



# Aqua America, Inc. (WTR)

Fine-Tuning 4Q09 EPS; Maintain Outperform Rating

Price: (2/10/10)	16.78	Rating:	Outperform	FY Dec	2008A	2009E	2010E
52WK H-L:	21 - 15			Q1	0.11A	0.14A	
Market Cap (mil):	2,270.33	Suitability:	Lower Risk	Q2	0.17A	0.19A	
Shares Out (mil):	135.3			Q3	0.26A	0.25A	
Float (mil):	135.0			Q4	0.19A	0.20E	
Avg. Daily Vol (mil):	1.18			<b>Total</b>	<b>0.73A</b>	<b>0.78E</b>	<b>0.92E</b>
		Price Target:	22	Previous		0.80E	
Dividend	0.58			FY P/E	23.0	21.5	18.2
Yield (%)	3.46						

Please refer to Appendix - Important Disclosures and Analyst Certification.

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## Action

**Maintain Outperform rating. We continue to believe that WTR's acquisition strategy and stable EPS growth will fuel above-average total returns. WTR's regulatory environment continues to improve, reflecting rate relief and regulatory division consolidation potentially providing upside for 2010 EPS. Abnormally wet weather is expected to pressure 4Q09 more than previously expected leading to a reduction of our 4Q09 and 2009 EPS estimates by \$0.02/share.**

## Summary

- Reducing 2009 estimate to \$0.78 from \$0.80 and 4Q09E EPS to \$0.20 from \$0.22 due to unfavorable weather.
- We maintain our Outperform rating. Weather swings are normal from year to year and usually have little impact on stock price from positive/negative EPS impacts. We continue to expect attractive total returns reflecting above-average EPS growth due to constructive regulatory environments, organic growth opportunities via regulated infrastructure and continued acquisitions opportunities. We maintain our \$22 price target and Outperform rating.

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## Investment Thesis

We rate Aqua America Outperform with a 12-month price target of \$22. Our price target is 22x our 2011 EPS estimate, we believe in line with its peers when fully valued due to its relative earnings consistency, longer-term growth opportunities and wider potential shareholder base reflecting its relative size and liquidity.

Key investment considerations include the following:

- **Strong leadership team.** We believe Aqua has a strong leadership team that has demonstrated a keen focus on developing strong regulatory relationships and engineering innovative solutions to improve water system quality while providing investors with appropriate recovery. We believe management has executed regulatory and investment plans that provide stable and consistent value creation for investors.
- **Attractive total return potential.** We expect 4-6% long-term annual EPS growth with a 60-70% dividend payout ratio, providing a current dividend yield of 3.5%. We believe growth could accelerate beyond this level if WTR is able to accelerate its acquisition program of water and wastewater systems.
- **Constructive regulatory mechanisms.** The majority of WTR's regulatory operations are located in states that maintain enhanced regulatory recovery mechanisms that enable stable earned returns, including infrastructure investment riders, statewide rates and incentive mechanisms for acquisitions of troubled water systems. We believe such mechanisms provide a constructive regulatory environment in which to make capital investments, enabling improved and more consistent earned returns, which should lead to a premium peer valuation.
- **Acquisition growth.** Aqua has successfully acquired hundreds of water and wastewater systems in the past decade to supplement its internal growth, which also provides significant follow-on investment opportunities as it improves the quality of the acquired water system. We believe such acquisitions are a key value driver for the company and the stock, as it continues to be a key player in consolidating some of the 53,000 water systems outstanding in the U.S. and rehabilitating those systems to improve water quality and drive investment growth.
- **Investment shifting to pipe replacement.** Following significant advancements in water quality standards that necessitated major water project investments into water treatment systems, Aqua's investment mix is shifting toward pipe replacement as its system quality has generally met the more stringent EPA water quality standards. While substantial capital investments will still be required to fund pipe replacement, the level of rate base growth could decline versus historical levels.
- **Water utility valuation.** We expect solid earned ROEs, 5-8% longer-term EPS growth potential and constructive regulatory investment recovery mechanisms should support a 20-22x forward P/E. The valuation is a premium to its regulated electric and gas utility peers reflecting significant industry consolidation and rate base growth opportunities with lowered regulatory risk, and generally more constructive regulatory mechanisms that enable earnings consistency.

