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PROFITS IN WATER

By Gordon Pape, Editor and Publisher

Water management is not a very exciting subject. Unless a toxic wastewater pond overflows or a city's drinking water is contaminated, we don't hear much about the business of getting potable water into our homes or taking it away.

In fact, it's a huge business and growing at a steady rate of 6.5% annually, according to a report published last year by London-based Meticulous Research. In it, the British firm estimates that the global market for water and wastewater treatment could be worth US$211.3 billion by 2025.

"Growing global demand for clean water, more stringent regulatory issues, and increasing environmental concerns make water and wastewater treatment systems more relevant than ever," the report says. "Rapid population growth and urbanization, growing demand for new water resources, rising focus on water quality and public health, increasing prevalence of water borne diseases, increase in industrial demand, and stringent governmental regulations on treating wastewater also aids in the growth of this market. Moreover, growing focus on sewage

Continued on page 2...

IN THIS ISSUE

Next issue:
April 26, 2021
1-888-287-8229

Water—continued from page 1...

treatment in countries like the U.S., China, and India; and potable water for small communities provide significant opportunities in this market."

The report goes on to note that the "high cost of equipment, operations, and disposal obstructs the growth of this market to some extent. In addition, aging water infrastructure, excess energy consumption, and rising expenditure due to excess sludge production are some of the major challenges in the overall water and wastewater treatment market."

Despite the obstacles, a few investors have discovered that water-based investing can offer slow but steady growth potential and respectable cash flow. But most ignore the sector or only have exposure to it through an infrastructure fund.

Here are three ways you can invest in the water industry.

Xylem Inc. (NYSE: XYL). Xylem is based in Rye Brook, New York. It is a leading global water technology provider, enabling customers to transport, treat, test, and efficiently use water in public utility, residential, and commercial building services, and in industrial and agricultural settings. It makes pumps and control systems used in management of wastewater and the collection and distribution of drinking water. It also offers smart metering, network technologies, and advanced data analytics for water, gas, and electric utilities. Xylem does business in more than 150 countries.

The stock has been a strong performer over the past year, almost doubling from its 52-week low of \$56.63 (figures in U.S. dollars) to close on Friday at \$108.64. The stock was first recommended here by contributing editor Glenn Rogers in May 2015 at \$37.14.

The company's fourth-quarter and fiscal 2020 financial results beat expectations, despite the economic impact of the pandemic. Revenue in the final quarter was \$1.37 billion, slightly higher than the same period in 2019. Net income was \$148 million (\$0.82 a share) compared to \$118 million (\$0.65 per share) in the same quarter pf 2019.

For the full year, Xylem reported revenue of almost \$4.9 billion, down from \$5.2 billion in 2019. Net income was \$254 million (\$1.40 per share), down from \$401 million (\$2.21 per share) in the prior year.

The company announced an 8% increase in the quarterly dividend, the 10th year in a row it has hiked its payout. The new rate is \$0.28 per share (\$1.12 per year) for a yield of 1%.

Continued on page 3...

Water—continued from page 2...

Xylem is forecasting a strong year in 2021, with revenue up 6-8% to between $5.16 and $5.26 billion. It is forecasting adjusted earnings per share of between $2.35 and $2.60.

American Water Works Company (NYSE: AWK). This company, which traces its history back to 1886, is the largest and most geographically diverse U.S. publicly traded water and wastewater utility. It employs more than 7,000 people who provide regulated and market-based drinking water, wastewater and other related services to more than 15 million consumers in 46 states.

The business involves the ownership of water and wastewater utilities that provide services to residential, commercial, and industrial customers, treating and delivering more than 1 billion gallons of water per day.

The stock has had a choppy year, but the overall trend has been up. The shares did not drop below $100, even during the market plunge of March 2020. They closed Friday at $160.12.

Fourth-quarter and year-end results for 2020 were impressive. Operating revenue for the final quarter was $923 million, up from $902 million in the prior year. Net income attributable to common shareholders was $145 million ($0.80 per share, fully diluted), a healthy increase from $98 million ($0.54 per share).

