



COMPANY UPDATE/ESTIMATE CHANGE

Water Utilities

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Key Metrics

WTR - NYSE (as of 11/4/10)	\$21.55
Price Target	\$23.00
52-Week Range	\$21.71-\$15.66
Shares Outstanding (mm)	137.4
Market Cap. (\$mm)	\$2,957.9
3-Mo. Average Daily Volume	660,063
Institutional Ownership	47.5%
Debt/Total Capital (9/10)	56.0%
ROE (9/10)	10.8%
Book Value/Share (9/10)	\$8.29
Price/Book Value	2.5x
Dividend Yield	2.9%
LTM EBITDA Margin	55.4%

EPS FY 12/31

	2009A	Prior 2010E	Curr. 2010E	Prior 2011E	Curr. 2011E
1Q	\$0.14	--	\$0.16A	--	--
2Q	\$0.19	--	\$0.22A	--	--
3Q	\$0.25	--	\$0.32A	--	--
4Q	\$0.20	\$0.23	\$0.22	--	--
Year	\$0.77	\$0.87	\$0.92	\$0.94	\$0.96
P/E	28.0x		23.4x		22.4x

Revenue (\$mm)

	2009A	Prior 2010E	Curr. 2010E	Prior 2011E	Curr. 2011E
1Q	\$154.5	--	\$160.5A	--	--
2Q	\$167.3	--	\$178.4A	--	--
3Q	\$180.8	--	\$207.8A	--	--
4Q	\$167.9	--	\$183.9	--	--
Year	\$670.5	\$717.3	\$730.7	\$738.0	\$740.8

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

Solid Q3 Results; Raise Estimates

Investment Highlights

- WTR reported Q3'10 EPS of \$0.32 versus \$0.25 in the year ago period, compared to our \$0.26 estimate and the \$0.28 consensus.
- Revenue increased 14.9% to \$207.8 million compared to our \$194.4 million estimate, driven by hot and dry weather in the east which drove higher usage.
- O&M rose 6.5% to \$73.0 million from non-cash charges and increased usage, but improved 280 bps as a percentage of revenue.
- Pending rate cases total ~\$19.1 million, and an additional ~\$11.5 million should be filed by year-end as well.
- The company has made 14 small acquisitions year to date, and still believes the year-end total will be in the 20-30 range.
- We are increasing our FY'10 EPS estimate by \$0.05 to \$0.92, and raising our FY'11 estimate by \$0.02 to \$0.96.

**Note Important Disclosures on Pages 5 - 6.
Note Analyst Certification on Page 5.**

ADDITIONAL DISCUSSION***Third Quarter Results***

Aqua America reported Q3 EPS of \$0.32 versus \$0.25 in the year ago period, compared to our \$0.26 estimate and the \$0.28 consensus. Revenue rose 14.9% to \$207.8 million compared to our \$194.4 million estimate and the \$200.0 million consensus, due to hot and dry weather in the east which drove higher usage.

O&M (Operations & Maintenance) expenses rose 6.5% to \$73.0 million due to non-cash charges from the write-off of previously deferred expenses related to rate filings and expenses associated with increased water use, which was up over 9% from the year ago period resulting from favorable weather. However, as a percentage of revenue O&M improved a very impressive 280 basis points to 35.1% and the company sees additional improvement. Depreciation increased 7.8% to \$27.4 million and operating income increased 25.4% to \$89.6 million.

Long-term debt was \$1.5 billion at quarter's end, and as a percentage of total capitalization decreased 40 basis points to 56.0%. (The company's target equity ratio is ~45%.) The company's weighted cost of debt is now 5.43%, and it has \$79 million available on revolvers. Earlier this month WTR announced it will issue \$141.4M in tax-exempt first mortgage bonds at a weighted average yield of 4.75%. Proceeds will be used to help finance infrastructure cap ex in Pennsylvania, and to refinance \$44 million of existing debt.

Capital expenditures were \$98.7 million in the quarter compared with \$77.8 million in the year ago period, and the company is on track to spend over \$300 million in cap ex in 2010, focused on pipe replacement projects.

Valuation

We are raising our FY'10 EPS estimate by \$0.05 to \$0.92, primarily due to Q3 results above our forecast and increasing our FY'11 EPS estimate by \$0.02 to \$0.96. We derive our \$23 price target 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 23.4x and 22.4x our 2010 and 2011 EPS estimates, respectively, compared to 21.5x and 20.3x its peer group.

Outlook

We were expecting a solid quarter, but certainly nothing approaching results that were \$0.06 above our estimate. The only bad news here is that next summer will now likely be much more challenging, given the favorable conditions the past few months. While the weather benefit may have driven price appreciation over the past few months, assuming a more normalized year the question then becomes from where the growth will come in 2011. Positively, pending rate cases total ~\$19.1 million, which are baked into our model, and the company expects to file for another \$11.5 million in rates this year. We anticipate additional filings, and it also sounds as if further margin improvement can be expected. Solar may make a minor contribution, and could be a logical step for the company.

