

**Water / Infrastructure**

**Aqua America, Inc.**

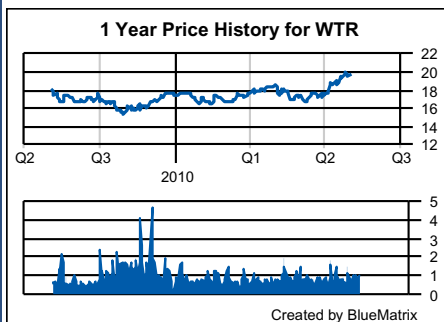
(WTR) - BUY

**Price:** **\$19.87**  
 Fair Value Estimate: \$21.00  
 52-Week Range: \$20.08-\$15.39  
 Market Cap (MM): \$2,722  
 Shr.O/S-Diluted (mm): 137.0  
 Average Daily Volume: 901,311  
 Dividend: \$0.58  
 Yield: 2.9%

| FYE: Dec   | 2009A  | 2010E  | 2011E  |
|------------|--------|--------|--------|
| EPS:       | \$0.77 | \$0.87 | \$0.93 |
| Prior EPS: |        | \$0.85 | NC     |
| P/E Ratio: | 25.8x  | 22.8x  | 21.4x  |

Quarterly EPS:

| Q1      | Q2      | Q3     | Q4     |
|---------|---------|--------|--------|
| \$0.14  | \$0.19  | \$0.25 | \$0.20 |
| \$0.16A | \$0.22A | \$0.27 | \$0.22 |
| \$0.17  | \$0.24  | \$0.29 | \$0.23 |



Equity Research  
**Note**

**Hot Weather and Steadfast Cost Controls Drive 2Q Beat; Maintain BUY**

**INVESTMENT CONCLUSION:**

Aqua America continues to show why it is a "best-of-breed" player in the investor owned utility space. The company is spending over \$1.5 billion in capital over the next five years to rehabilitate system infrastructure, to grow its rate base and set the stage for future growth. Management maintains a disciplined cost consciousness not only during off-peak water usage seasons, but also in higher consumption months. The company's Pennsylvania operations (more than 50% of sales), benefit from one of the most progressive regulatory jurisdictions in the country. Rate relief will favorably impact results in the near-term and a pipeline of planned cases offers support in 2011 and 2012. WTR shares trade at a well-deserved premium to the peer group, but 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 investors. We reiterate our BUY rating for WTR and increase our fair value to \$21 from \$20.