For the full year, AWK reported revenue of almost $3.8 billion, up from about $3.6 billion the year before. Net income was $709 billion ($3.91 per share) compared to $621 million ($3.43 per share) in 2019.

The company is projecting 2021 earnings per share of $4.18 to $4.28 and a five-year annual compound growth rate of 7-10%.

The stock pays a quarterly dividend of $0.55 a share ($2.20 annually) to yield 1.4%. We are adding AWK to our Recommended List.

iShares S&P Global Water Index Fund (TSX: CWW). If you'd prefer to put your money into a diversified fund rather than individual stocks, this is a good choice. It was recommended by contributing editor Gavin Graham in our companion Income Investor newsletter in July 2013 at $19.65. The units closed Friday at $48.70. (Figures here are in Canadian currency.)

This ETF provides exposure to 50 companies from developed markets on the basis of their relative importance to the global water industry. These include water utilities, infrastructure companies, and those involved in the manufacture and distribution of equipment. About half the portfolio is invested in U.S. companies.

Continued on page 4...

Water—continued from page 3...

The U.K. accounts for 13.2%, France 9%, and Switzerland 7.4%. Canada represents 3.6% of total investments.

The top two companies in the portfolio are those mentioned above: Xylem (9.3%) and American Water Works (8.4%). Rounding out the top five are France's Veolia (5.4%), Pentair (5%), and U.K.-based Halma PLC (4.7%).

The fund has been a strong performer. One-year return to March 31 was 31.8% and the 10-year average annual compound rate of return was 13.4%.

Since our original recommendation in 2013, we have a capital gain of 148%, plus distributions.

Those distributions are paid quarterly, and the amount varies considerably. The trailing 12-month payout to the end of March was $0.594 for a yield of 1.2% at the current price.

The fund was launched in June 2007 and has about $277 million in assets under management. The management expense ratio is on the high side at 0.66% but the high return makes the expense worthwhile.

We rate all these securities as buys.

UNMASKING AN INVESTMENT OPPORTUNITY

Contributing editor Glenn Rogers is here this week to discuss a topic he personally knows little about – but he lives with experts on the subject. Glenn has worked with private equity and venture groups on a variety of projects leading to successful exits for investors. Previously he held senior executive positions in both Canada and the U.S..

I don't claim to be an expert in cosmetics. But I do have two daughters and a wife and although none of them are heavy cosmetics users they certainly seem to be looking forward to a post mask environment where they can apply makeup to more than just their eyes. Just think about lipstick sales alone. In addition to wearing masks less frequently, we will also be going out to dinner and other events much more frequently.

All this is great for the cosmetics industry including the retailers and manufacturers who did not exactly flourish during the height of COVID. In fact, cosmetic sales were down by approximately 50% from their levels prior to the lockdown despite people still trying to look good on Zoom.

Now, there are lots of ways to play this reopening from a beauty point of view. The department stores that are still remaining, with their miles of cosmetics aisles, should benefit. I'm thinking here of

Continued on page 5...

Unmasking—continued from page 4...

Macy's, Target, and Ultra Beauty. But for cosmetics manufacturers the lift should be even better. These companies include Estee Lauder, Coty Inc., and Revlon Inc. Any of these three is worth a look right now. All are well established companies. But there's a smaller brand I want to focus on today. That brand is e.l.f. Beauty Inc. (NYSE: ELF).

ELF is the smallest of the four companies that I've now mentioned but it caters to a younger crowd with more reasonable prices. It has broad distribution through all the aforementioned department chains along with a decent online business. Many of its products cost $10 or less, which is great for budget minded millennials. The company doesn't pay a fortune for high-priced celebrity endorsers but relies on an army of young influencers and word of mouth. ELF will do collaborations with entertainers like Alicia Keys and famously they just did a copromotion with Chipotle. That tells you a little bit about where the brand sits, since it's hard to imagine Estee Lauder partnering up with a fast-food chain.

The brand operates a very strong loyalty program that has over 2.3 million members, up 40% from the prior year. This gives the company a strong recurring sales stream that accounted for 16% of the December quarter revenue. This is high margin business, which the company continues to grow. Analysts are expecting the stimulus package passed in Congress plus the ongoing reopening to be very good for cosmetic manufacturers in general and e.l.f. in particular.

