



COMPANY UPDATE/ESTIMATE CHANGE/
PRICE TARGET CHANGE

Water Utilities

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Key Metrics

WTR - NYSE (as of 8/3/10)	\$19.87
Price Target	\$23.00
52-Week Range	\$20.08-\$15.39
Shares Outstanding (mm)	137.0
Market Cap. (\$mm)	\$2,721.3
3-Mo. Average Daily Volume	931,817
Institutional Ownership	47.7%
Debt/Total Capital (6/10)	56.7%
ROE (6/10)	10.1%
Book Value/Share (6/10)	\$8.25
Price/Book Value	2.1x
Dividend Yield	2.9%
LTM EBITDA Margin	53.2%

EPS FY 12/31

	2009A	Prior 2010E	Curr. 2010E	Prior 2011E	Curr. 2011E
1Q	\$0.14	--	\$0.16A	--	--
2Q	\$0.19	--	\$0.22A	--	--
3Q	\$0.25	--	\$0.26E	--	--
4Q	\$0.20	--	\$0.23E	--	--
Year	\$0.77	\$0.86	\$0.87E	\$0.91	\$0.94E
P/E	25.8x		22.8x		21.1x

Revenue (\$mm)

	2009A	Prior 2010E	Curr. 2010E	Prior 2011E	Curr. 2011E
1Q	\$154.5	--	\$160.5A	--	--
2Q	\$167.3	--	\$178.4A	--	--
3Q	\$180.8	--	\$194.4E	--	--
4Q	\$167.9	--	\$183.9E	--	--
Year	\$670.5	\$716.2E	\$717.3E	\$730.0E	\$738.0E

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

**Solid Q2 Results a Penny Above our Forecast;
Raise Estimates and Price Target**

Investment Highlights

- WTR reported Q2'10 EPS of \$0.22 versus \$0.19 in the year ago period, a penny above our and the consensus estimate. (Excluding an asset sale, last year's comparison was actually ~\$0.18.)
- Revenue rose 6.6% to \$178.4 million compared to our \$177.4 million estimate, driven by favorable weather, new rates, and customer growth. O&M rose just 1.1% to \$69.3 million, and improved 220 bps as a percentage of revenue.
- The company also announced a 6.9% dividend increase, raising the quarterly payment from \$0.145 to \$0.155 per share. This is WTR's 20th dividend increase over the past 19 years.
- Pending rate cases total ~\$13.7 million, and an additional ~\$28.5 million should be filed in 2010 as well.
- The company has made 12 small acquisitions year to date, and believes the year-end total will be in the 20-30 range.
- Just like Q2, recall that WTR faces an easy comparison in Q3 given difficult weather conditions and record setting precipitation in the northeast in 2009. We are increasing our FY'10 EPS estimate by a penny to \$0.87 and our FY'11 EPS estimate by \$0.03 to \$0.94. We are raising our price target by \$1 to \$23.

Note Important Disclosures on Pages 5 - 7.

Note Analyst Certification on Page 5.

ADDITIONAL DISCUSSION***Second Quarter Results***

Aqua America reported Q2 EPS of \$0.22 versus \$0.19 in the year ago period, a penny above our and the consensus estimate. Moreover, last year's comparison includes the benefit of an asset sale that added about a penny to EPS, so results are actually more impressive than what headline results indicate. Revenue rose 6.6% to \$178.4 million compared to our \$177.4 million estimate driven by favorable weather, new rates, and customer growth (organic and acquisition related). O&M (Operations & Maintenance) expenses rose just 1.1% to \$69.3 million and as a percentage of revenue improved 220 basis points to 38.8% - but we anticipate a slight uptick in expenses in 2H'10. Depreciation increased 7.3% to \$26.8 million, but was only marginally above Q1'10. Operating income increased 12.3% to \$66.1 million.

Long-term debt was \$1.5 billion at quarter's end, about \$100 million above the prior quarter and as a percentage of total capitalization increased 120 basis points to 56.7%. (The company's target equity ratio is ~45%.) WTR has spent about \$141 million on capital expenditures through Q2, or just less than half of its budgeted \$300 million in cap ex in 2010, focused on pipe replacement projects. It will also be focusing on refinancing 7%-9% interest rate bearing debt while rates are attractive, and given favorable pricing, cash generated from operations, and the company's DRIP program, management does not anticipate (lacking an acquisition) issuing equity in the near-term.

Valuation

We are raising our FY'10 EPS estimate by a penny to \$0.87 due to Q2 results above our forecast. We are also increasing our FY'11 EPS estimate by \$0.03 to \$0.94, mostly attributed to the benefit from our rough approximation for new rates in 2011. We are raising our price target by \$1 to \$23, which we derive by applying a multiple of 24x to our 2011 earnings estimate, which is at the low end of multiples where the company typically trades. The stock is currently trading at 22.8x and 21.1x our 2010 and 2011 EPS estimates, respectively.

