

Water Utilities

Aqua America, Inc.
(WTR) - NEUTRAL

Price: **\$22.31**
 Fair Value Estimate: \$21.00
 52-Week Range: \$23.79-\$16.52
 Market Cap (MM): \$3,068
 Shr.O/S-Diluted (mm): 137.5
 Average Daily Volume: 691,004
 Dividend: \$0.62
 Yield: 2.8%

FYE: Dec	2009A	2010A	2011E
EPS:	\$0.77A	\$0.90A	\$0.95E
Prior EPS:			NC
P/E Ratio:	29.0x	24.8x	23.5x

Quarterly EPS:

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

Rate Relief and Cost Controls Drive Solid 2010 Growth - NEUTRAL on Valuation

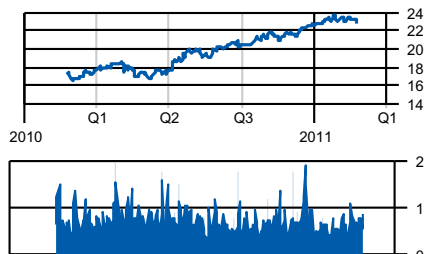
INVESTMENT CONCLUSION:

Aqua America succeeded in its goal to get back on the growth path in 2010 due to favorable weather patterns, cost discipline, and equitable regulatory treatment across its operating jurisdictions. The company is spending over \$1.5 billion in capital over the next five years to rehabilitate system infrastructure, to grow its rate base, and set the stage for future growth. Management maintains a disciplined cost consciousness and, despite already being notably lean in its cost structure, is still targeting additional improvement in its efficiency ratio. While WTR shares trade at a premium to the peer group, we believe the stock's current levels accurately account for the firm's future growth outlook. We maintain our NEUTRAL rating for WTR and \$21 fair value.

KEY POINTS:

- **Respectable growth in seasonally slow fourth quarter.** Aqua America reported fourth quarter earnings of \$0.21/share, in line with both our estimate and consensus, capping off a successful 2010. EPS grew 7% year-over-year as the company benefited from new rates enacted throughout the year and continued cost controls despite an elevated number of main breaks as a result of cold weather in December.
- **Lighter revenue offset by cost controls.** Quarterly revenue increased 7%, which was shy of our 9% expectations; organic growth associated with the overall housing market remained sluggish contributing 1%. The operations & maintenance expense / revenue ratio fell to 39.1% for the quarter (vs. our 40.3% assumptions), and contributed to a 36.7% operating margin (100 basis points ahead of our forecast). Aqua invested a record \$327 million in capital throughout 2010 - upgrading pipe, plants, and storage facilities. Additionally, management closed 23 tuck-in acquisitions this year focusing its attention on high-growth areas (Texas) while shedding operations where the company lacked critical mass (Missouri).
- **Rate relief continues to flow.** The company received \$54 million in annualized rate relief in 2010, and has outstanding requests for \$27 million in several states. So far in 2011 an additional \$7 million in awards have been received. With plans for over \$300 million in capital spending for 2011, management anticipates raising an additional \$65 million in debt at advantageous rates (2%) through an international investment program and utilizing internally generated cash for its equity funding needs.
- **Premium valuation reflects industry leader status.** While we believe WTR shares deserve a premium valuation (currently trading around 24 times our 2011 estimate) based upon the company's strong track record, we believe upside to this multiple is limited. While WTR remains a compelling source of competitive risk-adjusted total return for long-term oriented holders, we believe investors should be disciplined in seeking superior entry points and accordingly maintain our NEUTRAL rating on valuation.

1 Year Price History for WTR



Created by BlueMatrix

Aqua America, Inc.		Janney Montgomery Scott LLC								
Quarterly Income Statement, 2010										
	1Q10	Y/Y	2Q10	Y/Y	3Q10	Y/Y	4Q10	Y/Y	FY2010	Y/Y
Operating Revenues	160,517	3.9%	178,444	6.6%	207,797	14.9%	179,314	6.8%	726,072	8.3%
Operations and Maintenance	67,601		69,310		72,968		70,083		279,962	
<i>O&M Ratio</i>	42.1%		38.8%		35.1%		39.1%		38.6%	
Depreciation	26,200		26,802		27,431		27,628		108,061	
Amortization	3,172		3,314		3,629		2,891		13,006	
Taxes other than Income Taxes	12,890		12,943		14,182		12,982		52,967	
Operating Income	50,654	8.3%	66,075	12.3%	89,587	25.4%	65,730	8.9%	272,076	14.6%
<i>Operating Margin</i>	31.6%		37.0%		43.1%		36.7%		37.5%	
Interest Expense	18,430		18,504		19,150		19,568		75,652	
Allowance for Construction Funds	(1,541)		(1,461)		(1,077)		(983)		(5,062)	
Gain on Sale of other Assets	(1,929)		(110)		(291)		(253)		(2,583)	
Income before Income Taxes	35,694	15.5%	49,142	15.1%	71,805	30.3%	47,398	9.0%	204,069	18.5%
Income Taxes	14,213		19,287		28,054		18,540		80,094	
<i>Tax Rate</i>	39.8%		39.2%		39.1%		39.1%		39.2%	
Net Income	21,481	16.9%	29,855	15.5%	43,751	30.7%	28,858	8.2%	123,975	18.8%
Diluted EPS	\$0.16	16.1%	\$0.22	14.6%	\$0.32	29.6%	\$0.21	7.2%	\$0.90	17.8%
Diluted Shares Outstanding	136,800		137,012		137,394		137,904		137,296	

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%	192,583	7.4%	778,632	7.2%
Operations and Maintenance	72,984		75,857		82,911		76,070		307,822	
<i>O&M Ratio</i>	42.1%		39.0%		38.0%		39.5%		39.5%	
Depreciation	28,500		29,000		29,500		30,000		117,000	
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%	71,273	8.4%	289,230	6.3%
<i>Operating Margin</i>	32.3%		37.6%		40.7%		37.0%		37.1%	
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%	52,013	9.7%	215,230	5.5%
Income Taxes	15,087		21,665		27,719		20,285		84,756	
<i>Tax Rate</i>	39.5%		39.5%		39.5%		39.0%		39.4%	
Net Income	23,107	7.6%	33,183	11.1%	42,456	-3.0%	31,728	9.9%	130,474	5.2%
Diluted EPS	\$0.17	6.7%	\$0.24	10.4%	\$0.31	-3.4%	\$0.23	9.7%	\$0.95	4.7%
Diluted Shares Outstanding	137,900		137,900		138,000		138,200		138,000	

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

Research Analyst Certification

I, Ryan M. Connors, the Primarily Responsible Analyst for this research report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject securities or issuers. No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views I expressed in this research report.

Janney Montgomery Scott LLC ("JMS") Equity Research Disclosure Legend

Janney Montgomery Scott is a market maker in the securities of WTR, and may at any time hold a long or short position in this security.

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.

Definition of Ratings

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.**

Other Disclosures

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