

Another AWK/WTR Swap: AWK gets NY, WTR gets OH; Deal Makes Sense, but a Wash

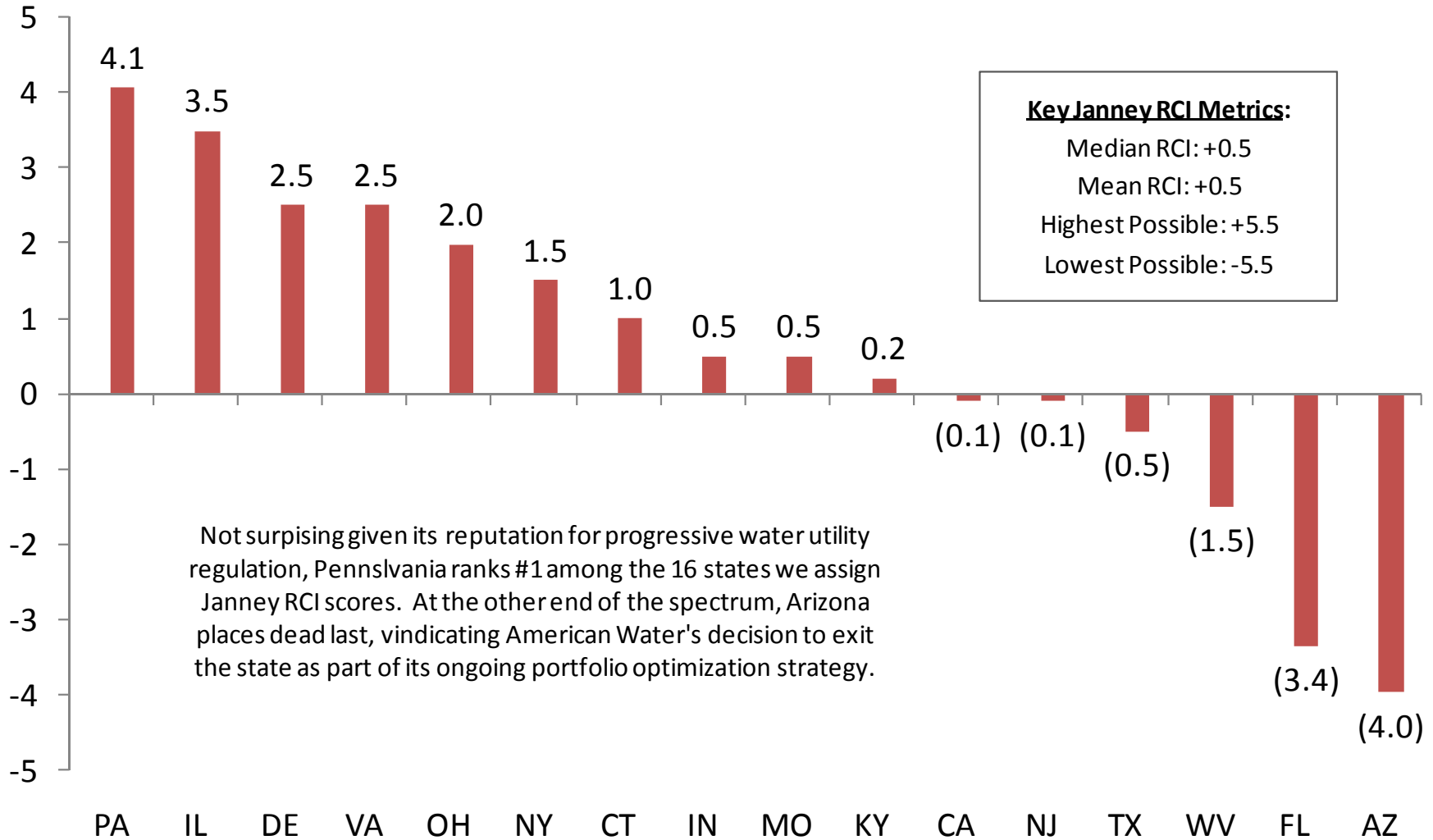
INVESTMENT CONCLUSION:

American Water and Aqua America, the two largest investor-owned water utilities in the U.S., have agreed to swap assets in states where each company has a critical mass advantage. Our review of the transactions is below.

KEY POINTS:

