



Utilities

AWK/WTR Engage in Asset Swap to Realign Regulatory Focuses

Company	Ticker	Closing Price 12/13/10	Mkt Cap (mil)	New Rating	Prior Rating	New Price Target	Prior Price Target
American Water Works Co.	AWK	25.00	4,372.50	No Chg	O / L	No Chg	26
Aqua America, Inc.	WTR	21.82	2,989.34	No Chg	O / L	No Chg	22

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Action

Unique transaction allows AWK and WTR to refocus time/capital on states where each company has existing regulatory relationships and growth potential. It reduces duplicative efforts and streamlines state processes. Offsetting geographic presences allowed for the strategic divestitures and subsequent redeployments of capital into states with economies of scale and future growth opportunities. AWK and WTR should be able to leverage their existing system operations and regulatory expertise to improve earned ROEs going forward.

Please refer to
Appendix - Important
Disclosures and
Analyst Certification.

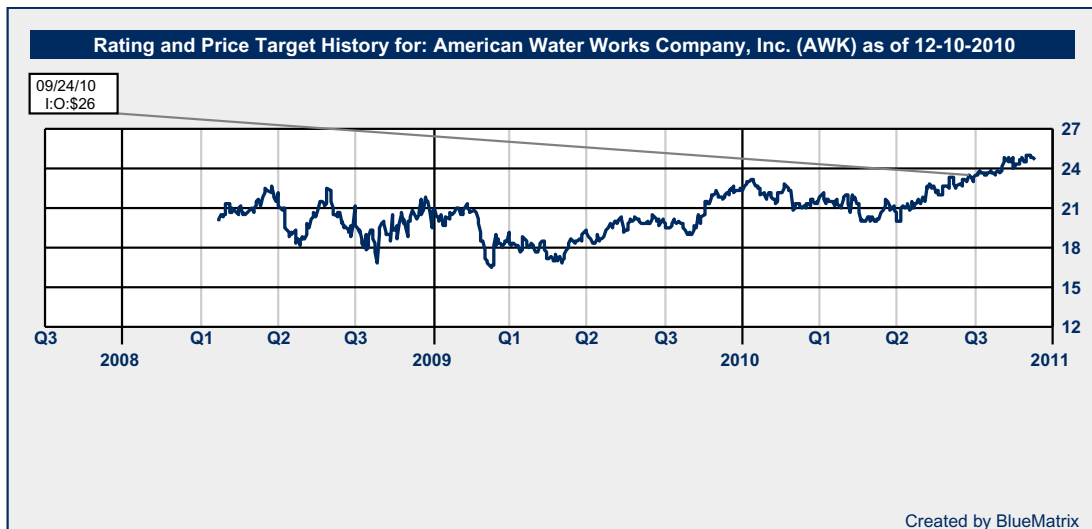
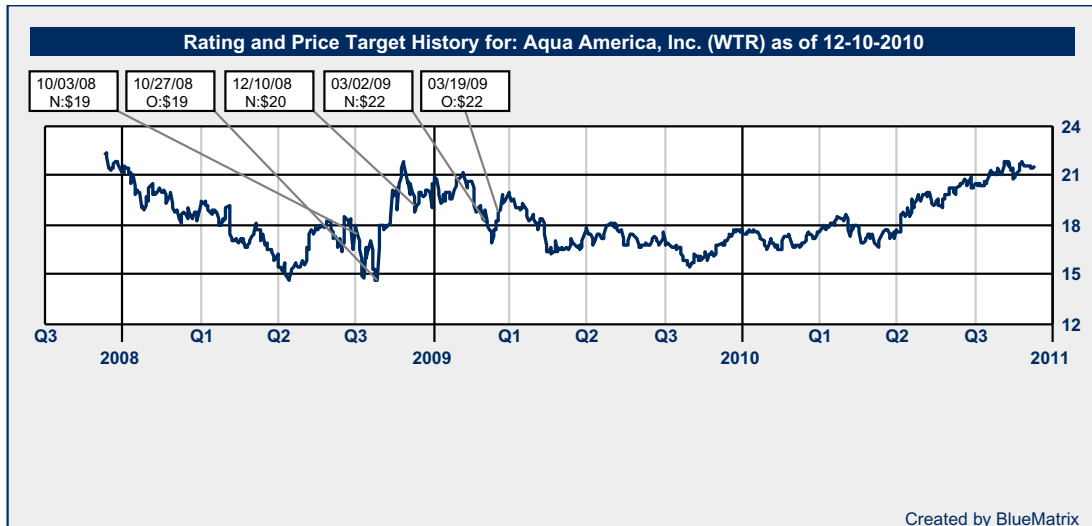
Summary

- **WTR agrees to buy TX assets from AWK for \$6 million.** This highlights WTR's growth-through-acquisition strategy, in which it targets states where it has established regulatory relationships, high growth potential, and an opportunity to increase its critical mass and economies of scale.
 - **TX acquisition will increase Aqua Texas' customer base by 8%.** Aqua Texas has experienced 2% YTD customer growth, largely attributable to prior acquisitions (1.3%). Nine of WTR's 21 acquisitions YTD have been of TX systems.
 - **WTR's pruning strategy remains intact,** as it agrees to sell its Missouri and South Carolina assets, which will conclude its operations in both states, if approved. WTR will redeploy capital from the sales into states with higher growth potential (i.e., TX) and effective regulatory return mechanisms (i.e., PA's DSIC mechanism).
 - **Reiterate Outperform rating for WTR and \$22 price target,** which is 21x our 2012 EPS estimate, in line with peers due to its earnings consistency and long-term growth opportunities.
- **AWK agrees to buy MO assets from WTR for \$3 million,** which will grow Missouri American's existing customer base by 2.2%. This growth in Missouri, AWK's fourth-largest state, is consistent with its strategy of leveraging its existing expertise to expand the system and optimize earned returns, while maintaining reasonable rates.
 - **Reiterate Outperform rating for AWK and \$26 price target,** which is 15.3x our 2012 EPS estimate, a discount to peers due to lower earned ROEs.
- **Both acquisitions are subject to regulatory approval and are expected to close by 8/2011.** We expect both acquisitions will receive necessary approval, given the acquirers' existing state operations, regulatory relationships, and strong financial standings.

Details

- Key risks for **WTR** include state/federal regulation, decreased water consumption, acquisition integration risk, and the water industry valuation premium.
 - Key risks for **AWK** include state/federal regulation, decreased water consumption, acquisition integration risk, water supply (notably in CA), balance sheet risk related to potential goodwill write-downs, and the water industry valuation premium.
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Utilities

December 14, 2010

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Utilities

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