

Cardiovascular Systems Inc  
Form DEF 14A  
October 01, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**SCHEDULE 14A**

**Proxy Statement Pursuant to Section 14(a) of the Securities**

**Exchange Act of 1934 (Amendment No.    )**

Filed by the Registrant ☐

Filed by a Party other than the Registrant ☐

Check the appropriate box:

- ☐ Preliminary Proxy Statement  
☐ Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))  
☒ Definitive Proxy Statement  
☐ Definitive Additional Materials  
☐ Soliciting Material Pursuant to §240.14a-12

**CARDIOVASCULAR SYSTEMS, INC.**

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- ☒ No fee required.  
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- (3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):
- (4) Proposed maximum aggregate value of transaction:
- (5) Total fee paid:
- .. Fee paid previously with preliminary materials.
- .. Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.
  - (1) Amount Previously Paid:
  - (2) Form, Schedule or Registration Statement No.:
  - (3) Filing Party:
  - (4) Date Filed:

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**CARDIOVASCULAR SYSTEMS, INC.**

**651 Campus Drive**

**St. Paul, Minnesota 55112**

**Telephone: 877-CSI-0360**

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS**

**To Be Held on November 13, 2013**

Dear Stockholder:

You are cordially invited to attend the Annual Meeting of Stockholders (the "Annual Meeting") of Cardiovascular Systems, Inc. (the "Company") on Wednesday, November 13, 2013, at 10:00 a.m. (Central Time) at the Company's offices, located at 651 Campus Drive, St. Paul, Minnesota 55112, for the following purposes:

1. To elect as Class II directors to hold office until the fiscal 2016 Annual Meeting of Stockholders, the following three nominees recommended by the Board of Directors: Brent G. Blackey, Scott Ward and Leslie L. Trigg.
2. To ratify the appointment of PricewaterhouseCoopers LLP as the independent registered public accounting firm of the Company for its fiscal year ending June 30, 2014.
3. To approve, on an advisory basis, the compensation paid to the Company's Named Executive Officers.
4. To conduct any other business properly brought before the meeting.

These items of business are more fully described in the proxy statement accompanying this Notice.

The record date for the Annual Meeting is September 16, 2013. Only stockholders of record at the close of business on that date may vote at the meeting or any adjournment thereof.

By Order of the Board of Directors,

Sincerely,

David L. Martin

President, Chief Executive Officer and Director

St. Paul, Minnesota

October 1, 2013

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**You are cordially invited to attend the meeting in person. Whether or not you expect to attend the meeting, please vote your shares. You may vote over the telephone or the Internet as instructed in this proxy statement. If you received a proxy card or voting instruction card by mail, you may submit your proxy card or voting instruction card by completing, signing, dating and mailing your proxy card or voting instruction card in the envelope provided. Any stockholder attending the meeting may vote in person, even if you already returned a proxy card or voting instruction card or voted by proxy over the telephone or the Internet. Please note, however, that if your shares are held of record by a broker, bank or other nominee and you wish to vote at the meeting, you must obtain a proxy issued in your name from that record holder.**

**IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE  
ANNUAL MEETING TO BE HELD ON NOVEMBER 13, 2013:**

**The Proxy Statement and Fiscal 2013 Annual Report to Stockholders are available at  
<http://www.proxyvote.com> and <http://www.csi360proxy.com>**

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**CARDIOVASCULAR SYSTEMS, INC.**

**651 Campus Drive**

**St. Paul, Minnesota 55112**

**Telephone: 877-CSI-0360**

**PROXY STATEMENT**

**FOR THE ANNUAL MEETING OF STOCKHOLDERS**

**TO BE HELD ON NOVEMBER 13, 2013**

**INFORMATION CONCERNING SOLICITATION AND VOTING**

The Board of Directors of Cardiovascular Systems, Inc. (the Company) is soliciting your proxy to vote at the Annual Meeting of Stockholders (the Annual Meeting) to be held at the Company's offices, located at 651 Campus Drive, St. Paul, Minnesota 55112, on Wednesday, November 13, 2013, at 10:00 a.m. (Central Time), including at any adjournments or postponements of the Annual Meeting. You are invited to attend the Annual Meeting to vote on the proposals described in this proxy statement. However, you do not need to attend the meeting to vote your shares. Instead, you may simply complete, sign and return the enclosed proxy card if you received paper copies of the proxy materials, or follow the instructions below to submit your proxy over the telephone or the Internet.

In accordance with rules and regulations adopted by the U.S. Securities and Exchange Commission (the SEC), we have elected to provide our beneficial owners and stockholders of record access to our proxy materials over the Internet. Beneficial owners are stockholders whose shares are held in the name of a broker, bank or other agent (i.e., in street name). Accordingly, a Notice of Internet Availability of Proxy Materials (the Notice) will be mailed on or about October 1, 2013 to our beneficial owners and stockholders of record who owned our common stock at the close of business on September 16, 2013. Beneficial owners and stockholders of record will have the ability to access the proxy materials on a website referred to in the Notice or request a printed set of the proxy materials be sent to them by following the instructions in the Notice. Beneficial owners and stockholders of record who have previously requested to receive paper copies of our proxy materials will receive paper copies of the proxy materials instead of a Notice.

**QUESTIONS AND ANSWERS ABOUT THIS PROXY MATERIAL AND VOTING**

**Why did I receive in the mail a Notice of Internet Availability of Proxy Materials this year instead of a full set of proxy materials?**

We are pleased to take advantage of the SEC rule that allows companies to furnish their proxy materials over the Internet. Accordingly, we have sent to our beneficial owners and stockholders of record a Notice of Internet Availability of Proxy Materials. Instructions on how to access the proxy materials over the Internet or to request a paper copy may be found in the Notice. Our stockholders may request to receive proxy materials in printed form by mail or electronically on an ongoing basis. A stockholder's election to receive proxy materials by mail or electronically by email will remain in effect until the stockholder terminates its election.

**Why did I receive a full set of proxy materials in the mail instead of a Notice of Internet Availability of Proxy Materials?**



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We are providing paper copies of the proxy materials instead of a Notice to beneficial owners or stockholders of record who have previously requested to receive paper copies of our proxy materials. If you are a beneficial owner or stockholder of record who received a paper copy of the proxy materials, and you would like to reduce the environmental impact and the costs incurred by us in mailing proxy materials, you may elect to receive all future proxy materials electronically via email or the Internet.

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You can choose to receive our future proxy materials electronically by visiting <http://www.proxyvote.com>. Your choice to receive proxy materials electronically will remain in effect until you instruct us otherwise by following the instructions contained in your Notice and visiting <http://www.proxyvote.com>, sending an electronic mail message to [sendmaterial@proxyvote.com](mailto:sendmaterial@proxyvote.com), or calling 1-800-579-1639.

The SEC has enacted rules that permit us to make available to stockholders electronic versions of the proxy materials even if the stockholder has not previously elected to receive the materials in this manner. We have chosen this option in connection with the Annual Meeting with respect to both our beneficial owners and stockholders of record.

### **Who can vote at the Annual Meeting?**

Only stockholders of record at the close of business on September 16, 2013 will be entitled to vote at the Annual Meeting. On the record date, there were 25,218,867 shares of common stock of the Company outstanding and entitled to vote.

#### ***Stockholder of Record: Shares Registered in Your Name***

If, on September 16, 2013, your shares were registered directly in your name with the Company's transfer agent, American Stock Transfer & Trust Company, then you are a stockholder of record. As a stockholder of record, you may vote in person at the meeting or vote by proxy. Whether or not you plan to attend the meeting, we urge you to vote your shares by completing, signing, dating and mailing your proxy card in the envelope provided, if you received paper copies of the proxy materials, or vote by proxy over the telephone or the Internet as instructed below to ensure your vote is counted.

#### ***Beneficial Owner: Shares Registered in the Name of a Broker or Bank***

If, on September 16, 2013, your shares were held, not in your name, but rather in an account at a brokerage firm, bank, dealer, or other similar organization, then you are the beneficial owner of shares held in "street name" and these proxy materials are being forwarded to you by that organization. The organization holding your account is considered to be the stockholder of record for purposes of voting at the Annual Meeting. As a beneficial owner, you have the right to direct your broker or other agent regarding how to vote the shares in your account. You are also invited to attend the Annual Meeting; however, since you are not the stockholder of record, you may not vote your shares in person at the meeting unless you request and obtain a valid proxy from your broker or other agent.

### **What am I voting on?**

There are three matters scheduled for a vote:

Election of the following three nominees recommended by the Board of Directors to be Class II directors and to hold office until the fiscal 2016 Annual Meeting of Stockholders: Brent G. Blackey, Scott Ward and Leslie L. Trigg.

Ratification of the selection by the Audit, Risk Management and Finance Committee of the Company's Board of Directors of PricewaterhouseCoopers LLP as independent auditors of the Company for its fiscal year ending June 30, 2014.

Approval, on an advisory basis, of the compensation paid to the Company's Named Executive Officers.

**How do I vote?**

You may either vote ☐ For all the nominees to the Board of Directors or you may ☐ Withhold your vote for any nominee you specify. For the ratification of the Audit, Risk Management and Finance Committee's selection

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of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for the fiscal year ending June 30, 2014, you may vote For or Against or abstain from voting. For the advisory vote on Named Executive Officer compensation, you may vote For or Against or abstain from voting.

The procedures for voting are as follows:

***Stockholder of Record: Shares Registered in Your Name***

If you are a stockholder of record, you may vote in person at the Annual Meeting, vote by proxy using the enclosed proxy card (if you received paper copies of the proxy materials), vote by proxy over the telephone, or vote by proxy over the Internet. Whether or not you plan to attend the meeting, we urge you to vote by proxy to ensure your vote is counted. You may still attend the meeting and vote in person even if you have already voted by proxy.

