



### COMPANY UPDATE/ESTIMATE CHANGE

#### Key Metrics

WTR - NYSE (as of 5/5/11)	\$22.43
Price Target	\$25
52-Week Range	\$23.79-\$16.52
Shares Outstanding (mm)	138.4
Market Cap. (\$mm)	\$3,094.6
3-Mo. Average Daily Volume	579,318
Institutional Ownership	46.3%
Debt/Total Capital (3/11)	56.2%
ROE (3/11)	11.4%
Book Value/Share (3/11)	\$8.62
Price/Book Value	2.7x
Dividend Yield	2.8%
LTM EBITDA Margin	54.7%

#### EPS FY 12/31

	2010A	Prior 2011E	Curr. 2011E	Prior 2012E	Curr. 2012E
1Q	\$0.16	--	*\$0.19A	--	--
2Q	\$0.22	--	\$0.23	--	--
3Q	\$0.32	--	\$0.30	--	--
4Q	\$0.21	--	\$0.25	--	--
Year	\$0.90	\$0.96	*\$0.97	--	\$1.03
P/E	24.9x		23.1x		21.8x

\*Exclusive of ~\$0.03 tax benefit

#### Revenue (\$mm)

	2010A	Prior 2011E	Curr. 2011E	Prior 2012E	Curr. 2012E
1Q	\$160.5	--	\$171.3A	--	--
2Q	\$178.4	--	\$182.6	--	--
3Q	\$207.8	--	\$202.1	--	--
4Q	\$179.3	--	\$190.9	--	--
Year	\$726.1	\$740.8	\$746.9	--	\$768.2

**Company Description:** Aqua America is a water and wastewater utility holding company with operating subsidiaries serving approximately three million people in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, New York, Indiana, Florida, Virginia, Maine, Missouri, South Carolina, and Georgia. The company's history spans over 100 years.

## Aqua America Inc.

WTR -- NYSE -- Buy-2

### Solid Q2 Results; Maintain Buy and \$25 Price Target

#### Investment Highlights

- WTR reported ongoing Q1'11 EPS of \$0.19 versus \$0.16, a penny above our and the consensus estimate. GAAP EPS were \$0.22 versus \$0.16, which includes a ~\$0.03 tax benefit.
- Revenue rose 6.7% to \$171.3 million and O&M expenses rose just 0.4% to \$67.3 million. However, while O&M includes the favorable impact from an asset sale, there would still have been efficiency ratio improvement given its exclusion.
- Thus far into 2011 WTR has received rate awards totaling \$11.5 million (including surcharges), has ~\$26 million in pending rate cases in seven states, and plans to file in an additional seven states this year.
- WTR completed 23 small acquisitions in FY'10 which drove ~1% customer growth, and the company believes it will have 15-20 by year-end.
- We are raising our FY'11 EPS estimate by a penny to \$0.97, and making no change to our FY'12 EPS estimate of \$1.03.

**Note Important Disclosures on Pages 5 - 6.**  
**Note Analyst Certification on Page 5.**

**ADDITIONAL DISCUSSION*****First Quarter Results***

Aqua America reported ongoing Q1'11 EPS of \$0.19 versus \$0.16 in the year ago period, a penny above our and the consensus estimate. GAAP results were \$0.22 versus \$0.16, with a ~\$0.03 tax benefit included in Q1'11. This was a \$4.3 million benefit associated with bonus depreciation for capital spending in Pennsylvania, which is anticipated to positively impact EPS throughout 2011. Revenue rose 6.7% to \$171.3 million.

O&M (Operations & Maintenance) expenses rose 0.4% to \$67.3 million and as a percentage of revenue improved 280 basis points to 39.3%. However, this quarter includes the benefit of a \$2.5 million asset sale, so while this is not an apples-to-apples comparison there would still have been an improvement in the efficiency ratio. Coming off a year with significant efficiency ratio improvement, management does not anticipate a repeat in FY'11 but 25-50 bps of improvement is possible and our model only assumes 20 bps so upside is possible. Depreciation increased 4.2% to \$27.3 million and operating income was up 20.3% at \$60.1 million.