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## Risks & Caveats

Our suitability rating on Aqua America is Lower Risk. Key risks include, but are not limited to, the following:

- **Regulation.** Regulated operations are subject to local, state and federal regulations. Changes in the regulatory environment can affect WTR's near-term and long-term performance.
- **Weather.** WTR's businesses are sensitive to fluctuations in the weather. Particularly

wet or dry weather can impact near-term financial results.

- **Acquisition risk.** WTR may have the opportunity to purchase assets or companies in the near future. Acquisitions carry risks related to personnel, expected-versus-actual growth and a myriad of unforeseen hurdles, all of which can negatively affect earnings.
- **Product quality.** Unique among its sister regulated utility sectors, water utilities provide a product that is ingested. Despite robust mandated service quality standards that lower risk, a quality failure could materially impact the earnings and stock of WTR.
- **Dividend legislation.** Congress has extended tax legislation that reduced the tax rate on dividends received. However, the extensions only last through 2009 and there can be no assurance that further extensions of the tax relief will occur or that a future Congress would not repeal the current legislation, which could have an adverse impact on the after-tax value of dividends and the stock.

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## Company Description

Aqua America is a holding company for numerous regulated water and wastewater utilities operating in the eastern half of the U.S. that serve over 2.8 million people. It is the second-largest investor-owned water utility in the U.S. Known as Philadelphia Suburban Corporation until 2004, Aqua America is headquartered in the Philadelphia suburbs where its corporate roots date back to 1886 for providing water and/or wastewater service.

