

# Equity Research

## Aqua America

WTR: No Change To Our EPS Outlook Or Thesis Following Q1

- Summary.** Q1 in line with expectations. Our 2011-13E EPS remain \$0.95, \$1.02, and \$1.08 and we continue to believe 6-7% average annual EPS growth is achievable. We continue to like WTR from a fundamental perspective--industry leading management team, proven EPS growth strategy, lean operator, strong balance sheet and considerable financial flexibility should a significant M&A opportunity arise--however, valuation considerations keep us on the sidelines. We reiterate our Market Perform rating as shares trade 21x our 2013E, a significant premium to the 15.5x peer group multiple.
- Q1 EPS In Line.** WTR reported ongoing Q1 EPS of \$0.18, in line with our estimate, versus \$0.15 last year. Q1 2011 EPS exclude a \$0.03 state tax benefit and a \$0.01 gain from the sale of a Texas system. Drivers include rate relief and O&M expense control.
- EPS Outlook.** Our 2011-13E EPS remain \$0.95, \$1.02, and \$1.08. We believe the wet start to Q2, which negatively affects customer consumption, may be offset by modestly lower operating cost trends and lower financing costs given state tax law changes. However, with only one quarter in the books and the weather-sensitive summer season ahead, we believe it would be premature to adjust our outlook. We believe five-year weather-normalized average annual EPS growth of 6-7% is achievable. We model efficiency ratio gains of about 50bps, which results in a lean 36% ratio in 15.
- Cash Flows And Balance Sheet.** Increased cash generation driven by growing earnings streams and bonus depreciation tax benefits alleviates the need for much external financing. We project only \$270MM of net new debt to fund \$1.55B of capex over the next five years as well as maintain \$0.04 annual dividend increases. We do not foresee any equity offerings outside the DRIP, barring a sizeable acquisition. However, we forecast improvement in the consolidated equity ratio to 44.2% from 41.6% at year-end 2010. WTR has considerable financial flexibility should a significant M&A opportunity arise, particularly at a time when many municipal systems are experiencing financial distress.
- Rate Relief.** WTR plans to file 18 rate requests throughout the year for roughly \$28MM in relief outside of Pennsylvania according to its 10-K filing. The utility is to make its biennial Pennsylvania filing this November with new rates effective mid-2012. Year to date, WTR has received \$11.5MM of rate awards and has seven cases pending totaling \$26MM of requested relief.

### Valuation Range: \$21.00 to \$22.00

Our VR is based on a relative P/E multiple (applying a 5-10% premium to the '12E group median of 18X to our '12E EPS) and DDM analyses. 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 4 for rating definitions, important disclosures and required analyst certifications**

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## Market Perform

Sector: Water Utilities  
Market Weight

### Earnings Reported

EPS	2010A		2011E		2012E	
			Curr.	Prior	Curr.	Prior
Q1 (Mar.)	\$0.15	\$0.15	\$0.19 A	0.18	NE	NE
Q2 (June)	0.22	0.23	0.23	NC	NE	NE
Q3 (Sep.)	0.32	0.31	0.31	NC	NE	NE
Q4 (Dec.)	0.21	0.23	0.23	NC	NE	NE
FY	\$0.89	\$0.95	\$0.95	NC	\$1.02	NC
CY	\$0.89	\$0.95	\$0.95		\$1.02	
FY P/E	25.2x	23.6x	23.6x		22.0x	
Rev.(MM)	\$726	\$774	\$774		\$821	

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters  
NA = Not Available, NC = No Change, NE = No Estimate, NM = Not Meaningful  
V = Volatile, \* = Company is on the Priority Stock List

