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Reports 1Q11; Maintaining Buy Rating and Raising Target Price to \$29

Buy
Target Price: \$29 (from \$26)

Investment Summary – Aqua America posted 1Q11 results that met expectations. Revenue in the quarter of \$171.3 million came in just below our \$173.3 million estimate and was up 6.7% from the same quarter last year, while adjusted EPS of \$0.19 matched our \$0.19 forecast, a substantial improvement YOY. We’ve adjusted our forward estimates, are maintaining our Buy rating and raising our target price to \$29, based on the shares attaining a level of 26x our 2012 EPS estimate of \$1.10. Risks to the achievement of our target price include integration of acquisitions, weather, environmental regulations, regulation of rates, energy costs, and interest rates.

Discussion

- **1Q11 results met expectations.** Revenue in the quarter of \$171.3 million came in just \$2.2 million shy of our estimate, and increased 6.7% from the same quarter last year. Adjusted EPS in the quarter of \$0.19 met our estimate and came in \$0.01 above consensus. Reported EPS of \$0.22 was positively impacted by a state income tax benefit of \$4.3 million associated with 100% bonus depreciation on the company’s capital spending in Pennsylvania, which will continue to positively impact earnings through the remainder of the year.
- **O&M expenses improve.** Operations and maintenance expenses decreased 0.4% to \$67.3 million, due to a gain of \$2.5 million resulting from the sale of the company’s Lake Conroe utility system in Texas. Their continued focus on containing expenses has dropped the expense-to-revenue ratio to 39%, down from the 42% from 1Q10.
- **Continued spending.** During the quarter, WTR invested \$60.3 million as part of its capital investment program, and expects to invest more than \$300 million on system improvements over the course of 2011. Aqua will not need to raise equity in 2011 – its cash generated from operations will exceed its capital spending plans. The company is also not planning to borrow for the remainder of 2011 – which should keep a lid on interest expenses.
- **Rate update.** Thus far in 2011, WTR has received rate awards in Indiana and Ohio, as well as infrastructure surcharges in various states estimated to add revenues of \$11.5 million. Currently, the company has \$26 million of rate cases pending before seven state regulatory entities and plans to file cases in seven states later in 2011 that are expected to impact 2012 results.
- **Adjusting/introducing estimates.** We have adjusted our estimates as follows: our adjusted (CORE) 2011 EPS estimate is now \$0.99, up from \$0.98, and our 2012 EPS estimate is now \$1.10, raised from \$1.07. We’ve introduced two classifications of EPS results for 2011 – “Adjusted (CORE) EPS, which excludes anticipated favorable tax impacts in 2011 due to bonus depreciation effects, and “Reported” EPS, which does include the aforementioned benefits.

Price	\$22.56
52-Week High/Low	\$23.79 - 16.52
Shares Outstanding (mm)	138.20
Market Cap. (mm)	\$3,117.84
Average Daily Volume (mm)	0.57

