

AQUA AMERICA INC  
Form 10-Q  
August 05, 2011

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON DC 20549  
FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 or 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

**For the quarterly period ended June 30, 2011**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 1-6659**

**AQUA AMERICA, INC.**

(Exact name of registrant as specified in its charter)

Pennsylvania

23-1702594

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

762 W. Lancaster Avenue, Bryn Mawr, Pennsylvania

19010 -3489

(Address of principal executive offices)

(Zip Code)

(610) 527-8000

(Registrant's telephone number, including area code)

(Former Name, former address and former fiscal year, if changed since last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12(b)-2 of the Exchange Act.:

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of July 22, 2011:

138,405,123



AQUA AMERICA, INC. AND SUBSIDIARIES  
TABLE OF CONTENTS

	Page
<u>Part I Financial Information</u>	
<u>Item 1. Financial Statements:</u>	
<u>Consolidated Balance Sheets (unaudited) June 30, 2011 and December 31, 2010</u>	2
<u>Consolidated Statements of Income and Comprehensive Income (unaudited) - Six Months Ended June 30, 2011 and 2010</u>	3
<u>Consolidated Statements of Income and Comprehensive Income (unaudited) Three Months Ended June 30, 2011 and 2010</u>	4
<u>Consolidated Statements of Capitalization (unaudited) June 30, 2011 and December 31, 2010</u>	5
<u>Consolidated Statement of Equity (unaudited) Six Months Ended June 30, 2011</u>	6
<u>Consolidated Statements of Cash Flow (unaudited) Six Months Ended June 30, 2011 and 2010</u>	7
<u>Notes to Consolidated Financial Statements (unaudited)</u>	8
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	21
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	28
<u>Item 4. Controls and Procedures</u>	28
<u>Part II Other Information</u>	
<u>Item 1. Legal Proceedings</u>	28
<u>Item 1A. Risk Factors</u>	30
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	31
<u>Item 5. Other Information</u>	32
<u>Item 6. Exhibits</u>	32
<u>Signatures</u>	33
<u>Exhibit Index</u>	34
<u>Exhibit 31.1</u>	
<u>Exhibit 31.2</u>	
<u>Exhibit 32.1</u>	

Exhibit 32.2

EX-101 INSTANCE DOCUMENT

EX-101 SCHEMA DOCUMENT

EX-101 CALCULATION LINKBASE DOCUMENT

EX-101 LABELS LINKBASE DOCUMENT

EX-101 PRESENTATION LINKBASE DOCUMENT

EX-101 DEFINITION LINKBASE DOCUMENT

**Table of Contents**Part 1 Financial Information  
Item 1. Financial StatementsAQUA AMERICA, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(In thousands of dollars, except per share amounts)  
(UNAUDITED)

	June 30, 2011	December 31, 2010
Assets		
Property, plant and equipment, at cost	\$ 4,616,437	\$ 4,488,195
Less: accumulated depreciation	1,060,585	1,020,395
Net property, plant and equipment	3,555,852	3,467,800
Current assets:		
Cash and cash equivalents	6,917	5,934
Accounts receivable and unbilled revenues, net	93,579	85,881
Income tax receivable	33,600	33,600
Deferred income taxes	20,764	
Inventory, materials and supplies	11,794	10,616
Prepayments and other current assets	11,375	10,846
Total current assets	178,029	146,877
Regulatory assets	226,875	217,376
Deferred charges and other assets, net	57,237	65,093
Funds restricted for construction activity	134,411	135,086
Goodwill	40,778	40,234
	\$ 4,193,182	\$ 4,072,466
Liabilities and Equity		
Aqua America stockholders' equity:		
Common stock at \$.50 par value, authorized 300,000,000 shares, issued 139,105,938 and 138,449,039 in 2011 and 2010	\$ 69,552	\$ 69,223
Capital in excess of par value	676,888	664,369
Retained earnings	477,574	452,470
Treasury stock, at cost, 703,065 and 673,472 shares in 2011 and 2010	(12,980)	(12,307)
Accumulated other comprehensive income	522	499
Total Aqua America stockholders' equity	1,211,556	1,174,254
Noncontrolling interest	581	572
Total equity	1,212,137	1,174,826

Edgar Filing: AQUA AMERICA INC - Form 10-Q

Long-term debt, excluding current portion	1,468,525	1,531,976
Commitments and contingencies		
Current liabilities:		
Current portion of long-term debt	90,502	28,413
Loans payable	118,884	89,668
Accounts payable	42,708	45,382
Accrued interest	16,930	15,891
Accrued taxes	10,632	16,401
Other accrued liabilities	27,226	27,960
Total current liabilities	306,882	223,715
Deferred credits and other liabilities:		
Deferred income taxes and investment tax credits	545,102	478,705
Customers advances for construction	66,143	66,966
Regulatory liabilities	39,489	35,921
Other	107,122	116,250
Total deferred credits and other liabilities	757,856	697,842
Contributions in aid of construction	447,782	444,107
	\$ 4,193,182	\$ 4,072,466

See notes to consolidated financial statements beginning on page 8 of this report.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME  
(In thousands, except per share amounts)  
(UNAUDITED)

	Six Months Ended June 30,	
	2011	2010
Operating revenues	\$ 359,553	\$ 338,961
Operating expenses:		
Operations and maintenance	137,762	136,911
Depreciation	54,871	53,002
Amortization	3,887	6,486
Taxes other than income taxes	27,211	25,803
	223,731	222,202
Operating income	135,822	116,759
Other expense (income):		
Interest expense, net	40,049	36,934
Allowance for funds used during construction	(3,909)	(3,002)
Gain on sale of other assets	(259)	(2,039)
Income before income taxes	99,941	84,866
Provision for income taxes	32,000	33,500
Net income attributable to common shareholders	\$ 67,941	\$ 51,366
Net income attributable to common shareholders	\$ 67,941	\$ 51,366
Other comprehensive income, net of tax:		
Unrealized holding gain on investments	96	902
Reclassification adjustment for gains reported in net income	(73)	(1,330)
Comprehensive income	\$ 67,964	\$ 50,938
Net income per common share:		
Basic	\$ 0.49	\$ 0.38
Diluted	\$ 0.49	\$ 0.38
Average common shares outstanding during the period:		
Basic	137,971	136,647



Diluted	138,518	136,960
Cash dividends declared per common share	\$ 0.31	\$ 0.29

See notes to consolidated financial statements beginning on page 8 of this report.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME  
(In thousands, except per share amounts)  
(UNAUDITED)

	Three Months Ended June 30,	
	2011	2010
Operating revenues	\$ 188,229	\$ 178,444
Operating expenses:		
Operations and maintenance	70,437	69,310
Depreciation	27,578	26,802
Amortization	1,931	3,314
Taxes other than income taxes	13,446	12,943
	113,392	112,369
Operating income	74,837	66,075
Other expense (income):		
Interest expense, net	20,106	18,504
Allowance for funds used during construction	(1,932)	(1,461)
Gain on sale of other assets	(138)	(110)
Income before income taxes	56,801	49,142
Provision for income taxes	19,211	19,287
Net income attributable to common shareholders	\$ 37,590	\$ 29,855
Net income attributable to common shareholders	\$ 37,590	\$ 29,855
Other comprehensive income, net of tax:		
Unrealized holding gain on investments	92	
Reclassification adjustment for gain reported in net income	(71)	
Comprehensive income	\$ 37,611	\$ 29,855
Net income per common share:		
Basic	\$ 0.27	\$ 0.22
Diluted	\$ 0.27	\$ 0.22
Average common shares outstanding during the period:		
Basic	138,114	136,785

