

Equity Research

Aqua America

WTR: Long-Term EPS Outlook Intact

- **Summary.** EPS outlook maintained. Continue to believe WTR's proven strategy will lead to above industry average EPS growth. Major Q4 rate filings in PA and NJ. Balance sheet and cash flow offer financial flexibility should an opportunity arise. Continue to rate shares MP largely due to valuation considerations.
- **EPS Outlook Unchanged.** 2009-11E EPS remain \$0.80, \$0.88 and \$0.92, respectively. Drivers include a return to normal weather and continued rate relief partially offset by increasing O&M, D&A and interest expense related to the growing rate base. While O&M expenses are forecasted to increase, revenues are growing at a fast rate thus resulting in an improvement in WTR's efficiency ratio of roughly 100 bps annually. After the sizeable backlog of rate relief works its way through and the earned ROEs in currently depressed states improve, we believe WTR's annual EPS growth rate may revert to a more realistic, low-risk regulated rate of 5-7% absent significant accretive external growth opportunities. This compares to the water utility industry average annual EPS growth rate of roughly 3-5%. We believe WTR's 2013E EPS power is in the \$1.00-\$1.05 range.
- **Rate Relief Update.** No major news on the rate activity front since Q2. WTR has received \$29 mm in rate increase YTD, \$12 mm of requests pending and plans to file roughly \$57 mm of additional cases by year-end. Major cases to be filed in 4Q include the biennial Pennsylvania rate case as well as New Jersey.
- **Strong Cash Flow Position.** We anticipate annual CapEx of ~\$300 mm through 2013 which is to be increasingly financed by internally generated cash stemming from stimulus related bonus depreciation, an increasing depreciable base and higher earnings. We project WTR will internally fund ~60% of annual investment. Absent a large acquisition, we believe roughly two-thirds of WTR's forecasted equity needs over the next three years can be accomplished via the company's DRIP program. WTR's strong balance sheet and credit rating enables access to relatively low cost sources of external capital which can be called upon should an opportunistic M&A opportunity arise. Also, the 65% payout ratio (off our '10E) leaves ample room to continue mid-single digit dividend growth.
- **Adverse Weather Continues.** WTR reported 3Q09 EPS of \$0.25, in line with our estimate, vs. \$0.26 in 3Q08 (includes a \$0.02 system sale gain). Recently received rate relief and a continued focus on cost containment were largely offset by a sharp 7% decrease in total sales. Mgmt estimates that extremely wet weather, in addition to the economic effects on consumption and organic growth, resulted in a (\$0.03) impact during Q3 and (\$0.05-0.06) YTD.

Valuation Range: \$17.00 to \$18.00

Our relative P/E multiple (applying a ~5% premium to the '10 group median of 18X to our '11E EPS) and DDM analyses results in our 12-18 month valuation range. Risks include regulatory risk, potential undertaking of dilutive growth ventures and deterioration in the water industry's premium multiple relative to electric utilities.

Investment Thesis:

We regard WTR as one of the highest quality, fastest growing water utilities. Strong fundamentals include a growing rate base, largely constructive regulation, a disciplined M&A strategy, relatively low risk EPS growth and a growing dividend. Our Market Perform rating largely reflects valuation considerations.

Please see page 2 for rating definitions, important disclosures and required analyst certifications

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Market Perform

Sector: Water Utilities

Market Weight

Earnings Reported - Full Analysis

EPS	2008A		2009E		2010E	
			Curr.	Prior	Curr.	Prior
Q1 (Mar.)	\$0.11		\$0.14	A NC		NE
Q2 (June)	0.17		0.19	A NC		NE
Q3 (Sep.)	0.26		0.25	A 0.25		NE
Q4 (Dec.)	0.19		0.21	NC		NE
FY	\$0.73		\$0.80	NC	\$0.88	NC
CY	\$0.73		\$0.80		\$0.88	
FY P/E	21.6x		19.7x		17.9x	
Rev.(MM)	\$627		\$685		\$747	

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters
NA = Not Available, NC = No Change, NE = No Estimate, NM = Not Meaningful

Ticker	WTR
Price (11/12/2009)	\$15.73
52-Week Range:	\$15-22
Shares Outstanding: (MM)	136.3
Market Cap.: (MM)	\$2,144.0
S&P 500:	1,085.47
Avg. Daily Vol.:	1,447,350
Dividend/Yield:	\$0.58/3.7%
LT Debt: (MM)	\$1,265.0
LT Debt/Total Cap.:	51.1%
ROE:	10.0%
3-5 Yr. Est. Growth Rate:	6.0%
CY 2009 Est. P/E-to-Growth:	3.3x
Last Reporting Date:	11/04/2009
	<i>After Close</i>