**Aqua America**  
**WTR - NYSE**

Date Printed: 2/10/2010

Recent Price: \$16.75

Yr	Revenue			Operating Expenses			Operating Income			Pretax Income			Tax	Net Income			TTM	Diluted EPS		Div.	Diluted Shares	
	\$mil	\$	Chg.	\$	%	Chg.	\$	%	Chg.	\$	%	Chg.	Rate	\$	%	Chg.	ROE	\$	% Chg.			
1990		82.3		54.5	66.3%		27.7	33.7%		15.6	18.9%		37.5%	9.7	11.8%			0.24		0.19	39.8	
1991		88.6	7.8%	57.0	64.3%	4.6%	31.6	35.7%	14.0%	18.1	20.4%	15.9%	39.2%	11.0	12.4%	12.7%	12.8%	0.27	8.9%	0.19	41.2	
1992		93.3	5.3%	59.0	63.2%	3.4%	34.3	36.8%	8.5%	19.5	20.9%	8.2%	41.1%	11.5	12.3%	4.8%	10.7%	0.26	-4.0%	0.20	45.0	
1993		101.2	8.5%	63.8	63.0%	8.2%	37.4	37.0%	9.0%	25.1	24.8%	28.7%	41.5%	14.7	14.5%	27.9%	10.8%	0.26	1.7%	0.21	56.6	
1994		108.6	7.3%	67.8	62.4%	6.2%	40.8	37.6%	9.1%	28.1	25.8%	11.7%	41.2%	16.5	15.2%	12.3%	11.5%	0.27	5.4%	0.21	60.2	
1995		117.0	7.7%	70.9	60.6%	4.6%	46.1	39.4%	12.9%	31.6	27.0%	12.4%	40.9%	18.7	15.9%	13.1%	11.9%	0.30	8.8%	0.22	62.6	
1996		122.5	4.7%	73.2	59.8%	3.2%	49.3	40.2%	6.9%	34.2	28.0%	8.5%	40.8%	20.3	16.5%	8.5%	11.2%	0.31	2.7%	0.23	66.2	
1997		136.2	11.2%	79.4	58.3%	8.4%	56.8	41.7%	15.2%	39.4	29.0%	15.2%	40.3%	23.4	17.2%	15.4%	12.0%	0.34	11.5%	0.24	68.4	
1998		151.0	10.9%	84.3	55.8%	6.2%	66.7	44.2%	17.4%	48.4	32.1%	22.8%	40.5%	28.6	19.0%	22.6%	12.2%	0.39	15.6%	0.26	72.6	
1999		257.3	70.4%	152.5	59.3%	80.9%	104.8	40.7%	57.2%	63.0	24.5%	30.1%	42.1%	36.4	14.1%	27.0%	9.9%	0.34	-14.3%	0.27	107.6	
2000		275.5	7.1%	158.4	57.5%	3.8%	117.2	42.5%	11.8%	87.1	31.6%	38.2%	39.2%	52.9	19.2%	45.4%	12.3%	0.49	43.5%	0.28	109.0	
2001		307.3	11.5%	172.9	56.3%	9.2%	134.3	43.7%	14.6%	99.1	32.2%	13.8%	39.3%	60.0	19.5%	13.5%	13.3%	0.52	7.9%	0.30	114.6	
2002		322.0	4.8%	181.5	56.4%	5.0%	140.5	43.6%	4.6%	109.3	33.9%	10.3%	38.5%	67.2	20.9%	11.9%	13.9%	0.58	11.1%	0.32	115.4	
2003		367.2	14.0%	213.7	58.2%	17.7%	153.6	41.8%	9.3%	116.7	31.8%	6.8%	39.3%	70.8	19.3%	5.4%	12.3%	0.59	2.2%	0.34	119.0	
