

AQUA AMERICA INC  
Form 10-Q  
November 06, 2015  
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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 September 30, 2015

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  
(State or other jurisdiction of  
incorporation or organization)

23-1702594  
(I.R.S. Employer  
Identification No.)

762 W. Lancaster Avenue, Bryn Mawr, Pennsylvania  
(Address of principal executive offices)

19010 -3489  
(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.)

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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 (do not check if a smaller reporting company)	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

October 23, 2015: 176,428,025

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AQUA AMERICA, INC. AND SUBSIDIARIES

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## AQUA AMERICA, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(In thousands of dollars, except per share amounts)

(UNAUDITED)

	September 30, 2015	December 31, 2014
Assets		
Property, plant and equipment, at cost	\$ 5,985,452	\$ 5,707,017
Less: accumulated depreciation	1,379,940	1,305,027
Net property, plant and equipment	4,605,512	4,401,990
Current assets:		
Cash and cash equivalents	4,071	4,138
Accounts receivable and unbilled revenues, net	111,076	96,999
Deferred income taxes	28,483	26,849
Inventory, materials and supplies	12,924	12,788
Prepayments and other current assets	11,753	11,748
Total current assets	168,307	152,522
Regulatory assets	799,858	725,591
Deferred charges and other assets, net	52,364	52,084
Investment in joint venture	41,397	43,334
Funds restricted for construction activity	-	47
Goodwill	33,907	31,184
Total assets	\$ 5,701,345	\$ 5,406,752
Liabilities and Equity		
Aqua America stockholders' equity:		
Common stock at \$.50 par value, authorized 300,000,000 shares, issued 179,192,150 and 178,591,254 as of September 30, 2015 and December 31, 2014	\$ 89,596	\$ 89,296
Capital in excess of par value	768,428	758,145
Retained earnings	933,144	849,952
Treasury stock, at cost, 2,633,430 and 1,837,984 shares as of September 30, 2015 and December 31, 2014	(63,106)	(42,838)
Accumulated other comprehensive income	619	788
Total Aqua America stockholders' equity	1,728,681	1,655,343
Noncontrolling interest	-	40
Total equity	1,728,681	1,655,383
Long-term debt, excluding current portion	1,681,114	1,560,655

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Commitments and contingencies (See Note 13)	-	-
Current liabilities:		
Current portion of long-term debt	47,599	58,615
Loans payable	28,030	18,398
Accounts payable	45,077	63,035
Accrued interest	21,155	12,437
Accrued taxes	27,048	31,462
Other accrued liabilities	47,113	41,388
Total current liabilities	216,022	225,335
Deferred credits and other liabilities:		
Deferred income taxes and investment tax credits	1,115,672	1,000,791
Customers' advances for construction	87,253	78,301
Regulatory liabilities	264,346	278,317
Other	98,043	109,692
Total deferred credits and other liabilities	1,565,314	1,467,101
Contributions in aid of construction	510,214	498,278
Total liabilities and equity	\$ 5,701,345	\$ 5,406,752

See notes to consolidated financial statements beginning on page 9 of this report.

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## AQUA AMERICA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF NET INCOME

(In thousands, except per share amounts)

(UNAUDITED)

	Three Months Ended September 30,	
	2015	2014
Operating revenues	\$ 221,051	\$ 210,535
Operating expenses:		
Operations and maintenance	78,519	72,374
Depreciation	31,981	29,482
Amortization	816	806
Taxes other than income taxes	14,663	12,815
Total operating expenses	125,979	115,477
Operating income	95,072	95,058
Other expense (income):		
Interest expense, net	19,239	18,990
Allowance for funds used during construction	(1,708)	(1,195)
Gain on sale of other assets	(170)	(75)
Equity loss in joint venture	698	736
Income from continuing operations before income taxes	77,013	76,602
Provision for income taxes	9,584	8,891
Income from continuing operations	67,429	67,711
Discontinued operations:		
Income from discontinued operations before income taxes	-	472
Provision for income taxes	-	187
Income from discontinued operations	-	285
Net income attributable to common shareholders	\$ 67,429	\$ 67,996
Income from continuing operations per share:		
Basic	\$ 0.38	\$ 0.38
Diluted	\$ 0.38	\$ 0.38
Income from discontinued operations per share:		

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Basic	\$ -	\$ 0.00
Diluted	\$ -	\$ 0.00
Net income per common share:		
Basic	\$ 0.38	\$ 0.38
Diluted	\$ 0.38	\$ 0.38
Average common shares outstanding during the period:		
Basic	176,704	176,900
Diluted	177,495	177,908
Cash dividends declared per common share	\$ 0.178	\$ 0.165

See notes to consolidated financial statements beginning on page 9 of this report.



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## AQUA AMERICA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF NET INCOME

(In thousands, except per share amounts)

(UNAUDITED)

	Nine Months Ended September 30, 2015	2014
Operating revenues	\$ 617,137	\$ 588,514
Operating expenses:		
Operations and maintenance	231,454	214,435
Depreciation	93,530	91,689
Amortization	2,589	2,685
Taxes other than income taxes	43,079	37,943
	370,652	346,752
Operating income	246,485	241,762
Other expense (income):		
Interest expense, net	56,804	57,393
Allowance for funds used during construction	(3,930)	(3,299)
(Gain) loss on sale of other assets	(338)	133
Equity loss in joint venture	1,496	2,673
Income from continuing operations before income taxes	192,453	184,862
Provision for income taxes	19,097	19,932

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Income from continuing operations		173,356		164,930
Discontinued operations:				
Income from discontinued operations before income taxes		-		2,497
Provision for income taxes		-		1,003
Income from discontinued operations		-		1,494
Net income attributable to common shareholders	\$	173,356	\$	166,424
Income from continuing operations per share:				
Basic	\$	0.98	\$	0.93
Diluted	\$	0.98	\$	0.93
Income from discontinued operations per share:				
Basic	\$	-	\$	0.01
Diluted	\$	-	\$	0.01
Net income per common share:				
Basic	\$	0.98	\$	0.94
Diluted	\$	0.98	\$	0.94
Average common shares outstanding during the period:				
Basic		176,891		176,933
Diluted		177,670		177,872
Cash dividends declared per common share	\$	0.508	\$	0.469

See notes to consolidated financial statements beginning on page 9 of this report.



