Fund, Eaton Vance Dividend Income Fund, Eaton Vance Tax-Advantaged Dividend Income Fund, Eaton Vance Tax-Advantaged Global Dividend Income Fund and Eaton Vance Tax-Advantaged Global Dividend Opportunities Fund. Before joining Eaton Vance in March of 1999, Ms. Saryan was a portfolio manager and equity analyst for State Street Global Advisors. Prior to her tenure at State Street Global, Ms. Saryan was with Colonial Management for more than 3 years, during which time she was the utilities analyst and Assistant Portfolio Manager of Colonial Tax-Managed Trust, a tax-managed utilities fund.

Ms. Saryan holds a degree in economics from Wellesley College and spent a year overseas studying developmental economics and comparative economic systems.



Q: How would you describe the differences between the different types of utility companies from an investing point of view?

A: We apply different standards for the evaluation of distribution and generation companies because those two businesses vary in terms of predictability. The distribution companies work in specific geographic regions where they have their pipelines or transmission networks. That gives them regional advantage because they usually don't have competing networks, certainly not the electricity distributors. Because the income and the cash flow of those companies tend to be very stable, they can handle more debt and we tend to be more flexible with our debt/capital rule. The dividend payout ratio that we look for can vary from nothing for a high-tech company to 70% for a regulated company.

While the distribution companies tend to be fairly consistent, the generation companies are much more cyclical. They used to be regulated but that has changed over the past 10 years. For generation companies, we try to understand where we are in the cycle. At the beginning of a cycle, we generally would expect prices to go up. We also define where we are in terms of capacity and utilization.

“Dividend growth is a core element of our investment philosophy.”

Q: How do you translate this concept into an investment process?

A: We're longer-term oriented and we use both a top-down and a bottom-up approach. We analyze each company looking for specific characteristics but we also analyze the overall industry to develop an understanding of where we might be in the cycle.

For telecom and generation companies, we evaluate the cyclical nature of the earnings, while in the fairly stable distribution business the cycles are mainly related to interest rates. In a rising interest rate environment, we tend to be less bullish on distribution companies. Overall, we don't try to predict quarter-to-quarter changes, but we develop a general view if interest rates are trending, flat, up or down. The macro view and the decision of where we are in the cycle are important parts of our strategy.

Q: Regarding the telecom companies, do you also consider the changes in the capital expenditure levels?

A: Yes, that's an important part of our analysis. When the capex is rising rapidly, we tend to be more negative on the industry. In periods when telecoms are spending heavily, the return on investment is going to decline and the cash flow may be negative. We prefer periods when the capex trend is downward because there is more free cash flow generation and the companies can use it to support higher dividends.

Q: Do you find opportunities in water companies as water can be a precious commodity?

A: Yes, but there are few investable water companies. But we do take a good look at the water companies, the capex environment, and the regulatory cycle.

The regulatory regime in the U.K. has been quite favorable so the UK water companies have been doing well in the past few years. But in areas where the regulation is not very consistent, any company that spends heavily on improving the infrastructure cannot have a

guarantee for the return. I believe that in the future more of this industry will be privatized. Most of the assets are still in the public hands but since the municipalities don't have enough income to keep re-investing and improving the infrastructure, that is likely to change.

Q: How does an idea turn into a holding?

A: We have a team of analysts who specialize in the utility and telecommunication areas. The analysts follow a rigorous assessment approach to come up with investment ideas that have above average total return prospects.

Our universe of potential candidates consists of approximately 175 names, including domestic and international, electric, telecom, natural gas, and water utilities. We estimate that approximately 85-100 of them have rising dividends. Currently, we own about 80 to 85 names in the fund. Every utility with a rising dividend is a potential candidate as long as it meets our investment criteria.

Q: Could you give us a couple of examples of stock holdings that you identified through your research process?

A: A good example would be Pacific Gas & Electric, a Californian regulated utility. We were watching the company closely after it filed for bankruptcy. We met with one of the key regulators and recognized that the regulators were concerned about improving the financials of the Californian utilities. They understood the importance of the industry for the stability and the growth of the state.

As a result, we took a much closer look at the company and we determined the assets were worth much more than the market was indicating. We expected the adequate regulation to help its ability to generate free cash and to institute a dividend. We bought the company four years ago at about \$12 to \$15 per share; currently it is trading at \$46 per share. That's an example of a company that we continue to own as we generally like to buy and hold stocks.