To vote in person, come to the Annual Meeting and we will give you a ballot when you arrive. If you would like directions to our offices, please call 877-CSI-0360.

If you received paper copies of the proxy materials, to vote using the proxy card, simply complete, sign and date the enclosed proxy card and return it promptly in the envelope provided. If you return your signed proxy card to us before the Annual Meeting, we will vote your shares as you direct.

To vote over the telephone, dial toll-free 1-800-690-6903 using a touch-tone phone and follow the recorded instructions. Please have available the 12-Digit Control Number from the enclosed proxy card, if you received one, or from your Notice. Your vote must be received by 11:59 p.m. Eastern Time (10:59 p.m. Central Time) on November 12, 2013, to be counted.

To vote over the Internet, go to <http://www.proxyvote.com> to complete an electronic proxy card. Please have available the 12-Digit Control Number from the enclosed proxy card, if you received one, or from your Notice. Your vote must be received by 11:59 p.m. Eastern Time (10:59 p.m. Central Time) on November 12, 2013, to be counted.

**We are providing Internet proxy voting to allow you to vote your shares online, with procedures designed to ensure the authenticity and correctness of your proxy vote instructions. However, please be aware that you must bear any costs associated with your Internet access, such as usage charges from Internet access providers and telephone companies.**

***Beneficial Owner: Shares Registered in the Name of Broker or Bank***

If you are a beneficial owner of shares registered in the name of your broker, bank, or other agent, you may have received a proxy card and voting instructions with these proxy materials from that organization rather than from us. Simply complete and mail the proxy card to ensure that your vote is submitted to your broker or bank. Alternatively, you may vote by telephone or over the Internet as instructed by your broker or bank. To vote in person at the Annual Meeting, you must obtain a valid proxy from your broker, bank, or other agent. Follow the instructions from your broker or bank included with these proxy materials, or contact your broker or bank to request a proxy form.

**How many votes do I have?**

On each matter to be voted upon, you have one vote for each share of common stock you own as of September 16, 2013. There is no cumulative voting for election of directors.

**What if I return a proxy card but do not make specific choices?**

If you return a signed and dated proxy card without marking any voting selections, your shares will be voted For the election of the nominees for director, For the ratification of the selection of PricewaterhouseCoopers

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LLP as the Company's independent auditors for the fiscal year ending June 30, 2014, and For the advisory vote on Named Executive Officer compensation. If any other matter is properly presented at the meeting, your proxyholder (one of the individuals named on your proxy card) will vote your shares using his or her best judgment.

### **Who is paying for this proxy solicitation?**

We will pay for the entire cost of soliciting proxies. Our directors and employees may solicit proxies in person, by telephone, or by other means of communication. Directors and employees will not be paid any additional compensation for soliciting proxies. We may also reimburse brokerage firms, banks and other agents for the cost of forwarding proxy materials to beneficial owners.

### **What does it mean if I receive more than one proxy card?**

If you receive more than one proxy card, your shares are registered in more than one name or are registered in different accounts. Please complete, sign and return **each** proxy card to ensure that all of your shares are voted.

### **Are proxy materials available on the Internet?**

This proxy statement and our fiscal 2013 Annual Report to Stockholders are available at <http://www.proxyvote.com> or <http://www.csi360proxy.com>.

### **Can I change my vote after submitting my proxy?**

Yes. You can revoke your proxy at any time before the final vote at the Annual Meeting. If you are the record holder of your shares, you may revoke your proxy in any one of four ways:

You may submit another properly completed proxy card with a later date.

You may submit a new vote by telephone or Internet.

You may send a timely written notice that you are revoking your proxy to our Secretary at 651 Campus Drive, St. Paul, Minnesota 55112.

You may attend the Annual Meeting and vote in person. Simply attending the Annual Meeting will not, by itself, revoke your proxy.

If your shares are held by your broker or bank as a nominee or agent, you should follow the instructions provided by your broker or bank.

### **How are votes counted?**

Votes will be counted by the inspector of election appointed for the meeting, who will separately count For and Withhold votes and broker non-votes for director elections; For and Against votes and abstentions for auditor selection ratification; and For and Against votes and abstentions and broker non-votes for the advisory vote on Named

Executive Officer compensation.

Abstentions will be counted towards the vote total for each proposal, and will have the same effect as **Against** votes. Broker non-votes have no effect and will not be counted towards the vote total for any proposal.

**What are broker non-votes ?**

Broker non-votes occur when a beneficial owner of shares held in **street name** does not give instructions to the broker or nominee holding the shares as to how to vote on matters deemed **non-routine**. Generally, if shares are held in street name, the beneficial owner of the shares is entitled to give voting instructions to the

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broker or nominee holding the shares. If the beneficial owner does not provide voting instructions, the broker or nominee can still vote the shares with respect to matters that are considered to be routine, but not with respect to non-routine matters. Under the rules and interpretations of the New York Stock Exchange, the ratification of the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm is currently considered a routine matter. The election of directors and advisory vote on Named Executive Officer compensation are currently considered non-routine matters under the rules of the New York Stock Exchange.

### **How many votes are needed to approve each proposal?**

For Proposal 1, the election of Class II directors, who are elected by a plurality, the three nominees receiving the most For votes (from the holders of shares present in person or represented by proxy and entitled to vote on the election of directors) will be elected. Only votes For or Withheld will affect the outcome.

To be approved, Proposal 2, ratification of the selection of PricewaterhouseCoopers LLP as our independent auditors for the fiscal year ending June 30, 2014, must receive a For vote from the majority of shares present and entitled to vote either in person or by proxy. If you Abstain from voting, it will have the same effect as an Against vote.

Proposal 3, regarding Named Executive Officer compensation, is an advisory vote, which means that the vote is not binding on the Company, our Board of Directors or the Human Resources and Compensation Committee of the Board of Directors. To the extent there is any significant vote against our Named Executive Officer compensation as disclosed in this proxy statement, the Human Resources and Compensation Committee will evaluate whether any actions are necessary to address the concerns of stockholders.

### **What is the quorum requirement?**

A quorum of stockholders is necessary to hold a valid meeting. A quorum will be present if stockholders holding at least a majority of the outstanding shares are present at the meeting in person or represented by proxy. On the record date, there were 25,218,867 shares outstanding and entitled to vote. Thus, the holders of 12,609,434 shares must be present in person or represented by proxy at the meeting to have a quorum.

Your shares will be counted towards the quorum only if you submit a valid proxy (or one is submitted on your behalf by your broker, bank or other nominee) or if you vote in person at the meeting. Abstentions and broker non-votes will be counted towards the quorum requirement. If there is no quorum, the holders of a majority of shares present at the meeting in person or represented by proxy, or the chairman of the meeting, may adjourn the meeting to another date.

### **How can I find out the results of the voting at the Annual Meeting?**

Preliminary voting results will be announced at the Annual Meeting. Final voting results will be published in a Current Report on Form 8-K, which we will file within three business days of the meeting.

### **When are stockholder proposals due for the Fiscal 2014 Annual Meeting?**



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Any appropriate proposal submitted by a stockholder and intended to be presented at the fiscal 2014 Annual Meeting must be submitted in writing to our Secretary at 651 Campus Drive, St. Paul, Minnesota 55112, and received no later than June 3, 2014, to be includable in the Company's proxy statement and related proxy for the fiscal 2014 Annual Meeting. A stockholder proposal will need to comply with the SEC regulations under Rule 14a-8 of the Securities Exchange Act of 1934, as amended (the Exchange Act), regarding the inclusion of stockholder proposals in company-sponsored proxy materials. Although our Board of Directors will consider

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stockholder proposals, we reserve the right to omit from our proxy statement, or to vote against, stockholder proposals that we are not required to include under the Exchange Act, including Rule 14a-8. Additionally, pursuant to the advance notice provisions of the Company's Bylaws, as authorized by applicable state law, in order for stockholders to present director nominations or other business at the fiscal 2014 Annual Meeting, a stockholder's notice of such nomination or other business must be received by our Secretary at the same address no earlier than the close of business on July 16, 2014, and no later than the close of business on August 15, 2014, and must be in a form that complies with the requirements set forth in the Company's Bylaws. You are advised to review the Company's Bylaws for these requirements.

## **EXPLANATORY NOTE**

We were incorporated as Replidyne, Inc. in Delaware in 2000. On February 25, 2009, Replidyne, Inc. ( Replidyne ) completed its business combination with Cardiovascular Systems, Inc., a Minnesota corporation ( CSI-MN ), in accordance with the terms of the Agreement and Plan of Merger and Reorganization, dated as of November 3, 2008, by and among Replidyne, Responder Merger Sub, Inc., a wholly-owned subsidiary of Replidyne ( Merger Sub ), and CSI-MN (the Merger Agreement ). Pursuant to the Merger Agreement, Merger Sub merged with and into CSI-MN, with CSI-MN continuing after the merger as the surviving corporation and a wholly-owned subsidiary of Replidyne. At the effective time of the merger, Replidyne changed its name to Cardiovascular Systems, Inc. ( CSI ) and CSI-MN changed its name to CSI Minnesota, Inc. Following the merger of Merger Sub with CSI-MN, CSI-MN merged with and into CSI, with CSI continuing after the merger as the surviving corporation. These transactions are referred to herein as the merger. Immediately following the effective time of the merger, former CSI-MN stockholders owned approximately 80.2% of the outstanding common stock of CSI, and Replidyne stockholders owned approximately 19.8% of the outstanding common stock of CSI. Unless the context otherwise requires or as otherwise stated herein, all references herein to the Company, CSI, we, us and our refer to CSI-MN prior to the completion of the merger to CSI following the completion of the merger and the name change, and all references to Replidyne refer to Replidyne prior to the completion of the merger and the name change.

