

American Water Works Company, Inc.

Form 10-Q

May 04, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2010

OR

.. **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 001-34028

AMERICAN WATER WORKS COMPANY, INC.

(Exact name of registrant as specified in its charter)

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Delaware (State or other jurisdiction of incorporation or organization)	51-0063696 (I.R.S. Employer Identification No.)
1025 Laurel Oak Road, Voorhees, NJ (Address of principal executive offices)	08043 (Zip Code)
(856) 346-8200 (Registrant's telephone number, including area code)	

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 12b-2 of the Exchange Act.

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>

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 the latest practicable date.

Class	Outstanding at April 29, 2010
Common Stock, \$0.01 par value per share	174,702,964 shares

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AMERICAN WATER WORKS COMPANY, INC.

REPORT ON FORM 10-Q

FOR THE QUARTER ENDED MARCH 31, 2010

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS****American Water Works Company, Inc. and Subsidiary Companies****Consolidated Balance Sheets (Unaudited)****(In thousands, except per share data)**

	March 31, 2010	December 31, 2009
ASSETS		
Property, plant and equipment		
Utility plant at original cost, net of accumulated depreciation of \$3,221,026 at March 31 and \$3,168,078 at December 31	\$ 10,590,989	\$ 10,523,844
Nonutility property, net of accumulated depreciation of \$126,377 at March 31 and \$117,245 at December 31	151,428	153,549
Total property, plant and equipment	10,742,417	10,677,393
Current assets		
Cash and cash equivalents	12,633	22,256
Restricted funds	40,273	41,020
Utility customer accounts receivable	138,024	149,417
Allowance for uncollectible accounts	(17,473)	(19,035)
Unbilled utility revenues	126,035	130,262
Non-Regulated trade and other receivables, net	71,919	75,086
Income taxes receivable	32,564	17,920
Materials and supplies	30,089	29,521
Other	63,164	52,680
Total current assets	497,228	499,127
Regulatory and other long-term assets		
Regulatory assets	987,963	952,020
Restricted funds	9,708	20,212
Goodwill	1,250,417	1,250,381
Other	52,829	53,518
Total regulatory and other long-term assets	2,300,917	2,276,131
TOTAL ASSETS	\$ 13,540,562	\$ 13,452,651

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**American Water Works Company, Inc. and Subsidiary Companies****Consolidated Balance Sheets (Unaudited)**

(In thousands, except per share data)

	March 31, 2010	December 31, 2009
CAPITALIZATION AND LIABILITIES		
Capitalization		
Common stock (\$.01 par value, 500,000 shares authorized, 174,693 and 174,630 shares outstanding at March 31 and December 31, respectively)	\$ 1,747	\$ 1,746
Paid-in-capital	6,142,663	6,140,077
Accumulated deficit	(2,082,263)	(2,076,287)
Accumulated other comprehensive loss	(63,203)	(64,677)
Common stockholders' equity	3,998,944	4,000,859
Preferred stock without mandatory redemption requirements	4,547	4,557
Total stockholders' equity	4,003,491	4,005,416
Long-term debt		
Long-term debt	5,256,955	5,288,180
Redeemable preferred stock at redemption value	23,947	23,946
Total capitalization	9,284,393	9,317,542
Current liabilities		
Short-term debt	147,893	119,497
Current portion of long-term debt	47,027	54,068
Accounts payable	116,843	138,609
Taxes accrued, including income taxes of \$0 at March 31 and \$1,777 at December 31	67,653	45,552
Interest accrued	103,935	60,128
Other	177,738	189,538
Total current liabilities	661,089	607,392
Regulatory and other long-term liabilities		
Advances for construction	631,900	633,509
Deferred income taxes	924,763	851,677
Deferred investment tax credits	32,198	32,590
Regulatory liabilities	327,651	322,281
Accrued pension expense	417,242	431,010
Accrued postretirement benefit expense	234,182	236,045
Other	48,054	47,325
Total regulatory and other long-term liabilities	2,615,990	2,554,437
Contributions in aid of construction	979,090	973,280
Commitments and contingencies (See Note 9)		
TOTAL CAPITALIZATION AND LIABILITIES	\$ 13,540,562	\$ 13,452,651

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The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**American Water Works Company, Inc. and Subsidiary Companies****Consolidated Statements of Operations (Unaudited)****(In thousands, except per share data)**