Despite the pandemic, e.l.f. Beauty delivered net sales growth of 10% when it announced its third quarter results at the beginning of February. That was somewhat of a miracle given that many of its competitors were down as much as 50%. The company's adjusted EBITDA for the quarter was down 14% year-over-year but that's very good considering the COVID impact.

The company gained 100 basis points of market share in U.S. colour cosmetics and raised its fiscal 2021 guidance.

The results represented eight consecutive quarters of net sales growth, even throughout the pandemic. This was in part due to the fact e.l.f. started out as an online brand and this saw it through the worst of the downturn.

The stock does not pay a dividend.

I like this entire sector and this stock in particular.

Action now: Buy with a target of $34. The shares closed Friday at $29.90.

GLENN ROGERS'S UPDATES

Recommendations are colour-coded:
Green indicates Buy
Yellow indicates Hold
Red indicates Sell

Crown Castle International NYSE: CCI

Originally recommended on Oct. 26/15 (#21538) at $85.32. Closed Friday at $179.62. (All figures in U.S. dollars.)

HOLD

Background: Crown Castle owns, operates, and leases more than 40,000 cell towers and approximately 80,000 route miles of fiber supporting small cells and fiber solutions across every major U.S. market and in Puerto Rico. It is based in Houston.

Performance: The stock has moved sharply higher recently and touched an all-time intraday high of $180.34 on Friday. This has been a good performer for us, particularly when you add the dividend stream we've enjoyed all these years. It closed Friday at $179.62 for a nice gain of 110% since my recommendation.

Recent developments: The company suffered minimal effect from the pandemic. Both revenue and profits were up in 2020 compared to the previous year, and the outlook for 2021 is for more of the same. Final results for fiscal 2020 show revenue from site rentals at $5.3 billion, up 4% from 2019. Net income was just over $1 billion ($2.35 per share) compared to $860 million ($1.79 per share) in the prior year. That was an improvement of 31% on an earnings per share basis. Adjusted funds from operations (AFFO) came in at $2.9 billion ($6.78 per share), up from $2.4 billion ($5.58 per share) last year. For fiscal 2021, management forecasts site rental revenue of between $5.532 and $5.577 billion. Net income is projected to be between $957 million and $1.037 billion. AFFO is expected to be between $2.883 billion ($6.64 per share) and $2.928 billion ($6.74 per share). In a separate announcement, the company said that it has signed a new long-term agreement with Verizon to support its 5G Ultra Wideband and 5G nationwide deployment. Specifically, Verizon has committed to lease 15,000 new small cells from Crown Castle over the next four years. Once installed, the small cell leases will have an initial term of 10 years.

Dividend: The shares pay a quarterly dividend of $1.33 ($5.32 a year) to yield 3% at the current price.

Outlook: There are only a couple of other tower companies that compete with CCI, the largest of which is American Tower Corp. Crown Castle is the second largest. SBA Communications is a smaller company. People generally buy these companies for their dividend and, even at this high price, Crown Castle is still yielding 3%. The rollout of 5G benefits this company immensely since the demand for cell towers continues to grow. This is a long-term Hold. Just tuck it in your portfolio and enjoy the dividend and capital appreciation. It's pricey, but add to your position on any pullback.

Action now: Hold.

Electronic Arts NDQ: EA

Originally recommended on Oct. 13/18 (#21836) at $106.10. Closed Friday at $141.05. (All figures in U.S. dollars.)

HOLD

Background: Electronic Arts is one of the bigger publishers of video games. They include such products as FIFA (which of course focuses on soccer), Madden (a series of NFL-based games), and Battlefield.

Performance: We recommended this stock in October 2018 when it was trading at $106.10. We updated it again about a year ago when it was trading at $116.62 and rated it as a Buy. It has been moving higher since and closed Friday at $141.05 for a gain of 33%.

Financials: The most recent financial results were solid with net bookings for the trailing 12 months just below $6 billion, up 8% year-over-year. Revenue was about $1.7 billion, an increase of $80 million from the same period the year before. Net income was $211 million ($0.72 a share), down from $346 million ($1.18 per share) in the prior year.

