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Industry: **WATER INFRASTRUCTURE**

Coverage:

Ticker	Rating	Price
AWK	BUY	\$24.25
AWR	NEUTRAL	\$36.85
CWT	NEUTRAL	\$36.66
PNR	BUY	\$32.53
WTR	NEUTRAL	\$21.05
WTS	NEUTRAL	\$33.29

The Water Rundown

Industry Updates

- Chances of Prolonged La Niña more than 50%
- Study Reveals Full Extent of Global Water Stress
- Asian Investment in Wastewater Infrastructure to Benefit Flow and Filtration Equipment Suppliers

Water Utilities Updates

- WTR Closes Debt Offering
- Commission Approves AWR Rate Case
- CWT Issues Debt

Water Infrastructure Updates

- LAYN Announces Acquisition
- ITT Completes Acquisition
- AOS Enters into Credit Agreement
- VE Likely to Keep 2010 Dividend Unchanged

Industry Data and Graphs

- Pump Market in Africa
- Pump Market in Americas

IMPORTANT DISCLOSURES ARE LOCATED IN THE APPENDIX.



END MARKET & INDUSTRY UPDATES

Chances of Prolonged La Niña more than 50% – La Niña, which occurs when there is a prolonged period of cooling of the sea surface in the Central Pacific Ocean, is expected to impact California for another year, or even possibly longer, according to meteorologists. The current La Niña is believed to be one of the strongest on record, which gives further credence to its staying power. If La Niña does indeed last through 2011 experts agree that it may result in prolonged water shortages for Southern California. In a typical La Niña, the Pacific Northwest is wetter than normal, while Southern California stays dry. This is concerning as the historically wet months of December, January and February in California, when 50% of the state's precipitation falls, is when the state's river basins, which are used to feed the region's water supply, are filled. Presently, pumping restrictions implemented by the DWR in the Sacramento-San Joaquin Delta continue to make it difficult to ship water from the north to Southern California, which imports the vast majority of the water it consumes. Though Southern California has not received its full allotment of water from the state since 2006, no reductions on water deliveries from the Colorado River basin are expected this year. Nevertheless, the biggest risks to water supplies remains a prolonged drought period caused by La Niña, which would result in depleted groundwater supplies.

Source: San Diego Union-Tribune

LBR Note: The Metropolitan Water District of Southern California recently approved an allocation plan that continues its original plan of water supply reductions to member agencies, including CWT and AWR, for a second year. The plan seeks to achieve a 10% reduction in deliveries and imposes penalty charges on those member agencies that do not reduce their deliveries by the required amount. These actions have improved the MWD's storage level forecast for the year and the group is considering ending the allocation program at its December board meeting. We note that WRAM decouples water sales from revenues in California and also encourages those public companies in the state to promote water conservation without taking a hit to earnings, which is necessary because of frequent droughts and increasing water shortages in California.

Study Reveals Full Extent of Global Water Stress – Large areas within Australia, China, India and the U.S. are highlighted in a recent study as suffering from extreme pressures on their renewable water supplies. The Water Stress Index, developed by global risks advisory firm Maplecroft, is calculated by evaluating the ratio of a country's total water use (domestic, industrial, and agricultural) vs. the renewable supply of water from various sources. The Index identified Egypt (1), Kuwait (2), UAE (3), Libya (4) and Saudi Arabia (5) as facing the greatest exposure to water risk.

Middle Eastern and North Africa countries receive just 1% of the world's precipitation, 85% of which is lost through evaporation. Other notable countries rated as "high risk" include Australia (19), India (29), China (40) and the USA (51). Maplecroft argues that expanding populations, most evident in India, along with rising global temperatures will only further exacerbate the problem, which may result in considerable challenges for governments, businesses and society as a whole. The study notes that in India and China higher water demand is driven by a growing population and rising industrial and agricultural use. The UN's estimates that industrial water withdrawal in India is growing at 8.9% annually, while municipal water withdrawal in China is growing 10.4% annually. In the US, there is a wide range of stress levels based on the region. The Great Plains and southwest regions are believed to be at the highest risk due to farming and low precipitation. Along the West Coast, groundwater is being consumed faster than it is being replenished, leading to steadily declining groundwater tables.

