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**Reports 2Q10 Results; Reiterate Buy Rating and \$26 Target Price**

**Buy**  
**Target Price: \$26**

**Investment Summary**

Aqua America reported 2Q10 results that essentially matched our expectations. Revenue in the quarter of \$178.4 million (a 6.6% YoY increase) slightly beat our \$177 million estimate, and EPS of \$0.22 met our Street-high estimate. Net income of \$29.9 million increased 15.5% YoY. Contributing to the strong performance was the company's ability to earn a fair return on capital investments as well as management's ability to control costs, as operating and maintenance expenses increased only 1.1% YoY. As an added bonus, the Board of Directors announced a dividend increase, the 20<sup>th</sup> in 19 years. We reiterate our Buy rating and \$26 target price, based on the shares attaining a level of 27x our 2011 EPS estimate of \$0.96.

**Discussion**

- **A great quarter, as expected.** Aqua America posted 2Q10 revenue of \$178.4 million, which was up 6.6% from the same quarter last year, and came in ahead of our \$177 million estimate. EPS in the quarter of \$0.22 met our Street-high expectations, as net income for the quarter increased 15.5% to a record \$29.9 million. Again, perhaps the most impressive factor in the quarter was management's ability to control costs, as operations and maintenance expenses grew only 1.1%, and the O&M to revenue ratio dropped to 38.8% from 41.0% in the same quarter last year.
- **Rate case update.** Thus far in 2010, WTR received rate awards in Pennsylvania, New Jersey, New York, North Carolina, Missouri, Ohio, Indiana, Maine, and Virginia, which combined increase the annualized revenue approximately \$43.7 million. Further, another \$13.7 million of rate cases is before four state regulatory bodies, and subsidiaries are expected to seek rate relief by filing more than \$28.5 million later in 2010 that would positively impact 2011 and 2012 results.
- **More acquisition activity.** Last year, the company closed 18 acquisitions. This year the company is expecting to complete between 25 – 30 acquisitions, with 12 completed thus far in 2010. Opportunities are materializing throughout all of the company's service territories.
- **Dividend increase.** The Board of Directors announced a dividend increase of 6.9% to \$0.155 per share for the December 1, 2010 quarterly dividend to all shareholders of record on November 17, 2010. This was the 20<sup>th</sup> increase in the last 19 years.
- **Adjusting estimates.** We have made the following changes to our forward estimates: our 2010 EPS estimate is now \$0.87 from \$0.89, and our 2011 EPS estimate is now \$0.96 from \$0.98. We consider our changes immaterial from a valuation perspective.