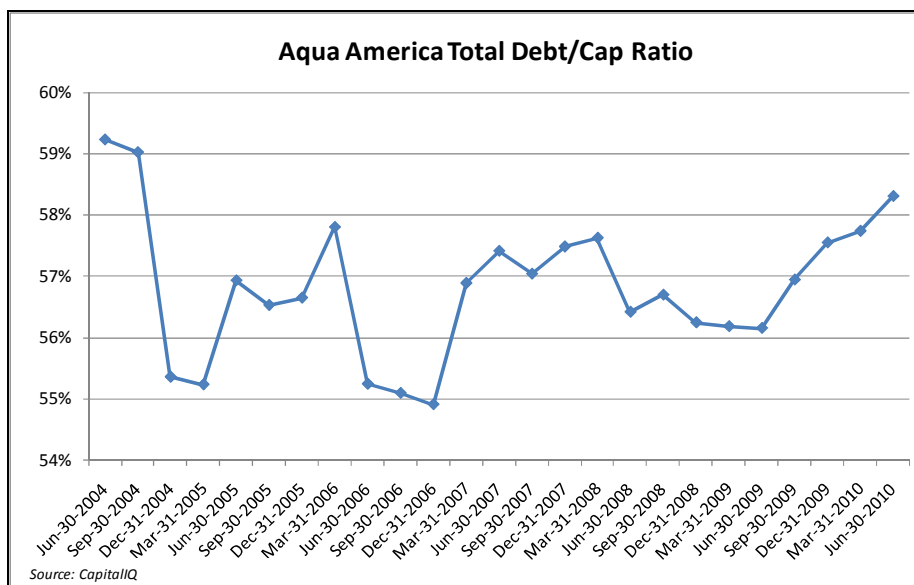
**KEY POINTS:**

- **Impressive Results.** Aqua America reported second quarter earnings of \$0.22/share, a penny ahead of consensus and \$0.02 ahead of our estimate. EPS grew 15% year-over-year as hot, dry weather in the northeast drove higher water consumption while management controlled costs.
- **Operations and Rate Base Growth.** Quarterly revenue increased 7%, ahead of our 4% expectations; and costs were lighter than we had forecast. The operations & maintenance expense/revenue ratio fell to 38.8% contributing to 37% operating margin (vs. our expectation of 35.6%). Aqua invested \$141 million in capital through 2010 - upgrading pipe, plants, and storage facilities. Additionally, management still expects to close between 20-30 tuck-in acquisitions this year (12 closed YTD), after completing 18 small acquisitions in 2009.
- **Regulatory Update.** The company received \$44 million in annualized rate relief so far this year, and has outstanding requests for \$14 million in four states. The Pennsylvania rate case was approved in late June, adding a meaningful contribution in the second half of the year. With plans for over \$300 million in capital spending this year, management anticipates filing for an additional \$28.5 million in rates before year-end (primarily in southern states), with an earnings impact in 2011 and 2012.
- **Dividend Increase.** Aqua declared a 7% dividend increase payable December 1<sup>st</sup>, bringing the annualized rate to \$0.62/share from \$0.58/share previously. This is the 20<sup>th</sup> increase over the last 19 years and the eighth consecutive year that the dividend increase was greater than five percent. Currently, Aqua's dividend yield is 3%; generally in line with its water utility peers.
- **Long-term Thesis Intact.** Aqua has outperformed its peer group so far in 2010 (due to strong performance in July), up 13% compared to the group mean of 2% (excluding SouthWest Water (SWWC; NR)). We favor the shares for long-term investors focused on risk-adjusted total returns and maintain our BUY rating. Our increased \$21 fair value (\$20 previously) represents ~22x our 2011 estimate, in line with Aqua's historical multiple.

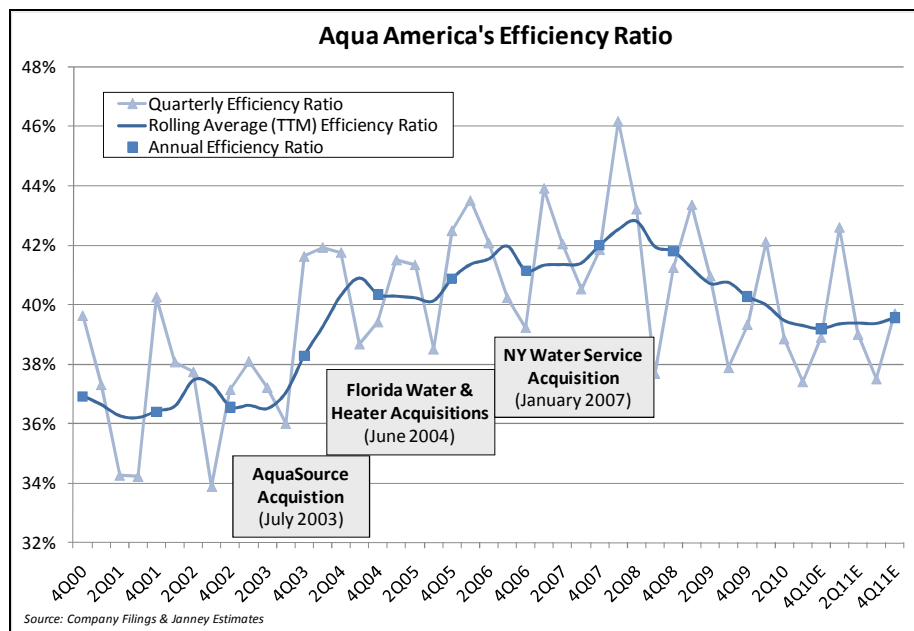
**Research Analyst Certifications and Important Disclosures are on pages 4 - 5 of this report**

