

Mid-Atlantic Institutional Research
Aqua America, Inc. (NYSE: WTR - \$17.64)
Analyst Day Review and Adjustment of Estimates
Maintain Market Outperform

October 1, 2009

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Long Term Rating: Market Outperform

Long Term Target Price: \$26

Investment Summary: On Tuesday Aqua America held an analyst day meeting in New York and provided a detailed overview of its operations. The meeting was well attended and the presentation was upbeat. Aqua highlighted the strong outlook for the water utility industry which gives management confidence that the company is still in the early innings of meaningful bottom-line growth. We agree with this view and believe this strong earnings growth potential has legs through 2010 and beyond. Overall, we felt that the company gave a solid presentation and we walked away from the meeting feeling bullish on the story. We are maintaining our Market Outperform rating on the stock and maintaining our \$26 price target.

Key Points

- **Aqua held an analyst meeting in New York this past Tuesday and we left feeling bullish on the story.** Our positive stance following the meeting is based on a few key takeaways - 1) The company is continuing to invest in its infrastructure which should translate into strong top-line growth, 2) Aqua's acquisition activity continues and should add not only add to its already large customer base, but it should also diversify the company geographically, 3) Management will continue to focus on its pruning policy with a laser like focus in order to divest underperforming assets that are negatively impacting earnings.
- **The company has made solid progress in cutting costs and will continue to take steps in order to reduce its expenses moving forward.** In Q408's earnings conference call, management indicated that the company intends to decrease its operating and maintenance (O&M) margin by over 100 basis points in 2009 versus 2008 not just through revenue growth, but also by cost reduction. Aqua intends to do so with various initiatives such as continuing to implement smart meters to reduce its staff of meter readers, change over its fleet of trucks to smaller and more fuel efficient vehicles and by striving to lower its chemical costs for water treatment.
- **Acquisition activity continues.** Aqua has an active acquisition strategy which has led to meaningful customer growth over the past two decades. With a fragmented water utility industry consisting of many smaller systems that are facing rising CapEx requirements, increased expenses and more stringent environmental standards, more and more smaller municipalities are considering selling their respective water system to larger water utilities such as Aqua America. Not only will this allow Aqua to increase its customer base, but it also exposes the company to faster growing markets such as Texas and also allows the company to invest in the acquired system's infrastructure—leading to the application of further rate relief. Our model does not account for customer growth through acquisitions, thus, any acquisition the company makes will positively impact our top-line estimate.

(continued on page 3)

Share Information

Price 9/30	\$17.64
52 Wk Lo-Hi	\$12.20-\$22.00
Div Yield	3.40%
Avg. Volume	683,072
Insiders Own	5.7%
S&P 500	1,057.08

Financial Statistics

Equity Mkt. Cap.	\$2.4B
'08 LTD/Cap.	54.1%
Ent. Value	\$3.7B
10 Yr. Treasury	3.3%
'08 FCF Yield	N/A

EPS

	EPS	P/E
2007A	\$0.71	24.8x
2008A	\$0.73	24.2x
2009E	\$0.78	22.6x
2010E	\$0.92	19.2x

EBITDA

	EBITDA	EV/EBITDA
2007A	\$304M	12.2x
2008A	\$320M	11.6x
2009E	\$355M	10.4x
2010E	\$384M	9.6x

Relative Daily Price 9/30/09


Source: BigCharts, Company Reports and Sturdivant & Co. Estimates.

STOCK PRICE PERFORMANCE

Rating and Price Target History for Aqua America, Inc. (WTR)



Source: BigCharts

MO: Market Outperform; T: Target

Mr. Verdi does not own shares of Aqua America

DISCLOSURES

Rating System Definitions

Sturdivant & Co.'s stock ratings system reflects the investment decisions our clients face every day, and is meant to assist clients in making these decisions by recommending a specific action to take with each stock we cover. All of the ratings correspond to a specific investment action that we recommend taking on the date the research is published. Thus, "Outperform" (equivalent to "Buy") ratings are reserved only for stocks that we would be actively buying at the time the research is published. "Marketperform" (equivalent to "Hold") ratings are reserved for stocks that we believe are in line with the market's anticipated performance and we recommend holding. "Underperform" (equivalent to "Sell") ratings are assigned to stocks where the analyst anticipates stock price declines relative to the market. Please note also that the price expectations that determine the rating are in absolute dollar terms, not in terms of relative performance to a sector or an index. Therefore, analysts will not use the "Outperform" rating for stocks that are expected to perform well relative to their sector but only for stocks that are expected to appreciate in actual dollar returns.

