

Water Utilities

Aqua America, Inc.

(WTR) - NEUTRAL

Price: **\$21.77**
 Fair Value Estimate: \$22.00
 52-Week Range: \$18.90-\$23.79
 Market Cap (MM): \$3,009
 Shr.O/S-Diluted (mm): 138.2
 Average Daily Volume: 563,799
 Dividend: \$0.62
 Yield: 2.8%

FYE: Dec	2010A	2011E	2012E
EPS:	\$0.90A	\$1.07E	\$1.10E
Prior EPS:	\$1.00	\$1.05	

Quarterly EPS:

Quarter	2011A	2011E	2010E
Q1	\$0.16A	\$0.22A	\$0.20E
Q2	\$0.22A	\$0.27A	\$0.26E
Q3	\$0.32A	\$0.32E	\$0.38E
Q4	\$0.21A	\$0.25E	\$0.26E

EPS: FY2011 EPS estimate reflects GAAP results including approximately \$0.04/share in net tax benefits.



**Equity Research
 Note**

Continued efficiency improvements drive 2Q beat. Neutral on Valuation.

INVESTMENT CONCLUSION:

Aqua America has earned a reputation for tightly managing expenses, ultimately benefiting customers with manageable water rates and shareholders with fair returns on investment. This efficiency focus continues to stand out on the company's P&L through double-digit earnings growth. Aside from managing expenses, Aqua is on pace to invest record amounts of capital in its systems during 2011, file for necessary rate relief, and seek out new growth avenues. The newest area of non-regulated growth potential is in the shale gas drilling market where water needs for hydraulic fracturing are significant. Aqua is already operating water-filling truck stations in the Marcellus Shale and recent expansion efforts in the gas-rich states of Ohio and Texas offer further opportunities to participate in the energy markets. Aqua America shares trade at a premium to the peer group, and we maintain our NEUTRAL rating at this time. We would however, look for advantageous entry points arising from broader market weakness in the near-term as Aqua America remains a top-tier player in the space.

KEY POINTS:

- **2Q-2011 earnings beat on solid top-line & cost controls.** Aqua America reported adjusted second quarter earnings of \$0.25/share, ahead of both our estimate (\$0.23/share) and consensus expectations (\$0.24/share). Including a state income tax benefit of \$0.02/share (expected to continue in the back half), GAAP results of \$0.27/share grew 24% to set a new Q2 record. Revenue grew 6% while O&M expenses increased modestly at 1.6%, driving 140bps of efficiency ratio improvement to 37.4% (from 38.8% a year ago). The resulting second quarter operating margin was the highest we have seen since 2003 at 39.8%.
- **Rate support on the horizon as capex plans test record levels.** YTD capex of \$134 million (which is now being fully covered by internally generated cash) puts Aqua on track to match the record \$327 million in capital spent in 2010. With \$18 million in annualized rate awards received so far in 2011, Aqua now has requests for \$25 million outstanding in seven states - including North Carolina, Texas, and Illinois. The company will file additional cases in seven states in 2011 (including its large PA rate case), providing a base for growth in 2012 and beyond.
- **Asset swaps build critical mass & open doors for non-reg growth.** Aqua has been busy swapping and selling systems in 2011, exiting both Missouri and New York via asset swaps and Maine via a system sale. In return, Aqua has picked up systems in Ohio and Texas, growing its customer base by 66% and 8% in each state, respectively. Established regulatory relationships, a core customer base upon which to grow, and active shale gas drilling markets in both states support the rationale for the transactions - critical mass drives efficiencies and active gas drilling markets rely heavily on access to large quantities of water.
- **Dependable dividend increases enhance total return.** WTR shares trade at a premium valuation due to the company's strong profitability track record. Yesterday's announcement of a 6.5% dividend increase supports our view of Aqua as a compelling source of risk-adjusted total return for long-term oriented holders. We maintain our NEUTRAL rating at this time, but would look for advantageous entry points to initiate or build on current positions.