Diluted	138,781	137,012
Cash dividends declared per common share	\$ 0.155	\$ 0.145

See notes to consolidated financial statements beginning on page 8 of this report.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CAPITALIZATION  
(In thousands of dollars, except per share amounts)  
(UNAUDITED)

	June 30, 2011	December 31, 2010		
Aqua America stockholders' equity:				
Common stock, \$.50 par value	\$ 69,552	\$ 69,223		
Capital in excess of par value	676,888	664,369		
Retained earnings	477,574	452,470		
Treasury stock, at cost	(12,980)	(12,307)		
Accumulated other comprehensive income	522	499		
 Total Aqua America stockholders' equity	 1,211,556	 1,174,254		
 Noncontrolling interest	 581	 572		
 Total equity	 1,212,137	 1,174,826		
 Long-term debt:				
Long-term debt of subsidiaries (substantially secured by utility plant):				
	Interest Rate Range	Maturity Date Range		
	0.00% to 0.99%	2012 to 2034	6,468	6,632
	1.00% to 1.99%	2011 to 2035	26,044	22,758
	2.00% to 2.99%	2019 to 2029	13,904	13,461
	3.00% to 3.99%	2016 to 2030	25,636	26,548
	4.00% to 4.99%	2020 to 2043	367,698	367,854
	5.00% to 5.99%	2012 to 2043	429,512	429,663
	6.00% to 6.99%	2011 to 2036	78,243	78,232
	7.00% to 7.99%	2012 to 2025	29,585	30,155
	8.00% to 8.99%	2021 to 2025	34,111	34,260
	9.00% to 9.99%	2011 to 2026	44,694	44,694
	10.40%	2018	6,000	6,000
			1,061,895	1,060,257
 Notes payable to bank under revolving credit agreement, variable rate, due May 2012			62,000	65,000
Unsecured notes payable:				
Notes ranging from 4.62% to 4.87%, due 2013 through 2024			193,000	193,000
Notes ranging from 5.01% to 5.95%, due 2014 through 2037			242,132	242,132

Edgar Filing: AQUA AMERICA INC - Form 10-Q

Current portion of long-term debt	1,559,027	1,560,389
	90,502	28,413
Long-term debt, excluding current portion	1,468,525	1,531,976
Total capitalization	\$ 2,680,662	\$ 2,706,802

See notes to consolidated financial statements beginning on page 8 of this report.

**Table of Contents**AQUA AMERICA, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF EQUITY

(In thousands of dollars)

(UNAUDITED)

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Total
Balance at December 31, 2010	\$ 69,223	\$ 664,369	\$ 452,470	\$ (12,307)	\$ 499	\$ 572	\$ 1,174,826
Net income			67,941			9	67,950
Unrealized holding gain on investments, net of income tax of \$52					96		96
Reclassification adjustment for gain reported in net income, net of income tax of \$39					(73)		(73)
Dividends paid			(42,813)				(42,813)
Sale of stock (299,441 shares)	143	5,920		325			6,388
Repurchase of stock (44,014 shares)				(998)			(998)
Equity compensation plan (14,716 shares)	7	(7)					
Exercise of stock options (357,703 shares)	179	5,388					5,567
Stock-based compensation		1,727	(24)				1,703
Employee stock plan tax benefits		(509)					(509)
Balance at June 30, 2011	\$ 69,552	\$ 676,888	\$ 477,574	\$ (12,980)	\$ 522	\$ 581	\$ 1,212,137

See notes to consolidated financial statements beginning on page 8 of this report.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOW  
(In thousands of dollars)  
(UNAUDITED)

	Six Months Ended June 30,	
	2011	2010
Cash flows from operating activities:		
Net income attributable to common shareholders	\$ 67,941	\$ 51,366
Adjustments to reconcile net income attributable to common shareholders to net cash flows from operating activities:		
Depreciation and amortization	58,758	59,488
Deferred income taxes	33,216	4,495
Provision for doubtful accounts	2,202	2,233
Stock-based compensation	1,727	2,159
Gain on sale of utility system	(4,317)	
Gain on sale of other assets	(259)	(2,039)
Net increase in receivables, inventory and prepayments	(12,806)	(8,394)
Net decrease in payables, accrued interest, accrued taxes and other accrued liabilities	(996)	(6,684)
Other	(9,522)	(3,233)
Net cash flows from operating activities	135,944	99,391
Cash flows from investing activities:		
Property, plant and equipment additions, including allowance for funds used during construction of \$3,909 and \$3,002	(142,844)	(140,767)
Acquisitions of utility systems and other, net	(6,533)	(1,621)
Additions to funds restricted for construction activity	(119)	(1,020)
Release of funds previously restricted for construction activity	794	4,216
Net proceeds from the sale of utility system and other assets	11,498	3,297
Proceeds from note receivable	5,289	580
Other	(383)	(4,838)
Net cash flows used in investing activities	(132,298)	(140,153)
Cash flows from financing activities:		
Customers' advances and contributions in aid of construction	2,307	4,243
Repayments of customers' advances	(1,275)	(4,818)
Net proceeds of short-term debt	29,216	23,946
Proceeds from long-term debt	22,293	101,329
Repayments of long-term debt	(23,562)	(50,897)
Change in cash overdraft position	214	(9,309)
Proceeds from issuing common stock	6,388	6,188
Proceeds from exercised stock options	5,567	1,411
Stock-based compensation windfall tax benefits		117
Repurchase of common stock	(998)	(527)
Dividends paid on common stock	(42,813)	(39,678)

Edgar Filing: AQUA AMERICA INC - Form 10-Q

Net cash flows (used in) from financing activities	(2,663)	32,005
Net increase (decrease) in cash and cash equivalents	983	(8,757)
Cash and cash equivalents at beginning of period	5,934	21,869
Cash and cash equivalents at end of period	\$ 6,917	\$ 13,112

See notes to consolidated financial statements beginning on page 8 of this report.



**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (In thousands of dollars, except per share amounts)  
 (UNAUDITED)

**Note 1 Basis of Presentation**

The accompanying consolidated balance sheets and statements of capitalization of Aqua America, Inc. and subsidiaries (the Company) at June 30, 2011, the consolidated statements of income and comprehensive income for the six and three months ended June 30, 2011 and 2010, the consolidated statements of cash flow for the six months ended June 30, 2011 and 2010, and the consolidated statement of equity for the six months ended June 30, 2011, are unaudited, but reflect all adjustments, consisting of only normal recurring accruals, which are, in the opinion of management, necessary to present fairly the consolidated financial position, the consolidated changes in equity, the consolidated results of operations, and the consolidated cash flow for the periods presented. Because they cover interim periods, the statements and related notes to the financial statements do not include all disclosures and notes normally provided in annual financial statements and, therefore, should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2010. The results of operations for interim periods may not be indicative of the results that may be expected for the entire year. The December 31, 2010 consolidated balance sheet data presented herein was derived from the Company's December 31, 2010 audited consolidated financial statements, but does not include all disclosures and notes normally provided in annual financial statements. Certain prior period amounts have been reclassified to conform to the current period presentation.

