

**KENTUCKY-AMERICAN WATER COMPANY**  
**CASE NO. 2010-00036**  
**ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION**

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**Witness:**     **Michael A. Miller**

438. Please provide copies of all investment reports on AWWC published since January 1, 2009.

**Response:**

Please see attached documents which are all the reports readily available to AWW and KAW. The Company has not performed an exhaustive search to determine if there may be some other published reports which AWW does not have in its possession. The attached reports on American Water Works Company, Inc., represent the opinions of third party research companies. American Water neither endorses the material, nor undertakes an obligation to publicly update any subsequent distributions by these or other research companies.

For the electronic version, refer to the following documents:

KAW\_R\_AGDR1#438\_PART1\_042610.pdf

KAW\_R\_AGDR1#438\_PART1\_042610.pdf

**American Water Works, Inc.**  
(AWK-NYSE)

Rating/Risk: **Outperform/High**  
Price: \$19.21  
Target Price: \$26

**Weather-driven volume decline prompts 4Q08 earnings to fall short of expectations, but growth outlook remains favorable; Reit. Outperform.**

***Investment Conclusion:** American Water Works offers investors the rare combination of above average growth and a discount valuation, and coupled with a robust dividend yield, AWK shares offer a compelling risk-adjusted total return opportunity. American Water's earnings growth will be driven by its ongoing program of rate filings, as management seeks to bring the company's return on equity back into line with industry averages after a period of scarce rate case activity. As this "earnings turnaround" story plays out, American Water's earnings are likely to expand at a pace exceeding industry averages before ultimately settling into a more stable pattern of consistent growth. Despite the company's growth prospects, however, many investors remain concerned about a perceived "overhang" issue, as majority shareholder RWE AG has signaled its intention to further reduce its stake after last year's IPO. In our view, such concerns are a major factor in AWK shares' discount valuation relative to peers. We believe that this issue will run its course as RWE further reduces its stake, and that this valuation discrepancy represents an opportunity for long-term oriented investors.*

**Key Points:**

- American Water Works earned \$0.23/share in the fourth quarter of 2008, somewhat below our estimate of \$0.27/share and consensus expectations of \$0.26/share.
- Lower volumes were the principal cause for the earnings shortfall, as a 7% year-on-year decline in water sold resulted in a \$0.10/share drag on earnings in the quarter.
- Despite the quarterly miss, the earnings outlook remains favorable, as the company received annualized rate relief of over \$120 million the fourth quarter alone.
- Rate base should continue to expand at a brisk pace in 2009, with more than \$100 million in rate filings pending and the capital improvement program ongoing.
- With the 4Q miss driven by transitory weather issues, our 2009 EPS estimate of \$1.35 is unchanged; We also introduce a preliminary 2010 estimate of \$1.50.
- Overall, we continue to believe AWK shares offer a compelling risk-adjusted total return opportunity for long-term investors; We reiterate our Outperform rating.

**Fundamental & Valuation Data**

|                | 2008A     |                  | 2009E     |         | 2010E |                  |
|----------------|-----------|------------------|-----------|---------|-------|------------------|
|                | Current   | Prior            | Consensus | Current | Prior | Consensus        |
| Mar.           | \$0.11    | <b>\$0.13</b>    | -         | -       | E     | <b>\$0.15</b>    |
| Jun.           | \$0.28    | <b>\$0.30</b>    | -         | -       | E     | <b>\$0.33</b>    |
| Sep.           | \$0.55    | <b>\$0.57</b>    | -         | -       | E     | <b>\$0.60</b>    |
| Dec.           | \$0.23    | <b>\$0.35</b>    | -         | -       | E     | <b>\$0.42</b>    |
| Year           | \$1.17    | <b>\$1.35</b>    | \$1.35    | \$1.40  | E     | <b>\$1.50</b>    |
| <b>Revenue</b> | \$2,336.9 | <b>\$2,533.0</b> |           |         |       | <b>\$2,729.8</b> |
| <b>EBITDA</b>  | \$834.4   | <b>\$957.6</b>   |           |         |       | <b>\$1,059.0</b> |
| P/E            | 16.4x     | 14.3x            |           | 13.7x   |       | 12.8x            |
| EV/Revenue     | 3.5x      | 3.2x             |           |         |       | 3.0x             |
| EV/Ebitda      | 9.8x      | 8.6x             |           |         |       | 7.7x             |

\*EPS estimates are non-GAAP

**February 26, 2009**  
**Industrials**

**Market Data**

|                          |             |
|--------------------------|-------------|
| Current Price:           | 19.21       |
| 52 Week Range:           | \$24 - \$16 |
| 12 Month Target:         | \$26        |
| Market Value (MM):       | \$3,073     |
| Shares Outstanding (MM): | 160.0       |
| Institutional Holdings:  | 9%          |
| Avg Daily Volume (Th):   | 415         |
| Dividend:                | \$0.80      |
| Dividend Yield:          | 4.2%        |
| Est. LT EPS CAGR         | 10%         |

**Capitalization**

|                         |      |
|-------------------------|------|
| Book Value / Share      | \$28 |
| Cash / Share            | \$0  |
| Long-Term Debt / Cap'l: | 51%  |

**Fundamental Summary**

|                        |     |
|------------------------|-----|
| 2-Yr. Rev. Growth Est. | 8%  |
| 2-Yr. EPS Growth Est.  | 14% |

Source: Stock Val & B&S

**Description**

*Serving a population of over 15 million and operating in 32 states, American Water Works is the largest water utility services company in the U.S. Founded in Pennsylvania in 1886, the company is headquartered in Voorhees, NJ.*

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## Acquisition Market Update: Is Fiscal Duress Leading More Municipalities to Consider Selling Their Water System to the Private Sector?

As an increasing number of municipalities face down budgetary crises, some water industry insiders theorize that the increased incidence of fiscal duress will lead more municipalities to consider “monetizing” their water systems via asset sales to private sector water utility companies such as American Water Works. Indeed, while often maligned by the press and community groups, “privatization” can provide struggling municipalities with a sizeable infusion of cash and up-front access to water billing revenues that are typically sequestered in “Enterprise Funds” and not eligible to help balance non-water aspects of the budget.

With such transactions representing a potentially significant source of acquisition-driven growth for American Water and its publicly-traded water utility peers, we examined the issue by speaking with a number of mid-size municipalities across the country coping with budgetary challenges. Our analysis focused on cities with populations of 40,000-50,000 – an appealing segment of the market for private sector operators for “platform” acquisitions upon which to subsequently build via “tuck-in” transactions. Unfortunately, the key take-away from our analysis is that a crisis-driven wave of asset privatization appears unlikely in the near-term.

While municipalities cited a wide range of reasons for their hesitation to privatize their water systems, below we lay out some of the frequently recurring rationales that we encountered.

- **Legal/Ownership Title Issues:** Municipal asset sales seem straightforward enough, but the legal realities of such transactions provide seemingly limitless opportunities for opponents to erect roadblocks that can lead to delays of years or even decades and ultimately cause cities to abandon the effort entirely. A prominent example is the city of Providence, RI – whose on-again/off-again flirtation with privatization is now a long-running industry saga. Officials we spoke with indicate that among the key impediments to a deal is the Rhode Island PUC’s contention that the Providence water system belongs to *ratepayers*, not the *city*. This stance effectively blocks the City of Providence from monetizing the asset to balance its budget.
- **Fear of Political Backlash:** For better or worse (we would argue for worse), a vocal and organized minority of the population is evangelically opposed to private sector involvement in the water supply industry. Despite a lack of industry knowledge, these groups can be relied upon to vociferously oppose any privatizations, and in the case of successful transactions to put private operators under an intense microscope not typically encountered municipal water departments. Under this heightened level of scrutiny, any slip-up is met with aggressive and relentless condemnation. Not surprisingly, few politicians are willing to assume these political risks, no matter how compelling the case for privatization.
- **Lack of Operational Distress:** For the so-called “Tuck-In” acquisitions that represent the core of American Water Works’ acquisition program, the ability to provide with immediate solutions to operational challenges is often a key selling point. Given their small size, these systems often have difficulty maintaining compliance with ever more stringent water quality standards and other mandates, and an industry leader such as American Water can bring its considerable expertise to bear on these issues, ensuring the community access to a clean, safe supply of water. Larger municipal systems tend to be in somewhat better operational condition, and this lack of “Operational Distress” decreased the urgency of privatization.

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*Some industry insiders theorize that increased fiscal duress will lead more municipalities to consider asset sales.*

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*Our channel check analysis, however, suggests that a crisis-driven wave of asset privatization is unlikely.*

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*Municipalities cite a wide range of reasons for their hesitation to consider selling their water assets to private operators.*

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*Among the rationales cited are legal questions, fear of political backlash, and lack of operational problems as a catalyst.*



**Earnings Model: FY2009-FY2010**

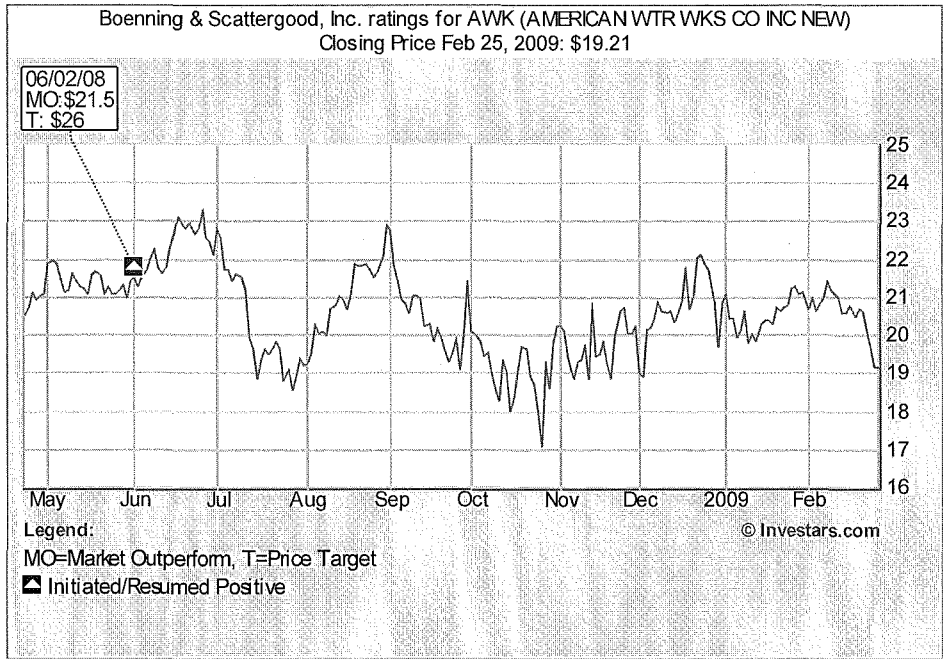
| American Water Works, Inc.        |                 | Boenning & Scattergood, Inc |                 |             |                 |             |                 |              |                  |              |  |
|-----------------------------------|-----------------|-----------------------------|-----------------|-------------|-----------------|-------------|-----------------|--------------|------------------|--------------|--|
| Quarterly Income Statement, 2009E |                 |                             |                 |             |                 |             |                 |              |                  |              |  |
|                                   | 1Q09E           | Y/Y                         | 2Q09E           | Y/Y         | 3Q09E           | Y/Y         | 4Q09E           | Y/Y          | FY2009E          | Y/Y          |  |
| <b>Revenue:</b>                   |                 |                             |                 |             |                 |             |                 |              |                  |              |  |
| Regulated Utility Sales           | \$472,011       | 5.0%                        | \$552,560       | 5.0%        | \$633,604       | 5.0%        | \$583,575       | 5.0%         | \$2,241,750      | 5.0%         |  |
| Non-Regulated Revenue             | 63,619          | 4.0%                        | 69,720          | 4.0%        | 76,825          | 4.0%        | 81,037          | 4.0%         | \$291,200        | 4.0%         |  |
| <b>Total Operating Revenue</b>    | <b>531,427</b>  | <b>4.9%</b>                 | <b>618,050</b>  | <b>4.9%</b> | <b>704,911</b>  | <b>4.9%</b> | <b>678,564</b>  | <b>19.3%</b> | <b>2,532,951</b> | <b>8.4%</b>  |  |
| <b>Operating Expenses:</b>        |                 |                             |                 |             |                 |             |                 |              |                  |              |  |
| Operations & Maintenance          | 301,851         |                             | 339,927         |             | 352,455         |             | 374,567         |              | 1,368,800        | 5.0%         |  |
| O&M Ratio                         | 56.8%           |                             | 55.0%           |             | 50.0%           |             | 55.2%           |              | 54.0%            |              |  |
| Depreciation & Amortization       | 74,000          |                             | 76,000          |             | 78,000          |             | 80,000          |              | 308,000          | 13.5%        |  |
| General Taxes                     | 52,000          |                             | 52,000          |             | 52,000          |             | 52,000          |              | 208,000          |              |  |
| (Gain) Loss of Sale of Assets     | (100)           |                             | (100)           |             | (100)           |             | (100)           |              | (400)            |              |  |
| <b>Total Operating Expenses</b>   | <b>427,751</b>  | <b>0.1%</b>                 | <b>467,827</b>  | <b>4.7%</b> | <b>482,355</b>  | <b>4.8%</b> | <b>506,467</b>  | <b>15.2%</b> | <b>1,884,400</b> | <b>3.7%</b>  |  |
| <b>Operating Income</b>           | <b>103,677</b>  | <b>30.2%</b>                | <b>150,222</b>  | <b>5.3%</b> | <b>222,555</b>  | <b>5.1%</b> | <b>172,096</b>  | <b>33.4%</b> | <b>648,551</b>   | <b>15.2%</b> |  |
| Operating Margin                  | 19.5%           |                             | 24.3%           |             | 31.6%           |             | 25.4%           |              | 25.6%            |              |  |
| <b>Other Income:</b>              |                 |                             |                 |             |                 |             |                 |              |                  |              |  |
| Interest, Net                     | (77,500)        |                             | (78,000)        |             | (78,000)        |             | (80,000)        |              | (313,500)        |              |  |
| Allowance for Funds (Other)       | 4,000           |                             | 4,000           |             | 4,000           |             | 4,000           |              | 16,000           |              |  |
| Allowance for Funds (Borrowed)    | 2,500           |                             | 2,500           |             | 2,500           |             | 2,500           |              | 10,000           |              |  |
| Amortization of Debt Expense      | (2,000)         |                             | (2,000)         |             | (2,000)         |             | (2,000)         |              | (8,000)          |              |  |
| Preferred Dividends of Subs.      | (65)            |                             | (65)            |             | (65)            |             | (65)            |              | (260)            |              |  |
| Other, Net                        | 1,250           |                             | 1,250           |             | 1,250           |             | 1,250           |              | 5,000            |              |  |
| <b>Total Other Income</b>         | <b>(71,815)</b> | <b>8.4%</b>                 | <b>(72,315)</b> | <b>7.9%</b> | <b>(72,315)</b> | <b>9.5%</b> | <b>(74,315)</b> | <b>15.3%</b> | <b>(290,760)</b> | <b>10.3%</b> |  |
| <b>Pre-Income Tax Income</b>      | <b>31,862</b>   | <b>137.5%</b>               | <b>77,907</b>   | <b>3.0%</b> | <b>150,240</b>  | <b>3.1%</b> | <b>97,781</b>   | <b>51.3%</b> | <b>357,791</b>   | <b>19.5%</b> |  |
| Taxes                             | 11,470          |                             | 28,047          |             | 54,087          |             | 35,201          |              | 128,805          |              |  |
| Tax Rate                          | 36.0%           |                             | 36.0%           |             | 36.0%           |             | 36.0%           |              | 36.0%            |              |  |
| <b>Net Income</b>                 | <b>20,391</b>   | <b>16.4%</b>                | <b>49,861</b>   | <b>9.6%</b> | <b>96,154</b>   | <b>9.1%</b> | <b>62,580</b>   | <b>71.9%</b> | <b>228,986</b>   | <b>22.1%</b> |  |
| <b>Earnings Per Share</b>         | <b>\$0.13</b>   | <b>15.7%</b>                | <b>\$0.30</b>   | <b>6.3%</b> | <b>\$0.57</b>   | <b>2.7%</b> | <b>\$0.35</b>   | <b>52.8%</b> | <b>\$1.35</b>    | <b>15.6%</b> |  |
| Shares Outstanding (Diluted)      | 161,000         |                             | 165,000         |             | 170,000         |             | 180,000         |              | 169,000          |              |  |

| American Water Works, Inc.        |                 | Boenning & Scattergood, Inc |                 |              |                 |              |                 |              |                  |              |  |
|-----------------------------------|-----------------|-----------------------------|-----------------|--------------|-----------------|--------------|-----------------|--------------|------------------|--------------|--|
| Quarterly Income Statement, 2010E |                 |                             |                 |              |                 |              |                 |              |                  |              |  |
|                                   | 1Q10E           | Y/Y                         | 2Q10E           | Y/Y          | 3Q10E           | Y/Y          | 4Q10E           | Y/Y          | FY2010E          | Y/Y          |  |
| <b>Revenue:</b>                   |                 |                             |                 |              |                 |              |                 |              |                  |              |  |
| Regulated Utility Sales           | \$509,772       | 8.0%                        | \$596,765       | 8.0%         | \$684,292       | 8.0%         | \$630,261       | 8.0%         | \$2,421,090      | 8.0%         |  |
| Non-Regulated Revenue             | 67,436          | 6.0%                        | 73,903          | 6.0%         | 81,434          | 6.0%         | 85,899          | 6.0%         | 308,672          | 6.0%         |  |
| <b>Total Operating Revenue</b>    | <b>572,669</b>  | <b>7.8%</b>                 | <b>666,099</b>  | <b>7.8%</b>  | <b>759,767</b>  | <b>7.8%</b>  | <b>731,228</b>  | <b>7.8%</b>  | <b>2,729,763</b> | <b>7.8%</b>  |  |
| <b>Operating Expenses:</b>        |                 |                             |                 |              |                 |              |                 |              |                  |              |  |
| Operations & Maintenance          | 317,831         |                             | 359,694         |              | 375,325         |              | 398,519         |              | 1,451,369        | 6.0%         |  |
| O&M Ratio                         | 55.5%           |                             | 54.0%           |              | 49.4%           |              | 54.5%           |              | 53.2%            |              |  |
| Depreciation & Amortization       | 80,000          |                             | 80,000          |              | 80,000          |              | 80,000          |              | 320,000          | 3.9%         |  |
| General Taxes                     | 55,000          |                             | 55,000          |              | 55,000          |              | 55,000          |              | 220,000          |              |  |
| (Gain) Loss of Sale of Assets     | (150)           |                             | (150)           |              | (150)           |              | (150)           |              | (600)            |              |  |
| <b>Total Operating Expenses</b>   | <b>452,681</b>  | <b>5.8%</b>                 | <b>494,544</b>  | <b>5.7%</b>  | <b>510,175</b>  | <b>5.8%</b>  | <b>533,369</b>  | <b>5.3%</b>  | <b>1,990,769</b> | <b>5.6%</b>  |  |
| <b>Operating Income</b>           | <b>119,988</b>  | <b>15.7%</b>                | <b>171,556</b>  | <b>14.2%</b> | <b>249,592</b>  | <b>12.1%</b> | <b>197,859</b>  | <b>15.0%</b> | <b>738,994</b>   | <b>13.9%</b> |  |
| Operating Margin                  | 21.0%           |                             | 25.8%           |              | 32.9%           |              | 27.1%           |              | 27.1%            |              |  |
| <b>Other Income:</b>              |                 |                             |                 |              |                 |              |                 |              |                  |              |  |
| Interest, Net                     | (82,000)        |                             | (82,000)        |              | (82,000)        |              | (82,000)        |              | (328,000)        |              |  |
| Allowance for Funds (Other)       | 3,000           |                             | 3,000           |              | 3,000           |              | 3,000           |              | 12,000           |              |  |
| Allowance for Funds (Borrowed)    | 1,500           |                             | 1,500           |              | 1,500           |              | 1,500           |              | 6,000            |              |  |
| Amortization of Debt Expense      | (1,250)         |                             | (1,250)         |              | (1,250)         |              | (1,250)         |              | (5,000)          |              |  |
| Preferred Dividends of Subs.      | (50)            |                             | (50)            |              | (50)            |              | (50)            |              | (200)            |              |  |
| Other, Net                        | 1,400           |                             | 1,400           |              | 1,400           |              | 1,400           |              | 5,600            |              |  |
| <b>Total Other Income</b>         | <b>(77,400)</b> | <b>7.8%</b>                 | <b>(77,400)</b> | <b>7.0%</b>  | <b>(77,400)</b> | <b>7.0%</b>  | <b>(77,400)</b> | <b>4.2%</b>  | <b>(309,600)</b> | <b>6.5%</b>  |  |
| <b>Pre-Income Tax Income</b>      | <b>42,588</b>   | <b>33.7%</b>                | <b>94,156</b>   | <b>20.9%</b> | <b>172,192</b>  | <b>14.6%</b> | <b>120,459</b>  | <b>23.2%</b> | <b>429,394</b>   | <b>20.0%</b> |  |
| Taxes                             | 15,332          |                             | 33,896          |              | 61,989          |              | 43,365          |              | 154,582          |              |  |
| Tax Rate                          | 36.0%           |                             | 36.0%           |              | 36.0%           |              | 36.0%           |              | 36.0%            |              |  |
| <b>Net Income</b>                 | <b>27,256</b>   | <b>33.7%</b>                | <b>60,260</b>   | <b>20.9%</b> | <b>110,203</b>  | <b>14.6%</b> | <b>77,094</b>   | <b>23.2%</b> | <b>274,812</b>   | <b>20.0%</b> |  |
| <b>Earnings Per Share</b>         | <b>\$0.15</b>   | <b>19.6%</b>                | <b>\$0.33</b>   | <b>10.8%</b> | <b>\$0.60</b>   | <b>5.6%</b>  | <b>\$0.42</b>   | <b>19.9%</b> | <b>\$1.51</b>    | <b>11.2%</b> |  |
| Shares Outstanding (Diluted)      | 180,000         |                             | 180,000         |              | 184,500         |              | 185,000         |              | 182,375          |              |  |



**Disclosure Appendix**

**Rating and Price Target History:**



**Associated Risk Factors:**

American Water’s earnings and ability to reach our price target could be negatively impacted by, among other things: unfavorable weather trends, negative regulatory and/or pricing developments, eminent domain seizure of water utility assets, and declining consumption of water in its service territories due to conservation initiatives. The realization of any or all of the following risk factors, among others, may adversely affect the company’s stock price: Commodity Prices, Raw Material Prices, Competition.

**Analyst Certification:**

The research analysts whose names appears on this research report certify that: (1) all of the views expressed in this research report accurately reflect their personal views about the subject security or issuer, and (2) no part of the research analysts’ compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analysts in this research report.

**Important Disclosures:**

Analyst compensation is based on, in part, Boenning & Scattergood, Inc.’s profitability, which includes revenues from investment banking. Boenning & Scattergood expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.

Boenning & Scattergood, Inc. managed or co-managed a public offering of the subject company’s securities in the past 12 months. Boenning & Scattergood has received compensation for investment banking services from AWK in the past 12 months.



**Boenning & Scattergood's Ratings System:**

Our three-tier investment ratings are based on a stock's return potential relative to a broad market index:

- **Outperform (Buy):** The security's total return over the year or longer is expected to exceed the total return of the S&P 500™ over the identical period.
- **Neutral (Hold):** The security's total return over the next year or longer is expected to be roughly equivalent to the total return of the S&P 500™ over the identical period.
- **Underperform (Sell):** The security's total return over the next year or longer is expected to be less than the total return of the S&P 500™ over the identical period.

Our four-tier risk ratings are based on a mix of price volatility and fundamental factors relative to the market and peer group.

- **Low:** The security has higher-than-average fundamental predictability and/or lower-than-average price volatility.
- **Moderate:** The security has average fundamental predictability and/or average price volatility.
- **High:** The security has lower-than-average fundamental predictability and/or higher-than-average price volatility.
- **Speculative:** The security has very inconsistent fundamental predictability and/or very high relative price volatility.

**Ratings Distribution (12/31/08):**

| <u>Coverage Universe</u> | <u>% of Universe</u> | <u>Investment Banking Clients (a)</u> | <u>% of Rating Group</u> |
|--------------------------|----------------------|---------------------------------------|--------------------------|
| Outperform (Buy)         | 56%                  | Outperform (Buy)                      | 7%                       |
| Neutral (Hold)           | 41%                  | Neutral (Hold)                        | 0%                       |
| Underperform (Sell)      | 3%                   | Underperform (Sell)                   | 0%                       |

(a) Related to services provided within the past 12 months.

Additional information on companies in a research report, including financial models, is available on request. Boenning & Scattergood, Inc. does and seeks to do business with companies covered in its research reports. As a result, Investors should be aware that they firm may have a conflict of interest that could affect the objectivity of this report. This report is not a complete analysis of every material fact representing company, industry or security mentioned herein. The information has been obtained from sources believed reliable, but is not necessarily complete and is not guaranteed. The reports are prepared for general information only and do not have regard to the specific investment objectives, financial situation or the particular needs of any specific person who may receive this report. The information is not to be relied upon in substitution for the exercise of independent judgment. It is recommended that Investors seek financial advice regarding the appropriateness of investing in any securities or investment strategies discussed in any report and should understand that statements regarding future prospects, earnings estimates and forecasts may not be realized. This communication shall not be deemed to constitute an offer, or solicitation on our part with respect to the sale or purchase of any securities. Securities and financial instruments mentioned herein may not be qualified for sale in all states. Opinions are subject to change without notice and reflect the opinion at its original date of publication. Boenning & Scattergood may have issued a trading opinion that may have identified a short term trading opportunity that may differ from the analyst's stock rating which is based on the expected return over a 12-month period. Boenning & Scattergood may trade for their own accounts as market maker, may have a long or short position in any securities of this issuer or related investments, and/or may be the opposite side of public orders. This firm or its officers, directors, stockholders, employees and clients, in the normal course of business, may have, acquire or sell a position including options, if any, in the securities mentioned. Boenning & Scattergood may also act as underwriter, placement agent, advisor, or lender to an issuer mentioned herein.

**BOENNING & SCATTERGOOD INSTITUTIONAL CONTACTS**

|                                      |                            |                                |              |
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**American Water Works, Inc.**  
(AWK-NYSE)

Rating/Risk: **Outperform/High**  
Price: **\$20**  
Target Price: **\$26**

**Second quarter 2009 earnings above expectations as rate relief offsets weather/recession-induced volume declines; Reiterate Outperform rating.**

***Investment Conclusion:** American Water Works offers investors the rare combination of above average growth and a discount valuation, and coupled with a robust dividend yield, AWK shares offer a compelling risk-adjusted total return opportunity. American Water's earnings growth will be driven by its ongoing program of rate filings, as management seeks to bring the company's return on equity back into line with industry averages after a period of scarce rate case activity. As this "turnaround" story plays out, American Water Works' earnings are likely to expand at a pace exceeding industry averages before ultimately settling into a more stable pattern of consistent growth. Despite the company's growth prospects, however, many investors remain concerned about a perceived "overhang" issue, as majority shareholder RWE AG has signaled its intention to further reduce its stake in the company. In our view, such concerns are a major factor in AWK shares' discount valuation relative to peers. We believe that this issue will run its course as RWE further reduces its stake, and that this valuation discrepancy represents an opportunity for long-term oriented investors.*

**Key Points:**

- American Water Works earned \$0.32/share in the second quarter ended 6/30/2009, above our estimate of \$0.30/share and in-line with consensus expectations.
- Higher rates offset volume declines, as the company posted 4% revenue growth despite a 6% drop in gallons shipped due to economic and weather headwinds.
- The top-line will likely continue to benefit from rate relief in the quarters ahead, with the company currently awaiting determinations on \$258 million in rate cases.
- While the recession is having a negative impact on volume sales, this is a "regulatory lag" issue, as consumption declines are "trued up" at the next rate proceeding.
- RWE's "overhang" on AWK shares is likely to dissipate significantly over the next 6-12 months, setting the stage for potentially meaningful P/E multiple expansion.
- Overall, we continue to believe AWK shares offer a compelling risk-adjusted total return opportunity for long-term investors, and we reiterate our Outperform rating.

**Fundamental & Valuation Data**

|                | 2008A     |                  | 2009E     |           |       | 2010E            |           |           |
|----------------|-----------|------------------|-----------|-----------|-------|------------------|-----------|-----------|
|                | Current   | Prior            | Consensus | Current   | Prior | Consensus        |           |           |
| Mar.           | \$0.11    | <b>\$0.19</b>    | \$0.19    | -         | A     | <b>\$0.21</b>    | \$0.20    | -         |
| Jun.           | \$0.28    | <b>\$0.32</b>    | \$0.29    | -         | A     | <b>\$0.33</b>    | \$0.34    | -         |
| Sep.           | \$0.55    | <b>\$0.52</b>    | \$0.56    | -         | E     | <b>\$0.59</b>    | \$0.60    | -         |
| Dec.           | \$0.23    | <b>\$0.32</b>    | \$0.31    | -         | E     | <b>\$0.37</b>    | \$0.36    | -         |
| Year           | \$1.17    | <b>\$1.35</b>    | \$1.35    | \$1.32    | E     | <b>\$1.50</b>    | \$1.50    | \$1.45    |
| <b>Revenue</b> | \$2,336.9 | <b>\$2,527.8</b> | \$2,548.9 | \$2,514.0 |       | <b>\$2,715.2</b> | \$2,717.5 | \$2,689.0 |
| <b>EBITDA</b>  | \$834.4   | <b>\$953.8</b>   | \$938.5   |           |       | <b>\$1,051.5</b> | \$1,046.5 |           |
| P/E            | 17.1x     | 14.8x            |           | 15.2x     |       | 13.3x            |           |           |
| EV/Revenue     | 3.7x      | 3.4x             |           |           |       | 3.2x             |           |           |
| EV/Ebitda      | 10.3x     | 9.0x             |           |           |       | 8.2x             |           |           |

\*EPS estimates are non-GAAP

**August 6, 2009**  
**Industrials**

**Market Data**

|                          |             |
|--------------------------|-------------|
| Current Price:           | \$20.00     |
| 52 Week Range:           | \$23 - \$16 |
| 12 Month Target:         | \$26        |
| Market Value (MM):       | \$3,491     |
| Shares Outstanding (MM): | 174.6       |
| Institutional Holdings:  | 33.5%       |
| Avg Daily Volume (Th):   | 814         |
| Dividend:                | \$0.84      |
| Dividend Yield:          | 4.2%        |

**Capitalization**

|                         |       |
|-------------------------|-------|
| Book Value / Share      | \$23  |
| Cash / Share            | \$0   |
| Long-Term Debt / Cap'l: | 56.0% |

**Fundamental Summary**

|                       |    |
|-----------------------|----|
| 3-Yr. Hist. Rev CAGR: | -  |
| 2-Yr. Fwd. EPS CAGR:  | 9% |
| ROE 2008A:            | 6% |

Source: Baseline & B&S

**Description**

*Serving a population of over 15 million and operating in 32 states, American Water Works is the largest water utility services company in the U.S. Founded in Pennsylvania in 1886, the company is headquartered in Voorhees, NJ.*

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### Key Points in Detail:

- **2Q09 earnings exceed our estimate as higher rates offset lower volumes.** American Water Works earned \$0.32/share in the quarter ended 6/30/2009, above our estimate of \$0.30/share and in-line with consensus expectations. Overall, it was a very solid quarterly performance in a difficult environment, as the company faced dual headwinds in the form of significant usage declines for industrial customers and wet weather conditions in its core Mid-Atlantic service territory. In particular, American Water Works' ability to continue delivering on its robust rate relief program, as well as its focus on disciplined cost control, enabled the company to deliver strong profitability in the quarter despite considerable challenges on the demand front.
- **Weather, economic headwinds cause gallons shipped to decline.** Rainy conditions blunt demand by reducing the amount of purchased water required for golf course and residential irrigation, and with 29 of 30 days in June exhibiting measurable rain in American Water's key service area, weather was a substantial headwind in the second quarter. Coupled with a 17% drop in volume shipped to industrial customers (who represent roughly 5% of total revenue), this drove a 5.5% decrease in gallons shipped – translating into a year-over-year revenue decline of \$24 million. Despite this considerable headwind, however, ongoing rate relief contributed an incremental \$47 million to the top-line – enabling revenue to *increase 4%* and underscoring a critical aspect of our positive investment thesis for American Water Works.
- **Rate case docket remains active, sets stage for further top-line gains.** Looking ahead, rate relief will remain a source of robust growth, with the company awaiting final determinations on nearly \$260 million in rate filings. Even discounting this gross figure by 30% to reflect the likelihood that final settlement amounts fall short of initial requests, this translates to roughly 12% of trailing four quarter regulated revenue – a sizable amount and a significant growth opportunity. Recently filed rate cases include requests for \$59 million in new rates in Illinois, \$58 million in Pennsylvania, and \$47 million in Indiana, among others. As American Water continues to work its way out of its current “under-earning” status, we believe that further rate relief will drive significant top- and bottom-line growth for an extended period of time.
- **With RWE stake now under 50%, end in sight for “overhang.”** Dating back to the April 2008 IPO, an oft-cited rationale for *not* investing in AWK shares is that major shareholder RWE's stated intention to liquidate much of its position will put a persistent “ask” over the stock, precluding it from moving higher or from sustaining any meaningful gains. Not only has this rationale been dead wrong (AWK shares have trounced the broad market indices and performed in-line with overhang-free peers since the IPO), but it becomes even less relevant with each subsequent share sale by RWE. Following the June offering, RWE now owns less than 50% of the company, and in our view further share sales will lead investors to recognize that this issue is in its twilight – enabling potentially meaningful P/E multiple expansion.
- **AWK shares offers attractive risk-adjusted total return opp'ty.** With valuations for many water utilities already at a significant premium to the broad market, investing in this area is largely predicated on an expectation of consistent earnings growth and the additive effect of dividends on total return rather than on P/E expansion (i.e. growing the “E” – not the “P”). In our view, the artificial RWE overhang issue makes American Water the exception by providing the opportunity for meaningful multiple expansion as this perceived overhang dissipates. Indeed, our \$26 target price (30% above current levels) reflects a forward multiple of just 17x – arguably *conservative* in relation to peers such as AWR (21x) and WTR (20x).

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*American Water posted solid second quarter EPS despite headwinds from both the economy and wet weather conditions.*

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*Revenue increased 4% from a year ago, as \$47 million in rate relief offset a \$24 million decline due to lower volumes.*

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*Not only has the RWE “overhang” argument been dead wrong, but it becomes less relevant with each RWE sale.*

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*This perceived overhang makes AWK a rarity among water utilities: A compelling “multiple expansion” based story.*

**BOENNING & SCATTERGOOD**  
ESTABLISHED 1914

| American Water Works, Inc.      | Quarterly Income Statement, 2009E |               |                 |              |                 |              | Boenning & Scattergood, Inc |              |                  |              |
|---------------------------------|-----------------------------------|---------------|-----------------|--------------|-----------------|--------------|-----------------------------|--------------|------------------|--------------|
|                                 | 1Q09                              | Y/Y           | 2Q09            | Y/Y          | 3Q09E           | Y/Y          | 4Q09E                       | Y/Y          | FY2009E          | Y/Y          |
| <b>Revenue:</b>                 |                                   |               |                 |              |                 |              |                             |              |                  |              |
| Regulated Utility Sales         | \$492,598                         | 9.6%          | \$554,948       |              | \$630,586       | 4.5%         | \$580,796                   | 4.5%         | \$2,258,929      | 5.8%         |
| Non-Regulated Revenue           | 57,572                            | -5.9%         | 64,238          |              | 70,915          | -4.0%        | 74,803                      | -4.0%        | \$267,528        | -4.5%        |
| <b>Total Operating Revenue</b>  | <b>550,170</b>                    | <b>8.6%</b>   | <b>612,740</b>  | <b>4.0%</b>  | <b>696,402</b>  | <b>3.6%</b>  | <b>668,518</b>              | <b>17.6%</b> | <b>2,527,829</b> | <b>8.2%</b>  |
| <b>Operating Expenses:</b>      |                                   |               |                 |              |                 |              |                             |              |                  |              |
| Operations & Maintenance        | 314,402                           |               | 330,597         |              | 348,201         |              | 371,027                     |              | 1,364,227        | 4.6%         |
| <i>O&amp;M Ratio</i>            | <i>57.1%</i>                      |               | <i>54.0%</i>    |              | <i>50.0%</i>    |              | <i>55.5%</i>                |              | <i>54.0%</i>     |              |
| Depreciation & Amortization     | 68,843                            |               | 73,242          |              | 77,000          |              | 79,000                      |              | 298,085          | 9.9%         |
| General Taxes                   | 52,497                            |               | 51,699          |              | 53,000          |              | 53,000                      |              | 210,196          |              |
| (Gain) Loss of Sale of Assets   | (202)                             |               | 10              |              | (100)           |              | (100)                       |              | (392)            |              |
| <b>Total Operating Expenses</b> | <b>435,540</b>                    | <b>2.0%</b>   | <b>455,548</b>  | <b>2.0%</b>  | <b>478,101</b>  | <b>3.8%</b>  | <b>502,927</b>              | <b>14.4%</b> | <b>1,872,116</b> | <b>3.0%</b>  |
| <b>Operating Income</b>         | <b>114,630</b>                    | <b>43.9%</b>  | <b>157,192</b>  | <b>10.2%</b> | <b>218,301</b>  | <b>3.1%</b>  | <b>165,590</b>              | <b>28.3%</b> | <b>655,713</b>   | <b>16.4%</b> |
| <i>Operating Margin</i>         | <i>20.8%</i>                      |               | <i>25.7%</i>    |              | <i>31.3%</i>    |              | <i>24.8%</i>                |              | <i>25.9%</i>     |              |
| <b>Other Income:</b>            |                                   |               |                 |              |                 |              |                             |              |                  |              |
| Interest, Net                   | (71,979)                          |               | (73,688)        |              | (76,000)        |              | (80,000)                    |              | (301,667)        |              |
| Other, Net                      | 1,114                             |               | (1,409)         |              | 800             |              | 800                         |              | 1,305            |              |
| <b>Total Other Income</b>       | <b>(67,138)</b>                   | <b>1.4%</b>   | <b>(71,066)</b> | <b>6.1%</b>  | <b>(70,700)</b> | <b>7.0%</b>  | <b>(74,700)</b>             | <b>15.9%</b> | <b>(283,604)</b> | <b>7.5%</b>  |
| <b>Pre-Income Tax Income</b>    | <b>47,492</b>                     | <b>254.0%</b> | <b>86,126</b>   | <b>13.8%</b> | <b>147,601</b>  | <b>1.3%</b>  | <b>90,890</b>               | <b>40.6%</b> | <b>372,109</b>   | <b>24.3%</b> |
| Taxes                           | 17,547                            |               | 34,137          |              | 56,088          |              | 34,538                      |              | 142,311          |              |
| <i>Tax Rate</i>                 | <i>36.9%</i>                      |               | <i>39.6%</i>    |              | <i>38.0%</i>    |              | <i>38.0%</i>                |              | <i>38.2%</i>     |              |
| <b>Net Income</b>               | <b>29,945</b>                     | <b>71.0%</b>  | <b>51,989</b>   | <b>14.3%</b> | <b>91,513</b>   | <b>3.8%</b>  | <b>56,352</b>               | <b>54.8%</b> | <b>229,799</b>   | <b>22.5%</b> |
| <b>Earnings Per Share</b>       | <b>\$0.19</b>                     | <b>70.9%</b>  | <b>\$0.32</b>   | <b>11.9%</b> | <b>\$0.52</b>   | <b>-5.1%</b> | <b>\$0.32</b>               | <b>41.6%</b> | <b>\$1.35</b>    | <b>15.2%</b> |
| Shares Outsanding (Diluted)     | 160,011                           |               | 163,301         |              | 175,000         |              | 175,000                     |              | 168,328          |              |

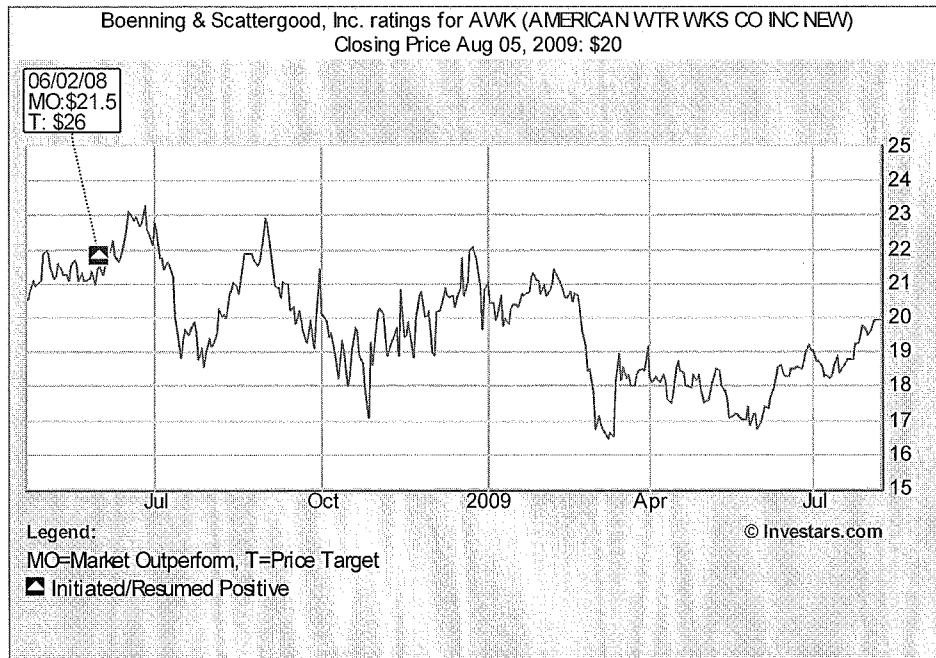
\*Segment revenue figures preliminary, pending release of 10Q

| American Water Works, Inc.      | Quarterly Income Statement, 2010E |              |                 |              |                 |              | Boenning & Scattergood, Inc |              |                  |              |
|---------------------------------|-----------------------------------|--------------|-----------------|--------------|-----------------|--------------|-----------------------------|--------------|------------------|--------------|
|                                 | 1Q10E                             | Y/Y          | 2Q10E           | Y/Y          | 3Q10E           | Y/Y          | 4Q10E                       | Y/Y          | FY2010E          | Y/Y          |
| <b>Revenue:</b>                 |                                   |              |                 |              |                 |              |                             |              |                  |              |
| Regulated Utility Sales         | \$532,006                         | 8.0%         | \$599,344       | 8.0%         | \$681,033       | 8.0%         | \$627,260                   | 8.0%         | \$2,439,643      | 8.0%         |
| Non-Regulated Revenue           | 59,875                            | 4.0%         | 66,808          | 4.0%         | 73,752          | 4.0%         | 77,795                      | 4.0%         | 278,230          | 4.0%         |
| <b>Total Operating Revenue</b>  | <b>587,678</b>                    | <b>6.8%</b>  | <b>659,190</b>  | <b>7.6%</b>  | <b>749,277</b>  | <b>7.6%</b>  | <b>719,007</b>              | <b>7.6%</b>  | <b>2,715,152</b> | <b>7.4%</b>  |
| <b>Operating Expenses:</b>      |                                   |              |                 |              |                 |              |                             |              |                  |              |
| Operations & Maintenance        | 324,986                           |              | 355,962         |              | 370,892         |              | 395,454                     |              | 1,447,295        | 6.1%         |
| <i>O&amp;M Ratio</i>            | <i>55.3%</i>                      |              | <i>54.0%</i>    |              | <i>49.5%</i>    |              | <i>55.0%</i>                |              | <i>53.3%</i>     |              |
| Depreciation & Amortization     | 75,000                            |              | 80,000          |              | 80,000          |              | 80,000                      |              | 315,000          | 5.7%         |
| General Taxes                   | 53,000                            |              | 54,000          |              | 55,000          |              | 55,000                      |              | 217,000          |              |
| (Gain) Loss of Sale of Assets   | (150)                             |              | (150)           |              | (150)           |              | (150)                       |              | (600)            |              |
| <b>Total Operating Expenses</b> | <b>452,836</b>                    | <b>4.0%</b>  | <b>489,812</b>  | <b>7.5%</b>  | <b>505,742</b>  | <b>5.8%</b>  | <b>530,304</b>              | <b>5.4%</b>  | <b>1,978,695</b> | <b>5.7%</b>  |
| <b>Operating Income</b>         | <b>134,842</b>                    | <b>17.6%</b> | <b>169,377</b>  | <b>7.8%</b>  | <b>243,535</b>  | <b>11.6%</b> | <b>188,703</b>              | <b>14.0%</b> | <b>736,458</b>   | <b>12.3%</b> |
| <i>Operating Margin</i>         | <i>22.9%</i>                      |              | <i>25.7%</i>    |              | <i>32.5%</i>    |              | <i>26.2%</i>                |              | <i>27.1%</i>     |              |
| <b>Other Income:</b>            |                                   |              |                 |              |                 |              |                             |              |                  |              |
| Interest, Net                   | (82,000)                          |              | (82,000)        |              | (82,000)        |              | (82,000)                    |              | (328,000)        |              |
| Other, Net                      | 1,200                             |              | 1,200           |              | 1,200           |              | 1,200                       |              | 4,800            |              |
| <b>Total Other Income</b>       | <b>(77,800)</b>                   | <b>15.9%</b> | <b>(77,800)</b> | <b>9.5%</b>  | <b>(77,550)</b> | <b>9.7%</b>  | <b>(77,550)</b>             | <b>3.8%</b>  | <b>(310,700)</b> | <b>9.6%</b>  |
| <b>Pre-Income Tax Income</b>    | <b>57,042</b>                     | <b>20.1%</b> | <b>91,577</b>   | <b>6.3%</b>  | <b>165,985</b>  | <b>12.5%</b> | <b>111,153</b>              | <b>22.3%</b> | <b>425,758</b>   | <b>14.4%</b> |
| Taxes                           | 20,535                            |              | 32,968          |              | 59,755          |              | 40,015                      |              | 153,273          |              |
| <i>Tax Rate</i>                 | <i>36.0%</i>                      |              | <i>36.0%</i>    |              | <i>36.0%</i>    |              | <i>36.0%</i>                |              | <i>36.0%</i>     |              |
| <b>Net Income</b>               | <b>36,507</b>                     | <b>21.9%</b> | <b>58,609</b>   | <b>12.7%</b> | <b>106,230</b>  | <b>16.1%</b> | <b>71,138</b>               | <b>26.2%</b> | <b>272,485</b>   | <b>18.6%</b> |
| <b>Earnings Per Share</b>       | <b>\$0.21</b>                     | <b>11.5%</b> | <b>\$0.33</b>   | <b>2.3%</b>  | <b>\$0.59</b>   | <b>12.9%</b> | <b>\$0.37</b>               | <b>16.3%</b> | <b>\$1.50</b>    | <b>11.3%</b> |
| Shares Outsanding (Diluted)     | 175,000                           |              | 180,000         |              | 180,000         |              | 190,000                     |              | 181,250          |              |



**Disclosure Appendix**

**Rating and Price Target History:**



**Associated Risk Factors:**

American Water’s earnings and ability to reach our price target could be negatively impacted by, among other things: unfavorable weather trends, negative regulatory and/or pricing developments, eminent domain seizure of water utility assets, and declining consumption of water in its service territories due to conservation initiatives. The realization of any or all of the following risk factors, among others, may adversely affect the company’s stock price: Commodity Prices, Raw Material Prices, Competition.

**Analyst Certification:**

The research analysts whose names appears on this research report certify that: (1) all of the views expressed in this research report accurately reflect their personal views about the subject security or issuer, and (2) no part of the research analysts’ compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analysts in this research report.

**Important Disclosures:**

Analyst compensation is based on, in part, Boenning & Scattergood, Inc.’s profitability, which includes revenues from investment banking. Boenning & Scattergood expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.

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- **Outperform (Buy):** The security's total return over the year or longer is expected to exceed the total return of the S&P 500™ over the identical period.
- **Neutral (Hold):** The security's total return over the next year or longer is expected to be roughly equivalent to the total return of the S&P 500™ over the identical period.
- **Underperform (Sell):** The security's total return over the next year or longer is expected to be less than the total return of the S&P 500™ over the identical period.

Our four-tier risk ratings are based on a mix of price volatility and fundamental factors relative to the market and peer group.

- **Low:** The security has higher-than-average fundamental predictability and/or lower-than-average price volatility.
- **Moderate:** The security has average fundamental predictability and/or average price volatility.
- **High:** The security has lower-than-average fundamental predictability and/or higher-than-average price volatility.
- **Speculative:** The security has very inconsistent fundamental predictability and/or very high relative price volatility.

**Ratings Distribution (6/30/09):**

| <u>Coverage Universe</u> | <u>% of Universe</u> | <u>Investment Banking Clients (a)</u> | <u>% of Rating Group</u> |
|--------------------------|----------------------|---------------------------------------|--------------------------|
| Outperform (Buy)         | 56%                  | Outperform (Buy)                      | 5%                       |
| Neutral (Hold)           | 44%                  | Neutral (Hold)                        | 0%                       |
| Underperform (Sell)      | 0%                   | Underperform (Sell)                   | 0%                       |

(a) Related to services provided within the past 12 months.

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MEMBER FINRA/SIPC

August 6, 2009

**American Water Works, Inc.**  
(AWK-NYSE)

# Heads Up

## What's New? / What Changed?

### Posts Solid 2Q09 EPS Despite Wet Weather.

|                      |                            |
|----------------------|----------------------------|
| Rating/Risk:         | <b>Outperform/Moderate</b> |
| Price:               | \$20.00                    |
| Target Price (US\$): | \$26.00                    |
| Market Cap (\$M):    | \$3,491                    |
| LTEPS:               | 9%                         |
| ADTV (\$M):          | \$16                       |

*\*Target Price and Rating is for 12 months  
Priced as of Previous Day's Close*

| EPS   | Q1     | Q2     | Q3     | Q4     | FY     | P/E   |
|-------|--------|--------|--------|--------|--------|-------|
| 2008A | \$0.11 | \$0.28 | \$0.55 | \$0.23 | \$1.17 | 17.1x |
| 2009E | \$0.19 | \$0.32 | -      | -      | \$1.35 | 14.8x |
| 2010E | -      | -      | -      | -      | \$1.50 | 13.3x |

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American Water earned \$0.32/share in the second quarter of 2009, above our estimate of \$0.30/share and in-line with consensus expectations. The results were impressive in light of the challenging conditions the company faced in the quarter – including unfavorable (i.e. wet) weather conditions in key service territories and continued macro headwinds.

Two key factors enabled the strong performance:

First, continued rate relief enabled the company to post 4% top-line growth despite a decline of nearly 6% in the volume of water sold (largely the result of wet weather and lower shipments to industrial and commercial customers due to the recession).

Second, prudent cost controls allowed the company to limit increases in operating expenses to just 2%, enabling the O&M Ratio to decline more than 200 basis points year-over-year to 54%. This contributed \$0.04/share of earnings upside versus our model.

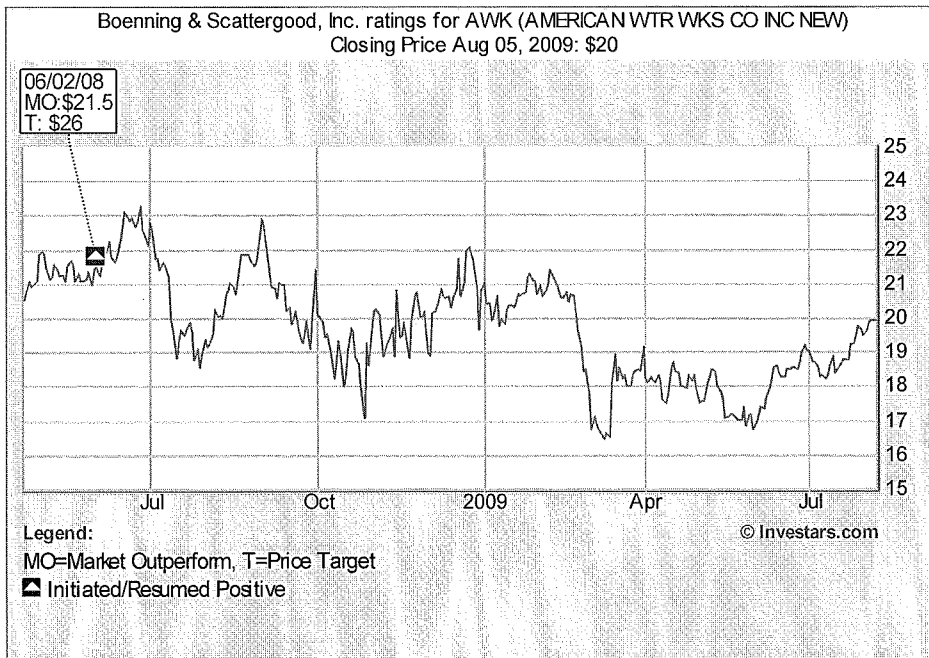
Rate relief remains a key aspect of our positive investment thesis for American Water, and with the company currently awaiting final decisions on nearly \$260 million in rate cases (15% of revenue), this part of the story remain very much on track. Even adjusting for the fact that most settlements come in below the initial request, this is a sizeable figure.

Overall, a combination of strong growth, a discount valuation, and a competitive dividend yield make American Water Works a compelling opportunity for investors. We reiterate our Outperform rating and \$26 target price (which represents an achievable forward P/E multiple of approximately 17 times).

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## Disclosure Appendix

### Rating and Price Target History:



### Associated Risk Factors:

The realization of any or all of the following risk factors, among others, may adversely affect the company's stock price and prevent it from reaching our target price: Commodity Prices, Raw Material Prices, Competition.

### Analyst Certification:

The research analysts whose names appears on this research report certify that: (1) all of the views expressed in this research report accurately reflect their personal views about the subject security or issuer, and (2) no part of the research analysts' compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analysts in this research report.

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**B&S Water Digest**

**October 26, 2009  
Industrials**

*Water price increases accelerate in 2009, with rates up 9% globally from 2008 levels; Trend confirms positive investment thesis for water stocks.*

***Investment Summary:** In many parts of the world, water prices remain well below the actual "all-in" cost of providing a reliable source of clean, safe drinking water and collecting & treating wastewater for re-introduction into the environment. While this lack of financial self-sufficiency can slow the rate of capital investment in the industry and acts as a moderator of growth throughout the water sector, more and more water systems are achieving full-cost pricing as water rates continue to rise. Indeed, with data from both Global Water Intelligence (GWI) and the U.S. Government indicating that water rates outpaced inflation again in 2009, more rational water pricing policies are likely to be a key enabler of infrastructure investment in the years ahead and a vital catalyst for technological innovation in areas such as desalination and metering. For utilities and providers of water-related equipment & technology, pricing gains are an important sign that the industry is on its way toward realizing its investment potential.*

**Key Points:**

- Water rates rose 8.7% in 2009 according to Global Water Intelligence (GWI), which recently published its authoritative annual survey of worldwide water pricing trends; GWI's data are consistent with water pricing data provided by the U.S. Government.
- This continues a multi-year trend of robust water pricing gains, underscoring the need for infrastructure investment and supporting the investment thesis for water stocks.
- With much of its infrastructure in dire need of rehabilitation, Europe has the world's highest water prices, including a whopping \$34 per 1,000 gallons in Copenhagen.
- Importantly, many cities in the developing world saw their first ever meaningful price increases, an important step in the road to reliable provision of safe drinking water.
- 2009 prices far outpaced inflation, reinforcing the investment thesis for both sides of the water sector – investor-owned utilities and providers of equipment & technology.
- For listed water utilities seeking rate increases, the data offer important confirmation of the need for full-cost pricing, while water-related equipment providers will benefit as water utilities invest these enhanced revenue streams in their critical infrastructure.

| <b>Boenning &amp; Scattergood:<br/>Water Coverage Universe</b> | <b>Ticker<br/>Symbol</b> | <b>Recent<br/>Price</b> | <b>Mkt Cap<br/>(\$MM)</b> | <b>Revenue<br/>(\$MM)</b> | <b>Daily<br/>Volume</b> | <b>P/E<br/>(2010E)</b> |
|--|--------------------------|-------------------------|---------------------------|---------------------------|-------------------------|------------------------|
| Ameron International   | AMN                      | \$67                    | \$614                     | \$668                     | 156,680                 | 16.3x                  |
| American Water Works, Inc.                                     | AWK                      | \$20                    | \$3,474                   | \$2,337                   | 708,933                 | 13.6x                  |
| Badger Meter Company   | BMI                      | \$39                    | \$576                     | \$280                     | 143,853                 | 20.2x                  |
| Connecticut Water Service, Inc.                                | CTWS                     | \$23                    | \$197                     | \$61                      | 13,696                  | 21.8x                  |
| Consolidated Water Company                                     | CWCO                     | \$15                    | \$221                     | \$60                      | 60,258                  | 18.5x                  |
| Energy Recovery, Inc.  | ERII                     | \$6                     | \$287                     | \$52                      | 326,152                 | 28.6x                  |
| Gorman-Rupp Company  | GRC                      | \$24                    | \$405                     | \$331                     | 51,793                  | 23.6x                  |
| Layne Christensen  | LAYN                     | \$29                    | \$560                     | \$1,008                   | 188,084                 | 31.3x                  |
| Lindsay Manufacturing  | LNN                      | \$36                    | \$445                     | \$336                     | 341,812                 | 26.4x                  |
| Middlesex Water Company  | MSEX                     | \$16                    | \$211                     | \$91                      | 34,804                  | 19.4x                  |
| Mueller Water Products   | MWA                      | \$6                     | \$672                     | \$1,859                   | 3,736,595               | 96.2x                  |
| Northwest Pipe Company   | NWPX                     | \$34                    | \$313                     | \$440                     | 89,639                  | 14.9x                  |
| Aqua America   | WTR                      | \$16                    | \$2,186                   | \$627                     | 928,737                 | 17.7x                  |
| Watts Water Technologies                                       | WTS                      | \$32                    | \$1,156                   | \$1,459                   | 232,770                 | 21.8x                  |
| York Water Company   | YORW                     | \$15                    | \$166                     | \$33                      | 37,354                  | 21.x                   |

**Boenning & Scattergood:  
Water Coverage Universe**

**Ameron International**  
(AMN-NYSE)

**American Water Works, Inc.**  
(AWK-NYSE)

**Aqua America, Inc.**  
(WTR-NYSE)

**Badger Meter, Inc.**  
(BMI-NYSE)

**Connecticut Water Service, Inc.**  
(CTWS-NASDAQ)

**Consolidated Water Company**  
(CWCO-NASDAQ)

**Energy Recovery, Inc.**  
(ERII-NASDAQ)

**The Gorman-Rupp Company**  
(GRC-AMEX)

**Layne Christensen**  
(LAYN-NASDAQ)

**Lindsay Corporation**  
(LNN-NYSE)

**Middlesex Water Company**  
(MSEX-NASDAQ)

**Mueller Water Products, Inc.**  
(MWA-NYSE)

**The Northwest Pipe Company**  
(NWPX-NASDAQ)

**Watts Water Technologies**  
(WTS-NYSE)

**The York Water Company**  
(YORW-NASDAQ)

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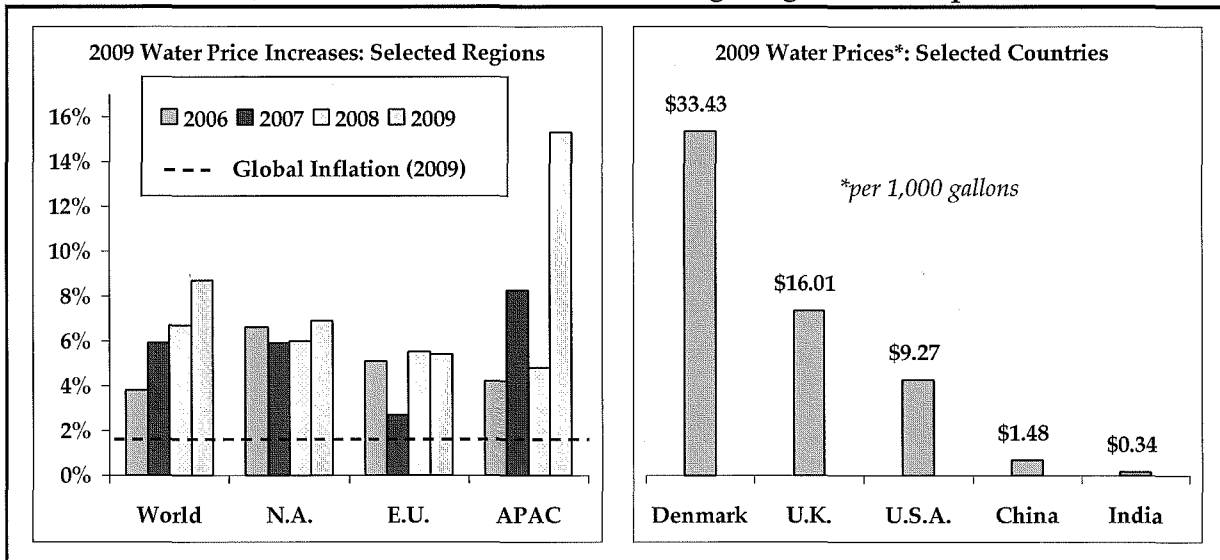


**Continuing multi-year trend, water prices outpace inflation yet again in 2009.**

No issue better highlights the link between water & wastewater utilities and providers of water-related infrastructure than full-cost pricing. Indeed, full-cost pricing, which refers to charging for the complete cost of water services (including treatment, storage, conveyance, maintenance, capital costs, regulatory compliance, customer service; and more) is a vital *prerequisite* to the broadly-defined “water sector” ultimately realizing its long-term investment potential. Only through improved pricing will utilities be able to raise the funds required make the capital investments that form the core of the investment case for providers of water-related equipment, while enhanced pricing also translates into stronger growth and superior returns on capital for utilities themselves. In short, investors looking at any of the water sector’s various sub-themes need to be in tune with trends in worldwide water pricing. Water prices rose 8.7% globally in 2009 according to Global Water Intelligence’s (GWI) annual authoritative survey of trends in water pricing, as prices gains accelerated from 2008 (+6.7%) and continue to outpace inflation.

*Water rates rose 9% in 2009, as prices gains accelerated from 2008 (+7%) and continued to outpace global inflation.*

**Water Prices Continue to Rise Worldwide, Though Regional Discrepancies Persist**



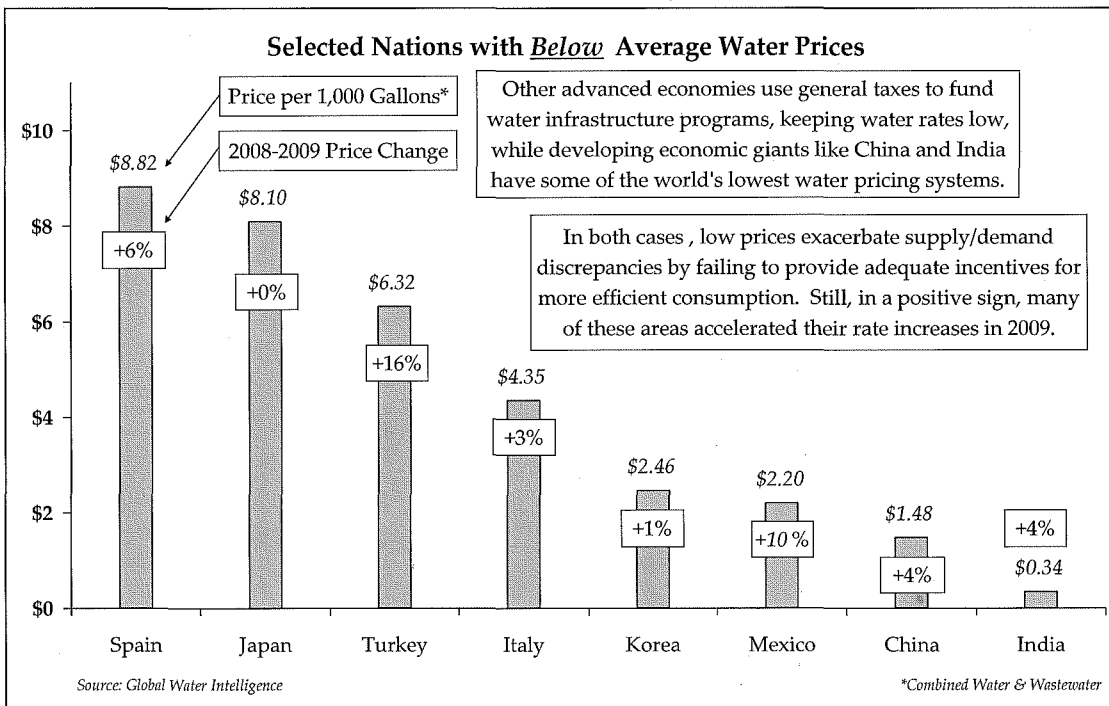
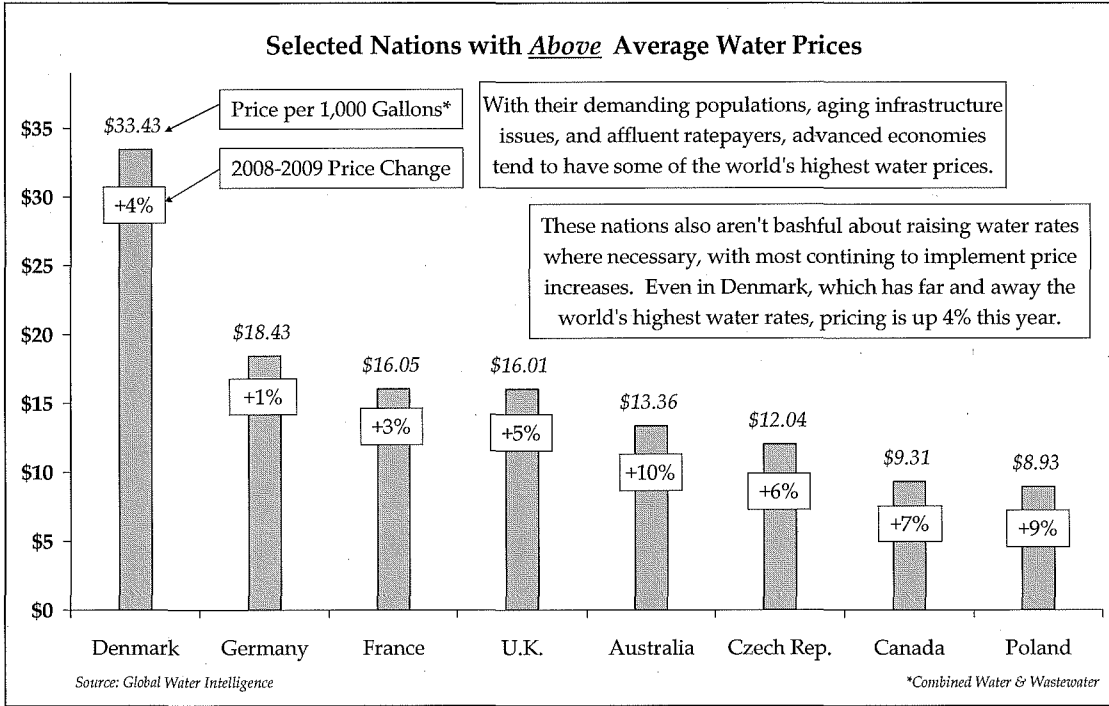
Source: Global Water Intelligence; Boenning & Scattergood

Ultimately, any investment in the water sector (whether in shares of a water utility or a water-related equipment/technology provider) amounts to a bullish bet on the long-term value of water resources. As in other commodity areas, including energy, base metals, and agriculture, an increase in the price of water will not only benefit those actually *monetizing* the commodity, but will also spur demand for products geared toward bringing new supply to market and/or helping to promote more efficient consumption. Because water does not trade on a financial exchange, water rates are a useful barometer of its perceived worth, and recent trends confirm that water’s value is on the rise and provide compelling support for our positive view of the sector’s long-term fundamentals. For investor-owned water utilities, pricing gains set the stage for continued success in recouping a fair return on capital for infrastructure investments via the regulated return framework. Providers of water-related equipment and technology also benefit – albeit indirectly – from higher prices at the tap (higher rates represent enhanced revenue streams for utilities looking to fund equipment purchases). For both groups of companies, the trend toward more rational pricing policies by water utilities represents a critical long-term growth driver.

*The trend toward more rational pricing policies represents a critical long-term driver for companies in the water industry.*

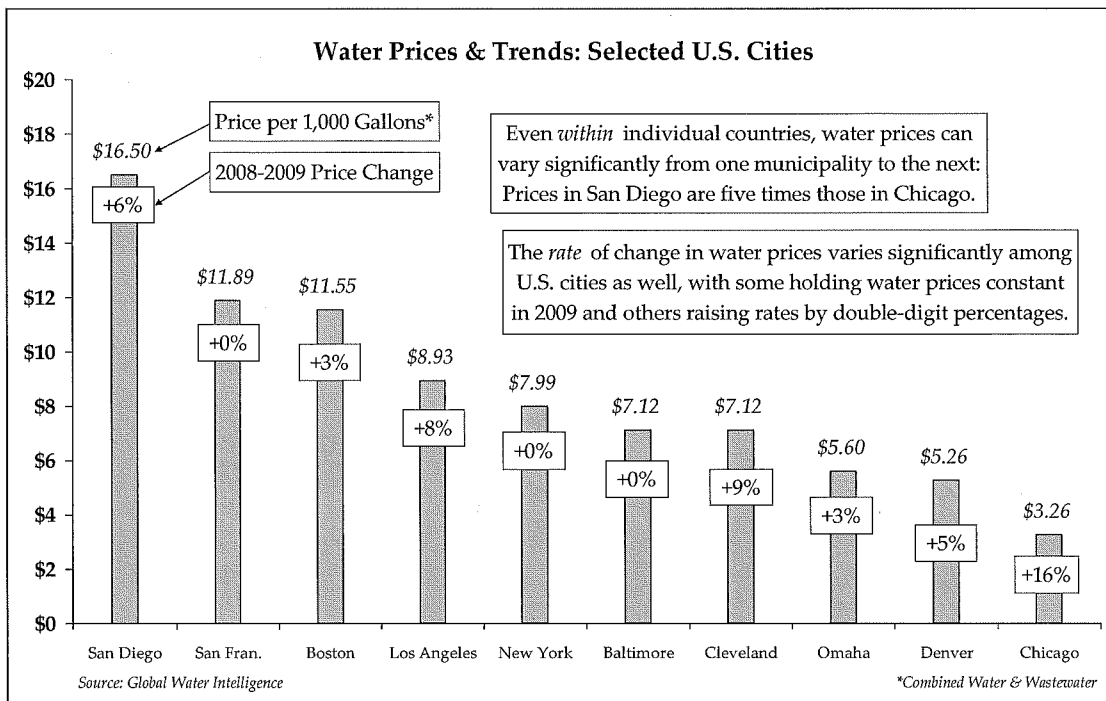
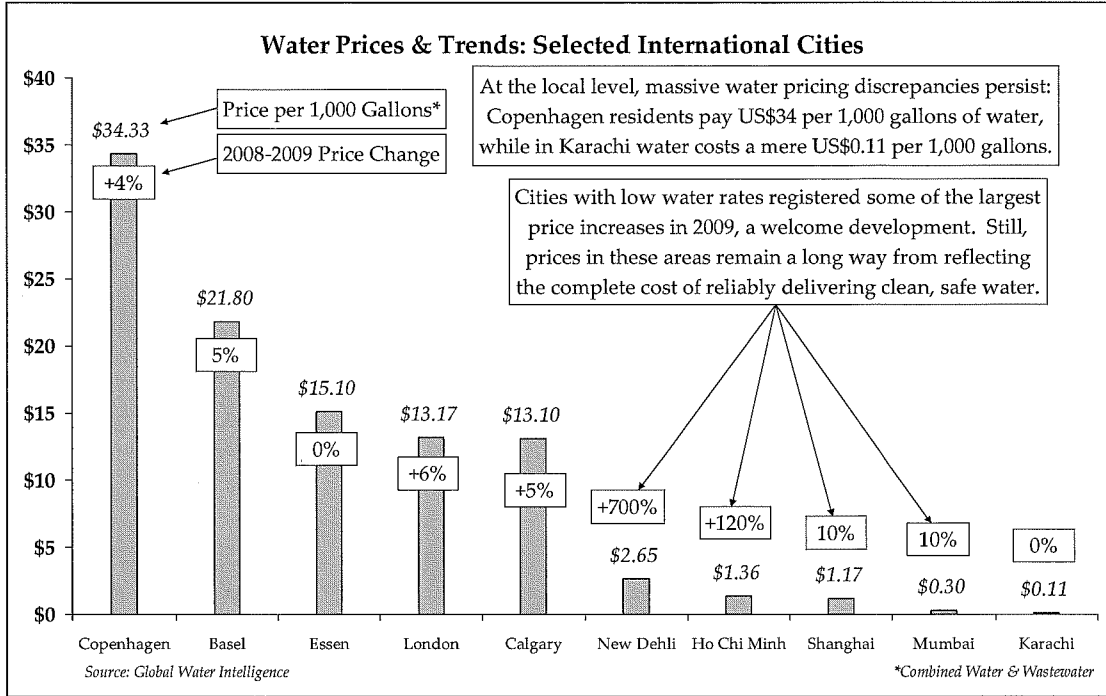


**Water Pricing Trends & Analysis: Selected Nations**





### Water Pricing Trends & Analysis: Selected Global Cities



**Water Services Universe: Fundamentals**

| Company Name                                      | Ticker | Mkt Cap (\$MM) | Water Exposure | Water Businesses                          | Non-Water Businesses                   |
|---|--------|----------------|----------------|---|--|
| <b>Construction/Engineering Services</b>          |        |                |                |   |  |
| Baker Michael Corp.                               | BKR    | \$347          | 20%            | Water-Infrastructure Consulting           | Energy-Related Consulting              |
| Cascal N.V.                                       | HOO    | \$174          | 100%           | Wastewater Treatment                      | (Not Applicable)                       |
| Clean Harbors, Inc.                               | CLH    | \$1,571        | 30%            | Waste & Wastewater Treatment              | Industrial Decontamination Services    |
| Insituform Technologies, Inc.                     | INSU   | \$726          | 100%           | Trenchless Pipe Replacement               | (Not Applicable)                       |
| Layne Christensen                                 | LAYN   | \$560          | 75%            | Water & Wastewater Infrastructure         | Mineral Exploration; Natural Gas       |
| Perini Corp.                                      | PCR    | -              | 10%            | Water-Infrastructure Construction         | Diversified General Contracting        |
| Tetra Tech, Inc.                                  | TTEK   | \$1,644        | 85%            | Water Resource/Infrastructure Consulting  | Communications Services                |
| Veolia Environment (ADR)                          | VE     | \$17,187       | 35%            | Integrated Water-Infrastructure           | Electricity; Municipal Waste           |
| <b>Specialties</b>                                |        |                |                |   |  |
| Badger Meter, Inc.                                | BMI    | \$576          | 80%            | Water Meters, including AMR               | Diversified Meter Applications         |
| Consolidated Water Co.                            | CWCO   | \$221          | 100%           | Desalination                              | (Not Applicable)                       |
| Dionex Corp.                                      | DNEX   | \$1,160        | 80%            | Fluid chromatography                      | Chemical-Monitoring Devices            |
| Energy Recovery, Inc.                             | ERII   | \$287          | 100%           | Desalination Equipment                    | (Not Applicable)                       |
| Esco Technologies, Inc.                           | ESE    | \$1,082        | 10%            | Aerospace Filtration & Valves             | Energy; Communication Infrastructure   |
| Itron, Inc.                                       | ITRI   | \$2,236        | 30%            | Water Automated Meter Reading             | Electric/Gas Metering Solutions        |
| Kadant, Inc.                                      | KAI    | \$173          | 20%            | Industrial Water Filtration               | Pulp & Papermaking Systems             |
| Lindsay Corporation                               | LNN    | \$445          | 80%            | Irrigation Equipment & Systems            | Highway Infrastructure Products        |
| Valmont Industries, Inc.                          | VMI    | \$2,038        | 25%            | Irrigation Equipment & Systems            | Steel/Concrete Tubular Products        |
| <b>Investor-Owned Utilities</b>                   |        |                |                |   |  |
| American States Water                             | AWR    | \$652          | 90%            | Water & Wastewater Services               | Electricity Distribution               |
| American Water Works                              | AWK    | \$3,474        | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| Aqua America, Inc.                                | WTR    | \$2,186        | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| California Water Service Group                    | CWT    | \$824          | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| Connecticut Water Service, Inc.                   | CTWS   | \$197          | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| Middlesex Water Co.                               | MSEX   | \$211          | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| Pennichuck Corp.                                  | PNNW   | \$100          | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| SJW Corp.   | SJW    | \$420          | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| Southwest Water Corp.                             | SWWC   | \$136          | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| York Water Corp.                                  | YORW   | \$166          | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| <b>Distribution Infrastructure/Fluid Handling</b> |        |                |                |   |  |
| Ameron International Corp.                        | AMN    | \$614          | 35%            | Large Diameter Water Transmission         | Specialty Piping; Infrastructure       |
| Flowserve Corp.                                   | FLS    | \$5,939        | 5%             | Pumps & Related Components                | Energy-Related Fluid Handling          |
| Franklin Electric Corp.                           | FELE   | \$674          | 85%            | Pumps & Related Components                | Energy-Related Pumping Systems         |
| Gorman-Rupp Co.                                   | GRC    | \$405          | 80%            | Pumps & Related Components                | Energy-Related Pumping Systems         |
| Mueller Water Products, Inc.                      | MWA    | \$672          | 80%            | Water & Wastewater Infrastructure         | HVAC; Oil & Gas Infrastructure         |
| Northwest Pipe Co.                                | NWPX   | \$313          | 75%            | Pipes & Related Transmission              | Fuel Storage                           |
| Pentair, Inc.                                     | PNR    | \$3,188        | 70%            | Pumps; Pool & Spa Equipment               | Telecom & Networking Solutions         |
| Robbins & Myers, Inc.                             | RBN    | \$827          | 20%            | Water & Wastewater Infrastructure         | Other Industrial Systems               |
| Watts Water Technologies, Inc.                    | WTS    | \$1,156        | 95%            | Valves & Related Components               | Floor Heating Technology               |
| <b>Filtration/Treatment</b>                       |        |                |                |   |  |
| Clarcor, Inc.                                     | CLC    | \$1,628        | 25%            | Water & Wastewater Filtration             | Diversified Filtration Solutions       |
| Met-Pro Corp.                                     | MPR    | \$139          | 30%            | Fluid Handling & Filtration               | Pollution Control; Air Filtration      |
| Millipore Corp.                                   | MIL    | \$3,944        | 30%            | Specialty Purification Systems            | Filtration Devices; Medical Equipment  |
| Nalco Holding Co.                                 | NLC    | \$2,917        | 50%            | Water & Wastewater Treatment              | Industrial Process Materials           |
| Pall Corp.  | PLL    | \$3,955        | 30%            | Water Filtration & Purification           | Specialty Industrial Purification      |
| <b>Water Rights</b>                               |        |                |                |   |  |
| Cadiz, Inc.                                       | CDZI   | \$141          | 85%            | Water Rights, Storage                     | Agriculture; Real Estate               |
| Pure Cycle Corp.                                  | PCYO   | \$63           | 100%           | Water & Wastewater Systems                | (Not Applicable)                       |
| PICO Holdings, Inc.                               | PICO   | \$789          | 60%            | Water Rights, Storage                     | Real Estate; Mineral Rights; Insurance |
| <b>Multi-Industry</b>                             |        |                |                |   |  |
| Crane Co.   | CR     | \$1,612        | 25%            | Valves; Couplings; Connectors             | Aerospace & Industrial Equipment       |
| Danaher Corp.                                     | DHR    | \$22,743       | 20%            | Water Treatment, Purification, & Analysis | Dental/Medical Devices                 |
| Honeywell International, Inc.                     | HON    | \$28,977       | 10%            | Diversified Water Solutions               | Diversified Energy, Aerospace Products |
| Idex Corp.  | IEX    | \$2,516        | 30%            | Pumps & Flow Measurement Systems          | Specialty Fluid Handling Systems       |
| ITT Corp.   | ITT    | \$10,109       | 40%            | Pumps; Treatment Equipment                | Military Equipment; Automotive         |
| Roper Industries, Inc.                            | ROP    | \$4,728        | 30%            | Pumps; Flow Measurement                   | Energy Systems & Controls              |
| Tyco International, LTD                           | TYC    | \$16,826       | 10%            | Flow Control; Fire Protection             | Energy & Security Systems; Materials   |

Note: "Water Exposure" represents B&S estimate of percentage of consolidated revenue derived from water-related businesses

Source: Company filings, B&S

Bold denotes B&S Coverage

**Water Services Universe: Financial Metrics**

| Company Name                                 | Ticker | Recent Price | 52 Wk. Range |      | Con. Growth Est. 09-10 | Fwd P/E | ROIC  | Avg. Daily Vol. (\$MM) | Mkt. Cap. (\$MM) |
|--|--------|--------------|--------------|------|------------------------|---------|-------|------------------------|------------------|
| <b>Construction/Engineering Services</b>     |        |              |              |      |                        |         |       |                        |                  |
| Baker Michael Corp.                          | BKR    | \$39         | \$45         | \$18 | N/A                    | 11.5x   | 16.0% | \$2.5                  | \$347            |
| Cascal N.V.                                  | HOO    | \$6          | \$9          | \$2  | 3.2%                   | 8.9x    | 5.0%  | \$0.4                  | \$174            |
| Clean Harbors, Inc.                          | CLH    | \$60         | \$67         | \$41 | 48.7%                  | 20.9x   | 12.0% | \$9.3                  | \$1,571          |
| Insituform Technologies, Inc.                | INSU   | \$19         | \$21         | \$9  | 19.8%                  | 16.3x   | 6.5%  | \$3.5                  | \$726            |
| Layne Christensen                            | LAYN   | \$29         | \$35         | \$10 | 46.0%                  | 31.3x   | 4.4%  | \$5.4                  | \$560            |
| Tutor Perini Corp.                           | TPC    | \$21         | \$27         | \$10 | -4.7%                  | 8.1x    | 17.8% | \$4.8                  | \$1,029          |
| Tetra Tech, Inc.                             | TTEK   | \$27         | \$32         | \$14 | -3.5%                  | 19.8x   | 12.1% | \$18.0                 | \$1,644          |
| Veolia Environment (ADR)                     | VE     | \$35         | \$40         | \$19 | 29.9%                  | 15.4x   | N/A   | \$7.7                  | \$17,187         |
| <b>Specialties</b>                           |        |              |              |      |                        |         |       |                        |                  |
| Badger Meter, Inc.                           | BMI    | \$39         | \$45         | \$18 | 5.5%                   | 20.2x   | 24.1% | \$5.6                  | \$576            |
| Consolidated Water Co.                       | CWCO   | \$15         | \$21         | \$6  | 3.8%                   | 18.5x   | 6.8%  | \$0.9                  | \$221            |
| Dionex Corp.                                 | DNEX   | \$66         | \$69         | \$40 | 14.6%                  | 18.6x   | 25.7% | \$4.9                  | \$1,160          |
| Energy Recovery, Inc.                        | ERII   | \$6          | \$10         | \$5  | 81.8%                  | 28.6x   | 10.4% | \$1.9                  | \$287            |
| Esco Technologies, Inc.                      | ESE    | \$41         | \$47         | \$25 | 18.9%                  | 19.2x   | 8.0%  | \$5.7                  | \$1,082          |
| Itron, Inc.                                  | ITRI   | \$56         | \$68         | \$34 | 53.1%                  | 17.3x   | 4.3%  | \$31.9                 | \$2,236          |
| Kadant, Inc.                                 | KAI    | \$14         | \$18         | \$7  | -509.1%                | 31.3x   | 3.3%  | \$0.6                  | \$173            |
| Lindsay Corporation                          | LNN    | \$36         | \$53         | \$21 | 29.2%                  | 20.4x   | 6.3%  | \$12.3                 | \$445            |
| Valmont Industries, Inc.                     | VMI    | \$78         | \$89         | \$37 | -15.2%                 | 16.1x   | 17.1% | \$23.0                 | \$2,038          |
| <b>Investor-Owned Utilities</b>              |        |              |              |      |                        |         |       |                        |                  |
| American States Water                        | AWR    | \$35         | \$39         | \$27 | 12.3%                  | 17.5x   | 5.1%  | \$2.2                  | \$652            |
| American Water Works                         | AWK    | \$20         | \$22         | \$16 | 11.5%                  | 13.6x   | N/A   | \$14.1                 | \$3,474          |
| Aqua America, Inc.                           | WTR    | \$16         | \$22         | \$14 | 13.8%                  | 17.7x   | 4.7%  | \$14.9                 | \$2,186          |
| California Water Service Group               | CWT    | \$40         | \$48         | \$29 | 3.3%                   | 18.3x   | 6.0%  | \$4.2                  | \$824            |
| Connecticut Water Service, Inc.              | CTWS   | \$23         | \$27         | \$17 | 0.0%                   | 21.8x   | 4.2%  | \$0.3                  | \$197            |
| Middlesex Water Co.                          | MSEX   | \$16         | \$18         | \$12 | 14.1%                  | 19.4x   | 4.1%  | \$0.5                  | \$211            |
| Pennichuck Corp.                             | PNNW   | \$23         | \$25         | \$15 | 40.7%                  | 30.9x   | 2.0%  | \$0.3                  | \$100            |
| SJW Corp.                                    | SJW    | \$23         | \$30         | \$18 | 35.4%                  | 21.3x   | 3.5%  | \$0.7                  | \$420            |
| Southwest Water Corp.                        | SWWC   | \$5          | \$10         | \$3  | 129.4%                 | 14.0x   |       | \$0.6                  | \$136            |
| York Water Corp.                             | YORW   | \$15         | \$18         | \$10 | 4.5%                   | 21.0x   | 4.9%  | \$0.5                  | \$166            |
| <b>Distribution Equipment/Fluid Handling</b> |        |              |              |      |                        |         |       |                        |                  |
| Ameron International Corp.                   | AMN    | \$67         | \$92         | \$33 | 50.4%                  | 16.3x   | 6.8%  | \$10.4                 | \$614            |
| Flowserve Corp.                              | FLS    | \$106        | \$109        | \$37 | -4.8%                  | 14.7x   | 20.7% | \$83.5                 | \$5,939          |
| Franklin Electric Corp.                      | FELE   | \$29         | \$44         | \$17 | 28.6%                  | 15.4x   | 6.4%  | \$3.3                  | \$674            |
| Gorman-Rupp Co.                              | GRC    | \$24         | \$33         | \$15 | -2.8%                  | 23.6x   | 13.0% | \$1.3                  | \$405            |
| Mueller Water Products, Inc.                 | MWA    | \$6          | \$9          | \$1  | N/A                    | 96.2x   | N/A   | \$21.6                 | \$672            |
| Northwest Pipe Co.                           | NWPX   | \$34         | \$46         | \$19 | 93.2%                  | 14.9x   | 6.3%  | \$3.0                  | \$313            |
| Pentair, Inc.                                | PNR    | \$32         | \$34         | \$17 | 24.1%                  | 18.5x   | 4.7%  | \$24.9                 | \$3,188          |
| Robbins & Myers, Inc.                        | RBN    | \$25         | \$25         | \$13 | 43.4%                  | 17.7x   | 10.6% | \$6.8                  | \$827            |
| Watts Water Technologies, Inc.               | WTS    | \$32         | \$33         | \$16 | 10.7%                  | 21.8x   | 4.3%  | \$7.3                  | \$1,156          |
| <b>Filtration/Treatment</b>                  |        |              |              |      |                        |         |       |                        |                  |
| Clarcor, Inc.                                | CLC    | \$32         | \$36         | \$23 | 19.7%                  | 19.5x   | 10.0% | \$8.6                  | \$1,628          |
| Met-Pro Corp.                                | MPR    | \$10         | \$14         | \$6  | 38.5%                  | 17.7x   | 8.4%  | \$0.4                  | \$139            |
| Millipore Corp.                              | MIL    | \$71         | \$73         | \$43 | 11.1%                  | 16.2x   | 9.0%  | \$29.8                 | \$3,944          |
| Nalco Holding Co.                            | NLC    | \$21         | \$23         | \$8  | 47.5%                  | 17.9x   | 3.5%  | \$26.0                 | \$2,917          |
| Pall Corp.                                   | PLL    | \$34         | \$35         | \$18 | 17.9%                  | 14.6x   | 11.7% | \$26.4                 | \$3,955          |
| <b>Water Rights</b>                          |        |              |              |      |                        |         |       |                        |                  |
| Cadiz, Inc.                                  | CDZI   | \$11         | \$16         | \$6  | N/A                    | N/A     | N/A   | \$0.2                  | \$141            |
| Pure Cycle Corp.                             | PCYO   | \$3          | \$6          | \$2  | N/A                    | N/A     | N/A   | \$0.0                  | \$63             |
| PICO Holdings, Inc.                          | PICO   | \$35         | \$35         | \$16 | N/A                    | N/A     | N/A   | \$3.0                  | \$789            |
| <b>Multi-Industry</b>                        |        |              |              |      |                        |         |       |                        |                  |
| Crane Co.                                    | CR     | \$28         | \$28         | \$11 | 10.1%                  | 13.3x   | 9.8%  | \$8.4                  | \$1,612          |
| Danaher Corp.                                | DHR    | \$71         | \$73         | \$47 | 11.2%                  | 18.9x   | 8.6%  | \$151.4                | \$22,743         |
| Honeywell International, Inc.                | HON    | \$39         | \$41         | \$23 | -3.2%                  | 14.3x   | 14.7% | \$246.0                | \$28,977         |
| Ilex Corp.                                   | IEX    | \$31         | \$31         |      | 15.1%                  | 18.6x   | 7.2%  | \$15.3                 | \$2,516          |
| ITT Corp.                                    | ITT    | \$55         | \$57         | \$32 | 5.2%                   | 14.4x   | 13.9% | \$93.1                 | \$10,109         |
| Roper Industries, Inc.                       | ROP    | \$52         | \$53         | \$35 | 5.7%                   | 18.9x   | 9.0%  | \$29.9                 | \$4,728          |
| Tyco International, LTD                      | TYC    | \$35         | \$36         | \$15 | 7.0%                   | 14.5x   | 6.5%  | \$112.3                | \$16,826         |
| S&P 500                                      | SPX    | 1,093        | 1,101        | 667  | 23.7%                  | 15.2x   |       |                        |                  |

Bold denotes B&S Coverage

Source: Baseline



## Boenning & Scattergood Water & Industrials Coverage Universe

(For detailed research on any of these companies, contact Boenning & Scattergood)

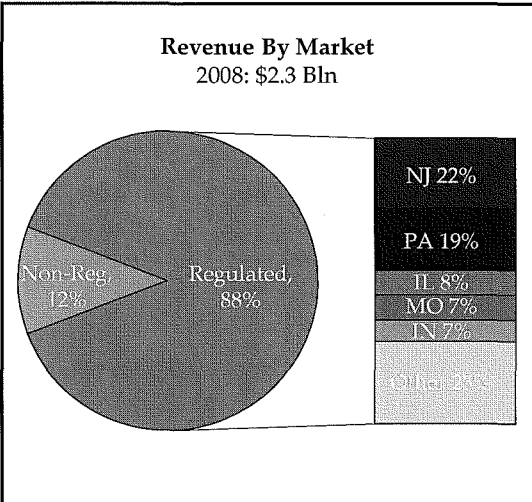
### American Water Works, Inc. (AWK)

**Outperform**

|                   |        |
|-------------------|--------|
| Recent Price:     | \$20   |
| 12M Price Target: | \$26   |
| 2009E:            | \$1.35 |
| 2010E:            | \$1.50 |

**Company Description:** Serving a population of over 15 million and operating in 32 states, American Water Works is the largest water utility services company in the United States. Headquartered in Voorhees, NJ, the company was formerly publicly-traded and re-entered the public markets with its April 2008 IPO.

- Key Investment Points:**
- **2010 Outlook: Rate relief to continue hitting P&L as RWE divestiture continues.**
    - AWK continues to recognize rate relief.
    - Regulatory relations much improved.
    - RWE "overhang" to dissipate over time.
  - **Refocused on core business, company poised for above-trend earnings growth.**
    - Continued aggressive rate case program.
    - Push to end "under-earning" on rate base.
    - Acquisitions back as part of strategy.
  - **Recent successful share offerings underscore compelling investment case for AWK.**
    - June 4: Prices 30 million shares at \$17¼.
    - August 13: 35 million shares at 19¼.
    - UWs exercise green-show on both deals.



\*Based on Fwd P/E of 19x; Risks include co. failing to meet our EPS estimate and/or shares failing to trade to our target multiple.

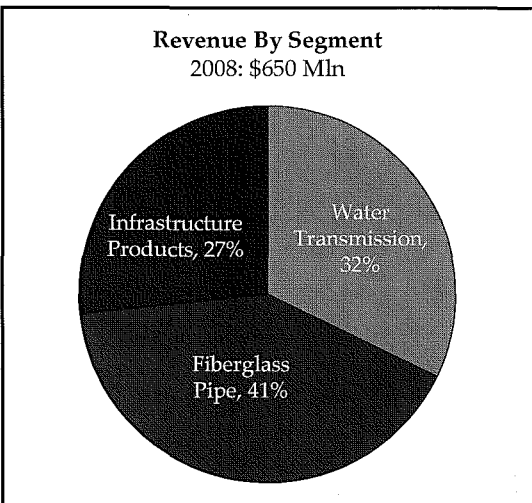
### Ameron International Corporation (AMN)

**Neutral**

|                   |        |
|-------------------|--------|
| Recent Price:     | \$67   |
| 12M Price Target: | N/A    |
| 2009E:            | \$2.65 |
| 2010E:            | \$3.65 |

**Company Description:** Ameron International provides highly-engineered products and materials for a range of industrial end-markets, including infrastructure, transportation, oil & gas, and petrochemical. The company also has substantial interests in a number of joint ventures, notably in the Middle East.

- Key Investment Points:**
- **2010 Outlook: Negative EPS momentum in the near-term, recent gains minimize upside.**
    - Macro headwinds impacting all segments.
    - TAMCO steel mini-mill largely idle.
    - Recent pullback justified in our view.
  - **Weak steel market creates significant headwinds for TAMCO joint venture.**
    - TAMCO is AMN's SoCal steel mini-mill.
    - Currently producing at very low levels.
    - Profitability likely to remain depressed.
  - **Fiberglass Pipe unit benefiting from ship-building market, but backlogs being worked off.**
    - Products sold into shipbuilding market higher mgn, creating positive mix effect.
    - Ship order cancellations rare, but backlogs being worked down; Downturn likely.







## Boenning & Scattergood Water & Industrials Coverage Universe

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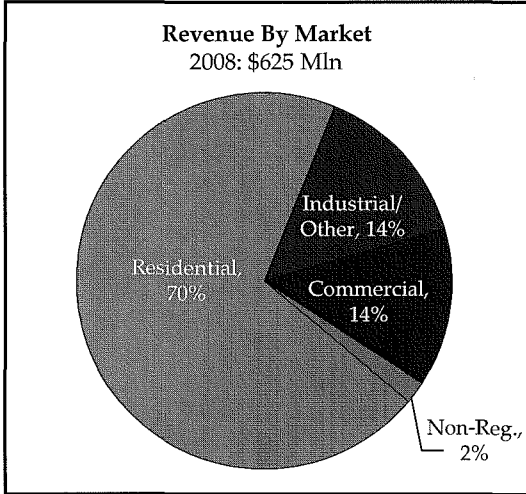
### Aqua America, Inc. (WTR)

**Outperform**

|                   |        |
|-------------------|--------|
| Recent Price:     | \$16   |
| 12M Price Target: | \$21   |
| 2009E:            | \$0.84 |
| 2010E:            | \$0.95 |

**Company Description:** Aqua America, the nation's largest publicly traded water utility, provides potable water and wastewater services to 2.5 million customers in its core market of Pennsylvania as well as in Florida, Illinois, Indiana, Maine, North Carolina, New Jersey, New York, Ohio, Texas, and Virginia.

- Key Investment Points:**
- **2010 Outlook: Rate relief positions Aqua for return to growth after a few lackluster years.**
    - Fell short of 10% EPS growth tgt. in 2008.
    - '08 rate cases will return growth trajectory.
    - Recently received improved DSIC status.
  - **Aqua America the industry standard; Peers emulate company's successful strategy.**
    - Combo of rate base growth & acquisitions.
    - Robust CapEx supports continued growth.
    - Track record justifies premium valuation.
  - **Acquisitions: Augmenting Growth & Diversifying the Company Geographically.**
    - Focus on "hub-and-spoke" acquisitions.
    - Focus on faster-growth Sun Belt States.
    - Geographic diversity offsets regional risks.



\*Based on Fwd P/E of 25x; Risks include co. failing to meet our EPS estimate and/or shares failing to trade to our target multiple.

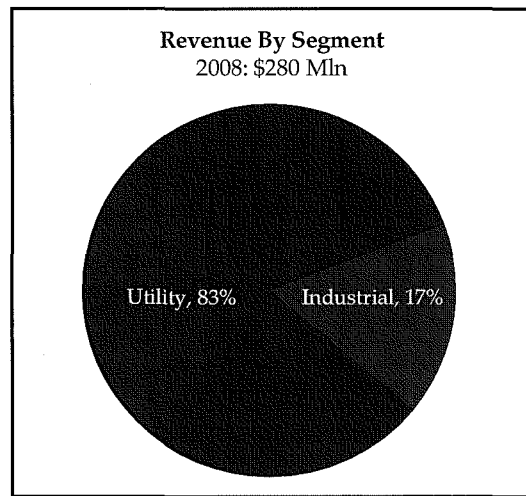
### Badger Meter, Inc. (BMI)

**Neutral**

|                   |        |
|-------------------|--------|
| Recent Price:     | \$39   |
| 12M Price Target: | N/A    |
| 2009E:            | \$1.80 |
| 2010E:            | \$1.75 |

**Company Description:** Badger Meter produces water metering and flow control technologies for use in residential, commercial, and industrial applications. Headquartered in Milwaukee, WI, the company serves two primary end-markets: Utility, which represents about 75% of revenue, and Industrial (~25%).

- Key Investment Points:**
- **2010 Outlook: Top-line proving resilient, but copper may become headwind in 2010.**
    - Utility biz *relatively* recession resistant.
    - Industrial metering more susceptible.
    - Copper: Tailwind YTD; Headwind soon?
  - **Adoption of metering technology presents sizeable market opportunity.**
    - 13 million U.S. households lack meters.
    - 75 million are still manual read.
    - Higher water prices drive AMR adoption.
  - **Top-line growth, margin improvement likely to drive long-term earnings growth.**
    - Secular dynamics should drive top-line.
    - Shift towards higher-margin products.
    - Still, industry not *immune* to downturn.





## Boenning & Scattergood Water & Industrials Coverage Universe

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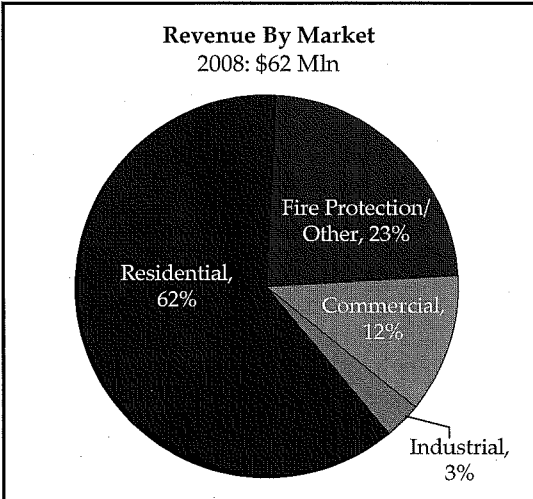
### Connecticut Water Service, Inc. (CTWS)

**Outperform**

|                   |        |
|-------------------|--------|
| Recent Price:     | \$23   |
| 12M Price Target: | \$23   |
| 2009E:            | \$1.10 |
| 2010E:            | \$1.05 |

**Company Description:** Headquartered in Clinton, CT, Connecticut Water Service, Inc. is an investor owned regulated water utility holding company serving a population of roughly 290,000 entirely within the state of Connecticut. In addition, the company provides some non-regulated water-related services.

- Key Investment Points:**
- **2010 Outlook: Connecticut Water takes unusual step of requesting rate reduction; 2010 rate case?**
    - Lower D&A expense to offset lower rates.
    - Impact on CF offset by infra. surcharge.
    - Improves reg. relations ahead of rate case.
  - **Acquisition program a consistent source of customer growth.**
    - Acquisitions provide incremental growth.
    - CT has 500 independent water systems.
    - Co. track record a force for acquisitions.
  - **Heavy exposure to residential/fire protection customers a plus in difficult environment.**
    - 85% exposure to residential/fire protection.
    - Demand is highly recession resilient.
    - Conservation could impede growth.



\*Based on Fwd P/E of 23x; Risks include co. failing to meet our EPS estimate and/or shares failing to trade to our target multiple.

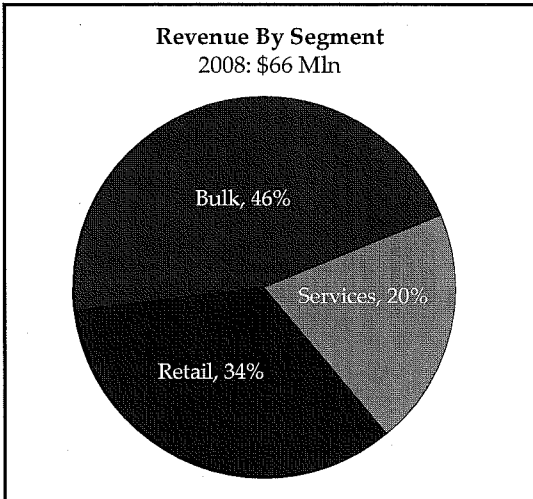
### Consolidated Water Company (CWCO)

**Outperform**

|                   |        |
|-------------------|--------|
| Recent Price:     | \$15   |
| 12M Price Target: | \$20   |
| 2009E:            | \$0.78 |
| 2010E:            | \$0.78 |

**Company Description:** Consolidated Water provides potable water in areas where fresh water sources are scarce, including the Cayman Islands, the British Virgin Islands, and the Bahamas. The company serves retail customers as a traditional water utility and also supplies utility customers through its "bulk" business.

- Key Investment Points:**
- **2010 Outlook: BVI situation finally coming to a head; Enabling company to look forward.**
    - Initial ruling against CWCO's interests.
    - Still, JV contributing losses, so resolution of situation likely to be accretive to EPS.
  - **Overall, Consolidated Water offers a desal play with an attractive business model.**
    - Capital committed on signed contracts.
    - Long-term inflation-hedged concessions.
    - Low tax rates add to returns on capital.
  - **Potential imposition of income tax in Cayman Island looms; Potentially a meaningful negative.**
    - Caymans faced fiscal crisis in early 2009.
    - UK government came thru with \$50B loan; Now agitating for adoption of income tax.
    - Consolidated Water's current tax rate 0%.



\*Based on Fwd P/E of 26x; Risks include co. failing to meet our EPS estimate and/or shares failing to trade to our target multiple.



## Boenning & Scattergood Water & Industrials Coverage Universe

(For detailed research on any of these companies, contact Boenning & Scattergood)

### Energy Recovery, Inc. (ERII)

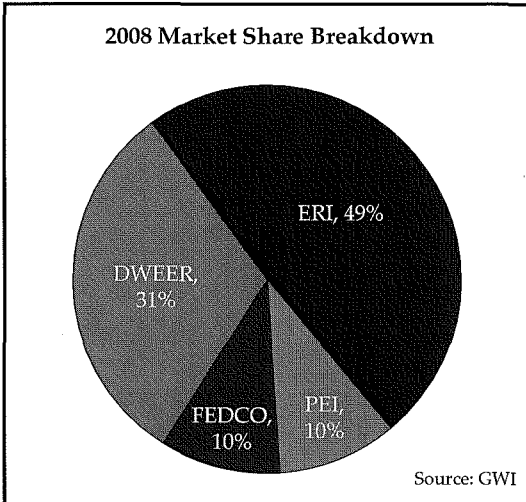
Neutral

|                   |        |
|-------------------|--------|
| Recent Price:     | \$6    |
| 12M Price Target: | \$ -   |
| 2009E:            | \$0.12 |
| 2010E:            | \$0.20 |

**Company Description:** Headquartered in San Leandro, California, Energy Recovery manufactures energy reduction devices for use in seawater desalination facilities. The company's primary product line is the Pressure Exchanger (PX) device, which has a leading market share in this niche industry.

**Key Investment Points:**

- **2010 Outlook:** After tough 2009 that included guidance cut, debate centers on 2010 desal mkt.
  - ERI slashed 2009 EPS guidance from \$0.09-\$0.13 to \$0.17-\$0.21 on project delays.
  - GWI believes 2009 a peak for desal market.
- **Global Desal capacity has been expanding briskly for over a decade.**
  - Credit crunch has had limited impact.
  - Most projects are built out of necessity.
  - Reverse Osmosis the dominant method.
- **Potential win in Melbourne offsets potential loss to Pump Engineering, Inc. on Mactaa.**
  - Melbourne, Australia: 411,000 cm3/day.
  - Mactaa, Algeria: 500,000 cm3/day.
  - Neither official, but rumors swirling.



### Gorman-Rupp Company (GRC)

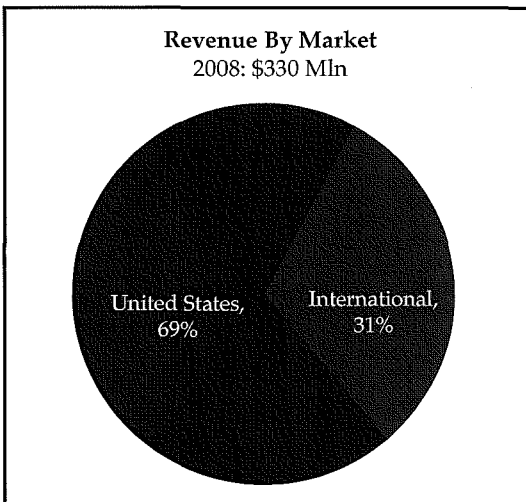
Neutral

|                   |        |
|-------------------|--------|
| Recent Price:     | \$24   |
| 12M Price Target: | N/A    |
| 2009E:            | \$1.06 |
| 2010E:            | \$0.85 |

**Company Description:** Gorman-Rupp manufactures a wide variety of pumps and related components, roughly 75% of which are used to move water for one purpose or other. Key end-markets include municipal, industrial, fire protection, OEM, petroleum, construction, government, and military.

**Key Investment Points:**

- **2010 Outlook:** Combo of macro headwinds and higher internal costs to pressure profits.
  - Macro headwinds buffeting end-markets
  - Turbine exhaust business at risk in 2010
  - Expanded facilities to raise overhead
- **Gorman-Rupp has a track record of delivering "best in class" financials over course of cycle.**
  - Margins stack up well versus comps.
  - Returns on capital also impressive.
  - Low debt minimizes financial risk.
- **Macro headwinds present near-term risk to earnings in 2009 and into 2010.**
  - Cyclical of industrial markets a factor.
  - Profitable contract manufacturing business (gas-fired turbine components) at risk.





## Boenning & Scattergood Water & Industrials Coverage Universe

(For detailed research on any of these companies, contact Boenning & Scattergood)

### Layne Christensen Company (LAYN)

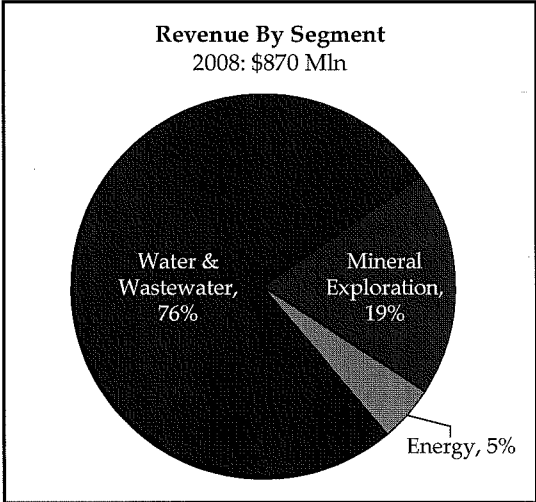
Neutral

|                   |        |
|-------------------|--------|
| Recent Price:     | \$29   |
| 12M Price Target: | N/A    |
| 2010E:            | \$0.60 |
| 2011E:            | \$0.70 |

**Company Description:** Headquartered in Mission Woods, Kansas, Layne Christensen provides products and services for the water, metals mining, and energy industries. The company is organized into three business units: Water Resources, Mineral Exploration and Geoconstruction, and Energy.

**Key Investment Points:**

- **2010 Outlook: Min-Ex could show nice y/y comps in 2010, but Energy likely to offset.**
  - Rebound in copper a big plus for Min-Ex.
  - Still, Energy results buoyed in 2009 by fwd gas sales, which twilight in March 2010.
- **Attractive three-pronged portfolio positions Layne for long-term growth.**
  - A portfolio of resource driven businesses.
  - Water leveraged to infra-rehab trends.
  - MinEx attractive play on commodities.
- **Concerns over municipal Water/Wastewater infrastructure spending overblown.**
  - 70% of Water Infra. sales to W/WW apps.
  - Most funding from water bills (not taxes).
  - Funding *relatively* resilient in recession.



\*Based on Fwd P/E of 13x; Risks include co. failing to meet our EPS estimate and/or shares failing to trade to our target multiple.

### Lindsay Corporation (LNN)

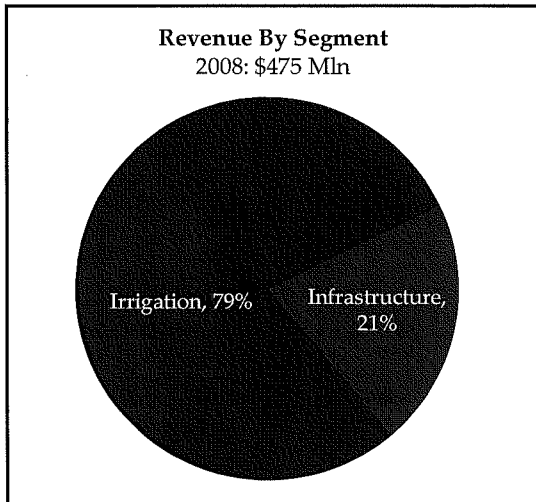
Neutral

|                   |        |
|-------------------|--------|
| Recent Price:     | \$36   |
| 12M Price Target: | N/A    |
| 2009E (FYE 8/30): | \$1.11 |
| 2010E (FYE 8/30): | \$1.45 |

**Company Description:** Headquartered in Omaha, NE, the Lindsay Corporation provides irrigation systems for the domestic and international agricultural industries. The company's principal product line is its Center Pivot Irrigation systems, which it markets under the *Zimmatic* brand name.

**Key Investment Points:**

- **2010 Outlook: After phenomenal year in 2008, irrigation market back to earth in 2009.**
  - Unit shipments rumored down 40-50%.
  - Rebates also pressuring profitability.
  - Could be years before 2008 highs revisited.
- **Water efficiency push to drive long-term demand for advanced irrigation systems.**
  - Agriculture uses 70% of potable water.
  - Improving efficiency a central focus.
  - Center-pivot irrigation systems are a high-ROI water conservation solution.
- **Still, with ag commodities not participating in rally, cyclical upturn for 2010 not assured.**
  - Corn left out of 2009 commodity rebound.
  - USDA reduces Farm Income estimates.





## Boenning & Scattergood Water & Industrials Coverage Universe

(For detailed research on any of these companies, contact Boenning & Scattergood)

### Middlesex Water Company (MSEX)

*Outperform*

|                   |        |
|-------------------|--------|
| Recent Price:     | \$16   |
| 12M Price Target: | \$18   |
| 2009E:            | \$0.70 |
| 2010E:            | \$0.78 |

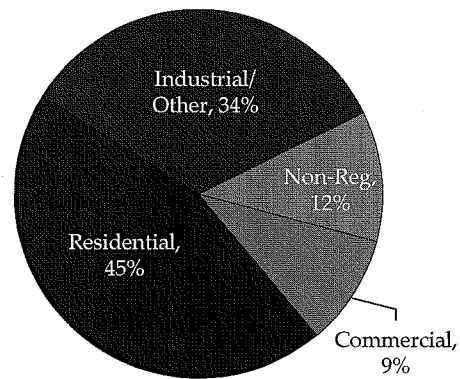
**Company Description:** Middlesex Water Company is a regulated water utility providing water and wastewater services for over 100,000 customers, primarily in Middlesex County, New Jersey and throughout the state of Delaware. The total population of served by the Middlesex Water Company is over 400,000.

#### Key Investment Points:

- **2010 Outlook: Major NJ rate case sets stage for return to solid growth trajectory in 2010.**
  - August 17: Middlesex Water files \$15.1 million rate case in core NJ territory.
  - Co. also received solid 10% ROE in DE.
- **Rate relief positions MSEX for strong near-term financial performance.**
  - Received rate relief in Delaware system.
  - Improved O&M ratio performance.
  - 9% rate increase recently passed in NJ.
- **New Jersey regulatory climate likely to improve in years ahead.**
  - NJBPU traditionally fairly challenging.
  - Prospect of NJ DSIC mechanism approval.
  - Improved odds for granted ROE increase.

#### Revenue By Market

2008: \$62 Mln



\*Based on Fwd P/E of 22x; Risks include co. failing to meet our EPS estimate and/or shares failing to trade to our target multiple.

### Mueller Water Products (MWA)

*Neutral*

|                   |          |
|-------------------|----------|
| Recent Price:     | \$6      |
| 12M Price Target: | N/A      |
| 2009E:            | (\$0.35) |
| 2010E:            | \$0.15   |

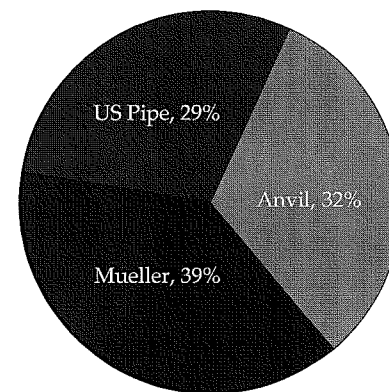
**Company Description:** Mueller Water Products manufactures a wide range of water-related infrastructure products for use in distribution networks throughout the United States. Operating in three business units (Mueller Company, U.S. Pipe, and Anvil), Mueller Water Products is headquartered in Atlanta, Georgia.

#### Key Investment Points:

- **2010 Outlook: Macro headwinds, leveraged financial structure weigh on per share earnings.**
  - 2009 a difficult year for MWA markets.
  - Sharecount significantly increased due to offering, limiting per share earnings power.
- **Leveraged balance sheet could lead to dilution for existing common shareholders.**
  - Liabilities exceed tangible asset base.
  - Balance sheet needs to be restructured, but it remains unclear how this will play out.
- **Aging infrastructure upgrades will take place, but should remain a slow, gradual process.**
  - Spending "tsunami" unlikely near-term.
  - Stimulus helps, but woefully insufficient given magnitude of infrastructure needs.

#### Revenue By Segment

2008: \$1.9 Bln





## Boenning & Scattergood Water & Industrials Coverage Universe

(For detailed research on any of these companies, contact Boenning & Scattergood)

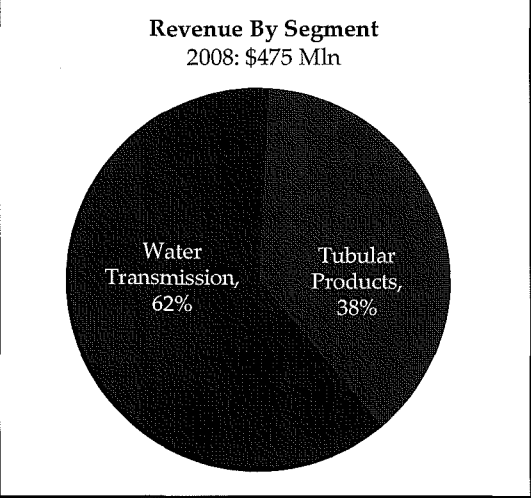
### Northwest Pipe Company (NWPX)

*Outperform*

|                   |        |
|-------------------|--------|
| Recent Price:     | \$34   |
| 12M Price Target: | \$38   |
| 2009E:            | \$1.10 |
| 2010E:            | \$1.85 |

**Company Description:** Northwest Pipe provides large-diameter, high-pressure pipeline systems for water-regulated applications. With ten production facilities spread across the U.S. and Mexico, NW Pipe is well-positioned across North America as water infrastructure upgrades continue to become a critical issue.

- Key Investment Points:**
- **2010 Outlook: Water Transmission solid, Tubular Products' natural gas exposure a risk.**
    - Water Trans. backlog resilient in 2009.
    - Tubular segment under severe headwinds due to steep decline in nat gas rig count.
  - **Water Transmission Market Primed for Sustained Growth in Project Activity.**
    - Western population growth a driver.
    - Infrastructure replacement in the East.
    - ST lumpy growth, LT steady increase.
  - **Broad Operating Footprint Positions Northwest Pipe to Compete for Projects Nationwide.**
    - Facilities from West Virginia to Oregon.
    - Can compete in nearly all U.S. markets.
    - Insulates co. from regional econ. risks.



\*Based on Fwd P/E of 17x; Risks include co. failing to meet our EPS estimate and/or shares failing to trade to our target multiple.

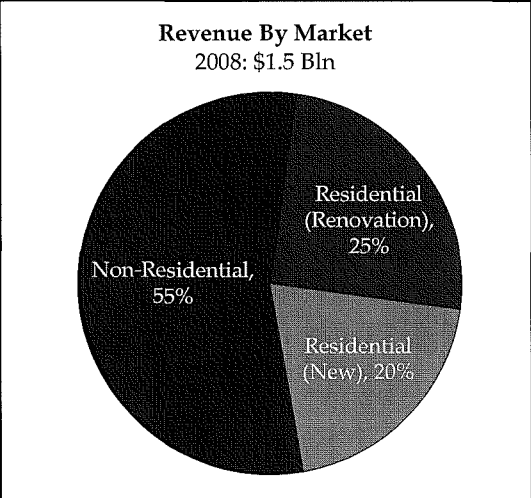
### Watts Water Technologies (WTS)

*Outperform*

|                   |        |
|-------------------|--------|
| Recent Price:     | \$32   |
| 12M Price Target: | \$38   |
| 2009E:            | \$1.25 |
| 2010E:            | \$1.45 |

**Company Description:** Watts Water Technologies provides water safety and flow control products for commercial and residential applications, with a focus on the "code-approved" market. Headquartered in North Andover, MA, Watts reports results in three segments: North America, Europe, and China.

- Key Investment Points:**
- **2010 Outlook: Cost cuts and lower input costs set stage for substantial earnings leverage.**
    - Restructuring savings roughly \$0.25/share.
    - Aggressive LEAN implementation.
    - Copper to become a mgn tailwind in 2H09.
  - **Still, weakness in Residential/Commercial construction markets a challenge near-term.**
    - Non-Rez in particular a 09-10 headwind.
    - Company taken steps to lean operations.
    - Relatively clean balance sheet a plus.
  - **Valuation creates compelling Reward/Risk opportunity for long-term investors.**
    - WTS shares trade at 15x normalized EPS.
    - This compares with long-term average P/E multiple range of 12x to 24x.



\*Based on Fwd P/E of 26x; Risks include co. failing to meet our EPS estimate and/or shares failing to trade to our target multiple.

## **B&S Water Digest: Past Topics and Back Issues**

Each month, Boenning & Scattergood publishes the *B&S Water Digest*, a unique investment journal focused on the fundamentals of the water industry. Each edition dissects a timely topic of relevance for investors looking at the water services sector, including detailed background information & charts and original, independent analysis & commentary.

- **September 2009:** *Late push for 2009 Water Bill stalls in California legislature, but State will ultimately have to act – creating opportunities for key solutions providers.*
- **August 2009:** *Aging water infrastructure rehabilitation will likely remain a frustratingly slow process, but leak detection technologies a compelling growth area.*
- **July 2009:** *Water Reuse: Why this “hidden source” of water supply is increasingly perceived as a mainstream complement to traditional water resources.*
- **June 2009:** *Fluid Handling Primer: An in-depth look at the end-markets, applications, competitive dynamics, and leading players in the global pump industry.*
- **May 2009:** *GE Water a major player globally, but often overlooked as a small piece of huge GE pie; We take an in-depth look at GE Water portfolio, strategy.*
- **April 2009:** *Guide to Water ETFs: We view passive investing as ill-suited to water sector, but analyze available products and recommend “least of evils.”*
- **March 2009:** *Municipal Water Utilities: Our survey of large muni systems yields key insight into the outlook for capital spending budgets, rates, and more.*
- **February 2009:** *International Water Stocks: A “Roadmap” for Equity Investors Seeking Water-Related Investment Opportunities Outside of the United States.*
- **January 2009:** *2009 Outlook: Infrastructure investment theme may finally be nearing an inflection point; Also, our in-depth 2008 water sector performance review.*
- **December 2008:** *Emerging concept of “Virtual Water” illustrates magnitude of industrial water consumption; Industrial water efficiency solutions a growth area.*
- **November 2008:** *An in-depth look at the state and direction of the water industry from the perspective of one of the nation’s largest municipal water systems, the Philadelphia Water Department.*
- **October 2008:** *Water prices continue to outpace inflation worldwide, as utilities continue to push towards a standard of full-cost pricing; Trend underscores the investment thesis for the water sector.*
- **September 2008:** *The Top 5: Our ranking of the Water Equipment & Technology Sector’s Most Compelling Themes; Metering, Desalination, Irrigation Top the List.*
- **August 2008:** *As increasing water scarcity worldwide drives adoption of mechanized irrigation systems, makers of Center Pivot systems among beneficiaries.*
- **July 2008:** *Legislative Update: An in-depth look at current water-related legislative initiatives – State and Federal - and their likely impact on the industry.*
- **June 2008:** *The commodity boom hits water: A look at the surging value of water rights; we profile ten water stocks flying below the market’s radar.*
- **May 2008:** *Short Selling in the Water Sector: Why shorting water stocks outright is fraught with peril, and how market neutral strategies can help to mitigate risk for those interested in betting on declines.*
- **April 2008:** *Climate Change & The Water Sector: An in-depth look at compelling investment ideas for investors looking to position their portfolios for ongoing changes in the environment.*
- **March 2008:** *Compelling options exist for valuing water utility shares despite industry’s negative free cash flow position; We analyze pros & cons of various valuation methodologies.*
- **February 2008:** *Infrastructure rehabilitation remains a key growth driver for water sector despite perceived municipal credit issues; ‘Asset Management’ products to lead the way near-term.*

■ **DISCLOSURE APPENDIX**

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Note: Please refer to <http://www.boenningandscattergood.com/content/content.aspx?cid=6.4> for analyst certifications, important disclosures regarding possible conflicts of interest, ratings definitions, ratings distribution, recommendation histories, and other disclosures concerning the recommendations referenced herein. Alternatively, call 800-883-1212 or write to Boenning & Scattergood, Inc. at Four Tower Bridge, 200 Barr-Harbor Drive, West Conshohocken, PA 19428 to the attention of the analyst listed on the front page of this report.





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**B&S Water Digest**

**November 30, 2009  
Industrials**

**With Federal stimulus dollars (finally) flowing, a look at the water industry niches being targeted and which companies are best positioned to benefit.**

*Investment Summary: Ridiculed throughout much of 2009 as “the anti-stimulus” due to its unintended consequences, the American Recovery and Reinvestment Act of 2009 (ARRA) appears to finally be having a tangible positive impact on demand for water-related infrastructure products and services. Indeed, both official figures and anecdotal observation suggest that funds are being released and ARRA-related projects are being put out for bid. While stimulus spending will be short-lived (all funds must be disbursed by September 2010 – less than a year away) and will not have a sustained impact on the industry, it nonetheless provides a timely source of demand given that budgets remain constrained for municipal water authorities. Our analysis of funding priorities indicates that wastewater treatment and water metering are two niches in particular that will experience a short-term boost in demand as stimulus funds are finally deployed over the next nine months. In this edition of the B&S Water Digest, we examine the likely impact of federal stimulus on the water industry in 2010, including a look at which industry niches and specific companies are best positioned to benefit as ARRA funds are let.*

**Key Points:**

- Our analysis of the American Recovery and Reinvestment Act (ARRA) indicates that approximately \$12 billion is earmarked for water-related infrastructure projects.
- The most targeted piece of this funding, roughly \$6 billion, is being disbursed via the State Revolving Funds (SRFs), with \$4 billion reserved for wastewater initiatives.
- While ARRA has been ridiculed as “anti-Stimulus” throughout 2009, official data and anecdotal indicators suggest disbursement has begun to accelerate in recent weeks.
- The impact of ARRA spending on the water sector as a whole will likely be marginal, but certain targeted industry niches will see disproportionate spending allocations.
- Metering and secondary wastewater treatment technology are two such areas, with our analysis indicating that each accounts for more than 35% of relevant SRF funding.
- Badger Meter (BMI), Layne Christensen (LAYN), and Gorman-Rupp (GRC) are three companies that should see a meaningful boost in demand given this spending mix.

| <b>Boenning &amp; Scattergood:<br/>Water Coverage Universe</b> | <b>Ticker<br/>Symbol</b> | <b>Recent<br/>Price</b> | <b>Mkt Cap<br/>(\$MM)</b> | <b>Revenue<br/>(\$MM)</b> | <b>Daily<br/>Volume</b> | <b>P/E<br/>(2010E)</b> |
|--|--------------------------|-------------------------|---------------------------|---------------------------|-------------------------|------------------------|
| Ameron International   | AMN                      | \$58                    | \$536                     | \$668                     | 122,258                 | 15.5x                  |
| American Water Works, Inc.                                     | AWK                      | \$22                    | \$4,665                   | \$2,337                   | 2,405,090               | 15.3x                  |
| Badger Meter Company   | BMI                      | \$36                    | \$541                     | \$280                     | 130,906                 | 18.9x                  |
| Connecticut Water Service, Inc.                                | CTWS                     | \$23                    | \$192                     | \$61                      | 20,293                  | 20.5x                  |
| Consolidated Water Company                                     | CWCO                     | \$13                    | \$193                     | \$60                      | 81,154                  | 16.8x                  |
| Energy Recovery, Inc.  | ERII                     | \$6                     | \$291                     | \$52                      | 250,926                 | 38.7x                  |
| Gorman-Rupp Company  | GRC                      | \$25                    | \$416                     | \$331                     | 46,686                  | 23.9x                  |
| Layne Christensen  | LAYN                     | \$26                    | \$509                     | \$1,008                   | 111,805                 | 28.4x                  |
| Lindsay Corporation  | LNN                      | \$35                    | \$434                     | \$336                     | 341,604                 | 29.4x                  |
| Middlesex Water Company  | MSEX                     | \$16                    | \$218                     | \$91                      | 46,179                  | 20.1x                  |
| Northwest Pipe Company   | NWPX                     | \$26                    | \$238                     | \$440                     | 100,359                 | 18.3x                  |
| Pure Technologies, Ltd   | PUR-V                    | \$4                     | \$130                     | \$26                      | 21,000                  | NM                     |
| Aqua America   | WTR                      | \$16                    | \$2,187                   | \$627                     | 1,590,315               | 17.9x                  |
| Watts Water Technologies                                       | WTS                      | \$31                    | \$1,152                   | \$1,459                   | 223,607                 | 19.9x                  |
| York Water Company   | YORW                     | \$14                    | \$182                     | \$33                      | 27,871                  | 21.3x                  |

**Boenning & Scattergood:  
Water Coverage Universe**

- Ameron International**  
(AMN-NYSE)
- American Water Works, Inc.**  
(AWK-NYSE)
- Aqua America, Inc.**  
(WTR-NYSE)
- Badger Meter, Inc.**  
(BMI-NYSE)
- Connecticut Water Service, Inc.**  
(CTWS-NASDAQ)
- Consolidated Water Company**  
(CWCO-NASDAQ)
- Energy Recovery, Inc.**  
(ERII-NASDAQ)
- The Gorman-Rupp Company**  
(GRC-AMEX)
- Layne Christensen**  
(LAYN-NASDAQ)
- Lindsay Corporation**  
(LNN-NYSE)
- Middlesex Water Company**  
(MSEX-NASDAQ)
- The Northwest Pipe Company**  
(NWPX-NASDAQ)
- Pure Technologies, Ltd.**  
(PUR.V-TSX)
- Watts Water Technologies**  
(WTS-NYSE)
- The York Water Company**  
(YORW-NASDAQ)

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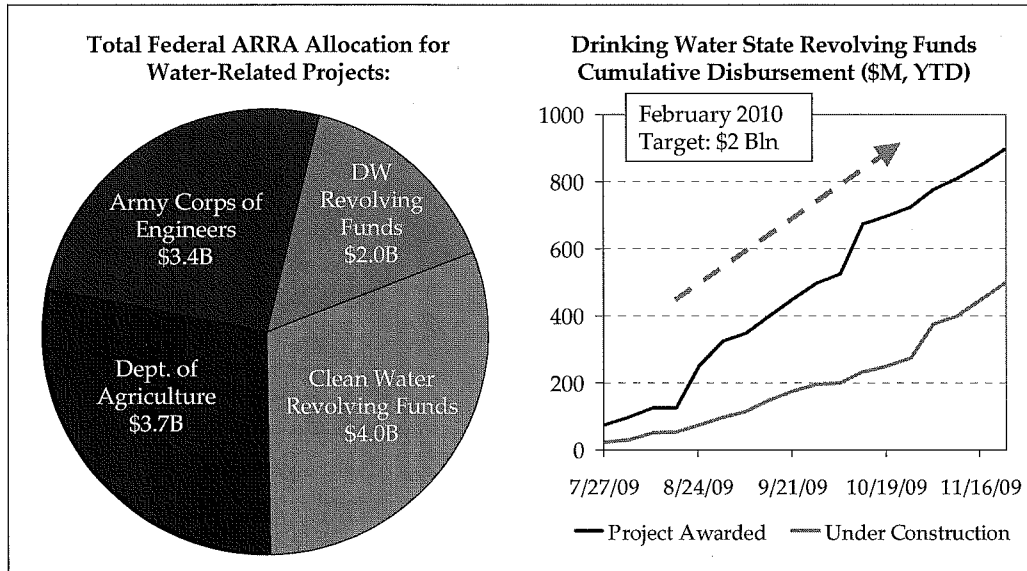


**Federal Stimulus Dollars (Finally) Begin to Flow in Recent Weeks.**

Mocked through much of the year as “anti-Stimulus” by water industry insiders and observers, the American Recovery & Reinvestment Act of 2009 (ARRA) appears to finally be providing a boost in water-related project activity. Indeed, both the official figures (which show funds deployed nearly doubling in November to more than \$500 million) and anecdotal indicators (we are hearing increasing chatter from the channel that stimulus-related jobs are bidding out) suggest that Federal stimulus as a demand driver in the water infrastructure market has moved from concept to reality in recent weeks. Although we continue to believe that the impact of such spending on the water sector as a whole will be marginal and (importantly) does not constitute a sound long-term investment thesis, certain industry niches are likely to see disproportionate levels of funding, creating opportunities for companies whose product lines are aligned with the Federal spending priorities. By analyzing where spending has been concentrated in major states, we have identified several key areas that should receive a sizeable share of ARRA funding.

*Mocked throughout 2009 as “anti-Stimulus”, ARRA appears to finally be providing a boost in water-related project activity.*

**Water-Related Federal Stimulus: An Overview**



Source: US Dept. of Agriculture, US Environmental Protection Agency, US ACE, Boenning & Scattergood

More than half of the ARRA spending that we estimate is earmarked for water infrastructure projects will be funneled through the already established State Revolving Fund (SRF) programs. These include \$4 billion via the Clean Water SRF (wastewater) and \$2 billion via the Drinking Water SRF (potable water). The SRF programs provide low-cost loans for eligible projects, and the \$6 billion allocation in 2009 is on top of the usual \$1-\$2 billion in annual funding available through these programs. Also adding to the stimulatory effect of the ARRA additions to the SRF programs is the fact that the typical 20% mandatory matching requirement for SRF funds has been waived for the incremental ARRA funds. Water-related funding in the ARRA package also includes \$3.7 billion for rural water and wastewater infrastructure (in the form of loans or grants for projects in towns of 10,000 people or less) and more than \$3 billion for the Army Corps of Engineers for major public works projects that often incorporate water-related infrastructure components such as large-scale fluid handling systems. Overall, while ARRA is by no means a panacea for the industry’s recent woes, it does represent a meaningful near-term demand driver.

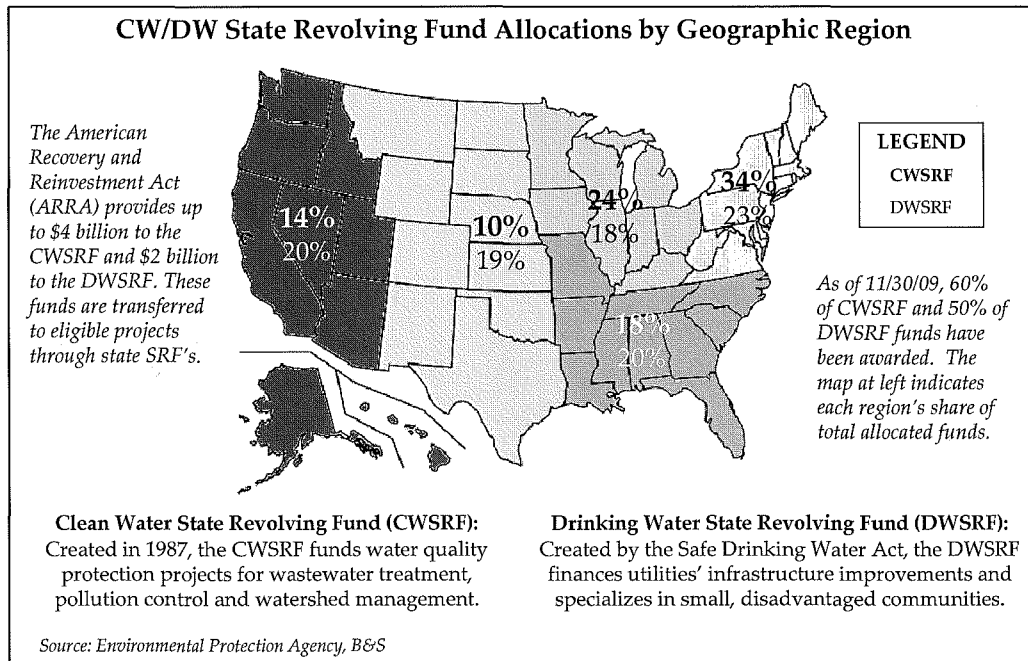
*Much of the ARRA spending earmarked for water projects will be funneled through State Revolving Funds (SRFs).*



**Focus on State Revolving Funds: Some Regions More Equal than Others.**

With the bulk of ARRA-related funding (and the lion’s share of spending relevant to companies in our coverage universe) being funneled through the State Revolving Funds, it is important for investors to understand how SRF funding will be prioritized. Geographically, the stimulus funds will not necessarily be evenly distributed, with the Midwest (24%) and Northeast/Upper Mid-Atlantic (34%) receiving more than half of the wastewater spending and the West Coast faring better in drinking water (20%) than on the wastewater side (14%). Such regional discrepancies are important given that the water sector remains highly fragmented and many key players in the industry are stronger in some regions and weaker in others. The Gorman-Rupp Company, for example, is well positioned to benefit from the spending mix given its strength in wastewater applications and its exceptional market presence in the eastern half of the country, where more than 75% of CWSRF funds are likely to be deployed. Headquartered in southern Indiana and with 15 of 18 branches in the east, Layne Christensen’s Reynolds unit is also well positioned.

*Regional discrepancies matter given that many key industry players are stronger in some regions and weaker in others.*



Several key dates loom for projects seeking ARRA funding, regardless of region. Projects must be identified by 2/17/2010 to be considered eligible for consideration under ARRA, providing local authorities less than three months to file the requisite paperwork (a compressed time period given that it is inclusive of the 2009-2010 holiday season). Another date – and one that is perhaps of more importance to investors – is September 2010. This is the point by which all water-related ARRA funds must be disbursed. This date lies at the core of why we see Federal stimulus as a welcome source of incremental near-term demand during a difficult time for the industry, but not as a significant and sustained industry driver over the intermediate-term. Indeed, with all funds to be disbursed in less than a year’s time, the twilight phase of the program is nearly upon us and investors and industry insiders are already looking for “what comes next” after the Federal spending runs out. The answer hinges on the outlook for state and local government budgets in the 2010-2011 fiscal year (which so far is not looking good).

