

Water

Aqua America, Inc.
(WTR) - BUY

Price: **\$15.74**
 Fair Value Estimate: \$20.00
 52-Week Range: \$22.00-\$15.39
 Market Cap (MM): \$2,139
 Shr.O/S-Diluted (mm): 135.9
 Average Daily Volume: 910,987
 Dividend: \$0.54
 Yield: 3.4%

FYE: Dec	2008A	2009E	2010E
EPS:	\$0.73	\$0.77	\$0.88
Prior EPS:		\$0.78	NC
P/E Ratio:	21.6x	20.4x	17.9x

Quarterly EPS:			
Q1	\$0.11	\$0.14A	\$0.16
Q2	\$0.17	\$0.19A	\$0.23
Q3	\$0.26	\$0.25	\$0.27
Q4	\$0.19	\$0.20	\$0.22

EPS: Annual estimate under review; does not reflect actual 2Q09 results or post-earnings model adjustments



In Line Quarter; Recent Share Decline Provides Opportunity - Maintain BUY

KEY POINTS:

- **Third Quarter Results.** Aqua America reported third quarter earnings of \$0.25, in line with our estimate and consensus. The company reported results of \$0.26 per share in the third quarter last year, which included a \$4.1 million gain for the sale of an Illinois water system and a \$2.5 million one-time, non-cash charge associated with "true-ing up" the accounting for the finalized Texas rate case. We believe 3Q08 operating results were \$0.25 per share, i.e., flat year over year.
- **Results At A Glance.** Quarterly revenue increased just 2.1%, below our 4% expectation due to uncooperative weather throughout the MidAtlantic region. In Pennsylvania, which accounts for over 50% of the company's customer base, consumption declined 9% and sendout levels in neighboring New Jersey fared even more poorly. Aqua managed to overcome this revenue shortfall and meet earnings expectations through diligent operating expense management. Excluding one time items in 3Q08, the company was actually able to decrease its operating expenses. Management believes wet weather was a three cent drag in the current period. Economic weakness is also a factor, though more difficult to quantify.
- **Regulatory Update.** The company has approximately \$12 million in pending rate cases, with the largest requests pending in North Carolina and New York. We expect the company to file for an additional \$57 million in increased rates in Pennsylvania and New Jersey before year end. While this may seem low compared to recent years, the company is largely done with AquaSource "catch up" rate requests, which had inflated the amount of rate cases pending over the past few years. Current regulatory activity reflects the company's normal rate case cycle. Additionally, with over 70% of the company's customers located in states that allow an infrastructure surcharge mechanism, the company is able to phase in rate increases as capital is invested, minimizing the need for large, politicized rate requests, and improving the timeliness of returns on investment.
- **Conference Call.** Management will host a conference call at 11 AM EST this morning. In addition to an update on regulatory matters, we expect management to comment on the impact the current economic climate has on customer usage and the company's ability to make acquisitions.
- **Outlook.** Aqua has underperformed the group for most of the year, and is the worst performer over the last month, down 8% compared to the group decline of just a 1%. We do not believe the fundamental earnings capability of the company has changed. If anything, the company has expanded its capital expenditure program throughout the year, accelerating its rate base growth, which will ultimately fuel future earnings growth. The shares are the cheapest they have been in over a year, at the low end of the stock's historical valuation range. We maintain our BUY rating and \$20 fair value ahead of today's conference call.

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, Debra G. Coy 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.

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The research analyst primarily responsible for preparing this research report or a member of the research analyst's household has a financial interest in the securities of the company in the form of options (O), warrants (W), futures (F), and/or a short position (S).

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 9/30/09

Rating	IB Serv./Past 12 Mos.			
	Count	Percent	Count	Percent
BUY [B]	140	49	15	3.50
NEUTRAL [N]	139	49	4	4.14
SELL [S]	5	2.00	0	0.00

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

Other Disclosures

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