



COMPANY UPDATE/ESTIMATE CHANGE

Key Metrics

WTR - NYSE (as of 8/2/11)	\$21.05
Price Target	\$25
52-Week Range	\$23.79-\$18.90
Shares Outstanding (mm)	138.8
Market Cap. (\$mm)	\$2,909.5
3-Mo. Average Daily Volume	550,837
Institutional Ownership	46.3%
Debt/Total Capital (6/11)	54.8%
ROE (6/11)	12.0%
Book Value/Share (6/11)	\$8.73
Price/Book Value	2.5x
Dividend Yield	2.9%
LTM EBITDA Margin	55.1%

EPS FY 12/31

	2010A	Prior 2011E	Curr. 2011E	Prior 2012E	Curr. 2012E
1Q	\$0.16	--	*\$0.19A	--	--
2Q	\$0.22	--	*\$0.25A	--	--
3Q	\$0.32	\$0.30	\$0.32	--	--
4Q	\$0.21	--	\$0.25	--	--
Year	\$0.90	\$0.97	*\$1.01	--	\$1.03
P/E	23.4x		20.8x		20.4x

*Excludes nonrecurring items

Revenue (\$mm)

	2010A	Prior 2011E	Curr. 2011E	Prior 2012E	Curr. 2012E
1Q	\$160.5	--	\$171.3A	--	--
2Q	\$178.4	--	\$188.2A	--	--
3Q	\$207.8	\$202.1	\$213.0	--	--
4Q	\$179.3	\$190.9	\$190.0	--	--
Year	\$726.1	\$746.9	\$762.6	\$768.2	\$765.6

Company Description: Aqua America is a water and wastewater utility holding company with operating subsidiaries serving approximately three million people in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, New York, Indiana, Florida, Virginia, Maine, Missouri, South Carolina, and Georgia. The company's history spans over 100 years.

Aqua America Inc.

WTR -- NYSE -- Buy-2

Q2 Results Ahead of Expectations and Improving Outlook

Investment Highlights

- Q2'11 EPS were \$0.25 versus \$0.22 (excluding a \$0.02 benefit related to bonus depreciation), compared to our \$0.23 estimate and the \$0.24 consensus. GAAP EPS were \$0.27 versus \$0.22.
- During the quarter the company announced another asset swap with American Water Works (AWK) – this time for the Ohio and New York assets, and separately, WTR sold its Maine subsidiary to Connecticut Water Service (CWTS).
- Yesterday WTR announced a 6.5% dividend increase, the 21st time the company has raised its dividend over the past 20 years.
- WTR also announced Wendell Holland has joined the Board of Directors. Mr. Holland is a former regulator at the Pennsylvania PUC, and in our view, this is a significant win for the company.
- We are raising our FY'11 EPS estimate by \$0.04 to \$1.01, but making no change to our FY'12 EPS estimate of \$1.03.

Note Important Disclosures on Pages 5 - 6.
Note Analyst Certification on Page 5.

ADDITIONAL DISCUSSION***Second Quarter Results***

Aqua America reported GAAP Q2'11 EPS of \$0.27 versus \$0.22 in the year ago period. However, after stripping out the benefit from bonus depreciation, EPS for the quarter were \$0.25, compared to our \$0.23 estimate and the \$0.24 consensus.

Revenue rose 5.5% to \$188.2 million, due largely to favorable weather. O&M (Operations & Maintenance) expenses rose just 1.6% to \$70.4 million and as a percentage of revenue improved 140 basis points to 37.4%. For the full year management believes it may be able to keep O&M below 38%, and possibly even get into the 36%-37% range beyond 2011. Depreciation increased 2.9% to \$27.6 million and operating income was up 13.3% to \$74.8 million.

Long-term debt decreased 4.0% from the sequential quarter to \$1.5 billion, and as a percentage of total capitalization decreased 140 bps to 55.8%. The company's target equity ratio is ~45%, and there are no debt borrowings or equity raises planned over the near-term. Moreover, this may be the first year for the company to have cash flows in excess of capital expenditures. During the quarter WTR invested over \$74 million in infrastructure improvements, and expects to invest over \$325 million (up from \$300 million) for the full year.

Asset Swap & Sale

This past July WTR and American Water Works agreed to exchange subsidiaries in Ohio and New York, creating the largest investor-owned water utilities in the two respective states. WTR will purchase AWK's regulated operations in Ohio and simultaneously sell its regulated operations in New York to AWK.

WTR will acquire ~\$98 million in rate base and increase its customer base in Ohio by about 50,280 customers. WTR will purchase eight water systems and one wastewater system serving about 50,730 water and about 6,550 wastewater connections for approximately \$120 million. AWK will buy seven systems in New York with about 50,250 customers for approximately \$71 million. The transactions are expected to close in Q1'12, pending regulatory approval. This asset swap is similar to the recent Texas/Missouri deal with AWK and WTR, and will likely have a minimal impact on EPS but should drive some economies of scale.

