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Industry: **WATER INFRASTRUCTURE**

Coverage:

Ticker	Rating	Price
AWK	BUY	\$21.74
AWR	NEUTRAL	\$34.12
CWT	BUY	\$36.66
PNR	BUY	\$34.31
WTR	NEUTRAL	\$17.77
WTS	NEUTRAL	\$31.56

Water Rundown

End Market and Industry Updates

- EPA Identifies \$298B In Wastewater Capex Needs
- Companies Conserving Water Surprised by Savings
- Australia Doubles Water Capex
- California Water Crisis Over?
- €100M for Water Improvements in Madrid

Water Utilities Updates

- AWK Rate Increase in Missouri, But Amount Slightly Disappointing
- AWK Takes Over Wastewater System in Missouri

Water Infrastructure Updates

- INSU Lands Contract in Austin
- WTS Announces Plans for Austrian Acquisition; Not Yet Closed
- AOS Formulates JV With Japanese Firm
- ITRI Wins New Contract
- PLL Prices Public Offering

Industry Data and Graphs

- 2008 Total Small Community Needs by State
- 2008 Total Needs by Category

IMPORTANT DISCLOSURES ARE LOCATED IN THE APPENDIX.



END MARKET & INDUSTRY UPDATES

EPA Identifies \$298.1B in Wastewater Capex Needs –

The Environmental Protection Agency published its quadrennial survey of wastewater and stormwater capital investments needs in the U.S., reporting that \$298.1B of infrastructure spending will be required over the next 20 years to merely maintain present operational levels. The EPA's estimates are a significant increase over its previous report released in 2004, which identified \$254.8B in needs. Stormwater management programs accounted for \$42.3B of capex needs, up 67% versus 2004. Funding needs for advanced wastewater treatment systems increased 56% compared to 2004. The total amount also includes \$192.2 billion for wastewater treatment plants, pipe repairs, and buying and installing new pipes and \$63.6 billion for combined sewer overflow correction. Small communities have reported needs of \$22.7 billion. In addition to the \$298.1 billion in wastewater and stormwater needs, other documented needs include nonpoint source pollution prevention (\$22.8 billion) and decentralized wastewater (septic) systems (\$23.9 billion). An estimated \$334.5 billion in needs are potentially eligible for assistance from EPA's Clean Water State Revolving Fund. New Jersey, California, and New York, all with close to \$30B in needs, reported the largest total needs. Florida, Illinois, Ohio, Pennsylvania, and Texas each have needs in excess of \$10B.

Source: The Environmental Protection Agency

LBR Note: While it is no surprise that the EPA adjusted its capex estimates upward, what is most interesting is the \$22.7B in reported capex needs for smaller communities. As we have seen in recent years, larger public water utilities generally prefer to acquire water systems in smaller communities that are in need of extensive infrastructure improvement. In general, such smaller communities lack the necessary capital to undertake such large improvement projects and find it logical to sell their assets to large publically traded water utilities with the financial capabilities to upgrade those systems in need of repair. We would not be surprised to see additional acquisitions of smaller water systems in the coming quarters.

Companies Conserving Water Surprised by Savings –

Ninety-nine percent of corporate sustainability managers saw water becoming a top priority for businesses in the next 5 to 10 years, according to a recent sustainability report. An additional 52% of managers ranked "water stewardship" within the top five most important issues their companies now deal with. Numerous multi-national corporations have already implemented initiatives such as fixing leaks, installing sensors on urinals, and reducing toilet water capacity. A large winery in California recently implemented various controls that allowed it to reduce its water usage by 70%. It also proposed that if just 35% of California wineries implemented the same technology, it could save the state one billion gallons of water annually.

Source: CNET News

Australia Doubles its Water Capex – Australian urban water utilities doubled their capex to USD\$7.4B in the fiscal year ended June 2009, according to recent data released by that National Water Commission of Australia. The increase is reflective of a drive to deliver new sources of bulk water through desalination plants, recycling facilities and new pipelines. Nevertheless, total residential water volume supplied rose only slightly in 2008-09, after falling steadily every year since 2004-08. The total volume supplied has fallen by 12% since that time, despite an 8% increase in total connections due to residential expansion and population growth. While the increase in total connections and higher water rates helped increase revenues, profit margins among large bulk water suppliers have declined significantly in recent years amid a reduction in per capita consumption. In general, industry players believe that household water is too cheap and does not reflect the true economic value of the resource. The report also noted that while recycled water accounts for just 4% of the total water supplied in the country, recycled volumes have increased 41% between 2005-06 and present day.