*All ARRA-related funds earmarked for the water industry must be disbursed by Sept. 2010 – less than a year away.*

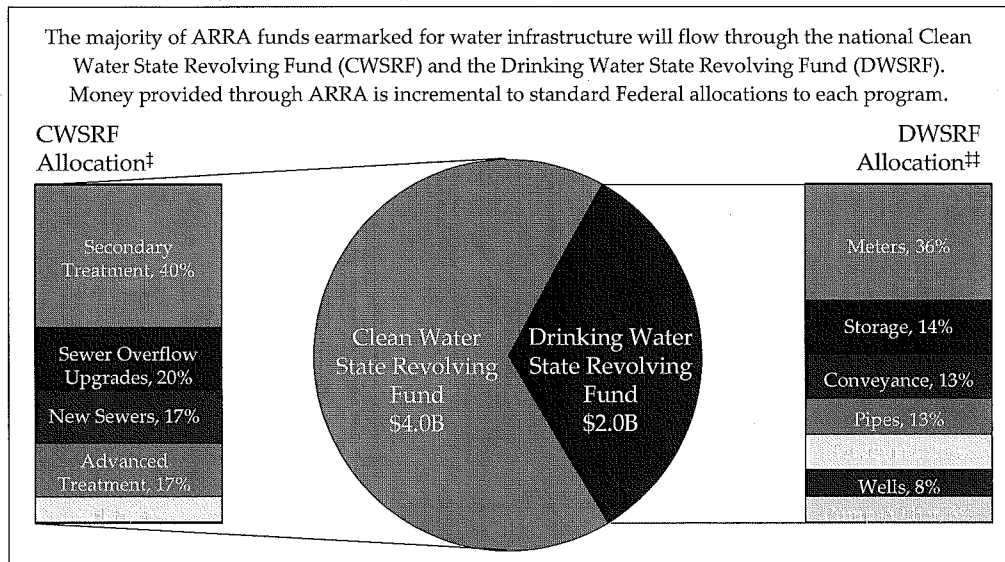


**Metering, Wastewater Treatment among Areas of Focus for ARRA Spending.**

While “water infrastructure” seems at first blush a narrowly defined component of the stimulus package incapable of further refinement, the reality is that these funds will go toward a wide range of water projects including pipelines, treatment, metering, and storage. Given that actual spending priorities will have a significant impact on which companies see the greatest benefit from federal spending, this further level of granularity is highly relevant for investors examining ARRA’s effect on the industry. In order to provide a snapshot of which applications are being prioritized in the ARRA process, we took a detailed look at how SRF allocations have been divvied up so far in the all-important state of California in order to establish a rough proxy for which industry niches are likely to see disproportionate levels of spending nationally. Although there will be state-by-state differences and non-SRF funding sources may be prioritized differently, we believe this analysis provides useful (if imperfect) insight for investors seeking to determine which water industry niches are best positioned to benefit from federal stimulus.

*To get a proxy for likely national priorities, we took a detailed look at how funds are being divvied up in California.*

**Projected ARRA Spending Deployment by Application**



Sources: Environmental Protection Agency, California SWRCB, B&S estimates; †Projected, based on national historical allocations  
‡Projected, based on actual current allocation in State of California, which we believe to be representative of national breakdown

On the wastewater (CWSRF) side, treatment technology has been far and away the greatest area of focus in California, with nearly 60% of total spending going to either secondary or advanced wastewater treatment. With the actual wastewater treatment system business highly fragmented (and at any rate with many key players bottled-up inside huge conglomerates), investors seeking to benefit from this focus on treatment infrastructure should focus on the E&C side of the business, where Layne Christensen’s Reynolds unit has a strong presence. Wastewater treatment plants also require significant fluid handling systems, and Gorman-Rupp is strong in this area. On the drinking water (DWSRF) side, water metering has been an area of focus, garnering more than 35% of SRF funding. This benefits key industry players such as Badger Meter (BMI) and Roper Industries (ROP). Storage (reservoirs) and distribution/conveyance (pipes/pipelines) are also priorities in California, with 40% of funding targeted for these areas. Companies such as Ameron International (AMN) and Northwest Pipe (NWPX) are likely to see increased demand for their long-distance water transmission products as a result the state’s focus on this area.

*Wastewater treatment and metering are areas of focus in California, likely foreshadowing national spending trends.*

**Water Services Universe: Fundamentals**

| Company Name                                      | Ticker | Mkt Cap (\$MM) | Water Exposure | Water Businesses                          | Non-Water Businesses                   |
|---|--------|----------------|----------------|---|--|
| <b>Construction/Engineering Services</b>          |        |                |                |   |  |
| Baker Michael Corp.                               | BKR    | \$338          | 20%            | Water-Infrastructure Consulting           | Energy-Related Consulting              |
| Cascal N.V.                                       | HOO    | \$171          | 100%           | Wastewater Treatment                      | (Not Applicable)                       |
| Clean Harbors, Inc.                               | CLH    | \$1,429        | 30%            | Waste & Wastewater Treatment              | Industrial Decontamination Services    |
| Insituform Technologies, Inc.                     | INSU   | \$810          | 100%           | Trenchless Pipe Replacement               | (Not Applicable)                       |
| Layne Christensen                                 | LAYN   | \$509          | 75%            | Water & Wastewater Infrastructure         | Mineral Exploration; Natural Gas       |
| Perini Corp.                                      | PCR    | -              | 10%            | Water-Infrastructure Construction         | Diversified General Contracting        |
| Tetra Tech, Inc.                                  | TTEK   | \$1,620        | 85%            | Water Resource/Infrastructure Consulting  | Communications Services                |
| Veolia Environment (ADR)                          | VE     | \$16,797       | 35%            | Integrated Water-Infrastructure           | Electricity; Municipal Waste           |
| <b>Specialties</b>                                |        |                |                |   |  |
| Badger Meter, Inc.                                | BMI    | \$541          | 80%            | Water Meters, including AMR               | Diversified Meter Applications         |
| Consolidated Water Co.                            | CWCO   | \$193          | 100%           | Desalination                              | (Not Applicable)                       |
| Dionex Corp.                                      | DNEX   | \$1,237        | 80%            | Fluid chromatography                      | Chemical-Monitoring Devices            |
| Energy Recovery, Inc.                             | ERII   | \$291          | 100%           | Desalination Equipment                    | (Not Applicable)                       |
| Esco Technologies, Inc.                           | ESE    | \$875          | 10%            | Aerospace Filtration & Valves             | Energy; Communication Infrastructure   |
| Itron, Inc.                                       | ITRI   | \$2,418        | 30%            | Water Automated Meter Reading             | Electric/Gas Metering Solutions        |
| Kadant, Inc.                                      | KAI    | \$169          | 20%            | Industrial Water Filtration               | Pulp & Papermaking Systems             |
| Lindsay Corporation                               | LNN    | \$434          | 80%            | Irrigation Equipment & Systems            | Highway Infrastructure Products        |
| Valmont Industries, Inc.                          | VMI    | \$1,999        | 25%            | Irrigation Equipment & Systems            | Steel/Concrete Tubular Products        |
| <b>Investor-Owned Utilities</b>                   |        |                |                |   |  |
| American States Water                             | AWR    | \$594          | 90%            | Water & Wastewater Services               | Electricity Distribution               |
| American Water Works                              | AWK    | \$4,665        | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| Aqua America, Inc.                                | WTR    | \$2,187        | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| California Water Service Group                    | CWT    | \$752          | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| Connecticut Water Service, Inc.                   | CTWS   | \$192          | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| Middlesex Water Co.                               | MSEX   | \$218          | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| Pennichuck Corp.                                  | PNNW   | \$99           | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| SJW Corp.   | SJW    | \$398          | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| Southwest Water Corp.                             | SWWC   | \$147          | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| York Water Corp.                                  | YORW   | \$182          | 100%           | Water Treatment & Distribution            | (Not Applicable)                       |
| <b>Distribution Infrastructure/Fluid Handling</b> |        |                |                |   |  |
| Ameron International Corp.                        | AMN    | \$536          | 35%            | Large Diameter Water Transmission         | Specialty Piping; Infrastructure       |
| Flowserve Corp.                                   | FLS    | \$5,604        | 5%             | Pumps & Related Components                | Energy-Related Fluid Handling          |
| Franklin Electric Corp.                           | FELF   | \$626          | 85%            | Pumps & Related Components                | Energy-Related Pumping Systems         |
| Gorman-Rupp Co.                                   | GRC    | \$416          | 80%            | Pumps & Related Components                | Energy-Related Pumping Systems         |
| Mueller Water Products, Inc.                      | MWA    | \$789          | 80%            | Water & Wastewater Infrastructure         | HVAC; Oil & Gas Infrastructure         |
| Northwest Pipe Co.                                | NWPX   | \$238          | 75%            | Pipes & Related Transmission              | Fuel Storage                           |
| Pentair, Inc.                                     | PNR    | \$2,983        | 70%            | Pumps; Pool & Spa Equipment               | Telecom & Networking Solutions         |
| Robbins & Myers, Inc.                             | RBN    | \$755          | 20%            | Water & Wastewater Infrastructure         | Other Industrial Systems               |
| Watts Water Technologies, Inc.                    | WTS    | \$1,152        | 95%            | Valves & Related Components               | Floor Heating Technology               |
| <b>Filtration/Treatment</b>                       |        |                |                |   |  |
| Clarcor, Inc.                                     | CLC    | \$1,630        | 25%            | Water & Wastewater Filtration             | Diversified Filtration Solutions       |
| Met-Pro Corp.                                     | MPR    | \$132          | 30%            | Fluid Handling & Filtration               | Pollution Control; Air Filtration      |
| Millipore Corp.                                   | MIL    | \$3,769        | 30%            | Specialty Purification Systems            | Filtration Devices; Medical Equipment  |
| Nalco Holding Co.                                 | NLC    | \$3,317        | 50%            | Water & Wastewater Treatment              | Industrial Process Materials           |
| Pall Corp.  | PLL    | \$3,789        | 30%            | Water Filtration & Purification           | Specialty Industrial Purification      |
| <b>Water Rights</b>                               |        |                |                |   |  |
| Cadiz, Inc.                                       | CDZI   | \$166          | 85%            | Water Rights, Storage                     | Agriculture; Real Estate               |
| Pure Cycle Corp.                                  | PCYO   | \$51           | 100%           | Water & Wastewater Systems                | (Not Applicable)                       |
| PICO Holdings, Inc.                               | PICO   | \$676          | 60%            | Water Rights, Storage                     | Real Estate; Mineral Rights; Insurance |
| <b>Multi-Industry</b>                             |        |                |                |   |  |
| Crane Co.   | CR     | \$1,645        | 25%            | Valves; Couplings; Connectors             | Aerospace & Industrial Equipment       |
| Danaher Corp.                                     | DHR    | \$22,756       | 20%            | Water Treatment, Purification, & Analysis | Dental/Medical Devices                 |
| Honeywell International, Inc.                     | HON    | \$28,939       | 10%            | Diversified Water Solutions               | Diversified Energy, Aerospace Products |
| Idex Corp.  | IEX    | \$2,420        | 30%            | Pumps & Flow Measurement Systems          | Specialty Fluid Handling Systems       |
| ITT Corp.   | ITT    | \$9,457        | 40%            | Pumps; Treatment Equipment                | Military Equipment; Automotive         |
| Roper Industries, Inc.                            | ROP    | \$4,745        | 30%            | Pumps; Flow Measurement                   | Energy Systems & Controls              |
| Tyco International, LTD                           | TYC    | \$17,088       | 10%            | Flow Control; Fire Protection             | Energy & Security Systems; Materials   |

Note: "Water Exposure" represents B&S estimate of percentage of consolidated revenue derived from water-related businesses

Source: Company filings, B&S

Bold denotes B&S Coverage

**Water Services Universe: Financial Metrics**

| Company Name                                 | Ticker | Recent Price | 52 Wk. Range |      | Con. Growth Est. 09-10 | Fwd P/E | ROIC  | Avg. Daily Vol. (\$MM) | Mkt. Cap. (\$MM) |
|--|--------|--------------|--------------|------|------------------------|---------|-------|------------------------|------------------|
|  |        |              | High         | Low  |                        |         |       |                        |                  |
| <b>Construction/Engineering Services</b>     |        |              |              |      |                        |         |       |                        |                  |
| Baker Michael Corp.                          | BKR    | \$38         | \$45         | \$24 | N/A                    | 12.5x   | 16.0% | \$2.1                  | \$338            |
| Cascal N.V.                                  | HOO    | \$6          | \$7          | \$2  | -10.0%                 | 8.9x    | 5.5%  | \$0.3                  | \$171            |
| Clean Harbors, Inc.                          | CLH    | \$55         | \$65         | \$41 | 42.1%                  | 20.2x   | 7.5%  | \$9.2                  | \$1,429          |
| Insituform Technologies, Inc.                | INSU   | \$21         | \$23         | \$11 | 26.5%                  | 16.2x   | 6.4%  | \$5.5                  | \$810            |
| Layne Christensen                            | LAYN   | \$26         | \$35         | \$10 | 46.0%                  | 28.4x   | 4.4%  | \$2.9                  | \$509            |
| Tutor Perini Corp.                           | TPC    | \$17         | \$27         | \$10 | -6.3%                  | 6.7x    | 10.4% | \$4.9                  | \$816            |
| Tetra Tech, Inc.                             | TTEK   | \$27         | \$32         | \$17 | 13.6%                  | 17.8x   | 12.1% | \$14.1                 | \$1,620          |
| Veolia Environment (ADR)                     | VE     | \$34         | \$40         | \$19 | 18.2%                  | 15.0x   | N/A   | \$4.9                  | \$16,797         |
| <b>Specialties</b>                           |        |              |              |      |                        |         |       |                        |                  |
| Badger Meter, Inc.                           | BMI    | \$36         | \$45         | \$23 | 5.5%                   | 18.9x   | 21.8% | \$4.8                  | \$541            |
| Consolidated Water Co.                       | CWCO   | \$13         | \$21         | \$6  | 23.4%                  | 16.8x   | 6.1%  | \$1.1                  | \$193            |
| Dionex Corp.                                 | DNEX   | \$70         | \$72         | \$40 | 14.3%                  | 19.5x   | 25.2% | \$6.4                  | \$1,237          |
| Energy Recovery, Inc.                        | ERII   | \$6          | \$10         | \$5  | 87.5%                  | 38.7x   | 6.6%  | \$1.5                  | \$291            |
| Esco Technologies, Inc.                      | ESE    | \$33         | \$47         | \$27 | 21.0%                  | 17.5x   | 7.8%  | \$10.6                 | \$875            |
| Itron, Inc.                                  | ITRI   | \$60         | \$68         | \$40 | 59.0%                  | 20.2x   | 3.8%  | \$45.0                 | \$2,418          |
| Kadant, Inc.                                 | KAI    | \$14         | \$17         | \$7  | 533.3%                 | 24.1x   | 1.2%  | \$0.7                  | \$169            |
| Lindsay Corporation                          | LNN    | \$35         | \$47         | \$21 | 32.5%                  | 22.2x   | 6.1%  | \$12.0                 | \$434            |
| Valmont Industries, Inc.                     | VMI    | \$76         | \$89         | \$37 | -15.3%                 | 15.8x   | 16.5% | \$26.4                 | \$1,999          |
| <b>Investor-Owned Utilities</b>              |        |              |              |      |                        |         |       |                        |                  |
| American States Water                        | AWR    | \$32         | \$39         | \$28 | 4.8%                   | 16.4x   | 5.5%  | \$2.1                  | \$594            |
| American Water Works                         | AWK    | \$22         | \$22         | \$16 | 13.4%                  | 15.3x   | N/A   | \$52.9                 | \$4,665          |
| Aqua America, Inc.                           | WTR    | \$16         | \$22         | \$15 | 12.5%                  | 17.9x   | 4.6%  | \$25.6                 | \$2,187          |
| California Water Service Group               | CWT    | \$36         | \$48         | \$33 | 6.0%                   | 17.2x   | 5.6%  | \$4.6                  | \$752            |
| Connecticut Water Service, Inc.              | CTWS   | \$23         | \$25         | \$17 | -7.6%                  | 20.5x   | 4.5%  | \$0.5                  | \$192            |
| Middlesex Water Co.                          | MSEX   | \$16         | \$18         | \$12 | 14.3%                  | 20.1x   | 3.8%  | \$0.7                  | \$218            |
| Pennichuck Corp.                             | PNNW   | \$23         | \$25         | \$15 | 37.0%                  | 31.3x   | 2.4%  | \$0.2                  | \$99             |
| SJW Corp.                                    | SJW    | \$21         | \$30         | \$18 | 27.2%                  | 20.9x   | 4.6%  | \$0.7                  | \$398            |
| Southwest Water Corp.                        | SWWC   | \$6          | \$6          | \$3  | 620.0%                 | 16.4x   |       | \$0.8                  | \$147            |
| York Water Corp.                             | YORW   | \$14         | \$18         | \$10 | 4.6%                   | 21.3x   | 5.5%  | \$0.4                  | \$182            |
| <b>Distribution Equipment/Fluid Handling</b> |        |              |              |      |                        |         |       |                        |                  |
| Ameron International Corp.                   | AMN    | \$58         | \$92         | \$41 | 37.9%                  | 15.5x   | 6.8%  | \$7.1                  | \$536            |
| Flowserve Corp.                              | FLS    | \$100        | \$109        | \$38 | -2.1%                  | 13.7x   | 21.0% | \$86.3                 | \$5,604          |
| Franklin Electric Corp.                      | FELE   | \$27         | \$35         | \$17 | 39.7%                  | 15.4x   | 4.8%  | \$4.1                  | \$626            |
| Gorman-Rupp Co.                              | GRC    | \$25         | \$33         | \$15 | -4.6%                  | 23.9x   | 12.6% | \$1.2                  | \$416            |
| Mueller Water Products, Inc.                 | MWA    | \$5          | \$9          | \$1  | N/A                    | 18.3x   | N/A   | \$14.1                 | \$789            |
| Northwest Pipe Co.                           | NWPX   | \$26         | \$46         | \$22 | 213.3%                 | 18.3x   | 6.3%  | \$2.6                  | \$238            |
| Pentair, Inc.                                | PNR    | \$30         | \$34         | \$17 | 27.3%                  | 16.7x   | 4.7%  | \$23.2                 | \$2,983          |
| Robbins & Myers, Inc.                        | RBN    | \$23         | \$26         | \$13 | 43.4%                  | 16.2x   | 10.6% | \$5.1                  | \$755            |
| Watts Water Technologies, Inc.               | WTS    | \$31         | \$33         | \$16 | 2.6%                   | 19.9x   | 4.4%  | \$7.0                  | \$1,152          |
| <b>Filtration/Treatment</b>                  |        |              |              |      |                        |         |       |                        |                  |
| Clarcor, Inc.                                | CLC    | \$32         | \$35         | \$23 | 19.7%                  | 19.5x   | 10.0% | \$7.3                  | \$1,630          |
| Met-Pro Corp.                                | MPR    | \$9          | \$14         | \$6  | 56.3%                  | 18.1x   | 6.3%  | \$0.3                  | \$132            |
| Millipore Corp.                              | MIL    | \$68         | \$73         | \$43 | 11.9%                  | 15.4x   | 9.2%  | \$29.3                 | \$3,769          |
| Nalco Holding Co.                            | NLC    | \$24         | \$25         | \$9  | 42.5%                  | 19.4x   | 3.6%  | \$30.7                 | \$3,317          |
| Pall Corp.                                   | PLL    | \$32         | \$35         | \$18 | 17.1%                  | 14.2x   | 11.7% | \$34.9                 | \$3,789          |
| <b>Water Rights</b>                          |        |              |              |      |                        |         |       |                        |                  |
| Cadiz, Inc.                                  | CDZI   | \$12         | \$14         | \$6  | N/A                    | N/A     | N/A   | \$0.4                  | \$166            |
| Pure Cycle Corp.                             | PCYO   | \$3          | \$4          | \$2  | N/A                    | N/A     | N/A   | \$0.0                  | \$51             |
| PICO Holdings, Inc.                          | PICO   | \$30         | \$36         | \$19 | N/A                    | N/A     | N/A   | \$2.5                  | \$676            |
| <b>Multi-Industry</b>                        |        |              |              |      |                        |         |       |                        |                  |
| Crane Co.                                    | CR     | \$28         | \$31         | \$12 | 5.2%                   | 12.7x   | 9.7%  | \$11.6                 | \$1,645          |
| Danaher Corp.                                | DHR    | \$71         | \$74         | \$47 | 12.4%                  | 18.3x   | 8.4%  | \$144.8                | \$22,756         |
| Honeywell International, Inc.                | HON    | \$38         | \$41         | \$23 | -9.5%                  | 15.0x   | 13.8% | \$200.1                | \$28,939         |
| Idex Corp.                                   | IEX    | \$30         | \$32         | \$15 | 15.9%                  | 17.8x   | 7.1%  | \$12.0                 | \$2,420          |
| ITI Corp.                                    | ITI    | \$52         | \$57         | \$32 | 5.6%                   | 13.2x   | 13.4% | \$85.7                 | \$9,457          |
| Roper Industries, Inc.                       | ROP    | \$52         | \$54         | \$37 | 7.7%                   | 18.7x   | 7.6%  | \$41.1                 | \$4,745          |
| Tyco International, LTD                      | TYC    | \$36         | \$37         | \$17 | 19.4%                  | 12.2x   | 6.2%  | \$121.1                | \$17,088         |
| S&P 500                                      | SPX    | 1,091        | 1,114        | 667  | 23.3%                  | 15.5x   |       |                        |                  |

Italic denotes B&S Coverage

Source: Baseline



## Boenning & Scattergood Water & Industrials Coverage Universe

(For detailed research on any of these companies, contact Boenning & Scattergood)

### American Water Works, Inc. (AWK)

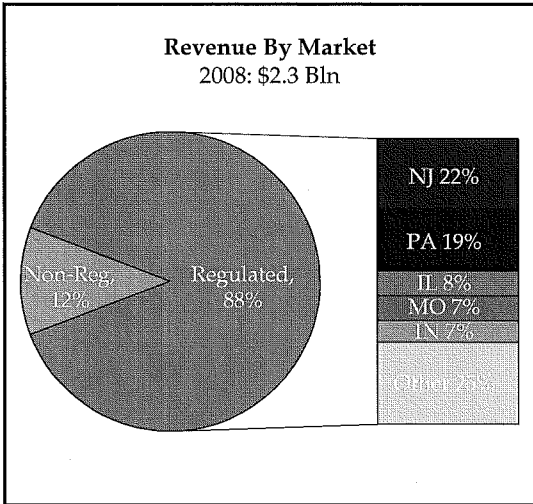
**Outperform**

|                   |        |
|-------------------|--------|
| Recent Price:     | \$22   |
| 12M Price Target: | \$26   |
| 2009E:            | \$1.33 |
| 2010E:            | \$1.45 |

**Company Description:** Serving a population of over 15 million and operating in 32 states, American Water Works is the largest water utility services company in the United States. Headquartered in Voorhees, NJ, the company was formerly publicly-traded and re-entered the public markets with its April 2008 IPO.

**Key Investment Points:**

- **2010 Outlook: Rate relief to continue hitting P&L as RWE divestiture continues.**
  - AWK continues to recognize rate relief.
  - Regulatory relations much improved.
  - RWE fully divested, a positive for P/E?
- **Refocused on core business, company poised for above-trend earnings growth.**
  - Continued aggressive rate case program.
  - Push to end "under-earning" on rate base.
  - Acquisitions back as part of strategy.
- **November 17 offering eliminates RWE ownership position; Underscores compelling thesis.**
  - Nov. 16: Final RWE offering announced.
  - Nov. 17: AWK shares surge 6% on news.
  - Nov. 17: Deal prices at close despite rally.



\*Based on Fwd P/E of 19x; Risks include co. failing to meet our EPS estimate and/or shares failing to trade to our target multiple.

### Ameron International Corporation (AMN)

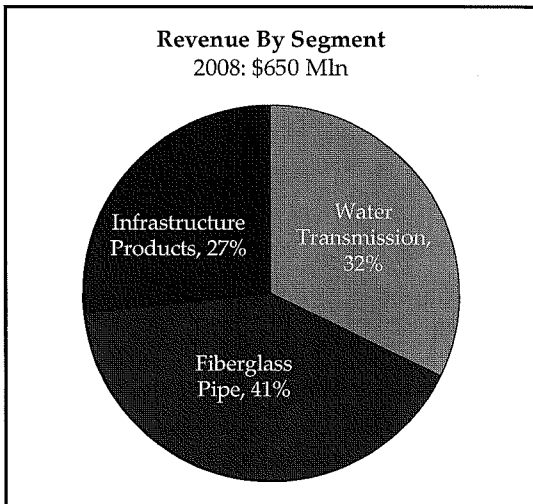
**Neutral**

|                   |        |
|-------------------|--------|
| Recent Price:     | \$58   |
| 12M Price Target: | N/A    |
| 2009E:            | \$2.65 |
| 2010E:            | \$3.50 |

**Company Description:** Ameron International provides highly-engineered products and materials for a range of industrial end-markets, including infrastructure, transportation, oil & gas, and petrochemical. The company also has substantial interests in a number of joint ventures, notably in the Middle East.

**Key Investment Points:**

- **2010 Outlook: Negative EPS momentum in the near-term, recent gains minimize upside.**
  - Macro headwinds impacting all segments.
  - TAMCO steel mini-mill largely idle.
  - Recent pullback justified in our view.
- **Weak steel market creates significant headwinds for TAMCO joint venture.**
  - TAMCO is AMN's SoCal steel mini-mill.
  - Currently producing at very low levels.
  - Profitability likely to remain depressed.
- **Fiberglass Pipe unit benefiting from shipbuilding market, but backlogs being worked off.**
  - Products sold into shipbuilding market higher mgn, creating positive mix effect.
  - Ship order cancellations rare, but backlogs being worked down; Downturn likely.







## Boenning & Scattergood Water & Industrials Coverage Universe

(For detailed research on any of these companies, contact Boenning & Scattergood)

### Aqua America, Inc. (WTR)

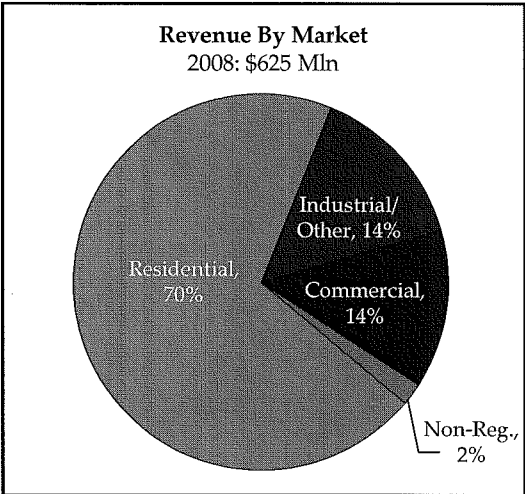
*Outperform*

|                   |        |
|-------------------|--------|
| Recent Price:     | \$16   |
| 12M Price Target: | \$21   |
| 2009E:            | \$0.78 |
| 2010E:            | \$0.90 |

**Company Description:** Aqua America, the nation's largest publicly traded water utility, provides potable water and wastewater services to 2.5 million customers in its core market of Pennsylvania as well as in Florida, Illinois, Indiana, Maine, North Carolina, New Jersey, New York, Ohio, Texas, and Virginia.

**Key Investment Points:**

- **2010 Outlook:** Recent rate case in key home state of Pennsylvania a focus point for investors.
  - Rate case filed November 18 w/ PA PUC.
  - Resolution anticipated third quarter 2010.
  - \$43 million in total rate relief requested.
- **Aqua America the industry standard; Peers emulate company's successful strategy.**
  - Combo of rate base growth & acquisitions.
  - Robust CapEx supports continued growth.
  - Track record justifies premium valuation.
- **Acquisitions: Despite recent "Pruning", 2009 Analyst Day confirms commitment to deals.**
  - Some fear Aqua deal machine slowing.
  - CorpDev chief Chris Luning emphatically reiterates commitment to acquisitions.



\*Based on Fwd P/E of 25x; Risks include co. failing to meet our EPS estimate and/or shares failing to trade to our target multiple.

### Badger Meter, Inc. (BMI)

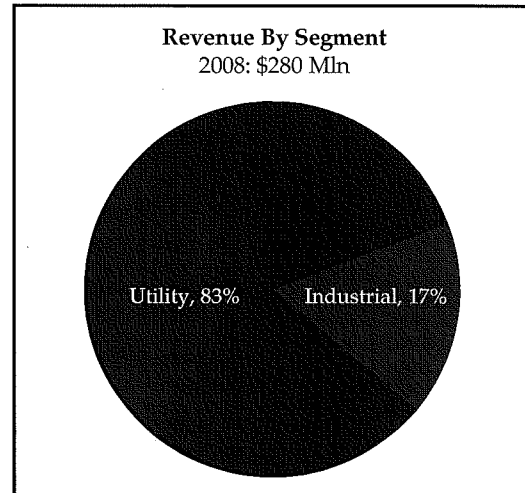
*Neutral*

|                   |        |
|-------------------|--------|
| Recent Price:     | \$36   |
| 12M Price Target: | N/A    |
| 2009E:            | \$1.80 |
| 2010E:            | \$1.75 |

**Company Description:** Badger Meter produces water metering and flow control technologies for use in residential, commercial, and industrial applications. Headquartered in Milwaukee, WI, the company serves two primary end-markets: Utility, which represents about 75% of revenue, and Industrial (~25%).

**Key Investment Points:**

- **2010 Outlook:** Top-line proving resilient, but copper may become headwind in 2010.
  - Utility biz *relatively* recession resistant.
  - Industrial metering more susceptible.
  - Copper: Tailwind YTD; Headwind soon?
- **Adoption of metering technology presents sizeable market opportunity.**
  - 13 million U.S. households lack meters.
  - 75 million are still manual read.
  - Higher water prices drive AMR adoption.
- **Top-line growth, margin improvement likely to drive long-term earnings growth.**
  - Secular dynamics should drive top-line.
  - Shift towards higher-margin products.
  - Still, industry not *immune* to downturn.





## Boenning & Scattergood Water & Industrials Coverage Universe

(For detailed research on any of these companies, contact Boenning & Scattergood)

### Connecticut Water Service, Inc. (CTWS)

**Outperform**

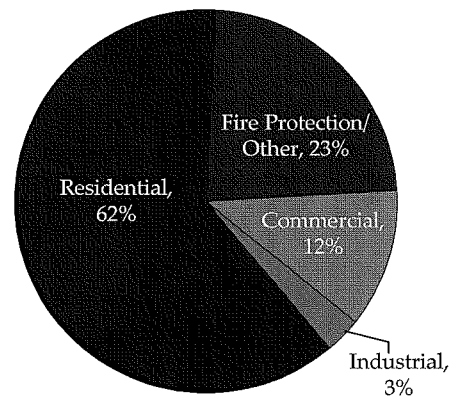
|                   |        |
|-------------------|--------|
| Recent Price:     | \$23   |
| 12M Price Target: | \$23   |
| 2009E:            | \$1.10 |
| 2010E:            | \$1.10 |

**Company Description:** Headquartered in Clinton, CT, Connecticut Water Service, Inc. is an investor owned regulated water utility holding company serving a population of roughly 290,000 entirely within the state of Connecticut. In addition, the company provides some non-regulated water-related services.

**Key Investment Points:**

- **2010 Outlook:** Connecticut Water takes unusual step of requesting rate *reduction*; 2010 rate case?
  - Lower D&A expense to offset lower rates.
  - Impact on CF offset by infra. surcharge.
  - Improves reg. relations ahead of rate case.
- **Acquisition program a consistent source of customer growth; Eventual move beyond CT?**
  - Acquisitions provide incremental growth.
  - CT has 500 independent water systems.
  - Co. track record a force for acquisitions.
- **Heavy exposure to residential/fire protection customers a plus in difficult environment.**
  - 85% exposure to residential/fire protection.
  - Demand is highly recession resilient.
  - Conservation could impede growth.

**Revenue By Market**  
2008: \$62 Mln



\*Based on Fwd P/E of 23x; Risks include co. failing to meet our EPS estimate and/or shares failing to trade to our target multiple.

### Consolidated Water Company (CWCO)

**Outperform**

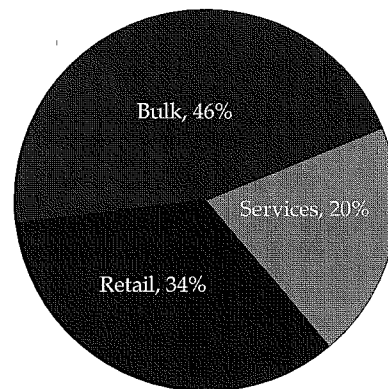
|                   |        |
|-------------------|--------|
| Recent Price:     | \$13   |
| 12M Price Target: | \$20   |
| 2009E:            | \$0.68 |
| 2010E:            | \$0.80 |

**Company Description:** Consolidated Water provides potable water in areas where fresh water sources are scarce, including the Cayman Islands, the British Virgin Islands, and the Bahamas. The company serves retail customers as a traditional water utility and also supplies utility customers through its "bulk" business.

**Key Investment Points:**

- **2010 Outlook:** BVI situation finally coming to a head; Enabling company to look forward.
  - Initial ruling against CWCO's interests.
  - Still, JV contributing losses, so resolution of situation likely to be accretive to EPS.
- **Overall, Consolidated Water offers a desal play with an attractive business model.**
  - Capital committed on signed contracts.
  - Long-term inflation-hedged concessions.
  - Low tax rates add to returns on capital.
- **Potential imposition of income tax in Cayman Island looms; Potentially a meaningful negative.**
  - Caymans faced fiscal crisis in early 2009.
  - UK government came thru with \$50B loan; Now agitating for adoption of income tax.
  - Consolidated Water's current tax rate 0%.

**Revenue By Segment**  
2008: \$66 Mln



\*Based on Fwd P/E of 26x; Risks include co. failing to meet our EPS estimate and/or shares failing to trade to our target multiple.



## Boenning & Scattergood Water & Industrials Coverage Universe

(For detailed research on any of these companies, contact Boenning & Scattergood)

### Energy Recovery, Inc. (ERII)

Neutral

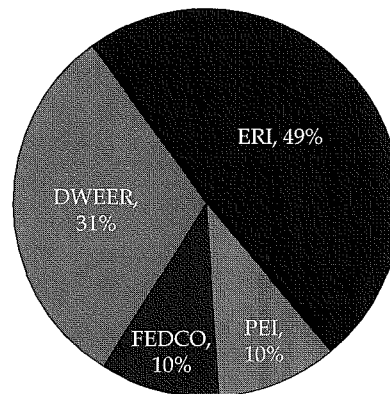
|                   |        |
|-------------------|--------|
| Recent Price:     | \$6    |
| 12M Price Target: | \$ -   |
| 2009E:            | \$0.08 |
| 2010E:            | \$0.16 |

**Company Description:** Headquartered in San Leandro, California, Energy Recovery manufactures energy reduction devices for use in seawater desalination facilities. The company's primary product line is the Pressure Exchanger (PX) device, which has a leading market share in this niche industry.

#### Key Investment Points:

- **2010 Outlook:** After tough 2009 that included guidance cut, debate centers on 2010 desal mkt.
  - ERI slashed 2009 EPS guidance from \$0.09-\$0.13 to \$0.17-\$0.21 on project delays.
  - GWI believes 2009 a peak for desal market.
- **Global Desal capacity has been expanding briskly for over a decade.**
  - Credit crunch has had limited impact.
  - Most projects are built out of necessity.
  - Reverse Osmosis the dominant method.
- **Debate rages among investors as to how rock-solid PX's competitive advantage really is.**
  - Common wisdom says PX is tops in field, but inroads by competitors raise eyebrows.
  - Focus on margin line; Can ERI sustain?

#### 2008 Market Share Breakdown



Source: GWI

### Gorman-Rupp Company (GRC)

Neutral

|                   |        |
|-------------------|--------|
| Recent Price:     | \$25   |
| 12M Price Target: | N/A    |
| 2009E:            | \$1.06 |
| 2010E:            | \$0.85 |

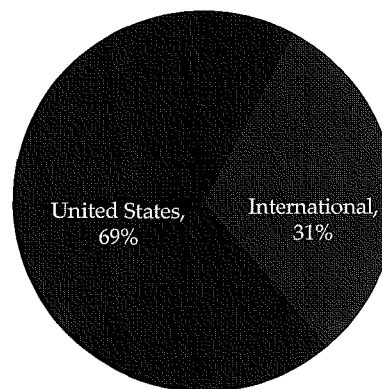
**Company Description:** Gorman-Rupp manufactures a wide variety of pumps and related components, roughly 75% of which are used to move water for one purpose or other. Key end-markets include municipal, industrial, fire protection, OEM, petroleum, construction, government, and military.

#### Key Investment Points:

- **2010 Outlook:** Combo of macro headwinds and higher internal costs to pressure profits.
  - Macro headwinds buffeting end-markets
  - Turbine exhaust business at risk in 2010
  - Expanded facilities to raise overhead
- **Gorman-Rupp has a track record of delivering "best in class" financials over course of cycle.**
  - Margins stack up well versus comps.
  - Returns on capital also impressive.
  - Low debt minimizes financial risk.
- **Macro headwinds present near-term risk to earnings in 2009 and into 2010.**
  - Cyclical of industrial markets a factor.
  - Profitable contract manufacturing business (gas-fired turbine components) at risk.

#### Revenue By Market

2008: \$330 Mln





## Boenning & Scattergood Water & Industrials Coverage Universe

(For detailed research on any of these companies, contact Boenning & Scattergood)

### Layne Christensen Company (LAYN)

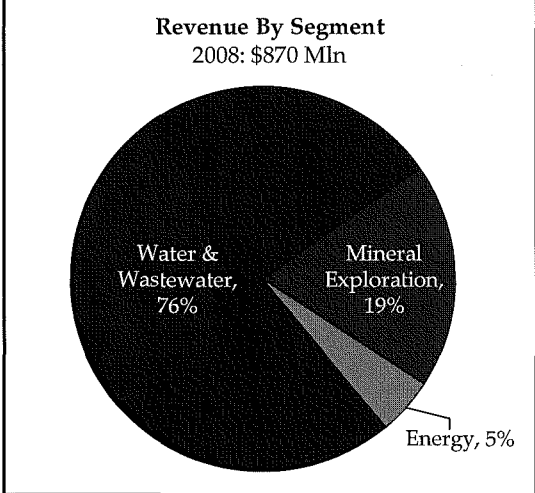
Neutral

|                   |        |
|-------------------|--------|
| Recent Price:     | \$26   |
| 12M Price Target: | N/A    |
| 2010E:            | \$0.60 |
| 2011E:            | \$0.70 |

**Company Description:** Headquartered in Mission Woods, Kansas, Layne Christensen provides products and services for the water, metals mining, and energy industries. The company is organized into three business units: Water Resources, Mineral Exploration and Geoconstruction, and Energy.

**Key Investment Points:**

- **2010 Outlook: Min-Ex could show nice y/y comps in 2010, but Energy likely to offset.**
  - Rebound in copper a big plus for Min-Ex.
  - Still, Energy results buoyed in 2009 by fwd gas sales, which twilight in March 2010.
- **Attractive three-pronged portfolio positions Layne for long-term growth.**
  - A portfolio of resource driven businesses.
  - Water leveraged to infra-rehab trends.
  - MinEx attractive play on commodities.
- **Concerns over municipal Water/Wastewater infrastructure spending overblown.**
  - 70% of Water Infra. sales to W/WW apps.
  - Most funding from water bills (not taxes).
  - Reynolds biz well positioned for stimulus.



### Lindsay Corporation (LNN)

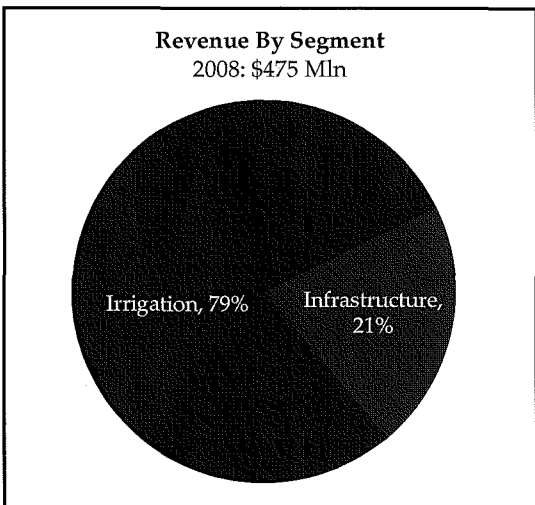
Neutral

|                   |        |
|-------------------|--------|
| Recent Price:     | \$35   |
| 12M Price Target: | N/A    |
| 2009E (FYE 8/30): | \$1.11 |
| 2010E (FYE 8/30): | \$1.45 |

**Company Description:** Headquartered in Omaha, NE, the Lindsay Corporation provides irrigation systems for the domestic and international agricultural industries. The company's principal product line is its Center Pivot Irrigation systems, which it markets under the *Zimmatic* brand name.

**Key Investment Points:**

- **2010 Outlook: After phenomenal year in 2008, irrigation market back to earth in 2009.**
  - Unit shipments rumored down 40-50%.
  - Rebates also pressuring profitability.
  - Could be years before 2008 highs revisited.
- **Water efficiency push to drive long-term demand for advanced irrigation systems.**
  - Agriculture uses 70% of potable water.
  - Improving efficiency a central focus.
  - Center-pivot irrigation systems are a high-ROI water conservation solution.
- **Still, with ag commodities not participating in rally, cyclical upturn for 2010 not assured.**
  - Corn left out of 2009 commodity rebound.
  - USDA reduces Farm Income estimates.





## Boenning & Scattergood Water & Industrials Coverage Universe

(For detailed research on any of these companies, contact Boenning & Scattergood)

### Middlesex Water Company (MSEX)

**Outperform**

|                   |        |
|-------------------|--------|
| Recent Price:     | \$16   |
| 12M Price Target: | \$18   |
| 2009E:            | \$0.70 |
| 2010E:            | \$0.80 |

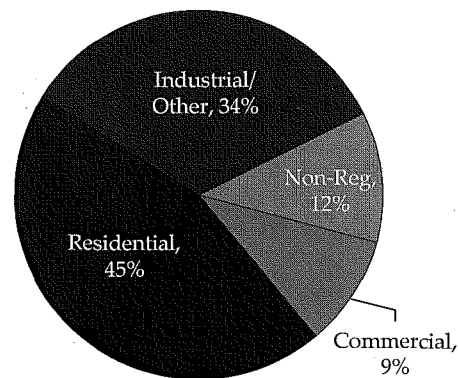
**Company Description:** Middlesex Water Company is a regulated water utility providing water and wastewater services for over 100,000 customers, primarily in Middlesex County, New Jersey and throughout the state of Delaware. The total population of served by the Middlesex Water Company is over 400,000.

#### Key Investment Points:

- **2010 Outlook: Major NJ rate case sets stage for return to solid growth trajectory in 2010.**
  - August 17: Middlesex Water files \$15.1 million rate case in core NJ territory.
  - Co. also received solid 10% ROE in DE.
- **Middlesex Water "Walking-the-Talk" of geographic expansion beyond core NJ franchise.**
  - Delaware now 20% of consolidated sales.
  - Recent forays into NC, PA small, but provide platforms for future growth.
- **New Jersey regulatory climate likely to improve in years ahead; Finally a surcharge mechanism?**
  - NJBPU traditionally fairly challenging.
  - Prospect of NJ DSIC mechanism approval.
  - Improved odds for granted ROE increase.

#### Revenue By Market

2008: \$62 Mln



\*Based on Fwd P/E of 22x; Risks include co. failing to meet our EPS estimate and/or shares failing to trade to our target multiple.

### Northwest Pipe Company (NWPX)

**Neutral**

|                   |        |
|-------------------|--------|
| Recent Price:     | \$26   |
| 12M Price Target: | N/A    |
| 2009E:            | \$0.48 |
| 2010E:            | N/A    |

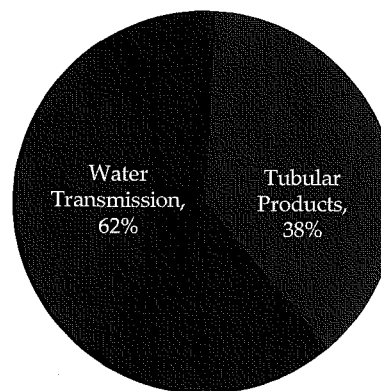
**Company Description:** Northwest Pipe provides large-diameter, high-pressure pipeline systems for water-regulated applications. With ten production facilities spread across the U.S. and Mexico, NW Pipe is well-positioned across North America as water infrastructure upgrades continue to become a critical issue.

#### Key Investment Points:

- **2010 Outlook: Recent dip in backlog a concern for investors; 4Q bookings will be critical.**
  - Backlog stands at \$125 million as-of 9/30, well below 6/30 level (\$190 million).
  - Bookings in 4Q key to 2010 EPS power.
- **Water Transmission Market Primed for Sustained Growth in Project Activity.**
  - Western population growth a driver.
  - Infrastructure replacement in the East.
  - ST lumpy growth, LT steady increase.
- **Board investigating accounting practices vis-à-vis revenue recognition; Details unclear.**
  - Investigation announced November 12<sup>th</sup>.
  - Management mum pending outcome.
  - Uncertainty to remain overhang on stock.

#### Revenue By Segment

2008: \$475 Mln





## Boenning & Scattergood Water & Industrials Coverage Universe

(For detailed research on any of these companies, contact Boenning & Scattergood)

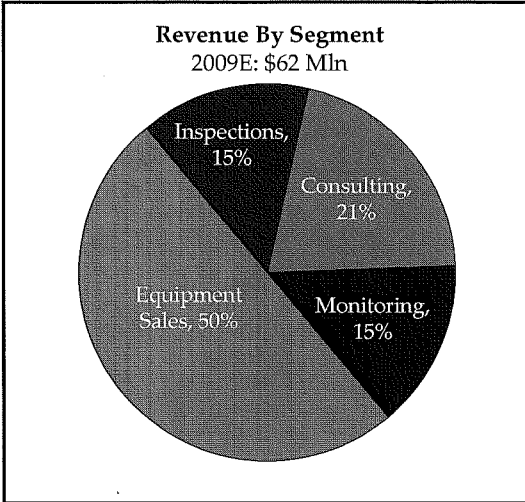
### Pure Technologies, Ltd. (PUR.V)

**Outperform**

|                   |          |
|-------------------|----------|
| Recent Price:     | \$4      |
| 12M Price Target: | \$5      |
| 2009E:            | (\$0.01) |
| 2010E:            | \$0.06   |

**Company Description:** Headquartered in Calgary, AB, Pure provides technologies for the management and surveillance of critical infrastructure. The Company's products and services are deployed on various types of infrastructure, including bridges, water pipelines, oil & gas pipelines, and structures/buildings.

- Key Investment Points:**
- **2010 Outlook: Continued adoption of signature technologies positions Pure for growth.**
    - SoundPrint AFO, SmartBall product lines continue to gain traction in marketplace.
    - Recent contract win in San Diego additive.
  - **Pure Tech. offers rare concentrated exposure to attractive "Infrastructure Diagnostics" space.**
    - Water utilities looking to "Spend Smarter."
    - Sets stage for growth in area of monitoring infrastructure to proactively detect issues.
  - **Increasing prevalence of recurring "data-based" revenue streams a positive for margins.**
    - Ongoing data collection and interpretation provides "perpetuity" revenue streams.
    - This aspect of business highly profitable.



12-month target derived from 3-yr \$7.50 target of 25x 3-year forward EPS est. of \$0.30 discounted back at 23% per annum; Risks include co. failing to meet our EPS estimate and/or shares failing to trade to our target multiple; All figures Canadian dollars

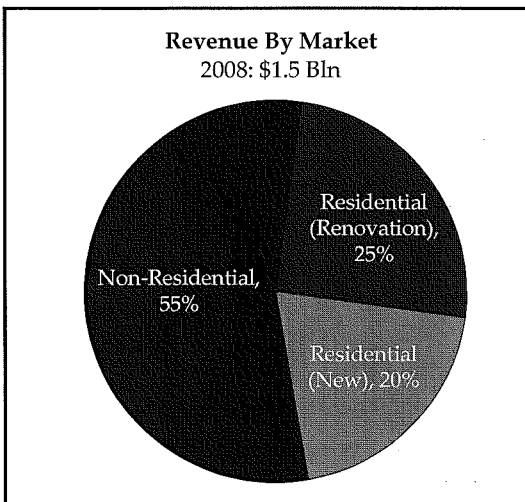
### Watts Water Technologies (WTS)

**Outperform**

|                   |        |
|-------------------|--------|
| Recent Price:     | \$31   |
| 12M Price Target: | \$38   |
| 2009E:            | \$1.45 |
| 2010E:            | \$1.55 |

**Company Description:** Watts Water Technologies provides water safety and flow control products for commercial and residential applications, with a focus on the "code-approved" market. Headquartered in North Andover, MA, Watts reports results in three segments: North America, Europe, and China.

- Key Investment Points:**
- **2010 Outlook: Cost cuts and lower input costs set stage for substantial earnings leverage.**
    - Restructuring savings roughly \$0.25/share.
    - Aggressive LEAN implementation.
    - Copper to become a mgn tailwind in 2H09.
  - **Still, weakness in Residential/Commercial construction markets a challenge near-term.**
    - Non-Res in particular a 09-10 headwind.
    - Company taken steps to lean operations.
    - Relatively clean balance sheet a plus.
  - **Valuation creates compelling Reward/Risk opportunity for long-term investors.**
    - WTS shares trade at 15x normalized EPS.
    - This compares with long-term average P/E multiple range of 12x to 24x.



\*Based on Fwd P/E of 26x; Risks include co. failing to meet our EPS estimate and/or shares failing to trade to our target multiple.



## Boenning & Scattergood Water & Industrials Coverage Universe

(For detailed research on any of these companies, contact Boenning & Scattergood)

### The York Water Company (YORW)

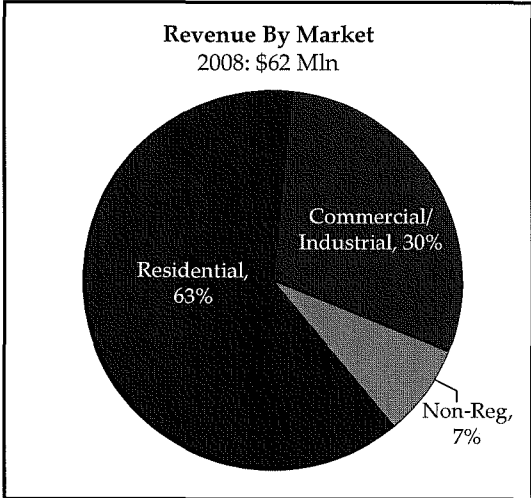
*Outperform*

|                   |        |
|-------------------|--------|
| Recent Price:     | \$14   |
| 12M Price Target: | \$18   |
| 2009E:            | \$0.70 |
| 2010E:            | \$0.73 |

**Company Description:** The York Water Company is an Investor Owned Utility (IOU) providing potable water for approximately 56,000 customers in south-central Pennsylvania, primarily in York County. The total population of served by the company's integrated water system is more than 160,000.

**Key Investment Points:**

- **2010 Outlook: Recent rate increase to help company expand earnings despite recession.**
  - Recently granted a 17% rate increase.
  - Will help resume upward earnings trend.
  - Low rate structure provides an oppt'y.
- **Strong Demographic trends in South-Central Pennsylvania enable organic growth.**
  - South Central PA a Baltimore "exurb."
  - MD anti-growth initiatives fueling PA.
  - Recession easing this trend temporarily.
- **Strong earnings growth & best-in-class profitability justify valuation premium.**
  - Growth opps. propel premium valuation.
  - Track record of reliable execution.
  - Bolt-on acquisition opportunities abound.



\*Based on Fwd P/E of 24x; Risks include co. failing to meet our EPS estimate and/or shares failing to trade to our target multiple.

## **B&S Water Digest: Past Topics and Back Issues**

Each month, Boenning & Scattergood publishes the *B&S Water Digest*, a unique investment journal focused on the fundamentals of the water industry. Each edition dissects a timely topic of relevance for investors looking at the water services sector, including detailed background information & charts and original, independent analysis & commentary.

- **October 2009:** *Water price increases accelerate in 2009, with rates up 9% globally from 2008 levels; Trend confirms positive investment thesis for water stocks.*
- **September 2009:** *Late push for 2009 Water Bill stalls in California legislature, but State will ultimately have to act – creating opportunities for key solutions providers.*
- **August 2009:** *Aging water infrastructure rehabilitation will likely remain a frustratingly slow process, but leak detection technologies a compelling growth area.*
- **July 2009:** *Water Reuse: Why this “hidden source” of water supply is increasingly perceived as a mainstream complement to traditional water resources.*
- **June 2009:** *Fluid Handling Primer: An in-depth look at the end-markets, applications, competitive dynamics, and leading players in the global pump industry.*
- **May 2009:** *GE Water a major player globally, but often overlooked as a small piece of huge GE pie; We take an in-depth look at GE Water portfolio, strategy.*
- **April 2009:** *Guide to Water ETFs: We view passive investing as ill-suited to water sector, but analyze available products and recommend “least of evils.”*
- **March 2009:** *Municipal Water Utilities: Our survey of large muni systems yields key insight into the outlook for capital spending budgets, rates, and more.*
- **February 2009:** *International Water Stocks: A “Roadmap” for Equity Investors Seeking Water-Related Investment Opportunities Outside of the United States.*
- **January 2009:** *2009 Outlook: Infrastructure investment theme may finally be nearing an inflection point; Also, our in-depth 2008 water sector performance review.*
- **December 2008:** *Emerging concept of “Virtual Water” illustrates magnitude of industrial water consumption; Industrial water efficiency solutions a growth area.*
- **November 2008:** *An in-depth look at the state and direction of the water industry from the perspective of one of the nation’s largest municipal water systems, the Philadelphia Water Department.*
- **October 2008:** *Water prices continue to outpace inflation worldwide, as utilities continue to push towards a standard of full-cost pricing; Trend underscores the investment thesis for the water sector.*
- **September 2008:** *The Top 5: Our ranking of the Water Equipment & Technology Sector’s Most Compelling Themes; Metering, Desalination, Irrigation Top the List.*
- **August 2008:** *As increasing water scarcity worldwide drives adoption of mechanized irrigation systems, makers of Center Pivot systems among beneficiaries.*
- **July 2008:** *Legislative Update: An in-depth look at current water-related legislative initiatives – State and Federal - and their likely impact on the industry.*
- **June 2008:** *The commodity boom hits water: A look at the surging value of water rights; we profile ten water stocks flying below the market’s radar.*
- **May 2008:** *Short Selling in the Water Sector: Why shorting water stocks outright is fraught with peril, and how market neutral strategies can help to mitigate risk for those interested in betting on declines.*
- **April 2008:** *Climate Change & The Water Sector: An in-depth look at compelling investment ideas for investors looking to position their portfolios for ongoing changes in the environment.*
- **March 2008:** *Compelling options exist for valuing water utility shares despite industry’s negative free cash flow position; We analyze pros & cons of various valuation methodologies.*



## ■ DISCLOSURE APPENDIX

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Note: Please refer to <http://www.boenningandscattergood.com/content/content.aspx?cid=6.4> for analyst certifications, important disclosures regarding possible conflicts of interest, ratings definitions, ratings distribution, recommendation histories, and other disclosures concerning the recommendations referenced herein. Alternatively, call 800-883-1212 or write to Boenning & Scattergood, Inc. at Four Tower Bridge, 200 Barr-Harbor Drive, West Conshohocken, PA 19428 to the attention of the analyst listed on the front page of this report.

Note: Pure Technologies, Ltd. (PUR-V) financial information is listed in Canadian dollars.



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**INITIATION REPORT**

**American Water Works Company, Inc.**  
July 1, 2009

(AWK/NYSE)



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Christopher Noon, 212-702-6623

[noonc@bmur.com](mailto:noonc@bmur.com)

**Initiating Coverage with Buy Rating, \$28 Target Price**

**Initiating Coverage at Buy Target Price: \$28**

**Investment Summary**

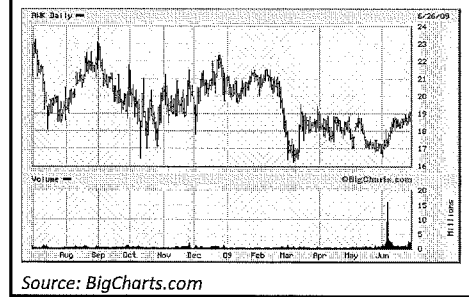
We are initiating coverage on the shares of American Water Works with a Buy rating and \$28 target price, based on a P/E multiple of 19x our 2010 EPS estimate of \$1.44. American Water Works is the largest investor-owned drinking water and wastewater utility in the United States, as measured by both operating revenue and population served. The company completed its IPO in the spring of 2008, returning to the NYSE after having been owned by German parent RWE AG since 2003. New and expected rate-case filings, coupled with increased capex and acquisitions should lead to significant growth in coming years. We recommend investors seeking both income and capital appreciation begin building positions at current levels.

|                           |                 |
|---------------------------|-----------------|
| Price                     | \$19.11         |
| 52-Week High/Low          | \$23.23 - 16.22 |
| Shares Outstanding (mm)   | 174.56          |
| Market Cap. (mm)          | \$3,335.88      |
| Average Daily Volume (mm) | 1.71            |

**Discussion**

- **Growth through rate-case activity is already yielding tangible results.** When RWE acquired American Water Works in 2003, it agreed not to file for rate increases in several states for three years in order to gain approval for the transaction. The end of those agreements has enabled the company to file for significantly higher rates across a wide swath of its service territory. In our opinion, the positive impacts of recent and future rate case activity will take several years to complete, leading to above-average organic revenue and earnings growth relative to the water utility peer group.
- **Increased capital expenditures should provide additional upside.** American Water Works is uniquely positioned for future growth. After the company successfully "catches up" in its bid for higher rates not obtained during the blackout period that spanned 2003-2006, it should be able to continue filing for higher rates based on increased capex, which languished during the RWE years.
- **Goodwill impairment charges are likely finished.** American Water Works came public with approximately \$2.5 billion in goodwill on its balance sheet. That amount was reduced significantly in 2008 and 2009. We believe rising earnings and stable industry valuations will result in higher share prices, which should keep the share prices at or above levels necessary to avoid future charges.
- **Acquisitions could positively impact forward estimates.** Prior to ownership by RWE, American Water Works was an active acquirer of utility systems, with transaction values close to \$40 million (on average) during the 1996-2002 period. The announced acquisition of systems in the Trenton, New Jersey area in December 2007 indicates to us that the company plans to become more active in expanding its operational footprint.

| EPS          | FY08A         | FY09E         | FY10E         |
|--------------|---------------|---------------|---------------|
| Mar          | \$0.08        | \$0.19A       | \$0.18        |
| Jun          | \$0.30        | \$0.38        | \$0.40        |
| Sep          | \$0.55        | \$0.53        | \$0.55        |
| Dec          | \$0.23        | \$0.29        | \$0.31        |
| <b>FY</b>    | <b>\$1.16</b> | <b>\$1.39</b> | <b>\$1.44</b> |
| Consensus    | -             | \$1.32        | \$1.46        |
| P/E          | 16.5x         | 13.7x         | 13.2x         |
| FY Rev. (mm) | \$2,337.0     | \$2,564.3     | \$2,755.0     |



**Valuation** – Based on the results of our summary valuation analysis, we are initiating coverage on the shares of American Water Works with a Buy rating and \$28 target price, based on the shares attaining a level of 19x our 2010 EPS estimate of \$1.44. If we judge the shares by 3 criteria – dividend yield, long term growth and valuation relative to the U.S. water utility peer group, the shares of American Water Works rank as the most attractive from current share price levels.

**Risks** – weather, acquisition integration, regulatory environment, additional equity offerings, potential goodwill impairments and changes in interest rates.

**INVESTMENT THESIS**

We are initiating coverage on the shares of American Water Works with a Buy rating and \$28 target price, based on a P/E multiple of 19x our 2010 EPS estimate of \$1.44. American Water Works is the largest investor-owned drinking water and wastewater utility in the United States, as measured by both operating revenue and population served. Our positive investment thesis is fueled by five drivers:

- 1) Rate-case activity and favorable regulatory environment should drive significant growth for at least the next several years.** American Water Works is in the process of filing significant rate cases across its geographic footprint. Prior to 2008, rate-case activity had been minimal due to the company's acquisition by German utility operator RWE in 2003. As a condition for approval of the RWE purchase of American Water Works, it agreed not to file for rate increases in several states for three years. The end of those agreements has now been reached, and the American Water Works is aggressively filing for significantly higher rates across a wide swath of its service territory. In our opinion, the positive impacts of previous and future rate-case activity will take several years to complete, leading to above-average organic revenue and earnings growth relative to the water utility peer group.

Benefits from rate-case filings and favorable regulatory environments in major service territories are already occurring; the State of New Jersey, where American Water Works is headquartered (and also its biggest contributor of revenues and earnings on a state-by-state basis) recently awarded American Water Works a 15.2% increase. In the State of Pennsylvania, a November ballot initiative created \$400 million for water and wastewater projects, with disbursement of funds to be through low interest loans (at expected rates of 1.0-1.5%). Pennsylvania also offers a DSIC (Distribution System Infrastructure Charge) mechanism that allow utilities to pass through to customers the rate on and return of the capital needed to replace water and wastewater infrastructure on a periodic basis and outside the normal rate case process. In California, the California Public Utility Commission has recently set a return on common equity for the three 'Class A' water utilities – California Water Service Company (CWT \$36.84, Buy), California-American Water Company, a subsidiary of American Water Works, and Golden State Water Company, a subsidiary of American States Water (AWR \$34.64, Buy) of 10.20%, and a temporary interest rate balancing account as an enhanced risk-reduction feature to aid these operators during the current market environment. Combined, the States of New Jersey, Pennsylvania and California accounted for 53% of American Water Works' 2008 regulated revenues. We believe the macro and micro environment for continued support from the regulatory bodies overseeing the industry will continue and improve, particularly due to (1) the recent federal stimulus plan targeting infrastructure, which will be distributed as low interest loans at least partly through the various State Drinking Water Funds, and (2) a continuation of the previous trend of improving regulatory practices. For clarity, a substantial portion of the planned stimulus won't be spent on water industry projects. That said, even a small amount diverted to the industry (the American Water Works Association (AWWA) Government's Affairs Office has calculated that at least \$10 billion worth of drinking water projects would be "shovel ready" within 120 days of receiving funding, and as high as \$40 billion if the time frame were extended to two years) would be quite substantial.

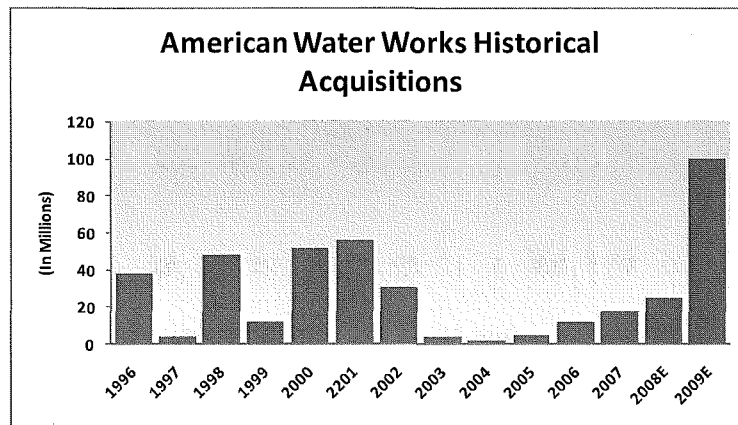
- 2) Increased capex investments should provide a "one-two" punch for earnings growth.** After the company successfully "catches up" in its bid for higher rates not obtained during the blackout period that spanned 2003-2006, it should be able to continue filing for higher rates based on increased capex spending, which languished during the RWE years. As we mentioned previously in this report, the macro and micro environments are extremely favorable for increased levels of infrastructure spending by the industry overall and particularly for American Water Works. If the company chooses to target its spending across both its biggest and most favorable regulatory regions, it should be able to maximize its opportunities to access low interest project financing while recovering its investments with a favorable return in a timely manner, both through the ratemaking and DSIC mechanisms.

- 3) **A substantial amount of the goodwill on the balance sheet has been removed.** American Water Works came public on April 23, 2008 with approximately \$2.5 billion in goodwill on its balance sheet. That amount has been reduced significantly since then, as the company recorded impairment charges of \$750 million and \$450 million in its 1Q08 and 1Q09 results, respectively, based on the market price and trading levels after the IPO. Also contributing to the impairment calculations was a decline in the fair value of the company's debt due to increased market interest rates.

We expect accelerating revenues and earnings will make the valuation of the equity more attractive and drive the share price higher, to a point where the company would close the valuation gap relative to its peer group, decreasing the likelihood of future impairment charges.

- 4) **Acquisitions could positively impact forward estimates.** Prior to ownership by RWE, American Water Works was an active acquirer of utility systems, with transaction values close to \$40 million (on average) during the 1996-2002 period (Exhibit 1). Under the current management team, we expect the company to return to its acquisitive nature to augment its anticipated growth from higher rates. Proof of this mindset has already materialized; the announced acquisition of systems in the Trenton, New Jersey area in December 2007 (with a transaction value estimated to be between \$80 million and \$100 million) indicates to us that the company plans to become more active in expanding its operational footprint. Looking forward, deteriorating conditions at the municipal level (lower tax receipts from declining macroeconomic conditions, coupled with previous growth in municipal debt relative to population and disposable income growth) could push more systems into the hands of larger operators like American Water, and potentially at attractive prices.

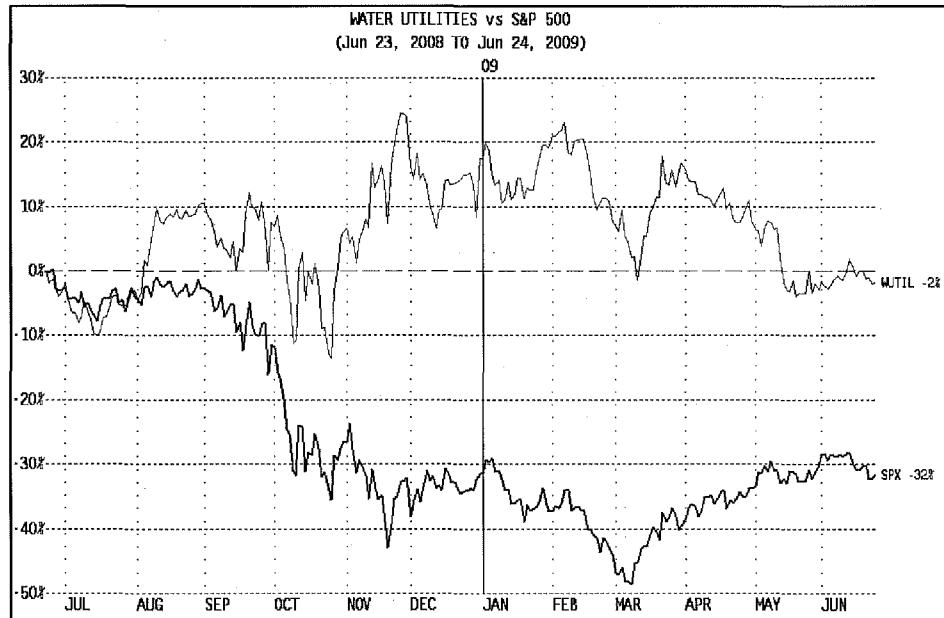
Exhibit 1: Acquisitions



Sources: Company Reports, Brean Murray, Carret & Co. estimates

- 5) **Valuation has become compelling.** Since the IPO, the shares of American Water Works have traded in range spanning \$16.53-23.65, and below the \$21.50 IPO price for the majority of the period. We believe this has occurred for several reasons; nervousness surrounding potential goodwill impairment charges, the share overhang to be sold from RWE AG; poor overall equity market conditions in general, and a lack of visibility (for the first several months as a publicly traded equity) as to how state regulators were going to treat American Water Works when they came in for rates. The risk profile with many of these issues has lessened, in our opinion; goodwill (from the IPO level of \$2.5 billion) has been halved, and regulators appear to have been fair (if not generous) in the rate cases that have already settled. With regard to poor overall market conditions in general, we note that while many industry sectors continue to decline or have at best stabilized, the water utility group has performed rather well recently (Exhibit 2).

Exhibit 2: Water Utilities vs. the S&P 500



Source: Baseline

Water utilities offer fairly predictable earnings and dividends given their monopoly status in regulated operations, and the shares of American Water are now trading at a substantial discount to their closest peer (Aqua America – WTR \$17.90, Buy). We believe a discount is warranted for several reasons. Aqua America maintains among the highest operating margins among the U.S. publicly traded water utility equities. Aqua America also does not have substantial goodwill on its balance sheet, nor is there a controlling shareholder waiting in the wings to sell a large stake as soon as is practicable. We have assigned a 30% discount to the valuation of American Water Works shares relative to Aqua America’s, for the aforementioned reasons. Should circumstances change in these three areas (RWE is able to completely divest its position, the majority of goodwill is removed from the balance sheet and American Water Works achieves comparable operating margins), we would revisit the discount percentage we have assigned for target price purposes. In Exhibit 3 we detail the consensus current and forward EPS estimates for the companies listed, along with our expected P/E derived share price trading ranges.

Based on the results of our fundamental and summary valuation analysis, we are assigning a \$28 target price on the shares of AWK. We consider the shares an excellent addition to investor portfolios with the requisite patience to hold positions while the earnings potential unfolds. We note that the shares also yield 4.3%, approximately 100 basis points higher than the next highest yielding water utility equity within our peer group. If we judge the shares by three criteria – dividend yield, long-term growth and valuation relative to the U.S. water utility peer group – the shares of American Water Works rank as the most attractive within the aforementioned group from current share price levels.

**INITIATION REPORT**

American Water Works Company, Inc. (AWK/NYSE)

**Exhibit 3: Water Utility Comps**

**Water Utility Segment Comparisons**

| Peer Group Analysis  | 06/29/09 |         |        | Mkt. Cap | EPS    | EPS    | EPS    | EPS    | P/E   | P/E   | P/E   | P/E   | Est. LT EPS |
|----------------------|----------|---------|--------|----------|--------|--------|--------|--------|-------|-------|-------|-------|-------------|
| Company Name         | Ticker   | Price   | Rating | (MM)     | CY07   | CY08   | CY09E  | CY10E  | CY07  | CY08E | CY09E | CY10E | Growth      |
| AMERICAN WATER WORKS | AWK      | \$19.26 | BUY    | \$3,362  | NA     | \$1.1E | \$1.32 | \$1.46 | NA    | 16.6x | 14.6x | 13.2x | 10.0%       |
| AQUA AMERICA         | WTR      | \$17.89 | BUY    | \$2,400  | \$0.72 | \$0.73 | \$0.84 | \$0.92 | 24.6x | 24.2x | 21.1x | 19.2x | 3.0%        |
| CALIFORNIA WATER     | CWT      | \$30.83 | BUY    | \$764    | \$1.50 | \$1.9C | \$2.00 | \$2.13 | 24.0x | 19.4x | 17.9x | 17.3x | 3.0%        |
| AMER STATES WATER    | AWR      | \$34.43 | BUY    | \$631    | \$1.56 | \$1.5E | \$1.63 | \$1.87 | 22.1x | 22.1x | 21.1x | 18.4x | 4.0%        |
| SJW                  | SJW      | \$22.52 | HOLD   | \$416    | \$1.04 | \$1.1E | \$0.99 | \$1.25 | 21.7x | 19.4x | 22.7x | 18.0x | NA          |
| Group Average        |          |         |        |          |        |        |        |        | 23.2x | 20.3x | 19.5x | 17.2x | 7.5%        |

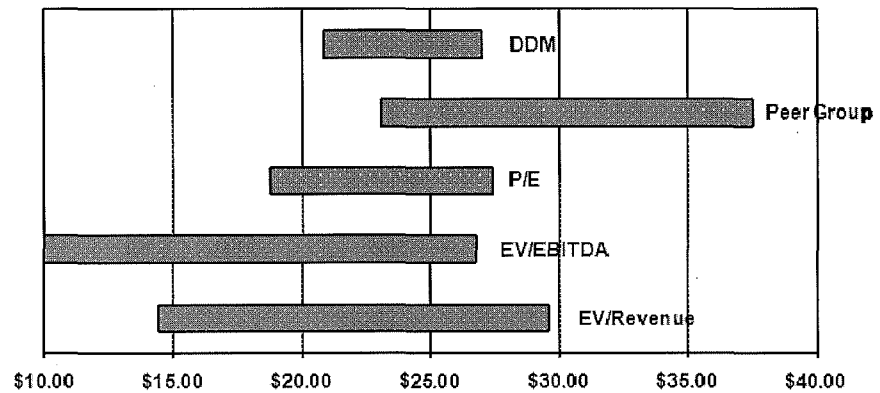
Source: Baseline

| Peer Group Analysis  | 06/29/09 |         |        | Mkt. Cap | Current  | Target   | Target   | Price   | Price   | Target  | Upside    | Yield |
|----------------------|----------|---------|--------|----------|----------|----------|----------|---------|---------|---------|-----------|-------|
| Company Name         | Ticker   | Price   | Rating | (MM)     | Multiple | Multiple | Multiple | Range   | Range   | Price   | Potential |       |
|                      |          |         |        |          | CY10     | (Low)    | (High)   | (Low)   | (High)  |         |           |       |
| AMERICAN WATER WORKS | AWK      | \$19.26 | BUY    | \$3,362  | 13.2x    | 14.3x    | 19.5x    | \$20.81 | \$28.47 | \$28.00 | 45%       | 4.2%  |
| AQUA AMERICA         | WTR      | \$17.80 | BUY    | \$2,400  | 10.2x    | 10.0x    | 26.0x    | \$17.48 | \$23.02 | \$26.00 | 47%       | 3.1%  |
| CALIFORNIA WATER     | CWT      | \$36.83 | BUY    | \$764    | 17.3x    | 16.0x    | 21.0x    | \$34.08 | \$44.73 | \$44.00 | 13%       | 3.2%  |
| AMER STATES WATER    | AWR      | \$34.43 | BUY    | \$631    | 18.4x    | 16.0x    | 21.0x    | \$25.92 | \$39.27 | \$38.00 | 13%       | 2.9%  |
| SJW                  | SJW      | \$22.52 | HOLD   | \$416    | 18.0x    | 16.0x    | 22.0x    | \$20.00 | \$27.50 | NA      | NA        | 2.9%  |

Sources: Baseline, Brean Murray, Carret & Co.

**SUMMARY VALUATION ANALYSIS**

**SUMMARY OF AMERICAN WATER WORKS VALUATION ANALYSIS**



| Metric              | Current Trading Multiple |      | Valuation Multiple |      | Implied Share Price |         |
|---------------------|--------------------------|------|--------------------|------|---------------------|---------|
|                     | Low                      | High | Low                | High | Low                 | High    |
| DDM                 |                          |      |                    |      | \$20.81             | \$26.94 |
| COMP/2010E Earnings |                          |      | 16.0               | 26.0 | \$23.08             | \$37.51 |
| 2010E P/E           | 12.3                     |      | 13.0               | 19.0 | \$18.75             | \$27.41 |
| EV/2010E EBITDA     | 8.6                      |      | 7.0                | 10.0 | \$9.43              | \$26.79 |
| EV/2010E Sales      | 3.3                      |      | 3.0                | 4.0  | \$14.43             | \$29.60 |

Source: Brean Murray, Carret & Co. estimates

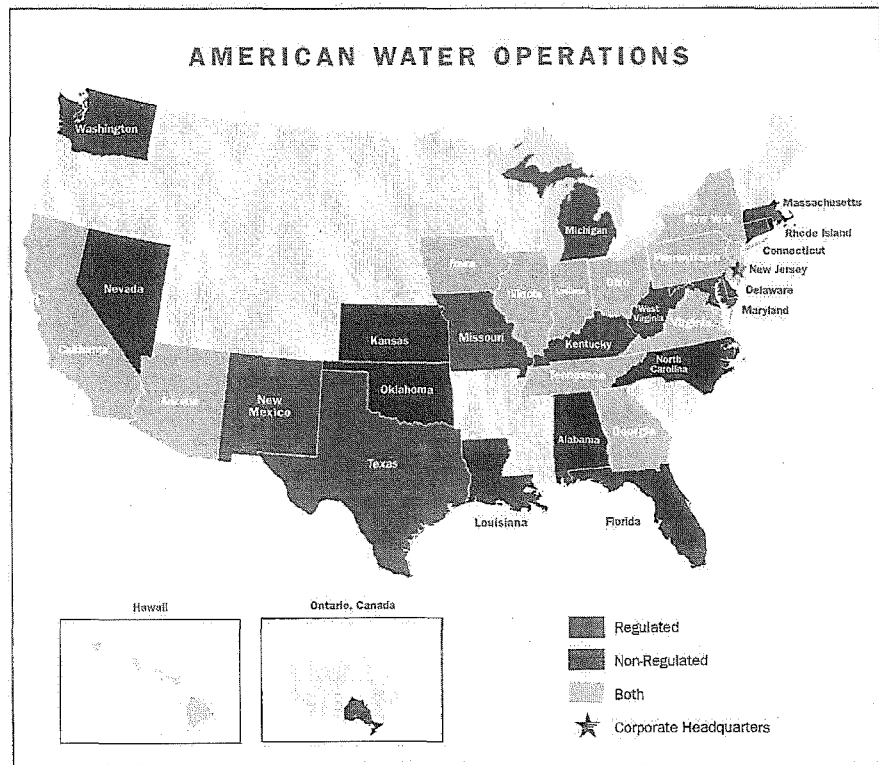
**INITIATION REPORT**

American Water Works Company, Inc. (AWK/NYSE)

**COMPANY OVERVIEW**

Headquartered in Voorhees, New Jersey, American Water Works Inc. is the largest investor-owned drinking water and wastewater utility in the United States, as measured by both operating revenue and population served. Employing approximately 7,300 people, American Water Works operates in regulated and non-regulated businesses which serve 32 states across the U.S. and Ontario, Canada (Exhibit 4).

**Exhibit 4: Areas of Operation**



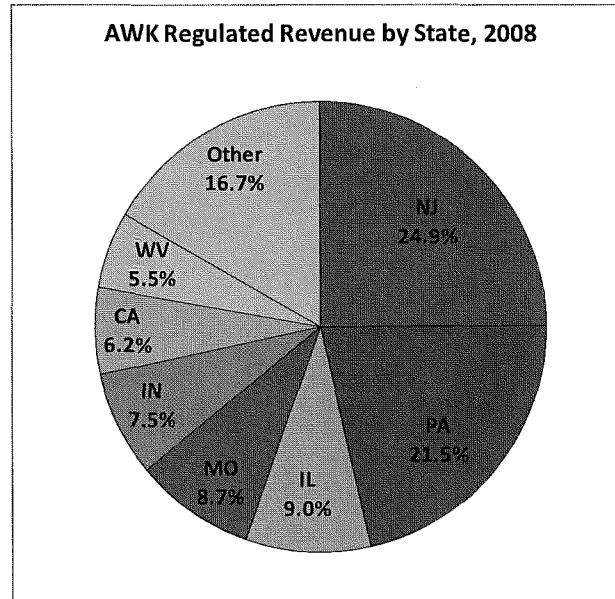
Source: American Water Works

With more than 15 million residential, commercial, and industrial customers, AWK serves roughly 5% of the U.S. population. Approximately 89% of the company's revenue is derived from its regulated operations which serve 3.3 million customers in 20 states (for a complete breakdown of revenue contribution by region, see Exhibit 5).

The regulated business owns and operates the underlying physical assets of various water systems and is subject to economic regulation by each state's regulatory commissions. In 2008, the regulated business generated approximately \$2.1 billion in operating revenue. Of total regulated revenues, the states of New Jersey and Pennsylvania comprise almost 50%.



Exhibit 5: Regulated Revenue by State



Source: American Water Works

Although water system ownership and operation are monopolies in the markets they serve, pricing power is limited by state regulatory agencies that authorize a return on equity for their specific jurisdictions. This limits the amount of profit water utilities like American Water Works can earn. It does, however provide consistency and visibility into future earnings if the utility operator files for rate increases in a meaningful manner over time.

The United States water utility market is highly fragmented, with more than 50,000 individual water systems serving the country. Approximately 16% of population is served by a publicly-traded water utility like American Water Works; while the remainder is served by municipal or private owners (with the bulk being municipalities). Many of these systems are small; approximately 47,000 serve less than 3,300 customers. Additionally, many of these small systems (particularly those owned by municipalities) have not been maintained through regular pipe replacement and system upgrades in an attempt to keep customer bill rates low. This has increased the average age of primary distribution pipe (fabricated from ductile iron) to a point where significant spending in many cases is necessary to restore system integrity. Publicly traded water utilities like American Water Works seek to purchase these systems to augment what are typically low organic growth rates (from increased customers via new residential construction and through increased per capita usage) when system owners are inclined to sell. The publicly traded water utility will then typically invest in the infrastructure (upgrading and replacing pipes and treatment facilities) and then go to the requisite state regulatory authority to request higher rates. Typically, all stakeholders benefit from this arrangement; the customers receive reliable water service through well maintained infrastructure at a reasonable cost; the utility secures an adequate rate of return for its shareholders, and the regulatory authority perpetuates its existence by providing oversight to a very fragmented industry.

The list of publicly traded water utilities in the United States market is very limited, and only a few have significant resources to consummate transactions of size. Within American Water Works geographic footprint, Aqua America is the closet peer (both companies have regulated operations in Texas, Missouri, Indiana, Illinois, Ohio, New York, Pennsylvania, New Jersey, Virginia, North Carolina, and Florida). Both companies derive a significant portion of their revenues from the states of Pennsylvania and New Jersey. American Water Works and Aqua America are also the two largest publicly traded water utilities as measured by market capitalization.

**INITIATION REPORT**

American Water Works Company, Inc. (AWK/NYSE)

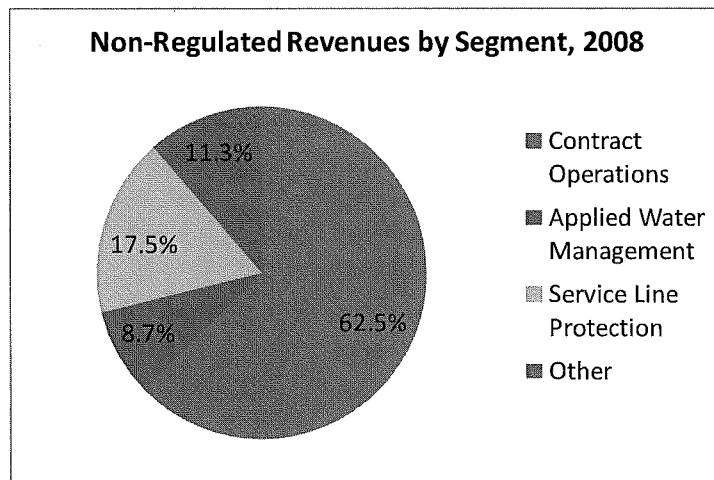
Outside of the aforementioned geographic region/states, American Water Works can also expect to compete for acquisitions in the State of California with California Water Service Group, American States Water, SJW Corp. and Southwest Water (SWWC \$5.51, Hold). Also worthy of mention is that the State of Texas is an area of intense interest for the U.S.-based water utility peer group; American Water Works, American States Water, Southwest Water, SJW Corp. and Aqua America all have operations there.

The remaining 10% of revenues comes from the non-regulated business, which includes three segments:

1. The Contract Operations Group, which enters into public/private partnerships, including O&M contracts for the provision of services to water and wastewater facilities for customers such as municipalities and the United States military.
2. The Homeowner Services Group, which provides services to homeowners to protect against the cost of repairing broken or leaking pipes inside and outside their homes.
3. The Applied Water Management Group, which works with customers to design, build, and operate small water and wastewater treatment plants.

In 2008, the non-regulated business generated approximately \$272 million in operating revenue. The largest revenue contribution to the non-regulated segment is from the Contract Operations Group, which provides a variety of services, including the aforementioned operation of water and wastewater facilities of behalf of customers (Exhibit 6). This group also takes on specialty project work, and was instrumental in making successful modifications to the Tampa Bay, Florida seawater desalination plant, which prior to the company's involvement had not performed to expectations (American Water's joint venture subsidiary American Water-Acciona Agua, LLC now operates the facility under a long-term contract). Competition for the Contract Operations Group is limited to only a handful of players with the requisite skill sets and resources, but is sufficient to keep operating margins from expanding significantly. In the North American market, major competitors include Veolia Environnement (VE/VIE \$29.54/€20.99, Buy), CH2M Hill (private), United Water, a division of Suez Environnement, Severn Trent (private), and Southwest Water.

**Exhibit 6: Non-Regulated Revenues by Segment, 2008**



Source: American Water Works

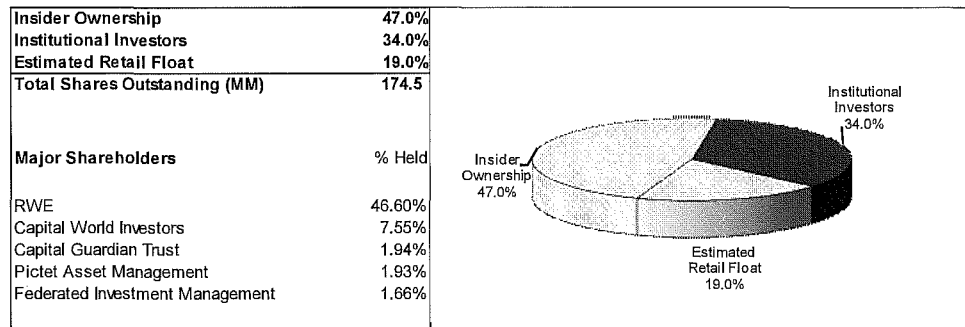
**INITIATION REPORT**

American Water Works Company, Inc. (AWK/NYSE)

**COMPANY HISTORY**

The company was founded in 1886 as the American Water Works & Guarantee Company, for the purpose of building and purchasing water systems in McKeesport, Pennsylvania. In 1935, the company was re-organized under its current name, and in 1947 became a publicly traded company on the New York Stock Exchange. From this point on, the company began acquiring water utilities throughout the United States until it was acquired by German utility RWE in 2003 and became a private company. RWE made the acquisition with the intent to grow through further mergers and acquisitions, but as part of the regulatory approval process, agreed not to file for rate case increases for specified periods of time in various states, which have now expired. However, those few years have put the company at a significant rate-case lag. Then in 2005, RWE decided to divest American Water through an initial public offering. The initial date for the IPO was set for the fall of 2007, but unfavorable macroeconomic conditions delayed the launch until April 23, 2008, when American Water once again became a publicly traded company. 58 million common shares were offered at \$21.50. While it still owns 46.6% of the company (82 million shares), RWE plans on selling its remaining interest through one or more secondary offerings as soon as practicable.

**Exhibit 7: Major Shareholders**



Sources: Company filings, BigDough

**KEY MANAGEMENT PERSONNEL**

**Donald L. Correll, President, Chief Executive Officer, and member of the Board of Directors.** Mr. Correll joined American Water on April 17, 2006 after spending the previous three years serving as President and Chief Executive Officer and member of the board of directors of Pennichuck Corporation, a New Hampshire-based water utility holding company. Prior to his time with Pennichuck, he spent 25 years with United Water Resources, where he served as Chairman, President, and Chief Executive Officer from 1991 to 2001. He also sits on the board of various organizations, including the Environmental Financial Advisory Board of the U.S. Environmental Protection Agency and the National Association of Water Companies, and most recently as a board member of the U.S. Chamber of Commerce.

**Ellen C. Wolf, Senior Vice President and Chief Financial Officer.** Ms. Wolf previously held the title of CFO of American Water Works from 1999 to 2003, at which time she went to work for USEC Inc., a global energy company, serving as Vice President and Chief Financial Officer, before returning to American Water in 2006. She also held various corporate accounting, finance, and business development positions for Bell Atlantic and its subsidiaries from 1987 through 1999. Ms. Wolf sits on the board of directors of C&D Technologies Inc., the National Association of Water Companies, and Water for People, a humanitarian organization.

**John S. Young, Chief Operating Officer.** Mr. Young joined American Water in 1977 and has held various operations, engineering, and executive positions, including Vice President of Engineering, Vice President of Technical Services, and Vice President of Operations and Investment Performance. He also sits on the board of directors of the American Water Works Association and serves on the National Drinking Water Advisory Council.

**INITIATION REPORT**

American Water Works Company, Inc. (AWK/NYSE)

| <b>American Water Works Company, Inc., 2009E</b>         |               |                |               |                |               |                |               |                |                |                |
|--|---------------|----------------|---------------|----------------|---------------|----------------|---------------|----------------|----------------|----------------|
| (\$M, except per share data)                             |               |                |               |                |               |                |               |                |                |                |
| Fiscal year ends December 31                             |               |                |               |                |               |                |               |                |                |                |
|  | 1Q09          | Rate or Margin | 2Q09E         | Rate or Margin | 3Q09E         | Rate or Margin | 4Q09E         | Rate or Margin | 2009E          | Rate or Margin |
| <b>Operating Revenues</b>                                | <b>550.2</b>  |                | <b>632.1</b>  |                | <b>717.6</b>  |                | <b>664.4</b>  |                | <b>2,564.3</b> |                |
| Operation and maintenance                                | 314.4         | 57%            | 331.8         | 53%            | 369.6         | 52%            | 382.0         | 58%            | 1,397.8        | 55%            |
| Depreciation and amortization                            | 68.8          | 13%            | 73.3          | 12%            | 73.9          | 10%            | 75.7          | 11%            | 291.8          | 11%            |
| General taxes  | 52.5          | 10%            | 52.5          | 8%             | 50.9          | 7%             | 51.2          | 8%             | 207.1          | 8%             |
| Loss (gain) on sales of assets                           | (0.2)         | 0%             | -             | 0%             | -             | 0%             | -             | 0%             | (0.2)          | 0%             |
| Impairment charges                                       | 450.0         | 82%            | -             | 0%             | -             | 0%             | -             | 0%             | 450.0          | 18%            |
| <b>Total operating expenses, net</b>                     | <b>435.5</b>  | <b>79%</b>     | <b>457.6</b>  | <b>72%</b>     | <b>494.4</b>  | <b>69%</b>     | <b>508.9</b>  | <b>77%</b>     | <b>1,896.5</b> | <b>74%</b>     |
| <b>Operating income</b>                                  | <b>114.7</b>  | <b>21%</b>     | <b>174.5</b>  | <b>28%</b>     | <b>223.2</b>  | <b>31%</b>     | <b>155.5</b>  | <b>23%</b>     | <b>667.8</b>   | <b>26%</b>     |
| Interest, net  | (72.0)        | -13.1%         | (74.0)        | -11.7%         | (71.8)        | -10.0%         | (73.7)        | -11.1%         | (291.5)        | -11.4%         |
| Amortization of debt expense                             | (1.5)         | -0.3%          | (1.5)         | -0.2%          | (1.4)         | -0.2%          | (1.5)         | -0.2%          | (5.9)          | -0.2%          |
| Other, net   | 6.3           | 1.1%           | 6.0           | 1.0%           | 4.9           | 0.7%           | 4.8           | 0.7%           | 22.0           | 0.9%           |
| <b>Total other income (deductions)</b>                   | <b>(67.2)</b> | <b>-12.2%</b>  | <b>(69.4)</b> | <b>-11.0%</b>  | <b>(68.3)</b> | <b>-9.5%</b>   | <b>(70.4)</b> | <b>-10.6%</b>  | <b>(275.4)</b> | <b>-10.7%</b>  |
| <b>Earnings from cont. ops before income taxes</b>       | <b>47.5</b>   | <b>8.6%</b>    | <b>105.0</b>  | <b>16.6%</b>   | <b>154.9</b>  | <b>21.6%</b>   | <b>85.0</b>   | <b>12.8%</b>   | <b>392.4</b>   | <b>15.3%</b>   |
| Income taxes   | 17.6          | 37.1%          | 42.0          | 40.0%          | 61.9          | 40.0%          | 34.0          | 40.0%          | 155.6          | 39.6%          |
| <b>Earnings from cont. ops</b>                           | <b>29.9</b>   | <b>5.4%</b>    | <b>63.0</b>   | <b>10.0%</b>   | <b>92.9</b>   | <b>12.9%</b>   | <b>51.0</b>   | <b>7.7%</b>    | <b>236.8</b>   | <b>9.2%</b>    |
| Income / (Loss) from discontinued operations, net of tax | -             | 0.0%           | -             | 0.0%           | -             | 0.0%           | -             | 0.0%           | -              | 0.0%           |
| <b>Net income</b>  | <b>29.9</b>   | <b>5.4%</b>    | <b>63.0</b>   | <b>10.0%</b>   | <b>92.9</b>   | <b>12.9%</b>   | <b>51.0</b>   | <b>7.7%</b>    | <b>236.8</b>   | <b>9.2%</b>    |
| <b>Earnings per share:</b>                               |               |                |               |                |               |                |               |                |                |                |
| <b>From continuing operations</b>                        | <b>\$0.19</b> |                | <b>\$0.38</b> |                | <b>\$0.53</b> |                | <b>\$0.29</b> |                | <b>\$1.39</b>  |                |
| Average common shares outstanding                        | 160           |                | 167           |                | 174           |                | 174           |                | 169            |                |

| <b>American Water Works Company, Inc., 2010E</b>         |               |                |               |                |               |                |               |                |                |                |
|--|---------------|----------------|---------------|----------------|---------------|----------------|---------------|----------------|----------------|----------------|
| (\$M, except per share data)                             |               |                |               |                |               |                |               |                |                |                |
| Fiscal year ends December 31                             |               |                |               |                |               |                |               |                |                |                |
|  | 1Q10E         | Rate or Margin | 2Q10E         | Rate or Margin | 3Q10E         | Rate or Margin | 4Q10E         | Rate or Margin | 2010E          | Rate or Margin |
| <b>Operating Revenues</b>                                | <b>583.1</b>  |                | <b>688.7</b>  |                | <b>769.63</b> |                | <b>713.58</b> |                | <b>2,755.0</b> |                |
| Operation and maintenance                                | 325.4         | 56%            | 349.9         | 51%            | 390.2         | 51%            | 406.7         | 57%            | 1,472.2        | 53%            |
| Depreciation and amortization                            | 77.0          | 13%            | 79.2          | 12%            | 80.8          | 11%            | 82.1          | 12%            | 319.0          | 12%            |
| General taxes  | 52.5          | 9%             | 62.0          | 9%             | 53.9          | 7%             | 57.1          | 8%             | 225.4          | 8%             |
| Loss (gain) on sales of assets                           | (0.2)         | 0%             | -             | 0%             | (0.8)         | 0%             | (6.4)         | -1%            | (7.4)          | 0%             |
| Impairment charges                                       | -             | 0%             | -             | 0%             | -             | 0%             | -             | 0%             | -              | 0%             |
| <b>Total operating expenses, net</b>                     | <b>454.6</b>  | <b>78%</b>     | <b>491.1</b>  | <b>71%</b>     | <b>524.1</b>  | <b>68%</b>     | <b>539.5</b>  | <b>76%</b>     | <b>2,009.3</b> | <b>73%</b>     |
| <b>Operating income</b>                                  | <b>128.5</b>  | <b>22%</b>     | <b>197.7</b>  | <b>29%</b>     | <b>245.5</b>  | <b>32%</b>     | <b>174.1</b>  | <b>24%</b>     | <b>745.8</b>   | <b>27%</b>     |
| Interest, net  | (78.1)        | -13.4%         | (79.2)        | -11.5%         | (80.0)        | -10.4%         | (81.3)        | -11.4%         | (318.7)        | -11.6%         |
| Amortization of debt expense                             | (1.4)         | -0.2%          | (1.4)         | -0.2%          | (1.5)         | -0.2%          | (1.4)         | -0.2%          | (5.8)          | -0.2%          |
| Other, net   | 4.9           | 0.8%           | 4.9           | 0.7%           | 4.9           | 0.6%           | 4.9           | 0.7%           | 19.6           | 0.7%           |
| <b>Total other income (deductions)</b>                   | <b>(74.7)</b> | <b>-12.8%</b>  | <b>(75.8)</b> | <b>-11.0%</b>  | <b>(76.6)</b> | <b>-10.0%</b>  | <b>(77.9)</b> | <b>-10.9%</b>  | <b>(304.9)</b> | <b>-11.1%</b>  |
| <b>Earnings from cont. ops before income taxes</b>       | <b>53.8</b>   | <b>9.2%</b>    | <b>121.9</b>  | <b>17.7%</b>   | <b>168.9</b>  | <b>22.0%</b>   | <b>96.2</b>   | <b>13.5%</b>   | <b>440.9</b>   | <b>16.0%</b>   |
| Income taxes   | 21.5          | 40.0%          | 48.8          | 40.0%          | 67.6          | 40.0%          | 38.5          | 40.0%          | 176.3          | 40.0%          |
| <b>Earnings from cont. ops</b>                           | <b>32.3</b>   | <b>5.5%</b>    | <b>73.1</b>   | <b>10.6%</b>   | <b>101.4</b>  | <b>13.2%</b>   | <b>57.7</b>   | <b>8.1%</b>    | <b>264.5</b>   | <b>9.6%</b>    |
| Income / (Loss) from discontinued operations, net of tax | -             | 0.0%           | -             | 0.0%           | -             | 0.0%           | -             | 0.0%           | -              | 0.0%           |
| <b>Net income</b>  | <b>32.3</b>   | <b>5.5%</b>    | <b>73.1</b>   | <b>10.6%</b>   | <b>101.4</b>  | <b>13.2%</b>   | <b>57.7</b>   | <b>8.1%</b>    | <b>264.5</b>   | <b>9.6%</b>    |
| <b>Earnings per share:</b>                               |               |                |               |                |               |                |               |                |                |                |
| <b>From continuing operations</b>                        | <b>\$0.18</b> |                | <b>\$0.40</b> |                | <b>\$0.55</b> |                | <b>\$0.31</b> |                | <b>\$1.44</b>  |                |
| Average common shares outstanding                        | 179           |                | 184           |                | 184           |                | 184           |                | 183            |                |

Sources: Company reports, Brean Murray, Carret & Co. estimates

**INITIATION REPORT**

American Water Works Company, Inc. (AWK/NYSE)

| <b>American Water Works Company, Inc.</b>                    |               | <b>Annual Balance Sheet</b> |               |               |               |               |  |
|--|---------------|-----------------------------|---------------|---------------|---------------|---------------|--|
| (\$M)  |               |                             |               |               |               |               |  |
| as on December 31  |               |                             |               |               |               |               |  |
|  | <b>2005</b>   | <b>2006</b>                 | <b>2007</b>   | <b>2008</b>   | <b>2009E</b>  | <b>2010E</b>  |  |
| <b>ASSETS</b>  |               |                             |               |               |               |               |  |
| Cash   | 65            | 30                          | 13            | 10            | 8             | 19            |  |
| Restricted funds   | 7             | 2                           | 3             | 1             | 1             | 1             |  |
| Utility customer accounts receivable                         | 137           | 154                         | 148           | 149           | 160           | 173           |  |
| Allowance for uncollectible accounts                         | (15)          | (23)                        | (21)          | (19)          | (19)          | (21)          |  |
| Unbilled utility revenues                                    | 106           | 123                         | 134           | 134           | 160           | 173           |  |
| Non-regulated trade and other receivables, net               | 110           | 54                          | 67            | 69            | 69            | 67            |  |
| Taxes receivable, including federal income                   | 0             | 0                           | 23            | 0             | 0             | 0             |  |
| Materials and supplies                                       | 27            | 23                          | 27            | 29            | 32            | 35            |  |
| Assets of discontinued operations                            | 61            | 13                          | 0             | 0             | 0             | 0             |  |
| Other  | 32            | 37                          | 35            | 45            | 46            | 47            |  |
| <b>Total current assets</b>                                  | <b>531</b>    | <b>412</b>                  | <b>430</b>    | <b>418</b>    | <b>456</b>    | <b>493</b>    |  |
| PP&E, net  | 8,207         | 8,721                       | 9,318         | 10,124        | 10,675        | 11,196        |  |
| Regulatory   | 530           | 587                         | 628           | 920           | 783           | 949           |  |
| Restricted funds   | 2             | 17                          | 10            | 11            | 11            | 11            |  |
| Goodwill   | 3,182         | 2,962                       | 2,457         | 1,700         | 1,250         | 1,250         |  |
| Other  | 90            | 83                          | 91            | 60            | 76            | 77            |  |
| <b>Total Assets</b>  | <b>12,542</b> | <b>12,783</b>               | <b>12,934</b> | <b>13,232</b> | <b>13,251</b> | <b>13,975</b> |  |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                  |               |                             |               |               |               |               |  |
| Short-term debt  | 374           | 720                         | 221           | 479           | 570           | 684           |  |
| Current portion of long-term debt                            | 1,644         | 287                         | 96            | 176           | 193           | 213           |  |
| Accounts payable   | 133           | 141                         | 169           | 150           | 159           | 168           |  |
| Taxes accrued, including federal income                      | 96            | 28                          | 56            | 53            | 58            | 64            |  |
| Interest accrued   | 53            | 35                          | 51            | 54            | 56            | 59            |  |
| Liabilities of discontinued operations                       | 14            | 2                           | 0             | 0             | 0             | 0             |  |
| Other  | 183           | 150                         | 182           | 194           | 204           | 214           |  |
| <b>Total current liabilities</b>                             | <b>2,496</b>  | <b>1,364</b>                | <b>774</b>    | <b>1,105</b>  | <b>1,240</b>  | <b>1,401</b>  |  |
| Advances for construction                                    | 561           | 616                         | 655           | 622           | 744           | 806           |  |
| Deferred income taxes  | 538           | 583                         | 639           | 706           | 741           | 778           |  |
| Deferred investment tax credits                              | 38            | 37                          | 35            | 34            | 36            | 37            |  |
| Regulatory liability —cost of removal                        | 153           | 167                         | 193           | 307           | 313           | 320           |  |
| Accrued pension expense                                      | 257           | 315                         | 291           | 502           | 512           | 522           |  |
| Accrued postretirement benefit expense                       | 141           | 145                         | 159           | 241           | 248           | 256           |  |
| Dividend payable   | 0             | 0                           | 0             | 0             | 0             | 0             |  |
| Other  | 67            | 110                         | 124           | 49            | 50            | 50            |  |
| <b>Total Regulatory and other long long-term liabilities</b> | <b>1,755</b>  | <b>1,972</b>                | <b>2,095</b>  | <b>2,461</b>  | <b>2,645</b>  | <b>2,769</b>  |  |
| Contributions in aid of construction                         | 695           | 754                         | 818           | 911           | 1,003         | 1,103         |  |
| Long-term debt   | 3,012         | 3,096                       | 4,675         | 4,624         | 4,581         | 4,801         |  |
| Redeemable preferred stock at redemption value               | 1,775         | 1,774                       | 24            | 24            | 24            | 24            |  |
| <b>Total Liabilities</b>                                     | <b>9,733</b>  | <b>8,961</b>                | <b>8,387</b>  | <b>9,125</b>  | <b>9,492</b>  | <b>10,099</b> |  |
| <b>Shareholders' Equity:</b>                                 |               |                             |               |               |               |               |  |
| Common stockholder's equity                                  | 2,805         | 3,817                       | 4,542         | 4,102         | 3,754         | 3,872         |  |
| Preferred stock without mandatory redemption requirements    | 5             | 5                           | 5             | 5             | 5             | 5             |  |
| <b>Shareholders' Equity</b>                                  | <b>2,809</b>  | <b>3,822</b>                | <b>4,547</b>  | <b>4,107</b>  | <b>3,758</b>  | <b>3,877</b>  |  |
| <b>Total Liabilities &amp; Shareholders' Equity</b>          | <b>12,542</b> | <b>12,783</b>               | <b>12,934</b> | <b>13,232</b> | <b>13,251</b> | <b>13,975</b> |  |

Sources: Company reports, Brean Murray, Carret & Co. estimates

**INITIATION REPORT**

American Water Works Company, Inc. (AWK/NYSE)

| <b>American Water Works Company, Inc.</b>                             |                |                |                |                  |                  |                  |
|---|----------------|----------------|----------------|------------------|------------------|------------------|
| (\$M)   |                |                |                |                  |                  |                  |
| Fiscal year ends December 31  |                |                |                |                  |                  |                  |
|   | 2005           | 2006           | 2007           | 2008             | 2009E            | 2010E            |
| <b>Operating Activities</b>   |                |                |                |                  |                  |                  |
| Net Income / (Loss)   | (325.0)        | (162.2)        | (342.8)        | (562.2)          | 236.8            | 264.5            |
| <b>Adjustments to reconcile net income from continuing operations</b> |                |                |                |                  |                  |                  |
| Loss on sale of discontinued businesses                               | 15.4           | 1.0            | 0.0            | 0.0              | 0.0              | 0.0              |
| Depreciation and amortization   | 261.4          | 259.2          | 267.3          | 271.3            | 291.8            | 319.0            |
| Impairment charges  | 420.4          | 227.8          | 509.3          | 750.0            | 450.0            | 0.0              |
| Removal costs net of salvage  | 32.2           | 34.6           | 38.4           | 41.5             | 42.3             | 43.2             |
| Provision for deferred income taxes                                   | 26.9           | 34.5           | 41.9           | 95.6             | 100.4            | 105.4            |
| Amortization of deferred investment tax credits                       | (1.6)          | (1.3)          | (1.5)          | (1.3)            | (1.3)            | (1.4)            |
| Provision for losses on utility accounts receivable                   | 27.5           | 26.7           | 17.6           | 17.3             | 17.8             | 18.4             |
| Allowance for other funds used during construction                    | (5.8)          | (6.0)          | (7.8)          | (14.5)           | (17.4)           | (20.9)           |
| (Gain) loss on sale of assets   | (6.5)          | 0.1            | (7.3)          | (0.4)            | (0.2)            | (7.4)            |
| Gain on early extinguishment of debt                                  | 0.0            | (3.7)          | (13.1)         | 0.0              | 0.0              | 0.0              |
| Other, net  | 29.4           | 9.7            | (45.1)         | (50.5)           | (55.6)           | (61.1)           |
| <b>Changes in assets and liabilities:</b>                             |                |                |                |                  |                  |                  |
| Receivables and unbilled utility revenues                             | 4.6            | 3.1            | (35.1)         | (20.7)           | (36.2)           | (22.2)           |
| Taxes receivable, including federal income                            | 0.0            | 0.0            | (23.1)         | 23.1             | 0.0              | 0.0              |
| Other current assets  | 20.1           | 0.3            | (1.2)          | (11.2)           | (3.8)            | (4.1)            |
| Accounts payable  | 23.1           | 7.2            | 6.9            | 3.0              | 9.4              | 8.5              |
| Taxes accrued, including federal income                               | 4.2            | (57.0)         | 42.4           | 13.5             | 5.3              | 5.8              |
| Interest accrued  | 4.6            | (18.1)         | 16.1           | 2.8              | 2.7              | 2.8              |
| Other current liabilities   | (5.2)          | (32.1)         | 10.8           | (4.9)            | 9.7              | 10.2             |
| <b>Net Cash Provided by Operating Activities</b>                      | <b>525.4</b>   | <b>323.7</b>   | <b>473.7</b>   | <b>552.2</b>     | <b>1,051.7</b>   | <b>660.7</b>     |
| <b>Investing Activities</b>   |                |                |                |                  |                  |                  |
| Construction expenditures   | (558.4)        | (688.8)        | (758.6)        | (1,008.8)        | (1,200.0)        | (1,300.0)        |
| Allowance for other funds used during construction                    | 5.8            | 6.0            | 7.8            | 0.0              | 0.0              | 0.0              |
| Acquisitions  | (5.0)          | (12.5)         | (15.9)         | (12.5)           | (115.0)          | 0.0              |
| Proceeds from sale of assets and securities                           | 1.5            | 3.7            | 16.3           | 12.6             | 0.0              | 0.0              |
| Proceeds from sale of discontinued operations                         | 15.3           | 30.2           | 9.7            | 0.0              | 0.0              | 0.0              |
| Removal costs from property, plant and equipment retirements          | (17.9)         | (20.4)         | (9.9)          | (24.8)           | (30.0)           | (20.0)           |
| Receivable from affiliates  | 0.6            | 0.0            | 0.0            | 0.0              | 0.0              | 0.0              |
| Net funds (restricted) released                                       | 28.0           | (9.4)          | 5.8            | 2.5              | 0.0              | 0.0              |
| Investment in equity investments                                      | 0.0            | 0.0            | (1.9)          | (2.6)            | 0.0              | 0.0              |
| <b>Net Cash Provided by Investing Activities</b>                      | <b>(530.2)</b> | <b>(691.4)</b> | <b>(746.6)</b> | <b>(1,033.6)</b> | <b>(1,345.0)</b> | <b>(1,320.0)</b> |
| <b>Financing Activities</b>   |                |                |                |                  |                  |                  |
| Proceeds from long-term debt  | 494.3          | 582.5          | 3,869.1        | 279.9            | 251.9            | 503.8            |
| Repayment of long-term debt   | (66.0)         | (637.5)        | (2,350.7)      | (241.5)          | (277.7)          | (263.8)          |
| Net borrowings (repayments) under short-term debt agreements          | (485.3)        | 345.7          | (541.6)        | 258.7            | 91.0             | 114.0            |
| Advances and contributions for construction, net of refunds           | 52.0           | 47.4           | 35.8           | 3.1              | 121.8            | 62.0             |
| Change in cash overdraft position                                     | 0.0            | 0.0            | 42.2           | (0.2)            | 0.0              | 0.0              |
| Capital contributions   | 0.0            | 0.0            | 967.1          | 245.0            | 250.0            | 400.0            |
| Debt issuance costs   | (3.3)          | (5.2)          | (14.9)         | (4.0)            | (10.0)           | 0.0              |
| Dividend paid for the year  | 0.0            | 0.0            | 0.0            | (64.1)           | (135.0)          | (146.2)          |
| Redemption of preferred stocks  | (0.6)          | (0.5)          | (1,750.4)      | 0.6              | 0.0              | 0.0              |
| <b>Net Cash Used for Financing Activities</b>                         | <b>(9.0)</b>   | <b>332.4</b>   | <b>256.6</b>   | <b>477.5</b>     | <b>292.0</b>     | <b>669.8</b>     |
| Increase (decrease) in cash   | (13.8)         | (35.3)         | (16.3)         | (3.9)            | (1.3)            | 10.5             |
| Cash, beginning of year   | 78.9           | 65.1           | 29.8           | 13.5             | 9.6              | 8.3              |
| <b>Cash, end of year</b>  | <b>65.1</b>    | <b>29.8</b>    | <b>13.5</b>    | <b>9.6</b>       | <b>8.3</b>       | <b>18.8</b>      |

Sources: Company reports, Brean Murray, Carret & Co. estimates

## INITIATION REPORT

American Water Works Company, Inc. (AWK/NYSE)

### Important Disclosures

#### Ratings and Target Price History

For historical rating and target price information please use the following links:

AWK: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=AWK&analystid=93&re=1&width=500&height=350&wmf=1>

WTR: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=WTR&analystid=93&re=1&width=500&height=350&wmf=1>

AWR: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=AWR&analystid=93&re=1&width=500&height=350&wmf=1>

CWT: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=CWT&analystid=93&re=1&width=500&height=350&wmf=1>

SJW: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=SJW&analystid=93&re=1&width=500&height=350&wmf=1>

SWWC: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=SWWC&analystid=93&re=1&width=500&height=350&wmf=1>

VE: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=VE&analystid=93&re=1&width=500&height=350&wmf=1>

All prices are as of the market close on 6/30/09.

At the time this report was published, Brean Murray, Carret & Co., LLC made a market in the securities of Southwest Water Co.

Brean Murray, Carret & Co., LLC has managed or co-managed a public offering or placement of securities of American Water Works Company, Inc. and American States Water Company within the past 12 months.

American Water Works Company, Inc. is, or within the last 12 months has been, a client of Brean Murray, Carret & Co., LLC, and investment banking and/or advisory services are being, or have been provided.

American States Water Company is, or within the last 12 months has been, a client of Brean Murray, Carret & Co., LLC, and investment banking and/or advisory services are being, or have been provided.

Brean Murray, Carret & Co., LLC expects to receive compensation or intends to seek compensation for investment banking and/or advisory services from American Water Works Company, Inc. and American States Water Company within the next 3 months.

In the normal course of its business, Brean Murray, Carret & Co., LLC does and intends to seek compensation for investment banking and/or non-investment banking services from the companies in its coverage universe. As a result, investors should be aware that the Firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decisions. Non-U.S. research analysts that may have contributed to this report are not registered/qualified as research analysts with the FINRA.

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**INITIATION REPORT**

American Water Works Company, Inc. (AWK/NYSE)

**Brean Murray, Carret & Co. Stock Rating System**

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<br>Past 12 mos. | % of Total Securities |
|--------------|-----------------|-----------------------|---|-----------------------|
| BUY          | 96              | 60.38%                | 10  | 10.42%                |
| HOLD         | 52              | 32.7%                 | 0   | 0%                    |
| SELL         | 9               | 5.66%                 | 0   | 0%                    |
| NOT RATED    | 2               | 1.26%                 | 0   | 0%                    |
| <b>TOTAL</b> | <b>159</b>      |                       |   |                       |

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

**Valuation Methodology and Risks**

**American Water Works Co.(AWK):** Our \$28 target price is based on the shares attaining a level of 19x our 2010 EPS estimate of \$1.44. Risks to the achievement of our target price include weather, acquisition integration, regulatory environment, additional equity offerings, potential goodwill impairments and changes in interest rates.

**American States Water:** Our \$38 target price is based on a multiple of 20x our FY10 EPS estimate of \$1.92. Risks to the achievement of our target price include integration of acquisitions, weather, environmental regulations, regulation of rates, energy costs, and interest rates.

**Aqua America:** Our \$26 target price is based on the shares achieving a P/E multiple of 28x our 2010 EPS estimate of \$0.94. Risks to the achievement of our target price include weather, acquisitions, interest rates, environmental / public health responsibilities and regulatory climate.

**California Water Service Group:** Our \$44 target price is based on a multiple of 18x our 2010 EPS estimate of \$2.25. Risks to the achievement of our target price include integration of acquisitions, weather, environmental regulations, and regulation of rates.

**Veolia Environnement:** Our target prices of \$40/€30 are based on the shares/ADRs attaining a level of 16x our 2010 estimates of €1.92/\$2.50. Risks to the achievement of our target prices include acquisition risk, contract competition, interest rates, weather, changes in legislation and environmental / public health responsibilities.

**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.



**INITIATION REPORT**

American Water Works Company, Inc. (AWK/NYSE)

**Disclaimers**

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COMPANY UPDATE

American Water Works Company, Inc.

(AWK/NYSE)

August 6, 2009



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Reports 2Q09 Results; Maintaining Buy Rating, \$28 Target Price

Buy

Investment Summary

Target Price: \$28

American Water Works reported 2Q09 results that were slightly ahead of expectations. Revenue in the quarter of \$612.7 million (a 4% YoY increase) came in ahead of our \$610 million estimate and EPS of \$0.32 was nicely above our estimate of \$0.29. These impressive results come in the face of exceptionally wet weather in the Northeast during the quarter (most notably May and June), and also reflects the company's ability to manage its cost structure. In the regulated business, revenue increased by \$28.7 million, and total general rate cases now total \$17.7 million for the first half of the year. As of July 31, 2009, AWK was awaiting final orders for general rate cases totaling \$258.1 million in additional revenue. The company's non-regulated business decreased by 4.1% YoY due to lower revenue in the Contract Operations Group and Applied Water Management Group, which was partially offset by an increase in revenues in the Homeowner Services Group. Looking forward, we believe American Water Works is well positioned to benefit from additional rate increases, tuck-in acquisitions, and planned capital expenditures. We are maintaining our Buy rating and \$28 target price, based on a P/E multiple of 20x our 2010 EPS estimate of \$1.41.

Discussion

- **Solid 2Q09 results.** American Water Works' 2Q09 results were ahead of estimates on both the top and bottom line. Revenue of \$612.7 million increased 4% from the same quarter last year and beat our \$610 million estimate. Contributing to the increase was the Regulated Business, which saw its revenue increase by \$28.7 million. These results are especially impressive given the wet weather in the Northeast (most notably Pennsylvania and New Jersey). Total volume sold actually decreased 5.5% in the quarter from the same period last year, which resulted in a \$24 million reduction in revenue (\$0.08 per share). The company's non-regulated business saw its revenue decrease 4.1% from the same quarter last year. Overall, we are impressed with the results given the miserable weather conditions AWK was faced with across approximately 50% of its service territory.
- **Rate case update.** AWK received additional rate increases in the quarter of \$12.5 million, which brings the YTD total to \$17.7 million. The company also filed rate applications in the quarter in Indiana, Iowa, Ohio, Pennsylvania, Maryland and Illinois, requesting an additional \$182.6 million. As of July 31, 2009, the company was awaiting final orders for rate cases in 10 states, totaling \$258.1 million in additional revenue.
- **Adjusting estimates.** Based on the results reported for 2Q09, we are adjusting our forward estimates as follows: our 2009 EPS estimate is now \$1.34 up from \$1.30, and our 2010 EPS estimate is now \$1.41, down from \$1.43. We consider the changes insignificant from a valuation perspective. We will make further adjustments if needed after the conference call scheduled for 9 AM ET today.

|                           |                 |               |               |
|---------------------------|-----------------|---------------|---------------|
| Price                     | \$20.00         |               |               |
| 52-Week High/Low          | \$23.12 - 16.22 |               |               |
| Shares Outstanding (mm)   | 174.56          |               |               |
| Market Cap. (mm)          | \$3,491.24      |               |               |
| Average Daily Volume (mm) | 0.80            |               |               |
| <b>EPS</b>                | <b>FY08A</b>    | <b>FY09E</b>  | <b>FY10E</b>  |
| Mar                       | \$0.08          | \$0.19A       | \$0.18        |
| Jun                       | \$0.30          | \$0.32A       | \$0.39        |
| Prior                     | -               | \$0.29        | -             |
| Sep                       | \$0.55          | \$0.53        | \$0.54        |
| Prior                     | -               | -             | \$0.55        |
| Dec                       | \$0.23          | \$0.30        | \$0.31        |
| Prior                     | -               | \$0.29        | -             |
| <b>FY</b>                 | <b>\$1.16</b>   | <b>\$1.34</b> | <b>\$1.41</b> |
| Prior                     | -               | \$1.30        | \$1.43        |
| Consensus                 | -               | \$1.32        | \$1.45        |
| P/E                       | 17.3x           | 14.9x         | 14.2x         |
| FY Rev. (mm)              | \$2,336.99      | \$2,512.76    | \$2,690.34    |

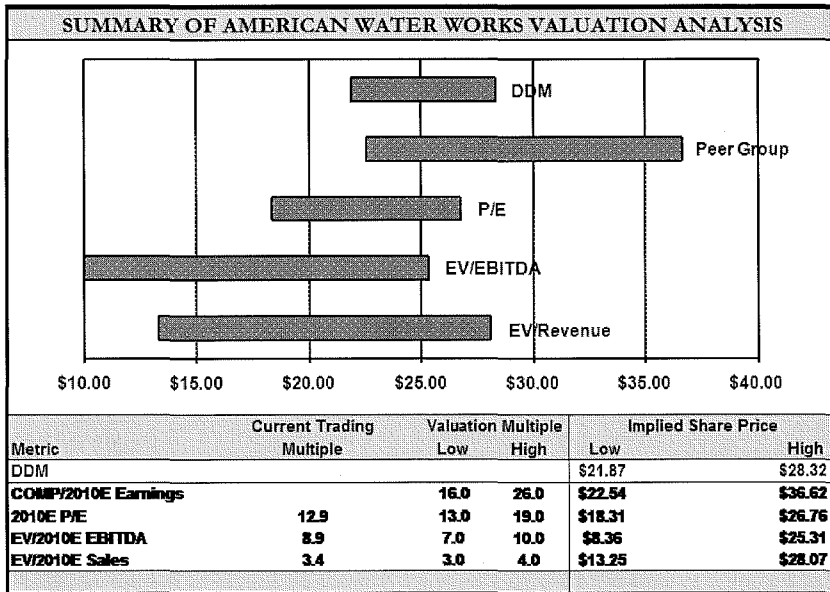
Source: BigCharts.com

**COMPANY UPDATE**

American Water Works Company, Inc. (AWK/NYSE)

**Valuation.** Based on the results of our summary valuation, we are maintaining our Buy rating and \$28 target price. Judging the shares by 3 criteria – dividend yield, projected long-term growth and valuation relative to the U.S. water utility peer group – we believe the shares of American Water Works rank as among the most attractive from current share price levels. We continue to expect the valuation gap between AWK and the water utility peer group to close (on a P/E basis) based on 1) continued successful recovery of costs through rate relief across the service territories, 2) continued unwinding of the RWE ownership position, and 3) its structured capital expense programs to improve water delivery and quality. Our \$28 target price is based on a P/E multiple of 20x our 2010 EPS estimate of \$1.41, and we recommend investors continue to accumulate shares or add to positions at current levels.

**Risks.** Weather, acquisition integration, regulatory environment, additional equity offerings, potential goodwill impairments and changes in interest rates.



Source: Company reports, Brean Murray, Carret & Co. estimates

**Water Utility Segment Comparisons**

| Peer Group Analysis         |        | 08/05/09 |        | Mkt. Cap | EPS    | EPS    | EPS    | EPS    | P/E   | P/E   | P/E   | P/E   | Est.LT EPS |
|-----------------------------|--------|----------|--------|----------|--------|--------|--------|--------|-------|-------|-------|-------|------------|
| Company Name                | Ticker | Price    | Rating | (MM)     | CY07   | CY08   | CY09E  | CY10E  | CY07  | CY08E | CY09E | CY10E | Growth     |
| <b>AMERICAN WATER WORKS</b> | AWK    | \$19.99  | BUY    | \$3,489  | NA     | \$1.16 | \$1.32 | \$1.45 | NA    | 17.2x | 15.1x | 13.8x | 10.0%      |
| AQUA AMERICA                | WTR    | \$18.12  | BUY    | \$2,458  | \$0.72 | \$0.73 | \$0.84 | \$0.92 | 25.2x | 24.8x | 21.6x | 19.7x | 9.0%       |
| CALIFORNIA WATER            | CWT    | \$37.99  | BUY    | \$788    | \$1.50 | \$1.90 | \$2.09 | \$2.17 | 25.3x | 20.0x | 18.2x | 17.5x | 8.0%       |
| AMER STATES WATER           | AWR    | \$36.84  | HOLD   | \$675    | \$1.56 | \$1.56 | \$1.65 | \$1.87 | 23.6x | 23.6x | 22.3x | 19.7x | 4.0%       |
| SJW                         | SJW    | \$21.99  | HOLD   | \$406    | \$1.04 | \$1.16 | \$0.85 | \$1.12 | 21.1x | 19.0x | 25.9x | 19.6x | NA         |
| <b>Group Average</b>        |        |          |        |          |        |        |        |        | 23.8x | 20.9x | 20.6x | 18.1x | 7.8%       |

Source: Baseline

| Peer Group Analysis         |        | 08/05/09 |        | Mkt. Cap | Current  | Target   | Target   | Price   | Price   | Target  | Upside    | Yield |
|-----------------------------|--------|----------|--------|----------|----------|----------|----------|---------|---------|---------|-----------|-------|
| Company Name                | Ticker | Price    | Rating | (MM)     | Multiple | Multiple | Multiple | Range   | Range   | Price   | Potential |       |
|                             |        |          |        |          | CY10     | (Low)    | (High)   | (Low)   | (High)  |         |           |       |
| <b>AMERICAN WATER WORKS</b> | AWK    | \$19.99  | BUY    | \$3,489  | 13.8x    | 14.3x    | 19.5x    | \$20.66 | \$28.28 | \$28.00 | 40%       | 4.2%  |
| AQUA AMERICA                | WTR    | \$18.12  | BUY    | \$2,458  | 19.7x    | 19.0x    | 26.0x    | \$17.48 | \$23.92 | \$26.00 | 43%       | 3.0%  |
| CALIFORNIA WATER            | CWT    | \$37.99  | BUY    | \$788    | 17.5x    | 16.0x    | 21.0x    | \$34.72 | \$45.57 | \$44.00 | 16%       | 3.1%  |
| AMER STATES WATER           | AWR    | \$36.84  | HOLD   | \$675    | 19.7x    | 16.0x    | 21.0x    | \$29.92 | \$39.27 | NA      | NA        | 2.7%  |
| SJW                         | SJW    | \$21.99  | HOLD   | \$406    | 19.6x    | 16.0x    | 22.0x    | \$17.92 | \$24.64 | NA      | NA        | 3.0%  |

Sources: Baseline, Brean Murray, Carret & Co.

**COMPANY UPDATE**

American Water Works Company, Inc. (AWK/NYSE)

| <b>American Water Works Company, Inc., 2009E</b>         |               |                   |               |                   |               |                   |               |                   |                |                   |
|--|---------------|-------------------|---------------|-------------------|---------------|-------------------|---------------|-------------------|----------------|-------------------|
| <small>(\$M, except per share data)</small>              |               |                   |               |                   |               |                   |               |                   |                |                   |
| <small>Fiscal year ends December 31</small>              |               |                   |               |                   |               |                   |               |                   |                |                   |
|  | 1Q09          | Rate or<br>Margin | 2Q09          | Rate or<br>Margin | 3Q09E         | Rate or<br>Margin | 4Q09E         | Rate or<br>Margin | 2009E          | Rate or<br>Margin |
| <b>Operating Revenues</b>                                | <b>550.2</b>  |                   | <b>612.7</b>  |                   | <b>700.9</b>  |                   | <b>649.0</b>  |                   | <b>2,512.8</b> |                   |
| Operation and maintenance                                | 314.4         | 57%               | 330.6         | 54%               | 350.4         | 50%               | 363.4         | 56%               | 1,358.9        | 54%               |
| Depreciation and amortization                            | 68.8          | 13%               | 73.2          | 12%               | 73.6          | 11%               | 74.0          | 11%               | 289.6          | 12%               |
| General taxes  | 52.5          | 10%               | 51.7          | 8%                | 51.2          | 7%                | 51.9          | 8%                | 207.3          | 8%                |
| Loss (gain) on sales of assets                           | (0.2)         | 0%                | -             | 0%                | -             | 0%                | -             | 0%                | (0.2)          | 0%                |
| Impairment charges                                       | 450.0         | 82%               | -             | 0%                | -             | 0%                | -             | 0%                | 450.0          | 18%               |
| <b>Total operating expenses, net</b>                     | <b>435.5</b>  | <b>79%</b>        | <b>455.5</b>  | <b>74%</b>        | <b>475.2</b>  | <b>68%</b>        | <b>489.3</b>  | <b>75%</b>        | <b>1,855.5</b> | <b>74%</b>        |
| <b>Operating income</b>                                  | <b>114.7</b>  | <b>21%</b>        | <b>157.2</b>  | <b>26%</b>        | <b>225.7</b>  | <b>32%</b>        | <b>159.7</b>  | <b>26%</b>        | <b>657.2</b>   | <b>26%</b>        |
| Interest, net  | (72.0)        | -13.1%            | (73.7)        | -12.0%            | (75.7)        | -10.8%            | (76.6)        | -11.8%            | (298.0)        | -11.9%            |
| Amortization of debt expense                             | (1.5)         | -0.3%             | (1.5)         | -0.2%             | (1.4)         | -0.2%             | (1.5)         | -0.2%             | (5.9)          | -0.2%             |
| Other, net   | 6.3           | 1.1%              | 4.2           | 0.7%              | 4.6           | 0.7%              | 4.9           | 0.8%              | 20.1           | 0.8%              |
| <b>Total other income (deductions)</b>                   | <b>(67.2)</b> | <b>-12.2%</b>     | <b>(71.1)</b> | <b>-11.6%</b>     | <b>(72.5)</b> | <b>-10.3%</b>     | <b>(73.1)</b> | <b>-11.3%</b>     | <b>(283.9)</b> | <b>-11.3%</b>     |
| <b>Earnings from cont. ops before income taxes</b>       | <b>47.5</b>   | <b>8.6%</b>       | <b>86.1</b>   | <b>14.1%</b>      | <b>153.2</b>  | <b>21.9%</b>      | <b>86.5</b>   | <b>13.3%</b>      | <b>373.3</b>   | <b>14.9%</b>      |
| Income taxes   | 17.6          | 37.1%             | 34.1          | 39.6%             | 60.7          | 39.6%             | 34.3          | 39.6%             | 146.6          | 39.3%             |
| <b>Earnings from cont. ops</b>                           | <b>29.9</b>   | <b>5.4%</b>       | <b>52.0</b>   | <b>8.5%</b>       | <b>92.5</b>   | <b>13.2%</b>      | <b>52.3</b>   | <b>8.1%</b>       | <b>226.7</b>   | <b>9.0%</b>       |
| Income / (Loss) from discontinued operations, net of tax | -             | 0.0%              | -             | 0.0%              | -             | 0.0%              | -             | 0.0%              | -              | 0.0%              |
| <b>Net income</b>  | <b>29.9</b>   | <b>5.4%</b>       | <b>52.0</b>   | <b>8.5%</b>       | <b>92.5</b>   | <b>13.2%</b>      | <b>52.3</b>   | <b>8.1%</b>       | <b>226.7</b>   | <b>9.0%</b>       |
| <b>Earnings per share:</b>                               |               |                   |               |                   |               |                   |               |                   |                |                   |
| <b>From continuing operations</b>                        | <b>\$0.19</b> |                   | <b>\$0.32</b> |                   | <b>\$0.53</b> |                   | <b>\$0.30</b> |                   | <b>\$1.34</b>  |                   |
| Average common shares outstanding                        | 160           |                   | 163           |                   | 174           |                   | 174           |                   | 168            |                   |
| <b>American Water Works Company, Inc., 2010E</b>         |               |                   |               |                   |               |                   |               |                   |                |                   |
| <small>(\$M, except per share data)</small>              |               |                   |               |                   |               |                   |               |                   |                |                   |
| <small>Fiscal year ends December 31</small>              |               |                   |               |                   |               |                   |               |                   |                |                   |
|  | 1Q10E         | Rate or<br>Margin | 2Q10E         | Rate or<br>Margin | 3Q10E         | Rate or<br>Margin | 4Q10E         | Rate or<br>Margin | 2010E          | Rate or<br>Margin |
| <b>Operating Revenues</b>                                | <b>569.5</b>  |                   | <b>672.5</b>  |                   | <b>751.52</b> |                   | <b>696.76</b> |                   | <b>2,690.3</b> |                   |
| Operation and maintenance                                | 317.8         | 56%               | 341.7         | 51%               | 381.0         | 51%               | 397.2         | 57%               | 1,437.6        | 53%               |
| Depreciation and amortization                            | 75.2          | 13%               | 77.3          | 12%               | 78.9          | 11%               | 80.1          | 12%               | 311.6          | 12%               |
| General taxes  | 51.3          | 9%                | 60.5          | 9%                | 52.6          | 7%                | 55.7          | 8%                | 220.1          | 8%                |
| Loss (gain) on sales of assets                           | (0.2)         | 0%                | -             | 0%                | (0.8)         | 0%                | (6.3)         | -1%               | (7.2)          | 0%                |
| Impairment charges                                       | -             | 0%                | -             | 0%                | -             | 0%                | -             | 0%                | -              | 0%                |
| <b>Total operating expenses, net</b>                     | <b>444.0</b>  | <b>78%</b>        | <b>479.5</b>  | <b>71%</b>        | <b>511.8</b>  | <b>68%</b>        | <b>526.8</b>  | <b>76%</b>        | <b>1,962.1</b> | <b>73%</b>        |
| <b>Operating income</b>                                  | <b>125.5</b>  | <b>22%</b>        | <b>193.0</b>  | <b>29%</b>        | <b>239.7</b>  | <b>32%</b>        | <b>170.0</b>  | <b>24%</b>        | <b>728.3</b>   | <b>27%</b>        |
| Interest, net  | (76.3)        | -13.4%            | (77.3)        | -11.5%            | (78.2)        | -10.4%            | (79.4)        | -11.4%            | (311.2)        | -11.6%            |
| Amortization of debt expense                             | (1.4)         | -0.2%             | (1.4)         | -0.2%             | (1.4)         | -0.2%             | (1.4)         | -0.2%             | (5.6)          | -0.2%             |
| Other, net   | 4.8           | 0.8%              | 4.8           | 0.7%              | 4.8           | 0.6%              | 4.8           | 0.7%              | 19.1           | 0.7%              |
| <b>Total other income (deductions)</b>                   | <b>(72.9)</b> | <b>-12.8%</b>     | <b>(74.0)</b> | <b>-11.0%</b>     | <b>(74.8)</b> | <b>-10.0%</b>     | <b>(76.1)</b> | <b>-10.9%</b>     | <b>(297.7)</b> | <b>-11.1%</b>     |
| <b>Earnings from cont. ops before income taxes</b>       | <b>52.6</b>   | <b>9.2%</b>       | <b>119.0</b>  | <b>17.7%</b>      | <b>165.0</b>  | <b>22.0%</b>      | <b>93.9</b>   | <b>13.6%</b>      | <b>430.5</b>   | <b>16.0%</b>      |
| Income taxes   | 21.0          | 40.0%             | 47.6          | 40.0%             | 66.0          | 40.0%             | 37.6          | 40.0%             | 172.2          | 40.0%             |
| <b>Earnings from cont. ops</b>                           | <b>31.5</b>   | <b>5.5%</b>       | <b>71.4</b>   | <b>10.6%</b>      | <b>99.0</b>   | <b>13.2%</b>      | <b>56.4</b>   | <b>8.1%</b>       | <b>258.3</b>   | <b>9.6%</b>       |
| Income / (Loss) from discontinued operations, net of tax | -             | 0.0%              | -             | 0.0%              | -             | 0.0%              | -             | 0.0%              | -              | 0.0%              |
| <b>Net income</b>  | <b>31.5</b>   | <b>5.5%</b>       | <b>71.4</b>   | <b>10.6%</b>      | <b>99.0</b>   | <b>13.2%</b>      | <b>56.4</b>   | <b>8.1%</b>       | <b>258.3</b>   | <b>9.6%</b>       |
| <b>Earnings per share:</b>                               |               |                   |               |                   |               |                   |               |                   |                |                   |
| <b>From continuing operations</b>                        | <b>\$0.18</b> |                   | <b>\$0.39</b> |                   | <b>\$0.54</b> |                   | <b>\$0.31</b> |                   | <b>\$1.41</b>  |                   |
| Average common shares outstanding                        | 179           |                   | 184           |                   | 184           |                   | 184           |                   | 183            |                   |

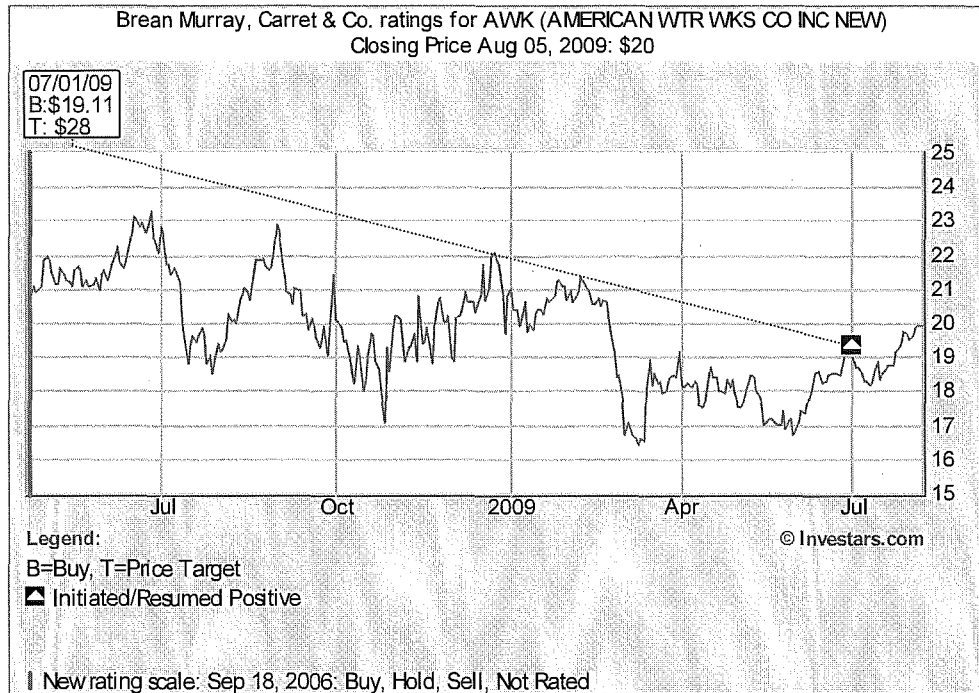
Source: Company Reports, Brean Murray, Carret & Co. estimates

**COMPANY UPDATE**

American Water Works Company, Inc. (AWK/NYSE)

**Important Disclosures**

**Ratings and Target Price History**



All prices are as of the market close on 8/5/2009.

Brean Murray, Carret & Co., LLC has managed or co-managed a public offering or placement of securities of American Water Works Company, Inc. within the past 12 months.

American Water Works Company, Inc. is, or within the last 12 months has been, a client of Brean Murray, Carret & Co., LLC, and investment banking and/or advisory services are being, or have been provided.

Brean Murray, Carret & Co., LLC expects to receive compensation or intends to seek compensation for investment banking and/or advisory services from American Water Works Company, Inc. within the next 3 months.

In the normal course of its business, Brean Murray, Carret & Co., LLC does and intends to seek compensation for investment banking and/or non-investment banking services from the companies in its coverage universe. As a result, investors should be aware that the Firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decisions. Non-U.S. research analysts that may have contributed to this report are not registered/qualified as research analysts with the FINRA.

The research analyst(s) or research associate(s) principally responsible for the preparation of this research report has received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors and firm revenues. The compensation is determined exclusively by research management and senior management (not including investment banking).

**Brean Murray, Carret & Co. Stock Rating System**

**COMPANY UPDATE**

American Water Works Company, Inc. (AWK/NYSE)

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<br>Past 12 mos. | % of Total Securities |
|--------------|-----------------|-----------------------|---|-----------------------|
| BUY          | 98              | 58.68%                | 10  | 10.2%                 |
| HOLD         | 59              | 35.33%                | 1   | 1.69%                 |
| SELL         | 8               | 4.79%                 | 0   | 0%                    |
| NOT RATED    | 2               | 1.2%                  | 0   | 0%                    |
| <b>TOTAL</b> | <b>167</b>      |                       |   |                       |

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

**Valuation Methodology and Risks**

**American Water Works (AWK):** Our \$28 target price is based on the shares achieving a P/E multiple of 20x our 2010 EPS estimate of \$1.41. Risks to the achievement of our target price include weather, acquisition integration, regulatory environment, additional equity offerings, potential goodwill impairments and changes in interest rates.