**Note 2 Goodwill**

The following table summarizes the changes in the Company's goodwill, by business segment:

	Regulated Segment	Other	Consolidated
Balance at December 31, 2010	\$ 36,113	\$ 4,121	\$ 40,234
Goodwill acquired	867		867
Reclassifications to utility plant acquisition adjustment	(323)		(323)
Balance at June 30, 2011	\$ 36,657	\$ 4,121	\$ 40,778

The reclassification of goodwill to utility plant acquisition adjustment results from a mechanism approved by the applicable public utility commission. The mechanism provides for the transfer over time, and the recovery through customer rates, of goodwill associated with certain acquisitions upon achieving certain objectives.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(In thousands of dollars, except per share amounts)  
(UNAUDITED)

Note 3 Acquisitions

As part of the Company's growth-through-acquisition strategy, in July 2011, the Company entered into a definitive agreement with American Water Works Company, Inc. (American Water) to purchase all of the stock of the subsidiary of American Water's regulated water and wastewater operations in Ohio for cash of approximately \$88,000 at closing plus certain assumed liabilities, including debt of approximately \$16,000. American Water's Ohio operations serve approximately 57,000 customers. The purchase price is subject to certain adjustments at closing, and closing is conditioned upon the closing of the Company's sale of its regulated water operations in New York to American Water, and is subject to applicable regulatory approvals. The transaction is expected to close in the first quarter of 2012.

In June 2011, the Company completed its acquisition of approximately 51 water and five wastewater systems in Texas serving approximately 5,300 customers. The total purchase price consisted of \$6,245 in cash. The pro forma effect of the business acquired is not material to the Company's results of operations.

Note 4 Dispositions

In July 2011, the Company entered into a definitive agreement with Connecticut Water Service, Inc. to sell its regulated water operations in Maine for cash of approximately \$35,800 at closing plus certain assumed liabilities, including debt of approximately \$17,500. The purchase price is subject to certain adjustments at closing. This subsidiary is included in the Regulated segment, and as of June 30, 2011, the carrying amount of Maine's assets and liabilities were \$57,340 and \$39,501, respectively. The Company's Maine operations serve approximately 16,000 customers. The sale is conditioned, among other things, on the receipt of regulatory approvals, and is expected to close in the first quarter of 2012. In the third quarter, the Company will recognize additional income tax expense of approximately \$5,000 for the additional deferred tax liabilities that arise from the difference between the stock and tax basis of the Company's investment in its Aqua Maine subsidiary. The completion of this transaction will conclude the Company's operations in Maine.

In July 2011, the Company entered into a definitive agreement with American Water to sell its regulated water operations in New York for cash of approximately \$42,000 at closing plus certain assumed liabilities, including debt of approximately \$23,000. This subsidiary is included in the Regulated segment, and as of June 30, 2011, the carrying amount of New York's assets and liabilities were \$105,801 and \$63,905, respectively. In the third quarter, the Company will recognize additional income tax expense of approximately \$2,500 for the additional deferred tax liabilities that arise from the difference between the stock and tax basis of the Company's investment in its Aqua New York subsidiary. The Company's New York operations serve approximately 51,000 customers. The purchase price is subject to certain adjustments at closing, and closing is conditioned upon the closing of the Company's acquisition of American Water's regulated water and wastewater operations in Ohio, and is subject to applicable regulatory approvals. The sale is expected to close in the first quarter of 2012. The completion of this transaction will conclude the Company's operations in New York.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(In thousands of dollars, except per share amounts)  
(UNAUDITED)

Based on an assessment of the sale prices and the carrying values of the Company's planned dispositions of its Maine and New York operations, there is no anticipated impairment expected to be recognized as a result of the sale agreements.

In June 2011, the Company sold a water and wastewater utility system for net proceeds of \$4,106. The sale resulted in the recognition of a gain on the sale, net of expenses, of \$1,580 in the second quarter of 2011, and is reported in the consolidated statements of income and comprehensive income as a reduction to operations and maintenance expense. As of June 30, 2011, an additional amount of contingent gain has been deferred pending the final regulatory treatment afforded to such item.

In May 2011, the Company sold its regulated water and wastewater operations in Missouri for net proceeds of \$3,225. This sale of the Company's Missouri operations concluded the bulk of our regulated utility operations in Missouri.

In January 2011, the Company sold a water and wastewater utility system in Texas for net proceeds of \$3,118. The sale resulted in the recognition of a gain on the sale of these assets, net of expenses, of \$2,452. The gain is reported in the consolidated statements of income and comprehensive income as a reduction to operations and maintenance expense.

The City of Fort Wayne, Indiana (the "City") has authorized the acquisition by eminent domain of the northern portion of the utility system of one of the operating subsidiaries that the Company acquired in connection with the AquaSource acquisition in 2003. In 2008, the Company reached a settlement with the City to transition the northern portion of the system in 2008 upon receipt of the City's initial valuation payment of \$16,911. The settlement agreement specifically stated that the final valuation of the northern portion of the Company's system will be determined through a continuation of the legal proceedings that were filed challenging the City's valuation. On February 12, 2008, the Company turned over the northern portion of the system to the City upon receipt of the initial valuation payment. The proceeds received by the Company are in excess of the book value of the assets relinquished. No gain has been recognized due to the contingency over the final valuation of the assets. Once the contingency is resolved and the asset valuation is finalized, through the finalization of the litigation between the Company and the City of Fort Wayne, the amounts deferred will be recognized in the Company's consolidated income statement. On March 16, 2009, oral argument was held on certain procedural aspects with respect to the valuation evidence that may be presented and whether the Company is entitled to a jury trial. On October 12, 2010, the Wells County Indiana Circuit Court ruled that the Company is not entitled to a jury trial, and that the Wells County judge should review the City of Fort Wayne Board of Public Works' assessment based upon a "capricious, arbitrary or an abuse of discretion" standard. The Company disagreed with the Court's decision and as such on November 11, 2010, requested that the Wells County

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(In thousands of dollars, except per share amounts)  
(UNAUDITED)

Indiana Circuit Court certify those issues for an interim appeal. The Wells County Indiana Circuit Court granted that request and on March 7, 2011, the Indiana Court of Appeals granted the Company's request to review the decision of those issues on appeal. On July 6, 2011, the Company filed its appeal with the Indiana Court of Appeals. Depending upon the outcome of all of the legal proceeding the Company may be required to refund a portion of the initial valuation payment, or may receive additional proceeds. The northern portion of the utility system relinquished represents approximately 0.4% of the Company's total assets.

**Note 5 Fair Value of Financial Instruments**

The carrying amount of current assets and liabilities that are considered financial instruments approximates their fair value as of the dates presented. The carrying amount and estimated fair value of the Company's long-term debt are as follows:

	June 30, 2011	December 31, 2010
Carrying Amount	\$ 1,559,027	\$ 1,560,389
Estimated Fair Value	1,586,315	1,483,816

The fair value of long-term debt has been determined by discounting the future cash flows using current market interest rates for similar financial instruments of the same duration. The Company's customers' advances for construction and related tax deposits have a carrying value of \$66,143 as of June 30, 2011, and \$66,966 as of December 31, 2010. Their relative fair values cannot be accurately estimated because future refund payments depend on several variables, including new customer connections, customer consumption levels, and future rate increases. Portions of these non-interest bearing instruments are payable annually through 2026 and amounts not paid by the contract expiration dates become non-refundable. The fair value of these amounts would, however, be less than their carrying value due to the non-interest bearing feature.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(In thousands of dollars, except per share amounts)  
(UNAUDITED)

**Note 6 Net Income per Common Share**

Basic net income per common share is based on the weighted average number of common shares outstanding. Diluted net income per common share is based on the weighted average number of common shares outstanding and potentially dilutive shares. The dilutive effect of employee stock-based compensation is included in the computation of diluted net income per common share. The dilutive effect of stock-based compensation is calculated using the treasury stock method and expected proceeds upon exercise or issuance of the stock-based compensation. The following table summarizes the shares, in thousands, used in computing basic and diluted net income per common share:

	Six Months Ended		Three Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Average common shares outstanding during the period for basic computation	137,971	136,647	138,114	136,785
Dilutive effect of employee stock-based compensation	547	313	667	227
Average common shares outstanding during the period for diluted computation	138,518	136,960	138,781	137,012

For the six and three months ended June 30, 2011, employee stock options to purchase 933,800 shares of common stock, were excluded from the calculations of diluted net income per share as the calculated proceeds from the options exercise were greater than the average market price of the Company's common stock during these periods. For the six and three months ended June 30, 2010, employee stock options to purchase 2,665,445 shares of common stock, were excluded from the calculations of diluted net income per share as the calculated proceeds from the options exercise were greater than the average market price of the Company's common stock during these periods.

