

Equity Research

Aqua America

WTR: Lowering 10E EPS--Maintaining 11E EPS of \$0.92

- **Summary.** Reported 09 EPS of \$0.77. Lowering '10E EPS to \$0.84 from \$0.88. Maintaining '11E EPS of \$0.92. Rate relief, in particular the pending PA rate case, is the primary EPS growth driver, in our view. Reiterate Market Perform rating. Our positive biased toward WTR's strategy and EPS growth profile is tempered by valuation considerations. On a forward looking basis, shares trade at roughly 19x our 2011E, in-line with the water utility 2010E P/E median.
- **Reported 2009 EPS of \$0.77**, modestly below our \$0.78 and the consensus \$0.79 estimate, versus \$0.73 in 2008. Abnormally cool and wet weather across WTR's service areas combined with the economy resulted in a 4-5% decrease in 2009 send out. Other notable trends include a 150 bp decrease in WTR's efficiency ratio (revs/O&M) and nearly 1% customer growth.
- **EPS Outlook.** We are lowering our '10E EPS to \$0.84 from \$0.88 but are maintaining our '11E EPS of \$0.92. Our new estimates result in earned ROEs of roughly 10.5% and are based on preliminary adjustments following 2009 earnings. We plan to fully scrub the model following the 10-K filing. After the sizeable backlog of rate relief works its way through the income statement and the earned ROEs in currently depressed states improve, we believe WTR's annual EPS growth rate may revert to 5-7%.
- **EPS Drivers.** 2010 and beyond EPS drivers include the usual suspects – rate relief, O&M expense control and opportunistic growth through acquisitions – as management remains committed to its proven strategy. Also, a return to normal weather would benefit 2010 EPS by roughly \$0.03. While our model does not assume a settlement agreement in the pending \$43.2MM Pennsylvania rate case, we believe one may be plausible, which could prove our '10E conservative.
- **Financial Flexibility.** WTR continues to aggressively invest in infrastructure rehabilitation projects utilizing its strong balance sheet and cash flows. We forecast operating cash flow will fund 85% of 2010's \$300MM CapEx budget. The balance would be achieved through debt and equity (our model reflects \$50-55MM of new equity through 2011) in order to maintain a roughly 45% consolidated equity structure. WTR's strong capital position provides financial flexibility should a significant M&A opportunity arise.
- **CEO Nick DeBenedictis' contract extended to Jan. 2013.** We continue to believe developing and articulating to the investment community a seamless transition plan may be one of WTR's greatest challenges over the next 3-5 years.

Valuation Range: \$17.00 to \$18.00

Our relative P/E multiple (applying a ~5% premium to the '10 group median of 18X to our '11E EPS) and DDM analyses results in our 12-18 month valuation range. Risks include regulatory risk, potential undertaking of dilutive growth ventures and deterioration in the water industry's premium multiple relative to electric utilities.

Investment Thesis:

We regard WTR as one of the highest quality, fastest growing water utilities. Strong fundamentals include a growing rate base, largely constructive regulation, a disciplined M&A strategy, relatively low risk EPS growth and a growing dividend. Our Market Perform rating largely reflects valuation considerations.

Please see page 2 for rating definitions, important disclosures and required analyst certifications

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Market Perform

Sector: Water Utilities

Market Weight

Earnings Estimate Revised Down

EPS	2009A		2010E		2011E	
			Curr.	Prior	Curr.	Prior
Q1 (Mar.)	\$0.14	\$0.15			NE	
Q2 (June)	0.19	0.20			NE	
Q3 (Sep.)	0.25	0.28			NE	
Q4 (Dec.)	0.20	0.21			NE	
FY	\$0.77	\$0.84	0.88		\$0.92	
CY	\$0.77	\$0.84			\$0.92	
FY P/E	22.6x	20.7x			18.9x	
Rev.(MM)	\$671	\$719			\$773	

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters
NA = Not Available, NC = No Change, NE = No Estimate, NM = Not Meaningful

Ticker	WTR
Price (02/25/2010)	\$17.40
52-Week Range:	\$15-21
Shares Outstanding: (MM)	136.3
Market Cap.: (MM)	\$2,371.6
S&P 500:	1,094.38
Avg. Daily Vol.:	682,665
Dividend/Yield:	\$0.58/3.3%
LT Debt: (MM)	\$1,387.0
LT Debt/Total Cap.:	53.7%
ROE:	10.0%
3-5 Yr. Est. Growth Rate:	6.0%
CY 2010 Est. P/E-to-Growth:	3.4x
Last Reporting Date:	02/24/2010
	After Close

