

Water/Infrastructure

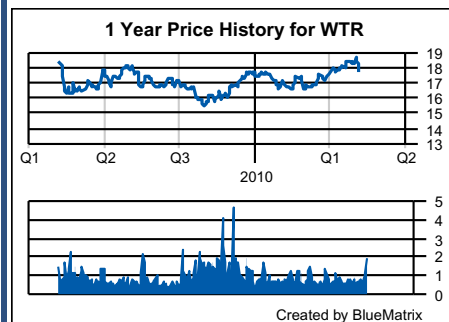
**Aqua America, Inc.
 (WTR) - BUY**

Price: \$17.75
 Fair Value Estimate: \$20.00
 52-Week Range: \$18.94-\$15.39
 Market Cap (MM): \$2,430
 Shr.O/S-Diluted (mm): 136.9
 Average Daily Volume: 740,121
 Dividend: \$0.58
 Yield: 3.3%

FYE: Dec	2009A	2010E	2011E
EPS:	\$0.77	\$0.85	\$0.93
Prior EPS:		NC	\$0.95
P/E Ratio:	23.1x	20.9x	19.1x

Quarterly EPS:

Quarter	2009	2010E	2011E
Q1	\$0.14	\$0.16A	\$0.17
Q2	\$0.19	\$0.20	\$0.24
Q3	\$0.25	\$0.27	\$0.30
Q4	\$0.20	\$0.22	\$0.23



**Equity Research
 Note**

Reiterate BUY Following Solid 1Q-'10 Results

INVESTMENT CONCLUSION:

Among the largest and best-run companies in the water utility arena, we view Aqua America as a "best-of-breed" player in this space. Indeed, Aqua is at or near the head of the class on most key financial metrics, and the company has concentrated regulatory exposure to Pennsylvania (Aqua PA represents more than 50% of sales), which is widely regarded as among the nation's most progressive, forward-looking regulatory jurisdictions. In the near-term, the company is primed to benefit from considerable rate relief, with \$65 million in rate cases outstanding (nearly 10% of 2009 consolidated revenue) and another \$20 million soon to be filed. Going forward, we expect Aqua America to continue delivering on its dual growth strategies of rate base growth and acquisitions, with the company targeting 10% net income growth over time. While WTR shares trade at a well-deserved premium to the peer group, we believe the combination of steady growth and a consistently rising dividend will enable the company to deliver compelling risk-adjusted total returns for long-term oriented investors. We reiterate our BUY rating for WTR.

KEY POINTS:

- **1Q-2010 above our estimate.** Excluding a one-time gain on an asset sale, Aqua recorded net income of \$0.15/share in the first quarter of 2010. This was a penny above our estimate (\$1.14/share) and in-line with consensus (\$0.15/share).
- **Top/Bottom-line growth solid.** Revenue grew 4% due primarily to new rates hitting the P&L, while O&M expenses rose less than 1% on strong cost controls. This enabled operating income to expand a solid 8% year-over-year, with net income up an impressive 17% due to a one-time gain on sale of a financial investment. Overall, it was a very solid quarter for Aqua America.
- **Management's tone improved.** On the quarterly conference call, CEO Nick Debenedictis exuded the most positive tone we've heard in quite some time. He cites the improving economy in general and the positive inflection point in the housing market in particular as contributing to his confidence that a return to organic demand growth is nearing for Aqua America.
- **Rates to drive growth into 2011.** The rate case docket remains very active, with nine cases totaling \$65 million currently awaiting decision - including in Pennsylvania, New Jersey, and Virginia. The company expects to file an additional \$20 million in rate cases in 2010, providing a strong base for further top-line growth in 2011. Recent trends in both municipal water pricing and industry ROEs give us confidence that Aqua's rate filing programs will continue to be successful.
- **Acquisition, organic growth to return.** After a relative lull in 2009 with 18 deals, Aqua expects to get back to its more typical 25-30 acquisitions in 2010, which should contribute 1%-2% to top-line growth. Coupled with a tepid return to organic growth via increased commercial usage and modestly improved housing starts, this should drive an acceleration in 2H-2010 and into 2011.
- **Total-return opportunity remains strong.** Overall, although we do not expect significant multiple expansion given WTR's premium multiple, we believe the combination of consistent long-term growth and growing dividend provide a compelling risk-adjusted total return opportunity for long-term investors. We maintain our BUY rating for shares of WTR.