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## AQUA AMERICA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands of dollars)

(UNAUDITED)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Net income attributable to common shareholders	\$ 67,429	\$ 67,996	\$ 173,356	\$ 166,424
Other comprehensive income, net of tax:				
Unrealized holding (loss) gain on investments, net of tax (benefit) expense of \$(120) and \$(33) for the three months and \$(90) and \$73 for the nine months ended September 30, 2015 and 2014, respectively	(223)	(62)	(169)	136
Reclassification adjustment for loss reported in net income, net of tax benefit of \$134 for the nine months ended September 30, 2014 (1)	-	-	-	249
Comprehensive income	\$ 67,206	\$ 67,934	\$ 173,187	\$ 166,809

(1) Amount of pre-tax loss of \$383 reclassified from accumulated other comprehensive income to loss on sale of other assets on the consolidated statements of net income for the nine months ended September 30, 2014.

See notes to consolidated financial statements beginning on page 9 of this report.

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## AQUA AMERICA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CAPITALIZATION

(In thousands of dollars, except per share amounts)

(UNAUDITED)

	September 30, 2015	December 31, 2014
Aqua America stockholders' equity:		
Common stock, \$.50 par value	\$ 89,596	\$ 89,296
Capital in excess of par value	768,428	758,145
Retained earnings	933,144	849,952
Treasury stock, at cost	(63,106)	(42,838)
Accumulated other comprehensive income	619	788
Total Aqua America stockholders' equity	1,728,681	1,655,343
Noncontrolling interest	-	40
Total equity	1,728,681	1,655,383
Long-term debt of subsidiaries (substantially secured by utility plant):		
Interest Rate Range	Maturity Date Range	
0.00% to 0.99%	2023 to 2033	5,148
1.00% to 1.99%	2016 to 2035	22,159
2.00% to 2.99%	2024 to 2031	18,597
3.00% to 3.99%	2016 to 2047	187,882
4.00% to 4.99%	2020 to 2054	483,837
5.00% to 5.99%	2016 to 2043	221,545
6.00% to 6.99%	2015 to 2036	64,960
7.00% to 7.99%	2022 to 2027	33,930
8.00% to 8.99%	2021 to 2025	18,607
9.00% to 9.99%	2018 to 2026	27,100
10.00% to 10.99%	2018	6,000
		1,089,765
Notes payable to bank under revolving credit agreement, variable rate, due 2017	105,000	72,000
Unsecured notes payable:		
Bank notes at 1.921% and 1.975% due 2017 and 2018	100,000	50,000

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Notes at 3.57% and 3.59% due 2027 and 2030	120,000	50,000
Notes ranging from 4.62% to 4.87%, due 2016 through 2024	144,400	144,400
Notes ranging from 5.20% to 5.95%, due 2016 through 2037	169,548	187,548
Total long-term debt	1,728,713	1,619,270
Current portion of long-term debt	47,599	58,615
Long-term debt, excluding current portion	1,681,114	1,560,655
Total capitalization	\$ 3,409,795	\$ 3,216,038

See notes to consolidated financial statements beginning on page 9 of this report.

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## 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	Noncontrolling Interest	Total
Balance at December 31, 2014	\$ 89,296	\$ 758,145	\$ 849,952	\$ (42,838)	\$ 788	\$ 40	\$ 1,655,383
Net income	-	-	173,356	-	-	-	173,356
Other comprehensive loss, net of income tax benefit of \$90	-	-	-	-	(169)	-	(169)
Dividends	-	-	(89,842)	-	-	-	(89,842)
Sale of stock (14,441 shares)	7	337	-	-	-	-	344
Repurchase of stock (795,446 shares)	-	-	-	(20,268)	-	-	(20,268)
Equity compensation plan (319,839 shares)	160	(160)	-	-	-	-	-
Exercise of stock options (266,616 shares)	133	4,385	-	-	-	-	4,518
Stock-based compensation	-	4,728	(322)	-	-	-	4,406
Employee stock plan tax benefits	-	1,648	-	-	-	-	1,648
Other	-	(655)	-	-	-	(40)	(695)
Balance at September 30, 2015	\$ 89,596	\$ 768,428	\$ 933,144	\$ (63,106)	\$ 619	\$ -	\$ 1,728,681

See notes to consolidated financial statements beginning on page 9 of this report.

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## AQUA AMERICA, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOW

(In thousands of dollars)

(UNAUDITED)

	Nine Months Ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net income	\$ 173,356	\$ 166,424
Income from discontinued operations	-	1,494
Income from continuing operations	173,356	164,930
Adjustments to reconcile income from continuing operations to net cash flows from operating activities:		
Depreciation and amortization	96,119	94,374
Deferred income taxes	13,855	15,055
Provision for doubtful accounts	3,693	4,648
Stock-based compensation	4,728	5,145
(Gain) loss on sale of other assets	(338)	133
Net change in receivables, inventory and prepayments	(18,677)	(13,928)
Net change in payables, accrued interest, accrued taxes and other accrued liabilities	16,450	16,241
Other	(6,804)	(11,023)
Operating cash flows from continuing operations	282,382	275,575
Operating cash flows used in discontinued operations, net	-	(1,142)
Net cash flows from operating activities	282,382	274,433
Cash flows from investing activities:		
Property, plant and equipment additions, including the debt component of allowance for funds used during construction of \$1,015 and \$1,033	(257,478)	(220,739)
Acquisitions of utility systems and other, net	(26,327)	(11,677)
Release of funds previously restricted for construction activity	47	-
Net proceeds from the sale of utility system and other assets	513	386
Other	(1,027)	513
Investing cash flows used in continuing operations	(284,272)	(231,517)
Investing cash flows from discontinued operations, net	-	(77)
Net cash flows used in investing activities	(284,272)	(231,594)
Cash flows from financing activities:		
Customers' advances and contributions in aid of construction	4,286	4,510
Repayments of customers' advances	(2,332)	(2,107)
Net proceeds of short-term debt	9,632	(29,743)
Proceeds from long-term debt	313,440	221,058

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Repayments of long-term debt	(203,851)	(128,395)
Change in cash overdraft position	(14,918)	(16,883)
Proceeds from issuing common stock	344	-
Proceeds from exercised stock options	4,518	4,870
Stock-based compensation windfall tax benefits	1,469	1,235
Repurchase of common stock	(20,268)	(13,973)
Dividends paid on common stock	(89,842)	(82,953)
Other	(655)	(580)
Financing cash flows from (used) in continuing operations	1,823	(42,961)
Financing cash flows used in discontinued operations, net	-	(93)
Net cash flows from (used) in financing activities	1,823	(43,054)
Net change in cash and cash equivalents	(67)	(215)
Cash and cash equivalents at beginning of period	4,138	5,058
Cash and cash equivalents at end of period	\$ 4,071	\$ 4,843
Non-cash investing activity:		
Property, plant and equipment additions purchased at the period end, but not yet paid for	\$ 24,742	\$ 28,933

See notes to consolidated financial statements beginning on page 9 of this report.

