

American Water Works Company, Inc.

Form 10-Q

August 06, 2009

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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 June 30, 2009

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 ☐ Accelerated filer ☐

Non-accelerated filer ☒ 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 the latest practicable date.

**Class**  
Common Stock, \$0.01 par value per share

**Outstanding at August 5, 2009**  
174,562,309 shares

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**AMERICAN WATER WORKS COMPANY, INC.**

**REPORT ON FORM 10-Q**

**FOR THE QUARTER ENDED JUNE 30, 2009**

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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)

|                                                                                                                          | June 30,<br>2009     | December 31,<br>2008 |
|--------------------------------------------------------------------------------------------------------------------------|----------------------|----------------------|
| <b>ASSETS</b>                                                                                                            |                      |                      |
| Property, plant and equipment                                                                                            |                      |                      |
| Utility plant at original cost, net of accumulated depreciation of \$3,057,127 at June 30 and \$2,969,869 at December 31 | \$ 10,255,426        | \$ 9,991,783         |
| Nonutility property, net of accumulated depreciation of \$101,542 at June 30 and \$101,287 at December 31                | 140,266              | 132,145              |
| <b>Total property, plant and equipment</b>                                                                               | <b>10,395,692</b>    | <b>10,123,928</b>    |
| Current assets                                                                                                           |                      |                      |
| Cash and cash equivalents                                                                                                | 9,012                | 9,542                |
| Restricted funds                                                                                                         | 33,007               | 454                  |
| Utility customer accounts receivable                                                                                     | 161,712              | 149,198              |
| Allowance for uncollectible accounts                                                                                     | (19,946)             | (18,644)             |
| Unbilled utility revenues                                                                                                | 152,105              | 134,204              |
| Non-Regulated trade and other receivables, net                                                                           | 63,823               | 68,877               |
| Materials and supplies                                                                                                   | 32,869               | 28,948               |
| State income taxes receivable                                                                                            | 4,775                |                      |
| Other                                                                                                                    | 58,348               | 45,096               |
| <b>Total current assets</b>                                                                                              | <b>495,705</b>       | <b>417,675</b>       |
| Regulatory and other long-term assets                                                                                    |                      |                      |
| Regulatory assets                                                                                                        | 945,572              | 919,654              |
| Restricted funds                                                                                                         | 46,416               | 10,599               |
| Goodwill                                                                                                                 | 1,250,067            | 1,699,517            |
| Other                                                                                                                    | 56,597               | 60,445               |
| <b>Total regulatory and other long-term assets</b>                                                                       | <b>2,298,652</b>     | <b>2,690,215</b>     |
| <b>TOTAL ASSETS</b>                                                                                                      | <b>\$ 13,190,049</b> | <b>\$ 13,231,818</b> |

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)

|                                                                                                                                            | <b>June 30,<br/>2009</b> | <b>December 31,<br/>2008</b> |
|--------------------------------------------------------------------------------------------------------------------------------------------|--------------------------|------------------------------|
| <b>CAPITALIZATION AND LIABILITIES</b>                                                                                                      |                          |                              |
| Capitalization                                                                                                                             |                          |                              |
| Common stock (\$.01 par value, 500,000 shares authorized, 174,562 and 160,000 shares outstanding at June 30 and December 31, respectively) | \$ 1,746                 | \$ 1,600                     |
| Paid-in-capital                                                                                                                            | 6,135,650                | 5,888,253                    |
| Accumulated deficit                                                                                                                        | (2,130,833)              | (1,705,594)                  |
| Accumulated other comprehensive loss                                                                                                       | (78,357)                 | (82,251)                     |
| Treasury stock                                                                                                                             |                          | (7)                          |
| Common stockholders' equity                                                                                                                | 3,928,206                | 4,102,001                    |
| Preferred stock without mandatory redemption requirements                                                                                  | 4,557                    | 4,557                        |
| Total stockholders' equity                                                                                                                 | 3,932,763                | 4,106,558                    |
| Long-term debt                                                                                                                             |                          |                              |
| Long-term debt                                                                                                                             | 4,981,912                | 4,624,063                    |
| Redeemable preferred stock at redemption value                                                                                             | 24,154                   | 24,150                       |
| Total capitalization                                                                                                                       | 8,938,829                | 8,754,771                    |
| Current liabilities                                                                                                                        |                          |                              |
| Short-term debt                                                                                                                            | 268,751                  | 479,010                      |
| Current portion of long-term debt                                                                                                          | 97,357                   | 175,822                      |
| Accounts payable                                                                                                                           | 123,116                  | 149,795                      |
| Taxes accrued, including income taxes of \$0 at June 30 and \$6,061 at December 31                                                         | 60,371                   | 52,488                       |
| Interest accrued                                                                                                                           | 56,152                   | 53,629                       |
| Other                                                                                                                                      | 187,040                  | 194,016                      |
| Total current liabilities                                                                                                                  | 792,787                  | 1,104,760                    |
| Regulatory and other long-term liabilities                                                                                                 |                          |                              |
| Advances for construction                                                                                                                  | 620,040                  | 622,227                      |
| Deferred income taxes                                                                                                                      | 757,967                  | 705,587                      |
| Deferred investment tax credits                                                                                                            | 33,220                   | 34,023                       |
| Regulatory liabilities                                                                                                                     | 318,575                  | 307,324                      |
| Accrued pension expense                                                                                                                    | 500,342                  | 502,062                      |
| Accrued postretirement benefit expense                                                                                                     | 237,268                  | 241,193                      |
| Other                                                                                                                                      | 48,398                   | 48,456                       |
| Total regulatory and other long-term liabilities                                                                                           | 2,515,810                | 2,460,872                    |
| Contributions in aid of construction                                                                                                       | 942,623                  | 911,415                      |
| Commitments and contingencies (See Note 9)                                                                                                 |                          |                              |
| <b>TOTAL CAPITALIZATION AND LIABILITIES</b>                                                                                                | <b>\$ 13,190,049</b>     | <b>\$ 13,231,818</b>         |

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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 Operations (Unaudited)

(In thousands, except per share data)

|                                                       | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |              |
|-------------------------------------------------------|--------------------------------|------------|------------------------------|--------------|
|                                                       | 2009                           | 2008       | 2009                         | 2008         |
| Operating revenues                                    | \$ 612,740                     | \$ 589,369 | \$ 1,162,910                 | \$ 1,096,184 |
| Operating expenses                                    |                                |            |                              |              |
| Operation and maintenance                             | 330,597                        | 330,576    | 644,999                      | 641,837      |
| Depreciation and amortization                         | 73,242                         | 67,307     | 142,085                      | 131,223      |
| General taxes                                         | 51,699                         | 49,628     | 104,196                      | 101,694      |
| (Gain) loss on sale of assets                         | 10                             | (800)      | (192)                        | (870)        |
| Impairment charge                                     |                                |            | 450,000                      | 750,000      |
| Total operating expenses, net                         | 455,548                        | 446,711    | 1,341,088                    | 1,623,884    |
| Operating income (loss)                               | 157,192                        | 142,658    | (178,178)                    | (527,700)    |
| Other income (deductions)                             |                                |            |                              |              |
| Interest, net                                         | (73,688)                       | (70,066)   | (145,667)                    | (140,034)    |
| Allowance for other funds used during construction    | 3,575                          | 3,387      | 6,918                        | 5,928        |
| Allowance for borrowed funds used during construction | 1,991                          | 1,725      | 3,863                        | 3,093        |
| Amortization of debt expense                          | (1,535)                        | (1,441)    | (3,023)                      | (2,759)      |
| Other, net                                            | (1,409)                        | (599)      | (295)                        | 550          |
| Total other income (deductions)                       | (71,066)                       | (66,994)   | (138,204)                    | (133,222)    |
| Income (loss) before income taxes                     | 86,126                         | 75,664     | (316,382)                    | (660,922)    |
| Provision for income taxes                            | 34,137                         | 30,166     | 44,708                       | 26,064       |
| Net income (loss)                                     | \$ 51,989                      | \$ 45,498  | \$ (361,090)                 | \$ (686,986) |
| Net income (loss) per common share:                   |                                |            |                              |              |
| Basic                                                 | \$ 0.32                        | \$ 0.28    | \$ (2.23)                    | \$ (4.29)    |
| Diluted                                               | \$ 0.32                        | \$ 0.28    | \$ (2.23)                    | \$ (4.29)    |
| Average common shares outstanding during the period:  |                                |            |                              |              |
| Basic                                                 | 163,229                        | 159,932    | 161,629                      | 159,966      |
| Diluted                                               | 163,301                        | 159,976    | 161,629                      | 159,966      |
| Dividends per common share                            | \$ 0.20                        | \$         | \$ 0.40                      | \$           |

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)

|                                                                                                                | <b>Six Months Ended<br/>June 30,</b> |              |
|----------------------------------------------------------------------------------------------------------------|--------------------------------------|--------------|
|                                                                                                                | <b>2009</b>                          | <b>2008</b>  |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                                                    |                                      |              |
| Net loss                                                                                                       | \$ (361,090)                         | \$ (686,986) |
| Adjustments                                                                                                    |                                      |              |
| Depreciation and amortization                                                                                  | 142,085                              | 131,223      |
| Impairment charge                                                                                              | 450,000                              | 750,000      |
| Amortization of removal costs net of salvage                                                                   | 20,144                               | 21,214       |
| Provision for deferred income taxes                                                                            | 47,196                               | 21,960       |
| Amortization of deferred investment tax credits                                                                | (803)                                | (808)        |
| Provision for losses on utility accounts receivable                                                            | 12,050                               | 6,368        |
| Allowance for other funds used during construction                                                             | (6,918)                              | (5,928)      |
| Gain on sale of assets                                                                                         | (192)                                | (870)        |
| Pension and non-pension post retirement benefits                                                               | 55,916                               | 24,768       |
| Other, net                                                                                                     | (11,495)                             | (23,933)     |
| Pension and non-pension post retirement benefit contributions                                                  | (55,018)                             | (59,676)     |
| Changes in assets and liabilities                                                                              |                                      |              |
| Receivables and unbilled utility revenues                                                                      | (34,859)                             | (23,098)     |
| Other current assets                                                                                           | (21,948)                             | (20,539)     |
| Accounts payable                                                                                               | (5,772)                              | (3,996)      |
| Taxes accrued, including income taxes                                                                          | 11,136                               | 2,172        |
| Interest accrued                                                                                               | 2,523                                | 2,853        |
| Other current liabilities                                                                                      | (14,247)                             | 6,551        |
| Net cash provided by operating activities                                                                      | 228,708                              | 141,275      |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                                                    |                                      |              |
| Construction expenditures                                                                                      | (400,174)                            | (425,960)    |
| Acquisitions                                                                                                   |                                      | (248)        |
| Proceeds from sale of assets and securities                                                                    | 221                                  | 798          |
| Removal costs from property, plant and equipment retirements, net                                              | (12,922)                             | (4,857)      |
| Net restricted funds released                                                                                  | 57,020                               | 2,653        |
| Other                                                                                                          | (1,250)                              |              |
| Net cash used in investing activities                                                                          | (357,105)                            | (427,614)    |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                                                    |                                      |              |
| Proceeds from long-term debt                                                                                   | 309,785                              | 201,546      |
| Repayment of long-term debt                                                                                    | (152,248)                            | (191,519)    |
| Redemption of preferred stock                                                                                  | (6)                                  | (14)         |
| Net (repayments) borrowings under short-term debt agreements                                                   | (198,333)                            | 36,773       |
| Proceeds from issuance of common stock (net of expenses of \$7,824)                                            | 242,301                              |              |
| Proceeds from employee stock plan issuances                                                                    | 1,010                                |              |
| Advances and contributions for construction, net of refunds of \$12,336 and \$38,735 at June 30, 2009 and 2008 | 6,184                                | 2,169        |
| Change in cash overdraft position                                                                              | (11,926)                             | (13,869)     |
| Capital contributions                                                                                          |                                      | 245,000      |
| Debt issuance costs                                                                                            | (4,894)                              | (1,314)      |
| Dividends paid                                                                                                 | (64,006)                             |              |

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|                                                                    |            |           |
|--------------------------------------------------------------------|------------|-----------|
| Net cash provided by financing activities                          | 127,867    | 278,772   |
| Net decrease in cash and cash equivalents                          | (530)      | (7,567)   |
| Cash and cash equivalents at beginning of period                   | 9,542      | 13,481    |
| Cash and cash equivalents at end of period                         | \$ 9,012   | \$ 5,914  |
| <b>Non-cash investing activity:</b>                                |            |           |
| Capital expenditures acquired on account but unpaid at quarter-end | \$ 51,760  | \$ 67,192 |
| <b>Non-cash financing activity:</b>                                |            |           |
| Long-term debt                                                     | \$ 125,431 | \$        |
| Advances and contributions                                         | \$ 39,347  | \$ 12,578 |

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 |           |                 |                     |                                      | Treasury Stock |         | Preferred Stock of Subsidiary Companies Without Mandatory Redemption Requirements | Total Stockholders' Equity |
|---------------------------------------------------------|--------------|-----------|-----------------|---------------------|--------------------------------------|----------------|---------|-----------------------------------------------------------------------------------|----------------------------|
|                                                         | Shares       | Par Value | Paid-in Capital | Accumulated Deficit | Accumulated Other Comprehensive Loss | Shares         | At Cost |                                                                                   |                            |
| <b>Balance at December 31, 2008</b>                     | 160,000      | \$ 1,600  | \$ 5,888,253    | \$ (1,705,594)      | \$ (82,251)                          |                | \$ (7)  | \$ 4,557                                                                          | \$ 4,106,558               |
| Net loss                                                |              |           |                 | (361,090)           |                                      |                |         |                                                                                   | (361,090)                  |
| Common stock offering, net of expenses of \$7,824       | 14,500       | 145       | 242,156         |                     |                                      |                |         |                                                                                   | 242,301                    |
| Stock-based compensation activity                       | 62           | 1         | 5,241           | (143)               |                                      |                | 7       |                                                                                   | 5,106                      |
| Other comprehensive income (loss) net of tax of \$1,931 |              |           |                 |                     | 3,894                                |                |         |                                                                                   | 3,894                      |
| Dividends per common share                              |              |           |                 | (64,006)            |                                      |                |         |                                                                                   | (64,006)                   |
| <b>Balance at June 30, 2009</b>                         | 174,562      | \$ 1,746  | \$ 6,135,650    | \$ (2,130,833)      | \$ (78,357)                          |                | \$      | \$ 4,557                                                                          | \$ 3,932,763               |

|                                                     | Common Stock |           |                 |                     |                                      | Treasury Stock |            | Preferred Stock of Subsidiary Companies Without Mandatory Redemption Requirements | Total Stockholders' Equity |
|-----------------------------------------------------|--------------|-----------|-----------------|---------------------|--------------------------------------|----------------|------------|-----------------------------------------------------------------------------------|----------------------------|
|                                                     | Shares       | Par Value | Paid-in Capital | Accumulated Deficit | Accumulated Other Comprehensive Loss | Shares         | At Cost    |                                                                                   |                            |
| <b>Balance at December 31, 2007</b>                 | 160,000      | \$ 1,600  | \$ 5,637,947    | \$ (1,079,118)      | \$ (18,383)                          |                | \$         | \$ 4,568                                                                          | \$ 4,546,614               |
| Net loss                                            |              |           |                 | (686,986)           |                                      |                |            |                                                                                   | (686,986)                  |
| Equity investment by RWE                            |              |           | 245,000         |                     |                                      |                |            |                                                                                   | 245,000                    |
| Contribution of common stock by RWE                 |              |           | 1,933           |                     |                                      | 90             | (1,933)    |                                                                                   |                            |
| Stock-based compensation activity                   |              |           | 2,992           |                     |                                      |                |            |                                                                                   | 2,992                      |
| Other comprehensive income (loss) net of tax of \$9 |              |           |                 |                     | (150)                                |                |            |                                                                                   | (150)                      |
| <b>Balance at June 30, 2008</b>                     | 160,000      | \$ 1,600  | \$ 5,887,872    | \$ (1,766,104)      | \$ (18,533)                          | 90             | \$ (1,933) | \$ 4,568                                                                          | \$ 4,107,470               |

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)

|                                                             | <b>Three Months Ended<br/>June 30,</b> |             |
|-------------------------------------------------------------|----------------------------------------|-------------|
|                                                             | <b>2009</b>                            | <b>2008</b> |
| Net income (loss)                                           | \$ 51,989                              | \$ 45,498   |
| Pension plan amortized to periodic benefit cost:            |                                        |             |
| Prior service cost, net of tax of \$8 and \$5, respectively | 12                                     | 7           |
| Actuarial cost, net of tax of \$958 and \$0, respectively   | 1,498                                  |             |
| Foreign currency translation adjustment                     | 1,414                                  | (18)        |
| Total comprehensive income (loss)                           | \$ 54,913                              | \$ 45,487   |

|                                                              | <b>Six Months Ended<br/>June 30,</b> |              |
|--------------------------------------------------------------|--------------------------------------|--------------|
|                                                              | <b>2009</b>                          | <b>2008</b>  |
| Net income (loss)                                            | \$ (361,090)                         | \$ (686,986) |
| Pension plan amortized to periodic benefit cost:             |                                      |              |
| Prior service cost, net of tax of \$15 and \$9, respectively | 23                                   | 13           |
| Actuarial cost, net of tax of \$1,916 and \$0, respectively  | 2,997                                |              |
| Foreign currency translation adjustment                      | 874                                  | (163)        |
| Total comprehensive income (loss)                            | \$ (357,196)                         | \$ (687,136) |

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 June 30, 2009, the consolidated statements of operations for the three and six months ended June 30, 2009 and 2008, the consolidated statements of cash flows for the six months ended June 30, 2009 and 2008, the consolidated statement of changes in stockholders' equity for the six months ended June 30, 2009, and the consolidated statements of comprehensive income (loss) for the three and six months ended June 30, 2009 and 2008, 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. The December 31, 2008 consolidated balance sheet was taken from audited financial statements. 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 consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. 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.

Effective with this report, the Company implemented a new accounting standard regarding subsequent events (see Note 2). The Company has evaluated all events or transactions that occurred after June 30, 2009 through August 6, 2009, the date the Company issued the accompanying financial statements. During this period, the Company did not have any material recognizable subsequent events that have not been reflected in the financial statements.

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

##### **Note 2: New Accounting Pronouncements**

In June 2009, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162" ("SFAS 168"). This standard establishes the FASB Accounting Standards Codification ("Codification") as the source of authoritative U.S. generally accepted accounting principles ("GAAP") recognized by the FASB to be applied by non-governmental entities. Rules and interpretive releases of the Securities and Exchange Commission ("SEC") under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. All other non-grandfathered non-SEC accounting literature not included in the Codification will become non-authoritative. This standard is effective for interim and annual periods ending after September 15, 2009. The adoption of SFAS 168 will not have an impact on the Company's results of operations, financial position or cash flows.

In June 2009, the FASB issued SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)" ("SFAS 167"). This standard will improve financial reporting by enterprises involved with variable interest entities by addressing the effects on certain provisions of FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" ("FIN 46(R)"), as a result of the elimination of the qualifying special-purpose entity concept in SFAS 166, "Accounting for Transfers of Financial Assets," and constituent concerns about the application of certain key provisions of FIN 46(R). This standard is effective for annual reporting periods beginning after November 15, 2009. The Company does not expect the adoption of SFAS 167 to have an impact on the Company's results of operations, financial position or cash flows.

