

**COMPANY UPDATE/ESTIMATE CHANGE**
**Key Metrics**

WTR - NYSE (as of 2/25/10)	\$17.49
Price Target	\$23.00
52-Week Range	\$20.37-\$15.39
Shares Outstanding (mm)	136.5
Market Cap. (\$mm)	\$2,383.4
3-Mo. Average Daily Volume	725,733
Institutional Ownership	47.5%
Debt/Total Capital (12/09)	55.6%
ROE (12/09)	9.6%
Book Value/Share (12/09)	\$8.15
Price/Book Value	2.1x
Dividend Yield	3.3%
LTM EBITDA Margin	52.6%

**EPS FY 12/31**

	2009A	Prior 2010E	Curr. 2010E	Prior 2011E	Curr. 2011E
1Q	\$0.14	--	\$0.15E	--	--
2Q	\$0.19	--	\$0.22E	--	--
3Q	\$0.25	--	\$0.27E	--	--
4Q	\$0.20	--	\$0.23E	--	--
Year	\$0.77	\$0.97E	\$0.87E	--	\$0.94E
P/E	22.7x		20.1x		18.6x

**Revenue (\$mm)**

	2009A	Prior 2010E	Curr. 2010E	Prior 2011E	Curr. 2011E
1Q	\$154.5	--	\$164.6E	--	--
2Q	\$167.3	--	\$180.5E	--	--
3Q	\$180.8	--	\$199.8E	--	--
4Q	\$167.9	--	\$180.8E	--	--
Year	\$670.5	\$725.7E	\$725.7E	--	\$735.2E

**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

**Q4 Results**
**Investment Highlights**

- WTR reported Q4'09 EPS of \$0.20 versus \$0.19 in the year ago period, matching consensus and a penny below our estimate.
- The company has ~\$65 million in pending rate cases, and plans to file for an additional \$25-\$30 million in 2010.
- We look for WTR to make more inroads this year on the acquisition front. It appears as though many municipalities are still looking for free government money to make infrastructure improvements – a strategy that clearly holds no water, in our view.
- Given some rather aggressive assumptions on our behalf, we are decreasing our FY'10 EPS estimate by \$0.10 per share to \$0.87. We are also inaugurating a FY'11 EPS estimate of \$0.94 and maintain our \$23 price target.

**Note Important Disclosures on Pages 5 and 6.**  
**Note Analyst Certification on Page 5.**

**ADDITIONAL DISCUSSION*****Fourth Quarter Results***

Aqua America reported third quarter EPS of \$0.20 versus \$0.19 in the year ago period, matching the consensus and a penny below our estimate. Revenue rose 5.0% to \$167.9 million, in line with our \$168.4 million estimate. As in the previous quarter, weather had a negative impact of ~\$0.03 per share.

O&M (Operations & Maintenance) expenses rose negligibly to \$66.0 million and as a percentage of revenue improved 200 basis points to 39.3% - and the potential for additional O&M improvement in FY'10 is very possible, especially in light of pending rate cases and what could be more normalized weather this year. Depreciation was 9.8% above the year ago level at \$26.2 million. Operating income increased 4.3% to \$60.4 million and net income rose 4.5% to \$26.8 million.

***Financial Condition***

Long-term debt was \$1.4 billion at quarter's end compared to \$1.3 billion in the sequential quarter, and as a percentage of total capitalization rose 160 basis points to 55.6%. (The company's target equity ratio is ~45%.) During the quarter WTR had ~\$89 million in capital expenditures compared to ~\$79 million in the year ago period, and the company anticipates approximately ~\$300 million in cap ex in 2010 focused on pipe replacement projects. A small equity raise in late 2010/early 2011 is probable, which would likely be in the 1-1.5 million share range (~\$17-\$26 million at the current share price) and exclusive of any benefits from the company's DRIP program.

***Valuation***

We are reducing our FY'10 EPS estimate by \$0.10 to \$0.87, as some of our assumptions had just been much too aggressive. We are also inaugurating a FY'11 EPS estimate of \$0.94. We are maintaining our \$23 price target, 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 20.1x and 18.6x our 2010 and 2011 EPS estimates, respectively.

***Outlook***

As was the case for much of 2009 - EPS were negatively impacted by weather in Q4, and with all of the weather anomalies last year we're glad to be moving on to what hopefully will be a year with weather that reverts back to the mean. Lacking weather issues, 2010 already appears to be shaping up positively and good weather could be a significant lever to EPS. In fact, management mentioned on the call that its model is set up for 8%-9% EPS growth with a return to normal weather. Following all of the precipitation that 2009 had to bear, at least the company's reservoirs are 100% full.

WTR has ~\$65 million in rate cases pending, and it will likely file for an additional \$25-\$30 million this year (with the bulk being filed in 2H'10). Efficiency ratio improvement is expected, which could easily be supported by improved weather and new rates not having complementary expenses.

We also expect the company to make more inroads this year on the acquisition front. Last year there were 18 transactions, with about 6,000 customers acquired and driving about 1% customer growth. We have been saying for some time that we expect consolidation to increase across the industry, driven in large part by the Stimulus Package - which falls woefully short of what is needed, as municipalities come to terms with what they will not get versus what is needed related to maintain an adequate infrastructure. While the pace has yet to gather much steam, we found it interesting on the call to hear WTR mention that the Stimulus Package probably did nothing but stall things, as municipalities have waited to see if they will get free money from the government. In our view this is not a viable strategy, and when the day

of reckoning comes the outcome for companies such as WTR will likely be better acquisition opportunities which will ultimately drive earnings higher.

