

Utilities

AWK/WTR Engage in Another Asset Swap to Realign Regulatory Focus

Portfolio optimization Incremental positive for AWK and WTR longer term; Maintain ratings and estimates. We believe this second asset swap between AWK and WTR is a positive trend as both seek to refocus time/capital on states with solid growth and regulatory relationships. While we maintain our current EPS estimates, today's transactions provide a positive bias for our EPS estimates post 2011 as we expect AWK and WTR to lever existing operations and regulatory expertise to improve earned ROEs.

- Asset swap likely leads to improved earned ROEs longer term; Maintain AWK and WTR EPS estimates and ratings. This marks the second asset swap between WTR and AWK in the past seven months, and we believe it is a positive trend. allowing each company to focus efforts on states where each has solid regulatory relationships and growth opportunities. Earned margins are likely to trend up in these states as duplicative efforts are reduced, state regulatory processes are streamlined and economies of scale are realized.
 - We expect regulatory approval in both states to be granted early next year.
- WTR agrees to buy Ohio assets for \$120 million. The company is adding 57,280 water and wastewater customers and approximately \$98 million.
 - In 2010, Ohio comprised of 6.1% of Aqua's revenues. Aqua has been in Ohio since the 1999 acquisition of Consumers Water Company and has a solid working relationship with the Ohio Commission.
 - Reiterate Neutral rating and \$24 price target. Our price target is 21x our 2012 EPS estimate, in line with its peers when fully valued due to its relative earnings consistency, longer-term growth opportunities. Key risks include regulatory risks on the local, state, and federal level.
- AWK to buy New York assets for \$71 million. American is almost doubling its Long Island service territory adding an additional 50,500 customers to its service territory.
 - New York is a small operation for each company, totally approximately \$125 million in rate base (less than 5%) for AWK and less than \$50 million in rate base for WTR.
 - We expect AWK to use the proceeds from the OH transaction to fund its capital expenditure program.
 - Reiterate Outperform rating and \$32 price target. We assume 17.8x our 2012 EPS estimate, a discount to its peers when fully valued due to lower earned ROEs. Additional upside exists as operating margins improve via rate relief, cost containment efforts, and growth of the Market-Based Operations. Key risks include regulatory risks on the local, state, and federal level.

INDUSTRY UPDATE

Prices as of 7/8/11

Ticker	Price	Mkt Cap (mil)	Rating	Risk
AWK	\$30.16	\$5,286	O	L
WTR	\$22.49	\$3,081	N	L

Baird covered companies

**Please refer to Appendix
- Important Disclosures
and Analyst Certification**

Appendix - Important Disclosures and Analyst Certification

Covered Companies Mentioned

All stock prices below are the July 8, 2011 closing price.

American Water Works Company, Inc. (AWK - \$30.16 - Outperform)

Aqua America, Inc. (WTR - \$22.49 - Neutral)

(See recent research reports for more information)



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