

Water Pricing Continues to Far Outpace CPI, Clearing Way for Rate Case Success.

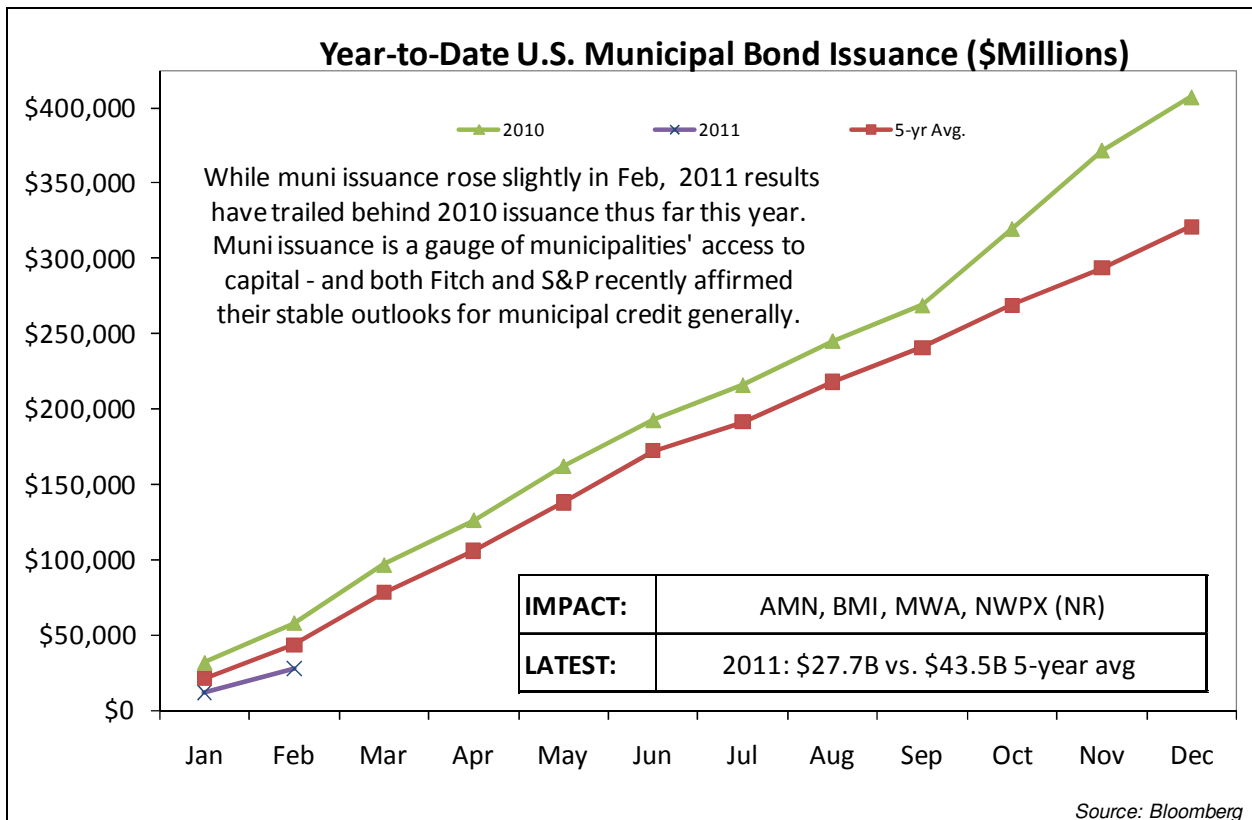
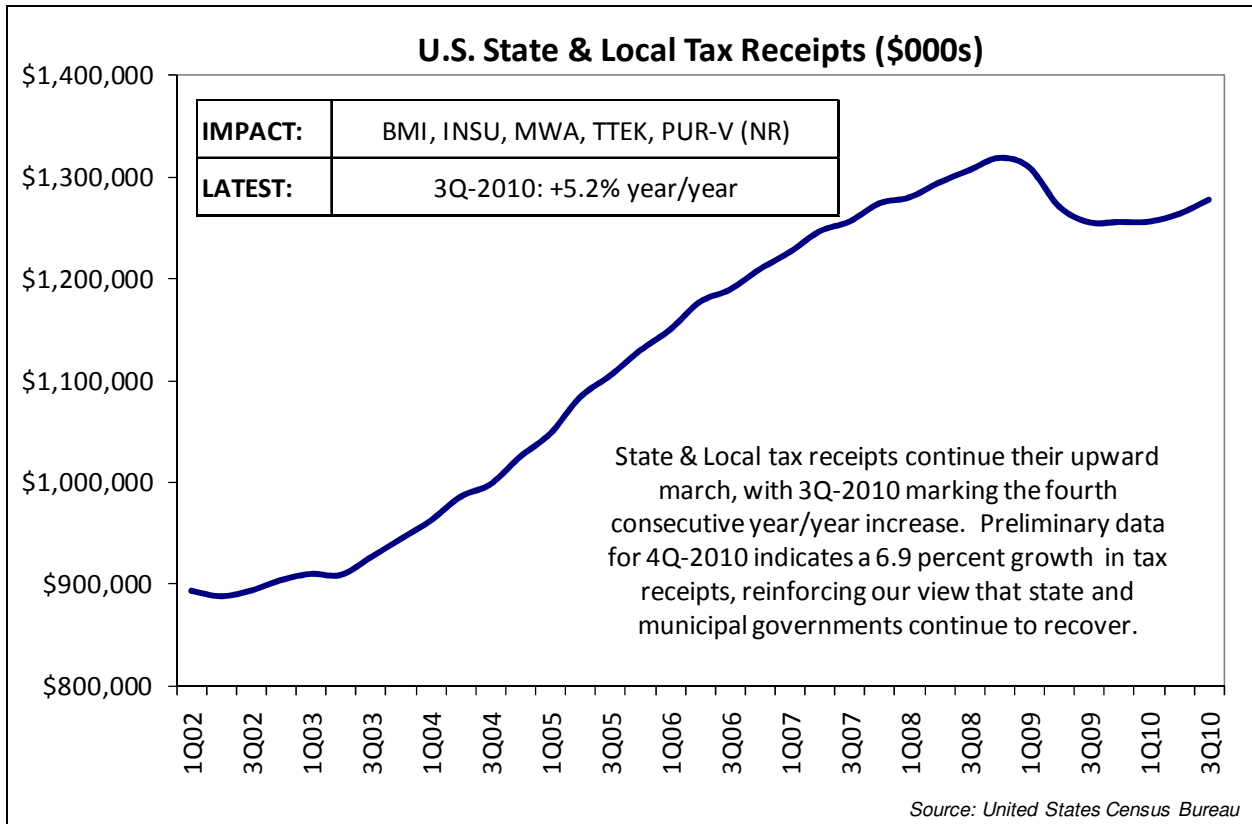
Janney Water Meter - March 2011

INVESTMENT CONCLUSION:

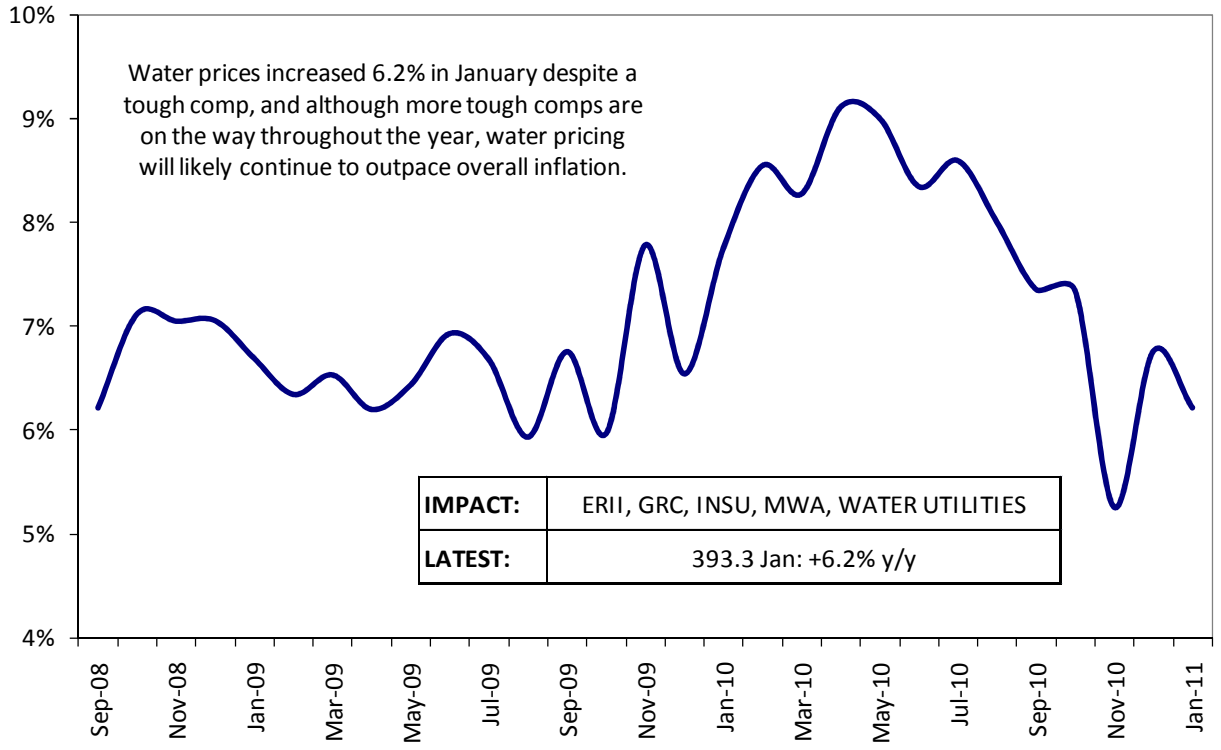
Water prices gained 8% in 2010, far above the overall rate of inflation - which ran at 1.6% (and just 1.0% ex-food/energy) - according to Federal Reserve CPI data. Despite the fact that year-ago data now presents challenging comps, water prices continued to increase at pace far exceeding broad inflationary measures in January 2011, up 6.2% versus a continued +1.6% overall / +1.0% core CPI. While this data largely reflects water pricing trends for *municipal* water utilities, it also offers important confirmation for our positive stance on investor-owned water utilities. By exposing unsustainably low "below-cost" pricing structures at many municipal water utilities, robust increases in municipal water prices undermine a stand-by ratepayer advocate argument against IOU rate increases and create a backdrop against which regulated utilities can achieve successful rate case outcomes). This is particularly important for BUY-rated American Water (AWK), which is relying on an aggressive rate case program to pull itself out of its current "under-earning" status and to deliver on its earnings growth targets. Overall, we believe that a notable silver-lining of the ongoing crunch in municipal budgets is that it is accelerating long overdue progress toward "full-cost pricing" of water and wastewater services, which benefits both investor-owned water utilities and makers of water-related equipment/technology.

