



Morning Meeting Notes

Tuesday, July 12, 2011

AMERICAN WATER WORKS CO INC (AWK - USD 29.66)

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Recommendation: BUY
Previous Recommendation: BUY
As of: 05-May-2011

Currency - USD			
Capitalization		Financial Metrics	
(in millions)		Fiscal YE	Dec 2011
Number of Shares	176	2012 PMV/sh	46.00
Price	29.66	E P S	
Market Cap	5,220	2012P	1.80
Net Debt(Cash)	5,708	2011E	1.65
Other	28	2010A	1.53
Total Enterprise Value	10,956	EBITDA (mm)	
		2012P	1,254
		2011E	1,167
		2010A	1,103
		PE Ratio	
		2012P	16.5
		2011E	18.0
		2010A	19.4

AWK and WTR to Swap More Assets

On July 11, American Water Works Company (AWK-29.64-BUY), the nation's largest publicly-traded water utility with regulated water utilities in 20 states, and Aqua America (WTR-22.26-BUY), the nation's second largest publicly-traded water utility with regulated water utilities in 13 states, announced an agreement to "trade" water systems in New York and Ohio. Under the agreement, WTR would purchase AWK's Ohio regulated operations for \$120 million and simultaneously sell its New York regulated operations to AWK for \$71 million.

We view the agreement favorably and expect the transaction to be modestly accretive for both companies. Both companies are now the largest investor-owned water utilities in each of the two respective states and the transaction would allow for greater economies of scale and rate efficiency.

As a result of this transaction, WTR would gain AWKs 8 water systems and 1 wastewater system in central and northeast Ohio, which serve 50,730 water and 6,550 wastewater connections. AWK would gain WTRs 7 New York water systems, which serve 50,520 customers, across the state. The water utility trade will increase WTRs Ohio customer base by 57,280 customers, or 66%, to 145,000 and AWKs population base served by 152,000, or 75%, to 372,000. Aqua will gain roughly \$98 million in Ohio rate base, while AWK increases its New York rate base by roughly \$50 million to roughly \$180 million. Both acquisitions are expected to close during the first quarter of 2012 and are subject to each other's closing as well as receipt of the necessary regulatory approvals.

In addition, the agreement is consistent with recent portfolio management strategies to rationalize water systems. On January 24, AWK announced an agreement to sell under-earning utility subsidiaries in New Mexico and Arizona for \$470 million to EPCOR Water (USA). On June 16, 2011, WTR completed the acquisition of AWKs 51 Texas water and five wastewater systems (4,200 water and 1,100 wastewater customers) for \$6 million. On May 17, 2011, AWK completed the acquisition of WTRs 60 small Missouri water and wastewater systems, which serve 3,700 customers for \$3.2 million.

Our 2011, 2012 and 2013 earnings estimates remain \$1.65, \$1.80 and \$1.90 per share, respectively. Through the achievement of operating efficiencies and rate recognition of infrastructure investment, we believe AWK can achieve 7%-plus earnings per share growth over the next several years. Over the long-term, we expect earnings growth to be enhanced via consolidation and privatization opportunities. Management appears more focused on cost-controls and has highlighted its intention to reduce its current O&M to operating revenue ratio to 40%.

AWK anticipates 2011 capital expenditures of \$800 million to \$1 billion. We estimate internal funding of this capital program, with operating cash flow of \$750 million and dividend payments of \$155 million in 2011. Management does not anticipate an "imminent" equity issuance. AWK's total capital expenditure budget is likely to total roughly \$4.0-4.5 billion over the next five years, or \$850 million per year.

We regard AWK as a high quality conservative utility with unique growth opportunities. Shares trade at 18.0X and 16.5X our 2011 and 2012 EPS estimates compared to the water utility group, which currently trades at 20.0X and 18.6X 2011 and 2012 EPS estimates. On a price-to-book value basis, AWK shares trade at 180% of tangible book value versus group average multiples of 179%. Our 2011 PMV is \$44 per share.

Please see the last page for important disclosures.

Important Disclosures

To obtain a price chart for any security in this report, please contact 1-800-422-2274.

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A **Buy** rated stock is one that in our view is trading at a meaningful discount to our estimated PMV. We could expect a more modest private market value to increase at an accelerated pace, the discount of the public stock price to PMV to narrow through the emergence of a catalyst, or some combination of the two to occur.

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- **AMERICAN WATER WORKS CO INC**
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