**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.

**Disclaimers**

Some companies that Brean Murray, Carret & Co., LLC follows are emerging growth companies whose securities typically involve a higher degree of risk and more volatility than the securities of more established companies. The securities discussed in Brean Murray, Carret & Co., LLC research reports may not be suitable for some investors. Investors must make their own determination as to the appropriateness of an investment in any securities referred to herein, based on their specific investment objectives, financial status and risk tolerance. This report may discuss numerous securities, some of which may not be qualified for sale in certain states and to certain categories of investors. Readers are advised that this analysis report is issued solely for informational purposes and is not to be construed as an offer to sell or the solicitation of an offer to buy. The information contained herein is based on sources which we believe to be reliable but is not guaranteed by us as being accurate and does not purport to be a complete statement or summary of the available data on the company, industry or security discussed in the report. Designated trademarks and brands are the property of their respective owners. Past performance is no guarantee of future results. Any opinions expressed herein are statements of our judgment as of the date of publication and are subject to change without notice. Entities including but not limited to the Firm, its officers, directors, employees, customers, affiliates may have a position, long or short, in the securities referred to herein, and/or other related securities, and from time to time may increase or decrease such position or take a contra position. The Firm (or persons related thereto) may make a market in the securities mentioned herein, and may from time to time perform investment banking or other services for, or solicit investment banking or other business from, and may have other relationships with any company mentioned in this report. Brean Murray, Carret & Co., LLC is a member of SIPC, FINRA, licensed with various state securities regulatory authorities, and a registered U.S. Broker-Dealer. No part of this report may be reproduced in any form without the express permission of Brean Murray, Carret & Co., LLC. Additional information is available upon request.

**INDUSTRY UPDATE**

**Water Utilities, Flow Technology and Purification**

October 16, 2009

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**Quarterly Water Industry Preview**

Brean Murray, Carret & Co. Universe Companies Mentioned in This Report

| Company                            | Ticker | Rating | Price   | Target  | 09E EPS / (P/E) | 10E EPS / (P/E) |
|------------------------------------|--------|--------|---------|---------|-----------------|-----------------|
| American Water Works Company, Inc. | AWK    | Buy    | \$19.76 | \$28.00 | \$1.32 (15.0x)  | \$1.39 (14.2x)  |
| American States Water Company      | AWR    | Buy    | \$36.26 | \$42.00 | \$1.92 (18.9x)  | \$2.32 (15.6x)  |
| Calgon Carbon Corp.                | CCC    | Buy    | \$16.29 | \$17.00 | \$0.50 (32.6x)  | \$0.83 (19.6x)  |
| Consolidated Water Co., Ltd.       | CWCO   | Buy    | \$14.67 | \$24.00 | \$0.80 (18.3x)  | \$1.00 (14.7x)  |
| California Water Service Group     | CWT    | Buy    | \$39.63 | \$44.00 | \$2.16 (18.3x)  | \$2.30 (17.2x)  |
| IDEX Corp.                         | IEX    | Sell   | \$29.33 | \$16.00 | \$1.43 (20.5x)  | \$1.61 (18.2x)  |
| Met-Pro Corp.                      | MPR    | Hold   | \$9.51  | NA      | \$0.65A (14.6x) | \$0.40 (23.8x)  |
| Mueller Water Products, Inc.       | MWA    | Buy    | \$5.50  | \$8.00  | \$-0.34 (NA)    | \$0.05 (110.0x) |
| Sabesp                             | SBS    | Buy    | \$43.32 | \$66.00 | \$7.17 (6.0x)   | \$7.36 (5.9x)   |
| SJW Corp.                          | SJW    | Hold   | \$22.79 | NA      | \$0.76 (30.0x)  | \$1.02 (22.3x)  |
| Southwest Water Co.                | SWWC   | Hold   | \$5.44  | NA      | \$0.18 (30.2x)  | \$0.38 (14.3x)  |
| Veolia Environnement SA            | VE     | Hold   | \$35.34 | NA      | \$1.54 (22.9x)  | \$2.14 (16.5x)  |
| Aqua America, Inc.                 | WTR    | Buy    | \$16.59 | \$26.00 | \$0.78 (21.3x)  | \$0.95 (17.5x)  |
| Watts Water Technologies, Inc.     | WTS    | Hold   | \$31.18 | NA      | \$1.40 (22.3x)  | \$1.68 (18.6x)  |
| The York Water Company             | YORW   | Buy    | \$14.73 | \$18.00 | \$0.65 (22.7x)  | \$0.65 (22.7x)  |

## INDUSTRY UPDATE

### Water Utilities, Flow Technology and Purification

#### Distribution

**Defined.** The Distribution segment comprises those companies with more than 75% of total revenues derived from providing potable water service. For the U.S.-based companies, customer rates are regulated.

**Outlook.** We remain positive on both the short- and long-term fundamentals for the majority of our Distribution coverage universe. Rate case filings have been timely, regulatory awards have largely met expectations, and capex trends to build its rate base have been tracking higher. Municipal budget problems brought on by declining tax receipts should create a more conducive environment for acquisitions by the publicly traded players in the space, due to their superior access to capital markets and economies of scale. That said, weather impacts (drought conditions in California, extremely wet conditions during the past six months in the Northeast region) are presenting challenges to achieving maximum EPS for many.

**Names to Watch: American Water Works (AWK), Aqua America (WTR), and Sabesp (SBS).**

#### Flow Technology

**Defined.** The Flow Technology segment comprises those companies with products that are involved in the transmission of water, including the residential, municipal, commercial or industrial end markets. Products typically falling within this category include pipes, pumps and valves.

**Outlook.** We consider valuations within this sector to be extremely rich at current levels. Many names are trading at or near historically high forward P/E levels, despite continued weak economic conditions and relatively high raw material costs, particularly copper. In our view, this segment holds the highest risk for a significant pullback in share prices, particularly if the overall market pulls back from its YTD 20%+ gains. We like the group long term, but recommend investors await a better entrance point from positive identifiable catalysts on a name-by-name basis before considering adding to or taking new positions with the exception of Mueller Water Products, which we are upgrading to Buy from Hold.

**Names to Watch: Watts Water Technologies (WTS) Mueller Water Products (MWA).**

#### Water Solutions

**Defined.** The Water Solutions segment comprises those companies involved in solving complex water problems (disinfection or purification, which includes desalination and filtration technologies).

**Outlook.** Although valuations have moved up along with the recent general market rallies, we still see excellent values within this segment. Fundamentals are strengthening for some of our covered names, and several have significant, identifiable catalysts to maintain EPS and share momentum to the upside.

**Names to Watch: Calgon Carbon Corp (CCC), Consolidated Water (CWCO).**



**INDUSTRY UPDATE**

**Water Utilities, Flow Technology and Purification**

**Exhibit 1: Quarterly EPS Estimate Tables**

**Distribution**

| Company               | Trading Data |                   |               | 3Q09            |            |               |               | FISCAL YEAR 2009 |            |               |               | FISCAL YEAR 2010 |               |               |
|-----------------------|--------------|-------------------|---------------|-----------------|------------|---------------|---------------|------------------|------------|---------------|---------------|------------------|---------------|---------------|
|                       | Symbol       | Price<br>10/14/09 | Market<br>Cap | YEAR AGO<br>QTR | BMC<br>EST | STREET<br>EST | Q/Q<br>GROWTH | YEAR<br>AGO      | BMC<br>EST | STREET<br>EST | Y/Y<br>GROWTH | BMC<br>EST       | STREET<br>EST | Y/Y<br>GROWTH |
| SABESP                | SBS          | \$42.64           | 4,857         | \$1.06          | \$1.94     | \$1.23        | 83%           | \$4.98           | \$7.17     | \$6.79        | 44%           | \$7.36           | \$4.83        | 3%            |
| AMERICAN WATER WORKS  | AWK          | \$19.82           | 3,460         | \$0.55          | \$0.51     | \$0.55        | -7%           | \$1.16           | \$1.32     | \$1.32        | 14%           | \$1.39           | \$1.46        | 6%            |
| AQUA AMERICA          | WTR          | \$16.81           | 2,285         | \$0.26          | \$0.24     | \$0.26        | -9%           | \$0.73           | \$0.78     | \$0.81        | 7%            | \$0.95           | \$0.91        | 21%           |
| CALIFORNIA WATER      | CWT          | \$39.55           | 820           | \$1.06          | \$0.98     | \$1.05        | -8%           | \$1.90           | \$2.16     | \$2.10        | 14%           | \$2.30           | \$2.17        | 6%            |
| AMERICAN STATES WATER | AWR          | \$36.29           | 665           | \$0.39          | \$0.55     | \$0.54        | 40%           | \$1.56           | \$1.92     | \$1.83        | 23%           | \$2.32           | \$2.01        | 21%           |
| SIW                   | SIW          | \$22.47           | 415           | \$0.44          | \$0.34     | \$0.40        | -23%          | \$1.16           | \$0.76     | \$0.80        | -35%          | \$1.02           | \$1.08        | 34%           |
| SOUTHWEST WATER       | SWWC         | \$5.45            | 136           | -\$0.02         | \$0.08     | \$0.08        | -517%         | -\$0.19          | \$0.18     | \$0.10        | -196%         | \$0.38           | \$0.39        | 107%          |
| MIDDLESEX WATER       | MSEX         | \$3.28            | 206           | \$0.35          | NA         | \$0.29        | -17%          | \$0.90           | NA         | \$0.69        | -23%          | NA               | \$0.79        | 14%           |
| CONNECTICUT WATER     | CTWS         | \$22.74           | 194           | \$0.34          | NA         | \$0.47        | 88%           | \$1.12           | NA         | \$1.08        | -4%           | NA               | \$1.06        | -2%           |
| YORK WATER            | YORW         | \$14.26           | 163           | \$0.15          | \$0.18     | \$0.20        | 19%           | \$0.57           | \$0.65     | \$0.67        | 14%           | \$0.65           | \$0.70        | 1%            |
| ARTESIAN RESOURCES    | ARTNA        | \$16.77           | 110           | \$0.35          | NA         | \$0.38        | 9%            | \$0.85           | NA         | \$1.07        | 24%           | NA               | \$1.11        | 4%            |
| PURE CYCLE            | PCYO         | \$3.24            | 65            | -\$0.06         | NA         | -\$0.06       | 0%            | -\$0.34          | NA         | -\$0.28       | -18%          | NA               | -\$2.40       | 757%          |
| PENNICHUCK            | PNNW         | \$28.86           | 102           | \$0.21          | NA         | \$0.32        | 52%           | \$0.57           | NA         | \$0.59        | 4%            | NA               | \$0.76        | 29%           |
| <b>MEDIAN</b>         |              |                   | <b>206</b>    |                 |            |               | <b>0%</b>     |                  |            |               | <b>7%</b>     |                  |               | <b>14%</b>    |

Source: Company reports, Thomson Baseline, and Brean Murray, Carret & Co. estimates

**Flow Technology**

| Company                  | Trading Data |                   |               | SEP 09          |            |               |               | FISCAL YEAR 2009 |            |               |               | FISCAL YEAR 2010 |               |               |
|--------------------------|--------------|-------------------|---------------|-----------------|------------|---------------|---------------|------------------|------------|---------------|---------------|------------------|---------------|---------------|
|                          | Symbol       | Price<br>10/14/09 | Market<br>Cap | YEAR AGO<br>QTR | BMC<br>EST | STREET<br>EST | Q/Q<br>GROWTH | YEAR<br>AGO      | BMC<br>EST | STREET<br>EST | Y/Y<br>GROWTH | BMC<br>EST       | STREET<br>EST | Y/Y<br>GROWTH |
| EMERSON ELECTRIC         | EMR          | \$39.87           | 29,966        | \$0.88          | NA         | \$0.60        | -32%          | \$3.15           | NA         | \$2.20        | -30%          | NA               | \$2.01        | -9%           |
| ITT                      | ITT          | \$54.87           | 10,008        | \$1.12          | NA         | \$0.90        | -20%          | \$4.04           | NA         | \$3.65        | -10%          | NA               | \$3.81        | 4%            |
| FLOWSWERVE               | FLS          | \$105.95          | 5,925         | \$1.94          | NA         | \$2.00        | 3%            | \$7.29           | NA         | \$7.57        | 4%            | NA               | \$7.17        | -5%           |
| SPX                      | SPW          | \$59.92           | 2,912         | \$1.65          | NA         | \$0.85        | -49%          | \$6.52           | NA         | \$3.97        | -39%          | NA               | \$3.94        | -1%           |
| ROPER INDUSTRIES         | ROP          | \$52.07           | 4,729         | \$0.82          | NA         | \$0.64        | -22%          | \$3.10           | NA         | \$2.61        | -16%          | NA               | \$2.77        | 6%            |
| PENTAIR                  | PNR          | \$32.27           | 3,173         | \$0.55          | NA         | \$0.41        | -25%          | \$2.17           | NA         | \$1.42        | -35%          | NA               | \$1.73        | 22%           |
| IEX                      | IEX          | \$29.47           | 2,379         | \$0.53          | \$0.35     | \$0.35        | -34%          | \$2.00           | \$1.38     | \$1.41        | -31%          | \$1.60           | \$1.61        | 16%           |
| CRANE COMPANY            | CR           | \$27.64           | 1,616         | \$0.60          | NA         | \$0.48        | -20%          | \$2.88           | NA         | \$1.89        | -34%          | NA               | \$2.08        | 10%           |
| ITRON                    | ITRI         | \$60.53           | 2,421         | \$0.81          | NA         | \$0.52        | -36%          | \$3.36           | NA         | \$2.12        | -37%          | NA               | \$3.23        | 52%           |
| WATTS WATER TECHNOLOGIES | WTS          | \$31.07           | 914           | \$0.48          | \$0.42     | \$0.37        | -12%          | \$1.83           | \$1.40     | \$1.31        | -24%          | \$1.68           | \$1.45        | 21%           |
| MUELLER INDUSTRIES       | MLI          | \$25.74           | 960           | \$0.56          | NA         | \$0.22        | -61%          | \$2.23           | NA         | \$0.49        | -78%          | NA               | \$1.40        | 186%          |
| AMERON INT'L             | AMN          | \$69.41           | 640           | \$1.91          | NA         | \$0.63        | -67%          | \$6.39           | NA         | \$2.72        | -57%          | NA               | \$4.48        | 65%           |
| ROBBINX & MYERS          | RBN          | \$28.44           | 770           | \$0.74          | NA         | \$0.20        | -73%          | \$2.20           | NA         | \$1.47        | -33%          | NA               | \$1.19        | -19%          |
| MUELLER WATER PRODUCTS   | MWA          | \$5.50            | 641           | \$0.15          | -\$0.04    | -\$0.08       | -125%         | \$0.46           | -\$0.34    | -\$0.35       | -173%         | \$0.05           | \$0.06        | NA            |
| FRANKLIN ELECTRIC        | FELE         | \$27.56           | 636           | \$0.74          | NA         | \$0.51        | -31%          | \$1.96           | NA         | \$1.49        | -24%          | NA               | \$1.88        | 26%           |
| CIRCOR INT'L             | CIR          | \$29.61           | 503           | \$1.16          | NA         | \$0.30        | -74%          | \$4.12           | NA         | \$1.63        | -60%          | NA               | \$1.82        | 12%           |
| BADGER METER             | BMI          | \$39.61           | 590           | \$0.39          | NA         | \$0.44        | 13%           | \$1.70           | NA         | \$1.83        | 8%            | NA               | \$1.94        | 6%            |
| INSITUFORM               | INSU         | \$19.46           | 756           | \$0.28          | NA         | \$0.32        | 14%           | \$0.77           | NA         | \$0.96        | 25%           | NA               | \$1.14        | 19%           |
| NORTHWEST PIPE           | NWXP         | \$35.01           | 323           | \$1.09          | NA         | \$0.28        | -74%          | \$3.45           | NA         | \$1.18        | -66%          | NA               | \$2.28        | 93%           |
| ENERGY RECOVERY          | ERII         | \$6.06            | 304           | \$0.01          | NA         | \$0.00        | -100%         | NA               | NA         | \$0.11        | NA            | NA               | \$0.20        | 82%           |
| DXP ENTERPRISES          | DXPE         | \$11.74           | 151           | \$0.51          | NA         | \$0.18        | -65%          | \$1.89           | NA         | \$0.77        | -59%          | NA               | \$1.13        | 47%           |
| <b>MEDIAN</b>            |              |                   | <b>914</b>    |                 |            |               | <b>-34%</b>   |                  |            |               | <b>-34%</b>   |                  |               | <b>17%</b>    |

\* November  
\*\* August

Source: Company reports, Thomson Baseline, and Brean Murray, Carret & Co. estimates

**INDUSTRY UPDATE**

**Water Utilities, Flow Technology and Purification**

**Water Solutions**

| Company              | Trading Data |                   |               | SEP 09          |            |               |               | FISCAL YEAR 2009 |            |               |               | FISCAL YEAR 2010 |               |               |
|----------------------|--------------|-------------------|---------------|-----------------|------------|---------------|---------------|------------------|------------|---------------|---------------|------------------|---------------|---------------|
|                      | Symbol       | Price<br>10/14/09 | Market<br>Cap | YEAR AGO<br>QTR | BMC<br>EST | STREET<br>EST | Q/Q<br>GROWTH | YEAR<br>AGO      | BMC<br>EST | STREET<br>EST | Y/Y<br>GROWTH | BMC<br>EST       | STREET<br>EST | Y/Y<br>GROWTH |
| GENERAL ELECTRIC     | GE           | \$16.84           | 178,956       | \$0.45          | NA         | \$0.20        | -56%          | \$1.94           | NA         | \$0.97        | -50%          | NA               | \$0.89        | -8%           |
| VEOLIA ENVIRONNEMENT | VE           | \$35.65           | 17,597        | NA              | NA         | NA            | NA            | \$1.07           | \$1.54     | \$1.74        | 44%           | \$2.14           | \$2.26        | 99%           |
| DANAHER              | DHR          | \$69.65           | 22,270        | \$1.14          | NA         | \$0.86        | -25%          | \$4.23           | NA         | \$3.37        | -20%          | NA               | \$3.72        | 10%           |
| AIR PRODUCTS & CHEM  | APD          | \$83.58           | 17,559        | \$1.25          | NA         | \$1.12        | -9%           | \$4.97           | NA         | \$4.05        | -19%          | NA               | \$4.74        | 18%           |
| NALCO HOLDING        | NLC          | \$22.85           | 3,157         | \$0.30          | NA         | \$0.25        | -17%          | \$1.30           | NA         | \$0.80        | -38%          | NA               | \$1.18        | 48%           |
| ASHLAND              | ASH          | \$43.01           | 3,201         | -\$0.01         | NA         | \$0.90        | NA            | \$2.30           | NA         | \$9.05        | 33%           | NA               | \$3.24        | 6%            |
| TETRA TECH           | TTEK         | \$26.75           | 1,620         | \$0.30          | NA         | \$0.32        | 7%            | \$1.02           | NA         | \$1.42        | 39%           | NA               | \$1.37        | -4%           |
| ARCH CHEMICALS       | ARJ          | \$30.69           | 769           | \$0.40          | NA         | \$0.33        | -18%          | \$2.18           | NA         | \$1.70        | -22%          | NA               | \$2.08        | 22%           |
| LAYNE CHRISTENSEN    | LAYN         | \$29.91           | 582           | \$0.65          | NA         | \$0.20        | -68%          | \$2.20           | NA         | \$0.62        | -72%          | NA               | \$0.95        | 53%           |
| CALGON CARBON        | CCC          | \$16.13           | 883           | \$0.12          | \$0.14     | \$0.13        | 13%           | \$0.56           | \$0.50     | \$0.50        | -11%          | \$0.83           | \$0.92        | 66%           |
| CASCAL               | HOO          | \$6.00            | 183           | \$0.17          | NA         | \$0.20        | 18%           | \$0.58           | NA         | \$0.62        | 7%            | NA               | \$0.64        | 3%            |
| CONSOLIDATED WATER   | CWCO         | \$15.00           | 218           | \$0.12          | \$0.16     | \$0.17        | 37%           | \$0.50           | \$0.80     | \$0.78        | 61%           | \$1.00           | \$0.82        | 25%           |
| CANTEL MEDICAL       | CMN          | \$16.86           | 280           | \$0.18          | NA         | \$0.22        | 22%           | \$0.59           | NA         | \$0.90        | 53%           | NA               | \$0.93        | 3%            |
| BARNWELL INDUSTRIES  | BRN          | \$5.85            | 48            | \$0.38          | NA         | NA            | NA            | \$1.28           | NA         | NA            | NA            | NA               | NA            | NA            |
| <b>MEDIAN</b>        |              |                   | <b>1,252</b>  |                 |            |               | <b>-9%</b>    |                  |            |               | <b>-11%</b>   |                  |               | <b>18%</b>    |

\* October  
\*\* July

Source: Company reports, Thomson Baseline, and Brean Murray, Carret & Co. estimates

**Water Solutions – Filtration**

| Company       | Trading Data |                   |               | SEP 09          |            |               |               | FISCAL YEAR 2009 |            |               |               | FISCAL YEAR 2010 |               |               |
|---------------|--------------|-------------------|---------------|-----------------|------------|---------------|---------------|------------------|------------|---------------|---------------|------------------|---------------|---------------|
|               | Symbol       | Price<br>10/14/09 | Market<br>Cap | YEAR AGO<br>QTR | BMC<br>EST | STREET<br>EST | Q/Q<br>GROWTH | YEAR<br>AGO      | BMC<br>EST | STREET<br>EST | Y/Y<br>GROWTH | BMC<br>EST       | STREET<br>EST | Y/Y<br>GROWTH |
| 3M COMPANY    | MMM          | \$76.57           | 53,470        | \$1.42          | NA         | \$1.16        | -18%          | \$5.16           | NA         | \$4.23        | -18%          | NA               | \$4.58        | 8%            |
| SHAW GROUP    | SHAW         | \$32.57           | 2,722         | \$0.77          | NA         | \$0.48        | -38%          | \$2.40           | NA         | \$2.00        | -17%          | NA               | \$2.38        | 19%           |
| FALL          | PLL          | \$33.54           | 3,921         | \$0.40          | NA         | \$0.42        | 5%            | \$1.77           | NA         | \$1.95        | 10%           | NA               | \$2.30        | 18%           |
| MILLIPORE     | MIL          | \$72.19           | 4,010         | \$0.93          | NA         | \$0.93        | 0%            | \$3.60           | NA         | \$3.95        | 10%           | NA               | \$4.38        | 11%           |
| CLARCOR       | CLC          | \$31.17           | 1,569         | \$0.56          | NA         | \$0.45        | -20%          | \$1.87           | NA         | \$1.37        | -27%          | NA               | \$1.64        | 20%           |
| LYDALL        | LDL          | \$5.06            | 85            | \$0.10          | NA         | \$0.05        | -50%          | \$0.37           | NA         | \$0.05        | -86%          | NA               | \$0.28        | 460%          |
| MET-PRO       | MPR          | \$9.55            | 139           | \$0.20          | \$0.12     | \$0.12        | -39%          | \$0.66           | \$0.65     | \$0.66        | -2%           | \$0.40           | \$0.39        | -40%          |
| <b>MEDIAN</b> |              |                   | <b>2,722</b>  |                 |            |               | <b>-20%</b>   |                  |            |               | <b>-17%</b>   |                  |               | <b>18%</b>    |

\* August  
\*\* October  
\*\*\* November

Source: Company reports, Thomson Baseline, and Brean Murray, Carret & Co. estimates

**INDUSTRY UPDATE**

**Water Utilities, Flow Technology and Purification**

**Exhibit 2: Comparative Valuation Statistics**

| Water Utilities<br>Comparative Valuation Statistics |          | Rating Data |         |       |         |              |                |              |             |             |            | Trading & Market Data |         |      |      |       |       |      |          |            |       | Valuation Statistics |       |       |       |       |       |   |  |  |  |
|---|----------|-------------|---------|-------|---------|--------------|----------------|--------------|-------------|-------------|------------|-----------------------|---------|------|------|-------|-------|------|----------|------------|-------|----------------------|-------|-------|-------|-------|-------|---|--|--|--|
| Symbol  | Price \$ | BMC         | Analyst | Price | Disc To | Daily Volume | Market Capital | 52-Week High | 52-Week Low | Avg. Volume | Free Float | Institutional         | Insider | Hldg | Hldg | Short | Beta  | TEV  | Mkt/Book | TEV/EBITDA | 2009E | 2010E                | 2011E | 2009E | 2010E | 2011E | P/EPs |   |  |  |  |
|   |          |             |         |       | Target  | 1000         | \$ (mil)       | \$           | \$          | (mil)       | (mil)      | %                     | %       | %    | %    | %     | X     | \$   | X        | X          | X     | X                    | X     | X     | X     | X     | X     | X |  |  |  |
| SABESP  | \$42.64  | Buy         | 1       | 66.00 | 95%     | 867          | 4,897          | 49           | 15          | 114         | NA         | NA                    | NA      | NA   | 2    | 1.5   | 7,796 | 0.9  | NA       | NA         | NA    | NA                   | 6.3   | 8.83  | NA    |       |       |   |  |  |  |
| AMERICAN WATER WORKS                                | \$19.82  | Buy         | 12      | 28.00 | 41%     | 833          | 3,460          | 22           | 16          | 175         | 161        | NA                    | NA      | 2    | NA   | NA    | 8,795 | 2.1  | 10.5     | 9.2        | 8.4   | 20.8                 | 18.5  | 17.2  |       |       |       |   |  |  |  |
| AQUA AMERICA  | \$18.81  | Buy         | 12      | 26.00 | 95%     | 1,158        | 2,285          | 22           | 14          | 186         | 186        | 1%                    | 46%     | 17   | 0.3  | 3,628 | 2.0   | 9.0  | 8.6      | 7.8        | 18.8  | 18.2                 | 16.4  |       |       |       |       |   |  |  |  |
| CALIFORNIA WATER                                    | \$39.55  | Buy         | 8       | 44.00 | 11%     | 44           | 820            | 48           | 29          | 21          | 20         | 1%                    | 50%     | 5    | 0.3  | 1,177 | 1.9   | 8.9  | 7.9      | NA         | 19.8  | 18.1                 | 17.1  |       |       |       |       |   |  |  |  |
| AMERICAN STATES WATER                               | \$36.29  | Buy         | 3       | 42.00 | 16%     | 41           | 665            | 39           | 27          | 18          | 18         | 1%                    | 59%     | 7    | 0.8  | 661   | 1.7   | NA   | NA       | NA         | NA    | 28.1                 | 20.8  | 18.7  |       |       |       |   |  |  |  |
| SIW   | \$22.47  | Hold        | 3       |       |         | 39           | 415            | 30           | 18          | 11          | 2%         | 46%                   | 7       | 0.8  | 661  | 1.1   | 9.7   | 7.6  | NA       | NA         | 54.5  | 14.0                 | NA    |       |       |       |       |   |  |  |  |
| SOUTHWEST WATER                                     | \$5.45   | Hold        | 3       |       |         | 73           | 136            | 11           | 3           | 25          | 23         | 9%                    | 43%     | 3    | 0.5  | 287   | 1.5   | 15.5 | 14.0     | NA         | NA    | 21.1                 | 21.45 | 17.1  |       |       |       |   |  |  |  |
| MIDDLESEX WATER                                     | \$15.28  | NR          | 3       |       |         | 30           | 206            | 18           | 12          | 13          | 12         | 3%                    | 36%     | 8    | 0.6  | 377   | 2.3   | 7.6  | 7.2      | NA         | NA    | 21.3                 | 20.7  | 15.1  | NA    |       |       |   |  |  |  |
| CONNECTICUT WATER                                   | \$22.74  | NR          | 3       |       |         | 11           | 194            | 27           | 17          | 9           | 9          | 2%                    | 33%     | 13   | 0.6  | 304   | 1.3   | NA   | NA       | NA         | NA    | 11.6                 | -13.5 | -18.0 |       |       |       |   |  |  |  |
| YORK WATER  | \$14.56  | Buy         | 4       | 18.00 | 26%     | 30           | 163            | 18           | 10          | 11          | 11         | 2%                    | 21%     | 7    | 0.7  | 163   | 1.3   | NA   | NA       | NA         | NA    | 40.4                 | 31.4  | 29.5  |       |       |       |   |  |  |  |
| ARTESIAN RESOURCES                                  | \$16.77  | NR          | 0       |       |         | 8            | 110            | 18           | 13          | 7           | 7          | 3%                    | 51%     | 4    | 0.4  | 241   | 2.2   | 13.6 | 12.1     | NA         | NA    | 20.8                 | 18.2  | 17.1  |       |       |       |   |  |  |  |
| PURE CYCLE  | \$3.24   | NR          | 1       |       |         | 3            | 65             | 6            | 2           | 20          | 14         | 0%                    | 49%     | 5    | 0.6  | 120   | 1.7   | 9.4  | 8.5      | 7.9        | 20.8  | 18.2                 | 17.1  |       |       |       |       |   |  |  |  |
| PENNICHUCK  | \$23.86  | NR          | 2       |       |         | 14           | 102            | 25           | 15          | 4           | 4          | 1%                    | 64%     | 9    | 0.3  | 168   | 1.7   | 9.4  | 8.5      | 7.9        | 20.8  | 18.2                 | 17.1  |       |       |       |       |   |  |  |  |
| MEDIAN  |          |             |         |       |         | 39           | 206            |              |             |             |            | 2%                    | 46%     | 7    | 0.5  |       |       |      |          |            |       |                      |       |       |       |       |       |   |  |  |  |

| Rating Data           |          |      |         |       |         |              |                |              |             | Liquidity and Profitability Ratios |            |               |         |      |      |       |       |       |          |            |       |       |       |       |       |       |       |
|-----------------------|----------|------|---------|-------|---------|--------------|----------------|--------------|-------------|------------------------------------|------------|---------------|---------|------|------|-------|-------|-------|----------|------------|-------|-------|-------|-------|-------|-------|-------|
| Symbol                | Price \$ | BMC  | Analyst | Price | Disc To | Daily Volume | Market Capital | 52-Week High | 52-Week Low | Avg. Volume                        | Free Float | Institutional | Insider | Hldg | Hldg | Short | Beta  | TEV   | Mkt/Book | TEV/EBITDA | 2009E | 2010E | 2011E | 2009E | 2010E | 2011E | P/EPs |
|                       |          |      |         |       | Target  | 1000         | \$ (mil)       | \$           | \$          | (mil)                              | (mil)      | %             | %       | %    | %    | %     | X     | \$    | X        | X          | X     | X     | X     | X     | X     | X     | X     |
| SABESP                | 0.00     | 0.0% | 0%      | 28%   | 8%      | 0.00         | 0.0%           | 26           | 0.7         | 0.7                                | 6          | 9%            | 11%     | 13%  | 12%  | 12%   | 12%   | 0     | NA       | NA         | NA    | NA    | 6.79  | 4.83  |       |       |       |
| AMERICAN WATER WORKS  | 42%      | 0%   | 0%      | 54%   | 4%      | 0.84         | 4.2%           | NA           | 0.6         | 0.3                                | 3          | -3%           | -13%    | -14% | -18% | -18%  | 1     | 22.50 | 93       | 1094       | 1116  | 1.31  | 1.46  | 1.56  |       |       |       |
| AQUA AMERICA          | 40%      | 0%   | 0%      | 51%   | 5%      | 0.68         | 3.5%           | 71           | 0.6         | 0.5                                | 5          | 4%            | 10%     | 4%   | 4%   | 1     | 7.91  | 345   | 399      | 481        | 2.10  | 0.91  | 0.98  |       |       |       |       |
| CALIFORNIA WATER      | 53%      | 0%   | 0%      | 48%   | 2%      | 1.18         | 3.0%           | 56           | 1.2         | 0.5                                | 6          | 4%            | 10%     | -5%  | 5%   | 5     | 19.56 | 181   | 138      | 152        | 2.10  | 2.17  | 2.41  |       |       |       |       |
| AMERICAN STATES WATER | 50%      | 0%   | 0%      | 46%   | 2%      | 0.66         | 2.9%           | 72           | 1.1         | 0.4                                | 4          | 4%            | 7%      | -7%  | 5%   | 1     | 19.13 | 110   | 123      | NA         | 1.83  | 2.01  | 2.12  |       |       |       |       |
| SIW                   | 44%      | 0%   | 0%      | 49%   | 1%      | 0.71         | 4.6%           | NA           | 1.7         | 0.7                                | 2          | -3%           | -23%    | -25% | -24% | 0     | 18.39 | NA    | NA       | NA         | NA    | 0.80  | 1.08  | 1.20  |       |       |       |
| SOUTHWEST WATER       | 44%      | 1%   | 0%      | 41%   | 18%     | 0.51         | 4.0%           | 93           | 0.6         | 0.4                                | 4          | 4%            | 9%      | 8%   | 6%   | 1     | 10.26 | 24    | 27       | NA         | NA    | 0.71  | 0.81  |       |       |       |       |
| MIDDLESEX WATER       | 48%      | 0%   | 0%      | 43%   | 8%      | 0.50         | 3.5%           | 80           | 0.4         | 0.4                                | 4          | 4%            | 9%      | -11% | 4%   | (12)  | 12.21 | 18    | 17       | NA         | 1.08  | 1.06  | 1.93  |       |       |       |       |
| CONNECTICUT WATER     | 40%      | 0%   | 0%      | 48%   | 11%     | 0.71         | 4.2%           | 71           | 0.3         | 0.3                                | 4          | 3%            | 7%      | -28% | 5%   | 4     | 6.22  | 21    | 23       | NA         | 0.67  | 0.69  |       |       |       |       |       |
| ARTESIAN RESOURCES    | 45%      | 0%   | 0%      | 54%   | 0%      | 0.00         | 0.0%           | 0            | 21.6        | 32.8                               | 0          | -6%           | -13%    | -3%  | -10% | 1     | 12.00 | 27    | 28       | NA         | 1.07  | 1.11  |       |       |       |       |       |
| PURE CYCLE            | 41%      | 0%   | 0%      | 48%   | 11%     | 0.70         | 2.9%           | NA           | 0.5         | 0.6                                | 2          | 4%            | 10%     | -6%  | 5%   | 1     | 2.40  | NA    | NA       | NA         | NA    | -0.28 | -0.24 | -0.18 |       |       |       |
| PENNICHUCK            | 47%      | 0%   | 0%      | 49%   | 9%      | \$0.70       | 3.0%           | 72           | 0.6         | 0.4                                | 4          | 4%            | 9%      | -6%  | 5%   | 1     | 11.05 | 12    | 14       | NA         | 0.59  | 0.76  | 0.81  |       |       |       |       |

Source: Company reports, Thomson Baseline, and Brean Murray, Carret & Co. estimates

Flow Technology Comparative Valuation Statistics

Michael Gaugler, 212-702-6539 gauglem@bmr.com

Rating Data: Table with columns for Symbol, Price, Analyst, Rating, Coverage, Target, and Disc To.

Trading & Market Data: Table with columns for Daily Volume, Market Capital, S2-Week High/Low, Avg Price, Free Float, Insider Hold, Inst. % of Float, Beta, and TEV.

Valuation Statistics: Table with columns for Mat/Book, TEV/EBITDA, and P/EPs ratios across different metrics.

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Balance Sheet and Credit Ratings: Table with columns for Common Equity, Pref Stock, Minority Interest, LT Debt, and ST Debt.

Liquidity and Profitability Ratios: Table with columns for Annual Rate, Div Yield, Payout Ratio, Current Ratio, Quick Ratio, Coverage, 2008 ROE, 2008 FCF2008 EPS, and 2010 PEG.

Financial Statistics/Estimates: Table with columns for Book Value, EBITDA, and EPS estimates for 2009E and 2010E.

Source: Company reports, Thomson Baseline, and Brean Murray, Carret & Co. estimates

| Water Solutions<br>Comparative Valuation Statistics |                   | Michael Gaugler, 212-702-6539 gauglerm@bmmur.com |         |                 |                   |                 |                                 |                 |                |                         |                        | Valuation Statistics |                     |             |                   | P/EPS        |             |       |       |        |       |                                  |        |      |       |      |    |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
|---|-------------------|--|---------|-----------------|-------------------|-----------------|---------------------------------|-----------------|----------------|-------------------------|------------------------|----------------------|---------------------|-------------|-------------------|--------------|-------------|-------|-------|--------|-------|----------------------------------|--------|------|-------|------|----|------------------------------------|--|--|--|--|--|--------------------------------|--|--|--|--|--|--|--|--|
| Symbol  | Price<br>10/14/09 | BMC<br>Rating                                    | Analyst | Price<br>Target | Disc To<br>Target | Daily<br>Volume | Market<br>Cap<br>1,000 \$ (mil) | 52-Week<br>High | 52-Week<br>Low | Avg<br>Shs Out<br>(mil) | Free<br>Float<br>(mil) | Inst. % of Float     | Short<br>% of Float | Beta        | TEV<br>\$ (mil)   | Mkt/<br>Book | TEV/EBITDA  | 2009E | 2010E | 2011E  | 2009E | 2010E                            | 2011E  |      |       |      |    |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
|   |                   |  |         |                 |                   |                 |                                 |                 |                |                         |                        |                      |                     |             |                   |              |             |       |       |        |       | Trading & Market Data            |        |      |       |      |    | Financial Statistics/Estimates     |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
|   |                   |  |         |                 |                   |                 |                                 |                 |                |                         |                        |                      |                     |             |                   |              |             |       |       |        |       | Balance Sheet and Credit Ratings |        |      |       |      |    | Liquidity and Profitability Ratios |  |  |  |  |  | Financial Statistics/Estimates |  |  |  |  |  |  |  |  |
| Common<br>Equity                                    | Pref<br>Stock     | Minority   | IT      | ST              | Debt              | %               | Annual<br>Rate                  | Div<br>Yield    | Div<br>Payout  | Current<br>Ratio        | Quick<br>Ratio         | Interest<br>Coverage | 2008<br>ROA         | 2008<br>ROE | 2008<br>FCF Yield | 2008<br>EPS  | 2010<br>P/E | 2009E | 2010E | 2011E* | 2009E | 2010E                            | 2011E* |      |       |      |    |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
| GENERAL ELECTRIC                                    | 18%               | 0%   | 1%      | 53%             | 28%               | 0.40            | 2.4%                            | 63              | 0.6            | 0.4                     | 2                      | 4%                   | 16%                 | 11%         | 11%               | 10.55        | 31133       | 29994 | 32943 | 0.97   | 0.91  | 1.22                             | 18.3   | 17.4 | 18.51 | 13.8 |    |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
| VEOLIA ENVIRONNEMENT                                | 22%               | 0%   | 8%      | 58%             | 12%               | 1.69            | 4.7%                            | NA              | 1.1            | 1.0                     | NA                     | 2%                   | 6%                  | -5%         | 2%                | 21.55        | 6065        | NA    | NA    | 1.74   | 1.74  | 2.26                             | 20.3   | 15.8 | 13.7  | 13.8 |    |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
| DANABER   | 78%               | 0%   | 0%      | 21%             | 0%                | 1.12            | 0.2%                            | 3               | 1.9            | 0.8                     | 14                     | 8%                   | 14%                 | 7%          | 6%                | 29.80        | 1886        | 2152  | 2372  | 3.38   | 3.76  | 4.40                             | 20.6   | 18.5 | 15.8  | 15.8 |    |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
| AIR PRODUCTS & CHEM                                 | 54%               | 0%   | 1%      | 41%             | 4%                | 1.80            | 2.2%                            | 58              | 1.4            | 0.8                     | 13                     | 8%                   | 17%                 | 2%          | 6%                | 23.46        | 2077        | 2295  | 2491  | 4.03   | 4.75  | 5.31                             | 20.7   | 17.6 | 15.7  | 15.7 |    |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
| NALCO HOLDING                                       | 12%               | 0%   | 1%      | 83%             | 4%                | 0.14            | 0.6%                            | NA              | 1.8            | 1.1                     | 1                      | -3%                  | -65%                | 7%          | -11%              | 3.24         | 614         | 688   | 763   | 0.80   | 0.80  | 1.18                             | 14.3   | 14.3 | 14.3  | 14.3 |    |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
| ASHLAND   | 65%               | 0%   | 0%      | 33%             | 2%                | 0.30            | 0.7%                            | NA              | 1.8            | 1.9                     | 4                      | 3%                   | 5%                  | 3%          | 6%                | 43.80        | 823         | 863   | 826   | 2.99   | 3.24  | 4.07                             | 14.4   | 13.3 | 10.6  | 10.6 |    |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
| TETRA TECH  | 92%               | 0%   | 0%      | 7%              | 1%                | 0.00            | 0.0%                            | 0               | 1.5            | 1.4                     | 84                     | 7%                   | 13%                 | 5%          | 4%                | 9.96         | 147         | 165   | 186   | 1.42   | 1.37  | 1.54                             | 18.8   | 19.5 | 17.4  | 17.4 |    |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
| ARCH CHEMICALS                                      | 59%               | 0%   | 0%      | 3%              | 4%                | 0.00            | 0.0%                            | 62              | 1.7            | 1.1                     | 22                     | 4%                   | 9%                  | 6%          | 5%                | 16.51        | 129         | 145   | NA    | 1.70   | 2.08  | 2.30                             | 20.6   | 18.5 | 15.8  | 15.8 |    |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
| LAYNE CHRISTENSEN                                   | 95%               | 0%   | 0%      | 3%              | 2%                | 0.00            | 0.0%                            | 0               | 1.7            | 1.1                     | 0                      | 7%                   | 12%                 | 1%          | 7%                | 23.42        | 75          | 81    | 93    | NA     | 0.63  | 0.92                             | NA     | NA   | NA    | NA   | NA |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
| CASCAL INV  | 82%               | 0%   | 1%      | 16%             | 1%                | 0.00            | 1.0%                            | 33              | 1.4            | 0.9                     | 4                      | 5%                   | 13%                 | 4%          | 4%                | 4.95         | 60          | 87    | 98    | 0.50   | 0.77  | 0.82                             | NA     | NA   | NA    | NA   |    |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
| CONSOLIDATED WATER                                  | 78%               | 0%   | 0%      | 18%             | 4%                | 0.00            | 0.0%                            | 0               | 2.4            | 1.2                     | 17                     | 4%                   | 5%                  | 6%          | 3%                | 13.09        | 20          | 19    | NA    | NA     | 0.78  | 0.82                             | NA     | NA   | NA    | NA   |    |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
| CANTREL MEDICAL                                     | 53%               | 0%   | 1%      | 35%             | 10%               | 0.00            | 0.0%                            | NA              | 1.4            | 1.0                     | -8                     | 10%                  | 20%                 | -4%         | 24%               | 4.57         | NA          | NA    | NA    | NA     | NA    | NA                               | NA     | NA   | NA    | NA   | NA |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
| BARNWELL INDUSTRIES                                 | 62%               | 0%   | 0%      | 34%             | 4%                | \$0.13          | 0.7%                            | 17              | 2              | 1                       | 2                      | 5%                   | 12%                 | 3%          | 5%                | 10.72        | 10          | 10    | NA    | NA     | 1.04  | 1.13                             | NA     | NA   | NA    | NA   | NA |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |
| MEDIAN  |                   |  |         |                 |                   | 266             | 1,252                           | 7               | 2              | 8                       | 6                      | 21%                  | 14%                 | 1           | 1.3               | 1.3          | 1.6         | 10.3  | 9.7   | 8.7    | 19.9  | 18.3                             | 15.3   | NA   | NA    | NA   | NA |                                    |  |  |  |  |  |                                |  |  |  |  |  |  |  |  |

Source: Company reports, Thomson Baseline, and Breen Murray, Carret & Co. estimates

**INDUSTRY UPDATE**

**Water Utilities, Flow Technology and Purification**

| Water Solutions - Filtration<br>Comparative Valuation Statistics |          | Rating Data |         |              |                |                 |                         |                 |        |              |                  | Trading & Market Data |            |              |         |        |              |            |         |         |         | Valuation Statistics |         |         |         |  |  |
|--|----------|-------------|---------|--------------|----------------|-----------------|-------------------------|-----------------|--------|--------------|------------------|-----------------------|------------|--------------|---------|--------|--------------|------------|---------|---------|---------|----------------------|---------|---------|---------|--|--|
| Symbol   | Price \$ | BMC Rating  | Analyst | Price Target | Disc To Target | Volume 10/14/09 | Market Capital \$ (mil) | 52-Week High \$ | Low \$ | Avg \$ (mil) | Free Float (mil) | Insider Hldg %        | % of Float | Inst. Hldg % | Short % | Beta   | TEV \$ (mil) | Mkt/Book X | 2009E X | 2010E X | 2011E X | 2009E X              | 2010E X | 2011E X | P/EPS X |  |  |
| 3M COMPANY   | \$76.57  | NR          | 17      |              |                | 4,122           | \$3,470                 | 77              | 41     | 698          | 698              | 0%                    | 67%        | 2            | 0.7     | 56,994 | 4.9          | 10.2       | 9.5     | 8.7     | 18.1    | 16.61                | 14.7    |         |         |  |  |
| SHAW GROUP   | \$32.57  | NR          | 12      |              |                | 659             | 2,772                   | 35              | 11     | 84           | 84               | 1%                    | 81%        | NA           | 1.6     | 2,814  | 2.0          | 7.8        | 6.8     | 5.8     | 16.3    | 13.7                 | 11.1    |         |         |  |  |
| PALL   | \$33.54  | NR          | 7       |              |                | 488             | 3,921                   | 35              | 18     | 117          | 118              | 0%                    | 89%        | 2            | 0.9     | 4,225  | 3.5          | 9.5        | 8.4     | 7.2     | NA      | 17.2                 | 14.6    |         |         |  |  |
| MILLIPORE  | \$72.19  | NR          | 10      |              |                | 776             | 4,010                   | 73              | 43     | 56           | 56               | 0%                    | 99%        | 4            | 0.7     | 4,873  | 2.8          | 11.0       | 10.4    | 9.3     | 18.3    | 16.4                 | 14.6    |         |         |  |  |
| CLARCOR  | \$31.17  | NR          | 0       |              |                | 175             | 1,569                   | 36              | 23     | 50           | 51               | 2%                    | 87%        | 9            | 0.9     | 1,568  | 2.3          | 11.0       | 9.8     | 9.1     | 22.8    | 19.0                 | 16.6    |         |         |  |  |
| LYDALL   | \$5.06   | NR          | NA      |              |                | 81              | 85                      | 7               | 2      | 17           | 17               | 3%                    | 72%        | 1            | 1.9     | 84     | 0.5          | NA         | NA      | NA      | 101.2   | 18.1                 | NA      |         |         |  |  |
| MET-PRO  | \$9.55   | Hold        | 2       |              |                | 23              | 139                     | 14              | 6      | 15           | 15               | 2%                    | 55%        | 5            | 1.4     | 115    | 1.7          | 10.7       | 8.0     | NA      | NA      | 24.5                 | 17.4    |         |         |  |  |
| MEDIAN   |          |             |         |              |                | 488             | 2,722                   |                 |        |              |                  | 1%                    | 81%        | 3            | 0.9     |        | 2.3          | 10.5       | 9.0     | 8.7     | 18.3    | 17.2                 | 14.7    |         |         |  |  |

| Balance Sheet and Credit Ratings |              |                     |           |           |                |             |              |                 |               | Liquidity and Profitability Ratios |       |            |                      |            |               |          |          |          |          | Financial Statistics/Estimates |          |        |          |          |          |
|----------------------------------|--------------|---------------------|-----------|-----------|----------------|-------------|--------------|-----------------|---------------|------------------------------------|-------|------------|----------------------|------------|---------------|----------|----------|----------|----------|--------------------------------|----------|--------|----------|----------|----------|
| Common Equity %                  | Pref Stock % | Minority Interest % | LT Debt % | ST Debt % | Annual Rate \$ | Div Yield % | Div Payout % | Current Ratio X | Quick Ratio X | Interest Coverage X                | ROA % | 2008 ROE % | 2008 FCF2008 Yield % | 2010 PEG X | Book Value \$ | 2009E \$ | 2010E \$ | 2011E \$ | 2009E \$ | 2010E \$                       | 2011E \$ | EPS \$ | 2009E \$ | 2010E \$ | 2011E \$ |
| 62%                              | 0%           | 2%                  | 30%       | 5%        | 2.04           | 2.7%        | 50           | 1.9             | 1.0           | 27                                 | 15%   | 32%        | 3%                   | 6%         | 15.47         | 5881     | 5985     | 6568     | 4.24     | 4.61                           | 5.20     |        |          |          |          |
| 50%                              | 0%           | 1%                  | 0%        | 49%       | 0.00           | 0.0%        | 0            | 1.1             | 0.9           | 2                                  | 4%    | 10%        | 6%                   | 5%         | 16.49         | 363      | 413      | 487      | 2.00     | 2.38                           | 2.93     |        |          |          |          |
| 61%                              | 0%           | 0%                  | 32%       | 8%        | 0.58           | 1.7%        | 35           | 2.2             | 1.4           | 21                                 | 8%    | 17%        | 3%                   | 5%         | 9.54          | 445      | 503      | 583      | -        | 1.95                           | 2.30     |        |          |          |          |
| 59%                              | 0%           | 0%                  | 39%       | 2%        | 0.00           | 0.0%        | 0            | 2.7             | 1.6           | 7                                  | 7%    | 12%        | 5%                   | 4%         | 25.85         | 444      | 469      | 521      | 3.95     | 4.39                           | 4.96     |        |          |          |          |
| 89%                              | 0%           | 0%                  | 10%       | 0%        | 0.39           | 1.3%        | 25           | 3.2             | 1.7           | 127                                | 12%   | 16%        | 5%                   | 6%         | 15.58         | 142      | 160      | 173      | 1.37     | 1.64                           | 1.88     |        |          |          |          |
| 95%                              | 0%           | 0%                  | 4%        | 1%        | 0.00           | 0.0%        | 0            | 2.6             | 1.3           | -23                                | -2%   | -3%        | 14%                  | -7%        | 9.33          | NA       | NA       | NA       | NA       | NA                             | 0.05     | 0.28   |          |          |          |
| 62%                              | 0%           | 0%                  | 10%       | 2%        | \$0.24         | 1.9%        | 25           | 3               | 1             | 43                                 | 8%    | 12%        | 5%                   | 5%         | 5.49          | 11       | 14       | NA       |          |                                | 0.99     | 0.55   |          |          |          |

**Footnotes to Statistical Table**  
 Data: Financial Data as of 6/30/09, or closest quarterly reporting date.  
 B = Buy, H = Hold, S = Sell  
 Rating Data: Free Float = outstanding shares minus restricted shares; % of Float Short = short interest divided by free float  
 Valuation Statistics: Mkt/Book = Price divided by book value per share, TEV/EBITDA = Enterprise Value/Earnings before interest, taxes, depreciation, amortization  
 P/EPS = Price/Earnings Estimates—EPS of non-followed companies based on consensus estimate.  
 Balance Sheet and Credit Ratings: Pref. = Preferred stock, common equity subtracts unowned minority interest and treasury stock, L-T Debt = long-term debt (incl. capital leases), S-T Debt = Short-term debt (incl. current maturities of long-term debt).  
 Liquidity and Profitability Ratios: Current Ratio = current assets divided by current liabilities; Quick Ratio = current assets minus inventories divided by current liabilities; Net WC Ratio = current assets minus current liabilities divided by total assets; Interest Coverage = earnings before interest, taxes, depreciation and amortization divided by interest expense  
 ROA = net income divided by average total assets; ROE = net income divided by average common equity; Div Yield = annual dividend per share divided by current share price  
 FCF Yield = free cash flow per share (cash flow from operations minus capital expenditures) divided by current share price  
 EPS Yield = earnings per share divided by current share price; PEG = current share price divided by earnings divided by growth rate  
 Financial Statistics/Estimates\* EBITDA and EPS estimates consensus estimates from Thomson.

*Source: Company reports, Thomson Baseline, and Brean Murray, Carret & Co. estimates*

## SEPTEMBER QUARTER 2009 – DISTRIBUTION KEY DATA POINTS

**Sabesp:** With the exception of the company still waiting on the Public Attorney's Office of Sao Paulo to issue a final determination over the treatment of R\$409 million for past pension amounts (and the delay of the 20-F filing as a result), developments in 3Q09 were favorable. On June 5, 2009 the company announced that a law authorizing the City of Sao Paulo to negotiate a renewable 30-year concession agreement was passed; on June 10, the company announced it had completed a R\$600 million note issue; on June 25, Sao Paulo mayor Gilberto Kassab approved a bill giving Sabesp the right to operate sanitation services in the city for 30 years; On July 27, ARSESP, the company's regulator, issued proposals for sector regulation that would clarify costs for tariff setting purposes while creating greater predictability in earnings; and on August 12, the company announced a 4.43% tariff increase effective September 11, 2009. Additionally, the Brazilian real continued to appreciate against the U.S. dollar, which should result in a positive foreign exchange (forex) impact across the company's loan portfolio. We have adjusted our 3Q09 EPS/ADR estimates upward based strictly on currency impacts: the changes to our model are as follows. For 3Q09, we now forecast an exchange gain of R\$91 million (our previous estimate was R\$0). We have adjusted the exchange rate forecast for all ADR calculations from 1.86/1 to 1.77/1, which reflects the exchange rate in effect on the last day of 3Q09. We will continue to forecast forward estimates without accounting for exchange gains/losses until the future quarters actually close. As a result, current and forward year EPS/EPADR estimates may not be indicative of what we consider to be superior earnings power and prospects relative to the overall group; we suggest investors obtain a copy of our forecast model for purposes of examining underlying growth trends ex-forex effects. We maintain our Buy rating and are raising our target price to \$66 from \$63, based on the ADRs attaining a level of 9x our 2010 EPADR estimate of \$7.36.

**American Water Works:** The key impact we see affecting American Water Works' 3Q09 results is unfavorable weather in the primary service regions of New Jersey and Pennsylvania. August was an especially wet month, and we are lowering our estimates to reflect lower anticipated volumes. Although weather impacts are mildly disappointing with regard to 3Q09 performance, we still forecast steady, rising improvement in earnings as the company continues to file for higher rates while investments grow its rate base. As we mentioned in our Distribution outlook, we believe the acquisition environment, driven by stressed municipal budgets, will continue to improve. We also expect the valuation discount versus the peer group to continue to narrow; the recent successful placement of 40.25 million shares (including the overallotment option) from RWE AG should serve to significantly reduce the overhang associated with RWE's unwinding of its remaining position (approximately 25%). We reiterate our Buy rating and \$28 target price, based on the shares attaining a level of 20x our 2010 EPS estimate of \$1.39. We recommend investors continue to accumulate positions, particularly ahead of what we anticipate will be very well received share offering(s) to close out the RWE position.

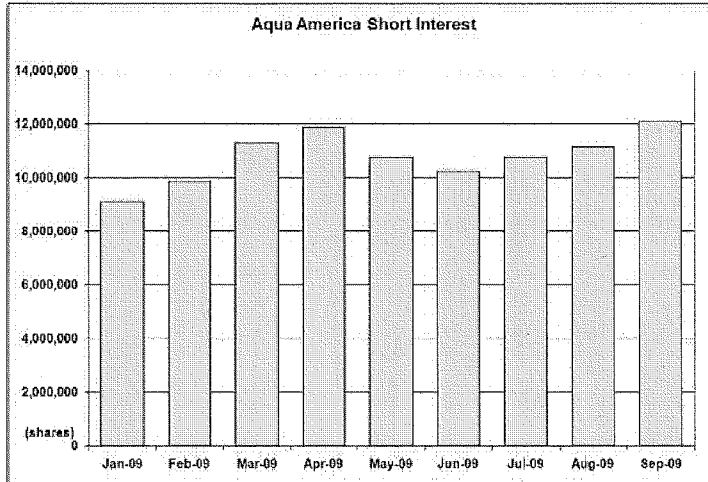
**Aqua America:** The key impact we see affecting Aqua America's 3Q09 results is unfavorable weather in the primary service regions of Pennsylvania and New Jersey. August was an especially wet month, and we are trimming our 3Q09 estimate to \$0.24 from \$0.28 to account for weather impacts. Looking forward, we note the company continues to seek rate relief across its various service territories, and we anticipate continued growth in infrastructure investments will add to its rate base. Aqua America's profitability ratios consistently rank among the highest in the peer group, and we expect solid earnings growth through 2011.

Despite all the positive momentum in the underlying fundamentals, Aqua America's share price continues to trade well below historical P/E multiples. This is true of the peer group overall; we believe the current trading range is due to a high level of investor interest in American Water Works shares, which have been offered in successive rounds since that company's IPO in April of 2008. In our opinion, some portfolio reallocation has occurred (selling of WTR shares to buy AWK shares) due to the deep discount AWK shares trade at relative to the peer group. We also believe Aqua America's liquidity has drawn high levels of short interest into the name (Exhibit 1) from investors putting on pairs trades (long AWK, short WTR). Our view is that this is a temporary situation, and that after RWE AG unwinds the last of its shares in the near future, AWK's valuation gap will narrow relative to the water utility peer group, which will unravel some of the outstanding short interest in WTR shares, resulting in a more favorable market environment for the shares to appreciate back to more normalized levels.

INDUSTRY UPDATE

Water Utilities, Flow Technology and Purification

Exhibit 3: Aqua America Short Interest



Source: Baseline

**California Water:** We noted no major developments during the quarter at California Water Service Group. Drought conditions in the State of California continue, and no visibility exists as to when it might end. Continuing dry conditions should keep water volumes lower due to conservation efforts. We are making no changes to our estimates at this time. Despite positive financial statement impacts from the recently enacted California Water Action Plan and a more favorable regulatory environment, the shares continue to trade well below historical levels on both a trailing and forward P/E basis. We believe this is due largely to successive share offerings from American Water Works since the June 2008 IPO. We view this situation as temporary, in that the majority selling shareholder in these offerings (RWE) has largely unwound its ownership position from 100% to approximately 25%. The most recent share offering was received well, and our view is that once the last tranche of RWE-owned shares are absorbed by the market, valuations will slowly return to more normalized levels. We reiterate our Buy rating and \$44 target price, based on the shares attaining a level of 20x our 2010 EPS estimate of \$2.25.

**American States Water:** On October 6, 2009 the company filed an 8-K indicating that the U.S. government issued contract modifications to subsidiaries of AWR's American States Utility Services, Inc. (ASUS) unit. The modifications provide funding for \$7.3 million in new construction projects at ASUS's Fort Bliss Water Services Company, Old Dominion Utility Services, Inc., Terrapin Utility Services, Inc., and Old North Utility Services, Inc. subsidiaries. The majority of this work will be performed during CY10. ASUS' Palmetto State Utility Services, Inc. subsidiary also received on September 30 a modification for a \$1.1 million equitable adjustment. This modification provides reimbursement for emergency construction costs previously incurred at Fort Jackson, South Carolina. The majority of the costs on these projects at Fort Jackson had been previously recognized by ASUS as construction expense in 2008. As a result of this modification, AWR will recognize construction revenues and operating income of \$1.1 million during 3Q09. As a result, we are raising our 3Q09 EPS estimate to \$0.55 from \$0.49 to account for this previously un-forecasted operating income.

Drought conditions in the State of California continue, and no visibility exists as to when it might end. Continuing dry conditions should keep water volumes lower due to conservation efforts. Despite positive financial statement impacts from the recently enacted California Water Action Plan and a more favorable regulatory environment, the shares continue to trade well below historical levels on both a trailing and forward P/E basis. We believe this is due largely to successive share offerings from American Water Works since the June 2008 IPO. We view this situation as temporary, in that the majority selling shareholder in these offerings (RWE) has largely unwound its ownership position from 100% to approximately 25%. The most recent share offering was received well, and our view is that once the last tranche of RWE-owned shares are absorbed by the market, valuations will slowly return to more normalized levels. We reiterate our Buy rating and \$42 target price, based on the shares attaining a level of 18x our 2010 EPS estimate of \$2.32.



INDUSTRY UPDATE

Water Utilities, Flow Technology and Purification

**San Jose Water:** We noted no major developments during the quarter at SJW Corp. An 8-K filed 9/23/09 stated the company had terminated its previous Controller and replaced her with an internal candidate from the same affected subsidiary (San Jose Water Company).

Drought conditions in the State of California continue, and no visibility exists as to when it might end. Continuing dry conditions should keep water volumes lower due to conservation efforts. We are making no changes to our estimates at this time. We maintain our Hold rating based on valuation.

**Southwest Water:** 3Q09 saw some significant changes at South West Water. After an extended period of time, we were able to reinstate forward estimates after the company became current on its 10Q and 10K filings. The company also is now reporting results across four operating segments (previously it was two):

**Utilities** – consists of owned water and wastewater utilities in California, Alabama and Michigan

**Texas Utilities** – consists of owned utilities in Texas

**O&M Services** – project-specific contracts with cities, public agencies and private owners typically for facility operations

**Texas MUD Services** – utility services to large number of small utilities in Texas

The company also made several changes to its corporate governance, including lowering the mandatory retirement age, adding two new directors, and separating the CEO and Chairman roles.

We're pleased to see Southwest Water return to current filing status, and the revised reporting segments should increase investor understanding surrounding the business model and key profit drivers. The changes to the Board structure should also prove beneficial over the long term. Those positives aside, valuation (derived from current estimates) leads us to conclude the shares are fairly valued at current levels. We are making no changes to our estimates at this time, and maintain our Hold rating.

**York Water:** Weather conditions for York Water in 3Q09 were not favorable. The summer months brought heavy rainfall, which anticipates decreased customer usage.

Significant corporate developments included a filing on September 16, 2009 to offer 950,000 shares of common stock (with an overallotment option of 120,000 that was exercised), which has been completed. We are maintaining our 3Q09 estimate of \$0.18, but lowering our full-year 2009 and 2010 estimates to \$0.65 and \$0.65 from \$0.66 and \$0.71, respectively, to account for the higher shares outstanding. We maintain our Buy rating but are lowering our target price from \$20 to \$18, based on the shares attaining a P/E multiple of 28x our forward estimates.

Like the rest of the water utility peer group, we note that The York Water Company share price continues to trade well below historical P/E multiples. Again, we believe the current trading range is due to a high level of investor interest in American Water Works shares, which have been offered in successive rounds since that company's IPO in April of 2008. AWK shares trade at a sizable discount to the peer group, which we believe is putting pressure on valuations across the sector. Our view is that this is a temporary situation, and that after RWE AG unwinds the last of its shares in the near future, AWK's valuation gap will narrow relative to the water utility peer group, resulting in a more favorable market environment for the shares to appreciate back to more normalized levels.

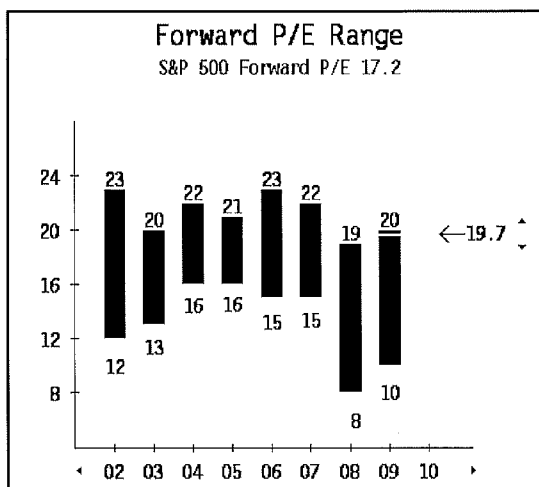
INDUSTRY UPDATE

Water Utilities, Flow Technology and Purification

SEPTEMBER QUARTER 2009 – FLOW TECHNOLOGY KEY DATA POINTS

**IDEX Corp:** We are making no changes to our estimates or rating at this time. Our expectations are that the company's revenues for its Health & Science Technology, Fire & Safety and Fluid & Metering segments will all decline YoY. Our belief is that end markets are at or near a "worst-case scenario" in terms of sales, but we see no compelling evidence of any fundamental improvement that could drive top-line growth anywhere near 2008 levels. We believe the key drivers short term for increasing EPS performance will be debt repayments, managing the cost structure and perhaps a few tuck-in acquisitions. We note the shares are currently trading at 20x forward EPS estimates, near the upper end of their historical range (Exhibit 2). We continue to recommend investors avoid the shares on the long side, and we reiterate our Sell rating and \$16 target price, based on the shares attaining a level of 10x our 2010 EPS estimate of \$1.61. We note that the shares have traded to a level of 10x forward estimates in both 2008 and 2009.

Exhibit 4: IDEX Forward P/E Range, 2002 - 2009



Source: Baseline

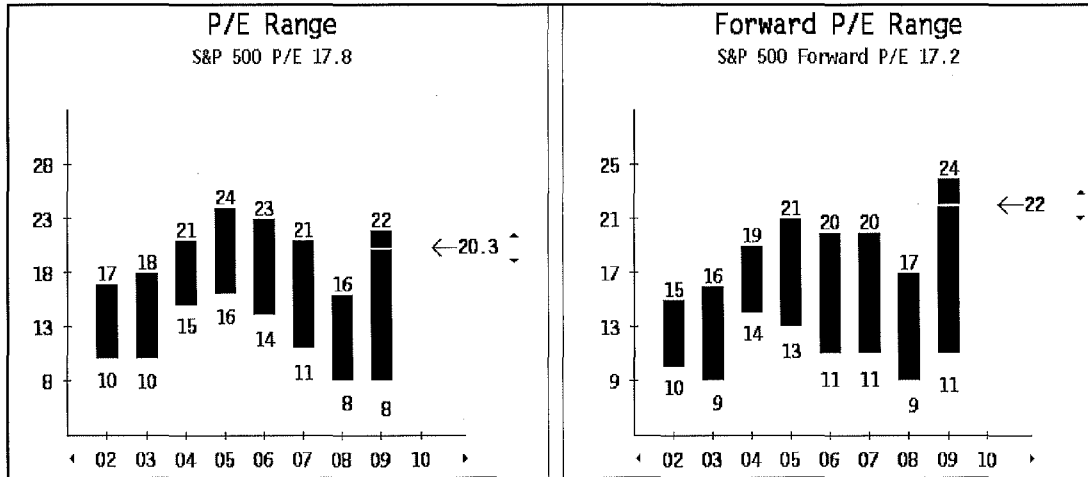
**Watts Water Technologies:** We are making no changes to our estimates or rating at this time. Watts Water Technologies has done an excellent job managing the business through less-than-stellar end markets; its experienced management team (CEO Pat O'Keefe has been in his current role for seven years, and CFO William McCartney for 24 years) have aggressively taken costs out of the business model, while simultaneously positioning the company to leverage its infrastructure when end markets improve. We note that the company's S,G&A expenses, averaging \$83 million a quarter in 2007 and \$90 million a quarter in 2008, have been held constant at \$81 million for the first two quarters of 2009 – this despite the integration of the Blucher acquisition, which at the time of the transaction generated approximately \$90 million in revenues.

Despite excellent cost control and positioning for the future, we find the shares trading at the high end of both trailing and forward P/E ranges (Exhibit 3). We also note copper prices, a key raw material used in many of the company's products, have continued to move higher. The company noted in its 2Q09 conference call that pricing power to pass through higher raw material costs is not as strong as it was in years prior to this latest recession, which leads us to conclude that margin pressure could be present in the first half of 2009 as this higher cost material flows through the company's inventory (Exhibit 4). We continue to look for an opportunity to become more positive from a ratings standpoint, but weak end markets and higher raw material costs will be difficult to overcome, even with further operating cost reductions, in our opinion. For now, we suggest investors hold existing positions while awaiting a new entrance point (more favorable valuation, strengthening end markets, lower raw material costs or sizable acquisitions).

**INDUSTRY UPDATE**

Water Utilities, Flow Technology and Purification

**Exhibit 5: Watts Water Technologies Trailing and Forward P/E Ranges**



Source: Baseline

**Exhibit 6: Copper Prices**



Source: Baseline

## INDUSTRY UPDATE

## Water Utilities, Flow Technology and Purification

**Mueller Water Products:** We are maintaining our 4QFY09 estimates, raising our FY10 EPS estimates and establishing FY11 EPS estimates on the shares of Mueller Water Products. We are also upgrading our rating from Hold to Buy and establishing an \$8 target price based on (1) a lowered risk profile as it pertains to debt levels, (2) an expectation that municipal and residential end markets will improve in mid-year 2010, and (3) an increase in the valuation multiples we expect the market will pay for the equity.

**Lowered risk profile.** The recent equity offering raised approximately \$176 million, which the company will use to repay debt obligations. Debt levels have been the major concern surrounding our Hold rating for quite some time; debt/equity levels have fluctuated substantially in 2009. The recently signed credit agreement was particularly unfavorable with regard to interest rate levels, and interest expense was set to rise meaningfully before the recent equity offering was completed. The shelf registration from June of 2009 indicated the company could offer or sell up to \$300 million of equity, debt, or other types of securities. Given the high cost of the credit agreement debt, we'd become incrementally more positive on the shares' long-term outlook if the company were to decide to continue offering equity to remove debt, especially if it can do so to gain enough leverage to return to interest levels on its remaining debt commensurate with its previous agreement (which was LIBOR +1.75), with the provision that it not be meaningfully dilutive to FY11 EPS.

**Key end markets appear to have stabilized.** Starting first with the municipal end market, we have noted that more numerous high-profile line breaks continue to occur in key metropolitan regions. The cities of Los Angeles and Boston have been experiencing large numbers of breaks (Los Angeles breaks doubled YoY in September). We attribute the high level of breaks we are seeing in the news to delayed, necessary maintenance not just from the last year of difficult credit market conditions for municipalities overall, but also from years prior. The breaks in Los Angeles and Boston that have materialized recently were certainly not from weather conditions (freezing and thawing) given the time of year they are occurring. Our view is that increasing breaks from delayed maintenance of aging infrastructure will contribute to stabilization and eventual growth in the repair and maintenance end market over the next several years.

Additionally, although we aren't expecting a meaningful impact from the recent stimulus plan on Mueller Water Product's forward outlook/results, it should certainly provide a fiscal environment more conducive to municipal spending overall. As for residential construction, we look at new permits, new starts, new residential home sales and existing home sales as a guide to overall market health (on a monthly basis). A review of this data has led us to conclude that the new residential construction market has hit bottom and stabilized (see the appendix for further details). A review of conference call commentary from major publicly traded home builders appears to confirm our thesis in the area. Further, we believe stabilization has occurred at a level below normal replacement. The lone dark cloud among Mueller Water Products' end markets is the non-residential market, which is expected to deteriorate through at least 2010. This should negatively impact the Anvil segment, but we believe improvements in the key end markets (new residential and municipal repair & replacement) will more than offset weakness in non-residential.

**Adjusting estimates.** We have adjusted our forward estimates to reflect 1) the higher share count associated with the recent equity offering, and 2) our lowered expectations surrounding future interest expense. Our new estimates are as follows: FY10 EPS is now \$0.05, versus our previous estimate of \$-0.01. Our newly established FY11 EPS estimate is \$0.51.

**Valuation.** We are using our FY11 EPS estimate of \$0.51 to derive our \$8 target price, assigning a 16x multiple. We have been on the sidelines with a Hold rating since June 2007, patiently waiting for signs that negative end-market conditions were likely to subside, and based on our end-market outlook above, we have concluded the worst is over in municipal repair and replacement and new residential construction. We also view the recent equity offering as the positive inflection point we have been looking for in terms of (1) balance sheet management, and (2) lowered risk profile as it pertains to debt levels. We note that FY11 consensus estimates vary widely, indicating Street expectations are across the spectrum in terms of outlook. Therein, we believe, is the opportunity with regard to Mueller Water Products shares. If we're wrong and the high end of consensus needs to come down, our expectation would be for the shares to trade in a relatively tight range of \$4.50-6.00 (we derive this range based on the high end of consensus coming down to EPS of \$0.35 (worst case scenario), an earnings level that appears to be reasonable given current conditions, and an assumption that the market would afford the shares a 13-17x P/E multiple, which reflects modest, but improving underlying earnings improvement YoY. We base our opinion of limited future downside due to the company's prodigious cash flow characteristics, which should allow it to not only meet minimum debt obligations but to continue reducing overall debt, even under the current low end FY11 EPS estimates in the \$0.22-0.35 range. We also note Mueller has the structure in place to offer additional equity to lower its debt profile further, should the economy double-dip and market conditions begin to deteriorate. Either way, we see limited downside and large upside potential over the next 12 months.

If we are correct and Mueller Water Products puts up approximately \$0.50 in EPS in FY11, we would expect the shares to trade in the 16-20x range, where its peer group is currently trading on CY10 estimates. That said, we wouldn't expect FY11 consensus estimates to begin moving toward the high end of the range until 2Q10, when residential construction data such as new permits for the all-important spring/summer building season are released. We recommend investors with the requisite patience to hold the shares well into 2010 begin to accumulate or take new positions now at current levels, particularly into any overall market weakness that may temporarily depress share prices.

## SEPTEMBER QUARTER 2009 – WATER SOLUTIONS KEY DATA POINTS

**Calgon Carbon:** We are making no changes to our estimates or rating at this time. Significant developments during the quarter included a Calgon Carbon Corp announcement that it will be supplying 12 Sentinel<sup>®</sup> Chevron 48 reactors, scheduled to be delivered in June 2012 to the city of Boston. Based on the Sentinel 48's recent selling price, we believe the order is worth approximately \$4.8 million. Other cities of similar size will be up against the same time constraints (the first compliance date is January 2013), and we anticipate we will begin to see UV sales ramp higher on a go-forward basis.

Calgon Carbon Corp. remains our top pick in the industrial universe. We continue to recommend adding to positions at current levels.

**Consolidated Water:** We are making no changes to our estimates or rating at this time. The key development in 3Q09 was a preliminary decision in the B.V.I. litigation. Key excerpts from the company's 8-K filing related to this situation are as follows: "On September 17, 2009, the Court issued a preliminary ruling with respect to the dispute between the BVI Government and OC-BVI. The Court determined that the BVI Government was entitled to immediate possession of the Plant. However, the Court also ordered the BVI Government to make an immediate interim payment of \$5 million to OC-BVI for amounts owed to OC-BVI. The Court will conduct a hearing to determine the reasonable rate for water produced by OC-BVI for the period from December 20, 2007 to the present and may order the BVI Government to make an additional payment to OC-BVI. Additionally, OC-BVI and the BVI Government have initiated preliminary discussions concerning the decision of the Court and the possibility of OC-BVI continuing to operate the Plant. There can be no assurances that the BVI Government and OC-BVI will reach an agreement regarding the continued operation of the Plant by OC-BVI. Depending upon the results of the discussions between the BVI Government and OC-BVI, the Company may be required to record impairment charges to reduce the carrying value of OC-BVI's assets. Such impairment charges would reduce the Company's earnings and could have a significant adverse impact on the Company's results of operations, financial condition and cash flows."

### What investors need to know:

- 1) The initial \$5 million payment equates to \$0.35 in EPS.
- 2) Which party ultimately owns the plant can be largely irrelevant to Consolidated Water's forward earnings profile (excluding any potential recorded impairment charges). Consolidated Water could still obtain an operating agreement similar to those it currently has in effect in other areas of the Caribbean.
- 3) Consolidated Water has the right to appeal the decision.
- 4) Depending upon the results of the discussions, the company may be required to record impairment charges to reduce the carrying value of OC-BVI's assets.

As we have maintained for quite some time now, we view any decision (for or against Consolidate Water's claims) as a positive development. The continual recording of losses by the company on these operations has now moved one step closer to cessation. Given that the decision is preliminary, we will refrain from making any adjustments to our forward estimates at this time. While we are disappointed the court determined the plant belonged to B.V.I., the forward momentum in settling this issue is a welcome development. We reiterate our Buy rating and \$24 target price on CWCO shares, and recommend investors not only accumulate at current levels, but also buy on any temporary dips in share price that may occur as a result of B.V.I.-related developments. The company has plenty of operational growth platforms to pursue beyond B.V.I., and we suggest investors ignore any future noise related to the B.V.I.-Baughers Bay operations and look beyond to the company's improving operational fundamentals and new opportunities.

### SEPTEMBER QUARTER 2009 – WATER SOLUTIONS - FILTRATION KEY DATA POINTS

**Met-Pro Corp:** We are making no changes to our estimates or rating at this time. Significant developments during the company's 3QFY10 included some large orders in July; the Duall Business Unit received an equipment order for approximately \$825,000, and the Systems Business Unit pulled down a \$500,000 order. Key items we'll be looking at when the company reports include backlog and end-market commentary, particularly on larger orders. Other items of interest will include a progress update on the restructuring of the Product Recovery & Pollution Control Technology segment discussed on the last quarterly conference call.

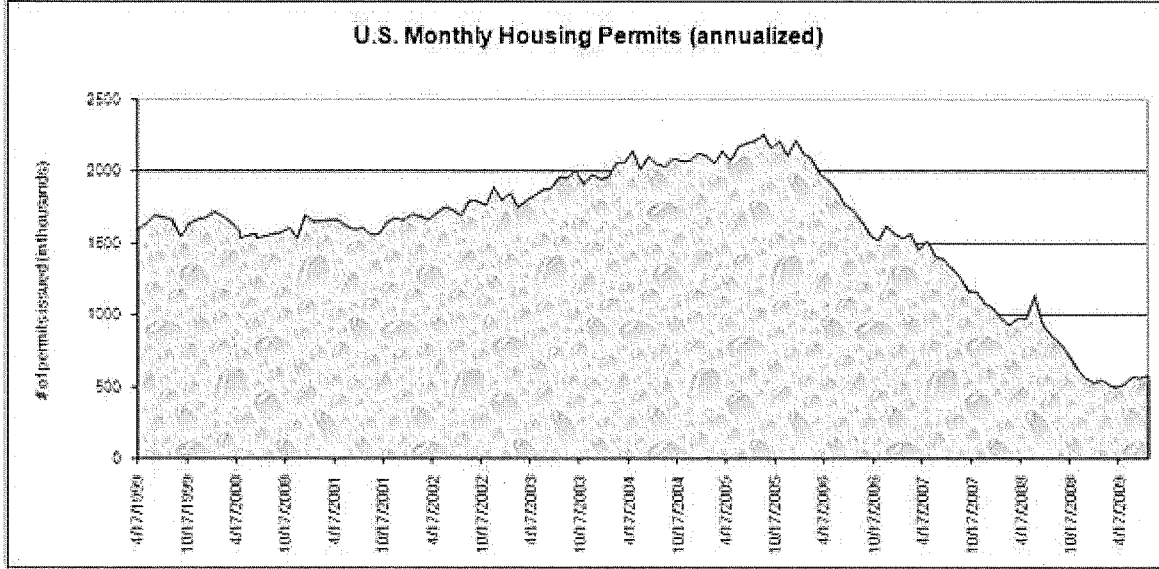
Met-Pro Corp shares have not participated in the recent market rally within the industrial universe. While we would expect the company's order flow to somewhat lag improving global economic conditions due to hesitancy by customers to make large capital outlays, we note these investments are typically unavoidable. We are becoming incrementally more positive on MPR shares at these levels, and aggressively looking for an opportunity to upgrade as soon as signs of improvement in end market conditions begin to show. The company ended its 2QFY10 with its cash balance at an all-time high of just over \$29 million, and debt is a paltry \$3.8 million. The company remains well-positioned to make acquisitions large or small, and while it waits, the cash balance just continues to increase. We reiterate our Hold rating based on valuation.

**INDUSTRY UPDATE**

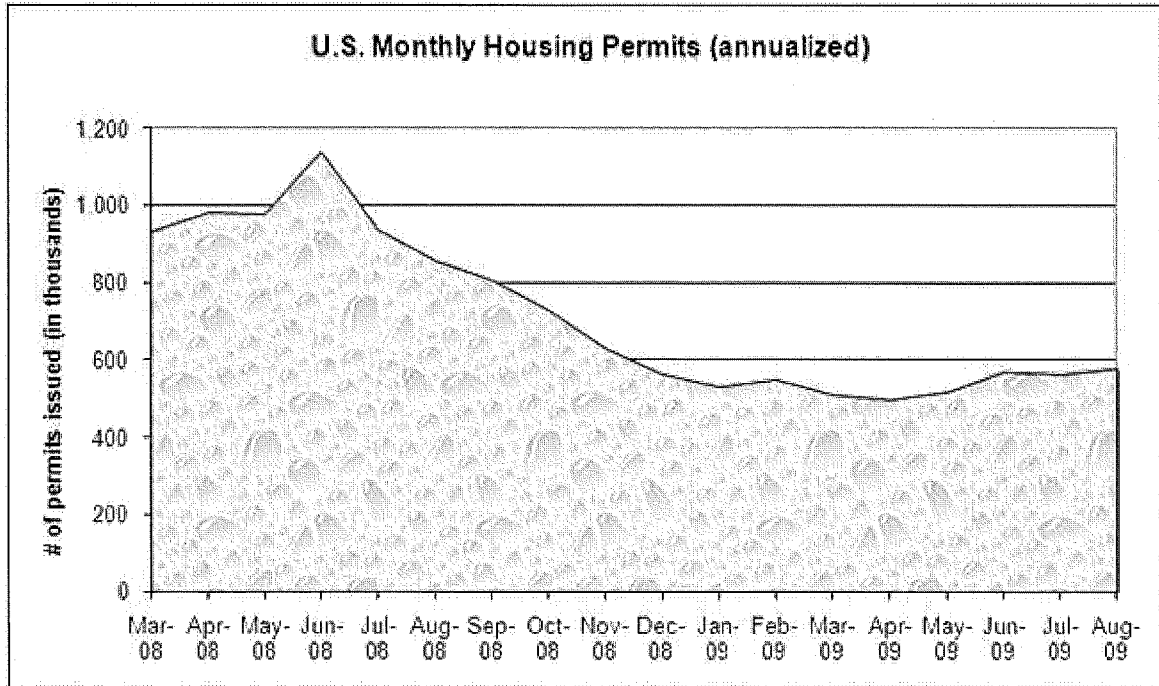
Water Utilities, Flow Technology and Purification

**APPENDIX A: MARKET DATA**

**Residential Construction Key Metrics**



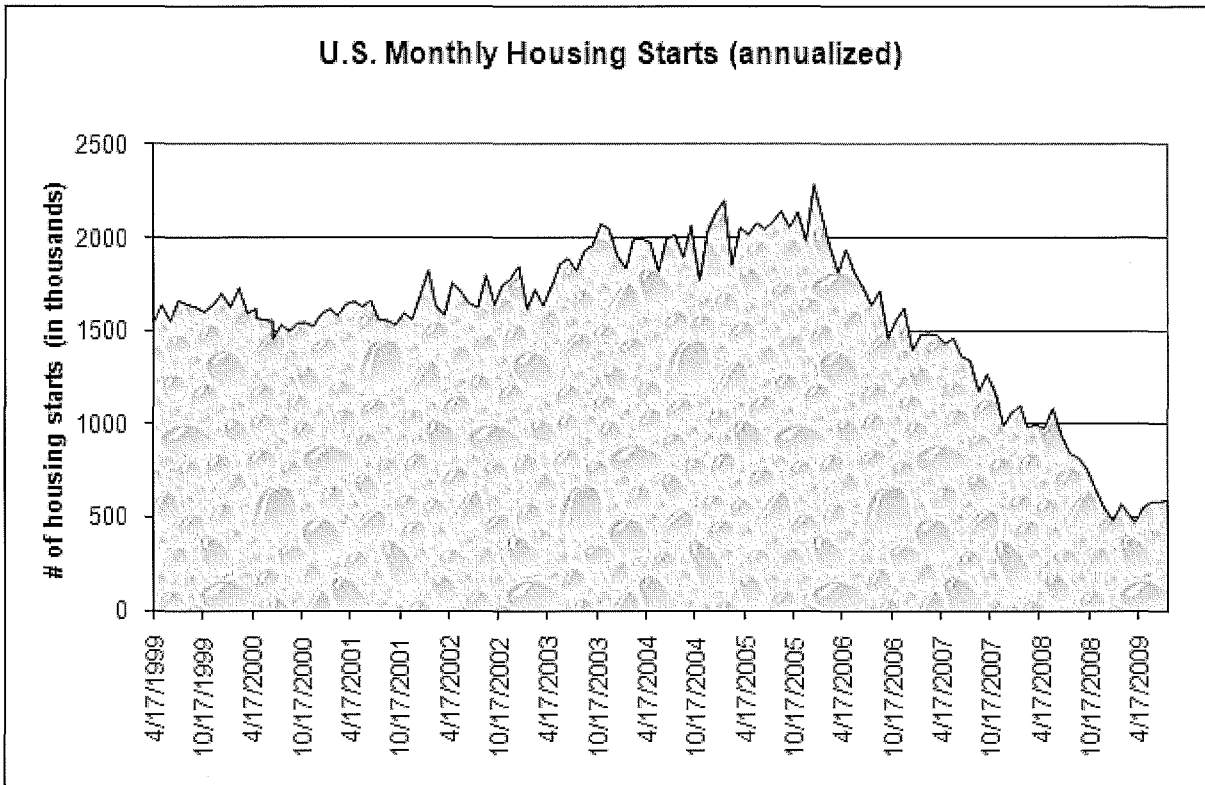
Source: The United States Census Bureau



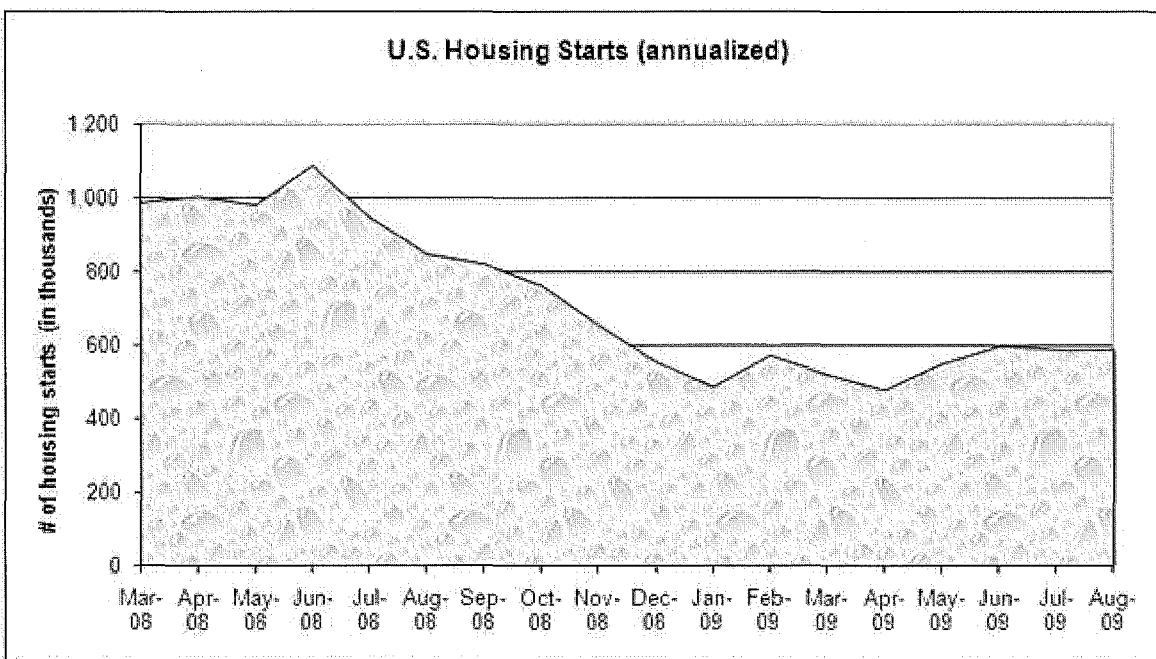
Source: The United States Census Bureau

INDUSTRY UPDATE

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Source: The United States Census Bureau

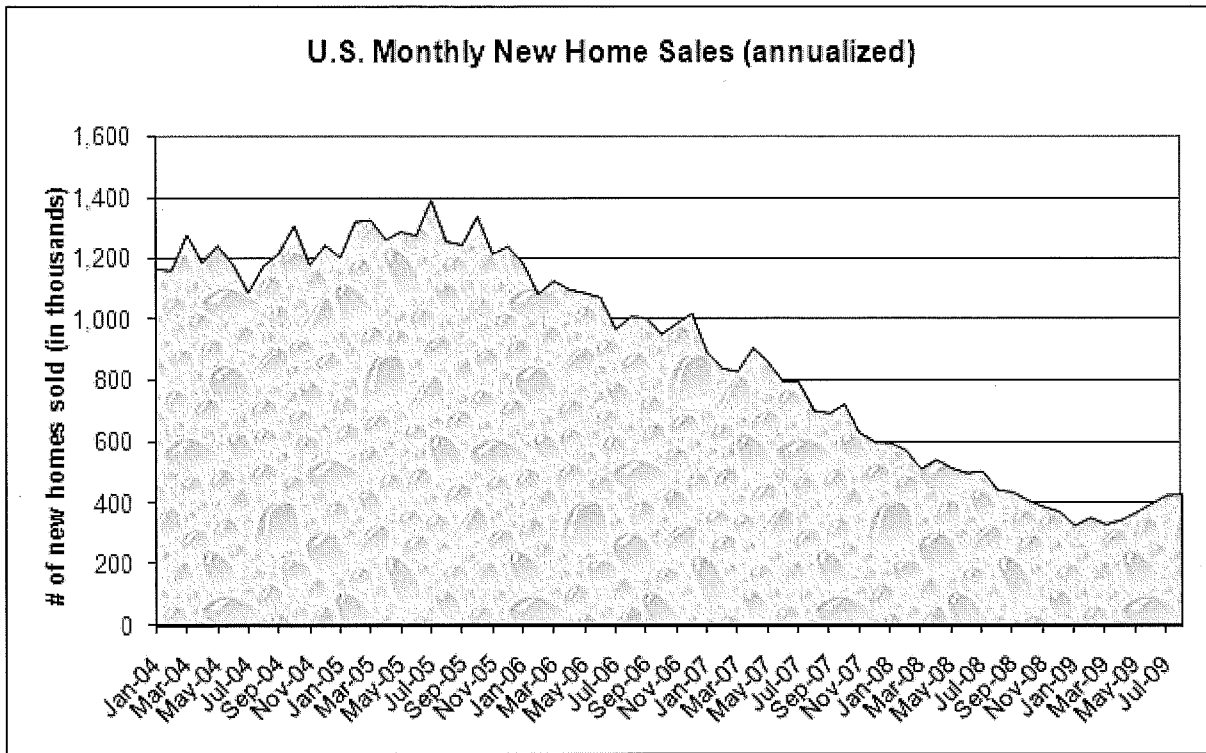


Source: The United States Census Bureau

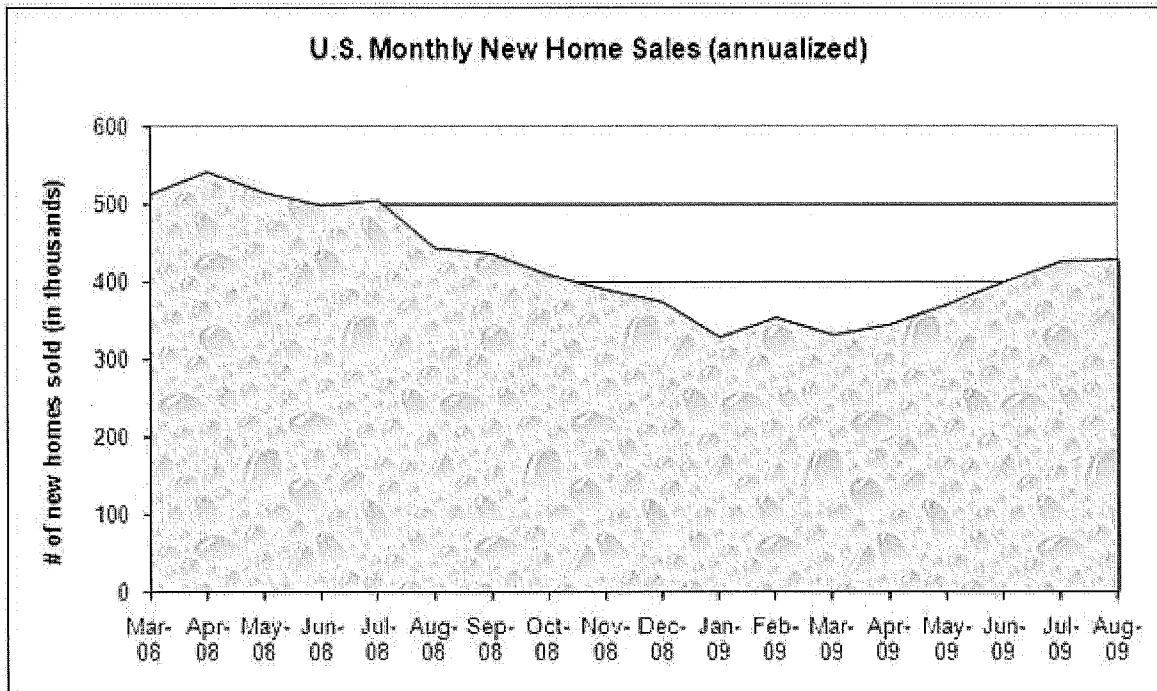


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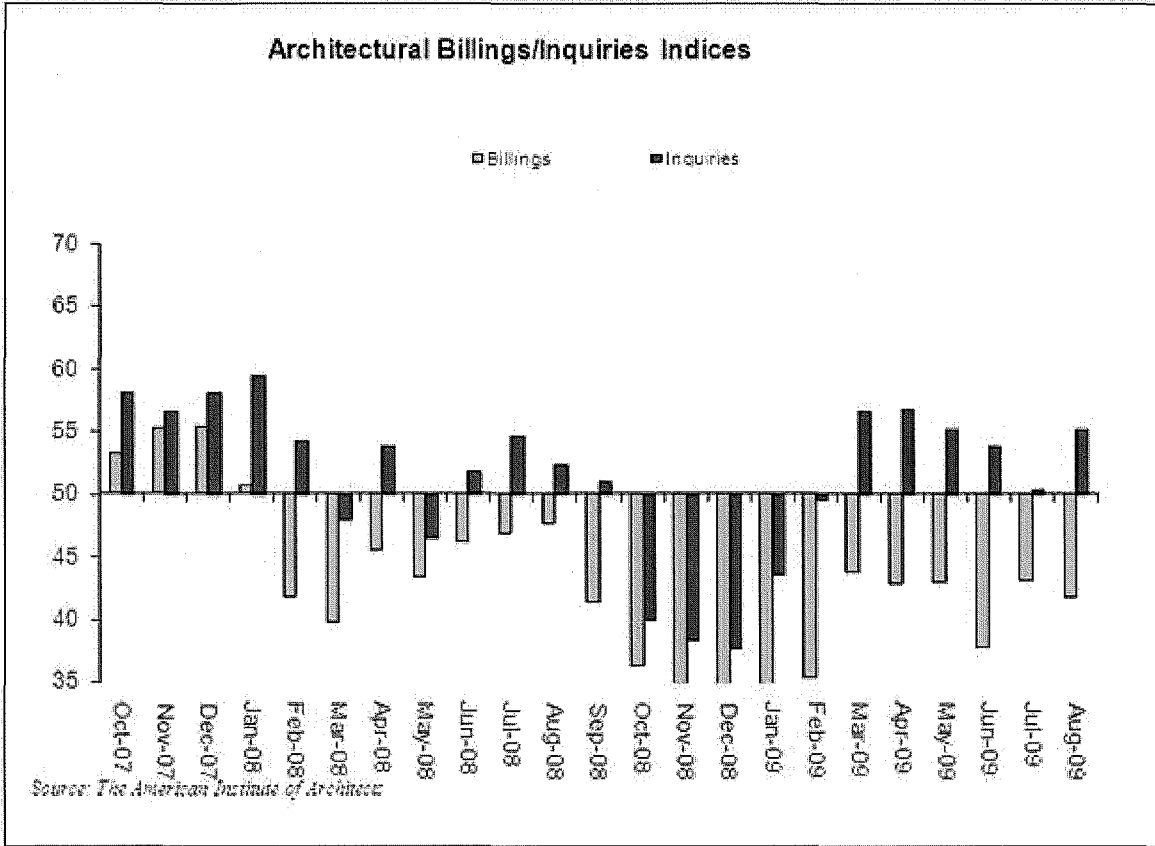
Source: The United States Census Bureau



Source: The United States Census Bureau

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**INDUSTRY UPDATE**

Water Utilities, Flow Technology and Purification

**APPENDIX B: COMPANY MODELS**

| <b>Sabesp</b>                                       |                  | <b>Quarterly Income Statement, 2009E</b> |                  |              |                  |              |                  |              |                  |              |  |
|---|------------------|--|------------------|--------------|------------------|--------------|------------------|--------------|------------------|--------------|--|
| (R\$000, except per share data)                     |                  |  |                  |              |                  |              |                  |              |                  |              |  |
| (Fiscal year ends December 31)                      |                  |  |                  |              |                  |              |                  |              |                  |              |  |
|   | (Mar)            | % Rev or                                 | (Jun)            | % Rev or     | (Sep)            | % Rev or     | (Dec)            | % Rev or     | FY09E            | % Rev or     |  |
|   | 1Q09             | Margin                                   | 2Q09             | Margin       | 3Q09E            | Margin       | 4Q09E            | Margin       |                  | Margin       |  |
| <b>Gross Revenue from Sales and Services</b>        | <b>1,779,367</b> |  | <b>1,743,652</b> |              | <b>1,825,173</b> |              | <b>1,951,333</b> |              | <b>7,299,525</b> |              |  |
| Water segment                                       | 995,611          |  | 969,436          |              | 1,006,678        |              | 1,074,719        |              | 4,045,445        |              |  |
| Sewage segment                                      | 754,904          |  | 743,991          |              | 787,733          |              | 844,336          |              | 3,130,964        |              |  |
| Services  | 28,852           |  | 30,225           |              | 31,762           |              | 32,277           |              | 123,117          |              |  |
| Taxes on Sales and Services - CONFINS and PASEP     | (126,001)        |  | (120,029)        |              | (127,762)        |              | (136,593)        |              | (510,385)        |              |  |
| <b>Net Revenue from Sales and Services</b>          | <b>1,653,366</b> |  | <b>1,623,623</b> |              | <b>1,697,411</b> |              | <b>1,814,740</b> |              | <b>6,789,140</b> |              |  |
| <b>Cost of sales</b>                                | <b>835,189</b>   | <b>50.5%</b>                             | <b>830,083</b>   | <b>51.1%</b> | <b>830,454</b>   | <b>48.9%</b> | <b>835,171</b>   | <b>46.0%</b> | <b>3,330,896</b> | <b>49.1%</b> |  |
| <b>Gross profit</b>                                 | <b>818,177</b>   | <b>46.0%</b>                             | <b>793,540</b>   | <b>45.5%</b> | <b>866,957</b>   | <b>47.5%</b> | <b>979,569</b>   | <b>50.2%</b> | <b>3,458,243</b> | <b>47.4%</b> |  |
| Selling expenses                                    | 208,516          | 11.7%                                    | 187,307          | 10.7%        | 182,152          | 10.0%        | 191,231          | 9.8%         | 769,206          | 10.5%        |  |
| Administrative expenses                             | 147,722          | 8.3%                                     | 100,884          | 5.8%         | 108,634          | 6.0%         | 108,894          | 5.6%         | 466,125          | 6.4%         |  |
| Other operating expenses, net                       | (5,470)          | -0.3%                                    | (2,345)          | -0.1%        | (4,244)          | -0.2%        | (4,537)          | -0.2%        | (16,595)         | -0.2%        |  |
| <b>Operating income before shareholdings</b>        | <b>467,409</b>   | <b>26.3%</b>                             | <b>507,694</b>   | <b>29.1%</b> | <b>580,414</b>   | <b>31.8%</b> | <b>683,991</b>   | <b>35.1%</b> | <b>2,239,508</b> | <b>30.7%</b> |  |
| Equity Result                                       | 31               | 0.0%                                     | 79               | 0.0%         | 75               | 0.0%         | 100              | 0.0%         | 285              | 0.0%         |  |
| <b>Earnings before financial results</b>            | <b>467,378</b>   | <b>26.3%</b>                             | <b>507,615</b>   | <b>29.1%</b> | <b>580,339</b>   | <b>31.8%</b> | <b>683,891</b>   | <b>35.0%</b> | <b>2,239,223</b> | <b>30.7%</b> |  |
| Financial, net                                      | (93,026)         | -5.2%                                    | (102,604)        | -5.9%        | (109,510)        | -6.0%        | (111,226)        | -5.7%        | (416,366)        | -5.7%        |  |
| Exchange gain (loss), net                           | 25,423           | 1.4%                                     | 237,769          | 13.6%        | 91,242           | 5.0%         | 0                | 0.0%         | 354,434          | 4.9%         |  |
| <b>Income before taxes and social contributions</b> | <b>399,775</b>   | <b>22.5%</b>                             | <b>642,780</b>   | <b>36.9%</b> | <b>562,071</b>   | <b>30.8%</b> | <b>572,665</b>   | <b>29.3%</b> | <b>2,177,291</b> | <b>29.8%</b> |  |
| Income taxes and social contributions - Deferred    | 176,354          | 9.9%                                     | 200,881          | 11.5%        | 174,833          | 9.6%         | 185,103          | 9.5%         | 737,172          | 10.1%        |  |
| Income taxes and social contributions - Current     | (32,793)         | -1.8%                                    | (22,766)         | -1.3%        | (24,360)         | -1.3%        | (27,039)         | -1.4%        | (106,958)        | -1.5%        |  |
| <b>Net income</b>                                   | <b>256,214</b>   | <b>14.4%</b>                             | <b>464,665</b>   | <b>26.6%</b> | <b>411,598</b>   | <b>22.6%</b> | <b>414,601</b>   | <b>21.2%</b> | <b>1,547,077</b> | <b>21.2%</b> |  |
| Earnings per share:                                 |                  |  |                  |              |                  |              |                  |              |                  |              |  |
| EPS Reported  | R\$ 1.12         |  | R\$ 2.04         |              | R\$ 1.81         |              | R\$ 1.82         |              | R\$ 6.79         |              |  |
| EPADS (USD)   | \$0.98           |  | \$2.19           |              | \$1.94           |              | \$2.06           |              | \$7.17           |              |  |
| Diluted shares outstanding                          | 227,836          |  | 227,836          |              | 227,836          |              | 227,836          |              | 227,836          |              |  |

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

**INDUSTRY UPDATE**

**Water Utilities, Flow Technology and Purification**

| <b>Sabesp</b>   |                  | <b>Quarterly Income Statement, 2010E</b> |                  |                    |                  |                    |                  |                    |                  |                    |  |
|---|------------------|--|------------------|--------------------|------------------|--------------------|------------------|--------------------|------------------|--------------------|--|
| <small>(R\$000, except per share data)<br/>(Fiscal year ends December 31)</small> |                  |  |                  |                    |                  |                    |                  |                    |                  |                    |  |
|   | (Mar)<br>1Q10E   | % Rev or<br>Margin                       | (Jun)<br>2Q10E   | % Rev or<br>Margin | (Sep)<br>3Q10E   | % Rev or<br>Margin | (Dec)<br>4Q10E   | % Rev or<br>Margin | FY10E            | % Rev or<br>Margin |  |
| <b>Gross Revenue from Sales and Services</b>                                      | 1,868,579        |  | 1,831,041        |                    | 1,916,622        |                    | 2,049,457        |                    | 7,665,699        |                    |  |
| Water segment   | 1,046,212        |  | 1,018,718        |                    | 1,056,788        |                    | 1,129,335        |                    | 4,251,054        |                    |  |
| Sewage segment  | 792,649          |  | 781,191          |                    | 827,119          |                    | 886,553          |                    | 3,287,512        |                    |  |
| Services  | 29,718           |  | 31,132           |                    | 32,715           |                    | 33,569           |                    | 127,133          |                    |  |
| Taxes on Sales and Services - CONFINS and PASEP                                   | (132,669)        |  | (133,666)        |                    | (134,164)        |                    | (141,413)        |                    | (541,911)        |                    |  |
| <b>Net Revenue from Sales and Services</b>  | <b>1,735,910</b> |  | <b>1,697,375</b> |                    | <b>1,782,459</b> |                    | <b>1,908,044</b> |                    | <b>7,123,787</b> |                    |  |
| Cost of sales   | 840,861          | 45.0%                                    | 823,968          | 45.0%              | 843,314          | 44.0%              | 860,772          | 42.0%              | 3,368,914        | 43.9%              |  |
| <b>Gross profit</b>   | <b>895,049</b>   | <b>47.9%</b>                             | <b>873,406</b>   | <b>47.7%</b>       | <b>939,145</b>   | <b>49.0%</b>       | <b>1,047,272</b> | <b>51.1%</b>       | <b>3,754,873</b> | <b>49.0%</b>       |  |
| Selling expenses  | 205,544          | 11.0%                                    | 190,428          | 10.4%              | 189,746          | 9.9%               | 202,898          | 9.9%               | 788,614          | 10.3%              |  |
| Administrative expenses   | 115,852          | 6.2%                                     | 117,187          | 6.4%               | 118,831          | 6.2%               | 122,967          | 6.0%               | 474,836          | 6.2%               |  |
| Other operating expenses, net   | (4,340)          | -0.2%                                    | (4,243)          | -0.2%              | (4,456)          | -0.2%              | (4,770)          | -0.2%              | (17,809)         | -0.2%              |  |
| <b>Operating income before shareholdings</b>                                      | <b>577,994</b>   | <b>30.9%</b>                             | <b>570,035</b>   | <b>31.1%</b>       | <b>635,025</b>   | <b>33.1%</b>       | <b>726,179</b>   | <b>35.4%</b>       | <b>2,509,232</b> | <b>32.7%</b>       |  |
| Equity Results  | 125              | 0.0%                                     | 150              | 0.0%               | 175              | 0.0%               | 200              | 0.0%               | 650              | 0.0%               |  |
| <b>Earnings before financial results</b>  | <b>577,869</b>   | <b>30.9%</b>                             | <b>569,885</b>   | <b>31.1%</b>       | <b>634,850</b>   | <b>33.1%</b>       | <b>725,979</b>   | <b>35.4%</b>       | <b>2,508,582</b> | <b>32.7%</b>       |  |
| Financial, net  | (115,852)        | -6.2%                                    | (117,187)        | -6.4%              | (120,747)        | -6.3%              | (120,918)        | -5.9%              | (474,704)        | -6.2%              |  |
| Exchange gain (loss), net   | 0                | 0.0%                                     | 0                | 0.0%               | 0                | 0.0%               | 0                | 0.0%               | 0                | 0.0%               |  |
| <b>Income before taxes and social contributions</b>                               | <b>462,017</b>   | <b>24.7%</b>                             | <b>452,698</b>   | <b>24.7%</b>       | <b>514,103</b>   | <b>26.8%</b>       | <b>605,061</b>   | <b>29.5%</b>       | <b>2,033,879</b> | <b>26.5%</b>       |  |
| Income taxes and social contributions - Deferred                                  | 179,384          | 9.6%                                     | 181,273          | 9.9%               | 183,996          | 9.6%               | 196,748          | 9.6%               | 741,400          | 9.7%               |  |
| Income taxes and social contributions - Current                                   | (46,714)         | -2.5%                                    | (45,776)         | -2.5%              | (47,916)         | -2.5%              | (51,236)         | -2.5%              | (191,642)        | -2.5%              |  |
| <b>Net income</b>   | <b>329,348</b>   | <b>17.6%</b>                             | <b>317,201</b>   | <b>17.3%</b>       | <b>378,022</b>   | <b>19.7%</b>       | <b>459,550</b>   | <b>22.4%</b>       | <b>1,484,121</b> | <b>19.4%</b>       |  |
| Earnings per share:   |                  |  |                  |                    |                  |                    |                  |                    |                  |                    |  |
| EPS Reported  | R\$ 1.45         |  | R\$ 1.39         |                    | R\$ 1.66         |                    | R\$ 2.02         |                    | R\$ 6.51         |                    |  |
| EPADS (USD)   | \$1.63           |  | \$1.57           |                    | \$1.87           |                    | \$2.28           |                    | \$7.36           |                    |  |
| Diluted shares outstanding  | 227,836          |  | 227,836          |                    | 227,836          |                    | 227,836          |                    | 227,836          |                    |  |

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

**INDUSTRY UPDATE**

**Water Utilities, Flow Technology and Purification**

| <b>American Water Works Company, Inc., 2009E</b>         |               |                |               |                |               |                |               |                |               |                |
|--|---------------|----------------|---------------|----------------|---------------|----------------|---------------|----------------|---------------|----------------|
| (\$M, except per share data)                             |               |                |               |                |               |                |               |                |               |                |
| Fiscal year ends December 31                             |               |                |               |                |               |                |               |                |               |                |
|  | 1Q09          | Rate or Margin | 2Q09          | Rate or Margin | 3Q09E         | Rate or Margin | 4Q09E         | Rate or Margin | 2009E         | Rate or Margin |
| <b>Operating Revenues</b>                                | 550.2         |                | 612.7         |                | 673.2         |                | 649.0         |                | 2,485.1       |                |
| Operation and maintenance                                | 314.4         | 57%            | 330.6         | 54%            | 336.6         | 50%            | 363.4         | 56%            | 1,345.0       | 54%            |
| Depreciation and amortization                            | 68.8          | 13%            | 73.2          | 12%            | 70.7          | 11%            | 74.0          | 11%            | 286.7         | 12%            |
| General taxes  | 52.5          | 10%            | 51.7          | 8%             | 49.1          | 7%             | 51.9          | 8%             | 205.3         | 8%             |
| Loss (gain) on sales of assets                           | (0.2)         | 0%             | -             | 0%             | -             | 0%             | -             | 0%             | (0.2)         | 0%             |
| Impairment charges                                       | 450.0         | 82%            | -             | 0%             | -             | 0%             | -             | 0%             | 450.0         | 18%            |
| <b>Total operating expenses, net</b>                     | 435.5         | 79%            | 455.5         | 74%            | 455.4         | 68%            | 489.3         | 75%            | 1,836.8       | 74%            |
| <b>Operating income</b>                                  | 114.7         | 21%            | 157.2         | 26%            | 216.8         | 32%            | 159.7         | 25%            | 648.3         | 26%            |
| Interest, net  | (72.0)        | -13.1%         | (73.7)        | -12.0%         | (72.7)        | -10.8%         | (76.6)        | -11.8%         | (295.0)       | -11.9%         |
| Amortization of debt expense                             | (1.5)         | -0.3%          | (1.5)         | -0.2%          | (1.3)         | -0.2%          | (1.5)         | -0.2%          | (5.8)         | -0.2%          |
| Other, net   | 6.3           | 1.1%           | 4.2           | 0.7%           | 4.4           | 0.7%           | 4.9           | 0.8%           | 19.9          | 0.8%           |
| <b>Total other income (deductions)</b>                   | (67.2)        | -12.2%         | (71.1)        | -11.6%         | (69.6)        | -10.3%         | (73.1)        | -11.3%         | (281.0)       | -11.3%         |
| <b>Earnings from cont. ops before income taxes</b>       | 47.5          | 8.6%           | 86.1          | 14.1%          | 147.2         | 21.9%          | 86.5          | 13.3%          | 367.3         | 14.8%          |
| Income taxes   | 17.6          | 37.1%          | 34.1          | 39.6%          | 58.3          | 39.6%          | 34.3          | 39.6%          | 144.2         | 39.3%          |
| <b>Earnings from cont. ops</b>                           | 29.9          | 5.4%           | 52.0          | 8.5%           | 88.9          | 13.2%          | 52.3          | 8.1%           | 223.0         | 9.0%           |
| Income / (Loss) from discontinued operations, net of tax | -             | 0.0%           | -             | 0.0%           | -             | 0.0%           | -             | 0.0%           | -             | 0.0%           |
| <b>Net income</b>  | 29.9          | 5.4%           | 52.0          | 8.5%           | 88.9          | 13.2%          | 52.3          | 8.1%           | 223.0         | 9.0%           |
| <b>Earnings per share:</b>                               |               |                |               |                |               |                |               |                |               |                |
| <b>From continuing operations</b>                        | <b>\$0.19</b> |                | <b>\$0.32</b> |                | <b>\$0.51</b> |                | <b>\$0.30</b> |                | <b>\$1.32</b> |                |
| Average common shares outstanding                        | 160           |                | 163           |                | 174           |                | 174           |                | 168           |                |
| <b>American Water Works Company, Inc., 2010E</b>         |               |                |               |                |               |                |               |                |               |                |
| (\$M, except per share data)                             |               |                |               |                |               |                |               |                |               |                |
| Fiscal year ends December 31                             |               |                |               |                |               |                |               |                |               |                |
|  | 1Q10E         | Rate or Margin | 2Q10E         | Rate or Margin | 3Q10E         | Rate or Margin | 4Q10E         | Rate or Margin | 2010E         | Rate or Margin |
| <b>Operating Revenues</b>                                | 583.2         |                | 665.1         |                | 743.15        |                | 688.99        |                | 2,660.4       |                |
| Operation and maintenance                                | 314.3         | 56%            | 337.9         | 51%            | 376.8         | 51%            | 392.7         | 57%            | 1,421.6       | 53%            |
| Depreciation and amortization                            | 74.3          | 13%            | 76.5          | 12%            | 78.0          | 11%            | 79.2          | 12%            | 308.1         | 12%            |
| General taxes  | 50.7          | 9%             | 59.9          | 9%             | 52.0          | 7%             | 55.1          | 8%             | 217.7         | 8%             |
| Loss (gain) on sales of assets                           | (0.2)         | 0%             | -             | 0%             | (0.7)         | 0%             | (6.2)         | -1%            | (7.1)         | 0%             |
| Impairment charges                                       | -             | 0%             | -             | 0%             | -             | 0%             | -             | 0%             | -             | 0%             |
| <b>Total operating expenses, net</b>                     | 439.1         | 78%            | 474.2         | 71%            | 506.1         | 68%            | 520.9         | 76%            | 1,940.3       | 73%            |
| <b>Operating income</b>                                  | 124.1         | 22%            | 190.9         | 29%            | 237.1         | 32%            | 168.1         | 24%            | 720.2         | 27%            |
| Interest, net  | (75.5)        | -13.4%         | (76.5)        | -11.5%         | (77.3)        | -10.4%         | (78.5)        | -11.4%         | (307.8)       | -11.6%         |
| Amortization of debt expense                             | (1.4)         | -0.2%          | (1.4)         | -0.2%          | (1.4)         | -0.2%          | (1.4)         | -0.2%          | (5.6)         | -0.2%          |
| Other, net   | 4.7           | 0.8%           | 4.7           | 0.7%           | 4.8           | 0.6%           | 4.7           | 0.7%           | 18.9          | 0.7%           |
| <b>Total other income (deductions)</b>                   | (72.1)        | -12.6%         | (73.2)        | -11.0%         | (73.9)        | -10.0%         | (75.2)        | -10.9%         | (294.4)       | -11.1%         |
| <b>Earnings from cont. ops before income taxes</b>       | 52.0          | 9.2%           | 117.7         | 17.7%          | 163.1         | 22.0%          | 92.9          | 13.5%          | 425.7         | 16.0%          |
| Income taxes   | 20.8          | 40.0%          | 47.1          | 40.0%          | 65.2          | 40.0%          | 37.2          | 40.0%          | 170.3         | 40.0%          |
| <b>Earnings from cont. ops</b>                           | 31.2          | 5.5%           | 70.6          | 10.6%          | 97.9          | 13.2%          | 55.7          | 8.1%           | 255.4         | 9.6%           |
| Income / (Loss) from discontinued operations, net of tax | -             | 0.0%           | -             | 0.0%           | -             | 0.0%           | -             | 0.0%           | -             | 0.0%           |
| <b>Net income</b>  | 31.2          | 5.5%           | 70.6          | 10.6%          | 97.9          | 13.2%          | 55.7          | 8.1%           | 255.4         | 9.6%           |
| <b>Earnings per share:</b>                               |               |                |               |                |               |                |               |                |               |                |
| <b>From continuing operations</b>                        | <b>\$0.17</b> |                | <b>\$0.38</b> |                | <b>\$0.53</b> |                | <b>\$0.30</b> |                | <b>\$1.39</b> |                |
| Average common shares outstanding                        | 179           |                | 184           |                | 184           |                | 184           |                | 183           |                |

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

**INDUSTRY UPDATE**

**Water Utilities, Flow Technology and Purification**

| <b>Aqua America</b>            |               | <b>Quarterly Income Statement, 2009E</b> |               |                    |               |                    |               |                    |                |                    |
|--------------------------------|---------------|--|---------------|--------------------|---------------|--------------------|---------------|--------------------|----------------|--------------------|
| (\$000, except per share data) |               |  |               |                    |               |                    |               |                    |                |                    |
| Fiscal year ends December 31   |               |  |               |                    |               |                    |               |                    |                |                    |
|                                | 1Q09          | % Rev or<br>Margin                       | 2Q09          | % Rev or<br>Margin | 3Q09E         | % Rev or<br>Margin | 4Q09E         | % Rev or<br>Margin | 2009E          | % Rev or<br>Margin |
| <b>Sales</b>                   | 154,487       |  | 167,333       |                    | 189,495       |                    | 180,619       |                    | 691,934        |                    |
| Operating & maintenance        | 66,989        | 43.4%                                    | 68,549        | 41.0%              | 77,693        | 41.0%              | 73,151        | 40.5%              | 286,382        | 41.4%              |
| Depreciation                   | 26,387        | 17.1%                                    | 24,972        | 14.9%              | 26,529        | 14.0%              | 26,190        | 14.5%              | 104,078        | 15.0%              |
| Amortization                   | 2,755         | 1.8%                                     | 3,064         | 1.8%               | 1,895         | 1.0%               | 2,709         | 1.5%               | 10,423         | 1.5%               |
| Non-income taxes               | 11,590        | 7.5%                                     | 11,884        | 7.1%               | 11,938        | 6.3%               | 12,101        | 6.7%               | 47,514         | 6.9%               |
| <b>Operating income</b>        | <b>46,766</b> | <b>30.3%</b>                             | <b>58,864</b> | <b>35.2%</b>       | <b>71,440</b> | <b>37.7%</b>       | <b>66,468</b> | <b>36.8%</b>       | <b>243,537</b> | <b>35.2%</b>       |
| Interest expense, net          | 16,628        | 10.8%                                    | 16,809        | 10.0%              | 18,570        | 9.8%               | 17,701        | 9.8%               | 69,708         | 10.1%              |
| AFC                            | (625)         | -0.4%                                    | (568)         | -0.3%              | (750)         | -0.4%              | (1,000)       | -0.6%              | (2,943)        | -0.4%              |
| Gain on sale of other assets   | (133)         | -0.1%                                    | (80)          | 0.0%               | (800)         | -0.4%              | (500)         | -0.3%              | (1,513)        | -0.2%              |
| Income before taxes            | 30,896        | 20.0%                                    | 42,703        | 25.5%              | 54,419        | 28.7%              | 50,267        | 27.8%              | 178,285        | 25.8%              |
| Income taxes                   | 12,525        | 40.5%                                    | 16,850        | 39.5%              | 22,312        | 41.0%              | 20,107        | 40.0%              | 71,794         | 40.3%              |
| <b>Net income</b>              | <b>18,371</b> | <b>11.9%</b>                             | <b>25,853</b> | <b>15.5%</b>       | <b>32,107</b> | <b>16.9%</b>       | <b>30,160</b> | <b>16.7%</b>       | <b>106,492</b> | <b>15.4%</b>       |
| <b>Earnings per share</b>      | <b>\$0.14</b> |  | <b>\$0.19</b> |                    | <b>\$0.24</b> |                    | <b>\$0.22</b> |                    | <b>\$0.78</b>  |                    |
| Shares outstanding (000)       | 135,876       |  | 135,939       |                    | 136,139       |                    | 136,339       |                    | 136,073        |                    |
| <b>Aqua America</b>            |               | <b>Quarterly Income Statement, 2010E</b> |               |                    |               |                    |               |                    |                |                    |
| (\$000, except per share data) |               |  |               |                    |               |                    |               |                    |                |                    |
| Fiscal year ends December 31   |               |  |               |                    |               |                    |               |                    |                |                    |
|                                | 1Q10E         | % Rev or<br>Margin                       | 2Q10E         | % Rev or<br>Margin | 3Q10E         | % Rev or<br>Margin | 4Q10E         | % Rev or<br>Margin | 2010E          | % Rev or<br>Margin |
| <b>Sales</b>                   | 163,756       |  | 177,373       |                    | 200,865       |                    | 191,456       |                    | 733,450        |                    |
| Operating & maintenance        | 68,123        | 41.6%                                    | 72,723        | 41.0%              | 79,542        | 39.6%              | 75,817        | 39.6%              | 296,205        | 40.4%              |
| Depreciation                   | 26,201        | 16.0%                                    | 25,187        | 14.2%              | 25,108        | 12.5%              | 25,847        | 13.5%              | 102,343        | 14.0%              |
| Amortization                   | 2,456         | 1.5%                                     | 2,661         | 1.5%               | 2,009         | 1.0%               | 2,106         | 1.1%               | 9,232          | 1.3%               |
| Non-income taxes               | 10,972        | 6.7%                                     | 11,174        | 6.3%               | 12,052        | 6.0%               | 11,679        | 6.1%               | 45,877         | 6.3%               |
| <b>Operating income</b>        | <b>56,005</b> | <b>34.2%</b>                             | <b>65,628</b> | <b>37.0%</b>       | <b>82,154</b> | <b>40.9%</b>       | <b>76,008</b> | <b>39.7%</b>       | <b>279,794</b> | <b>38.1%</b>       |
| Interest expense, net          | 17,194        | 10.5%                                    | 17,737        | 10.0%              | 16,873        | 8.4%               | 17,997        | 9.4%               | 69,801         | 9.5%               |
| AFC                            | (1,000)       | -0.6%                                    | (1,000)       | -0.6%              | (1,000)       | -0.5%              | (1,000)       | -0.5%              | (4,000)        | -0.5%              |
| Gain on sale of other assets   | (500)         | -0.3%                                    | (500)         | -0.3%              | (500)         | -0.2%              | (500)         | -0.3%              | (2,000)        | -0.3%              |
| Income before taxes            | 40,310        | 24.6%                                    | 49,391        | 27.8%              | 66,781        | 33.2%              | 59,511        | 31.1%              | 215,993        | 29.4%              |
| Income taxes                   | 16,124        | 40.0%                                    | 19,756        | 40.0%              | 26,712        | 40.0%              | 23,805        | 40.0%              | 86,397         | 40.0%              |
| <b>Net income</b>              | <b>24,186</b> | <b>14.8%</b>                             | <b>29,634</b> | <b>16.7%</b>       | <b>40,069</b> | <b>19.9%</b>       | <b>35,707</b> | <b>18.7%</b>       | <b>129,596</b> | <b>17.7%</b>       |
| <b>Earnings per share</b>      | <b>\$0.18</b> |  | <b>\$0.22</b> |                    | <b>\$0.29</b> |                    | <b>\$0.26</b> |                    | <b>\$0.95</b>  |                    |
| Shares outstanding (000)       | 136,589       |  | 136,839       |                    | 137,089       |                    | 137,339       |                    | 136,964        |                    |

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

INDUSTRY UPDATE

Water Utilities, Flow Technology and Purification

| California Water Service Group              |               | Quarterly Income Statement, 2009E |               |                    |               |                    |               |                    |                |                    |
|---|---------------|-----------------------------------|---------------|--------------------|---------------|--------------------|---------------|--------------------|----------------|--------------------|
| (\$000, except per share data)              |               |                                   |               |                    |               |                    |               |                    |                |                    |
| Fiscal year ends December 31                |               |                                   |               |                    |               |                    |               |                    |                |                    |
|   | 1Q09          | % Rev or<br>Margin                | 2Q09          | % Rev or<br>Margin | 3Q09E         | % Rev or<br>Margin | 4Q09E         | % Rev or<br>Margin | 2009E          | % Rev or<br>Margin |
| <b>Total Revenues</b>                       | 86,613        |                                   | 116,667       |                    | 140,921       |                    | 105,113       |                    | 449,315        |                    |
| Water production costs                      | 28,868        | 33.3%                             | 41,702        | 35.7%              | 56,368        | 40.0%              | 37,315        | 35.5%              | 164,254        | 36.6%              |
| Other operations                            | 31,317        | 36.2%                             | 33,716        | 28.9%              | 29,593        | 21.0%              | 25,227        | 24.0%              | 119,854        | 26.7%              |
| Maintenance                                 | 4,635         | 5.4%                              | 4,313         | 3.7%               | 4,509         | 3.2%               | 4,205         | 4.0%               | 17,662         | 3.9%               |
| Depreciation and amortization               | 10,198        | 11.8%                             | 10,282        | 8.8%               | 9,900         | 7.0%               | 10,000        | 9.5%               | 40,380         | 9.0%               |
| <b>Operating income</b>                     | <b>11,595</b> | <b>13.4%</b>                      | <b>26,654</b> | <b>22.8%</b>       | <b>40,550</b> | <b>28.8%</b>       | <b>28,366</b> | <b>27.0%</b>       | <b>107,165</b> | <b>23.9%</b>       |
| Non-regulated income, net                   | 240           | 0.3%                              | 2,378         | 2.0%               | 750           | 0.5%               | 750           | 0.7%               | 4,118          | 0.9%               |
| Gain (loss) on sale of non-utility property | 603           | 0.7%                              | 72            | 0.1%               | 0             | 0.0%               | 0             | 0.0%               | 0              | 0.0%               |
| Interest expense                            | 5,038         | 5.8%                              | 5,961         | 5.1%               | 5,350         | 3.8%               | 5,400         | 5.1%               | 21,749         | 4.8%               |
| Capitalized interest                        | 679           | 0.8%                              | 640           | 0.5%               | 800           | 0.6%               | 800           | 0.8%               | 2,919          | 0.6%               |
| <b>Income before taxes</b>                  | <b>8,079</b>  | <b>9.3%</b>                       | <b>23,783</b> | <b>20.4%</b>       | <b>36,750</b> | <b>26.1%</b>       | <b>24,516</b> | <b>23.3%</b>       | <b>92,453</b>  | <b>20.6%</b>       |
| Income taxes                                | 1,570         | 19.4%                             | 7,782         | 32.7%              | 12,495        | 34.0%              | 8,826         | 36.0%              | 30,673         | 33.2%              |
| Property and other tax                      | 4,088         | 50.6%                             | 3,911         | 16.4%              | 3,800         | 10.3%              | 5,516         | 22.5%              | 17,315         | 18.7%              |
| <b>Net income</b>                           | <b>2,421</b>  | <b>2.8%</b>                       | <b>12,090</b> | <b>10.4%</b>       | <b>20,455</b> | <b>14.5%</b>       | <b>10,174</b> | <b>9.7%</b>        | <b>45,140</b>  | <b>10.0%</b>       |
| <b>Earnings per share</b>                   | <b>\$0.12</b> |                                   | <b>\$0.58</b> |                    | <b>\$0.98</b> |                    | <b>\$0.49</b> |                    | <b>\$2.16</b>  |                    |
| Diluted shares outstanding (000)            | 20,800        |                                   | 20,767        |                    | 20,900        |                    | 20,950        |                    | 20,854         |                    |

| California Water Service Group              |               | Quarterly Income Statement, 2010E |               |                    |               |                    |               |                    |                |                    |
|---|---------------|-----------------------------------|---------------|--------------------|---------------|--------------------|---------------|--------------------|----------------|--------------------|
| (\$000, except per share data)              |               |                                   |               |                    |               |                    |               |                    |                |                    |
| Fiscal year ends December 31                |               |                                   |               |                    |               |                    |               |                    |                |                    |
|   | 1Q10E         | % Rev or<br>Margin                | 2Q10E         | % Rev or<br>Margin | 3Q10E         | % Rev or<br>Margin | 4Q10E         | % Rev or<br>Margin | 2010E          | % Rev or<br>Margin |
| <b>Total Revenues</b>                       | 92,676        |                                   | 122,500       |                    | 147,967       |                    | 110,369       |                    | 473,513        |                    |
| Water production costs                      | 32,622        | 35.2%                             | 45,080        | 36.8%              | 59,187        | 40.0%              | 39,181        | 35.5%              | 176,070        | 37.2%              |
| Other operations                            | 31,510        | 34.0%                             | 31,850        | 26.0%              | 31,073        | 21.0%              | 28,696        | 26.0%              | 123,129        | 26.0%              |
| Maintenance                                 | 4,200         | 4.5%                              | 4,225         | 3.4%               | 4,250         | 2.9%               | 4,275         | 3.9%               | 16,950         | 3.6%               |
| Depreciation and amortization               | 10,100        | 10.9%                             | 10,200        | 8.3%               | 10,300        | 7.0%               | 10,400        | 9.4%               | 41,000         | 8.7%               |
| <b>Operating income</b>                     | <b>14,244</b> | <b>15.4%</b>                      | <b>31,145</b> | <b>25.4%</b>       | <b>43,157</b> | <b>29.2%</b>       | <b>27,817</b> | <b>25.2%</b>       | <b>116,364</b> | <b>24.6%</b>       |
| Non-regulated income, net                   | 800           | 0.9%                              | 800           | 0.7%               | 800           | 0.5%               | 800           | 0.7%               | 3,200          | 0.7%               |
| Gain (loss) on sale of non-utility property | 0             | 0.0%                              | 0             | 0.0%               | 0             | 0.0%               | 0             | 0.0%               | 0              | 0.0%               |
| Interest expense                            | 5,450         | 5.9%                              | 5,500         | 4.5%               | 5,550         | 3.8%               | 5,575         | 5.1%               | 22,075         | 4.7%               |
| Capitalized interest                        | 800           | 0.9%                              | 800           | 0.7%               | 800           | 0.5%               | 800           | 0.7%               | 3,200          | 0.7%               |
| <b>Income before taxes</b>                  | <b>10,394</b> | <b>11.2%</b>                      | <b>27,245</b> | <b>22.2%</b>       | <b>39,207</b> | <b>26.5%</b>       | <b>23,842</b> | <b>21.6%</b>       | <b>100,689</b> | <b>21.3%</b>       |
| Income taxes                                | 1,039         | 10.0%                             | 9,808         | 36.0%              | 13,330        | 34.0%              | 8,583         | 36.0%              | 32,761         | 32.5%              |
| Property and other tax                      | 7,068         | 68.0%                             | 3,250         | 11.9%              | 3,800         | 9.7%               | 5,364         | 22.5%              | 19,483         | 19.3%              |
| <b>Net income</b>                           | <b>2,287</b>  | <b>2.5%</b>                       | <b>14,187</b> | <b>11.6%</b>       | <b>22,077</b> | <b>14.9%</b>       | <b>9,894</b>  | <b>9.0%</b>        | <b>48,445</b>  | <b>10.2%</b>       |
| <b>Earnings per share</b>                   | <b>\$0.11</b> |                                   | <b>\$0.67</b> |                    | <b>\$1.05</b> |                    | <b>\$0.47</b> |                    | <b>\$2.30</b>  |                    |
| Diluted shares outstanding (000)            | 21,000        |                                   | 21,050        |                    | 21,100        |                    | 21,150        |                    | 21,075         |                    |

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

**INDUSTRY UPDATE**

Water Utilities, Flow Technology and Purification

| Quarterly Income Statement, 2009E                         |               |                |               |                |               |                |               |                |                | American States Water Company (AWR) |  |
|---|---------------|----------------|---------------|----------------|---------------|----------------|---------------|----------------|----------------|-------------------------------------|--|
| (Amounts In thousands USD Dollars, except per share data) |               |                |               |                |               |                |               |                |                |                                     |  |
|   | 1Q 2009       | Rate or Margin | 2Q 2009       | Rate or Margin | 3Q 2009E      | Rate or Margin | 4Q 2009E      | Rate or Margin | 2009E          | Rate or Margin                      |  |
| <b>Operating Revenues</b>                                 |               |                |               |                |               |                |               |                |                |                                     |  |
| Water Revenue   | 56,794        | 71.3%          | 74,157        | 79.3%          | 73,527        | 78.2%          | 65,390        | 76.6%          | 269,868        | 76.5%                               |  |
| Electric Revenue  | 8,632         | 10.8%          | 5,888         | 6.3%           | 6,810         | 7.2%           | 6,870         | 8.0%           | 28,201         | 8.0%                                |  |
| Contracted Services / Other Revenue                       | 14,183        | 17.8%          | 13,508        | 14.4%          | 13,730        | 14.6%          | 13,136        | 15.4%          | 54,557         | 15.5%                               |  |
| <b>Operating Revenues</b>                                 | <b>79,609</b> | <b>100.0%</b>  | <b>93,553</b> | <b>100.0%</b>  | <b>94,067</b> | <b>100.0%</b>  | <b>85,396</b> | <b>100.0%</b>  | <b>352,625</b> | <b>100.0%</b>                       |  |
| <b>Cost of Sales</b>                                      |               |                |               |                |               |                |               |                |                |                                     |  |
| Water purchased   | 7,951         | 14.0%          | 12,607        | 17.0%          | 14,705        | 20.0%          | 11,378        | 17.4%          | 46,641         | 17.3%                               |  |
| Power purchased for pumping                               | 2,158         | 3.8%           | 2,591         | 3.5%           | 2,724         | 3.7%           | 3,641         | 5.6%           | 11,114         | 4.1%                                |  |
| Groundwater production assessment                         | 2,215         | 3.9%           | 2,892         | 3.9%           | 2,720         | 3.7%           | 2,485         | 3.8%           | 10,312         | 3.8%                                |  |
| Power purchased for resale                                | 2,590         | 30.0%          | 2,708         | 46.0%          | 3,133         | 46.0%          | 2,885         | 42.0%          | 11,316         | 40.1%                               |  |
| Supply costs  | 19,909        | 25.0%          | 23,537        | 25.2%          | 23,283        | 24.8%          | 20,389        | 23.9%          | 79,384         | 22.5%                               |  |
| Unrealized loss (gain) on purchased power contracts       | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0              | 0.0%                                |  |
| Supply cost balancing accounts (income)                   | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0              | 0.0%                                |  |
| <b>Cost of Sales</b>                                      | <b>19,909</b> | <b>25.0%</b>   | <b>23,537</b> | <b>25.2%</b>   | <b>23,283</b> | <b>24.8%</b>   | <b>20,389</b> | <b>23.9%</b>   | <b>87,118</b>  | <b>24.7%</b>                        |  |
| <b>Gross Profit</b>                                       | <b>59,700</b> | <b>75.0%</b>   | <b>70,016</b> | <b>74.8%</b>   | <b>70,784</b> | <b>75.2%</b>   | <b>65,007</b> | <b>76.1%</b>   | <b>265,507</b> | <b>75.3%</b>                        |  |
| <b>Operating Expenses</b>                                 |               |                |               |                |               |                |               |                |                |                                     |  |
| Other operating expenses                                  | 7,153         | 9.0%           | 7,165         | 7.7%           | 7,525         | 8.0%           | 7,429         | 8.7%           | 29,273         | 8.3%                                |  |
| Administrative and general expenses                       | 16,865        | 21.2%          | 15,522        | 16.6%          | 16,462        | 17.5%          | 16,225        | 19.0%          | 65,074         | 18.5%                               |  |
| Depreciation and amortization                             | 8,361         | 10.5%          | 8,387         | 9.0%           | 8,466         | 9.0%           | 8,454         | 9.9%           | 33,668         | 9.5%                                |  |
| Maintenance   | 4,073         | 5.1%           | 3,887         | 4.2%           | 4,986         | 5.3%           | 3,757         | 4.4%           | 16,703         | 4.7%                                |  |
| Property and other taxes                                  | 3,400         | 4.3%           | 2,712         | 2.9%           | 3,386         | 3.6%           | 2,989         | 3.5%           | 12,487         | 3.5%                                |  |
| Construction expenses                                     | 8,445         | 10.6%          | 7,829         | 8.4%           | 7,902         | 8.4%           | 7,429         | 8.7%           | 31,605         | 9.0%                                |  |
| Net gain on sale of property                              | (15)          | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | (15)           | 0.0%                                |  |
| Gain on sale of water rights                              | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0              | 0.0%                                |  |
| Gain on settlement for removal of wells                   | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0              | 0.0%                                |  |
| <b>Operating Expenses</b>                                 | <b>48,282</b> | <b>60.6%</b>   | <b>45,502</b> | <b>48.6%</b>   | <b>48,727</b> | <b>51.8%</b>   | <b>46,285</b> | <b>54.2%</b>   | <b>188,795</b> | <b>53.5%</b>                        |  |
| <b>Operating Income</b>                                   | <b>11,418</b> | <b>14.3%</b>   | <b>24,514</b> | <b>26.2%</b>   | <b>22,057</b> | <b>23.4%</b>   | <b>18,722</b> | <b>21.9%</b>   | <b>76,711</b>  | <b>21.8%</b>                        |  |
| <b>EBITDA</b>   | <b>19,779</b> | <b>24.8%</b>   | <b>32,901</b> | <b>35.2%</b>   | <b>30,523</b> | <b>32.4%</b>   | <b>27,176</b> | <b>31.8%</b>   | <b>110,380</b> | <b>31.3%</b>                        |  |
| Refund of water right lease revenues income               | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0              | 0.0%                                |  |
| Other income (loss)                                       | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0              | 0.0%                                |  |
| <b>EBIT</b>   | <b>11,418</b> | <b>14.3%</b>   | <b>24,514</b> | <b>26.2%</b>   | <b>22,057</b> | <b>23.4%</b>   | <b>18,722</b> | <b>21.9%</b>   | <b>76,711</b>  | <b>21.8%</b>                        |  |
| Interest expense (loss)                                   | (5,294)       | -6.7%          | (5,659)       | -6.0%          | (5,631)       | -6.1%          | (5,764)       | -6.8%          | (22,408)       | -6.4%                               |  |
| Interest income   | 202           | 0.3%           | 296           | 0.3%           | 400           | 0.4%           | 400           | 0.5%           | 1,298          | 0.4%                                |  |
| Interest on long-term debt (loss)                         | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0              | 0.0%                                |  |
| Other interest and amortization of debt expense (loss)    | (30)          | 0.0%           | 82            | 0.1%           | 0             | 0.0%           | 0             | 0.0%           | 52             | 0.0%                                |  |
| <b>EBT</b>  | <b>6,296</b>  | <b>7.9%</b>    | <b>19,233</b> | <b>20.6%</b>   | <b>16,766</b> | <b>17.8%</b>   | <b>13,358</b> | <b>15.6%</b>   | <b>55,653</b>  | <b>15.8%</b>                        |  |
| Income tax expense  | 1,364         | 1.7%           | 7,734         | 8.3%           | 6,679         | 7.1%           | 5,124         | 6.0%           | 20,901         | 5.9%                                |  |
| <b>Net Income</b>   | <b>4,932</b>  | <b>6.2%</b>    | <b>11,499</b> | <b>12.3%</b>   | <b>10,088</b> | <b>10.7%</b>   | <b>8,234</b>  | <b>9.6%</b>    | <b>34,753</b>  | <b>9.9%</b>                         |  |
|   | 17,440        |                | 17,861        |                | 18,450        |                | 18,500        |                | 18,063         |                                     |  |
| <b>EPS (as adjusted)</b>                                  | <b>\$0.28</b> |                | <b>\$0.64</b> |                | <b>\$0.55</b> |                | <b>\$0.45</b> |                | <b>\$1.92</b>  |                                     |  |