## **PROPOSAL 1 ELECTION OF DIRECTORS**

The Board of Directors is divided into three classes, with each class serving staggered three-year terms. Vacancies on the Board of Directors may be filled only by persons elected by a majority of the remaining directors. A director elected by the Board of Directors to fill a vacancy in a class, including vacancies created by an increase in the number of directors, shall serve for the remainder of the full term of that class and until the director's successor is elected and qualified.

The term of office of the Class II directors expires at the Annual Meeting. The Governance/Nominating Committee recommended to the Board, and the Board has set the number of Class II directors at three and has nominated Brent G. Blackey, Scott Ward and Leslie L. Trigg for election at the Annual Meeting. Mr. Blackey has been a member of CSI's Board of Directors since 2007; Ms. Trigg has been a member of CSI's Board of Directors since 2010; and Mr. Ward, if elected, would become a new member of CSI's Board of Directors. If elected at the Annual Meeting, each of these nominees would serve until the fiscal 2016 annual meeting and until his or her successor is elected and has qualified, or, if sooner, until the director's death, resignation or removal.

Directors are elected by a plurality of the votes of the holders of shares present in person or represented by proxy and entitled to vote on the election of directors at the annual meeting at which a quorum is present. The three nominees receiving the most For votes (among votes properly cast in person or by proxy) will be elected. If no contrary indication is made, shares represented by executed proxies will be voted For the election of the three nominees named above or, if any nominee becomes unavailable for election as a result of an unexpected occurrence, For the election of

a substitute nominee designated by our Board of Directors. Each nominee has agreed to serve as a director if elected, and we have no reason to believe that any nominee will be unable to serve.

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The following is a brief biography for each nominee for Class II director and each person whose term of office as a Class I or Class III director will continue after the Annual Meeting.

<b>Name</b>	<b>Age(1)</b>	<b>Position</b>
<b>Class I Director Nominees:</b>		
Edward Brown(3)	50	Director
Augustine Lawlor(2)	57	Director
Scott Bartos(3)(4)	50	Director
<b>Class II Directors:</b>		
Brent G. Blackey(4)	54	Director
Scott Ward	53	Director Nominee
Leslie L. Trigg(2)(3)	42	Director
<b>Class III Directors:</b>		
David L. Martin	49	President, Chief Executive Officer and Director
Glen D. Nelson, M.D.(2)	76	Chairman

- (1) As of the date of this proxy statement.  
 (2) Member of the Governance/Nominating Committee.  
 (3) Member of the Human Resources and Compensation Committee.  
 (4) Member of the Audit, Risk Management and Finance Committee.

**NOMINEES FOR ELECTION FOR A THREE-YEAR TERM EXPIRING AT THE FISCAL 2016 ANNUAL MEETING**

*Brent G. Blackey.* Mr. Blackey has been a member of CSI's Board of Directors since 2007. Since 2004, Mr. Blackey has served as the President and Chief Operating Officer for Holiday Companies. Between 2002 and 2004, Mr. Blackey was a Senior Partner at the accounting firm of Ernst & Young LLP. Prior to 2002, Mr. Blackey served most recently as a Senior Partner at the accounting firm of Arthur Andersen LLP. Since April 2006, Mr. Blackey has served on the board of directors of Datalink Corporation, a publicly-held company. Mr. Blackey also serves on the Board of Overseers for the University of Minnesota, Carlson School of Management. We believe that Mr. Blackey's accounting background, experience as an executive officer and his service as a board member of a public company are strong endorsements for membership on our Board and invaluable to his role as our audit committee financial expert and Chairman of the Audit Committee.

*Scott Ward.* Mr. Ward was recommended to our Governance/Nominating Committee for nomination to the Board by a non-management director of our Board. Since 2013, Mr. Ward has been a Managing Director at SightLine Partners and, since 2011, Mr. Ward has been President of Raymond Holdings. From 1981 to 2010, Mr. Ward was employed by Medtronic, Inc. and held a number of senior leadership positions. Mr. Ward was Senior Vice President and President of Medtronic's CardioVascular business from May 2007 to November 2010. Prior to that he was Senior Vice President and President of Medtronic's Vascular business from May 2004 to May 2007, Senior Vice President and President of Medtronic's Neurological and Diabetes Business, from February 2002 to May 2004, and was President of Medtronic's Neurological business from January 2000 to January 2002. He was Vice President and General Manager of Medtronic's Drug Delivery Business from 1995 to 2000. Prior to that, Mr. Ward led the Company's Neurological Ventures in the successful development of new therapies. Mr. Ward is Chairman of the Board of Gillette Children's Specialty Healthcare, Chairman of the Board of Creganna-Tactx Medical and also serves on the Boards of

ImpediMed, Ltd. and Surmodics, Inc. We believe that Mr. Ward's experience running businesses within a large medical device company and his knowledge of the medical device industry will allow him to make a valuable contribution to our Board.

*Leslie L. Trigg.* Ms. Trigg has been a member of CSI's Board of Directors since 2010. Ms. Trigg currently serves as an Executive in Residence for Warburg Pincus. From 2010 to 2012, Ms. Trigg served as Executive Vice President, Marketing and Commercial Strategy for Lutonix, a medical device company in the drug-coated

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balloon space. Prior to that, Ms. Trigg held the positions of Chief Business Officer and Sr. Vice President, Sales & Marketing of AccessClosure, Inc. between September 2006 and June 2009. Before joining AccessClosure, Ms. Trigg was the Vice President, Marketing for FoxHollow Technologies, Inc. from March 2003 to August 2006, Business Unit Director at Cytoc Corporation from November 2001 to September 2002, and Director, Market Development at Pro-Duct Health, Inc. from July 2000 to November 2001. Ms. Trigg has also held marketing positions for Guidant Corporation. We believe that Ms. Trigg's experience as an executive officer of several public and private companies in the medical device industry make her a valued member of our Board.

## **DIRECTORS CONTINUING IN OFFICE UNTIL THE FISCAL 2015 ANNUAL MEETING**

*Edward Brown.* Mr. Brown has been a member of CSI's Board of Directors since February 2009. Mr. Brown was a member of Replidyne's Board of Directors from May 2007 to February 2009. Mr. Brown currently serves as a Partner at Health Evolution Partners. Mr. Brown was previously a Managing Director at TPG Growth from 2007 to 2009 and a Managing Director and co-founder of Healthcare Investment Partners, a private equity fund focused on healthcare investments, from 2004 to 2007. Before Healthcare Investment Partners, Mr. Brown was a Managing Director in the healthcare group of Credit Suisse Group where he led the firm's West Coast healthcare effort and was one of the senior partners responsible for the firm's global life sciences practice. Mr. Brown currently serves on the board of two private companies, Freedom Innovations, LLC, and Prolacta Biosciences, Inc. Mr. Brown previously served on the public company boards of Angiotech Pharmaceuticals Inc., from January 2007 to June 2011, Oculus Innovative Sciences, Inc., from September 2005 to June 2008, and Replidyne, Inc., from May 2007 to February 2009, as well as several private company boards. We believe that Mr. Brown's leadership experience with investment firms and his service as a board member of public and private healthcare companies enable him to bring valuable insight and knowledge to our Board.

*Augustine Lawlor.* Mr. Lawlor has been a member of CSI's Board of Directors since February 2009. He was a member of Replidyne's Board of Directors from March 2002 to February 2009. Mr. Lawlor is the Managing Partner of HealthCare Ventures LLC, where he was a Managing Director from 2000 to 2007. Mr. Lawlor was previously Chief Operating Officer of LeukoSite, Inc. and has also served as a management consultant with KPMG Peat Marwick. Mr. Lawlor serves on the board of directors of numerous companies, and served on the Board of Directors of Human Genome Sciences, Inc. from March 2004 to August 2012 and the board of directors of Replidyne, Inc. from March 2002 to March 2009. We believe that Mr. Lawlor's leadership experience in operating companies with investment firms and his service as a board member of public companies enable him to bring valuable insight and knowledge to our Board.

*Scott Bartos.* Mr. Bartos has been a member of CSI's Board of Directors since October 2012. Mr. Bartos has more than 20 years' experience as a healthcare executive and director, and was appointed President & CEO and a member of the board of directors of Rural/Metro Corporation in May 2013. He is an advisor to EDG Partners, LLC and has been a director of Alliance HealthCare Services, Inc. since 2012. He currently serves as Chairman of the Board of Home Dialysis Plus. Mr. Bartos previously served as President, Chief Executive Officer and Director of LaVie Care Centers from July 2009 through the sale of the company in December 2011. From December 2008 to July 2009, Mr. Bartos was an Executive in Residence at Warburg Pincus LLC. Mr. Bartos was Division President for Gambro Healthcare Inc. from 2000 to 2004 and COO East from 2004 to 2005. Mr. Bartos previously was the founder, President, CEO and a Director of Endoscopy Specialists Inc. We believe that Mr. Bartos's experience in business design, strategic planning, new product and service innovation, sales and marketing, and mergers and acquisitions with large, medium and small businesses in both the public and private company settings allow him to make valuable contributions to our Board.