Source: Global Water Intelligence

California Water Crisis Over? – Despite the wettest spring since 2006, which resulted in many reservoirs nearing capacity, Silicon Valley's largest water provider voted to keep in place mandatory water conservation measures for this summer. Santa Clara Valley Water District is the only water district to enact a mandatory 10% conservation plan, which replaces a 15% conservation plan the agency put in place in March 2009 at the height of the three-year drought. The district provides bulk water to 13 retailers, including the San Jose Water Company (SJW, NR). Last year, lost water sales cost San Jose Water \$6 million, which it has asked the PUC to cover by allowing it to temporarily raise rates 2.5%.

Source: South Bay News

LBR Note: By way of background, since the passage of Water Recovery Adjustment Mechanism (WRAM) and Modified Cost Balancing Account (MCBA), water utilities operating in California have had their revenues and costs decoupled from water consumption and wholesale water prices. Companies are allowed to recover any loss due to consumption declines or increases in water prices and vice-versa.

€100M for Water Improvements in Madrid – The European Investment Bank (EIB) has granted a loan of EUR 100M to the city of Madrid, Spain to finance investment in water supply and wastewater treatment systems. The loan will finance a range of works on the supply, sewerage and wastewater treatment infrastructure. The region is characterized by an overall scarcity in water, so any improvements in water pipes and the surrounding infrastructure, with a reduction in leaks, should have considerable environmental benefits. The EIB is the long-term financing arm of the EU and is focused on financing that is geared toward upgrading the aging water infrastructure network in Europe.

Source: Water World



WATER UTILITIES UPDATES

Missouri American Water gets OK for \$28M rate increase – Regulators have approved a \$28 million rate increase for Missouri American Water customers in St. Louis and St. Charles counties. The Missouri Public Service Commission approved a rate increase that will raise the monthly water bill for the average St. Louis County customer using 7,500 gallons of water by about \$3.70 per month or \$44.40 a year. The average St. Charles County customer using 7,500 gallons of water per month will see rates increase by about \$4.34 per month or \$52.08 a year. This represents a rate increase of about 15%. New rates are expected to take effect on or about July 1 and will result in \$28 million in additional revenue for the company. Missouri American Water said it invested about \$97 million in the St. Louis Metro area from Oct. 1, 2008 to April 30, 2010.

Source: St. Louis Business Journal

LBR Note: The approved amount represents 57% of the \$48.7M AWK was seeking. While this falls within the 50-70% range PUC's typically approve relative to what is applied for, we assumed \$32M would be granted. On annual basis, the decision relative to our expectations would have little EPS impact.

American Water (AWK, BUY, \$24 PT) – AWK announced that its wholly owned subsidiary, Missouri American Water, has taken over a wastewater system serving the Lake Tamarack Residents Association in Cedar Hill, Missouri. The system adds 53 customers to the company's customer count and serves a population of 140 residents.

WATER INFRASTRUCTURE UPDATES

Insituform Technologies, Inc. (INSU, NR) – INSU announced that it was awarded a three-year \$11.7M contract by the city of Austin, Texas. The contract calls for the company to rehabilitate sewer pipelines in the city and the company has already received its first work order under the contract valued at \$2.3M. Since 2004, INSU has completed nearly \$20M in rehabilitation work for Austin.

Watts Water Technologies (WTS, N) – WTS reported that it plans to buy Austroflex Rohr-Isoliertechnik GmbH, an Austrian company, by the end of June. WTS said that it has yet to sign a definitive purchase agreement with Austroflex and it did not disclose a purchase price, though it did note that the deal would not have a significant impact on its financing standing or cash reserves. Austroflex makes PEX pipes for carrying hot and cold water, as well as stainless steel pipes used in solar and high temperature applications.