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



**INDUSTRY UPDATE**

**Water Utilities, Flow Technology and Purification**

| Quarterly Income Statement, 2010E                         |               |                |               |                |               |                |               |                |                | American States Water Company (AWR) |  |
|---|---------------|----------------|---------------|----------------|---------------|----------------|---------------|----------------|----------------|-------------------------------------|--|
| (Amounts in thousands USD Dollars, except per share data) |               |                |               |                |               |                |               |                |                |                                     |  |
|   | 1Q 2010E      | Rate or Margin | 2Q 2010E      | Rate or Margin | 3Q 2010E      | Rate or Margin | 4Q 2010E      | Rate or Margin | 2010E          | Rate or Margin                      |  |
| <b>Operating Revenues</b>                                 |               |                |               |                |               |                |               |                |                |                                     |  |
| Water Revenue   | 59,634        | 71.4%          | 77,865        | 78.9%          | 77,203        | 77.7%          | 68,659        | 76.2%          | 283,361        | 76.3%                               |  |
| Electric Revenue  | 8,977         | 10.8%          | 6,182         | 6.3%           | 7,151         | 7.2%           | 7,282         | 8.1%           | 29,593         | 8.0%                                |  |
| Contracted Services / Other Revenue                       | 14,892        | 17.8%          | 14,589        | 14.8%          | 14,965        | 15.1%          | 14,187        | 15.7%          | 58,633         | 15.8%                               |  |
| <b>Operating Revenues</b>                                 | <b>83,503</b> | <b>100.0%</b>  | <b>98,636</b> | <b>100.0%</b>  | <b>99,319</b> | <b>100.0%</b>  | <b>90,129</b> | <b>100.0%</b>  | <b>371,587</b> | <b>100.0%</b>                       |  |
| <b>Cost of Sales</b>                                      |               |                |               |                |               |                |               |                |                |                                     |  |
| Water purchased   | 8,289         | 13.9%          | 13,782        | 17.7%          | 14,669        | 19.0%          | 11,260        | 16.4%          | 48,000         | 16.9%                               |  |
| Power purchased for pumping                               | 2,693         | 4.5%           | 2,658         | 3.4%           | 2,860         | 3.7%           | 3,714         | 5.4%           | 11,926         | 4.2%                                |  |
| Groundwater production assessment                         | 2,385         | 4.0%           | 2,959         | 3.8%           | 2,934         | 3.8%           | 2,472         | 3.6%           | 10,750         | 3.8%                                |  |
| Power purchased for resale                                | 2,963         | 33.0%          | 2,597         | 42.0%          | 3,361         | 47.0%          | 3,277         | 45.0%          | 12,197         | 41.2%                               |  |
| Unrealized loss (gain) on purchased power contracts       | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0              | 0.0%                                |  |
| Supply cost balancing accounts (income)                   | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0              | 0.0%                                |  |
| <b>Cost of Sales</b>                                      | <b>16,330</b> | <b>19.6%</b>   | <b>21,996</b> | <b>22.3%</b>   | <b>23,824</b> | <b>24.0%</b>   | <b>20,723</b> | <b>23.0%</b>   | <b>82,873</b>  | <b>22.3%</b>                        |  |
| <b>Gross Profit</b>                                       | <b>67,173</b> | <b>80.4%</b>   | <b>76,640</b> | <b>77.7%</b>   | <b>75,496</b> | <b>76.0%</b>   | <b>69,406</b> | <b>77.0%</b>   | <b>288,714</b> | <b>77.7%</b>                        |  |
| <b>Operating Expenses</b>                                 |               |                |               |                |               |                |               |                |                |                                     |  |
| Other operating expenses                                  | 7,766         | 9.3%           | 7,891         | 8.0%           | 7,350         | 7.4%           | 7,571         | 8.4%           | 30,577         | 8.2%                                |  |
| Administrative and general expenses                       | 16,868        | 20.2%          | 17,163        | 17.4%          | 15,494        | 15.6%          | 15,772        | 17.5%          | 65,297         | 17.6%                               |  |
| Depreciation and amortization                             | 8,768         | 10.5%          | 8,680         | 8.8%           | 8,343         | 8.4%           | 8,382         | 9.3%           | 34,173         | 9.2%                                |  |
| Maintenance   | 4,927         | 5.9%           | 5,129         | 5.2%           | 4,867         | 4.9%           | 4,506         | 5.0%           | 19,429         | 5.2%                                |  |
| Property and other taxes                                  | 3,424         | 4.1%           | 3,551         | 3.6%           | 3,575         | 3.6%           | 3,154         | 3.5%           | 13,705         | 3.7%                                |  |
| Construction expenses                                     | 9,185         | 11.0%          | 9,568         | 9.7%           | 9,038         | 9.1%           | 9,463         | 10.5%          | 37,255         | 10.0%                               |  |
| Net gain on sale of property                              | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0              | 0.0%                                |  |
| Gain on sale of water rights                              | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0              | 0.0%                                |  |
| Gain on settlement for removal of wells                   | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0              | 0.0%                                |  |
| <b>Operating Expenses</b>                                 | <b>50,937</b> | <b>61.0%</b>   | <b>51,981</b> | <b>52.7%</b>   | <b>48,666</b> | <b>49.0%</b>   | <b>48,850</b> | <b>54.2%</b>   | <b>200,434</b> | <b>53.9%</b>                        |  |
| <b>Operating Income</b>                                   | <b>16,236</b> | <b>19.4%</b>   | <b>24,659</b> | <b>25.0%</b>   | <b>26,829</b> | <b>27.0%</b>   | <b>20,556</b> | <b>22.8%</b>   | <b>88,280</b>  | <b>23.8%</b>                        |  |
| <b>EBITDA</b>   | <b>25,004</b> | <b>29.9%</b>   | <b>33,339</b> | <b>33.8%</b>   | <b>35,172</b> | <b>35.4%</b>   | <b>28,938</b> | <b>32.1%</b>   | <b>122,453</b> | <b>33.0%</b>                        |  |
| Refund of water right lease revenues income               | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0              | 0.0%                                |  |
| Other income (loss)                                       | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0              | 0.0%                                |  |
| <b>EBIT</b>   | <b>16,236</b> | <b>19.4%</b>   | <b>24,659</b> | <b>25.0%</b>   | <b>26,829</b> | <b>27.0%</b>   | <b>20,556</b> | <b>22.8%</b>   | <b>88,280</b>  | <b>23.8%</b>                        |  |
| Interest expense (loss)                                   | (5,929)       | -7.1%          | (6,115)       | -6.2%          | (6,207)       | -6.3%          | (6,489)       | -7.2%          | (24,741)       | -6.7%                               |  |
| Interest income   | 370           | 0.4%           | 380           | 0.4%           | 390           | 0.4%           | 400           | 0.4%           | 1,540          | 0.4%                                |  |
| Interest on long-term debt (loss)                         | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0              | 0.0%                                |  |
| Other interest and amortization of debt expense (loss)    | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0             | 0.0%           | 0              | 0.0%                                |  |
| <b>EBT</b>  | <b>10,677</b> | <b>12.8%</b>   | <b>18,923</b> | <b>19.2%</b>   | <b>21,012</b> | <b>21.2%</b>   | <b>14,467</b> | <b>16.1%</b>   | <b>65,079</b>  | <b>17.5%</b>                        |  |
| Income tax expense  | 4,843         | 5.8%           | 6,609         | 6.7%           | 4,867         | 4.9%           | 5,498         | 6.1%           | 21,816         | 5.9%                                |  |
| <b>Net Income</b>   | <b>5,834</b>  | <b>7.0%</b>    | <b>12,315</b> | <b>12.5%</b>   | <b>16,145</b> | <b>16.3%</b>   | <b>8,969</b>  | <b>10.0%</b>   | <b>43,263</b>  | <b>11.6%</b>                        |  |
|   | 18,550        |                | 18,600        |                | 18,650        |                | 18,700        |                | 18,625         |                                     |  |
| <b>EPS (as adjusted)</b>                                  | <b>\$0.31</b> |                | <b>\$0.66</b> |                | <b>\$0.87</b> |                | <b>\$0.48</b> |                | <b>\$2.32</b>  |                                     |  |

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

**INDUSTRY UPDATE**

**Water Utilities, Flow Technology and Purification**

| <b>SJW Corp.</b>                                       |               | <b>Quarterly Income Statement, 2009E</b> |               |                    |                |                    |                |                    |          |                    |  |
|--|---------------|--|---------------|--------------------|----------------|--------------------|----------------|--------------------|----------|--------------------|--|
| (\$000, except per share data)                         |               |  |               |                    |                |                    |                |                    |          |                    |  |
| (Fiscal year ends December 31)                         |               |  |               |                    |                |                    |                |                    |          |                    |  |
|  | (Mar)<br>1Q09 | % Rev or<br>Margin                       | (Jun)<br>2Q09 | % Rev or<br>Margin | (Sep)<br>3Q09E | % Rev or<br>Margin | (Dec)<br>4Q09E | % Rev or<br>Margin | FY09E    | % Rev or<br>Margin |  |
| Revenues   | 40,021        |  | 58,194        |                    | 67,256         |                    | 49,333         |                    | 214,803  |                    |  |
| Cost of sales  | 13,601        | 34.0%                                    | 23,898        | 41.1%              | 29,593         | 44.0%              | 20,226         | 41.0%              | 87,318   | 42.3%              |  |
| Gross profit   | 26,420        | 66.0%                                    | 34,296        | 58.9%              | 37,663         | 56.0%              | 29,106         | 59.0%              | 127,485  | 59.3%              |  |
| Administrative and general and other operating expense | 11,107        | 27.8%                                    | 11,444        | 19.7%              | 11,781         | 17.5%              | 9,565          | 19.4%              | 43,897   | 20.4%              |  |
| Maintenance  | 2,916         | 7.3%                                     | 3,216         | 5.5%               | 3,363          | 5.0%               | 2,960          | 6.0%               | 12,455   | 5.8%               |  |
| Property taxes and other nonincome taxes               | 2,290         | 5.7%                                     | 2,392         | 4.1%               | 1,749          | 2.6%               | 1,727          | 3.5%               | 8,157    | 3.8%               |  |
| Depreciation and amortization                          | 6,551         | 16.4%                                    | 6,238         | 10.7%              | 6,150          | 9.1%               | 6,175          | 12.5%              | 25,114   | 11.7%              |  |
| Operating income                                       | 3,556         | 8.9%                                     | 11,006        | 18.9%              | 14,621         | 21.7%              | 8,679          | 17.6%              | 37,863   | 17.6%              |  |
| Interest expense                                       | (3,339)       | -8.3%                                    | (3,613)       | -6.2%              | (3,700)        | -5.5%              | (3,700)        | -7.5%              | (14,352) | -6.7%              |  |
| Non operating income (expense)                         | 0             | 0.0%                                     | 0             | 0.0%               | 0              | 0.0%               | 0              | 0.0%               | 0        | 0.0%               |  |
| Income before taxes                                    | 217           | 0.6%                                     | 7,393         | 12.7%              | 10,921         | 16.2%              | 4,979          | 10.1%              | 23,511   | 10.9%              |  |
| Income taxes   | 101           | 46.5%                                    | 2,975         | 40.2%              | 4,600          | 42.1%              | 1,625          | 32.6%              | 9,301    | 39.6%              |  |
| Net income   | 116           | 0.3%                                     | 4,418         | 7.6%               | 6,321          | 9.4%               | 3,354          | 6.8%               | 14,210   | 6.6%               |  |
| Earnings per share: Basic                              | \$0.01        |  | \$0.24        |                    | \$0.34         |                    | \$0.18         |                    | \$0.77   |                    |  |
| Earnings per share: Diluted                            | \$0.01        |  | \$0.24        |                    | \$0.34         |                    | \$0.18         |                    | \$0.76   |                    |  |
| Earnings per share: Basic - Continuing operations      | \$0.01        |  | \$0.24        |                    | \$0.34         |                    | \$0.18         |                    | \$0.77   |                    |  |
| Earnings per share: Diluted - Continuing operations    | \$0.01        |  | \$0.24        |                    | \$0.34         |                    | \$0.18         |                    | \$0.76   |                    |  |
| Basic shares outstanding (000)                         | 16,470        |  | 18,463        |                    | 18,500         |                    | 18,525         |                    | 18,525   |                    |  |
| Diluted shares outstanding (000)                       | 18,658        |  | 18,670        |                    | 18,700         |                    | 18,725         |                    | 18,725   |                    |  |

| <b>SJW Corp.</b>                                       |                | <b>Quarterly Income Statement, 2010E</b> |                |                    |                |                    |                |                    |          |                    |  |
|--|----------------|--|----------------|--------------------|----------------|--------------------|----------------|--------------------|----------|--------------------|--|
| (\$000, except per share data)                         |                |  |                |                    |                |                    |                |                    |          |                    |  |
| (Fiscal year ends December 31)                         |                |  |                |                    |                |                    |                |                    |          |                    |  |
|  | (Mar)<br>1Q10E | % Rev or<br>Margin                       | (Jun)<br>2Q10E | % Rev or<br>Margin | (Sep)<br>3Q10E | % Rev or<br>Margin | (Dec)<br>4Q10E | % Rev or<br>Margin | FY10E    | % Rev or<br>Margin |  |
| Revenues   | 40,631         |  | 60,440         |                    | 69,914         |                    | 51,516         |                    | 222,501  |                    |  |
| Cost of sales  | 13,002         | 32.0%                                    | 21,758         | 36.0%              | 28,665         | 41.0%              | 19,576         | 38.0%              | 83,001   | 40.2%              |  |
| Gross profit   | 27,629         | 68.0%                                    | 38,681         | 64.0%              | 41,249         | 59.0%              | 31,940         | 62.0%              | 139,500  | 62.7%              |  |
| Administrative and general and other operating expense | 10,951         | 27.0%                                    | 10,477         | 17.3%              | 12,040         | 17.2%              | 10,861         | 21.1%              | 44,328   | 19.9%              |  |
| Maintenance  | 3,454          | 8.5%                                     | 3,324          | 5.5%               | 3,391          | 4.9%               | 3,349          | 6.5%               | 13,517   | 6.1%               |  |
| Property taxes and other nonincome taxes               | 1,625          | 4.0%                                     | 2,297          | 3.8%               | 2,237          | 3.2%               | 1,855          | 3.6%               | 8,014    | 3.6%               |  |
| Depreciation and amortization                          | 6,200          | 15.3%                                    | 6,250          | 10.3%              | 6,300          | 9.0%               | 6,350          | 12.3%              | 25,100   | 11.3%              |  |
| Operating income                                       | 5,400          | 13.3%                                    | 16,334         | 27.0%              | 17,281         | 24.7%              | 9,526          | 18.6%              | 48,541   | 21.8%              |  |
| Interest expense                                       | (3,800)        | -9.4%                                    | (3,800)        | -6.3%              | (3,850)        | -5.5%              | (3,850)        | -7.5%              | (15,300) | -6.9%              |  |
| Non operating income (expense)                         | 0              | 0.0%                                     | 0              | 0.0%               | 0              | 0.0%               | 0              | 0.0%               | 0        | 0.0%               |  |
| Income before taxes                                    | 1,600          | 3.9%                                     | 12,534         | 20.7%              | 13,431         | 19.2%              | 5,676          | 11.0%              | 33,241   | 14.9%              |  |
| Income taxes   | 700            | 43.8%                                    | 5,500          | 43.9%              | 5,750          | 42.8%              | 2,100          | 37.0%              | 14,050   | 42.3%              |  |
| Net income   | 900            | 2.2%                                     | 7,034          | 11.6%              | 7,681          | 11.0%              | 3,576          | 6.9%               | 19,191   | 8.6%               |  |
| Earnings per share: Basic                              | \$0.05         |  | \$0.38         |                    | \$0.41         |                    | \$0.19         |                    | \$1.03   |                    |  |
| Earnings per share: Diluted                            | \$0.05         |  | \$0.37         |                    | \$0.41         |                    | \$0.19         |                    | \$1.02   |                    |  |
| Earnings per share: Basic - Continuing operations      | \$0.05         |  | \$0.38         |                    | \$0.41         |                    | \$0.19         |                    | \$1.03   |                    |  |
| Earnings per share: Diluted - Continuing operations    | \$0.05         |  | \$0.37         |                    | \$0.41         |                    | \$0.19         |                    | \$1.02   |                    |  |
| Basic shares outstanding (000)                         | 18,550         |  | 18,575         |                    | 18,600         |                    | 18,625         |                    | 18,625   |                    |  |
| Diluted shares outstanding (000)                       | 18,750         |  | 18,775         |                    | 18,800         |                    | 18,825         |                    | 18,825   |                    |  |

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

**INDUSTRY UPDATE**

**Water Utilities, Flow Technology and Purification**

| <b>Southwest Water Co.</b>           |         | <b>Quarterly Income Statement, 2009E</b> |          |                    |         |                    |         |                    |          |                    |  |
|--------------------------------------|---------|--|----------|--------------------|---------|--------------------|---------|--------------------|----------|--------------------|--|
| (\$000, except per share data)       |         |  |          |                    |         |                    |         |                    |          |                    |  |
| Fiscal year ends December 31         |         |  |          |                    |         |                    |         |                    |          |                    |  |
|                                      | 1Q09    | % Rev or<br>Margin                       | 2Q09     | % Rev or<br>Margin | 3Q09E   | % Rev or<br>Margin | 4Q09E   | % Rev or<br>Margin | 2009E    | % Rev or<br>Margin |  |
| <b>Total revenues</b>                | 52,396  |  | 52,416   |                    | 60,388  |                    | 55,912  |                    | 221,112  |                    |  |
| Total expenses                       | 45,961  | 87.7%                                    | 44,381   | 84.7%              | 48,375  | 80.1%              | 46,031  | 82.3%              | 184,748  | 83.6%              |  |
| SG&A expenses                        | 9,629   | 18.4%                                    | 17,643   | 33.7%              | 6,643   | 11.0%              | 6,150   | 11.0%              | 40,065   | 18.1%              |  |
| <b>Operating income</b>              | (3,194) | -6.1%                                    | (9,608)  | -18.3%             | 5,370   | 8.9%               | 3,730   | 6.7%               | (3,701)  | -1.7%              |  |
| Interest expense                     | (2,076) | -4.0%                                    | (2,975)  | -5.7%              | (2,100) | -3.5%              | (2,000) | -3.6%              | (9,151)  | -4.1%              |  |
| Interest income                      | 36      | 0.1%                                     | 48       | 0.1%               | 50      | 0.1%               | 52      | 0.1%               | 186      | 0.1%               |  |
| Gains on sale of land                | 0       | 0.0%                                     | 0        | 0.0%               | 0       | 0.0%               | 0       | 0.0%               | 0        | 0.0%               |  |
| Other                                | 0       | 0.0%                                     | 0        | 0.0%               | 0       | 0.0%               | 0       | 0.0%               | 0        | 0.0%               |  |
| <b>Income before taxes</b>           | (5,234) | -10.0%                                   | (12,535) | -23.9%             | 3,320   | 5.5%               | 1,782   | 3.2%               | (12,666) | -5.7%              |  |
| Income taxes                         | (2,002) | 38.2%                                    | (4,472)  | 35.7%              | 1,262   | 38.0%              | 677     | 38.0%              | (4,535)  | 35.8%              |  |
| <b>Income from continuing ops</b>    | (3,232) |  | (8,063)  |                    |         |                    |         |                    |          |                    |  |
| Income (loss) from discontinued ops  | 0       |  | 17,559   |                    |         |                    |         |                    |          |                    |  |
| Preferred dividends                  | 0       | 0.0%                                     | 6        | 0.0%               | 6       | 0.0%               | 6       | 0.0%               | 18       | 0.0%               |  |
| <b>Net income</b>                    | (3,232) | -6.2%                                    | 9,490    | 18.1%              | 2,053   | 3.4%               | 1,099   | 2.0%               | 9,410    | 4.3%               |  |
| <b>Earnings per share (Cont Ops)</b> | \$0.03  |  | \$0.03   |                    | \$0.08  |                    | \$0.04  |                    | \$0.18   |                    |  |
| Diluted shares outstanding (000)     | 24,600  |  | 24,608   |                    | 24,608  |                    | 24,608  |                    | 24,606   |                    |  |
| Dividends Paid                       | 0.0576  |  | 0.0576   |                    | 0.0576  |                    | 0.0576  |                    | 0.23     |                    |  |
|                                      | 1,417   |  | 1,417    |                    | 1,417   |                    | 1,417   |                    | 5,669    |                    |  |
| <b>Southwest Water Co.</b>           |         | <b>Quarterly Income Statement, 2010E</b> |          |                    |         |                    |         |                    |          |                    |  |
| (\$000, except per share data)       |         |  |          |                    |         |                    |         |                    |          |                    |  |
| Fiscal year ends December 31         |         |  |          |                    |         |                    |         |                    |          |                    |  |
|                                      | 1Q10E   | % Rev or<br>Margin                       | 2Q10E    | % Rev or<br>Margin | 3Q10E   | % Rev or<br>Margin | 4Q10E   | % Rev or<br>Margin | 2010E    | % Rev or<br>Margin |  |
| <b>Total revenues</b>                | 52,928  |  | 52,999   |                    | 61,130  |                    | 56,541  |                    | 223,597  |                    |  |
| Total expenses                       | 45,017  | 85.1%                                    | 44,190   | 83.4%              | 47,137  | 77.1%              | 44,997  | 79.6%              | 181,340  | 81.1%              |  |
| SG&A expenses                        | 5,293   | 10.0%                                    | 5,035    | 9.5%               | 4,952   | 8.1%               | 4,862   | 8.6%               | 20,142   | 9.0%               |  |
| <b>Operating income</b>              | 2,618   | 4.9%                                     | 3,774    | 7.1%               | 9,041   | 14.8%              | 6,681   | 11.8%              | 22,115   | 9.9%               |  |
| Interest expense                     | (1,900) | -3.6%                                    | (1,850)  | -3.5%              | (1,800) | -2.9%              | (1,750) | -3.1%              | (7,300)  | -3.3%              |  |
| Interest income                      | 55      | 0.1%                                     | 58       | 0.1%               | 61      | 0.1%               | 64      | 0.1%               | 238      | 0.1%               |  |
| Gains on sale of land                | 0       | 0.0%                                     | 0        | 0.0%               | 0       | 0.0%               | 0       | 0.0%               | 0        | 0.0%               |  |
| Other                                | 0       | 0.0%                                     | 0        | 0.0%               | 0       | 0.0%               | 0       | 0.0%               | 0        | 0.0%               |  |
| <b>Income before taxes</b>           | 773     | 1.5%                                     | 1,982    | 3.7%               | 7,302   | 11.9%              | 4,995   | 8.8%               | 15,053   | 6.7%               |  |
| Income taxes                         | 294     | 38.0%                                    | 753      | 38.0%              | 2,775   | 38.0%              | 1,898   | 38.0%              | 5,720    | 38.0%              |  |
| Preferred dividends                  | 6       | 0.0%                                     | 6        | 0.0%               | 6       | 0.0%               | 6       | 0.0%               | 24       | 0.0%               |  |
| <b>Net income</b>                    | 473     | 0.9%                                     | 1,223    | 2.3%               | 4,521   | 7.4%               | 3,091   | 5.5%               | 9,309    | 4.2%               |  |
| <b>Earnings per share</b>            | \$0.02  |  | \$0.05   |                    | \$0.18  |                    | \$0.13  |                    | \$0.38   |                    |  |
| Diluted shares outstanding (000)     | 24,650  |  | 24,675   |                    | 24,700  |                    | 24,725  |                    | 24,688   |                    |  |

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

**INDUSTRY UPDATE**

**Water Utilities, Flow Technology and Purification**

| <b>YORW Quarterly Income Statement, FY09E</b> |               |              |               |              |               |              |               |              |               |              |
|---|---------------|--------------|---------------|--------------|---------------|--------------|---------------|--------------|---------------|--------------|
| (Fiscal year ends December 31)                |               |              |               |              |               |              |               |              |               |              |
| (000s)  |               |              |               |              |               |              |               |              |               |              |
|   | (Mar)         | % Rev or     | (Jun)         | % Rev or     | (Sep)         | % Rev or     | (Dec)         | % Rev or     | FY09E         | % Rev or     |
|   | 1Q09          | Margin       | 2Q09          | Margin       | 3Q09E         | Margin       | 4Q09E         | Margin       |               | Margin       |
| Residential                                   | 5,533         |              | 5,832         |              | 5,804         |              | 5,776         |              | 22,945        |              |
| Commercial and industrial                     | 2,522         |              | 2,659         |              | 2,719         |              | 2,702         |              | 10,602        |              |
| Other   | 719           |              | 719           |              | 748           |              | 740           |              | 2,926         |              |
| <b>Revenues</b>                               | <b>8,774</b>  |              | <b>9,210</b>  |              | <b>9,270</b>  |              | <b>9,218</b>  |              | <b>36,473</b> |              |
| Operation and maintenance                     | 1,797         | 20.5%        | 1,723         | 18.7%        | 1,798         | 19.4%        | 1,687         | 18.3%        | 7,005         | 19.2%        |
| Administrative and general                    | 1,651         | 21.1%        | 1,712         | 18.6%        | 1,669         | 18.0%        | 1,715         | 18.6%        | 6,946         | 19.0%        |
| Depreciation and amortization                 | 1,069         | 12.2%        | 1,090         | 11.8%        | 1,110         | 12.0%        | 1,130         | 12.3%        | 4,399         | 12.1%        |
| Taxes other than income taxes                 | 85            | 1.0%         | 457           | 5.0%         | 278           | 3.0%         | 277           | 3.0%         | 1,098         | 3.0%         |
| <b>Operating income</b>                       | <b>3,971</b>  | <b>45.3%</b> | <b>4,228</b>  | <b>45.9%</b> | <b>4,415</b>  | <b>47.6%</b> | <b>4,410</b>  | <b>47.8%</b> | <b>17,024</b> | <b>46.7%</b> |
| Interest on long-term debt                    | 1,271         | 14.5%        | 1,262         | 13.7%        | 973           | 10.5%        | 876           | 9.5%         | 4,382         | 12.0%        |
| Interest on interim bank loans                | 0             | 0.0%         | 0             | 0.0%         | 56            | 0.6%         | 55            | 0.6%         | 111           | 0.3%         |
| Allowance for funds used during construction  | (98)          | -1.1%        | (37)          | -0.4%        | (167)         | -1.8%        | (165)         | -1.8%        | (468)         | -1.3%        |
| Other income, net                             | 341           | 3.9%         | (81)          | -0.9%        | 100           | 1.1%         | 100           | 1.1%         | 460           | 1.3%         |
| <b>Income before taxes</b>                    | <b>2,457</b>  | <b>28.0%</b> | <b>3,084</b>  | <b>33.6%</b> | <b>3,453</b>  | <b>37.2%</b> | <b>3,545</b>  | <b>38.5%</b> | <b>12,539</b> | <b>34.4%</b> |
| Income taxes                                  | 960           | 39%          | 1,171         | 38%          | 1,243         | 36%          | 1,276         | 36%          | 4,650         | 37%          |
| <b>Net income</b>                             | <b>1,497</b>  | <b>17.1%</b> | <b>1,913</b>  | <b>20.8%</b> | <b>2,210</b>  | <b>23.8%</b> | <b>2,269</b>  | <b>24.6%</b> | <b>7,889</b>  | <b>21.6%</b> |
| <b>Earnings per share</b>                     | <b>\$0.13</b> |              | <b>\$0.17</b> |              | <b>\$0.18</b> |              | <b>\$0.17</b> |              | <b>\$0.65</b> |              |
| Shares Outstanding                            | 11,374        |              | 11,411        |              | 12,400        |              | 13,470        |              | 12,164        |              |

| <b>YORW Quarterly Income Statement, FY10E</b> |               |              |               |              |               |              |               |              |               |              |
|---|---------------|--------------|---------------|--------------|---------------|--------------|---------------|--------------|---------------|--------------|
| (Fiscal year ends December 31)                |               |              |               |              |               |              |               |              |               |              |
| (000s)  |               |              |               |              |               |              |               |              |               |              |
|   | (Mar)         | % Rev or     | (Jun)         | % Rev or     | (Sep)         | % Rev or     | (Dec)         | % Rev or     | FY10E         | % Rev or     |
|   | 1Q10E         | Margin       | 2Q10E         | Margin       | 3Q10E         | Margin       | 4Q10E         | Margin       |               | Margin       |
| Residential                                   | 5,810         |              | 6,124         |              | 6,094         |              | 6,065         |              | 24,092        |              |
| Commercial and industrial                     | 2,623         |              | 2,765         |              | 2,828         |              | 2,810         |              | 11,026        |              |
| Other   | 748           |              | 748           |              | 777           |              | 777           |              | 3,050         |              |
| <b>Revenues</b>                               | <b>9,180</b>  |              | <b>9,637</b>  |              | <b>9,699</b>  |              | <b>9,652</b>  |              | <b>38,168</b> |              |
| Operation and maintenance                     | 1,836         | 20.0%        | 1,985         | 20.6%        | 1,920         | 19.8%        | 1,747         | 18.1%        | 7,489         | 19.6%        |
| Administrative and general                    | 2,093         | 22.8%        | 1,927         | 20.0%        | 1,756         | 18.1%        | 1,728         | 17.9%        | 7,504         | 19.7%        |
| Depreciation and amortization                 | 1,157         | 12.6%        | 1,108         | 11.5%        | 1,067         | 11.0%        | 1,062         | 11.0%        | 4,394         | 11.5%        |
| Taxes other than income taxes                 | 275           | 3.0%         | 337           | 3.5%         | 291           | 3.0%         | 290           | 3.0%         | 1,193         | 3.1%         |
| <b>Operating income</b>                       | <b>3,819</b>  | <b>41.6%</b> | <b>4,279</b>  | <b>44.4%</b> | <b>4,665</b>  | <b>48.1%</b> | <b>4,826</b>  | <b>50.0%</b> | <b>17,589</b> | <b>46.1%</b> |
| Interest on long-term debt                    | 1,058         | 11.5%        | 1,060         | 11.0%        | 999           | 10.3%        | 975           | 10.1%        | 4,090         | 10.7%        |
| Interest on interim bank loans                | 55            | 0.6%         | 48            | 0.5%         | 58            | 0.6%         | 58            | 0.6%         | 219           | 0.6%         |
| Allowance for funds used during construction  | (184)         | -2.0%        | (193)         | -2.0%        | (175)         | -1.8%        | (174)         | -1.8%        | (725)         | -1.9%        |
| Other income, net                             | 184           | 2.0%         | 67            | 0.7%         | 58            | 0.6%         | 58            | 0.6%         | 367           | 1.0%         |
| <b>Income before taxes</b>                    | <b>2,708</b>  | <b>29.5%</b> | <b>3,296</b>  | <b>34.2%</b> | <b>3,724</b>  | <b>38.4%</b> | <b>3,909</b>  | <b>40.5%</b> | <b>13,638</b> | <b>35.7%</b> |
| Income taxes                                  | 948           | 35%          | 1,154         | 35%          | 1,341         | 36%          | 1,407         | 36%          | 4,849         | 36%          |
| <b>Net income</b>                             | <b>1,760</b>  | <b>19.2%</b> | <b>2,142</b>  | <b>22.2%</b> | <b>2,384</b>  | <b>24.6%</b> | <b>2,502</b>  | <b>25.9%</b> | <b>8,788</b>  | <b>23.0%</b> |
| <b>Earnings per share</b>                     | <b>\$0.13</b> |              | <b>\$0.16</b> |              | <b>\$0.18</b> |              | <b>\$0.19</b> |              | <b>\$0.65</b> |              |
| Shares Outstanding                            | 13,470        |              | 13,470        |              | 13,470        |              | 13,470        |              | 13,470        |              |

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

**INDUSTRY UPDATE**

Water Utilities, Flow Technology and Purification

| <b>IDEX Corp.</b>                  |                | <b>Quarterly Income Statement, 2009E</b> |                |                   |                |                   |                |                   |                  |                   |
|------------------------------------|----------------|--|----------------|-------------------|----------------|-------------------|----------------|-------------------|------------------|-------------------|
| (\$000, except per share data)     |                |  |                |                   |                |                   |                |                   |                  |                   |
| Fiscal year ends December 31       |                |  |                |                   |                |                   |                |                   |                  |                   |
|                                    | 1Q09           | Rate or<br>Margin                        | 2Q09           | Rate or<br>Margin | 3Q09E          | Rate or<br>Margin | 4Q09E          | Rate or<br>Margin | 2009E            | Rate or<br>Margin |
| <b>Sales:</b>                      |                |  |                |                   |                |                   |                |                   |                  |                   |
| Fluid & Metering Technologies      | 157,018        |  | 157,000        |                   | 160,043        |                   | 161,240        |                   | 635,301          |                   |
| Health & Science Technologies      | 74,188         |  | 73,816         |                   | 74,600         |                   | 74,700         |                   | 297,305          |                   |
| Dispensing Equipment               | 32,873         |  | 45,658         |                   | 33,751         |                   | 30,851         |                   | 143,133          |                   |
| Fire & Safety/Diversified Products | 64,982         |  | 62,127         |                   | 64,951         |                   | 66,027         |                   | 258,087          |                   |
| Intersegment eliminations          | (2,448)        |  | (2,146)        |                   | (2,200)        |                   | (2,250)        |                   | (9,044)          |                   |
| <b>Total sales</b>                 | <b>326,613</b> |  | <b>336,455</b> |                   | <b>331,145</b> |                   | <b>330,568</b> |                   | <b>1,324,781</b> |                   |
| <b>Operating income:</b>           |                |  |                |                   |                |                   |                |                   |                  |                   |
| Fluid & Metering Technologies      | 24,069         | 15.3%                                    | 24,221         | 15.4%             | 24,807         | 15.5%             | 25,798         | 16.0%             | 98,895           | 15.6%             |
| Health & Science Technologies      | 12,649         | 17.0%                                    | 11,603         | 15.7%             | 11,936         | 16.0%             | 12,326         | 16.5%             | 48,514           | 16.3%             |
| Dispensing Equipment               | 3,979          | 12.1%                                    | 10,021         | 21.9%             | 6,750          | 20.0%             | 5,862          | 19.0%             | 26,612           | 18.6%             |
| Fire & Safety/Diversified Products | 13,571         | 20.9%                                    | 13,738         | 22.1%             | 13,640         | 21.0%             | 14,196         | 21.5%             | 55,144           | 21.4%             |
| Corporate office and other         | (9,785)        |  | (9,598)        |                   | (9,900)        |                   | (10,000)       |                   | (39,283)         |                   |
| <b>Total operating income</b>      | <b>44,483</b>  | <b>13.6%</b>                             | <b>46,735</b>  | <b>13.9%</b>      | <b>47,233</b>  | <b>14.3%</b>      | <b>48,181</b>  | <b>14.6%</b>      | <b>186,632</b>   | <b>14.1%</b>      |
| Other expense (income)             | (191)          | -0.1%                                    | 385            | 0.1%              | (200)          | -0.1%             | (225)          | -0.1%             | (231)            | 0.0%              |
| Interest expense                   | 4,821          | 1.5%                                     | 4,440          | 1.3%              | 3,974          | 1.2%              | 3,636          | 1.1%              | 16,871           | 1.3%              |
| Pretax income                      | 39,853         | 12.2%                                    | 41,910         | 12.5%             | 43,459         | 13.1%             | 44,770         | 13.5%             | 169,992          | 12.8%             |
| Income taxes                       | 11,544         | 29.0%                                    | 13,988         | 33.4%             | 14,776         | 34.0%             | 15,222         | 34.0%             | 55,530           | 32.7%             |
| <b>Net income</b>                  | <b>28,309</b>  | <b>8.7%</b>                              | <b>27,922</b>  | <b>8.3%</b>       | <b>28,683</b>  | <b>8.7%</b>       | <b>29,548</b>  | <b>8.9%</b>       | <b>114,462</b>   | <b>8.6%</b>       |
| <b>EPS (adjusted)</b>              | <b>\$0.34</b>  |  | <b>\$0.37</b>  |                   | <b>\$0.35</b>  |                   | <b>\$0.36</b>  |                   | <b>\$1.43</b>    |                   |
| Shares outstanding (000)           | 82,600         |  | 80,507         |                   | 81,000         |                   | 81,500         |                   | 82,088           |                   |
| <b>IDEX Corp.</b>                  |                |  |                |                   |                |                   |                |                   |                  |                   |
| (\$000, except per share data)     |                |  |                |                   |                |                   |                |                   |                  |                   |
| Fiscal year ends December 31       |                |  |                |                   |                |                   |                |                   |                  |                   |
|                                    | 1Q10E          | Rate or<br>Margin                        | 2Q10E          | Rate or<br>Margin | 3Q10E          | Rate or<br>Margin | 4Q10E          | Rate or<br>Margin | 2010E            | Rate or<br>Margin |
| <b>Sales:</b>                      |                |  |                |                   |                |                   |                |                   |                  |                   |
| Fluid & Metering Technologies      | 164,869        |  | 164,850        |                   | 166,444        |                   | 167,690        |                   | 663,853          |                   |
| Health & Science Technologies      | 76,414         |  | 76,769         |                   | 77,584         |                   | 77,688         |                   | 308,455          |                   |
| Dispensing Equipment               | 33,530         |  | 45,658         |                   | 34,764         |                   | 33,319         |                   | 147,271          |                   |
| Fire & Safety/Diversified Products | 66,931         |  | 67,097         |                   | 67,549         |                   | 68,008         |                   | 269,585          |                   |
| Intersegment eliminations          | (2,300)        |  | (2,350)        |                   | (2,400)        |                   | (2,450)        |                   | (9,500)          |                   |
| <b>Total sales</b>                 | <b>339,444</b> |  | <b>352,024</b> |                   | <b>343,941</b> |                   | <b>344,255</b> |                   | <b>1,379,664</b> |                   |
| <b>Operating income:</b>           |                |  |                |                   |                |                   |                |                   |                  |                   |
| Fluid & Metering Technologies      | 27,203         | 16.5%                                    | 28,025         | 17.0%             | 29,128         | 17.5%             | 30,184         | 18.0%             | 114,540          | 17.3%             |
| Health & Science Technologies      | 12,990         | 17.0%                                    | 13,204         | 17.2%             | 13,500         | 17.4%             | 13,829         | 17.8%             | 53,523           | 17.4%             |
| Dispensing Equipment               | 5,700          | 17.0%                                    | 8,218          | 18.0%             | 6,953          | 20.0%             | 6,664          | 20.0%             | 27,535           | 18.7%             |
| Fire & Safety/Diversified Products | 14,591         | 21.8%                                    | 14,761         | 22.0%             | 15,131         | 22.4%             | 15,302         | 22.5%             | 59,785           | 22.2%             |
| Corporate office and other         | (10,100)       |  | (10,200)       |                   | (10,300)       |                   | (10,400)       |                   | (41,000)         |                   |
| <b>Total operating income</b>      | <b>50,385</b>  | <b>14.8%</b>                             | <b>54,009</b>  | <b>15.3%</b>      | <b>54,411</b>  | <b>15.8%</b>      | <b>55,578</b>  | <b>16.1%</b>      | <b>214,383</b>   | <b>15.5%</b>      |
| Other expense (income)             | (250)          | -0.1%                                    | (275)          | -0.1%             | (300)          | -0.1%             | (325)          | -0.1%             | (1,150)          | -0.1%             |
| Interest expense                   | 3,400          | 1.0%                                     | 3,200          | 0.9%              | 3,000          | 0.9%              | 2,800          | 0.8%              | 12,400           | 0.9%              |
| Pretax income                      | 47,235         | 13.9%                                    | 51,084         | 14.5%             | 51,711         | 15.0%             | 53,103         | 15.4%             | 203,133          | 14.7%             |
| Income taxes                       | 16,532         | 35.0%                                    | 17,879         | 35.0%             | 18,099         | 35.0%             | 18,586         | 35.0%             | 71,096           | 35.0%             |
| <b>Net income</b>                  | <b>30,703</b>  | <b>9.0%</b>                              | <b>33,204</b>  | <b>9.4%</b>       | <b>33,612</b>  | <b>9.8%</b>       | <b>34,517</b>  | <b>10.0%</b>      | <b>132,036</b>   | <b>9.6%</b>       |
| <b>EPS</b>                         | <b>\$0.37</b>  |  | <b>\$0.40</b>  |                   | <b>\$0.41</b>  |                   | <b>\$0.42</b>  |                   | <b>\$1.61</b>    |                   |
| Shares outstanding (000)           | 82,000         |  | 82,200         |                   | 82,400         |                   | 82,600         |                   | 82,088           |                   |

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

**INDUSTRY UPDATE**

**Water Utilities, Flow Technology and Purification**

| <b>Watts Water Technologies, Inc. Quarterly Income Statement, 2009E</b> |               |              |                |              |                |              |                |              |                |              |
|---|---------------|--------------|----------------|--------------|----------------|--------------|----------------|--------------|----------------|--------------|
| (\$000, except per share data)<br>Fiscal year ends December 31          |               |              |                |              |                |              |                |              |                |              |
|   | Mar-09        | % Rev or     | Jun-09         | % Rev or     | Sep-09         | % Rev or     | Dec-09         | % Rev or     | 2009E          | % Rev or     |
|   | 1Q09          | Margin       | 2Q09           | Margin       | 3Q09E          | Margin       | 4Q09E          | Margin       |                | Margin       |
| <b>Sales</b>  | 294,900       |              | 312,400        |              | 316,994        |              | 286,996        |              | 1,211,290      |              |
| Cost of sales   | 197,700       | 67.0%        | 201,900        | 64.6%        | 202,876        | 64.0%        | 186,547        | 65.0%        | 789,024        | 65.1%        |
| <b>Gross profit</b>   | <b>97,200</b> | <b>33.0%</b> | <b>110,500</b> | <b>35.4%</b> | <b>114,118</b> | <b>36.0%</b> | <b>100,449</b> | <b>35.0%</b> | <b>422,266</b> | <b>34.9%</b> |
| SG&A  | 81,000        | 27.5%        | 81,300         | 26.0%        | 85,149         | 26.9%        | 75,543         | 26.3%        | 322,992        | 26.7%        |
| <b>Operating income (from cont ops)</b>                                 | <b>16,200</b> | <b>5.5%</b>  | <b>29,200</b>  | <b>9.3%</b>  | <b>28,969</b>  | <b>9.1%</b>  | <b>24,906</b>  | <b>8.7%</b>  | <b>99,275</b>  | <b>8.2%</b>  |
| Interest income   | (200)         |              | (300)          |              | (400)          |              | (500)          |              | (1,400)        |              |
| Interest expense  | 5,600         | 1.9%         | 5,700          | 1.8%         | 5,500          | 1.7%         | 5,300          | 1.8%         | 22,100         | 1.8%         |
| Minority interest   | 0             |              | 0              |              | 0              |              | 0              |              | 0              |              |
| Other expense, net  | (500)         |              | 0              |              | 0              |              | 0              |              | (500)          |              |
| Income before taxes   | 11,300        | 3.8%         | 23,800         | 7.6%         | 23,869         | 7.5%         | 20,106         | 7.0%         | 79,075         | 6.5%         |
| Income taxes  | 2,900         | 25.7%        | 7,900          | 33.2%        | 8,163          | 34.2%        | 6,876          | 34.2%        | 25,839         | 32.7%        |
| Income from cont. operations  | 8,400         | 2.8%         | 15,900         | 5.1%         | 15,706         | 5.0%         | 13,230         | 4.6%         | 53,235         | 4.4%         |
| Discontinued operations   | 0             |              | 0              |              | 0              |              | 0              |              | 0              |              |
| <b>Net income</b>   | <b>8,400</b>  | <b>2.8%</b>  | <b>15,900</b>  | <b>5.1%</b>  | <b>15,706</b>  | <b>5.0%</b>  | <b>13,230</b>  | <b>4.6%</b>  | <b>53,235</b>  | <b>4.4%</b>  |
| Earnings per share:   |               |              |                |              |                |              |                |              |                |              |
| <b>EPS from continuing operations</b>                                   | <b>\$0.23</b> |              | <b>\$0.39</b>  |              | <b>\$0.42</b>  |              | <b>\$0.36</b>  |              | <b>\$1.40</b>  |              |
| Diluted shares outstanding (000)  | 36,900        |              | 37,000         |              | 37,100         |              | 37,200         |              | 37,050         |              |
| <b>Watts Water Technologies, Inc. Quarterly Income Statement, 2010E</b> |               |              |                |              |                |              |                |              |                |              |
| (\$000, except per share data)<br>Fiscal year ends December 31          |               |              |                |              |                |              |                |              |                |              |
|   | Mar-10        | % Rev or     | Jun-10         | % Rev or     | Sep-10         | % Rev or     | Dec-10         | % Rev or     | 2010E          | % Rev or     |
|   | 1Q10E         | Margin       | 2Q10E          | Margin       | 3Q10E          | Margin       | 4Q10E          | Margin       |                | Margin       |
| <b>Sales</b>  | 257,705       |              | 287,950        |              | 313,179        |              | 300,189        |              | 1,159,023      |              |
| Cost of sales   | 168,797       | 65.5%        | 189,471        | 65.8%        | 205,445        | 65.6%        | 196,624        | 65.5%        | 760,337        | 65.6%        |
| <b>Gross profit</b>   | <b>88,908</b> | <b>34.5%</b> | <b>98,479</b>  | <b>34.2%</b> | <b>107,733</b> | <b>34.4%</b> | <b>103,565</b> | <b>34.6%</b> | <b>398,686</b> | <b>34.4%</b> |
| SG&A  | 65,227        | 25.3%        | 70,799         | 24.6%        | 76,739         | 24.5%        | 74,141         | 24.7%        | 286,904        | 24.8%        |
| <b>Operating income</b>   | <b>23,682</b> | <b>9.2%</b>  | <b>27,681</b>  | <b>9.6%</b>  | <b>30,995</b>  | <b>9.9%</b>  | <b>29,424</b>  | <b>9.8%</b>  | <b>111,782</b> | <b>9.6%</b>  |
| Interest income   | (550)         |              | (600)          |              | (650)          |              | (700)          |              | (2,500)        |              |
| Interest expense  | 5,200         | 2.0%         | 5,100          | 1.8%         | 5,000          | 1.6%         | 4,900          | 1.6%         | 20,200         | 1.7%         |
| Minority interest   | 0             |              | 0              |              | 0              |              | 0              |              | 0              |              |
| Other expense, net  | 0             |              | 0              |              | 0              |              | 0              |              | 0              |              |
| Income before taxes   | 19,032        | 7.4%         | 23,181         | 8.1%         | 26,645         | 8.5%         | 25,224         | 8.4%         | 94,082         | 8.1%         |
| Income taxes  | 6,280         | 33.0%        | 7,650          | 33.0%        | 8,793          | 33.0%        | 8,324          | 33.0%        | 31,047         | 33.0%        |
| <b>Net income</b>   | <b>12,751</b> | <b>4.9%</b>  | <b>15,531</b>  | <b>5.4%</b>  | <b>17,852</b>  | <b>5.7%</b>  | <b>16,900</b>  | <b>5.6%</b>  | <b>63,035</b>  | <b>5.4%</b>  |
| Earnings per share:   |               |              |                |              |                |              |                |              |                |              |
| <b>EPS from continuing operations</b>                                   | <b>\$0.34</b> |              | <b>\$0.42</b>  |              | <b>\$0.48</b>  |              | <b>\$0.45</b>  |              | <b>\$1.68</b>  |              |
| Diluted shares outstanding (000)  | 37,300        |              | 37,400         |              | 37,500         |              | 37,600         |              | 37,450         |              |

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

**INDUSTRY UPDATE**

**Water Utilities, Flow Technology and Purification**

| <b>Mueller Water Products, Inc.</b> |                   | <b>Quarterly Income Statement, FY2009E</b> |                   |                    |                   |                    |                   |                    |          |                    |  |
|-------------------------------------|-------------------|--|-------------------|--------------------|-------------------|--------------------|-------------------|--------------------|----------|--------------------|--|
| (\$000,000, except per share data)  |                   |  |                   |                    |                   |                    |                   |                    |          |                    |  |
| Fiscal year ends September 30       |                   |  |                   |                    |                   |                    |                   |                    |          |                    |  |
|                                     | Dec-08<br>FY1Q09  | % Rev or<br>Margin                         | Mar-09<br>FY2Q09  | % Rev or<br>Margin | Jun-09<br>FY3Q09  | % Rev or<br>Margin | Sep-09<br>FY4Q09E | % Rev or<br>Margin | FY2009E  | % Rev or<br>Margin |  |
| Total Revenues                      | 367.7             |  | 322.2             |                    | 363.2             |                    | 377.1             |                    | 1,430.2  |                    |  |
| Total Cost of Sales                 | 282.7             | 76.9%                                      | 267.3             | 83.0%              | 305.4             | 84.1%              | 305.6             | 81.0%              | 1,161.0  | 81.2%              |  |
| Gross Profit                        | 75.0              | 20.4%                                      | 54.9              | 17.0%              | 57.8              | 16.9%              | 71.5              | 19.0%              | 259.2    | 18.1%              |  |
| Total operating expenses            | 62.3              | 16.9%                                      | 60.0              | 18.6%              | 66.3              | 18.3%              | 66.0              | 14.9%              | 244.6    | 17.1%              |  |
| Adjusted Operating Income           | 12.7              | 3.6%                                       | (5.1)             | -1.6%              | (8.5)             | -2.3%              | 15.4              | 4.1%               | 14.5     | 1.0%               |  |
| Interest expense                    | 17.3              | 4.7%                                       | 16.6              | 5.2%               | 17.2              | 4.7%               | 22.0              | 5.9%               | 73.1     | 5.1%               |  |
| Gain on repurchase of debt          | (1.5)             | -0.4%                                      | 0.0               | 0.0%               | 2.3               | 0.6%               | 0.0%              | 0.0%               | 0.8      | 0.1%               |  |
| Income before taxes                 | (3.1)             | -0.8%                                      | (21.7)            | -6.7%              | (28.0)            | -7.7%              | (6.6)             | -1.7%              | (59.4)   | -4.2%              |  |
| Income taxes                        | (2.9)             | 93.5%                                      | (6.3)             | 29.0%              | (9.0)             | 32.1%              | (2.2)             | 34.0%              | (20.4)   | 34.4%              |  |
| Net income                          | (0.2)             | -0.1%                                      | (15.4)            | -4.8%              | (19.0)            | -5.2%              | (4.3)             | -1.1%              | (38.9)   | -2.7%              |  |
| Earnings per share:                 |                   |  |                   |                    |                   |                    |                   |                    |          |                    |  |
| Adjusted net income per share       | (\$0.00)          |  | (\$0.13)          |                    | (\$0.16)          |                    | (\$0.04)          |                    | (\$0.34) |                    |  |
| Diluted shares outstanding          | 115.4             |  | 115.4             |                    | 116.0             |                    | 116.0             |                    | 115.7    |                    |  |
| <b>Mueller Water Products, Inc.</b> |                   | <b>Quarterly Income Statement, FY2010E</b> |                   |                    |                   |                    |                   |                    |          |                    |  |
| (\$000,000, except per share data)  |                   |  |                   |                    |                   |                    |                   |                    |          |                    |  |
| Fiscal year ends September 30       |                   |  |                   |                    |                   |                    |                   |                    |          |                    |  |
|                                     | Dec-09<br>FY1Q10E | % Rev or<br>Margin                         | Mar-10<br>FY2Q10E | % Rev or<br>Margin | Jun-10<br>FY3Q10E | % Rev or<br>Margin | Sep-10<br>FY4Q10E | % Rev or<br>Margin | FY2010E  | % Rev or<br>Margin |  |
| Total Revenues                      | 353.0             |  | 326.9             |                    | 376.9             |                    | 391.5             |                    | 1,448.2  |                    |  |
| Total Cost of Sales                 | 285.0             | 80.7%                                      | 259.2             | 79.3%              | 294.6             | 78.2%              | 173.3             | 44.3%              | 1,012.1  | 69.9%              |  |
| Gross Profit                        | 68.0              | 19.3%                                      | 67.7              | 20.7%              | 82.3              | 21.8%              | 90.0              | 23.0%              | 308.0    | 21.3%              |  |
| Total operating expenses            | 51.4              | 14.6%                                      | 54.6              | 16.7%              | 55.1              | 14.6%              | 55.2              | 14.1%              | 216.3    | 14.9%              |  |
| Operating Income                    | 14.4              | 4.1%                                       | 10.9              | 3.3%               | 25.1              | 6.7%               | 32.7              | 8.4%               | 83.1     | 5.7%               |  |
| Interest expense                    | 18.0              | 5.1%                                       | 17.8              | 5.4%               | 17.6              | 4.7%               | 17.4              | 4.4%               | 70.8     | 4.9%               |  |
| Income before taxes                 | (3.6)             | -1.0%                                      | (6.9)             | -2.1%              | 7.5               | 2.0%               | 15.3              | 3.9%               | 12.3     | 0.8%               |  |
| Income taxes                        | (1.5)             | 41.5%                                      | (2.9)             | 41.5%              | 3.1               | 41.5%              | 6.4               | 41.5%              | 5.1      | 41.5%              |  |
| Net income                          | (2.1)             | -0.6%                                      | (4.1)             | -1.2%              | 4.4               | 1.2%               | 9.0               | 2.3%               | 7.2      | 0.5%               |  |
| Earnings per share:                 |                   |  |                   |                    |                   |                    |                   |                    |          |                    |  |
| Net income per share                | (\$0.01)          |  | (\$0.03)          |                    | \$0.03            |                    | \$0.06            |                    | \$0.05   |                    |  |
| Diluted shares outstanding          | 153.1             |  | 153.1             |                    | 153.1             |                    | 153.1             |                    | 153.1    |                    |  |
| <b>Mueller Water Products, Inc.</b> |                   | <b>Quarterly Income Statement, FY2011E</b> |                   |                    |                   |                    |                   |                    |          |                    |  |
| (\$000,000, except per share data)  |                   |  |                   |                    |                   |                    |                   |                    |          |                    |  |
| Fiscal year ends September 30       |                   |  |                   |                    |                   |                    |                   |                    |          |                    |  |
|                                     | Dec-10<br>FY1Q11E | % Rev or<br>Margin                         | Mar-11<br>FY2Q11E | % Rev or<br>Margin | Jun-11<br>FY3Q11E | % Rev or<br>Margin | Sep-11<br>FY4Q11E | % Rev or<br>Margin | FY2011E  | % Rev or<br>Margin |  |
| Total Revenues                      | 378.0             |  | 349.8             |                    | 403.6             |                    | 419.4             |                    | 1,550.9  |                    |  |
| Total Cost of Sales                 | 284.1             | 75.2%                                      | 260.6             | 74.5%              | 296.9             | 73.5%              | 186.2             | 44.4%              | 1,027.8  | 66.3%              |  |
| Gross Profit                        | 93.9              | 24.8%                                      | 89.2              | 25.6%              | 106.8             | 26.6%              | 111.0             | 26.6%              | 400.9    | 26.8%              |  |
| Total operating expenses            | 49.2              | 13.0%                                      | 46.6              | 13.3%              | 46.4              | 11.5%              | 46.1              | 11.0%              | 188.4    | 12.1%              |  |
| Operating Income                    | 41.0              | 10.8%                                      | 38.9              | 11.1%              | 56.7              | 14.1%              | 61.3              | 14.6%              | 197.9    | 12.8%              |  |
| Interest expense                    | 17.0              | 4.5%                                       | 16.6              | 4.7%               | 16.2              | 4.0%               | 15.8              | 3.8%               | 65.6     | 4.2%               |  |
| Income before taxes                 | 24.0              | 6.3%                                       | 22.3              | 6.4%               | 40.5              | 10.0%              | 45.5              | 10.8%              | 132.3    | 8.5%               |  |
| Income taxes                        | 9.7               | 40.5%                                      | 9.0               | 40.5%              | 16.4              | 40.5%              | 18.4              | 40.5%              | 53.6     | 40.5%              |  |
| Net income                          | 14.3              | 3.8%                                       | 13.3              | 3.8%               | 24.1              | 6.0%               | 27                | 6.5%               | 78.7     | 5.1%               |  |
| Earnings per share:                 |                   |  |                   |                    |                   |                    |                   |                    |          |                    |  |
| Net income per share                | \$0.09            |  | \$0.09            |                    | \$0.16            |                    | \$0.18            |                    | \$0.51   |                    |  |
| Diluted shares outstanding          | 153.2             |  | 153.2             |                    | 153.2             |                    | 153.2             |                    | 153.2    |                    |  |

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

**INDUSTRY UPDATE**

Water Utilities, Flow Technology and Purification

| <b>Calgon Carbon Corporation</b>         |               | <b>Quarterly Income Statement, 2009E</b> |               |                    |               |                    |               |                    |                |                    |
|--|---------------|--|---------------|--------------------|---------------|--------------------|---------------|--------------------|----------------|--------------------|
| (\$000, except per share data)           |               |  |               |                    |               |                    |               |                    |                |                    |
| Fiscal year ends December 31             |               |  |               |                    |               |                    |               |                    |                |                    |
|  | 1Q09          | % Rev or<br>Margin                       | 2Q09          | % Rev or<br>Margin | 3Q09E         | % Rev or<br>Margin | 4Q09E         | % Rev or<br>Margin | 2009E          | % Rev or<br>Margin |
| <b>Sales</b>                             | 90,633        |  | 103,090       |                    | 102,814       |                    | 110,196       |                    | 406,732        |                    |
| Cost of sales                            | 61,214        | 67.5%                                    | 70,319        | 68.2%              | 68,885        | 67.0%              | 74,382        | 67.5%              | 274,800        | 67.6%              |
| <b>Gross profit</b>                      | <b>29,419</b> | <b>32.5%</b>                             | <b>32,771</b> | <b>31.8%</b>       | <b>33,929</b> | <b>33.0%</b>       | <b>35,814</b> | <b>32.5%</b>       | <b>131,932</b> | <b>32.4%</b>       |
| SGA&R                                    | 16,707        | 18.4%                                    | 18,626        | 18.1%              | 17,110        | 16.6%              | 17,736        | 16.1%              | 70,179         | 17.3%              |
| Depreciation & Amortization              | 3,776         | 4.2%                                     | 3,972         | 3.9%               | 4,100         | 4.0%               | 4,200         | 3.8%               | 16,048         | 3.9%               |
| <b>Operating income</b>                  | <b>8,936</b>  | <b>9.9%</b>                              | <b>10,173</b> | <b>9.9%</b>        | <b>12,718</b> | <b>12.4%</b>       | <b>13,877</b> | <b>12.6%</b>       | <b>45,705</b>  | <b>11.2%</b>       |
| Interest income                          | 106           | 0.1%                                     | 0             | 0.0%               | 150           | 0.1%               | 175           | 0.2%               | 431            | 0.1%               |
| Interest expense                         | 0             | 0.0%                                     | (109)         | -0.1%              | 0             | 0.0%               | 0             | 0.0%               | (109)          | 0.0%               |
| Equity in income from equity investments | 441           | 0.5%                                     | 0             | 0.0%               | 0             | 0.0%               | 50            | 0.0%               | 491            | 0.1%               |
| Other expense, net                       | (428)         | -0.5%                                    | (1,500)       | -1.5%              | (750)         | -0.7%              | (750)         | -0.7%              | (3,428)        | -0.8%              |
| Income before taxes                      | 9,055         | 10.0%                                    | 8,564         | 8.3%               | 12,118        | 11.8%              | 13,352        | 12.1%              | 43,090         | 10.6%              |
| Income taxes                             | 3,081         | 34.0%                                    | 2,893         | 33.8%              | 4,484         | 37.0%              | 4,940         | 37.0%              | 15,398         | 35.7%              |
| Income before minority interest          | 5,974         | 6.6%                                     | 6,098         | 5.9%               | 7,635         | 7.4%               | 8,412         | 7.6%               | 28,118         | 6.9%               |
| Minority interest                        | 0             |  | 0             |                    | 0             |                    | 0             |                    | 0              |                    |
| <b>Net income</b>                        | <b>5,974</b>  | <b>6.6%</b>                              | <b>6,098</b>  | <b>5.9%</b>        | <b>7,635</b>  | <b>7.4%</b>        | <b>8,412</b>  | <b>7.6%</b>        | <b>28,118</b>  | <b>6.9%</b>        |
| <b>EPS, Continuing Operations</b>        | <b>\$0.11</b> |  | <b>\$0.11</b> |                    | <b>\$0.14</b> |                    | <b>\$0.15</b> |                    | <b>\$0.50</b>  |                    |
| Shares outstanding (000)                 | 56,079        |  | 56,285        |                    | 56,300        |                    | 56,400        |                    | 56,266         |                    |

| <b>Calgon Carbon Corporation</b>         |               | <b>Quarterly Income Statement, 2010E</b> |               |                    |               |                    |               |                    |                |                    |
|--|---------------|--|---------------|--------------------|---------------|--------------------|---------------|--------------------|----------------|--------------------|
| (\$000, except per share data)           |               |  |               |                    |               |                    |               |                    |                |                    |
| Fiscal year ends December 31             |               |  |               |                    |               |                    |               |                    |                |                    |
|  | 1Q10E         | % Rev or<br>Margin                       | 2Q10E         | % Rev or<br>Margin | 3Q10E         | % Rev or<br>Margin | 4Q10E         | % Rev or<br>Margin | 2010E          | % Rev or<br>Margin |
| <b>Sales</b>                             | 107,939       |  | 113,870       |                    | 113,648       |                    | 121,121       |                    | 456,578        |                    |
| Cost of sales                            | 70,700        | 65.5%                                    | 72,308        | 63.5%              | 73,303        | 64.5%              | 79,334        | 65.5%              | 295,645        | 64.8%              |
| <b>Gross profit</b>                      | <b>37,239</b> | <b>34.5%</b>                             | <b>41,563</b> | <b>36.5%</b>       | <b>40,345</b> | <b>35.5%</b>       | <b>41,787</b> | <b>34.5%</b>       | <b>160,933</b> | <b>35.2%</b>       |
| SGA&R                                    | 16,337        | 15.1%                                    | 17,679        | 15.5%              | 17,391        | 15.3%              | 17,098        | 14.1%              | 68,505         | 15.0%              |
| Depreciation & Amortization              | 4,300         | 4.0%                                     | 4,400         | 3.9%               | 4,300         | 3.8%               | 4,200         | 3.5%               | 17,200         | 3.8%               |
| <b>Operating income</b>                  | <b>16,602</b> | <b>15.4%</b>                             | <b>19,484</b> | <b>17.1%</b>       | <b>18,654</b> | <b>16.4%</b>       | <b>20,488</b> | <b>16.9%</b>       | <b>75,228</b>  | <b>16.5%</b>       |
| Interest income                          | 200           | 0.2%                                     | 250           | 0.2%               | 300           | 0.3%               | 350           | 0.3%               | 1,100          | 0.2%               |
| Interest expense                         | 0             | 0.0%                                     | 0             | 0.0%               | 0             | 0.0%               | 0             | 0.0%               | 0              | 0.0%               |
| Equity in income from equity investments | 325           | 0.3%                                     | 325           | 0.3%               | 325           | 0.3%               | 325           | 0.3%               | 1,300          | 0.3%               |
| Other expense, net                       | (750)         | -0.7%                                    | (750)         | -0.7%              | (750)         | -0.7%              | (750)         | -0.6%              | (3,000)        | -0.7%              |
| Income before taxes                      | 16,377        | 15.2%                                    | 19,309        | 17.0%              | 18,529        | 16.3%              | 20,413        | 16.9%              | 74,628         | 16.3%              |
| Income taxes                             | 6,059         | 37.0%                                    | 7,144         | 37.0%              | 6,856         | 37.0%              | 7,553         | 37.0%              | 27,613         | 37.0%              |
| Income before minority interest          | 10,317        | 9.6%                                     | 12,165        | 10.7%              | 11,674        | 10.3%              | 12,860        | 10.6%              | 47,016         | 10.3%              |
| Minority interest                        | 0             |  | 0             |                    | 0             |                    | 0             |                    | 0              |                    |
| <b>Net income</b>                        | <b>10,317</b> | <b>9.6%</b>                              | <b>12,165</b> | <b>10.7%</b>       | <b>11,674</b> | <b>10.3%</b>       | <b>12,860</b> | <b>10.6%</b>       | <b>47,016</b>  | <b>10.3%</b>       |
| <b>EPS, Continuing Operations</b>        | <b>\$0.18</b> |  | <b>\$0.21</b> |                    | <b>\$0.21</b> |                    | <b>\$0.23</b> |                    | <b>\$0.83</b>  |                    |
| Shares outstanding (000)                 | 56,500        |  | 56,600        |                    | 56,700        |                    | 56,800        |                    | 56,650         |                    |

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



**INDUSTRY UPDATE**

**Water Utilities, Flow Technology and Purification**

| <b>Consolidated Water Co., Ltd.</b> |            | <b>Quarterly Income Statement, 2009E</b> |            |                    |            |                    |            |                    |             |                    |
|-------------------------------------|------------|--|------------|--------------------|------------|--------------------|------------|--------------------|-------------|--------------------|
| <i>(in dollars)</i>                 |            |  |            |                    |            |                    |            |                    |             |                    |
| Fiscal year ends December 31        |            |  |            |                    |            |                    |            |                    |             |                    |
|                                     | 1Q09       | % Rev or<br>Margin                       | 2Q09       | % Rev or<br>Margin | 3Q09E      | % Rev or<br>Margin | 4Q09E      | % Rev or<br>Margin | 2009E       | % Rev or<br>Margin |
| <b>Total revenue</b>                | 15,864,055 |  | 15,454,998 |                    | 14,672,212 |                    | 15,451,426 |                    | 61,442,691  |                    |
| Total cost of sales                 | 9,883,555  | 62.3%                                    | 7,867,945  | 50.9%              | 9,003,839  | 61.4%              | 9,341,944  | 60.5%              | 36,097,283  | 58.7%              |
| <b>Gross profit</b>                 | 5,980,500  | 37.7%                                    | 7,587,053  | 49.1%              | 5,668,373  | 38.6%              | 6,109,481  | 39.5%              | 25,345,407  | 41.3%              |
| G&A                                 | 2,501,203  | 15.8%                                    | 2,670,059  | 17.3%              | 2,567,637  | 17.5%              | 2,549,485  | 16.5%              | 10,288,384  | 16.7%              |
| <b>Operating income</b>             | 3,479,297  | 21.9%                                    | 4,916,994  | 31.8%              | 3,100,736  | 21.1%              | 3,559,996  | 23.0%              | 15,057,023  | 24.5%              |
| Interest income                     | 156,304    | 1.0%                                     | 150,373    | 1.0%               | 161,394    | 1.1%               | 169,966    | 1.1%               | 640,037     | 1.0%               |
| Interest expense, net               | (426,229)  | -2.7%                                    | (443,824)  | -2.9%              | (400,000)  | -2.7%              | (380,000)  | -2.5%              | (1,650,053) | -2.7%              |
| Other income/expense                | 45,407     | 0.3%                                     | 47,856     | 0.3%               | 45,000     | 0.3%               | 50,000     | 0.3%               | 188,263     | 0.3%               |
| Equity in earnings of affiliates    | (608,999)  |  | (589,022)  |                    | (511,637)  |                    | (487,086)  |                    | (2,196,744) |                    |
| <b>Income before taxes</b>          | 2,647,780  | 16.7%                                    | 4,082,377  | 26.4%              | 2,395,493  | 16.3%              | 2,912,876  | 18.9%              | 12,038,527  | 19.6%              |
| Income taxes                        | 0          | 0.0%                                     | 0          | 0.0%               | 0          | 0.0%               | 0          | 0.0%               | 0           | 0.0%               |
| Other income/expense                | 97,622     |  | 214,761    |                    | 0          |                    | 0          |                    | 312,383     |                    |
| <b>Net income</b>                   | 2,550,158  | 16.1%                                    | 3,867,616  | 25.0%              | 2,395,493  | 16.3%              | 2,912,876  | 18.9%              | 11,726,144  | 19.1%              |
| Basic earnings per share            | \$0.18     |  | \$0.27     |                    | \$0.16     |                    | \$0.20     |                    | \$0.81      |                    |
| Diluted earnings per share          | \$0.18     |  | \$0.26     |                    | \$0.16     |                    | \$0.20     |                    | \$0.80      |                    |
| Basic shares outstanding (000)      | 14,530,183 |  | 14,531,991 |                    | 14,560,000 |                    | 14,565,000 |                    | 14,546,794  |                    |
| Diluted shares outstanding (000)    | 14,550,733 |  | 14,596,670 |                    | 14,600,000 |                    | 14,625,000 |                    | 14,593,101  |                    |
| Dividends/Share Paid                | \$0.065    |  | \$0.065    |                    | \$0.065    |                    | \$0.075    |                    | \$0.27      |                    |
|                                     | 944,462    |  | 944,579    |                    | 946,400    |                    | 1,092,375  |                    | 3,927,816   |                    |
| <b>Consolidated Water Co., Ltd.</b> |            | <b>Quarterly Income Statement, 2010E</b> |            |                    |            |                    |            |                    |             |                    |
| <i>(in dollars)</i>                 |            |  |            |                    |            |                    |            |                    |             |                    |
| Fiscal year ends December 31        |            |  |            |                    |            |                    |            |                    |             |                    |
|                                     | 1Q10E      | % Rev or<br>Margin                       | 2Q10E      | % Rev or<br>Margin | 3Q10E      | % Rev or<br>Margin | 4Q10E      | % Rev or<br>Margin | 2010E       | % Rev or<br>Margin |
| <b>Total revenue</b>                | 14,986,031 |  | 14,624,215 |                    | 15,345,013 |                    | 16,561,497 |                    | 61,516,755  |                    |
| Total cost of sales                 | 8,864,226  | 59.1%                                    | 8,776,463  | 60.0%              | 9,414,204  | 61.4%              | 10,074,672 | 60.8%              | 37,129,565  | 60.4%              |
| <b>Gross profit</b>                 | 6,121,805  | 40.9%                                    | 5,847,752  | 40.0%              | 5,930,809  | 38.6%              | 6,486,824  | 39.2%              | 24,387,190  | 39.6%              |
| G&A                                 | 2,547,625  | 17.0%                                    | 2,573,862  | 17.6%              | 2,608,652  | 17.0%              | 2,567,032  | 15.5%              | 10,297,171  | 16.7%              |
| <b>Operating income</b>             | 3,574,179  | 23.9%                                    | 3,273,890  | 22.4%              | 3,322,157  | 21.6%              | 3,919,792  | 23.7%              | 14,090,019  | 22.9%              |
| Interest income                     | 224,790    | 1.5%                                     | 241,300    | 1.7%               | 276,210    | 1.8%               | 322,949    | 2.0%               | 1,065,249   | 1.7%               |
| Interest expense, net               | (360,000)  | -2.4%                                    | (340,000)  | -2.3%              | (320,000)  | -2.1%              | (300,000)  | -1.8%              | (1,320,000) | -2.1%              |
| Other income/expense                | 50,000     | 0.3%                                     | 50,000     | 0.3%               | 50,000     | 0.3%               | 50,000     | 0.3%               | 200,000     | 0.3%               |
| Equity in earnings of affiliates    | 175,000    |  | 175,000    |                    | 175,000    |                    | 175,000    |                    | 700,000     | 1.1%               |
| <b>Income before taxes</b>          | 3,663,970  | 24.4%                                    | 3,400,190  | 23.3%              | 3,503,367  | 22.8%              | 4,167,742  | 25.2%              | 14,735,269  | 24.0%              |
| Income taxes                        | 0          | 0.0%                                     | 0          | 0.0%               | 0          | 0.0%               | 0          | 0.0%               | 0           | 0.0%               |
| Other income/expense                | 0          |  | 0          |                    | 0          |                    | 0          |                    | 0           | 0.0%               |
| <b>Net income</b>                   | 3,663,970  | 24.4%                                    | 3,400,190  | 23.3%              | 3,503,367  | 22.8%              | 4,167,742  | 25.2%              | 14,735,269  | 24.0%              |
| Basic earnings per share            | \$0.25     |  | \$0.23     |                    | \$0.24     |                    | \$0.29     |                    | \$1.01      |                    |
| Diluted earnings per share          | \$0.25     |  | \$0.23     |                    | \$0.24     |                    | \$0.28     |                    | \$1.00      |                    |
| Basic shares outstanding (000)      | 14,570,000 |  | 14,575,000 |                    | 14,580,000 |                    | 14,585,000 |                    | 14,577,500  |                    |
| Diluted shares outstanding (000)    | 14,650,000 |  | 14,675,000 |                    | 14,700,000 |                    | 14,725,000 |                    | 14,687,500  |                    |

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

**INDUSTRY UPDATE**

Water Utilities, Flow Technology and Purification

| <b>Met-Pro Corp. Quarterly Income Statement, FY10E</b> |        |          |        |          |        |          |        |          |        |          |
|--|--------|----------|--------|----------|--------|----------|--------|----------|--------|----------|
| (\$000, except per share data)                         |        |          |        |          |        |          |        |          |        |          |
| Fiscal year ends January 31                            |        |          |        |          |        |          |        |          |        |          |
|  | Apr-09 | % Rev or | Jul-09 | % Rev or | Oct-09 | % Rev or | Jan-10 | % Rev or | 2010E  | % Rev or |
|  | 1Q10   | Margin   | 2Q10   | Margin   | 3Q10E  | Margin   | 4Q10E  | Margin   |        | Margin   |
| Sales  | 19,641 |          | 20,866 |          | 23,514 |          | 24,312 |          | 88,353 |          |
| Cost of sales  | 12,628 | 64.3%    | 13,780 | 66.0%    | 15,237 | 64.8%    | 15,681 | 64.5%    | 57,326 | 64.9%    |
| Gross profit   | 7,013  | 35.7%    | 7,106  | 34.0%    | 8,277  | 35.2%    | 8,631  | 35.5%    | 31,027 | 35.1%    |
| SG&A   | 5,541  | 28.2%    | 5,336  | 25.5%    | 5,568  | 23.7%    | 5,682  | 23.4%    | 22,127 | 25.0%    |
| Operating income                                       | 1,472  | 7.5%     | 1,770  | 8.5%     | 2,709  | 11.5%    | 2,949  | 12.1%    | 8,899  | 10.1%    |
| Interest expense                                       | 54     | 0.3%     | 54     | 0.3%     | 50     | 0.2%     | 45     | 0.2%     | 203    | 0.2%     |
| Other income, net                                      | 14     |          | 63     |          | 50     |          | 50     |          | 177    |          |
| Income before taxes                                    | 1,432  | 7.3%     | 1,779  | 8.5%     | 2,709  | 11.5%    | 2,954  | 12.1%    | 8,874  | 10.0%    |
| Income taxes   | 480    | 33.5%    | 596    | 33.5%    | 908    | 33.5%    | 989    | 33.5%    | 2,973  | 33.5%    |
| Net income   | 952    | 4.8%     | 1,183  | 5.7%     | 1,801  | 7.7%     | 1,964  | 8.1%     | 5,901  | 6.7%     |
| EPS  | \$0.07 |          | \$0.08 |          | \$0.12 |          | \$0.13 |          | \$0.40 |          |
| Diluted shares outstanding (000)                       | 14,646 |          | 14,661 |          | 14,700 |          | 14,750 |          | 14,689 |          |
| <b>Met-Pro Corp. Quarterly Income Statement, FY11E</b> |        |          |        |          |        |          |        |          |        |          |
| (\$000, except per share data)                         |        |          |        |          |        |          |        |          |        |          |
| Fiscal year ends January 31                            |        |          |        |          |        |          |        |          |        |          |
|  | Apr-10 | % Rev or | Jul-10 | % Rev or | Oct-10 | % Rev or | Jan-11 | % Rev or | 2011E  | % Rev or |
|  | 1Q11E  | Margin   | 2Q11E  | Margin   | 3Q11E  | Margin   | 4Q11E  | Margin   |        | Margin   |
| Sales  | 20,546 |          | 21,861 |          | 24,642 |          | 25,620 |          | 92,669 |          |
| Cost of sales  | 13,047 | 63.5%    | 13,991 | 64.0%    | 15,771 | 64.0%    | 16,397 | 64.0%    | 59,205 | 63.9%    |
| Gross profit   | 7,499  | 36.5%    | 7,870  | 36.0%    | 8,871  | 36.0%    | 9,223  | 36.0%    | 33,464 | 36.1%    |
| SG&A   | 5,073  | 24.7%    | 5,280  | 24.2%    | 5,567  | 22.6%    | 5,708  | 22.3%    | 21,629 | 23.3%    |
| Operating income                                       | 2,426  | 11.8%    | 2,590  | 11.8%    | 3,304  | 13.4%    | 3,515  | 13.7%    | 11,835 | 12.8%    |
| Interest expense                                       | 45     | 0.2%     | 40     | 0.2%     | 40     | 0.2%     | 35     | 0.1%     | 160    | 0.2%     |
| Other income, net                                      | 50     |          | 50     |          | 50     |          | 50     |          | 200    |          |
| Income before taxes                                    | 2,431  | 11.8%    | 2,600  | 11.9%    | 3,314  | 13.4%    | 3,530  | 13.8%    | 11,875 | 12.8%    |
| Income taxes   | 814    | 33.5%    | 871    | 33.5%    | 1,110  | 33.5%    | 1,183  | 33.5%    | 3,978  | 33.5%    |
| Net income   | 1,616  | 7.9%     | 1,729  | 7.9%     | 2,204  | 8.9%     | 2,348  | 9.2%     | 7,897  | 8.5%     |
| EPS  | \$0.11 |          | \$0.12 |          | \$0.15 |          | \$0.16 |          | \$0.53 |          |
| Diluted shares outstanding (000)                       | 14,800 |          | 14,850 |          | 14,900 |          | 14,950 |          | 14,875 |          |

Sources: Company Specific Data, Brean Murray, Carret & Co. estimates

**INDUSTRY UPDATE**

Water Utilities, Flow Technology and Purification

**Important Disclosures**

**Ratings and Target Price History**

For historical rating and target price information please use the following links:

AWK: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=AWK&analystid=93&re=1&width=500&height=350&wmf=1>

AWR: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=AWR&analystid=93&re=1&width=500&height=350&wmf=1>

CCC: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=CCC&analystid=93&re=1&width=500&height=350&wmf=1>

CWCO: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=CWCO&analystid=93&re=1&width=500&height=350&wmf=1>

CWT: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=CWT&analystid=93&re=1&width=500&height=350&wmf=1>

IEX: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=IEX&analystid=93&re=1&width=500&height=350&wmf=1>

MPR: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=MPR&analystid=93&re=1&width=500&height=350&wmf=1>

MWA: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=MWA&analystid=93&re=1&width=500&height=350&wmf=1>

SBS: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=SBS&analystid=93&re=1&width=500&height=350&wmf=1>

SJW: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=SJW&analystid=93&re=1&width=500&height=350&wmf=1>

SWWC: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=SWWC&analystid=93&re=1&width=500&height=350&wmf=1>

VE: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=VE&analystid=93&re=1&width=500&height=350&wmf=1>

WTR: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=WTR&analystid=93&re=1&width=500&height=350&wmf=1>

WTS: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=WTS&analystid=93&re=1&width=500&height=350&wmf=1>

YORW: <http://www2.investars.com/cgi-bin/charts/nasdaq.exe?f=1&s=YORW&analystid=93&re=1&width=500&height=350&wmf=1>

All prices are as of the market close on 10/15/09].

At the time this report was published, Brean Murray, Carret & Co., LLC made a market in the securities of Consolidated Water Co., Ltd., Southwest Water Co. and The York Water Company

Brean Murray, Carret & Co., LLC has managed or co-managed a public offering or placement of securities of American Water Works Company, Inc., American States Water Company and Mueller Water Products, Inc. within the past 12 months.

American Water Works Company, Inc. is, or within the last 12 months has been, a client of Brean Murray, Carret & Co., LLC, and investment banking and/or advisory services are being, or have been provided.

American States Water Company is, or within the last 12 months has been, a client of Brean Murray, Carret & Co., LLC, and investment banking and/or advisory services are being, or have been provided.

Mueller Water Products, Inc. is, or within the last 12 months has been, a client of Brean Murray, Carret & Co., LLC, and investment banking and/or advisory services are being, or have been provided.

**INDUSTRY UPDATE****Water Utilities, Flow Technology and Purification**

Brean Murray, Carret & Co., LLC expects to receive compensation or intends to seek compensation for investment banking and/or advisory services from American Water Works Company, Inc. and Mueller Water Products, Inc. within the next 3 months.

Brean Murray, Carret & Co., LLC has received compensation for investment banking and/or advisory services from American Water Works Company, Inc. and American States Water Company within the past 12 months.

In the normal course of its business, Brean Murray, Carret & Co., LLC does and intends to seek compensation for investment banking and/or non-investment banking services from the companies in its coverage universe. As a result, investors should be aware that the Firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decisions. Non-U.S. research analysts that may have contributed to this report are not registered/qualified as research analysts with the FINRA.

The research analyst(s) or research associate(s) principally responsible for the preparation of this research report has received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors and firm revenues. The compensation is determined exclusively by research management and senior management (not including investment banking).

**Brean Murray, Carret & Co. Stock Rating System**

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<br>Past 12 mos. | % of Total Securities |
|--------------|-----------------|-----------------------|---|-----------------------|
| BUY          | 105             | 58.33%                | 10  | 9.52%                 |
| HOLD         | 63              | 35%                   | 0   | 0%                    |
| SELL         | 10              | 5.56%                 | 0   | 0%                    |
| NOT RATED    | 2               | 1.11%                 | 0   | 0%                    |
| <b>TOTAL</b> | <b>180</b>      |                       |   |                       |

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

**Valuation Methodology and Risks**

**American States Water Company (AWR):** Our target price of \$42 is based on 18x our 2010 EPS estimate of \$2.32. Risks to the achievement of our target price include integration of acquisitions, weather, environmental regulations, regulation of rates, and interest rates.

**American Water Works (AWK):** Our \$28 target price is based on the shares achieving a P/E multiple of 20x our 2010 EPS estimate of \$1.41. Risks to the achievement of our target price include weather, acquisition integration, regulatory environment, additional equity offerings, potential goodwill impairments and changes in interest rates.

**Aqua America (WTR):** Our \$26 target price is based on the shares achieving a P/E multiple of 28x our 2010 EPS estimate of \$0.94. Risks to the achievement of our target price include weather, acquisitions, interest rates, environmental / public health responsibilities and regulatory climate.

**California Water Service Group (CWT):** Our \$44 target price is based on a multiple of 19x our 2010 EPS estimate of \$2.30. Risks to the achievement of our target price include integration of acquisitions, weather, environmental regulations, and regulation of rates.

**Calgon Carbon (CCC):** Our \$17 target price is based on the shares attaining a level of approximately 20x our 2010 EPS estimate of \$0.83. Risks to the achievement of our target price include global macroeconomic conditions, foreign exchange exposure, changes in environmental regulations.

**Consolidated Water (CWCO):** Our \$24 target price is based on a multiple of 24x our FY10 EPS estimate of \$1.00. Risks to the achievement of our target price include weather, acquisition integration, environmental regulations, and political climates in the company's service territories.

## INDUSTRY UPDATE

### Water Utilities, Flow Technology and Purification

**IDEX Corp. (IEX):** Our \$16 target price is based on our expectation that the shares will trade at a level just above 10x our 2010 EPS estimate of \$1.61. Risks to the achievement of our target price include accretive acquisitions, acquisition of the company, improving macroeconomic fundamentals.

**Mueller Water Products (MWA):** We are using our FY11 EPS estimate of \$0.51 to derive our \$8 target price, assigning a 16x multiple. Risks to the achievement of our target price include global economic conditions, natural disasters, commodity pricing, labor issues, and foreign exchange exposure.

**National Coal Corp (NCOC):** Our \$5 target price is based on a multiple of 4x our 2010 EPS estimate of \$1.24. Risks to the achievement of our target price include global economic conditions, natural disasters, mining conditions, and labor disruptions.

**Sabesp (SBS):** Our target price of \$66 is based on the shares attaining a P/E multiple of 9x our 2010 EPADR estimate of \$7.36. Risks to the achievement of our target price include majority government ownership, legislation, currency fluctuations, environmental regulations, outstanding accounts receivable, water supply agreements and weather.

**Veolia Environnement (VE):** Our €30 and ADR \$40 target prices are based on the shares attaining a level of 18x our 2010 EPS/ADR estimates of €1.63/US\$2.31, respectively. Risks to the achievement of our target price include acquisitions, changes in energy prices, currency effects, contract competition, interest rates, weather, changes in legislation and environmental / public health responsibilities.

**York Water (YORW):** Our \$18 target price is based on a multiple of 28x our 2010 EPS estimate of \$0.65. Risks to the achievement of our target price include unfavorable weather, acquisition integration, interest rate variability, environmental/ public health responsibilities, macroeconomic conditions 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.

### Disclaimers

Some companies that Brean Murray, Carret & Co., LLC follows are emerging growth companies whose securities typically involve a higher degree of risk and more volatility than the securities of more established companies. The securities discussed in Brean Murray, Carret & Co., LLC research reports may not be suitable for some investors. Investors must make their own determination as to the appropriateness of an investment in any securities referred to herein, based on their specific investment objectives, financial status and risk tolerance. This report may discuss numerous securities, some of which may not be qualified for sale in certain states and to certain categories of investors. Readers are advised that this analysis report is issued solely for informational purposes and is not to be construed as an offer to sell or the solicitation of an offer to buy. The information contained herein is based on sources which we believe to be reliable but is not guaranteed by us as being accurate and does not purport to be a complete statement or summary of the available data on the company, industry or security discussed in the report. Designated trademarks and brands are the property of their respective owners. Past performance is no guarantee of future results. Any opinions expressed herein are statements of our judgment as of the date of publication and are subject to change without notice. Entities including but not limited to the Firm, its officers, directors, employees, customers, affiliates may have a position, long or short, in the securities referred to herein, and/or other related securities, and from time to time may increase or decrease such position or take a contra position. The Firm (or persons related thereto) may make a market in the securities mentioned herein, and may from time to time perform investment banking or other services for, or solicit investment banking or other business from, and may have other relationships with any company mentioned in this report. Brean Murray, Carret & Co., LLC is a member of SIPC, FINRA, licensed with various state securities regulatory authorities, and a registered U.S. Broker-Dealer. No part of this report may be reproduced in any form without the express permission of Brean Murray, Carret & Co., LLC. Additional information is available upon request.

COMPANY UPDATE

American Water Works Company, Inc.

(AWK/NYSE)

November 10, 2009



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Reports 3Q09 Results; Maintaining Buy Rating, \$28 Target Price

Buy

Target Price: \$28

Investment Summary

American Water Works reported 3Q09 results that were slightly ahead of our expectations. Revenue in the quarter of \$680 million (a 1.2% increase YoY) came in slightly ahead of our \$673 million estimate and EPS of \$0.52 was a touch above our \$0.51 estimate, but shy of the consensus estimate of \$0.54. We consider these results impressive considering the impact that weather had on the company in the quarter, where 11 of 20 of American Water Works' regulated states experienced either above-average rainfall, cooler temperatures, or both. The Northeast region had its eighth-wettest summer on record, with New Jersey experiencing its fifth-wettest summer on record. In the regulated business, revenue increased by \$17.6 million (2.9% YoY), and the company received authorizations for additional annualized revenues from general rate increases of approximately \$16.8 million. As of September 30, 2009, the company had filed general rate cases in 10 states, which would provide an additional \$258 million in annualized revenue. Revenue in the non-regulated business decreased by \$8.6 million (11.7% YoY) due to lower revenues in the Contract Operations Group. Looking ahead, we believe American Water Works is well positioned to benefit from additional rate increases, tuck-in acquisitions, and planned capital expenditures. We are maintaining our Buy rating and \$28 target price, based on a P/E multiple of 20x our 2010 EPS estimate \$1.37.

|                           |                 |
|---------------------------|-----------------|
| Price                     | \$20.31         |
| 52-Week High/Low          | \$22.35 - 16.22 |
| Shares Outstanding (mm)   | 179.81          |
| Market Cap. (mm)          | \$3,651.98      |
| Average Daily Volume (mm) | 0.87            |

| EPS   | FY08A  | FY09E   | FY10E  |
|-------|--------|---------|--------|
| Mar   | \$0.08 | \$0.19A | \$0.16 |
| Prior | -      | -       | \$0.17 |
| Jun   | \$0.30 | \$0.32A | \$0.40 |
| Prior | -      | -       | \$0.38 |
| Sep   | \$0.55 | \$0.52A | \$0.53 |
| Prior | -      | \$0.51  | \$0.53 |
| Dec   | \$0.23 | \$0.21  | \$0.28 |
| Prior | -      | \$0.30  | -      |
| FY    | \$1.16 | \$1.24  | \$1.37 |
| Prior | -      | \$1.32  | \$1.39 |

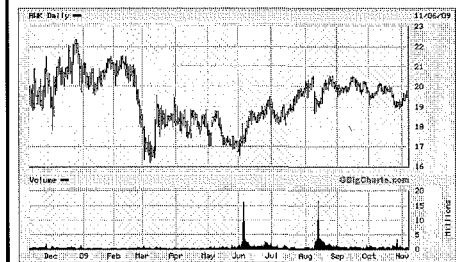
Consensus - \$1.30 \$1.44

P/E 17.5x 16.4x 14.8x

FY Rev. (mm) \$2,336.99 \$2,451.07 \$2,616.36

Discussion

- Solid 3Q09 results.** American Water Works' 3Q09 results came in ahead of our expectations on both the top and bottom lines. Revenue of \$680 million increased 1.5% from the same quarter last year and beat our \$673 million estimate. Contributing to the increase was the Regulated business, which saw its revenue increase by \$17.6 million. The company's non-regulated business saw its revenue decrease 11.7% from the same quarter last year. Overall, we were impressed with the results given the unfavorable weather conditions American Water Works has been faced with.
- Significant weather impacts.** In the quarter, 11 of American Water Works' 20 regulated states experienced above average rainfall, cooler temperatures, or both. The Northeast region had its eighth-wettest summer on record, and New Jersey had its fifth wettest summer on record. Further, July 2009 was the coldest July on record for six of American Water Works' states. On the bright side, the gross margin stayed constant at 31.5% from the same quarter last year in the face of weather impacts. Without the poor weather, gross margin would have increased. For the past two quarters combined, we estimate that weather has stripped out \$0.22 from EPS (\$0.08 in 2Q09 and \$0.14 in 3Q09).



Source: BigCharts.com

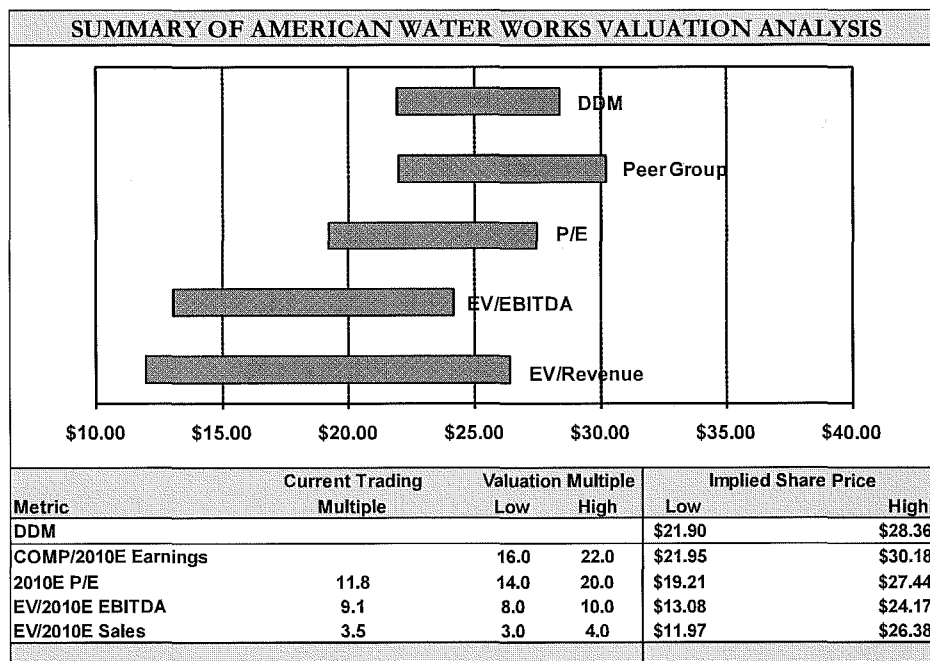
**COMPANY UPDATE**

American Water Works Company, Inc. (AWK/NYSE)

**Rate case and general updates.** American Water Works received additional rate increases in the quarter of \$16.8 million and were authorized increases of \$6.9 million related to infrastructure charges. The average authorized return on equity in these cases was 10.5%. We note that the average authorized return on equity increased from the rate increases granted in 2Q09, which had an authorized return on equity of 10.3%. Subsequent to the end of the quarter, the Company settled their rate case in Pennsylvania which grants \$31 million in annual revenue in addition to the \$23 million previously received through infrastructure surcharges. And in October, American Water Works received authorizations for an additional \$4.6 million of annual revenue in various other states related to infrastructure surcharges. At the end of the quarter, the company was awaiting final orders in 10 states (including the recently settled Pennsylvania case) requesting an additional annualized revenues of \$258 million. Subsequent to the end of the quarter, American Water Works filed a rate case in Missouri for \$48.7 million, where we note the cost of water service is relatively low. Further, American Water Works is having discussions with approximately 75 municipalities across the country which serves a population of several hundred thousand, as it seeks to increase its operational footprint while looking to provide solutions for potential new customers. This could take several forms, including bulk sale contracts, operating and maintenance agreements, public-private partnerships or acquisitions, depending upon customer preference.

**Adjusting estimates.** Based on the results reported for 3Q09, we are adjusting our forward estimates as follows: our 2009 EPS estimate is now \$1.24, down from \$1.32, and our 2010 EPS estimate is now \$1.37, down from \$1.39. We have lowered our 4Q09 estimates to reflect continuing wet conditions in the company's primary service territories of Pennsylvania and New Jersey. We consider the changes insignificant from a valuation perspective.

**Valuation.** Based on the results of our summary valuation, we are maintaining our Buy rating and \$28 target price. Judging the shares by three criteria (dividend yield, projected long-term growth and valuation relative to the U.S. water utility peer group), we believe the shares of American Water Works rank among the most attractive from current share price levels. We continue to expect the valuation gap between American Water Works and the water utility peer group to close (on a P/E basis) based on (1) continued successful recovery of costs through rate relief across the service territories, (2) continued unwinding of the RWE ownership position, and (3) its structured capital expense programs to improve water and delivery quality. Our \$28 target price is based on a P/E multiple of 20x our 2010 EPS estimate of \$1.37, and we recommend investors continue to accumulate shares or add to positions at current levels.



Source: Company reports, Brean Murray, Carret & Co. estimates

**COMPANY UPDATE**

American Water Works Company, Inc. (AWK/NYSE)

**Water Utility Segment Comparisons**

| Peer Group Analysis         |        | 11/09/09 |        | Mkt. Cap | EPS    | EPS    | EPS    | EPS    | P/E   | P/E   | P/E   | P/E   | Est LT EPS |
|-----------------------------|--------|----------|--------|----------|--------|--------|--------|--------|-------|-------|-------|-------|------------|
| Company Name                | Ticker | Price    | Rating | (MM)     | CY07   | CY08   | CY09E  | CY10E  | CY07  | CY08E | CY09E | CY10E | Growth     |
| <b>AMERICAN WATER WORKS</b> | AWK    | \$19.56  | BUY    | \$3,517  | NA     | \$1.16 | \$1.08 | \$1.44 | NA    | 16.9x | 18.1x | 13.6x | 12.0%      |
| AQUA AMERICA                | WTR    | \$16.16  | BUY    | \$2,196  | \$0.72 | \$0.73 | \$0.80 | \$0.90 | 22.4x | 22.1x | 20.2x | 18.0x | 9.0%       |
| CALIFORNIA WATER            | CWT    | \$36.32  | BUY    | \$753    | \$1.50 | \$1.90 | \$1.99 | \$2.11 | 24.2x | 19.1x | 18.3x | 17.2x | 8.0%       |
| AMER STATES WATER           | AWR    | \$34.71  | BUY    | \$642    | \$1.56 | \$1.56 | \$1.79 | \$1.95 | 22.3x | 22.3x | 19.4x | 17.8x | NA         |
| SJW                         | SJW    | \$22.24  | HOLD   | \$411    | \$1.04 | \$1.16 | \$0.83 | \$1.07 | 21.4x | 19.2x | 26.8x | 20.8x | NA         |
| <b>Group Average</b>        |        |          |        |          |        |        |        |        | 22.6x | 19.9x | 20.5x | 17.5x | 9.7%       |

Source: Baseline

| Peer Group Analysis         |        | 11/09/09 |        | Mkt. Cap | Current  | Target   | Target   | Price   | Price   | Target  | Upside    | Yield |
|-----------------------------|--------|----------|--------|----------|----------|----------|----------|---------|---------|---------|-----------|-------|
| Company Name                | Ticker | Price    | Rating | (MM)     | Multiple | Multiple | Multiple | Range   | Range   | Price   | Potential |       |
|                             |        |          |        |          | CY10     | (Low)    | (High)   | (Low)   | (High)  |         |           |       |
| <b>AMERICAN WATER WORKS</b> | AWK    | \$19.56  | BUY    | \$3,517  | 13.6x    | 14.3x    | 19.5x    | \$20.52 | \$28.08 | \$28.00 | 43%       | 4.3%  |
| AQUA AMERICA                | WTR    | \$16.16  | BUY    | \$2,196  | 18.0x    | 19.0x    | 26.0x    | \$17.10 | \$23.40 | \$26.00 | 61%       | 3.6%  |
| CALIFORNIA WATER            | CWT    | \$36.32  | BUY    | \$753    | 17.2x    | 16.0x    | 21.0x    | \$33.76 | \$44.31 | \$43.00 | 18%       | 3.2%  |
| AMER STATES WATER           | AWR    | \$34.71  | BUY    | \$642    | 17.8x    | 16.0x    | 21.0x    | \$31.20 | \$40.95 | \$44.00 | 27%       | 3.0%  |
| SJW                         | SJW    | \$22.24  | HOLD   | \$411    | 20.8x    | 16.0x    | 22.0x    | \$17.12 | \$23.54 | NA      | NA        | 3.0%  |

Sources: Baseline, Brean Murray, Carret & Co.



**COMPANY UPDATE**

American Water Works Company, Inc. (AWK/NYSE)

| <b>American Water Works Company, Inc., 2009E</b>         |               |                   |               |                   |               |                   |               |                   |                |                   |
|--|---------------|-------------------|---------------|-------------------|---------------|-------------------|---------------|-------------------|----------------|-------------------|
| <small>(\$M, except per share data)</small>              |               |                   |               |                   |               |                   |               |                   |                |                   |
| <small>Fiscal year ends December 31</small>              |               |                   |               |                   |               |                   |               |                   |                |                   |
|  | 1Q09          | Rate or<br>Margin | 2Q09          | Rate or<br>Margin | 3Q09          | Rate or<br>Margin | 4Q09E         | Rate or<br>Margin | 2009E          | Rate or<br>Margin |
| <b>Operating Revenues</b>                                | <b>550.2</b>  |                   | <b>612.7</b>  |                   | <b>680.0</b>  |                   | <b>608.2</b>  |                   | <b>2,451.1</b> |                   |
| Operation and maintenance                                | 314.4         | 57%               | 330.6         | 54%               | 340.9         | 50%               | 340.6         | 56%               | 1,326.5        | 54%               |
| Depreciation and amortization                            | 68.8          | 13%               | 73.2          | 12%               | 74.9          | 11%               | 75.4          | 12%               | 292.3          | 12%               |
| General taxes  | 52.5          | 10%               | 51.7          | 8%                | 50.6          | 7%                | 51.1          | 8%                | 205.9          | 8%                |
| Loss (gain) on sales of assets                           | (0.2)         | 0%                | -             | 0%                | (1.0)         | 0%                | -             | 0%                | (1.2)          | 0%                |
| Impairment charges                                       | 450.0         | 82%               | -             | 0%                | -             | 0%                | -             | 0%                | 450.0          | 18%               |
| <b>Total operating expenses, net</b>                     | <b>435.5</b>  | <b>79%</b>        | <b>455.5</b>  | <b>74%</b>        | <b>465.4</b>  | <b>68%</b>        | <b>467.1</b>  | <b>77%</b>        | <b>1,823.5</b> | <b>74%</b>        |
| <b>Operating income</b>                                  | <b>114.7</b>  | <b>21%</b>        | <b>157.2</b>  | <b>26%</b>        | <b>214.6</b>  | <b>32%</b>        | <b>141.1</b>  | <b>23%</b>        | <b>627.6</b>   | <b>26%</b>        |
| Interest, net  | (72.0)        | -13.1%            | (73.7)        | -12.0%            | (74.1)        | -10.9%            | (74.8)        | -12.3%            | (294.6)        | -12.0%            |
| Amortization of debt expense                             | (1.5)         | -0.3%             | (1.5)         | -0.2%             | (2.1)         | -0.3%             | (1.5)         | -0.2%             | (6.6)          | -0.3%             |
| Other, net   | 6.3           | 1.1%              | 4.2           | 0.7%              | 4.0           | 0.6%              | 4.4           | 0.7%              | 18.9           | 0.8%              |
| <b>Total other income (deductions)</b>                   | <b>(67.2)</b> | <b>-12.2%</b>     | <b>(71.1)</b> | <b>-11.6%</b>     | <b>(72.6)</b> | <b>-10.7%</b>     | <b>(71.9)</b> | <b>-11.8%</b>     | <b>(282.8)</b> | <b>-11.5%</b>     |
| <b>Earnings from cont. ops before income taxes</b>       | <b>47.5</b>   | <b>8.6%</b>       | <b>86.1</b>   | <b>14.1%</b>      | <b>141.8</b>  | <b>20.9%</b>      | <b>69.2</b>   | <b>11.4%</b>      | <b>344.6</b>   | <b>14.1%</b>      |
| Income taxes   | 17.6          | 37.1%             | 34.1          | 39.6%             | 50.2          | 35.4%             | 32.4          | 46.8%             | 134.3          | 39.0%             |
| <b>Earnings from cont. ops</b>                           | <b>29.9</b>   | <b>5.4%</b>       | <b>52.0</b>   | <b>8.5%</b>       | <b>91.6</b>   | <b>13.5%</b>      | <b>36.8</b>   | <b>6.1%</b>       | <b>210.3</b>   | <b>8.6%</b>       |
| Income / (Loss) from discontinued operations, net of tax | -             | 0.0%              | -             | 0.0%              | -             | 0.0%              | -             | 0.0%              | -              | 0.0%              |
| <b>Net income</b>  | <b>29.9</b>   | <b>5.4%</b>       | <b>52.0</b>   | <b>8.5%</b>       | <b>91.6</b>   | <b>13.5%</b>      | <b>36.8</b>   | <b>6.1%</b>       | <b>210.3</b>   | <b>8.6%</b>       |
| <b>Earnings per share:</b>                               |               |                   |               |                   |               |                   |               |                   |                |                   |
| <b>From continuing operations</b>                        | <b>\$0.19</b> |                   | <b>\$0.32</b> |                   | <b>\$0.52</b> |                   | <b>\$0.21</b> |                   | <b>\$1.24</b>  |                   |
| Average common shares outstanding                        | 160           |                   | 163           |                   | 175           |                   | 174           |                   | 168            |                   |
| <b>American Water Works Company, Inc., 2010E</b>         |               |                   |               |                   |               |                   |               |                   |                |                   |
| <small>(\$M, except per share data)</small>              |               |                   |               |                   |               |                   |               |                   |                |                   |
| <small>Fiscal year ends December 31</small>              |               |                   |               |                   |               |                   |               |                   |                |                   |
|  | 1Q10E         | Rate or<br>Margin | 2Q10E         | Rate or<br>Margin | 3Q10E         | Rate or<br>Margin | 4Q10E         | Rate or<br>Margin | 2010E          | Rate or<br>Margin |
| <b>Operating Revenues</b>                                | <b>554.0</b>  |                   | <b>654.0</b>  |                   | <b>730.80</b> |                   | <b>677.53</b> |                   | <b>2,616.4</b> |                   |
| Operation and maintenance                                | 309.1         | 56%               | 332.3         | 51%               | 370.5         | 51%               | 386.2         | 57%               | 1,398.1        | 53%               |
| Depreciation and amortization                            | 75.9          | 14%               | 76.5          | 12%               | 77.1          | 11%               | 77.9          | 12%               | 307.4          | 12%               |
| General taxes  | 51.0          | 9%                | 51.7          | 8%                | 51.2          | 7%                | 51.5          | 8%                | 205.3          | 8%                |
| Loss (gain) on sales of assets                           | -             | 0%                | -             | 0%                | -             | 0%                | -             | 0%                | -              | 0%                |
| <b>Total operating expenses, net</b>                     | <b>436.0</b>  | <b>79%</b>        | <b>460.4</b>  | <b>70%</b>        | <b>498.8</b>  | <b>68%</b>        | <b>515.6</b>  | <b>76%</b>        | <b>1,910.8</b> | <b>73%</b>        |
| <b>Operating income</b>                                  | <b>118.0</b>  | <b>21%</b>        | <b>193.6</b>  | <b>30%</b>        | <b>232.0</b>  | <b>32%</b>        | <b>161.9</b>  | <b>24%</b>        | <b>705.6</b>   | <b>27%</b>        |
| Interest, net  | (74.2)        | -13.4%            | (75.2)        | -11.5%            | (76.0)        | -10.4%            | (77.2)        | -11.4%            | (302.7)        | -11.6%            |
| Amortization of debt expense                             | (1.4)         | -0.2%             | (1.4)         | -0.2%             | (1.4)         | -0.2%             | (1.4)         | -0.2%             | (5.5)          | -0.2%             |
| Other, net   | 4.5           | 0.8%              | 4.5           | 0.7%              | 4.5           | 0.6%              | 4.5           | 0.7%              | 18.0           | 0.7%              |
| <b>Total other income (deductions)</b>                   | <b>(71.1)</b> | <b>-12.8%</b>     | <b>(72.1)</b> | <b>-11.0%</b>     | <b>(72.9)</b> | <b>-10.0%</b>     | <b>(74.1)</b> | <b>-10.9%</b>     | <b>(290.1)</b> | <b>-11.1%</b>     |
| <b>Earnings from cont. ops before income taxes</b>       | <b>46.9</b>   | <b>8.6%</b>       | <b>121.5</b>  | <b>18.6%</b>      | <b>159.1</b>  | <b>21.8%</b>      | <b>87.9</b>   | <b>13.0%</b>      | <b>415.4</b>   | <b>15.9%</b>      |
| Income taxes   | 18.3          | 39.0%             | 47.4          | 39.0%             | 62.1          | 39.0%             | 36.0          | 41.0%             | 163.8          | 39.4%             |
| <b>Earnings from cont. ops</b>                           | <b>28.6</b>   | <b>5.2%</b>       | <b>74.1</b>   | <b>11.3%</b>      | <b>97.1</b>   | <b>13.3%</b>      | <b>51.8</b>   | <b>7.7%</b>       | <b>251.7</b>   | <b>9.6%</b>       |
| Income / (Loss) from discontinued operations, net of tax | -             | 0.0%              | -             | 0.0%              | -             | 0.0%              | -             | 0.0%              | -              | 0.0%              |
| <b>Net income</b>  | <b>28.6</b>   | <b>5.2%</b>       | <b>74.1</b>   | <b>11.3%</b>      | <b>97.1</b>   | <b>13.3%</b>      | <b>51.8</b>   | <b>7.7%</b>       | <b>251.7</b>   | <b>9.6%</b>       |
| <b>Earnings per share:</b>                               |               |                   |               |                   |               |                   |               |                   |                |                   |
| <b>From continuing operations</b>                        | <b>\$0.16</b> |                   | <b>\$0.40</b> |                   | <b>\$0.53</b> |                   | <b>\$0.28</b> |                   | <b>\$1.37</b>  |                   |
| Average common shares outstanding                        | 179           |                   | 184           |                   | 184           |                   | 184           |                   | 183            |                   |

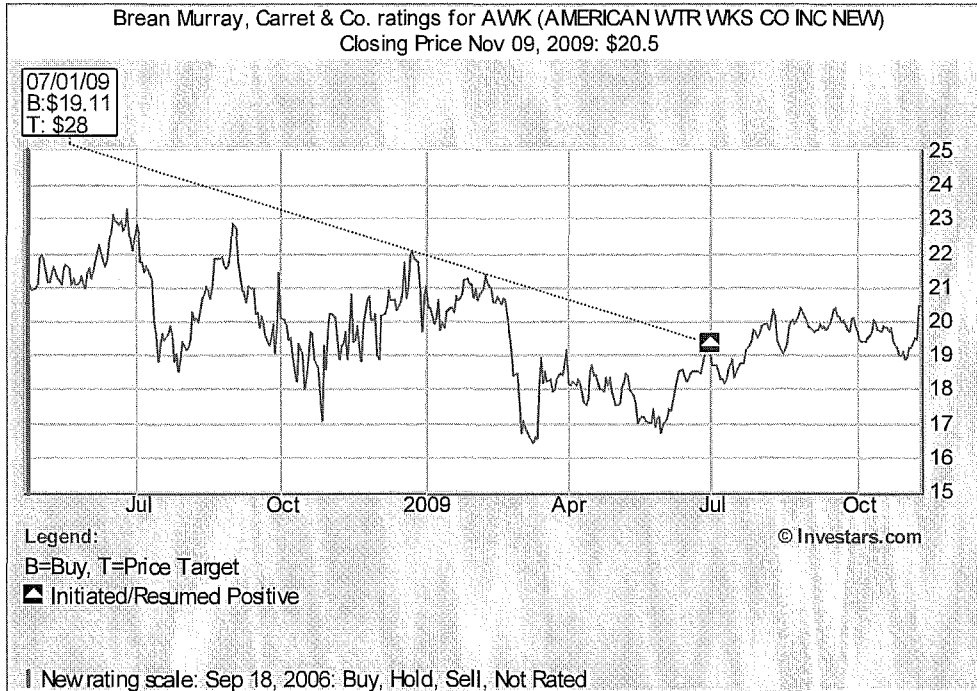
Source: Company reports, Brean Murray, Carret & Co. estimates

COMPANY UPDATE

American Water Works Company, Inc. (AWK/NYSE)

Important Disclosures

Ratings and Target Price History



Priced intraday on 11/10/09.

Brean Murray, Carret & Co., LLC has managed or co-managed a public offering or placement of securities of American Water Works Company, Inc. within the past 12 months.

American Water Works Company, Inc. is, or within the last 12 months has been, a client of Brean Murray, Carret & Co., LLC, and investment banking and/or advisory services are being, or have been provided.

Brean Murray, Carret & Co., LLC expects to receive compensation or intends to seek compensation for investment banking and/or advisory services from American Water Works Company, Inc. within the next 3 months.

Brean Murray, Carret & Co., LLC has received compensation for investment banking and/or advisory services from American Water Works Company, Inc. within the past 12 months.

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**COMPANY UPDATE**

American Water Works Company, Inc. (AWK/NYSE)

**Brean Murray, Carret & Co. Stock Rating System**

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          | 102             | 55.74%                | 10   | 9.8%                  |
| HOLD         | 68              | 37.16%                | 0  | 0%                    |
| SELL         | 11              | 6.01%                 | 0  | 0%                    |
| NOT RATED    | 2               | 1.09%                 | 0  | 0%                    |
| <b>TOTAL</b> | <b>183</b>      |                       |  |                       |

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

**Valuation Methodology and Risks**

**American Water Works (AWK):** Our \$28 target price is based on a P/E multiple of 20x our 2010 EPS estimate of \$1.37. Risks to the achievement of our target price include weather, acquisition integration, regulatory environment, additional equity offerings, potential goodwill impairments and changes in interest rates.

**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.

**Disclaimers**

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**Company Focus**

 SMALL &  
 MID CAP

24 June 2009 | 13 pages

## American Water Works Company, Inc. (AWK)

 Rating change   
 Target price change   
 Estimate change 

### RWE Sell Down a Plus; LT Value Offset by ST Headwinds; \$20.50 TP

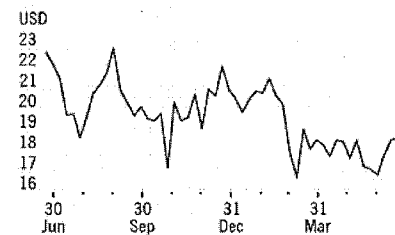
■ **Valuation and Outlook** — We are resuming coverage of AWK with a Hold, Medium Risk rating and \$20.50 target. Our previous rating and target were Hold High Risk and \$24.50. Our target is lower as a result of our revaluation of utility stocks late last year, which took into account a higher cost of capital in the current market and our revised estimates. Our risk rating is lower as a result of RWE's ownership position moving below 50%. We therefore believe a minority discount/risk is no longer warranted in our rating. We continue to believe that capital market risk remains given the anticipated sell down of RWE's remaining stake in AWK (81 million shares or 46.6% of outstanding stock); however, we believe the stock is modestly undervalued.

■ **Earnings and Capex Outlook** — We estimate 2009, 2010 and long-term EPS power of \$1.28, \$1.42 and \$1.80. Our 2009 and 2010 EPS estimates are approximately \$0.15 p/s lower than our previous estimates as a result of higher pension costs, which we believe will eventually be recovered over the next five years. We estimate AWK's utilities will achieve a weighted average ROE of 7.1% for 2009. We estimate achieved ROEs will rise to 9.1% by 2013. Infrastructure replacement, new treatment facilities and desalination will drive between 7-10% rate base growth through 2013 (\$0.7 to \$1.0 bn annual capex).

■ **Catalysts** — AWK currently has \$300 million in pending rate case decisions. The recovery of pension costs in current rate cases will be crucial in AWK earning its authorized ROE. Lastly, AWK is involved in a number of desalination projects both at its unregulated and regulated units. We believe these projects could add another layer of EPS growth we currently do not include in estimates.

|                              |              |
|------------------------------|--------------|
| <b>Hold/Medium Risk</b>      | <b>2M</b>    |
| <i>from Hold/High Risk</i>   |              |
| Price (24 Jun 09)            | US\$18.55    |
| Target price                 | US\$20.50    |
| <i>from US\$24.50</i>        |              |
| Expected share price return  | 10.5%        |
| Expected dividend yield      | 4.3%         |
| <b>Expected total return</b> | <b>14.8%</b> |
| Market Cap                   | US\$3,238M   |

#### Price Performance (RIC: AWK.N, BB: AWK US)



| EPS          | Q1           | Q2           | Q3           | Q4           | FY           | FC Cons      |
|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| <b>2008A</b> | 0.04A        | 0.31A        | 0.55A        | 0.23A        | 1.12A        | 1.10A        |
| <b>2009E</b> | <b>0.19A</b> | <b>0.33E</b> | <b>0.54E</b> | <b>0.22E</b> | <b>1.28E</b> | <b>1.33E</b> |
| Previous     | na           | na           | na           | na           | na           | na           |
| <b>2010E</b> | <b>0.17E</b> | <b>0.40E</b> | <b>0.60E</b> | <b>0.25E</b> | <b>1.42E</b> | <b>1.46E</b> |
| Previous     | na           | na           | na           | na           | na           | na           |
| <b>2011E</b> | <b>0.17E</b> | <b>0.41E</b> | <b>0.65E</b> | <b>0.28E</b> | <b>1.51E</b> | <b>1.53E</b> |
| Previous     | na           | na           | na           | na           | na           | na           |

Source: Company Reports and dataCentral, CIR. FC Cons: First Call Consensus.

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See Appendix A-1 for Analyst Certification and important disclosures.

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American Water Works Company, Inc.  
(AWK)  
24 June 2009

| Fiscal year end 31-Dec                   | 2007          | 2008          | 2009E         | 2010E         | 2011E         |
|--|---------------|---------------|---------------|---------------|---------------|
| <b>Valuation Ratios</b>                  |               |               |               |               |               |
| P/E adjusted (x)                         | 18.3          | 16.5          | 14.5          | 13.1          | 12.3          |
| EV/EBITDA adjusted (x)                   | na            | 9.9           | 9.3           | 8.5           | 8.0           |
| P/BV (x)                                 | 0.7           | 0.7           | 0.8           | 0.8           | 0.8           |
| Dividend yield (%)                       | 0.0           | 2.2           | 4.5           | 4.9           | 5.4           |
| <b>Per Share Data (US\$)</b>             |               |               |               |               |               |
| EPS adjusted                             | 1.02          | 1.12          | 1.28          | 1.42          | 1.51          |
| EPS reported                             | 1.02          | 1.12          | 1.28          | 1.42          | 1.51          |
| BVPS                                     | 28.39         | 25.64         | 23.67         | 23.62         | 23.86         |
| DPS                                      | 0.00          | 0.40          | 0.84          | 0.91          | 0.99          |
| <b>Profit &amp; Loss (US\$M)</b>         |               |               |               |               |               |
| Net sales                                | 2,214         | 2,337         | 2,492         | 2,628         | 2,733         |
| Operating expenses                       | -1,697        | -1,765        | -1,852        | -1,900        | -1,941        |
| <b>EBIT</b>                              | <b>517</b>    | <b>572</b>    | <b>640</b>    | <b>728</b>    | <b>793</b>    |
| Net interest expense                     | -283          | -285          | -299          | -313          | -325          |
| Non-operating/exceptionals               | 13            | 21            | 16            | 15            | 15            |
| <b>Pre-tax profit</b>                    | <b>247</b>    | <b>308</b>    | <b>357</b>    | <b>430</b>    | <b>482</b>    |
| Tax                                      | -84           | -128          | -141          | -172          | -193          |
| Extraord./Min.Int./Pref.div.             | 0             | 0             | 0             | 0             | 0             |
| <b>Reported net income</b>               | <b>162</b>    | <b>180</b>    | <b>216</b>    | <b>258</b>    | <b>289</b>    |
| Adjusted earnings                        | 162           | 180           | 216           | 258           | 289           |
| Adjusted EBITDA                          | 784           | 843           | 932           | 1,043         | 1,126         |
| <b>Growth Rates (%)</b>                  |               |               |               |               |               |
| Sales                                    | na            | 5.5           | 6.6           | 5.5           | 4.0           |
| EBIT adjusted                            | na            | 10.6          | 11.9          | 13.8          | 8.9           |
| EBITDA adjusted                          | na            | 7.5           | 10.6          | 11.8          | 8.0           |
| EPS adjusted                             | na            | 10.8          | 13.7          | 10.7          | 6.8           |
| <b>Cash Flow (US\$M)</b>                 |               |               |               |               |               |
| <b>Operating cash flow</b>               | <b>474</b>    | <b>552</b>    | <b>540</b>    | <b>573</b>    | <b>623</b>    |
| Depreciation/amortization                | 267           | 271           | 293           | 315           | 334           |
| Net working capital                      | 17            | -100          | -2            | 0             | 0             |
| <b>Investing cash flow</b>               | <b>-747</b>   | <b>-1,034</b> | <b>-877</b>   | <b>-750</b>   | <b>-775</b>   |
| Capital expenditure                      | -759          | -1,009        | -871          | -750          | -775          |
| Acquisitions/disposals                   | 0             | -25           | -5            | 0             | 0             |
| <b>Financing cash flow</b>               | <b>257</b>    | <b>478</b>    | <b>280</b>    | <b>35</b>     | <b>-39</b>    |
| Borrowings                               | 1,004         | 293           | 168           | 0             | 0             |
| Dividends paid                           | 0             | -64           | -141          | -165          | -189          |
| <b>Change in cash</b>                    | <b>-16</b>    | <b>-4</b>     | <b>-58</b>    | <b>-143</b>   | <b>-190</b>   |
| <b>Balance Sheet (US\$M)</b>             |               |               |               |               |               |
| <b>Total assets</b>                      | <b>12,934</b> | <b>13,232</b> | <b>13,362</b> | <b>13,798</b> | <b>14,239</b> |
| Cash & cash equivalent                   | 13            | 10            | 0             | 0             | 0             |
| Accounts receivable                      | 328           | 334           | 334           | 334           | 334           |
| Net fixed assets                         | 9,318         | 10,124        | 10,689        | 11,124        | 11,565        |
| <b>Total liabilities</b>                 | <b>8,387</b>  | <b>9,125</b>  | <b>9,370</b>  | <b>9,513</b>  | <b>9,704</b>  |
| Accounts payable                         | 169           | 150           | 115           | 115           | 115           |
| Total Debt                               | 5,016         | 5,303         | 5,520         | 5,662         | 5,853         |
| <b>Shareholders' funds</b>               | <b>4,547</b>  | <b>4,107</b>  | <b>3,992</b>  | <b>4,285</b>  | <b>4,535</b>  |
| <b>Profitability/Solvency Ratios (%)</b> |               |               |               |               |               |
| EBITDA margin adjusted                   | 35.4          | 36.1          | 37.4          | 39.7          | 41.2          |
| ROE adjusted                             | na            | 4.2           | 5.3           | 6.2           | 6.6           |
| ROIC adjusted                            | na            | 3.5           | 3.9           | 4.2           | 4.4           |
| Net debt to equity                       | 110.0         | 128.9         | 138.3         | 132.2         | 129.1         |
| Total debt to capital                    | 52.5          | 56.4          | 58.0          | 56.9          | 56.3          |

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### RWE Overhang Slowly Being Removed

Minority discount removed

After a recent sale of 15 million AWK shares, RWE owns 46.6% of AWK stock. We believe this event is significant because it removes the minority discount that we applied to shares as a result of RWE's previous majority ownership.

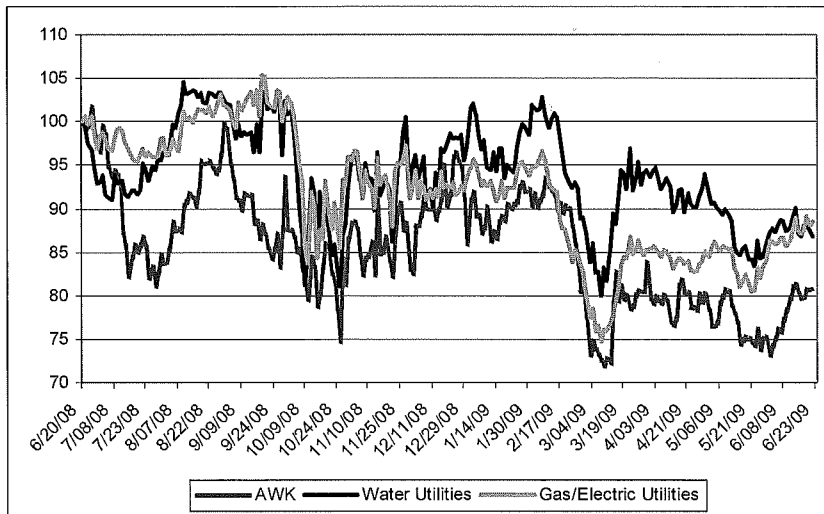
However, some regulatory overhang still remains. RWE must fully divest of its ownership in AWK by April 22, 2010, otherwise AWK will be required to seek an extension or other approvals from commissions in California and Virginia. New Jersey requires a full divestiture by April 22, 2011. While we believe extensions could be granted, we believe RWE will exit within the next 12 to 24 months.

### Recommendation

We are maintaining our Hold rating and reducing our target price to \$20.50 per share as a result of new utility multiples that we applied to both the gas and electric utility industry late last year. We also lowered our estimates as a result of higher post retirement expense.

We estimate that AWK trades at a 32% discount to water utilities, in-line with defensive gas and electric utility stocks and at a 6% discount to our academic calculation of P/E for the industry using our proprietary dividend discount model.

Figure 1. Price Performance of Utilities Over Past 12 Months



Source: Citi Investment Research and Analysis, FactSet

Though AWK has plans to grow its regulatory asset base between 7% and 10% annually for the next five years, our excitement is tempered by near-term headwinds relating to the overhang that exists from the future sale of RWE's remaining stake as well as AWK's need to issue primary equity to fund its \$4 billion capex budget through 2013.

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Figure 2. Comparable Utility-Focused Companies

|                   | AWK   | NWN   | WEC   | XEL   | Water Group |
|-------------------|-------|-------|-------|-------|-------------|
| Regulatory Growth | 7-10% | 6.5%  | 8.5%  | 7.5%  | 10.0%       |
| NTM P/E           | 13.1x | 15.9x | 11.5x | 11.3x | 18.4x       |
| Dividend Yield    | 4.3%  | 3.5%  | 3.3%  | 5.3%  | 3.8%        |

Source: Citi Investment Research and Analysis

### Rate Cases Slightly Ahead of Plan

As part of its 2003 acquisition of American Water, RWE agreed to short-term rate freezes throughout its service territories. However, RWE did not realize the cost synergies and economies of scale it had expected. Consequently, AWK continues to under-earn (6.3% ROE for 2008). The company continues to apply for rate relief and we expect ROE levels to reach industry averages (~9%) within 3-4 years.

Figure 3. Consolidated Utility Earnings

|                                  | 2008A          | 2009E          | 2010E          | 2011E          | 2012E          | 2013E          |
|----------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| <b>Operating Revenues</b>        | 2082.7         | 2245.6         | 2381.8         | 2486.8         | 2614.6         | 2742.7         |
| Operating expenses               |                |                |                |                |                |                |
| Operation and maintenance        | 1091.7         | 1135.9         | 1168.2         | 1201.5         | 1235.7         | 1271.0         |
| Depreciation and amortization    | 254.8          | 277.7          | 299.8          | 318.9          | 338.6          | 356.6          |
| General taxes                    | 199.1          | 199.6          | 199.6          | 199.6          | 199.6          | 199.6          |
| Loss (gain) on sale of assets    | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            |
| Impairment charges               | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            |
| Total Operation Expenses, net    | 1545.6         | 1613.2         | 1667.6         | 1720.0         | 1774.0         | 1827.2         |
| <b>Operating Income</b>          | <b>537.1</b>   | <b>632.4</b>   | <b>714.2</b>   | <b>766.8</b>   | <b>840.7</b>   | <b>915.4</b>   |
| <b>Utility Rate Base</b>         | <b>6,861.6</b> | <b>7,458.7</b> | <b>7,912.5</b> | <b>8,372.2</b> | <b>8,837.1</b> | <b>9,159.4</b> |
| <b>Achieved Return on Equity</b> | <b>6.2%</b>    | <b>7.1%</b>    | <b>7.8%</b>    | <b>8.0%</b>    | <b>8.5%</b>    | <b>9.1%</b>    |

Source: Citi Investment Research and Analysis, Company Data

### Recent Rate Relief

AWK has received rate increases of \$190 million through 2008 and 2009 so far with rate relief exceeding our expectations by about 25%. Returns on Equity have been authorized in the 10.0-10.6% range, including 10.3% in NJ and 10.6% in PA, AWK's largest service areas (over 50% of total rate base combined). American Water appears to be benefiting from constructive relationships with state commissions, which allow the company to earn more timely returns on capital spent.

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Figure 4. Rates Approved in 2008 and 2009

| Service Area | Date Approved | Filing Date | Increase Approved | Citi's Previous Estimate | Approved ROE |
|--------------|---------------|-------------|-------------------|--------------------------|--------------|
| California   | 6/1/08        | 1/1/07      | \$13.0            | \$9.3                    | 10.15%       |
| Illinois     | 8/8/08        | 8/31/07     | \$21.6            | \$29.2                   | 10.35%       |
| Missouri     | 11/28/08      | 3/31/08     | \$34.5            | \$13.5                   | 10.00%       |
| New Jersey   | 12/8/08       | 1/14/08     | \$72.1            | \$56.9                   | 10.30%       |
| Pennsylvania | 11/14/08      | 4/28/08     | \$1.9             | \$0.0                    | 10.60%       |
| Other        | Multiple      | Multiple    | \$49.8            | \$45.0                   | n/a          |
| <b>Total</b> |               |             | <b>\$192.9</b>    | <b>\$153.9</b>           |              |

Source: Citi Investment Research and Analysis

**Upcoming Rate Relief**

American Water continues to await final orders on an additional \$300 million. Approximately 80% of these filings are for rates in California, Pennsylvania, Illinois and Indiana. During the upcoming five years, on average we estimate the company will receive about \$100 million in rate relief annually. We expect these increases to be partially offset by increases in O&M, depreciation and interest.

Figure 5. Rate Cases Filed

| Service Area | Filing Date | Rate Base Filed  | Citi Rate Base Estimate | ROE Requested | Citi ROE Estimate | Amount Filed   | Citi Approval Estimate |
|--------------|-------------|------------------|-------------------------|---------------|-------------------|----------------|------------------------|
| California   | Various     | n/a              | \$330.5                 | 10.2-11.5%    | 10.1%             | \$79.0         | \$16.0                 |
| Illinois     | 5/29/09     | \$610.3          | \$556.0                 | 12.25%        | 10.0%             | \$58.6         | \$26.5                 |
| Indiana      | 4/30/09     | \$670.5          | \$637.1                 | 12.00%        | 10.0%             | \$46.9         | \$19.5                 |
| Pennsylvania | 4/24/09     | \$1,861.3        | \$1,860.0               | 12.00%        | 10.0%             | \$58.1         | \$42.0                 |
| Other        | Various     | n/a              | \$1,055.7               | Various       | n/a               | \$61.9         | \$25.0                 |
| <b>Total</b> |             | <b>\$3,142.1</b> | <b>\$4,439.3</b>        |               |                   | <b>\$304.5</b> | <b>\$129.0</b>         |

Note: Approximately 2/3 of CA's request pertains to costs (e.g. consumer programs, hiring) that would be incurred if approved. We do not include relief for these items as there would be no impact on earnings.

Source: Citi Investment Research and Analysis, Company Reports

We estimate AWK will spend about \$4 billion in capex over the next 5 years. The capital will be spent on projects to replace existing infrastructure as well as construction on new distribution and treatment facilities. Over that period we estimate depreciation will total \$1.7 billion. Therefore, rate base will grow by about \$2-\$2.5 billion.

**Unregulated Business Growing: Desalination Projects**

Currently comprising only 5% of earnings, we do not give credit for growth in the non-regulated segment, due to lack of visibility on long-term growth and regulatory and environmental hurdles. However, we believe the Applied Water Management Group of American Water could have upside, including desalination and wastewater recycling projects. With concern over the limited water sources in the country, these additional sources of water will become necessary in the years ahead. See thematic report by Edward Kerschner at <https://geo.ny.ssmb.com/pdf/SGL00635.pdf>.



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**Desalination Projects**

American Water (with JV partner Acciona Aguaco) operates a 25 million gallon/day desalination facility in Tampa Bay. The facility provides 10% of the region's drinking water supply and is the largest seawater desalination plant in the country. This project is included in earnings of the Applied Water Management Group. Over time, other desalination projects could be considered for inclusion in rate base and charged through in rates to utility customers.

With experience running this large project, the group recently won a contract to provide engineering and operating support for a pilot, 50,000 gallon/day project in Laredo, Texas. The project will provide another learning experience for American Water, who will apply a new technology called Advanced Vapor Compression, intended to reduce costs to remove dissolved solids from drinking water.

Also on the horizon is a desalination facility in Monterey County, California. The pilot facility was built in 2008 at a cost of \$2 million. The capacity is about 22,000 gallons/day, while the final proposed project could flow at a rate of up to 11 million gallons/day.

**Liquidity – Available, FCF, Covenants**

At the end of 1Q'09, AWK had cash and available liquidity of about \$115 million. During 2Q, AWK has issued about \$275 million of long-term debt, which it will use to pay off shorter term debt and help with its capital expansion program. In addition to debt, we anticipate AWK will utilize equity issuances (14.5 million shares issued recently) and retained earnings to fund its capital growth program. We estimate the company will need to issue equity annually to help fund its large capex plan (\$4-\$4.5 billion over 5 years). Including dividend payments and the equity issuances, we estimate the company will run free cash negative over the near-term.

**Figure 6. Earnings and Cash Flow**

|                                   | 2007A    | 2008A     | 2009E    | 2010E    | 2011E    | 2012E    | 2013E    |
|-----------------------------------|----------|-----------|----------|----------|----------|----------|----------|
| Per share:                        |          |           |          |          |          |          |          |
| Recurring Earnings                | \$1.02   | \$1.12    | \$1.28   | \$1.42   | \$1.51   | \$1.66   | \$1.79   |
| Extraordinary/Discontinued Ops    | (\$3.16) | (\$4.67)  | (\$2.63) | \$0.00   | \$0.00   | \$0.00   | \$0.00   |
| Reported Earnings                 | (\$2.14) | (\$3.54)  | (\$1.35) | \$1.42   | \$1.51   | \$1.66   | \$1.79   |
| Number of Diluted Shares          | 160.0    | 160.0     | 168.7    | 182.0    | 191.3    | 197.6    | 202.6    |
| EBITDA                            | 790.9    | 847.9     | 933.6    | 1,042.6  | 1,126.4  | 1,226.0  | 1,318.8  |
| CFO                               | 473.7    | 552.2     | 539.8    | 572.6    | 623.3    | 681.7    | 733.5    |
| Capex                             | (758.6)  | (1,008.8) | (871.2)  | (750.0)  | (775.0)  | (800.0)  | (825.0)  |
| Capital Offerings                 | 0.0      | 0.0       | 250.7    | 200.0    | 150.0    | 100.0    | 100.0    |
| Dividends                         | 0.0      | (64.1)    | (141.1)  | (185.3)  | (188.7)  | (211.8)  | (238.0)  |
| FCF (Including Capital Offerings) | (284.9)  | (520.7)   | (221.9)  | (142.7)  | (190.5)  | (230.1)  | (227.6)  |
| Operating Cash Flow Per Share     | \$2.96   | \$3.45    | \$3.20   | \$3.15   | \$3.26   | \$3.45   | \$3.62   |
| Free Cash Flow Per Share          | (\$1.78) | (\$3.25)  | (\$1.32) | (\$0.78) | (\$1.00) | (\$1.16) | (\$1.12) |
| Payout ratio                      |          | 71%       | 65%      | 64%      | 65%      | 65%      | 65%      |
| Net Debt                          | 5,002.6  | 5,293.5   | 5,519.7  | 5,662.4  | 5,852.8  | 6,083.0  | 6,310.6  |
| Net Debt / EBITDA                 | 6.3x     | 6.2x      | 5.9x     | 5.4x     | 5.2x     | 5.0x     | 4.8x     |
| Debt/Cap                          | 52.5%    | 56.4%     | 58.0%    | 56.9%    | 56.3%    | 56.2%    | 55.9%    |

Note: 2008 payout ratio is pro-rated.

Source: Citi Investment Research and Analysis, Company Data

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American Water has an \$840 million revolving credit facility split between 11 banks expiring September 15, 2012. Interest rates on the revolver are based on LIBOR or prime plus a margin not to exceed 55 basis points. As such, the short term interest rate for the first quarter was about 1%. The facility requires that AWK's debt to capitalization does not exceed 70%. Debt to capitalization was only 59.5% at the end of the first quarter. We estimate this will ratio will approach 55% over the long-term.

### Changes to Valuation & Estimates

When we last updated our valuation, gas and electric utilities were trading at 14.8x NTM earnings and water utilities were trading over 20.6x NTM earnings. Today, these multiples have declined to 12.5x and 18.4x, respectively, on higher equity risk premiums and higher borrowing costs in the market. Our utility multiples also consider growth in regulatory asset base. Applying current market conditions and assuming the industry can grow rate base by nearly 10% a year would result in a 13.4x multiple today for the water industry on next year's earnings. Though the median multiple in the water industry today is 18.4x, the industry is closer to earning its allowed ROE when compared to American Water and thus could warrant a premium.

We are decreasing our 2009 EPS estimate to \$1.28 per share (from \$1.42) to take into account unfavorable weather conditions and higher operating costs, pension expenses and conservation, slightly offset by greater rate relief at the regulated utilities. Our 2010-11 estimates are now \$1.42 and \$1.51, from \$1.57 and \$1.65

### Accounting

#### Goodwill

At 3/31/09, American Water had \$1.2 billion of goodwill on its balance sheet, primarily relating to RWE's acquisition of American Water earlier this decade. This includes a goodwill impairment during the quarter of \$450 million. While the impact on cash flows and ongoing earnings is nil, debt covenants could be triggered. For AWK's \$840 million revolver, the company is required to maintain a debt to capitalization ratio below 70%. Even with a full write-off of the goodwill balance, which we find unlikely, this ratio only reaches 69%. Furthermore, the ratio at the end of 1Q'09 was 59.5% and we expect this will fall in the future to about 55%.