**Note 7 Stock-based Compensation**

Under the Company's 2009 Omnibus Equity Compensation Plan (the 2009 Plan), as approved by the Company's shareholders to replace the 2004 Equity Compensation Plan (the 2004 Plan), stock options, stock units, stock awards, stock appreciation rights, dividend equivalents, and other stock-based awards may be granted to employees, non-employee directors, and consultants and advisors. The 2009 Plan authorizes 5,000,000 shares for issuance under the plan. A maximum of 50% of the shares available for issuance under the 2009 Plan may be issued as restricted stock and the maximum number of shares that may be subject to grants under the Plan to any one individual in any one year is 200,000. Awards under the 2009 Plan are made by a committee of the Board of Directors. At June 30, 2011, 4,149,814 shares underlying stock-based compensation awards were still available for grants under the 2009 Plan. No further grants may be made under the 2004 Plan.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
 (In thousands of dollars, except per share amounts)  
 (UNAUDITED)

**Performance Share Units** A performance share unit ( PSU ) represents the right to receive a share of the Company's common stock if specified performance goals are met over the three year performance period specified in the grant, subject to certain exceptions through the three year vesting period. Each grantee is granted a target award of PSUs, and may earn between 0% and 200% of the target amount depending on the Company's performance against the performance goals. During the six and three months ended June 30, 2011, the Company recorded stock-based compensation related to PSUs as a component of operations and maintenance expense of \$361, and \$260, respectively. The following table summarizes nonvested PSU transactions for the six months ended June 30, 2011:

	Number of Share Units	Weighted Average Fair Value
Nonvested share units at beginning of period		\$
Granted	109,375	24.38
Performance criteria adjustment	14,027	24.38
Forfeited	(1,475)	24.38
Vested		
Share unit awards issued		
Nonvested share units at end of period	121,927	\$ 24.38

The fair value of PSUs was estimated at the grant date based on the probability of satisfying the performance conditions associated with the PSUs using the Monte Carlo valuation method. The per unit weighted-average fair value at the date of grant for PSUs granted during the six months ended June 30, 2011 was \$24.38. The fair value of each PSU grant is amortized into compensation expense on a straight-line basis over their respective vesting periods, which range from 24 to 36 months. The accrual of compensation costs is based on our estimate of the final expected value of the award, and is adjusted as required. The Company assumes that forfeitures will be minimal, and recognizes forfeitures as they occur, which results in a reduction in compensation expense. The recording of compensation expense for PSUs has no impact on net cash flows.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(In thousands of dollars, except per share amounts)  
(UNAUDITED)

**Restricted Stock Units** A restricted stock unit ( RSU ) represents the right to receive a share of the Company s common stock. RSUs are eligible to be earned at the end of a specified restricted period, generally three years, beginning on the date of grant. During the six and three months ended June 30, 2011, the Company recorded stock-based compensation related to awards of RSUs as a component of operations and maintenance expense of \$141, and \$102, respectively. The Company assumes that forfeitures will be minimal, and recognizes forfeitures as they occur, which results in a reduction in compensation expense. The following table summarizes nonvested RSU transactions for the six months ended June 30, 2011:

	Number of Stock Units	Weighted Average Fair Value
Nonvested stock units at beginning of period		\$
Granted	44,342	22.21
Vested		
Forfeited		
Nonvested stock units at end of period	44,342	\$ 22.21

**Stock Options** The fair value of stock options is estimated at the grant date using the Black-Scholes option-pricing model. The following table provides compensation costs for stock-based compensation related to stock options granted in prior periods:

	Six months ended June 30,		Three months ended June 30,	
	2011	2010	2011	2010
Stock-based compensation for stock options within operations and maintenance expenses	\$ 769	\$ 1,013	\$ 329	\$ 519
Income tax benefit	420	301	46	149

There were no stock options granted during the six months ended June 30, 2011. During the second quarter of 2011, the Company recorded an adjustment related to its historical stock option forfeitures that resulted in a favorable adjustment to compensation expense of \$644 and additional income tax expense of \$52.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
 (In thousands of dollars, except per share amounts)  
 (UNAUDITED)

The following table summarizes stock option transactions for the six months ended June 30, 2011:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Life (years)	Aggregate Intrinsic Value
Options:				
Outstanding at beginning of period	3,839,197	\$ 19.54		
Granted				
Forfeited	(12,356)	18.56		
Expired	(10,796)	23.13		
Exercised	(357,703)	15.56		
Outstanding at end of period	3,458,342	\$ 19.95	5.4	\$ 10,975
Exercisable at end of period	2,973,498	\$ 20.28	4.9	\$ 8,997

**Restricted Stock** During the six months ended June 30, 2011 and 2010, the Company recorded stock-based compensation related to restricted stock awards as a component of operations and maintenance expense in the amounts of \$1,100 and \$1,144, respectively. During the three months ended June 30, 2011 and 2010, the Company recorded stock-based compensation related to restricted stock awards as a component of operations and maintenance expense in the amounts of \$711 and \$692, respectively. The following table summarizes nonvested restricted stock transactions for the six months ended June 30, 2011:

	Number of Shares	Weighted Average Fair Value
Nonvested shares at beginning of period	233,387	\$ 17.62
Granted	16,000	22.44
Vested	(85,204)	18.63
Forfeited	(1,824)	17.23
Nonvested share units at end of period	162,359	\$ 17.57



**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(In thousands of dollars, except per share amounts)  
(UNAUDITED)

**Note 8 Pension Plans and Other Postretirement Benefits**

The Company maintains qualified defined benefit pension plans, nonqualified pension plans and other postretirement benefit plans for certain of its employees. The net periodic benefit cost is based on estimated values and an extensive use of assumptions about the discount rate, expected return on plan assets, the rate of future compensation increases received by the Company's employees, mortality, turnover, and medical costs. The following tables provide the components of net periodic benefit costs:

	Pension Benefits			
	Six Months Ended		Three Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Service cost	\$ 2,087	\$ 2,344	\$ 1,044	\$ 1,172
Interest cost	5,928	6,440	2,964	3,220
Expected return on plan assets	(5,191)	(5,592)	(2,596)	(2,796)
Amortization of prior service cost	87	70	43	35
Amortization of actuarial loss	2,033	2,060	1,016	1,030
Capitalized costs	(1,808)	(1,685)	(951)	(888)
Settlement charge		884		884
Net periodic benefit cost	\$ 3,136	\$ 4,521	\$ 1,520	\$ 2,657

	Other Postretirement Benefits			
	Six Months Ended		Three Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Service cost	\$ 751	\$ 610	\$ 376	\$ 305
Interest cost	1,623	1,240	812	620
Expected return on plan assets	(1,243)	(924)	(621)	(462)
Amortization of transition obligation	69	52	34	26
Amortization of prior service cost	(178)	(134)	(89)	(67)
Amortization of actuarial loss	411	342	206	171
Amortization of regulatory asset	68	68	34	34
Capitalized costs	(343)	(250)	(188)	(129)
Net periodic benefit cost	\$ 1,158	\$ 1,004	\$ 564	\$ 498

The Company made cash contributions of \$16,540 to its defined benefit pension plans during the first six months of 2011, and intends to make cash contributions of \$600 to the plans during the remainder of 2011. In addition, the Company expects to make cash contributions of \$2,012 for the funding of its other postretirement benefit plans during the remainder of 2011.



