

COMPANY UPDATE/ESTIMATE CHANGE

Key Metrics

WTR - NYSE (as of 5/6/10)	\$17.75
Price Target	\$23.00
52-Week Range	\$18.94-\$15.39
Shares Outstanding (mm)	136.8
Market Cap. (\$mm)	\$2,418.8
3-Mo. Average Daily Volume	752,206
Institutional Ownership	47.4%
Debt/Total Capital (3/10)	54.7%
ROE (3/10)	9.6%
Book Value/Share (3/10)	\$8.45
Price/Book Value	2.1x
Dividend Yield	3.3%
LTM EBITDA Margin	52.7%

EPS FY 12/31

	2009A	Prior 2010E	Curr. 2010E	Prior 2011E	Curr. 2011E
1Q	\$0.14	--	\$0.16A	--	--
2Q	\$0.19	\$0.22	\$0.22E	--	--
3Q	\$0.25	\$0.27	\$0.27E	--	--
4Q	\$0.20	\$0.23	\$0.23E	--	--
Year	\$0.77	\$0.87	\$0.88E	\$0.94	\$0.94E
P/E	23.1x		20.2x		18.9x

Revenue (\$mm)

	2009A	Prior 2010E	Curr. 2010E	Prior 2011E	Curr. 2011E
1Q	\$154.5	--	\$160.5A	--	--
2Q	\$167.3	\$180.5	\$180.5E	--	--
3Q	\$180.8	\$198.9	\$198.9E	--	--
4Q	\$167.9	\$187.3	\$187.3E	--	--
Year	\$670.5	\$731.3	\$727.2E	\$740.9	\$740.9E

Company Description: Aqua America is a water and wastewater utility holding company with operating subsidiaries serving approximately three million people in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, New York, Indiana, Florida, Virginia, Maine, Missouri, South Carolina, and Georgia. The company's history spans over 100 years.

Aqua America Inc.

WTR -- NYSE -- Buy-2

Inline Q1 Results with Rate Cases, Acquisitions, and Weather all Possible Catalysts in 2010
Investment Highlights

- WTR reported Q1'10 EPS of \$0.15 (excluding ~\$0.01 from an after-tax gain) versus \$0.14 in the year ago period, matching our and the consensus estimate.
- Revenue came in 3.9% above last year at \$160.5 million compared to our \$164.6 million estimate. O&M improved 130 bps – We were looking for 110 bps of improvement, and believe further margin expansion is likely in 2010.
- The company has ~\$65 million in pending rate cases, and plans to file for an additional ~\$20 million in 2010.
- The company has made 8 small acquisitions year to date, which could be the precipice of industry-wide consolidation we have been predicting.
- Recall that WTR faces easy comparisons in 2010, given difficult weather conditions and record setting precipitation in the northeast in 2009.
- We are increasing our FY'10 EPS estimate by a penny to \$0.88 but making no change to our FY'11 EPS estimate of \$0.94.

Note Important Disclosures on Pages 5 and 6.
Note Analyst Certification on Page 5.

ADDITIONAL DISCUSSION***First Quarter Results***

Aqua America reported Q1 EPS of \$0.15 (excluding ~\$0.01 from after-tax sale of investments) versus \$0.14 in the year ago period, matching our and the consensus estimate. Revenue rose 3.9% to \$160.5 million compared to our \$164.5 million estimate, driven by new rates. O&M (Operations & Maintenance) expenses rose just 0.9% to \$67.6 million and as a percentage of revenue improved 130 basis points to 42.1% - and management expects continued margin improvement as well. Depreciation actually declined negligibly to \$26.2 million, flat with Q4 although the year ago level was somewhat inflated. Operating income increased 8.4% to \$50.7 million.

Long-term debt was \$1.4 billion at quarter's end, flat with the yearend level, and as a percentage of total capitalization declined 90 basis points to 54.7%. (The company's target equity ratio is ~45%.) During the quarter WTR had ~\$67 million in capital expenditures compared to ~\$62 million in the year ago period, and the company anticipates approximately ~\$300 million in cap ex in 2010 focused on pipe replacement projects. It will also be focusing on refinancing 7%-9% interest rate bearing debt while rates are attractive, and a small equity raise in late 2010/early 2011 is likely, which would probably be in the 1.0-1.5 million share range (~\$18-\$27 million at the current share price) and exclusive of any benefits from the company's DRIP program.

