



Morning Meeting Notes

Tuesday, July 12, 2011

AQUA AMERICA INC
(WTR - USD 22.30)

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Recommendation: BUY
Previous Recommendation: BUY
As of: 09-May-2011

		Currency - USD	
Capitalization		Financial Metrics	
(in millions)		Fiscal YE	Dec 2011
Number of Shares	138	2012 PMV/sh	28.00
Price	22.30	E P S	
		2012P	1.08
		2011E	0.98
Market Cap	3,075	2010A	0.90
Net Debt(Cash)	1,645	EBITDA (mm)	
Other	0	2012P	458
		2011E	421
Total Enterprise Value	4,720	2010A	401
		PE Ratio	
		2012P	20.5
		2011E	22.7
		2010A	24.6

AWK and WTR to Swap More Assets

On July 11, American Water Works Company, Inc. (AWK-29.64-BUY), the nation's largest publicly-traded water utility with regulated water utilities in 20 states, and Aqua America, Inc. (WTR-22.26-BUY), the nation's second largest publicly-traded water utility with regulated water utilities in 13 states, announced an agreement to "trade" water systems in New York and Ohio. Under the agreement, WTR would purchase AWK's Ohio regulated operations for \$120 million and simultaneously sell its New York regulated operations to AWK for \$71 million.

We view the agreement favorably and expect the transaction to be modestly accretive for both companies. Both companies are now the largest investor-owned water utilities in each of the two respective states and the transaction would allow for greater economies of scale and rate efficiency.

As a result of this transaction, WTR would gain AWKs 8 water systems and 1 wastewater system in central and northeast Ohio, which serve 50,730 water and 6,550 wastewater connections. AWK would gain WTRs 7 New York water systems, which serve 50,520 customers, across the state. The water utility trade will increase WTRs Ohio customer base by 57,280 customers, or 66%, to 145,000 and AWKs population base served by 152,000, or 75%, to 372,000. Aqua will gain roughly \$98 million in Ohio rate base, while AWK increases its New York rate base by roughly \$50 million to roughly \$180 million. Both acquisitions are expected to close during the first quarter of 2012 and are subject to each other's closing as well as receipt of the necessary regulatory approvals.

In addition, the agreement is consistent with recent portfolio management strategies to rationalize water systems. On January 24, AWK announced an agreement to sell under-earning utility subsidiaries in New Mexico and Arizona for \$470 million to EPCOR Water (USA). On June 16, 2011, WTR completed the acquisition of AWKs 51 Texas water and five wastewater systems (4,200 water and 1,100 wastewater customers) for \$6 million. On May 17, 2011, AWK completed the acquisition of WTRs 60 small Missouri water and wastewater systems, which serve 3,700 customers for \$3.2 million.

Our 2011, 2012 and 2013 earnings estimates remain \$0.98, \$1.08 and \$1.15, respectively. We do not expect the roughly \$50 million payment to AWK to require near-term equity financing given WTRs strong earnings and cash flow outlook. Management estimates EBITDA will grow to \$420-425 million in 2011 from \$400 million in 2010, a 6% increase. Our estimates result in nearly 8.5% annual earnings growth over the 2010-2012 period. Strong growth will be driven by rate relief, including large revenue increases in PA (\$24 million) and NJ (\$4 million) in mid 2010, the acquisition of smaller systems, and continued cost control.

We regard WTR as a well-managed, low-risk, high quality conservative utility with ample growth opportunities. WTR shares currently trade at 22.7x and 20.5x our 2011 and 2012 earnings estimates and 256% of book value, which compares to group multiples of 20.0x and 18.6x and 179% of book value. We believe WTR shares warrant premium multiples given the company's national presence, strong financial condition, successful track record, EPS outlook, and strong reputation. Over the past ten years, WTR shares have traded between 15-35x forward earnings and significant premium multiples to the group. Our 2011 PMV is \$27 per share.

Please see the last page for important disclosures.

Important Disclosures

To obtain a price chart for any security in this report, please contact 1-800-422-2274.

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A **Buy** rated stock is one that in our view is trading at a meaningful discount to our estimated PMV. We could expect a more modest private market value to increase at an accelerated pace, the discount of the public stock price to PMV to narrow through the emergence of a catalyst, or some combination of the two to occur.

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- **AQUA AMERICA INC**

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