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## 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 September 30, 2015, the consolidated statements of net income and comprehensive income for the three and nine months ended September 30, 2015 and 2014, the consolidated statements of cash flow for the nine months ended September 30, 2015 and 2014, and the consolidated statement of equity for the nine months ended September 30, 2015 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, 2014. 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, 2014 consolidated balance sheet data presented herein was derived from the Company’s December 31, 2014 audited consolidated financial statements, but does not include all disclosures and notes normally provided in annual financial statements.

## 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, 2014	\$ 24,564	\$ 6,620	\$ 31,184
Goodwill acquired	-	12	12
Reclassifications from (to) utility plant acquisition adjustment, net	2,723	-	2,723
Other	-	(12)	(12)

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Balance at September 30, 2015	\$ 27,287	\$ 6,620	\$ 33,907
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AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

The reclassification from utility plant acquisition adjustment to goodwill represents the purchase price in excess of the fair market value of the net assets acquired, from a prior acquisition, which was originally accounted for as utility plant acquisition adjustment. The reclassification from 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.

The Company tested the goodwill attributable for each of our reporting units for impairment as of July 31, 2015, in conjunction with the timing of our annual strategic business plan, and concluded that the estimated fair value of each reporting unit, which has goodwill recorded, exceeded the reporting unit's carrying amount, indicating that none of the Company's goodwill was impaired.

Note 3 – Acquisitions

In May 2015, the Company acquired the water utility systems assets of Mt. Jewett Borough water system located in Hamlin Township, Pennsylvania serving approximately 440 customers. The total purchase price consisted of \$1,166 in cash.

In April 2015, the Company acquired the water and wastewater utility system assets of North Maine Utilities located in the Village of Glenview, Illinois serving approximately 7,400 customers. The total purchase price consisted of \$23,079 in cash. The purchase price allocation for this acquisition consists primarily of acquired property, plant and equipment.

In December 2014, the Company acquired the water utility system assets of Lake Mohawk and Lake Tomahawk utilities located in Northeastern Ohio serving approximately 1,250 customers. The total purchase price consisted of \$1,770 in cash.

In December 2014, the Company acquired a business that specializes in providing water distribution system services to prevent the contamination of potable water, including training to waterworks operators. The total purchase price consisted of \$1,800 in cash, of which \$700 was paid in the first quarter of 2015. This business is included in the Company's market-based activities.

In September 2014, the Company acquired the water and wastewater utility system assets of Texas H2O, Inc. located in Mansfield, Texas serving approximately 1,100 customers. The total purchase price consisted of \$2,796 in cash.

In September 2014, the Company acquired the water utility system assets of Lake Caroline Water Co. located in Caroline County, Virginia serving approximately 1,040 customers. The total purchase price consisted of \$1,377 in cash.

In August 2014, the Company acquired a business that specializes in the inspection, cleaning and repair of storm and sanitary sewer lines. The total purchase price consisted of \$3,010 in cash, of which a total of \$810 is contingent upon satisfying certain annual performance targets over a three-year period. This business is included in the Company's market-based activities.

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AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

In March 2014, the Company acquired the wastewater utility system assets of Penn Township located in Chester County, Pennsylvania serving approximately 800 customers. The total purchase price consisted of \$3,668 in cash.

Note 4 – Discontinued Operations

In December 2014, we completed the sale of our water utility system in southwest Allen County, Indiana to the City of Fort Wayne, Indiana. The completion of this sale settled the dispute concerning the City of Fort Wayne’s valuation of the northern portion of our water and wastewater utility systems, which were acquired by the City of Fort Wayne in February 2008, by eminent domain. In addition, as a result of this transaction, Aqua Indiana will expand its sewer customer base by accepting new wastewater flows from the City of Fort Wayne.

In March 2014, we completed the sale of our wastewater treatment facility in Georgia.

The operating results and cash flows of the Company’s operations named above, during the periods owned, have been presented in the Company’s consolidated statements of net income and consolidated statements of cash flow as discontinued operations. These operations were included in the Company’s “Regulated” segment.

A summary of discontinued operations presented in the consolidated statements of net income include the following:

	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
Operating revenues	\$ 1,935	\$ 5,234

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Total operating expenses	1,463	2,603
Operating income	472	2,631
Other expense:		
Loss on sale	-	134
Income from discontinued operations before income taxes	472	2,497
Provision for income taxes	187	1,003
Income from discontinued operations	\$ 285	\$ 1,494

As of September 30, 2015 and December 31, 2014, there were no assets or liabilities associated with the Company's discontinued operations.

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AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

Note 5 – Capitalization

In October 2015, the Company provided notice for the early redemption of \$4,000 of first mortgage bonds at 8.14% that were originally maturing in 2025 and \$95,985 of tax-exempt bonds at 5.00% that were originally maturing between 2035 and 2038. The Company anticipates refinancing this debt through the issuance of long-term debt during the fourth quarter of 2015.

In May 2015, the Company issued \$70,000 of senior unsecured notes due in 2030 with an interest rate of 3.59%. The proceeds were used to repay existing indebtedness and for general corporate purposes.

In May 2015, Aqua Pennsylvania Inc., a subsidiary of the Company (“Aqua Pennsylvania”) entered into a \$50,000 three-year unsecured loan at an interest rate of 1.975%. The proceeds from this loan were used for refinancing existing indebtedness and general working capital purposes.

In February 2015, the Company renewed its universal shelf registration, which had expired in February 2015, through a filing with the Securities and Exchange Commission (“SEC”) to allow for the potential future sale by the Company, from time to time, in one or more public offerings, of an indeterminate amount of our common stock, preferred stock, debt securities and other securities specified therein at indeterminate prices.

In February 2015, the Company filed a registration statement with the SEC to update an existing filing which permits the offering, from time to time, of an aggregate of \$500,000 in shares of common stock and shares of preferred stock in connection with acquisitions. The form and terms of any securities issued under these shelf registration statements will be determined at the time of issuance.

Note 6 – Fair Value of Financial Instruments

The Company follows the Financial Accounting Standards Board's ("FASB") accounting guidance for fair value measurements and disclosures, which defines fair value and establishes a framework for using fair value to measure assets and liabilities. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1: unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access;
  
- Level 2: inputs other than Level 1 that are observable, either directly or indirectly, such as quoted market prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in non-active markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; or
  
- Level 3: inputs that are unobservable and significant to the fair value measurement.

