

**COMPANY UPDATE/PRICE TARGET
CHANGE**

Water Utilities

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Key Metrics

WTR - NYSE (as of 2/24/11)	\$22.31
Price Target	\$25
52-Week Range	\$23.79-\$16.52
Shares Outstanding (mm)	137.3
Market Cap. (\$mm)	\$3,068.5
3-Mo. Average Daily Volume	647,011
Institutional Ownership	47.5%
Debt/Total Capital (12/10)	56.6%
ROE (12/10)	10.9%
Book Value/Share (12/10)	\$8.62
Price/Book Value	2.6x
Dividend Yield	2.8%
LTM EBITDA Margin	54.1%

EPS FY 12/31

	2010A	Prior 2011E	Curr. 2011E	Prior 2012E	Curr. 2012E
1Q	\$0.16	--	\$0.18	--	--
2Q	\$0.22	--	\$0.23	--	--
3Q	\$0.32	--	\$0.30	--	--
4Q	\$0.21	--	\$0.25	--	--
Year	\$0.90	--	\$0.96	--	\$1.03
P/E	24.8x		23.3x		21.7x

Revenue (\$mm)

	2010A	Prior 2011E	Curr. 2011E	Prior 2012E	Curr. 2012E
1Q	\$160.5	--	\$165.2	--	--
2Q	\$178.4	--	\$182.6	--	--
3Q	\$207.8	--	\$202.1	--	--
4Q	\$179.3	--	\$190.9	--	--
Year	\$726.1	--	\$740.8	--	\$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

Q4 Results Inline with Expectations; Raise Price Target \$2 to \$25

Investment Highlights

- WTR reported Q4'10 EPS of \$0.21 versus \$0.20 in the year ago period, matching our and the consensus estimate.
- Revenue rose 6.8% to \$179.3 million while O&M expenses rose 6.1% to \$70.1 million, but as a percentage of revenue improved 20 basis points to 39.1%.
- The company has been awarded \$6.8 million in new rates thus far into FY'11, and pending rate cases total \$26.6 million. WTR also has plans to file this year in Pennsylvania, New Jersey, Ohio, Illinois, and Texas.
- Our FY'11 EPS estimate of \$0.96 is unchanged, and we are inaugurating a FY'12 EPS estimate of \$1.03.
- We also note the company raised its dividend this past December, its 20th increase in the past 19 years.

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

ADDITIONAL DISCUSSION***Fourth Quarter Results***

Aqua America reported Q4 EPS of \$0.21 versus \$0.20 in the year ago period, matching our and the consensus estimate. Revenue rose 6.8% to \$179.3 million. O&M (Operations & Maintenance) expenses rose 6.1% to \$70.1 million but as a percentage of revenue improved 20 basis points to 39.1% despite twice the normal number of main breaks (185) in December in southeastern PA. However, O&M improvement in FY'11 is expected to be ~25 bps on the heels of 170 bps of y/y improvement in FY'10. Depreciation increased 5.4% to \$27.6 million and operating income increased 8.9% to \$65.7 million.

Long-term debt at year's end was flat with the sequential quarter at \$1.5 billion, but as a percentage of total capitalization decreased 60 bps to 56.6%. (The company's target equity ratio is ~45%). Capital expenditures were ~\$88 million in the quarter and basically flat with the year ago period, and the company anticipates FY'11 cap ex of +\$300 million with the bulk spent on utility system improvements, and in line with FY'10.

Valuation

We are making no change to our FY'11 EPS estimate of \$0.96, and inaugurating a FY'12 EPS estimate of \$1.03. On the call management commented it is comfortable with the current \$0.97 consensus for FY'11, as well as with the \$0.18 consensus for Q1'11 – which is where we had been for Q1 as well, so no change here either. We also note that our FY'12 estimate assumes no planned rate cases, and with anticipated filings in 2011 for some of the more important states, we will raise our FY'12 estimate once we have a better feel for the timing and amounts.

We are raising our price target by \$2 to \$25, which we derive by applying 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 23.3x and 21.7x our 2010 and 2011 EPS estimates, respectively.

Outlook

Q4 results matched our expectations, and our overall thesis for WTR remains intact. We also note the company lost a penny from a tax law related to a production tax credit it was using, so the quality of earnings was slightly higher than the reported \$0.21. FY'11 should again see significant activity related to rates – there has been \$6.8 million awarded thus far into the year, with another \$26.6 million pending which is spread over 18 rate cases and additional filings are expected in Pennsylvania, New Jersey, Ohio, Illinois, and Texas. The Pennsylvania and New Jersey rate cases will likely be large and the most significant, and in both states the company typically files every other year in December and November, respectively. If either are settled, there could be a benefit in mid-2012, but if not the impact would likely be some time in Q4'12.

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 10 bps so upside is possible. We also expect a continuation of tuck-in acquisitions, following the 23 WTR made in FY'10. Acquisitions drove ~1% customer growth in 2010, as organic growth remains slow but housing is returning in WTR's footprint. And while the company is making acquisitions, we're also pleased to see it continue to prune nonperforming assets and maintaining a heightened focus on states with better growth opportunities and equitable ratemaking environments.

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. The main breaks which plagued

Q4'10 continued into January, but the company feels good about this already being absorbed and we were pleased to hear management endorse our previous \$0.18 estimate for Q1'11. We also note the company raised its dividend this past December, its 20th increase in the past 19 years. Including the 2.8% yield, we believe total return potential is approximately 15%.

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.