KEY POINTS:

- **Water utilities: Water pricing continues to outpace broad inflation measures in January.** Water pricing increased 6.2% in January, impressive given that pricing is now lapping difficult comps (prices increased 8% in 2010). Continued strength in municipal water pricing creates a favorable backdrop for investor-owned water utilities and reinforces our positive thesis for BUY-rated American Water (AWK) in particular as rate catch-up remains a core aspect of the investment thesis.
- **Ag/Irrigation: Commodities remain elevated, setting stage for strong 2011 selling season.** Despite a recent pullback from particularly lofty levels in recent weeks, key agricultural commodity prices (most notably corn) remain elevated by any historical measure, and with droughts among the key factors impacting supply, 2011 is shaping up as a strong year for center pivot sales. Still, we believe shares of Lindsay Corporation (LNN) and Valmont Industries (VMI) both Neutral-rated, are already discounting stellar 2011 results.
- **Industrial: Key industrial demand indicators continue to give off favorable cyclical signs.** As the economy continues to gradually work its way out of the deep 2008-2009 recession, demand indicators for companies serving the industrial water market continue to trend favorably. As a result, we expect continued positive top-line comps throughout 2011 for companies leveraged to this key vertical, including BUY-rated Nalco Holding (NLC).
- **Construction: Mixed, but remodeling strong, commercial upturn inching closer.** The outlook for construction markets remains decidedly mixed, with remodeling already showing solid growth, commercial still weak but showing early signs of life, and residential