

	Value	Blend	Growth
Large			
Mid	■		
Small			

Aqua America Inc.

(WTR - NYSE)

Q3 results in-line with expectations; Reiterate Buy rating and \$23 price target

Recent Price	\$15.71	Fiscal Year (Dec.)	2008	2009	2010
12-Month Price Target	\$23	Q1	\$0.11	\$0.14	
52-Week Range	\$15-22	Q2	\$0.17	\$0.19	
Shares Outstanding (M-Q3'09)	136.3	Q3	\$0.26	\$0.25	
Market Cap. (M)	\$2,141	Q4	\$0.19	\$0.23	E
L-T Debt / Total Cap. (Q3'09)	54.0%	Diluted Earnings Per Share	\$0.73	\$0.81	E \$0.97 E
Est. 3-Year EPS Growth	10.0%	P/E Multiple	21.5x	19.4x	16.2x
Dividend / Annl. Yield	\$0.58 3.7%	ROE	9.6%	10.3%	12.4%
Avg. Daily Volume ('000)	912	EBITDA Margin	51.1%	52.5%	53.6%

Company Description: Aqua America is the largest publicly traded water utility in the United States. It provides water and wastewater services to approximately 3 million residents in Pennsylvania, Ohio, Illinois, Texas, New Jersey, Indiana, Virginia, Florida, North Carolina, Maine, Missouri, New York, and South Carolina. The company's history spans over 100 years.

- **WTR reported third quarter EPS of \$0.25 versus \$0.26 (which included a ~\$0.02 utility system sale) in the year ago period, matching our and the consensus estimate.** Revenue increased 2.1% to \$180.8 million compared to our \$182.4 million estimate, despite one of the wettest summer's on record for the company. O&M rose 2.6% to \$68.5 million and as a percentage of revenue increased 20 basis points to 37.7%. However, exclusion of the utility sale would translate to a favorable q/q O&M comparison.
- **Year-to-date the company has \$29.3 million in rate awards in addition to ~\$12 million in pending cases and ~\$57 million in anticipated filings (mostly in Q4'09) for new rates.**
- **The company has made 15 "tuck'in" acquisitions thus far in 2009 and management anticipates about 10 more by year-end, driving much of the current ~1.5% customer growth rate.**
- **We are lowering our FY'09 EPS estimate by just a penny to \$0.81 but our FY'10 EPS estimate of \$0.97 is unchanged.** The stock is trading at 19.4x and 16.2x our FY'09 and FY'10 EPS estimates, respectively, a significant discount to the company's peer group trading at 22.0x and 18.2x FY'09 and FY'10 EPS estimates.
- **Maintain Buy rating and \$23 price target.**

Note Important Disclosures on Pages 6 and 7.
Note Analyst Certification on Page 6.

ADDITIONAL DISCUSSION***Third Quarter Results***

Aqua America reported third quarter EPS of \$0.25 versus \$0.26 (which includes a ~\$0.02 utility system sale for an underperforming asset) in the year ago period, matching our and the consensus estimate. Revenue rose 2.1% to \$180.8 million compared to our \$182.4 million estimate, despite the negative impact of heavy rainfall with one of the wettest summers on record for the company. Weather had a negative impact of ~\$0.03 per share. There was a historically wet summer in the Mid-Atlantic, the 8th wettest summer in the last 137 years in southeastern Pennsylvania (~half of the company's customer base), with a similar story in New Jersey.

O&M (Operations & maintenance) expenses rose 2.6% to \$68.5 million and as a percentage of revenue was 20 basis points higher at 37.7%. However, exclusion of the asset sale would have translated to a favorable q/q O&M comparison. We anticipate further O&M improvement in Q4'09 and anticipate about 140 basis points of improvement for the full year. Depreciation was 11.5% above the year ago level at \$25.4 million. Operating income decreased 4.2% to \$71.5 million and net income fell 5.4% to \$35.4 million.

Financial Condition

Long-term debt was \$1.3 billion at quarter's end compared to \$1.2 billion in the sequential quarter, and as a percentage of total capitalization rose 50 basis points to 54.0%. During the quarter WTR had ~\$77.9 million in capital expenditures compared to ~\$77.5 million in the year ago period, and the company anticipates approximately ~\$300 million in cap ex in 2009 focused on pipe replacement projects and plant upgrades, compared to \$267 million in 2008. In FY'10 \$300-\$310 billion of cap ex is anticipated. Due to internally generated cash, the company does not anticipate any equity raising needs for the near term but an equity offering could be necessary in 2010.

