

Is Water a Rising Tide for Investors?

Despite the drought in the western U.S., the water sector remains a good investment.



With reservoirs, dams, pipelines and other aging water infrastructure in need of replacing, investors could see a steady flow of opportunities in the water sector.

By [Joanne Cleaver](#) July 16, 2015 | 9:00 a.m. EDT+ [More](#)

Drought, floods and insatiable thirst for irrigation: [the water sector](#) is suddenly simmering.

But, like climate change, the water sector is a long-term play, analysts say. Here's how to size up potential opportunities in both [municipal bonds](#) and equities, based on the reasonable assumption that water is an ever-more-valuable commodity.

At first glance, [drought in the western U.S.](#) might seem to compromise municipalities' abilities to repay bonds based on water income. After all, they can't charge for water that's not flowing, right?

Not so fast, says Dick Larkin, director of credit analysis with HJ Sims & Co., an investment banking firm in Boca Raton, Florida.

Municipalities can charge more for water, ensuring cash flow and offsetting the lower volume of water. And it's standard, he adds, for bonds to have a one-year reserve of payments for precisely these types of situations.

The bigger opportunity is how municipalities and whole regions must start replacing aging water infrastructure, Larkin says. Reservoirs, dams, pipelines and treatment plants that were built in the mid-20th century are starting to spring leaks. With increased public awareness of water conservation and increased expectations of stewardship, water agencies may well reinvent how water is sourced, stored and purified – instead of just plugging leaks.

It's the [discussion about climate change](#), more than the actual current climate, that is shaping the investing environment, Larkin says. "If the water isn't coming down, we have to figure out how to reuse the water we're using today," he says. "I believe that eventually it will result in a crisis unless leaders start planning for it. There's a great need for municipal bonds to build [water infrastructure], but we won't see that for at least 10 years. This crisis needs to season a little bit."

"It's a slower moving trend, but it won't go away," agrees David Parker, senior utility analyst with Baird, a Milwaukee-based investment management firm. Drought and [unusual weather patterns](#) – which may or may not evolve into genuine climate change – are injecting urgency into water agencies' decisions. "When you have a crisis, that's when stakeholders and policymakers think, 'Maybe we should do something and not just hope it will rain tomorrow,'" he says.

Equity analysts agree that the main opportunities in water are in measuring, controlling and purifying it. Technical innovation is slow and steady, mainly because it keeps pace with market demand: Water agencies must merge new technologies with existing infrastructure, and that means a constantly evolving patchwork. "It is a long-term play. There's no silver bullet technology. There's no Uber for water industry, no killer app. The rate of adoption of new technology is slow," says Matthew Dickerson, managing director of Summit Global Management, a San Diego-based investment management firm.

That also translates, they say, to unglamorous but consistently performing companies whose gear are embedded in wells, distribution systems and plants. As pressure rises for better water management, utilities are likely to accelerate their adoption of new technologies, analysts say, especially in [developing nations](#).

Water equities, however, are rarely a pure play because most companies that produce water gauges, meters, pipes and systems do the same for gas, oil and other aspects of infrastructure, says David Brigham, co-portfolio manager of Piper Hill Partners, a research firm in Weston, Vermont.

Badger Meter Inc. (ticker: BMI), in Milwaukee, is one of the few, Brigham says. It is an analyst favorite due to its constant drizzle of innovations. Another up-and-comer is Artesian Resources Corp. (ARTNA), which provides large-scale consulting, engineering and project management. Northwest Pipe Co. (NWPX) has even figured out how to generate electricity as a byproduct of water flowing through its new line of wired pipes. "Water is a mid-cap universe," Brigham says.

Utilities and agencies are most likely to invest in efficiency and recapture technologies, Dickerson says. Ultraviolet treatment for purifying water has been available for more than two decades and finally might be worth its cost. Smart metering, leak detection, cost-effective desalination and monitoring software are all technologies poised for rapid adoption, he says.

Meanwhile, well-run utilities are starting to anticipate changes in water sourcing, demand and use, and that means demand for innovations that will improve efficiency and lower waste. "The system has assumed that you could use as much as you like, but now it's starting to be focused on sustainability," Parker says.

Baird gives positive marks to proactive utilities including American Water Works Co. (AWK), Aqua America Inc. (WTR) and The York Water Co (YORW).

"Water is misunderstood because people take it for granted until they run out of it," says Marc H. Robert, a partner with Water Asset Management LLC in New York. Utilities and agencies will likely find that they can raise the temperature on prices a bit to support innovations and infrastructure improvement. "Water is relatively inexpensive for what it provides, and is underpriced relative to its full cost of delivery. It's similar to other infrastructure – but you can't live without water," Robert says.