Acquisitions: The company is not just counting on organic growth. In February it announced a large acquisition, acquiring Glu Mobile for $2.4 billion in cash.

"Our acquisition of Glu combines amazing teams and deeply-engaging products to create a mobile games leader with proven expertise across many fast-growing genres," said Andrew Wilson, CEO of Electronic Arts. "Mobile continues to grow as the biggest gaming platform in the world, and with the addition of Glu's games and talent, we're doubling the size of our mobile business. With a deep IP portfolio and an expanding global audience, we'll deliver more exciting experiences for our players and drive further growth for Electronic Arts."

The company also bought the U.K. based racing game maker Codemasters. Both moves represent a significant investment in mobile gaming.

Dividend and buybacks: The stock pays a small quarterly dividend of $0.17 a share ($0.68 annually) to yield 0.5%.

The company repurchased 2.5 million of its shares in the latest quarter. It has purchased nearly 6 million shares in the past 12 months.

Outlook: Gaming has been very robust during the pandemic with a lot of people sitting around with too much time on their hands. As a result, it has been a good time for game publishers in general and Electronic Arts in particular.

There are lots of ways you can invest in the home gaming and mobile gaming industry, but I think Electronic Arts represents a solid all-around play and I would continue to hold onto it.

Action now: Hold.

Vail Resorts NYSE: MTN

Originally recommended on Jan. 29/18 (#21805) at $229.88. Closed Friday at $319.79. (All figures in U.S. dollars.)

SELL

Background: This company owns 37 ski resorts in North America and Australia, including Canada's famous Whistler Blackcomb. It also operates three urban ski centres and has with agreements with operators in Japan and Europe.

Performance: Amazingly, the stock continues to move up and recently hit an all-time high of $333.95. At the current level it is ahead 39% from our original recommended price.

Recent developments: Vail announced second-quarter fiscal 2021 results on March 11. The company reported revenue of $684.6 million, which beat analysts' estimates. That was down 26% compared to the same quarter last year, but that's a pretty good performance given the pandemic.

Net income was $147.8 million ($3.62 a share, fully diluted). That compares to $206.4 million ($5.04 per share) the year before. Again, not bad considering the toll COVID took on the hospitality and recreation industry.

Dividend: The stock was paying a dividend of $1.76 per share but the company suspended it in April due to the financial uncertainty created by the pandemic.

Comments: You would think that Vail results would have had a terrible year. Many of their mountains were closed at various times throughout the pandemic, which affected not only cash from lift tickets but hotel and restaurant bookings. But things worked out better than most people expected.

Part of the reason for is that the company presells annual passes, so it already had considerable amount of cash in the bank. Additionally, when the mountains were able to open people were so fed up with being indoors, they flocked to go skiing as fast as they could.

The stock is pretty pricey at this level so I would be inclined to take profits at this point. But I wouldn't blame you if you decided to hold on to 50% of whatever you have. Once the pandemic is truly behind us, I expect to see earnings take off, and the share price as well.

Action now: Sell.

Sabre Corp. NDQ: SABR

BUY

Originally recommended on July 26/10 (#20217) at C$31.59, US$30.45. Closed Friday at C$169.27, US$135.17.

Background: This is a technology solutions company that operates in the global travel and tourism industry. It's a software as a service firm that powers the back end of many travel related companies. These include airlines, airports, car rental companies, cruise lines, hotels, search engines, and online travel agencies.

If you book a hotel room or a flight on American Airlines, for instance, you are very likely using the Sabre platform.

Performance: The stock was crushed during the pandemic, falling to below $6 a share during the market plunge a year ago. I recommended it last December when it was trading at $10.97. It closed Friday at $14.99 for a very nice gain of 37%.

Recent developments: The company recently released fourth-quarter and year -end results and, as you might expect, they were rather ugly.

Fourth-quarter revenue decreased 67% from the previous year, to $314 million. That was down from $941 million in the fourth quarter of 2019. The company said the decline in revenue was driven by "unprecedented reductions" in global air, hotel, and other travel bookings due to the COVID-19 pandemic.