Valuation

We are lowering our FY'09 EPS estimate by just a penny but making no change to our FY'10 EPS estimate of \$0.97. We are also maintaining our \$23 price target, which we derive by applying a multiple of 24x to our 2009 earnings estimate, which is at the low end of multiples where the company typically trades. The stock is currently trading at 19.4x and 16.2x our 2009 and 2010 EPS estimates, respectively, a meaningful discount to the company's peer group trading at 22.0x and 18.2x FY'09 and FY'10 EPS estimates.

Outlook

Given the myriad of weather issues, even with a penny below last year (or a penny above stripping out the utility sale) we view Q3 results rather favorably. Positively, not only will incremental rates soon be in effect, but next year will also bring easier q/q comparisons and additional O&M leverage is expected as well. Thus far in 2009, the company has been granted rate awards totaling \$29.3 million. It also has pending rate cases totaling ~\$12 million in New York, Indiana, Missouri, Virginia, and North Carolina. Moreover, WTR plans to file (mostly) in Q4'09 for ~\$57 million in new rates.

We also note that in July the Pennsylvania PUC increased the company's surcharge or DSIC (Distribution System Improvement Charge) from 5.0% to 7.5% (lacking an appeal). This is meaningful as it allows certain infrastructure improvements to be immediately included in rates, prior to settlement of a full blown rate case. Management is hopeful New Jersey will be next to adopt a surcharge mechanism, which would translate to much more capital being invested in the state and an increased rate base on which to earn a return and it sounds as if the overall regulatory climate may improve given the recent election of Chris Christie to Governor in the state.

Acquisitions continue to be a big piece of the company's growth strategy with 15 "tuck-ins" on the books for FY'09. Management believes it can add another 10 or so by year-end, important given this is what is driving about two-thirds of the overall 1.5% customer growth rate. Recent tuck-ins include an 8,000 customer system in Lawrence Township, New Jersey, and a ~500 customer system in Schuylkill County, Pennsylvania.

Bad debt remains below 1%, and we also note during the quarter the company announced a 7.4% dividend increase during the quarter, raising the quarterly payment from \$0.135 to \$0.145. This marks the 19th dividend increase in the past 18 years. Our thesis remains intact and we reiterate our Buy rating.

INVESTMENT CONSIDERATIONS

- 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.