**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(In thousands of dollars, except per share amounts)  
(UNAUDITED)

**Note 9 Water and Wastewater Rates**

During the first six months of 2011, the Company's operating divisions in Ohio, Pennsylvania, and Indiana, were granted base rate increases designed to increase total operating revenues on an annual basis by \$3,421.

**Note 10 Taxes Other than Income Taxes**

The following table provides the components of taxes other than income taxes:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2011	2010	2011	2010
Property	\$ 13,852	\$ 13,039	\$ 6,781	\$ 6,513
Capital stock	1,773	1,791	892	924
Gross receipts, excise and franchise	4,937	4,680	2,620	2,459
Payroll	3,940	3,748	1,621	1,600
Other	2,709	2,545	1,532	1,447
<b>Total taxes other than income</b>	<b>\$ 27,211</b>	<b>\$ 25,803</b>	<b>\$ 13,446</b>	<b>\$ 12,943</b>

**Note 11 Segment Information**

The Company has identified thirteen operating segments and has one reportable segment named the Regulated segment. The reportable segment is comprised of twelve operating segments for the Company's water and wastewater regulated utility companies which are organized by the states where we provide these services. In addition, one segment is not quantitatively significant to be reportable and is comprised of the businesses that provide on-site septic tank pumping, sludge hauling services and certain other non-regulated water and wastewater services. This segment is included as a component of Other in the tables below. Also included in Other are corporate costs that have not been allocated to the Regulated segment and intersegment eliminations.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(In thousands of dollars, except per share amounts)  
(UNAUDITED)

The following tables present the Company's segment information:

	Three Months Ended June 30, 2011			Three Months Ended June 30, 2010		
	Regulated	Other	Consolidated	Regulated	Other	Consolidated
Operating revenues	\$ 184,956	\$ 3,273	\$ 188,229	\$ 175,593	\$ 2,851	\$ 178,444
Operations and maintenance expense	68,024	2,413	70,437	66,523	2,787	69,310
Depreciation	28,112	(534)	27,578	27,179	(377)	26,802
Operating income	73,849	988	74,837	66,038	37	66,075
Interest expense, net of AFUDC	17,087	1,087	18,174	16,342	701	17,043
Gain on sale of other assets	23	115	138	110		110
Income tax	19,338	(127)	19,211	20,009	(722)	19,287
Net income attributable to common shareholders	37,447	143	37,590	29,797	58	29,855

	Six Months Ended June 30, 2011			Six Months Ended June 30, 2010		
	Regulated	Other	Consolidated	Regulated	Other	Consolidated
Operating revenues	\$ 353,221	\$ 6,332	\$ 359,553	\$ 333,599	\$ 5,362	\$ 338,961
Operations and maintenance expense	134,283	3,479	137,762	132,581	4,330	136,911
Depreciation	55,764	(893)	54,871	53,784	(782)	53,002
Operating income	133,179	2,643	135,822	115,889	870	116,759
Interest expense, net of AFUDC	34,095	2,045	36,140	32,565	1,367	33,932
Gain (loss) on sale of other assets	98	161	259	(7)	2,046	2,039
Income tax	31,989	11	32,000	33,853	(353)	33,500
Net income attributable to common shareholders	67,193	748	67,941	49,464	1,902	51,366
Capital expenditures	141,967	877	142,844	140,500	267	140,767

	June 30, 2011	December 31, 2010
Total assets:		
Regulated	4,088,525	3,991,493
Other and eliminations	104,657	80,973
Consolidated	\$ 4,193,182	\$ 4,072,466

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(In thousands of dollars, except per share amounts)  
(UNAUDITED)

Note 12 Commitments and Contingencies

The Company is routinely involved in various disputes, claims, lawsuits and other regulatory and legal matters, including both asserted and unasserted legal claims, in the ordinary course of business. The status of each such matter, referred to herein as a loss contingency, is reviewed and assessed in accordance with applicable accounting rules regarding the nature of the matter, the likelihood that a loss will be incurred, and the amounts involved. As of June 30, 2011, the aggregate amount of \$11,106 is accrued for loss contingencies and is reported in the Company's consolidated balance sheet as other accrued liabilities and other liabilities. These accruals represent management's best estimate of probable loss (as defined in the accounting guidance) for loss contingencies or the low end of a range of losses if no single probable loss can be estimated. For some loss contingencies, the Company is unable to estimate the amount of the probable loss or range of probable losses. While the final outcome of these loss contingencies cannot be predicted with certainty, and unfavorable outcomes could negatively impact the Company, at this time in the opinion of management, the final resolution of these matters are not expected to have a material adverse effect on the Company's financial position, results of operations or cash flows. Further, the Company has insurance coverage for certain of these loss contingencies, and as of June 30, 2011, estimates that approximately \$1,244 of the amount accrued for these matters are probable of recovery through insurance, which amount is also reported in the Company's consolidated balance sheet as deferred charges and other assets, net.

The Company maintains agreements with other water purveyors for the purchase of water to supplement its water supply, particularly during periods of peak demand. The agreements stipulate purchases of minimum quantities of water to the year 2026. During the second quarter of 2011, the Company received notice of increased rates on certain purchase water agreements. As a result of these increases, the Company's estimated annual commitments related to all of such purchases through 2015 are expected to average \$12,274 and the aggregate of the commitments for the years remaining approximates \$49,697.

Note 13 Income Taxes

As of June 30, 2011, the Company recorded a deferred tax asset for a Federal net operating loss ( NOL ) carryforward of \$55,400, and for the Company's Pennsylvania operating subsidiary, a state NOL of \$13,743. The Company believes the Federal and state NOL carryforwards are more likely than not to be recovered and require no valuation allowance. The Company's Federal and state NOL carryforwards do not begin to expire until 2030 and 2031, respectively.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(In thousands of dollars, except per share amounts)  
(UNAUDITED)

Note 14 Recent Accounting Pronouncements

There have been no recent accounting pronouncements or changes in accounting pronouncements that the Company has adopted that would have a material impact on the Company's consolidated results of operations or consolidated financial position during the six months ended June 30, 2011.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(In thousands of dollars, except per share amounts)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-looking Statements

