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**Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, Tortoise provides a timely update on trending topics in the market.**

Welcome to the Tortoise podcast series on the water sector. Thanks for listening. I am Maggie Zastrow, and I'm joined by Nick Holmes and Evan Lang, leaders of Tortoise's water platform. We are touching base with them to discuss performance year-to-date and the latest news in the sector

**Maggie:** Nick let's start with you and performance. Can you give us a brief overview of how the water market has performed during these interesting times?

**Nick:** Thanks Maggie. Sure, performance has generally been relatively strong for the water sector YTD. After a strong start to the year, the sector proved to be relatively defensive during extreme market volatility in March driven by COVID-19. Through 1Q, the S&P Water Index was outperforming global equities by ~200 bps, however during the market rebound in April the water sector performance has lagged a bit and is now performing in-line YTD through April. I would note that Tortoise managed water strategies are performing well for the year, outperforming the water index by ~500 bps. [For additional information, please visit [www.tortoiseadvisors.com](http://www.tortoiseadvisors.com).]

**Maggie:** That's Great, what do you attribute the relatively solid performance to year to date?

**Nick:** Sure, in our view, performance of the asset class during the height of market volatility in 1Q highlighted the defensive nature of water infrastructure companies, specifically the regulated utilities. The critical nature of their activities provides support for sustainability of earnings and cash flow generation, which was clearly highlighted in equity performance during market uncertainty. Water utilities are particularly well positioned due to their regulated asset base, earnings stability, and attractiveness in the low rate environment.

**Maggie:** So as the market continues to evolve during these uncertain times what opportunities and risks do you see for the water equities?

**Nick:** Good question, I would start by saying we continue to favor regulated utilities for the reasons I just mentioned. However, we do expect to see volatility in the near-term in some of the equipment and services companies in the sector. Specifically, we believe companies with residential and commercial end market exposure will face some challenges in the coming quarters. Additionally, we could see spots of weakness in certain municipal end markets as there is potential for project delays which would slow growth for those companies selling into that end market. The last point I would make here is we expect industrial activity to pick back up fairly quickly, as we have witnessed in China, following the relaxation of shelter in place orders which would benefit companies providing products, technology and services to the industrial space. Specifically, we are seeing increased investment from health care, pharmaceuticals and food and beverage industries within the industrial sector.

**Maggie:** Evan, let's turn to you. Nick highlighted the resiliency of the water sector and the short-term impacts of COVID-19. I want to re-focus the discussion on the long-term. How do you see this pandemic impacting long-term themes in the water sector?

**Evan:** Thanks, Maggie. That's a great question. As Nick highlighted, we believe the water sector is relatively well insulated in the short-term, and the sector will largely continue as normal, if there is such a thing these days. Over the long-term, though, we believe the virus will act as an important catalyst to accelerate many of the trends currently underway. An acceleration of these trends could have a profound impact on not only the day-to-day operations of the water sector, but also the total return opportunity for investors.

**Maggie:** That's great to hear, let's start unpacking these long-term views. Where do you see the largest, most immediate impact in the sector?

**Evan:** The most notable impact, in our view, will be on government owned water systems. For this discussion, we will focus on the US where there are approximately 49,000 and 18,000 government owned water and wastewater systems, respectively. With coronavirus unfortunately resulting in rising unemployment and lower incomes, state and local governments are expected to face acute budget shortfalls due to lower tax revenue. At the same time, water and wastewater infrastructure are in desperate need of investment as water leaks remain rampant with 20-30% of water supplies lost due to poor condition of pipes and water systems face increasing threats from emerging contaminants, including PFAS, lead, and algae blooms. As a result of the imbalance between lower budgets and continued need for investment, industry participants believe state and local officials are more likely to sell their water systems in order to improve their balance sheets, plug underfunded holes such as pensions, and ensure needed investments are made. Investor-owned utilities remain the natural acquirer, and regulations are in place to facilitate these transactions, supporting our view that M&A will remain robust. We believe this is a compelling opportunity as for investors as M&A increases long-term earnings growth, and in turn, the total return profile of the investment.

**Maggie:** That's interesting. Where do you see other opportunities?

**Evan:** The area we see the most opportunity is technology. We have long been proponents of the exciting innovation of the sector. In fact, the technological innovation and growth in the sector is a key reason we entered the space over 5 years ago. The situation the world faces today is magnifying the positive impacts technology is having on the water sector, and we expect those with leading technology offerings will emerge strongest out of the current environment.

**Maggie:** And what technologies do you feel are best positioned?

**Evan:** The technology that stands out the most currently is smart water solutions, which harness state of the art hardware and software applications that allow for offsite monitoring and operational control through a digitally enabled network. This technology empowers utilities and industrial users of water to gather real-time insights into water supplies and asset condition, analyze water quality, and utilize advanced algorithms and artificial intelligence to detect leaks and optimize capital spending. As cities across the globe enact shelter in place measures, this technology is proving incredibly valuable. We believe it will become even more critical as severe weather driven by climate change, such as recent wildfires in California and Australia, limits physical access to water and wastewater systems. We believe the current environment, along with increased impacts from climate change, will drive accelerated uptake of the technology. Current global adoption is relatively low, providing line of sight to a long run way of attractive growth.