Source: Water Tech Online

Asian Investment in Wastewater Infrastructure to Benefit Flow and Filtration Equipment Suppliers – The growth of sewage transport and treatment is creating market opportunities for manufactures of pumps, valves, scrubbers, chemicals, controls, and filters, according to a study by the McMellvaine Company, a research firm. The study found that the amount of the world's wastewater that will be collected and transported will expand by 27,000MGD from 2010 to 2015. Meanwhile, secondary market treatment capacity will expand to 160,000MDG in that time, an increase of 15,000MGD from present levels. At that time, the Middle East will account for 23% of the secondary treatment market and Asia will account for 33% of the total. As a result, the group estimates that the municipal wastewater valve market will grow to \$4.4B in 2015, while the pump market will expand to \$8.8B. Total macrofiltration revenues, or simply sales of filtration products for municipal wastewater applications, is expected to reach \$1.2B in 2015. Municipal wastewater plants are expected to spend \$4.5B for treatment chemicals globally in 2015, of which \$1.3B will be spent on inorganic coagulants, while \$1.8B will be spent on organic flocculants. The researchers believe that the Middle East countries will be leaders in terms of percentage gains, while China will be the leader in terms of quantitative gains.

Source: Impeller

LBR Note: PNR (BUY, \$39TP) remains focused on expanding its presence in the Asia and the Middle East. 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. China, in particular, 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.

WATER UTILITIES UPDATES

Aqua America Closes Debt Offering (WTR, N) – WTR announced that its Pennsylvania Subsidiary closed on \$141.4M of first mortgage bonds issued to the Pennsylvania Economic Development Financing Authority (PEDFA). The bonds were issued in two series: The \$42.5M 2010 Series A was priced at a 5% coupon with a 23-year maturity, while the \$96.2M 2010 Series B was priced at a 4.92% with a 32-year maturity. The proceeds of the bonds will be used to finance part of the company's \$1.5B multi-year capital plan to enhance delivery infrastructure systems in the state, most of which will be funded by internally generated cash and retained earnings. The proceeds will also be used to refinance \$44M of existing debt priced at 6%.

Commission Approves AWR Rate Case – The CPUC last week approved Commissioner Bohn's revised alternate decision on the company's Region 2/3/General Office rate case. The decision was in line with expectations and will raise rates \$31M. The company estimates regulatory lag impacted FY10 EPS by \$0.12/share.

California Water Issues Debt (CWT, N) – CWT announced that it intends to sell \$100M of first mortgage bonds priced at 5.50% that are set to mature in 2040. The bonds will be secured by a lien on substantially all of CWT's properties. The offering is expected to close on November 22, 2010. The company plans to use a portion of the proceeds to pay down outstanding short-term borrowings. CWT intends to use the remainder of the net proceeds for general corporate purposes, including capital projects.

