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Industry: **WATER INFRASTRUCTURE**

## Coverage:

<b>Ticker</b>	<b>Rating</b>	<b>Price</b>
AWK	BUY	\$20.01
AWR	NEUTRAL	\$32.37
CWT	BUY	\$34.89
PNR	BUY	\$33.21
WTR	NEUTRAL	\$17.00
WTS	NEUTRAL	\$30.75

## Water Rundown

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**End Market and Industry Updates**

- Water Shortage is a Taste of Things to Come
- Baltimore Raises Water Rates
- Water Treatment Membranes a New Growth Market
- India Mulls Water User Fee
- India and Pakistan Dispute Water Use for Hydropower

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- American States Water Sells Chaparral City System
- SJW Issues Bonds
- MSEX Prices Public Offering

**Water Infrastructure Updates**

- INSU Renews Contract with London, ON
- PLL Reports Results
- ITRI Expands Revolver

**Industry Data and Graphs**

- San Francisco Water Consumption

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



END MARKET & INDUSTRY UPDATES

**Water Shortage is a Taste of Things to Come** – South Africa, following years of heavy investment in its infrastructure ahead of the World Cup, continues to face an imminent water crisis in the coming years. South Africa's water supply is expected to fall short of demand by more than 17% in 2030, with industrial centers such as Johannesburg seeing a shortfall as high as 40%, due in part to increasing per-capita income and additional demand from the manufacturing industry. The Department of Water Affairs reported that \$1.3B was needed over the next 10 years to simply maintain bulk water infrastructure, but that just \$450M was available. The funding problem is only exacerbated by low water rates, which are expected to jump between 6-43% in the coming years and increased usage among the nation's increasingly affluent population. The proportion of households with access to clean water rose from 60% in 1995 to 95% in 2008. Nevertheless, a third of water treatment facilities operate without even a single professional water engineer. As a result, 45% of wastewater treatment plants processed effluent to an acceptable standard, with just 7% meeting international benchmark levels.

*Source: The Financial Times*

*LBR Note: While much of the water infrastructure in the U.S. has aged beyond its intended use, many emerging economies in Africa, Asia, and South America are grappling with young water and wastewater systems that cannot sufficiently meet the needs of its citizenry. With growing per-capita in many of the world's emerging economies, the demand for water used in both residential, commercial, and industrial applications should continue to expand. As a result, foreign governments will need to be forward looking and secure the monies needed to fund the necessary expansion necessary to meet demand in the next 10-20 years.*

**Baltimore Raises Water Rates Amid Crumbling Infrastructure** – Baltimore residents will soon see a 9% increase in their water and sewer bills, the first in a series of increases planned for the next five years. The approved rate increase will help fund repairs of the city's deteriorating infrastructure and pipes, many of which are more than 65 years old. The measure is expected to generate \$16M in revenue this year, not nearly enough to cover the \$1.8B in improvements needed to meet tougher federal standards. The city loses about a fifth of its drinking water to leaks and water main breaks. The city averages over 1000 water main breaks each year.

*Source: The Baltimore Sun*

**Water Treatment Membranes a New Growth Market** –

Water treatment membranes are seeing a slow rise in applications and usage, which should result in 5.9% growth through 2020, according to a new study. Membrane-based water treatment is the dominant technology used in desalination processes, though its uses are expected to expand in to new markets which were once dominated by chemical, biological, and basic filtration technologies. As a result, the membrane technologies market is expected to grow from \$1.5B in 2009 to \$2.8B in 2020. RO membranes are expected to remain the biggest segment of the market, though demand for ultra-filtration products is expected to jump CAGR 6.5% by 2020. Demand for recycled water, especially in regions of extreme water stress like India and China, should drive demand for the technology.

*Source: Business Wire*

**India Mulls Water User Fee** – India, a county facing an imminent water crisis given its growing population and lack of access to sufficient water supplies, is formulating a policy on integrated water management. Government officials recently admitted that the nation's water crisis is far more serious than its energy crisis due to drying rivers causing regional water shortages throughout the country. While the government has existing policies that force its citizens to pay for energy, officials are suggesting that a policy needs to be formulated on levying user fees on industries that are water intensive, at least until a more stable supply of water, possibly through desalination, is secured. Officials suggested that the over-exploitation of groundwater for agricultural purposes is putting a strain on the system, leaving the general population, which continues to grow, with limited supply. The government reported that nearly 80% of India's water goes to agriculture and this can be reduced to 50%, whereas the productivity can be pushed to 100%.