	Three Months Ended March 31,	
	2010	2009
Operating revenues	\$ 588,053	\$ 550,170
Operating expenses		
Operation and maintenance	330,423	314,402
Depreciation and amortization	76,232	68,843
General taxes	55,404	52,497
Gain on sale of assets	(71)	(202)
Impairment charge		450,000
Total operating expenses, net	461,988	885,540
Operating income (loss)	126,065	(335,370)
Other income (expenses)		
Interest, net	(78,715)	(71,979)
Allowance for other funds used during construction	2,151	3,343
Allowance for borrowed funds used during construction	1,397	1,872
Amortization of debt expense	(684)	(1,488)
Other, net	71	1,114
Total other income (expenses)	(75,780)	(67,138)
Income (loss) before income taxes	50,285	(402,508)
Provision for income taxes	19,477	10,571
Net income (loss)	\$ 30,808	\$ (413,079)
Income (loss) per common share:		
Basic	\$ 0.18	\$ (2.58)
Diluted	\$ 0.18	\$ (2.58)
Average common shares outstanding during the period:		
Basic	174,721	160,011
Diluted	174,797	160,011
Dividends per common share	\$ 0.21	\$ 0.20

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**American Water Works Company, Inc. and Subsidiary Companies****Consolidated Statements of Cash Flows (Unaudited)****(In thousands, except per share data)**

	Three Months Ended March 31,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ 30,808	\$ (413,079)
Adjustments		
Depreciation and amortization	76,232	68,843
Impairment charge		450,000
Amortization of removal costs net of salvage	10,676	10,009
Provision for deferred income taxes	46,522	31,627
Amortization of deferred investment tax credits	(392)	(401)
Provision for losses on utility accounts receivable	3,189	5,298
Allowance for other funds used during construction	(2,151)	(3,343)
Gain on sale of assets	(71)	(202)
Pension and non-pension post retirement benefits	22,336	26,283
Other, net	(8,009)	(3,049)
Changes in assets and liabilities		
Receivables and unbilled utility revenues	14,036	8,329
Income taxes receivable	(14,644)	
Other current assets	(11,052)	(15,324)
Pension and non-pension post retirement benefit contributions	(37,780)	(27,509)
Accounts payable	(18,268)	(12,493)
Taxes accrued, including income taxes	20,827	(165)
Interest accrued	43,807	37,276
Other current liabilities	(76)	(19,601)
Net cash provided by operating activities	175,990	142,499
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(142,682)	(196,178)
Acquisitions	(528)	
Proceeds from sale of assets and securities	87	204
Removal costs from property, plant and equipment retirements, net	(5,910)	(5,031)
Net restricted funds released (invested)	11,251	(26)
Other		(1,250)
Net cash used in investing activities	(137,782)	(202,281)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt	1,101	75,000
Repayment of long-term debt	(38,001)	(150,451)
Net borrowings under short-term debt agreements	53,592	189,940
Proceeds from employee stock plan issuances	801	526
Advances and contributions for construction, net of refunds of \$11,941 and \$5,616 at March 31, 2010 and 2009	(3,170)	2,608
Change in cash overdraft position	(25,196)	(23,858)
Debt issuance costs	(269)	(2,937)
Redemption of preferred stocks	(10)	
Dividends paid	(36,679)	(32,072)

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Net cash (used in) provided by financing activities	(47,831)	58,756
Net decrease in cash and cash equivalents	(9,623)	(1,026)
Cash and cash equivalents at beginning of period	22,256	9,542
Cash and cash equivalents at end of period	\$ 12,633	\$ 8,516
Non-cash investing activity:		
Capital expenditures acquired on account but unpaid at quarter-end	\$ 55,699	\$ 50,267
Non-cash financing activity:		
Advances and contributions	\$ 7,554	\$ 12,078

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**American Water Works Company, Inc. and Subsidiary Companies****Consolidated Statement of Changes in Stockholders' Equity (Unaudited)**

(In thousands, except per share data)

	Common Stock		Paid-in	Accumulated	Accumulated	Treasury Stock		Mandatory	Total
	Shares	Par Value	Capital	Deficit	Other Comprehensive Loss	Shares	At Cost	Redemption Requirements	Stockholders' Equity
Balance at December 31, 2009	174,630	\$ 1,746	\$ 6,140,077	\$ (2,076,287)	\$ (64,677)			\$ 4,557	\$ 4,005,416
Net income				30,808					30,808
Stock-based compensation activity	63	1	2,586	(105)					2,482
Preferred stock redemption								(10)	(10)
Other comprehensive income, net of tax of \$710					1,474				1,474
Dividends				(36,679)					(36,679)
Balance at March 31, 2010	174,693	\$ 1,747	\$ 6,142,663	\$ (2,082,263)	\$ (63,203)		\$	\$ 4,547	\$ 4,003,491

