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Industry: **WATER INFRASTRUCTURE**

Coverage:

| Ticker | Rating | Price |
|---------------|---------------|--------------|
| AWK | BUY | \$27.74 |
| AWR | NEUTRAL | \$33.54 |
| CWT | NEUTRAL | \$35.28 |
| PNR | BUY | \$37.08 |
| WTR | NEUTRAL | \$22.52 |
| WTS | NEUTRAL | \$39.11 |

The Water Rundown

WTS Earnings Recap

AWK Earnings Recap

WTR Earnings Recap

CWT Earnings Recap

Water Infrastructure Updates

- FELE Reports Earnings
- INSU Reports Earnings

Industry Data and Graphs

- Water Industry Capital Expenditures
- Sources of Funding for Capital Projects

IMPORTANT DISCLOSURES ARE LOCATED IN THE APPENDIX.



WTS EARNINGS RECAP

WTS (N) reported adjusted 4Q10 EPS of \$0.40 vs. consensus of \$0.47. 4Q10 EPS excludes a negative \$0.10/share impact from restructuring and other charges. The miss came from weaker EBIT margins and a higher-than-expected corporate tax rate of 37.9%, which negatively impacted EPS by \$0.03/share. Revenues for the quarter were \$316M vs. our \$301M estimate and consensus of \$312M.

Sales Slip in Europe and China, Steady in North America: Overall sales declined 2% y/y vs. our -6.6% forecast. An organic sales decline of 1% and a 2% reduction due to foreign exchange, due primarily to the weakening of the Euro vs. the USD, was offset by 1% contribution from acquisitions. Sales declined in Europe and China but increased in North America. North American sales (60% of revenues) increased 3% y/y. Sales to the wholesale market increased organically by 4% during the quarter, whereas sales to the retail home improvement market slipped 5% y/y due to decreased unit volumes related to continued inventory destocking. Broadly, the company noted that discretionary remodeling spending remains strong and that the recent introduction of the Blücher product line in North America should support growth in FY11. European sales (38% of revenues) declined 8% y/y. Organic sales to the European wholesale market increased 2% y/y, while sales to the OEM market (40% of European sales) declined 16% y/y. In Europe, the company's drains business was hit by shipping delays because of severe weather in northern and central Europe. Sales in China declined 7% y/y due to a volume decrease to the European export market. Broadly speaking, management believes that it can achieve top-line growth of 12-14% annually in the longer term, half of which would be achieved organic growth initiatives and the remaining portion from strategic acquisitions.

Price Increase to Offset Copper Costs, Gross Margins Healthy: The company announced that it, along with its competitors, has announced a 4-10% price increase during the quarter effective in January and February. Management noted that the magnitude of the increase, which it expects to fully realize, is able to fully offset purchased copper costs of \$3.90/lb during the quarter. That being said, management noted that if copper costs remain at currently elevated levels (~\$4.40/lb), then further price increases would need to be implemented during 2Q11 to offset further cost pressures. We note that it generally takes 3-4 months for raw material purchases to run through the company's P&L so WTS would need to act quickly to maintain margin stability. Finally, management noted it witnessed only marginal levels of prebuying activity during the quarter and that it was no greater than prior periods. For more detail see *WTS: 4Q Earnings Recap; Maintaining NEUTRAL* originally published February 28, 2011.

AWK EARNINGS RECAP

AWK reported 4Q10 diluted EPS of \$0.23, slightly below consensus expectations of \$0.24. Earnings were impacted by a 17% y/y increase in D&A, which negatively impacted EPS by (\$0.06). Revenues of \$665M increased 11.2% y/y and were in line with our forecast and ahead of consensus of \$647M. Regulated business revenues increased 10% y/y primarily due new rate awards as well as increased water sales. Non-regulated business revenues increased 16% y/y due to revenue increases from industrial and military contracts. We were looking for an 11% increase in the regulated segment and a 15% increase in non-regulated revenues. The company's O&M ratio of 55.4% was better than our estimate of 57%. EBIT margins of 22.9% were directly in line with our estimate. As a reminder, the company pre-released 4Q10 earnings ahead of its February 15th investor day in NYC.

