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Industry: **WATER INFRASTRUCTURE**

Coverage:

<b>Ticker</b>	<b>Rating</b>	<b>Price</b>
AWK	BUY	\$24.92
AWR	NEUTRAL	\$34.98
CWT	NEUTRAL	\$37.39
PNR	BUY	\$34.04
WTR	NEUTRAL	\$21.58
WTS	NEUTRAL	\$33.91

## The Water Rundown

### NYSSA Water Utilities Conference Highlights

#### Industry Updates

- Copper Prices Continue to Rise

#### Water Utilities Updates

- Commission Approves CWT Rate Case
- WTR Announces Acquisition
- CPUC Approves AWK Desalination Facility

#### Water Infrastructure Updates

- INSU Announces Contract Win
- TTEK Announces Contract Win

#### Industry Data and Graphs

- Spot Copper Price
- PPI, Water-Treating Compounds

**IMPORTANT DISCLOSURES ARE LOCATED IN THE APPENDIX.**



## NYSSA Water Utilities Conference Highlights

We attended the 14th Annual Water Utilities Conference hosted by the New York Society of Securities Analyst (NYSSA) on Wednesday in New York City. The conference was an opportunity for investors to better understand the industry's current market drivers and the future of regulated water utilities companies, along with how each of the companies in attendance participates in the industry and what sets each apart from the other. In particular, conference participants discussed supply and demand, investment in infrastructure, environmental and local regulation, and advancements in water related technologies. The presentations by CWT CEO Peter Nelson, AWR CEO Robert Sprows and WTR Chairman, President and CEO Nicholas DeBenedictis all emphasized these points. Representatives from Middlesex Water (MSEX, NR), Consolidated Water (CWCO, NR), Artesian Resources (ARTNA, NR), the York Water Company (YORW, NR), Pure Cycle (PCYO, NR) and Connecticut Water Services (CTWS, NR) also hosted their own presentations.

We offer a summary of WTR's presentation first detailed in our publication *Water Utilities Conference Takeaways*, December 3, 2010, below:

**Acquisitions:** WTR has completed 15 acquisitions YTD and Chairman, President and CEO Nicholas DeBenedictis noted in his remarks that WTR will close on at least a half-dozen acquisitions in the coming weeks, including a sizable operation in Texas with over 1,000 customers. The amount would put the company at the low end of its forecast of 20-30 acquisitions for the year. Management noted that it expects to be an active bidder in the 32 water and wastewater systems the Lower Colorado River Authority (LRCA) intends to put up for bidding in the coming months. We note that the LRCA's assets generated \$36M in revenues in FY09. WTR completed 18 acquisitions in the whole of 2009, a low amount by historical standards. Overall, we expect 1.5-2% customer growth through acquisition over the next several years to go towards offsetting declines in water usage due to conservation efforts.

**Capex:** Management expects FY10 capex of \$310M, above its \$300M forecast for the year. The company expects to invest a similar amount in FY11 and \$1.5B over the next five years. In that the company is generating 80-85% of its cash internally, there is no immediate need to issue equity to fund its capex program.

**Solar Farm Investments:** In that water treatment is energy intensive, WTR recently completed a 4.5 acres 1.1 MW solar farm that is capable of fully serving one of its plants energy needs and generates enough excess energy that the company is able to, sell an additional 300 kW back to the grid. Management expects to invest in additional solar plants in those markets with stable water demand, specifically those markets where WTR serves large institutions with signs of staying power, such as colleges, hospitals and prisons. Given the company's low cost of capital and the incremental benefit for the ratepayer, we would expect WTR to continue its strategic rollout of solar farms.

**Cost of Capital:** WTR's weighted-average cost of long-term fixed-rate debt was 5.49% at the end of FY09. Management believes it will be able to reduce its cost of debt by 10bp in the coming quarters.