	Common Stock		Paid-in	Accumulated	Accumulated	Treasury Stock		Mandatory	Total
	Shares	Par Value	Capital	Deficit	Other Comprehensive Loss	Shares	At Cost	Redemption Requirements	Stockholders' Equity
Balance at December 31, 2008	160,000	\$ 1,600	\$ 5,888,253	\$ (1,705,594)	\$ (82,251)		\$ (7)	\$ 4,557	\$ 4,106,558
Net loss				(413,079)					(413,079)
	31		2,514				7		2,521

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Stock-based compensation activity									
Other comprehensive income net of tax of \$965						970			970
Dividends						(32,072)			(32,072)
Balance at March 31, 2009	160,031	\$ 1,600	\$ 5,890,767	\$ (2,150,745)	\$ (81,281)	\$	\$	4,557	\$ 3,664,898

The accompanying notes are an integral part of these consolidated financial statements.

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American Water Works Company, Inc. and Subsidiary Companies

Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

(In thousands, except per share data)

	Three Months Ended March 31,	
	2010	2009
Net income (loss)	\$ 30,808	\$ (413,079)
Pension plan amortized to periodic benefit cost:		
Prior service cost, net of tax of \$12 and \$7, respectively	20	11
Actuarial loss, net of tax of \$698 and \$958, respectively	1,092	1,499
Foreign currency translation adjustment	362	(540)
Total comprehensive income (loss)	\$ 32,282	\$ (412,109)

The accompanying notes are an integral part of these consolidated financial statements.

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American Water Works Company, Inc. and Subsidiary Companies

Notes to Consolidated Financial Statements (Unaudited)

(In thousands, except per share data)

Note 1: Basis of Presentation

The accompanying Consolidated Balance Sheet of American Water Works Company, Inc. and Subsidiary Companies (the Company) at March 31, 2010, the Consolidated Statements of Operations for the three months ended March 31, 2010 and 2009, the Consolidated Statements of Cash flows for the three months ended March 31, 2010 and 2009, the Consolidated Statement of Changes in Stockholders' Equity for the three months ended March 31, 2010 and 2009, and the Consolidated Statements of Comprehensive Income (Loss) for the three months ended March 31, 2010 and 2009, are unaudited, but reflect all adjustments, which are, in the opinion of management, necessary to present fairly the consolidated financial position, the consolidated changes in stockholders' equity, the consolidated results of operations and comprehensive income (loss), and the consolidated cash flows for the periods presented. All adjustments are of a normal, recurring nature, except as otherwise disclosed. Because they cover interim periods, the unaudited consolidated financial statements and related notes to the consolidated 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 Consolidated Financial Statements and related Notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the year, due primarily to the seasonality of the Company's operations.

Certain reclassifications have been made to conform previously reported data to the current presentation.

Note 2: New Accounting Pronouncements

Fair Value Measurements

In January 2010, the Financial Accounting Standards Board (FASB) issued authoritative guidance that requires new disclosures of (i) the amounts of significant transfers into and out of Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers and (ii) information in the reconciliation of recurring Level 3 measurements (those using significant unobservable inputs) about purchases, sales, issuances, and settlements on a gross basis. This update also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. This guidance is effective for interim and annual periods beginning after December 15, 2009, except for the requirement to disclose information about purchases, sales, issuances and settlements in the reconciliation of Level 3 measurements, which does not become effective until interim and annual periods beginning after December 15, 2010. As this guidance clarifies and provides for additional disclosure requirements only, the adoption of this guidance did not have an impact on the Company's results of operations, financial position or cash flows.

Consolidation of Variable Interest Entities

In June 2009, the FASB issued authoritative guidance that replaces the quantitative-based risk and rewards calculation for determining which reporting entity has a controlling financial interest in a variable interest entity with a qualitative approach. This revised guidance also requires additional disclosures about a reporting entity's involvement in variable interest entities. This guidance is effective for the Company beginning January 1, 2010. These changes did not have an impact on the Company's results of operations, financial position or cash flows; however, these changes could impact the accounting for the Company's interests in a variable interest entity in the future.

Note 3: Goodwill

At March 31, 2010 the Company's goodwill totaled \$1,250,417. The Company's annual goodwill impairment test is conducted at November 30 of each calendar year and interim reviews are performed when the Company determines that a triggering event that would more likely than not reduce the fair value of a reporting unit below its carrying value has occurred. The Company concluded no such triggering event occurred during the three months ended March 31, 2010, accordingly no interim review was performed for this period.

During the first quarter of 2009, the Company's stock price experienced a high degree of volatility and, as of March 31, 2009, had a sustained period for which it was below historical averages and 10% below the market price employed in the Company's 2008 annual goodwill impairment test. Having considered both qualitative and quantitative factors, management concluded that this sustained decline in market value below the market value that existed at the 2008 annual impairment test was an interim triggering event and performed an interim impairment test. The

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Company's calculated market capitalization at March 31, 2009 was \$1,186,000 below its aggregated carrying value of its reporting units.

