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COMPANY INTERVIEW

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Aqua America, Inc.

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Aqua America, Inc. (WTR)



NICHOLAS DEBENEDICTIS is the Chairman and CEO of Aqua America, Inc. Previously Mr. DeBenedictis was Senior Vice President of Corporate and Public Affairs for PECO Energy. Prior to that, Mr. DeBenedictis was President of the Greater Philadelphia Chamber of Commerce. He served in two cabinet positions in the Pennsylvania government. Before joining the cabinet, he spent eight years with the U.S. Environmental Protection Agency. Mr. DeBenedictis received a bachelor's degree in business administration from Drexel University in 1968, and a master's degree in environmental engineering and science from Drexel in 1969. He served in the Army Corps of Engineers between 1970 and 1973, reaching the rank of Captain.

SECTOR — UTILITIES

(ALJ606) TWST: In Q2 your revenue was up almost 7%. Walk us through the factors that contributed to that increase.

Mr. DeBenedictis: As a utility, our revenues are dependent on how many assets we deploy, of which we've been doing a lot in the last four years. So a part of our 7% revenue growth was due to pricing to pay for the assets, while the remainder is due to new growth. We are one of the faster-growing utilities in the country because the water sector is not 100% franchised like the electric sector. There is a large market share, about 85%, that is still municipal. Some of the growth is from purchases of small systems. The third factor influencing revenues is weather. Good weather for us is hot and dry because that's when people use more of our product. We had a good spring — not a great spring — and that helped to increase revenues over the prior year.

TWST: What is the latest status of your rate cases?

Mr. DeBenedictis: This year to date, we have more than \$40 million in recoveries already approved in 2010. We have several cases pending and will have updated numbers for our earnings call on November 5. When you are in 14 states, there is always some investment recovery through rates that you have to do. Every situation in each state is different relative to when you are putting the infrastructure or new plants in service, EPA rules and also what the growth factors are in each state. So there will always be, I would predict, three or four rate cases ongoing at any time in the company. Fair recovery on our investments is part of our business model. But this year and last, we saw extraordinary gains due to rates because we had three or four years of construction expense necessary to fix up old systems that we bought from electric companies in the South. They needed a lot of work before we could even go in for rates, and because of that, the rate recovery backed up, causing us to go in for an inordinate amount of rates in 2009 and 2010. The rates schedule should settle to a more normal pace as we go forward and begin recovering our investments on a more regular basis.

TWST: You said on your Q2 earnings call that you expected your total number of acquisitions to be between 25 and

30 by year-end. Is that still the current projection? What are the characteristics or geographies that you look for in targets?

Mr. DeBenedictis: First, to put the water industry demographics in perspective, there are more than 50,000 water companies in the country regulated by the EPA. Some are small, some are large. We target small- to medium-size systems; the larger ones are usually municipally owned city operations. Every year we do a couple dozen acquisitions. This year we are projecting 20 to 30 and are still on track to do that. All of them are in states where we already have operations. We call them tuck-in acquisitions that fill in the areas where we already have a presence and bring economies of scale. They add customers and allow us to spread our overhead across more customers and also present a new place to invest in assets. Growth through acquisition is a core part of our business. We've done well over 200 acquisitions over the last decade or so.

TWST: Give us some insight into your capital program. What types of projects do you have underway or planned at this point?

Mr. DeBenedictis: We plan in five-year increments. In the next five years, we will spend about \$1.5 billion in capital mainly on infrastructure — pipe, tanks, pumps, much of which is underground. If the infrastructure isn't working properly it can undermine the entire economic development of our society. So infrastructure is crucial. It's very bothersome to me that municipalities seem to defer maintenance and infrastructure investment because of the significant costs, but at Aqua we've been able to work with our states to encourage them to give us an economic incentive to actually make the investment in infrastructure. I use the expression, "Pay me now, or pay me later." It's less expensive to make the investments now under a strategic reinvestment plan like we are doing, where we have smaller rate increases every other year, than to wait until things break and then try and fix them all at once.

TWST: I know you have done some borrowing recently to support your capital program. Would you comment on the overall strength of your balance sheet at this point in time?