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## AQUA AMERICA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. There have been no changes in the valuation techniques used to measure fair value or asset or liability transfers between the levels of the fair value hierarchy for the quarter ended September 30, 2015.

Financial instruments are recorded at carrying value in the financial statements and approximate fair value as of the dates presented. The fair value of these instruments is disclosed below in accordance with current accounting guidance related to financial instruments.

The fair value of funds restricted for construction activity and loans payable are determined based on their carrying amount and utilizing Level 1 methods and assumptions. As of September 30, 2015, the Company did not have any funds restricted for construction activity and as of December 31, 2014, the carrying amount of the Company's funds restricted for construction activity was \$47, which equates to its estimated fair value. As of September 30, 2015 and December 31, 2014, the carrying amount of the Company's loans payable was \$28,030 and \$18,398, respectively, which equates to their estimated fair value. The fair value of cash and cash equivalents, which is comprised of a money market fund, is determined based on the net asset value per unit utilizing Level 2 methods and assumptions. As of September 30, 2015 and December 31, 2014, the carrying amounts of the Company's cash and cash equivalents was \$4,071 and \$4,138, respectively, which equates to their fair value.

The carrying amounts and estimated fair values of the Company's long-term debt is as follows:

	September 30, 2015	December 31, 2014
Carrying Amount	\$ 1,728,713	\$ 1,619,270
Estimated Fair Value	1,905,055	1,694,424

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 utilizing Level 2 methods and assumptions. The Company's customers' advances for construction have a carrying value of \$87,253 as of September 30, 2015, and \$78,301 as of December 31, 2014. 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 2025 and amounts not paid by the respective 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.

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## AQUA AMERICA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

## Note 7 – 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 treasury stock method assumes that the proceeds from the exercise of stock options are used to purchase the Company's common stock at the average market price during the period. The following table summarizes the shares, in thousands, used in computing basic and diluted net income per common share:

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2015	
	2014	2015	2014	2015
Average common shares outstanding during the period for basic computation	176,704	176,900	176,891	176,933
Dilutive effect of employee stock-based compensation	791	1,008	779	939
Average common shares outstanding during the period for diluted computation	177,495	177,908	177,670	177,872

For the three and nine months ended September 30, 2015 and 2014, all of the Company's employee stock options were included in the calculations of diluted net income per share as the calculated cost to exercise the stock options was less than the average market price of the Company's common stock during these periods.

Note 8 – Stock-based Compensation

Under the Company's 2009 Omnibus Equity Compensation Plan, as amended as of February 27, 2014 (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 6,250,000 shares for issuance under the plan. A maximum of 3,125,000 shares under the 2009 Plan may be issued pursuant to stock awards, stock units and other stock-based awards, subject to adjustment as provided in the 2009 Plan. During any calendar year, no individual may be granted (i) stock options and stock appreciation rights under the 2009 Plan for more than 500,000 shares of Company stock in the aggregate or (ii) stock awards, stock units or other stock-based awards under the 2009 Plan for more than 500,000 shares of Company stock in the aggregate, subject to adjustment as provided in the 2009 Plan. Awards under the 2009 Plan are made by a committee of the Board of Directors of the Company, or in the case of awards to non-employee directors, by the Board of Directors of the Company. At September 30, 2015, 4,218,666 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.

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## 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 exceptions through the respective vesting period, generally three years. 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. The following table provides compensation costs for stock-based compensation related to PSUs:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Stock-based compensation within operations and maintenance expenses	\$ 836	\$ 1,220	\$ 3,475	\$ 3,689
Income tax benefit	339	495	1,414	1,506

The following table summarizes nonvested PSU transactions for the nine months ended September 30, 2015:

	Number of Share Units	Weighted Average Fair Value
Nonvested share units at December 31, 2014	582,644	\$ 22.98
Granted	141,762	26.45
Performance criteria adjustment	11,080	25.57
Forfeited	(13,401)	25.92
Share units vested	(86,425)	26.25
Share units issued	(217,014)	18.49
Nonvested share units at September 30, 2015	418,646	\$ 25.78

A portion of the fair value of PSUs was estimated at the grant date based on the probability of satisfying the market-based conditions associated with the PSUs using the Monte Carlo valuation method, which assesses probabilities of various outcomes of market conditions. The other portion of the fair value of the PSUs is based on the fair market value of the Company's stock at the grant date, regardless of whether the market-based condition is satisfied. The per unit weighted-average fair value at the date of grant for PSUs granted during the nine months ended September 30, 2015 and 2014 was \$26.45 and \$25.31, respectively. The fair value of each PSU grant is amortized monthly into compensation expense on a straight-line basis over their respective vesting periods, generally 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 for the portion based on the performance-based condition. The Company assumes that forfeitures will be minimal, and recognizes forfeitures as they occur, which results in a reduction in compensation expense. As the payout of the PSUs includes dividend equivalents, no separate dividend yield assumption is required in calculating the fair value of the PSUs. The recording of compensation expense for PSUs has no impact on net cash flows.



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## AQUA AMERICA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

On July 1, 2015, in association with the appointment of the Company's Executive Vice President and President and Chief Operating Officer, Regulated Operations, to Chief Executive Officer ("CEO"), the Company granted 9,892 PSUs to the CEO. The fair market value of the PSUs granted is \$25.80 per unit.

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. In some cases the right to receive the shares is subject to certain performance goals established at the time the grant is made. The Company assumes that forfeitures will be minimal, and recognizes forfeitures as they occur, which results in a reduction in compensation expense. As the payout of the RSUs includes dividend equivalents, no separate dividend yield assumption is required in calculating the fair value of the RSUs. The following table provides compensation costs for stock-based compensation related to RSUs:

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2014	
Stock-based compensation within operations and maintenance expenses	\$ 209	\$ 295	\$ 888	\$ 827
Income tax benefit	86	122	367	342

The following table summarizes nonvested RSU transactions for the nine months ended September 30, 2015:

	Number of Stock Units	Weighted Average Fair Value
Nonvested stock units at December 31, 2014	122,565	\$ 22.29
Granted	46,910	25.97
Stock units vested in prior period and issued in current period	11,500	17.99
Stock units vested but not issued	(1,563)	24.72

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Stock units vested and issued	(89,025)	20.96
Forfeited	(2,409)	24.93
Nonvested stock units at September 30, 2015	87,978	\$ 24.92

The per unit weighted-average fair value at the date of grant for RSUs granted during the nine months ended September 30, 2015 and 2014 was \$25.97 and \$24.80, respectively.

