

Water Utilities

Aqua America, Inc.

(WTR) - BUY

Price: **\$19.28**
 Fair Value Estimate: \$22.00
 52-Week Range: \$18.90-\$23.79
 Market Cap (MM): \$2,668
 Shr.O/S-Diluted (mm): 138.4
 Average Daily Volume: 601,822
 Dividend: \$0.62
 Yield: 3.2%

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

Quarterly EPS:

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

Sell-Off Creates Opportunity to Own Blue-Chip Water Utility: Upgrade to BUY.

INVESTMENT CONCLUSION:

Aqua America has a well deserved reputation as a "best of breed" player in the water utility space, with the company's profitability, returns on capital, and growth rates consistently at/near the top of the peer group averages. In addition, the company's concentrated exposure to Pennsylvania - which ranks #1 in our proprietary Janney RCI ranking of state regulatory jurisdictions - lends a degree of stability to the story as Aqua is able to benefit from PA's progressive approach to economic regulation of private sector water utilities. Still, despite these benefits, and despite the fact that Aqua and its peers proved among the broad market's best performers during the 2008-2009 crisis in terms of both earnings stability and shareholder returns, WTR shares have not been spared by the relentless selling pressure in equities over the last several days. Indeed, after posting stellar second quarter earnings just last week, WTR shares have subsequently experienced one of the worst sell-offs in their history - culminating in an 8% decline yesterday. Given that Aqua's principal regulated business of providing water service to residential customers is impacted little by the broader economic environment, we believe this sell-off creates a buying opportunity for investors seeking relative safe havens within equities to ride out the current storm. As a result we raise our rating to BUY from Neutral.

KEY POINTS:

- **Aqua's business impacted little by recessions - even "The Big One."** In 2008, as earnings for the S&P 500 declined 40%, Aqua America grew earning by a 2.2% - not mind-blowing in absolute terms but a dramatic relative outperformance that underscored the defensive nature of the water utility business model. The reason is simple, as water is the ultimate non-discretionary item, and residential consumption declines little in recessions. We expect the same will be true this time around if the economy double-dips.
- **Last week's 2Q earnings report shows company executing well.** Evidencing Aqua's status as a top-notch operator in the space, the company's second quarter earnings were well above expectations - impressive during an earnings season where unfavorable weather has been a headwind for many peers. Overall, Aqua continues to execute well, and we expect further earnings strength going forward.
- **PA rate case creates revenue/earnings catalyst for 2012.** The defensiveness of the regulated business model mitigates the risk of earnings downside for Aqua, and the company's rate case pipeline sets the stage for the company to even post solid growth into the teeth of a double-dip recession. The company will likely file a rate case in its core regulatory jurisdiction of Pennsylvania by year-end 2011, and given PA's importance in the portfolio (55% of revenue), Aqua should be able to grow in 2012 regardless of the macro environment.
- **Valuation and dividend yield look highly compelling after sell-off.** After the recent sell-off, WTR shares currently trade at 17.5 times forward earnings (notably, our 2012 estimate of \$1.10/share currently includes no new rates for Aqua-PA), near the bottom of the 10-year range of 17.1-37.8 times. With the stock now yielding 3.1%, our \$22 Fair Value estimate equates to a 12-month total return of nearly 20% - highly compelling on a risk-adjusted basis.

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.

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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.

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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

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