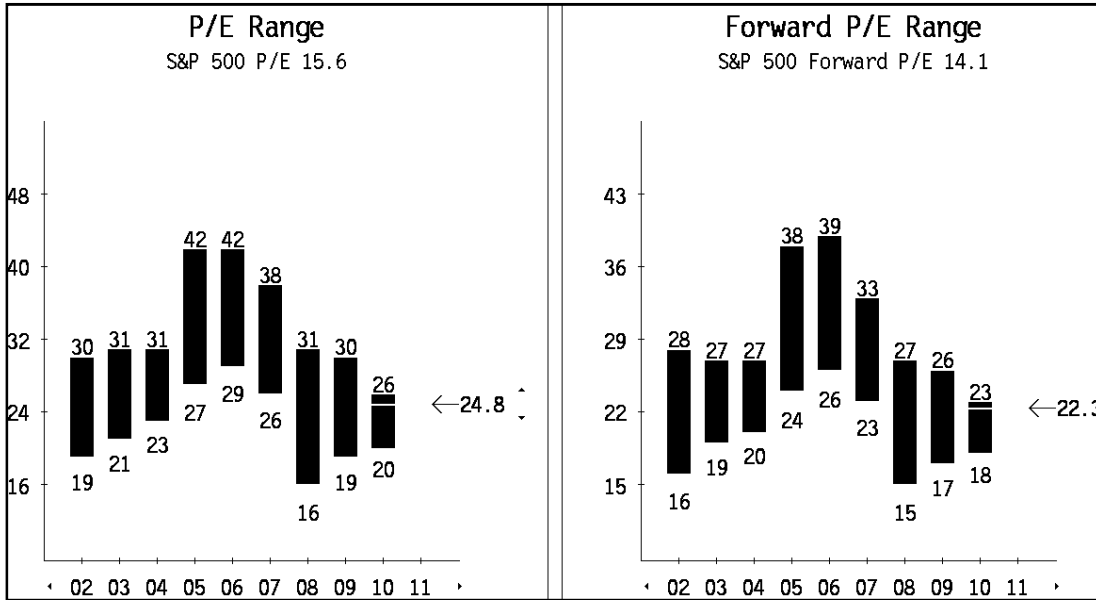
Price	\$19.87		
52-Week High/Low	\$20.08 - 15.39		
Shares Outstanding (mm)	136.96		
Market Cap. (mm)	\$2,721.30		
Average Daily Volume (mm)	0.89		
<b>EPS</b>	<b>FY09A</b>	<b>FY10E</b>	<b>FY11E</b>
Mar	\$0.14	\$0.16A	\$0.19
<i>Prior</i>	-	-	\$0.20
Jun	\$0.19	\$0.22A	\$0.24
Sep	\$0.25	\$0.28	\$0.29
Dec	\$0.20	\$0.22	\$0.24
<i>Prior</i>	-	\$0.24	\$0.25
<b>FY</b>	<b>\$0.77</b>	<b>\$0.87</b>	<b>\$0.96</b>
<i>Prior</i>	-	\$0.89	\$0.98
Consensus	-	\$0.88	\$0.96
P/E	25.9x	22.8x	20.6x
FY Rev. (mm)	\$670.54	\$715.71	\$772.96

Source: BigCharts.com

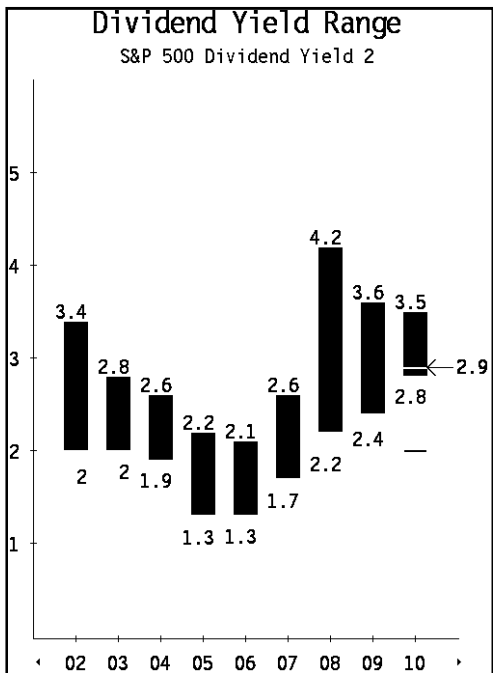
**Valuation.** With the shares now trading at 20.6x our 2011 EPS estimate of \$0.96, we consider them attractively priced at current levels. The company has once again proven itself to be the model of consistency. We recommend investors add to or take new positions, especially given the shares now trade toward the bottom of historical P/E ranges and carry a 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 \$0.96