Research Analyst Compensation

Analyst compensation is based on: (1) the analyst's productivity, including the quality of the analyst's research and the analyst's contribution to the growth and development of our overall research effort; (2) ratings and direct feedback from our investing clients, our sales force and from independent rating services. Sturdivant & Co.'s Compliance and Research Departments are responsible for establishing these compensation guidelines and for reviewing and approving senior analyst compensation. Analyst contribution to our investment banking business is not a factor in determining analyst compensation and compensation is not, directly or indirectly, related to the specific recommendations or views expressed in the report.

Research Analyst Certification

The senior research analyst(s) certifies that the views expressed in this research report and/or financial model accurately reflect such senior analyst's personal views about the subject securities or issuers and that no part of his or her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report. Mr. Verdi does not own shares of Aqua America. This is not a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy. The Dow Jones Industrial Average, S&P 500, S&P 400 and Russell 2000 are examples of unmanaged common stock indices used to measure and report performance of various sectors of the stock market; direct investment in indices is not available. A complete listing of all companies covered by Sturdivant & Co., Inc. and applicable research disclosures can be obtained from the Company.

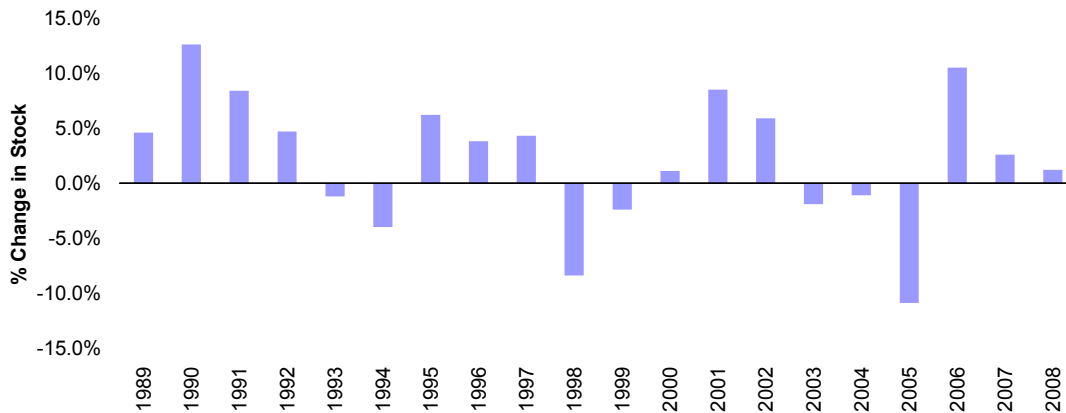
Price Target Risks

Investment risks associated with the achievement of the price target include, but are not limited to, the company's failure to achieve our earnings and revenue estimates, unforeseen macroeconomic and/or industry events that adversely impact demand for the company's products or services, product obsolescence, changes in investor sentiment regarding the specific company or industry, intense and rapidly changing competitive pressures, the continuing development of industry standards, the company's ability to compete for talent, and adverse market conditions. For a complete discussion of the risk factors that could affect the market price of the company's shares, refer to the most recent form 10-Q or 10-K that the company has filed with the SEC.

