

Aqua America, Inc.

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(WTR/NYSE)

BREAN MURRAY
CARRET & CO.

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WTR Earnings Preview

Buy
Target Price: \$26

Aqua America is scheduled to report its 2Q10 results after the close August 3 and will host a conference call August 4 at 11 AM ET. We expect it to meet our revenue estimate of \$177 million and our Street high EPS estimate of \$0.22 (vs. consensus of \$180 million and \$0.21). Weather patterns in the company's key geographic regions of Pennsylvania and New Jersey were very favorable in 2Q10, which should translate into higher volumes. Additionally, we note short interest remains relatively high (17 days normal volume in the latest reported period), which could translate into additional buying pressure if WTR meets our expectations (or exceeds them). We reiterate our Buy rating and \$26 target price ahead of the quarter, based on the shares attaining a P/E level of 26x our 2011 EPS estimate of \$0.98. Risks to the achievement of our target price include acquisitions, interest rates, environmental / public health responsibilities and regulatory climate.

Key Points

It's hard to imagine a better set up to exceed expectations than 2Q10. With extremely favorable weather patterns beginning just before the start of 2Q10, spring arrived several weeks early in the key regions of Pennsylvania and New Jersey. 2Q10 was just plain hot, with temperatures above 90 degrees common, and rainfall scarce. Our Street-high 2Q10 EPS estimate of \$0.22 is above consensus, and above the company's own guidance. We're willing to stick to our forecast, believing that if there was ever a quarter in the recent past for Aqua America to surpass expectations, 2Q10 contains all the right elements. Additionally, the company received rate increases earlier than we expected in Pennsylvania and New Jersey (June), which also should provide some incremental upside to what should be an already strong earnings report.

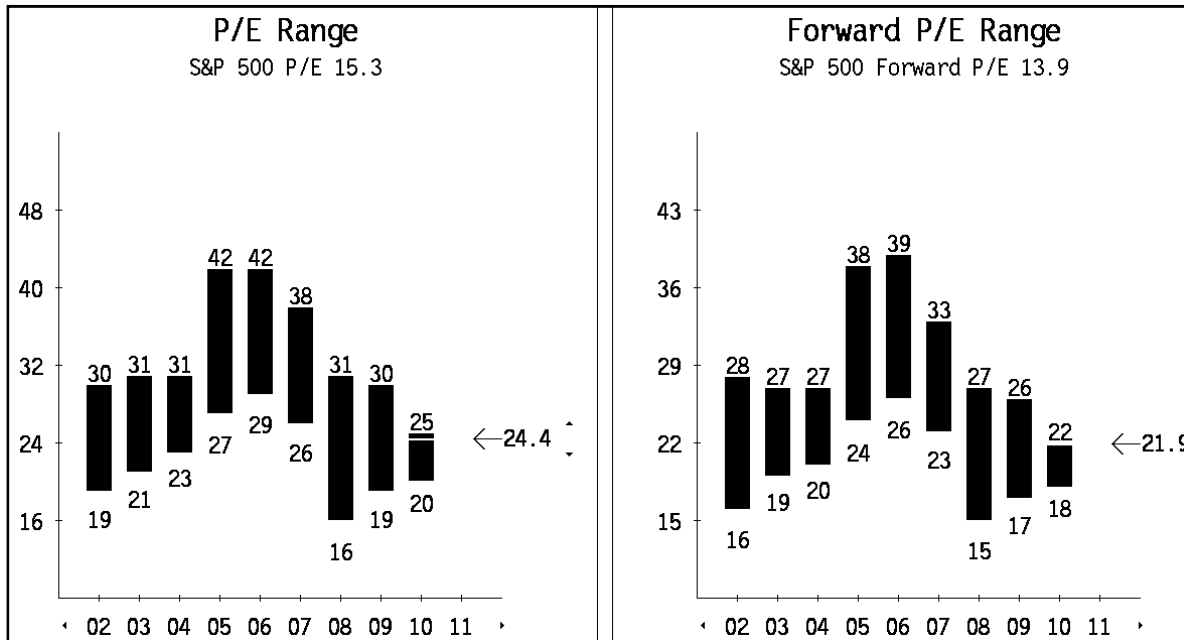
Not a good time to be short the name, in our opinion. The latest data available shows 17 days of normal volume (approximately 2.4 million shares) are short Aqua America. If this situation doesn't change dramatically by August 4, the door to cover and exit WTR positions could get very crowded, and lead to a spike in share prices after the release. That said, even if short covering occurs ahead of the quarter, it should add substantial buying pressure on top of whatever positive momentum could be expected from, and going into, a strong earnings report. We note favorable weather trends continued into the third quarter, and a high likelihood exists that 3Q10 results could please investors as much as we expect 2Q10 numbers will, so waiting to cover short positions may not be the best of strategies either for those investors with a negative bias.