Management concluded the fair value of certain of the Company's reporting units were below their carrying values as of March 31, 2009. Upon completing the impairment calculation, the Company recognized \$450,000 as a goodwill impairment charge for the three months ended March 31, 2009.

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The following table summarizes the three-month changes in the Company's goodwill by reporting unit:

	Regulated Unit		Non-Regulated Units		Consolidated		Total Net
	Cost	Accumulated Impairment	Cost	Accumulated Impairment	Cost	Accumulated Impairment	
Balance at January 1, 2010	\$ 3,565,913	\$ (2,443,628)	\$ 235,715	\$ (107,619)	\$ 3,801,628	\$ (2,551,247)	\$ 1,250,381
Reclassifications and other activity	36				36		36
Balance at March 31, 2010	\$ 3,565,949	\$ (2,443,628)	\$ 235,715	\$ (107,619)	\$ 3,801,664	\$ (2,551,247)	\$ 1,250,417
Balance at January 1, 2009	\$ 3,565,215	\$ (1,995,380)	\$ 235,549	\$ (105,867)	\$ 3,800,764	\$ (2,101,247)	\$ 1,699,517
Impairment losses		(448,248)		(1,752)		(450,000)	(450,000)
Reclassifications and other activity	322				322		322
Balance at March 31, 2009	\$ 3,565,537	\$ (2,443,628)	\$ 235,549	\$ (107,619)	\$ 3,801,086	\$ (2,551,247)	\$ 1,249,839

The Company may be required to recognize an impairment of goodwill in the future due to market conditions or other factors related to the Company's performance. These market events could include a decline over a period of time of the Company's stock price, a decline over a period of time in valuation multiples of comparable water utilities, the lack of an increase in the Company's market price consistent with its peer companies, or decreases in control premiums. A decline in the forecasted results in our business plan, such as changes in rate case results or capital investment budgets or changes in our interest rates, could also result in an impairment charge. Recognition of impairments of a significant portion of goodwill would negatively affect the Company's reported results of operations and total capitalization, the effect of which could be material and could make it more difficult to maintain its credit ratings, secure financing on attractive terms, maintain compliance with debt covenants and meet expectations of our regulators.

The Company uses a two-step impairment test to identify potential goodwill impairment and measure the amount of a goodwill impairment loss to be recognized (if any). The step 1 calculation used to identify potential impairment compares the calculated fair value for each of the Company's reporting units to their respective net carrying values (book values), including goodwill, on the measurement date. If the fair value of any reporting unit is less than such reporting unit's carrying value, then step 2 is performed to measure the amount of the impairment loss (if any) for such reporting unit.

The step 2 calculation of the impairment test compares, by reporting unit, the implied fair value of the goodwill to the carrying value of goodwill. The implied fair value of goodwill is equal to the excess of the fair value of each reporting unit above the fair value of such reporting unit's identified assets and liabilities. If the carrying value of goodwill exceeds the implied fair value of goodwill for any reporting unit, an impairment loss is recognized in an amount equal to the excess (not to exceed the carrying value of goodwill) for that reporting unit.

The determination of the fair value of each reporting unit and the fair value of each reporting unit's assets and liabilities is performed as of the measurement date using observable market data before and after the measurement date (if that subsequent information is relevant to the fair value on the measurement date).

The estimated fair value of the Regulated reporting unit for step 1 is based on a combination of the following valuation techniques:

observable trading prices of comparable equity securities of publicly-traded water utilities considered by us to be the Company's peers; and

discounted cash flow models developed from the Company's internal forecasts.

The estimated fair values of the Non-Regulated reporting units are determined entirely on the basis of discounted cash flow models.

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The first valuation technique applies average peer multiples to the Regulated reporting unit's historic and forecasted cash flows. The peer multiples are calculated using the average trading prices of comparable equity securities of publicly-traded water utilities, their published cash flows and forecasts of market price and cash flows for those peers.

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The second valuation technique forecasts each reporting unit's five-year cash flows using an estimated long-term growth rate and discounts these cash flows at their respective estimated weighted average cost of capital.

In conjunction with step 1, the Company also reconciles the difference between the calculated market capitalization and the aggregate carrying value of the reporting units to ensure that any excess is supportable by relevant market information. The Company makes certain assumptions, which it believes to be appropriate, that support this reconciliation. The Company considers, in addition to the listed trading price of the Company's shares, the applicability of a control premium to the Company's shares and certain other factors the Company deems appropriate. As a result, the Company may conclude that the Company's fair value exceeds what the Company might otherwise have concluded had it relied on market price alone.