On July 1, 2015, in association with the appointment of the Company's Executive Vice President and President and Chief Operating Officer, Regulated Operations, to CEO, the Company granted 4,935 RSUs to the CEO. The fair market value of the RSUs granted is \$24.80 per unit.

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## AQUA AMERICA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

Stock Options – The following table provides the income tax benefit for stock-based compensation related to stock options granted in prior periods:

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2014	
Income tax benefit	\$ 28	\$ 2	\$ 143	\$ 98

For the nine months ended September 30, 2015 and 2014, there were no compensation costs for stock-based compensation related to stock options, as stock options were fully amortized in 2013. Additionally, there were no stock options granted during the nine months ended September 30, 2015 or 2014.

The following table summarizes stock option transactions for the nine months ended September 30, 2015:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Life (years)	Aggregate Intrinsic Value
Outstanding at December 31, 2014	1,084,992	\$ 17.06		
Forfeited	-	-		
Expired / Cancelled	(750)	13.72		
Exercised	(266,616)	16.95		
Outstanding and exercisable at September 30, 2015	817,626	\$ 17.10	2.6	\$ 7,659

Restricted Stock – The following table provides compensation costs for stock-based compensation related to restricted stock:

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2014	
Stock-based compensation within operations and maintenance expenses	\$ -	\$ 92	\$ -	\$ 629
Income tax benefit	-	38	-	261

For the nine months ended September 30, 2015, there were no compensation costs for stock-based compensation related to restricted stock, as restricted stock was fully amortized in 2014. Additionally, there was no restricted stock granted during the nine months ended September 30, 2015 or 2014.

Stock Awards – On June 3, 2015, the Company granted an aggregate of 13,800 shares of common stock to the non-employee members of the Board of Directors continuing in office. The fair market value of the shares is \$26.44 per share. The shares granted are not subject to any restrictions. In the second quarter of 2015, the Company recognized \$365 of compensation expense and an income tax benefit of \$151 associated with this grant.

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## AQUA AMERICA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

## Note 9 – Pension Plans and Other Postretirement Benefits

The Company maintains a qualified defined benefit pension plan (the “Pension Plan”), a nonqualified pension plan 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 cost:

	Pension Benefits			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Service cost	\$ 750	\$ 1,004	\$ 2,600	\$ 3,291
Interest cost	3,255	3,564	9,699	10,589
Expected return on plan assets	(4,677)	(4,495)	(14,025)	(13,105)
Amortization of prior service cost	44	69	130	208
Amortization of actuarial loss	1,465	628	4,529	1,628
Curtailment loss	-	84	-	84
Net periodic benefit cost	\$ 837	\$ 854	\$ 2,933	\$ 2,695
	Other			
	Postretirement Benefits			
	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Service cost	\$ 273	\$ 283	\$ 952	\$ 878
Interest cost	681	722	2,120	2,181
Expected return on plan assets	(731)	(686)	(2,192)	(2,057)
Amortization of prior service cost	(211)	(68)	(476)	(210)
Amortization of actuarial loss	309	59	972	200
Net periodic benefit cost	\$ 321	\$ 310	\$ 1,376	\$ 992

The Company made cash contributions of \$13,756 to its Pension Plan during the first six months of 2015, which completed the Company's 2015 cash contributions.

Note 10 – Water and Wastewater Rates

During the first nine months of 2015, the Company's operating divisions in Illinois, Ohio, and Texas were granted base rate increases designed to increase total operating revenues on an annual basis by \$3,347. Further, during the first nine months of 2015, the Company's operating divisions in New Jersey, Illinois, Pennsylvania (wastewater), and North Carolina received approval to bill infrastructure rehabilitation surcharges designed to increase total operating revenues on an annual basis by \$1,805.

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AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

Note 11 – Taxes Other than Income Taxes

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Property	\$ 6,945	\$ 6,860	\$ 20,776	\$ 17,938
Capital stock	538	(274)	1,619	749
Gross receipts, excise and franchise	2,859	2,727	7,855	8,476
Payroll	2,072	1,650	7,425	5,913
Regulatory assessments	693	694	2,033	1,877
Other	1,556	1,158	3,371	2,990
Total taxes other than income	\$ 14,663	\$ 12,815	\$ 43,079	\$ 37,943

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## AQUA AMERICA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

## Note 12 – Segment Information

The Company has identified ten operating segments and has one reportable segment named the “Regulated” segment. The reportable segment is comprised of eight 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, two segments are not quantitatively significant to be reportable and are comprised of the Company’s market-based activities: Aqua Resources, Inc. and Aqua Infrastructure, LLC. Aqua Resources provides liquid waste hauling and disposal; water and wastewater service through operating and maintenance contracts with municipal authorities and other parties in close proximity to our utility companies’ service territories; offers, through a third party, water and wastewater line repair service and protection solutions to households; inspects, cleans and repairs storm and sanitary wastewater lines; installs and tests devices that prevent the contamination of potable water; designs and builds water and wastewater systems; and provides other market-based water and wastewater services. Aqua Infrastructure provides non-utility raw water supply services for firms in the natural gas drilling industry. These two segments are 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. Corporate costs include general and administrative expense, and interest expense.

The following table presents information about the Company’s reportable segment:

	Three Months Ended September 30, 2015			Three Months Ended September 30, 2014		
	Regulated	Other	Consolidated	Regulated	Other	Consolidated
Operating revenues	\$ 213,023	\$ 8,028	\$ 221,051	\$ 203,303	\$ 7,232	\$ 210,535
Operations and maintenance expense	72,373	6,146	78,519	68,319	4,055	72,374
Depreciation	31,890	91	31,981	29,273	209	29,482
Operating income	93,828	1,244	95,072	92,783	2,275	95,058
Interest expense, net of allowance for funds used during construction	16,461	1,070	17,531	16,805	990	17,795
Income tax expense (benefit)	9,883	(299)	9,584	8,832	59	8,891
Income (loss) from continuing operations	67,654	(225)	67,429	67,221	490	67,711
	Nine Months Ended			Nine Months Ended		



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	September 30, 2015			September 30, 2014		
	Regulated	Other	Consolidated	Regulated	Other	Consolidated
Operating revenues	\$ 590,519	\$ 26,618	\$ 617,137	\$ 571,180	\$ 17,334	\$ 588,514
Operations and maintenance expense	210,639	20,815	231,454	204,291	10,144	214,435
Depreciation	93,276	254	93,530	91,378	311	91,689
Operating income	243,101	3,384	246,485	236,638	5,124	241,762
Interest expense, net of allowance for funds used during construction	50,085	2,789	52,874	50,654	3,440	54,094
Income tax expense (benefit)	19,679	(582)	19,097	20,701	(769)	19,932
Income (loss) from continuing operations	173,670	(314)	173,356	165,587	(657)	164,930
Capital expenditures	256,924	554	257,478	219,465	1,274	220,739

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## AQUA AMERICA, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

	September 30, 2015	December 31, 2014
Total assets:		
Regulated	\$ 5,490,578	\$ 5,195,191
Other	210,767	211,561
Consolidated	\$ 5,701,345	\$ 5,406,752

## Note 13 – 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 September 30, 2015, the aggregate amount of \$13,371 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 September 30, 2015, estimates that approximately \$961 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.