Mr. DeBenedictis: Our Aqua Pennsylvania subsidiary,

which is our largest, just got an A+ corporate rating from S&P last week, and I think that tells it all. We are borrowing out of Aqua Pennsylvania because that's where we are doing most of the infrastructure this year; over \$200 million of our \$300 million budget has gone into Pennsylvania. I think we've always had a sound balance sheet. The irony is that we get an A+ in Pennsylvania even though we are cash negative, and that I think speaks to the rating agency's confidence in the regulatory mechanisms in place in Pennsylvania for investment recovery. I think the S&P rating indicates our balance sheet is firm. We do have a solid equity position in the company. We've been around for 125 years, and we've had consistent earnings growth for the last 10 years.

TWST: You've received solar grants. Tell us about the solar projects that you've completed or are in the process of completing. How will they create value for your shareholders?

Mr. DeBenedictis: They create value for both our ratepayers and our shareholders, which is really a win-win. The solar allows us to employ capital. Because we are getting some grant money, the cost for that capital is, in both cases, the one we've already built and the one we are planning to break ground on. Both solar farms — 1.0 and 1.5 megawatts each — will help power two of our water treatment plants. During periods of low electric demand, we will actually sell electricity back to the grid. The farms will displace rising electric costs at those two plants with basically no operational costs. That's where it helps the ratepayer. It helps the shareholder because we will invest about \$3,800 a kilowatt, which is very competitive. I'm on the board of an electric company, and Aqua's cost is very competitive with the cost at which we install new generation. So it's really good for the electric grid, also less expensive power. The capital that we deploy, which in this case would be around \$9 million to \$10 million a megawatt, is all recoverable in rates.

TWST: Tell us about your other efforts, initiatives or programs to protect the environment and promote sustainability.

Mr. DeBenedictis: We have a sustainability report you can get by going to our Web site. The company has been in the water business for 125 years. Our business focus — the treatment of water to make it safe for people to drink — has stayed the same over that century and a quarter. I think just defining our mission tells you that we're a 100% environmentally conscious company. Even the way we handle our backwash water and the treatment of the residuals is done in a sustainable fashion. There is nothing more sustainable than water. There has not been a new drop of water created since the beginning of time. So if we don't treat water supply with respect, survival is at stake.

TWST: Tell us about some of your most significant costs and the strategies you've been using to control those costs.

Mr. DeBenedictis: We track costs very carefully, and we compare them to revenues. We look at what we refer to as our efficiency ratio, which is operation and maintenance costs over revenue. That's a balancing benchmark to compare any major corporation and/or utility. First, you look at the bottom line, and we are very good there. We have a healthy, about 16% return on revenue after

taxes. We don't have a lot of revenue — \$700 million isn't a lot of revenue. On the other hand, that revenue is profitable, and part of the reason is that we keep costs down and pass those savings along to our ratepayers — once again a win-win. Less than \$0.40 on the dollar goes into running the business; all the rest goes to capitalizing our huge asset base, which is more than \$3.5 billion. At 39% I think the record shows we are the most efficient utility in the country, based on operating expenses to revenue.

TWST: What's the most difficult challenge that you're facing right now, and what are you and your team doing to mitigate any negative impact it could have on the company?

Mr. DeBenedictis: The most difficult business challenge is something we cannot control, and that's growth in the economy. A lot of our new growth comes from new housing starts. So with new construction down, we would love to see a return in the confidence factor so builders start building homes because people want to buy them again. That's part of our inherent, or what we call organic, growth on the system. Complementary to the new housing growth is the fact that there are some small systems out of those 50,000 companies I mentioned that need growth in order to just stay alive. Without the growth, they are put in a position that might force them to be consolidated into a larger company like ours. We are the second largest water company in the country.

TWST: To close, explain why now is a good time to be invested in Aqua America.

Mr. DeBenedictis: First of all, during the 2008 credit crunch, because of the market's defensive nature and our steady dividend and earnings, our stock didn't go down like most companies or like the general market. If you take a look at the 10-year picture, we are exceeding S&P and the Dow performance by a significant margin. We believe we are one of the more favored companies in the utility industry. Water is a niche industry, and we believe we are the best and one of most profitable companies, not only among the water utilities but of the utility universe. Investors in Aqua have the security of monopoly status and knowledge that we provide a product that we think has no threat of going out of business. Couple that with the consistency of performance, the fact that we have more cash generation now than we've ever had, little share dilution and achieve the kind of growth that we are experiencing. We basically have good performing assets, which is the key if you are going to buy a long-term utility investment. Make sure the assets are well positioned and are good performing assets.

TWST: Thank you. (MES)

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