In addition, given recent market conditions, management determined that it is appropriate for the Company to consider the average of the Company's closing market price over a thirty day period rather than using a particular date to calculate its market capitalization.

If step 2 of the impairment test is required, the Company determines the fair value of the applicable reporting unit's assets and liabilities. The fair values of the applicable debt are highly dependent upon market conditions surrounding the measurement date. For the step 2 calculations of the fair value of debt, the Company uses observable prices of instruments and indices that have risks similar to those instruments being valued, adjusted to compensate for differences in credit profile, collateral, tax treatment and call features, to calculate the fair value of each reporting unit's debt.

Note 4: Stockholders' Equity

Common Stock

On March 23, 2010, the Company filed a Form S-3 Registration Statement with the SEC to register 5,000 shares of the Company's common stock issuable under American Water Stock Direct, a dividend reinvestment and direct stock purchase plan (the "DRIP"). Under the DRIP, stockholders may reinvest cash dividends and purchase additional Company common stock, up to certain limits, through a transfer agent without commission fees. The Company's transfer agent may buy newly issued shares directly from the Company or shares held in the Company's treasury. The transfer agent may also buy shares in the public markets or in privately negotiated transactions. Purchases generally will be made for the DRIP and credited to DRIP accounts once each week. The Company issued 127 shares of common stock during the first quarter of 2010 under the DRIP.

On March 1, 2010, the Company made a cash dividend payment of \$0.21 per share to all common shareholders of record as of February 18, 2010, amounting to \$36,679.

On April 30, 2010, the Company declared a quarterly cash dividend payment of \$0.21 per share payable on June 1, 2010 to all shareholders of record as of May 18, 2010.

Stock Based Compensation

The Company has granted stock option and restricted stock unit awards to non-employee directors, officers and other key employees of the Company pursuant to the terms of its 2007 Omnibus Equity Compensation Plan (the "Plan"). As of March 31, 2010, a total of 11,738 shares are available for grant under the Plan. Shares issued under the Plan may be authorized but unissued shares of Company stock or reacquired shares of Company stock, including shares purchased by the Company on the open market for purposes of the Plan.

The Company recognizes compensation expense for stock awards over the vesting period of the award. The following table presents stock-based compensation expense recorded in operations and maintenance expense in the accompanying Consolidated Statements of Operations for the three months ended March 31, 2010 and 2009:

	2010	2009
Stock options	\$ 905	\$ 942
Restricted stock units	1,203	938
Employee stock purchase plan	86	114

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Stock-based compensation in operation and maintenance expense	2,194	1,994
Income tax benefit	(856)	(778)
After-tax stock-based compensation expense	\$ 1,338	\$ 1,216

There were no significant stock-based compensation costs capitalized during the three months ended March 31, 2010 and 2009, respectively.

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Stock options granted in 2008 included 1,470 stock options that were subject to performance-based vesting requirements. In February 2009, the Company cancelled 311 of these stock options related to the first performance vesting period because the performance goals were not fully met at December 31, 2008. In February 2010, the Company cancelled 459 of these stock options related to the second performance vesting period because the second performance goals were not fully met at December 31, 2009. The Company continues to recognize expense on the remaining stock options during the service period, which ends December 31, 2010.

In the first quarter of 2010, the Company granted 867 non-qualified stock options to certain employees under the Plan. The stock options vest ratably over a three-year service period from January 1, 2010. These awards have no performance vesting conditions and the grant date fair value is amortized through expense over the requisite service period using the straight-line method. The following table presents the weighted average assumptions used in the pricing model for 2010 grants and the resulting weighted average grant date fair value of stock options granted:

Dividend yield	3.83 %
Expected volatility	31.86 %
Risk-free interest rate	2.22 %
Expected life (years)	4.32
Exercise price	\$ 21.94
Grant date fair value	\$ 4.36

Stock options granted under the Plan have maximum terms of seven years, vest over periods ranging from one to three years, and are granted with exercise prices equal to the market value of the Company's common stock on the date of grant. As of March 31, 2010, \$6,179 of total unrecognized compensation cost related to the nonvested stock options is expected to be recognized over the weighted-average period of 1.4 years. The table below summarizes stock option activity for the three months ended March 31, 2010.

	Shares	Weighted Average Exercise Price (per share)	Weighted Average Remaining Life (years)	Aggregate Intrinsic Value
Options outstanding at January 1, 2010	2,724	\$ 21.19		
Granted	867	21.94		
Cancelled	(459)	21.50		
Forfeited or expired	(52)	20.99		
Exercised	(9)	21.46		
Options outstanding at March 31, 2010	3,071	\$ 21.36	5.39	\$ 1,482
Exercisable at March 31, 2010 (a)	865	\$ 21.18	4.27	\$ 501

(a) Includes stock options issued to retired employees

Cash received for stock options exercised during the three months ended March 31, 2010 was \$185 and the intrinsic value of the options was \$13.