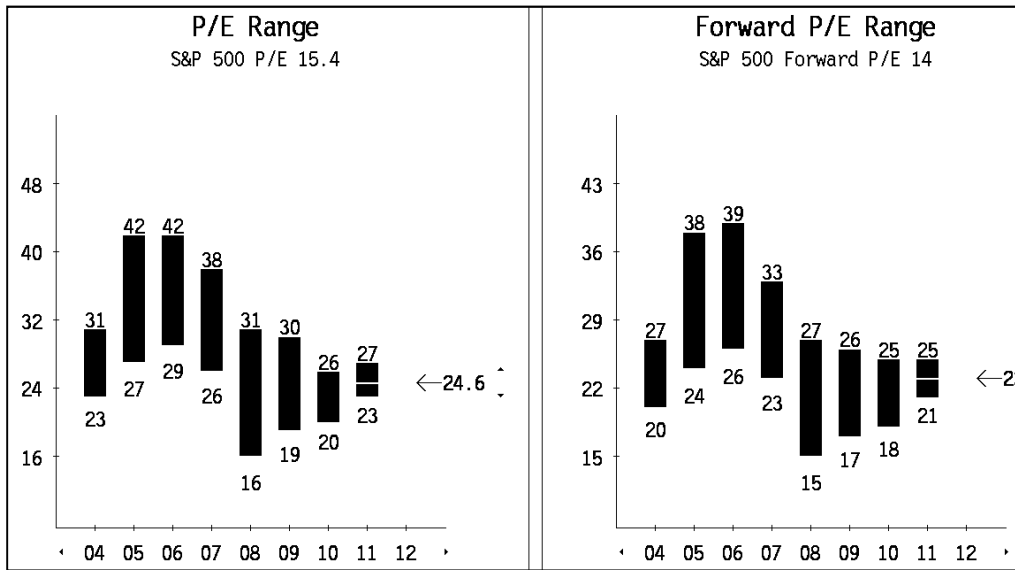
EPS	FY10A	FY11E	FY12E
Mar	\$0.16	\$0.19A	\$0.21
<i>Prior</i>	-	\$0.19	\$0.21
Jun	\$0.22	\$0.23	\$0.27
<i>Prior</i>	-	\$0.24	\$0.26
Sep	\$0.32	\$0.32	\$0.36
<i>Prior</i>	-	\$0.31	\$0.34
Dec	\$0.21	\$0.24	\$0.25
<i>Prior</i>	-	\$0.24	\$0.25
FY	\$0.90	\$0.99	\$1.10
<i>Prior</i>	-	\$0.98	\$1.07
Consensus	-	\$0.98	\$1.06
P/E	25.0x	22.9x	20.6x
FY Rev. (mm)	\$726.07	\$782.12	\$813.26



Source: BigCharts.com

Valuation. We believe Aqua America is poised for strong future growth. Its ability to access low-cost capital, as well as its strong internal cash generation and proven track record to acquire new systems and invest prudently in its asset base should continue to drive top and bottom-line growth going forward. With the shares now trading at 20x our 2012 EPS estimate of \$1.10, we continue to recommend share accumulation. We reiterate our Buy rating and raise our target price to \$29, based on the shares attaining a level of 26x our 2012 EPS estimate of \$1.10. We note the shares currently yield 2.8%.

Aqua America Historical Trailing and Forward P/E Ratios, 2004 – 2011



Source: Baseline

SUMMARY OF AQUA AMERICA VALUATION ANALYSIS					
Metric	Current Trading Multiple	Valuation Multiple		Implied Share Price	
		Low	High	Low	High
DDM				\$21.35	\$31.49
COMP/2012E Earnings		18.0	26.0	\$20.01	\$28.90
2012E P/E	24.8	20.0	26.0	\$22.23	\$28.90
EV/2012E EBITDA	12.1	10.0	13.0	\$17.04	\$26.80
EV/2012E Sales	6.5	5.0	7.0	\$14.31	\$26.23

Source: Company data and Brean Murray, Carret & Co. estimates

Aqua America		Quarterly Income Statement, 2011E									
(\$000, except per share data)											
Fiscal year ends December 31											
	1Q11	% Rev or Margin	2Q11E	% Rev or Margin	3Q11E	% Rev or Margin	4Q11E	% Rev or Margin	2011E	% Rev or Margin	
Sales	171,324		192,720		224,421		193,659		782,123		
Operating & maintenance	67,325	39.3%	75,161	39.0%	85,280	38.0%	75,140	38.8%	302,905	38.7%	
Depreciation	27,293	15.9%	27,366	14.2%	27,604	12.3%	27,887	14.4%	110,150	14.1%	
Amortization	1,956	1.1%	3,084	1.6%	3,366	1.5%	3,292	1.7%	11,698	1.5%	
Non-income taxes	13,765	8.0%	14,454	7.5%	14,363	6.4%	13,362	6.9%	55,944	7.2%	
Operating income	60,985	35.6%	72,655	37.7%	93,808	41.8%	73,978	38.2%	301,426	38.5%	
Interest expense, net	19,943	11.6%	20,043	10.4%	19,973	8.9%	19,947	10.3%	79,906	10.2%	
AFC	(1,977)	-1.2%	(1,000)	-0.5%	(1,000)	-0.4%	(1,000)	-0.5%	(4,977)	-0.6%	
Gain on sale of other assets	(121)	-0.1%	(400)	-0.2%	(400)	-0.2%	(400)	-0.2%	(1,321)	-0.2%	
Income before taxes	43,140	25.2%	54,012	28.0%	75,234	33.5%	55,431	28.6%	227,818	29.1%	
Income taxes	12,789	29.6%	18,904	35.0%	26,332	35.0%	18,847	34.0%	76,872	33.7%	
Net income	30,351	17.7%	35,108	18.2%	48,902	21.8%	36,584	18.9%	150,946	19.3%	
Earnings per share	\$0.22		\$0.25		\$0.35		\$0.26		\$1.09		
Adjusted (CORE) EPS	\$0.19		\$0.23		\$0.32		\$0.24		\$0.99		
Shares outstanding (000)	138,384		138,684		138,984		139,284		138,175		