Long-term debt decreased negligibly from the sequential quarter to \$1.5 billion, and as a percentage of total capitalization decreased 40 bps to 56.2%. The company's target equity ratio is ~45%, and there are no debt borrowings or equity raises planned over the near-term. During the quarter WTR invested over \$60 million in infrastructure improvements, and expects to invest over \$300 million for the full year.

***Valuation***

We are raising our FY'11 EPS estimate by a penny to \$0.97, and making no change to our FY'12 EPS estimate of \$1.03. We note that on the call management commented it is comfortable with the current \$0.97 consensus for FY'11. There are several rate cases the company will be filing over the remainder of the year, and once we have a better feel for the amounts and timing we will likely be revising our FY'12 estimate upward.

We derive our \$25 price target using a multiple of 24x to our 2012 earnings estimate, which is at the low end of multiples where the company typically trades. The stock is currently trading at 23.1x and 21.8x our 2010 and 2011 EPS estimates, respectively.

***Outlook***

Thus far into 2011 WTR has received rate awards totaling \$11.5 million (including surcharges), has ~\$26 million in pending rate cases in seven states, and plans to file in an additional seven states this year. This will likely be the biggest driver of earnings over the near-term, but the company could begin to add some additional layers of EPS drivers over the next 1-2 years.

Drilling in the Marcellus Shale should create some opportunities for the company to both supply and treat water. With a tremendous amount of water needed in the drilling process, WTR is looking at establishing water stations, similar to gas stations, to serve this need. Moreover, this would be an unregulated business and therefore have much higher margins than serving residential customers. WTR has many small acquisitions planned this quarter, and the company believes it will make 15-20 by year-end. WTR made 23 acquisitions in FY'10, which drove ~1% of the company's customer growth in 2010, as organic growth remains due to the weak housing market.

We also believe it is prudent to remind investors that the coming summer will likely be much more challenging than what we had in 2010 given the extremely favorable weather. Thus, we forecast only a penny of incremental EPS growth in Q2 and a \$0.02 lower comp in Q3.

**CONSIDERATIONS AND RISKS**

- Water companies are subject to seasonal fluctuations, drought, and heavy rainfall. Demand varies with rainfall and temperature changes, and infrastructure replacements could become burdensome.
- Compliance with an increasingly stringent EPA will likely become an even greater cost going forward. Each state regulatory body deals with cost recoveries somewhat differently, affecting the timing of revenues and costs. Rate increases are not retroactive.
- The company's growth strategy via acquisitions could potentially be dilutive or have other adverse effects on normal business operations.

