Edward Jones
MAKING SENSE OF INVESTING

AQUA AMERICA

Utilities (NYSE: WTR)

Company Update

Rating	**HOLD**
Suitability	**Growth & Income**
Dividend Outlook	**Rising**
Date	**November 8, 2010**
Price	**$21.93**
Dividend	**$0.58**
Yield	**2.6%**

Company Overview

Aqua America (WTR) is the second-largest publicly traded water utility in the United States, providing water service to roughly 2.8 million residents in 13 different states (Pennsylvania, Texas, Ohio, Illinois, Florida, South Carolina, North Carolina, Virginia, New Jersey, New York, Maine, Indiana and Missouri). The company was incorporated in 1886 in Philadelphia, Pennsylvania.

Market Data

52-Week Range	**$21.72 – $15.66**
Market Cap.	**$2.3bn.**
Div. Pmt. Months	**Mar Jun Sep Dec**
Est. Earnings Date	**November 3, 2010**

Valuation	2009A	2010E	2011E
Earnings	**0.77**	**0.90**	**0.97**
P/E	**28.5x**	**24.4x**	**22.6x**
PEGY	**3.0x**	**2.5x**	**2.3x**

Growth Outlook

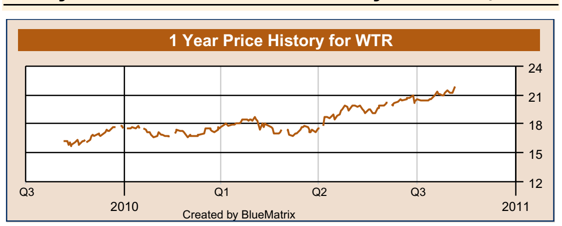
Est. 5-Yr. EPS Growth	**7%**
Est. 5-Yr. Div. Growth	**7%**

Financial Data

% Revenues International	**0%**
Debt Ratings (S&P/Moody's)	**NA/NA**

Dividends can be increased, decreased or totally eliminated at any point without notice.

Headquarters	**United States of America**
Analyst	**Andy Pusateri, CFA**



INVESTMENT SUMMARY

We rate shares of Aqua America a Hold with a Growth & Income suitability. Aqua America has seen better earnings growth recently and we believe they are the premier operator in the water utility industry. However, we believe share are currently fairly valued trading at a deserved premium to the peer group.

Earnings Returning to Growth

For a time, WTR had struggled to translate customer growth into earnings growth as the company faced cost inflation and the standard regulatory lag common to utilities. Aqua has strung together a few quarters of growth now and we believe the company will continue to be successful in getting approval for higher customer rates, and the outlook for long-term earnings growth remains solid in our view.

Growth Through Acquisitions

Aqua America has completed over 200 acquisitions of smaller water systems since 1995. Because of the fragmented nature of the water utility industry as well as the capital needs to repair and maintain infrastructure, we believe that the company will have success in acquiring smaller utility systems and ultimately to earnings growth.

Future Dividend Increases

We believe WTR has strong management and solid financial strength, making the company well-positioned to continue its track record of annual dividend increases (WTR has paid a dividend for 60 consecutive years and increased its dividend 20 times in the past 19 years).

Valuation

Shares of Aqua America are currently trading below its historic average and above peers based on several valuation measurements. While we believe the shares deserve to trade at a premium to the group we do not believe shares should trade in line with historic high multiples.

Risks

The primary risks to our Hold opinion include adverse regulatory decisions, unusually wet weather, drought restrictions and rising long-term interest rates, and an increase in dividend tax levels, which could each negatively impact earnings and the share price. Much of the company's growth is reliant on acquisitions. If the company is unable to successfully acquire smaller water systems, earnings and the stock price may be negatively impacted. Risks to the upside include the ability of the company to return to earnings growth faster than we anticipate.

RECENT NEWS AND ANALYSIS

11/5/10: Aqua America reported third-quarter earnings per share of $0.32 compared to $0.25 per share in the same quarter of 2009. Earnings exceeded our estimate and the consensus. The company benefited from hot and dry weather in the East which led to increased usage. Aqua America also received rate increases in many of the states in which it operates. Offsetting these positives were an increase in operating expenses. O&M over revenue, a metric used to measure efficiency in water utilities, was 35% for the quarter. While that is a very positive number, the warm weather helped, and this is a number that is probably not sustainable. We continue to believe that Aqua America can benefit from earning returns on investment in water utility infrastructure.

08/04/10: Aqua America reported earnings per share of $0.22 for the second quarter of 2010. This exceeded our expectations as well as earnings for the same quarter of 2009. Aqua was able to control costs well and only saw an increase in operating expenses of 1.1%. Higher revenues were driven largely by rate increases in the company's service area. Year-to-date, Aqua has received increases of approximately $43.7 million, and still has approximately $13.7 million pending. While this was a strong quarter for Aqua America, we believe that shares are fairly valued at more than 22 times our 2010 estimate.