In June 2009, the FASB issued SFAS No. 166, "Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140" ("SFAS 166"). This statement amends current guidance for accounting for the transfers of financial assets. Key provisions of SFAS 166 include (i) the removal of the concept of qualifying special purpose entities, (ii) the introduction of the concept of a participating interest, in which a portion of a financial asset has been transferred and (iii) the requirement that to qualify for sale accounting, the transferor must evaluate whether it maintains effective control over transferred financial assets either directly or indirectly. Further, SFAS 166 requires enhanced disclosures about transfers of financial assets and a transferor's continuing involvement. SFAS 166 is effective for the Company beginning January 1, 2010, and is required to be applied prospectively. The Company is currently assessing the impacts SFAS 166 may have on its financial statements.

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On May 28, 2009, the FASB issued SFAS No. 165, Subsequent Events ( SFAS 165 ). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This standard sets forth: (i) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions, (ii) the circumstances under which an entity should recognize events or transactions and (iii) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. This standard is effective for interim and annual periods ending after June 15, 2009. The adoption of SFAS 165 did not have an impact on the Company's results of operations, financial position or cash flows. (See Note 1)

On April 9, 2009, the FASB issued FASB Staff Position ( FSP ) No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments. This staff position amends SFAS No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends Accounting Principles Board Opinion No. 28, Interim Financial Reporting, to

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require those disclosures in summarized financial information at interim reporting periods. This FSP is effective for interim reporting periods ending after June 15, 2009. In periods after initial adoption, this FSP requires comparative disclosures only for periods ending after initial adoption. As this FSP provides for additional disclosure requirements only, the adoption of this FSP did not have an impact on the Company's results of operations, financial position or cash flows.

On April 9, 2009, the FASB issued FSP No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS 157-4), which amends SFAS No. 157, *Fair Value Measurements* (SFAS 157), to provide additional guidance on fair value measurements in inactive markets when the volume and level of activity for the asset and liability have significantly decreased. This FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP FAS 157-4 is effective for interim reporting periods ending after June 15, 2009. The adoption of this FSP did not have an impact on the Company's results of operations, financial position or cash flows. (See Note 12)

On April 9, 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, which amends impairment guidance for certain debt securities and will require an entity to assess whether it (a) has the intent to sell the debt security or (b) more likely than not will be required to sell the debt security before its anticipated recovery. If either of these conditions is met, the entity must recognize an other-than-temporary impairment. If an entity is able to meet the criteria to assert that it will not have to sell the security before recovery, impairment charges related to credit losses would be recognized in earnings, while impairment charges related to non-credit losses (for example, liquidity risk) would be reflected in other comprehensive income. The FSP is effective for interim reporting periods ending after June 15, 2009. The adoption of this FSP did not have an impact on the Company's results of operations, financial position or cash flows.

On April 1, 2009, the FASB issued FSP No. FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arises from Contingencies* (FSP FAS 141(R)-1), to amend and clarify the initial recognition and measurement, subsequent measurement and accounting, and related disclosures arising from contingencies in a business combination under SFAS 141(R), *Business Combinations*. Under FSP FAS 141(R)-1, assets acquired and liabilities assumed in a business combination that arise from contingencies should be recognized at fair value on the acquisition date if fair value can be determined during the measurement period. If fair value can not be determined, companies should account for the acquired contingencies using existing guidance. FSP FAS 141(R)-1 is effective for the Company for business combinations finalized after January 1, 2009.

In February 2008, the FASB issued FSP SFAS 157-2 which allowed a one-year deferral of adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities (such as intangible assets, property, plant and equipment and goodwill) that are required to be measured at fair value on a periodic basis (such as at acquisition or impairment). The Company elected to use this deferral option and accordingly, adopted SFAS 157 for the Company's nonfinancial assets and liabilities valued on a non-recurring basis on January 1, 2009. The adoption of this FSP did not have a significant impact on the Company's results of operations, financial position or cash flows.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (SFAS 160). SFAS 160 clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 requires that changes in a parent's ownership interest in a subsidiary be reported as an equity transaction in the consolidated financial statements when it does not result in a change in control of the subsidiary. When change in a parent's ownership interest results in deconsolidation, a gain or loss should be recognized in the consolidated financial statements. SFAS 160 was applied prospectively as of January 1, 2009, except for the presentation and disclosure requirements, which were applied retrospectively for all periods presented. The adoption of SFAS 160 did not have a material impact on the Company's results of operations, cash flows or financial positions; however, it could impact future transactions entered into by the Company. As a result of the adoption of SFAS 160, beginning in the first quarter of 2009, the Company reflects its subsidiaries' preferred stock without mandatory redemption requirements in its consolidated financial statements within equity. The Company reclassified these preferred shares to equity within the Company's Consolidated Balance Sheets and Statements of Changes in Stockholders' Equity in accordance with SFAS 160 for all periods presented. In the Company's 2008 Form 10-K, these preferred shares were presented as preferred stock without mandatory redemption requirements separate from equity within the Company's Consolidated Balance Sheets. The dividends on these preferred shares have not been reflected separately on the Company's Statements of Operations or the Company's Statements of Comprehensive Loss, as the amounts are not considered material.

### **Note 3: Goodwill**

At June 30, 2009 the Company's goodwill totaled \$1,250,067. 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.



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

|                              | <b>Regulated<br/>Unit</b> | <b>Non-regulated<br/>Units</b> | <b>Consolidated</b> |
|------------------------------|---------------------------|--------------------------------|---------------------|
| Balance at December 31, 2008 | \$ 1,569,835              | \$ 129,682                     | \$ 1,699,517        |
| Impairment losses            | (448,248)                 | (1,752)                        | (450,000)           |
| Other activity               | 550                       |                                | 550                 |
| Balance at June 30, 2009     | \$ 1,122,137              | \$ 127,930                     | \$ 1,250,067        |

The Company's calculated market capitalization at March 31, 2009 was \$1,186,000 below its aggregated carrying value of its reporting units. During the first quarter of 2009, the Company's market 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 which existed at the 2008 annual impairment test, was an interim triggering event and performed an interim impairment test.

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.

The Company recognized goodwill impairment charges of \$450,000 and \$750,000 for the six months ended June 30, 2009 and 2008, respectively.

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 additional declines 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 and the overhang effect. 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.

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.

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 effect on that price due to RWE Aktiengesellschaft's (RWE) ownership level, the effect of RWE's expected disposition of its owned Company shares on the market for those shares, the applicability of a control premium to 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.

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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 June 10, 2009 the Company completed the public offering of 29,900 shares of its common stock. Pursuant to the offering, the Company sold 14,500 shares of common stock and 15,400 shares were sold by RWE.

The Company completed the sale of 14,500 shares of common stock at \$17.25 per share. The proceeds from the offering, net of underwriters discounts and expenses payable by the Company were \$242,301. The Company used the proceeds to repay short-term debt.

RWE completed a partial divestiture of its investment in the Company through the sale of 11,500 shares at a price of \$17.25. RWE granted the underwriters a 30-day option to purchase up to an additional 3,900 shares of the Company's stock at a price of \$17.25. The underwriters exercised their option and purchased 3,900 shares to cover over-allotments. The Company did not receive any proceeds from the RWE sale of the Company's shares. Prior to the sale of shares by RWE and the Company, RWE owned approximately 60% of the Company's common shares. After the sales of shares and exercise of the underwriters' over-allotment option, RWE owns approximately 47% of the Company's shares.

In March 2009, the Company made a cash dividend payment of \$0.20 per share to all common shareholders of record as of February 18, 2009, amounting to \$32,000. In June 2009, the Company made a cash dividend payment of \$0.20 per share to all common shareholders of record as of May 18, 2009, amounting to \$32,006.

On July 31, 2009, the Company declared a quarterly cash dividend payment of \$0.21 per share payable on September 1, 2009 to all shareholders of record as of August 18, 2009.

#### **Stock Based Compensation**

The Company has granted stock option and restricted stock unit awards to directors, officers and other key employees of the Company pursuant to the terms of its 2007 Omnibus Equity Compensation Plan (the "Plan"). The total aggregate number of shares of common stock that may be issued under the Plan was increased to 15,500 from 6,000 in May of 2009. As of June 30, 2009, a total of 12,175 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.

Stock options and restricted stock units granted in 2008 included 1,470 stock options and 190 restricted stock units that are subject to performance-based vesting requirements. On February 20, 2009, the Company cancelled 311 of these stock options and 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. The Company recognizes expense on the remaining stock options and restricted stock units where achievement of the performance goals is considered probable. At June 30, 2009, 439 stock options and 58 restricted stock unit awards are not considered probable to meet performance conditions.

The Company's Nonqualified Employee Stock Purchase Plan ("ESPP") was effective as of July 1, 2008. As of June 30, 2009, there were 1,898 shares of common stock reserved for issuance under the ESPP.

The Company recognizes compensation expense for stock awards over the vesting period of the award. The following table presents stock-based compensation expense for the three and six months ended June 30, 2009 and 2008:

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|                                                               | Three Months<br>Ended<br>June 30,<br>2009 | Three Months<br>Ended<br>June 30,<br>2008 | Six Months<br>Ended<br>June 30,<br>2009 | Six Months<br>Ended<br>June 30,<br>2008 |
|---------------------------------------------------------------|-------------------------------------------|-------------------------------------------|-----------------------------------------|-----------------------------------------|
| Stock options                                                 | \$ 889                                    | \$ 470                                    | \$ 1,831                                | \$ 470                                  |
| Restricted stock units                                        | 1,258                                     | 218                                       | 2,196                                   | 436                                     |
| Restricted stock                                              |                                           | 1,406                                     |                                         | 1,406                                   |
| Employee stock purchase plan                                  | 96                                        |                                           | 210                                     |                                         |
| Stock-based compensation in operation and maintenance expense | 2,243                                     | 2,094                                     | 4,237                                   | 2,312                                   |
| Income tax benefit                                            | (875)                                     | (817)                                     | (1,653)                                 | (902)                                   |
| After-tax stock-based compensation expense                    | \$ 1,368                                  | \$ 1,277                                  | \$ 2,584                                | \$ 1,410                                |

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At June 30, 2009, unrecognized compensation expense for unvested stock options and restricted stock units totaled approximately \$5,721 and \$4,120, respectively.

### Stock Options

On February 20, 2009, the Company granted 1,091 non-qualified stock options to certain employees under the Plan. The stock options vest ratably over a three-year service period from January 1, 2009. The grant date fair value and exercise price of options awarded in 2009 were \$3.96 and \$20.70, respectively.

The following table presents the assumptions used in the pricing model for the February 2009 option grant:

|                         |         |
|-------------------------|---------|
| Dividend yield          | 3.86%   |
| Expected volatility     | 31.67%  |
| Risk-free interest rate | 1.79%   |
| Expected life (years)   | 4.36    |
| Grant date fair value   | \$ 3.96 |

Stock options granted under the Plan generally 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. There are no option awards vested and no stock options have been exercised as of June 30, 2009. The table below summarizes stock option activity for the six months ended June 30, 2009.

|                                        | Shares | Weighted<br>Average<br>Exercise Price<br>(per share) | Weighted<br>Average<br>Remaining<br>Life (years) | Aggregate<br>Intrinsic<br>Value |
|----------------------------------------|--------|------------------------------------------------------|--------------------------------------------------|---------------------------------|
| Options outstanding at January 1, 2009 | 2,060  | \$ 21.50                                             |                                                  |                                 |
| Granted                                | 1,091  | 20.70                                                |                                                  |                                 |
| Cancelled                              | (311)  | 21.50                                                |                                                  |                                 |
| Forfeited or expired                   | (36)   | 21.22                                                |                                                  |                                 |
| Exercised                              |        |                                                      |                                                  |                                 |
| Options outstanding at June 30, 2009   | 2,804  | \$ 21.19                                             | 5.70                                             | \$                              |

### Restricted Stock Units

On May 8, 2009 and June 19, 2009, the Company granted 15 and 5 restricted stock units, respectively, to certain non-employee directors under the Plan. The restricted stock units vested on the date of the grant; however, distribution of the shares will be made within 30 days of the earlier of August 12, 2010 or the participant's separation from service. The grant date fair value of the restricted stock units awarded in May 2009 is \$18.55 and \$18.58 in June 2009.

On February 20, 2009, the Company granted 195 restricted stock units to certain employees under the Plan. The restricted stock units vest ratably over the three year performance period beginning January 1, 2009 (the Performance Period); however, distribution of the shares is contingent upon the achievement of certain market thresholds over the Performance Period. The grant date fair value of the restricted stock units awarded in February 2009 is \$22.08.

Restricted stock units generally vest over periods ranging from one to three years. Restricted stock units granted without market conditions are valued at the market value of the Company's common stock on the date of grant. Restricted stock units granted with market conditions are valued using a Monte Carlo model. The weighted-average remaining life of the Company's restricted stock units is 1.3 years. The table below summarizes restricted stock unit activity for the six months ended June 30, 2009.

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|                                    | Shares | Weighted Average<br>Grant Date<br>Fair Value<br>(per share) |
|------------------------------------|--------|-------------------------------------------------------------|
| Nonvested total at January 1, 2009 | 267    | \$ 21.50                                                    |
| Granted                            | 215    | 21.75                                                       |
| Vested                             | (20)   | 18.56                                                       |
| Cancelled                          | (39)   | 21.50                                                       |
| Forfeited                          | (5)    | 21.75                                                       |
| Nonvested total at June 30, 2009   | 418    | \$ 21.77                                                    |

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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 will pay the employee a lump sum cash payment equal to the value of the dividend equivalents accrued. During the three and six months ended June 30, 2009, the Company accrued additional dividend equivalents totaling \$71 and \$143, respectively.

**Employee Stock Purchase Plan**

Under 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. During the six months ended June 30, 2009, the Company issued 62 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 Range   | Weighted<br>Average Rate | Maturity<br>Date | June 30,<br>2009 | December 31,<br>2008 |
|---------------------------------------------------------|--------------|--------------------------|------------------|------------------|----------------------|
| Long-term debt of American Water Capital Corp. ( AWCC ) |              |                          |                  |                  |                      |
| Private activity bonds and government funded debt       |              |                          |                  |                  |                      |
| Fixed rate                                              | 6.00%-6.75%  | 6.26%                    | 2018-2039        | \$ 98,290        | \$                   |
| Floating rate (a)                                       | 0.90%-2.25%  | 1.00%                    | 2032             | 23,325           | 86,860               |
| Senior notes                                            |              |                          |                  |                  |                      |
| Fixed rate                                              | 5.39%-10.00% | 6.27%                    | 2011-2039        | 3,056,000        | 2,959,000            |
| Long-term debt of other subsidiaries                    |              |                          |                  |                  |                      |
| Private activity bonds and government funded debt       |              |                          |                  |                  |                      |
| Fixed rate                                              | 0.00%-6.88%  | 5.07%                    | 2009-2039        | 1,054,176        | 937,835              |
| Floating rate (b)                                       | 0.90%-2.40%  | 1.00%                    | 2015             | 8,560            | 33,420               |
| Mortgage bonds                                          |              |                          |                  |                  |                      |
| Fixed rate                                              | 5.48%-9.71%  | 7.48%                    | 2009-2039        | 775,664          | 675,200              |
| Senior debt                                             |              |                          |                  |                  |                      |
| Fixed rate                                              |              |                          |                  |                  | 40,613               |
| Mandatory redeemable preferred stock                    | 4.60%-9.75%  | 8.34%                    | 2013-2036        | 24,419           | 24,425               |
| Notes payable and other (c)                             | 5.76%-11.91% | 10.35%                   | 2011-2026        | 2,763            | 2,882                |
| Long-term debt                                          |              |                          |                  | 5,043,197        | 4,760,235            |
| Unamortized debt discount, net (d)                      |              |                          |                  | 60,226           | 63,800               |
| Total long-term debt                                    |              |                          |                  | \$ 5,103,423     | \$ 4,824,035         |

- (a) Variable rate tax-exempt bonds which are remarketed for periods up to 270 days. These bonds may be converted to other short-term variable-rate structures, a fixed-rate structure or subject to redemption. If the remarketing fails and no investors purchase the bonds, the Company is obligated to purchase the bonds at par. During 2009, AWCC purchased these bonds because no buyer was willing to purchase the bonds at market rates and subsequently was able to remarket \$23,325 for periods of 1 to 8 days. Additionally in 2009, \$52,900 was remarketed to fixed rate private activity bonds and government funded debt.
- (b) \$24,860 of the 2008 total represents variable rate tax-exempt bonds which are remarketed every 7 days. These bonds may be converted to other short-term variable-rate structures, a fixed-rate structure or subject to redemption. The remaining \$8,560 represents variable rate tax-exempt bonds remarketed for periods up to 270 days. During 2009, AWCC purchased these bonds because no buyer was willing to purchase the bonds at market rates and subsequently was able to remarket \$8,560 for periods of 3 to 8 days.
- (c) Includes capital lease obligations of \$1,784 and \$1,829 at June 30, 2009 and December 31, 2008, respectively.
- (d) Includes fair value adjustments previously recognized in acquisition purchase accounting.



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The following long-term debt was issued in 2009:

| Company                      | Type                           | Interest Rate | Maturity | Amount |
|------------------------------|--------------------------------|---------------|----------|--------|
| American Water Capital Corp. | Private activity-fixed rate    | 6.25%         | 2039     | 45,390 |
| American Water Capital Corp. | Private activity-fixed rate    | 6.00%         | 2018     | 18,250 |
| American Water Capital Corp. | Private activity-fixed rate    | 6.10%         | 2019     | 17,950 |
| American Water Capital Corp. | Private activity-fixed rate    | 6.75%         | 2031     | 16,700 |
| American Water Capital Corp. | Private activity-floating rate | 1.00%         | 2032     | 23,325 |
| American Water Capital Corp. | Senior notes-fixed rate        | 8.27%         | 2039     | 25,500 |
| American Water Capital Corp. | Senior notes-fixed rate        | 7.21%         | 2019     | 24,500 |
| American Water Capital Corp. | Senior notes-fixed rate        | 8.25%         | 2038     | 75,000 |
| Other subsidiaries           | Private activity-fixed rate    | 6.20%         | 2039     | 80,000 |
| Other subsidiaries           | Private activity-floating rate | 1.00%         | 2015     | 8,560  |
| Other subsidiaries           | Mortgage bonds-fixed rate      | 5.48%         | 2019     | 25,000 |
| Other subsidiaries           | Mortgage bonds-fixed rate      | 6.35%         | 2039     | 75,000 |
| Other                        | Capital lease                  | 8.82%         | 2011     | 41     |

Total Issuances \$ 435,216

The following long-term debt was retired through optional redemption or payment at maturity during 2009:

| Company                              | Type                        | Interest Rate | Maturity  | Amount    |
|--------------------------------------|-----------------------------|---------------|-----------|-----------|
| Long-term debt                       |                             |               |           |           |
| American Water Capital Corp.         | Senior notes-fixed rate     | 6.87%         | 2011      | \$ 28,000 |
| American Water Capital Corp.         | Floating rate               | 1.55%-2.20%   | 2018-2032 | 86,860    |
| Other subsidiaries                   | Floating rate               | 1.50%-10.00%  | 2015-2032 | 33,420    |
| Other subsidiaries                   | Notes payable and other     | 9.87%         | 2013      | 74        |
| Other subsidiaries                   | Private activity-fixed rate | 0.00%-9.10%   | 2009-2034 | 3,808     |
| Mandatory redeemable preferred stock |                             | 4.75%-5.75%   | 2017-2019 | 6         |
| Other                                | Capital lease               |               |           | 86        |

Total retirements & redemptions \$ 152,254

Interest, net includes interest income of approximately \$2,413 and \$4,962 for the three and six months ended June 30, 2009 and \$2,961 and \$4,619 for the three and six months ended June 30, 2008, respectively.

