



**May 12, 2011**

**AQUA AMERICA INC. (WTR)**

**Rating: NEUTRAL**  
**Current Price: \$22.99**  
**Target Price: NA**

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Industry: Water Utilities							Valuation		Valuation	
Fiscal Year: Dec		1Q11A	2Q11E	3Q11E	4Q11E	FY11E	Multiple	FY12E	Multiple	
<b>Market Cap (\$MM):</b>	3,157	<b>EPS:</b>	\$0.22	\$0.23	\$0.35	\$0.22	\$1.02	22.5x	\$1.09	21.1x
		Prior:	\$0.19	-	-	-	\$0.99		-	
<b>Net Debt (\$MM):</b>	1,535	Consensus:		\$0.24	\$0.33	\$0.24	\$1.01	22.8x	\$1.07	21.5x
<b>Enterprise Value (\$MM):</b>	4,692	Last Year:	\$0.16	\$0.22	\$0.32	\$0.21	\$0.90			
<b>Shares - FD (MM):</b>	137.3									
		<b>EBITDA:</b>	\$0.67	\$0.76	\$0.95	\$0.75	\$3.13	10.9x	\$3.36	10.2x
<b>Dividend:</b>	\$0.58	Growth:	10%	6%	7%	7%	7%		7%	
<b>Yield:</b>	2.5%									
<b>Beta:</b>	0.69	<b>Revenue:</b>	\$171	\$194	\$228	\$188	\$783	6.0x	\$836	5.6x
<b>Rel. P/E (FY2011E):</b>	173%	Growth:	7%	9%	10%	5%	8%		7%	

## WTR: Updating Estimates To Be In Compliance With GAAP

### SUMMARY

- We are updating our 1Q11 EPS figure for WTR to reflect \$0.03 in state tax benefits related to WTR's ability to deduct 100% bonus depreciation for certain capital projects in PA. We had previously excluded benefit in our reported EPS calculation as we viewed this as one-time in nature.
- Our revised 1Q11 for WTR is now \$0.22 and is in congruence with consensus, per ThomsonReuters. The \$0.22 reported EPS is also in compliance with GAAP. Our corresponding FY11E becomes \$1.02 (+\$0.03).
- We remain NEUTRALB rated on WTR and view the shares as fairly valued at 22.6x FY11E of \$1.02 and 21.1x FY12E of \$1.09.

## **INVESTMENT THESIS**

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We rate WTR shares NEUTRAL. While we are encouraged by the potential for earnings growth from improved ROEs under systems that were acquired in the southern states during 2003-2004, as well as the resumption of acquisition activity, we believe shares are fairly valued at these levels. Shares are currently trading at 22.6x our FY11E EPS of \$1.02 and 21.1x our FY12E EPS of \$1.09 which is a slight discount to the company's historical 23x average. While we believe WTR should be valued at a premium given the company's size and operational efficiency (the O&M ratio is currently industry leading), we see less upside given valuations are reflecting historically in-line multiples.

## **VALUATION**

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WTR shares closed Wednesday at \$22.99 which is 22.6x our FY11E EPS of \$1.02 and 21.1x our FY12E EPS of \$1.09. The shares are trading at a discount to the company's historical 23x average, though within the normalized range of 20-30x forward P/E.

## **RISKS**

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Potential downside risks to our investment thesis include, but are not limited to: 1) a delay in rate case processing or lower rate increases by the regulators than our expectations, 2) a significant revenue loss from lower water demand caused by weather or economic conditions, 3) a significant increase in input costs, including electricity, fuel, chemical and purchase water prices, and 4) large acquisition(s) at excessive valuation(s) (significantly above the rate base).

Potential upside risks to our investment thesis include, but are not limited to: 1) favorable rate case approvals above our expected ROE, 2) weather conditions leading to near-term revenue increases, and 3) a pullback in input costs.