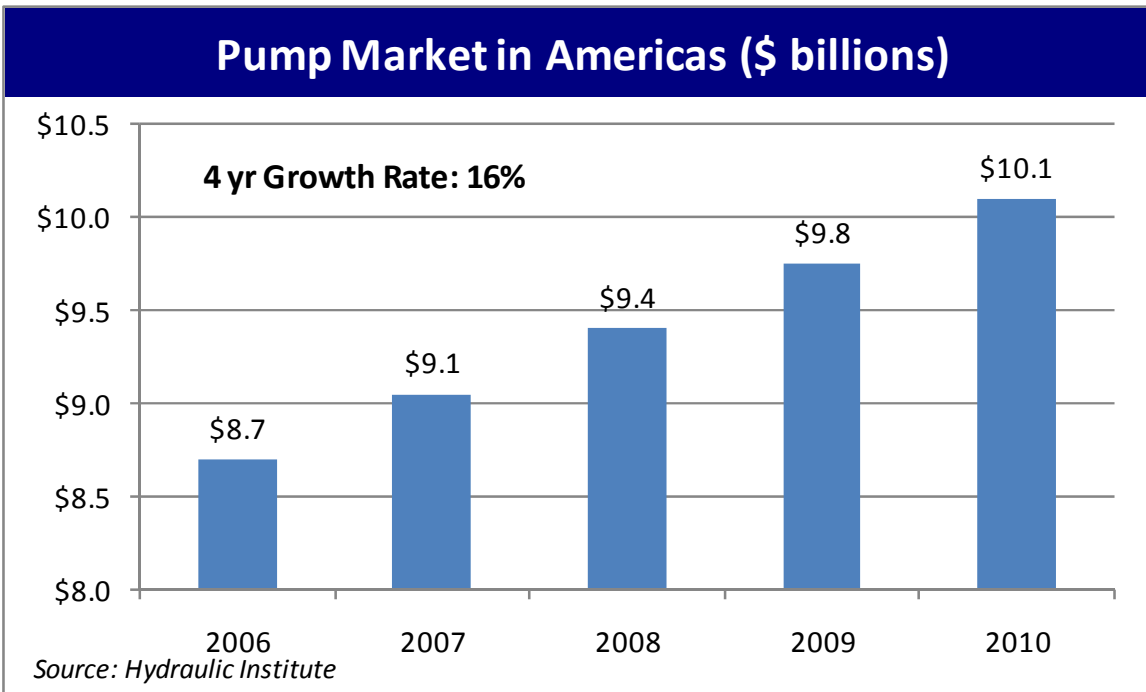
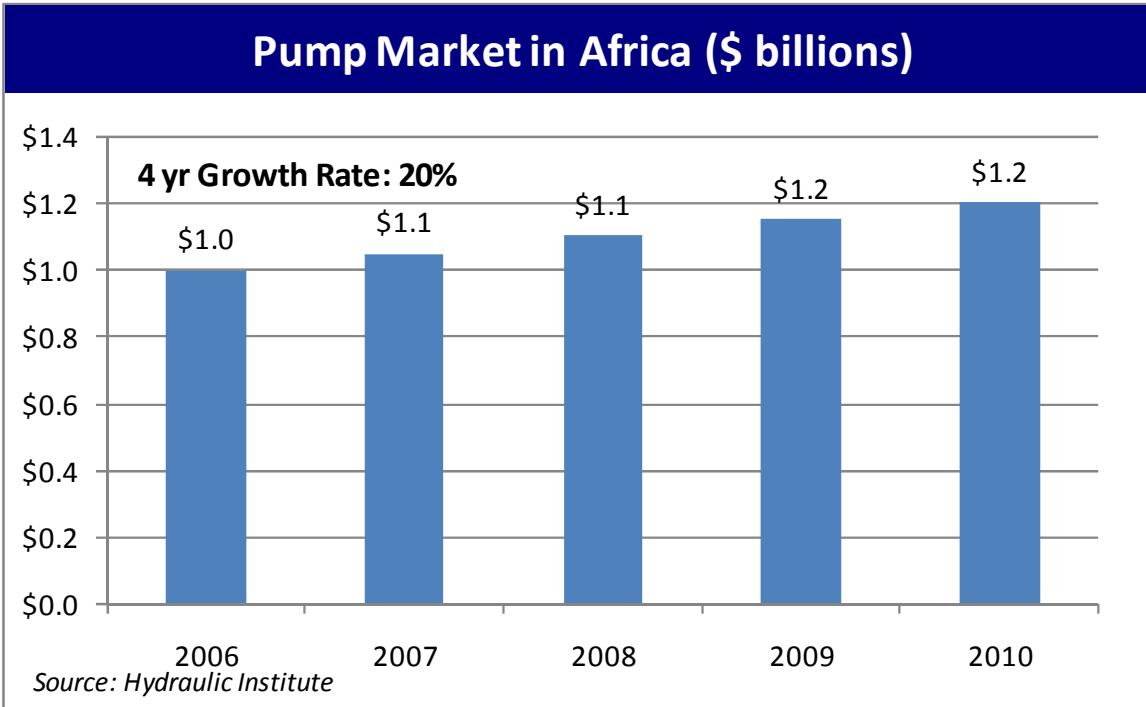
WATER INFRASTRUCTURE UPDATES