Ticker	WTR
Price (05/06/2011)	\$22.43
52-Week Range:	\$16-24
Shares Outstanding: (MM)	138.0
Market Cap.: (MM)	\$3,095.3
S&P 500:	1,335.10
Avg. Daily Vol.:	542,454
Dividend/Yield:	\$0.62/2.8%
LT Debt: (MM)	\$1,530.0
LT Debt/Total Cap.:	53.8%
ROE:	11.0%
3-5 Yr. Est. Growth Rate:	6.0%
CY 2011 Est. P/E-to-Growth:	3.9x
Last Reporting Date:	05/06/2011
	After Close

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

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Together we'll go far



**Utilities**

**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.

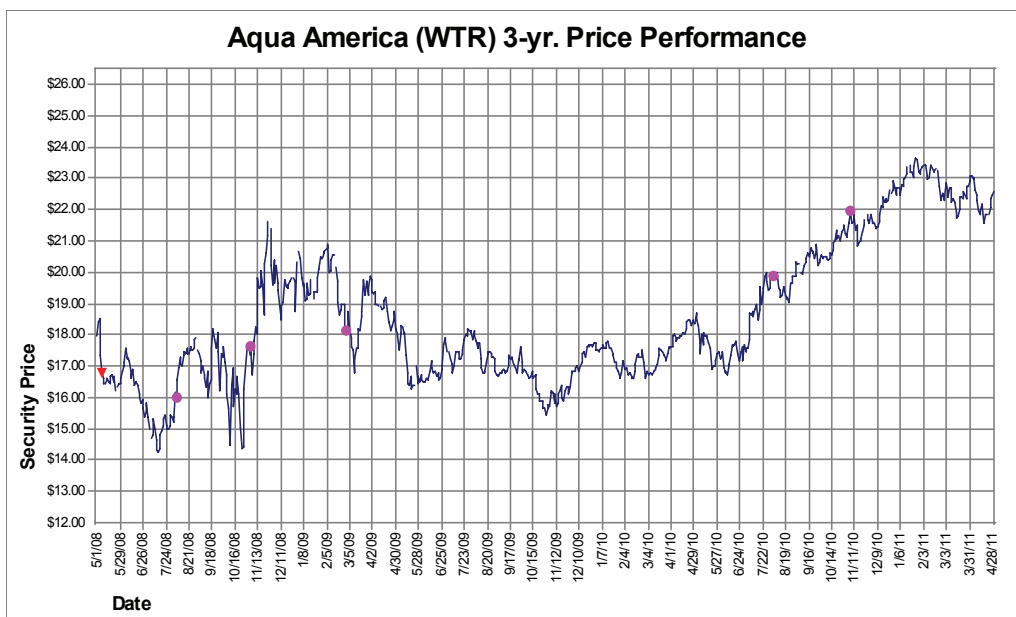
Earnings Model (\$ in thousands, except per share data)	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
<b>Revenues</b>	<b>626,972</b>	<b>670,539</b>	<b>726,072</b>	<b>774,355</b>	<b>821,420</b>	<b>861,291</b>	<b>902,168</b>	<b>942,829</b>
<b>Operating Expenses</b>								
Operation & Maintenance	262,122	270,060	279,962	294,707	308,513	319,181	329,818	339,969
Efficiency Ratio	41.8%	40.3%	38.6%	38.1%	37.6%	37.1%	36.6%	36.1%
Depreciation & Amortization	94,300	114,939	121,067	130,978	140,158	149,089	157,742	166,433
Other taxes	44,749	48,081	52,967	56,528	59,964	62,874	65,858	68,827
<b>Total Operating Expenses</b>	<b>401,171</b>	<b>433,080</b>	<b>453,996</b>	<b>482,213</b>	<b>508,634</b>	<b>531,144</b>	<b>553,418</b>	<b>575,229</b>
<b>Operating Income</b>	<b>225,801</b>	<b>237,459</b>	<b>272,076</b>	<b>292,142</b>	<b>312,786</b>	<b>330,147</b>	<b>348,750</b>	<b>367,600</b>
<b>EBITDA</b>	<b>320,101</b>	<b>352,398</b>	<b>393,143</b>	<b>423,120</b>	<b>452,944</b>	<b>479,236</b>	<b>506,491</b>	<b>534,033</b>
Other Income	5,273	3,343	7,645	3,000	3,000	3,000	3,000	3,000