## END MARKET & INDUSTRY UPDATES

**Copper Prices Continue to Rise** – Copper prices continue to expand on speculation that the Federal Reserve may take more steps to spur economic growth. Furthermore, a month-long strike at the world's third largest mine, along with data suggesting that copper inventories have contracted for the 42<sup>nd</sup> week in a row added to the upward pressure on copper costs. Copper inventories tracked by the London Metals Exchange fell to 352,375 tons and have declined 30% this year, heading for the first annual decline since 2004. Copper prices have risen 18% in 2010. Meanwhile, it does not appear that copper prices will decline in the months ahead due to reports that China's spending on a national power grid may account for 50% of the increase in the country's overall copper demand next year, which is expected to increase to 7.74M tons in 2011.

*Source: Bloomberg*

*LBR Note: High copper costs could be a near term negative for Watts Water (WTS-NEUTRAL) as it should see a 1-2 quarter margin squeeze before price increases are implemented.*

## WATER UTILITIES UPDATES

**Commission Approves CWT Rate Case** – The California Public Utilities Commission (CPUC) has approved CWT's (NEUTRAL) 2009 General Rate Case. The ruling will add \$25.44M to gross revenues beginning January 1, 2011 and an additional \$8M in rate relief may be obtained after the completion of certain capital projects. We note that the company has already realized \$9.8M in step-up rate increases associated with the 2009 GRC. The ruling was expected as it was based largely off the recommended proposed decision released in conjunction with the company's 3Q10 results. The decision also allows CWT to file for smaller increases in the second and third years of the three-year rate case cycle (2012 and 2013). We believe this to be a positive as it will reduce earnings volatility during periods of regulatory lag. The next GRC is schedule to be filed in July of 2012 with rates effective in January of 2014.

The 2009 GRC also allows for the implementation of two distinct expense mechanisms which are expected to reduce the volatility associated with pension and healthcare-related costs.

**WTR Announces Acquisitions** – WTR (N) announced that its New Jersey subsidiary has completed the acquisition of the water system assets of the Vernon Water Company, which serves some 600 people in Sussex County. The purchase price was \$180,000. The acquisition is the second for Aqua

New Jersey and the fifteenth for Aqua America this year. The acquired water system will be operated by Aqua's nearby Northern Division, which also manages the company's system in Fredon Township, Sussex County. The acquisition is viewed as a tuck-in and will maximize the company's economies of scale in the region.

**CPUC Approves AWK Desalination Facility** – AWK (BUY, \$29PT) announced that the California Public Utilities Commission (CPUC) has approved the company's plans to develop the Regional Desalination Project, which will be built along California's central coast. The new facility, which is expected to be completed by 2015, will produce 10M gallons of water daily for the Monterey Peninsula and will replace the water currently taken from the Carmel River. Water from the Regional Desalination Project will provide water to the Monterey Peninsula, as well as the Marina Coast Water District and the Monterey County Water Resources Agency, two local public water agencies. The construction of the facility is in response to a Cease and Desist order issued by the state last year which requires a 70% cutback on water taken from the Carmel River by 2016. The project's estimated cost is ~\$400M. Customer water rates are expected to double in the next five years, which will help offset construction costs incurred by AWK. The project is slated for completion in 2015.

