Water Company Makes Big Splash With Investors

UTILITY: American States’ military contracts help lift shares to all-time high.

By HOWARD FINE Staff Reporter

It’s definitely not the kind of performance you’d expect from a regulated water utility, since the rates of return are limited by law and every proposed rate increase is vigorously opposed. But American States Water Co. has been riding a wave of investor enthusiasm.

Buoyed by stronger-than-expected performance from its contracting business on military bases, the San Dimas water services company has seen its stock break free of a five-year trading range and soar to all-time highs in recent weeks. In the process, it has exceeded even the most bullish of analyst projections.

The stock climbed to an all-time high of nearly $52 a share Feb. 6, up 40 percent from its year-ago level.

“It was a phenomenal run,” said David Parker, senior utility analyst with Robert W. Baird & Co. in New York. Three months ago, Parker issued a report with a “buy” recommendation that forecast the stock would hit a target price of $46 a share this year.

The success can be traced to decisions that American States made in the late 1990s. Frustrated with low rates of return, the company decided to diversify. Other water companies tried; some succeeded, some had to drop their diversification plans.

American States saw an opportunity when the Defense Department launched an initiative to privatize infrastructure services on its military bases. During the next 10 years, the company snagged 50-year contracts at nine bases, mostly to maintain and upgrade water and wastewater services.

These weren’t just any bases: Among them are Fort Bragg, N.C., which in most recent years has been the largest Army base in the world by population, and Fort Bliss, near El Paso, Texas, which is the second largest military base by land area in the United States. American States also won the right to service Andrews Air Force Base in Maryland, famous as the site of presidential flights.

But even as the contracts rolled in, investors remained cautious because the history of utilities diversifying is dotted with failures.

American States Chief Executive Robert Sprowls told the Business Journal last week that it took until 2007 for the company to start turning a profit on the military business. The company spent years evaluating the water and wastewater systems and determining how to set prices.

Another reason the military business became profitable is that the company started getting contracts for construction work that was needed to upgrade the systems.

“It took time to get our legs under us in this business,” Sprowls said. “It was a new process for both us and the government, and things went slower than we had hoped.”

Revenue gusher

But American States stood with it, and last year the company was rewarded. Sprowls said a series of major construction contracts the military gave to the company for upgrading water and wastewater systems on the bases rolled in last year. American States makes money by subcontracting out the work.

“’In 2012, it all sort of came together for us,” he said. “It was an exceptionally strong year for us.” As a result, total revenue for the company’s unregulated water and wastewater services business surged. In the third quarter, it accounted for 24 percent of overall revenue, compared with less than 6 percent in 2007.

Besides signaling success on its own merits, the extra revenue allowed American States to increase its dividend by 27 percent to 36 cents a share that quarter. That gives it a dividend yield of about 2.8 percent based on the $52 price—which made the stock much more attractive to investors.

The company’s San Dimas headquarters is in a one-story building set amid other offices and residential tract. The 732 employees work at various facilities, including an office in Anaheim.

Uncertain picture

For this year, the picture is a little more uncertain, especially with the threat of sequestration hanging over all military operations. Faced with steep budget cuts, the Defense Department might scale back construction on its bases, which could put a damper on revenue for American States.

On the other hand, the department might decide to consolidate operations to some of the larger bases, which could turn to American States.

“We are somewhat concerned about sequestration, but until we see more about what will actually happen, it’s not an overriding concern,” Sprowls said.

Analyst Parker concurred, saying that whatever happens on the sequestration front, American States likely won’t feel a significant impact this year or even next year.

“This is a concern for the out years,” he said.

As the company finally cashes in on its military business, its main regulated water utility, American States Water Co., in San Dimas, went slower than we had hoped.”

The Ojai system isn’t a big part of American States business. However, if the activists succeed in driving it out of the valley, customers in other territories served by American States business. However, if the activists succeed in driving it out of the valley, customers in other territories served by American States has been embroiled in a fight with activists in the Ojai Valley area who claim its rates are too high and have been pushing for nearly two years to have a neighboring municipal water district take over water service.

Next month, the board of the Casitas Municipal Water District is set to vote on whether to authorize the formation of a special taxing district, the first step in the process of taking over the Golden State Water system. If the board votes to go ahead, then voters will have to approve $60 million in bonds to buy the water system from Golden State. That vote, likely this summer, requires two-thirds approval.

If voters approve, then the municipal district can challenge Golden State Water for control.

If no deal is reached, the two sides would then face off in court over whether the Casitas MWD can use eminent domain to take over the Golden State system.

The Ojai system isn’t a big part of American States business. However, if the activists are successful in driving it out of the valley, customers in other territories served by Golden State could try similar tactics to get lower rates. Sprowls intends to keep control of the system.

“I have said before and say again, our system in Ojai is not for sale,” Sprowls said last week.

Golden State Water, is under fire. Golden State has been embroiled in a fight with activists in the Ojai Valley area who claim its rates are too high and have been pushing for nearly two years to have a neighboring municipal water district take over water service.

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