Janney
CAPITAL MARKETS

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My name is Ryan Connors. I am a Director in the equity research department at Janney Montgomery Scott, a full service brokerage firm with headquarters in Philadelphia and with 11 offices throughout the state of New Jersey. I head the firm's equity research practice in the water industry, and it is my job to make recommendations to both retail and institutional clients regarding where to allocate capital.

In advising clients, Return on Equity is a critical facet of our analysis, as is our view of the *direction* of regulation in relevant states for water utility stocks. Essentially, when it comes to water utilities, we recommend clients invest in those companies earnings competitive returns on equity capital or where we think regulation is improving. Conversely, we advise clients to steer capital away from companies where the regulatory environment precludes them from earnings competitive returns on equity and we don't see that regulation improving.

Infrastructure surcharge mechanisms such as the one being considered by the NJ BPU are critical in our view, because they help to minimize the impact of so-called "regulatory lag" on realized equity returns. In effect, "DSIC-like" regulatory mechanisms ensure that realized returns on equity capital don't fall meaningfully short of granted returns.

Right now, we maintain BUY ratings for the water utilities we follow that have heavy exposure to New Jersey regulation. A significant factor in our rationale for recommending these stocks is that the BPU's consideration of a DSIC is an important signal in our view that the regulatory environment in NJ is in fact improving. If the DSIC were not to be implemented, or were to pass with offsetting negative regulatory developments, such as an understanding (either tacit or official) that granted returns on equity would fall, we would likely advise clients to sell these stocks and invest their capital outside of New Jersey. The real-world impact of this (particularly in the event other brokerage houses do similarly) would be that New Jersey water utilities would find it more difficult and more expensive to access equity capital markets to finance water system repair, maintenance, and upgrade projects.

A key issue for the commission to keep in mind as it deliberates on the issue is that there are plenty of alternative destinations for investor capital. No investor is *required* to provide their capital to New Jersey water utilities. If we do not believe investors are likely to earn appropriate returns in New Jersey, we will do our part to see to it that capital migrates to other areas where investors can achieve superior returns. Notable among these is neighboring Pennsylvania, which has a successful DSIC program.

A couple of key issues I would also like to address: First, the idea that a DSIC mitigates the risk profile of a water utility's business model, thereby making a lower return profile appropriate. Second, the issue of "capping" surcharges at a defined percentage of customer bills.

On the first point, it's important to once again stress that investors care most about actual returns (as opposed to "granted" returns), and that other regulatory jurisdictions (such as Pennsylvania and Delaware) already grant competitive – and in some cases superior – returns on equity than New Jersey and *also* provide a DSIC mechanism. Therefore implementation of a DSIC simultaneous with issuing lower returns is self-defeating in that on balance it does nothing to make NJ a more attractive destination for capital.

In addition, we are part of a growing movement that views the water sector holistically and includes non-regulated companies as valid alternatives for investors seeking exposure to key water-related investment themes. With this in mind, it's worth noting that current granted returns already adequately compensate for the water utility industry's lower risk profile relative to other niches of the water industry. Consider that water meter manufacturer Badger Meter (BMI-NYSE) earns an ROE of 18%, municipal pump manufacturer Gorman-Rupp (GRC-AMEX) earns an ROE of 14%, and environmental consulting firm Stantec (STN-NYSE) earns an ROE of 16%. Current granted ROEs in New Jersey already fall well short of these "riskier" businesses, and therefore we believe the goal of the DSIC should be to help utilities actually meet their existing granted ROE levels.

On the second point, we believe it is appropriate to cap the percentage increase in customer bills due to infrastructure surcharges the interim periods between rate cases, but also believe that any such cap should be competitive with what is offered in other regulatory jurisdictions in order to accomplish the goal of providing NJ water utilities with a balanced playing field when competing for capital with investor-owned utilities outside the state. Current caps are largely in the area of 7.5%, and we believe this is the appropriate range, with any DSIC falling meaningfully short of this range likely to prove less effective in making New Jersey a more attractive destination for equity capital.

Thank you.

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