Income Statements (000's)	FY'08	FY'09	Q1'10	Q2'10	Q3'10	Q4'10	FY'10	Q1'11E	Q2'11E	Q3'11E	Q4'11E	FY'11E	FY'12E
Operating revenues	\$626,972	\$670,539	\$160,517	\$178,444	\$207,797	\$179,314	\$726,072	\$165,227	\$182,567	\$202,081	\$190,887	\$740,762	\$768,204
Costs and expenses:													
Operation and maintenance	262,122	270,060	67,601	69,310	72,968	70,083	279,962	66,091	71,201	72,749	75,400	285,441	287,431
Depreciation	88,785	103,001	26,200	26,802	27,431	27,628	108,061	26,300	26,900	27,000	26,900	107,100	108,000
Amortization	5,515	11,938	3,172	3,314	3,629	2,891	13,006	3,200	3,300	3,100	3,100	12,700	12,700
Taxes other than income taxes	44,749	48,081	12,860	12,943	14,182	12,982	52,967	12,392	11,867	12,933	11,453	48,645	50,466
Operating income	401,171	433,080	109,833	112,369	118,210	113,584	453,996	107,983	113,268	115,782	116,854	453,887	458,597
Other expense (income):													
Interest expense (net)	68,572	68,607	18,430	18,504	19,150	19,568	75,652	17,300	17,300	17,300	17,300	69,200	69,200
Allow. for funds used dur. const.	(3,674)	(2,871)	(1,541)	(1,461)	(1,077)	(983)	(5,062)	(900)	(900)	(700)	(1,100)	(3,600)	(3,600)
Gain on sale of water system													
Gain on sale of other assets	(1,599)	(472)	(1,929)	(110)	(291)	(253)	(2,583)	(100)	(600)	(200)	(300)	(1,200)	(1,200)
Income before income taxes	162,502	172,195	35,724	49,142	71,805	47,398	204,069	40,944	53,499	69,898	58,134	222,475	245,207
Provision for income taxes	64,584	67,842	14,213	19,287	28,054	18,540	80,094	16,296	20,972	27,959	22,381	87,608	95,699
Net income	97,918	104,353	21,511	29,855	43,751	28,858	123,975	24,648	32,527	41,939	35,752	134,867	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	\$24,648	\$32,527	\$41,939	\$35,752	\$134,867	\$149,508
Net income	97,918	104,353	21,511	29,855	43,751	28,858	123,975	24,648	32,527	41,939	35,752	134,867	149,508
Other comp. income (loss), net of tax:													
Unreal. hold. gain (loss) on certain inv.	195	289	902		272	414	1,588						
Minimum pension liability adjustment													
Unrealized gains on securities													
Reclass. adj. for gains reported	(209)	5	(1,330)			(39)	(1,369)						
Comprehensive income	\$97,904	\$104,647	\$21,083	\$29,855	\$44,023	\$29,233	\$124,194	\$24,648	\$32,527	\$41,939	\$35,752	\$134,867	\$149,508
EPS (FD)	0.73	\$0.77	\$0.16	\$0.22	\$0.32	\$0.21	\$0.90	\$0.18	\$0.23	\$0.30	\$0.25	\$0.96	\$1.03
Diluted average shares outstanding	134,705	136,129	136,800	137,012	137,394	137,904	137,296	139,104	140,304	141,504	142,704	141,083	145,851
Cash div. per share of com. stk.	\$0.510	\$0.550	\$0.145	\$0.145	\$0.145	\$0.155	\$0.590	\$0.145	\$0.145	\$0.145	\$0.152	\$0.587	\$0.587
Rate of Change Analysis:													
Revenues	4.1%	6.9%	3.9%	6.6%	14.9%	6.8%	8.3%	2.9%	2.3%	-2.8%	6.5%	2.0%	3.7%
Operating income	4.5%	5.2%	8.4%	12.3%	25.4%	8.9%	14.6%	12.9%	4.9%	-3.7%	12.6%	5.4%	7.9%
EPS	2.8%	5.5%	14.3%	15.8%	28.0%	5.0%	16.9%	10.7%	5.4%	-7.4%	19.3%	6.2%	7.2%
EBITDA	5.3%	10.1%	5.5%	10.7%	20.7%	7.3%	11.6%	8.4%	3.4%	-3.5%	8.1%	3.4%	5.8%
Margin Analysis:													
O&M	41.8%	40.3%	42.1%	38.8%	35.1%	39.1%	38.6%	40.0%	39.0%	36.0%	39.5%	38.5%	37.4%
D&A	15.0%	17.1%	18.3%	16.9%	14.9%	17.0%	16.7%	17.9%	16.5%	14.9%	15.7%	16.2%	15.7%
Taxes other than inc. taxes	7.1%	7.2%	8.0%	7.3%	6.8%	7.2%	7.3%	7.5%	6.5%	6.4%	6.0%	6.6%	6.6%
Operating income	36.0%	35.4%	31.6%	37.0%	43.1%	36.7%	37.5%	34.6%	38.0%	42.7%	38.8%	38.7%	40.3%
Net income	15.6%	15.6%	13.1%	16.7%	21.2%	16.3%	17.1%	14.9%	17.8%	20.8%	18.7%	18.2%	19.5%
Tax rate	39.7%	39.4%	39.8%	39.2%	39.1%	39.1%	39.2%	39.8%	39.2%	40.0%	38.5%	39.4%	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.

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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



Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	41	24%	0%	100%
Long-term Buy	35	21%	0%	100%
Neutral	88	52%	1%	99%
Underperform	4	2%	0%	100%
Restricted	2	1%	100%	0%

As of 8 February 2011

Other Disclosures

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