**Aqua America (WTR)**  
**Quarterly Earnings Statement**  
*(dollars in millions, except per share data)*
*FY ends December 31*

	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11E	3Q11E	4Q11E	1Q12E	2Q12E	3Q12E	4Q12E
<b>Total Operating Revenue</b>	139.3	150.8	177.1	159.8	154.5	167.3	180.8	167.9	160.5	178.4	207.8	179.3	171.3	194.4	228.4	188.3	191.2	208.1	238.4	198.3
<b>Operation &amp; Maintenance</b>	64.3	65.1	66.7	65.9	67.0	68.5	68.5	66.0	67.6	69.3	73.0	70.1	67.3	75.6	81.8	71.6	78.0	80.3	84.6	75.4
Depreciation	21.5	20.6	22.8	23.9	26.4	25.0	25.4	26.2	26.2	26.8	27.5	27.6	27.3	27.5	27.7	31.1	31.3	31.5	31.7	24.8
Amortization	1.2	1.0	1.8	1.5	2.8	3.1	3.0	3.1	3.2	3.3	3.6	2.9	2.0	3.4	3.4	3.4	3.4	3.4	3.4	3.4
General Taxes	12.1	10.8	11.2	10.6	11.6	11.9	12.4	12.2	12.9	12.9	14.2	13.0	13.8	15.6	16.0	13.2	14.3	14.6	14.3	13.9
Recovery of restructuring costs																				
<b>Total Expenses</b>	99.1	97.6	102.5	102.0	107.7	108.5	109.4	107.5	109.8	112.4	118.2	113.6	110.3	122.1	128.9	119.2	127.0	129.8	134.0	117.4
<b>Income from Operations</b>	40.2	53.1	74.6	57.9	46.8	58.9	71.5	60.4	50.7	66.1	89.6	65.7	61.0	72.4	99.6	69.1	64.1	78.3	104.4	80.9
<b>Operating Margin (%)</b>	28.9%	35.2%	42.1%	36.2%	30.3%	35.2%	39.5%	36.0%	31.6%	37.0%	43.1%	36.7%	35.6%	37.2%	43.6%	36.7%	33.6%	37.6%	43.8%	40.8%
All. for Borrowed Funds Used in Const.	1.0	1.1	1.0	0.6	0.6	0.6	0.7	0.9	1.5	1.5	1.1	1.0	2.0	1.4	1.4	1.4	1.5	1.4	1.4	1.5
Gain (loss) on sale of other assets		0.6	0.5	0.5	0.1	0.1	0.2	0.1	1.9	0.1	0.3	0.3	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other																				
<b>EBIT</b>	41.2	54.8	76.1	59.0	47.5	59.5	72.4	61.4	54.2	67.6	90.9	67.0	63.1	73.9	101.1	70.7	65.9	79.9	106.0	82.5
<b>EBIT (%)</b>	29.6%	36.3%	43.0%	36.9%	30.8%	35.6%	40.0%	36.6%	33.7%	37.9%	43.8%	37.3%	36.8%	38.0%	44.3%	37.5%	34.5%	38.4%	44.5%	41.6%
Interest Expense	17.1	17.1	17.0	17.4	16.6	16.8	17.3	17.9	18.4	18.5	19.2	19.6	19.9	20.1	20.3	21.1	21.3	21.5	21.7	20.7