Interest Expense	68,572	68,607	75,652	77,268	79,473	82,506	85,262	87,034
EBT	162,502	172,195	204,069	217,873	236,314	250,641	266,488	283,566
Income Tax Expense	64,584	67,842	80,094	85,949	94,492	99,675	106,713	113,629
Tax Rate	39.7%	39.4%	39.2%	39.4%	40.0%	39.8%	40.0%	40.1%
Net Income	97,918	104,353	123,975	131,924	141,822	150,965	159,775	169,937
Other Comprehensive Income	(14)	294	219	0	0	0	0	0
Non-Recurring Items	(195)	(289)	(1,588)	0	0	0	0	0
Ongoing Net Income	97,709	104,358	122,606	131,924	141,822	150,965	159,775	169,937
Diluted EPS, as reported	\$0.73	\$0.77	\$0.90	\$0.95	\$1.02	\$1.08	\$1.13	\$1.20
Adjustments	(\$0.00)	(\$0.00)	(\$0.01)	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
<b>Ongoing Diluted EPS</b>	<b>\$0.73</b>	<b>\$0.77</b>	<b>\$0.89</b>	<b>\$0.95</b>	<b>\$1.02</b>	<b>\$1.08</b>	<b>\$1.13</b>	<b>\$1.20</b>
Avg. Diluted Common Shares Out	134,705	136,129	137,296	138,926	139,626	140,326	141,026	141,726
Dividends								
Dividends Paid Per Share	\$0.51	\$0.55	\$0.59	\$0.63	\$0.67	\$0.71	\$0.75	\$0.79
Payout Ratio	70%	72%	66%	66%	66%	66%	66%	66%
Statistics								
Year-end BVPS	\$7.82	\$8.12	\$8.52	\$8.92	\$9.34	\$9.78	\$10.25	\$10.75
Average BVPS	\$7.57	\$7.97	\$8.32	\$8.72	\$9.13	\$9.56	\$10.02	\$10.50
<b>Earned ROE, ongoing</b>	<b>9.6%</b>	<b>9.6%</b>	<b>10.7%</b>	<b>10.9%</b>	<b>11.1%</b>	<b>11.3%</b>	<b>11.3%</b>	<b>11.4%</b>
EBITDA Per Share	\$2.38	\$2.59	\$2.86	\$3.05	\$3.24	\$3.42	\$3.59	\$3.77
Free CFPS	(\$0.64)	(\$1.00)	(\$1.47)	(\$0.36)	(\$0.67)	(\$0.62)	(\$0.53)	(\$0.44)
FCF (After Dividends, Before Financing)	(85,769)	(136,803)	(201,267)	(50,517)	(93,534)	(86,509)	(75,152)	(62,461)