At June 30, 2009, other subsidiaries senior debt of \$40,149 and \$464 was reclassified to other subsidiaries fixed rate private activity bonds and government funded debt and mortgage bonds, respectively.

**Note 6: Short-Term Debt**

The components of short-term debt are as follows:

|                                        | June 30,<br>2009 | December 31,<br>2008 |
|----------------------------------------|------------------|----------------------|
| Revolving credit line                  | \$               | \$ 437,000           |
| Commercial paper, net of \$58 discount | 238,667          |                      |
| Book overdraft                         | 30,084           | 42,010               |

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|                       |            |            |
|-----------------------|------------|------------|
| Total short-term debt | \$ 268,751 | \$ 479,010 |
|-----------------------|------------|------------|

### **Note 7: Income Taxes**

The Company's estimated annual effective tax rate is 39.4% and 39.5% for the six months ended June 30, 2009 and 2008, respectively, excluding various discrete items including goodwill impairment. The Company's actual effective tax rates for the three months ended June 30, 2009 and 2008 were 39.6% and 39.9%, respectively. The Company's actual effective rates for the six months ended June 30, 2009 and 2008 of (14.1%) and (3.9%), respectively, reflect the tax effects of goodwill impairments as discrete items as the Company considers these charges as infrequently occurring or unusual.

**Table of Contents****Note 8: Pension and Other Postretirement Benefits**

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

|                                                 | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |           |
|-------------------------------------------------|--------------------------------|----------|------------------------------|-----------|
|                                                 | 2009                           | 2008     | 2009                         | 2008      |
| Components of net periodic pension benefit cost |                                |          |                              |           |
| Service cost                                    | \$ 7,106                       | \$ 6,551 | \$ 14,213                    | \$ 13,102 |
| Interest cost                                   | 15,729                         | 14,549   | 31,459                       | 29,098    |
| Expected return on plan assets                  | (10,556)                       | (12,925) | (21,112)                     | (25,850)  |
| Amortization of:                                |                                |          |                              |           |
| Prior service cost                              | 46                             | 45       | 91                           | 90        |
| Actuarial loss                                  | 5,992                          | 1        | 11,984                       | 2         |
| Periodic pension benefit cost                   | 18,317                         | 8,221    | 36,635                       | 16,442    |
| Special termination pension benefit charge      |                                |          |                              |           |
| Net periodic pension benefit cost               | \$ 18,317                      | \$ 8,221 | \$ 36,635                    | \$ 16,442 |

|                                                              | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|--------------------------------------------------------------|--------------------------------|----------|------------------------------|----------|
|                                                              | 2009                           | 2008     | 2009                         | 2008     |
| Components of net periodic other postretirement benefit cost |                                |          |                              |          |
| Service cost                                                 | \$ 3,293                       | \$ 3,106 | \$ 6,586                     | \$ 6,212 |
| Interest cost                                                | 7,295                          | 7,049    | 14,590                       | 14,098   |
| Expected return on plan assets                               | (4,659)                        | (5,751)  | (9,319)                      | (11,502) |
| Amortization of:                                             |                                |          |                              |          |
| Transition obligation                                        | 44                             | 43       | 87                           | 86       |
| Prior service (credit) cost                                  | (295)                          | 203      | (590)                        | 406      |
| Actuarial loss (gain)                                        | 2,288                          | (295)    | 4,577                        | (590)    |
| Net periodic other postretirement benefit cost               | \$ 7,966                       | \$ 4,355 | \$ 15,931                    | \$ 8,710 |

The Company contributed \$34,200 to its defined benefit pension plan in the first six months of 2009 and expects to contribute \$50,000 during the balance of 2009. In addition, the Company contributed \$20,818 for the funding of its other postretirement plans in the first six months of 2009 and expects to contribute \$20,818 during the balance of 2009.

**Note 9: Commitments and Contingencies**

OMI/Thames Water Stockton, Inc. ( OMI/TW ) is a 50/50 joint venture between a subsidiary of the Company and Operations Management International, Inc. ( OMI ). In February 2003, OMI/TW and the City of Stockton California (the City ) entered into a 20-year service contract for capital improvements and management services of water, wastewater and storm water utilities. By mutual agreement, OMI/TW and the City of Stockton terminated the contract effective February 29, 2008 (the Termination Date ). Upon termination, responsibility for management and operation of the system was returned to the City. OMI/TW agreed to provide a limited twelve-month warranty relating to certain components of the facilities that OMI/TW constructed (the WW39 Plant ), which expired on December 31, 2008. OMI/TW also agreed to correct any latent defects relating to significant deficiencies in the structural components of certain capital improvements discovered prior to November 15, 2009, if any. Additionally, OMI/TW committed to pay for certain employee transition costs and assumed financial responsibility for regulatory fines levied through the Termination Date, if any, resulting from OMI/TW's failure to comply with applicable National Pollutant Discharge Elimination System permit requirements and/or incidents traced to design defects in the WW39 Plant. During 2007, the California State Water Resources Control Board (the Board ) issued a notice of violation and a corresponding Settlement Communication related to a discharge into an adjacent river. OMI/TW has agreed to pay a civil penalty and monitoring costs of \$425 to resolve this matter and is awaiting the approval of the

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settlement from the Board. Given the uncertainties related to resolving the remaining issues described above and financial settlement with OMI, the Company has a loss reserve of approximately \$1,300 at June 30, 2009 and December 31, 2008, respectively.

The Company is also routinely involved in condemnation proceedings and legal actions incident to the normal conduct of its business. At June 30, 2009, the Company had accrued approximately \$4,100 as probable costs and it is reasonably possible that additional losses could range up to \$19,400 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.

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 2059 and have remaining performance commitments as measured by estimated remaining contract revenue of \$1,179,000 at June 30, 2009. The Company's Operations and Maintenance agreements with municipalities and other customers expire between 2009 and 2048 and have remaining performance commitments as measured by estimated remaining contract revenue of \$1,115,000 at June 30, 2009. 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.

**Table of Contents****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 \$7,958 at June 30, 2009 and \$10,538 at December 31, 2008, respectively. At June 30, 2009, \$7,700 of the accrual (including \$1,100 accrued in 2009) 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 paid \$3,500 related to this agreement during the first six months of 2009. 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**

Basic net income (loss) per common share is based on the weighted average number of common shares outstanding. Outstanding shares consist of issued shares less treasury stock (if any). 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 the 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 table sets forth the components of basic and diluted earnings per share and shows the effect of the common stock equivalents on the weighted average number of shares outstanding used in calculating diluted earnings per share:

|                                           | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |              |
|-------------------------------------------|----------------------------------------|-------------|--------------------------------------|--------------|
|                                           | <b>2009</b>                            | <b>2008</b> | <b>2009</b>                          | <b>2008</b>  |
| <b>Numerator</b>                          |                                        |             |                                      |              |
| Net income (loss)                         | \$ 51,989                              | \$ 45,498   | \$ (361,090)                         | \$ (686,986) |
| <b>Denominator</b>                        |                                        |             |                                      |              |
| Average common shares outstanding basic   | 163,229                                | 159,932     | 161,629                              | 159,966      |
| <b>Effect of dilutive securities:</b>     |                                        |             |                                      |              |
| Stock options                             |                                        |             |                                      |              |
| Restricted stock units                    | 71                                     | 11          |                                      |              |
| Restricted stock                          |                                        | 33          |                                      |              |
| Employee stock purchase plan              | 1                                      |             |                                      |              |
| Average common shares outstanding diluted | 163,301                                | 159,976     | 161,629                              | 159,966      |

Options to purchase 1,980 and 608 shares of the Company's common stock were excluded from the calculation of diluted common shares outstanding because they are anti-dilutive for the three-month periods ended June 30, 2009 and 2008, respectively. There were also 304 and 190 restricted stock units and 824 and 1,470 stock options which were excluded from the calculation of diluted common shares outstanding because certain performance conditions were not satisfied as of June 30, 2009 and 2008, respectively. All of the potentially dilutive securities have been excluded for the six months ended June 30, 2009 and 2008, respectively, because they are anti-dilutive.

**Table of Contents****Note 12: Fair Value of Assets and Liabilities****Fair Value of Financial Instruments**

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments.

Current assets and current liabilities: The carrying amount reported in the Consolidated Balance Sheets for current assets and current liabilities, including revolving credit debt due to the short-term maturities and variable interest rates, approximates their fair values.

Preferred stock with mandatory redemption requirements and long-term debt: The fair values of preferred stock with mandatory redemption requirements and long-term debt are determined by a valuation model which is based on a conventional discounted cash flow methodology and utilizes assumptions of current market rates. As a majority of the Company's debts do not trade in active markets, the fair values are highly dependent upon market conditions surrounding the measurement date. The Company calculated a base yield curve using a risk-free rate (a US Treasury securities yield curve) plus a credit spread that is based on the following two factors: an average of the Company's own publicly-traded debt securities and the current market rates for US Utility BBB+ debt securities. The Company used these yield curve assumptions to derive a base yield and then adjusted the base yield for specific features of the debt securities for differences in credit profile, collateral, tax treatment and call features.

The carrying amounts (including fair value adjustments previously recognized in acquisition purchase accounting) and fair values of the financial instruments are as follows:

|                                                         | Carrying<br>Amount | Fair Value |
|---------------------------------------------------------|--------------------|------------|
| <b>At Fair Value as of June 30, 2009</b>                |                    |            |
| Preferred stocks with mandatory redemption requirements | \$ 24,372          | \$ 25,176  |
| Long-term debt (excluding capital lease obligations)    | 5,077,267          | 5,211,494  |
| <b>At Fair Value as of December 31, 2008</b>            |                    |            |
| Preferred stocks with mandatory redemption requirements | \$ 24,368          | \$ 23,887  |
| Long-term debt (excluding capital lease obligations)    | 4,797,838          | 4,430,117  |

**Recurring Fair Value Measurements**

The following table presents assets and liabilities measured and recorded at fair value on a recurring basis and their level within the fair value hierarchy as of June 30, 2009 and December 31, 2008, respectively:

| Recurring Fair Value Measures    | At Fair Value as of June 30, 2009 |            |         |           |
|----------------------------------|-----------------------------------|------------|---------|-----------|
|                                  | Level 1                           | Level 2    | Level 3 | Total     |
| <b>Assets:</b>                   |                                   |            |         |           |
| Cash equivalents                 | \$                                | \$         | \$      | \$        |
| Restricted funds                 | 79,423                            |            |         | 79,423    |
| Rabbi trust investments          |                                   | 3,045      |         | 3,045     |
| Deposits                         | 10,985                            |            |         | 10,985    |
| Total assets                     | 90,408                            | 3,045      |         | 93,453    |
| <b>Liabilities:</b>              |                                   |            |         |           |
| Deferred compensation obligation |                                   | 7,698      |         | 7,698     |
| Total liabilities                |                                   | 7,698      |         | 7,698     |
| Total net assets (liabilities)   | \$ 90,408                         | \$ (4,653) | \$      | \$ 85,755 |

| Recurring Fair Value Measures | At Fair Value as of December 31, 2008 |         |         |        |
|-------------------------------|---------------------------------------|---------|---------|--------|
|                               | Level 1                               | Level 2 | Level 3 | Total  |
| <b>Assets:</b>                |                                       |         |         |        |
| Cash equivalents              | \$                                    | \$      | \$      | \$     |
| Restricted funds              | 11,053                                |         |         | 11,053 |
| Rabbi trust investments       |                                       | 3,562   |         | 3,562  |

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| Recurring Fair Value Measures    | At Fair Value as of December 31, 2008 |            |         |           |
|----------------------------------|---------------------------------------|------------|---------|-----------|
|                                  | Level 1                               | Level 2    | Level 3 | Total     |
| Deposits                         | 10,958                                |            |         | 10,958    |
| Total assets                     | 22,011                                | 3,562      |         | 25,573    |
| <b>Liabilities:</b>              |                                       |            |         |           |
| Deferred compensation obligation |                                       | 7,741      |         | 7,741     |
| Total liabilities                |                                       | 7,741      |         | 7,741     |
| Total net assets (liabilities)   | \$ 22,011                             | \$ (4,179) | \$      | \$ 17,832 |

**Restricted funds** The Company's restricted funds primarily represent proceeds received from financings for the construction and capital improvement of facilities and from customers for future services under operations and maintenance projects. The proceeds of these financings are held in escrow until the designated expenditures are incurred. Restricted funds expected to be released within twelve months subsequent to year-end are classified as current.

**Rabbi trust investments** The Company's rabbi trust investments consist primarily of fixed income investments from which supplemental executive retirement plan benefits are paid. The Company includes these assets in other long-term assets.

**Deposits** Deposits includes escrow funds and certain other deposits held in trust. The Company includes cash deposits in other current assets.

**Deferred compensation obligations** The Company's deferred compensation plans allow participants to defer certain cash compensation into notional investment accounts. The Company includes such plans in other long-term liabilities. The value of the Company's deferred compensation obligations is based on the market value of the participants' notional investment accounts. The notional investments are comprised primarily of mutual funds, which are based on observable market prices.

## Non-recurring Fair Value Measurements

As discussed in Note 3, the Company recognized goodwill impairment charges of \$450,000 and \$750,000 for the six months ended June 30, 2009 and 2008, respectively. The Company's goodwill valuation model includes significant unobservable inputs and falls within level 3 of the fair value hierarchy.

## Note 13: Segment Information

The Company has two operating segments which are also the Company's two reportable segments referred to as the Regulated Businesses and Non-Regulated Businesses segments. Other includes inter-segment revenues.

The following table includes the Company's summarized segment information:

|                               | As of or for the Three Months Ended |               |            |              |
|-------------------------------|-------------------------------------|---------------|------------|--------------|
|                               | June 30, 2009                       |               |            |              |
|                               | Regulated                           | Non-Regulated | Other      | Consolidated |
| Net operating revenues        | \$ 554,977                          | \$ 64,264     | \$ (6,501) | \$ 612,740   |
| Depreciation and amortization | 67,656                              | 1,464         | 4,122      | 73,242       |
| Impairment charge             |                                     |               |            |              |
| Total operating expenses, net | 407,541                             | 58,557        | (10,550)   | 455,548      |
| Adjusted EBIT (1)             | 147,731                             | 5,387         |            |              |
| Total assets                  | 11,336,826                          | 241,133       | 1,612,090  | 13,190,049   |
| Capital expenditures          | 202,798                             | 1,239         |            | 204,037      |

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|                               | As of or for the Three Months Ended<br>June 30, 2008 |               |            |              |
|-------------------------------|------------------------------------------------------|---------------|------------|--------------|
|                               | Regulated                                            | Non-Regulated | Other      | Consolidated |
| Net operating revenues        | \$ 526,248                                           | \$ 67,038     | \$ (3,917) | \$ 589,369   |
| Depreciation and amortization | 63,656                                               | 1,861         | 1,790      | 67,307       |
| Impairment charge             |                                                      |               |            |              |
| Total operating expenses, net | 392,038                                              | 62,924        | (8,251)    | 446,711      |
| Adjusted EBIT (1)             | 134,213                                              | 4,681         |            |              |
| Total assets                  | 10,472,290                                           | 250,337       | 1,804,055  | 12,526,682   |

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|                      | As of or for the Three Months Ended<br>June 30, 2008 |               |       |              |
|----------------------|------------------------------------------------------|---------------|-------|--------------|
|                      | Regulated                                            | Non-Regulated | Other | Consolidated |
| Capital expenditures | 235,279                                              | 2,244         |       | 237,523      |

|                               | As of or for the Six Months Ended<br>June 30, 2009 |               |             |              |
|-------------------------------|----------------------------------------------------|---------------|-------------|--------------|
|                               | Regulated                                          | Non-Regulated | Other       | Consolidated |
| Net operating revenues        | \$ 1,052,347                                       | \$ 121,796    | \$ (11,233) | \$ 1,162,910 |
| Depreciation and amortization | 133,849                                            | 2,774         | 5,462       | 142,085      |
| Impairment charge             |                                                    |               | 450,000     | 450,000      |
| Total operating expenses, net | 797,943                                            | 112,501       | 430,644     | 1,341,088    |
| Adjusted EBIT (1)             | 255,457                                            | 10,102        |             |              |
| Total assets                  | 11,336,826                                         | 241,133       | 1,612,090   | 13,190,049   |
| Capital expenditures          | 397,491                                            | 2,724         |             | 400,215      |

|                               | As of or for the Six Months Ended<br>June 30, 2008 |               |            |              |
|-------------------------------|----------------------------------------------------|---------------|------------|--------------|
|                               | Regulated                                          | Non-Regulated | Other      | Consolidated |
| Net operating revenues        | \$ 975,782                                         | \$ 128,210    | \$ (7,808) | \$ 1,096,184 |
| Depreciation and amortization | 123,948                                            | 3,269         | 4,006      | 131,223      |
| Impairment charge             |                                                    |               | 750,000    | 750,000      |
| Total operating expenses, net | 770,253                                            | 120,449       | 733,182    | 1,623,884    |
| Adjusted EBIT (1)             | 206,113                                            | 9,263         |            |              |
| Total assets                  | 10,472,290                                         | 250,337       | 1,804,055  | 12,526,682   |
| Capital expenditures          | 422,934                                            | 3,026         |            | 425,960      |

- (1) Management evaluates the performance of its segments and allocates resources based on several factors, of which the primary measure is Adjusted EBIT. Adjusted EBIT does not represent cash flow for periods presented and should not be considered as an alternative to net income as an indicator of the Company's operating performance or as an alternative to cash flows as a source of liquidity. Adjusted EBIT as defined by the Company may not be comparable with Adjusted EBIT as defined by other companies.