FY11 Guidance: AWK recently offered FY11E guidance at its investor day of \$1.65-1.75, though management noted this was a working number as it is heavily dependent upon consumption trends in FY11 and, to a lesser degree, input costs like fuel & power (\$100M annually) and chemicals (\$53M annually). Nevertheless, company guidance is above the Street's view of \$1.68. Our FY11E EPS forecast of \$1.72 is within management's guidance. In regard to the company's guidance, management noted that just a 1% change in consumption would impact EPS by \$0.02/share, thereby reducing FY11 EPS to \$1.63 on the low end or \$1.77 on the high end. To reach the high end of the range, management noted that its O&M expense and interest rates would need to decline 1%, while Fuel & Power and Chemical costs would need to decline 10%. For more detail see *AWK: Fundamentals Remain Strong, Raising Target Price* originally published March 1, 2011.



WTR EARNINGS RECAP

WTR reported 4Q10 EPS of \$0.21, in line with its previously announced guidance and consensus of \$0.21. Total revenues increased 7% y/y. Net income increased 8% to \$29M. Operating margin of 36.7% exceeded our expectations of 36.0%.

O&M Expenses: Operations and maintenance expenses increased 6% y/y. That being said, the O&M ratio of 39% improved 20bp y/y vs. our expectation of a 180bp increase mainly from increased water main breaks. Leverage off improved sales drove the increase and more than offset. We note that WTR already has the highest efficiency ratio among the large publicly traded water utilities and its focus on cost control helps cash flows and reduces its reliance outside funding for its capital programs. We're modeling an 80bp improvement in 1Q11E and a 30bp improvement in FY11E.

Revenue Growth: Revenues grew 7% y/y, most of which was attributed to rate increases and surcharges. Total customer count grew 1% y/y from acquisitions. We note this is better than the company's average of 0.4% during the housing slowdown. WTR reports seeing increased demand in rural parts Pennsylvania adjacent to the Marcellus Shale project as well as improved demand in TX due to a stabilizing housing market there. With the improved economy, the company should continue to see strengthening demand conditions.

Rate Cases: WTR received \$53M in rate awards and infrastructure surcharges in FY10 and has received another \$7M in January alone. The company has 18 rate cases pending for a total of \$26-\$27M. It also plans to file additional rate cases but in PA, NJ, OH, IL and TX this year. The primary driver of the aforementioned rate case filings is the recovery of infrastructure investments.

Acquisition Outlook: WTR completed 23 acquisitions in FY10 and 9 in 4Q alone. It focused on increasing its footprint in TX where 10 deals were completed during the year. As customer growth grew 1% this past year and as the rate of deals accelerated towards the end, we'd expect WTR to remain active its deal book.

Guidance: The Company indicated Street estimates for 1Q11E of \$0.18 (in line with our forecast) appears reasonable despite a continued headwind of water main breaks due to the cold winter weather. For FY11E, it noted Street estimates of \$0.98 also look achievable (we're at \$1.00). Consequently, we maintain our current forecasts and are offering a \$1.10 FY12E estimate. We expect 9% revenue growth in FY11E and 6% in FY12E. There could be upside to the out year pending visibility into the size/timing of future rate case filings. We also expect a cumulative 50bp improvement in its O&M ratio over the next two years. For more detail see *WTR: 4Q and Outlook In-line With Street Forecasts* originally published February 25, 2011.

CWT EARNINGS RECAP

CWT Reported 4Q10 EPS of \$0.23 vs. consensus of \$0.35. Revenues of \$106M declined 1.4% from the year ago period and came in below our \$110M (+3.8% y/y) estimate and consensus of \$111M. We note that the net effect of the WRAM and the MCBA mechanisms during the quarter negatively impacted revenues by \$2.9M. We note that these adjustment mechanisms were a \$0.04 negative impact during the quarter, while a one-time charge related to capitalized interest also negatively impacted earnings by \$0.04/share. Adjusting for these one-time impacts, we believe CWT reported a more normalized \$0.31/share, which was still below our view and consensus.