*Source: Times of India*

**India and Pakistan Dispute Water Use for Hydropower** –

Pakistan has begun formal arbitration against an Indian hydroelectric project along the Kishanganga River that would violate the 50-year-old Indus Waters Treaty with Pakistan. The \$800M project would redirect water that is used for agricultural production to generate 330 megawatts of energy for India. There are currently more than 30 other hydropower projects that are being contested by Pakistan. The argument is reflective of the grave water shortages both nations face. Groundwater tables in the area have been dropping for years and farmers who would once get water at a depth of 2-5 meters are now going 20 to 50 meters below the surface to get water. In the past 30 years, water access per capita in Pakistan has fallen from nearly 3000 to 1500 cubic meters per person, a similar trend seen in India during that same time. Pakistan claims that India's plans are simply exacerbating existing regional water supply issues. Shortages have made farmers pump groundwater since irrigation canals, which were once full year-round, are now empty three months per year.

*Source: The Wall Street Journal*



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**WATER UTILITIES UPDATES**

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**American States Water (AWR, N)** – AWR announced it reached an agreement to sell Chapparral City Water Company (CWCC) to Canadian-based EPCOR Water for \$35M. Excluding \$6M that will go toward long-term debt, AWR will receive \$29M. The deal is subject to closing which could take four to six quarters depending on the length of time needed to pass through the Arizona public utilities commission. Management hopes to close the deal in early 2011 but admitted it could take up to as much as 18 months. Having a one-off utility outside the company's core California market was no longer deemed desirable in the long run as the Arizona market has been increasingly less favorable both from a growth and regulatory standpoint.

**San Jose Water Company (SJW, NR)** – SJW entered in to a Bond Purchase program for the purchase of \$50M aggregate principal amount of 5.10% fixed rated California Pollution Control Financing Authority Revenue Bonds with a maturity date of June 1, 2040. The proceeds will be used to finance capital costs, improvements to existing infrastructure, distribution systems and facilities. The funds will also be used to purchase equipment for the water systems and pay certain costs related to the issuance of the Bonds.

**Middlesex Water (MSEX, NR)** – MSEX announced the pricing of a public offering of 1.7M shares of common stock at \$15.21 per share. The net proceeds of \$24.6M after expenses are expected to be used to reduce the balance of the company's short term borrowings.

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**WATER INFRASTRUCTURE UPDATES**

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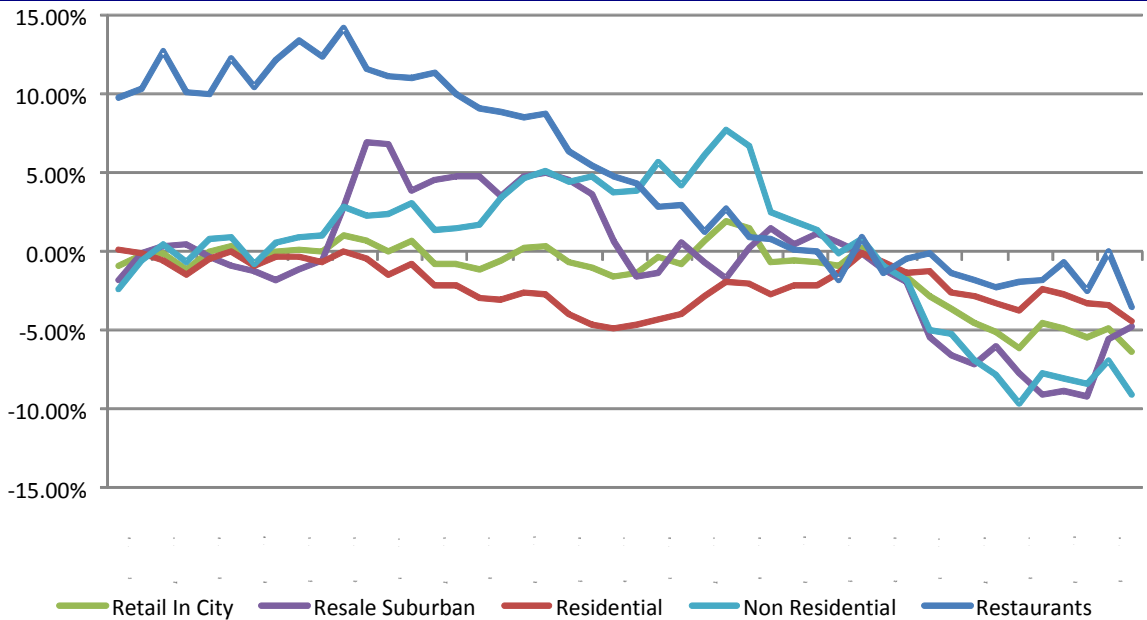
**Insituform Technologies, Inc. (INSU, NR)** – INSU announced the renewal of its \$6.2M term contract with London, Ontario Canada. Some \$2M is being funded through Canada's Stimulus Funding Infrastructure Renewal Program. The company has already been awarded \$12M in contacts with the city in just the past two years. The city estimates that INSU's services have saved them \$81M over the past five years.

