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Aqua America CEO eyes more acquisitions in 2017

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Aqua America is in the right place at the right time.

At least that's the outlook from CEO Christopher Franklin, who expects the Bryn Mawr-based water and wastewater company to continue a ramped up acquisition strategy in the coming year thanks to legislative changes in its home state, an increased federal focus on infrastructure and a ripening market for water system privatization.

Its situation is strong enough for one industry analyst to call the publicly held company – which employs 738 people in Pennsylvania, including 427 in the southeastern region, and serves more than 1.4 million people in the state – “among the best-run companies in the water space.”

While the number of Aqua's acquisitions in 2016 was in line with 2015 – it bought 19 municipal water systems, nine in the fourth quarter alone – the amount of customers it drew in with each purchase was more substantial, said Franklin. Last year, its acquisition growth included the addition of 6,500 customers.

It plans to spend five times as much money on acquisitions in 2017 to bring in substantially more customers per deal. In just the first few weeks of 2017, Aqua is already looking at agreements that would add more than 9,000.

“I think it's an exciting time to be in this industry,” said Franklin.

Three factors have aligned to help fuel this excitement, he said.

1) A legislative sea change in its home state

Harrisburg changed the utility game in March 2016 when it allowed private companies like Aqua to pay a municipality a higher amount to acquire its water system. The company can now bring in an outside engineer to assess the system's fair value and base its offer on that, rather than its depreciated value under prior law. The legislative shift boosted Aqua's acquisition efforts in its most important market, said Franklin.

“There's a lot of activity now that the legislation passed ... We're very optimistic about our ability to grow in Pennsylvania in particular,” he said. “Pennsylvania is about half of our company. It is very important to us.”

It's also one of the best states in the company when it comes to regulations that bal-



Chris Franklin, CEO of Aqua America.

ance customers' needs and shareholders' needs, said Franklin. Boenning & Scattergood Analyst Ryan Connors backed up this assessment, saying in a note Tuesday that the company “enjoys a structural advantage over peers given its majority position in the favorable regulatory jurisdiction of Pennsylvania.”

2) More municipalities seeking tax relief

That same “fair value” legislation is especially impactful as cash-strapped municipalities reckon with growing pension costs and aging infrastructures that are pricey to repair or replace.

“We have an opportunity to partner with them, to come in as a solution or as a white knight,” said Franklin. While Aqua spent the past year focused on smaller, troubled water systems with about 300 to 500 customers, it plans to pivot toward larger regional systems in the middle market and acquire anywhere from 2,500 to 25,000 customers at a time. The two pending deals for 2017 so far include a system of 5,400 customers, with a price tag of \$75 million and 2,100 customers for \$30 million.

“All told, Aqua expects to spend more than \$113 million on acquisitions (almost exclusively of municipal systems) in 2017, marking a five-fold increase over 2016 (\$22 million),” Connors noted. He added those acquisition goals “shows the company is holding its own in the competitive world of ‘fair value’ municipal M&A.”

It does face challenges, particularly in New

Jersey, where voters in a municipality must approve the sale of any municipal-owned utility through a public referendum. That effort failed in the small Gloucester County borough of Westville last fall after voters rejected Aqua's bid to buy their system for \$8.4 million.

“When [municipalities] have an asset, there's a proclivity to holding onto that,” said Franklin, adding water service can be an emotional topic for voters, even when they're not aware how owners of the system itself is operated.

“There's a fear of losing control. We do our best to work with public officials to educate the entire public.”

3) A national focus on infrastructure

The incoming presidential administration promised to address the nation's aging and failing infrastructure, and Franklin said the likelihood that any initiative will favor public-private partnerships bodes well for Aqua. The local company updates infrastructure and drew the comment from Connors that “Aqua remains the water industry's gold standard in terms of operational efficiency.”

“We believe that we can play a significant role in this infrastructure without looking to the government for major grants or dollars,” said Franklin. “We've been very active in suggesting we can be a part of the solution.”

After all, Franklin said, a thriving business base can't function if it's built on a crumbling and unsafe foundation.