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The following table reconciles Adjusted EBIT, as defined by the Company, to income (loss) before income taxes:

|                                                       | For the Three Months Ended<br>June 30, 2009 |               |                   |
|-------------------------------------------------------|---------------------------------------------|---------------|-------------------|
|                                                       | Regulated                                   | Non-Regulated | Total<br>Segments |
| Adjusted EBIT                                         | \$ 147,731                                  | \$ 5,387      | \$ 153,118        |
| Add:                                                  |                                             |               |                   |
| Allowance for other funds used during construction    | 3,575                                       |               | 3,575             |
| Allowance for borrowed funds used during construction | 1,991                                       |               | 1,991             |
| Less:                                                 |                                             |               |                   |
| Interest, net                                         | (57,423)                                    | 867           | (56,556)          |
| Amortization of debt expense                          | (1,396)                                     |               | (1,396)           |
| Segments income before income taxes                   | \$ 94,478                                   | \$ 6,254      | 100,732           |
| Interest, net                                         |                                             |               | (17,132)          |
| Other                                                 |                                             |               | 2,526             |
| Income before income taxes                            |                                             |               | \$ 86,126         |

|                                                       | For the Three Months Ended<br>June 30, 2008 |               |                   |
|-------------------------------------------------------|---------------------------------------------|---------------|-------------------|
|                                                       | Regulated                                   | Non-Regulated | Total<br>Segments |
| Adjusted EBIT                                         | \$ 134,213                                  | \$ 4,681      | \$ 138,894        |
| Add:                                                  |                                             |               |                   |
| Allowance for other funds used during construction    | 3,387                                       |               | 3,387             |
| Allowance for borrowed funds used during construction | 1,725                                       |               | 1,725             |
| Less:                                                 |                                             |               |                   |
| Interest, net                                         | (55,085)                                    | 750           | (54,335)          |
| Amortization of debt expense                          | (1,441)                                     |               | (1,441)           |
| Segments income before income taxes                   | \$ 82,799                                   | \$ 5,431      | 88,230            |
| Interest, net                                         |                                             |               | (15,731)          |
| Other                                                 |                                             |               | 3,165             |
| Income before income taxes                            |                                             |               | \$ 75,664         |

|                                                       | For the Six Months Ended<br>June 30, 2009 |               |                   |
|-------------------------------------------------------|-------------------------------------------|---------------|-------------------|
|                                                       | Regulated                                 | Non-Regulated | Total<br>Segments |
| Adjusted EBIT                                         | \$ 255,457                                | \$ 10,102     | \$ 265,559        |
| Add:                                                  |                                           |               |                   |
| Allowance for other funds used during construction    | 6,918                                     |               | 6,918             |
| Allowance for borrowed funds used during construction | 3,863                                     |               | 3,863             |
| Less:                                                 |                                           |               |                   |
| Interest, net                                         | (113,817)                                 | 1,699         | (112,118)         |
| Amortization of debt expense                          | (2,744)                                   |               | (2,744)           |
| Segments income before income taxes                   | \$ 149,677                                | \$ 11,801     | 161,478           |
| Impairment charge                                     |                                           |               | (450,000)         |

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|                          |              |
|--------------------------|--------------|
| Interest, net            | (33,549)     |
| Other                    | 5,689        |
| Loss before income taxes | \$ (316,382) |

|                                                       | For the Six Months Ended<br>June 30, 2008 |               |                   |
|-------------------------------------------------------|-------------------------------------------|---------------|-------------------|
|                                                       | Regulated                                 | Non-Regulated | Total<br>Segments |
| Adjusted EBIT                                         | \$ 206,113                                | \$ 9,263      | \$ 215,376        |
| Add:                                                  |                                           |               |                   |
| Allowance for other funds used during construction    | 5,928                                     |               | 5,928             |
| Allowance for borrowed funds used during construction | 3,093                                     |               | 3,093             |
| Less:                                                 |                                           |               |                   |
| Interest, net                                         | (111,821)                                 | 1,386         | (110,435)         |
| Amortization of debt expense                          | (2,759)                                   |               | (2,759)           |
| Segments income before income taxes                   | \$ 100,554                                | \$ 10,649     | 111,203           |
| Impairment charge                                     |                                           |               | (750,000)         |
| Interest, net                                         |                                           |               | (29,599)          |
| Other                                                 |                                           |               | 7,474             |
| Loss before income taxes                              |                                           |               | \$ (660,922)      |

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### **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FORWARD-LOOKING STATEMENTS**

Certain matters within this Quarterly Report on Form 10-Q include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements included in this Form 10-Q, other than statements of historical fact, may constitute forward-looking statements. Forward-looking statements can be identified by the use of words such as may, should, will, could, estimates, predicts, potential, continue, anticipates, believes, plans, expect and similar expressions. Forward-looking statements may involve known and unknown risks, uncertainties and other factors that may cause the actual results or performance to differ from those projected in the forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. Factors that could cause or contribute to differences in results and outcomes from those in our forward-looking statements include, without limitation, those items discussed in the Risk Factors section or other sections in the Company's Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission (SEC) and subsequent SEC filings as well as in Item IA of Part II of this Quarterly Report. All forward-looking statements are expressly qualified in their entirety by such risk factors. We undertake no obligation, other than as required by law, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

### **GENERAL**

American Water Works Company, Inc. (herein referred to as American Water or the Company) is the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served. Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers. Our Regulated Businesses provide these services and are generally subject to economic regulation by state regulatory agencies in the states in which they operate. We report the results of these businesses in our Regulated Businesses segment. We also provide services that are not subject to economic regulation by state regulatory agencies. We report the results of these businesses in our Non-Regulated Businesses segment. For further description of our businesses see the Business section found in our Form 10-K for the year ended December 31, 2008 filed with the SEC.

You should read the following discussion in conjunction with our Consolidated Financial Statements and related Notes included elsewhere in this Quarterly Report on Form 10-Q and in our Form 10-K for the year ended December 31, 2008 filed with the SEC.

### **OVERVIEW**

*Financial Results* American Water's net income was \$52.0 million for the three months ended June 30, 2009 as compared to \$45.5 million for the three months ended June 30, 2008. Diluted earnings per average common share were \$0.32 for the three months ended June 30, 2009 compared to \$0.28 for the three months ended June 30, 2008.

American Water's net loss was \$361.1 million for the six months ended June 30, 2009 compared to a net loss of \$687.0 million for the six months ended June 30, 2008. The Company recognized goodwill impairment charges, net of tax, of \$443.0 million and \$738.5 million for the six months ended June 30, 2009 and 2008, respectively. Diluted loss per average common share was \$2.23 for the six months ended June 30, 2009 compared to \$4.29 for the six months ended June 30, 2008.

The increase in net income and earnings per share for the three months ended June 30, 2009 compared to the same period in the prior year is primarily the result of higher revenues partially offset by higher operating expenses. Revenues for the three months ended June 30, 2009 increased by \$23.3 million compared to the same period in the prior year. This was primarily due to increased revenues in our Regulated Businesses of \$28.7 million, which was largely attributable to rate increases. Offsetting this increase was lower revenues of \$2.8 million in our Non-Regulated Businesses, primarily due to decreased Contract Operations Group and Applied Water Management Group revenues, partially offset by increased revenues in our Homeowner Services Group.

Operating expenses for the three months ended June 30, 2009 were \$455.5 million compared to \$446.7 million for the three months ended June 30, 2008. This \$8.8 million increase was primarily due to an increase in our Regulated Businesses of \$15.5 million partially offset by a decrease in our Non-Regulated Businesses of \$4.4 million for the three months ended June 30, 2009 compared to the three months ended June 30, 2008. The Regulated Businesses' increase in operating expenses was mainly driven by higher operations and maintenance expenses of \$9.5 million, higher depreciation expense of \$4.0 million and increased general taxes of \$1.7 million. The decrease in the Non-Regulated Businesses' operating expenses was primarily the result of lower operating and maintenance expenses of \$4.2 million which corresponds with their decreased revenues.

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Other items affecting income before income taxes for the three months ended June 30, 2009 as compared to the same period in the prior year include increased interest expense of \$3.6 million attributable to increased long term debt from capital spending and higher income tax expense of \$4.0 million mainly the result of higher taxable income for the three months ended June 30, 2009.

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Revenues for the six months ended June 30, 2009 increased by \$66.7 million compared to the same period in the prior year. This was primarily due to increased revenues in our Regulated Businesses of \$76.6 million, which was largely attributable to rate increases. Offsetting this increase was lower revenues of \$6.4 million in our Non-Regulated Businesses, primarily due to a decrease in revenues for our Contract Operations, Canadian Fixed Residuals and Applied Water Management Groups, partially offset by increased revenues in our Homeowner Services Group.

Operating expenses for the six months ended June 30, 2009 were \$1,341.1 million compared to \$1,623.9 million for the six months ended June 30, 2008. Impairment charges were \$450.0 million and \$750.0 million for the six months ended June 30, 2009 and 2008, respectively. All other operating expenses totaled \$891.1 million for the six months ended June 30, 2009 compared to \$873.9 million for the six months ended June 30, 2008. This \$17.2 million increase was primarily driven by increased operating expenses in our Regulated Businesses of \$27.7 million partially offset by a decrease in our Non-Regulated Businesses of \$7.9 million for the six months ended June 30, 2009 compared to the six months ended June 30, 2008. The Regulated Businesses' increase in operating expenses was mainly driven by higher operations and maintenance expenses of \$14.5 million, higher depreciation expense of \$9.9 million and increased general taxes of \$3.0 million. The decrease in the Non-Regulated Businesses' operating expenses was primarily the result of lower operating and maintenance expenses of \$7.7 million which corresponds with their decreased revenues.

Other items affecting loss before income taxes for the six months ended June 30, 2009 as compared to the same period in the prior year include increased interest expense of \$5.6 million attributable to long term debt from capital spending and higher income tax expense of \$18.6 million mainly the result of higher taxable income for the six months ended June 30, 2009 and tax benefits associated with the impairment charges of \$7.0 million and \$11.5 million recorded in the six months ended June 30, 2009 and 2008, respectively.

*Rate Case Developments* During the three months ended June 30, 2009, we received authorizations for additional annualized revenues from general rate cases totaling \$12.5 million. During May 2009, the New Mexico rate case, which was filed in 2008 was finalized. The final order authorized additional annualized revenues of \$1.4 million with an effective date for new rates of May 20, 2009. Also in May 2009, our Applied Wastewater Management, Inc. rate case was finalized authorizing additional annualized revenues of \$0.7 million for 2009, effective May 14, 2009, with staged increases of \$0.5 million effective in 2010 and \$0.4 million in 2011. During June 2009, our Kentucky rate case, which was filed in 2008, was finalized. The final order authorized additional annualized revenues of \$10.3 million with an effective date of June 1, 2009. Also during the three months ended June 30, 2009, we were granted an additional annualized \$7.5 million in revenues from infrastructure surcharges in several of our states.

As of June 30, 2009, we were awaiting a final order for Hawaii's general case that was filed in 2007, requesting \$1.3 million in total additional annual revenues. In October 2008, the Hawaii Public Utilities Commission approved, on an interim basis, an increase in additional annualized revenues of \$0.7 million. The interim rates were effective for the fourth quarter of 2008. Also, at June 30, 2009, we were awaiting final orders in three states for general rate cases filed in 2008 and in eight states for general rate cases filed in 2009, requesting additional annualized revenues of \$279.9 million, including the recovery of higher pension and postretirement benefit costs. In regards to the pension and postretirement benefit cost, we have begun discussions with the majority of our regulators about the appropriate treatment for these incremental costs in order to minimize regulatory lag between incurring the expense and any recovery of the expense. To date, we have authorization to recover or defer \$7.1 million of this annual increase and have requested permission to recover or defer as a deferred asset until the next rate case is concluded an additional \$7.5 million of this increase in 2009. Until we receive permission from the regulators to defer costs, we will continue to expense them. We are also discussing with regulators other ways in which to defer the costs until future rate cases are filed. There is no assurance that the filed amount, or any portion thereof, of any requested increases will be granted. Since June 30, 2009, we filed a rate case in one state requesting additional annualized revenues of \$20.6 million. In July 2009, additional annualized revenues of \$0.2 million in Michigan from a general rate filing as well as \$2.4 million and \$2.7 million resulting from infrastructure charges in our Pennsylvania and Missouri subsidiaries, respectively, became effective. In addition, we were granted a \$1.8 million increase for an arsenic surcharge in our Arizona subsidiary, allowing for recovery of costs associated with the construction and operation of arsenic treatment facilities. Also, in July 2009, the California rate case which was filed for in 2008 for \$43.5 million, was approved authorizing additional annualized revenues of \$12.5 million with staged increases of \$1.5 million and \$2.0 million in 2010 and 2011, respectively. As a result of the issuance of this final rate case order, for the three and six months ended June 30, 2009, we recorded pre-tax revenue of \$1.4 million primarily as a result of the effective date of the order being May 13, 2009. Offsetting the revenue was a \$4.5 million charge to expenses included the write-off of deferred rate case expenses of \$3.5 million and the establishment of a \$1.0 million reserve for assets not recoverable at this time. On July 27, 2009, Iowa American Water received an interim or temporary rate order from the Iowa Utilities Board ( IUB ) allowing additional annualized revenues of \$6.8 million. The interim rates will be in effect while the IUB continues to review the company's full rate increase request filed in April 2009 requesting additional annualized revenues of \$9.4 million and which is included in the \$279.9 million disclosed above.

*Financing Activities* During the six months ended June 30, 2009, we met our capital resource requirements with internally generated cash as well as funds from external sources primarily through an equity offering, commercial paper, borrowings under our credit facilities and the issuance of debt.

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On June 10, 2009, the Company completed a public offering of 29.9 million shares of its common stock. Pursuant to the offering, the Company sold 14.5 million shares of common stock at \$17.25 per share. The proceeds from the offering, net of underwriters' discounts and expenses payable by the Company were \$242.3 million. The proceeds from the offering were used to repay short-term debt.

At the same time, RWE continued to divest of its investment in the Company through the sale of 11.5 million shares also at a price of \$17.25. RWE granted the underwriters a 30-day option to purchase up to an additional 3.9 million shares of the Company's stock at a price of \$17.25. The underwriters exercised their option and purchased 3.9 million shares to cover over-allotments. The Company did not receive any proceeds from the RWE sale of the Company's shares. Prior to the sale of shares by RWE and the Company, RWE owned approximately 60% of the Company's common shares. After the sales of shares and exercise of the underwriters' over-allotment option, RWE owns approximately 47% of the Company's shares.

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In regards to debt financings, on June 23, 2009, American Water Capital Corp. ( AWCC ) closed an offering of \$45.4 million in tax-exempt water facility revenue bonds issued by Owen County in Kentucky. The bonds have a coupon of 6.25% with a maturity of 2039. The proceeds from the bond offering will be used to repay short-term debt related to the construction of a water treatment and transmission facility located in Owen County, Kentucky, as well as to pay the remaining costs of acquisition, construction, installation and equipping of the water treatment and transmission facility as the construction proceeds to completion.

On May 21, 2009, AWCC successfully remarketed \$31.9 million variable rate demand notes previously held in the Company's treasury. The net proceeds from this offering were used to repay commercial paper. Also, on May 21, 2009, AWCC remarketed \$52.9 million variable rate demand notes as fixed rate Tax Exempt Water Facility Revenue bonds with interest rates ranging from 6.00% to 6.75%. The net proceeds from this offering were used to repay short-term debt.

On May 19, 2009, AWCC closed a private placement offering of \$25.5 million in aggregate principal amount of 8.27% senior unsecured notes due 2039 and \$24.5 million in aggregate principal amount of 7.21% senior unsecured notes due 2019. The proceeds were used to pay down short-term debt.

On May 13, 2009, New Jersey-American Water Company, Inc. ( NJAWC ) closed its private offering of \$75 million in aggregate principal amount of its 6.35% first mortgage bonds due 2039 and \$25 million in aggregate principal amount of its 5.48% first mortgage bonds due 2019. NJAWC used the proceeds principally to pay down short-term debt.

On April 8, 2009, our Pennsylvania subsidiary, Pennsylvania-American Water Company, closed an offering to issue \$80.0 million in tax-exempt water facility revenue bonds through the Pennsylvania Economic Development Financing Authority ( PEDFA ). The coupon rate on the bonds is 6.2% with a maturity date of April 1, 2039. The \$80 million bond was rated A by Standard & Poor's and A3 by Moody's. The proceeds from the offering will be used to fund certain capital improvement projects.

### *Other Matters*

*Impairment Charge:* At June 30, 2009, the Company's goodwill totaled \$1,250.1 million. The Company's annual impairment reviews are performed as of November 30 of each year, in conjunction with the timing of the completion of the Company's annual strategic business plan. The Company also undertakes interim reviews 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. During the first quarter of 2009, despite no apparent significant adverse changes in its underlying business, the Company's market 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 which existed at the 2008 annual impairment test, was an interim triggering event and performed an interim impairment test. 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 \$450.0 million as a goodwill impairment charge for the first quarter of 2009.

In light of the initial public offering price and trading levels in our common stock after the date of the initial public offering, the Company performed an interim impairment test and, on May 9, 2008, concluded that the current carrying value of the Company's goodwill was impaired as a result of the current market price at that time and trading levels of the Company's common stock. The Company believed the initial public offering price was indicative of the value of the Company at March 31, 2008, and accordingly, based on those factors, recorded an impairment charge to goodwill related to its Regulated Businesses in the amount of \$750.0 million in the financial statements as of and for the fiscal quarter ended March 31, 2008. The impairment charge was primarily due to the market price of the Company's common stock (both the initial public offering price and the price during subsequent trading) being less than that implied by the trading value of peer companies during the 2007 annual test. Also contributing to the impairment was a decline in the fair value of the Company's debt (due to increased market interest rates). As a result of the impairment charge, RWE Aqua Holdings GmbH transferred \$245.0 million to the Company on May 13, 2008. This cash was used to reduce short-term debt.

*Growth:* During 2007, NJAWC entered into an agreement with the City of Trenton, New Jersey (the City ) to purchase the assets of the City's water system located in the four surrounding townships. The agreement required approval from the New Jersey Board of Public Utilities ( BPU ). The initial proposed purchase price of \$100.0 million was subsequently amended to \$75.0 million and the agreement has also been amended to include the provision of technical services by the City over seven years to ensure a smooth transition of ownership at a cost to NJAWC of \$5.0 million. The administrative law judge hearing the matter issued an initial decision (the Initial Decision ) approving a stipulation of settlement reflecting the changed agreement (the Stipulation ) and sent the Initial Decision to the BPU for consideration.

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On February 25, 2009, a small group of Trenton residents filed a petition with the City Clerk seeking to force the sale to a referendum. On April 3, 2009, the BPU issued its order approving the Stipulation. The effective date of the Stipulation has been automatically stayed pending the resolution of court proceedings initiated in New Jersey Superior Court by the residents. The trial court ruled in March 2009 that a referendum is not required but the residents filed for reconsideration of that ruling. On July 13, 2009, the court denied the residents' motion for reconsideration. The Committee of Petitioners filed a notice of appeal of the trial court decision with the New Jersey Superior Court Appellate Division. The Company can provide no assurance as to the outcome of the court proceedings. The acquisition is expected to add approximately forty thousand customers to the Company's customer base.

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*Dividend:* In March and June 2009, the Company made a cash dividend payment of \$0.20 per share to all shareholders of record as of February 18, 2009 and May 18, 2009, respectively. There were no dividend payments made for the three months or six months ended June 30, 2008.

On July 31, 2009 our board of directors declared a quarterly cash dividend payment of \$0.21 per share payable on September 1, 2009 to all shareholders of record as of August 18, 2009.