## **DIRECTORS CONTINUING IN OFFICE UNTIL THE FISCAL 2014 ANNUAL MEETING**

*Glen D. Nelson, M.D.* Dr. Nelson has been a member of CSI's Board of Directors since 2003 and CSI's Chairman since August 2007. Since 2002, Dr. Nelson has been Chairman of GDN Holdings, LLC, a private investment company of which he is the sole owner. Dr. Nelson was a member of the board of directors of

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Medtronic, Inc. from 1980 until 2002. Dr. Nelson joined Medtronic as Executive Vice President in 1986, and he was elected Vice Chairman in 1988, a position held until his retirement in 2002. Before joining Medtronic, Dr. Nelson practiced surgery from 1969 to 1986. Dr. Nelson was Chairman of the Board and Chief Executive Officer of American MedCenters, Inc. from 1984 to 1986. Dr. Nelson also was Chairman, President and Chief Executive Officer of the Park Nicollet Medical Center, a large multi-specialty group practice in Minneapolis, Minnesota, from 1975 to 1986. Dr. Nelson serves as a director for American Public Media/Minnesota Public Radio (non-profit) and for 9 private companies; Anhesi, LLC, Arstasis, Inc., Carlson Holdings, Inc., Guided Delivery Systems, Inc., Inspire Medical Systems, LLC, InterValue, Inc., MyMeds, Inc., NxThera, and RedBrick Health. Dr. Nelson has previously served in the past five years on the board of directors of The Travelers Companies, Inc. We believe that Dr. Nelson's extensive experience in medicine and the medical device industry and previous positions of leadership and service as a board member of several companies provide invaluable contributions to our Board.

*David L. Martin.* Mr. Martin has been CSI's President and Chief Executive Officer since February 2007, and a director since August 2006. Mr. Martin also served as CSI's Interim Chief Financial Officer from January 2008 to April 2008. Prior to joining CSI, Mr. Martin was Chief Operating Officer of FoxHollow Technologies, Inc. from January 2004 to February 2006, Executive Vice President of Sales and Marketing of FoxHollow Technologies, Inc. from January 2003 to January 2004, Vice President of Global Sales and International Operations at Cardiovention Inc. from October 2001 to May 2002, Vice President of Global Sales for RITA Medical Systems, Inc. from March 2000 to October 2001 and Director of U.S. Sales, Cardiac Surgery for Guidant Corporation from September 1999 to March 2000. Mr. Martin has also held sales and sales management positions for The Procter & Gamble Company and Boston Scientific Corporation. Among other attributes, skills and qualifications, we believe Mr. Martin is uniquely qualified to serve as a director because, as the Company's President and Chief Executive Officer, he is the person most familiar with the Company's business and industry and most capable of effectively identifying strategic priorities and leading the execution of strategy.

## **INFORMATION REGARDING THE BOARD OF DIRECTORS AND CORPORATE GOVERNANCE**

### **INDEPENDENCE OF THE BOARD OF DIRECTORS**

As required under the Nasdaq Stock Market (Nasdaq) listing standards, a majority of the members of a listed company's Board of Directors must qualify as independent, as affirmatively determined by the Board of Directors. The Board of Directors consults with the Company's counsel to ensure that the Board of Directors' determinations are consistent with relevant securities and other laws and regulations regarding the definition of independent, including those set forth in pertinent listing standards of Nasdaq, as in effect from time to time.

Consistent with these considerations, after review of all relevant transactions or relationships between each director, nominee, or any of his or her family members, and the Company, its senior management and its independent registered public accounting firm, the Board of Directors, following the determination of the Governance/Nominating Committee, has affirmatively determined that the following directors and nominees are independent within the meaning of the applicable Nasdaq listing standards: Messrs. Blackey, Brown, Friedman, Ward (director nominee), Bartos and Lawlor, Ms. Trigg and Dr. Nelson. In making this determination, the Board of Directors found that none of these directors or nominees for director had a material or other disqualifying relationship with the Company. Mr. Martin, the Company's President and Chief Executive Officer, is not an independent director by virtue of his employment with the Company.

### **BOARD LEADERSHIP STRUCTURE**



We have separate individuals serving as Chairman of the Board and as President and Chief Executive Officer because we believe independent directors and management have different perspectives and roles in strategy development. The President and CEO is responsible for setting the strategic direction of the Company

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and managing the day-to-day leadership and performance of the Company, while the Chairman provides guidance to the President and CEO, sets the agenda for meetings of the Board and presides over meetings of the full Board. We believe this structure promotes active participation of the independent directors and strengthens the role of the Board in fulfilling its oversight responsibility and fiduciary duties to our stockholders while recognizing the day-to-day management direction of the Company by the President and CEO.

## **OVERSIGHT OF RISK MANAGEMENT**

The Board has an active role, as a whole and also at the committee level, in overseeing management of the Company's risks. The Board regularly reviews information regarding the Company's credit, liquidity and operations, as well as the risks associated with each, and the Board receives regular reports from members of senior management on areas of material risk to the Company, including operational, financial, legal, regulatory, strategic and reputational risks. The Human Resources and Compensation Committee is responsible for overseeing the management of risks relating to the Company's executive compensation plans and arrangements. While the Human Resources and Compensation Committee addresses risk by setting compensation within the range of what the Company can manage and what is competitive, the Human Resources and Compensation Committee did not formally undertake a risk assessment. The Audit, Risk Management and Finance Committee oversees our internal controls and regularly assesses financial and accounting processes, and reviews and assesses the Company's major enterprise, financial condition and operational risks. The Governance/Nominating Committee manages risks associated with the independence of the Board and potential conflicts of interest. While each committee is responsible for evaluating certain risks and overseeing the management of such risks, the entire Board of Directors is regularly informed through committee reports about such risks and has overall risk management oversight responsibility.

## **CODE OF ETHICS AND BUSINESS CONDUCT**

The Company has adopted the Cardiovascular Systems, Inc. Code of Ethics and Business Conduct that applies to all officers, directors and employees, which was last amended on January 31, 2012. We intend to maintain the highest standards of ethical business practices and compliance with all laws and regulations applicable to our business. The Code of Ethics and Business Conduct, as amended, is available on our website at <http://www.csi360.com> in the Investors' section. We intend to satisfy the disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to, or waiver from, a provision of our Code of Ethics and Business Conduct by posting such information on our website at the web address and location specified above.

## **STOCKHOLDER COMMUNICATIONS WITH THE BOARD OF DIRECTORS**

Stockholders may communicate directly with the Board of Directors. All communications should be directed to the Company's Secretary at the address below and should prominently indicate on the outside of the envelope that it is intended for the Board of Directors or for non-management directors, and the Company's Secretary will forward the communications to all specified directors. If no director is specified, the communication will be forwarded to the entire Board. Stockholder communications to the Board should be sent to:

Cardiovascular Systems, Inc. Board of Directors, Attention: Secretary, 651 Campus Drive St. Paul, MN 55112.

## **DIRECTOR ATTENDANCE AT ANNUAL MEETINGS OF STOCKHOLDERS**

Directors' attendance at annual meetings of our stockholders can provide stockholders with an opportunity to communicate with directors about issues affecting the Company. We encourage, but do not require, our directors and nominees for director to attend annual meetings of stockholders. Five of our eight directors (including Mr. Bartos, as a

nominee for director) attended our last annual meeting of stockholders on October 31, 2012.

**Table of Contents****MEETINGS OF THE BOARD OF DIRECTORS**

The Board of Directors met five times during the fiscal year ended June 30, 2013. All directors attended at least 75% of the aggregate of the meetings of the Board of Directors and of the committees on which they served and which were held during the period for which they were directors or committee members. In addition, the directors often communicate informally to discuss the affairs of the Company and, when appropriate, take formal action by written consent, in accordance with the Company's charter and bylaws and Delaware law.

**INFORMATION REGARDING COMMITTEES OF THE BOARD OF DIRECTORS**

During the fiscal year ended June 30, 2013, the Board of Directors maintained three standing committees: the Audit, Risk Management and Finance Committee; the Human Resources and Compensation Committee; and the Governance/Nominating Committee. The following table provides current committee membership, and meeting information for fiscal 2013 for each of the committees of the Board of Directors in existence through June 30, 2013:

<b>Name</b>	<b>Audit, Risk Management and Finance Committee</b>	<b>Human Resources and Compensation</b>	<b>Governance/ Nominating</b>
Brent G. Blackey	X*		
Edward Brown		X*	
John H. Friedman	X		
Augustine Lawlor			X
David L. Martin			
Glen D. Nelson, M.D.			X*
Leslie Trigg		X	X
Scott Bartos	X	X	
Total meetings in fiscal 2013	8	9	4

\* Committee Chairperson

Below is a description of each committee of the Board of Directors as such committees are presently constituted. The Board of Directors has determined that each current member of each committee meets the applicable SEC and Nasdaq rules and regulations regarding independence and that each member is free of any relationship that would impair his individual exercise of independent judgment with regard to the Company.

**Audit, Risk Management and Finance Committee**

The Audit, Risk Management and Finance Committee of the Board of Directors (the "Audit Committee") was established by the Board of Directors in accordance with Section 3(a)(58)(A) of the Exchange Act to oversee the Company's corporate accounting and financial reporting processes and audits of its financial statements. The Audit Committee is composed of Brent G. Blackey, Chair, John H. Friedman and Scott Bartos. The Board of Directors has adopted an Audit, Risk Management and Finance Committee Charter, which was last amended on August 1, 2013 and is available on our website at <http://www.csi360.com> in the "Investors" section. The functions of the Audit Committee include, among other things:

serving as an independent and objective party to monitor the Company's financial reporting process and internal control system;

coordinating, reviewing and appraising the audit efforts of the Company's independent auditors and management and, to the extent the Company has an internal auditing or similar department or persons performing the functions of such department ( internal auditing department or internal auditors ), the internal auditing department;

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communicating directly with the independent auditors, the financial and senior management, the internal auditing department, and the Board of Directors regarding the matters related to the committee's responsibilities and duties;

monitoring, overseeing and reviewing the Company's risk management and exercising principal oversight responsibility with respect to certain of the Company's material financial matters; and

reviewing and making recommendations to the Board regarding the financial policies of the Company, the Company's capital structure and the Company's current and anticipated financial requirements, and overseeing management of the financial affairs of the Company.

Our independent registered public accounting firm, outside legal counsel and management periodically meet privately with our Audit Committee.

