

## Equity Research

### Aqua America

WTR: Attractive EPS Outlook Tempered By Premium Valuation

- Summary.** We have modestly increased our 2011-13E EPS to \$0.95, \$1.02 and \$1.08 from \$0.94, \$1.00 and \$1.07 though our 2011E is below the \$0.97 estimate management indicated it is "comfortable" with. 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--valuation considerations keep us on the sidelines. Reiterate Market Perform as shares trade 22x our 2012E, a significant premium to 16x peer group multiple.
- 2010 Results.** WTR reported 2010 ongoing EPS of \$0.89, in line with our estimate, vs. \$0.77 last year. Results exclude a \$0.01 investment sale gain. EPS drivers include favorable weather (we estimate was +\$0.06 vs. 2009 and +\$0.03 vs. normal), rate relief and continued cost controls (efficiency ratio lowered 170bps to 38.6%) partially offset by its growing depreciable base, higher interest expense and modest share dilution.
- EPS Outlook.** Modestly increased our 2011-13E EPS to \$0.95, \$1.02 and \$1.08 from \$0.94, \$1.00 and \$1.07. Increased cash generation driven by growing earnings streams and bonus depreciation tax benefits eliminated additional debt needs we had previously baked in. Management acknowledged on its earnings call it was "comfortable" with \$0.97 consensus estimate in 2011 thus we plan to fully scrub our model after the 10-k is filed to see where we may be overly conservative. Forecasting efficiency ratio gains of ~50bps going forward however this leaves us somewhat short of management's 36% goal by 2014. We believe 5-year weather normalized average annual EPS growth of 6-7% is achievable.
- Focused Growth Strategy.** 1% customer growth was achieved in 2010 consisting of 0.4% organic and 0.6% acquisition growth. Though slower than WTR's historical levels, we are encouraged by WTR's focused growth strategy. Opportunistic large acquisitions in 2003-04 hampered WTR's EPS growth from 2006-08 as the systems were digested however we believe the company is back on track to achieve above average growth underpinned by proven M&A efforts. Management has exited states where it lacks a significant presence or reasonable returns are not achievable and has focused its tuck-in acquisition strategy to states it believes have the best prospects. WTR completed 23 deals in 2010 in addition to the exchange of its MO operations (4,000 customers) and \$3MM for AWK's TX systems (5,300 customers). We believe 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 '11E group median of 19X 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	\$0.18			NE	
Q2 (June)	0.22	0.23			NE	
Q3 (Sep.)	0.32	0.31			NE	
Q4 (Dec.)	0.21	0.23			NE	
FY	\$0.89	<b>\$0.95</b>	<b>0.94</b>		\$1.02	
CY	\$0.89	\$0.95			\$1.02	
FY P/E	25.1X	23.5X			21.9X	
Rev.(MM)	\$726	\$775			\$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 (02/24/2011)	\$22.31
52-Week Range:	\$16-24
Shares Outstanding: (MM)	138.0
Market Cap.: (MM)	\$3,078.8
S&P 500:	1,306.10
Avg. Daily Vol.:	670,244
Dividend/Yield:	\$0.62/2.8%
LT Debt: (MM)	\$1,450.0
LT Debt/Total Cap.:	54.2%
ROE:	11.0%
3-5 Yr. Est. Growth Rate:	6.0%
CY 2011 Est. P/E-to-Growth:	3.9x
Last Reporting Date:	02/23/2011
	After Close

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

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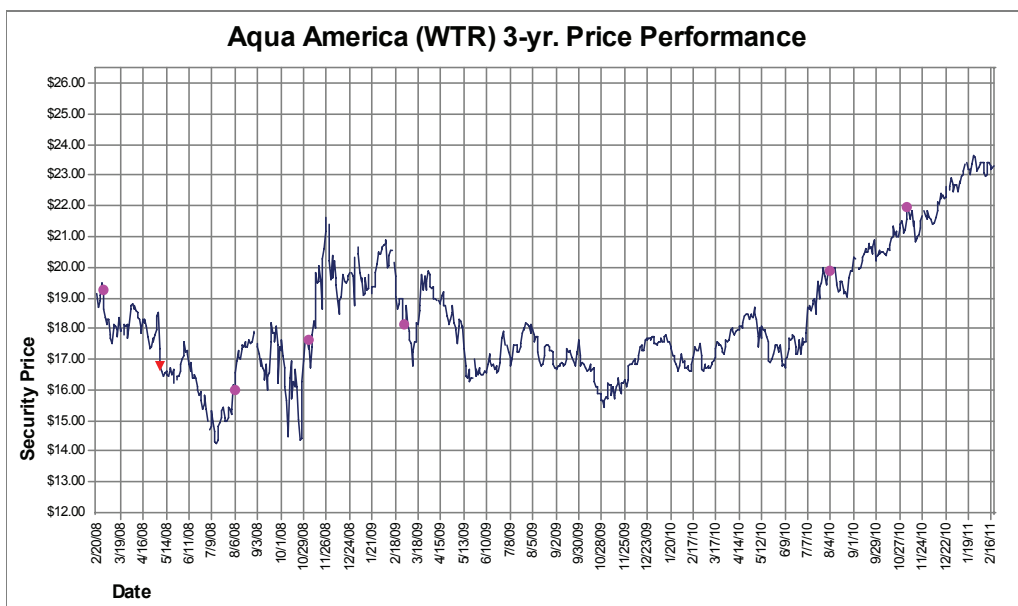
Together we'll go far



**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 (\$)
	2/20/2008		Kalton			
	2/20/2008	NA	1	24.00	26.00	19.16
●	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
●	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

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

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**Aqua America**

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As of: February 24, 2011

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