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Industry: **WATER INFRASTRUCTURE**

## Coverage:

<b>Ticker</b>	<b>Rating</b>	<b>Price</b>
AWK	BUY	\$24.72
AWR	NEUTRAL	\$34.65
CWT	NEUTRAL	\$37.63
PNR	BUY	\$35.50
WTR	NEUTRAL	\$21.59
WTS	NEUTRAL	\$35.10

## The Water Rundown

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



**END MARKET & INDUSTRY UPDATES**

**Columbia Opens Doors to Private Sector Water Finance –**

The Columbia minister for the environment, housing and development, Beatriz Uribe, has announced that she is open to local and international investors playing a far greater role in financing the country's water and wastewater infrastructure. In a recent speech she called out to private investors to supplement lackluster government funding in the sector, and went on to suggest that one way to attract private capital is through the issuance of bonds, rather than public-private partnerships or design, build, operate contracts. The proceeds of the bonds would be used exclusively to finance water and sanitation projects. Columbia has issued such bonds in the past, but never on a large scale and rarely to international investors. Earlier this year a group of Columbian communities banded together to issue \$92M of peso-denominated bonds to domestic investors on the Columbian stock exchange. The capital raise allowed small and medium-sized municipalities to access long-dated funds at competitive rates to finance local water and wastewater projects.

*Source: Global Water Intelligence*

**Opportunities Plentiful in the Chinese Water Market –**

Considerable opportunities are obtainable for international water treatment firms in China, according to a recent study by Lux Research, an emerging markets research firm. The group notes that the country's rapid growth in recent years has come at the cost of widespread water pollution. Indeed, in many regions of the country, entire watersheds are worthless, even for industrial use. That said, China's business culture and convoluted regulations have made entering the market a difficult process. The researchers found that companies familiar with the Chinese water treatment market often lack staying power due to a lack of product innovation, product offerings and a lack of complimentary service offerings. The report also noted that the political landscape in China is slowly shifting toward favoring water infrastructure market participants. Specifically, the group noted that the central government recently abandoned trivial fines for illegal waste discharge and began to enforce industry compliance by charging factory executives with the same laws used to prosecute terrorists who poison water supplies, with the most serious cases being punishable by death. The report also noted that most Western businesses operating in China have focused on the high end industrial market, with most ignoring the residential and commercial markets. That being said, the industrial market is indeed the largest sector of the water infrastructure market in China and is able to support a number of international players.

*Source: Water World*

*LBR Note: PNR (BUY, \$39PT) remains focused on expanding its presence in Asia. Limited investment in the last decade, coupled with increasing demand and greater per capita income, suggests that there is indeed a high level of pent-up demand in the region. Most notable is that PNR is focused on expanding its presence in the industrial, commercial and residential market in China. As the article hinted, most market participants have focused solely on the industrial market, thereby allowing PNR to establish a greater foothold in the country's growing water market as a whole. We note that China accounts for less than 3% of overall sales (or \$90M), and is expected to increase to 6% of total sales by 2014 through new product offerings and deeper channel penetration. The company recently noted that just one point of market share gain in APAC would result in 12-15% of segment growth, or \$50M.*

**Build American Bonds Left Out of Deal to Extend Bush-Era Tax Cuts –**

An extension of the Build America Bond (BAB) program was excluded from a compromise that President Obama reached with lawmakers to extend the Bush-era tax cuts, according to White House officials. BABs are taxable municipal bonds that offer special tax credits that reduce the cost of borrowing for state and local government issuers. Under the terms of the program, the federal government pays 35% of the interest on the debt. The BAB program is set to expire at the end of the year after more than \$179B of the taxable securities have been sold since April 2009, making it the fastest-growing segment of the \$2.8T municipal bond market. The bonds were used primarily to fund water/wastewater and transportation infrastructure projects, with California alone borrowing a staggering \$37.2B under the program. With the Dec. 31 program expiration approaching, states and municipalities are expected to sell more than \$3B of the bonds next week. Just last week Chicago issued \$600M in BAB secures to help finance a \$2.7 billion, five-year rehabilitation of sewer lines.

