

May 2, 2018

**Water Opportunities Separately Managed Account Program (WO SMAP)
April 2018 Update**

The main underlying thesis for investing in U.S. water utility/infrastructure stocks is their ability to steadily invest increasing amounts of capital and earn regulated returns which drives steady earnings and dividend growth. Hundreds of billions of dollars in investment is needed to improve America's water and wastewater infrastructure.

According to the Society of American Engineers, without renewal or replacement of existing water systems, pipes classified as poor, very poor, or life elapsed will increase from 10% of all pipes in the United States to 44% by 2020. The American Water Works Association (AWWA) estimates that investment needs for buried drinking water infrastructure total more than \$1 trillion nationwide over the next 25 years.

Water utility infrastructure is getting old and needs greater investments. Consolidation would, therefore, drive the necessary infrastructure overhauls that have become imperative. A recent example of the potential from the industry consolidation is the present bidding war going on for Connecticut Water Service, a stock we own in the WO SMAP.

The opportunities for growth in our sector is reflected in the fact that only 16% of the distributed water supplies are held by investor-owned companies. Most are controlled by municipalities and industries. Waste water facilities represent only 2%. These factors in our opinion create a huge opportunity for our 'investment space'. State legislatures are moving in the direction of incentivizing the sale of such facilities to accelerate the needed infrastructure. While water equities have been attractive longer term investments for many years, the impact of publicity following the Flint, Michigan disaster, and the ongoing media attention given to the deteriorating water systems in the US, has added significantly to the growth outlook of the companies in our portfolio.

While the March and April months for ELCO's Water Opportunities Separately Managed Account Program (WO SMAP) were profitable, there was some uncertainty as to regulatory impact from the Tax Cuts and Jobs Act which created negative reactions in January and February. The March and April numbers however reflects a better understanding of the impact coupled with greater visibility of future capital spending and its positive impact on margins. M&A continued with our largest holding, American Water Works, having made several acquisitions of municipal owned assets and reportedly several more are anticipated in the near future. In a recent conference call, it was reported that American Water Works plans to spend more than \$8 billion over the next five years in cap-ex and affirmed a 7-10 % long term EPS

growth rate for the 2018-2022 period. They also indicated a 5-year dividend growth rate (CAGR) of 11%.

In conclusion, scarce clean water with its positive long term pricing power and imbedded inflation protection stands in stark contrast to the glut conditions exacerbated by technology advancements and software disruption in other major asset classes such as power, transportation, retail, real estate, manufacturing, and insurance, to name a few. In our opinion, there is a scarcity value in this space which has created unique investment opportunities.

If you have any questions, please feel free to contact us.

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