Valuation

We are raising our FY'10 EPS estimate by a penny to \$0.88 and making no change to our FY'11 EPS estimate of \$0.94. On the call management commented that it believes a 10% EBITDA CAGR is possible - we had 9%+ modeled, so our forecast may be slightly conservative. The company will also be filing for ~\$20 million in new rates in 2010, and once we have more details, an upward revision to our 2011 estimate is likely, depending on the timing.

We are maintaining our \$23 price target, which we derive by applying a multiple of 24x to our 2011 earnings estimate, which is at the low end of multiples where the company typically trades. The stock is currently trading at 20.2x and 18.9x our 2010 and 2011 EPS estimates, respectively.

Outlook

Q1 makes the smallest contribution to overall results due to seasonality, and this was a rather straightforward quarter with no surprises. Having said that, the outlook has improved and we believe the earnings potential at the company is significant for the foreseeable future. WTR has ~\$65 million in rate cases pending, and it will likely file for an additional ~\$20 million this year (with the bulk being filed in 2H'10). Efficiency ratio improvement is expected, which could easily be supported by improved weather and new rates not having complementary expenses and management believes 50-100 bps of O&M improvement is possible this year. Usage is beginning to pick up and the commercial and industrial markets are showing signs of improvement. The housing market is stabilizing in the company's footprint, and no charges from the healthcare reform bill are anticipated.

We believe consolidation could be a meaningful driver of growth in the group, and that WTR will benefit more than all others in the industry. The company has made 8 small tuck-in acquisitions year to date, and believes this number could end up in the 25-30 range for the year. Part of what should drive acquisitions is the issues facing municipalities, as many are struggling to meet budgets with declining tax revenues. As the infrastructure continues to deteriorate, you can only defer maintenance for so long. Some municipalities are of the mentality of letting the next mayor deal with the problem - with many questioning why they want to be in the water business. Some still continue to wait for free money - and

even WTR has received about \$3 million but made the comment that all the red tape involved almost made it not worth it, and believes this practice is likely to stop by yearend.

We also remind investors that following last year's difficult weather conditions and record setting precipitation in the northeast, the industry faces much easier comparisons in 2010. This could mean related to weather, any reversion to the mean in 2010 could be a significant lever to earnings. The higher revenue generating months in Q2 and Q3 are approaching fast as consumers will soon begin to fill swimming pools, water lawns, and wash cars – and any of the looming catalysts could translate to multiple expansion with an increase in share price.