Q1		99.8	24.0%	63.3	63.5%	31.8%	36.4	36.5%	12.3%	25.7	25.8%	15.4%	39.4%	15.6	15.6%	16.9%	12.2%	0.12	6.8%	0.09	125.1	
Q2		106.5	27.8%	66.1	62.0%	37.4%	40.5	38.0%	14.7%	29.8	28.0%	17.7%	40.0%	17.9	16.8%	17.3%	11.9%	0.14	8.8%	0.09	125.1	
Q3		120.3	17.8%	69.3	57.6%	24.1%	51.0	42.4%	10.1%	39.8	33.1%	1.1%	39.5%	24.1	20.0%	2.0%	11.5%	0.19	-2.0%	0.09	125.4	
Q4		115.4	14.1%	68.5	59.3%	11.0%	47.0	40.7%	18.9%	36.8	31.9%	23.7%	38.9%	22.5	19.5%	20.8%	11.7%	0.18	18.1%	0.10	127.3	
2004		442.0	20.4%	267.1	60.4%	25.0%	174.9	39.6%	13.9%	132.1	29.9%	13.2%	39.4%	80.0	18.1%	13.0%	11.4%	0.64	7.0%	0.37	125.7	
Q1		114.0	14.3%	8.1%	71.2	62.5%	12.5%	42.8	37.5%	17.4%	30.8	27.0%	19.9%	38.8%	18.9	16.6%	21.2%	11.8%	0.15	17.6%	0.10	128.9
Q2		123.1	15.6%	10.3%	74.5	60.5%	12.8%	48.6	39.5%	20.1%	36.8	29.9%	23.5%	39.6%	22.2	18.0%	24.3%	12.1%	0.17	20.1%	0.10	129.5
Q3		136.8	13.7%	13.7%	77.7	56.8%	12.1%	59.1	43.2%	15.9%	46.3	33.9%	16.3%	39.7%	27.9	20.4%	15.9%	12.2%	0.21	11.6%	0.10	130.2
Q4		122.9	6.5%	6.5%	76.9	62.5%	12.3%	46.1	37.5%	-2.0%	34.2	27.8%	-7.2%	35.1%	22.2	18.0%	-1.4%	11.8%	0.17	-3.4%	0.11	129.8
2005		496.8	12.4%	9.5%	300.3	60.4%	12.4%	196.5	39.6%	12.4%	148.1	29.8%	12.1%	38.4%	91.2	18.3%	13.9%	11.7%	0.71	10.9%	0.40	129.2
Q1		117.9	3.5%	2.0%	77.3	65.6%	8.6%	40.6	34.4%	-5.0%	27.6	23.4%	-10.3%	40.1%	16.6	14.0%	-12.2%	11.3%	0.13	-13.6%	0.11	130.9
Q2		131.7	7.0%	6.1%	81.7	62.0%	9.6%	50.1	38.0%	3.1%	37.1	28.2%	0.9%	39.7%	22.4	17.0%	0.8%	11.0%	0.17	-0.4%	0.11	131.0
Q3		147.0	7.4%	5.8%	87.4	59.5%	12.5%	59.5	40.5%	0.7%	45.6	31.0%	-1.6%	40.0%	27.3	18.6%	-2.1%	10.6%	0.21	-3.9%	0.12	132.7
Q4		136.8	11.3%	8.5%	81.5	59.6%	6.1%	55.3	40.4%	20.1%	41.9	30.7%	22.8%	38.7%	25.7	18.8%	16.1%	10.6%	0.19	13.0%	0.12	133.4
2006		533.5	7.4%	6.4%	327.9	61.5%	9.2%	205.5	38.5%	4.6%	152.3	28.5%	2.8%	39.6%	92.0	17.2%	0.9%	10.6%	0.70	-1.0%	0.44	131.8
Q1		137.3	16.4%	10.5%	93.6	68.1%	21.0%	43.7	31.9%	7.7%	28.0	20.4%	1.3%	39.8%	16.9	12.3%	1.8%	10.4%	0.13	0.0%	0.12	133.2
