

Water / Infrastructure

Aqua America, Inc.

(WTR) - BUY

Price: \$19.87
 Fair Value Estimate: \$21.00
 52-Week Range: \$20.08-\$15.39
 Market Cap (MM): \$2,722
 Shr.O/S-Diluted (mm): 137.0
 Average Daily Volume: 901,311
 Dividend: \$0.58
 Yield: 2.9%

FYE: Dec	2009A	2010E	2011E
EPS:	\$0.77	\$0.87	\$0.93
Prior EPS:		\$0.85	NC
P/E Ratio:	25.8x	22.8x	21.4x

Quarterly EPS:

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



Equity Research
Note

Hot Weather and Steadfast Cost Controls Drive 2Q Beat; Maintain BUY

INVESTMENT CONCLUSION:

Aqua America continues to show why it is a "best-of-breed" player in the investor owned utility space. 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. Management maintains a disciplined cost consciousness not only during off-peak water usage seasons, but also in higher consumption months. The company's Pennsylvania operations (more than 50% of sales), benefit from one of the most progressive regulatory jurisdictions in the country. Rate relief will favorably impact results in the near-term and a pipeline of planned cases offers support in 2011 and 2012. WTR shares trade at a well-deserved premium to the peer group, but we believe the combination of steady growth and a consistently rising dividend will enable the company to deliver compelling risk-adjusted total returns for long-term investors. We reiterate our BUY rating for WTR and increase our fair value to \$21 from \$20.

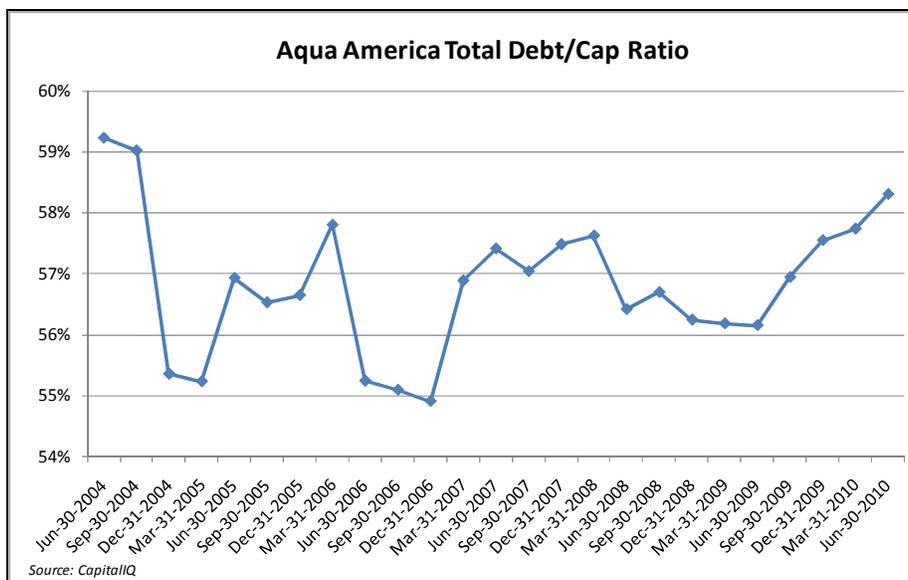
KEY POINTS:

