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Swim Among the Water Stocks

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By Laura Cohn

The world is facing a growing shortage of fresh water. In fact, dwindling supplies of this most natural of resources are making water nearly as hard to find as oil. That means companies involved in selling, purifying or facilitating the transport of water should be good investments as the world grapples with reduced flows of the wet stuff.

Shares of water-related companies have bucked the tide during the market downturn. Over the past year to September 8, PowerShares Water Resources, an exchange-traded fund, broke even, while Standard & Poor's 500-stock index sank 14%. Some water stocks have performed remarkably well. Shares of [Northwest Pipe](#) -- which, not surprisingly, makes pipes for water infrastructure and other purposes -- have jumped 49% over the past year. Shares of American Water Works, a utility, have risen 3% since the company went public in April, outshining the S&P 500 by 13 percentage points.

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If you want to swim in the world of water, you have a choice of pools. You could buy shares of companies that make equipment for utilities, purification programs and other water-related projects. Also worth a look are companies that will replace the nation's aging pipes and provide new ones for transporting water to growing population centers. In addition, water utilities offer generous dividends and provide steady growth that could accelerate as demand increases and state regulators approve rate hikes.

Meanwhile, companies in the U.S. and in places with burgeoning populations and desert environments are investing in desalination plants, which purify seawater by extracting salt and other minerals.

Water, water everywhere. The purest water plays are, of course, water utilities. **American Water** works (symbol [AWK](#)), which went public in the spring after German utility RWE spun off 36% of its interest, is the nation's largest investor-owned water utility, with more than 15 million customers in 32 states and Canada. It also manages the largest desalination operation in the U.S., in Tampa. The stock, at \$21 in early September, trades at 15 times estimated 2009 profits of \$1.40 per share and yields 3.7%.

Some 2.8 million customers in 13 states, most of them east of the Mississippi, are served by **Aqua America** ([WTR](#)). Its shares, recently \$17, have sunk 27% this year, but bulls think

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they could recover if the company wins rate hikes in Florida and North Carolina next year. On average, analysts see earnings growing 16% in 2009, well above the industry norm of 10%. The stock trades at 20 times estimated '09 earnings of 85 cents a share and yields 3.0%.

The second-largest water utility, [California Water Service Group \(CWT\)](#), serves four western states and two million customers. It's the top pick of Hilliard Lyons analyst James Lykins, who says changes in California's regulatory climate are "constructive" and create "fair rate-making mechanisms." He sees the stock, recently \$38, climbing to \$44 within a year. The company has raised its dividend every year for 41 years running. The stock trades at 19 times estimated '09 earnings of \$1.99 per share and yields 3.0%.

Global manager. No company may be better positioned to cash in on rising global demand for liquids than [France's Veolia Environnement \(VE\)](#). It derives more than half of its revenues from managing municipal and industrial water facilities around the world. And it has desalination operations in Spain, Australia and the United Arab Emirates.

Veolia also has a presence in the world's most insatiable economy: China. The company serves 29 million people in China, thanks in part to a contract to supply water and operate a treatment facility in the city of Shenzhen, just north of Hong Kong. It also recently cut a water-production deal in Tianjin, the nation's third-largest city after Beijing and Shanghai.

Rising fuel prices have hurt Veolia's nonwater businesses, such as transport, putting its stock under pressure. At \$47, Veolia is down 46% since last December. But analysts look for a 17% jump in profits next year, to \$3.59 per American depository share. The stock trades at a reasonable 13 times expected earnings.

Backbone stocks. Infrastructure companies seem particularly good investments because of the looming water crisis. The U.S. has some 1.5 million miles of pipe transporting drinking water and wastewater from state to state. Over the next five years, 70% of the network will surpass its useful life. That means pipe builders will be busy replacing the nation's network of concrete pipes with steel pipes. What's more, the U.S. population is shifting to drier areas, such as Arizona, California and Texas. As the populations of those states continue to grow, local governments will have to add more pipes to carry water to residents and businesses.

Eric Marshall, co-manager of Hodges Small Cap fund, calls [Northwest Pipe \(NWPX\)](#) "the best pure play" in water infrastructure. The company is the leading manufacturer in North America of large-diameter steel pipelines for water systems. Dry states, in particular, covet Northwest's products because they're less subject to ruptures than traditional concrete pipes.

The company has a record order backlog of \$264 million, and it's likely to win more business in the coming months. Northwest is a strong contender to build a 350-mile pipeline project in Nevada that would move water to Las Vegas. The stock, at \$54, trades at 16 times expected 2009 earnings of \$3.35 per share, which represents a 14% increase from expected '08 results.

Who says oil and water don't mix? [Ameron International \(AMN\)](#) makes concrete and steel pipes for transporting water, as well as fiberglass pipes for moving oil and chemicals. In truth, Ameron's water-transmission business has been sluggish lately because of below-normal activity in the Southwest. But Ameron has strong pipeline businesses in South America, Europe and Asia, along with several joint ventures in the Middle East, so it seems well positioned to benefit from the global surge in water demand. William Brennan, president of Aqua Terra Asset Management and manager of the Kinetics Water Infrastructure fund, thinks the company, which recently bought a fiberglass-pipe manufacturer in Brazil, could be in the market for more acquisitions.

Analysts see Ameron's profits progressing smoothly. They forecast \$6.86 per share for the fiscal year that ends November 2008, up 12% from the previous year, and \$8.15 for the November '09 year. At \$109, the stock sells for 13 times '09 forecasts.

Desalination plays. Shares of some well-established foreign companies in the water business trade on the pink sheets, the non-Nasdaq, over-the-counter market. Consider [Christ Water Technology \(CRSWF.PK\)](#), an Austrian concern with \$396 million in annual revenues that sells desalination equipment. The company recently signed a deal for a major desalination project in the United Arab Emirates. Its shares trade at \$7. Japan's [Kurita Water Industries \(KTWIF.PK\)](#) builds desalination plants and sells other water gear,

deriving all of its annual revenues of about \$2 billion from water. The stock trades at \$32.

A domestic desalination stock with big potential -- and a lot of risk -- is **Energy Recovery (ERII)**. The San Leandro, Cal., company makes products that save energy during the desalination process. Given the massive amount of energy that desalination requires, the company's primary energy-saving product, called the PX, could prove to be a hot seller. However, the company is small (analysts expect sales of \$50 million in 2008), and quarterly results could be erratic, leading to big swings in the stock. Analysts see Energy Recovery earning 27 cents a share next year, up from 15 cents in 2008. At \$9, the stock has held steady since going public in July.

If you prefer to dip your toes into water stocks through a packaged approach, you can choose from three exchange-traded funds. As its name suggests, **Claymore S&P Global Water Index ETF (CGW)** invests in companies all over the world. At last report, 62% of its assets were in foreign stocks, with the vast majority representing large and midsize companies. It lost 9% over the past year to September 8. **First Trust ISE Water (FIW)** and **PowerShares Water Resources (PHO)** focus on U.S. stocks. PowerShares invests in companies of all sizes, while First Trust mostly owns small- and midsize-company stocks. Over the past year, the First Trust and the PowerShares ETFs essentially broke even.

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