Each Audit Committee member is a non-employee director of our Board. The Board of Directors reviews the Nasdaq listing standards definition of independence for Audit Committee members on an annual basis and has determined that all current members of the Company's Audit Committee are independent (as independence is currently defined in Rule 5605(a)(2) of the Nasdaq listing standards and Rule 10A-3(b)(1) under the Exchange Act).

### **Audit Committee Financial Expert**

The Board has determined that Mr. Blackey is the audit committee financial expert, as defined in Item 407(d)(5)(ii) of Regulation S-K, as amended. As noted above, Mr. Blackey is independent within the meaning of Nasdaq's listing standards. A description of Mr. Blackey's experience is set forth above under Nominees for Election for a Three-Year Term Expiring at the Fiscal 2016 Annual Meeting. The designation of Mr. Blackey as the audit committee financial expert does not impose on Mr. Blackey any duties, obligations or liability that are greater than the duties, obligations and liability imposed on Mr. Blackey as a member of the Audit Committee and the Board of Directors in the absence of such designation or identification.

### **Report of the Audit Committee of the Board of Directors**

In accordance with its written charter, the Audit Committee assists the Board of Directors with fulfilling its oversight responsibility regarding the quality and integrity of the accounting, auditing and financial reporting practices of the Company. In discharging its oversight responsibilities regarding the audit process, the Audit Committee:

(1) reviewed and discussed the audited financial statements with management and the independent auditors;

(2) discussed with the independent auditors the material required to be discussed by Statement on Auditing Standards No. 61, as amended (AICPA, Professional Standards, Vol. 1, AU section 380), as adopted by the Public Company Accounting Oversight Board in

Change in cash overdraft position  
(10,173) (10,449)

Proceeds from issuing common stock  
9,288 8,776

Proceeds from exercised stock options  
3,889 1,579

Stock-based compensation windfall tax benefits

302 98

Repurchase of common stock

(744) (302)

Dividends paid on common stock

(59,584) (54,969)

Net cash flows from financing activities

2,077 5,800

Net (decrease) increase in cash and cash equivalents

(8,315) 3,071

Cash and cash equivalents at beginning of period

21,869 14,944

Cash and cash equivalents at end of period

\$13,554 \$18,015

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

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

**Note 1 Basis of Presentation**

The accompanying consolidated balance sheets and statements of capitalization of Aqua America, Inc. and subsidiaries (the Company) at September 30, 2010, the consolidated statements of income and comprehensive income for the nine and three months ended September 30, 2010 and 2009, the consolidated statements of cash flow for the nine months ended September 30, 2010 and 2009, and the consolidated statement of equity for the nine months ended September 30, 2010, are unaudited, but reflect all adjustments, consisting of only normal recurring accruals, which are, in the opinion of management, necessary to present fairly the consolidated financial position, the consolidated changes in equity, the consolidated results of operations, and the consolidated cash flow for the periods presented. Because they cover interim periods, the statements and related notes to the financial statements do not include all disclosures and notes normally provided in annual financial statements and, therefore, should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2009. The results of operations for interim periods may not be indicative of the results that may be expected for the entire year. The December 31, 2009 consolidated balance sheet data presented herein was derived from the Company's December 31, 2009 audited consolidated financial statements, but does not include all disclosures and notes normally provided in annual financial statements.

**Note 2 Goodwill**

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

	Regulated Segment	Other	Consolidated
Balance at December 31, 2009	\$ 38,962	\$ 4,121	\$ 43,083
Reclassifications to utility plant acquisition adjustment	(1,522)	0	(1,522)
Other	90	0	90
Balance at September 30, 2010	\$ 37,530	\$ 4,121	\$ 41,651

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

As of July 31, 2010, management performed its annual test of goodwill for impairment, in conjunction with the timing of the Company's annual five-year financial plan. Based on the Company's comparison of the estimated fair value of each reporting unit to its respective carrying amounts management concluded that none of the Company's goodwill was impaired.



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AQUA AMERICA, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
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Note 3 Dispositions

The City of Fort Wayne, Indiana (the "City") has authorized the acquisition by eminent domain of the northern portion of the utility system of one of the operating subsidiaries that the Company acquired in connection with the AquaSource acquisition in 2003. The Company challenged whether the City was following the correct legal procedures in connection with the City's attempted condemnation, but the Indiana Supreme Court, in an opinion issued in June 2007, supported the City's position. In October 2007, the City's Board of Public Works approved proceeding with its process to condemn the northern portion of the Company's utility system at a preliminary price based on the City's valuation. The Company has filed an appeal with the Allen County Circuit Court challenging the Board of Public Works' valuation on several bases. In November 2007, the City Council authorized the taking of the northern portion of the Company's system and the payment of \$16,911 based on the City's valuation of this portion of the system. In January 2008, the Company reached a settlement with the City to transition the northern portion of the system in February 2008 upon receipt of the City's initial valuation payment of \$16,911. The settlement agreement specifically stated that the final valuation of the northern portion of the Company's system will be determined through a continuation of the legal proceedings that were filed challenging the City's valuation. On February 12, 2008, the Company turned over the northern portion of the system to the City upon receipt of the initial valuation payment. The Indiana Utility Regulatory Commission also reviewed and acknowledged the transfer of the Certificate of Territorial Authority for the northern portion of the system to the City. The proceeds received by the Company are in excess of the book value of the assets relinquished. No gain has been recognized due to the contingency over the final valuation of the assets. The net book value of the assets relinquished has been removed from the consolidated balance sheet and the difference between the net book value and the initial payment received has been deferred and is recorded in other accrued liabilities on the Company's consolidated balance sheet. Once the contingency is resolved and the asset valuation is finalized, through the finalization of the litigation between the Company and the City of Fort Wayne, the amounts deferred will be recognized in the Company's consolidated income statement. On March 16, 2009, oral argument was held on certain procedural aspects with respect to the valuation evidence that may be presented and whether the Company is entitled to a jury trial. On October 12, 2010, the Wells County Indiana Circuit Court ruled that the Company is not entitled to a jury trial, and that the Wells County judge should review the City of Fort Wayne Board of Public Works' assessment based upon a "capricious, arbitrary or an abuse of discretion" standard. The Company disagrees with the Court's decision and is evaluating its legal options with respect to this decision. Depending upon the ultimate outcome of all of the legal proceedings, the Company may be required to refund a portion of the initial valuation payment, or may receive additional proceeds. The northern portion of the utility system relinquished represents approximately 0.50% of the Company's total assets.

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AQUA AMERICA, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(In thousands of dollars, except per share amounts)  
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Note 4 Long-term Debt and Loans Payable

In June 2010, the Company issued \$70,000 of senior unsecured notes, of which \$15,000 is due in 2021, \$20,000 in 2024, and \$35,000 in 2028 with interest rates of 4.62%, 4.83%, and 5.22%, respectively.

Note 5 Fair Value of Financial Instruments

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

	September 30, 2010	December 31, 2009
Carrying Amount	\$ 1,463,143	\$ 1,446,134
Estimated Fair Value	1,524,859	1,315,954

The fair value of long-term debt has been determined by discounting the future cash flows using current market interest rates for similar financial instruments of the same duration. The Company's customers' advances for construction and related tax deposits have a carrying value of \$68,592 as of September 30, 2010, and \$76,913 as of December 31, 2009. Their relative fair values cannot be accurately estimated because future refund payments depend on several variables, including new customer connections, customer consumption levels, and future rate increases. Portions of these non-interest bearing instruments are payable annually through 2025 and amounts not paid by the contract expiration dates become non-refundable. The fair value of these amounts would, however, be less than their carrying value due to the non-interest bearing feature.

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AQUA AMERICA, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
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**Note 6 Net Income per Common Share**

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

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2010	2009	2010	2009
Average common shares outstanding during the period for basic computation	136,798	135,673	137,095	135,975
Dilutive effect of employee stock options	314	333	299	285
 Average common shares outstanding during the period for diluted computation	 137,112	 136,006	 137,394	 136,260

For the nine and three months ended September 30, 2010, employee stock options to purchase 2,623,273 and 1,512,197 shares of common stock, respectively, were excluded from the calculations of diluted net income per share as the calculated proceeds from the options exercise were greater than the average market price of the Company's common stock during these periods. For the nine and three months ended September 30, 2009, employee stock options to purchase 2,705,004 shares of common stock, were excluded from the calculations of diluted net income per share as the calculated proceeds from the options exercise were greater than the average market price of the Company's common stock during these periods.

**Note 7 Stock-based Compensation**

Under the Company's 2009 Omnibus Equity Compensation Plan (the "2009 Plan"), as approved by the Company's shareholders to replace the 2004 Equity Compensation Plan (the "2004 Plan"), stock options, stock units, stock awards, stock appreciation rights, dividend equivalents, and other stock-based awards may be granted to employees, non-employee directors, and consultants and advisors. The 2009 Plan authorizes 5,000,000 shares for issuance under the plan. A maximum of 50% of the shares available for issuance under the 2009 Plan may be issued as restricted stock and the maximum number of shares that may be subject to grants under the Plan to any one individual in any one year is 200,000. Awards under the 2009 Plan are made by a committee of the Board of Directors. At September 30, 2010, 4,322,775 shares underlying stock option and restricted stock awards were still available for grants under the 2009 Plan. No further grants may be made under the 2004 Plan.

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

**Stock Options** During the nine months ended September 30, 2010 and 2009, the Company recognized compensation costs associated with stock options as a component of operations and maintenance expense of \$1,540 and \$1,866, respectively. During the three months ended September 30, 2010 and 2009, the Company recognized compensation costs associated with stock options as a component of operations and maintenance expense of \$526 and \$665, respectively. For the nine months ended September 30, 2010 and 2009, the Company recognized income tax benefits associated with stock options in its income statement of \$502 and \$359, respectively. For the three months ended September 30, 2010 and 2009, the Company recognized income tax benefits associated with stock options in its income statement of \$201 and \$124, respectively. In addition, for the nine and three months ended September 30, 2010 and 2009, the Company capitalized compensation costs associated with stock options within property, plant and equipment of \$0 and \$73, respectively.