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters

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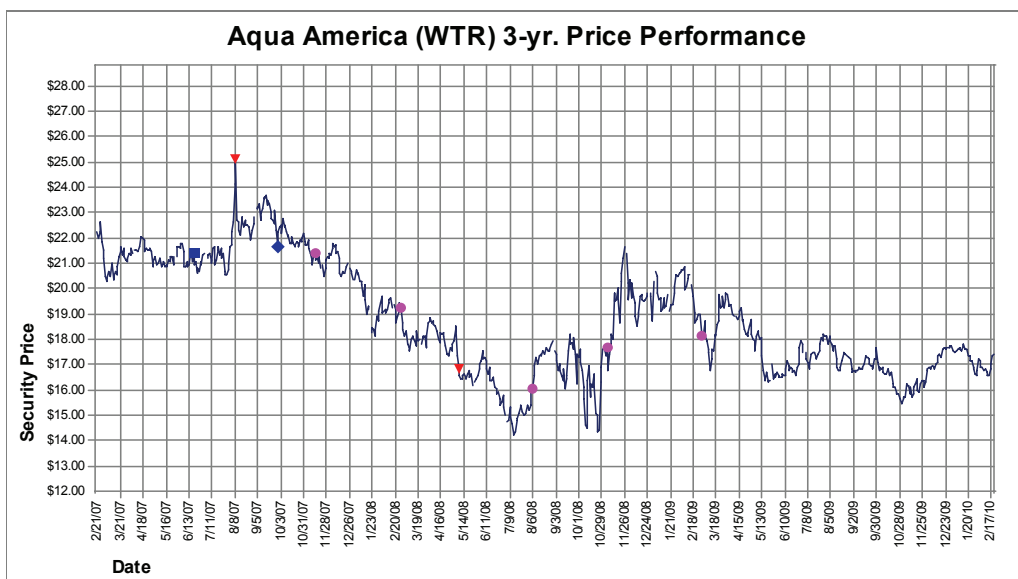
Together we'll go far



Company Description:

Headquartered in Bryn Mawr, PA, Aqua America (WTR) is one of the largest U.S.-based investor-owned regulated water and wastewater utilities. Aqua America, formally Philadelphia Suburban Corporation (PSC), serves approximately 2.8 million residents in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, New York, Indiana, Florida, Virginia, Maine, Missouri, and South Carolina. WTR's largest subsidiary, Aqua Pennsylvania, accounts for approximately half of the company's total customer base. The company's aggressive, yet disciplined, growth-through-acquisition strategy has resulted in more than 130 acquisitions and growth ventures adding roughly 250,000 customers over the last five years.

Required Disclosures



	Date	Publication Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
	2/21/2007		Winter			
	2/21/2007	NA	1	25.00	25.00	22.23
■	6/19/2007		Kalton			
▼	8/9/2007	NA	2	NE	NE	25.07
◆	9/28/2007	NA	NR	NE	NE	21.62
◆	11/14/2007	22.34	1	24.00	26.00	21.39
●	2/27/2008	19.57	1	22.00	23.00	19.24
●	5/7/2008	17.99	2	19.00	20.00	16.80
●	8/6/2008	16.42	2	17.00	18.00	16.01
●	11/5/2008	18.04	2	18.00	19.00	17.65
●	3/2/2009	18.40	2	17.00	18.00	18.13

Source: Wells Fargo Securities, LLC estimates and Reuters data

Symbol Key

- ▼ Rating Downgrade
- ▲ Rating Upgrade
- Valuation Range Change
- ◆ Initiation, Resumption, Drop or Suspend
- Analyst Change
- Split Adjustment

Rating Code Key

- 1 Outperform/Buy
- 2 Market Perform/Hold
- 3 Underperform/Sell
- SR Suspended
- NR Not Rated
- NE No Estimate

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WTR: Risks include regulatory risk, potential undertaking of dilutive growth ventures and deterioration in the water industry's premium multiple relative to electric utilities.

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2=Market Perform: The stock appears appropriately valued, and we believe the stock's total return will be in line with the market over the next 12 months. HOLD

3=Underperform: The stock appears overvalued, and we believe the stock's total return will be below the market over the next 12 months. SELL

SECTOR RATING

O=Overweight: Industry expected to outperform the relevant broad market benchmark over the next 12 months.

M=Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.

U=Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.

VOLATILITY RATING

V = A stock is defined as volatile if the stock price has fluctuated by +/-20% or greater in at least 8 of the past 24 months or if the analyst expects significant volatility. All IPO stocks are automatically rated volatile within the first 24 months of trading.

As of: February 25, 2010

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