Operating loss was $220 million, versus operating income of $58 million in the fourth quarter of 2019. Net loss attributable to common stockholders was $311 million (-$0.98 per share, fully diluted), versus net income of $10 million ($0.04 per share) in the fourth quarter of 2019.

For the full year, revenue decreased 66% to $1.3 billion, compared to $4 billion in 2019. Net loss totaled $1.28 billion (-$4.42 per share), versus net income of $159 million ($0.57 per share) in 2019.

As I said: ugly.

Outlook: Sabre is not offering any forward guidance at this time but just check the evening news for pictures of crowded U.S. airports as travelers return to the skies even though the pandemic rages on. This has to be good for the company's business and the sharp rise in the share price since my original recommendation reflects that.

The stock traditionally trades in the low $20s and I think that's exactly where it's going again. That still gives you plenty of upside so I would add to your position if you followed our advice on this one. If not, take one now.

Action now: Buy with a target of $21.

Veolia Environment Services OTC: VEOEY

Originally recommended on April 27/07 (#2713) at $74.32. Closed Friday at $29.89. (All figures in U.S. dollars, except where indicated in euros.)

SELL

Background: Veolia group is a French-based company that designs and provides water, waste, and energy management solutions which contribute to the sustainable development of communities and industries. Through its three complementary business activities, Veolia helps to develop access to resources, preserve available resources, and to replenish them.

In 2019, the Veolia group supplied 98 million people with drinking water and 67 million people with wastewater service, produced nearly 45 million megawatt hours of energy, and treated 50 million metric tons of waste. Veolia Environnement recorded consolidated revenue of €27.189 billion in 2019 ($29.9 billion).

Performance: This stock was recommended many years ago, in 2007. It has always appeared to have good prospects, but that has never translated into a strong upward move in the share price. We are well down on this one.

Recent developments: Last week, Veolia announced it had reached a deal to purchase rival Suez SA in a deal worth $15.5 billion. Suez is another of my past recommendations that did not work out well.

Veolia says the agreement would allow the creation of a "new" Suez made up of assets with real growth potential, with revenues of around €7 billion. It would also enable the implementation of Veolia's plan to create a global champion of ecological transformation, with revenues of around €37 billion.

Outlook: Big promises, but both these companies have been disappointments. If you want to invest in the water industry, go with Xylem or American Water Works.

Action now: Sell.

GORDON PAPE'S UPDATES

Recommendations are colour-coded:
Green indicates Buy
Yellow indicates Hold
Red indicates Sell

UnitedHealth Group Inc. NYSE: UNH

Originally recommended by Tom Slee on March 2/14 (#21409) at $76.01. Closed Friday at $391.34. (All currency figures in U.S. dollars.)

BUY

Background: UnitedHealth Group is the largest healthcare company in the world. It is divided into two segments, with UnitedHealth providing insurance coverage while Optum provides information and technology-enabled health services.

Performance: After a dip in February, the stock resumed its steady climb and last Friday posted an all-time high of $394.04 before slipping back a bit in late trading. The shares are up 415% since our original recommendation.

Recent developments: First-quarter results blew away analysts' expectations. The company reported revenue of $70.2 billion, well in excess of estimates. For the same period last year, revenue was $64.4 billion.

Net earnings attributable to shareholders were $4.9 billion ($5.08 per share) compared to $3.4 billion ($3.52 per share) in the first quarter of 2019.

Based upon initial 2021 business performance trends, the company increased its full year net earnings outlook to $17.15 to $17.65 per share and adjusted earnings to $18.10 to $18.60 per share. This includes approximately $1.80 per share in potential net unfavorable impact to accommodate continuing COVID-19 effects, such as testing and treatment costs.

Cash flows from operations in first quarter 2021were $6 billion or 1.2 times net income. Return on equity was 29.5%, reflecting the company's strong overall operating performance and efficient capital structure.

Dividend: The shares pay a quarterly dividend of $1.25 ($5 annually) to yield 1.3% at the current price. I expect to see a significant boost in the dividend shortly.

Outlook: This is a stock that keeps on giving and the company is on track to keep doing that.

Action now: Buy.

Gilead Sciences NDQ: GILD

Originally recommended on March 2/20 (#22009) at $69.36. Closed Friday at $66.87. (All figures in U.S. dollars.)

