



**Morning Meeting Notes**

Friday, September 4, 2009

**AQUA AMERICA INC**  
(WTR - USD 16.69)

**Timothy Winter, CFA**

Ph: 314-238-1314

[twinter@gabelli.com](mailto:twinter@gabelli.com)

Recommendation: BUY

Previous Recommendation: BUY

As of: 07-Aug-2009

Currency - USD			
Capitalization		Financial Metrics	
(in millions)		Fiscal YE	Dec 2009
Number of Shares	136	2010 PMV/sh	24.00
Price	16.69	<b>E P S</b>	
Market Cap	2,268	2010P	0.88
Net Debt(Cash)	1,352	2009E	0.80
Other	0	2008A	0.73
		<b>EBITDA (mm)</b>	
		2010P	379
		2009E	348
		2008A	320
		<b>PE Ratio</b>	
		2010P	19.1
		2009E	20.9
		2008A	22.9
<b>Total Enterprise Value</b>	<b>3,621</b>		

Weather/Recession/Conservation To Impact Results; Continue To Rate Buy

We have lowered our 2009, 2010 and 2011 earnings estimates to \$0.80, \$0.88 and \$1.00, respectively, per share from \$0.84, \$0.95 and \$1.03, respectively. The lower 2009 estimate is primarily due to unfavorable third quarter weather as the company's Northeast and Midwest service areas have experienced unusually mild temperatures and above-normal precipitation during July and August. We expect WTR to report third quarter earnings results of \$0.26 per share compared with \$0.24 (excludes a \$0.02 asset sale gain) for the same period last year.

Our lower 2010 estimate is primarily due to later than originally expected Pennsylvania and New Jersey rate filings, which are expected in November/December of 2009. As a result, higher rates in these important states will likely not be implemented until after the important 2010 summer watering season. In addition, we expect usage-per-customer to decline given the negative impact of the recession, conservation efforts and modest price elasticity. Organic customer growth has been adversely effected by the national housing slowdown, but through acquisitions, the company continues to show customer growth.

Despite our earnings revision, we expect WTRs annual earnings growth to return to the historic target rate of 8-10% per share driven by rate relief, improved profit levels in the Southern region and increased operational efficiency. WTR plans to request additional rate relief of approximately \$50 million in 2009, including in the states of Pennsylvania and New Jersey where over 60% of revenues are generated. In the first half of 2009, WTR subsidiaries were granted rate relief totaling \$27.2 million (PA, OH, NY, FL, IN, SC & NC) as well as material infrastructure surcharges. Pending rate requests total \$9.2 million. In 2008, WTR subsidiaries received rate relief totaling \$60 million, including \$39 million in third quarter increases for PA and NJ. Year-to-date, Aqua America subsidiaries have completed eleven acquisitions of systems serving approximately 4,200 people.

WTRs capital budget of roughly \$300 million annually is manageable and an increasing portion of future capital will be directed toward pipe replacement in states where rate mechanisms are in place to allow immediate rate increases. We expect WTR to internally-fund 60-65% of its 2009 capital budget. WTR has ample access to capital as evidenced by its balance sheet (44.3% common equity), A+-rated senior corporate debt and historical valuation multiples ranging between 200%-375% of book value. WTR boasts among the highest credit ratings of any publicly-traded utility and its overall embedded cost of debt is 5.6%.

We recommend purchase of WTR shares. Shares currently trade at 21.6X and 19.0X our 2009 and 2010 EPS estimates, which compares to group multiples of 20.9X and 19.0X, and 213% of book value, which compares to the group multiple of 176%. Over the past ten years, WTR shares have traded between 15-35X forward earnings and significant premium multiples to the group. Our estimated 2010 private market value estimate is \$24 per share. We believe that a takeover of WTR would require a 300-325% premium to book value, or \$24-26 per share, which compares to 250-325% premiums in the last ten takeover agreements. We believe WTR shares warrant premium multiples given the company's national presence, strong financial condition, strong reputation, strong EPS outlook and successful track record.

Primary Risks to our recommendation include regulatory risk (poor rate decision), an acquisition announcement at a premium multiple, potential retirement of the CEO, interest rate move higher and market risk.

**Please see the last page for important disclosures.**

## Important Disclosures

To obtain a price chart for any security in this report, please contact 1-800-422-2274.

Gabelli & Company, Inc. ("we" or "us") attempts to provide timely, value-added insights into companies or industry dynamics for institutional investors. Our research reports generally contain a recommendation of "buy," "hold," "sell" or "non-rated". We do not undertake to "upgrade" or "downgrade" ratings after publishing a report. We currently have reports on 706 companies, of which 40%, 43%, 2% and 15% have a recommendation of buy, hold, sell or non-rated, respectively. The percentage of companies so rated for which we provided investment banking services within the past 12 months is 0%, 0%, 0% and less than 1%.

**Ratings** - Analysts' ratings are largely (but not always) determined by our "private market value," or PMV methodology. Our basic goal is to understand in absolute terms what a rational, strategic buyer would pay for an asset in an open, arms-length transaction. At the same time, analysts also look for underlying catalysts that could encourage those private market values to surface.

A **Buy** rated stock is one that in our view is trading at a meaningful discount to our estimated PMV. We could expect a more modest private market value to increase at an accelerated pace, the discount of the public stock price to PMV to narrow through the emergence of a catalyst, or some combination of the two to occur.

A **Hold** is a stock that may be trading at or near our estimated private market value. We may not anticipate a large increase in the PMV, or see some other factors at work.

A **Sell** is a stock that may be trading at or above our estimated PMV. There may be little upside to the value, or limited opportunity to realize the value. Economic or sector risk could also be increasing.

We prepared this report as a matter of general information. We do not intend for this report to be a complete description of any security or company and it is not an offer or solicitation to buy or sell any security. All facts and statistics are from sources we believe to be reliable, but we do not guarantee their accuracy. We do not undertake to advise you of changes in our opinion or information. Unless otherwise noted, all stock prices reflect the closing price on the business day immediately prior to the date of this report. We do not use "price targets" predicting future stock performance. We do refer to "private market value" or PMV, which is the price that we believe an informed buyer would pay to acquire 100% of a company. There is no assurance that there are any willing buyers of a company at this price and we do not intend to suggest that any acquisition is likely. Additional information is available on request.

Because the portfolio managers at our affiliates make individual investment decisions with respect to the client accounts they manage, these accounts may have transactions inconsistent with the recommendations in this report. These portfolio managers may know the substance of our research reports prior to their publication as a result of joint participation in research meetings or otherwise. The analyst who wrote this report may receive commissions from customers' transactions in the securities mentioned in this report.

Our affiliates may receive compensation from the companies referred to in this report for non-investment banking securities-related services, or may be soliciting these companies as clients for non-investment banking securities-related services.

- **AQUA AMERICA INC**

I, Timothy Winter, CFA hereby certify that the views expressed in this report accurately reflect the analyst's personal views about the subject companies and their securities. I have not been, and will not be receiving direct or indirect compensation for expressing the specific recommendation or view in this report.

Our affiliates beneficially own on behalf of their investment advisory clients or otherwise less than 1% of the common stock of AQUA AMERICA INC as of July 31, 2009.

One of our affiliates serves as an investment adviser to AQUA AMERICA INC or an affiliated entity and has received compensation within the past 12 months for these non-investment banking securities-related services.