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Industry: **WATER INFRASTRUCTURE**

Coverage:

<b>Ticker</b>	<b>Rating</b>	<b>Price</b>
AWK	BUY	\$24.79
AWR	NEUTRAL	\$37.73
CWT	NEUTRAL	\$37.47
PNR	BUY	\$33.11
WTR	NEUTRAL	\$21.82
WTS	NEUTRAL	\$33.63

## The Water Rundown

### Industry Updates

- LRCA to Sell its Water and Wastewater Utilities
- Water Challenges with Chinese Urbanization
- Kuwait to Build \$1.8B Wastewater Treatment Plant
- Philippines to Promote Public-Private Partnerships
- Ireland's Austerity Plan to Affect Water Industry

### Water Utilities Updates

- Commissions Approves AWR Rate Case
- YORW Announces Dividend Increase

### Water Infrastructure Updates

- WTS Investigates Potential Foreign Bribery

### Industry Data and Graphs

- Y/Y Change in Water Supply and Sewage and Waste Disposal
- Water & Sewage Public Construction Spending vs. Highway Construction Spending

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



END MARKET & INDUSTRY UPDATES

**LRCA to Sell its Water and Wastewater Utilities** – The Lower Colorado River Authority (LRCA), a bulk water supplier, has decided to sell all of its 32 water and wastewater systems scattered across Central Texas. The systems, mostly retail, include water and wastewater systems in West Lake Hills and Travis counties, along with much smaller systems in Hill, Bastrop and Williamson counties. LRCA has invested some \$300M in the 32 systems since acquiring them in the 1990's, but with consolidated revenues of just \$36M annually, LRCA has been unable to keep up with the necessary operating costs. The group did not mention the asking price for the systems.

*Source: The Austin Statesman*

*LBR Note: Aqua Texas, a subsidiary of WTR, purchased the Harper Water System in Gillespie County and the London Water System in Kimble County from the LRCA in FY09 for \$300K, thus making the company a likely suitor for the other 32 systems currently up for sale, whether in whole or piecemeal. We note that WTR has completed 14 acquisitions YTD (2 in 3Q) and management expects to complete 25 acquisitions in FY10. Management's tone during the most recent conference call suggested that they were in final discussions with numerous water utilities. Overall, we expect 1.5-2.0% customer growth through acquisition over the next several years which may help offset declines in water usage due to conservation efforts.*

**Water Challenges with Chinese Urbanization** – 350M individuals will have moved to a major Chinese city between 2005 and 2025, while 216 Chinese cities will have a population greater than 1M by that time, according to a recent study by the McKinsey Global Institute. The increase coincides with estimates that the Chinese urban population will increase to 65% of the total population by 2030, from 46% last year and 18% in 1978. Meanwhile, the extension of tap water service has increased from just 36% of households in 1978 to 94% in 2008. The continued pace of urban sprawl, however, is heavily dependent upon the protection of drinking waters sources, according to a new report by the Worldwide Fund for Nature (WWF) and the Chinese Ministry of Water Resources. According to a World Bank report, of the nation's rivers that are monitored for water quality, just 28% are acceptable for human consumption, while 40-60% fall in the non-use category. In fact, more than 25% of water withdrawn for use in major cities did not meet the quality standard for drinking water in 2009, while 25% of cities and 70% of counties in China did not have sewage treatment facilities in 2010.

*Source: Circle of Blue*

*LBR Note: PNR (BUY, \$39PT) remains focused on expanding its presence in the 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. 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.*

**Kuwait to Build \$1.8B Wastewater Treatment Plant** – Kuwait plans to build a \$1.8B wastewater treatment plant to serve cities being constructed in the southern part of the country. Government officials expect the project to be completed by 2015, generally in line with when construction on the new cities is expected to be completed. The new plant is part of the government's public-private partnership (P3) program which began in 2008 and aims to allow private capital and expertise into industries normally operated by the government. Officials noted that a company will be selected to build the plant, with 50% of the shares being sold in an IPO, 40% being tendered to private stakeholders and the remaining 10% would be owned by the government. Construction is expected to begin sometime in 2011.