HOLD

Background: Gilead is an American biotechnology company that researches, develops, and commercializes drugs. The company focuses primarily on antiviral drugs used in the treatment of HIV, hepatitis B, hepatitis C, and influenza. It also has a drug that is used for treating patients with COVID.

Performance: The stock fell as low as $56.56 in December but has gradually edged higher since. However, it is still trading below our original recommended price.

Recent developments: The company recently announced fourth-quarter and year-end results. Sales for the final quarter of 2020 were up 26% year-over-year to $7.3 billion, primarily due to remdesivir, Gilead's COVID treatment, which is being marketed under the name Veklury. Sales of the drug totaled $1.9 billion, more than 26% of total revenue.

"Gilead continues to play a central role in the pandemic, with Veklury now treating one in two hospitalized patients in the United States. At the same time, we continue to meet the needs of people living with HIV, cancer, viral hepatitis, and other conditions," said CEO Daniel O'Day.

For the full year, product sales were $24.4 billion, with Veklury accounting for $2.8 billion of that.

Earnings varied widely, depending on whether they were based on GAAP or non-GAAP reporting principles. On a GAAP basis, Gilead reported fourth-quarter net income of $1.6 billion ($1.23 per share, fully diluted). That was down 42% from the same period in 2019. For the full year, GAAP net income was $123 million ($0.10 a share), down 98% from the previous year.

But on a non-GAAP basis, the picture looks very different. Fourth-quarter earnings were up 97% to $2.8 billion ($2.19 per share). For the year, earnings were just under $9 billion ($7.09 per share), an improvement of 14%.

The company said the weak GAAP numbers were "primarily due to changes in the fair value of Gilead's equity investments in Galapagos NV, a 2019 discrete tax benefit related to intra-entity transfers, and higher acquisition-related expenses. Full year 2020 was also impacted by higher acquired in-process research and development expenses".

Dividend: Gilead increased its quarterly dividend by 4.4% to $0.71 ($2.84 per year) effective with the March payment. The stock yields 4.2% at the new rate.

Outlook: The company provided guidance for 2021 although it stressed that the pandemic makes the picture uncertain. It projects product sales including Veklury of $23.7 billion to $25.1 billion and non-GAAP diluted earnings per share of $6.75 to $7.45.

Action now: Hold.

Stryker Corp. NYSE: SYK

Originally recommended by Gordon Pape on July 18/14 (#21427) at $80.44. Closed Friday at $256.95. (All currency figures in U.S. dollars.)

SELL HALF

Background: Stryker Corp. is a Fortune 500 medical technology company with a market capitalization of $70.3 billion. It is based in Michigan but operates in 100 countries and employs more than 33,000 people. The company has three main product lines. The orthopedics segment provides hip and knee implants. The medical surgical segment sells surgical equipment, including robots and other navigational aids, as well emergency medical equipment and disposable products. The neurotechnology segment provides products for brain and skull surgery.

Performance: The chart looks choppy, but the broad trend has been upwards over the past year. The shares touched an all-time high of $259.25 on Friday. The stock is up 219% since it was first recommended.

Recent developments: Stryker's 2020 results were negatively impacted by the pandemic, which forced the delay of many elective surgeries. Fourth-quarter sales of $4.3 billion managed a 3.2% gain over 2019 but for the full year sales were down 3.6% to $14.4 billion. The main weakness was in orthopedics, where sales for the year were off by 5.6%.

Fourth-quarter net earnings were $568 million ($1.49 per share, fully diluted), down about 22% from 2019. Full year earnings were $1.6 billion ($4.20 per share), a drop of about 23% from the year before.

Dividend: The company raised the dividend by 9.6% in December to $0.63 per quarter ($2.52 per year), to yield 1%.

Outlook: Stryker continues to monitor the impact of the pandemic on its business, but it predicts 2021 organic net sales growth in the range of 8% to 10% from 2019, which it says is a more normal baseline given the variability throughout 2020. It expects adjusted net earnings per diluted share to be in the range of $8.80 to $9.20.

Action now: Take half profits. The stock has performed well but looks expensive with a p/e ratio of about 61.