

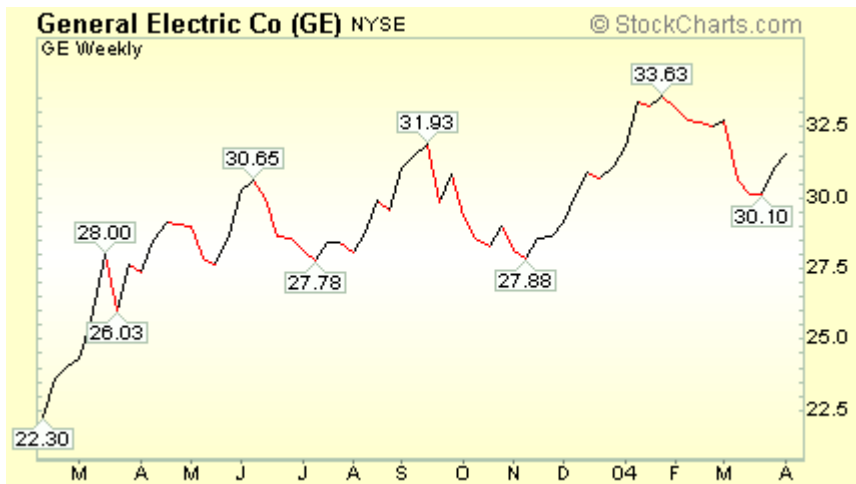


March 2004

Water Roundtable

The following is a transcript from the "water roundtable" section of the television program, *Wall Street Week with FORTUNE* as it aired on KPBS, March 19th, 2004.

GEOFF COLVIN: Oil is the world's biggest industry, followed by electricity, but what's third? The answer is the ultimate necessity, water -- a global business growing so fast that some analysts say it's the coming century's oil. In the developing world, dirty water is the planet's worst health problem. In developed countries, demand is rocketing while the water infrastructure is crumbling. Giant corporations are suddenly interested: When [General Electric](#) recently identified a handful of industries likely to grow twice as fast as the economy for years to come, water was prominent among them, and GE has jumped into the business. Should you?



Debra Coy is the leading investment analyst covering the water industry; she's with the Charles Schwab Washington Research Group. And John Dickerson is one of the world's leading water-industry investors. He joins us from San Diego.

Debra, here in the U.S. most people get their water from water utilities. Most of these are not investor owned, not publicly traded. The prices are regulated. Where's the investment opportunity?

DEBRA COY: Well, even those that are not investor owned have to buy a lot of pumps and valves and filtration equipment. Their pipes are falling apart. We've got to work on that. So there's certainly a lot of investment that the non-investor-owned water utilities are making. And because it's often difficult for particularly some small cities to meet all those requirements, new environmental standards, upgrade of treatment systems, they're turning to the private sector in some cases to help them manage or even to take over ownership of their small utility systems, so that's an opportunity as well.

COLVIN: It is a big trend, privatization of water utilities. Now where is this whole vast world water industry are the best opportunities for profit now?

JOHN DICKERSON: Well, as Debra said, they're in the industrial side of the water industry, the pumps, pipes, valves, filters. We have the same amount of water today on the planet that we had a million years ago, but we have 6 billion people now competing for that asset. At the same time, we're not only competing for the asset, we're more and more increasingly polluting the other, the remaining water, if you will, both ground water, MTBE, and the like.

COLVIN: And that's where we get into purification, which both of you have talked about as a big opportunity, and in fact some big companies now are getting into this. It used to be a small business kind of industry. Now big companies, including General Electric, are getting into it in a big way. And in fact they have been running a commercial on television very heavily promoting their involvement.

(video clip begins)

COMMERCIAL: Each year GE technology helps industry purify billions of gallons of water to a standard even higher than drinking water, because pure water just performs better.

(video clip ends)

COLVIN: And of course the classical music aficionados recognize that as the "Water Music" by George Friedrich Handel. But what is the significance of GE, Debra, being in this business now?

COY: Well, I think GE has figured out, as they started looking around their portfolio of businesses, that they wanted to be in some higher growth businesses. They didn't want to be an old industrial company. They want to be a new industrial company. And water certainly has the prospect of growing at about twice the rate of the overall economy, as they have said, as I have seen, because of the need for investment, both for industrial treatment and for municipal infrastructure upgrades

COLVIN: We haven't seen all the gains yet?

COY: No, I don't think so. I mean I think we're really at the very early stages. I look at this sometimes like the early stages of growth and consolidation in the telecom industry. We're seeing technology development. We're seeing consolidation. There are literally hundreds of little companies out there that GE and some of the others are looking to buy. We're going to see larger companies develop I think.

COLVIN: Debra, I don't know if you remember a reality series recently called Rich Girls, but oddly enough they had something to say about water.

(video clip begins)

CLIP FROM RICH GIRLS: You know what I find is weird kind of, Allie? People pay money for clothes, okay? But shouldn't it be like a free necessity like water because you need it?

(video clip ends)

COLVIN: Now she thinks water is free, and apparently a lot of other people do, too.