Restricted Stock Units

Restricted stock units granted in 2008 included 190 restricted stock units that were subject to performance-based vesting requirements. In February 2009, the Company cancelled 39 of these restricted stock units related to the first performance vesting period because the performance goals were not fully met at December 31, 2008. In February 2010, the Company cancelled 60 of these restricted stock units related to the second performance vesting period because the second performance goals were not fully met at December 31, 2009. The Company continues to recognize expense on the remaining restricted stock units during the service period, which ends December 31, 2010.

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In the first quarter of 2010, the Company granted 243 restricted stock units to certain employees under the Plan. The restricted stock units vest ratably over the three year performance period beginning January 1, 2010 (the Performance Period); however, distribution of the shares is contingent upon the achievement of internal performance measures and, separately, certain market thresholds over the Performance Period. The restricted stock units granted with performance and service conditions are valued at the market value of the Company s common stock on the date of grant. The restricted stock units granted with market and service conditions are valued using a Monte Carlo model.

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The value of restricted stock awards at the date of the grant is amortized through expense over the requisite service period using the straight-line method for the restricted stock units with service and/or performance vesting. The grant date fair value of the restricted stock awards that have (a) market and/or performance and service conditions and (b) vest ratably is amortized through expense over the requisite service period using the graded-vesting method. As of March 31, 2010, \$6,103 of total unrecognized compensation cost related to the nonvested restricted stock units is expected to be recognized over the weighted-average remaining life of 1.3 years.

The table below summarizes restricted stock unit activity for the three months ended March 31, 2010.

	Shares	Weighted Average Grant Date Fair Value (per share)
Nonvested total at January 1, 2010	402	\$ 21.77
Granted	243	23.35
Distributed	(40)	21.50
Cancelled	(60)	21.50
Forfeited	(9)	21.94
Undistributed vested awards	(24)	21.50
Nonvested total at March 31, 2010	512	\$ 22.58

The aggregate intrinsic value of restricted stock units distributed was \$894, on which the Company recognized an income tax benefit of \$14, which has been recorded in the accompanying Consolidated Balance Sheets.

If dividends are declared with respect to shares of the Company's common stock before the restricted stock units are distributed, the Company credits a liability for the value of the dividends that would have been paid if the restricted stock units were shares of Company common stock. When the restricted stock units are distributed, the Company pays the employee a lump sum cash payment equal to the value of the dividend equivalents accrued. The Company accrued dividend equivalents totaling \$105 and \$72 to retained earnings during the three months ended March 31, 2010 and 2009, respectively.

Employee Stock Purchase Plan

Under the Nonqualified Employee Stock Purchase Plan (the "ESPP"), employees can use payroll deductions to acquire Company stock at the lesser of 90% of the fair market value of (a) the beginning or (b) the end of each three-month purchase period. As of March 31, 2010 there were 1,802 shares of common stock reserved for issuance under the ESPP. During the three months ended March 31, 2010, the Company issued 30 shares under the ESPP.

Note 5: Long-Term Debt

The Company primarily issues long-term debt to fund capital expenditures at the regulated subsidiaries. The components of long-term debt are as follows:

	Rate	Weighted Average Rate	Maturity Date	March 31, 2010	December 31, 2009
Long-term debt of American Water Capital Corp. ("AWCC")					
Private activity bonds and government funded debt(a)					
Fixed rate	5.25%-6.75%	6.03%	2018-2039	\$ 200,975	\$ 200,975
Senior notes					
Fixed rate	5.39%-10.00%	6.26%	2011-2039	3,087,853	3,115,853
Long-term debt of other subsidiaries					
Private activity bonds and government funded debt					
Fixed rate	0.00%-6.88%	5.30%	2010-2039	1,196,000	1,197,611

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Floating rate(b)	0.90%-1.05%	0.92%	2015	8,560	8,560
Mortgage bonds					
Fixed rate	5.48%-9.71%	7.48%	2010-2039	747,824	754,966
Mandatory redeemable preferred stock	4.60%-9.75%	8.37%	2013-2036	24,207	24,207
Notes payable and other(c)	4.90%-13.31%	7.29%	2011-2026	6,414	6,561
Long-term debt				5,271,833	5,308,733
Unamortized debt discount, net(d)				56,096	57,461
Total long-term debt				\$ 5,327,929	\$ 5,366,194