Layne Christensen Announces Acquisition (LAYN, NR) – LAYN announced that it has acquired the Bencor Corporation of America, one of North America's leading contractors in foundation and underground engineering. The company specifically focuses on deep foundations for dams & levees, and earth support systems for high-rise structures, subway lines and stations and depressed highway. The company, which has 100 employees in the U.S., has performed work in the U.S., Canada, South America, Europe and North Africa. The purchase price was \$32.1M and LAYN management now projects first year revenues and earnings per share of approximately \$50M and \$0.20-0.25/share, respectively, after purchase accounting adjustments.

ITT Completes Acquisition (ITT, NR) – ITT announced that it has completed its previously announced acquisition of O.I. Corporation for ~\$29M. OI is a provider of instruments for laboratory and environmental testing in the pharmaceutical, petrochemical, power and industrial markets. The company believes the acquisition will improve its Analytics business, which was strengthened by its acquisition of Nova Analytics earlier this year. OI specializes in total organic carbon (TOC) analyzers and gas-chromatography related instrumentation and recorded revenues of \$20M in 2009.

AO Smith Enters into Credit Agreement (AOS, NR) – AOS announced that it has entered into a credit agreement that replaces its existing \$425M revolving credit facility. The new revolver matures on November 12, 2013. The initial maximum amount of availability under the revolving credit facility is \$425M, of which ~\$201M was drawn as of November 12, 2010. The company has the option to increase its maximum availability under the revolver to \$525M if certain conditions are satisfied.

Veolia Likely to Keep 2010 Dividend Unchanged (VE, NR) – VE's CFO announced that he has "all reason to believe" that the company will propose to keep its 2010 dividend unchanged from present levels. The dividend was €1.21/share for 2007-2009.