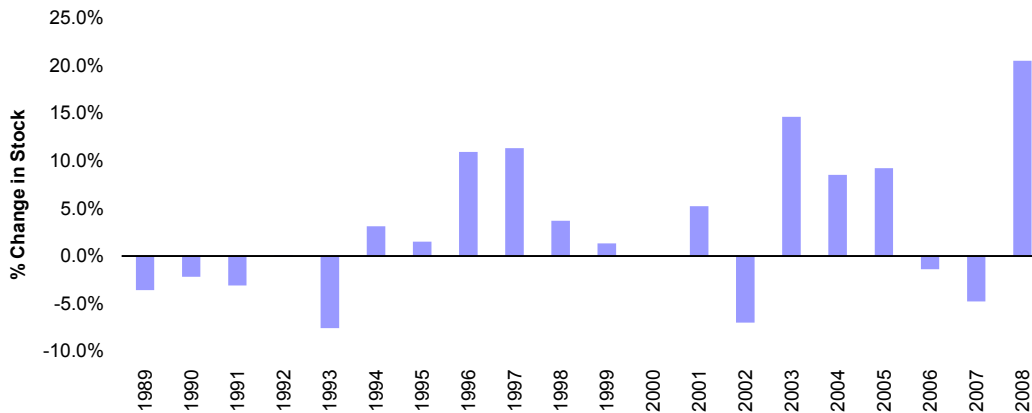
Additional Supporting Points

- **Extensive need for infrastructure improvement should drive rate base growth.** During the presentation, Chief Financial Officer (CFO) David Smeltzer discussed the company’s average annual capital investment program. Aqua is budgeting for \$275 million in CapEx from 2007 to 2011 to repair or replace items such as pipes and meters and to comply with the strict environmental standards for water quality. This should set the stage for increased earnings moving forward as the company applies for future rate relief in order to recoup its expenditures. So far this year, the company has received \$27.4 million in rate relief and has or intends to file for an additional \$59.9 million. While we have already accounted for this relief in our model, we found comfort in the fact that the company indicated during its presentation that these plans have not changed.
- **Adjusting estimates downward again.** Two weeks ago, we issued a note adjusting our estimates downward due to unfavorable weather patterns during Q309. On that note, we adjusted our Q309 revenue forecast downward to \$183.3 million from \$191.3 million which led to a decline in our diluted EPS estimate of \$0.02 to \$0.25. During Tuesday’s event, management indicated that Q309 diluted earnings will probably be \$0.24. As a result of this indication, we are decreasing our Q309 revenue projection to \$182.4 million and in turn, our new earnings estimate for Q309 is \$0.24. For the FY2009, our revenue estimate falls to \$674.9 million from \$675.7 million and our diluted earnings estimate is now \$0.78. The adjustments made to our earnings forecast are insignificant from a valuation perspective.
- **We believe October would be a good time for investors to own the stock.** While past performance is not indicative of future results, history does have a way of repeating itself. On that note, seasonal patterns suggest Aqua may perform well in October and November. The stock has been up 13 of the last 20 Octobers (65% of the time) with an average return of 2.2% and in November the stock has been up 12 of the last 20 Novembers (60%) with an average return of 3.0%. With the market rally maturing, now may be the time for investors to revisit the name in both the short- and long-term. We would be buyers now.

Figure 1: Aqua’s October Returns (1989-2008)



Source: Bloomberg, Sturdivant & Company Equity Research

Figure 2: Aqua's November Returns (1989-2008)

Source: Bloomberg, Sturdivant & Company Equity Research

- Maintaining Market Outperform rating and \$26 price target.** We continue to consider Aqua America one of our favorite picks under our coverage umbrella. The company's solid and relatively consistent operating performance, strong customer growth potential and sound management team all together make WTR an essential investment in any portfolio. Our one-year price target of \$26 is based on a blended approach of P/E, EV/EBITDA and EV/R valuation analysis. At current trading levels, we believe valuation is compelling and recommend potential investors to build positions in the stock now and for current investors to continue to accumulate shares of the company.

Investment Risks

If the company experiences any or all of the following risk factors, as well as others, the company's stock price may be affected.

