

Water / Infrastructure

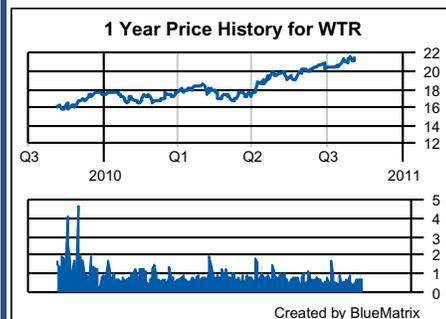
Aqua America, Inc.
(WTR) - NEUTRAL

Price: \$21.55
 Fair Value Estimate: \$21.00
 52-Week Range: \$21.72-\$15.66
 Market Cap (MM): \$2,959
 Shr.O/S-Diluted (mm): 137.3
 Average Daily Volume: 661,922
 Dividend: \$0.62
 Yield: 2.9%

FYE: Dec	2009A	2010E	2011E
EPS:	\$0.77A	\$0.92E	\$0.95E
Prior EPS:		\$0.87	\$0.93
P/E Ratio:	28.0x	23.4x	22.7x

Quarterly EPS:

Quarter	2010	2011	2012
Q1	\$0.14A	\$0.16A	\$0.17E
Q2	\$0.19A	\$0.22A	\$0.24E
Q3	\$0.25A	\$0.32A	\$0.31E
Q4	\$0.20A	\$0.22E	\$0.23E



Solid 3Q Earnings Driven by Hot Weather & Cost Leverage; NEUTRAL on Valuation

INVESTMENT CONCLUSION:

Aqua America has earned a well-deserved reputation for tightly managing expenses and nimbly navigating the regulatory process in the water utility space. The model is simple and socially beneficial – invest in aging infrastructure to provide customers with safe reliable water service and earn a fair return on investment. The company is spending over \$1.5 billion in capital over the next five years to rehabilitate system infrastructure, to grow its rate base, and set the stage for future growth. Successful implementation of this investment strategy is more difficult than the model suggests and requires engineering expertise, regulatory know-how, and financial flexibility. Still, management maintains a disciplined cost consciousness and ongoing rate relief will keep Aqua moving in the right direction. While Aqua America shares trade at a well-deserved premium to the peer group, we believe the stock’s current levels accurately account for the firm’s future growth outlook. We maintain our NEUTRAL rating for shares of WTR and \$21 fair value.

KEY POINTS:

- **Rates & weather drive impressive 3Q results.** Aqua America reported third quarter earnings of \$0.32/share, a nickel ahead of our estimate and \$0.04 ahead of consensus expectations. EPS grew 30% year-over-year as hot, dry weather in the northeast drove higher residential water consumption and management continued to control operating and maintenance expenses as a percentage of revenue.
- **Efficient operations drive leverage while rate base grows.** Quarterly revenue increased 15%, ahead of our 9% expectations; and costs were lighter than we had forecasted. The operations & maintenance expense / revenue ratio fell to 35% - a level not seen since 2002 - contributing to 43% operating margin (vs. our expectation of 40%). Aqua invested \$240 million in capital through 2010 - upgrading pipe, plants, and storage facilities. Additionally, management still expects to close between 20-30 tuck-in acquisitions this year (14 closed YTD), after completing 18 small acquisitions in 2009.
- **Rate relief continues to flow.** The company received \$49 million in annualized rate relief so far this year, and has outstanding requests for \$19 million in five states. With plans for over \$300 million in capital spending this year, management anticipates filing for an additional \$12 million in annualized rates before year-end (primarily in southern states), with an earnings impact in 2011 and 2012.
- **Valuation reflects industry leader status.** Aqua has led the peer group performance so far in 2010, up 23% year-to-date, which reflects strong financial and operational performance that we have come to expect from this water utility bellwether. We believe WTR shares deserve a premium valuation (currently trading around 23 times our 2011 estimate) based upon the company's strong track record, though upside to this multiple appears limited. 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 and accordingly maintain our NEUTRAL rating on current valuation.

Aqua America, Inc.		Janney Montgomery Scott LLC									
Quarterly Income Statement, 2010E											
	1Q10	Y/Y	2Q10	Y/Y	3Q10	Y/Y	4Q10E	Y/Y	FY2010E	Y/Y	
Operating Revenues	160,517	3.9%	178,444	6.6%	207,797	14.9%	184,682	10.0%	731,440	9.1%	
Operations and Maintenance	67,601		69,310		72,968		71,841		281,720		
<i>O&M Ratio</i>	42.1%		38.8%		35.1%		38.9%		38.5%		
Depreciation	26,200		26,802		27,431		28,000		108,433		
Amortization	3,172		3,314		3,629		3,200		13,315		
Taxes other than Income Taxes	12,890		12,943		14,182		12,200		52,215		
Operating Income	50,654	8.3%	66,075	12.3%	89,587	25.4%	69,441	15.0%	275,757	16.1%	
<i>Operating Margin</i>	31.6%		37.0%		43.1%		37.6%		37.7%		
Interest Expense	18,430		18,504		19,150		19,207		75,291		
Allowance for Construction Funds	(1,541)		(1,461)		(1,077)		(750)		(4,829)		
Gain on Sale of other Assets	(1,929)		(110)		(291)		(150)		(2,480)		
Income before Income Taxes	35,694	15.5%	49,142	15.1%	71,805	30.3%	51,134	17.6%	207,775	20.7%	
Income Taxes	14,213		19,287		28,054		20,351		81,905		
<i>Tax Rate</i>	39.8%		39.2%		39.1%		39.8%		39.4%		
Net Income	21,481	16.9%	29,855	15.5%	43,751	30.7%	30,783	15.5%	125,870	20.6%	
Diluted EPS	\$0.16	16.1%	\$0.22	14.6%	\$0.32	29.6%	\$0.22	14.6%	\$0.92	19.7%	
Diluted Shares Outstanding	136,800		137,012		137,394		137,500		137,177		

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%	218,187	5.0%	197,610	7.0%	783,659	7.1%	
Operations and Maintenance	72,984		75,857		82,911		78,451		310,203		
<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%	88,776	-0.9%	71,809	3.4%	289,767	5.1%	
<i>Operating Margin</i>	32.3%		37.6%		40.7%		36.3%		37.0%		
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%	70,176	-2.3%	52,549	2.8%	215,766	3.8%	
Income Taxes	15,087		21,665		27,719		20,757		85,228		
<i>Tax Rate</i>	39.5%		39.5%		39.5%		39.5%		39.5%		
Net Income	23,107	7.6%	33,183	11.1%	42,456	-3.0%	31,792	3.3%	130,539	3.7%	
Diluted EPS	\$0.17	6.9%	\$0.24	10.5%	\$0.31	-3.4%	\$0.23	2.8%	\$0.95	3.2%	
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 or an affiliate managed or co-managed a public offering of WTR security in the past 12 months.

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 09/30/2010

Rating	IB Serv./Past 12 Mos.			
	Count	Percent	Count	Percent
BUY [B]	195	54	20	10
NEUTRAL [N]	157	43	10	6
SELL [S]	10	3	1	10

***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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