



**Morning Meeting Notes**

Thursday, August 4, 2011

**AQUA AMERICA INC**  
(WTR - USD 21.78)

**Timothy Winter, CFA**  
Ph: 314-238-1314  
[twinter@gabelli.com](mailto:twinter@gabelli.com)

Recommendation: BUY  
Previous Recommendation: BUY  
As of: 12-Jul-2011  
Fiscal YE: Dec 2011

		Currency - USD			
<b>Capitalization</b>		<b>Financial Metrics</b>			
(in millions)					
<b># of Shares</b>	138		<b>2010A</b>	<b>2011E</b>	<b>2012P</b>
<b>Market Cap</b>	3,006	<b>Revenue(mm)</b>	687	711	737
<b>Net Debt(Cash)</b>	1,678	<b>EBITDA(mm)</b>	401	426	459
<b>Other</b>	0	<b>EPS</b>	0.90	1.00	1.08
<b>TEV</b>	4,684	<b>TEV/EBITD</b>			
		<b>A</b>	11.7	11.0	10.2
		<b>PE</b>	24.1	21.8	20.2
		<b>PMV/sh</b>			28.00

Strong Second Quarter and First Half Earnings

On August 3, 2011 WTR reported 2011 second quarter earnings of \$0.25 per share (excludes \$0.02 per non-recurring tax benefit), which compares favorably to the \$0.22 per share reported last year. Second quarter revenues grew 5.5%, while operating and maintenance (O&M) expense rose a modest 3%. First half 2011 earnings were \$0.44 per share (excludes \$0.05 per share of tax benefits) compared to \$0.38 per share for the same period last year. First half revenues grew 6.1% while O&M expenses rose a modest 1%.

Strong results in both 2011 periods were driven by rate awards, higher consumption and customer additions as well as cost controls. During 2010, the company implemented rate awards designed to increase annualized revenues by \$53.9 million and an additional \$18 million of higher revenues were implemented year-to-date.

Management's emphasis on cost controls resulted in a second quarter efficiency ratio (O&M as percent of operating revenues) of 37.4%, which compares to 38.8% in the second quarter of 2010. The first half 2011 efficiency ratio declined to 38.3%, from 40.4% in same period of 2010.

Given strong first half 2011 results and favorable July weather conditions, we raised our 2011 earnings estimate to \$1.00 per share. Our 2012 and 2013 earnings estimates remain \$1.08 and \$1.15 per share, respectively, and result in nearly 8.5% annual growth over the 2010-2013 period. Strong growth will be driven by continued rate relief, cost controls, acquisitions and organic growth. We also expect recent decisions to sell water subsidiaries in New York, Missouri and Maine, while buying systems in the more favorable environments of Ohio and Texas will improve financial results.

In addition to the \$53.9 million of 2010 rate awards and \$18 million received year-to-date, WTR has requests pending for an additional \$25 million, including larger requests in North Carolina, Texas, and Illinois. Further, management expects to file for roughly \$45-50 million in seven states later this year, including Pennsylvania.

WTR continues its focus on increasing its presence in states with positive regulatory and business climate and divest those operations in less favorable operating climates. On July 27, 2011, WTR agreed to sell its Maine operations, which consists of 11 water systems serving 16,000 customers, to Connecticut Water for \$53.5 million. The transaction is expected to be completed in the first quarter of 2011. On July 11, 2011, WTR announced an agreement where WTR would purchase AWK's Ohio regulated operations for \$120 million and simultaneously sell its New York regulated operations to AWK for \$71 million. Both acquisitions are expected to close during the first quarter of 2012 and are subject to each other's closing as well as receipt of the necessary regulatory approvals. The two companies also traded MO and TX assets in mid-2011.

Shares currently trade at a relatively high 21.8x and 20.2x our 2011 and 2012 earnings estimates and 249% of book value, which compares to group multiples of 19.5x and 17.9x and 171% of book value. We consider WTR to be the premier water utility in the nation and the premium warranted. Our 2012 and 2013 PMVs are \$28 and \$30 per share.

**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.

Gabelli & Company, Inc. ("we" or "us") attempts to provide timely, value-added insights into companies or industry dynamics for institutional investors. Our research reports generally contain a recommendation of "buy," "hold," "sell" or "non-rated". We do not undertake to "upgrade" or "downgrade" ratings after publishing a report. We currently have reports on 685 companies, of which 44%, 39%, 3% and 15% have a recommendation of buy, hold, sell or non-rated, respectively. The percentage of companies so rated for which we provided investment banking services within the past 12 months is 0%, 0%, 0% and less than 1%.

**Ratings** - Analysts' ratings are largely (but not always) determined by our "private market value," or PMV methodology. Our basic goal is to understand in absolute terms what a rational, strategic buyer would pay for an asset in an open, arms-length transaction. At the same time, analysts also look for underlying catalysts that could encourage those private market values to surface.

A **Buy** rated stock is one that in our view is trading at a meaningful discount to our estimated PMV. We could expect a more modest private market value to increase at an accelerated pace, the discount of the public stock price to PMV to narrow through the emergence of a catalyst, or some combination of the two to occur.

A **Hold** is a stock that may be trading at or near our estimated private market value. We may not anticipate a large increase in the PMV, or see some other factors at work.

A **Sell** is a stock that may be trading at or above our estimated PMV. There may be little upside to the value, or limited opportunity to realize the value. Economic or sector risk could also be increasing.

We prepared this report as a matter of general information. We do not intend for this report to be a complete description of any security or company and it is not an offer or solicitation to buy or sell any security. All facts and statistics are from sources we believe to be reliable, but we do not guarantee their accuracy. We do not undertake to advise you of changes in our opinion or information. Unless otherwise noted, all stock prices reflect the closing price on the business day immediately prior to the date of this report. We do not use "price targets" predicting future stock performance. We do refer to "private market value" or PMV, which is the price that we believe an informed buyer would pay to acquire 100% of a company. There is no assurance that there are any willing buyers of a company at this price and we do not intend to suggest that any acquisition is likely. Additional information is available on request.

Because the portfolio managers at our affiliates make individual investment decisions with respect to the client accounts they manage, these accounts may have transactions inconsistent with the recommendations in this report. These portfolio managers may know the substance of our research reports prior to their publication as a result of joint participation in research meetings or otherwise. The analyst who wrote this report may receive commissions from customers' transactions in the securities mentioned in this report.

Our affiliates may receive compensation from the companies referred to in this report for non-investment banking securities-related services, or may be soliciting these companies as clients for non-investment banking securities-related services.

- **AQUA AMERICA INC**

I, Timothy Winter, CFA hereby certify that the views expressed in this report accurately reflect the analyst's personal views about the subject companies and their securities. I have not been, and will not be receiving direct or indirect compensation for expressing the specific recommendation or view in this report.

Our affiliates beneficially own on behalf of their investment advisory clients or otherwise less than 1% of the common stock of AQUA AMERICA INC as of May 31, 2011.

One of our affiliates serves as an investment adviser to AQUA AMERICA INC or an affiliated entity and has received compensation within the past 12 months for these non-investment banking securities-related services.

Additional Securities Mentioned in this Note:

- **AMERICAN WATER WORKS CO INC**

Our affiliates beneficially own on behalf of their investment advisory clients or otherwise less than 1% of the common stock of AMERICAN WATER WORKS CO INC as of May 31, 2011.