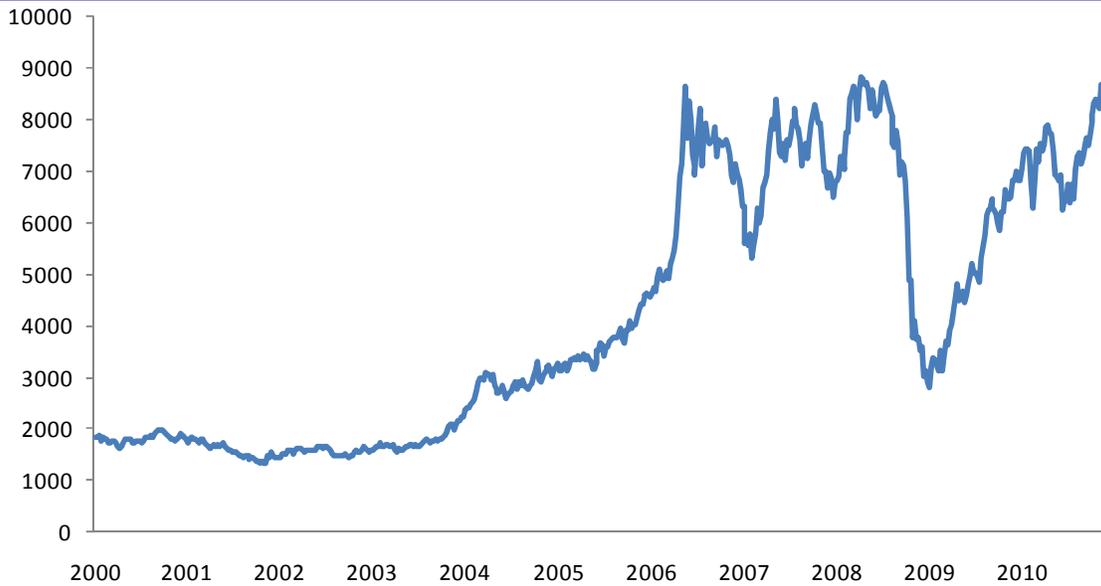
## WATER INFRASTRUCTURE UPDATES

**Insituform Technologies (INSU, NR)** – INSU won a \$10.3M contract to install a liner system in mining pipelines in Chile. The company's United Pipeline Systems will install more than 14 miles of liner in 24-inch pipelines used in the transport of pre-treated water and seawater. The installation is believed to be the largest such installation in an aqueduct ever completed. Work on the project is expected to be completed in March 2011. This is the second such mining contract the company has secured with Freeport-McMoRan Mining Co, with the cumulative value of the contracts being \$16.5M.

**Tetra Tech (TTEK, NR)** – TTEK announced that it has secured a \$40M contract to manage a U.S. government forestry program in Indonesia. The contract will last four years with an up-front payment of \$13.8M. In a separate announcement, the company announced it won a \$119M contract from the U.S. government to help the local government in Afghanistan's capital deliver public services. The contract has a base length of one year with two one-year options after that.