## Results of Operations

*Three Months Ended June 30, 2009 Compared To Three Months Ended June 30, 2008*

| (In thousands)                                        | For the three months ended<br>June 30, |            | Favorable<br>(Unfavorable)<br>Change |
|-------------------------------------------------------|----------------------------------------|------------|--------------------------------------|
|                                                       | 2009                                   | 2008       |                                      |
| Operating revenues                                    | \$ 612,740                             | \$ 589,369 | \$ 23,371                            |
| Operating expenses                                    |                                        |            |                                      |
| Operation and maintenance                             | 330,597                                | 330,576    | (21)                                 |
| Depreciation and amortization                         | 73,242                                 | 67,307     | (5,935)                              |
| General taxes                                         | 51,699                                 | 49,628     | (2,071)                              |
| (Gain) loss on sale of assets                         | 10                                     | (800)      | (810)                                |
| Total operating expenses, net                         | 455,548                                | 446,711    | (8,837)                              |
| Operating income                                      | 157,192                                | 142,658    | 14,534                               |
| Other income (deductions)                             |                                        |            |                                      |
| Interest, net                                         | (73,688)                               | (70,066)   | (3,622)                              |
| Allowance for other funds used during construction    | 3,575                                  | 3,387      | 188                                  |
| Allowance for borrowed funds used during construction | 1,991                                  | 1,725      | 266                                  |
| Amortization of debt expense                          | (1,535)                                | (1,441)    | (94)                                 |
| Other, net                                            | (1,409)                                | (599)      | (810)                                |
| Total other income (deductions)                       | (71,066)                               | (66,994)   | (4,072)                              |
| Income before income taxes                            | 86,126                                 | 75,664     | 10,462                               |
| Provision for income taxes                            | 34,137                                 | 30,166     | (3,971)                              |
| Net income                                            | \$ 51,989                              | \$ 45,498  | 6,491                                |
| Income per common share:                              |                                        |            |                                      |
| Basic                                                 | \$ 0.32                                | \$ 0.28    |                                      |
| Diluted                                               | \$ 0.32                                | \$ 0.28    |                                      |
| Average common shares outstanding during the period:  |                                        |            |                                      |
| Basic                                                 | 163,229                                | 159,932    |                                      |
| Diluted                                               | 163,301                                | 159,976    |                                      |

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The following table summarizes certain financial information for our Regulated and Non-Regulated Businesses for the periods indicated (without giving effect to inter-segment eliminations):

|                    | For the three months ended June 30, |                                 |                         |                                 |
|--------------------|-------------------------------------|---------------------------------|-------------------------|---------------------------------|
|                    | 2009                                | 2008                            | 2009                    | 2008                            |
|                    | Regulated<br>Businesses             | Non-<br>Regulated<br>Businesses | Regulated<br>Businesses | Non-<br>Regulated<br>Businesses |
|                    | (In thousands)                      |                                 |                         |                                 |
| Operating revenues | \$ 554,977                          | \$ 64,264                       | \$ 526,248              | \$ 67,038                       |
| Adjusted EBIT(1)   | \$ 147,731                          | \$ 5,387                        | \$ 134,213              | \$ 4,681                        |

- (1) Adjusted EBIT is defined as earnings before interest and income taxes from continuing operations. Management evaluates the performance of its segments and allocates resources based on several factors, of which the primary measure is Adjusted EBIT. Adjusted EBIT does not represent cash flow for the periods presented and should not be considered as an alternative to net income as an indicator of the Company's operating performance or as an alternative to cash flows as a source of liquidity. Adjusted EBIT as defined by the Company may not be comparable with Adjusted EBIT as defined by other companies.

**Operating revenues** Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial, industrial and other customers. As such, our results of operations are significantly impacted by rates authorized by the regulatory commissions of the states in which we operate. The table below details the annualized revenues resulting from rate authorizations, including infrastructure charges, which were granted and became effective in the second quarter of 2009.

| State                                   | Annualized Rate<br>Increases Granted<br>(In millions) |
|-----------------------------------------|-------------------------------------------------------|
| <i>General rate case:</i>               |                                                       |
| Kentucky                                | \$ 10.3                                               |
| New Jersey*                             | 0.7                                                   |
| New Mexico                              | 1.4                                                   |
| California                              | 0.1                                                   |
| <i>Subtotal- General Rate Cases</i>     | <i>12.5</i>                                           |
| <i>Infrastructure Charges:</i>          |                                                       |
| Pennsylvania                            | 2.4                                                   |
| Indiana                                 | 3.8                                                   |
| Illinois                                | 0.7                                                   |
| Ohio                                    | 0.6                                                   |
| <i>Subtotal- Infrastructure Charges</i> | <i>7.5</i>                                            |
| <i>Total</i>                            | <i>\$ 20.0</i>                                        |

\* Additional staged increases of \$0.5 million effective in 2010 and \$0.4 million effective in 2011

Operating revenues increased by \$23.3 million, or 4.0% for the three months ended June 30, 2009 compared to the three months ended June 30, 2008. Regulated Businesses' revenues increased by \$28.7 million, or 5.5% for the three months ended June 30, 2009 compared to the same period in the prior year. The Non-Regulated Businesses' revenues for the three months ended June 30, 2009 decreased by \$2.8 million, or 4.1% compared to the three months ended June 30, 2008.

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The increase in revenues from the Regulated Businesses for the three months ended June 30, 2009 compared to the three months ended June 30, 2008 was primarily due to rate increases obtained through rate authorizations for many of our operating companies (most of which were granted and became effective during periods throughout 2008) of which the second quarter 2009 impact was approximately \$46.5 million. In addition, surcharge and balancing account revenues increased by \$1.4 million for the three months ended June 30, 2009 compared to the same period in 2008. Revenues also increased by \$1.6 million for the three months ended June 30, 2009 compared to the same period in the prior year as a result of 2008 water and sewer acquisitions. These increases were offset by decreased revenues of approximately \$24.0 million attributable to reduced customer consumption, primarily in our Mid-Atlantic state subsidiaries, mainly as a result of the wet weather in the second quarter of 2009 compared to the second quarter of 2008.

The net decrease in revenues from the Non-Regulated Businesses was primarily attributable to lower revenues in our Contract Operations Group of \$3.0 million and in our Applied Water Management Group of \$1.0 million offset by increased revenues in Homeowner Services of \$1.3 million. The decrease in the Contract Operation Group revenues was mainly attributable to lower revenues associated with design and build contracts offset by increased military project revenues

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The following table sets forth the percentage of Regulated Businesses' revenues and water sales volume by customer class:

| Customer Class                         | 2009                   |        | For the three months ended June 30, 2008 |        | 2009                  |        | 2008                  |        |
|----------------------------------------|------------------------|--------|------------------------------------------|--------|-----------------------|--------|-----------------------|--------|
|                                        | Operating Revenues     |        | Operating Revenues                       |        | Water Sales Volume    |        | Water Sales Volume    |        |
|                                        | (Dollars in thousands) |        | (Dollars in thousands)                   |        | (gallons in millions) |        | (gallons in millions) |        |
| Water service:                         |                        |        |                                          |        |                       |        |                       |        |
| Residential                            | \$ 319,737             | 57.6%  | \$ 302,634                               | 57.5%  | 49,163                | 53.5%  | 51,625                | 53.1%  |
| Commercial                             | 107,104                | 19.3%  | 102,656                                  | 19.5%  | 20,373                | 22.2%  | 21,423                | 22.0%  |
| Industrial                             | 25,367                 | 4.6%   | 26,511                                   | 5.0%   | 8,626                 | 9.4%   | 10,370                | 10.7%  |
| Public and other                       | 68,063                 | 12.2%  | 62,935                                   | 12.0%  | 13,702                | 14.9%  | 13,811                | 14.2%  |
| Other water revenues                   | 12,760                 | 2.3%   | 11,860                                   | 2.3%   |                       |        |                       |        |
| Total water revenues and sales volumes | 533,031                | 96.0%  | 506,596                                  | 96.3%  | 91,864                | 100.0% | 97,229                | 100.0% |
| Wastewater service                     | 21,946                 | 4.0%   | 19,652                                   | 3.7%   |                       |        |                       |        |
|                                        | \$ 554,977             | 100.0% | \$ 526,248                               | 100.0% |                       |        |                       |        |

The following discussion related to water services indicates the increase or decrease in the Regulated Businesses' revenues and associated water sales volumes by customer class. Like operating expense increases, declines in water sales volumes generally only impact our results during a period of regulatory lag, as future rate proceedings consider these factors.

**Water Services** Water service operating revenues from residential customers for the three months ended June 30, 2009 totaled \$319.7 million, a \$17.1 million increase, or 5.7%, over the same period of 2008, mainly due to rate increases partially offset by a decrease in sales volume. The volume of water sold to residential customers decreased by 4.8% for the three months ended June 30, 2009 to 49.2 billion gallons, from 51.6 billion gallons for the same period in 2008. We believe this decrease is attributable mainly to wetter than normal weather conditions during the quarter in the Mid-Atlantic region of the United States.

Water service operating revenues from commercial water customers for the three months ended June 30, 2009 increased by \$4.4 million, or 4.3%, to \$107.1 million mainly due to rate increases offset by decreases in sales volume compared to the same period in 2008. The volume of water sold to commercial customers decreased by 4.9% for the three months ended June 30, 2009, to 20.4 billion gallons, from 21.4 billion gallons for the three months ended June 30, 2008.

Water service operating revenues from industrial customers totaled \$25.4 million for the three months ended June 30, 2009, a decrease of \$1.1 million, or 4.3%, from those recorded for the same period of 2008 mainly due to decreased sales volume offset by rate increases. The volume of water sold to industrial customers totaled 8.6 billion gallons for the three months ended June 30, 2009, a decrease of 16.8% from the 10.4 billion gallons for the three months ended June 30, 2008. We attribute this decrease to the current economic environment as customers reduce demand due to a slow-down in their production process or the shut-down of production altogether in the case of some bankruptcies.

Water service operating revenues from public and other customers increased \$5.1 million, or 8.1%, for the three months ended June 30, 2009 to \$68.1 million mainly due to rate increases. Revenues from municipal governments for fire protection services and customers requiring special private fire service facilities totaled \$28.4 million for the three months ended June 30, 2009, an increase of \$2.2 million over the same period of 2008. Revenues generated by sales to governmental entities and resale customers for the three months ended June 30, 2009 totaled \$39.7 million, an increase of \$2.9 million from the three months ended June 30, 2008.

**Wastewater services** Our subsidiaries provide wastewater services in 12 states. Revenues from these services increased by \$2.3 million, or 11.7%, to \$21.9 million for the three months ended June 30, 2009. The increase was attributable to increases in rates charged to customers in a number of our operating companies as well as higher revenues as a result of acquisitions of wastewater systems in Pennsylvania and West Virginia in the last six months of 2008.

**Operation and maintenance** Operation and maintenance expense remained relatively unchanged for the three months ended June 30, 2009 compared to the same period in the prior year.



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Operation and maintenance expenses for the three months ended June 30, 2009 and 2008, by major expense category, were as follows:

|                                    | For the three months ended June 30, |            |                        |            |
|------------------------------------|-------------------------------------|------------|------------------------|------------|
|                                    | 2009                                | 2008       | Increase<br>(Decrease) | Percentage |
|                                    | (In thousands)                      |            |                        |            |
| Production costs                   | \$ 77,161                           | \$ 72,582  | \$ 4,579               | 6.3%       |
| Employee-related costs             | 133,160                             | 131,422    | 1,738                  | 1.3%       |
| Operating supplies and services    | 58,630                              | 66,748     | (8,118)                | (12.2)%    |
| Maintenance materials and services | 31,763                              | 37,221     | (5,458)                | (14.7)%    |
| Customer billing and accounting    | 13,196                              | 11,941     | 1,255                  | 10.5%      |
| Other                              | 16,687                              | 10,662     | 6,025                  | 56.5%      |
| Total                              | \$ 330,597                          | \$ 330,576 | \$ 21                  | 0.0%       |

Production costs, including fuel and power, purchased water, chemicals and waste disposal increased by \$4.6 million, or 6.3%, for the three months ended June 30, 2009 compared to the same period in the prior year. Production costs, by major expense type were as follows:

|                 | For the three months ended June 30, |           |                        |            |
|-----------------|-------------------------------------|-----------|------------------------|------------|
|                 | 2009                                | 2008      | Increase<br>(Decrease) | Percentage |
|                 | (In thousands)                      |           |                        |            |
| Fuel and power  | \$ 27,486                           | \$ 26,969 | \$ 517                 | 1.9%       |
| Purchased water | 24,850                              | 24,397    | 453                    | 1.9%       |
| Chemicals       | 16,562                              | 12,630    | 3,932                  | 31.1%      |
| Waste disposal  | 8,263                               | 8,586     | (323)                  | (3.8)%     |
| Total           | \$ 77,161                           | \$ 72,582 | \$ 4,579               | 6.3%       |

The increase is primarily the result of increased chemical costs due to rising prices for those commodities compared to the same period in the prior year.

Employee-related costs including wage and salary, group insurance, and pension expense increased \$1.7 million or 1.3%, for the three months ended June 30, 2009, compared to the same period in the prior year. These employee related costs represented 40.3% and 39.8% of operation and maintenance expenses for the three months ended June 30, 2009 and 2008, respectively.

|                    | For the three months ended June 30, |            |                        |            |
|--------------------|-------------------------------------|------------|------------------------|------------|
|                    | 2009                                | 2008       | Increase<br>(Decrease) | Percentage |
|                    | (In thousands)                      |            |                        |            |
| Salaries and wages | \$ 96,066                           | \$ 98,243  | \$ (2,177)             | (2.2)%     |
| Pensions           | 13,651                              | 10,499     | 3,152                  | 30.0%      |
| Group insurance    | 18,446                              | 17,421     | 1,025                  | 5.9%       |
| Other benefits     | 4,997                               | 5,259      | (262)                  | (5.0)%     |
| Total              | \$ 133,160                          | \$ 131,422 | \$ 1,738               | 1.3%       |

The decrease in salaries and wages is primarily due to \$3.3 million of wages related to job reclassification of certain hourly employees for services performed which was recorded in 2008 in addition to less overtime worked in 2009, partially offset by salary increases and increased headcount. Pension expense increased for the three months ended June 30, 2009 due to an increase in the amortization of actuarial losses

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attributable to lower than expected returns on plan assets in 2008 as a result of the decline in the economic environment. These market conditions are also the primary reason for the rise of other post employment benefits which are included in the group insurance figures above.

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Operating supplies and services include the day-to-day expenses of office operation, legal and other professional services, as well as information systems and other office equipment rental charges. For the three months ended June 30, 2009, these costs decreased by \$8.1 million or 12.2%, compared to the same period in 2008.

|                              | For the three months ended June 30, |           |                                          |            |
|------------------------------|-------------------------------------|-----------|------------------------------------------|------------|
|                              | 2009                                | 2008      | Increase<br>(Decrease)<br>(In thousands) | Percentage |
| Contracted services          | \$ 20,300                           | \$ 25,359 | \$ (5,059)                               | (19.9)%    |
| Office supplies and services | 14,215                              | 13,511    | 704                                      | 5.2%       |
| Transportation               | 6,453                               | 10,144    | (3,691)                                  | (36.4)%    |
| Rents                        | 5,314                               | 5,780     | (466)                                    | (8.1)%     |
| Other                        | 12,348                              | 11,954    | 394                                      | 3.3%       |
| Total                        | \$ 58,630                           | \$ 66,748 | \$ (8,118)                               | (12.2)%    |

Contracted services decreased for the three months ended June 30, 2009 compared to the same period in 2008. This decrease is primarily due to the consulting fees associated with our remediation efforts to comply with the Sarbanes-Oxley Act of 2002. These costs amounted to \$2.9 million for the period ended June 30, 2008. Additionally, contracted services decreased in our Contract Operations group by \$2.1 million primarily related to a decreased level of activity for the design, build and operate project in Fillmore, California. The decrease in transportation costs was due to lower gasoline prices during the three months ended June 30, 2009 compared to the same period in 2008. The increase in other operating supplies and services is primarily due to the establishment of the \$1.0 million reserve for assets not recoverable at this time associated with the California rate case and \$0.7 million of condemnation expenses. In addition, 2009 costs are also higher as our 2008 Non-Regulated Businesses expenses included profits of \$1.5 million as a result of the finalization and acceptance by the third party related to a construction project. These increases were offset by lower divestiture and IPO related costs of \$3.8 million for the three months ended June 30, 2009. These costs totaled \$4.4 million in 2008 compared to \$0.6 million for the three months ended 2009.

Maintenance materials and services, which include emergency repairs as well as costs for preventive maintenance, decreased \$5.5 million or by 14.7%, for the three months ended June 30, 2009 compared to the same period in the prior year.

|                                   | For the three months ended June 30, |           |                                          |            |
|-----------------------------------|-------------------------------------|-----------|------------------------------------------|------------|
|                                   | 2009                                | 2008      | Increase<br>(Decrease)<br>(In thousands) | Percentage |
| Maintenance services and supplies | \$ 21,628                           | \$ 26,560 | \$ (4,932)                               | (18.6)%    |
| Removal costs, net                | 10,135                              | 10,661    | (526)                                    | (4.9)%     |
| Total                             | \$ 31,763                           | \$ 37,221 | \$ (5,458)                               | (14.7)%    |

The Regulated Businesses maintenance materials and service costs decreased by \$2.1 million for the three months ended June 30, 2009. In addition to lower removal costs, the expenses for the quarter ended June 30, 2008 included \$0.8 million in costs associated with a program in Illinois to maintain valves. The Non-Regulated Businesses maintenance materials and service costs decreased by \$2.1 million for the three months ended June 30, 2009. This decrease was primarily due to a lower level of repairs in our Homeowner Services Group.

Customer billing and accounting expenses increased by \$1.3 million, or 10.5%, for the three months ended June 30, 2009 compared to the same period in the prior year.

| For the three months ended June 30, |      |            |
|-------------------------------------|------|------------|
| 2009                                | 2008 | Percentage |

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|                                |           |           | <b>Increase<br/>(Decrease)</b> |       |
|--------------------------------|-----------|-----------|--------------------------------|-------|
|                                |           |           | <b>(In thousands)</b>          |       |
| Uncollectible accounts expense | \$ 6,467  | \$ 5,527  | \$ 940                         | 17.0% |
| Postage                        | 3,077     | 2,971     | 106                            | 3.6%  |
| Other                          | 3,652     | 3,443     | 209                            | 6.1%  |
| Total                          | \$ 13,196 | \$ 11,941 | \$ 1,255                       | 10.5% |

The increase was the result of higher uncollectible accounts expense in our Regulated Businesses of \$1.1 million due to increases in our overall write-off percentages and specific provisions for certain receivables, including reserves established mostly for bankrupt commercial and industrial customers in certain of our operating companies, due to the uncertainty of collectability in 2009 mainly as a result of the current economic environment. Our Non-Regulated Businesses uncollectible expense decreased by \$0.2 million.

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Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. These costs increased by \$6.0 million, or 56.5%, in 2009.

|                     | For the three months ended June 30, |                  |                                          |              |
|---------------------|-------------------------------------|------------------|------------------------------------------|--------------|
|                     | 2009                                | 2008             | Increase<br>(Decrease)<br>(In thousands) | Percentage   |
| Insurance           | \$ 10,248                           | \$ 7,869         | \$ 2,379                                 | 30.2%        |
| Regulatory expenses | 6,439                               | 2,793            | 3,646                                    | 130.5%       |
| <b>Total</b>        | <b>\$ 16,687</b>                    | <b>\$ 10,662</b> | <b>\$ 6,025</b>                          | <b>56.5%</b> |

Insurance expense increased due to increased claims experienced in 2009 compared to 2008 in addition to increased general liability and property insurance premiums. The increase in regulatory expense was primarily due to \$3.5 million write-off of rate case expenses associated with our California subsidiary.

**Depreciation and amortization** Depreciation and amortization expense increased by \$5.9 million, or 8.8%, for the three months ended June 30, 2009 compared to the same period in the prior year as a result of additional utility plant placed in service.

**General taxes** General taxes expense, which includes taxes for property, payroll, gross receipts, and other miscellaneous items, increased by \$2.1 million, or 4.2%, in the three months ended June 30, 2009 compared to the three months ended June 30, 2008. This increase is due to higher property taxes primarily in Illinois, Ohio and Indiana and an increase in gross receipts taxes in New Jersey and West Virginia.

**Other income (deductions)** Interest expense, net of interest income, which is the primary component of our other income (deductions), increased by \$3.6 million, or 5.2%, for the three months ended June 30, 2009 compared to the same period in the prior year. The increase is primarily due to the increased borrowings associated with capital expenditures. Partially offsetting the change in interest expense was an increase in AFUDC of \$0.5 million for the three months ended June 30, 2009 compared to the same period in 2008 as a result of increased construction work in progress.