**Pall Corp (PLL, NR)** – PLL report that sales in 3Q10 increased 10.8% to \$615,982 from \$555,883 in the third quarter of fiscal year 2009. Increased pricing contributed \$526 to overall sales in the quarter. Gross margin in the third quarter of fiscal year 2010 increased to 50.9% from 47.5% in the third quarter of fiscal year 2009. Pricing did not have a material impact on gross margins. R&D costs increases 17.1%, while SG&A costs increased 11% during the quarter.

**Itron Inc (ITRI, NR)** – ITRI announced the expansion of its revolving line of credit. Under the agreement, its multicurrency revolving line of credit expands from \$115M to \$240M, with the number of participating banks increases from four to 10. There were reportedly no changes to the loan agreement.

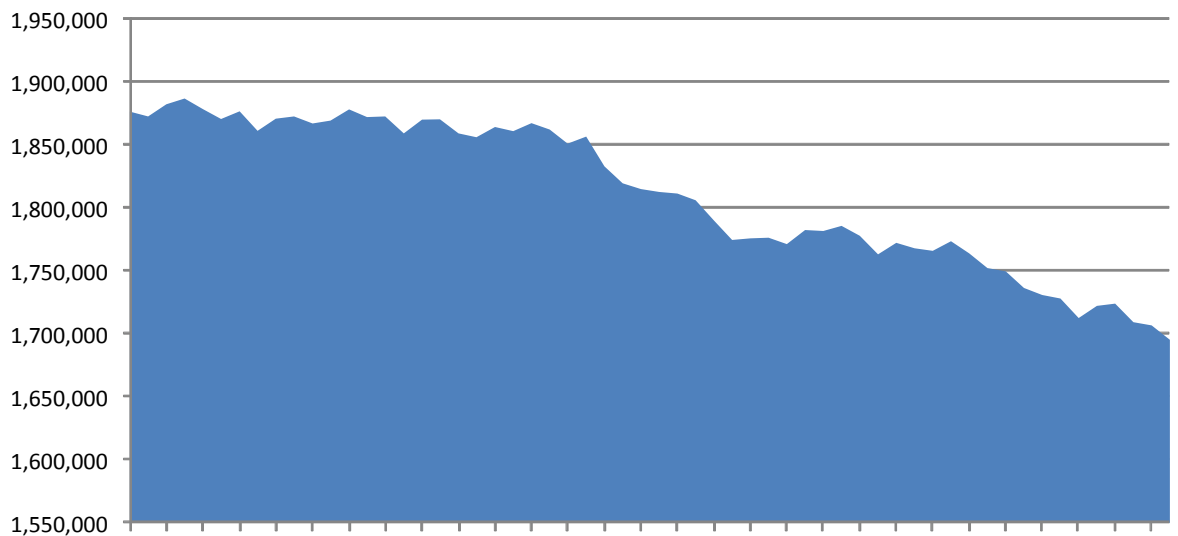


### San Francisco Water Use - % Change from 12 Month Average



Source: San Francisco Department of Water

### San Francisco Water Use - Residential 12 Month Average (Ccf)



Source: San Francisco Department of Water

**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			\$32.68	\$39.61	\$31.20	\$ 605	\$ 361	1.63	1.83	2.11	17.9x	15.5x	3.2%	1.8x
AMERICAN WATER WORKS	AWK	Dec.	BUY	\$24	19%	\$20.10	\$23.77	\$18.07	\$ 3,512	\$ 2,337	1.25	1.39	1.60	14.4x	12.6x	4.2%	1.3x
AQUA AMERICA	WTR	Dec.	Neutral			\$17.05	\$18.73	\$15.39	\$ 2,323	\$ 671	0.77	0.88	0.95	19.3x	18.0x	3.4%	2.2x
CALIFORNIA WATER	CWT	Dec.	BUY	\$43	23%	\$34.91	\$40.65	\$33.81	\$ 726	\$ 449	1.95	1.99	2.40	17.5x	14.5x	3.4%	1.8x
ARTESIAN RESOURCES	ARTNA	Dec.	NR			\$17.52	\$19.33	\$14.33	\$ 132	\$ 61	0.97	1.07	1.12	16.4x	15.6x	4.3%	1.5x
CONNECTICUT WATER	CTWS	Dec.	NR			\$21.17	\$26.44	\$20.00	\$ 182	\$ 59	1.19	1.08	1.14	19.6x	18.6x	4.3%	2.0x
MIDDLESEX WATER	MSEX	Dec.	NR			\$15.40	\$18.70	\$13.16	\$ 236	\$ 91	0.72	0.91	0.92	16.7x	16.7x	4.7%	1.7x
PENNICHUCK	PNNW	Dec.	NR			\$22.10	\$24.80	\$19.00	\$ 103	\$ 33	0.55	0.76	0.79	29.1x	28.0x	3.3%	1.8x
SIW	SIW	Dec.	NR			\$23.37	\$28.24	\$20.63	\$ 433	\$ 216	0.81	1.09	1.24	21.4x	18.8x	2.9%	1.7x
YORK WATER CO (THE)	YORW	Dec.	NR			\$13.62	\$17.95	\$12.83	\$ 172	\$ 37	0.64	0.67	0.71	20.3x	19.2x	3.8%	2.1x
Average														19.3x	17.8x	3.8%	1.8x
<b>EQUIPMENT/ FILTRATION/ TREATMENT SECTOR</b>																	