*This Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Quarterly Report contain, in addition to historical information, forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements address, among other things: our belief in our ability to renew our short-term lines of credit; the impact and the actions we may need to take if we are unable to obtain sufficient capital; the projected impact of various legal proceedings; the projected effects of recent accounting pronouncements; prospects, plans, objectives, expectations and beliefs of management, as well as information contained in this report where statements are preceded by, followed by or include the words believes, expects, anticipates, plans, future, potential, probably, predictions, intends, will, continue or the negative of such terms or similar expressions. Forward-looking statements are based on a number of assumptions concerning future events, and are subject to a number of risks, uncertainties and other factors, many of which are outside our control, which could cause actual results to differ materially from those expressed or implied by such statements. These risks and uncertainties include, among others: the effects of regulation, abnormal weather, changes in capital requirements and funding, acquisitions, changes to the capital markets, and our ability to assimilate acquired operations, as well as those risks, uncertainties and other factors discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 under the captions Risk Factors and Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in such report. As a result, readers are cautioned not to place undue reliance on any forward-looking statements. We undertake no obligation to update or revise forward-looking statements, whether as a result of new information, future events or otherwise.*

General Information

*Nature of Operations* - Aqua America, Inc. ( we or us ), a Pennsylvania corporation, is the holding company for regulated utilities providing water or wastewater services to what we estimate to be approximately 3 million people in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, New York, Florida, Indiana, Virginia, Maine, and Georgia. Our largest operating subsidiary, Aqua Pennsylvania, Inc., provides water or wastewater services to approximately one-half of the total number of people we serve, who are located in the suburban areas in counties north and west of the City of Philadelphia and in 25 other counties in Pennsylvania. Our other subsidiaries provide similar services in 11 other states. In July 2011, we entered into a definitive agreement to purchase all of American Water Works Company, Inc.'s regulated operations in Ohio (the Ohio acquisition ), which serve approximately 57,000 customers, and to simultaneously sell our regulated water and wastewater operations in New York, which serve approximately 51,000 customers. Also, in July 2011, we entered into a definitive agreement to sell our operations in Maine, which serve approximately 16,000 customers. The Ohio acquisition will be financed by the issuance of long-term and / or short-term debt. The proceeds from the

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

(In thousands of dollars, except per share amounts)

dispositions of our operations in New York and Maine will be used to paydown a portion of our short-term debt and other general corporate purposes. These transactions are conditioned, among other things, on the receipt of regulatory approvals, and are expected to close in the first quarter of 2012. The completion of these transactions will conclude our operations in New York and Maine. In December 2010, we entered into a definitive agreement to sell our regulated water and wastewater operations in Missouri, which served approximately 3,900 customers. The sale of our utility in Missouri closed in May 2011, concluding the bulk of our utility operations in Missouri. In addition, we provide water and wastewater service through operating and maintenance contracts with municipal authorities and other parties close to our utility companies' service territories as well as sludge hauling, septage and grease services, backflow prevention services, and certain other non-regulated water and wastewater services.

Aqua America, Inc., which prior to its name change in 2004 was known as Philadelphia Suburban Corporation, was formed in 1968 as a holding company for its primary subsidiary, Aqua Pennsylvania, Inc., formerly known as Philadelphia Suburban Water Company. In the early 1990s, we embarked on a growth-through-acquisition strategy focused on water and wastewater operations. Our most significant transactions to date have been the merger with Consumers Water Company in 1999, the acquisition of the regulated water and wastewater operations of AquaSource, Inc. in 2003, the acquisition of Heater Utilities, Inc. in 2004, and the acquisition of New York Water Service Corporation in 2007. Since the early 1990s, our business strategy has been primarily directed toward the regulated water and wastewater utility industry and has extended our regulated operations from southeastern Pennsylvania to include operations in 11 other states.

Financial Condition

During the first six months of 2011, we had \$142,844 of capital expenditures, and repaid debt and made sinking fund contributions and other loan repayments of \$23,562. The capital expenditures were related to improvements to treatment plants, new and rehabilitated water mains, tanks, hydrants, and service lines, well and booster improvements, and other enhancements and improvements.

At June 30, 2011, we had \$6,917 of cash and cash equivalents compared to \$5,934 at December 31, 2010. During the first six months of 2011, we used the proceeds from internally generated funds, the sale of other assets, and the sale or issuance of common stock through our equity compensation plan and dividend reinvestment plan, to fund the cash requirements discussed above and to pay dividends.

At June 30, 2011, our \$95,000 unsecured revolving credit facility, which expires in May 2012, had \$15,399 available for borrowing. At June 30, 2011, we had short-term lines of credit of \$167,000, of which \$48,116 was available. On July 1, 2011, we did not renew one of our credit lines in the amount of \$2,500, which expired on July 1, 2011, as it was no longer needed. One of our short-term lines of credit is an Aqua Pennsylvania \$100,000 364-day unsecured revolving credit facility with three banks, which is used to provide working capital, and as of June 30, 2011, \$7,857 was available.



**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

(In thousands of dollars, except per share amounts)

Our short-term lines of credit of \$167,000 are subject to renewal on an annual basis. Although we believe we will be able to renew these facilities, there is no assurance that they will be renewed, or what the terms of any such renewal will be. The United States credit and liquidity crisis that occurred in 2008 and 2009 caused substantial volatility in capital markets, including credit markets and the banking industry, generally reduced the availability of credit from financing sources, and could re-occur in the future. If in the future, our credit facilities are not renewed or our short-term borrowings are called for repayment, we would have to seek alternative financing sources; however, there can be no assurance that these alternative financing sources would be available on terms acceptable to us. In the event we are not able to obtain sufficient capital, we may need to reduce our capital expenditures and our ability to pursue acquisitions that we may rely on for future growth could be impaired.

The Company's consolidated balance sheet historically has had a negative working capital position whereby routinely our current liabilities exceed our current assets. Management believes that internally generated funds along with existing credit facilities and the proceeds from the issuance of long-term debt and common stock will be adequate to provide sufficient working capital to maintain normal operations and to meet our financing requirements for at least the next twelve months.

Results of Operations

Analysis of First Six Months of 2011 Compared to First Six Months of 2010

Revenues increased \$20,592 or 6.1% primarily due to additional revenues associated with increased water and wastewater rates of \$19,956, and additional water and wastewater revenues of \$1,289 associated with a larger customer base due to acquisitions.

Operations and maintenance expenses increased by \$851 or 0.6% primarily due to increased water production costs of \$2,723, an increase in postretirement benefits expenses of \$1,396, increases in operating costs associated with acquired utility systems of \$821, increases in fuel costs for our service vehicles of \$475, and normal increases in other operating costs. Offsetting these increases were the gains on the sales of our utility systems recognized during the first six months of 2011 of \$4,312, the effect of the write-off in the first quarter of 2010 of previously deferred regulatory expenses of \$1,011, and decreased insurance expense of \$734. The increase in water production costs is primarily due to an increase in the cost of purchased water.

Depreciation expense increased \$1,869 or 3.5% due to the utility plant placed in service since June 30, 2010.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

(In thousands of dollars, except per share amounts)

Amortization decreased \$2,599 primarily due to the additional expense recognized in the first six months of 2010 of \$3,431 resulting from the recovery of our costs associated with a completed rate filing in Texas, offset by the amortization of the costs associated with, and other costs being recovered in, various rate filings.

Taxes other than income taxes increased by \$1,408 or 5.5% primarily due to an increase in property taxes of \$813 and an increase in gross receipts, excise and franchise taxes of \$257. The increase in property taxes is attributable to an increase in recoverable expenses associated with a rate award received in February 2010 for one of our states. In that state, recovery of the property taxes began with the conclusion of the most recent rate proceeding, whereas previously these taxes had been deferred pending the inclusion in future rates. The increase in gross receipts, excise and franchise taxes is attributable to an increase in revenue.

