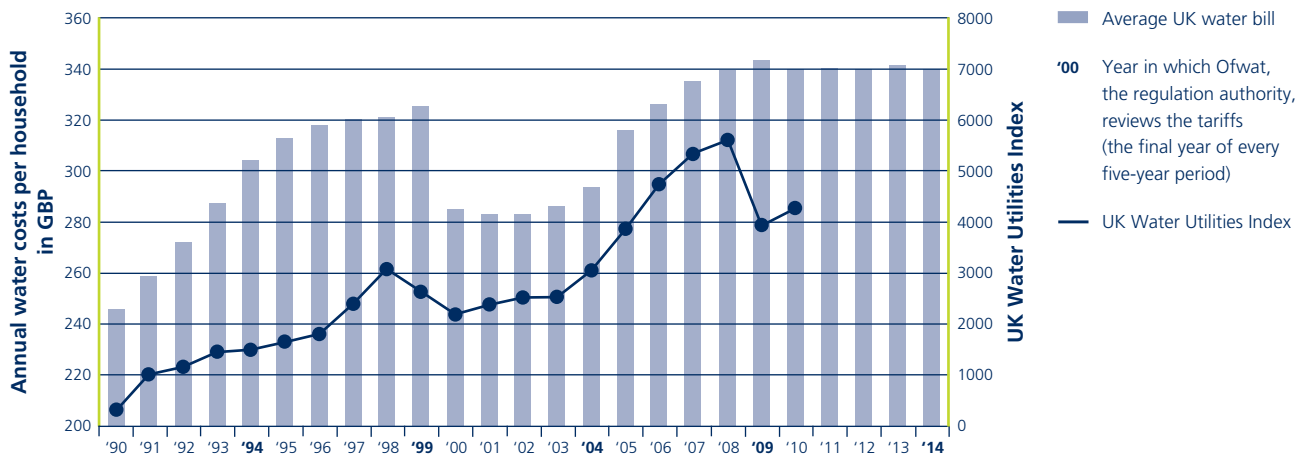


UK water utilities: untapped potential

Clean water pays off



Source: Ofwat, SAM

SAM's sustainable water strategy spans both cyclical and defensive investment clusters. The latter include water utility companies, whose business – both the supply of drinking water and the treatment of wastewater – is capital intensive and heavily regulated. There are only a handful of privatized water utilities worldwide whose shares are available to investors. There are a few opportunities in England and Wales. Of the 28 private water utilities active there, four are listed on the stock market. Every five years the UK water services regulation authority, Ofwat, sets the operating parameters for these companies. It specifies the level of investment to be made, water and sewage charges and the permitted return on assets. As the effects of inflation are also passed on to customers, the business performance of the utilities can be fairly accurately predicted five years ahead. The above chart illustrates that the UK Water Utilities Index often tends to anticipate tariff trends.

Water utilities are to a large extent immune to economic cycles. The shares of defensive water companies therefore tend to

outperform during economic crises. However, last year investors were well advised to steer clear of UK utilities despite the crisis, because the economy slumped in exactly the same year as the new five-year tariff plan was agreed; and most market players assumed a negative impact from stricter regulation. We took advantage of an opportune entry point at the end of the year, when the market had priced in an unduly pessimistic scenario and the final tariff agreement had been published. Also going forward we believe that UK water utilities offer further upside potential in the short term.

“The shares of UK water utilities could continue to climb. Given the growing interest from infrastructure funds in making acquisitions, UK water utilities are suitable as defensive shares to complement any water portfolio.”



Urs Schön
Senior Analyst

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