<b>Income Before Taxes</b>	24.0	37.7	59.1	41.7	30.9	42.7	55.1	43.5	35.7	49.1	71.8	47.4	43.1	53.8	80.8	49.6	44.5	58.4	84.3	61.8
<b>Provision for Income Taxes</b>	9.7	15.2	23.7	16.0	12.5	16.9	21.6	16.8	14.2	19.3	28.1	18.5	12.8	21.5	32.3	19.3	17.8	23.4	33.7	24.1
<b>Implied Tax Rate</b>	40.4%	40.2%	40.1%	38.4%	40.5%	39.5%	39.3%	38.7%	39.8%	39.3%	39.1%	39.1%	29.6%	40.0%	40.0%	39.0%	40.0%	40.0%	40.0%	39.0%
<b>Net Income before extraord. Item</b>	14.3	22.6	35.4	25.7	18.4	25.9	33.5	26.7	21.5	29.8	43.7	28.9	30.4	32.3	48.5	30.2	26.7	35.1	50.6	37.7
Comprehensive Income	14.3	22.7	35.2	25.7	18.4	26.1	33.3	26.8	21.1	29.8	43.7	28.9	30.4	32.3	48.5	30.2	26.7	35.1	50.6	37.7
<b>Diluted Net Income Per Share</b>	0.11	0.17	0.26	0.19	0.14	0.19	0.25	0.20	0.16	0.22	0.32	0.21	0.22	0.23	0.35	0.22	0.19	0.25	0.36	0.27
Weighted Avg. Shares	134.0	134.1	135.3	135.6	135.9	135.9	136.3	136.5	136.8	137.3	137.4	137.9	137.8	138.6	139.1	139.5	138.2	138.6	139.1	139.5
<b>Financial Summary (values in %)</b>																				
Revenue Growth	1.4%	0.1%	7.0%	7.2%	10.9%	11.0%	2.1%	5.0%	3.9%	6.6%	14.9%	6.8%	6.7%	9.0%	9.9%	5.0%	11.6%	7.0%	4.4%	5.3%
Operations & Maintenance/Revenue	46.2%	43.2%	37.7%	41.2%	43.4%	41.0%	37.9%	39.3%	42.1%	38.8%	35.1%	39.1%	39.3%	38.9%	35.8%	38.0%	40.8%	38.6%	35.5%	38.0%
EBIT (% of rev.)	29.6%	36.3%	43.0%	36.9%	30.8%	35.6%	40.0%	36.6%	33.7%	37.9%	43.8%	37.3%	36.8%	38.0%	44.3%	37.5%	34.5%	38.4%	44.5%	41.6%
General taxes as % of revenue	8.7%	7.2%	6.3%	6.7%	7.5%	7.1%	6.9%	7.3%	8.0%	7.3%	6.8%	7.2%	8.0%	8.0%	7.0%	7.0%	7.5%	7.0%	6.0%	7.0%
EBITDA	63.8	76.4	100.7	84.4	76.7	87.5	100.8	90.7	83.5	97.8	122.0	97.5	92.3	104.8	132.2	105.2	100.5	114.8	141.1	110.7
Net Income Growth	-15.0%	-5.0%	19.9%	3.0%	28.3%	14.6%	-5.4%	3.9%	17.1%	15.5%	30.6%	8.2%	41.1%	8.1%	10.9%	4.8%	-12.0%	8.6%	4.3%	24.6%
EPS Growth	-15.5%	-5.3%	18.6%	1.8%	26.5%	13.0%	-6.1%	3.2%	16.3%	14.4%	29.5%	7.1%	40.0%	7.1%	9.6%	3.6%	-12.2%	8.6%	4.3%	24.6%