Outlook

Following favorable Q2 results, we expect much of the same in Q3. Weather thus far into the quarter has been very positive and the company will have the benefit of new rates as well. Given last year's difficult weather conditions and record setting precipitation in the northeast, the industry faces much easier comparisons in 2010. This could mean related to weather, any reversion to the mean in 2010 could be a significant lever to earnings. WTR also has about \$13.7 million in pending rate cases and it intends to file for more than \$28.5 million in 2010, although most of the benefit will likely begin to be realized in 2011.

The company has also made 12 acquisitions year-to-date, and believes it will end the year in the 20-30 range. Thus far most have been the smaller tuck-in's, but from the call at least one may be in the works of a size that is more in line with its sweet spot related to size. The issues that could drive acquisition growth in the industry are numerous, and we believe WTR should be one of the prime beneficiaries from industry consolidation.

The company also announced a 6.9% dividend increase, raising the quarterly payment from \$0.145 to \$0.155 per share, payable to shareholders of record on November 17, 2010. This is the company's 20th increase over the past 19 years.

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.

Aqua America, Inc.

Income Statements (000's)	FY'07	FY'08	Q1'09	Q2'09	Q3'09	Q4'09	FY'09	Q1'10A	Q2'10A	Q3'10E	Q4'10E	FY'10E	FY'11E
Operating revenues	\$602,499	\$626,972	\$154,487	\$167,333	\$180,826	\$167,893	\$670,539	\$160,517	\$178,444	\$194,401	\$183,904	\$717,265	\$737,990
Costs and expenses:													
Operation and maintenance	253,092	262,122	66,989	68,549	68,488	66,034	270,060	67,601	69,310	75,816	73,561	286,289	288,406
Depreciation	83,178	88,785	26,387	24,972	25,436	26,206	103,001	26,200	26,802	26,900	26,800	106,702	107,100
Amortization	4,833	5,515	2,755	3,064	3,029	3,090	11,938	3,172	3,314	3,100	3,100	12,686	12,700
Taxes other than income taxes	45,380	44,749	11,590	11,884	12,418	12,189	48,081	12,860	12,943	12,442	11,034	49,279	48,474
Operating income	216,016	225,801	46,766	58,864	71,455	60,374	237,459	50,684	66,075	76,143	69,408	262,310	281,310
Other expense (income):													
Interest expense (net)	66,921	68,572	16,628	16,809	17,256	17,914	68,607	18,430	18,504	18,504	18,504	73,942	69,200
Allow. for funds used dur. const.	(2,953)	(3,674)	(625)	(568)	(747)	(931)	(2,871)	(1,541)	(1,461)	(700)	(1,100)	(4,802)	(3,600)
Gain on sale of water system													
Gain on sale of other assets	(3,494)	(1,599)	(133)	(80)	(162)	(97)	(472)	(1,929)	(110)	(200)	(300)	(2,539)	(1,200)
Income before income taxes	155,542	162,502	30,896	42,703	55,108	43,488	172,195	35,724	49,142	58,539	52,304	195,709	216,910
Provision for income taxes	60,528	64,584	12,525	16,850	21,638	16,829	67,842	14,213	19,287	23,415	20,137	77,052	85,395
Net income	95,014	97,918	18,371	25,853	33,470	26,659	104,353	21,511	29,855	35,123	32,167	118,656	131,515
Dividends on preferred stock													
Net income available to common stk.	\$95,014	\$97,918	\$18,371	\$25,853	\$33,470	\$26,659	\$104,353	\$21,511	\$29,855	\$35,123	\$32,167	\$118,656	\$131,515
Net income	95,014	97,918	18,371	25,853	33,470	26,659	104,353	21,511	29,855	35,123	32,167	118,656	131,515
Other comp. income (loss), net of tax:													
Unreal. hold. gain (loss) on certain inv.	1,121	195	37	232	(142)	162	289	902					
Minimum pension liability adjustment													
Unrealized gains on securities													
Reclass. adj. for gains reported	(1,315)	(209)		5			5	(1,330)					
Comprehensive income	\$94,820	\$97,904	\$18,408	\$26,090	\$33,328	\$26,821	\$104,647	\$21,083	\$29,855	\$35,123	\$32,167	\$118,656	\$131,515
EPS (FD)	\$0.71	\$0.73	\$0.14	\$0.19	\$0.25	\$0.20	\$0.77	\$0.16	\$0.22	\$0.26	\$0.23	\$0.87	\$0.94
Diluted average shares outstanding	133,602	134,705	135,876	135,939	136,260	136,510	136,129	136,800	137,012	137,212	137,412	136,376	140,575
Cash div. per share of com. stk.	\$0.480	\$0.510	\$0.135	\$0.135	\$0.135	\$0.145	\$0.550	\$0.145	\$0.145	\$0.145	\$0.152	\$0.587	\$0.587
Rate of Change Analysis:													
Revenues	12.9%	4.1%	10.9%	11.0%	2.1%	5.0%	6.9%	3.9%	6.6%	7.5%	9.5%	7.0%	2.9%
Operating income	5.1%	4.5%	16.3%	10.8%	-4.2%	4.3%	5.2%	8.4%	12.3%	6.6%	15.0%	10.5%	7.2%
EPS	1.4%	2.8%	27.3%	11.8%	-3.8%	5.3%	5.5%	14.3%	15.8%	2.4%	17.0%	13.0%	7.5%
EBITDA	8.4%	5.3%	20.7%	16.2%	0.7%	7.7%	10.1%	5.5%	10.7%	6.2%	10.7%	8.3%	5.1%
Margin Analysis:													
O&M	42.0%	41.8%	43.4%	41.0%	37.9%	39.3%	40.3%	42.1%	38.8%	39.0%	40.0%	39.9%	39.1%
D&A	14.6%	15.0%	18.9%	16.8%	15.7%	17.4%	17.1%	18.3%	16.9%	15.4%	16.3%	16.6%	16.2%
Taxes other than inc. taxes	7.5%	7.1%	7.5%	7.1%	6.9%	7.3%	7.2%	8.0%	7.3%	6.4%	6.0%	6.9%	6.6%
Operating income	35.9%	36.0%	30.3%	35.2%	39.5%	36.0%	35.4%	31.6%	37.0%	39.2%	37.7%	36.6%	38.1%
Net income	15.7%	15.6%	11.9%	15.6%	18.4%	16.0%	15.6%	13.1%	16.7%	18.1%	17.5%	16.5%	17.8%
Tax rate	38.9%	39.7%	40.5%	39.5%	39.3%	38.7%	39.4%	39.8%	39.2%	40.0%	38.5%	39.4%	39.4%