However, the biggest growth driver could easily be acquisitions. Year-to-date, the company has made 14 tuck-in's, and expects transactions to number ~25 for the year. What we are hoping for is to see one of size, and it certainly appears as though the company is in related discussions and if it was going to issue equity to do a deal, the recent run up in share price makes this an opportune time to do so.

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	Q2'10A	Q3'10A	Q4'10E	FY'10E	FY'11E
Operating revenues	\$602,499	\$626,972	\$154,487	\$167,333	\$180,826	\$167,893	\$670,539	\$160,517	\$178,444	\$207,797	\$183,904	\$730,662	\$740,762
Costs and expenses:													
Operation and maintenance	253,092	262,122	66,989	68,549	68,488	66,034	270,060	67,601	69,310	72,968	73,561	283,440	285,441
Depreciation	83,178	88,785	26,387	24,972	25,436	26,206	103,001	26,200	26,802	27,431	26,800	107,233	107,100
Amortization	4,833	5,515	2,755	3,064	3,029	3,090	11,938	3,172	3,314	3,629	3,100	13,215	12,700
Taxes other than income taxes	45,380	44,749	11,590	11,884	12,418	12,189	48,081	12,860	12,943	14,182	13,425	53,410	48,645
Operating income	216,016	225,801	46,766	58,864	71,455	60,374	237,459	50,684	66,075	89,587	67,017	273,363	286,875
Other expense (income):													
Interest expense (net)	66,921	68,572	16,628	16,809	17,256	17,914	68,607	18,430	18,504	19,150	19,150	75,234	69,200
Allow. for funds used dur. const.	(2,953)	(3,674)	(625)	(568)	(747)	(931)	(2,871)	(1,541)	(1,461)	(1,077)	(1,100)	(5,179)	(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)	(110)	(291)	(300)	(2,630)	(1,200)
Income before income taxes	155,542	162,502	30,896	42,703	55,108	43,488	172,195	35,724	49,142	71,805	49,267	205,938	222,475
Provision for income taxes	60,528	64,584	12,525	16,850	21,638	16,829	67,842	14,213	19,287	28,054	19,066	80,620	87,608
Net income	95,014	97,918	18,371	25,853	33,470	26,659	104,353	21,511	29,855	43,751	30,201	125,318	134,867
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	\$29,855	\$43,751	\$30,201	\$125,318	\$134,867
Net income	95,014	97,918	18,371	25,853	33,470	26,659	104,353	21,511	29,855	43,751	30,201	125,318	134,867
Other comp. income (loss), net of tax:													
Unreal. hold. gain (loss) on certain inv.	1,121	195	37	232	(142)	162	289	902		272			
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	\$29,855	\$44,023	\$30,201	\$125,318	\$134,867
EPS (FD)	\$0.71	0.73	\$0.14	\$0.19	\$0.25	\$0.20	\$0.77	\$0.16	\$0.22	\$0.32	\$0.22	\$0.92	\$0.96
Diluted average shares outstanding	133,602	134,705	135,876	135,939	136,260	136,510	136,129	136,800	137,012	137,394	137,594	136,290	140,773
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%	6.6%	14.9%	9.5%	9.0%	1.4%
Operating income	5.1%	4.5%	16.3%	10.8%	-4.2%	4.3%	5.2%	8.4%	12.3%	25.4%	11.0%	15.1%	4.9%
EPS	1.4%	2.8%	27.3%	11.8%	-3.8%	5.3%	5.5%	14.3%	15.8%	28.0%	9.7%	19.4%	4.2%
EBITDA	8.4%	5.3%	20.7%	16.2%	0.7%	7.7%	10.1%	5.5%	10.7%	20.7%	8.1%	11.8%	3.3%
Margin Analysis:													
O&M	42.0%	41.8%	43.4%	41.0%	37.9%	39.3%	40.3%	42.1%	38.8%	35.1%	40.0%	38.8%	38.5%
D&A	14.6%	15.0%	18.9%	16.8%	15.7%	17.4%	17.1%	18.3%	16.9%	14.9%	16.3%	16.5%	16.2%
Taxes other than inc. taxes	7.5%	7.1%	7.5%	7.1%	6.9%	7.3%	7.2%	8.0%	7.3%	6.8%	7.3%	7.3%	6.6%
Operating income	35.9%	36.0%	30.3%	35.2%	39.5%	36.0%	35.4%	31.6%	37.0%	43.1%	36.4%	37.4%	38.7%
Net income	15.7%	15.6%	11.9%	15.6%	18.4%	16.0%	15.6%	13.1%	16.7%	21.2%	16.4%	17.2%	18.2%
Tax rate	38.9%	39.7%	40.5%	39.5%	39.3%	38.7%	39.4%	39.8%	39.2%	39.1%	38.7%	39.1%	39.4%

Source: Company reports and Hilliard Lyons estimates

Analyst Certification

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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	50	29%	2%	98%
Long-term Buy	37	22%	0%	100%
Neutral	79	46%	5%	95%
Underperform	4	2%	0%	100%

As of 8 October 2010

Other Disclosures

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