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters

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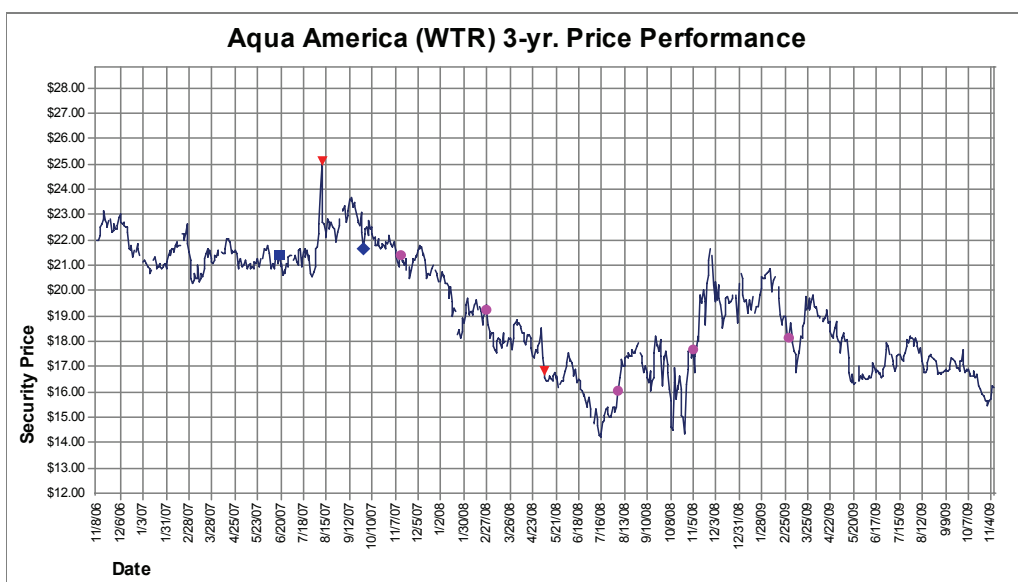
Together we'll go far



Company Description:

Headquartered in Bryn Mawr, PA, Aqua America (WTR) is one of the largest U.S.-based investor-owned regulated water and wastewater utilities. Aqua America, formally Philadelphia Suburban Corporation (PSC), serves approximately 2.8 million residents in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, New York, Indiana, Florida, Virginia, Maine, Missouri, and South Carolina. WTR's largest subsidiary, Aqua Pennsylvania, accounts for approximately half of the company's total customer base. The company's aggressive, yet disciplined, growth-through-acquisition strategy has resulted in more than 130 acquisitions and growth ventures adding roughly 250,000 customers over the last five years.

Required Disclosures



	Date	Publication Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
	11/8/2006		Winter			
	11/8/2006	NA	1	25.00	25.00	21.95
■	6/19/2007		Kalton			
▼	8/9/2007	NA	2	NE	NE	25.07
◆	9/28/2007	NA	NR	NE	NE	21.62
◆	11/14/2007	22.34	1	24.00	26.00	21.39
◆	2/27/2008	19.57	1	22.00	23.00	19.24
◆	5/7/2008	17.99	2	19.00	20.00	16.80
◆	8/6/2008	16.42	2	17.00	18.00	16.01
◆	11/5/2008	18.04	2	18.00	19.00	17.65
◆	3/2/2009	18.40	2	17.00	18.00	18.13

Source: Wells Fargo Securities, LLC estimates and Reuters data

Symbol Key		Rating Code Key	
▼ Rating Downgrade	◆ Initiation, Resumption, Drop or Suspend	1 Outperform/Buy	SR Suspended
▲ Rating Upgrade	■ Analyst Change	2 Market Perform/Hold	NR Not Rated
◆ Valuation Range Change	□ Split Adjustment	3 Underperform/Sell	NE No Estimate

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Aqua America

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2=Market Perform: The stock appears appropriately valued, and we believe the stock's total return will be in line with the market over the next 12 months. HOLD

3=Underperform: The stock appears overvalued, and we believe the stock's total return will be below the market over the next 12 months. SELL

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O=Overweight: Industry expected to outperform the relevant broad market benchmark over the next 12 months.

M=Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.

U=Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.

VOLATILITY RATING

V = A stock is defined as volatile if the stock price has fluctuated by +/-20% or greater in at least 8 of the past 24 months or if the analyst expects significant volatility. All IPO stocks are automatically rated volatile within the first 24 months of trading.

As of: November 12, 2009

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