Source: Aqua America and Longbow Research  
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**Aqua America (WTR)**  
**Annual Earnings Statement**  
*(dollars in millions, except per share data)*

<i>Income Statement</i>	FY04A	FY05A	FY06A	FY07A	FY08A	FY09	FY10	FY11E	FY12E
<b>Total Operating Revenue</b>	<b>442.0</b>	<b>496.8</b>	<b>533.5</b>	<b>602.5</b>	<b>627.0</b>	<b>670.5</b>	<b>726.1</b>	<b>783</b>	<b>836</b>
Operation & Maintenance	178.3	203.1	219.6	253.1	262.1	270.1	280.0	296.3	318.3
Depreciation	54.6	60.7	70.9	83.2	88.8	103.0	108.2	113.6	119.2
Amortization	4.3	4.7	4.1	4.8	5.5	11.9	13.0	12.2	13.6
General Taxes	27.6	31.7	33.3	45.4	44.7	48.1	53.0	58.5	57.1
-	-	-	-	-	-	-	-	-	-
<b>Total Expenses</b>	<b>264.8</b>	<b>300.3</b>	<b>327.9</b>	<b>386.5</b>	<b>401.2</b>	<b>433.1</b>	<b>454.1</b>	<b>480.5</b>	<b>508.2</b>
<b>Income from Operations</b>	<b>177.2</b>	<b>196.5</b>	<b>205.6</b>	<b>216.0</b>	<b>225.8</b>	<b>237.5</b>	<b>272.0</b>	<b>302.0</b>	<b>327.8</b>
<b>Operating Margin (%)</b>	<b>40.1%</b>	<b>39.6%</b>	<b>38.5%</b>	<b>35.9%</b>	<b>36.0%</b>	<b>35.4%</b>	<b>37.5%</b>	<b>38.6%</b>	<b>39.2%</b>
Allow. for Borrowed Funds Used in Const.	2.3	2.4	3.9	3.0	3.7	2.9	5.1	6.1	5.8
Gain (loss) on sale of other assets	1.3	1.2	1.2	3.5	1.6	0.5	2.6	0.7	0.8
Other	-	-	-	-	-	-	-	-	-
<b>EBIT</b>	<b>180.8</b>	<b>200.1</b>	<b>210.7</b>	<b>222.5</b>	<b>231.1</b>	<b>240.8</b>	<b>279.6</b>	<b>308.9</b>	<b>334.4</b>
<b>EBIT (%)</b>	<b>40.9%</b>	<b>40.3%</b>	<b>39.5%</b>	<b>36.9%</b>	<b>36.9%</b>	<b>35.9%</b>	<b>38.5%</b>	<b>39.5%</b>	<b>40.0%</b>
Interest Expense	48.7	52.1	58.4	66.9	68.6	68.6	76.3	81.6	85.3
<b>Income Before Taxes</b>	<b>132.1</b>	<b>148.1</b>	<b>152.3</b>	<b>155.5</b>	<b>162.5</b>	<b>172.2</b>	<b>203.4</b>	<b>227.3</b>	<b>249.1</b>
<b>Provision for Income Taxes</b>	<b>52.1</b>	<b>56.9</b>	<b>60.2</b>	<b>60.5</b>	64.6	67.8	80.1	86.0	99.0
<b>Implied Tax Rate</b>	<b>39.4%</b>	<b>38.4%</b>	<b>39.6%</b>	<b>38.9%</b>	<b>39.7%</b>	<b>39.4%</b>	<b>39.4%</b>	<b>37.8%</b>	<b>39.8%</b>
<b>Net income</b>	<b>80.0</b>	<b>91.2</b>	<b>92.0</b>	<b>95.0</b>	<b>97.9</b>	<b>104.4</b>	<b>123.3</b>	<b>141.3</b>	<b>151.1</b>
<b>Comprehensive Income</b>	<b>78.1</b>	<b>89.8</b>	<b>95.3</b>	<b>94.8</b>	<b>97.9</b>	<b>104.7</b>	<b>122.0</b>	<b>141.3</b>	<b>151.1</b>
<b>Diluted Net Income Per Share</b>	<b>0.64</b>	<b>0.71</b>	<b>0.70</b>	<b>0.71</b>	<b>0.73</b>	<b>0.77</b>	<b>0.90</b>	<b>1.02</b>	<b>1.09</b>
Weighted Avg. Shares	125.7	129.2	131.8	133.6	134.7	136.1	137.3	138.7	138.8
<b>Financial Summary (values in %)</b>									
Revenue Growth	20.4%	12.4%	7.4%	12.9%	4.1%	6.9%	8.3%	7.8%	6.8%
Operations & Maintenance/Revenue	40.3%	40.9%	41.2%	42.0%	41.8%	40.3%	38.6%	37.9%	38.1%
Dep/Net Fixed Asset	3.0%	2.9%	3.1%	3.3%	3.2%	3.4%	3.4%	3.3%	3.3%
Depreciation Growth	12.5%	11.3%	16.7%	17.3%	6.7%	16.0%	5.0%	5.0%	5.0%
General taxes as % of revenue	6.2%	6.4%	6.2%	7.5%	7.1%	7.2%	7.3%	7.5%	6.8%
Interest Exp/ Average Net Debt	5.6%	5.3%	5.8%	5.9%	5.2%	5.0%	5.0%	4.8%	4.9%
Interest Expense/Revenue	11.0%	10.5%	11.0%	11.1%	10.9%	10.2%	10.5%	10.4%	10.2%
EBITDA	239.7	265.6	285.7	310.5	325.4	355.7	400.8	434.6	467.2
Net income growth	13.0%	13.9%	0.9%	3.3%	3.1%	6.6%	18.1%	14.7%	6.9%
Average ROE	11.4%	11.7%	10.6%	10.0%	9.6%	9.6%	10.8%	11.7%	11.8%
EPS Growth (exspecial items and FAS 123)	7.0%	10.9%	-1.0%	1.9%	2.2%	5.5%	17.1%	13.5%	6.8%

