

Insituform Technologies (INSU)

Rehabilitates sewer, water, energy and mining pipelines in 36 countries

BUY (potential to double in 2-3 years)

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Current Price \$25.84

Min. Target Price \$32.00



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Investment thesis

INSU is uniquely positioned to benefit from an accelerating shift towards trenchless CIPP method from the traditional "dig and replace" method in wastewater infrastructure repair. It will also benefit from \$40bn spending needed over the next decade to correct decades of underinvestment in US's sewer pipelines. 45% of sewer pipelines in US violate the Clean Water Act. In July 2010, EPA changed its enforcement plan to focus on pipelines, which was earlier left for states to self-regulate. This will force the states and municipalities to fix their sewer and storm-water pipelines, driving revenue toward INSU.

Key factors that will drive the stock price

1. N. American Sewer rehab segment has been mistaken to be stagnant

Sewer rehab is considered a mature industry, and the street is projecting flat growth for this segment. But, Insituform's specialty is in CIPP trenchless sewer rehab, which is half as cheap as traditional methods, and hence is taking share, growing at a rate of 10-12%, compared to sector growth of 2-3%.

Credit crunch faced by municipalities, who collectively are Insituform's biggest clients, is cited as a risk. But, sewers are mandated by EPA consent decrees, and financed by revenue bonds backed by water and sewer fees.

2. Large wastewater infrastructure investment backlog

According to the EPA and other government agencies, the majority of the America's sewer pipe network was installed after WW-II and has reached the end of its useful life. A minimum of \$40bn of sewer infrastructure investment is needed over the next decade. According to Mayors Water Council, "spending on water and sewer to comply with water laws over the next 20 years may be one and half to three times what was spent over the last 53 years." About 50% of wastewater facilities in US violate the Clean Water Act, and INSU offers the cheapest solution for the municipalities to comply with federal rules.

3. Recent acquisitions in energy and mining sector offer synergies

In Q1 2009, the firm acquired two firms—Bayou and Corrpro that contribute almost 40% of its sales today by providing pipeline protection services to industrial companies. There are significant cross-selling opportunities between Bayou and Corrpro. This also allows Insituform to win larger bids, which will demand less management per dollar earned, allowing for EBIT margin expansion.

Undervalued by every measure

Even if we completely ignore the coming wastewater infrastructure spending, Insituform is undervalued when compared to its pipeline maintenance peers because street gives little credit to growth prospects of its US sewer rehab business. Its pipeline maintenance peers, Furmanite Corporation and Team, Inc. trade at EV/EBITDA '11 of 8.2x and 10.1x, while Insituform trades at EV/EBITDA '11 ratio of 7.4x. A value of 9x gives us a price target of \$32, a 24% upside. DCF valuation confirms the base target price with a range of \$30-\$39.

Risks

1. Deeper fiscal deficits could delay investments needed to repair America's infrastructure, and in turn limit Insituform's upside.
2. Recent capacity buildup in the oil and gas sector may further limit growth of the energy & mining segment in the following 2 years, due to limited investments in new pipelines.
3. INSU has several small specialized pipeline-related businesses, and it will be difficult to replace key personnel internally and quickly, if they were to leave.

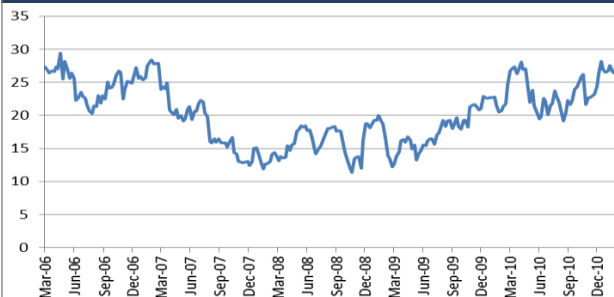
Stock Summary

Market Cap	\$1.0 bn	52-week Range	\$18.5 - \$30.0
Net Debt	-\$10m	1-yr Cumulative Return	5%
Trailing P/E	16.8	5-yr Cumulative Return	-3%
Forward P/E	13.0	Dividend Yield	N/A
Shares	39.25m	Daily Volume	260,000

