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Reports 3Q10 Results; Maintaining Buy Rating and \$26 Target Price

**Buy
Target Price: \$26**

Investment Summary

Aqua America reported 3Q10 results that came in nicely ahead of expectations. Revenue of \$207.8 million (a 15% YoY improvement) came in above our estimate of \$197 million. Contributing to the increase was hot and dry weather in the Eastern U.S., rate increases, and management’s ability to control costs (O&M expenses were less than we anticipated). Bottom line of \$0.32 beat our forecast and consensus by \$0.04. Steady, incremental improvements were achieved as the company continues to benefit from rate case activity, as expected. To date, Aqua America has received rate awards of \$48.6 million, with \$19.1 million in requests pending in various states. Another \$11.5 million in rate requests are expected to be filed later in 2010. We have slightly adjusted our estimates, and reiterate our Buy rating and \$26 target price, based on the shares attaining a level of 27x our 2011 EPS estimate of \$0.97.

Discussion

- **Another great quarter.** Aqua America posted 3Q10 revenue of \$207.8 million, which increase 15% from the same quarter last year, and beat our estimate of \$197 million. EPS in the quarter of \$0.32 beat our and Street expectations of \$0.28. As is usually the case, the most impressive factor in the quarter was management’s ability to control costs, as operating margin of 43.1% increased from 39.5% the same quarter a year ago.
- **Rate case update.** Thus far in 2010, Aqua America has received rate awards in Pennsylvania, New Jersey, New York, North Carolina, Missouri, Ohio, Indiana, Maine and Virginia, and infrastructure surcharges that increased annual revenue by \$48.6 million. There is another \$19.1 million of rate cases pending, and the company expects to file another \$11.5 million in rate cases in 2010, which are expected to impact 2011 and 2012 results.
- **Continued acquisition activity.** Aqua has completed 14 acquisitions of water or wastewater systems in 2010. It is important for the company to continue acquiring systems to help grow the customer base, especially given the national housing slowdown which has limited organic growth. Aqua America management still expects to complete between 20 and 30 for the full year 2010. With regard to the rumored availability of a stake in the Connecticut-based Aquarion water utility properties, Aqua indicated it would be “realistically disciplined and aggressive” in pursuing an opportunity of that nature, if approached. With approximately 180,000 connections, Aquarion represents a significant opportunity.
- **Dividend increase.** In August, the Board of Directors declared a quarterly cash dividend payment of \$0.155 per share payable to all shareholders of record on November 17, 2010. This payment is the 20th dividend increase in the past 19 years. The shares currently yield 2.9%.

Price	\$21.90
52-Week High/Low	\$21.72 - 15.66
Shares Outstanding (mm)	137.26
Market Cap. (mm)	\$3,005.95
Average Daily Volume (mm)	0.66

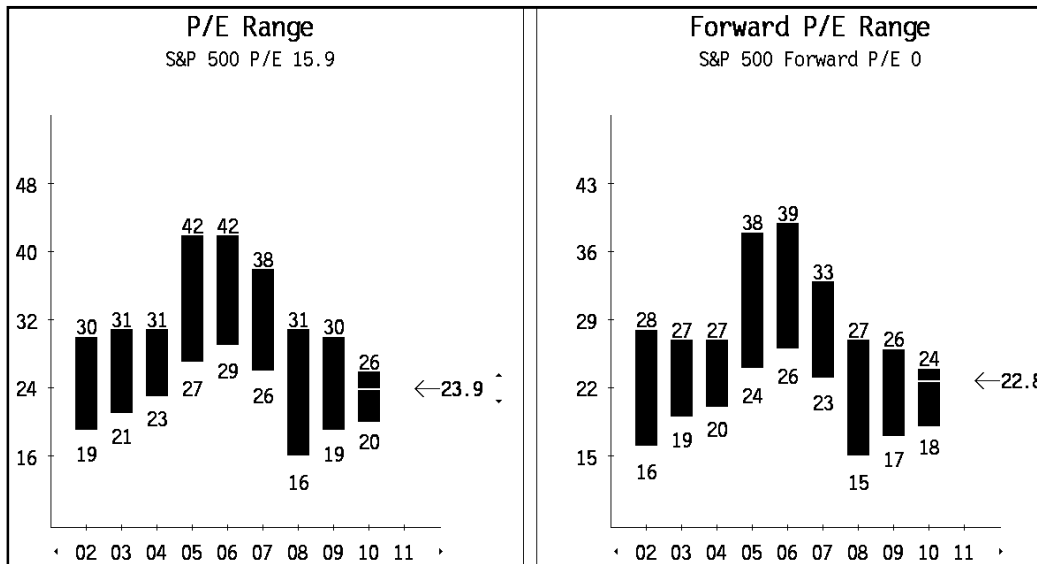
EPS	FY09A	FY10E	FY11E
Mar	\$0.14	\$0.16A	\$0.19
Jun	\$0.19	\$0.22A	\$0.24
Sep	\$0.25	\$0.32A	\$0.31
Prior	-	\$0.28	\$0.29
Dec	\$0.20	\$0.21	\$0.24
Prior	-	\$0.22	-
FY	\$0.77	\$0.90	\$0.97
Prior	-	\$0.87	\$0.96
Consensus	-	\$0.89	\$0.96
P/E	28.6x	24.2x	22.5x
FY Rev. (mm)	\$670.54	\$723.05	\$780.89



Adjusting estimates. We have made the following changes to our forward estimates: our 2010 EPS estimate is now \$0.90 from \$0.87, and our 2011 EPS estimate is now \$0.97 from \$0.96. We consider the changes insignificant from a valuation perspective.