*Source: Bloomberg*



## WATER UTILITIES UPDATES

**Aqua America Announces Acquisitions** – WTR (N) announced that its Texas subsidiary has acquired the water system assets of Pecan Utilities Co. in Llano County, and the water system assets of Cavern Springs Water Company in Burnet County in a single transaction valued at \$394,000. The two systems serve a combined 600 residents. The Cavern Springs system includes two 45-acre tracts of land that can be built-out into between 80 and 200 residential units. Pecan is an established subdivision, which still contains about 30-to-40 additional lots for development. The company also announced that its New Jersey subsidiary has acquired the Wallkill Water and Wallkill Sewer Company, each of which serves about 1,200 people in Hardyston Township, Sussex County. The company paid a combined \$600,000 for the acquired assets in New Jersey.

WTR CEO Nicholas DeBenedictis reiterated his continued interest in expanding the company's presence in high-growth markets like Texas. He noted that Texas is one of the company's fastest growing states – through the first nine months of the year customer growth in Texas increased approximately 2% y/y, with the majority of the growth coming from acquisitions. The New Jersey subsidiary experienced customer growth of 1% y/y during the same nine month period.

## WATER INFRASTRUCTURE UPDATES

**CH2M Hill Announces Project Win** – CH2M Hill (private), a global provider of engineering, construction, and operations services, announced that it has won the competitively bid contract to design, build and operate (DBO) a new 32MGD water reclamation plant serving the city of Tucson, Arizona. The new plant will be built at a cost of \$172M and will replace the ageing Roge Road Water Reclamation Facility. The contract will run for 15 years with a five-year extension.

*Source: Global Water Intelligence*

**LG Expands Water Market Presence with MBR Process (LG, NR)** – LG electronics launched its first wastewater treatment solution – the Green Membrane Bioreactor (G-MBR) process – just two months after formally announcing its entrance into the water treatment industry. The company said its MBR process requires 34% less space than comparable MBR systems. Just two months ago the company announced that it would invest \$400M over the next decade in order to expand its footprint in the water treatment market and would use the funds to develop advanced membrane filtration systems. The company expects to generate \$7B in revenues by 2020 and in the process become a top 10 global water treatment technology provider.