Valuation remains compelling, despite recent share price appreciation. The shares have moved higher recently, rebounding off the recent low of \$15.39 set back on October 30. On a historical basis, 24x trailing and 22x forward P/E multiples have been toward the lower end of valuation for this name. With an improved earnings outlook and the American Water Works (AWK \$21.72, Buy) flotation of shares previously owned by RWE AG now absorbed by the market, we expect Aqua America shares to once again trade toward the 25x- 30x P/E multiple range that had been the norm for many years. We recommend investors buy aggressively below the \$20 level, based on our expectation that the next major resistance point to the upside will be around the \$22 level.

Price	\$19.88
52-Week High/Low	\$19.88 - 15.39
Shares Outstanding (mm)	136.96
Market Cap. (mm)	\$2,722.67
Average Daily Volume (mm)	0.87

EPS	FY09A	FY10E	FY11E
Mar	\$0.14	\$0.16A	\$0.20
Jun	\$0.19	\$0.22	\$0.24
Sep	\$0.25	\$0.28	\$0.29
Dec	\$0.20	\$0.24	\$0.25
FY	\$0.77	\$0.89	\$0.98
Consensus	-	\$0.88	\$0.96
P/E	25.9x	22.2x	20.3x
FY Rev. (mm)	\$670.54	\$707.53	\$764.13





Source: Baseline

SUMMARY OF AQUA AMERICA VALUATION ANALYSIS					
Metric	Current Trading Multiple	Valuation Multiple		Implied Share Price	
		Low	High	Low	High
DDM				\$18.47	\$27.25
COMP/2011E Earnings		18.0	26.0	\$16.10	\$23.25
2011E P/E	21.8	22.0	28.0	\$19.67	\$25.04
EV/2011E EBITDA	11.6	11.0	14.0	\$18.53	\$27.44
EV/2011E Sales	6.1	6.0	8.0	\$19.25	\$30.39