Additionally in July, WTR announced the sale of its Maine assets (16,000 customers) to Connecticut Water for \$53.5 million, in a state that had little organic growth and lacked single tariff pricing. WTR was paid 23x earnings and 1.6x rate base, and the deal is expected to close in Q1'12.

Valuation

We are raising our FY'11 EPS estimate by \$0.04 to \$1.01, but making no change to our FY'12 EPS estimate of \$1.03. We also note that our FY'12 is somewhat conservative, as it does not fully reflect the impact of pending and planned rate cases. We also note this is ongoing earnings – WTR had a ~\$0.03 tax related benefit in Q1'11, a ~\$0.02 tax related benefit in Q2'11, there will likely be another \$0.02 benefit in Q3'11. There will likely be a negative \$0.05-\$0.06 impact in Q3 from negative held for sale accounting for the company's Maine asset sale to Connecticut Water, and then this will reverse in 2012 when the sale is final.

We derive our \$25 price target using a multiple of 24x to our 2012 earnings estimate, which is at the low end of multiples where the company typically trades. The stock is currently trading at 20.8x and 20.4x our 2010 and 2011 EPS estimates, respectively.

Outlook

Thus far into 2011 WTR has received rate awards totaling \$18.0 million (including surcharges) in Pennsylvania, Indiana, and Ohio, has ~\$25 million in pending rate cases in North Carolina, Texas, and Illinois, and plans to file in an additional seven states this year totaling about \$45-50 million.

We note that yesterday the company announced a 6.5% dividend increase, raising the quarterly payment from \$0.155 per share to \$0.165 payable December 1, 2011 for shareholders of record on November 17, 2011. This is the company's 21st dividend increase over the past 20 years. Additionally, WTR declared the regular \$0.155 per share quarterly dividend to be paid September 1, 2011 to shareholders of record on August 17, 2011.

The company also announced yesterday it has added Wendell Holland to its Board of Directors. We are familiar with Mr. Holland, who previously was a regulator at the Pennsylvania PUC and consider this a significant win for the company.

The asset swaps and sale will allow the company to concentrate on states where it has a critical mass, and everything appears to be clicking for WTR at present. This is even more impressive given the company is up against difficult weather comparisons, although this is proving to be a benefit as well. Every single state in the company's footprint has had favorable weather, which is an anomaly and something that has never occurred. Our thesis remains intact and we reiterate our Buy rating.

CONSIDERATIONS AND RISKS

- Water companies are subject to seasonal fluctuations, drought, and heavy rainfall. Demand varies with rainfall and temperature changes, and infrastructure replacements could become burdensome.
- Compliance with an increasingly stringent EPA will likely become an even greater cost going forward. Each state regulatory body deals with cost recoveries somewhat differently, affecting the timing of revenues and costs. Rate increases are not retroactive.
- The company's growth strategy via acquisitions could potentially be dilutive or have other adverse effects on normal business operations.

Additional information is available upon request.

Prices of stock mentioned: American Water Works (AWK - \$27.64, \$31 PT, Buy), Connecticut Water Service (CTWS - \$25.58, NR)

Aqua America, Inc.