*Additional information is available upon request.*

**Aqua America, Inc.**

<b>Income Statements (000's)</b>	<b>FY'08</b>	<b>FY'09</b>	<b>Q1'10</b>	<b>Q2'10</b>	<b>Q3'10</b>	<b>Q4'10</b>	<b>FY'10</b>	<b>Q1'11A</b>	<b>Q2'11E</b>	<b>Q3'11E</b>	<b>Q4'11E</b>	<b>FY'11E</b>	<b>FY'12E</b>
Operating revenues	\$626,972	\$670,539	\$160,517	\$178,444	\$207,797	\$179,314	\$726,072	\$171,324	\$182,567	\$202,081	\$190,887	\$746,859	\$768,204
Costs and expenses:													
Operation and maintenance	262,122	270,060	67,601	69,310	72,968	70,083	279,962	67,325	70,288	70,728	72,537	280,879	287,431
Depreciation	88,785	103,001	26,200	26,802	27,431	27,628	108,061	27,293	27,300	27,500	28,000	110,093	108,000
Amortization	5,515	11,938	3,172	3,314	3,629	2,891	13,006	1,956	3,300	3,100	3,100	11,456	12,700
Taxes other than income taxes	44,749	48,081	12,860	12,943	14,182	12,982	52,967	13,765	11,867	12,933	11,453	50,018	50,466
Operating income	401,171	433,080	109,833	112,369	118,210	113,584	453,996	110,339	112,755	114,261	115,090	452,446	458,597
Other expense (income):													
Interest expense (net)	68,572	68,607	18,430	18,504	19,150	19,568	75,652	19,943	19,500	19,500	19,500	78,443	69,200
Allow. for funds used dur. const.	(3,674)	(2,871)	(1,541)	(1,461)	(1,077)	(983)	(5,062)	(1,977)	(900)	(700)	(1,100)	(4,677)	(3,600)
Gain on sale of water system													
Gain on sale of other assets	(1,599)	(472)	(1,929)	(110)	(291)	(253)	(2,583)	(121)	(600)	(200)	(300)	(1,221)	(1,200)
Income before income taxes	162,502	172,195	35,724	49,142	71,805	47,398	204,069	43,140	51,812	69,219	57,697	221,868	245,207
Provision for income taxes	64,584	67,842	14,213	19,287	28,054	18,540	80,094	12,789	20,310	27,688	22,213	83,000	95,699
Net income	97,918	104,353	21,511	29,855	43,751	28,858	123,975	30,351	31,502	41,532	35,483	138,868	149,508
Dividends on preferred stock													
Net income available to common stk.	\$97,918	\$104,353	\$21,511	\$29,855	\$43,751	\$28,858	\$123,975	\$30,351	\$31,502	\$41,532	\$35,483	\$138,868	\$149,508
Net income	97,918	104,353	21,511	29,855	43,751	28,858	123,975	30,351	31,502	41,532	35,483	138,868	149,508
Other comp. income (loss), net of tax:													
Unreal. hold. gain (loss) on certain inv.	195	289	902		272	414	1,588	4					
Minimum pension liability adjustment													
Unrealized gains on securities													
Reclass. adj. for gains reported	(209)	5	(1,330)			(39)	(1,369)	(2)					
Comprehensive income	\$97,904	\$104,647	\$21,083	\$29,855	\$44,023	\$29,233	\$124,194	\$30,353	\$31,502	\$41,532	\$35,483	\$138,868	\$149,508
EPS (FD)	0.73	\$0.77	\$0.16	\$0.22	\$0.32	\$0.21	\$0.90	\$0.22	\$0.23	\$0.30	\$0.25	\$0.99	\$1.03
EPS (FD) excluding tax benefit	0.73	\$0.77	\$0.16	\$0.22	\$0.32	\$0.21	\$0.90	\$0.19	\$0.23	\$0.30	\$0.25	\$0.97	\$1.03
Diluted average shares outstanding	134,705	136,129	136,800	137,012	137,394	137,904	137,296	138,384	139,584	140,784	141,984	140,186	145,131
Cash div. per share of com. stk.	\$0.510	\$0.550	\$0.145	\$0.145	\$0.145	\$0.155	\$0.590	\$0.155	\$0.155	\$0.155	\$0.165	\$0.630	\$0.670
<b>Rate of Change Analysis:</b>													
Revenues	4.1%	6.9%	3.9%	6.6%	14.9%	6.8%	8.3%	6.7%	2.3%	-2.8%	6.5%	2.9%	2.9%
Operating income	4.5%	5.2%	8.4%	12.3%	25.4%	8.9%	14.6%	20.3%	5.7%	-2.0%	15.3%	8.2%	5.2%
EPS	2.8%	5.5%	14.3%	15.8%	28.0%	5.0%	16.9%	37.5%	2.6%	-7.8%	19.0%	10.1%	4.0%
EBITDA	5.3%	10.1%	5.5%	10.7%	20.7%	7.3%	11.6%	12.7%	4.4%	-1.8%	11.1%	5.8%	3.4%
<b>Margin Analysis:</b>													
O&M	41.8%	40.3%	42.1%	38.8%	35.1%	39.1%	38.6%	39.3%	38.5%	35.0%	38.0%	37.6%	37.4%
D&A	15.0%	17.1%	18.3%	16.9%	14.9%	17.0%	16.7%	17.1%	16.8%	15.1%	16.3%	16.3%	15.7%
Taxes other than inc. taxes	7.1%	7.2%	8.0%	7.3%	6.8%	7.2%	7.3%	8.0%	6.5%	6.4%	6.0%	6.7%	6.6%
Operating income	36.0%	35.4%	31.6%	37.0%	43.1%	36.7%	37.5%	35.6%	38.2%	43.5%	39.7%	39.4%	40.3%
Net income	15.6%	15.6%	13.1%	16.7%	21.2%	16.3%	17.1%	17.7%	17.3%	20.6%	18.6%	18.6%	19.5%
Tax rate	39.7%	39.4%	39.8%	39.2%	39.1%	39.1%	39.2%	29.6%	39.2%	40.0%	38.5%	37.4%	39.0%