In addition to the aforementioned loss contingencies, the Company self-insures its employee medical benefit program, and maintains stop-loss coverage to limit the exposure arising from these claims. The Company's reserve for these

claims totaled \$1,496 at September 30, 2015 and represents a reserve for unpaid claim costs, including an estimate for the cost of incurred but not reported claims.

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AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

Note 14 – Income Taxes

During the nine months ended September 30, 2015, the Company utilized \$67,733 of its Federal net operating loss (“NOL”) carryforward. In addition, during the nine months ended September 30, 2015, the Company’s state NOL carryforward increased by \$1,994. As of September 30, 2015, the balance of the Company’s Federal NOL was \$141,840. The Company believes its Federal NOL carryforward is more likely than not to be recovered and requires no valuation allowance. As of September 30, 2015, the balance of the Company’s gross state NOL was \$568,827, a portion of which is offset by a valuation allowance because the Company does not believe the NOLs are more likely than not to be realized. The Company’s Federal and state NOL carryforwards begin to expire in 2032 and 2024, respectively. The Company has unrecognized tax positions that result in the associated tax benefit being unrecognized. The Company’s Federal and state NOL carryforwards are reduced by an unrecognized tax position, on a gross basis, of \$61,813 and \$83,543, respectively. The amounts of the Company’s Federal and state NOL carryforwards prior to being reduced by the unrecognized tax positions were \$203,653 and \$652,370, respectively. The Company records its unrecognized tax benefit as a reduction to its deferred income tax liability.

In accordance with a 2012 settlement agreement with the Pennsylvania Public Utility Commission, Aqua Pennsylvania expenses, for tax purposes, qualifying utility asset improvement costs, which results in a substantial reduction in income tax expense and greater net income and cash flows. The Company’s effective income tax rate for the third quarter of 2015 and 2014, for its continuing operations, was 12.4% and 11.6%, respectively, and for the first nine months of 2015 and 2014, for its continuing operations, was 9.9% and 10.8% respectively.

As of September 30, 2015, the total gross unrecognized tax benefit was \$26,723, of which \$17,157, if recognized, would affect the Company’s effective tax rate as a result of the regulatory treatment afforded for qualifying infrastructure improvements in Pennsylvania. At December 31, 2014, the Company had unrecognized tax benefits of \$25,292.

Accounting rules for uncertain tax positions specify that tax positions for which the timing of resolution is uncertain should be classified as long-term liabilities. Judgment is required in evaluating the Company’s uncertain tax positions and determining the provision for income taxes. Management believes that an adequate provision has been made for any adjustments that may result from tax examinations. Although the timing of income tax audit resolutions and negotiations with taxing authorities is highly uncertain, the Company does not anticipate a significant change to the

total amount of unrecognized income tax benefits within the next 12 months.

Note 15 – Recent Accounting Pronouncements

In September 2015, the FASB issued updated accounting guidance on simplifying measurement-period adjustment in business combinations, which eliminates the requirement that an acquirer in a business combination account for measurement-period adjustments retrospectively. Instead, an acquirer will recognize a measurement-period adjustment during the period in which it determines the amount of the adjustment. The updated guidance is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years, with early adoption available. The Company does not expect

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AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

the provisions of this accounting standard to have a material impact on its results of operations or financial position.

In April 2015, the FASB issued updated accounting guidance on simplifying the presentation of debt issuance costs, which requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability. Previously, debt issuance costs were presented in the balance sheet as a deferred charge. The accounting standard is effective for reporting periods beginning after December 15, 2015, and will be applied retrospectively. The Company does not expect the provisions of this accounting standard to have a material impact on its results of operations or financial position.

In August 2014, the FASB issued an accounting standard that will require management to assess an entity's ability to continue as a going concern for each annual and interim reporting period and to provide related footnote disclosures in circumstances in which substantial doubt exists. The accounting standard is effective in the first annual reporting period ending after December 15, 2016. The Company does not expect the provisions of this accounting standard to have an impact on its results of operations or financial position.

In May 2014, the FASB issued updated accounting guidance on recognizing revenue from contracts with customers, which outlines a single comprehensive model that an entity will apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. The updated guidance also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to fulfill a contract. In July 2015, the FASB approved a one year deferral to the original effective date of this guidance. The updated guidance is effective for reporting periods beginning after December 15, 2017, and will be applied retrospectively. The Company is evaluating the requirements of the updated guidance to determine the impact of adoption.

In April 2014, the FASB issued updated accounting guidance which changes the criteria for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. The updated guidance is effective prospectively for reporting periods beginning after December 15, 2014, with early adoption available. The Company adopted the provisions of the updated accounting guidance for its quarterly reporting period beginning January 1, 2015, and the adoption of the revised guidance did not have an impact on the Company's

consolidated results of operations or consolidated financial position.

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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: 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, 2014 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

Aqua America, Inc. (“we”, “us”, “our” or the “Company”), a Pennsylvania corporation, is the holding company for regulated utilities providing water or wastewater services to what we estimate to be almost three million people in Pennsylvania, Ohio, Texas, Illinois, North Carolina, New Jersey, Indiana, and Virginia. Our largest operating subsidiary, Aqua



Pennsylvania, 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 27 other counties in Pennsylvania. Our other regulated utility subsidiaries provide similar services in seven other states. In addition, the Company's market-based activities are conducted through Aqua Resources, Inc. and Aqua Infrastructure, LLC. Aqua Resources provides liquid waste hauling and disposal; water and wastewater service through operating and maintenance contracts with municipal authorities and other parties close to our utility companies' service territories; offers, through a third party, water and wastewater line repair service and protection solutions to households; inspects, cleans and repairs storm and sanitary wastewater lines; installs and tests devices that prevent the contamination of potable water; designs and builds water and wastewater systems; and provides other market-based water and wastewater services. Aqua Infrastructure provides non-utility raw water supply services for firms in the natural gas drilling industry.