Income Statements (000's)	FY'06	FY'07	Q1'08	Q2'08	Q3'08	Q4'08	FY'08	Q1'09A	Q2'09A	Q3'09A	Q4'09E	FY'09E	FY'10E
Operating revenues	\$533,491	\$602,499	\$139,283	\$150,751	\$177,098	\$159,840	\$626,972	\$154,487	\$167,333	\$180,826	\$179,154	\$681,800	\$725,678
Costs and expenses:													
Operation and maintenance	219,560	253,092	64,304	65,146	66,743	65,929	262,122	66,989	68,549	68,488	71,662	275,688	283,547
Depreciation	70,895	83,178	21,481	20,619	22,809	23,876	88,785	26,387	24,972	25,436	25,500	102,295	104,000
Amortization	4,146	4,833	1,173	1,012	1,815	1,515	5,515	2,755	3,064	3,029	1,600	10,448	6,955
Taxes other than income taxes	33,343	45,380	12,109	10,845	11,157	10,638	44,749	11,590	11,884	12,418	12,541	48,433	47,712
Operating income	327,944	386,483	99,067	97,622	102,524	101,958	401,171	107,721	108,469	109,371	111,302	436,863	442,214
Other expense (income):													
Interest expense (net)	58,432	66,921	17,130	17,063	17,014	17,365	68,572	16,628	16,809	17,256	17,256	67,949	69,200
Allow. for funds used dur. const.	(3,941)	(2,953)	(956)	(1,100)	(976)	(642)	(3,674)	(625)	(568)	(747)	(1,000)	(2,940)	(3,600)
Gain on sale of water system													
Gain on sale of other assets	(1,194)	(3,494)		(553)	(532)	(514)	(1,599)	(133)	(80)	(162)	(100)	(475)	(1,200)
Income before income taxes	152,250	155,542	24,042	37,719	59,068	41,673	162,502	30,896	42,703	55,108	51,696	180,403	219,064
Provision for income taxes	60,246	60,542	9,721	15,167	23,688	16,008	64,584	12,525	16,850	21,638	19,903	70,916	86,679
Net income	92,004	95,014	14,321	22,552	35,380	25,665	97,918	18,371	25,853	33,470	31,793	109,487	132,385
Dividends on preferred stock													
Net income available to common stk.	\$92,004	\$95,014	\$14,321	\$22,552	\$35,380	\$25,665	\$97,918	\$18,371	\$25,853	\$33,470	\$31,793	\$109,487	\$132,385
Net income	92,004	95,014	14,321	22,552	35,380	25,665	97,918	18,371	25,853	33,470	31,793	109,487	132,385
Other comp. income (loss), net of tax:													
Unreal. hold. gain (loss) on certain inv.	194	1,121		189	4	2	195	37	232	(142)			
Minimum pension liability adjustment	3,082												
Unrealized gains on securities													
Reclass. adj. for gains reported		(1,315)			(209)		(209)		5				
Comprehensive income	\$95,280	\$94,820	\$14,321	\$22,741	\$35,175	\$25,667	\$97,904	\$18,408	\$26,090	\$33,328	\$31,793	\$109,487	\$132,385
EPS (FD)	\$0.70	\$0.71	\$0.11	\$0.17	\$0.26	\$0.19	0.73	\$0.14	\$0.19	\$0.25	\$0.23	\$0.81	\$0.97
Diluted average shares outstanding	131,774	133,602	133,970	134,060	135,279	135,586	134,705	135,876	135,939	136,260	136,460	134,673	136,994
Cash div. per share of com. stk.	\$0.444	\$0.480	\$0.125	\$0.125	\$0.125	\$0.135	\$0.510	\$0.135	\$0.135	\$0.135	\$0.145	\$0.550	\$0.587
Rate of Change Analysis:													
Revenues	7.4%	12.9%	1.4%	0.1%	7.0%	7.2%	4.1%	10.9%	11.0%	2.1%	12.1%	8.7%	6.4%
Operating income	4.6%	5.1%	-8.1%	-3.0%	14.1%	11.0%	4.5%	16.3%	10.8%	-4.2%	17.2%	8.5%	15.7%
EPS	-1.4%	1.4%	-15.4%	-5.6%	18.2%	0.0%	2.8%	27.3%	11.8%	-3.8%	22.6%	11.4%	18.9%
EBITDA	7.1%	8.4%	-3.4%	-2.2%	13.3%	11.2%	5.3%	20.7%	16.2%	0.7%	14.0%	11.7%	10.3%
Margin Analysis:													
O&M	41.2%	42.0%	46.2%	43.2%	37.7%	41.2%	41.8%	43.4%	41.0%	37.9%	40.0%	40.4%	39.1%
D&A	14.1%	14.6%	16.3%	14.3%	13.9%	15.9%	15.0%	18.9%	16.8%	15.7%	15.1%	16.5%	15.3%
Taxes other than inc. taxes	6.2%	7.5%	8.7%	7.2%	6.3%	6.7%	7.1%	7.5%	7.1%	6.9%	7.0%	7.1%	6.6%
Operating income	38.5%	35.9%	28.9%	35.2%	42.1%	36.2%	36.0%	30.3%	35.2%	39.5%	37.9%	35.9%	39.1%
Net income	17.9%	15.7%	10.3%	15.1%	19.9%	16.1%	15.6%	11.9%	15.6%	18.4%	17.7%	16.1%	18.2%
Tax rate	39.6%	38.9%	40.4%	40.2%	40.1%	38.4%	39.7%	40.5%	39.5%	39.3%	38.5%	39.3%	39.6%

Source: Company reports and Hilliard Lyons estimates

Aqua America, Inc.