**Provision for income taxes** Our consolidated provision for income taxes increased \$4.0 million, or 13.2%, to \$34.1 million for the three months ended June 30, 2009. The effective tax rates for the three months ended June 30, 2009 and 2008 were 39.6% and 39.9%, respectively.

**Net income** Net income increased \$6.5 million, to \$52.0 million for the three months ended June 30, 2009 compared to a net income of \$45.5 million for the three months ended June 30, 2008. The increase is the result of the aforementioned changes.

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### Results of Operations

Six Months Ended June 30, 2009 Compared To Six Months Ended June 30, 2008

| (In thousands)                                        | For the six months ended<br>June 30, |              | Favorable<br>(Unfavorable)<br>Change |
|-------------------------------------------------------|--------------------------------------|--------------|--------------------------------------|
|                                                       | 2009                                 | 2008         |                                      |
| Operating revenues                                    | \$ 1,162,910                         | \$ 1,096,184 | 66,726                               |
| Operating expenses                                    |                                      |              |                                      |
| Operation and maintenance                             | 644,999                              | 641,837      | (3,162)                              |
| Depreciation and amortization                         | 142,085                              | 131,223      | (10,862)                             |
| General taxes                                         | 104,196                              | 101,694      | (2,502)                              |
| Gain on sale of assets                                | (192)                                | (870)        | (678)                                |
| Impairment charge                                     | 450,000                              | 750,000      | 300,000                              |
| Total operating expenses, net                         | 1,341,088                            | 1,623,884    | 282,796                              |
| Operating loss                                        | (178,178)                            | (527,700)    | 349,522                              |
| Other income (deductions)                             |                                      |              |                                      |
| Interest, net                                         | (145,667)                            | (140,034)    | (5,633)                              |
| Allowance for other funds used during construction    | 6,918                                | 5,928        | 990                                  |
| Allowance for borrowed funds used during construction | 3,863                                | 3,093        | 770                                  |
| Amortization of debt expense                          | (3,023)                              | (2,759)      | (264)                                |
| Other, net                                            | (295)                                | 550          | (845)                                |
| Total other income (deductions)                       | (138,204)                            | (133,222)    | (4,982)                              |
| Loss before income taxes                              | (316,382)                            | (660,922)    | 344,540                              |
| Provision for income taxes                            | 44,708                               | 26,064       | (18,644)                             |
| Net loss                                              | \$ (361,090)                         | \$ (686,986) | \$ 325,896                           |
| Loss per common share:                                |                                      |              |                                      |
| Basic                                                 | \$ (2.23)                            | \$ (4.29)    |                                      |
| Diluted                                               | \$ (2.23)                            | \$ (4.29)    |                                      |
| Average common shares outstanding during the period:  |                                      |              |                                      |
| Basic                                                 | 161,629                              | 159,966      |                                      |
| Diluted                                               | 161,629                              | 159,966      |                                      |

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The following table summarizes certain financial information for our Regulated and Non-Regulated Businesses for the periods indicated (without giving effect to inter-segment eliminations):

|                    | For the six months ended June 30, |                                 |                         |                                 |
|--------------------|-----------------------------------|---------------------------------|-------------------------|---------------------------------|
|                    | 2009                              | 2008                            | 2009                    | 2008                            |
|                    | Regulated<br>Businesses           | Non-<br>Regulated<br>Businesses | Regulated<br>Businesses | Non-<br>Regulated<br>Businesses |
|                    | (In thousands)                    |                                 |                         |                                 |
| Operating revenues | \$ 1,052,347                      | \$ 121,796                      | \$ 975,782              | \$ 128,210                      |
| Adjusted EBIT(1)   | \$ 255,457                        | \$ 10,102                       | \$ 206,113              | \$ 9,263                        |

- (1) Adjusted EBIT is defined as earnings before interest and income taxes from continuing operations. Management evaluates the performance of its segments and allocates resources based on several factors, of which the primary measure is Adjusted EBIT. Adjusted EBIT does not represent cash flow for the periods presented and should not be considered as an alternative to net income as an indicator of the Company's operating performance or as an alternative to cash flows as a source of liquidity. Adjusted EBIT as defined by the Company may not be comparable with Adjusted EBIT as defined by other companies.

**Operating revenues** Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial, industrial and other customers. As such, our results of operations are significantly impacted by rates authorized by the state regulatory commissions in the states in which we operate. The table below details the annualized revenues resulting from rate authorizations, including infrastructure charges, which were granted and became effective during the six months ended June 30, 2009.

| State                                   | Annualized Rate<br>Increases Granted<br>(In millions) |
|-----------------------------------------|-------------------------------------------------------|
| <i>General rate case:</i>               |                                                       |
| Kentucky                                | \$ 10.3                                               |
| West Virginia                           | 5.2                                                   |
| New Jersey*                             | 0.7                                                   |
| New Mexico                              | 1.4                                                   |
| California                              | 0.1                                                   |
| <i>Subtotal- General Rate Cases</i>     | 17.7                                                  |
| <i>Infrastructure Charges:</i>          |                                                       |
| Pennsylvania                            | 8.4                                                   |
| Indiana                                 | 3.8                                                   |
| Illinois                                | 0.7                                                   |
| Ohio                                    | 0.6                                                   |
| Other                                   | 0.6                                                   |
| <i>Subtotal- Infrastructure Charges</i> | 14.1                                                  |
| <i>Total</i>                            | \$ 31.8                                               |

\* Additional staged increases of \$0.5 million effective in 2010 and \$0.4 million effective in 2011

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Operating revenues increased by \$66.7 million, or 6.1% for the six months ended June 30, 2009 compared to the six months ended June 30, 2008. Regulated Businesses' revenues increased by \$76.6 million, or 7.8% for the six months ended June 30, 2009 compared to the same period in the prior year. The Non-Regulated Businesses' revenues for the six months ended June 30, 2009 decreased by \$6.4 million, or 5.0% compared to the six months ended June 30, 2008.

The increase in revenues from the Regulated Businesses for the six months ended June 30, 2009 compared to the six months ended June 30, 2008 was primarily due to rate increases obtained through rate authorizations for many of our operating companies (most of which were granted and became effective during periods throughout 2008) of which the year-to-date 2009 impact was approximately \$90.0 million. In addition, surcharge and balancing account revenues increased by \$5.1 million for the six months ended June 30, 2009 compared to the same period in 2008. Revenues also increased by \$3.0 million for the six months ended June 30, 2009 compared to the same period in the prior year as a result of 2008 water and sewer acquisitions. These increases were offset by decreased revenues of approximately \$24.6 million attributable to lower demand, primarily in our operating companies in the Mid-Atlantic region of the United States in the six months ended June 30, 2009 compared to the six months ended June 30, 2008.

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The net decrease in revenues from the Non-Regulated Businesses was primarily attributable to lower revenues in our Contract Operations Group of \$6.2 million and in our Applied Water Management Group of \$1.5 million offset by increased revenues in Homeowner Services of \$2.6 million. The decrease in the Contract Operation Group revenues was mainly attributable to lower revenues associated with design and build contracts offset by increased military project revenues.

The following table sets forth the percentage of Regulated Businesses' revenues and water sales volume by customer class:

| Customer Class                         | For the six months ended June 30,           |        |            |        |                    |        |         |        |  |
|----------------------------------------|---------------------------------------------|--------|------------|--------|--------------------|--------|---------|--------|--|
|                                        | 2009                                        |        |            |        | 2008               |        |         |        |  |
|                                        | Operating Revenues                          |        |            |        | Water Sales Volume |        |         |        |  |
|                                        | (Dollars in thousands, gallons in millions) |        |            |        |                    |        |         |        |  |
| Water service:                         |                                             |        |            |        |                    |        |         |        |  |
| Residential                            | \$ 606,357                                  | 57.6%  | \$ 559,858 | 57.4%  | 93,718             | 53.3%  | 96,870  | 52.6%  |  |
| Commercial                             | 198,236                                     | 18.9%  | 185,508    | 19.0%  | 38,602             | 21.9%  | 40,339  | 21.9%  |  |
| Industrial                             | 48,447                                      | 4.6%   | 50,349     | 5.2%   | 17,255             | 9.8%   | 20,278  | 11.0%  |  |
| Public and other                       | 130,872                                     | 12.4%  | 120,755    | 12.4%  | 26,316             | 15.0%  | 26,770  | 14.5%  |  |
| Other water revenues                   | 24,824                                      | 2.4%   | 20,906     | 2.1%   |                    |        |         |        |  |
| Total water revenues and sales volumes | 1,008,736                                   | 95.9%  | 937,376    | 96.1%  | 175,891            | 100.0% | 184,257 | 100.0% |  |
| Wastewater service                     | 43,611                                      | 4.1%   | 38,406     | 3.9%   |                    |        |         |        |  |
|                                        | \$ 1,052,347                                | 100.0% | \$ 975,782 | 100.0% |                    |        |         |        |  |

The following discussion related to water services indicates the increase or decrease in the Regulated Businesses' revenues and associated water sales volumes by customer class. Like operating expense increases, declines in water sales volumes generally only impact our results during a period of regulatory lag, as future rate proceedings consider these factors.

**Water Services** Water service operating revenues from residential customers for the six months ended June 30, 2009 totaled \$606.4 million, a \$46.5 million increase, or 8.3%, over the same period of 2008, mainly due to rate increases partially offset by a decrease in sales volume. The volume of water sold to residential customers decreased by 3.3% for the six months ended June 30, 2009 to 93.7 billion gallons, from 96.9 billion gallons for the same period in 2008. We attribute this decrease to wetter than normal weather conditions.

Water service operating revenues from commercial water customers for the six months ended June 30, 2009 increased by \$12.7 million, or 6.9%, to \$198.2 million mainly due to rate increases offset by decreases in sales volume compared to the same period in 2008. The volume of water sold to commercial customers decreased by 4.3% for the six months ended June 30, 2009, to 38.6 billion gallons, from 40.3 billion gallons for the six months ended June 30, 2008.

Water service operating revenues from industrial customers totaled \$48.4 million for the six months ended June 30, 2009, a decrease of \$1.9 million, or 3.8%, from those recorded for the same period of 2008 mainly due to decreased sales volume offset by rate increases. The volume of water sold to industrial customers totaled 17.3 billion gallons for the six months ended June 30, 2009, a decrease of 14.9% from the 20.3 billion gallons for the six months ended June 30, 2008. We attribute this decrease to the current economic environment as customers reduce demand due to a slow-down in their production process or the shut-down of production altogether in the case of some bankruptcies.

Water service operating revenues from public and other customers increased \$10.1 million, or 8.4%, for the six months ended June 30, 2009 to \$130.9 million from \$120.8 million for the six months ended June 30, 2008 mainly due to rate increases. Revenues from municipal governments for fire protection services and customers requiring special private fire service facilities totaled \$55.7 million for the six months ended June 30, 2009, an increase of \$3.8 million over the same period of 2008. Revenues generated by sales to governmental entities and resale customers for the six months ended June 30, 2009 totaled \$75.2 million, an increase of \$6.3 million from the six months ended June 30, 2008.

**Wastewater services** Our subsidiaries provide wastewater services in 12 states. Revenues from these services increased by \$5.2 million, or 13.6%, to \$43.6 million for the six months ended June 30, 2009, from \$38.4 million for the same period of 2008. The increase was attributable to increases in rates charged to customers in a number of our operating companies as well as higher revenues as a result of acquisitions of

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wastewater systems in Pennsylvania and West Virginia in the last six months of 2008.

***Operation and maintenance*** Operation and maintenance expense increased by \$3.2 million, or 0.5%, for the six months ended June 30, 2009 compared to the same period in the prior year.

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Operation and maintenance expenses for the six months ended June 30, 2009 and 2008, by major expense category, were as follows:

|                                    | For the six months ended June 30, |            |                                          |            |
|------------------------------------|-----------------------------------|------------|------------------------------------------|------------|
|                                    | 2009                              | 2008       | Increase<br>(Decrease)<br>(In thousands) | Percentage |
| Production costs                   | \$ 146,188                        | \$ 136,810 | \$ 9,378                                 | 6.9%       |
| Employee-related costs             | 265,771                           | 258,255    | 7,516                                    | 2.9%       |
| Operating supplies and services    | 115,460                           | 136,243    | (20,783)                                 | (15.3)%    |
| Maintenance materials and services | 64,005                            | 72,168     | (8,163)                                  | (11.3)%    |
| Customer billing and accounting    | 23,999                            | 19,351     | 4,648                                    | 24.0%      |
| Other                              | 29,576                            | 19,010     | 10,566                                   | 55.6%      |
| Total                              | \$ 644,999                        | \$ 641,837 | \$ 3,162                                 | 0.5%       |

Production costs, including fuel and power, purchased water, chemicals and waste disposal increased by \$9.4 million, or 6.9%, for the six months ended June 30, 2009 compared to the same period in the prior year. Production costs, by major expense type were as follows:

|                 | For the six months ended June 30, |            |                                          |            |
|-----------------|-----------------------------------|------------|------------------------------------------|------------|
|                 | 2009                              | 2008       | Increase<br>(Decrease)<br>(In thousands) | Percentage |
| Fuel and power  | \$ 53,392                         | \$ 52,187  | \$ 1,205                                 | 2.3%       |
| Purchased water | 45,201                            | 43,747     | 1,454                                    | 3.3%       |
| Chemicals       | 31,389                            | 23,897     | 7,492                                    | 31.4%      |
| Waste disposal  | 16,206                            | 16,979     | (773)                                    | (4.6)%     |
| Total           | \$ 146,188                        | \$ 136,810 | \$ 9,378                                 | 6.9%       |

The increase in fuel and power and purchased water is primarily due to rate increases by our suppliers. Chemical costs increased due to rising prices for those commodities.

Employee-related costs including wage and salary, group insurance, and pension expense increased \$7.5 million or 2.9%, for the six months ended June 30, 2009, compared to the same period in the prior year. These employee related costs represented 41.2% and 40.2% of operation and maintenance expenses for the six months ended June 30, 2009 and 2008, respectively.

|                    | For the six months ended June 30, |            |                                          |            |
|--------------------|-----------------------------------|------------|------------------------------------------|------------|
|                    | 2009                              | 2008       | Increase<br>(Decrease)<br>(In thousands) | Percentage |
| Salaries and wages | \$ 188,772                        | \$ 190,916 | \$ (2,144)                               | (1.1)%     |
| Pensions           | 28,300                            | 21,759     | 6,541                                    | 30.1%      |
| Group insurance    | 38,710                            | 35,231     | 3,479                                    | 9.9%       |
| Other benefits     | 9,989                             | 10,349     | (360)                                    | (3.5)%     |
| Total              | \$ 265,771                        | \$ 258,255 | \$ 7,516                                 | 2.9%       |

The decrease in salaries and wages is primarily due to \$3.3 million of wages related to job reclassification of certain hourly employees for services performed which was recorded in 2008 in addition to less overtime worked in 2009, partially offset by increased headcount and salary

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increases. Pension expense increased for the six months ended June 30, 2009 due to an increase in the amortization of actuarial losses attributable to lower than expected returns on plan assets in 2008 as a result of the decline in the economic environment. These market conditions are also the primary reason for the rise of other post employment benefits which are included in the group insurance figures above.

Operating supplies and services include the day-to-day expenses of office operation, legal and other professional services, as well as information systems and other office equipment rental charges. For the six months ended June 30, 2009, these costs decreased by \$20.8 million or 15.3%, compared to the same period in 2008.

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|                              | For the six months ended June 30, |            |                        |            |
|------------------------------|-----------------------------------|------------|------------------------|------------|
|                              | 2009                              | 2008       | Increase<br>(Decrease) | Percentage |
|                              |                                   |            | (In thousands)         |            |
| Contracted services          | \$ 38,864                         | \$ 52,378  | \$ (13,514)            | (25.8)%    |
| Office supplies and services | 29,057                            | 28,316     | 741                    | 2.6%       |
| Transportation               | 13,734                            | 18,597     | (4,863)                | (26.1)%    |
| Rents                        | 10,680                            | 11,497     | (817)                  | (7.1)%     |
| Other                        | 23,125                            | 25,455     | (2,330)                | (9.2)%     |
| Total                        | \$ 115,460                        | \$ 136,243 | \$ (20,783)            | (15.3)%    |

Contracted services decreased for the six months ended June 30, 2009 compared to the same period in 2008. This decrease is primarily due to the consulting fees associated with our remediation efforts to comply with the Sarbanes-Oxley Act of 2002. These costs amounted to \$8.9 million for the six months ended June 30, 2008. Additionally, contracted services decreased in our Contract Operations Group by \$5.1 million primarily related to a decreased level of activity for the design, build and operate project in Fillmore, California. The decrease in transportation costs was due to lower gasoline prices during the six months ended June 30, 2009 compared to the same period in 2008. Other operating supplies and services decreased due to lower divestiture and IPO related costs of \$6.8 million. These costs totaled \$7.8 million in 2008 compared to \$1.0 million in 2009. Offsetting this decrease was 2009 condemnation costs of \$1.3 million and the establishment of a \$1.0 million reserve for assets not recoverable at this time associated with the California rate case. In addition, 2009 costs are also higher as our 2008 Non-Regulated Businesses expenses included profits of \$1.5 million as a result of the finalization and acceptance by the third party related to a construction project.

Maintenance materials and services, which include emergency repairs as well as costs for preventive maintenance, decreased \$8.2 million or by 11.3%, for the six months ended June 30, 2009 compared to the same period in the prior year.

|                                   | For the six months ended June 30, |           |                        |            |
|-----------------------------------|-----------------------------------|-----------|------------------------|------------|
|                                   | 2009                              | 2008      | Increase<br>(Decrease) | Percentage |
|                                   |                                   |           | (In thousands)         |            |
| Maintenance services and supplies | \$ 43,861                         | \$ 50,954 | \$ (7,093)             | (13.9)%    |
| Removal costs, net                | 20,144                            | 21,214    | (1,070)                | (5.0)%     |
| Total                             | \$ 64,005                         | \$ 72,168 | \$ (8,163)             | (11.3)%    |

The Regulated Businesses maintenance materials and service costs decreased by \$5.1 million for the six months ended June 30, 2009. In addition to lower removal costs, the expenses for the six months ended June 30, 2008 included \$2.8 million in costs associated with a program in Illinois to maintain valves. Additionally, tank painting expenses were lower by \$1.4 million. The Non-Regulated Businesses maintenance materials and service costs decreased by \$3.0 million for the six months ended June 30, 2009. Homeowner Services maintenance services and supplies decreased \$1.9 million due to favorable claims experience in addition to reduction in Contract Operations of \$1.0 million primarily due to lower levels of maintenance projects with some of our military contracts compared to the six months ended June 30, 2008.

Customer billing and accounting expenses increased by \$4.6 million, or 24.0 %, for the six months ended June 30, 2009 compared to the same period in the prior year.

|                                | For the six months ended June 30, |          |                        |            |
|--------------------------------|-----------------------------------|----------|------------------------|------------|
|                                | 2009                              | 2008     | Increase<br>(Decrease) | Percentage |
|                                |                                   |          | (In thousands)         |            |
| Uncollectible accounts expense | \$ 11,202                         | \$ 6,934 | \$ 4,268               | 61.6%      |
| Postage                        | 6,043                             | 5,768    | 275                    | 4.8%       |
| Other                          | 6,754                             | 6,649    | 105                    | 1.6%       |

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|       |           |           |          |       |
|-------|-----------|-----------|----------|-------|
| Total | \$ 23,999 | \$ 19,351 | \$ 4,648 | 24.0% |
|-------|-----------|-----------|----------|-------|

The increase was the result of higher uncollectible accounts expense in our Regulated Businesses of \$5.0 million due to an unusually low balance in 2008 as the result of a collection effort in the first quarter of 2008 to collect previously written off accounts. Our overall 2009 write-off percentages and specific provisions for certain receivables, including a number of commercial and industrial customers that have filed for bankruptcy, increased in 2009 due to the uncertainty of collectability, which we believe is attributable to the current economic environment. Our Non-Regulated Businesses uncollectible expense decreased by \$0.7 million in 2009 primarily as a result of the collection of accounts previously written-off.