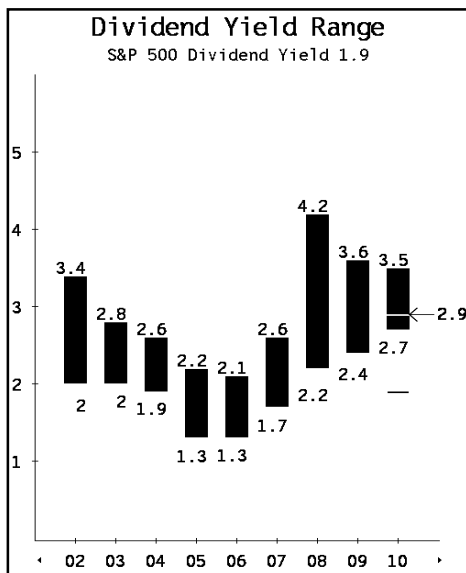
Valuation. With the shares now trading at 22x our 2011 EPS estimate of \$0.97, we consider them attractively priced at current levels. The company has done another magnificent job at controlling costs, as operating margin in the quarter reached a remarkable 43.1%. We recommend investors add to or accumulate new positions, especially given the shares are now trading toward the midpoint of their historical P/E ranges while carrying a still respectable dividend yield of 2.9%. We reiterate our Buy rating and maintain our target price of \$26, based on the shares attaining a P/E multiple of 27x our 2011 EPS estimate of \$0.97.

Aqua America Historical and Forward P/E Ranges



Source: Baseline

Aqua America Dividend Yield Range



Source: Baseline

Aqua America		Quarterly Income Statement, 2010E								
(\$000, except per share data)										
Fiscal year ends December 31										
	1Q10	% Rev or Margin	2Q10	% Rev or Margin	3Q10	% Rev or Margin	4Q10E	% Rev or Margin	2010E	% Rev or Margin
Sales	160,517		178,444		207,797		176,288		723,046	
Operating & maintenance	67,601	42.1%	69,310	38.8%	72,968	35.1%	67,166	38.1%	277,045	38.3%
Depreciation	26,200	16.3%	26,802	15.0%	27,431	13.2%	27,325	15.5%	107,758	14.9%
Amortization	3,172	2.0%	3,314	1.9%	3,629	1.7%	3,349	1.9%	13,464	1.9%
Non-income taxes	12,860	8.0%	12,943	7.3%	14,182	6.8%	12,869	7.3%	52,854	7.3%
Operating income	50,684	31.6%	66,075	37.0%	89,587	43.1%	65,579	37.2%	271,925	37.6%
Interest expense, net	18,430	11.5%	18,504	10.4%	19,150	9.2%	19,392	11.0%	75,476	10.4%
AFC	(1,541)	-1.0%	(1,461)	-0.8%	(1,077)	-0.5%	(1,000)	-0.6%	(5,079)	-0.7%
Gain on sale of other assets	(1,929)	-1.2%	(110)	-0.1%	(291)	-0.1%	(500)	-0.3%	(2,830)	-0.4%
Income before taxes	35,724	22.3%	49,142	27.5%	71,805	34.6%	47,687	27.1%	204,358	28.3%
Income taxes	14,213	39.8%	19,287	39.2%	28,054	39.1%	18,837	39.5%	80,391	39.3%
Net income	21,511	13.4%	29,855	16.7%	43,751	21.1%	28,851	16.4%	123,968	17.1%
Earnings per share	\$0.16		\$0.22		\$0.32		\$0.21		\$0.90	
Shares outstanding (000)	136,800		137,012		137,394		137,494		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		192,720		224,421		190,391		780,889	
Operating & maintenance	68,997	39.8%	76,124	39.5%	87,524	39.0%	74,633	39.2%	307,278	39.3%
Depreciation	27,217	15.7%	27,366	14.2%	29,624	13.2%	27,035	14.2%	111,242	14.2%
Amortization	2,947	1.7%	3,084	1.6%	3,366	1.5%	3,237	1.7%	12,634	1.6%
Non-income taxes	13,002	7.5%	13,298	6.9%	14,363	6.4%	13,137	6.9%	53,799	6.9%
Operating income	61,196	35.3%	72,848	37.8%	89,544	39.9%	72,348	38.0%	295,936	37.9%
Interest expense, net	19,243	11.1%	19,465	10.1%	21,096	9.4%	19,420	10.2%	79,223	10.1%
AFC	(1,000)	-0.6%	(1,000)	-0.5%	(1,000)	-0.4%	(1,000)	-0.5%	(4,000)	-0.5%
Gain on sale of other assets	(400)	-0.2%	(400)	-0.2%	(400)	-0.2%	(400)	-0.2%	(1,600)	-0.2%
Income before taxes	43,353	25.0%	54,783	28.4%	69,848	31.1%	54,329	28.5%	222,313	28.5%
Income taxes	17,341	40.0%	21,475	39.2%	27,381	39.2%	21,460	39.5%	87,656	39.4%
Net income	26,012	15.0%	33,308	17.3%	42,468	18.9%	32,869	17.3%	134,656	17.2%
Earnings per share	\$0.19		\$0.24		\$0.31		\$0.24		\$0.97	
Shares outstanding (000)	137,594		137,694		137,794		137,894		138,175	

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

Important Disclosures

Ratings and Target Price History



All prices are as of the market close on [CLOSE_PRICE_DATE].

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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	139	66.19%	17	12.23%
HOLD	60	28.57%	2	3.33%
SELL	7	3.33%	0	0%
NOT RATED	4	1.9%	0	0%
TOTAL	210			

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

Valuation Methodology and Risks

Aqua America (WTR): \$26 target price, based on the shares attaining a level of 27x our 2011 EPS estimate. 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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