Source: Wells Fargo Securities, LLC estimates and company filings

<b>Cash Flow Model</b> <b>(\$ in thousands)</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011E</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>	<b>2015E</b>
<b>Operating Cash Flows</b>								
Net Income	97,918	104,353	123,975	131,924	141,822	150,965	159,775	169,937
Depreciation and Amortization	94,300	114,939	121,067	130,978	140,158	149,089	157,742	166,433
Other	29,288	39,298	18,800	108,600	55,000	25,000	25,000	25,000
<b>Net Cash Flows from Operations</b>	<b>221,506</b>	<b>258,590</b>	<b>263,842</b>	<b>371,502</b>	<b>336,979</b>	<b>325,054</b>	<b>342,517</b>	<b>361,370</b>
<b>Investing Cash Flows</b>								
Capital Expenditures	(267,418)	(283,584)	(326,626)	(325,000)	(325,000)	(300,000)	(300,000)	(300,000)
Acquisitions	(14,659)	(3,373)	(8,625)	(10,000)	(12,500)	(12,500)	(12,500)	(12,500)
Other	43,306	(33,707)	(48,951)	0	0	0	0	0
<b>Net Cash Flows from Investing</b>	<b>(238,771)</b>	<b>(320,664)</b>	<b>(384,202)</b>	<b>(335,000)</b>	<b>(337,500)</b>	<b>(312,500)</b>	<b>(312,500)</b>	<b>(312,500)</b>
<b>Financing Cash Flows</b>								
Issuance of Long-term Debt	52,741	197,855	272,754	65,000	107,000	103,000	141,000	105,000
Repayment of Long-term Debt	(39,038)	(20,789)	(161,096)	(28,413)	(39,638)	(34,393)	(85,692)	(63,215)
Short-term Debt, net	23,671	(53,102)	62,181	0	0	0	0	0
Common Stock Issuance, net	46,192	13,280	17,438	15,400	16,170	16,979	17,827	18,719
Dividends on Common Stock	(68,504)	(74,729)	(80,907)	(87,019)	(93,013)	(99,063)	(105,169)	(111,331)
Other	2,607	6,484	(5,945)	1,500	1,500	1,500	1,500	1,500
<b>Net Cash Flows from Financing</b>	<b>17,669</b>	<b>68,999</b>	<b>104,425</b>	<b>(33,532)</b>	<b>(7,981)</b>	<b>(11,978)</b>	<b>(30,534)</b>	<b>(49,327)</b>
Net Change in Cash	404	6,925	(15,935)	2,970	(8,502)	576	(517)	(458)
Beginning of Year Balance	14,540	14,944	21,869	5,934	8,904	402	978	461
<b>End of Year Balance</b>	<b>14,944</b>	<b>21,869</b>	<b>5,934</b>	<b>8,904</b>	<b>402</b>	<b>978</b>	<b>461</b>	<b>4</b>
<b>Capital Structure (\$ in thousands)</b>								
Common Equity	1,058,446	1,108,904	1,174,254	1,234,559	1,299,537	1,368,418	1,440,852	1,518,176
Long-term Debt	1,248,104	1,386,557	1,531,976	1,568,563	1,635,925	1,704,532	1,759,840	1,801,625
Short-term Debt	87,886	87,064	118,081	118,081	118,081	118,081	118,081	118,081
Minority Interest	2,181	560	572	572	572	572	572	572
<b>Total Capitalization</b>	<b>2,396,617</b>	<b>2,583,085</b>	<b>2,824,883</b>	<b>2,921,775</b>	<b>3,054,115</b>	<b>3,191,603</b>	<b>3,319,345</b>	<b>3,438,454</b>
<b>% Common Equity</b>	<b>44.2</b>	<b>42.9</b>	<b>41.6</b>	<b>42.3</b>	<b>42.6</b>	<b>42.9</b>	<b>43.4</b>	<b>44.2</b>
% Long-term Debt	52.1	53.7	54.2	53.7	53.6	53.4	53.0	52.4
% Other	3.8	3.4	4.2	4.1	3.9	3.7	3.6	3.5
<b>Year-end Rate Base</b>	<b>2,569,262</b>	<b>2,741,798</b>	<b>2,923,587</b>	<b>3,051,109</b>	<b>3,191,951</b>	<b>3,328,863</b>	<b>3,457,121</b>	<b>3,576,688</b>

Source: Wells Fargo Securities, LLC estimates and company filings

## Required Disclosures



	Date	Publication Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
	5/1/2008		Kalton			
	5/1/2008	NA	1	22.00	23.00	17.94
▼ ●	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
●	8/4/2010	19.75	2	19.00	20.00	19.87
●	11/5/2010	21.89	2	21.00	22.00	21.93

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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**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.

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As of: May 6, 2011

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Wells Fargo Securities, LLC has provided investment banking services for 48% of its Equity Research Market Perform-rated companies.

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