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Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. These costs increased by \$10.6 million, or 55.6%, in 2009.

|                     | For the six months ended June 30, |           |                                          |            |
|---------------------|-----------------------------------|-----------|------------------------------------------|------------|
|                     | 2009                              | 2008      | Increase<br>(Decrease)<br>(In thousands) | Percentage |
| Insurance           | \$ 20,592                         | \$ 14,347 | \$ 6,245                                 | 43.5%      |
| Regulatory expenses | 8,984                             | 4,663     | 4,321                                    | 92.7%      |
| Total               | \$ 29,576                         | \$ 19,010 | \$ 10,566                                | 55.6%      |

Insurance expense increased due to increased claims experienced in 2009 compared to 2008 in addition to increased general liability and property insurance premiums. Regulatory expenses are higher in 2009 as a result of a \$3.5 million write-off of rate case expenses associated with our California subsidiary, costs incurred in connection with the rate case appeal in our Tennessee subsidiary as well as increased amortization of costs related to final rate orders received in several states.

**Depreciation and amortization** Depreciation and amortization expense increased by \$10.9 million, or 8.3%, for the six months ended June 30, 2009 compared to the same period in the prior year as a result of additional utility plant placed in service.

**General taxes** General taxes expense, which includes taxes for property, payroll, gross receipts, and other miscellaneous items, increased by \$2.5 million, or 2.5%, in the six months ended June 30, 2009 compared to the six months ended June 30, 2008.

**Gain on sale of assets** Gain on sale of assets was \$0.2 million for the six months ended June 30, 2009 compared to a gain of \$0.9 million for the six months ended June 30, 2008 due to non-recurring sales of assets no longer used in our operations.

**Impairment charge** For the six months ended June 30, 2009, we recorded an impairment charge to goodwill of our Regulated Businesses in the amount of \$448.2 million and our Non-Regulated Businesses of \$1.8 million. For the six months ended June 30, 2008, we recorded an impairment charge of \$750.0 million in our Regulated Businesses. The 2009 impairment charge, which was recorded in the first quarter of 2009, was primarily related to the high degree of stock market volatility experienced and, as of March 31, 2009, the sustained period for which the Company's market price was below its carrying value. The 2008 impairment charge was primarily due to the market price of our common stock (both the initial public offering price and the price during subsequent trading) being less than what was anticipated during our 2007 annual test. Also contributing to the impairment charge was a decline in the fair value of our debt (due to increased market interest rates).

**Other income (deductions)** Interest expense, net of interest income, which is the primary component of our other income (deductions), increased by \$5.6 million, or 4.0%, for the six months ended June 30, 2009 compared to the same period in the prior year. The increase is primarily due to the increased borrowings associated with capital expenditures. Partially offsetting the change in interest expense was an increase in AFUDC of \$1.8 million for the six months ended June 30, 2009 compared to the same period in 2008 as a result of increased construction work in progress.

**Provision for income taxes** Our consolidated provision for income taxes increased \$18.6 million, or 71.5%, to \$44.7 million for the six months ended June 30, 2009. The effective tax rates for the six months ended June 30, 2009 and 2008 of (14.1%) and (3.9%), respectively, reflect the tax effects of goodwill impairments as discrete items as the Company considers these charges as infrequently occurring or unusual.

**Net loss** Net loss decreased \$325.9 million, to \$361.1 million for the six months ended June 30, 2009 compared to a net loss of \$687.0 million for the six months ended June 30, 2008. The decrease is the result of the aforementioned changes.

**Liquidity and Capital Resources**

Our business is capital intensive and requires considerable capital resources. A portion of these capital resources are provided by internally generated cash flows from operations. When necessary we obtain funds from external sources in the capital markets and through bank borrowings. Our access to external financing on reasonable terms depends on our credit ratings and current business conditions, including that of the water utility industry in general as well as conditions in the debt or equity capital markets. If these business and market conditions deteriorate to the extent that we no longer have access to the capital markets at reasonable terms, we have access to revolving credit facilities with aggregate

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bank commitments of \$850.0 million, of which \$633.0 million was available as of August 3, 2009, that we use to fulfill our short-term liquidity needs, to issue letters of credit and back our \$64.5 million outstanding commercial paper. As of August 3, 2009, the Company can issue additional commercial paper of \$568.5 million which is backed by the credit facilities. See the Credit Facilities and Short-Term Debt section below for further discussion.

In addition, our regulated utility subsidiaries receive advances and contributions from customers, home builders and real estate developers to fund construction necessary to extend service to new areas. Advances for construction are refundable for limited periods, which vary according to state regulations, as new customers begin to receive service or other contractual obligations are fulfilled. Amounts which are no longer refundable are reclassified to contributions in aid of construction. Utility plant funded by advances and contributions is excluded from the rate base. Generally, we depreciate contributed property and amortize contributions in aid of construction at the composite rate of the related property. Some of our subsidiaries do not depreciate contributed property, based on regulatory guidelines.

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We use our capital resources, including cash, to (i) fund capital requirements, including construction expenditures, (ii) pay off maturing debt, (iii) pay dividends, (iv) fund pension and postretirement welfare obligations and (v) invest in new and existing ventures. We spend a significant amount of cash on construction projects that have a long-term return on investment. Additionally, we operate in rate-regulated environments in which the amount of new investment recovery may be limited, and where such recovery takes place over an extended period of time, as our recovery is subject to regulatory lag. As a result of these factors, our working capital, defined as current assets less current liabilities, was in a net deficit position of \$297.1 million as of June 30, 2009.

We expect to fund future maturities of long-term debt through a combination of external debt and cash flow from operations. We have no plans to reduce debt significantly.

We rely on our revolving credit facility and the capital markets to satisfy our liquidity needs. Disruptions in the credit markets may discourage lenders from meeting their existing lending commitments, extending the terms of such commitments or agreeing to new commitments. Market disruptions may also limit our ability to issue debt securities in the capital markets. In order to meet our short-term liquidity needs we are borrowing under AWCC's existing \$850.0 million revolving credit facilities. AWCC had \$170.0 million of outstanding borrowings under its lines of credit, \$47.0 million of outstanding letters of credit under this credit facility and \$64.5 million of outstanding overnight commercial paper as of August 3, 2009. We can provide no assurances that our lenders will meet their existing commitments or that we will be able to access the commercial paper or loan markets in the future on terms acceptable to us or at all.

During 2009, the Company used its commercial paper and revolver, to redeem, through its subsidiaries \$120.3 million of its variable rate demand bonds. On May 21, 2009, AWCC remarketed \$52.9 million of these variable rate demand notes as fixed rate Tax Exempt Water Facility Revenue bonds with interest rates ranging from 6.00% to 6.75%. The net proceeds from this offering were used to repay short-term debt. Also on May 21, 2009, AWCC successfully remarketed \$31.9 million of variable rate demand notes previously held in the Company's treasury. The net proceeds from this offering were used to repay commercial paper. The remaining \$35.5 million is held in the Company's treasury at June 30, 2009.

As a result of the American Recovery and Reinvestment Tax Act of 2009 (the Act), we have and will continue as long as available to apply for subsidized financing under the Act in many of the states where we operate. Since the issuance of tax-exempt bonds and financing from state revolving funds is subject to governmental approvals, at this time we are not certain how much of these funds, if any, will be available to investor owned utilities. Also in connection with the Act, the Company has reflected the benefits from the extension of bonus depreciation in its results for the three and six months ended June 30, 2009.

### Cash Flows from Operating Activities

Cash flows from operating activities primarily result from the sale of water and wastewater services and, due to the seasonality of operations, are weighted toward the third quarter of each fiscal year. Our future cash flows from operating activities will be affected by economic utility regulation; infrastructure investment; inflation; compliance with environmental, health and safety standards; production costs; customer growth; declining per customer usage of water; weather and seasonality; and other business impacts. Cash flows from operating activities have been a reliable, steady source of cash flow, sufficient to meet operating requirements and a portion of our capital expenditures requirements. We will seek access to debt and equity capital markets to meet the balance of our capital expenditure requirements. There can be no assurance that we will be able to successfully access such markets on favorable terms or at all. Operating cash flows can be negatively affected by changes in our rate regulatory environments or changes in our customer economic outlook and ability to pay for service in a timely manner. We can provide no assurance that our customers' historical payment pattern will continue in the future. Cash flows from operating activities for the six months ended June 30, 2009 were \$228.7 million compared to \$141.3 million for the six months ended June 30, 2008.

The following table provides a summary of the major items affecting our cash flows from operating activities for the six months ended June 30, 2009 and 2008:

|                                   | For the six months ended<br>June 30, |              |
|-----------------------------------|--------------------------------------|--------------|
|                                   | 2009                                 | 2008         |
|                                   | (In thousands)                       |              |
| Net income (loss)                 | \$ (361,090)                         | \$ (686,986) |
| Add (subtract):                   |                                      |              |
| Non-cash operating activities (1) | 707,983                              | 923,994      |

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|                                                     |            |            |
|-----------------------------------------------------|------------|------------|
| Changes in working capital (2)                      | (63,167)   | (36,057)   |
| Pension and postretirement healthcare contributions | (55,018)   | (59,676)   |
| Net cash flows provided by operations               | \$ 228,708 | \$ 141,275 |

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- (1) Includes depreciation and amortization, impairment charges, removal costs net of salvage, provision for deferred income taxes, amortization of deferred investment tax credits, provision for losses on utility accounts receivable, allowance for other funds used during construction, gain on sale of assets, and other non-cash items, net, less pension and postretirement healthcare contributions.
- (2) Changes in working capital include changes to receivables and unbilled utility revenue, other current assets, accounts payable, taxes accrued (including income taxes), interest accrued and other current liabilities.

### ***Cash Flows from Investing Activities***

Cash flows used in investing activities for the six months ended June 30, 2009 and 2008 were \$357.1 million and \$427.6 million, respectively. Construction expenditures decreased \$25.8 million to \$400.2 million for the six months ended June 30, 2009 from \$426.0 million for the six months ended June 30, 2008. This decrease was attributable to our conscientious decision, as a result of the credit market disruptions, to decrease, in the current year, our investment in our regulated utility plant projects. We anticipate investing approximately \$800.0 million on construction and other capital projects in 2009.

Our construction program consist of both infrastructure renewal programs, where we replace infrastructure as needed, and construction of new water and wastewater treatment and delivery facilities to meet new customer growth and environmental requirements. An integral aspect of our strategy is to seek growth through tuck-ins and other acquisitions which are complementary to our existing business and support the continued geographical diversification and growth of our operations. Generally, acquisitions and construction expenditures are funded initially with short-term debt and later refinanced with the proceeds from long-term debt or equity offerings.

Included in 2009 are planned construction expenditures of approximately \$83 million to construct a new water treatment plant on the Kentucky River. On April 25, 2008, the Kentucky Public Service Commission approved Kentucky American Water's application for a certificate of convenience and necessity to construct a 20.0 million gallon per day treatment plant on the Kentucky River and a 30.6 mile pipeline to meet Central Kentucky's water supply deficit. The Kentucky project is expected to be completed by 2010 with an estimated cost of \$162 million.

As previously disclosed above, with respect to our New Jersey subsidiary's agreement with the city of Trenton to purchase the assets of its water system for \$75.0 million, the BPU issued its order on April 3, 2009 approving the Stipulation. The effective date of the Stipulation is automatically stayed pending resolution of court proceedings initiated in New Jersey Superior Court by a small number of Trenton residents seeking to submit the acquisition to a referendum. The trial court ruled in March 2009 that a referendum is not required but the residents have filed for reconsideration of that ruling. On July 13, 2009, the court denied the residents' motion for reconsideration. The Committee of Petitioners filed a notice of appeal of the trial court decision with the New Jersey Superior Court Appellate Division. The Company can provide no assurance as to the outcome of the court proceedings.

Our investing activities require considerable capital resources which we have generated in operations and attained through financing activities. We can provide no assurance that the resources will be sufficient to meet our expected investment needs and may be required to delay or reevaluate our investment plans.

### ***Cash Flows from Financing Activities***

Our financing activities include the issuance of long-term and short-term debt, primarily through our wholly-owned financing subsidiary, AWCC, as well as the issuance of equity. We intend to access the capital markets on a regular basis, subject to market conditions. In addition, we intend to issue equity in the future to maintain an appropriate capital structure, subject to any restrictions in our registration rights agreement with RWE. In order to finance new infrastructure, we received customer advances and contributions for construction (net of refunds) of \$6.2 million and \$2.2 million for the six months ended June 30, 2009 and 2008, respectively.

On May 1, 2009, we and AWCC filed a universal shelf registration statement that enables us to offer and sell from time to time various types of securities, including common stock, preferred stock and debt securities, subject to market demand and ratings status. On June 10, 2009, the Company completed the public offering of 29.9 million shares of its common stock. Pursuant to the offering, the Company sold 14.5 million shares of common stock and 15.4 million shares were sold by RWE.

The Company completed the sale of 14.5 million shares of common stock at \$17.25 per share. The proceeds from the offering, net of underwriters' discounts and expenses payable by the Company were \$242.3 million. The proceeds from the offering were used to repay short-term debt.

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RWE completed a partial divestiture of its investment in the Company through the sale of 11.5 million shares also at a price of \$17.25. RWE granted the underwriters a 30-day option to purchase up to an additional 3.9 million shares of the Company's stock at a price of \$17.25. The underwriters exercised their option and purchased 3.9 million shares to cover over-allotments. We did not receive any proceeds from the RWE sale of the Company's shares. Prior to the sale of shares by RWE and the Company, RWE owned approximately 60% of the Company's common shares. After the sales of shares and exercise of the underwriters' over-allotment option, RWE owns approximately 47% of the Company's shares.

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In regards to debt financings, the following long-term debt was issued in the first six months of 2009:

| Company                      | Type                           | Interest Rate | Maturity | Amount (In thousands) |
|------------------------------|--------------------------------|---------------|----------|-----------------------|
| American Water Capital Corp. | Private activity-fixed rate    | 6.25%         | 2039     | \$ 45,390             |
| American Water Capital Corp. | Private activity-fixed rate    | 6.00%         | 2018     | 18,250                |
| American Water Capital Corp. | Private activity-fixed rate    | 6.10%         | 2019     | 17,950                |
| American Water Capital Corp. | Private activity-fixed rate    | 6.75%         | 2031     | 16,700                |
| American Water Capital Corp. | Private activity-floating rate | 1.00%         | 2032     | 23,325                |
| American Water Capital Corp. | Senior notes-fixed rate        | 8.27%         | 2039     | 25,500                |
| American Water Capital Corp. | Senior notes-fixed rate        | 7.21%         | 2019     | 24,500                |
| American Water Capital Corp. | Senior notes                   | 8.25%         | 2038     | 75,000                |
| Other subsidiaries           | Private activity-fixed rate    | 6.20%         | 2039     | 80,000                |
| Other subsidiaries           | Private activity-floating rate | 1.00%         | 2015     | 8,560                 |
| Other subsidiaries           | Mortgage bonds-fixed rate      | 5.48%         | 2019     | 25,000                |
| Other subsidiaries           | Mortgage bonds-fixed rate      | 6.35%         | 2039     | 75,000                |
| Other                        | Capital lease                  | 8.82%         | 2011     | 41                    |
| Total issuances              |                                |               |          | \$ 435,216            |

On June 23, 2009, AWCC closed an offering of \$45.4 million in tax-exempt water facility revenue bonds issued by Owen County in Kentucky. The bonds have a coupon of 6.25% with a maturity of 2039. The proceeds from the bond offering will be used to repay short-term debt related to the construction of a water treatment and transmission facility located in Owen County, Kentucky, as well as to pay the remaining costs of acquisition, construction, installation and equipping of the water treatment and transmission facility as the construction proceeds to completion.

On May 21, 2009, AWCC successfully remarketed \$31.9 million of variable rate demand notes previously held in the Company's treasury. The net proceeds from this offering were used to repay commercial paper. Also, on May 21, 2009, AWCC remarketed \$52.9 million of these variable rate demand notes as fixed rate Tax Exempt Water Facility Revenue bonds with interest rates ranging from 6.00% to 6.75%. The net proceeds from these offerings were used to repay short-term debt.

On May 19, 2009, AWCC closed its private placement offering of \$25.5 million in aggregate principal amount of 8.27% senior unsecured notes due 2039 and \$24.5 million in aggregate principal amount of 7.21% senior unsecured notes due 2019. The proceeds were used to pay down short-term debt.

On May 13, 2009, NJAWC closed its private offering of \$75 million in aggregate principal amount of its 6.35% first mortgage bonds due 2039 and \$25 million in aggregate principal amount of its 5.48% first mortgage bonds due 2019. NJAWC used the proceeds principally to pay down short-term debt.

On April 8, 2009, Pennsylvania-American Water Company, closed an offering to issue \$80.0 million in tax-exempt water facility revenue bonds through the Pennsylvania Economic Development Financing Authority ( PEDFA ). The coupon rate on the bonds is 6.2% with a maturity date of April 1, 2039. The \$80 million bond was rated A by Standard & Poor's and A3 by Moody's. These bonds have been upgraded by Moody's from A3 to A2. The proceeds from the offering will be used to fund certain capital improvement projects.

In February 2009, AWCC completed its public offering of \$75.0 million of 8.25% senior notes with a maturity of 2038. The net proceeds of the offering were used to repay short-term debt.

From time to time and as market conditions warrant, we may consider offerings of other tax-exempt water facility revenue bonds. Under a tax-exempt offering, the interest paid to investors is non-taxable. As an additional benefit to bondholders, the recently enacted Act has established that the interest is not includable in the Alternative Minimum Tax calculation. Separately, during 2009 we filed applications totaling \$288.3 million with state revolving loan fund agencies for either the Act or other governmental subsidized funds. To date we have been awarded \$21.7 million. As of August 3, 2009, we have outstanding applications amounting to \$97.9 million that can still be funded through one of these programs. Due to the demand for these funds, we believe the likelihood of being awarded these funds is low.



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The following long-term debt was retired through optional redemption or payment at maturity during the first six months of 2009:

| Company                              | Type                        | Interest Rate | Maturity  | Amount<br>(In thousands) |
|--------------------------------------|-----------------------------|---------------|-----------|--------------------------|
| <i>Long-term debt:</i>               |                             |               |           |                          |
| American Water Capital Corp.         | Floating rate               | 1.55%-2.20%   | 2018-2032 | \$ 86,860                |
| American Water Capital Corp.         | Senior notes-fixed rate     | 6.87%         | 2011      | 28,000                   |
| Other subsidiaries                   | Floating rate               | 1.50%-10.00%  | 2015-2032 | 33,420                   |
| Other subsidiaries                   | Notes payable and other     | 9.87%         | 2009-2013 | 74                       |
| Other subsidiaries                   | Private activity-fixed rate | 0.00% - 9.10% | 2009-2034 | 3,808                    |
| Mandatory redeemable preferred stock |                             | 4.75%-5.75%   | 2017-2019 | 6                        |
| Other                                | Capital lease               |               |           | 86                       |
| Total retirements & redemptions      |                             |               |           | \$ 152,254               |

From time to time and as market conditions warrant, we may engage in long-term debt retirements via tender offers, open market repurchases or other viable alternatives to strengthen our balance sheet.

