



Industry Commentary

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Dealmaking Amid America's Water Dilemma

The United States has a problem with water. As outlined during the WEFTEC conference in November 2021, the western states, drought conditions have reached historic levels, calling into question whether the region will have even a minimal amount of water to supply its growing population. In the rest of the country, the water supply may not be an issue yet, but our aging water infrastructure certainly is. These conditions—along with the critical need for upgrades, ongoing repairs, and entirely new water systems—have created a rich M&A environment for companies that can help solve America's most pressing water issues.

We explore current trends in infrastructure spending, water quality, and smart water technologies that are driving dealmaking activity in the U.S. water industry today.

Aging Infrastructure Compels Significant Spending

In 2021, the average age of water and sewage pipelines in the United States hit 45 years—an alarming number. The United States now experiences an average of 240,000 water main breaks per year—a 27% increase since 2012—and up to 30% of treated water is lost or unaccounted for in our water networks. Perhaps most telling, the American Society of Civil Engineers recently gave our country's drinking water infrastructure a grade of C- and our wastewater infrastructure a grade of D+.

This sobering backdrop means that the United States needs to spend a substantial amount of money on water. In fact, the EPA estimates that the United States will need to spend \$1 trillion on water infrastructure over the next 25 years, and the Biden administration's Infrastructure Bill has allocated \$55 billion to water infrastructure in order to expand

access to clean drinking water across the country. States have also begun to ramp up their spending; Michigan, for example, announced a \$500 million water infrastructure plan in 2020.

Complex Rebuilding Challenge

Meeting America's water needs is a complex challenge, and repairing and replacing underground water infrastructure is one of its most important aspects. While some parts (such as lead pipes) need to be dug up and replaced, others can be upgraded without being excavated. This method is less expensive, less labor-intensive, and does much less damage to the surrounding community.

Innovative companies in this space have developed "trenchless rehab," a process by which many underground parts can be repaired, renewed, or replaced with minimal excavation. For example, St. Louis-based Aegion, which was acquired by New Mountain Capital earlier this year, provides trenchless infrastructure repair and rehabilitation

products in addition to its broader solution offering.

In cases where water infrastructure needs to be physically installed or replaced, equipment manufacturers, distributors, and service providers are set to capitalize on growing market demand. One such company, Evoqua Water Technologies, provides water and wastewater treatment solutions and offers a broad portfolio of products, services, and expertise to support industrial, municipal, and recreational customers. Another company in this space is Franklin Electric, a leading manufacturer and distributor of pumps and related products for the movement and management of water.

If Water Is Abundant, Is It Safe?

Despite the drought in the western United States, water is not particularly scarce in the rest of the country. If anything, climate change appears to be creating storm and flood patterns that threaten to overwhelm some regions of the country with too much water. Even in areas where water is abundant, however, water quality remains a critical concern. Contaminants such as lead, algae, and PFAS (per- and polyfluoroalkyl substances, a group of human-made industrial chemicals) continue to threaten the water supply, compelling states and municipalities to use ever-more sophisticated diagnostic technologies and water treatment facilities.

Global demand for clean drinking water is also increasing rapidly. Currently, an estimated 30% of the world's population doesn't have access to

safe drinking water, and according to *Fortune Business Insights*, the global water and wastewater treatment market is expected to grow at a 7.3% compound annual rate to \$465 billion by 2028. On that basis, U.S. companies that can capitalize on global demand will have a distinct competitive advantage over their more domestically oriented peers and will likely attract more M&A interest.

Water quality companies can be roughly split across product and service providers. Product companies provide high-value equipment and components to enable water treatment, while services companies offer much-needed maintenance, repair, and disposal services.

One leading product company is Komline-Sanderson, which has undergone rapid growth under the leadership of CEO Danai Brooks over the past four years. Komline-Sanderson manufactures equipment for filtration, drying, thermal processing, wastewater treatment, sludge processing, and pollution control.

The Leading Edge: Smart Water

Smart water refers to a group of emerging technologies in the water industry that include hardware, software, and analytics designed to help water and wastewater utilities solve problems through automation, data gathering, and data analysis. In particular, smart water technologies are designed to detect leaks, which according to the U.S. Water Alliance cause about two trillion gallons of treated water to be lost every year,

equivalent to approximately \$7.6 billion in value.

Smart water technologies offer the industry several critical benefits that their analog counterparts cannot. Most importantly, smart water can detect failing infrastructure and provide actionable intelligence remotely. Subsequent data analysis and automation can help improve efficiency and reduce a company's reliance on labor. This in turn helps preserve clean water supplies, reduces operating costs, and promotes sustainability.

Given its unique effectiveness, remote, digital water management is the fastest-growing segment among water subsectors. According to Bluefield Research, spending in this space is projected to grow from \$5.4 billion in 2019 to approximately \$10.8 billion in 2030. Strategic buyers are aggressively pursuing data, analytics, and software platforms of scale, and we anticipate robust M&A activity in this area over the coming years.