A.O. Smith Corp (AOS, NR) – AOS reported that it is launching a joint venture with Takagi Industrial Co., a Japanese company, to market and build tankless water heaters in North America. AOS will take over management of privately held Takagi's North

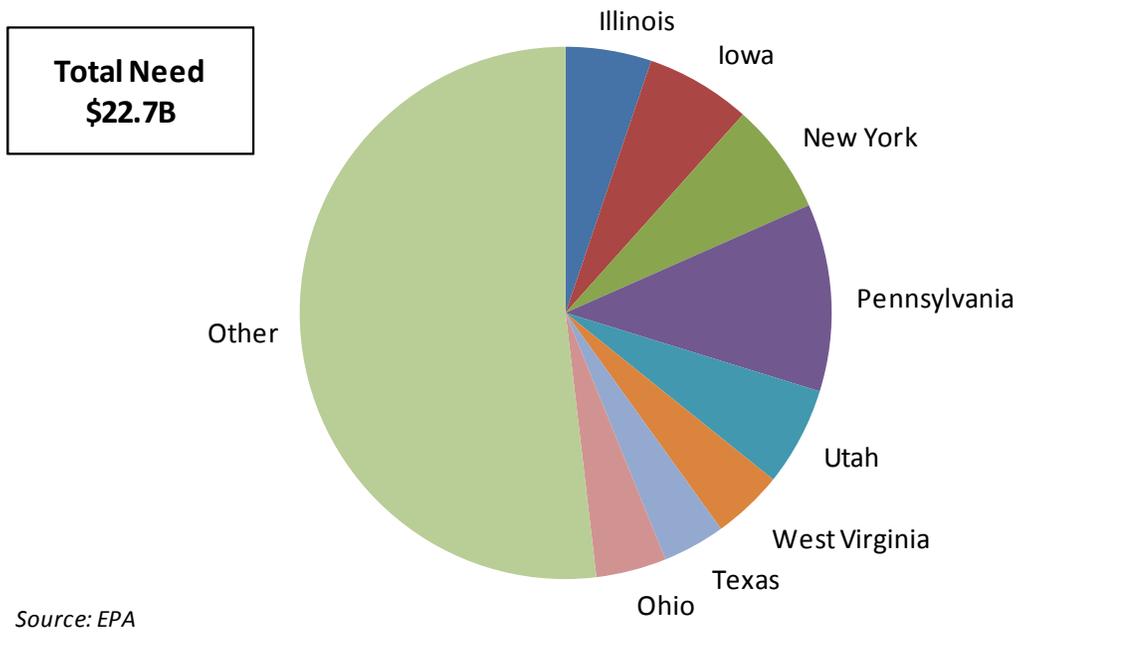
American sales and distribution and headquarters in Irvine, California. The company did not disclose the financial details of the venture and expects the deal to close in 3Q10. The JV will expand AOS' line of high-efficiency water heating products.

Itron Inc. (ITRI, NR) – INRI reported that it was selected by Iberdrola, one of the world's largest electricity utilities, for the first phase of the company's smart metering program. Under the terms of the agreement, ITRI will be responsible development and integration of an advanced meter management system. The first phase of the project is expected to run from July until the end of 2010. ITRI will initially deploy 100,000 meters, with the potential to expand to ten million meters countrywide.