#### Pension

Nearly all of American Water's pension obligations relate to its utilities. The incremental pension and post-retirement cost for 2009 will be approximately \$32 million pre-tax. We assume pension costs will be recovered through rates over a two-year period (beginning in mid-2010) as a cost of service adjustment. For approximately half of the company's employees, state commissions have approved the company to record pension expenses as regulatory assets that will be recovered over time with little impact to earnings. The other half of the pension expense is recorded under FAS 87, whereby the company must record the expense in the period incurred. Each commission will later determine whether in include these expenses in rates, which is the most common treatment.

AWK continues to under-fund its pension plan. Compared with the ABO, it appears AWK was less than 60% funded at the end of 2008. With its planned \$85 million pension contribution in 2009, we estimate AWK will be closer to 70% by the end of the year. Any rebounds in the capital and fixed income markets and pension relief in rate will alleviate cash flows in the future.

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## American Water Works Company, Inc.

### Company description

American Water is the largest investor-owned and most geographically diversified provider of drinking water and wastewater services in North America as measured both by operating revenue and population served. The company has almost 7,000 employees and provides 15.6 million people with drinking water, wastewater and other water services in 32 states and Ontario, Canada.

### Investment strategy

We rate the shares of American Water Hold/Medium Risk (2M). After agreeing to rate freezes as part of its acquisition by RWE in 2003, RWE did not realize the cost synergies and economies of scale it had expected. As a result, American Water finds itself earning a regulated ROE of about 6.5%. Even assuming rate base growth of 7-10% and increases in expenses, we expect reasonable rate relief will allow AWK to earn returns close to industry average within 3-4 years. This will allow the company to grow earnings at an annual rate of about 10% through 2013. Limiting our conviction on the name, we continue to believe that capital market risk remains given the anticipated sell down of RWE's remaining stake in AWK (81 million shares or 46.6% of outstanding stock) over the next 12-24 months.

### Valuation

We use several valuation scenarios to reach our target of \$20.50 per share.

Our NAV analysis yields a current value of \$21.13 per share.

Our NAV takes into account American Water's regulated asset base ("rate base") for its water assets of \$7 billion. We derive our rate base estimates from state utility filings and company reports and apply a 1.3x multiple to these utility assets.

For unregulated operations that traditionally have more volatile earnings, we apply a 6.0x multiple to LTM EBITDA.

Our estimates are offset by \$5.4 billion in net debt and \$300 million in required pension liabilities.

Our DDM values the dividend stream to common shareholders based on what we estimate AWK can eventually payout in the form of a dividend. Dividend growth is based upon the utilities returns on equity, authorized returns in the utilities' latest rates cases. Our DDM yields a price of \$24.54.

Our EV/EBITDA analysis is based on historical EV to LTM EBITDA of about 20 electric, gas and water utilities. A 10-year analysis yields a median EV to LTM EBITDA of 8.4x. Our academic calculation of P/E for the industry using our proprietary dividend discount model yields a multiple of 13.4x. For the non-regulated division, we apply multiples of 6.0x and 10.0x, respectively, to our 2010E values. Our EV/EBITDA analysis yields \$17.36, while our P/E analysis yields \$18.96.

## Risks

In addition to the items listed below, our Medium Risk rating primarily considers the balance of AWK's significant regulated asset base and RWE's large ownership percentage, which we believe will be further reduced over the next 2 years.

Capital Investment Growth – AWK spends capital in excess of depreciation to provide acceptable service to its growing customer base and relies on adequate rate to earn its cost of capital. Failure to obtain adequate financing through the equity and debt markets could limit investment.

Bad Debt Recovery – In a bad economy, customers are less able to pay their utility bills on time or at all.

Weather & Conservation – Without weather normalization or decoupling rate mechanisms, AWK is exposed to fluctuations in temperatures, water conditions and customer conservation.

Goodwill Impairment – AWK has a significant amount of goodwill that may never be fully realized. Impairments could impact the market's outlook on AWK.

Regulatory Costs – The company's operations are subject to various regulations, including environmental. Costs to comply with rules may be significant.

Capital Maintenance – Failure to maintain capital could create future liabilities.

Rate Relief – Upside risk: Several hundred million dollars of rate relief is pending for AWK and only a portion is included in our estimates. The company may be successful in obtaining more rate relief than we currently anticipate. This would positively impact earnings and cash flows.

If the impact on the company from any of these factors proves to be less than we anticipate, the stock could materially outperform our target price. Conversely, if the impact on the company from any of these factors proves to be greater than we anticipate, the stock could underperform our target price.

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## Appendix A-1

### Analyst Certification

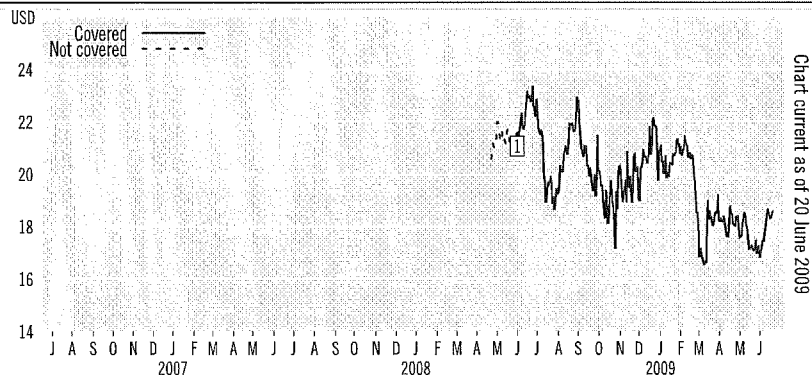
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#### American Water Works Company, Inc. (AWK)

#### Ratings and Target Price History Fundamental Research

Analyst: Faisal Khan, CFA  
Covered since June 3 2008



| Date       | Rating | Target Price | Closing Price |
|------------|--------|--------------|---------------|
| 1 2-Jun-08 | *2H    | *24.50       | 21.60         |

\* Indicates change

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|--|-----|------|------|
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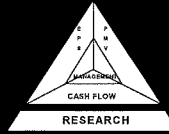
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**Morning Meeting Notes**

Thursday, October 15, 2009

**AMERICAN WATER WORKS  
CO INC**  
**(AWK - USD 19.82)**
**Timothy Winter, CFA**  
 Ph: 314-238-1314  
[twinter@gabelli.com](mailto:twinter@gabelli.com)

 Recommendation: BUY  
 Previous Recommendation: BUY  
 As of: 11-Aug-2009

| Currency - USD                |       |                    |          |
|-------------------------------|-------|--------------------|----------|
| Capitalization                |       | Financial Metrics  |          |
| (in millions)                 |       | Fiscal YE          | Dec 2009 |
| <b>Number of Shares</b>       | 175   | <b>2010 PMV/sh</b> | 40.00    |
| <b>Price</b>                  | 19.82 | <b>EPS</b>         |          |
|                               |       | 2010P              | 1.45     |
|                               |       | 2009E              | 1.27     |
| <b>Market Cap</b>             | 3,461 | 2008A              | 1.10     |
| <b>Net Debt(Cash)</b>         | 5,348 | <b>EBITDA (mm)</b> |          |
| <b>Other</b>                  | 29    | 2010P              | 1,016    |
|                               |       | 2009E              | 928      |
|                               |       | 2008A              | 834      |
| <b>Total Enterprise Value</b> | 8,837 | <b>PE Ratio</b>    |          |
|                               |       | 2010P              | 13.7     |
|                               |       | 2009E              | 15.6     |
|                               |       | 2008A              | 18.0     |

Despite Third Quarter Weather, We Consider AWK the Best Buy in the Water Utility Group

We have revised our 2009 earnings estimate to \$1.27 per share, from \$1.30, to reflect the negative impact of mild and wet weather during the third quarter. We expect AWK to report third earnings of \$0.52 per share, which compares to \$0.55 for the same period last year. (Release date is 11/5) The company's Midwest and, to a lesser degree, Northeast service areas experienced unusually mild temperatures and higher than normal precipitation during the third quarter.

Our 2010 and 2011 earnings estimates remain \$1.45 and \$1.60, respectively, per share. The primary driver of growth is rate recognition of past investments necessary to achieve returns near those authorized. AWK is currently awaiting orders on requests for over \$250 million in annual revenue increases. With roughly 90% of earnings generated from the low-risk regulated water utility business, we assume reasonable regulatory treatment leads to an EPS rebound to over \$1.45 by 2010, which results in a roughly 9.5% return on common equity. Water utilities were authorized roughly 60-80% revenue requests over the past twelve-months and allowed returns on equity have averaged roughly 10-10.5% over the past few years.

AWK's capital expenditures are projected at \$850 million per year over the next five years to replace and upgrade an aging distribution network, comply with increasingly stringent environmental standards and to build and maintain treatment plants and storage facilities. We forecast internally generated cash of roughly of \$590 million in 2009 and \$650 million in 2010.

As the largest and most geographically diverse water utility, AWK's size, scale, technological and financial resources provide it with competitive advantages, including the ability to shape issues on the regulatory and legislative front, ability to receive rate recognition of investments and the ability to participate in water and wastewater infrastructure growth opportunities and projects of various sizes and in various regions. We believe the water and wastewater industry is ripe for new rounds of consolidation and privatization as the sector is in the early stages of an extended period of restructuring.

At the current price, we consider AWK shares to be relatively inexpensive compared to the other publicly-traded water utilities. AWK shares trade at 15.6X our new 2009 EPS estimate of \$1.27 and 13.7X our 2010 EPS estimate, well-below current and historical group multiples. The water utility group currently trades at 21.1X and 18.7X 2009 and 2010 EPS estimates and has traded at a range of 15-27X over the past fifteen years. In addition, AWK trades at 129% of tangible book value, which compares to the group median of 175%. We believe AWK shares warrant at least an industry-average multiple.

We recommend purchase of AWK shares. Although we consider a takeover of AWK highly unlikely, our 2010 private market value is \$40 per share as we believe that a takeover of AWK would require a 250% premium to book value. Over the past ten years, water utility acquisitions have ranged between 250-350% of book value, including the RWE takeover of AWK at 270% of book value. Primary risks to our recommendation include a poor regulatory decision for a major subsidiary (New Jersey or Pennsylvania), a large acquisition at a significant premium and a material move in interest rates.

**Please see the last page for important disclosures.**

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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.

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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.

- AMERICAN WATER WORKS CO 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 AMERICAN WATER WORKS CO INC as of September 30, 2009.

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November 10, 2009

Gabelli & Company, Inc.

**American Water Works (AWK - \$20.50 - NYSE) Underlying Results Strong - Buy**

| <u>Year</u> | <u>EPS</u> | <u>P/E</u> | <u>PMV</u> |                                       |
|-------------|------------|------------|------------|---------------------------------------|
| 2011P       | \$1.60     | 12.8x      | \$39       | Dividend: \$0.84 Current Return: 4.1% |
| 2010P       | 1.45       | 14.2       | 40         | Shares O/S: 174.6 million             |
| 2009E       | 1.27       | 16.2       | 39         | 52-Week Range: \$22.35 - \$16.22      |
| 2008A       | 1.10       | 18.6       | -          |                                       |

**SUMMARY AND OPINION**

Headquartered in Voorhees, NJ, American Water Works is the largest investor-owned water and wastewater utility company in the United States. The company provides water and wastewater services to approximately 15.6 million people in 32 states and Ontario, Canada. The company's regulated utilities serve approximately 1,600 communities in 20 states, with each regulated subsidiary subject to economic regulation by state Public Utility Commission (PUC) in the states in which the utility operates. In 2008, regulated operations generated \$2.08 billion in revenues, or roughly 89% of consolidated revenues. Non-regulated businesses include Contract Operations Group, Applied Water Management Group and Homeowner Services Group and generated roughly 11% of 2008 consolidated revenues. We recommend investors purchase shares.

- On November 9, 2009, AWK reported third quarter earnings of \$0.52 per share compared with \$0.55 per share for the same period last year. Lower year-over-year quarterly results were due to the negative impact of one of the wetter summers experienced by much of the country as eleven of twenty regulated state service territories experienced either above average rainfall and/or cooler temperatures. The lower volume of water, which was primarily weather-related, resulted in an estimated decrease of \$44.2 million in revenues and approximately \$23.7 million in earnings, or \$0.14 per share.
- Despite the material decline in water volumes, operating revenues rose 1.2% to \$680.0 million due primarily to ongoing efforts to receive rate recognition of investments in the business. The company received authorizations for additional annualized revenues from general rate cases of \$16.8 million in the third quarter 2009, which brings the total for the first nine months of the year to \$31.4 million. In addition, AWK subsidiaries implemented rate increases totaling \$182 million since June 30, 2008, which favorably impacted third quarter revenues by \$50.7 million.
- Our 2009, 2010 and 2011 earnings estimates remain \$1.27, \$1.45, and \$1.60 per share, respectively, which results in a 2008-2011 CAGR of 13.3%. Earnings results through the first nine-months of 2009 were \$1.05 compared with \$0.87 for the same period last year. We estimate weather negatively impacted year-to-date results by roughly \$0.15 per share.

We regard AWK as a high quality conservative utility with unique growth opportunities. Shares offer investors a competitive 4.1% current return with earnings growth potential through rate increases necessary to boost under-earning returns, rate base additions and consolidation/privatization opportunities. AWK benefits from public and regulatory support of investment in water and wastewater infrastructure. In addition, the company's national presence, diverse geographic footprint, technical expertise, operating reputation and financial resources favorably position it to consolidate and privatize the extremely fragmented and municipally dominated water and wastewater industry.

We consider AWK shares to be relatively inexpensive compared to the other publicly-traded water utilities. Shares trade at 16.2X and 14.2X our 2009 and 2010 earnings estimates of \$1.27 and \$1.45 per share, respectively, well below current and historic group multiples. On a price-to-book value basis, AWK shares trade at 129% of tangible book value (excludes goodwill) versus group average multiples of 195%. We believe AWK shares warrant at least an industry-average multiple.

*-Please Refer To Important Disclosures At The End Of This Report-*

**Underlying Third Quarter Results Show Significant Improvement**

On November 9, 2009, AWK reported third quarter earnings of \$0.52 per share compared with \$0.55 per share for the same period last year. Lower year-over-year quarterly results were due to the negative impact of one of the wetter summers experienced by much of the country as eleven of twenty regulated state service territories experienced either above average rainfall and/or cooler temperatures. The northeast region experienced its eighth wettest summer on record with New Jersey experiencing its fifth wettest summer on record. July 2009 was also officially the coldest July on record in six of AWK's states including Iowa, Illinois, Indiana, Ohio, West Virginia and Pennsylvania.

As a result, third quarter total volume of water sold decreased 9.1 billion gallons, or 7.4%. Weather-sensitive residential water volumes declined 7.0% while economically-sensitive commercial and industrial (5% of regulated revenues) sales declined 5.3% and 14.6%, respectively. The lower volume of water sold resulted in an estimated decrease of \$44.2 million in revenues and approximately \$23.7 million in earnings, or \$0.14 per share.

Despite the material decline in water volumes, operating revenues rose 1.2% to \$680.0 million due primarily to ongoing efforts to receive rate recognition of investments in the business. The company received authorizations for additional annualized revenues from general rate cases of \$16.8 million in the third quarter 2009, which brings the total for the first nine-months of the year to \$31.4 million. In addition, AWK subsidiaries implemented rate increases totaling \$182 million since June 30, 2008, which favorably impacted third quarter revenues by \$50.7 million. The company's Regulated Businesses revenues increased by \$17.6 million, or 2.9%, while Non-regulated Businesses' revenues decreased by \$8.6 million, or 11.7% for the third quarter.

Material changes in 2009 third quarter revenue compared with the same period last year were as follows:

**Table 1 Year-Over-Year Third Quarter Comparison**

|                                   |                        |
|-----------------------------------|------------------------|
| <b>Third quarter 2008 revenue</b> | <b>\$672.2 million</b> |
| Rate increases                    | 50.7 million           |
| Balancing accounts                | 7.5 million            |
| Lower consumption                 | (44.2) million         |
| Lower contract revenue            | (7.6) million          |
| Other, net                        | 1.4 million            |
| <b>Third quarter 2009 revenue</b> | <b>\$680.0 million</b> |

*Source: Company data*

Larger rate awards authorized over the past twelve-months are as follows:

| <b>Subsidiary</b> | <b>Revenue Increase</b> | <b>Allowed ROE</b> | <b>Effective Date</b> |
|-------------------|-------------------------|--------------------|-----------------------|
| Illinois          | \$21.6 million          | 10.4%              | 8/8/2008              |
| Missouri          | 34.5 "                  | 10.0               | 11/28/2008            |
| New Jersey        | 72.1 "                  | 10.3               | 12/8/2008             |
| Kentucky          | 10.3 "                  | 10.0               | 6/1/2009              |
| California        | 12.1 "                  | 10.2               | 5/11/2009             |
| Pennsylvania      | 30.8 "                  | 10.8               | 11/7/2009             |

*Source: Company data*

Third quarter 2009 operating expenses increased a modest 1.1% to \$465.6 million driven by higher pension and other post-employment benefits expenses of \$6.4 million and depreciation of \$6.5 million. These increases were offset by lower costs in contract operations of \$9.4 million. More shares outstanding as a result of the June 2009 issuance of 14.5 million shares at \$17.25 negatively impacted per share results by \$0.05.

**Growth Initiatives**

AWK's non-regulated Military Services Group was awarded contracts for the operation and maintenance of the water and the wastewater systems at Fort Belvoir, Virginia and Fort Meade, Maryland, which brings the military portfolio to ten installations across the country. In addition, AWK acquired four municipal systems serving 4,200 people for \$7 million in Pennsylvania and a system in Indiana serving 500 people.

We expect AWK to accelerate its acquisition of smaller water systems and continue to profitability consolidate the municipal water/wastewater markets. Management reported that it is in discussions with roughly 75 different municipalities across the country regarding water and wastewater systems serving several hundred thousand people. Given AWK's technical and financial resources, we expect some of these discussions to lead to various forms of growth ventures ranging from bulk water sales agreements, operating and maintenance agreements, or acquisitions.

**EPS Outlook Remains**

Our 2009, 2010 and 2011 earnings estimates remain \$1.27, \$1.45, and \$1.60 per share, respectively, which results in a 2008-2011 CAGR of 13.3%. Earnings results through the first nine-months of 2009 were \$1.05 compared with \$0.87 for the same period last year. We estimate weather negatively impacted year-to-date results by roughly \$0.15 per share. The primary driver of growth is rate recognition of past investments necessary to achieve returns near those authorized. Improved 2009 and full-year 2008 results as well as the recent rate relief highlight AWK's strategic progress toward boosting returns at previously "under-earning" subsidiaries via necessary rate relief. We estimate AWK regulated subsidiaries earned a roughly 8% average return on common equity in 2008, which results in potential for further earnings improvement of roughly \$0.30-0.40 per share to reach its 10.0% ROE potential.

Year-to-date, AWK subsidiaries received rate increases totaling \$72 million and, as of September 30, 2009, the company was awaiting final orders for general rate cases in ten states, requesting \$258.0 million in total additional annual revenues. Subsequent to the quarter's end, the company settled its rate case in Pennsylvania, which grants an increase of approximately \$30.8 million in annual revenue in addition to the approximately \$23.0 million previously received through infrastructure surcharges. The company also filed a \$48.7 million rate request in Missouri.

With roughly 90% of earnings generated from the low-risk regulated water utility business, we assume reasonable regulatory treatment leads to an EPS rebound to over \$1.45 by 2010, which results in a roughly 9.5% return on common equity. Water utilities were authorized roughly 60-80% revenue requests over the past twelve-months and allowed returns on equity have averaged roughly 10-10.5% over the past few years.

Partially offsetting the positive impact of significant rate relief will be higher interest expense, more shares outstanding, and higher depreciation expense associated with infrastructure investment as well as higher pension expense and higher overall operating expenses.

**Capital Budget**

AWK anticipates a 2009 capital expenditure budget of \$800 million and construction expenditures for the nine months ended September 30, 2009 were \$592.9 million compared to \$714.6 million in the prior year period. A \$162 million 31-mile water main and 20 million gallon a day treatment plant project in Kentucky is more than 70% complete. AWK management estimates capital expenditures to total roughly \$4.0-4.5 billion over the next five years, or \$850 million per year. Capital expenditures are to replace and upgrade an aging distribution network, comply with increasingly stringent environmental standards and to build and maintain treatment plants and storage facilities.

We forecast internally generated cash of roughly of \$590 million in 2009 and \$640 million in 2010. After dividends of \$260 million in 2009 and 2010, we assume AWK issues \$350 million in equity and \$400 million in debt over the forecast period. Net cash provided by operating activities for the nine-months ended September 30, 2009, increased approximately \$78.6 million, or 20%, to \$471.6 million. The company raised \$245 million in common equity through the issuance of 14.5 million shares prices at \$17.25 share in June of 2009 and \$53.2 million in new tax-exempt bonds during the third quarter 2009 at rates ranging from 1.27-6.25%.

## Gabelli &amp; Company, Inc.

As of September 30, 2009, common equity represents 42.6% of total capitalization, including goodwill and short-term debt. Excluding \$1.25 billion in goodwill, common equity represented 33.8% of total capitalization. S&P recently affirmed AWK's corporate and unsecured credit ratings of BBB+. Given AWK's solid financial condition and strong outlook, we expect minimal challenges accessing the capital markets to fund its capital expenditure needs.

**RWE Ownership**

On August 18, 2009, American Water completed a secondary public offering of 40.25 million shares of its common stock, priced at \$19.25 per share, with all shares sold by RWE and all proceeds going to RWE. RWE's ownership has been reduced to 23.5% of American Water's outstanding shares of common stock.

**Valuation**

At the current price, we consider AWK shares to be relatively inexpensive compared to the other publicly-traded water utilities. AWK shares trade at 16.2X our 2009 EPS estimate of \$1.27 and 14.2X our 2010 EPS estimate, well-below current and historical group multiples. The water utility group currently trades at 21.0X and 19.0X 2009 and 2010 EPS estimates and has traded at a range of 15-27X over the past fifteen years. We believe AWK shares warrant at least an industry-average multiple. We also believe the unique characteristics of American Water Works and the sector have been somewhat neglected. These unique characteristics include a greater certainty of rate base growth than typically achieved in the regulated electric and gas utility sector as well as greater opportunity for customer growth through consolidation and privatization opportunities.

Over the past ten years, water utility acquisitions have ranged between 250-350% of book value, including the RWE takeover of AWK at 270% of book value. On a price-to-book value basis, AWK shares trade at 130% of tangible book value (excludes goodwill) versus group average multiples of 195%. Assuming a 250% premium to book, our 2010 and 2011 private market values are \$40 and \$39, respectively.

Primary risks to our recommendation include a poor regulatory decision for a major subsidiary (New Jersey or Pennsylvania), a large acquisition at a significant premium and a material move in interest rates.

**Table 3 American Water Works Private Market Analysis, 2005A-2012P**

| <i>(in millions, except per share data)</i> | 2005A     | 2006A     | 2007A     | 2008A     | 2009E     | 2010P      | 2011P      | 2012P      |
|---|-----------|-----------|-----------|-----------|-----------|------------|------------|------------|
| Revenue                                     | \$2,136.7 | \$2,093.1 | \$2,214.2 | \$2,336.9 | \$2,494.5 | \$2,636.9  | \$2,805.0  | \$2,951.8  |
| EBITDA (margin)                             | 751.9     | 733.5     | 784.5     | 834.0     | 926.9     | 1,013.5    | 1,120.9    | 1,202.5    |
| Valuation Multiple                          | 11.0      | 11.0      | 11.0      | 10.0      | 10.0      | 10.0       | 10.0       | 10.0       |
| Segment Value                               | \$8,270.4 | \$8,068.0 | \$8,629.3 | \$8,339.9 | \$9,269.0 | \$10,134.8 | \$11,208.6 | \$12,024.6 |
| Total Private Market Value                  | \$8,270.4 | \$8,068.0 | \$8,629.3 | \$8,339.9 | \$9,269.0 | \$10,134.8 | \$11,208.6 | \$12,024.6 |
| Less: Net Debt                              | (4,965.0) | (4,073.8) | (4,978.3) | (5,269.4) | (5,703.5) | (6,333.1)  | (6,529.6)  | (7,143.7)  |
| Less: Preferred                             | (1,774.7) | (1,774.5) | (24.3)    | (28.7)    | (28.7)    | (28.7)     | (28.7)     | (28.7)     |
| Less: Options Payments (1)                  | 0.0       | 0.0       | (1.9)     | 0.0       | 0.0       | (0.1)      | (5.5)      | (7.1)      |
| Equity Private Market Value                 | \$1,530.7 | \$2,219.8 | \$3,624.8 | \$3,041.8 | \$3,536.8 | \$3,772.9  | \$4,644.8  | \$4,845.0  |
| Shares Outstanding (year-end)               | 160.0     | 160.0     | 160.0     | 160.0     | 174.0     | 174.9      | 186.9      | 187.6      |
| PMV per share                               | \$10      | \$14      | \$23      | \$19      | \$20      | \$22       | \$25       | \$26       |
| Discount to PMV                             | -114.3%   | -47.8%    | 9.5%      | -7.8%     | -0.9%     | 5.0%       | 17.5%      | 20.6%      |
| Year-End Book Value Per Share               |           |           | \$13.04   | \$14.99   | \$15.65   | \$16.13    | \$15.79    | \$16.54    |
| Takeover at 250%                            |           |           | \$33      | \$37      | \$39      | \$40       | \$39       | \$41       |
| EPS   | \$0.69    | \$0.41    | \$1.00    | \$1.10    | \$1.27    | \$1.45     | \$1.60     | \$1.75     |
| P/E   | 29.7      | 49.8      | 20.6      | 18.6      | 16.2      | 14.2       | 12.8       | 11.7       |
| P/B   |           |           | 157%      | 137%      | 131%      | 127%       | 130%       | 124%       |

Source: Company data and Gabelli & Company, Inc. estimates

(1) After-tax payments to buy out option holders at Private Market Value

Table 4

| <b>American Water Works</b>              |                 |                 |                 |                 |                |                |                |                |
|--|-----------------|-----------------|-----------------|-----------------|----------------|----------------|----------------|----------------|
| Financial Statements (2005A-2012P)       |                 |                 |                 |                 |                |                |                |                |
| (In \$ millions unless otherwise noted)  |                 |                 |                 |                 |                |                |                |                |
|  | 2005A           | 2006A           | 2007A           | 2008A           | 2009E          | 2010P          | 2011P          | 2012P          |
| <b>Operating revenues</b>                | <b>\$2,137</b>  | <b>\$2,093</b>  | <b>\$2,214</b>  | <b>\$2,337</b>  | <b>\$2,264</b> | <b>\$2,337</b> | <b>\$2,393</b> | <b>\$2,465</b> |
| Rate increases                           |                 |                 |                 |                 | 230            | 300            | 412            | 487            |
| <b>Operating revenues</b>                | <b>\$2,137</b>  | <b>\$2,093</b>  | <b>\$2,214</b>  | <b>\$2,337</b>  | <b>\$2,494</b> | <b>\$2,637</b> | <b>\$2,805</b> | <b>\$2,952</b> |
| <b>Operating expenses</b>                |                 |                 |                 |                 |                |                |                |                |
| Operation & maintenance                  | \$1,201         | \$1,175         | \$1,249         | \$1,304         | \$1,362        | \$1,412        | \$1,467        | \$1,525        |
| Depreciation & amortization              | 261             | 259             | 267             | 271             | 293            | 316            | 342            | 369            |
| General taxes                            | 183             | 185             | 183             | 199             | 205            | 211            | 218            | 224            |
| Gain on sale of assets                   | (7)             | 0               | (7)             | (0)             |                |                |                |                |
| Impairment charge                        | 385             | 222             | 509             | 750             |                |                |                |                |
| <b>Total operating expenses</b>          | <b>\$2,025</b>  | <b>\$1,841</b>  | <b>\$2,201</b>  | <b>\$2,524</b>  | <b>\$1,861</b> | <b>\$1,940</b> | <b>\$2,026</b> | <b>\$2,118</b> |
| <b>Operating income</b>                  | <b>112</b>      | <b>253</b>      | <b>13</b>       | <b>(187)</b>    | <b>634</b>     | <b>697</b>     | <b>779</b>     | <b>833</b>     |
| <b>Operating income excl. impairment</b> | <b>491</b>      | <b>474</b>      | <b>515</b>      | <b>563</b>      | <b>634</b>     | <b>697</b>     | <b>779</b>     | <b>833</b>     |
| <b>Other income</b>                      |                 |                 |                 |                 |                |                |                |                |
| Interest                                 | 345             | 366             | 281             | (285)           | (285)          | (285)          | (285)          | (285)          |
| New interest expense                     |                 |                 |                 | 0               | (2)            | (13)           | (23)           | (29)           |
| AFUDC                                    |                 |                 | 8               | 14              | 15             | 15             | 15             | 15             |
| AFUDC                                    |                 |                 | 3               | 8               | 8              | 8              | 8              | 8              |
| Amortization of debt expense             |                 |                 | (5)             | (6)             | (5)            | (5)            | (5)            | (5)            |
| Preferred dividends                      |                 |                 | (0)             | (0)             |                |                |                |                |
| Other                                    | (10)            | (5)             | 6               | 5               | 5              | 5              | 5              | 5              |
| <b>Total other income</b>                | <b>\$336</b>    | <b>\$361</b>    | <b>\$271</b>    | <b>(\$264)</b>  | <b>(\$282)</b> | <b>(\$293)</b> | <b>(\$303)</b> | <b>(\$309)</b> |
| Income from continuing operations        | 155             | 113             | 244             | 299             | 352            | 404            | 476            | 524            |
| Provision for income taxes               | 51              | 47              | 86              | 112             | 132            | 151            | 178            | 196            |
| Tax rate                                 | 32.9%           | 41.6%           | 35.4%           | 37.4%           | 37.4%          | 37.4%          | 37.4%          | 37.4%          |
| <b>Net income</b>                        | <b>(275)</b>    | <b>(156)</b>    | <b>(344)</b>    | <b>(562)</b>    | <b>220</b>     | <b>253</b>     | <b>298</b>     | <b>328</b>     |
| <b>Net income, excluding impairment</b>  | <b>104</b>      | <b>66</b>       | <b>158</b>      | <b>187</b>      | <b>220</b>     | <b>253</b>     | <b>298</b>     | <b>328</b>     |
| Shares outstanding                       | 160             | 160             | 160             | 160             | 174            | 175            | 187            | 188            |
| <b>EPS</b>                               | <b>(\$1.72)</b> | <b>(\$0.97)</b> | <b>(\$2.15)</b> | <b>(\$3.52)</b> | <b>\$1.27</b>  | <b>\$1.45</b>  | <b>\$1.60</b>  | <b>\$1.75</b>  |
| <b>EPS excluding non-recurring</b>       | <b>\$0.65</b>   | <b>\$0.41</b>   | <b>\$0.99</b>   | <b>\$1.10</b>   | <b>\$1.27</b>  | <b>\$1.45</b>  | <b>\$1.60</b>  | <b>\$1.75</b>  |
| Dividends                                |                 |                 |                 |                 | \$0.82         | \$0.89         | \$0.90         | \$0.94         |

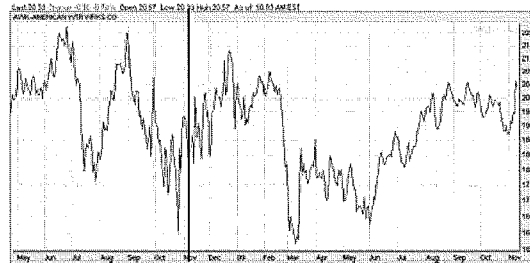
Source: Company data and Gabelli & Company, Inc. estimates

Gabelli & Company, Inc.

**Other Companies Mentioned:**

RWE (RWE.HM)

**American Water Works  
Price Performance Since Initial Recommendation**



Source: Public Data. On November 6, 2008 we placed a BUY on AWK at a price of \$18.16

We, *Tim Winter, CFA, and Jose Garza* the Research Analysts who prepared this report, hereby certify that the views expressed in this report accurately reflect the analyst's personal views about the subject companies and their securities. The Research Analysts have not been, are not and will not be receiving direct or indirect compensation for expressing the specific recommendation or view in this report.

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**Important Disclosures**

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**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.

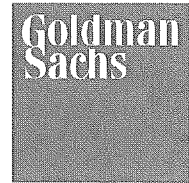
A **Sell** is a stock that may be trading at or above our estimated PMV. There may be little upside to the value, or limited opportunity to realize the value. Economic or sector risk could also be increasing.

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May 11, 2009



COMPANY UPDATE

**American Water Works Co., Inc. (AWK)**

Neutral

**Raising 2009/2010 estimates to reflect stronger operating margins**

**What's changed**

American Water reported 1Q2009 EPS of \$0.19, above our \$0.17 estimate, excluding goodwill impairments. The key driver of this outperformance was lower than expected O&M and depreciation expenses. Rate cases approved during 2008 drove strong revenue growth (+8.6%), more than offsetting volume declines (-3.5%) in the quarter. The Trenton acquisition (\$80 million) was approved in April and should close by the end of June.

**Implications**

We have increased our 2009 EPS estimate to \$1.46 from \$1.34 to reflect the 1Q2009 \$0.02 beat and our assumption of lower O&M and depreciation expenses as a percent of sales for the remainder of the year. We have also increased our 2010/2011 EPS estimates to \$1.52 and \$1.62, respectively from \$1.47 and \$1.55 previously. AWK has an important opportunity to increase its rate base and returns through infrastructure investment and filing rate cases. We forecast strong revenue and net income growth over the next 3 years, but we believe EPS growth will be tempered by the need to raise equity to fund the company's capex program and restore its equity to cap ratio to 45% over time.

**Valuation**

We maintain our Neutral rating. Our updated price target of \$21 is based on multiples (P/E and EBITDA) and our DDM. The reduction in our price target to \$21 from \$24 can be explained by incorporating EV/EBITDA in our analysis, a higher assumed overhang discount of 15% (up from 10%), and a higher cost of equity of 9.0% (up from 8.5%).

**Key risks**

Key adverse risks include regulatory decisions and regulatory lag that limit ROE expansion, and financing risk associated with funding the large capital investment program. Upside to our price target could come from faster-than-expected price recovery through rates, lower O&M expenses, and strong free cash flow generation that reduces the need for new equity.

**INVESTMENT LIST MEMBERSHIP**

Neutral

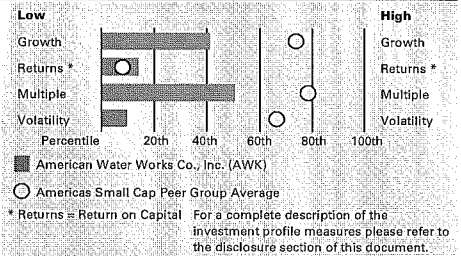
**Coverage View: Neutral**

United States:  
Water

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**Investment Profile**

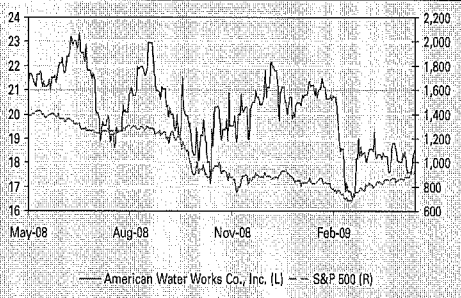


| Key data                   | Current |
|----------------------------|---------|
| Price (\$)                 | 18.55   |
| 12 month price target (\$) | 21.00   |
| Market cap (\$ mn)         | 2,968.2 |

|                     | 12/08   | 12/09E  | 12/10E  | 12/11E  |
|---------------------|---------|---------|---------|---------|
| Revenue (\$ mn) New | 2,336.9 | 2,538.6 | 2,696.8 | 2,864.3 |
| Revenue (\$ mn) Old | 2,395.4 | 2,639.3 | 2,828.3 | 3,004.2 |
| EPS (\$ New)        | 1.10    | 1.46    | 1.52    | 1.62    |
| EPS (\$ Old)        | 1.13    | 1.34    | 1.47    | 1.55    |
| P/E (X)             | 16.9    | 12.7    | 12.2    | 11.4    |
| EV/EBITDA (X)       | 10.3    | 8.9     | 8.6     | 8.1     |
| ROE (%)             | 4.1     | 6.1     | 6.5     | 6.7     |

|          | 3/09 | 6/09E | 9/09E | 12/09E |
|----------|------|-------|-------|--------|
| EPS (\$) | 0.19 | 0.38  | 0.57  | 0.31   |

**Price performance chart**



| Share price performance (%) | 3 month | 6 month | 12 month |
|-----------------------------|---------|---------|----------|
| Absolute                    | (11.8)  | (4.1)   | (12.7)   |
| Rel. to S&P 500             | (17.5)  | (4.0)   | 31.3     |

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 6/08/2009 close.

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May 11, 2009

American Water Works Co., Inc. (AWK)

## American Water Works Co., Inc.: Summary financials

| Profit model (\$ mn)                      | 12/08            | 12/09E         | 12/10E         | 12/11E         | Balance sheet (\$ mn)                 | 12/08           | 12/09E          | 12/10E          | 12/11E          |
|---|------------------|----------------|----------------|----------------|---------------------------------------|-----------------|-----------------|-----------------|-----------------|
| Total revenue                             | 2,336.9          | 2,538.6        | 2,696.8        | 2,864.3        | Cash & equivalents                    | 9.5             | 8.5             | 8.5             | 8.5             |
| Cost of goods sold                        | (1,575.1)        | (1,645.8)      | (1,732.1)      | (1,817.8)      | Accounts receivable                   | 199.4           | 219.3           | 233.7           | 251.1           |
| SG&A                                      | (199.1)          | (211.6)        | (215.7)        | (229.1)        | Inventory                             | 28.9            | 33.7            | 31.1            | 32.2            |
| R&D                                       | 0.0              | 0.0            | 0.0            | 0.0            | Other current assets                  | 179.8           | 205.6           | 215.3           | 227.0           |
| Other operating profit/(expense)          | 0.4              | 0.2            | 0.0            | 0.0            | <b>Total current assets</b>           | <b>417.7</b>    | <b>467.2</b>    | <b>488.6</b>    | <b>518.9</b>    |
| ESO expense                               | 0.0              | 0.0            | 0.0            | 0.0            | Net PP&E                              | 10,123.9        | 10,737.0        | 11,323.9        | 11,832.3        |
| <b>EBITDA</b>                             | <b>834.4</b>     | <b>969.4</b>   | <b>1,067.1</b> | <b>1,164.0</b> | Net intangibles                       | 1,699.5         | 1,249.8         | 1,249.8         | 1,249.8         |
| Depreciation & amortization               | (271.3)          | (288.0)        | (318.1)        | (346.6)        | Total investments                     | 0.0             | 0.0             | 0.0             | 0.0             |
| <b>EBIT</b>                               | <b>563.1</b>     | <b>681.4</b>   | <b>749.0</b>   | <b>817.4</b>   | Other long-term assets                | 990.7           | 1,014.5         | 1,034.5         | 1,054.5         |
| Net interest income/(expense)             | (291.1)          | (297.9)        | (313.8)        | (334.1)        | <b>Total assets</b>                   | <b>13,231.8</b> | <b>13,468.5</b> | <b>14,096.8</b> | <b>14,655.5</b> |
| Income/(loss) from associates             | 0.0              | 0.0            | 0.0            | 0.0            | Accounts payable                      | 149.8           | 150.0           | 163.1           | 169.3           |
| Others                                    | 27.4             | 25.8           | 26.0           | 26.0           | Short-term debt                       | 654.8           | 707.6           | 707.6           | 707.6           |
| <b>Pretax profits</b>                     | <b>299.4</b>     | <b>409.4</b>   | <b>461.2</b>   | <b>509.3</b>   | Other current liabilities             | 300.1           | 346.6           | 346.6           | 346.6           |
| Provision for taxes                       | (123.4)          | (160.5)        | (184.5)        | (203.7)        | <b>Total current liabilities</b>      | <b>1,104.8</b>  | <b>1,204.1</b>  | <b>1,217.2</b>  | <b>1,223.4</b>  |
| Minority interest                         | 0.0              | 0.0            | 0.0            | 0.0            | Long-term debt                        | 4,648.2         | 4,783.2         | 5,054.7         | 5,272.4         |
| <b>Net income pre-preferred dividends</b> | <b>176.1</b>     | <b>248.9</b>   | <b>276.7</b>   | <b>305.6</b>   | Other long-term liabilities           | 3,372.3         | 3,406.6         | 3,431.6         | 3,456.6         |
| Preferred dividends                       | 0.0              | 0.0            | 0.0            | 0.0            | <b>Total long-term liabilities</b>    | <b>8,020.5</b>  | <b>8,189.8</b>  | <b>8,486.2</b>  | <b>8,729.0</b>  |
| <b>Net income (pre-exceptionals)</b>      | <b>176.1</b>     | <b>248.9</b>   | <b>276.7</b>   | <b>305.6</b>   | <b>Total liabilities</b>              | <b>9,125.3</b>  | <b>9,393.9</b>  | <b>9,703.5</b>  | <b>9,952.4</b>  |
| Post tax exceptionals                     | (738.5)          | (443.0)        | 0.0            | 0.0            | Preferred shares                      | 4.6             | 4.6             | 4.6             | 4.6             |
| <b>Net income (post-exceptionals)</b>     | <b>(562.4)</b>   | <b>(194.1)</b> | <b>276.7</b>   | <b>305.6</b>   | <b>Total common equity</b>            | <b>4,102.0</b>  | <b>4,070.0</b>  | <b>4,388.8</b>  | <b>4,698.6</b>  |
| EPS (basic, pre-exception) (\$)           | 1.10             | 1.46           | 1.52           | 1.64           | Minority interest                     | 0.0             | 0.0             | 0.0             | 0.0             |
| EPS (diluted, pre-exception) (\$)         | 1.10             | 1.46           | 1.52           | 1.62           | <b>Total liabilities &amp; equity</b> | <b>13,231.8</b> | <b>13,468.5</b> | <b>14,096.8</b> | <b>14,655.5</b> |
| EPS (basic, post-exception) (\$)          | (3.52)           | (1.14)         | 1.52           | 1.64           | <b>Additional financials</b>          | <b>12/08</b>    | <b>12/09E</b>   | <b>12/10E</b>   | <b>12/11E</b>   |
| EPS (diluted, post-exception) (\$)        | (3.52)           | (1.14)         | 1.52           | 1.62           | Net debt/equity (%)                   | 128.9           | 134.5           | 131.0           | 127.0           |
| Common dividends paid                     | (64.1)           | (141.3)        | (158.0)        | (171.8)        | Interest cover (X)                    | 1.9             | 2.3             | 2.4             | 2.4             |
| DPS (\$)                                  | 0.40             | 0.82           | 0.86           | 0.90           | Inventory days                        | 6.5             | 7.0             | 6.8             | 6.4             |
| Dividend payout ratio (%)                 | 36.4             | 56.1           | 56.7           | 54.9           | Receivable days                       | 32.5            | 30.1            | 30.7            | 30.9            |
|   |                  |                |                |                | BVPS (\$)                             | 25.64           | 23.10           | 24.12           | 24.74           |
| <b>Growth &amp; margins (%)</b>           | <b>12/08</b>     | <b>12/09E</b>  | <b>12/10E</b>  | <b>12/11E</b>  | ROA (%)                               | 1.3             | 1.9             | 2.0             | 2.1             |
| Sales growth                              | 5.5              | 8.6            | 6.2            | 6.2            | CROCI (%)                             | 4.5             | 4.5             | 4.4             | 4.6             |
| EBITDA growth                             | 5.4              | 16.2           | 10.1           | 9.1            | <b>Dupont ROE (%)</b>                 | <b>4.3</b>      | <b>6.1</b>      | <b>6.3</b>      | <b>6.5</b>      |
| EBIT growth                               | 7.4              | 21.0           | 9.9            | 9.1            | Margin (%)                            | 7.5             | 9.8             | 10.3            | 10.7            |
| Net income (pre-exception) growth         | 10.5             | 41.4           | 11.2           | 10.4           | Turnover (X)                          | 0.2             | 0.2             | 0.2             | 0.2             |
| EPS growth                                | 10.6             | 32.9           | 3.8            | 8.3            | Leverage (X)                          | 3.2             | 3.3             | 3.2             | 3.1             |
| Gross margin                              | 32.6             | 35.2           | 35.8           | 36.5           | Free cash flow per share (\$)         | (2.85)          | (1.56)          | (1.69)          | (1.17)          |
| EBITDA margin                             | 35.7             | 38.2           | 39.6           | 40.6           | Free cash flow yield (%)              | (13.8)          | (8.4)           | (9.1)           | (6.3)           |
| EBIT margin                               | 24.1             | 26.8           | 27.8           | 28.5           |                                       |                 |                 |                 |                 |
| <b>Cash flow statement (\$ mn)</b>        | <b>12/08</b>     | <b>12/09E</b>  | <b>12/10E</b>  | <b>12/11E</b>  |                                       |                 |                 |                 |                 |
| Net income                                | 176.1            | 248.9          | 276.7          | 305.6          |                                       |                 |                 |                 |                 |
| D&A add-back (incl. ESO)                  | 271.3            | 288.0          | 318.1          | 346.6          |                                       |                 |                 |                 |                 |
| Minority interest add-back                | 0.0              | 0.0            | 0.0            | 0.0            |                                       |                 |                 |                 |                 |
| Net (inc)/dec working capital             | 5.5              | (13.7)         | (8.3)          | (24.1)         |                                       |                 |                 |                 |                 |
| Other operating cash flow                 | 99.3             | 30.7           | (20.0)         | (20.0)         |                                       |                 |                 |                 |                 |
| <b>Cash flow from operations</b>          | <b>552.2</b>     | <b>553.9</b>   | <b>566.6</b>   | <b>608.1</b>   |                                       |                 |                 |                 |                 |
| Capital expenditures                      | (1,008.8)        | (820.0)        | (875.0)        | (825.0)        |                                       |                 |                 |                 |                 |
| Acquisitions                              | (12.5)           | (95.0)         | (30.0)         | (30.0)         |                                       |                 |                 |                 |                 |
| Divestitures                              | 0.0              | 0.0            | 0.0            | 0.0            |                                       |                 |                 |                 |                 |
| Others                                    | (12.3)           | (6.1)          | 0.0            | 0.0            |                                       |                 |                 |                 |                 |
| <b>Cash flow from investing</b>           | <b>(1,033.7)</b> | <b>(921.1)</b> | <b>(905.0)</b> | <b>(855.0)</b> |                                       |                 |                 |                 |                 |
| Dividends paid (common & pref)            | (64.1)           | (141.3)        | (158.0)        | (171.8)        |                                       |                 |                 |                 |                 |
| Inc/(dec) in debt                         | 292.9            | 187.0          | 271.4          | 217.7          |                                       |                 |                 |                 |                 |
| Other financing cash flows                | 248.7            | 320.5          | 225.0          | 201.0          |                                       |                 |                 |                 |                 |
| <b>Cash flow from financing</b>           | <b>477.6</b>     | <b>366.2</b>   | <b>338.4</b>   | <b>246.9</b>   |                                       |                 |                 |                 |                 |
| <b>Total cash flow</b>                    | <b>(3.9)</b>     | <b>(1.0)</b>   | <b>0.0</b>     | <b>0.0</b>     |                                       |                 |                 |                 |                 |

Note: Last actual year may include reported and estimated data.  
Source: Company data, Goldman Sachs Research estimates.

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May 11, 2009

American Water Works Co., Inc. (AWK)

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The prices in the body of this report are based on the market close of May 8, 2009.

## Investment view

We rate American Water shares Neutral with a 12-month price target of \$21, upside of 13%. We forecast robust revenue, EBITDA and net income growth in the coming years, but given the large capital investment program of \$4.0-\$4.5 billion over five years and the need to restore the company's equity to capital ratio to 45%-50% from 40% at March 31, we expect future primary equity issuance will dilute EPS growth, as shown in Exhibit 1. Our forecast assumes that American Water gradually returns to a 45% equity ratio by 2012.

We also believe that the overhang associated with RWE's 60% ownership of American Water will continue to weigh on the company's shares near-term. Given that the company would need to renew regulatory approval for a share sale after April 2010 (the 24 month anniversary of the IPO), we believe that RWE will try to monetize its stake prior to this deadline.

We would be more constructive on the stock if stronger-than-expected cash flow generation reduced the need to issue as much equity as we forecast (\$300 million in 2009, \$200 million in 2010, and \$175 million in 2011).

### Exhibit 1: American Water financial summary

|                                       | 2006A     | 2007A     | 2008A     | 2009E     | 2010E     | 2011E     | 2012E     |
|---------------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| \$ in millions, except per share data |           |           |           |           |           |           |           |
| Revenue                               | \$2,093.1 | \$2,214.2 | \$2,336.9 | \$2,538.6 | \$2,696.8 | \$2,864.3 | \$3,016.2 |
| Operating Profit                      | 474.2     | 524.5     | 563.1     | 681.4     | 749.0     | 817.4     | 869.4     |
| EBITDA                                | 733.4     | 791.8     | 834.4     | 969.4     | 1,067.1   | 1,164.0   | 1,244.5   |
| Net Income, Cont. Ops                 | 61.7      | 159.3     | 176.1     | 248.9     | 276.7     | 305.6     | 326.1     |
| Diluted Shares                        | 160.0     | 160.0     | 160.0     | 170.1     | 182.4     | 188.4     | 194.5     |
| EPS                                   | 0.39      | 1.00      | 1.10      | 1.46      | 1.52      | 1.62      | 1.68      |
| yoy change, %                         |           |           |           |           |           |           |           |
| Revenue                               | -2.0%     | 5.8%      | 5.5%      | 8.6%      | 6.2%      | 6.2%      | 5.3%      |
| Operating Profit                      | -4.6%     | 10.6%     | 7.4%      | 21.0%     | 9.9%      | 9.1%      | 6.4%      |
| EBITDA                                | -3.3%     | 8.0%      | 5.4%      | 16.2%     | 10.1%     | 9.1%      | 6.9%      |
| Net Income, Cont. Ops                 | -40.1%    | 158.4%    | 10.5%     | 41.4%     | 11.2%     | 10.4%     | 6.7%      |
| EPS                                   | -40.1%    | 158.4%    | 10.6%     | 32.9%     | 3.7%      | 6.9%      | 3.4%      |
| margins, % of sales                   |           |           |           |           |           |           |           |
| Operating margin                      | 22.7%     | 23.7%     | 24.1%     | 26.8%     | 27.8%     | 28.5%     | 28.8%     |
| EBITDA margin                         | 35.0%     | 35.8%     | 35.7%     | 38.2%     | 39.6%     | 40.6%     | 41.3%     |
| Net Income margin                     | 2.9%      | 7.2%      | 7.5%      | 9.8%      | 10.3%     | 10.7%     | 10.8%     |

Source: Company filings, Goldman Sachs Research estimates.

May 11, 2009

American Water Works Co., Inc. (AWK)

### **Growth through rates, capital investment and tuck-in acquisitions**

American Water has an important opportunity to invest in water infrastructure, following many years of significant underinvestment by the industry at large. We believe that there are three core drivers of growth that will support strong revenue and return growth for American Water: (1) rate case catch-ups, (2) incremental infrastructure investment, and (3) tuck-in acquisitions.

#### **Rate case catch-up continues**

American Water has demonstrated that it is committed to filing rate cases in each state in which it operates approximately every two to three years. Rate cases approved during 2008 supported strong revenue growth during the first quarter of 2009, offsetting the volume declines during the period. Since the beginning of 2009, American Water has filed six new rate cases in Pennsylvania, Indiana, California, Iowa, Ohio and Maryland totaling \$156.7 million. In addition, pending rate cases filed in 2007 and 2008 total \$89.2 million. In our analysis, we assume that American Water is granted 50% of the amount that it has filed for in each state.

Exhibit 2 summarizes the rate cases that have been filed, our assumption for how much will be granted, and when this revenue should begin to contribute to the company's revenue line. Historically, the company has received approximately 60% of the amount filed. We believe that it is more prudent to assume a lower percentage, 50%, given that this is the second round of large rate increases requested in a 2-3 year period, in a particularly difficult economic environment.

#### **Incremental infrastructure investment**

We continue to assume that American Water will invest \$4.0-\$4.5 billion over the next five years. We forecast \$800 million is invested in 2009 and \$850 million in invested in 2010 and that this investment is funded approximately 50/50 debt and equity.

#### **Tuck-in acquisitions**

We expect tuck-in acquisition activity to pick up, particularly given the increasing economic pressure on municipalities to bridge their budget shortfalls. American Water completed 10 small tuck-in acquisitions in 2008. Tuck-in acquisitions in 2009 have been slower to materialize, but we do believe that they will be a source of incremental growth in the future, adding approximately 1.0% growth to the revenue line.

May 11, 2009

American Water Works Co., Inc. (AWK)

**Exhibit 2: American Water rate case requests from 2006 to present**  
\$ millions

| State                                   | Date Filed | Amount Filed   | Amount Granted | %            | ROE Filed | ROE Granted | Expected Grant Date | Status    |
|---|------------|----------------|----------------|--------------|-----------|-------------|---------------------|-----------|
| <b>General Rate Cases Filed in 2006</b> |            |                |                |              |           |             |                     |           |
| Ohio                                    | 3/1/06     | \$5.1          | \$3.4          | 66.7%        | 11.0%     | 10.0%       | 3/1/07              | Completed |
| New Jersey                              | 3/31/06    | 99.0           | 56.2           | 56.8%        | 11.2%     | 10.0%       | 4/1/07              | Completed |
| New Mexico                              | 5/30/06    | 1.3            | 1.3            | 100.0%       | 10.0%     | 9.7%        | 5/1/07              | Completed |
| Arizona (Anthem)                        | 6/16/06    | 7.0            | 4.3            | 61.4%        | 11.8%     | 8.8%        | 6/4/08              | Completed |
| Arizona (Sun City)                      | 7/28/06    | 3.9            | 2.4            | 61.5%        | 11.8%     | 10.6%       | 4/1/08              | Completed |
| Texas                                   | 10/16/06   | \$0.8          | \$0.7          | 87.5%        | 12.0%     | 12.0%       | 1/1/07              | Completed |
| Tennessee                               | 11/22/06   | 6.4            | 4.1            | 64.1%        | 11.0%     | 9.6%        | 5/23/07             | Completed |
| Indiana                                 | 12/5/06    | 24.7           | 14.0           | 56.7%        | 11.5%     | 10.0%       | 12/1/07             | Completed |
| Missouri                                | 12/15/06   | 41.5           | 21.4           | 51.6%        | 11.3%     | 10.0%       | 11/1/07             | Completed |
| <b>Total Granted (2006)</b>             |            | <b>\$189.7</b> | <b>\$107.8</b> | <b>56.8%</b> |           |             |                     |           |
| <b>Total Pending (2006)</b>             |            | <b>\$0.0</b>   | <b>\$0.0</b>   |              |           |             |                     |           |
| <b>General Rate Cases Filed in 2007</b> |            |                |                |              |           |             |                     |           |
| California                              | 1/1/07     | \$16.4         | \$13.0         | 100.0%       | 11.5%     | 10.2%       | 6/1/08              | Completed |
| Michigan                                | 1/8/07     | 0.2            | 0.2            | 100.0%       | 12.0%     | 10.0%       | 1/8/07              | Completed |
| Maryland                                | 3/29/07    | 0.6            | 0.6            | 100.0%       | 11.8%     | 10.5%       | 10/1/07             | Completed |
| Pennsylvania                            | 4/27/07    | 59.2           | 36.0           | 60.8%        | 11.8%     | N/A         | 11/30/07            | Completed |
| Arizona (Sun City)                      | 4/30/07    | 2.2            | 1.9            | 86.4%        | 11.8%     | 10.8%       | 6/1/08              | Completed |
| Kentucky                                | 4/30/07    | 13.2           | 8.0            | 60.6%        | 11.4%     | 10.0%       | 12/1/07             | Completed |
| Long Island                             | 5/1/07     | 9.6            | 6.6            | 68.8%        | 11.0%     | 9.5%        | 4/1/08              | Completed |
| West Virginia                           | 6/1/07     | 24.1           | 14.5           | 60.2%        | 11.3%     | 10.0%       | 3/28/08             | Completed |
| Iowa                                    | 8/30/07    | 6.1            | 4.3            | 70.5%        | 11.3%     | 10.4%       | 2/1/08              | Completed |
| Illinois                                | 8/31/07    | 32.8           | 21.6           | 65.9%        | 11.3%     | 10.4%       | 8/8/08              | Completed |
| Ohio                                    | 10/1/07    | 5.5            | 5.3            | 95.6%        | 11.3%     | 10.9%       | 11/13/08            | Completed |
| Hawaii                                  | 11/1/07    | 1.3            | 0.7            | 50.0%        | 10.6%     |             | 11/1/08             | Pending   |
| <b>Total Granted (2007)</b>             |            | <b>\$169.9</b> | <b>\$112.0</b> | <b>65.9%</b> |           |             |                     |           |
| <b>Total Pending (2007)</b>             |            | <b>\$1.3</b>   | <b>\$0.7</b>   | <b>50.0%</b> |           |             |                     |           |
| <b>General Rate Cases Filed in 2008</b> |            |                |                |              |           |             |                     |           |
| New Jersey                              | 1/14/08    | \$125.0        | \$72.1         | 57.7%        | 11.5%     | 10.3%       | 12/7/08             | Completed |
| Texas                                   | 2/21/08    | 0.9            | 0.4            | 50.0%        | 12.0%     |             | 6/30/08             | Pending   |
| California (Monterey, GO)               | 1/30/08    | 43.5           | 21.8           | 50.0%        | 11.5%     |             | 1/1/09              | Pending   |
| California (ROE)                        | 5/1/08     | 2.8            | 1.4            | 50.0%        | 11.5%     |             | 5/1/09              | Pending   |
| Virginia                                | 1/30/08    | 4.3            | 3.4            | 79.1%        | 11.3%     | 10.5%       | 7/8/08              | Completed |
| Michigan                                | 1/1/08     | 0.2            | 0.2            | 100.0%       | 10.0%     | 10.0%       | 1/1/08              | Completed |
| Tennessee                               | 3/14/08    | 7.6            | 1.7            | 21.6%        | 11.8%     | 10.2%       | 10/1/08             | Completed |
| Missouri                                | 3/31/08    | 49.8           | 34.5           | 69.3%        | 11.3%     | 10.0%       | 11/28/08            | Completed |
| Pennsylvania - WW                       | 4/28/08    | 2.7            | 1.9            | 70.4%        | 11.5%     | 10.6%       | 11/14/08            | Completed |
| Arizona                                 | 5/1/08     | 20.0           | 10.0           | 50.0%        | 11.8%     |             | 5/1/09              | Pending   |
| West Virginia                           | 5/30/08    | 14.8           | 5.2            | 35.1%        | 11.8%     | 10.0%       | 3/26/09             | Completed |
| New Mexico (Clovis)                     | 6/30/08    | 2.2            | 1.1            | 50.0%        | 11.8%     |             | 7/1/09              | Pending   |
| Kentucky                                | 10/31/08   | 18.5           | 9.3            | 50.0%        | 11.5%     |             | 6/30/09             | Pending   |
| <b>Total Granted (2008)</b>             |            | <b>\$204.4</b> | <b>\$119.0</b> | <b>58.2%</b> |           |             |                     |           |
| <b>Total Pending (2008)</b>             |            | <b>\$87.9</b>  | <b>\$43.9</b>  | <b>50.0%</b> |           |             |                     |           |
| <b>General Rate Cases Filed in 2009</b> |            |                |                |              |           |             |                     |           |
| California (Sac, LA, Lark)              | 1/23/09    | \$32.7         | \$16.4         | 50.0%        | 10.2%     |             | 1/1/10              | Pending   |
| Pennsylvania                            | 4/24/09    | \$58.1         | \$29.1         | 50.0%        | 12.0%     |             | 1/1/10              | Pending   |
| Iowa                                    | 4/30/09    | \$9.4          | \$4.7          | 50.0%        | 12.2%     |             | 3/1/10              | Pending   |
| Indiana                                 | 4/30/09    | \$46.9         | \$23.5         | 50.0%        | 12.0%     |             | 5/1/10              | Pending   |
| Maryland                                | 4/30/09    | \$0.8          | \$0.4          | 50.0%        | 11.8%     |             | 2/1/10              | Pending   |
| Ohio                                    | 5/7/09     | \$8.8          | \$4.4          | 50.0%        | N/A       |             | 1/1/10              | Pending   |
| <b>Total Granted (2009)</b>             |            | <b>\$0.0</b>   | <b>\$0.0</b>   | <b>0.0%</b>  |           |             |                     |           |
| <b>Total Pending (2009)</b>             |            | <b>\$156.7</b> | <b>\$78.3</b>  | <b>50.0%</b> |           |             |                     |           |
| <b>Total Granted (2006 - present)</b>   |            | <b>\$564.0</b> | <b>\$338.7</b> | <b>60.1%</b> |           |             |                     |           |
| <b>Total Pending (2006 - present)</b>   |            | <b>\$245.9</b> | <b>\$122.9</b> | <b>50.0%</b> |           |             |                     |           |

Source: Company filings, various State Public Utility Commission news releases, Goldman Sachs Research estimates.

May 11, 2009

American Water Works Co., Inc. (AWK)

**Declining water demand partially offsets strong rate increases**

First-quarter water volume sold declined 3.5% year-on-year, with declines registered in all segments – residential, commercial, industrial, and public/other (see Exhibit 3). As expected, the industrial segment declined the most (-12.9%) driven by the decline in economic activity. The industrial segment represents 10% of total water volume and 5% of revenue. We expect this segment, followed by the commercial segment, will remain under pressure throughout 2009.

**Exhibit 3: 1Q2009 regulated business water volume**

| Customer Class   | Water Sales Volumes |               | Operating Revenues |
|------------------|---------------------|---------------|--------------------|
|                  | % change yoy        | % of total    | % of total         |
| Residential      | -1.5%               | 53.0%         | 57.6%              |
| Commerical       | -3.6%               | 21.7%         | 18.3%              |
| Industrial       | -12.9%              | 10.3%         | 4.7%               |
| Public & Other * | -2.7%               | 15.0%         | 19.4%              |
| <b>Total</b>     | <b>-3.5%</b>        | <b>100.0%</b> | <b>100.0%</b>      |

\* Public and Other includes revenue from wastewater service

Source: Company filings.

**O&M declines as a percent of revenue**

Expenses came in below our forecast principally due to lower operating supplies and services expense, and lower depreciation. The lower operating supplies can be explained by the reduction in contracted services employed by American Water in 1Q2008 to support the company's Sarbanes-Oxley remediation efforts and certain costs associated with the company's IPO. Depreciation expenses were lower than our forecast and below depreciation in the fourth quarter. We believe this may be explained by fully depreciated assets rolling off and possible changes to depreciation schedules. As a result we have reduced our forecast for O&M as a percent of sales as well as depreciation going forward.

We expect less commodity inflation pressure on the O&M line as we begin to lap last year's steep increases, particularly in the case of fuel and chemical costs. The one area where we do expect expenses to increase is pension-related expenses and post-retirement healthcare benefits. The company plans to expense \$32 million during 2009 and will seek rate relief on a portion of these expenses.

**Bad debt expense has crept up but remains low**

Bad debt expense (as measured by uncollectible accounts expense as a percent of revenues) for the first quarter (0.9% of sales) remained relatively flat with fourth quarter 2008, although it increased year-on-year (0.3% in first quarter 2008). We will continue to monitor the bad debt expense line given the difficult economic environment. We believe that American Water is actively focusing on collections of past due accounts and expect that bad debt expense should not increase meaningfully from here.

**Stimulus Funds available for water infrastructure investment**

American Water, like other water utilities, plans to take advantage of all sources of funding available to support its capital investment program. The company issued \$75 million in senior monthly notes in February, \$80 million in Pennsylvania tax-exempt revenue bonds and has indicated that it plans to issue a further \$300 million in tax-exempt financing in the coming months.

May 11, 2009

American Water Works Co., Inc. (AWK)

## Valuation: 13% upside potential to our 12-month price target of \$21

Our 12-month price target of \$21 implies 13% upside from current levels. Our price target is based on multiples (P/E and EBITDA) and our dividend discount model.

We believe that the best way to value a water utility is a combination of multiples analysis and a dividend discount model. In the past, we have focused principally on P/E as the primary metric for comparative valuation, due to the regulated return framework which sets an allowed ROE, or essentially a fair rate of return. Given American Water's higher level of leverage relative to comparable companies, we are also incorporating EV/EBITDA multiples into our analysis. Note that the comparable group for American Water is quite limited. There are 10 publicly traded water utilities in the United States including American Water, and only three such companies with a market capitalization in excess of US\$500 million (see Exhibit 4).

### Exhibit 4: American Water comparative valuation

| Company  | Ticker | Share Price | Mkt. Cap (mm) | Enterprise Value | P/E           |               | EV/EBITDA     |              | Dividend Yield | ROE (adj.)  | Debt/Cap (BV) |
|--|--------|-------------|---------------|------------------|---------------|---------------|---------------|--------------|----------------|-------------|---------------|
|  |        |             |               |                  | 2009E         | 2010E         | 2009E         | 2010E        |                |             |               |
| American Water Works Company                   | AWK    | \$18.55     | \$2,969       | \$8,352          | 12.7 x        | 12.2 x        | 8.6 x         | 7.8 x        | 4.3%           | 7.8%        | 59.6%         |
| <b>US Water Utilities</b>                      |        |             |               |                  |               |               |               |              |                |             |               |
| <b>Mid Cap*</b>                                |        |             |               |                  |               |               |               |              |                |             |               |
| Aqua America Inc.                              | WTR    | \$18.36     | \$2,495       | \$3,833          | 21.7 x        | 20.0 x        | 10.7 x        | 9.8 x        | 2.9%           | 9.6%        | 55.6%         |
| California Water Service Group                 | CWT    | \$37.36     | \$775         | \$1,091          | 18.0 x        | 17.5 x        | 8.3 x         | 8.2 x        | 3.2%           | 10.0%       | 45.0%         |
| American States Water Co.                      | AWR    | \$33.88     | \$590         | \$925            | 19.8 x        | 17.5 x        | 8.9 x         | 8.2 x        | 3.0%           | 9.2%        | 52.4%         |
| <b>Average of Mid Cap US Water Utilities</b>   |        |             |               |                  | <b>19.8 x</b> | <b>18.3 x</b> | <b>9.3 x</b>  | <b>8.8 x</b> | <b>3.0%</b>    | <b>9.6%</b> | <b>51.0%</b>  |
| <b>Median of Mid Cap US Water Utilities</b>    |        |             |               |                  | <b>19.8 x</b> | <b>17.5 x</b> | <b>8.9 x</b>  | <b>8.2 x</b> | <b>3.0%</b>    | <b>9.6%</b> | <b>52.4%</b>  |
| <b>Small Cap</b>                               |        |             |               |                  |               |               |               |              |                |             |               |
| SJW Corp.                                      | SJW    | \$23.60     | \$440         | \$682            | 20.0 x        | 16.8 x        | N/A           | N/A          | 2.8%           | 8.4%        | 48.6%         |
| Middlesex Water Company                        | MSEX   | \$14.18     | \$193         | \$356            | 15.6 x        | 14.6 x        | 10.6 x        | 9.8 x        | 5.0%           | 8.5%        | 53.4%         |
| Connecticut Water Service Inc.                 | CTWS   | \$20.52     | \$174         | \$278            | 18.2 x        | 17.7 x        | 13.9 x        | 12.9 x       | 4.3%           | 9.4%        | 50.0%         |
| York Water Company                             | YORW   | \$13.65     | \$149         | \$241            | 20.6 x        | 20.6 x        | N/A           | N/A          | 3.7%           | 9.2%        | 57.0%         |
| Southwest Water Company                        | SWWC   | \$5.27      | \$130         | \$320            | 11.7 x        | N/A           | N/A           | N/A          | 1.9%           | 4.9%        | 48.4%         |
| Artesian Resource Corp.                        | ARTNA  | \$14.48     | \$108         | \$215            | 15.7 x        | 14.5 x        | N/A           | N/A          | 4.9%           | 7.3%        | 59.5%         |
| <b>Average of Small Cap US Water Utilities</b> |        |             |               |                  | <b>17.0 x</b> | <b>16.8 x</b> | <b>12.2 x</b> | <b>nm</b>    | <b>3.8%</b>    | <b>8.0%</b> | <b>52.8%</b>  |
| <b>Median of Small Cap US Water Utilities</b>  |        |             |               |                  | <b>16.9 x</b> | <b>16.8 x</b> | <b>12.2 x</b> | <b>nm</b>    | <b>4.0%</b>    | <b>8.5%</b> | <b>51.7%</b>  |

\* Mid Cap = we define as companies with market cap >\$500mn  
Prices as of close on 5/8/2009

Source: FactSet, Goldman Sachs Research estimates.

The share overhang remains very large (approximately 60% of the shares outstanding) and will likely keep some pressure on the valuation of American Water shares in the near term. RWE has indicated that it intends to sell its remaining stake in the company. We expect this will take place over the next 12 months. In light of this, we have increased our share overhang discount to 15% from 10%.

American Water's comparables trade at 19.8X 2009E and 17.5X 2010E EPS, and 8.9X 2009E and 8.2X 2010E EBITDA, respectively. If we apply a multiple of 20X 2010E EPS, and discount it by 15% for the share overhang, this implies a 12-month target price of \$25.75. If we use a multiple of 9X 2010E EBITDA, and discount it by 15% for the share overhang, this implies a 12-month target price of \$17.50. On a blended basis, our multiple analysis implies a price target of \$21.63 (50% P/E and 50% EV/EBITDA).

The second valuation method that we employ is a dividend discount model (DDM). Our DDM analysis implies a price target of \$20.50 assuming a 9.0% cost of equity and a 5% long-term dividend growth rate.

To arrive at our price target, we place a 50% weight on our multiples analysis and a 50% weight on our DDM analysis to imply our price target of \$21 versus our previous price target of \$24. Our new price target implies upside of 13%. American Water's current dividend yield is 4.3%.

## **Positive catalysts: Potential upside to our earnings forecast**

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### **Better than expected pricing/ROE recovery**

American Water currently under-earns typical authorized ROEs of approximately 10% and the average for comparable water utilities of 9.6%. We estimate that American Water's 2008 regulated ROE was approximately 6% (7.8% for consolidated). While we expect American Water to gain pricing and steadily approach a 10% regulated ROE during the next few years, a faster than expected price recovery would increase both ROE and earnings growth.

### **Greater than anticipated accretive tuck-in acquisition activity**

We estimate that tuck-in acquisitions will boost revenue by 1% but could add as much as 2% annually over the next few years. Greater-than-expected accretive acquisition opportunities, particularly from medium-sized acquisitions (i.e., Trenton for \$80 million), could result in upside to our earnings.

### **Better than anticipated growth in the non-regulated business**

Greater than anticipated operations & maintenance contract wins could result in the non-regulated business growing faster than our estimate of a 1% 3-year revenue CAGR (2008-2011E), resulting in upside to our earnings estimates.

## **Risks to our view: Economic environment may slow rate relief**

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### **Adverse regulatory decisions/rate shock**

American Water ultimately must rely on decisions from Public Utility Commissions in setting authorized ROEs and approved water rates. The timing of regulatory decisions or authorized ROE targets/water rates could come in below our expectations, reducing our earnings estimates. In addition, given rate case stay-outs, American Water's requested rate increases have often exceeded 25%, fueling increased public/political opposition and potentially reducing American Water's chances of reaching targeted returns.

### **Regulatory lag**

Operating or capital costs could rise faster than expected, and American Water may not be able to recover these costs until the conclusion of future rate cases, creating regulatory lag and potentially reducing our earnings estimates.

### **Financing risk**

American Water will remain free cash flow negative for the foreseeable future and will need to access the capital markets (both debt and equity) regularly over the next several years to fund its capital expenditure program and bring its equity ratio back to the 45%-50% range. To the extent that American Water is faced with adverse financing conditions, its growth plans may be at risk.

### **Goodwill impairment could negatively impact credit ratings or trigger negative regulatory conditions**

While the company's \$450 million goodwill impairment in the first quarter is a non-cash charge, it does have the effect of reducing the company's equity ratio to 40% (at March 31) from approximately 44% at December 31, 2008. The company has indicated that its long-term target equity ratio is 45%-50%. We assume that the company returns to a 45% ratio in 2012.



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American Water has approximately \$1.2 billion of goodwill on the balance sheet, primarily as a result of the company's acquisition by RWE in 2003. Goodwill could be further impaired in the future, which could have negative implications for American Water's credit rating, rate case outcomes or potentially require dilutive equity infusions. The company is required to test for impairment at the end of each fiscal year, unless there is a triggering event sooner. It appears that a sustained decline in the company's share price alone can constitute a triggering event, as was the case in the first quarter. To the extent that the company's share price falls meaningfully below book value per share for a sustained period of time, goodwill impairments will be more likely.

As of March 31, American Water's book value per share was \$22.87 following the impairment charge. This compares with the company's average price of \$19.56 during the first quarter, the closing price of \$19.24 on March 31 and \$18.55 on May 8.

#### **Unfavorable weather conditions**

Unseasonably wet or dry weather can negatively impact volumes and earnings as was the case during much of 2008. Greater rainfall could reduce demand for water, while severe droughts could limit available supply, also negatively impacting volumes.

#### **Condemnation and eminent domain**

Municipalities can petition to acquire water utility assets through eminent domain or condemnation. Such cases could be a negative distraction for management and, in the extreme case, force American Water to sell assets, negatively impacting the earnings outlook. In 2008, California American Water Company sold its water and wastewater operations to the town of Felton (1,300 customers), following an extended court battle. Some political leaders in Homer Glen, Illinois, Anthem, Arizona, Scottsdale, Arizona, and Tennessee have also been threatening to explore this option.

## **Financial model assumptions**

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Our key model assumptions are as follows:

#### **Regulated business**

Incremental revenue growth due to:

- **Core growth** – We estimate that core growth will be essentially flat over the coming years; population growth (0.64%) offset mostly by declining per capita usage (-0.60%).
- **Acquisitions** – 1% growth due to tuck-in acquisitions.
- **DSIC** – nominal amount of surcharges implemented between rate cases.
- **Rate cases** – assume that company receives 50% of the amount filed in pending rate cases.

Assume operation and maintenance expenses will increase 4% in 2009 and 3% in 2010.

#### **Non-regulated business**

With the completion of certain contracts and the delayed ramp up on several others we now assume that non-regulated revenue declines during 2009 and recovers in 2010.

- **Revenue growth** – assume 6% decline in 2009 and 5% growth in 2010.
- **Expense growth** – assume 3% decline in 2009 and 4% increase in 2010.

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**Target equity to capitalization ratio of 45%**

Assume negative free cash flow will be funded with new financing (both debt and equity) with the objective of restoring the company's equity to capitalization ratio to 45% from 40%. Our model assumes that the company raises \$676 million in equity from 2009-2011 and \$676 million in debt over the same period.

**Dividend growth of 5%**

Assume dividend grows at 5% and the dividend payout trends down from 73% in 2008 to 57% in 2010.

**3-year EPS CAGR (2008-2011E) of 13.8%**

Driven by steady improvement to 9.4% regulated ROE, 7.0% average annual rate base growth, and small tuck-in acquisitions; EPS growth peaks in 2009 (+33%) and slows to 4% in 2010 and 7% in 2011.

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## American Water model

### Exhibit 5: American Water annual income statement 2006-2012E

\$ millions, except per-share data

| INCOME STATEMENT                      | 2006A          | 2007A          | 2008A          | 2009E          | 2010E          | 2011E          | 2012E          |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Operating Revenues                    | 2,093.1        | 2,214.2        | 2,336.9        | 2,538.6        | 2,696.8        | 2,864.3        | 3,016.2        |
| <i>YY Growth</i>                      | -2.0%          | 5.8%           | 5.5%           | 8.6%           | 6.2%           | 6.2%           | 5.3%           |
| Operation and maintenance             | (1,174.5)      | (1,246.5)      | (1,303.8)      | (1,357.9)      | (1,414.0)      | (1,471.2)      | (1,530.4)      |
| Depreciation and amortization         | (259.2)        | (267.3)        | (271.3)        | (288.0)        | (318.1)        | (346.6)        | (375.1)        |
| General taxes                         | (185.1)        | (183.3)        | (199.1)        | (211.6)        | (215.7)        | (229.1)        | (241.3)        |
| % of revenues                         | 8.8%           | 8.3%           | 8.5%           | 8.3%           | 8.0%           | 8.0%           | 8.0%           |
| Gain (loss) on sale of assets         | (0.1)          | 7.3            | 0.4            | 0.2            | 0.0            | 0.0            | 0.0            |
| Operating Profit                      | 474.2          | 524.5          | 563.1          | 681.4          | 749.0          | 817.4          | 869.4          |
| <i>Operating Margin</i>               | 22.7%          | 23.7%          | 24.1%          | 26.8%          | 27.8%          | 28.5%          | 28.8%          |
| Interest, net                         | (371.0)        | (288.0)        | (291.1)        | (297.9)        | (313.8)        | (334.1)        | (351.9)        |
| AFUDC                                 | 8.6            | 11.2           | 22.7           | 20.2           | 20.0           | 20.0           | 20.0           |
| Other inc/exp                         | 0.9            | 6.2            | 4.7            | 5.6            | 6.0            | 6.0            | 6.0            |
| Pretax Income                         | 112.7          | 253.8          | 299.4          | 409.4          | 461.2          | 509.3          | 543.4          |
| Provision for Income Taxes            | (51.1)         | (94.5)         | (123.4)        | (160.5)        | (184.5)        | (203.7)        | (217.4)        |
| <i>Tax Rate</i>                       | 45.3%          | 37.2%          | 41.2%          | 39.2%          | 40.0%          | 40.0%          | 40.0%          |
| Net Income, Continuing Ops            | 61.7           | 159.3          | 176.1          | 248.9          | 276.7          | 305.6          | 326.1          |
| Preferred Dividend                    | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            |
| Non-recurring/Discontinued Ops        | (6.4)          | (0.6)          | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            |
| Extraordinary Items                   | (217.5)        | (501.5)        | (738.5)        | (443.0)        | 0.0            | 0.0            | 0.0            |
| <b>Net Income - Reported</b>          | <b>(162.2)</b> | <b>(342.8)</b> | <b>(562.4)</b> | <b>(194.1)</b> | <b>276.7</b>   | <b>305.6</b>   | <b>326.1</b>   |
| Shares Outstanding - Basic (Avg)      | 160.0          | 160.0          | 160.0          | 170.1          | 182.3          | 185.9          | 193.8          |
| Shares Outstanding - Diluted (Avg)    | 160.0          | 160.0          | 160.0          | 170.1          | 182.4          | 188.4          | 194.5          |
| Shares Outstanding - Basic (EOP)      | 160.0          | 160.0          | 160.0          | 176.2          | 182.0          | 189.9          | 197.8          |
| Shares Outstanding - Diluted (EOP)    | 160.0          | 160.0          | 160.0          | 176.2          | 186.4          | 190.4          | 198.5          |
| EPS - Continuing Ops - Basic          | 0.39           | 1.00           | 1.10           | 1.46           | 1.52           | 1.64           | 1.68           |
| <b>EPS - Continuing Ops - Diluted</b> | <b>0.39</b>    | <b>1.00</b>    | <b>1.10</b>    | <b>1.46</b>    | <b>1.52</b>    | <b>1.62</b>    | <b>1.68</b>    |
| <i>YY EPS Growth (diluted)</i>        | -40.1%         | 158.4%         | 10.6%          | 32.9%          | 3.7%           | 6.9%           | 3.4%           |
| EPS - Net Income - Reported - Basic   | -1.01          | -2.14          | -3.52          | -1.14          | 1.52           | 1.64           | 1.68           |
| EPS - Net Income - Reported - Diluted | -1.01          | -2.14          | -3.52          | -1.14          | 1.52           | 1.62           | 1.68           |
| <b>EBITDA</b>                         | <b>733.4</b>   | <b>791.8</b>   | <b>834.4</b>   | <b>969.4</b>   | <b>1,067.1</b> | <b>1,164.0</b> | <b>1,244.5</b> |
| <i>YY Growth</i>                      | -3.3%          | 8.0%           | 5.4%           | 16.2%          | 10.1%          | 9.1%           | 6.9%           |
| <i>EBITDA Margin</i>                  | 35.0%          | 35.8%          | 35.7%          | 38.2%          | 39.6%          | 40.6%          | 41.3%          |
| <b>MARGIN ANALYSIS:</b>               |                |                |                |                |                |                |                |
| O&M as a % of Revenue                 | 56.1%          | 56.3%          | 55.8%          | 53.5%          | 52.4%          | 51.4%          | 50.7%          |
| EBITDA as % of Revenue                | 35.0%          | 35.8%          | 35.7%          | 38.2%          | 39.6%          | 40.6%          | 41.3%          |
| EBIT as % of Revenue                  | 22.7%          | 23.7%          | 24.1%          | 26.8%          | 27.8%          | 28.5%          | 28.8%          |
| Pretax as % of Revenue                | 5.4%           | 11.5%          | 12.8%          | 16.1%          | 17.1%          | 17.8%          | 18.0%          |
| Net Income - Cont Ops as % of Revenue | 2.9%           | 7.2%           | 7.5%           | 9.8%           | 10.3%          | 10.7%          | 10.8%          |
| Net Income - Reported as % of Revenue | -7.8%          | -15.5%         | -24.1%         | -7.6%          | 10.3%          | 10.7%          | 10.8%          |
| <b>YOY GROWTH</b>                     |                |                |                |                |                |                |                |
| Revenue                               | -2.0%          | 5.8%           | 5.5%           | 8.6%           | 6.2%           | 6.2%           | 5.3%           |
| EBIT                                  | -4.6%          | 10.6%          | 7.4%           | 21.0%          | 9.9%           | 9.1%           | 6.4%           |
| EBITDA                                | -3.3%          | 8.0%           | 5.4%           | 16.2%          | 10.1%          | 9.1%           | 6.9%           |
| D&A                                   | -0.8%          | 3.1%           | 1.5%           | 6.2%           | 10.5%          | 9.0%           | 8.2%           |
| Pretax Income                         | -30.1%         | 125.1%         | 18.0%          | 36.7%          | 12.7%          | 10.4%          | 6.7%           |
| Net Income - Cont Ops                 | -40.1%         | 158.4%         | 10.5%          | 41.4%          | 11.2%          | 10.4%          | 6.7%           |
| EPS                                   | -40.1%         | 158.4%         | 10.6%          | 32.9%          | 3.7%           | 6.9%           | 3.4%           |

Source: Company filings, Goldman Sachs Research estimates.

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**Exhibit 6: American Water balance sheet and cash flow statements, 2006-2012E**

\$ millions

| <b>BALANCE SHEET</b>                  | <b>2006A</b>     | <b>2007A</b>     | <b>2008A</b>     | <b>2009E</b>     | <b>2010E</b>     | <b>2011E</b>     | <b>2012E</b>     |
|---------------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Cash and cash equivalents             | 29.8             | 13.5             | 9.5              | 8.5              | 8.5              | 8.5              | 8.5              |
| Restricted funds                      | 2.1              | 3.3              | 0.5              | 1.4              | 1.4              | 1.4              | 1.4              |
| Utility customers accounts receivable | 130.5            | 126.7            | 130.6            | 143.9            | 153.4            | 164.8            | 173.5            |
| Unbilled utility revenues             | 123.2            | 134.3            | 134.2            | 147.6            | 157.3            | 169.0            | 178.0            |
| Materials and supplies                | 23.0             | 27.5             | 28.9             | 33.7             | 31.1             | 32.2             | 33.5             |
| Other receivables, net                | 54.5             | 89.7             | 68.9             | 75.4             | 80.3             | 86.3             | 90.9             |
| Other current assets                  | 36.6             | 35.5             | 45.1             | 56.6             | 56.6             | 56.6             | 56.6             |
| Assets of Disc. Ops.                  | 12.8             | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| <b>Total Current Assets</b>           | <b>412.4</b>     | <b>430.4</b>     | <b>417.7</b>     | <b>467.2</b>     | <b>488.6</b>     | <b>518.9</b>     | <b>542.4</b>     |
| Net Property Plant & Equipment        | 8,720.6          | 9,318.0          | 10,123.9         | 10,737.0         | 11,323.9         | 11,832.3         | 12,312.2         |
| Goodwill & Other Intangibles          | 2,962.5          | 2,457.0          | 1,699.5          | 1,249.8          | 1,249.8          | 1,249.8          | 1,249.8          |
| Investments                           | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| Other Assets                          | 687.6            | 728.8            | 990.7            | 1,014.5          | 1,034.5          | 1,054.5          | 1,074.5          |
| <b>Total Assets</b>                   | <b>12,783.1</b>  | <b>12,934.1</b>  | <b>13,231.8</b>  | <b>13,468.5</b>  | <b>14,096.8</b>  | <b>14,655.5</b>  | <b>15,179.0</b>  |
| Short-term Debt                       | 1,007.1          | 317.0            | 654.8            | 707.6            | 707.6            | 707.6            | 707.6            |
| Accounts payable                      | 140.7            | 168.9            | 149.8            | 150.0            | 163.1            | 169.3            | 176.1            |
| Accrued liabilities                   | 62.9             | 106.9            | 106.1            | 161.5            | 161.5            | 161.5            | 161.5            |
| Other current liabilities             | 150.5            | 181.8            | 194.0            | 185.0            | 185.0            | 185.0            | 185.0            |
| Liabilities of Disc. Ops.             | 2.5              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| <b>Total Current Liabilities</b>      | <b>1,363.7</b>   | <b>774.5</b>     | <b>1,104.8</b>   | <b>1,204.1</b>   | <b>1,217.2</b>   | <b>1,223.4</b>   | <b>1,230.2</b>   |
| Long-term debt                        | 4,870.9          | 4,699.1          | 4,648.2          | 4,783.2          | 5,054.7          | 5,272.4          | 5,436.0          |
| Taxes payable, Def. Taxes & Revs.     | 2,726.6          | 2,913.8          | 3,372.3          | 3,406.6          | 3,431.6          | 3,456.6          | 3,481.6          |
| <b>Total Liabilities</b>              | <b>8,961.1</b>   | <b>8,387.5</b>   | <b>9,125.3</b>   | <b>9,393.9</b>   | <b>9,703.5</b>   | <b>9,952.4</b>   | <b>10,147.9</b>  |
| Preferred Equity                      | 4.6              | 4.6              | 4.6              | 4.6              | 4.6              | 4.6              | 4.6              |
| Shareholder's Equity                  | 3,817.4          | 4,542.0          | 4,102.0          | 4,070.0          | 4,388.8          | 4,698.6          | 5,026.6          |
| <b>Total Liabilities &amp; Equity</b> | <b>12,783.1</b>  | <b>12,934.1</b>  | <b>13,231.8</b>  | <b>13,468.5</b>  | <b>14,096.8</b>  | <b>14,655.5</b>  | <b>15,179.0</b>  |
| <b>CASH FLOW STATEMENT</b>            | <b>2006A</b>     | <b>2007A</b>     | <b>2008A</b>     | <b>2009E</b>     | <b>2010E</b>     | <b>2011E</b>     | <b>2012E</b>     |
| <b>Sources:</b>                       |                  |                  |                  |                  |                  |                  |                  |
| EBITDA                                | 733.4            | 791.8            | 834.4            | 969.4            | 1,067.1          | 1,164.0          | 1,244.5          |
| Interest Income                       | 0.4              | 1.9              | 0.1              | 0.1              | 0.1              | 0.1              | 0.1              |
| <b>Total Sources</b>                  | <b>733.7</b>     | <b>793.7</b>     | <b>834.5</b>     | <b>969.5</b>     | <b>1,067.2</b>   | <b>1,164.1</b>   | <b>1,244.6</b>   |
| <b>Uses:</b>                          |                  |                  |                  |                  |                  |                  |                  |
| Interest Expense Paid                 | (371.4)          | (289.9)          | (291.2)          | (298.0)          | (313.9)          | (334.2)          | (352.1)          |
| Book Taxes                            | (51.1)           | (94.5)           | (123.4)          | (160.5)          | (184.5)          | (203.7)          | (217.4)          |
| Other Non-Operating Expenses          | 109.1            | 47.7             | 126.7            | 56.5             | 6.0              | 6.0              | 6.0              |
| Change in Current Accounts (ex taxes) | (96.6)           | 16.8             | 5.5              | (13.7)           | (8.3)            | (24.1)           | (16.8)           |
| Capital Expenditures                  | (682.9)          | (750.8)          | (1,008.8)        | (820.0)          | (875.0)          | (825.0)          | (825.0)          |
| % of total revenues                   | 32.6%            | 33.9%            | 43.2%            | 32.3%            | 32.4%            | 28.8%            | 27.4%            |
| <b>Total Uses</b>                     | <b>(1,092.9)</b> | <b>(1,070.8)</b> | <b>(1,291.1)</b> | <b>(1,235.7)</b> | <b>(1,375.6)</b> | <b>(1,381.0)</b> | <b>(1,405.2)</b> |
| <b>Free Cash Flow</b>                 | <b>(359.1)</b>   | <b>(277.1)</b>   | <b>(456.6)</b>   | <b>(266.1)</b>   | <b>(308.4)</b>   | <b>(216.9)</b>   | <b>(160.6)</b>   |
| <i>y/y growth</i>                     | <i>nm</i>        | <i>-22.8%</i>    | <i>64.8%</i>     | <i>-41.7%</i>    | <i>15.9%</i>     | <i>-29.7%</i>    | <i>-26.0%</i>    |
| Net Investments                       | (26.2)           | 10.4             | (12.3)           | (6.1)            | 0.0              | 0.0              | 0.0              |
| Acquisitions                          | (12.5)           | (15.9)           | (12.5)           | (95.0)           | (30.0)           | (30.0)           | (30.0)           |
| Dividends                             | 0.0              | 0.0              | (64.1)           | (141.3)          | (158.0)          | (171.8)          | (187.9)          |
| Discontinued Operations               | 30.2             | 9.7              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| Translation Adjustments               | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| <b>Cash Flow before Financing</b>     | <b>(367.7)</b>   | <b>(272.9)</b>   | <b>(545.6)</b>   | <b>(508.5)</b>   | <b>(496.4)</b>   | <b>(418.8)</b>   | <b>(378.5)</b>   |
| Contributions in aid of construction  | 47.4             | 35.8             | 3.1              | 20.0             | 25.0             | 25.0             | 25.0             |
| Net new Debt                          | 285.5            | 1,004.0          | 292.9            | 187.0            | 271.4            | 217.7            | 163.6            |
| Net New Equity                        | (0.5)            | (783.3)          | 245.6            | 300.5            | 200.0            | 176.0            | 189.9            |
| <b>Net Change in Cash</b>             | <b>(35.3)</b>    | <b>(16.3)</b>    | <b>(3.9)</b>     | <b>(1.0)</b>     | <b>(0.0)</b>     | <b>0.0</b>       | <b>0.0</b>       |
| Beginning Cash                        | 65.1             | 29.8             | 13.5             | 9.5              | 8.5              | 8.5              | 8.5              |
| Ending Cash                           | 29.8             | 13.5             | 9.5              | 8.5              | 8.5              | 8.5              | 8.5              |

Source: Company filings, Goldman Sachs Research estimates.

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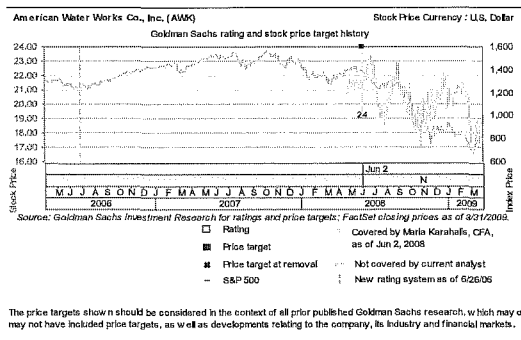
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May 11, 2009

American Water Works Co., Inc. (AWK)

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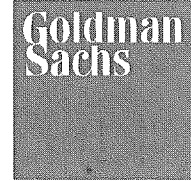
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August 9, 2009



COMPANY UPDATE

**American Water Works Co., Inc. (AWK)**

Neutral

**2Q09 earnings in line; weather hurts volumes**

**What's changed**

American Water reported 2Q EPS of \$0.32, in line with our forecast, although both revenue and O&M expenses were below our expectations. Poor weather in the Northeast was the principal driver of the volume shortfall. In addition, commercial and industrial volumes remained under pressure due to weaker economic activity and several customer bankruptcies. Lower contracted services, transportation, and maintenance expenses explain the improvement on the O&M line.

**Implications**

We are reducing our 2009 EPS estimate to \$1.25 from \$1.34 due to our lower volume forecast for the second half of the year (weaker 3Q09 volume due to poor weather in July and pushing revenue from the Trenton acquisition to 2010 from 4Q09, given recent transaction delays). As the second quarter volume decline was principally weather driven, we do not believe that this has negative implications for volume in 2010 or 2011. We maintain our 2010 and 2011 EPS estimates of \$1.44 and \$1.56, respectively.

**Valuation**

We maintain our Neutral rating. We are rolling forward our valuation year to 2011 from 2010, and our 12-month price target increases to \$21.50 from \$20.00. Our price target is based on a combination of relative valuation metrics (both P/E and EV/EBITDA), as well as a dividend discount model (5% dividend growth and 9% cost of equity).

**Key risks**

Key risks include (1) regulatory decisions and regulatory lag that limit ROE expansion and (2) financing risk associated with funding the large capital investment program.

Upside to our price target could come from (1) faster-than-expected recovery through rates, (2) lower O&M expenses, and (3) stronger free cash flow generation that reduces the need for new equity.

**INVESTMENT LIST MEMBERSHIP**

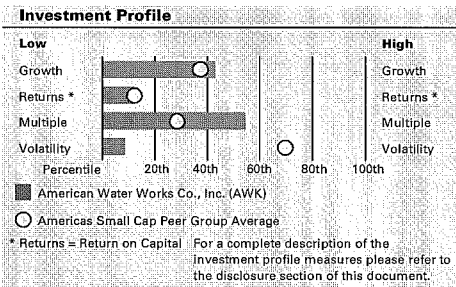
Neutral

**Coverage View: Neutral**

United States:  
Water

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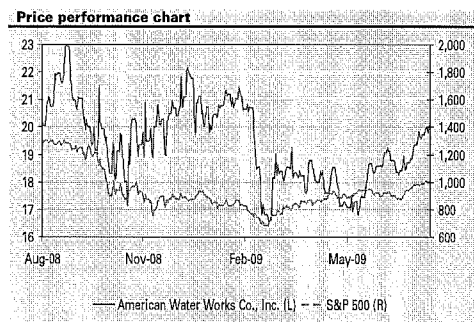
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| Key data                   | Current |
|----------------------------|---------|
| Price (\$)                 | 20.13   |
| 12 month price target (\$) | 21.50   |
| Market cap (\$ mn)         | 3,287.2 |

|                     | 12/08   | 12/09E  | 12/10E  | 12/11E  |
|---------------------|---------|---------|---------|---------|
| Revenue (\$ mn) New | 2,336.9 | 2,476.4 | 2,681.3 | 2,846.5 |
| Revenue (\$ mn) Old | 2,336.9 | 2,532.8 | 2,691.2 | 2,858.3 |
| EPS (\$ New)        | 1.10    | 1.25    | 1.44    | 1.56    |
| EPS (\$ Old)        | 1.10    | 1.34    | 1.44    | 1.56    |
| P/E (X)             | 18.3    | 16.0    | 14.0    | 12.9    |
| EV/EBITDA (X)       | 10.3    | 9.7     | 8.9     | 8.4     |
| ROE (%)             | 4.1     | 5.1     | 6.3     | 6.6     |

|          | 6/09 | 9/09E | 12/09E | 3/10E |
|----------|------|-------|--------|-------|
| EPS (\$) | 0.32 | 0.52  | 0.24   | 0.22  |



| Share price performance (%) | 3 month | 6 month | 12 month |
|-----------------------------|---------|---------|----------|
| Absolute                    | 9.8     | (4.3)   | (0.1)    |
| Rel. to S&P 500             | (1.4)   | (17.7)  | 25.2     |

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 8/07/2009 close.

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August 9, 2009

American Water Works Co., Inc. (AWK)

**American Water Works Co., Inc.: Summary financials**

| <b>Profit model (\$ mn)</b>               | <b>12/08</b>     | <b>12/09E</b>  | <b>12/10E</b>  | <b>12/11E</b>  | <b>Balance sheet (\$ mn)</b>          | <b>12/08</b>    | <b>12/09E</b>   | <b>12/10E</b>   | <b>12/11E</b>   |
|---|------------------|----------------|----------------|----------------|---------------------------------------|-----------------|-----------------|-----------------|-----------------|
| Total revenue                             | 2,336.9          | 2,476.4        | 2,681.3        | 2,846.5        | Cash & equivalents                    | 9.5             | 9.0             | 9.0             | 9.0             |
| Cost of goods sold                        | (1,575.1)        | (1,645.5)      | (1,719.0)      | (1,796.1)      | Accounts receivable                   | 199.4           | 215.0           | 233.7           | 249.6           |
| SG&A                                      | (199.1)          | (209.3)        | (214.5)        | (227.7)        | Inventory                             | 28.9            | 34.1            | 31.3            | 31.8            |
| R&D                                       | 0.0              | 0.0            | 0.0            | 0.0            | Other current assets                  | 179.8           | 236.1           | 248.7           | 259.3           |
| Other operating profit/(expense)          | 0.4              | 0.2            | 0.0            | 0.0            | <b>Total current assets</b>           | <b>417.7</b>    | <b>494.2</b>    | <b>522.7</b>    | <b>549.6</b>    |
| ESO expense                               | 0.0              | 0.0            | 0.0            | 0.0            | Net PP&E                              | 10,123.9        | 10,658.9        | 11,325.7        | 11,833.9        |
| <b>EBITDA</b>                             | <b>834.4</b>     | <b>915.5</b>   | <b>1,066.0</b> | <b>1,169.4</b> | Net intangibles                       | 1,699.5         | 1,250.1         | 1,250.1         | 1,250.1         |
| Depreciation & amortization               | (271.3)          | (293.7)        | (318.2)        | (346.7)        | Total investments                     | 0.0             | 0.0             | 0.0             | 0.0             |
| <b>EBIT</b>                               | <b>563.1</b>     | <b>621.7</b>   | <b>747.8</b>   | <b>822.7</b>   | Other long-term assets                | 990.7           | 1,058.6         | 1,078.6         | 1,098.6         |
| Net interest income/(expense)             | (291.1)          | (307.9)        | (336.4)        | (351.6)        | <b>Total assets</b>                   | <b>13,231.8</b> | <b>13,461.7</b> | <b>14,177.0</b> | <b>14,732.2</b> |
| Income/(loss) from associates             | 0.0              | 0.0            | 0.0            | 0.0            | Accounts payable                      | 149.8           | 151.7           | 164.1           | 166.8           |
| Others                                    | 27.4             | 25.5           | 26.0           | 26.0           | Short-term debt                       | 654.8           | 366.1           | 366.1           | 366.1           |
| <b>Pretax profits</b>                     | <b>299.4</b>     | <b>339.3</b>   | <b>437.4</b>   | <b>497.0</b>   | Other current liabilities             | 300.1           | 303.6           | 303.6           | 303.6           |
| Provision for taxes                       | (123.4)          | (132.3)        | (175.0)        | (198.8)        | <b>Total current liabilities</b>      | <b>1,104.8</b>  | <b>821.3</b>    | <b>833.8</b>    | <b>836.5</b>    |
| Minority interest                         | 0.0              | 0.0            | 0.0            | 0.0            | Long-term debt                        | 4,648.2         | 5,189.3         | 5,512.5         | 5,648.3         |
| <b>Net income pre-preferred dividends</b> | <b>176.1</b>     | <b>206.4</b>   | <b>262.5</b>   | <b>298.2</b>   | Other long-term liabilities           | 3,372.3         | 3,467.2         | 3,492.2         | 3,517.2         |
| Preferred dividends                       | 0.0              | 0.0            | 0.0            | 0.0            | <b>Total long-term liabilities</b>    | <b>8,020.5</b>  | <b>8,656.5</b>  | <b>9,004.8</b>  | <b>9,165.6</b>  |
| <b>Net income (pre-exceptionals)</b>      | <b>176.1</b>     | <b>206.4</b>   | <b>262.5</b>   | <b>298.2</b>   | <b>Total liabilities</b>              | <b>9,125.3</b>  | <b>9,477.9</b>  | <b>9,838.6</b>  | <b>10,002.0</b> |
| Post tax exceptionals                     | (738.5)          | (443.0)        | 0.0            | 0.0            | Preferred shares                      | 4.6             | 4.6             | 4.6             | 4.6             |
| <b>Net income (post-exceptionals)</b>     | <b>(562.4)</b>   | <b>(236.7)</b> | <b>262.5</b>   | <b>298.2</b>   | <b>Total common equity</b>            | <b>4,102.0</b>  | <b>3,979.3</b>  | <b>4,333.8</b>  | <b>4,725.6</b>  |
| EPS (basic, pre-exception) (\$)           | 1.10             | 1.25           | 1.44           | 1.58           | Minority interest                     | 0.0             | 0.0             | 0.0             | 0.0             |
| EPS (diluted, pre-exception) (\$)         | 1.10             | 1.25           | 1.44           | 1.56           | <b>Total liabilities &amp; equity</b> | <b>13,231.8</b> | <b>13,461.7</b> | <b>14,177.0</b> | <b>14,732.2</b> |
| EPS (basic, post-exception) (\$)          | (3.52)           | (1.44)         | 1.44           | 1.58           | <b>Additional financials</b>          | <b>12/08</b>    | <b>12/09E</b>   | <b>12/10E</b>   | <b>12/11E</b>   |
| EPS (diluted, post-exception) (\$)        | (3.52)           | (1.44)         | 1.44           | 1.56           | Net debt/equity (%)                   | 128.9           | 139.2           | 135.3           | 127.0           |
| Common dividends paid                     | (64.1)           | (137.3)        | (158.0)        | (175.9)        | Interest cover (X)                    | 1.9             | 2.0             | 2.2             | 2.3             |
| DPS (\$)                                  | 0.40             | 0.82           | 0.86           | 0.90           | Inventory days                        | 6.5             | 7.0             | 6.9             | 6.4             |
| Dividend payout ratio (%)                 | 36.4             | 65.3           | 59.6           | 57.1           | Receivable days                       | 32.5            | 30.5            | 30.5            | 31.0            |
|   |                  |                |                |                | BVPS (\$)                             | 25.64           | 22.80           | 23.72           | 24.31           |
| <b>Growth &amp; margins (%)</b>           | <b>12/08</b>     | <b>12/09E</b>  | <b>12/10E</b>  | <b>12/11E</b>  | ROA (%)                               | 1.3             | 1.5             | 1.9             | 2.1             |
| Sales growth                              | 5.5              | 6.0            | 8.3            | 6.2            | CROCI (%)                             | 4.5             | 4.3             | 4.4             | 4.6             |
| EBITDA growth                             | 5.4              | 9.7            | 16.4           | 9.7            | <b>Dupont ROE (%)</b>                 | <b>4.3</b>      | <b>5.2</b>      | <b>6.0</b>      | <b>6.3</b>      |
| EBIT growth                               | 7.4              | 10.4           | 20.3           | 10.0           | Margin (%)                            | 7.5             | 8.3             | 9.8             | 10.5            |
| Net income (pre-exception) growth         | 10.5             | 17.2           | 27.2           | 13.6           | Turnover (X)                          | 0.2             | 0.2             | 0.2             | 0.2             |
| EPS growth                                | 10.6             | 14.0           | 15.0           | 9.6            | Leverage (X)                          | 3.2             | 3.4             | 3.3             | 3.1             |
| Gross margin                              | 32.6             | 33.6           | 35.9           | 36.9           | Free cash flow per share (\$)         | (2.85)          | (1.93)          | (1.82)          | (1.19)          |
| EBITDA margin                             | 35.7             | 37.0           | 39.8           | 41.1           | Free cash flow yield (%)              | (13.8)          | (9.6)           | (9.0)           | (5.9)           |
| EBIT margin                               | 24.1             | 25.1           | 27.9           | 28.9           |                                       |                 |                 |                 |                 |
| <b>Cash flow statement (\$ mn)</b>        | <b>12/08</b>     | <b>12/09E</b>  | <b>12/10E</b>  | <b>12/11E</b>  |                                       |                 |                 |                 |                 |
| Net income                                | 176.1            | 206.4          | 262.5          | 298.2          |                                       |                 |                 |                 |                 |
| D&A add-back (incl. ESO)                  | 271.3            | 293.7          | 318.2          | 346.7          |                                       |                 |                 |                 |                 |
| Minority interest add-back                | 0.0              | 0.0            | 0.0            | 0.0            |                                       |                 |                 |                 |                 |
| Net (inc)/dec working capital             | 5.5              | (33.1)         | (16.0)         | (24.3)         |                                       |                 |                 |                 |                 |
| Other operating cash flow                 | 99.3             | 30.1           | (20.0)         | (20.0)         |                                       |                 |                 |                 |                 |
| <b>Cash flow from operations</b>          | <b>552.2</b>     | <b>497.1</b>   | <b>544.7</b>   | <b>600.6</b>   |                                       |                 |                 |                 |                 |
| Capital expenditures                      | (1,008.8)        | (815.0)        | (875.0)        | (825.0)        |                                       |                 |                 |                 |                 |
| Acquisitions                              | (12.5)           | 0.0            | (110.0)        | (30.0)         |                                       |                 |                 |                 |                 |
| Divestitures                              | 0.0              | 0.0            | 0.0            | 0.0            |                                       |                 |                 |                 |                 |
| Others                                    | (12.3)           | (6.1)          | 0.0            | 0.0            |                                       |                 |                 |                 |                 |
| <b>Cash flow from investing</b>           | <b>(1,033.7)</b> | <b>(771.9)</b> | <b>(985.0)</b> | <b>(855.0)</b> |                                       |                 |                 |                 |                 |
| Dividends paid (common & pref)            | (64.1)           | (137.3)        | (158.0)        | (175.9)        |                                       |                 |                 |                 |                 |
| Inc/(dec) in debt                         | 292.9            | 125.6          | 323.3          | 135.8          |                                       |                 |                 |                 |                 |
| Other financing cash flows                | 248.7            | 258.3          | 275.0          | 294.5          |                                       |                 |                 |                 |                 |
| <b>Cash flow from financing</b>           | <b>477.6</b>     | <b>246.6</b>   | <b>440.3</b>   | <b>254.4</b>   |                                       |                 |                 |                 |                 |
| <b>Total cash flow</b>                    | <b>(3.9)</b>     | <b>(28.3)</b>  | <b>0.0</b>     | <b>0.0</b>     |                                       |                 |                 |                 |                 |

Note: Last actual year may include reported and estimated data.  
Source: Company data, Goldman Sachs Research estimates.

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August 9, 2009

American Water Works Co., Inc. (AWK)

## Details on our model changes

Exhibit 1 summarizes the key differences between our 2Q estimates and the results reported by American Water.

**Exhibit 1: American Water 2Q2009 actuals versus expected**  
\$ in millions, except per share data

|                                    | 2Q09A   | 2Q09E   | % Chg    | 2Q08A   | % Chg      | 1Q09A   | % Chg       |
|------------------------------------|---------|---------|----------|---------|------------|---------|-------------|
| Operating Revenues                 | 612.7   | 637.4   | -3.9%    | 589.4   | 4.0%       | 550.2   | 11.4%       |
| Y/Y Growth                         | 4.0%    | 8.2%    | -419 bps | 5.5%    | -152 bps   | 8.6%    | -459 bps    |
| Operating and maintenance          | (330.6) | (360.9) | -8.4%    | (330.6) | 0.0%       | (314.4) | 5.2%        |
| Depreciation and amortization      | (73.2)  | (70.6)  | 3.8%     | (67.3)  | 8.8%       | (68.8)  | 6.4%        |
| General taxes                      | (51.7)  | (51.0)  | 1.4%     | (49.6)  | 4.2%       | (52.5)  | -1.5%       |
| % of revenues                      | 8.4%    | 8.0%    | +44 bps  | 8.4%    | +2 bps     | 9.5%    | -110 bps    |
| Gain (loss) on sale of assets      | (0.0)   | 0.0     |          | 0.8     | -101.3%    | 0.2     | -105.0%     |
| Operating Profit                   | 157.2   | 154.9   | 1.4%     | 142.7   | 10.2%      | 114.6   | 37.1%       |
| Operating Margin                   | 25.7%   | 24.3%   | +135 bps | 24.2%   | +145 bps   | 20.8%   | +482 bps    |
| Interest, net                      | (75.2)  | (75.3)  | 0.0%     | (71.5)  | 5.2%       | (73.5)  | 2.4%        |
| AFUDC                              | 5.6     | 5.0     | 11.3%    | 5.1     | 8.9%       | 5.2     | 6.7%        |
| Other inc/exp                      | (1.4)   | 1.5     | -193.9%  | (0.6)   | 135.2%     | 1.1     | -226.5%     |
| Pretax Income                      | 86.1    | 86.2    | -0.1%    | 75.7    | 13.8%      | 47.5    | 81.3%       |
| Provision for Income Taxes         | (34.1)  | (34.0)  | 0.3%     | (30.2)  | 13.2%      | (17.5)  | 94.5%       |
| Tax Rate                           | 39.6%   | 39.5%   | +14 bps  | 39.9%   | -23 bps    | 36.9%   | +269 bps    |
| Net Income, Continuing Ops         | 52.0    | 52.1    | -0.3%    | 45.5    | 14.3%      | 29.9    | 73.6%       |
| Preferred Dividend                 | 0.0     | 0.0     |          | 0.0     |            | 0.0     |             |
| Non-recurring/Discontinued Ops     | 0.0     | 0.0     |          | 0.0     |            | 0.0     |             |
| Extraordinary Items                | 0.0     | 0.0     |          | 0.0     |            | (443.0) | -100.0%     |
| Net Income                         | 52.0    | 52.1    | -0.3%    | 45.5    | 14.3%      | (413.1) | -112.6%     |
| Shares Outstanding - Basic         | 163.2   | 164.9   | -1.0%    | 159.9   | 2.1%       | 160.0   | 2.0%        |
| Shares Outstanding - Diluted       | 163.3   | 164.9   | -1.0%    | 160.0   | 2.1%       | 160.0   | 2.1%        |
| Shares Outstanding - Basic (EOP)   | 174.6   | 174.7   | -0.1%    | 160.0   | 9.1%       | 160.0   | 9.1%        |
| Shares Outstanding - Diluted (EOP) | 174.6   | 174.7   | -0.1%    | 160.0   | 9.1%       | 160.0   | 9.1%        |
| EPS - Continuing Ops- Basic        | 0.32    | 0.32    | 0.7%     | 0.28    | 12.0%      | 0.19    | 70.2%       |
| EPS - Continuing Ops- Diluted      | 0.32    | 0.32    | 0.7%     | 0.28    | 11.9%      | 0.19    | 70.1%       |
| Y/Y EPS Growth (diluted)           | 11.9%   | 11.2%   | +78 bps  | -9.0%   | +2,090 bps | 399.8%  | -38,786 bps |
| EPS - Net Income- Basic            | 0.32    | 0.32    | 0.7%     | 0.28    | 12.0%      | -2.58   | -112.3%     |
| EPS - Net Income- Diluted          | 0.32    | 0.32    | 0.7%     | 0.28    | 11.9%      | -2.58   | -112.3%     |
| EBITDA                             | 230.4   | 225.5   | 2.2%     | 210.0   | 9.7%       | 183.5   | 25.6%       |
| Y/Y Growth                         | 9.7%    | 7.4%    | +235 bps | -4.4%   | +1,415 bps | 27.8%   | -1,806 bps  |
| EBITDA Margin                      | 37.6%   | 35.4%   | +223 bps | 35.6%   | +198 bps   | 33.3%   | +426 bps    |
| <b>MARGIN ANALYSIS:</b>            |         |         |          |         |            |         |             |
| O&M as a % of Revenue              | 54.0%   | 56.6%   | -267 bps | 56.1%   | -214 bps   | 57.1%   | -319 bps    |
| EBITDA                             | 37.6%   | 35.4%   | +223 bps | 35.6%   | +198 bps   | 33.3%   | +426 bps    |
| EBIT                               | 25.7%   | 24.3%   | +135 bps | 24.2%   | +145 bps   | 20.8%   | +482 bps    |
| Pretax                             | 14.1%   | 13.5%   | +53 bps  | 12.8%   | +122 bps   | 8.6%    | +542 bps    |
| Net-Continuing Operations          | 8.5%    | 8.2%    | +30 bps  | 7.7%    | +76 bps    | 5.4%    | +304 bps    |
| Net Income                         | 8.5%    | 8.2%    | +30 bps  | 7.7%    | +76 bps    | -75.1%  | +8,357 bps  |
| <b>YOY GROWTH</b>                  |         |         |          |         |            |         |             |
| Revenue                            | 4.0%    | 8.2%    | -419 bps | 5.5%    | -152 bps   | 8.6%    | -459 bps    |
| EBIT                               | 10.2%   | 8.6%    | +157 bps | -5.8%   | +1,602 bps | 43.9%   | -3,374 bps  |
| EBITDA                             | 9.7%    | 7.4%    | +235 bps | -4.4%   | +1,415 bps | 27.8%   | -1,806 bps  |
| D&A                                | 8.8%    | 4.8%    | +400 bps | -1.2%   | +1,004 bps | 7.7%    | +111 bps    |
| Pretax Income                      | 13.8%   | 13.9%   | -8 bps   | -8.4%   | +2,226 bps | 254.0%  | -24,022 bps |
| Net Income                         | 14.3%   | 14.6%   | -34 bps  | -9.0%   | +2,324 bps | 399.8%  | -38,557 bps |
| EPS                                | 11.9%   | 11.2%   | +78 bps  | -9.0%   | +2,090 bps | 399.8%  | -38,786 bps |

Source: Company data, Goldman Sachs Research estimates.

Exhibits 2 and 3 summarize our expected full year forecasts for the company's income statement, balance sheet and cash flows.

August 9, 2009

American Water Works Co., Inc. (AWK)

**Exhibit 2: American Water annual income statement, 2006-2012E**

\$ in millions, except per share data

| INCOME STATEMENT                      | 2006A          | 2007A          | 2008A          | 2009E          | 2010E          | 2011E          | 2012E          |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Operating Revenues                    | 2,093.1        | 2,214.2        | 2,336.9        | 2,476.4        | 2,681.3        | 2,846.5        | 2,996.0        |
| <i>Y/Y Growth</i>                     | -2.0%          | 5.8%           | 5.5%           | 6.0%           | 8.3%           | 6.2%           | 5.3%           |
| Operation and maintenance             | (1,174.5)      | (1,246.5)      | (1,303.8)      | (1,351.8)      | (1,400.8)      | (1,449.4)      | (1,499.5)      |
| Depreciation and amortization         | (259.2)        | (267.3)        | (271.3)        | (293.7)        | (318.2)        | (346.7)        | (375.2)        |
| General taxes                         | (185.1)        | (183.3)        | (199.1)        | (209.3)        | (214.5)        | (227.7)        | (239.7)        |
| % of revenues                         | 8.8%           | 8.3%           | 8.5%           | 8.5%           | 8.0%           | 8.0%           | 8.0%           |
| Gain (loss) on sale of assets         | (0.1)          | 7.3            | 0.4            | 0.2            | 0.0            | 0.0            | 0.0            |
| Operating Profit                      | 474.2          | 524.5          | 563.1          | 621.7          | 747.8          | 822.7          | 881.6          |
| <i>Operating Margin</i>               | 22.7%          | 23.7%          | 24.1%          | 25.1%          | 27.9%          | 28.9%          | 29.4%          |
| Interest, net                         | (371.0)        | (288.0)        | (291.1)        | (307.9)        | (336.4)        | (351.6)        | (364.0)        |
| AFUDC                                 | 8.6            | 11.2           | 22.7           | 20.8           | 20.0           | 20.0           | 20.0           |
| Other incl/exp                        | 0.9            | 6.2            | 4.7            | 4.7            | 6.0            | 6.0            | 6.0            |
| Pretax Income                         | 112.7          | 253.8          | 299.4          | 339.3          | 437.4          | 497.0          | 543.6          |
| Provision for Income Taxes            | (51.1)         | (94.5)         | (123.4)        | (132.9)        | (175.0)        | (198.8)        | (217.4)        |
| <i>Tax Rate</i>                       | 45.3%          | 37.2%          | 41.2%          | 39.2%          | 40.0%          | 40.0%          | 40.0%          |
| Net Income, Continuing Ops            | 61.7           | 159.3          | 176.1          | 206.4          | 262.5          | 298.2          | 326.1          |
| Preferred Dividend                    | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            |
| Non-recurring/Discontinued Ops        | (6.4)          | (0.6)          | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            |
| Extraordinary Items                   | (217.5)        | (501.5)        | (738.5)        | (443.0)        | 0.0            | 0.0            | 0.0            |
| <b>Net Income - Reported</b>          | <b>(162.2)</b> | <b>(342.8)</b> | <b>(562.4)</b> | <b>(236.7)</b> | <b>262.5</b>   | <b>298.2</b>   | <b>326.1</b>   |
| Shares Outstanding - Basic (Avg)      | 160.0          | 160.0          | 160.0          | 164.5          | 181.9          | 188.5          | 198.3          |
| Shares Outstanding - Diluted (Avg)    | 160.0          | 160.0          | 160.0          | 164.5          | 182.1          | 191.0          | 199.0          |
| Shares Outstanding - Basic (EOP)      | 160.0          | 160.0          | 160.0          | 174.5          | 182.7          | 194.4          | 202.1          |
| Shares Outstanding - Diluted (EOP)    | 160.0          | 160.0          | 160.0          | 174.6          | 186.9          | 195.0          | 203.0          |
| EPS - Continuing Ops - Basic          | 0.39           | 1.00           | 1.10           | 1.25           | 1.44           | 1.58           | 1.65           |
| <b>EPS - Continuing Ops - Diluted</b> | <b>0.39</b>    | <b>1.00</b>    | <b>1.10</b>    | <b>1.25</b>    | <b>1.44</b>    | <b>1.56</b>    | <b>1.64</b>    |
| <i>Y/Y EPS Growth (diluted)</i>       | -40.1%         | 158.4%         | 10.6%          | 14.0%          | 14.9%          | 8.4%           | 4.9%           |
| EPS - Net Income - Reported - Basic   | -1.01          | -2.14          | -3.52          | -1.44          | 1.44           | 1.58           | 1.65           |
| EPS - Net Income - Reported - Diluted | -1.01          | -2.14          | -3.52          | -1.44          | 1.44           | 1.56           | 1.64           |
| <b>EBITDA</b>                         | <b>733.4</b>   | <b>791.8</b>   | <b>834.4</b>   | <b>915.5</b>   | <b>1,066.0</b> | <b>1,169.4</b> | <b>1,256.8</b> |
| <i>Y/Y Growth</i>                     | -3.3%          | 8.0%           | 5.4%           | 9.7%           | 16.4%          | 9.7%           | 7.5%           |
| <i>EBITDA Margin</i>                  | 35.0%          | 35.8%          | 35.7%          | 37.0%          | 39.8%          | 41.1%          | 41.9%          |
| <b>MARGIN ANALYSIS:</b>               |                |                |                |                |                |                |                |
| O&M as a % of Revenue                 | 56.1%          | 56.3%          | 55.8%          | 54.6%          | 52.2%          | 50.9%          | 50.1%          |
| EBITDA as % of Revenue                | 35.0%          | 35.8%          | 35.7%          | 37.0%          | 39.8%          | 41.1%          | 41.9%          |
| EBIT as % of Revenue                  | 22.7%          | 23.7%          | 24.1%          | 25.1%          | 27.9%          | 28.9%          | 29.4%          |
| Pretax as % of Revenue                | 5.4%           | 11.5%          | 12.8%          | 13.7%          | 16.3%          | 17.5%          | 18.1%          |
| Net Income - Cont Ops as % of Revenue | 2.9%           | 7.2%           | 7.5%           | 8.3%           | 9.8%           | 10.5%          | 10.9%          |
| Net Income - Reported as % of Revenue | -7.8%          | -15.5%         | -24.1%         | -9.6%          | 9.8%           | 10.5%          | 10.9%          |
| <b>YOY GROWTH</b>                     |                |                |                |                |                |                |                |
| Revenue                               | -2.0%          | 5.8%           | 5.5%           | 6.0%           | 8.3%           | 6.2%           | 5.3%           |
| EBIT                                  | -4.6%          | 10.6%          | 7.4%           | 10.4%          | 20.3%          | 10.0%          | 7.2%           |
| EBITDA                                | -3.3%          | 8.0%           | 5.4%           | 9.7%           | 16.4%          | 9.7%           | 7.5%           |
| D&A                                   | -0.8%          | 3.1%           | 1.5%           | 8.3%           | 8.3%           | 9.0%           | 8.2%           |
| Pretax Income                         | -30.1%         | 125.1%         | 18.0%          | 13.3%          | 28.9%          | 13.6%          | 9.4%           |
| Net Income - Cont Ops                 | -40.1%         | 158.4%         | 10.5%          | 17.2%          | 27.2%          | 13.6%          | 9.4%           |
| EPS                                   | -40.1%         | 158.4%         | 10.6%          | 14.0%          | 14.9%          | 8.4%           | 4.9%           |

Source: Company data, Goldman Sachs Research estimates.

August 9, 2009

American Water Works Co., Inc. (AWK)

**Exhibit 3: American Water annual balance sheet and cash flow statement, 2006-2012E**  
\$ in millions, except per share data

| <b>BALANCE SHEET</b>                   | <b>2006A</b>     | <b>2007A</b>     | <b>2008A</b>     | <b>2009E</b>     | <b>2010E</b>     | <b>2011E</b>     | <b>2012E</b>     |
|--|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Cash and cash equivalents              | 29.8             | 13.5             | 9.5              | 9.0              | 9.0              | 9.0              | 9.0              |
| Restricted funds                       | 2.1              | 3.3              | 0.5              | 33.0             | 33.0             | 33.0             | 33.0             |
| Utility customers accounts receivable  | 130.5            | 126.7            | 130.6            | 141.1            | 153.4            | 163.8            | 172.4            |
| Unbilled utility revenues              | 123.2            | 134.3            | 134.2            | 144.7            | 157.3            | 167.9            | 176.8            |
| Materials and supplies                 | 23.0             | 27.5             | 28.9             | 34.1             | 31.3             | 31.8             | 32.9             |
| Other receivables, net                 | 54.5             | 89.7             | 68.9             | 73.9             | 80.3             | 85.8             | 90.3             |
| Other current assets                   | 36.6             | 35.5             | 45.1             | 58.3             | 58.3             | 58.3             | 58.3             |
| Assets of Disc. Ops.                   | 12.8             | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| <b>Total Current Assets</b>            | <b>412.4</b>     | <b>430.4</b>     | <b>417.7</b>     | <b>494.2</b>     | <b>522.7</b>     | <b>549.6</b>     | <b>572.7</b>     |
| <i>Utility plant, net</i>              | <i>8,605.3</i>   | <i>9,199.9</i>   | <i>9,991.8</i>   | <i>10,518.6</i>  | <i>11,185.4</i>  | <i>11,693.7</i>  | <i>12,173.5</i>  |
| <i>Nonutility property, net</i>        | <i>115.2</i>     | <i>118.1</i>     | <i>132.1</i>     | <i>140.3</i>     | <i>140.3</i>     | <i>140.3</i>     | <i>140.3</i>     |
| Net Property Plant & Equipment         | 8,720.6          | 9,318.0          | 10,123.9         | 10,658.9         | 11,325.7         | 11,833.9         | 12,313.7         |
| Regulatory Assets                      | 587.2            | 661.0            | 919.7            | 945.6            | 945.6            | 945.6            | 945.6            |
| Restricted Funds                       | 17.2             | 10.3             | 10.6             | 46.4             | 46.4             | 46.4             | 46.4             |
| Goodwill & Other Intangibles           | 2,962.5          | 2,457.0          | 1,699.5          | 1,250.1          | 1,250.1          | 1,250.1          | 1,250.1          |
| Investments                            | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| Other Assets                           | 83.2             | 74.8             | 60.4             | 66.6             | 86.6             | 106.6            | 126.6            |
| <b>Total Assets</b>                    | <b>12,783.1</b>  | <b>12,951.3</b>  | <b>13,231.8</b>  | <b>13,461.7</b>  | <b>14,177.0</b>  | <b>14,732.2</b>  | <b>15,255.0</b>  |
| Short-term Debt                        | 1,007.1          | 317.0            | 654.8            | 366.1            | 366.1            | 366.1            | 366.1            |
| Accounts payable                       | 140.7            | 168.9            | 149.8            | 151.7            | 164.1            | 166.8            | 172.5            |
| Accrued liabilities                    | 62.9             | 106.9            | 106.1            | 116.5            | 116.5            | 116.5            | 116.5            |
| Other current liabilities              | 150.5            | 181.8            | 194.0            | 187.0            | 187.0            | 187.0            | 187.0            |
| Liabilities of Disc. Ops               | 2.5              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| <b>Total Current Liabilities</b>       | <b>1,363.7</b>   | <b>774.5</b>     | <b>1,104.8</b>   | <b>821.3</b>     | <b>833.8</b>     | <b>836.5</b>     | <b>842.2</b>     |
| Long-term debt                         | 4,870.9          | 4,699.1          | 4,648.2          | 5,189.3          | 5,512.5          | 5,648.3          | 5,811.6          |
| Advances for construction              | 615.7            | 655.4            | 622.2            | 620.0            | 620.0            | 620.0            | 620.0            |
| Deferred income taxes                  | 583.4            | 638.9            | 705.6            | 758.0            | 758.0            | 758.0            | 758.0            |
| Deferred investment tax credits        | 36.5             | 35.4             | 34.0             | 33.2             | 33.2             | 33.2             | 33.2             |
| Regulatory liability-cost of removal   | 166.9            | 266.7            | 307.3            | 318.6            | 318.6            | 318.6            | 318.6            |
| Accrued pension expense                | 314.6            | 290.7            | 502.1            | 500.3            | 500.3            | 500.3            | 500.3            |
| Accrued postretirement benefit expense | 144.9            | 158.5            | 241.2            | 237.3            | 237.3            | 237.3            | 237.3            |
| Other long term liabilities            | 110.4            | 67.1             | 48.5             | 48.4             | 48.4             | 48.4             | 48.4             |
| Contributions in Aid of Construction   | 754.2            | 818.4            | 911.4            | 951.4            | 976.4            | 1,001.4          | 1,026.4          |
| <b>Total Liabilities</b>               | <b>8,961.1</b>   | <b>8,404.7</b>   | <b>9,125.3</b>   | <b>9,477.9</b>   | <b>9,838.6</b>   | <b>10,002.0</b>  | <b>10,196.0</b>  |
| Preferred Equity                       | 4.6              | 4.6              | 4.6              | 4.6              | 4.6              | 4.6              | 4.6              |
| Shareholder's Equity                   | 3,817.4          | 4,542.0          | 4,102.0          | 3,979.3          | 4,333.8          | 4,725.6          | 5,054.5          |
| <b>Total Liabilities &amp; Equity</b>  | <b>12,783.1</b>  | <b>12,951.3</b>  | <b>13,231.8</b>  | <b>13,461.7</b>  | <b>14,177.0</b>  | <b>14,732.2</b>  | <b>15,255.0</b>  |
| <b>CASH FLOW STATEMENT</b>             | <b>2006A</b>     | <b>2007A</b>     | <b>2008A</b>     | <b>2009E</b>     | <b>2010E</b>     | <b>2011E</b>     | <b>2012E</b>     |
| <b>Sources:</b>                        |                  |                  |                  |                  |                  |                  |                  |
| EBITDA                                 | 733.4            | 791.8            | 834.4            | 915.5            | 1,066.0          | 1,169.4          | 1,256.8          |
| Interest Income                        | 0.4              | 1.9              | 0.1              | 0.1              | 0.1              | 0.1              | 0.1              |
| <b>Total Sources</b>                   | <b>733.7</b>     | <b>793.7</b>     | <b>834.5</b>     | <b>915.6</b>     | <b>1,066.2</b>   | <b>1,169.5</b>   | <b>1,257.0</b>   |
| <b>Uses:</b>                           |                  |                  |                  |                  |                  |                  |                  |
| Interest Expense Paid                  | (371.4)          | (289.9)          | (291.2)          | (308.1)          | (336.5)          | (351.8)          | (364.2)          |
| Book Taxes                             | (51.1)           | (94.5)           | (123.4)          | (132.9)          | (175.0)          | (198.8)          | (217.4)          |
| Other Non-Operating Expenses           | 109.1            | 47.7             | 126.7            | 83.3             | 6.0              | 6.0              | 6.0              |
| Change in Current Accounts (ex taxes)  | (96.6)           | 16.8             | 5.5              | (33.1)           | (16.0)           | (24.3)           | (17.3)           |
| Capital Expenditures                   | (682.9)          | (750.8)          | (1,008.8)        | (815.0)          | (875.0)          | (825.0)          | (825.0)          |
| <b>% of total revenues</b>             | <b>32.6%</b>     | <b>33.9%</b>     | <b>43.2%</b>     | <b>32.9%</b>     | <b>32.6%</b>     | <b>29.0%</b>     | <b>27.5%</b>     |
| <b>Total Uses</b>                      | <b>(1,092.9)</b> | <b>(1,070.8)</b> | <b>(1,291.1)</b> | <b>(1,205.8)</b> | <b>(1,396.5)</b> | <b>(1,393.9)</b> | <b>(1,417.9)</b> |
| <b>Free Cash Flow</b>                  | <b>(359.1)</b>   | <b>(277.1)</b>   | <b>(456.6)</b>   | <b>(290.2)</b>   | <b>(330.3)</b>   | <b>(224.4)</b>   | <b>(160.9)</b>   |
| <i>y/y growth</i>                      | <i>nm</i>        | <i>-22.8%</i>    | <i>64.8%</i>     | <i>-36.5%</i>    | <i>13.8%</i>     | <i>-32.1%</i>    | <i>-28.3%</i>    |
| Net Investments                        | (26.2)           | 10.4             | (12.3)           | 43.1             | 0.0              | 0.0              | 0.0              |
| Acquisitions                           | (12.5)           | (15.9)           | (12.5)           | 0.0              | (110.0)          | (30.0)           | (30.0)           |
| Dividends                              | 0.0              | 0.0              | (64.1)           | (137.3)          | (158.0)          | (175.9)          | (192.1)          |
| Discontinued Operations                | 30.2             | 9.7              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| Translation Adjustments                | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| <b>Cash Flow before Financing</b>      | <b>(367.7)</b>   | <b>(272.9)</b>   | <b>(545.6)</b>   | <b>(384.4)</b>   | <b>(598.3)</b>   | <b>(430.3)</b>   | <b>(383.0)</b>   |
| Contributions in aid of construction   | 47.4             | 35.8             | 3.1              | 15.0             | 25.0             | 25.0             | 25.0             |
| Net new Debt                           | 285.5            | 1,004.0          | 292.9            | 125.6            | 323.3            | 135.8            | 163.2            |
| Net New Equity                         | (0.5)            | (783.3)          | 245.6            | 243.3            | 250.0            | 269.5            | 194.7            |
| <b>Net Change in Cash</b>              | <b>(35.3)</b>    | <b>(16.3)</b>    | <b>(3.9)</b>     | <b>(0.5)</b>     | <b>0.0</b>       | <b>(0.0)</b>     | <b>(0.0)</b>     |
| Beginning Cash                         | 65.1             | 29.8             | 13.5             | 9.5              | 9.0              | 9.0              | 9.0              |
| Ending Cash                            | 29.8             | 13.5             | 9.5              | 9.0              | 9.0              | 9.0              | 9.0              |

Source: Company data, Goldman Sachs Research estimates.

August 9, 2009

American Water Works Co., Inc. (AWK)

## **Rate case summary**

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Exhibit 4 outlines American Water's rate case requests from 2006 to the present. We have assumed that American Water receives approximately 50% of the amount requested for each pending rate case. For cases that have already been concluded, the percentage has been higher at closer to 58%, but we believe it is prudent to assume a lower rate for the next round of rate cases, as this is the second round of meaningful increases following large increases only a year or two ago.

August 9, 2009

American Water Works Co., Inc. (AWK)

**Exhibit 4: American Water rate case requests from 2006 to present**  
\$ in millions

| State                                   | Date Filed | Amount Filed | Amount Granted | %      | ROE Filed | ROE Granted | Expected Grant Date | Status    |
|---|------------|--------------|----------------|--------|-----------|-------------|---------------------|-----------|
| <b>General Rate Cases Filed in 2006</b> |            |              |                |        |           |             |                     |           |
| Ohio                                    | 3/1/06     | \$5.1        | \$3.4          | 66.7%  | 11.0%     | 10.0%       | 3/1/07              | Completed |
| New Jersey                              | 3/31/06    | 99.0         | 56.2           | 56.8%  | 11.2%     | 10.0%       | 4/1/07              | Completed |
| New Mexico                              | 5/30/06    | 1.3          | 1.3            | 100.0% | 10.0%     | 9.7%        | 5/1/07              | Completed |
| Arizona (Anthem)                        | 6/16/06    | 7.0          | 4.3            | 61.4%  | 11.8%     | 8.8%        | 6/4/08              | Completed |
| Arizona (Sun City)                      | 7/28/06    | 3.9          | 2.4            | 61.5%  | 11.8%     | 10.6%       | 4/1/08              | Completed |
| Texas                                   | 10/16/06   | \$0.8        | \$0.7          | 87.5%  | 12.0%     | 12.0%       | 1/1/07              | Completed |
| Tennessee                               | 11/22/06   | 6.4          | 4.1            | 64.1%  | 11.0%     | 9.6%        | 5/23/07             | Completed |
| Indiana                                 | 12/5/06    | 24.7         | 14.0           | 56.7%  | 11.5%     | 10.0%       | 12/1/07             | Completed |
| Missouri                                | 12/15/06   | 41.5         | 21.4           | 51.6%  | 11.3%     | 10.0%       | 11/1/07             | Completed |

|                             |                |                |              |
|-----------------------------|----------------|----------------|--------------|
| <b>Total Granted (2006)</b> | <b>\$189.7</b> | <b>\$107.8</b> | <b>56.8%</b> |
| <b>Total Pending (2006)</b> | <b>\$0.0</b>   | <b>\$0.0</b>   |              |

| State                                   | Date Filed | Amount Filed | Amount Granted | %      | ROE Filed | ROE Granted | Expected Grant Date | Status    |
|---|------------|--------------|----------------|--------|-----------|-------------|---------------------|-----------|
| <b>General Rate Cases Filed in 2007</b> |            |              |                |        |           |             |                     |           |
| California *                            | 1/1/07     | \$16.4       | \$13.0         | 100.0% | 11.5%     | 10.2%       | 6/1/08              | Completed |
| Michigan                                | 1/8/07     | 0.2          | 0.2            | 100.0% | 12.0%     | 10.0%       | 1/8/07              | Completed |
| Maryland                                | 3/29/07    | 0.6          | 0.6            | 100.0% | 11.8%     | 10.5%       | 10/1/07             | Completed |
| Pennsylvania                            | 4/27/07    | 59.2         | 36.0           | 60.8%  | 11.8%     | N/A         | 11/30/07            | Completed |
| Arizona (Sun City)                      | 4/30/07    | 2.2          | 1.9            | 86.4%  | 11.8%     | 10.8%       | 6/1/08              | Completed |
| Kentucky                                | 4/30/07    | 13.2         | 8.0            | 60.6%  | 11.4%     | 10.0%       | 12/1/07             | Completed |
| Long Island **                          | 5/1/07     | 9.6          | 6.6            | 68.8%  | 11.0%     | 9.5%        | 4/1/08              | Completed |
| West Virginia                           | 6/1/07     | 24.1         | 14.5           | 60.2%  | 11.3%     | 10.0%       | 3/28/08             | Completed |
| Iowa                                    | 8/30/07    | 6.1          | 4.3            | 70.5%  | 11.3%     | 10.4%       | 2/1/08              | Completed |
| Illinois                                | 8/31/07    | 32.8         | 21.6           | 65.9%  | 11.3%     | 10.4%       | 8/8/08              | Completed |
| Ohio                                    | 10/1/07    | 5.5          | 5.3            | 95.6%  | 11.3%     | 10.9%       | 11/13/08            | Completed |
| Hawaii ***                              | 11/1/07    | 1.3          | 0.7            | 50.0%  | 10.6%     |             | 11/1/08             | Pending   |

\* California rate increase includes step increase of \$2.0mn effective in 2009 and \$2.5mn effective in 2010  
 \*\* Long Island rate increase includes step increase of \$1.0mn in 2009 and \$1.0mn in 2010  
 \*\*\* Hawaii temporary rate increase of \$0.7mn put in place Oct. 2008 and will be subject to adjustment upon issuance of final order

|                             |                |                |              |
|-----------------------------|----------------|----------------|--------------|
| <b>Total Granted (2007)</b> | <b>\$169.9</b> | <b>\$112.0</b> | <b>65.9%</b> |
| <b>Total Pending (2007)</b> | <b>\$1.3</b>   | <b>\$0.7</b>   | <b>50.0%</b> |

| State                                   | Date Filed | Amount Filed | Amount Granted | %      | ROE Filed | ROE Granted | Expected Grant Date | Status    |
|---|------------|--------------|----------------|--------|-----------|-------------|---------------------|-----------|
| <b>General Rate Cases Filed in 2008</b> |            |              |                |        |           |             |                     |           |
| Michigan                                | 1/1/08     | \$0.2        | \$0.2          | 100.0% | 10.0%     | 10.0%       | 1/1/08              | Completed |
| New Jersey                              | 1/14/08    | 125.0        | 72.1           | 57.7%  | 11.5%     | 10.3%       | 12/7/08             | Completed |
| California (Monterey Water)             | 1/30/08    | 35.3         | 12.1           | 34.3%  | 11.5%     | 10.2%       | 5/11/09             | Completed |
| California (Monterey WW)                | 1/30/08    | 1.8          | 1.7            | 94.4%  | 11.5%     | 10.2%       | 7/9/09              | Completed |
| California (Gen. Office)                | 1/30/08    | 6.4          | 2.2            | 34.4%  | 11.5%     | 10.2%       | 5/11/09             | Completed |
| Virginia                                | 1/30/08    | 4.3          | 3.4            | 79.1%  | 11.3%     | 10.5%       | 11/1/08             | Completed |
| Texas *                                 | 2/21/08    | 0.9          | 0.4            | 50.0%  | 12.0%     |             | 6/30/08             | Pending   |
| Tennessee                               | 3/14/08    | 7.6          | 1.7            | 21.6%  | 11.8%     | 10.2%       | 10/1/08             | Completed |
| Missouri                                | 3/31/08    | 49.8         | 34.5           | 69.3%  | 11.3%     | 10.0%       | 11/28/08            | Completed |
| Pennsylvania - WW                       | 4/28/08    | 2.7          | 1.9            | 70.4%  | 11.5%     | 10.6%       | 11/14/08            | Completed |
| California (ROE)                        | 5/1/08     | 2.8          | 0.1            | 3.6%   | 11.5%     | 10.2%       | 5/6/09              | Completed |
| Arizona                                 | 5/1/08     | 20.0         | 10.0           | 50.0%  | 11.8%     |             | 9/1/09              | Pending   |
| West Virginia                           | 5/30/08    | 14.8         | 5.2            | 35.3%  | 11.8%     | 10.0%       | 3/26/09             | Completed |
| New Mexico (Clovis)                     | 6/30/08    | 2.2          | 1.4            | 61.8%  | 11.8%     | 10.3%       | 5/12/09             | Completed |
| Kentucky                                | 10/31/08   | 18.5         | 10.3           | 55.7%  | 11.5%     | 10.0%       | 6/1/09              | Completed |

\* Texas temporary rate increase of \$0.4mn put in place June 2008 and will be subject to adjustment upon issuance of final order

|                             |                |                |              |
|-----------------------------|----------------|----------------|--------------|
| <b>Total Granted (2008)</b> | <b>\$271.4</b> | <b>\$146.7</b> | <b>54.1%</b> |
| <b>Total Pending (2008)</b> | <b>\$20.9</b>  | <b>\$10.4</b>  | <b>50.0%</b> |

| State                                   | Date Filed | Amount Filed | Amount Granted | %      | ROE Filed | ROE Granted | Expected Grant Date | Status    |
|---|------------|--------------|----------------|--------|-----------|-------------|---------------------|-----------|
| <b>General Rate Cases Filed in 2009</b> |            |              |                |        |           |             |                     |           |
| California (Sac, LA, Lark)              | 1/23/09    | \$32.7       | \$16.4         | 50.0%  | 10.2%     |             | 1/1/10              | Pending   |
| Pennsylvania                            | 4/24/09    | 58.1         | 29.1           | 50.0%  | 12.0%     |             | 1/1/10              | Pending   |
| Iowa *                                  | 4/30/09    | 9.4          | 6.8            | 72.3%  | 12.2%     |             | 2/1/10              | Pending   |
| Indiana                                 | 4/30/09    | 46.9         | 23.5           | 50.0%  | 12.0%     |             | 5/1/10              | Pending   |
| Maryland                                | 4/30/09    | 0.8          | 0.4            | 50.0%  | 11.8%     |             | 1/1/10              | Pending   |
| Ohio                                    | 5/7/09     | 8.8          | 4.4            | 50.0%  | 12.2%     |             | 2/1/10              | Pending   |
| Illinois                                | 5/29/09    | 58.6         | 29.3           | 50.0%  | 12.3%     |             | 5/1/10              | Pending   |
| Michigan                                | 6/22/09    | 0.2          | 0.2            | 100.0% | 10.5%     |             | 7/1/09              | Completed |
| Arizona                                 | 7/2/09     | 20.6         | 10.3           | 50.0%  | 12.3%     |             | 7/1/10              | Pending   |

\* Iowa temporary rate increase of \$6.8mn put in place July 2009 and will be subject to adjustment upon issuance of final order

|                             |                |                |               |
|-----------------------------|----------------|----------------|---------------|
| <b>Total Granted (2009)</b> | <b>\$0.2</b>   | <b>\$0.2</b>   | <b>100.0%</b> |
| <b>Total Pending (2009)</b> | <b>\$235.9</b> | <b>\$120.0</b> | <b>50.9%</b>  |

|                                       |                |                |              |
|---------------------------------------|----------------|----------------|--------------|
| <b>Total Granted (2006 - present)</b> | <b>\$631.2</b> | <b>\$366.7</b> | <b>58.1%</b> |
| <b>Total Pending (2006 - present)</b> | <b>\$258.1</b> | <b>\$131.1</b> | <b>50.8%</b> |

Source: Company data, various State Public Utility Commission news releases, Goldman Sachs Research estimates.

