

Water / Infrastructure

Aqua America, Inc.
(WTR) - NEUTRAL

Price: **\$20.91**
 Fair Value Estimate: \$21.00
 52-Week Range: \$20.99-\$15.39
 Market Cap (MM): \$2,870
 Shr.O/S-Diluted (mm): 137.3
 Average Daily Volume: 772,470
 Dividend: \$0.62
 Yield: 3.0%

FYE: Dec	2009A	2010E	2011E
EPS:	\$0.77A	\$0.87E	\$0.93E
Prior EPS:		NC	NC
P/E Ratio:	27.2x	24.0x	22.5x

Quarterly EPS:

	2009A	2010E	2011E
Q1	\$0.14A	\$0.16A	\$0.17E
Q2	\$0.19A	\$0.22A	\$0.24E
Q3	\$0.25A	\$0.27E	\$0.29E
Q4	\$0.20A	\$0.22E	\$0.23E

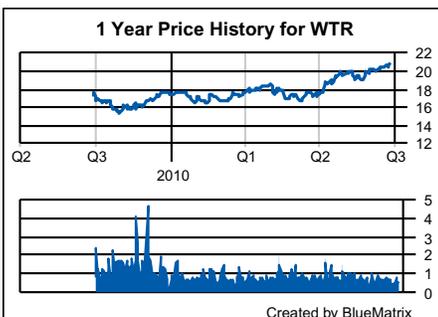
Downgrade to NEUTRAL on Valuation.
Compelling Fundamentals Largely Priced into
Stock After Recent Run-Up.

INVESTMENT CONCLUSION:

While Aqua America continues to execute admirably well on its simple - yet compelling - strategy (namely, invest \$1.5 billion in capital over the next five years to rehabilitate system infrastructure, and earn a timely, fair return on these investments), WTR shares have performed strongly year-to-date, leaving little room for further near-term upside in our view. Indeed, the stock has been flirting with our \$21 fair value estimate, and already boasting a sporty P/E multiple of 22 times (versus an internal earnings growth target of 10%), we believe further multiple expansion is unlikely. Regulatory relations and cost discipline remain core competencies for the company and will likely continue to drive steady earnings growth, and we believe WTR shares will continue to trade at a premium to the peer group for these reasons - in addition to a favorable regulatory footprint. Still, we believe these positives are reflected in the valuation at current levels, and lower our rating to NEUTRAL from Buy. While WTR remains a compelling source of competitive risk-adjusted total return for long-term oriented holders, we believe investors seeking to put new money to work should be disciplined in seeking superior entry points.

KEY POINTS:

- **Downgrade to NEUTRAL on valuation; long-term thesis intact.** We downgrade shares of WTR to NEUTRAL from Buy on valuation after the stock's strong year-to-date performance. Shares are nearing our fair value estimate of \$21, currently trading at 22 times both our 2011 earnings estimate of \$0.93/share and consensus of \$0.96/share. While we believe WTR shares deserve a premium valuation based upon the company's strong track record of operational execution and favorable regulatory footprint, we believe upside to this multiple is limited.
- **Premium P/E multiple versus comparable peers.** WTR's Forward P/E multiple of approximately 22 times represents a substantial premium to key peers including American Water (AWK-BUY) at 15 times, California Water (CWT-BUY) at 16 times, and American States Water (AWR-BUY) at 17 times. Note that our peer group excludes micro-cap water utilities, as we believe comparison with these is of limited value to investors given the extremely low liquidity of these stocks.
- **Rate cases support future outlook.** Aqua received \$44 million in annualized rate relief so far this year, and has outstanding requests for \$14 million in four states. The Pennsylvania rate case will provide relief that will positively affect the second half of the year. With plans for over \$300 million in capital spending this year, management anticipates filing for an additional \$28.5 million in rates before year-end (primarily in southern states), impacting earnings in 2011-2012.
- **Third quarter outlook.** We expect Aqua to report 3Q-2010 results during the first week of November. Our \$0.27/share estimate reflects 9% growth vs. the same period in 2009 and is a penny shy of the consensus forecast. Rainfall in the Philadelphia region was 2" above average in July, but reverted to 2"-3" below average in August and September, respectively. We believe increased consumption based on weather could drive modest upside to our third quarter estimate.



