Gabelli & Company, Inc.

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Morning Meeting Notes

Monday, May 9, 2011

AQUA AMERICA INC
(WTR - USD 22.56)

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Recommendation: BUY
Previous Recommendation: BUY
As of: 10-Mar-2011

Currency - **USD**

Capitalization (in millions)		**Financial Metrics**	
Number of Shares	138	**Fiscal YE**	Dec 2011
Price	22.56	**2012 PMV**/sh	28.00
Market Cap	3,109	**E P S**	
Net Debt(Cash)	1,645	2012P	1.08
Other	0	2011E	0.98
Total Enterprise Value	4,753	2010A	0.90
		EBITDA (mm)	
		2012P	458
		2011E	421
		2010A	401
		PE Ratio	
		2012P	20.9
		2011E	23.1
		2010A	25.0

Strong Start to the Year

- On 5/6/2011, Aqua America reported first quarter 2011 operating earnings of $0.19 per share, excluding a $0.03 per share income tax benefit, compared to $0.16 per share in the first quarter of 2010. Higher results were driven by increased revenues of $171.3 million vs. $160.5 million, or a 7% increase from the first quarter of last year, resulting from rate awards and customer growth from acquisitions, as well as continued cost controls. The company's efficiency ratio (operations and maintenance expense-to-revenue) declined to 39.3% of revenues from 42.2% in 2010. WTR completed the sale of a small system in Texas (Lake Conroe) in the first quarter.
- Year-to-date, the company has received rate awards totaling approximately $11.5 million, and is awaiting orders on $26 million of revenue requests in seven states. In mid-to-late 2011, WTR plans to file general rate cases in several larger states, including PA, NJ, and TX which would positively impact 2012 and 2013 earnings.
- During the first quarter, WTR invested $60.3 million of capital, and anticipates investing more than $300 million annually for utility system improvements with a significant portion allocated toward surcharge eligible pipe replacement. We have modeled an additional $25 million per year for utility acquisitions and WTR anticipates 15-20 acquisitions of systems in 2011.
- WTR recorded a tax benefit of $4.3 million in the first quarter ($0.03 per share) as a result of a PA tax law that was implemented in February 2011 which allows 100% bonus depreciation. WTR expects these benefits to continue to the remainder of the year at roughly $0.01-0.02 per share per quarter. We expect that the positive cash impact of bonus depreciation and growing internal cash will fund the capital program without the need for an equity offering. Management does not intend to issue material debt in 2011 due to these positive cash flow dynamics as well.
- Our 2011, 2012 and 2013 earnings estimates are $0.98, $1.08 and $1.15, respectively. Management stated that it was comfortable with the 2011 consensus earnings estimate of $0.97 per share (excluding $0.06-0.09 per share tax benefits). 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 23.1x and 20.9x our 2011 and 2012 earnings estimates and 266% of book value, which compares to group multiples of 21.5x and 20.3x and 184% 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.

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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- AQUA AMERICA INC
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