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American Water Intelligence

Market-Leading Analysis of the American Water Industry

COMPANY NEWS

Veolia's gateway to the West

Veolia has been tapped to help the St. Louis Water Division improve its operations. The French firm is now eyeing similar opportunities in southern California. PG8

INSIGHT

Déjà vu for Siemens' water segment?

Former Siemens Water Technologies and USFilter executives give their thoughts on what can be expected from the sale of SWT – and on the history that shouldn't be repeated. PG9

MUNICIPAL NEWS

Louisville's top slugger

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MARKET ANALYSIS

Chasing paper

The changing water needs of the pulp and paper industry put suppliers of advanced treatment equipment in a great position. PG18

TRACKER UPDATES

Visalia WWTP Upgrade, CA: Mandatory statements of qualification are due Jan. 18 for this $140 million project.

Greenwood New WWTP, MS: A construction RFP will be advertised Jan. 4 for this $31 million contract for a new activated sludge WWTP.

Turn to page 32 for this month's tracker: $272.8 million in new projects and $4.4 billion in updates.

ANALYSIS AND COMMENTARY

2013 regulatory forecast

AWI explores key federal regulations and legal developments that could impact public and private players in the water and wastewater sectors in the coming year. PG14

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THE WATER ECONOMY

Alexander Miles, a managing partner at Kingfisher Capital, explores new, innovative and contrarian ways of evaluating water as an investment.

It's a new world ... be brave

As developed economies continue to navigate The Great Era of De-leveraging, investors are adapting to their new surroundings. Federal and municipal governments face both immediate and long-term fiscal challenges resulting from a host of issues, ranging from a tepid economic outlook to the impending, sustained austerity initiatives for addressing structural debts and deficits.

At the time of this publication in late December, our federal lawmakers are attempting to meet the latest in a series of fiscal planning deadlines. And their apparent ineffectiveness in collaborating for meaningful, common-sense compromise continues to test the wills of those who allocate capital, particularly to long-lived assets, for a living. While a deal to avert the "fiscal cliff" is certainly likely, the composition of the compromise will not likely transform the debate on either entitlement or tax reform, nor will it provide any long-run transparency for those looking to plan in years and decades rather than months and election cycles. Worse yet, the delay in reaching agreement highlights a disturbing and increasingly inherent dysfunction in the manner in which our government operates. Were market participants to eventually conclude that this dysfunction was a permanent rather than a fleeting condition, they might further withdraw risk capital and ultimately exit the system, in similar fashion to what Southern Europe is facing.

The coordinated efforts of central monetary authorities around the world, led by Federal Reserve Chairman Ben Bernanke, have provided an unprecedented flood of liquidity into global capital markets. Bernanke's purchases of treasury bonds and other assets have been designed to keep interest rates low and the yield curve flat. His initial target has been to allow banks to recapitalize in advance of increased regulation, while inflating the value of residential housing, where much of our consumer wealth is trapped. Thus far, his efforts have helped restore confidence to risk markets and spurred renewed interest in infrastructure investments. But these actions are a bridge, not a destination, and the recovery remains fragile. The hope is that by removing the threat of deflation, the Fed can sponsor a virtuous cycle in which asset prices rise, spurring confidence and ultimately investment. But fiscal authorities must leverage the positive momentum to demonstrate a longer-term path toward sustainable deficit reduction.

Despite any real progress in promoting fiscal responsibility, the global economy appears to be on the mend. The spread between Spanish and German 10-year government bonds had contracted from a peak of 626 bps in late July to 375 bps by late December, demonstrating an increased confidence that the Eurozone will remain unified and avoid a deeper recession. Global stock markets turned up into year end, many closing at or near their annual highs. U.S. banks are healthier than they have been in five years, and are poised to benefit from a further uptick in the economy and an eventual steepening of the yield curve.

The value of water

In last month's issue (*p4*), AWI pointed out that many water and wastewater utilities have been slow to cash in on the profligate debt issuance opportunities that many other infrastructure-minded enterprises have "leveraged" over the past couple of years. History may prove them to have been overly risk-averse. Yet water utilities' caution speaks to a greater fear – the fear that they may not be able to pass on higher rates to their customers and earn a fair return on their investments.

Capital has always migrated to where it is best treated, and I have long believed that the retail price of water will likely never reflect its true economic value. Xylem's insightful Value of Water Index points to some of the reasons why. Nearly 90 percent of survey participants believe that government should be accountable for fixing water infrastructure problems. What exactly does that mean? Does it mean that citizens are entitled to receive and our government is obliged to provide abundant clean water and wastewater management services? Are we to fund that investment through rate increases or in the form of higher taxes? Are we equally entitled to live in a safe neighborhood? Are we entitled to electricity? Are we entitled to medical care? Are we entitled to an education? How about cable television and an internet connection?

Our government has ever-increasing responsibilities and diminishing sources of revenue. Many European economies, as well as Japan, may have already reached the tipping point at which sustained, elevated debt levels curb economic growth. As the obligations grow, the share of revenue contribution grows so disproportionate that rational individual and corporate generators of wealth are forced to exit the system, leaving an even bigger hole for governments to fill. Eventually, governments will be forced to restructure past promises to their citizenry, but not before losing the most productive members of their economy.

Both consumers and governments must prioritize how they allocate capital, and the Xylem survey observed that 60 percent of water utility customers are willing to pay more each month if those funds are allocated to supporting their water infrastructure. This data is a very positive sign that water users are beginning to think more rationally, and that customers may be finally recognizing that the provision of clean water is not free, whether provided by the government or someone else.

Alexander Miles is managing partner and chief investment officer at Kingfisher Capital.