August 9, 2009

American Water Works Co., Inc. (AWK)

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|        | Rating Distribution |      |      | Investment Banking Relationships |      |      |
|--------|---------------------|------|------|----------------------------------|------|------|
|        | Buy                 | Hold | Sell | Buy                              | Hold | Sell |
| Global | 30%                 | 51%  | 19%  | 54%                              | 52%  | 44%  |

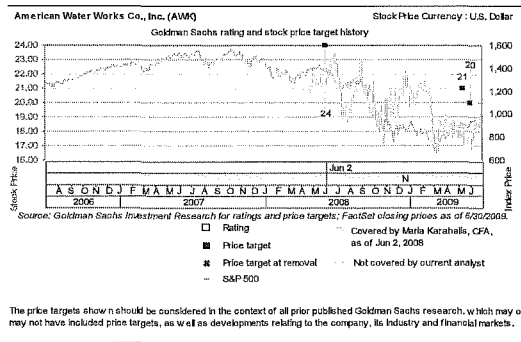
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August 9, 2009

American Water Works Co., Inc. (AWK)

### Price target and rating history chart(s)



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August 9, 2009

American Water Works Co., Inc. (AWK)

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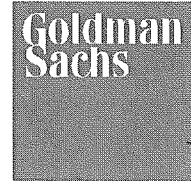
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November 11, 2009



COMPANY UPDATE

**American Water Works Co., Inc. (AWK)**

Neutral

**Narrowing the ROE gap with rate case filings**

**What's changed**

American Water reported 3Q results essentially in-line with our EPS forecast. As was the case in 2Q, lower water usage due to poor weather and weak commercial/industrial volumes was offset by O&M expenses that have been trending below expectations. American Water announced \$38 million in approved rate case requests since June 30, bringing the annual revenue awarded to \$71 million for 2009. Several large rate cases totaling \$239 million in 9 states are still pending. American Water also announced the acquisition of five small water systems serving 1,600 customers in September and October.

**Implications**

We have updated our forecast to adjust for the lower water volume, which is essentially offset by lower O&M expenses, updated rate case filings, and a slightly lower tax rate. Our 2009, 2010, and 2011 EPS estimates remain unchanged at \$1.25, \$1.44, and \$1.56, respectively.

**Valuation**

We maintain our Neutral rating. Our 12-month price target is \$21.50. Our price target is based on a combination of relative valuation metrics (both P/E and EV/EBITDA), as well as a dividend discount model (5% dividend growth and 9% cost of equity).

**Key risks**

Downside risks include (1) regulatory decisions and regulatory lag that limit ROE expansion and (2) financing risk associated with funding the large capital investment program.

Upside to our price target could come from (1) faster-than-expected recovery through rates, (2) lower O&M expenses (3) stronger free cash flow generation that reduces the need to issue new equity, and (4) elimination of the share overhang.

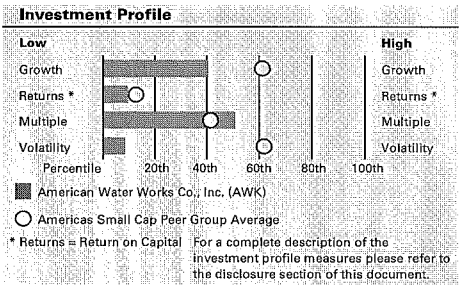
**INVESTMENT LIST MEMBERSHIP**

Neutral

**Coverage View: Neutral**

United States:  
Water

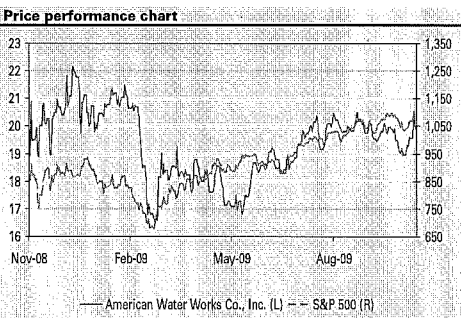
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| Key data                   | Current |
|----------------------------|---------|
| Price (\$)                 | 19.91   |
| 12 month price target (\$) | 21.50   |
| Market cap (\$ mn)         | 3,478.1 |
| Dividend yield (%)         | 4.1     |
| Net margin (%)             | 8.6     |
| Debt/total capital (%)     | 57.9    |

|                 | 12/08   | 12/09E  | 12/10E  | 12/11E  |
|-----------------|---------|---------|---------|---------|
| Revenue (\$ mn) | 2,336.9 | 2,435.9 | 2,660.9 | 2,824.9 |
| EPS (\$)        | 1.10    | 1.25    | 1.44    | 1.56    |
| P/E (X)         | 18.1    | 15.9    | 13.9    | 12.8    |
| EV/EBITDA (X)   | 10.3    | 9.6     | 8.8     | 8.3     |
| ROE (%)         | 4.1     | 5.2     | 6.3     | 6.5     |

|          | 9/09 | 12/09E | 3/10E | 6/10E |
|----------|------|--------|-------|-------|
| EPS (\$) | 0.52 | 0.21   | 0.23  | 0.36  |



| Share price performance (%) | 3 month | 6 month | 12 month |
|-----------------------------|---------|---------|----------|
| Absolute                    | (1.5)   | 7.7     | 0.6      |
| Rel. to S&P 500             | (10.9)  | (10.9)  | (17.7)   |

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 11/11/2009 close.

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November 11, 2009

American Water Works Co., Inc. (AWK)

## American Water Works Co., Inc.: Summary financials

| Profit model (\$ mn)                      | 12/08            | 12/09E         | 12/10E         | 12/11E         | Balance sheet (\$ mn)  | 12/08           | 12/09E          | 12/10E          | 12/11E          |
|---|------------------|----------------|----------------|----------------|--|-----------------|-----------------|-----------------|-----------------|
| Total revenue                             | 2,336.9          | 2,435.9        | 2,660.9        | 2,824.9        | Cash & equivalents   | 9.5             | 7.8             | 7.8             | 7.8             |
| Cost of goods sold                        | (1,575.1)        | (1,606.7)      | (1,699.9)      | (1,776.4)      | Accounts receivable  | 199.4           | 208.0           | 227.7           | 247.7           |
| SG&A                                      | (199.1)          | (202.3)        | (212.9)        | (226.0)        | Inventory  | 28.9            | 32.3            | 34.3            | 31.3            |
| R&D                                       | 0.0              | 0.0            | 0.0            | 0.0            | Other current assets   | 179.8           | 247.9           | 261.1           | 274.6           |
| Other operating profit/(expense)          | 0.4              | 1.0            | 0.0            | 0.0            | <b>Total current assets</b>  | <b>417.7</b>    | <b>495.9</b>    | <b>530.9</b>    | <b>561.4</b>    |
| ESO expense                               | 0.0              | 0.0            | 0.0            | 0.0            | Net PP&E   | 10,123.9        | 10,684.4        | 11,351.0        | 11,859.0        |
| <b>EBITDA</b>                             | <b>834.4</b>     | <b>921.6</b>   | <b>1,066.7</b> | <b>1,169.5</b> | Net intangibles  | 1,699.5         | 1,250.1         | 1,250.1         | 1,250.1         |
| Depreciation & amortization               | (271.3)          | (293.7)        | (318.5)        | (347.0)        | Total investments  | 0.0             | 0.0             | 0.0             | 0.0             |
| <b>EBIT</b>                               | <b>563.1</b>     | <b>627.9</b>   | <b>748.2</b>   | <b>822.5</b>   | Other long-term assets   | 990.7           | 1,052.0         | 1,072.0         | 1,092.0         |
| Net interest income/(expense)             | (291.1)          | (305.8)        | (338.8)        | (355.0)        | <b>Total assets</b>  | <b>13,231.8</b> | <b>13,482.5</b> | <b>14,204.0</b> | <b>14,762.5</b> |
| Income/(loss) from associates             | 0.0              | 0.0            | 0.0            | 0.0            | Accounts payable   | 149.8           | 125.5           | 133.3           | 137.1           |
| Others                                    | 27.4             | 20.6           | 26.0           | 26.0           | Short-term debt  | 654.8           | 130.9           | 130.9           | 130.9           |
| <b>Pretax profits</b>                     | <b>299.4</b>     | <b>342.8</b>   | <b>435.4</b>   | <b>493.5</b>   | Other current liabilities  | 300.1           | 350.5           | 350.5           | 350.5           |
| Provision for taxes                       | (123.4)          | (132.1)        | (174.2)        | (197.4)        | <b>Total current liabilities</b>   | <b>1,104.8</b>  | <b>606.8</b>    | <b>614.7</b>    | <b>618.4</b>    |
| Minority interest                         | 0.0              | 0.0            | 0.0            | 0.0            | Long-term debt   | 4,648.2         | 5,350.3         | 5,685.6         | 5,854.0         |
| <b>Net income pre-preferred dividends</b> | <b>176.1</b>     | <b>210.6</b>   | <b>261.3</b>   | <b>296.1</b>   | Other long-term liabilities  | 3,372.3         | 3,533.2         | 3,558.2         | 3,583.2         |
| Preferred dividends                       | 0.0              | 0.0            | 0.0            | 0.0            | <b>Total long-term liabilities</b>   | <b>8,020.5</b>  | <b>8,883.5</b>  | <b>9,243.7</b>  | <b>9,437.1</b>  |
| <b>Net income (pre-exceptionals)</b>      | <b>176.1</b>     | <b>210.6</b>   | <b>261.3</b>   | <b>296.1</b>   | <b>Total liabilities</b>   | <b>9,125.3</b>  | <b>9,490.3</b>  | <b>9,858.4</b>  | <b>10,055.6</b> |
| Post tax exceptionals                     | (738.5)          | (443.0)        | 0.0            | 0.0            | Preferred shares   | 4.6             | 4.6             | 4.6             | 4.6             |
| <b>Net income (post-exceptionals)</b>     | <b>(562.4)</b>   | <b>(232.4)</b> | <b>261.3</b>   | <b>296.1</b>   | <b>Total common equity</b>   | <b>4,102.0</b>  | <b>3,987.6</b>  | <b>4,341.0</b>  | <b>4,702.4</b>  |
| EPS (basic, pre-exception) (\$)           | 1.10             | 1.25           | 1.44           | 1.58           | Minority interest  | 0.0             | 0.0             | 0.0             | 0.0             |
| EPS (diluted, pre-exception) (\$)         | 1.10             | 1.25           | 1.44           | 1.56           | <b>Total liabilities &amp; equity</b>  | <b>13,231.8</b> | <b>13,482.5</b> | <b>14,204.0</b> | <b>14,762.5</b> |
| EPS (basic, post-exception) (\$)          | (3.52)           | (1.38)         | 1.44           | 1.58           | <b>Additional financials</b>   |                 |                 |                 |                 |
| EPS (diluted, post-exception) (\$)        | (3.52)           | (1.38)         | 1.44           | 1.56           | Net debt/equity (%)  | 128.9           | 137.1           | 133.7           | 127.0           |
| Common dividends paid                     | (64.1)           | (137.3)        | (157.9)        | (174.4)        | Interest cover (X)   | 1.9             | 2.1             | 2.2             | 2.3             |
| DPS (\$)                                  | 0.40             | 0.82           | 0.86           | 0.90           | Inventory days   | 6.5             | 7.0             | 7.1             | 6.7             |
| Dividend payout ratio (%)                 | 36.4             | 65.4           | 59.9           | 57.2           | Receivable days  | 32.5            | 30.5            | 29.9            | 30.7            |
| <b>Growth &amp; margins (%)</b>           |                  |                |                |                | BVPS (\$)  | 25.64           | 22.84           | 23.78           | 24.39           |
| Sales growth                              | 5.5              | 4.2            | 9.2            | 6.2            | ROA (%)  | 1.3             | 1.6             | 1.9             | 2.0             |
| EBITDA growth                             | 5.4              | 10.5           | 15.7           | 9.6            | CROCI (%)  | 4.5             | 4.9             | 4.4             | 4.6             |
| EBIT growth                               | 7.4              | 11.5           | 19.2           | 9.9            | <b>Dupont ROE (%)</b>  | <b>4.3</b>      | <b>5.3</b>      | <b>6.0</b>      | <b>6.3</b>      |
| Net income (pre-exception) growth         | 10.5             | 19.6           | 24.0           | 13.3           | Margin (%)   | 7.5             | 8.6             | 9.8             | 10.5            |
| EPS growth                                | 10.6             | 13.8           | 14.7           | 9.8            | Turnover (X)   | 0.2             | 0.2             | 0.2             | 0.2             |
| Gross margin                              | 32.6             | 34.0           | 36.1           | 37.1           | Leverage (X)   | 3.2             | 3.4             | 3.3             | 3.1             |
| EBITDA margin                             | 35.7             | 37.8           | 40.1           | 41.4           | Free cash flow per share (\$)  | (2.85)          | (1.24)          | (1.88)          | (1.22)          |
| EBIT margin                               | 24.1             | 25.8           | 28.1           | 29.1           | Free cash flow yield (%)   | (13.8)          | (6.2)           | (9.5)           | (6.1)           |
| <b>Cash flow statement (\$ mn)</b>        |                  |                |                |                | Note: Last actual year may include reported and estimated data.<br>Source: Company data, Goldman Sachs Research estimates. |                 |                 |                 |                 |
| Net income                                | 176.1            | 210.6          | 261.3          | 296.1          |  |                 |                 |                 |                 |
| D&A add-back (incl. ESO)                  | 271.3            | 293.7          | 318.5          | 347.0          |  |                 |                 |                 |                 |
| Minority interest add-back                | 0.0              | 0.0            | 0.0            | 0.0            |  |                 |                 |                 |                 |
| Net (inc)/dec working capital             | 5.5              | (14.2)         | (27.1)         | (26.7)         |  |                 |                 |                 |                 |
| Other operating cash flow                 | 99.3             | 117.0          | (20.0)         | (20.0)         |  |                 |                 |                 |                 |
| <b>Cash flow from operations</b>          | <b>552.2</b>     | <b>607.1</b>   | <b>532.6</b>   | <b>596.3</b>   |  |                 |                 |                 |                 |
| Capital expenditures                      | (1,008.8)        | (815.0)        | (875.0)        | (825.0)        |  |                 |                 |                 |                 |
| Acquisitions                              | (12.5)           | (7.6)          | (110.0)        | (30.0)         |  |                 |                 |                 |                 |
| Divestitures                              | 0.0              | 0.0            | 0.0            | 0.0            |  |                 |                 |                 |                 |
| Others                                    | (12.3)           | (6.1)          | 0.0            | 0.0            |  |                 |                 |                 |                 |
| <b>Cash flow from investing</b>           | <b>(1,033.7)</b> | <b>(755.3)</b> | <b>(985.0)</b> | <b>(855.0)</b> |  |                 |                 |                 |                 |
| Dividends paid (common & pref)            | (64.1)           | (137.3)        | (157.9)        | (174.4)        |  |                 |                 |                 |                 |
| Incl/dec) in debt                         | 292.9            | 25.1           | 335.3          | 168.4          |  |                 |                 |                 |                 |
| Other financing cash flows                | 248.7            | 258.7          | 275.0          | 264.7          |  |                 |                 |                 |                 |
| <b>Cash flow from financing</b>           | <b>477.6</b>     | <b>146.5</b>   | <b>452.4</b>   | <b>258.7</b>   |  |                 |                 |                 |                 |
| <b>Total cash flow</b>                    | <b>(3.9)</b>     | <b>(1.7)</b>   | <b>0.0</b>     | <b>0.0</b>     |  |                 |                 |                 |                 |

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## New developments reflected in our forecasts

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### Approved rate cases:

During 3Q 2009, American Water received approval for additional annualized revenues in the following states:

- **Michigan rate case:** awarded 100% of filed amount
  - Awarded annualized revenues of \$0.2 million; requested \$0.2 million
  - ROE: awarded 10.5%; requested 10.5%
  - Rates effective July 1, 2009
- **Maryland rate case:** awarded 77.1% of filed amount
  - Awarded annualized revenues of \$0.6 million; requested \$0.8 million
  - ROE: awarded 10.75%; requested 11.75%
  - Rates effective September 10, 2009

Since September 30, 2009, American Water has received approval for additional annualized revenues in the following states:

- **Iowa rate case:** awarded 64.5% of filed amount
  - Awarded annualized revenues of \$6.1 million on October 8, 2009; requested \$9.4 million
  - Interim rates of \$6.8 million were put in place on July 27, 2009; Customers will receive refunds with interest due to interim rates being higher than final rates granted
  - ROE: awarded 10.5%; requested 12.2%
  - Rates effective November 3, 2009
- **Pennsylvania rate case:** awarded 53% of filed amount
  - Awarded annualized revenues of \$30.8 million; requested \$58.1 million
  - ROE: awarded 10.8%; requested 12.2%
  - Effective November 6, 2009

In addition, American Water finalized annualized revenues of \$22 million in distribution system improvement charges (DSIC) or infrastructure charges in the first nine months of 2009, with \$6.9 million awarded in 3Q 2009. Since September 30, 2009, the company was granted additional DSIC of \$4.6mn. Our model assumes that DSIC will contribute approximately 1% to revenue growth going forward.

### Pending rate cases:

Since June 30, 2009, American Water has filed rate cases for additional annualized revenue increases of approximately \$70 million:

- **Arizona:** filed for \$20.6 million in annualized revenues and 12.25% ROE
  - Filed July 2, 2009; rate case could take up to 2 years (mid 2011)
- **New Mexico:** filed for \$0.7 million in annualized revenues and 12.25% ROE
  - Filed August 21, 2009; award expected mid 2010
- **Missouri:** filed for \$48.7 million in annualized revenues and 11.6% ROE
  - Filed October 30, 2009; award expected October 2010

November 11, 2009

American Water Works Co., Inc. (AWK)

**Exhibit 1: American Water rate case requests from 2006 to present**  
\$ millions

| State                                   | Date Filed | Amount Filed | Amount Granted | %      | ROE Filed | ROE Granted | Expected Grant Date | Status    |
|---|------------|--------------|----------------|--------|-----------|-------------|---------------------|-----------|
| <b>General Rate Cases Filed in 2006</b> |            |              |                |        |           |             |                     |           |
| Ohio                                    | 3/1/06     | \$5.1        | \$3.4          | 66.7%  | 11.0%     | 10.0%       | 3/1/07              | Completed |
| New Jersey                              | 3/31/06    | 99.0         | 56.2           | 56.8%  | 11.2%     | 10.0%       | 4/1/07              | Completed |
| New Mexico                              | 5/30/06    | 1.3          | 1.3            | 100.0% | 10.0%     | 9.7%        | 5/1/07              | Completed |
| Arizona (Anthem)                        | 6/16/06    | 7.0          | 4.3            | 61.4%  | 11.8%     | 8.8%        | 6/4/08              | Completed |
| Arizona (Sun City)                      | 7/28/06    | 3.9          | 2.4            | 61.5%  | 11.8%     | 10.6%       | 4/1/08              | Completed |
| Texas                                   | 10/16/06   | \$0.8        | \$0.7          | 87.5%  | 12.0%     | 12.0%       | 1/1/07              | Completed |
| Tennessee                               | 11/22/06   | 6.4          | 4.1            | 64.1%  | 11.0%     | 9.6%        | 5/23/07             | Completed |
| Indiana                                 | 12/5/06    | 24.7         | 14.0           | 56.7%  | 11.5%     | 10.0%       | 12/1/07             | Completed |
| Missouri                                | 12/15/06   | 41.5         | 21.4           | 51.6%  | 11.3%     | 10.0%       | 11/1/07             | Completed |

|                             |                |                |              |
|-----------------------------|----------------|----------------|--------------|
| <b>Total Granted (2006)</b> | <b>\$189.7</b> | <b>\$107.8</b> | <b>56.8%</b> |
| <b>Total Pending (2006)</b> | <b>\$0.0</b>   | <b>\$0.0</b>   |              |

| State                                   | Date Filed | Amount Filed | Amount Granted | %      | ROE Filed | ROE Granted | Expected Grant Date | Status    |
|---|------------|--------------|----------------|--------|-----------|-------------|---------------------|-----------|
| <b>General Rate Cases Filed in 2007</b> |            |              |                |        |           |             |                     |           |
| California *                            | 1/1/07     | \$16.4       | \$13.0         | 100.0% | 11.5%     | 10.2%       | 6/1/08              | Completed |
| Michigan                                | 1/8/07     | 0.2          | 0.2            | 100.0% | 12.0%     | 10.0%       | 1/8/07              | Completed |
| Maryland                                | 3/29/07    | 0.6          | 0.6            | 100.0% | 11.8%     | 10.5%       | 10/1/07             | Completed |
| Pennsylvania                            | 4/27/07    | 59.2         | 36.0           | 60.8%  | 11.8%     | N/A         | 11/30/07            | Completed |
| Arizona (Sun City)                      | 4/30/07    | 2.2          | 1.9            | 86.4%  | 11.8%     | 10.8%       | 6/1/08              | Completed |
| Kentucky                                | 4/30/07    | 13.2         | 8.0            | 60.6%  | 11.4%     | 10.0%       | 12/1/07             | Completed |
| Long Island **                          | 5/1/07     | 9.6          | 6.6            | 68.8%  | 11.0%     | 9.5%        | 4/1/08              | Completed |
| West Virginia                           | 6/1/07     | 24.1         | 14.5           | 60.2%  | 11.3%     | 10.0%       | 3/28/08             | Completed |
| Iowa                                    | 8/30/07    | 6.1          | 4.3            | 70.5%  | 11.3%     | 10.4%       | 2/1/08              | Completed |
| Illinois                                | 8/31/07    | 32.8         | 21.6           | 65.9%  | 11.3%     | 10.4%       | 8/8/08              | Completed |
| Ohio                                    | 10/1/07    | 5.5          | 5.3            | 95.6%  | 11.3%     | 10.9%       | 11/13/08            | Completed |
| Hawaii ***                              | 11/1/07    | 1.3          | 0.7            | 50.0%  | 10.6%     |             | 11/1/08             | Pending   |

\* California rate increase includes step increase of \$2.0mn effective in 2009 and \$2.5mn effective in 2010

\*\* Long Island rate increase includes step increase of \$1.0mn in 2009 and \$1.0mn in 2010

\*\*\* Hawaii temporary rate increase of \$0.7mn put in place Oct. 2008 and will be subject to adjustment upon issuance of final order

|                             |                |                |              |
|-----------------------------|----------------|----------------|--------------|
| <b>Total Granted (2007)</b> | <b>\$169.9</b> | <b>\$112.0</b> | <b>65.9%</b> |
| <b>Total Pending (2007)</b> | <b>\$1.3</b>   | <b>\$0.7</b>   | <b>50.0%</b> |

| State                                   | Date Filed | Amount Filed | Amount Granted | %      | ROE Filed | ROE Granted | Expected Grant Date | Status    |
|---|------------|--------------|----------------|--------|-----------|-------------|---------------------|-----------|
| <b>General Rate Cases Filed in 2008</b> |            |              |                |        |           |             |                     |           |
| Michigan                                | 1/1/08     | \$0.2        | \$0.2          | 100.0% | 10.0%     | 10.0%       | 1/1/08              | Completed |
| New Jersey                              | 1/14/08    | 125.0        | 72.1           | 57.7%  | 11.5%     | 10.3%       | 12/7/08             | Completed |
| California (Monterey Water)             | 1/30/08    | 35.3         | 12.1           | 34.3%  | 11.5%     | 10.2%       | 5/11/09             | Completed |
| California (Monterey WW)                | 1/30/08    | 1.8          | 1.7            | 94.4%  | 11.5%     | 10.2%       | 7/9/09              | Completed |
| California (Gen. Office)                | 1/30/08    | 6.4          | 2.2            | 34.4%  | 11.5%     | 10.2%       | 5/11/09             | Completed |
| Virginia                                | 1/30/08    | 4.3          | 3.4            | 79.1%  | 11.3%     | 10.5%       | 11/1/08             | Completed |
| Texas *                                 | 2/21/08    | 0.9          | 0.4            | 50.0%  | 12.0%     |             | 6/30/08             | Pending   |
| Tennessee                               | 3/14/08    | 7.6          | 1.7            | 21.6%  | 11.8%     | 10.2%       | 10/1/08             | Completed |
| Missouri                                | 3/31/08    | 49.8         | 34.5           | 69.3%  | 11.3%     | 10.0%       | 11/28/08            | Completed |
| Pennsylvania - WW                       | 4/28/08    | 2.7          | 1.9            | 70.4%  | 11.5%     | 10.6%       | 11/14/08            | Completed |
| California (ROE)                        | 5/1/08     | 2.8          | 0.1            | 3.6%   | 11.5%     | 10.2%       | 5/6/09              | Completed |
| Arizona                                 | 5/1/08     | 20.0         | 10.0           | 50.0%  | 11.8%     |             | 9/1/09              | Pending   |
| West Virginia                           | 5/30/08    | 14.8         | 5.2            | 35.3%  | 11.8%     | 10.0%       | 3/26/09             | Completed |
| New Mexico (Clovis)                     | 6/30/08    | 2.2          | 1.4            | 61.8%  | 11.8%     | 10.3%       | 5/12/09             | Completed |
| Kentucky                                | 10/31/08   | 18.5         | 10.3           | 55.7%  | 11.5%     | 10.0%       | 6/1/09              | Completed |

\* Texas temporary rate increase of \$0.4mn put in place June 2008 and will be subject to adjustment upon issuance of final order

|                             |                |                |              |
|-----------------------------|----------------|----------------|--------------|
| <b>Total Granted (2008)</b> | <b>\$271.4</b> | <b>\$146.7</b> | <b>54.1%</b> |
| <b>Total Pending (2008)</b> | <b>\$20.9</b>  | <b>\$10.4</b>  | <b>50.0%</b> |

| State                                   | Date Filed | Amount Filed | Amount Granted | %      | ROE Filed | ROE Granted | Expected Grant Date | Status    |
|---|------------|--------------|----------------|--------|-----------|-------------|---------------------|-----------|
| <b>General Rate Cases Filed in 2009</b> |            |              |                |        |           |             |                     |           |
| California (Sac, LA, Lark)              | 1/23/09    | \$32.7       | \$16.4         | 50.0%  | 10.2%     |             | 1/1/10              | Pending   |
| Pennsylvania                            | 4/24/09    | 58.1         | 30.8           | 53.0%  | 12.0%     | 10.8%       | 11/6/09             | Completed |
| Iowa                                    | 4/30/09    | 9.4          | 6.1            | 64.5%  | 12.2%     | 10.5%       | 11/3/09             | Completed |
| Indiana                                 | 4/30/09    | 46.9         | 23.5           | 50.0%  | 12.0%     |             | 5/1/10              | Pending   |
| Maryland                                | 4/30/09    | 0.8          | 0.6            | 77.1%  | 11.8%     | 10.8%       | 9/10/09             | Completed |
| Ohio                                    | 5/7/09     | 8.8          | 4.4            | 50.0%  | 12.2%     |             | 2/1/10              | Pending   |
| Illinois                                | 5/29/09    | 58.6         | 29.3           | 50.0%  | 12.3%     |             | 5/1/10              | Pending   |
| Michigan                                | 6/22/09    | 0.2          | 0.2            | 100.0% | 10.5%     | 10.5%       | 7/1/09              | Completed |
| Arizona                                 | 7/2/09     | 20.6         | 10.3           | 50.0%  | 12.3%     |             | 7/1/10              | Pending   |
| New Mexico (Edgewood)                   | 8/21/09    | 0.7          | 0.3            | 50.0%  | 12.3%     |             | 7/1/10              | Pending   |
| Missouri                                | 10/30/09   | 48.7         | 24.4           | 50.0%  | 11.6%     |             | 10/1/10             | Pending   |

|                             |                |                |              |
|-----------------------------|----------------|----------------|--------------|
| <b>Total Granted (2009)</b> | <b>\$68.5</b>  | <b>\$37.6</b>  | <b>54.9%</b> |
| <b>Total Pending (2009)</b> | <b>\$217.0</b> | <b>\$108.5</b> | <b>50.0%</b> |

|                                       |                |                |              |
|---------------------------------------|----------------|----------------|--------------|
| <b>Total Granted (2006 - present)</b> | <b>\$699.5</b> | <b>\$404.1</b> | <b>57.8%</b> |
| <b>Total Pending (2006 - present)</b> | <b>\$239.2</b> | <b>\$119.6</b> | <b>50.0%</b> |

Source: Company data, various State Public Utility Commission news releases, Goldman Sachs Research estimates.

November 11, 2009

American Water Works Co., Inc. (AWK)

Exhibit 1 outlines American Water's rate case requests from 2006 to the present. Pending rate cases could increase annualized revenues by up to \$239.2 million. We have assumed that American Water receives approximately 50% of the amount requested for each pending rate case. For rate cases that have been concluded in 2009, the percentage has been higher at closer to 55%-56%, but we believe it is prudent to assume a lower rate for the next round of rate cases, as this is the second round of meaningful increases following large increases only a year or two ago.

Key pending rate cases include:

- Arizona (filed in May 2008) for \$20.0 million
- California (filed in January 2009) for \$32.7 million
- Indiana (filed in April 2009) for \$46.9 million
- Illinois (filed in May 2009) for \$58.6 million
- Arizona (filed in July 2009) for \$20.6 million
- Missouri (filed in October 2009) for \$48.7 million

### **Tuck-in acquisitions**

We expect tuck-in acquisition activity to pick up, particularly given the increasing economic pressure on municipalities to bridge their budget shortfalls. Since June 30, 2009, American Water has completed five small tuck-in acquisitions. We forecast tuck-in acquisitions will add 1% to top-line growth over the next several years.

- **Pennsylvania** (Clearfield, Centre, Washington)
  - Clearfield (purchased assets of Wallaceton Municipal Authority)
  - Centre (purchased assets of Boggs Township Municipal Authority)
  - Washington (purchased assets of Amwell Township Water Authority)
  - Acquired 2 of the water systems in September 2009 and 1 water system on October 1, 2009
  - Total combined purchase price: \$0.935 million (\$0.65 million recognized in 3Q 2009)
  - 200 water customers (population of 600)
- **Indiana** (Waveland Water Utility)
  - Approved by Indiana PUC on September 23, 2009; acquired on October 26, 2009
  - Purchase price: \$0.68 million
  - 213 customers (population of 500)
- **Pennsylvania** (Saxonburg Area Authority water system in Butler County)
  - Effective Oct 28, 2009)
  - Purchase price: \$6 million
  - 1,200 customers (population of 3,600)
  - Newly acquired system serves Saxonburg Borough and portions of Jefferson and Clinton townships
- **Trenton update:**
  - On April 3, 2009 the Board of Public Utilities approved the \$75 million sale by American Water of the City of Trenton assets.
  - However, the approval is pending the resolution of court proceedings initiated in New Jersey Superior Court by Trenton residents seeking to require a referendum for the asset sale.

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American Water Works Co., Inc. (AWK)

- In May 2009, Trenton trial court ruled that a referendum is not required. Trenton residents filed for reconsideration and on July 13, 2009, the court denied the resident's motion.
- An appeal was filed with the New Jersey Superior Court Appellate Court and oral arguments were held in October 2009.
- The Appellate Court ruling is still pending and the company did not provide additional color on expected timing for closure.
- Given the regulatory hurdles, Goldman Sachs Research estimates that the acquisition will close in the 1H 2010.

### **Non-regulated operation & maintenance (O&M) contracts:**

American Water announced on October 1, 2009 that its Military Services Group was awarded contracts for O&M of the water and wastewater systems at Fort Belvoir, Virginia and Fort Meade, Maryland.

- **Fort Belvoir, Virginia:** estimated c.\$288 million of additional revenues over 50 year period (c.\$5.76 million/year or c.\$1.44 million/quarter)
- **Fort Meade, Maryland:** estimated c.\$650 million of additional revenues over 50 year period (c.\$13 million/year or c.\$3.25 million/quarter)
- Subject to price re-determination

We expect to see the full impact to non-regulated revenues from these contracts in the second half of 2010, as we believe it will take several months for the project to fully ramp.

Goldman Sachs forecasts non-regulated revenues to increase 4.5% in 2010, 2011 and 2012.

### **Capitalization:**

American Water had net debt of \$5,344.8 million as of September 30, 2009, total debt of \$5,352.6 million and cash of \$7.9 million.

- **Secondary Equity Offering** (announced August 11, 2009)
  - RWE reduced its stake in American Water to 23.54%. We expect RWE will try to sell its remaining stake by April 2010, when certain regulatory approvals expire.
  - RWE sold 35 million shares of common stock (upsized by 5mn shares) priced at \$19.25 on August 13, 2009.
  - The underwriters exercised the over allotment of 5.25 million shares from selling shareholder RWE on August 18, 2009.
  - No primary shares were sold during this offering
- **\$26 million Tax-Exempt Debt Offering** (closed September 10, 2009)
  - Water facility revenue bonds issued by Owen County in Kentucky
  - 5.625% coupon with a 30-year maturity and 10-year call option
  - Proceeds used to pay short term debt related to construction of a water treatment and transmission facility located in Owen County, Kentucky as well as to pay a portion of the remaining costs of acquisition, construction, installation and equipping of the water treatment and transmission facility.
- **\$28.5 million Tax-Exempt Debt Offering** (closed October 1, 2009)
  - Water facility revenue bonds issued by Illinois Finance Authority
  - 5.25% coupon with a 30-year maturity and 10-year call option



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- Proceeds used to pay short term debt related to construction of a water treatment and transmission facility consisting of supply mains, distribution mains, service lines, meters and miscellaneous equipment in Champaign County, Illinois and certain other Illinois American Water service.
- **\$134.2 million Tax-Exempt Debt Offering** (closed October 20, 2009)
  - Water facility revenue bonds issued by New Jersey
  - 5.70% coupon with a 30-year maturity
- **\$10.5 million Tax-Exempt Debt Offering** (closed October 20, 2009)
  - Water facility revenue bonds issued by New Jersey
  - 5.0% coupon with a 30-year maturity

## Details on our model changes

Exhibit 2 summarizes the key differences between our 3Q estimates and the results reported by American Water.

**Exhibit 2: American Water 3Q2009 actuals versus expected**  
\$ millions, except per-share data

|                                    | 3Q09A   | 3Q09E   | % Chg    | 3Q08A   | % Chg      | 2Q09A   | % Chg      |
|------------------------------------|---------|---------|----------|---------|------------|---------|------------|
| Operating Revenues                 | 680.0   | 700.3   | -2.9%    | 672.2   | 1.2%       | 612.7   | 11.0%      |
| YY Growth                          | 1.2%    | 4.2%    | -303 bps | 6.2%    | -502 bps   | 4.0%    | -281 bps   |
| Operating and maintenance          | (340.9) | (360.8) | -5.5%    | (342.2) | -0.4%      | (330.6) | 3.1%       |
| Depreciation and amortization      | (74.9)  | (75.0)  | -0.1%    | (68.4)  | 9.5%       | (73.2)  | 2.2%       |
| General taxes                      | (50.6)  | (56.0)  | -9.6%    | (49.4)  | 2.5%       | (51.7)  | -2.1%      |
| % of revenues                      | 7.4%    | 8.0%    | -56 bps  | 7.3%    | +10 bps    | 8.4%    | -99 bps    |
| Gain (loss) on sale of assets      | 0.8     | 0.0     |          | (0.5)   | -271.6%    | (0.0)   | -7940.0%   |
| Operating Profit                   | 214.4   | 208.5   | 2.8%     | 211.8   | 1.3%       | 157.2   | 36.4%      |
| Operating Margin                   | 31.5%   | 29.8%   | +176 bps | 31.5%   | +3 bps     | 25.7%   | +588 bps   |
| Interest, net                      | (76.3)  | (78.8)  | -3.3%    | (74.3)  | 2.7%       | (75.2)  | 1.4%       |
| AFUDC                              | 4.0     | 5.0     | -20.7%   | 7.4     | -46.5%     | 5.6     | -28.8%     |
| Other inc/exp                      | (0.3)   | 2.5     | -112.4%  | 0.8     | -137.5%    | (1.4)   | -78.0%     |
| Pretax Income                      | 141.8   | 137.1   | 3.4%     | 145.7   | -2.7%      | 86.1    | 64.6%      |
| Provision for Income Taxes         | (50.2)  | (54.2)  | -7.4%    | (57.5)  | -12.8%     | (34.1)  | 47.0%      |
| Tax Rate                           | 35.4%   | 39.5%   | -412 bps | 39.5%   | -412 bps   | 39.6%   | -426 bps   |
| Net Income - Continuing Ops        | 91.6    | 83.0    | 10.4%    | 88.2    | 3.9%       | 52.0    | 76.3%      |
| Preferred Dividend                 | 0.0     | 0.0     |          | 0.0     |            | 0.0     |            |
| Non-recurring/Discontinued Ops     | 0.0     | 0.0     |          | 0.0     |            | 0.0     |            |
| Extraordinary Items                | 0.0     | 0.0     |          | 0.0     |            | 0.0     |            |
| Net Income                         | 91.6    | 83.0    | 10.4%    | 88.2    | 3.9%       | 52.0    | 76.3%      |
| Shares Outstanding - Basic         | 174.6   | 160.0   | 9.1%     | 159.9   | 9.2%       | 163.2   | 7.0%       |
| Shares Outstanding - Diluted       | 174.7   | 160.0   | 9.2%     | 160.0   | 9.2%       | 163.3   | 7.0%       |
| Shares Outstanding - Basic (EOP)   | 174.6   | 174.6   | 0.0%     | 160.0   | 9.1%       | 174.6   | 0.0%       |
| Shares Outstanding - Diluted (EOP) | 174.8   | 174.6   | 0.1%     | 160.0   | 9.3%       | 174.6   | 0.1%       |
| EPS - Continuing Ops- Basic        | 0.52    | 0.52    | 1.2%     | 0.55    | -4.8%      | 0.32    | 64.8%      |
| EPS - Continuing Ops- Diluted      | 0.52    | 0.52    | 1.2%     | 0.55    | -4.8%      | 0.32    | 64.8%      |
| YY EPS Growth (diluted)            | -4.8%   | -5.9%   | +109 bps | 10.9%   | -1,570 bps | 11.9%   | -1,674 bps |
| EPS - Net Income- Basic            | 0.52    | 0.52    | 1.2%     | 0.55    | -4.8%      | 0.32    | 64.8%      |
| EPS - Net Income- Diluted          | 0.52    | 0.52    | 1.2%     | 0.55    | -4.8%      | 0.32    | 64.8%      |
| EBITDA                             | 289.3   | 283.4   | 2.1%     | 280.1   | 3.3%       | 230.4   | 25.5%      |
| YY Growth                          | 3.3%    | 1.2%    | +208 bps | 8.4%    | -514 bps   | 9.7%    | -649 bps   |
| EBITDA Margin                      | 42.5%   | 40.5%   | +207 bps | 41.7%   | +87 bps    | 37.6%   | +493 bps   |
| <b>MARGIN ANALYSIS:</b>            |         |         |          |         |            |         |            |
| O&M as a % of Revenue              | 50.1%   | 51.5%   | -140 bps | 50.9%   | -78 bps    | 54.0%   | -382 bps   |
| EBITDA                             | 42.5%   | 40.5%   | +207 bps | 41.7%   | +87 bps    | 37.6%   | +493 bps   |
| EBIT                               | 31.5%   | 29.8%   | +176 bps | 31.5%   | +3 bps     | 25.7%   | +588 bps   |
| Pretax                             | 20.9%   | 19.6%   | +127 bps | 21.7%   | -82 bps    | 14.1%   | +680 bps   |
| Net-Continuing Operations          | 13.5%   | 11.8%   | +163 bps | 13.1%   | +36 bps    | 8.5%    | +499 bps   |
| Net Income                         | 13.5%   | 11.8%   | +163 bps | 13.1%   | +36 bps    | 8.5%    | +499 bps   |
| <b>YOY GROWTH</b>                  |         |         |          |         |            |         |            |
| Revenue                            | 1.2%    | 4.2%    | -303 bps |         |            |         |            |
| EBIT                               | 1.3%    | -1.5%   | +280 bps |         |            |         |            |
| EBITDA                             | 3.3%    | 1.2%    | +208 bps |         |            |         |            |
| D&A                                | 9.5%    | 9.6%    | -14 bps  |         |            |         |            |
| Pretax Income                      | -2.7%   | -5.9%   | +320 bps |         |            |         |            |
| Net Income                         | 3.9%    | -5.9%   | +983 bps |         |            |         |            |
| EPS                                | -4.8%   | -5.9%   | +109 bps |         |            |         |            |

Source: Company filings, Goldman Sachs Research estimates.

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## American Water financial model

### Exhibit 3: American Water annual income statement, 2006-2012E

\$ millions, except per-share data

| INCOME STATEMENT                      | 2006A          | 2007A          | 2008A          | 2009E          | 2010E          | 2011E          | 2012E          |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Operating Revenues                    | 2,093.1        | 2,214.2        | 2,336.9        | 2,435.9        | 2,660.9        | 2,824.9        | 2,973.3        |
| <i>YY Growth</i>                      | -2.0%          | 5.8%           | 5.5%           | 4.2%           | 9.2%           | 6.2%           | 5.3%           |
| Operation and maintenance             | (1,174.5)      | (1,246.5)      | (1,303.8)      | (1,313.0)      | (1,381.4)      | (1,429.4)      | (1,478.9)      |
| Depreciation and amortization         | (259.2)        | (267.3)        | (271.3)        | (293.7)        | (318.5)        | (347.0)        | (375.5)        |
| General taxes                         | (185.1)        | (183.3)        | (199.1)        | (202.3)        | (212.9)        | (226.0)        | (237.9)        |
| % of revenues                         | 8.8%           | 8.3%           | 8.5%           | 8.3%           | 8.0%           | 8.0%           | 8.0%           |
| Gain (loss) on sale of assets         | (0.1)          | 7.3            | 0.4            | 1.0            | 0.0            | 0.0            | 0.0            |
| Operating Profit                      | 474.2          | 524.5          | 563.1          | 627.9          | 748.2          | 822.5          | 881.0          |
| <i>Operating Margin</i>               | 22.7%          | 23.7%          | 24.1%          | 25.8%          | 28.1%          | 29.1%          | 29.6%          |
| Interest, net                         | (371.0)        | (288.0)        | (291.1)        | (305.8)        | (338.8)        | (355.0)        | (366.5)        |
| AFUDC                                 | 8.6            | 11.2           | 22.7           | 19.7           | 20.0           | 20.0           | 20.0           |
| Other incl/exp                        | 0.9            | 6.2            | 4.7            | 0.9            | 6.0            | 6.0            | 6.0            |
| Pretax Income                         | 112.7          | 253.8          | 299.4          | 342.8          | 435.4          | 493.5          | 540.5          |
| Provision for Income Taxes            | (51.1)         | (94.5)         | (123.4)        | (132.1)        | (174.2)        | (197.4)        | (216.2)        |
| <i>Tax Rate</i>                       | 45.3%          | 37.2%          | 41.2%          | 38.6%          | 40.0%          | 40.0%          | 40.0%          |
| Net Income, Continuing Ops            | 61.7           | 159.3          | 176.1          | 210.6          | 261.3          | 296.1          | 324.3          |
| Preferred Dividend                    | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            |
| Non-recurring/Discontinued Ops        | (6.4)          | (0.6)          | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            |
| Extraordinary Items                   | (217.5)        | (501.5)        | (738.5)        | (443.0)        | 0.0            | 0.0            | 0.0            |
| <b>Net Income - Reported</b>          | <b>(162.2)</b> | <b>(342.8)</b> | <b>(562.4)</b> | <b>(232.4)</b> | <b>261.3</b>   | <b>296.1</b>   | <b>324.3</b>   |
| Shares Outstanding - Basic (Avg)      | 160.0          | 160.0          | 160.0          | 168.1          | 181.8          | 187.7          | 196.6          |
| Shares Outstanding - Diluted (Avg)    | 160.0          | 160.0          | 160.0          | 168.2          | 182.1          | 190.1          | 197.4          |
| Shares Outstanding - Basic (EOP)      | 160.0          | 160.0          | 160.0          | 174.6          | 182.6          | 192.8          | 200.4          |
| Shares Outstanding - Diluted (EOP)    | 160.0          | 160.0          | 160.0          | 174.6          | 186.8          | 193.4          | 201.3          |
| EPS - Continuing Ops - Basic          | 0.39           | 1.00           | 1.10           | 1.25           | 1.44           | 1.58           | 1.65           |
| <b>EPS - Continuing Ops - Diluted</b> | <b>0.39</b>    | <b>1.00</b>    | <b>1.10</b>    | <b>1.25</b>    | <b>1.44</b>    | <b>1.56</b>    | <b>1.64</b>    |
| <i>YY EPS Growth (diluted)</i>        | -40.1%         | 158.4%         | 10.6%          | 13.8%          | 14.6%          | 8.5%           | 5.5%           |
| EPS - Net Income - Reported - Basic   | -1.01          | -2.14          | -3.52          | -1.38          | 1.44           | 1.58           | 1.65           |
| EPS - Net Income - Reported - Diluted | -1.01          | -2.14          | -3.52          | -1.38          | 1.44           | 1.56           | 1.64           |
| <b>EBITDA</b>                         | <b>733.4</b>   | <b>791.8</b>   | <b>834.4</b>   | <b>921.6</b>   | <b>1,066.7</b> | <b>1,169.5</b> | <b>1,256.5</b> |
| <i>YY Growth</i>                      | -3.3%          | 8.0%           | 5.4%           | 10.5%          | 15.7%          | 9.6%           | 7.4%           |
| <i>EBITDA Margin</i>                  | 35.0%          | 35.8%          | 35.7%          | 37.8%          | 40.1%          | 41.4%          | 42.3%          |
| <b>MARGIN ANALYSIS:</b>               |                |                |                |                |                |                |                |
| O&M as a % of Revenue                 | 56.1%          | 56.3%          | 55.8%          | 53.9%          | 51.9%          | 50.6%          | 49.7%          |
| EBITDA as % of Revenue                | 35.0%          | 35.8%          | 35.7%          | 37.8%          | 40.1%          | 41.4%          | 42.3%          |
| EBIT as % of Revenue                  | 22.7%          | 23.7%          | 24.1%          | 25.8%          | 28.1%          | 29.1%          | 29.6%          |
| Pretax as % of Revenue                | 5.4%           | 11.5%          | 12.8%          | 14.1%          | 16.4%          | 17.5%          | 18.2%          |
| Net Income - Cont Ops as % of Revenue | 2.9%           | 7.2%           | 7.5%           | 8.6%           | 9.8%           | 10.5%          | 10.9%          |
| Net Income - Reported as % of Revenue | -7.8%          | -15.5%         | -24.1%         | -9.5%          | 9.8%           | 10.5%          | 10.9%          |
| <b>YOY GROWTH</b>                     |                |                |                |                |                |                |                |
| Revenue                               | -2.0%          | 5.8%           | 5.5%           | 4.2%           | 9.2%           | 6.2%           | 5.3%           |
| EBIT                                  | -4.6%          | 10.6%          | 7.4%           | 11.5%          | 19.2%          | 9.9%           | 7.1%           |
| EBITDA                                | -3.3%          | 8.0%           | 5.4%           | 10.5%          | 15.7%          | 9.6%           | 7.4%           |
| D&A                                   | -0.8%          | 3.1%           | 1.5%           | 8.3%           | 8.4%           | 8.9%           | 8.2%           |
| Pretax Income                         | -30.1%         | 125.1%         | 18.0%          | 14.5%          | 27.0%          | 13.3%          | 9.5%           |
| Net Income - Cont Ops                 | -40.1%         | 158.4%         | 10.5%          | 19.6%          | 24.0%          | 13.3%          | 9.5%           |
| EPS                                   | -40.1%         | 158.4%         | 10.6%          | 13.8%          | 14.6%          | 8.5%           | 5.5%           |

Source: Company filings, Goldman Sachs Research estimates.

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**Exhibit 4: American Water balance sheet and cash flow statements, 2006-2012E**

\$ millions

| <b>BALANCE SHEET</b>                   | <b>2006A</b>     | <b>2007A</b>     | <b>2008A</b>     | <b>2009E</b>     | <b>2010E</b>     | <b>2011E</b>     | <b>2012E</b>     |
|--|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Cash and cash equivalents              | 29.8             | 13.5             | 9.5              | 7.8              | 7.8              | 7.8              | 7.8              |
| Restricted funds                       | 2.1              | 3.3              | 0.5              | 38.9             | 38.9             | 38.9             | 38.9             |
| Utility customers accounts receivable  | 130.5            | 126.7            | 130.6            | 136.5            | 149.4            | 162.5            | 171.1            |
| Unbilled utility revenues              | 123.2            | 134.3            | 134.2            | 140.0            | 153.2            | 166.7            | 175.4            |
| Materials and supplies                 | 23.0             | 27.5             | 28.9             | 32.3             | 34.3             | 31.3             | 32.4             |
| Other receivables, net                 | 54.5             | 89.7             | 68.9             | 71.5             | 78.3             | 85.1             | 89.6             |
| Other current assets                   | 36.6             | 35.5             | 45.1             | 69.0             | 69.0             | 69.0             | 69.0             |
| Assets of Disc. Ops.                   | 12.8             | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| <b>Total Current Assets</b>            | <b>412.4</b>     | <b>430.4</b>     | <b>417.7</b>     | <b>495.9</b>     | <b>530.9</b>     | <b>561.4</b>     | <b>584.3</b>     |
| <i>Utility plant, net</i>              | <i>8,605.3</i>   | <i>9,199.9</i>   | <i>9,991.8</i>   | <i>10,540.0</i>  | <i>11,206.6</i>  | <i>11,714.6</i>  | <i>12,194.1</i>  |
| <i>Nonutility property, net</i>        | <i>115.2</i>     | <i>118.1</i>     | <i>132.1</i>     | <i>144.4</i>     | <i>144.4</i>     | <i>144.4</i>     | <i>144.4</i>     |
| Net Property Plant & Equipment         | 8,720.6          | 9,318.0          | 10,123.9         | 10,684.4         | 11,351.0         | 11,859.0         | 12,338.5         |
| Regulatory Assets                      | 587.2            | 661.0            | 919.7            | 956.3            | 956.3            | 956.3            | 956.3            |
| Restricted Funds                       | 17.2             | 10.3             | 10.6             | 35.9             | 35.9             | 35.9             | 35.9             |
| Goodwill & Other Intangibles           | 2,962.5          | 2,457.0          | 1,699.5          | 1,250.1          | 1,250.1          | 1,250.1          | 1,250.1          |
| Investments                            | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| Other Assets                           | 83.2             | 74.8             | 60.4             | 59.8             | 79.8             | 99.8             | 119.8            |
| <b>Total Assets</b>                    | <b>12,783.1</b>  | <b>12,951.3</b>  | <b>13,231.8</b>  | <b>13,482.5</b>  | <b>14,204.0</b>  | <b>14,762.5</b>  | <b>15,284.9</b>  |
| Short-term Debt                        | 1,007.1          | 317.0            | 654.8            | 130.9            | 130.9            | 130.9            | 130.9            |
| Accounts payable                       | 140.7            | 168.9            | 149.8            | 125.5            | 133.3            | 137.1            | 141.8            |
| Accrued liabilities                    | 62.9             | 106.9            | 106.1            | 165.3            | 165.3            | 165.3            | 165.3            |
| Other current liabilities              | 150.5            | 181.8            | 194.0            | 185.2            | 185.2            | 185.2            | 185.2            |
| Liabilities of Disc. Ops.              | 2.5              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| <b>Total Current Liabilities</b>       | <b>1,363.7</b>   | <b>774.5</b>     | <b>1,104.8</b>   | <b>606.8</b>     | <b>614.7</b>     | <b>618.4</b>     | <b>623.2</b>     |
| Long-term debt                         | 4,870.9          | 4,699.1          | 4,648.2          | 5,350.3          | 5,685.6          | 5,854.0          | 6,018.0          |
| Advances for construction              | 615.7            | 655.4            | 622.2            | 633.8            | 633.8            | 633.8            | 633.8            |
| Deferred income taxes                  | 583.4            | 638.9            | 705.6            | 811.8            | 811.8            | 811.8            | 811.8            |
| Deferred investment tax credits        | 36.5             | 35.4             | 34.0             | 32.8             | 32.8             | 32.8             | 32.8             |
| Regulatory liability-cost of removal   | 166.9            | 266.7            | 307.3            | 317.9            | 317.9            | 317.9            | 317.9            |
| Accrued pension expense                | 314.6            | 290.7            | 502.1            | 490.8            | 490.8            | 490.8            | 490.8            |
| Accrued postretirement benefit expense | 144.9            | 158.5            | 241.2            | 235.2            | 235.2            | 235.2            | 235.2            |
| Other long term liabilities            | 110.4            | 67.1             | 48.5             | 47.4             | 47.4             | 47.4             | 47.4             |
| Contributions in Aid of Construction   | 754.2            | 818.4            | 911.4            | 963.3            | 988.3            | 1,013.3          | 1,038.3          |
| <b>Total Liabilities</b>               | <b>8,961.1</b>   | <b>8,404.7</b>   | <b>9,125.3</b>   | <b>9,490.3</b>   | <b>9,858.4</b>   | <b>10,055.6</b>  | <b>10,249.4</b>  |
| Preferred Equity                       | 4.6              | 4.6              | 4.6              | 4.6              | 4.6              | 4.6              | 4.6              |
| Shareholder's Equity                   | 3,817.4          | 4,542.0          | 4,102.0          | 3,987.6          | 4,341.0          | 4,702.4          | 5,030.9          |
| <b>Total Liabilities &amp; Equity</b>  | <b>12,783.1</b>  | <b>12,951.3</b>  | <b>13,231.8</b>  | <b>13,482.5</b>  | <b>14,204.0</b>  | <b>14,762.5</b>  | <b>15,284.9</b>  |
| <b>CASH FLOW STATEMENT</b>             | <b>2006A</b>     | <b>2007A</b>     | <b>2008A</b>     | <b>2009E</b>     | <b>2010E</b>     | <b>2011E</b>     | <b>2012E</b>     |
| <b>Sources:</b>                        |                  |                  |                  |                  |                  |                  |                  |
| EBITDA                                 | 733.4            | 791.8            | 834.4            | 921.6            | 1,066.7          | 1,169.5          | 1,256.5          |
| Interest Income                        | 0.4              | 1.9              | 0.1              | 0.1              | 0.1              | 0.1              | 0.1              |
| <b>Total Sources</b>                   | <b>733.7</b>     | <b>793.7</b>     | <b>834.5</b>     | <b>921.7</b>     | <b>1,066.8</b>   | <b>1,169.6</b>   | <b>1,256.6</b>   |
| <b>Uses:</b>                           |                  |                  |                  |                  |                  |                  |                  |
| Interest Expense Paid                  | (371.4)          | (289.9)          | (291.2)          | (305.9)          | (338.9)          | (355.1)          | (366.7)          |
| Book Taxes                             | (51.1)           | (94.5)           | (123.4)          | (132.1)          | (174.2)          | (197.4)          | (216.2)          |
| Other Non-Operating Expenses           | 109.1            | 47.7             | 126.7            | 137.6            | 6.0              | 6.0              | 6.0              |
| Change in Current Accounts (ex taxes)  | (96.6)           | 16.8             | 5.5              | (14.2)           | (27.1)           | (26.7)           | (18.1)           |
| Capital Expenditures                   | (682.9)          | (750.8)          | (1,008.8)        | (815.0)          | (875.0)          | (825.0)          | (825.0)          |
| <i>% of total revenues</i>             | <i>32.6%</i>     | <i>33.9%</i>     | <i>43.2%</i>     | <i>33.5%</i>     | <i>32.9%</i>     | <i>29.2%</i>     | <i>27.7%</i>     |
| <b>Total Uses</b>                      | <b>(1,092.9)</b> | <b>(1,070.8)</b> | <b>(1,291.1)</b> | <b>(1,129.6)</b> | <b>(1,409.2)</b> | <b>(1,396.2)</b> | <b>(1,420.0)</b> |
| <b>Free Cash Flow</b>                  | <b>(359.1)</b>   | <b>(277.1)</b>   | <b>(456.6)</b>   | <b>(207.9)</b>   | <b>(342.4)</b>   | <b>(228.7)</b>   | <b>(163.3)</b>   |
| <i>y/y growth</i>                      | <i>1213.1%</i>   | <i>-22.8%</i>    | <i>64.8%</i>     | <i>-54.5%</i>    | <i>64.7%</i>     | <i>-33.2%</i>    | <i>-28.6%</i>    |
| Net Investments                        | (26.2)           | 10.4             | (12.3)           | 67.3             | 0.0              | 0.0              | 0.0              |
| Acquisitions                           | (12.5)           | (15.9)           | (12.5)           | (7.6)            | (110.0)          | (30.0)           | (30.0)           |
| Dividends                              | 0.0              | 0.0              | (64.1)           | (137.3)          | (157.9)          | (174.4)          | (190.4)          |
| Discontinued Operations                | 30.2             | 9.7              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| Translation Adjustments                | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| <b>Cash Flow before Financing</b>      | <b>(367.7)</b>   | <b>(272.9)</b>   | <b>(545.6)</b>   | <b>(285.5)</b>   | <b>(610.3)</b>   | <b>(433.1)</b>   | <b>(383.8)</b>   |
| Contributions in aid of construction   | 47.4             | 35.8             | 3.1              | 15.0             | 25.0             | 25.0             | 25.0             |
| Net new Debt                           | 285.5            | 1,004.0          | 292.9            | 25.1             | 335.3            | 168.4            | 164.1            |
| Net New Equity                         | (0.5)            | (783.3)          | 245.6            | 243.7            | 250.0            | 239.7            | 194.7            |
| <b>Net Change in Cash</b>              | <b>(35.3)</b>    | <b>(16.3)</b>    | <b>(3.9)</b>     | <b>(1.7)</b>     | <b>0.0</b>       | <b>(0.0)</b>     | <b>(0.0)</b>     |
| Beginning Cash                         | 65.1             | 29.8             | 13.5             | 9.5              | 7.8              | 7.8              | 7.8              |
| Ending Cash                            | 29.8             | 13.5             | 9.5              | 7.8              | 7.8              | 7.8              | 7.8              |

Source: Company filings, Goldman Sachs Research estimates.

November 11, 2009

American Water Works Co., Inc. (AWK)

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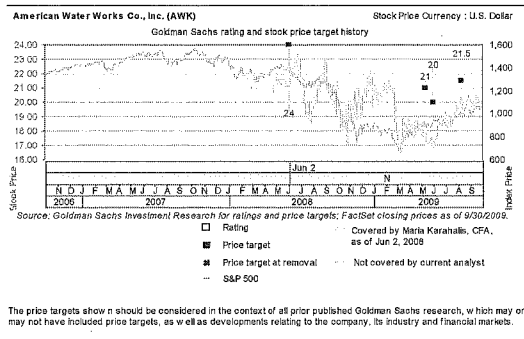
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|--------|---------------------|------|------|----------------------------------|------|------|
|        | Buy                 | Hold | Sell | Buy                              | Hold | Sell |
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American Water Works Co., Inc. (AWK)

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November 11, 2009

American Water Works Co., Inc. (AWK)

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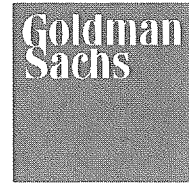
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March 3, 2010



COMPANY UPDATE  
**American Water Works Co., Inc. (AWK)**

Neutral

**In-line 4Q09 results; higher opex offset by lower taxes**

**What's changed**

American Water reported fourth quarter EPS of \$0.21, in line with our forecast. EBITDA came in at \$215 million, just below our \$218 million estimate. Revenue was 0.8% above our forecast but operating expenses were 3.5% higher. The lower EBITDA relative to our forecast was offset by lower taxes and slightly lower interest expense to arrive at EPS in line with our forecast. The company's equity ratio declined to 42% at the end of 2009. We assume that this ratio will need to steadily increase to 45% by 2012.

**Implications**

We are updating our estimates to reflect additional rate case awards, higher O&M expenses, the acquisition of EMC and debt financing completed during the fourth quarter. Our 2010/2011/2012 EPS estimates move to \$1.40/\$1.55/\$1.64 from \$1.44/\$1.56/\$1.64. Our \$1.40 estimate for 2010 compares with management's recently issued guidance of \$1.30-\$1.40. Management did not provide any context for revenue growth or margin improvement embedded in this guidance.

**Valuation**

We maintain our Neutral rating. Our 12-month price target moves to \$23.00 from \$21.50 after eliminating the share overhang associated with RWE. Our price target is based on a combination of relative valuation metrics (both P/E and EV/EBITDA), as well as a dividend discount model (5% dividend growth and 8.5% cost of equity from 9.0% previously).

**Key risks**

**Upside risks** to our view and price target include faster-than-expected recovery through rates, lower O&M expenses, and stronger free cash flow generation that reduces the need to issue new equity. **Downside risks** include regulatory decisions and regulatory lag that limit ROE expansion and financing risk associated with funding the large capital investment program.

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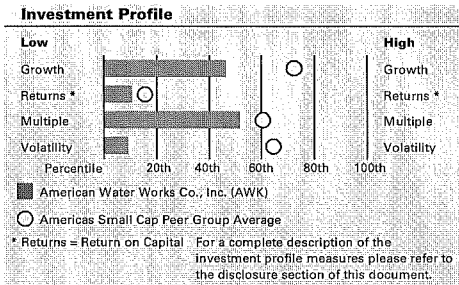
Neutral

**Coverage View:** Neutral

United States:  
Water

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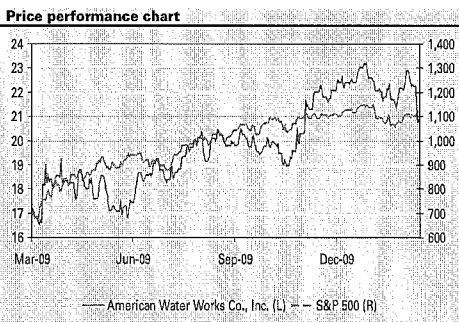
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| Key data                   | Current |
|----------------------------|---------|
| Price (\$)                 | 20.92   |
| 12 month price target (\$) | 23.00   |
| Market cap (\$ mn)         | 3,656.4 |

|                     | 12/09   | 12/10E  | 12/11E  | 12/12E  |
|---------------------|---------|---------|---------|---------|
| Revenue (\$ mn) New | 2,440.7 | 2,685.9 | 2,868.9 | 3,026.0 |
| Revenue (\$ mn) Old | 2,435.9 | 2,860.9 | 2,824.9 | 2,973.3 |
| EPS (\$) New        | 1.25    | 1.40    | 1.55    | 1.64    |
| EPS (\$) Old        | 1.25    | 1.44    | 1.56    | 1.64    |
| P/E (X)             | 16.8    | 14.9    | 13.5    | 12.7    |
| EV/EBITDA (X)       | 9.5     | 9.2     | 8.6     | 8.2     |
| ROE (%)             | 5.2     | 6.1     | 6.6     | 6.8     |

|          | 12/09 | 3/10E | 6/10E | 9/10E |
|----------|-------|-------|-------|-------|
| EPS (\$) | 0.21  | 0.19  | 0.36  | 0.54  |



| Share price performance (%) | 3 month | 6 month | 12 month |
|-----------------------------|---------|---------|----------|
| Absolute                    | (4.0)   | 5.8     | 24.3     |
| Rel. to S&P 500             | (5.7)   | (5.2)   | (22.6)   |

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 3/03/2010 close.

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March 3, 2010

American Water Works Co., Inc. (AWK)

## American Water Works Co., Inc.: Summary financials

| Profit model (\$ mn)                      | 12/09          | 12/10E         | 12/11E         | 12/12E         | Balance sheet (\$ mn)                 | 12/09           | 12/10E          | 12/11E          | 12/12E          |
|---|----------------|----------------|----------------|----------------|---------------------------------------|-----------------|-----------------|-----------------|-----------------|
| Total revenue                             | 2,440.7        | 2,685.9        | 2,868.9        | 3,026.0        | Cash & equivalents                    | 22.3            | 22.3            | 22.3            | 22.3            |
| Cost of goods sold                        | (1,618.6)      | (1,745.9)      | (1,824.1)      | (1,903.8)      | Accounts receivable                   | 205.5           | 233.5           | 251.5           | 265.3           |
| SG&A                                      | (199.3)        | (214.9)        | (229.5)        | (242.1)        | Inventory                             | 29.5            | 35.5            | 32.4            | 33.5            |
| R&D                                       | 0.0            | 0.0            | 0.0            | 0.0            | Other current assets                  | 241.9           | 268.7           | 280.9           | 290.2           |
| Other operating profit/(expense)          | 0.8            | 0.0            | 0.0            | 0.0            | <b>Total current assets</b>           | <b>499.1</b>    | <b>560.0</b>    | <b>587.0</b>    | <b>611.2</b>    |
| ESO expense                               | 0.0            | 0.0            | 0.0            | 0.0            | Net PP&E                              | 10,677.4        | 11,305.4        | 11,813.3        | 12,292.8        |
| <b>EBITDA</b>                             | <b>917.8</b>   | <b>1,043.7</b> | <b>1,162.4</b> | <b>1,255.7</b> | Net intangibles                       | 1,250.4         | 1,250.4         | 1,250.4         | 1,250.4         |
| Depreciation & amortization               | (294.2)        | (318.5)        | (347.0)        | (375.5)        | Total investments                     | 0.0             | 0.0             | 0.0             | 0.0             |
| <b>EBIT</b>                               | <b>623.6</b>   | <b>725.1</b>   | <b>815.3</b>   | <b>880.1</b>   | Other long-term assets                | 1,025.8         | 1,045.8         | 1,065.8         | 1,085.8         |
| Net interest income/(expense)             | (303.2)        | (332.7)        | (351.7)        | (364.1)        | <b>Total assets</b>                   | <b>13,452.7</b> | <b>14,161.5</b> | <b>14,716.5</b> | <b>15,240.1</b> |
| Income/(loss) from associates             | 0.0            | 0.0            | 0.0            | 0.0            | Accounts payable                      | 138.6           | 138.1           | 141.6           | 146.5           |
| Others                                    | 17.9           | 26.0           | 26.0           | 26.0           | Short-term debt                       | 173.6           | 173.6           | 173.6           | 173.6           |
| <b>Pretax profits</b>                     | <b>338.3</b>   | <b>418.4</b>   | <b>489.6</b>   | <b>542.0</b>   | Other current liabilities             | 295.2           | 295.2           | 295.2           | 295.2           |
| Provision for taxes                       | (128.4)        | (163.2)        | (190.9)        | (211.4)        | <b>Total current liabilities</b>      | <b>607.4</b>    | <b>606.9</b>    | <b>610.4</b>    | <b>615.3</b>    |
| Minority interest                         | 0.0            | 0.0            | 0.0            | 0.0            | Long-term debt                        | 5,312.1         | 5,649.4         | 5,817.0         | 5,981.5         |
| <b>Net income pre-preferred dividends</b> | <b>209.9</b>   | <b>255.2</b>   | <b>298.7</b>   | <b>330.6</b>   | Other long-term liabilities           | 3,527.7         | 3,552.7         | 3,577.7         | 3,602.7         |
| Preferred dividends                       | 0.0            | 0.0            | 0.0            | 0.0            | <b>Total long-term liabilities</b>    | <b>8,839.8</b>  | <b>9,202.1</b>  | <b>9,394.7</b>  | <b>9,584.2</b>  |
| <b>Net income (pre-exceptionals)</b>      | <b>209.9</b>   | <b>255.2</b>   | <b>298.7</b>   | <b>330.6</b>   | <b>Total liabilities</b>              | <b>9,447.2</b>  | <b>9,809.0</b>  | <b>10,005.1</b> | <b>10,199.6</b> |
| Post tax exceptionals                     | (443.0)        | 0.0            | 0.0            | 0.0            | Preferred shares                      | 4.6             | 4.6             | 4.6             | 4.6             |
| <b>Net income (post-exceptionals)</b>     | <b>(233.1)</b> | <b>255.2</b>   | <b>298.7</b>   | <b>330.6</b>   | <b>Total common equity</b>            | <b>4,000.9</b>  | <b>4,347.9</b>  | <b>4,706.8</b>  | <b>5,036.0</b>  |
| EPS (basic, pre-exception) (\$)           | 1.25           | 1.40           | 1.56           | 1.65           | Minority interest                     | 0.0             | 0.0             | 0.0             | 0.0             |
| EPS (diluted, pre-exception) (\$)         | 1.25           | 1.40           | 1.55           | 1.64           | <b>Total liabilities &amp; equity</b> | <b>13,452.7</b> | <b>14,161.5</b> | <b>14,716.5</b> | <b>15,240.1</b> |
| EPS (basic, post-exception) (\$)          | (1.39)         | 1.40           | 1.56           | 1.65           | <b>Additional financials</b>          | <b>12/09</b>    | <b>12/10E</b>   | <b>12/11E</b>   | <b>12/12E</b>   |
| EPS (diluted, post-exception) (\$)        | (1.39)         | 1.40           | 1.55           | 1.64           | Net debt/equity (%)                   | 136.4           | 133.3           | 126.7           | 121.7           |
| Common dividends paid                     | (137.3)        | (158.1)        | (177.8)        | (193.8)        | Interest cover (X)                    | 2.1             | 2.2             | 2.3             | 2.4             |
| DPS (\$)                                  | 0.79           | 0.86           | 0.90           | 0.95           | Inventory days                        | 6.6             | 6.8             | 6.8             | 6.3             |
| Dividend payout ratio (%)                 | 63.0           | 61.4           | 57.9           | 57.4           | Receivable days                       | 30.3            | 29.8            | 30.9            | 31.2            |
|   |                |                |                |                | BVPS (\$)                             | 22.91           | 23.30           | 23.96           | 24.69           |
| <b>Growth &amp; margins (%)</b>           | <b>12/09</b>   | <b>12/10E</b>  | <b>12/11E</b>  | <b>12/12E</b>  | ROA (%)                               | 1.6             | 1.8             | 2.1             | 2.2             |
| Sales growth                              | 4.4            | 10.0           | 6.8            | 5.5            | CROCI (%)                             | 5.8             | 4.3             | 4.5             | 4.7             |
| EBITDA growth                             | 10.0           | 13.7           | 11.4           | 8.0            | <b>Dupont ROE (%)</b>                 | <b>5.2</b>      | <b>5.9</b>      | <b>6.3</b>      | <b>6.6</b>      |
| EBIT growth                               | 10.7           | 16.3           | 12.4           | 7.9            | Margin (%)                            | 8.6             | 9.5             | 10.4            | 10.9            |
| Net income (pre-exception) growth         | 19.2           | 21.6           | 17.0           | 10.7           | Turnover (X)                          | 0.2             | 0.2             | 0.2             | 0.2             |
| EPS growth                                | 13.4           | 12.3           | 11.3           | 5.9            | Leverage (X)                          | 3.4             | 3.3             | 3.1             | 3.0             |
| Gross margin                              | 33.7           | 35.0           | 36.4           | 37.1           | Free cash flow per share (\$)         | (1.12)          | (1.96)          | (1.16)          | (0.79)          |
| EBITDA margin                             | 37.6           | 38.9           | 40.5           | 41.5           | Free cash flow yield (%)              | (5.8)           | (9.4)           | (5.6)           | (3.8)           |
| EBIT margin                               | 25.6           | 27.0           | 28.4           | 29.1           |                                       |                 |                 |                 |                 |
|   |                |                |                |                |                                       |                 |                 |                 |                 |
| <b>Cash flow statement (\$ mn)</b>        | <b>12/09</b>   | <b>12/10E</b>  | <b>12/11E</b>  | <b>12/12E</b>  |                                       |                 |                 |                 |                 |
| Net income                                | 209.9          | 255.2          | 298.7          | 330.6          |                                       |                 |                 |                 |                 |
| D&A add-back (incl. ESO)                  | 294.2          | 318.5          | 347.0          | 375.5          |                                       |                 |                 |                 |                 |
| Minority interest add-back                | 0.0            | 0.0            | 0.0            | 0.0            |                                       |                 |                 |                 |                 |
| Net (inc)/dec working capital             | (187.6)        | (61.3)         | (23.6)         | (19.3)         |                                       |                 |                 |                 |                 |
| Other operating cash flow                 | 279.6          | (20.0)         | (20.0)         | (20.0)         |                                       |                 |                 |                 |                 |
| <b>Cash flow from operations</b>          | <b>596.2</b>   | <b>492.4</b>   | <b>602.1</b>   | <b>666.9</b>   |                                       |                 |                 |                 |                 |
| Capital expenditures                      | (785.3)        | (850.0)        | (825.0)        | (825.0)        |                                       |                 |                 |                 |                 |
| Acquisitions                              | (18.1)         | (96.5)         | (30.0)         | (30.0)         |                                       |                 |                 |                 |                 |
| Divestitures                              | 0.0            | 0.0            | 0.0            | 0.0            |                                       |                 |                 |                 |                 |
| Others                                    | (6.1)          | 0.0            | 0.0            | 0.0            |                                       |                 |                 |                 |                 |
| <b>Cash flow from investing</b>           | <b>(703.6)</b> | <b>(946.5)</b> | <b>(855.0)</b> | <b>(855.0)</b> |                                       |                 |                 |                 |                 |
| Dividends paid (common & pref)            | (137.3)        | (158.1)        | (177.8)        | (193.8)        |                                       |                 |                 |                 |                 |
| Inc/dec in debt                           | (7.9)          | 337.2          | 167.6          | 164.6          |                                       |                 |                 |                 |                 |
| Other financing cash flows                | 265.4          | 275.0          | 263.0          | 217.3          |                                       |                 |                 |                 |                 |
| <b>Cash flow from financing</b>           | <b>120.2</b>   | <b>454.1</b>   | <b>252.9</b>   | <b>188.1</b>   |                                       |                 |                 |                 |                 |
| <b>Total cash flow</b>                    | <b>12.7</b>    | <b>0.0</b>     | <b>0.0</b>     | <b>0.0</b>     |                                       |                 |                 |                 |                 |

Note: Last actual year may include reported and estimated data.  
Source: Company data, Goldman Sachs Research estimates.

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## New developments reflected in our forecast

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### Approved rate cases

During 4Q 2009, American Water received approval for additional annualized revenues in the following states.

- **Iowa rate case:** awarded 64.5% of filed amount
  - Awarded annualized revenues of \$6.1 million on October 8, 2009; requested \$9.4 million
  - Interim rates of \$6.8 million were put in place on July 27, 2009; Customers will receive refunds with interest due to interim rates being higher than final rates granted
  - ROE: awarded 10.5%; requested 12.2%
  - Rates effective November 3, 2009
- **Pennsylvania rate case:** awarded 53.0% of filed amount
  - Awarded annualized revenues of \$30.8 million; requested \$58.1 million
  - ROE: awarded 10.8%; requested 12.2%
  - Effective November 6, 2009
- **Texas rate case:** awarded 56.2% of filed amount
  - Awarded annualized revenues of \$0.5 million; requested \$0.9 million
  - ROE: awarded 12.0%; requested 12.0%
  - Effective November 30, 2009
- **Arizona rate case:** awarded 40.1% of filed amount
  - Awarded annualized revenues of \$8.0 million effective December 1, 2009; requested \$20.0 million
  - ROE: awarded 9.9%; requested 11.8%

In addition, American Water finalized annualized revenues of \$26.6 million in distribution system improvement charges (DSIC) or infrastructure charges in 2009, with \$4.6 million awarded in 4Q 2009. Our model assumes that DSIC will contribute approximately 1% to revenue growth going forward.

### Pending rate cases

Since September 30, 2009, American Water has filed rate cases for additional annualized revenue increases of approximately \$75 million.

- **Missouri:** filed for \$48.7 million in annualized revenues and 11.6% ROE
  - Filed October 30, 2009; award expected October 2010
- **Virginia:** filed for \$0.6 million in annualized revenues and 10.5% ROE
  - Filed December 7, 2009; award expected December 2010
- **Kentucky:** filed for \$25.8 million in annualized revenues and 11.5% ROE
  - Filed February 26, 2010; award expected October 2010

In February 2010, West Virginia American Water filed a petition with the Public Service Commission (PSC) seeking approval for the implementation of a DSIC program in the state. This would help reduce regulatory lag by allowing immediate rate increases (capped at

March 3, 2010

American Water Works Co., Inc. (AWK)

7.5% of revenues) for infrastructure improvements completed between official rate cases. The PSC has scheduled meetings in August 2010 to begin the hearing process.

Exhibit 1 outlines American Water's rate case requests from 2006 to the present. Pending rate cases could increase annualized revenues by up to \$244.7 million. We have assumed that American Water receives approximately 50% of the amount requested for each pending rate case. For rate cases that have been concluded in 2009, the percentage has been slightly lower at around 46% (on a weighted average basis – total annualized revenues requested/total annualized revenues awarded).

Key pending rate cases include the following.

- California (filed in January 2009) for \$32.7 million
- Indiana (filed in April 2009) for \$46.9 million
- Illinois (filed in May 2009) for \$58.6 million
- Arizona (filed in July 2009) for \$20.6 million
- Missouri (filed in October 2009) for \$48.7 million
- Kentucky (filed in February 2010) for \$25.8 million

March 3, 2010

American Water Works Co., Inc. (AWK)

**Exhibit 1: American Water rate case requests from 2006 to present**

\$ millions

| State                                   | Date Filed | Amount Filed | Amount Granted | %      | ROE Filed | ROE Granted | Expected Grant Date | Status    |
|---|------------|--------------|----------------|--------|-----------|-------------|---------------------|-----------|
| <b>General Rate Cases Filed in 2006</b> |            |              |                |        |           |             |                     |           |
| Ohio                                    | 3/1/06     | \$5.1        | \$3.4          | 66.7%  | 11.0%     | 10.0%       | 3/1/07              | Completed |
| New Jersey                              | 3/31/06    | 99.0         | 56.2           | 56.8%  | 11.2%     | 10.0%       | 4/1/07              | Completed |
| New Mexico                              | 5/30/06    | 1.3          | 1.3            | 100.0% | 10.0%     | 9.7%        | 5/1/07              | Completed |
| Arizona (Anthem)                        | 6/16/06    | 7.0          | 4.3            | 61.4%  | 11.8%     | 8.8%        | 6/4/08              | Completed |
| Arizona (Sun City)                      | 7/28/06    | 3.9          | 2.4            | 61.5%  | 11.8%     | 10.6%       | 4/1/08              | Completed |
| Texas                                   | 10/16/06   | \$0.8        | \$0.7          | 87.5%  | 12.0%     | 12.0%       | 1/1/07              | Completed |
| Tennessee                               | 11/22/06   | 6.4          | 4.1            | 64.1%  | 11.0%     | 9.6%        | 5/23/07             | Completed |
| Indiana                                 | 12/5/06    | 24.7         | 14.0           | 56.7%  | 11.5%     | 10.0%       | 12/1/07             | Completed |
| Missouri                                | 12/15/06   | 41.5         | 21.4           | 51.6%  | 11.3%     | 10.0%       | 11/1/07             | Completed |

|                             |                |                |              |
|-----------------------------|----------------|----------------|--------------|
| <b>Total Granted (2006)</b> | <b>\$189.7</b> | <b>\$107.8</b> | <b>56.8%</b> |
| <b>Total Pending (2006)</b> | <b>\$0.0</b>   | <b>\$0.0</b>   |              |

| State                                   | Date Filed | Amount Filed | Amount Granted | %      | ROE Filed | ROE Granted | Expected Grant Date | Status    |
|---|------------|--------------|----------------|--------|-----------|-------------|---------------------|-----------|
| <b>General Rate Cases Filed in 2007</b> |            |              |                |        |           |             |                     |           |
| California *                            | 1/1/07     | \$16.4       | \$13.0         | 100.0% | 11.5%     | 10.2%       | 6/1/08              | Completed |
| Michigan                                | 1/8/07     | 0.2          | 0.2            | 100.0% | 12.0%     | 10.0%       | 1/8/07              | Completed |
| Maryland                                | 3/29/07    | 0.6          | 0.6            | 100.0% | 11.8%     | 10.5%       | 10/1/07             | Completed |
| Pennsylvania                            | 4/27/07    | 59.2         | 36.0           | 60.8%  | 11.8%     | N/A         | 11/30/07            | Completed |
| Arizona (Sun City)                      | 4/30/07    | 2.2          | 1.9            | 86.4%  | 11.8%     | 10.8%       | 6/1/08              | Completed |
| Kentucky                                | 4/30/07    | 13.2         | 8.0            | 60.6%  | 11.4%     | 10.0%       | 12/1/07             | Completed |
| Long Island **                          | 5/1/07     | 9.6          | 6.6            | 68.8%  | 11.0%     | 9.5%        | 4/1/08              | Completed |
| West Virginia                           | 6/1/07     | 24.1         | 14.5           | 60.2%  | 11.3%     | 10.0%       | 3/28/08             | Completed |
| Iowa                                    | 8/30/07    | 6.1          | 4.3            | 70.5%  | 11.3%     | 10.4%       | 2/1/08              | Completed |
| Illinois                                | 8/31/07    | 32.8         | 21.6           | 65.9%  | 11.3%     | 10.4%       | 8/8/08              | Completed |
| Ohio                                    | 10/1/07    | 5.5          | 5.3            | 95.6%  | 11.3%     | 10.9%       | 11/13/08            | Completed |
| Hawaii ***                              | 11/1/07    | 1.3          | 0.7            | 50.0%  | 10.6%     |             | 11/1/08             | Pending   |

\* California rate increase includes step increase of \$2.0mn effective in 2009 and \$2.5mn effective in 2010

\*\* Long Island rate increase includes step increase of \$1.0mn in 2009 and \$1.0mn in 2010

\*\*\* Hawaii temporary rate increase of \$0.7mn put in place Oct. 2008 and will be subject to adjustment upon issuance of final order

|                             |                |                |              |
|-----------------------------|----------------|----------------|--------------|
| <b>Total Granted (2007)</b> | <b>\$169.9</b> | <b>\$112.0</b> | <b>65.9%</b> |
| <b>Total Pending (2007)</b> | <b>\$1.3</b>   | <b>\$0.7</b>   | <b>50.0%</b> |

| State                                   | Date Filed | Amount Filed | Amount Granted | %      | ROE Filed | ROE Granted | Expected Grant Date | Status    |
|---|------------|--------------|----------------|--------|-----------|-------------|---------------------|-----------|
| <b>General Rate Cases Filed in 2008</b> |            |              |                |        |           |             |                     |           |
| Michigan                                | 1/1/08     | \$0.2        | \$0.2          | 100.0% | 10.0%     | 10.0%       | 1/1/08              | Completed |
| New Jersey                              | 1/14/08    | 125.0        | 72.1           | 57.7%  | 11.5%     | 10.3%       | 12/7/08             | Completed |
| California (Monterey Water)             | 1/30/08    | 35.3         | 12.1           | 34.3%  | 11.5%     | 10.2%       | 5/11/09             | Completed |
| California (Monterey WW)                | 1/30/08    | 1.8          | 1.7            | 94.4%  | 11.5%     | 10.2%       | 7/9/09              | Completed |
| California (Gen. Office)                | 1/30/08    | 6.4          | 2.2            | 34.4%  | 11.5%     | 10.2%       | 5/11/09             | Completed |
| Virginia                                | 1/30/08    | 4.3          | 3.4            | 79.1%  | 11.3%     | 10.5%       | 11/1/08             | Completed |
| Texas                                   | 2/21/08    | 0.9          | 0.5            | 56.2%  | 12.0%     | 12.0%       | 11/30/09            | Completed |
| Tennessee                               | 3/14/08    | 7.6          | 1.7            | 21.6%  | 11.8%     | 10.2%       | 10/1/08             | Completed |
| Missouri                                | 3/31/08    | 49.8         | 34.5           | 69.3%  | 11.3%     | 10.0%       | 11/28/08            | Completed |
| Pennsylvania - WW                       | 4/28/08    | 2.7          | 1.9            | 70.4%  | 11.5%     | 10.6%       | 11/14/08            | Completed |
| California (ROE)                        | 5/1/08     | 2.8          | 0.1            | 3.6%   | 11.5%     | 10.2%       | 5/6/09              | Completed |
| Arizona                                 | 5/1/08     | 20.0         | 8.0            | 40.1%  | 11.8%     | 9.9%        | 9/1/09              | Completed |
| West Virginia                           | 5/30/08    | 14.8         | 5.2            | 35.3%  | 11.8%     | 10.0%       | 3/26/09             | Completed |
| New Mexico (Clovis)                     | 6/30/08    | 2.2          | 1.4            | 61.8%  | 11.8%     | 10.3%       | 5/12/09             | Completed |
| Kentucky                                | 10/31/08   | 18.5         | 10.3           | 55.7%  | 11.5%     | 10.0%       | 6/1/09              | Completed |

|                             |                |                |              |
|-----------------------------|----------------|----------------|--------------|
| <b>Total Granted (2008)</b> | <b>\$292.3</b> | <b>\$155.2</b> | <b>53.1%</b> |
| <b>Total Pending (2008)</b> | <b>\$0.0</b>   | <b>\$0.0</b>   |              |

| State                                   | Date Filed | Amount Filed | Amount Granted | %      | ROE Filed | ROE Granted | Expected Grant Date | Status    |
|---|------------|--------------|----------------|--------|-----------|-------------|---------------------|-----------|
| <b>General Rate Cases Filed in 2009</b> |            |              |                |        |           |             |                     |           |
| California (Sac, LA, Lark)              | 1/23/09    | \$32.7       | \$16.4         | 50.0%  | 10.2%     |             | 1/1/10              | Pending   |
| Pennsylvania                            | 4/24/09    | 58.1         | 30.8           | 53.0%  | 12.0%     | 10.8%       | 11/6/09             | Completed |
| Iowa                                    | 4/30/09    | 9.4          | 6.1            | 64.5%  | 12.2%     | 10.5%       | 11/3/09             | Completed |
| Indiana                                 | 4/30/09    | 46.9         | 23.5           | 50.0%  | 12.0%     |             | 5/1/10              | Pending   |
| Maryland                                | 4/30/09    | 0.8          | 0.6            | 77.1%  | 11.8%     | 10.8%       | 9/10/09             | Completed |
| Ohio                                    | 5/7/09     | 8.8          | 4.4            | 50.0%  | 12.2%     |             | 2/1/10              | Pending   |
| Illinois                                | 5/29/09    | 58.6         | 29.3           | 50.0%  | 12.3%     |             | 5/1/10              | Pending   |
| Michigan                                | 6/22/09    | 0.2          | 0.2            | 100.0% | 10.5%     | 10.5%       | 7/1/09              | Completed |
| Arizona                                 | 7/2/09     | 20.6         | 10.3           | 50.0%  | 12.3%     |             | 7/1/10              | Pending   |
| New Mexico (Edgewood)                   | 8/21/09    | 0.7          | 0.3            | 50.0%  | 12.3%     |             | 7/1/10              | Pending   |
| Missouri                                | 10/30/09   | 48.7         | 24.4           | 50.0%  | 11.6%     |             | 10/1/10             | Pending   |
| Virginia                                | 12/7/09    | 0.6          | 0.3            | 50.0%  | 10.5%     |             | 12/1/10             | Pending   |

|                             |                |                |              |
|-----------------------------|----------------|----------------|--------------|
| <b>Total Granted (2009)</b> | <b>\$68.5</b>  | <b>\$37.6</b>  | <b>54.9%</b> |
| <b>Total Pending (2009)</b> | <b>\$217.6</b> | <b>\$108.8</b> | <b>50.0%</b> |

| State                                   | Date Filed | Amount Filed | Amount Granted | %     | ROE Filed | ROE Granted | Expected Grant Date | Status  |
|---|------------|--------------|----------------|-------|-----------|-------------|---------------------|---------|
| <b>General Rate Cases Filed in 2010</b> |            |              |                |       |           |             |                     |         |
| Kentucky                                | 2/26/10    | \$25.8       | \$12.9         | 50.0% | 11.5%     |             | 10/1/10             | Pending |

|                                       |                |                |              |
|---------------------------------------|----------------|----------------|--------------|
| <b>Total Granted (2006 - present)</b> | <b>\$720.4</b> | <b>\$412.6</b> | <b>57.3%</b> |
| <b>Total Pending (2006 - present)</b> | <b>\$244.7</b> | <b>\$122.4</b> | <b>50.0%</b> |

Source: Company data, various State Public Utility Commission news releases, Goldman Sachs Research estimates.

## Tuck-in acquisition update

We expect tuck-in acquisition activity to pick up, particularly given the increasing economic pressure on municipalities to bridge their budget shortfalls. Since September 30, 2009, American Water has completed several small tuck-in acquisitions that are summarized below. During 2009, American Water completed six small tuck-in acquisitions for a combined purchase price of \$7.8 million. We forecast tuck-in acquisitions will add approximately 1% to top-line growth over the next several years. As these tuck-ins are generally small in size, it would either take a large number of tuck-in acquisitions to impact revenues in a more meaningful way or a series of mid-sized acquisitions which generally take longer to complete.

- **Pennsylvania** (Clearfield, Centre, Washington)
  - Clearfield (purchased assets of Wallacetown Municipal Authority)
  - Centre (purchased assets of Boggs Township Municipal Authority)
  - Washington (purchased assets of Amwell Township Water Authority)
  - Acquired 2 of the water systems in September 2009 and 1 water system on October 1, 2009
  - Total combined purchase price: \$0.935 million (\$0.65 million recognized in 3Q 2009)
  - 200 water customers (population of 600)
- **Indiana** (Waveland Water Utility)
  - Approved by Indiana PUC on September 23, 2009; acquired on October 26, 2009
  - Purchase price: \$0.68 million
  - 213 customers (population of 500)
- **Pennsylvania** (Saxonburg Area Authority water system in Butler County)
  - Effective Oct 28, 2009
  - Purchase price: \$6 million
  - 1,200 customers (population of 3,600)
  - Newly acquired system serves Saxonburg Borough and portions of Jefferson and Clinton townships
- **West Virginia** (Arbuckle Public Service District water system in Fayette County)
  - Acquired on December 16, 2009
  - Purchase price: \$0.06 million
  - 500 residents
  - The Arbuckle water system will be incorporated into West Virginia American Water's Fayette County service area which currently serves ~27,000 customers.
- **Pennsylvania** (Nittany Water Company)
  - Acquired on February 3, 2010
  - Purchase price: \$0.52 million
  - Population of 1,500

## Trenton update

- On April 3, 2009 the Board of Public Utilities approved the \$75 million sale by American Water of the City of Trenton assets.
- However, the approval is pending the resolution of court proceedings initiated in New Jersey Superior Court by Trenton residents seeking to require a referendum for the asset sale.

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- In May 2009, Trenton trial court ruled that a referendum is not required. Trenton residents filed for reconsideration and on July 13, 2009, the court denied the resident's motion.
- An appeal was filed with the New Jersey Superior Court Appellate Division and oral arguments were held in October 2009.
- On December 19, 2009, the New Jersey Supreme Court Appellate panel published its decision unanimously upholding a March 2009 trial court decision in favor of the City of Trenton and New Jersey American Water.
- The New Jersey Supreme Court granted the petitioners' request for certification and oral argument is scheduled for March 22, 2010.
- American Water expects a decision within the next couple of months. If the ruling is favorable, the company anticipates closing the acquisition within 30-60 days of the resolution.
- Our model assumes that the acquisition will close in the third quarter of 2010, but if the Supreme Court rules in favor of the petitioners, we would need to strip out the Trenton acquisition from our forecast. We assume that Trenton contributes approximately \$25 million in incremental revenue to American Water in 2011.

## **Non-regulated business update**

### **Environmental Management Corporation Acquisition**

On December 14, 2009, American Water acquired Environmental Management Corporation (EMC), a water and wastewater contract operator, from The Linde Group. EMC is estimated to have contracts with about 55 industrial and municipal customers in the United States and Canada. EMC revenues in 2008 were approximately \$50 million. The acquisition will be consolidated into American Water's non-regulated business, American Water Enterprises. The acquisition price was not disclosed; however we estimate a transaction price of approximately \$10 million. American Water indicated that it paid approximately \$18.1 million for acquisitions during 2009 of which \$7.8 million were tuck-ins. We assume that the difference represents EMC.

We have incorporated EMC into American Water's non-regulated segment beginning in 2010. We assume that there is some client turnover during the integration of the two businesses and therefore have assumed incremental revenues of approximately \$40 million for 2010, instead of the \$50 million reported for 2008. Our non-regulated revenue assumption for the non-regulated business now implies revenue growth of 21% in 2010, 4.5% in 2011 and 4.5% in 2012. We have also assumed that the gross margin for EMC is similar to the gross margin for American Water's non-regulated business.

### **Military Services Group Contracts – Fort Belvoir and Fort Meade**

American Water announced on October 1, 2009 that its Military Services Group was awarded contracts for O&M of the water and wastewater systems at Fort Belvoir, Virginia and Fort Meade, Maryland.

- **Fort Belvoir, Virginia:** estimated \$288 million of additional revenues over 50 year period (\$5.76 million/year or \$1.44 million/quarter)
- **Fort Meade, Maryland:** estimated \$650 million of additional revenues over 50 year period (\$13 million/year or \$3.25 million/quarter)
- Subject to price re-determination

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We expect to see the full impact to non-regulated revenues from these contracts in the second half of 2010, as we believe it will take several months for the project to fully ramp.

### **Capitalization:**

American Water's equity ratio fell to 42.2% at the end of 2009 from 43.6% in 2008, largely due to the large (\$785 million) capital investment program which was principally funded with debt financing. The company had net debt of \$5,463.4 million as of December 31, 2009, total debt of \$5,485.7 million and cash of \$22.3 million.

We estimate the company will need to raise additional capital in future years in order to fund the planned capital investment program of \$800 million to \$1 billion per year and to restore its' equity ratio to a level closer to the target ratio of 45% - 50%. In our model, we assume that the company funds its capex program with debt financing of \$337 million in 2010, \$168 million in 2011 and \$164 million in 2012 and equity financing of \$250 million in 2010, \$238 million in 2011 and \$192 million in 2012. This should allow American Water to return to a 45% equity ratio by 2012. To reach 45% sooner or to bring the equity ratio closer to 50% would require additional equity issuance.

### **Summary of Debt Financing Completed since September 30, 2009**

- **\$28.5 million Tax-Exempt Debt Offering** (closed October 1, 2009)
  - Water facility revenue bonds issued by Illinois Finance Authority
  - 5.25% coupon with a 30-year maturity and 10-year call option
  - Proceeds used to pay short term debt related to construction of a water treatment and transmission facility consisting of supply mains, distribution mains, service lines, meters and miscellaneous equipment in Champaign County, Illinois and certain other Illinois American Water service.
- **\$134.2 million Tax-Exempt Debt Offering** (closed October 20, 2009)
  - Water facility revenue bonds issued by New Jersey
  - 5.7% coupon with a 30-year maturity
  - Proceeds used to pay down short-term debt
- **\$10.5 million Tax-Exempt Debt Offering** (closed October 20, 2009)
  - Water facility revenue bonds issued by New Jersey
  - 5.0% coupon with a 30-year maturity
  - Proceeds used to pay down short-term debt
- **\$60.0 million Taxable Debt Offering** (closed December 4, 2009)
  - The proceeds from the bond offering will be used to repay short-term debt related to infrastructure upgrades in Illinois, Indiana, Tennessee, Long Island and Maryland.
  - 6.0% coupon with a 30-year maturity

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## Details on our model changes

Exhibit 2 summarizes the key differences between our 4Q estimates and reported results.

### Exhibit 2: American Water 4Q2009 actuals versus expected

\$ millions, except per-share data

|                                      | 4Q09A        | 4Q09E        | % Chg        | 4Q08A        | % Chg        | 3Q09A        | % Chg         |
|--------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|
| Operating Revenues                   | 597.8        | 593.0        | 0.8%         | 568.6        | 5.2%         | 680.0        | -12.1%        |
| <i>Y/Y Growth</i>                    | 5.2%         | 4.3%         | + 85 bps     | 2.7%         | + 249 bps    | 1.2%         | + 400 bps     |
| Operating and maintenance            | (338.5)      | (327.1)      | 3.5%         | (319.7)      | 5.9%         | (340.9)      | -0.7%         |
| Depreciation and amortization        | (77.3)       | (76.8)       | 0.7%         | (71.7)       | 7.9%         | (74.9)       | 3.3%          |
| General taxes                        | (44.4)       | (47.4)       | -6.3%        | (48.1)       | -7.5%        | (50.6)       | -12.2%        |
| % of revenues                        | 7.4%         | 8.0%         | - 57 bps     | 8.5%         | - 102 bps    | 7.4%         | - 1 bps       |
| Gain (loss) on sale of assets        | (0.2)        | 0.0          |              | (0.0)        | 446.2%       | 0.8          | -127.2%       |
| Operating Profit                     | 137.4        | 141.7        | -3.0%        | 129.1        | 6.5%         | 214.4        | -35.9%        |
| <i>Operating Margin</i>              | 23.0%        | 23.9%        | - 91 bps     | 22.7%        | + 28 bps     | 31.5%        | - 855 bps     |
| Interest, net                        | (78.2)       | (80.8)       | -3.2%        | (74.0)       | 5.8%         | (76.3)       | 2.6%          |
| AFUDC                                | 4.0          | 5.0          | -20.7%       | 6.2          | -36.4%       | 4.0          | 0.0%          |
| Other Inc/exp                        | (0.2)        | 1.5          | -112.5%      | 3.3          | -105.7%      | (0.3)        | -39.7%        |
| Pretax Income                        | 62.9         | 67.3         | -6.6%        | 64.6         | -2.6%        | 141.8        | -55.6%        |
| Provision for Income Taxes           | (26.5)       | (30.3)       | -12.4%       | (28.2)       | -5.9%        | (50.2)       | -47.1%        |
| <i>Tax Rate</i>                      | 42.2%        | 45.0%        | - 281 bps    | 43.7%        | - 147 bps    | 35.4%        | + 681 bps     |
| Net Income, Continuing Ops           | 36.4         | 37.0         | -1.8%        | 36.4         | -0.1%        | 91.6         | -60.3%        |
| Preferred Dividend                   | 0.0          | 0.0          |              | 0.0          |              | 0.0          |               |
| Non-recurring/Discontinued Ops       | 0.0          | 0.0          |              | 0.0          |              | 0.0          |               |
| Extraordinary Items                  | 0.0          | 0.0          |              | 0.0          |              | 0.0          |               |
| <b>Net Income</b>                    | <b>36.4</b>  | <b>37.0</b>  | <b>-1.8%</b> | <b>36.4</b>  | <b>-0.1%</b> | <b>91.6</b>  | <b>-60.3%</b> |
| Shares Outstanding - Basic           | 174.6        | 174.6        | 0.0%         | 160.0        | 9.2%         | 174.6        | 0.0%          |
| Shares Outstanding - Diluted         | 174.8        | 174.7        | 0.0%         | 160.0        | 9.2%         | 174.7        | 0.0%          |
| Shares Outstanding - Basic (EOP)     | 174.6        | 174.6        | 0.0%         | 160.0        | 9.1%         | 174.6        | 0.0%          |
| Shares Outstanding - Diluted (EOP)   | 174.8        | 174.6        | 0.1%         | 160.0        | 9.2%         | 174.7        | 0.0%          |
| EPS - Continuing Ops- Basic          | 0.21         | 0.21         | -1.8%        | 0.23         | -8.5%        | 0.52         | -60.3%        |
| <b>EPS - Continuing Ops- Diluted</b> | <b>0.21</b>  | <b>0.21</b>  | <b>-1.8%</b> | <b>0.23</b>  | <b>-8.5%</b> | <b>0.52</b>  | <b>-60.3%</b> |
| <i>Y/Y EPS Growth (diluted)</i>      | -8.5%        | -6.8%        | - 171 bps    | 32.9%        | - 4,143 bps  | -4.8%        | - 372 bps     |
| EPS - Net Income- Basic              | 0.21         | 0.21         | -1.8%        | 0.23         | -8.5%        | 0.52         | -60.3%        |
| EPS - Net Income- Diluted            | 0.21         | 0.21         | -1.8%        | 0.23         | -8.5%        | 0.52         | -60.3%        |
| <b>EBITDA</b>                        | <b>214.7</b> | <b>218.4</b> | <b>-1.7%</b> | <b>200.7</b> | <b>7.0%</b>  | <b>289.3</b> | <b>-25.8%</b> |
| <i>Y/Y Growth</i>                    | 7.0%         | 8.8%         | - 187 bps    | 14.2%        | - 721 bps    | 3.3%         | + 370 bps     |
| <i>EBITDA Margin</i>                 | 35.9%        | 36.8%        | - 93 bps     | 35.3%        | + 61 bps     | 42.5%        | - 663 bps     |
| <b>MARGIN ANALYSIS:</b>              |              |              |              |              |              |              |               |
| O&M as a % of Revenue                | 56.6%        | 55.2%        | + 146 bps    | 56.2%        | + 38 bps     | 50.1%        | + 649 bps     |
| EBITDA                               | 35.9%        | 36.8%        | - 93 bps     | 35.3%        | + 61 bps     | 42.5%        | - 663 bps     |
| EBIT                                 | 23.0%        | 23.9%        | - 91 bps     | 22.7%        | + 28 bps     | 31.5%        | - 855 bps     |
| Pretax                               | 10.5%        | 11.4%        | - 83 bps     | 11.4%        | - 84 bps     | 20.9%        | - 1,033 bps   |
| Net-Continuing Operations            | 6.1%         | 6.2%         | - 16 bps     | 6.4%         | - 32 bps     | 13.5%        | - 739 bps     |
| Net Income                           | 6.1%         | 6.2%         | - 16 bps     | 6.4%         | - 32 bps     | 13.5%        | - 739 bps     |
| <b>YOY GROWTH</b>                    |              |              |              |              |              |              |               |
| Revenue                              | 5.2%         | 4.3%         | + 85 bps     |              |              |              |               |
| EBIT                                 | 6.5%         | 9.8%         | - 333 bps    |              |              |              |               |
| EBITDA                               | 7.0%         | 8.8%         | - 187 bps    |              |              |              |               |
| D&A                                  | 7.9%         | 7.1%         | + 75 bps     |              |              |              |               |
| Pretax Income                        | -2.6%        | 4.2%         | - 684 bps    |              |              |              |               |
| Net Income                           | -0.1%        | 1.7%         | - 182 bps    |              |              |              |               |
| EPS                                  | -8.5%        | -6.8%        | - 171 bps    |              |              |              |               |

Source: Company data, Goldman Sachs Research estimates.

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## American Water financial model

### Exhibit 3: American Water annual income statement, 2006-2012E

\$ millions, except per-share data

| INCOME STATEMENT                      | 2006A          | 2007A          | 2008A          | 2009A          | 2010E          | 2011E          | 2012E          |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Operating Revenues                    | 2,093.1        | 2,214.2        | 2,336.9        | 2,440.7        | 2,685.9        | 2,868.9        | 3,026.0        |
| <i>YY Growth</i>                      | -2.0%          | 5.8%           | 5.5%           | 4.4%           | 10.0%          | 6.8%           | 5.5%           |
| Operation and maintenance             | (1,174.5)      | (1,246.5)      | (1,303.8)      | (1,324.4)      | (1,427.3)      | (1,477.1)      | (1,528.3)      |
| Depreciation and amortization         | (259.2)        | (267.3)        | (271.3)        | (294.2)        | (318.5)        | (347.0)        | (375.5)        |
| General taxes                         | (185.1)        | (183.3)        | (199.1)        | (199.3)        | (214.9)        | (229.5)        | (242.1)        |
| % of revenues                         | 8.8%           | 8.3%           | 8.5%           | 8.2%           | 8.0%           | 8.0%           | 8.0%           |
| Gain (loss) on sale of assets         | (0.1)          | 7.3            | 0.4            | 0.8            | 0.0            | 0.0            | 0.0            |
| Operating Profit                      | 474.2          | 524.5          | 563.1          | 623.6          | 725.1          | 815.3          | 880.1          |
| <i>Operating Margin</i>               | 22.7%          | 23.7%          | 24.1%          | 25.6%          | 27.0%          | 28.4%          | 29.1%          |
| Interest, net                         | (371.0)        | (288.0)        | (291.1)        | (303.2)        | (332.7)        | (351.7)        | (364.1)        |
| AFUDC                                 | 8.6            | 11.2           | 22.7           | 18.7           | 20.0           | 20.0           | 20.0           |
| Other inc/exp                         | 0.9            | 6.2            | 4.7            | (0.8)          | 6.0            | 6.0            | 6.0            |
| Pretax Income                         | 112.7          | 253.8          | 299.4          | 338.3          | 418.4          | 489.6          | 542.0          |
| Provision for Income Taxes            | (51.1)         | (94.5)         | (123.4)        | (128.4)        | (163.2)        | (190.9)        | (211.4)        |
| <i>Tax Rate</i>                       | 45.3%          | 37.2%          | 41.2%          | 37.9%          | 39.0%          | 39.0%          | 39.0%          |
| Net Income, Continuing Ops            | 61.7           | 159.3          | 176.1          | 209.9          | 255.2          | 298.7          | 330.6          |
| Preferred Dividend                    | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            |
| Non-recurring/Discontinued Ops        | (6.4)          | (0.6)          | 0.0            | 0.0            | 0.0            | 0.0            | 0.0            |
| Extraordinary Items                   | (217.5)        | (501.5)        | (738.5)        | (443.0)        | 0.0            | 0.0            | 0.0            |
| <b>Net Income - Reported</b>          | <b>(162.2)</b> | <b>(342.8)</b> | <b>(562.4)</b> | <b>(233.1)</b> | <b>255.2</b>   | <b>298.7</b>   | <b>330.6</b>   |
| Shares Outstanding - Basic (Avg)      | 160.0          | 160.0          | 160.0          | 168.2          | 182.1          | 191.5          | 200.2          |
| Shares Outstanding - Diluted (Avg)    | 160.0          | 160.0          | 160.0          | 168.2          | 182.3          | 192.1          | 201.0          |
| Shares Outstanding - Basic (EOP)      | 160.0          | 160.0          | 160.0          | 174.6          | 186.6          | 196.4          | 204.0          |
| Shares Outstanding - Diluted (EOP)    | 160.0          | 160.0          | 160.0          | 174.8          | 187.1          | 197.2          | 204.8          |
| EPS - Continuing Ops - Basic          | 0.39           | 1.00           | 1.10           | 1.25           | 1.40           | 1.56           | 1.65           |
| <b>EPS - Continuing Ops - Diluted</b> | <b>0.39</b>    | <b>1.00</b>    | <b>1.10</b>    | <b>1.25</b>    | <b>1.40</b>    | <b>1.55</b>    | <b>1.64</b>    |
| <i>YY EPS Growth (diluted)</i>        | -40.1%         | 158.4%         | 10.6%          | 13.4%          | 12.1%          | 11.1%          | 5.8%           |
| EPS - Net Income - Reported - Basic   | -1.01          | -2.14          | -3.52          | -1.39          | 1.40           | 1.56           | 1.65           |
| EPS - Net Income - Reported - Diluted | -1.01          | -2.14          | -3.52          | -1.39          | 1.40           | 1.55           | 1.64           |
| <b>EBITDA</b>                         | <b>733.4</b>   | <b>791.8</b>   | <b>834.4</b>   | <b>917.8</b>   | <b>1,043.7</b> | <b>1,162.4</b> | <b>1,255.7</b> |
| <i>YY Growth</i>                      | -3.3%          | 8.0%           | 5.4%           | 10.0%          | 13.7%          | 11.4%          | 8.0%           |
| <i>EBITDA Margin</i>                  | 35.0%          | 35.8%          | 35.7%          | 37.6%          | 38.9%          | 40.5%          | 41.5%          |
| <b>MARGIN ANALYSIS:</b>               |                |                |                |                |                |                |                |
| O&M as a % of Revenue                 | 56.1%          | 56.3%          | 55.8%          | 54.3%          | 53.1%          | 51.5%          | 50.5%          |
| EBITDA as % of Revenue                | 35.0%          | 35.8%          | 35.7%          | 37.6%          | 38.9%          | 40.5%          | 41.5%          |
| EBIT as % of Revenue                  | 22.7%          | 23.7%          | 24.1%          | 25.6%          | 27.0%          | 28.4%          | 29.1%          |
| Pretax as % of Revenue                | 5.4%           | 11.5%          | 12.8%          | 13.9%          | 15.6%          | 17.1%          | 17.9%          |
| Net Income - Cont Ops as % of Revenue | 2.9%           | 7.2%           | 7.5%           | 8.6%           | 9.5%           | 10.4%          | 10.9%          |
| Net Income - Reported as % of Revenue | -7.8%          | -15.5%         | -24.1%         | -9.5%          | 9.5%           | 10.4%          | 10.9%          |
| <b>YOY GROWTH</b>                     |                |                |                |                |                |                |                |
| Revenue                               | -2.0%          | 5.8%           | 5.5%           | 4.4%           | 10.0%          | 6.8%           | 5.5%           |
| EBIT                                  | -4.6%          | 10.6%          | 7.4%           | 10.7%          | 16.3%          | 12.4%          | 7.9%           |
| EBITDA                                | -3.3%          | 8.0%           | 5.4%           | 10.0%          | 13.7%          | 11.4%          | 8.0%           |
| D&A                                   | -0.8%          | 3.1%           | 1.5%           | 8.5%           | 8.3%           | 8.9%           | 8.2%           |
| Pretax Income                         | -30.1%         | 125.1%         | 18.0%          | 13.0%          | 23.7%          | 17.0%          | 10.7%          |
| Net Income - Cont Ops                 | -40.1%         | 158.4%         | 10.5%          | 19.2%          | 21.6%          | 17.0%          | 10.7%          |
| EPS                                   | -40.1%         | 158.4%         | 10.6%          | 13.4%          | 12.1%          | 11.1%          | 5.8%           |

Source: Company data, Goldman Sachs Research estimates.



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**Exhibit 4: American Water balance sheet and cash flow statement, 2006-2012E**  
\$ millions

| <b>BALANCE SHEET</b>                      | <b>2006A</b>     | <b>2007A</b>     | <b>2008A</b>     | <b>2009A</b>     | <b>2010E</b>     | <b>2011E</b>     | <b>2012E</b>     |
|---|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Cash and cash equivalents                 | 29.8             | 13.5             | 9.5              | 22.3             | 22.3             | 22.3             | 22.3             |
| Restricted funds                          | 2.1              | 3.3              | 0.5              | 41.0             | 41.0             | 41.0             | 41.0             |
| Utility customers accounts receivable     | 130.5            | 126.7            | 130.6            | 130.4            | 153.2            | 165.1            | 174.1            |
| Unbilled utility revenues                 | 123.2            | 134.3            | 134.2            | 130.3            | 157.1            | 169.3            | 178.5            |
| Materials and supplies                    | 23.0             | 27.5             | 28.9             | 29.5             | 35.5             | 32.4             | 33.5             |
| Other receivables, net                    | 54.5             | 89.7             | 68.9             | 75.1             | 80.3             | 86.5             | 91.2             |
| Other current assets                      | 36.6             | 35.5             | 45.1             | 70.6             | 70.6             | 70.6             | 70.6             |
| Assets of Disc. Ops.                      | 12.8             | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| <b>Total Current Assets</b>               | <b>412.4</b>     | <b>430.4</b>     | <b>417.7</b>     | <b>499.1</b>     | <b>560.0</b>     | <b>587.0</b>     | <b>611.2</b>     |
| Utility plant, net                        | 8,605.3          | 9,199.9          | 9,991.8          | 10,523.8         | 11,151.8         | 11,659.8         | 12,139.2         |
| Nonutility property, net                  | 115.2            | 118.1            | 132.1            | 153.5            | 153.5            | 153.5            | 153.5            |
| <b>Net Property Plant &amp; Equipment</b> | <b>8,720.6</b>   | <b>9,318.0</b>   | <b>10,123.9</b>  | <b>10,677.4</b>  | <b>11,305.4</b>  | <b>11,813.3</b>  | <b>12,292.8</b>  |
| Regulatory Assets                         | 587.2            | 661.0            | 919.7            | 952.0            | 952.0            | 952.0            | 952.0            |
| Restricted Funds                          | 17.2             | 10.3             | 10.6             | 20.2             | 20.2             | 20.2             | 20.2             |
| Goodwill & Other Intangibles              | 2,962.5          | 2,457.0          | 1,699.5          | 1,250.4          | 1,250.4          | 1,250.4          | 1,250.4          |
| Investments                               | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| Other Assets                              | 83.2             | 74.8             | 60.4             | 53.5             | 73.5             | 93.5             | 113.5            |
| <b>Total Assets</b>                       | <b>12,783.1</b>  | <b>12,951.3</b>  | <b>13,231.8</b>  | <b>13,452.7</b>  | <b>14,161.5</b>  | <b>14,716.5</b>  | <b>15,240.1</b>  |
| Short-term Debt                           | 1,007.1          | 317.0            | 654.8            | 173.6            | 173.6            | 173.6            | 173.6            |
| Accounts payable                          | 140.7            | 168.9            | 149.8            | 138.6            | 138.1            | 141.6            | 146.5            |
| Accrued liabilities                       | 62.9             | 106.9            | 106.1            | 105.7            | 105.7            | 105.7            | 105.7            |
| Other current liabilities                 | 150.5            | 181.8            | 194.0            | 189.5            | 189.5            | 189.5            | 189.5            |
| Liabilities of Disc. Ops.                 | 2.5              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| <b>Total Current Liabilities</b>          | <b>1,363.7</b>   | <b>774.5</b>     | <b>1,104.8</b>   | <b>607.4</b>     | <b>606.9</b>     | <b>610.4</b>     | <b>615.3</b>     |
| Long-term debt                            | 4,870.9          | 4,699.1          | 4,648.2          | 5,312.1          | 5,649.4          | 5,817.0          | 5,981.5          |
| Advances for construction                 | 615.7            | 655.4            | 622.2            | 633.5            | 633.5            | 633.5            | 633.5            |
| Deferred income taxes                     | 583.4            | 638.9            | 705.6            | 851.7            | 851.7            | 851.7            | 851.7            |
| Deferred investment tax credits           | 36.5             | 35.4             | 34.0             | 32.6             | 32.6             | 32.6             | 32.6             |
| Regulatory liability-cost of removal      | 166.9            | 266.7            | 307.3            | 322.3            | 322.3            | 322.3            | 322.3            |
| Accrued pension expense                   | 314.6            | 290.7            | 502.1            | 431.0            | 431.0            | 431.0            | 431.0            |
| Accrued postretirement benefit expense    | 144.9            | 158.5            | 241.2            | 236.0            | 236.0            | 236.0            | 236.0            |
| Other long term liabilities               | 110.4            | 67.1             | 48.5             | 47.3             | 47.3             | 47.3             | 47.3             |
| Contributions in Aid of Construction      | 754.2            | 818.4            | 911.4            | 973.3            | 998.3            | 1,023.3          | 1,048.3          |
| <b>Total Liabilities</b>                  | <b>8,961.1</b>   | <b>8,404.7</b>   | <b>9,125.3</b>   | <b>9,447.2</b>   | <b>9,809.0</b>   | <b>10,005.1</b>  | <b>10,199.6</b>  |
| Preferred Equity                          | 4.6              | 4.6              | 4.6              | 4.6              | 4.6              | 4.6              | 4.6              |
| Shareholder's Equity                      | 3,817.4          | 4,542.0          | 4,102.0          | 4,000.9          | 4,347.9          | 4,706.8          | 5,036.0          |
| <b>Total Liabilities &amp; Equity</b>     | <b>12,783.1</b>  | <b>12,951.3</b>  | <b>13,231.8</b>  | <b>13,452.7</b>  | <b>14,161.5</b>  | <b>14,716.5</b>  | <b>15,240.1</b>  |
| <b>CASH FLOW STATEMENT</b>                | <b>2006A</b>     | <b>2007A</b>     | <b>2008A</b>     | <b>2009A</b>     | <b>2010E</b>     | <b>2011E</b>     | <b>2012E</b>     |
| <b>Sources:</b>                           |                  |                  |                  |                  |                  |                  |                  |
| EBITDA                                    | 733.4            | 791.8            | 834.4            | 917.8            | 1,043.7          | 1,162.4          | 1,255.7          |
| Interest Income                           | 0.4              | 1.9              | 0.1              | 0.2              | 0.3              | 0.3              | 0.3              |
| <b>Total Sources</b>                      | <b>733.7</b>     | <b>793.7</b>     | <b>834.5</b>     | <b>918.0</b>     | <b>1,044.0</b>   | <b>1,162.7</b>   | <b>1,256.0</b>   |
| <b>Uses:</b>                              |                  |                  |                  |                  |                  |                  |                  |
| Interest Expense Paid                     | (371.4)          | (289.9)          | (291.2)          | (303.3)          | (333.1)          | (352.0)          | (364.4)          |
| Book Taxes                                | (51.1)           | (94.5)           | (123.4)          | (128.4)          | (163.2)          | (190.9)          | (211.4)          |
| Other Non-Operating Expenses              | 109.1            | 47.7             | 126.7            | 297.5            | 6.0              | 6.0              | 6.0              |
| Change in Current Accounts (ex taxes)     | (96.6)           | 16.8             | 5.5              | (187.6)          | (61.3)           | (23.6)           | (19.3)           |
| Capital Expenditures                      | (682.9)          | (750.8)          | (1,008.8)        | (785.3)          | (850.0)          | (825.0)          | (825.0)          |
| <b>% of total revenues</b>                | <b>32.6%</b>     | <b>33.9%</b>     | <b>43.2%</b>     | <b>32.2%</b>     | <b>31.6%</b>     | <b>28.8%</b>     | <b>27.3%</b>     |
| <b>Total Uses</b>                         | <b>(1,092.9)</b> | <b>(1,070.8)</b> | <b>(1,291.1)</b> | <b>(1,107.1)</b> | <b>(1,401.6)</b> | <b>(1,385.6)</b> | <b>(1,414.1)</b> |
| <b>Free Cash Flow</b>                     | <b>(359.1)</b>   | <b>(277.1)</b>   | <b>(456.6)</b>   | <b>(189.1)</b>   | <b>(357.6)</b>   | <b>(222.9)</b>   | <b>(158.1)</b>   |
| <i>y/y growth</i>                         | <i>1213.1%</i>   | <i>-22.8%</i>    | <i>64.8%</i>     | <i>-58.6%</i>    | <i>89.1%</i>     | <i>-37.7%</i>    | <i>-29.1%</i>    |
| Net Investments                           | (26.2)           | 10.4             | (12.3)           | 99.8             | 0.0              | 0.0              | 0.0              |
| Acquisitions                              | (12.5)           | (15.9)           | (12.5)           | (18.1)           | (96.5)           | (30.0)           | (30.0)           |
| Dividends                                 | 0.0              | 0.0              | (64.1)           | (137.3)          | (158.1)          | (177.8)          | (193.8)          |
| Discontinued Operations                   | 30.2             | 9.7              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| Translation Adjustments                   | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              | 0.0              |
| <b>Cash Flow before Financing</b>         | <b>(367.7)</b>   | <b>(272.9)</b>   | <b>(545.6)</b>   | <b>(244.8)</b>   | <b>(612.2)</b>   | <b>(430.6)</b>   | <b>(381.8)</b>   |
| Contributions in aid of construction      | 47.4             | 35.8             | 3.1              | 21.2             | 25.0             | 25.0             | 25.0             |
| Net new Debt                              | 285.5            | 1,004.0          | 292.9            | (7.9)            | 337.2            | 167.6            | 164.6            |
| <b>Net New Equity</b>                     | <b>(0.5)</b>     | <b>(783.3)</b>   | <b>245.6</b>     | <b>244.2</b>     | <b>250.0</b>     | <b>238.0</b>     | <b>192.3</b>     |
| <b>Net Change in Cash</b>                 | <b>(35.3)</b>    | <b>(16.3)</b>    | <b>(3.9)</b>     | <b>12.7</b>      | <b>0.0</b>       | <b>(0.0)</b>     | <b>(0.0)</b>     |
| Beginning Cash                            | 65.1             | 29.8             | 13.5             | 9.5              | 22.3             | 22.3             | 22.3             |
| Ending Cash                               | 29.8             | 13.5             | 9.5              | 22.3             | 22.3             | 22.3             | 22.3             |

Source: Company data, Goldman Sachs Research estimates.

March 3, 2010

American Water Works Co., Inc. (AWK)

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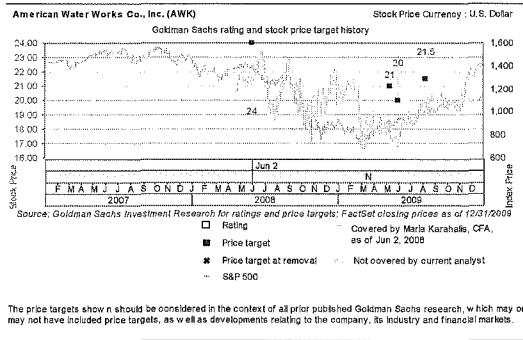
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|--------|---------------------|------|------|----------------------------------|------|------|
|        | Buy                 | Hold | Sell | Buy                              | Hold | Sell |
| Global | 31%                 | 53%  | 16%  | 53%                              | 47%  | 40%  |

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American Water Works Co., Inc. (AWK)

### Price target and rating history chart(s)



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American Water Works Co., Inc. (AWK)

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**Water Utilities**

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January 25, 2010

**INITIATION OF COVERAGE**

| <b>Key Metrics</b>         |                 |
|----------------------------|-----------------|
| AWK - NYSE (as of 1/25/10) | \$22.15         |
| Price Target               | \$26.00         |
| 52-Week Range              | \$23.77-\$16.22 |
| Shares Outstanding (mm)    | 174.7           |
| Market Cap. (\$mm)         | \$3,851.7       |
| 3-Mo. Average Daily Volume | 2,051,000       |
| Institutional Ownership    | 72.0%           |
| Debt/Total Capital (9/09)  | 56.6%           |
| ROE (9/09)                 | 5.2%            |
| Book Value/Share (9/09)    | \$22.82         |
| Price/Book Value           | 0.9x            |
| Dividend Yield             | 3.8%            |
| LTM EBITDA Margin          | 37.4%           |

| <b>EPS FY 12/31</b> |              |                    |                    |                    |                    |
|---------------------|--------------|--------------------|--------------------|--------------------|--------------------|
|                     | <b>2008A</b> | <b>Prior 2009E</b> | <b>Curr. 2009E</b> | <b>Prior 2010E</b> | <b>Curr. 2010E</b> |
| 1Q                  | \$0.04       | --                 | \$0.19             | --                 | \$0.20E            |
| 2Q                  | \$0.28       | --                 | \$0.32             | --                 | \$0.38E            |
| 3Q                  | \$0.55       | --                 | \$0.52             | --                 | \$0.61E            |
| 4Q                  | \$0.23       | --                 | \$0.21E            | --                 | \$0.29E            |
| Year                | \$1.10       | --                 | \$1.24             | --                 | \$1.47E            |
| P/E                 | 20.1x        |                    | 17.9x              |                    | 15.1x              |

| <b>Revenue (\$mm)</b> |              |                    |                    |                    |                    |
|-----------------------|--------------|--------------------|--------------------|--------------------|--------------------|
|                       | <b>2008A</b> | <b>Prior 2009E</b> | <b>Curr. 2009E</b> | <b>Prior 2010E</b> | <b>Curr. 2010E</b> |
| 1Q                    | \$506.8      | --                 | \$550.2            | --                 | \$570.6E           |
| 2Q                    | \$589.4      | --                 | \$612.7            | --                 | \$646.6E           |
| 3Q                    | \$672.2      | --                 | \$680.0            | --                 | \$740.2E           |
| 4Q                    | \$568.6      | --                 | \$592.3E           | --                 | \$624.7E           |
| Year                  | \$2,336.9    | --                 | \$2,435.2E         | --                 | \$2,582.1E         |

*Company Description: Founded in 1886, American Water is the largest investor-owned U.S. water and wastewater utility company. With headquarters in Voorhees, NJ, the company employs more than 7,000 professionals who provide drinking water, wastewater and other related services to approximately 15 million people in 32 states and Ontario, Canada.*

**American Water Works Co.**

AWK -- NYSE -- Buy-2

**Free from RWE, AWK poised for growth**

**Investment Highlights**

- We are initiating coverage with a Buy rating and \$26 price target.
- Unique and enviable total return story: Reasonably predictable utility segment that has monopoly-like status, with non-regulated lever to grow earnings.
- Acquisitions present a meaningful growth platform for the company, which we believe will account for the largest component of EPS growth.
- The (so-called) Stimulus Package: We see a huge opportunity for the company here. Not from what it will get, but rather from what it will not. With just \$6 billion allocated for water/wastewater and an estimated \$335 billion needed over the next 20 years, we think this translates to an environment ripe for acquisitions. This should bode well for AWK, as acquisitions are an integral part of the company's strategy.
- With German based RWE's ownership of AWK declining from 100% to 0%, investors no longer have this overhang on the stock.
- We estimate FY'09 and FY'10 EPS of \$1.24 and \$1.47, respectively.

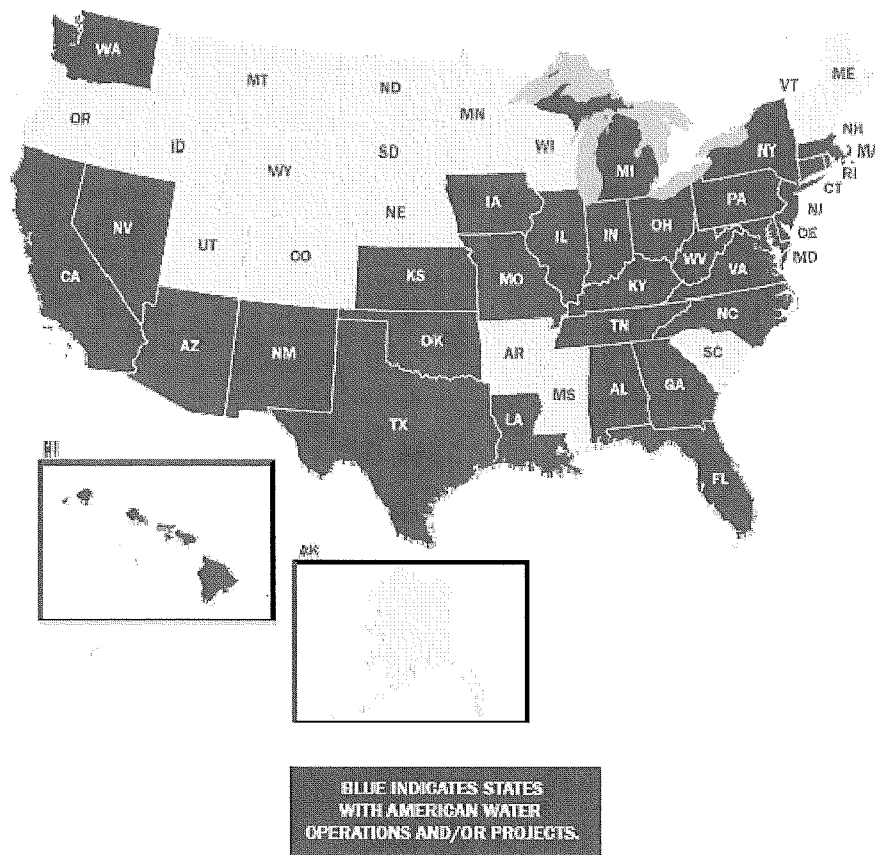
**Note Important Disclosures on Pages 16 and 17.  
Note Analyst Certification on Page 16.**

**OVERVIEW**

American Water Works Co. was founded in 1886 as American Water Works & Guarantee Company, for the purposes of building and purchasing water systems in McKeesport, Pennsylvania. In 1935 it reorganized under current name, and in 1947 became a publicly traded company on the NYSE. In 2003 it was acquired by German based RWE AG and no longer was a publicly traded company. In 2005 RWE divested American Water and in March 2006 effected the divestiture through the sale of shares from public offerings. Upon completion of its initial public offering in April 2008, the company again became listed on the NYSE.

Today, AWK is the largest and most geographically diversified water utility in the United States, providing about 15 million people or 5% of the country with drinking water, wastewater, and other water-related services in 32 states in addition to operations in Ontario, Canada. In 2008, the regulated side of the business drove \$2.1 billion or about 89% of overall revenues and non-regulated revenues amounted to \$272.2 million or approximately 11% of the total. AWK has close to 7,300 employees (~51% unionized), and every day it treats and delivers over 1 billion gallons of water.

**Exhibit 1  
Company Footprint**



Source: Company reports

**INVESTMENT THESIS**

We believe AWK is a unique and enviable total return story, and in our view offers moderate capital appreciation potential coupled with a reasonable dividend yield which should grow annually given the company's payout expectations. Positive ratemaking environments and an aggressive acquisition strategy should drive a solid core utility business, while the company is also well positioned to further augment earnings via a plethora of opportunities from the non-regulated side of the business.

The industry has high barriers to entry and the regulated businesses are virtual monopolies, which should appeal to risk averse investors. The company's regulated operations are reasonably predictable, inelastic, necessary to sustain life, and not dependent on discretionary consumer spending levels. Moreover, the impact of weather is diminished as the company's operations are spread across broad geographic regions encompassing several states. While organic growth will be largely dependent on housing starts and population increases, we believe meaningful revenue growth will come in the form of acquisitions as we expect AWK to be an integral player in the group as the industry continues to consolidate.

Growth opportunities for the company are numerous and should come from an array of drivers that we believe will positively impact earnings. On the regulated side, AWK should benefit from the regulated model - as long as it is treated fairly among its regulatory commissions. As capital expenditures are funded, the company will earn a return on an expanding rate base and it is also expected to benefit from customer growth in its service territory, but we anticipate the bulk of customer growth to be driven by acquisitions.

An additional lever to ratchet earnings higher comes from the company's non-regulated businesses. Growth rates from this segment have the potential to be in excess of the core utility, and we expect AWK to aggressively grow this side of the business as well.

**Regulated Businesses**

The company's primary business involves the ownership of water and wastewater utilities that provide services to residential, commercial and industrial customers. Its subsidiaries that provide these services are generally subject to economic regulation by the state PUCs where they operate. The federal government and the states also regulate environmental, health and safety and water quality matters.

**Exhibit 2**  
**Water Service Revenues (MM's)**

| <b>Water Service</b> | <b>2008</b> | <b>2007</b> | <b>2006</b> |
|----------------------|-------------|-------------|-------------|
| Residential          | \$1,197.7   | \$1,146.1   | \$1,067.9   |
| Commercial           | 403.6       | 385.3       | 362.7       |
| Industrial           | 101.8       | 94.7        | 92.0        |
| Public and other     | 255.6       | 247.6       | 230.2       |
| Total water services | \$1,958.7   | \$1,873.7   | \$1,752.8   |
| Wastewater services  | 79.9        | 75.6        | 72.2        |
| Total                | \$2,038.6   | \$1,949.3   | \$1,825.0   |

\*excludes other water revenues

Source: Company reports

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AWK serves ~1,600 communities in 20 states. It owns substantially all of the assets used by the regulated businesses, including approximately 80 surface water treatment plants, 600 groundwater treatment plants, 1,100 groundwater wells, 50 wastewater treatment facilities, 1,100 treated water storage facilities, 1,200 pumping stations, 100 dams and 48,000 miles of mains and collection pipes. Generally, it owns the land and physical assets used to store, extract, and treat source water, but not the water itself which is allocated through contracts and rights granted by federal and state agencies or through the ownership of water rights pursuant to local law.

**Exhibit 3**  
**2008 Revenue and Customers by State**

|                             | <b>Operating Revenue (\$MM's)</b> | <b>% of total</b> | <b>Number of customers</b> | <b>% of total</b> |
|-----------------------------|-----------------------------------|-------------------|----------------------------|-------------------|
| New Jersey                  | \$517.7                           | 24.9%             | 643,330                    | 19.4%             |
| Pennsylvania                | 447.9                             | 21.5%             | 648,958                    | 19.5%             |
| Illinois                    | 187.5                             | 9.0%              | 307,734                    | 9.3%              |
| Missouri                    | 181.1                             | 8.7%              | 456,887                    | 13.8%             |
| Indiana                     | 156.4                             | 7.5%              | 283,886                    | 8.5%              |
| California                  | 128.6                             | 6.2%              | 170,853                    | 5.1%              |
| West Virginia               | 115.7                             | 5.5%              | 170,404                    | 5.1%              |
| Subtotal (top seven states) | 1,734.9                           | 83.3%             | 2,682,052                  | 80.7%             |
| Other*                      | 347.8                             | 16.7%             | 639,663                    | 19.3%             |
| Total regulated businesses  | \$2,082.7                         | 100.0%            | 3,321,715                  | 100.0%            |

\*Includes data from Arizona, Georgia, Hawaii, Iowa, Kentucky, Maryland, Michigan, New Mexico, New York, Ohio, Tennessee, Texas, and Virginia

Source: Company reports

**Exhibit 4**  
**Customers by Segment**

|                          | 2008      |            | 2007      |            | 2006      |            |
|--------------------------|-----------|------------|-----------|------------|-----------|------------|
|                          | Water     | Wastewater | Water     | Wastewater | Water     | Wastewater |
| Residential              | 2,892,137 | 138,770    | 2,887,134 | 135,313    | 2,866,036 | 134,624    |
| Commercial               | 226,935   | 6,214      | 227,831   | 5,825      | 229,354   | 5,922      |
| Industrial               | 4,552     | 14         | 4,658     | 13         | 4,668     | 13         |
| Private fire             | 36,748    | 4          | 34,542    | 9          | 33,208    | 10         |
| Public authority & other | 16,145    | 196        | 17,130    | 173        | 16,990    | 177        |
| Total                    | 3,176,517 | 145,198    | 3,171,295 | 141,333    | 3,150,256 | 140,746    |

Source: Company reports

Water utilities are heavily impacted by rainfall. The peak revenue months typically occur during the summer months when usage is highest, driven by activities such as landscape irrigation, filling swimming pools, and washing automobiles. Additionally, in general a higher average in temperatures will drive an increase in water consumption. During the winter, the concern from cold temperatures is what the impact



will be from main breaks. The bulk of the summertime activities will often occur on weekends, and the number of days of consecutive rainfall is important, as two days in a row of slight rainfall can have more of a negative impact on revenues than one day of heavy rainfall.