Rate Case Filings: The company is in the process of filing its first rate case in Hawaii (2% of customer base) following its FY08 acquisition of a number of wastewater assets for \$1.8M. Management expects to file a total of seven rate cases in the state during 1H11, the benefits of which should be realized in 4Q11 or 1Q12. That being said, management was unable to offer at this time the expected EPS benefit from the aforementioned rate cases and expects to offer additional color on the matter later in 1Q11. The company will also jointly file a cost of capital proceeding with three other water utilities in the state on May 1st of 2011. The company's cost of capital helps its allowed ROE and is filed every three years. As a reminder, in May, 2009, the CPUC approved CWT's cost of capital application with a 10.2% allowed ROE and 52% equity-capital-ratio. For more detail see *CWT: 4Q Disappoints in Part Due to One-Time Adjustments* originally published February 25, 2011.



WATER INFRASTRUCTURE UPDATES

Franklin Electric Reports Earnings – FELE (NR), a water and fuel pump manufacturer, reported 4Q10 adjusted EPS of \$0.39 vs. consensus of \$0.38. The company believes it is gaining market share in the water pump market (groundwater pumps and residential sump, sewage, effluent, and utility pumps), citing trade association data that shows shipments of company products in the U.S. grew at twice the rate of the industry as a whole.

Water Systems segment revenues increased 15% y/y to \$136M. Segment growth was entirely organic, as FX accounted for less than 1% of sales during the quarter. Water Systems sales in the U.S. and Canada (45% of segment sales) increased 18% from the year ago period. Sales of residential groundwater and wastewater pumps were particularly strong, while the industrial and irrigation product categories also grew at a double digit pace. Sales in developing regions (42% of segment sales) increased 21% y/y, with the Brazil, Mexico, Middle East, Africa, China and ASEAN markets each growing by more than 20%. Lastly, sales in Western Europe (13% of segment sales) increased 2% y/y. Double digit sales gains in Northern Europe were partially offset by declines in Southern Europe. Segment margins increased 90bp y/y as expense controls and operating leverage combined to more than offset higher raw material cost. That said, operating margins declined 70bp from the year ago periods due to higher SG&A costs. Furthermore, Water Systems sales price increases averaging about 4% and covering about 85% of the company's consolidated sales base will be fully effective 2Q11.

Fueling Systems segment revenues increased 45% y/y to \$39M. Management noted that the Fueling Systems segment will implement price increases in 1Q11 to offset raw material increases. These price increases average 5% and will impact about half of the Fueling Systems global sales volume. Price increases for the balance of the Fueling Systems revenue will become effective during 2Q11.

Regarding the outlook, management expects Water Systems sales growth to be in the mid-single digits in developing regions and moderate growth in the U.S. and Canada. Furthermore, the company is encouraged by early signs that 2011 may be a stronger year in the U.S. for agricultural and irrigation spending which would benefit sales in 2H11. Fueling system sales growth is expected to be 30% during 1Q11.