Interest expense increased by \$3,115 or 8.4% primarily due to additional borrowings to finance capital projects, offset partially by decreased interest rates on long-term debt.

Allowance for funds used during construction ( AFUDC ) increased by \$907 primarily due to an increase in the average balance of proceeds held from tax-exempt bond issuances that are restricted to funding certain capital projects.

Gain on sale of other assets totaled \$259 in the first half of 2011 and \$2,039 in the first half of 2010. The decrease of \$1,780 is principally due to a gain on the sale of an investment in the first half of 2010.

Our effective income tax rate was 32.0% in the first half of 2011 and 39.5% in the first half of 2010. The effective income tax rate decreased as a result of the recognition in 2011 of the net state income tax benefit of \$7,811 associated with 100% bonus depreciation for qualifying capital additions.

Net income attributable to common shareholders increased by \$16,575 or 32.3%, in comparison to the same period in 2010 primarily as a result of the factors described above. On a diluted per share basis, earnings increased \$0.11 reflecting the change in net income attributable to common shareholders and a 1.1% increase in the average number of common shares outstanding. If earnings were adjusted to exclude the net state income tax benefit associated with 100% bonus depreciation, a non-GAAP financial measure, earnings would have increased by \$0.05 per share, as compared to the first half of 2010. The increase in the number of shares outstanding is primarily a result of the additional shares sold or issued through our equity compensation plan and dividend reinvestment plan.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

(In thousands of dollars, except per share amounts)

Results of Operations

Analysis of Second Quarter of 2011 Compared to Second Quarter of 2010

Revenues increased \$9,785 or 5.5% primarily due to additional revenues associated with increased water and wastewater rates of \$7,905, and additional water and wastewater revenues of \$716 associated with a larger customer base due to acquisitions.

Operations and maintenance expenses increased by \$1,127 or 1.6% primarily due to increased water production costs of \$1,343, an increase in postretirement benefits expenses of \$671, increases in operating costs associated with acquired utility systems of \$363, increases in fuel costs for our service vehicles of \$339, and normal increases in other operating costs. Offsetting these increases were the gains on the sales of our utility systems recognized in the second quarter of 2011 of \$1,860. The increase in water production costs is primarily due to an increase in the cost of purchased water.

Depreciation expense increased \$776 or 2.9% due to the utility plant placed in service since June 30, 2010.

Amortization decreased \$1,383 primarily due to the additional expense recognized in the second quarter of 2010 of \$1,796 resulting from the recovery of our costs associated with a completed rate filing in Texas, offset by the amortization of the costs associated with, and other costs being recovered in, various rate filings.

Taxes other than income taxes increased by \$503 or 3.9% primarily due to an increase in property taxes of \$268 and an increase in gross receipts, excise and franchise taxes of \$161. The increase in property taxes is attributable to an increase in recoverable expenses associated with a rate award received in February 2010 for one of our states. In that state, recovery of the property taxes began with the conclusion of the most recent rate proceeding, whereas previously these taxes had been deferred pending the inclusion in future rates. The increase in gross receipts, excise and franchise taxes is attributable to an increase in revenue.

Interest expense increased by \$1,602 or 8.7% primarily due to additional borrowings to finance capital projects, offset partially by decreased interest rates on long-term debt.

Allowance for funds used during construction ( AFUDC ) increased by \$471 primarily due to an increase in the average balance of proceeds held from tax-exempt bond issuances that are restricted to funding certain capital projects.

Gain on sale of other assets totaled \$138 in the second quarter of 2011 and \$110 in the second quarter of 2010. The increase of \$28 is principally due to the timing of sales of land and other property.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

(In thousands of dollars, except per share amounts)

Our effective income tax rate was 33.8% in the second quarter of 2011 and 39.2% in the second quarter of 2010. The effective income tax rate decreased as a result of the recognition in 2011 of the net state income tax benefit of \$3,483 associated with 100% bonus depreciation for qualifying capital additions.

Net income attributable to common shareholders increased by \$7,735 or 25.9%, in comparison to the same period in 2010 primarily as a result of the factors described above. On a diluted per share basis, earnings increased \$0.05 reflecting the change in net income attributable to common shareholders and a 1.3% increase in the average number of common shares outstanding. If earnings were adjusted to exclude the net state income tax benefit associated with 100% bonus depreciation, a non-GAAP financial measure, earnings would have increased by \$0.03 per share, as compared to the second quarter of 2010. The increase in the number of shares outstanding is primarily a result of the additional shares sold or issued through our equity compensation plan and dividend reinvestment plan.

Impact of Recent Accounting Pronouncements

There have been no recent accounting pronouncements or changes in accounting pronouncements that the Company has adopted that would have a material impact on the Company's consolidated results of operations or consolidated financial position during the six months ended June 30, 2011.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

(In thousands of dollars, except per share amounts)

Non-Generally Accepted Accounting Principle ( Non-GAAP ) Financial Measures

In addition to reporting net income attributable to common shareholders and net income per common share, U.S. GAAP financial measures, we are presenting below income attributable to common shareholders before net state income tax benefit associated with 100% bonus depreciation and income per common share before net state income tax benefit associated with 100% bonus depreciation, which are considered non-GAAP financial measures. The Company is providing disclosure of the reconciliation of these non-GAAP measures to their most comparable GAAP financial measures. The Company believes that the non-GAAP financial measures provide investors the ability to measure the Company's financial operating performance excluding the net state income tax benefit associated with 100% bonus depreciation, which is more indicative of the Company's ongoing performance, and is more comparable to measures reported by other companies. The Company further believes that the presentation of these non-GAAP financial measures is useful to investors as a more meaningful way to compare the Company's operating performance against its historical financial results and to assess the underlying profitability of our core business. As currently enacted, 100% bonus depreciation is in effect for qualifying capital additions placed in service from September 8, 2010 through December 31, 2011.

	Six Months Ended June 30,		Three Months Ended June 30,	
	2011	2010	2011	2010
Net income attributable to common shareholders (GAAP financial measure)	\$ 67,941	\$ 51,366	\$ 37,590	\$ 29,855
Less: Net state income tax benefit associated with 100% bonus depreciation	7,811		3,483	
Income attributable to common shareholders before net state income tax benefit associated with 100% bonus depreciation (Non-GAAP financial measure)	\$ 60,130	\$ 51,366	\$ 34,107	\$ 29,855
Net income per common share (GAAP financial measure):				
Basic	\$ 0.49	\$ 0.38	\$ 0.27	\$ 0.22
Diluted	\$ 0.49	\$ 0.38	\$ 0.27	\$ 0.22
Income per common share before net state income tax benefit associated with 100% bonus depreciation (Non-GAAP financial measure):				
Basic	\$ 0.44	\$ 0.38	\$ 0.25	\$ 0.22
Diluted	\$ 0.43	\$ 0.38	\$ 0.25	\$ 0.22
Average common shares outstanding:				
Basic	137,971	136,647	138,114	136,785
Diluted	138,518	136,960	138,781	137,012



**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES

Item 3. **Quantitative and Qualitative Disclosures About Market Risk**

We are subject to market risks in the normal course of business, including changes in interest rates and equity prices. There have been no significant changes in our exposure to market risks since December 31, 2010. Refer to Item 7A of the Company's Annual Report on Form 10-K for the year ended December 31, 2010 for additional information.

Item 4. **Controls and Procedures**

(a) Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this report are effective such that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure.