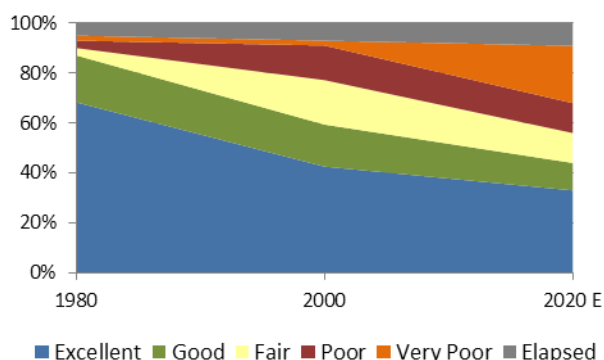
Company Summary

Insituform is known for its leadership in sewer rehabilitation industry, which contributes to 60% of the firm's sales. INSU invented the CIPP trenchless rehabilitation method, which is half as costly and a less intrusive method than the traditional "dig and replace" method. Other 40% of sales come from other pipeline rehabilitation businesses that serve energy and mining firms.

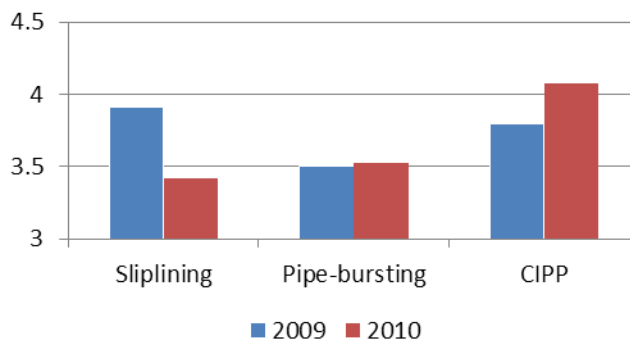
5 Year Price History for INSU



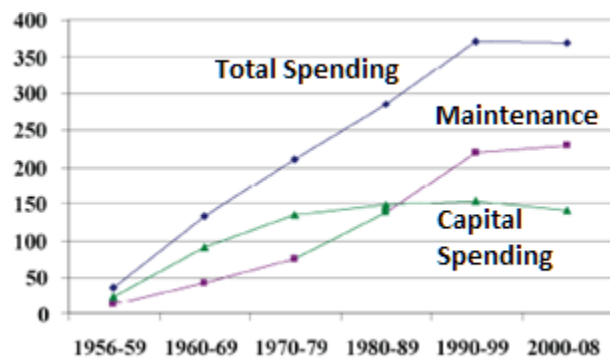
Rapidly Aging Pipelines (EPA Water Infrastructure Gap Analysis)



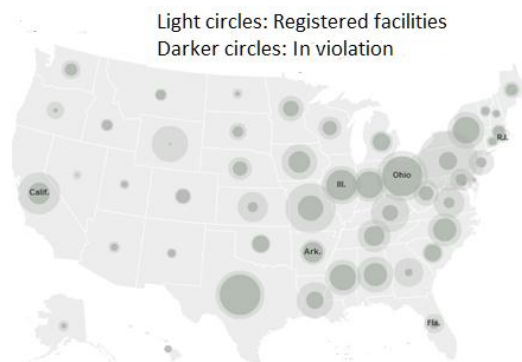
Municipalities increasingly rate CIPP higher (scale of 1-5) (Underground Construction Magazine)



Flat wastewater spending (Mayors Water Council) (in \$bn)



Clean Water Act violations near 50% (ECHO, New York Times)