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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)

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, formerly known as Philadelphia Suburban Water Company. Since the early 1990s, we have 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 American Water Works Company, Inc.'s regulated operations in Ohio in 2012. Since the early 1990s, our business strategy has been primarily directed toward the regulated water and wastewater utility industry, where we have more than quadrupled the number of regulated customers we serve, and has extended our regulated operations from southeastern Pennsylvania to include operations in seven other states.

Beginning in 2010, and substantially completed in 2013, we pursued a portfolio rationalization strategy to focus our operations in areas where we have critical mass and economic growth potential and to divest operations where limited customer growth opportunities exist, or where we are unable to achieve favorable operating results or a return on equity that we consider acceptable. In 2014, we sold our operation in Georgia; in 2013, we sold our operations in Florida; in 2012, we sold our operations in Maine and New York; in 2011, we sold our operations in Missouri; and in 2010, we sold our operations in South Carolina. In connection with the sale of our New York and Missouri operations, we acquired additional utility systems (and customers) in Ohio and Texas, two of the larger states in our portfolio.

In December 2014, we completed the sale of our water utility system in southwest Allen County, Indiana to the City of Fort Wayne, Indiana. The completion of this sale settled the dispute concerning the City of Fort Wayne's valuation of the northern portion of our water and wastewater utility systems, which were acquired by the City of Fort Wayne in February 2008, by eminent domain. In addition, as a result of this transaction, Aqua Indiana will expand its sewer customer base by accepting new wastewater flows from the City of Fort Wayne.

The following discussion and analysis of our financial condition and results of operations should be read together with our consolidated financial statements and related notes.

Financial Condition

During the first nine months of 2015, we had \$257,478 of capital expenditures, expended \$26,327 primarily for the acquisition of water and wastewater utility systems, issued \$313,440 of long-term debt, and repaid debt and made sinking fund contributions and other loan repayments of \$203,851. The capital expenditures were related to new and rehabilitated water mains, improvements to treatment plants, tanks, hydrants, and service lines, well and booster improvements, and other enhancements and improvements. The issuance of long-term debt was comprised principally of the funds borrowed under our revolving credit facility of \$172,000, the proceeds from the issuance of \$70,000 of senior unsecured notes due in 2030, and the funds borrowed under a three-year unsecured loan of \$50,000.

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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)

At September 30, 2015, we had \$4,071 of cash and cash equivalents compared to \$4,138 at December 31, 2014. During the first nine months of 2015, we used the proceeds from the issuance of long-term debt and internally generated funds to fund the cash requirements discussed above and to pay dividends.

At September 30, 2015, our \$200,000 unsecured revolving credit facility, which expires in March 2017, had \$73,740 available for borrowing. At September 30, 2015, we had short-term lines of credit of \$160,500, of which \$132,470 was available for borrowing. One of our short-term lines of credit is an Aqua Pennsylvania \$100,000 364-day unsecured revolving credit facility with four banks, which is used to provide working capital, and as of September 30, 2015, \$76,710 was available for borrowing.

Our short-term lines of credit of \$160,500 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 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 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.

On June 7, 2012, Aqua Pennsylvania reached a settlement agreement in its rate filing with the Pennsylvania Public Utility Commission, which in addition to a water rate increase, provided for a reduction in current income tax expense as a result of the recognition of qualifying income tax benefits upon Aqua Pennsylvania changing its tax accounting method to permit the expensing of qualifying utility asset improvement costs that have historically been capitalized and depreciated for book and tax purposes. In December 2012, Aqua Pennsylvania implemented this change, which resulted in a substantial reduction in income tax expense and greater net income and cash flow, and as a result allowed Aqua Pennsylvania to suspend its water Distribution System Improvement Charges in 2013 and lengthen the amount

of time until the next Aqua Pennsylvania rate case is filed. During 2013, our Ohio and North Carolina operating divisions implemented this change. These divisions currently do not employ a method of accounting that provides for a reduction in current income taxes as a result of the recognition of income tax benefits, and as such the change in the Company's tax method of accounting in these operating divisions has no impact on our effective income tax rate.

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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 Third Quarter of 2015 Compared to Third Quarter of 2014

Unless specifically noted, the following discussion of the Company's results of operations for the third quarter of 2015 refers to the Company's results of operations from continuing operations.

Revenues increased by \$10,516 or 5.0%, primarily due to an increase in customer water consumption, additional water and wastewater revenues of \$3,050 associated with a larger customer base due to utility acquisitions, an increase in water and wastewater rates of \$2,292, and an increase in market-based activities revenues of \$841 principally associated with acquisitions.

Operations and maintenance expenses increased by \$6,145 or 8.5%, primarily due to additional operating costs associated with acquired utility systems and market-based activities of \$3,622, an increase in water production costs of \$1,686, the recording of a legal contingency reserve of \$1,580, an increase in the Company's self-insured employee medical benefit program expense of \$1,183, an increase in legal fees of \$621, and additional leadership transition expenses of \$480, offset by a decrease in postretirement benefits expense of \$1,125.

Depreciation expense increased by \$2,499 or 8.5%, primarily due to the utility plant placed in service since September 30, 2014 and the absence of a credit recognized in the third quarter of 2014 for the effect of decreased depreciation rates implemented in our Texas operating subsidiary, offset by a decrease in depreciation rates, implemented in January 2015, for our Pennsylvania operating subsidiary.

Taxes other than income taxes increased by \$1,848 or 14.4%, primarily due to an increase in capital stock taxes of \$812 for our Pennsylvania operating subsidiary resulting from the effect of a favorable credit recorded in the third quarter of 2014.

Interest expense increased by \$249 or 1.3%, primarily due to a an increase in average borrowings, offset by a decrease in the effective interest rate on average borrowings as compared to the third quarter of 2014.

Allowance for funds used during construction (“AFUDC”) increased by \$513, due to an increase in the average balance of utility plant construction work in progress, to which AFUDC is applied and an increase in the AFUDC rate.

Our effective income tax rate was 12.4% in the third quarter of 2015 and 11.6% in the third quarter of 2014. The effective income tax rate increased due to an increase in the Company’s reserve for uncertain tax positions for certain qualifying infrastructure improvements for Aqua Pennsylvania.