*Source: Global Water Intelligence*

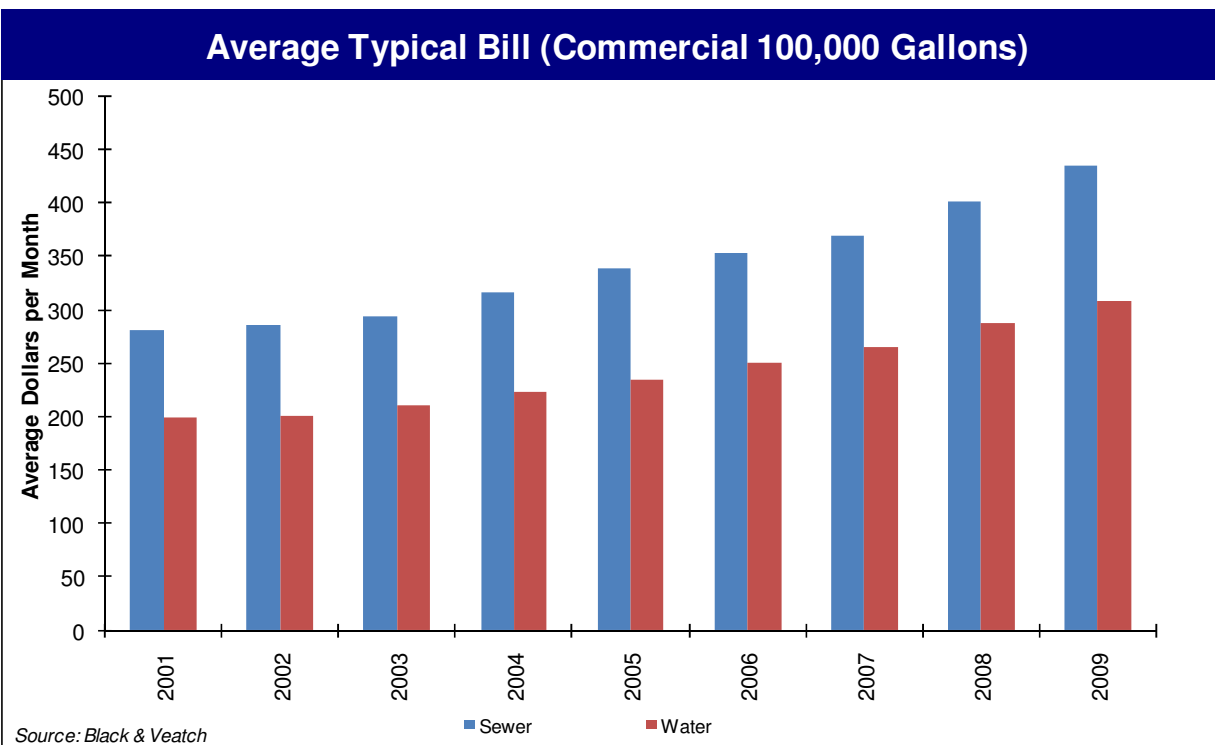
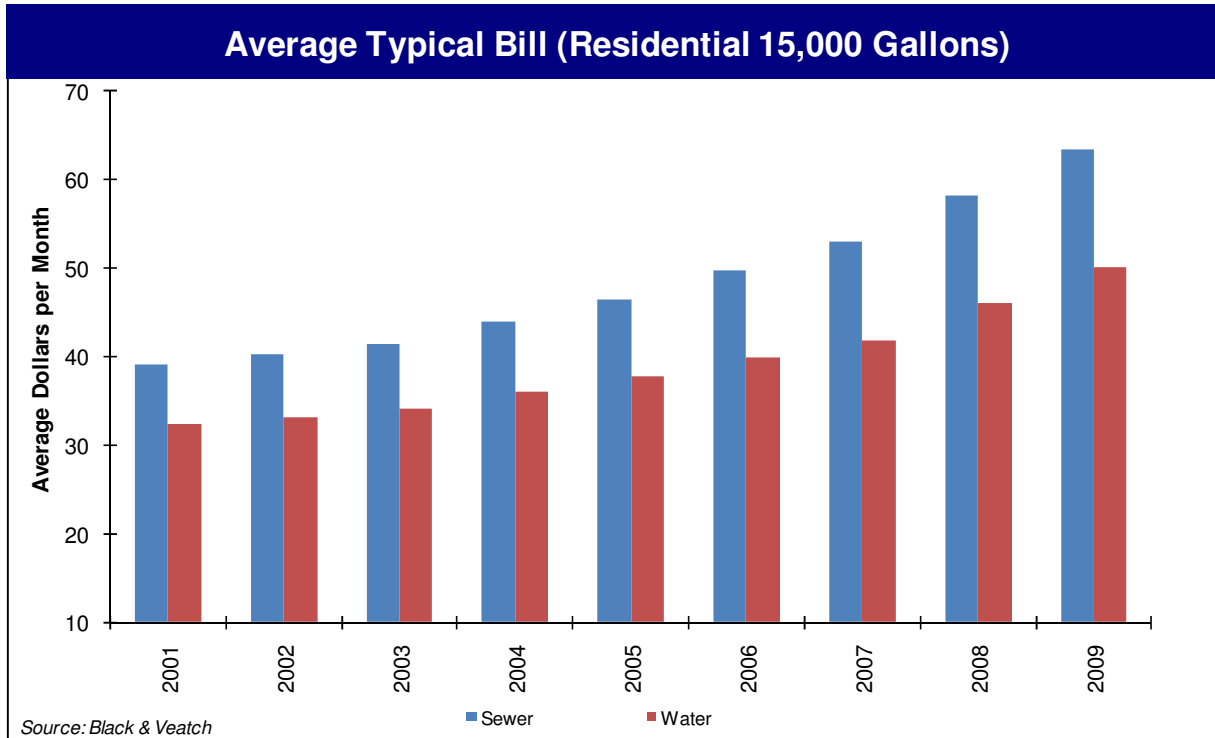
**Layne Christensen Announces Earnings (LAYN, NR)** – LAYN, a drilling and construction service provider, announced 3Q10 EPS of \$0.42 vs. consensus expectations of \$0.30, an increase of 24% y/y. Net income expanded in large part due to lower energy production costs and higher revenues. Revenues increased 24% to \$270M for the quarter. Revenues in the company's water infrastructure division increased 20% to \$210M, due in large part to sales from operations it bought a year earlier and specialty water well drilling in Afghanistan. The backlog for the water infrastructure division was \$625M compared to \$540M during the comparable period last year. Mineral exploration revenues jumped 68% to \$52M, while sales in the energy division decreased 58% y/y as a result of lower natural gas prices and the expiration of favorably priced forward sales contracts. Cost of goods sold increased 30% y/y to 77.7% of total revenues (+340bps y/y), due predominantly to an unusually low cost structure for the water infrastructure division last year.

