

Equity Research

Aqua America

WTR: EPS Outlook Increased--Reiterate Market Perform

- Summary.** Q2 report and conference call prompts model revisions. New 2011E-13E ongoing EPS are \$0.99, \$1.05 and \$1.12 versus \$0.95, \$1.02 and \$1.08 previously. Assuming 2011 "weather-normalized" EPS power of roughly \$0.97, we project a healthy 6% EPS CAGR over the next 5 years driven by rate relief, cost controls and minimal external financing needs. 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. Reiterate our Market Perform rating as shares trade 19.5x our 2013E, a significant premium to the 15.5x "large cap" water utility group multiple and 12.5x regulated electric utility multiple.
- Q2 EPS.** Reported ongoing Q2 EPS of \$0.25, modestly ahead of expectations, versus \$0.22 last year. Q2 2011 EPS excludes a \$0.02 state tax benefit. Primary EPS drivers include rate relief and O&M expense control.
- EPS Outlook.** We increase our 2011E-13E EPS to \$0.99, \$1.05 and \$1.12 from \$0.95, \$1.02 and \$1.08. Favorable June and July weather to kick off the summer has led us to increase our sales forecast. Assuming 2011 "weather-normalized" EPS power of roughly \$0.97, we project a healthy 6% EPS CAGR through 2015 driven by rate relief, cost controls and minimal external financing needs. Including infrastructure mechanisms, WTR has received \$18MM in rate relief in 2011 with another \$25MM pending. The company plans to file 7 cases before year-end requesting \$45-50MM of additional relief, the bulk of which will be attributable to its biennial PA filing this November (new rates effective mid-2012). We model efficiency ratio gains of roughly 50bps going forward which results in a lean 36% ratio in 2015.
- Cash Flows & Balance Sheet.** Increased cash generation driven by growing earnings and 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 a nearly 300bps improvement in the equity ratio to 44.3%. While WTR has been busy optimizing its portfolio of states, the additions in OH and TX have been almost entirely offset by the divestiture of ME, MO, NY and SC from both a cash flow and rate base perspective. We think WTR has considerable financial flexibility should a significant M&A opportunity arise, particularly at a time when many municipal systems are experiencing financial distress.

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 2 for rating definitions, important disclosures and required analyst certifications

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Market Perform

Sector: Water Utilities

Market Weight

Earnings Estimates Revised Up

EPS	2010A	2011E		2012E	
		Curr.	Prior	Curr.	Prior
Q1 (Mar.)	\$0.15	\$0.19 A	NC	NE	
Q2 (June)	0.22	0.25 A	0.23	NE	
Q3 (Sep.)	0.32	0.34	0.31	NE	
Q4 (Dec.)	0.21	0.23	NC	NE	
FY	\$0.89	\$0.99	0.95	\$1.05	1.02
CY	\$0.89	\$0.99		\$1.05	
FY P/E	24.5x	22.0x		20.7x	
Rev.(MM)	\$726	\$772		\$811	

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

Our 2011E excludes the expected PA state tax benefit (+\$0.09), TX system sale gain (+\$0.01) and ME and NY held for sale accounting adjustment (-\$0.04-0.05).

Ticker	WTR
Price (08/03/2011)	\$21.77
52-Week Range:	\$18-24
Shares Outstanding: (MM)	138.0
Market Cap.: (MM)	\$3,004.3
S&P 500:	1,257.42
Avg. Daily Vol.:	511,046
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:	3.7x
Last Reporting Date:	08/02/2011
	After Close

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

Neil Kalton, CFA, Senior Analyst
 (314) 955-5239 / neil.kalton@wellsfargo.com
 Jonathan Reeder, Associate Analyst
 (314) 955-2462 /
 jonathan.reeder@wellsfargo.com
 Sarah Akers, CFA, Associate Analyst
 (314) 955-6209 / sarah.akers@wellsfargo.com

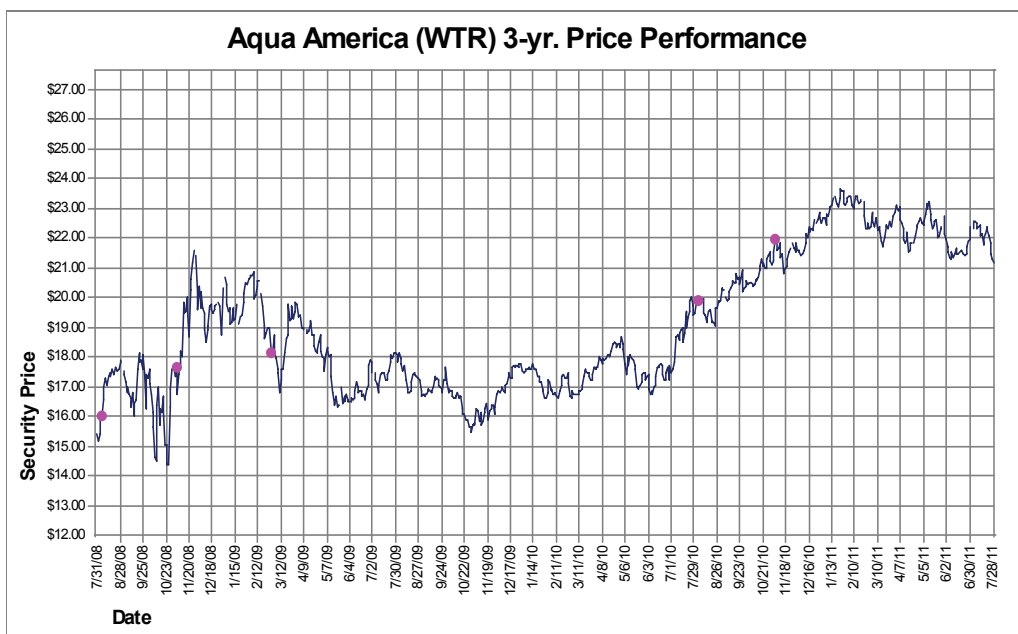
Together we'll go far



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 (\$)
	7/31/2008		Kalton			
	7/31/2008	NA	2	19.00	20.00	15.40
●	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

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|-------------------|---|------------------------|---------------------|
| Symbol Key | | Rating Code Key | |
| ▼ | Rating Downgrade | 1 | Outperform/Buy |
| ▲ | Rating Upgrade | 2 | Market Perform/Hold |
| ● | Valuation Range Change | 3 | Underperform/Sell |
| ◆ | Initiation, Resumption, Drop or Suspend | SR | Suspended |
| ■ | Analyst Change | NR | Not Rated |
| □ | Split Adjustment | NE | No Estimate |

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Aqua America

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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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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

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

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

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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.

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