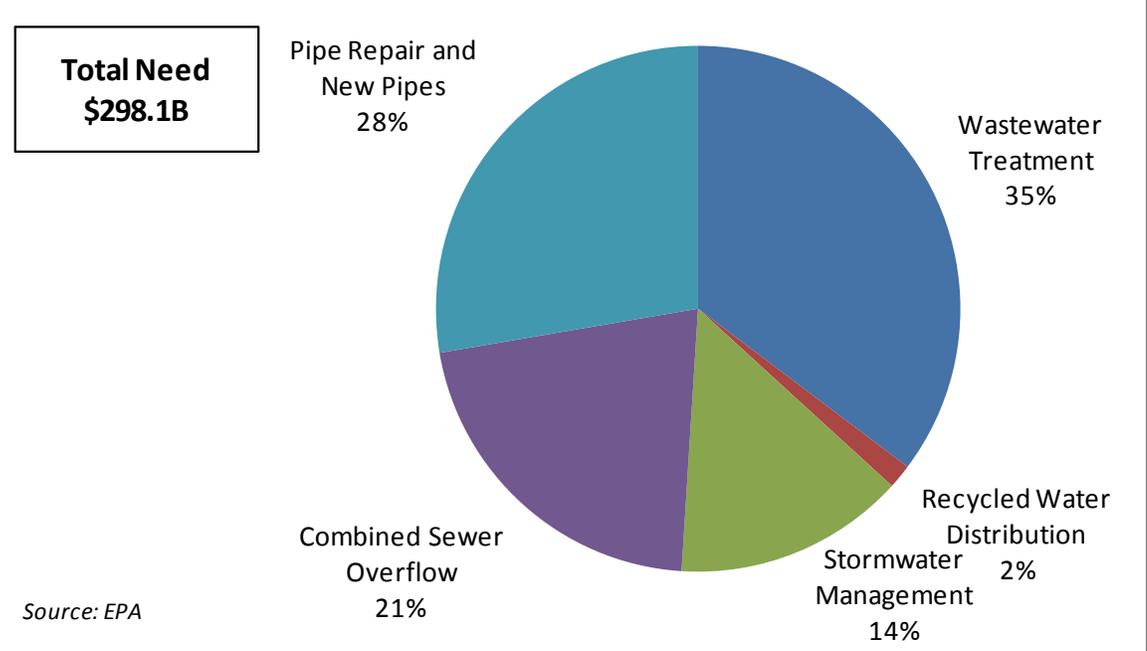
Pall Corp (PLL, NR) – PLL announced the pricing of its public offering of \$375M aggregate principal amount of 5.00% Senior Notes due June 15, 2020. PLL expects to receive net proceeds from the offering of \$370M and intends to use the proceeds to redeem the \$280 million aggregate principal amount of its outstanding 6% Senior Notes due 2012. Additional proceeds will be used for general corporate purposes.