Income Statements (000's)	FY'08	FY'09	Q1'10	Q2'10	Q3'10	Q4'10	FY'10	Q1'11A	Q2'11A	Q3'11E	Q4'11E	FY'11E	FY'12E
Operating revenues	\$626,972	\$670,539	\$160,517	\$178,444	\$207,797	\$179,314	\$726,072	\$171,324	\$188,229	\$213,028	\$190,041	\$762,622	\$765,620
Costs and expenses:													
Operation and maintenance	262,122	270,060	67,601	69,310	72,968	70,083	279,962	67,325	70,437	74,560	72,215	284,537	286,464
Depreciation	88,785	103,001	26,200	26,802	27,431	27,628	108,061	27,293	27,578	27,500	28,000	110,371	108,000
Amortization	5,515	11,938	3,172	3,314	3,629	2,891	13,006	1,956	1,931	2,000	2,000	7,887	12,700
Taxes other than income taxes	44,749	48,081	12,860	12,943	14,182	12,982	52,967	13,765	13,446	13,634	11,402	52,247	50,299
Operating income	401,171	433,080	109,833	112,369	118,210	113,584	453,996	110,339	113,392	117,694	113,618	455,043	457,463
Other expense (income):													
Interest expense (net)	68,572	68,607	18,430	18,504	19,150	19,568	75,652	19,943	20,106	20,106	20,106	80,261	69,200
Allow. for funds used dur. const.	(3,674)	(2,871)	(1,541)	(1,461)	(1,077)	(983)	(5,062)	(1,977)	(1,932)	(700)	(1,100)	(5,709)	(3,600)
Gain on sale of water system													
Gain on sale of other assets	(1,599)	(472)	(1,929)	(110)	(291)	(253)	(2,583)	(121)	(138)	(200)	(300)	(759)	(1,200)
Income before income taxes	162,502	172,195	35,724	49,142	71,805	47,398	204,069	43,140	56,801	76,129	57,717	233,786	243,757
Provision for income taxes	64,584	67,842	14,213	19,287	28,054	18,540	80,094	12,789	19,211	28,929	22,221	83,150	95,134
Net income	97,918	104,353	21,511	29,855	43,751	28,858	123,975	30,351	37,590	47,200	35,496	150,637	148,623
Dividends on preferred stock													
Net income available to common stk.	\$97,918	\$104,353	\$21,511	\$29,855	\$43,751	\$28,858	\$123,975	\$30,351	\$37,590	\$47,200	\$35,496	\$150,637	\$148,623
Net income	97,918	104,353	21,511	29,855	43,751	28,858	123,975	30,351	37,590	47,200	35,496	150,637	148,623
Other comp. income (loss), net of tax:													
Unreal. hold. gain (loss) on certain inv.	195	289	902		272	414	1,588	4	92				
Minimum pension liability adjustment													
Unrealized gains on securities													
Reclass. adj. for gains reported	(209)	5	(1,330)			(39)	(1,369)	(2)	(71)				
Comprehensive income	\$97,904	\$104,647	\$21,083	\$29,855	\$44,023	\$29,233	\$124,194	\$30,353	\$37,611	\$47,200	\$35,496	\$150,637	\$148,623
EPS (FD)	0.73	\$0.77	\$0.16	\$0.22	\$0.32	\$0.21	\$0.90	\$0.22	\$0.27	\$0.34	\$0.25	\$1.08	\$1.03
EPS (FD) excluding tax benefit	0.73	\$0.77	\$0.16	\$0.22	\$0.32	\$0.21	\$0.90	\$0.19	\$0.25	\$0.32	\$0.25	\$1.01	\$1.03
Diluted average shares outstanding	134,705	136,129	136,800	137,012	137,394	137,904	137,296	138,384	138,781	139,981	141,181	139,658	144,326
Cash div. per share of com. stk.	\$0.510	\$0.550	\$0.145	\$0.145	\$0.145	\$0.155	\$0.590	\$0.155	\$0.155	\$0.155	\$0.165	\$0.630	\$0.670
Rate of Change Analysis:													
Revenues	4.1%	6.9%	3.9%	6.6%	14.9%	6.8%	8.3%	6.7%	5.5%	2.5%	6.0%	5.0%	0.4%
Operating income	4.5%	5.2%	8.4%	12.3%	25.4%	8.9%	14.6%	20.3%	13.3%	6.4%	16.3%	13.0%	0.2%
EPS	2.8%	5.5%	14.3%	15.8%	28.0%	5.0%	16.9%	37.5%	22.7%	5.4%	19.7%	19.8%	-4.5%
EBITDA	5.3%	10.1%	5.5%	10.7%	20.7%	7.3%	11.6%	12.7%	8.5%	3.5%	10.6%	8.3%	0.7%
Margin Analysis:													
O&M	41.8%	40.3%	42.1%	38.8%	35.1%	39.1%	38.6%	39.3%	37.4%	35.0%	38.0%	37.3%	37.4%
D&A	15.0%	17.1%	18.3%	16.9%	14.9%	17.0%	16.7%	17.1%	15.7%	13.8%	15.8%	15.5%	15.8%
Taxes other than inc. taxes	7.1%	7.2%	8.0%	7.3%	6.8%	7.2%	7.3%	8.0%	7.1%	6.4%	6.0%	6.9%	6.6%
Operating income	36.0%	35.4%	31.6%	37.0%	43.1%	36.7%	37.5%	35.6%	39.8%	44.8%	40.2%	40.3%	40.2%
Net income	15.6%	15.6%	13.1%	16.7%	21.2%	16.3%	17.1%	17.7%	20.0%	22.2%	18.7%	19.8%	19.4%
Tax rate	39.7%	39.4%	39.8%	39.2%	39.1%	39.1%	39.2%	29.6%	33.8%	38.0%	38.5%	35.6%	39.0%

Source: Company reports and Hilliard Lyons estimates

Analyst Certification

I, James O. Lykins, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.

Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues.

Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

Underperform - We believe the stock is vulnerable to a price decline in the next 12 months.

Suitability Ratings

1 - A large cap, core holding with a solid history

2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks

3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage

4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base



Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	40	23%	0%	100%
Long-term Buy	38	22%	5%	95%
Neutral	92	53%	2%	98%
Underperform	3	2%	0%	100%

As of 6 July 2011

Other Disclosures

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