Aqua America		Quarterly Income Statement, 2012E									
(\$000, except per share data)											
Fiscal year ends December 31											
	1Q12E	% Rev or Margin	2Q12E	% Rev or Margin	3Q12E	% Rev or Margin	4Q12E	% Rev or Margin	2012E	% Rev or Margin	
Sales	181,603		202,355		235,642		193,659		813,260		
Operating & maintenance	72,278	39.8%	78,919	39.0%	89,544	38.0%	73,590	38.0%	327,133	40.2%	
Depreciation	27,241	15.0%	27,116	13.4%	27,334	11.6%	28,274	14.6%	109,965	13.5%	
Amortization	1,816	1.0%	2,024	1.0%	1,885	0.8%	1,743	0.9%	7,468	0.9%	
Non-income taxes	13,075	7.2%	12,951	6.4%	14,139	6.0%	13,362	6.9%	53,527	6.6%	
Operating income	67,193	37.0%	81,347	40.2%	102,740	43.6%	76,689	39.6%	327,969	40.3%	
Interest expense, net	19,976	11.0%	19,831	9.8%	20,030	8.5%	20,722	10.7%	80,558	9.9%	
AFC	(1,000)	-0.6%	(1,000)	-0.5%	(1,000)	-0.4%	(1,000)	-0.5%	(4,000)	-0.5%	
Gain on sale of other assets	(300)	-0.2%	(300)	-0.1%	(300)	-0.1%	(300)	-0.2%	(1,200)	-0.1%	
Income before taxes	48,517	26.7%	62,816	31.0%	84,010	35.7%	57,267	29.6%	252,611	31.1%	
Income taxes	19,213	39.6%	24,875	39.6%	33,268	39.6%	22,678	39.6%	100,034	39.6%	
Net income	29,304	16.1%	37,941	18.7%	50,742	21.5%	34,590	17.9%	152,577	18.8%	
Earnings per share	\$0.21		\$0.27		\$0.36		\$0.25		\$1.10		
Shares outstanding (000)	138,684		138,984		139,284		139,584		139,134		

Source: Company data and Brean Murray, Carret & Co. estimates

Important Disclosures

Ratings and Target Price History



All prices are as of the market close on 5/6/11.

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- Buy - Expected to appreciate by at least 10% within the next 12 months.
- Hold - Fully valued, not expected to appreciate or decline materially within the next 12 months.
- Sell - Expected to decline by at least 10% within the next 12 months.

	# of Securities	% of Total Securities	# of IB-Related Securities in Past 12 mos.	% of Total Securities
BUY	142	58.68%	16	11.27%
HOLD	67	27.69%	2	2.99%
SELL	6	2.48%	0	0%
NOT RATED	27	11.16%	3	11.11%
TOTAL	242			

Note : Stock price volatility may cause temporary non-alignment of some ratings with some target prices.

Valuation Methodology and Risks

Aqua America (WTR): \$29 target price, based on the shares attaining a level of 26x our 2012 EPS estimate. Risks to the achievement of our target price include weather, acquisitions, interest rates, environmental / public health responsibilities and regulatory climate.

Analyst Certification

We, Michael Gaugler and Christopher Noon, hereby certify that the views expressed in this research report accurately reflect our personal views about any and all of the subject securities or issuers referred to in this document. The analyst and associate analyst further certify that they have not received and will not be receiving direct or indirect compensation in exchange for expressing the recommendation contained in this publication.

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