Source: Company Reports, Brean Murray, Carret & Co. estimates

Aqua America		Quarterly Income Statement, 2010E								
(\$000, except per share data)										
Fiscal year ends December 31										
	1Q10	% Rev or Margin	2Q10E	% Rev or Margin	3Q10E	% Rev or Margin	4Q10E	% Rev or Margin	2010E	% Rev or Margin
Sales	160,517		177,373		191,676		177,967		707,532	
Operating & maintenance	67,601	42.1%	72,723	41.0%	75,904	39.6%	70,475	39.6%	286,702	40.5%
Depreciation	26,200	16.3%	25,187	14.2%	23,959	12.5%	24,025	13.5%	99,372	14.0%
Amortization	3,172	2.0%	2,661	1.5%	1,917	1.0%	1,958	1.1%	9,707	1.4%
Non-income taxes	12,860	8.0%	11,174	6.3%	11,501	6.0%	10,856	6.1%	46,391	6.6%
Operating income	50,684	31.6%	65,628	37.0%	78,395	40.9%	70,653	39.7%	265,360	37.5%
Interest expense, net	18,430	11.5%	17,737	10.0%	16,101	8.4%	16,729	9.4%	68,997	9.8%
AFC	(1,541)	-1.0%	(1,000)	-0.6%	(1,000)	-0.5%	(1,000)	-0.6%	(4,541)	-0.6%
Gain on sale of other assets	(1,929)	-1.2%	(500)	-0.3%	(500)	-0.3%	(500)	-0.3%	(3,429)	-0.5%
Income before taxes	35,724	22.3%	49,391	27.8%	63,795	33.3%	55,424	31.1%	204,333	28.9%
Income taxes	14,213	39.8%	19,756	40.0%	25,518	40.0%	22,170	40.0%	81,657	40.0%
Net income	21,511	13.4%	29,634	16.7%	38,277	20.0%	33,254	18.7%	122,676	17.3%
Earnings per share	\$0.16		\$0.22		\$0.28		\$0.24		\$0.89	
Shares outstanding (000)	136,800		137,050		137,300		137,550		137,175	
Aqua America		Quarterly Income Statement, 2011E								
(\$000, except per share data)										
Fiscal year ends December 31										
	1Q11E	% Rev or Margin	2Q11E	% Rev or Margin	3Q11E	% Rev or Margin	4Q11E	% Rev or Margin	2011E	% Rev or Margin
Sales	173,358		191,563		207,010		192,204		764,135	
Operating & maintenance	72,117	41.6%	78,541	41.0%	81,769	39.5%	76,113	39.6%	308,539	40.4%
Depreciation	24,617	14.2%	25,095	13.1%	24,841	12.0%	25,755	13.4%	100,308	13.1%
Amortization	1,734	1.0%	1,916	1.0%	1,656	0.8%	1,730	0.9%	7,035	0.9%
Non-income taxes	11,615	6.7%	12,068	6.3%	12,421	6.0%	11,724	6.1%	47,828	6.3%
Operating income	63,276	36.5%	73,943	38.6%	86,323	41.7%	76,882	40.0%	300,424	39.3%
Interest expense, net	19,589	11.3%	19,923	10.4%	19,666	9.5%	20,566	10.7%	79,744	10.4%
AFC	(800)	-0.5%	(800)	-0.4%	(800)	-0.4%	(800)	-0.4%	(3,200)	-0.4%
Gain on sale of other assets	(300)	-0.2%	(300)	-0.2%	(300)	-0.1%	(300)	-0.2%	(1,200)	-0.2%
Income before taxes	44,786	25.8%	55,121	28.8%	67,757	32.7%	57,416	29.9%	225,080	29.5%
Income taxes	17,915	40.0%	22,048	40.0%	27,103	40.0%	22,966	40.0%	90,032	40.0%
Net income	26,872	15.5%	33,072	17.3%	40,654	19.6%	34,449	17.9%	135,048	17.7%
Earnings per share	\$0.20		\$0.24		\$0.29		\$0.25		\$0.98	
Shares outstanding (000)	137,800		138,050		138,300		138,550		138,175	

Source: Company Reports, Brean Murray, Carret & Co. estimates

Important Disclosures

Ratings and Target Price History



All prices are as of the market close on 7/26/2010.

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Brean Murray, Carret & Co. Stock Rating System

- Buy - Expected to appreciate by at least 10% within the next 12 months.
- Hold - Fully valued, not expected to appreciate or decline materially within the next 12 months.
- Sell - Expected to decline by at least 10% within the next 12 months.

	# of Securities	% of Total Securities	# of IB-Related Securities in Past 12 mos.	% of Total Securities
BUY	135	68.53%	19	14.07%
HOLD	53	26.9%	1	1.89%
SELL	5	2.54%	0	0%
NOT RATED	4	2.03%	0	0%
TOTAL	197			

Note : Stock price volatility may cause temporary non-alignment of some ratings with some target prices.

Valuation Methodology and Risks

Aqua America (WTR): Our target price of \$26 is based on the shares attaining a P/E multiple of 26x our 2011 EPS estimate of \$0.98. Risks to the achievement of our target price include weather, acquisitions, interest rates, environmental / public health responsibilities and regulatory climate.

Analyst Certification

We, Michael Gaugler and Christopher Noon, hereby certify that the views expressed in this research report accurately reflect our personal views about any and all of the subject securities or issuers referred to in this document. The analyst and associate analyst further certify that they have not received and will not be receiving direct or indirect compensation in exchange for expressing the recommendation contained in this publication.

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