Source: Company reports and Hilliard Lyons estimates

### Analyst Certification

I, James O. Lykins, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

### Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

### Investment Ratings

**Buy** - We believe the stock has significant total return potential in the coming 12 months.

**Long-term Buy** - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues.

**Neutral** - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

**Underperform** - We believe the stock is vulnerable to a price decline in the next 12 months.

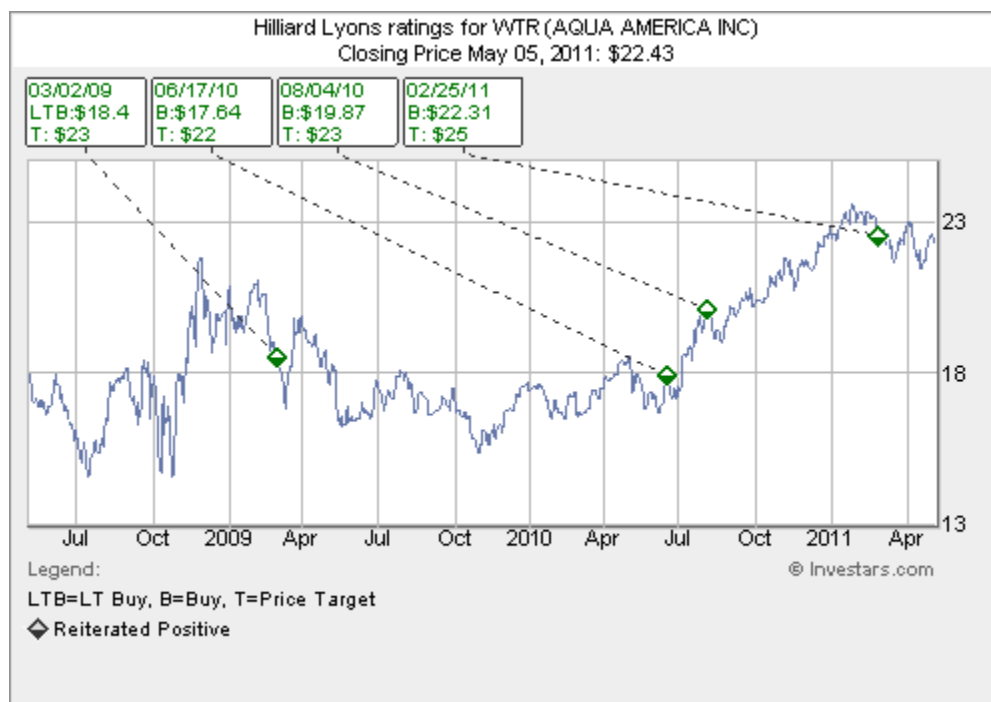
### Suitability Ratings

**1** - A large cap, core holding with a solid history

**2** - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks

**3** - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage

**4** - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base



<b>Rating</b>	<b>Hilliard Lyons Recommended Issues</b>		<b>Investment Banking Provided in Past 12 Mo.</b>	
	<b># of Stocks Covered</b>	<b>% of Stocks Covered</b>	<b>Banking</b>	<b>No Banking</b>
<b>Buy</b>	38	23%	0%	100%
<b>Long-term Buy</b>	35	21%	6%	94%
<b>Neutral</b>	90	54%	1%	99%
<b>Underperform</b>	3	2%	0%	100%
<b>Restricted</b>	1	1%	100%	0%

*As of 3 May 2011*

### Other Disclosures

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