- (a) As of March 31, 2010 and December 31, 2009, respectively, the Company held \$10,635 of floating rate debt in its treasury, as it had not been able to re-issue the debt to investors at acceptable interest rates.
- (b) Represents variable rate tax-exempt bonds remarketed for periods up to 270 days. The \$8,560 balance is classified as current portion of long-term debt in the accompanying Consolidated Balance Sheets because it was repurchased by the Company during the first quarter of 2009 when no investor was willing to purchase it at market rates. This debt was subsequently remarketed as floating rate debt in the second quarter of 2009.
- (c) Includes capital lease obligations of \$5,532 and \$5,679 at March 31, 2010 and December 31, 2009, respectively.
- (d) Includes fair value adjustments previously recognized in acquisition purchase accounting.

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The following long-term debt was issued in 2010:

Company	Type	Interest Rate	Maturity	Amount
Other subsidiaries	Private activity bonds and government funded debt - fixed rate	0.94%	2029	\$ 857
Other subsidiaries	Private activity bonds and government funded debt - fixed rate	2.31%	2030	148
Other subsidiaries	Private activity bonds and government funded debt - fixed rate	0.0%	2021	96
Total issuances				\$ 1,101

The following long-term debt was retired through optional redemption or payment at maturity during 2010:

Company	Type	Interest Rate	Maturity	Amount
American Water Capital Corp.	Senior notes-fixed rate	6.87%	2011	\$ 28,000
Other subsidiaries	Mortgage bonds - fixed rate	8.21%-8.98%	2010-2011	7,142
Other subsidiaries	Private activity bonds and government funded debt	0.00%-5.90%	2010-2034	2,712
Other	Capital leases			147
Total retirements & redemptions				\$ 38,001

Interest, net includes interest income of approximately \$2,305 and \$2,549 for the three months ended March 31, 2010 and 2009, respectively.

Note 6: Short-Term Debt

The components of short-term debt are as follows:

	March 31, 2010	December 31, 2009
Commercial paper, net of \$13 and \$5 discount, respectively	\$ 138,587	\$ 84,995
Bank overdraft	9,306	34,502
Total short-term debt	\$ 147,893	\$ 119,497

The Company had no outstanding borrowings on its revolving credit line as of March 31, 2010 and December 31, 2009, respectively.

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The Company's estimated annual effective tax rate for the three months ended March 31, 2010 was 40.5% compared to 39.5% for the three months ended March 31, 2009, excluding various discrete items including goodwill impairment. The Company's actual effective tax rates for the three months ended March 31, 2010 and 2009 were 38.7% and (2.6%), respectively. The 2009 rate reflects the tax effects of goodwill impairments as discrete items as the Company considers these charges as infrequently occurring or unusual.

President Obama signed the Patient Protection and Affordable Care Act (the PPACA) into law on March 23, 2010 and on March 30, 2010, signed the Health Care and Education Reconciliation Act of 2010, which makes various amendments to certain aspects of the PPACA (together, the Acts). The PPACA effectively changes the tax treatment of federal subsidies paid to sponsors of retiree health benefit plans that provide a benefit that is at least actuarially equivalent to the benefits under Medicare Part D. As a result of the Acts, these subsidy payments will effectively become taxable in tax years beginning after December 31, 2012.

Although this change does not take effect immediately, companies are required to recognize the full accounting impact in their financial statements in the period in which the legislation was enacted. As a result, in the first quarter of 2010, the Company followed its original accounting for the underfunded status of other postretirement benefits for the Medicare Part D adjustment and recorded a reduction in its deferred tax assets and an increase in its regulatory assets amounting to \$27,128.

Note 8: Pension and Other Postretirement Benefits

The following table provides the components of net periodic benefit costs:

	Three Months Ended March 31,	
	2010	2009
Components of net periodic pension benefit cost		
Service cost	\$ 7,669	\$ 7,107
Interest cost	16,900	15,730
Expected return on plan assets	(14,188)	(10,556)
Amortization of:		
Prior service cost	81	45
Actuarial loss	4,476	5,992
Net periodic pension benefit cost	\$ 14,938	\$ 18,318

	Three Months Ended March 31,	
	2010	2009
Components of net periodic other postretirement benefit cost		
Service cost	\$ 3,666	\$ 3,293
Interest cost	8,037	7,295
Expected return on plan assets	(6,093)	(4,660)
Amortization of:		
Transition obligation	43	43
Prior service (credit) cost	(295)	(295)
Actuarial loss	2,040	2,289
Net periodic other postretirement benefit cost	\$ 7,398	\$ 7,965

The Company contributed \$28,100 to its defined benefit pension plan in the first three months of 2010 and expects to contribute \$53,100 during the balance of 2010. In addition, the Company contributed \$9,680 for the funding of its other postretirement plans in the first three months of 2010 and expects to contribute \$29,039 during the balance of 2010.