- **Impressive Results.** Aqua America reported second quarter earnings of \$0.22/share, a penny ahead of consensus and \$0.02 ahead of our estimate. EPS grew 15% year-over-year as hot, dry weather in the northeast drove higher water consumption while management controlled costs.
- **Operations and Rate Base Growth.** Quarterly revenue increased 7%, ahead of our 4% expectations; and costs were lighter than we had forecast. The operations & maintenance expense/revenue ratio fell to 38.8% contributing to 37% operating margin (vs. our expectation of 35.6%). Aqua invested \$141 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 (12 closed YTD), after completing 18 small acquisitions in 2009.
- **Regulatory Update.** The company 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 was approved in late June, adding a meaningful contribution in 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), with an earnings impact in 2011 and 2012.
- **Dividend Increase.** Aqua declared a 7% dividend increase payable December 1st, bringing the annualized rate to \$0.62/share from \$0.58/share previously. This is the 20th increase over the last 19 years and the eighth consecutive year that the dividend increase was greater than five percent. Currently, Aqua's dividend yield is 3%; generally in line with its water utility peers.
- **Long-term Thesis Intact.** Aqua has outperformed its peer group so far in 2010 (due to strong performance in July), up 13% compared to the group mean of 2% (excluding SouthWest Water (SWWC; NR)). We favor the shares for long-term investors focused on risk-adjusted total returns and maintain our BUY rating. Our increased \$21 fair value (\$20 previously) represents ~22x our 2011 estimate, in line with Aqua's historical multiple.

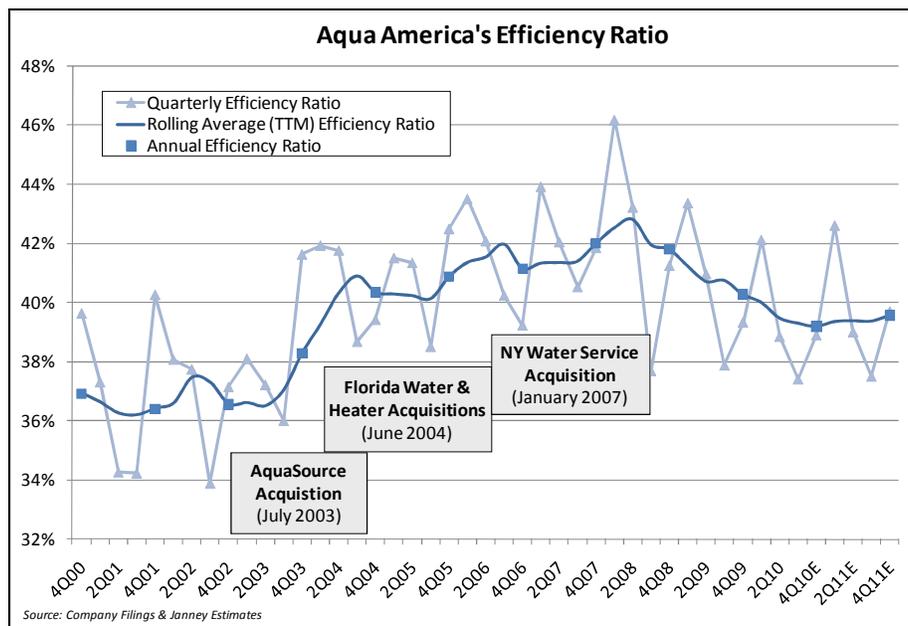
Research Analyst Certifications and Important Disclosures are on pages 4 - 5 of this report

WTR 2Q-2010: ADDITIONAL COMMENTARY & ANALYSIS

Equity Financing Needs Fade. Aqua closed a \$70 million debt financing in June, at an average rate of below 5%. With a solid credit rating the company is securing debt at favorable rates, which ultimately benefits customers (as interest costs are passed through in customer bills). The company's total debt to capital ratio has inched higher over the last year to 58% - a level last seen in 2004. We believe the company can rely on internally generated cash, shares issued via the DRP, and debt to finance its future capital plans (\$1.5 billion over the next five years). We do not expect an equity offering (barring a large, likely accretive, acquisition), and would note that DRP dilution remains around 1% of outstanding shares.



Efficiency Ratio Steadily Improves. Aqua has long been regarded as one of the leanest water utilities in the group with an O&M / revenue ratio averaging 39.5% over the last 10 years (on a rolling twelve month basis). This focus on cost containment, paired with rate relief in PA and more favorable year-over-year weather comps, drives our belief that annual efficiency ratio for the next two years will remain below 40%, driving operating margins and earnings growth.



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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