#### **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.**

<b>Income Statements (000's)</b>	<b>FY'07</b>	<b>FY'08</b>	<b>Q1'09</b>	<b>Q2'09</b>	<b>Q3'09</b>	<b>Q4'09</b>	<b>FY'09</b>	<b>Q1'10E</b>	<b>Q2'10E</b>	<b>Q3'10E</b>	<b>Q4'10E</b>	<b>FY'10E</b>	<b>FY'11E</b>
Operating revenues	\$602,499	\$626,972	\$154,487	\$167,333	\$180,826	\$167,893	\$670,539	\$164,627	\$180,485	\$199,798	\$180,768	\$725,678	\$735,164
Costs and expenses:													
Operation and maintenance	253,092	262,122	66,989	68,549	68,488	66,034	270,060	69,637	72,194	77,921	72,307	292,060	280,515
Depreciation	83,178	88,785	26,387	24,972	25,436	26,206	103,001	27,500	27,500	27,500	27,500	110,000	112,000
Amortization	4,833	5,515	2,755	3,064	3,029	3,090	11,938	3,000	3,100	3,100	3,100	12,300	12,300
Taxes other than income taxes	45,380	44,749	11,590	11,884	12,418	12,189	48,081	12,347	11,732	12,787	10,846	47,712	48,337
Operating income	386,483	401,171	107,721	108,469	109,371	107,519	433,080	112,484	114,526	121,308	113,753	462,072	453,152
Other expense (income):													
Interest expense (net)	66,921	68,572	16,628	16,809	17,256	17,914	68,607	18,000	18,000	18,000	18,000	72,000	69,200
Allow. for funds used dur. const.	(2,953)	(3,674)	(625)	(568)	(747)	(931)	(2,871)	(900)	(900)	(700)	(1,100)	(3,600)	(3,600)
Gain on sale of water system													
Gain on sale of other assets	(3,494)	(1,599)	(133)	(80)	(162)	(97)	(472)	(100)	(600)	(200)	(300)	(1,200)	(1,200)
Income before income taxes	155,542	162,502	30,896	42,703	55,108	43,488	172,195	35,143	49,460	61,390	50,415	196,407	217,612
Provision for income taxes	60,528	64,584	12,525	16,850	21,638	16,829	67,842	14,233	19,537	24,556	19,410	77,735	86,105
Net income	95,014	97,918	18,371	25,853	33,470	26,659	104,353	20,910	29,923	36,834	31,005	118,672	131,508
Dividends on preferred stock													
Net income available to common stk.	\$95,014	\$97,918	\$18,371	\$25,853	\$33,470	\$26,659	\$104,353	\$20,910	\$29,923	\$36,834	\$31,005	\$118,672	\$131,508
Net income	95,014	97,918	18,371	25,853	33,470	26,659	104,353	20,910	29,923	36,834	31,005	118,672	131,508
Other comp. income (loss), net of tax:													
Unreal. hold. gain (loss) on certain inv.	1,121	195	37	232	(142)	162	289						
Minimum pension liability adjustment													
Unrealized gains on securities													
Reclass. adj. for gains reported	(1,315)	(209)		5			5						
Comprehensive income	\$94,820	\$97,904	\$18,408	\$26,090	\$33,328	\$26,821	\$104,647	\$20,910	\$29,923	\$36,834	\$31,005	\$118,672	\$131,508
EPS (FD)	\$0.71	0.73	\$0.14	\$0.19	\$0.25	\$0.20	\$0.77	\$0.15	\$0.22	\$0.27	\$0.23	\$0.87	\$0.94
Diluted average shares outstanding	133,602	134,705	135,876	135,939	136,260	136,510	136,129	136,710	136,910	137,110	137,310	137,041	140,499
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
<b>Rate of Change Analysis:</b>													
Revenues	12.9%	4.1%	10.9%	11.0%	2.1%	5.0%	6.9%	6.6%	7.9%	10.5%	7.7%	8.2%	1.3%
Operating income	5.1%	4.5%	16.3%	10.8%	-4.2%	4.3%	5.2%	11.5%	12.1%	9.8%	11.0%	11.0%	7.0%
EPS	1.4%	2.8%	27.3%	11.8%	-3.8%	5.3%	5.5%	9.3%	15.0%	7.5%	12.9%	12.5%	8.1%
EBITDA	8.4%	5.3%	20.7%	16.2%	0.7%	7.7%	10.1%	8.9%	11.1%	9.2%	8.9%	9.5%	5.3%
<b>Margin Analysis:</b>													
O&M	42.0%	41.8%	43.4%	41.0%	37.9%	39.3%	40.3%	42.3%	40.0%	39.0%	40.0%	40.2%	38.2%
D&A	14.6%	15.0%	18.9%	16.8%	15.7%	17.4%	17.1%	18.5%	17.0%	15.3%	16.9%	16.9%	16.9%
Taxes other than inc. taxes	7.5%	7.1%	7.5%	7.1%	6.9%	7.3%	7.2%	7.5%	6.5%	6.4%	6.0%	6.6%	6.6%
Operating income	35.9%	36.0%	30.3%	35.2%	39.5%	36.0%	35.4%	31.7%	36.5%	39.3%	37.1%	36.3%	38.4%
Net income	15.7%	15.6%	11.9%	15.6%	18.4%	16.0%	15.6%	12.7%	16.6%	18.4%	17.2%	16.4%	17.9%
Tax rate	38.9%	39.7%	40.5%	39.5%	39.3%	38.7%	39.4%	40.5%	39.5%	40.0%	38.5%	39.6%	39.6%

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**

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**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	47	27%	2%	98%
Long-term Buy	37	21%	0%	100%
Neutral	86	49%	6%	94%
Underperform	4	2%	0%	100%

As of 5 February 2010

### Other Disclosures

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