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Publicly Traded Water Utilities Draw Investors.

Stocks of publicly traded water utilities are drawing investors who are searching for sustainable investments

Publicly traded water utilities—usually one of the more stolid corners of the already-conservative utilities sector—have been on a tear for more than a year. Institutions are increasingly on the hunt for investments that meet new environmental, social and governance, or ESG, benchmarks. Meanwhile, individual investors, particularly retirees, are joining in on the rush as they look for safety and dividends.

In the 12 months ended Feb. 27, the water-utilities sector increased 23.9%, versus 10.5% for the Dow Jones Utility Average and 4.7% for the S&P 500. The stock prices of the three largest companies in the sector— Essential Utilities (formerly Aqua America), American States Water and American Water Works —rose 30.9%, 18.3% and 28.4%, respectively.

Looking for do-good stocks

One big aspect of water companies' appeal is a strong ESG profile. Water firms operate under environmental and governance mandates, and they provide an essential social service—which makes them look attractive in the current climate.

Investors searching for stocks that hit those standards don't "have much they can look at in the [utilities] sector," says Angie Storozynski, a former managing director at Macquarie Capital in New York. "Funds with strict ESG mandates cannot invest in most electric utilities because of their nukes and coal plants."

What's more, water utilities' fundamentals are much more appealing, Ms. Storozynski says. "To me, a water utility is the best kind of a utility, way better than electric or gas. Water utilities have a much longer investment horizon, lower operating risk, face lower customer-affordability pressures. They don't face technology risks."

There are also many fewer water companies on the stock market than other utilities, which means investors will crowd into a few names, driving their prices up. The whole sector consists of just nine publicly traded firms, and "there are only two publicly traded water utilities in the U.S. with a market cap above $10 billion," Ms. Storozynski says.

Reliable dividends

Dividends are another key part of water's appeal—even though on the surface their numbers don't seem to be as attractive as their peers'.

Companies in the water sector have been raising their dividends consistently—but their stock prices have risen even higher, driving down their dividend yields. The water sector's dividend yield now stands at 1.91%, compared with 2.61% for electric and 3.99% for gas, while the utilities sector as a whole yields 2.81%.

Water utilities' "dividend yields are very low versus the average for the S&P 500, and while they all consistently grow their dividends faster than the rest of the market…the total dividend-driven return for water utilities is not so big," Ms. Storozynski says.

Even so, the reliability of dividends paid by water utilities is attractive to investors, she adds.

Indeed, York Water, with an almost miniature market capitalization of about $600 million, has paid a dividend every quarter since 1816, the longest streak in U.S. stock markets, and American States Water, with a much larger market capitalization, $3.2 billion, has raised its dividend annually for the past 64 years, with an average annual total return of 15% from 2009 to 2019—not bad for a stock in a sector best known for its low risk and high regulations.

Mergers and acquisitions among publicly traded water utilities haven't been a substantial factor in recent years. Michael Gaugler, managing director for utilities and infrastructure at Janney Montgomery Scott in Philadelphia, says that there is occasional takeover chatter among the smaller names, but the potential acquirers, the larger water companies, are usually more interested in buying less expensive private or municipal water systems or systems located in a single state, to avoid multistate regulatory oversight.

He also calls water utilities a proxy for the ultrasafe but currently low-yielding 10-year Treasurys, although the sector didn't keep up with the record-shattering rise in bonds (and fall in their yields) at the end of February. Even so, "the only way this group gets, gets clobbered is if rates go the other way," Mr. Gaugler says. "And even then, it's probably a very soft landing."

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By Nick Ravo

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