Source: Aqua America and Longbow Research

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**WATER INDUSTRY PEER VALUATION**

(\$ in millions, except per share data)

Company	Ticker	FY End	Rating	Target	% Upside	Share Price	52 Week		Mkt Cap	Revenue Last	Earnings per Share			P/E		Dividend Rate	Price/Book	
							Hi	Lo			Last FY	Current FY	Next FY	Current FY	Next FY			
<b>U.S. WATER UTILITIES</b>																		
AMER STATES WATER	AWR	Dec.	Neutral			\$33.57	\$39.44	\$31.24	\$ 631	\$ 434	2.02	2.00	2.15	16.8x	15.6x	3.3%	0.9x	
AMERICAN WATER WORKS	AWK	Dec.	BUY	\$32	8%	\$29.67	\$29.91	\$19.41	\$ 5,119	\$ 2,093	1.53	1.72	1.88	17.2x	15.8x	3.0%	1.1x	
AQUA AMERICA	WTR	Dec.	Neutral			\$22.99	\$23.79	\$16.52	\$ 3,095	\$ 726	0.90	1.02	1.09	22.6x	21.1x	2.8%	2.6x	
CALIFORNIA WATER	CWT	Dec.	Neutral			\$36.75	\$39.53	\$33.81	\$ 763	\$ 460	1.81	2.04	2.22	18.0x	16.5x	3.4%	1.8x	
ARTESIAN RESOURCES	ARTNA	Dec.	NR			\$19.34	\$19.99	\$16.43	\$ 143	\$ 65	1.01	1.07	1.15	18.1x	16.8x	4.0%	1.5x	
CONNECTICUT WATER	CTWS	Dec.	NR			\$25.24	\$28.27	\$20.00	\$ 217	\$ 66	1.13	1.2	1.25	21.0x	20.2x	3.7%	2.1x	
MIDDLESEX WATER	MSEX	Dec.	NR			\$18.62	\$19.31	\$14.74	\$ 281	\$ 103	0.94	0.95	0.95	19.6x	19.6x	4.1%	1.6x	
PENNICHUCK	PNNW	Dec.	NR			\$28.47	\$28.60	\$20.77	\$ 133	\$ 36	0.85	0.8	1.15	35.6x	24.8x	2.6%	1.8x	
SIW	SIW	Dec.	NR			\$22.80	\$28.00	\$22.25	\$ 419	\$ 216	0.93	0.99	1.10	23.0x	20.7x	3.1%	1.9x	
YORK WATER CO (THE)	YORW	Dec.	NR			\$17.07	\$18.00	\$12.83	\$ 214	\$ 39	0.71	0.76	0.79	22.5x	21.6x	3.1%	2.4x	
<b>Average</b>														21.4x	19.3x	3.3%	1.8x	
<b>EQUIPMENT/ FILTRATION/ TREATMENT SECTOR</b>																		
PENTAIR	PNR	Dec.	BUY	\$45	14%	\$39.36	\$40.57	\$29.41	\$ 3,837	\$ 3,031	2.00	2.44	2.82	16.1x	14.0x	2.1%	1.7x	
WATTS WATER TECH	WTS	Dec.	Neutral			\$36.01	\$40.75	\$27.51	\$ 1,344	\$ 1,275	1.60	1.68	2.24	21.4x	16.1x	1.2%	1.5x	
AMERON INT'L	AMN	Nov.	NR			\$67.43	\$85.25	\$55.42	\$ 613	\$ 503	5.10	1.55	3.62	43.5x	18.6x	1.8%	1.1x	
BADGER METER	BMI	Dec.	NR			\$36.46	\$45.49	\$33.98	\$ 546	\$ 277	1.88	1.67	2.01	21.8x	18.1x	1.5%	3.9x	
CALGON CARBON	CCC	Dec.	NR			\$17.36	\$18.20	\$11.75	\$ 987	\$ 482	0.75	0.82	0.98	21.2x	17.7x	0.0%	2.5x	