Note 9: Commitments and Contingencies

The Company is also routinely involved in legal actions incident to the normal conduct of its business. At March 31, 2010, the Company has accrued approximately \$3,500 as probable costs and it is reasonably possible that additional losses could range up to \$17,000 for these matters. For certain matters, the Company is unable to estimate possible losses. The Company believes that damages or settlements, if any, recovered by plaintiffs in such claims or actions will not have a material adverse effect on the Company's results of operations, financial position or cash flows.

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The Company enters into agreements for the provision of services to water and wastewater facilities for the United States military, municipalities and other customers. The Company's military services agreements expire between 2051 and 2060 and have remaining performance commitments as measured by estimated remaining contract revenue of \$2,084,000 at March 31, 2010. The Company's Operations and Maintenance agreements with municipalities and other customers expire between 2010 and 2048 and have remaining performance commitments as measured by estimated remaining contract revenue of \$1,355,000 at March 31, 2010. Some of the Company's long-term contracts to operate and maintain a municipality's, federal government's or other party's water or wastewater treatment and delivery facilities include responsibility for certain major maintenance for some of those facilities, in exchange for an annual fee. Unless specifically required to perform certain maintenance activities, the maintenance costs are recognized when the maintenance is performed.

Note 10: Environmental Matters

The Company's water and wastewater operations are subject to federal, state, local and foreign requirements relating to environmental protection and as such the Company periodically becomes subject to environmental claims in the normal course of business. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated. Remediation costs accrued amounted to \$7,891 at March 31, 2010 and \$7,947 at December 31, 2009, respectively. At March 31, 2010 and December 31, 2009 respectively, \$7,700 of the accrual relates to a conservation agreement entered into by a subsidiary of the Company with the National Oceanic and Atmospheric Administration requiring the Company to, among other provisions, implement certain measures to protect the steelhead trout and its habitat in the Carmel River watershed in the state of California. The Company has agreed to pay \$1,100 annually from July 2010 through July 2016. The payments will be used to improve habitat conditions for the steelhead trout in the Carmel River Watershed and will end upon a regional desalination plant becoming operational and the subsidiary's diversions from the Carmel River coming within permitted limits. The Company pursues recovery of incurred costs through all appropriate means, including regulatory recovery through customer rates.

Note 11: Net Income (Loss) per Common Share

Earnings per share is calculated using the two-class method. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security. The Company has participating securities related to restricted stock units, granted under the Company's 2007 Omnibus Equity Compensation Plan, that earn dividend equivalents on an equal basis with common shares. In applying the two-class method, undistributed earnings are allocated to both common shares and participating securities. There were no participating securities for the three months ended March 31, 2009. The following is a reconciliation of the Company's net income (loss) and weighted average common shares outstanding for calculating basic net income (loss) per share:

	Three Months Ended March 31,	
	2010	2009
Basic		
Net income (loss)	\$ 30,808	\$ (413,079)
Less: Distributed earnings to common shareholders (a)	36,779	32,072
Less: Distributed earnings to participating securities	9	
Undistributed earnings	(5,980)	(445,151)
Undistributed earnings allocated to common shareholders (b)	(5,978)	(445,151)
Undistributed earnings allocated to participating securities	(2)	
Total income (loss) available to common shareholders, basic (a) + (b)	\$ 30,801	\$ (413,079)
Weighted average common shares outstanding, basic	174,721	160,011
Basic net income (loss) per common share	\$ 0.18	\$ (2.58)

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Diluted net income (loss) per common share is based on the weighted average number of common shares outstanding adjusted for the dilutive effect of common stock equivalents related to the restricted stock units, stock options, and employee stock purchase plan. The dilutive effect of restricted stock units, stock options, and the employee stock purchase plan is calculated using the treasury stock method and expected proceeds on vesting of the restricted stock units, exercise of the stock options and purchases under the employee stock purchase plan. The following is a reconciliation of the Company's net income (loss) and weighted average common shares outstanding for calculating diluted net income (loss) per share:

	Three Months Ended	
	March 31,	
	2010	2009
Diluted		
Total income (loss) available to common shareholders, basic	\$ 30,801	\$ (413,079)
Undistributed earnings allocated to participating securities	(2)	
Total income (loss) available to common shareholders, diluted	\$ 30,799	\$ (413,079)
Weighted average common shares outstanding, basic	174,721	160,011
Stock-based compensation:		
Restricted stock units	65	
Stock options	10	
Employee stock purchase plan	1	