While precipitation has a meaningful impact on summer revenues, it is important in other times of the year as well – but for different reasons. Lacking snow and rain, reservoirs and underground aquifers will not be full. The lower the reservoir levels starting with spring, the greater the likelihood water companies could be impacted by drought conditions if the government imposes restrictions and limits usage.

### ***Non-Regulated Businesses***

Non-Regulated businesses involve providing water and wastewater-related services to water and wastewater utilities and other customers on a contract basis. This includes engineering and consulting companies and numerous other fee for service businesses. These include the building and operating of water and wastewater utility systems, system repair services, lab services, sale of water infrastructure and distribution products (such as pipes), and other specialized services. The company has contract operations in close to 300 different communities, similar to managing water and wastewater and is looking to do more in the water reuse area.

AWK provides these services which are not subject to economic regulation by state PUCs through non-regulated businesses. It offers operation and maintenance (O&M) contracts and will also design, build, and operate (DBO) where it will oversee the design and build phases as well as the long run operation and maintenance of a facility. No single group generates in excess of 10%, but revenues from this segment can be choppy depending on the projects involved. Growth targets are O&M contracts, water reuse, desalination, DBO, and military contracts. The non-regulated businesses are as follows:

*Contract Operations Group* – enters into public/private partnerships, including O&M, and operates DBO contracts for the provision of services to water and wastewater facilities for municipalities, the United States military and other customers. For the military, AWK operates water and wastewater facilities for 10 bases which typically have 50-year contracts with mid-teens margins. The company has over 140 contracts serving 3 million people, and in general O&M contracts are not capital intensive. 2008 revenues amounted to \$170.1 million or 62.5% of overall non-regulated revenues.

*Applied Water Management Group* – works with customers to design, build and operate small water and wastewater treatment plants, currently numbering over 20. Typical customers are real estate developers, industrial companies, and new or expanding communities and are as varied as residential buildings in Battery Park City in New York City and Gillette Stadium in Foxborough, Massachusetts. Revenue in 2008 from this segment was \$23.8 million or 8.7% of overall non-regulated revenues.

*Homeowner Services Group* – provides services to domestic homeowners to protect against the cost of repairing broken or leaking pipes inside and outside their homes. AWK has over 730,000 contracts (only ~5% penetration among its customer base) in 16 states, and is expanding to include utilities outside of its territories. This segment generated \$47.5 million of revenue in 2008 or 17.5% of total non-regulated.

Other non-regulated businesses include the *Carbon Services Group* which provides granular activated carbon for water purification and the Residuals Group, *Terratec Environmental Ltd.*, which provides environmentally sustainable management and disposal of biosolids and wastewater by-products. Other non-regulated businesses generated revenue of \$30.8 million in 2008, representing 11.3% of non-regulated revenue.

The company's non-regulated businesses face competition from a number of service providers, particularly in the area of O&M contracting. Securing new O&M contracts is highly competitive, as these contracts are awarded based on a combination of customer relationships, service levels, competitive pricing, references, and technical expertise.

The emergence of Public Private Partnerships (PPP) continues to trend upward with 26 states now having enacted PPP legislation, as states vary from very PPP friendly to unfriendly. They are varied and include roads, bridges, airports, ports, transit/rail - as well as water and wastewater. Opportunities are numerous, and at AWK include operations assistance, contract O&M, contract operations & financing, DBO, and lease & operate. Characteristics common to PPP's include essential infrastructure, a long useful life, stable earnings, cash generative, and favorable regulation. Moreover, PPP's also serve as a great segway for additional business development opportunities and potential acquisitions, and discussions are underway with ~75 municipalities at present.

### ***Regulatory Environment***

Operating in constructive regulatory environments is imperative to any utility. Unfair treatment can negatively impact revenues and serve as a disincentive for any company to invest in its service territory. Commissions that move slow negatively impact earnings as well, as regulatory lag serves as an overhang as utilities wait to recoup costs for which they have been out of pocket after making capital expenditures. With AWK having regulated utility operations in 20 states, the company is much more insulated than its peers from having any one specific regulatory commission that becomes problematic negatively impacting earnings. (This point holds true for extreme weather variations as well.)

In general, we characterize the ratemaking environment in which AWK operates as favorable. Importantly, we believe Pennsylvania (~20% of AWK's customer base) has one of the best regulatory climates in the country and we also highlight how the ratemaking environment has evolved in New Jersey (~19% of the customer base) given the proactive nature of regulators in the state. California has several new innovative ratemaking mechanisms as well, and what we view as the less favorable states from a regulatory perspective drive some of the lowest revenue levels for the company.

We note that in seven states in AWK's regulated footprint there are surcharge mechanisms in place that allow the company to immediately include a portion of cap ex in rates prior to filing a full blown rate case, which diminishes the impact of regulatory lag. In AWK's footprint this includes Pennsylvania, Illinois, Indiana, Missouri, Ohio, New York, and California (trial basis).

Given the company's size and scope, pending rate cases will likely be in effect at all times. In 2008 the company was awarded \$187.7 million in rate increases and in 2009 it was awarded \$80.9 million in new rates. Moreover, the pending backlog of rate cases highlighted in Exhibit 5 is significant, amounting to over \$218 million and in addition, should have a positive impact on margins.

**Exhibit 5**  
**Pending Rate Cases (MM's)**

| <b>Date Filed</b> | <b>State</b>       | <b>Amount Filed</b> | <b>Requested ROE</b> | <b>Rate Base</b> |
|-------------------|--------------------|---------------------|----------------------|------------------|
| 11/1/07           | HI                 | \$ 1.3              | 10.60%               | \$ 24.9          |
| 1/23/09           | CA (Sac, LA, Lark) | \$ 32.7             | 10.20%               | \$ 215.8         |
| 4/30/09           | IN                 | \$ 46.9             | 12.00%               | \$ 670.5         |
| 5/7/09            | OH                 | \$ 8.8              | 12.20%               | \$ 74.8          |
| 5/29/09           | IL                 | \$ 58.6             | 12.25%               | \$ 610.3         |
| 7/2/09            | AZ (Anthem, etc.)  | \$ 20.6             | 12.25%               | \$ 220.4         |
| 8/21/09           | NM (Edgewood)      | \$ 0.7              | 12.25%               | \$ 4.0           |
| 10/30/09          | MO                 | \$ 48.7             | 11.60%               | \$ 792.3         |
|                   |                    | <u>\$ 218.3</u>     |                      |                  |

Source: Company reports

**Acquisitions**

Acquisitions are an integral part of the company's strategy and we believe the volume will continue to increase for the foreseeable future for several reasons. This encompasses several sector themes, which include an aging infrastructure, fragmented industry, population growth, increasing environmental requirements, inefficiency of small systems, focus on security, access to capital, and technological requirements. The company is currently in discussions with dozens of municipalities related to potential acquisitions, and currently awaiting a decision for an \$80 million acquisition in Trenton, NJ, including four municipalities and ~40,000 customers.

In 2008 the company closed on 10 water & wastewater transactions for an aggregate purchase price of \$12.5 million and in 2007 nine regulated water systems for \$15.9 million. The bulk of acquisitions will likely be "tuck-in's", mid-size municipal systems with a population of 20,000-100,000 which represents about 5% of systems but 35% of the population, in addition to those of a larger size and the company is in discussions with several larger cities. Most will also likely come from inside the company's footprint versus the less desirable non-connected systems.

While we anticipate the smaller tuck-ins to represent the majority of the number of transactions, we believe AWK will acquire large systems as well, and it has made a number of such deals over the past few years. In 2002 it acquired the water and wastewater facilities in six states from Citizens Communications Company for an aggregate purchase price of \$979.8 million. In 1999 the company acquired the privately held National Enterprises Inc. in a transaction valued at \$700.0 million. In 1996, the company's PAWC subsidiary acquired the regulated water operations of Pennsylvania Gas and Water Company (subsidiary of Pennsylvania Enterprise Inc.) for approximately \$409.4 million.

Capital expenditures needed in the industry are staggering, and the EPA estimates approximately \$335 billion will need to be spent over the next 20 years. Moreover, in its 2009 Infrastructure Report Card the ASCE (American Society of Civil Engineers) rates both drinking water and wastewater a D-. This finding is based partly on an annual shortfall of at least \$11 billion to replace aging facilities and comply with regulations (not accounting for any growth) and pipes leaking an estimated 7 billion gallons of clean drinking water daily.

We believe privatization will continue to increase, as municipalities struggle with the ever increasing costs and issues associated with providing a safe and reliable drinking supply. While we had long been of the opinion that acquisition activity and privatization would continue to increase, we think the curve will now be even steeper in the wake of the recent events coming out of Washington, namely.....

***The Stimulus Package...***

For some time investors have wondered what the impact would be from the stimulus package and how utilities would benefit. Our take is somewhat different, and we see a big opportunity here: *not from what the company will receive, but rather from what it will not get*. President Obama's \$787 billion stimulus package had ~\$6 billion (~\$2 billion slated for water/~\$4 billion for wastewater) allocated for clean and drinking water projects. However, with the EPA estimating ~\$335 billion needing to be spent over the next 20 years, it's interesting just how small \$6 billion can seem.

As municipalities continue to struggle to meet budgets, we think an increasing number of them will question how much they really want to be in the water business and acquisition activity from publicly traded water utilities should ramp up and better opportunities could increasingly become available. We believe AWK will be one of the prime beneficiaries, which we expect to be one of the most aggressive and active in making acquisitions. This will continue to be part of the company's growth strategy with the logical targets being immediately accretive, purchased at or below book, having costs which can be managed lower, and in a positive ratemaking environment where the company can go in for new rates after making infrastructure improvements.

To give the devil his due, there are some water related positives that will come from the stimulus plan. This will come in the form of increased access to low interest financing, expanded tax-free debt issuance programs, and continued tax relief from accelerated depreciation.

The opportunities are seemingly endless, as there are about 52,000 community water systems and 16,000 community wastewater facilities. The majority are small, serving a population of 500 or less. These systems are fragmented, and inefficiencies abound as smaller utilities often do not have the operating expertise, financial and technological capability, economies of scale to provide services, or ability to raise capital as efficiently as larger utilities.

**RECENT RESULTS**

AWK reported Q3'09 EPS of \$0.52 versus \$0.55. Revenue rose 1.2% to \$680.0 million largely from the impact of new rates, despite the negative impact of an extremely wet summer as 11 of the company's 20 regulated states had above average rainfall, cooler temperatures, or both. Total volume decreased 7.4% or 9.1 billion gallons mostly related to weather, which equates to about \$44.2 million in revenue, \$23.7 million in net income or \$0.14 per share. Regulated Business revenues rose 2.9% or \$17.6 million, driven mostly by the impact of rate awards. Non-regulated Businesses' revenues fell 11.7% or \$8.6 million, mostly due to lower revenues in the Contract Operations Group.

O&M expenses decreased negligibly to \$340.9 million driven mostly by pension and other post-employment expenses, and as a percentage of revenue improved about 80 basis points to 50.1%. D&A rose 9.5% to \$74.9 million and interest expense was 2.0% higher at \$74.1 million. Total operating expenses rose 1.1% to \$465.6 million. Cap ex for the quarter was \$592.9 million versus \$714.6 million.

## MANAGEMENT AND BOARD COMPOSITION

### Executive Management

*Donald L. Correll* – 58, President and CEO

Mr. Correll has served as President and CEO since April 2006. Prior to joining American Water, he spent three years serving as President and CEO and member of the board of directors of Pennichuck Corporation. He previously spent 25 years with United Water Resources, where he served as Chairman, President and CEO from 1991 through 2001. He is a member of the board of directors of HealthSouth Corp. and New Jersey Resources Corporation.

*Ellen C. Wolf* – 55, SVP and CFO

Ms. Wolf has been SVP and CFO since March 2006 and served as a member of the board from March 2006 until August 2007. From 1987 through 1999, Ms. Wolf held various positions in corporate accounting, finance and business development for Bell Atlantic and several of its subsidiaries. From 1999 through 2003, she was employed by American Water as VP and CFO. Prior to re-joining American, she served as SVP and CFO of USEC Inc.

*John S. Young* – 55, President of American Water Services and American Water Works Service Co.

Mr. Young became President of American Water Services in July 2008 and is also President of American Water Works Service Company. Prior to July 2008, he was COO and served as a member of the board from October 2005 until August 2007. Mr. Young began his career with American Water in 1977.

### Outside Board Members

*Stephen P. Adik*, recent Vice Chairman, EVP and CFO of NiSource, Inc., Board member since June 2009

*Julie A. Dobson*, recent COO of TeleCorp PCX, Board member since June 2009

*Martha Clark Goss*, COO and CFO of Amwell Holdings/Hopewell Holdings LLC, Board member since October 2003

*Richard R. Grigg*, EVP of FirstEnergy Corp and President of FirstEnergy Utilities Group, Board member since August 2008

*Julia L. Johnson*, President of NetCommunications, LLC, Board member since August 2008

*George MacKenzie*, Non-Executive Chairman of the Board, recent interim President and CEO of American Water until appointment of Mr. Correll, Board member since May 2006

*William J. Marrazzo*, CEO and President of WHYI, Inc, Board member since October 2003

## VALUATION

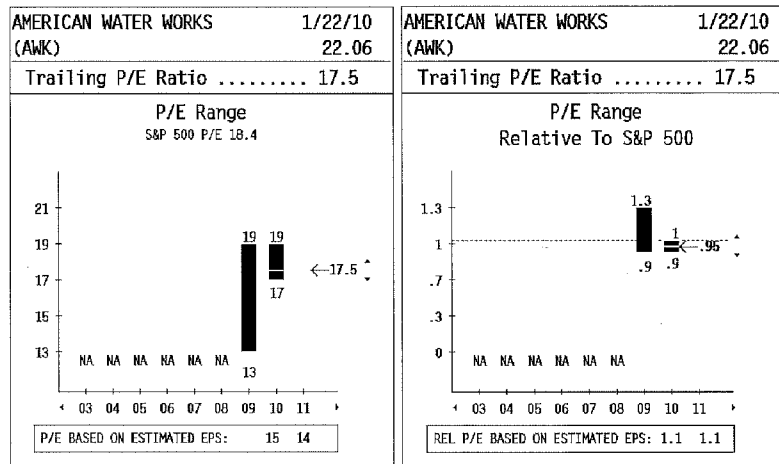
We are initiating coverage with FY'09 and FY'10 EPS estimates of \$1.24 and \$1.47, respectively. Management has an annual goal of 7%-10% EPS growth, but does not issue guidance. We derive our \$26 price target using a multiple of 18x our FY'10 EPS estimate, which we believe is justified given the company's growth prospects and historical trading range. The stock is trading at 17.9x our FY'09 EPS estimate and 15.1x our FY'10 EPS estimate, meaningful discounts to the company's peer group trading at

American Water Works Co.

January 25, 2010

22.8x and 18.4x 2009 and 2010 estimates, respectively. We rate the stock Buy with a suitability rating of "2".

**Exhibit 7**  
**AWK Historical P/E Multiples**



Source: Baseline

**Exhibit 6**  
**Selected Peer Group Comparisons**

| Company                        | Tkr   | Price<br>22-Jan-10 | Target<br>Price | Rating  | LFY<br>Revs<br>(\$MM) | Mkt<br>Cap<br>(\$MM) | Cap/<br>Sales | LTD/<br>Cap.<br>(%) | EPS    |        |        | P/E          |              |              | 3-Yr<br>Avg EPS<br>Growth | LFY<br>EBITDA<br>Share | LFY<br>EV/<br>EBITDA | Div.<br>Payout<br>Yld. (%) | Short<br>Interest<br>Ratio | 30-day<br>Avg. Vol. |           |
|--------------------------------|-------|--------------------|-----------------|---------|-----------------------|----------------------|---------------|---------------------|--------|--------|--------|--------------|--------------|--------------|---------------------------|------------------------|----------------------|----------------------------|----------------------------|---------------------|-----------|
|                                |       |                    |                 |         |                       |                      |               |                     | FY'08  | FY'09E | FY'10E | FY'08        | FY'09E       | FY'10E       |                           |                        |                      |                            |                            |                     |           |
| American States                | AWR   | \$ 33.52           | -               | NR      | 318.7                 | 620.5                | 1.9x          | 46.0                | \$1.56 | \$1.84 | \$1.98 | 23.8x        | 18.2x        | 16.9x        | 7%                        | 5.1x                   | 7.8x                 | 3.10%                      | 55                         | 3.4%                | 81,812    |
| American Water Works           | AWK   | \$ 22.06           | \$ 26           | Buy     | 2,336.9               | 3,851.7              | 1.6x          | 57.0                | \$1.10 | \$1.24 | \$1.47 | 20.1x        | 17.8x        | 15.0x        | -                         | 5.2x                   | 9.5x                 | 3.81%                      | 65                         | 1.4%                | 1,356,332 |
| Aqua America                   | WTR   | \$ 17.14           | \$ 23           | Buy     | 627.0                 | 2,335.7              | 3.7x          | 54.0                | \$0.73 | \$0.79 | \$0.97 | 23.5x        | 21.8x        | 17.7x        | 4%                        | 2.4x                   | 12.5x                | 3.38%                      | 71                         | 10.1%               | 909,080   |
| Artesian Resources             | ARTNA | \$ 17.84           | \$ 19           | Buy     | 56.2                  | 133.6                | 2.4x          | 54.0                | \$0.86 | \$0.94 | \$1.12 | 21.2x        | 19.0x        | 15.9x        | -1%                       | 3.4x                   | 9.2x                 | 4.20%                      | 78                         | 2.3%                | 18,533    |
| California Water Service Group | CWT   | \$ 36.47           | \$ 48           | Buy     | 410.3                 | 756.6                | 1.8x          | 47.0                | \$1.90 | \$1.93 | \$2.19 | 19.2x        | 18.9x        | 16.6x        | 19%                       | 5.8x                   | 10.4x                | 3.24%                      | 59                         | 2.5%                | 100,278   |
| Connecticut Water Service      | CTWS  | \$ 22.93           | -               | NR      | 61.3                  | 195.8                | 3.2x          | 31.0                | \$1.12 | \$1.23 | -      | 20.8x        | 18.6x        | -            | 13%                       | 2.9x                   | 13.5x                | 3.97%                      | 69                         | 2.8%                | 19,676    |
| Consolidated Water             | CWCO  | \$ 12.91           | -               | NR      | 60.3                  | 187.7                | 3.1x          | 14.0                | \$0.50 | \$0.76 | \$0.98 | 25.8x        | 17.0x        | 13.2x        | -1%                       | 1.1x                   | 10.0x                | 2.32%                      | 46                         | 3.6%                | 134,259   |
| Mid Essex Water                | MSEX  | \$ 16.33           | -               | NR      | 91.0                  | 220.5                | 2.4x          | 47.0                | \$0.90 | \$0.70 | \$0.80 | 17.2x        | 23.3x        | -            | 0%                        | 2.5x                   | 11.4x                | 4.41%                      | 96                         | 2.5%                | 33,156    |
| Pennichuck Corp.               | PNNW  | \$ 20.24           | -               | NR      | 31.0                  | 93.4                 | 3.0x          | 53.0                | \$0.57 | \$0.58 | \$0.75 | 27.0x        | 34.9x        | 27.0x        | 15%                       | 3.6x                   | 13.3x                | 3.46%                      | 117                        | 3.5%                | 15,545    |
| SIW Corp.                      | SIW   | \$ 22.26           | -               | NR      | 220.3                 | 411.8                | 1.9x          | -                   | \$1.16 | \$0.81 | \$1.09 | 19.2x        | 27.5x        | 20.4x        | -7%                       | 4.0x                   | 6.5x                 | 2.96%                      | 73                         | 2.0%                | 35,738    |
| Southwest Water Co.            | SWWC  | \$ 5.92            | -               | Neutral | 222.1                 | 147.3                | 0.7x          | 56.0                | \$0.04 | \$0.17 | \$0.34 | 13.2x        | 34.8x        | -            | NM                        | 0.6x                   | 16.5x                | 3.38%                      | -                          | 2.7%                | 78,731    |
| York Water Co.                 | YORW  | \$ 13.60           | -               | Neutral | 32.8                  | 170.5                | 5.2x          | 47.0                | \$0.57 | \$0.63 | \$0.60 | 22.7x        | 21.4x        | 22.6x        | 3%                        | 1.6x                   | 12.7x                | 3.76%                      | 77                         | 2.7%                | 25,598    |
| <b>Average:</b>                |       |                    |                 |         |                       | <b>2.6x</b>          |               |                     |        |        |        | <b>21.1x</b> | <b>22.8x</b> | <b>18.4x</b> | <b>5.2%</b>               | <b>3.2x</b>            | <b>11.1x</b>         | <b>3.5x</b>                | <b>73.3x</b>               | <b>3.5%</b>         |           |

Source: Company reports, Baseline, and Hilliard Lyons estimates

Source: Company reports, Baseline, and Hilliard Lyons' estimates

**Financial Condition**

As of Q3'09, the company had \$7.8 million of cash on hand, down from \$9.0 million at the end of the sequential quarter. Long-term debt increased 4.3% from the prior quarter to \$5.2 billion, and as a percentage of total capitalization rose 70 basis points to 56.4%, and there are no plans to reduce debt significantly. As of March 31, 2009, a 100 bp increase in interest rates related to short-term borrowing would decrease pre-tax earnings by about \$4.7 million. There were no borrowings under the company's

\$850 million revolver as of Q3'09, and it can issue additional commercial paper amounting to \$140.3 million backed by its credit facilities.

Capital expenditures from 2009 are expected to amount to about \$800 million, and there is a substantial cap ex program going forward. Over the next five years, capital expenditures of \$4.0-\$4.5 billion (about \$790 million - \$1 billion per year) are expected for infrastructure, renewal programs, acquisitions, and major projects. Of this amount, \$1.3 - \$1.4 billion will likely be needed to replace infrastructure including mains, meters, and supply and treatment facilities. Approximately \$1.2 - \$1.3 billion is allocated to be spent on facilities to serve new customer growth, \$300 - \$400 million to comply with water quality standards and other regulatory requirements, ~\$800 million for projects to enhance system reliability, quality of service, and risk reduction, and \$400 - \$600 million for efficiency related projects.

The company does not anticipate issuing any equity for the near-term, following several offerings over the last year related to RWE's ownership in the company and has a long-term target of 45%-55% equity/total cap

#### ***RWE Overhang***

Although not exactly on schedule...RWE's ownership of AWK has now been reduced from 100% to nothing, as of the company's latest offering in November 2009. Following AWK's IPO in April 2008, RWE owned about 61% million of the 160 million shares outstanding.

In June of 2009 the company completed a public offering of 29.9 million shares of common stock priced at \$17.25 per share. AWK issued 14.5 million shares, and RWE sold 15.4 million (including the over-allotment). In August of 2009 the company had an additional secondary offering for 40.25 million shares at \$19.25, with all shares sold by RWE and proceeds going to RWE reducing ownership to about 24%. This past November the company completed another offering for 37.4 million shares (or 41.1 million including the over-allotment) at \$21.63 per share with all proceeds going to RWE (AWK did not sell any shares or receive any proceeds), reducing RWE's ownership to nothing. Subsequently, all AWK Board members from RWE resigned.

## **OUTLOOK**

At its core, AWK provides a product necessary for life – an inelastic good that people need versus want. Despite the state of the economy and discretionary spending levels from consumers, the company has monopoly-like status and at a minimum there is a finite amount of the company's services that must be used. Providing 5% of the U.S. with drinking water is significant, and not only is it likely that this percentage will trend higher, but this size creates additional opportunities in addition to economies of scale and purchasing power. The regulated utility is reasonably predictable and in general operating in positive ratemaking environments.

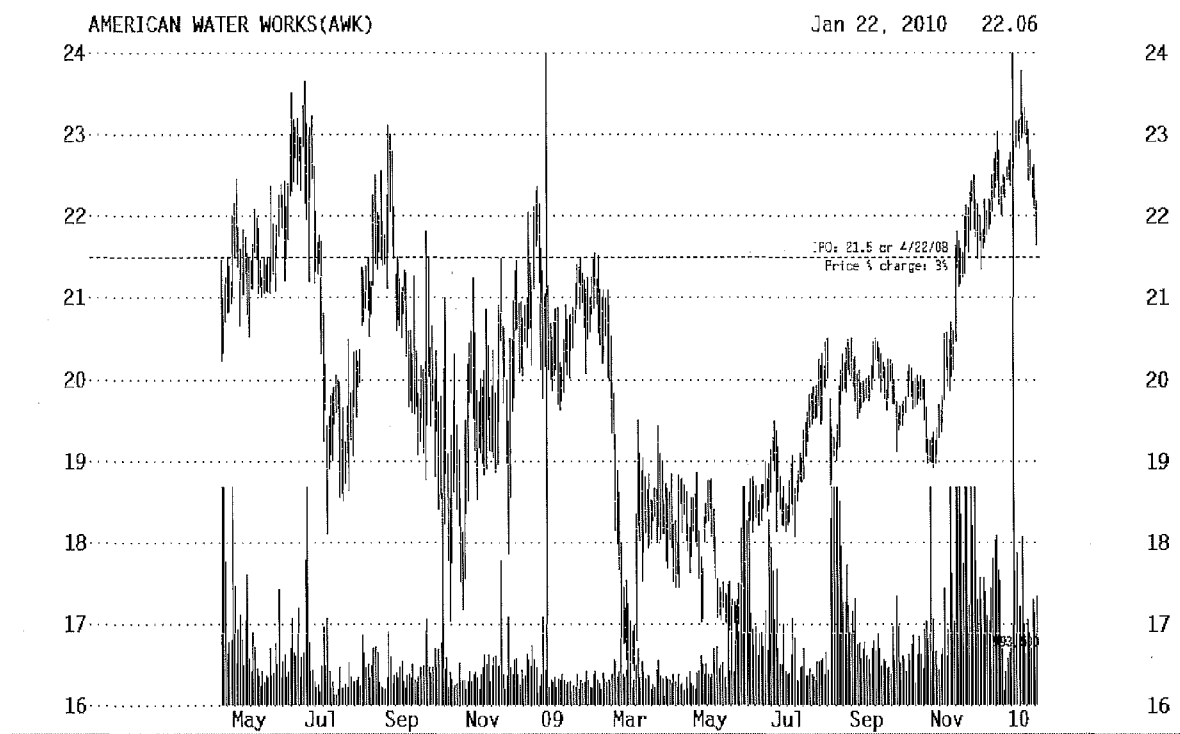
The regulated model should position AWK to grow earnings as it makes capital expenditures and increases its rate base, and subsequently recovering a portion in new rates. We again highlight the number of surcharge mechanisms the company has in varying states, which we view as of extreme significance as they reduce/eliminate the negative impact of regulatory lag. In addition to rate cases, organic and to a higher degree acquisitions should drive customer growth.

We anticipate consolidation being a meaningful driver of growth in the industry, and believe AWK will be one of the major players. Several factors highlighted in this report should contribute to increased privatization, and there should be opportunities for the company to benefit from public/private

partnerships as well. Tuck-ins of reasonable size will likely be the bread and butter on the acquisition front, in addition to the less frequent but more sizable transactions. In addition to the regulated utility, AWK will pursue “reg like” opportunities and complimentary lines of business with recurring revenue streams requiring little cap ex.

We also note the company targets a 50%-70% payout ratio, and since its IPO has raised its quarterly dividend once (in Q3'09) by 5% to \$0.21 per share. We anticipate a high level of importance being placed on the company’s dividend policy going forward, and expect this to include annual dividend increases supported by the payout ratio and our perception of earnings growth.

**Exhibit 8**  
**AWK Historical Price Performance**



Source: Baseline



**CONSIDERATIONS AND RISKS**

Risks to investing in this company include but are not limited to the following: Utility operations are heavily regulated and subject to extensive environmental laws and regulations. Weather, natural hazards, and availability of water supplies and competing uses could interfere with sources of water, demand for water services, and the ability to supply water to customers. Risks associated with the collection, treatment, and disposal of wastewater could impose significant costs.

Significant capital expenditures are required to maintain infrastructure and expand rate base and could suffer lacking appropriate funding to make investments, or if delays are incurred in completing projects. Contamination of water could result in service interruptions or cause enforcement actions. Water assets can be subject to condemnation through eminent domain. The company's non-regulated businesses provide performance guarantees and have long-term contracts. Additionally, the company is subject to all other risks that result from operating as a publicly traded company.

*Additional information is available upon request.*

Prices of other stocks mentioned:

RWE AG (RWEQY - \$93.82, NR)  
FirstEnergy (FE - \$44.13, Neutral)  
HealthSouth (HLS - \$18.77, NR)  
New Jersey Resources (NJR - \$36.44, Buy)  
NiSource (NI - \$14.58, Neutral)  
Pennichuck Corp. (PNNW - \$20.24, NR)  
USEC (USU - \$3.69, NR)

American Water Works Co.

January 25, 2010

| American Water Works Company                 |             |             |             |           |           |           |             |           |           |           |           |             |
|--|-------------|-------------|-------------|-----------|-----------|-----------|-------------|-----------|-----------|-----------|-----------|-------------|
| Income Statements (000's)                    | FY'07       | FY'08       | Q1'09A      | Q2'09A    | Q3'09A    | Q4'09E    | FY'09E      | Q1'10E    | Q2'10E    | Q3'10E    | Q4'10E    | FY'10E      |
| Operating revenues                           | \$2,214,215 | \$2,336,928 | \$550,170   | \$612,740 | \$679,956 | \$592,328 | \$2,435,194 | \$570,568 | \$646,621 | \$740,190 | \$624,749 | \$2,582,128 |
| Operating expenses                           |             |             |             |           |           |           |             |           |           |           |           |             |
| Operation and maintenance                    | 1,246,479   | 1,303,798   | 314,402     | 330,597   | 340,862   | 345,327   | 1,331,188   | 319,518   | 349,175   | 378,977   | 356,107   | 1,403,778   |
| Depreciation and amortization                | 267,335     | 271,261     | 68,843      | 73,242    | 74,854    | 75,000    | 291,939     | 71,000    | 74,000    | 75,000    | 76,000    | 296,000     |
| General taxes                                | 183,253     | 199,139     | 52,497      | 51,699    | 50,618    | 48,571    | 203,385     | 56,486    | 53,023    | 56,254    | 49,355    | 215,119     |
| Gain on sale of assets                       | (7,326)     | (374)       | (202)       | 10        | (784)     | (300)     | (1,276)     | (200)     | (1,000)   | (200)     | (300)     | (1,700)     |
| Impairment charge                            | 509,345     | 750,000     | 450,000     |           |           |           |             |           |           |           |           |             |
| Total operating expenses, net                | 2,199,086   | 2,523,824   | 885,540     | 455,548   | 465,550   | 468,598   | 1,825,236   | 446,805   | 475,198   | 510,032   | 481,162   | 1,913,197   |
| Operating income (loss)                      | 15,129      | (186,896)   | (335,370)   | 157,192   | 214,406   | 123,730   | 609,958     | 123,764   | 171,423   | 230,158   | 143,587   | 668,932     |
| Other income (deductions)                    |             |             |             |           |           |           |             |           |           |           |           |             |
| Interest, net                                | (283,165)   | (285,155)   | (71,979)    | (73,688)  | (74,124)  | (74,124)  | (293,915)   | (74,124)  | (74,124)  | (74,124)  | (74,124)  | (296,496)   |
| Advance for other funds used during constrn  | 7,759       | 14,497      | 3,343       | 3,575     | 2,290     | 3,300     | 12,508      | 1,900     | 3,000     | 3,000     | 3,300     | 11,200      |
| Advance for borwd funds used drng constrn    | 3,449       | 8,171       | 1,872       | 1,991     | 1,674     | 1,600     | 7,137       | 1,600     | 1,500     | 1,900     | 1,600     | 6,600       |
| Amortization of debt expense                 | (4,867)     | (5,895)     | (1,488)     | (1,535)   | (2,135)   | (1,400)   | (6,558)     | (1,400)   | (1,300)   | (1,400)   | (1,400)   | (5,500)     |
| Preferred dividends of subsidiaries          | (225)       | (225)       |             |           |           | (56)      | (56)        | (56)      | (56)      | (56)      | (56)      | (224)       |
| Other, net                                   | 6,401       | 4,909       | 1,114       | (1,409)   | (310)     | 2,800     | 2,195       | 1,200     | (100)     | 1,000     | 2,800     | 4,900       |
| Total other income (deductions)              | (270,648)   | (263,698)   | (67,138)    | (71,066)  | (72,605)  | (67,880)  | (278,689)   | (70,880)  | (71,080)  | (69,680)  | (67,880)  | (279,520)   |
| Inc (loss) from cont op before inc taxes     | (255,519)   | (450,594)   | (402,508)   | 86,126    | 141,801   | 55,850    | 331,269     | 52,884    | 100,343   | 160,478   | 75,707    | 389,412     |
| Provision for income taxes                   | 86,756      | 111,827     | 10,571      | 34,137    | 50,165    | 22,061    | 116,934     | 20,889    | 39,635    | 63,389    | 29,904    | 153,818     |
| Income (loss) from continuing ops            | (342,275)   | (562,421)   | (413,079)   | 51,989    | 91,636    | 33,789    | 214,335     | 31,995    | 60,707    | 97,089    | 45,803    | 235,594     |
| Inc (loss) from discontinued ops, net of tax | (551)       |             |             |           |           |           |             |           |           |           |           |             |
| Net income (loss)                            | (\$342,826) | (\$562,421) | (\$413,079) | \$51,989  | \$91,636  | \$33,789  | \$214,335   | \$31,995  | \$60,707  | \$97,089  | \$45,803  | \$235,594   |
| Income (loss) from continuing operations     | \$ 2.14     | \$ 3.52     | \$ (2.58)   |           |           |           |             |           |           |           |           |             |
| Inc (loss) from discontinued ops, net of tax | \$ -        | \$ -        | \$ (2.58)   |           |           |           |             |           |           |           |           |             |
| EPS (FD)                                     | \$ 2.14     | \$ 3.52     | \$ (2.58)   |           |           |           |             |           |           |           |           |             |
| Diluted average shares outstanding           | 160,000     | 159,967     | 160,011     | 163,301   | 174,691   | 160,000   | 167,066     | 160,000   | 160,000   | 160,000   | 160,000   | 160,000     |
| Net inc (loss) excluding impairment charge   |             |             |             |           |           |           |             |           |           |           |           |             |
| Net income (loss)                            | (342,826)   | (562,421)   | (413,079)   | 51,989    | 91,636    | 33,789    | 214,335     | 31,995    | 60,707    | 97,089    | 45,803    | 235,594     |
| Add: Impairment charge                       | 509,345     | 750,000     | 450,000     |           |           |           |             |           |           |           |           |             |
| N/I excludng imprmt chrg bef assctd tax ben  | 166,519     | 187,579     | 36,921      | 51,989    | 91,636    | 33,789    | 214,335     | 31,995    | 60,707    | 97,089    | 45,803    | 235,594     |
| Less: Inc tax ben relating to imprmt chrg    | 7,830       | 11,525      | 6,976       |           |           |           |             |           |           |           |           |             |
| Net income excluding impairment charge       | 158,689     | 176,054     | 29,945      | 51,989    | 91,636    | 33,789    | 207,359     | 31,995    | 60,707    | 97,089    | 45,803    | 235,594     |
| EPS (FD) excluding impairment charge         | \$ 0.99     | \$ 1.10     | \$ 0.19     | \$ 0.32   | \$ 0.52   | \$ 0.21   | \$ 1.24     | \$ 0.20   | \$ 0.38   | \$ 0.61   | \$ 0.29   | \$ 1.47     |
| Cash dividend per share of common stock      | \$ -        | \$ 0.40     | \$ 0.20     | \$ 0.20   | \$ 0.21   | \$ 0.21   | \$ 0.82     | \$ 0.21   | \$ 0.21   | \$ 0.22   | \$ 0.22   | \$ 0.86     |
| <b>Rate of Change Analysis:</b>              |             |             |             |           |           |           |             |           |           |           |           |             |
| Revenues                                     | 5.8%        | 5.5%        | 8.6%        | 4.0%      | 1.2%      | 4.2%      | 4.2%        | 3.7%      | 5.5%      | 8.9%      | 5.5%      | 6.0%        |
| Operating income                             | -94.0%      | -1335.3%    | -50.0%      | 10.2%     | 1.3%      | -4.1%     | -426.4%     | -136.9%   | 9.1%      | 7.3%      | 16.0%     | 9.7%        |
| EPS  |             | 11.1%       | 375.0%      | 14.3%     | -5.5%     | -8.2%     | 12.8%       | 5.2%      | 18.6%     | 16.7%     | 35.6%     | 18.6%       |
| EBITDA                                       |             |             |             |           |           |           |             |           |           |           |           |             |
| <b>Margin Analysis:</b>                      |             |             |             |           |           |           |             |           |           |           |           |             |
| O&M  | 56.3%       | 55.8%       | 57.1%       | 54.0%     | 50.1%     | 58.3%     | 54.7%       | 56.0%     | 54.0%     | 51.2%     | 57.0%     | 54.4%       |
| D&A  | 12.1%       | 11.6%       | 12.5%       | 12.0%     | 11.0%     | 12.7%     | 12.0%       | 12.4%     | 11.4%     | 10.1%     | 12.2%     | 11.5%       |
| General taxes                                | 8.3%        | 8.5%        | 9.5%        | 8.4%      | 7.4%      | 8.2%      | 8.4%        | 9.9%      | 8.2%      | 7.6%      | 7.9%      | 8.3%        |
| Operating income                             | 0.7%        | -8.0%       | -61.0%      | 25.7%     | 31.5%     | 20.9%     | 25.0%       | 21.7%     | 26.5%     | 31.1%     | 23.0%     | 25.9%       |
| Net income                                   | 7.2%        | 7.5%        | 5.4%        | 8.5%      | 13.5%     | 5.7%      | 8.5%        | 5.6%      | 9.4%      | 13.1%     | 7.3%      | 9.1%        |
| Tax rate                                     |             | 41.2%       | 36.9%       | 39.6%     | 35.4%     | 39.5%     | 35.3%       | 39.5%     | 39.5%     | 39.5%     | 39.5%     | 39.5%       |

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

|                      | Hilliard Lyons<br>Recommended Issues |                        | Investment Banking<br>Provided in Past 12 Mo. |            |
|----------------------|--------------------------------------|------------------------|---|------------|
|                      | # of<br>Stocks Covered               | % of<br>Stocks Covered | Banking                                       | No Banking |
| <b>Rating</b>        |                                      |                        |   |            |
| <b>Buy</b>           | 43                                   | 25%                    | 2%  | 98%        |
| <b>Long-term Buy</b> | 38                                   | 22%                    | 0%  | 100%       |
| <b>Neutral</b>       | 87                                   | 51%                    | 7%  | 93%        |
| <b>Underperform</b>  | 4                                    | 2%                     | 0%  | 100%       |

*As of 8 January 2010*

**Other Disclosures**

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Natural Resources & Energy  
Water Utilities  
Equity – United States



HSBC   
Global Research

## Company report

# American Water Works (AWK US)

### Overweight

Target price (USD) 25.00  
Share price (USD) 21.10  
Potential total return (%) 18.5

| Dec                | 2009a     | 2010e     | 2011e      |
|--------------------|-----------|-----------|------------|
| HSBC EPS           | 1.23      | 1.40      | 1.63       |
| HSBC PE            | 17.2      | 15.0      | 13.0       |
| <b>Performance</b> | <b>1M</b> | <b>3M</b> | <b>12M</b> |
| Absolute (%)       | -4.8      | -4.4      | 16.2       |
| Relative^ (%)      | -11.0     | -7.9      | -23.6      |

23 March 2010

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Issuer of report: HSBC Bank plc

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This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it

Initiate with OW: Work-in-progress

- ▶ **Cheap compared to US peers, in our view; AWK needs to improve its margins and returns through rate cases in order to create additional value**
- ▶ **Rate cases, asset purchase and management to underpin growth – housing might be a bonus**
- ▶ **Initiating at Overweight: target price USD25**

**American Water looks cheap to us** –American Water is the largest listed water company in the US. It is trading at 15.0x PE for FY2010e, a 22% discount to Aqua America (WTR.N, Overweight, current price USD17.49) and a 14% discount to its other US peers. We believe this is because it offers lower margins and returns than its peers; a legacy of its ownership by RWE (RWE.G.DE, Overweight, current price EUR64.42). If AWK can successfully negotiate rate cases in 2010 and improve the efficiency of its business relative to its peers, we believe it has scope to create additional value.

**Housing recovery, rate cases and El nino to generate growth:** If AWK receives the rate increases it has requested in 2010 its revenues will increase by cUSD150m. The 'El Nino' climate effect currently occurring in the Pacific is expected to increase temperatures in the states in which AWK operates. Warmer, drier weather than average in 2010 will increase volumes and revenues for AWK. All of these may provide revenue and earnings growth above consensus for 2010 onwards. The latest data released by the US Consensus Bureau suggests that the slump in the housing sector in US which occurred in 2008-09 might be on the verge of a slight recovery. The Housing Market Index (HMI) developed by the National Association of Home Builders (NAHB) in the US further supports this optimism.

**Initiating at Overweight, TP USD25:** We use four valuation techniques to value AWK: DDM (USD26), sum-of-the-parts (USD19), value-creation analysis (USD27) and DCF (USD27). We take the average of these, and round it to USD25, to derive our target price, which offers 18.5% potential return to the current price of USD21.10. We initiate coverage of AWK at Overweight.

|             |         |                   |       |
|-------------|---------|-------------------|-------|
| Index^      | S&P 500 | Free float (%)    | 100   |
| Index level | 1,151   | Market cap (USDm) | 3,686 |
| RIC         | AWK.N   |                   |       |
| Bloomberg   | AWK US  | Source: HSBC      |       |

Source: HSBC

The Extel Survey runs from 22 March to 8 May. To vote for HSBC Global Research, go to [www.extelsurveys.com](http://www.extelsurveys.com) or send an email to [extelsurveys@thomsonreuters.com](mailto:extelsurveys@thomsonreuters.com)

Thank you for your support.

## Financials & valuation

### Financial statements

| Year to                                 | 12/2009a | 12/2010e | 12/2011e | 12/2012e |
|---|----------|----------|----------|----------|
| <b>Profit &amp; loss summary (USDm)</b> |          |          |          |          |
| Revenue                                 | 2,441    | 2,638    | 2,865    | 3,117    |
| EBITDA                                  | 907      | 1,018    | 1,125    | 1,228    |
| Depreciation & amortisation             | -294     | -310     | -325     | -338     |
| Operating profit/EBIT                   | 613      | 707      | 801      | 889      |
| Net interest                            | -297     | -299     | -317     | -330     |
| PBT                                     | -112     | 408      | 484      | 559      |
| Taxation                                | -121     | -159     | -189     | -218     |
| Net profit                              | -233     | 249      | 295      | 341      |

### Cash flow summary (USDm)

|                           |      |      |      |      |
|---------------------------|------|------|------|------|
| Cash flow from operations | 596  | 574  | 634  | 696  |
| Capex                     | -685 | -800 | -800 | -800 |
| Cash flow from investment | -704 | -800 | -800 | -800 |
| Dividends                 | -137 | -153 | -164 | -175 |
| Change in net debt        | 170  | 315  | 245  | 216  |
| FCF pre dividends         | -384 | -226 | -166 | -104 |

### Balance sheet summary (USDm)

|                         |        |        |        |        |
|-------------------------|--------|--------|--------|--------|
| Intangible fixed assets | 1,250  | 1,250  | 1,250  | 1,250  |
| Tangible fixed assets   | 11,629 | 12,119 | 12,595 | 13,056 |
| Current assets          | 499    | 518    | 540    | 564    |
| Cash & others           | 22     | 22     | 22     | 22     |
| Total assets            | 13,453 | 13,961 | 14,459 | 14,945 |
| Operating liabilities   | 2,410  | 2,444  | 2,480  | 2,521  |
| Financial liabilities   | 5,462  | 5,777  | 6,022  | 6,239  |
| Total liabilities       | 9,423  | 9,773  | 10,054 | 10,311 |
| Net debt                | 5,439  | 5,755  | 6,000  | 6,216  |
| Shareholders funds      | 4,029  | 4,189  | 4,404  | 4,634  |

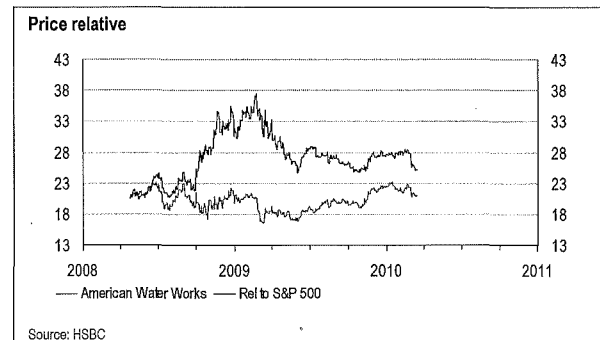
### Ratio, growth and per share analysis

| Year to                      | 12/2009a | 12/2010e | 12/2011e | 12/2012e |
|------------------------------|----------|----------|----------|----------|
| <b>Y-o-y % change</b>        |          |          |          |          |
| Revenue                      | 4.4      | 8.1      | 8.6      | 8.8      |
| EBITDA                       | 9.4      | 12.2     | 10.6     | 9.1      |
| Operating profit             | 9.8      | 15.4     | 13.2     | 11.1     |
| PBT                          |          |          | 18.6     | 15.5     |
| HSBC EPS                     | 7.4      | 14.4     | 16.0     | 13.6     |
| <b>Ratios (%)</b>            |          |          |          |          |
| ROE                          | 5.1      | 6.1      | 6.9      | 7.5      |
| ROCE                         | 4.1      | 4.4      | 4.8      | 5.1      |
| EBITDA margin                | 37.2     | 38.6     | 39.3     | 39.4     |
| Operating profit margin      | 25.1     | 26.8     | 27.9     | 28.5     |
| Net debt/equity              | 135.0    | 137.4    | 136.2    | 134.2    |
| CF from operations/net debt  | 11.0     | 10.0     | 10.6     | 11.2     |
| <b>Per share data (USD)</b>  |          |          |          |          |
| EPS reported (fully diluted) | -1.39    | 1.40     | 1.63     | 1.85     |
| HSBC EPS (fully diluted)     | 1.23     | 1.40     | 1.63     | 1.85     |
| DPS                          | 0.82     | 0.86     | 0.90     | 0.95     |
| Gross CFPS                   | 4.66     | 3.15     | 3.42     | 3.68     |

### Valuation data

| Year to                 | 12/2009a | 12/2010e | 12/2011e | 12/2012e |
|-------------------------|----------|----------|----------|----------|
| EV/sales                | 3.7      | 3.6      | 3.4      | 3.2      |
| EV/EBITDA               | 10.0     | 9.2      | 8.6      | 8.0      |
| P/CF                    | 4.5      | 6.7      | 6.2      | 5.7      |
| PE*                     | 17.2     | 15.0     | 13.0     | 11.4     |
| FCF yield (pre div) (%) | -10.6    | -6.2     | -4.6     | -2.9     |
| Dividend yield (%)      | 3.9      | 4.1      | 4.3      | 4.5      |

Note: \* = Based on HSBC EPS (fully diluted)



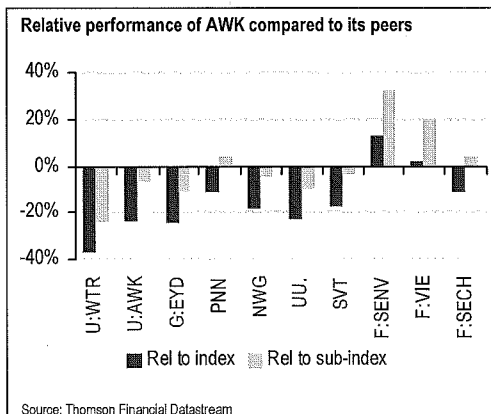
Note: price at close of 15 Mar 2010

# Investment summary

- ▶ AWK an underperformer relative to its peers
- ▶ Drivers for growth – rate cases, housing recovery, and warmer temperatures
- ▶ Initiate with Overweight rating and a TP of USD25

## Key investment proposition

In relative terms AWK has underperformed by 24% over 12 months against the MSCI USA index, and by 7 % against the DJ Utilities index. We set out below the relative performance chart to compare AWK with the other water stocks in our coverage.



AWK is the most geographically diversified publicly traded water and wastewater utility company in the US. It is also the largest operator in terms of operating revenue and population served.

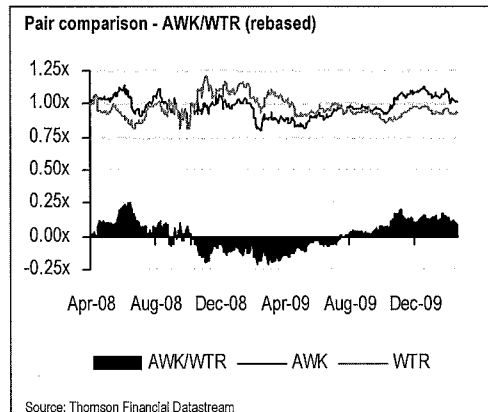
## 2010 outlook

AWK has issued earnings guidance for 2010 to be in the range of USD1.30-1.40 per share. Successful completion of its pending rate cases,

which could be worth as much as USD200m per year of revenue, hold the key for organic growth. In addition warmer weather from the El Nino effect and some degree of growth in the US housing market in 2010 could also underpin further earnings growth above the range indicated by management.

## Peer group comparison

We compare the performance of AWK with that of WTR. We note that, except in Nov 2008-Aug 2009, AWK has always performed better than WTR. We also plot the outperformance of AWK using an AWK/WTR multiple (see chart below). We note that the pair multiple is now at 0.09x, which means that AWK is trading at 9% premium over WTR (rebased on the 23 Apr 2008 price).

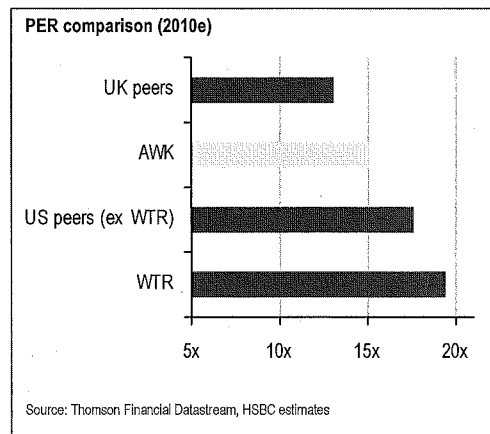
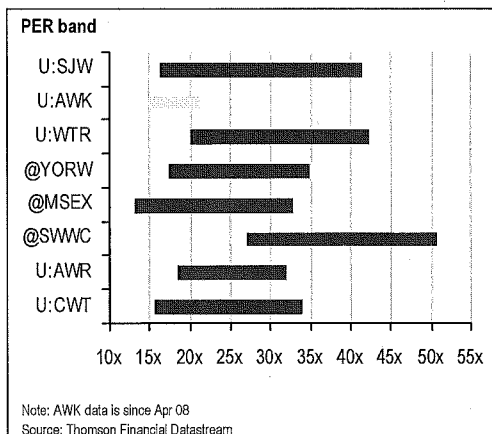
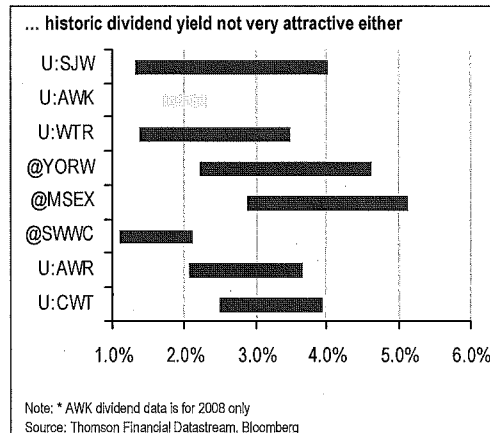
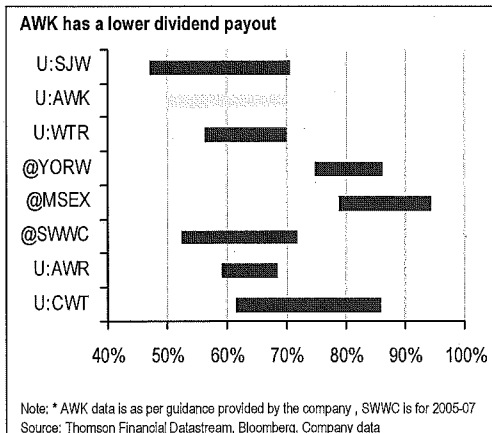
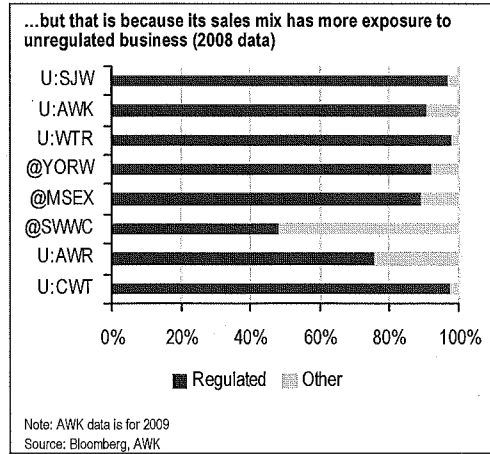
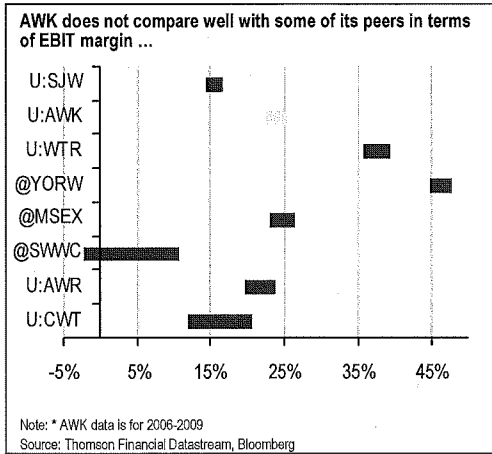


We set out a peer comparison in the charts below.





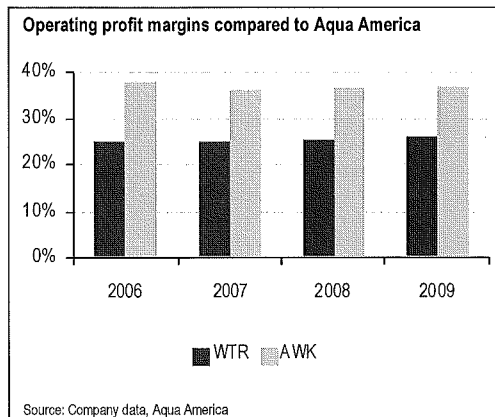
### US peer comparison (2005-2008 bands)



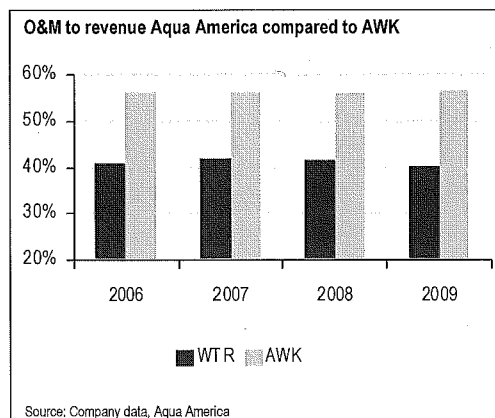


## A recovery story

AWK under RWE ownership was perceived to be poorly managed, which led to unattractive operational metrics. The company did not manage to file rate cases in a timely manner, and we believe it was less committed to growing its contract operations business than previously. We show this graphically in relation to Aqua America.

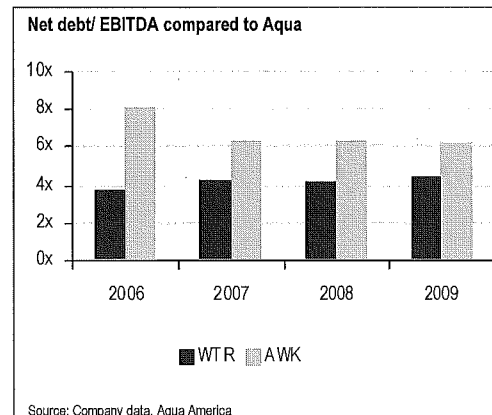


Compared to Aqua America its costs were also higher as a percentage of revenue. This reflects its inability to recover cost increases through rate cases but also WTR's strong culture of cost control.



Another disadvantage AWK has relative to Aqua is its less strong balance sheet. We do believe that this limits its scope for growth. This also applies

to the number two regulated US player, United Water which is owned by Suez Environnement (SEVI.PA, Overweight, current price EUR17.20).



This chart however demonstrates the improvement in debt capacity of AWK and the stable profile it now offers. However this is reflected in its rating Baa2/BB+ stable.

## Managing rate cases

In order to deliver the recovery story and earnings growth, AWK will have to manage rate cases successfully in all the states in which it operates and will have to repair (which we believe it is doing) its regulatory relationships after a difficult few years, during which RWE took out a layer of management in each of the states, undermining the regulatory relationships which are by nature, local in the US. One of the reasons for the relative cost differential is that the current management has decided to 'staff up' to increase operational delivery and strengthen regulatory relationships. This was an important part of rebuilding the business.

## Non regulated strategy

We look below at the peers. AWK has an unregulated business which is lower margin and of lower capital intensity than the regulated business. It competes with Veolia. This could be area of growth for AWK. We set out below how it



compares with its US peers to show that the business mix does affect its overall margins and ability to grow its dividend.

## Conclusion

In the sections below we outline some of the potential upside for American Water outside what we would call the regulatory rate case phase which might provide catalysts for earnings in 2010. These are warmer temperatures following on from 2009, which was one of the coldest, wettest years on record on the East coast of America. (This can affect EPS by several cents.) In addition any improvement in the US housing market, and we set out the circumstantial evidence that we may shortly see improvement, should offer additional growth.

## Forecasts and valuation

### Forecasts

We assume that AWK is able to increase its earnings to USD1.40 in 2010e from USD1.23 in 2009 by successfully negotiating rate cases which will allow it to increase its allowed revenues.

### Valuation

We have used four valuation methods, namely DCF, DDM, SOTP and value creation analysis, to value AWK. We take the simple average of the value yielded by the four methods to arrive at our target price of USD25. The table below presents a summary of our valuation.

#### Summary of valuation methods

|                         | USD/share         |
|-------------------------|-------------------|
| Current price 15/3/2010 | 21.10             |
| DCF                     | 27.12             |
| DDM                     | 26.49             |
| SOTP                    | 19.02             |
| Value creation          | 27.36             |
| <b>Target price</b>     | <b>25.00</b>      |
| Potential return        | 18.5%             |
| <b>Rating</b>           | <b>Overweight</b> |

HSBC Estimates

### DCF valuation

In HSBC's standard DCF model, three separate stages are used:

- ▶ Stage 1: explicit forecasts for five years, to 2014.
- ▶ Stage 2: a semi-explicit forecast period for a further 5 years, to 2019, assuming 2% annual revenue growth, and 28% EBIT margins.
- ▶ Stage 3: terminal 1.5% annual free cash flow growth.

#### WACC inputs and DCF valuation

| WACC inputs                 | Equity valuation               | (USDm)         |
|-----------------------------|--------------------------------|----------------|
| <b>Cost of debt</b>         | + DCF value                    | 10,208         |
| Pre-tax cost of debt 5.5%   | + ST marketable assets         | -              |
| Marginal tax rate 39%       | + Value of associates          | -              |
| <b>Cost of equity</b>       | + Other assets                 | 1,026          |
| Risk-free rate 4.0%         | <b>EV (asset side)</b>         | <b>11,234</b>  |
| Equity risk premium 3.5%    | - Net debt (+ if Net cash)     | (5,755)        |
| Additional risk premium     | - Quasi debt (pension)         | (667)          |
| Beta 0.47                   | - Value of minorities          | -              |
| Debt - 61%                  | <b>Total non-equity claims</b> | <b>(6,422)</b> |
| Equity - 39%                | <b>Value of Equity</b>         | <b>4,812</b>   |
| <b>Cost of capital 4.3%</b> | <b>Value per share (USD)</b>   | <b>27.12</b>   |

Source: HSBC

In the table below we set out a sensitivity table illustrating the effect of different terminal FCF growth rates and WACC on AWK's DCF valuation.

#### Sensitivity of DCF value to WACC and terminal growth rate

|      | 1.25% | 1.5% |
|------|-------|------|
| 4.0% | 28    | 33   |
| 4.3% | 23    | 27   |
| 4.5% | 18    | 22   |
| 4.8% | 15    | 17   |

Source: HSBC

### DDM valuation

AWK has committed to a payout of 50-70%. This translates into DPS growth of 5% every year. Since there is a clear established link between earnings and dividends, we believe that the DDM is an appropriate tool for valuing AWK's equity.



Our DDM value of USD26.49 is based on a cost of equity of 5.6% and a long-term growth assumption of 2%. There is a 5-year explicit forecast period till 2014. The share of explicit and terminal forecast valuation is shown in the following table.

| DDM valuation (USD) |            |            |            |            |              |         |
|---------------------|------------|------------|------------|------------|--------------|---------|
|                     | Q1         | Q2         | Q3         | Final      | Total        | % share |
| Explicit            | 0.8        | 1.0        | 1.1        | 1.0        | 3.9          | 15%     |
| Terminal            | 5.5        | 5.7        | 5.9        | 5.5        | 22.6         | 85%     |
| <b>Value</b>        | <b>6.3</b> | <b>6.7</b> | <b>7.0</b> | <b>6.5</b> | <b>26.49</b> |         |

Source: HSBC

### Value creation analysis

We use this methodology to calculate AWK's ability to create value above its WACC.

#### Value creation analysis

|  | (USDm)       |
|--|--------------|
| Opening invested capital               | 10,946       |
| ROIC 2010e on average invested capital | 3.9%         |
| WACC                                   | 4.3%         |
| Spread of ROCE above WACC              | -0.4%        |
| Value creation                         | (1,010)      |
| <b>Estimated enterprise value</b>      | <b>9,936</b> |
| Financial and other assets             | 1,026        |
| Net debt 2009, pensions & Minority     | (6,107)      |
| Estimated equity value                 | 4,855        |
| <b>Equity value per share (USD)</b>    | <b>27.36</b> |

Source: HSBC

### SOTP valuation

We use a US water peer group multiples to derive our sum of the parts applying a multiple to our EBITDA estimates.

| SOTP valuation (USDm)               |              |             |              |
|-------------------------------------|--------------|-------------|--------------|
|                                     | 2010e EBITDA | Multiple    | EV           |
| Residential water                   | 616          | 8.9x        | 5,498        |
| Commercial water                    | 172          | 9.3x        | 1,596        |
| Industrial water                    | 30           | 9.3x        | 274          |
| Public and other                    | 111          | 8.9x        | 988          |
| Wastewater                          | 28           | 8.9x        | 252          |
| Other water                         | 18           | 9.2x        | 163          |
| <b>Regulated business</b>           | <b>974</b>   | <b>9.0x</b> | <b>8,772</b> |
| Financial and other assets          |              |             | 1,026        |
| Net debt 2010e, pensions & Minority |              |             | (6,422)      |
| Estimated equity value              |              |             | 3,376        |
| <b>Equity value per share (USD)</b> |              |             | <b>19.02</b> |

Source: HSBC, Thomson Financial Datastream

#### Peer list for SOTP valuation

| Residential water       | Price (USD) | Market Cap (USDm) | EV/EBITDA 2010e |
|-------------------------|-------------|-------------------|-----------------|
| AQUA AMERICA            | 16.9        | 2,313             | 8.8x            |
| CAL.WATER SER.          | 36.8        | 763               | 7.7x            |
| AMERICAN STS.WATER      | 32.5        | 604               | 7.3x            |
| SOUTHWEST WATER         | 10.5        | 260               | 11.0x           |
| MIDDLESEX WATER         | 17.6        | 238               | 14.6x           |
| YORK WATER              | 14.0        | 176               | 11.4x           |
| <b>WEIGHTED AVERAGE</b> |             |                   | <b>8.9x</b>     |

| Industrial & Commercial | Price (USD) | Market Cap (USDm) | EV/EBITDA 2010e |
|-------------------------|-------------|-------------------|-----------------|
| ITT                     | 52.8        | 9,661             | 6.5x            |
| PENTAIR                 | 34.6        | 3,413             | 9.2x            |
| DANAHER                 | 78.0        | 25,238            | 10.5x           |
| NALCO HLDG.             | 23.5        | 3,250             | 7.8x            |
| <b>WEIGHTED AVERAGE</b> |             |                   | <b>9.3x</b>     |

Source: Thomson Financial Datastream

### Conclusion: target price of USD25

Based on the rounded average of our four valuation methodologies – DCF, DDM, SOP, and value creation analysis – we arrive at a target price of USD25.

We are initiating our equity coverage of AWK with an Overweight rating. Under HSBC research model, for stocks without a volatility indicator, the Neutral band is 5pp above and below the hurdle rate of 7.5% for US stocks (ie between 2.5% and 12.5%). Our 12-month target price of USD25 implies a potential total return of 18.5%, which is above the Neutral range and therefore justifies our Overweight rating.

### Risks

#### Downside

- ▶ Slowdown in organic growth revenue in 2010
- ▶ Inability to maintain cost controls, thus resulting in even higher O&M expenses than currently
- ▶ Failure to achieve a high proportion of the desired revenues from rate cases
- ▶ Lack of contract operations growth



## Peer comparison

### Valuation and rating of Aqua America

We continue to value Aqua America using December 2010 as the next forecast year and based on four methods – DCF, DDM, sum-of-parts (SOP) and divisional value creation analysis. We take the average of these, USD20.21, and round it down to USD20 to obtain our target price.

Under HSBC's research model, the Neutral band for stocks without a volatility indicator such as Aqua America is five percentage points above and below the hurdle rate of 7.5% for US stocks. For Aqua America, this translates into a Neutral band of 2.5-12.5% above the current share price of USD16.92. As our target price of USD20 implies a potential total return of 18%, we maintain our Overweight rating.

#### Aqua America: Summary of valuation

| Particulars                    | USD               |
|--------------------------------|-------------------|
| <b>Current price 15/3/2010</b> | <b>16.92</b>      |
| DCF                            | 24.83             |
| DDM                            | 24.46             |
| SOP                            | 16.13             |
| Value creation analysis        | 15.46             |
| <b>Target price (rounded)</b>  | <b>20.00</b>      |
| Potential return               | 18%               |
| <b>Rating</b>                  | <b>Overweight</b> |

Source: HSBC

#### Negative risks

- ▶ Reduced organic growth in Aqua's revenue in 2010
- ▶ Rate cases that do not deliver improved returns
- ▶ Aqua is unable to maintain cost control
- ▶ Cost of debt increases as Aqua refinances its short-term debt

#### Aqua America: WACC inputs and DCF valuation

| WACC inputs                 | Equity Valuation             | USDm         |
|-----------------------------|------------------------------|--------------|
| Cost of debt                | + DCF value                  | 4,650        |
| Pre-tax cost of debt 4.9%   | + ST marketable assets       | -            |
| Marginal tax rate 38.9%     | + Value of associates        | -            |
| Cost of equity              | + Other assets               | 311          |
| Risk-free rate 4.0%         | EV (asset side)              | 4,962        |
| Equity risk premium 3.5%    | - Net debt (+ if Net cash)   | (1,564)      |
| Additional risk premium     | - Quasi debt (pension)       | -            |
| Beta 0.6                    | - Value of minorities        | (1)          |
| HEW                         | 7RWR HT WRDP V               |              |
| ( T W                       | 9DHR HT W                    |              |
| <b>Cost of capital 4.8%</b> | <b>Value per share (USD)</b> | <b>24.83</b> |

Source: HSBC estimates

#### Aqua America: DDM valuation (USD)

|          | Q1   | Q2   | Q3   | Final | Total | % share |
|----------|------|------|------|-------|-------|---------|
| Explicit | 0.70 | 0.69 | 0.68 | 0.71  | 2.78  | 11%     |
| Terminal | 5.47 | 5.39 | 5.31 | 5.50  | 21.68 | 89%     |
| Value    | 6.18 | 6.08 | 5.99 | 6.20  | 24.46 |         |

Source: HSBC

#### Aqua America: Value creation analysis

|  | (USDm)       |
|--|--------------|
| Opening invested capital               | 2,826        |
| ROIC 2010e on average invested capital | 5.6%         |
| WACC                                   | 4.8%         |
| Spread of ROCE above WACC              | 0.7%         |
| Value creation                         | 431          |
| <b>Estimated enterprise value</b>      | <b>3,257</b> |
| Financial and other assets             | 311          |
| Net debt 2009, pensions & minority     | (1,452)      |
| Estimated equity value                 | 2,116        |
| <b>Equity value per share (USD)</b>    | <b>15.46</b> |

Source: HSBC

#### Aqua America: SOP valuation (USDm)

|                                     | 2010e EBITDA | Multiple    | EV           |
|-------------------------------------|--------------|-------------|--------------|
| Residential water                   | 264          | 8.7x        | 2,283        |
| Commercial water                    | 53           | 9.3x        | 490          |
| Industrial water                    | 7            | 9.3x        | 68           |
| Other water                         | 32           | 9.2x        | 293          |
| Wastewater                          | 31           | 9.2x        | 284          |
| Other utility                       | 5            | 9.2x        | 43           |
| <b>Regulated business</b>           | <b>391</b>   | <b>8.8x</b> | <b>3,460</b> |
| Financial and other assets          |              |             | 311          |
| Net debt 2010e, pensions & Minority |              |             | (1,565)      |
| Estimated equity value              |              |             | 2,207        |
| <b>Equity value per share (USD)</b> |              |             | <b>16.13</b> |

Source: HSBC, Thomson Financial Datastream

American Water Works (AWK US)  
Water Utilities  
23 March 2010



**Aqua America - segmental analysis (USDm)**

|                                | 2009a      | 2010e      | 2011e      | 2012e      | 2013e      | 2014e        |
|--------------------------------|------------|------------|------------|------------|------------|--------------|
| <b>Sales</b>                   |            |            |            |            |            |              |
| Regulated                      | 659        | 715        | 775        | 841        | 912        | 989          |
| Residential water              | 392        | 425        | 462        | 501        | 543        | 590          |
| Commercial water               | 94         | 102        | 110        | 119        | 128        | 138          |
| Industrial water               | 19         | 21         | 23         | 24         | 26         | 29           |
| Other water                    | 70         | 76         | 82         | 89         | 96         | 103          |
| Wastewater                     | 70         | 77         | 85         | 93         | 103        | 113          |
| Other utility                  | 13         | 13         | 14         | 15         | 15         | 16           |
| Other & Eliminations           | 12         | 13         | 14         | 15         | 16         | 17           |
| <b>Total</b>                   | <b>671</b> | <b>727</b> | <b>789</b> | <b>855</b> | <b>928</b> | <b>1,006</b> |
| <b>Sales growth</b>            |            |            |            |            |            |              |
| Regulated                      | 7%         | 8%         | 8%         | 8%         | 8%         | 8%           |
| Residential water              | 5%         | 9%         | 9%         | 9%         | 9%         | 9%           |
| Commercial water               | 5%         | 8%         | 8%         | 8%         | 8%         | 8%           |
| Industrial water               | -2%        | 8%         | 8%         | 8%         | 8%         | 8%           |
| Other water                    | 20%        | 8%         | 8%         | 8%         | 8%         | 8%           |
| Wastewater                     | 19%        | 10%        | 10%        | 10%        | 10%        | 10%          |
| Other utility                  | -5%        | 5%         | 5%         | 5%         | 5%         | 5%           |
| Other & Eliminations           | -1%        | 8%         | 8%         | 8%         | 8%         | 8%           |
| <b>Total</b>                   | <b>7%</b>  | <b>8%</b>  | <b>8%</b>  | <b>8%</b>  | <b>8%</b>  | <b>8%</b>    |
| <b>Operating profit</b>        |            |            |            |            |            |              |
| Regulated                      | 237        | 268        | 294        | 323        | 356        | 392          |
| Other & Eliminations           | 0          | -          | -          | -          | -          | -            |
| <b>Total</b>                   | <b>237</b> | <b>268</b> | <b>294</b> | <b>323</b> | <b>356</b> | <b>392</b>   |
| <b>Operating profit margin</b> |            |            |            |            |            |              |
| Regulated                      | 36%        | 37%        | 38%        | 38%        | 39%        | 40%          |
| Other & Eliminations           | 3%         | 0%         | 0%         | 0%         | 0%         | 0%           |
| <b>Total</b>                   | <b>35%</b> | <b>37%</b> | <b>37%</b> | <b>38%</b> | <b>38%</b> | <b>39%</b>   |
| <b>Operating profit growth</b> |            |            |            |            |            |              |
| Regulated                      | 6%         | 13%        | 10%        | 10%        | 10%        | 10%          |
| Other & Eliminations           | -78%       | NM         | NM         | NM         | NM         | NM           |
| <b>Total</b>                   | <b>5%</b>  | <b>13%</b> | <b>10%</b> | <b>10%</b> | <b>10%</b> | <b>10%</b>   |

Source: Company data, HSBC estimates

# Opportunities for growth

- ▶ Highly fragmented water sector; ageing infrastructure
- ▶ Housing recovery likely to underpin growth
- ▶ Pending rate case analysis and non regulated opportunities

## Regulated sector

The water and wastewater utility operations in the US are regulated by the state regulatory commissions. These commissions have broad administrative powers and authority to regulate rates and charges, determine franchise areas and conditions of service, approve acquisitions and authorise the issuance of securities. The profitability of a utility play is influenced to a great extent by the timeliness and adequacy of rate allowances in the various states in which it operates.

## Highly fragmented

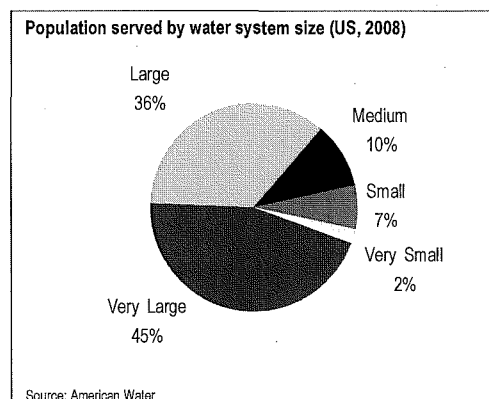
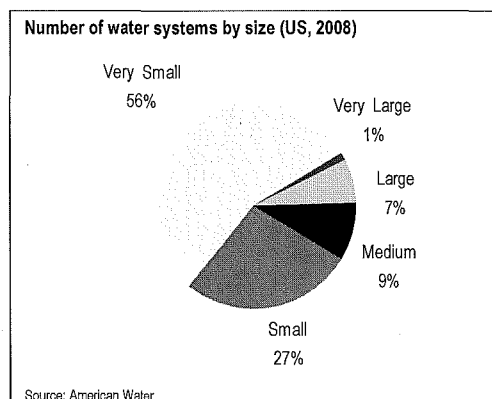
The market for operating water and sewerage services in the US is estimated at USD47-53bn per annum. However, the water and wastewater industry in the country is highly fragmented, with c52,000 community water systems and c16,000

community wastewater facilities. The following table represents the water systems operating in the US based on population served by them.

| Classification of water systems operating in the US |                   |
|---|-------------------|
| Water systems                                       | Population served |
| Very large  | 100,001 or more   |
| Large   | 10,001-100,000    |
| Medium  | 3,301-10,000      |
| Small   | 501-3,300         |
| Very small  | 500 or less       |

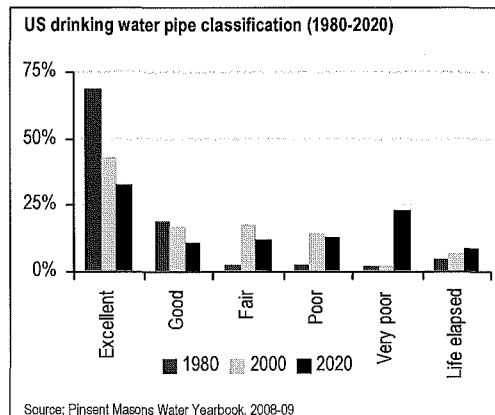
Source: HSBC

In the following charts, we set out the total US water industry by system size and the total population served by them in 2008. As the industry is highly fragmented, there is immense scope for consolidation, leading to improved operating efficiencies, lower unit costs and better services.



## Ageing infrastructure

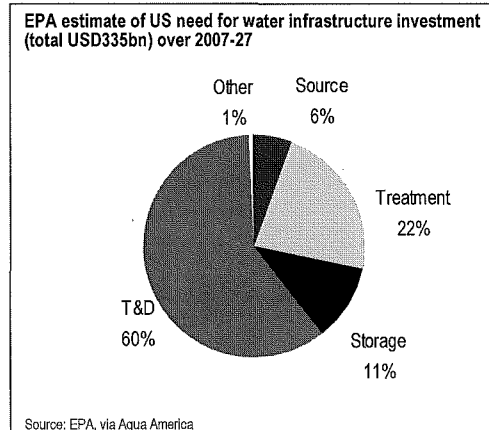
The water and wastewater infrastructure in the US is ageing, and in constant need of modernisation and replacement. In the chart below, we set out the drinking water pipe classification as per the US Environmental Protection Agency (EPA).



In its most recent (January 2009) report card for America's Infrastructure, the American Society of Civil Engineers (ASCE) has rated the wastewater and drinking water infrastructure in the country a 'D-', where A = Exceptional, B = Good, C = Mediocre, D = Poor, F = Failing.

### Spending forecasts

As mentioned earlier, there is a need to modernise infrastructure. Better regulations to improve water quality and management of wastewater discharge are among primary concerns. The EPA estimates that to ensure compliance with the existing and future water regulations, the country's water infrastructure would need an investment of USD335bn over 2007-27. We set out the various compositions of the EPA estimate in the following chart.



The replacement cost for the ageing water and wastewater network, and upgrading and extending the treatment facilities according to the US water trade organisation at USD550-1,000bn over the next 20 years. Moreover, as per EPA estimates, the country needs to spend USD137bn during 1996-2016 to reach the EPA's acceptable level of discharges from sewage treatment plant.

### Summary of spending forecasts

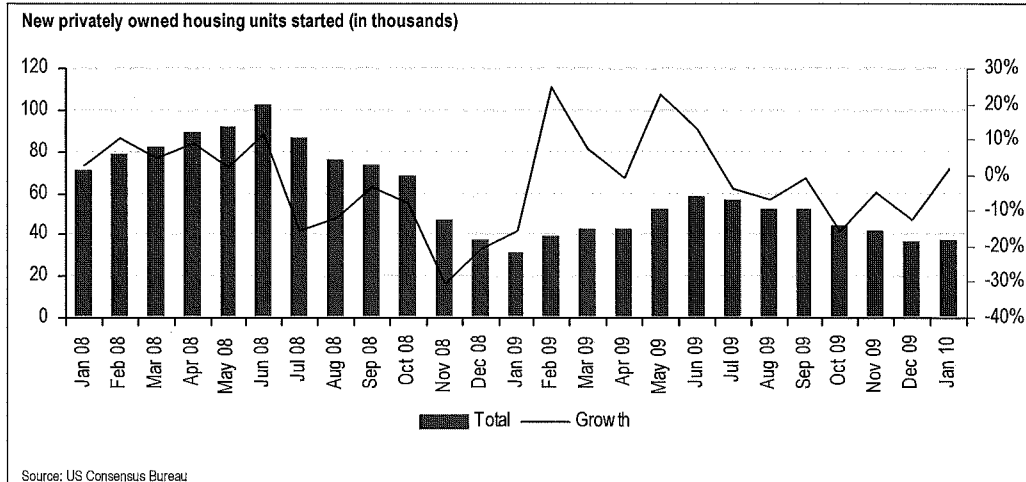
| Particulars   | (USDbn)   | Period                 |
|---|-----------|------------------------|
| Water infrastructure                                      | 335       | 2007-27                |
| Replacement, upgrade and extension cost                   | 550-1,000 | Over the next 20 years |
| Sewage treatment projects                                 | 137       | 1996-2016              |
| Overall capital spending on drinking water and wastewater | 492-820   | 2003-23                |

Source: Pinstent Masons Water Yearbook, 2008-09

### Fiscal stimulus

Forms of concessionary, finance tax-free loans have been made available to improve water infrastructure in the country. It appears to us that Aqua America and American Water have been the earliest beneficiaries of the initiative.



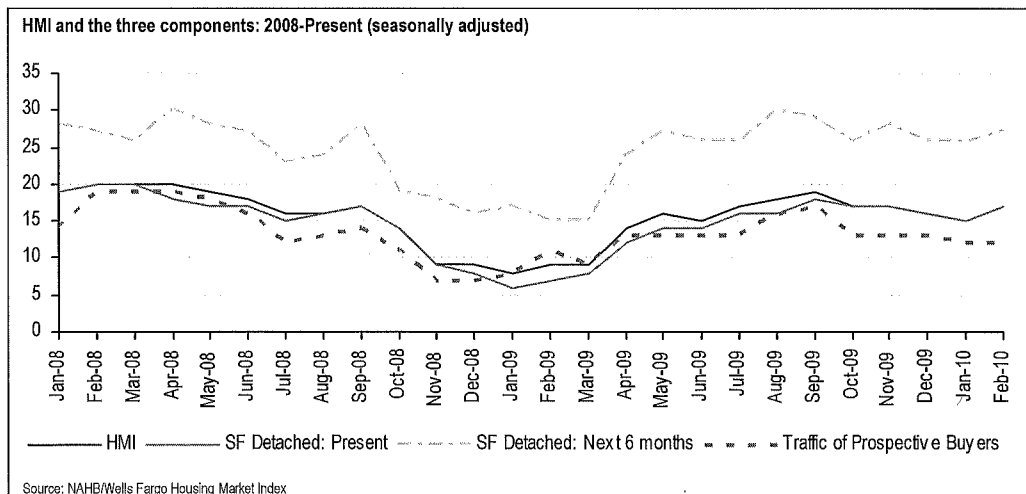


**Potential catalysts**

**US housing: On the road to recovery?**

The latest data released by the US Consensus Bureau suggests that the slump in the housing sector in the US witnessed in 2008-09 is on the verge of a recovery. The optimism is further supported by the Housing Market Index (HMI), developed by the National Association of Home Builders (NAHB). The HMI is based on a monthly survey of NAHB members and is designed to take the pulse of the single-family (SF) housing market. The survey asks respondents to rate market conditions for the sale of new

homes at the present time and in the next six months as well as the traffic of prospective buyers of new homes. This index is used in conjunction with the latest 'housing starts' figure to forecast demand for new homes. The forecast serves as an indicator of economic growth. Values from the index range from 0 to 100, with 50 indicating an average demand for new homes. The chart above shows the expected progress in house prices. This will provide underlying additional growth in revenues for US water companies by as much as 1-2% in our view.



American Water Works (AWK US)  
Water Utilities  
23 March 2010



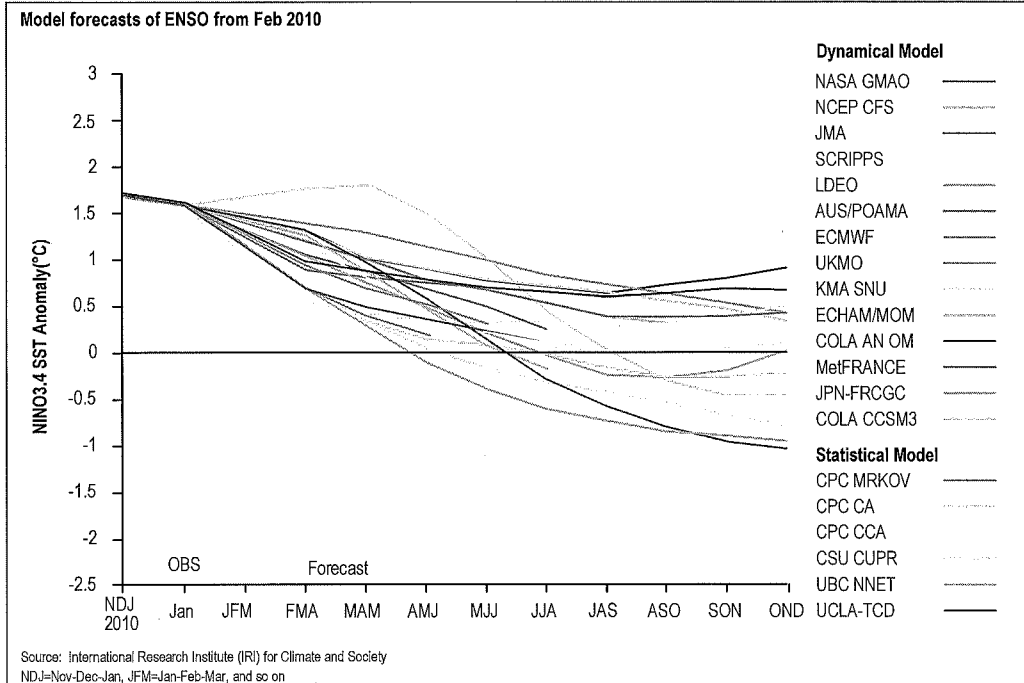
**Rate cases pending**

AWK needs to be successful in the following rate cases to increase revenues and earnings in 2010 onwards.

**General rate cases awaiting final order (31 December 2009)**

|                                    | Date filed | Amt filed<br>(USD) requested | ROE    | Rate base<br>filed<br>(USD) | Status  |
|------------------------------------|------------|------------------------------|--------|-----------------------------|---|
| Hawaii*                            | 1-Nov-07   | 1.3                          | 10.6%  | 24.9                        | Awaiting<br>final order                               |
| California<br>(Sac, LA,<br>Lark)** | 23-Jan-09  | 32.7                         | 10.2%  | 215.8                       | Discovery<br>(Data<br>Requests,<br>Investigati<br>on) |
| Indiana                            | 30-Apr-09  | 46.9                         | 12.0%  | 670.5                       |   |
| Ohio                               | 7-May-09   | 8.8                          | 12.2%  | 74.8                        |   |
| Illinois                           | 29-May-09  | 58.6                         | 12.25% | 610.3                       |   |
| Arizona<br>(Anthem,<br>etc.)       | 2-Jul-09   | 20.6                         | 12.25% | 220.4                       |   |
| New Mexico<br>(Edgewood)           | 21-Aug-09  | 0.7                          | 12.25% | 4.0                         |   |
| Missouri                           | 30-Oct-09  | 48.7                         | 11.6%  | 792.3                       | Case Filed  |

Source: Company data  
\* Interim rates implemented (USD0.7m additional annual revenues) and will be subject to adjustment upon issuance of final order from commission.  
\*\* California rate increase amount includes test year (2010) increase of USD26.1m, and staged increase of \$6.6m effective in escalation year of 2011.



**Water volumes likely to be on the rise (El Niño effect)**

The US Climate Prediction Center (CPC) has confirmed that a significant El Niño persisted throughout the equatorial Pacific Ocean during January 2010. The National Oceanic and Atmospheric Administration (NOAA) forecasts temperatures to be warmer than average across much of the western and central US and below average in the Southeast and mid-Atlantic from southern and eastern Texas northward to southern Pennsylvania and south through Florida in 2010.

As evident from the chart above, Sea surface temperatures (SST) are more than 1.0°C above-average across most of the central and east-central equatorial Pacific. Based on current observations and dynamical model forecasts, El Niño is expected to continue in the Northern Hemisphere at least until late Spring 2010.

From Q2 onwards this may lead to a recovery in water usage in states where AWK operates, particularly in New Jersey and Pennsylvania (47%

of revenue share, 39% of customer base). This might provide additional revenue growth both for AWK and WTR.

**AWK regulated business 2009 – breakdown by state**

|               | Revenue share | Customer base |
|---------------|---------------|---------------|
| New Jersey    | 25%           | 19%           |
| Pennsylvania  | 21%           | 20%           |
| Illinois      | 9%            | 9%            |
| Missouri      | 9%            | 14%           |
| Indiana       | 7%            | 8%            |
| California    | 6%            | 5%            |
| West Virginia | 5%            | 5%            |
| Other         | 17%           | 19%           |

Source: Company data

**Non-regulated growth**

It competes with Veolia, United Water and Severn Trent Services to provide operating contracts for municipalities. We expect this to be an area of growth for AWK. Its flagship project in 2009 is the water recycling plant in Fillmore California. It operates this under a 20 year DBO contract. This provides waste water reuse in an area of water scarcity.



Quarterly Update

Water Utility Research

Member FINRA, SIPC

February 27, 2009  
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## American Water Works (AWK)

Rate Relief More Than Offsets  
Weather and the Economy

Current Price: \$18.50  
Target Price: \$25

**BUY**

| Revenues and Earnings    | F2007A    | F2008E         | F2009E    | F2010E    |
|--------------------------|-----------|----------------|-----------|-----------|
| Sales (\$ mil.)          | \$2,214.0 | \$2,336.9      | \$2,523.5 | \$2,675.5 |
| 1Q                       | \$468.5   | \$506.8        |           |           |
| 2Q                       | \$558.7   | \$589.4        |           |           |
| 3Q                       | \$633.0   | \$672.2        |           |           |
| 4Q                       | \$553.8   | \$568.6        |           |           |
| <hr/>                    |           |                |           |           |
| EPS                      | \$0.99    | \$1.10         | \$1.30    | \$1.45    |
| 1Q                       | 0.02      | \$0.04         |           |           |
| 2Q                       | 0.29      | \$0.28         |           |           |
| 3Q                       | 0.46      | \$0.56         |           |           |
| 4Q                       | 0.19      | \$0.22         |           |           |
| Current Annual Dividend: | \$0.80    | Current Yield: | 4.3%      |           |
| P/E (x)                  | 18.7      | 16.8           | 14.2      | 12.8      |
| Book Value               | \$13.04   | \$14.99        | \$16.36   | \$16.51   |
| ROE                      | 7.6%      | 7.9%           | 8.3%      | 8.8%      |

| Stock Data                   |                   |
|------------------------------|-------------------|
| 52-Week Range                | \$16.47 - \$23.65 |
| Shares Outstanding (mil.)    | 159.98            |
| Market Capitalization (mil.) | \$3,073.3         |
| Enterprise Value (mil.)      | \$8,187.9         |
| Debt to Capital              | 59.0%             |
| Insider Ownership            | 60.5%             |
| Institutional Ownership      | 36.7%             |
| Short Interest (mil. shares) | 3.56              |
| Average Daily Volume         | 476,947           |

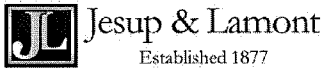
### Highlights

- AWK reported full year 2008 EPS results of \$1.10, below our \$1.15 estimate, but 11% higher than the \$0.99 for the same period last year. Higher results were primarily driven by significant rate relief implemented in 2007 and 2008.
- In 2008, the Midwest experienced some of the wettest weather on record. Total volume of water sold decreased (4.4%) versus 2007, which negatively impacted revenues by (\$52.3 million), net income by (\$30.8 million) and EPS by (\$0.19). Industrial water sales declined (5.8%) for the year and a more significant (11.6%) in the fourth quarter.
- While water utilities are less economically-sensitive than most other companies, we are closely monitoring the recent declines in retail water sales.
- We attribute roughly “half” of the usage decline to the economy and “half” to weather and conservatively estimate “weather normalized” 2008 results would have been roughly \$1.20. (calculating weather-related volume declines during this economic recession is an uncertain science given potential impacts of price elasticity and budget-related constraints)
- We consider fourth quarter and full year weather-normalized results to be solid and encouraging.
- **We have raised our 2009 and 2010 EPS estimates to \$1.30 and \$1.45, respectively, from \$1.25 and \$1.40, respectively.** Given the strong weather-normalized 2008 results and significant rate relief both granted (over \$200 million in 2008) and pending (over \$100 million), we continue to forecast accelerated EPS growth over the next few years.
- During 2008, AWK was authorized rate increases totaling approximately \$206.3 million, including \$120 million authorized during the fourth quarter.
- Shares currently trade at 12.8X our 2010 EPS estimate and 123% of book value, which represent material discounts to group median/averages of 18.5X and 175%. AWK is a high quality conservative utility with unique growth opportunities. Shares offer investors a 4.3% dividend yield, the likelihood of consistent annual dividend increases and, more importantly, earnings growth through rate base additions and consolidation/privatization opportunities.

### Company Description

American Water Works (AWK) is the largest investor-owned water and wastewater utility company in the United States.

**\*\*\*See Last Page for Disclosure\*\*\***



February 27, 2009

**2008 Results Rise 11% to \$1.10 vs. \$0.99**

**Improvement Highlights the Significant Impact Rate Relief Can Have On EPS Results**

**Sales Volume Declines Negatively Impacted Results By (\$0.19)**

**We Estimate Weather-Normalized EPS Were \$1.20**

**AWK Received Rate Awards Totaling \$120 Million in the Fourth Quarter**

**Roughly \$104 Million In Revenue Requests Pending With Various PUCs**

**2008 EPS Results Rise 11% to \$1.10; Weather-Normalized Results Were Roughly ~\$1.20**

On February 25, AWK reported full year 2008 EPS results of \$1.10, below our \$1.15 estimate, versus \$0.99 for the same period last year. Results rose 11%, but were lower than our estimate primarily due to weather-related sales volumes declines, which negatively impacted annual results by (\$0.19) per share.

During the third quarter and early fourth quarter, the Midwest experienced some of the wettest weather on record. Total volume of water sold in 2008 decreased (4.4%) versus 2007, which negatively impacted revenues by (\$52.3 million), net income by (\$30.8 million) and EPS by (\$0.19). We note that calculating weather-related volume declines during this economic recession is an uncertain science given potential impacts of price elasticity and budget-related constraints. However, we are comfortable that results would have exceeded our estimate absent milder and wetter than normal weather. We remind investors that our forecasts assume normal weather and conservatively estimate "weather normalized" 2008 results would have been roughly \$1.20.

Fourth quarter 2008 EPS results were \$0.23, below our \$0.27 estimate, vs. \$0.19 for the same period last year. Fourth total volume of water decreased (6.7%) in the fourth quarter, which negatively impacted revenues by (\$27.3 million), net income by (\$16.1 million) and EPS by (\$0.10).

While water utilities are less economically-sensitive than most other companies, we are closely monitoring the recent declines in retail water sales. In recent years, AWK has observed customer usage decline at rates averaging roughly (0%-to-1.5%). However, the fourth quarter and full year showed the following sales declines:

|              | <b>4<sup>th</sup>-Qtr.</b> | <b>2008</b>   |
|--------------|----------------------------|---------------|
| Residential  | (6.0%)                     | (4.2%)        |
| Commercial   | (3.3%)                     | (5.0%)        |
| Industrial   | (5.8%)                     | (11.6%)       |
| <b>Total</b> | <b>(4.4%)</b>              | <b>(6.7%)</b> |

We attribute roughly "half" of the usage decline to the economy and "half" to weather. As a result, we consider fourth quarter and full year weather-normalized results to be solid and encouraging. Higher results were primarily driven by significant rate relief implemented in 2007 and 2008, including the following more significant decisions: Illinois (\$24.9 million-8/8/08), Pennsylvania (\$36 million-11/07) and West Virginia (\$32.8 million-3/28/08). During 2008, AWK was authorized rate increases totaling approximately \$206.3 million, including \$120 million authorized during the fourth quarter. Large recent rate increases include a roughly a \$72.1 million, or 15%, increase for New Jersey-American authorized in mid-December and a \$34.5 million increase for Missouri-American. The allowed returns on common equity have averaged more than 10%.

The company's Non-regulated Businesses' revenues increased by \$29.5 million, or 12.2%, while operating expenses increased \$22.8 million. During 2008, AWK subsidiaries acquired ten small systems serving 5,000 water customers and 1,600

**We Have Raised Our  
2009 & 2010 EPS  
Estimates to \$1.30 and  
\$1.45**

wastewater customers.

2008 capital expenditures totaled \$1 billion and operating cash flow totaled \$552 million. Excluding goodwill, the common equity ratio was 31% and book value was \$14.98 at year-end 2008.

**EPS Outlook Remains**

**We have raised our 2009 and 2010 EPS estimates to \$1.30 and \$1.45, respectively, from \$1.25 and \$1.40, respectively.** Given the strong weather-normalized 2008 results and significant rate relief both granted (over \$200 million in 2008) and pending (over \$100 million), we continue to forecast accelerated EPS growth over the next few years. With roughly 90% of earnings generated from the low-risk regulated water utility business, we assume reasonable regulatory treatment leads to an EPS rebound to over \$1.45 by 2010, which results in a roughly 9.5% return on common equity. Water utility allowed returns on equity have averaged roughly 10-11% over the past few years. In addition, management has instilled the growth-through-acquisition culture that marked the “Water Works” of yore and we expect an acceleration of growth opportunities.

Improved 2008 results as well as the recent rate relief highlight AWKs strategic progress toward boosting returns at previously “under-earning” subsidiaries via necessary rate relief. We estimate AWK subsidiaries earned a roughly 8% return on common equity in 2008, which results in potential for further earnings improvement of roughly \$0.20-0.30 per share to reach a 9.5% ROE. As of year-end 2008, AWK subsidiaries were awaiting decisions on rate requests totaling \$104 million in additional revenues, including roughly \$79 million for California-American. We consider the California Public Utilities Commission (CPUC) to be among the more constructive PUCs in the nation.

**Capital Expenditure  
Budget Remains Heavy**

Partially offsetting the positive impact of significant rate relief will be higher interest expense, more shares outstanding (roughly 16 million shares), higher pension expense and higher overall operating expenses. Management estimates capital expenditures to total roughly \$4.0-4.5 billion over the next five years or \$850 million per year. We forecast internally generated cash of roughly of \$590 million in 2009 and \$640 million in 2010. After dividends of \$260 million in 2009/2010, we assume AWK issues \$350 million in equity and \$400 million in debt over the forecast period.

**RWE Intends  
Secondary Offering In  
the Near-Term**

**IPO and Future Offerings**

RWE sold roughly 63.2 million shares, or 39.5%, of a total 160 million shares outstanding, in the April 23<sup>rd</sup> initial public offering. RWE has stated its intention for full divestiture as soon as reasonably practical and we believe the general market opinion is for a second offering in the near-term. We believe the over-hang of additional share offerings as well as RWE control issues have resulted in a discounted valuation. We remind investors that any such discount should theoretically diminish following the share issuances.

**Reiterate Our Buy Rating**

At the current price, we consider AWK shares to be remarkably inexpensive relative

February 27, 2009

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to the other publicly-traded water utilities. AWK shares trade at 14.2X our 2009 EPS estimate of \$1.30 and 12.8X our 2010 EPS estimate of \$1.45, which compares to group multiples of 18.5X and 17.0X, respectively, and historical water utility multiples of 20-25X. On a price-to-book value basis, AWK shares trade at 123% of tangible book value (includes the write-off of all goodwill) versus group average multiples of 175%. We believe AWK shares warrant at least an industry-average multiple.

We believe the market and investment community have under-estimated the value of the growth-oriented water utility. Based on the published research reports, we believe the unique characteristics of American Water Works and the sector have been somewhat neglected. These unique characteristics include a greater certainty of rate base growth than typically achieved in the regulated electric and gas utility sector as well as greater opportunity for customer growth through consolidation and privatization opportunities.

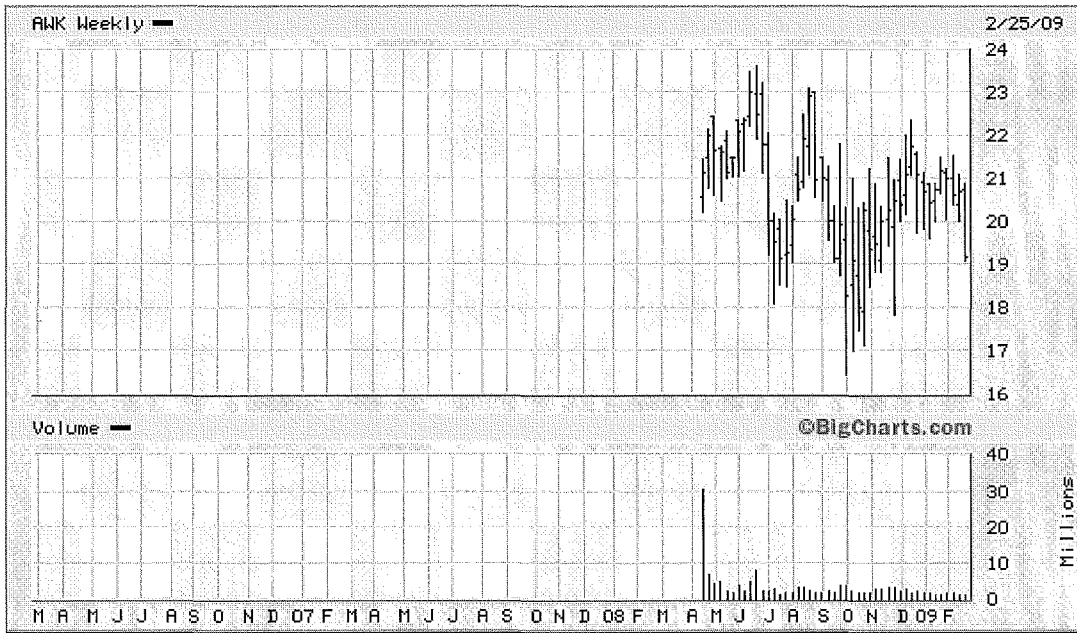
In addition, we believe the market has assigned a 15-to-20% discount to AWK shares based on the pending RWE secondary. Given that we expect the offering to take place over the near-term, we believe this discount will diminish and/or be eliminated in the near future.

**American Water Works**  
Financial Statements (2005-2010)  
(In \$ millions unless otherwise noted)

| <b>Income Statement</b>                  | <b>2005A</b>    | <b>2006A</b>    | <b>2007A</b>    | <b>2008A</b>    | <b>2009E</b>  | <b>2010E</b>  |
|--|-----------------|-----------------|-----------------|-----------------|---------------|---------------|
| <b>Operating revenues</b>                | <b>2,137</b>    | <b>2,093</b>    | <b>2,214</b>    | <b>2,337</b>    | <b>2,279</b>  | <b>2,335</b>  |
| Rate increases                           |                 |                 |                 | 0               | 245           | 340           |
| <b>Operating revenues</b>                | <b>2,137</b>    | <b>2,093</b>    | <b>2,214</b>    | <b>2,337</b>    | <b>2,524</b>  | <b>2,675</b>  |
| <b>Operating expenses</b>                |                 |                 |                 |                 |               |               |
| Operation & maintenance                  | 1,201           | 1,175           | 1,249           | 1,304           | 1,369         | 1,437         |
| Depreciation & amortization              | 261             | 259             | 267             | 271             | 288           | 305           |
| General taxes                            | 183             | 185             | 183             | 199             | 205           | 211           |
| Gain on sale of assets                   | (7)             | 0               | (7)             | (0)             |               |               |
| Impairment charge                        | 385             | 222             | 509             | 750             |               |               |
| <b>Total operating expenses</b>          | <b>2,025</b>    | <b>1,841</b>    | <b>2,201</b>    | <b>2,524</b>    | <b>1,862</b>  | <b>1,953</b>  |
| <b>Operating income</b>                  | <b>112</b>      | <b>253</b>      | <b>13</b>       | <b>(187)</b>    | <b>662</b>    | <b>722</b>    |
| <b>Operating income excl. impairment</b> | <b>491</b>      | <b>474</b>      | <b>515</b>      | <b>563</b>      | <b>662</b>    | <b>722</b>    |
| <b>Other income</b>                      |                 |                 |                 |                 |               |               |
| Interest                                 | 345             | 366             | 281             | (285)           | (285)         | (285)         |
| New interest expense                     |                 |                 |                 | 0               | (20)          | (25)          |
| AFUDC                                    |                 |                 | 11              | 22              | 23            | 23            |
| Amortization of debt expense             |                 |                 | (5)             | (6)             | (5)           | (5)           |
| Other                                    | (10)            | (5)             | 6               | 5               | 5             | 5             |
| <b>Total other income</b>                | <b>336</b>      | <b>361</b>      | <b>271</b>      | <b>(264)</b>    | <b>(300)</b>  | <b>(305)</b>  |
| Income from continuing operations        | 155             | 113             | 244             | 299             | 362           | 417           |
| Provision for income taxes               | 51              | 47              | 86              | 112             | 135           | 156           |
| Tax rate                                 | 32.9%           | 41.6%           | 35.4%           | 37.5%           | 37.5%         | 37.5%         |
| <b>Net income</b>                        | <b>(275)</b>    | <b>(156)</b>    | <b>(344)</b>    | <b>(563)</b>    | <b>226</b>    | <b>261</b>    |
| <b>Net income, excluding impairment</b>  | <b>104</b>      | <b>66</b>       | <b>158</b>      | <b>176</b>      | <b>226</b>    | <b>261</b>    |
| Shares outstanding                       | 160             | 160             | 160             | 160             | 174           | 180           |
| <b>EPS</b>                               | <b>(\$1.72)</b> | <b>(\$0.97)</b> | <b>(\$2.15)</b> | <b>(\$3.52)</b> | <b>\$1.30</b> | <b>\$1.45</b> |
| <b>EPS excluding non-recurring</b>       | <b>\$0.65</b>   | <b>\$0.41</b>   | <b>\$0.99</b>   | <b>\$1.10</b>   | <b>\$1.30</b> | <b>\$1.45</b> |
| <b>Cash Flow Statement</b>               | <b>2005A</b>    | <b>2006A</b>    | <b>2007A</b>    | <b>2008E</b>    | <b>2009E</b>  | <b>2010E</b>  |
| Net income                               | (275)           | (156)           | (344)           | 176             | 226           | 261           |
| Depreciation                             | 261             | 259             | 267             | 271             | 288           | 305           |
| Other                                    | 539             | 220             | 551             | 94              | 75            | 75            |
| <b>Operating cash flow</b>               | <b>525</b>      | <b>324</b>      | <b>474</b>      | <b>541</b>      | <b>589</b>    | <b>641</b>    |
| Capital expenditures                     | (558)           | (689)           | (759)           | (1,000)         | (850)         | (850)         |
| Other                                    | 28              | 3               | 12              |                 |               |               |
| <b>Investing cash flow</b>               | <b>(530)</b>    | <b>(691)</b>    | <b>(747)</b>    | <b>(1,000)</b>  | <b>(900)</b>  | <b>(900)</b>  |
| Debt issuance                            |                 |                 |                 |                 | 100           | 400           |
| Common equity                            |                 |                 |                 |                 | 350           |               |
| Common dividends                         |                 |                 |                 |                 | (128)         | (134)         |
| Other                                    |                 |                 |                 |                 |               |               |
| <b>Financing cash flow</b>               |                 |                 |                 | <b>0</b>        | <b>322</b>    | <b>266</b>    |
| <b>Balance sheet</b>                     | <b>2005A</b>    | <b>2006A</b>    | <b>2007A</b>    | <b>2008E</b>    | <b>2009E</b>  | <b>2010E</b>  |
| <b>Common equity</b>                     | <b>2,805</b>    | <b>3,817</b>    | <b>4,543</b>    | <b>4,102</b>    | <b>4,550</b>  | <b>4,677</b>  |
| <b>Common equity (excl. goodwill)</b>    |                 |                 | <b>2,086</b>    | <b>2,398</b>    | <b>2,846</b>  | <b>2,973</b>  |
| Goodwill                                 | 3,188           | 2,966           | 2,457           | 1,704           | 1,704         | 1,704         |
| Preferred equity                         | 1,779           | 1,779           | 29              | 29              | 29            | 29            |
| Short-term debt                          | 0               | 0               | 317             | 655             | 17            | 17            |
| Long-term debt                           | 5,030           | 4,104           | 4,675           | 4,648           | 4,748         | 5,148         |
| <b>Total capitalization</b>              | <b>9,614</b>    | <b>9,700</b>    | <b>9,563</b>    | <b>9,434</b>    | <b>9,344</b>  | <b>9,871</b>  |



**American Water Works (AWK) – 3 Year Price Chart**



**Price Target and Ratings Changes over the Past 3 Years:**

| Date      | Stock Price | Rating | Target Price | Initiation |
|-----------|-------------|--------|--------------|------------|
| 8/14/2008 | \$21.09     | Buy    | \$25.00      | X          |

**Companies Mentioned in Report:**

- None



February 27, 2009

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## Analyst Disclosure

I, **Tim Winter**, the author of this research report, certify that the views expressed in this report accurately reflect my personal views about the subject securities and issuers, and no part of my compensation was, is or will be directly or indirectly tied to the specific recommendations or views contained in this research report.

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- 1) **Buy** means the stock is expected to appreciate and produce a total return of at least 10% and outperform the S&P 500 over the next 12-18 months;
- 2) **Hold** means the stock is expected to perform generally in line with the S&P 500 over the next 12-18 months; and
- 3) **Sell** means the stock is expected to under perform the S&P 500 over the next 12-18 months and should be sold.

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January 23, 2009

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**American Water Works Company, Inc. (AWK-\$20.60)  
Updating Estimates; Maintain BUY**

**Company Statistics**

|                                 |           |
|---------------------------------|-----------|
| Price:                          | \$20.60   |
| Market Capitalization (M):      | \$3,311.7 |
| Average Daily Volume (1-month): | 431,173   |
| Dividend:                       | \$0.40    |
| Yield:                          | 1.9%      |
| Rating:                         | BUY       |

**Financials**

|                |    | 2007A  | 2008E  | 2009E  |
|----------------|----|--------|--------|--------|
| FYE Dec        |    |        |        |        |
| EPS:           |    | \$1.18 | \$1.16 | \$1.39 |
| Prior EPS:     |    | -      | \$1.17 | \$1.41 |
| Quarterly EPS: | Q1 | \$0.02 | \$0.04 | --     |
|                | Q2 | \$0.31 | \$0.30 | --     |
|                | Q3 | \$0.59 | \$0.55 | --     |
|                | Q4 | \$0.27 | \$0.27 | --     |
| P/E Ratio:     |    | 17.4x  | 17.7x  | 14.8x  |

**Research Analyst Certification and Important Disclosures start on page 6 of this document.**

**INVESTMENT CONCLUSION:** Since the new year began, American Water Works has announced another small debt offering, following on the heels of its November transaction. It hasn't given any further indication on the timing of its planned \$600 million equity offering, though we still expect that to take place in the first quarter. Its parent company, RWE AG, has announced a major electric company acquisition in Europe that may be causing some distraction, but American says the main issue impacting timing of the equity offering remains "market conditions." Our review of 4Q'08 weather suggests it could be a slight drag on the quarter, causing us to trim a penny from our estimate. Looking ahead, we have slightly revised our 2009 estimate to take into account our updated view on the pending Trenton, New Jersey, acquisition, as well as the impact of this most recent debt offering. While the company is meeting its expected schedule of rate increases, higher costs of debt and equity in the current market environment are making it somewhat more expensive for the company to fund ongoing capital expenditures while waiting for rate case recovery. Still, our trimmed EPS estimate for 2009 implies 18% earnings growth, and we believe the company can show similar EPS growth in 2010. We maintain our BUY rating and \$26 fair value target, as we continue to believe the valuation discount on AWK relative to its peers should subside this year.

**KEY POINTS:**

- **Trenton Acquisition Still Awaiting Final Approval.** Trenton news sources have recently quoted \$80 million as the expected settlement price, down from the original \$100 million transaction price announced a year ago. The timing on closing has slipped a bit, now expected in 1Q versus our earlier expectations of completion by year end 2008. While the transaction isn't finalized, we currently anticipate that the acquisition will contribute somewhat less to net income than we had previously forecast, trimming about a penny from our 2009 estimate. For additional information on this acquisition, refer to the section titled "Trenton Update."
- **Debt Filing.** On January 16<sup>th</sup>, American Water filed an S-1 registration statement for an additional \$75 million in senior notes to be issued by its capital corporation subsidiary. This comes on the heels of a \$75 million debt offering (10% Senior Monthly notes due 2038) completed in late November. Similar to the November transaction, the company intends to use these proceeds to redeem short-term debt. The company's proforma estimates in the S-1 assume a 9% rate on this transaction, though the actual rate will depend on market conditions at the time of the offering.



- **No Goodwill Impairment in 4Q.** American Water disclosed in the S-1 filing for its proposed debt transaction that its annual impairment test conducted in the fourth quarter had determined that no goodwill impairment is required. The filing offers detailed disclosure regarding how the assessment was made. Year-to-date, the company recorded an impairment of \$750 million, which was booked during the first quarter. Investors may remember that the company booked impairment charges of \$396 million, \$228 million, and \$509 million, in 2005, 2006, and 2007, respectively. As of September 30, 2008, American Water carried \$1.7 billion of goodwill on its balance sheet. Barring any additional “triggering events” in the coming year, the next impairment test will be conducted in 4Q of 2009. For additional information, refer to the following section titled “Annual Goodwill Impairment Test Completed.”
- **Timing of Equity Still Unclear.** The company has given no further indication of the timing of its planned \$600 million equity offering since filed its registration statement in mid-December. We had expected pricing this month, but that looks unlikely at this point. The company has until February 15<sup>th</sup> to complete the transaction with current financials; after that date, it must re-file with 4Q financials. As outlined in the December filing, RWE plans to sell \$300 million of its 60% stake, and American plans to issue \$300 million of primary shares, with any additional issuance from the over-allotment option allocated to RWE. Please refer to our [December 19, 2008](#) for additional details and adjustments to our earnings estimate associated with this offering. Earlier this month, RWE announced its plan to acquire most of Dutch utility Essent for Euro 9.3 billion (approx \$12.5 billion), prompting credit watch announcements from the ratings agencies. We suspect this transaction would make RWE more interested in completing its divestiture of American Water, though the \$300 million equity offering envisioned for the near-term won’t make much difference to RWE’s overall balance sheet.
- **Weather May Have Still Been a Small Factor in 4Q.** Wet weather in the Midwest last summer had a significant dampening effect on earnings in 2Q and 3Q. Our review of weather records indicates that this pattern continued in October though precipitation normalized in the latter part of the quarter in most of the country. December was also colder than usual in the Midwest, which may have caused a higher than usual number of water main breaks, though typically this is a bigger issue in the March quarter. Overall, we have trimmed our 4Q estimate by a penny, to \$0.27 from \$0.28, to account for some modest weather impacts.
- **Estimate Revisions.** Our revised 2008 estimate is \$1.16, versus \$1.17 previously, while our 2009 estimate is \$1.39, versus \$1.41 previously. (We had cut our estimate from \$1.47 to \$1.41 in December to account for the anticipated equity offering, assuming \$300 million of dilution at \$20 per share. Changes in the timing or pricing of the offering could result in additional adjustment.) We expect to introduce our 2010 estimate after the company reports year-end earnings.

**VALUATION SUMMARY:** American’s stock price has held up well relative to the market in recent months. The shares are down just 2% since Oct. 1 of 2008, compared to a 25% declines for the S&P 500. The stock was above the IPO price of \$21.50 when the secondary offering was announced in December, though it has subsided somewhat since then. The shares have also outperformed the water utility group, which was down about 14.8% in 2008 and down 3.9% thus far in January. The RWE overhang and uncertainty about the company’s ability to generate the rate increases necessary to improve its returns on equity have been the key factors putting pressure on the stock price, in our view. We believe the company is proving itself on rate increases, particularly with its recent awards, and the RWE overhang concerns should abate somewhat as the parent company continues to reduce its ownership.

| Current Data Points              |         |
|----------------------------------|---------|
| Price                            | \$20.60 |
| Shares outstanding               | 160.0   |
| Market cap (\$ mil)              | 3,295.2 |
| Net debt/total capital           | 55.1%   |
| Net debt                         | 5,110.1 |
| Shareholders equity              | 4,162.4 |
| Adjusted shareholders equity**   | 3,310.2 |
| Est. 2008 ROE, excl goodwill     | 4.5%    |
| Est. 2008 ROE on adjusted equity | 5.6%    |
| Book value/share                 | \$26.02 |
| Price/Book                       | 0.8x    |
| Goodwill                         | 1,704.3 |
| Adjusted book value/share        | \$20.69 |
| Price/book, adjusted             | 1.00x   |
| Dividend***                      | \$0.80  |
| Dividend Payout Ratio            | 69%     |
| Yield                            | 3.9%    |

\*\*Adjusted equity includes est. portion of goodwill captured in rate base for ROE  
\*\*\*Payout ratio based on 2008 income excl impairment chg

Source: Company data, Janney Estimates

On a P/E basis, American trades at about 15x our revised 2009 estimate, compared to the current peer group average of 19.5x. On an EV/EBITDA basis, the company trades at 8.3x our current 2009 EBITDA estimates vs. the group average of 8.9x. On a price/book basis, the stock is currently trading at about 1x on “adjusted shareholder equity” (including the portion of goodwill that is captured in rate base), a large discount to the group average of 1.7x book value.

Our fair value of \$26 implies a 2009 P/E of 18.7x of our revised earnings estimate and an EV/EBITDA multiple of 9.2x. This compares favorably to our average fair value target multiples for the peer group of 21.3x and 9.5x, respectively.

| <b>American Water Works (AWK)</b> |             |             |              |              |
|-----------------------------------|-------------|-------------|--------------|--------------|
|                                   | <b>2006</b> | <b>2007</b> | <b>2008E</b> | <b>2009E</b> |
| Sales (\$ bil)                    | 2,093.1     | 2,214.2     | 2,366.5      | 2,595.0      |
| Revenue growth                    |             | 5.8%        | 6.9%         | 9.7%         |
| Price/Sales                       |             | 1.5x        | 1.4x         | 1.3x         |
| EBITDA (\$ mil)                   | 723.2       | 791.0       | 841.8        | 1,006.9      |
| Price/EBITDA                      |             | 4.2x        | 3.9x         | 3.3x         |
| EV/EBITDA                         |             | 10.6x       | 10.0x        | 8.3x         |
| Reported net income               | (162.2)     | (342.8)     | (555.0)      | 243.8        |
| Impairment & one-time costs       | 254.8       | 531.8       | 741.6        | -            |
| Net income ex impairment*         | 92.6        | 189.0       | 186.5        | 243.8        |
| EPS ex one-time items             | \$0.58      | \$1.18      | \$1.16       | \$1.39       |
| EPS Growth                        |             | 104.2%      | -1.4%        | 19.7%        |
| P/E                               |             |             | 17.7x        | 14.8x        |

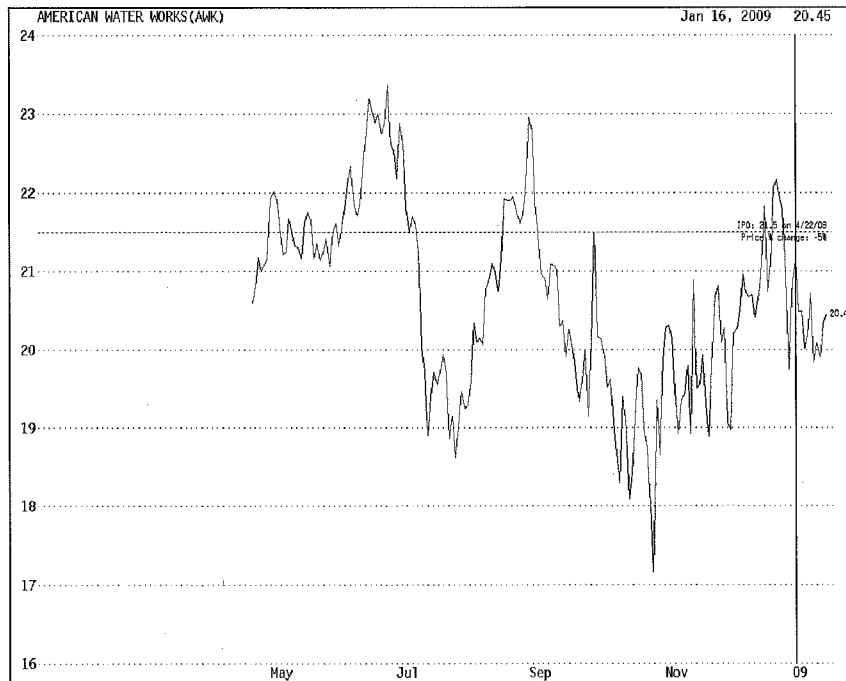
\*Net income ex impairment and one-time costs, net of tax

Source: Company data, Janney Estimates

| <b>Pro Forma</b>                        |         |
|---|---------|
| Estimated offering price                | \$20.00 |
| Shares outstanding                      | 175.0   |
| Market cap (\$ mil)                     | 3,499.2 |
| Net debt/total capital                  | 53.4%   |
| Net debt (incl add'l \$75 mil offering) | 5,116.0 |
| Shareholders equity                     | 4,457.3 |
| Adjusted shareholders equity**          | 3,605.2 |
| Est. 2009 ROE, excl goodwill            | 5.5%    |
| Est. 2009 ROE on adjusted equity        | 6.8%    |
| Book value/share                        | \$25.48 |
| Price/Book                              | 0.8x    |
| Goodwill                                | 1,704.3 |
| Adjusted book value/share               | \$20.61 |
| Price/book, adjusted                    | 0.97x   |
| Current RWE ownership                   | 60.5%   |
| \$300 mil sale                          | 46.7%   |
| \$390 mil sale, incl over allotment     | 44.1%   |

\*\*Adjusted equity includes est. portion of goodwill captured in rate base for ROE

Source: Company data, Janney estimates



## **TRENTON UPDATE**

**Trenton Background.** While we refer to it as the “Trenton acquisition”, the pending transaction actually includes four suburban water systems located in the Trenton suburbs that are currently owned and operated by the city of Trenton. The acquisition includes approximately 40,000 customers and 460 miles of water mains in Ewing, Hamilton, Lawrence, and Hopewell townships, which would increase American Water’s customer base in New Jersey by 5%. The initial agreement, announced on December 5, 2007, included a purchase price of \$100 million. While the price was based on the company’s assessment of asset value, it is contingent on approval from the New Jersey Board of Public Utilities, as the company stated that it would not pay more than what the regulators would allow as rate base (in other words, it did not want pay a premium and add to its goodwill balance).

**Valuing the Assets.** The state’s Department of the Public Advocate’s Division of Rate Counsel estimated the value of the system at about \$54.4 million. Various intervenors, including the suburban cities up for sale and other investor-owned water utilities operating in the state, had also believed the systems were worth less than the proposed \$100 million transaction price. Local newspapers are now reporting that settlement discussions are taking place at the \$80 million level. In the interest of making the arrangement more attractive for the city, American Water is also likely to take on the full cost of physically separating the system, which is expected to cost \$9 million - \$13 million and should take about three years. Originally, Trenton was expected to share half of this separation expense. We believe such capital expenditures would likely be allowable as increases to rate base in the next rate case.

**Acquisition Timing.** We have done some local checks, and it no longer seems likely that the acquisition will close before the end of January. The transaction was not on this week’s city council agenda. The city council plans to hold two public hearings and then wait twenty days after the second hearing before ruling on the transaction. The final step will be approval from the New Jersey Board of Public Utilities (BPU). Depending on the timing of city council sign-off, we expect the acquisition to be on the BPU Agenda on either February 24<sup>th</sup> or, more likely, March 20<sup>th</sup>.

**Impact to Earnings Estimates.** We have been expecting that Trenton would contribute about \$5 million to 2009 net income. This expectation was based on a variety of assumptions that have since changed, including the timing and value of the transaction, in addition to various regulatory factors tied to the recently completed rate case. A settlement price of \$80 million, down from the original \$100 million transaction price earlier announced, would **decrease** the company’s expected rate base and earning contribution. On the other hand, the company’s allowed ROE in New Jersey recently increased to 10.3% from 10.0%, which would **increase** the earnings contribution. The \$5 million contribution had also assumed a completion date of December 2008, so the 2009 contribution would **decrease** to account for any timing delays. There are additional variables that are difficult for us to analyze tied to the recently completed rate case, including depreciation schedules, deferred credits, and debt treatment, among other factors. Overall, we roughly assume the acquisition may contribute \$3.0-3.5 million to net income this year, versus \$5 million, trimming about a penny from our EPS estimate. Should the transaction close before American files their Form 10K, we would expect an update on this acquisition’s contribution.

## **ANNUAL GOODWILL IMPAIRMENT TEST COMPLETED**

The company performs its annual impairment test around November 30<sup>th</sup> each year, in conjunction with strategic planning. The company may perform additional interim reviews throughout the year, if management believes a triggering event has occurred. American defines a triggering event as something that “would more likely or not reduce the fair value of a reporting unit below its carrying value.” Although the company has disclosed some factors that may determine impairment, including a decline in the company’s stock price, a decline in comparable water utilities valuation assessment, a decline in expected rate case results or capital expenditure plans, or changes in interest rates, it had not previously disclosed many details about the testing process.

As we have noted before, impairment testing is more an art than a science, requiring judgment and various assumptions. In the recent S-1 filing, American outlined its two-step test to identify possible goodwill impairments and measure the amount to be taken. In step 1 the company compares the calculated fair value for each reporting unit to its respective net carrying value (book value). Only if the fair value of any unit is below the carrying value is

step 2 performed to determine the necessary impairment loss. In assessing the fair value to the book value, the company compared trading prices of the company's regulated water utility peers. For the unregulated business, American used five-year discounted cash flow models from internal forecasts.

*"In reaching our conclusion, we also made certain assumptions, which we believe to be appropriate, that support the fair value of our reporting units. We considered, in addition to the listed trading price of the Company's shares, the effect on that price due to RWE's majority ownership, the effect of RWE's expected disposition of its owned Company shares on the market for those shares, the applicability of a control premium to our shares and certain other factors we deemed appropriate. As a result, we concluded that the Company's fair value exceeds what we might otherwise have concluded had we relied on market price alone."*

The company did note in its disclosures that the estimated fair value of its reporting units is approximately in line with its carrying value, leaving little value in excess of the required threshold. It said that if the fair value was less, the step 2 review then triggered would have resulted in an impairment charge for the fair value of its long-term debt of an estimated \$300 million, due to accounting guidance that must be followed to measure the implied fair value of goodwill. This fair value assessment of long-term debt is not required as part of step 1.

**COMPANY DESCRIPTION:** *American Water is the largest investor-owned water and wastewater utility in the U.S., serving approximately 15.6 million people in 32 states across the U.S. & Ontario, Canada. Its primary business as a regulated utility operation accounts for 90% of revenue, supplemented by small but growing non-regulated businesses.*

**IMPORTANT DISCLOSURES**

**Research Analyst Certification**

Each of the primarily responsible analysts for this research report, Debra G. Coy and Heike M. Doerr, certify that all the views in this research report accurately reflect her personal views about any and all of the subject securities or issuers. No part of her compensation was, is, or will be directly or indirectly, related to the specific recommendations or views expressed in this research report.

**Janney Montgomery Scott LLC Equity Research Disclosure Legend January 23, 2009**

| <b>Company</b>                           | <b>Disclosure(s)</b> |
|--|----------------------|
| American Water Works Company, Inc. (AWK) | 1,4,5,7,8            |

**Janney Montgomery Scott LLC (“JMS”) Equity Research Disclosure Legend**

1. JMS is a market maker in the securities of the company and may at any time hold a long or short position in this security.
2. The research analyst primarily responsible for preparing this research report or a member of the research analyst’s household has a financial interest in the securities of the company in the form of a long position in such securities.
3. The research analyst primarily responsible for preparing this research report or a member of the research analyst’s household has a financial interest in the securities of the company in the form of options (O), warrants (W), futures (F), and/or a short position (S).
4. JMS or an affiliate managed or co-managed a public offering of securities for the company in the past 12 months.
5. JMS or an affiliate received compensation for investment banking services from the company in the past 12 months.
6. JMS or an affiliate received compensation for products or services other than investment banking services from the company in the past 12 months.
7. JMS may seek compensation for investment banking services from the subject company (ies) in the next 3 months.
8. The research analyst is compensated based on, in part, JMS’s profitability, which includes its investment banking revenues.
9. JMS or an affiliate beneficially owns 1% or more of any class of common equity securities of the company.
10. An Employee or Director of JMS is an officer or Director of subject company.
11. Other:

**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.

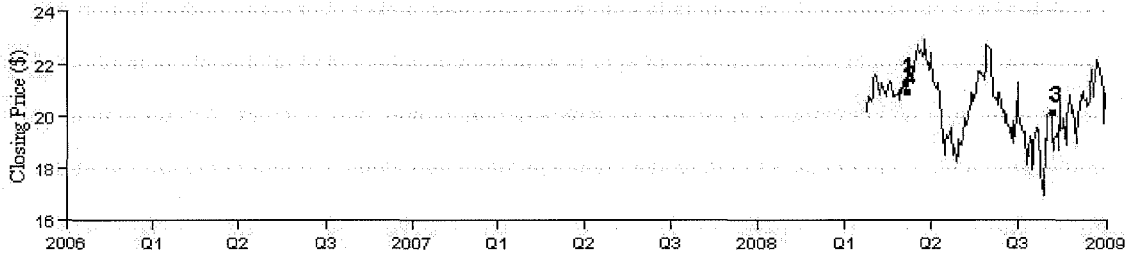




**Price Charts**

AWK

|             |             |             |
|-------------|-------------|-------------|
| 1) 06/02/08 | 2) 06/03/08 | 3) 11/03/08 |
| Buy         | Buy \$28    | Buy \$26    |



**Janney Montgomery Scott Ratings Distribution as of December 31, 2008\***

|                   |                       |                    |
|-------------------|-----------------------|--------------------|
| <b><u>BUY</u></b> | <b><u>NEUTRAL</u></b> | <b><u>SELL</u></b> |
| 48%               | 49%                   | 3%                 |

\*As a percent of total coverage. See ratings definition above.

**Janney Montgomery Scott Ratings of Investment Banking Relationships as of December 31, 2008\*\***

|                   |                       |                    |
|-------------------|-----------------------|--------------------|
| <b><u>BUY</u></b> | <b><u>NEUTRAL</u></b> | <b><u>SELL</u></b> |
| 11%               | 2%                    | 0%                 |

\*\*Percentages of each rating category where JMS has performed Investment Banking services over the past 12 months.

**Other Disclosures**

Investment opinions are based on each stock's 6-12 month return potential. Our ratings are not based on formal price targets, however our analysts will discuss fair value and/or target price ranges in research reports. Decisions to buy or sell a stock should be based on the investor's investment objectives and risk tolerance and should not rely solely on the rating. Investors should read carefully the entire research report, which provides a more complete discussion of the analyst's views.

This research report is provided for informational purposes only and shall in no event be construed as an offer to sell or a solicitation of an offer to buy any securities. The information described herein is taken from sources which we believe to be reliable, but the accuracy and completeness of such information is not guaranteed by us. The opinions expressed herein may be given only such weight as opinions warrant. This Firm, its officers, directors, employees, or members of their families may have positions in the securities mentioned and may make purchases or sales of such securities from time to time in the open market or otherwise and may sell to or buy from customers such securities on a principal basis. Supporting information related to the recommendation, if any, made in the research report is available upon request.



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American Water Works

AWK - BUY

August 7, 2009

**Water**

**American Water Works  
(AWK) - BUY**

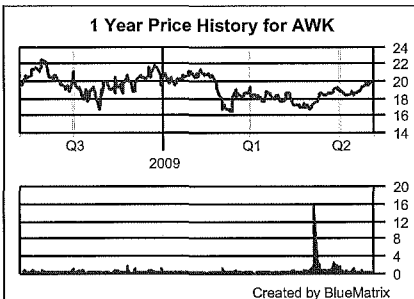
**Price: \$19.80**  
Fair Value Estimate: \$26.00  
52-Week Range: \$23.12-\$16.22  
Market Cap (MM): \$3,457  
Shr.O/S-Diluted (mm): 174.6  
Average Daily Volume: 1,121,324  
Dividend: \$0.80  
Yield: 4.0%

| FYE: Dec   | 2008A  | 2009E  | 2010E  |
|------------|--------|--------|--------|
| EPS:       | \$1.12 | \$1.36 | \$1.50 |
| Prior EPS: |        | \$1.33 | NC     |
| P/E Ratio: | 17.7x  | 14.6x  | 13.2x  |

Quarterly EPS:

| Quarter | 2008A  | 2009E   | 2010E |
|---------|--------|---------|-------|
| Q1      | \$0.04 | \$0.19A | --    |
| Q2      | \$0.30 | \$0.32A | --    |
| Q3      | \$0.55 | \$0.58  | --    |
| Q4      | \$0.23 | \$0.26  | --    |

EPS: Excludes impairment charges; quarters may not sum to annual due to rounding



**Equity Research  
Note**

**Another Good Quarter and More in the Pipeline; Maintain BUY**

**INVESTMENT CONCLUSION:**

Yes, it's still a "boring" water utility with a long-term view, but we like it. American Water is simply getting the job done, as it promised when it came back to the public markets last year. It followed up a strong first quarter with solid results in the second quarter, and we expect strong growth to continue through 2009. Management filed several significant cases in key jurisdictions during the quarter, and awards received in the last twelve months more than offset a declining usage pattern. Industrial usage dropped 17% in the quarter and residential usage dropped 5%, the latter mainly due to wet northeast weather. Investor caution around the RWE overhang was somewhat ameliorated after the June offering, but the overhang remains. Overall the company is growing as planned: spending \$400 million in the first half of the year, awaiting authorizations on \$258 million in requested filings, and progressing on acquisitions. We've revised our 2009 estimate to \$1.36 from \$1.33 and maintain our 2010 estimate of \$1.50, though we see opportunity for further upside next year. We maintain our BUY and 12-month fair value of \$26.

**KEY POINTS:**

- **Second Quarter Results:** American Water reported 2Q earnings of \$0.32/share, a penny ahead of our estimate and consensus, and up 14% year over year. Despite a 5.5% decline in volumetric send-out, revenue grew 4% over the same period last year due to \$46.5 million in new rates. The efficiency ratio improved 210 basis points to 54%, and operating margin improved to 25.7% from 24.2% last year. Lower than expected interest expense also helped on the bottom line. Operating cash flow for the first six months was \$228.7 million, suggesting that our full-year expectation of \$500-600 million is on target.
- **Capital & Growth:** American sold 14.5 million shares in June and completed several debt issuances in the second quarter amounting to \$275 million (\$360 million so far in 2009). These funds, along with the internally generated cash flow are being put to work. American is on schedule to spend \$800 million in 2009. The company is growing via projects in NJ and Texas. The company is also returning capital to shareholders via the recent 5% dividend increase (to \$0.21/quarter) – its first increase since rejoining the public equity markets.
- **Rate Activity:** Rate awards received in the second quarter were modest at \$12.5 million, mainly a \$10 million award in Kentucky. American filed significant cases in the quarter, however, and now has over \$258 million in pending requests, up from \$104 million at the start of the year.
- **Valuation Attractive:** While it has recovered in recent weeks, the stock continues to trade at a steep discount to peers at a P/E of around 15x and 13x our 2009 and 2010 estimates and a 8.3x on a 2010 EV/EBITDA multiple. Our 12-18 month outlook remains positive, as rates flow in and organic growth gradually recovers along with the economy. We maintain our BUY rating and \$26 fair value.

Research Analyst Certifications and Important Disclosures are on pages 5 - 6 of this report

**VALUATION SUMMARY:**

Since the equity offering in early June, AWK shares have steadily increased from around \$17 to over \$20 (10.1% increase in the last three months). Year to date, the stock is down 4.2% compared to the average decline of 11% among the larger investor-owned water utilities (excluding SouthWest Water's rebound).