Aqua America, Inc.		Janney Montgomery Scott LLC								
Quarterly Income Statement, 2010E										
	1Q10	Y/Y	2Q10	Y/Y	3Q10E	Y/Y	4Q10E	Y/Y	FY2010E	Y/Y
Operating Revenues	160,517	3.9%	178,444	6.6%	197,100	9.0%	184,682	10.0%	720,744	7.5%
Operations and Maintenance	67,601		69,310		73,913		71,841		282,665	
<i>O&M Ratio</i>	42.1%		38.8%		37.5%		38.9%		39.2%	
Depreciation	26,200		26,802		27,500		28,000		108,502	
Amortization	3,172		3,314		3,400		3,200		13,086	
Taxes other than Income Taxes	12,890		12,943		13,367		12,200		51,400	
Operating Income	50,654	8.3%	66,075	12.3%	78,921	10.4%	69,441	15.0%	265,091	11.6%
<i>Operating Margin</i>	31.6%		37.0%		40.0%		37.6%		36.8%	
Interest Expense	18,430		18,504		19,000		19,207		75,141	
Allowance for Construction Funds	(1,541)		(1,461)		(750)		(750)		(4,502)	
Gain on Sale of other Assets	(1,929)		(110)		(150)		(150)		(2,339)	
Income before Income Taxes	35,694	15.5%	49,142	15.1%	60,821	10.4%	51,134	17.6%	196,791	14.3%
Income Taxes	14,213		19,287		24,207		20,351		78,058	
<i>Tax Rate</i>	39.8%		39.2%		39.8%		39.8%		39.7%	
Net Income	21,481	16.9%	29,855	15.5%	36,614	9.4%	30,783	15.5%	118,733	13.8%
Diluted EPS	\$0.16	16.1%	\$0.22	14.6%	\$0.27	8.6%	\$0.22	14.7%	\$0.87	13.0%
Diluted Shares Outstanding	136,800		137,012		137,200		137,400		137,103	

Aqua America, Inc.		Janney Montgomery Scott LLC								
Quarterly Income Statement, 2011E										
	1Q11E	Y/Y	2Q11E	Y/Y	3Q11E	Y/Y	4Q11E	Y/Y	FY2011E	Y/Y
Operating Revenues	173,358	8.0%	194,504	9.0%	212,868	8.0%	197,610	7.0%	778,341	8.0%
Operations and Maintenance	72,984		75,857		80,890		78,451		308,182	
<i>O&M Ratio</i>	42.1%		39.0%		38.0%		39.7%		39.6%	
Depreciation	28,500		29,000		29,500		32,010		119,010	
Amortization	3,000		3,500		3,500		2,100		12,100	
Taxes other than Income Taxes	12,840		13,000		13,500		13,240		52,580	
Operating Income	56,034	10.6%	73,147	10.7%	85,478	8.3%	71,809	3.4%	286,469	8.1%
<i>Operating Margin</i>	32.3%		37.6%		40.2%		36.3%		36.8%	
Interest Expense	18,740		19,200		19,500		20,160		77,600	
Allowance for Construction Funds	(750)		(750)		(750)		(750)		(3,000)	
Gain on Sale of other Assets	(150)		(150)		(150)		(150)		(600)	
Income before Income Taxes	38,194	7.0%	54,847	11.6%	66,878	10.0%	52,549	2.8%	212,469	8.0%
Income Taxes	15,087		21,665		26,417		20,757		83,925	
<i>Tax Rate</i>	39.5%		39.5%		39.5%		39.5%		39.5%	
Net Income	23,107	7.6%	33,183	11.1%	40,461	10.5%	31,792	3.3%	128,544	8.3%
Diluted EPS	\$0.17	6.9%	\$0.24	10.5%	\$0.29	9.9%	\$0.23	2.7%	\$0.93	7.6%
Diluted Shares Outstanding	137,600		137,800		138,000		138,200		137,900	

Company Description

Aqua America, Inc. provides water and wastewater utility service to suburban areas outside of Philadelphia, Chicago, and Cleveland, as well as other communities throughout 13 states, including Pennsylvania, New York, Ohio, North Carolina, Illinois, Texas, Florida, New Jersey, Indiana, Virginia, Maine, Missouri, and South Carolina.

IMPORTANT DISCLOSURES

Research Analyst Certification

I, Ryan M. Connors and Heike M. Doerr, the Primarily Responsible Analyst for this research report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject securities or issuers. No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views I expressed in this research report.

Janney Montgomery Scott LLC ("JMS") Equity Research Disclosure Legend

Janney Montgomery Scott is a market maker in the securities of WTR, and may at any time hold a long or short position in this security.

Janney Montgomery Scott may seek compensation for investment banking services from the subject company (ies) WTR security in the next 3 months.

The research analyst is compensated based on, in part, Janney Montgomery Scott's profitability, which includes its investment banking revenues.

Definition of Ratings

BUY: Janney expects that the subject company will appreciate in value. Additionally, we expect that the subject company will outperform comparable companies within its sector.

NEUTRAL: Janney believes that the subject company is fairly valued and will perform in line with comparable companies within its sector. Investors may add to current positions on short-term weakness and sell on strength as the valuations or fundamentals become more or less attractive.

SELL: Janney expects that the subject company will likely decline in value and will underperform comparable companies within its sector.

Price Charts



Janney Montgomery Scott Ratings Distribution as of 06/30/2010

Rating	IB Serv./Past 12 Mos.			
	Count	Percent	Count	Percent
BUY [B]	184	53	18	10
NEUTRAL [N]	155	45	4	3
SELL [S]	7	2	2	29

***Percentages of each rating category where Janney has performed Investment Banking services over the past 12 months.**

Other Disclosures

Investment opinions are based on each stock's 6-12 month return potential. Our ratings are not based on formal price targets, however our analysts will discuss fair value and/or target price ranges in research reports. Decisions to buy or sell a stock should be based on the investor's investment objectives and risk tolerance and should not rely solely on the rating. Investors should read carefully the entire research report, which provides a more complete discussion of the analyst's views.

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