The fair value of options was estimated at the grant date using the Black-Scholes option-pricing model. The per share weighted-average fair value at the date of grant for stock options granted during the nine months ended September 30, 2010 and 2009 was \$3.49 and \$4.37 per option, respectively. There were no stock options granted during the three months ended September 30, 2010 and 2009. The following assumptions were used in the application of this valuation model:

	2010	2009
Expected term (years)	6.0	5.3
Risk-free interest rate	2.8%	2.2%
Expected volatility	26.7%	31.3%
Dividend yield	3.3%	3.0%

Historical information was the principal basis for the selection of the expected term and dividend yield. The expected volatility is based on a weighted-average combination of historical and implied volatilities over a time period that approximates the expected term of the option. The risk-free interest rate was selected based upon the U.S. Treasury yield curve in effect at the time of grant for the expected term of the option.

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AQUA AMERICA, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
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The following table summarizes stock option transactions for the nine months ended September 30, 2010:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Life (years)	Aggregate Intrinsic Value
Options:				
Outstanding at beginning of period	3,895,329	\$ 19.17		
Granted	459,837	17.14		
Forfeited	(11,839)	18.91		
Expired	(43,033)	23.22		
Exercised	(327,344)	11.88		
Outstanding at end of period	3,972,950	\$ 19.50	5.9	\$ 9,157
Exercisable at end of period	2,952,181	\$ 19.87	5.0	\$ 7,141

**Restricted Stock** During the nine months ended September 30, 2010 and 2009, the Company recorded stock-based compensation related to restricted stock awards as a component of operations and maintenance expense in the amounts of \$1,555 and \$848, respectively. During the three months ended September 30, 2010 and 2009, the Company recorded stock-based compensation related to restricted stock awards as a component of operations and maintenance expense in the amounts of \$412 and \$219, respectively. The following table summarizes nonvested restricted stock transactions for the nine months ended September 30, 2010:

	Number of Shares	Weighted Average Fair Value
Nonvested shares at beginning of period	102,918	\$ 19.73
Granted	197,288	17.19
Vested	(64,587)	19.66
Forfeited	(600)	17.23
Nonvested shares at end of period	235,019	\$ 17.62

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AQUA AMERICA, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
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**Note 8 Pension Plans and Other Postretirement Benefits**

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

	Pension Benefits			
	Nine Months Ended		Three Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Service cost	\$ 3,396	\$ 3,276	\$ 1,052	\$ 1,092
Interest cost	9,702	9,411	3,262	3,137
Expected return on plan assets	(8,545)	(7,037)	(2,953)	(2,346)
Amortization of transition asset		(136)		(45)
Amortization of prior service cost	141	113	71	38
Amortization of actuarial loss	3,222	3,848	1,162	1,283
Capitalized costs	(2,493)	(2,027)	(808)	(707)
Settlement charge	1,068	641	184	0
Net periodic benefit cost	\$ 6,491	\$ 8,089	\$ 1,970	\$ 2,452

	Other Postretirement Benefits			
	Nine Months Ended		Three Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Service cost	\$ 847	\$ 810	\$ 237	\$ 270
Interest cost	1,831	1,716	591	572
Expected return on plan assets	(1,402)	(1,266)	(478)	(422)
Amortization of transition obligation	78	78	26	26
Amortization of prior service cost	(201)	(209)	(67)	(70)
Amortization of actuarial loss	464	440	122	147
Amortization of regulatory asset	102	102	34	34
Capitalized costs	(369)	(274)	(119)	(95)
Net periodic benefit cost	\$ 1,350	\$ 1,397	\$ 346	\$ 462

The Company made cash contributions of \$12,706 to its defined benefit pension plans during the first nine months of 2010, and intends to make cash contributions of \$300 to the plans during the remainder of 2010. In addition, the Company made cash contributions of \$191 and expects to make cash contributions of \$1,494 for the funding of its other postretirement benefit plans during the remainder of 2010.



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

**Note 9 Water and Wastewater Rates**

On June 17, 2010, the Pennsylvania Public Utility Commission granted the Company's operating subsidiary in Pennsylvania a water rate increase designed to increase total operating revenues by \$23,600, on an annualized basis. The rates in effect at the time of the filing included \$24,256 in Distribution System Improvement Charges ( DSIC ) or 7.5% above prior base rates. Consequently, the total base rates increased by \$47,856, and the DSIC was reset to zero. During the first nine months of 2010, in addition to Pennsylvania, the Company's operating divisions in New York, New Jersey, Maine, North Carolina, Ohio, Missouri, and Indiana were granted base rate increases designed to increase total operating revenues on an annual basis by approximately \$14,275.

**Note 10 Taxes Other than Income Taxes**

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

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2010	2009	2010	2009
Property	\$ 20,466	\$ 17,941	\$ 7,376	\$ 6,115
Capital stock	2,641	1,887	850	642
Gross receipts, excise and franchise	7,790	6,740	3,111	2,534
Payroll	5,267	5,313	1,519	1,582
Other	3,821	4,011	1,326	1,545
Total taxes other than income	\$ 39,985	\$ 35,892	\$ 14,182	\$ 12,418



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

**Note 11 Segment Information**

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

The following tables present the Company's segment information:

	Three Months Ended September 30, 2010			Three Months Ended September 30, 2009		
	Regulated	Other	Consolidated	Regulated	Other	Consolidated
Operating revenues	\$ 204,976	\$ 2,821	\$ 207,797	\$ 177,872	\$ 2,954	\$ 180,826
Operations and maintenance expense	70,074	2,894	72,968	66,133	2,355	68,488
Depreciation	27,643	(212)	27,431	25,854	(418)	25,436
Operating income (loss)	89,700	(113)	89,587	70,819	636	71,455
Interest expense, net of AFUDC	16,727	1,346	18,073	16,443	66	16,509
Income tax	29,124	(1,070)	28,054	21,548	90	21,638
Net income (loss) attributable to common shareholders	44,113	(362)	43,751	32,986	484	33,470

	Nine Months Ended September 30, 2010			Nine Months Ended September 30, 2009		
	Regulated	Other	Consolidated	Regulated	Other	Consolidated
Operating revenues	\$ 538,575	\$ 8,183	\$ 546,758	\$ 493,911	\$ 8,735	\$ 502,646
Operations and maintenance expense	202,655	7,224	209,879	197,403	6,623	204,026
Depreciation	81,427	(994)	80,433	77,990	(1,195)	76,795
Operating income	205,589	757	206,346	175,007	2,078	177,085
Interest expense, net of AFUDC	49,292	2,713	52,005	48,495	258	48,753
Gain on sale of other assets	257	2,073	2,330	359	16	375
Income tax	62,977	(1,423)	61,554	50,876	137	51,013
Net income attributable to common shareholders	93,577	1,540	95,117	75,995	1,699	77,694
Capital expenditures	239,141	326	239,467	194,196	690	194,886

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AQUA AMERICA, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)  
(In thousands of dollars, except per share amounts)  
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	September 30, 2010	December 31, 2009
Total assets:		
Regulated	\$ 3,833,263	\$ 3,689,689
Other and eliminations	80,019	72,908
Consolidated	\$ 3,913,282	\$ 3,762,597

**Note 12 Recent Accounting Pronouncements**

In June 2009, the Financial Accounting Standards Board issued revised accounting guidance for variable interest entities, which replaces the quantitative approach for determining which reporting entity has a controlling financial interest in a variable interest entity with a qualitative approach that focuses on which reporting entity controls the most significant economic activities of the variable interest entity. The revised guidance is effective January 1, 2010. The Company adopted the revised guidance as required, and the adoption did not have an impact on the Company's consolidated results of operations or consolidated financial position.

**Note 13 Commitments and Contingencies**

The Company is routinely involved in various disputes, claims, lawsuits and other regulatory and legal matters, including both asserted and unasserted legal claims, in the ordinary course of business. The status of each such matter, referred to herein as a loss contingency, is reviewed and assessed in accordance with applicable accounting rules regarding the nature of the matter, the likelihood that a loss will be incurred, and the amounts involved. As of September 30, 2010, the aggregate amount of \$14,860 is accrued for loss contingencies and is reported in the Company's consolidated balance sheet as other accrued liabilities and other liabilities. These accruals represent management's best estimate of probable loss (as defined in the accounting guidance) for loss contingencies or the low end of a range of losses if no single probable loss can be estimated. For some loss contingencies, the Company is unable to estimate the amount of the probable loss or range of probable losses. While the final outcome of these loss contingencies cannot be predicted with certainty, and unfavorable outcomes could negatively impact the Company, at this time in the opinion of management, the final resolution of these matters are not expected to have a material adverse effect on the Company's financial position, results of operations or cash flows. Further, Aqua America has insurance coverage for certain of these loss contingencies, and as of September 30, 2010, estimates that approximately \$2,920 of the amount accrued for these matters are probable of recovery through insurance, which amount is also reported in the Company's consolidated balance sheet as deferred charges and other assets, net.