flat on its back. Still, with sentiment around the construction markets bearish, we believe some construction-related stocks look compelling, including BUY-rated Watts Water (WTS).
- **Municipal: Rumors of muni water utilities' financial death remain greatly exaggerated.** In the current environment of weak state/local finances, conventional wisdom holds that makers of water-related infrastructure products will experience a sharp downward trajectory in demand in 2011. In our view, the prevalence of water enterprise account financial structures, improving local tax receipts, rising water prices, and the non-discretionary nature of water infrastructure will drive surprisingly resilient demand in the municipal channel in 2011.

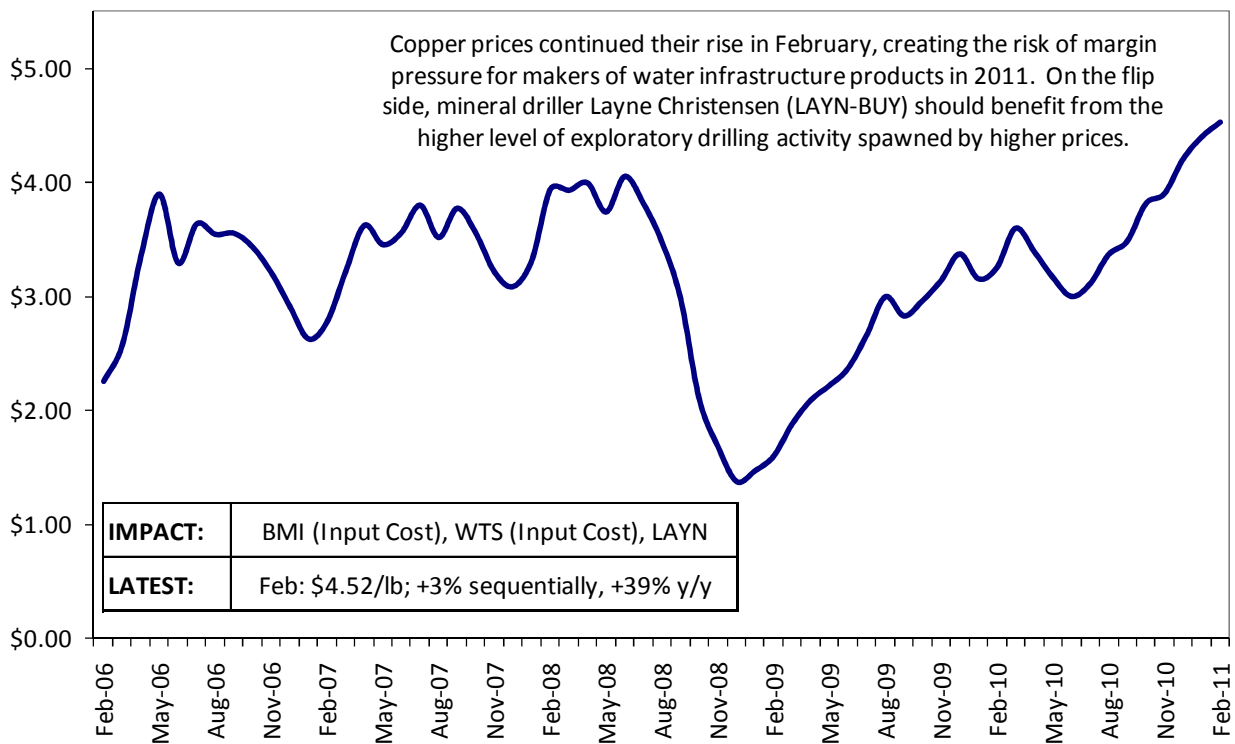


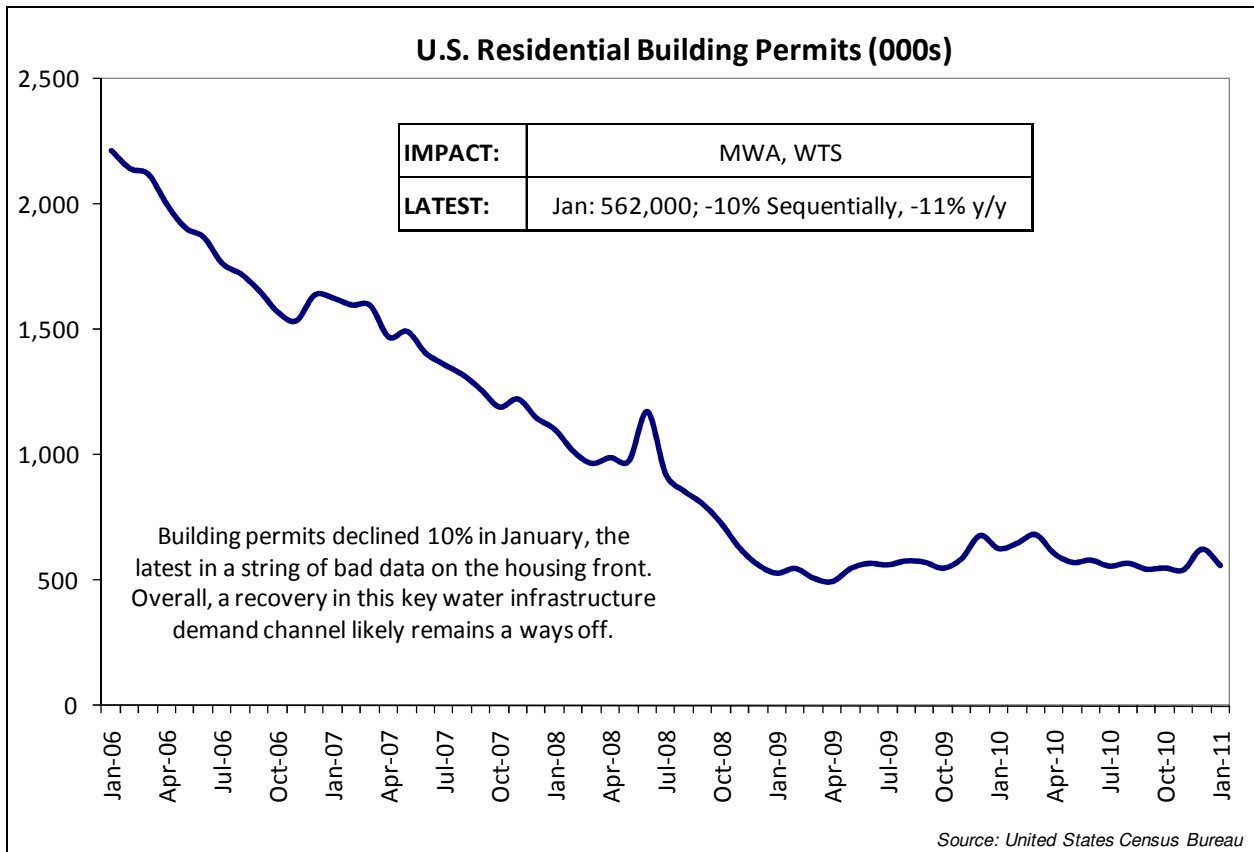
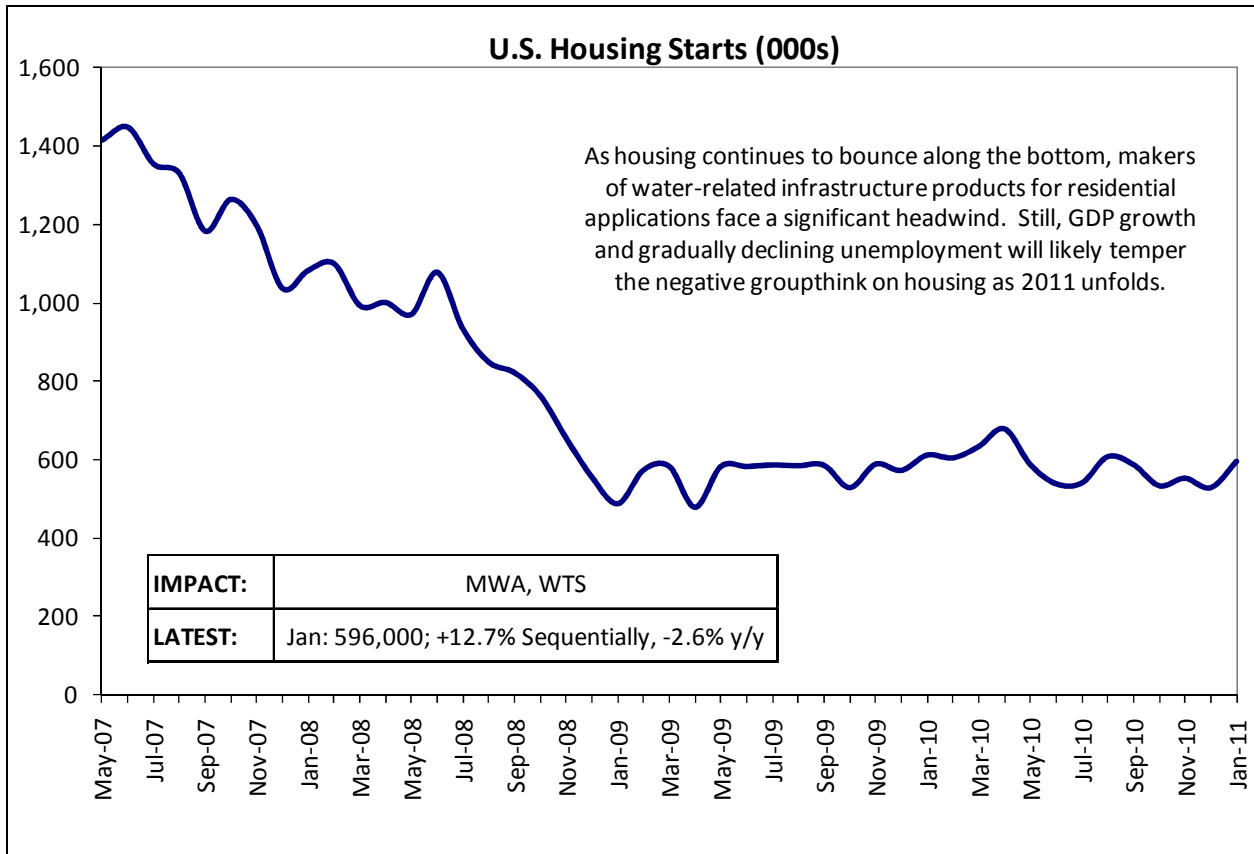
Municipal Water & Wastewater Pricing (Year/Year Rate of Change)



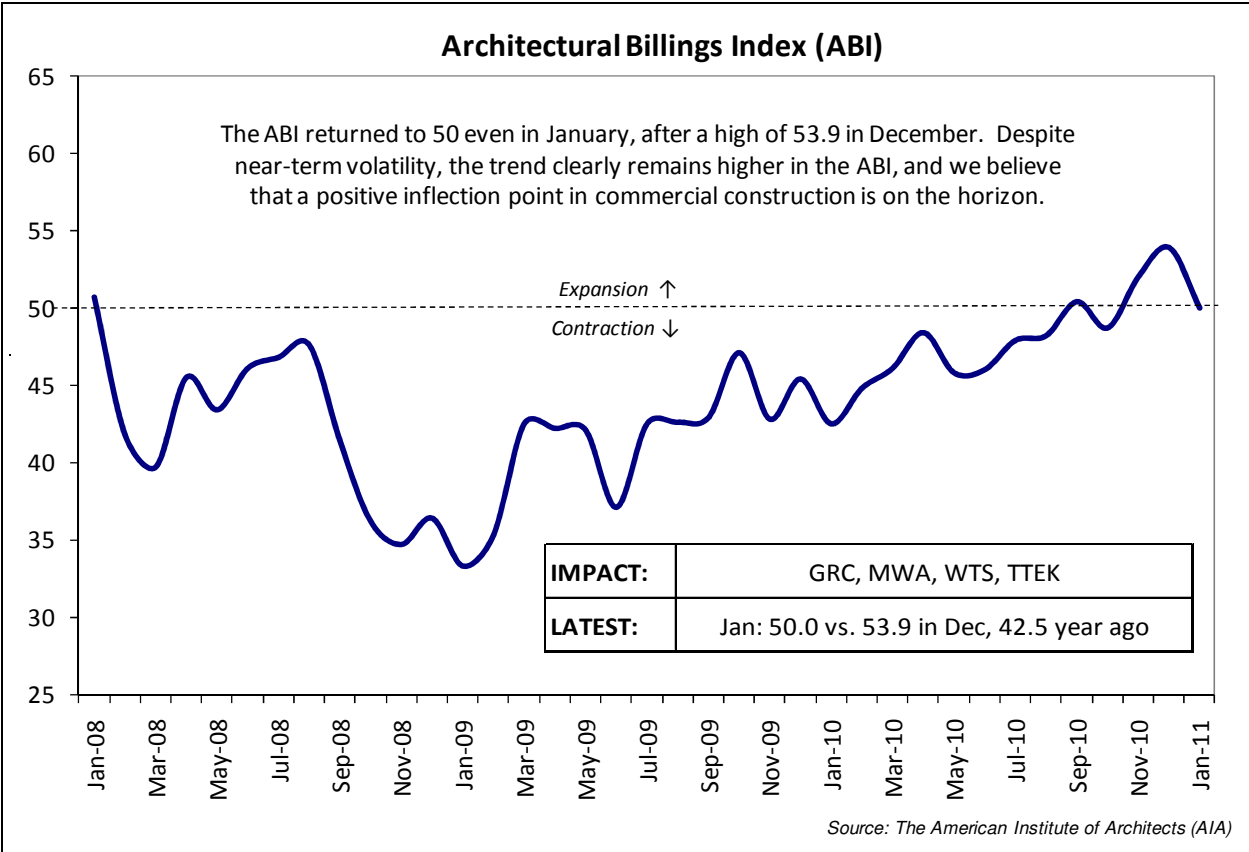
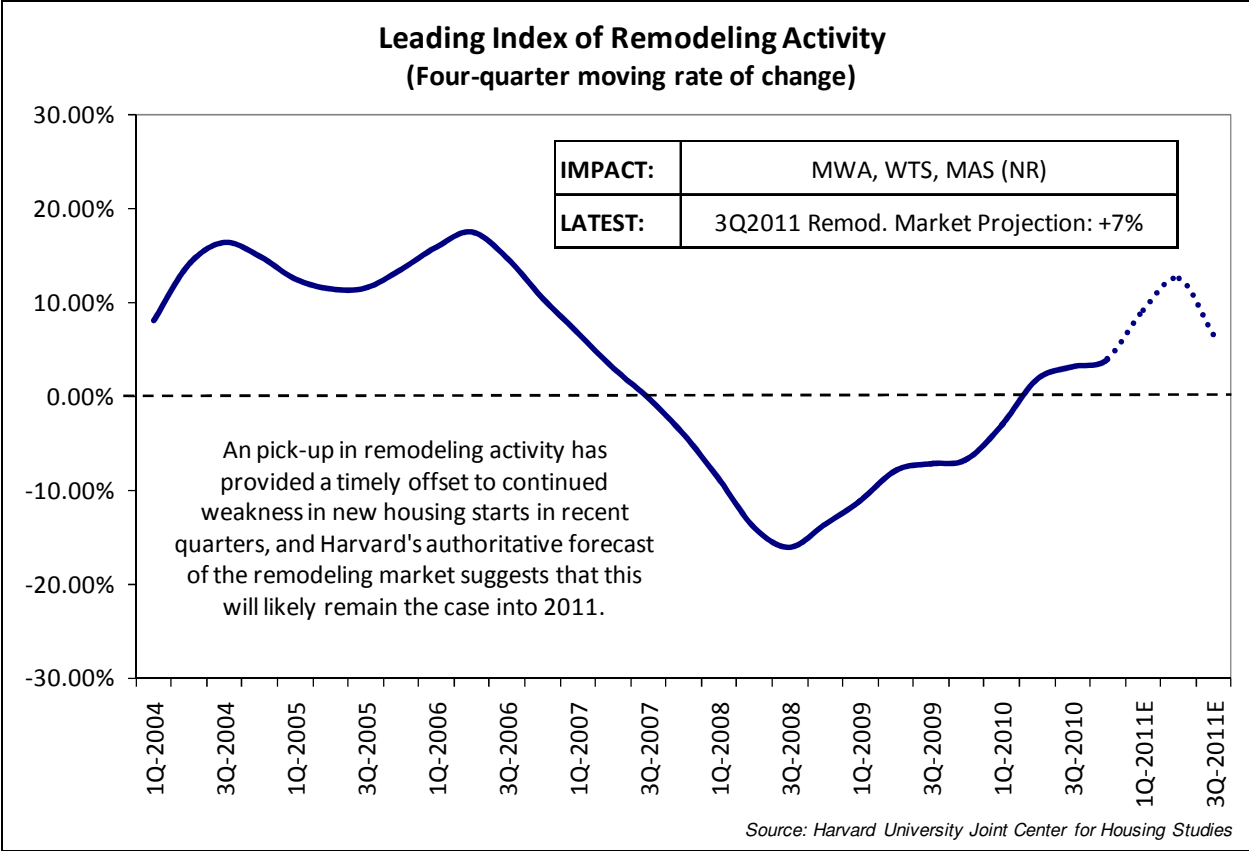
Source: United States Federal Reserve

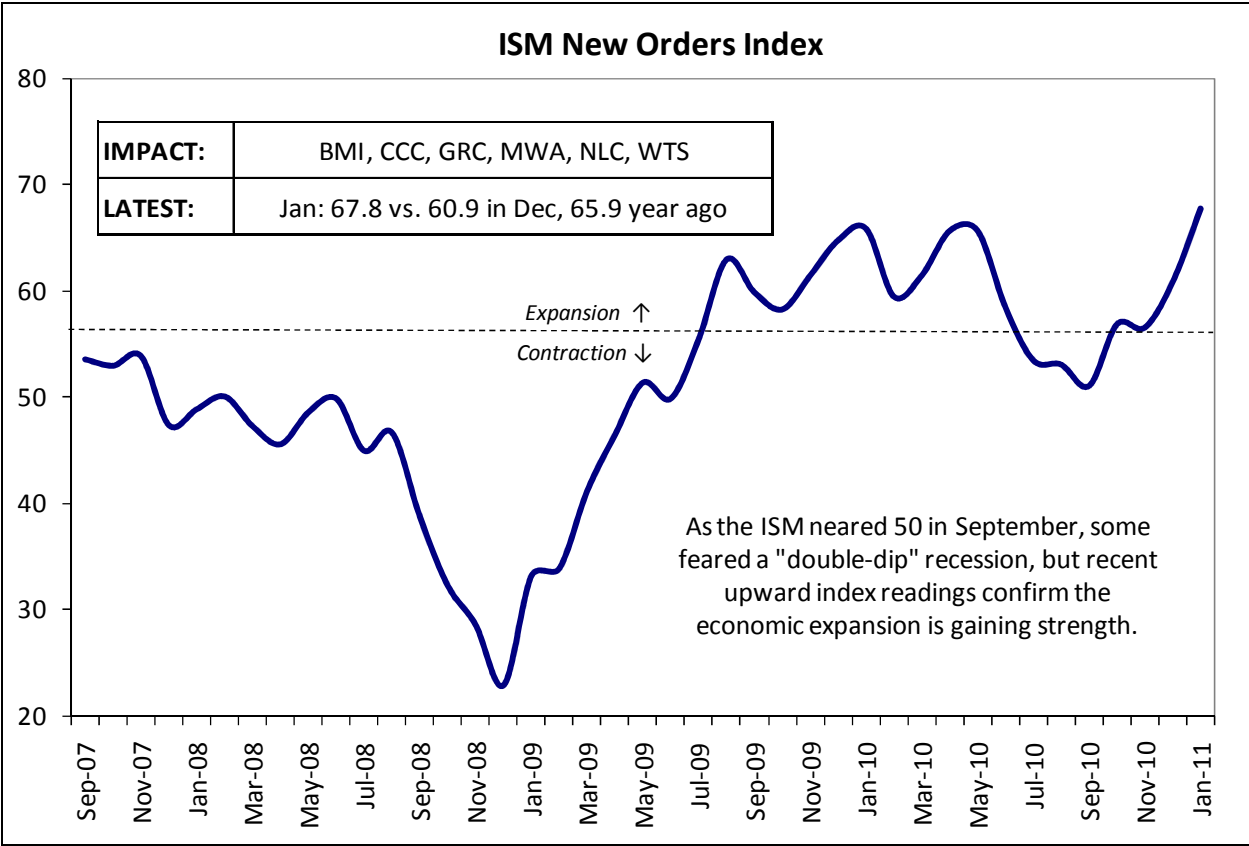
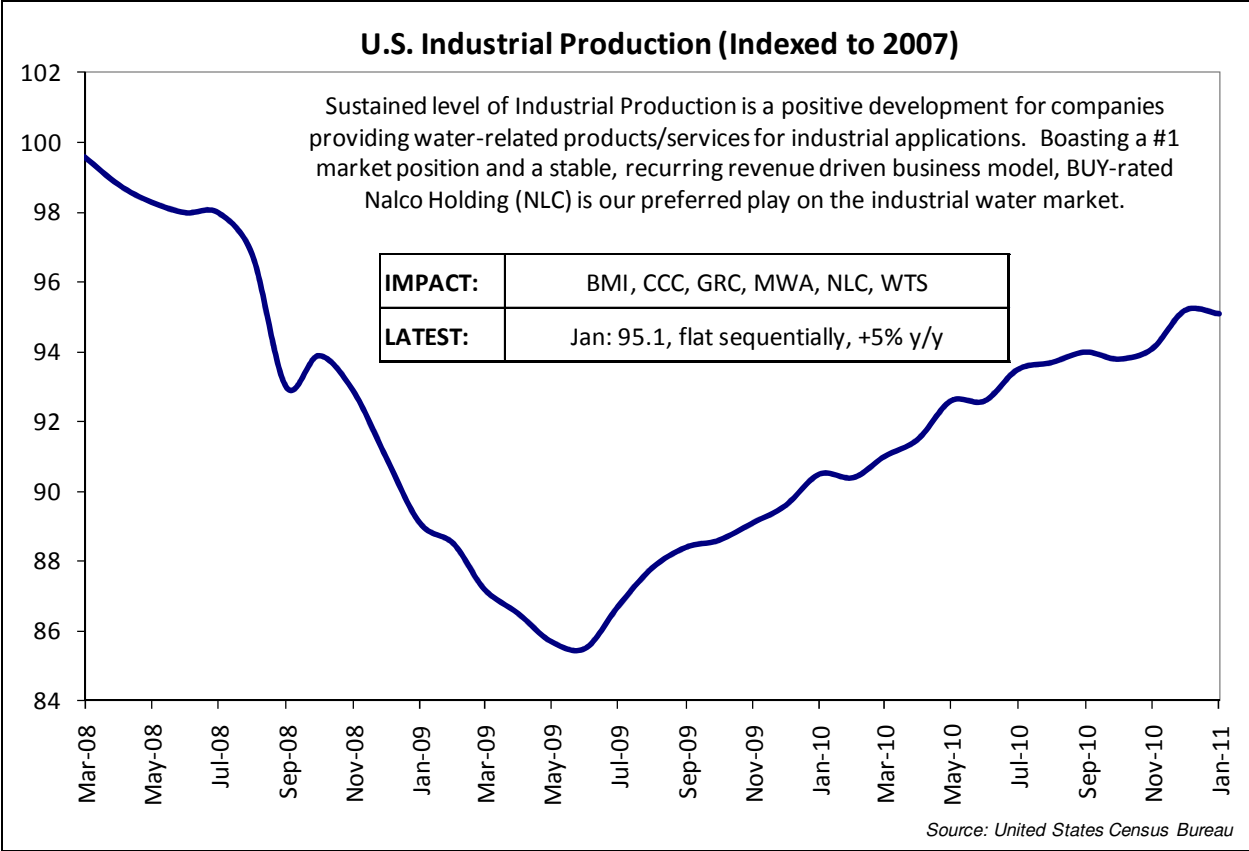
Copper Pricing (US\$/lb.)