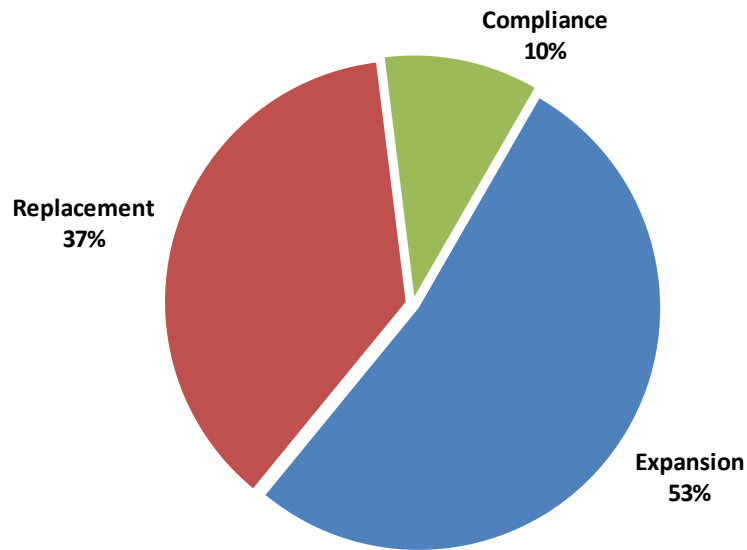
Insituform Reports Earnings – INSU (NR), a water, oil and gas pipeline rehabilitation company, reported 4Q10 EPS of \$0.44, in line with consensus expectations. Revenues during the quarter increased 15% from the year ago period to \$246M. This increase was primarily due to strength in the company's Energy and Mining and North American Sewer Rehabilitation segments. Energy and Mining segment sales increased 31% from the year ago period, primarily as a result of significantly increased activity in its industrial contracting and pipe coating businesses. Revenues in the North American Sewer Rehab segment increased 10%, while revenues in its European Sewer Rehab market declined 6% y/y primarily due to continuing market weakness in France and the United Kingdom. The company's Asia-Pacific Sewer Rehabilitation and Water Rehabilitation segments were relatively flat, quarter over quarter but declined marginally from the year ago period.

Gross margins in North American Sewer Rehab declined 460bp y/y to 23.7%. Management noted that market conditions in this segment remain strong and that the market will grow modestly in FY11. The European Sewer Rehab business achieved an operating margin of 11.2% despite a 6% decline in revenues. The company noted that backlogs in this segment were lower than the year ago period, but that it expects backlogs to expand in the months ahead as a result of growth in the UK. The decline represents the company's exit from the Romanian, Polish and Belgian contracting markets. More broadly, while the Water Rehabilitation operations came in below the company's expectations during the quarter, it expects business conditions to improve in FY11 as management now has a line of sight on a significant number of large projects to be bid or negotiated in 2011.

The company noted that total contract backlog stands at \$409M, while stronger bidding conditions are prevailing in early 2011. Furthermore, management is expecting FY11 to be the strongest in the company's history on continued momentum in every business segment. FY11 EPS is expected to be in the range of \$1.75 to \$1.90