	2008	2009	2010	2011 E					2012 E	2013 E	2014 E	2015 E
	FY	FY	FY	Q1 E	Q2 E	Q3 E	Q4 E	FY	FY	FY	FY	FY
Income Statement												
Revenue												
N. Amer. Rehab	340.3	354.4	400.7	84.7	104.6	120.2	117.2	426.6	447.9	492.7	532.2	574.7
Euro. Rehab	112.2	86.0	74.1	18.2	18.5	16.4	23.2	76.3	76.3	76.3	76.3	76.3
A. Pacific Rehab	10.1	33.3	43.5	11.8	17.9	11.7	14.2	55.6	66.7	80.0	100.0	125.0
Water Rehab	13.4	11.5	14.6	5.2	2.1	7.1	4.5	18.9	26.5	33.1	39.7	45.7
Energy & Mining	60.6	241.7	382.3	89.0	111.2	118.3	121.1	439.6	483.6	522.3	553.6	575.7
Total Revenue	536.7	726.9	915.1	208.8	254.3	273.7	280.1	1,017.0	1,101.0	1,204.4	1,301.8	1,397.5
Growth rate												
N. Amer. Rehab	-	4%	13%	-5%	5%	12%	12%	6%	5%	10%	8%	8%
Euro. Rehab	-	-23%	-14%	3%	3%	3%	3%	3%	0%	0%	0%	0%
A. Pacific Rehab	-	228%	31%	20%	30%	30%	30%	28%	20%	20%	25%	25%
Water Rehab	-	-14%	26%	0%	0%	60%	60%	30%	40%	25%	20%	15%
Energy & Mining	-	299%	58%	15%	15%	15%	15%	15%	10%	8%	6%	4%
Total Revenue	-	35%	26%	5%	10%	14%	14%	11%	8%	9%	8%	7%
Total Gross Profit	129.6	190.5	229.5	53.7	66.3	67.8	69.8	257.5	294.9	322.4	348.4	374.1
Gross Profit Margin	24%	26%	25%	26%	26%	25%	25%	25%	27%	27%	27%	27%
Operating Expenses	92.0	129.4	144.3	31.3	38.2	41.1	42.0	152.5	165.1	180.7	195.3	209.6
Op. Exp. As %age of sales	17%	18%	16%	15%	15%	15%	15%	15%	15%	15%	15%	15%
Operating Income	37.6	61.2	85.2	22.3	28.1	26.7	27.8	105.0	129.8	141.7	153.1	164.4
Operating Margin	7%	8%	9%	11%	11%	10%	10%	10%	12%	12%	12%	12%
Interest Expense	(5.5)	(8.3)	(8.7)	(1.6)	(1.5)	(1.5)	(1.5)	(6.0)	(5.9)	(5.6)	(4.3)	(4.3)
Interest Income	3.8	0.7	0.3	0.1	0.2	0.2	0.2	0.6	0.9	2.9	5.4	6.9
Earnings before taxes	33.7	42.7	78.6	20.8	26.8	25.4	26.5	99.6	124.8	139.0	154.2	167.0
Income Tax Expense	8.6	12.6	23.0	4.8	6.2	5.9	6.1	23.1	28.9	32.2	35.7	38.7
Tax Rate (%age)	26%	29%	29%	23%	23%	23%	23%	23%	23%	23%	23%	23%
Minority Int. in Earnings	(1.0)	(1.1)	(1.4)	(1.0)	(1.0)	(1.0)	(1.0)	(4.0)	(4.2)	(4.4)	(4.6)	(4.9)
Income from affiliates	(0.2)	1.2	5.5	1.2	1.5	2.8	-	5.5	5.7	6.0	6.3	6.6
Net Income	21.4	26.3	59.6	16.1	21.1	21.3	19.4	78.0	97.4	108.4	120.2	130.1
Profit Margin	4%	4%	7%	8%	8%	8%	7%	8%	9%	9%	9%	9%
Profit growth	N/A	23%	127%					31%	25%	11%	11%	8%
EPS	0.55	0.67	1.53	0.41	0.54	0.55	0.50	2.00	2.49	2.78	3.08	3.33
Operating Line Items												
Depreciation & Amortization	(16.4)	(22.7)	(25.7)	(6.4)	(6.5)	(6.7)	(6.8)	(26.5)	(27.8)	(30.3)	(34.5)	(36.6)
D&A as a %age of PP&E		32%	17%	4%	4%	4%	4%	16%	16%	16%	16%	16%
Amortization of Intangibles	(0.9)	(5.7)	(5.1)	(1.5)	(1.4)	(1.4)	(1.4)	(5.7)	(5.4)	(5.0)	(4.6)	(4.2)
Amort. as %age of Intangibles			7%	2%	2%	2%	2%	8%	8%	8%	8%	8%
Capital Expenditures	(11.9)	(14.4)	(39.0)	(9.6)	(9.8)	(10.0)	(10.2)	(39.7)	(43.4)	(56.8)	(47.5)	(45.8)
Capex as a %age of PP&E		20%	24%	6%	6%	6%	6%	25%	25%	30%	22%	20%
Cash Acquisitions	-	(221.3)	(1.3)	-	-	-	-	-	-	-	-	-
EBITDA	54.9	89.6	116.0	30.22	36.10	34.81	36.00	137.1	162.97	176.99	192.25	205.27
EBITDA margin	10%	12%	13%	14%	14%	13%	13%	13%	15%	15%	15%	15%
FCFF				67.0	-4.6	8.7	16.3	87.4	104.6	69.0	88.6	99.2
RoIC				12%	15%	14%	14%	13%	17%	17%	17%	18%