Research Analyst Certifications and Important Disclosures are on pages 3 - 4 of this report

Aqua America, Inc.		Janney Montgomery Scott LLC Ryan M. Connors									
Quarterly Income Statement, 2011E											
	1Q11	Y/Y	2Q11	Y/Y	3Q11E	Y/Y	4Q11E	Y/Y	FY2011E	Y/Y	
Operating Revenues	171,324	6.7%	188,229	5.5%	219,226	5.5%	189,176	5.5%	767,955	5.8%	
Operations and Maintenance	67,325		70,437		76,729		73,211		287,702		
<i>O&M Ratio</i>	39.3%		37.4%		35.0%		38.7%		37.5%		
Depreciation	27,293		27,578		28,100		28,500		111,471		
Amortization	1,956		1,931		2,000		2,000		7,887		
Taxes other than Income Taxes	13,765		13,446		14,100		13,250		54,561		
Operating Income	60,985	20.4%	74,837	13.3%	98,297	9.7%	72,215	9.9%	306,334	12.6%	
<i>Operating Margin</i>	35.6%		39.8%		44.8%		38.2%		39.9%		
Interest Expense	19,943		20,106		20,000		20,000		80,049		
Allowance for Construction Funds	(1,977)		(1,932)		(2,000)		(1,000)		(6,909)		
Gain on Sale of other Assets	(121)		(138)		(300)		(300)		(859)		
Income before Income Taxes	43,140	20.9%	56,801	15.6%	80,597	12.2%	53,515	12.9%	234,053	14.7%	
Income Taxes	12,789		19,221		35,500		18,000		85,510		
<i>Tax Rate</i>	29.6%		33.8%		44.0%		33.6%		36.5%		
Net Income	30,353	41.3%	37,580	25.9%	45,097	3.1%	35,515	23.1%	148,543	19.8%	
Diluted EPS	\$0.22	39.7%	\$0.27	24.3%	\$0.32	1.7%	\$0.25	21.7%	\$1.07	18.4%	
Diluted Shares Outstanding	138,384		138,781		139,200		139,400		138,941		

Aqua America, Inc.		Janney Montgomery Scott LLC Ryan M. Connors									
Quarterly Income Statement, 2012E											
	1Q12E	Y/Y	2Q12E	Y/Y	3Q12E	Y/Y	4Q12E	Y/Y	FY2012E	Y/Y	
Operating Revenues	180,747	5.5%	198,582	5.5%	234,572	7.0%	200,527	6.0%	814,427	6.1%	
Operations and Maintenance	71,034		74,468		82,100		76,200		303,802		
<i>O&M Ratio</i>	39.3%		37.5%		35.0%		38.0%		37.3%		
Depreciation	28,800		29,200		29,800		30,200		118,000		
Amortization	2,000		2,000		2,000		2,000		8,000		
Taxes other than Income Taxes	13,500		13,500		13,500		13,240		53,740		
Operating Income	65,413	7.3%	79,413	6.1%	107,172	9.0%	78,887	9.2%	330,885	8.0%	
<i>Operating Margin</i>	36.2%		40.0%		45.7%		39.3%		40.6%		
Interest Expense	20,000		20,000		20,000		20,160		80,160		
Allowance for Construction Funds	(1,000)		(1,000)		(1,000)		(1,000)		(4,000)		
Gain on Sale of other Assets	(150)		(150)		(150)		(150)		(600)		
Income before Income Taxes	46,563	7.9%	60,563	6.6%	88,322	9.6%	59,877	11.9%	255,325	9.1%	
Income Taxes	18,393		23,923		34,887		23,651		100,853		
<i>Tax Rate</i>	39.5%		39.5%		39.5%		39.5%		39.5%		
Net Income	28,171	-7.2%	36,641	-2.5%	53,435	18.5%	36,225	2.0%	154,472	4.0%	
Diluted EPS	\$0.20	-8.1%	\$0.26	-3.3%	\$0.38	17.6%	\$0.26	1.2%	\$1.10	3.1%	
Diluted Shares Outstanding	139,750		140,000		140,250		140,500		140,125		

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 9 states, including Pennsylvania, Ohio, North Carolina, Illinois, Texas, Florida, New Jersey, Indiana, and Virginia.

IMPORTANT DISCLOSURES

Research Analyst Certification

I, Ryan M. Connors, 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 ("Janney") 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 06/30/11

Rating	IB Serv./Past 12 Mos.			
	Count	Percent	Count	Percent
BUY [B]	202	56	23	8
NEUTRAL [N]	151	42	8	6
SELL [S]	8	2	0	0

***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.

This research report is provided for informational purposes only and shall in no event be construed as an offer to sell or a solicitation of an offer to buy any securities. The information described herein is taken from sources which we believe to be reliable, but the accuracy and completeness of such information is not guaranteed by us. The opinions expressed herein may be given only such weight as opinions warrant. This Firm, its officers, directors, employees, or members of their families may have positions in the securities mentioned and may make purchases or sales of such securities from time to time in the open market or otherwise and may sell to or buy from customers such securities on a principal basis. Supporting information related to the recommendation, if any, made in the research report is available upon request.