08/03/10: Aqua America announced a 7% increase in its quarterly dividend from $0.145 per share to $0.155 per share. The dividend will be payable 12/01/10 (ex-date: 11/15/10). Aqua will pay one more dividend at the $0.145 rate before increasing with the December payment. Shares currently yield 2.9%. This increase marks the 20th time the company has increased the dividend in the past 19 years. We view this increase positively, and believe the company will have the ability to grow the dividend roughly in line with earnings going forward.

05/07/10: Aqua America announced first-quarter 2010 earnings per share of $0.16 per share. This number is slightly below our expectation, but in line with the average analyst estimate. Earnings per share were up 14% versus the same quarter last year. Higher earnings are primarily a result of rate increases during the past year. Operating expenses were up less than one percent and operations and maintenance expense to revenue ratio remained low for the company. While we consider Aqua America the premier water utility operator in the nation, we believe that shares are currently appropriately valued at around 19 times our 2011 earnings estimate. We reiterate our Hold rating on these shares.

2/25/10: Aqua America reported 2009 full-year earnings per share (EPS) of $0.77. This is below our and the Street's estimate of $0.80 per share. While earnings were less than expectations, the company was able to grow earnings by 5.5% in a challenging economic year. Higher earnings year-over-year were driven primarily by higher rates in Aqua's service territory that more than offset higher operating costs as well as higher depreciation costs. We believe that overall this was an average result for the company. We view positively the fact that Aqua is showing signs of translating customer growth into earnings growth. While organic growth is likely to remain below historic levels, we still believe that Aqua America can benefit from growth through acquisitions of smaller water systems. We expect this activity to pick up in 2010. We are maintaining our 2010 earnings per share estimate of $0.90, and we are initiating a 2011 EPS estimate of $0.97 per share.

INDUSTRY AND COMPANY OUTLOOK

Our outlook for the utility sector is quite positive as we see average annual earnings growth of about 5% going forward, much improved from years past. This improved growth outlook primarily reflects our expectations for more spending on utility infrastructure going forward.

It is our view that the utility industry in general has underinvested in infrastructure in recent decades. As a result, much of the utility assets in the U.S. today are old and are in need of maintenance, repair or outright replacement. The various areas needing investment going forward include electric transmission wires, power plants, natural gas pipelines and water utility infrastructure. This investment will be needed to address the effects of aging infrastructure as well as to meet demand related to natural customer growth. Many estimates forecast the potential investment needs to be several hundreds of billions of dollars over the next two or three decades. It is this spending that we believe will accelerate the future earnings growth of many utilities.

In a 2009 needs assessment, the United States Environmental Protection Agency estimated that over $334.8 billion of capital spending will be necessary for United States water systems to replace aging infrastructure and meet water quality standards by the year 2027.

As water utilities spend more on infrastructure, they can earn a regulated return on the invested capital. As a result, earnings can grow faster than they otherwise would absent the increased infrastructure investment. This is why we believe the long-term growth outlook for the industry is improving.

Further, the water utility industry is highly fragmented. There are numerous small water systems, many of which are inefficient and could have a difficult time meeting current and future water quality standards. Accordingly, we believe the potential exists for larger water utility companies like Aqua America to selectively acquire multiple small systems each year, thereby adding to their normal rate of customer growth.

Aqua America's three main avenues for earnings growth
Aqua America has three main avenues for earnings growth. First, normal growth in the service area provides some increases in customers and sales. While this growth is currently below historical levels, we expect it to improve as the economy turns around. Second, the company has been aggressive in acquiring smaller water systems, mostly adjacent to its existing systems. The company generally acquires 20 to 30 smaller water systems each year. In July of 2003, the company completed its acquisition of AquaSource, a water and wastewater subsidiary of DQE Incorporated. This acquisition added roughly 130,000 regulated customers and increased the number of states the company conducts business in to 14. The acquisition was immediately accretive to earnings. In addition, we believe that worsening conditions at municipalities could provide Aqua America with the opportunity to acquire more systems at attractive prices. Finally, rate increases can have a significant impact on revenues and earnings. WTR aggressively files rate cases in all of its districts. Overall, we think earnings growth of 6% is achievable.

While Aqua America has grown its customer base at higher levels than peers, this growth hasn't translated into earnings growth as well in recent history. Significant cost inflation combined with regulatory lag have been the primary reasons for the company's lack of earnings growth. However, we do believe that the company will begin to receive better rate increases (more importantly in the South), and see solid longer-term earnings growth.