Q2		150.6	14.3%	7.9%	95.9	63.6%	17.4%	54.8	36.4%	9.3%	39.4	26.2%	6.2%	39.8%	23.7	15.8%	6.0%	10.3%	0.18	4.0%	0.12	133.5
Q3		165.5	12.6%	5.4%	100.1	60.5%	14.5%	65.3	39.5%	9.8%	49.2	29.7%	7.9%	40.0%	29.5	17.8%	8.0%	10.3%	0.22	7.1%	0.13	133.8
Q4		149.1	8.9%	7.1%	96.9	65.0%	18.9%	52.2	35.0%	-5.7%	39.0	26.2%	-7.0%	36.1%	24.9	16.7%	-3.2%	10.0%	0.19	-3.6%	0.13	134.0
2007		602.5	12.9%	7.6%	386.5	64.1%	17.9%	216.0	35.9%	5.1%	155.5	25.8%	2.2%	38.9%	95.0	15.8%	3.3%	10.0%	0.71	1.9%	0.48	133.6
Q1		139.3	1.4%	1.0%	99.1	71.1%	5.9%	40.2	28.9%	-8.1%	24.0	17.3%	-14.1%	40.4%	14.3	10.3%	-15.0%	9.6%	0.11	-15.5%	0.13	134.0
Q2		150.8	0.1%	-0.1%	97.6	64.8%	1.8%	53.1	35.2%	-3.0%	37.7	25.0%	-4.2%	40.2%	22.6	15.0%	-5.0%	9.3%	0.17	-5.3%	0.13	134.1
Q3		177.1	7.0%	4.5%	102.5	57.9%	2.4%	74.6	42.1%	14.1%	59.1	33.4%	20.2%	40.1%	35.4	20.0%	19.9%	9.8%	0.26	18.6%	0.13	135.3
Q4		159.8	7.2%	-0.2%	102.0	63.8%	5.2%	57.9	36.2%	11.0%	41.7	26.1%	6.8%	38.4%	25.7	16.1%	3.0%	9.7%	0.19	1.8%	0.14	135.6
2008		627.0	4.1%	3.1%	401.2	64.0%	3.8%	225.8	36.0%	4.5%	162.5	25.9%	4.5%	39.7%	97.9	15.6%	3.1%	9.6%	0.73	2.2%	0.51	134.7
Q1		154.5	10.9%	10.0%	107.7	69.7%	8.7%	46.8	30.3%	16.3%	30.9	20.0%	28.5%	40.5%	18.4	11.9%	28.3%	9.9%	0.14	26.5%	0.14	135.9
Q2		167.3	11.0%	9.2%	108.5	64.8%	11.1%	58.9	35.2%	10.8%	42.7	25.5%	13.2%	39.5%	25.9	15.5%	14.6%	10.0%	0.19	12.2%	0.15	136.9
Q3E		180.8	2.1%	-0.1%	109.4	60.5%	6.7%	71.5	39.5%	-4.2%	55.1	30.5%	-6.7%	39.3%	33.5	18.5%	-5.4%	9.8%	0.25	-6.1%	0.15	136.3
Q4E		180.8	13.1%	11.6%	113.3	62.7%	11.1%	67.5	37.3%	16.6%	49.0	27.1%	17.5%	42.1%	28.4	15.7%	10.6%	9.9%	0.20	4.1%	0.15	137.1
2009E		670.9	7.0%	6.5%	426.3	63.5%	6.3%	244.6	36.5%	8.3%	179.1	26.7%	10.2%	40.0%	107.4	16.0%	9.7%	10.0%	0.78	7.9%	0.55	137.0
2010E		733.9	9.4%	6.4%	455.9	62.1%	7.0%	278.0	37.9%	13.7%	211.8	28.9%	18.3%	40.0%	127.1	17.3%	18.3%	11.0%	0.92	17.3%	0.59	138.1
2011E		791.2	7.8%	5.6%	487.1	61.6%	6.8%	304.1	38.4%	9.4%	233.3	29.5%	10.1%	40.0%	140.0	17.7%	10.1%	11.1%	1.00	8.4%	0.63	140.3