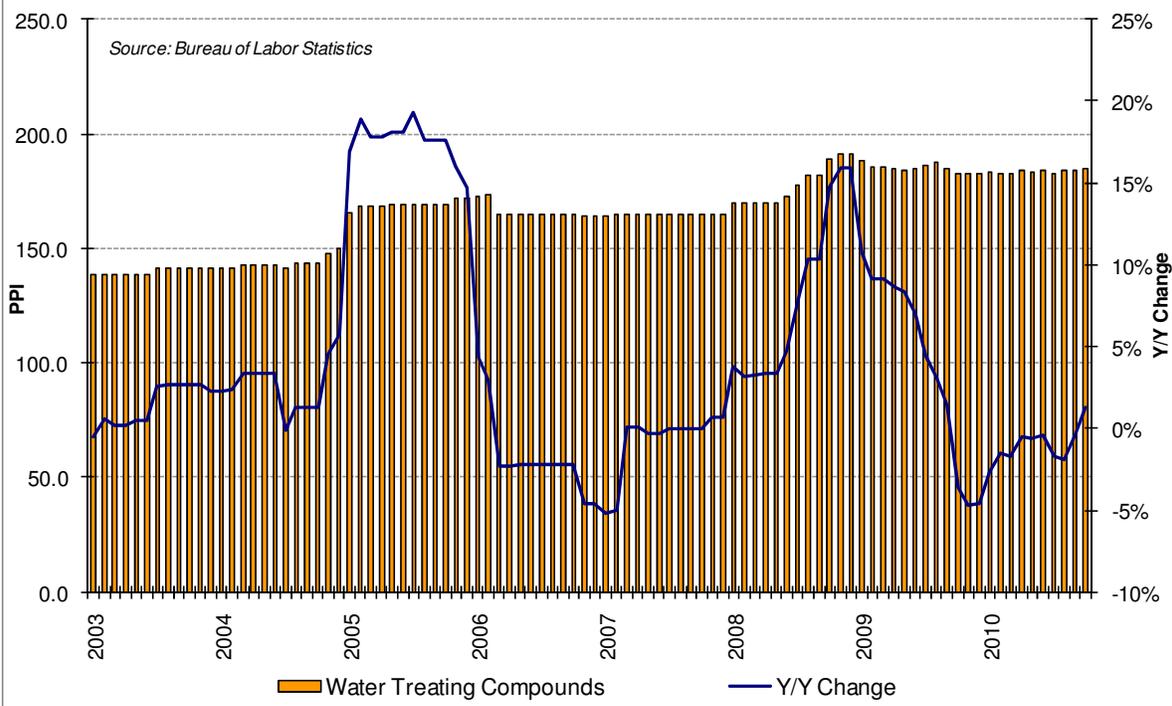


### Spot Copper Price (London Metal Exchange)



Source: Bloomberg

### PPI, Water-Treating Compounds



Source: Bureau of Labor Statistics

**WATER INDUSTRY PEER VALUATION**

(\$ in millions, except per share data)