## WTR 2Q-2010: ADDITIONAL COMMENTARY & ANALYSIS

**Equity Financing Needs Fade.** Aqua closed a \$70 million debt financing in June, at an average rate of below 5%. With a solid credit rating the company is securing debt at favorable rates, which ultimately benefits customers (as interest costs are passed through in customer bills). The company's total debt to capital ratio has inched higher over the last year to 58% - a level last seen in 2004. We believe the company can rely on internally generated cash, shares issued via the DRP, and debt to finance its future capital plans (\$1.5 billion over the next five years). We do not expect an equity offering (barring a large, likely accretive, acquisition), and would note that DRP dilution remains around 1% of outstanding shares.



**Efficiency Ratio Steadily Improves.** Aqua has long been regarded as one of the leanest water utilities in the group with an O&M / revenue ratio averaging 39.5% over the last 10 years (on a rolling twelve month basis). This focus on cost containment, paired with rate relief in PA and more favorable year-over-year weather comps, drives our belief that annual efficiency ratio for the next two years will remain below 40%, driving operating margins and earnings growth.



| Aqua America, Inc.                |                | Janney Montgomery Scott LLC |                |       |                |       |                |       |                |       |
|-----------------------------------|----------------|-----------------------------|----------------|-------|----------------|-------|----------------|-------|----------------|-------|
| Quarterly Income Statement, 2010E |                |                             |                |       |                |       |                |       |                |       |
|                                   | 1Q10           | Y/Y                         | 2Q10           | Y/Y   | 3Q10E          | Y/Y   | 4Q10E          | Y/Y   | FY2010E        | Y/Y   |
| <b>Operating Revenues</b>         | <b>160,517</b> | 3.9%                        | <b>178,444</b> | 6.6%  | <b>197,100</b> | 9.0%  | <b>184,682</b> | 10.0% | <b>720,744</b> | 7.5%  |
| Operations and Maintenance        | 67,601         |                             | 69,310         |       | 73,913         |       | 71,841         |       | 282,665        |       |
| <i>O&amp;M Ratio</i>              | 42.1%          |                             | 38.8%          |       | 37.5%          |       | 38.9%          |       | 39.2%          |       |
| Depreciation                      | 26,200         |                             | 26,802         |       | 27,500         |       | 28,000         |       | 108,502        |       |
| Amortization                      | 3,172          |                             | 3,314          |       | 3,400          |       | 3,200          |       | 13,086         |       |
| Taxes other than Income Taxes     | 12,890         |                             | 12,943         |       | 13,367         |       | 12,200         |       | 51,400         |       |
| <b>Operating Income</b>           | <b>50,654</b>  | 8.3%                        | <b>66,075</b>  | 12.3% | <b>78,921</b>  | 10.4% | <b>69,441</b>  | 15.0% | <b>265,091</b> | 11.6% |
| <i>Operating Margin</i>           | 31.6%          |                             | 37.0%          |       | 40.0%          |       | 37.6%          |       | 36.8%          |       |
| Interest Expense                  | 18,430         |                             | 18,504         |       | 19,000         |       | 19,207         |       | 75,141         |       |
| Allowance for Construction Funds  | (1,541)        |                             | (1,461)        |       | (750)          |       | (750)          |       | (4,502)        |       |
| Gain on Sale of other Assets      | (1,929)        |                             | (110)          |       | (150)          |       | (150)          |       | (2,339)        |       |
| Income before Income Taxes        | 35,694         | 15.5%                       | 49,142         | 15.1% | 60,821         | 10.4% | 51,134         | 17.6% | 196,791        | 14.3% |
| Income Taxes                      | 14,213         |                             | 19,287         |       | 24,207         |       | 20,351         |       | 78,058         |       |
| <i>Tax Rate</i>                   | 39.8%          |                             | 39.2%          |       | 39.8%          |       | 39.8%          |       | 39.7%          |       |
| <b>Net Income</b>                 | <b>21,481</b>  | 16.9%                       | <b>29,855</b>  | 15.5% | <b>36,614</b>  | 9.4%  | <b>30,783</b>  | 15.5% | <b>118,733</b> | 13.8% |
| <b>Diluted EPS</b>                | <b>\$0.16</b>  | 16.1%                       | <b>\$0.22</b>  | 14.6% | <b>\$0.27</b>  | 8.6%  | <b>\$0.22</b>  | 14.7% | <b>\$0.87</b>  | 13.0% |
| Diluted Shares Outstanding        | 136,800        |                             | 137,012        |       | 137,200        |       | 137,400        |       | 137,103        |       |

