

July 27, 2018

**Water Opportunities Separately Managed Account Program (WO SMAP)
June 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.

SJW Group (San Jose Water) has revised its bid for Connecticut Water (CTWS), as expected, to \$70 a share in cash in a roughly \$843 million transaction, which is about a 33% premium over the March 14 closing price of CTWS. The deal would create the nation's third largest publicly traded water utility. We believed a higher offer was forthcoming as consolidation is the need of the hour in the fragmented US water utility space. Water utility infrastructure is getting old and needs greater investments and its easier for bigger players to make. Consolidation would therefore drive the necessary infrastructure overhauls that have become imperative. In a recent conference call, it was reported that American Water Works plans to spend over \$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 affirmed a 5-year dividend growth rate (CAGR) of 11%.

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. More recently, North Carolina passed such legislation.

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.

Paul Elliot, CFA

Dan Tulis, CFA

James Elliot, CFA

Paul Doran

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200 Park Avenue
Suite 1700
New York, NY 10166
212.603.7585
212.333.9645 (fax)
msantos@elcomanagement.com