PENTAIR	PNR	Dec.	BUY	\$41	22%	\$33.48	\$39.32	\$23.20	\$ 3,292	\$ 2,692	1.47	1.96	2.38	17.1x	14.0x	2.3%	1.6x
WATTS WATER TECH	WTS	Dec.	Neutral			\$31.25	\$37.00	\$19.50	\$ 1,146	\$ 1,234	1.54	1.89	2.14	16.5x	14.6x	1.4%	1.3x
AMERON INT'L	AMN	Nov.	NR			\$64.72	\$91.66	\$50.44	\$ 597	\$ 547	3.05	2.74	4.16	23.6x	15.6x	1.9%	1.1x
BADGER METER	BMI	Dec.	NR			\$40.80	\$44.90	\$32.58	\$ 611	\$ 250	1.80	1.79	2.06	22.8x	19.8x	1.2%	4.1x
CALGON CARBON	CCC	Dec.	NR			\$14.36	\$18.35	\$10.93	\$ 804	\$ 412	0.69	0.79	0.93	18.2x	15.4x	0.0%	2.5x
ENERGY RECOVERY	ERII	Dec.	NR			\$3.25	\$7.40	\$3.15	\$ 170	\$ 47	0.07	0.04	0.17	NM	NM	0.0%	2.9x
FRANKLIN ELECTRIC	FELE	Jan.	NR			\$29.77	\$36.59	\$22.43	\$ 692	\$ 626	1.29	1.76	2.1	16.9x	14.2x	1.7%	1.7x
GORMAN-RUPP	GRC	Dec.	NR			\$27.84	\$30.49	\$18.44	\$ 465	\$ 266	1.15	1.17	1.39	23.8x	20.0x	1.5%	2.6x
ITRON	ITRI	Dec.	NR			\$65.85	\$81.95	\$50.15	\$ 2,645	\$ 1,687	2.09	3.26	3.89	20.2x	16.9x	0.0%	1.9x
LAYNE CHRISTENSEN	LAYN	Jan.	NR			\$26.18	\$35.14	\$17.53	\$ 511	\$ 866	0.81	1.10	1.51	23.8x	17.3x	0.0%	1.1x
MUELLER WATER PRODUC	MWA	Sept.	NR			\$3.91	\$5.99	\$2.52	\$ 604	\$ 1,428	-0.29	(0.09)	0.15	NM	NM	1.8%	1.9x
NORTHWEST PIPE	NWPX	Dec.	NR			\$19.23	\$40.47	\$18.33	\$ 178	\$ 440	0.47	1.30	1.6	14.8x	12.0x	0.0%	1.3x
PALL	PLL	Jul.	NR			\$36.81	\$41.82	\$24.85	\$ 4,320	\$ 2,329	1.77	2.19	2.19	16.8x	16.8x	1.7%	3.2x
SMITH (A.O.)	AOS	Dec.	NR			\$49.23	\$56.64	\$29.44	\$ 1,495	\$ 1,991	2.85	3.54	3.91	13.9x	12.6x	1.6%	1.7x
Average														18.6x	15.7x	0.9%	2.0x
<b>WATER RESOURCES/ INFRASTRUCTURE</b>																	
INSITUFORM TECH	INSU	Dec.	NR			\$19.74	\$28.38	\$14.71	\$ 772	\$ 727	1.04	1.47	1.72	13.4x	11.5x	0.0%	1.6x
LINDSAY	LNN	Aug.	NR			\$35.20	\$47.45	\$29.71	\$ 439	\$ 336	1.11	1.29	1.78	23.0x	21.2x	0.9%	2.5x
TETRA TECH	TTEK	Sept.	NR			\$21.00	\$32.00	\$19.51	\$ 1,295	\$ 2,287	1.22	1.17	1.37	18.2x	15.7x	0.0%	2.5x
Average														17.3x	15.6x	0.9%	2.3x
<b>Relevant Indices</b>																	
						Share Price											
Dow Jones Industrials						DJ30		\$10,211.07									
S&P 500						SPX		\$1,091.60									
Nasdaq Composite						NDX		\$1,847.15									

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	127	57.2%
Sell	0	0.0%

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

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