| 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  |
| <b>Operating Revenues</b>         | <b>173,358</b> | 8.0%                        | <b>194,504</b> | 9.0%  | <b>212,868</b> | 8.0%  | <b>197,610</b> | 7.0% | <b>778,341</b> | 8.0% |
| Operations and Maintenance        | 72,984         |                             | 75,857         |       | 80,890         |       | 78,451         |      | 308,182        |      |
| <i>O&amp;M Ratio</i>              | 42.1%          |                             | 39.0%          |       | 38.0%          |       | 39.7%          |      | 39.6%          |      |
| Depreciation                      | 28,500         |                             | 29,000         |       | 29,500         |       | 32,010         |      | 119,010        |      |
| Amortization                      | 3,000          |                             | 3,500          |       | 3,500          |       | 2,100          |      | 12,100         |      |
| Taxes other than Income Taxes     | 12,840         |                             | 13,000         |       | 13,500         |       | 13,240         |      | 52,580         |      |
| <b>Operating Income</b>           | <b>56,034</b>  | 10.6%                       | <b>73,147</b>  | 10.7% | <b>85,478</b>  | 8.3%  | <b>71,809</b>  | 3.4% | <b>286,469</b> | 8.1% |
| <i>Operating Margin</i>           | 32.3%          |                             | 37.6%          |       | 40.2%          |       | 36.3%          |      | 36.8%          |      |
| Interest Expense                  | 18,740         |                             | 19,200         |       | 19,500         |       | 20,160         |      | 77,600         |      |
| 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        | 38,194         | 7.0%                        | 54,847         | 11.6% | 66,878         | 10.0% | 52,549         | 2.8% | 212,469        | 8.0% |
| Income Taxes                      | 15,087         |                             | 21,665         |       | 26,417         |       | 20,757         |      | 83,925         |      |
| <i>Tax Rate</i>                   | 39.5%          |                             | 39.5%          |       | 39.5%          |       | 39.5%          |      | 39.5%          |      |
| <b>Net Income</b>                 | <b>23,107</b>  | 7.6%                        | <b>33,183</b>  | 11.1% | <b>40,461</b>  | 10.5% | <b>31,792</b>  | 3.3% | <b>128,544</b> | 8.3% |
| <b>Diluted EPS</b>                | <b>\$0.17</b>  | 6.9%                        | <b>\$0.24</b>  | 10.5% | <b>\$0.29</b>  | 9.9%  | <b>\$0.23</b>  | 2.7% | <b>\$0.93</b>  | 7.6% |
| Diluted Shares Outstanding        | 137,600        |                             | 137,800        |       | 138,000        |       | 138,200        |      | 137,900        |      |

## 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 and Heike M. Doerr, 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



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## **Janney Montgomery Scott Ratings Distribution as of 06/30/2010**

| <b>Rating</b>      | <b>IB Serv./Past 12 Mos.</b> |                |              |                |
|--------------------|------------------------------|----------------|--------------|----------------|
|                    | <b>Count</b>                 | <b>Percent</b> | <b>Count</b> | <b>Percent</b> |
| <b>BUY [B]</b>     | 184                          | 53             | 18           | 10             |
| <b>NEUTRAL [N]</b> | 155                          | 45             | 4            | 3              |
| <b>SELL [S]</b>    | 7                            | 2              | 2            | 29             |

**\*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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