



## Morning Meeting Notes

Friday, November 5, 2010

### AQUA AMERICA INC (WTR - USD 21.55)

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Recommendation: BUY  
Previous Recommendation: BUY  
As of: 05-Aug-2010

Currency - USD			
Capitalization		Financial Metrics	
(in millions)		Fiscal YE	Dec 2010
Number of Shares	137	2011 PMV/sh	27.00
Price	21.55	<b>E P S</b>	
Market Cap	2,961	2011P	1.00
Net Debt(Cash)	1,511	2010E	0.88
Other	0	2009A	0.77
<b>Total Enterprise Value</b>	<b>4,472</b>	<b>EBITDA (mm)</b>	
		2011P	436
		2010E	396
		2009A	356
		<b>PE Ratio</b>	
		2011P	21.6
		2010E	24.5
		2009A	28.1

### Aqua Reports Strong Third Quarter Results

- WTR reported third quarter earnings of \$0.32 per share compared to \$0.25 per share for the same period last year. For the first nine-months of 2010 earnings were \$0.69 per share compared with \$0.57 per share for the same period last year. Third quarter results benefitted from hot and dry weather in the East, which led to a 9% increase in customer usage in key operating areas compared to the same period in 2009. So far in 2010, WTR completed 14 acquisitions of water or wastewater systems and management expects to complete between 20 and 30 acquisitions in 2010
- Both periods benefitted from \$49 million in annual rate increases implemented year-to-date, including rate awards in PA, NJ, NY, NC, MO, OH, IN, ME, and VA. The company has \$19.1 million in annual rate requests pending and expects to file for an additional \$11.5 million in rate requests later in 2010. The operations and maintenance expense-to-revenue ratio (efficiency ratio) was more than 200 basis points less for the 12 months ending September 30, 2010, compared to the same period in 2009.
- Our 2010 and 2011 earnings estimates are \$0.88 and \$1.00, respectively, per share. Earnings growth will be driven by large revenue increases in Pennsylvania (\$24 million) and New Jersey (\$4 million) in mid 2010, the acquisition of smaller systems, and continued cost control. Longer term, we expect annual earnings growth to return to WTR's historic target rate of 8-10% per share driven by ongoing rate relief, improved profit levels in the Southern region, customer growth and increased operational efficiency. We expect continued rate relief and efficiency improvement at underperforming systems in Florida and North Carolina. The company acquired these troubled southern systems in 2004 and 2005 and has spent several years working to improve operational performance and earned returns. We expect the low earned returns in the Florida and Carolina jurisdictions to improve to normal 10% levels by 2012.
- WTR shares currently trade at 24.6X and 21.6X our 2010 and 2011 earnings estimates and 260% of book value, which compares to group multiples of 21.3X and 19.0X and 195% of book value. Over the past ten years, WTR shares have traded between 15-35X forward earnings and significant premium multiples to the group. Our estimated 2011 private market value estimate is \$27 per share.
- We believe that the Private Market Value of WTR is around \$25-27 per share, at a premium of 300-325% to book value, which compares to 250-325% premiums in the last ten takeover agreements, including the recent announcement that Southwest Water (SWWC) has agreed to be purchased at 268% of tangible book value by a private equity infrastructure group. We believe WTR shares warrant premium multiples given the company's national presence, strong financial condition, strong reputation, strong EPS outlook and successful track record. Standard and Poor's recently reiterated its A+ credit rating for Aqua Pennsylvania, Inc., Aqua America's largest subsidiary.
- Primary Risks to our recommendation include regulatory risk (poor rate decision), an acquisition announcement at a premium multiple, potential retirement of the CEO, higher interest rates, and market risk.

Please see the last page for important disclosures.

## Important Disclosures

To obtain a price chart for any security in this report, please contact 1-800-422-2274.

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- **AQUA AMERICA INC**

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