

## Clean Water

### 1. EXECUTIVE SUMMARY

- Increasing awareness of the main water challenges: water scarcity, rising water demand as well as water quality concerns continues to support the sector.
- Momentum for privatization of water utilities and outsourcing of contracts continues to be high. Meanwhile, M&A activities in the sector started to pick up.
- Stabilizing but weak global construction and renovation markets adversely affect water infrastructure providers.
- Water reuse, treatment and desalination continue to receive much attention. Companies in the sector were not immune for the market downturn, yet the regulatory frameworks continue to fuel the momentum.

### 2. CLEAN WATER

**Main water challenges of scarcity, increasing demand and quality concerns remain**

In emerging countries, the main water challenges are scarcity, lack of infrastructure and contamination.<sup>1</sup> Similar challenges, evidenced in lack of funding, apply on a global level too. During the fourth quarter and in early January, these challenges continued to make an impact, from the discussions at the Copenhagen Climate Change Summit and droughts which continued to affect people and livestock in China<sup>2</sup>, Australia<sup>3</sup>, the USA<sup>4</sup> and many other countries around the world, the topics continued to feature in the press. In January, the United Nations panel of climate scientists said it was reviewing a report containing a little-known projection that Himalayan glaciers might vanish by 2035, a finding trenchantly criticised by the Indian government. The announcement of the review follows an email scandal which emerged around the Copenhagen Climate Change Summit in December in which climate change sceptics accused researchers of colluding to suppress others' data.<sup>5</sup>

#### 2.1 WATER UTILITIES

**Outsourcing of water production and distribution services continues**

A lack of funds to update ageing infrastructure is one of the main drivers behind the privatization of water utilities and the outsourcing of water production and distribution services. Brazilian water utility Companhia de Saneamento de Minas Gerais' move in December for concession of sanitary sewage services to the cities of Carmo do Parnaíba and Buritis and the renewal of each city's water concession for 30 years is a case in point for this.<sup>6</sup> The municipality of Royan in France, in January awarded Veolia Water a 12-year contract to manage its water production and distribution services expected to generate cumulative revenue of EUR 17.3m.<sup>7</sup>

M&A activity in the sector continued to pick up in the fourth quarter; Agbar and Christ Water Technology have been taken over by Suez Environnement and GLV, respectively.<sup>8</sup> Meanwhile, American Water's non-regulated subsidiary acquired Environmental Management Company, a contract operations firm with a focus on municipal wastewater and water operations, in December.<sup>9</sup>

The regulatory framework continues to strongly affect the sector. At the end of November, industry regulator OFWAT published its final determination on price limits for the 2010 – 2015 period; forcing UK water companies to cut their tariffs by 1% in real terms over the next five years.<sup>10</sup> By end January all listed UK water utilities had accepted the ruling.<sup>11</sup> Also in January the water regulator for the Brazilian state of Minas Gerais set the 2010 tariff allowing COPASA a 4% increase.<sup>12</sup> As this is below the expected inflation rate, COPASA's share price was negatively affected by this decision.

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## 2.2 WATER INFRASTRUCTURE

**Construction markets stabilizing at a weak level thus adversely affecting water infrastructure firms**

Stabilising but weak global construction and renovation markets continued to adversely affect water infrastructure providers in the fourth quarter. In the US, privately-owned housing starts in December were at a seasonally adjusted annual rate of 557'000. This is 4% below the revised November estimate of 580'000, but 0.2% below the December 2008 rate of 556'000. An estimated 553,800 housing units were started in 2009, 38.8% below the 2008 figure of 905,500.<sup>13</sup> In Europe, the seasonally adjusted construction output decreased by 1.1% in the euro area and by 0.6% in the EU27 countries in November, compared with the previous month. In October, production fell by 0.4% and 0.3% respectively.<sup>14</sup>

In these conditions, infrastructure providers communicated that they expected the market environment to remain challenging for the remainder of the year. Wavin's announcement that revenue decline in Q4 will be more moderate than in the previous quarters as it compares to an increasingly weak last quarter in 2008 is a case in point for this.<sup>15</sup> As a coping strategy, Pentair for example focused on cost-cutting as one of the chief strategies to confront sagging demand for its products.<sup>16</sup>

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## 2.3 WATER TREATMENT

**Momentum for water treatment continues to be high, supported mainly by regulatory frameworks**

Momentum for water treatment, desalination and reuse continues to be high, although companies in the space have not been immune against the downward trend in the market. Desalination technology companies like Energy Recovery Inc., whose shares declined by 9% over the last twelve months, may have got caught up in a certain amount of hype surrounding the perceived potential of the market.<sup>17</sup> Tetra Tech Inc meanwhile, in November announced a net revenue increase for fiscal 2009 to US\$1.39 bn, an increase of 11.3% for the same period last year.<sup>18</sup>