Company	Ticker	FY End	Rating	Target	% Upside	Share Price	52 Week		Mkt Cap	Revenue Last	Last FY	Earnings per Share		P/E		Dividend Rate	Price/Book
							Hi	Lo				Current FY	Next FY	Current FY	Next FY		
<b>U.S. WATER UTILITIES</b>																	
AMER STATES WATER	AWR	Dec.	Neutral			\$34.98	\$39.61	\$31.20	\$ 650	\$ 361	1.62	1.78	2.15	19.7x	16.3x	3.0%	1.8x
AMERICAN WATER WORKS	AWK	Dec.	BUY	\$29	16%	\$24.92	\$25.14	\$19.41	\$ 4,358	\$ 2,841	1.25	1.55	1.70	16.1x	14.6x	3.5%	1.0x
AQUA AMERICA	WTR	Dec.	Neutral			\$21.58	\$21.97	\$16.45	\$ 2,962	\$ 671	0.77	0.92	1.00	23.4x	21.6x	2.9%	2.2x
CALIFORNIA WATER	CWT	Dec.	Neutral			\$37.39	\$39.70	\$33.81	\$ 779	\$ 449	1.95	1.91	2.20	19.6x	17.0x	3.2%	1.8x
ARTESIAN RESOURCES	ARTNA	Dec.	NR			\$18.96	\$19.59	\$16.43	\$ 143	\$ 61	0.97	1.02	1.09	18.6x	17.4x	4.0%	1.5x
CONNECTICUT WATER	CTWS	Dec.	NR			\$25.35	\$26.44	\$20.00	\$ 219	\$ 59	1.19	1.2	1.19	21.1x	21.3x	3.7%	2.0x
MIDDLESEX WATER	MSEX	Dec.	NR			\$17.83	\$18.70	\$14.74	\$ 277	\$ 91	0.72	0.94	0.93	19.0x	19.2x	4.1%	1.7x
PENNICHUCK	PNNW	Dec.	NR			\$27.55	\$28.39	\$19.00	\$ 128	\$ 33	0.55	0.84	0.95	32.8x	29.0x	2.7%	1.8x
SJW	SJW	Dec.	NR			\$25.08	\$28.24	\$21.49	\$ 465	\$ 216	0.81	0.96	1.06	26.1x	23.7x	2.7%	1.7x
YORK WATER CO (THE)	YORW	Dec.	NR			\$16.20	\$16.76	\$12.83	\$ 205	\$ 37	0.64	0.7	0.75	23.1x	21.6x	3.2%	2.1x
Average													21.9x	20.2x	3.3%	1.7x	
<b>EQUIPMENT/ FILTRATION/ TREATMENT SECTOR</b>																	
PENTAIR	PNR	Dec.	BUY	\$39	15%	\$34.04	\$39.32	\$29.41	\$ 3,360	\$ 2,692	1.47	1.96	2.28	17.3x	14.9x	2.2%	1.6x
WATTS WATER TECH	WTS	Dec.	Neutral			\$33.91	\$37.00	\$27.51	\$ 1,251	\$ 1,234	1.54	1.92	2.23	17.7x	15.2x	1.3%	1.3x
AMERON INT'L	AMN	Nov.	NR			\$75.27	\$76.79	\$54.27	\$ 696	\$ 547	3.05	2.94	4.25	25.6x	17.7x	1.6%	1.1x
BADGER METER	BMI	Dec.	NR			\$43.85	\$44.71	\$32.58	\$ 659	\$ 250	1.80	1.91	2.08	23.0x	21.1x	1.3%	4.1x
CALGON CARBON	CCC	Dec.	NR			\$14.39	\$18.35	\$11.75	\$ 808	\$ 412	0.69	0.68	0.87	21.2x	16.5x	0.0%	2.5x
ENERGY RECOVERY	ERII	Dec.	NR			\$3.75	\$7.28	\$3.08	\$ 197	\$ 47	0.07	(0.08)	-	NM	NM	0.0%	2.9x
FRANKLIN ELECTRIC	FELE	Jan.	NR			\$40.92	\$41.37	\$24.93	\$ 951	\$ 626	1.29	1.86	2.25	22.0x	18.2x	1.3%	1.7x
GORMAN-RUPP	GRC	Dec.	NR			\$31.87	\$31.91	\$22.81	\$ 535	\$ 266	1.15	1.34	1.6	23.8x	19.9x	1.3%	2.6x
ITRON	ITRI	Dec.	NR			\$53.84	\$81.95	\$52.03	\$ 2,174	\$ 1,687	2.09	4.03	4.33	13.4x	12.4x	0.0%	1.9x
LAYNE CHRISTENSEN	LAYN	Jan.	NR			\$33.48	\$33.96	\$22.97	\$ 653	\$ 866	0.81	1.23	1.56	27.2x	21.5x	0.0%	1.1x
MUELLER WATER PRODUC	MWA	Sept.	NR			\$3.72	\$5.99	\$2.21	\$ 576	\$ 1,338	-0.29	(0.17)	0.15	NM	NM	1.9%	1.2x
NORTHWEST PIPE	NWPX	Dec.	NR			\$22.78	\$31.46	\$14.62	\$ 212	\$ 283	-0.26	0.12	0.73	189.8x	31.2x	0.0%	1.0x
PALL	PLL	Jul.	NR			\$47.60	\$47.22	\$31.06	\$ 5,553	\$ 2,402	1.77	2.33	2.33	20.4x	20.4x	1.3%	3.7x
SMITH (A.O.)	AOS	Dec.	NR			\$41.30	\$40.50	\$27.39	\$ 1,891	\$ 1,991	1.90	2.70	2.94	15.3x	14.0x	1.4%	1.7x
Average													44.6x	19.7x	0.8%	2.0x	
<b>WATER RESOURCES/ INFRASTRUCTURE</b>																	
INSITUFORM TECH	INSU	Dec.	NR			\$24.35	\$28.38	\$18.52	\$ 955	\$ 727	1.04	1.52	1.77	16.0x	13.8x	0.0%	1.6x
LINDSAY	LNN	Aug.	NR			\$62.08	\$66.48	\$30.80	\$ 775	\$ 358	1.11	1.81	2.15	33.9x	27.7x	0.5%	2.0x
TETRA TECH	TTEK	Sept.	NR			\$24.38	\$28.18	\$18.00	\$ 1,505	\$ 2,201	1.22	1.25	1.43	20.0x	17.7x	0.0%	1.7x
Average													25.0x	18.9x	0.7%	2.1x	
<b>Relevant Indices</b>																	
Dow Jones Industrials	DJ30	Share Price															
S&P 500	SPX	\$11,382															
Nasdaq Composite	NDX	\$1,225															
		\$2,191															

Source: Baseline; Company reports and LBR Estimates. EPS reflects diluted EPS, excluding extraordinary items. Numbers in italics reflect consensus estimates.

\*\* Time period for annual estimates may vary based on reporting date.

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**APPENDIX**

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Neutral	146	63.2%
Sell	2	0.9%

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