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.

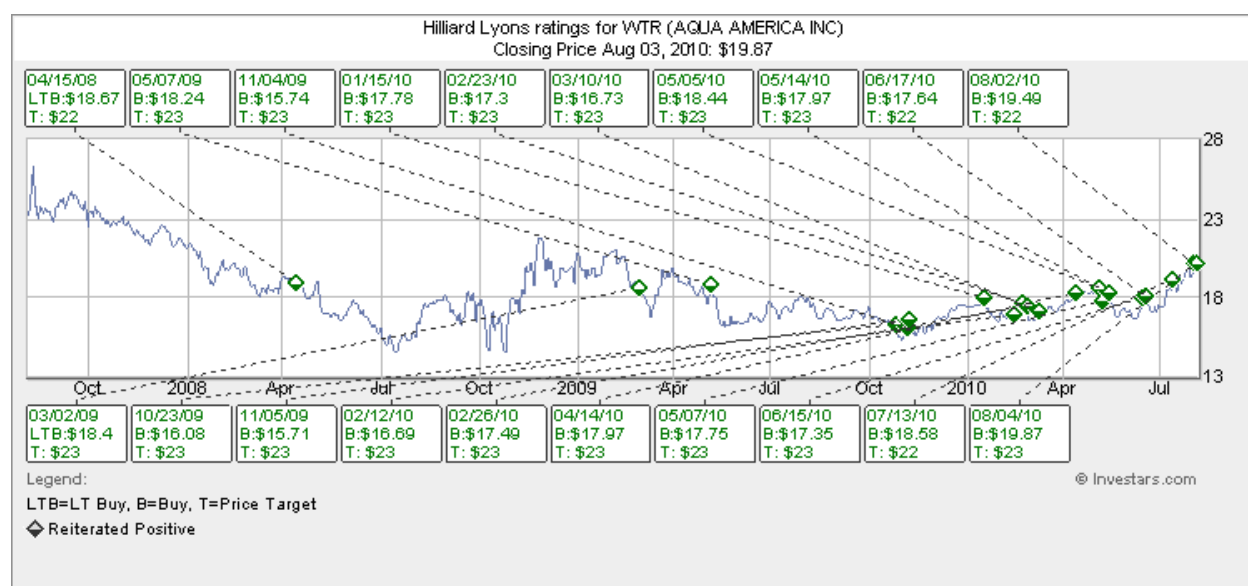
Suitability Ratings

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	50	29%	2%	98%
Long-term Buy	37	21%	0%	100%
Neutral	82	47%	6%	94%
Underperform	4	2%	0%	100%
Not Rated	1	1%	0%	100%

As of 9 July 2010

Other Disclosures

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