Regulatory frameworks continue to provide support for the sector. The Chinese government looks set to double the amount it is committing to environmental protection. In the 2011-2015 Five-Year Plan US\$ 454bn has been earmarked for wastewater treatment.<sup>19</sup> Privatization of water assets in the Middle East took another step forward with the decision by the Dubai Electricity and Water Authority to tender for consultants to advise it on an independent water and power project, thus opening up the possibility of other desalination technologies being adopted, including multiple-effect distillation and reverse osmosis.<sup>20</sup>

### 3. INDEX NEWS

#### WOWAX offers exposure to the global water sector

The World Water Index (WOWAX) comprises the 20 largest companies in the global water business. The index covers all three clusters described above: water infrastructure, water treatment, and water utilities. Based on the last review in December 2009, Companhia de Saneamento de Minas Gerais and Wavin NV qualified for inclusion in the WOWAX. Companhia de Saneamento de Minas Gerais (COPASA) is a Brazilian water utility focussing especially on water supply and sewage services in the State of Minas Gerais. The company also provides technical cooperation services to municipalities and the private sector. Dutch firm Wavin offers innovative plastic pipe systems and solutions to customers and is active in two market segments: Building & Installation (above-ground pipe systems) and Civils & Infrastructure (below-ground pipe systems). Badger Meter and Calgon Carbon Corp were deleted from the WOWAX in December 2009.

Cluster allocation	cap weighted
Water Infrastructure	21.55%
Water Treatment	25.87%
Water Utilities	52.59%
	100.00%

Index performance	Q4 2009	FY 2009
WOWAX cap weighted	9.26%	25.57%
MSCI World	6.03%	25.94%

Additions & Deletions Q4 2009	Cluster	Type
Badger Meter Inc.	Water Infrastructure	Deletion
Calgon Carbon Corp.	Water Treatment	Deletion
CIA SANEAMENTO MINAS GERAIS	Water Utilities	Addition
Wavin NV	Water Infrastructure	Addition

Top 5 in Q4 2009	Performance (in USD)	Cluster
Uponor Oyj	29.18%	Water Infrastructure
Nalco Holding Co.	24.50%	Water Treatment
Guangdong Investment Ltd.	18.54%	Water Utilities
Geberit AG	15.27%	Water Infrastructure
Pennon Group PLC	13.94%	Water Utilities

Index components	ISIN	Cluster
American Water Works Co.	US0304201033	Water Utilities
Aqua America Inc.	US03836W1036	Water Utilities
CIA SANEAMENTO MINAS GERAIS	BRCSMGACNOR5	Water Utilities
Companhia de Saneamento Basico do Estado de S	BRBSPACNOR5	Water Utilities
Dionex Corp.	US2545461046	Water Treatment
Geberit AG	CH0030170408	Water Infrastructure
Guangdong Investment Ltd.	HK0270001396	Water Utilities
Kurita Water Industries Ltd.	JP3270000007	Water Treatment
Nalco Holding Co.	US62985Q1013	Water Treatment
Northumbrian Water Group PLC	GB0033029744	Water Utilities
Pennon Group PLC	GB00B18V8630	Water Utilities
Pentair Inc.	US7096311052	Water Infrastructure
Severn Trent PLC	GB00B1FH8J72	Water Utilities
Tetra Tech Inc.	US88162G1031	Water Treatment
United Utilities Group PLC	GB00B39J2M42	Water Utilities
Uponor Oyj	FI0009002158	Water Infrastructure
Veolia Environnement S.A.	FR0000124141	Water Utilities
Watts Water Technologies Inc. CI A	US9427491025	Water Infrastructure
Wavin NV	NL0000290856	Water Infrastructure
Woonjin Coway Co. Ltd.	KR7021240007	Water Treatment

## ENDNOTES

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<sup>7</sup> Veolia Environnement (2010): Veolia wins 12-year contract to manage water services in Royan, France, <http://www.veolia.com/en/medias/press-releases/water-services-royan.htm>.

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<sup>9</sup> American Water (2009): American Water Acquires Environmental Management Corporation, [http://pr.amwater.com/Press\\_Releases/releasedetail.cfm?ReleaseID=429995](http://pr.amwater.com/Press_Releases/releasedetail.cfm?ReleaseID=429995).

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<sup>12</sup> ARSAE (2010): RESOLUÇÃO NORMATIVA Nº 001/2010-ARSAE-MG DE 27 DE JANEIRO DE 2010, [http://api.ning.com/files/W4imgHtEjreWSr9h7TjFKtxAtq8bIC8R\\*DY9difObuW\\*Ax4XZml6b-EMYkGx-I8BDqXSe6-vRhzrFFgPM1Hr7rCYB7iz1APk/resolucao\\_normativa\\_001\\_2010.pdf](http://api.ning.com/files/W4imgHtEjreWSr9h7TjFKtxAtq8bIC8R*DY9difObuW*Ax4XZml6b-EMYkGx-I8BDqXSe6-vRhzrFFgPM1Hr7rCYB7iz1APk/resolucao_normativa_001_2010.pdf).

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