On a P/E basis, American trades at about 15x and 13x our 2009 & 2010 estimates respectively, compared to the current peer group average of 23x and 20x. On an EV/EBITDA basis, the company trades at 8.3x our current 2010 EBITDA estimate vs. the group average of 9.7x. On a price/book basis, the stock is currently trading at about 1.1x on "adjusted shareholder equity" (including the estimated portion of goodwill that is captured in rate base), a large discount to the group average of 1.8x book value. Our fair value of \$26 implies a 2009 P/E of 19x and 2010 P/E of 17x. This compares to the assumed group P/E multiples of 23x and 20x 2009 and 2010 estimates, respectively. Our fair value assumes a 2010 EV/EBITDA multiple of 9.3x, compared to the peer group average of 9.5x. American's higher debt load compared to the group accounts for the higher current EV/EBITDA multiple relative to peers. The estimated 2009 ROE on adjusted equity (including a portion of goodwill) is now over 7% -- a steadily improving metric which still offers plenty of room for upside relative to the company's average allowed ROE in the 10-10.5% range.

| <b>Current Data Points</b>   |         |
|--|---------|
| Price  | \$20.00 |
| Shares outstanding   | 174.5   |
| Market cap (\$ mil)  | 3,490.2 |
| Net debt/total capital   | 57.7%   |
| Net debt   | 5,363.2 |
| Shareholders equity  | 3,928.2 |
| Adjusted shareholders equity*  | 3,203.2 |
| Est. 2009 ROE, excl goodwill   | 5.8%    |
| Est. 2009 ROE on adjusted equity   | 7.2%    |
| Book value/share   | \$22.51 |
| Price/Book   | 0.9x    |
| Goodwill   | 1,250.1 |
| Adjusted book value/share  | \$18.36 |
| Price/book, adjusted   | 1.1x    |
| 2009 Dividend  | \$0.82  |
| Dividend Payout Ratio**  | 60%     |
| Yield  | 4.1%    |
| *Adjusted equity includes est. portion of goodwill captured in rate base for ROE |         |
| **Payout ratio based on 2009E EPS excl. impairment chg                           |         |

Source: Company data, Janney Estimates

| <b>American Water Works (AWK)</b>                        |             |              |              |
|--|-------------|--------------|--------------|
|  | <b>2008</b> | <b>2009E</b> | <b>2010E</b> |
| Sales (\$ bil)   | 2,336.9     | 2,512.0      | 2,750.0      |
| Revenue growth   | 5.5%        | 7.5%         | 9.5%         |
| Price/Sales  | 1.5x        | 1.4x         | 1.3x         |
| EBITDA (\$ mil)  | 831.2       | 962.4        | 1,069.8      |
| EBITDA Growth  | 5.1%        | 15.8%        |              |
| Price/EBITDA   | 4.2x        | 3.6x         | 3.3x         |
| EV/EBITDA  | 10.7x       | 9.2x         | 8.3x         |
| Reported net income                                      | (562.4)     | (213.8)      | 267.6        |
| Impairment & one-time costs                              | 741.6       | 443.0        | -            |
| Net income ex impairment*                                | 179.2       | 229.2        | 267.6        |
| EPS ex one-time items                                    | \$1.12      | \$1.36       | \$1.50       |
| EPS Growth   | -5.2%       | 21.7%        | 10.3%        |
| P/E  | 17.9x       | 14.7x        | 13.3x        |
| *Net income ex impairment and one-time costs, net of tax |             |              |              |

Source: Company data, Janney Estimates

**Cash flow and capex.** American is using internally generated cash flow as well as new equity and debt to fund its capital investment program. The \$400 million in capex spent in the first half was partially funded with some of the \$228.7 million in operating cash flow generated so far in the year. We still anticipate that the company can generate \$500-600 million in operating cash flow in 2009 compared to plans for \$800 million in capex and approximately \$138 million in dividend payments. The shortfall will be funded with equity capital raised in June and ongoing debt issuances, a typical financing plan for water utilities.

**RECENT RATE ACTIVITY:** American secured \$12.5 million in new annualized revenue through general rate cases in the second quarter, primarily from a \$10 million Kentucky case effective June 1<sup>st</sup>. Paired with the West Virginia case received in the first quarter, the company has now been granted \$17.7 million in 2009 in general rate case awards. An additional \$21 million in surcharges was finalized so far in 2009.

American was busy in the second quarter filing new cases in key states, specifically in PA, IN, IL, IA and most recently in OH and AZ as noted in the exhibit below. In Iowa, the company has implemented \$6.8 million in interim rates subject to refund pending final case approval. The most recent significant cases request 12%-12.25% allowed ROEs. We believe the higher requests reflect the higher equity risk we are now seeing in the financial markets, and allowed ROEs may be trending upward slightly from the 10.0-10.2% average we've typically seen in the last couple of years. As a reminder, we typically expect to see awards averaging about 60% of requests.

|                      | State | File Date | Water/ Sewer  | Region                                | % Increase                                  | \$ Increase (M)                       | Docket #         | Req. ROE | Status Summary   |
|----------------------|-------|-----------|---------------|---------------------------------------|---|---------------------------------------|------------------|----------|--|
| American Water Works | NJ    |           |               | DSIC Mechanism                        | N/A   | N/A                                   | WO08050358       | N/A      | Delayed at July 29th meeting.  |
|                      | CA    | 1/23/09   | Water         | Sacramento, LA, & Larkfield Districts | 51.3% & 10.25%; 41.3% & 4.1%; 23.4% & 4.07% | \$26.1M, \$6.6M, combined 2010 & 2011 | A0901013         | 10.20%   | Public hearings held in early June. Two cities recently approved as intervenors. |
|                      | AZ    | 5/1/08    | Water & Sewer | 10 Districts                          | 26.4%-169%                                  | \$20M                                 | W-01303A-08-0227 | 11.75%   | Waiting on report from ALJ.  |
|                      | PA    | 4/24/09   | Water         | Consolidated                          | 13%   | \$58M                                 | R-2009-2097323   | 12.00%   | Discovery phase  |
|                      | IN    | 4/30/09   | Water         | Muncie                                | 39%   | \$46.9M                               | 43680            | 12.00%   | Discovery phase  |
|                      | IA    | 4/30/09   | Water         | Quad City / Clinton                   | 31% average                                 | \$9.4M                                | RPU-09-TBD       | 12.20%   | Discovery phase  |
|                      | OH    | 5/7/09    | Water & Sewer | Multiple                              | 71%-78%                                     | \$8.8M                                | 09-391-WS-AIR    | 12.20%   | Discovery phase  |
|                      | IL    | 5/29/09   | Water         | Metro-East                            | 28% average                                 | \$58.6M                               | 09-TBD           | 12.25%   | Discovery phase  |
|                      | AZ    | 7/2/09    | Water & Sewer | Multiple                              | N/A   | \$20.6                                | TBD              | 12.25%   | Discovery phase  |

American has filed for a Distribution System Improvement Charge (DSIC) in New Jersey. This mechanism is utilized in several states and allows the company to immediately begin recovering the cost of (and earn a return on) qualifying plant (usually pipe), instead of waiting for the next general rate filing. American requested a 7.5% cap on DSIC increases between rate cases, the level it currently receives in PA. At the end of July, the NJ Board of Public Utilities (BPU) delayed approval of the surcharge. At the same time the BPU requested a management audit of New Jersey American, a common industry practice, to review practices & procedures. Regulatory audits are a part of business as usual, and this audit appears to be unrelated to the DSIC filing and more a function of the time lapsed since the last audit in 1997.

**EARNINGS OUTLOOK:**

We have raised our 2009 estimate to \$1.36 from \$1.33, accounting for a lower interest expense and the earnings beat in 2Q relative to our forecast. We are currently forecasting approximately 7.5% revenue growth for the year, versus 8% previously in light of the wet summer and hamstrung industrial demand. We expect continued improvements in the operating expense ratio, which improved to 54% from 56.1% in the same period last year, ahead of our forecast. We expect to see improvements of 200 bps per quarter in coming quarters, with the expense ratio for the year dropping to 53% of revenues from 56% in 2008.

Most of the outstanding debt in the second quarter was commercial paper and revolving credit borrowings that carried low interest rates of 25-100 basis points. With longer term debt issued to pay down the short term loans, the interest expense

should pick up in the second half based on rates for the longer term debt of 6-6.5%. Our interest expense assumptions had been too high in the second quarter and we have brought them down to \$80 million from \$85 million in the third quarter, with a similar \$5 reduction in the fourth quarter.

We have maintained our 2010 estimate of \$1.50, which includes 9% revenue growth, assuming normalized weather after two unusually wet summers and a more modest improvement in the operating expense ratio of only 50 basis points. However, if American can continue its pace of rate cases without significant additional operating expense growth, we believe it could generate better leverage from its existing asset base.

The non-regulated segment has been quiet as all eyes seem focused on getting the regulated utility back up to speed, but we may see a resumption of growth in the military base business and municipal contracts business in the next one to two years. Given economic conditions and municipal budgets, we have been hearing more discussion of privatization and outsourcing in recent months. While transactions take time to develop, we continue to believe this part of American Water's business has significant growth potential over the next several years. For the first six months of 2009, revenues in the segment were down slightly year over year, to \$122 million from \$128 million, but EBIT contribution improved to \$10.1 million from \$9.3 million last year on better operating margins.

### **SECOND QUARTER REVIEW:**

**Revenue.** American posted revenue growth of 4% in the second quarter to \$613 million. This growth came despite a 5.5% volumetric usage decline, including a 16% decline in the industrial customer class, which makes up about 5% of total revenues. These usage declines are sequentially worse than the first quarter, a result of wet weather in the Northeast. More than offsetting the total 5.3 billion gallon shortfall in sendout (\$24 million decline versus last year) was \$46.5 million in rate awards. The remaining incremental revenue came from surcharges and acquisitions offset by a decrease in contract operations. The unregulated business revenue fell 4%, or \$2.8 million, to \$64 million, due to a decline in the contract operations business partially offset by the Homeowner Services Group.

**Operating Costs.** Year over year, total operating & maintenance (O&M) expenses in the quarter were flat due in part to the decreased send-out, leading to an improved efficiency ratio of 54% from 56%. Production costs were up, led by a 31% increase in chemical costs, a year over year trend that should persist despite somewhat lower chemical costs since the beginning of the year. Employee costs were up slightly, driven by increased pension costs. Notably the "other" cost line item jumped \$6.8 million, about half of which is related to a one-time charge for disallowed rate case expenses in California along with overall higher rate case costs associated with the increased number of filings. We now anticipate a 7% increase in employee costs in 2009, driven mainly by pension expense.

**Pension expense.** We had expected American's pension expense to grow in 2009, and this was evident in the 30% year over year increase in the second quarter. The jump in expenses is a result of increased amortization of actuarial losses on plan assets associated with stock declines. Management is working with regulators in certain states that currently do not allow for recovery of these costs in the regulatory process but the increased costs remain a drag on margins this year.

**Depreciation & Amortization.** Depreciation as a percentage of revenue increased to 12% from 11.4% and in absolute terms increased 8.8%. We expect depreciation to increase 8.5% in 2009 as a result of robust capital spending but remain stable as a percentage of revenue.

**Growth.** American's acquisition of four township water systems outside of Trenton, for \$80 million is still pending. With the timing of closing still unclear, we have assumed a modest penny enhancement to 2009 EPS, although this could easily slip into 2010. Specifically on Trenton, citizens have asked to put the acquisition approval to a referendum which has stretched out the approval process. The company is also growing in New Jersey in Pine Hill (pipeline extension), Warren Township (3 treatment plants), and the ongoing Trenton suburbs acquisition. In Texas, the company is working on a 50,000 GPD desalination pilot program, highlighting the variety of opportunities American has to capitalize on.

**Dividend.** American's Board of Directors increased the quarterly cash dividend by 5% to \$0.21 from \$0.20; payable September 1<sup>st</sup>. This is the company's fifth dividend payment and first increase since the IPO. We expect the company to maintain a 50%-70% payout ratio and pay \$0.82 in total dividend in 2009.

## **Company Description**

*American Water is the largest investor-owned water and wastewater utility in the U.S., serving approximately 15.6 million people in 32 states across the U.S. & Ontario, Canada. Its primary business as a regulated utility operation accounts for 90% of revenue, supplemented by small, but growing, non-regulated businesses.*

## **IMPORTANT DISCLOSURES**

### **Research Analyst Certification**

I, Debra G. Coy and Heike M. Doerr, 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**

JMS is a market maker in the securities of AWK, and may at any time hold a long or short position in this security.

JMS or an affiliate managed or co-managed a public offering of AWK security in the past 12 months.

JMS or an affiliate received compensation for investment banking services from AWK security in the past 12 months.

JMS may seek compensation for investment banking services from the subject company (ies) AWK security in the next 3 months.

The research analyst is compensated based on, in part, JMS's profitability, which includes its investment banking revenues.

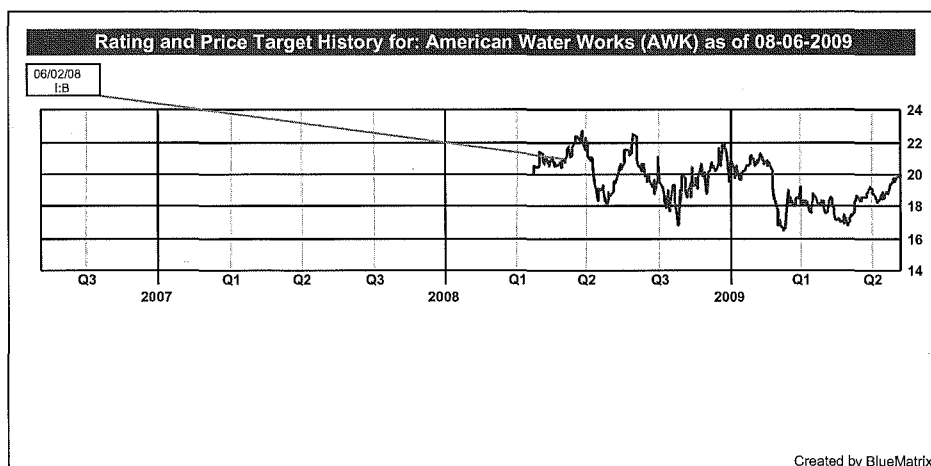
### **Definition of Ratings**

**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 6/30/09**

| Rating      | Count | Percent | IB Serv./Past 12 Mos. |         |
|-------------|-------|---------|-----------------------|---------|
|             |       |         | Count                 | Percent |
| BUY [B]     | 136   | 51      | 11                    | 8       |
| NEUTRAL [N] | 125   | 47      | 5                     | 4       |
| SELL [S]    | 5     | 2       | 0                     | 0.00    |

**\*Percentages of each rating category where JMS has performed Investment Banking services over the past 12 months.**

**Other Disclosures**

Investment opinions are based on each stock's 6-12 month return potential. Our ratings are not based on formal price targets, however our analysts will discuss fair value and/or target price ranges in research reports. Decisions to buy or sell a stock should be based on the investor's investment objectives and risk tolerance and should not rely solely on the rating. Investors should read carefully the entire research report, which provides a more complete discussion of the analyst's views.

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Water

August 27, 2009

## Water Infrastructure Funding Update Anybody Feeling Stimulated Yet?

### INVESTMENT CONCLUSION:

Some six months after economic stimulus legislation was enacted by Congress, much ink and much chatter has been spent on the topic of stimulus, but the level of money actually spent remains small. However, the flow of work is finally beginning in the water sector, and we expect federal and municipal contract activity to ramp up this fall and into the first half of 2010. At the federal level, agencies have been hampered by onerous contracting and reporting requirements, but the logjam is starting to clear, and we expect to see incremental growth in water-related spending in the coming year. At the municipal government level, stimulus spending will continue to be partially offset by budget weakness, but a stabilization of the bond markets and increased certainty about funding options is helping to restart delayed projects. On balance, we think 2010 may be a surprisingly strong rebound year for water infrastructure markets, with growth in the 5-10% range after a flat to down 2009. (See p. 2 for a list of stocks likely to benefit.)

### KEY POINTS:

- **Not much paid out yet....** Key federal stimulus programs impacting the water infrastructure industry are the U.S. EPA's state revolving fund programs, which received \$6 billion under the stimulus law, and the U.S. Army Corps of Engineers, which received \$4.6 billion. The U.S. Agriculture Department's rural water programs also received about \$4 billion in funding. As of the most recent weekly status reports, dated Aug. 21, the EPA reports that it has paid out only \$75 million to date, the Corps has spent \$177 million, and the USDA had paid out only about \$10 million in small grants and loans. Obviously, there is a long way to go.
- **....But don't give up.** We think the slow pace of spending so far belies a high level of behind-the-scenes activity that is just beginning to translate into contracting activity. New administrative requirements set by Congress, along with shortages of staff to deal with the influx of funds, have bogged down the process, but these hurdles are finally beginning to be cleared. In addition, we believe record-keeping methodologies understate the level of project activity, since the EPA and Ag Department loan and grant funds do not show up as "paid out" until states and municipalities have actually started projects and requested reimbursement.
- **EPA water & sewer funds.** The U.S. EPA has released funds to 45 states after approving their "intended use" plans, and the states are in turn releasing money to specific projects. EPA remains firm on its Feb. 2010 deadline by which states must show that funds have been signed into contract, though this may prove ambitious. The focus of the program remains on smaller projects, a disappointment for larger engineering and services firms, though it should benefit equipment firms through purchases of pipes, pumps, valves, etc., in the coming year.
- **Corps of Engineers water resource projects.** The Corps has selected a list of 172 construction projects, 523 operations and maintenance projects, and 45 Mississippi River projects to receive its stimulus funding. The project list was finalized at the end of April but is only now beginning to result in project bids. The agency's updated plan, released July 30, targets \$850 million to be spent by the end of FY09 - likely a stretch goal - and \$2.5 billion in FY10. The agency is now starting to announce awards of contracts for dredging, shore protection, levee construction, etc.
- **Agriculture Department water projects.** The USDA announced \$175 million in water and environmental projects this week, and says it has committed \$1.5 billion in project loan and grant funding so far. These are mostly small projects benefiting small and rural communities that will likely go to local, not national, contractors.

Equity Research  
Industry Report

Research Analyst Certifications and Important Disclosures  
are on pages 8 - 9 of this report



**INFRASTRUCTURE STIMULUS RECAP:**

The Obama administration pushed hard for an economic stimulus program after taking office last November. Congress passed the American Recovery and Reinvestment Act (ARRA) in February of this year, including about \$150 billion in funding for infrastructure projects. Transportation and energy received the most dollars – and the most public attention – under the bill, but water and wastewater received significant funding as well, as least compared to levels of federal funding provided previously.

Approximately \$15 billion in water-related funding is included in the bill, mainly through the EPA’s state revolving fund program, the Army Corps of Engineers water resources management program, and the Agriculture Department’s rural water assistance program. For all of these agencies, the influx of new funds has created a significant challenge. Not only have they faced large workload increases, but they have also had to deal with a bewildering range of new reporting and administrative requirements that Congress imposed in the interest of “transparency”. The “Buy America” clauses in the procurement requirements have also slowed down implementation.

Nevertheless, six months into the process, the procedures are finally largely in place to start putting the money to work – now that the recession is being declared over in some quarters. Needed or not, we believe the federal government remains committed to spending the bulk of these funds. It now appears that a temporary “bulge” in spending is likely in FY’10 and FY’11, as agencies push out stimulus money along with their regular appropriations, with spending likely to subside in FY’12 (the federal fiscal year ends Sept. 30).

A range of companies are likely to benefit from the coming surge, though companies we talk to are all reporting that they aren’t seeing much yet – consistent with the government’s spending numbers thus far. Below is a list of companies that are involved in water infrastructure markets at the federal, state, and local level, though none are “pure plays” on stimulus spending.

**Companies that participate in water infrastructure markets**

| Company name              | Ticker | Rating  | Recent price | Market Cap | Infrastructure businesses                         |
|---------------------------|--------|---------|--------------|------------|---|
| AECOM*                    | ACM    | BUY     | \$28.42      | \$3,115    | Consulting and engineering                        |
| American Water Works      | AWK    | BUY     | \$20.47      | \$3,573    | Contract operations and design-build services     |
| Ameron                    | AMN    | NR      | \$75.35      | \$694      | Coatings and pipeline systems                     |
| Badger Meter              | BMI    | NR      | \$36.99      | \$551      | Water utility meters                              |
| Calgon Carbon             | CCC    | NR      | \$14.24      | \$772      | Water treatment systems                           |
| Great Lakes Dredge & Dock | GLDD   | NR      | \$6.79       | \$397      | Largest provider of dredging services in the U.S. |
| Insituform                | INSU   | BUY     | \$19.12      | \$742      | Pipeline rehabilitation                           |
| ITT Industries**          | ITT    | BUY     | \$50.74      | \$9,255    | Pumps, treatment                                  |
| Layne Christensen         | LAYN   | NEUTRAL | \$26.97      | \$523      | Water utility construction, well drilling         |
| Michael Baker*            | BKR    | NEUTRAL | \$35.63      | \$316      | Consulting and engineering                        |
| Mueller Water Products    | MWA    | NR      | \$4.87       | \$568      | Pipes and related products                        |
| Northwest Pipe            | NWPX   | NR      | \$35.21      | \$325      | Pipes   |
| Orion Marine              | ORN    | NR      | \$21.57      | \$473      | Construction and maintenance on waterways         |
| Shaw Group                | SGR    | NR      | \$32.57      | \$2,722    | Consulting and engineering                        |
| Southwest Water           | SWWC   | BUY     | \$5.00       | \$124      | Contract operations and design-build services     |
| Stantec                   | STC    | NR      | \$14.55      | \$265      | Consulting and engineering                        |
| Tetra Tech                | TTEK   | BUY     | \$31.00      | \$1,875    | Consulting and engineering                        |
| URS                       | URS    | NR      | \$45.13      | \$3,805    | Consulting and engineering                        |

Source: Thomson Baseline

\*Covered by Joe Foresi

\*\*ITT covered by Jim Lucas

NR - Not Rated

**ARMY CORPS OF ENGINEERS:**

The U.S. Army Corps of Engineers received \$4.6 billion in stimulus funds, more than doubling its annual appropriation. The bulk of the funding is targeted to water resource-related civil works projects. *These are not municipal water and sewer system projects but rather projects that relate to navigation, water storage and supply, hydropower, and flood risk management in coastal and waterway areas.*

In late April, the Corps released its list of projects that would receive ARRA funding, and the lists have since been updated somewhat. The Corps is planning about 175 construction projects, 525 operations and maintenance projects, and 45 Mississippi River projects. Examples of some of the larger projects include:

- Construct pump station to be integrated into regional wastewater treatment plant in Phoenix - \$20 million
- Complete channel improvements on the Santa Ana River in California - \$26 million
- Construct pump station in the Florida Everglades - \$41 million
- Deepening of Jacksonville Harbor, FL - \$24 million
- Rehabilitate canal walls, Illinois Waterway - \$49 million
- Improve locks on Kentucky Locks on Tennessee River - \$46 million
- Main channel dredging in Galveston - \$44 million
- Replace lock gates, Chicago Harbor - \$18 million
- Coastline mapping, Mississippi - \$10 million

Paging through the lists of projects, it appears that a significant amount will be spent on harbor and waterway dredging and maintenance, which is already beginning to benefit firms such as **Great Lakes Dredge and Dock (GLDD)** and **Orion Marine (ORN)**.

The Corps said in its most recent weekly update report that it has spent \$177 million to date, about 4% of its total funding, and obligated \$1.1 billion, or 24%, to new contracts and new work orders under existing contracts. *Its target spending, or outlays, for FY09 are \$850 million, as outlined in the chart below, with about \$2.5 billion in additional outlays targeted for FY10.* Since the fiscal year ends in a month, on Sept. 30, it appears that the FY09 target is ambitious. **Tetra Tech (TTEK)**, for example, which counts the Corps among its top three clients, has yet to see much work emerge from the agency but is monitoring pre-bid activity and expects to see its volume of bids picking up this fall.

| US Army Corps of Engineers |              |                   |              |
|----------------------------|--------------|-------------------|--------------|
| (\$ mil)                   |              |                   |              |
| Total ARRA Funding         | 4,600        |                   |              |
| Released to date (8-21-09) | 1,102        |                   |              |
| Spent to date (8-21-09)    | 177          |                   |              |
| % of total                 | 4%           |                   |              |
|                            |              | Projected Outlays |              |
|                            | Funding      | FY09              | FY10         |
| Mississippi River          | 375          | 62                | 192          |
| Construction               | 2,000        | 354               | 899          |
| Operations & maintenance   | 2,100        | 393               | 1,299        |
| Other smaller programs     | 125          | 47                | 76           |
| <b>Total</b>               | <b>4,600</b> | <b>857</b>        | <b>2,465</b> |

Source: US Army Corps of Engineers

**US ENVIRONMENTAL PROTECTION AGENCY:**

The EPA received \$6 billion in water and wastewater funding under ARRA, \$4 billion for wastewater and \$2 billion for drinking water projects. The funds were allocated to the agency's established State Revolving Fund (SRF) programs, which provide low-cost loans to states to distribute for municipal and some private sector projects. The \$6 billion in ARRA funding represented a major increase for the programs, which have typically received about \$1.5 billion per year through regular appropriations. In a departure from the loan structure of the program, half of the ARRA funds are to be distributed as direct grants rather than loans.

The EPA had an initial goal of committing 50% of its new funds to projects that were ready to start construction by June 2009. This proved to be ambitious, as it took states some time to pull together prioritized lists of projects that were eligible to receive funding. Most states were overwhelmed by municipal project requests that far exceeded the allocations they received under the revolving fund programs. By now, however, states have submitted their "Intended Use Plans" as required, and EPA has approved and released funds to about 45 of the 50 states. States are now in the process of releasing the funds to water and sewer utilities for specific projects.

We had heard some discussion earlier about the new funds being targeted to larger projects in larger cities, versus the focus on assistance for smaller communities that has existed under the SRF program. It does not appear that this shift is taking place, however, as most states are using their increased allocations to continue support for smaller cities and towns, resulting in a long list of small projects to be funded under ARRA.

**The EPA is sticking with its firm deadline that projects receiving allocations must have signed contracts or construction underway by Feb. 17<sup>th</sup>, 2010, one year after the passage of the ARRA.** With only \$75 million of \$6 billion, or slightly over 1%, paid out under the program to date, this deadline appears to be optimistic. However, it's important to note that the EPA's tracking of actual "outlays" significantly lags contract activity, since the EPA reimburses states for project work undertaken, it does not provide the funding up front. The largest funding release to date have been in California, where the EPA has so far spent \$11 million in reimbursements out of the state's \$443 million allocation, and in Michigan, where \$14 million of the state's \$239 million allocation has been spent so far. Some states, including large ones with large allocations such as New York and New Jersey, have yet to spend a penny, according to EPA data. However, we believe that the level of local contracting activity is already picking up, and this will be reflected in the EPA's data in coming months.

The House Transportation and Infrastructure Committee tracks activity under the Clean Water SRF (Drinking Water is overseen by the Natural Resources Committee). In its quarterly ARRA report, it said that 19 states had put 195 clean water projects out to bid as of June 30, with a total value of \$512 million. We have not seen a similar data point for the Drinking Water SRF.

As noted in the table below, **EPA is targeting expenditure of 80% of its Drinking Water SRF and 92% of its Clean Water SRF (which is focused on wastewater projects) by the end of FY10.** Under this scenario, the large majority of projects' allocated funding would be underway and eligible to request EPA reimbursement within the coming year.

| US Environmental Protection Agency |                |                 |
|------------------------------------|----------------|-----------------|
| (\$ mil)                           |                |                 |
| Total ARRA Funding                 | 7,200          |                 |
| Released to date (8-21-09)         | 6,279          |                 |
| Spent to date (8-21-09)            | 75             |                 |
| % of total                         | 1%             |                 |
|                                    | <b>Funding</b> | <b>Target %</b> |
| Drinking water                     | 2,000          | 80%             |
| Clean water                        | 4,000          | 92%             |
| Other environmental programs       | 1,200          |                 |

Source: US EPA

**US DEPARTMENT OF AGRICULTURE:**

While it has received considerably less attention than the EPA's SRFs within the investor community, the Agriculture Department also has received a significant chunk of water funding. USDA manages a rural assistance program and has long provided funding for small and rural communities for water, wastewater, and other infrastructure projects. The agency received \$27 billion in stimulus funding for its rural community development programs, the bulk of which is going to broadband expansion and housing loans. Water and waste disposal programs received \$3.7 billion, and watershed management programs received approximately \$0.4 billion.

The water and waste program offers funding for drinking water, sanitary sewer, solid waste, and storm drainage facilities in rural areas and in cities of 10,000 people or less. Like EPA, the agency has also been allocating its funds to states and lists of projects, and it began releasing funds to selected projects at the end of May. **This week, the USDA announced \$175 million in water and environmental project loans and grants for projects ready to be funded "immediately," bringing its total project announcements to date to \$1.47 billion.** Most projects are small, less than \$5 million. But some larger ones have also been included, such as:

- \$14 million in loans and grants to Granite Falls, Minnesota, to replace its existing water treatment plant,
- \$23 million to Hood River, Oregon, for water system improvements, and
- \$22 million to Indiana's Twin Lakes regional sewer district for upgrades.

While we expect that most of these projects will be awarded to local contractors rather than large national firms such as **Layne Christensen** and **Tetra Tech**, we also expect that municipal business should pick up somewhat for these larger firms as well. For work that does flow to publicly traded firms, we anticipate that contracts related to the \$1.47 billion in awards should go to bid within the next few months, with orders for infrastructure equipment needed for these projects lagging by a few more months after that. On balance, we believe that firms will see more noticeable increases in stimulus-related backlog by mid-2010.

**MUNICIPAL MARKET IMPACTS:**

A frequent point of discussion about the impact of the stimulus funds on the municipal water infrastructure markets is whether they will actually result in incremental spending, or whether communities are simply using the funds to replace spending they can no longer afford during this period of economic downturn. In our view, the answer is “some of both.”

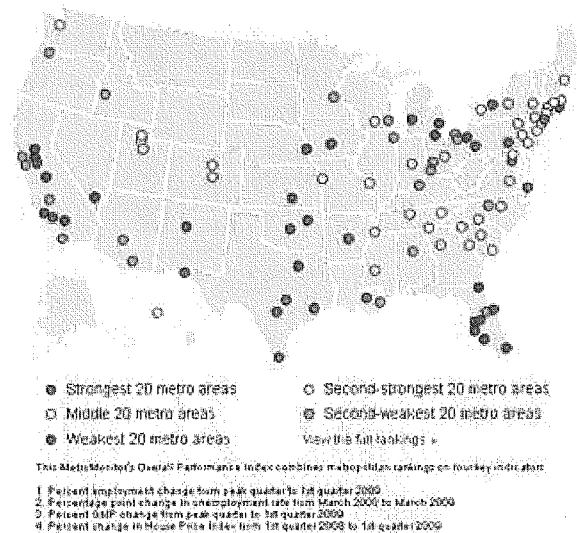
It is clear that state and local budgets remain under tremendous pressure due to weak housing markets and lower tax revenues. According to the Center on Budget and Policy Priorities, a D.C. think tank, 48 states face budget shortfalls for the coming fiscal year totaling \$165 billion, or 24% of total state budgets, with a similar shortfall anticipated for FY11. Federal assistance in various forms under ARRA is not enough to fill the gap. What does this mean for water and wastewater spending?



Source: Center for Budget and Policy Priorities, July 2009

First of all, it's important to note that water and wastewater systems are supported mainly by local spending, not state or federal spending. With \$30-40 billion in annual funding needed, the \$6 billion from the federal stimulus program hardly fills the gap in any case. Economic performance at the local level varies regionally, as outlined below, with California, Florida, and the upper Midwest being particularly hard-hit. Overall, while many municipal budgets are in no better shape than state budgets, and many cities are announcing spending cutbacks, we believe that water and sewer programs will fare relatively well in the coming year, for the reasons outlined below.

Overall Performance of the Largest 100 Metros



Source: Brookings Institution, June 2009

- **Unlike most other city budget items (police, schools, parks, etc.), water and sewer systems have a source of stable revenue via user fees.** As a result, water and sewer systems can be financed through revenue bonds tied to these incoming fees, not general obligation bonds tied to broader municipal finances. Since water and sewer bills remain low in most jurisdictions (typically \$30-50/month), the vast majority of consumers can still pay their water and sewer bill even during a recession. Typically, municipalities who receive federal dollars can leverage them with additional municipal bond funding to expand the total spending amount.
- **Municipal bond markets have substantially recovered after a freeze in late 2008 and early 2009.** The traditional tax-exempt markets began to resume normal activity this spring and are being augmented by new taxable issuances via the “Build America” bonds provided under the ARRA. This temporary stimulus provision allows muni issuers to offer taxable debt during 2009 and 2010 with a 35% subsidy on interest costs. The sale of these bonds got underway in June and about \$26 billion worth have been issued so far, though more issuances are for transportation and school districts than for water and sewer districts. Some of the larger Build America water bond issues in the last month include the Greater Chicago Metropolitan Water Reclamation District, \$600 million; the Metropolitan Wastewater Reclamation District in Denver, \$187 million; and the Metropolitan Water District of Southern California, \$251 million.
- **Water and sewer systems are making a better case on the jobs impact of infrastructure spending.** While transportation still gets far more attention, the water industry – led by municipal groups along with the services and equipment vendors that depend on municipal spending – has done a better job of getting their message out in the last year or two. Awareness of the rising need for investment in dilapidated water and sewer infrastructure is now being combined with some data on jobs and other economic benefits of such investment. A report recently distributed by Clean Water Alliance, a coalition of industry groups, offered data showing that for every \$1 billion in investment, 20,000 to 26,000 jobs would be generated, along with an estimated \$2.87 to \$3.46 billion in broader economic demand, including ripple effects in spending by utility construction workers.

*On balance, we maintain our earlier forecasts that municipal infrastructure markets will end 2009 approximately flat, though some markets – such as large ductile iron pipe replacement projects – which got off to a very slow start this year, may end down. For 2010, we expect growth to resume, in the 5-10% range.* We are already seeing signs of life in smaller scale markets, such as sewer pipe rehabilitation. As municipalities have gained a greater level of certainty as to how much funding is available via federal stimulus, and have come back to the bond markets, we believe market activity is getting back to “recession normal,” i.e., flat. As we move into 2010, we believe that the push to spend federal stimulus dollars (and to take

advantage of lower labor and commodity costs before inflation resumes in earnest) will result in market growth, perhaps not to 2007's level of around 10%, but likely back into the upper single digits.

**IMPORTANT DISCLOSURES**

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I, Debra G. Coy and Heike M. Doerr, 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.

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**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.

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| Rating      | Count | Percent | IB Serv./Past 12 Mos. |         |
|-------------|-------|---------|-----------------------|---------|
|             |       |         | Count                 | Percent |
| BUY [B]     | 136   | 51      | 11                    | 8       |
| NEUTRAL [N] | 125   | 47      | 5                     | 4       |
| SELL [S]    | 5     | 2       | 0                     | 0.00    |

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Industry Report

Water

October 19, 2009

## Water Utility 3Q Preview & Conference Takeaways

### KEY POINTS:

We attended the water utility industry's annual conference last week, meeting with regulators and company managements. While wet weather in the Mid-Atlantic has caused us to lower 3Q estimates for East Coast utilities, we believe the underlying fundamentals in the industry remain intact - ongoing capital investment need and regulatory support for continued rate increases, despite economic pressures. While stocks have recovered from their lows, we still see some BUY opportunities for those stocks still at the lower end of their historical valuation ranges. We believe the industry will continue to benefit from broader public attention to water issues and the gradual, value-driven recalibration of water rates, which remain far below the price for other commodities and utility services.

| Company               | (Ticker-\$Price) | Rating | FV      | EPS FY2008A | FY2009E | FY2010E | P/E'08 | P/E'09 |
|-----------------------|------------------|--------|---------|-------------|---------|---------|--------|--------|
| American States Water | AWR-\$36.08      | BUY    | \$40.00 | \$1.47      | \$1.74  | \$1.93  | 24.5x  | 20.7x  |

| Company              | (Ticker-\$Price) | Rating | FV      | EPS FY2008A | FY2009E | FY2010E | P/E'08 | P/E'09 |
|----------------------|------------------|--------|---------|-------------|---------|---------|--------|--------|
| American Water Works | AWK-\$19.95      | BUY    | \$26.00 | \$1.12      | \$1.34  | \$1.50  | 17.8x  | 14.9x  |

| Company            | (Ticker-\$Price) | Rating | FV      | EPS FY2008A | FY2009E | FY2010E | P/E'08 | P/E'09 |
|--------------------|------------------|--------|---------|-------------|---------|---------|--------|--------|
| Aqua America, Inc. | WTR-\$16.65      | BUY    | \$20.00 | \$0.73      | \$0.78  | \$0.88  | 22.8x  | 21.3x  |

| Company        | (Ticker-\$Price) | Rating | FV      | EPS FY2008A | FY2009E | FY2010E | P/E'08 | P/E'09 |
|----------------|------------------|--------|---------|-------------|---------|---------|--------|--------|
| Artesian Water | ARTNA-\$16.59    | BUY    | \$21.00 | \$0.86      | \$1.03  | \$1.09  | 19.3x  | 16.1x  |

| Company                  | (Ticker-\$Price) | Rating | FV      | EPS FY2008A | FY2009E | FY2010E | P/E'08 | P/E'09 |
|--------------------------|------------------|--------|---------|-------------|---------|---------|--------|--------|
| California Water Service | CWT-\$39.56      | BUY    | \$46.00 | \$1.90      | \$2.12  | \$2.10  | 20.8x  | 18.7x  |

| Company                   | (Ticker-\$Price) | Rating  | FV      | EPS FY2008A | FY2009E | FY2010E | P/E'08 | P/E'09 |
|---------------------------|------------------|---------|---------|-------------|---------|---------|--------|--------|
| Connecticut Water Service | CTWS-\$22.80     | NEUTRAL | \$20.00 | \$1.11      | \$1.05  | \$0.98  | 20.5x  | 21.7x  |

| Company             | (Ticker-\$Price) | Rating  | FV      | EPS FY2008A | FY2009E | FY2010E | P/E'08 | P/E'09 |
|---------------------|------------------|---------|---------|-------------|---------|---------|--------|--------|
| Middlesex Water Co. | MSEX-\$15.44     | NEUTRAL | \$15.00 | \$0.89      | \$0.66  | \$0.79  | 17.3x  | 23.4x  |

| Company          | (Ticker-\$Price) | Rating | FV      | EPS FY2008A | FY2009E | FY2010E | P/E'08 | P/E'09 |
|------------------|------------------|--------|---------|-------------|---------|---------|--------|--------|
| Pennichuck Corp. | PNNW-\$23.22     | SELL   | \$16.00 | \$1.11      | \$0.49  | \$0.79  | 20.9x  | 47.4x  |

| Company         | (Ticker-\$Price) | Rating | FV     | EPS FY2008A | FY2009E | FY2010E | P/E'08 | P/E'09 |
|-----------------|------------------|--------|--------|-------------|---------|---------|--------|--------|
| SouthWest Water | SWWC-\$5.39      | BUY    | \$8.00 | \$(0.55)    | \$0.14  | \$0.39  | NA     | 38.5x  |

| Company    | (Ticker-\$Price) | Rating  | FV      | EPS FY2008A | FY2009E | FY2010E | P/E'08 | P/E'09 |
|------------|------------------|---------|---------|-------------|---------|---------|--------|--------|
| York Water | YORW-\$14.56     | NEUTRAL | \$15.00 | \$0.57      | \$0.66  | \$0.70  | 25.5x  | 22.1x  |

Research Analyst Certifications and Important Disclosures  
are on page 9 of this report  
Additional Information Available on Request

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### **TAKEAWAYS FROM DRINKING WATER SYMPOSIUM:**

Last week we attended the Drinking Water Symposium held in Orlando, Florida. This biennial event is hosted by the National Association of Water Companies, the trade group for regulated water utilities, with co-sponsorship by the U.S. Environmental Protection Agency. Attendance at the event includes public utility commissioners and staffers, federal regulators, water utility executives, and industry professionals. The goal of the event is to share best practices among water operators and educate regulators. Topics highlighted included water resource management, financing infrastructure needs, public-private partnerships, and consumer awareness. We had the opportunity to sit down with senior executives from each of the regulated water utilities to discuss the business outlook and regulatory climate. Below are some themes that came out of these meetings.

- **Unfavorable Third Quarter Consumption Patterns.** Water consumption continues to be hampered by economic weakness, particularly commercial and industrial (C&I) usage. We expect C&I consumption trends in the third quarter to mirror second quarter performance and have forecasted accordingly. Additionally, companies suffered through another year of uncooperative summer weather patterns, with rain on the East Coast reducing water use and drought on the West Coast driving conservation.
- **Rate Cases Timing Unchanged.** While we continue to receive investor questions on the topic, the timing of rate case filings and commission decisions *has not* been hampered by the economic slowdown. While utility executives are sensitive to the impact that rate increases have on consumers, rate relief requests are not being postponed and commissioners are not taking longer than normal to finalize decisions. Additionally, rate awards and respective return on equity allowances have held steady. When it comes to needed rate increases, we believe that water companies continue to benefit from having the lowest household rates of any utility service.
- **Capital Expenditure Spending Continues.** Water utilities continue to invest capital dollars in their systems. As we have mentioned previously, states that have infrastructure surcharge mechanisms (that minimize regulatory lag) are receiving a higher proportion of these replacement capital dollars.
- **Access to Capital Exists.** York Water recently completed an equity offering, the third equity issuance in the group this year, though valuation and stock prices are lower than they have been in recent years. High credit ratings also ensure access to debt markets, as spreads have come down with the easing of the financial crisis. Debt offerings for the two largest investor-owned water utilities are expected to be priced later this month.

### **WHAT TO EXPECT ON THE REGULATORY FRONT BEFORE YEAR END:**

Regulatory activity across the group has been largely quiet over the past few months as no meaningful rate cases were filed or decisions granted. We expect regulatory activity in three of the most important operating jurisdictions to pick-up before year end. The following is a synopsis of regulatory matters we expect news on between now and the end of the year.

#### **California:**

- **American States Rate Case.** The company expects a final decision in its Golden Water subsidiary before year-end. This decision will cover Region II and Region III in addition to General Office expenses. The company's totally request of \$62.5 million includes an increase of \$42 million in 2010.
- **San Jose Water (SJW) Rate Case.** The Administrative Law Judge (ALJ) filed his proposed decision on October 14, 2009. The company had requested a \$71.3 million request and had reached a partial settlement with the PUC staff this summer. The proposed decision includes a rate increase of \$18.6 million in 2010, compared to the company's \$36.2 million request. The return on equity allowance will be determined in the cost of capital proceeding, which is also pending and expected to be completed before year-end.
- **Cost of Capital Proceeding.** Similar to the proceeding the larger California utilities completed earlier this year, the California subsidiaries of SouthWest Water and SJW Corp, along with 5 other private utilities are having their allowed return on equity determined through a joint proceeding. The initial requests were filed in May 2009 and a final decision is expected before year-end. The Division of Ratepayers Advocate (DRA) filed its recommendation this summer, suggesting an ROE of 9.5% for Suburban Water (SWWC), and 9.75% for San Jose (SJW).

#### **Pennsylvania:**

- **Aqua America Rate Filing.** We expect the company to file for rate relief at its largest operating subsidiary during November.

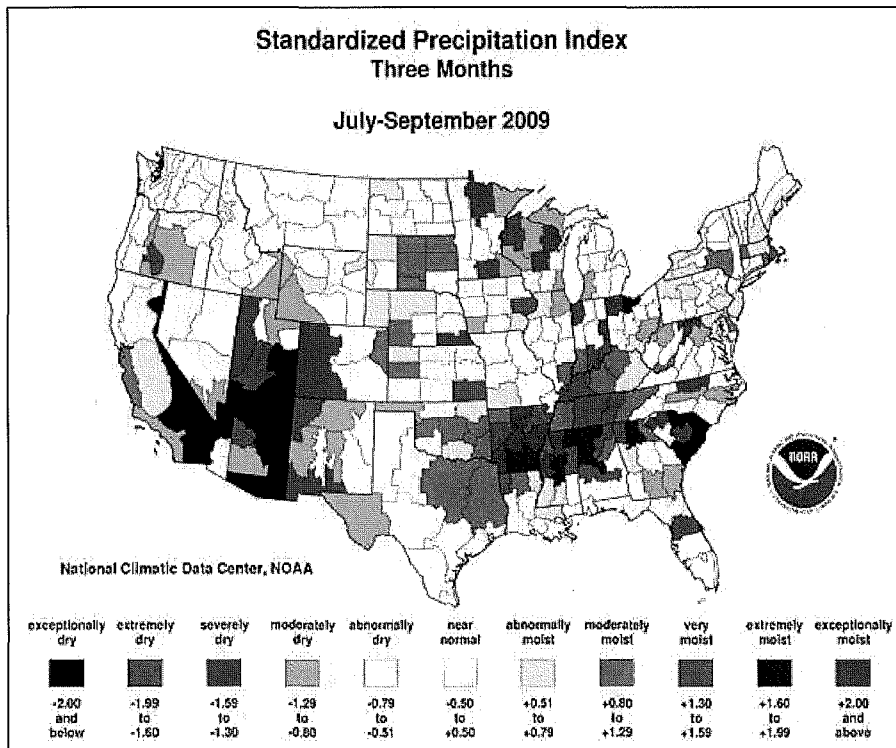
**New Jersey:** Once the state’s gubernatorial election is held in early November, we expect activity in the state to pick-up.

- **DSIC.** We are optimistic that approval of American Water’s surcharge mechanism will be approved before year-end. This mechanism allows water utilities to add an infrastructure rehabilitation surcharge to customers’ rates for capital expenditure improvements made to the distribution system (normally pipe replacement). The mechanism adjusts periodically based on additional qualified capital expenditures completed or anticipated in a future period and is capped at a percentage of base rates. The company has requested a 7.5% surcharge mechanism.
- **Aqua America Rate Filing.** We expect Aqua America to file for rate relief in December. The company is currently earnings an allowed ROE of 10.0%, 30 basis points below recent awards.
- **Trenton Acquisition.** Originally anticipated to close by the end of 2008, we are hopeful that American Water will have good news to report on this transaction before its December 7<sup>th</sup> Analyst Day

**THIRD QUARTER WEATHER ASSESSMENT:**

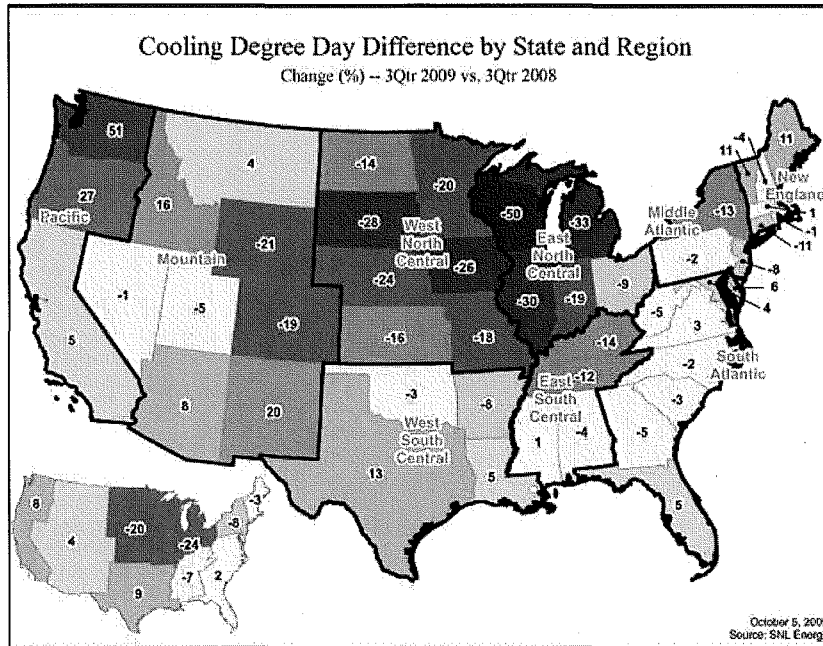
The weather was unusually hot in Orlando, Florida, for last week’s Drinking Water Symposium. Water executives in attendance couldn’t help but notice that this was in stark contrast to the weather experienced throughout the MidAtlantic and New England regions this summer. Once again, water utilities were faced with uncooperative weather patterns in the important summer months. Not only did the region experience higher than normal precipitation levels, but it was also unseasonably cool.

The chart below shows the pockets of above-average precipitation across the Mid-Atlantic and New England regions during the third quarter. States of particular importance within the investor-owned water utility group that have been negatively affected include New Jersey, Pennsylvania, Delaware, Connecticut and New Hampshire. In California, the opposite has been true, and much of the southern part of the state fell into the “exceptionally dry” category. Drought-related conservation efforts are likely to negatively impact SouthWest Water and SJW Corp (SJW-\$22.66; Not Rated), which do not have a decoupling mechanism in place to lessen the impact of reduced consumption on earnings.



Temperature also plays a part in water consumption patterns, though to a somewhat lesser degree than precipitation patterns. During cool or cloudy weather periods, moisture is better retained so that plants need to be watered less frequently,

swimming pools have less evaporation, etc. The chart on the following page indicates the year-over year change in temperature during the third quarter as measured by cooling degree days.



Unfortunately, there is no straightforward way to discern the earnings impact unseasonable weather will have on water utilities; this exercise is more an art than a science. A variety of factors need to be accounted for, including inches of accumulated rain, how frequently it has rained, the temperature on non-rainy days, and on what days of the week rain has fallen (water usage is higher on the weekends). It is also difficult to separate out the impact of the economy and weather trends, though this factors more into commercial and industrial use than residential.

We have adjusted our estimates for our East Coast coverage group to reflect our estimates of the impact that cooler, rainy weather has had on third quarter results. For the small-cap companies that do not benefit from geographic diversity and have a smaller revenue base, the earnings impact of unfavorable weather can be considerable. We have not made revisions for our California water utilities as our assumptions have already taken into account conservation efforts at SouthWest Water and the larger utilities have regulatory mechanisms in place that decouple revenue from consumption patterns and mitigate the risk of weather on earnings. The following chart outlines our revised third quarter estimates as compared to Street estimates across the water utility group.

| <b>Third Quarter 2009 Expectations as of 10/16/09</b> |                     |          |        |                |        |          |        |
|---|---------------------|----------|--------|----------------|--------|----------|--------|
| Ticker  | Company Name        | JMS 3Q09 |        | Bloomberg 2Q09 |        | Versus   |        |
|   |                     | Est.     | Cons.  | Low            | High   | Cons.    | 3Q08   |
| AWR   | American States     | \$0.48   | \$0.55 | \$0.48         | \$0.68 | (\$0.07) | \$0.39 |
| AWK   | American Water      | \$0.56   | \$0.55 | \$0.52         | \$0.58 | \$0.01   | \$0.55 |
| WTR   | Aqua America        | \$0.25   | \$0.28 | \$0.22         | \$0.29 | (\$0.03) | \$0.26 |
| ARTNA   | Artesian Water**    | \$0.35   | \$0.38 |                |        | N/A      | \$0.35 |
| CWT   | California Water    | \$1.07   | \$1.06 | \$0.98         | \$1.09 | \$0.01   | \$1.06 |
| CTWS  | Connecticut Water** | \$0.50   | \$0.49 |                |        | \$0.01   | \$0.33 |
| MSEX  | Middlesex Water     | \$0.28   | \$0.30 | \$0.29         | \$0.32 | (\$0.02) | \$0.35 |
| PNNW  | Pennichuck*         | \$0.26   |        |                |        | N/A      | \$0.21 |
| SWWC  | Southwest Water     | N/A      | \$0.08 |                |        | N/A      | n/a    |
| YORW  | York Water          | \$0.20   | \$0.20 | \$0.17         | \$0.22 | \$0.00   | \$0.15 |

\* Consensus # reflects only other street estimate;

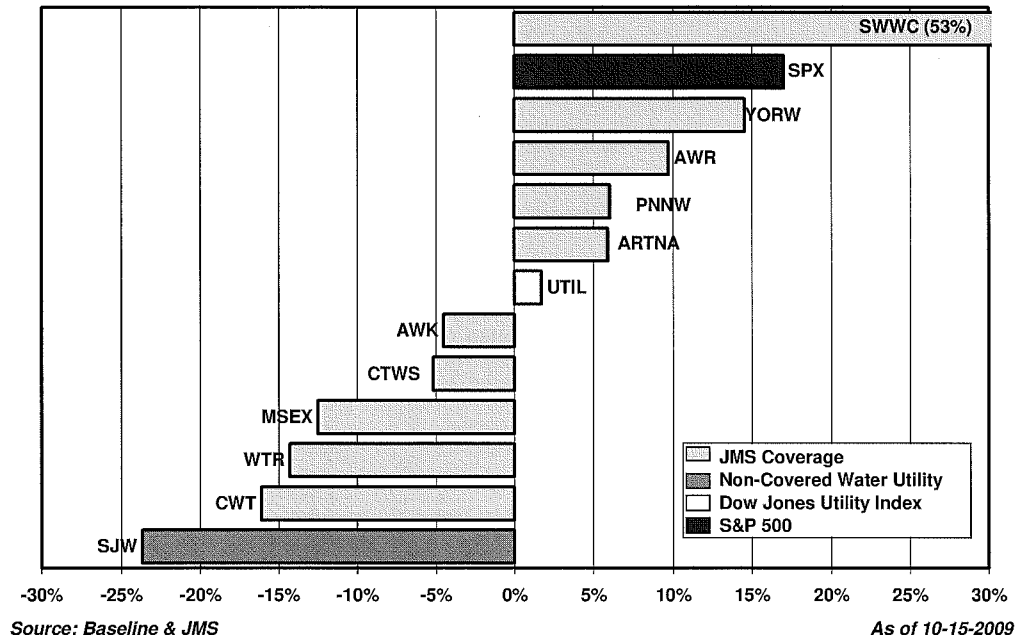
\*\* Janney is only published estimate; \*\* One other estimate exists

Source: Bloomberg & JMS Estimates

**SECTOR THESIS AND VALUATION DISCUSSION:**

Year-to-date the water utility sector has collectively appreciated 4%, predictably lagging the broader market indices during the recent rebound. Less than half of the group is outperforming the Dow Jones Utility Index, which is up a modest 3% year to date. Individual stock performance has ranged from down 24% (SJW Corp.) to up 58% (SouthWest Water), with the extremes driven by stock-specific catalysts. As shown in the following chart, the group is almost equally divided between those that have posted declines and those that have shown positive 2009 performance.

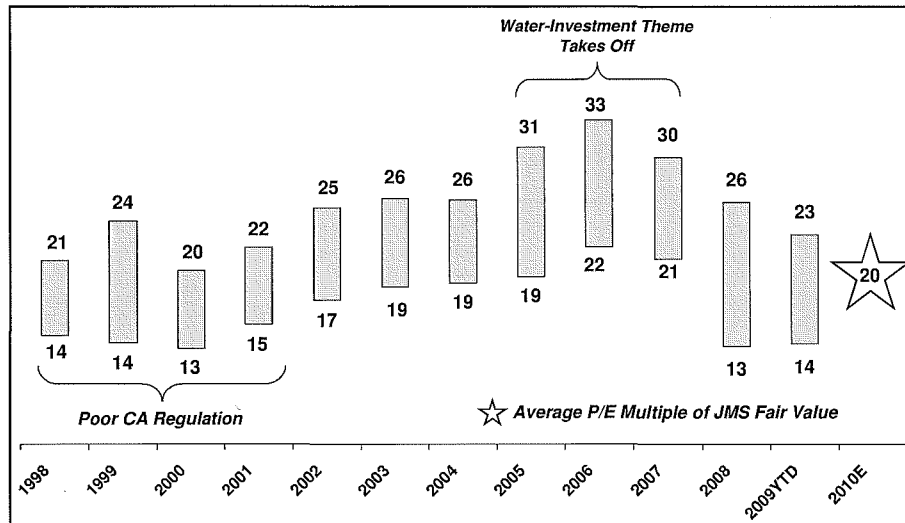
**Year-to-Date Water Utility Performance**



While investors may question putting money to work in the sector on the cusp of an economic recovery, we believe some attractive investment opportunities remain within the water utility group. We continue to favor the sector’s largest water utilities, which benefit from an expanded geographic footprint, which allows them to better navigate the current economic slowdown, have greater opportunities for meaningful acquisitions, and mitigate the effects of regulatory lag through multiple rate jurisdictions. The smaller, geographically limited, water utilities can be more vulnerable to declining consumption patterns and regulatory lag in individual operating territories.

The water utility group is currently trading at average P/E multiples of 25.0x and 19.7x our 2009 and 2010 estimates, a 2009 EV/EBITDA multiple of 10.8x, and price/book multiple of 1.7x. Investors often note that water utilities are expensive compared to other utilities, but they are now still at the low end of the five-year historical range. The following chart shows the steep valuation decline on a price-to-earnings basis experienced across the group since 2007 (similar trends are seen for EV/EBITDA and Price/Book multiples).

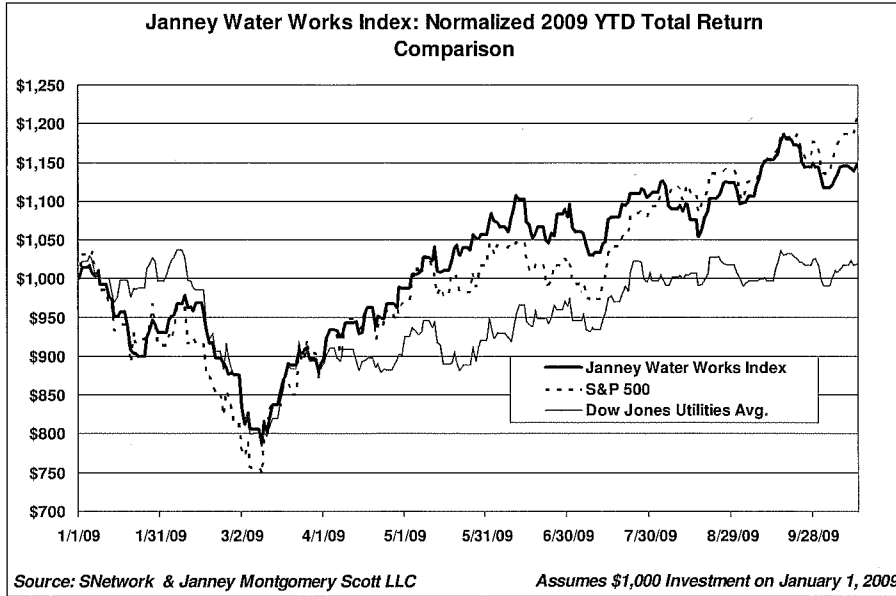
**Water Utility Average Forward P/E Multiples**  
(As of October 8, 2009)



While we believe the group is unlikely to return to the peak valuations of 2005-2007 any time soon, if ever, we continue to believe that the group is currently oversold relative to its underlying asset value and long-term growth prospects, and several stocks offer attractive BUY opportunities now. While earnings growth for each company is not consistent from year to year, given the varied timing of rate cases, weather volatility, and acquisitions, the group's underlying long-term earnings growth trend remains solidly up, with an average in the 6-10% range over time. We expect several companies to have 10%+ earnings growth in 2009 and 2010. While the high capital investment requirements of water utility systems is a challenge in today's environment, it also provides assurance of steady earnings growth, as long as regulators provide the rate increases needed to provide a return on that investment.

In this environment, we continue to advocate buying stocks when they are at the lower end of their trading range or are looking ahead to the prospect of earnings growth at the higher end of their range due to rate case, acquisition, or weather timing. We would expect the small-cap stocks to continue to trade at a discount to the group given their limited growth and lack of liquidity. For investors with a long time horizon, however, we believe the small-cap stocks' annual earnings growth of 5-7% coupled with annual dividend increases offer stable investment opportunities.

Looking past our coverage, we review the Janney Water Works Index (JWW), which includes 30 of the leading investor-owned global water utilities. In 2008, the JWW had dropped more sharply than the S&P 500 and DJ Utility index, a result of the broader market downturn paired with weakness in the large European water firms which are dominant weightings in the index. After trending largely in line with the indices earlier this year, the JWW has outperformed DJ Utility Index and S&P 500 recently. Over the summer, the S&P rally outperformed the JWW, which had been ahead previously. The JWW has increased 14.6% compared to the S&P growth of 20.9% and a modest 2.8% increase in the Dow Jones Utility Index. (For more information, please refer to [www.janneywaterindexes.com](http://www.janneywaterindexes.com).)



**WATER UTILITY STOCK VALUATION COMPARISON**

| Name              | Symbol | JMS Rating | Fair Value | Recent Price | Mkt Cap (\$ mil) | Avg Daily Vol 12mo | P/E          |              | 5 YR AVG.    | Current Yield | Price/Book  | 2009 EV/ EBITDA | 2010 EV/ EBITDA | ROE (TTM)   | Total Debt/ Total Cap |
|-------------------|--------|------------|------------|--------------|------------------|--------------------|--------------|--------------|--------------|---------------|-------------|-----------------|-----------------|-------------|-----------------------|
|                   |        |            |            |              |                  |                    | 2009E        | 2010E        |              |               |             |                 |                 |             |                       |
| American States*  | AWR    | BUY        | \$40       | \$36.08      | \$667            | 132,483            | 20.8x        | 18.7x        | 25.7x        | 3.0%          | 1.7x        | 8.9x            | 7.9x            | 8.0%        | 47.3%                 |
| American Water**  | AWK    | BUY        | \$26       | \$19.95      | \$3,481          | 798,630            | 14.9x        | 13.3x        | N/A          | 4.1%          | 1.1x        | 9.3x            | 8.3x            | 7.0%        | 57.8%                 |
| Aqua America      | WTR    | BUY        | \$20       | \$16.65      | \$2,263          | 1,020,789          | 21.4x        | 18.8x        | 30.1x        | 3.4%          | 2.1x        | 10.0x           | 9.0x            | 10.0%       | 55.7%                 |
| Artesian Water    | ARTNA  | BUY        | \$20       | \$16.59      | \$124            | 16,565             | 16.1x        | 15.2x        | 21.7x        | 4.0%          | 1.5x        | 9.6x            | 9.0x            | 8.4%        | 59.5%                 |
| California Water  | CWT    | BUY        | \$46       | \$39.56      | \$821            | 182,920            | 18.7x        | 18.8x        | 25.1x        | 3.2%          | 1.9x        | 9.2x            | 8.8x            | 11.1%       | 51.7%                 |
| Connecticut Water | CTWS   | NEUTRAL    | \$20       | \$22.80      | \$194            | 21,003             | 21.8x        | 23.2x        | 24.4x        | 4.1%          | 1.8x        | 12.9x           | 12.6x           | 7.8%        | 51.2%                 |
| Middlesex Water   | MSEX   | NEUTRAL    | \$14       | \$15.44      | \$208            | 42,560             | 23.4x        | 19.5x        | 22.5x        | 4.7%          | 1.5x        | 13.2x           | 11.7x           | 7.5%        | 54.8%                 |
| Pennichuck ***    | PNNW   | SELL       | \$16       | \$23.22      | \$99             | 10,179             | 47.1x        | 29.4x        | N/A          | 2.9%          | 2.2x        | 13.7x           | 11.7x           | 4.5%        | 57.8%                 |
| SJW Corp          | SJW    | NR         | N/A        | \$22.66      | \$419            | 69,773             | 28.7x        | 21.2x        | 25.9x        | 3.0%          | 1.6x        | N/A             | N/A             | 6.8%        | N/A                   |
| Southwest Water   | SWWC   | BUY        | \$8        | \$5.39       | \$134            | 147,031            | 38.6x        | 14.0x        | 41.9x        | 2.2%          | 1.0x        | 9.4x            | 7.4x            | N/A         | 55.7%                 |
| York Water        | YORW   | NEUTRAL    | \$15       | \$14.56      | \$166            | 24,446             | 22.0x        | 20.9x        | 27.4x        | 3.1%          | 2.6x        | 12.0x           | 11.2x           | 10.0%       | 57.6%                 |
| <b>Average</b>    |        |            |            |              |                  |                    | <b>24.9x</b> | <b>19.4x</b> | <b>27.2x</b> | <b>3.4%</b>   | <b>1.7x</b> | <b>10.8x</b>    | <b>9.8x</b>     | <b>8.1%</b> | <b>54.9%</b>          |

\* Estimates for AWR exclude hedging contract & unusual items

\*\* For AWK, EPS data/estimates and valuation metrics are adjusted to exclude goodwill impairments

\*\*\* Pennichuck EPS is normalized to exclude one-time gains and the costs related to eminent domain

Source: Thomson Financial/Baseline; JMS estimates on rated cos.

**REVISED JANNEY ESTIMATES COMPARED TO CONSENSUS**

**2009 and 2010 Expectations: JMS versus First Call Consensus**

| Ticker | Company Name         | FY  | JMS 2009 |        | Bloomberg 2009 |        | Vs. Cons. | JMS 2010 |        | Bloomberg 2010 |        | Vs. Cons. |
|--------|----------------------|-----|----------|--------|----------------|--------|-----------|----------|--------|----------------|--------|-----------|
|        |                      |     | Est.     | Cons.  | High           | Low    |           | Est.     | Cons.  | High           | Low    |           |
| AWR    | American States      | Dec | \$1.74   | \$1.80 | \$2.06         | \$1.65 | (\$0.06)  | \$1.93   | \$2.01 | \$2.32         | \$2.32 | (\$0.08)  |
| AWK    | American Water       | Dec | \$1.34   | \$1.31 | \$1.36         | \$1.25 | \$0.03    | \$1.50   | \$1.44 | \$1.50         | \$1.35 | \$0.06    |
| WTR    | Aqua America         | Dec | \$0.78   | \$0.81 | \$0.84         | \$0.78 | (\$0.03)  | \$0.88   | \$0.91 | \$0.97         | \$0.88 | (\$0.03)  |
| ARTNA  | Artesian Water **    | Dec | \$1.03   | \$1.07 |                |        |           | \$1.09   | \$1.12 |                |        | (\$0.03)  |
| CWT    | California Water     | Dec | \$2.12   | \$2.10 | \$2.16         | \$2.00 | \$0.02    | \$2.10   | \$2.17 | \$2.30         | \$2.05 | (\$0.07)  |
| CTWS   | Connecticut Water ** | Dec | \$1.05   | \$1.10 |                |        |           | \$0.98   | \$1.05 |                |        | (\$0.07)  |
| MSEX   | Middlesex Water      | Dec | \$0.66   | \$0.71 | \$0.76         | \$0.67 | (\$0.05)  | \$0.79   | \$0.81 | \$0.85         | \$0.78 | (\$0.02)  |
| PNNW   | Pennichuck *         | Dec | \$0.49   |        |                |        | \$0.49    | \$0.79   |        |                |        | \$0.79    |
| SWWC   | Southwest Water      | Dec | \$0.14   | \$0.17 | \$0.20         | \$0.14 | (\$0.03)  | \$0.39   | \$0.39 | \$0.39         | \$0.38 | \$0.00    |
| YORW   | York Water           | Dec | \$0.66   | \$0.67 | \$0.68         | \$0.65 | (\$0.01)  | \$0.70   | \$0.69 | \$0.71         | \$0.71 | \$0.01    |

\* Janney is only published estimate; \*\* Only one other estimate exists

Source: Bloomberg & Janney Estimates



**IMPORTANT DISCLOSURES**

**Research Analyst Certification**

I, Heike M. Doerr and Debra G. Coy, 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**

Individual disclosures for the companies mentioned in this report can be obtained by calling or writing Janney Montgomery Scott LLC as provided on the first page of this report. [Disclosure Site](#)

**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.

**Janney Montgomery Scott Ratings Distribution as of 9/30/09**

| Rating      | Count | Percent | IB Serv./Past 12 Mos. |         |
|-------------|-------|---------|-----------------------|---------|
|             |       |         | Count                 | Percent |
| BUY [B]     | 140   | 49      | 15                    | 3.50    |
| NEUTRAL [N] | 139   | 49      | 4                     | 4.14    |
| SELL [S]    | 5     | 2.00    | 0                     | 0.00    |

**\*Percentages of each rating category where Janney has performed Investment Banking services over the past 12 months.**

**Other Disclosures**

Investment opinions are based on each stock's 6-12 month return potential. Our ratings are not based on formal price targets, however our analysts will discuss fair value and/or target price ranges in research reports. Decisions to buy or sell a stock should be based on the investor's investment objectives and risk tolerance and should not rely solely on the rating. Investors should read carefully the entire research report, which provides a more complete discussion of the analyst's views.

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American Water Works

AWK - BUY

November 10, 2009

**Water**

**American Water Works  
(AWK) - BUY**

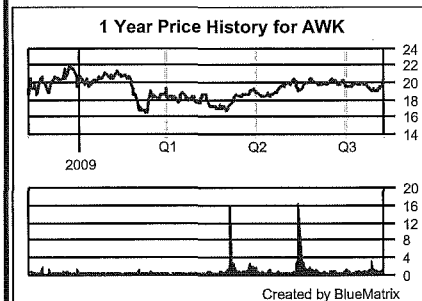
**Price: \$20.50**  
Fair Value Estimate: \$26.00  
52-Week Range: \$22.35-\$16.22  
Market Cap (MM): \$3,579  
Shr.O/S-Diluted (mm): 174.6  
Average Daily Volume: 1,288,903  
Dividend: \$0.82  
Yield: 4.0%

| FYE: Dec   | 2008A  | 2009E  | 2010E  | 2011E  |
|------------|--------|--------|--------|--------|
| EPS:       | \$1.12 | \$1.28 | \$1.48 | \$1.66 |
| Prior EPS: | \$1.34 | \$1.50 | NC     |        |
| P/E Ratio: | 18.3x  | 16.0x  | 13.9x  | 12.3x  |

Quarterly EPS:

| Q  | 2009   | 2009A   | 2009   | 2009 |
|----|--------|---------|--------|------|
| Q1 | \$0.04 | \$0.19A | \$0.19 | --   |
| Q2 | \$0.30 | \$0.32A | \$0.39 | --   |
| Q3 | \$0.55 | \$0.52A | \$0.60 | --   |
| Q4 | \$0.23 | \$0.24  | \$0.30 | --   |

EPS: Excludes impairment charges



Equity Research  
**Note**

**"Cruel Summer": Weather Hampers Results;  
Strategy & Fundamentals Intact - BUY**

**INVESTMENT CONCLUSION:**

American Water's third quarter suffered at the hands of wet, cool summer weather and weak industrial demand - dragging down results by \$0.14 per share. Although not very discernible in earnings performance, American Water continues to execute on its strategy and the third quarter was actually impressive, excluding the ever-fickle weather impact and economic weakness. The company is on track to meet our operating cash flow and capital expenditure forecasts and is filing and receiving rate cases on schedule. We continue to believe our 2010 Street-high EPS estimate of \$1.48 is reasonable and introduce a 2011 estimate of \$1.66. With the completion of the September secondary, RWE's ownership in American Water is below 24%. While many investors would like to see a full exit before year-end, the German's timeline remains unclear. We maintain our BUY and 12-month fair value of \$26.

**KEY POINTS:**

- **Third Quarter Results:** American Water reported third quarter earnings of \$0.52 per share, well below our \$0.56 estimate and the \$0.55 achieved in the third quarter last year. Revenue weakness was the culprit, and management estimated reduced volumes resulted in a \$0.14 EPS drag on quarterly performance, added to the \$0.08 negative impact in 2Q. The company delivered 9.1 billion fewer gallons of water compared to 2008 or a 7.4% decrease.
- **Cap Ex & Operating Cash Flow On Track:** American has recorded operating cash flow of \$471 million year-to-date, up 20% compared to last year. This is in line with our 2009 OCF forecast of \$550 million. The company has spent \$600 million on capital expenditures during the first nine months and remains on track to spend \$800 million during the year. Notably, 70% of a \$162 million capital project in Kentucky has been completed.
- **Rate Activity:** Year-to-date, the company has received \$72 million in annualized rate relief and an additional \$27 million in infrastructure surcharges. The company has \$259 million in rate proceedings still pending. Just last week the company received a \$31 million annual increase in PA (10.8% ROE) and a \$6 million annual increase in Iowa (10.5% ROE). Due to rate case timing, we would not expect final decisions in the largest of these cases until next spring.
- **Growth Opportunities Abound:** In the non-regulated business, contract awards at Fort Meade & Fort Belvoir indicate management's strategic vision to expand this business. These awards were for \$288 million over a 50-year period for Fort Belvoir and \$650 million over a 50-year period for Fort Meade - subject to price re-determinations. Management said it has done about a dozen tuck in acquisitions, some of which were the purchase of municipal water systems.
- **Valuation Attractive:** The stock continues to trade at a steep discount to peers at a P/E of around 14x and 12x our 2010 and 2011 estimates and 8.5x & 7.7x on 2010 and 2011 EV/EBITDA respectively. Our 12-18 month outlook remains positive as rates flow and usage patterns normalize with the weather. We maintain our BUY rating and \$26 fair value.

Research Analyst Certifications and Important Disclosures are on pages 6 - 7 of this report

**VALUATION SUMMARY:**

Since hitting a pre-offering low in early June below \$17, AWK shares have rebounded and appreciated more than twice the water utility group average (16% vs. 6%) since June 1<sup>st</sup>. After a strong day yesterday, the stock is down 3% year to date - better than the average water utility decline closer to 5% (excluding SouthWest Water's rebound).

On a P/E basis, American trades at about 14x & 12x our 2010 & 2011 estimates respectively. We do not have 2011 estimates for all of the water utilities under coverage, but based on our 2010 estimates the stock is 3.5x below the peer group average P/E of 17.5x. On an EV/EBITDA basis, the company trades at 8.5x and 7.7x our 2010 and 2011 estimates vs. a 2010 group average of 8.3x. On a price/book basis, the stock is currently trading at about 1.1x on "adjusted shareholder equity" (including the estimated portion of goodwill that is captured in rate base), a large discount to the group average of 1.7x book value.

Our fair value of \$26 implies a 2010 and 2011 P/E of 17.5x and 16x, respectively – discounted compared to the peer group's assumed 2010 P/E of 20.5x. Although RWE ownership is currently down to 23.5%, we think that the discount will remain for awhile yet, given additional risk around future equity offerings, ROE catch-up, capital structure, and rate case filings. Our fair value assumes 2010 and 2011 EV/EBITDA multiples of 9.4x and 8.6x respectively, inline with the 2010 peer group average of 9.3x. American's higher debt load compared to the group accounts for the higher EV/EBITDA multiple. Management envisions a longer term debt/equity ratio of 45%, though this will likely take 3-5 years to achieve.

With an implied total return of over 25% American Water offers one of the highest upside returns across the water utility group and is, we believe, deserving of our "Best Pick" status within the water utility group.

| <b>American Water Works (AWK)</b> |             |              |              |              |
|-----------------------------------|-------------|--------------|--------------|--------------|
|                                   | <b>2008</b> | <b>2009E</b> | <b>2010E</b> | <b>2011E</b> |
| Sales (\$ bil)                    | 2,336.9     | 2,434.7      | 2,621.6      | 2,819.9      |
| Revenue growth                    | 5.5%        | 4.2%         | 7.7%         | 7.6%         |
| Price/Sales                       | 1.5x        | 1.5x         | 1.4x         | 1.3x         |
| EBITDA (\$ mil)                   | 831.2       | 921.5        | 1,048.7      | 1,153.3      |
| EBITDA Growth                     | 5.1%        | 10.9%        | 13.8%        | 10.0%        |
| Price/EBITDA                      | 4.3x        | 3.9x         | 3.4x         | 3.1x         |
| EV/EBITDA                         | 10.7x       | 9.7x         | 8.5x         | 7.7x         |
| Reported net income               | (562.4)     | (227.4)      | 265.0        | 311.2        |
| Impairment & one-time costs       | 741.6       | 443.0        | -            | -            |
| Net income ex impairment*         | 179.2       | 215.6        | 265.0        | 311.2        |
| EPS ex one-time items             | \$1.12      | \$1.28       | \$1.48       | \$1.66       |
| EPS Growth                        | -5.2%       | 14.5%        | 15.7%        | 11.7%        |
| P/E                               | 18.3x       | 16.0x        | 13.8x        | 12.4x        |

\*Net income ex impairment and one-time costs, net of tax

Source: Company data, Janney Estimates

| <b>Current Data Points</b>       |         |
|----------------------------------|---------|
| Price                            | \$20.50 |
| Shares outstanding               | 174.7   |
| Market cap (\$ mil)              | 3,581.2 |
| Total debt/total capital         | 57.3%   |
| Total debt                       | 5,352.6 |
| Net debt                         | 5,344.8 |
| Shareholders equity              | 3,987.3 |
| Adjusted shareholders equity*    | 3,262.2 |
| Est. 2009 ROE, excl goodwill     | 5.4%    |
| Est. 2009 ROE on adjusted equity | 6.6%    |
| Book value/share                 | \$22.82 |
| Price/Book                       | 0.9x    |
| Goodwill                         | 1,250.1 |
| Adjusted book value/share        | \$18.67 |
| Price/book, adjusted             | 1.1x    |
| 2009 Dividend                    | \$0.82  |
| Dividend Payout Ratio**          | 64%     |
| Yield                            | 4.0%    |

\*Adjusted equity includes est. portion of goodwill captured in rate base for ROE

\*\*Payout ratio based on 2009E EPS excl. impairment chg

Source: Company data, Janney Estimates

**RECENT RATE ACTIVITY:**

American implemented \$72.3 million in new annualized rate revenues so far in 2009 with an additional \$26.6 million in infrastructure surcharges finalized since January. The company has \$258 million in pending requests in 10 states, which we expect will begin impact results in the next 6-9 months depending on filing date.

In Iowa, the company recently received a \$6.1 million final award (10.5% allowed ROE), compared to the \$6.8 million in interim rates they had implemented earlier this year while the case was being finalized. The Pennsylvania case is the most recent significant case received and includes a \$30.8 million annual rate increase and 10.8% allowed ROE. This decision is in-line with awards granted in Pennsylvania to other investor-owned water utilities have received over the last year.

**EARNINGS OUTLOOK:**

We have adjusted our 2009 estimate to \$1.28 from \$1.34, to account for the third quarter results and trim our fourth quarter estimate by two cents to \$0.34, given continued wet weather in October. We are currently forecasting approximately 4.2% revenue growth for the year, versus 7.5% previously, in light of the wet summer and continued hamstrung industrial demand. We think regulated growth of 6% will offset the 7% revenue decline in the non-regulated business, due to a large non-recurring project. We expect continued improvements in the operating expense ratio, around of 200 bps, with the expense ratio for the year dropping to 54% of revenues from 56% in 2008.

We reduced our 2010 estimate to \$1.48, from \$1.50 previously, but now include dilution from an offering we think could take place in the third quarter. Our offering assumptions include \$225 million in proceeds at a price of \$23, yielding 9.8 million new shares (\$0.03 dilution). These numbers are placeholders for now, since timing and pricing of an offering of course remains uncertain.

We are looking for revenue growth of around 8%, which will be primarily driven by the regulated utility operations. We expect the unregulated business to begin showing growth around 3% after declines through 2009. With new rates flowing, we expect 200 basis points of efficiency ratio improvement to 52%. Ultimately we think the company can achieve net income growth of 23% after a tepid 2009 performance. If American can continue its pace of rate cases without significant additional operating expense growth, we believe it could generate better leverage from its existing asset base.

We introduce a 2011 estimate of \$1.66, representing 12% EPS growth. This assumes 8% revenue growth (8% regulated and 4% non-regulated) to \$2.8 billion. We think the operational improvements will slow as the company gets caught up on its rate cases but still expect 100 basis points of improvement in the efficiency ratio to 51%. We think net income can achieve \$311 million and by using a 188 million share EPS denominator arrive at our \$1.66 estimate.

**THIRD QUARTER REVIEW:**

**Revenue:** American posted revenue growth of 1% in the third quarter to \$680 million. In the regulated business, volumetric usage fell 9.1 billion gallons, 7.4%, compared to the third quarter last year, as 11 of the 20 states with regulated operations experienced above average rainfall, cooler temperatures, or both. These usage declines are sequentially worse than the second quarter, which had a 5.3 billion gallon shortfall in send-out. Industrial declines of 15% led the customer groups in terms of percentage change, but residential declines of 4.6 billion gallons accounted for the majority of the weakness. Rate awards of \$51 million implemented over the last 12 months made up the \$44 million consumption shortfall, and revenue grew about 3%. Non-regulated business revenue fell 12%, or \$8.6 million, due to a \$7.6 million decline in the contract operations business.

**Operating Costs:** Year over year, total operating & maintenance (O&M) expenses in the quarter were generally flat due in part to the decreased send-out, leading to an improved efficiency ratio of 50% from 51%. Employee costs were up \$12.2 million driven by increased pension costs and benefits expenses. Production costs were up \$2.6 million led by chemical cost increases (26%), a year over year trend that should persist despite somewhat lower chemical costs since the beginning of the year. Depreciation as a percentage of revenue increased slightly to 11% and in absolute terms increased 9.4%, in part due to almost \$600 million in capital spent so far this year. Non-regulated expenses fell \$9.8 million primarily due to reduced activity at a specific project in California.

| O&M Breakdown                      |           |           | % Change |
|------------------------------------|-----------|-----------|----------|
|                                    | 3Q08      | 3Q09      | YOY      |
| Fuel & power                       | 33,789    | 30,804    | -8.8%    |
| Purchased water                    | 28,645    | 29,367    | 2.5%     |
| Chemicals                          | 14,437    | 18,130    | 25.6%    |
| Waste disposal                     | 7,221     | 8,372     | 15.9%    |
| Production costs                   | 84,092    | 86,673    | 3.1%     |
| Salaries and wages                 | 95,598    | 99,778    | 4.4%     |
| Pensions                           | 9,623     | 13,573    | 41.0%    |
| Group Insurance                    | 16,904    | 20,575    | 21.7%    |
| Other benefits                     | 5,259     | 5,707     | 8.5%     |
| Employee-related costs             | 127,384   | 139,633   | 9.6%     |
| Operating Supplies and services    | 72,152    | 60,227    | -16.5%   |
| Maintenance materials and services | 32,049    | 31,723    | -1.0%    |
| Customer billing and accounting    | 13,445    | 12,690    | -5.6%    |
| Other                              | 13,103    | 9,916     | -24.3%   |
| Total                              | \$342,225 | \$340,862 | -0.4%    |

Source: American Water Works; dollars in thousands

**Interest Expense:** Management has utilized commercial paper for its short term financing and working capital purposes and has not drawn down any of its revolving credit facility. Considering continued rate case filings, long term debt has replaced short term debt in the capital structure (commercial paper outstanding was down to \$42 million at October 30<sup>th</sup> vs. \$214 million at September 30<sup>th</sup>). Third quarter interest expense grew only 2% over the same period last year to 11% of revenue – a figure we expect to increase in the fourth quarter, but remain relatively constant in 2010.

Wet, cool weather in concentrated customer areas will always be the wildcard for water utility results in the summer months. Distinguishing between weather related impact, general lower ongoing usage patterns, and economic related volume declines is difficult. However, we think that the weather related impact trumps the other catalysts for reduced send-out and would not expect such a severe negative impact in the future, since weather patterns typically revert back to their mean.

| Annual Earnings Statement  |          |        |        |        |          |          |        |        |        |          | American Water Works, Inc. |        |        |        |          |          |
|--|----------|--------|--------|--------|----------|----------|--------|--------|--------|----------|----------------------------|--------|--------|--------|----------|----------|
| Debra G. Coy/Heike M. Doerr  |          |        |        |        |          |          |        |        |        |          |                            |        |        |        |          |          |
| <i>(dollars in millions, except per share data)</i>  |          |        |        |        |          |          |        |        |        |          |                            |        |        |        |          |          |
| <i>FY ends December 31</i>   | 1Q08     | 2Q08   | 3Q08   | 4Q08   | 2008     | 1Q09     | 2Q09   | 3Q09   | 4Q09E  | 2009E    | 1Q10E                      | 2Q10E  | 3Q10E  | 4Q10E  | 2010E    | 2011E    |
| <b>Total Operating Revenue</b>   | 506.82   | 589.37 | 672.19 | 568.55 | 2,336.93 | 550.17   | 612.74 | 679.96 | 591.82 | 2,434.69 | 587.36                     | 659.04 | 738.23 | 636.98 | 2,621.61 | 2,819.86 |
| <b>Expenses</b>  |          |        |        |        |          |          |        |        |        |          |                            |        |        |        |          |          |
| Operation & Maintenance  | 311.26   | 330.58 | 342.23 | 319.74 | 1,303.80 | 314.40   | 330.60 | 340.86 | 321.95 | 1,307.81 | 328.33                     | 340.72 | 352.14 | 335.69 | 1,356.88 | 1,435.31 |
| Depreciation & Amortization  | 63.92    | 67.31  | 68.38  | 71.66  | 271.26   | 68.84    | 73.24  | 74.85  | 76.34  | 293.28   | 76.36                      | 77.11  | 78.99  | 78.99  | 311.44   | 332.74   |
| General Taxes  | 52.07    | 49.63  | 49.38  | 48.07  | 199.14   | 52.50    | 51.70  | 50.62  | 51.49  | 206.30   | 54.04                      | 54.70  | 53.15  | 54.14  | 216.03   | 231.23   |
| (Gain) loss on sale of assets  | (0.07)   | (0.80) | 0.46   | 0.04   | (0.37)   | (0.20)   | 0.01   | (0.78) | -      | (0.98)   | -                          | -      | -      | -      | -        | -        |
| Impairment charges   | 750.00   | -      | -      | -      | 750.00   | 450.00   | -      | -      | -      | 450.00   | -                          | -      | -      | -      | -        | -        |
| <b>Total Expenses</b>  | 1,177.17 | 446.71 | 460.44 | 439.50 | 2,523.82 | 885.54   | 465.55 | 465.55 | 449.78 | 2,256.42 | 458.72                     | 472.53 | 484.28 | 468.82 | 1,884.36 | 1,999.28 |
| <b>Income from Operations</b>  | (670.36) | 142.66 | 211.75 | 129.05 | (166.90) | (335.37) | 157.19 | 214.41 | 142.04 | 178.26   | 128.63                     | 186.51 | 253.95 | 168.16 | 737.25   | 820.58   |
| <b>Operating Margin (%)</b>  | -132.3%  | 24.2%  | 31.5%  | 22.7%  | -8.0%    | -61.0%   | 25.7%  | 31.5%  | 24.0%  | 7.3%     | 21.9%                      | 28.3%  | 34.4%  | 26.4%  | 28.1%    | 29.1%    |
| Allowance for funds used during construction   | 2.54     | 3.39   | 4.44   | 4.13   | 14.50    | 3.34     | 3.58   | 2.29   | 3.00   | 12.21    | 3.90                       | 3.90   | 3.80   | 3.80   | 15.20    | 15.00    |
| Allowance for borrowed funds used during construc  | 1.37     | 1.73   | 2.97   | 2.11   | 8.17     | 1.67     | 1.99   | 1.67   | 2.00   | 7.54     | 2.50                       | 2.50   | 2.50   | 2.50   | 10.00    | 10.00    |
| Amortization of debt expense   | (1.32)   | (1.44) | (1.60) | (1.54) | (5.90)   | (1.49)   | (1.54) | (2.14) | (1.50) | (6.66)   | (1.60)                     | (1.60) | (1.60) | (1.60) | (6.40)   | (6.00)   |
| Dividends on Preferred Stock of Subs.  | (0.06)   | (0.06) | (0.06) | (0.06) | (0.22)   | 0.00     | 0.00   | 0.00   | -      | -        | -                          | -      | -      | -      | -        | (0.22)   |
| Other, net   | 1.21     | (0.54) | 0.88   | 3.37   | 4.91     | 1.11     | (1.41) | (0.31) | -      | (0.61)   | -                          | -      | -      | -      | -        | -        |
| <b>EBIT</b>  | (666.62) | 145.73 | 218.39 | 137.06 | (165.44) | (330.53) | 159.81 | 215.93 | 145.54 | 190.75   | 133.33                     | 191.21 | 258.65 | 172.86 | 756.05   | 839.36   |
| <i>Adjusted EBIT*</i>  | 76.48    | 142.66 | 211.75 | 129.05 | 563.10   | 114.63   | 159.81 | 214.41 | 142.04 | 628.26   | 128.63                     | 186.51 | 253.95 | 168.16 | 737.25   | 820.58   |
| <b>EBITDA</b>  | 140.4    | 210.0  | 280.1  | 200.7  | 831.2    | 183.5    | 233.1  | 289.3  | 218.4  | 921.5    | 205.0                      | 263.6  | 332.9  | 247.1  | 1,048.7  | 1,153.3  |
| <b>EBITDA Margin %</b>   | 27.7%    | 35.6%  | 41.7%  | 35.3%  | 35.6%    | 33.3%    | 38.0%  | 42.5%  | 36.9%  | 37.9%    | 34.9%                      | 40.0%  | 45.1%  | 38.8%  | 40.0%    | 40.9%    |
| Interest Expense, net  | 69.97    | 70.07  | 72.68  | 72.44  | 285.16   | 71.98    | 73.69  | 74.12  | 76.00  | 295.79   | 78.00                      | 78.00  | 80.00  | 82.00  | 318.00   | 325.00   |
| <b>Income Before Taxes</b>   | (736.59) | 75.66  | 145.71 | 64.62  | (450.59) | (402.51) | 86.13  | 141.80 | 69.54  | (105.04) | 55.33                      | 113.21 | 178.65 | 90.86  | 438.05   | 514.36   |
| <b>Extraord. Item—merger expenses</b>  |          |        |        |        |          |          |        |        |        |          |                            |        |        |        |          |          |
| Provision for Income Taxes   | (4.10)   | 30.17  | 57.55  | 28.22  | 111.83   | 10.57    | 34.14  | 50.17  | 27.47  | 122.34   | 21.86                      | 44.72  | 70.57  | 35.89  | 173.03   | 203.17   |
| Implied Tax Rate   | NM       | 39.9%  | 39.5%  | 43.7%  | -24.8%   | -2.6%    | 39.6%  | 35.4%  | 39.5%  | -116.5%  | 39.5%                      | 39.5%  | 39.5%  | 39.5%  | 39.5%    | 39.5%    |
| <b>Income (cont ops)</b>   | (732.48) | 45.50  | 88.16  | 36.41  | (562.42) | (413.08) | 51.99  | 91.64  | 42.07  | (227.38) | 33.48                      | 68.49  | 108.08 | 54.97  | 265.02   | 311.19   |
| <b>Income (loss) on discontinued ops</b>   | -        | -      | -      | -      | -        | -        | -      | -      | -      | -        | -                          | -      | -      | -      | -        | -        |
| <b>Net Income</b>  | (732.48) | 45.50  | 88.16  | 36.41  | (562.42) | (413.08) | 51.99  | 91.64  | 42.07  | (227.38) | 33.48                      | 68.49  | 108.08 | 54.97  | 265.02   | 311.19   |
| <b>Net Income Available to Common</b>  | (732.48) | 45.50  | 88.16  | 36.41  | (562.42) | (413.08) | 51.99  | 91.64  | 42.07  | (227.38) | 33.48                      | 68.49  | 108.08 | 54.97  | 265.02   | 311.19   |
| One time impairment charges, SOX and divestiture costs, net of tax 2006-07; impairment charges only 2008 | 738.5    | 3.10   | -      | -      | 741.6    | 443.0    | 0.0    | -      | -      | 443.0    | -                          | -      | -      | -      | -        | -        |
| <b>Net income, ex impairment charges</b>   | 5.99     | 48.60  | 88.16  | 36.41  | 179.15   | 29.95    | 51.99  | 91.64  | 42.07  | 215.64   | 33.48                      | 68.49  | 108.08 | 54.97  | 265.02   | 311.19   |
| <b>EPS (fully diluted)</b>   | (\$4.58) | \$0.28 | \$0.55 | \$0.23 | (\$3.52) | (\$2.58) | \$0.32 | \$0.52 | \$0.24 | (\$1.35) | \$0.19                     | \$0.39 | \$0.60 | \$0.30 | \$1.48   | \$1.66   |
| <b>EPS ex impairment charges</b>   | \$0.04   | \$0.30 | \$0.55 | \$0.23 | 1.12     | \$0.19   | \$0.32 | \$0.52 | \$0.24 | \$1.28   | \$0.19                     | \$0.39 | \$0.60 | \$0.30 | \$1.48   | \$1.66   |
| Weighted Avg. Shares   | 160.0    | 160.0  | 160.0  | 160.0  | 160.0    | 160.0    | 163.6  | 174.7  | 174.8  | 168.3    | 175.0                      | 175.2  | 180.1  | 185.0  | 178.8    | 188.0    |

\*Adjusted EBIT = earnings before interest and income taxes for continuing ops  
Source: Company reports and JMS estimates

## Company Description

American Water is the largest investor-owned water and wastewater utility in the U.S., serving approximately 15.6 million people in 32 states across the U.S. & Ontario, Canada. Its primary business as a regulated utility operation accounts for 90% of revenue, supplemented by small, but growing, non-regulated businesses.

## IMPORTANT DISCLOSURES

### Research Analyst Certification

I, Debra G. Coy and Heike M. Doerr, 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 AWK, 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 AWK security in the past 12 months.

Janney Montgomery Scott or an affiliate received compensation for investment banking services from AWK security in the past 12 months.

Janney Montgomery Scott may seek compensation for investment banking services from the subject company (ies) AWK 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.

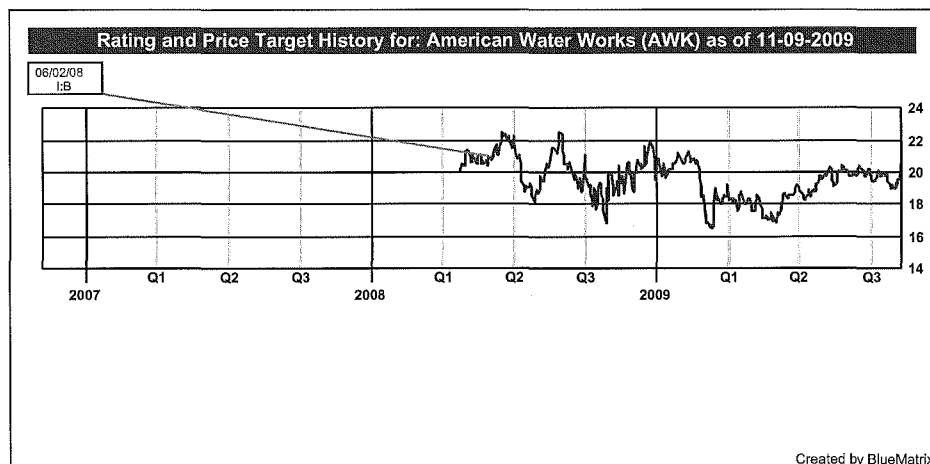
### Definition of Ratings

**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 9/30/09**

| Rating      | Count | Percent | IB Serv./Past 12 Mos. |         |
|-------------|-------|---------|-----------------------|---------|
|             |       |         | Count                 | Percent |
| BUY [B]     | 140   | 49      | 15                    | 3.50    |
| NEUTRAL [N] | 139   | 49      | 4                     | 4.14    |
| SELL [S]    | 5     | 2.00    | 0                     | 0.00    |

**\*Percentages of each rating category where Janney has performed Investment Banking services over the past 12 months.**

**Other Disclosures**

Investment opinions are based on each stock's 6-12 month return potential. Our ratings are not based on formal price targets, however our analysts will discuss fair value and/or target price ranges in research reports. Decisions to buy or sell a stock should be based on the investor's investment objectives and risk tolerance and should not rely solely on the rating. Investors should read carefully the entire research report, which provides a more complete discussion of the analyst's views.

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CAPITAL MARKETS

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American Water Works

AWK - BUY

December 8, 2009

Water

**American Water Works**

(AWK) - BUY

**Price:** **\$21.76**  
Fair Value Estimate: \$26.00  
52-Week Range: \$22.50-\$16.22  
Market Cap (MM): \$3,799  
Shr.O/S-Diluted (mm): 174.6  
Average Daily Volume: 1,656,676  
Dividend: \$0.82  
Yield: 3.8%

| FYE: Dec   | 2008A  | 2009E  | 2010E  | 2011E  |
|------------|--------|--------|--------|--------|
| EPS:       | \$1.12 | \$1.28 | \$1.48 | \$1.66 |
| Prior EPS: | NC     | NC     | NC     | NC     |
| P/E Ratio: | 19.4x  | 17.0x  | 14.7x  | 13.1x  |

Quarterly EPS:

| Q1     | Q2      | Q3     | Q4 |
|--------|---------|--------|----|
| \$0.04 | \$0.19A | \$0.19 | -- |
| \$0.30 | \$0.32A | \$0.39 | -- |
| \$0.55 | \$0.52A | \$0.60 | -- |
| \$0.23 | \$0.24  | \$0.30 | -- |

EPS: Excludes impairment charges

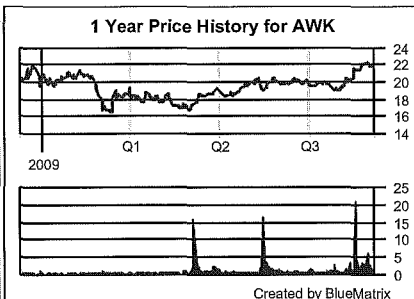
**Out From the Shadow, Into the Spotlight**

**INVESTMENT CONCLUSION:**

Now that American Water is finally out from under the shadow of former parent RWE, the focus is on the company's own performance. With the RWE overhang gone, the stock has moved up from its lows, but it is still trading at a discount to peers. Investors who are new to American Water seem to be waiting a bit cautiously for the company to prove that it can manage the business – and the balance sheet – to generate improved returns on its existing assets as well as future growth. At its first analyst meeting post-IPO, held in New York this week, the company showcased the depth of its management bench and reiterated its strategy for proactive regulatory relations and rate recovery. It also gave more insight into an ambitious program for additional investment, complemented by pursuit of “asset light” expansion via contracts and partnerships. This is clearly a growth-oriented strategy that should be able to deliver American’s targeted 7-10% earnings growth for years to come, after its initial “rate case catch-up” period is complete. We reiterate our BUY rating and \$26 fair value.

**KEY POINTS:**

- **The business case:** Essentially, American is saying that it believes it has the regulatory and community relationships to continue to allow it to spend \$0.8 - \$1.0 billion per year on infrastructure investment – with ongoing debt and equity issuance – and get a sufficient return on that investment to generate shareholder returns. The company is also beginning to outline a significant acquisition and public-private partnership strategy that it expects to develop over the next three to five years, which could require additional capital infusion. Obviously, a higher stock price and higher price to book multiple – American’s is currently at the low end for the group – would make this strategy more cost-effective; hence the importance of investor buy-in for the company’s story.
- **Growth:** Perhaps the business development portion of the meeting had the most “new” information for investors, since it has received limited attention so far on quarterly calls. American noted that it has only about a 2.2% market share in the \$90 billion U.S. water market and sees acquisition opportunities in the 66% of the market that is municipally owned as well as in the 14% of the market comprised of engineering, consulting, operating, and other services firms. On the municipal side, the company said it sees mid-size municipal systems as a target rich group, particularly given high infrastructure costs and local budget issues. The business development team has developed a proprietary database of municipalities that would be well-suited to partnering with American, either via asset sales, a long-term concession, or operating contact. Some of these opportunities, which will develop gradually over the next several years, would require capital – others may be “asset light”, utilizing funding from other sources, including private infrastructure funds.



Equity Research  
**Note**

Research Analyst Certifications and Important Disclosures  
are on pages 3 - 4 of this report

- Regulation focus:** In detailed presentations from several of its executives, the company emphasized that not only state regulatory but local community relationships are critical to its success in continuing to generate the rate increases necessary to pay for investments. American is targeting its large capital spending program to best match discretionary investment with the most attractive returns. Management noted that its adjusted (taking into account goodwill) return on equity at the state level is still only about 6.5%, relative to the allowed levels of 10-11%. This implies the key earnings driver over the next three years will continue to be regulated rate cases to catch up on this regulatory lag.
- Financial focus:** With the top line mainly dependent on regulated rates and on sales volumes (which are sensitive to weather), controlling operating costs is critical to the bottom line. The company noted margin improvement despite a difficult weather year so far in 2009 and said it is in the “middle innings” of improving its cost structure, after having had to invest pre-IPO on re-filling necessary customer service and regulatory resources neglected during the RWE period. Cost management should assist the company in achieving its return targets without being entirely dependent on rate filings.
- Earnings outlook:** The company gave some additional color on the 22 cents of volume-related impact on earnings year to date in 2009. Management noted that this is a “high end” estimate based on normalized volumes. However, the company also noted that it will likely have to catch up on some deferred costs from 2009, so even a weather and economy rebound wouldn’t likely drive all the earnings to the bottom line. We will review our earnings outlook after the company reports year-end earnings in March.
- Valuation:** We reiterate our BUY rating and \$26 fair value based on our current outlook for 2010 and 2011. This is based on P/E multiples of 17.5x and 16x for 2010 and 2011, respectively, and EV/EBITDA multiples of 9.4x and 8.6x. Over time, we believe the stock has further upside, with room for valuation expansion supported by earnings growth.

| Current Data Points  |         |
|--|---------|
| Price  | \$21.76 |
| Shares outstanding   | 174.7   |
| Market cap (\$ mil)  | 3,801.3 |
| Total debt/total capital   | 57.3%   |
| Total debt   | 5,352.6 |
| Net debt   | 5,344.8 |
| Shareholders equity  | 3,987.3 |
| Adjusted shareholders equity*  | 3,262.2 |
| Est. 2009 ROE, excl goodwill   | 5.4%    |
| Est. 2009 ROE on adjusted equity   | 6.6%    |
| Book value/share   | \$22.82 |
| Price/Book   | 1.0x    |
| Goodwill   | 1,250.1 |
| Adjusted book value/share  | \$18.67 |
| Price/book, adjusted   | 1.2x    |
| 2009 Dividend  | \$0.82  |
| Dividend Payout Ratio**  | 64%     |
| Yield  | 3.8%    |
| *Adjusted equity includes est. portion of goodwill captured in rate base for ROE |         |
| **Payout ratio based on 2009E EPS excl. impairment chg                           |         |

Source: Company data, Janney Estimates

| American Water Works (AWK)  |         |         |         |         |
|-----------------------------|---------|---------|---------|---------|
|                             | 2008    | 2009E   | 2010E   | 2011E   |
| Sales (\$ bil)              | 2,336.9 | 2,434.7 | 2,621.6 | 2,819.9 |
| Revenue growth              | 5.5%    | 4.2%    | 7.7%    | 7.6%    |
| Price/Sales                 | 1.6x    | 1.6x    | 1.4x    | 1.3x    |
| EBITDA (\$ mil)             | 831.2   | 921.5   | 1,048.7 | 1,153.3 |
| EBITDA Growth               | 5.1%    | 10.9%   | 13.8%   | 10.0%   |
| Price/EBITDA                | 4.6x    | 4.1x    | 3.6x    | 3.3x    |
| EV/EBITDA                   | 11.0x   | 9.9x    | 8.7x    | 7.9x    |
| Reported net income         | (562.4) | (227.4) | 265.0   | 311.2   |
| Impairment & one-time costs | 741.6   | 443.0   | -       | -       |
| Net income ex impairment*   | 179.2   | 215.6   | 265.0   | 311.2   |
| EPS ex one-time items       | \$1.12  | \$1.28  | \$1.48  | \$1.66  |
| EPS Growth                  | -5.2%   | 14.5%   | 15.7%   | 11.7%   |
| P/E                         | 19.4x   | 17.0x   | 14.7x   | 13.1x   |

\*Net income ex impairment and one-time costs, net of tax

Source: Company data, Janney Estimates

## **Company Description**

*American Water is the largest investor-owned water and wastewater utility in the U.S., serving approximately 15.6 million people in 32 states across the U.S. & Ontario, Canada. Its primary business as a regulated utility operation accounts for 90% of revenue, supplemented by small, but growing, non-regulated businesses.*

## **IMPORTANT DISCLOSURES**

### **Research Analyst Certification**

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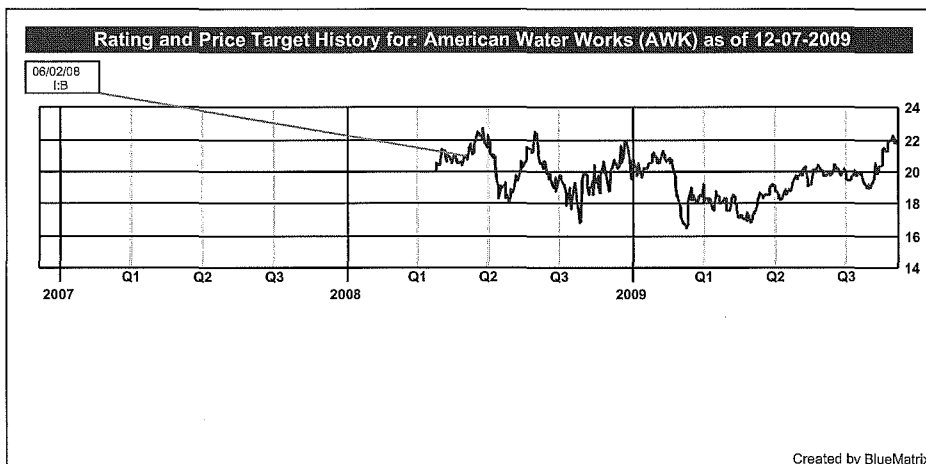
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**SELL:** Janney expects that the subject company will likely decline in value and will underperform comparable companies within its sector.

## **Price Charts**



**Janney Montgomery Scott Ratings Distribution as of 9/30/09**

| Rating      | IB Serv./Past 12 Mos. |         |       |         |
|-------------|-----------------------|---------|-------|---------|
|             | Count                 | Percent | Count | Percent |
| BUY [B]     | 140                   | 49      | 15    | 3.50    |
| NEUTRAL [N] | 139                   | 49      | 4     | 4.14    |
| SELL [S]    | 5                     | 2.00    | 0     | 0.00    |

**\*Percentages of each rating category where Janney has performed Investment Banking services over the past 12 months.**

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Aqua America, Inc.

WTR - BUY

February 26, 2010

**Water**

**Aqua America, Inc.**

**(WTR) - BUY**

**Price:** **\$17.49**  
Fair Value Estimate: \$20.00  
52-Week Range: \$20.37-\$15.39  
Market Cap (MM): \$2,354  
Shr.O/S-Diluted (mm): 136.3  
Average Daily Volume: 989,038  
Dividend: \$0.58  
Yield: 3.4%

| FYE: Dec   | 2009A  | 2010E  | 2011E  |
|------------|--------|--------|--------|
| EPS:       | \$0.77 | \$0.85 | \$0.95 |
| Prior EPS: | \$0.89 | NC     |        |
| P/E Ratio: | 22.7x  | 20.6x  | 18.4x  |

Quarterly EPS:

|    |        |        |    |
|----|--------|--------|----|
| Q1 | \$0.14 | \$0.15 | -- |
| Q2 | \$0.19 | \$0.20 | -- |
| Q3 | \$0.25 | \$0.28 | -- |
| Q4 | \$0.20 | \$0.22 | -- |

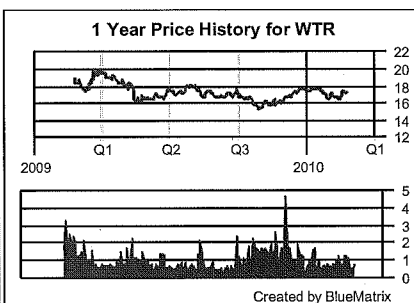
**Holding On For a Rebound in 2010 - Maintain BUY**

**INVESTMENT CONCLUSION:**

During 2009, Aqua America faced strong headwinds including abnormally wet summer weather leading to significant usage declines in the Mid-Atlantic region. Additionally, organic growth slowed amidst a constrained economic environment. Always up to the challenge, Aqua's management did an impressive job weathering the storm by consistently improving its efficiency ratio, accessing low cost debt financing to maintain its capital spending program, and diligently filing for (and receiving) rate relief. The company spent a record \$284 million in capex to improve service reliability and ensure the sustained viability of its earning assets. Though earnings growth has lagged over the past 3-4 years, WTR shares still boast an average annual total return of 11% over the last decade, compared to 5% for the S&P 500 Utilities index and 1% for the Dow. We believe the next two years should show an earnings rebound to the 10-11% range, as macroeconomic factors gradually improve and cost discipline endures. We maintain our BUY rating and \$20 fair value, implying close to 20% total return from current levels.

**KEY POINTS:**

- **Closing out 2009.** Aqua America reported 4Q and 2009 earnings of \$0.20 and \$0.77 respectively, in line with our estimates. The company managed 7% top and bottom line growth in a difficult operating environment, a result of increased rates and cost discipline (the efficiency ratio improved 150 bps to 40.3%). D&A grew 22% over 2008 to represent 17% of revenue, driven by \$550 million in capital spending in 2008-2009. Despite a higher debt load, the company maintained its credit rating and interest expense increased minimally, as the company accessed low cost financing.
- **Regulatory Update.** Aqua received \$37 million in annualized rate awards in 2009 and another \$6 million so far in 2010. Pending cases total \$65 million, primarily in PA and NJ. The company anticipates filing between \$25-\$30 million in annualized revenue requests and surcharges before the end of 2010. Regulatory management has been a strong point for the company, and it continues to work with regulators on consolidating rate structures to reduce filing costs, regulator resources, and customer rate shock.
- **Recalibrating Estimates.** We think Aqua's historical 10% EPS growth target is back within reach over the next 2 years after a hiatus since 2007. We are adjusting our 2010 EPS estimate to \$0.85 from \$0.89 on lower growth assumptions in the first half of the year. Lackluster revenue growth should rebound when increased rates take effect in 3Q, with 3-4 cents of upside potential if a hot dry summer materializes. We introduce a 2011 estimate of \$0.95, representing 11.5% growth.
- **Valuation.** We believe investors have an attractive opportunity to own one of the nation's most efficient water utilities, with one of the best long-term growth records. Our \$20 fair value is based on our 2011 outlook assuming a P/E multiple of 21x and EV/EBITDA multiple of 10x, at the low end of the company's historical valuation range. When combined with a dividend yield of 3.7%, our fair value target offers total return potential of 18%.



**Equity Research Note**

Research Analyst Certifications and Important Disclosures are on pages 4 - 5 of this report

**VALUATION SUMMARY:**

Aqua's shares have remained in a holding pattern between \$16.50 and \$17.50 recently and are unchanged in 2010 compared to the peer group decline around 1.9% (excluding the 15% increase in SouthWest Water). Investor interest has remained muted, evidenced by a falling 12-month rolling average daily volume trend. Short interest increased 1 million shares in the first half of February to 14.8 million shares (or 17 days to cover).

Currently, the water utility group is trading at an average 2011 P/E multiple of 18.3x (based on consensus estimates) and a price/book multiple of 1.6x. Aqua trades in line with the group multiple on 2011 earnings at 18.5x and at a premium price/book multiple of 2x (due to a relatively high debt/total cap ratio of 57%).

We apply P/E multiples of 23.5x and 21x to 2010 and 2011 earnings, respectively, to generate a \$20 fair value. This translates into assumed 2010 and 2011 EV/EBITDA multiples of 11x and 10x. Aqua's earnings potential remains above that of peers that have a more limited geographic footprint. As a result, we believe a modest premium multiple is deserved given the company's growth prospects, lean cost structure, and regulatory leadership. Our expected 2010 dividend of \$0.59 implies a yield around 3.4%, or 18% total return from current levels.

| <b>Aqua America (WTR)</b>   |             |             |              |              |
|-----------------------------|-------------|-------------|--------------|--------------|
|                             | <b>2008</b> | <b>2009</b> | <b>2010E</b> | <b>2011E</b> |
| Sales (\$ mil)              | 627.0       | 670.5       | 723.6        | 785.8        |
| Price/Sales                 | 3.81x       | 3.56x       | 3.30x        | 3.04x        |
| O&M/Revenue                 | 41.8%       | 40.3%       | 39.6%        | 39.4%        |
| EBITDA (\$ mil)             | 325.4       | 355.7       | 390.8        | 425.7        |
| EBITDA growth               | 4.8%        | 9.3%        | 9.9%         | 8.9%         |
| Price/EBITDA                | 7.3x        | 6.7x        | 6.1x         | 5.6x         |
| EV/EBITDA                   | 11.6x       | 10.6x       | 9.6x         | 8.8x         |
| EPS                         | \$0.73      | \$0.77      | \$0.85       | \$0.95       |
| EPS growth                  | 2.2%        | 5.5%        | 11.3%        | 10.9%        |
| P/E                         | 24.1x       | 22.8x       | 20.5x        | 18.5x        |
| Dividend                    | \$0.51      | \$0.55      | \$0.59       | \$0.63       |
| <b>Current Data Points:</b> |             |             |              |              |
| Recent Price                | \$17.49     |             |              |              |
| Current Yield               | 3.4%        |             |              |              |
| Market cap                  | \$2.39 bil  |             |              |              |
| Total debt                  | 1,474 mil   |             |              |              |
| Total Debt/cap              | 57.0%       |             |              |              |
| Book value/Share            | \$8.13      |             |              |              |
| Price/Book                  | 2.2x        |             |              |              |
| ROE (TTM)                   | 9.6%        |             |              |              |

Source: Baseline, JMS Estimates

**ADJUSTING OUR FORWARD ASSUMPTIONS:**

We have lowered our 2010 EPS estimate to \$0.85 from \$0.89 on lower first half growth assumptions. There isn't much to get excited about in the next two quarters, though we expect the third quarter to benefit from rate increases (PA rate case should impact September) and more normalized consumption patterns. Revenue growth of 8% may prove conservative if Mid-Atlantic summer weather reverts to hotter, drier conditions. We expect the company's 2009 efficiency ratio to reach 39.6%, a 70 bps improvement over 2009. Interest expense should increase 6-7% on a higher debt load and expectations of higher short term rates. We estimate that another \$0.03-\$0.04 cents of upside would stem from a hot, dry summer; however, we have taken a more "base case" view in our current forecast.

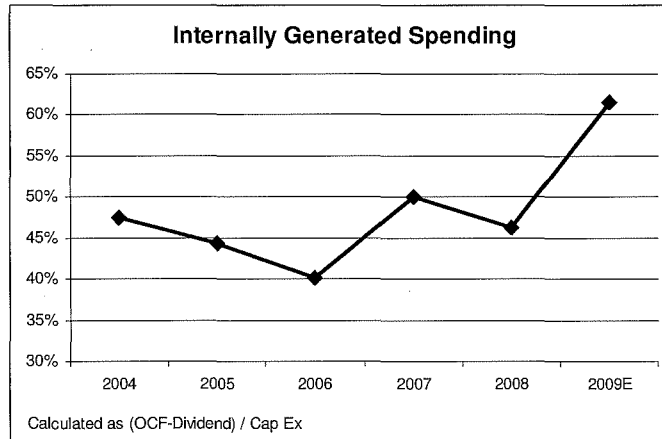
We introduce a 2011 EPS estimate of \$0.95, or 11% growth above 2010. Revenue growth of 8% is expected to benefit from almost three quarters of favorable comps on the inclusion of new PA rates (due to take effect around Aug. 2010), and a full year of higher NJ rates (assuming December 2010 approval). Amortization will decline to more normalized levels as the TX rate case regulatory asset is fully worked down. We assume an efficiency ratio of 39.4%, another 20 bps of improvement over 2010's level. We have not adjusted the share count for a potential equity offering in late 2010 or early 2011, which management indicated could be in the range of 1-1.5 million shares (only about 1% dilution).

**FOURTH QUARTER AND FULL YEAR RESULTS:**

Aqua America reported fourth quarter earnings of \$0.20, in line with our estimate and a penny shy of consensus. The company reported results of \$0.19 per share in the fourth quarter last year. Quarterly revenue increased 5%, below our 6.5% expectation as consumption fell 3-5% due to economic factors (weather is less of a factor in the fourth quarter). Operating cost controls, evidenced by an O&M/revenue ratio below 40%, helped the company earn 36.6% operating margin. Depreciation expenses grew 15% as expected due to investments made in the last year. Interest expense grew 7% to \$19 million on a \$1.7 billion total debt load.

Looking at 2009 in total, revenue grew 7% to \$671 million, as higher water rates offset significant declines in consumption (due to wet weather and the slumping economy). Management aggressively managed costs and improved the efficiency ratio 150bps to 40.3%. EBITDA growth of 9.3% compared favorably to the 4.8% growth last year; though D&A grew 22% in the year, partially due to some regulatory adjustments, and EBIT margin of 36% dipped from the 37% levels we saw the last two years, a result of a difficult third quarter operating environment. Interest expense grew negligibly, leading to \$0.77 in EPS on 1 million more shares outstanding (mainly due to the company's dividend reinvestment program).

The company spent \$284 million in capex during 2009, up about 10% from 2008 levels, and has plans to spend another \$300 million or so in 2010. The company is using internally generated funds to cover a larger portion of its capital budget – approximately 90% in 2009. Using a rough estimate of operating cash flow less the dividend as a percentage of capex, the chart on the right exhibits the company's ability to fund its capital program internally.



| <b>Annual Earnings Statement</b>                    |                  | <b>Aqua America, Inc.</b> |                  |                  |                  |  |
|---|------------------|---------------------------|------------------|------------------|------------------|--|
| <i>(dollars in millions, except per share data)</i> |                  |                           |                  |                  |                  |  |
| <i>FY ends December 31</i>                          | <b>2007</b>      | <b>2008</b>               | <b>2009</b>      | <b>2010E</b>     | <b>2011E</b>     |  |
| <b>Total Operating Revenue</b>                      | <b>\$ 602.50</b> | <b>\$ 626.97</b>          | <b>\$ 670.54</b> | <b>\$ 723.57</b> | <b>\$ 785.76</b> |  |
| <b>Expenses</b>                                     |                  |                           |                  |                  |                  |  |
| Operation & Maintenance                             | 253.09           | 262.12                    | 270.06           | 286.63           | 309.92           |  |
| Depreciation  | 83.18            | 88.79                     | 103.00           | 111.04           | 121.98           |  |
| Amortization  | 4.83             | 5.52                      | 11.94            | 12.52            | 8.15             |  |
| General Taxes                                       | 45.38            | 44.75                     | 48.08            | 49.38            | 53.40            |  |
| <b>Total Expenses</b>                               | <b>386.48</b>    | <b>401.17</b>             | <b>433.08</b>    | <b>459.58</b>    | <b>493.45</b>    |  |
| <b>Income from Operations</b>                       | <b>216.02</b>    | <b>225.80</b>             | <b>237.46</b>    | <b>264.00</b>    | <b>292.31</b>    |  |
| <b>Operating Margin (%)</b>                         | <b>35.9%</b>     | <b>36.0%</b>              | <b>35.4%</b>     | <b>36.5%</b>     | <b>37.2%</b>     |  |
| Allow. for Borrowed Funds Used in Const.            | 2.95             | 3.67                      | 2.87             | 3.00             | 3.00             |  |
| Gain (loss) on sale of properties                   | 3.49             | 1.60                      | 0.47             | 0.60             | 0.60             |  |
| <b>EBIT</b>   | <b>222.46</b>    | <b>231.07</b>             | <b>240.80</b>    | <b>267.24</b>    | <b>295.55</b>    |  |
| <b>EBIT (%)</b>                                     | <b>36.9%</b>     | <b>36.9%</b>              | <b>35.9%</b>     | <b>36.9%</b>     | <b>37.6%</b>     |  |
| Interest Expense                                    | 66.92            | 68.57                     | 68.61            | 72.76            | 78.00            |  |
| <b>Income Before Taxes</b>                          | <b>155.54</b>    | <b>162.50</b>             | <b>172.20</b>    | <b>194.48</b>    | <b>217.55</b>    |  |
| <b>Provision for Income Taxes</b>                   | <b>60.53</b>     | <b>64.58</b>              | <b>67.84</b>     | <b>77.45</b>     | <b>86.73</b>     |  |
| <b>Implied Tax Rate</b>                             | <b>38.9%</b>     | <b>39.7%</b>              | <b>39.4%</b>     | <b>39.8%</b>     | <b>39.9%</b>     |  |
| <b>Net income</b>                                   | <b>\$95.01</b>   | <b>\$97.92</b>            | <b>\$104.35</b>  | <b>\$117.03</b>  | <b>\$130.82</b>  |  |
| <b>EPS (fully diluted)</b>                          | <b>\$0.71</b>    | <b>\$0.73</b>             | <b>\$0.77</b>    | <b>\$0.85</b>    | <b>\$0.95</b>    |  |
| Weighted Avg. Shares                                | 133.6            | 134.8                     | 136.1            | 137.2            | 138.3            |  |

**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, Debra G. Coy and Heike M. Doerr, 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.

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The research analyst primarily responsible for preparing this research report or a member of the research

analyst's household has a financial interest in the securities of the company in the form of options (O),

warrants (W), futures (F), and/or a short position (S).

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.

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**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 12/31/09**

| Rating      | IB Serv./Past 12 Mos. |         |       |         |
|-------------|-----------------------|---------|-------|---------|
|             | Count                 | Percent | Count | Percent |
| BUY [B]     | 164                   | 51.00   | 15    | 9.00    |
| NEUTRAL [N] | 152                   | 47.00   | 7     | 5.00    |
| SELL [S]    | 5                     | 2.00    | 0     | 0.00    |

**\*Percentages of each rating category where Janney has performed Investment Banking services over the past 12 months.**

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J.P.Morgan

North America Equity Research  
05 May 2009

## American Water Works

Solid 1Q09 Beat Should Lift the Shares - Positive for  
Stock - ALERT

**Neutral**

AWK, AWK US

Price: \$17.66

05 May 2009

- **Solid 1Q09 beat should lift the shares.** After market close today, American Water Works posted better-than-expected 1Q09 earnings and robust cash flow, primarily as a result of additional rate increases at its regulated utilities. Moreover, the company appears to be successfully managing expenses as it weathers through the current economic turmoil. We believe the solid 1Q09 results emphasize the stability of AWK's utility business model, and expect the stock to outperform its peer group in tomorrow's trading. Longer term, however, we remain cautious on AWK, as we expect RWE's considerable ownership stake in the company to continue to weigh on the stock.
- **Strong 1Q09 results driven primarily by regulatory improvements.** American Water Works reported ongoing 1Q09 EPS of \$0.19 excluding a \$450 million non-cash goodwill impairment charge. This was modestly ahead of our estimate of \$0.15 per share and the consensus estimate of \$0.13 per share, and compares to EPS of \$0.04 in 1Q08. The solid beat in the quarter was mainly driven by the positive impact of higher rates from rate cases completed throughout 2008, which is in line with our expectations. Going forward, we expect regulated revenues to continue to grow as the company works through the balance of its rate case calendar.
- **Volume trends do not appear to be breaking apart.** In our opinion, one of the main factors that has weighed on AWK shares since the company released 4Q08 results was the fear over a precipitous decline in sales volumes. In fact, about \$0.03 of the difference between our 1Q09 estimate and reported EPS stems from our assumption that sales volumes deteriorate about in line with 4Q08 trends. AWK reported a 3.5% overall decline in sales volumes this quarter, with residential usage down 1.5% and industrial demand down nearly 13%. While the company is certainly experiencing a negative impact of the overall economic weakness, it appears that sales trends, especially on the residential side, have not suffered a major blow. We believe this confirms our view that the majority of American Water's business is resilient and countercyclical, and expect this to support the stock going forward.
- **Conference call details.** Management will host a conference call with investors at 9:00 a.m. EDT tomorrow morning. The dial-in number is: 800-762-8795; pass code: 4058090.

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**Electric Utilities**

**Andrew Smith**<sup>AC</sup>

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North America Equity Research  
05 May 2009

J.P.Morgan

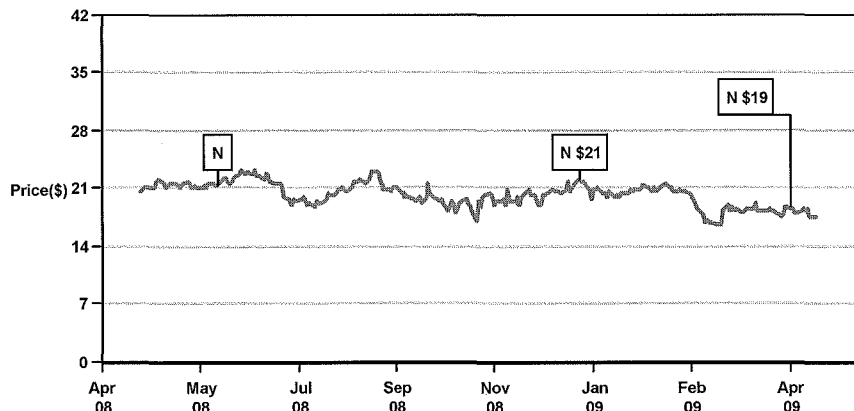
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- **Investment Banking (past 12 months):** JPMSI or its affiliates received in the past 12 months compensation for investment banking services from American Water Works.
- **Investment Banking (next 3 months):** JPMSI or its affiliates expect to receive, or intend to seek, compensation for investment banking services in the next three months from American Water Works.
- **Non-Investment Banking Compensation:** JPMSI has received compensation in the past 12 months for products or services other than investment banking from American Water Works. An affiliate of JPMSI has received compensation in the past 12 months for products or services other than investment banking from American Water Works.

American Water Works (AWK) Price Chart



| Date      | Rating | Share Price (\$) | Price Target (\$) |
|-----------|--------|------------------|-------------------|
| 04-Jun-08 | N      | 21.32            | -                 |
| 23-Dec-08 | N      | 22.06            | 21.00             |
| 20-Apr-09 | N      | 18.79            | 19.00             |

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Jun 04, 2008. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period. J.P. Morgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

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J.P. Morgan uses the following rating system: **Overweight** [Over the next six to twelve months, we expect this stock will outperform the average total return of the stocks in the analyst’s (or the analyst’s team’s) coverage universe.] **Neutral** [Over the next six to twelve months, we expect this stock will perform in line with the average total return of the stocks in the analyst’s (or the analyst’s team’s) coverage universe.] **Underweight** [Over the next six to twelve months, we expect this stock will underperform the average total return of the stocks in the analyst’s (or the analyst’s team’s) coverage universe.] The analyst or analyst’s team’s coverage universe is the sector and/or country shown on the cover of each publication. See below for the specific stocks in the certifying analyst(s) coverage universe.

Coverage Universe: **Andrew Smith:** AGL Resources (AGL), Ameren Corp (AEE), American Electric Power (AEP), American Water Works (AWK), CMS Energy Corp (CMS), Consolidated Edison (ED), Constellation Energy Group (CEG), Covanta Holding Corp. (CVA), Dominion Resources (D), Duke Energy Corp. (DUK), Dynegy, Inc. (DYN), Edison International (ELX), Entergy Corp. (ETR), Exelon Corp. (EXC), FPL Group Inc. (FPL), ITC Holdings (ITC), Integrys Energy Group (TEG), NRG Energy (NRG), NV Energy Inc. (NVE), Northeast Utilities (NU), PG&E Corp. (PCG), PNM Resources Inc (PNM), Pepco Holdings (POM), Pinnacle West Capital Corp (PNW), Portland General Electric Co. (POR),

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North America Equity Research  
05 May 2009

J.P.Morgan

Progress Energy (PGN), RRI Energy, Inc (RRI), Sempra Energy (SRE), Southern Company (SO), Unisource Energy (UNS), Vectren Corp (VVC), Westar Energy Inc (WR), Wisconsin Energy Corp (WEC)

**J.P. Morgan Equity Research Ratings Distribution, as of March 31, 2009**

|                                     | <b>Overweight<br/>(buy)</b> | <b>Neutral<br/>(hold)</b> | <b>Underweight<br/>(sell)</b> |
|-------------------------------------|-----------------------------|---------------------------|-------------------------------|
| JPM Global Equity Research Coverage | 35%                         | 46%                       | 19%                           |
| IB clients*                         | 54%                         | 54%                       | 42%                           |
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05 May 2009

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North America Equity Research  
05 August 2009

## American Water Works

### 2Q09 Beat Excluding a Negative Weather Impact Should Lift AWK Shares - ALERT

**Neutral**

**AWK, AWK US**

Price: \$20.00

05 August 2009

• **Headline 2Q09 beat, especially after normalizing for weather, but reduced volumes may continue to worry investors.** American Water Works reported solid 2Q09 results of \$0.32 per share, about in line with expectations. The company noted, however, that the 5.5% decline in overall sales volumes vs. 2Q08 resulted in an \$0.08 hit to EPS, in part driven by wet weather in the Northeast. While it is unclear what portion of the \$0.08 impact is in fact related to weather vs. fundamental weakness in sales volumes due to a weak economy, it is clear that AWK would have beat expectations absent the unusually wet weather in the current quarter, and we expect investors to disregard the weather impact, as weather is mean-reverting. We also caution that investors will likely remain concerned about the underlying weakness in sales trends, but expect solid 2Q09 results to outweigh these concerns. Accordingly, we expect modest outperformance in AWK shares in trading tomorrow, and would look for additional color on water sales trends on the company's conference call.

• **Solid 2Q09 results driven by rate relief and cost cuts.** After market close today, American Water Works reported 2Q09 earnings of \$0.32 per share, slightly ahead of our estimate of \$0.30 and about in line with Bloomberg consensus estimate of \$0.31 per share. This compares to \$0.28 in the year-ago quarter. We note that \$0.02 of the year-over-year increase appears to be related to the absence of divestiture and SOX compliance costs, which were not factored into our forecast. AWK continued to benefit from the resolution of additional rate cases in its regulated utilities, and regulatory actions drove a \$0.17 EPS uplift vs. 2Q08, \$0.03 better than our forecast. This was partly offset by usage declines, primarily due to wet weather in the Northeast, which resulted in an \$0.08 hit to EPS. Higher operating expenses reduced EPS by about \$0.06, better than our expectation for a \$0.09 hit in the quarter. It appears to us that American Water Works is using cost management as a way to counterbalance reduced sales volumes, although we note that the company noted in its 1Q09 call that it is unlikely to continue to hold the line on expenses at the same pace for the balance of the year.

• **Conference call details.** Management will host a conference call with investors at 9:00 a.m. EDT tomorrow morning (8/6/09). The dial-in number is: 877-941-6011; pass code: 4120496.

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05 August 2009

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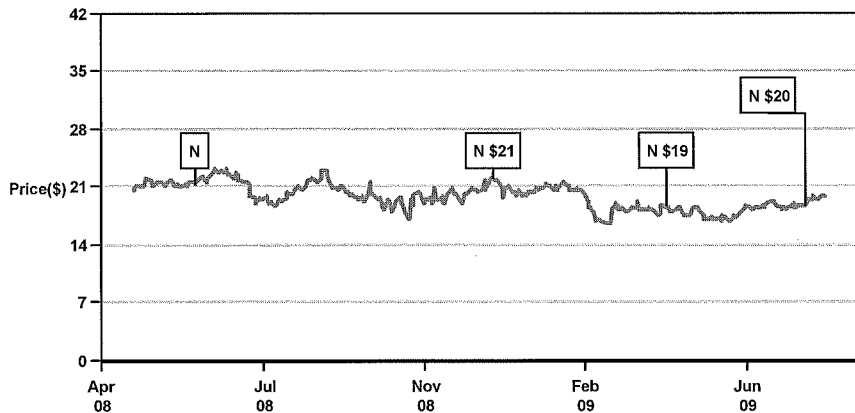
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American Water Works (AWK) Price Chart



| Date      | Rating | Share Price (\$) | Price Target (\$) |
|-----------|--------|------------------|-------------------|
| 04-Jun-08 | N      | 21.32            | -                 |
| 23-Dec-08 | N      | 22.06            | 21.00             |
| 20-Apr-09 | N      | 18.79            | 19.00             |
| 22-Jul-09 | N      | 18.83            | 20.00             |

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Jun 04, 2008. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period. J.P. Morgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

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|                                     | Overweight<br>(buy) | Neutral<br>(hold) | Underweight<br>(sell) |
|-------------------------------------|---------------------|-------------------|-----------------------|
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North America Equity Research  
11 August 2009

## American Water Works

RWE's Continued Exit of Its AWK Stake Reduces  
Near-Term Overhang - Positive for Stock - ALERT

**Neutral**

AWK, AWK US

Price: \$20.22

11 August 2009

- **RWE monetization should drive near-term outperformance in AWK shares.** After market close, Neutral-rated American Water Works announced that its majority shareholder RWE A.G. is selling 30 million shares of AWK common stock, a transaction that would reduce its existing stake in AWK to about 30%. The deal gives the underwriters the option to purchase an additional 4.5 million shares from RWE over a 30-day period, which, if exercised, would further reduce RWE's position to about 26%. We view today's announcement as an incremental positive for AWK as it reduces the near-term overhang on the shares. We note, however, that it does not resolve longer-term structural issues associated with RWE's still-sizable remaining AWK stake.
- **We remain on the sidelines until RWE overhang diminishes further.** Although today's transaction is a step in the right direction in terms of reducing the existing overhang on AWK, we remain on the sidelines at least until the overhang is further reduced because we believe that RWE's sizable remaining position in American Water Works will continue to weigh on the stock. Recall that the German utility has announced its intention to fully exit the U.S. water business as soon as practicable, which we expect to continue to pressure AWK shares. Accordingly, we reiterate our Neutral rating on the stock.

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North America Equity Research  
11 August 2009

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**Other Companies Recommended in This Report (all prices in this report as of market close on 11 August 2009)**  
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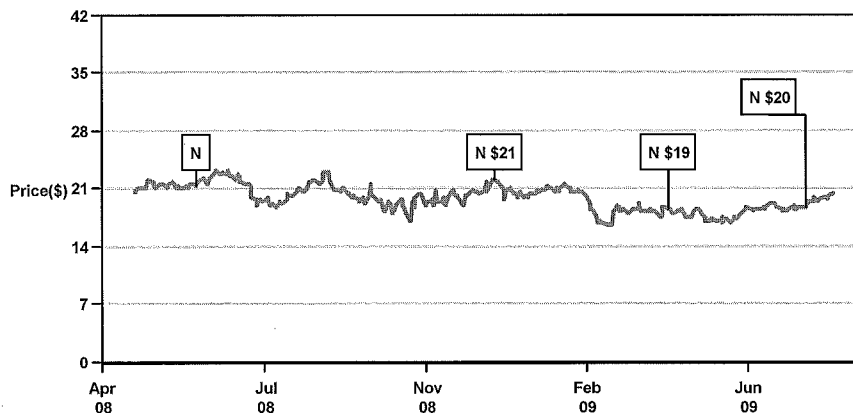
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American Water Works (AWK) Price Chart



| Date      | Rating | Share Price (\$) | Price Target (\$) |
|-----------|--------|------------------|-------------------|
| 04-Jun-08 | N      | 21.32            | -                 |
| 23-Dec-08 | N      | 22.06            | 21.00             |
| 20-Apr-09 | N      | 18.49            | 19.00             |
| 22-Jul-09 | N      | 18.83            | 20.00             |

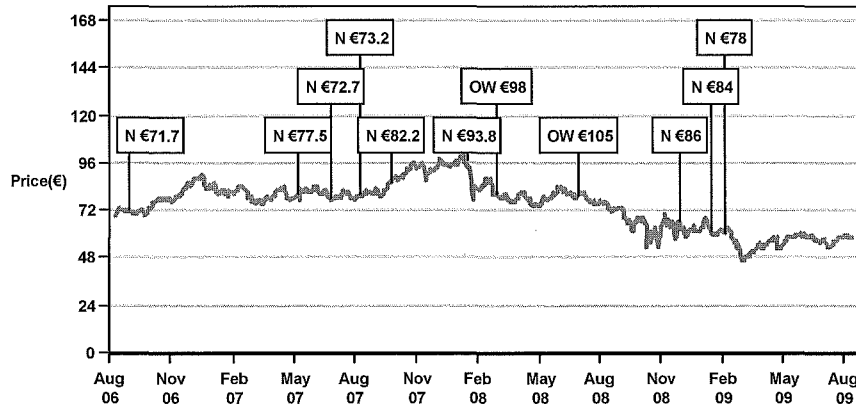
Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.  
Initiated coverage Jun 04, 2008. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.  
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RWE (RWE.G.F) Price Chart



| Date      | Rating | Share Price (€) | Price Target (€) |
|-----------|--------|-----------------|------------------|
| 30-Aug-06 | N      | 71.94           | 71.70            |
| 08-May-07 | N      | 80.00           | 77.50            |
| 25-Jun-07 | N      | 78.46           | 72.70            |
| 09-Aug-07 | N      | 80.25           | 73.20            |
| 25-Sep-07 | N      | 85.66           | 82.20            |
| 14-Jan-08 | N      | 96.84           | 93.80            |
| 29-Feb-08 | OW     | 79.86           | 98.00            |
| 30-Jun-08 | OW     | 78.68           | 105.00           |
| 28-Nov-08 | N      | 65.80           | 86.00            |
| 14-Jan-09 | N      | 61.65           | 84.00            |
| 03-Feb-09 | N      | 60.09           | 78.00            |

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.  
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|-------------------------------------|------------------|----------------|--------------------|
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09 November 2009

## American Water Works

Strong 3Q09 Results Excluding Weak Weather Should  
Lift AWK Shares - ALERT

**Neutral**

AWK, AWK US

Price: \$19.56

06 November 2009

- **Strong underlying 3Q09 results excluding weather should lift AWK shares.** American Water Works reported strong 3Q09 results this morning after normalizing for abnormally wet weather in the quarter. The reported EPS of \$0.52 (vs. our estimate of \$0.55 and the Street estimate of \$0.53) include a hit of \$0.14 related to lower usage, primarily due to wet weather, suggesting that underlying results absent the weather effect were ahead of expectations. Our estimate incorporated an \$0.08/share decline related to lower water usage. Furthermore, AWK management appears to be successful in keeping costs in check, helping to partly offset some of the revenue decline, vs. our assumption for cost escalation of about \$0.06 year-over-year. Accordingly, we expect modest outperformance in AWK shares this morning on the strong 3Q09 results, which in our opinion suggest that fundamentals in the water utility industry remain intact.
- **Conference call details.** Management will host a conference call with investors at 9:00 a.m. EST. The dial-in number is: 877-941-1848; pass code: 4173835.

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Electric Utilities

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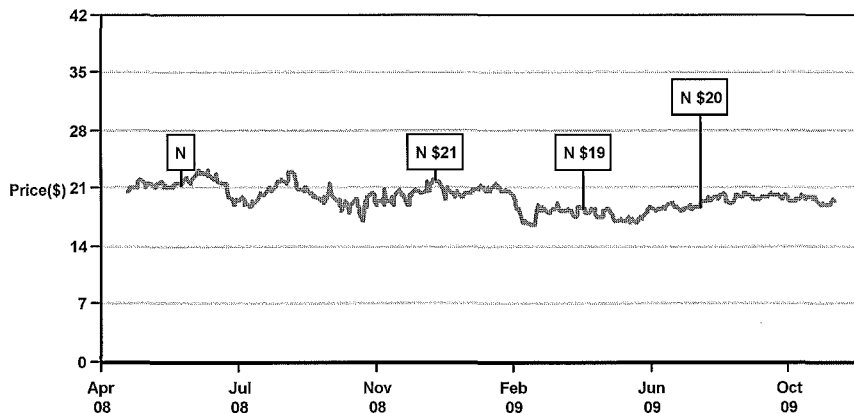
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American Water Works (AWK) Price Chart



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Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Jun 04, 2008. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period. J.P. Morgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

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