Income from continuing operations decreased by \$282 or 0.4%, primarily as a result of the factors described above.

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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)

Income from discontinued operations decreased by \$285, primarily as a result of the sale of our water utility system in southwest Allen County, Indiana completed in the fourth quarter of 2014.

Net income attributable to common shareholders decreased by \$567 or 0.8%, primarily as a result of the factors described above.

Analysis of First Nine Months of 2015 Compared to First Nine Months of 2014

Unless specifically noted, the following discussion of the Company's results of operations for the first nine months of 2015 refers to the Company's results of operations from continuing operations.

Revenues increased by \$28,623 or 4.9%, primarily due to an increase in market-based activities revenues of \$9,390 principally associated with acquisitions, an increase in water and wastewater rates of \$7,514, additional water and wastewater revenues of \$6,209 associated with a larger customer base due to utility acquisitions, and an increase in customer water consumption, offset by a decrease in infrastructure rehabilitation surcharges of \$2,246.

Operations and maintenance expenses increased by \$17,019 or 7.9%, primarily due to additional operating costs associated with acquired utility systems and market-based activities of \$12,757, an increase in water production costs of \$3,012, leadership transition expenses of \$2,329, the recording of a reserve of \$1,862 for water rights held for future use, an increase in legal fees of \$1,642, and the effect of the favorable recognition of a regulatory asset in the second quarter of 2014 of \$1,575, offset by a decrease in postretirement benefits expense of \$2,966, a decrease in bad debt expense of \$1,105, and reduced operating costs of \$662 associated with severe winter weather conditions experienced in many of our service territories in the first quarter of 2014. The increase in water production costs of \$3,012 was impacted by an increase in energy costs resulting from the extreme cold temperatures experienced in many of our service territories in the first quarter of 2015.



Depreciation expense increased by \$1,841 or 2.0%, primarily due to the utility plant placed in service since September 30, 2014 and the absence of a credit recognized in the third quarter of 2014 for the effect of decreased depreciation rates implemented in our Texas operating subsidiary, offset by a decrease in depreciation rates, implemented in January 2015, for our Pennsylvania operating subsidiary.

Amortization expense decreased by \$96, primarily due to the completion of the recovery of our costs associated with various completed rate filings.

Taxes other than income taxes increased by \$5,136 or 13.5%, primarily due to an increase in property taxes of \$2,838 largely due to the effect of a non-recurring credit realized in the first quarter of 2014 that resulted in a reduction in property taxes for our Ohio operating subsidiary, and an increase in capital stock taxes of \$870 for our Pennsylvania operating subsidiary resulting from the effect of a favorable credit recorded in the third quarter of 2014.

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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)

Interest expense decreased by \$589 or 1.0%, primarily due to a decrease in the effective interest rate on average borrowings as compared to the first nine months of 2014, offset by an increase in average borrowings.

Allowance for funds used during construction increased by \$631, primarily due to an increase in the AFUDC rate and an increase in the average balance of utility plant construction work in progress, to which AFUDC is applied.

Equity loss in joint venture decreased by \$1,177 primarily due to a decrease in depreciation expense resulting from the January 2015 increase in the depreciable life for the joint venture's pipeline assets.

Our effective income tax rate was 9.9% in the first nine months of 2015 and 10.8% in the first nine months of 2014. The effective income tax rate decreased due to the effect of additional tax deductions recognized in the first nine months of 2015 for certain qualifying infrastructure improvements for Aqua Pennsylvania, offset by an increase in the Company's reserve for uncertain tax positions for certain qualifying infrastructure improvements for Aqua Pennsylvania.

Income from continuing operations increased by \$8,426 or 5.1%, primarily as a result of the factors described above. On a diluted per share basis, income from continuing operations increased by \$0.05, reflecting the change in income from continuing operations.

Income from discontinued operations decreased by \$1,494, primarily as a result of the sale of our water utility system in southwest Allen County, Indiana completed in the fourth quarter of 2014.

Net income attributable to common shareholders increased by \$6,932 or 4.2%, primarily as a result of the factors described above. On a diluted per share basis, earnings increased by \$0.04 reflecting the change in net income attributable to common shareholders.

#### Impact of Recent Accounting Pronouncements

We describe the impact of recent accounting pronouncements in Note 15, Recent Accounting Pronouncements, of the consolidated financial statements in this report.

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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, 2014. Refer to Item 7A of the Company's Annual Report on Form 10-K for the year ended December 31, 2014 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 Securities and Exchange Commission'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

We are party to various legal proceedings. Although the results of legal proceedings cannot be predicted with certainty, there are no pending legal proceedings to which we or any of our subsidiaries is a party or to which any of

our properties is the subject that we believe are material or are expected to have a material adverse effect on our financial position, results of operations or cash flows.

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, 2014 under “Part 1, Item 1A – Risk Factors.”

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## Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds

The following table summarizes the Company's purchases of its common stock for the quarter ended September 30, 2015:

Period	Issuer Purchases of Equity Securities			
	Total Number of Shares Purchased (1)	Average Price Paid per Share	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)
July 1-31, 2015	165,287	\$ 24.95	161,000	803,348
August 1-31, 2015	161,169	\$ 25.69	161,000	642,348
September 1-30, 2015	161,000	\$ 25.13	161,000	481,348
Total	487,456	\$ 25.26	483,000	481,348

(1) These amounts include 4,456 shares we acquired from employees associated with the withholding of shares to pay certain withholding taxes upon the vesting of RSUs by delivering to us shares of our common stock in accordance with the terms of our equity compensation plan 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 plan. We purchased these shares at their fair market value, as determined by reference to the closing price of our common stock on the day of vesting of the RSUs.

(2) In December 2014, our Board of Directors authorized a share buyback program of up to 1,000,000 shares to minimize share dilution through timely and orderly share repurchases. This program expires on the earliest of December 31, 2015 or when all authorized repurchases have been made.

## Item 6 – Exhibits

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

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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.

November 6, 2015

Aqua America,  
Inc.  
Registrant

/s/ Christopher  
H. Franklin  
Christopher H.  
Franklin  
President and  
Chief  
Executive  
Officer

/s/ David P.  
Smeltzer  
David P.  
Smeltzer  
Executive Vice  
President and  
Chief Financial  
Officer





EXHIBIT INDEX

Exhibit No. Description

10.1	Form of Change in Control Agreement between the Company and each of Daniel Schuller, Executive Vice President, and Richard Scott Fox, Chief Operating Officer*
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

\*Indicates management contract