- The rates Aqua America charges its customers are subject to government regulation.** If Aqua is unable to obtain government approval for its rate increase requests or if approved rate increases are untimely or inadequate to cover the company's capital investments and to recover expenses, the company's profitability may suffer.
- Aqua requires significant capital expenditures that are dependent on the company's ability to secure appropriate funding.** If Aqua is unable to obtain sufficient capital or if the cost of borrowing increases, it may materially and adversely affect the company's financial condition and results of operations.
- Federal and state environmental laws and regulations impose substantial compliance requirements on Aqua's operations.** The company's operating costs could be significantly increased in order to comply with new or stricter regulatory standards imposed by federal and state environmental agencies.
- Aqua's business is impacted by weather conditions and is subject to seasonal fluctuations which could adversely affect demand for its water service and its revenues.**
- Drought conditions and government imposed water use restrictions may impact Aqua's ability to serve current and future customers.** This may adversely affect the company's financial condition and results of operations.
- An important element of Aqua's growth strategy is the acquisition of water and wastewater systems.** Any future acquisitions may involve risks.

Aqua America, Inc.
Income Statement
(in millions except per share data)

Sturdivant & Co.
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December Fiscal Year	FY 2005		FY 2006		FY 2007		FY 2008		FY 2009		FY 2010		
	Year	Year	Year	Year	Year	Year	Year	Year	Year	Year	Year	Year	
Revenue	\$496.8	\$533.5	\$602.5	\$139.3	\$150.8	\$177.1	\$159.8	\$627.0	\$154.5	\$167.3	\$182.4	\$170.6	\$724.6
Operating & Maintenance	203.1	219.6	253.1	64.3	65.1	66.7	65.9	262.1	67.0	68.5	71.1	66.5	273.2
Depreciation	60.7	70.9	83.2	21.5	20.6	22.8	23.9	88.8	26.4	25.0	25.0	25.0	101.4
Amortization	4.7	4.1	4.8	1.2	1.0	1.8	1.5	5.5	2.8	3.1	3.0	3.0	11.8
Non-Income Taxes	31.7	33.3	45.4	12.1	10.8	11.2	10.6	44.7	11.6	11.9	11.8	11.8	47.0
Operating Income	196.5	205.5	216.0	40.2	53.1	74.6	57.9	225.8	46.8	58.9	71.5	64.3	241.5
Interest Expense, Net	(52.1)	(58.4)	(66.9)	(17.1)	(17.1)	(17.0)	(17.4)	(88.6)	(16.6)	(16.8)	(16.9)	(16.9)	(67.1)
Allow. for Funds for Construction	2.4	3.9	3.0	1.0	1.1	1.0	0.6	3.7	0.6	0.6	0.6	0.6	2.4
Gain on Sale of Other Assets	1.2	1.2	3.5	0.0	0.6	0.5	0.5	1.6	0.1	0.1	0.1	0.1	0.5
Income Before Taxes	148.1	152.3	155.5	24.0	37.7	59.1	41.7	162.5	30.9	42.7	55.4	48.2	177.2
Income Taxes	56.9	60.2	60.5	9.7	15.2	23.7	16.0	64.6	12.5	16.9	22.2	19.3	70.8
Net Income	91.2	92.0	95.0	14.3	22.6	35.4	25.7	97.9	18.4	25.9	33.2	28.9	106.4
Diluted EPS	\$0.71	\$0.70	\$0.71	\$0.11	\$0.17	\$0.26	\$0.19	\$0.73	\$0.14	\$0.19	\$0.24	\$0.21	\$0.78
Diluted Shares Outstanding	129.6	132.0	133.6	134.0	134.1	135.3	135.6	134.7	135.9	135.9	136.2	136.4	136.1

Margin Analysis

Operating & Maintenance	40.9%	41.2%	42.0%	46.2%	43.2%	37.7%	41.2%	41.8%	43.4%	41.0%	39.0%	39.0%	40.5%
Depreciation	12.2%	13.3%	13.8%	15.4%	13.7%	12.9%	14.9%	14.2%	17.1%	14.9%	13.7%	14.7%	13.8%
Amortization	1.0%	0.8%	0.8%	0.8%	0.7%	1.0%	0.9%	0.9%	1.8%	1.8%	1.6%	1.8%	1.7%
Non-Income Taxes	6.4%	6.2%	7.5%	8.7%	7.2%	6.3%	6.7%	7.1%	7.5%	7.1%	6.4%	6.9%	6.5%
Operating Income	39.6%	38.5%	35.9%	28.9%	35.2%	42.1%	36.2%	36.0%	30.3%	35.2%	39.2%	37.7%	37.6%
Income Before Taxes	29.8%	28.5%	25.8%	17.3%	25.0%	33.4%	26.1%	25.9%	20.0%	25.5%	30.4%	28.3%	28.8%
Income Taxes	38.4%	39.6%	38.9%	40.4%	40.2%	40.1%	38.4%	39.7%	40.5%	39.5%	40.0%	40.0%	40.0%
Net Income	18.3%	17.2%	15.8%	10.3%	15.0%	20.0%	16.1%	15.6%	11.9%	15.5%	18.2%	17.0%	17.3%