Research Analyst Certifications and Important Disclosures are on pages 4 - 5 of this report

WTR 1Q-2010: ADDITIONAL COMMENTARY & ANALYSIS

- **Active rate case docket sets stage for growth in 2H-2010, 2011.** Aqua America is currently awaiting decisions on \$65 million in rate cases, with the largest of these being in PA and NJ and smaller cases pending in Maine and Indiana. The company plans to file for an additional \$20 million in rate cases during the remainder of 2010, including in FL (where the company can now consolidated filings, lowering costs and mitigating regulatory lag), Ohio (where Aqua hasn't been in for rates in five years), NC, VA, and TX. In addition, the company continues to take advantage of surcharge mechanisms across its service territory, and with these so-called "DSIC-like" mechanisms now available in many of the company's territories, this is enabling Aqua to keep regulatory lag to a minimum. Overall, the active rate/surcharge docket sets the stage for solid growth in 2H2010 and into 2011.
- **Low rates, capital intensity vs. electric bode well for Aqua, peers.** With water representing less than 0.5% of a typical household's income in the U.S. versus up to 3% for electric, water utilities have significant runway to raise rates before they run into the type of fierce opposition often faced by electric utilities. Water is also the most capital intensive of the basic utilities, and with regulatory commissions cognizant that maintaining solid ROE metrics is critical to water utilities sustaining their stellar credit ratings (which save customers money on passed-through interest costs), most commissions continue to award very competitive ROEs. Indeed, in a recent Missouri case, Aqua achieved a favorable outcome even after a high-ranking politician attempted to intervene in the case, claiming that rates for should not go up during recessionary times. With commissions recognizing that capital will only be available if given competitive returns, many ROEs are coming in above the key 10% threshold.
- **New Jersey surcharge mechanism may take longer than expected.** Although the general trend nationwide is toward more progressive, forward-looking regulatory practices that encourage capital deployment toward much-needed water infrastructure rehabilitation, New Jersey continues to lag this trend. A case in point is that Aqua New Jersey and its fellow NJ investor-owned water utilities have formed a unified front in pushing for a DSIC-like mechanism, to no avail. American Water's New Jersey subsidiary has formally filed a petition for a surcharge mechanism, but unfortunately, there has been no movement on this front, and the lack of progress is discouraging. While the new gubernatorial regime in New Jersey offers renewed hope, we believe that Aqua New Jersey will continue to suffer from heightened regulatory lag due in part to the lack of a surcharge mechanism.
- **Management expects growth to accelerate in second half of 2010.** While Aqua America's net income expanded at a 10% clip in the first quarter of 2010 (excluding a one-time gain on sale of investment), management cautions investors that growth will likely decelerate in the second quarter due to more challenging year-over-year weather comparables and the fact that there will be little in the way of new rates hitting the P&L (our model calls for 2Q2010 EPS growth of 5%). Still, heading into the third quarter, easier year-over-year weather comps and more significant rate increases will drive a re-acceleration of growth, with our model calling for EPS growth of 11% and 13% in the third and fourth quarters, respectively. Looking ahead to 2011, management is favorable on the growth outlook, citing a combination of a return to organic demand growth, acquisitions, and new rates.
- **With higher dividend tax rate looming, Aqua discusses priorities.** With the 2003 Bush tax cuts set to expire and some in Congress talking of instituting a punitive 40%-plus rate of taxation on equity dividends as early as 2011, we believe that capital deployment prioritization will be a key issue in the years ahead for investor-owned utilities as companies look to ensure a rational, shareholder value maximizing allocation of available funds. In response to our question on whether and how Aqua America would alter its cash deployment priorities, management indicated that it sees maintenance of a consistently growing dividend (the dividend has grown at a steady pace of roughly 7% for years) as a top priority given its firm belief that both retail and institutional shareholders view the dividend as a critical component of the total return opportunity for the company.