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Date Printed: 2/10/2010

Fiscal Year: DEC

(in millions)

## Aqua America WTR - NYSE

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Balance Sheet	2004	2005	2006	2007	2008	3Q09	Cash Flow Statement	2004	2005	2006	2007	2008	2009E	2010E	
<b>ASSETS</b>							<b>Net Income</b>	80.0	91.2	92.0	95.0	97.9	107.4	127.1	
Cash & Equivalents	13.1	11.9	44.0	14.5	14.9	13.8	Depreciation & Amort	58.9	65.5	75.0	88.0	94.3	112.5	119.2	
Receivables	51.2	56.3	57.7	62.3	64.5	62.7	Net changes in (CA) & CL	(1.9)	20.5	(14.4)	(14.6)	(9.7)	15.2	(6.0)	
Inventory	4.4	4.4	4.6	5.8	6.9	7.8	Deferred taxes/Non-Cash	36.6	22.5	18.1	25.8	39.0	25.8	(9.8)	
Other	21.4	17.3	28.4	32.8	34.7	38.2	<b>Cash Flow from Operations</b>	173.6	199.7	170.7	194.2	221.5	261.0	230.4	
<b>Total Current</b>	90.1	90.0	134.7	115.5	121.0	122.5	Dividend Payments	(45.8)	(51.1)	(58.0)	(63.8)	(68.5)	(75.3)	(81.7)	
Fixed Assets	2,069.8	2,280.0	2,506.0	2,792.8	2,997.4	3,060.5	Net Capital Expenditures	(195.7)	(237.5)	(271.7)	(238.1)	(267.4)	(280.0)	(280.0)	
Goodwill & Intangible Asset	20.1	20.2	22.6	36.6	41.0	40.8	<b>Free Cash Flow</b>	(\$67.9)	(\$88.9)	(\$159.0)	(\$107.7)	(\$114.4)	(\$94.3)	(\$131.3)	
Other Assets	160.2	236.6	214.6	282.0	325.6	306.4	Operating Cash Flow Per Share	\$1.38	\$1.55	\$1.30	\$1.45	\$1.64	\$1.90	\$1.67	
<b>Total Assets</b>	2,340.2	2,626.7	2,877.9	3,226.9	3,485.0	3,530.3	Free Cash Flow Per Share	(\$0.54)	(\$0.69)	(\$1.21)	(\$0.81)	(\$0.85)	(\$0.69)	(\$0.95)	
<b>LIAB. &amp; EQUITY</b>							<b>Du Pont Formula</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009E</b>	<b>2010E</b>	
Current Debt	271.2	298.5	313.5	231.2	168.7	111.9	Net Margins (N/S)	18.1%	18.3%	17.2%	15.8%	15.6%	16.0%	17.3%	
Payables	20.6	27.7	31.1	32.3	23.5	55.5	Assets Turnover (S/A)	0.2	0.2	0.2	0.2	0.2	0.2	0.2	
Other	(74.4)	(62.8)	(88.9)	(80.3)	0.9	24.6	Leverage (A/E)	3.1	3.2	3.2	3.2	3.3	3.3	3.2	
<b>Total Current</b>	217.4	263.3	255.6	183.2	193.2	192.0	<b>Return on Equity</b>	11.4%	11.7%	10.6%	10.0%	9.6%	10.0%	11.0%	
L/T Debt & Lease	784.5	878.4	951.7	1,215.1	1,248.1	1,226.2	<b>Valuation Parameters</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009E</b>	<b>Recent</b>	
Deferred Taxes	414.3	474.2	523.5	580.9	662.8	365.5	Price (Common) - WTR	High	18.48	29.22	29.79	26.62	22.00	21.50	16.75
Other Liabilities	658.9	788.7	896.9	1,018.7	1,172.9	635.4	Low	14.18	17.49	20.13	18.86	12.20	16.12		
Preferred Stock	-	-	-	-	-	-	<b>Forward P/E Ratio</b>	High	25.7x	37.0x	34.9x	32.2x	26.4x	25.0x	
Common Equity	747.2	811.9	921.6	976.3	1,058.4	1,075.4	Low	20.5x	23.8x	25.2x	22.8x	14.7x	18.4x		
<b>Total Liab. &amp; Equity</b>	2,822.3	3,216.7	3,549.4	3,974.1	4,335.4	3,494.6	Close	25.5x	33.8x	27.6x	25.4x	21.4x	18.4x	21.4x	
<b>Ratio Analysis:</b>							<b>Book Value</b>	\$5.88	\$6.30	\$6.96	\$7.28	\$7.78	\$7.99	\$8.77	
Current Ratio	0.4	0.3	0.5	0.6	0.6	0.6	<b>Price/Book Ratio</b>	High	3.1x	4.6x	4.3x	3.7x	2.8x	2.7x	2.3x
Working Capital	(\$5)	(\$22)	(\$15)	(\$1)	\$1	\$18	Low	2.4x	2.8x	2.9x	2.6x	1.6x	2.0x	1.9x	
Working Cap/Assets	(0.2%)	(0.8%)	(0.5%)	(0.0%)	0.0%	0.5%	Close	3.1x	4.3x	3.3x	2.9x	2.6x	2.5x	2.2x	
Inventory Turns	NM	NM	NM	NM	NM	NM	<b>EBITDA</b>	\$235.4	\$260.9	\$281.6	\$305.6	\$319.9	\$351.2	\$391.3	
Total Debt/Capital	60%	62%	59%	59%	58%	58%	<b>Enterprise Value</b>	High	\$3,230	\$4,805	\$4,983	\$4,838	\$4,285	\$4,314	\$4,175
LT Debt/Equity	105%	108%	103%	124%	118%	115%	Low	2,689	3,290	3,711	3,801	2,964	3,577	3,776	
EBIT/Interest Expense	3.7x	3.8x	3.6x	3.3x	3.4x	3.5x	<b>EV / EBITDA</b>	High	13.7x	18.4x	17.7x	15.8x	13.4x	12.3x	10.7x
Total Debt/EBIT	5.1x	5.2x	5.2x	5.8x	5.8x	5.6x	Low	11.4x	12.6x	13.2x	12.4x	9.3x	10.2x	9.6x	
							Close	13.7x	17.5x	14.4x	13.5x	12.8x	11.7x	10.4x	

Please refer to "Appendix - Important Disclosures" and Analyst Certification.

## Appendix - Important Disclosures and Analyst Certification



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