*Source: Bloomberg*

**Philippines to Promote Public-Private Partnerships** – The Philippines recently released its updated framework on public-private partnerships as the country seeks to promote a pipeline of over 100 infrastructure P3s in the coming years. The updated framework released by the government seeks to emphasize transparency, with a commitment to evaluate each proposal within six months. The first of many projects is expected to be the delayed Laiban dam and water treatment plant, which seeks to increase capacity by 1.83 m3/d of water to Manila. The city faces a shortfall of 1.6M m3/d by 2015.

*Source: Global Water Intelligence*

**Ireland's Austerity Plan to Affect Water Industry** – Ireland's new austerity plan calls for the implementation of domestic water charges and metering by 2014, which the government estimates will generate operational savings of up to €500M (\$661.95M) annually. This is an abrupt change of pace from previous policy as water supply and sanitation services were provided free of charge to domestic users since 1997. The majority of the costs of services provided were met by tax revenues transferred by the national government to local authorities. The new measure will bring to an end the concept of "free water" in Ireland. Indeed, the charges were created in an attempt to recover operating costs currently shouldered by local authorities, which thereby put a strain on the government as a whole.

*Source: Global Water Intelligence*



## WATER UTILITIES UPDATES

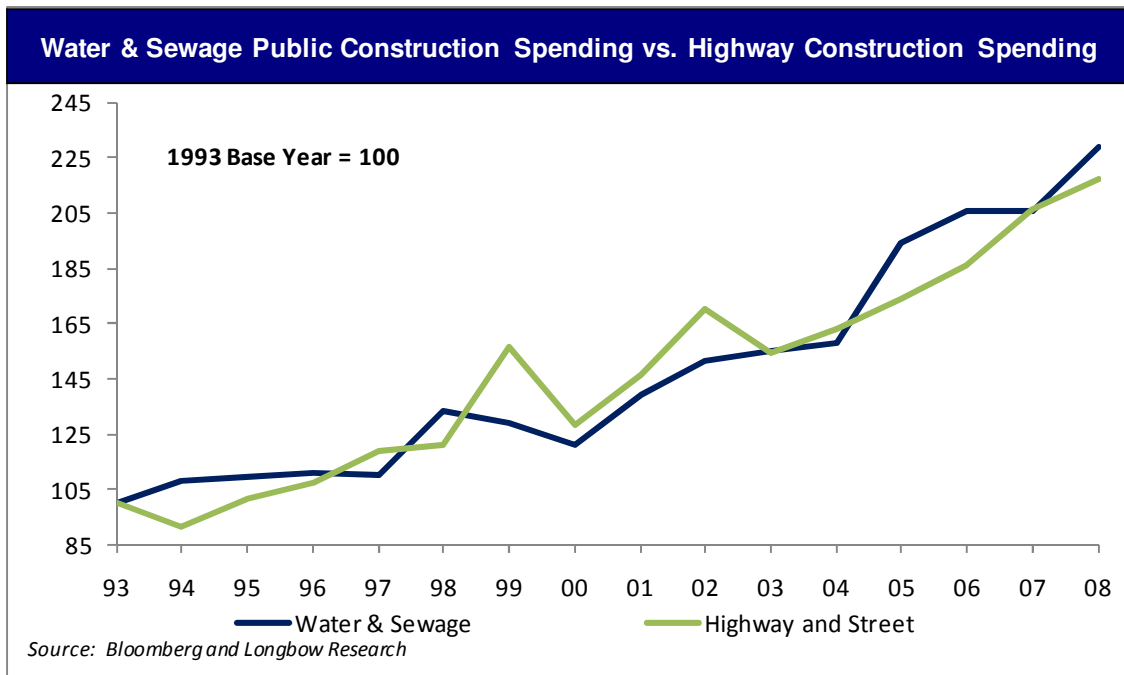
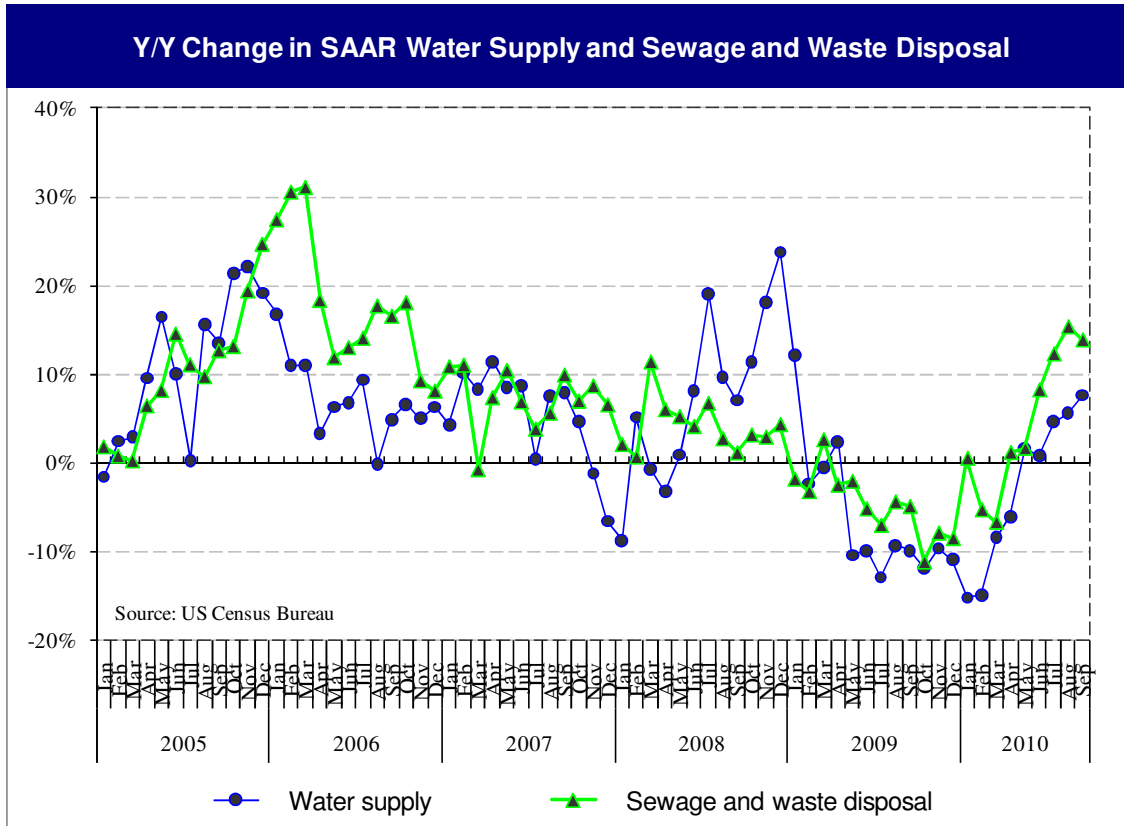
**Commission Approves AWR Rate Case (AWR, N)** – The California Public Utilities Commission (CPUC) recently approved Commissioner Bohn’s revised alternate decision on the company’s Regions II, II and General Office rate case. The ruling came in at \$32M (50% of the requested amount), which was expected as it was based largely off of the recommended proposed decision released in conjunction with the company’s 3Q10 results. The approved revenue increase totals \$32M, which includes an increase of \$14M for supply costs, and is retroactive to January 1, 2010. Management estimates regulatory lag had a (\$0.12) impact on 3Q10 and a (\$0.33/share) impact on YTD results (pretax). The amount will be recorded in 4Q10 and a surcharge will be implemented to recovery the retroactive revenues over eight quarters. As a reminder, the company intends to file a general rate case for all three water regions in July 2011 with rates effective January 2013.