An example of a company that we sold because of a change in the fundamentals would be British Energy, a U.K. nuclear generator. When the company came out of bankruptcy, our analyst went to England to meet with the management and to take a detailed look of the company. He was convinced that it had potential to operate its nuclear plants more efficiently than before. In the US the nuclear plants run at above 90% capacity utilization, up from 60% about 15 years ago, and we believe that the same trend could happen in the UK.

Our analysis of British Energy was based on expectation for only 5% to 7% improvement in the utilization factor. We bought the stock two years ago and we decided to sell it last year mainly because the company ran into problems operating some of its plants and had to shut them down. We bought it very early at approximately 250 to 300 pence per share, and we were able to sell most of it in the 600 to 640 pence range. It's currently trading at 485. We were very strict in our sell discipline because this is a cyclical name with company issues.

Q: Did you have the misfortune of getting close to Enron?

A: Enron is a good example because we did well with this stock. We bought a small position back in 2000. The more we analyzed the company, the less comfortable we were with the financials, so we decided to sell it. We got out of our position in the period January through March 2001, long before the real disaster.

But we recognized that the fundamentals were already deteriorating. The stock price had just begun to drop and the company was sending out conflicting messages. In the end, we actually made about \$2 million in Enron.

Q: Would you explain your portfolio construction process? Do you follow any benchmarks?

A: We use some top-down analysis of the industry, but we buy companies one

by one strictly on a fundamental basis to make sure that we are buying quality companies. We use the top-down analysis to build a general view on whether it's a favorable time to lean towards generators, distributors, or telecomm.


We try to have exposure in all of those areas, but the weightings vary depending on our macro view. Right now we have a slight overweight in the telecomm area because it has a more attractive outlook. As the stocks of the electric utilities have risen rapidly, we're a little nervous about those stocks, so there is price sensitivity in our approach.

We don't really use any specific benchmarks. The S&P Utility average isn't a good benchmark for us because it only includes domestic electric utilities. Some of the company weightings in the index can be as large as 7% or 9%, while in our portfolio the weightings are less than 4%. We are reluctant to follow a benchmark that would send us away from our discipline and lead us to concentrated positions. Diversifying and keeping the individual weightings below 4% is one of the ways to mitigate risk.

Q: How large is your international exposure?

A: Our international exposure varies depending on where we find opportunities. Right now it's about 41% but it has been as low as 20% in the past. We stay within the markets of our expertise, which are US, Canada, Mexico, and Europe. We definitely look at central Europe because it's moving rapidly into the EU and that's a good place to find growth.

Q: What is the rationale behind your sell decisions?

A: We trim stocks when they're selling at significant premiums to the market and to other utilities, or when there's a change of fundamentals. Another reason to sell would be if a stock drops by more than 10-15% from our purchase price and we decide that we've made a poor purchasing decision. We'd also sell a stock if we just find a better security. 

Eaton Vance Utilities Fund

Symbol	EVTMX
Website	www.eatonvance.com
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Tel. No.	800-225-6265
Inception	12/18/1981

PORTFOLIO

Total Net Assets*	\$1,377
Avg Mkt Cap (\$ Weighted)*	\$30,112
Average Price/Earnings Ratio	15.58
Average Price/Book Ratio	3.36
Turnover Ratio**	54%

INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	\$1,000
Min Subsequent Investment	\$50
Min Initial IRA Investment	N/A

RISK (AGAINST S&P 500 - 3 YEARS)

Alpha	14.62
Beta	0.66
R-Squared	0.31
Ann. Std Deviation	8.13
Sharpe Ratio	2.37

RETURNS VS. S&P 500 UTIL SEC TR IX INDEX

	EVTMX	Index
1 Year (Cum.)	28.51%	20.99%
3 Year (Ann.)	24.57%	20.66%
5 Year (Ann.)	16.33%	9.20%

RETURNS VS. S&P 500 DAILY REINV IX INDEX

	EVTMX	Index
1 Year (Cum.)	28.51%	15.79%
3 Year (Ann.)	24.57%	10.44%
5 Year (Ann.)	16.33%	6.19%

FEES AND EXPENSES

Max Sales Charge - Front	5.75%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee	0.00%
Total Expense Ratio	1.08%

PORTFOLIO MANAGER

Judith A. Saryan	03/31/99
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*millions **as of 12/31/05

Data through: 12/31/06

Source: Company Documents; Lipper

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Our interview covers investment philosophy and strategy, research process, portfolio construction and risk control for funds. Through an interview we uncover long-term strategies and processes that help to generate long-term returns.

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