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			\$36.85	\$39.61	\$31.20	\$ 685	\$ 361	1.62	1.94	2.15	19.0x	17.2x	2.8%	1.8x
AMERICAN WATER WORKS	AWK	Dec.	BUY	\$29	20%	\$24.25	\$24.93	\$19.41	\$ 4,241	\$ 2,841	1.25	1.55	1.70	15.6x	14.2x	3.6%	1.0x
AQUA AMERICA	WTR	Dec.	Neutral			\$21.05	\$21.97	\$15.78	\$ 2,889	\$ 671	0.77	0.92	1.00	22.8x	21.1x	2.9%	2.2x
CALIFORNIA WATER	CWT	Dec.	Neutral			\$36.66	\$39.70	\$33.81	\$ 764	\$ 449	1.95	1.91	2.20	19.2x	16.7x	3.2%	1.8x
ARTESIAN RESOURCES	ARTNA	Dec.	NR			\$18.84	\$19.59	\$16.42	\$ 142	\$ 61	0.97	1.04	1.09	18.1x	17.3x	4.0%	1.5x
CONNECTICUT WATER	CTWS	Dec.	NR			\$25.16	\$26.44	\$20.00	\$ 217	\$ 59	1.19	1.15	1.14	21.9x	22.1x	3.7%	2.0x
MIDDLESEX WATER	MSEX	Dec.	NR			\$17.92	\$18.70	\$14.74	\$ 279	\$ 91	0.72	0.94	0.93	19.1x	19.3x	4.1%	1.7x
PENNICHUCK	PNNW	Dec.	NR			\$27.45	\$28.39	\$19.00	\$ 128	\$ 33	0.55	0.83	0.94	33.1x	29.2x	2.7%	1.8x
SIW	SIW	Dec.	NR			\$24.87	\$28.24	\$20.95	\$ 461	\$ 216	0.81	1	1.03	24.9x	24.1x	2.7%	1.7x
YORK WATER CO (THE)	YORW	Dec.	NR			\$16.15	\$16.76	\$12.83	\$ 205	\$ 37	0.64	0.7	0.75	23.1x	21.5x	3.2%	2.1x
Average														21.7x	20.3x	3.3%	1.7x
EQUIPMENT/ FILTRATION/ TREATMENT SECTOR																	
PENTAIR	PNR	Dec.	BUY	\$39	20%	\$32.53	\$39.32	\$29.41	\$ 3,211	\$ 2,692	1.47	1.96	2.28	16.6x	14.2x	2.3%	1.6x
WATTS WATER TECH	WTS	Dec.	Neutral			\$33.29	\$37.00	\$27.51	\$ 1,228	\$ 1,234	1.54	1.92	2.23	17.4x	14.9x	1.3%	1.3x
AMERON INT'L	AMN	Nov.	NR			\$67.67	\$76.79	\$54.27	\$ 626	\$ 547	3.05	3.12	4.18	21.7x	16.2x	1.8%	1.1x
BADGER METER	BMI	Dec.	NR			\$42.27	\$44.71	\$32.58	\$ 635	\$ 250	1.80	1.91	2.08	22.1x	20.3x	1.3%	4.1x
CALGON CARBON	CCC	Dec.	NR			\$14.52	\$18.35	\$11.75	\$ 816	\$ 412	0.69	0.68	0.87	21.4x	16.7x	0.0%	2.5x
ENERGY RECOVERY	ERII	Dec.	NR			\$3.60	\$7.28	\$3.08	\$ 189	\$ 47	0.07	(0.08)	-	NM	NM	0.0%	2.9x
FRANKLIN ELECTRIC	FELE	Jan.	NR			\$38.41	\$38.27	\$24.93	\$ 892	\$ 626	1.29	1.86	2.25	20.7x	17.1x	1.4%	1.7x
GORMAN-RUPP	GRC	Dec.	NR			\$30.09	\$31.91	\$22.81	\$ 505	\$ 266	1.15	1.34	1.6	22.5x	18.8x	1.4%	2.6x
ITRON	ITRI	Dec.	NR			\$58.00	\$81.95	\$52.05	\$ 2,342	\$ 1,687	2.09	4.03	4.33	14.4x	13.4x	0.0%	1.9x
LAYNE CHRISTENSEN	LAYN	Jan.	NR			\$31.99	\$31.25	\$22.97	\$ 624	\$ 866	0.81	1.23	1.56	26.0x	20.5x	0.0%	1.1x
MUELLER WATER PRODUC	MWA	Sept.	NR			\$3.49	\$5.99	\$2.21	\$ 539	\$ 1,338	-0.29	(0.17)	0.15	NM	NM	2.0%	1.9x
NORTHWEST PIPE	NWPX	Dec.	NR			\$21.43	\$31.46	\$14.62	\$ 199	\$ 283	-0.26	0.64	0.92	33.5x	23.3x	0.0%	1.3x
PALL	PLL	Jul.	NR			\$45.13	\$44.78	\$31.06	\$ 5,265	\$ 2,402	1.77	2.33	2.33	19.4x	19.4x	1.4%	3.7x
SMITH (A.O.)	AOS	Dec.	NR			\$37.55	\$40.24	\$27.37	\$ 1,719	\$ 1,991	1.90	2.70	2.94	13.9x	12.8x	1.5%	1.7x
Average														21.5x	17.9x	0.9%	2.1x
WATER RESOURCES/ INFRASTRUCTURE																	
INSITUFORM TECH	INSU	Dec.	NR			\$22.95	\$28.38	\$18.52	\$ 900	\$ 727	1.04	1.52	1.77	15.1x	13.0x	0.0%	1.6x
LINDSAY	LNN	Aug.	NR			\$58.77	\$66.48	\$30.80	\$ 734	\$ 358	1.11	1.80	2.13	32.1x	26.7x	0.6%	2.5x
TETRA TECH	TTEK	Sept.	NR			\$22.88	\$28.18	\$18.00	\$ 1,413	\$ 2,201	1.22	1.25	1.43	18.8x	16.6x	0.0%	2.5x
Average														20.1x	17.7x	0.7%	2.4x
Relevant Indices						Share Price											
Dow Jones Industrials						DJ30		\$11,204									
S&P 500						SPX		\$1,200									
Nasdaq Composite						NDX		\$2,135									

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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