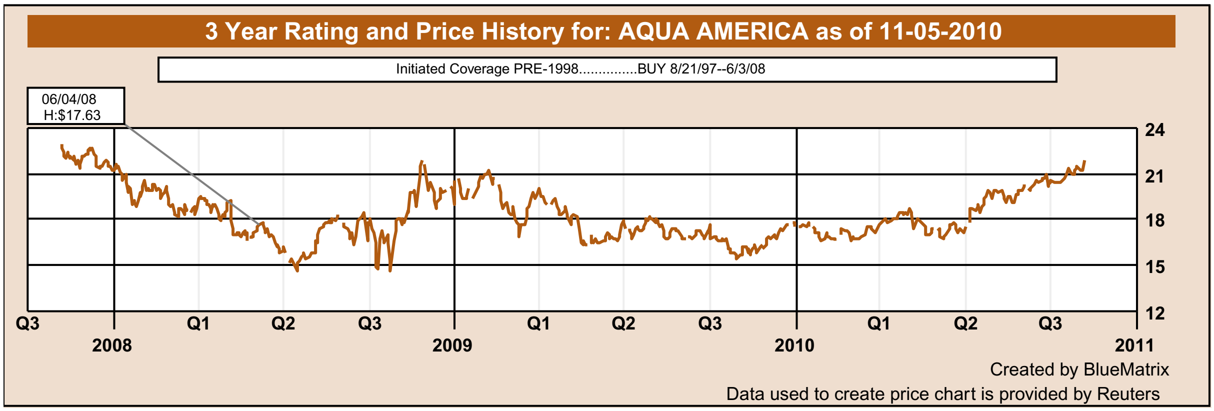
Regulatory Overview - Management has constructive relationships with regulators and community leaders. These relationships are necessary for regulated water utilities to grow their asset base and receive timely recovery of spent funds through rate increases. The company has suffered from regulatory lag recently (Regulatory Lag: The time between when costs rise or investments are made and the time utilities are allowed to raise rates to recover and earn higher returns). We believe as the company develops stronger relationships in its Southern states, it will be successful in its goal to continue to recover invested capital and increase regulatory activity. We give Aqua America credit for successfully consolidating its rate divisions from 125 to 25. Overall, we feel that the majority of Aqua America's business is focused in states that provide regulatory recovery mechanisms that will provide more stable future returns and cut back on regulatory lag. For example, the company has approval in Pennsylvania to raise rates quarterly, up to an additional 5%, for capital improvements without filing a request.

FINANCIAL POSITION

Aqua America's financial position appears strong. Although the company's corporate debt is not rated, the debt of its primary subsidiary, Aqua America-Pennsylvania, is rated 'A+' by Standard & Poor's. As of 3/31/10, Aqua America's capital structure consisted of 57% corporate debt and 43% equity. The company has operating cash flows that are over three times its annual dividends paid. We feel this gives the company sufficient flexibility to continue increasing dividends and invest capital back into the business. In addition, the company has adequate access to capital and enjoys among the lowest costs of debt in the industry.

Dividend Outlook - Aqua America has paid a dividend for more than 60 consecutive years and increased it 20 times in the past 19 years. Aqua America's current dividend payout ratio is 64% of our 2010 earnings per share estimate. While this is slightly above peers and higher than the company has had in the past, we believe it is manageable. In our opinion, the company's strong financial position and expected long-term earnings growth will allow the company to meet this goal.

Important Research Disclosures



November 8, 2010	BUY	HOLD	SELL
Stocks	58%	40%	2%
Investment Banking Services	5%	3%	0%

The table at left lists the percent of stocks we follow globally in each of our rating categories. Investment banking services indicate the percentage of those companies that have been investment banking clients within the past 12 months.

Buy (B)	Hold (H)	Sell (S)	FYI (FI)
Our opinion is to Buy this stock. We believe its fundamentals and/or valuation are compelling.	Our opinion is to keep this stock. We believe the fundamentals and/or valuation are stable. Or a special situation exists, such as a merger, that warrants no action.	Our opinion is to Sell this stock. We believe the fundamentals are deteriorating considerably and/or a recovery is highly uncertain. Or we believe the stock is significantly overvalued.	For information. Factual, no opinion.

Analyst Certification

- I certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers; and no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report. Andy Pusateri, CFA

Important Disclosures

- Edward Jones expects to receive or intends to seek compensation from this company for investment banking services within the next three months.
- Initiated Coverage PRE-1998...............BUY 8/21/97--6/3/08

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- Holders of shares of companies domiciled outside the country of residence of the holder are generally subject to a withholding tax on dividends paid by that company. Subject to certain conditions and limitations, these holders may be entitled to a partial refund of the withholding tax or the withholding taxes may be treated as foreign taxes eligible for a deduction or credit against the holder's tax liability. Holders should consult their own tax advisors regarding ownership of shares and the procedures for claiming a deduction, tax credit or a refund of the withholding tax. When investing in companies incorporated outside your own country of residence, an investor should consider all other material risks including currency risk, political risk, liquidity risk and accounting rules differences, which can adversely affect the value of your investment. Please consult your financial advisor for more information.
- Debt ratings should not be considered an indication of future performance.
- Suitability: Growth & income (G/I) stocks provide a balance of dividends and price appreciation; growth (G) stocks offer little or no current income but greater future capital appreciation than other stocks; and aggressive (A) stocks offer potentially higher returns for considerably higher levels of risk.
- Dividend Outlook: Rising – We believe the dividend is stable at the current level and is likely to increase based on historical trends, the current payout ratio, and expected future earnings and cash flow; Stable – We believe the dividend is stable at the current level but is unlikely to increase at a rate greater than or equal to 3% on a regular basis; At Risk – We believe the dividend is at risk of being reduced or eliminated; No Dividend – This company does not pay a dividend.