**Maggie:** Again, that's great. What other technologies are playing a key role in combating Coronavirus?

**Evan:** Another one in the news recently is water testing technologies as they are being used to detect COVID-19 in wastewater supplies. We applaud the creative approach to detect the virus and believe it is a testament of the innovative technology in the water sector. This is not the first time testing is making headlines for its benefits to society as water testing has been used to detect emerging contaminants, opioids, and the spread of antibiotic resistance. Advancements in technologies have been substantial over the years. We use to measure water in terms of parts per millions, now it is so advanced we do it parts per trillion! Even further, testing technologies are being developed that enable portable testing devices to analyze water on the spot and potentially link the contaminants to health effects. We believe Coronavirus is the latest example of the benefits of water testing technologies, and we expect increased adoption of these going forward as the water sector faces an increasing number of threats from viruses, bacteria, and chemicals. Detection of these are key.

**Maggie:** So, if the Coronavirus is being found in our wastewater, is there a public health risk?

**Evan:** Good question, that brings us to the last technology we wanted to highlight, and that's water filtration and treatment technologies. Advanced filtration and treatment methods, such as reverse osmosis, membrane filtration, and ultraviolet (UV) disinfection, have made significant technological strides through improvements in material science, system design, and energy efficiencies. Now, these technologies are increasingly deployed to rid water and wastewater of bacteria, viruses, and other harmful contaminants. Filtration and treatment technologies are now so advanced that the sector can tune the quality

of water to meet an exact specification required by end users. Examples range from optimizing water quality for the world's largest coffee chain to ensure taste consistency across the globe to treating water to its ultrapure form in the manufacturing of semiconductors. With these technologies, along with other treatment methods, we don't see public health risk from Coronavirus in wastewater. But we do believe the increased attention to sanitation as a result of Coronavirus is the most recent addition to a number of tailwinds driving growth going forward.

**Maggie:** And how do investors participate in this growth?

**Evan:** Within our global universe, technology offerings are found in the equipment and services sector, which is comprised of over 60 companies with an aggregate market cap of ~\$400B. We believe the current sector composition presents an attractive set of investment opportunities. Going forward, we expect this universe to grow through IPOs, spinoffs, and other corporate actions as companies try to highlight and capture the premium multiple the market places on water technologies. We have seen a number of examples of this over the past 5 years, and we expect the trend to continue.

**Maggie:** And how will the technology offerings impact total return?

**Evan:** At Tortoise, we view total return as yield plus growth plus the change in multiple. Technology oriented companies are attractive within this framework. Let's take each component step by step. First, the sector's current yield is ~2.5% [as of 5/6/20], but technology oriented companies generally pay little to no yield. As a result, this is largely an earnings growth story. Based on our view, we see long-term growth in the high single digits for the water sector, with key technology offerings growing in excess of that, some well into the double digits. All in, our projections is yield plus growth for the sector equates to a 10-12% expected total return, with technology-oriented companies potentially offering upside to that.

**Maggie:** So in your opinion, how will the change in multiple impact potential returns?

**Evan:** The change in multiple is always hard to predict, but water appears well positioned to re-rate as technology adoption occurs. Based on M&A in the water sector over the past 10 years, cash flow multiples for high-end technologies fall in the 15-20x range due to the growth, profitability and barriers to entry. Currently, the water sector trades at a 10-12x multiple. As innovative technology are adopted, we believe the water sector could re-rate to the premium technology multiple, driving further upside to the 10-12% total return potential noted earlier.

**Maggie:** Thanks, Evan. That's great color on the long-term opportunity within the water sector. Any closing thoughts before we wrap up?

**Nick:** Sure, this is Nick, I will provide a few concluding comments. As we have discussed today, we believe infrastructure companies in the water sector will provide resilient earnings this year which will be rewarded in equity markets. While we expect near-term volatility in certain areas of the water sector, we believe long-term tailwinds will emerge due to COVID-19 as Evan has laid out. These tailwinds will largely be centered around the technologies mentioned as well as the need for investment in infrastructure. We believe the fundamental issues around water scarcity and quality issues that are impacting the world today haven't changed and in some instances have been exacerbated by COVID-19 highlighting the need for water infrastructure and technology, which presents a compelling fundamental investment opportunity in our view.

Thank you both for joining. You can find our next water podcast following the end of Q2.

**Thank you for joining us. And stay tuned for our next cast. Have topics you want covered or other feedback to share? Write us at [info@tortoiseadvisors.com](mailto:info@tortoiseadvisors.com).**

The **S&P Global Water Index** is comprised of approximately 50 securities selected based on the relative importance of the global water industry within the company's business model from a universe of companies listed on global developed market exchanges.

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