**Mueller Water Union Members Reject Bargaining Agreement (MWA, NR)** – MWA announced that union members at the company's U.S. Pipe facility in Alabama and its Marvel City mini-mill facility have rejected proposed collective bargaining agreements proposed by the company. The previous collective bargaining agreement between the company and the union expired on October 21, 2010, but the members of the union continued working under extensions of the agreement. On December 5, 2010, the workers commenced an economic strike at the two facilities. The company reports that negotiations with the union are ongoing.

**Itron Announces Acquisition (ITRI, NR)** – ITRI, an electric-grid technology provider, announced that it has acquired French energy information management software company Asais. Asais develops energy information management and smart grid software, along with providing a variety of data services. ITRI has worked close with the company over the last four years on smart electric grid projects in Europe, Africa and elsewhere. Financial details of the deal were not disclosed and the sale is expected to close in 1Q11.

**Sumitomo Eyes Entrance into Indian Water Sector** – Sumitomo, a conglomerate, announced that it has entered into a strategic alliance with VA Tech Wabag to secure a foothold in the fast-growing Indian water market. The agreement will provide Wabag with access to Sumitomo's fund-raising abilities. The announcement comes following a recent announcement by the company that it will invest \$616M in the Chinese water market over the next three years. Sumitomo holds stakes in a number of water companies in Mexico and the Middle East.