Several smart water companies are poised to lead this segment of the market. For example, Xylem, a major water leader, provides subscription-based software platforms that can test and detect harmful contaminants in water; and track leaks and damages to critical infrastructure and track leaks and damages to critical infrastructure.

Another example is VC-backed SewerAI, which provides software to inspect, identify, and analyze sewer infrastructure defects and a cloud platform to help cities and service firms manage this data.

Recent William Blair Transactions

 <p>has agreed to make a significant investment in</p>  <p>Pending</p>	<p>\$480,000,000</p>  <p>a portfolio company of Platinum Equity</p> <p>has agreed to be acquired by</p>  <p>Pending</p>	<p>\$178,264,880</p>  <p>Follow-on Offering</p>	 <p>has been acquired by</p> 	<p>HYDROMAX USA</p> <p>has been acquired by</p> 
 <p>a portfolio company of</p>  <p>has been acquired by</p> 	<p>\$172,500,000</p>  <p>Initial Public Offering</p>	 <p>has received a strategic investment from</p> 	 <p>has been acquired by</p> 	<p>SEEBACH</p> <p>has been acquired by</p> 

Expert Voices: An Interview With Will Sarni

Will Sarni is one of the world's leading experts on water. For more than 30 years, Will has been a sustainability and water strategy advisor to multinationals, water technology companies, investors, and nongovernmental organizations. Today, he is the founder and CEO of Water Foundry, LLC, a trusted advisor to public and private sector clients in solving water-related challenges. Prior to Water Foundry, Will was a managing director at Deloitte Consulting, where he founded and led the firm's water strategy practice.

We recently met with Will to ask him a series of questions on the unique challenges that companies face concerning water, and particularly the three dimensions of risk that companies should consider when designing a water strategy.

What is the most important trend you have seen in the water industry over the past several years?

Sarni: *The digital transformation of the industry has arguably been the most influential trend in water. This was well underway prior to the COVID-19 pandemic, but the pandemic accelerated the process. Digital technology allows water companies to gather and analyze data on the quantity and quality of their water supply on a real-time basis. It also allows them to assess infrastructure and identify problems remotely, which is critical to increase operating efficiency.*

Another important trend is the rise in decentralized, distributed water treatment technologies. For the most part, our centralized water treatment infrastructure is aging and underfunded. Decentralized treatment will allow for solutions at a local level, thereby reducing our reliance on large-scale, centralized facilities.

What are some of the key risks that companies should consider when designing a water strategy?

Sarni: *There are three key dimensions to consider. The first is physical: How much water does the company need, and at what quality? How much is available, and at what price? How might those figures change going forward?*

The second key dimension is regulatory risk. Obviously, companies need to be aware of current regulations as they pertain to water, but they also need to consider how those regulations might change going forward. That of

course entails keeping a keen eye on the political environment and how a single senator's vote, for example, could significantly impact the company's water strategy.

The third key risk is reputational. It's important to understand that water is a common pool resource. In other words, companies extract water from common sources, and in doing so, they affect every other company that's using that resource, as well as the broader community. On that basis, companies need to practice strong water stewardship, not just water management. And to be good stewards, companies need to carefully limit their water use and cooperate with their competitors early in the business cycle in order to ensure that no single firm is abusing an area's water supply.

How should these risk dimensions affect an investor's assessment of a company that uses a significant amount of water?

Sarni: *Investors should consider each company within the context of water stewardship. For example, will the company have enough water given the needs of all its competitors in the area? Is the company practicing strong environmental and social governance (ESG)? Is the company legally and politically savvy as it relates to water? If the company is going to have a sound water strategy, all of these conditions must be met.*

Are there companies that have more water risk than one might expect? What are some common misconceptions that companies have about water?

Sarni: *Some industries definitely have more water risk than meets the eye. The apparel industry, for example, has to consider how much water it takes to grow vast amounts of cotton, but also how much water consumers need to wash the clothes they buy. In cloud computing, many data centers rely on water for cooling, even though we tend to think of the cloud as something that's much more intangible.*

The most important misconception that companies typically have about water is that it's abundant. Companies need to remember that water is very much a local resource, and each location will have particular constraints around its water supply. In that sense, water isn't carbon—it isn't fungible. Rather, water

is a very limited resource that requires companies to operate as responsible stewards of it.

The second misconception is that water is low-cost. While that may be true in some cases, in most areas water is more expensive than many companies think. And in areas where supply is diminishing, water will of course become more expensive over time.

What can companies do to design an effective water strategy?

Sarni: *First, a company should consider its water strategy along the three dimensions of risk that I mentioned, especially in terms of future projections. Second, in cases where a company's water needs are particularly complex, consider contracting an outside advisor who can help the company design a water strategy on a holistic basis.*

To learn more about these and other trends that are shaping the dealmaking environment in the water industry, please don't hesitate to reach out.

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