COY: A lot of people do, but it's not. Water may fall from the sky, but it doesn't get to your, doesn't get to your tap for free. And that's the thing that people forget because it is a very, very cheap utility, and people aren't used to thinking about their water bills, so it's only just beginning to become apparent to them how much effort it takes to get the water from here to there.

COLVIN: Most of us still don't pay very much for water. We don't even notice how much we pay for water, for the most part. How big is the water problem facing the United States?

COY: Well, certainly a lot of people lately are looking at an EPA study that they came out with about a year and a half ago, their so-called gap analysis, which was the gap between what's being spent on water infrastructure and what needs to be spent. The number that they came up with, and this came from surveying cities all around the country, was a half a trillion dollars is the shortfall in terms of what needs to be spent to upgrade water infrastructure across the U.S. So that's a big number. Even in Washington they notice those kinds of numbers.

COLVIN: Yes, you would notice that. And that means what? Rates are going to have to go up, right? Bottom line.

COY: That means rates are going to have to go up. And that is certainly, investors say, well, water's been a problem for a long time, why do you think that finally this investment is going to start taking place? And I think because of contamination problems and water main breaks, people are noticing. And when they start to look at it, they complain about their water rates going up, but their water rates are cheap. The average water bill in this country is about \$16, \$17 a month. Relative to cable and electric and cell phone, it's cheap.

COLVIN: There's a Charles Schwab Water index.



COY: Yes.

COLVIN: Which since January 2001 is up 34 percent, a period over which the S&P is down 14 percent.

COY: Correct.

COLVIN: Nobody thinks of water as a growth industry, right? As something that would outperform the S&P.

COY: I do.

COLVIN: You do, but this is the battle you're fighting, right?

COY: The truth is that water utilities, relative to electric and gas utilities, are already faster growing because of the capital investment and return on that and because of the consolidation that's taking place. But then there's these other treatment equipment technology firms which are growing again through a combination of demand and also consolidation, so we have earnings growth rates in some of these companies that's certainly in growth rate territory in the fifteenish percent kind of range, which does.

DICKERSON: Geoff, could I say something on that?

COLVIN: Sure.

DICKERSON: I have some numbers I brought along on Aqua America. It used to be named Philadelphia Suburban. I lot of people know it by that name. But for the 10 years just ended at the end of January, Aqua America had a 10-year compound growth rate of 20.5 percent. It exceeded the growth rate, total return, of companies like Johnson & Johnson, General Electric, Wal-Mart, Home Depot, Procter & Gamble, Merck, it goes on. In other words, the stocks have been exceedingly good performers for a very long time, and nobody knows it. Nobody pays attention.

Aqua America (WTR) NYSE



COLVIN: Nobody pays attention, and that company is not even in the technology or the filtration or any of that. Those are utilities.

COY: That's a utility.

DICKERSON: They have grown very heavily by acquisition and they're able to by these little utilities from very much a buyer's market. These little utilities don't have access to capital markets, cannot upgrade their systems to meet regulatory standards. And a Philly Suburban and many of the other investor owned utilities are able to buy the Mom & Pop utility at a return on capital or a return on equity that rivals any business in the land.

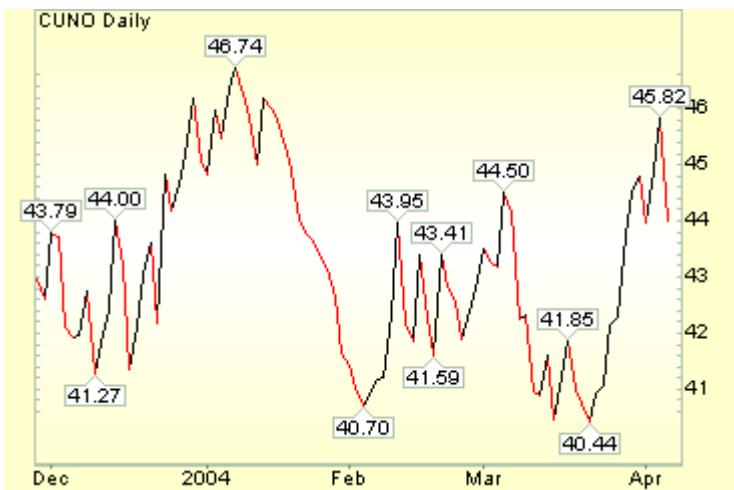
COLVIN: Now who do you like? I mean the companies that you think are most promising.

COY: Pentair is a company that was a diversified industrial manufacturer and has recently announced that they're divesting their tools business and acquiring a water company, one that's more in the pipes and pumps and valves and pool and spa treatment business, and they're turning themselves into a water company. It's an interesting opportunity. We've certainly already seen some response in the stock price. And there are some of the small filtration companies that aren't Wall Street household names, but have performed very well over time, including in the filtration side Cuno would come to mind. Cuno is a top filtration manufacturer of both the kind of small, the small cartridges that go into refrigerators that give you clean water out of your refrigerator, all the way up to industrial and pharmaceutical manufacturing.

Pentair, Inc. (PNR) NYSE



Cuno, Inc. (CUNO) NasdaqNM



COLVIN: A fast-growing industry where most people least expect to find it. John Dickerson, Debra Coy, thank you very much.

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