***Credit Facilities and Short-Term Debt***

The components of short-term debt were as follows:

|                       | June 30, 2009<br>(In thousands) |
|-----------------------|---------------------------------|
| Commercial paper, net | \$ 238,667                      |
| Book overdraft        | 30,084                          |
| Total short-term debt | \$ 268,751                      |

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At June 30, 2009, AWCC had the following sub-limits and available capacity under the revolving credit facility and indicated amounts of outstanding commercial paper.

| Credit Facility | Available       | Available        | Outstanding       |
|-----------------|-----------------|------------------|-------------------|
| Commitment      | Credit Facility | Letter of Credit | Commercial        |
| (In thousands)  | Capacity        | Sublimit         | Paper             |
| (In thousands)  | (In thousands)  | (In thousands)   | (Net of Discount) |
| (In thousands)  | (In thousands)  | (In thousands)   | (In thousands)    |
| \$ 850,000      | \$ 803,578      | \$ 150,000       | \$ 238,667        |

Interest rates on advances under the revolving credit facility is currently LIBOR plus 22.5 basis points. The maximum LIBOR margin is 55 basis points and is based on our credit ratings, as well as total outstanding amounts under the agreement at the time of the borrowing.

The weighted average interest rate on short-term borrowings for the six months ended June 30, 2009 was approximately 0.92% compared to 3.62% for the six months ended June 30, 2008.

AWCC has entered into a \$10.0 million committed revolving line of credit with PNC Bank, N.A. This line of credit will terminate on December 31, 2009 unless extended and is used primarily for short-term working capital needs. Interest rates on advances under this line of credit are based on either the prime rate of PNC Bank, N.A. or the applicable LIBOR for the term selected plus 200 basis points. In addition, there is a fee of 25 basis points charged quarterly on the portion of the commitment that is undrawn. As of August 3, 2009, we had no outstanding borrowings under this revolving line of credit. If this line of credit were not extended beyond its current maturity date of December 31, 2009, AWCC would continue to have access to its \$840.0 million unsecured revolving credit facility described below.

AWCC, our finance subsidiary, entered into an \$840 million senior unsecured credit facility syndicated among the following group of 11 banks with JPMorgan Chase Bank, N.A. acting as administrative agent.

| Bank                                  | Commitment Amount<br>Through<br>September 15, 2012<br>(In thousands) | Commitment Amount<br>Through<br>September 15, 2013<br>(In thousands) |
|---------------------------------------|----------------------------------------------------------------------|----------------------------------------------------------------------|
| JPMorgan Chase Bank, N.A.             | \$ 115,000                                                           | \$ 0                                                                 |
| Citibank, N.A.                        | 115,000                                                              | 115,000                                                              |
| Citizens Bank of Pennsylvania         | 80,000                                                               | 80,000                                                               |
| Credit Suisse, Cayman Islands Branch  | 80,000                                                               | 80,000                                                               |
| William Street Commitment Corporation | 80,000                                                               | 80,000                                                               |
| Merrill Lynch Bank USA                | 80,000                                                               | 80,000                                                               |
| Morgan Stanley Bank                   | 80,000                                                               | 80,000                                                               |
| UBS Loan Finance LLC                  | 80,000                                                               | 80,000                                                               |
| National City Corporation             | 50,000                                                               | 50,000                                                               |
| PNC Bank, National Association        | 40,000                                                               | 40,000                                                               |
| The Bank of New York Mellon           | 40,000                                                               | 0                                                                    |
|                                       | \$ 840,000                                                           | \$ 685,000                                                           |

If any lender defaults in its obligation to fund advances, the Company may request the other lenders to assume the defaulting lender's commitment or replace such defaulting lender by designating an assignee willing to assume the commitment, however the remaining lenders have no obligation to assume a defaulting lender's commitment and we can provide no assurances that we will replace a defaulting lender. As of August 3, 2009, AWCC had \$170.0 million of outstanding borrowings under its lines of credit, \$47.0 million of outstanding letters of credit under this credit facility and \$64.5 million of commercial paper outstanding.

## Capital Structure

Our capital structure was as follows:

|                                                                   | At<br>June 30,<br>2009 | At<br>December 31,<br>2008 |
|-------------------------------------------------------------------|------------------------|----------------------------|
| Total stockholders' equity                                        | 42%                    | 44%                        |
| Long-term debt and redeemable preferred stock at redemption value | 54%                    | 49%                        |
| Short-term debt and current portion of long-term debt             | 4%                     | 7%                         |
|                                                                   | 100%                   | 100%                       |

**Table of Contents****Debt Covenants**

Our debt agreements contain financial and non-financial covenants. To the extent that we are not in compliance, we or our subsidiaries may be restricted in our ability to pay dividends, issue debt or access our revolving credit lines. Our failure to comply with restrictive covenants under our credit facilities could trigger repayment obligations. We were in compliance with our covenants as of June 30, 2009.

The revolving credit facility requires us to maintain a ratio of consolidated debt to consolidated capitalization of not more than 0.70 to 1.00. As of June 30, 2009, our ratio was 0.58 and therefore we were in compliance with the ratio.

**Security Ratings**

Our access to the capital markets, including the commercial paper market, and their respective financing costs in those markets depend on the securities ratings of the entity that is accessing the capital markets. We primarily access the capital markets, including the commercial paper market, through AWCC. However, we do issue debt at our regulated subsidiaries, primarily in the form of secured securities, to lower our overall cost of debt. The following table shows the Company's securities ratings as of June 30, 2009:

| Securities            | Moody's Investors Service | Standard & Poor's Ratings Service |
|-----------------------|---------------------------|-----------------------------------|
| Senior unsecured debt | Baa2                      | BBB+                              |
| Commercial paper      | P2                        | A2                                |

Moody's rating outlook for both American Water and AWCC is stable.

On May 1, 2009, Standard & Poor's reaffirmed its ratings. On August 5, 2009, Moody's upgraded the credit rating on all First Mortgage bonds issued by NJAWC and Pennsylvania-American Water Company from A3 to A2. They also assigned issuer ratings of Baa1 to these two American Water subsidiaries.

A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the assigning rating agency, and each rating should be evaluated independently of any other rating. Security ratings are highly dependent upon our ability to generate cash flows from financing and operating activities in an amount sufficient to service our debt and meet our investment plans. We can provide no assurance that our ability to generate cash flow is sufficient to maintain our existing ratings.

None of our borrowings are subject to default or prepayment as a result of a downgrading of securities although such a downgrading could increase fees and interest charges under our credit facilities.

As part of the normal course of business, we routinely enter into contracts for the purchase and sale of water, energy, fuels and other services. These contracts either contain express provisions or otherwise permit us and our counterparties to demand adequate assurance of future performance when there are reasonable grounds for doing so. In accordance with the contracts and applicable contract law, if we are downgraded by a credit rating agency, especially if such downgrade is to a level below investment grade, it is possible that a counterparty would attempt to rely on such a downgrade as a basis for making a demand for adequate assurance of future performance. Depending on our net position with a counter party, the demand could be for the posting of collateral. In the absence of expressly agreed provisions that specify the collateral that must be provided, the obligation to supply the collateral requested will be a function of the facts and circumstances of the Company's situation at the time of the demand. If we can reasonably claim that we are willing and financially able to perform our obligations, it may be possible to successfully argue that no collateral should be posted or that only an amount equal to two or three months of future payments should be sufficient. We do not expect to post any collateral which will have a material adverse impact on the Company's results of operation, financial position or cash flows.

**Dividends**

Our board of directors has adopted a dividend policy to distribute a portion of our net cash provided by operating activities to our stockholders as regular quarterly dividends, rather than retaining that cash for other purposes. We expect to distribute 50% to 70% of our annual net income, adjusted for certain non-cash items.

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On March 2, 2009, we paid a cash dividend of \$32.0 million or \$0.20 per share to all shareholders of record as of February 18, 2009. Also, on June 1, 2009, we paid a cash dividend of \$32.0 million or \$0.20 per share to all shareholder of record as of May 18, 2009. There were no dividend payments made for the six months ended June 30, 2008 as we were not a publicly traded company until April 23, 2008.

On July 31, 2009, our board of directors declared a quarterly cash dividend payment of \$0.21 per share payable on September 1, 2009 to all shareholders of record as of August 18, 2009.

### ***Current Credit Market Position***

The Company believes it has sufficient liquidity despite the current disruption of the capital and credit markets. The Company funds liquidity needs for capital investment, working capital and other financial commitments through cash flows from operations, public and private debt offerings, commercial paper markets and credit facilities with \$850.0 million in aggregate total commitment from a diversified group of banks. As of August 3, 2009, we had \$633.0 million available to fulfill our short-term liquidity needs, to issue letters of credit and back our \$64.5 million outstanding commercial paper. As of August 3, 2009, the Company can issue additional commercial paper of \$568.5 million which is backed by the credit facilities. The market disruption has caused the Company to redeem its tax exempt bonds in variable rate structures. The Company closely monitors the financial condition of the financial institutions associated with its credit facilities.

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The Company's retirement trust assets are exposed to the market prices of debt and equity securities. Changes to the retirement trust asset value can impact the Company's pension and other benefits expense, funded status and future minimum funding requirements. Our risk is reduced through our ability to recover pension and other benefit costs through rates. In addition, pension and other benefits liabilities decrease as fixed income asset values decrease (fixed income yields rise) since the rate at which we discount pension and other retirement trust asset future obligations is highly correlated to fixed income yields. During 2008, the market value of our pension and postretirement benefit trust assets declined by \$171.9 million. Additionally, a reduction in fixed income yields (rate used to discount obligations) at the end of 2008 caused an increase to pension and postretirement benefit liabilities. The reduction of asset values combined with an increase in pension and postretirement benefit liabilities will constitute an increase to pension and postretirement benefit expense of \$32.0 million during 2009 compared to 2008. We have begun discussions with the majority of our regulators about the appropriate treatment for these incremental costs in order to minimize regulatory lag between incurring the expense and any recovery of the expense. To date, we have authorization to recover or defer \$7.1 million of this annual increase and have requested permission to recover or defer as a deferred asset until the next rate case is concluded an additional \$7.5 million of this increase in 2009. Until we receive permission from the regulators to defer costs, we will continue to expense them. We are also discussing with regulators other ways in which to defer the costs until future rate cases are filed.

The Company also assessed the impact of the severe liquidity crises at major financial institutions on the Company's ability to access capital markets on reasonable terms. On September 15, 2008, the Company was unable to access short-term liquidity through its A-2/P-2 rated commercial paper program. The Company therefore utilized its credit facilities to repay maturing commercial paper and fund its short-term liquidity needs. Although the Company's credit facility syndicate banks are currently meeting all of their lending obligations, there can be no assurance that these banks will be able to meet their obligations in the future if the liquidity crises intensify or are protracted.

At this time, the Company does not believe recent market disruptions will impact its long-term ability to obtain financing. The Company expects to have access to liquidity in the capital markets on favorable terms before the maturity dates of its current credit facilities and the Company does not expect a significant number of its lenders to default on their commitments thereunder. In addition, the Company can delay major capital investments or pursue financing from other sources to preserve liquidity, if necessary. The Company believes it can rely upon cash flows from operations to meet its obligations and fund its minimum required capital investments for an extended period of time.

### ***Market Risk***

We are exposed to market risk associated with changes in commodity prices, equity prices and interest rates. As of June 30, 2009, a hypothetical 100 basis point increase in interest rates associated with our short-term borrowing will decrease our 2009 pre-tax earning by \$1.2 million. Our risks associated with price increase for chemicals, electricity and other commodities are reduced through contracts and the ability to recover price increases through rates. Non-performance by these commodity suppliers could have a material impact on our results of operations, cash flows and financial position.

Our common stock began trading on the New York Stock Exchange on April 23, 2008. The market price of our common stock may experience fluctuations, many of which are unrelated to our operating performance. In particular, our stock price may be affected by general market movements as well as developments specifically related to the water and wastewater industry. These could include, among other things, interest rate movements, quarterly variations or changes in financial estimates by securities analysts and governmental or regulatory actions. This volatility may make it difficult for us to access the capital markets in the future through additional offerings of our common stock, regardless of our financial performance, and such difficulty may preclude us from being able to take advantage of certain business opportunities or meet business obligations.

We are exposed to credit risk through our water, wastewater and other water-related activities for both our Regulated and Non-Regulated Businesses. Our Regulated Businesses serve residential, commercial, industrial and municipal customers while our Non-Regulated Businesses engage in business activities with developers, government entities and as well as other customers. Our primary credit risk is exposure to customer default on contractual obligations and the associated loss that may be incurred due to the nonpayment of customer account receivable balances. Our credit risk is managed through established credit and collection policies which are in compliance with applicable regulatory requirements and involve monitoring of customer exposure and the use of credit risk mitigation measures such as letters of credit or prepayment arrangements. Our credit portfolio is diversified with no significant customer or industry concentrations. In addition, our Regulated Businesses are generally able to recover all prudently incurred costs including uncollectible customer accounts receivable expenses and collection costs through rates.

We are also exposed to a potential national economic recession or further deterioration in local economic conditions in the markets in which we operate. The credit quality of our customer accounts receivable is dependent on the economy and the ability of our customers to manage through unfavorable economic cycles and other market changes. In addition, as a result of the downturn in the economy and heightened sensitivity of the impact of additional rate increases on certain customers, there can be no assurances that regulators will grant sufficient rate authorizations. Therefore our ability to fully recover operating expense, recover our investment and provide an appropriate return on invested capital in our

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Regulated Businesses may be adversely impacted.

### ***Application of Critical Accounting Policies and Estimates***

Our financial condition, results of operations and cash flows are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. See Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates, in our Form 10-K for the year ended December 31, 2008 filed with the SEC for a discussion of the critical accounting policies.

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### ***Recent Accounting Pronouncements***

See Part I, Item 1 Financial Statements (Unaudited) Note 2 New Accounting Pronouncements in this Quarterly Report on Form 10-Q for a discussion of new accounting standards recently adopted or pending adoption.

### **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. For further discussion of market risks see Market Risk in Part I, Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### ***Evaluation of Disclosure Controls and Procedures***

American Water Works Company, Inc. maintains disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the Exchange Act)) that are designed to ensure that information required to be disclosed in its reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including the chief executive officer and the chief financial officer, to allow timely decisions regarding required disclosures. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

As of June 30, 2009, our previously identified material weakness in our internal control over financial reporting relating to controls over maintenance of contracts and agreements remains. Specifically, effective controls did not exist to ensure the accuracy and completeness of accounting and disclosure for such contracts and agreements.

Such deficiency could result in misstated consolidated financial statements affecting results of operations, financial position, cash flows and disclosures that would result in a material misstatement of the consolidated financial statements that would not be prevented or detected. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis.

As a result of this material weakness, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of June 30, 2009. Nevertheless, management has concluded that the consolidated financial statements in this Form 10-Q fairly present, in all material respects, our financial position, results of operations and cash flows as of the dates, and for the periods, presented, in conformity with generally accepted accounting principles in the United States of America.

#### ***Plan for Remediation of Material Weakness***

We believe that we have taken the appropriate actions to remediate the material weakness described above by (1) conducting training on controls over maintenance of contracts and agreements for personnel, (2) hiring additional resources, and (3) designing and implementing new policies, procedures and controls. We believe this material weakness will remain until we have had sufficient experience with the sustainability of the controls.

#### ***Changes in Internal Control over Financial Reporting***

There have been no changes in our internal control over financial reporting that occurred during the six months ended June 30, 2009, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

Previously reported under Part I, Item 3 Legal Proceedings in the Company's Form 10-K for the year ended December 31, 2008.

**ITEM 1A. RISK FACTORS**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in the Risk Factors in the Company's Form 10-K for the year ended December 31, 2008, and our other public filings, which could materially affect our business, financial condition or future results. There have been no material changes from risk factors previously disclosed in Risk Factors in the Company's Form 10-K for the year ended December 31, 2008 and our Form 10-Q for the quarterly period ended March 31, 2009, filed on May 6, 2009.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None

**Table of Contents****ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The Annual Meeting of the Stockholders of American Water was held on May 8, 2009, at The Mansion, located at 3000 Main Street, in Voorhees, New Jersey, pursuant to the Notice sent on or about March 26, 2009, to all stockholders of record at the close of business on March 16, 2009. At that meeting:

- (1) The following nominees were elected as directors of American Water for a term expiring at the 2010 Annual Meeting and received the votes set forth adjacent to their names below:

| Name of Nominee     | For         | Withheld  |
|---------------------|-------------|-----------|
| Donald L. Correll   | 148,231,447 | 2,114,861 |
| Martha Clark Goss   | 149,064,803 | 1,281,505 |
| Dr. Manfred Döss    | 148,061,962 | 2,284,346 |
| Richard R. Grigg    | 148,978,324 | 1,367,984 |
| Julia L. Johnson    | 148,912,457 | 1,433,851 |
| George MacKenzie    | 148,859,556 | 1,486,752 |
| William J. Marrazzo | 148,940,105 | 1,406,203 |
| Dr. Rolf Pohligh    | 148,054,718 | 2,291,590 |
| Andreas G. Zetzsche | 148,058,721 | 2,287,587 |

- (2) The appointment of PricewaterhouseCoopers LLP as the independent registered public accountants for the fiscal year ending December 31, 2009 was ratified by the following vote of:

| For         | Against | Abstain |
|-------------|---------|---------|
| 149,894,995 | 377,566 | 73,747  |

- (3) The approval of the Amended and Restated American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan was approved by the following vote of:

| For         | Against   | Abstain |
|-------------|-----------|---------|
| 134,153,017 | 6,503,792 | 151,281 |

**ITEM 5. OTHER INFORMATION**

None

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**ITEM 6. EXHIBITS**

**Exhibit**

| <b>Number</b> | <b>Exhibit Description</b>                                                                                                                                                                                                                                                                                                                                                          |
|---------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1.1           | Underwriting Agreement, dated June 4, 2009, among American Water Works Company, Inc., RWE Aqua holdings GmbH, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Citigroup Global Markets Inc. and Goldman, Sachs & Co. Inc. (incorporated by reference to Exhibit 1.1 to American Water Works Company, Inc.'s current report on Form 8-K, File No. 001-34028, filed June 8, 2009) |
| *10.1         | Amended and Restated American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan, effective as of May 8, 2009.                                                                                                                                                                                                                                                         |
| *10.2         | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan Stock Unit Grant Form for Non-Employee Directors.                                                                                                                                                                                                                                                          |
| *31.1         | Certification of Donald L. Correll, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act                                                                                                                                                                                                                                                        |
| *31.2         | Certification of Ellen C. Wolf, Senior Vice President and Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act                                                                                                                                                                                                                                                |
| *32.1         | Certification of Donald L. Correll, President and Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act                                                                                                                                                                                                                                                        |
| *32.2         | Certification of Ellen C. Wolf, Senior Vice President and Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act                                                                                                                                                                                                                                                |

\* filed herewith.

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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 signed on its behalf by the undersigned, thereunto duly authorized.

American Water Works Company, Inc.  
(Registrant)

August 6, 2009  
(Date)

/s/ Donald L. Correll  
Donald L. Correll  
President and Chief Executive Officer  
(Principal Executive Officer)

August 6, 2009  
(Date)

/s/ Ellen C. Wolf  
Ellen C. Wolf  
Senior Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)

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**EXHIBIT INDEX**

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\* filed herewith.