CONSIDERATIONS AND RISKS

- 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'07	FY'08	Q1'09	Q2'09	Q3'09	Q4'09	FY'09	Q1'10A	Q2'10E	Q3'10E	Q4'10E	FY'10E	FY'11E
Operating revenues	\$602,499	\$626,972	\$154,487	\$167,333	\$180,826	\$167,893	\$670,539	\$160,517	\$180,485	\$198,949	\$187,288	\$727,238	\$740,890
Costs and expenses:													
Operation and maintenance	253,092	262,122	66,989	68,549	68,488	66,034	270,060	67,601	72,194	77,590	76,788	294,173	285,823
Depreciation	83,178	88,785	26,387	24,972	25,436	26,206	103,001	26,200	26,200	26,200	26,200	104,800	112,000
Amortization	4,833	5,515	2,755	3,064	3,029	3,090	11,938	3,172	3,100	3,100	3,100	12,472	12,300
Taxes other than income taxes	45,380	44,749	11,590	11,884	12,418	12,189	48,081	12,860	11,732	12,733	11,237	48,561	48,677
Operating income	386,483	401,171	107,721	108,469	109,371	107,519	433,080	109,833	113,226	119,623	117,325	460,006	458,800
Other expense (income):													
Interest expense (net)	66,921	68,572	16,628	16,809	17,256	17,914	68,607	18,430	18,430	18,430	18,430	73,720	69,200
Allow. for funds used dur. const.	(2,953)	(3,674)	(625)	(568)	(747)	(931)	(2,871)	(1,541)	(900)	(700)	(1,100)	(4,241)	(3,600)
Gain on sale of water system													
Gain on sale of other assets	(3,494)	(1,599)	(133)	(80)	(162)	(97)	(472)	(1,929)	(600)	(200)	(300)	(3,029)	(1,200)
Income before income taxes	155,542	162,502	30,896	42,703	55,108	43,488	172,195	35,724	50,330	61,796	52,932	200,782	217,690
Provision for income taxes	60,528	64,584	12,525	16,850	21,638	16,829	67,842	14,213	19,880	24,718	20,379	79,191	86,136
Net income	95,014	97,918	18,371	25,853	33,470	26,659	104,353	21,511	30,449	37,078	32,553	121,591	131,554
Dividends on preferred stock													
Net income available to common stk.	\$95,014	\$97,918	\$18,371	\$25,853	\$33,470	\$26,659	\$104,353	\$21,511	\$30,449	\$37,078	\$32,553	\$121,591	\$131,554
Net income	95,014	97,918	18,371	25,853	33,470	26,659	104,353	21,511	30,449	37,078	32,553	121,591	131,554
Other comp. income (loss), net of tax:													
Unreal. hold. gain (loss) on certain inv.	1,121	195	37	232	(142)	162	289	902					
Minimum pension liability adjustment													
Unrealized gains on securities													
Reclass. adj. for gains reported	(1,315)	(209)		5			5	(1,330)					
Comprehensive income	\$94,820	\$97,904	\$18,408	\$26,090	\$33,328	\$26,821	\$104,647	\$21,083	\$30,449	\$37,078	\$32,553	\$121,591	\$131,554
EPS (FD)	\$0.71	\$0.73	\$0.14	\$0.19	\$0.25	\$0.20	\$0.77	\$0.16	\$0.22	\$0.27	\$0.24	\$0.89	\$0.94
Diluted average shares outstanding	133,602	134,705	135,876	135,939	136,260	136,510	136,129	136,800	137,000	137,200	137,400	136,707	140,589
Cash div. per share of com. stk.	\$0.480	\$0.510	\$0.135	\$0.135	\$0.135	\$0.145	\$0.550	\$0.145	\$0.145	\$0.145	\$0.152	\$0.587	\$0.587
Rate of Change Analysis:													
Revenues	12.9%	4.1%	10.9%	11.0%	2.1%	5.0%	6.9%	3.9%	7.9%	10.0%	11.6%	8.5%	1.9%
Operating income	5.1%	4.5%	16.3%	10.8%	-4.2%	4.3%	5.2%	8.4%	14.3%	11.0%	15.9%	12.5%	5.6%
EPS	1.4%	2.8%	27.3%	11.8%	-3.8%	5.3%	5.5%	14.3%	17.0%	8.1%	18.5%	15.5%	5.2%
EBITDA	8.4%	5.3%	20.7%	16.2%	0.7%	7.7%	10.1%	5.5%	11.1%	8.7%	10.7%	9.1%	5.7%
Margin Analysis:													
O&M	42.0%	41.8%	43.4%	41.0%	37.9%	39.3%	40.3%	42.1%	40.0%	39.0%	41.0%	40.5%	38.6%
D&A	14.6%	15.0%	18.9%	16.8%	15.7%	17.4%	17.1%	18.3%	16.2%	14.7%	15.6%	16.1%	16.8%
Taxes other than inc. taxes	7.5%	7.1%	7.5%	7.1%	6.9%	7.3%	7.2%	8.0%	6.5%	6.4%	6.0%	6.7%	6.6%
Operating income	35.9%	36.0%	30.3%	35.2%	39.5%	36.0%	35.4%	31.6%	37.3%	39.9%	37.4%	36.7%	38.1%
Net income	15.7%	15.6%	11.9%	15.6%	18.4%	16.0%	15.6%	13.1%	16.9%	18.6%	17.4%	16.7%	17.8%
Tax rate	38.9%	39.7%	40.5%	39.5%	39.3%	38.7%	39.4%	39.8%	39.5%	40.0%	38.5%	39.4%	39.6%

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.

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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	46	26%	2%	98%
Long-term Buy	38	22%	0%	100%
Neutral	83	48%	6%	94%
Underperform	6	3%	0%	100%
Not Rated	1	1%	0%	100%

As of 12 April 2010

Other Disclosures

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