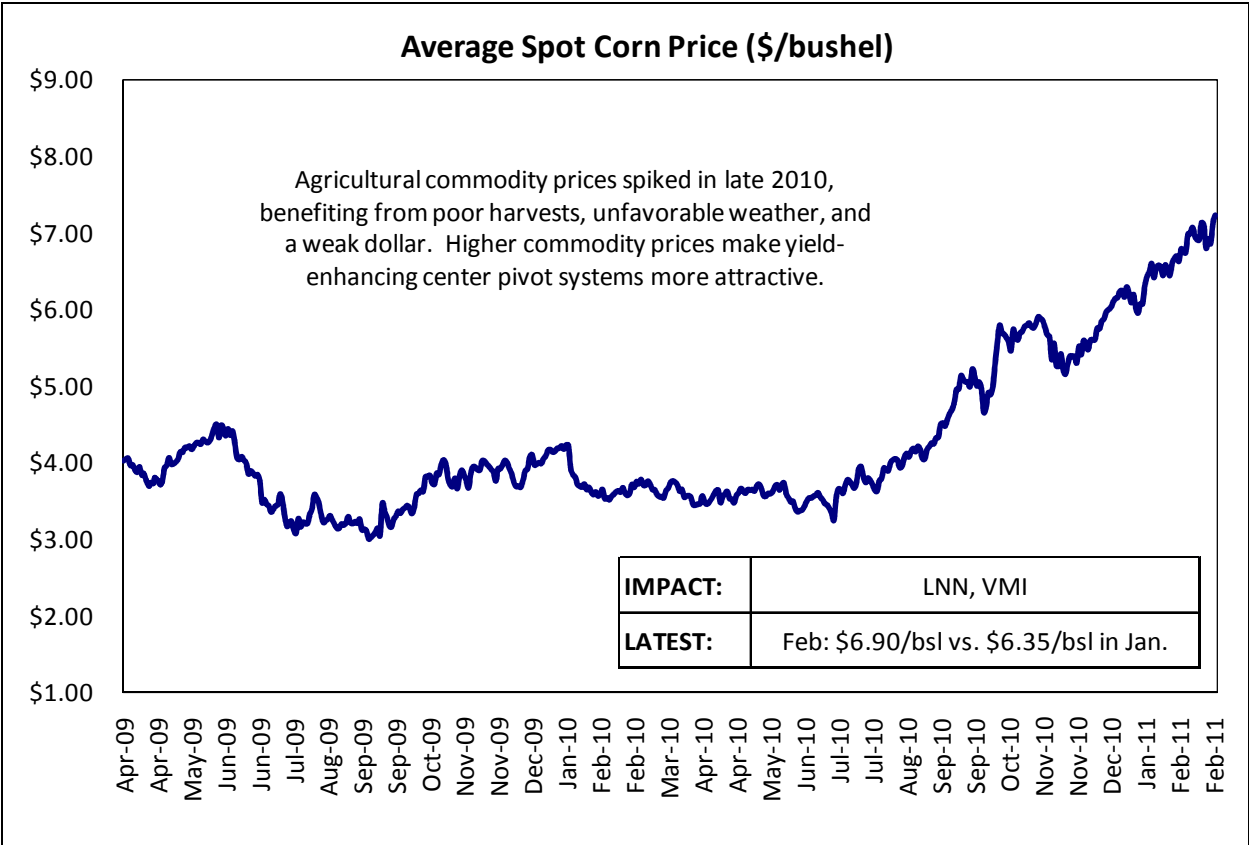
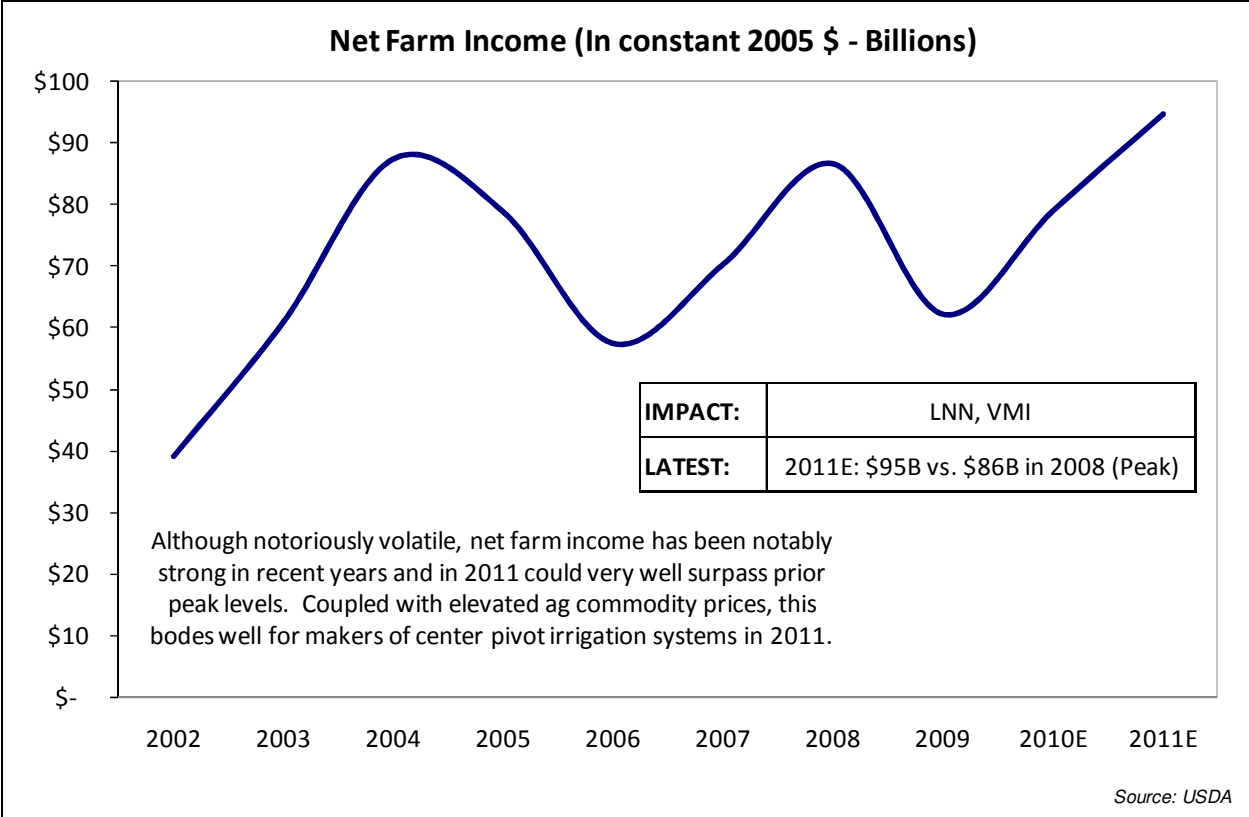




Source: United States Census Bureau







IMPORTANT DISCLOSURES

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			Count	Percent
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