Selected Balance Sheet Items	FY'06	FY'07	Q1'08	Q2'08	Q3'08	Q4'08	FY'08	Q1'09A	Q2'09A	Q3'09E	Q4'09E	FY'09E	FY'10E
Cash	\$44,039	\$14,540	\$16,509	\$14,800	\$15,968	\$14,944	\$14,944	\$16,744	\$13,822	\$10,794	\$26,230	\$26,230	\$14,382
A/R	72,149	82,921	73,674	81,864	94,086	84,523	84,523	77,280	84,851	94,030	93,877	93,877	94,723
Other	18,512	18,050	19,936	23,198	19,817	21,574	21,574	20,707	23,857	21,699	21,498	21,498	21,692
Total current assets	134,700	115,511	110,119	119,862	129,871	121,041	121,041	114,731	122,530	126,522	141,605	141,605	130,797
Net PP&E	2,505,995	2,792,794	2,802,123	2,872,247	2,922,516	2,997,383	2,997,383	3,026,696	3,060,481	3,109,516	3,187,416	3,187,416	3,396,461
Regulatory assets	165,063	164,034	160,429	158,805	162,983	222,057	222,057	230,378	230,786	230,786	230,786	230,786	232,786
Other	72,145	154,573	153,212	143,323	148,669	144,541	144,541	120,164	116,467	151,894	164,822	164,822	166,307
Total Assets	\$2,877,903	\$3,226,912	\$3,225,883	\$3,294,237	\$3,364,039	\$3,485,022	\$3,485,022	\$3,481,969	\$3,530,264	3,618,718	3,724,629	3,724,629	3,926,351
Current portion of long-term debt	31,155	23,927	11,956	7,002	7,123	7,297	7,297	27,533	27,659	27,659	27,659	27,659	30,000
Loans payable	119,150	56,918	83,827	79,725	103,069	80,589	80,589	84,407	97,078	173,593	143,323	143,323	144,615
A/P	49,406	45,801	23,420	28,256	30,801	50,044	50,044	27,157	29,521	43,398	57,329	57,329	57,846
Goodwill	22,580	36,631	36,876	36,867	37,979	41,007	41,007	40,842	40,842	40,842	40,842	40,842	40,842
Other	33,320	19,935	18,382	11,714	39,311	14,234	14,234	12,096	10,672	86,796	68,795	68,795	69,415
Total current liab	255,611	183,212	174,461	163,564	218,283	193,171	193,171	192,035	205,722	372,289	337,949	337,949	342,718
LTD	951,660	1,215,053	1,213,640	1,212,423	1,211,388	1,248,104	1,248,104	1,226,232	1,227,744	1,235,244	1,310,244	1,310,244	1,382,903
Def inc taxes & invst tax credits	273,199	307,651	307,966	326,990	341,875	355,166	355,166	365,525	375,907	318,254	365,474	365,474	368,768
Customers' adv for construction	76,820	85,773	82,378	83,115	71,892	72,955	72,955	73,890	77,998	101,263	103,909	103,909	104,846
Other	78,285	83,236	80,369	80,237	77,475	137,485	137,485	135,547	148,085	86,796	101,043	101,043	101,953
CIAC	320,698	375,689	386,354	405,794	415,107	419,695	419,695	425,946	419,317	383,351	444,302	444,302	448,306
Shareholders' equity	921,630	976,289	980,715	1,022,114	1,028,019	1,058,446	1,058,446	1,062,794	1,075,441	1,075,441	1,075,441	1,075,441	1,075,441
Total Liab & SE	\$2,877,903	\$3,226,912	\$3,225,883	\$3,294,237	\$3,364,039	\$3,485,022	\$3,485,022	\$3,481,969	\$3,530,264	3,618,718	3,724,629	3,724,629	3,926,351
Selected Cash Flow Items	FY'06	FY'07	Q1'08	Q2'08	Q3'08	Q4'08	FY'08	Q1'09A	Q2'09A	Q3'09E	Q4'09E	FY'09E	FY'10E
Net income	\$92,004	\$95,014	\$14,321	\$22,552	\$35,380	\$25,665	\$97,918	\$18,371	\$25,853	\$33,470	\$31,793	\$109,487	\$132,385
D&A	75,041	88,011	22,654	21,631	24,624	25,391	94,300	29,142	28,036	28,465	27,100	112,743	110,955
(Inc.) dec. in working cap.	(20,305)	(82,709)	(1,390)	(22,349)	45,878	(17,306)	4,833	6,974	3,016	11,432	(8,169)	13,252	13,009
Other operating activities	23,986	93,852	8,289	12,281	(27,780)	31,665	24,455	8,209	(13,052)	5,000	20,000	20,157	29,200