**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	3Q10E	% Rev or Margin	4Q10E	% Rev or Margin	2010E	% Rev or Margin	
<b>Sales</b>	160,517		178,444		197,100		179,646		715,707		
Operating & maintenance	67,601	42.1%	69,310	38.8%	74,898	38.0%	68,445	38.1%	280,254	39.2%	
Depreciation	26,200	16.3%	26,802	15.0%	27,003	13.7%	27,126	15.1%	107,131	15.0%	
Amortization	3,172	2.0%	3,314	1.9%	3,351	1.7%	2,874	1.6%	12,711	1.8%	
Non-income taxes	12,860	8.0%	12,943	7.3%	13,206	6.7%	13,114	7.3%	52,123	7.3%	
<b>Operating income</b>	<b>50,684</b>	<b>31.6%</b>	<b>66,075</b>	<b>37.0%</b>	<b>78,643</b>	<b>39.9%</b>	<b>68,086</b>	<b>37.9%</b>	<b>263,488</b>	<b>36.8%</b>	
Interest expense, net	18,430	11.5%	18,504	10.4%	18,922	9.6%	19,042	10.6%	74,898	10.5%	
AFC	(1,541)	-1.0%	(1,461)	-0.8%	(1,500)	-0.8%	(1,000)	-0.6%	(5,502)	-0.8%	
Gain on sale of other assets	(1,929)	-1.2%	(110)	-0.1%	(1,000)	-0.5%	(500)	-0.3%	(3,539)	-0.5%	
Income before taxes	35,724	22.3%	49,142	27.5%	62,221	31.6%	50,543	28.1%	197,631	27.6%	
Income taxes	14,213	39.8%	19,287	39.2%	24,391	39.2%	20,217	40.0%	78,108	39.5%	
<b>Net income</b>	<b>21,511</b>	<b>13.4%</b>	<b>29,855</b>	<b>16.7%</b>	<b>37,831</b>	<b>19.2%</b>	<b>30,326</b>	<b>16.9%</b>	<b>119,523</b>	<b>16.7%</b>	
<b>Earnings per share</b>	<b>\$0.16</b>		<b>\$0.22</b>		<b>\$0.28</b>		<b>\$0.22</b>		<b>\$0.87</b>		
Shares outstanding (000)	136,800		137,012		137,112		137,212		137,034		

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	
<b>Sales</b>	173,358		192,720		212,868		194,017		772,963		
Operating & maintenance	68,997	39.8%	76,124	39.5%	83,019	39.0%	76,055	39.2%	304,194	39.4%	
Depreciation	27,217	15.7%	27,366	14.2%	28,099	13.2%	27,550	14.2%	110,232	14.3%	
Amortization	2,947	1.7%	3,084	1.6%	3,193	1.5%	3,298	1.7%	12,522	1.6%	
Non-income taxes	13,002	7.5%	13,298	6.9%	13,624	6.4%	13,387	6.9%	53,310	6.9%	
<b>Operating income</b>	<b>61,196</b>	<b>35.3%</b>	<b>72,848</b>	<b>37.8%</b>	<b>84,934</b>	<b>39.9%</b>	<b>73,727</b>	<b>38.0%</b>	<b>292,704</b>	<b>37.9%</b>	
Interest expense, net	19,243	11.1%	19,465	10.1%	20,010	9.4%	19,790	10.2%	78,507	10.2%	
AFC	(1,000)	-0.6%	(1,000)	-0.5%	(1,000)	-0.5%	(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%	66,325	31.2%	55,337	28.5%	219,798	28.4%	
Income taxes	17,341	40.0%	21,475	39.2%	25,999	39.2%	21,858	39.5%	86,674	39.4%	
<b>Net income</b>	<b>26,012</b>	<b>15.0%</b>	<b>33,308</b>	<b>17.3%</b>	<b>40,326</b>	<b>18.9%</b>	<b>33,479</b>	<b>17.3%</b>	<b>133,124</b>	<b>17.2%</b>	
<b>Earnings per share</b>	<b>\$0.19</b>		<b>\$0.24</b>		<b>\$0.29</b>		<b>\$0.24</b>		<b>\$0.96</b>		
Shares outstanding (000)	137,312		137,412		137,512		137,612		138,175		

Company reports, BMC Research

**Important Disclosures**

**Ratings and Target Price History**



All prices are as of the market close on 8/4/2010.

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- 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	136	68.69%	19	13.97%
HOLD	53	26.77%	1	1.89%
SELL	5	2.53%	0	0%
NOT RATED	4	2.02%	0	0%
TOTAL	198			

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

## Valuation Methodology and Risks

**Aqua America (WTR):** Our target price of \$26 is based on the shares attaining a P/E multiple of 26x 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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