

Water Utilities

Aqua America, Inc.

(WTR) - NEUTRAL

Price: **\$23.19**
Fair Value Estimate: \$21.00
52-Week Range: \$23.79-\$16.52
Market Cap (MM): \$3,189
Shr.O/S-Diluted (mm): 137.5
Average Daily Volume: 698,876
Dividend: \$0.62
Yield: 2.7%

FYE: Dec	2009A	2010E	2011E
EPS:	\$0.77A	\$0.90E	\$0.95E
Prior EPS:		\$0.92	NC
P/E Ratio:	30.1x	25.8x	24.4x

Quarterly EPS:

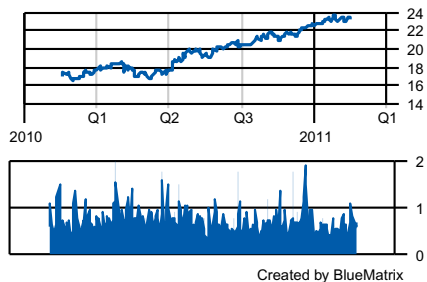
Quarter	2010	2011E	2011E
Q1	\$0.14A	\$0.16A	\$0.17E
Q2	\$0.19A	\$0.22A	\$0.24E
Q3	\$0.25A	\$0.32A	\$0.31E
Q4	\$0.20A	\$0.21E	\$0.23E

Fourth Quarter Preview - Expect In-line Results in Seasonally Slow Quarter

KEY POINTS:

- Aqua will report fourth quarter and full year 2010 results on February 24th and hold a conference call with investors at 11am ET. Our earnings estimate of \$0.21/share reflects 6% growth vs. the same period in 2009 - in line with the consensus forecast.
- We expect 9% revenue growth in the fourth quarter, which will support similar growth assumptions we have for the full year. Recall that during 2010, the company benefited from hot, dry summer weather in the northeastern U.S. during the third quarter and a corresponding increase in incremental water usage.
- As typically seen in the seasonally slow fourth quarter, we expect operating and maintenance expenses to grow as a percentage of revenue. The "efficiency ratio" which we define as O&M expenses/revenue should increase to slightly over 40% as cold December weather in Southeastern Pennsylvania (Aqua's core service territory) drives an increase in distribution system main breaks and expenses associated with remediating such system disturbances. For the full year we expect the company's well-regarded cost discipline will be reflected in results with an impressive efficiency ratio of 38.9%
- For the full year 2010, our operating income growth expectation of 14% (off revenue growth of 9%) is a prime demonstrative example of how private water utilities benefit from incremental customer usage during favorable weather conditions as high fixed-cost operating leverage takes hold. Much of this annual growth stems from the third quarter, when 15% revenue growth translated into 25% operating income growth. We have not seen such a rapid pace of annual operating income growth since 2004.
- We expect the company will end the year having been awarded approximately \$50 million in annualized rate relief (driven in part by the large Pennsylvania case) and will have pending cases amounting to \$25-\$30 million across several states (larger cases in the southern states including Texas, North Carolina, and Florida). We expect sustained capital spending plans for approximately \$300 million in 2011 which will drive growth in future years and with internally generated cash providing funding support, we do not anticipate any immediate equity needs.
- We maintain our NEUTRAL rating on WTR shares, primarily due to valuation as the stock surged in 2010 by almost 30% and has continued to improve by 3% year-to-date. While we believe WTR shares deserve a premium valuation based upon the company's strong track record of operational execution and a favorable regulatory footprint, we believe upside to the current forward multiple (24 times our 2011 estimate) is limited.