ENERGY RECOVERY	ERII	Dec.	NR			\$2.91	\$4.88	\$2.84	\$ 152	\$ 46	-0.08	(0.13)	0.02	NM	NM	0.0%	1.6x	
FRANKLIN ELECTRIC	FELE	Jan.	NR			\$43.19	\$48.23	\$27.04	\$ 988	\$ 714	1.94	2.39	2.82	18.1x	15.3x	1.2%	2.2x	
GORMAN-RUPP	GRC	Dec.	NR			\$43.68	\$40.75	\$24.00	\$ 646	\$ 297	1.53	1.80	2.08	24.3x	21.0x	1.2%	2.7x	
ITRON	ITRI	Dec.	NR			\$53.50	\$78.45	\$50.76	\$ 2,157	\$ 2,265	4.00	4.23	4.25	12.6x	12.6x	0.0%	1.6x	
LAYNE CHRISTENSEN	LAYN	Jan.	NR			\$28.60	\$38.00	\$22.97	\$ 548	\$ 1,026	1.54	1.55	1.92	18.5x	14.9x	0.0%	-	
MUELLER WATER PRODUC	MWA	Sept.	NR			\$4.28	\$5.22	\$2.21	\$ 656	\$ 1,338	-0.19	0.01	0.15	NM	NM	1.7%	1.2x	
NORTHWEST PIPE	NWPX	Dec.	NR			\$24.45	\$24.94	\$14.62	\$ 200	\$ 387	-0.16	0.68	1.34	36.0x	18.2x	0.0%	0.9x	
PALL	PLL	Jul.	NR			\$55.87	\$59.50	\$31.84	\$ 6,402	\$ 2,402	2.12	3.00	3	18.6x	18.6x	1.3%	3.7x	
SMITH (A.O.)	AOS	Dec.	NR			\$42.53	\$45.80	\$29.24	\$ 1,910	\$ 2,026	2.87	2.09	2.44	20.3x	17.4x	1.3%	2.1x	
<b>Average</b>														21.2x	16.9x	0.7%	2.0x	
<b>WATER RESOURCES/ INFRASTRUCTURE</b>																		
INSITUFORM TECH	INSU	Dec.	NR			\$25.55	\$30.00	\$18.52	\$ 988	\$ 915	1.50	1.74	2.22	14.5x	11.3x	0.0%	1.7x	
LINDSAY	LNN	Aug.	NR			\$64.15	\$85.87	\$30.80	\$ 810	\$ 358	1.83	2.68	-	24.5x	22.0x	0.5%	2.0x	
TETRA TECH	TTEK	Sept.	NR			\$24.12	\$27.16	\$18.00	\$ 1,409	\$ 2,201	1.22	1.40	1.64	16.2x	14.3x	0.0%	1.7x	
<b>Average</b>														19.2x	16.8x	0.6%	2.2x	
<b>Relevant Indices</b>																		
Dow Jones Industrials	DJ30																Share Price	\$12,540.00
S&P 500	SPX																Share Price	\$1,332.25
Nasdaq Composite	NDX																Share Price	\$2,377.50

Source: Baseline; Company reports and LBR Estimates. EPS reflects diluted EPS, excluding extraordinary items. Numbers in italics reflect consensus estimates.

\*\* Time period for annual estimates may vary based on reporting date.



## APPENDIX

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### Covered Companies Mentioned In This Report:

Aqua America Inc.	WTR	\$22.99	Neutral
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