2008 Total Small Community Needs by State (% of Total)



2008 Total Needs by Category (% of Total)



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		
U.S. WATER UTILITIES																	
AMER STATES WATER	AWR	Dec.	Neutral			\$34.12	\$39.61	\$31.20	\$ 624	\$ 361	1.63	1.83	2.11	18.6x	16.1x	3.1%	1.8x
AMERICAN WATER WORKS	AWK	Dec.	BUY	\$24	10%	\$21.74	\$23.77	\$18.07	\$ 3,684	\$ 2,337	1.25	1.39	1.60	15.6x	13.6x	4.0%	1.3x
AQUA AMERICA	WTR	Dec.	Neutral			\$17.77	\$18.73	\$15.39	\$ 2,412	\$ 671	0.77	0.88	0.95	20.2x	18.8x	3.3%	2.2x
CALIFORNIA WATER	CWT	Dec.	BUY	\$43	17%	\$36.66	\$40.65	\$33.81	\$ 755	\$ 449	1.95	1.99	2.40	18.4x	15.3x	3.3%	1.8x
ARTESIAN RESOURCES	ARTNA	Dec.	NR			\$17.32	\$19.33	\$14.61	\$ 130	\$ 61	0.97	1.07	1.12	16.2x	15.5x	4.3%	1.5x
CONNECTICUT WATER	CTWS	Dec.	NR			\$21.63	\$26.44	\$20.00	\$ 184	\$ 59	1.19	1.08	1.14	20.0x	19.0x	4.3%	2.0x
MIDDLESEX WATER	MSEX	Dec.	NR			\$16.11	\$18.70	\$13.16	\$ 242	\$ 91	0.72	0.91	0.92	17.7x	17.5x	4.5%	1.7x
PENNICHUCK	PNNW	Dec.	NR			\$22.80	\$24.80	\$19.00	\$ 104	\$ 33	0.55	0.76	0.79	30.0x	28.9x	3.2%	1.8x
SIJW	SIJW	Dec.	NR			\$24.59	\$28.24	\$20.63	\$ 449	\$ 216	0.81	1.09	1.24	22.6x	19.8x	2.8%	1.7x
YORK WATER CO (THE)	YORW	Dec.	NR			\$13.95	\$17.95	\$12.83	\$ 175	\$ 37	0.64	0.67	0.71	20.8x	19.6x	3.7%	2.1x
Average													20.0x	18.4x	3.7%	1.8x	
EQUIPMENT/ FILTRATION/ TREATMENT SECTOR																	
PENTAIR	PNR	Dec.	BUY	\$41	19%	\$34.31	\$39.32	\$23.20	\$ 3,358	\$ 2,692	1.47	1.96	2.38	17.5x	14.4x	2.2%	1.6x
WATTS WATER TECH	WTS	Dec.	Neutral			\$31.56	\$37.00	\$19.50	\$ 1,151	\$ 1,234	1.54	1.89	2.14	16.7x	14.8x	1.4%	1.3x
AMERON INT'L	AMN	Nov.	NR			\$62.75	\$91.66	\$50.44	\$ 587	\$ 547	3.05	2.74	4.16	22.9x	15.1x	1.9%	1.1x
BADGER METER	BMI	Dec.	NR			\$41.42	\$44.90	\$32.58	\$ 630	\$ 250	1.80	1.79	2.06	23.1x	20.1x	1.1%	4.1x
CALGON CARBON	CCC	Dec.	NR			\$15.33	\$18.35	\$10.93	\$ 831	\$ 412	0.69	0.79	0.93	19.4x	16.5x	0.0%	2.5x
ENERGY RECOVERY	ERII	Dec.	NR			\$3.91	\$7.40	\$3.15	\$ 209	\$ 47	0.07	0.04	0.16	NM	NM	0.0%	2.9x
FRANKLIN ELECTRIC	FELE	Jan.	NR			\$31.27	\$36.59	\$22.80	\$ 737	\$ 626	1.29	1.76	2.1	17.8x	14.9x	1.6%	1.7x
GORMAN-RUPP	GRC	Dec.	NR			\$27.77	\$30.49	\$18.44	\$ 470	\$ 266	1.15	1.17	1.39	23.7x	20.0x	1.5%	2.6x
ITRON	ITRI	Dec.	NR			\$27.58	\$81.95	\$50.15	\$ 2,756	\$ 1,687	2.09	3.26	3.89	8.5x	7.1x	0.0%	1.9x
LAYNE CHRISTENSEN	LAYN	Jan.	NR			\$21.07	\$35.14	\$17.53	\$ 525	\$ 866	0.81	1.10	1.48	19.2x	14.2x	0.0%	1.1x
MUELLER WATER PRODUC	MWA	Sept.	NR			\$4.17	\$5.99	\$2.52	\$ 660	\$ 1,428	-0.29	(0.09)	0.15	NM	NM	1.6%	1.9x
NORTHWEST PIPE	NWPX	Dec.	NR			\$20.26	\$40.47	\$18.33	\$ 187	\$ 440	0.47	1.30	1.6	15.6x	12.7x	0.0%	1.3x
PALL	PLL	Jul.	NR			\$37.25	\$41.82	\$24.85	\$ 4,396	\$ 2,329	1.77	2.19	2.19	17.0x	17.0x	1.7%	3.2x
SMITH (A.O.)	AOS	Dec.	NR			\$49.24	\$56.64	\$30.02	\$ 1,505	\$ 1,991	2.85	3.54	3.91	13.9x	12.6x	1.6%	1.7x
Average													16.5x	14.1x	0.9%	2.0x	
WATER RESOURCES/ INFRASTRUCTURE																	
INSITUFORM TECH	INSU	Dec.	NR			\$22.52	\$28.38	\$15.10	\$ 860	\$ 727	1.04	1.47	1.72	14.9x	12.7x	0.0%	1.6x
LINDSAY	LNN	Aug.	NR			\$36.29	\$47.45	\$29.71	\$ 449	\$ 336	1.11	1.27	1.74	23.4x	22.1x	0.9%	2.5x
TETRA TECH	TTEK	Sept.	NR			\$21.40	\$32.00	\$19.51	\$ 1,334	\$ 2,287	1.22	1.17	1.37	18.8x	16.1x	0.0%	2.5x
Average													17.4x	15.8x	0.8%	2.3x	

Relevant Indices

		Share Price
Dow Jones Industrials	DJ30	\$10,390.00
S&P 500	SPX	\$1,110.25
Nasdaq Composite	NDX	\$1,912.50

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	125	56.8%
Sell	0	0.0%

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