Operating cash flow	170,726	194,168	43,874	34,115	78,102	65,415	221,506	62,696	43,853	78,367	70,723	255,639	285,549
Cap ex	(271,706)	(238,140)	(56,467)	(54,056)	(77,540)	(79,355)	(267,418)	(62,135)	(54,999)	(77,500)	(105,000)	(299,634)	(320,000)
Acq. of water & wastewater systems	(11,848)	(51,226)	0	(1,600)	(12,625)	(434)	(14,659)	(290)	(880)	(10,000)	(10,000)	(21,170)	(40,000)
Divestiture gains							0			0	0	0	0
Other investing activities	58,205	(54,678)	18,062	13,124	4,427	7,693	43,306	23,794	5,773	0	0	29,567	50,000
Investing cash flow	(225,349)	(344,044)	(38,405)	(42,532)	(85,738)	(72,096)	(238,771)	(38,631)	(50,106)	(87,500)	(115,000)	(291,237)	(310,000)
Customer adv and CIAC	12,031	9,605	1,769	2,097	1,466	1,033	6,365	581	1,943	2,000	2,000	6,524	8,000
Long-term debt proceeds	103,360	275,757	56	15,386	1,408	35,891	52,741	303	3,402	20,000	75,000	98,705	75,000
Debt (repaid)	(43,961)	(109,219)	13,401	(25,707)	21,013	(24,074)	(15,367)	1,897	10,942	0	0	12,839	0
Stock issued	58,088	10,399	2,628	25,009	2,731	2,929	33,297	2,879	3,017	2,500	2,500	10,896	10,000
Stock (repurchased)	(972)	(863)	(283)	(12)	(3)	(99)	(397)	(300)	0	0	0	(300)	0
Dividends	(58,023)	(63,763)	(16,678)	(16,705)	(16,875)	(18,246)	(68,504)	(18,283)	(18,313)	(18,395)	(19,787)	(74,778)	(80,398)
Other financing activities	16,267	(1,539)	(4,393)	6,640	(936)	8,223	9,534	(9,342)	2,340	0	0	(7,002)	0
Financing cash flow	86,790	120,377	(3,500)	6,708	8,804	5,657	17,669	(22,265)	3,331	6,105	59,713	46,884	12,602
Net cash flow	32,167	(29,499)	1,969	(1,709)	1,168	(1,024)	404	1,800	(2,922)	(3,029)	15,437	11,286	(11,848)
Free cash flow (incl div)	(112,646)	(213,639)	(11,209)	(25,122)	(24,511)	(24,927)	(85,769)	5,782	(24,566)	(27,529)	(64,063)	(110,376)	(104,848)
FCF/share	(\$0.85)	(\$1.60)	(\$0.08)	(\$0.19)	(\$0.18)	(\$0.18)	(\$0.64)	\$0.04	(\$0.18)	(\$0.20)	(\$0.47)	(\$0.82)	(\$0.77)
EBITDA	280,588	304,027	62,870	74,760	99,198	83,273	320,101	75,908	86,900	99,920	94,952	357,680	394,419
EBITDA margin	52.6%	50.5%	45.1%	49.6%	56.0%	52.1%	51.1%	49.1%	51.9%	55.3%	53.0%	52.5%	54.4%
EBITDA/share	2.1x	2.3x	0.5x	0.6x	0.7x	0.6x	2.4x	0.6x	0.6x	0.7x	0.7x	2.7x	2.9x
EV/EBITDA	13.9x	13.3x	14.8x	11.2x	9.1x	12.1x	12.5x	12.9x	10.5x	10.2x	11.3x	11.9x	11.1x
Selected Financial Statistics	FY'06	FY'07	Q1'08	Q2'08	Q3'08	Q4'08	FY'08	Q1'09A	Q2'09A	Q3'09E	Q4'09E	FY'09E	FY'10E
Book value	\$6.99	\$7.31	\$7.32	\$7.62	\$7.60	\$7.81	\$7.86	\$7.82	\$7.91	\$7.89	\$7.88	\$7.99	\$7.85
Tangible book value	\$6.82	\$7.03	\$7.05	\$7.35	\$7.32	\$7.50	\$7.55	\$7.52	\$7.61	\$7.59	\$7.58	\$7.68	\$7.55
Price/book	3.3x	2.9x	2.6x	2.1x	2.3x	2.6x	2.6x	2.6x	2.3x	2.7x	2.8x	2.8x	2.8x
LT debt/total capital	50.8%	55.4%	55.3%	54.3%	54.1%	54.1%	54.1%	53.6%	53.3%	53.5%	54.9%	54.9%	56.3%
ROE (TTM)	10.6%	10.0%	9.6%	9.2%	9.7%	9.6%	9.6%	9.8%	10.0%	9.7%	10.2%	10.3%	12.3%

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

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

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	44	26%	2%	98%
Long-term Buy	35	21%	0%	100%
Neutral	83	49%	5%	95%
Underperform	7	4%	14%	86%

As of 2 October 2009

Other Disclosures

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