As a part of the 2009 GRC, AWR requested a two-way balancing account to track fluctuation in the pension expense. The company’s request was approved and we believe this to be a positive as it will reduce the variability in EPS resulting from large swings in pension expenses.

**York Water Company (YORW, NR)** – YORW announced that its Board of Directors has approved an increase in the quarterly dividend from \$0.128/share to \$0.131/share, or 2.3%. The increase marks the 560<sup>th</sup> consecutive dividend to be paid by the company and is the 14<sup>th</sup> consecutive year that the Board has approved a dividend increase. YORW, the oldest investor owned utility in the U.S., has paid dividends for 194 consecutive years.

## WATER INFRASTRUCTURE UPDATES

**Watts Water Investigates Potential Foreign Bribery (WTS, N)** – WTS has announced that an investigation is being conducted over a possible breach of fiduciary duties by certain officers and directors of the company. WTS has thus far spent \$2.4M on the foreign bribery probe. The investigation is in regard to whether certain officers and directors breached their fiduciary duties and whether they can be held liable for possibly violating the U.S. Foreign Corrupt Practices Act (FCPA). The Act prohibits companies from making improper payments to foreign officials in an attempt to obtain or keep business. The investigation relates to information the company received in July 2009 that employees of Watts Valve Co. Ltd., at the time an indirect wholly-owned subsidiary that was sold in January 2010, made payments to employees of state-owned agencies. WTS believes such payments may have violated the FCPA.