Growth Rates yr/yr

Revenue	12.4%	7.4%	12.9%	1.4%	0.1%	7.0%	7.2%	4.1%	10.9%	11.0%	3.0%	6.7%	7.4%
Operating Income	10.9%	4.6%	5.1%	-8.1%	-3.0%	14.1%	11.0%	4.5%	16.3%	10.8%	-4.1%	11.1%	12.7%
Income Before Taxes	12.1%	2.8%	2.2%	-14.1%	-4.2%	20.2%	6.8%	4.5%	28.5%	13.2%	-6.2%	15.7%	18.0%
Net Income	13.9%	0.9%	3.3%	-15.0%	-5.0%	19.9%	3.0%	3.1%	28.3%	14.6%	-6.1%	12.7%	17.9%
Diluted EPS	10.9%	-1.3%	2.1%	-15.5%	-5.3%	18.6%	1.8%	2.1%	26.5%	13.1%	-6.7%	12.0%	17.1%

Source: Company Reports, Sturdivant & Co. Estimates

**Sturdivant & Co.'s
Businessman's Approach to Value Philosophy**

Sturdivant & Co. uses the businessman's approach to evaluating stocks. This philosophy is predicated on looking at a company as a prudent man would were he to consider making a reasoned investment in a business. We focus on a company's strategy, the competitive position a company has versus its peers, quality of management, risk factors, its prospect for growth, as well as critical catalysts and milestones as evidence of progress. Finally, of course, we look at a company's valuation to determine where we feel the stock is priced attractively.

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	<u>Date</u>	<u>Price</u>	<u>Rating</u>	<u>Target</u>
WTR	06/24/08	\$16.28	Market Outperform	\$23.00
	08/11/08	\$17.79	Market Outperform	\$24.00
	11/05/08	\$18.04	Market Outperform	\$24.00
	03/24/09	\$19.38	Market Outperform	\$24.00
	05/06/09	\$18.24	Market Outperform	\$26.00
	08/05/09	\$17.92	Market Outperform	\$26.00
	09/15/09	\$17.00	Market Outperform	\$26.00
	09/30/09	\$17.64	Market Outperform	\$26.00

Total Industrial Group

Outperform	Marketperform	Underperform
55% (6)	45% (5)	0

Investment Banking Relationship

Outperform	Marketperform	Underperform
100%	0%	0%

US - Industrial Services and Utilities

Investment Rating	Company	Ticker Symbol	Initial Coverage Date	Research Analyst
Market Outperform				
	American Water Works	AWK	10/16/2008	Richard Verdi
	Aqua America, Inc.	WTR	6/25/2008	Richard Verdi
	Artesian Resources Corp.	ARTNA	2/11/2009	Richard Verdi
	Met-Pro Corp.	MPR	5/29/2007	Richard Verdi
	Middlesex Water Co.	MSEX	1/29/2009	Richard Verdi
	Tyco International Ltd.	TYC	1/29/2009	Richard Verdi
Market Perform				
	Ametek, Inc.	AME	3/26/2008	Richard Verdi
	Badger Meter	BMI	7/11/2007	Richard Verdi
	Calgon Carbon Corp.	CCC	7/27/2009	Richard Verdi
	Echelon Corp.	ELON	12/6/2007	Richard Verdi
	Itron Inc.	ITRI	9/13/2007	Richard Verdi
Market Underperform				
N/A				

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