- **AWK and WTR announce another asset swap; AWK gets NY, WTR gets OH.** This morning, American Water (AWK-BUY) and Aqua America (WTR-Neutral) announced an asset swap in which American will pay \$71 million (Enterprise Value) for Aqua America's New York regulated operations while Aqua will pay \$120 million (Enterprise Value) for American Water's regulated operations in Ohio. The deal is expected to close during 1Q-2012. This is the second such deal the companies have announced, following a similar transaction in which American Water received Aqua's Missouri operations and Aqua America took ownership of American Water's Texas business.
- **What each company gets: customer base and geographic focus of the properties.** The New York operations that American Water gets are located on Long Island, perfectly complementing American's water existing New York properties - also located on Long Island. American Water's existing New York franchise population base of roughly 220,000 will be nearly doubled by adding Aqua's 150,000 population served. American's Ohio operations are located throughout the state of Ohio, including the Cleveland and metropolitan area, and Aqua America will add nearly 60,000 customers to its existing Ohio customer base of about 100,000. Both companies will now be the largest investor-owned utilities in these respective states.
- **New York has a slightly higher Janney RCI score, but regulatory climates similar.** We believe regulatory environment is far and away the most important factor in driving water utility fundamentals, and use our proprietary Janney Regulatory Climate Indicator (RCI) to gage state's relative attractiveness. At 2.0, New York's Janney RCI score is modestly higher than Ohio's (1.5), but the difference is not significant enough to say that either company's "wins" in this transaction from a regulatory standpoint. As a result, there is no change to our fair value estimates or ratings for either company. Similarly, the prices paid on both side of the transaction appear fair. Of note, AWK gets more cash than WTR, making it the net "divester" in the deal - and in theory the transaction could delay the timeframe for a secondary offering. For full Janney RCI rankings see page 2.
- **Deal makes a lot of sense; Scale matters, and swaps a means of rationalization.** Overall, we are big fans of these "swap" transactions between the water utility industry's two biggest players, as both companies' portfolios had gotten somewhat unwieldy after years of "tuck-in" acquisition activity. Scale matters in the regulated business, as larger players carry more political clout and therefore are in a better position not only in rate case proceedings but also in moving forward progressive regulatory approaches. In addition, these deals are a great way to rally around strong territories and enable a "fresh start" where a regulatory relationship had degraded. In this case, Senator Charles Schumer's recent criticism of Aqua's rate increases and American's sub-optimal treatment in Ohio (AWK's last granted ROE in OH was 9.3% versus WTR's 10.5%) were likely factors helping to drive the deal forward.
- **While we like the asset swap transactions, true industry consolidation remains elusive.** Although we believe this transaction makes tremendous sense on a number of levels, an ironic sidebar is what continued asset swaps among the industry's largest players say about the state of true industry consolidation in the space. Indeed, the two AWK/WTR swaps now register as among the largest recent deals in the space, with the others being American's divestiture of New Mexico and Arizona and Nashua's (NH) impending take-over of Pennichuck. In our view, the evidence is supportive of the notion that consolidation is an overplayed growth theme in the water utility space.

Janney RCI Scores for Key Investor-Owned Utility States



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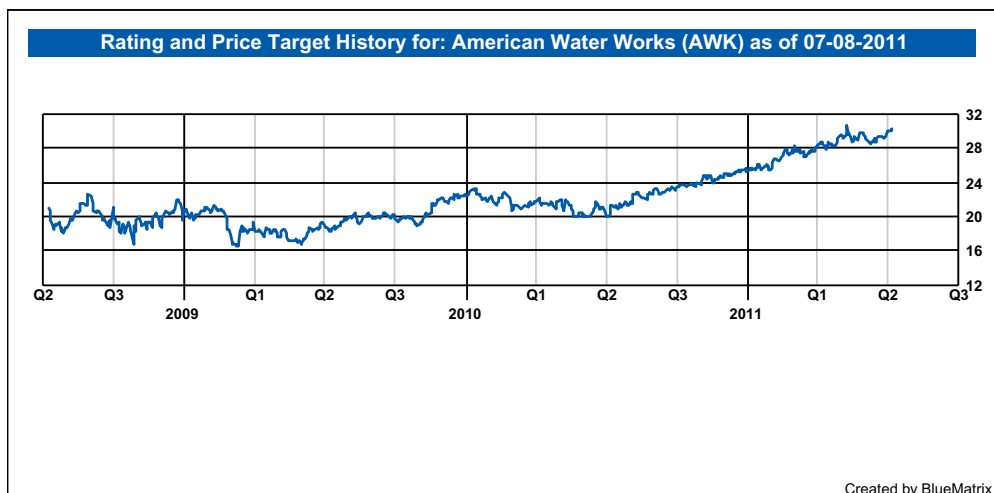
Definition of Ratings

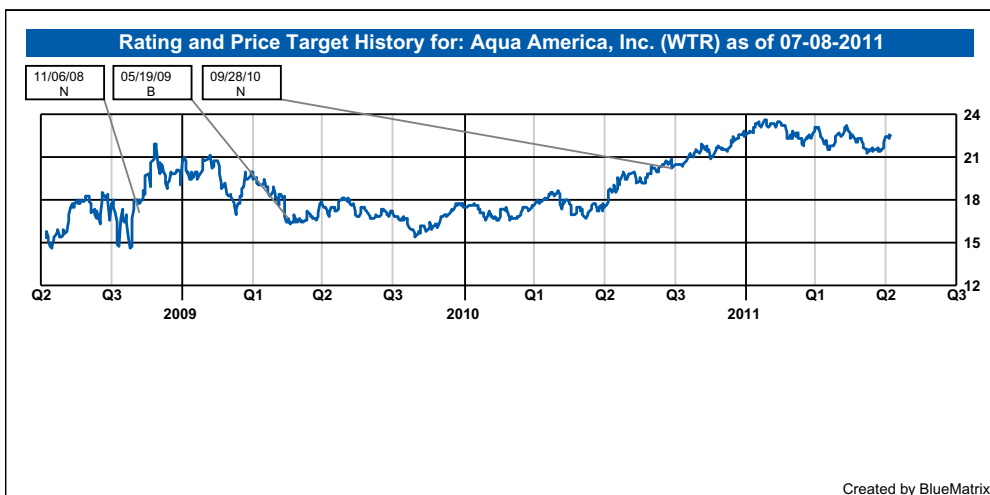
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Price Charts





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			Count	Percent
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***Percentages of each rating category where Janney has performed Investment Banking services over the past 12 months.**

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