**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			\$37.73	\$39.61	\$31.20	\$ 702	\$ 361	1.62	1.94	2.15	19.4x	17.6x	2.8%	1.8x
AMERICAN WATER WORKS	AWK	Dec.	BUY	\$29	17%	\$24.79	\$24.93	\$19.41	\$ 4,335	\$ 2,841	1.25	1.55	1.70	16.0x	14.6x	3.5%	1.0x
AQUA AMERICA	WTR	Dec.	Neutral			\$21.82	\$21.97	\$15.78	\$ 2,995	\$ 671	0.77	0.92	1.00	23.6x	21.9x	2.8%	2.2x
CALIFORNIA WATER	CWT	Dec.	Neutral			\$37.47	\$39.70	\$33.81	\$ 781	\$ 449	1.95	1.91	2.20	19.6x	17.1x	3.2%	1.8x
ARTESIAN RESOURCES	ARTNA	Dec.	NR			\$18.77	\$19.59	\$16.42	\$ 142	\$ 61	0.97	1.04	1.09	18.0x	17.2x	4.0%	1.5x
CONNECTICUT WATER	CTWS	Dec.	NR			\$25.19	\$26.44	\$20.00	\$ 218	\$ 59	1.19	1.15	1.14	21.9x	22.1x	3.7%	2.0x
MIDDLESEX WATER	MSEX	Dec.	NR			\$17.91	\$18.70	\$14.74	\$ 279	\$ 91	0.72	0.94	0.93	19.1x	19.3x	4.1%	1.7x
PENNICHUCK	PNNW	Dec.	NR			\$27.40	\$28.39	\$19.00	\$ 128	\$ 33	0.55	0.83	0.94	33.0x	29.1x	2.7%	1.8x
SIW	SIW	Dec.	NR			\$24.99	\$28.24	\$20.95	\$ 463	\$ 216	0.81	1	1.03	25.0x	24.3x	2.7%	1.7x
YORK WATER CO (THE)	YORW	Dec.	NR			\$16.13	\$16.76	\$12.83	\$ 204	\$ 37	0.64	0.7	0.75	23.0x	21.5x	3.2%	2.1x
<b>Average</b>														21.9x	20.5x	3.3%	1.7x
<b>EQUIPMENT/ FILTRATION/ TREATMENT SECTOR</b>																	
PENTAIR	PNR	Dec.	BUY	\$39	18%	\$33.11	\$39.32	\$29.41	\$ 3,268	\$ 2,692	1.47	1.96	2.28	16.9x	14.5x	2.3%	1.6x
WATTS WATER TECH	WTS	Dec.	Neutral			\$33.63	\$37.00	\$27.51	\$ 1,240	\$ 1,234	1.54	1.92	2.23	17.6x	15.1x	1.3%	1.3x
AMERON INT'L	AMN	Nov.	NR			\$69.18	\$76.79	\$54.27	\$ 640	\$ 547	3.05	3.12	4.18	22.2x	16.6x	1.7%	1.1x
BADGER METER	BMI	Dec.	NR			\$43.09	\$44.71	\$32.58	\$ 647	\$ 250	1.80	1.91	2.08	22.6x	20.7x	1.3%	4.1x
CALGON CARBON	CCC	Dec.	NR			\$14.35	\$18.35	\$11.75	\$ 806	\$ 412	0.69	0.68	0.87	21.1x	16.5x	0.0%	2.5x
ENERGY RECOVERY	ERII	Dec.	NR			\$3.55	\$7.28	\$3.08	\$ 186	\$ 47	0.07	(0.08)	-	NM	NM	0.0%	2.9x
FRANKLIN ELECTRIC	FELE	Jan.	NR			\$39.82	\$39.69	\$24.93	\$ 925	\$ 626	1.29	1.86	2.25	21.4x	17.7x	1.3%	1.7x
GORMAN-RUPP	GRC	Dec.	NR			\$30.65	\$31.91	\$22.81	\$ 515	\$ 266	1.15	1.34	1.6	22.9x	19.2x	1.4%	2.6x
ITRON	ITRI	Dec.	NR			\$58.58	\$81.95	\$52.05	\$ 2,365	\$ 1,687	2.09	4.03	4.33	14.5x	13.5x	0.0%	1.9x
LAYNE CHRISTENSEN	LAYN	Jan.	NR			\$33.52	\$33.37	\$22.97	\$ 654	\$ 866	0.81	1.23	1.56	27.3x	21.5x	0.0%	1.1x
MUELLER WATER PRODUC	MWA	Sept.	NR			\$3.54	\$5.99	\$2.21	\$ 547	\$ 1,338	-0.29	(0.17)	0.15	NM	NM	2.0%	1.9x
NORTHWEST PIPE	NWPX	Dec.	NR			\$22.24	\$31.46	\$14.62	\$ 207	\$ 283	-0.26	0.12	0.73	185.3x	30.5x	0.0%	1.0x
PALL	PLL	Jul.	NR			\$46.02	\$46.16	\$31.06	\$ 5,369	\$ 2,402	1.77	2.33	2.33	19.8x	19.8x	1.4%	3.7x
SMITH (A.O.)	AOS	Dec.	NR			\$37.38	\$40.24	\$27.39	\$ 1,711	\$ 1,991	1.90	2.70	2.94	13.8x	12.7x	1.5%	1.7x
<b>Average</b>														43.6x	19.3x	0.8%	2.1x
<b>WATER RESOURCES/ INFRASTRUCTURE</b>																	
INSITUFORM TECH	INSU	Dec.	NR			\$23.16	\$28.38	\$18.52	\$ 909	\$ 727	1.04	1.52	1.77	15.2x	13.1x	0.0%	1.6x
LINDSAY	LNN	Aug.	NR			\$61.03	\$66.48	\$30.80	\$ 762	\$ 358	1.11	1.80	2.13	33.3x	27.7x	0.6%	2.0x
TETRA TECH	TTEK	Sept.	NR			\$23.24	\$28.18	\$18.00	\$ 1,435	\$ 2,201	1.22	1.25	1.43	19.0x	16.9x	0.0%	1.7x
<b>Average</b>														24.1x	18.2x	0.7%	2.1x
<b>Relevant Indices</b>						<b>Share Price</b>											
Dow Jones Industrials						DJ30											
S&P 500						SPX											
Nasdaq Composite						NDX											

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	145	62.8%
Sell	2	0.9%

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