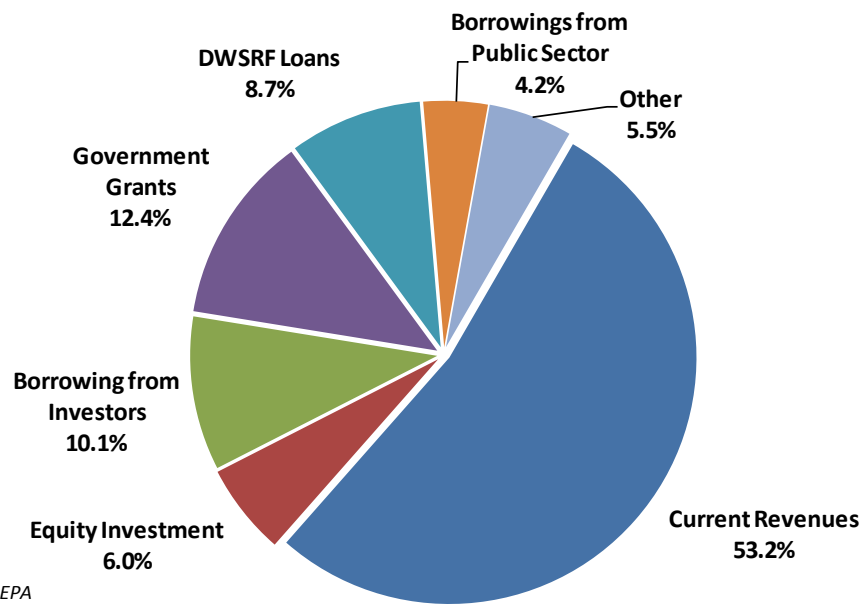


Water Industry Capital Expenditures



Source: EPA

Sources of Funding for Capital Projects



Source: EPA

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 | | | \$33.54 | \$39.61 | \$31.24 | \$ 618 | \$ 361 | 1.62 | 1.78 | 2.15 | 18.9x | 15.6x | 3.1% | 1.8x |
| AMERICAN WATER WORKS | AWK | Dec. | BUY | \$32 | 15% | \$27.74 | \$27.93 | \$19.41 | \$ 4,792 | \$ 2,093 | 1.53 | 1.72 | 1.88 | 16.2x | 14.7x | 3.2% | 1.0x |
| AQUA AMERICA | WTR | Dec. | Neutral | | | \$22.52 | \$23.79 | \$16.52 | \$ 3,129 | \$ 671 | 0.64 | 1.00 | 1.10 | 22.4x | 20.5x | 2.7% | 2.2x |
| CALIFORNIA WATER | CWT | Dec. | Neutral | | | \$35.28 | \$39.70 | \$33.81 | \$ 751 | \$ 460 | 1.34 | 2.12 | 2.28 | 16.7x | 15.5x | 3.4% | 1.8x |
| ARTESIAN RESOURCES | ARTNA | Dec. | NR | | | \$19.54 | \$19.66 | \$16.43 | \$ 145 | \$ 61 | 1.04 | 1.15 | 1.24 | 17.0x | 15.8x | 4.0% | 1.5x |
| CONNECTICUT WATER | CTWS | Dec. | NR | | | \$25.49 | \$28.27 | \$20.00 | \$ 214 | \$ 59 | 1.20 | 1.2 | 1.28 | 21.2x | 19.9x | 3.8% | 2.0x |
| MIDDLESEX WATER | MSEX | Dec. | NR | | | \$18.77 | \$19.31 | \$14.74 | \$ 279 | \$ 91 | 0.94 | 0.95 | 0.95 | 19.8x | 19.8x | 4.1% | 1.7x |
| PENNICHUCK | PNNW | Dec. | NR | | | \$28.12 | \$28.39 | \$20.49 | \$ 131 | \$ 33 | 0.84 | 0.95 | 1.15 | 29.6x | 24.5x | 2.6% | 1.8x |
| SIW | SIW | Dec. | NR | | | \$24.82 | \$28.24 | \$21.70 | \$ 444 | \$ 216 | 0.93 | 1.06 | 1.20 | 23.4x | 20.7x | 2.9% | 1.7x |
| YORK WATER CO (THE) | YORW | Dec. | NR | | | \$16.97 | \$18.00 | \$12.83 | \$ 215 | \$ 37 | 0.71 | 0.76 | 0.81 | 22.3x | 21.0x | 3.1% | 2.1x |
| Average | | | | | | | | | | | | | | 20.8x | 18.8x | 3.3% | 1.7x |
| EQUIPMENT/ FILTRATION/ TREATMENT SECTOR | | | | | | | | | | | | | | | | | |
| PENTAIR | PNR | Dec. | BUY | \$41 | 11% | \$37.08 | \$39.32 | \$29.41 | \$ 3,633 | \$ 3,031 | 2.00 | 2.31 | 2.73 | 16.1x | 13.6x | 2.2% | 1.6x |
| WATTS WATER TECH | WTS | Dec. | Neutral | | | \$39.11 | \$40.75 | \$27.51 | \$ 1,410 | \$ 1,234 | 1.60 | 1.68 | 2.24 | 23.3x | 17.5x | 1.2% | 1.3x |
| AMERON INT'L | AMN | Nov. | NR | | | \$70.66 | \$85.25 | \$55.42 | \$ 634 | \$ 503 | 5.10 | 3.22 | 4.25 | 21.9x | 16.6x | 1.7% | 1.1x |
| BADGER METER | BMI | Dec. | NR | | | \$39.31 | \$45.49 | \$35.35 | \$ 579 | \$ 277 | 1.88 | 2.05 | 2.31 | 19.2x | 17.0x | 1.5% | 3.9x |
| CALGON CARBON | CCC | Dec. | NR | | | \$14.04 | \$18.35 | \$11.75 | \$ 765 | \$ 412 | 0.68 | 0.88 | 1.05 | 16.0x | 13.4x | 0.0% | 2.5x |