HISTORICAL & PROJECTED P&L

Aqua America, Inc.		Janney Montgomery Scott LLC								
Quarterly Income Statement, 2010E										
	1Q10	Y/Y	2Q10E	Y/Y	3Q10E	Y/Y	4Q10E	Y/Y	FY2010E	Y/Y
Operating Revenues	160,517	3.9%	174,026	4.0%	198,909	10.0%	184,682	10.0%	718,134	7.1%
Operations and Maintenance	67,601		69,611		74,392		71,841		283,445	
<i>O&M Ratio</i>	42.1%		40.0%		37.4%		38.9%		39.5%	
Depreciation	26,200		27,237		27,918		29,106		110,460	
Amortization	3,172		3,120		3,150		3,150		12,592	
Taxes other than Income Taxes	12,890		12,123		13,367		12,004		50,384	
Operating Income	50,654	8.3%	61,936	5.2%	80,083	12.1%	68,581	13.6%	261,253	10.0%
<i>Operating Margin</i>	31.6%		35.6%		40.3%		37.1%		36.4%	
Interest Expense	18,430		17,570		18,650		19,207		73,857	
Allowance for Construction Funds	(1,541)		(750)		(750)		(750)		(3,791)	
Gain on Sale of other Assets	(1,929)		(150)		(150)		(150)		(2,379)	
Income before Income Taxes	35,694	15.5%	45,266	6.0%	62,333	13.1%	50,274	15.6%	193,566	12.4%
Income Taxes	14,213		17,925		24,808		20,009		76,956	
<i>Tax Rate</i>	39.8%		39.6%		39.8%		39.8%		39.8%	
Net Income	21,481	16.9%	27,341	5.8%	37,524	12.1%	30,265	13.5%	116,611	11.7%
Diluted EPS	\$0.16	16.1%	\$0.20	4.9%	\$0.27	11.2%	\$0.22	12.6%	\$0.85	10.9%
Diluted Shares Outstanding	136,800		137,100		137,400		137,600		137,225	

Aqua America, Inc.		Janney Montgomery Scott LLC								
Quarterly Income Statement, 2011E										
	1Q11E	Y/Y	2Q11E	Y/Y	3Q11E	Y/Y	4Q11E	Y/Y	FY2011E	Y/Y
Operating Revenues	173,358	8.0%	194,039	11.5%	214,821	8.0%	197,610	7.0%	779,829	8.6%
Operations and Maintenance	73,851		75,675		79,699		78,451		307,676	
<i>O&M Ratio</i>	42.6%		39.0%		37.1%		39.7%		39.5%	
Depreciation	28,916		29,734		31,321		32,010		121,980	
Amortization	2,000		2,000		2,050		2,100		8,150	
Taxes other than Income Taxes	12,840		13,322		13,999		13,240		53,400	
Operating Income	55,752	10.1%	73,308	18.4%	87,753	9.6%	71,809	4.7%	288,623	10.5%
<i>Operating Margin</i>	32.2%		37.8%		40.8%		36.3%		37.0%	
Interest Expense	18,740		19,200		19,900		20,160		78,000	
Allowance for Construction Funds	(750)		(750)		(750)		(750)		(3,000)	
Gain on Sale of other Assets	(150)		(150)		(150)		(150)		(600)	
Income before Income Taxes	37,911	6.2%	55,008	21.5%	68,753	10.3%	52,549	4.5%	214,222	10.7%
Income Taxes	15,089		21,893		27,364		20,915		85,261	
<i>Tax Rate</i>	39.8%		39.8%		39.8%		39.8%		39.8%	
Net Income	22,823	6.2%	33,115	21.1%	41,390	10.3%	31,635	4.5%	128,962	10.6%
Diluted EPS	\$0.17	5.3%	\$0.24	20.2%	\$0.30	9.5%	\$0.23	3.8%	\$0.93	9.7%
Diluted Shares Outstanding	138,000		138,200		138,400		138,600		138,300	

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 13 states, including Pennsylvania, New York, Ohio, North Carolina, Illinois, Texas, Florida, New Jersey, Indiana, Virginia, Maine, Missouri, and South Carolina.

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.

Janney Montgomery Scott LLC ("JMS") Equity Research Disclosure Legend

Janney Montgomery Scott is a market maker in the securities of WTR, and may at any time hold a long or short position in this security.

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.

Definition of Ratings

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 03/31/2010

Rating	IB Serv./Past 12 Mos.			
	Count	Percent	Count	Percent
BUY [B]	165	51.00	18	11.00
NEUTRAL [N]	144	46.00	4	3.00
SELL [S]	10	3.00	1	10.00

***Percentages of each rating category where Janney has performed Investment Banking services over the past 12 months.**

Other Disclosures

Investment opinions are based on each stock's 6-12 month return potential. Our ratings are not based on formal price targets, however our analysts will discuss fair value and/or target price ranges in research reports. Decisions to buy or sell a stock should be based on the investor's investment objectives and risk tolerance and should not rely solely on the rating. Investors should read carefully the entire research report, which provides a more complete discussion of the analyst's views.

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