1 Year Price History for WTR



Aqua America, Inc.		Janney Montgomery Scott LLC								
Quarterly Income Statement, 2010E										
	1Q10	Y/Y	2Q10	Y/Y	3Q10	Y/Y	4Q10E	Y/Y	FY2010E	Y/Y
Operating Revenues	160,517	3.9%	178,444	6.6%	207,797	14.9%	183,003	9.0%	729,761	8.8%
Operations and Maintenance	67,601		69,310		72,968		73,750		283,629	
<i>O&M Ratio</i>	42.1%		38.8%		35.1%		40.3%		38.9%	
Depreciation	26,200		26,802		27,431		28,200		108,633	
Amortization	3,172		3,314		3,629		3,500		13,615	
Taxes other than Income Taxes	12,890		12,943		14,182		12,200		52,215	
Operating Income	50,654	8.3%	66,075	12.3%	89,587	25.4%	65,353	8.2%	271,669	14.4%
<i>Operating Margin</i>	31.6%		37.0%		43.1%		35.7%		37.2%	
Interest Expense	18,430		18,504		19,150		19,207		75,291	
Allowance for Construction Funds	(1,541)		(1,461)		(1,077)		(1,100)		(5,179)	
Gain on Sale of other Assets	(1,929)		(110)		(291)		(150)		(2,480)	
Income before Income Taxes	35,694	15.5%	49,142	15.1%	71,805	30.3%	47,396	9.0%	204,037	18.5%
Income Taxes	14,213		19,287		28,054		18,864		80,418	
<i>Tax Rate</i>	39.8%		39.2%		39.1%		39.8%		39.4%	
Net Income	21,481	16.9%	29,855	15.5%	43,751	30.7%	28,532	7.0%	123,619	18.5%
Diluted EPS	\$0.16	16.1%	\$0.22	14.6%	\$0.32	29.6%	\$0.21	6.3%	\$0.90	17.6%
Diluted Shares Outstanding	136,800		137,012		137,394		137,500		137,177	

Aqua America, Inc.		Janney Montgomery Scott LLC								
Quarterly Income Statement, 2011E										
	1Q11E	Y/Y	2Q11E	Y/Y	3Q11E	Y/Y	4Q11E	Y/Y	FY2011E	Y/Y
Operating Revenues	173,358	8.0%	194,504	9.0%	218,187	5.0%	196,546	7.4%	782,595	7.2%
Operations and Maintenance	72,984		75,857		82,911		77,636		309,387	
<i>O&M Ratio</i>	42.1%		39.0%		38.0%		39.5%		39.5%	
Depreciation	28,500		29,000		29,500		32,010		119,010	
Amortization	3,000		3,500		3,500		2,000		12,000	
Taxes other than Income Taxes	12,840		13,000		13,500		13,240		52,580	
Operating Income	56,034	10.6%	73,147	10.7%	88,776	-0.9%	71,661	9.7%	289,618	6.6%
<i>Operating Margin</i>	32.3%		37.6%		40.7%		36.5%		37.0%	
Interest Expense	18,740		19,200		19,500		20,160		77,600	
Allowance for Construction Funds	(750)		(750)		(750)		(750)		(3,000)	
Gain on Sale of other Assets	(150)		(150)		(150)		(150)		(600)	
Income before Income Taxes	38,194	7.0%	54,847	11.6%	70,176	-2.3%	52,401	10.6%	215,618	5.7%
Income Taxes	15,087		21,665		27,719		20,698		85,169	
<i>Tax Rate</i>	39.5%		39.5%		39.5%		39.5%		39.5%	
Net Income	23,107	7.6%	33,183	11.1%	42,456	-3.0%	31,702	11.1%	130,449	5.5%
Diluted EPS	\$0.17	6.9%	\$0.24	10.5%	\$0.31	-3.4%	\$0.23	10.5%	\$0.95	5.0%
Diluted Shares Outstanding	137,600		137,800		138,000		138,200		137,900	

Company Description

Aqua America, Inc. provides water and wastewater utility service to suburban areas outside of Philadelphia, Chicago, and Cleveland, as well as other communities throughout 13 states, including Pennsylvania, New York, Ohio, North Carolina, Illinois, Texas, Florida, New Jersey, Indiana, Virginia, Maine, Missouri, and South Carolina.

IMPORTANT DISCLOSURES

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Janney Montgomery Scott or an affiliate managed or co-managed a public offering of WTR security in the past 12 months.

Janney Montgomery Scott may seek compensation for investment banking services from the subject company (ies) WTR security in the next 3 months.

The research analyst is compensated based on, in part, Janney Montgomery Scott's profitability, which includes its investment banking revenues.

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BUY: Janney expects that the subject company will appreciate in value. Additionally, we expect that the subject company will outperform comparable companies within its sector.

NEUTRAL: Janney believes that the subject company is fairly valued and will perform in line with comparable companies within its sector. Investors may add to current positions on short-term weakness and sell on strength as the valuations or fundamentals become more or less attractive.

SELL: Janney expects that the subject company will likely decline in value and will underperform comparable companies within its sector.

Price Charts



Janney Montgomery Scott Ratings Distribution as of 12/31/2010

Rating	IB Serv./Past 12 Mos.			
	Count	Percent	Count	Percent
BUY [B]	184	51	18	10
NEUTRAL [N]	155	46	4	3
SELL [S]	7	3	0	0

***Percentages of each rating category where Janney has performed Investment Banking services over the past 12 months.**

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