| ENERGY RECOVERY | ERII | Dec. | NR | | | \$3.39 | \$6.77 | \$3.08 | \$ 172 | \$ 47 | -0.08 | - | 0.14 | NM | NM | 0.0% | 2.9x |
| FRANKLIN ELECTRIC | FELE | Jan. | NR | | | \$42.50 | \$45.63 | \$27.04 | \$ 950 | \$ 626 | 1.86 | 2.29 | 2.69 | 18.6x | 15.8x | 1.3% | 1.7x |
| GORMAN-RUPP | GRC | Dec. | NR | | | \$37.35 | \$38.93 | \$22.81 | \$ 604 | \$ 297 | 1.53 | 1.75 | 2 | 21.3x | 18.7x | 1.2% | 2.7x |
| ITRON | ITRI | Dec. | NR | | | \$56.71 | \$81.95 | \$52.03 | \$ 2,255 | \$ 2,265 | 4.00 | 4.20 | 4.2 | 13.5x | 13.5x | 0.0% | 1.6x |
| LAYNE CHRISTENSEN | LAYN | Jan. | NR | | | \$33.37 | \$36.92 | \$22.97 | \$ 626 | \$ 866 | 1.42 | 1.63 | 1.63 | 20.5x | 20.5x | 0.0% | 1.1x |
| MUELLER WATER PRODUC | MWA | Sept. | NR | | | \$4.06 | \$5.99 | \$2.21 | \$ 606 | \$ 1,338 | -0.19 | 0.01 | 0.15 | NM | NM | 1.8% | 1.2x |
| NORTHWEST PIPE | NWPX | Dec. | NR | | | \$23.74 | \$25.50 | \$14.62 | \$ 201 | \$ 283 | 0.12 | 0.73 | 1.47 | 32.5x | 16.1x | 0.0% | 1.0x |
| PALL | PLL | Jul. | NR | | | \$54.36 | \$56.00 | \$31.84 | \$ 6,066 | \$ 2,402 | 2.12 | 2.80 | 2.8 | 19.4x | 19.4x | 1.3% | 3.7x |
| SMITH (A.O.) | AOS | Dec. | NR | | | \$40.40 | \$45.80 | \$29.24 | \$ 1,816 | \$ 2,026 | 2.87 | 2.07 | 2.47 | 19.5x | 16.4x | 1.4% | 1.9x |
| Average | | | | | | | | | | | | | | 20.8x | 17.2x | 0.8% | 2.0x |
| WATER RESOURCES/ INFRASTRUCTURE | | | | | | | | | | | | | | | | | |
| INSITUFORM TECH | INSU | Dec. | NR | | | \$25.84 | \$30.00 | \$18.52 | \$ 976 | \$ 727 | 1.52 | 1.80 | 2.29 | 13.9x | 10.9x | 0.0% | 1.6x |
| LINDSAY | LNN | Aug. | NR | | | \$70.61 | \$79.56 | \$30.80 | \$ 858 | \$ 358 | 1.83 | 2.25 | - | 31.0x | 25.0x | 0.5% | 2.0x |
| TETRA TECH | TTEK | Sept. | NR | | | \$23.50 | \$27.16 | \$18.00 | \$ 1,406 | \$ 2,201 | 1.22 | 1.41 | 1.64 | 16.3x | 14.4x | 0.0% | 1.7x |
| Average | | | | | | | | | | | | | | 20.1x | 17.2x | 0.7% | 2.2x |
| Relevant Indices | | | | | | Share Price | | | | | | | | | | | |
| Dow Jones Industrials | | | | | | DJ30 | | \$12,219 | | | | | | | | | |
| S&P 500 | | | | | | SPX | | \$1,327 | | | | | | | | | |
| Nasdaq Composite | | | | | | NDX | | \$2,351 | | | | | | | | | |

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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|------------------------|--------------|----------------|
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| Sell | 2 | 0.8% |

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period.

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