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

(In thousands of dollars, except per share amounts)

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

Forward-looking Statements

*This Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Quarterly Report contain, in addition to historical information, forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements address, among other things: our belief in our ability to renew our short-term lines of credit; the impact and the actions we may need to take if we are unable to obtain sufficient capital; the projected impact of various legal proceedings; the projected effects of recent accounting pronouncements; prospects, plans, objectives, expectations and beliefs of management, as well as information contained in this report where statements are preceded by, followed by or include the words believes, expects, anticipates, plans, future, potential, probably, predictions, intends, will, continue or the negative of such terms or similar expressions. Forward-looking statements are based on a number of assumptions concerning future events, and are subject to a number of risks, uncertainties and other factors, many of which are outside our control, which could cause actual results to differ materially from those expressed or implied by such statements. These risks and uncertainties include, among others: the effects of regulation, abnormal weather, changes in capital requirements and funding, acquisitions, changes to the capital markets, and our ability to assimilate acquired operations, as well as those risks, uncertainties and other factors discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009 under the captions Risk Factors and Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in such report. As a result, readers are cautioned not to place undue reliance on any forward-looking statements. We undertake no obligation to update or revise forward-looking statements, whether as a result of new information, future events or otherwise.*

General Information

*Nature of Operations* Aqua America, Inc. ( we or us ), a Pennsylvania corporation, is the holding company for regulated utilities providing water or wastewater services to what we estimate to be approximately 3 million people in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, New York, Florida, Indiana, Virginia, Maine, Missouri, South Carolina, and Georgia. Our largest operating subsidiary, Aqua Pennsylvania, Inc., provides water or wastewater services to approximately one-half of the total number of people we serve, who are located in the suburban areas in counties north and west of the City of Philadelphia and in 25 other counties in Pennsylvania. Our other subsidiaries provide similar services in 13 other states. In addition, we provide water and wastewater service through operating and maintenance contracts with municipal authorities and other parties close to our utility companies' service territories as well as sludge hauling, septage and grease services and backflow prevention services.

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FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

(In thousands of dollars, except per share amounts)

Aqua America, Inc., which prior to its name change in 2004 was known as Philadelphia Suburban Corporation, was formed in 1968 as a holding company for its primary subsidiary, Aqua Pennsylvania, Inc., formerly known as Philadelphia Suburban Water Company. In the early 1990s we embarked on a growth through acquisition strategy focused on water and wastewater operations. Our most significant transactions to date have been the merger with Consumers Water Company in 1999, the acquisition of the regulated water and wastewater operations of AquaSource, Inc. in 2003, the acquisition of Heater Utilities, Inc. in 2004, and the acquisition of New York Water Service Corporation in 2007. Since the early 1990s, our business strategy has been primarily directed toward the regulated water and wastewater utility industry and has extended our regulated operations from southeastern Pennsylvania to include operations in 13 other states.

Financial Condition

During the first nine months of 2010, we had \$239,467 of capital expenditures, issued \$114,313 of long-term debt, repaid debt and made sinking fund contributions and other loan repayments of \$97,678, and repaid \$5,203 of customer advances for construction. The capital expenditures were related to improvements to treatment plants, new and rehabilitated water mains, tanks, hydrants, and service lines, well and booster improvements, and other enhancements and improvements. The issuance of \$114,313 of long-term debt was comprised principally of the proceeds received from the June 2010 issuance of senior unsecured notes payable of \$70,000, and the funds borrowed under our revolving credit facility of \$43,000.

At September 30, 2010, we had \$13,554 of cash and cash equivalents compared to \$21,869 at December 31, 2009. During the first nine months of 2010, we used the proceeds from internally generated funds, the issuance of long-term debt, the issuance of common stock, the sale of other assets, and available working capital to fund the cash requirements discussed above and to pay dividends.

At September 30, 2010, our \$95,000 unsecured revolving credit facility, which expires in May 2012, had \$10,848 available for borrowing. At September 30, 2010, we had short-term lines of credit of \$137,000, of which \$67,528 was available. One of our short-term lines of credit is an Aqua Pennsylvania \$70,000 364-day unsecured revolving credit facility with two banks, which is used to provide working capital.

Our short-term lines of credit of \$137,000 are subject to renewal on an annual basis. Although we believe we will be able to renew these facilities, there is no assurance that they will be renewed, or what the terms of any such renewal will be. The United States credit and liquidity crisis that started in 2008 and caused substantial volatility in capital markets, including credit markets and the banking industry, has reduced the availability of credit from financing sources, which may continue or worsen in the future. If in the future, our credit facilities are not renewed or our short-term borrowings are called for repayment, we would have to seek alternative financing sources, although there can be no assurance that these alternative financing sources would be available on terms acceptable to us. In the event we are not able to obtain sufficient capital, we may need to reduce our capital expenditures and our ability to pursue acquisitions that we may rely on for future growth could be impaired.

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AQUA AMERICA, INC. AND SUBSIDIARIES  
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(In thousands of dollars, except per share amounts)

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

**Results of Operations**

**Analysis of First Nine Months of 2010 Compared to First Nine Months of 2009**

Revenues increased \$44,112 or 8.8% primarily due to additional revenues associated with increased water and wastewater rates of \$25,310, increased water consumption as compared to the first nine months of 2009, additional revenues associated with increased infrastructure rehabilitation surcharges of \$2,413, and additional wastewater and water revenues of \$2,118 associated with a larger customer base due to acquisitions. The increase in customer water consumption is largely due to favorable weather conditions in many of our service territories during May, June, and the third quarter of 2010, which increased water usage. Further impacting the comparison is the unfavorable weather conditions experienced in 2009 in our service territories that reduced water usage in the third quarter of 2009.

Operations and maintenance expenses increased by \$5,853 or 2.9% primarily due to the write-off of previously deferred regulatory expenses of \$2,082, the absence of the June 2009 gain on sale of a utility system of \$1,009, which had the effect of reducing operations and maintenance expense in 2009, increases in operating costs associated with acquisitions of \$938, a write-off of capitalized costs of \$715, increases in fuel costs for our service vehicles of \$536, and normal increases in other operating costs. Offsetting these increases were decreases in water production costs of \$1,227, decreased bad debt expense of \$1,052, and reduced expenses of \$175 associated with the dispositions of utility systems. The decreased water production costs, principally for chemicals utilized to treat water, were associated with vendor price decreases.

Depreciation expense increased \$3,638 or 4.7% due to the utility plant placed in service since September 30, 2009, offset by the effect of the additional expense of \$2,037 recognized in the first quarter of 2009 resulting from a rate case adjustment related to our rate filing in North Carolina.

Amortization increased \$1,267 or 14.3% primarily due to additional amortization of \$579 resulting from the recovery through a surcharge of our costs associated with our rate filing in Texas and the amortization of the costs associated with, and other costs being recovered in, various rate filings, offset by the effect of the additional amortization recognized in the first quarter of 2009 of \$394 resulting from a rate case adjustment related to a rate filing.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
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(In thousands of dollars, except per share amounts)

Taxes other than income taxes increased by \$4,093 or 11.4% primarily due to an increase in property taxes of \$2,525, an increase in gross receipts, excise and franchise taxes of \$1,050 and an increase in capital stock taxes for our operating subsidiary in Pennsylvania of \$754. The increase in property taxes is attributable to an increase in recoverable expenses associated with a recent rate award. The increase in gross receipts, excise and franchise taxes is attributable to an increase in revenue.

Interest expense increased by \$5,391 or 10.6% primarily due to an increase in borrowings to finance capital projects, offset partially by decreased interest rates on long-term debt.

Allowance for funds used during construction ( AFUDC ) increased by \$2,139 primarily due to an increase in the average balance of utility plant construction work in progress, to which AFUDC is applied, and an increase in short-term interest rates, which are a component of the applied AFUDC rate.

Gain on sale of other assets totaled \$2,330 during the first nine months of 2010 and \$375 in the first nine months of 2009. The increase of \$1,955 is due primarily to a gain on the sale of an investment in the first quarter of 2010.

Our effective income tax rate was 39.3% in the first nine months of 2010 and 39.6% in the first nine months of 2009. The effective income tax rate decreased due to an increase in a tax credit for qualified domestic production activities in the first nine months of 2010 versus the same period in 2009.

Net income attributable to common shareholders increased by \$17,423 or 22.4%, in comparison to the same period in 2009 primarily as a result of the factors described above. On a diluted per share basis, earnings increased \$0.12 reflecting the change in net income attributable to common shareholders and a 0.8% increase in the average number of common shares outstanding. The increase in the number of shares outstanding is primarily a result of the additional shares sold or issued through our dividend reinvestment plan, equity compensation plan, employee stock purchase plan, and the additional shares issued in August 2009 in connection with an acquisition.

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AQUA AMERICA, INC. AND SUBSIDIARIES  
MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
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(In thousands of dollars, except per share amounts)

Results of Operations

Analysis of Third Quarter of 2010 Compared to Third Quarter of 2009

Revenues increased \$26,971 or 14.9% primarily due to additional revenues associated with increased water and wastewater rates of \$17,431, increased water consumption as compared to the third quarter of 2009, and additional water and wastewater revenues of \$815 associated with a larger customer base due to acquisitions. The increase in customer water consumption is largely due to favorable weather conditions in many of our service territories during the third quarter of 2010, which increased water usage. Further impacting the comparison is the unfavorable weather conditions experienced in some of our service territories that resulted in reduced water usage in the third quarter of 2009.

Operations and maintenance expenses increased by \$4,480 or 6.5% primarily due to the write-off of previously deferred regulatory expenses of \$1,071, increased water production costs of \$534, increases in operating costs associated with acquisitions of \$326, and normal increases in other operating costs. Offsetting these increases was decreased bad debt expense of \$169. The increase in water production costs is a result of increased water consumption, offset primarily by vendor price decreases for chemicals utilized to treat water.

Depreciation expense increased \$1,995 or 7.8% due to the utility plant placed in service since September 30, 2009. Amortization increased \$600 or 19.8% due to the amortization of the costs associated with, and other costs being recovered in, various rate filings.