(b) Changes in Internal Control over Financial Reporting

No change in our internal control over financial reporting occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II. Other Information

Item 1. **Legal Proceedings**

The City of Fort Wayne, Indiana (the "City") authorized the acquisition by eminent domain of the northern portion of the utility system of one of the Company's operating subsidiaries in Indiana. In 2008, we reached a settlement agreement with the City to transition this portion of the system in 2008 upon receipt of the City's initial valuation payment of \$16,910,500. The settlement agreement specifically stated that the final valuation of the system will be determined through a continuation of the legal proceedings that were filed challenging the City's valuation. On February 12, 2008, we turned over the northern portion of the system to the City upon receipt of the initial valuation payment. The proceeds received by the Company are in excess of the book value of the assets relinquished. No gain has been recognized due to the contingency over the final valuation of the assets. Once the contingency is resolved and the asset valuation is finalized, through the finalization of the litigation between the Company and the City of Fort Wayne, the amounts deferred will be recognized in the Company's consolidated income statement. On March 16, 2009, oral argument was held before the Allen County Circuit Court on certain procedural aspects with respect to the valuation evidence that may be presented and whether we are entitled to a jury trial. On October 12, 2010, the Wells County Indiana Circuit Court ruled that the Company is not entitled to a jury trial, and that the Wells County judge should review the City of Fort Wayne Board of Public Works assessment based upon a "capricious, arbitrary or an abuse of discretion" standard. The Company disagreed with the Court's decision and as such, on November 11, 2010, requested that the Wells County Indiana Circuit Court certify those issues for an interim appeal. The Wells County Circuit Court granted that request and on March 7, 2011, the Indiana Court of Appeals granted the Company's request to review the decision of those issues on appeal. On July 6, 2011, the Company filed its appeal with the Indiana Court of Appeals. Depending upon the ultimate outcome of all of the legal proceedings we may be required to refund a portion of the initial valuation payment, or may receive additional proceeds. The northern portion of the system relinquished represented approximately 0.50% of Aqua America's total assets.

**Table of Contents**

**AQUA AMERICA, INC. AND SUBSIDIARIES**

A lawsuit was filed by a husband and wife who lived in a house abutting a percolation pond at a wastewater treatment plant owned by one of the Company's subsidiaries, Aqua Utilities Florida, Inc., in Pasco County, Florida. The lawsuit was originally filed in August 2006 in the circuit court for the Sixth Judicial Circuit in and for Pasco County, Florida and has been amended several times by the plaintiffs. The lawsuit alleged our subsidiary was negligent in the design, operation and maintenance of the plant, resulting in bodily injury to the plaintiffs and various damages to their property. Subsequent amendments to the complaint included additional counts alleging trespass, nuisance, and strict liability. A trial of this matter during January 2011 resulted in a judicial dismissal of the count for strict liability and jury verdicts in favor of the Company on the remaining counts. On June 16, 2011, the plaintiffs agreed to dismiss their appeals and to release all claims against our subsidiary and the Company, which resulted in the conclusion of the original plaintiffs' litigation against our subsidiary. In the third quarter of 2008, approximately thirty-five additional plaintiffs, associated with approximately eight other homes in the area, filed a lawsuit with the same court making similar allegations against our subsidiary with respect to the operation of the facility. No trial date has been set for this lawsuit, but some of these plaintiffs testified in the trial of the original lawsuit in which all allegations were resolved in the Company's favor. The lawsuit has been submitted to our insurance carriers, who have reserved their rights with respect to various portions of the plaintiffs' claims. Based on the ultimate outcome of the litigation, we may or may not have insurance coverage for parts or all of the claim. The Company continues to assess this matter and any potential loss. At this time, the Company believes that the estimated amount of any potential loss would not be material to the Company's consolidated results of operations or consolidated financial condition.



**Table of Contents**

**AQUA AMERICA, INC. AND SUBSIDIARIES**

In July 2010 one of the Company's subsidiaries, Aqua Pennsylvania, Inc., received a notice of violation from the Pennsylvania Department of Environmental Protection (the "DEP"). The notice of violation resulted from the subsidiary's commencement of construction of a water tank prior to receipt of a construction permit from DEP. The permit was subsequently received. On September 29, 2010, the DEP notified the Company of a proposed penalty of \$120,000 in connection with the violation. A settlement has been reached with the DEP and the penalty amount was reduced to \$80,000 as of August 1, 2011.

**Item 1A. Risk Factors**

There have been no material changes to the risks disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010 ( "Form 10-K" ) under Part 1, Item 1A "Risk Factors."

**Table of Contents**

## AQUA AMERICA, INC. AND SUBSIDIARIES

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table summarizes Aqua America's purchases of its common stock for the quarter ended June 30, 2011:

Period	Issuer Purchases of Equity Securities		Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plan or Programs (2)
	Total Number of Shares Purchased (1)	Average Price Paid per Share		
April 1 - 30, 2011				548,278
May 1 - 31, 2011				548,278
June 1 - 30, 2011	12,036	\$ 21.91		548,278
Total	12,036	\$ 21.91		548,278

- (1) These amounts consist of shares we purchased from employees who elected to pay the exercise price of their stock options (and then hold shares of the stock) upon exercise by delivering to us (and, thus, selling) shares of Aqua America common stock in accordance with the terms of our equity compensation plans that were previously approved by our shareholders and disclosed in our proxy statements. This feature of our equity compensation plan is available to all employees who receive stock-based compensation under the plans. We purchased these shares at their fair market value, as determined by reference to the closing price of our common stock on the day prior to the option exercise.
- (2) On August 5, 1997, our Board of Directors authorized a common stock repurchase program that was publicly announced on August 7, 1997, for up to 1,007,351 shares. No repurchases have been made under this program since 2000. The program has no fixed expiration date. The number of shares authorized for purchase was adjusted as a result of the stock splits affected in the form of stock distributions since the authorization date.

**Table of Contents**

AQUA AMERICA, INC. AND SUBSIDIARIES

Item 5. Other Information

At their regularly scheduled meeting on August 2, 2011, the Board of Directors of the Company appointed Wendell F. Holland, Esq., a partner in the law firm of Saul Ewing LLP in Philadelphia, PA, to the Board of Directors of the Company. Mr. Holland will participate in the normal compensation arrangements for non-employee directors as described in the "Director Compensation" section of the Company's Proxy Statement for the 2011 Annual Meeting filed on April 1, 2011.

The Company or its subsidiaries have used the law firm of Saul Ewing for legal services for several years prior to Mr. Holland joining the firm. In 2010 and to date in 2011, the Company paid the firm approximately \$837,000 for legal services, the majority of which were provided by other attorneys in the firm. The Company's use of this law firm was reviewed by the Corporate Governance Committee of the Board of Directors under the Company's Related Person Transaction Policy and determined to be in the best interests of the Company.

Item 6. Exhibits

The information required by this Item is set forth in the Exhibit Index hereto which is incorporated herein by reference.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be executed on its behalf by the undersigned thereunto duly authorized.

August 5, 2011

Aqua America, Inc.

Registrant

Nicholas DeBenedictis

Nicholas DeBenedictis  
Chairman, President and  
Chief Executive Officer

David P. Smeltzer

David P. Smeltzer  
Chief Financial Officer

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description</b>
31.1	Certification of Chief Executive Officer, pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934.
31.2	Certification of Chief Financial Officer, pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934.
32.1	Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350.
32.2	Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRES	XBRL Taxonomy Extension Presentation Linkbase Document