*Source: Global Water Intelligence*





**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			\$34.65	\$39.61	\$31.20	\$ 644	\$ 361	1.62	1.78	2.15	19.5x	16.1x	3.0%	1.8x
AMERICAN WATER WORKS	AWK	Dec.	BUY	\$29	17%	\$24.72	\$25.21	\$19.41	\$ 4,323	\$ 2,841	1.25	1.55	1.70	15.9x	14.5x	3.6%	1.0x
AQUA AMERICA	WTR	Dec.	Neutral			\$21.59	\$21.97	\$16.45	\$ 2,963	\$ 671	0.77	0.92	1.00	23.4x	21.6x	2.9%	2.2x
CALIFORNIA WATER	CWT	Dec.	Neutral			\$37.63	\$39.70	\$33.81	\$ 784	\$ 449	1.95	1.91	2.20	19.7x	17.1x	3.2%	1.8x
ARTESIAN RESOURCES	ARTNA	Dec.	NR			\$18.98	\$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			\$26.36	\$26.44	\$20.00	\$ 228	\$ 59	1.19	1.2	1.19	22.0x	22.2x	3.5%	2.0x
MIDDLESEX WATER	MSEX	Dec.	NR			\$18.58	\$18.70	\$14.74	\$ 289	\$ 91	0.72	0.94	0.93	19.8x	20.0x	3.9%	1.7x
PENNICHUCK	PNNW	Dec.	NR			\$27.38	\$28.39	\$19.00	\$ 128	\$ 33	0.55	0.84	0.95	32.6x	28.8x	2.7%	1.8x
SIW	SIW	Dec.	NR			\$26.44	\$28.24	\$21.50	\$ 490	\$ 216	0.81	0.96	1.06	27.5x	24.9x	2.6%	1.7x
YORK WATER CO (THE)	YORW	Dec.	NR			\$17.62	\$17.59	\$12.83	\$ 223	\$ 37	0.64	0.7	0.75	25.2x	23.5x	3.0%	2.1x
<b>Average</b>														22.4x	20.6x	3.2%	1.7x
<b>EQUIPMENT/ FILTRATION/ TREATMENT SECTOR</b>																	
PENTAIR	PNR	Dec.	BUY	\$39	10%	\$35.50	\$39.32	\$29.41	\$ 3,504	\$ 2,692	1.47	1.96	2.28	18.1x	15.5x	2.1%	1.6x
WATTS WATER TECH	WTS	Dec.	Neutral			\$35.10	\$37.00	\$27.51	\$ 1,295	\$ 1,234	1.54	1.92	2.23	18.3x	15.8x	1.3%	1.3x
AMERON INT'L	AMN	Nov.	NR			\$79.96	\$79.98	\$54.90	\$ 740	\$ 547	3.05	2.90	3.84	27.6x	20.8x	1.5%	1.1x
BADGER METER	BMI	Dec.	NR			\$44.28	\$44.71	\$32.58	\$ 665	\$ 250	1.80	1.91	2.08	23.2x	21.3x	1.3%	4.1x
CALGON CARBON	CCC	Dec.	NR			\$15.47	\$18.35	\$11.75	\$ 869	\$ 412	0.69	0.68	0.86	22.8x	18.0x	0.0%	2.5x
ENERGY RECOVERY	ERII	Dec.	NR			\$3.94	\$7.28	\$3.08	\$ 207	\$ 47	0.07	(0.08)	-	NM	NM	0.0%	2.9x
FRANKLIN ELECTRIC	FELE	Jan.	NR			\$39.50	\$41.37	\$24.93	\$ 918	\$ 626	1.29	1.86	2.25	21.2x	17.6x	1.3%	1.7x
GORMAN-RUPP	GRC	Dec.	NR			\$33.97	\$33.44	\$22.81	\$ 570	\$ 266	1.15	1.34	1.6	25.4x	21.2x	1.2%	2.6x
ITRON	ITRI	Dec.	NR			\$55.89	\$81.95	\$52.03	\$ 2,257	\$ 1,687	2.09	4.02	4.33	13.9x	12.9x	0.0%	1.9x
LAYNE CHRISTENSEN	LAYN	Jan.	NR			\$34.17	\$36.92	\$22.97	\$ 669	\$ 866	0.81	1.42	1.67	24.1x	20.5x	0.0%	1.1x
MUELLER WATER PRODUC	MWA	Sept.	NR			\$4.01	\$5.99	\$2.21	\$ 620	\$ 1,338	-0.29	(0.17)	0.15	NM	NM	1.7%	1.2x
NORTHWEST PIPE	NWPX	Dec.	NR			\$23.13	\$31.46	\$14.62	\$ 215	\$ 283	-0.26	0.12	0.73	192.8x	31.7x	0.0%	1.0x
PALL	PLL	Jul.	NR			\$50.00	\$48.81	\$31.84	\$ 5,833	\$ 2,402	1.77	2.45	2.45	20.4x	20.4x	1.3%	3.7x
SMITH (A.O.)	AOS	Dec.	NR			\$43.07	\$42.89	\$27.39	\$ 1,972	\$ 1,991	1.90	2.70	2.94	16.0x	14.6x	1.3%	1.7x
<b>Average</b>														44.8x	19.8x	0.8%	2.0x
<b>WATER RESOURCES/ INFRASTRUCTURE</b>																	
INSITUFORM TECH	INSU	Dec.	NR			\$26.33	\$28.38	\$18.52	\$ 1,033	\$ 727	1.04	1.52	1.77	17.3x	14.9x	0.0%	1.6x
LINDSAY	LNN	Aug.	NR			\$66.16	\$67.35	\$30.80	\$ 826	\$ 358	1.11	1.79	2.19	36.2x	29.4x	0.5%	2.0x
TETRA TECH	TTEK	Sept.	NR			\$25.26	\$28.18	\$18.00	\$ 1,560	\$ 2,201	1.22	1.25	1.43	20.7x	18.3x	0.0%	1.7x
<b>Average</b>														25.9x	19.6x	0.6%	2.1x
<b>Relevant Indices</b>						<b>Share Price</b>											
Dow Jones Industrials						DJ30											
S&P 500						\$1,410											
Nasdaq Composite						SPX											
						\$1,240											
						NDX											
						\$2,215											

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	144	62.3%
Sell	3	1.3%

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"Buy" means that Longbow Securities expects total return to exceed 20% over a 12-month



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period.

“Neutral” means that Longbow Securities expects total return to be within a range of plus or minus 20% over a 12-month period.

“Sell” means that Longbow Securities expects total return to be negative by greater than 20% over a 12-month period.

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