Taxes other than income taxes increased by \$1,764 or 14.2% primarily due to an increase in property taxes of \$1,261, an increase in gross receipts, excise and franchise taxes of \$577, and an increase in capital stock taxes for our operating subsidiary in Pennsylvania of \$208. The increase in property taxes is attributable to an increase in recoverable expenses associated with a recent rate award. The increase in gross receipts, excise and franchise taxes is attributable to an increase in revenue.

Interest expense increased by \$1,894 or 11.0% primarily due to additional borrowings to finance capital projects, offset partially by decreased interest rates on long-term debt.

Allowance for funds used during construction ( AFUDC ) increased by \$330 primarily due to an increase in the average balance of utility plant construction work in progress, to which AFUDC is applied, and an increase in short-term interest rates, which are a component of the applied AFUDC rate.

Gain on sale of other assets totaled \$291 in the third quarter of 2010 and \$162 in the third quarter of 2009. The increase of \$129 is principally due to the timing of sales of land and other property.

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(In thousands of dollars, except per share amounts)

Our effective income tax rate was 39.1% in the third quarter of 2010 and 39.3% in the third quarter of 2009. The effective income tax rate decreased due to an increase in a tax credit for qualified domestic production activities in the third quarter of 2010 versus the same period in 2009.

Net income attributable to common shareholders increased by \$10,281 or 30.7%, in comparison to the same period in 2009 primarily as a result of the factors described above. On a diluted per share basis, earnings increased \$0.07 reflecting the change in net income attributable to common shareholders and a 0.8% increase in the average number of common shares outstanding. The increase in the number of shares outstanding is primarily a result of the additional shares sold or issued through our dividend reinvestment plan, equity compensation plan, and employee stock purchase plan, and the additional shares issued in August 2009 in connection with an acquisition.

Impact of Recent Accounting Pronouncements

We describe the impact of recent accounting pronouncements in Note 12, *Recent Accounting Pronouncements*, of the consolidated financial statements.



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AQUA AMERICA, INC. AND SUBSIDIARIES

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are subject to market risks in the normal course of business, including changes in interest rates and equity prices. There have been no significant changes in our exposure to market risks since December 31, 2009. Refer to Item 7A of the Company's Annual Report on Form 10-K for the year ended December 31, 2009 for additional information.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

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

(b) Changes in Internal Control over Financial Reporting

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

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**AQUA AMERICA, INC. AND SUBSIDIARIES**

**Part II. Other Information**

**Item 1. Legal Proceedings**

The City of Fort Wayne, Indiana (the "City") authorized the acquisition by eminent domain of the northern portion of the utility system of one of the Company's operating subsidiaries in Indiana. We challenged whether the City was following the correct legal procedures in connection with the City's condemnation, but the Indiana Supreme Court, in an opinion issued in June 2007, supported the City's position. In October 2007, the City's Board of Public Works approved proceeding with its process to condemn the northern portion of our utility system at a preliminary price based on the City's valuation. In October 2007, we filed an appeal with the Allen County Circuit Court challenging the Board of Public Works' valuation on several bases. In November 2007, the City Council authorized the taking of this portion of our system and the payment of \$16,910,500 based on the City's valuation of the system. In January 2008, we reached a settlement agreement with the City to transition this portion of the system in February 2008 upon receipt of the City's initial valuation payment of \$16,910,500. The settlement agreement specifically states that the final valuation of the system will be determined through a continuation of the legal proceedings that were filed challenging the City's valuation. On February 12, 2008, we turned over the northern portion of the system to the City upon receipt of the initial valuation payment. The Indiana Utility Regulatory Commission also reviewed and acknowledged the transfer of the Certificate of Territorial Authority for the northern portion of the system to the City. The proceeds received by the Company are in excess of the book value of the assets relinquished. No gain has been recognized due to the contingency over the final valuation of the assets. The net book value of the assets relinquished has been removed from the consolidated balance sheet and the difference between the net book value and the initial payment received has been deferred and is recorded in other accrued liabilities on the Company's consolidated balance sheet. Once the contingency is resolved and the asset valuation is finalized, through the finalization of the litigation between the Company and the City of Fort Wayne, the amounts deferred will be recognized in the Company's consolidated income statement. On March 16, 2009, oral argument was held before the Allen County Circuit Court on certain procedural aspects with respect to the valuation evidence that may be presented and whether we are entitled to a jury trial. On October 12, 2010, the Wells County Indiana Circuit Court ruled that the Company is not entitled to a jury trial, and that the Wells County judge should review the City of Fort Wayne Board of Public Works' assessment based upon a "capricious, arbitrary or an abuse of discretion" standard. The Company disagrees with the Court's decision and is evaluating its legal options with respect to this decision. Depending upon the ultimate outcome of all of the legal proceedings we may be required to refund a portion of the initial valuation payment, or may receive additional proceeds. The northern portion of the system relinquished represented approximately 0.50% of Aqua America's total assets.

A lawsuit was filed by a husband and wife who lived in a house abutting a percolation pond at a wastewater treatment plant owned by one of the Company's subsidiaries, Aqua Utilities Florida, Inc., in Pasco County, Florida. The lawsuit was originally filed in August 2006 in the circuit court for the Sixth Judicial Circuit in and for Pasco County, Florida and has been amended several times by the plaintiffs. The lawsuit alleges our subsidiary was negligent in the design, operation and maintenance of the plant, resulting in bodily injury to the plaintiffs and various damages to their property. The plaintiffs filed an amended complaint in July 2008 to include additional counts alleging nuisance and strict liability. In the third quarter of 2008, approximately thirty-five additional plaintiffs, associated with approximately eight other homes in the area, filed another lawsuit with the same court making similar allegations against our subsidiary with respect to the operation of the facility. Both lawsuits have been submitted to our insurance carriers, who have reserved their rights with respect to various portions of the plaintiffs' claims. Based on the ultimate outcome of the litigation, we may or may not have insurance coverage for parts or all of the claims. The Company continues to assess the matter and any potential losses. At this time, the Company believes that the estimated amount of any potential losses would not be material to the Company's consolidated results of operations or consolidated financial condition.



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**AQUA AMERICA, INC. AND SUBSIDIARIES**

Two homeowners associations comprised of approximately 180 homes located next to a wastewater plant owned by one of the Company's subsidiaries in Indiana claim that the subsidiary's prior management, before our acquisition of the subsidiary in 2003, allegedly entered into an agreement to cease the majority of operations at the wastewater plant and to remove most of the facilities located at the plant site by April 2009. The Company filed a formal request for review of the purported agreement with the Indiana Utility Regulatory Commission (IURC). In September 2009, the homeowners associations filed suit in Allen County, Indiana Superior Court, claiming breach of contract, breach of warranty, fraud, unjust enrichment, promissory estoppel and constructive fraud. On September 8, 2010, the IURC approved the settlement agreement between the Company and the homeowners associations, and the suit filed by the homeowners association was dismissed. The settlement agreement includes the payment of \$2,600,000 to the homeowners associations, certain conditions for future plant improvements, which should not materially interfere with the operation of the plant, and the transfer of a parcel of land to the homeowners associations for which the Company will receive a \$50,000 credit to the settlement amount. This matter is not covered by any of the Company's insurance policies.

In July, 2010 one of the Company's subsidiaries received a notice of violation from the Pennsylvania Department of Environmental Protection (DEP). The notice of violation resulted from the subsidiary's commencement of construction of a water tank prior to receipt of a construction permit from DEP. The permit was subsequently received. On September 29, 2010, the DEP notified the Company about a proposed penalty of \$120,000 in connection with the notice of violation. The Company's subsidiary is contesting the amount of the proposed penalty and working with DEP to reach an amicable resolution.

There are no other pending legal proceedings to which we or any of our subsidiaries is a party or to which any of their properties is the subject that we believe are material or are expected to have a material effect on our financial position, results of operations or cash flows.

**Item 1A. Risk Factors**

There have been no material changes to the risks disclosed in our Annual Report on Form 10-K for the year ended December 31, 2009 ( Form 10-K ) under Part 1, Item 1A Risk Factors.

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## AQUA AMERICA, INC. AND SUBSIDIARIES

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

The following table summarizes Aqua America's purchases of its common stock for the quarter ended September 30, 2010:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plan or Programs (2)
July 1 – 31, 2010	8,508	\$ 19.26	0	548,278
August 1 – 31, 2010	2,602	\$ 19.93	0	548,278
September 1 – 30, 2010	112	\$ 20.71	0	548,278
Total	11,222	\$ 19.43	0	548,278

(1) These amounts consist of the following:

(a) shares we purchased from employees who elected to have us withhold shares to pay certain withholding taxes upon the vesting of restricted stock awards granted to such employees; and  
(b) shares we purchased from employees who elected to pay the exercise price of their stock options (and then hold shares of the

stock) upon exercise by delivering to us (and, thus, selling) shares of Aqua America common stock in accordance with the terms of our equity compensation plans that were previously approved by our shareholders and disclosed in our proxy statements.

These features of our equity compensation plan are available to all employees who receive stock-based compensation under the plans. We purchased these shares at their fair market value, as determined by reference to the closing price of our common stock on the day of vesting of the restricted stock award or on the day prior to the option exercise.

- (2) On August 5, 1997, our Board of Directors authorized a common stock repurchase program that

was publicly announced on August 7, 1997, for up to 1,007,351 shares. No repurchases have been made under this program since 2000. The program has no fixed expiration date. The number of shares authorized for purchase was adjusted as a result of the stock splits effected in the form of stock distributions since the authorization date.

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AQUA AMERICA, INC. AND SUBSIDIARIES

Item 6. Exhibits

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



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**SIGNATURES**

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

November 5, 2010

Aqua America, Inc.

Registrant

/s/ Nicholas DeBenedictis

Nicholas DeBenedictis  
Chairman, President and  
Chief Executive Officer

/s/ David P. Smeltzer

David P. Smeltzer  
Chief Financial Officer

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**EXHIBIT INDEX**

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